

PUBLIC VERSION
BEFORE THE
SURFACE TRANSPORTATION BOARD

ENTERED
Office of Proceedings
December 19, 2016
Part of
Public Record

STB DOCKET NO. EP 665 (SUB-NO. 2)

EXPANDING ACCESS TO RATE RELIEF

REPLY COMMENTS OF
MONTANA WHEAT AND BARLEY COMMITTEE
ALLIANCE FOR RAIL COMPETITION
IDAHO BARLEY COMMISSION
IDAHO GRAIN PRODUCERS ASSOCIATION
IDAHO WHEAT COMMISSION
MINNESOTA FARMERS UNION
MONTANA FARMERS UNION
NEBRASKA WHEAT BOARD
NORTH DAKOTA FARMERS UNION
NORTH DAKOTA GRAIN DEALERS ASSOCIATION
OKLAHOMA WHEAT COMMISSION
OREGON WHEAT COMMISSION
SOUTH DAKOTA FARMERS UNION
SOUTH DAKOTA WHEAT COMMISSION
TEXAS WHEAT PRODUCERS BOARD
US GLASS PRODUCERS TRANSPORTATION COUNCIL
WASHINGTON GRAIN COMMISSION
WISCONSIN FARMERS UNION
WYOMING WHEAT MARKETING COMMISSION
US DRY BEAN COUNCIL
US DRY PEA & LENTIL COUNCIL

Terry C. Whiteside
Registered Practitioner
Whiteside & Associates
P.O. Box 20574
Billings, MT 59104-0574
406-245-5132
twhitesd@wtp.net
Representing Shipper Interests
Identified Above

John M. Cutler, Jr.
Law Office
Suite 640
5335 Wisconsin Avenue, NW
Washington, DC 20015
202-715-6243
johnmcutlerjr@gmail.com
Attorney for Montana Wheat and
Barley Committee and ARC

I. INTRODUCTION

Montana Wheat and Barley Committee (“MWBC”) and the other captive rail customer interests on the cover (“MWBC, et al.”) hereby reply to opening comments filed by other captive customers and agricultural interests in this proceeding, and by railroad parties. For varying reasons, the consensus of captive customer representatives is that the Board’s proposed new methodology for challenges limited to “outlier” rates in “very small rate disputes” will do little to address the problem of inadequate access to rate relief.

In addition, the shipper and producer parties generally urge the Board to expand the comparable rate group under consideration here, and devote appropriate resources to more effective unreasonable rate remedies for larger disputes not involving outliers – a category into which almost all rate disputes fall.

The railroad parties have their own consensus, which also adds up to opposition to the Board’s latest proposals. In brief, the railroads argue that there is no problem with the status quo for STB rate regulation, and that differential pricing of captive traffic must continue, limited only by SAC, SSAC, Three-Benchmark (with no changes in Three-Benchmark), regardless of the extent to which railroad revenues exceed revenue adequacy.

They also argue that the Board’s proposals in this proceeding are irremediably flawed, but that if the Board implements a version of its proposed new test, the comparison group should be as small as possible.

The Board must not tell itself that, because captive shippers and producers and railroads all oppose the new rate reasonableness test for very small cases, it must

have found a good balance between the interests of shippers and carriers under the Act. The railroads would have the Board terminate this proceeding and do nothing else. Captive rail customers would have the Board focus on more effective regulation that would help the majority of underserved shippers and producers which have no other alternative to paying whatever rates monopoly railroads impose, instead of focusing on a tiny minority of potential rate disputes.

The regulatory status quo is untenable, as the Board recognized in initiating this proceeding. The railroads' attempts to block more effective regulation (at the same time they are attempting to block more effective competition in EP 711 (Sub-No. 1), Reciprocal Switching) must be rejected. Changes in rail regulation are long overdue.

II. SHIPPER COMMENTS

MWBC, et al. agree with most of the opening comments filed by captive shipper and producer interests in this proceeding, including American Chemistry Council ("ACC"), The National Grain and Feed Association jointly with other agricultural interests ("NGFA, et al."), and the South Dakota Department of Transportation. While USDA urges the Board to adopt simpler and more expeditious procedures for small rate challenges involving agricultural commodities, it reserves judgment as to many specifics.

In his attached Reply Verified Statement, MWBC Witness Fauth addresses many of those specifics, explaining why most shipper and producer arguments are correct, and most railroad arguments are misguided.

Considered together, two principal concerns emerge from the opening comments filed by MWBC, et al., NGFA, et al., and ACC. The first is that the Board has done too little to address the problems inherent in a rate reasonableness test based on comparing the rates challenged by a captive shipper or producer with other rates on similar captive traffic, with “similar” defined narrowly. Such a test depends for its effectiveness on comparison group rates that are themselves not excessive.

A. STB Limits on Comparable Rates Undermine the Test

A consistent argument by major railroads, in proceeding after proceeding, is that STB rate regulation should strive to replicate the results produced by the competitive market. See, e.g., the AAR comments filed September 5, 2014 in EP 722, Railroad Revenue Adequacy, VS of AAR Witness Joseph Kalt at 23:

Where markets do not work or are not realistically viable, then regulation may be necessary. Under those circumstances, the economically appropriate goal of regulatory policy is to mimic the outcome that competitive markets would generate if competition were workable.

To the same effect see the AAR comments at 6.

The railroads also assert, as the main reason for their support of SAC as the only truly valid test of maximum reasonable rail rates, that SAC meets their “mimics competition” standard. Though we agree with it, MWBC will ignore for now the testimony of Professor Gerald Faulhaber that SAC identifies not reasonable rates but the absolute highest rates that may not be outright unlawful. See the Faulhaber VS filed by Concerned Shipper Associations on September 5, 2014 in EP 722.

Let us assume, for now, that the railroads' "mimics competition" test is in fact valid. If mimicking competition is the "economically appropriate goal", it makes no sense for a comparable rates test to compare challenged rates only with the rates of similarly situated captive rail shippers or producers. However, under Three-Benchmark the Board looks only at such rates, and the Board's latest "very small rate dispute" proposals do nothing to remedy this defect.

While Board efforts to reduce litigation costs and delays for those who can least afford them are welcome, a cheap, fast methodology that inherently favors the current pricing practices of market dominant railroads is not what captive rail customers need.

