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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB EX PARTE NO. 665 (Sub. No-2)

EXPANDING ACCESS TO RATE RELIEF

**OPENING COMMENTS OF
BNSF RAILWAY COMPANY**

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In its August 31, 2016 Advanced Notice of Proposed Rulemaking decision (“Decision”) in this proceeding, the Board asked for comments on a possible new rate reasonableness methodology for use in small disputes. BNSF Railway Company (“BNSF”) respectfully submits these opening comments. BNSF also supports and joins in the opening comments filed by the Association of American Railroads in this proceeding.

BNSF understands that certain rail customers feel that the Board’s existing formal rate reasonableness procedures are not easily accessible to them, or otherwise do not provide a realistic opportunity to obtain regulatory relief. BNSF believes that rail customers should have access to regulatory relief in appropriate situations, and is not opposed to balanced approaches that result in improvements to the Board’s existing adjudicatory processes. BNSF has also worked with those customer groups to develop alternative market-based mechanisms outside of the Board’s existing formal proceedings that allow the parties to address rate reasonableness concerns on an accelerated time frame in the context of the real-world competitive markets for the commodities involved. As the STB considers expanding its own direct regulation of rates, it is essential that the STB’s rate regulation be consistent with the Congressional requirement, embodied in the Rail Transportation Policy, “to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation.” 49 U.S.C. §10101(1).

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. The Board’s search for a quicker, cheaper, and easier rate case process that “expands access” to rate relief has led it to a proposal that 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 is particularly concerned that this proposal comes at a time when the railroad industry is facing significant commercial headwinds, including the structural decline of the coal transportation business. The Board must consider the cumulative effect that this proposal, and the other fundamental changes currently being considered by the Board in numerous other pending proceedings, would have on the industry's ability and incentive to make infrastructure investments.

In addition to explaining in more detail the concerns BNSF has about the Board's proposal, BNSF also comments on certain specific aspects of the proposed simplified methodology. First, if a new simplified methodology was adopted, it would be of critical importance to apply careful screening to limit the number of cases that could be brought. Second, on the question of an appropriate comparison group, the Board should not use any movements with R/VC ratios below 180% or data from non-defendant railroads. There are other ways to ensure a sufficiently large comparison group that do not further compromise the integrity of the rate review standards. Third, a full market dominance analysis is required by statute, and short cuts in that analysis (beyond those already implemented by the Board) would not be appropriate or legal. Fourth, the Board must allow the presentation of "other relevant factors" evidence so that the simplified process does not become a mechanistic rate setting approach that fails to reflect market realities. Finally, BNSF believes that the Board should not take any further action on its proposed simplified process until other issues that could have a bearing on the structure and substance of a simplified process, like standing, have been addressed in a subsequent decision.

I. The Proposed Simplified Process Represents a Significant Expansion of Regulatory Intervention Disconnected from the Board's Articulated Goals.

The Board's Decision does not identify a valid basis for undertaking the significant expansion of existing rate reasonableness procedures and standards that is contemplated here. The Board's proposal arose out of the investigation of grain rates in Ex Parte No. 665 (Sub-No.1), but

the evidence gathered in that proceeding did not demonstrate a need for the new, further simplified “very small” case procedures the Board is pursuing now. In that proceeding, the Board sought information on grain transportation markets to better understand why there has been a lack of grain rate cases in recent years. BNSF submitted evidence demonstrating that the lack of rate litigation against BNSF was likely because BNSF’s grain rates are effectively constrained by strong competition in grain transportation markets. Moreover, because BNSF’s commercial interest is in growing the volume of grain it transports in domestic and export markets, BNSF prices its grain transportation to achieve that objective. And while some participating parties presented vague complaints about rate levels, they presented no credible evidence of a problem with rates that might justify the adoption of new, more expansive rate reasonableness standards. The most reasonable conclusion to be drawn from the evidence in the EP 665-1 proceeding is that there has not been rate litigation in recent years because grain shippers have had no need to file rate cases.¹

The Board has also failed to identify flaws in its existing rate case procedures that would warrant further simplification. Much attention has been given to the complexity and cost of Stand Alone Cost (“SAC”) cases, but the Board’s proposed approach in this proceeding will have no impact on—and frankly has no relevance to—the SAC standard or potential simplification of SAC analyses. The cases that would be pursued under the proposed new simplified process for very small cases are not claims that shippers would otherwise contemplate bringing as SAC or Simplified SAC cases. The Board’s proposal is instead apparently intended to further simplify rate cases that would otherwise be brought under the Three Benchmark standard, which is itself already a simplified alternative to SAC and Simplified SAC.

