

BEFORE THE
SURFACE TRANSPORTATION BOARD

218416

Ex Parte No. 646 (Sub-No. 1)
RAIL RATE CHALLENGES IN SMALL CASES

**REBUTTAL COMMENTS OF
CARGILL INCORPORATED**

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REBUTTAL COMMENTS OF CARGILL INCORPORATED

Cargill Incorporated ("Cargill") hereby submits rebuttal comments in the above-captioned proceeding. In its opening comments, Cargill commended the Board for initiating this proceeding, but explained that the Board's proposals fall far short of offering effective and meaningful rail rate regulation and in fact would create a worse situation than exists under the current standards. Cargill commented generally on the proposed Simplified Stand-Alone Cost ("SSAC") proposal and the refinements to the existing three-benchmark approach, but focused its comments principally on the Board's proposed criteria for determining eligibility to use these rate standards. Cargill adopted the joint comments filed by several trade associations, including the National Grain and Feed Association, of which Cargill is a member ("Joint Commenters").

In these rebuttal comments, Cargill responds to various comments made by the railroads in their reply comments. Cargill also adopts the reply and rebuttal joint comments filed by the Joint Commenters.

I. THE RAILROADS GROSSLY UNDERSTATE THE NEED OF LARGE SHIPPERS FOR EFFECTIVE SMALL RATE CASE STANDARDS.

Although the railroad industry reply comments primarily address the Joint Commenters, the two western carriers, Union Pacific and BNSF, make certain misleading, inaccurate, and unfair comments about Cargill and other large shippers in general. They contend that large shippers such as Cargill do not need protection from unreasonable rates because they are so much larger than the railroads that serve them. BNSF Reply at 4; UP Reply at 64. But, neither carrier explains how this contention relates to their ability to engage in monopoly abuse.

The rail industry, and at most Cargill facilities a single rail carrier, possesses a stranglehold over much of Cargill's distribution chain for commodities that must move by rail. This is the single most relevant factor in measuring the ability of a rail carrier to exercise monopoly

power over the movement of Cargill's commodities, regardless of the comparative size of Cargill to any single railroad that provides service to it.

The monopoly power of railroads over Cargill is borne out by multiple examples. First, contracts are being replaced by tariffs for a greater number of movements. Second, pricing, whether it is pursuant to a contract or a tariff, simply is dictated to Cargill with little or no negotiation. Third, the railroads rarely, if ever, agree to be accountable for their service failures. Fourth, the railroads are continually imposing new fees and surcharges against Cargill for actions that allegedly add costs to the railroads, but reject any reciprocal charges by the shipper for railroad actions that add costs to Cargill. These unilateral actions do not reflect an industry that is constrained by effective competition or that is being bullied by its larger customers.

UP suggests that, since Cargill has not filed a single rate case in ten years, it strains credulity that Cargill has been subject to market abuse. UP Reply at 64, note 208. That fact demonstrates little more than the uncertainty of the small case standards that have stifled virtually any small rate cases. Moreover, whether rate protection was necessary in the past says nothing about whether such protection is required in today's capacity-constrained rail market.

Indeed, the need for effective and meaningful regulatory constraints on railroad pricing is greater in today's rail market than it has been at anytime since the Staggers Act. Although the railroads claim that the current market simply reflects the laws of supply and demand at work, those laws work very differently in competitive and monopoly markets. In a truly competitive market, the higher prices caused by supply shortages will attract new entrants with additional supply that will decrease prices. Since barriers to entry preclude new railroad entrants, additional capacity must come from the incumbent railroads. But, the incumbent railroads have very little incentive to add sufficient capacity to meet total demand, since doing so would reduce

revenue below the profit maximizing levels for a monopolist. Thus, while rates may decline with additional capacity, they will not decline to the same levels as a truly competitive market.¹

Capacity constraints have given railroads unprecedented pricing leverage. This requires a heightened level of vigilance against monopoly abuse of captive traffic, and not, as the railroads suggest, a free hand to set rates at whatever level the market will bear. Since so much of their rail traffic moves at volumes and frequencies that prevent the stand-alone cost ("SAC") constraint from being an effective regulatory constraint on monopoly abuse given the value of the case, shippers such as Cargill can only be protected by access to effective small case standards.