There are obviously many rail rates set by competition that are unobjectionable, including many rates set at or below the threshold of STB jurisdiction, i.e., 180% of variable cost. However, as proposed, the Board's new test would interpose screens designed to preclude comparisons between such rates and challenged rates. And, as Witness Fauth points out (Reply VS at 7, 11, and 13), some such rates have low R/VCs because service costs are exaggerated under URCS.

The Board in its August 31, 2016 ANPR would exclude from comparison groups any rates that do not have R/VC percentages of 180% or higher. August 31 decision at 13. Rates producing such high R/VCs are, of course, high enough to raise concerns (though not a presumption) of unreasonableness, and therefore unlawfulness.¹ Moreover, the challenged and comparison rates are supposed to be applicable to similar commodities in similar service. August 31 decision at 14.

¹ It should be noted that even the R/VC 180% jurisdictional prerequisite for a rate reasonableness challenge incorporates a pro-railroad bias. At the time of enactment of the Staggers rail act of 1980, when Congress adopted (on a phased-in basis), the 180% threshold, Congress also found that if all of a railroad's freight moved at 150% of variable cost, the railroad

MWBC, et al., NGFA and USDA argued in the last phase of this proceeding, EP 665 (Sub-No. 1), Rail Transportation of Grain, Rate Regulation Review, that a comparable rate test which compares a captive complainant's rate only with other captive shippers' or producers' rates on the same commodity set by the same railroad is an exercise in futility. This is especially true for the vast majority of rail rates on grain and other agricultural commodities. The test will do more to validate existing pricing than to promote, let alone ensure, rate reasonableness. Producers and shippers of agricultural commodities need a better alternative to SAC.

We reiterate here the arguments we made there. At a minimum, the Board must correct features of URCS costing that exaggerate rail costs for these shipments, it must allow comparisons with rates of non-defendant railroads, and it must allow comparisons with rates on comparable shipments which produce R/VC percentages below 180%. For more detail on these issues, see the attached Reply VS of Mr. Fauth.

All of these requirements find support in the recommendations of the Transportation Research Board in its June 10, 2015 Report 318, Modernizing Freight Rail Regulation. Notably, that Report was not mentioned at all in any of the railroads' comments in this proceeding. Without such corrective action, it is immaterial that filing fees have been reduced and the relief cap has been raised, as AAR points out (Opening Comments at 8).

The Board acknowledged in its ANPR that such arguments by shippers and producers (and USDA) provided persuasive evidence of "accessibility challenges" for grain shippers and producers and other shippers under the Three-Benchmark

would be revenue adequate. House Report No. 96-1035, May 16, 1980, at page 121; 1980 U.S. Code Cong. & Ad. News, 96th Cong., 2d Sess., at page 4065.

approach. August 31 decision at 10. However, the Board's proposals give rise to the second principal concern for captive rail customer parties to this proceeding.

B. The STB's Focus on Outlier Rates also Undermines its New Test

The "accessibility challenges" cited by the Board would be worsened, not ameliorated, by the proposals to restrict the new test to outlier rates and to very small rate disputes. If only the highest rates qualify for scrutiny, and if the universe of potential complainants is reduced further by excluding challenges where those high rates are imposed broadly rather than to isolated shipments, "accessibility" will not improve.

To its credit, the Board seems genuinely concerned about the cost and complexity of Three-Benchmark for shippers and producers with rate disputes, particularly where the captive rail customer is put at a competitive disadvantage by a monopoly railroad's pricing decisions. MWBC, et al., whose members include and represent many smaller captive rail customers, share these concerns. However, there are better remedies for these problems than the ones the Board has proposed, and the ones the Board has proposed will rarely, if ever, be effective.

As explained above, SAC is not the only way to regulate challenged rail rates in a manner that mirrors competition. It should be obvious that the most direct way to test whether captive rail rates mimic non-captive rail rates is through a well-designed comparable rates test.

Only railroad lawyers and consultants could argue that massive rate cases costing \$5 million or more, straining the resources of complainants, defendants and the Board, are the best way to carry out a "mimics competition" test. And the reason is clear; the cost and complexity of SAC cases constitutes an almost

insurmountable barrier to litigation of meritorious rate cases, especially where multiple origins or destinations (or both) are involved.

A comparable rates test that seeks to mimic competitive outcomes should help many captive rail customers who are the intended beneficiaries of 49 USC§ 10701(d)(3), in which Congress mandated a “simplified and expedited method for determining the reasonableness of challenged rail rates in cases in which a stand-alone cost presentation is too costly, given the value of the case.” Captive rail customers with small disputes over outlier rates would gain newly effective regulatory recourse, but so would other captive shippers and producers for whom SAC and SSAC are prohibitively expensive.

The Board’s attempt to limit relief to the smallest cases involving outlier rates also risks undermining relief for the very class of shippers and producers the Board seems to want to help in this proceeding. Shippers and producers with the smallest rate disputes may have relatively small amounts at stake. As the Board appears to recognize, this makes efforts to reduce litigation costs and burdens all the more important. However, it also makes the potential complainants reluctant to assume the risks that railroads upon which they depend for their survival will react adversely to challenges to high rates, even if those rates are outliers.

Railroad retaliation can take many forms. Service quality or access to equipment could suffer, leaving the captive rail customer worse off than before, even if rate reductions are ordered. Increases on rates other than the challenged rates are also possible, and the Board offers no remedy in such a situation. And, of course, a complainant could fail to prove market dominance, or could meet (at considerable expense), the threshold market dominance test only to be told that the challenged rates, though high, are outside the STB screen, or are not excessive.

Any of these scenarios means that the shipper or producer is not just still subject to the challenged rates, but is also vulnerable to increases in its rail rates, in addition to the lost litigation costs.

Under the circumstances, it is the rare captive rail customer who would consider invoking the Board's new proposed "remedy".² When account is taken of the new test's relief cap and other restrictions discussed above and by Witness Fauth, the likelihood of meaningful regulatory reform is diminished further.

