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July 16, 2019

Via E-Filing

Scott Zimmerman
Acting Director, Office of Proceedings
Surface Transportation Board
395 E Street, S.W.
Washington, D.C. 20423-0001

ENTERED
Office of Proceedings
July 16, 2019
Part of
Public Record

Re: STB Docket No. EP 704 (Sub No. 1)
Review of Commodity, Boxcar and TOFC/COFC Exemptions

Dear Mr. Zimmerman:

Enclosed please find BNSF Railway Company's Comments in Response to the Release of Summaries of Ex Parte Meetings in the above-referenced docket.

Sincerely,

A handwritten signature in black ink, appearing to be "Jill Mulligan", written over a circular stamp that contains the name "Jill Mulligan" in a serif font.

Jill Mulligan

Enclosure

Surface Transportation Board
Docket No. EP 704 (Sub.-No. 1), Review of Commodity, Boxcar and TOFC/COFC Exemptions

**BNSF Railway Comments Submitted in Response to
Release of Summaries of Ex Parte Meetings**

BNSF Railway Company (BNSF) serves transportation markets that are highly competitive and fluid with shippers make sourcing and product delivery decisions across multiple transportation options including other railroads, trucks, and barges in response to numerous market factors. Together with our customers, we also face extensive geographic competition from domestic and international competitors and in many markets, strong product competition. As a result, BNSF must offer competitive rates and terms and innovative service products across our network to attract and retain customers and their volumes on our railroad. For BNSF, this is especially true for the five exempt commodity categories that the Board proposed class-wide revocation for in its 2016 Notice of Proposed Rulemaking (NPRM).

The STB's proposal, if pursued now based on the incomplete record before it, would represent a sharp pivot away from the policy and practice of allowing market forces to set rates and drive service innovation towards blunt regulatory interference in the functional markets where BNSF competes. While the Surface Transportation Board (STB) serves an important role by providing effective oversight when market forces are deficient and market abuse is present, the central tenet of STB authority is the Congressional directive first to determine that regulatory interference is justified and then tailor its actions to address identified market failures. Deciding whether to regulate, and then how much, requires careful, sophisticated analysis. These considerations are particularly important here, where the STB has proposed wholesale revocation of longstanding exemptions for broad commodity groups across all U.S. railroads. BNSF believes that the record before the STB from the prior rounds of this proceeding, including the summaries of recent Ex Parte meetings, does not meet the legal standard for revoking exemptions or Congress's policy directives for balanced, appropriate regulation. The class-wide revocations proposed by the Board should not be taken at this time.

BNSF appreciates this opportunity to provide these supplemental comments in response to the filed summaries of the Board Member's recent Ex Parte meetings in the above captioned proceeding and submits the following outline of key areas of concern (with references to the existing record) that we hope the Board will consider in weighing next steps in this proceeding.

1. It is critically important that the STB maintain fidelity to the legal standards for revoking exemptions and Congressional directives, including the Rail Transportation Policy.

- The AAR's comments detail the important statutory provisions governing exemptions, the history of the longstanding Congressional directive to utilize exemptions to the maximum extent (recognized in the agency's exemptions case law), as well as the statutory Rail Transportation Policy (RTP) mandates "to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates," 49 U.S.C. § 10101(1), and "to minimize the need for Federal regulatory control over the rail transportation system," 49 U.S.C. § 10101(2). See Comments of the Association of American Railroads, EP 704 (Sub-No. 1) at 4-7, 17-20 (filed July 26, 2016) (AAR Opening Comments); Reply Comments of the

Association of American Railroads, EP 704 (Sub-No. 1) at 6-10 (filed Aug. 26, 2016).

- Comments submitted in support of the NPRM, including the recent Ex Parte meeting summaries, largely ignore the applicable legal standard for revoking exemptions, which provides that the Board may revoke an existing exemption only when regulation is necessary to carry out the RTP. 49 U.S.C. § 10502(d).
- Individual shippers with legitimate concerns can seek revocation of an exemption under 49 U.S.C. 10502(d). This narrowly tailored remedy is available to shippers without bearing the burden of showing the appropriateness of an exemption outside the specific transportation markets that they participate in (e.g., across all U.S. railroads as the NPRM proposes).

