

UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD

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PUBLIC HEARING

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 IN THE MATTER OF: : Docket No.
 : EP 665
 RAIL TRANSPORTATION OF GRAIN, : (Sub-No. 1)
 RATE REGULATION REVIEW :
 :
 -----x

Wednesday,
June 10, 2015

Surface Transportation Board
Suite 120
395 E Street, S.W.
Washington, D.C.

The above-entitled matter came on for
hearing, pursuant to notice, at 9:29 a.m.

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(9:29 a.m.)

CHAIR MILLER: Good morning. Very nice to see everyone here. We've been really excited. I think I can speak for Ann and me when I say that about having this hearing. I am Deb Miller. I am serving as the Acting Chair at the Surface Transportation Board. I think many of you will know my fellow commissioner, Ann Begeman, who is up here with me today. I want to thank all of the panelists who will be participating in this hearing. We really do recognize and realize you have travel issues, the time and energy it takes to get all of your materials prepared, can be a very big lift and we know that and appreciate it. I think we have important policy issues before the Board and the only way we can make really valuable informed decisions is by hearing what you have to say and having the opportunity to engage and so we're really pleased to have this chance today.

As I'm sure many of you know, being

1 active watchers of issues before the Surface
2 Transportation Board, we're having another
3 hearing in July on the issue of revenue adequacy.
4 I could imagine that when we announce this
5 hearing and the hearing on revenue adequacy,
6 there may have been collective groans that went
7 up from the community. In fact, I think I might
8 have heard a few even sitting in my office. I
9 know in the past there have been times when the
10 Board has started proceedings, held hearings and
11 then our stakeholders, after waiting patiently,
12 saw the Board do nothing. I want to assure you,
13 that is certainly not our intention today. I
14 certainly view this hearing as a means to an end
15 and that end would be a resolution of this
16 proceeding. But it's not just this proceeding
17 that the Board is likely to be looking at.

18 A number of the proceedings that have
19 been initiated at the Board and are currently
20 open as well as the issues we'll be looking at
21 today, have a lot that is in common. I think
22 when we want to look at these proceedings, which

1 would include issues like exempt commodities,
2 reciprocal switching, grain rates and the revenue
3 adequacy issue we'll be exploring in July, that
4 because of the common issues that they share, we
5 want to think about all of these issues together
6 and jointly.

7 It would be my hope, as many of you
8 may have heard me say, that we can come out of
9 this summer's hearings looking at all of those
10 issues together and come back with a
11 comprehensive package of approaches that will
12 make sense for how the Board moves forward in the
13 future on a number of issues. It's too early, of
14 course, to say what the Board will do but what I
15 can tell you is that I've got some ideas; I know
16 our staff has some ideas and I'm confident that
17 Vice Chairman Begeman has some ideas as well.

18 So, we may find that in the next few
19 months we'll be looking at making significant
20 changes to our processes and looking at a lot of
21 Board reforms. Perhaps what we'll find is that
22 things are going pretty well based on what we're

1 hearing from our stakeholders and learning
2 through the pleadings you filed and the testimony
3 we'll be hearing and perhaps all we need to do is
4 make a few tweaks or do nothing. But one way or
5 another, what I want to be sure is, is that we
6 have a resolution to the issues that are before
7 the Board.

8 So, my goal today for this hearing,
9 for myself at least, is to become much more
10 knowledgeable on these issues and to have a much
11 better understanding at the end of the day about
12 how our rate processes apply to grain shipments.
13 What those issues are both from the perspective
14 of those of you who deal in the agricultural
15 industry as well as those of you who are in the
16 railroad industry. In my year at the Board, I've
17 had many opportunities to meet and engage with
18 agricultural shippers and based on those
19 conversations, I certainly understand how
20 important consistent, reliable rail service is at
21 a fair price in order for those businesses to
22 flourish. But it's also important to hear from

1 the railroads and understand the issues from
2 their perspective as well.

3 We all know that there are challenges
4 dealing with the grain markets and it's not
5 necessarily easy to be the one who is serving
6 those markets either. Certainly, since the
7 passage of Staggers, when we saw a railroad
8 industry literally on the verge of collapse,
9 going to one that's strong and healthy today,
10 we're all very vested in ensuring that the
11 continues to be a strong and thriving railroad
12 industry. Still, it's clear from the
13 conversations that we have with grain shippers
14 from the meetings we have in our offices from the
15 things that are filed before us, that many grain
16 shippers do not feel they have fully received the
17 benefits of Staggers and have concerns and so
18 that's why we're here today. I'm curious to hear
19 more and will be listening very attentively and
20 Vice Chairman Begeman, would you like to make a
21 statement?

22 VICE CHAIR BEGEMAN: Thank you Deb.

1 I'll be relatively brief. First, I want to
2 certainly thank the Acting Chairman for holding
3 this hearing today and I welcome all of the
4 witnesses who have taken the time and effort to
5 join us today and give us their views on what I
6 consider to be a really, really important issue.

7 The AG community has had some deep
8 frustrations with the agency's rate methodologies
9 since they were first created. Despite the
10 efforts that the Board has taken to establish a
11 process for small cases as Congress directed, we
12 hear the same message that our methodologies,
13 even the most simplified 3B methodology, is
14 unusable for a grain shipper. We heard that
15 message yet again during the rate reform rule
16 making proceeding from the National Grain and
17 Feed Association and the Alliance for Rail
18 Competition, among others.

19 I really appreciate that the former
20 chairman, Dan Elliott, I'm not sure if he's here
21 yet, I think he was going to join us --- yes, he
22 is here. Hello Dan. He agreed that we could not

1 ignore these important stakeholders' concerns and
2 we really need to explore what more the Board can
3 do to fulfill its statutory obligation.

4 The whole purpose, at least certainly
5 my purpose, isn't to debate rates. We already
6 know the perspectives. The shippers think rates
7 are high and we'll hear from the industry that
8 they're not too high. But my goal is to fulfill
9 the statutory mandate to ensure that there is a
10 process here that every shipper has access to in
11 order to have their rate judged fairly and
12 timely.

13 So again, I also want to thank the
14 Acting Chairman for making this issue her very
15 first to explore during the hearing process. I
16 think it sends a really good signal to
17 stakeholders, it certainly does to me, and I look
18 forward to the hearing. I will probably have a
19 few questions during the hearing, I guess that's
20 why we're here. And just one more final comment.

21 In preparation for a hearing like
22 this, a lot of work goes into it. I know that

1 the Board staff put a lot of work into it and
2 there are a couple of unsung heroes around this
3 agency. A few that I see in the audience, Mike
4 Smith, Douglas Plesey, Frank O'Connor, who really
5 have such a handle on the AG component of what
6 goes on with rail service, and I just want to
7 publicly thank you for your service to the Board
8 and to the public. Thank you.

9 CHAIR MILLER: Thank you very much,
10 Ann, and thank you for thinking to call out
11 staff. It certainly is true, getting ready for a
12 hearing like this, as I'm sure in your worlds,
13 it's been very hectic. It certainly has been in
14 ours and I do want to say Dan Elliott, former
15 chairman here and perhaps soon to be chairman
16 again, Dan, if you could stand up. I'm glad you
17 could be here today. Come on. Thank you for
18 coming. I think it's really great you have time
19 in your schedule to be able to be here. It will
20 be important to hear the issues.

21 Now, before we get started with the
22 testimony, let me do kind of the standard

1 procedural points so everybody is kind of
2 prepared. I want those who will be testifying to
3 know that we have the lights up here. Your
4 testimony is timed. Everybody has been sort of
5 assigned roughly a time, generally what you
6 requested, and I know it can be very difficult
7 but we'd like people as best as possible to stay
8 within their timeframe. We have a long list of
9 those who will be testifying today.

10 Just so you know, what's going to
11 happen is the yellow light will go on when you
12 have a minute left in your testimony and when you
13 see the red light, that's going to be a signal to
14 you that your time has expired. We would ask
15 that you move as quickly as you can to wrap up
16 your testimony and if not quickly enough, then
17 I'll push the button that sends a mild electrical
18 shock to your seat. No, I'm just kidding. No
19 electrical shocks in the room. But, at any rate,
20 we ask that you be as mindful as you can be in
21 the thick of giving your testimony. So a couple
22 of things. If you're scheduled to speak, please

1 be sure that you've checked in with the clerk who
2 is at the front of the room. I want to remind
3 speakers, as I'm trying to remind myself to speak
4 clearly into the microphone. Not only does it
5 make a difference in terms of the ability of all
6 of those in the room to hear what you're saying
7 but we are recording this and so we want to be
8 sure we capture all of your words because we know
9 how good and interesting they're all going to be
10 and then for those who are both with us today as
11 well as those who might be watching. We will be
12 placing this hearing on the STB website a few
13 days within the close of this hearing.

14 In the unlikely event that we have a
15 fire alarm or there are other events requiring
16 evacuation, we ask that everybody proceed to
17 these doors in the back of the room and then exit
18 this building through the front doors that you
19 came through. There are specific instructions
20 posted at the back of the room for assembly and
21 notification should we have any issues like that
22 and of course, as we would often do, we remind

1 everyone if you haven't already done it, to
2 please turn your cell phone off which is a good
3 reminder to me because I don't think I've turned
4 my cell phone off yet so I'll do that here in
5 just a minute.

6 I want to remind all of the parties,
7 we're going to be leaving this proceeding open
8 for fourteen days after the conclusion of the
9 hearing. If there are additional pieces of
10 information you didn't have a chance to provide
11 or you realized later you wished you would have,
12 you'll have an opportunity to do that. If you
13 have rebuttal information for things you hear
14 today, you're welcomed to provide that as well.

15 I want to say one final thing before
16 I turn it over to our first witness, we weren't
17 able to get it all done today, but for those of
18 you who have regularly participated at the Board,
19 I want you to know that we have some improvements
20 coming that we're very excited about. Hopefully,
21 if nothing goes wrong, the next time you come
22 here for a hearing, there will in fact, be wifi

1 available in this room. We're looking at
2 improving and enlarging our screens. I don't
3 know about you all, I just know when I'm in this
4 room, they are simply not big enough for me to
5 see the materials that's on them. So hopefully,
6 for any of you who are back for our revenue
7 adequacy hearing, you'll see some improvements in
8 the hearing room and we're very excited about it.

9 We're going to get started now. I'm
10 very pleased that we have with us today Dr.
11 Richard Schmalensee who is Dean Emeritus from the
12 MIT Sloan School of Management. He has just
13 completed chairing a policy study for the
14 Transportation Research Board that has to do with
15 the STB, how we regulate in the rail industry.
16 Dr. Schmalensee, please come to the table and
17 thank you for being here.

18 DR. SCHMALENSEE: Thank you Madam
19 Chairman for the opportunity to testify this
20 morning. I think we will try to set up some
21 slides. I'll be reporting on some of the
22 results, the findings and recommendations of a

1 study that a number of us have just completed for
2 the TRB, an arm of the National Academies of
3 Science, Engineering and Medicine. The study was
4 formally released twelve minutes ago. It's
5 available on the National Academy's website and
6 there are summary descriptions at the back of the
7 room.

8 This study, there we go, was requested
9 by Congress in 2005, funded in 2013 and completed
10 as we said just a few minutes ago. We were asked
11 to talk about rate and service trends post-
12 Stagers, particularly since 2000 to look at the
13 performance of the regulatory regime and to make
14 recommendations for the future role of STB. I'm
15 going to focus on the last of these just in the
16 interest of being relevant to this hearing. The
17 study process is familiar to those who follow TRB
18 studies. We were briefed by lots of people. We
19 reviewed the literature. We did an unusual
20 amount for one of these committees of statistical
21 analysis of the waybill data, the carload waybill
22 sample and other data and, of course, we

1 deliberated.

2 One of the key findings, as I said we
3 were asked to talk about events post-Staggers and
4 I guess I would summarize our findings in that
5 respect by saying that this is just not the same
6 industry in almost any respect that confronted
7 the authors of Staggers. It was being bailed out.
8 It was financial shaky. I think many observers,
9 particularly many economists, thought that when
10 regulation was relaxed, prices would, of course,
11 rise since you had financially distressed firms.
12 In fact, as everyone knows, prices fell
13 dramatically particularly over the two decades
14 after Staggers because ICC regulation had
15 restricted the industry's ability to innovate.
16 It restricted its ability to consolidate traffic,
17 to negotiate contracts, to match up with shipper
18 needs and on and on. So the industry became much
19 more efficient.

20 While rates have risen recently, they
21 are still below the levels of the 1980's. This
22 slide mentions one change post 2000 that I want

1 to emphasize that's particularly relevant to
2 today's hearing. The use of contract carriage of
3 non-exempt commodities has risen sharply since
4 the year 2000. 2012 was the latest year for
5 which we have data and a lot of that has to do
6 with coal. If you look on the left, that pie
7 chart shows that in 2000, coal accounted for just
8 about half of the ton-miles moving under tariff.
9 By 2012, coal's use of ton-miles of coal under
10 tariff went from about half of all coal ton miles
11 to just about 5 percent. So coal traffic shifted
12 rather dramatically over this relatively short
13 period, from tariff to contract. That did not
14 happen, for what we have there is the total of
15 grain, oil seeds and food and kindred. It didn't
16 happen. About 70 percent of that traffic by ton-
17 miles moved under tariff in 2000, moved under
18 tariff in 2012.

19 Thus, this hearing is particularly
20 relevant because when one considers the
21 reasonability of tariff rates, one is
22 increasingly considering the reasonability of

1 rates charged to grain, oil seeds and the
2 shippers of food. So, I want to focus on the
3 rate relief process and our findings and
4 recommendations with the background that we're
5 not thinking much about coal anymore. Really, we
6 are thinking about the particular characteristics
7 of these other shippers, grain, oil seeds and
8 food.

9 The current process, as I think
10 everyone in this room knows, has three steps.
11 There is the initial screen based on the
12 relationship of the rate charged, the tariff rate
13 posted to variable costs as determined by the
14 uniform rail costing system universally referred
15 to as URCS. If a rate exceeds that 180 percent
16 threshold, the next step in the process is an
17 inquiry about whether the market involved is
18 dominated by the carrier at issue. Assuming that
19 hurdle is cleared, there then becomes an inquiry
20 into the reasonableness of the rate using either
21 the stand alone costs process, the first process
22 devised or the simplified SAC or the three

1 benchmark processes.

2 It's important here to note that our
3 committee, as I think most people retain the
4 objectives of Stagers which is to have an
5 industry with adequate revenue. That is to say
6 not to treat it as a public utility but to treat
7 it as an industry governed by the marketplace.
8 But also to make sure that we respect the
9 Stagers goal of protecting shippers against
10 unreasonable rates, particularly in settings
11 where those rates are driven by market dominance.

12 Our first finding relates to this
13 first step in the process, the 180 percent of
14 variable cost test. If you read our report, this
15 is perhaps the point on which the committee felt
16 most strongly that the URC system attempts to
17 estimate something that is not defined as a
18 matter of economics and thus produces inevitably
19 estimates that are arbitrary and unreliable.
20 Costs are omitted, railroads points out that the
21 cost of bearing the risk of shipping hazardous
22 chemicals don't show up on their income

1 statements and thus don't show up in URCS and
2 it's not a surprise that many hazardous chemicals
3 move at rates above 180 percent of URCS.

4 Determining what's fixed and what's variable and
5 what fraction of a locomotive is variable and
6 what fraction is fixed is essentially arbitrary.
7 Allocating common costs among the traffic
8 involved is inherently arbitrary. We have plenty
9 of examples of that.

10 There are odd features that go beyond
11 arbitrariness as that second set of bullets
12 indicates. Some kinds of traffic, particularly
13 short haul traffic have rates systematically
14 above this threshold, above 180 percent of URCS
15 variable cost and 20 to 25 percent of traffic
16 year in and year out moves at rates that the
17 system says are below variable costs. That, of
18 course, doesn't make any sense.

19 If you take it literally, that means
20 that railroads are moving 20 to 25 percent of
21 their traffic in an out of pocket loss. The key
22 part that we would stress is this can't be fixed

1 in the sense that you can't reform the procedure
2 of deciding what's fixed and what is variable and
3 allocating costs among elements of traffic
4 without producing an arbitrary outcome.

5 Now, to step back, it's not hard to
6 see why when Staggers was passed, the authors
7 wanted some threshold to determine the
8 eligibility of shippers to challenge rates and
9 this was, you know, you could do it and if I were
10 sitting in 1980, it's not clear, I would have
11 done anything different. But it's not 1980. We
12 now have plenty of rates that are determined
13 under competitive conditions and those rates, we
14 submit, can be used as a benchmark and those
15 rates as a benchmark make more economic sense
16 than essentially arbitrary estimates of variable
17 costs and I will come back in a moment to how we
18 might do that. The second finding relates to the
19 second step in the current process and that is
20 the market dominance hearing or the market
21 dominance assessment.

22 Now, we understand why the Board has

1 excluded evidence on product and geographic
2 substitute ability. That's complicated evidence.
3 But of course, excluding a category of evidence
4 that suggests market dominance is not present is
5 clearly going to bias decisions. It just is an
6 economic or a logical matter. That evidence can
7 be difficult to process, of course, but I've done
8 a fair amount of anti-trust work over the years
9 and one observes the Department of Justice and
10 the Federal Trade Commission dealing with
11 evidence of that complexity routinely and simply
12 in informal proceedings. In quasi-judicial or
13 judicial proceedings, of course, evidence of this
14 complexity is hard to deal with. In informal
15 proceedings, not that difficult. Time limits, we
16 suggest, ought to replace exclusion of categories
17 of evidence.

18 Sorry, I went past one. All right.

19 I need to go back. Excuse me. Manual
20 intervention. The third step in the process is
21 either the standalone cost test or one of the
22 simplified procedures introduced later. Our

1 committee suggested, concluded, found that those
2 should be replaced. It's important to understand
3 that given the Staggers Act's enabling of shipper
4 specific contracts, railroads and shippers have
5 every incentive to move all traffic that can be
6 profitably moved so that you don't have here the
7 sort of classic monopoly loss problem that you
8 have in regulating electric power or telephone
9 that gee, if the price is too high, there will be
10 too little volume. There is not that loss
11 problem.

12 The regulatory issue here seemed to us
13 to be inherently about fairness. And the
14 standalone cost tests embodies one notion of
15 fairness that if I'm paying more than the
16 standalone costs then I'm subsidizing somebody
17 else under public utility regulation. The
18 standalone cost test comes out of public utility
19 regulation. It comes out of telecom debates in
20 fact in the 70's and comes out of a concern that
21 prices too high encourage inefficient entry not as
22 we understand it a live issue in rail today.

1 It seemed to us that the simplified
2 procedure, and the fact which the slide doesn't
3 state but everyone knows, well it sort of does,
4 that this SAC procedure has really not been
5 useable by small shippers particularly by grain
6 shippers that ship to multiple destinations.
7 Maybe one reason why there is less contracting
8 for those shippers but in any case the SAC
9 procedure, we were told, about five million
10 dollars a case is not useable by small shippers.
11 The simplified procedures are simpler but they
12 make use of URCS and if that's fundamentally
13 flawed, simplifying by making more use of a
14 fundamentally flawed measuring stick is not, we
15 submit, a move in the right direction.

16 So let me say what we suggest be done
17 instead and I will preface this by saying almost
18 everything I'm about to describe almost certainly
19 required legislative change, which is good news
20 or bad news depending on your point of view but
21 our task was not to think about what's feasible
22 but to think about what should be done. So we

1 proposed using the competitively determined rates
2 that I mentioned a few moments ago as benchmarks.
3 The report describes how we do that but the
4 fundamental notion again, is a fairness notion
5 that it ought to be the case that a shipper in a
6 market dominated by a single railroad shouldn't
7 have to pay a rate that is too far out of line
8 with rates paid by shippers in competitive
9 markets for similar shipments.

10 So, we can look at statistically, we
11 can model the determination of rates in
12 competitive markets as a function of shipment
13 characteristics. We can then ask what does that
14 model predict for rates in non-competitive
15 markets and what that graph shows for farm
16 products is it happens, given our data, the
17 ratios of actual rates in non-competitive markets
18 to predicted rates in those markets. Predicted
19 on the basis of the model of competitively
20 determined rates. Now you will see that a
21 reasonable fraction of the actual rates are less
22 than the predicted rates. Those are the rates

1 represented by the mass to the left of the
2 vertical line at 1. And that's, of course,
3 because it's a model and it doesn't fit data
4 precisely and we don't, we aren't able to
5 precisely predict all competitive rates. That's
6 a worthwhile caution because it says that many of
7 the observations to the right of that line where
8 the actual rate exceeds the rate predicted under
9 competition, are there simply because the model
10 is like all models, imperfect. So we wouldn't
11 propose that all of the tariff rates to the
12 right, be treated as subject to detailed
13 examination. That is to say, treated, as if they
14 had passed the URCS test, the 180 percent test.
15 But the farther out you go, the more likely it is
16 that what's happening is serious use of market
17 power to raise rates.

18 Our suggestion is this sort of
19 modeling can be perfected. Our report contains
20 what we consider to be a proof of concept using
21 waybill data and other data that are readily
22 accessible and a lot of work. Two of the members

1 of our committee produced a model of competitive
2 rate setting, applied it to non-competitive
3 markets and such a model can be tested, can be
4 refined, can be debated but those are technical
5 questions. The policy question is what replaces
6 180 because 180 is an arbitrary number. There is
7 no economics to it. I assume it was a late night
8 negotiation.

9 To use this approach, one needs to
10 come up with a replacement number to say that
11 rates that are twice the competitive or three
12 times the competitive prediction or one and a
13 half times the competitive prediction or 180
14 percent of the competitive prediction if you like
15 that, are subject to challenge.

16 This approach, a few points about it,
17 we advocate this to replace the URCS test and
18 this could have not been done when Stagers was
19 written. There weren't rates that you would say
20 are determined under competition in an efficient
21 rail system. We have such rates now. The
22 threshold, what replaces 180? It's a policy

1 decision. If you set it too low, you place
2 revenue adequacy at risk. If you set it too
3 high, you risk not granting rate relief to people
4 who ought to get it. There is no magic number.
5 It's likely to be controversial but like the
6 determination of 180, it can be transparent.

7 Appendix B of our report, thanks to a
8 lot of work by two members of our committee, has
9 detailed analysis and a proof of concept. It is
10 not the last word but it suggests that you can do
11 this credibly and we think it's much better than
12 SAC. For the second and third stages, the
13 dominance test, the dominance proceeding before
14 the STB and the standalone cost test for
15 reasonability if dominance is cleared, we propose
16 again in the interest of reducing costs and
17 proceeding expeditiously and not excluding
18 relevant evidence, we propose moving to
19 arbitration at that point. If the screening tool
20 is appropriate, one doesn't have to rely on
21 stringency at the second and third stages to
22 preserve revenue adequacy. Arbitration can be

1 informal.

2 We propose it to be behind closed
3 doors with confidential results so we don't set
4 precedent. It can be fast, it can be economical,
5 and it can consider complex evidence. We propose
6 this be final offer arbitration, baseball style
7 arbitration, because experience has shown that
8 promotes settlement because of uncertainty about
9 the arbitrators decision. It also promotes the
10 parties making reasonable offers because
11 unreasonable offers are unlikely to be accepted.

12 Now, one reason why we have some
13 confidence in the merits of this recommendation
14 is the Canadian experience. Now this is not to
15 say the Canadian experience is a panacea or we
16 should imitate all aspects of the Canadian
17 experience but in Canada, a shipper doesn't have
18 to pass any sort of screen to be entitled to
19 arbitration. A shipper can raise its hand, get
20 rate arbitration or get service arbitration even.
21 The Canadian system, as we can tell, has not
22 involved a lot of cases even without a screen for

1 eligibility. Most of those have settled and
2 while nobody likes to be at the mercy of an
3 arbitrator, the system proceeds without five
4 million dollars of case costs and it proceeds in
5 a manner that makes it accessible to small
6 shippers and it proceeds without the need to
7 exclude evidence in order to move on a timely
8 fashion.

9 We think dominance does need to be
10 part of the arbitrator's task but there is no
11 reason why an arbitrator can't, like the Anti-
12 Trust Division does, consider complex evidence
13 with a time limit. We also think there is no
14 reason why the kind of cost evidence that would
15 undoubtedly be brought forward in this sort of
16 arbitration can't be considered.

17 Again, the Canadian experience, while
18 not perfection and not necessarily something we
19 want to imitate in detail, suggests that this
20 approach is workable and can be done in a timely,
21 expeditious, relatively inexpensive fashion.

22 I would mention, since I still have a

1 green light, two other aspects of our proposals
2 and then of course, I would welcome your
3 questions. I know you have before you a proposal
4 by NITL regarding reciprocal switching and we
5 discussed reciprocal switching at our
6 deliberations. We did not take a position on the
7 NITL proposal. We did observe that Canada has
8 reciprocal switching everywhere if you're within
9 20 kilometers of a switch point.

10 We didn't reach a conclusion on that
11 proposal or proposals like it but it did seem to
12 us that in the context of arbitration, that it
13 would not be unreasonable to allow either side to
14 propose reciprocal switching as part of its final
15 offer. A railroad might say well we think our
16 rate is terrific but if you really think it
17 isn't, we will allow for switching at a certain
18 price and let you negotiate with the other
19 railroad at the switch point or the shipper might
20 say I don't want to rely on you at all, I want
21 switching and I'm willing to pay X for it. We
22 think that if you get to arbitration, it's not

1 unreasonable to have that be part of either
2 party's final offer.

3 With elimination of the URCS test,
4 there is no longer a concern that this might lead
5 to a rate below 180 percent of variable cost.
6 Again, putting it in through arbitration and not
7 a blanket nationwide policy removes concerns
8 about fee schedules, distances and so forth.
9 That would be part of the arbitration. The
10 second point up there that is relevant here, of
11 course, it's more relevant to your next hearing
12 but I'm here today and if you will permit me a
13 few moments to just round this out, we recommend
14 eliminating the annual revenue adequacy
15 determination described by the Board itself as a
16 mechanical process, pass/fail grading.

17 Our reason is twofold, first, the
18 prolonged use of this process that looks on its
19 surface like public utility regulation, compare
20 the cost of capital, to learn the cost of
21 capital, suggests to some on both sides of the
22 debate that perhaps there out to be a cap of some

1 sort based on this kind of comparison of returns
2 with cost of capital. We think that's
3 inconsistent with Staggers. We think it's
4 impractical and we think it's not the way
5 forward. The second reason is there is good
6 reason why the railroad industry needs to be
7 looked at closely in terms of revenue adequacy,
8 in terms of competitive conditions, in terms of
9 exercise of market power. The annual revenue
10 adequacy determination is not such a look.

11 Our recommendation is that the annual
12 exercise be dropped but that the Board be tasked
13 with periodically, let's say every five years,
14 issuing an in-depth report on competitive
15 conditions, revenue adequacy, long-term prospects
16 and so forth to assess whether you know, the
17 policy we have is producing the results that we
18 want, which I don't think and we don't think the
19 annual revenue adequacy determinations do. With
20 that, I will pause and thank you for your
21 patience.

22 CHAIR MILLER: Thank you very much,

1 Professor Schmalensee. I suspect there are lots
2 of people in the audience right now that wish
3 they had the opportunity to ask you questions and
4 if we could do that, we could probably just spend
5 the rest of the day peppering you but fortunately
6 for Ann and I, we get the opportunity to ask some
7 questions and I would say that those of you who
8 are in the room, we did have the opportunity
9 yesterday, Dr. Schmalensee was kind enough to
10 come up and give us a preview of the report so we
11 have had an opportunity to already ask a few
12 questions but I certainly find that I come up
13 with other questions every time I hear you go
14 through this analysis.

15 There are just a couple of things I
16 want to clarify. You've talked about the issue
17 of market dominance not restricting categorical
18 evidence but using time limits and that works
19 better in an informal proceeding. When you talk
20 about informal proceeding, is that another way to
21 say arbitration? Is that really what that means?

22 DR. SCHMALENSEE: That's what that

1 means in this context. Yes ma'am.

2 CHAIR MILLER: Okay. I just wanted to
3 be sure that there weren't other ways you all
4 were thinking about it. One of the other things
5 that I was wondering, when you talk about SAC and
6 you say, really the purpose is really more to
7 determine fairness than to efficiency. Is one of
8 the reasons why the committee concluded that
9 there is no economic justification for the use of
10 SAC because the analysis is a fairness analysis,
11 not an efficiency analysis? Am I drawing too
12 many connections from what you said?

13 DR. SCHMALENSEE: Well, it's my lack
14 of clarity I'm afraid. I think the approach we
15 take is fundamentally a fairness approach as is
16 the SAC approach. So that's not, if you could do
17 SAC inexpensively and quickly and it could be
18 made accessible to small shippers, you could
19 argue that this is one definition of fairness.
20 The comparison with competitive rates that we
21 propose is another. Ours is very quick, however.
22 The arbitration is very quick and an arbitrator

1 will naturally be concerned with issues of
2 fairness. The SAC test is a particular measure
3 of fairness. We could have a long discussion
4 about its properties. It's not obviously the
5 right one here. I could see why it was done when
6 Stagers, after Stagers was passed when
7 confronted with a railroad industry that you know
8 the costs are too high because of the legacy of
9 regulation then to say well, let's look at the
10 costs of an efficient alternative that just
11 serves you and fairness says you shouldn't be
12 subsidizing other people.

13 Of course, without a rate of return
14 constraint, it's not clear there is a subsidy but
15 you shouldn't be paying more than a standalone
16 cost of an efficient system. That makes a
17 certain amount of sense but there is no theorem
18 that says that's the way to do fairness. I could
19 see why it happened when Stagers was passed. I
20 think experience has shown that it's unwieldy and
21 not the only way to think about fairness.

22 CHAIR MILLER: Certainly it is

1 unwieldy, no question about that. I have a final
2 question and then I'll turn it over to the Vice
3 Chairman, but I want to go back. In terms of the
4 issue of revenue adequacy, again, this is maybe
5 my interpretation of what you said and that is
6 that really where we are, 35 years post-Staggers,
7 is that there is no real purpose served by the
8 revenue adequacy test and the approach that's
9 been suggested by your committee of doing more of
10 a five-year in depth analysis as much as
11 anything, is a way to continue to monitor whether
12 or not we're continuing to see you know, a good
13 competitive market but not really because revenue
14 adequacy is needed in the regulatory process?
15 Again, am I going too far in interpreting the
16 panel's recommendations?

17 DR. SCHMALENSEE: No, I don't think
18 you're going too far. I think the notion that
19 the Board should revise its process if the
20 industry is found to be revenue adequate, which
21 kind of lurks from earlier statements; I think
22 it's too mechanical in a way. Nobody asks, is

1 General Electric revenue adequate this year? You
2 look at businesses over the business cycle. You
3 look at long-term prospects. You look at a
4 variety of things in judging the health of an
5 institution or an industry.

6 Now, we were not tasked with assessing
7 the methods used in the annual review. We did
8 have discussions about them but at the end of the
9 day it seemed to us that what's happened after
10 Stagers, 35 years after Stagers as the industry
11 has invested and innovated and reinvented itself,
12 is it looks a lot more like a normal industry
13 than it did with Stagers.

14 CHAIR MILLER: Uh-huh.

15 DR. SCHMALENSEE: When Stagers was
16 passed, you could see why you would want annual
17 revenue adequacy determinations because are we
18 going to have to bail them out again? It was
19 clearly on people's minds and logically on
20 people's minds given how much had been spent.
21 That's not on anybody's mind today as far as I
22 can tell. The industry is making substantial

1 investments. The industry is expanding capacity.
2 So the notion of, do they have what they need to
3 live and if they do, maybe we should tighten the
4 regulation, seems counter to the thrust of
5 Stagers at the end of the day.

6 Stagers was about making this into an
7 ordinary, maybe wholesome or not, healthy
8 industry. We can debate wholesome if you'd like.
9 But healthy industry that yes, still needs
10 regulatory oversight because it has inevitably a
11 fair amount of market power and is an important
12 industry but Stagers pointed toward light-handed
13 regulation not public utility style regulation
14 and the annual revenue adequacy looked to us a
15 lot like public utility regulation and periodic,
16 say five year examination of the industry, looked
17 a lot like let's inform policy and see if we're
18 in the right direction and do we need to make
19 changes. It just seemed to serve, that seemed to
20 be the right purpose today. Are we on the right
21 track? Not turn the crank, yes, no, revenue
22 adequate, not revenue adequate.

1 CHAIR MILLER: Thank you very much.
2 Vice Chair Begeman?

3 VICE CHAIR BEGEMAN: Yes, thank you
4 very much. I think you have a lot of people
5 needing some air in the room. Thank you for
6 getting us out of the group-think mentality, that
7 a lot of times we get sucked into when we start
8 dealing with these issues and rate case
9 methodologies. You certainly have made clear that
10 much of what you're suggesting is not in our
11 power to do without legislation. But one of the
12 questions I wanted to ask, you mentioned that
13 because of the change in coal shipments, you did
14 not include that element in your process as far
15 as what you were developing. But, even if you
16 had, would you have come out with a different
17 outcome?

18 DR. SCHMALENSEE: No, we would not. I
19 wouldn't say that we excluded them, it was just
20 that we noticed that you know, almost all coal
21 now travels under contract. My sense is, and I
22 think the sense of the committee, without being

1 able to document it, is that one reason why, a
2 couple reasons why contracting coal is easier
3 than contracting in grain but an important
4 reason, we suspect, is that there were all of
5 those coal cases which sort of set bounds on what
6 kind of rates might stand up. That makes
7 negotiation a little easier. We didn't exclude
8 coal from our consideration, the approach we
9 proposed would apply as well to coal as to
10 anything else. But coal shippers appear willing
11 to enter into contracts and thus not be eligible
12 for a reasonability determination.

13 VICE CHAIR BEGEMAN: Thank you for
14 correcting my impression because I thought you
15 said that you weren't thinking about coal
16 anymore, but it had a different meaning?

17 DR. SCHMALENSEE: No ma'am. It was
18 just to point out that the composition of tariff
19 traffic has changed but what we proposed would
20 apply to all tariff traffic.

21 VICE CHAIR BEGEMAN: On the modeling
22 that you had on the screen for the farm

1 commodities of the different pyramid, if you
2 will.

3 DR. SCHMALENSEE: Right.

4 VICE CHAIR BEGEMAN: Was that just
5 illustrative or was it actually based on the
6 waybill data?

7 DR. SCHMALENSEE: It was based on the
8 waybill data. It was based on the waybill data
9 plus data on, and I don't remember the name of
10 the database, but it provided locational
11 information so that we could assess is there
12 barge competition nearby and so forth. It was
13 based on the real waybill data.

14 VICE CHAIR BEGEMAN: So it was where
15 the traffic was, what was moving, if there was
16 competition, and what the distance was?

17 DR. SCHMALENSEE: Yes, we started with
18 contract or exempt traffic, where there was rail
19 competition nearby or barge competition nearby.
20 We treated those as competitive benchmark rates
21 modeled how they depended on shipment
22 characteristics such as distance, number of

1 carloads and so on and so forth, and then used
2 that model to say well, if this other shipment,
3 this tariff shipment without rail competition
4 available, what would that rate have been if it
5 had been competitive in line with these other
6 competitive rates and of course, the model is not
7 perfect. It can't be perfect. So there is
8 modeling error.

9 As opposed to URCS, we're at least
10 trying to predict something real, that is to say
11 the competitive rate not something imaginary like
12 variable costs. So, that was based on a rather
13 extensive analysis of the waybill data done by
14 two members of our committee with staff help.
15 Again, we don't, let me be clear, we don't say
16 take Appendix B, write it into the legislation
17 and use it. The point of Appendix B, which is
18 where the analysis is done, is to say this
19 approach is feasible. It can undoubtedly be done
20 better than we did it, but it's feasible.

21 VICE CHAIR BEGEMAN: And as far as the
22 "punch line" of arbitration, did you have

1 opinions on whether or not it's something that
2 could be done within the Board, or actually,
3 should it be outside of the Board?

4 DR. SCHMALENSEE: We resisted the
5 usual academic temptation to reorganize the
6 federal government. My understanding is, again,
7 I'm not a lawyer and nobody involved is, but that
8 it would be --

9 VICE CHAIR BEGEMAN: That's okay,
10 neither are we.

11 DR. SCHMALENSEE: I'm not sure --

12 VICE CHAIR BEGEMAN: It's a feature,
13 not a flaw.

14 DR. SCHMALENSEE: I'm not sure the
15 Board has the authority to hand off decision
16 making to an arbitrator. If it did, then it
17 could. If it doesn't, then it can't.

18 VICE CHAIR BEGEMAN: But if the
19 parties would agree to it, they could.

20 DR. SCHMALENSEE: Oh, if the parties
21 would agree to it, then perhaps it can. We don't
22 propose mutual agreement to be the test. We just

1 propose that to be what you do at that point. In
2 part, based on prior cases, would save an
3 enormous amount of person hours at the Board to
4 be able to do that.

5 VICE CHAIR BEGEMAN: Well I guess
6 we're sort of left with trying to fix the
7 unfixable, at least with this proceeding. Thank
8 you for that. But if you have any ideas on what
9 we could do, we still have a mandate, we have an
10 obligation.

11 DR. SCHMALENSEE: You do and it is a
12 difficult one and it's a little bit of an
13 unwieldy mandate which was part of the point that
14 we tried to make and I wish we had been able to
15 come up with, given your statutory authority,
16 here is the obvious way forward but we didn't
17 impose that constraint on ourselves and I don't
18 want to make something up here as I sit here.

19 VICE CHAIR BEGEMAN: Well, thank you
20 very much.

21 CHAIR MILLER: Thank you. We
22 appreciate your being here today.

1 DR. SCHMALENSEE: Thank you for your
2 time.

3 CHAIR MILLER: Okay, we're going to
4 move to Panel II and ask that those who are on
5 Panel II come forward which includes Deputy Under
6 Secretary Gary Woodward and from the Montana
7 Department of Agriculture, Benjamin Tiller and
8 Mike O'Hara from the Montana Wheat and Barley
9 Committee, I think. And for those of you in the
10 audience who might need to do some planning or
11 thinking, we'll continue to monitor time and make
12 sure it still seems sensible but we believe we
13 will likely take a break for lunch after Panel
14 III and before Panel IV. Okay, thank you. It
15 looks like we're ready to begin. So Deputy Under
16 Secretary Woodward, I'll turn it over to you.

17 MR. WOODWARD: Great. Thank you Madam
18 Chairman. Madam Vice Chairman. I'm going to
19 start out this morning doing something that I was
20 told I should never do at the beginning of a
21 meeting and apologize. I woke up this morning
22 and realized that my allergies had given me a

1 swift kick in the pants and so my throat is a
2 little scratchy and my voice is coming and going
3 but I will do my best to project as well as I can
4 this morning so that you all, and the folks at
5 home can hear me. Again, Gary Woodward, I'm the
6 Deputy Under Secretary for Marketing and
7 Regulatory Programs at the United States
8 Department of Agriculture. It's a mission area
9 at USDA that encompasses the agricultural
10 marketing service, which has as part of their
11 mandate, the task of monitoring US transportation
12 systems as they relate to agriculture.

13 I'll join the Chairman and the Vice
14 Chairman this morning in pointing out the good
15 work of staff and I want to thank Arthur Neal and
16 his team at AMS who are sitting behind me for
17 their yeoman's work in this area. They are the
18 real policy experts on these issues and so I want
19 to thank them and highlight their work on behalf
20 of US Agriculture. The US Department of
21 Agriculture does appreciate the opportunity to
22 present testimony at this hearing and sincerely

1 thanks the Service Transportation Board for
2 investigating ways in which rail rates challenge
3 procedures can be made more accessible for grain
4 and oilseed shippers.

5 The USDA believes that it is critical
6 for these procedures to provide effective
7 protection against unreasonable freight rail
8 transportation rates where there is an absence of
9 effective competition. For too long, most
10 agricultural producers and shippers have been
11 left with no practically accessible means to
12 challenge rail rates, much less seek redress. It
13 is telling that no grain or oilseed shipper has
14 filed a rail rate challenge using any of the
15 Board's processes since the McCarty Farms case
16 was decided in 1997. This is not because there
17 have been no complaints about rates, instead the
18 USDA believes that there have been no rate
19 challenges mainly because the Board's procedures
20 are too lengthy and expensive for virtually all
21 agricultural shippers. The cost of bringing a
22 challenge is only part of the issue.

1 Equally important but as easily
2 quantified is the constant changing of rules and
3 procedures within the current rate challenge
4 system. This makes the outcome of any rate
5 challenge very difficult to predict and
6 undermines the shipper's willingness to take part
7 in such a system. Any newly proposed processes
8 or amendments to existing rate challenge
9 procedures are likely to be met with skepticism
10 by agricultural shippers if they believe the new
11 process will not be consistently applied and
12 therefore subject to unattainable preconditions.
13 A consistent process also establishes
14 credibility, not only will it encourage greater
15 shipper participation but it will also lessen the
16 need for litigation and/or rate challenges by
17 shippers as time goes on.

18 In the opening comments of this
19 proceeding submitted last year, some rail
20 carriers argued that the possibility of
21 litigation before the Service Transportation
22 Board served to prevent rate increases in areas

1 where competition is not as strong. Litigation
2 only serves as an effective check, however, if
3 STB's processes are consistently applied. This
4 also underscores the importance of designing and
5 effective and accessible rail rate challenge
6 procedure for grain shippers and producers in
7 order to ensure its credibility as a check
8 against unreasonable rail rate increases. USDA
9 believes that effective regulatory mechanisms are
10 critical to rounding out the rail transportation
11 policies complimentary directive of allowing
12 competition to establish reasonable rates.

13 Therefore, USDA encourages the Board to purposely
14 seek simplicity, practicality and consistently in
15 developing alternative rate relief methodologies
16 for agricultural shippers and their unique needs.

17 USDA believes that the most promising
18 ways for the Board to encourage greater use by
19 agricultural shippers of a specific rate
20 challenge procedure are through one,
21 significantly lowering the costs associated with
22 the procedure; and two, demonstrating a

1 commitment to a predictable set of outcomes
2 through the development of a process that is
3 simple to use and easy to understand. USDA
4 believes a formula based procedure using data
5 that is easy to obtain and deterministic in
6 nature, would have wide appeal to agricultural
7 shippers. Two such procedures have been
8 submitted for the Board's examination in the
9 course of this setting. The AG commodity maximum
10 rate methodology proposed by the National Grain
11 and Feed Association and the two benchmark tests
12 proposed by the Alliance for Rail Competition.
13 Both of these alternative methods adhere to the
14 criteria of simplicity, practicality and
15 consistency.

16 Additionally, their inclusion into
17 treatment of railroad revenue adequacy make them
18 strong candidates for challenging rail rates
19 moving forward as the regulatory environment
20 increasingly incorporates this concept. To
21 compliment formal processes, USDA has also
22 encouraged mediation and arbitration in its

1 opening reply comments. A major benefit of
2 mediation and arbitration is that they have the
3 potential to offer rail rate challenge procedures
4 that are less time consuming and lower cost than
5 formal Board processes.

6 In addition, these informal processes
7 foster direct business discussions, facilitate an
8 informal resolution of many issues before they
9 require formal procedure. If broadly utilized by
10 the nation's shippers and railroads, mediation
11 and arbitration systems could offer agricultural
12 shippers greater access to rate dispute
13 settlement mechanisms that have a reputation for
14 being fair, easily understood, accessible and
15 affordable. Examples of these types of
16 arbitration systems that already exist include
17 the National Grain and Feed Association's rail
18 arbitration system and the Montana BNSF mediation
19 arbitration system. These systems have not been
20 broadly used for rate disputes because railroads
21 have generally been unwilling to arbitrate rates.

22 In addition, the scope of these

1 systems cannot handle all agricultural rate
2 disputes because of limitations on shipper
3 membership, geographic application and commodity.
4 Nevertheless, they serve as good examples of how
5 such systems can effectively resolve disputes and
6 foster good business relationships. As a
7 practical way to advance fairness for
8 agricultural rate disputes, USDA believes that
9 the Board should actively assist in facilitating
10 the expansion and creation of the mediation and
11 arbitration system. Such system could be the
12 most promising and viable procedure for the
13 average agricultural shipper who may not have the
14 disposition, inclination or time and money for a
15 formal process. At the same time, the use,
16 expansion and success of mediation in arbitration
17 is contingent upon the Board encouraging
18 railroads to use them when handling rate
19 disputes.

20 As a result of decades of efficiency
21 improvements and recent, but consistent rate
22 increases, the railroads are now earning

1 approximately their cost of capital as documented
2 through the study by Christiansen Associates and
3 there is no doubt that the rail industry today is
4 in far better financial health than it was in the
5 immediate post-deregulation period and it's in
6 everyone's interest for railroads to earn
7 sufficient returns on their investments to be
8 able to maintain, improve, expand and safely
9 operate their extensive and expensive
10 infrastructure and rolling stock. USDA realizes
11 that gains in efficiency, improvements in service
12 and investments in infrastructure would not be
13 possible without the financial success of the
14 rail industry. Yet, railroads are national
15 monopolies and the rail transportation policy
16 requires the board to maintain reasonable rates
17 where there is an absence of effective
18 competition. Producers with few transportation
19 options such as wheat farmers in remote areas
20 have the highest rates and bear the brunt of any
21 rail service disruptions. Look no further than
22 the rail service problems of 2014 to see numerous

1 examples of grain and oilseed shippers who lacked
2 competitive transportation options. As a result,
3 inadequate competitive transportation options,
4 those shippers faced skyrocketing costs, which in
5 some areas widen the grain basis and depress the
6 vignette prices that farmers received.

7 Ultimately, this lowered incomes as producers
8 absorbed much of the increased transportation
9 costs. USDA recognizes that policy changes
10 should not reduce railroads ability to invest in
11 a network or to grade service.

12 Furthermore, the USDA does not believe
13 that every rate increase by a railroad is
14 unreasonable or that railroads necessarily charge
15 noncompetitive rates to grain and oilseed
16 shippers in general. The ability to charge such
17 rates exists in noncompetitive markets, however,
18 and this warrants careful consideration of
19 prescriptions by the Board. This is why the rail
20 transportation policy requires the Board to
21 maintain reasonable rates where there is an
22 absence of effective competition and why

1 development a workable rate challenge process for
2 grain and oilseed shippers is so important.

3 As its core, this proceeding is being
4 held to establish a means for challenging rail
5 rates for grain and oilseed shippers who have
6 neither competitive transportation options nor
7 access to regulatory relief. Once such processes
8 are established, this objective of the rail
9 transportation policy will have been met. Going
10 forward, the task will be for the Board to decide
11 the merits of the rate challenges that are
12 brought forth. With that, I will end and say
13 thanks again for allowing me to present the views
14 of the US Department of Agriculture here and I
15 thank you all for your interest in American
16 agriculture.

17 CHAIR MILLER: Thank you and thank you
18 for being with us today. Mr. Tiller?

19 MR. TILLER: Thank you, Madam Chair.
20 May it please the honorable members of the Board?
21 My name is Benjamin Tiller and I'm here today
22 representing the Montana Department of

1 Agriculture. The Department's mission fits
2 squarely within the subject matter of VP665 and
3 we appreciate the Board's recognition of these
4 important issues to America's farmers. With me
5 today is Mike O'Hara. He is a farmer from Fort
6 Benton, Montana. He's a member of the Montana
7 Wheat and Barley Committee and he is the former
8 Chair of Montana's Rail Service Competition
9 Counsel. I appreciate the Board giving him the
10 opportunity to speak today on short notice.

11 I'd like to preface my comments with
12 an assurance that the Montana Department of
13 Agriculture is not here today as a rail critic.
14 We appreciate the services that the railroads
15 provide and understand their critical role in our
16 AG economies. Positive communication between the
17 Department of Agriculture and the BNSF has
18 increased considerably since the service collapse
19 of 2013 and we commend them for those efforts. I
20 will speak on four principal issues today.
21 First, I will give an outline of Montana's
22 rapidly changing AG economy. Next, I will

1 discuss the difficulty Montana's small elevators
2 face when negotiating rates and service with the
3 railroads. Next, I will explain how not having
4 an accessible appeal option directly affects the
5 producers. Finally, I will offer the
6 Department's suggestions for meaningful changes.

7 Montana produces 5.2 million metric
8 tons of wheat per year. 75 percent of which is
9 exported to foreign markets. Nearly all of that
10 reaches the export terminals via rail. Recent
11 shuttle facility development by private industry
12 throughout the state has made it more efficient
13 for the railroads to deliver this grain to port.
14 Despite these efficiencies, however, we have not
15 seen a decrease. We've only seen increases in
16 shipping rates per bushel since the mid-2000's.
17 The increasing costs of shipping grain in a
18 system that is increasingly more efficient is
19 concerning to the Department. More concerning,
20 however, is how substantial developing
21 agricultural industries in our state are facing
22 an ever widening pricing differential.

1 Montana, last year, became the number
2 one producer of pulse crops in the nation. Most
3 people know pulse crops as chickpeas and lentils
4 but they also include various edible dried beans
5 and peas. Since 2000, Montana's pulse acreage
6 has more than doubled and our data indicates that
7 it's going to double again in the next five
8 years. This rapid development means more
9 productive farms and a greater abundance of
10 highly nutritious food for the rest of the world.
11 Unfortunately, as these crops gain marketability,
12 shipping costs are quickly becoming a market
13 deterrent. Smaller elevators that lack
14 negotiating power handle most of the pulse crops
15 in our state. This lack of negotiating power
16 stems from the absence of a meaningful regulatory
17 threat and that's why we're here today. Pulse
18 crop volumes might, in the future, justify
19 shuttle shipments but today's volumes don't
20 support it. This is why the smaller facilities
21 handling these crops continue to pay higher rates
22 and suffer greater service problems than the

1 larger, more established wheat trades.

2 This hearing could not have been
3 timelier. On May 1st, new BNSF rail rates went
4 into effect for the State of Montana. The new
5 rates will decrease the bottom line on Montana's
6 farms in three concerning ways. First, BNSF
7 eliminated the differential between domestic and
8 international shipments. The new rates are in
9 excess of both the domestic rate which was
10 traditionally more expensive and the
11 international rate. To put it another way,
12 shipping on the cheap route on May 1st this year
13 was more expensive than shipping on the expensive
14 route the day before. Second, BNSF eliminated
15 the fuel sur charge and incorporated that expense
16 back into the tariff. The rates from Shelby to
17 the PNW are roughly equal to what they were this
18 time last year. Unfortunately, the fuel sur
19 charge on April 30th of 2014 was 38 cents per
20 mile. On April 30th of 2015, it was 9 cents per
21 mile.

22 In essence, BNSF has captured as

1 profit what used to be a fuel expense and taken
2 away the oversight the STB has over fuel sir
3 charges. Montana's farmers are no longer
4 receiving the benefit of 63 dollar barrel oil.
5 Finally, and most concerning is that the
6 differential for less than shuttle rates, those
7 cars that will carry the bulk of those pulse
8 crops that I talked about at the beginning, have
9 increased at a rate far greater than the larger
10 shuttle shipments. This pricing differential is
11 a market deterrent. Montana farmers should not
12 be forced to grow wheat because the rail enjoys
13 maximum efficiency to ship it. Smaller elevators
14 should not be forced by unreasonable rates to
15 bear the entire cost of expanding to shuttle
16 operations before the industry can support the
17 investment. The BNSF will tell you that these
18 rates are getting higher because moving smaller
19 units is simply less efficient. If the increase
20 of shuttle and non-shuttle rates was on the same
21 trajectory or there was some indication that the
22 system as a whole was getting less efficient then

1 this argument might make sense.

2 However, as private industry shuttle
3 facility investment has continued to make the
4 rail system more efficient as a whole, BNSF's
5 prices continue to go up. Increased efficiency
6 in one area should not cause another area to
7 become more inefficient. This is counter to the
8 railroad's constant refrain that efficiency on
9 the network is efficiency for all. This pricing
10 differential and the disparate trajectories of
11 the increases likely has less to do with
12 efficiencies and more to do with carrier
13 preference. It runs contrary to the railroad's
14 common carrier obligations. The railroads often
15 dismiss, out of hand, potentially cost saving
16 solutions from the industry. For example, even
17 if various small shippers were to organize a 110
18 car train from various locations within our
19 state, what the Department has termed a reverse
20 DET or Destination Efficiency Train so in effect
21 it's an origination efficiency train. The
22 railroad won't offer the discounted DET rate and

1 we haven't received an explanation for why this
2 train is less efficient to move than the reverse.
3 Smaller shippers are discouraged by these rates
4 but they have no recourse.

5 First, they fear retaliation. Our
6 small elevators struggle weekly with inconsistent
7 car deliveries. For example, they will order
8 three cars a week yet consistently get twelve
9 cars every four weeks. Is this because of
10 crowding on the rail system or is it because it
11 just makes more economic sense for the railroad
12 to deliver all of those cars at once? In any
13 event, it is cheaper to deliver all of those cars
14 at once and those savings are profit to the rail.
15 But rather than risk retaliation by challenging
16 the service, these small elevators simply
17 scramble to try and fill these cars and they have
18 to pay the demerge while they're sitting there.
19 Retaliation is a large and real fear for these
20 smaller shippers. Second, they fear the cost of
21 the rate case. We've heard it twice today. The
22 STB estimates a three benchmark proceeding would

1 take approximately eight months and cost
2 \$500,000. A standalone cost case would cost more
3 than 5 million dollars. Small shippers can't
4 take that risk when there is virtually no
5 precedent guidance. But the small shippers
6 aren't the ones suffering here.

7 When faced with the risk of
8 retaliation or the cost of a rate case, the
9 common sense solution is to simply pass the cost
10 off to the customer. Remember, the customer is
11 the farmer, the Mike O'Hara's of the world.
12 Large shippers face a similar conundrum. Are
13 they meeting their duty to the shareholders if
14 they chose to litigate over a rate that they
15 could simply pass off to their customer? And the
16 farmer has no power. He possesses a massive
17 volume of a product with an expiration date. His
18 market influenced is limited to the next time his
19 loan payment is due or the next time he needs
20 somewhere to put his new crop. The Department
21 has some ideas to help solve these issues.

22 At a very minimum, standing to bring

1 the case must be granted to the real party in
2 interest. I can think of no other judicial or
3 quasi-judicial proceeding in which the entity
4 that doesn't suffer the harm is the only entity
5 that can bring a case. The farmer bears that
6 cost of shipping and should have the change to
7 challenge those rates. Second, parties must be
8 allowed to aggregate their claims to take
9 advantage of economies of scale. Montana farmers
10 move their grain from the same terminals on the
11 same rails and are charged the same rates. When
12 the real parties in interest can prove they are
13 similarly situated, they should be able to bring
14 an aggregated claim. This would increase
15 efficiency for the Board and protect the rail
16 from constant piecemeal litigation. Then, state
17 Attorney's General should be allowed to bring
18 cases on behalf of shippers and producers. This
19 policy is sound because the state need not fear
20 retaliation. It can act on behalf of others
21 without regard to shareholder profits and it has
22 the resources and transportation expertise to

1 effectively pursue a just remedy.

2 Rate cases shouldn't be the only
3 remedy available. Binding arbitration should be
4 explored and it is with Senate Bill 808. Others
5 in this proceeding have suggested an arbitration
6 system based on the NGFA model. This may be a
7 good place to begin but modifications are
8 necessary. The NGFA calls for choosing three
9 arbitrators from the industries in the dispute.
10 What this means is that one industry in the
11 dispute will always have a majority on that
12 arbitration panel. We recommend the arbitration
13 panel include a member of the STB Board or
14 governmental magistrate and we think that will
15 work, especially if this Board is expanded to
16 five members. Then add to that panel, one member
17 from each of the industries.

18 Second, appeals from the arbitration
19 should be limited to those grounds in the Federal
20 Arbitration Act and expanded to also include
21 situations where the arbitrator's conclusions of
22 law are clearly erroneous and where the findings

1 of fact are not supported by substantial
2 evidence. Without such limitations, arbitration
3 will simply become an expensive first step at an
4 even lengthier litigation process.

5 Third, arbitration must be subject to
6 time limits. An arbitration decision should be
7 rendered within six months of the filing of the
8 case, except in instances of extraordinary
9 circumstances.

10 Finally, the Board could consider
11 mandating arbitration for certain cases to bring
12 the parties to the table. Obviously this might
13 require a legislative change but it could serve
14 as an effective deterrent to abuse of pricing on
15 smaller shipments. For the sake of discussion
16 and for the sake of discussion only, the rule
17 could require aggregated claims with a value of
18 less than \$500,000 brought by fewer than 15
19 farmers to be subject to mandatory arbitration.

20 If an arbitration mandate is
21 considered, we would encourage further hearings
22 to explore the appropriate jurisdictional limits.

1 Others have supported final arbitration. We've
2 heard that already today. We're hesitant to join
3 them because inevitably the railroad will always
4 have more information. The shipper will be
5 incented to request only a minimal concession for
6 fear that the railroad's offer will receive
7 deference because it owns the data and professes
8 expertise on its own rail system.

9 Montana's farmers are in an unenviable
10 situation right now. Commodity prices are low
11 and they have no power to effectively negotiate
12 or appeal the rail rates that are eating up a
13 considerable portion of their margins. The
14 Department of Agriculture is confident that
15 today's conversations will provide the Board with
16 the information it needs to make meaningful
17 changes. We believe that the solution begins
18 with allowing producers to bring claims since
19 they are the ones bearing the cost of
20 transportation, allowing parties to consolidate
21 their claims to increase the efficiency of the
22 process and developing a binding arbitration

1 system. Mandatory in certain situations perhaps
2 where decisions are made by a balanced panel of
3 arbitrators.

4 You will hear later that BNSF is
5 investing 6 billion dollars this year and it
6 spent 5.5 billion dollars last year in capital
7 investments. If these investments are working,
8 why is the price to ship our smaller volume yet
9 very high potential and high value crops,
10 increasing at a faster rate than the increase on
11 other commodities? Is it because their
12 investments discriminate against these small
13 shipments that fall within the common carrier
14 obligation? Until there is a cost efficient way
15 to challenge these rates, there will be no way to
16 know. With that, I would like to turn over the
17 remainder of my time to Mr. Mike O'Hara. Thank
18 you.

19 MR. O'HARA: My name is Mike O'Hara
20 and I would like to thank you for giving me time
21 today for this testimony. My testimony will be
22 specific to Montana grain growers and more

1 specifically to our farm. My grandfather, Oliver
2 O'Hara, arrived in Fort Benton, Montana in 1912
3 in a box car on the Great Northern Railroad with
4 his life's possessions and the dream of making a
5 life of homesteading.

6 Today, my wife and I have a family
7 partnership with our two sons in the same area
8 that my grandfather homesteaded. Located in
9 Choteau County, we are in the heart of the
10 largest production area of quality milling wheat
11 in Montana. Our farm has been predominately
12 raising wheat for the past 45 years until five
13 years ago. We have diversified into oilseed,
14 pulse crops and malt barley because the profit
15 margins had more potential. Our farm will be
16 paying \$150,000 freight on its 2015 wheat crop.
17 The wheat production on our farm that freight is
18 to deliver it to the West Coast for export to our
19 foreign customers.

