

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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HEARING ON REVENUE ADEQUACY

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Ex Parte No. 761

Montana agricultural producers support the STB's efforts to develop more affordable, accessible, and practical procedures for handling both large and small rate disputes. The work of the Rate Reform Task Force (RRTF) is timely and offers a number of reasonable suggestions for adapting revenue adequacy calculations to modern economic realities. Specifically, the Incumbent Network Cost Analysis (INCA), represents a promising new way for assessing rate reasonableness based on the incumbent carrier's assets and operating expenses, rather than those of a hypothetical entrant. Agricultural producers across the state of Montana applaud the STB's recognition of standing to challenge a rail transportation rate for grain given that "the price the producers are paid by elevators for their grain is generally affected at least to some extent by the transportation rate the railroad charged to the grain elevators."¹ The ongoing efforts of the STB to learn from history, engage openly with stakeholders, and conduct objective, analytical decision-making informed by accurate information instills a renewed level of confidence in the outcome of the Board's rate reform efforts.

To understand the plight of the Montana ag shipper it's worth a look back at the storied history of rail transportation in Montana. Montana's railroad history traces back to the mid-nineteenth century where Westward Expansion fueled entrepreneurial homesteaders, farmers, and cattlemen to travel the routes of miners and trappers before them in search of their very own piece of virgin soil. The coming of the transcontinental railroads to Montana Territory in the 1880s is considered the single most transformational economic development in the entire history of the state.²

¹ See *Rail Transp. of Grain, Rate Regulation Review*, EP 665 (Sub-No. 1) et al., slip op. at 8 (STB served Dec. 29, 2016).

² Fritz, Harry. "Train Trips to Paradise: The Railroad Transformed Montana." This is Montana. <http://www.umt.edu/this-is-montana/columns/stories/the-railroad-transformed-montana.php>, Web. November 25, 2019.

By 1909 Montana boasted three transcontinental railroads linking the state to vital national markets and further encouraging settlement and development of the land.³

The Northern Pacific in 1900 was the largest landowner in Montana, and it had millions of acres to sell. The Great Northern and the Milwaukee Road depended for their very existence on filling up the plains – once home to widespread Indian nations and buffalo – with productive, Jeffersonian, agrarian yeomen. Their message to potential farmers all over America and Europe was simple: Come hither, and replenish the earth.⁴

For years cheap transportation, ample rainfall, and high commodity prices fueled explosive growth before markets collapsed following the end of the Great War. Low prices, drought, fire, hail, dust storms, and a flu epidemic tested even the most steadfast of Montana residents and the state's population receded throughout the 1920's.⁵ Soon trucks and significant public highway projects presented the railroads with unforeseen competition and railroads were forced to recede, adapt, and often merge to remain viable. In the 1970's, Burlington Northern (BN) was created through the merger of the Chicago, Burlington & Quincy; the Great Northern; the Northern Pacific; the Spokane, Portland and Seattle; and the Pacific Coast Railroad.

During this time, railroads were regulated by the Interstate Commerce Commission (ICC), authorized by a nearly 100-year-old statute designed "to protect small shippers in a developing economy from abusive practices by powerful, dominant railroads."⁶ The railroad industry as a whole was in poor financial condition and Congress was forced to act.

To revitalize the industry, Congress passed the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act),⁵ and a few years later the Staggers Act. Those two statutes fundamentally changed the ICC's regulatory role: the ICC was still charged with protecting captive shippers from abuses of market power, and indeed retained its longstanding authority to declare rail rates unreasonable. But given the level of competition that had developed within and among the modes for most traffic, the impetus behind both laws was a desire to give railroads more leeway to operate in the marketplace like other industries.⁷

This era of deregulation worked and for some time over 70 Class I railroads operating under new business models competed in the open market. Congress encouraged railroads to compete more like unregulated businesses by enacting provisions allowing railroads and shippers to enter into contracts establishing the rates and terms governing specific movements and providing that transportation pursuant to such railroad/shipper contracts would be exempt from most regulation (49 U.S.C. § 10713 [now § 10709]).⁸ Additionally, Congress recognized

³ *Id.* at pt. 2.

