

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

Summary of Ex Parte Meeting held on June 14, 2019 between
American Forest and Paper Association, Escalation Consultants, Inc., and Chairman Begeman

Escalation Consultants, Inc. (“Escalation”) and American Forest and Paper Association (“AF&PA”) Attendees:

- Jay Roman, President, Escalation
- Julie Landry, American Forest & Paper Association
- Karyn Booth, Thompson Hine LLP
- Kerem Bilge, Thompson Hine LLP

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June 25, 2019
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STB Attendees:

- Chairman Ann D. Begeman
- Valerie Quinn, Attorney-Advisor
- Frank O’Connor, Deputy Director, Office of Economics

Meeting Summary:

The meeting began with introductions and AF&PA thanked the STB Attendees for the opportunity to meet and discuss AF&PA’s evidence supporting revocation of the paper and forest products exemptions and the issues in this proceeding.

Escalation presented information (*See Exhibit-1*) showing the operating profit per car on constant dollars for the railroads between 1980 and 2017. Escalation explained that the profit per car stayed stable until 2005. In 2005, the profit per car number started increasing drastically. Escalation discussed the relationship between the data and the change in the railroads’ business model, shifting from increasing market share to de-marketing business model and a focus on increasing profitability in the traffic transported. Escalation also explained how the railroads’ share prices increased significantly during the same period (*See Exhibit-2*). Additionally, Escalation discussed how the rail carloads for paper and forest products commodities substantially decreased between 2006 and 2017. Escalation explained that even though the carloads decreased substantially, there was a 940% increase in potentially captive revenue, in which railroads priced their movements in excess of 180% R/VC. Escalation further explained that, overall, these changes indicate that between 1980 and 2017 the railroads de-marketed lower margin traffic and substantially increased their market power over the remaining more rail dependent traffic for paper and forest products.

Thompson Hine explained the legal and policy arguments supporting revocation including that the statute and legislative history provide the Board with broad discretion to revoke a class exemption and the railroads are wrong that a showing of competitive abuse is required.

Thompson Hine also explained that revocation is justified by the substantial changes that have occurred in the rail market and the statute since the exemptions were granted, including the number of railroads who are revenue adequate today and the loss of any exemption benefits to rail customers. Additionally, Thompson Hine discussed the substantial increase in the exercise of railroad market power over paper and forest products shippers which is systemic and not episodic, and the lack of effective competitive alternatives for rail dependent traffic. *See Exhibit-3.*

Chairman Begeman asked why the industry did not petition the Board to revoke the exemption for the forest and paper industry before the 2016 Board-proposed rule. Thompson Hine explained that AF&PA did not want to petition the Board while there was a pending proceeding which was opened in 2011 and AF&PA specifically testified at the 2011 oversight hearing that the Board should open a rulemaking to review the propriety of the exemptions based on substantial changes that have occurred since the exemptions were granted. AF&PA further explained that it was advocating for the revocation of the exemption in other venues during the period between 2011 and 2016.

AF&PA stated that the current rail market data and its members' experiences indicate that railroads have changed their business models and de-marketed paper and forest products shipments for the sake of their own profitability at the cost of the rail customers' efficiency in moving these products. In response to the 50-foot box car discussion, AF&PA stated that in a competitive market, railroads would be working with their customers in order to serve them better. However, that is not the case here, and they force a shift to 60-foot box cars even though their customers do not have such a demand. AF&PA also stated that the ex parte meetings showed that its members are highly rail dependent and cannot shift to other modes of transportation due to facilities that are designed for rail, customer requirements, product dimensions, and length of haul. AF&PA stated that its members are facing systemic problems in a variety of areas, such as service, car supply, demurrage and rates and the Board should revoke the exemptions for forest and paper products. AF&PA stated that the forest and paper industry desires and needs access to the STB's regulatory oversight and processes.

The meeting concluded with each side thanking the other for participating in the meeting.