20 With the current price of wheat for
21 this marketing year, we show a 70-cent bushel
22 profit after our production costs. This is close

1 to the break-even cost reflecting an average crop
2 year, not taking into account the risk of drought
3 and other perils that agriculture faces every
4 day. The crops we have diversified to currently
5 depend on single car tariff rates. These new
6 markets are being threatened as a result of the
7 higher costs of transportation.

8 All these costs are passed on to the
9 farm reflecting lower prices. As freight rates
10 rise on the smaller shipments, how long will the
11 profitability remain in these crops? How much
12 time do we have until margins of these crops are
13 as tight as wheat currently is? As we innovate
14 into crops with more profit margin, those profits
15 are being taken by higher freight rates. Thank
16 you again for this opportunity to share our story
17 and the effects it has on our family farm depends
18 on our livelihood. Thank you.

19 CHAIR MILLER: Thank you Mr. O'Hara.
20 Thank you so much for being with us today. We
21 really appreciate that. Vice Chairman Begeman,
22 do you want to start the questioning?

1 VICE CHAIR BEGEMAN: Yes. Mr. Tiller,
2 could you tell me what role has your agency had,
3 or what understanding you have of the arbitration
4 process that, I believe it's with Montana,
5 certain Montana farms, or a group in Montana has
6 with BNSF and I'm sure that Mr. Miller later can
7 be more specific from his perspective. But what
8 has your experience or your constituent's
9 experience been with that?

10 MR. TILLER: Yes ma'am, Vice
11 Chairman. So there is an arbitration agreement,
12 a standing arbitration agreement between the
13 Montana Grain Grower's Association, Montana Farm
14 Bureau Federation and the BNSF.

15 VICE CHAIR BEGEMAN: And is that a
16 large group?

17 MR. TILLER: Yes. Those are two of
18 the largest farm groups in the State of Montana
19 especially when it comes to wheat commodities and
20 this arbitration agreement has been in place, you
21 know, someone else will have to fill you in on
22 the date but it's only ever been used once and

1 it's only effective for negotiating wheat and
2 barley rates. BNSF has not agreed to negotiate
3 these smaller rates that we discussed earlier
4 today. It was used once in a rail case for
5 shipping wheat from Shelby, Montana which is the
6 location I mentioned earlier today to the PNW but
7 I believe that was nearly a decade ago. So, to
8 tell you what the perspective is, I think that
9 the usage kind of answers that question. It's
10 been used one time and I'm sure that that's
11 because the rate is necessarily reasonable, I
12 think it's because the process just doesn't work
13 as well as one might hope.

14 CHAIR MILLER: Can you say more about
15 why do you think there's only been one attempt at
16 using it? Was that because the farmers and
17 others who were interested just didn't think it
18 was going to work for them? Has it been a
19 reluctance on the part of the railroads to
20 participate?

21 MR. TILLER: No, there is certainly
22 not a reluctance, Madam Chairman, on the

1 railroads to participate. I think the agreement
2 is standing. If somebody wanted to arbitrate one
3 of these rate cases, they could bring it. I
4 think in the countryside there is some perception
5 issues on how that's done and I think that goes
6 to Deputy Under Secretary Woodward's comments
7 that any of these proceedings have to have, they
8 have to be trusted by the constituents in order
9 to be utilized.

10 VICE CHAIR BEGEMAN: Well certainly,
11 I realize that's outside of our purview. We have
12 a job that we need to do as well, but to the
13 extent that private agreements or private
14 resolutions can be achieved, I'm all for it. You
15 know, every now and then, actually fairly
16 frequently, we hear the comment that the Board
17 needs to clarify standing for the growers or
18 farmers. Can I ask, why don't farmers think they
19 have standing?

20 MR. TILLER: Madam Vice Chairman, I
21 think our request is for clarification on that
22 issue. As you look back at the federal court

1 opinion in McCarty Farms, you will see that they
2 do mention that they are in fact, suffering this
3 harm. However, I think that this concern about
4 whether standing actually exists is more of a
5 fear of having to litigate that issue at the
6 beginning of a case. Because it isn't an
7 entirely settled precedent. So you know that
8 that's going to be one of the very first
9 dispositive motions filed by your opponent in the
10 case and I think that's probably the deterrent
11 there and that's why some clarification would be
12 helpful.

13 VICE CHAIR BEGEMAN: And since we
14 kicked the hearing off with sort of, kind of,
15 putting the law aside, how best can the Board
16 accomplish a fair process or fair rate
17 methodologies? Is arbitration your preference?
18 What would your silver bullet be? I'll really ask
19 all three of you if you don't mind.

20 MR. TILLER: Madam Vice Chairman, I'm
21 not sure if I could put my finger on what the
22 Department thinks the silver bullet is. I can

1 tell you, I mean, I am a litigator and when I
2 look at the complexity of bringing a stand alone
3 cost case, I don't understand how even a large
4 group of farmers with a very large case would be
5 able to find the representation that they
6 actually needed especially considering you're
7 breaking new ground. There is no precedent. As
8 a trial lawyer, you would look at that and say
9 well, yeah, I think you're probably right. I
10 think the damages are there but can you make that
11 determination as to whether or not you're
12 actually going to have a chance to succeed?
13 There is just no precedent and so you don't know.
14 I'm not sure what the silver bullet is. I think
15 that there probably is no silver bullet but what
16 we need is some sort of access.

17 We need something that the people who
18 are harmed by these rates can actually understand
19 and that they can actually get fair
20 representation on. I think arbitration is a good
21 place to begin because it is more informal, it
22 doesn't require litigators to learn an entire new

1 area of law and procedure and they can get in
2 there and make their cases in a much more
3 informal setting and I think that's what's
4 beneficial about arbitration moving forward.

5 MR. WOODWARD: Maybe I'll just say
6 that for reasons of protocol and practicality,
7 USDA is not in a position at this point to really
8 offer specific statutory fixes that might
9 alleviate the situation from a shipper's
10 standpoint but I think we'd be happy to comment
11 on any proposals that come forward at the STB's
12 request.

13 VICE CHAIR BEGEMAN: Thank you.

14 MR. O'HARA: Well from a farmer's
15 perspective, I think arbitration has a lot of
16 potential because of the system with that now is
17 economically infeasible for us to bring cases
18 before you, so this could be a huge improvement
19 and some place where we could have a voice of
20 what's going on with our freight rates so --

21 VICE CHAIR BEGEMAN: Mr. O'Hara have
22 you testified in Washington before?

1 MR. O'HARA: Have I testified before?

2 VICE CHAIR BEGEMAN: Yes.

3 MR. O'HARA: No.

4 VICE CHAIR BEGEMAN: I thank you for
5 the effort that you made to come here. Many
6 folks have heard me say, and they're maybe tired
7 of hearing it, but I'm a farmer's daughter. I
8 certainly know that it's not the first thing that
9 farmers do, to come to Washington to try to get
10 help. Really, they usually just complain a bit.
11 Rightly so, perhaps. But they have other more
12 important things to do than to come here and make
13 their case, so thank you for the effort that you
14 made to be here today.

15 MR. O'HARA: Thank you. I appreciate
16 that.

17 VICE CHAIR BEGEMAN: Thank you.

18 CHAIR MILLER: Mr. Tiller, I'm
19 curious, you made the point when you were talking
20 about one of the things that's frustrating is
21 that even though private investments being made
22 in shuttle services and other things that should

1 be making the costs more, making the system more
2 efficient therefore, lowering the costs. You're
3 not seeing that. You made the comment that there
4 has been a price increase for grain. I'm not
5 sure if it was wheat or basically the various
6 pulse crops as well that's outpacing other
7 commodities and I'm curious, are you all tracking
8 that and sort of what's the basis for concluding
9 that grain is, the price rate is going up faster
10 than it is for other commodities?

11 MR. TILLER: Madam Chairman, thank you
12 for the question. We do track that and Montana
13 Wheat and Barley committee hired Terry Whiteside
14 who has considerable past data on those rates.
15 This one was easy because we had April 30 rates
16 in our possession and then we had the May 1st
17 rates, which were published and announced 20 days
18 prior. So what we did is we compared. We said,
19 what is the percentage increase on these shuttle
20 shipments of grain? I can't site the percentages
21 but then we compared that to what is the
22 percentage increase of these smaller shipments

1 and it went up higher. It went up faster and so
2 when you graph this out, you'll see that there is
3 a steeper increase on these smaller shipments.

4 Remember, these smaller crops have a higher
5 market price on average. You're looking at, and
6 Mr. O'Hara will correct me if I'm wrong,
7 averaging five dollars for wheat roughly and you
8 can sell chick peas for twenty-two dollars a
9 bushel thereabouts. Correct me.

10 MR. O'HARA: I'm pretty sure it's
11 eighteen but it's still profitable.

12 MR. TILLER: Right. So you see, you
13 have that more valuable commodity and you see
14 that steeper increase filling in that space there
15 and so as Mr. O'Hara said earlier today, when
16 does that margin become as small as the margin is
17 for wheat?

18 CHAIR MILLER: So I just want to be
19 sure that I understand. What you're saying is,
20 is that the rate for those carload pulse crops is
21 going up more rapidly than the shuttle?

22 MR. TILLER: That is absolutely

1 correct, Madam Chair.

2 CHAIR MILLER: But the carload pulse
3 crops are likely more expensive to transport than
4 the shuttle services, aren't they?

5 MR. TILLER: They certainly are but
6 our question is, are they getting less efficient?
7 You know? So as the system increases in its
8 efficiency because of these shuttle shipments,
9 the system as a whole should be more efficient
10 and so when you see these price increases going
11 up, there is no real justification for why it
12 should go up more for these pulse crops than the
13 larger shipments. Why should it go up at a
14 faster clip?

15 CHAIR MILLER: You're saying that that
16 system is more efficient as well but you're not
17 seeing the benefit of the efficiency playing out
18 in the rate?

19 MR. TILLER: That's correct, Madam
20 Chair. We have not seen an explanation as to why
21 that rate should be going up at a faster rate.

22 CHAIR MILLER: I thought, also, you

1 had said when you were kind of going through your
2 example the domestic grain, did you say it was
3 less expensive and that it flipped?

4 MR. TILLER: Madam Chair, what
5 happened is domestic grain was usually more
6 expensive because once it got to the PNW, it had
7 to go somewhere else.

8 CHAIR MILLER: Right.

9 MR. TILLER: So there is the
10 operational costs of exploding that train. So
11 that was traditionally more expensive. But, no,
12 what we're seeing there is so we had those two
13 different rates, when the new rates came out,
14 those base tariffs were actually higher than both
15 the cheap rate from April 30th and the expensive
16 rate from April 30th and so they basically
17 leapfrogged and so we now have the most expensive
18 rate, which is the rate that we're stuck with
19 now. And so a producer cannot make the decision
20 anymore, well, you know, it is cheaper for me to
21 find an international market than a domestic
22 market. It's the same either way and so they've

1 lost that kind of market advantage that they had
2 prior to April 30th.

3 CHAIR MILLER: Uh-huh, I see. One of
4 the things I'm curious about is going back to the
5 issue of arbitration. When you all talk about
6 arbitration, does that invariably when you say
7 that mean binding arbitration? I mean, is it
8 your view for arbitration to be effective, it has
9 to be a binding arbitration?

10 MR. TILLER: Madam Chair, it does.
11 Otherwise, like I said, it becomes just the first
12 step in an even lengthier litigation process. I
13 think that it would be beneficial too if those
14 decisions, although they don't have precedent
15 value, they do have informative value. I mean we
16 have non-site opinions from the federal courts
17 all the time and those non-site opinions they
18 still inform us as litigators as to what the
19 likely outcome is and so I think you heard
20 earlier today the professor mentioned that the
21 coal cases, you know, those are almost all under
22 contract now because they have some certainty

1 from the coal cases that existed at the beginning
2 of this type of regulation and so I think you
3 would see that same kind of effect if those
4 arbitration results were made public with
5 obviously trade secret information redacted.

6 CHAIR MILLER: Deputy Secretary
7 Woodward, do you have anything to add to that?

8 MR. WOODWARD: I would just say the
9 USDA does feel that it should be binding but, of
10 course, the devil is in the details.

11 CHAIR MILLER: Uh-huh. Did you want
12 to ask a follow-up questions?

13 VICE CHAIR BEGEMAN: Do you mind if I
14 ask another question? Mr. Tiller, back to the
15 arbitration program that does exist between BNSF
16 and the two Montana Associations, with respect to
17 the wheat growers essentially, of the world of
18 farm products grown in Montana, what percentage
19 of your industry does actually have access to
20 this arbitration program? 10 percent, 2 percent,
21 80 percent? I'm just curious, who is left out?

22 MR. TILLER: Madam Vice Chair, and I

1 know Mr. O'Hara will get into what percentages on
2 his farm are represented by the different
3 commodities. He can provide that to you. Wheat
4 is the number one commodity in the State of
5 Montana.

6 VICE CHAIR BEGEMAN: It is?

7 MR. TILLER: Yes. So most farmers, at
8 least at some point, include wheat in their crop
9 rotation. I can safely say, without quoting an
10 exact percentage, that a vast majority of Montana
11 farmers are putting wheat in the ground at some
12 point during their rotation and if you'd like,
13 Mr. O'Hara probably has more detailed
14 information.

15 VICE CHAIR BEGEMAN: Is it the
16 associations that have to arbitrate or is it the
17 actual grower that has the opportunity to
18 arbitrate?

19 MR. TILLER: Do you know the answer to
20 that question?

21 VICE CHAIR BEGEMAN: You can answer
22 for the record if you don't know. With BNSF

1 here, they can answer as well.

2 MR. TILLER: Yes, and I know that
3 Kevin Kaufman is here as well and he can answer
4 that.

5 VICE CHAIR BEGEMAN: He's no longer
6 with BNSF, I don't think.

7 MR. TILLER: No, he is not but he is
8 here.

9 VICE CHAIR BEGEMAN: He does have a
10 wealth of information, I know that.

11 MR. TILLER: Yes.

12 VICE CHAIR BEGEMAN: Mr. O'Hara?

13 MR. O'HARA: Specifically, through the
14 arbitration that has been used once and I'm sure
15 Kevin will correct me if I'm wrong when he has a
16 chance, it was on one specific freight rate from
17 Shelby, Montana to the Pacific Northwest. The
18 percentage of our wheat that goes to there is
19 zero. So, what percentage of the wheat that
20 would be affected by that freight rate from
21 Shelby, I couldn't answer that question because
22 it was specifically to that point of origin. It

1 would be not a large percentage of the wheat in
2 the State of Montana.

3 VICE CHAIR BEGEMAN: Thank you.

4 CHAIR MILLER: Mr. Tiller, I have one
5 final question. Just the nature of grain and the
6 multiple origination points in many ways,
7 destination points, make it understandable why
8 there don't tend to be a lot of contract
9 movements but I'm wondering is that something
10 that you all have tried to create opportunities
11 to get contracts for movements that more commonly
12 have gone under tariffs? Is that even an
13 opportunity for your farmers?

14 MR. TILLER: Well Madam Chairman,
15 obviously and I'm not I completely understand
16 your question but many farmers do contract with a
17 purchaser at the beginning of the season.

18 CHAIR MILLER: I'm thinking with the
19 railroad.

20 MR. TILLER: When it comes to the
21 railroad, you will see that our larger elevators,
22 like Columbia Grains of the world, they are

1 contracting rates. However, it is the smaller
2 elevators who are paying the tariff and are
3 sometimes left with purchasing freight on the
4 secondary market when they need it, which is an
5 added cost and so no, it's not, they are not
6 getting the benefit of contracted rates and it's
7 private too. Again, back to the coal example,
8 you don't know what a good rate is. What are
9 other people negotiating? Until you have that
10 precedent, until the STB has come out and said
11 these are the rates and this is how we determined
12 this, I mean that is really the motivating
13 factor. That's the influence, to bring it to the
14 table to say let's put this under contract
15 because it's fair.

16 CHAIR MILLER: Thank you all very
17 much. Thank you for being here and again, Mr.
18 O'Hara, thank you for coming in. We really do
19 appreciate it. It's very helpful.

20 MR. TILLER: Thank you for the
21 opportunity.

22 CHAIR MILLER: So, Panel III, which is

1 the Association of American Railroads, if you
2 could start making your way to the front.
3 Everybody ready? So, we have Timothy Strafford,
4 Counsel to the AAR and John T. Gray, Senior Vice
5 President for Policy and Economics. Welcome to
6 both of you. Thank you for being here. Mr.
7 Strafford?

8 MR. STRAFFORD: Good morning Chairman
9 Miller, Vice Chairman Begeman. My name is Tim
10 Strafford. I'm here today on behalf of the
11 Association of American Railroads. I'm joined by
12 my colleague John Gray, Senior Vice President for
13 Economics and Policy at the AAR. This morning, I
14 will provide a brief overview of the AAR's
15 comments in this proceeding and try to put this
16 proceeding into historical context of the
17 agencies previous attempts to craft rate
18 reasonableness standards consistent with the
19 statutory responsibilities. Mr. Gray will then
20 briefly discuss the economic environment in which
21 railroads transport grain products, the economic
22 underpinnings of sound rail rate regulation and

1 the flaws and proposals made by shipper interest
2 in this proceeding. I'd be happy to answer any
3 questions the Board may have at the conclusion of
4 our testimony.

5 The Board began this proceeding with
6 the stated goal of ensuring that its rate
7 reasonableness process is accessible for railroad
8 customers that ship or receive grain. There is a
9 fundamental difference between ensuring a process
10 is available, the proposals by shipper interest
11 in this proceeding that received rate
12 prescriptions based on economically suspect
13 revenue desirable cost ratios and generic
14 formulas. There is no basis in this record or
15 any other for the Board to conclude that the
16 transportation of grain should be subject to
17 unique rate reasonableness rules. The AAR
18 submits the Board's processes are accessible to
19 railroad customers and other stakeholders and
20 that recent efforts by the Board have made them
21 more so. Through its rail customer and public
22 assistance program, the Board makes its staff

1 available to answer inquiries about its processes
2 and engage in informal mediation efforts. Where
3 formal rate relief has been sought, the Board has
4 established two forms of simplified rate cases.

5 In the four cases decided under its
6 simplest three benchmark process have rendered
7 decisions within nine months. Mandatory
8 mediation is part of all rate complaint
9 proceedings. In response to calls from shipper
10 groups, the Board has lowered its filing fees for
11 complaints down to \$350, well below levels
12 otherwise consistent with its user fee policy.
13 Also in response to requests by shippers, the
14 Board recently increased limits on relief on
15 simplified cases by eliminating the limit on
16 simplified SAC and nearly quadrupling the limit
17 on three benchmark cases. Some shipper comments
18 in this proceeding and some of the Board's
19 questions in the notice scheduling this hearing,
20 refer to the concept of revenue adequacy.

21 For the purposes of today's hearings,
22 there are no unique aspects of grain

1 transportation that requires special
2 consideration of revenue adequacy in this
3 proceeding. The Board has already compiled a
4 separate record in X party 722 and scheduled a
5 two-day hearing for next month. The AAR intends
6 to participate in that hearing and provide expert
7 testimony on issues related to revenue adequacy.

8 My colleague, Mr. Gray, will speak to
9 some of the economic principals underling sound
10 rail rate regulation and some of the problems in
11 shipper proposals in this record that would rely
12 on unrestricted rate comparisons. Before he
13 does, I'd like to briefly note some of the
14 historical struggles the agency has confronted in
15 judging the reasonableness of rail rates and
16 consider some of those efforts that the court
17 adjudged to be arbitrary and capricious. This
18 history helps illustrate the legal standards that
19 would apply to efforts to craft special rate
20 reasonableness rules for grain traffic.

21 Prior to the legislative reforms of
22 the 1970's, the ICC prescribed rates using its

1 traditional pre-reform criteria. Rate
2 comparisons with other similar movements,
3 analysis of economic impact to the community and
4 a determination of the railroad's fully allocated
5 costs of moving traffic. This, along with other
6 regulatory constraints, contributes to a railroad
7 industry in severe financial distress.

8 By 1978, the agency recognized the
9 rate comparisons were of limited value. The
10 agency began the long effort to determine rate
11 guidelines that would be consistent with sound
12 economics to three and four RX and later the
13 Staggers Act which culminated in 1985, Coal Rate
14 Guidelines Decision. During that process, the
15 ICC struggled to find an appropriate way to allow
16 for the necessary differential pricing for a
17 healthy rail system that could invest to meet
18 customer demand. The agency recognized the need
19 for pricing above fully allocated cost levels and
20 tried to apply a 7 percent additive to attempt to
21 reflect differential pricing. The courts
22 rejected this so called 7 percent solution as

1 arbitrary and capricious. The agency also
2 considered judging rates based on a ton to ton-
3 mile ratio but later recognized that such an
4 approach did not reflect customer demand for
5 service. Coal rate guidelines recognized the
6 need for differential pricing and railroad rate
7 making and a need for the rate reasonableness
8 standards to reflect demand characteristics.

9 The standalone cost standards
10 implemented reflect such principals to ensure
11 that where a railroad has market dominance, a
12 complaining shipper is not required to subsidize
13 parts of the network it does not use or pay for
14 inefficiencies. As the Board well knows, the SAC
15 standard can be time consuming, complex and
16 expensive. This is not necessarily surprising as
17 railroads are networks moving a mix of
18 competitive and captive traffic and different
19 service and different equipment. Railroad rates
20 used to be complex litigation with hundreds of
21 millions of dollars at stake. Comparable
22 litigation in the federal courts is time

1 consuming and complex as well.

2 The AAR has long stated its desire to
3 work with the agency to streamline the SAC
4 process where possible. Railroads do not like
5 spending money on lawyers and consultants any
6 more than shippers do but the proposals by
7 shipper interest in this proceeding are not aimed
8 at improving the Board's processes but instead
9 are R/VC tests untethered from economic theory
10 and unconstrained by any limits on relief.

11 Previous attempts to avoid the economic analysis
12 of market demand and cross subsidy by applying
13 such tests have been overturned by the courts.

14 McCarty Farms, the ICC tried to
15 shortcut an economic analysis of the rates at
16 issue and instead looked at whether the R/VC
17 ratios generated by those rates were higher than
18 those of the comparison benchmark traffic. The
19 court of appeals for the DC circuit found that
20 the ICC's approach and explanation lacked
21 "supporting principal or intellectual coherence"
22 and the agency "had not intelligibly explained

1 why the tradeoff chosen was reasonable". The
2 court concluded that R/VC comparisons not passed
3 for recent decision-making and the court remanded
4 the case to the ICC. Mr. Gray will address the
5 limited value and economic meaning of R/VC
6 ratios.

7 I just note, in closing, that the only
8 instance where R/VC ratio comparisons have
9 withstood judicial scrutiny in the last 35 years,
10 has been their use in the three benchmark test
11 where they have been allowed in cases of limited
12 value in response to direct congressional
13 authorization for the agency to develop
14 simplified methodologies for small value cases.
15 The agency and the courts have explicitly
16 recognized that the three benchmark test is crude
17 and imprecise and the Court of Appeals for the DC
18 circuit has observed that the three benchmark
19 process does not facilitate the search for truth
20 and "there is good reason to believe that
21 judgments rendered pursuant to the three
22 benchmark framework more often than not, will be

1 the antithesis of mathematical certainty". The
2 only justification for the use of R/VC
3 comparisons at all has been their limited
4 application; put limits on relief in small cases.
5 The Board has only justified their use by stating
6 that most rates are set according to market
7 forces and most regulator rates should be subject
8 to the SAC test. With that, I'll turn things
9 over to John.

10 MR. GRAY: Thanks Tim. I'm John Gray.
11 I'm Senior Vice President for Policy & Economics
12 at AAR and today, I'd like to put the discussion
13 on the grain rate issues into a bit of economic
14 context.

15 First, to quickly overview the rail
16 system. Today, railroads account for about 40
17 percent of our nations inner city freight ton-
18 miles and serve merely every agricultural,
19 industrial, wholesale, retail resource base
20 sector in our economy including both grain and
21 grain related products. In 2014, US Class I
22 railroads originated almost 1.5 million carloads

1 of grain which translates into almost 140 million
2 tons of grain. While significant, grain
3 represents only 4.9 percent of total carloads and
4 7.6 percent of total tonnage for the rail system
5 as a whole. The United States is the world's top
6 grain producer with average US grain production
7 from 2005 to 2014 of 533 million tons. What
8 crops are grown where and in what quantities and
9 how and when they are transported is determined
10 by complex interaction with international and
11 other market forces. The variety of forces that
12 impact grain production consumption make it clear
13 that generalized conclusions about grain are
14 exceedingly problematic. Simply put, there is no
15 homogenous grain market in the United States or
16 anywhere else in the world.

17 As illustrated in AAR's written
18 testimony, various types of grains and grades of
19 grain have unique characteristics and are also
20 marked by unique market volatility. Like US
21 grain production generally, US grain exports also
22 fluctuate sharply because they are a function of

1 many complex market, regulatory and geopolitical
2 factors. American grain shipper's benefit from
3 strong competition among railroads, trucks and
4 barges. According to 2011 USDA data, the most
5 recent available, the truck share of total US
6 grains transported was almost 60 percent. When
7 compared with the just 28 percent for railroads
8 and 12 percent for barges.

9 The fact that the trucks share of tons
10 has been rising for several years, it was only 50
11 percent in 2006, is strong evidence of the market
12 and of the intensity of the competition that
13 railroads face if they wish to participate in
14 grain markets. There is no escaping the reality
15 that absent government subsidy shippers including
16 grain shippers must pay for rail services they
17 demand. Growth in this demand will provide the
18 incentive for railroads to make the investments
19 needed to increase the capacity in their networks
20 but only if freight rates are allowed to reflect
21 the true marketplace.

22 In recent years, railroads have been

1 putting more money back into their networks than
2 ever before. From 1980 through 2014, they spend
3 \$575 billion of their own funds on renewal,
4 maintenance and expansion of their infrastructure
5 and equipment. Even so, much remains to be done.
6 For this reason, expenditures have rapidly
7 accelerated during the last seven years with
8 almost \$165 billion spent during this period.

9 An additional \$29 billion in spending
10 is planned for 2015. Recently, in a public
11 hearing and in written comments to the Board, it
12 was suggested that railroads needs to invest more
13 in capacity to alleviate the service issues that
14 occurred in parts of the country. We agree.
15 However, we must always remember that the
16 railroad's ability to commit massive funding to
17 their network is entirely dependent on financial
18 performance that produces the necessary cash flow
19 and returns on investment. There is no question
20 that the majority of rail rates, including rail
21 rates for transporting grain, are driven by
22 competition including competition between

1 railroads, other modes of transportation and by
2 product and geographic competition, both at home
3 and overseas. This competition results in grain
4 rates that are measured by revenue per ton mile
5 being 29 percent lower on an inflation just basis
6 in 2013 versus 1981. The same measure is also
7 lower for major individual types of grain as
8 well.

9 Moreover, according to USDA data from
10 2000 to 2013, the last year again that is
11 available, average prices that farmers paid for
12 most of their supplies rose much faster than the
13 rail rates to move their grain. Some movements
14 of grain are governed by rail transportation
15 contracts. Additionally, over 60 percent moves on
16 common carrier tariff rates generating revenues
17 to variable cost ratios below 180 percent. Thus
18 the potential universe for rate complaints by
19 grain shippers is relatively small. For those
20 limited instances where the Board is authorized
21 by statute to regulate rates, economically sound
22 regulations should seek to simulate competitive

1 outcomes rather than artificially constrained
2 railroad rates below competitive market levels.
3 So what do the economics of rail regulation and
4 operation tell us about what should be the
5 outcomes of sound regulation should be?

6 First, because economies of density
7 exist in the railroad industry, that is that the
8 unit cost of transportation declines as traffic
9 volume increases, marginal costs are almost
10 always lower than average costs. In other words,
11 the cost to a railroad with handling an
12 additional unit of traffic is usually less than
13 the average cost of handling each unit of
14 traffic. Because of high, fixed costs associated
15 with track, facilities and equipment and the need
16 for railroads to cover their risk adjusted
17 capital costs, railroads cannot price all their
18 traffic at marginal costs or even an average
19 variable cost and still cover their total costs.
20 Any firm that cannot cover all of its costs,
21 ultimately cannot survive.

22 Neither can railroads price on the

1 basis of average costs. Because of competition,
2 much rail traffic moves at rates below average
3 costs and above marginal costs. Any traffic
4 moving at rates above marginal costs makes at
5 least some contribution to the fixed cost and
6 everyone is therefore better off than they would
7 be if that traffic were not moving at all. If
8 the rates on traffic were raised to the average
9 total cost, much of this traffic would be
10 diverted to other modes and would simply not move
11 at all. That traffic's contribution to fix costs
12 would be lost. If this happens, railroads would
13 lose revenue than they would have had otherwise.
14 Either the revenue would have to be made up
15 through other rail customers or the railroads
16 would have to reduce costs perhaps by reducing
17 employment, service offerings, cutting
18 reinvestments or eliminating infrastructure or by
19 some other means.

20 For a sustainable rail system, it is
21 absolutely necessary to price service
22 differentially based on demand in order to allow

1 the possibility of recovering their variable
2 costs plus a fixed cost plus the risk adjust and
3 cost of capital. Without differential pricing,
4 the rail industry could not have achieved its
5 tremendous gains operating efficiency and the
6 financial health which in turn, have allowed the
7 railroads to make their massive investments in
8 the networks and to accommodate their customer's
9 needs. This rate regulation principal
10 implemented by the ICC and the Board following
11 the Staggers Act, was not a temporary remedy to
12 address the financial state of the industry.
13 Rather, demand based, differential pricing was a
14 structural reform reflecting fundamental railroad
15 economics.

16 Now, I'd like to address some very
17 specific issues in this proceeding. The
18 proposals made by shipper groups for grain
19 specific reasonableness rates should be rejected.
20 Simply put, the economics of rail transportation
21 do not change based upon the commodities in the
22 rail car. When shipper groups, including grain

1 shippers, complain about the stand alone cost
2 test or other Board methodologies, they often
3 simply don't like the result produced by sound
4 economics. For example, when the groups that
5 represent grain shippers talk about the SAC test
6 being unworkable for shippers on light density
7 lines, what they frequently are saying is that a
8 SAC analysis will show that rates are not
9 unreasonable.

10 When they say that varied destinations
11 of grain traffic make grains case analysis
12 difficult, the Board should consider whether a
13 grain complaint would be significantly more
14 complex than chemical cases which incidentally
15 may involve hundreds of origin destination pairs
16 that it is already considering. When grain
17 shippers say diverse origin destination lanes
18 make great prescriptions undesirable, the Board
19 should consider how or if the proposals that they
20 have put forward will solve that problem.

21 Let's look at a few of the details.
22 First, the Board should not make specific

1 adjustments to URCS without making holistic
2 changes to the costing system. The Alliance for
3 Rail Competition propose that the Board develop a
4 grain cost adjustment factor because it believes
5 that the uniform rail costing system overstates
6 the variable costs associated with grain
7 shipments. ARC points to the fact that URCS
8 understates the costs of certain shipments such
9 as the shipment of hazardous materials and
10 concludes that URCS must therefore overstate the
11 cost of other, non-hazardous materials. The AAR
12 has states in other proceedings that URCS does
13 understate hazardous material risk costs because,
14 as Dr. Schmalensee noted earlier this morning,
15 they are not even included in URCS. Since they
16 are not even reported in the R1 report on which
17 URCS is based.

18 Thus, in terms of URCS, the costs ARC
19 is redistribute are really phantom dollars. In
20 fact, the extensive use of system wide average
21 costs throughout the regulatory regime, strongly
22 counsels against piecemeal adjustments or

1 favoring shippers of the 1.5 million carloads of
2 grain versus the shippers of 15 million carloads
3 of other commodities and 13 million intermodal
4 units. The effect of such approach would be to
5 lower the URCS calculation of variable costs for
6 grain shipments presumably with the intent to
7 artificially increase proportion of grain traffic
8 subject to the Board's jurisdiction. However,
9 since URCS is a closed system, the Board would
10 then need to decide which other lines of traffic
11 should absorb the increases of costs. Thus, the
12 Board would ultimately be set in the position of
13 having to artificially select winners and losers
14 on this issue.

15 Second, both NGFA and ARC offer up a
16 variance of the Board's three benchmark test and
17 I ask the Board to use unrestricted RBC
18 comparisons. NGFA's AG commodity maximum rate
19 methodology takes the already crude and
20 inappropriately used average RBC ratios for a
21 group of comparable traffic and reduces that
22 analysis into a formula. ARC advocates for a two

1 benchmark test that ignores comparable traffic
2 and therefore even the minimal primitive analysis
3 of rail markets already embedded in the three
4 benchmark method is worth remembering why a
5 comparison of R/VC ratios tells you almost
6 nothing about market demand. Economists think
7 about demand elasticity in price terms by looking
8 at markup over long run marginal costs. The URCS
9 variable costs are not marginal costs, have no
10 uniform relationship to marginal costs and can
11 never be adjusted to, nor approximate the
12 direction of marginal costs.

13 In reality, all an R/VC ratio tells
14 you is something about the value of a particular
15 line of business to the provider of that service.
16 It says nothing about whether the price is that
17 which is appropriate in the market. In the real
18 world, two movements with the same R/VC ratio can
19 have very different demand characteristics and
20 reflect very different market conditions. While
21 such a crude tool may be minimally acceptable for
22 simplified cases with limits on relief, it lacks

1 any sort of economic justification as a method
2 for judging all grain rates. To make matters
3 worse, both NGFA and ARC seek to have comparisons
4 of challenge rates to R/VC ratios on railroads
5 other than those handling the movement in
6 question. The Board should reject these calls on
7 the same ground as done in simplified standards
8 decision. Comparisons of R/VC ratios of
9 different carriers defeat the very purpose of
10 trying to determine the appropriate contributions
11 joint and common costs complaining shipper should
12 be making. The Board correctly concluded that
13 "the R/VC ratio of potential captive traffic of
14 one carrier provides no useful information
15 concerning the appropriate contribution to fixed
16 and common costs of another carrier".

17 Third, as part of its formula, NGFA
18 would have the Board compare R/VA ratios of a
19 challenged rate to an average R/VC ratio that
20 includes movements that are less than 180
21 percent. In simplified standards, the Board also
22 concluded the comparison groups should consist of

1 only traffic moving in R/VA ratios in excess of
2 180 percent in order to judge the amount of
3 contribution to joint and common costs that the
4 complaining shipper should be responsible for.

5 The Board noted that "the rates available to
6 traffic with competitive alternatives will
7 provide little evidence on the degree of
8 permissible demand based differential pricing
9 needed to provide a reasonable return on
10 investment".

11 In short, ARC and NGFA would have the
12 Board take the worst possible measurement tool
13 available, the R/VC ratio and use it as broadly
14 and as inappropriately as possible. Finally, I
15 would like to address the appropriateness of
16 using RSAM as a rate reasonableness tool. RSAM
17 suffers from several infirmities. First, the
18 Board's annual revenue adequacy calculations
19 dramatically understates the railroad net
20 investment base and therefore, overstates return
21 on investment. Second, any use of averages
22 presents a ratcheting problem. As R/VC's above

1 the average are moved down by regulation, the
2 corresponding average moves down as well. Third,
3 use of such an average fails to recognize that
4 some movements with higher demand, are
5 appropriately priced above the average reflected
6 in the RSAM. Fourth, the use of the RSAM as a
7 rate making tool would force rates below
8 competitive levels and does not allow for the
9 analysis of customer demand. Finally and
10 critically, RSAM is just another form of an R/VC
11 ratio suffering from all the same frailties and
12 limitations as a market measurement tool as to
13 all other R/VC ratios.

14 In conclusion, I would ask that the
15 Board continue to rely on sound economics and its
16 established processes as a basis for judging the
17 reasonableness of all rail rates including grain
18 rates. Thank you.

19 CHAIR MILLER: Thank you both very
20 much. This is perhaps not fair because I know
21 you only heard this morning from Dr. Schmalensee
22 but as you were talking about RSAM and R/VC being

1 very crude, I'm just wondering how much his
2 description of URCS being flawed and really
3 unfixable resonated with you and if you'd care to
4 comment on that as an economist?

5 MR. GRAY: I would comment that I
6 fully agree that URCS is flawed. It's very
7 flawed. As I discussed with them actually before
8 the meeting, I disagree with him on the fact that
9 it is unfixable. But it is not fixable in the
10 form in which it exists today. It would take an
11 enormous amount of work, probably almost as long
12 as it would take to change the statutes around it
13 to create the type of modeling that would
14 reflect, be able to properly reflect density in
15 the rail system, that would be able to deal with
16 the location specific issues around the rail
17 system. It would take a tremendous amount of
18 additional data to do that. So, I'm not sure
19 that the fix is practical but I disagree that
20 with enough money, that it couldn't be done.

21 CHAIR MILLER: One of the things I'm
22 curious about is the issue of arbitration that

1 was raised by the folks from Montana and their
2 interest in seeing more things arbitrated.
3 Again, it was an interesting theme that you saw
4 in Dr. Schmalensee's presentation when you look
5 at the use of SAC and the complications of that
6 process versus arbitration. What's your reaction
7 to the viability of more arbitration?

8 MR. GRAY: Well I reflect one of Tim's
9 comments in his testimony that railroads are not
10 great fans of the money that is spent on rate
11 cases in terms of the legal fees or the
12 consultant fees. In fact, they probably end up
13 spending more money than the shipper community
14 does. So a methodology that permits some
15 acceleration of the process is attractive to us.
16 What we object to is not arbitration per se. It
17 is what I would call compulsory arbitration. We
18 feel that arbitration if it is going to exist
19 needs to be voluntary between the parties.
20 Otherwise it's unlikely to lead to a really
21 satisfactory solution.

22 CHAIR MILLER: We have the

1 opportunity to arbitration now though and it
2 seems that it's rarely utilized so when left to
3 the choice of the parties it seems like the
4 parties are rarely willing to choose it. Is that
5 a misperception?

6 MR. GRAY: I can't argue with the fact
7 that it has been very rarely used and apparently
8 as you say when left to the discretion of the two
9 parties involved that it is infrequently used. I
10 know that at least one of our members has offered
11 from the beginning to participate in arbitration
12 and I don't believe they've had any --

13 CHAIR MILLER: Any takers.

14 MR. GRAY: Any takers.

15 CHAIR MILLER: Uh-huh. That's true.

16 Then one other question before I give the vice
17 chairman a chance to get in here, but going back
18 to the issue of grain rates reflecting on the
19 testimony that we heard from the Montana
20 Department of Transportation from Mr. Tiller,
21 looking back to the GAO Study that was done
22 nearly ten years ago now that talked about the

1 fact that grain rates were trending higher than
2 other commodity rates, I don't know if a renewal
3 of the GAO Study would say the same thing today,
4 but certainly we have evidence at that time and
5 what we were hearing today from the Department of
6 Agriculture and the Montana Department of
7 Agriculture is that grain rates tend to be
8 trending higher than other commodities. Again is
9 that a misperception? Is that a fact? Why would
10 grain rates tend to go up higher and faster?

11 MR. GRAY: Well, first of all I had
12 not looked at that specific issue in preparation
13 for this. We looked at the grain rates within
14 themselves and noted that yes, they, for a long
15 time they trended lower and for the last few
16 years the revenue per revenue ton mile
17 measurement that we have since we don't have
18 access to the actual rates, has moved higher.
19 Now, you know, is it something that is unusual?
20 I think on that or is there a reason behind it? I
21 think on that it's probably at best when you have
22 the panel of the railroads later this afternoon

1 to ask them about that because these things tend
2 to be very individual. They're focused on the
3 individual market that a particular railroad is
4 engaged in and there are probably instances in
5 which, significant instances in which grain rates
6 have not trended higher at a faster rate. I don't
7 know but that is something that the individual
8 railroads would be much better equipped to answer
9 than our organization.

10 CHAIR MILLER: Okay. You want to
11 jump in, Ann?

12 VICE CHAIR BEGEMAN: Yes, I won't take
13 too much of your time but I certainly appreciate
14 your representing a wide group of members, which
15 can be kind of difficult, so I'm not going to put
16 you on the spot as much as I might want. Is your
17 message that the status quo -- although the 3B
18 method is perhaps inaccurate, but it is
19 sufficient from your industry's perspective with
20 respect to rate cases?

21 MR. GRAY: I think that we are always
22 open to improvements in process. What concerns

1 us is not improvements in the process which make
2 it more efficient, make it better for both
3 parties quite frankly if it is. What concerns us
4 is taking what is already a rather delicate item
5 like the 3B methodology, in terms of its economic
6 validity and pushing it ever further away from
7 sound economics. We are always willing to look
8 at other types of proposals but again our
9 emphasis is that whatever those proposals are and
10 however they're developed, the ability to reflect
11 economics that is as sound as possible is really
12 important.

13 We think that the SAC method obviously
14 it is something as Dr. Schmalensee indicated this
15 morning, was adapted from other network
16 industries and we think that while it is being
17 used somewhat differently in this context, in the
18 regulatory context that the STB uses, that it
19 does represent a concept which has some economic
20 validity behind it for looking at the range in
21 which reasonable rates might fall. It does not
22 necessarily get to the fairness issue that he was

1 describing but it does get to a reasonableness
2 issue in terms the market for those rates.

3 Likewise, the simplified SAC method
4 retains most of those characteristics while
5 simplifying the application dramatically but
6 again the concept is process whatever can be done
7 to improve that we're interested in. Straying
8 too far from economic foundations, no. That's
9 something that is not where we'd like to go and
10 our problem with the proposals that are in front
11 of you is as I said they take basically a very
12 frail system in which the 3B methodology is
13 economically and push it further away from
14 economics.

15 VICE CHAIR BEGEMAN: Well, I will say
16 that with this proceeding, we really invited any
17 and all parties, including AAR and the industry,
18 to offer ideas and put something else on the
19 table so that we could establish a meaningful,
20 workable process that I don't believe we have
21 necessarily fulfilled yet, and that is still on
22 the table. Really, I am open to any and all

1 ideas within the law. One of the things that your
2 boss mentioned during the House T&I Hearing in
3 May was "speed and accuracy," and I can assure
4 you --- and I think I can for Deb --- that's our
5 goal as well.

6 We certainly aren't looking to just
7 make something up, whatever it takes to get a
8 case in and out. We want accuracy as well, so I'm
9 going to state for all the parties, all the
10 stakeholders whether you're here or listening in.
11 I am open minded to ideas, creative ideas, maybe
12 even like a negotiated rule making where several
13 parties could come together with different views
14 and see if there is something that folks could
15 tentatively agree on or reluctantly agree on just
16 to try to move the process forward. Thank you for
17 participating here today. Thanks, Tim.

18 CHAIR MILLER: So, John, I have a
19 couple of other questions. You said this pretty
20 clearly I think in your testimony but I'd like to
21 hear you say a bit more about it and that's the
22 proposal that I think came from NGFA or perhaps

1 it was ARC but that the traffic pool could
2 include other railroads.

3 MR. GRAY: Yes.

4 CHAIR MILLER: And you sort of rejected
5 that idea but, you know, I'm wondering whether if
6 you're talking about the western railroads or the
7 eastern railroads if you don't see enough of the
8 same characteristics in terms of their operating
9 environment I'm just wondering why that isn't
10 reasonable to use them in the comparison group.

11 MR. GRAY: I think that one of the real
12 concerns and large part on that is that first of
13 all as I said, it doesn't tell you a lot about
14 whether those two carriers are in what would be
15 comparable markets. Even if you're only making a
16 regional comparison, you find that the railroads
17 in the two regions while they have some markets
18 that are in common and can be identified in
19 common, there are an awful lot of markets that
20 are very different and have very different
21 operating characteristics for them to serve those
22 markets.

1 It's not uncommon that you'll have one
2 railroad that has very different route
3 characteristics between an origin and destination
4 pair. It has very different means by which it
5 has to provide the service between those
6 locations and thus will generate very, very
7 different R/VC ratios on what is essentially the
8 same market, even if they may have similar prices
9 in that market, will generate very different R/VC
10 ratios from that market. It's kind of the
11 reverse issue of what I said earlier where you
12 have some instances where movements that have
13 very different characteristics will have the same
14 R/VC ratio. This is one of those cases where they
15 may have the same very similar price
16 characteristics because of the basic market
17 they're in but will generate very different R/VC
18 ratios so identifying the details of that is
19 first of all it's a huge job. It is something
20 you'd have to do on a case by case basis to even
21 identify whether you had similar moves. When you
22 get to the end of it, you don't really know much

1 about whether these moves; even if you can
2 identify them as somewhat similar, you don't know
3 very much about whether they speak to the issue
4 of what the contribution that particular traffic
5 should be to the fixed cost given that the
6 railroads' business portfolios, the total
7 business that they have may be very different and
8 they may be in very different positions within a
9 market than another carrier.

10 So, first of all, it fails in terms of
11 the just the technical analysis because the
12 technical analysis cannot show you that you're
13 going to get a similar result because of just the
14 operating characteristics. It fails probably in
15 terms of the market analysis and it certainly
16 fails in terms of the portfolio business type of
17 analysis.

18 CHAIR MILLER: As near as I can tell
19 in some ways whether it's shippers looking at
20 various processes or the railroads, I mean you
21 hear some of the same thing, everybody's
22 interested in simplified processes so we can go

1 faster and it can be cheaper but when you start
2 talking about a simplified process then depending
3 on who thinks its disadvantageous to them, they
4 find inaccuracies in that process that then
5 argues that it's not going to be useful process.
6 I'm just wondering, do you have proposals or
7 approaches that would allow us to simplify and
8 speed up our processes while retaining sufficient
9 detail to be reasonably accurate?

10 MR. GRAY: Certainly any process which
11 speeds up anything and simplifies anything almost
12 inevitably results in compromise.

13 CHAIR MILLER: Right.

14 MR. GRAY: It results in compromise,
15 not just to the parties that might be
16 participating in it but it results in compromise
17 of the technical accuracy and it results in
18 compromise in the ability to use all available
19 information in the process. So putting together
20 what is a simplified process I guess we could
21 cynically say, we're glad it's your job and not
22 ours on this, but the reality is that the Board

1 has been working on trying to develop the
2 simplified processes so that they have at least
3 some reasonable grounding in economics for ten
4 years now and it hasn't proven to be a very
5 fruitful or productive process for you.

6 I applaud you for the effort that
7 you've made in trying to negotiate through this
8 minefield, but it is a minefield and I think we
9 can say that improving the process should be a
10 goal but it is something that is unlikely to
11 satisfy all parties, no matter what the proposal
12 is. I think it is, as evidenced by the difficult
13 time that you've had for ten years working on
14 this project, I think it's going to be very
15 difficult to move forward. While I wish I had
16 some ideas that could help with it, unfortunately
17 any ideas that I have that would make the process
18 simpler would also unconditionally compromise the
19 validity of the results that you would get and I
20 think that's a lot of the concern that you're
21 running into.

22 CHAIR MILLER: One final question and

1 I'm not sure if I understood correctly as you
2 were going through your testimony and you were
3 talking about the fact that the R/VC ratio really
4 doesn't tell you anything about market and
5 marginal cost pricing and what that is versus
6 average price. Did I understand you to say that
7 the marginal price is the best way to evaluate
8 the market price or did I misunderstand?

9 MR. GRAY: No, no. Economics says
10 that in a perfectly competitive world that the
11 price that you would charge in a market would be
12 equal to the total marginal cost. It's an
13 economic concept that's very, very difficult to
14 actually put into reality but it says that you
15 would price at marginal cost. What I was saying
16 on that was that because of the issues of density
17 that we have where the marginal cost tends to get
18 much lower much quicker as you add volume to the
19 network than does the average cost or certainly
20 the total cost, effectively you cannot sustain a
21 railroad pricing at marginal cost. It just can't
22 be done.

1 CHAIR MILLER: I said that was my
2 final question but actually, I have one more
3 question. Well, actually I'll just leave it
4 there for now. I'll just leave it there for now.
5 We'll come back to it maybe in July. Thank you
6 both very much for being here and we'll be
7 interested in hearing what your member railroads
8 have to say this afternoon. We can explore some
9 of these issues in more detail. Thank you very
10 much. I think we will plan to take our lunch
11 break now.

12 So I've been asked to remind you,
13 which is the complicated issue around lunch, that
14 security wants to be sure that you are aware that
15 if you leave the building for your lunch break,
16 leave your luggage and bags in the Hearing room
17 so none of those have to be re-screened again
18 because you will have to sign in again when you
19 come in if so you can let's simplify that coming
20 back into the building thing as much as possible.
21 This may just be hopeful thinking but we'll try
22 to start again at 12:30 if at all possible. I

1 know there are some difficulties because you're
2 going to have to leave the building and get
3 signed back in and if that proves to be too
4 aggressive, we'll certainly try to give people an
5 opportunity to reconvene. What's most important
6 is that our Panel IV members are able to be back
7 to the building so if they're here and Ann and I
8 are here, we'll get started. Otherwise we'll
9 wait for them to come back.

10 (Whereupon, the above-entitled matter
11 went off the record at 11:48 a.m. and resumed at
12 12:37 p.m.)

13 CHAIR MILLER: Our panel has done an
14 exceptional job of being here right on time and
15 ready to go so let's get started with our fourth
16 panel of the day and it should be an interesting
17 one when we get to hear more about this proposal
18 that has already been discussed extensively even
19 though we've not gotten through it yet so we have
20 from the National Grain & Feed Association Kevin
21 Thompson, who is chair of the Rail Shipper
22 Receiver Committee; we have Bruce Sutherland,

1 vice president at Michigan Agricultural
2 Commodities; Thomas Crowley, president of L.E.
3 Peabody & Associates and Thomas Wilcox, a
4 principle with GKG Law. So we'll get started
5 with you, Mr. Thompson.

6 MR. THOMPSON: Thank you and good
7 afternoon. I think, Chairman Miller and
8 Commissioner Begeman, I'm Kevin Thompson,
9 assistant vice president and transportation lead
10 for Cargill, Incorporated in Minneapolis,
11 Minnesota. I chair the National Grain and Fee
12 Association's Rail Shipper Receiver Committee
13 which is comprised of 24 NGFA member companies
14 from all over North America and responsible for
15 representing the broad policy interests of NGFA
16 member companies who ship and receive
17 agricultural commodities by rail. NGFA commends
18 the Board for initiating this public hearing and
19 for conducting this public hearing to examine
20 proposals for creating more accessible,
21 streamlined, cost effective and workable
22 procedures for captive grain shippers to use to

1 challenge rail rates they believe are
2 unreasonable. NGFA's presentation is divided up
3 into four parts that address NGFA's submissions
4 generally and also the technical aspects of our
5 proposal.

6 NGFA member companies are major users
7 of the nation's rail system. Rail represents a
8 significant modal share within major geographical
9 regions particular in the upper plains states as
10 well as for major agricultural commodities
11 including more than 70 percent of wheat, 52
12 percent of barley, 20 to 25 percent of corn and
13 beans. US Class I railroad revenues for STCC
14 Code 01 which are foreign products and STCC Code
15 20 which are food products equal 10.77 billion
16 and 11.97 billion in 2013 and 2014 respectively.
17 This represents 14.9 percent of classical and
18 railroad revenues in 2013 and 15.6 percent of
19 revenues in 2014. NGFA's opening statement in
20 this proceeding echoed arguments NGFA made in
21 proceedings dating back to 2006 detailing why we
22 believe the Board's three existing rate complaint

1 procedures simply are inappropriate and
2 unworkable for ag commodities.

3 To summarize, first, pursuing a rate
4 case under each of the existing procedures is
5 costly, complex and time consuming. Second,
6 agriculture commodity movements typically are not
7 static or predictable. They typically have
8 multiple origin and destination pairs that vary
9 year to year as do the annual volumes. Third,
10 market demand for ag commodities frequently
11 changes quickly which is not conducive to the
12 timeliness needed to process a rate case under
13 the Board's existing procedures. Fourth, rate
14 setting practices that establish uniformly high
15 rates across the board for certain commodities or
16 groups of commodities make reg relief under even
17 the three benchmark methodology unattainable
18 since those rules are designed to remedy cases
19 where a shipper is singled out for market abuse.
20 This flaw is compounded by the fact that under
21 the current three benchmark rules only the
22 movements of the defendant railroad may be

1 included in the comparison group.

2 The NGFA commends the Board for
3 recognizing that its current rate complaint
4 process procedures need to change so they are
5 more effective, accessible while rendering well
6 reason and sound outcomes. We appreciate the
7 recent statements to congress in that regard by
8 acting Chairman Miller as well as former Chairman
9 Elliott during his recent senate confirmation
10 hearing. The NGFA shares these goals. We
11 believe strongly that having a rate complaint
12 process in place that is viewed by both captive
13 shippers and railroads as being reasonably
14 accessible will have a broad salutary effect in
15 disciplining unreasonable rate behavior by
16 carriers which now operate in what, at best, is a
17 duopolistic market.

18 Further, we do not believe that
19 adoption of NGFA's proposal will result in a
20 torrent of rate cases filed at the STB. Instead,
21 by disciplining market behavior it will change
22 the dynamic under which commercial decisions are

1 made outside of the Board's purview. This is not
2 unlike the beneficial impacts NGFA has
3 experienced from its rail arbitration rules
4 whereby the mere existence of mandatory
5 arbitration that works has resulted in not more
6 arbitrations but reasonable business behavior and
7 ongoing communications between both railroads and
8 shippers to resolve differences in a balanced
9 manner.

10 In any event, the NGFA took very
11 seriously the Board's willingness to consider
12 modified or entirely new approaches to replace
13 the current rate rules that apply to captive
14 grain shippers. We began by serving captive
15 shipper member companies and devised a new
16 approach that contains the following features
17 that we believe are essential elements of any new
18 rate complaint approach for captive shippers of
19 Ag commodities ultimately adopted by the Board.

20 First, the approach must be accessible
21 and inexpensive to administer and preferably
22 should be based upon an objective formula to

1 provide a form for complaints with smaller
2 claims. In this regard, the NGFA's methodology
3 relies upon information obtainable from the STB
4 or available publicly and does not allow the use
5 of other relevant factors or other methods
6 utilized in the current three benchmark rules
7 that at times have been injected by railroads to
8 complicate and delay such cases.

9 Second, the rule must provide a
10 meaningful constraint on the current unfettered
11 ability of railroads to virtually dictate if they
12 wish to the markets to which captive ag commodity
13 shippers can serve simply through their rate
14 pricing or other measures. The rules also should
15 reasonably preserve rail revenues and carrier's
16 ability to continue to invest in their networks.
17 We believe the NGFA's proposed methodology
18 accomplishes this by using a rate comparison
19 approach somewhat similar to the Board's current
20 three benchmark approach that also takes into
21 account both revenue adequacy determinations and
22 the current market for the type of captive

1 traffic whose rate is being challenged.

2 Third, any new system must provide for
3 expedited presentation of evidence, prompt agency
4 deliberations and timely decisions given the
5 fluidity and inherent changes in the US and
6 global agricultural markets. NGFA's proposal
7 achieves this by establishing a procedural
8 schedule under which the Board could issue a
9 final decision within 170 days after a complaint
10 is filed, which we believe is a minimum time for
11 a decision that parties could reasonably expect.

12 NGFA has also proposed that the new
13 rate complaint rules apply to a broad range of
14 agricultural commodities as opposed to a narrow
15 subset of just grain. We recognize that our
16 recommendations includes grain based products
17 such as ethanol and bio-diesel. Our rationale is
18 that the Board should err on the side of being
19 more rather than less inclusive at this stage of
20 the process. We note that the 68 agricultural
21 commodities and products that we propose be
22 eligible for the new rate challenge process are

1 identical to those that were agreed to by the
2 railroads to be covered under NGFA's rail
3 arbitration rules.

4 Further, NGFA's proposal urges the
5 Board to reconfirm and if necessary clarify
6 existing rules that allow parties directly or
7 indirectly affected by potentially unreasonable
8 rates to seek relief. This would permit parties
9 such as farmers who did not directly pay rail
10 rates but often bear the brunt of railroad
11 increases to challenge the reasonableness of the
12 rail rates charged to captive shippers such as
13 elevators to whom they sell their crops and to
14 obtain refunds or other damages for their share
15 of the increased costs attributable to the
16 unreasonable rate levels.

17 Finally, and importantly, the NGFA
18 firmly believes that new rules to judge the
19 reasonableness of the rates for ag commodity
20 shipments must include a component that takes
21 into account the revenue adequate status of the
22 defendant railroad. The Board and the industry

1 have entered a new phase where the rail revenue
2 related objectives of the Staggers Act of 1980
3 for carriers have been achieved and that the
4 classman railroads are or nearly are revenue
5 adequate under Board procedures. This should
6 change the way the Board exercises its regulatory
7 responsibility.

8 So NGFA's proposed methodology
9 includes a way that revenue adequacy can be
10 accounted for in rate reasonableness
11 determinations. As stated in NGFA's reply
12 comments, the Board should reject arguments to
13 keep the status quo. These arguments ignore the
14 ground truths that have emerged as a result of
15 the reduced competitive options available to ag
16 commodity shippers from the consolidation of the
17 rail industry into regional duopolies. Simply
18 put, ineffective and unworkable rate
19 reasonableness rules have enabled and emboldened
20 the railroads to extract excessive profits from
21 captive agricultural shippers at times
22 determining who wins and who loses and serving

1 domestic and global agricultural markets. Others
2 will propose that arbitration should be the sole
3 remedy available to captive shippers to challenge
4 unreasonable rail rates.

5 As the Board knows, the NGFA is a huge
6 proponent of arbitration and as a form or
7 resolving disputes in a knowledgeable, cost
8 effective and business-like manner. We believe
9 the mere existence of arbitration encourages more
10 direct and earnest communication between parties
11 and trying to resolve business related disputes.
12 NGFA's rail arbitration system has been around
13 since 1998. It was developed with the
14 involvement and cooperation of several of the
15 Class I railroads participating in this
16 proceeding. But while the NGFA's rail
17 arbitration system provides for compulsory
18 arbitration of several specific types of disputes
19 between railroads and rail users, we have been
20 unsuccessful thus far achieving agreement among
21 rail carriers to consider making arbitration of
22 rail rate complaints mandatory despite a couple

1 serious attempts to do so. The NGFA, of course,
2 remains receptive to future dialogue with rail
3 carriers on this possibility. I should hasten to
4 add that there is nothing to preclude a rail
5 carrier from voluntarily agreeing to arbitrate a
6 rate dispute with a shipper now under the NGFA's
7 existing system. The STB's experience has also
8 been that arbitration has never been shown to be
9 usable for rate disputes. That may yet occur
10 someday but until then there is real and
11 immediate need for the Board to establish new
12 rules that are accessible to captive agriculture
13 shippers and producers.