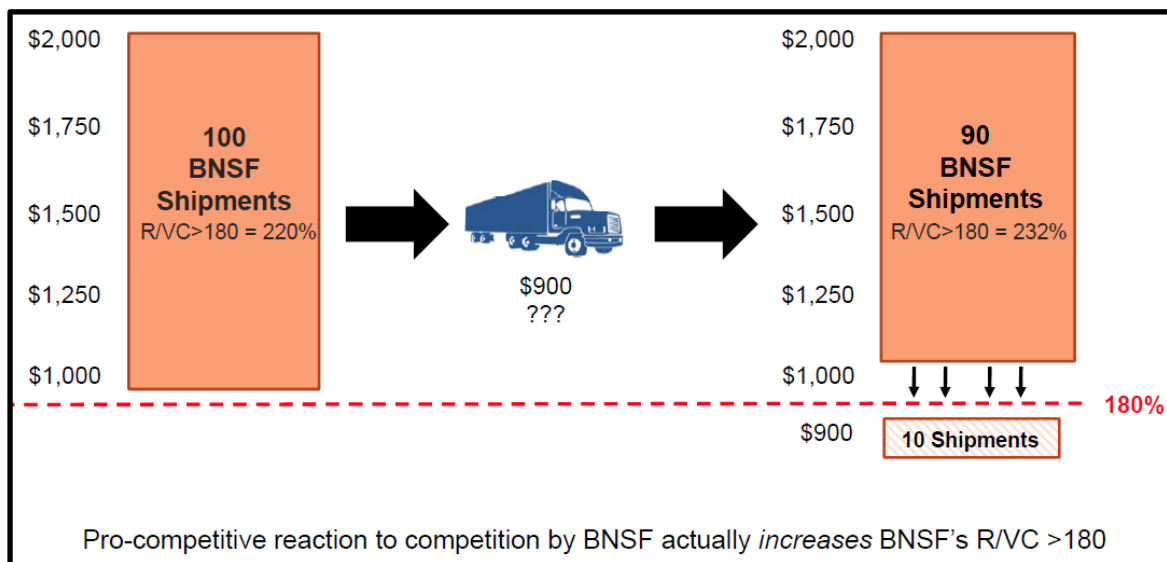
2. The STB's NPRM failed to support its proposal with evidence that railroad(s) have abused market power or that revocation is necessary as the statute requires, and subsequent comments do not make up for that deficiency.

- The NPRM relied only on R/VC ratios and vague, general assertions of marketplace changes to justify the proposed exemption revocations. The Board seemed to recognize that it had insufficient evidence when, in the NPRM, it concluded that the R/VCs and other evidence only “suggests that railroads may be exerting increased market power.” See AAR Opening Comments at 12-14, 20-22. That is an insufficient basis for the proposed actions.
- In her dissent from the NPRM, Commissioner (now Chairman) Begeman recognized that only compelling circumstances justify revoking exemptions, and expressed concern that “the ‘record’ the majority has relied on to support its proposed changes is a waybill-based hunch using limited information on these commodities.” NPRM at 15 (Commissioner Begeman, dissenting). Commissioner Begeman also identified that the dated record (“created over half a decade ago”) failed to account for considerable events and market changes that had taken place following 2013. *Id.* at 15-16. The record has only grown more dated since then.
- While the STB recently allowed new perspectives through Ex Parte meetings, the summaries of those meetings show the discussions largely lacked systematic discussion of the subject commodities, serving railroads, access to alternative modes, and the roles of product and geographic competition play. While several participants detailed some of these areas as it relates to their specific circumstance, nothing in the record allows the Board to draw conclusions about the broader spectrum that the Board proposes to deregulate—broad commodity categories regardless of which railroad they move on, what markets are involved, and the relevant competitive circumstances.

a. R/VC ratios or changes in R/VC ratios over time are not reliable indicators of market power or the existence of competition.

- Industry R/VC averages tell the STB nothing about the market experience of shippers generally, let alone BNSF or the customers that we serve.
- As the AAR indicated in its opening comments:

- R/VCs say nothing about shipment- or commodity-specific characteristics because the STB uses system-wide average unit costs to calculate the variable cost component of R/VCs. *Id.* at 23. R/VCs also vary widely on a county-by-county basis, so using them to decide to revoke exemptions nationwide will result in regulating competitive traffic in different areas. *Id.* at 27.
- R/VCs do not account for rail service elements such as quality, investment, or properly calculated marginal cost measures, so changes in R/VCs say nothing about a railroad's competitiveness or market power in general, let alone in shipment- or commodity-specific circumstances. *Id.* at 23.
- An STB-commissioned study of R/VCs revealed that when aggregated by commodity, they weakly correlate with railroad competition measures. Further, methodological changes in R/VCs' calculations have led to large R/VC shifts, showing they vary due to *non-market* reasons. *Id.* at 24. A 2005 Transportation Research Board study made similar findings. *Id.* at 24-25.
- Studies and expert statements examining URCS have revealed more fundamental cost calculation issues that underscore R/VC unreliability. *Id.* at 25-27.
- BNSF also submitted comments outlining our concerns that R/VC-based metrics do not reflect true market conditions (BNSF Opening at 2-7) and fail to properly recognize and incentivize capital investment (*Id.* at 14-15). BNSF asked the Board to consider the examples included in our opening comments outlining where patently competitive actions can result in increases in average R/VC or R/VC>180 figures. *Id.* at 4-8. One example included there was the situation where a railroad lowers rate for existing rates (to below 180% in the example) to beat a competitive truck bid and retain the traffic, and the overall result is that the railroad's R/VC>180 actually *increases*, as illustrated below. This shows how R/VC-based metrics fail to tell the true story of market conditions.