II. THE BOARD SHOULD FOCUS ON REFINING THE THREE-BENCHMARK APPROACH.

Cargill has been among the chorus of shipper voices that, for a decade, have requested greater clarification and guidance of the three-benchmark approach adopted in *Rate Guidelines—Non-Coal Proceedings*, 1 S.T.B. 1004 (1996) ("*Non-Coal Guidelines*"). That decision left many unanswered questions as to how the Board would apply the three-benchmark approach and when a case would qualify as a small case and thus be eligible to use the three-benchmark approach. The resulting uncertainties created a chilling effect that discouraged small rate case challenges. Instead of providing the requested guidance, however, the Board has created an entirely new, more costly, more time consuming, and more complex Simplified SAC approach ("SSAC") that perpetuates the problems of the past 10 years and all but abandons the three-benchmark approach.

The railroads attack the three-benchmark approach because it is not premised upon Constrained Market Pricing ("CMP"). But, in *Non-Coal Guidelines*, the Board flatly rejected the

¹ In fact, rates will not decline at all if new capacity is added at a pace less than demand is growing, or merely keeps pace with demand growth in an already capacity-constrained market.

railroad industry's "underlying assumption that CMP is susceptible to adequate simplification without losing its effectiveness, and that other (non-CMP) simplified procedures cannot be considered." *Id.* at 1021. The Board also noted that "other procedures can, and indeed must, be made available for those cases in which CMP simply cannot be used—because the traffic is so infrequent or widely dispersed that it is not susceptible to a SAC presentation or because the case is so small in value that the substantial expense of a CMP presentation...cannot be justified." *Id.* As demonstrated by shipper comments in this proceeding, the Board's SSAC proposal is too complex, costly and time-consuming for most captive shippers and thus cannot provide relief in small rate cases.

As the Board held in *Non-Coal Guidelines*, "[a]ccuracy must be sacrificed for simplicity...to ensure that no shipper is foreclosed from exercising its statutory right to challenge the reasonableness of rates charged on its captive traffic." *Id.* at 1008. The Board concluded that the three-benchmark approach "provide[s] an appropriate frame of reference for our rate reasonableness analysis [and] properly introduce[s] all of the factors that must be looked at in our analysis." *Id.* at 1020. Neither the Board nor any commenter has presented any reason to reconsider those holdings now.

Furthermore, neither the Board nor the railroad commenters has demonstrated that SSAC truly is a simplified version of Full-SAC that preserves the essence of CMP. As the Joint Commenters have demonstrated, SSAC adopts and simplifies only those portions of CMP that will increase railroad costs, while disregarding those portions that lower costs by developing the most efficient stand-alone railroad for the selected traffic group. Thus, it is not at all clear that SSAC implements CMP at all, much less in a truly simplified and less costly manner.

If the Board is interested in establishing "a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case," 49 U.S.C. § 10701(d)(3), that is truly meaningful, then it should focus on refining the three-benchmark approach and clarifying the eligibility standard, rather than venturing into the uncharted and choppy waters of SSAC. Only in recent years, as railroads have imposed unprecedented rate increases, have the stakes been raised to such a level that any captive shipper has been willing to brave the uncertainties surrounding the three-benchmark approach to file a small rate case. Even then, there have been a total of two complaints in as many years. But, just as the three-benchmark approach is being tested in real cases for the first time, the Board has proposed to turn back the clock by adopting SSAC, which is a radically more complex, costly and time consuming approach that is untested, thereby imposing even greater risks and uncertainties upon potential complainants than those that have existed under *Non-Coal Guidelines* for the past decade.