¹ Since the EP 665-1 proceeding only concerned grain rates, the Board has no basis from the record in EP 665-1 record to assume that complaints by shippers of other commodities somehow justify the Board’s new proposal.

Of particular concern to BNSF is the fact that the Board's stated goal to "expand access to rate relief" seems indistinguishable from a goal of generating more rate cases. BNSF does not believe that goal is appropriate or consistent with the Rail Transportation Policy. The statute instructs the Board "to minimize the need for Federal regulatory control over the rail transportation system and to require fair and expeditious regulatory decisions when regulation is required." 49 U.S.C. §10101(2). Lacking any evidence of a market failure that needs to be addressed through expanded rate reasonableness litigation, or any flaw in the already simplified Three Benchmark standard, there is no justification for simplification of the existing standards that is designed simply to generate more rate reasonableness litigation and more direct involvement by the Board in setting rail rates.

Moreover, the proposed simplifying procedures appear to create the incentive for shippers to bring rate cases regardless of the underlying merits, thereby impermissibly expanding Board intervention into functioning markets and imposing unfair burdens on railroads. Under the Board's proposal, apart from paying a nominal filing fee and alleging certain basic information about the issue traffic, the only substantive material a shipper would be required to submit to the Board would be qualitative market dominance evidence. And, as discussed below, the Board suggests it might consider applying a less rigorous market dominance standard. The Board, not the parties, would then build the comparison group and perform the initial screen to determine whether further proceedings are justified. Because of this significantly lowered evidentiary burden, there would be little reason for shippers not to file claims, even those of questionable merit.

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. And even if the Board had the resources to deal with

such a scenario, it would be contrary to the RTP to expand the Board's role in rate regulation so dramatically. As noted previously, the statute instructs the Board "to minimize the need for Federal regulatory control over the rail transportation system and to require fair and expeditious regulatory decisions when regulation is required." 49 U.S.C. §10101(2). Any simplified rate review process that incentivizes shippers to file potentially meritless rate cases because they have very little or nothing to lose would be contrary to Congress' clear intent to minimize the Board's intervention in rail markets. BNSF is also concerned that the "roll the dice" option the Decision outlines will undercut the various informal and formal interactions that BNSF already engages in with its shippers outside the auspices of the Board.

II. The Proposal Would Improperly Increase Board Intervention in Functioning Markets.

The Board's proposal is inconsistent with the RTP's direction "to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation." 49 U.S.C. §10101(1). The Board's proposed simplified process would, after applying a preliminary screen, utilize the basic Three Benchmark approach, which evaluates rates based on the (adjusted) mean of the R/VCs in a comparison group. Such a methodology tends to produce uniform rates by eliminating the natural distribution of rates produced by market forces. Moreover, repeated application of such a methodology tends to ratchet down overall rate levels, potentially driving them to the jurisdictional threshold.

The Board recognized these concerns when it adopted the Three Benchmark methodology, but nevertheless concluded that these effects would result only if there was a large number of cases.² Here, the apparent objective of the Board's simplified process is to increase the number of cases where rates are set based on the comparison group methodology. By seeking deliberately to

² See *Simplified Standards for Rail Rate Cases*, Ex Parte No. 646 (Sub-No.1), at 74 (served September 5, 2007).

expand the number of cases brought under a comparison group methodology that does not adequately reflect market forces, the Board would be undermining Congress' desire to allow rail rates to be set based on market forces "to the maximum extent possible."

The Board's approach also ignores the effect of expanded rate regulation on railroads' ability and incentive to make investments in rail infrastructure. More aggressive rate regulation will affect railroads' ability to make investments by reducing overall revenues. Moreover, rate reasonableness approaches that fail to adequately reflect market forces will distort railroad investment decisions by reducing the incentive to make investments where the market demand is strongest. This runs counter Congress' clear instructions that the Board must facilitate rail investment by helping carriers earn revenues that are adequate "for the infrastructure and investment needed to meet the present and future demand for rail services[.]" 49 U.S.C. § 10704(a)(2).

