

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 704 (Sub-No.1)

REVIEW OF COMMODITY, BOXCAR, AND TOFC/COFC EXEMPTIONS

**REPLY COMMENTS CONCERNING PROPOSED NEW APPROACH FOR
CONSIDERING CLASS EXEMPTION AND REVOCATION ISSUES**

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I. INTRODUCTION

Highroad Consulting, Ltd. ("Highroad") hereby submits its Reply Comments in this proceeding, pursuant to the decision of the Surface Transportation Board ("Board") served on December 23, 2020 and decision later served on January 7, 2021, granting extension of time for comments on January 29, 2021, and for replies on March 1, 2021.

Highroad respects the significant effort put forth by the Board's OE to develop a "robust", yet complex approach that has been proposed by the Board.

The model proposed by the Board should not be adopted. It is flawed and unwarranted and it has no relevance to the issues or to this initial proceeding. Furthermore, it does not address all of the issues and challenges faced by shippers of exempt commodities.

The proposed approach goes beyond what is required by the revocation statute in which the scope of considerations for exemption revocations omits any mention of "market power." If adopted, it will turn proceedings to consider revocation of exemptions and requests for new exemptions into complicated, lengthy, and

expensive proceedings that would be cost prohibitive for most, if not all, shippers to use.

Most important, the Board has changed the scope of this proceeding, thereby setting aside the evidence submitted by shippers and shipper associations of the subject commodities, and the original and primary objectives of Ex Parte 704, i.e., to address the potential revocation of five specific STCC commodity groups. (AF&PA subsequently requested consideration of four additional STCC's.) Current commodities under consideration include:

14 – 2	Crushed or Broken Stone or Rip-Rap
24	Lumber or Wood Products ¹
26	Pulp, Paper or Allied Products, and Wallboard
29-914	Coke Produced from Coal
33-12	Primary Iron or Steel Products
32-4	Hydraulic Cement
40-211	Iron or Steel Scrap, Wastes or Tailings
40-231	Wood Scrap or Waste
40-241	Paper Waste or Scrap

II. BACKGROUND

Highroad has participated in this proceeding from the very beginning when the Board announced a public hearing “to review categorical exemptions from regulation...” Subsequently, on March 23, 2016, the Board issued a decision seeking comments on a proposal to revoke the class exemptions on five STCC's.

In 2019, the Board conducted Ex Parte meetings with interested parties that included shippers and some trade associations that represent shippers of commodities encompassed in this proceeding. At the Ex Parte meetings with shippers

¹ Consideration of STCC's 24; 26; 40-231; 40241 include shipments in boxcars of those commodities, but boxcar shipments limited to the subject commodities.

and shipper associations, additional evidence was presented that supports the Board's decision to propose revocation of the exemptions for those commodities.

What I have described here is a topic that has been before the Board for more than ten years, and nearly five years since the Board proposed revocation of the exemptions. To say shippers were disappointed by this most recent decision proposing a new approach, is a gross understatement. Initially, Highroad represented two clients in Ex Parte 704, but at a certain point they questioned why they should spend the time and resources to participate in a process that has produced no results. When the Board changed course, proposing a new overwhelming approach, they were extremely frustrated, asking, *What's the Point?*

Highroad is submitting these Reply Comments on its own, not only representing the interests of two clients, but also representing the interests of all of our clients and rail shippers in general, since the scope has been expanded to include potential consideration to exempt additional commodities. We are doing because we believe the evidence presented by shippers of exempt commodities in this proceeding is more than adequate to justify revocation of the exemptions for the subject commodities, and we are committed to protecting the interests of our clients.

III. THE PROPOSED MODEL IS FLAWED, UNWIELDY, AND IRRELEVANT AND SHOULD NOT BE APPROVED.

The proposed methodology is overly complex, arbitrary, and by the Board's own description, ill-suited to making final determinations on exemption revocation questions. Given the level of detail and the extent of work obviously associated with OE's development of the proposed model, shippers would be required to incur the costs to retain economic consultants and legal representation to develop and present

evidence. This would be cost prohibitive and it is highly unlikely that shippers would file a request for revocation of an exemption. Even worse, shippers could be forced to assume litigation costs to defend their regulated position, if a railroad or railroads filed to exempt additional commodities.

