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December 19, 2016

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Office of Proceedings
December 19, 2016
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Public Record

Ms. Cynthia T. Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423

Re: STB Docket No. EP 665 (Sub-No. 2), *Expanding Access to Rate Relief*

Dear Ms. Brown:

Pursuant to the Advance Notice of Proposed Rulemaking served in this proceeding on August 31, 2016, attached please find the reply comments of the Association of American Railroads.

Respectfully submitted,

Timothy J. Strafford
Counsel for the Association of
American Railroads

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 665 (Sub-No. 2)

EXPANDING ACCESS TO RATE RELIEF

REPLY COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS

Pursuant to the schedule established by the Surface Transportation Board (“STB” or “Board”) in the Advance Notice of Proposed Rulemaking (“ANPRM”) served in this proceeding on August 31, 2016, the Association of American Railroads (“AAR”) respectfully submits these reply comments.

In opening comments filed on November 14, 2016, the AAR observed that the independent contractor retained by the Board to evaluate the agency’s rate reasonableness methodologies recently concluded that further simplification of the Three Benchmark test would undermine the economic foundation of the test.¹ The AAR therefore urged the Board to discontinue this proceeding. The AAR submitted that, if the Board does not discontinue this proceeding, the Board should not propose new “very small rate case” rules unless it precisely defines a problem to be solved rather than making general allusions to improving “access” to the rate reasonableness process, which is already accessible to stakeholders as most recently

¹ InterVISTAS, *Surface Transportation Board, 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 132 (“Further simplification to the Three-Benchmark Test would likely reduce its adherence to CMP principles.”).

confirmed by the Board's independent contractor.² The AAR also urged the Board not to propose rules without analyzing their potential impact and the cumulative impact of all of the other additional regulatory burdens that it is currently proposing.³

To a limited extent, the AAR expressed support for those aspects of the ANPRM that reflected procedural improvements to the Board's existing processes for handling small rate cases. This support is consistent with the AAR's long-standing support for Board efforts to streamline its rate reasonableness procedures, consistent with sound economics, and to eliminate unnecessary expense and delay. However, as much of the ANPRM proposed to weaken the already limited substantive connections between the Three-Benchmark rate comparison test and the sound economic underpinnings of the long-standing Constrained Market Pricing ("CMP") principles, the AAR expressed grave concerns that aspects of the ANPRM were steps in the wrong direction. Nonetheless, the AAR submitted that if the Board proceeds to propose a new methodology for very small cases, that proposal should adhere to the Board's stated methodology for establishing limits on awards and set limits substantially less than the cost to bring a Three Benchmark case.

Opening Comments filed by interest groups representing shippers, such as the joint submission of wheat and barley commissions and boards ("ARC *et al.*"), the National Grain and Feed Association ("NGFA"), and the American Chemistry Council ("ACC"), similarly do not express support for the ANPRM and often highlight and confirm the concerns raised in

² See, e.g., InterVISTAS Report at 44, 128-29.

³ See, e.g., *Reciprocal Switching*, EP 711 (Sub-No. 1); *Revenue Adequacy*, EP 722; *Review of Commodity, Boxcar, and TOFC/COFC Exemptions*, EP 704 (Sub-No. 1); *Review of the General Purpose Costing System*, EP 431 (Sub-No. 4); *Expediting Rate Cases*, EP 733.

the AAR Opening Comments. For example, ARC *et al.* questions the “value” of the ANPRM,⁴ NGFA believes the Board “has erred” in even proposing the ANPRM,⁵ and ACC “is skeptical that the direction the Board proposes to take in this proceeding will accomplish [the Board’s objectives]” and “perceives little reason to adopt a separate rate case methodology.”⁶ Consistent with the AAR’s Opening Comments, comments filed by these groups indicate that the ANPRM seems unlikely to result in the expedited or lower cost regulatory process that seems to have motivated the Board to issue the ANPRM. For example, the ACC’s Opening Comments state that “there is little basis for the Board to conclude that its proposed comparison methodology offers much, if any, savings over the Three-Benchmark methodology. Indeed, some elements of the new methodology could increase costs.”⁷ ACC’s Opening Comments implicitly acknowledge that the comparison-based methodology proposed in the ANPRM lacks any basis in sound economic principles.⁸ And, shipper groups take issue with the ANPRM’s proposed preliminary screens related to market dominance.⁹

In the reply comments that follow, the AAR responds to NGFA’s and ARC *et al.*’s detour from the ANPRM into a renewed call for grain-specific rate case methodologies. The AAR notes that third party reports on the Board’s rate reasonableness processes do not

⁴ ARC *et al.* Opening Comments at 2.

⁵ NGFA Opening Comments at 1.

⁶ ACC Opening Comments at 1.