The Board must also consider the cumulative effect that this proposal and the other various changes in the regulatory landscape that are pending will have on the industry's ability and incentive to make infrastructure investments. The Board is currently considering, among other things, draft rules and shipper proposals that would make reciprocal switching more readily available (EP 711-1), impose new rate constraints based on a railroad's overall revenue adequacy status (EP 722), increase the realm of traffic that would be subject to the revamped and expanded regulatory framework (EP 704), and in the present matter, expand shipper access to rate cases. Taken together, these proposals seek to expand the available regulatory tools and the pool of shippers that are able to use those tools, including shippers in properly functioning markets with no need for regulatory intervention. The cumulative effect of this new regulatory agenda could seriously undermine railroads' ability and incentive to make infrastructure and other rail

investments, and their ability to properly direct investments to areas where market forces would otherwise justify them.

III. Comments on Specific Aspects of the Proposed Methodology.

As explained above, BNSF does not believe the Board should adopt the new rate methodology for small cases described in its Decision. However, if the Board decides to advance such a methodology, BNSF provides the following comments regarding certain aspects of the proposed methodology.

A. Preliminary Screen.

BNSF believes that it is critical that any further simplification of the rate review process be limited in scope. As the Board recognizes, one way to limit the scope of the new methodology is to apply a preliminary screen early in the rate review process to exclude rate claims that are unlikely to be successful. The Board is “considering requiring that challenged traffic meet certain threshold criteria in order to be eligible to be reviewed under the new methodology” in an attempt to “identify those movements for which truck transportation alternatives are unlikely and the rates are significant outliers[.]” Decision at 15. Such a preliminary screen is appropriate and necessary to reduce the burden on both the Board and defendant railroads from fully litigating claims that are unlikely to be successful, and to reduce any unnecessary interference by the Board in properly functioning markets.

BNSF also agrees that it would be appropriate to use a preliminary screen that attempts, as an initial matter, to exclude all but “outlier” rates. Such a screen would be appropriate since the underlying methodology for assessing the reasonableness of the challenged rate is a comparison methodology that targets those rate that substantially deviate from the mean of the comparison group. BNSF believes that a combination of the two approaches mentioned by the Board—a standard deviation-based approach or a top XX% approach—would be best. Assigning an

arbitrary percentage-based approach has the potential to permit challenges to some rates that are nonetheless close enough to the mean of the comparison group that they should not truly be considered “outliers”. While a standard deviation-based approach is a less arbitrary and more mathematically reliable way to ensure that only anomalous rates are challenged, it still could allow the same phenomenon to occur if the population of rates happens to be distributed in certain ways. To address this issue, BNSF suggests that only rates that are both in the top 10% of the comparison group and at least one standard deviation from the mean should pass this component of the preliminary screen.

BNSF also agrees that the preliminary screen should exclude complainants that previously filed rate claims under the new methodology within a certain number of years. Given the extremely small burden on shippers under the new methodology, shippers might have an incentive to file numerous individual cases under the new simplified process when they should really be filing a larger case under the existing SAC, Simplified SAC or Three Benchmark methodologies. BNSF believes that a five-year exclusion period that tracks the prescription period in a Three Benchmark case would be appropriate. In addition, a complainant should be defined to include brother/sister corporations and other corporate affiliates to avoid possible gamesmanship by complaining shippers.

B. Comparison Group.

As noted previously, the proposed new methodology is based on the approach used in the Three Benchmark methodology which compares the issue traffic rate (using its R/VC ratio) to the mean of the rates for movements in a comparison group. It is therefore essential that an appropriate comparison group be used in the rate assessment. To simplify the Three Benchmark methodology, the Board proposes to use certain default parameters in establishing the comparison group. BNSF offers the following comments on possible parameters:

First, the Board should use only traffic that is at or above the 180% R/VC jurisdictional threshold for assessing the reasonableness of a rate. The Board has already concluded that it would be improper to include rates in a comparison group that are below the jurisdictional threshold, and there is no reason to revisit that conclusion. When it adopted the Three Benchmark methodology, the Board explained that “the comparison group should consist of only captive traffic over which the carrier has market power. The rates available to traffic with competitive alternatives would provide little evidence on the degree of permissible demand-based differential pricing to provide a reasonable return on the investment.”³ Further, including movements with R/VC ratios below 180% in a comparison group would improperly lead to a “ratcheting” down of R/VC ratios until the Board ends up prescribing rates at 180% R/VC. A rate reasonableness methodology that effectively establishes maximum rates at the jurisdictional threshold would not be lawful, as the courts have acknowledged.⁴

Second, the comparison group should not include traffic of non-defendant railroads. Once again, the Board has already recognized that it would be inappropriate to include non-defendant traffic in a comparison-based rate reasonableness methodology because such traffic would not be comparable to movements on the defendant railroad. As the Board explained in its Decision, “varying joint and common costs can lead to inevitable differences in R/VC ratios among different carriers.” Decision at 15. When it adopted the Three Benchmark methodology, the Board similarly concluded that “the R/VC ratio of potentially captive traffic of one carrier provides no useful indicia of the lawful contribution to fixed and common costs for another carrier.”⁵ The Board suggested in its Decision that it might be appropriate to reconsider this conclusion for

³ *Simplified Standards* at 17.

⁴ *Burlington Northern RR Co. v. Interstate Commerce Comm’n*, 985 F.2d 589, 597 (D.C. Cir. 1993).

⁵ *Simplified Standards* at 82-83.

purposes of further simplification, “to ensure that the initial comparison group includes sufficient movements from the Waybill Sample on which the Board can base its rate reasonableness determination.” Decision at 15. But as explained below, there are other means to ensure the selection of a sufficiently large comparison group that do not violate basic economic principles underlying the rate reasonableness methodology.

Third, BNSF agrees that a comparison group must be sufficiently large to provide meaningful information on the mean and distribution of rates for comparable movements. The Board has proposed that the default comparison group include at least 20 movements. If at least 20 observations are necessary for a valid comparison group, the use of data from the Waybill Sample in the same 5 or 7 digit STCC as the issue traffic may be insufficient for many commodities to create a large enough comparison group. However, the Board can ensure that there are a sufficient number of movements in the comparison group (without having to resort to non-defendant movements or traffic below 180% R/VC) in one of the following ways:

- The Board can adjust the waybill sample data reporting requirements to ensure that every commodity is represented by a minimum number of movements. The Board may already be considering this option as it has stated that it will propose modifications to the waybill sampling rate in a subsequent decision. Decision, at 15, n. 14.
- If the Board determines that the waybill sample contains an insufficient number of movements in an individual case, the Board can request additional waybill data (i.e., additional moves) from the carrier that meets the comparison group parameters.

Fourth, the Board should exclude from the default comparison group the rates on any movements that have previously been reduced under the new rate case methodology or the existing Three Benchmark methodology. The objective of a comparison-based methodology is to identify outlier rates as compared to other rates set by market forces. If rates set by regulatory intervention were included in the comparison group, the necessary connection to market-based rates would be severed.

C. Market Dominance.

In addition to the use of default factors to identify a comparison group, the Board proposes to simplify small case disputes by applying a looser standard to its legal obligation to determine whether market dominance exists. The Board has said that it “envision[s] determining qualitative market dominance without as extensive an analysis as under the current methodologies.” Decision, at 20. Specifically, the Board has proposed that the complainant “would be permitted to present an abbreviated evidentiary submission” that simply requires the complainant to explain “why the use of other transportation modes is not feasible.” *Id.*, at 19. The Board further proposes that the defendant rail carrier’s response to the qualitative market dominance evidence “could be limited to information disclosed by the complainant with its complaint or opening evidence or developed independently by the defendant.” *Id.*

There is no legal basis or justification for applying a market dominance approach that is less rigorous than the approach already required in rate reasonableness cases. By statute, “[w]hen a rate for transportation by a rail carrier providing transportation subject to the jurisdiction of the Board under this part is challenged as being reasonably high, the Board *shall determine* whether the rail carrier proposing the rate has market dominance over the transportation to which the rate applies.” 49 U.S.C. § 10707(b) (emphasis added). Market dominance is defined as “an absence of effective competition from other rail carriers or modes of competition for the transportation to

which a rate applies.” 49 U.S.C. § 10707(a). The statutory requirement cannot be ignored in the interest of simplification.