14 I also wanted to briefly address the
15 Board's request that parties address requirement
16 that carriers file agricultural contract
17 summaries pursuant to 49 C.F.R. part 1313. NGFA
18 has previously suggested in ex parte 725 that the
19 board make summaries more readily accessible to
20 rail shippers electronically and that the data be
21 searchable. Also one of my colleagues at
22 Cargill found a letter in that proceeding

1 suggesting that the Board may be more diligent
2 about ensuring the railroads submit the data that
3 is called for in the regulations such as specific
4 OD pairs instead of vague ranges of origins and
5 destinations that are not particularly useful or
6 informative. We will provide additional
7 information and thoughts when we file on the
8 record.

9 Now, let me turn to my colleague, Mr.
10 Sutherland, who will discuss some of the impacts
11 that current rate setting practices employed by
12 rail carriers can have on the ability of
13 agriculture shippers to serve markets and the
14 farmer customers.

15 MR. SUTHERLAND: Thank you, Kevin.
16 Good afternoon acting Chairman Miller and Vice
17 Chairman Begeman. I am Bruce Sutherland, vice
18 president of Michigan Agricultural Commodities
19 headquartered in Lansing, Michigan. I am also a
20 member of NGFA's Board of Directors and appearing
21 today at the request of NGFA to add some current
22 real world perspectives on the rate issues you

1 are considering in this proceeding.

2 As a brief background, Michigan
3 Agricultural Commodities, otherwise known as MAC,
4 was established in 1976 and consists of eight
5 grain elevators at seven locations throughout
6 Michigan with combined storage capacity of over
7 43 million bushels. Our facilities annually
8 handle approximately 50 million bushels of corn,
9 soy beans, dry edible beans and oats. MAC also
10 operates an agronomy business that serves our
11 producer customers in two locations in central
12 Michigan.

13 Michigan is a short line dominated
14 state and CSX Transportation is the dominant and
15 often the only Class I connection for our short
16 line railroads. The majority of Michigan
17 agricultural shippers are short line served and,
18 therefore, captive to CSX by Class I connection
19 we had reached both domestic and export markets
20 served by CSX and other Class I railroads. In
21 many ways, I regret the business related
22 circumstances that cause me to be here today. I

1 also am reluctant to single out one Class I
2 railroad for attention since the rate issues
3 faced by agricultural commodity shippers are
4 common to all Class I railroads. However, the
5 recent actions finalized on May 29, 2015 by CSX,
6 essentially changed its rates for agricultural
7 commodities nationwide provided a timely example
8 to this Board as to why captive agricultural
9 commodity shippers need access to a workable,
10 cost effective and expeditious rate complaint
11 process.

12 Let me provide a few specifics. CSX
13 rates for corn and soy beans are published in CSX
14 tariff 4315. Since 1999, very few movements of
15 these commodities are by contract anymore by
16 carrier choice.

17 In April of this year, CSX announced
18 to the agricultural industry they had decided to
19 simultaneously make wholesale changes to many of
20 its common carrier rates for agricultural
21 commodities in Michigan and other Midwestern
22 states. This was not done on an individual

1 customer basis but rather on a system basis. The
2 increased their rates and the rate spread for
3 Michigan shippers ranged from 35 to 100 percent
4 and they are to take effect October 1 of this
5 year. When I refer to a rate spread, I mean the
6 geographical and cents per bushel difference
7 between Columbus, Ohio, which is one of the base
8 points for the CSX tariff 4315 and specific
9 origins named in each state of the tariff. Two
10 of MAC's elevator locations in Breckenridge and
11 Marlette, Michigan were the most affected by this
12 action with a rate increase of over 70 percent
13 applied to each location. This increase added
14 12.8 cents per bushel to those elevator shipping
15 costs which far exceeds typical grain trading
16 margins. The increase forced us to immediately
17 reduce prices by 10 cents per bushel for corn and
18 soy beans purchased from farmer customers that do
19 business with those two facilities just to cover
20 the increased freight rate. Since these two
21 facilities handle more than 15 million bushels of
22 corn and soy beans annually this increased rail

1 rate translates to a \$1.5 million reduction in
2 income to these corn and soy bean customers.

3 Unfortunately, our company is not
4 alone. I've heard reports of other shippers
5 operating facilities in Michigan, Illinois, Ohio,
6 and Indiana with even more severe rate increases
7 that result in reduced price bids to farmers of
8 up to 20 cents or more per bushel. These
9 increases in rail rates are several orders of
10 magnitude greater than typically thin grain
11 trading margins.

12 Consequently, if we were able to be
13 price competitive in selling commodities to
14 invested users and foreign buyers that we
15 inevitably have to try to pass on the cost of
16 impacts we can't absorb back to the farmer
17 customers. Seldom are we able to pass such costs
18 forward to the ultimate buyer as they have
19 ultimate sources of supply in the grain market,
20 which is a truly competitive market.

21 CSX is but one part of the overall
22 domestic and global agricultural marketplace.

1 The dramatic changes in the rates have resulted
2 in changing the competitive balance in Michigan
3 and surrounding states and they stand to change
4 the flow of grain that normally would occur based
5 on the response to market demand. In some cases,
6 the new CSX rate structure will force a shift
7 from rail to much less efficient and much more
8 costly truck transportation, creating more
9 burdens on the states' highways, roads and
10 bridges that already are at or beyond capacity,
11 given their current condition.

12 We are still analyzing the effects of
13 the new rate scheme, but it is apparent that it
14 could result in fewer agricultural commodities
15 being carried by CSX and a greater concentration
16 of these commodities being moved on CSX mainline
17 origins, to the detriment of the Michigan short
18 lines which rely on agricultural volumes for that
19 economic viability. Unstructured rate increases
20 for agricultural commodities also have the
21 harmful effect of undermining investment that we
22 and others have made in our facilities, often at

1 the direct encouragement of the rail industry.

2 MAC spent more than \$35 million over
3 the past five years to increase grain storage and
4 loading capacity to be able to handle both the
5 growth and grain production and the ability to
6 ship 90 car unit trains. The latter of which was
7 done in response to warnings from CSX about the
8 need to make improvements to meet larger train
9 sizes that are preferred by the railroad.

10 Millions of dollars similarly have been invested
11 by other rail shippers in their storage and
12 handling facilities for similar reasons. I know
13 of an NGFA Member Company in Ohio that invested
14 in expanding its facilities to handle 90 car unit
15 trains based on the implicit or explicit
16 assurance from the Class I carrier, that the
17 rates spread through Columbus would remain
18 competitive and be preserved.

19 However, the new 90 car unit trains
20 prices are now the equivalent to what previously
21 applied to only 3 car shipments. This member
22 believes the rug has been pulled out from under

1 them. Other Class I railroads engage in similar
2 pricing behavior but CSX provides a current
3 example that substantiates the assertions in NGFA
4 submissions in this proceeding about how
5 unstructured unilateral rate increases can and do
6 demarket the movement of agricultural commodities
7 to domestic and export markets.

8 In fact, another NGFA member company
9 reports that rail rates charged for transporting
10 milling wheat from South Dakota through the
11 Chicago gateway increasingly are being
12 implemented on percentage basis which
13 disproportionately affects shippers with higher base
14 rates. Rates were increased by five cents per
15 bushel in January 2015 for milling wheat from
16 South Dakota through the Chicago gateway and are
17 scheduled for additional three cent per bushel
18 increase effective August 1. This shipper
19 reports that it had just invested \$5 million in
20 track and storage upgrades as well.

21 These unilateral rate actions can have
22 the outcome of changing of competitive dynamics

1 within our industry and, in fact, picking winners
2 and losers based on a carrier's dictates and
3 preferences on which types and sizes of
4 facilities that it desires to serve and
5 commodities it wishes to carry. MAC believes
6 broad geographic areas of CSX grain origin
7 markets will see wrenching changes as a result of
8 these rate increases and structure, with
9 commensurate disruptions in customary grain flows
10 to customers.

11 From a global perspective, it is not
12 unreasonable to anticipate that these increased
13 freight costs will encourage customers
14 particularly those near ports to pursue imports
15 of grain from South America as a more cost
16 competitive alternative to the detriment of US
17 farmers and the American economy.

18 MAC and NGFA believe that the
19 existence of effective and a successful
20 agricultural rate rails rules would help prevent
21 or mitigate some of the adverse consequences of
22 the railroad pricing behavior exhibited by Class

1 I railroads.

2 Again, we don't believe that this
3 would result through dozens of rate cases being
4 filed before the Board. Rather such meaningful
5 regulatory backstop would alter the current
6 market dynamic such that railroads might not be
7 inclined to make such dramatic and arbitrary rate
8 proposals in the first place and captive shippers
9 that conclude that they are harmed by such
10 practices would have a better chance of reaching
11 mutually acceptable commercial resolutions for
12 their differences.

13 Thank you for this opportunity to
14 discuss some of the real world impacts that
15 actual rate setting practices by rail carriers
16 have had on captive shippers and our farmer
17 customers and our markets we serve. Now I'll
18 turn to Mr. Crowley to explain NGFA's proposal.

19 MR. CROWLEY: Good afternoon. Thank
20 you, Bruce. To be effective a rail rate regime
21 for agricultural commodities must meet certain
22 criteria. The rules must provide meaningful

1 constraint against the ability of railroads to
2 unilaterally control access to captive ag
3 commodity markets while reasonably preserving
4 railroad revenues and incentives to invest in
5 their systems. The rules must be inexpensive to
6 administer and based upon an objective formula.
7 The rules must allow expedited evidentiary
8 presentations and expedited final decisions.
9 Commodity producers, elevators, intermediaries,
10 and processors captive to a single railroad at
11 origin and/or destination have little or no
12 ability to expand their business and to try to
13 develop and/or sustain local communities.

14 If rate reasonableness rules and
15 processes are in place for ag commodities it
16 would allow shippers the opportunity to expand
17 and sustain their businesses both nationally and
18 internationally. NGFA proposes a new maximum
19 rate approach for ag commodities. The ag
20 commodities maximum rate methodology also known
21 as ACMRM. I will now outline the major
22 components of ACMRM and provide an example of how

1 one would apply the ACMRM approach and I have
2 some slides to help me. We've got several
3 PowerPoint presentations. I'm not sure which one
4 it is.

5 CHAIR MILLER: What's it called?

6 MR. CROWLEY: I don't know.

7 MR. THOMPSON: That's NGFA right
8 there.

9 MR. CROWLEY: Thank you. That one
10 goes up? Okay, thank you. ACMRM uses a
11 comparison group approach similar to the Board's
12 current 3 benchmark methodology but some of the
13 components are different than the 3 benchmark
14 methodology. The comparison group includes rates
15 for shipments above and below the 108 percent
16 R/VC cost level. The comparison group includes
17 shipments from all railroads, not just shipments
18 from the incumbent carrier. The shipper would
19 select all comparable moves that meet the
20 selection criteria for the movement at issue from
21 a confidential waybill sample. How do you go
22 back?

1 CHAIR MILLER: We need to go back, is
2 that it?

3 MR. CROWLEY: Get right to the answer.
4 Other one. Yes, that's the one. Offer ability
5 to the issue movement will be based on the
6 following factors. First, distance plus or minus
7 20 percent of the issue movement miles. Second,
8 commodity at the five digit stick level. Third,
9 the rail car type. Fourth, the rail car owner.
10 And fifth, the movement type, whether the
11 movement is originating, terminating, originated,
12 delivered, received, terminated, et cetera.

13 Even though the comparison group would
14 include movements with R/VC ratios below 180
15 percent, the maximum reasonable rate produced by
16 this analysis would be subject to the statutory
17 180 percent floor. NGFA's ACMRM approach will
18 not allow for the examination of other relevant
19 factors. It takes a lawyer and a consultant to
20 handle it. The ACMRM also makes commodities
21 specific adjustments to reflect each Class I
22 carrier's revenue adequacy standards. This is

1 accomplished through the development of the
2 Revenue Adequacy Adjustment Factor or what we
3 call RAAF.

4 The use of the RAAF addresses two
5 flaws in the Board's 3 benchmark adjustment
6 approach. First, the RAAF approach takes into
7 consideration the amount of issued commodity
8 traffic and allocates the burden of helping
9 achieve revenue adequacy to those commodities
10 that provide the most revenues; and two, it
11 removes the overweighing of the railroad's
12 historical financial performance by using the
13 most current financial data reported to the
14 Board.

15 The RAAF is calculated as follows:

16 The formula you see up on the screen is the
17 formula used to develop the RAAF. We'll look at
18 this formula as its laid on the screen and then
19 we'll show you an example of how it works, but
20 it's basically broken into two parts. The left
21 side of the RAAF takes into account the factors
22 that are readily calculated by the STB. The

1 factors on the right, and when I say on the
2 right, I mean to the right of the time sign, are
3 factors that are drawn from either the
4 confidential waybill sample or from ex parte
5 proceeding.

6 Using the Union Pacific 2014, I've
7 calculated an example of the application of the
8 RAAF for STCC 01132, which is corn. Coming down
9 the left hand item column, the railroad industry
10 cost of capital, the return on investment, the
11 investment base and the tax rate, all four of
12 those items as you can see in column two are
13 available and calculated by the Board. The
14 values for these numbers in 2014 are shown in
15 column three. Lines five, six and seven on this
16 slide are assumed numbers. We did not have
17 access to the 2014 UP data from the waybill
18 samples so we assumed these values for purposes
19 of this slide. Line 8 is the first part of the
20 application of the formula we were just looking
21 at. Line 9 is the application of the second part
22 of the formula.

1 When these two parts are combined, the
2 RAAF for UP for STCC 00132, corn, is -12.5
3 percent. The way the formula works, a negative
4 number means the carrier is revenue adequate. A
5 positive number means the carrier is not revenue
6 adequate based on the Board's current standards.
7 The RAAF fits into the overall ACMRM formula and
8 the application of that formula is shown in the
9 example on the screen. For purposes of this
10 example, all of these numbers are hypothetical.
11 I have included, as part of my written comments
12 in this proceeding, actual examples of the
13 application of the ACMRM using the highly
14 confidential waybill sample so you can look in
15 that testimony, that file testimony and see real
16 world application of how this would apply, but
17 for purposes of this example, it's all
18 hypothetical.

19 Now let me walk you through the
20 application of the ACMRM. The first thing we do
21 is identify the issue movement parameters which
22 are the top six lines on the slide. First is the

1 commodity at the five digit STCC level. For
2 purposes of this example, we're using corn, STCC
3 01132. The distance in miles. For purposes of
4 this example it's 120 miles. Total revenue per
5 car and the variable cost per car are shown on
6 lines three and four. Variable costs are
7 calculated using the URCS Phase III model. The
8 revenue to variable costs ratio is simply
9 dividing the rate by the variable costs and the
10 jurisdictional threshold is the application of
11 the 1.80 ratio to the variable cost on line four.

12 Now the comp group, based on the
13 criteria that was previously outlined, we would
14 search the confidential way bill file and find
15 all movements that meet the selection criteria
16 for all railroads regardless of the revenue cost
17 relationship and identify them. For purposes of
18 this example, we have assumed there would be
19 comparable moves on the Union Pacific, the BNSF
20 and CSXT as shown in column two of the bottom
21 table. The distance based on the criteria is
22 plus or minus 20 percent around the 120 mile

1 issue movement parameter and the distance in
2 column three falls within that bracket. The
3 revenue per car in column four is the revenue
4 appearing for each of those movements in a
5 confidential waybill file.

6 Next we identify the RAAF or the
7 Revenue Adequacy Adjustment Factor for each
8 carrier for corn. This RAAF would be calculated
9 for each carrier for the particular commodity
10 that's the issue movement and those numbers
11 appear in column five. For purposes of this
12 example, we have assumed as I explained a moment
13 ago that the Union Pacific was revenue adequate
14 and at an RAAF of 12.5 percent. You can tell the
15 revenue adequacy by the negative sign. BNSF for
16 purposes of this example is also revenue adequate
17 as you can see the negative sign before the 4.2
18 percent and CSXT is considered revenue inadequate
19 because there is no negative sign and again these
20 are based on the current revenue adequacy
21 procedures.

22 We next apply the Revenue Adequacy

1 Adjustment Factor to the revenues and the results
2 are shown in column six. It's simply taking
3 column 4 and either increasing it or decreasing
4 it for the Revenue Adequacy Adjustment Factor.
5 We then compare the adjusted revenue to the
6 variable costs and again based on Ag Phase III
7 for that movement as it appears in the
8 confidential waybill file and get the adjusted
9 RBC ration appearing in column eight. This is
10 done for each movement in the comparable group.

11 We then go to line seven and take the
12 simple average of the RBC ratios appearing in
13 column eight for lines A through J. The simple
14 average in this example is 185.5 percent. We
15 next adjust or calculate the rate based on this
16 adjusted RBC ratio by taking the variable costs
17 of the issue movement which appears on line four
18 and multiplying that value by the 185.5 percent.
19 The result is \$742 that appears on line eight.
20 We next identify the maximum reasonable rate,
21 which is the greater of the number we just
22 calculated on line eight or the jurisdictional

1 threshold appearing on line six. In this case,
2 in this example the adjusted RBC ratio produced
3 the maximum rate.

4 I'd like to change the subject
5 slightly and talk about corporate structure and
6 railroad revenue adequacy. Current STB rules and
7 policies allow the railroads latitude in what
8 subsidiaries they include in their annual report
9 form, R1 statement. The Board requires the
10 railroads to include in their R1 reports
11 financial and operating statistics for the
12 consolidated railroad entity. The decision of
13 what constitutes a railroad and rail related
14 affiliate and therefore, what and what not to
15 include in the R1 ultimately lies with the parent
16 companies of the railroads.

17 In addition, the STB in its role as
18 regulator of railroad economic issues in the US
19 has chosen to require railroads to report only
20 their US based operations. The Canadian National
21 R1 report filed with the STB covers the prior
22 Grand Trunk Western and the Canadian Pacific

1 covers the prior Soo Line. For ROI purposes,
2 return on investment purposes, we suggest that
3 the Board change its policy and require the CN
4 and the CP to report on their entire corporate
5 structure. The chart on the screen demonstrates
6 the difference between the ROI for parent CN and
7 CP versus the ROI for subsidiary, Grand Truck and
8 Soo and I'd just like to walk you through that
9 chart.

10 On the left side of the chart is the
11 Grand Trunk and Canadian National ROIs. The blue
12 is the Grand Trunk and the green is the Canadian
13 National, which we estimated based on filings at
14 the SEC made by Canadian Nationals. You can see
15 in all years shown the Canadian National as a
16 parent had substantially higher ROIs than the
17 Grand Truck Corporation.

18 On the right side, it's a similar
19 analysis for the Soo Line and the Canadian
20 Pacific. The interesting thing here is the 2014
21 calculations. In 2014, there is no return on
22 investment for the Soo Line because the R1 report

1 of the Soo includes the write down of the sale of
2 the DM&E.

3 While that write down had little
4 impact on the parent, as you can see at 16.1
5 percent estimated ROI for the Soo Line portion of
6 the parent there is no return. It's actually a
7 negative return. That concludes my comments and
8 I'll turn it over to Mr. Wilcox.

9 MR. WILCOX: Good afternoon, Chairman
10 Miller, Vice Chairman Begeman. Thank you for the
11 opportunity to be here today. With the remaining
12 time we have on our panel I was going to address
13 a few legal aspects of the NGFA proposal and one
14 of the other topics that you mentioned in the May
15 8 hearing notice, that in particular being the 49
16 C.F.R. 1300.5 regulation on notice of grain
17 rates.

18 CHAIR MILLER: Could you maybe talk
19 more directly into the mic?

20 MR. WILCOX: Is that better?

21 CHAIR MILLER: Yes.

22 MR. WILCOX: Okay. So I'm going to

1 address three of the points as times permits. If
2 I don't get to all of them, I'll include it in
3 our supplemental comments since you're keeping
4 the record open but we want to get to your
5 questions, so, the first point is that NGFA
6 included in part four of its opening submission a
7 thorough review of the Board's authority to adopt
8 a separate rate rule scheme for a group or a
9 class of commodities and then to also adopt a
10 rule scheme along the lines proposed by NGFA.
11 This authority derives from Section 10701(d)(1),
12 10701(d)(2) and the rail transportation policy.
13 The original D.C. Circuit opinion in McCarty
14 Farms which you heard about earlier today from a
15 couple panels affirmed that the agency has very
16 wide latitude and discretion when adopting rules
17 to the test of reasonableness of rail rates.

18 In June of last year, the D.C.
19 Circuit, when they upheld the changes in ex parte
20 715 to the rate rules confirmed this broad
21 authority and that under 10701(d)(3) and that the
22 simplified approach under that section can be

1 used regardless of the value of the case. The
2 court rejected the argument of the railroad that
3 there's no statutory mandate to use SAC once the
4 case reached a certain value and in response to
5 some of the testimony you heard earlier today
6 from the AAR Panel on the 1993 McCarty Farms
7 opinion, we explained, this is pages 18 to 20 of
8 our opening evidence, the reasons why that
9 opinion or the reasons that the court relied upon
10 in that decision are no longer applicable to the
11 current facts or NGFA's proposal and, in fact,
12 certain parts of it were overruled by the opinion
13 in ex parte 715.

14 In that case, and we go into it in
15 detail in the opening, the Court, D.C. Circuit,
16 placed a very heavy emphasis on the fact that BN
17 at that time was revenue inadequate and that the
18 STB or ICC at that time needed to ensure that
19 BNSF, or BN became revenue adequate and the Court
20 in that case also looked at I think looked at two
21 or three coal cases involving multiple origins
22 and destinations and then concluded that grain

1 oriented cases could be brought under the SAC
2 case with the multiple origins and destinations
3 and it's been many years since that decision. We
4 still haven't seen a grain SAC case so the
5 Court's rationale for deciding for not upholding
6 an ICC in that case has been superseded by time.
7 And the NGFA's arguments on authority at the end
8 of the day were really not strongly refuted by
9 the railroad commenters.

10 In essence, they only argue that the
11 STB can't adopt a rate methodology of the type
12 proposed by the NGFA, that there is no statutory
13 authority to preclude you from doing it. They
14 are arguing that STB shouldn't and that the Board
15 should adhere to the status quo and in doing so
16 they are ignoring a key premise of the NGFA's
17 proposal which you heard about from our panel so
18 far is that the STB's rate rules, you know, now
19 must factor in that the Class I railroads are
20 revenue adequate or nearly revenue adequate and
21 that changes the past focus on differential
22 pricing, extreme market pricing, SAC concepts.

1 The Board is addressing those issues in EP72 as
2 was mentioned earlier today but it shouldn't
3 ignore revenue adequacy in this proceeding and so
4 NGFA's approach was to include revenue adequacy,
5 some concept of it or some way to account for it
6 in their proposal.

7 The second point is that some of the
8 railroads in their comments have resurrected the
9 argument that because NGFA's proposal, its
10 methodology utilizes RBC comparisons that all ag
11 commodity rates will be ratcheted down
12 immediately to the 180 percent jurisdictional
13 threshold. The STB and the D.C. Circuit put that
14 argument to bed last year in the EP715 appeal
15 opinion, at least as to the 3 benchmark and our
16 methodology is similar to 3 benchmark.

17 In that case, the Court agreed with
18 the STB that ratcheting would not occur under the
19 3B rules because in those cases relief would be
20 limited, an avalanche of cases would be required
21 and the Board can reassess if it looks like
22 they're being flooded with cases and the rates

1 are ratcheting down, the Board can reassess its
2 rules and then the last point was that there was
3 a need to balance any ratcheting concerns with a
4 need to give shippers with smaller claims a way
5 to challenge rates.

6 The third issue is NGFA and you heard
7 testimony earlier today on the issue of
8 aggregating of claims and standing. NGFA feels
9 very similar to the Montana witnesses you heard
10 earlier today about how you're finding a way in a
11 ag rate proposal to aggregate claims and to allow
12 producers and other parties who don't directly
13 pay the rate but feel the brunt of the rate to
14 bring claims. Notwithstanding the railroad
15 parties and their comments do not disagree that
16 parties indirectly affected by rail rate
17 increases could file a complaint under 11701(b)
18 but they argued that standing would be determined
19 on a case by case basis. I believe it was Mr.
20 Tiller who, earlier today, pointed out a good
21 point. That this, would required cases be filed
22 in order to establish the rules on standing, so

1 you'd have to litigate to whether you have
2 standing, which is a deterrent to bring in a
3 case. So the guidance from the STB on the
4 parameters of standing, would be helpful in that
5 regard rather than requiring someone to bring a
6 case to you to determine whether standing can
7 occur.

8 The other issue is whether parties who
9 indirectly suffer from rate increases can receive
10 reparations. The general rules they establish
11 that the party who paid the rate to the railroad
12 is entitled to reparations but the ultimate test
13 is whether there is injury, in fact, or pravity
14 to the railroad in terms of assessing the rate
15 and paying the rate, so in that regard the
16 railroad's again saying no guidance from the STB
17 is needed but the Board and effective parties
18 could explore in a rule making whether and how
19 various parties affected by railroad rate
20 increased in the agricultural markets could
21 establish the necessary injury.

22 In fact, the big issue we've heard

1 today is the fact that producers often bear
2 directly the past through from rate increases but
3 there are other players in the agricultural
4 market that do feel the brunt of the rate
5 increases indirectly.

6 The final point was to address the 49
7 C.F.R. 1300.5 rules. The Staggers Act contains
8 many provisions that are specifically geared
9 towards protecting shippers of agricultural
10 products and that's broadly defined. One of the
11 provisions in the Act that protects agricultural
12 shippers and is 1149 US Code 1110.1(d) and that
13 requires more information on rates and service
14 changes but it also includes references to
15 proposed as well as actual rate increases. This,
16 at least, applies a longer lead time of notice to
17 ag commodity shippers than the 20 days' notice
18 that appears in 1110.1(b) and in the Board's
19 regulations under 1300.5(d) they require that any
20 scheduled changes must be published in a manner
21 that provides timely notice to subscribers.

22 A current area of uncertainty is

1 whether rate changes for agricultural products
2 are subject to the same 20 day notice requirement
3 for other rates in 1110.1(b) or whether 1110.1(d)
4 and the Board's regulations create a longer
5 timeline of timely notice, which is be a more
6 fact specific inquiry so what notice is timely in
7 one set of circumstances but maybe it's not
8 timely in another. The latter approach could
9 help situations where shippers have made
10 significant capital investments based on
11 representations by the railroad of certain rate
12 levels and certain investments were made. If you
13 have a longer lead time for rate increases in
14 those situations, it could help mitigate capital
15 investments being stranded. If sufficient notice
16 is given, then maybe the investment's not made or
17 maybe there's some way to mitigate the damages.
18 That concludes my testimony. I'll give it back
19 to Kevin.

20 CHAIR MILLER: Great. Thank you all
21 very much. So, Kevin, I think maybe this is a
22 question to you, although anyone on the panel

1 would be welcome to respond to it. When you
2 started off, if I could make sense of my notes, I
3 think you talked a bit about the issues that are
4 specific to grain that led to this proposal but
5 really the suggestion here is that we have a rate
6 relief process designed specifically for grain
7 shippers and I would like to hear a bit more
8 about what makes grain distinct from other
9 commodities such that it should have its own rate
10 relief process.

11 MR. THOMPSON: Well, Madam Chairman,
12 I think the one thing is grain is not a commodity
13 like coal that typically moves from one origin to
14 one destination all the time. We have a lot of
15 moving parts. They're driven by global market
16 dynamics and because of that, spreads change,
17 market changes and because of that, the railroads
18 can move their rates and spread it around to
19 dictate where grain can flow. Just from the
20 onset, you've got multiple changes in OD Pair
21 changes can change years that will change
22 volumes. So really, when you look at just the

1 commodity side of the business there's so many
2 different moving parts. That could be
3 regionally, that could be by commodity, it could
4 be between eastern US and western US

5 There are just a lot of different
6 things that can change year on year for ag that
7 can be dictated by changing of rail rates and
8 other things. Some of the things that Bruce
9 talked about that kind of makes ag a little bit
10 different than some of the other commodities that
11 only flow from point A to point B, pretty much
12 year on year.

13 CHAIR MILLER: Isn't that also true
14 though for commodities like any of the chemical
15 commodities, a lot of the origin and destination
16 pairs are changing all the time?

17 MR. THOMPSON: To be honest, I'm not
18 familiar with the chemical side so I'm probably
19 not the best one to answer that.

20 CHAIR MILLER: Sure. That's fair
21 enough. And, Mr. Wilcox, you mention the issue
22 of ratcheting but you know that has been a

1 concern expressed about the proposal, that in
2 fact it would lead to a ratcheting and bringing
3 all rates to roughly the 180 percent and you
4 cited to a court case that said that our 3B
5 process wouldn't likely lead to ratcheting but
6 could you say a bit more why this particular
7 proposal wouldn't?

8 MR. WILCOX: Well I can speak from
9 experience in litigating three benchmark cases is
10 that they are, well rate cases in general are
11 rare and their shippers are very reluctant to
12 bring them to begin with and so I think that the
13 other aspect of as I said earlier if you have a
14 rate methodology that works and that both parties
15 know work, then you will reach a negotiated
16 solutions that I think would most likely be above
17 the 180 percent and then again what as D.C.
18 Circuit said and the STD said in that case if it
19 looked like there was an avalanche of cases, we
20 haven't seen an avalanche of three benchmark
21 cases and that was the same fear when we --

22 CHAIR MILLER: We certainly haven't.

1 MR. WILCOX: -- when simplified
2 standards were passed or in the process, you
3 heard a lot about ratcheting there as well, that
4 if that was to come to pass, if there was an
5 influx of all these cases, then the Board could
6 reassess because as we said, at the outset, NGFA
7 wants to find a solution to the fact that cases
8 have not been brought in 30 years for grain
9 shippers but they want the railroads industry to
10 be healthy and so I think those would be
11 mitigating circumstances. Mr. Crowley can speak
12 more to this than me but in a revenue adequate
13 industry, RSMs come down to around 180 percent or
14 less, I think its revenue adequate situation the
15 180 percent. It's not an objectionable rate.

16 CHAIR MILLER: I want to go back, Mr.
17 Thompson, I think at the end of your testimony,
18 you brought up the issue of the ag contracts
19 which was one of the things we were interested in
20 pursuing, I mean just getting an understanding
21 about how useful or helpful those are and so I
22 just sort of want to confirm. I take it from your

1 testimony that you would say yes, it's important
2 that they're out there but the current way
3 they're being posted is not so helpful, so if
4 that requirement is to remain in place we should
5 change some of the requirements in terms of
6 what's reported and then how it's posted. Is
7 that a correct understanding of your comments?

8 MR. THOMPSON: Yes, by and large.

9 Basically, it's just the formatting of the way
10 that when they're posted if we could somehow do a
11 better way of sorting it out and then finding out
12 specific, because some of the way the OD pairs
13 are reported they don't, they're not specific to
14 the origin or destination. They're in groups and
15 it really doesn't give you any information on
16 what that is and sometimes not even what the
17 commodity is, so I guess just a little bit more
18 transparency and specificity on really what those
19 contents are.

20 CHAIR MILLER: So I think if I'm
21 understanding you correctly, there are both
22 things that the STB could do in terms of how

1 we're posting it to make it more usable but also
2 ways that the railroads could change the
3 information they're providing that would make it
4 more usable.

5 MR. THOMPSON: That is correct. I
6 think there is only one or two of the Class I's
7 that aren't really reporting them in the
8 granularity to where you can actually see what
9 the contracts are.

10 CHAIR MILLER: Uh-huh.

11 MR. THOMPSON: So I think ---

12 CHAIR MILLER: So perhaps we could
13 look to the ones that are being reported in a
14 more granular method and use that as an example
15 of what would be useful?

16 MR. THOMPSON: That is correct. Yes.

17 CHAIR MILLER: Can I ask you a sort of
18 a related question but on the issue of tariffs.
19 One of the things I've been interested in is if
20 you're looking for a tariff for a specific
21 commodity, is that an easy thing to find? I mean
22 what do you have to do to find out what the

1 tariff is for a commodity?

2 MR. THOMPSON: Basically so every
3 Class I railroad website has all the tariffs
4 listed so basically all we do is go into the
5 website and then search basically by commodity
6 and then you can sort through the tariffs there.
7 Some of them are pretty user friendly, some of
8 them are not but it's all out there public for
9 you to see.

10 CHAIR MILLER: And generally, if you
11 need to know what a tariff is, you can find that
12 information without problem?

13 MR. THOMPSON: Oh, yes. Yes,
14 typically without a problem.

15 CHAIR MILLER: Okay. All right.
16 Thank you. Ann?

17 VICE CHAIR BEGEMAN: Thank you very
18 much, and I'm going to apologize in advance
19 because my questions are all over my head and all
20 over my papers. If I don't get to them now, I may
21 shout some into the audience towards you later.
22 If I could start with you, Mr. Thompson, although

1 you're all welcome to fill in the hot seat a
2 little bit, help me understand how your proposal
3 helps a grain shipper across the board? I mean,
4 does it help Cargill to the same extent it helps
5 Mr. O'Hara, who was on the previous panel in
6 Montana? Is it across the board fairness or is
7 it somehow more orchestrated for larger grain
8 shippers?

9 MR. THOMPSON: No, no, and I think
10 that's kind of why we went down this path is
11 because being as for formulaic as it is and being
12 able to look at defendant care and other cares,
13 you're really going to get the subset of
14 everything that's out there. This should have
15 the same impact on a small shipper versus any
16 larger shipper so really it's an all-encompassing
17 approach. We were looking for something fast,
18 easy and fair and this is what we came up with to
19 achieve that goal.

20 VICE CHAIR BEGEMAN: Does a large
21 grain shipper typically ship under tariff or do
22 you perhaps also ship under contract or is it

1 kind of a mixed bag?

2 MR. THOMPSON: It's a mixed bag and it
3 depends on the products. By and large, the
4 western US on corn and beans, they do still ship
5 on tariff. In the eastern for example, the
6 eastern railroads we still negotiate contracts
7 for soy beans and in the case of corn it's done
8 by the destination so it varies by railroad and
9 it varies by commodities.

10 VICE CHAIR BEGEMAN: Mr. Crowley, if
11 you could help me a bit with your charts, they
12 are actually really helpful. I appreciate that
13 you clarified that things are hypothetical as far
14 as some of the railroad data. Let's start with
15 the fact that the comparison group would include
16 movements both above and below 180. I'm trying
17 to understand what sort of criteria or what
18 safeguards, that's not quite the right word that
19 I mean but, because we want to have a fair
20 process. I wouldn't feel comfortable putting
21 something out that allowed every comparison group
22 to be at or below 180. So what is the criteria --

1 I guess the factors of A through E -- the
2 distance? Commodity? What is going to constrain
3 your comparison group so you can't just go to 100
4 percent to get your comparison?

5 MR. CROWLEY: The way the procedure
6 works is you don't have a choice. You have to
7 take all of the movements that meet the criteria
8 so in the example on the text it was 120 mile
9 haul of corn so all movements between 96 miles
10 and 144 miles of corn regardless of the R/VC
11 ratios are in the comp group.

12 VICE CHAIR BEGEMAN: So they're not
13 selected?

14 MR. CROWLEY: They're not selected.
15 It's a given. You've got to take them all.

16 VICE CHAIR BEGEMAN: Okay.

17 MR. CROWLEY: That, in our opinion, is
18 the relevant market for corn that goes 120 miles.

19 VICE CHAIR BEGEMAN: Tom, this may be
20 a question for you, but I know that you do not
21 care for "other relevant factors", at least with
22 respect to 3B. I guess, I'd like to hear a bit

1 more from you. It seems, in my opinion, from my
2 experience with one of the cases, that ultimately
3 settled, because 3B is crude, but the relevant
4 factors did allow some reality to be brought in
5 by either party.

6 MR. WILCOX: Well, the issue has with
7 other relevant factors and I may know the case
8 you're referring to is that I think that the
9 original intent of the 3 Benchmark rules was
10 expanded upon by the defendants in terms of with
11 the aim of putting burdens on the complainant and
12 what it ---

13 VICE CHAIR BEGEMAN: By burden do you
14 mean costs?

15 MR. WILCOX: Well, yes, the 3
16 Benchmark methodology is designed to be simple,
17 cost effective and that was directed towards the
18 smaller shippers but the other relevant factors
19 component of 3 Benchmark at least in the last
20 case we've seen was really expanded into some
21 realms that involved expert testimony, costs that
22 raised the estimate of what are, or the

1 expectations of what a complainant would pay to
2 have his rates litigated to be greatly expanded
3 in reality and that puts a chilling effect on
4 subsequent 3 Benchmark cases. Our proposal
5 again, the emphasis is to try to find a way to
6 get a decision done quickly. As we also said, in
7 terms of market dominance, we proposed that the
8 Board use its current, well the traditional
9 market dominance rules as opposed to the limit
10 prized, but that it be done on an expedited
11 basis. So that in essence is the reason why we
12 did not include other relevant factors, was to
13 make sure that the understanding that the result
14 and the process would be somewhat crude like
15 through Benchmark but also to get a faster result
16 and keep the costs down.

17 VICE CHAIR BEGEMAN: Mr. Thompson, and
18 Deb, you are welcome to interrupt and ask a
19 question, I'm kind of free flowing, but could we
20 go back to the beginning of your testimony? You
21 mentioned the NGFA's arbitration process, and
22 there's been some discussion, some outreach, with

1 respect to allowing rates to be arbitrated. Did
2 I understand that correctly?

3 MR. THOMPSON: So today in our real
4 arbitration system we basically arbitrate
5 everything but rates. All right, so rates are
6 not included but as NGFA we would be very open to
7 have those discussions. What would have to
8 happen, we would have to have all the member
9 Class I railroads agree to a mandatory
10 arbitration system.

11 VICE CHAIR BEGEMAN: And why would
12 they all have to agree? Could one just volunteer
13 and let's say, I don't want to even make a
14 hypothetical, one carrier said we'll arbitrate.
15 Could you not just allow your member to proceed?

16 MR. THOMPSON: Yes. So if a railroad
17 came and agreed to arbitration with a member
18 company that could happen.

19 VICE CHAIR BEGEMAN: Okay.

20 MR. THOMPSON: As long as they were
21 both members.

22 VICE CHAIR BEGEMAN: Okay.

1 CHAIR MILLER: Can I slip in there
2 because I'm hoping I'm understanding this
3 correctly, but I think under the Board's
4 arbitration procedures there is one railroad
5 that's agreed to arbitrate and I don't think any
6 shipper has stepped forward to take them up on
7 it.

8 MR. THOMPSON: Yes --

9 VICE CHAIR BEGEMAN: But not rates.

10 CHAIR MILLER: But not rates. Thank
11 you.

12 MR. THOMPSON: So I will say that with
13 that being said we have been approached within
14 the last six months by a Class I that wanted to
15 have open dialogue about the potential of
16 starting up the rail arbitration process again,
17 or not the process but the discussion, so we have
18 entered into discussions with one. We were
19 having ongoing discussions but now, you know, to
20 make this happen we have to reach out and get the
21 other Class 1's to agree to go down that path as
22 well and today we do not have a standard process

1 for rate arbitration, so we would have to come up
2 with what that would look like, what the rules
3 would be, you know, what are we going to
4 arbitrate against, so we would have to have some
5 work to do but, you know, we really would want
6 somewhat of a good understanding that most of the
7 railroads or all the railroads for that matter,
8 would want to enter into NGFA arbitration for
9 really for us to really put a lot of time and
10 effort to go forward on it.

11 VICE CHAIR BEGEMAN: I say take what
12 you can get and if one will do it, start your
13 program.

14 MR. THOMPSON: Well, what the problem
15 is we have a lot of members that are captive to
16 other railroads.

17 VICE CHAIR BEGEMAN: I know. I know.
18 It's just that I assume it's a large railroad. I
19 mean if it's a short line I can understand your
20 hesitation.

21 MR. THOMPSON: No, it's a large
22 railroad.

1 VICE CHAIR BEGEMAN: Mr. Sutherland,
2 could you please clarify something? I think I may
3 have misunderstood your discussion of a certain
4 rate increase that your state has recently
5 received from a Class 1 carrier. I thought that
6 what you said was -- now I can't find my notes --
7 - but that it was going to lead to more traffic
8 on that carrier's main line and off of the short
9 lines.

10 MR. SUTHERLAND: Right. Right. We
11 felt that at first analysis it certainly looks
12 like short line origins with the new rate
13 structure will be at a significant disadvantage
14 to main line carriers, or main line shippers
15 because of the rate spread now at rail cost is
16 much, will be significantly more than perhaps
17 what the truck difference would be out of an
18 origin that would be in a short line area moving
19 to a main line point, so it puts that short line
20 shipper at a disadvantage in the new structure to
21 a main line shippers.

22 VICE CHAIR BEGEMAN: Are you saying

1 basically, that as a shipper you'd be induced to
2 trucking your grain to a location where it can
3 get picked up on the main line?

4 MR. SUTHERLAND: That or a farmer
5 customer may see, because of increased freight
6 costs and the bid difference has gotten so wide,
7 that they can afford to actually now truck beyond
8 your short line shipper origin to a main line
9 shipper because unfortunately of uncompetitive
10 situation from a price standpoint.

11 VICE CHAIR BEGEMAN: Mr. Crowley, I'd
12 like to know if you have an opinion on some of
13 the earlier comments? The TRB's first comment
14 with respect to URCS, and then kind of contrast
15 it with Mr. Gray's comments that it's actually
16 fixable, but it certainly would cost us. Do you
17 have an opinion on this?

18 MR. CROWLEY: I have an opinion. I'm
19 not quite ready to bury the URCS formula. I
20 think it is outdated. I think it should be
21 updated and I think we've been advocating that
22 for a while. The regression analyses that form

1 the basis of the variable cost calculations were
2 performed back when there were a lot of
3 railroads. There aren't a lot of railroads today
4 and so I think what you'll find ----

5 CHAIR MILLER: Is your microphone on?

6 MR. CROWLEY: It's not on?

7 CHAIR MILLER: I'm not sure.

8 VICE CHAIR BEGEMAN: Maybe pull it
9 closer.

10 MR. CROWLEY: How's that? There's
11 fewer railroads today obviously than there were
12 when the regression analyses were done that have
13 formed the basis of the variable cost
14 calculations in URCS and so I think at a minimum
15 that should be done. It's a formula. Any
16 formula you can tinker with and you can make it
17 as expensive as you want it be to update it. To
18 update the regression package, I don't think
19 that's necessarily a big deal. It's not totally
20 inexpensive, but not a big deal. There is one
21 thing that I did agree with that the AAR witness,
22 Mr. Gray, stated, so I think I'll share that with

1 you. There was only one and that is I believe he
2 said that we should factor in density in these
3 calculations and I agree with that. Density was
4 a part of a rail form A which was the URCS
5 predecessor and it was captured through a
6 curvilinear regression equation which was
7 eliminated when URCS came along. URCS is based on
8 just a straight line regression, simple
9 regression analysis, so if you're going to update
10 URCS consider the curvilinear or density impact
11 on the variable cost calculations. Did I answer
12 your question?

13 VICE CHAIR BEGEMAN: Yes.

14 Now I just lost my train of thought,
15 please excuse me for a second.

16 When you walked us through the
17 proposal, it struck me that although it
18 certainly is easier to understand than trying to
19 have you explain to us the SAC process, or at
20 least to do a flow chart of the SAC process, it
21 sounds to me that we would still need consultants
22 to review the cases if you need your confidential

1 waybill data. But then since you're a
2 consultant, maybe there was something behind
3 that. How simple is simple?

4 MR. CROWLEY: When I was asked to put
5 this simple proposal together one of the criteria
6 wasn't to eliminate the consultants so.

7 VICE CHAIR BEGEMAN: Uh-huh.

8 MR. CROWLEY: So I kept my job. It is
9 simple and it is straightforward. I don't even, I
10 think if you follow the rules that we've laid out
11 I don't think you need either party. I think the
12 Board staff could do this without having either
13 party involved.

14 VICE CHAIR BEGEMAN: Right, and we
15 just need the permission or the confidentiality
16 request. You'd have to get permission to use the
17 waybill.

18 MR. CROWLEY: The staff would not need
19 the permission. They could just solve the
20 equation themselves. They wouldn't need either
21 the railroad consultant, I just put myself out of
22 business, or the shipper consultant to make these

1 calculations. There's theoretically nothing to
2 argue about. Follow the rules and you'll get the
3 answer. Do it quickly, simply, cheaply. We just
4 made it cheaper.

5 CHAIR MILLER: I was curious and I
6 guess in some ways you're now reflecting on this.
7 I don't know if I would have asked the question
8 if it hadn't been for Dr. Schmalensee this
9 morning basically throwing cold water on the
10 relevancy of a revenue adequacy finding and
11 really talking about quite a different process
12 and obviously built into your formula is a factor
13 related to revenue adequacy and I'm wondering
14 what the consequences of using or not using the
15 factor, if you just got rid of that factor what
16 would end up happening under the formula?

17 MR. CROWLEY: There'd be one less
18 calculation for each probable move. That would
19 be about it. It would depend on the revenue
20 adequacy status of each of the railroads in the
21 comparable group. If they were revenue adequate
22 the revenue comes down on the comparable moves

1 and the R/VC ratio for the comp group comes down
2 as well, so if you took that calculation out they
3 were all revenue adequate railroads then the
4 result would go up and the opposite would be true
5 if it's the other way. So the revenue adequacy
6 adjustment factor protects both sides, both the
7 revenue adequate side and the revenue inadequate
8 side.

9 CHAIR MILLER: Mm-hmm.

10 MR. CROWLEY: In the comp group
11 calculations. So you probably heard this, this
12 morning in the AAR panel basically disagreement
13 with the idea of including other railroads in the
14 comparable group and I guess primarily arguing
15 that, you know, no matter how much alike they may
16 look they're not alike enough to include. I'm
17 just wondering what you all would say about that?

18 MR. CROWLEY: The railroads are
19 amazingly alike, especially now that we're down
20 to four big ones and a few small Class 1
21 railroads and I think you can see that by looking
22 at the URCS formula that nobody likes except me.

1 URCS will tell you on a total system basis, the
2 total variable costs that it calculated and the
3 total fixed cost, which are these common costs
4 that they were talking about, common or fixed
5 costs. If you look at the relationship for each
6 carrier you'll see they're very, very close.

7 In other words, the fixed costs of one
8 carrier's basically the same percentage as
9 another carrier so what they have to recover is
10 basically the same thing. Now the other point is
11 that this cross carrier idea, I know the Board
12 hasn't necessarily liked it in a lot of these
13 analyses but they use it, the Board, you guys use
14 this cross carrier idea in the revenue accuracy
15 calculation. You calculate the cost or capital
16 for an individual railroad and then you compare
17 it to the railroad industry cost capitals based
18 on all the railroads. So we get inputs from all
19 the railroads to compare to an individual
20 railroad. We're not doing anything different
21 here in this approach.

22 VICE CHAIR BEGEMAN: Do you care to

1 comment on ARCs proposals, the 2B approach. Since
2 they're going to testify later and you won't be
3 back, you're welcome to give comments now.

4 MR. CROWLEY: I think that obviously
5 that the NGFA approach is superior to the --

6 VICE CHAIR BEGEMAN: We know that.

7 MR. CROWLEY: Yes.

8 VICE CHAIR BEGEMAN: We knew that.

9 MR. CROWLEY: I'm glad you do but I do
10 think the ARC approach is better than your 3
11 Benchmark approach so if you don't like our
12 approach I'd go with ARC before I'd go back to 3
13 Benchmark.

14 CHAIR MILLER: Do you want to say more
15 about why you think the 3 Benchmark would be a
16 better approach than the 2 Benchmark?

17 MR. CROWLEY: It's the other way
18 around.

19 CHAIR MILLER: Sorry.

20 MR. CROWLEY: I think ARC will take
21 care of all that for you.

22 CHAIR MILLER: Okay. I misunderstood

1 you, or I didn't listen carefully maybe. So Mr.
2 Thompson, did you say or now am I confusing this
3 with what I've read, is it your proposal to
4 broaden the definition of grain so it would
5 include ethanol and other?

6 MR. THOMPSON: Correct. Correct.
7 Basically what we were proposing is that of the
8 68 commodities that would mirror what we use
9 today in our trade rules, so everything that's in
10 our what we use in NGFA today would be in there
11 which does include ethanol and the bio-diesel.

12 CHAIR MILLER: So could you maybe say
13 a bit more about that because it seems on its
14 face that shipping ethanol or bio-diesel is very
15 different than shipping corn or shipping wheat?

16 MR. THOMPSON: I guess when we looked
17 at it we looked at ag products and when we looked
18 at ag products it was everything that evolved
19 around that. I guess I'm not quite sure what the
20 dynamics would be versus shipping the ethanol. I
21 mean obviously you've got the tank car side and
22 the regulations and everything that goes along

1 with that, but basically I mean you still have,
2 you'd still have your OD pairs, you know, a lot
3 of the ethanol is in contract form so to us it's
4 another commodity. We're not really looking at
5 this so much as a hazmat or a different product
6 versus what we're doing on the grain, corn, beans
7 and wheat side of things.

8 VICE CHAIR BEGEMAN: Okay. Well I
9 just really wanted to thank you for the effort
10 that your association went to, to heed our call
11 and make a recommendation that we could explore
12 and perhaps tinker with or do more than that. I
13 know there was a cost in time and expense, Mr.
14 Crowley. Thank you for the effort that you've
15 made to help us get to the goal that we have.

16 MR. CROWLEY: Thanks for the
17 opportunity.

18 CHAIR MILLER: Thank you all very
19 much. Very interesting. Okay, we're ready for
20 Panel Number Five, which includes Union Pacific
21 and BNSF. Welcome. Mr. Miller, are you leading
22 off here?

1 MR. MILLER: I am.

2 CHAIR MILLER: Okay.

3 MR. MILLER: If that suits.

4 CHAIR MILLER: You bet.

5 MR. MILLER: Is this on or can you
6 hear me?

7 CHAIR MILLER: Do you have a red
8 light?

9 MR. MILLER: There we go. Thank you
10 very much. Chairman Miller and Vice Chairman
11 Begeman, thank you for the honor to speak here
12 today. My name is John Miller, group vice
13 president of agricultural products, BNSF Railway.
14 I have been with BNSF for over seven years now
15 and prior to that I spent 25 years in various
16 management roles in the grain industry on the
17 shipping side. Again, thank you for the
18 opportunity today.

19 As the lead Class 1 rail carrier of
20 agricultural products, we are continually
21 investing to maintain and expand our network, our
22 grain network. Our customers are responding to

1 market opportunities with significant investments
2 in BNSF grain facilities which I'll describe in a
3 bit. The massive combined investments between
4 railroad and shippers suggests a very strong
5 belief in our ability to deliver commercially
6 competitive rates for a liable grain service over
7 time along with the expectation that when more
8 investments are needed to meet demand for service
9 we will respond.

10 In my remarks today, I will give a
11 brief overview of the BNSF grain business and our
12 record of innovation which is well known to this
13 agency and the stakeholders here. I will
14 describe the virtuous cycle of investment by both
15 BNSF in our agricultural business as well as by
16 our customers on our railroad. I will address
17 some of the concerns we know that some of our
18 customers have about the rate process as well as
19 outlining the innovative steps BNSF has taken on
20 its own to address its customers' concerns. I
21 will take some of my time to address several of
22 the issues raised by the groups and our customers

1 that have been in testimony today.

2 Before I get into the detail on our
3 grain system, I would like to address a couple of
4 issues from this morning. I'd like to speak for
5 a moment to the small shipper. To the small
6 shipper that feels that he or she does not have
7 access to the rate relief, that feeling is
8 justified. We always advise our customer to come
9 call us at BNSF, at marketing to voice his
10 concerns about the market rate. We get feedback
11 about the markets all the time. Our shippers are
12 not shy about telling us when the rates aren't
13 competitive as well as when there are also
14 working opportunities that benefit us both. We
15 treat that trust with great care. If he has
16 already done that or is not satisfied with our
17 response and still feels he has a rate concern,
18 then the process allows them to address it to the
19 STB. Is that process flawed in terms of taking
20 too much time or costing too much for the small
21 shipper? Yes. We agree. This is exactly why we
22 listened in Montana and after multiple

1 discussions with Montana grain growers and the
2 Montana Farm Bureau, we agreed upon a
3 comprehensive solution which I'll refer to a
4 little bit more in detail later.

5 This is why we are also willing to
6 consider a different solution to rate complaints
7 brought before the STB changing the process but
8 not changing the methodology. To this small
9 shipper, I would say we have already made a
10 proposal to the NGFA to use the current NGFA
11 arbitration base system for practices to be
12 tailored to STB complaints for rates. The
13 organization which has the largest membership of
14 grain companies today has the tools to lead an
15 effort to get a faster and less costly process
16 for you and the railroad alike.

17 While we are waiting to hear back from
18 NGFA, we are willing to support them in the
19 effort to bring all railroads into the solution
20 to get to the point where you do feel like you
21 have better access to market based solutions to
22 address your rate concerns.

1 Another issue that I feel like I've
2 got to address up front is, and it was mentioned
3 earlier today, and is that this notion that
4 customers out there today are reluctant to raise
5 rate concerns or rate complaints because they
6 feel retaliation. Personally I'm offended by
7 that. We've heard that over time in the past and
8 from my standpoint and our staff at BNSF and all
9 of our employees at BNSF, it's not true. I
10 cannot disagree with somebody of the way they
11 feel and they may feel that way but today the
12 notion of retaliation at BNSF is a personal
13 affront to us and it's just simply not part of
14 our culture and that's not how we run our
15 company.

16 To the contrary, we have robust open
17 discussions about rates with customers daily. In
18 fact, we encourage the give and take with our
19 customers about how to capture and market
20 opportunities. Our customers again, aren't shy
21 about telling us when they don't work. We
22 encourage that. That tells us what works and

1 what doesn't work. It's part of that daily
2 discovery of what the market is for us. We are
3 constantly assessing market dynamics to address
4 those issues and how they may be raised.

5 Okay, let me get on to the slides and
6 talk about the breadth of our marketplace. More
7 than half of our whole grain shipments moved to
8 export markets. The export market is
9 increasingly important to our grain shippers.
10 Grain shippers need efficient transportation to
11 participate in these export markets. As I will
12 discuss in a moment, the investments we have made
13 to improve the efficiency of our rail network
14 have been critical to the success of US farmers
15 in this important export sector. For domestic
16 consumption, we also transport a significant
17 amount of grain, mostly wheat and corn, while our
18 export destinations tend to be concentrated in a
19 discreet number of large export facilities, our
20 domestic grain shipments are delivered to a large
21 number of widely dispersed domestic destinations
22 including feed lots, ethanol plants and flour

1 mills.

2 Let me move next to BNSF's investments
3 in our network in general and in our agricultural
4 network in particular. As I said, we are in a
5 virtuous cycle of investment in our agricultural
6 business taking the revenues we earn and
7 investing it right back into our network. We
8 have made enormous capital investments in the
9 system-wide infrastructure. In 2014, we had an
10 all-time high capital budget of \$5 billion and
11 actually spent \$5.5 billion. BNSF plans to
12 exceed that in 2015 investing \$6 billion. I know
13 this slide is hard to see but we take this to
14 customers all the time so we thought we'd include
15 it. Our 2015 capacity project plan includes a
16 number of critical infrastructure projects across
17 our network, many of which benefit agricultural
18 shippers. Many of BNSF's more recent capital
19 expenditures have concentrated on the northern
20 corridor where much grain traffic moves and the
21 breakdown of 2015 capital projects shows
22 continued investment in areas of our network that

1 our grain customers rely on which of course,
2 include this northern region. These capital
3 investments and our physical plant will provide
4 permanent capacity that will benefit every
5 business sector. Our investments extend beyond
6 just track. Our grain shippers benefit from the
7 additional system-wide investments that BNSF made
8 in 2014 and 2015 in locomotives and personnel.
9 BNSF also made significant investments that
10 directly benefits its grain shippers including
11 over \$1.5 billion in investments in our own fleet
12 of grain cars.

13 Our rail service is improving as a
14 result of these investments. We have seen strong
15 velocity in our agricultural business reflected
16 in a return to historical trip per month shuttle
17 figures and key lanes and minimal past dues
18 across our network. Those investments and
19 resulting velocity gains have brought reliability
20 back into the grain system. I will also note we
21 are currently storing over 7000 BNSF grain hopper
22 cars as a result of slackening demand at the

1 moment which can simply highlight how cyclical ag
2 really is. Over time our innovative programs and
3 investments have enabled producers in many states
4 to access destination markets whether they be
5 overseas markets, Mexico or domestic markets like
6 California.

7 As a result of BNSF's innovations
8 efficient transportation and reasonable rates,
9 grain shippers made significant investment of
10 their own and built their grain facilities on
11 BNSF. BNSF's grain shuttle train program is a
12 prime example of the improved efficiency in the
13 supply chain that has resulted from innovation
14 and investment. BNSF's written testimony and our
15 prior submissions describe in detail our shuttle
16 program, which grew out of a recognition by BNSF
17 and our shippers that competing with other grain
18 exporting countries required increased
19 efficiencies across all elements of the supply
20 chain. The number of grain shuttle facilities
21 built on us has increased dramatically over this
22 time frame. It went from 69 shuttle origins in

1 2000, a few years after the grain shuttle program
2 was initiated to a total of 229 BNSF served
3 shuttle origins by the end of 2014. More
4 importantly that represents an estimated \$2.2
5 billion in investment by our customers since the
6 shuttle program started.

7 The number of unit and gathered train
8 ethanol facilities built on us has also increased
9 significantly over the same timeframe
10 representing an estimated \$2.1 billion additional
11 in customer investment. The number of uni-train
12 fertilizer facilities built on us over the same
13 timeframe has increased significantly with
14 another \$750 million in customer investment.
15 These investments by our customers on BNSF's
16 network reflect the partnership that exists
17 between BNSF and its grain shippers.

18 Let's turn now to the nature of the
19 grain markets and this is important. Contrary to
20 some of the claims made today, the constant
21 drumbeat of market economics has resulted in
22 reasonable and competitive rates across our

1 network for BNSF agricultural shippers. The
2 market reality is that we have to keep our rates
3 competitive to keep the business. The key
4 feature of grain transportation is that grain
5 must move by truck to a grain elevator at the
6 very beginning. Since it moves at the first
7 instance, a grain producer can often direct the
8 truck to deliver the grain to multiple elevators
9 as a first step in the supply chain or even to
10 other local end users. An important
11 characteristic of grain markets is the existence
12 of strong and widespread geographic competition.
13 There are several types of geographic competition
14 that affects rail rates. For example, in this
15 slide, a grain shipper in Aberdeen, South Dakota
16 has the option to ship to multiple markets on
17 BNSF. Each of those destination markets you see
18 there are also buying from multiple origins
19 including origins not served by BNSF providing a
20 multitude of competitive options.