⁴ *Id.*

⁵ *Id.*

⁶ Rate Reform Task Force. "Report to the Surface Transportation Board." April 25, 2019. p. 2.

⁷ *Id.*

⁸ *Id.* at p 3.

some degree of differential pricing would occur because rail carriers have high fixed costs that would not be recovered if they had to price their competitive and captive traffic at the same level.⁹

Under differential pricing, railroads generally price their services in inverse relation to “demand elasticity” (the price sensitivity of the traffic), charging captive shippers higher “markups” over costs than they charge shippers with competitive alternatives. See Burlington N. R.R. v. ICC, 985 F.2d 589, 595-96 (D.C. Cir. 1993); Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520, 526-27 (1985), aff’d sub nom. Consol. Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987).

The ability to price differentially, however, was never intended to be unfettered. Thus, to ensure that individual captive shippers would not have to pay more than their fair share of the carriers’ differentially priced services, Congress gave the ICC (and now the Board) the authority to determine whether challenged rates on captive traffic are unreasonably high, 49 U.S.C. § 10701a [now § 10701], and, if so, to prescribe a maximum reasonable rate for future shipments, 49 U.S.C. § 10704(a)(1), and award reparations for past shipments, 49 U.S.C. § 11704(b).¹⁰

At the core of this discussion is the concept of revenue adequacy. Adequate revenues are defined as those that are “adequate, under honest, economical, and efficient management, for the infrastructure and investment needed to meet the present and future demand for rail services and to cover total operating expenses, including depreciation and obsolescence, plus a reasonable and economic profit or return (or both) on capital employed in the business.” 49 U.S.C. § 10704(a)(2). The STB annually conducts this audit and determines which Class I rail carriers are revenue adequate.¹¹

In 1995, BN and Santa Fe merged to create the modern Burlington Northern and Santa Fe Railway, (later rebranded BNSF Railway) the largest rail network in North America. Today, BNSF Railway is the product of some 390 different railroad lines that merged or were acquired during more than 160 years.¹² In 2017, BNSF was one of four Class I’s to achieve revenue adequacy; reporting a rate of return on net investment equal to at least the current cost of capital for the railroad industry in 2017, which the board determined to be 10.04 percent.¹³ BNSF also achieved revenue adequacy in 2015 and 2016, with ROI rates of 12.82% and 10.11% respectively.

⁹ *Id.*

¹⁰ *Id.*

¹¹ Currently, a railroad is considered revenue adequate when its rate of return on net investment equals or exceeds the industry cost of capital. *Standards for R.R. Revenue Adequacy*, 364 I.C.C. 803, 807 (1981).

¹² *Our Railroad*. <https://www.bnsf.com/about-bnsf/our-railroad/index.html> Web. November 25, 2019.

¹³ Progressive Railroading. “STB reveals four Class 1s were ‘revenue adequate’ in 2017. December 27, 2018. https://www.progressiverailroading.com/class_is/news/STB-reveals-four-Class-1s-were-revenue-adequate-in-2017--56383 Web. November 26, 2019.