The proposed approach is faulty because it creates a one-size-fits-all nationwide standard for all commodities, and it arbitrarily averages independent datapoints and indicators. Such an approach fails to recognize the substantial differences in market conditions, different shipping characteristics, different operations and customer requirements.

The Board's analysis relies on many arbitrary distinctions, including simple averaging of eight indicators. This has no basis. Also, there is arbitrary reliance on the Overall Dashboard Signal Thresholds. There does not appear to be any relevance or significance.

The most serious flaw in the proposed approach is the Indicator Dashboard which distorts real-world information on market conditions into a series of arbitrary scores and color-coded signals, all of which are combined to identify "strong"; "moderate"; or "weak" cases for revocation or exemption. The overall dashboard signal is not grounded in economic theory and the Board staff confirmed that the Dashboard's signals and numerical scores, and the assumptions underlying them, are unsupported by any statistical validation.

The proposed approach relies heavily on Revenue-to-Variable Cost (RVC) ratios and Revenue Per Car (RPC), neither of which are reasonable indicators of

market dominance. Average RVC's are meaningless; they can be skewed by distance and when performing year-over-year comparisons, changes in traffic mix.

Distance can have a significant impact on RVC's. Very short hauls have high RVC's even when a rate for a move might be considered to be reasonable and fair. As the averaged length of haul increases, the average RVC can be lowered, but that is not an indicator of market dominance, and it does not necessarily mean that the rate aligns with the market.

The URCS rail costing model used by the Board has been criticized and is currently under scrutiny for change. We have performed studies for clients that requested parallel costing, to report costs calculated with URCS, and costs calculated with Highroad's rail costing model, INSIGHT: RailEdition© ("Insight").² While the results vary, overall URCS costs are double the costs calculated with the Insight model.

Of course, we perform costing with the URCS model when required for STB proceedings, but we advise our clients not to make decisions based on URCS. Overstated rail costs are unfair to shippers when judging market power and when the Board orders reparations in rate cases. Any analysis based on URCS, including calculation of RVC's based on URCS, will be flawed because of the inaccuracy of the model and, therefore, should not be included.

AAR submits that the 500-mile threshold is too low. The proposed approach for evaluating truck competition assumes that 500 miles represents a reasonable distance for direct trucking alternatives, but 1,000 miles does not, and this proposed

² Highroad's INSIGHT: RailEdition© is based on the railroads' costs reported in the R-1 reports.

standard does not vary by commodity. Either this was an oversight, or OE disregarded the information submitted by shippers in filings and in Ex Parte meetings.

In the Ex Parte meeting with Verso Corporation, Verso cited capacity constraints and the shortage of truck drivers, especially for longer hauls. They further explained that rail shipments of inbound wood to one of their mills ranged from 170 to 400 miles.³ Another example of the variance in lengths of haul was presented by a shipper of unit trains of limestone. He explained that due to the volumes shipped and the shortage of truck drivers, it is not practical to ship by truck beyond 60 miles.⁴ Of course, it is likely that the benchmark would be different for a shipper of the same commodity with lower volumes. This underscores the fact that application of a one-size-fits-all standard will not convey a true picture of truck competition.

Some participants have submitted that consideration of average lengths of haul has no relevance when measuring market power. We agree; however, review of average length of haul, one of the indicators of changes that have occurred, and the need for carriers to respond to change.

Finally, the approach proposed by the Board does not address all of the evidence presented by the shippers and shipper associations, nor does it address all of the challenges that shippers of exempt commodities face on a daily basis. Two issues that have not been raised in this proceeding are Common Carrier Obligation and railroad de-marketing of business. Shippers need protection from such abuse,

³ STB Ex Parte 704 (Sub-No. 1), Summary of Ex Parte Meeting held on June 6, 2019 between Verso Corporation, American Forest & Paper Association, and Member Oberman, P. 2.