21 With respect to export markets, BNSF
22 must consider rail rates for transportation of

1 grain to a particular export facility based on
2 alternatives available to shippers at other
3 export facilities including foreign competition.
4 For example, corn from the upper plains moving to
5 the P&W competes with corn from the corn belt
6 transported to New Orleans via barge into foreign
7 markets. A key reason that we do not have rate
8 cases is the fact that our rates are reasonable.
9 As you can see in this slide, the constant
10 pressure of competition in grain markets has
11 resulted in reasonable and competitive rates
12 across our railroad for agricultural shippers.
13 There have been few rate cases precisely because
14 these market mechanisms have worked so well.

15 BNSF sets rates based on market
16 conditions, not on regulated costs but I know
17 this agency often focuses on revenue to URCS
18 variable costs when it analyzes rates so as shown
19 in the study submitted by our outside experts,
20 our grain rates are low on a revenue to variable
21 costs basis. BNSF believes that these shuttle
22 RVCs are overstated in fact for the shuttle side

1 because they do not reflect the meaningful
2 loading and unloading and incentive payments that
3 are paid to qualifying shuttle trade movements
4 and that actually reduce the actual rates paid to
5 transport that grain. These payments are
6 actually left out when consultants and other
7 third parties generate their studies of ag rates.

8 We regularly communicate with our
9 customers and our customer groups to better
10 understand the issues they face and we have
11 developed good working relations with them. Some
12 of these groups are set out in this slide. Our
13 rates are reasonable but as I said when I started
14 out we do understand that in some regions and
15 particularly some shippers and customers in those
16 regions do not agree and view the regulatory
17 process as unworkable. We understand that
18 concern and that's why we have proposed
19 alternatives. As mentioned, BNSF established an
20 arbitration mechanism with Montana grain
21 producers. It is a two-tier structure of
22 mediation followed by arbitration using

1 predefined market based standards that take into
2 account the complexities and competitiveness of
3 agricultural markets.

4 As mentioned, we have recently offered
5 ideas to the NGFA executive committee and our
6 support for expanding their existing arbitration
7 process to cover rail rates without undermining
8 the current rate case criteria. We remain
9 interested in discussing ideas that will provide
10 expert based market focused resolutions that also
11 maintain a strong incentive to continue to
12 reinvest by all in the industry. We are proud of
13 the level of investment we have made in our
14 agricultural network to meet current and future
15 agricultural demand and the significant
16 investments our grain customers have in turn made
17 to bring more and more of their business to BNSF.

18 This is clear evidence that the market
19 is working well. While improvements in the
20 process for resolving disputes can always be made
21 the large industry investment and the supply
22 chain's success story experience by US grain

1 participants suggests strongly the overall
2 premise is that the competitive marketplace is
3 working efficiently. Methodologies for resolving
4 grain rate disputes including those offered by
5 the STB must take into account the practical
6 realities of agricultural markets including their
7 complexity and their competitiveness.

8 We believe that the alternatives
9 proposed by others here, even if well
10 intentioned, will create a range of unintended
11 consequences. Some of these suggested rate
12 setting alternatives will enhance the influence
13 of larger market participants through either cost
14 based or distance based rate making and will
15 encourage volume based contractual agreements. A
16 result would be to limit producer market and
17 geographic access. A net decrease in competitive
18 market based solutions. A longer term result
19 would be fewer dollars to support rail network
20 investment and a less responsive and resilient
21 rail system with less ability to provide
22 capacity. Making thoughtful changes to the

1 process by exploring market based arbitration
2 solutions that embrace industry expertise in a
3 complex market environment makes sense. Making
4 arbitrary and outcome oriented changes to the
5 STB's existing standards by which agricultural
6 rates are reviewed does not.

7 Finally, let me just address a couple
8 of points from earlier today and then I'm done.
9 Let's go back to earlier in the testimony. Rate
10 increases that were mentioned earlier in the
11 state of Montana. I have a couple of points.
12 After not raising rates on the pulses and wheat
13 rates across the whole system and certainly in
14 Montana for the last couple of years, since back
15 since 2013, we engaged the industry to understand
16 what the market competitive rates would be this
17 year and after announcing our wheat rate
18 increases earlier this year, we actually pulled
19 back part of that rate increase after discussion
20 with the Montana grain growers and that was not
21 mentioned. We also had a rather good and robust
22 discussion with all of our pulse shippers and the

1 feedback from the pulse shippers about our
2 increase in pulse rates this year are market
3 responsive and we have had no complaints about
4 the price increases. In fact, the most often
5 response we get back is keep investing in the
6 railroad. We love the massive reinvestment plan
7 that you have out there. Make sure that you have
8 capacity to move what we want to move and the
9 rates are certainly rates that the market can
10 absorb.

11 As far as the standing in Montana,
12 farmer does go through the association if they
13 would like to file a rate complaint for wheat and
14 barley and they can ask them to represent the
15 farmer to BNSF and the arbitration proceedings so
16 they do have standing. The percentage of wheat
17 and barley that moves on us out of Montana is 90
18 percent of what we move, so of all the
19 agricultural products you can certainly make the
20 case that the farmer that moves stuff on BNSF in
21 Montana is well represented in terms of what we
22 move. It's a vast, vast majority of what we

1 move.

2 One other comment about contracts out
3 of Montana, there was illusion to contracts of
4 wheat being moved to Montana and the difficulty
5 of understanding what they are. We don't have
6 contracts that move wheat out of Montana. They
7 all move on tariff. They're all public and I
8 just wanted to make sure that's clear. So, thank
9 you for the opportunity to speak to you today.
10 We do appreciate it. My colleague, Jim Mulligan,
11 and I are here to answer any questions as follow-
12 up and when the panel's done.

13 CHAIR MILLER: Thank you very much.
14 Ms. Rinn?

15 MS. RINN: Good afternoon, Chairman
16 Miller, Vice Chairman Begeman. I'm Lou Ann Rinn
17 and I represent Union Pacific Railroad. Mr.
18 Jason Hess, our vice president and general
19 manager of agricultural products is also here
20 this afternoon to observe this Hearing.

21 In my remarks today, I will explain
22 how competition to transport grain ensures

1 reasonable rates, how the result oriented rate
2 tests proposed by the grain shippers have no
3 economic validity and how such special rate rules
4 for grain shipments would raise serious public
5 policy concerns. Competition to move grain as
6 resulting market driven rates explain why no
7 grain rate cases have been brought despite
8 numerous changes by the Board to make it easier
9 to pursue complaints. All the parties agree that
10 competition to sell and buy grain between nations
11 and within the US is intense. Such competition
12 extends to the transportation of grain. If Union
13 Pacific's rates are not competitive to the
14 national and global markets, someone else will
15 move the grain and we will lose the revenue. All
16 grain moves by truck to either a barge terminal,
17 nearby processor or an elevator.

18 This map of Iowa, which has the most
19 acres of production of any state illustrates
20 these choices. Producers can send grain to
21 dozens of processors, those are the blue squares,
22 to receive corn or soy beans by truck. They can

1 send grain to hundreds of elevators located on
2 different nearby railroads. There are five
3 railroads that crisscross Iowa east to west and
4 in addition KCS and NS have haulage rights that
5 allow them to transport Iowa grain.

6 Don't forget the brown triangles near
7 the rivers representing the barge terminals.

8 Iowa with access to multiple carriers and modes
9 is far from unique among the major grain
10 producing states that we serve. Illinois,
11 Minnesota, Missouri and Wisconsin are
12 crisscrossed with railroads with at least four
13 and as many as six Class 1 railroads, not to
14 mention the short lines placing most farmers
15 within trucking distance of two or more
16 railroads.

17 Likewise, they have many processors
18 and they have barge access. Even states with
19 fewer railroads and perhaps not as much water
20 benefit from geographic competition and what do I
21 mean by geographic competition? Railroads
22 serving different origins but similar

1 destinations compete to move grain. For example,
2 BNSF, CN, KCS and UP all compete in the
3 Midwestern grain states to take grain to the gulf
4 ports. Or you have carriers that are serving a
5 common origin competing to move grain to
6 different destinations. We compete with trucks
7 to move corn only we want to move them to feed
8 processors or export markets and the trucks are
9 going to move them to the ethanol producers.

10 So we have a lot of competition and
11 that competition is basically what informs and
12 drives the rates we charge for our customers.
13 Because grain is fungible and because it competes
14 in both national and international markets, our
15 rail rates would be found reasonable if they were
16 tested under a method that has a valid economic
17 principal behind it and the record is going to
18 support this.

19 First of all, the grain shippers admit
20 that the R/VC ratios for grain are generally
21 below 180. URCS admits that 61 percent of the
22 top four grain and 69 percent of the top four

1 grain products all have revenue to variable cost
2 ratios below the jurisdictional threshold. Now
3 contrary to ARC's claims, the prevalence of so
4 many movements below the jurisdictional threshold
5 basis is not based on a problem with URCS not
6 recognizing the efficiencies trainload moves.
7 URCS does recognize the efficiencies associated
8 with grain trends.

9 This slide shows a hypothetical
10 movement. The difference between the URCS
11 variable cost per car on a trainload movement and
12 the same car in cargo service is more than \$1000
13 or 37 percent less than it would be in a car
14 moving by itself but in a train. That's not just
15 the train, it's a manifest train. So if you
16 recalculated URCS to assign even greater
17 efficiencies to trainload grain movements more
18 cost would have to then be assigned to single
19 carload shippers, ironically including grain
20 customers, who do ship by single carloads which
21 would increase their cost and force more of those
22 movements below the jurisdictional threshold

1 basis. There's no basis for making a grain cost
2 adjustment factor and there's also no reason to
3 think that somehow the prevalence of movements
4 below the jurisdictional threshold for grain and
5 grain products is a technicality on URCS and is
6 not reflective of market reality.

7 For grain traffic that is above 180,
8 the record offers other evidence that rail rates
9 are reasonable. The shippers justify their
10 proposal on claims that railroads are charging
11 higher rates and capturing an unfair share of the
12 economic rates. They assume the unreasonableness
13 of these rates as a given but the facts say
14 otherwise. USDA and AAR data show that Class 1
15 railroad revenue from grain as a percentage of
16 farm income actually has been trending downward
17 for the last decade and while there was an
18 increase last year because we all know 2014 was a
19 memorable year as much as we might like to forget
20 it, there was an increase to only 5.2 percent.
21 In other words, we get a nickel for every dollar
22 of farm net income in 2014 and that figure is

1 still below the average for the last 10 years.

2 So rail rates may have increased but income to

3 producers has grown faster.

4 Pervasive competition and market
5 driven rates are a better explanation for the
6 lack of rate cases by producers than problems
7 with the STB rate complaint process. I will also
8 add one point here that we, of course, do market
9 different rates but we also look at if we think
10 there's a danger zone, we look to comply with the
11 Board standards are so we actively are trying to
12 not get into rate cases. So we're going to claim
13 credit for that and not blame the board.

14 The NGFA and ARC proposals are result
15 oriented and they are not based on economic
16 principals. Neither the NGFA nor the ARC
17 proposal simplifies the 3B test. Both seek to
18 change critical features of the 3B test with a
19 clear goal. Rates for grain should be reduced to
20 the jurisdictional threshold. Our reply comments
21 and those of other railroad parties address in
22 detail about how those proposals are merely

1 mechanisms to drive rates down. Critically, both
2 NGFA and ARC would expand comparable traffic to
3 include movements with R/VC ratios below 180 and
4 movements on nondependent railroads.

5 In reality, this would merely collect
6 a large set of mostly irrelevant data points. It
7 would not constitute a meaningful market or
8 economic analysis. To take an example from
9 outside the railroad world, if you were
10 considering buying a first class ticket from New
11 York to LA on United, you would not compare
12 United's R/VC for that ticket with what the R/VC
13 would be for Southwest to take you from Baltimore
14 through Denver to LA. You don't compare R/VCs
15 when you're buying something. You look at what
16 the rate is. You don't compare it. The R/VC,
17 particularly the R/VC by other firms, does not
18 tell you anything about the transportation market
19 for different transportation products and it
20 doesn't tell you anything about the cost
21 structure or what the returns are of one carrier
22 versus another carrier. That is why this is not

1 an economic or a market analysis.

2 The special way rules for grain
3 shippers also that ignore economic principals
4 would raise serious public policy issues. Grain
5 shippers can't justify why they are entitled to
6 special rules especially once they extend the
7 scope beyond commodities grown by small farmers
8 to include agricultural products that are
9 processed and made by large conglomerates. Grain
10 product originations on Union Pacific are not
11 widely dispersed. More than 80 percent of our
12 shipments are accounted for by only 21 origins
13 for ethanol, 8 origins for soy bean meal and 5
14 origins for corn syrup. That is not the model of
15 widely dispersed small and they don't know how
16 much they're going to produce that was given to
17 you by one of the advocates for the grain
18 proposal.

19 With regard to corn, wheat and soy
20 beans, the majority of our traffic is shipped by
21 large companies that could well afford to bring a
22 3B case and they concentrate on 60 origins which

1 draw from producers in a larger area yet the NGFA
2 and the ARC proposals would apply to all of
3 those. They are not making any distinction as
4 much as they may press forward with a certain
5 subset they are not limiting their proposals to
6 any such subset. They want everybody to be able
7 to use these rules. The grain and grain products
8 customers do not appear to be markedly different
9 than other customers in terms of the majority of
10 traffic still moves over certain lengths.

11 I believe that Chairman Miller, you
12 asked about chemical shippers. Yes, in more than
13 one proceeding we have had the ACC and chemical
14 shippers say that they are the very same as grain
15 in the sense that they move to a lot of different
16 destinations. They don't know where it's going
17 and they're moving in carload, not as many
18 trainload but they identify with many of the
19 complaints you've heard from the grain customers
20 today. But even if there were a subset of small
21 grain customers who really were different than
22 all the other shippers in a way that justified

1 special rules, the rules would still have to be
2 economically valid.

3 Rate reasonableness determinations
4 require the Board to allocate economic rents
5 between the shippers and the rail carriers. If
6 one group of customers gets more, than economic
7 principals justify that extra share must either
8 come from other shippers, which would be an
9 impermissible cross subsidy or it must come from
10 the defendant railroad. By imposing an R/VC rate
11 cap based on traffic moved by non-defendant
12 railroads without regard to difference in
13 supply/demand situations, route characteristics,
14 cost structure, those proposals would punish more
15 efficient carriers and discourage efficiency by
16 all other railroads because you get hurt if your
17 R/VCs get higher and one way to increase an R/VC
18 is to become more efficient.

19 Worse, by completely detaching the
20 conclusion about whether or not a rate is
21 reasonable from market information from your
22 customers on the traffic that you're originating

1 or terminating or interchanging you're losing
2 critical market signals about the demand and we
3 rely on that information in order to determine
4 not only where we need to be investing for growth
5 but also where do we need to have crews. Do we
6 have enough power? Are we prepared to handle the
7 traffic? Without that kind of information, you
8 end up not providing the reliable type of service
9 that our customers want to have.

10 Thank you very much for the
11 opportunity to appear today. I will be pleased to
12 answer any questions and I would be particularly
13 delighted if you would ask me a question about
14 how the NGFA proposal will guarantee work for
15 consultants but put my marketing people at risk.

16 VICE CHAIR BEGEMAN: Thank you, thank
17 you very much. Mr. Miller, I don't want to put
18 words in your mouth, but in case I didn't write
19 it down quite precisely, I think what you said
20 was that, with respect to whether or not there is
21 a workable rate methodology for the Board that
22 you're not necessarily sympathetic but you

1 recognize there needs to be a process. You
2 support a different process but not a different
3 method. Is that what you said?

4 MR. MILLER: Yes.

5 VICE CHAIR BEGEMAN: I'm sorry. I
6 can't find where I wrote it.

7 MR. MILLER: Yes. It's a good question
8 for clarification. It's the process by which a
9 resolution is resolved so that would be the
10 moving to an arbitration process that again, you
11 know, uses market based and sort of expert
12 reviewed processes that we can agree on and we're
13 just at the starting stages here to try to define
14 that but those are sort of key characteristics.
15 By methodology I'm referring to the change in
16 methodology being proposed by NGFA in terms of
17 just all the, essentially a soft rate cap, which
18 I allude to in terms of the consequences which
19 would be I think very wrong for both shippers and
20 the railroad.

21 VICE CHAIR BEGEMAN: I commend you for
22 your willingness to have the discussion with NGFA

1 to try to establish a program with their members.
2 What would your hesitation be to joining an
3 arbitration program here?

4 MR. MILLER: It simply has to be, we
5 have to be involved, I think since we're part of
6 this, at the design phase, so the key is what is
7 the design of the criteria used to decide the
8 arbitration ---

9 VICE CHAIR BEGEMAN: You just want to
10 know what you're signing up for?

11 MR. MILLER: Exactly. Right, so when
12 it talks about Montana, use that as an example.
13 Montana was carefully negotiated on both sides.
14 I think we took into consideration what the
15 association and farmers needed and they took into
16 consideration frankly the market based nature of
17 the markets and what was really quite frankly
18 prevalent and obvious in determining rates and we
19 came to resolution so if that could be that
20 process of making sure what is it that we're
21 getting into and making sure that we've got
22 things that safeguard which we, which I alluded

1 to or outlined in the presentation.

2 VICE CHAIR BEGEMAN: Did you say that
3 90 percent of all the ag products that BN moves
4 is eligible --

5 MR. MILLER: Out of Montana, yes.

6 VICE CHAIR BEGEMAN: Out of Montana,
7 is eligible for that --

8 MR. MILLER: Yes.

9 VICE CHAIR BEGEMAN: -- that
10 arbitration program?

11 MR. MILLER: It's wheat and barley so
12 it's eligible for arbitration so.

13 VICE CHAIR BEGEMAN: So 90 percent --

14 MR. MILLER: Of our ag products.

15 VICE CHAIR BEGEMAN: -- of your ag
16 products --

17 MR. MILLER: Right. The rest are
18 going to be pulses and small, small grains, so
19 but wheat and barley, we move so much wheat and
20 barley the percentage of what we haul that
21 essentially means, referring to your earlier
22 question earlier in the day that it is widely

1 available to many farmers in the state of
2 Montana.

3 VICE CHAIR BEGEMAN: It's more widely
4 available than I would have envisioned. That's
5 amazing.

6 MR. MILLER: Yes, and to make a follow-
7 up comment on that, we've had, the most recent
8 case, which was the Shelby case referred to the
9 December of 2009 and part of the arbitration
10 proceeding we agreed to is there's a mediation at
11 the very beginning. That was solved in mediation
12 and that was resulted in \$165 rate per car drop
13 at the time and didn't go to the arbitration
14 phase because the mediation worked but what
15 happens now quite frequently is we have rather
16 robust conversation and frequent conversation
17 with the groups in Montana, with customers in
18 Montana about what works and what doesn't work so
19 if, as a strong advocate as a former shipper and
20 also would be NSF today, that if a procedure is
21 known and defined and clear ahead of time and
22 both sides believe that there is some consistency

1 and predictability to what it will get at, it
2 causes all sorts of great discussions. Some
3 others mentioned that, too, but before you ever
4 there, that's one of the reasons why you don't
5 see any arbitration cases in Montana.

6 We're constantly talking and evidenced
7 in most recent, which is May 1 rate increase we
8 rolled back. We've got, essentially, feedback
9 from the growers that it was not market
10 responsive, we needed to be lower on the
11 increases and we did and we came to a good
12 accommodation for both. So no arbitration
13 needed. No mediation needed. That's a
14 discussion that ought to be had and certainly
15 that's preferable by all of us for our customers,
16 right, to have that constant discussion so that
17 it doesn't, we're eliminating costs and time when
18 we have those kind of discussions and it does
19 work that way.

20 VICE CHAIR BEGEMAN: Could you comment
21 on something that the representative from the
22 Montana Ag Department mentioned? He stated that

1 they were trying to put together, or they had
2 proposed putting together, their own shuttle --
3 no, I'm not getting the right words for it but
4 their own more efficient trains, but that BN
5 rejected that.

6 MR. MILLER: Oh, he referred to a
7 reverse deed. Yes, that is do you have any that
8 origin in a way to then move then as a unit at a
9 later time is what I believe he's referring to.
10 I haven't talked to him specifically to see if
11 that was what he was referring to but we've
12 looked at that. We'll have discussions about it.
13 It's certainly a cost inherent, shippers, what
14 they'd like to of course have is try to do that
15 in a way and Montana is a big state and you've
16 got broad geography that you'd like to try to
17 gather those facilities over but there are costs
18 inherent to us that are part of that so you just
19 simply cannot be the same cost base, simply the
20 same kind of rate that you see for a pure 100
21 car, 110 car shuttle loader on the system.

22 VICE CHAIR BEGEMAN: Because you have

1 to pick up freight along the way?

2 MR. MILLER: Pick up, yes, they're
3 assembled, moved.

4 VICE CHAIR BEGEMAN: It's not that
5 it's all in one spot?

6 MR. MILLER: No.

7 VICE CHAIR BEGEMAN: They haven't
8 moved it to one spot. You have to gather it.

9 MR. MILLER: Right. They're miles
10 apart from each other; that's why they call it
11 gathered. You'd have to bring them together and
12 move them together so there's costs in doing that
13 as opposed to 110 car shuttle where that loads
14 and once it starts moving, it moves straight
15 without stopping all the way.

16 CHAIR MILLER: So could you say, now
17 I'm curious, in that proposal what were they
18 doing then? Just like sort of lining up the
19 number of cars and getting a commitment? I mean
20 what was their role in sort of assembling ---

21 MR. MILLER: Well I think the proposal
22 is that they would like to do that and have

1 access to a rate that's better than the less than
2 100 car shuttle rate that's out there today,
3 right, so try to create a different product.
4 We're always amenable to those kinds of ideas but
5 it's typically when they don't work it's because
6 the rate that they would like to have is not the
7 rate that we can provide for that kind of
8 product.

9 VICE CHAIR BEGEMAN: Have you explored
10 whether it would make sense to try to offer an
11 arbitration program, a private program as you
12 have with Montana, to other states?

13 MR. MILLER: We have but it's going to
14 be difficult. Montana has got some unique
15 characteristics. We are by and large the primary
16 normal railroad. You've got two other railroads
17 that do come into the southwest and the northeast
18 but it's very small. Montana is sort of wheat and
19 barley so it's very specific to one or two
20 commodities, typically moves all in one
21 direction. It's created a platform that makes it
22 more amenable to making this kind of system work.

1 Other states, other railroads you need to make
2 sure, in that case and you have to have other
3 railroads that both buy in for competitive
4 reasons we need to make sure we're all adhering
5 to the same proceedings and I would reiterate
6 that point. Even we have done that with NGFA as
7 well as far as arbitration that we think can be
8 better, less costly, more timely, we do think we
9 can't do it unilaterally. It has to be done with
10 all railroads in mind for strictly competitive
11 reasons. To be held to a different standard than
12 others than our competitor is not something that
13 we believe is fair for us.

14 VICE CHAIR BEGEMAN: For both of you,
15 do you think the Board has fulfilled its mandate
16 to provide a workable rate review process for all
17 shippers?

18 MR. MILLER: Again, since we have lots
19 of discussions with folks, I think the feedback
20 is that small shippers and I will agree with our
21 counterparty on the table that large shippers, if
22 they want to bring a rate case they certainly

1 can, right? If they don't like the resources or
2 the time to do this. It's really a case for the
3 small shippers and that's why I spoke to the
4 small shipper earlier. We think that there are
5 some folks that clearly feel that way. There's no
6 doubt about it. It's not do they feel that way
7 or we think they might. They do. In fact, we
8 think that we'd have to agree with them that
9 there's a better process, a faster less costly
10 process that we should be all striving to get
11 forward. Not only for them, but for us. We
12 think that's the right thing to do. We're in
13 markets that change all the time so as for the
14 alacrity in getting a response and clarity and
15 consistency and predictability of what the
16 outcome is, they're all equally important, and
17 they need to be market based because as you know,
18 we are in a rabid market based environment at the
19 railroad and those things have to be taken into
20 consideration and I'll agree they're complex but
21 they're not unsolvable. They can be solved. It
22 just takes sitting down and walking through the

1 specific lane that is out there that is to be
2 looked at.

3 It's important for that small shipper
4 we think to know that they have the option. I
5 really don't think it creates a complicated
6 cases, I don't, but I do think it creates more
7 discussion and it creates a chance for the small
8 shipper to be heard or at least feel like that he
9 can be heard and today they're not, there are
10 some that feel like they can't.

11 MS. RINN: I think we're always looking
12 for ways of improving the process. I think that
13 the feasibility of 3B can't be condemned now
14 based on current experience in grain cases
15 because I will point that the last two 3B cases,
16 one of which was litigated against Union Pacific,
17 both involved chlorine, a TIH, so clearly you've
18 got issues about who pays for PTC. You've got
19 what is the risk and at least in the case that we
20 had, which was litigated to a victory by the way
21 by Mr. Wilcox on behalf of his client, also
22 involved a lot but a very serious difference of

1 opinion where UP said you've got to use other
2 chlorine movements to determine comparable
3 traffic and USM disagreed and they came up with a
4 group that was mostly ammonia.

5 We did not make that issue up to
6 create costs for USM and I want to make a
7 personal record that I thought that that comment
8 was uncalled for and that Union Pacific has a
9 definite record of stipulating to market
10 dominance. We have stipulated that we wouldn't
11 win a SAC case and all we have to do is figure
12 out what 180 percent is. We do not try cases in
13 order to drive up costs for our opponents and I
14 think the record needs to be clear on that. So
15 if you take away the very unique and very serious
16 issues in the first time either of those parties
17 or lawyers had tried a 3B case, I don't think you
18 can take the USM as an example or as a benchmark
19 as to what it would cost for grain.

20 We move a lot of grain. We don't move
21 much chlorine. We move more ammonia but we don't
22 move that much more ammonia so there should not

1 be anywhere near the issues of finding comparable
2 traffic and because grain is fungible I just, I
3 cannot rule out that there are no other issues
4 but the likelihood of there being the type of
5 contentious issues that complicated the record in
6 the USM and the other last 3B case I think are
7 not there, so we haven't seen whether 3B can work
8 in a grain case and we are certain and I will
9 make one point. There was a lot of discovery in
10 the USM case, but it was discovery compounded by
11 the shipper against UP. Our discovery requests
12 were very modest because we were too busy
13 producing all the documents we were requested to
14 produce. Do I have any ideas right now on what
15 we can do to improve 3B? No, but if we come up
16 with any by the 24th we will share them with you.

17 VICE CHAIR BEGEMAN: We'll extend the
18 comment period if it's necessary. Please, I know
19 you wanted to be asked a question about how the
20 proposal that we just discussed with the previous
21 panel, how that would promote the consultants.
22 Maybe you were being facetious.

1 MS. RINN: I was, but I'm also very
2 serious. When Mr. Crowley was making the point
3 that the NGFA formula is very simple to apply,
4 all you have to do is go through the wave of
5 data, plug it in the computer ---

6 VICE CHAIR BEGEMAN: That even we
7 could do it, I think, is what he said.

8 MS. RINN: Exactly. However, nobody
9 in Omaha could do it because we do not have
10 access to the waybill data. We can only see our
11 own waybill movements. We do not have access to
12 waybill data on specific movements for any other
13 railroad. Therefore, the only people who can
14 evaluate whether or not a rate is likely to be
15 above or close or below what the NGFA formula
16 would tell you would be the maximum reasonable
17 rate are going to be consultants and outside
18 counsel and members at the STB.

19 Worse yet, if that system were in
20 place today and Mr. Hess were to come to me and
21 say these are the rates that we have in mind.
22 Can you tell me whether or not if a rate case was

1 brought against us we would be able to win? I
2 would be giving him advice for forward looking.
3 What is the 2015 harvest season where we spend a
4 lot of time talking to our customers trying to
5 figure out where, how much and when it's growing
6 based on waybill data from I think 2012 is still
7 the most recent year available for other
8 railroads whose rates and certainly ratios we
9 can't see.

10 If you want to have what I would
11 consider the Board's objective should be for a
12 good workable rate test standard, yes, it should
13 be predictable. It should allow parties an
14 opportunity for a remedy but it also has to be
15 workable in the sense that those who are subject
16 to the standard have the ability, particularly
17 when you're talking about it applying to a whole
18 large block of business, they have to be able to
19 comply with it and that system makes it
20 impossible. It makes it impossible so the only
21 way I could guarantee that we would be able to
22 comply is if we drive our rates all down to 180,

1 which is not what I understand to be the purpose
2 of or a proper objective of a definition of a
3 successful rate test.

4 CHAIR MILLER: I'm curious for both of
5 you. You use slightly different language but you
6 sort of talked about market based rate setting I
7 think is how you said that so when you're saying
8 that basically what your railroads do is, you
9 know, you create a market based rate. Can you
10 say a little bit more about what that means? I
11 mean what is it then that you know based on the
12 market that goes into your determination of your
13 rate?

14 MR. MILLER: It's constant and
15 persistent market economics that we see every
16 day. So today, as I saw one of the slides that
17 you saw up there. You saw the fact that the P&W
18 exporter competes with a New Orleans exporter
19 every day on sales to Asia, Korea, Taiwan, Japan,
20 three of the biggest buyers in the China shipping
21 for soy beans. It's constant. It's an ocean
22 freight spread. It is the spread between our

1 rail rates going west and the barge rates going
2 south and of course if you're anywhere close to
3 that it's trucks going one way or the other.
4 Certainly, it's processor demand that's pulling
5 grain away from our rail and it's also our
6 competitor and that's a very strong competitive
7 environment. We're all fighting for market
8 share.

9 CHAIR MILLER: So you're looking at
10 truck rates, you're looking to see what's
11 happening with other railroads, you're looking at
12 commodity prices?

13 MR. MILLER: Sure. We get elevators
14 that will come to us and say, I'm losing volume
15 here. This isn't working. It's being trucked to
16 the ethanol company, the ethanol plant down the
17 road is outbidding us. We get that feedback all
18 the time, so when we look at a rate increase as
19 they may happen we consider all these sort of
20 market complexities and there's lots of it. I
21 mean it's just constant, so we get that feedback
22 really every day and it is something that we have

1 to take into account and informed and frankly our
2 customers are very well informed on it. The
3 shippers know what works and what doesn't work
4 because it's just pure economics.

5 CHAIR MILLER: Mm-hmm.

6 MR. MILLER: The beauty of it is that
7 you've got multiple markets and this is what
8 geographic competition is all about. It isn't
9 that you're on BNSF and ship only on BNSF and
10 then there's no other choice. You have to
11 compete. If BNSF corn shipper in South Dakota or
12 a soy bean shipper in North Dakota is competing
13 with soy bean shipper/farmer in the Delta going
14 through New Orleans to China, they're competing
15 with each other and that forces us to compete as
16 well. We're volume driven. We're back to this
17 virtuous cycle of investment. We have to have
18 growth, which begets revenue which begets
19 reinvestment which builds capacity and growth
20 which revs it up all year long and year after
21 year, so that's what we mean by market based and
22 it's hard to explain frankly in a few sound bites

1 and I don't mean to do that, but that's what we
2 have to do frankly. That's what keeps it rather
3 competitive and oh, by the way, we look at how it
4 plays out with R/VCs it turns out that really
5 that this works right because R/VCs are more than
6 reasonable and, in fact, if you look at the R/VCs
7 as you saw on the chart for the manifest shippers
8 they're extremely reasonable. So and that's the
9 result of this market based competition.

10 MS. RINN: Mr. Hess and his team are
11 doing the same thing. What we're looking at what
12 are the production, what are the weather reports
13 here in Canada, in South America, in the rest of
14 the world? Are people shifting to this? Are
15 they shifting to that? Is there a new product
16 coming up here? What is it costing to send it
17 overseas? What are the barges costing? If
18 you're talking about the pulse products in the
19 areas we serve, ours are mostly in domestic
20 markets. Are we competitive with truck that
21 would either be moving it to say the Snake River
22 and Columbia River or is it going to be

1 competitive with trucks that are going to be
2 moving it to processors? We are always getting
3 information. We make our best guesses. Our
4 customers tell us when they think that we've got
5 it wrong and they press us for adjustments.
6 Sometimes we agree with them and we make
7 adjustments, sometimes we don't but we are always
8 in a two-way dialogue with the customers on the
9 origin end and the customers on the destination
10 end, not to mention all the brokers who are out
11 there who are using the same information to
12 figure out what the markets are. It is not as
13 simple as basically sitting in and putting a
14 program in, in Omaha and it comes out with the
15 rates.

16 CHAIR MILLER: So how often, generally
17 I guess, we're talking tariff rates, I suppose
18 that same kind of thinking goes into your
19 contract negotiations but if you're setting
20 tariff rates, is that something that gets done
21 annually? Does it happen when you think there
22 have been significant changes in the market

1 conditions?

2 MR. MILLER: Well, and I should know
3 we have the right to raise them on 20 days'
4 notice or drop them immediately but we don't, the
5 industry likes some certainty from us. We have
6 to take that into account so we do have sort of,
7 we do our best to certainly give them plenty of
8 notice so typically speaking 60-90 day notice if
9 we're going to take a rate increase. Partly that
10 is to put it out there and then have discussions
11 with the customers about this, does this make
12 sense, but it's also mostly to give them some
13 notice about what's coming, so before they make
14 sales or purchases based upon a certain rate,
15 they have an idea.

16 In some cases, we're actually talking
17 six months ahead of time. We're notifying them
18 of rate changes, particularly ahead of a harvest,
19 which has got lots of volume. So typically
20 speaking for us you'll see your rate changes once
21 or twice a year. Now that can change, it
22 certainly can be more frequent or less depending

1 upon the market conditions, but typically that's
2 what the customer sees from us and that's again
3 varies by commodity but it's typically one to two
4 times a year.

5 MS. RINN: It would be very much the
6 same. We have, and this is based on the feedback
7 we've gotten from our customers. I guess they're
8 looking for something that's relatively stable in
9 what is obviously a very dynamic marketplace for
10 them, but we aim to give them here is the price
11 for this season. They know when we're going to
12 give that price but before that price is
13 established there is discussion going on saying
14 this is what we're looking at. What do you
15 think? We get that feedback before it's
16 established and it is published before the rate
17 becomes effective. We are not rigid about that.
18 If something happens and there has to be an
19 adjustment again we talk to our customers and we
20 do that. That may or may not be in the form of a
21 tariff.

22 CHAIR MILLER: Your tariff rates on a

1 website, searchable, even I could figure out what
2 they are?

3 MR. MILLER: Our tariff rates are
4 available to all of our shippers that ship on us
5 and if you ask us for those rates we can walk you
6 through and explain those to you. For BNSF,
7 virtually all of our movements are tariff based.
8 I know that there was an illusion earlier about
9 the railroads are different and we are virtually
10 all tariff based. We've got very few contracts
11 on the grain side. They're very narrow and very
12 specific but we are virtually all tariff based.

13 MS. RINN: I believe they are. I have
14 not recently done it myself but I have in the
15 past been able to find what I was looking for on
16 our website and I am not technically adept.

17 CHAIR MILLER: So, here's the other
18 thing that I'm wondering and I thought Mr.
19 Miller, your charts were very interesting
20 showing, you know, the huge growth in shuttle
21 facilities and investment made both by your
22 customers as well as by the company and certainly

1 and broadly, just even for the US economy, that
2 kind of an investment has a wonderful effect.
3 What we heard earlier today though from the folks
4 who were here from Montana was the feeling that
5 we're doing what the railroads have asked us to
6 do, we're making investment but we don't feel
7 like that efficiency that should be created from
8 that investment then is showing up in our rate
9 and I'm, you know, wondering what you say about
10 that and let me add one more thing. As near as I
11 understand it, and maybe there's a lag in the
12 numbers, but you can see the grain rates have
13 tended to trend higher than other commodity type
14 rates and so I'm wondering where it seems like
15 there is a lot of investment on from ag shippers
16 in this world, is that efficiency then not
17 getting played out in the rate?

18 MR. MILLER: I think that's a really
19 different argument to make it that way. We are
20 market based. I'll bring it back to that. We're
21 market based by commodity and how we price the
22 rates so when someone says to me that our rate

1 increases are different percentage than say
2 lumber, I say we don't know what lumber is
3 priced. I don't, what I do know is what the
4 market is for corn and what it takes to be
5 competitive on corn. For example, last year we
6 took zero based increase in wheat, corn or soy
7 beans across the US. That's a zero percent. You
8 know, that's based upon what we felt at the time
9 was valid and the right thing to do and this year
10 we're taking different increases.

11 It's market based. It's as simple as
12 that. So comparing to other commodities for us
13 is something we just don't do and I don't know
14 how to respond to it other than to simply say
15 that. We also talk a lot about it being a right
16 to grow so we are again, this virtuous cycle of
17 investment, we are massively reinvesting in the
18 railroad. That is putting tremendous amounts of
19 money and cost back into the system. That's also
20 the right thing to do. That's exactly what our
21 customers want us to do. That's how we all grow.
22 So I think the combination of being market based

1 and making sure we earn the right to grow at BNSF
2 results in rates that the market sees.

3 Again, I hate to harp on it but as we
4 get feedback that the rates aren't valid with the
5 marketplace or they're not competitive and if we
6 agree we'll assess them over multiple inputs we
7 get from the marketplace, as we did on May 1, and
8 we'll pull them back. We pulled back part of the
9 wheat increases, so again that's an argument that
10 pulls me in a direction that frankly isn't the
11 reality about how we set grain rates. It's set
12 to the market for each commodity.

13 MS. MULLIGAN: I would just add to
14 that just on some evidence that's in the record,
15 like John said he doesn't pay attention to it but
16 we did take the waybill sample that was available
17 in this proceeding and we looked at the relative
18 increases across different commodity groups for
19 BNSF. If you look in our opening evidence under
20 the FTI, fair fight statement, there's a chart
21 there that shows where the various grain
22 commodities fit in terms of percent increase

1 versus other commodities and they're pretty close
2 to the median in one case and then both the other
3 two major grain commodities are significantly
4 below that.

5 CHAIR MILLER: Okay. Thank you. Ms.
6 Rinn, you used the term that, you know, if the
7 rates are getting in the danger zone you do
8 something about it but can you say a bit more
9 about what you meant by that?

10 MS. RINN: Well, what I meant is that
11 our marketing department, the folks in the
12 regulating areas, if they're taking an increase
13 and they're concerned about whether or not that,
14 in fact, could get them into rate litigation they
15 consult with us in the law department and we take
16 a look at it based on what we know, what about
17 the Board standards are, about whether or not it
18 is and we discuss with them, you know, whether it
19 and what our options are. I really can't go much
20 beyond that without getting in attorney client
21 privilege and even if BNSF is at the far end of
22 the table --

1 CHAIR MILLER: They're in the room.

2 MS. RINN: They are competitors.

3 CHAIR MILLER: Thank you. And then a
4 question that I have for both of you is one of
5 the things we were looking at is, you know, we
6 have this auction format for grain shuttles and
7 grain cars, but that's a cost that then doesn't
8 show up in the R/VC ratio and is that a flaw in
9 R/VC? Should it be there?

10 MS. MULLIGAN: I can add maybe a point
11 of clarity on that. In terms of the primary
12 auction that BNSF participates in and that we do
13 see revenues from in times frankly, mostly where
14 we have capacity constrained environment like
15 last year, so last year was a bit of anomaly for
16 us, but as I understand it when we generate the
17 revenues as part of our waybill sample that we
18 pass on to the Board, we do include premiums from
19 the auction for that period. It's not allocated
20 down to individual shipments, but it is allocated
21 to show traffic that participates in the auction,
22 so it is actually in our waybill sample.

1 MR. MILLER: And I would just follow
2 up by saying that last year was a rather unusual
3 year. Historically speaking, those premiums are
4 very close to zero or just slightly above zero in
5 most years and which we're back to today, in
6 fact.

7 MS. RINN: In our case, likewise, most
8 of the time it's zero on the auction in terms of
9 the revenue we get. Last year was unusual in
10 that we did get revenue because those were viewed
11 as very valuable. My understanding though is I
12 don't believe that the revenue we are paid for
13 the shuttle is, in fact, reported in the waybill
14 data that we report to the sample because it
15 really is an option on a train and then that
16 customer basically decides where that train is
17 going to be loaded and we don't know that at the
18 time they give us the money. We also have
19 incentives that are associated with the shuttle
20 so we pay to the parties who load and unload the
21 shuttle to make sure that they load it quickly
22 and they unload it quickly so that we can keep

1 the locomotive with the shuttle so that train is
2 always ready to go.

3 So that's a cost and we don't get that
4 is not treated as an adjustment and that's not in
5 the waybill sample, plus if the, we have a mutual
6 commitment on the shuttle that the customer is
7 basically going to get that train and as soon as
8 it's basically dropped off one load they're
9 supposed to send it someplace else for another
10 load. If they live up to their volume commitment
11 we give them an incentive and we likewise don't
12 reflect that as a net adjustment because we don't
13 know when that, again, is happening at the time
14 we have to report the waybill movement. So they
15 are commercially related but from an accounting
16 point of view, trying to match them up on time
17 for a reporting basis does not work out.

18 CHAIR MILLER: Thank you. And then
19 I'm just curious, one of the things that you said
20 was that the R/VC ratio doesn't really tell you
21 about the transportation market.

22 MS. RINN: Mm-hmm.

1 CHAIR MILLER: And that seemed to be,
2 that made me think back to what I heard this
3 morning from TRB in their report when they were
4 talking about this alternative model where you
5 would use market based rates or rates that had
6 been determined in the market I guess is the way
7 I would say to determine what your threshold was
8 for when you could bring a rate case and I was
9 just sort of curious when, maybe I didn't hear
10 what you said correctly or maybe I'm still not
11 quite understanding the proposal but I'm just
12 wondering if that resonated with you, if that
13 felt like that was more of a market based way to
14 judge rates, what you were hearing the professor
15 say this morning.

16 MS. RINN: I am also very curious to
17 see that report and how they did that market
18 analysis.

19 CHAIR MILLER: Yes, we don't know too
20 much about it yet. I'm not trying to, you know,
21 trick you into endorsing the TRB report.

22 MS. RINN: But I will make one

1 observation. In my experience when I see
2 marketing people assessing the market and trying
3 to figure out what's the sweet spot for the rate,
4 I don't see them comparing R/VC ratios for
5 different customers. What I see them doing is try
6 to come up with something, whether' it's mills
7 per ton mile or it's dollars, they're using
8 something about that goes to what is the price
9 the customer pays in the relevant market to try
10 to figure out whether or not it's market based.

11 CHAIR MILLER: Any more questions.

12 VICE CHAIR BEGEMAN: Just maybe one or
13 two. Mr. Miller, you mentioned that you
14 currently have 7000 cars in storage, and again,
15 not that we want to relive last year in any way,
16 probably especially you, so I don't really want
17 you to compare it to a year ago. But generally,
18 at this point, this second week of June is it
19 normal that you have 7000 in storage or is it, I
20 mean you have what, 22?

21 MR. MILLER: 28,000 cars.

22 VICE CHAIR BEGEMAN: 28 total.

1 MR. MILLER: It's more normal than
2 people realize. I think three out of the last six
3 years we were near this number but it really
4 changes. The crop size and crop demand. One is
5 where I'm at right now is the US dollar is
6 hurting US exports we're massive crops in
7 Ukraine, Brazil, Russia are hurting the ability
8 to compete because they're currencies have
9 devalued and they've got massive crops and the
10 farmers in the US as you've seen prices drop are
11 holding on to it and combine that with our very
12 strong velocity across the system and you're
13 seeing you know, velocity actually kick assets
14 back out so it's creating cars that are parked
15 and we have locomotives now in storage on the
16 system and it has changed quite fast in the last
17 seven, eight, nine months. But we think that was
18 led clearly by resources coming to bear on our
19 railroad.

20 Velocity was our problem last year and
21 velocity has brought us out of it. We have come
22 back in spades on velocity and that's directly

1 due to the investment in locomotives, people,
2 track capacity across the system and we know that
3 this is part of being in the ag markets. There's
4 some reciprocity and volatility that's part of
5 it but it's a cost that I think some folks don't
6 really fully realize that there's some years when
7 this happens and then ten months ago, I'm not
8 sure anybody would have forecasted 7000 cars
9 parked. We're offering freight today we're not
10 getting a bid for and we're getting some
11 customers that would like us to slow down, so
12 we're moving too fast. It's a good problem to
13 have. I'd much rather be in that environment.

14 Quite frankly, our message today in
15 the marketplace is we're ready and willing and
16 able to carry us, see the next big harvest come
17 because we've got lots of capacity planned to
18 take it and we're real hopeful that's going to be
19 the case this fall.

20 MS. RINN: Likewise, we have them in
21 storage. Last year, we had actually gotten down
22 to the point where I think you could count on

1 your fingers and toes the covered hoppers that
2 weren't in service. Thank goodness we were able
3 to lease those 1500 in January. We now have more
4 than 1500 in storage. Partly it is in fact yes,
5 velocity has been restored but it's also demand
6 is down this year as compared to last year.

7 VICE CHAIR BEGEMAN: Well, I'll end it
8 where I started earlier. This proceeding really
9 isn't to debate in this forum whether or not
10 grain rates are too high. It's really to make
11 sure that we are meeting our obligation of having
12 a meaningful, economically sound and fast but, a
13 fair process. So for post-hearing comments, we
14 are open to constructive ideas. And that applies
15 to everyone in the room and everyone listening.

16 MS. RINN: Thank you.

17 MR. MILLER: Thank you.

18 MS. MILLER: Thank you, Ann. Thank
19 you, panelists, and I think we'll take a 10
20 minute break before we start our next panel.
21 When we come back it's Panel Number VI and
22 that'll be NS, CSX, CP and CN.

1 (Whereupon, the above-entitled matter
2 went off the record at 3:09 p.m. and resumed at
3 3:20 p.m.)

4 CHAIR MILLER: All right. Welcome
5 back. I think we'll get started now with our
6 sixth Panel and it's also a panel of railroad
7 representatives. So we have Patrick Simonic from
8 NS along with John Scheib and with CST we have
9 Tim McNulty and Pat Hitchcock; with Canadian
10 Pacific, James Clements is here and with the
11 Canadian National Railway, Ted Kalick. So,
12 welcome to you all. Thank you very much and
13 we'll start with Norfolk Southern.

14 MR. SCHEIB: Good afternoon. My name
15 is John Scheib and I serve as general counsel of
16 commerce and represent Norfolk Southern Railway
17 Company this afternoon. With me is Pat Simonic,
18 who serves as group vice president for
19 agriculture, fertilizer and consumer products.
20 Mr. Simonic will open our presentation by
21 discussing the extensive competition Norfolk
22 Southern faces to transport grain which NS

1 believes is a core reason why there have been no
2 grain rate cases involving Norfolk Southern. As
3 you've seen in the highly confidential record,
4 NS's grain rates are such that only a small
5 percentage of those shipments could meet the
6 quantitative market dominance test before even
7 considering the qualitative test. Then I'll
8 return to address some of the issues raised in
9 the Board's notice. All of those issues have
10 been fully briefed and so obviously, we
11 incorporate all our positions stated in those
12 papers. Pat.

13 MR. SIMONIC: Good afternoon. As John
14 mentioned, my name's Pat Simonic. I'm group vice
15 president of agriculture, fertilizer and consumer
16 products group with Norfolk Southern. Today I'll
17 define our network and the diverse markets we
18 serve, the competitive landscape in which we
19 operate and some of the operating challenges this
20 business can present and you will see that we are
21 quite different from some of the other Class 1's.
22 For the purpose of definition, my comments refer

1 to the Commodity Group grain as defined by the
2 AAR group, Standard Transportation Commodity
3 Codes 0113 and 0114. Although NS hauls less
4 grain than any other railroads, NS moved
5 approximately 200,000 carloads of grain in 2014.
6 Of those, 120,000 carloads were corn and
7 approximately 40,000 carloads were each wheat and
8 soy beans. That total expands to approximately
9 350,000 carloads when you include the AAR group
10 grain mill products.

11 My testimony will briefly highlight
12 some of a few of the ways that the different
13 types of grain transportation on Norfolk Southern
14 face very different market conditions and define
15 any sweeping generalizations. First, our average
16 length to haul for grain is approximately 565
17 miles. But specific movements vary widely due to
18 the variety of markets we serve. For example, we
19 receive wheat from beyond Chicago and deliver to
20 milling facilities at distances in excess of 1200
21 miles but we also handle unit trains of soy beans
22 and corn traveling within one crude district

1 which sometimes can be less than 40 miles. Due
2 to the type of the market and the location of the
3 markets within our network all offer very
4 different competitive and operating challenges.

5 From a competitive modal perspective,
6 we compete with truck, barge, imports, and other
7 rail both directly and indirectly. The direct
8 modal competition we face is easy to define. For
9 example, where two competing modes serve a set of
10 common points; however, today with customers
11 national and international market distribution we
12 must look much further into a supply chain and
13 consider the impact of indirect competition,
14 market competition as well. For example, take a
15 hypothetical move, corn from an elevator in
16 northern Illinois to a feed mill located 1200
17 miles away in a destination market where both the
18 shipper and the receiver are both served by NS.
19 There are a number of factors we consider when
20 trying to ensure our customers are receiving the
21 lowest delivered cost in the marketplace.

22 First, on the supply side we want to

1 attract as much grain to our network as possible.
2 The farmer has a number of choices before the
3 corn can even get to an NS served elevator. The
4 corn can be delivered by truck to another
5 elevator on another competing railroad or to a
6 river terminal or to a local processing plant or
7 it can simply be stored awaiting future sales
8 depending on certain market conditions. On the
9 destination side, we must take into account that
10 we are competing with larger crops of corn being
11 grown locally in our destination market that can
12 be trucked to a customer. Barge and rail truck
13 transfers that allow plants to source from other
14 locations. Other commodities that can be
15 substitute for corn and delivered locally by
16 truck. And in some locations, South American
17 imports. We must provide an all in delivered
18 price that allows this particular feed mill to
19 produce and price his product competitively in
20 the markets in which he competes.

21 Finally, grain transportation all
22 provides us some very significant operating and

1 cost challenges across our network. Agriculture
2 products are seasonal, cyclical and many of our
3 agricultural customers are located in rural areas
4 on our lighter density network. For example,
5 unlike most non-agriculture production facilities
6 we serve, grain and grain products do not always
7 load at the same location or at the same time of
8 day or at the same day of the week or even the
9 same time of the year to a single common point.

10 Due to this, we are unable to schedule
11 these movements and in turn plan resources in
12 advance. So a lot of our grain and grain product
13 shipments require on demand service which can
14 cause a major strain on resources, track
15 capacity, equipment and our crew base and all
16 must be available for all the different lanes
17 over which this customer might tender a
18 particular shipment. Further, agriculture
19 products move across many of our lower density
20 lines and sometimes are the only business
21 supporting the operation in certain branch lines,
22 so in some cases these branch lines are

1 subsidized by the balance of the network.

2 In conclusion, while this is just a
3 cursory summary, grain transportation on NS is
4 varied in its form and in its market. In short,
5 Norfolk Southern's traffic does not support many
6 of the generalizations made about grain
7 transportation, grain rates in this docket and
8 the Board should avoid relying on sweeping
9 assumptions or conclusions about these markets.
10 Those are my comments and I'll pass it back over
11 to John for.

12 MR. SCHEIB: Thank you, Pat. As Pat
13 noted, we price to the market. Nevertheless, we
14 recognize the regulatory regime and our core
15 principle in this proceeding is simple. It's the
16 economics of providing the rail transportation
17 service that matters when evaluating the
18 reasonableness of a rail rate. The stand alone
19 cost test is a gold standard precisely because it
20 is firmly rooted in economics of providing the
21 transportation service in a contestable market.
22 In order for the Board to adopt a rate

1 reasonableness test for grain only, that test
2 must be rooted in the same sound economics but a
3 grain only test would require more. It must be
4 based on some unique characteristic of rail
5 transportation that affects grain and only grain
6 differently than the economics of rail
7 transportation for any other commodity and to be
8 clear, the relevant inquiry is not whether
9 there's something unique about grain markets.
10 The question is whether there is something unique
11 about the economics of providing rail
12 transportation services for grain shipments that
13 should result in a different test for the
14 reasonableness of rail rates for grain than for
15 any other commodity.

16 Now, I'll turn briefly to a few of the
17 issues in the Board's notice. First, the Board
18 asked the parties to address whether the board
19 should revisit the prohibition on movement
20 specific adjustments in determining the
21 quantitative market dominance threshold in rate
22 cases for grain shipments. The real question the

1 Board is asking is whether the Board should allow
2 movement specific adjustments in all rate cases.
3 If grain shippers believe that the system average
4 cost of URCS overstates the cost of their
5 shipments, that means they also must believe that
6 URCS understates the cost of other shipments,
7 perhaps like coal and chlorine. Or there may be
8 under or overstatements based on whether a
9 commodity moves in a single car, a unit train or
10 a multi-car service. It's simply the nature of
11 averages like URCS uses. Some movements are
12 actually above the average and some are below and
13 that proposition's not controversial.

14 Even a shipper witness, Mr. Fauth, a
15 witness for ARC in this proceeding acknowledges
16 this fact when he says, "Since URCS reflects a
17 railroad's system average cost movement specific
18 cost adjustments can work both ways. Actual
19 variable costs can be higher or lower than the
20 system average." Accordingly, in order for the
21 regulatory system to account for all railroad
22 costs, the issue of whether to permit movement

1 specific adjustments is simply an all or nothing
2 proposition.

3 Second, we've presented substantial
4 evidence that the specific proposals for new rate
5 methodologies in this proceeding are all
6 arbitrary at best and in some cases, completely
7 unsupported. Arbitrary rate regimes have been
8 struck down by the courts time and again over the
9 years. These proposals in this docket like any
10 economic underpinning, in fact, this morning when
11 you heard about proposals, they didn't once
12 explain the economics underpinning them and
13 they're merely a rate cap. Finally they fail
14 core principals, they're not economically sound
15 and they do not account of any aspect of rail
16 transportation that's unique to grain. Indeed
17 the DC circuit has already expressed skepticism
18 that grain requires a test different from any
19 other commodity in Burlington Northern versus
20 ICC, 985 F2nd 589. In short, the STB is not an
21 ATM. The economics are the economics and sound
22 economics cannot be sacrificed for the political

1 desire of a single segment of shippers.

2 Third, the board invited comment on
3 the issue of revenue adequacy in the context of
4 this proceeding. Any consideration of revenue
5 adequacy in this proceeding is premature given
6 the fact that there's a separate revenue adequacy
7 proceeding in an upcoming hearing. Therefore
8 we're not going to spend a lot of time on it
9 except to say that the evidence in revenue
10 adequacy proceeding clearly shows first that the
11 only statutory purpose behind revenue adequacy
12 was to establish an annual benchmark to ensure
13 that the agency was doing its job to help
14 railroads become revenue adequate. Second the
15 annual calculation substantially overstates
16 whether a railroad is revenue adequate and third,
17 a separate top down revenue adequacy restraint
18 would function as a rate of return regulation
19 which is the kind of regulation that is
20 disfavored by economist and is being abandoned
21 all the world and across the United States
22 because of the substantial disincentives that it

1 creates.

2 Finally, the board asks whether more
3 information should be provided in agriculture
4 contract summary in the interest of, quote, great
5 transparency, close quote. Those reports are not
6 filed for generally transparency. 49 USC 10709G
7 clearly states that railroads file those
8 summaries for only one reason, so that the
9 shipper can bring a complaint and the board can
10 open a proceeding within 30 days after the
11 summary's filing based on four limited grounds.
12 All the information necessary to achieve the only
13 regulatory purpose is already included in those
14 contract summaries.

15 Now, our point is different, no such
16 complaint has ever been filed so in essence CSX
17 petition about a year ago to have the board
18 exempt from regulation, the requirement that
19 railroads file summaries of agriculture contracts
20 because it's not clear that these summaries are
21 needed even for that limited regulatory purpose.
22 Although they take substantial resources to

1 compile, it appears shippers hardly, if ever
2 access them at all much less review the summaries
3 to evaluate or file a complaint under the
4 statute. The shippers basically admitted as much
5 in response to our petition. Although shippers
6 may want to place more owners reporting
7 requirements on railroads, there's no general
8 right to transparency into the private contracts
9 of other parties. Thank you.

10 MR. MCNULTY: Thank you and good
11 afternoon. My name is Tim McNulty and I'm
12 responsible for the agriculture and food markets
13 for CSX transportation. We did bring a few
14 slides with us.

15 MR. SIMONIC: The slides are ready and
16 showing here on this monitor, so we just need to
17 get them connect them to the screens.

18 MR. MCNULTY: Perfect. Thank you.
19 Now, if I can figure out how to work the remote
20 we'll be in good shape. Right here, perfect.
21 Thank you. This first slide gives a sense of how
22 important agriculture is to CSX's diverse

1 portfolio. We're a \$11 billion company and AG
2 represents about 9 percent of our revenues and
3 it's critically important to CSX over the long
4 term. I think it may be a distance thing, why
5 don't you just drop them for me. That would be
6 great.

7 In this next slide represents again
8 just to qualify a little bit, about 60 percent of
9 CSX business is related to feed grain commodities
10 and those are really what we'll be discussing
11 over the course of the next several slides. Of
12 those commodities really the preponderance of it
13 is feeding animals in the southeast. About 60
14 percent of our business of the category we're
15 talking about represents animal feeding. There's
16 25 percent that goes into processing markets
17 which mostly soybeans or wheat that will move
18 into a further process channel and then the
19 balance is export grains. So 15 percent of our
20 business is export grain. While export grain is
21 an important commodity just the eastern dynamics
22 don't necessarily allow for a large quantity of

1 grain to be exported off the east coast and
2 there's several options relative to river
3 facilities and the lake facilities. That just
4 makes it difficult to compete.

5 Just from a perspective of public
6 versus private rates, CSX is structure only 18
7 percent moves under the public domain and there's
8 really three reasons I think for that. First and
9 foremost, we try to reach an agreement with our
10 customers on an economics that they need to
11 enhance their business. We understand that
12 feeding costs are a large percentage of chicken
13 production and rate stability is an important
14 component of our customers in terms of how they
15 treat their business. So we strive to reach
16 agreement. The second benefit of that is in a
17 quid pro quo situation, customers are generally
18 committing some volume to us so it allows us to
19 plan better for the harvest season. Grain can be
20 volatile enough given crop conditions and car
21 supplies so we have to very solid idea going into
22 a harvest period of exactly how much grain we

1 expect to handle from our customers.

2 So in addition to our contracts we
3 have pre-harvest discussion with all of our
4 customers relative to what they're expecting for
5 the upcoming season and it helps balance and
6 smooth our expectations as well as our customers'
7 expectations. And thirdly just to kind of a
8 little bit on that public domain, our tariff
9 freights are readily available on the internet
10 and what we find is they're used for a lot of
11 different reasons, across a lot of different size
12 companies. So even some of our larger customers
13 will use our tariff publications to handle spot
14 movements or to handle rejected cars, there's a
15 multitude of reasons why someone might use our
16 public information, so it's a very valuable tool
17 to allow our customers to get rates quickly and
18 to make decisions quickly relative to their
19 business.