BNSF Railway owns 1939 miles of active rail in Montana running both parallel to Canada through the northernmost counties or “hi line” of the state and south along the Yellowstone River before cutting through more centrally located Great Falls and accessing significant portions of the “Golden Triangle” named for the high-quality wheat and barley raised there. (Attachment A). According to a 2018 grain elevator survey, 88% of Montana grain traffic is shipped via Shuttle or Destination Efficiency Train (DET). BNSF's Dedicated Train service is recognized as the most efficient and economical way to move high-volumes of single commodities from a single origin to a single destination.¹⁴ BNSF originates approximately 50,000 grain volume units per year from Montana.¹⁵ Although agricultural products represent a minority portion of BNSF's total business, BNSF continues to grow this sector and set new records for grain volume moved to the PNW where about 30 percent of all the wheat, corn, and soybeans were exported from the United States last year.¹⁶ For Montana, nearly 70 percent of total ag products are exported through the PNW to Pacific Rim and South American countries. Montana has 14 shuttle loading facilities served by BNSF and 40-45 trains pass across Montana's hi-line daily. (Attachment B) Over the past 3 years BNSF has invested over \$500M in capital investments in Montana not including a significant expansion project over Idaho's Lake Pend Oreille.

Today, BNSF Railway and Union Pacific operates as a duopoly in the Western United States. However, UP's relative nexus to Montana ag shipments is de minimis and inconsequential to a market dominance evaluation. Market dominance considerations are especially important to Montana grain producers because to make the case that a rate is not reasonable, a shippers only way to examine a subset of the network is by using the stand-alone cost (SAC) test. The RRTF adequately addresses the weaknesses of SAC but could elaborate on market dominance determinations and the Board's resultant standard of review.

49 U.S.C. § 10707(a) establishes that market dominant carriers are those that lack effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies. It is recognized that BNSF effectively controls all the routes in and out of Montana and that Montana is very captive. (Attachment C) Montana Rail Link represents only 817 miles, crossing the continental divide to connect BNSF's southern line to BNSF's northern line just across the Montana border in Sandpoint, Idaho. The Union Pacific to Butte in Southwest Montana is located far from Montana's prime agricultural production areas. BNSF in Montana does not experience competition for ag shipments from other rail carriers or modes of transportation. The notion that trains originating outside of Montana, in areas where competition exists, experience a lower price shipping option despite a higher cost consistently fails to satisfy any notion of economic fairness to Montana's agriculture industry.

¹⁴ <https://www.bnsf.com/ship-with-bnsf/ways-of-shipping/dedicated-train-service.html> Web. November 26, 2019.

¹⁵ Sexhus, Sam. Ag Update. Presented May 2018. p. 4.

¹⁶ BNSF News. “BNSF Moves Record Grain Volume to the PNW” February 25, 2017. Web < <https://bnsfnorthwest.com/news/2017/02/25/bnsf-moves-record-grain-volume-pnw/> >

The MWBC supports the Task Force's proposal to set a list of criteria that once pled will lead to a finding by rule that the complainant has made its prima facie case of market dominance over the traffic. In addition to the long distance shipped by Montana producers, the sheer volume of Montana ag products also serves as a significant barrier to semi-truck shipments via interstate highway. For example, where one truck can haul approximately 967 bushels, a single unit train will move over 350,000 bu.

Arguably most problematic to a Montana rate case is access to relevant data where the grain elevator is the exclusive party arranging and providing payment for transportation. Even where standing to challenge the rail transportation rate for grain is acknowledged, an agricultural producer generally lacks access to the relevant information necessary to present a viable rate case on their own. Typically, grain shipping terminals arrange for transportation from a centralized headquarters where limited officers of the company possess information otherwise inaccessible or withheld as information proprietary to the company's operations as a private company. Although tariff rates may be made publicly available (to a degree), they fail to describe the full cost of shipping and the lack of effective negotiation leaves these shippers in the position of a take it or leave it deal.

One additional meaningful regulatory change might be to consider shifting the burden of proving the reasonableness of a rate to the railroad. For example, for the 3-benchmark process to be effective, the regulation must first determine when it should be up to the railroad to demonstrate that its rate is reasonable. If the RVC for a contested movement is greater than the average RVC for a comparable move, then the burden of proof should fall on the railroad, not the shipper, to demonstrate that a rate is reasonable. A more hands-on approach by the STB into the process for setting and adjusting tariff rates on captive ag shippers would likely provide a substantial check on market dominant price structures and an assurance of fairness to the agricultural producer. Rail rate challenges and prolonged rate cases under any test are not the preferred avenue for Montana ag shippers.

