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VIA ELECTRONIC FILING

The Honorable Ann D. Begeman, Chairman
The Honorable Patrick J. Fuchs, Vice Chairman
The Honorable Martin Oberman, Commissioner
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423-0001

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Re: Docket No. EP 755 – Final Offer Rate Review

Dear Board Members:

Enclosed please find Opening Comments of BNSF Railway Company to the Board's Notice of Proposed Rulemaking decided on September 11, 2019 in the above-referenced docket.

Very truly yours,

A handwritten signature in blue ink, appearing to be "J-K" followed by a stylized flourish.

Jill Mulligan

Enclosure

BEFORE THE
SURFACE TRANSPORTATION BOARD

Docket No. EP 755

FINAL OFFER RATE REVIEW

OPENING COMMENTS OF BNSF RAILWAY COMPANY

BNSF Railway Company (“BNSF”) submits these comments in response to the Surface Transportation Board’s (“STB”) September 11, 2019 notice of proposed rulemaking in the above-captioned docket that proposes adopting a Final Offer Rate Review (FORR) process as a “new procedure for challenging the reasonableness of railroad rates in smaller cases.” NPRM at 1.

BNSF believes that the STB serves an important role for railroads and shippers alike by allowing competitive markets to determine transportation rates and drive service innovations, while also providing effective oversight when those market forces are not present. Critical to that role is ensuring that, in the instances where the STB finds that markets are not functioning and market power abuse exists, that the rate adjudication process is accessible, fair and effective for all stakeholders. BNSF understands that certain rail customers, particularly small shippers, feel that the STB’s existing formal rate reasonableness procedures are not easily accessible to them, or otherwise do not provide a realistic opportunity to obtain regulatory relief. While BNSF believes that the STB can and should develop an expedited rate review process for smaller shippers, for the reasons set out in this filing and in the comments being filed by the Association of American Railroads (“AAR”) in the above-captioned docket, BNSF respectfully requests that

the STB reconsider the FORR proposal and give the principles for rate review that BNSF sets out due consideration in determining the STB's next steps on rate reasonableness reform.

Framework for Board Action

As the STB considers expanding its own direct regulation of rates beyond current Board mechanisms and methodologies, BNSF believes that there are several core principles that should inform those considerations. First, it is essential that the STB's rate regulation be consistent with the Congressional requirement, embodied in the Rail Transportation Policy, "to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation." 49 U.S.C. §10101(1). The starting point of the STB's exercise of regulatory authority over rates is to decide when it is appropriate to regulate. The central tenet of the regulatory scheme established by Staggers and embodied in ICCTA is that the STB will intervene only to address market failures and abuses of market power, which is implemented through the market dominance determination requirements. Understanding the importance of this analysis, BNSF is separately submitting comments today in response to the NPRM issued by the Board in Ex Parte No. 756, *Streamlined Market Dominance Determination*.

Second, when the STB does determine it is appropriate to substantively review and potentially prescribe maximum reasonable rates, the methodology the STB applies should be grounded in sound economic theory and approximate, to the extent possible, rates that are reflective of market forces and realities. Transportation and commodity markets are sophisticated and interlinked and the adjustment of rates away from a market level has the potential not only to shift significant amounts of revenue between parties but produce ripple effects far beyond the narrow area of direct regulation, arbitrarily creating winners and losers among entities competing in commodities markets. Fashioning the appropriate balance between

access to meaningful oversight while respecting both the complexity of the businesses of shippers and railroads, as well as the sophistication of the markets that we offer our services and goods into, has been the hard and serious work of STB commissioners and staff for decades. That effort has resulted in a body of case law grounded in the governing statutes of the Interstate Commerce Act, core economic principles and an increased knowledge around practical application in complex markets. BNSF supports the efforts of the STB to reduce the burdens of adjudications, but BNSF urges the STB not to do so using formulaic or results-oriented devices to wholesale sidestep the innate complexity and sophistication of the core task before the agency. Such an approach will likely distort markets more than address an imbalance in the markets.