III. THE RAILROADS HAVE PROPOSED UNDUE CONSTRAINTS UPON THE THREE-BENCHMARK APPROACH.

In addition to restricting the availability of the three-benchmark approach to only the smallest subset of small cases, the railroads propose unnecessary limits on comparable traffic that threaten the viability of the approach itself. Specifically, the railroads argue that the comparable traffic automatically should exclude contract traffic and any other commodities no matter how similar their transportation characteristics may be to the issue traffic. Cargill opposes any blanket restrictions as both unnecessary and unjustified.

Contracts can be, and in today's rail markets usually are, comparable to common carrier tariffs. Indeed, the railroads themselves no longer draw significant distinctions between the two. They have moved, and are continuing to move, much contract traffic to tariff. Moreover, when

railroads do enter into contracts, those contracts are typically for short terms and frequently look like tariffs and/or incorporate wholesale tariff provisions into the contract. Any argument that a particular contract is not comparable to a challenged movement should be made on the facts of the individual case, since a blanket prohibition on contract traffic would unfairly exclude a large number of movements that are in fact comparable.

Similarly, commodities need not be identical to be comparable. Indeed, in the agricultural arena where Cargill conducts business, there are many examples of commodities whose transportation characteristics are virtually indistinguishable, such as wheat, corn, and beans. Therefore, a blanket prohibition once again would unnecessarily exclude potentially comparable traffic. This is another issue that should be reserved for a case-by-case determination.

IV. THE ELIGIBILITY THRESHOLDS ARE BASED ON UNREASONABLE ASSUMPTIONS THAT RENDER THEM ENTIRELY UNREALISTIC.

Cargill remains extremely concerned that the eligibility thresholds proposed by the Board and supported by the railroads are entirely unrealistic. Unless they are raised to realistic levels and are predicated upon reasonable assumptions, these thresholds will deny shippers adequate regulatory rate protection regardless what approach the Board may adopt to determine reasonableness.

A. The Railroads Have Proposed A Reasonable Alternative To Calculating The MVC.

In its opening comments, Cargill pointed out that it was unreasonable to equate the actual value of a rate case ("AVC") with a maximum value of the case ("MVC") based upon the jurisdictional threshold because a reasonable rate could, and likely would, be above the MVC for many, and perhaps most, commodities. Therefore, the jurisdictional threshold would overstate the AVC.

In their reply comments, however, several railroad commenters have made a proposal that could be an acceptable foundation for addressing Cargill's concern. Namely, the railroads have suggested allowing the complainant to specify the AVC of its case for purposes of determining eligibility to use the small case standards, if the complainant is willing to accept its election as the MVC for purposes of rate relief.

It is unclear, however, whether the railroads' proposal is to allow the complainant to define the maximum value of its case or the maximum RVC ratio for its movement. *Compare* BNSF Reply at 10-11 *with* AAR Reply at 11-12. Cargill supports the former, but not the latter. Thus, for example, if an MVC of \$500,000 was predicated upon a rate reduction of \$100/car multiplied by 1000 cars annually for 5 years, the complainant would be entitled to rate relief up to a MVC of \$500,000 over 5 years regardless whether it moved more or less than 1000 cars in any single year.

Cargill believes such a proposal reasonably addresses its concerns, **but only if** the complainant possesses all available information for it to make a fair assessment of the actual value of its case. Thus, for the three-benchmark approach, the complainant must have access to the costed waybill sample prior to filing its complaint so that it may identify comparable traffic in order to generate a reasonable estimate of its potential rate relief. Moreover, the complainant must have access to the unmasked revenues, or its estimates will be skewed either too high or too low. It would be arbitrary to bind the complainant to an estimated case value that is based upon masked revenues.

B. A Risk Factor Is Required To Ensure That Complainants Have The Opportunity To Obtain Meaningful Relief.

The railroad commenters have criticized Cargill and other shippers for using a risk factor to determine the eligibility thresholds. But this criticism is based on the erroneous contention that a risk factor requires a subjective assessment of a complainant's likelihood of success and that it insulates complainants from downside risks. Both of these contentions are false.