- The R/VCs the STB cited in the NPRM do not resemble BNSF-specific ratios, including in levels overall or trends over time. Averages of the R/VCs of seven railroads with diverse networks serving distinct markets should not be used as the basis for re-regulating broad commodities across all railroads.
 - Supporting Comments and the NPRM suggest that re-regulation is required when a rate exceeds 180% of variable costs, despite the clear language of 49 U.S.C. § 10707(d)(2). Despite that flawed premise, BNSF R/VC levels remain low. For all but one of the commodities (including forest products) discussed in this proceeding, BNSF's R/VCs remain significantly below 180% for the entire period between 2006-2018.¹
- b. The STB has before it numerous studies and analyses, including a report commissioned by the STB, that show that anecdotal evidence that the STB relies on in its NPRM, like changes in rates or R/VC over time, were not due to increased exercise of market power.**
- The AAR Opening Comments contained an overview of scholarship reviewing changes in railroad rates and identifying underlying causes other than increased railroad market power, including the 2009 study performed by Christensen Associates for the STB. See AAR Opening Comments at 9-10. The AAR Opening Comments also surveyed studies by Christensen Associates, the Transportation Research Board, and others concluding that R/VCs are unreliable indicators of market power. *Id.* at 24-25. The AAR Opening Comments also contained a new study by Professors Israel and Orszag about the shortcomings of R/VC measures of markets, including a review of the more reliable market indicators for the five commodities at issue, including geographic competition. *Id.* at 27-28; Verified Statement of Mark Israel and Jonathan Orszag (July 26, 2016).
 - As part of the AAR Opening Comments, Messrs. Baranowski and Fisher submitted a study demonstrating that a significant portion (perhaps as much as 100%) of the observed changes in the STB's industry average R/VCs appears directly related to historic assumptions embedded in the URCS modeling that fail to properly account for changes in the rail industry like the significant increase in intermodal traffic. Verified Statement of Michael Baranowski and Benton Fisher (July 26, 2016).
- c. In the ex parte meetings, shippers did not provide data or additional information that address the flaws in the R/VC analyses that led the STB to initiate this proceeding.**
- The commentary provided in Ex Parte meeting summaries helps to highlight the fact that the individual circumstances of a shipper (including the geographic area, the markets it participated in and competes against, and the presence of modal and geographic competition) are central to determining whether regulation should be imposed. The record in this proceeding presents an incomplete view of the complexity and competitiveness of

¹ Only crushed stone exceeded 180% on BNSF's R/VC calculations, and in 2018 the R/VC was only slightly above 180%. Because upwards of 95% of the crushed stone volume on BNSF moves in unit trains, the URCS make-whole adjustment likely undercosts and inflates R/VCs on these unit train movements. While the Board has recognized issues with the make-whole adjustment, it has recently terminated a six-year proceeding undertaken to make necessary accuracy improvements without implementing any changes. See *Review of the General Purpose Costing System*, EP 431 (Sub-No. 4) (STB served June 6, 2019).

the nationwide markets for these commodities and should not form the basis for the Board to undertake class-wide revocations.