Third, there is significant value in identifying further simplifications of existing STB mechanisms from a procedural and substantive standpoint, but those efforts should be well-tailored in how it mitigates the core issue that the STB is addressing as well as who is eligible to proceed under significantly less accurate methodologies.¹ For example, the STB has identified concerns raised by small shippers regarding their ability to undertake the expense and burden that can be present even in some Three Benchmark cases. BNSF agrees that in certain circumstances, the STB should modify its methodologies in ways that add meaningful simplifications, even when that may mean uncomfortable departures from the core case law and economic principles. BNSF also believes, however, that the STB should ensure these changes are limited to the discrete population of small sized shippers moving modest sized shipments that

¹ The Board's economic consultants, InterVISTAS Consulting LLC, urged the Board to be cautious in further simplifying its rate reasonableness methodologies. *See InterVISTAS, Surface Transportation Board, An Examination of the STB's Approach to Freight Rail Rate Regulation and Options for Simplification*, Project FY 14-SB-157, at xvii (Sept. 14, 2016) ("the Team believes that simplification of either the Three-Benchmark or Simplified-SAC tests risks moving the approaches further away from the bedrock CMP principles, undermine the reliability of the tests, and would not necessarily incentivize shippers to use those tests.")

are inordinately impacted by the cost and complexity of the STB's current methodologies. As BNSF shared with the Rate Reform Task Force prior to their report, the focus of any further simplified methodologies by the STB should be focused on the highest of the high rates and should focus on true small-sized shippers.

Fourth, as we have indicated to the STB many times, BNSF believes that maximum rate reasonableness determinations should be made based on market conditions and real world market factors rather than on formulaic application of revenue to variable cost ("R/VC") ratios. R/VC ratios are not reliable indicators of the existence of competition or market power. Many of the commodities carried on the railroad and potentially subject to maximum rate regulation because they exceed the 180% R/VC jurisdictional threshold are clearly subject to robust competition, including aggressive truck competition. In addition, a number of third party experts, stakeholders and the Board itself have acknowledged deficiencies and inaccuracies in Uniform Rail Costing System ("URCS") which is translated into an R/VC ratio for STB use. Unfortunately, when URCS-based R/VCs are incorporated into regulatory mechanisms, it actually rewards the highest cost, least efficient railroad and discourages capital investment and other efforts to increase productivity and efficiency. For example, the STB has recognized issues with its makewhole adjustment, which, when applied to BNSF traffic, penalizes unit train movements by undercosting those moves and inflating R/VCs, but recently discontinued the six-year proceeding to make necessary accuracy improvements before adopting any changes.

Fifth and finally, any small rate case rate reasonableness adjudications by the STB, as with all agency actions, should involve the application of clear and discernible principles and standards that the parties can assess outside a formal STB process and weigh potential outcomes. That gives the regulated parties a chance to engage commercially and discuss those outcomes in

the context of current market conditions and their broader business partnership. It is BNSF's experience that many issues can be resolved commercially without formal adjudication and that is a preferred result for all parties involved, but only if the railroad and customer have a common, general understanding of the likely outcome of a rate case brought before the STB.

FORR Proposal

The proposal of FORR represents a sharp pivot away from the core principles identified above and in BNSF's view will create significant unintended consequences. The AAR is submitting more fulsome comments that identify legal deficiencies with the current FORR proposals. In these more limited comments, BNSF would like to highlight elements of FORR of particular concern to BNSF as significant departures from the core principles identified above.

First, the FORR proposal's lack of clear standards or prescribed methodology is BNSF's primary source of concern. The NPRM outlines a FORR process where each of the two parties involved in an adjudication get to pick what standard the Board should apply, and neither party is limited to applying an existing standard in whole or in part. The result is that shippers and railroads alike do not know what standard will be applied until the STB issues a *final* decision. In that final decision, the agency is selecting whichever rate proposal comes closer to a "correct outcome," but as measured against the sliding scale of an amorphous, changing standard.