⁷ ACC Opening Comments at 11.

⁸ See, e.g., ACC Opening Comments at 4 (“While the Board proposes a different process for selecting the comparison group, there is no basis to conclude that one process is superior to the other . . .”).

⁹ See, e.g., NGFA Opening Comments at 11 (describing preliminary screen criteria as “not workable or correct”); ARC *et al.* Opening Comments at 8 (expressing that it is “troubled by the outlier focus”).

support the ANPRM's proposals. The AAR also responds to calls for the Board to shortcut the statutory market dominance standards required by the Interstate Commerce Act, as amended. Finally, the AAR explains how shipper comments on the ANPRM highlight the ANPRM's many flaws and demonstrate that the Board should discontinue this proceeding.

Comments

I. The Board Should Not Propose Commodity-Specific Rate Reasonableness Rules

In the ANRPM, the Board concluded that any proposed rules for very small cases should apply to shippers of all commodities because many of the concerns raised in the EP 665 (Sub-No. 1) docket were general in nature and because giving access to a new methodology to a subset of shippers would be arbitrary.¹⁰ Instead, the Board reiterated its oft-stated goal of reducing delay and expense associated with rate disputes, while achieving the same objectives of the Board's other rate case methodologies and minimizing any loss of precision.¹¹ Nonetheless, the agricultural interests that filed comments in this docket, including the U.S. Department of Agriculture ("USDA"), continue to ask the Board to change the substantive rules related to rate reasonableness cases to advantage grain shippers over shippers of other commodities and to judge the reasonableness of rates without regard to sound economics and market forces.¹² The agricultural interests persist in seeking to drive rail rates for favored shippers below competitive market levels, the same goals that such groups have been seeking for over thirty years.

¹⁰ ANRPM at 12.

¹¹ ANPRM at 11. *See Simplified Standards for Rail Cases*, EP 646 (Sub-No. 1) (STB served Sept. 5, 2007) ("*Simplified Standards*"); *Rate Regulation Reforms*, EP 715 (STB served July 18, 2013); *Expediting Rate Cases*, EP 733 (STB served June 15, 2016).

¹² *See* USDA Comments at 3; ARC *et al.* at 6; NGFA Comments at 8. *See also* ARC *et al.* at 24 ("Procedural issues are obviously secondary to substantive concerns.").

The AAR continues to oppose such efforts from interest groups representing agricultural parties seeking special treatment for their constituents, because such efforts are inconsistent with sound economic principles and would undermine the ability for railroads to provide competitive rail services for the benefit of all shippers. The record compiled in the EP 665 (Sub-No. 1) proceeding demonstrated that most grain movements by rail face pervasive competition and therefore should not be subject to the Board's rate reasonableness jurisdiction. Most grain rates are below the Congressionally set 180% R/VC threshold for Board jurisdiction to even consider rate reasonableness complaints.¹³ Moreover, the shipper interest groups noted that railroads compete for grain traffic and acknowledged the incontrovertible fact that grain can and does also move by truck and by barge.¹⁴ In addition to providing origin to destination transportation, such truck transportation can be used to reach multiple railroads.¹⁵ Though the Board has refused to consider geographic competition in market dominance determinations for administrative efficiency reasons, these economic forces constrain rail rates in the real world. The AAR and railroad commenters in the EP 665 (Sub-No. 1) docket also provided ample evidence that grain transportation by rail is subject to extensive competition.¹⁶

¹³ See NGFA Comments, EP 665 (Sub-No. 1), Crowley V.S. at 3 (filed June 26, 2014); ARC Comments, EP 665 (Sub-No. 1), Fauth V.S. at 5 (filed June 26, 2014).

¹⁴ See, e.g., NGFA Comments, EP 665 (Sub-No. 1) at 9-10.

¹⁵ ARC Comments, EP 665 (Sub-No. 1), Fauth V.S. at 15 ("Many large volume railroad grain movements involve relatively short distances to processing facilities and river terminals and many large grain destinations have two or more railroads serving their facilities."); NGFA Comments EP 665 (Sub-No. 1) at 7 ("Grain elevators aggregate the crops grown on farms they serve, which typically are delivered to the elevator primarily by truck.").

¹⁶ See, e.g., AAR Opening Comments, EP 665 (Sub-No. 1), at 7-8 (filed June 26, 2014); CSX Transportation Opening Comments, EP 665 (Sub-No. 1), at 2-3 (filed June 26, 2014); Norfolk Southern Opening Comments, EP 665 (Sub-No. 1), at 10-14 (filed June 26, 2014); Union Pacific

NGFA's and ARC *et al.*'s desire for rate reasonableness rules that favor grain shippers over the shippers of other commodities stems, at least in part, from the fact that the economic analysis of rail rates under a SAC, Simplified-SAC, or Three-Benchmark test for grain movements would show that the rates are not unreasonable. The fact that a SAC Analysis would show that a particular shipper's rate is reasonable means that that shipper is not paying to subsidize parts of the network it does not use and is not paying for inefficiencies in the carrier's operations. And, the Board's independent contractor recently confirmed that SAC remains the most precise way to determine the reasonableness of rates—for all shippers and commodities.¹⁷ Complaints about lack of “access” to “rate relief” ring hollow when under any valid economic theory those shippers would not be entitled to relief.