Exhibit-1

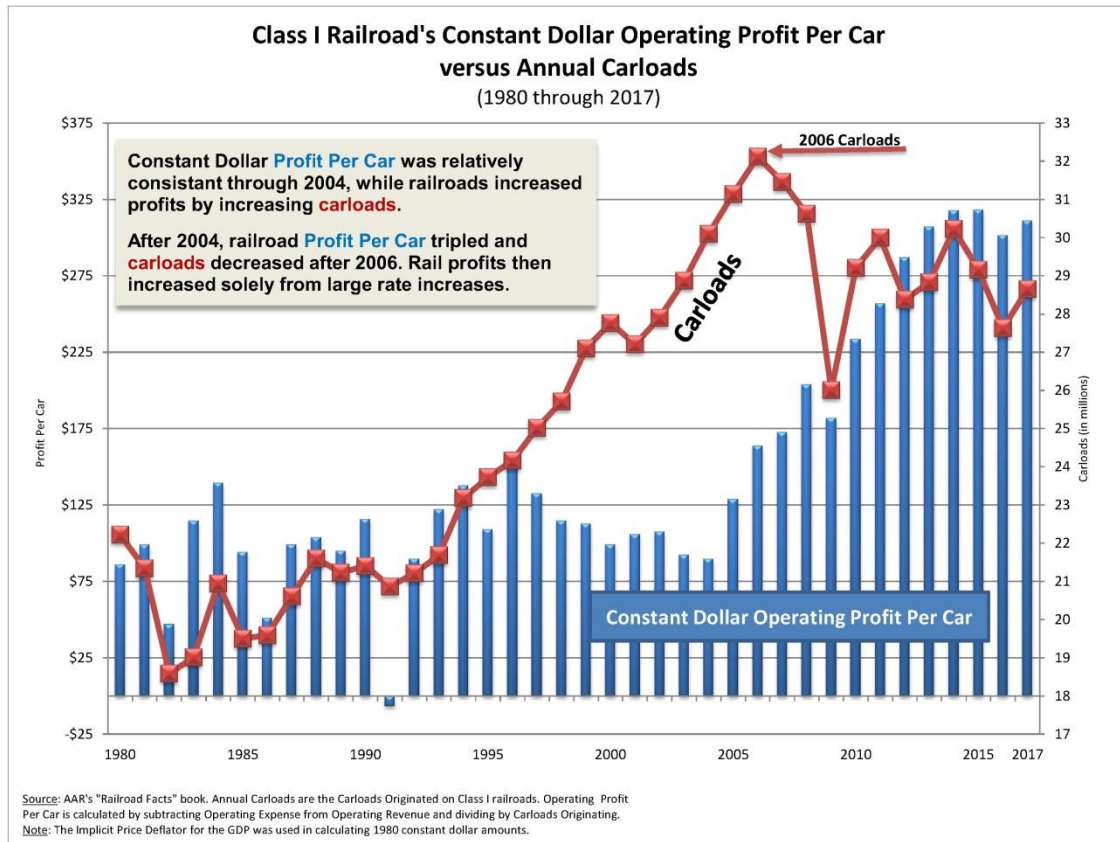


Exhibit-2

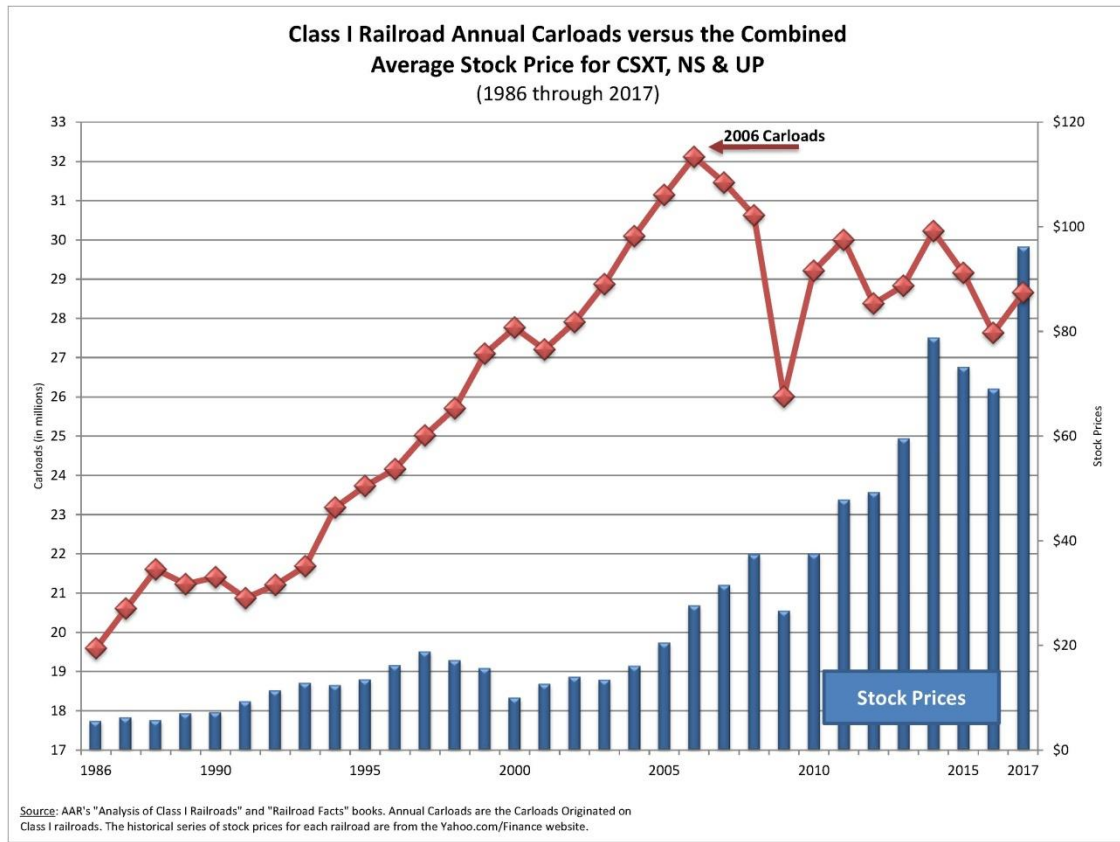


Exhibit-3

**Legal Arguments Supporting Revocation of
the Paper and Wood Products Commodity Exemptions**

I. Statute

- “The Board may revoke an exemption, to the extent it specifies, when it finds that application whole or part of a provision of this part to the person, class, or transportation is necessary to carry out the transportation policy of section 10101 of this title.” 49 U.S.C. § 10502(d). AF&PA Comments 08.26.16 at 4.
 - STB has broad discretion to decide when restoring regulatory oversight is necessary.
- Abuse of market power is not required by the revocation statute. Compare 49 U.S.C. § 10502(a)(2) to 49 U.S.C. § 10502(d). AF&PA Comments 08.26.16 at 5-6.
- Revocation can occur on a class-wide basis, as made clear by the plain language of 49 U.S.C. § 10502(d). AF&PA Comments 08.26.16 at 22.
- Revocation does not require a finding of market abuse. Comments 08.26.16 at 7.
- Revocation is supported by the national rail transportation policy of 49 USC § 10101. Comments 01.31.11 at 9. Comments 07.26.16 at 21-22. Comments 08.26.16 at 5.
 - Transportation Policy has competing interests, STB balances and determines the weight to provide to the factors based on the circumstances:
 - Historically—revenue adequacy and minimizing regulation was focus
 - Present—promoting sound economic conditions; regulating where there is a lack of effective competition; honest and efficient management; avoiding undue concentrations of market power.

II. Legislative History

Conference report emphasizes that, in evaluating a revocation request, Board can require demonstrated abuse of market power **or that regulation is needed to carry out the rail transportation policy**. H.Rep. 104-422 at p. 169 (Dec. 18, 1995). AF&PA Comments 08.26.16 at 8-9.

- Board itself has stated: it looks at “whether the shipper lacks sufficient intermodal alternatives and whether the carrier has market power that **it could** abuse with respect to the traffic, thus necessitating regulatory oversight.”¹

III. Revocation is Supported By Substantial Changes Since Exemptions Were Granted

Since exemptions were granted in 1989-1993:

¹ Pejepscot Industrial Park, Inc. d/b/a Grimm Industries—Petition for Declaratory Order, STB Docket No. 33989, slip op. at 7 (n. 15) (served May 15, 2003).