In preparing Opening Comments in this proceeding, MWBC put considerable effort into trying to identify members or constituents who might benefit from the Board's proposals, which we assume to be well-intentioned. Unfortunately, for a long list of reasons, those efforts were unsuccessful. See the Opening VS of Mr. Fauth.

In those comments, MWBC, et al. suggested a number of ways in which the Board's new test might be improved. Even if the Board is unwilling at this time to make the Three-Benchmark approach a more promising remedy for more shippers and producers, doing something to help smaller shippers and producers remains a worthy goal. Such relief could be part of a larger program of regulatory reforms including competitive remedies, in the form of access under consideration in EP 711 (Sub-No. 1), Reciprocal Switching, and a revenue adequacy constraint, under consideration in EP 722, Railroad Revenue Adequacy.

² In past comments in EP 665, we have mentioned the possibility of help from a State government with concerns about the viability of an essential segment of the local economy, but further discussion of that possibility must await STB guidance on producer standing and related issues. See August 31 decision at 3, n.3.

Without modifications, however, the small rate dispute test for outlier rates proposed here stands little chance of success even as to the excessively narrow segment of captive rail customers for whom it is intended.

III. RAILROAD COMMENTS

The railroad parties to this proceeding, including the AAR and the four largest Class Is -- UP, BNSF, NS and CSX -- have their own consensus. In their view, the Board's proposed new test is unnecessary, because SAC, SSAC and Three-Benchmark provide more than enough regulatory recourse for captive rail customers. They also argue that the new test is illegal to the extent that it would restrict continued differential pricing of captive traffic.

It should surprise no one that the railroads would defend the regulatory status quo. They have for decades enjoyed the best of both worlds. They are largely immune from antitrust exposure, because they are presumptively regulated by the STB. However, as the Board acknowledges in its August 31 decision, rail rate cases are rare when SAC cases are included, and even rarer when they are not. Of the small number of rate cases that are brought, many are unsuccessful, or produce only limited relief. This history, combined with the steady increase in grain rates discussed in our Opening Comments and the Opening Fauth VS and Whiteside VS, clearly describes a regulatory environment in which railroad revenue gains are given a higher priority than protection of reasonable rates for captive shippers.

Rates aside, railroads face little competition, thanks to mergers, paper barriers, and antiquated access policies, and the Board's power to remedy service problems

and unreasonable rail practices is little used and limited in impact. Captive rail customers therefore face the worst of both worlds, because of too little effective competition and too little effective regulation. Rail rates rise and are almost never reduced, and costs and burdens are shifted to shippers, but the neutral arbiter of railroad reasonableness designated by Congress has adopted tests that are exorbitantly expensive, unworkable, or both.

In opposing the Board's latest proposals, all railroad parties look to the InterVISTAS report, "An Examination of the STB's Approach to Freight Rail Rate Regulation and Options for Simplification", and none of the five railroad parties even mentions the TRB report. Several mention the "ratchet" issue, i.e., that more regulation would allegedly drive rail rates to the jurisdictional threshold, and BNSF raises the specter of captive rail customers filing frivolous rate cases if rate litigation becomes less burdensome and costly.

All railroads support the narrowest definition of a comparison group, and the proposed relief cap, but they nevertheless call on the Board to discontinue this proceeding without Expanding Access to Rate Relief. Here again, Witness Fauth provides a detailed rebuttal on technical points in his Reply VS.

The railroads' attempt to rely on the InterVISTAS report is misguided for several reasons. First, that report acknowledges, the precise problem discussed above and in the Opening Comments of MWBC, et al. See the InterVISTAS report at 53:

The Three-Benchmark procedure is designed to protect individual shippers that are being singled out for abuse. With grain, the “comparable group” is composed of other grain shippers. Yet those shippers argue that railroads have instituted across-the-board high rates, causing all comparison groups to face high rates. As a result, rate relief would be unavailable.

InterVISTAS accurately describes the problem but offers no solution.³ Obviously, under the circumstances described, Three-Benchmark does not provide adequate protection (or any protection) against unreasonable rail rates for captive shippers and producers of agricultural commodities. Nor does it protect other shippers, e.g., shippers of sand for fracking or glass production, who may face similar pricing.⁴

The Congressional mandate in 49 USC§ 10701(d)(1) that rates on captive traffic “must be reasonable” cannot be ignored because a consultant, or four outside expert groups, identify shortcomings in available remedies without providing solutions acceptable to the STB. Nor may the Board satisfy its statutory duty by proposing a less expensive approach limited to a minor subset of shippers that fails to address the problems identified. What are grain shippers and producers to do when SAC is too costly and Three-Benchmark works, if at all, only in some sort of STB class action? How will the Board implement the third Long-Cannon factor of Section 10701(d)(2)(C), and determine whether “one commodity is paying an unreasonable share of the carrier’s overall revenues”?

³ See also the discussion at page 7 of the Opening Comments of MWBC, et al., citing studies by GAO, Christensen Associates, and TRB finding disproportionate increases in grain rates over several decades, both in unit train volumes and in smaller volume shipments.

⁴ The Board has said it will accept public comments on the InterVISTAS report at some future date. When it does, captive rail customers will have other objections to the report’s conclusions. One of these will address the failure of InterVISTAS to recognize the fact that major railroads are now exceeding revenue adequacy.

The InterVISTAS report, and the railroads in their opening comments, also defend Three-Benchmark as consistent with Constrained Market Pricing, offering this as a rationale for rejection of the Board’s new test. See, e.g., the Opening Comments of BNSF (at 15), UP (at 3 and 15), CSX (at 5) the AAR (at 2) and NS (passim). The problem with these “fidelity to CMP” arguments is that until a revenue adequacy constraint is implemented, CMP is just another way of saying SAC.

SAC is not merely prohibitively expensive for 99% of rail rate disputes, but Congress recognized that defect in 49 USC§ 10701(d)(3). Accordingly, InterVISTAS and the railroads are essentially telling the Board that Three-Benchmark is preferable to the Board’s new approach because Three-Benchmark is closer in its features to a methodology whose cost and complexity leave most captive rail customers remediless.