Yet grain shippers continue to attempt to blur the line between the Board's processes being accessible and substantive changes that would move the goal posts and show reasonable rates to be unreasonable. Grain shippers simultaneously admit that their rates would not be unreasonable under the SAC or Simplified-SAC test because of their low volume shipments over low density lines and that their rates would not be unreasonable under the Three-Benchmark test (or likely even the ANPRM-proposed methodology) because there are few unusually high outlier rates.¹⁸ The fact that the Board's rules would show that rail rates are reasonable is not a problem that requires changes in those rules or special treatment for grain shippers.

Opening Comments, EP 665 (Sub-No. 1), at 15-19 (filed June 26, 2014); BNSF Opening Comments, EP 665 (Sub-No. 1), Miller V.S. (filed June 26, 2014).

¹⁷ InterVISTAS Report at xviii.

¹⁸ See, e.g., NGFA Comments at 12-13 (citing NGFA's Opening Comments, EP 665 (Sub-No. 1), at 15).

II. Third Party Reports Do Not Support the ANPRM Proposals

The Board recently commissioned an independent consultant, InterVISTAS, to review its rate reasonableness processes, but the ANPRM proposals are directly at odds with the findings of that consultant. The InterVISTAS Report concludes that the Board's existing SAC test "has stood the test of time as a maximum rate reasonableness methodology."¹⁹ Though a SAC presentation entails significant "complexity and costs of preparing and litigating a case,"²⁰ this complexity flows from the economic foundations of SAC and the structure of the rail industry.²¹ As the InterVISTAS Report explains, "[b]ecause the rail industry is a network industry, when trying to determine the reasonableness of rates charged. . . ., an accurate cost analysis is necessarily a complex undertaking."²²

However, the report finds that less complex methodologies are accessible to shippers of all sizes. If "shippers want a simpler, faster and less expensive procedure," they can use the Simplified SAC and Three Benchmark test.²³ The InterVISTAS Report states that in many cases, "there is reason to believe that [shippers] can achieve similar results to Full SAC

¹⁹ InterVISTAS Report at xviii.

²⁰ *Id.* at 39.

²¹ InterVISTAS Report at viii. *See, e.g., id.* at 129 (SAC is the only methodology "that allows shippers to avoid cross-subsidization [and] benefit from the economies of scope in the [rail] network"). Notably, the InterVISTAS Report also concludes that shippers' litigation decisions contribute to the complexity of SAC presentations. *Id.* at 44 (noting that "some of the complexity can also be attributed to the effort of the shippers to develop increasingly complex [stand-alone railroads] that maximize cross-over traffic and associated economies of scope").

²² InterVISTAS Report at 40. *See also id.* at 44 (noting that the "complexity of [SAC] is a necessary exercise for those who want to estimate an economically efficient rate for the traffic in a network industry").

²³ InterVISTAS Report at 44. *See also id.* at 129 (noting that if shippers "believe that other nuances concerning their shipments need to be captured to get a more precise result," SAC should be used).

under these less-costly alternatives These results support the choice that the STB currently offers the shipper between full SAC, Simplified SAC or Three-Benchmark, with the shipper deciding whether full SAC is worth the cost.”²⁴

The InterVISTAS Report emphasizes that the Three Benchmark test is a highly simplified and cost-effective avenue for shippers with smaller claims to seek rate relief.²⁵ Because of this, the InterVISTAS Report cautions that “[a]ny additional simplification would, in our opinion, deviate further from these characteristics of CMP and would compromise the nature of the test and its adherence to the CMP principles.”²⁶ The combination of existing access to the regulatory process for shippers of all sizes and the ANPRM’s proposals to simplify the Three-Benchmark test in direct contradiction of the InterVISTAS Report and sound economic principles counsels strongly against the Board moving forward to propose rules based on the ANPRM.

Moreover, comments by shippers invoking the report by the ad-hoc Committee for a Study of Freight Rail Transportation and Regulation on behalf of the Transportation Research Board (“TRB Report”) misstate the recommendations of that report. Contrary to the assertions of ARC *et al.*, the TRB Report did not urge “basing maximum reasonable rate determinations on unregulated, market-based rail prices, as to which the Board has extensive information in its Confidential Waybill Sample.”²⁷ Instead of suggesting a rate reasonableness test, the TRB Report contemplated an alternative to the statutorily-defined

²⁴ InterVISTAS Report at 127-28.