The Board suggests that a watered down analysis would be adequate here because the preliminary screen will limit the application of the new methodology to “shippers that are more likely to be considered captive.” Decision, at 11. But even if the preliminary screen were to identify movements that are most likely to be made by a railroad with market dominance, the statute still requires a determination that market dominance actually exists. The Board cannot justify the use of a lesser standard on grounds that the statute will likely only be violated in a relatively small number of cases. Indeed, when the Board decided to eliminate evidence of product and geographic competition from the existing market dominance analysis, it did so only after concluding that the short-cut methodology would not result in the regulation of rates that should be free of regulatory interference. Since rigorous, market-based rate reasonableness standards would be used to assess the reasonableness of challenged rates even where market dominance was found under the new standards, the Board was “confident that a rate constrained by effective product or geographic competition would not be affected by the regulatory process.”⁶ Here, however, the Board’s proposed use of a highly simplified rate reasonableness methodology means that the backstop that previously gave the Board comfort in adopting a less rigorous market dominance standard is not present.

As to the proper test for market dominance, BNSF reiterates our view that the Board’s Limit Price test is improper. As explained in BNSF’s comments recently filed in Ex Parte No. 711 (Sub-No.1), *Reciprocal Switching*, at 7-9 (filed October 26, 2016), the Limit Price test is logically and economically unsound because it ignores the market conditions for the traffic at issue and

⁶ *Market Dominance Determinations—Product and Geographic Competition*, Ex Parte No. 627, at 3 (served April 6, 2001).

relies heavily on a railroad's Revenue Shortfall Allocation Method ("RSAM").⁷ Any market dominance assessment that relies on the RSAM is fundamentally flawed. The RSAM contains no information at all on the particular market involved in a movement of freight and no information on a particular shipper's demand for a railroad's service. Moreover, the level of the RSAM can be driven by the degree of success that a railroad has had in competitive markets, resulting in low RSAMs for railroads, like BNSF, that generate substantial revenues by competing successfully in competitive markets. In addition to being a perverse penalty for railroads that successfully compete, the use of RSAM to assess market dominance is irrational because it says nothing about the existence of market dominance over a particular movement. RSAM should not be used for any purpose in assessing market dominance.

D. Other Relevant Factors

The Board requested comments on the "advisability of allowing parties' presentations to include 'other relevant factors' evidence" because it could "increase the cost and time required to prepare for submission of a case." Decision, at 19-20. BNSF believes that the Board must allow the parties to include "other relevant factors" evidence. In fact, the more automated and mechanical that the Board makes the comparison-based test, as the Board proposes here, the more important it is to provide parties with the opportunity to submit other evidence on the reasonableness of the challenged rate to avoid arbitrary results. The Board has already imposed limits on the type of other relevant evidence that can be submitted in a Three Benchmark case. Further limits would completely undermine the viability of a simplified methodology by making it even less likely that any rate established under the new methodology would have a connection to market factors. Thus, eliminating the option to present Other Relevant Factors evidence would

⁷ See, also, AAR Comments, NOR 42123 (filed Nov. 28, 2012); AAR Amicus Comments, NOR 42121 (filed July 24, 2013).

be a further simplification to the Three-Benchmark test that would likely reduce its adherence to Constrained Market Pricing principles, a concern expressed in the September 2016 InterVISTAS Report commissioned by the STB.⁸

IV. Conclusion.

BNSF believes that the Board's proposal to greatly expand access to rate relief does not represent an appropriate balancing of deregulatory statutory directives, the needs of railroads, and common sense changes to address complaints from shippers about the complexity and expense of large rate cases. Instead, the Board's proposal seems likely to encourage the filing of rate cases (regardless of their possible merits) through the prospect of obtaining below-market rates, and to lead to unwarranted Board intervention in properly functioning markets. For these reasons, and the other reasons stated above, the Board should abandon its proposal.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Jill K. Mulligan', written over a horizontal line.

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⁸ InterVISTAS Report, *An Examination of the STB's Approach to Freight Rail Rate Regulation and Options for Simplification*, dated September 14, 2016, at 132.