In lieu of fixing SAC, the proposed Incumbent Network Cost Analysis (INCA) for assessing rate reasonableness based on carriers' assets and operating expenses rather than those of a hypothetical entrant is a promising method of determining rate reasonableness. There is an obvious benefit to judging the rate at issue against costs of an actual railroad instead of a hypothetical. A two-year lookback period appears well thought out and sufficiently justified by the Task Force. Maximum Markup Methodology (MMM) provides a clear threshold for achieving rate relief.

Montana's ag shippers, having experienced first-hand the length and expense of rail rate challenges under prior methodologies (See *McCarty Farms*), support limits to the time and cost of market dominance analyses. The Montana Department of Agriculture echoes the sentiments of USDA that procedural limitations are a favorable alternative to substantive limitations for streamlining and expediting rate reasonable reviews. The amount of evidence necessary to

prevail in a modern rate case significantly hinders the ability of a Montana ag producer to bring an independent reasonableness review.

The primary challenge, as indicated by many observers is that if the goal of the STB intervention in captive rail markets is to duplicate the outcomes that would occur in competitive markets any test must allow for accurate measurement of rail costs.¹⁷ But not even with access to the best data is this possible. The railroad themselves cannot be sure year over year what exact costs will be. However, just as the railroad relies on projections and historic trends, so can the STB. Montana ag shippers do not support the TRB Committee's recommendation to Congress to eliminate the STB's direct role in maximum rate determinations in favor of independent arbitration and ask instead whether STB's role in fair rate evaluation is direct enough.

Along with mandatory disclosure requirements to automate and expedite portions of the discovery process the STB should consider scenarios where it will be willing to exercise its investigatory authority and to what degree. If rate reasonableness provisions are to be meaningful to any but a limited number of rail shippers any remedy must be expedient and inexpensive. In some situations, the STB may be the proper authority to facilitate Final Offer Decision-making or simply prescribe fair rates based on an agreed upon set of factors.

The description of revenue adequacy spelled out in the *Coal Rate Guidelines* recognizes that captive shippers should not be required to pay differentially higher rates than other shippers. All revenue adequacy determinations should continue to reflect this basic principle. However, long-term revenue adequacy needs to be defined by the Board for use in applying the revenue adequacy constraint articulated in *Coal Rate Guidelines*. It is not clear whether the RRTF's new definition of revenue adequacy constraint would benefit the MT ag shipper where an interchange point with a second carrier is not feasible. Most importantly for MT ag shippers is to acknowledge that while accounting for continued viability of a railroad through long-term business cycles is important no railroad should be entitled to ever increasing revenues with no constraint ever.¹⁸

Despite railroads being allowed to engage in price differentiation to achieve revenue adequacy Congress has long expected the STB to put limits on railroads' use of such practices. Simply put, captive shippers should not be required to pay differentially higher rates than other shippers. Any mechanism to assure fairness outside of formal rate case proceedings is welcomed. The Montana Wheat and Barley Committee supports further development and measured application of recommendations to this end. In some circumstances, it may be

¹⁷ Blanton, Bruce, Constrained Market Pricing and Revenue Adequacy: Regulatory Implications for Shippers and Class I U.S. Freight Railroads (Summary), U.S. Department of Agriculture, Agricultural Marketing Service, October 2015. Web

¹⁸ Blanton, Bruce, Constrained Market Pricing and Revenue Adequacy: Regulatory Implications for Shippers and Class I U.S. Freight Railroads (Summary), U.S. Department of Agriculture, Agricultural Marketing Service, October 2015. Web <<http://dx.doi.org/10.9752/TS215.10-2015>>

beneficial for the STB to instigate such cases themselves on a provisional or limited scope basis as new methods are applied to present practices.