The NPRM even contemplates that a party may use a "revised version" of existing methodologies, creating the potential for a party to select only the favorable elements of an existing methodology while discarding less favorable elements (including essential procedural protections), even when those elements were codified by the STB following a full rulemaking proceeding and often in response to clear statutory requirements, to protect the public interest or to serve other important policy goals. In many cases, those methodologies have been the subject

of, and modified in light of, appellate court review. But the NPRM seems to empower a party to propose such modifications and for the STB to ultimately enter a maximum rate prescription that relies on those modifications.

But under the administrative process outlined by the NPRM, there is of course no obligation for either party – or the STB -- to even partially tether a presentation to an existing methodology and a party can instead submit an entirely new and untested methodology. In that instance, the STB is relying on the parties in the case to perform the legal, economic and policy analysis that would normally be a part of any new rule (which would otherwise be accomplished through an Administrative Procedures Act required notice and comment period seeking input from all stakeholders)—as well as its proper application to transportation at issue in the case—in the *ten* days the NPRM allotted for a reply filing.

In fact, the entire period for all substantive submissions under the FORR proposal is 45 days. Because they initiate any case to challenge a rate, the practical reality is that a shipper has an unlimited amount of time to plan for discovery, prepare its market dominance presentation, and to design its rate reasonableness proffer under its chosen methodology before initiating a dispute. Once initiated, the 45-day period includes a 20-day discovery period where parties are obligated, without recourse to any formal process, to produce all the information that the Board may ultimately deem to be relevant under the standard and methodology that it ultimately selects to resolve the particular case. It also bears noting that a railroad, which is the party that has historically born the greater discovery burdens of producing significant volumes of data and other information under existing methodologies, faces the greater risk that it will be retrospectively found not to have meet its burden to produce all information relevant to the applicable standard that, again, is unknown until the final decision. BNSF is particularly

concerned because the NPRM stated that if the STB retrospectively disagrees with the railroad's level of discovery it may take the railroad's approach against it in determining a legal maximum rate. As a result, it appears that a railroad could "lose" a case and see the STB choose the shippers rate, even when the railroad has proposed the superior standard for determining rate reasonableness and proposed an otherwise reasonable rate, because the railroad's production of information retroactively is deemed to be insufficient to support one of the competing standards in the case.

Given the control that a shipper has in initiating a dispute (especially when considering the two-year reparations period that mitigates the risk of any delay in initiating a case) and the uneven discovery burdens for railroads, the current FORR proposal does not present a fair process for all Board stakeholders. While BNSF agrees that neither should not use the discovery process to delay or prevent the timely adjudication of rate reasonableness, this FORR proposal goes too far in the other direction. BNSF also believes this uneven risk to railroads from FORR is contrary to the statutory burden of proof a shipper bears under the Administrative Procedures Act for demonstrating that a rate is unreasonable.

While the extremely aggressive filing schedule does reduce the amount of time, and very likely reduces the costs of pursuing rate claims (by practically limiting the depth of analysis that can reasonably be performed), it does so at the expense of other important principles like the application of sound legal and economic theory to well-developed facts. Unfortunately, the elements of FORR do not seem likely to lead to an adjudication of the "maximum reasonable rate" that stakeholders before the Board could have confidence in as reflective of, or responsive to, real world conditions in the relevant transportation and commodity markets. In addition to the putting shippers and defending railroads in untenable situations when they are directly

involved in cases, BNSF is concerned that the lack of specified standards would also negatively impact important shipper-railroad relationships outside the adjudicatory process. It has been BNSF's experience that its pricing issues with individual customers are routinely resolved through informal commercial discussions against the backdrop of market conditions. In some cases, that discussion involves the parties' respective expectations of the likely outcome if a rate reasonableness proceeding were initiated by the customer before the STB.

Rather than providing a framework for informed commercial negotiations around potential outcomes, the FORR promises complete uncertainty of outcome to all parties involved. It leaves a railroad in the position of not knowing what level rate it could offer that would withstand regulatory scrutiny and the customer uncertain of what type of relief the agency might determine from one case to the next. It also inserts into the commercial relationship the potential for one of the parties to obtain a one-time favorable-but-arbitrary, and ultimately non-replicable case outcome divorced from the real-world market that the railroad and shipper price. That structural uncertainty has the strong potential not only to distort the market for transportation services for rail and beyond, but also to distort sophisticated commodity markets that our customers compete, creating regulatory winners and losers unconnected to market realities.