20 And our customers are large. This
21 graph represents the annual revenues, 2014 annual
22 revenues of a lot of public customers, and then

1 we have a large contingency of privately owned
2 customers too. But I think the point is that the
3 customers that we're dealing with are very
4 complex. Most of them have multi facilities that
5 are either on the feed mill side or they have
6 multiple feed mill or on the processing side and
7 these companies have significant competition
8 available to them and significant choices on how
9 they're going to source their business and supply
10 the needs of their animals.

11 So this one is going to be tough on
12 you, Pat, all right, so be ready. I really want
13 to tell the story of what Pat outlined. At the
14 end of the day we want to feed chickens and we
15 want to feed as many chickens as we possibly can
16 feed. In order to do that, we really do
17 understand that not only do you have to have
18 incentives to build feed mills on CSX
19 transportation but you also have to very vibrant
20 origin elevator infrastructure and we take that
21 balance very seriously to make sure that both of
22 the ends of the equation make sense from an CSX

1 perspective. In order to really have a healthy
2 elevator system you have to have a healthy farmer
3 that's what to sell to that elevator.

4 So under a perfect scenario that
5 farmer will sell to that elevator and then that
6 elevator will sell to that chicken, the chicken
7 gets fed and everybody's happy.

8 CHAIR MILLER: That's some chicken.

9 MR. MCNULTY: Yes, it is. As we peel
10 back though to one level of completely, really
11 look at the farmer and he says, you know, that
12 farmer has a choice, he can sell to a processing
13 facility and in fact east of the Mississippi
14 there's north of 55 processing facility that they
15 have choice to sell to and most of those
16 processing facilities, whether they're ethanol
17 processing facilities or either they're being a
18 corn processing facilities, they're mostly
19 located in Michigan, Indiana, Ohio and Illinois
20 which is the corn that we want to grab to feed
21 those markets. So that farmer does have a choice
22 to sell to those processing markets.

1 Secondly he has a choice to sell to
2 river terminals. I mean, quite frankly the river
3 system in our country is adequate, it needs
4 investment but it's certainly adequate in
5 locations that it attracts grain to move down to
6 those situations and also the Great Lakes.
7 There's a lot of eastern grain will move out over
8 Toledo, Ohio. So though there are options for
9 those farmers to sell to that, the rivers or the
10 lakes. He has another option he can sell to
11 another elevator. We feel that once that farmer
12 loads into a truck it's not that hard to go to a
13 different elevator and if goes to a different
14 elevator than what we consider that primary
15 elevator, it could be on CSX, it could be on the
16 river, it could be on a competing railroad, it
17 could be on any number of things so it's a
18 choice.

19 And the real catch is, is that farmer
20 can choose not to do anything and he can store it
21 on his own farm facility and wait until tomorrow
22 and make those same kind of choices. We hope

1 that he does sell it to the elevator, but once he
2 does again, that elevator has those same choices.
3 That elevator can in turn sell to the processing
4 facilities, much like the farmer, or he can sell
5 into the river system. So all that action is
6 taking place and we haven't even fed our poor
7 chicken in North Carolina or South Carolina. So
8 let's just talk about him for a little bit.

9 That chicken does have some choices as
10 well. He can buy from that elevator which is
11 what want to happen, or he can buy from another
12 elevator. And that choice is out there for him,
13 it could be closer for him, it could be further
14 away, it's an option that he has. He can also
15 buy from the river system. Several of the
16 Tennessee, Alabama are designation river points
17 are transfer points for grain and that grain can
18 work into as far as east as North Carolina. The
19 chicken also has a choice of the local crop.
20 Now, granted there's probably not enough local
21 crop to feed all the chickens in the southeast,
22 but improved faming practice really have shown

1 that over the past ten years that local crop has
2 increased 30 percent so it is significant and
3 it's significantly growing.

4 If the chicken doesn't like that local
5 southeast grain, he also has the option to call
6 on his closes port and feed on South American
7 grain. And over the past three years South
8 American grain has come in through Wilmington,
9 through Norfolk, through New Orleans and even
10 through Tampa in drought situations. So to think
11 that we can control whether that happens, I think
12 is a little bit difficult to do because economics
13 will dictate whether that grain is imported
14 through South America and it's been happening.
15 All those complexities are at work and all we're
16 trying to do is again, make sure that that
17 chicken can thrive and grow.

18 But what really keeps us up at night
19 is that chicken relocating to another area,
20 whether that be a different feed mill in the
21 southeast or a feed mill closer to the corn
22 supply which cuts out rail altogether or even

1 worse, is if moves internationally or moves to
2 another source. All those we feel are capable of
3 occurring.

4 CHAIR MILLER: Tim, excuse me, I'm
5 wondering could you let that chicken know that we
6 need more eggs and it should get busy laying and
7 stop doing so much grain buying. It's like
8 focusing on the wrong things right now.

9 MR. MCNULTY: We'll do our best. Just
10 one other thing, if you look at this complexity
11 and how this completion translates into the
12 market I think here's a great graph that shows
13 are receipts for CSX at 170 percent. I want to
14 take one minute real quickly with the remaining
15 about my time to address an earlier conversation
16 from the Panel about some spread changes that CSX
17 has made. And I want to be very clear about what
18 that is just for the purposes of this. And
19 origin spread change as we see it, it's a car
20 grain pricing A plus, B pricing. The A portion
21 of it is the origin grain spread and that's the
22 rate from the origin elevator to Columbus, Ohio,

1 that's the A portion. The B portion is the rate
2 from Columbus to the designation.

3 The A portion of the rate which is
4 being discussed in terms of the origin spreads
5 represents less than 25 percent of the through
6 rates and that A portion has not been touched by
7 CSX in 15 years. So there have been changes to
8 shoreline economics, there's been changes to
9 productivity within CSX costing, there's been
10 changes within the shoreline industry as I said
11 and just things that have really evolved that we
12 needed to address that. I think before you can
13 make any assumptions on that we have to look
14 through toll through transportation and the rates
15 that have changed on that. So just keep in mind
16 as we talk about origin spreads that is a
17 significant factor.

18 Number two, not to confuse origin
19 spreads with capital investment and incentives of
20 our origin elevator or destination feed mills to
21 grow. Because we have encouraged investment in
22 feed mills and those investments are separate

1 from the origin spreads. We offer anywhere from
2 15 to 18 percent rate discounts for facility
3 developments through rate encouragement and we
4 also have express load incentives that offer
5 additional rate incentives to be efficient and
6 load quickly and that can amount to a 2 to 4
7 percent of the rates. So keep those separate in
8 your mind also. And really, what I really want
9 to address is process, because we did change
10 those origin spreads but we want to be very clear
11 on the process associated with doing that.

12 We announced these changes back in
13 April and we did give a 45 day kind of discussion
14 period with our customers, with our shoreline
15 partners to give them an opportunity to discuss
16 with us how those changes were going to impact
17 them, should things be done differently and we
18 encouraged and did discuss with every major
19 agriculture customer across CSX about how it
20 should evolve. After that 45 day period, we did
21 reissue the spreads and they were different than
22 what the spread was in April. So when you talk

1 about process I want to make sure that we're very
2 clear that we implemented that process to take
3 feedback from our short lines, from our customers
4 and then secondly we gave six month notification
5 that come October 1 is when those changes were
6 going to go in.

7 People can argue that that wasn't long
8 enough or that was too long, I don't know what
9 the right answer to that is, but six months
10 appears reasonable from our perspective to
11 prepare yourself for some of those economic
12 changes. So thank you very much, I appreciate
13 it.

14 CHAIR MILLER: Thank you.

15 MR. CLEMENTS: Thank you and I'm
16 grateful today to be in front of the board with
17 an opportunity to present the comments of
18 Community and Pacific Railway Company on its own
19 behalf and also on the behalf of Soo Line Railway
20 Corporation, Delaware and Hudson Railway
21 Corporation and Dakota, Minnesota and Eastern
22 Railway.

1 My name is James Clements, I'm the
2 vice president of strategic planning and
3 transportation services at CP. I have over 20
4 years of experience at CP and I think most
5 relevant to this hearing includes more than three
6 years in various roles in our Canadian grain
7 marketing and sales group and another three years
8 as the director of our US grain marketing and
9 sales team.

10 Today I will specifically be
11 addressing the proposal made by the National
12 Grain and Feed Association in this proceeding
13 that the board shall consider the revenue and
14 cost of CP's combined US and Canadian system
15 operations when determining revenue adequacy and
16 the reasonableness challenges of grain shipments.
17 I will note that the issues raised by the NGFA
18 proposal and my remarks apply more generally all
19 of the CP's business as well. In terms of policy
20 issues, the NGFA proposal is bad policy, it
21 focuses only on the immediately allegedly
22 positive impacts on revenue adequacy

1 determinations for the purposes of making it
2 easier for US grain shippers to obtain rate
3 prescription from the STB and fails to take into
4 account the unintended and adverse policy
5 implications.

6 Firstly, this proposal would distort
7 the measure of financial health of the US rail
8 operations and undermine the board's ability to
9 regulate effectively the rail operations subject
10 to its jurisdiction. In 2001 deliberations
11 regarding consolidating reporting for commonly
12 controlled class 1 carries, ex parte 634, the
13 board recognized that due to different regulatory
14 and labor regimes in Canada and the US which can
15 effect cost structures and earnings of railroads
16 and require the report their non US operations
17 may distort the operations subject to the board
18 regulation and to avoid that distortion the board
19 confirmed it would continue to require reporting
20 only on rail operations within the United States.

21 Secondly, the proposal makes US
22 regulatory decisions sensitive to Canadian

1 regulatory decision and the economic environment
2 in Canada. If the regulatory and economic
3 conditions in Canada create superior financial
4 performance for the Canadian rail entity, this
5 proposal would essentially amount to cross
6 boarder subsidies to the US shippers. Similarly
7 if those conditions create inferior financial
8 performance for the Canadian rail entity the
9 proposal would make it more difficult for the US
10 shipper to obtain a rate prescription. Consider
11 a situation where there is an adverse Canadian
12 regulatory situation that lowers the rates for
13 moving Canadian grain and negatively impacts CP's
14 financial performance in the Canadian entity.
15 That regulatory change could than have a negative
16 effect on the revenue adequacy calculation for
17 the US grain shippers and making it harder for
18 them to obtain rate relief.

19 The end result is that the US grain
20 shipper would get a competitive disadvantage, in
21 some ways you could say it's a double
22 disadvantage because you had a decrease in Canada

1 and now no access to rate relief on the US side
2 at the same time. Thirdly the NGFA's proposal
3 could penalize and discourage corporate
4 structures that enable railroads to provide more
5 efficient cross boarder service and realize
6 economies of scale. Consolidation of management,
7 back office and other functions translates into
8 lower cost for operating entitles on both sides
9 of the boarder. These lower costs are reflected
10 in the US operating entities data reported in the
11 R1 and in turn flow through to the revenue
12 adequacy determination.

13 Finally, the proposal is
14 discriminatory as it focuses only on CP and CN.
15 It ignores performance of the foreign operations
16 of railroads affiliated with other class 1
17 railroads. A summary of the difference in the
18 Canadian and US regulatory environments highlight
19 the potential that Canadian could discourage US
20 regulatory determinations under the NGFA
21 proposal. CP is subject to differences in labor
22 laws in Canada and the US and the differences in

1 those laws and other regulations mean we have
2 different work rules and separate labor
3 agreements for US and Canadian workforces. The
4 result is that the cost structure and nature of
5 the operations in Canada are different from the
6 US operating entities, likewise the potential
7 financial and operating impact of labor disputes
8 in the two countries differ.

9 The approach to rail policy and
10 regulation in the two countries is radically
11 different. The Canada policy objectives stress
12 the need for competition to achieve the lowest
13 total cost for all modes of transportation and to
14 advance the well-being of Canadians, irrespective
15 of the impacts on the rail industry. There is
16 not explicit provision in Canadian legislature or
17 supporting regulation to review and consider rail
18 revenue adequacy. Canada tends to take a more
19 heavy hand to regulation than the US.

20 Regulatory differences are evident at
21 the technical level as well. CP does report
22 separate ledgers of the relevant entities under

1 both the Canadian uniformed classification of
2 accounts, the US uniformed system of accounts and
3 for tax treatment in Canada and the US. These
4 differences can have material impacts on the
5 reported company's finances. For example, in
6 Canadian regulatory accounting pensions and other
7 employee benefits are recognized on a cash basis
8 as opposed to an accrual basis in the US. The US
9 rail regulation has been fairly stable in the
10 post staggers area. In contrast, in this same
11 period the Canada rail regulation has experience
12 numerous significant changes. In fact, the
13 Canadian Transportation Act mandates regular
14 comprehensive reviews of the act. Such a review
15 by the federal government is currently underway
16 and recommendations for change are due in
17 December.

18 The changes could affect any component
19 of the law or regulation and with the NGFA
20 proposal could then flow down into determination
21 in the US market. Most significantly on a
22 regulatory basis the regulation of Canadian grain

1 for the movement to export positions is done
2 under the form of a maximum revenue entitlement.
3 This is adjusted annually to reflect changes in
4 input prices and also the volumes moved by the
5 railways. There's also significant economic
6 differences between Canada and the US, at the
7 highest level Canada has a population similar to
8 California and is the second largest country in
9 the world by area. So as result we are very
10 sparsely populated country and very heavily
11 dependent on primary resource industries like
12 mining and agriculture.

13 We also have a relatively small
14 domestic market leading to a much more focused
15 movement towards export markets. The other
16 factor is there's a different currency involved
17 and currency fluctuations can correct two types
18 of variability. This creates changes in the
19 measured financial report performance of CP and
20 its entities as reported in Canada dollars, and
21 these changes can also affect the relative
22 competitiveness of Canada and CP based customers

1 that are export oriented. CP's transportation
2 mix reflects the export orientation of the
3 Canadian economy. Similarly in the context of
4 the NGFA proposal there are other market
5 differences focused in the grain area. US
6 produces eight times as much cereals, coarse
7 grains and oil seeds than Canada does, but Canada
8 exports a much higher proportion of those.

9 For example, Canada exports of these
10 crops were one-third the value of the US exports
11 even though there was eight time the production
12 in the US. In our franchise we have about
13 290,000 car loads of Canadian grain, 75 percent
14 of that moves to export. In the US we have about
15 170,000 car loads of grain and about 28 percent
16 of that moves to export, so again you can see the
17 significant differences.

18 Finally, there are issues of what I
19 would call reporting integrity and implications
20 that CP made artificially understate the revenue
21 adequacy of its US operations. CP offers a
22 highly integrated transportation service in North

1 America to its customers and this high degree of
2 integration requires centralized management that
3 benefits the entire CP network. There are
4 functions that exist within CP in Canada that
5 provides serves to the entire CP network and the
6 -- both in Canada and the US. CP consistently
7 uses the services cost method in accordance with
8 the IRS treasury regulations section 1.482-9B to
9 allocate head office cost that benefit the US
10 operations. Canada has similar tax regulations
11 requiring such allocations. In accordance with
12 our intercompany policies, we have an internal
13 transfer pricing committee and we follow
14 consistent practice from year to year for the
15 allocation of these management services cost. We
16 have undergone tax audits from both the Canadian
17 and US tax authorities to ensure that such
18 allocations have been reasonable made.

19 As a check, we also look at the
20 operating ratios of the Canada and US entities to
21 ensure that they're reasonable and we will
22 investigate any unusual variance and you might be

1 interested to know that somewhat similar to
2 evidence that we saw from the NGFA in 2013 the
3 Canadian entities operating ratio were slightly
4 higher than the US entities operating ratio.
5 Finally I just want to make a brief comment on
6 the jurisdiction, the proposal by the NGFA is
7 fundamentally inconsistent with the statute
8 authority of the STB and its mandate and the STB
9 lacks jurisdiction over rail transportation in
10 Canada. The NGFA proposal ignores the long term
11 negative implications of making US shipper access
12 to rate relief dependent on the rail operations
13 in Canada. It's an effort to manipulate revenue
14 adequacy and again, we think it is neither lawful
15 or in the interest of US rail carriers and
16 shippers. Thank you.

17 CHAIR MILLER: Thank you. Apparently
18 Vice Chairman Begeman didn't hear the part about
19 turning off your cell phone.

20 MR. KALICK: Chairman Miller, Vice
21 Chairman Begeman, good afternoon. I'm Ted
22 Kalick, senior US regulatory counsel for CN and

1 I'm happy to be here this afternoon. CN joined
2 in the comments today of the AAR and a we ago
3 many of the comments of our rail colleagues with
4 regard to the importance of maintaining sound
5 rail economics as a basis for evaluating
6 reasonableness. CN is here today like CP to
7 address the question raised by the board in its
8 notice of quote, whether the board should
9 consider the revenues and cost of Canadian
10 carriers full system operations to include the
11 parent company and subsidiaries when determining
12 revenue adequacy and rate reasonableness
13 challenges of grain shipments.

14 Just to make a couple of points and a
15 contextual point at the outset. Echoing Mr.
16 Scheib's comments, if the board were to look into
17 revenue adequacy in this situation it is
18 premature. The board should be looking at that
19 issue holistically, not piecemeal and it has
20 proceeding as you well know, set up to do that in
21 July. There really is nothing you can see from
22 this record or the testimony that would somehow

1 require grain to be treated differently in that
2 context if the board were to undertake that
3 examination. There was a legal point to make
4 that Mr. Clements just made and that is that the
5 board's jurisdiction is confined to
6 transportation in the United States. What does
7 that mean really when it comes down to it? It
8 means that if you were to order apparent Canadian
9 company to provide reports on its Canadian
10 revenues and cost for its Canadian operations, we
11 respectfully submit that that would exceed the
12 board's jurisdiction.

13 But I think the important point here
14 and it may be equally important with the
15 jurisdictional point is not whether you can do
16 that but whether you should do that. And there
17 the board has looked at that matter before in the
18 ex parte 3634 proceedings some years back when it
19 ordered commonly controlled US railroads to file
20 consolidated reporting. And the issue was raised
21 there, whether Canadian information should be
22 included in that report and the board found that

1 it would distort results. There really has been
2 nothing since then to my knowledge or anything
3 presented today that should change that result.

4 We'd also suggest that it's really
5 important for reasons of regulatory economy as
6 well that it would be imposing different and
7 overlaying reporting requirements on carrier
8 operations regulated in Canada would be an
9 inappropriate intrusion into Canadian rail
10 regulation. It would wrongly impose regulatory
11 requirements from cost on entities properly
12 subject to Canada's rail regulatory regime it
13 could create new regulatory coordination issues
14 as Canadian regulators must take into account
15 relief granted by US authorities based on
16 conditions in Canada and it would in the end, I
17 think be generally viewed as an attack on the
18 control of Canadian authorities over entities
19 delivering rail service within Canada. And as a
20 matter of regulatory economy we would
21 respectfully submit the board should avoid this
22 court.

1 Lastly, Mr. Crowley's presentation
2 this morning on making the request to include
3 Canadian information had a chart comparing
4 revenue adequacy determinations in the US and
5 other information gathered suggested that revenue
6 inadequacy carriers in the US, CN, CP. He had
7 posed would be found revenue adequacy if in the
8 fact the Canadian information was included. I
9 would just point out that in 2013 CN and its US
10 operations under GTC Corporation was found
11 revenue adequacy. Before some of my rail
12 colleagues tried to lasso me out of here I would
13 be remised to say that one year's finding of
14 revenue adequacy is not, in our judgment a
15 determination that a carrier is revenue adequacy
16 over the long haul which I think is the way that
17 the board should be looking at that. And I would
18 certainly predict in advance that CN and other
19 shipper interest are likely to disagree of
20 revenue adequacy in looking at the reasonableness
21 of individual rail rates. But I point that out
22 that there's really nothing that has been pointed

1 out about the board's calculation today, the way
2 it calculates revenue adequacy today. The inputs
3 that go into that calculation that were in error
4 so that the determination of CN was revenue
5 adequacy in 2013, was an error.

6 When you contrast that to the risks
7 and the cost I think that are involved in trying
8 to add additional information that's post both
9 jurisdictional and other elements, that is
10 another reason why the board should not consider
11 that information or require that kind of
12 information in its consideration. I'll be happy
13 to try to address any questions you may have.

14 CHAIR MILLER: Thank you all very
15 much. So I want to follow up on a couple of the
16 questions related to the Canadian issue and, sir,
17 I appreciate that. We have our hands full trying
18 to be the regulator on the American side of the
19 boarder. We certainly don't want to slip over
20 and try to regulate on the Canadian side. But
21 when this issue of revenue adequacy and the
22 companies come up I'm not asking this question to

1 imply any determination having been made up in my
2 mind, it's just a curiosity in some ways as I
3 think about it. As I understand it, your
4 companies, I mean you operate holistically, is
5 that correct? I mean, you don't have an
6 American operation with personnel and bookkeeping
7 and administration and all of that in the
8 Canadian, it is one company. Is that a correct
9 understanding?

10 MR. CLEMENTS: Yes, for the most part
11 that would be correct.

12 MR. KALICK: And it's true for CN as
13 well. Legally we are organized differently.

14 CHAIR MILLER: So broadly if you're
15 looking at whether or not the company is
16 operating at a revenue adequacy level it feels
17 like, you know, one has to holistically look at
18 the company?

19 MR. CLEMENTS: Well, that's why I made
20 the comments about there are standards in both in
21 Canada and the US about allocation of common
22 costs if you want to call them that.

1 CHAIR MILLER: And how you allocate
2 from the US to versus Canada.

3 MR. CLEMENTS: With financial
4 statements and the R1.

5 CHAIR MILLER: Uh-huh.

6 MR. CLEMENTS: Everything that is
7 consisted with the appropriate guidance on
8 transfer pricing and cost that we can allocate to
9 the different entities. As I said, we have
10 policies internally, we've been audited by the
11 tax authorities and we follow a number of
12 standards. So we do report through the results
13 in the US that are related to the operations in
14 the US through Soo Line Corporation. That has
15 all of our US operations incorporated into it and
16 reflects some of those head office costs.

17 The point I'd also make is that by
18 operating as a common entity and then having
19 these cross boarder allocations for tax purposes
20 and regulatory reporting we can be much more
21 efficient than if we had to have two accounting
22 departments.

1 CHAIR MILLER: Oh sure.

2 MR. CLEMENTS: Two engineering
3 departments and everything else. So those
4 benefits, because we can create those cost
5 efficiencies and then allocate a portion of that
6 through the US gives you a better result than you
7 would otherwise with duplication.

8 CHAIR MILLER: I'm wondering after we
9 had the presentation this morning from Dr.
10 Schmalensee on the TRB proposal and one of the
11 things they focused on was the issue of
12 arbitration and final offer arbitration I think
13 is what he called it and referenced the Canadian
14 approach. If you all have any comment about
15 that.

16 MR. CLEMENTS: You are probably
17 talking about one of the few people in the room
18 that's participated in a Canadian final offer
19 arbitration. The biggest thing or the first
20 thing I'd say is that it's a very contentious
21 process, in some ways if you look at the design
22 it's baseball style arbitration so there's offer

1 A and offer B. The arbitrator in the Canadian
2 process does not have the ability to say these
3 elements are good from this offer and you can't
4 pick and choose and they can't actually find a
5 middle ground.

6 CHAIR MILLER: Yes, that's the way I
7 understood from our discussion with TRB, that was
8 their proposal as well.

9 MR. CLEMENTS: Yes. What that does is
10 creates a lot of tension, a lot of animosity
11 where really you should be looking at trying to
12 create a solution between you and the customer in
13 a more, I'd say standard arbitration process
14 where the arbitrator is trying to help the two
15 parties come together or find a solution to the
16 problem at hand. We've said this in the Canadian
17 regulatory proceedings, there's no test about
18 competition and market dominate so you can end up
19 in final offer arbitration when there's alternate
20 modes, competing railroads and a number of
21 factors. I think, without having some kind of
22 test, you can create unneeded final offer

1 arbitration and then end up in a very aggressive
2 situation with a customer. So it's not ideal, if
3 you want to say that.

4 MR. KALICK: I would concur with Mr.
5 Clements so I don't have firsthand experience
6 with participating in an FOA, I certainly know
7 from my colleagues the difficulties with
8 processing. The only thing that I would add is
9 that at the end of the day there really no
10 standards attached. You essentially get a one
11 line answer as to what the rate is and so there's
12 no explanation, so there's consistency, it's not
13 really rooted in any kind of sound economic
14 policy. One case may weigh some evidence one way
15 but there's no kind of coherent whole into how to
16 fairly evaluate what the right rate should be.

17 MR. HITCHCOCK: If I could elaborate
18 on that from an invest perspective. I listened
19 carefully to Dr. Schmalensee this morning. I
20 understood him and the TRB to be indicating that
21 anything that would require arbitration of rates
22 would be require legislation and I have to agree

1 with that and I believe it took legislation in
2 Canada to get to that result. So the parties
3 today who have been suggesting that the board
4 should pursue mandatory arbitration really are
5 kind of in the forum respectfully. And then I
6 would like to echo what --

7 CHAIR MILLER: I'm sorry, would you
8 say that again?

9 MR. HITCHCOCK: It is in the wrong
10 forum, they should be up on Capitol Hill if
11 that's their goal and not asking the board to do
12 something that would require legislation. I'd
13 like to echo something that Ted Kalick just said
14 and that is we heard a lot of arbitration today.
15 We heard nothing about standards except from the
16 gentleman from Burlington Northern Santa Fe.
17 Every arbitration I've ever been in and I've been
18 in a lot of commercial arbitrations in 30 plus
19 years, has applied some legal standards, tort
20 case, was the defendant negligent, a contract
21 case, was there a meeting of the minds, another
22 contract case, what is the measure of damages as

1 contract law provides. An arbitration that takes
2 place without a standard, it's a small claims
3 court or worse television court. I mean, you
4 have to have a standard if you're going to have
5 any kind of a justified result.

6 Lastly, that standard needs to be
7 economically based. If a standard for rates is
8 not economically based than it's simply a matter
9 of somebody's judgment about what's fairer to one
10 party and fairer to another party. And how one
11 would ever define that concept is beyond me.

12 CHAIR MILLER: Well, I guess in some
13 ways whether we're using arbitration or not isn't
14 that what the board's asked to do in many cases
15 is to determine an economically based rate.

16 MR. HITCHCOCK: Absolutely. The board
17 is a governmental authority, it's invested with
18 the power to transfer from funds from one private
19 entity, a railroad to another private entity, the
20 shipper in the event that it finds that a rate is
21 not reasonable. So yes, the board does make that
22 determination but they're not a private

1 arbitrator, they're an official of the
2 government, they're taking a government action
3 subject to review and above all it is subject to
4 a standard which is today the gold standard for
5 what is an economically appropriately rate in the
6 event of market dominance and that's standing one
7 cost.

8 MR. CLEMENTS: And I'll just add in
9 the Canadian side and final offer arbitration,
10 Mr. Hitchcock is exactly right, there is no
11 mandate that there is an economic basis or any
12 theory. It is the determination of an arbitrary
13 of what is the most fair of the two offers with
14 no other guidance or no other input. Clearly
15 parties will make arguments around economics and
16 other factors is to their proposal, but that is
17 not a specific mandate of the arbitrator and in
18 fact one of the other flaws is the arbiters often
19 don't come from the rail industry, don't have any
20 understanding and so you can have somebody making
21 on a very arbitrary basis a decision in economic
22 and regulatory type decision with no expertise or

1 understanding of the industry and it can create
2 considerable inconsistency in the decisions that
3 come forth because you get in somewhat what
4 arbitrator you end up with and what do they think
5 and what are their individual personal
6 philosophies.

7 CHAIR MILLER: It's been interesting
8 today though how often arbitrations come up and
9 how many different witnesses have mentioned it in
10 one way or another. So I wonder if arbitration
11 would be a feasible decision making approach if
12 one did fully define the standards to be used and
13 address some of the issues that you found to be
14 lacking in the Canada system.

15 MR. CLEMENTS: I'd say that is
16 reasonable if it's defined, well defined and with
17 a clear process around it. I think it creates an
18 opportunity for more efficiency and lower cost in
19 the process.

20 CHAIR MILLER: One last thing, I mean
21 I guess not really a question but one of the
22 things I found interesting in Dr. Schmalensee's

1 presentation this morning was his point that
2 arbitration was an informal way to discuss the
3 issues and these more complicated issue can more
4 easily and quickly be dealt in an arbitration
5 kind of setting, not a legal pleading setting and
6 I probably have a room full of attorneys who
7 might all have strong feelings on that, but.

8 MR. CLEMENTS: Actually, one comment
9 I had while into the Canadian piece and maybe at
10 danger of saying too much. Final offer
11 arbitration has been around for a little while in
12 the Canadian regulatory environment. They have
13 actually added an informal mediation and
14 arbitration process subsequent to creation of the
15 regulation and legislation around FOA. Which
16 wasn't mandated through legislation and because
17 of some of the concerns I think around FOA and
18 other proceedings, and that has been used a
19 number of times as well and it's a process
20 supported by the agency in Canada.

21 Dispute resolution in the context of
22 a commercial disagreement between the seller and

1 a buyer occurs only after there is a failure of
2 the parties to come to an agreement. Now, the
3 parties may fail to come to an agreement for many
4 different reasons but one reason the parties can
5 sometimes fail to come to an agreement
6 unfortunately is that one party may see dispute
7 resolution as a better alternative to a
8 negotiated settlement and therefore looks to the
9 dispute resolution process as a better result.

10 VICE CHAIR BEGEMAN: I have a few
11 questions. You asked what I was really
12 interested in with respect to the Canadian
13 system. So how does the arbitrator get picked?

14 MR. CLEMENTS: In the final offer
15 arbitration or the other one?

16 VICE CHAIR BEGEMAN: Yes.

17 MR. CLEMENTS: There is submission of
18 proposal, and I may not get this exactly right,
19 proposed arbitrators by both parties. There is a
20 common recommendation on arbitrators than there
21 is usually the agency will pick that or appoint
22 that person. If there's a failure to have some

1 commonality there's a bit of a negotiation
2 between the agency and the two parties to try and
3 determine who is going to be the arbitrator for
4 the process.

5 VICE CHAIR BEGEMAN: How long has the
6 process been in effect for Canada?

7 MR. CLEMENTS: I can't remember
8 exactly iteration of Canadian --

9 VICE CHAIR BEGEMAN: It's been awhile?

10 MR. CLEMENTS: I think it was since
11 '87 but let me confirm that back to you.

12 VICE CHAIR BEGEMAN: Okay. Between
13 the two carriers, has it been used against one of
14 you more than the other?

15 MR. CLEMENTS: The process of final
16 offer arbitration is supposed to be completely
17 confidential, even the specific cases.

18 VICE CHAIR BEGEMAN: Oh.

19 MR. CLEMENTS: Yes, so we don't really
20 know specifically what has happened with a
21 Canadian National Case and they don't know
22 specifically what's happened with us.

1 VICE CHAIR BEGEMAN: I understand.

2 MR. CLEMENTS: So I can't comment.

3 VICE CHAIR BEGEMAN: There's not a way
4 to find out how much it's utilized?

5 MR. CLEMENTS: No, unless the agency
6 would share it with yourselves on a confidential
7 basis.

8 VICE CHAIR BEGEMAN: Oh, that's
9 interesting. I'll stay with you, Mr. Clements,
10 because of some the discussions that kicked off
11 about URCS and subjective cost allocations, et
12 cetera, when you talked about the cost
13 allocations between your operations in the US and
14 Canada, I assume that they are robustly and
15 accurately accounted for?

16 MR. CLEMENTS: There's tax law in
17 particular that prescribes what you can and can't
18 do and you have a logical and sort of
19 methodological approach that they agree with on
20 the allocation of those costs. And like I said
21 there is audits and we've been subject to tax
22 audits. So yes, I would say it's a little more

1 robust.

2 MR. HITCHCOCK: If I could comment on
3 the URCS discussion. URCS got a pretty bad rap
4 this morning.

5 VICE CHAIR BEGEMAN: It did.

6 MR. HITCHCOCK: Let me first say that
7 I'm an economic regulation lawyer but not an
8 economist but it seemed to me that Dr.
9 Schmalensee and Dr. Gray were not that far apart.
10 Now, it sounded very much like it but what I
11 understood Dr. Schmalensee to be saying that
12 there is no economic construct that you can apply
13 to a costing system that will support the
14 decisions that have to be made in coming to a
15 costing system. Now, any costing system takes a
16 set of total expenses of an enterprise or an
17 organization and attempts to break those down
18 attributing some portion of those cost to certain
19 activities and that's a very effective way for
20 management to make evaluations of what decisions
21 it should be making internally, should they be
22 producing this product, increasing its production

1 of another produce, all kinds of industries use
2 cost accounting for managerial purposes.

3 So there is, from an economist
4 standpoint at Dr. Schmalensee was looking at it,
5 there is an arbitrariness to anytime that you
6 take the railroads R1 expenses and start trying
7 to decide how should they be allocated here or
8 here or here, what part of them should be
9 consider capital, what should be considered
10 maintenance, what parts should be considered just
11 the very barest of incremental cost, what should
12 be sort of a marginal cost in a longer term
13 basis. They are judgmental but they're not
14 wholly arbitrary. They might not have an
15 economic foundation which is Dr. Schmalensee's
16 point. But as Dr. Gray said there is value in
17 them. They are, if not perfect they are
18 directionally helpful in making management
19 decisions including making regulatory decisions.
20 Can any costing system when it involves decisions
21 about how to allocate cost be made better,
22 absolutely, no question about that.

1 But and you heard the experts
2 including Mr. Crowley agree with that I think.
3 You know, it could be made better but I don't
4 think that the two of them were in such violent
5 disagreement as it might have appeared because
6 they were looking at URCS from two different
7 standpoints.

8 CHAIR MILLER: So I might be
9 addressing this question to sort of the wrong
10 group, maybe this is more of a shipper group, but
11 I've appreciated Vice Chairman Begeman's point
12 that she's made several times today that really
13 our purpose here shouldn't be to try to
14 understand our grain rates too high but rather is
15 the process available to grain shippers. And I'm
16 wondering how you all would address that from
17 your various perspectives and your railroads
18 experience?

19 MR. SCHEIB: I'd be happy to take a
20 crack at it.

21 VICE CHAIR BEGEMAN: Surprise us,
22 John.

1 MR. SCHEIB: I'll be happy to take a
2 crack at it but, you know, Pat and I were having
3 a side bar about Mr. McNulty's presentation
4 because, you know, similar to CSX we serve those
5 chickens with those same operations. And we're
6 not sure we can leave a better imprint on you
7 other than maybe standing up and doing the
8 chicken dance. With that said --

9 CHAIR MILLER: I'd like to see it.

10 MR. SCHEIB: That said, I think
11 there's a simple reason why you're not seeing
12 grain rate cases. If you look at our highly
13 confidential filing you will see what our average
14 R/VC ration is and you will see the substance
15 percentage of our traffic that moves below 180
16 percent. Add into that fact that the remainder
17 of our traffic a very high percentage, which we
18 would be happy to provide to you highly
19 confidentially, a high percentage of our traffic
20 moves under confidential contracts. There's just
21 not a lot of traffic that would even meet the
22 jurisdictional threshold for you have to rate

1 case from us.

2 Add into that fact all the indirect
3 competition that Pat's talked about that's
4 surprising those rates and I just don't think
5 you're going to see one, you know, regarding
6 Norfolk Southern.

7 MR. HITCHCOCK: There was a consider
8 amount of criticism of the three benchmark test
9 and certainly CSX has plenty of criticisms of the
10 outcomes of those test and the size of the awards
11 that are available, but the law is the law, we
12 accept that. I would just like to point out that
13 by my count seven traffic lanes have been
14 challenged so far since the board adopted its
15 three benchmark test. Six of those involve CSX
16 going from memory, one involved Union Pacific.
17 CSX was successful in defending one of those
18 lanes that was challenged because the vast
19 preponderance of the business had already been
20 moving for some time by barge. Direct head to
21 head competition and were successful in having
22 that dismissed of no market dominance.

1 We lost the remainder of those lanes;
2 Union Pacific lost its lane so by my count
3 looking at lane by lane challenges by shippers
4 using the three benchmark test the score is
5 shippers seven, railroads one. Now, if I've
6 miscounted I stand to be corrected but I'm not
7 far off I don't believe.

8 MR. CLEMENTS: In terms of the system
9 I first would look at the CP system and say
10 competition is alive and well. You've had a
11 number of people testify that grain gets a truck
12 before it arrives in an elevator and if you look
13 at the regions of the states that we service
14 there's competing elevator on another system or
15 ethanol plants and other processing that overlays
16 the entire production territory that we serve in
17 the US. So I think you've got a strong market
18 base system that is setting the rates across our
19 network. We haven't put in evidence on the R/VC
20 and we haven't done a recent analysis but, you
21 know, there's a very strong competitive
22 environment.

1 If there is any opportunity for
2 improvement, I've heard the comment of the very
3 small shipper and, you know, I'd echo those that,
4 you know, their perception is their reality and
5 so there's always opportunity to improve. And I
6 think the efficiency and the access and the cost
7 to expeditiously deal with the complaints of the
8 small shipper. The large shippers are
9 sophisticated multinationals, they have as many
10 resources as any of the railroads and I think
11 have the capability if there's a concern that
12 they have with their rates to bring forward
13 complaints.

14 CHAIR MILLER: Anything to add?

15 MR. KALICK: No, I think I would just
16 go with some of Mr. Scheib's points. There are
17 forces out there whether the board considers them
18 or not on rate matters. They keep rates at
19 competitive at levels, I think that may be a
20 reason, you know, why you don't see as many rates
21 cases as you do. In terms of process, you know,
22 I think like the rest of the railroads I think

1 we're all interested in making a process that
2 works for you, in essence to serve your
3 objectives. I think at least a discussion with
4 regard to final offer arbitration as discussed
5 this morning by the professor and I don't want to
6 mangle his name, but, you know, I think leaves a
7 lot to be desired. It's something to look into
8 as certainly based on the Canadian for a way.
9 It's not in good process for the reasons we've
10 discussed. If there's something in between that
11 can, let's say, improve the current system and
12 make it more accessible I think the industry is
13 open to considering that.

14 I think we have to be careful of
15 arbitration. I know in terms like informal
16 arbitration as compared to regular arbitration
17 leads a lot, you know, to be defined. I think I
18 can speak for myself, my own involvement at
19 commercial arbitration with CN, arbitration can
20 approach full blown litigation, whether we're at
21 the board or in court. It really depends on the
22 process and the rights that are involved in

1 arbitration, including the right to discovery.
2 You can have an arbitration proceeding that lasts
3 a long time and there are fairness reasons to do
4 that. At least with regard to moving through
5 arbitration, I think it needs to be studied
6 pretty carefully.

7 VICE CHAIR BEGEMAN: Well, one of the
8 benefits that all of you have on that side of the
9 dais is that, starting with BNF's conversations
10 with the National Grain and Feed Association and
11 the idea of getting other carriers to
12 participate, et cetera, and then everyone
13 discusses the development of an agreed upon
14 process and what the criteria for both sides
15 would be and how it would be judged. You have
16 the ability to more freely have those
17 conversations than we can. We would love to just
18 sit down and talk with you all together about
19 what would work. Unfortunately, that's not
20 reality at this point for us. But to any extent
21 dialogue and efforts in the private sector can
22 bear fruit, and then you can bring it our way,

1 we're certainly interested. Again, we're just
2 trying to help the small shipper. You said it
3 best, the perceived problem is that he feels he
4 has a problem, that he or she has nowhere to go.

5 MR. SIMONIC: Vice Chairman Begeman,
6 you know, we've listened to your inquiries this
7 morning about are there things that we can do
8 and, you know, if you look at the record one of
9 the things there seems to agreement on is some
10 sort of nonbinding mediation. We talk to our
11 customers all the time so I don't know how fruit
12 nonbinding mediation will be because it seems to
13 me to be just kind of a replay of what we do
14 every day with our customers but certainly
15 there's an agreement in the record that that
16 might be something to look.

17 There are other things in the record
18 that there's an agreement to look at discarding
19 the limit price test. Universally, every party
20 that's filed has said we should get rid of that.

21 VICE CHAIR BEGEMAN: I think you know
22 my position on that one.

1 MR. SIMONIC: I think we've read it
2 yes. Reconsidering moving specific adjustment is
3 another one has agreement across the filings.
4 The same is true with sort of reaffirming what
5 the statute already tells us in 49 USC 17701B
6 about who can bring Complaint. So there are
7 areas, if you look at those pleading where there
8 does seem to be some agreement on issues to move
9 forward.

10 VICE CHAIR BEGEMAN: Thank you for
11 kind of consolidating that.

12 CHAIR MILLER: Thank you for reading
13 the record. Any more questions, Ann? Thank you
14 all very much.

15 VICE CHAIR BEGEMAN: Appreciate it.
16 And Tim, thanks for great testimony, you kept us
17 going.

18 CHAIR MILLER: I want to meet that
19 chicken. Okay. Panel number VII if you could
20 forward, it's the alliance for rail competition,
21 Terry Whiteside, Mr. Fauth and John Cutler. I
22 don't see Terry Whiteside, oh. Okay. Welcome, I

1 think we'll get started. So Mr. Cutler, can I
2 assume by the way you're lined up there, you're
3 our leadoff. Oh, going the other way. Oh, we're
4 mixing it up. That's good. We're late in the
5 day, let's change it around. Mr. Whiteside,
6 we'll start with you.

7 MR. WHITESIDE: Thank you. Chairman
8 Miller and Chairman Begeman; thank you for
9 inviting us and also for lasting all day. I wore
10 a bright shirt so that you would --

11 CHAIR MILLER: And we appreciate it.

12 MR. WHITESIDE: -- and my baseball tie
13 just to make darn sure that, anything about being
14 this late is number seven is one before number
15 eight and that's the end of the day, so. We want
16 to thank you for holding the hearing. I was
17 reading a book last night called Railroads and
18 the Granger Laws from 1830 through, he gave it to
19 me, he wanted me to do something for the evening.
20 It's all about the act to regulate commerce back
21 in 1887; and it was the Grangers that brought
22 about such actions. Here we are, a long time

1 from there and we're here for the same reason.

2 Why is it so important for grain to be
3 singled out? That's been asked all day. Let me
4 share one with you. The grain producers bear the
5 cost but they don't pay it; and that's what makes
6 them unique.

7 CHAIR MILLER: Say that again? They
8 bear the cost?

9 MR. WHITESIDE: They bear the cost of
10 the transportation, but they don't pay it. It's
11 paid by the elevators or the merchandisers and
12 that's what makes this whole proceeding unique
13 because that's what elevates this to the point
14 where they need some help. The Board in the
15 hearing process you're going to be holding on
16 7/22 and also 7/11, competitive access, this has
17 encouraged captive shippers and producers who are
18 earners of the freight and practices, but not the
19 payers to look positively towards future
20 regulatory remedies. My name's Terry Whiteside,
21 I'm the principal of Whiteside and Associates in
22 Billings, Montana. I have previously submitted

1 opening and reply verify comments in this
2 proceeding.

3 I also serve as the Chairman for the
4 Alliance of Rail Competition and represent and
5 appear on behalf, and I'm going to list the names
6 because they want to hear their names on your
7 video broadcast. Montana Wheat and Barley, the
8 Alliance for Rail Competition, Colorado Wheat
9 Administrative Committee, Idaho Barley, Idaho
10 Grain and Idaho Wheat Commission, Minnesota Corn
11 Growers and Minnesota Farmer's Union. Montana
12 Farmer's Union, Nebraska Corn Growers, Nebraska
13 Wheat Board, North Dakota Corn and North Dakota
14 Farmer's Union, Oklahoma Wheat Commission, Oregon
15 Wheat Commission, South Dakota Wheat Growers and
16 South Dakota Farmer's Union. South Dakota Wheat
17 Commission, Texas Wheat Board, Washington Grain
18 and Wisconsin Farmer's Union along with the
19 Wyoming Wheat and Marketing Committee.

20 For years, the farm producer's been
21 faced with a situation of being price takers,
22 coupled with no real negotiating power due to

1 lack of movement competition and little
2 regulatory recourse. John Cutler will talk more
3 about this in a few minutes and then the Board
4 opening in this proceeding in December of 2013
5 said, to consider what regulatory changes could
6 be implemented to insure that the Board's rate
7 case procedures are fully accessible to grain
8 shippers and provide effective relief from
9 excessive rail rates.

10 We have tried at ARC in ARC's pleading
11 in the Montana Wheat and Barley, to give you an
12 alternative; and that was the point in this
13 proceeding. The participants provided opening
14 and reply statements. I'm accompanied by John
15 and I've also got Gerald Fauth here, and the team
16 will address the seven major bullet points that
17 you asked for in your hearing. Both Mr. Cutler
18 and Mr. Fauth will explore with the Board answers
19 to these inquiries and also I was happy this
20 morning you make sure that Michael Hara got
21 introduced to the Board, because he's going to
22 have the transportation portfolio at the Montana

1 Wheat and Barley Committee; and as you know they
2 have been very active over the years.

3 So I'll not take a lot of time today.

4 I just wanted the team to concentrate in the
5 areas of expertise. I'm struck, though, by a
6 couple of the things, the railroad's responses.

7 Railroads argue that government intervention is
8 necessary to insure they earn adequate revenues.

9 But at the same time, they argue that no

10 government intervention is necessary to limit

11 their monopoly power. Now, they're doing it in

12 this proceeding; the railroads state there's no

13 need to go forward with change, anything

14 regulatory, anything with regulation in respect

15 to grain. They state that no shipper complaints

16 means no shippers and farm producers are

17 concerned. Really? Shippers are concerned,

18 that's clear from the opening reply statements in

19 the proceeding. The last major rate case on

20 grain was McCarty Farms. I know I don't look

21 that old, but I was part of that. I filed the

22 Section 229 case at the ICC that brought that

1 case on.

2 Eighteen years later, 3.2 million
3 dollars later, the farm producer received
4 adjudication both against and for the farmers in
5 that case. In our opening reply statements, we
6 made it clear why the three benchmark
7 adjudication procedures is not appropriate.
8 Gerald Fauth will discuss this further and John
9 Cutler will testify in a few minutes and talk
10 about the grain price. It's interesting, the
11 grain price is figured on the basis which
12 determines the price given to the farm producer.
13 And we saw in Fargo last year, when the service
14 kind of went in the tank, the basis got all
15 screwed up and the farm producer lost money.
16 Things such as poor service effects secondary
17 markets.

18 It isn't a matter of the rate cases or
19 the rate levels; it can be service, it can be
20 almost anything that the railroads are doing.
21 Railroads state that any change by this
22 regulatory body will transfer into greater burden

1 on railroads and price and railroads and
2 shippers. They express that the grain rates are
3 market-based. It's always humorous to me that
4 the words market-based rates are utilized to
5 describe how monopolies or oligopolies price
6 rates in markets they control. They imply that
7 today's rail rates on grain are not based upon
8 captivity or lack of effective competition.

9 Really? Well, if they truly were based upon the
10 market as the railroads claim, then when the
11 price of grain falls, shouldn't the rail-based
12 market rates fall?

13 If the demand for grain falls,
14 shouldn't the market-based freight rates fall if
15 they were built on market rates? When corn
16 doesn't move due to low prices in the
17 marketplace, do the rail rates fall? The
18 railroads even state they are there to open up
19 markets for the grain producers, yet time and
20 again we have observed in various states that the
21 railroads close off the markets they don't want
22 to a particular group of farm producers? Why?

1 To fit the operational models the railroads want.

2 For example, in Colorado, they'll
3 force the railroads down to, oh you got that
4 chair. I usually get that chair. They force
5 them to go down to the Gulf coast because they
6 don't want to take the transit times in the
7 Pacific Northwest. John Cutler will talk the
8 practice of how the railroads love to ration
9 prices in high demand or service meltdowns to
10 fulfill operational and financial goals.

11 Railroads state that they're just like every
12 other US industry. They are? Fact, the
13 railroads were given a Federal franchise to
14 operate and they were protected from competition.
15 As many courts have stated over the years, the
16 railroads are quote "greatly affected with the
17 public interest." And the Federal government has
18 seen fit when it granted these protected Federal
19 franchise to operate and operate in the public
20 interest and that regulatory oversight was
21 appropriate. That's why we're here.

22 And thus establish the ICC and the STB

1 especially captive shippers, for the protection
2 of market domination. We've talked about, you
3 heard earlier today about barley producers, the
4 inability to move shuttles, but the railroads are
5 trying to force them into shuttles. Pea and
6 lentil people, the rotational crops don't lend
7 themselves to shuttles and quick loading and yet
8 the railroads are giving them equipment that is
9 bad ordered. There continues to be rate and
10 service issues on grain in 2015, which our team
11 will discuss.

12 So when I watch all of this, I think
13 to myself, we're still here working on the same
14 problem, that's why we came up with the 2B Rules,
15 to see if we can morph this into a process where
16 we can get the farm producers and the ones that
17 are actually bearing the freight to have some
18 access. I was impressed with Mr. Miller starting
19 to think about arbitration, but arbitration isn't
20 the total answer. We've got to still have
21 something that we need to arbitrate because there
22 is a regulatory process. So I thank you, thank

1 the Board for initiating this and holding the
2 hearing and I want the team to testify so I'm
3 going to have Gerald Fauth talk a little bit
4 about the 2B process.

5 MR. FAUTH: Good afternoon. My
6 name is Gerald Fauth, I'm President of G. W.
7 Fauth and Associates, based in Alexandria,
8 Virginia. I have previously testified in both
9 the opening and reply comments and submitted
10 confidential and public versions of those. The
11 Board, as Terry mentioned, specifically invited
12 comments on several issues and I'll try to go
13 through those one by one and I'll try to be brief
14 and to the point.

15 The first one was concerning movement-
16 specific adjustments to URCS and whether the
17 Board should revisit this prohibition on
18 movement-specific adjustments, which was adopted
19 in 2007. I believe there's some form of URCS
20 cost adjustments to grain movements is justified.
21 Many grain shippers and grain product shippers
22 were hurt by the STB's adoption of unadjusted

1 URCS jurisdictional costing in 2007, under which
2 movement-specific adjustments, which more
3 accurately reflect the railroad's variable costs
4 are not allowed.

5 Since URCS, as some of the railroad
6 witnesses that made the point, since URCS reflect
7 the system average cost, movement-specific cost
8 adjustments can work both ways. Actual variable
9 costs can be higher or lower than system average,
10 which makes sense. In other words, there are
11 winners and losers and most grain and grain
12 producers would be in the loser group. Many
13 grain and grain products move in efficient
14 shuttle trains and larger than average grain
15 trainloads which represent some of the most
16 efficient and least costly movements for the
17 railroads.

18 In my opening comments, I indicated
19 the cast majority of corn and soybeans move in
20 trainloads and nearly half of wheat and ethanol
21 are moved in trainloads; which the Board
22 currently considers fifty cars. They have

1 proposed moving that number to eighty, but it's
2 still fifty. Moreover, the multiple car
3 shipments are different and they usually move in
4 larger than average trainloads. You talked about
5 gathering earlier, that's what happens with many
6 of these in Montana, these multiple car shipments
7 of up to twenty-five cars or even up to forty-
8 nine cars, moved together and are joined or
9 married into larger cars and moved, a lot of them
10 to the Pacific Northwest. That's different than
11 a multiple carload shipment of say, plastic
12 pellets, which might go in a general train. So a
13 lot of these are the same commodity, moving the
14 same place, but they are multiple car shipments
15 moving in larger trains.

16 Now, allowing for movement-specific
17 adjustments would certainly help resolve the
18 problem; however, developing such adjustments in
19 rate cases can be time consuming, costly and
20 contentious and you had to hire bad consultant
21 like me, huh, Mrs. Rinn? We'd like to know.
22 Without guidelines from the parties would likely

1 disagree on the development of such adjustments,
2 which would increase the litigation costs. The
3 issue could be dealt with by the Board's adoption
4 of simplified procedures or defined procedures
5 for the development of such movement-specific
6 adjustments which takes some of the
7 contentiousness out of it.

8 For example, one of the big economies
9 and certainly in shuttle trains is car costs.
10 These cars move in shuttle trains and they're
11 switched quickly, less than fifteen hours, moved
12 back. But in URCS costing, unadjusted costing,
13 you can reflect that. And car cost is pretty
14 simple, a pretty simple movement-specific cost
15 adjustment to make. You can take the car value,
16 the car aids, the car cycle time and develop the
17 actual car costs, car maintenance costs. And the
18 Board could look at, for example, a specific
19 formula on how you could develop movement-
20 specific car costs to remove some of the
21 contentiousness and time and cost out of the
22 process.

1 Now in order to account for the
2 problems and issues associated with URCS, I
3 propose that the Board develop and adopt grain
4 cost adjustment factors; which are different than
5 movement-specific adjustments. Such grain cost
6 adjustment factors would be similar to the so-
7 called ex parte 270 adjustments that you
8 currently use and costing multiple car and
9 trainloads. Those adjustments were developed in
10 the 1970's in the Eastern coal case and they are
11 still used today. They certainly are not
12 applicable to grain movements. Such adjustments
13 could more accurately reflect the fact that grain
14 movements generally have lower than system
15 average switching, crew costs, locomotive costs
16 and other costs.

17 They could also make an adjustment to
18 the fact that many single car movements on the
19 waybill sample are actually moved in unit trains
20 or trainloads. I don't think they're really any
21 true single car shipments anymore. If you look,
22 it might show up as a single car in the waybill

1 sample, but that car could be one of a hundred
2 and ten cars. Yet on the waybill sample, it's
3 treated as single car move and allocated more
4 cost. You'd be hard pressed to find a movement,
5 I think, in Montana, where a BN comes out and
6 switches a single car from a facility. It just
7 doesn't happen. But you'll find if you look at
8 the waybill sample, there are many number of
9 single car movements.

10 If properly developed and applied,
11 such grain cost adjustments would likely increase
12 the amount of grain and grain products traffic
13 that would be subject, potentially subject to STB
14 jurisdiction. So that's how the grain shippers
15 are hurt; they can't even get in the door because
16 of the way URCS currently allocates costs; the
17 shippers without such adjustments are barred from
18 this place. As I said, it wouldn't, if you
19 adopted such adjustments, it wouldn't require the
20 STB to reverse its position concerning no
21 movement-specific adjustments. If they'd be done
22 by commodity and by railroad and thus would not

1 be movement-specific, but for example, you could
2 do a study of BN and wheat and apply grain
3 adjustments to BN by railroad and to Union
4 Pacific. So it might vary greatly by railroad
5 and by commodity, but they wouldn't be quote
6 "movement-specific" per se.

7 The railroads maintain that URCS
8 understates the cost for hazardous commodities
9 and continues to support the Board's effort to
10 utilize URCS to more accurately cost specific
11 railroad movements as appropriate. However, the
12 railroads are strongly against piecemeal
13 adjustments or favoring grain shippers over
14 shippers of other commodities. In other words,
15 the railroads maintain that it's okay to increase
16 URCS costs for hazardous traffic, but not to
17 decrease URCS cost for grain or other low cost
18 traffic. This could be called wanting to have
19 your cake and eat it too.

20 But I want to address one point that Dr. Gray
21 brought up. I didn't listen to all the testimony
22 today, but I did listen to part of his testimony

1 and it talked about how hazardous shipments are a
2 little different, that these are phantom costs
3 that aren't in URCS. Well, all costs are
4 supposed to be in URCS. I don't know exactly
5 what type of phantom cost he's talking about, but
6 if it costs more to route a train of hazardous
7 shipments, that routing cost or clerical cost
8 would be included in URCS. Maybe a loss and
9 damage cost is included in URCS. Maybe there's
10 some insurance cost that's not, but it certainly
11 could be and URCS takes whatever they report and
12 allocates it, so I'm not really sure what he's
13 talking about, about phantom costs.

14 I would also say that URCS, like I used the
15 plastic pellets example, that grain, multiple car
16 shipments of grain does not, may not cost the
17 same as a multi-car shipment of even plastic
18 pellets, which could cost more. Because they're
19 putting a general trainload whereas these
20 gathering of multi-car shipments of grain are
21 usually put in heavier trains and solid grain
22 trains. The Board has asked whether to have an

1 expansive definition of grain; I believe an
2 expansive definition of grain is appropriate. I
3 believe, as I pointed out, if you've really
4 restricted it to just grain, you'd be looking at
5 just one commodity under grain as a STCC code
6 01013, which would exclude soybeans. Soybeans
7 are technically not a grain, but I think
8 everybody would agree soybeans should be included
9 in it and it is in most studies of grain
10 movements. But those other products, such as
11 should be included too, I mean, wheat flour, corn
12 syrup, soybean meal, even ethanol should be
13 included under grain, since these are simply
14 processed forms of grain.

15 If you look at soybean meal, it's just the
16 soybean comes in, gets crushed and comes out as
17 soybean meal; it's the same soybean, it's just
18 crushed up. It's similar to the old transit
19 movements where it comes, gets processed and
20 moves out the other side, but it's not going to
21 move out the other side unless it moves in the
22 front side first, so.

1 The Board has asked whether or not it's to allow
2 the use of nondefended traffic with R/VC rates or
3 with traffic with R/VC ratios below 180 in
4 comparison groups for grain shipments and I
5 believe they should be allowed. The R/VC comp
6 test is currently limited to the same or similar
7 traffic, i.e., traffic with R/VC's grade on 180
8 on the same railroad. For example, under R/VC
9 comp benchmark tests, the reasonable rate for
10 BNSF wheat movements moving a thousand miles
11 would likely be based on other BNSF wheat
12 movements over a hundred and eighty moving
13 similar distances. I'd like to call it the
14 similarly-screwed shippers, because you're
15 comparing other BN traffic which is priced
16 similarly to the same traffic moving the same
17 distance, generally moving to the same place. A
18 lot of this traffic moves from Montana for
19 example, moves to the PNW and so you can't look
20 at other railroads or how they price traffic
21 and/or other traffic on the same railroad moving
22 below 180 and it could be significant.

1 That restriction makes it really hard to win a
2 three benchmark case, because you're looking at,
3 they say they're looking at market-based rates,
4 but they're looking at the same market-based
5 rates, the same market. So you're comparing, if
6 they do look at market-based rates, that's what
7 they're comparing it to, so. I will note that
8 they said the railroads don't want to look at
9 other railroads, but they want, they talk about
10 the competition and market-based rates and some,
11 and that they do compete with other railroads,
12 but they don't want you to look at those other
13 railroads revenue cost ratios and for example, if
14 you looked at BN's rates or even BN's rates to
15 the Gulf compared to UP's rates to the Gulf.
16 It's the same market, they're going to the same
17 place. But you can't look at UP's rates, just
18 look at BN's rates.

19 UP doesn't have as much going to the PNW, but
20 certainly going to the export market, so if you
21 want to look at export grain on BN, you can't
22 look at export grain on UP under the current

1 standards. The Board asked whether or not to
2 adopt a new rate reasonableness procedure such as
3 a two benchmark approach, which we suggested, or
4 the AG commodity maximum rate methodology that
5 National Grain and Feed suggested. The Board
6 could make changes to URCS and a waybill sample
7 and a three benchmark test which would make it
8 more accessible to grain shippers and help
9 provide effective relief from excessive freight
10 rates, which is the goal of this proceeding.