- The rail industry is no longer financially fragile. AF&PA Comments 07.26.16 at 4 and 9-13. AF&PA Comments 01.31.11 at 9-11.
- Substantial consolidation in the rail industry resulting in high degree of rail customer captivity to a single railroad. Comments 07.26.16 at 7.
- Economic changes in railroad pricing demonstrate increased exercise of market power. Comments 07.26.16 at 8, 14, and 19-20. Comments 08.26.16 at 13.
- ICCTA removed railroads' tariff and contract summary filing requirements and other regulatory burdens, thereby mooting one of the main reasons for the original exemptions. AF&PA Comments 01.31.11 at 8-9. AF&PA Comments 07.26.16 at 5. AF&PA Comments 08.26.16 at 11-12.

IV. ICC Found Mutual Benefits; Today Exemptions Offer No Benefits to Rail Customers

- Shippers previously supported the exemptions to lower railroads' costs and allow railroads to compete more efficiently with trucks for paper and forest products market share; and ICC found mutual benefits and no concerns about market power by paper and forest products shippers. AF&PA Testimony 1.31.11 at 3-8.
 - "In determining whether regulation is necessary to protect shippers from an abuse of market power, a significant consideration is whether the participating shippers actually seeking transportation are concerned about an abuse of market power...."²
- Today, AF&PA members strongly support revocation of the exemptions. AF&PA Comments 08.26.16 at 11.

V. Exercise of Railroad Market Power is Systemic Not Episodic

- Exercise of market power and challenges with railroads are wide-spread and systemic (rail service, equipment, practices/demurrage, rates, inability to negotiate). AF&PA Supplemental Comments 10.3.16, Exhibit A and Ex Parte Meetings with PCA, Verso, IP and GP.
- Highly impractical to require individual revocations—too costly, time-consuming, burdensome, and uncertain.

VI. Trucking/Intermodal is Not Effective Competition for Rail Dependent Traffic

- Truck transportation is impossible or infeasible for many shipments due to facility limitations and size/weight restrictions applicable to trucks. Comments 07.26.16 at 8 and 24-25.

² Rail Exemption—Transportation of Selected Commodity Groups, 9 I.C.C.2d 969, 973 (1993).

- Truck transportation is limited due to high fuel prices, driver shortages, enforcement, and other constraints. Comments 07.26.16 at 8-9.
- Intermodal and intramodal competition has decreased since the exemptions were created and trucks, barges and intermodal service are not effective for rail dependent traffic. Transload and intermodal are the exception and not workable for outbound mill shipments. AF&PA Supplemental Comments 10.3.16, Exhibit A; Ex Parte Meetings with PCA, Verso, IP and GP; Comments 07.26.16 at 4 and 7-9; Comments 01.31.11 at 11-13.

VII. Additional Precedent Supporting Revocation

- Revocation can be warranted merely by “facts indicating a real possibility of competitive harm.” Mr. Sprout, 8 F.3d 118, 126 (2nd Cir. 1993). AF&PA Comments 08.26.16 at 8.
- Use of R/VC Data is Consistent with Precedent, Authority, and Railroad Practice:
 - Reliance on aggregated R/VC data in exemption analysis is “justified” even though it may not be “perfect.” Brae Corp. v. U.S., 740 F.2d 1023, 1040-1041 (D.C. Cir. 1984). AF&PA Comments 08.26.16 at 17.
 - An accepted method of “measuring market power” is based on the view that “a firm with market power” can raise prices without a loss of net revenue. CF Industries v. STB, 255 F.3d 816, 823 (D.C. Cir. 2001). AF&PA Comments 08.26.16 at 16.
 - “Competitive pressure” is related to a railroad’s ability to raise prices. Arizona Public Service Co. v. U.S., 742 F.2d 644, 654 (D.C. Cir. 1984). Comments 08.26.16 at 16.
 - The Board uses R/VC ratios for a wide variety of regulatory purposes, including market dominance and the Maximum Markup Methodology. AF&PA Comments 08.26.16 at 14-16 and 19.