The railroads’ comments regarding the superiority of Three-Benchmark should be seen more as a way of opposing the Board’s latest proposals than as support for a workable remedy for shippers unable to afford SAC. See, e.g., the October 3, 2012 Opening Comments of CSX and NS in Ex Parte No. 715, Rate Regulation Reforms. At page 23 of those comments, the two railroads called Three-Benchmark “deeply flawed”, and reiterated their call for a relief cap of \$200,000 – less than the cost of any conceivable rate challenge under that approach.

The railroads’ other main complaint about the Board’s latest proposal involves their claim that, under CMP, differential pricing by market dominant railroads must be subject to minimal constraints (i.e., limited only by SAC), consistent with the Rail Transportation Policy.

There are numerous defects in this reasoning. First, the RTP section on which the railroads rely is 49 USC§ 10101(1), calling on the Board to “allow, to the maximum extent possible, competition and the demand for services to establish

reasonable rates for transportation by rail.” However, captive rail customers with potentially meritorious rate cases cannot rely on competitive forces to produce reasonable rates. Having met the threshold test of demonstrating market dominance, they are paying rates above (usually well above) 180% of variable cost, and the Board has found an absence of effective competition.

Effective competition, by definition, is competition that keeps rates reasonable. See the decision served September 27, 2012 in Docket NOR 42123, M&G Polymers USA, LLC v. CSX Transp. Inc., at 2, and Ariz. Pub. Serv. Co. v. United States, 742 F.2d 644, 650-51 (D.C. Cir. 1984). Its absence means that competition cannot prevent unreasonable rates, and the applicable section of the RTP is to be found at 49 USC § 10101(6).

That is, the Board is called on “to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital.” It is hard to imagine a better description of the situation we are addressing here.

The foregoing considerations, and Coal Rate Guidelines,⁵ also rebut the railroads’ arguments against reasonable regulatory limits on demand-based differential pricing. As indicated, Congress in the RTP directed the Board not just to set, but also to maintain, reasonable rates when railroad revenues “exceed the amount necessary to maintain the rail system and attract capital”, i.e., when STB revenue adequacy standards are exceeded. For BNSF and UP, and other Class Is, that time is now.⁶ Coal Rate Guidelines establishes the principle that continued differential pricing should no longer enjoy regulatory favor after revenue adequacy is achieved.

⁵ Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520 (1985), aff’d sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987).

⁶ See the Board’s September 8, 2016 decision in EP 552 (Sub-No. 20), Railroad Revenue Adequacy – 2015 Determination.

To be clear, MWBC, et al., and other captive shipper and producer interests do not seek elimination of all differential pricing, nor could we. Claims by railroads to the contrary are specious. Current railroad rate structures are the product of decades of differential pricing of captive traffic.⁷ Statutory limitation periods preclude challenges to many such rates, even aside from market dominance and SAC, SSAC and Three-Benchmark issues. In any event, demand-based differential pricing of most rail freight, whose rates are not challenged or cannot be challenged, will continue with no regulatory impediments.

In addition, under the CMP principles of which the railroads are so fond, there is clear precedent for a revenue adequacy constraint, currently under consideration in EP 722, Railroad Revenue Adequacy. The main goal of most captive rail customers in that proceeding is a limit on additional future differential pricing that is no longer needed by many railroads, but that exacerbates the competitive disadvantages of shippers and producers. See Coal Rate Guidelines, 1 I.C.C. 2d at 535-36: “captive shippers should not be required to continue to pay differentially higher rates than other shippers when some or all of that differential is no longer needed to ensure a financially sound carrier capable of meeting its current and future service needs.”

As relevant to this proceeding, railroads cannot legitimately argue that their use of demand-based differential pricing necessitates narrowly-defined comparison groups, or necessitates keeping Three-Benchmark ineffective. As we argued in EP 665 (Sub-No. 1), Rate Transportation of Grain, Rate Regulation Review, the rationale for the R/VCcomp benchmark is to preserve demand-based differential pricing, which led to our calls for a Two-Benchmark test for revenue-adequate

⁷ See the Opening Comments of MWBC, et al. at 6-7, and Whiteside Opening VS at 16-18, for details of the continuing rail rate increases borne by shippers of agricultural commodities.

railroads. At a minimum, for BNSF, UP and other high-revenue railroads, that rationale must be revisited.

Several railroads revive the “ratchet” argument, which posits a deluge of rate cases driving rates down to the threshold of STB jurisdiction through an iterative process. Such concerns cannot be taken seriously. In the first place, that argument was rejected by the court in CSX Transp. Inc. v. STB, 568 F.3d 236 (D.C. Cir 2009), in which the Board’s adoption of the Three-Benchmark test was affirmed. In addition, a rate reasonableness test limited to very small disputes over outlier rates could not affect overall rate levels and revenues no matter how effective it was, and all parties question the workability of the Board’s proposals.⁸

Finally, if “ratchet” effects are to be considered, the Board should also consider the impact on railroad pricing of captive traffic of year after year in which there is essentially no enforcement of the statutory command that rates on captive traffic “must be reasonable” under 49 USC§ 10701(d)(1). No wonder rail rates imposed on captive grain producers and shippers maintain a steady upward trend, not even falling when wheat prices fall, as shown by Witness Whiteside. The “ratchet” most familiar to captive rail customers moves rates steadily higher.

MWBC, et al., do not disagree with all of the arguments in the railroads’ opening comments. We agree with BNSF (Opening Comments at 3) that the Board needs to fulfill its promise to address producer standing and related issues, and that sound decision-making supports doing so sooner rather than later. We also agree with UP (Opening Comments at 5, n.2) when it urges the Board not to adopt a strict five-digit STCC limit. See Fauth Reply VS at 8.

⁸ BNSF warns (Opening Comments at 5-6) that the Board’s proposals could lead shippers to file “meritless rate cases because they have very little or nothing to lose”. This is a far-fetched argument. The Board can address issues caused by too many rate cases being filed by agricultural interests after any such cases start to be filed. Anyway, as explained above, shippers have nothing to gain from challenging reasonable rates, and much to lose, inasmuch as they would thereafter be vulnerable to increases in rates unsuccessfully challenged.

More fundamentally, MWBC, et al. do not pursue more effective regulatory remedies in an effort to undermine the railroad industry's progress toward (or beyond) revenue adequacy. Rather, our concern is that captive rail customers, which have contributed disproportionately to Class I railroad revenue gains for over 35 years, need recourse for the future that better balances the RTP policies of Section 10101(1) and Section 10101(6). The Staggers Act's promise of an honest broker where market discipline does not exist or does not work needs to become less apparent and more real.