11 Since the Board asked for ideas, we suggested
12 that a two benchmark approach may be appropriate
13 for grain shippers and this would be, the
14 railroads say that this would cause great harm
15 and would not be fair, but it would be very
16 limited application. We suggested it be
17 restricted to only revenue adequate railroads,
18 first of all. You're only taking about a limited
19 amount of traffic that's jurisdictional, so the
20 application would be very limited. Currently it
21 wouldn't apply to CSX since they are not revenue
22 adequate, it would apply to BN.

1 I'm sure Mr. Crowley, I didn't listen to all his
2 testimony, but I'm sure he talked about their
3 approach and I won't dwell on that. But I think
4 that talking about the three benchmark, it does
5 have some economic basis, it was developed by the
6 Board, it would be simple to administer and the
7 Board develops those numbers based on an economic
8 and rational approach. If you're looking for
9 simplicity and an easy test to administer, I
10 think that would be a good one to use.

11 I also note that the Board commissioned a study
12 last year to look at alternatives to reduce the
13 time, complexity and expenses associated with the
14 stand alone cost methodology and maybe they'll
15 have some ideas on that on how to improve those
16 tests. Whether the Board decides to make
17 improvements to URCS and the three benchmark test
18 or adopt a new test, no test is going to be
19 perfect. I will say over the years I've been
20 involved in many different tests, starting with
21 the fully allocated cost test and the seven
22 percent solution and the ton and ton mile and the

1 R/VC comp test, so I've been around for a few
2 tests. These tests take time and those tests
3 that I mentioned were all proposed by the Board,
4 formula replacement costs, and they were
5 subsequently rejected, so. If the Board does
6 decide to come up with a completely new test, I
7 would suggest that the Board keep the modified
8 three benchmark test in place until this test is
9 fully studied and developed, if it adopts a test.
10 I don't have much to say on the Canadian proposal
11 as I'm sure National Grain and Feed fully went
12 into that. The only thing I would say is that it
13 appears logical and sound and such a policy
14 should result in more accurate ROI calculations
15 and preclude CN and CP from playing financial
16 games by shifting revenues and expenses in
17 investments between US and Canadian carriers. It
18 seems like a logical approach.

19 Number six, whether the Board shall allow
20 multiple agricultural farmers and other
21 agricultural shippers to aggregate their distinct
22 rate claims against the same carrier into a

1 single proceeding. I think Terry addressed that,
2 that the farmers and the producers are actually
3 the one, they don't actually pay the freight, but
4 they incur the cost. It's a logical approach to
5 do, it's to allow parties to aggregate disputes.
6 Farmers are economically impacted by higher
7 rates, but they may not be, it's not settled law
8 whether or not they're considered a shipper. If
9 the Board could clarify that it would be helpful,
10 I think.

11 Other ideas such as whether there are
12 ways in which the Board could create greater
13 transparency for grain shippers regarding how
14 rates are set. In my younger days starting as a
15 teenager, I hung out at the ICC tariff room, I
16 spent many hundreds of hours --

17 CHAIR MILLER: You are a wild one.

18 MR. FAUTH: In the ICC's tariff room
19 and the ICC's reference room, working for my dad
20 as a teenager even, Christmas and summers. I was
21 able to go in the IC tariff room and look at any
22 tariff I wanted to and pull out and study and

1 analyze the tariffs and I did. And until
2 recently I was able to go to BNSF website and
3 look at their public, their quote "public
4 available rates." I'm no longer able to do that.
5 After forty years of looking at public rates, I'm
6 not allowed to look at public rates anymore.
7 You've talked about it and the railroads have
8 sort of had said well that, they're there and
9 we'll walk you through the process, but I went
10 through the process, I registered on the Board's,
11 the BNSF website, I'm a registered user and I
12 have a password, but I still am locked out of
13 looking at the rates. And if you go on the
14 website, they have a little lock on those tariffs
15 and it's there for a reason; it's only available
16 to who they want to let look at the rates and I'm
17 not one of those people.

18 So I urge the Board to have
19 transparency and make publicly available rates
20 publicly available. I'm not able to see them
21 anymore, so. Anyway, that concludes my remarks;
22 I think John will have a little more.

1 MR. CUTLER: Thank you Terry. Let me
2 begin with some preliminary thoughts about this
3 morning's TRF presentation. First, I thought it
4 was great to hear some of the economists talk
5 about fairness; I rarely hear economists
6 recognize that of any interest what so ever in a
7 regulatory context. And the TRF guys did, it was
8 very refreshing. The second thing I noticed is I
9 didn't hear any support from TRF for differential
10 pricing of captive traffic. Now, ARC has argued
11 for a long time that with revenue adequacy
12 achieved or imminent, there's no longer any
13 justification for captive shippers and producers
14 paying more than non-captive shippers and
15 producers; thereby experiencing a competitive
16 disadvantage in their markets. TRF of course,
17 ignores revenue adequacy completely but that's
18 because they have the luxury of ignoring the
19 statute and the rest of us have to try to figure
20 out some legal way of getting from where we are
21 today to a brighter future.
22 For us, the achievement of revenue adequacy,

1 particularly in the context of co-rate guidelines
2 constrained market pricing and the ICC's promise
3 in 1985 that once revenue adequacy was achieved,
4 that's as much money as a regulated entity should
5 be able to recover from captive traffic through
6 differential pricing. Now, for us, the
7 attainment of differential, of revenue adequacy
8 is a hinge point, a huge hinge point in
9 regulation of railroads, because for decades now
10 our feeling has been that as to service issues,
11 as to revenue adequacy definitions, as to
12 mergers, as to paper barriers, and certainly as
13 to rates. Over and over the benefit of the doubt
14 has gone to the railroads for understandable
15 reasons, because Penn Central bankruptcy, late
16 seventies, concerns about the fragility of the
17 entire industry, the importance of the industry,
18 the feeling understandably enough even though we
19 kept losing case after case was, okay, benefit of
20 the doubt goes to the railroads because they need
21 more money.
22 If shippers have to be gouged a little bit,

1 presumably the railroads aren't going to
2 overreach, they're not going to drive their
3 customers out of business, but there needs to be
4 a new look at this whole approach to railroad
5 regulation. Because we've reached the point at
6 which after thirty years of funding, along the
7 competitive shippers, the revival of the railroad
8 industry into an industry that's now has a huge
9 and extremely bright future, making a lot of
10 money, five railroads revenue adequate in the
11 last analysis. Particularly, the major grain
12 hauling railroads seem to be doing the best of
13 all. We've felt for a long time that the time,
14 the Board in this proceeding and in ex parte 722
15 and as the years go by, because let's face it, we
16 don't have an NPR on our hands, we have an
17 inquiry.

18 Nothing has been proposed for action by you or
19 for comment by us other than sort of, what do you
20 think about grain rate regulation today and what
21 do you think revenue adequacy means? We're
22 talking about a span of two, three, four years

1 during which these issues are grappled with; and
2 our guess is that as those years go by, not only
3 we'll be looking at railroads achieving revenue
4 adequacy, we'll be looking at railroads exceeding
5 revenue adequacy by greater and greater amounts.

6 During which time captive shippers continue to be
7 subject to a really inadequate selection of
8 remedies, two of which are just prohibitively
9 expensive, SAC and simplified SAC. Three
10 benchmark, we've talked about before. One more
11 point about the TRF.

12 It sounded like they might agree with us that the
13 R/VC comp benchmark should include all rail
14 traffic, not just captive rail traffic. Why?

15 Because they don't see any reason for higher
16 prices on captive traffic than on non-captive
17 traffic. Well, if the ideal is for captive rates
18 to match competitive rates, they why in the world
19 would you want to restrict the R/VC comp
20 benchmark to captive traffic? In fact, and also
21 why would you want to restrict it to a single
22 railroad? In fact, if you compare one set of

1 rates controlled by a monopoly railroad with
2 another set of rates controlled by that same
3 monopoly railroad, isn't that pretty much of a
4 stacked deck? Can't the railroad control the
5 answer to the question?

6 Also, to anticipate the possible question from
7 the Board, bear in mind that the R/VC comp choice
8 made by the shipper is going to be

9 counterbalanced by the R/VC group developed by
10 the railroad and you are the ultimate deciders of
11 which one is preferable. Now right now, it seems
12 to us that we are limited in our ability to look
13 at the universe of possible competitors and offer
14 those as our R/VC comp for you to say yea or nay.

15 I mean, a lot of freight can't even be on the
16 table, whereas if you allowed us to offer rates
17 below 180 percent or rates of a competitor and
18 the shipper went too far, tried to suggest that
19 totally dissimilar commodities or totally
20 dissimilar circumstances or totally dissimilar
21 rate levels ought to dominate the rate
22 comparison; you would be in the position to say

1 well, this is ridiculous, we're not going to
2 treat those rates as comparable.

3 But suppose the shipper is in a position to say,
4 look, BNSF and UP have a very similar cost
5 structures for the rates in question. Or we're
6 suggesting that because UP's rates are a little
7 bit lower than BNSF's, not wildly lower, but a
8 little bit lower; but the BNSF shipper or
9 producer that I represent is losing business
10 because of that disparity. You would be in a
11 position to say well, in this circumstance, maybe
12 a broader definition of the R/VC comp component
13 of the three benchmark test ought to be broadened
14 a little bit. So I guess that would be, that's
15 part of my thinking based on TRF and let me hedge
16 that by saying that like everybody else in this
17 room, I haven't read the report. Very curious
18 about what it says, very curious about what the
19 rationale is. And to say that this is how it
20 should work if we had a clean slate to work on;
21 but it has to be fixed by Congress, well all of
22 us who live in Washington know how likely it is

1 that Congress is going to fix this real soon.
2 You can't even get as highway built through
3 Congress these days; some of the most basic
4 functions of government are not being covered.
5 But the other question that crosses my mind and
6 I'm running out of time so I'll try to speed
7 through this. You've heard railroad after
8 railroad say we don't, we set our rates in order
9 to enable captive shippers to remain viable
10 competitors for non-captive shippers. Well, if
11 that's the case, why all the resistance to a more
12 relaxed approach to rate regulation for grain?
13 Grain is subject to all these forces that the
14 smallest shippers, the most isolated shippers
15 need some help with. The railroads say, we tried
16 to give them some help; but what they're really
17 saying is, we want to dictate how much help they
18 get, we don't want the shipper to have regulatory
19 recourse if there's a dispute.
20 I mean, they say the door's always open, we
21 appreciate that, and we appreciate the service
22 that the railroad industry provides; but there

1 needs to be, as you have said a couple of times,
2 Vice Chairman Begeman and as you reiterated,
3 Chairman Miller, the issue here is not are rail
4 rates too high. The issue is on those occasions,
5 no matter how rare they may be, on those
6 occasions where a grain shipper, particularly a
7 small grain shipper or an isolated grain shipper
8 has a serious dispute with the railroad, is there
9 a regulatory remedy? Not talking to the
10 marketing department of BNSF, is there regulatory
11 recourse?

12 Now, this doesn't mean a lot of rail rates,
13 freight rates, rail rates are going to be
14 challenged; but what the big difference is that
15 in negotiations, the captive shipper has
16 leverage. Maybe not a lot, but at least it has
17 more than none. The captive shipper will be in
18 position to say, look I'd like to work this out
19 with you; if we can't do that I think I have a
20 remedy under the three benchmark test as expanded
21 in ex parte 665 Sub 1, and I'm going to pursue
22 that remedy. Maybe we should talk a little bit

1 further, maybe you should give a little bit more.
2 Today, that shipper doesn't have that remedy and
3 that's really what we're asking for in this
4 proceeding. Thank you.

5 CHAIR MILLER: Thank you very much.

6 Ann, you want to start?

7 VICE CHAIR BEGEMAN: Whoever wants to
8 may answer this question. About the 3B process
9 that the Board has for the smallest cases, the
10 most simplified process that we have. We talked
11 about it a bit more this afternoon than we did
12 this morning. It's been used -- I thought it was
13 around five times, seven times apparently based
14 on what the last panel mentioned, but, why does
15 3B not work for frian shippers? I mean, why
16 doesn't it work for grain if it works for a
17 chemical shipper? It seems like there --

18 MR. CUTLER: I think part of the
19 problem is the restrictions on the comp group;
20 but the other is even if --

21 VICE CHAIR BEGEMAN: As they apply to
22 the other commodity as well?

1 MR. CUTLER: No, I'm saying, for the
2 smallest shippers, there's a resource problem,
3 they don't have a lot of money. It's difficult
4 and you have to hire lawyers and experts to try
5 and figure this out. This is one of the reasons
6 that we proposed eliminating the R/VC comp test
7 entirely once the railroad becomes revenue-
8 adequate. There are two ways of looking at the
9 R/VC and the three benchmark test. One would be
10 to find and fix the outlier rate. There are lots
11 of shippers paying lots of rates and most of them
12 are here and one of them is here. That person
13 could use the R/VC comp test to attack his
14 individual rate but we're talking about rate
15 structures for grain. So an entire state or
16 entire region may be paying essentially the same
17 rate. Now, I think in that kind of situation,
18 the R/VC comp benchmark tends really to be the
19 way for the railroads to look at our RSM level,
20 look at the R/VC 180 level and layer on top of
21 that as much differential pricing as they think
22 they can get away with. As I said before, once

1 the railroads attain revenue adequacy, it becomes
2 a question of whether any further differential
3 pricing should be allowed. This may be more of
4 an ex parte 722 issue than for here. But for
5 grain, it's particularly important because grain
6 shippers are in this category of having an entire
7 structure work against them. Where if --

8 VICE CHAIR BEGEMAN: How is their
9 structure different than a chemical shipper?

10 MR. CUTLER: It tends not to be an
11 outlier situation. It tends to be, the railroad
12 doesn't just raise my rate, the railroad tends to
13 raise Montana grain rates across the state. And
14 if the only potential members of the comp group
15 are other Montana wheat --

16 VICE CHAIR BEGEMAN: I understand that
17 part.

18 MR. CUTLER: Okay. Terry, you want
19 to?

20 MR. FAUTH: I'd only like to add that
21 despite the railroads saying they only look at
22 the market and weather in Canada, I heard one

1 railroad attorney say that that was one of the
2 market-based things they look at. They play, in
3 captive situations like Montana, they paid very
4 close attention to the URCS cost and they know
5 exactly how high they can push those rates. And
6 I think that is proven by a case that Montana
7 brought, it's a forty-eight carload case. I
8 don't know if you're familiar with it. But where
9 the railroads were setting rates to get below the
10 fifty car trainload threshold, so they, the
11 market based rates that they have certainly in
12 captive situations, they paid close attention to
13 URCS and they know exactly how high they can push
14 those rate levels before they would get into a
15 three benchmark situation, so. That's one of the
16 reasons why there aren't any three benchmark
17 cases. They're very careful to go just below
18 that level to avoid those cases.

19 MR. WHITESIDE: And the R comps
20 basically rise all boats; so you can't look
21 around in the immediate area and come up with
22 lower rates at all; they'll all be in the --

1 VICE CHAIR BEGEMAN: No, I understand
2 that, but I would think that applies to other
3 commodities as well. I mean, they can't go below
4 180, they have to be a captive shipper. I'm
5 still lost on how grain is unique with respect to
6 3B, how 3B can work for others.

7 MR. WHITESIDE: Well, I'm back to the
8 basic premise.

9 MR. CUTLER: It hasn't worked for very
10 many people.

11 MT WHITESIDE: Yes. Back to the basic
12 premise. They don't pay freight rate, they bear
13 it. The first thing that the railroads went
14 after in McCarty Farms was objecting to farmer
15 standing in the rate case. We have the same
16 issues that are going on now that they're the
17 bearers of the freight, they don't pay it. So
18 therefore, when you start looking at R comps,
19 they're not paying those. They're bearing them,
20 but they're not paying them. That's what makes
21 the farm producer unique.

22 MR. CUTLER: Maybe the explanation is

1 that it's a bunch of things. So Terry --

2 VICE CHAIR BEGEMAN: So the elevator
3 could do a 3B case, but the producer, the farmer,
4 couldn't, is that what you're saying?

5 MR. CUTLER: Well, that's part of it,
6 but I think maybe the way to answer your
7 question, Vice Chairman Begeman, is it's not one
8 thing. It's a bunch of things. You have the
9 issue of standing, you have the farmer versus
10 elevator issue. For the elevator, it may be an
11 issue of if I challenge the rate at elevator A,
12 I'm just shooting myself in the foot because the
13 railroad will simply raise the rate at my
14 elevator in the next county and I won't get
15 anywhere that way. There's the concern about the
16 rate structure problem.

17 There's the fact that in the US Magnesium case,
18 the Board's decision granted relief, but the
19 relief prevented the railroad from raising their
20 rates above 350 percent of variable costs. Now
21 if you say to someone who's paying 280 percent of
22 variable cost, that the last time anyone won one

1 of these, that was the point at which relief was
2 provided. He's going to say, oh my God, this is
3 hopeless. That means the railroad can raise my
4 rate seventy points; I don't want to call
5 attention to myself in that kind of situation.

6 And you have market dominance, well in Montana
7 you probably don't have market dominance

8 concerns, but some shippers do. The Montana
9 Department of Agriculture speaker this morning

10 posed the possibility of a test case being
11 brought, for example by the State of Montana on
12 behalf of a group or a small or a large group of
13 grain shippers.

14 That's the kind of thing that might get past some
15 of these obstacles, create the perception among
16 farmers that there's the possibility of this
17 working. But you add it all up, not to mention
18 McCarty Farms, and you have this perception that
19 it's such a long shot, it's going to cost a lot
20 of money, it's going to take a lot of time,
21 market conditions may have changed by the time
22 the decision is reached, and I think you add it

1 all up and it's understandable frankly, that no
2 one wants to go first, stick his head up and
3 tackle this. There's always next year's harvest
4 to get hauled by the railroad.

5 MR. WHITESIDE: We keep talking about
6 Montana, but it's North Dakota, it's South
7 Dakota, it's the whole northern plains. They're
8 all in the same boat together and the, I think,
9 the thing that we keep coming back to is, there
10 is a process. If they had a process that would
11 work, then they're in much better shape to
12 arbitrate or negotiate. But right now, it's
13 pretty tough for the small farm producer to be
14 able to arise; you know we were talking the other
15 day that this is all about profit on the farm.
16 How much can they take? Every time they come up
17 with an innovation and they're having it right
18 now with the pulse crops. The rail rates come
19 in, take more and more and more of it every year;
20 and the reason for that is because they can. So
21 they have no way of being able to isolate that
22 crop and take that profit for themselves, which

1 is what they produced.

2 VICE CHAIR BEGEMAN: Mr. Fauth, I
3 think it was when you were talking about the
4 Grain Cost Adjustments Factor or maybe it was
5 stemming from the, what's it called?

6 CHAIR MILLER: The market?

7 VICE CHAIR BEGEMAN: The other cost
8 adjustment factor that you were asked about, you
9 mentioned that folks are barred from getting in
10 the door here from bringing a case. To what
11 extent?

12 MR. FAUTH: Well, if you look at --

13 VICE CHAIR BEGEMAN: You need to be
14 market dominant but --

15 MR. FAUTH: Well, the single car --

16 VICE CHAIR BEGEMAN: -- would the
17 adjustment be -- I would assume it's a small
18 percentage.

19 MR. FAUTH: If you look at single car
20 traffic of wheat for example, most of it will be
21 under the jurisdictional threshold, because of
22 the costing problems, so simply they, the traffic

1 is quite profitable but according to your costing
2 approach, they're losing, you know, they can't go
3 over 180.

4 VICE CHAIR BEGEMAN: But how much of
5 a swing?

6 MR. FAUTH: Well, I don't know; it
7 depends on the --

8 VICE CHAIR BEGEMAN: But what I'm
9 trying to understand is, are you saying that
10 someone, at least from your perspective --

11 MR. FAUTH: How much traffic --

12 VICE CHAIR BEGEMAN: Is it really at
13 190 so they should get in, or are they at 500
14 over variable cost? How extreme?

15 MR. FAUTH: Well, the most important
16 thing is they're below 180 and they can't get in,
17 so if you can't get in under 180 and there's a --

18 VICE CHAIR BEGEMAN: Well, you must be
19 assuming that otherwise they could get in but for
20 the fact that they're not able to make the
21 adjustment?

22 CHAIR MILLER: Could I ask a question,

1 because maybe I'm not understanding correctly
2 either. I thought what you were saying, I
3 thought part of the point that you were making is
4 that a lot of the grain rates are showing up
5 under 180 but you would argue that in fact,
6 they're more costly than that and it's just that
7 URCS isn't fully costing the grain?

8 MR. FAUTH: They're less costly than
9 that.

10 CHAIR MILLER: Oh, they're less
11 costly, excuse me.

12 MR. FAUTH: Because the R/VC ratios,
13 they're more efficient than is reflected in the
14 Board's costing approach.

15 VICE CHAIR BEGEMAN: So "how off is
16 the costing approach" is, I guess, what we're
17 trying to understand.

18 MR. FAUTH: I think the railroad put
19 up a graph comparing the trainload rates and the
20 multiple car rates and said there was like
21 thousand car per car difference, but in reality,
22 the shuttle trains are very efficient and much

1 lower costs and the multiple car and the single
2 car movements are lower than to a certain degree,
3 but I mean, a lot of these traffic, a lot of this
4 traffic moves in efficient trainloads and it's
5 not like a multiple car of plastic pellets or
6 hazardous materials or anything else.

7 It's very efficient and it's not treated, that
8 efficiency is not reflected in the URCS
9 adjustment, so the only adjustments that you make
10 are the 25 percent. You take 25 percent of
11 switching for trainload movements and 50 percent
12 for multiple car movements, then you add that
13 back, the 50 percent back in the make-whole
14 adjustment, so. The multiple car shippers really
15 what's taken away is added back with the make-
16 whole adjustments. Now the trainload shippers,
17 they often have no switching at all, but they
18 still get 25 percent of the switching costs
19 allocated to them, whereas these trains are
20 shuttle trains with the same locomotives and a
21 lot of times the shuttle facility will do any
22 switching that's required. So there are a lot of

1 economies and car costs that are reflected. I
2 don't know, I haven't done a study on how much
3 traffic should be jurisdictional, but I --

4 VICE CHAIR BEGEMAN: Maybe I can ask
5 it in a different way or we could just move on,
6 but at what point do you envision an R/VC ratio
7 would need to be to prompt a case?

8 MR. FAUTH: Well, it certainly
9 probably has to be over 180 but I don't know how
10 far off --

11 VICE CHAIR BEGEMAN: I think I knew
12 that.

13 MR. FAUTH: I don't know how high is
14 up on that. I can't tell you a number. But you
15 know, in the 300 range maybe that you would
16 consider a case, 250, I don't know.

17 MR. WHITESIDE: Let me try something.
18 Let me, simple view for me. You take a twenty-
19 six car unit and they put them together, which
20 has make-whole adjustment applied on it, which
21 means that the R/VC's are low. And they put it
22 together with three other 26's and they move it

1 as a 98 car movement, which is what happens. The
2 economics are really shuttle train economics once
3 it's been put together in Montana or in North
4 Dakota or in South Dakota. So what's happening
5 is that there is no way that you'll see those
6 with the make-whole adjustments that you'll be
7 able to see and not being able to adjust some of
8 the URCS costing.

9 It's almost like a single car, it would be like
10 having a locomotive and a single car going all
11 the way to the coast. That's what it cost as,
12 but that's not really reality. And so if you
13 have two 48's, they put them together, away they
14 go. And somewhere in the state they get put
15 together, from then on, they act like a unit
16 train. That's one of the issues with trying to
17 get, and that's one of the reasons why we wanted
18 to talk about the possibility of putting together
19 adjustments, because we know that's what's going
20 on. They don't take 26's all the way to the
21 coast, never seen one. Go ahead.

22 MR. FAUTH: I was just going to say,

1 lots of multiple car shipments or even single car
2 shipments, go to the same destination; so they
3 all may be going to Rivergate. It's unlike
4 plastic pellets or anything else that could go to
5 multiple different destinations on the train. So
6 when these things go over the mountains, go down
7 the Columbia River Gorge, they're all on the same
8 train going to the same place.

9 MR. WHITESIDE: But the URCS ones just
10 don't show that. What they show is it's as if
11 this 26 goes all the way to the coast with a
12 locomotive; it's not how it works.

13 CHAIR MILLER: The costing in URCS
14 makes that assumption, basically?

15 MR. WHITESIDE: Right. It is late in
16 the day and I think you guys have done wonderful.
17 I want to compliment the staff, they've done
18 wonderfully today, too.

19 CHAIR MILLER: They stayed awake.

20 VICE CHAIR BEGEMAN: All the folks out
21 here are helping keep this going.

22 CHAIR MILLER: Can I go back? I'm

1 sorry, maybe it is just because it's late in the
2 day because I'm sure yesterday when we were
3 talking about this stuff, I knew the answer, but
4 in your proposal when you're talking about 2B,
5 what makes it the 2B over 3B as it's the R/VC
6 comp test that you're removing? Is that correct?

7 MR. FAUTH: Right.

8 CHAIR MILLER: And --

9 MR. FAUTH: Just for revenue-adequate
10 railroads on the long term.

11 CHAIR MILLER: Is this correct, part
12 of your argument is that for grain shippers, that
13 doesn't help them very much because the rates are
14 being set on a statewide or a region wide basis,
15 so everybody is at the same rate?

16 MR. FAUTH: Your R/VC comp test
17 doesn't help then.

18 MS MILLER: It doesn't shed any light
19 or show a different sort of rate.

20 MR. CUTLER: But without the R/VC comp
21 bench mark you're dealing with two numbers that
22 the Board produces every year. It couldn't be

1 easier.

2 CHAIR MILLER: Yes, so you're saying
3 it also simplifies it --

4 MR. CUTLER: Yes.

5 CHAIR MILLER: -- and takes any
6 argument out.

7 MR. CUTLER: Yes

8 CHAIR MILLER: It is objective.

9 MR. CUTLER: Once again the Railroads,
10 this is where the Railroads argue that we're
11 simply trying to drive all the Rail rates down to
12 whatever RSM is, but the fact of the matter is as
13 you said at the outset, Vice Chairman Begeman,
14 farmers don't want to hire lawyers and litigate.
15 After they complain a little bit, they want to
16 figure something out in a reasonable way and that
17 means some give and take but if they are looking
18 only at the SAM number and the R/VC 180 number
19 that the Board gives them every year for each
20 railroad and they think their rate is way out of
21 line with those two numbers out of their two
22 benchmark tests, then they have some bargaining

1 leverage to sit down with the railroad and say,
2 look we know you guys have to make money too, we
3 appreciate the service you're giving us but how
4 do you justify this disparity.

5 VICE CHAIR BEGEMAN: I appreciate the
6 chance, that you have prompted me to correct any
7 misimpression if I left it, I really was kind of
8 teasing --

9 MR. CUTLER: Yes, we understand.

10 VICE CHAIR BEGEMAN: -- but it is
11 true.

12 MR. CUTLER: We brought a farmer here.

13 VICE CHAIR BEGEMAN: Well folks, their
14 first choice is not to hire a lawyer--

15 MR. CUTLER: Yes.

16 VICE CHAIR BEGEMAN: -- that's
17 probably their last choice, beyond their last
18 choice even.

19 MR. CUTLER: Pretty much their last
20 resort.

21 VICE CHAIR BEGEMAN: They have a farm
22 to run.

1 MR: CUTLER: Yes.

2 MR. FAUTH: Can I make one more point
3 about the two benchmark and the RSM for revenue
4 adequate railroad eventually if they're long term
5 revenue adequate would be necessarily below 180.
6 For example, BN's most current RSM would be I
7 think 177 because you're allocating the surplus
8 to the traffic over 180 group but in reality the
9 rates could never go below 180. So or you could
10 set the rates to 177 and the end could increase
11 them to 180. So there's a surplus there a
12 benefit there built in too under the three
13 benchmark that although their RSM might be below
14 180 the rates could never set below 180.

15 VICE CHAIR BEGEMAN: Mr. Whiteside, if
16 I could just ask you this question because you're
17 from Montana. I was really surprised to hear the
18 extent to which the Montana BNSF arbitration
19 program covers 90 percent of all of shipments
20 there. I'm curious if you know -- they mention a
21 case maybe in 2009 -- and perhaps you're not
22 personally familiar with it, but whether or not

1 some of your folks you hang around with are or?

2 MR. WHITESIDE: Look, I don't want to
3 get in political trouble --

4 VICE CHAIR BEGEMAN: That's a good
5 idea.

6 MR. WHITESIDE: So, but I think the
7 thing is what's interesting to me about that
8 process is the fact that the Burlington Northern
9 sat down with the growers and made it work. It
10 has a standard that starts well above 180, you
11 can't even challenge them either it's 220 or 225
12 under that system, but I was impressed with Mr.
13 Miller today in talking to NGFA about their
14 process. I think we're going to end up with an
15 arbitration process for grain over time and I
16 think that's important but I think what's
17 important from our standpoint is that two
18 benchmark would at least them a regulatory
19 backstop. So I think the process, the railroads
20 have spent a lot of time trying to work out this
21 process in Montana and for that you just got to
22 pat them on the back because they've done well.

1 The two organizations, I don't think represent 90
2 percent of all the farm producers but what you
3 were saying was 90 percent of the traffic ---

4 VICE CHAIR BEGEMAN: Yes.

5 MR. WHITESIDE: --- and all of those
6 farm producers can go ask and become involved.
7 And I think that's accurate, so it's unique it's
8 a start ---

9 CHAIR MILLER: Uh-huh.

10 MR. WHITESIDE: You know I mean and
11 we'd love to see it down here at the Board. One
12 of the things the Board can do is provide
13 guidance in that process over at with BN moving
14 at NGFA, they can provide guidance to an
15 arbitration process that would be encouraged
16 here. I do think that voluntary arbitration
17 proposed up in congress coming down here is just
18 ridiculous. Voluntary arbitrations won't work
19 they got to have some kind of binding process to
20 them at some point. But mediation arbitration
21 who knows if we can get it working over at NGFA
22 then yes, we might be able to get something done

1 over there. So that was kind of the bright light
2 today when NGFA suggested, wouldn't tell us who
3 and then BN volunteered that it was them. So I
4 think that's a good start and it's going down the
5 path.

6 MR. CUTLER: It's been a long time
7 since I looked into the BNSF Montana arbitration
8 program in detail, I do think they have been some
9 questions raised about the specifics of that
10 particular arbitration program and we have some
11 time, I'll see if I can find any further
12 information for you on that.

13 VICE CHAIR BEGEMAN: I'm not looking
14 for trouble ---

15 MR. CUTLER: But it's very interesting
16 to hear that ---

17 VICE CHAIR BEGEMAN: --- looking for
18 good things.

19 MR. CUTLER: The NGFA arbitration
20 program has been a big success dealing with
21 everything other than rates.

22 ACTING CHAIR MILLER: Uh-huh.

1 MR. CUTLER: The possibility of its
2 being expanding to cover rates was some of the
3 suggestions that you've heard today for tweaking
4 is very appealing and we're all I think
5 interested in seeing where that might lead. But
6 one more thing about arbitration I think it was
7 Mr. Hitchcock who said you can't really talk
8 about arbitration without talking about the
9 standard that the arbitrator's going to be using
10 to try to decide the case. Now if arbitration
11 was to be based on SAC it would mean no progress
12 whatever ---

13 VICE CHAIR BEGEMAN: Uh-huh.

14 MR. CUTLER: -- because we would have
15 to back up truckloads of data for our poor
16 arbitrator to try to figure out and then hire
17 your staff to help him understand ---

18 VICE CHAIR BEGEMAN: They're not
19 available.

20 MR. CUTLER: Yes, so with that caveat,
21 I think the idea of expansion of a well-
22 established popular successful NGFA arbitration

1 program covering grain rate issues has a lot of
2 natural appeal.

3 VICE CHAIR BEGEMAN: Thank you, great.

4 CHAIR MILLER: Thank you, thank you
5 all.

6 MR. WHITESIDE: Thank you guys,
7 appreciate it.

8 CHAIR MILLER: We need our last panel
9 to come up and I think we probably need to take
10 just a few minutes break so our poor court
11 reporter can take just a little bit of a break
12 and make a phone call. So the panel come on up
13 and we'll wait until our Court Reporter's in
14 place and ready to start.

15 (Whereupon, the above-entitled matter
16 went off the record at 5:38 p.m. and resumed at
17 5:46 p.m.)

18 CHAIR MILLER: Okay, we are on our
19 eighth panel.

20 MR. MACDOUGALL: Let him go first
21 otherwise, if I go first, I won't want to listen
22 to him.

1 CHAIR MILLER: We're enforcing
2 discipline on you.

3 MR. MACDOUGALL: I spent a whole day
4 down there learning things.

5 CHAIR MILLER: Yes, if you spent the
6 whole day you might well as just keep going
7 right? Alright, so we have Mr. Kaufman from the
8 TTMS group who's going to lead us off.

9 MR. KAUFMAN: Thank you, Madam
10 Chairman. My name is Kevin Kaufman I am the
11 Managing Director of TTMS group which is a DBA
12 which is Texas Trade and Transportation Services
13 from South Lake, Texas, it's a little consulting
14 group I formed after I left BNSF in February. I
15 have kind of a unique background actually,
16 Commissioner Begeman and I have known each other
17 for a long time, back in 1995, there's the ICC
18 Termination Act and we were involved with that.

19 CHAIR MILLER:: You weren't buddies at
20 that point, at that time.

21 MR. KAUFMAN: No, I wasn't a buddy I
22 worked for a shipper, I worked for a large

1 shipper Dreyfus Corporation, I worked for them
2 for 25 years and we were involved, just in the
3 transition that was going on because it was
4 important.

5 VICE CHAIR BEGEMAN: Nobody was my
6 buddy during that time, I think that's what he's
7 saying.

8 MR. KAUFMAN: From that you know they
9 formed the Rail Shipper Transportation Advisory
10 Committee and I was a charter member of that and
11 served there for six years so I had experience
12 with that which was great and then after that
13 about 12 years ago I went to work for BNSF. So
14 I'm sitting here before you with kind of a unique
15 set of credentials I've been an ag shipper, a
16 large ag shipper for a multinational. Worked for
17 a large Class I railroad is the head of
18 agricultural products, the V.P. of agricultural
19 products and then now I'm representing producers
20 as one of the people our group work with and my
21 fellow partners are Loch E. and Dan Kidd from
22 Montana and we got to know each other about ten

1 years ago when we started working on these
2 problems in Montana. We were very much involved
3 with this arbitration process in Montana, so I'm
4 going to speak about that a little bit later.

5 I'm representing US producers and they
6 really have the largest economic interest in this
7 hearing. I don't agree with Terry Whiteside very
8 often but the fact in the matter is ag producers,
9 for most of the history in the grain industry
10 that I've been part of for 35 years, have been
11 price takers which means that in the business of
12 agriculture and agriculture economics as price
13 takers, they basically pay the cost because in a
14 supply push market, basically the international
15 world of agriculture sets prices and then the
16 logistical supply chain works backwards and all
17 the costs get passed onto the producers. So the
18 producer pays for it and so when he brought up
19 the point that shippers pay the freight but the
20 producers bear the cost, that's absolutely true
21 because in the world of agriculture and it is a
22 bit of a conflict of interest when the ag

1 shippers stand up here and talk about rates, the
2 reality is they are all pass throughs for them
3 and their pass throughs to the producers. In a
4 hypothetical situation, for instance, if an ag
5 shipper brought a rate case and it's no
6 coincidence that an ag shipper hasn't brought a
7 rate case and McCarty farms was producer based
8 not ag shipper based, an ag shipper wouldn't
9 necessarily if he won a rate case, pass the
10 winnings, as we want to call them, back to the ag
11 producer he'd probably pocket them and that's
12 just the way the grain industry works, right?

13 The fact of the matter is and you have
14 a copy of it in your files. North Dakota State
15 University did a study of it about five years ago
16 that proved that actually margins of the elevator
17 charged by the ag shippers was actually grew much
18 faster pace than rates from the railroads. You
19 have a situation where rail rates have increased
20 over a period of time and actually less than you
21 would expect because of productivity but at the
22 same time, elevator margins in some cases have

1 trebled in that same period and most of the
2 reason is because we're dealing with a duopoly in
3 the ag shipping group.

4 In fact, if you take the HH index that
5 the Justice Department uses which is the
6 Herfindahl-Hirschman Index you'll find that ag
7 shippers actually exceed that index in some
8 regions of the United States and so it's always
9 interesting to me that they were testifying about
10 rail rates when the reality is that they probably
11 have more price taking power from the producer,
12 than the railroads have had in the past or will
13 have in the future. So I find it interesting
14 that they're advocating on the basis, talking
15 about railroads and advocating changes in your
16 process where the fact is they don't actually
17 need the process because it's a pass through for
18 them. I find that interesting.

19 Shippers and producers are pretty
20 smart and they are less interested in rail rates
21 and more interested in service because in the
22 case of, for instance, last year the cost that

1 producers bore because of poor railroad service
2 far exceeded anything that had to do with rates.
3 Then on top of that, when you sit there and talk
4 about well, let's talk about rates in the same
5 context of service to me it's a little bit bass
6 ackwards because in reality increase in rates
7 will never increase railroad service, it's just
8 economically not viable. So in reality when we
9 talk about rates, yes producers have a real
10 interest in transparency because they really do
11 want to understand their costs and what they're
12 paying for and what they're bearing but for them,
13 it's about having reasonable rates that they
14 could understand but more importantly they want
15 to have service they can rely on because if they
16 lose markets, they are absolutely in a bad way.

17 Now in the case of Montana for
18 instance last year, last year when we had all
19 these service matrix with the Northern Plains and
20 you guys went out to Fargo for instance, in June
21 and held a hearing, the interesting fact is
22 because Montana was kind of west of where the

1 real bottlenecks were in the BNSF shipping
2 patterns. The Montana producers in almost no
3 case where the shippers had any problems with
4 service during that period and in spite of being
5 grain piles being alleged to be caused by poor
6 service those actually were the result of poor
7 Canadian rail services so the Canadian farmers
8 sent their grain to Montana and it sat in piles
9 in Montana. That's another subject about taking
10 markets away for the Montana producers because of
11 poor rail service but it had nothing to do with
12 BNSF' poor rail service in Montana.

13 When we talk about these things
14 there's a lot interconnecting facts and realities
15 that are going on between shippers, producers,
16 the entire logistic supply chains, back it all
17 the way up from the People's Republic of China,
18 wherever the destination is. It influences what
19 these costs are and it's one of the reason why as
20 an expert, I guess in the grain industry and
21 generally global transportation, I just wonder
22 about how and what your job really is in the STB

1 as far as to oversee agriculture rates because
2 it's really complicated. The railroads talk about
3 market pricing but the reality is, and if you
4 look at the USDA study I think that they put out
5 in February where they were talking about looking
6 for a relationship between rail rates and
7 commodity prices, there's very little correlation
8 it's very hard to find these correlations. If it
9 was easy, the grain industry would have done away
10 with hundreds of traders that they pay billions
11 of dollars to, to trade this stuff to make money
12 and instead they sit there and come up with an
13 algorithm and push a computer every day to decide
14 how are they correct trade cash grain against
15 cash futures and how they are going to involve
16 their transportation costs and apply it across
17 the whole spectrum to make money. They don't,
18 they use people. So it's really hard to come up
19 with the idea that we're going to somehow pull
20 something out of the sky that's going to allow us
21 to somehow simply, and I hate this word simply,
22 analyze rates, put them in some sort of context

1 based on a formulary one size fits all process
2 and somehow do no harm.

3 So let's talk about the Montana
4 arbitration. I'm a big advocate of arbitration
5 and you know that because when we started with
6 the restack one of the first things we put out
7 from restack is a recommendation in fact the base
8 of the arbitration provision within the STB today
9 came from myself and Andy Goldstein who wrote
10 them coming from restack. Now they've been
11 bifurcated and changed and they don't look at all
12 what we originally proposed, but we started with
13 that process with arbitration for ag because it's
14 so complicated.

15 So in the case of the BNSF in Montana,
16 why arbitration? Well for one thing Montana
17 really is unique, it is really probably the only
18 place where economically you can make the
19 argument that it really is a captive shipping
20 area. Most other places you can say they're
21 single serve, the UP put up that lovely slide of
22 Iowa but in reality there's all this market

1 competition because people forget if there's a
2 ethanol plant, if there's a crush plant, if
3 there's a whatever, all a farmer has to do is put
4 their grain on a truck and truck it to the best
5 market and farmers are really smart, they truck
6 it to the best market. In Montana, it's a little
7 bit different because God put Montana where it is
8 in the United States, there aren't a lot of
9 markets. There's no crushing facilities that I
10 know of, there's no ethanol plants that I know
11 of, it's mainly a wheat producing state. There
12 are some mills, there's one in Great Falls but
13 there's not a lot of milling demand so most of
14 them go for export. If you want to use that
15 economic definition, they are kind of captive.

16 When we thought about this, we
17 thought, who legitimately should worry about how
18 there could be market dominance by the railroad
19 and control their pricing. It was Montana so we
20 negotiated with them, which is when I worked with
21 BNSF to create an arbitration process that really
22 works. How do you know it works? There's never

1 been one arbitration in this process in Montana,
2 there's been three or four mediations but there's
3 never been an arbitration because it was
4 mandatory mediation and it's really, really
5 simple. How does it work? Producers think that
6 he's getting a bad deal from his local elevator.
7 He can't figure it out why but he thinks it's
8 because of rail costs, he can go to farmers, to
9 Farm Bureau or Montana Grain Growers and say, I
10 think I've got a bad deal here.

11 Now the beauty of this is, both Grain
12 Growers and Farm Bureau have a stake in the game
13 and seen that it works and it's legitimate. They
14 don't want somebody just saying, hey I don't like
15 the railroads, let's go ahead and file a rate
16 case. Farmer comes in, proves his case, they say
17 fine, they call up BNSF and they say we have a
18 legitimate case here we want to mediate this and
19 that's exactly what happened in the case of
20 Shelby. For whatever reason, we, I worked for the
21 railroad at that time had screwed up with the
22 rate mod in Shelby. The rate in Shelby was out

1 of alignment with all the other rates in
2 highline. They're all related, all of the rates
3 are related because of the markets they compete
4 with. I don't want to get into grain 101 but the
5 drawing arcs for all these elevators compete for
6 truck grain from these farmers so there's always
7 an economic relationship with all of them.

8 So you can't change one rate and not
9 change a bunch of rates and that's what makes
10 rate cases so tricky because if you change the
11 rate for XYZ elevator, you've suddenly put the
12 elevator down the road at a competitive
13 disadvantage. What does he have to do now? He's
14 got to file a rate case too, otherwise you've
15 ensured that he's got a competitive disadvantage
16 for whatever the length of time that the
17 prescription lasts.

18 In the case of Shelby, it was
19 legitimate, it was out of alignment and so we sat
20 down we recognized it was out of alignment and we
21 immediately changed it. We've had other
22 mediation issues or BNSF has in Montana where

1 these things are resolved but in most cases
2 people when they're put into a situation where
3 they could have a reasonable dialog and there's a
4 structure and you can read this arbitration, it's
5 ten pages long, it's not super complicated. I
6 listen to some of the other railroad attorneys
7 talking about you need to have standards and all
8 this kind of stuff, you know what, you do need to
9 have certain rules and you do need to have some
10 sort of parameters but it doesn't have to be
11 overly technical. When we're talking about ag,
12 we're talking about relationships between your
13 elevators, we're talking about relationships
14 between transportation, we're talking about
15 relationships among commodities you can't just
16 tweak one and not affect the whole thing and so
17 you really do need an expert or somebody
18 reasonable sitting at the table that understands
19 agriculture so they can sit there and say, you're
20 right it doesn't fit, oh but if we change that
21 it's probably going to affect those markets.

22 What happens many cases when you get

1 together on these things, you don't just change
2 one rate you have to change 5, 10, 15 rates all
3 the rates that are related you have to do it
4 across the board. So it's not simple it's very,
5 very complicated.

6 Now, who's done this really well,
7 National Grain and Feed has done it for a hundred
8 years, has done it really well. I have always
9 asked myself, why won't the rest of the railroads
10 agree to arbitration under an existing formula
11 that exists with National Grain and Feed, they
12 have rail shipper arbitration. The existing
13 arbitration is about what the rules says not
14 about the rule. In other words, if they all
15 agree that the rule is X you can arbitrate the
16 rule but if the rule is stupid like for instance
17 if you have rules tariff at the railroad and it's
18 really not very good, let's take for example the
19 case, reciprocal switching cost with the eastern
20 railroads. Let's just pick a number that says
21 \$550.00 a car, you can't arbitrate that. If you
22 could, you would let out the gas out of a lot of

1 tires because suddenly people would feel like
2 there was some sort of judicial review and the
3 process already works.

4 They've got expert arbitrators within
5 the whole organization, so they sit there and
6 today in National Grain and Feed, of course, it's
7 all voluntary and so you've got peer arbitration.
8 Well, if you include railroad arbitration, you
9 are going to go through in the railroaders too,
10 on top of that, you are going to have peer
11 review. Now, you and I can play the games of how
12 you pick the arbitrator, pick one from this list
13 one from that, if you don't agree, you get to
14 pick a third one, whatever. Have five
15 arbitrators, have three arbitrators that's not a
16 big deal the hard thing is to have arbitrators
17 that actually know the business they're
18 arbitrating and so that's what producers, when we
19 think about this, are really worried about.

20 Maybe your rate is too high, but
21 remember the United States is the envy of the
22 world for shipping agricultural products within

1 this country by rail. We have a 45 to 60 dollar
2 a metric ton advantage over Brazil. I get it
3 that there are some problems. I get it that
4 there needs to be judicial review so that people
5 understand the process and I absolutely agree
6 with you, that there needs to be some sort of
7 transparent process so people don't feel like
8 they're getting a bad deal. Remember, we've got
9 something that already works.

10 So to me, the issue is, how do we do
11 this without making something worse? Okay, URCS
12 is screwed up, great at least we know what it is.
13 I hear sometimes Montana complaining my gosh, 180
14 percent we got single car shippers and why don't
15 you bring a rate case because they're at less
16 than 180 percent. Oh, well somebody's been
17 following the rules is that a bad thing or a good
18 thing? You can change the rules but you have to
19 be careful that when you change the rules, you
20 don't make it worse. I guess what my point is
21 and I think I've almost used up my time, I'm
22 timing myself so that thing doesn't have to go

1 beep in front of me.

2 My point is producers really care more
3 than anything else about getting a square deal
4 through the entire logistical supply chain. They
5 do want some additional transparency, so they
6 know what it is. But the biggest concern they
7 have is not getting reliable service, because if
8 they wake up one day and, especially Montana, if
9 they lose that export market because the
10 railroad, in the case of last year, didn't work
11 for them but for instance North Dakotans, they
12 suddenly couldn't move their grain to the west
13 coast. It couldn't get there. That's a problem
14 because when that happens, the price backs all
15 the way back to the farmer, the basis goes from,
16 make up a number, 25 under to 100 under because
17 now what happens is the function of the market is
18 to incent the farmer to store that grain and to
19 hold it until the rail transportation is fixed,
20 it's really costly.

21 So, for farmers, what we're interested
22 in is reliable service. If we're going to mess

1 with the rate structure and make it more
2 transparent, yay, we do need judicial review but
3 let's be careful about thinking about how we do
4 that because we don't want to affect service when
5 we do that and on top of that, we keep asking
6 ourselves, why do we want to make a new thing
7 when something that is successful already exists.
8 In fact, the STB currently has arbitration
9 provision, maybe we ought to examine some tweaks
10 we didn't need to make to it, to make it a little
11 more viable. Originally, when we proposed it to
12 the STB, way back in I don't know must have been
13 '98 or something like that, we thought it would
14 work, ALJ's don't work as soon as they decided
15 that they were going to make the arbitrators
16 ALJ's, end of story.

17 If you have an arbitration, both
18 parties have to believe in the arbitrators
19 because whoever loses has to still say it was a
20 fair decision that was rendered. An ag
21 arbitration doesn't work with baseball style
22 arbitration because it's too complicated. You

1 need an expert who can actually render a decision
2 that is economically reasonable. Baseball
3 arbitration, sometimes you just get so desperate,
4 you just want to get out of there and end it and
5 it doesn't necessarily end with a good deal. So,
6 that's kind of the end of my story about where we
7 are, I hope I can answer some questions for you.
8 I've been around this place for a long, long
9 time. I think I sat at this chair four or five
10 times, shocking, but I've heard pretty much some
11 of the same things for 10 or 15 years. Thanks.

12 CHAIR MILLER: Thank you very much Mr.
13 MacDougall.

14 MR. MACDOUGALL: I will be very brief,
15 last time I was the last speaker at one of things
16 the fire drill came so we shut down and I got a
17 very short shift, which is good. I'm here on
18 behalf of SMART Transportation Division the
19 general committee of adjustment, the General
20 Chairman is J.L. Schoemeyer and that represents
21 the BNSF lines on the present northern lines.
22 The case started back in the involvement of that

1 time of year, to you, in this case, was when the
2 chairman of the STB was in Great Falls, Montana
3 on the Columbus Day weekend and that was a big
4 thing for Great Falls chairman of the STB. They
5 were bitching about the grain rates and Mr.
6 Fitzgerald, at that time, was the general
7 chairman of the UTU for the northern lines. He
8 said well, you're all bitching about the freight
9 rates, so the chairman said we're going to have a
10 hearing. I'm going to open a hearing the next day
11 that was the beginning of ex parte 665, that was
12 October 11, 2006.

13 We want the system to work better. We
14 haven't taken sides for what should be done about
15 the grain rates. We do have some ideas and we
16 filed four separate pleadings in this case since
17 2006. The most recent one, which I just
18 summarized is we think you ought to have the
19 rates before you. I question, and I've been in
20 many rate cases myself whether you know freight
21 rates you deal with ton mile earnings, you deal
22 with R/VC's to make your decisions. We don't

1 deal with freight rates and we suggest that you
2 have an investigation into the grain rate
3 structure. There's been two of them before, one
4 of course after 1925 docket 17,000 cases and the
5 second one in the early '70's under commissioner,
6 I forgot his name, but the staff person was
7 Leonard Goodman.

8 We need to understand what the rates
9 are because what you deal with is a rate from
10 point to point but as the last speaker just said
11 it's the structure and you don't know the
12 structure, you make decisions but still, you
13 don't you know it and anybody that's been in rate
14 cases for a long period of time realizes it. So
15 you have very little credibility among the
16 railroad people but you don't know it because you
17 deal in 180. They question whether you know the
18 rate structure and I would read Volume 345, 245,
19 I think, 345 the ICC reports which is the last
20 rate structure case and all the rates of the
21 United States at that time, all the basic rate
22 structure but if you just do the green one you'll

1 find out more and the 180 meaning something a
2 little different then ton mile earnings you'll
3 realize that your report 10 years wasn't worth
4 much. They use ton mile earnings and not the way
5 freight weights are made, they taper, therefore
6 they have grain rates falling when actually they
7 had them rising for those years.

8 That's all I have to say and I said
9 the thing was filed August 25th of last year, our
10 recommendation is bring a grain rate structure
11 investigation, so that you'll learn what's all
12 about and not just dealing in figures that are
13 manipulated. The average person in Montana, and
14 I've only been there a few times, is interested
15 in the rate. They're not interested in talking
16 about 180, what are you talking about, ton mile
17 earnings and you make your decisions and you
18 don't discuss rates. You discuss 180's and all
19 that and so I think it's time to review the rate
20 structure and it shouldn't take too long, it has
21 been done twice before this week you have some
22 background to it and if you restrict it just to

1 grain, it will be a lot easier because the last
2 investigation was of all of the rate structures
3 and it took several years.

4 CHAIR MILLER: Thank you very much,
5 Mr. MacDougall and thank you for graciously being
6 our last testifier today. So Mr. Kaufman, I am
7 curious, clearly as your background shows and as
8 your testimony indicated, you have a lot of
9 experience in this area. I think what I could
10 take from your testimony is that any changes we
11 make we should be very careful and cautious and
12 perhaps am I going too far if I say that you
13 don't see the need for wholesale changes?

14 MR. KAUFMAN: I don't know, the fact
15 stays and BNSF even testified to that, there is a
16 need for judicial review, if nothing else, to let
17 the air out of the tires to stop people from
18 saying, my gosh, our rates are unreasonable and
19 nobody cares. There does needs to be a judicial
20 review process, I just think that agriculture by
21 nature is so complicated that it's going to be
22 really difficult to come up with a one size fits

1 all structure, in order to evaluate it. I'm
2 suggesting it's going to be really hard to come
3 up with something. As much as we disparage the
4 current system that exists, at least we know what
5 it is and we know the harm it causes. That's
6 always the problem when we dabble into new
7 things. We think we are going to make it better.

8 It's kind of like back in my day when
9 the USDA came up with the PICK program. I mean
10 you have no idea what that is but they had no
11 idea, it looked like a great idea to subsidize as
12 an export, it has the subsidy but when it ended
13 up doing is creating a marvelous new trading
14 environment for train companies to make millions
15 of dollars. It was just an unintended
16 consequence. When you start messing with
17 something like this, you just worry that it's
18 going to make things worse.

19 The ag producers look at trucking.
20 They're regulating trucking more and more and
21 more and it's getting worse and worse and worse
22 and more and more expensive. So the bias is

1 always that if we fuss with something, it's
2 probably not going to be cheaper, it's going to
3 be more expensive.

4 Again, I really worry about the
5 inverse relationship between rates and service.
6 What I'm talking about is, you regulate rates,
7 the railroads don't have to the serve
8 agriculture, and in fact you have to understand
9 agriculture is really volatile. One year, we got
10 7,000 cars that cost you know 75 or 85 thousand
11 dollars apiece in storage. The next year
12 hallelujah we got an export market. This year,
13 we have a horrible export market and when you
14 don't have an export market, it means we have all
15 these stranded resources and stranded capitol
16 because of it.

17 How is URCS going to take into account
18 the volatility of ag? I remember too many
19 anecdotes for you guys I know, but I remember
20 sitting in a Minnesota hearing. This is when
21 Roger was the chairman and each one of the
22 railroads, except for the BNSF raised their hands

1 and said we don't make any money shipping ag.
2 You don't know but 30 years ago, the BN seriously
3 thought about divesting all its ag businesses
4 because they didn't think they could make any
5 money at it. So when you look at agriculture and
6 its volatility and its costs and how it works,
7 you have to careful about fussing with it too
8 much because somebody might say, it's not worth
9 it anymore or we're going to change the game.

10 One of the reasons why US agriculture
11 can ship the millions of tons it does by rail and
12 if you don't pay attention to this you wouldn't
13 know this, but the ag changes in ag shuttles to
14 make it more efficient was led by the farmer
15 because the farmer started to having to take
16 because of yields increasing off the field they
17 were filling up their trailer in the field every
18 15 minutes. They needed to be able to get it
19 somewhere so it could be moved quickly. The
20 whole development of ag shuttles is sufficient
21 movement of grain out of Iowa and all across the
22 board, has allowed the US to become extremely

1 efficient exporter, not just by barge but by
2 rail. You simply make it so that it's not in
3 somebody's interest to efficiently move that
4 stuff by transportation, remember each shuttle
5 train is carrying 12,000 tons of grain. It only
6 takes four trains to fill up a ship or five
7 trains. You mess with that and change the
8 economics so that it is no longer in their
9 interest; you've created a lot of harm.

10 CHAIR MILLER: So is it reasonable to
11 conclude that for the proposals that have been
12 brought to us in this procedure where part of
13 what the parties who prepared them are trying to
14 do is to create something that was formulary that
15 was predictable that had simplicity built in,
16 again I don't want to put words into your mouth
17 but I'm good at doing it so that's what I'm going
18 to try to do. Would you say that just does not
19 fit the complexity of the agricultural market and
20 it's sort of a fool's errand to try?

21 MR. KAUFMAN: Give you an example,
22 when they talk about trying to bundle rates, so

1 we're going to compare like markets and
2 competitive areas or something like that and
3 we're going to compare CSX rates with BNSF rates
4 to come up with a bundle, it's comparing apples
5 and rutabagas. By doing that, you'll have a
6 wonderful revenue transfer to the ag shipper
7 because you're going to plummet rates. You're
8 suddenly going to make the maximum threshold for
9 a railroad, for instance to ship, you're going to
10 cut it down to a point where maybe they're not
11 making any money or enough money that it's even
12 worth them to devote the resources to handling
13 it.

14 CHAIR MILLER: Why do you say that's
15 apples to rutabagas?

16 MR. KAUFMAN: So if you take the
17 United States and you divide it at the
18 Mississippi River, there's very little
19 interaction market wise. It goes on between
20 agriculture west of the Mississippi and east of
21 the Mississippi--

22 CHAIR MILLER: Uh-huh.

1 MR. KAUFMAN: -- for instance, look
2 there's no question that some Iowa corn moves
3 east in the chicken markets but that's only in
4 drought times or whatever. Where it doesn't
5 work, most of the times stuff east of the
6 Mississippi goes to --

7 CHAIR MILLER: Uh-huh.

8 MR. KAUFMAN: -- eastern markets or it
9 goes down the river, now look I'm not including
10 the fact that you know along the river there's a
11 very strong drawing arc down the river for each
12 side of the river but for the most part
13 agricultural products don't cross the Mississippi
14 River; look wheat goes from hard wheat from
15 Kansas to eastern mill markets and stuff like
16 that but just as a rule the bulk of the
17 commodities don't. So rate structures in the
18 eastern railroad is like the NS and CSX they're
19 mainly receiver contracts or they're lottery
20 receiver contracts, they don't have as one
21 testified they don't nearly as many tariff based
22 rates, it's a completely different market.

1 CHAIR MILLER: But what about BNSF and
2 UP, is that a Gala to a Fuji?

3 MR. KAUFMAN: Yes, you could compare
4 those rates but you know the situation you have
5 if you look at the math, in most cases except
6 maybe in Montana and parts of North Dakota the UP
7 and the BNSF are within 200 miles from each other
8 so if they get out of whack with their rates,
9 farmers just puts in a truck and moves it to the
10 other elevator, which is exactly what happened
11 when the railroad BNSF was broken down on service
12 last year. The UP you noticed their market share
13 went up to the roof because they were handling
14 much more grain. So the system flexes. When I
15 look at these formulas, they're going to say well
16 I'm going to mix all these things together and
17 come up with a legitimate rate. I think one
18 person testified, I think the UP, she did a great
19 job but there's probably enough density of rates
20 in each individual railroad, that if you're going
21 to compare competitive moves, just compare them
22 within railroads. If you have to do that, that

1 may work. But, when you start reaching out, I'm
2 sorry, but I think you begin to find that it's
3 not simple anymore, it makes it complicated.