⁴ STB Ex Parte No. 704 (Sub-No. 1), Comments of Texas Crushed Stone, July 26, 2016, P. 4.

and they should have the ability to go to the STB to seek relief when abuses occur. This will be covered in more detail in Part VI.

IV. POTENTIAL IMPROVEMENTS - IF THE PROPOSED NEW APPROACH IS ADOPTED

The model is seriously flawed and cannot be remedied. However, while we are opposed to the proposed new approach, or to any model that would be irrelevant and so complex that it would serve as a barrier for shippers that have a valid need to file for revocation of an exemption, there are only a few changes that could improve the model.

- The analysis should be based on RPTM instead of RVC's or RPC's. (See additional discussion, Part V).
- The dashboard approach would be more informative and less controversial, if it presented actual data instead of conclusions.
- The Board should adjust the model, so it has more than three years' of recorded data. Data collected for a short period of time may not portray an accurate picture. For example, events can impact on the results. When updating our Insight model with 1996 data reported by Union Pacific Railroad, UP's costs spiked. Subsequently, when UP's service meltdown (following the acquisition of Southern Pacific) ended, UP's costs settled down to normal. Also, the model should include comparing data for more than two comparative years over a time span of five years or more. Of course, this would exacerbate the amount of work to be done, and detail to be analyzed, but a longer time span would improve the quality of the analysis.

- AAR submits the RVC threshold should be revised from 5% to 50%.⁵ Except as a gatekeeping function as proposed by Dr. Israel (Part V below), RVC's should not be included in the analysis.
- The analysis should not be limited to data reported in the Waybill File. The Commodity Flow Study (CFS) is a potential additional source. Highroad has performed studies using CFS when we needed to compare modes.

V. THE PROPOSED WATERFALL METHOD

At first glance, the Waterfall Method proposed by Norfolk Southern's Dr. Israel appears to be simple and somewhat logical, but it is more complex than it seems. Also, NS states the three-part screen is not intended to create a irrebuttable presumption in favor of an exemption or a revocation. Individualized data will be needed. While it appears to be simpler than the new approach proposed by the Board, shippers would still be required to assume the costs to hire economic consultants and attorneys, so the proposed process lacks practicality as it would be cost prohibitive for most shippers and possibly for shipper associations.

The first stage of the Waterfall is the R/VC 180 Screen, which NS submits is an accounting measure, not an economic measure, and not an accurate measure of costs. Therefore, the Waterfall limits the analysis of RVC ratios to the role contemplated by Congress, which is a gatekeeping function. Once through that gate, Dr. Israel leaves RVC ratios behind and he moves on to more "instructive inquiries."⁶

⁵Comments of AAR, Ex Parte No. 704 (Sub-No.1), January 29, 2021, C(1), "The Proposed R.VC Threshold is Too Low", P. 57.

⁶STB 704 (Sub-No. 1), Comments of Norfolk Southern Railway Company, P. 24

("The RVC screen should be applied in a way that rests the hypothesis that average rail rates for the commodities (or shipments) at issue are at or below the 180 jurisdictional threshold..." Israel at Page 3. Later, in the NS comments, they present analyses based on Revenue Per Ton-Mile (RPTM), which we submit is a more accurate indicator.

Dr. Israel, when addressing modal competition, stated, "However, if shippers believe that the FAF data indicator is incorrect for a specific commodity they should have the opportunity to present commodity-specific data and evidence to prove the specific commodity under review is not subject to competition from alternative modes."⁷ Subsequently, Israel presented some ways the GMIM analysis can be expanded to capture competition more accurately and completely and point out areas where econometric analysis could be used to test and refine the specific thresholds and metrics used at each step.

The question is, how detailed a presentation would be needed, and what would it take for a shipper to make a case for revocation? Also, since the Board has expanded the scope to include exemptions, shippers would be required to incur the costs of hiring economic consultants and legal counsel to defend their regulated position.