IV. CONCLUSION

For the reasons set forth in these Reply Comments, in our Opening Comments, and in comments filed by other captive rail customer interests, MWBC, et al. urge the Board to revise its latest proposals to correct the many shortcomings that render the new outlier rate remedy for very small disputes unlikely to meet captive rail customers' needs. Whether or not the Board improves its latest rate reasonableness proposals in further proceedings in this docket, the STB must do more to address the defects of the Three-Benchmark test for larger rate disputes that do not involve outlier rates, including the vast majority of rate disputes of concern to producers and shippers of agricultural commodities.

Respectfully submitted,



Terry C. Whiteside
Registered Practitioner
Whiteside & Associates
P.O. Box 20574
Billings, MT 59104-0574
406-245-5132
twhitesd@wtp.net

Representing Shipper Interests
Identified Above



John M. Cutler, Jr.
Law Office
Suite 640
5335 Wisconsin Ave., NW
Washington, DC 20015
301-767-7592 (Cell)
johnmcutlerjr@gmail.com

Attorney for Montana Wheat and
Barley Committee and ARC

December 19, 2016

CERTIFICATE OF SERVICE

I hereby certify that I have this 19th day of December 2016 caused copies of the foregoing document to be served by mail or electronic means on all parties of record.

A handwritten signature in dark ink, appearing to read "John M. Cutler, Jr.", with a large, stylized flourish at the end.

John M. Cutler, Jr.

PUBLIC VERSION

BEFORE THE

SURFACE TRANSPORTATION BOARD

DOCKET NO. EP 665 (SUB-NO. 2)

EXPANDING ACCESS TO RATE RELIEF

REPLY VERIFIED STATEMENT

OF

GERALD W. FAUTH III

My name is Gerald W. Fauth III. I am President of G. W. Fauth & Associates, Inc., an economic consulting firm with offices at 116 South Royal Street, Alexandria, Virginia 22314. I previously submitted an Opening Verified Statement in this Surface Transportation Board (STB or Board) proceeding, which was included as part of the Opening Comments filed by Montana Wheat and Barley Committee (MWBC) and other captive rail customer interests (MWBC, et al.) on November 14, 2016.¹ A statement of my background and qualifications is attached thereto as Appendix GWF-1.

¹ Other parties included in MWBC's filing, most of which represent agricultural interests, include: Alliance For Rail Competition; Idaho Barley Commission; Idaho Grain Producers Association; Idaho Wheat Commission; Minnesota Farmers Union; Montana Farmers Union; Nebraska Wheat Board; North Dakota Farmers Union; North Dakota Grain Dealers Association; Oklahoma Wheat Commission; Oregon Wheat Commission; South Dakota Farmers Union; South Dakota Wheat Commission; Texas Wheat Producers Board; U.S. Glass Producers Transportation Council; Washington Grain Commission; Wisconsin Farmers Union; Wyoming Wheat Marketing Commission; and U.S. Dry Pea & Lentil Council.

PUBLIC VERSION

In a decision in this proceeding served August 31, 2016, the Board sought comments and suggestions through an Advance Notice of Proposed Rulemaking (ANPR) regarding the Board's effort to develop a new rate reasonableness methodology for use in very small disputes, which would be available to shippers of all commodities where the challenged rates qualify as "outliers."

The Board's decision in this proceeding is an outgrowth of its earlier decision in STB Docket No. EP 665 (Sub-No.1), Rail Transportation of Grain, Rate Regulation Review, served December 12, 2013, in which the Board invited public comment on how to ensure that the Board's existing rate complaint procedures are accessible to grain shippers and provide effective protection against unreasonable freight rail transportation rates, including proposals for modifying existing procedures or new alternative rate relief methodologies. The Board stated: "We believe it is appropriate to consider what regulatory changes could be implemented to ensure that the Board's rate case procedures are fully accessible to grain shippers and provide effective relief from excessive freight rail rates, as appropriate." (Decision at page 2).

In my Opening Verified Statement, I commended the Board for its efforts to develop a new expedited rate review process which "would be more affordable and accessible to shippers of all commodities with small disputes." (Decision at page 3). I indicated that it is possible that such an approach could be applied in limited number of high-rated "outlier" situations. However, I pointed out that the proposed new rate review process will do little to help the problems faced by grain shippers. I encouraged the Board to continue to "to consider what regulatory changes could be implemented to ensure that the Board's rate case procedures are fully accessible to grain shippers and provide effective relief from excessive freight rail rates, as appropriate," consistent with the Board's decision in the previous phase of this proceeding.

PUBLIC VERSION

I have been asked by MWBC to submit this reply verified statement in response to the opening comments submitted by other parties in this proceeding, including: U.S. Department of Agriculture (USDA); South Dakota Department of Transportation (SDDOT); American Chemistry Council (ACC); Association of American Railroads (AAR); National Grain & Feed Association (along with other Interested Agricultural Parties) (NGFA); BNSF Railway Company (BNSF); CSX Transportation, Inc. (CSX); Norfolk Southern Railway Company (NS); Union Pacific Railroad Company (UP); and Larry R. Miller, Jr., on behalf of SMART/TD General Committee Of Adjustment GO-386 (LRM). Since many parties made similar points, I have not attempted to respond to every comment made by the individual parties.

USDA Comments

USDA is generally supportive of the Board's proposals, but "USDA is concerned that in moving toward a new rate review process for smaller disputes for all shippers—and away from a process specifically for grain rate reviews—the unique needs of agricultural shippers could be lost in the shuffle." (USDA page 3). USDA encouraged the Board "to revert the proceeding back to a grain rate review as originally intended, perhaps as a pilot project. If over time the process proves to be workable for agricultural shippers, the Board could always expand the process later for other shippers with small disputes and have the added benefit of any lessons learned from the change for grain shippers." (USDA page 3).