A risk factor merely ensures that complainants have the opportunity to obtain meaningful relief under the small case standards. The proposed eligibility thresholds have been set at or very near to a complainant's likely litigation costs. Consequently, a complainant's most probable litigation scenario is to break even by recovering its litigation costs, but no more, and probably less. In that circumstance, no shipper will ever file a complaint under the small case standards.

A risk factor of three multiplied by a realistic estimate of litigation costs would generate a reasonable eligibility threshold. For example, based upon the Board's estimated Full-SAC litigation cost of \$3.5 million, a shipper would be required to use Full-SAC if its MVC exceeds \$10.5 million over 5 years. Using those numbers, Cargill believes that an MVC below \$10.5 million should qualify to use the three-benchmark approach. However, if the Board were to adopt SSAC over shipper objections, the Board should multiply a *reasonable* SSAC litigation cost (which is far above the \$200,000 estimated by the Board) by a risk factor of three in order to determine the floor above which a plaintiff must use SSAC. Anything below that would qualify to use the three-benchmark approach.

Contrary to the representation of railroad commenters, the risk factor does not require any assessment of the likelihood of success in any individual case, nor does it insulate shippers from litigation risk. Shippers still assume the risk that they may not obtain any rate relief or may obtain less relief than anticipated. In either case, the shipper still incurs its litigation costs and is

not guaranteed any result. The risk factor merely provides shippers with the opportunity, but not the guarantee, to do better than break-even.

C. The Aggregation Rule Is An Unjustified Response To An Exaggerated Risk.

The railroads support the aggregation rule as necessary to prevent “gaming” by shippers who might separately challenge multiple movements in order to avoid a Full-SAC analysis. But there is no evidence that many shippers even would have the ability, much less the incentive, to “game” the eligibility thresholds in this manner.

The aggregation rule is predicated upon an assumption that is unsupported by actual experience. Although no aggregation rule has existed for the past decade since *Non-Coal Guidelines*, there has not been any gaming of the system by aggregating movements. Furthermore, if shippers could economically justify a Full-SAC case today for aggregated movements, it is reasonable to believe that such cases would have been filed over the past 20 years. In reality, however, such cases are more complex and costly than Full-SAC cases for unit train coal transportation. Thus, shippers who may choose to separately challenge individual movements can claim with all honesty and sincerity that Full-SAC is too complex and costly given the value of the case. This is all that the statute requires for a complainant to be eligible to use the small case procedures.

Even in situations where “gaming” might be possible, it is not at all clear that shippers would benefit substantially, if at all, by disaggregating their individual movements. Multiple cases require substantial duplication of time and effort for speculative gains, since there is no demonstrated advantage to results from the three-benchmark or SSAC approaches over the Full-SAC approach.

Finally, while the Board expresses "gaming" concerns as to shippers, it does not acknowledge, much less attempt to address, potential "gaming" by railroads. But, the railroads have a greater ability, through their control over the tariff rate, to influence the factors in the MVC calculation than shippers. Since their incentive to "game" is no less than the shippers' incentive to do so, and their ability certainly is greater than the shippers' ability, it is arbitrary to address potential gaming by one but not the other.

Respectfully submitted,



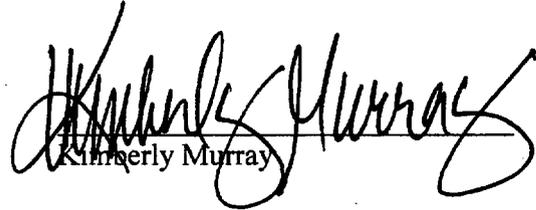
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CERTIFICATE OF SERVICE

I hereby certify that I have on this 11th day of January, 2007, served a copy of the foregoing Rebuttal Comments on all parties of record, by first class mail, postage prepaid.


Kimberly Murray