3. There is substantial competition in the BNSF markets that would be impacted by the STB's proposed revocations.

- BNSF's real-world experience confirms that significant market forces effectively limit the level of rates that BNSF can put in place and expect to attract and keep customers shipping the commodities at issue. When BNSF's rates are not competitive, traffic volume is lost to other modes or to other plants that BNSF and the customer compete with to serve the destination market.
- BNSF invests significantly to increase the competitiveness of our service offerings and ensure we have the resources to meet the growth opportunities our customers bring us. BNSF makes significant investments every year to maintain and expand our linehaul and terminal capacity—undertaking nearly \$65B in capital investments since 2000. Also, BNSF undertakes substantial investment in our car fleet, including in the commodity areas covered by the NPRM. For example, BNSF has 8,500 cars supporting steel; that represents over \$650M in replacement value for owned cars and about \$20M in annual rental costs. Most recently, BNSF added 150 coil cars to the fleet. At any given point a number of those cars go into storage because of market fluctuations, and in the last ten years, at various points as many as 2,500 cars have been stored.
- BNSF has also recognized the power of transloading to enable non-rail served customers to take advantage of BNSF's rail economics and service innovations and to access rail served plants that BNSF does not directly serve. In 2018 alone, BNSF's steel product transload volume increased by 20%. Our transload network includes 361 facilities capable of handling multiple commodities, including steel products, aggregates, and bulk cement. On average, 29 facilities are added as BNSF transload facilities on our network every year.
- In addition, BNSF shippers and receivers continue to make significant investments in new and expanded facilities on our network as they bring more business to BNSF. Just in the period of 2015-2018, shippers and receivers have invested nearly \$15 billion dollars in 450 new or expanded facilities on BNSF. That included a large sheet steel producer in 2017 electing to locate, after an extensive review of site locations with various modal service profiles, at a BNSF solely-served location. That same producer is now planning new investments to double the production at its facility. On the scrap metals side, this year a different BNSF customer is opening a large facility at a rail location solely served on BNSF in order to compete head-to-head with barged scrap shipments into numerous steel mills around the country. As mentioned above, a significant number of aggregate shippers have spent tens of millions of dollars and continue to invest to site facilities on BNSF in Texas and Oklahoma to compete with truck, vessel, and barge. A similar pattern of investment in BNSF-served facilities is happening in the cement area, including new production sites and terminal operations.
- One of the innovations that have allowed BNSF to enter entirely new markets is implementing unit train service to compete with truck, vessel, and barge in areas not previously served by BNSF. BNSF moves aggregates, steel pipe, scrap metals, sheet steel, steel ingots, construction

sand and gravel in unit train service. With unit train economics, BNSF was able to enter an entirely new market in Kansas for steel products that previously moved exclusively by barge, and in California for aggregates that previously moved entirely in truck. We have also seen significant increases in the number of new crushed stone, construction sand, and gravel facilities being located on BNSF for the purpose of converting truck share to rail. Low cost, highly efficient unit train offerings also allow BNSF-carried products to geographically compete with producers served by other railroads as well as import commodities coming in at U.S. ports that are shipped to a wide range of ultimate destinations.

- Even the Ex Parte summaries acknowledge that there is a wide diversity of market conditions, including the prevalence of intramodal and intermodal competition. And we have seen sensitivity of demand in response to tariff policies that demonstrate the truly global nature of the markets for these commodities.
- While many shippers ignored product and geographic competition in their comments and in their meeting summaries, those competitive forces are strong and widespread in the markets that BNSF serves. BNSF competes head to head with other carriers and can lose business if our pricing is not market-based.

4. Revocation of Exemptions is not a neutral paper exercise as some of the discussion summaries seem to presume.

- A number of the Ex Parte meeting summaries reflect discussions with Board members focused on the supposed lack of immediate impact of a class-wide revocation. BNSF believes that the standard should not and cannot be that regulatory action can be taken, contrary to the law, as long as the regulator feels there is not an identified immediate impact or burden. That would be the definition of arbitrary action and would jeopardize the Board's role as an expert agency equipped to call balls and strikes when market circumstances require regulatory intervention.
- It is also hard to take comfort in the message of no immediate impact or burden when there are several pending proposals that would dramatically alter core elements of STB oversight. This includes proposals from the Board's staff that would, if adopted, result in explicit or indirect caps on rates with minimal legal process or recourse. BNSF also does not believe that there would be no immediate consequences of adopting the proposed rule. Revocation of the exemptions represents the intrusion of regulatory authority into highly functioning competitive markets with the ultimate risk that market-determined rates are going to be replaced with regulated pricing that does not reflect market conditions. And several participants in the Ex Parte meetings seemed to recognize that point since they expressly cited the prospect of a regulatory pricing option over a market rate as having a direct impact on their negotiation leverage. This prospect of regulatory intervention leading to lower, non-market based prices in competitive markets threatens BNSF's business model. BNSF has demonstrated that we invest when we can grow our business, improve our operational efficiency and receive appropriate value for our services, thereby creating the incentive for us to invest further—what we refer to as the virtuous investment cycle. The Board's approach to regulation should support such an investment cycle by examining applications for revocation of exemptions on an individualized basis. Such an approach allows the Board to craft regulatory remedies responsive to real-world circumstances and any specific problem the Board might identify from a particular shipper's

complaint. The Board's current proposal to revoke the exemptions for numerous products under the four- or five-level STCCs that the STB has identified does not fit that model and would artificially inject significant uncertainty into those complex markets and ongoing investment decision making.

- Notably, several exempt shippers submitted comments in response to the NPRM urging the Board not to revoke their exemptions, citing concerns about the impact of regulatory intrusion into complex, sensitive and highly competing markets. These shippers included United States Gypsum Company (USG), JB Hunt, Hub Group, Inc., Wisconsin Central Group, and the Intermodal Association of North America. As USG explained: "The industry has adapted, it's healthy, it's re-investing in itself and it's growing to meet the future needs of the nation...[O]ur objective now is to stay out of the way and let the progress continue." USG Comments (Jan. 27, 2011).