USDA stated that the Board "should realize that a grain-specific rate review would entail a significantly lesser degree of changes -- because it would be limited to a smaller universe of shippers -- and therefore would inherently be less risky and more cautious." (USDA pages 3 and 4). USDA states that the Board "could use this opportunity to implement not only streamlined

prescreens, but also a competitive benchmark along with tight and strict procedural deadlines.”
(USDA page 4)

I agree with USDA that the “unique needs of agricultural shippers could be lost in the shuffle.” As I demonstrated in my opening verified statement, the efficiencies associated with most grain movements are not adequately reflected in the STB’s URCS costing procedures. In many cases, the R/VC ratios for shuttle and trainload movements are significantly understated as a result of an overstatement of the variable cost stemming from the use of unadjusted URCS switching and car cost. There is little or no switching associated with these shuttle and trainload movements, and the car costs are generally lower than URCS system average as a result of significantly lower than average car cycle times.

I also demonstrated that there are significant numbers of captive grain movements, which, despite the captive nature of the traffic (such as service limited to a single Class I carrier and moving great distances) move at rates below the STB’s jurisdictional threshold of 180% of variable cost, primarily as a result of these URCS issues. In addition, I demonstrated the existence of “R/VC uniformity” associated with many grain movements. As a result, despite very high and profitable R/VC levels, many grain shippers could not obtain substantive rate relief under the STB’s current Three Benchmark approach or the new proposed procedures, since both compare R/VC ratios with comparable movements narrowly defined. As a result, the proposed new rate review process will do little to help the “unique” problems faced by grain shippers.

NGFA Comments

NGFA states that the Board “has erred by (1) suggesting changes that potentially would address only a small subset of rate disputes despite the overwhelming body of evidence that none of the current methodologies for challenging unreasonable rail rates are workable for agricultural shippers; and (2) expanding Docket No. EP 665 (Sub-No. 1) to apply to non-agricultural commodities, which we do not believe is warranted given both the unique characteristics of rail movements of grains, oilseeds and grain products, as well as the absence of involvement of non-agricultural shipper interests seeking an alternative rate methodology in that proceeding.” (NGFA pages 1 and 2).

I do not agree with NGFA that the Board “*erred*” by suggesting new procedures that would only help a very limited number of shippers. Any new procedures which would reduce the regulatory burden on even a very limited number shippers could be useful and should be considered. However, I do agree with NGFA that “none of the current methodologies for challenging unreasonable rail rates are workable for agricultural shippers.”

In its Opening and Reply Comments in Docket No. EP 665 (Sub-No.1) and again in its Opening Comments in Docket No. EP 665 (Sub-No.2), NGFA provided extensive documentation and rationales for why rail movements of grains, oilseeds and other agricultural commodities differ in fundamental ways from non-agricultural commodities, such as coal, ores and chemicals. I also agree with NGFA that the STB should continue to pursue a workable approach for grain shippers “given both the unique characteristics of rail movements of grains, oilseeds and grain products, as well as the absence of involvement of non-agricultural shipper interests seeking an alternative rate methodology in that proceeding.”

PUBLIC VERSION

NGFA also commented on several specific aspects of the Board ANPR. NGFA states: “The Scope of the ANPR is Far Too Narrow” (NGFA page 9). NGFA states that narrowly defining the term “very small dispute” and significantly limiting the available relief will result in few, if any, rate cases being brought by captive agricultural shippers. (NGFA page 10). I agree with NGFA and this is a point that I emphasized and demonstrated in my Opening Verified Statement.

NGFA also maintains that “exempting Class II and III carriers from being subject to a new rail rate-challenge methodology may shut facilities located in entire regions of the country out of the opportunity to challenge rates they believe are unreasonable.” (NGFA pages 10 and 11). I note that in many grain movements involving Class II and Class III carriers, the Class II and III revenues are “absorbed” by the Class I carriers. As a result, the Class II and III revenues cannot be separately challenged. I also note that Class II and Class II carriers are currently exempt from the STB’s other simplified procedures, i.e., Three-Benchmark and Simplified-Stand Alone Cost (Simplified-SAC). Therefore, exempting Class II and Class III carriers may have fewer adverse impacts on captive shippers and producers than NGFA fears.

I agree with NGFA’s belief that “the 500-mile limit applied to these specific commodities is far too long to be appropriate for agricultural shipments.” (NGFA page 11). NGFA has a proposed a 200-mile limit. As I demonstrated in my Opening Verified Statement, many of the grain movements with the highest R/VC ratios move distances that are shorter than the average grain movements.

For example, the BNSF Montana wheat movement with the highest R/VC () moves a distance of only miles, and the BNSF Montana barley movement with the highest R/VC () moves a distance of only miles. These “outliers” would be excluded

PUBLIC VERSION

based on the STB's proposed 500-mile screen and the barley movement would be excluded based on NGFA's proposed 200 mile limit.

NGFA maintains that the Board should consider "other fast-track factors for determining if a rail carrier is market dominant for movements exceeding 200 miles" such as "determination that the rate being charged exceeds 180 percent of the variable cost for providing the service and that the facility being served is effectively "closed" to competition from a second rail carrier (NGFA page 13). Whether the R/VC exceeds a carrier's STB calculated and published RSAM and/or RVC>180 factors could be an appropriate fast-track factor. Whether a facility is effectively "closed" to competition from a second rail carrier may also be an appropriate fast-track factor, but, as I demonstrated in my Opening Verified Statement, many movements which have origins and/or destinations served by more than one Class I carrier have high R/VC ratios.

NGFA believes that "the Board should not limit the initial comparison group only to rail traffic priced at or above the 180 percent of revenue-to-variable cost (R/VC), thereby excluding traffic priced below this threshold." (NGFA page 14). NGFA states: "Limiting the comparison group solely to movements that exceed 180 percent of R/VC would not provide sufficient representation of the "true" market for rail rates for the commodities involved." (NGFA page 15). I agree with NGFA. As I indicated in my Opening Verified Statement, many captive grain movements move at R/VC ratios below 180%. This is not a result solely of reasonable freight rates, but often results from problems with the STB's URCS costing procedure.