Like the Task Force, the MWBC does not wish to undermine the rail industry's financial health and long-term viability. However, we support the STB's openness to new regulatory structures and ultimate decision authority on these matters. The STB is further encouraged to exercise its investigatory powers to access information otherwise not available and review it from a new and objective perspective. We agree with many of the Task Force's proposed solutions to remedy the situation of apparent unfairness and provide more workable oversight of the unique rail shipping industry. Any effort to simplify or streamline rail rate case proceedings and provide greater ease of access to requisite information is further encouraged.

Moving forward, the STB should continue to look to history with a respect for partial economic deregulation, continue to collaborate and engage stakeholders directly, and continue to reach decisions based on good data and sound economic principles. It is critical for the shippers of Montana that STB provides adequate assurances that rail rates are fair and reasonable. Montana grain producer's welcome STB oversight into our industry should it wish to further examine this distinctly captive shipping environment. In the meantime, the MWBC along with the Montana Department of Agriculture will continue to collaborate directly with BNSF to better understand their economic data and business considerations for long term viability while seeking out new business opportunities and cost-saving efficiencies.

Respectfully,

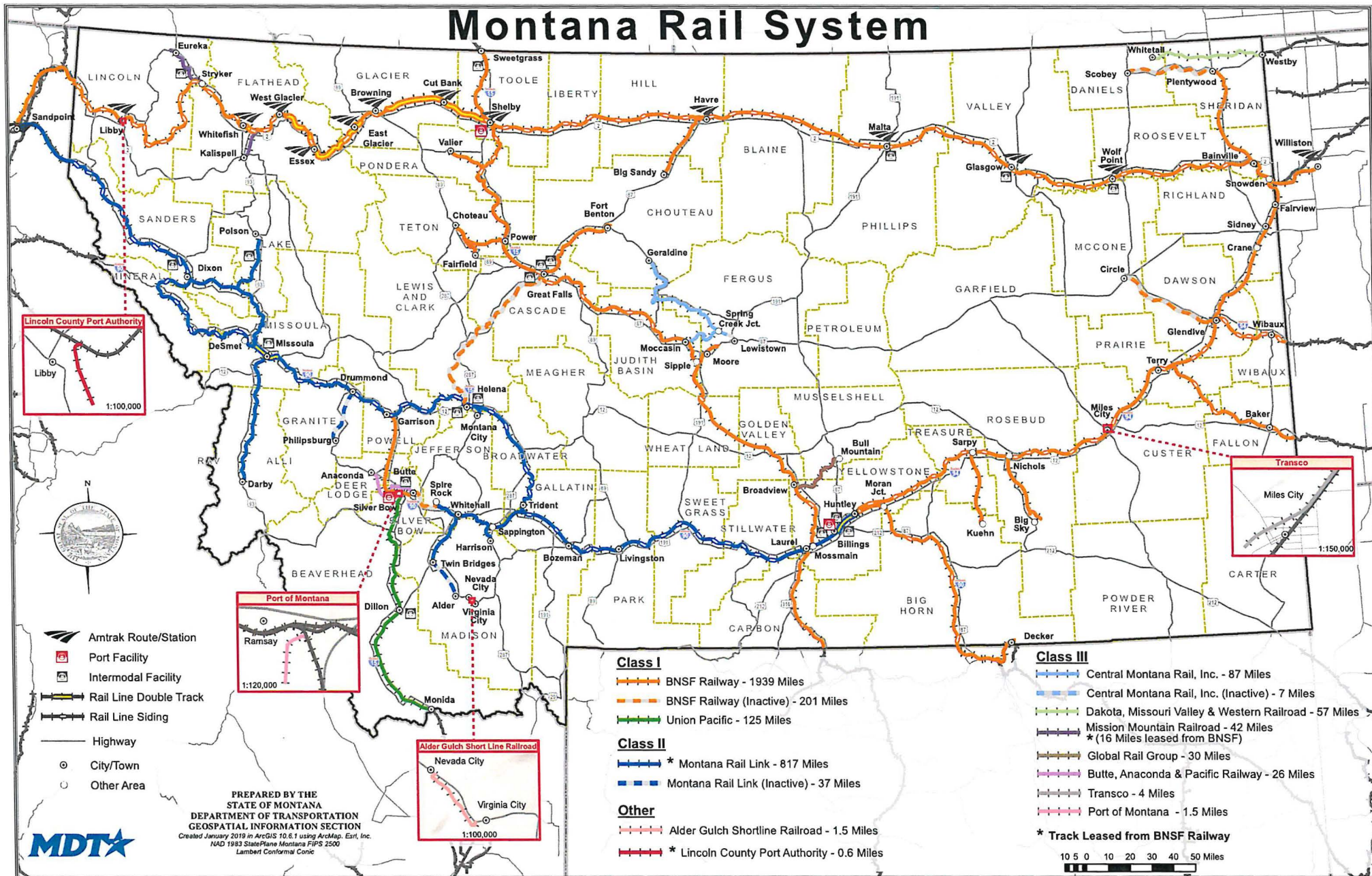


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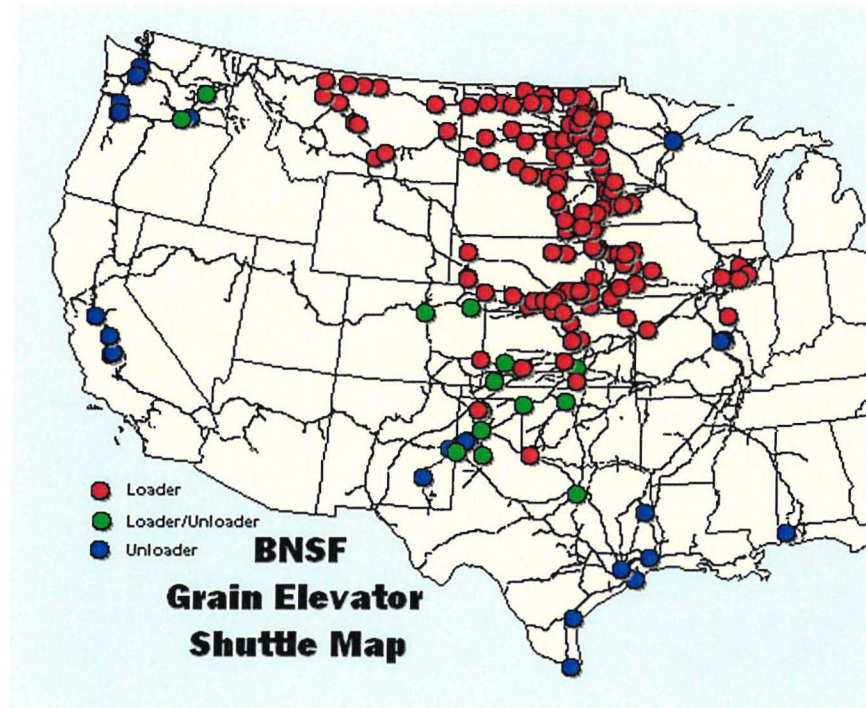
Dated: November 26, 2019