Union Pacific suggested The Waybill Sample could be used to identify situations in which shorter trucking moves could likely compete with longer rail moves, but this would lead to subjective judgement. There are contributing factors when assessing length of haul (truck vs, rail), including shipping volumes, the availability of trucks,

⁷ STB Ex Parte 704 (Sub-No. 1). Norfolk Southern Railway Company Comments, Israel, P. 29.

and sometimes customers order carload volumes for short distances, even though they pay a premium on the freight. This is especially prevalent for shipments in private cars. The customers may not have adequate storage and they need to have product positioned to ensure they do not have plant shutdowns, so they use the vendor cars for short-term storage.

Finally, Dr. Israel suggests the Board should require shippers to provide data and information relevant to the assessment of geographical alternatives. This would include providing, “any documents or data related to the purchase, sale, or transportation of the commodity under review. Documents may include (but are not limited to): strategic plans, management presentations, records of negotiations, and/or any analysis of alternative options.”⁸

This is not feasible. I polled some shippers, asking how their management and their attorneys would view such a request. The consensus was their management and legal team would never supply such data unless compelled to do so by a court of law.

VI. THE BOARD’S STAFF’S GOAL TO “SUMMARIZE INSIGHTS AND INFERENCES FROM DATA VISUALIZATIONS DOES NOT ADDRESS ALL OF THE ISSUES.

Shippers of exempt commodities need equal protection from railroad market abuse, and when abuse occurs, they should have the option to seek relief at the STB.

Common Carrier Obligation

Shippers of regulated commodities have been afforded the protection of Common Carrier Obligation. This is a topic that has not been addressed in this

⁸ STB Ex Parte 704 (Sub-No. 1). Israel, P. 43.

proceeding. I will present two examples of the kind of challenges faced by our clients, that may not have occurred if the shippers' commodities had been regulated, and they were protected by Common Carrier Obligation.

The first example was a shipper of aggregates that needed to move 150,000 tons of rock during the shipping season, for the Chicago Deep Tunnel project. Their switching schedule was three days/week. They planned 15-car shipments of 15 on each of those three days; based on that schedule, they could fulfill the volume requirement in the sales agreement. When the client called Highroad for assistance, they had not received a switch for more than three weeks, so their volume commitment to the project was in jeopardy. In the initial meeting with the railroad, the Director of Marketing explained the railroad did not want to stop the train to switch the quarry because it interfered with their mainline operations. In essence, it was a conscious decision on the part of the railroad to refuse service. This was not an acceptable answer. Within a week, after a meeting and a series of phone calls, service was restored. However, the client incurred the costs for a consultant to resolve a problem that should not have happened in the first place.

The other example is a large foundry in the Midwest, that receives high volumes of steel from Birmingham by truck. We confirmed with the vendor (the steel company) that they prefer rail vs truck for long haul moves. Mode conversion to rail would have resulted in significant cost savings for the foundry, and the railroad would have secured new single line business of more than 500 cars annually. Surprisingly, when we approached the railroad, they refused the business, citing operating issues in the Birmingham area. The project with that client ended, and the foundry is still receiving steel by truck.

De-Marketing

De-marketing and predatory pricing of traffic by railroads is widespread. In most cases, the reasons are transparent. Reasons can include capacity, but the most egregious incidents occur because a railroad is directing markets, and deciding where they want their customer(s) to do business, or where they want to exclude a customer from a specific market.

I have observed this throughout my career, in my role as General Manager of a strategic business unit at Chicago & North Western, and since as a consultant.

One example was a conversation with the market manager of a connecting carrier who told me his strategy was to let Shipper A have Ohio, and Shipper B can have Indiana. I informed him that he was violating anti-trust laws by dividing markets, and I ended the conversation. The point here is he was pricing to de-market customers in select markets.

We also performed a project for a shipper association and during the course of performing research based on the Waybill data, it was evident that railroads were controlling markets with pricing. These were not shipper specific, but regional in nature. To their frustration, shippers in a western region were totally absent in a midwestern market, because their rates were not market competitive.

These are issues that cannot be identified or corrected with an analytical model. Shippers of commodities that are exempt should have the same protection and recourse as shippers of regulated commodities.