4 By the way, you don't think the people
5 involved can game the process? You change the
6 rules, everybody's going to also game the process
7 too, right? So it's not as predictable as
8 everybody thinks. We certainly learned that in
9 the grain trade for the last 35 years, every time
10 the US government changes the rules on the way
11 grain trade is handled. Canada is another
12 negative example. We're reciting, oh what a
13 wonderful job the Canadian regulatory people have
14 done. Well, I hope you take the time to look at
15 what happened in Canada last year. It wasn't
16 just because they had a huge miraculous crop, the
17 railroads couldn't handle it but the regulatory
18 things made it far worse. You want another
19 anecdote, a little example?

20 CHAIR MILLER: Sure.

21 MR. KAUFMAN: The Canadian government
22 mandated that they had to move so many tons. You

1 have to move this many tons of grains per month,
2 the railroads then just changed the thing so they
3 moved it in little short distances back and
4 forth, back and forth, back and forth, back and
5 forth. Then what happened, they also said, oh my
6 gosh, I have these cars back because I have to
7 have this stuff moving so we're not going to let
8 any of our grain go over Chicago anymore,
9 remember?

10 CHAIR MILLER: Uh-huh.

11 MR. KAUFMAN: All the complaints, not
12 going to go over Chicago anymore. So suddenly
13 everybody wanted to use the BNSF to go over
14 Chicago where the service was melting down. What
15 did the BNSF do, they raised the rates over
16 Chicago \$500.00 a car. Everybody said, boo, boo,
17 boo, you raised the rates \$500.00 a car but it
18 was because everybody only had one railroad that
19 they wanted to use over Chicago, in order to get
20 the grain to the eastern milling markets.
21 There's always these consequences that nobody
22 thinks about how they're fussing with it, it's

1 and interrelated network business I'm sorry if
2 it's complicated and that's why I'm an advocate
3 of arbitration.

4 CHAIR MILLER: Can you say a bit more
5 about, you made the point and I think you said
6 sort of an inverse relationship between rates and
7 service?

8 MR. KAUFMAN: Well it's about rate
9 regulation not rates per se ---

10 CHAIR MILLER: Uh-huh.

11 MR. KAUFMAN: If you want to reduce it
12 absurd if the railroad could charge infinity for
13 their rates, their service would be marvelous.
14 The joke, sometimes, is the railroad would
15 operate perfectly without customers, right.
16 There really is a relationship though when you
17 increase regulation, it never increases service.
18 Can you cite an example of where we increase
19 regulation and somehow the cost goes down and
20 service goes up, I don't think you can come up
21 with a very good example. That's the problem I
22 worry about, even well-meaning regulation,

1 because it has the impact of somebody who has a
2 choice choosing to do something else.

3 A perfect example is Canada again when
4 they put in their regulation on export rates,
5 where do you think the Canadian railroads
6 invested all their money? Intermodal, petroleum,
7 everything that wasn't regulated on the grain
8 side. I know you guys haven't paid attention to
9 this but there's a problem in Canada with the
10 rail cars. When was the last time a Canadian
11 railroad spent any money on rail cars? Most of
12 the rail cars in Canada are almost 40 years old
13 reaching their interchange life. That's a
14 problem that still haven't been solved. Why?
15 Because if you're getting incentive serving
16 everybody else and you getting regulated to serve
17 a particular thing, where do you put your
18 investments? You put your investments where the
19 best return is, so that's the unintended
20 consequence.

21 Whereas, BNSF and I can't speak for
22 them but I worked for them long enough to know

1 the billions of dollars they're putting into
2 their network is real. You're going to see
3 there's going to be a long tail to this money
4 from a ag service standpoint. They really were
5 shocked by the poor service they had or the
6 problems they had, which was at the very end of
7 my tenure as leaving all of -- -

8 CHAIR MILLER: So you were responsible
9 then?

10 MR. KAUFMAN: I absolutely was.

11 CHAIR MILLER: We can point our
12 fingers at you, now we know.

13 MR. KAUFMAN: After I left they spent
14 all this money to fix it, but you know it does
15 work. At the same time, I'm not sitting here
16 saying you don't need some sort of judicial
17 review process because just like Terry Whiteside
18 and the Montana guys were talking about, there
19 are shippers that feel left out. As long as
20 there are shippers that feel left out or farmers
21 that feel left out, you're going to get
22 complaints and so there is a legitimate reason to

1 have some sort of process where people at least
2 feel like they're getting a fair deal.

3 CHAIR MILLER: So let me ask this
4 question then, we do have a process and
5 apparently they still feel left out so what is it
6 that needs to be tweaked in that process so that
7 it feels more inclusive and available?

8 VICE CHAIR BEGEMAN: Can I interrupt
9 just a second?

10 CHAIR MILLER: Sure.

11 VICE CHAIR BEGEMAN: I think it's more
12 than just a feeling of being left out, I think
13 that it's a reality.

14 CHAIR MILLER: Their reality.

15 MR. KAUFMAN: They are left out, I
16 don't disagree, yes.

17 VICE CHAIR BEGEMAN: Oh, I was curious
18 to know if you disagreed with that.

19 MR. KAUFMAN: No, I don't.

20 VICE CHAIR BEGEMAN: Okay.

21 MR. KAUFMAN: When I worked for the
22 BNSF, why did we attack, I mean attack in a

1 positive way, Montana so hard because it was
2 clear that they had a legitimate beef. I don't
3 mean to talk about the economics of captivity but
4 they really are, in my opinion, the only state
5 except maybe western North Dakota, that is
6 economically technically captive from a
7 transportation standpoint, they had a legitimate
8 beef so we tried to fix that.

9 Again I can tell you another anecdote.
10 Shortly after I worked for the BNSF, I went to
11 Helena and met with these people. I was ripped a
12 new one and I came away and I said, oh, there's
13 something I don't know. One of the things I
14 didn't recognize, the great epiphany was that it
15 wasn't about the shippers, it was about the
16 farmers. The farmers were the ones that felt
17 like they were getting a raw deal, the shippers
18 you know were treating the farmers like mushrooms
19 like they usually do. So they didn't know really
20 what was going on.

21 Then I discovered what they perceived
22 the railroad was doing to them, was really

1 negative and so we tried to attack it so it's
2 real. I'm not saying it's a feeling but the
3 biggest problem with ag is density. We talk
4 about filing a rate case but even the most dense
5 ag origins probably ship no more than 10,000 or
6 12,000 cars a year. So when you sit there and
7 raise your hand and have some sort of case or
8 judicial review, it's going to cost a million
9 dollars. Forget that, let's pretend it's going
10 to cost \$100,000.00 and I might earn a million
11 dollars. It's not worth it. Think about it,
12 even if you ship 12,000 cars, what do I get I get
13 a prescription for three years of my rate; what
14 my rates going to be cut \$100.00 per car, do the
15 math.

16 VICE CHAIR BEGEMAN: Oh.

17 MR. KAUFMAN: That's part of the
18 problem is the one size fits all doesn't fit very
19 well for the way agriculture really exists. We
20 talk about single serve places but there's a
21 reason why they're single serve, there's just no
22 density. The other side of it is again; a dirty

1 little secret, do shippers really care about
2 rates? No, what they care about is relative
3 rates. They care about what their competitive
4 elevator down the road is being charged. They
5 don't care about absolute rates because it's a
6 pass through. Unless rates are so egregious that
7 it stops the farmer from planting a crop, they
8 don't pay it. They're interested much more in
9 relative rates and how the United States fits in
10 the total global paradigm of agriculture. When
11 you add those things up, it's really hard to come
12 up with something that's going to be cheap enough
13 to regulate rates in a way that's going to make
14 it simple enough that somebody can get judicial
15 review that works.

16 That's why I like arbitration because
17 NGFA works with these same guys, these same
18 elevators, big or small. Their cases cost less
19 than \$10,000.00 to prosecute and get a decision
20 in six months. The process works. I truly
21 believe if railroads were incorporated in some of
22 that, you wouldn't have very much arbitration.

1 You wouldn't have issues that come up like
2 reciprocal switch costs that go up in the east
3 suddenly. You get a phone call that says, my
4 gosh I'm being charged \$550.00, \$650.00 because
5 somebody would say ooh I can't do that because
6 somebody's going to arbitrate it NGFA. That's
7 why I go that direction. As much as I love you,
8 I just don't know if you can put together
9 something that works. Even though, like you
10 said, that's responsibility.

11 MR. MACDOUGALL: Well let me just say
12 one thing, I think it wasn't mentioned but the
13 shippers used to have a forum and it wasn't here,
14 it was the rate bureaus. I'm serious, it was the
15 rate bureaus and every week I used come down
16 there in ICC it was published all the rate
17 dockets. When there was going to be a hearing
18 and a lot of things, the other railroads were
19 there. So you had a railroad able to talk to
20 other railroads that were serving other regions
21 of the shippers, so this thing worked out. This
22 existed from way back in 1880's. It didn't end

1 until about the time of Staggers. It was rate
2 bureau thing and those of us they had schools in
3 Chicago, if you wanted to go into transportation,
4 you learned the rate bureau procedure. It was a
5 manual.

6 How you make out your proposal? They
7 have one in New York as well Arthur Arshom ran
8 that one there. They had one there. The decline
9 of the evolution of the rate bureaus put greater
10 burden on the ICC and on this agency because that
11 initial review process was no longer legal. You
12 could only go to your individual railroad. They
13 can't put it on the docket and you can't go to a
14 hearing. That used to be an important process.
15 I recall when Volkswagen put up a plant in
16 Pennsylvania, we had to go to the rate bureau in
17 New York, DEA. That is where it was resolved to
18 get the freight rate not to the ICC.

19 CHAIR MILLER: So Mr. MacDougall
20 sounds like you're saying that we need to have
21 more hearings.

22 MR. MACDOUGALL: Hearing?

1 CHAIR MILLER: We need to have more
2 hearings so the railroads and shippers can ---

3 MR. MACDOUGALL: But you see there
4 were discussing not just the point to point rate
5 what you get with your percentages. They look at
6 how that was going to affect, in other words, you
7 could want a reduced rate on lumber from Coos Bay
8 to Chicago but got to affect the rate from
9 Hattiesburg to Chicago.

10 CHAIR MILLER: Uh-huh.

11 MR. MACDOUGALL: They all from
12 different railroads but you're not getting that
13 in your rate cases you're getting point to point
14 with a formula and you're not seeing the
15 structure and if you had a hearing, you might
16 hear more other people might come in. But the
17 evolution of the rate bureaus is what
18 precipitated problems for small shippers because
19 it didn't have a forum. Then they formed a
20 forum, which didn't have to pay any money. They
21 just go themselves and talk.

22 VICE-CHAIR BEGEMAN: I think that's one

1 of the things that prompted this hearing and the
2 proceeding. We know the frustration out there
3 for folks, --

4 MR. MACDOUGALL: I'm just giving you
5 some background of these changes and it wasn't
6 the Staggers Act, we had a hearing on the
7 Staggers Act ex parte 653 or 658 and pointed out
8 that all these things didn't come about it was
9 the Staggers Act. The Staggers Act's only major
10 thing was contract rates. All of that stuff was
11 done before our act and the professors have
12 written a book on that. So in the Staggers Act,
13 in fact when I heard you were going to have this
14 thing, I brought down the filings I made in the
15 proceedings on the Staggers Act, which is
16 instituted really by the late board member,
17 Mulvey, he's the one that got the funding for the
18 TRB and told him at the time, I said --

19 VICE CHAIR BEGEMAN: Former, not dead.

20 MR. MACDOUGALL: Former.

21 VICE CHAIR BEGEMAN: Former, not late.

22 MR. MACDOUGALL: Yes, it wasn't the

1 Staggers Act that was a propaganda stunt. They
2 called it the Staggers because he was a labor guy
3 and they wanted to blame the labor people for it.
4 The Staggers Act didn't do these things, it was a
5 minor little tinkering in the Staggers Act on
6 market dominance and some other things but the
7 Staggers Act after 35 years of using it after 25
8 years is a fake, for all this rate regulations.
9 In fact, the ICC gave the railroads the contract
10 rates but they wouldn't use it so the chairman of
11 the ICC went down to Arizona, to the practitioner
12 and said why you railroads are not using it, we
13 gave you the authority. Well the real reason is
14 what happened in the steamship industry. The
15 Federal Maritime Board, at the time, said come on
16 in here and prove your dual rates. The Supreme
17 Court, Judge Black was there and he was on the
18 Merchant Marine committee, or whatever was the
19 Senate committee and knew all that he knew when
20 steamships come to the FMC to be regulated with
21 proof contracts rates, it was wrong it was an
22 Anti-trust violation.

1 CHAIR MILLER: Well, Mr. MacDougall --

2 MR. MACDOUGALL: The railroad here
3 said we're not going to use the contract rates
4 until it had congressional approval because they
5 weren't going to be like the steamship industry.
6 The staff person they could study of contract
7 rates in the United States, the had the sewer
8 line and pipe rates in contract, New York Central
9 had the Amsterdam New York thing but it took
10 legislation and anything that was different than
11 what the proposal was, it's secret the railroads
12 had never wanted secret tariffs, it was their
13 shippers that wanted it big shippers. They
14 wanted to know what their competitors were doing
15 so if the contract rates would pass it made it
16 secret.

17 CHAIR MILLER: So Mr. MacDougall it
18 sounds like --

19 MR. MACDOUGALL: Just some background,
20 that's all.

21 CHAIR MILLER: Yes, I was going to say
22 maybe we can follow up sometime. It sounds like

1 you have history that I certainly am not familiar
2 with and I'm sure I could learn a lot.

3 VICE CHAIR BEGEMAN: Well if I could
4 just say, thank you. Really I think the hearing
5 ended as interestingly as it started, thank you.
6 I also thank the folks that have managed to stay
7 here throughout this whole process. You know who
8 you are. We can count you on about two hands but
9 --

10 CHAIR MILLER: Blue ribbons will be
11 handed out later.

12 VICE CHAIR BEGEMAN: Thank you all for
13 sticking with us for the whole day and really
14 thank you for sharing with us your perspectives.
15 Kevin will keep figuring out a way to get the
16 right answer.

17 MR. MACDOUGALL: Make sure to repeat
18 on the record that that there are 14 days for
19 their comments.

20 CHAIR MILLER: Yes the record is open
21 for 14 days.

22 MR. MACDOUGALL: Because I don't think

1 the people just on the website will know.

2 CHAIR MILLER: Thank you all very much
3 and for those of you who stuck with us thank you
4 for hanging in there.

5 (Whereupon, the above-entitled matter
6 went off the record at 6:35 p.m.)

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C E R T I F I C A T E

This is to certify that the foregoing transcript

In the matter of: Rail Transportation of Grain, Rate
Regulation Review

Before: US STB

Date: 06-10-2015

Place: Washington, D.C.

was duly recorded and accurately transcribed under
my direction; further, that said transcript is a
true and accurate record of the proceedings.



Court Reporter

NEAL R. GROSS

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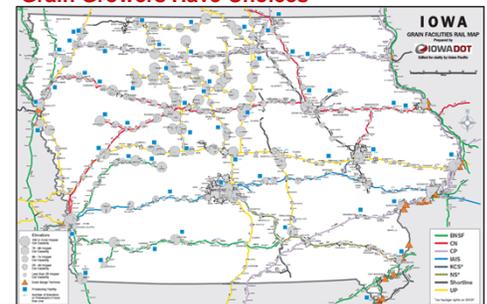


June 10, 2015

Ex Parte 665(1) Rail Transportation of Grain, Rate Regulation Review

Louise A. Rinn
Associate General Counsel

Grain Growers Have Choices





"Previous studies have concluded that many agricultural shippers have a range of transportation alternatives, that grain transportation markets are largely competitive, and that different modes of transportation often compete head-to-head to move grain." USDA Reply Comments at p. 3.

URCS Costs Do Reflect Grain Train Efficiencies

Trainload Costs 37% Lower than Carload

2013 West Region URCS Hypothetical Movement

	Trainload per car	Carload per car	Variance per car
1 Gross Ton Mile	\$824.24	\$824.24	\$0.00
2 Locomotive Unit Mile	\$378.38	\$919.02	(\$540.64)
3 Carload Chg & Term Clerical	\$19.06	\$25.34	(\$6.28)
4 Carload Handled Other	\$2.80	\$2.80	\$0.00
5 Crew Wages	\$176.74	\$271.16	(\$94.42)
6 Train Mile Other	\$8.76	\$13.45	(\$4.69)
7 Switching	\$49.46	\$321.51	(\$272.05)
8 Car Mile Running	\$149.41	\$149.41	\$0.00
9 Car Mile Yard	\$1.55	\$5.05	(\$3.50)
10 Car Day Running	\$76.32	\$76.32	\$0.00
11 Car Day Yard	\$81.42	\$264.61	(\$183.19)
12 Car Mile Running Accessorial	\$3.67	\$3.67	\$0.00
13 Car Mile Yard Accessorial	\$0.04	\$0.13	(\$0.09)
14 Car Day Running Accessorial	\$1.12	\$1.12	\$0.00
15 Car Day Yard Accessorial	\$1.20	\$3.90	(\$2.70)
16 Loss & Damage	\$2.96	\$2.96	\$0.00
17 Ex Parte Adjustments - Make Wholes	\$0.00	\$245.64	(\$245.64)
18 Variable Cost Per Car @ 2013 Cost Level	\$1,777.14	\$2,800.33	(\$1,023.19)



Grain Can Also Cost More

- Longer cycle times for cars to Mexico
- Car storage due to variability and seasonality
- Fuel costs for export trains moving over Blue Mountains

Specified operating parameters: 1000 mile local move; 110 cars in train; railroad-owned covered hoppers; 95 tons per car

NGFA proposes a new maximum rate approach for Ag commodities -- The Ag Commodities Maximum Rate Methodology (“ACMRM”)

1. ACMRM uses a comparison group approach similar to the Board’s current Three Benchmark Methodology.
2. The comparison group includes rates for shipments above and below the 180% R/VC cost level.
3. The comparison group includes shipments from all railroads, not just shipments from the incumbent carrier.
4. The shipper would select all comparable moves that meet the selection criteria for the movement at issue from Confidential Waybill Samples.

NGFA proposes a new maximum rate approach for Ag commodities -- The Ag Commodities Maximum Rate Methodology (“ACMRM”) -- Continued

5. Comparability to the issue movement will be based on the following factors:
 - a. Distance (+/- 20% of issue movement miles);
 - b. Commodity;
 - c. Railcar Type;
 - d. Railcar Ownership; and
 - e. Movement Type (originate/terminate, originate/deliver, etc.).
6. Even though the comparison group would include movements with R/VC ratios below 180%, the maximum reasonable rate produced by the analysis would be subject to the statutory 180% floor.
7. NGFA’s ACMRM approach *will not* allow for examination of “other relevant factors.”

NGFA proposes a new maximum rate approach for Ag commodities -- The Ag Commodities Maximum Rate Methodology (“ACMRM”) -- Continued

8. The ACMRM also makes commodity specific adjustments to reflect each Class I carrier’s revenue adequacy status.

The proposed ACMRM Revenue Adequacy Adjustment Factor (“RAAF”)

$$\text{RAAF} = \{[(\text{COC} - \text{ROI}) \times \text{RRIB}] \div (1 - \text{Tax Rate})\} \times (\text{STCC Rev}_{>180} \div \text{RR Rev}_{>180}) \div \text{STCC Rev}$$

Where:

RAAF	=	Revenue Adequacy Adjustment Factor
COC	=	Railroad Industry Cost of Capital
ROI	=	Railroad Specific Return on Investment
RRIB	=	Railroad Specific Tax Adjusted Net Investment Base
Tax Rate	=	Railroad Specific Marginal Tax Rate
STCC Rev _{>180}	=	Railroad Specific Revenue by STCC from Movements with R/VC Ratios Greater Than 180%
RR Rev _{>180}	=	Railroad Specific Revenues from Movements with R/VC Ratios Greater Than 180%
STCC Rev	=	Railroad Specific Revenues by STCC

The RAAF calculation is based on data already calculated by the STB

Example - 2014 Union Pacific RAAF For STCC 01132 - Corn

<u>Item</u>	<u>Source</u>	<u>Statistic 1/</u>
(1)	(2)	(3)
1. Railroad Industry Cost of Capital	STB Ex Parte No. 558	10.65%
2. Return on Investment	STB Ex Parte No. 552	17.35%
3. Investment Base	STB Ex Parte No. 552	\$30,455,169
4. Tax Rate	STB Ex Parte No. 682	38.83%
5. UP Total Revenues for STCC 01132	QCS or Waybill Sample 2/	\$748,869
6. UP Revenues >180% for STCC 01132	Waybill Sample 2/	\$314,525
7. UP Total Revenues >180%	STB Ex Parte 689 2/	<u>\$11,213,960</u>
8. Total Railroad Shortfall/(Overage)	$[(L.1 - L.2) \times L.3] \div (1-L.4)$	(\$3,335,780)
9. STCC 01132 Shortfall/(Overage)	$(L.6 \div L.7) \times L.8$	<u>(\$93,561)</u>
10. UP STCC 01132 RAAF	L.9 ÷ L.5	-12.5%

1/ Dollars in thousands.

2/ Figures assumed for this example.

Applying the ACMRM approach provides a straightforward assessment of the reasonableness of an Ag commodity rate

Example of the Ag Commodity Maximum Rate Methodology

Issue Movement Parameters

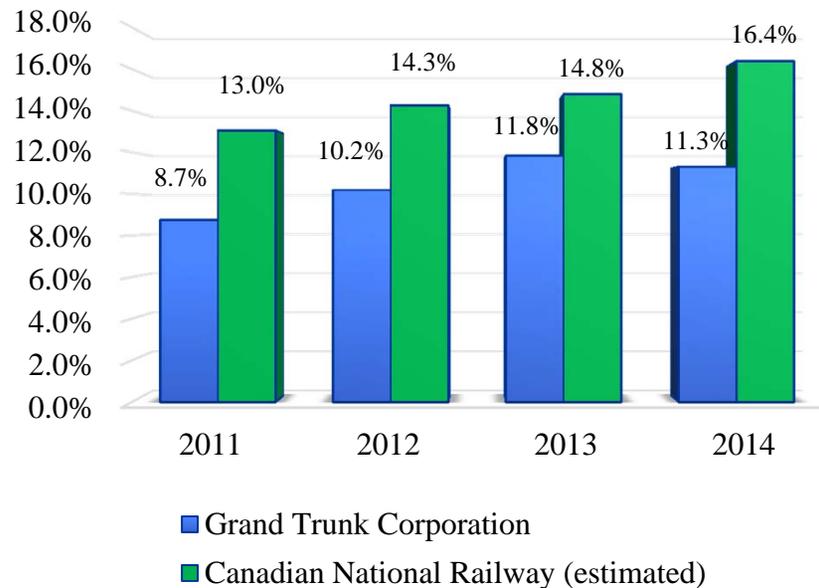
1. 5-Digit STCC	01132 - Corn
2. Distance - Miles	120.0
3. Total Revenue Per Car	\$1,800
4. Variable Cost (Per Car)	\$400
5. Revenue to Variable Cost ("R/VC") Ratio	450.0%
6. Jurisdictional Threshold (Per Car)	\$720

Comp Group Analysis

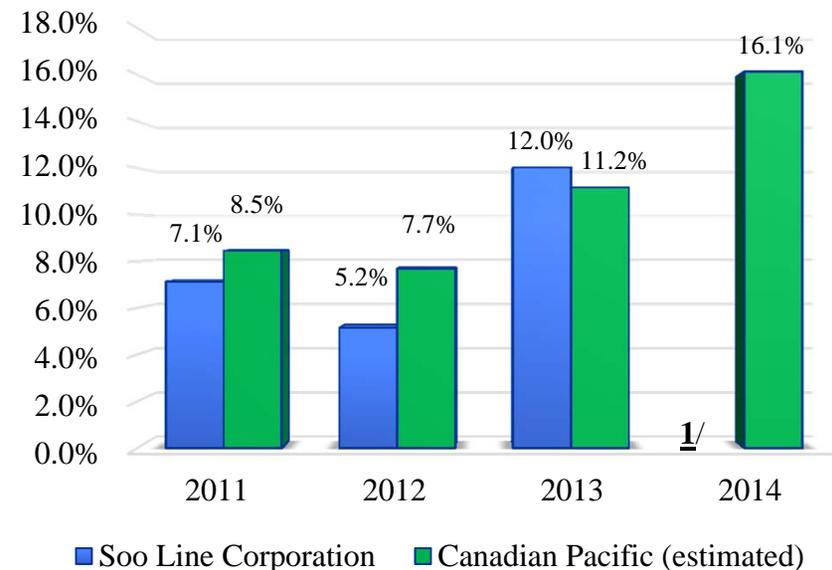
<u>Movement</u>	<u>Railroad</u>	<u>Distance</u>	<u>Revenue</u>	<u>RAAF</u>	<u>Adjusted Revenue</u>	<u>Variable Cost</u>	<u>Adjusted R/VC Ratio</u>
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
a.	UP	115.0	\$935	-12.5%	\$818	\$580	141.0%
b.	UP	112.0	\$835	-12.5%	\$731	\$400	182.8%
c.	UP	112.0	\$835	-12.5%	\$731	\$383	190.9%
d.	UP	115.0	\$1,900	-12.5%	\$1,663	\$432	385.0%
e.	UP	110.0	\$1,200	-12.5%	\$1,050	\$571	183.9%
f.	BNSF	110.0	\$440	-4.2%	\$422	\$330	127.9%
g.	BNSF	96.0	\$350	-4.2%	\$335	\$255	131.4%
h.	CSXT	140.0	\$890	2.8%	\$915	\$384	238.3%
i.	CSXT	96.0	\$450	2.8%	\$463	\$309	149.8%
j.	CSXT	132.0	\$450	2.8%	\$463	\$372	124.5%
7. Simple Average R/VC (Line a. through Line j.)							185.5%
8. Adjusted Issued Traffic Rate (Line 4 x Line 7)							\$742
9. Maximum Reasonable Rate (Greater of Line 6 or Line 8)							\$742

The choice of including some, but not all, of a railroad's subsidiary companies impacts the railroad's ROI

Grand Trunk Corporation and Canadian National Railway Return On Investment – 2011 to 2014



Soo Line Corporation and Canadian Pacific Return On Investment – 2011 to 2014



1/ Soo Line's 2014 Schedule 250 shows an Adjusted Net Railway Operating Income of negative \$12.1 million due to write downs from its sale of the DME.



Modernizing Freight Rail Regulation

RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW
Docket No. EP 665 (Sub-No. 1)

Richard Schmalensee
June 10, 2015

Congressional Study Request

Examine and Make Recommendations on:

- **Rate and service trends, post-Staggers**
- **Regulatory performance in balancing revenue adequacy and reasonable rates**
- **Future role of STB in regulating rates and service**

Funded by USDOT

NAS/TRB Role:

- **Congressionally chartered to advise government**
- **Committee members: no financial conflicts, balance of views and expertise, serve pro bono**
- **Reports are peer reviewed, fully independent**

Committee for a Study of Freight Rail Regulation

- **Richard Schmalensee, MIT, *Chair***
- **Ken Boyer, Michigan State University**
- **Jerry Ellig, George Mason University**
- **Tony Gómez-Ibáñez, Harvard University**
- **Anne Goodchild, University of Washington**
- **Wes Wilson, University of Oregon, Eugene**
- **Frank Wolak, Stanford University**

Study Process

Briefings by:

Government agencies (STB, FRA, USDA)

Railroad industry (AAR, Short-lines)

Rail Labor

Shipper Groups (coal, grain, chemicals, other)

Briefings on Canadian system

Academic Experts and Consultants

Review of literature & STB documents

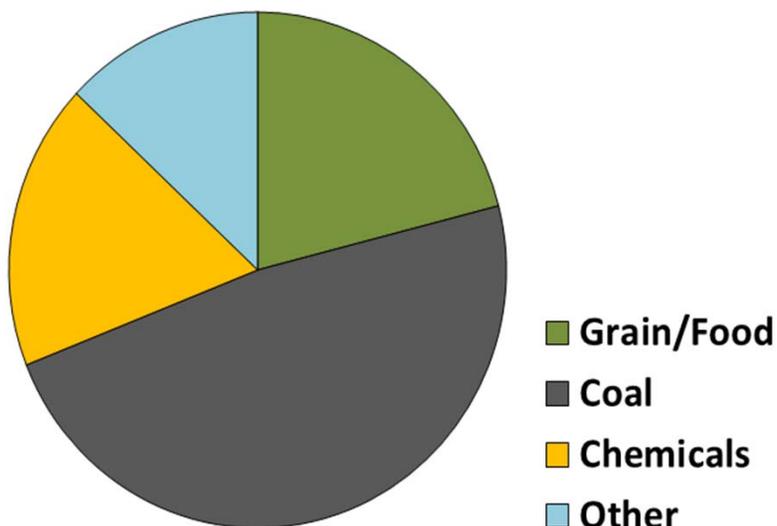
***Statistical Analysis* of Carload Waybill Sample**

Closed Deliberations to Develop Report

Use of Common Carriage (with Reasonable Rate Obligation)

Share of Total Common Carriage Ton-miles

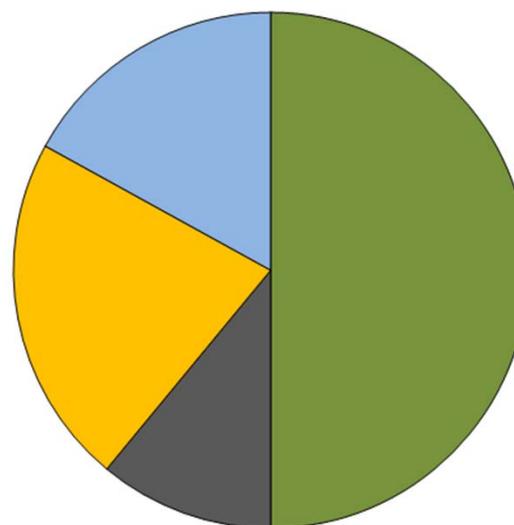
Year 2000



>Coal drops from 48% to 11%
[Use falls from 52% to 5%]

>Grain/Food up from 21% to 50%
[Use **remains** ~70%]

Year 2012



Current Rate Relief Process: 3 Steps

- 1. Initial screen: 180% R/VC formula, using URCS VC numbers**
- 2. Market dominance inquiry for rates > 180% R/VC**
- 3. Rate reasonableness ruling: SAC, simplified SAC, or 3-benchmark**

Process, level of relief must respect the law's interest in protecting revenue adequacy

Best viewed as a “system”—a permissive and/or unreliable URCS R/VC screen will prompt regulators to rely on steps 2 and 3 to safeguard revenue adequacy.

Finding : Variable Cost Allocations (a la URCS) are Economically Invalid and Unreliable, Better Alternatives Exist

With joint & common costs, there is no economically valid measure of shipment-specific variable cost (in contrast to incremental cost)

- Omitted costs—costs not recorded in expense records (e.g., risk)
- Arbitrary time frame for fixed/variable determinations
- Any allocation of common cost is purely arbitrary
- So, no reason why rates should reflect URCS numbers

URCS is unreliable—but its unreliability is not random

- Some types of traffic have uniformly high R/VCs
- Illogical results, 20-30% of traffic R/VCs below 100%

URCS cannot be fixed: Such cost allocation is fundamentally flawed

A better alternative: *use rates determined under competition for screening*. Not possible when Staggers was enacted, feasible now

Finding: Market Dominance Inquiries Should be Disciplined by Time Limits, not Categorical Limits on Evidence

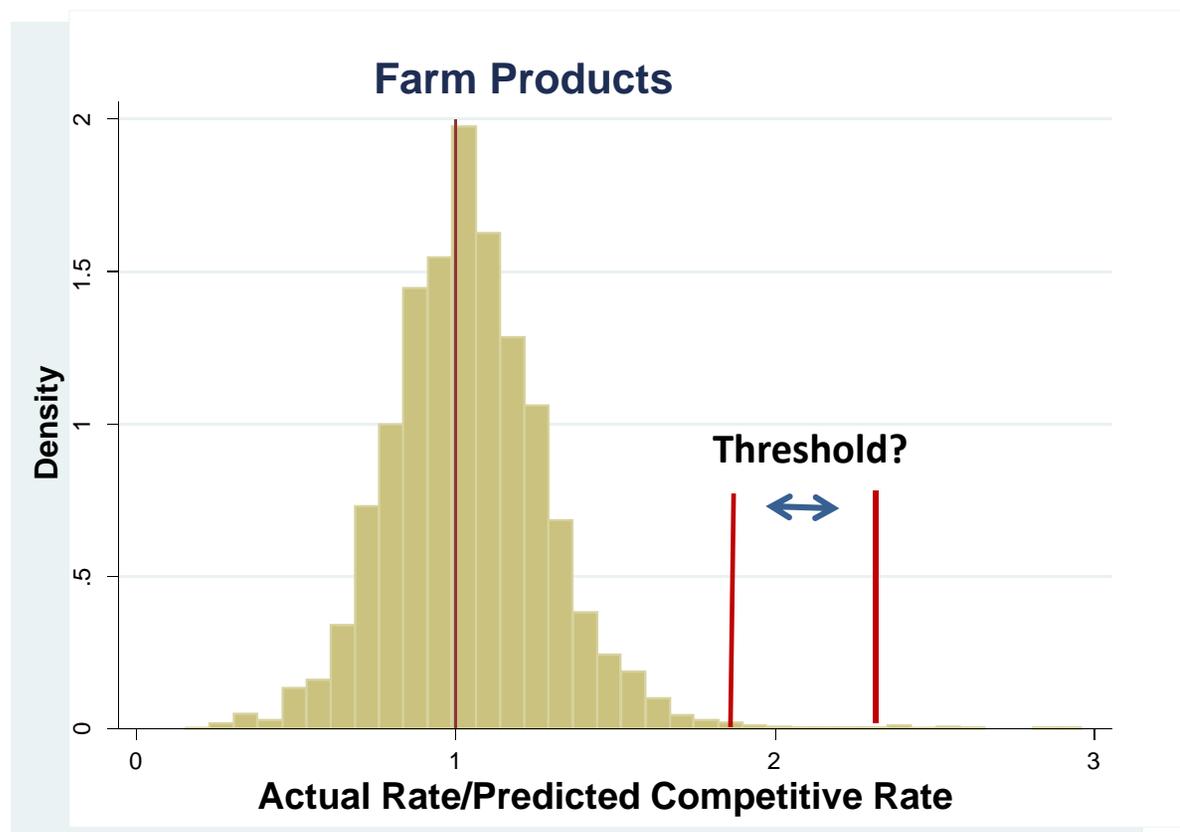
- **Considering all substitution possibilities can slow and deter cases, *but excluding evidence biases outcomes***
- **Antitrust agencies routinely examine complex product and geographic competition – *in informal proceedings***
- **Time limits on all sides compel prioritization of arguments**

Finding: Methods for assessing rate reasonableness lack a sound economic rationale and are unusable by most shippers; sounder and more economical methods needed

- **Railroads & shippers have incentives to move all profitable traffic, so rate relief is about fairness, not efficiency**
- **SAC aimed to prevent uneconomic entry in telecom (not an issue here!), not indicative of actual revenue needs, & too costly & time-consuming to be usable by small shippers**
- **Simplified procedures conceptually flawed, seldom used by shippers, & make more use of URCS – *the wrong direction!***

Recommendation: Prepare (via method development) to Replace R/VC and URCS With Competitive Rate Benchmarking

- Determines *potentially* unreasonable tariff rates based on comparable rates in competitive markets
- The farther a tariff rate is from its predicted level under competition, the more likely lack of competition was a factor



Competitive Rate Benchmarking (cont.)

- **Benchmarking (like the URCS R/VC test) can only identify plausible candidates for further scrutiny**
- **Regulators would determine the threshold(s), taking revenue adequacy into account.**
- **Threshold determination is likely to be controversial, *but transparent***
- **Report has a “proof of concept”; USDOT should develop, test, and refine competitive rate prediction methods.**
- **Legislation would be required to implement this approach**

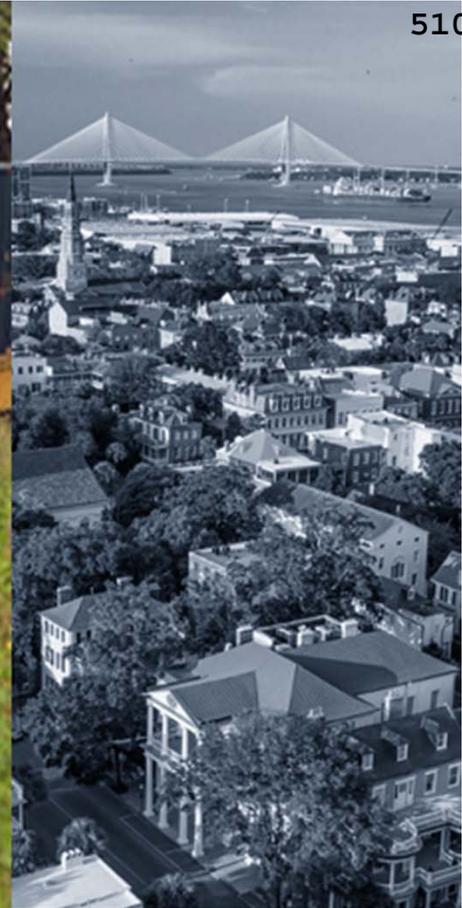
Recommendation: Replace STB rate reasonableness hearings (dominance, SAC, etc.) with time-limited final offer arbitration

- **With a sound & unbiased screening tool, burdensome processes no longer needed for safeguarding revenue adequacy**
- **Arbitration is relatively informal, so can be fast, economical, & will not deter cases.**
- **Final offer rule will prompt compromise and settlement.**
- **Canada has shown effectiveness when accompanied by time limits**
- **Arbitrator should assess market dominance; competitive rate benchmark cannot assure dominance was cause of high rate.**
 - **No artificial evidence restrictions, only time limits**
 - **If dominance not demonstrated, case dropped or RR offer selected.**

Other Relevant Recommendations

Allow reciprocal switching to be proposed in arbitration proceedings

End annual revenue adequacy determinations; require periodic, deeper assessments of industrywide economic and competitive conditions.

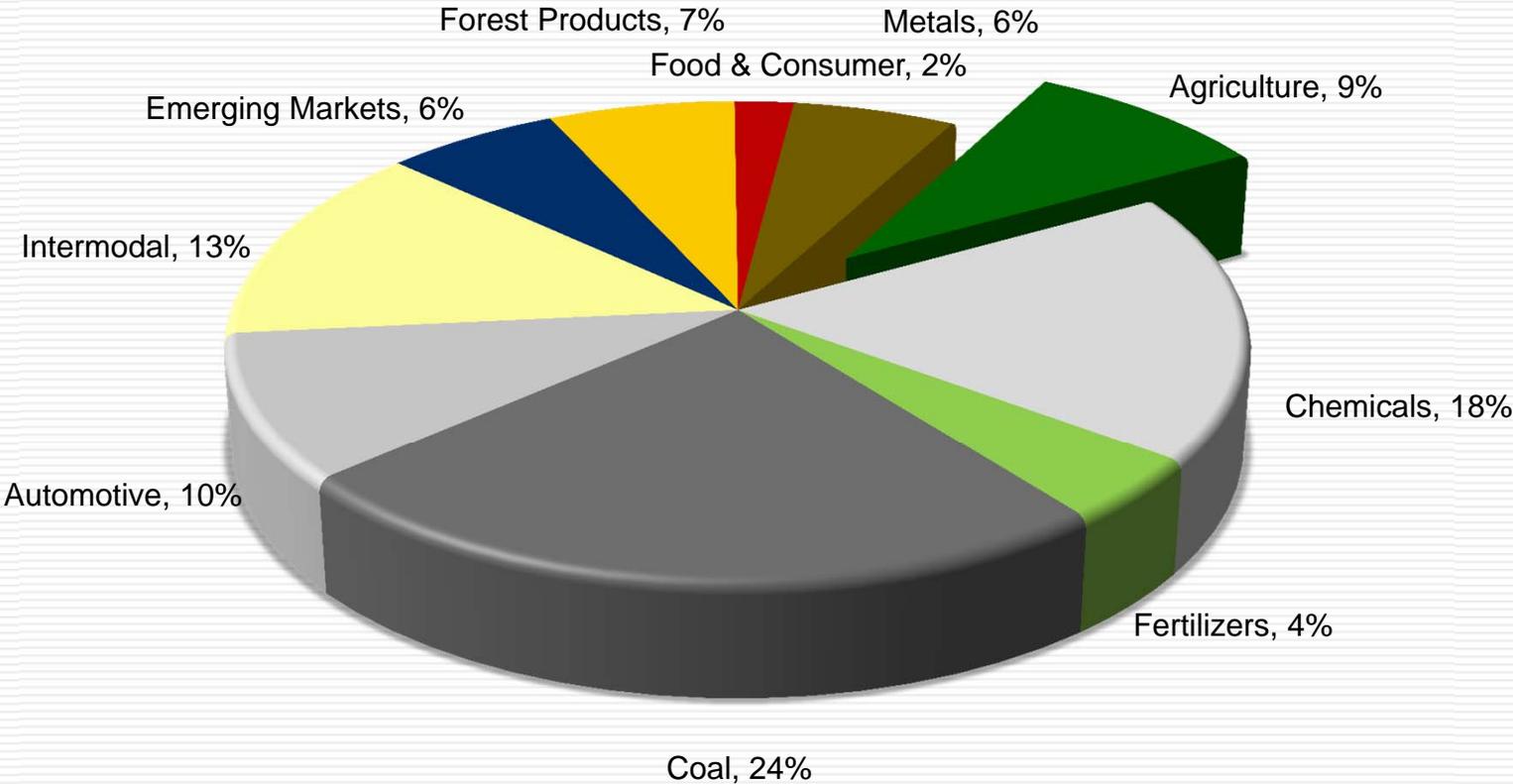


CSX Testimony STB Hearing

June 10, 2015

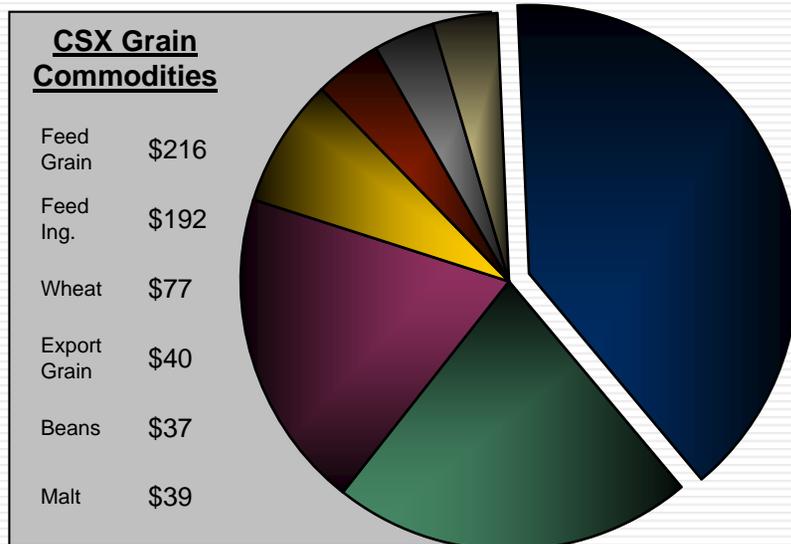


CSX is a \$11 billion rail transportation company moving a diverse business portfolio of products



Grain comprises 60% of CSX AG line haul revenues

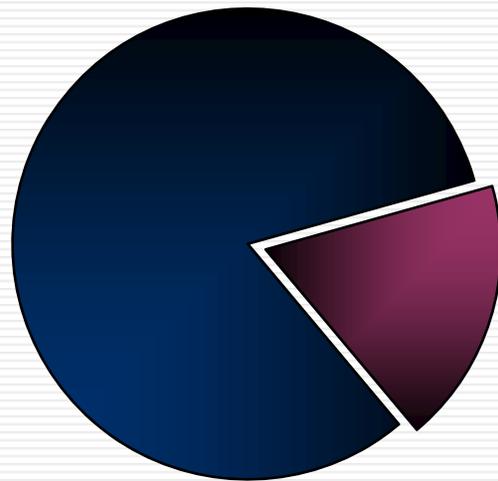
2014 Line Haul Revenue Agricultural Products



- Feed mill consumption represents 60% of grain revenues
- Grain for processing represents 25% of grain revenues
- Balance is export grain

Majority of CSX grain traffic moves under contract

CSX Grain Carloads



■ Private/Contract

■ Public

2014 CSX Grain Carloads <i>Carloads in Thousands</i>	
Private/Contract	214
Public Tariff	48
Total	262

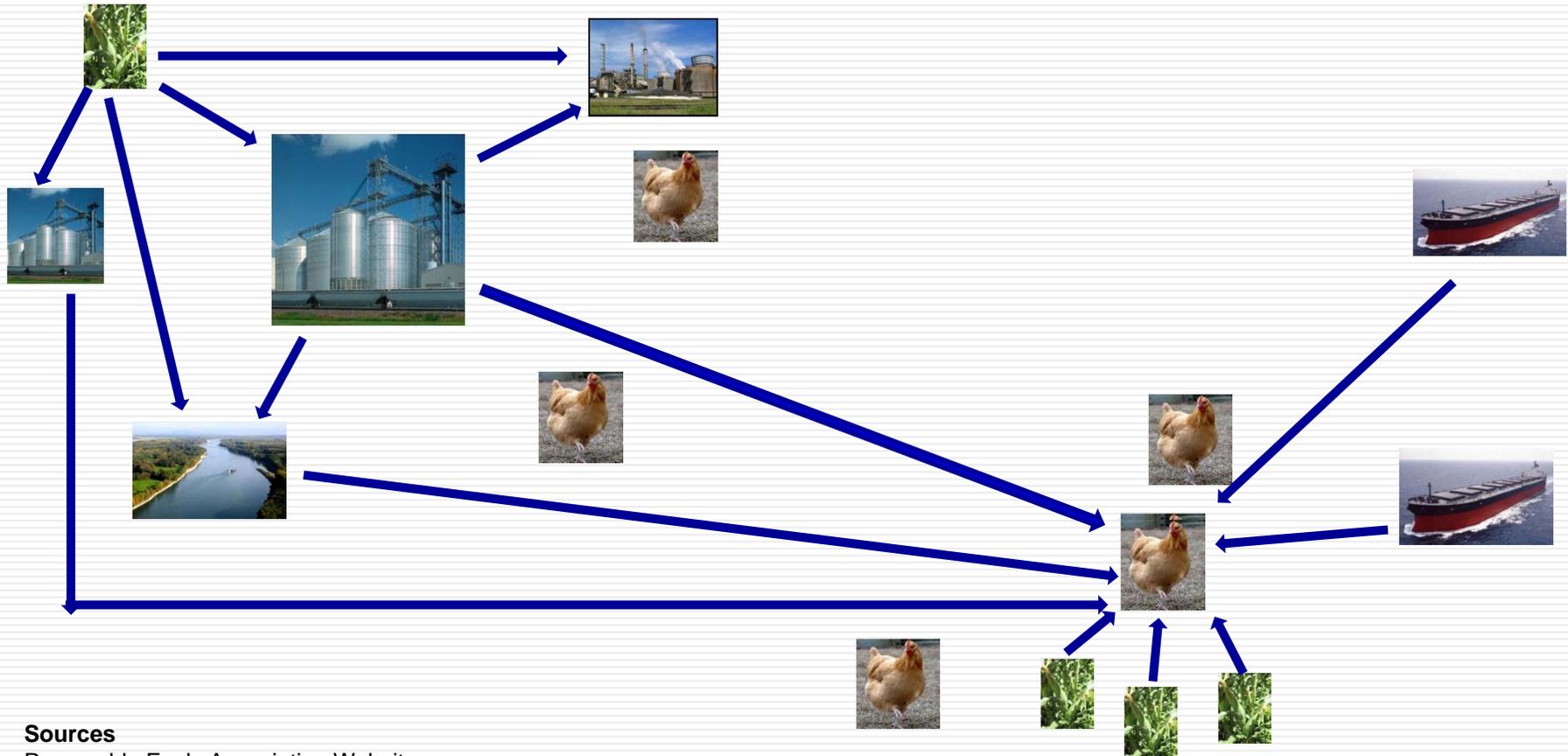
Only 18% of CSX Grain carloads move under public tariff

CSX Agricultural customers are large corporations

Largest Publicly Traded CSX Grain Customers
2014 Corporate Revenues in Billions



Eastern Industry has varied options

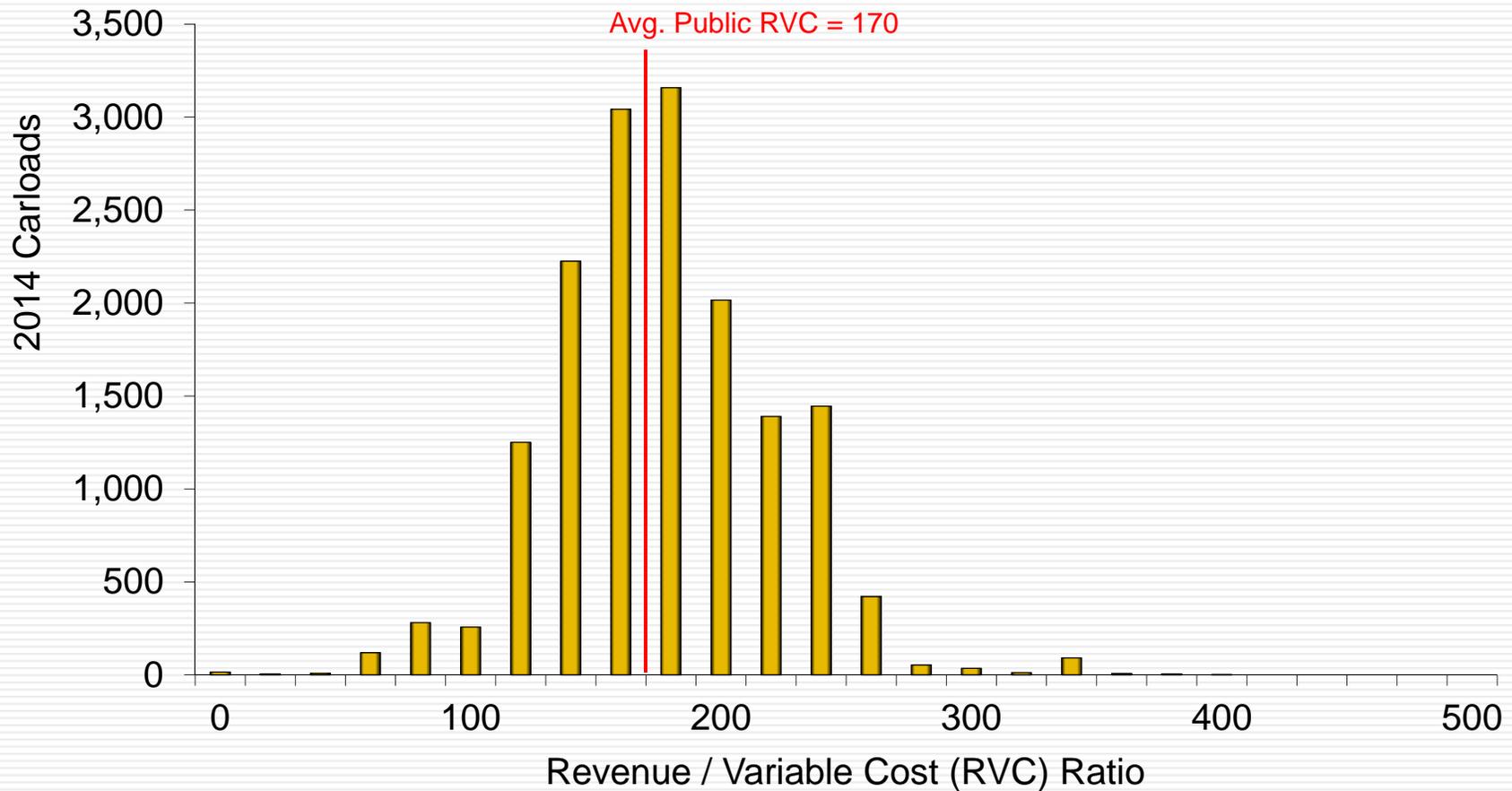


Sources

- Renewable Fuels Association Website
- National Grain and Feed Association
- United States Department of Agriculture
- ProExporter

Regulatory Profitability Analysis— Grain 2014 URCS Costs

Public Tariff Traffic



CSX has a vast network of Products & Programs to better serve the AG customer

- **Unit train products**
 - 90 Car Unit Train Product
 - 65 Car Unit Train Product
 - Single Car Product
- **Express Programs**
 - 15 hour Incentive Load/Unload Programs
- **Network Operations => Grain Desk**
 - Direct communication
- **Blend of Railroad and Private Car Incentives**
 - Pre-load inspection
 - BidCSX program

In summary...