NGFA advocates a +/- 20% mileage standard in lieu of the +/- 15% mileage standard proposed by the Board for comparison groups. (See NGFA pages 15 and 16) A 15% mileage standard may be appropriate in some cases, but a 20% or greater standard may be appropriate in other cases. NGFA also believes the STB's five-digit STCC groups "are sufficiently granular to

PUBLIC VERSION

result in an aggregation of the same type of agricultural commodities.” As I indicated in my Opening Verified Statement, the proposed use of the same five-digit STCC codes may also not be appropriate in all cases. For example, most BNSF Montana wheat (STCC 01-137-10) moves west, whereas most BNSF Montana durum wheat (STCC 01-137-20) moves east. As I indicated, I do not believe there is a “*one size fits all*” approach for shipping characteristics.

NGFA maintains that there should not be a common-carrier adjustment as proposed by the Board (See NGFA pages 16 through 18). I agree with NGFA. As I indicated in my Opening Verified Statement, I do not believe that a “common carrier adjustment,” such as the 14.8% adjustment referenced by the STB applied in Docket No. NOR 42114, U.S. Magnesium, L.L.C. v. Union Pacific Railroad, decision served Jan. 28, 2010, would be appropriate in grain cases. There is no evidence that grain contract rates are significantly lower than non-contract rates, and there is no shortage of data as to tariff rates on grain in the Waybill Sample.

ACC Comments

ACC concludes (at page 14) “Rather than adopt a fourth methodology for rate cases that is so similar to the existing Three-Benchmark methodology . . . the Board should consider making appropriate modifications to the Three-Benchmark methodology itself.” ACC then goes on to state its preference that the Board devote its efforts to development of an effective revenue adequacy constraint, something I agree is needed. ACC’s suggestion may be worth considering. The STB’s might adopt new procedures as a Simplified Three-Benchmark test for the smallest cases, and adopt additional, complementary changes to the existing Three-Benchmark test for larger, non-outlier rate challenges which also involve rate disputes too small to support Full-SAC or Simplified- SAC litigation.

What the Board should not do, however, is to focus only on very small disputes involving outlier rates and leave the many deficiencies in the Three-Benchmark approach uncorrected. Moreover, a new and separate methodology may be appropriate for grain movements, which represent a large set of potentially captive railroad traffic with unique characteristics and problems.

AAR Comments

AAR cites the STB's recently issued InterVISTAS Report which states that "Further simplification to the Three-Benchmark Test would likely reduce its adherence to CMP principles."² The AAR argues that because of this statement "the Board should not proceed to propose new rules and should discontinue this proceeding." (AAR page 2). The fact that simplification to the Three-Benchmark test may "reduce its adherence to CMP principles," is not a valid reason for the Board to abandon its efforts and discontinue this proceeding. Under this logic, the Board should abandon the Simplified-SAC test, since it does not fully adhere to STB's CMP principles. As used by the railroads, "CMP" and "sound economic principles" are simply other ways of saying SAC, which is prohibitively expensive for all but a handful of captive rail customers.

AAR maintains that, if the Board continues with this proceeding, it "should establish by empirical study that a problem exists and then consider the potential impacts of proposed rules, and how those rules will interact with the other regulatory proposals it is considering." (AAR

² InterVISTAS, An Examination of the STB's Approach to Freight Rail Rate Regulation and Options for Simplification, Project FY 14-SB-157 (Sept. 14, 2016) (InterVISTAS Report) at page 132.

page 2). AAR also complains that the Board “cites no empirical analysis of rates” for its determination that a new approach is needed, “instead reciting the anecdotal claims put forth by the trade associations and interest groups representing agricultural interests in the EP 665 (Sub-No. 1) docket that the Board's existing rate reasonableness are inaccessible.” (AAR page 8).

AAR states that there “is no evidence that the Board's process is inaccessible for small shippers or for others. Informal assistance and mediation are available to shippers of all sizes through the Board's Rail Customer and Public Assistance program. If a rail customer believes its rate would be found unreasonable under one of the Board's tests, it can file a complaint with a minimal filing fee.”

I do not believe that a new “empirical study” is required. The fact that there have only been a very small number of rate cases since the Board was established over 20 years ago provides ample support for the Board’s conclusion that its procedures are not working, especially for non-coal shippers. In my verified statements in STB Docket No. EP-665 (Sub-No.1) and in my Opening Verified Statement in this proceeding, I clearly demonstrated the problems faced by grain and other shippers associated with the application of the STB’s Three-Benchmark test, as well as the proposed new procedures. Those problems are not corrected by low filing fees or higher relief caps.

In terms of addressing the Board’s specific proposals, AAR maintains that the “introduction of traffic of a non-defendant railroad would introduce an ‘apples to oranges’ comparison of R/VC ratios.” (AAR page 20). This is not always the case, especially with grain movements. For example, corn and soybeans generally originate from the same areas and grain elevators and both generally move in covered-hoppers.

PUBLIC VERSION

In my Opening Verified Statement, I demonstrated that and served similar corn and soybean markets with similar R/VC levels. Therefore, it may be appropriate to compare, for example, a corn movement with comparable (i.e. similar equipment type and ownership, shipment size and distance) soybean movements and corn and soybean movements.

AAR maintains that “inclusion of traffic below 180% would impermissibly eliminate consideration of market demand in establishing the maximum lawful rate.” (AAR page 22). The fact that R/VC percentages may be below 180% (which is an arbitrary figure established by Congress in 1980) most often has little or nothing to do with “market demand.” As I demonstrated in my Opening Verified Statement, many captive grain movements move at R/VC’s below 180%. This fact has more to do with the STB’s URCS costing procedures rather than “market demand.” Moreover, the inclusion of traffic below 180% may be necessary on a case-by-case basis in order to establish a representative comparison group.

BNSF Comments

BNSF is “concerned that the new small rate case procedure proposed by the Board in its Decision is highly likely to interfere with properly functioning markets and does not strike the appropriate regulatory balance.” (BNSF page 2) BNSF states that the Board’s proposal “incentivizes the filing of cases of questionable merit and increases the risk of regulatory results that have no economic foundation or rationale, and interferes with properly functioning markets in a fundamental way.” (BNSF page 2). It is easy to understand why BNSF believes that captive grain movements, such as the captive Montana wheat market, represent a “properly functioning market.” In BNSF’s view, it is properly functioning market for BNSF because it is generating enormous profits and Montana wheat shippers have little recourse.