Principles to Consider Going Forward

As we have indicated many times, BNSF supports meaningful and effective enhancements and alternatives to the Board's existing methodologies consistent with the principles we have outlined in this submission. While BNSF is deeply concerned about the adoption of a methodology similar to the NPRM's FORR proposal, BNSF believes that rail customers should have access to regulatory relief to address market failures and is not opposed to balanced approaches that result in improvements to the STB's existing adjudicatory processes.

BNSF has a history of supporting enhancements to the STB's existing rate review processes, including the procedural and substantive streamlining of existing methodologies of SAC, SSAC and Three Benchmark.

Among the concepts that BNSF has supported is a streamlined comparison group approach built on existing Three Benchmark methodology but using prescribed factors to minimize complexity of presentation and disputes. This approach should be combined with a screening process akin to the STB's proposal in Ex Parte No. 665 Sub 2, *Expanding Rate Relief*, to ensure the right kinds of cases are being adjudicated by the STB under this truncated methodology (which offers fewer procedural and substantive protections for parties). As explained in BNSF's Opening Comments in that proceeding, a preliminary screen is appropriate and necessary to (i) focus the STB's oversight on outlier rates and reduce the burden on both the STB and railroad and shipper stakeholders from fully litigating claims that are unlikely to be successful, and (ii) reduce any unnecessary interference by the STB in properly functioning markets. BNSF shared these ideas again with the members of the STB's Rate Reform Task Force in October of 2018. Similar concepts are also incorporated into the concept that the AAR recently shared with STB that are references in the AAR's October 21, 2019 letter in this docket. Finally, the AAR and BNSF are submitting comments today in Ex Parte No. 756, *Streamlined Market Dominance Determination*, that recognize the STB's authority to make streamlining changes to its current market dominance approach and provides what we believe is helpful constructive guidance on how to implement a set of simplifying assumptions to accomplish that goal.

BNSF has also worked with customer groups to develop alternative market-based mechanisms outside of the STB's existing formal proceedings, allowing parties to address rate

reasonableness concerns on an accelerated time frame in the context of the real-world competitive markets for the involved commodities. As the STB is aware, BNSF worked with the Montana Grain Growers Association (“MGGA”) and Montana Farm Bureau (“MFB”) to establish an alternative dispute resolution process for Montana grain producers of wheat or barley shipped in Montana that has been in place since 2009. Attachment A to this filing is a letter that BNSF submitted in 2012 in STB Docket No. 699, *Assessment of Mediation and Arbitration Procedures*, that describes the Montana ADR program in more detail. At a high level, the Montana ADR program has a two-tier structure of mediation followed by arbitration using pre-defined market-based standards that take into account the complexities and competitiveness of agricultural markets and that maintain a strong incentive to continue to reinvest by all in the industry. Under this privately-negotiated arbitration program, agricultural producers have the ability to challenge rail rates and obtain relief even when they are not the direct payor of freight. To date, disputes have been resolved prior to formal arbitration proceedings because the parties have been able to negotiate a favorable resolution within the substantive framework provided by the arbitration standards, and that is viewed as highly successful outcome for BNSF, MGGA and MFB. BNSF has also discussed at different times with the National Grain and Feed Association’s executive committee various concepts for expanding our Montana approach to implement similar expert-based, market-focused ADR resolutions for its broader membership base.

BNSF encourages the STB to move away from the FORR proposal contained in its September 11, 2019 NPRM. BNSF believes that there are credible ways for the STB to improve its existing rate reasonableness oversight by implementing reforms designed to improve accessibility for disadvantaged groups like small shippers while allowing the Board to meet its statutory goals of prescribing rates reflecting sound economics and market outcomes, and to appropriately minimize impacts to functioning transportation and commodity markets.

Respectfully submitted,



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