VII. THE DECISION PROPOSING THIS NEW APPROACH CHANGES AND EXPANDS THE SCOPE OF EX PARTE 704.

The Board, when proposing this new approach, changed the scope of Ex Parte 704, and set aside its initial objectives and evidence presented in this proceeding by the shippers and shipper associations. In addition to the initial objective to consider revocations, the proposed approach would apply to requests for new class-wide exemptions. Therefore, shippers of commodities that are currently regulated could be forced into a position to defend the regulated status of their commodities, and to preserve Board oversight.

The possibility of applying the proposed new approach to new exemption requests is very concerning, as shippers of regulated commodities have not been involved in this proceeding. The Board should not expand the scope of this proceeding at the last minute by inserting the issue of new exemptions into the debate.

VIII. RECOMMENDATIONS

The proposed new approach should not be adopted. The proposed approach is extremely complex and the cost for consultants and attorneys would be so daunting, it is unlikely a shipper would file a request for revocation. Furthermore, the Board stated it would not necessarily be limited to the data when making their decisions. If so, then what's the point? Why spend the time and resources for a convoluted analysis that is not relevant, that may not be used?

The Board should not incorporate geographic competition into the model, as suggested by the railroads. Such a step would exacerbate an already unwieldy process.

This proceeding and the proposed approach should not develop into a market dominance issue. The Board's Request for Comments recognized that "understanding

market conditions is important when considering commodity exemptions and revocation exemptions,” but asserts that consideration of market power is “not required by statute”.⁹

The Board should re-focus on the original intent of EP 704 and make decisions based on the evidence presented in the proceeding. Expanding the scope at the last minute by inserting exemptions into the debate would be unfair to shippers of regulated commodities that have not participated in this proceeding.

The Board should revoke the exemptions on the five commodity groups as proposed, and the Board should consider revocation of the commodities submitted for consideration by AF&PA. Shippers of the subject commodities have presented evidence that exemptions on their commodities should be revoked, which is the reason the Board proposed the revocations.

IX. CONCLUSIONS

We sincerely respect the amount of attention the Board has afforded to these issues during the ten-year term of this proceeding, and the dedication and hard work of the OE staff, when responding to the Board’s request to develop a “robust” model. However, this has been a lengthy proceeding, and the original intent and objectives of Ex Parte 704 have been derailed.

In the Transportation Research Board report to Congress, it found, “the standards and procedures used by the ICC and STB for ruling on the reasonableness of challenged rates have proved to be slow, costly, and inappropriate to many shippers’

⁹ STB EP 704 (Sub-No. 1), Decision, September 29, 2020, Discussion, P. 5.

circumstances over three decades. Thus, they prevent shippers from having equal and effective access to the law's maximum rate protections. Efforts to streamline and expedite the process. . . have not overcome these deficiencies in some respects have made matters worse."¹⁰

That is a good analogy as that is what has developed with Ex Parte 704; by changing and expanding the scope of this proceeding, shippers are actually worse off than when this proceeding was first opened.

The Board repeatedly emphasized that the proposed methodology would not allow the Board to make a final determination as to an exemption or revocation but, instead, would only provide a partial, imperfect set of information to which the Board necessarily would apply some other, unspecified analysis in order to make final revocation determinations. These candid admissions of the inadequacy of the proposed "tool" to its fundamental task raise legitimate questions as to why there is any need to engage in such a complex process in the first place.

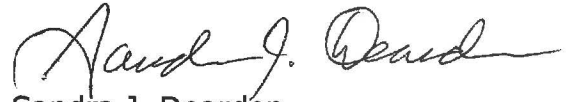
It is not practical to assume that the proposed model, or any analytical model can provide adequate information for the Board to use when making their decisions. As submitted by the AAR, "no other approach would survive scrutiny."¹¹

Shippers and shipper associations that have participated in this proceeding have been extremely patient, and they have presented evidence that supports their positions. We respectfully submit that the time has come to confirm the revocation of the exemptions on the commodities in question.

¹⁰ Transportation Research Board Special Report 318, *Modernizing Freight Rail Regulation*, PP. 6 - 7

¹¹ AAR Comments, STB Ex Parte 704 (Sub-No. 1), January 29, 2021, P. 10.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Sandra J. Dearden". The signature is fluid and cursive, with the first name "Sandra" being more prominent than the last name "Dearden".

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