PUBLIC VERSION

BNSF maintains that “the lack of grain rate cases in recent years” (it would be more accurate to say “in the last 20 years” rather than limiting the problem to “recent years”) was “likely because BNSF's grain rates are effectively constrained by strong competition in grain transportation markets.” (BNSF page 4)

As I demonstrated in my Opening Verified Statement, there is effectively no competition in many grain markets, such as the Montana wheat and barley market. Moreover, in areas and markets served by both _____ and _____, such as the corn and soybean rail transportation markets, _____ and _____ have essentially carved up the markets and do not vigorously compete, which is demonstrated by _____

(see, for example, GWF Opening Verified Statement, Figures 11 and 12)

BNSF states that a “low-cost "lottery ticket" procedure of this type could very well flood the Board with unnecessary and unmeritorious cases and burden railroads with the costs and distractions of defending against ill-conceived rate claims. (BNSF page 5) This “Chicken Little” or “The sky is falling!” argument has been made by the Class I railroads for years.

Clearly, the STB has not been flooded with cases since it adopted the Simplified-SAC and Three Benchmark approaches. Moreover, the Board's proposed new procedures would only be applied in very small outlier cases and would not be available to most grain shippers. Therefore, there would be very few rate complaint cases filed under the proposed new procedures even if those procedures were modified as MWBC and other captive rail customer interests have recommended.

UP Comments

UP states: “The Board apparently proposes to consider only one factor related to “shipment type” in identifying comparable traffic—shipment size. See ANPR at 13. However, other factors can have a meaningful impact on rates and costs, and thus on R/VC levels. These other factors include car type, car ownership (railroad or private), and movement type (single-line or interline).” (UP page 4). I agree with this statement. As I indicated in my Opening Verified Statement, I found significant difference in R/VC ratios for grain movements in private and railroad cars. However, as I noted, URCS car costs for railroad-owned cars are likely overstated for most grain movements. Movement type (single-line or interline) should also be considered by the STB. However, I note that it is often difficult to properly evaluate single-line and interline movements based on the STB’s Waybill Sample data because of so-called “Rebill” movements. This Rebill problem is described in the STB’s 2014 Carload Waybill Sample

Reference Guide:

While the STB provides a precise set of instructions for the sampling and reporting of the Waybill Sample, there exists a flexibility in the billing methods authorized in the Official Railway Accounting Rules which can produce subtle nuances in the sample data. One example is the rebilling of interline received or bridge traffic as local traffic. This rebilling tends to understate the actual length of haul for the movement. Unless these nuances in the Waybill Sample are fully understood, the use of these data and the ensuing conclusions from their analysis may be flawed. The remainder of this paper addresses several major waybill data concepts which, in some recent applications, appear to have been discounted or ignored, and provides guidelines for their interpretation. (page 174)

UP maintains that the “Board’s concern that allowing non-defendant traffic into the comparison group would complicate the proceeding and increase the time and expense is well-founded.” (UP page 9). I disagree with UP.

PUBLIC VERSION

Allowing non-defendant traffic into the comparison group would not significantly “complicate the proceeding and increase the time and expense.” The comparison groups are determined from STB’s Confidential Waybill Sample data. As I demonstrated in my Opening Verified Statement, it is fairly simply to identify comparable movements on other railroads. Most of the time involved in analyzing the STB’s Waybill Sample data is in processing the data and identifying the relevant records. Sorting and summarizing the records by commodity, railroad, origin and destination code (i.e. SPLC code) and distance, which would enable parties to easily identify non-defendant comparable traffic, is not a difficult or time-consuming process.

NS Comments

NS states: “Thus, a well-functioning regulatory environment should result in relatively few rates cases filed and litigated to completion, especially given the STB's mandates under the Rail Transportation PolicySeven 3-B cases and two SSAC cases have been filed with the STB to date; and, the STB reached a decision as to rate reasonableness in at least four of these cases.” (NS page 6). Nine simplified cases in the past 20 years is not indicative of a “well-functioning regulatory environment.” I note that none of the nine simplified cases cited by NS involved grain movements, which, based on the captivity and high R/VC ratios associated with grain movements, is indicative of a poorly functioning regulatory environment.

CSX Comments

CSX supports the concept of initial market dominance disclosures. CSX maintains that shippers should be required to provide four categories of information at the time of their complaint: “(1) a narrative statement explaining why the complainant believes that intermodal and intramodal competitive alternatives are not effective; (2) information on any use of transportation alternatives for the issue shipment during the previous five years; (3) information on any studies or consideration of transportation alternatives during the previous five years; and (4) any transportation contracts that could have been used for the issue traffic. . . .Railroads would similarly have to disclose any information they had relating to transportation alternatives.” (CSX page 8). CSX market dominance disclosure categories 1, 2 and 4 appears fairly reasonable and relevant to market dominance determinations. However, market dominance disclosure category 3 (i.e. “information on any studies or consideration of transportation alternatives during the previous five years.”) would be irrelevant in many cases. The mere study or consideration of transportation alternatives has nothing to do with a shipper’s captivity.

Conclusion

Again, I commend the Board for looking for a new expedited rate review process which “would be more affordable and accessible to shippers of all commodities with small disputes.” (Decision at page 3). It is possible that such an approach could be applied in limited number of high-rated “outlier” situations. For example, some chemical shippers may be able to benefit from such an approach.

PUBLIC VERSION

Unfortunately, this proposed new rate review process will do little to help the problems faced by grain shippers. I encourage the Board to continue to “to consider what regulatory changes could be implemented to ensure that the Board’s rate case procedures are fully accessible to grain shippers and provide effective relief from excessive freight rail rates, as appropriate.” (Docket No. EP 665 (Sub-No.1) Decision at page 2).

Verification Page

I, Gerald W. Fauth III, declare under penalty of perjury that the foregoing Verified Statement submitted in Surface Transportation Board Docket No. Docket No. EP 665 (Sub-No. 2), Expanding Access To Rate Relief, is true and correct. Further, I certify that I am qualified and authorized to sponsor this testimony.

Executed, December 16, 2016, by:

A handwritten signature in black ink, appearing to read "Gerald W. Fauth III", written over a horizontal line.

Gerald W. Fauth III