- ❑ **Agriculture is an important business to CSX**
- ❑ **CSX services align with large Multi-faceted agricultural companies**
 - *Competition on origin and destination grain sourcing is vibrant*
- ❑ **CSX is working to improve efficiencies for both CSX and our customers through mutually beneficial programs**
 - *90 Car Product*
 - *Express Programs*
 - *Blend of RR and Private car investment*
- ❑ **CSX appreciates the partnerships that we have with our customers**

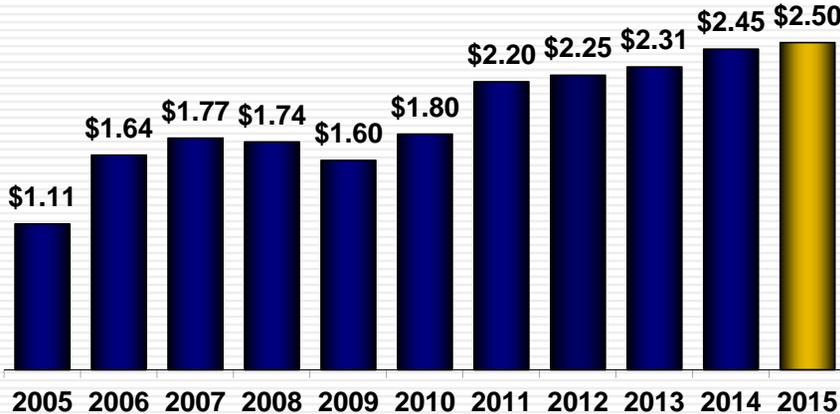
Appendix

CSX has invested significant capital over the past ten years inclusive of Agriculture investment

- Core investment remains at 16% – 17% of revenue for 2015
 - Infrastructure spend maintains a safe and reliable network
 - Locomotive, car investment driven by commercial demand
 - Strategic investments support growth and productivity



CSX Capital Spend In Billions



New Car Purchases

- ☐ 2,155 cars since 2008
- ✓ 5201 Cubic Foot
- ✓ 286K GWR

Fleet Upgrade Program

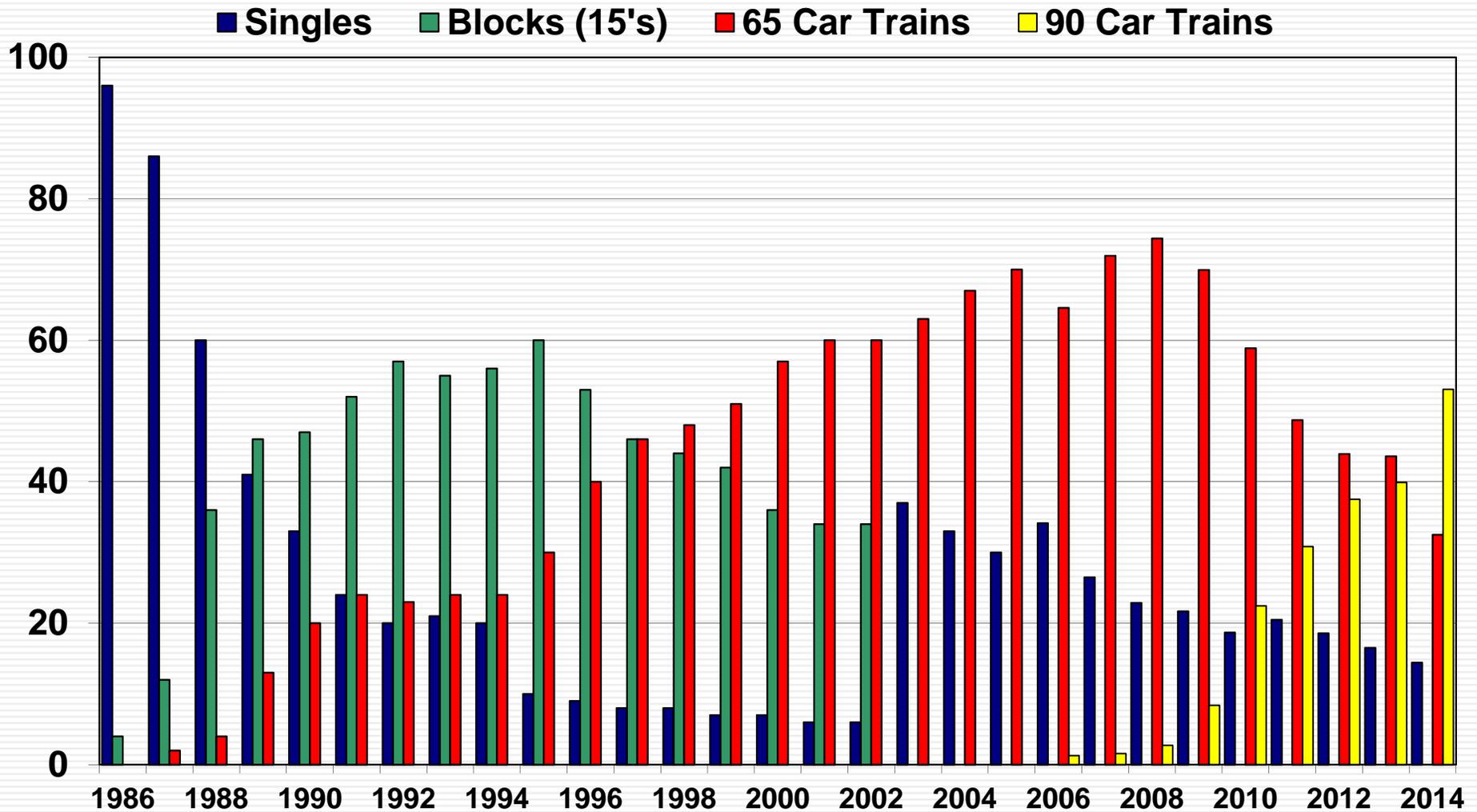
- ☐ New doors, hatch covers and paint
- ☐ 200-300 yearly

The Agriculture strategic direction over the past 12 years has focused on Simplicity, Size and Speed

- 1999-00 Simplify CSX pricing structure by forming 80 distinct origin elevator groups.
- 2000-03 Create common origin spread relationships and simplified price documents
- 2003 Development of Ethanol Network
- 2003-04 Elimination of 15 Car Product
- 2004 CSXBid preferred car placement
- 2005 Train Expansions/Refine Express Programs
- 2007-12 TSI: Optimizing the size and speed of our grain network to 90 car trains
- 2012-17 Finish transition to 90's and enhance express programs



History would indicate that larger units will become the standard

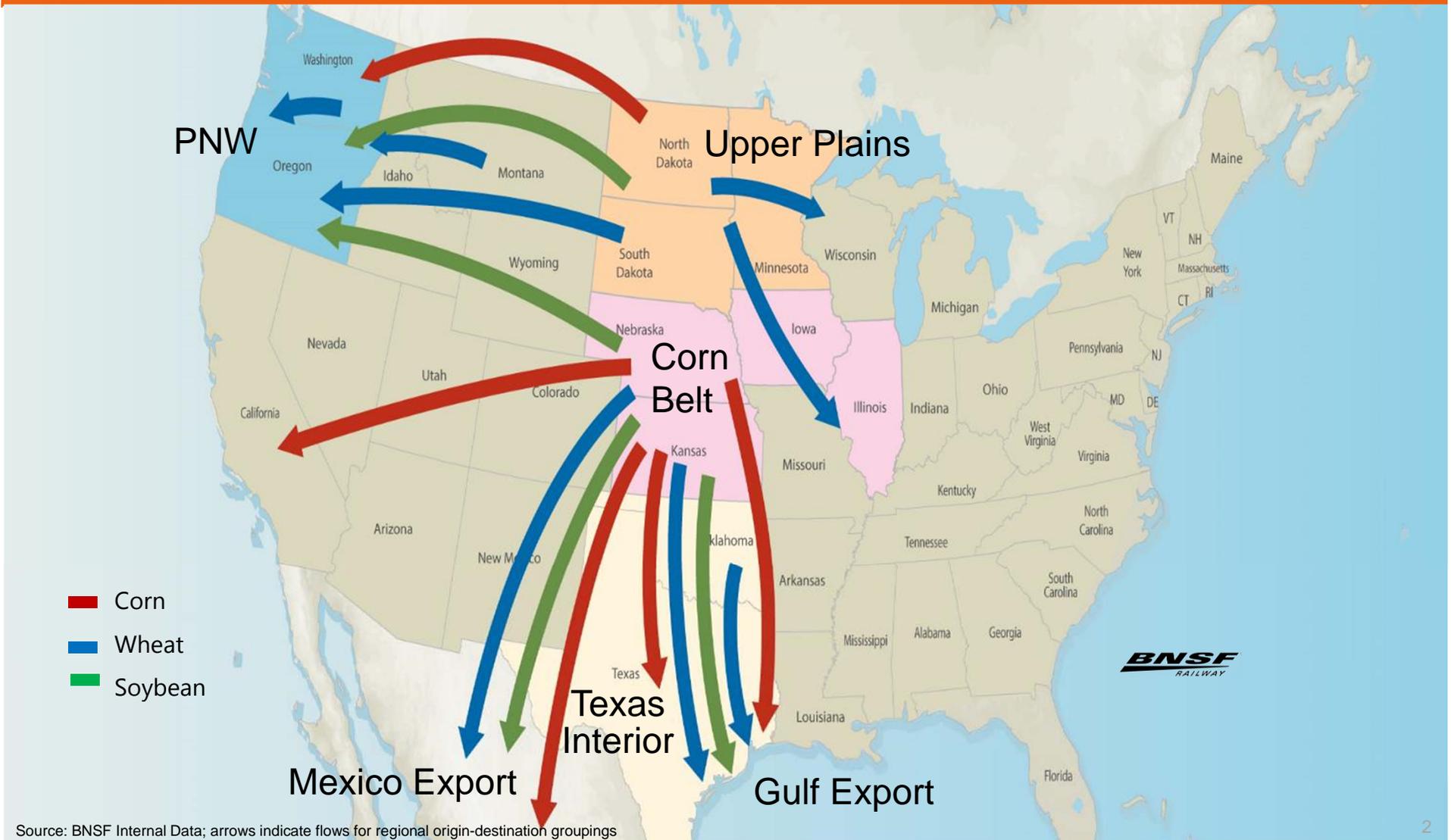


Docket No. EP 665
(Sub-No. 1)
Rail Transportation
of Grain Rate Regulation
Review

JUNE 10, 2015

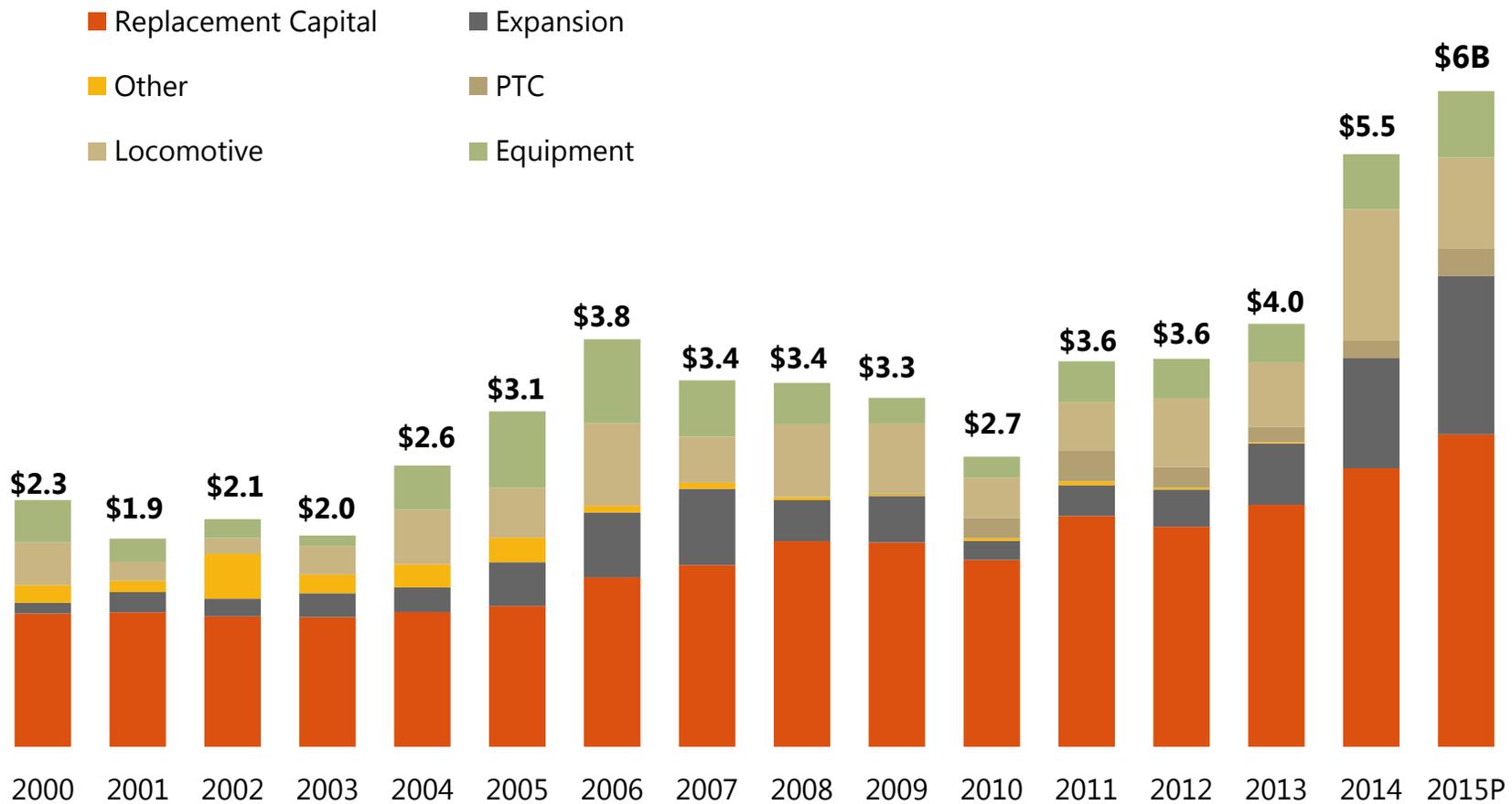


Predominant BNSF Grain Traffic Flows 2010 to 2012

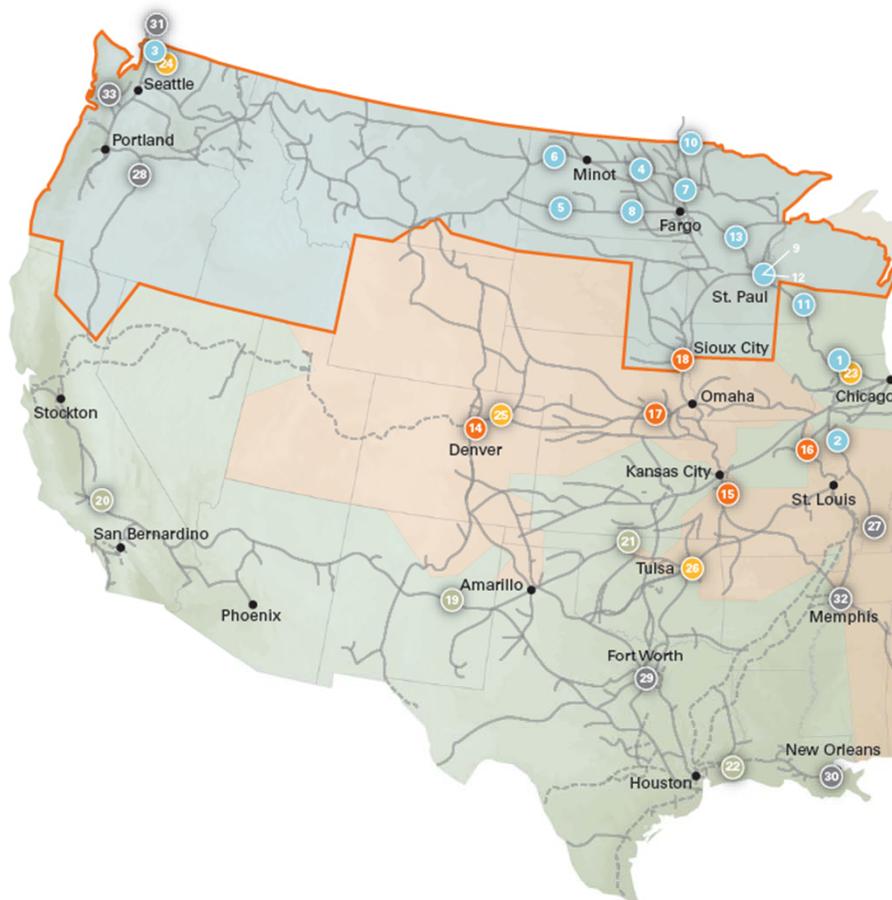


BNSF Investing to Meet Capacity Demands

\$ Billions



BNSF's 2015 Capacity Projects



Terminal & Line Capacity Expansion Projects

Major line and terminal projects by region, route and subdivision (sub)

North Region

- 1 **Aurora sub:** CTC signaling project with crossover plants
- 2 **Beardstown sub:** five siding extensions plus CTC signaling on the north end of the subdivision
- 3 **Bellingham sub:** one double-track project
- 4 **Devils Lake sub:** CTC signaling on subdivision
- 5 **Dickinson sub:** one siding extension
- 6 **Glasgow sub:** complete three double-track projects started in 2014
- 7 **Hillsboro sub:** CTC signaling on subdivision and connection upgrade
- 8 **Jamestown sub:** completing CTC signaling project started in 2014
- 9 **Midway sub:** one double-track project, Northtown connection to Canadian Pacific and track upgrades
- 10 **Noyes sub:** one new siding
- 11 **St. Croix sub:** CTC signaling project with crossover plants
- 12 **St. Paul sub:** one triple-track project
- 13 **Staples sub:** one CTC signaling project and three double-track projects

Central Region

- 14 **Brush sub:** seven siding extensions
- 15 **Ft. Scott sub:** one double-track project
- 16 **Hannibal sub:** complete two siding projects started in 2014
- 17 **Ravenna sub:** two new double-track projects
- 18 **Sioux City sub:** new bypass track at Sioux City

South Region

- 19 **Clovis sub:** one double-track project
- 20 **Mojave sub:** one double-track and one siding extension project
- 21 **Panhandle sub:** two new double-track projects
- 22 **Silsbee sub:** one new siding

Terminals

- 23 **Aurora sub:** complete double-tracking project through LaCrosse, WI terminal (project started in 2013)
- 24 **Bellingham sub:** Everett, WA yard expansion
- 25 **Brush sub:** extend tracks at Denver, CO terminal
- 26 **Cherokee sub:** add new receiving / departure tracks at Tulsa, OK terminal

Bridges

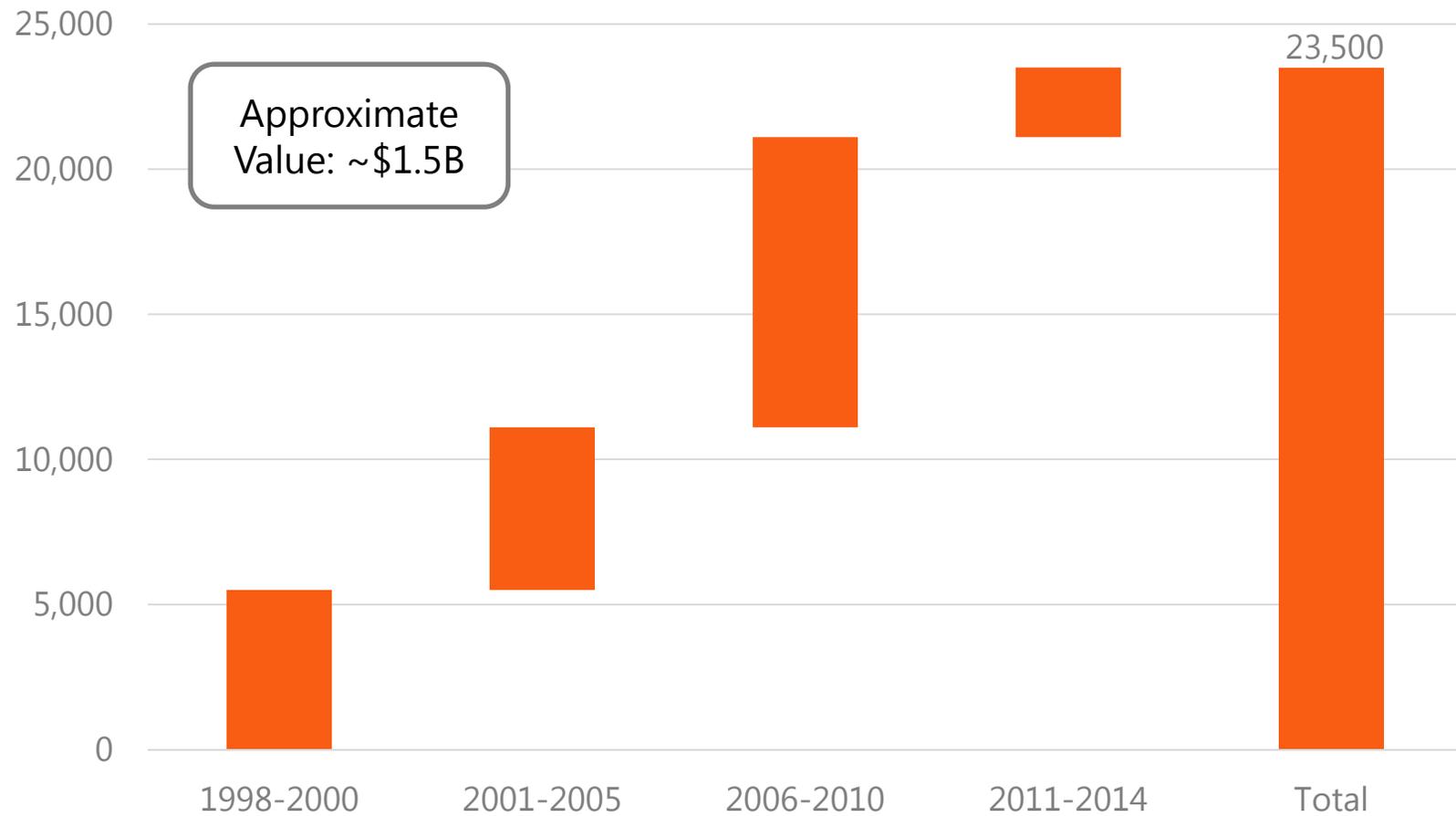
- 27 **Beardstown sub:** Bridge 212.07 in Metropolis, IL; design, permitting and land access ongoing with construction starting this year
- 28 **Fallbridge sub:** Bridge 24.8 over Washougal River in Camas, WA; permitting and right-of-way constraints continue with this project. Once project begins the replacement of the river bridge will take more than two years to complete.
- 29 **Fort Worth sub:** Bridge 348.5 in Fort Worth, TX; reconstruction of the bridge over the Trinity River
- 30 **Lafayette sub:** Bridge 32.06 in Des Allemands, LA; major work to the moveable bridge that crosses Bayou Des Allemands will start this year
- 31 **New Westminster sub:** Bridge 129.3 near Vancouver, BC; completing final phase of 3-phase project on bridge over Serpentine River
- 32 **Thayer South sub:** Bridge 482.1 in Memphis, TN; construction of the Memphis Bridge over the Mississippi River will be done in several phases. The first phase of the project will start this year. Other phases of the project are under design.
- 33 **Seattle sub:** Bridge 81.4 in Vader, WA; design, access and permitting ongoing with construction starting at the end of 2015

Additional Projects

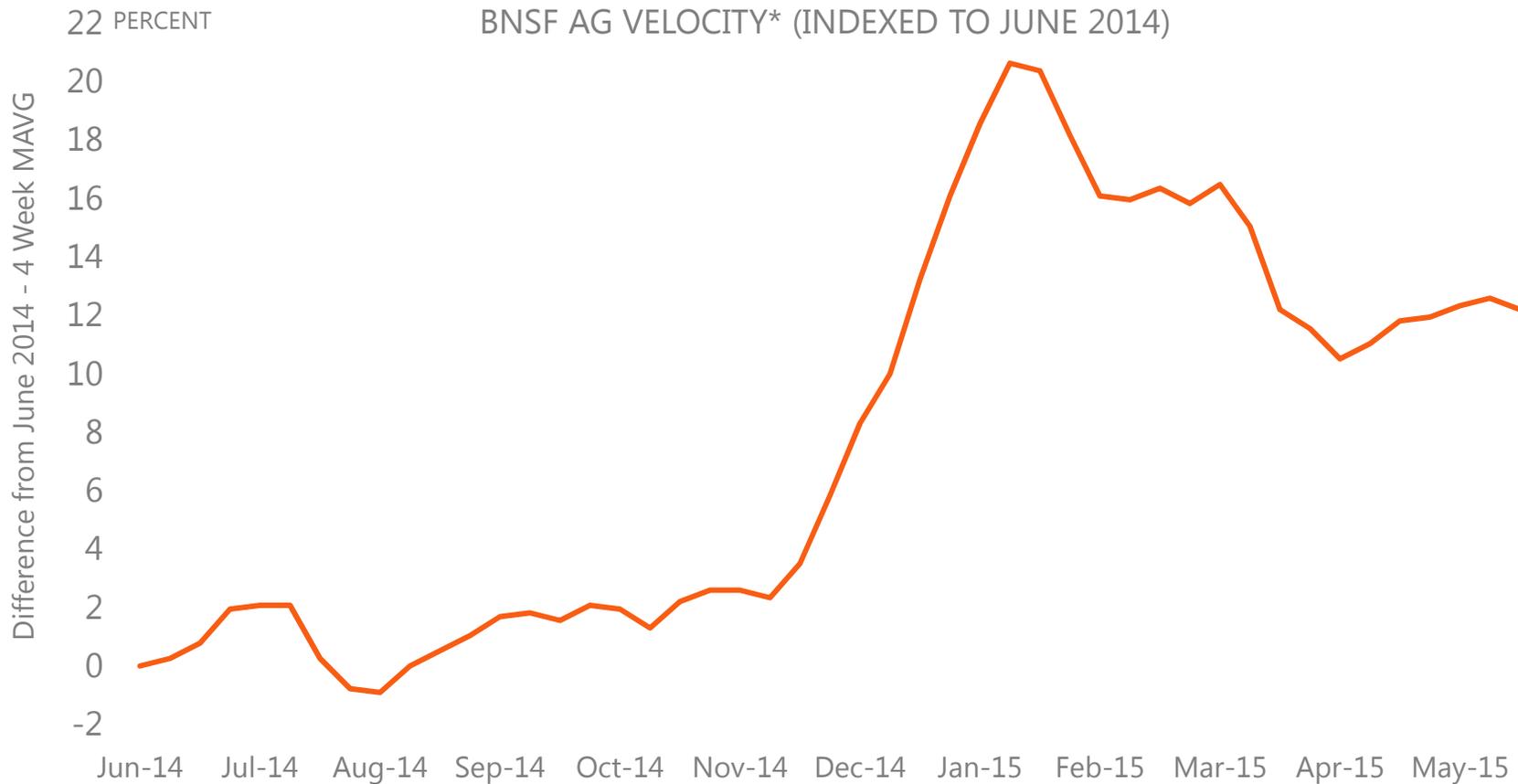
Intermodal facility expansion: Railcar loading/unloading track, support track and/or parking expansions at the following locations: Alliance (Haslet, TX); LPC (Elwood, IL); LPKC (Edgerton, KS); Lorenzo Rd (IL); Phoenix, AZ; Stockton, CA; Willow Springs, IL

Automotive facility expansion: Railcar loading/unloading track and/or parking expansions at the following locations: Alliance (Haslet, TX); Amarillo, TX; Portland, OR; San Bernardino, CA; LPC (Elwood, IL)

Grain Fleet Car Additions



With Added Capacity Comes Improved Performance

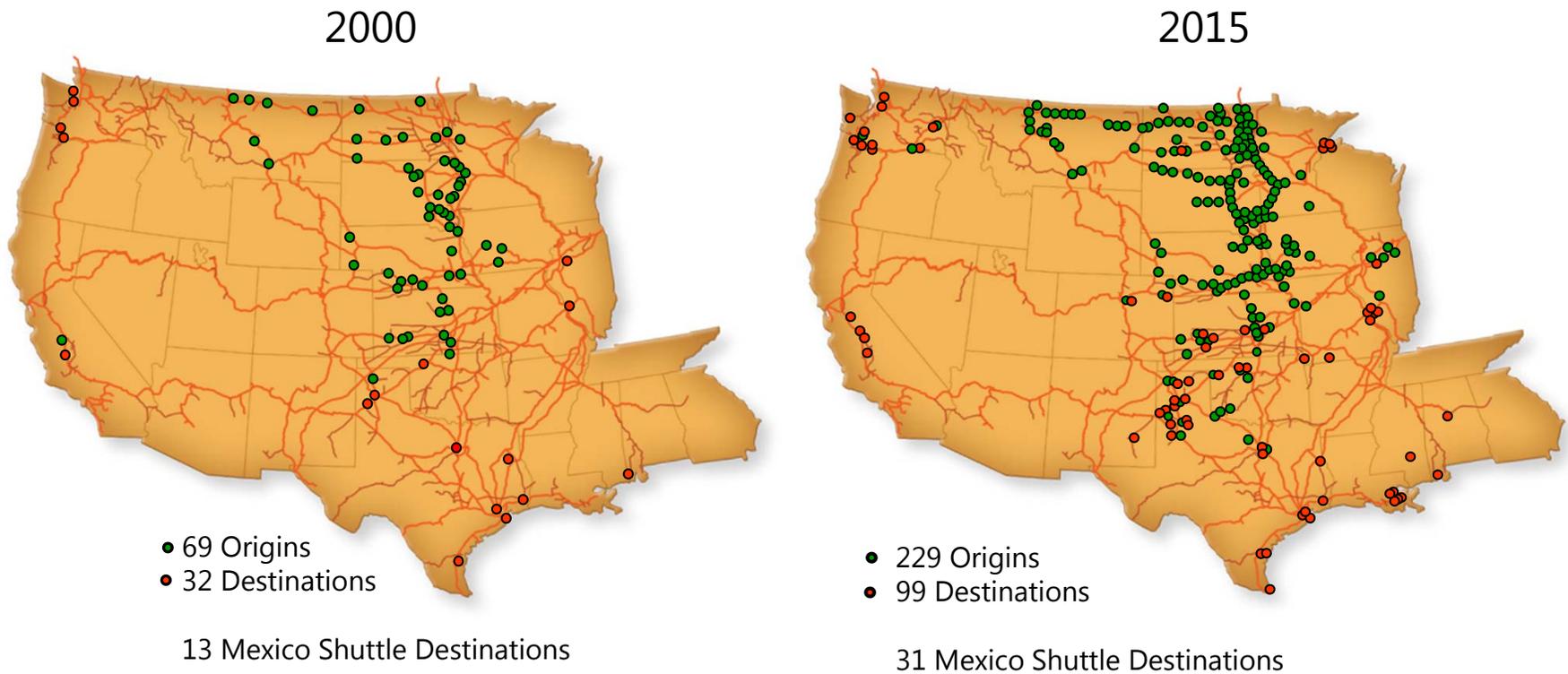


*Four-week moving average (measured in miles per hour) ending on the dates shown versus the average train speed recorded for the four-week period ending 6/27/14



BNSF and Our Customers Have Grown Our Business

The number of BNSF shuttle facilities has increased dramatically over the last 15 years



Estimated Total Customer Investments: \$2.2B



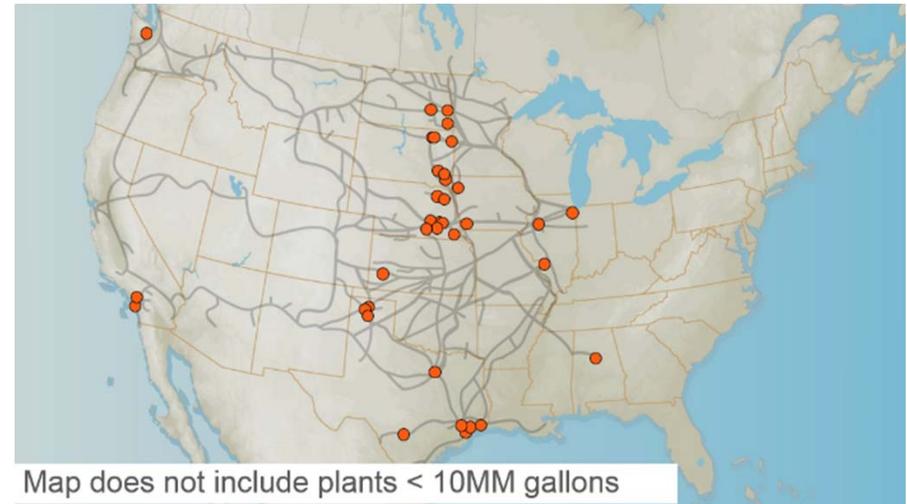
BNSF-Served Unit and Gathered Train Ethanol Network

2003



- 5 Origins
- 1 Destination

2015



- 24 Origins
- 12 Destinations

Estimated Customer Investments: \$2.1B

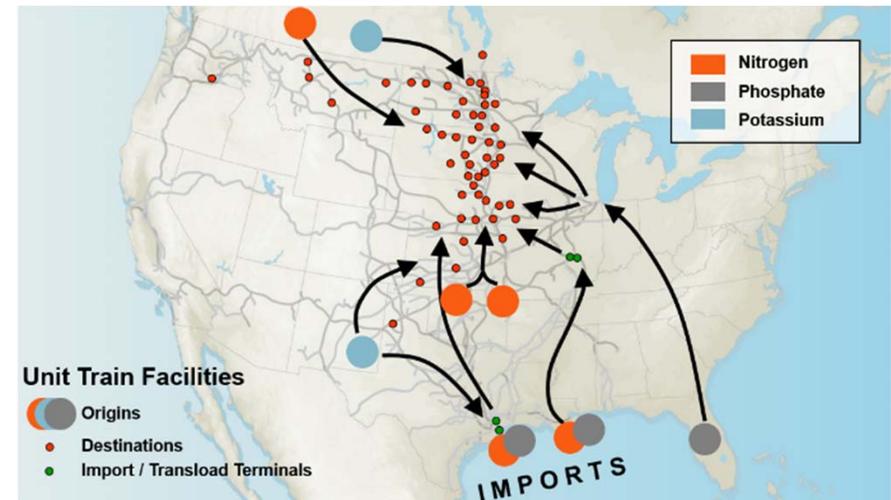
BNSF-Served Unit Train Fertilizer Network

2002



- 1 Origins
- 5 Destination

2015



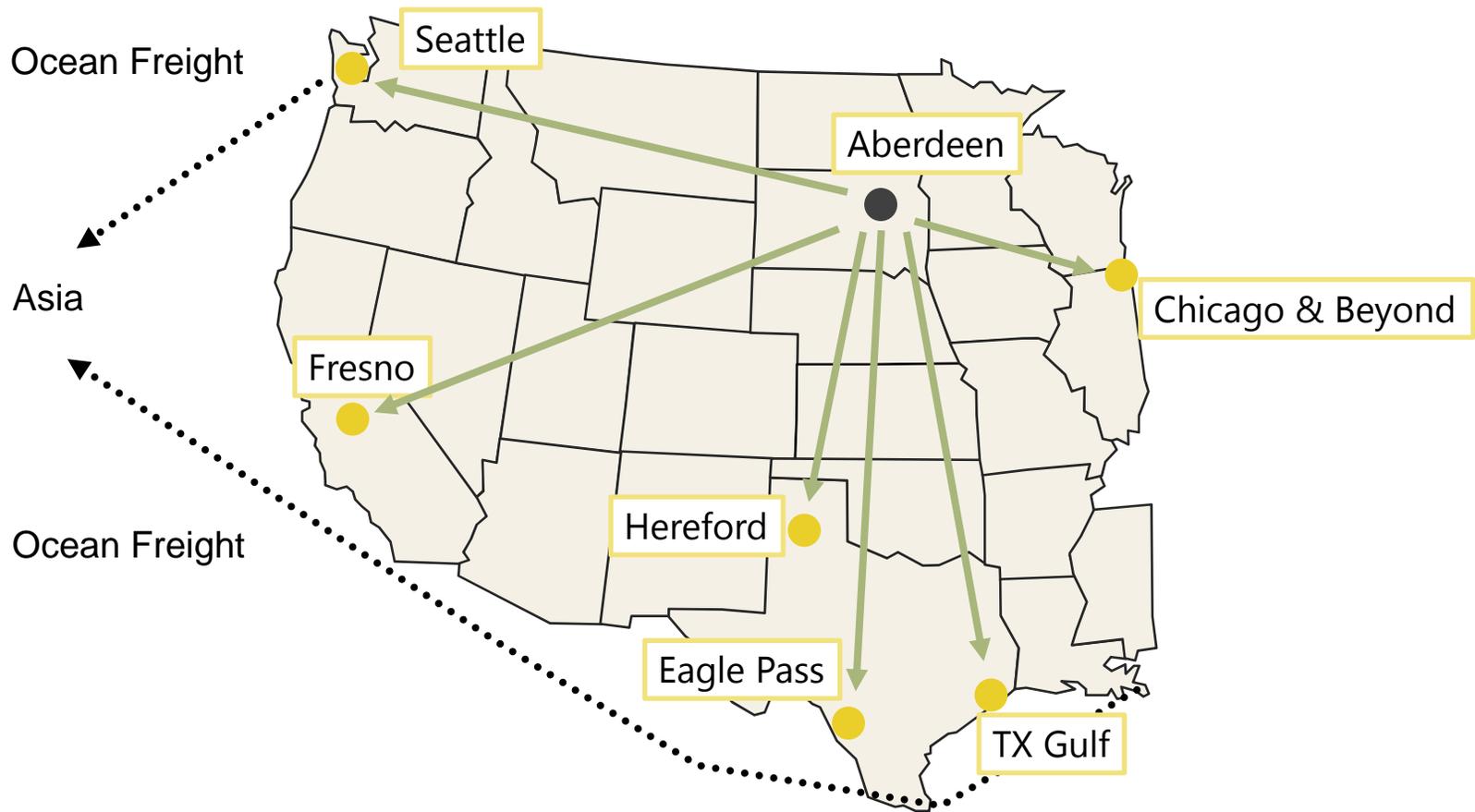
- 14 Origins
- 52 Destination

Estimated Customer Investment: \$750M

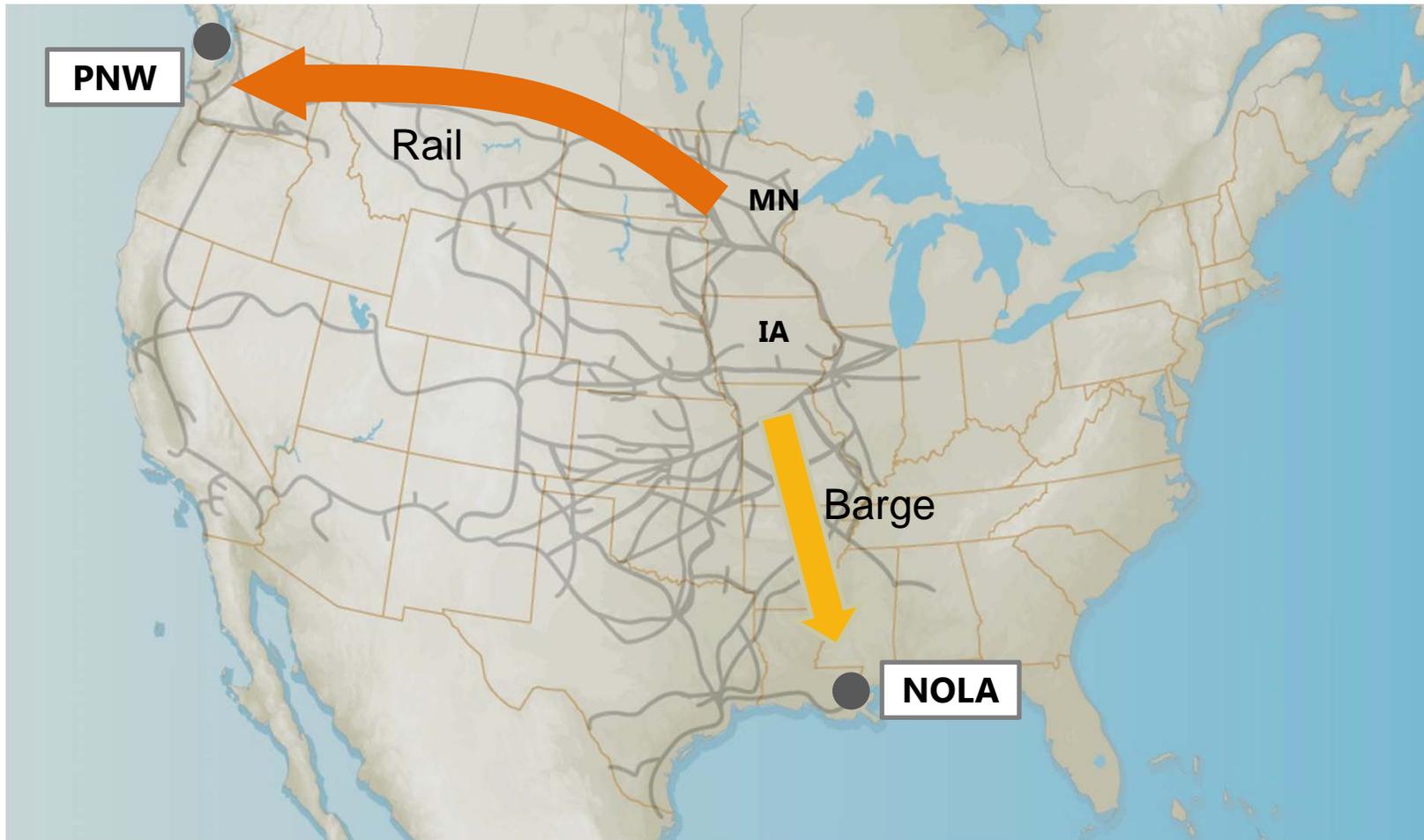
Grain Markets are Highly Competitive

- Market competition in rail rates for grain is everywhere and is persistent.
- Grain shippers have multiple options in many geographic areas.
- Grain shippers' competitive options include other railroads, trucks, barges and extensive geographic competition.

Destination Options from Aberdeen, SD

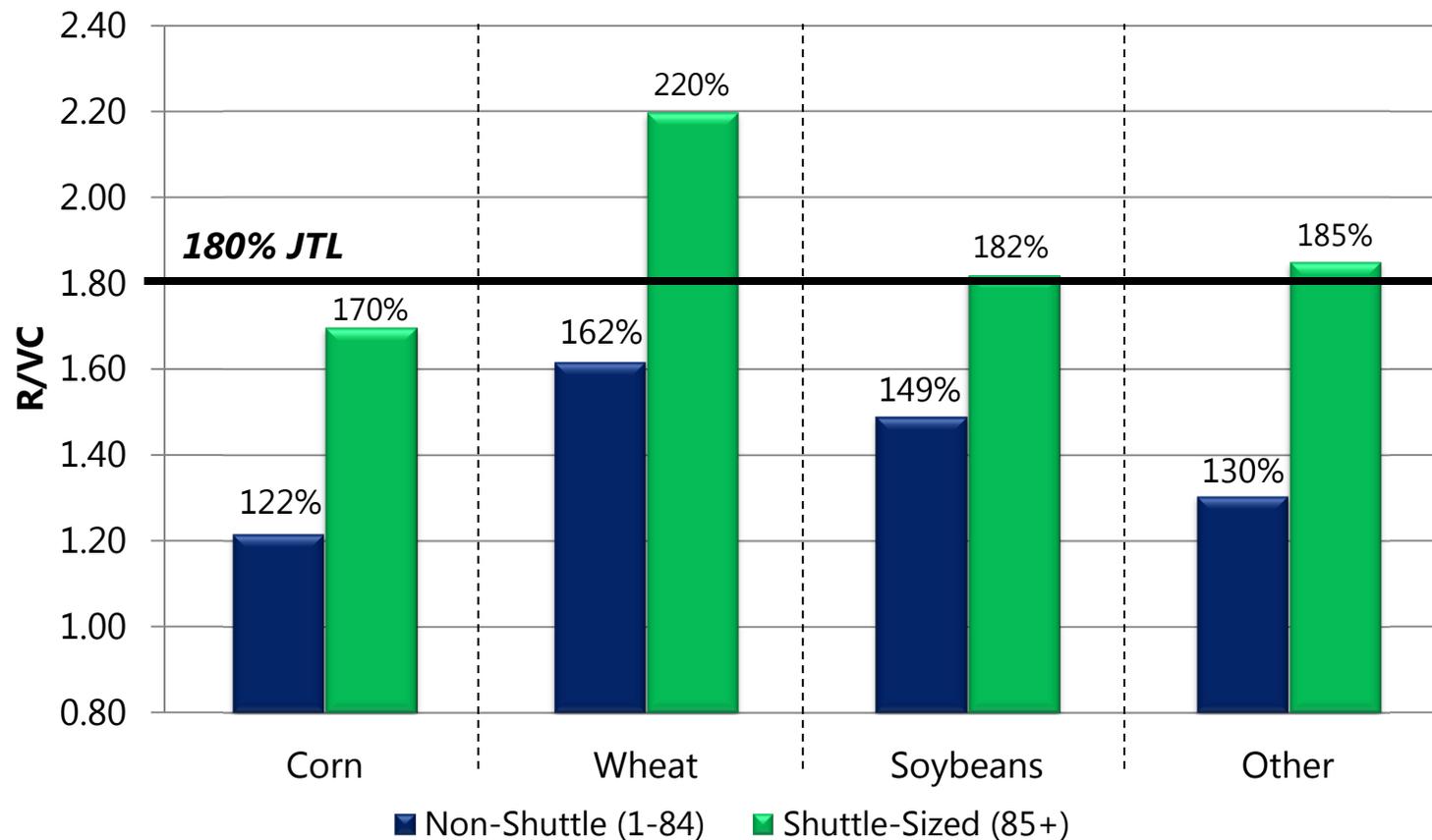


Examples of Corn Export Markets



BNSF R/VCs: Non-Shuttle versus Shuttle Shipments

2010 to 2012 CWS Data (FTI Opening Exhibit 10)



Agricultural Shipper and Producer Outreach

- Montana Alternative Dispute Resolution
 - Ag Rail Business Council
 - Regional Ag Coalitions
 - Ag Symposiums
 - Customer Advisory Board
 - Trade and Industry Events
 - Producer Organization Events
 - Ag Ombudsman Program
 - Participation in broad number of shipper-sponsored and producer-sponsored forums every year
- 
- Grassroots, Seminars, Town Halls, Listening Sessions
 - Bi-weekly Podcasts and ag-focused service and market communications

Conclusion

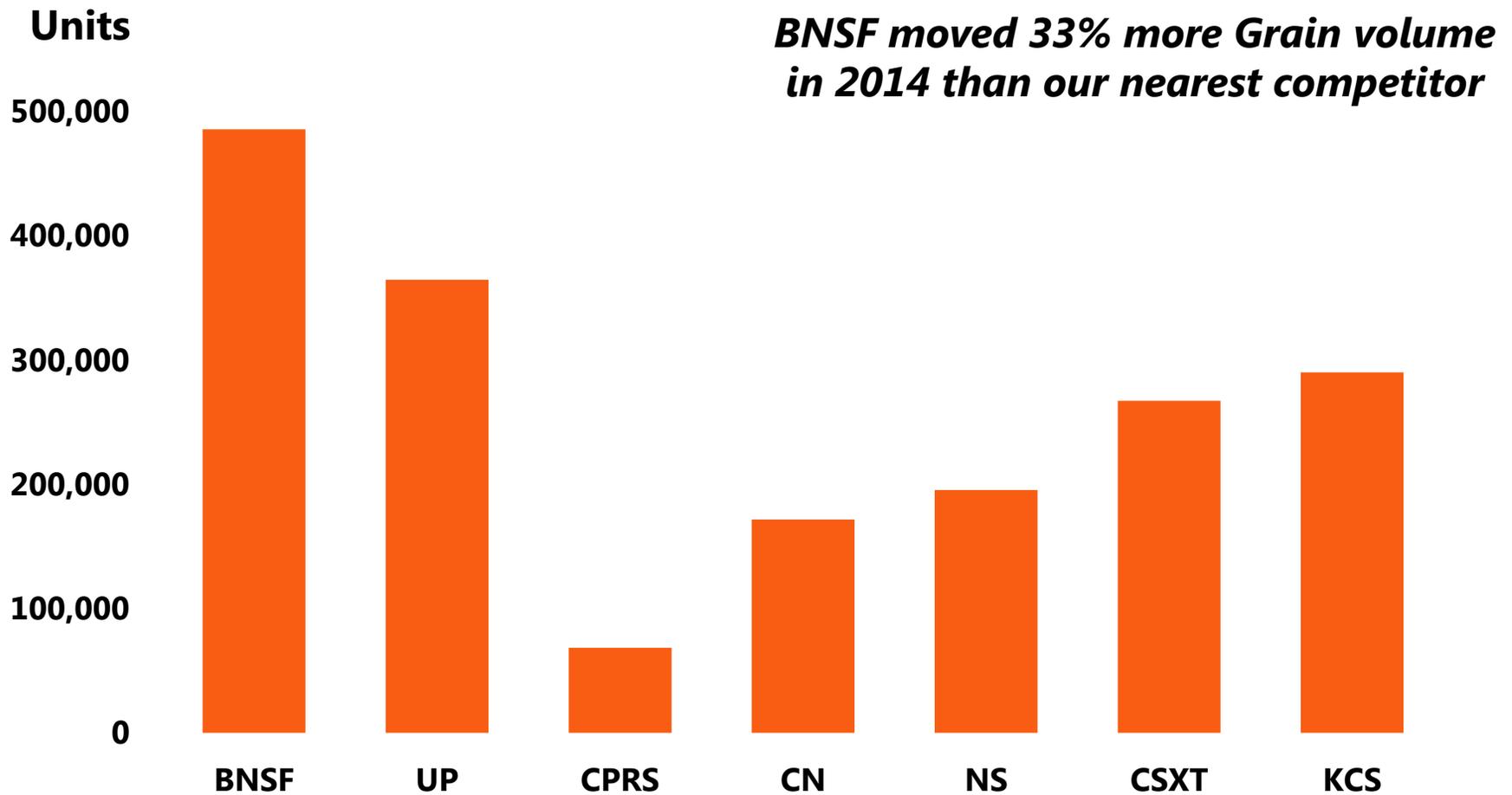
- Virtuous cycle of investments.
- Service has and will continue to improve.
- The competitive market place is working efficiently.
- We have pursued alternative resolution mechanisms.
- Formulaic, outcome-oriented regulations are not productive and would have unintended consequences.



BNSF®

Appendix

BNSF is the Grain Leader in U.S. Rail Shipments



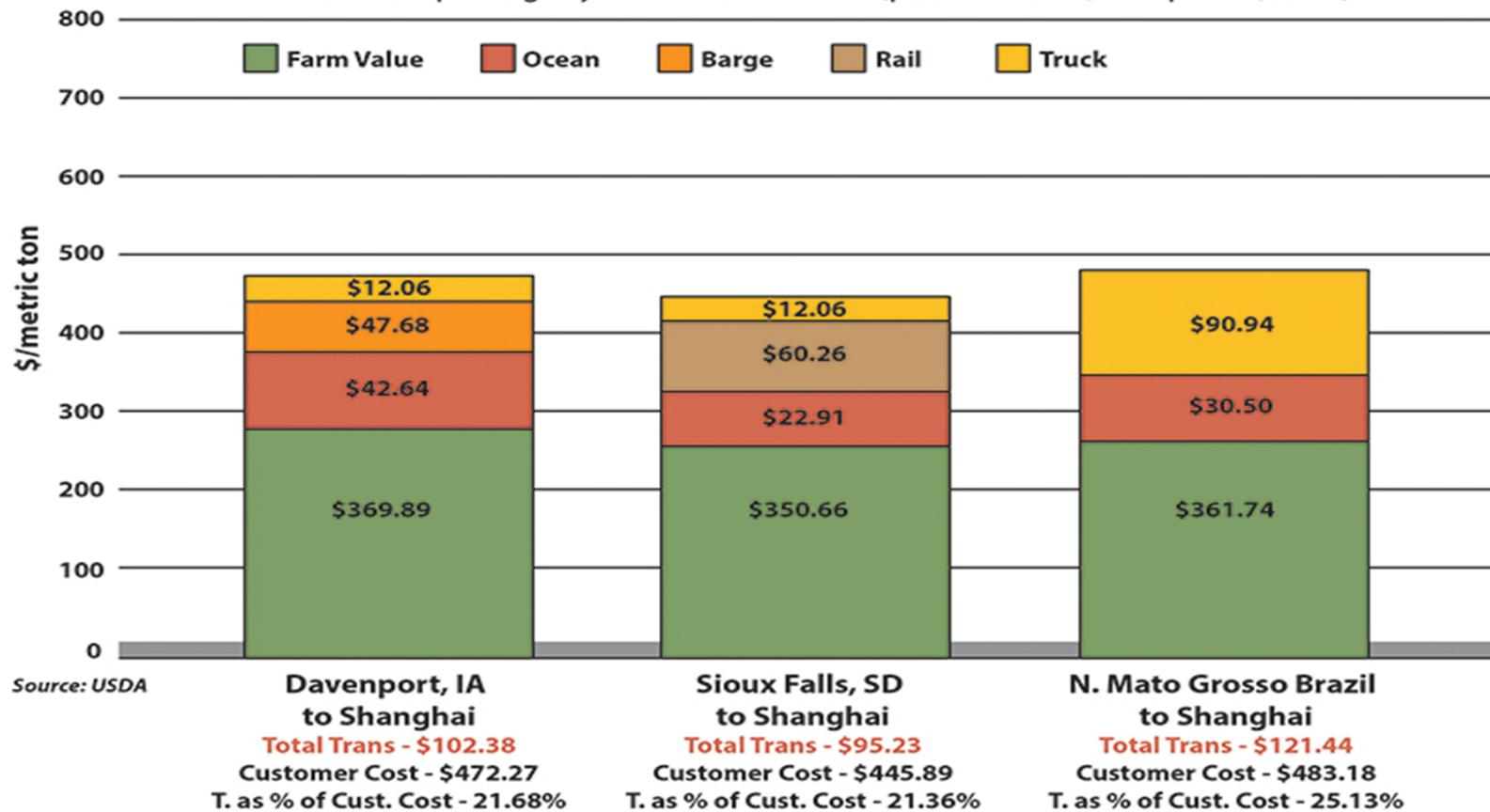
Source: Association of American Railroads (AAR) FY 2014 Weeks 1-52 Units Handled



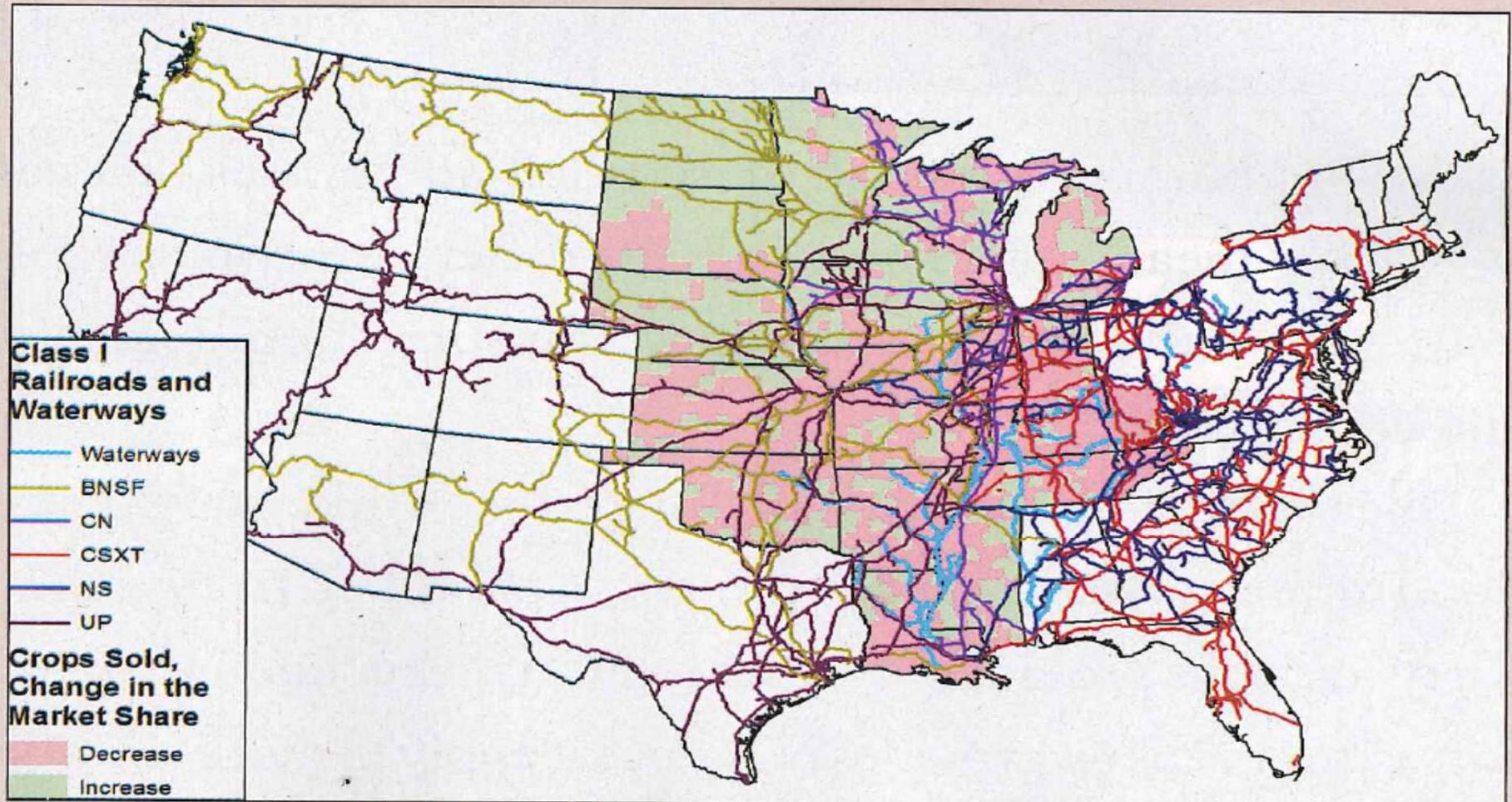


Why Should Farmers Care About Transportation? ...because our international competitiveness depends on it.

Costs of transporting soybeans: U.S. vs. Brazil (per metric ton; 4th quarter, 2014)



Crops sold, 1997-2012 change in the market share



Source: USDA, National Transportation Atlas, Moffatt & Nichol.

**Testimony of James E. Byrum
President, Michigan Agri-Business Association
Before the U.S. Surface Transportation Board**

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

June 10, 2015

Acting Chairman Miller and Commissioner Begeman, I am James Byrum, president of the Michigan Agri-Business Association headquartered in East Lansing, Michigan. Thank you for the opportunity to appear before you today. The Michigan Agri-Business Association (MABA) represents more than 500 grain handlers, agronomy retailers, agricultural input providers, agricultural transporters and food manufacturers. Country elevators are a critical part of Michigan's agricultural supply chain and an important segment of our membership. The commercial grain industry helps drive Michigan's growing agriculture sector. Those in the grain industry are vital partners in rural communities, and their impact has far-reaching effects on other sectors of the agricultural and rural economy overall.

I hope to build on testimony you heard earlier today from the National Grain and Feed Association, and emphasize the atmosphere of tremendous uncertainty in the countryside.

This is due to two facts:

First, pending rail rate increases are beginning to cause market shifts that could fundamentally alter U.S. and international grain markets.

Second, we see little in the way of fair or reasonable avenues of recourse for grain handlers to address this situation. I wish to share our Association's concern that the current rail rate appeal processes through the U.S. Surface Transportation Board (STB) – the Stand Alone Cost, Simplified Stand Alone Cost and Three-Benchmark methods – are too complex, too time consuming and too costly to be relevant to grain shippers, especially country elevators, and they are unlikely to be a useful recourse for our industry in this situation.

The impacts of rate increases are virtually immediate, while the current appeal processes can take months or years, even then. A resolution through this process only happens long after the effects have changed the industry.

We are concerned that the Board's three existing rate-complaint procedures simply are inappropriate and unworkable for agricultural commodities and country elevators. To challenge a rate under any of the authorities provided by the STB is costly both in terms of time and money. Those costs often outweigh the potential recovery of rate overcharges. The evidentiary burden on captive shippers, even under the simplified stand-alone cost rules, is excessive.

Commodity movements are also a "moving target" by the very nature of the business. Origin and destination pairs, freight volumes, and production trends vary, which makes contesting a rate case more difficult. Market demands also shift constantly, making it more difficult to show long-term trends that are crucial to contesting an STB rate case. In addition, commodity shippers often do not generate the tonnage necessary to meet traffic densities needed to bring a rate challenge under the Board's current procedures. This is due in part to the low-density rural areas where our members and customers are located.

Finally, the railroads make the process difficult by virtue of their "bully pulpit" in the commodity transportation markets. Railroads use their market power to impose rates across-the-board for certain commodities or groups of commodities. Because STB rules require proof of a single market actor abusing the market, this industry-wide practice makes contesting a rail rate case more difficult. Under the current three-benchmark rules, only the movements of the defendant railroad may be included in a comparison group.

With regard to the market impacts of this rate increase, MABA and our members have multiple concerns. The pending rate increases are a surprise to our sector given the significant investments many in the grain industry have made in response to requests in the past by Class I railroads. These actions could have a number of significant impacts on the U.S. grain trade. For example:

The changes will arbitrarily determine “winners and losers” in the grain market. I want to emphasize that many, if not most, major rail infrastructure investments by private companies have been predicated on what Class I railroads explicitly requested, or demanded.

Many grain handlers that now are impacted negatively by these new rates have already invested heavily to improve their own rail loading operations to handle larger unit trains and move commodities more efficiently in partnership with the railroads. These investments often have been made with the encouragement or insistence of railroads.

Earlier today, for example, the Committee heard from my past Board Chairman, Bruce Sutherland with Michigan Agricultural Commodities (MAC), that his company invested more than \$35 million over the past five years on such improvements. Specifically, MAC increased storage capacity and expanded operations to ship 90-car unit trains. I can highlight other companies with a similar story, such as the Cooperative Elevator Company and Auburn Bean and Grain – now The Andersons – who have invested and are now penalized. These investments were made at the insistence of CSX. These are just a few examples among many others across Michigan, Indiana, Ohio and other states. These stories highlight how pending rate changes would undercut the value of proactive infrastructure investments by the private sector.

Markets will likely fundamentally shift for Michigan-produced commodities, and U.S. producers will be at an economic disadvantage against foreign suppliers.

Proposed rate increases likely will alter and disrupt customary “grain flows,” with significant consequences on agribusinesses, farmers and customers. Currently, Michigan-produced grain moves primarily to markets in the Southeastern U.S., and these changes would signal a paradigm shift in that marketing opportunity. As a result, Michigan producers and agribusinesses likely would keep grain closer to home, sending it to local livestock or ethanol production facilities whose needs are different from those of current customers in the Southeast.

In addition, current customers would be forced to look to other markets for grain. This likely would mean an increase in imports from South America for major feeders located near ports, which would hurt Michigan and U.S. companies, producers and others in the long run.

Anecdotally, we are already hearing of some customers making preparations or even carrying out plans to import corn from Brazil and Argentina.

Short line railroads that grain producers depend on would be hurt as well. The cumulative potential of lower grain volumes moving on rail puts additional pressure on the viability of short line railroads, which rely on agricultural shipments for their livelihood. This comes at a difficult time for short line operators, who are looking for opportunities to improve deteriorating infrastructure. Lower volume could mean decreased revenue and ultimately even more deterioration of the infrastructure, if not the abandonment of some lines. This would in turn cause additional harm to grain handlers and farmers.

We are already seeing pending price increases reflected in elevator bids across Michigan, and we believe the long-term economic impact will be in the tens of millions of dollars. Given the percentage of Michigan grain moved by rail, a 10 cent increase per bushel on transportation costs would result in an annual impact on Michigan producer income of nearly \$50 million annually. The increase in transportation cost will be passed down to farmers, who will ultimately be hit in the pocketbook.

As the president of a local trade association, I field calls on a daily basis from those concerned about the impact of this action by CSX. As I mentioned at the beginning of my testimony, our members face a very uncertain future.

Perhaps of the greatest concern, there is no clear or timely recourse for Michigan grain handlers under current STB practices.

Ultimately, our grain shippers and other members whose livelihoods are based on grain markets are in a difficult spot. They face the many market uncertainties I outlined for you today, but have little or no reasonable opportunity to seek relief. This is a unique issue, but it has far-reaching consequences – and I hope that together, we can find reasonable ways to work through this issue and maintain the competitiveness of Michigan’s agriculture sector.

Mr. Chairman and members of the committee, once again, I appreciate the opportunity to join you today, and thank you and your staff for reviewing this situation. This remains an uncertain

time for grain handlers for a wide variety of reasons I outlined for you today, and I hope that we can work together to remedy this issue.