Attachment A

Montana Rail System



Attachment B



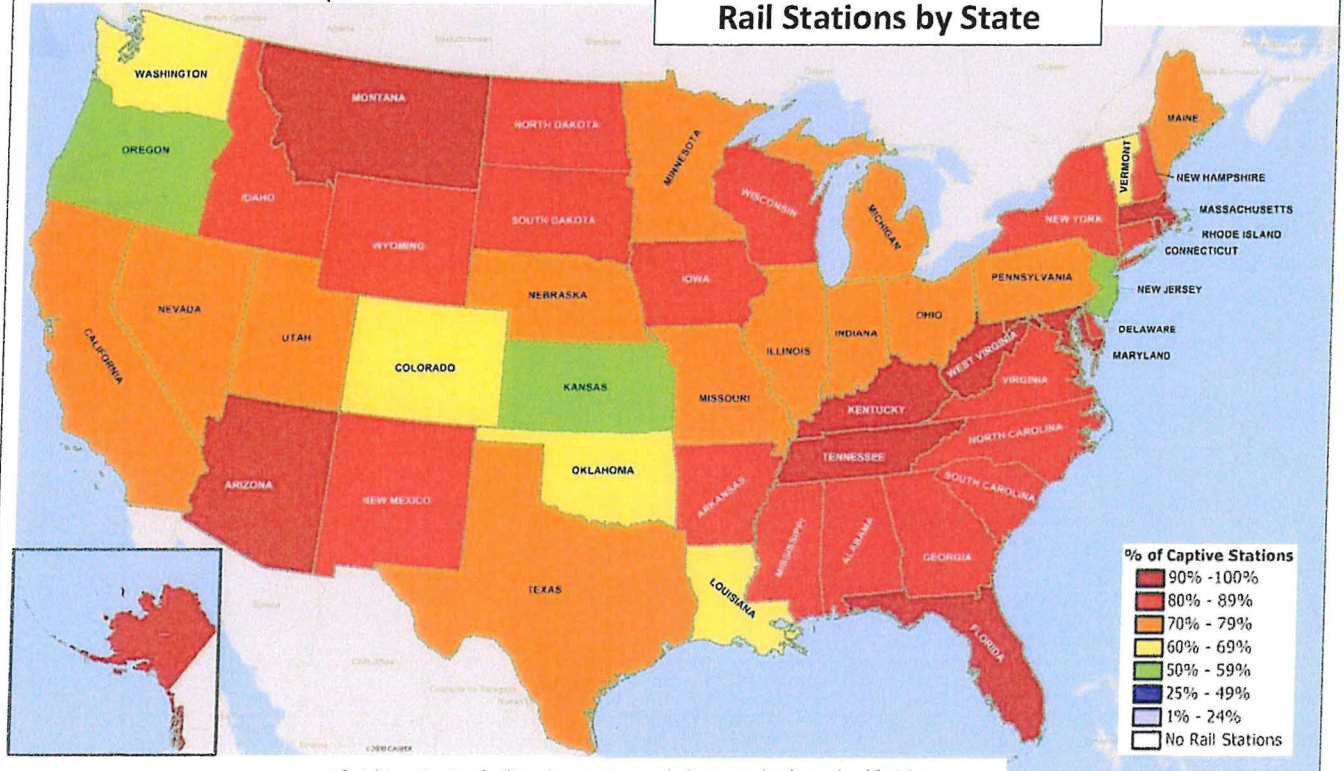
Source: <http://www.bnsf.com/customers/grain-facilities/shuttles/#MT>

508	L	Peavey Co.	Billings	MT
518	L	Columbia Grain Inc.	Carter	MT
2353	L	Mountain View Coop	Collins	MT
2358	L	CHS Inc.	Glendive	MT
2456	L	United Harvest, LLC	Grove	MT
558	L	Columbia Grain Inc.	Harlem	MT
561	L	ADM/CHS, LLC	Havre	MT
562	L	ADM/CHS, LLC	Havre	MT
2387	LU	Columbia Grain	Kasa Point	MT
581	L	CHS Inc.	Macon	MT
588	L	Peavey Co.	Moore	MT
2364	L	United Harvest, LLC	Pompeys Pillar	MT
603	L	Columbia Grain Inc.	Rudyard	MT
608	L	CHS Inc.	Shelby	MT

Attachment C

78.4% of All US Rail Stations are Captive

Competition at U.S. Freight Rail Stations by State



- A freight station is a facility where trains regularly stop to load or unload freight.
- Freight stations are captive when they have access to only one Class I railroad.



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