²⁵ *Id.* at 128-29.

²⁶ *Id.* at 129.

²⁷ ARC *et al.* Opening Comments at 13-14 (citing TRB Report at 91).

market dominance screen in light of the report's criticism of the Uniform Railroad Costing System and recognition that the Board's current market dominance approach inappropriately ignores product and geographic competition.²⁸ That is, the TRB Report contemplated hypothetical reforms *outside* of the current statutory framework legislated by Congress. The statute currently in effect plainly requires a showing that the challenged rate exceeds 180% of variable cost as calculated by URCS and a showing of a lack of effective competitive alternatives. Absent legislative changes, the TRB Report offers no practical alternative for the Board to consider in this or other proceedings.²⁹

III. The Board's Standards for Evaluating Market Dominance Cannot Vary by the Size of the Dispute

There is no statutory basis for the Board to shortcut the analysis of market dominance under 49 U.S.C. § 10707.³⁰ Yet some shipper comments in this proceeding ask the Board to rely exclusively on a few broad screens as a replacement for actual analysis with the goal of sweeping rail traffic with competitive options within the Board's regulatory jurisdiction, without any particularized findings of actual market conditions.³¹

As explained in the AAR's opening comments, the Board's authority to judge the reasonableness of rates is limited by statute to cases where it makes a finding that the carrier

²⁸ See TRB Report at 141-42.

²⁹ See AAR Supplemental Comments, EP 665 (Sub-No. 1) (filed June 24, 2015).

³⁰ The AAR continues to object to the Board's "limit price" rule applied in two recent cases, for the reasons set forth in comments filed in other proceedings. See AAR Comments, NOR 42123 (filed Nov. 28, 2012); AAR Amicus Comments, NOR 42121 (filed July 24, 2013).

³¹ See ACC Opening Comments at 4-5; NGFA Opening Comments at 11-12.

possesses market dominance.³² Section 10707 requires that the Board make an affirmative finding that the transportation to which a challenged rate applies lacks effective competition.³³ But neither the ANPRM's proposed screens nor any of the modifications suggested in the opening comments provides any basis for an abbreviated market dominance test, let alone a conclusive finding of market dominance.

IV. Shipper Interest Comments in this Proceeding Highlight Problems with the ANPRM's Proposals

Many of the comments filed in this proceeding concur with the AAR's assessment that the ANPRM's proposals would be unlikely to achieve the goals set forth by the Board of lowering litigation costs, while retaining the precision and economic underpinnings of the Board's rate case methodologies. ACC states that it "does not perceive any cost savings in the modified procedure for selecting the comparison group, indeed, some of the proposals could increase costs if adopted."³⁴ Some railroads and shippers agree that the ANPRM's suggestion to replace rebuttal evidence with a staff-run hearing would not necessarily result in lower cost litigation.³⁵ Despite complaining about litigation costs, shippers question the benefits of some of the procedural tweaks proposed by the ANPRM that could limit their

³² 49 U.S.C § 10701(d)(1) ("If the Board determines, under section 10707 of this title, that a rail carrier has market dominance over the transportation to which a particular rate applies, the rate established by such carrier for such transportation must be reasonable.").

³³ 49 U.S.C. § 10707 (b) ("When a rate for transportation by a rail carrier providing transportation subject to the jurisdiction of the Board under this part is challenged as being unreasonably high, *the Board shall determine* whether the rail carrier proposing the rate has market dominance over the transportation to which the rate applies.") (emphasis added).

³⁴ ACC Opening Comments at 4.

³⁵ CSX Opening Comments at 17; ACC Opening Comments at 8-9.

ability to present evidence and argument. For example, *ARC et al.* opposes any page or word limits in evidentiary submissions.³⁶

Unsurprisingly, shipper interest comments favor those aspects of the ANPRM that would alter the existing Three Benchmark test in ways that would bring rates down, without regard for any valid economic principle. Such comments ignore the reality that differential pricing is a structural necessity in the rail industry.³⁷ For example, NGFA, *ARC et al.*, and ACC all favor allowing the Board to include in comparison groups movements traveling at rates under 180% of variable cost, as well as movements on non-defendant railroads in the comparison group that could lower the maximum lawful rate. Shipper comments start from the premise that rates that would not be found unreasonable under existing law or that are not subject to the Board's rate reasonableness jurisdiction because of an R/VC ratio below 180%, nonetheless should have "access" to a process that offers "relief." As such, according to the shipper comments, inclusion of traffic that can lower the maximum lawful rate should be the rule, regardless of the rationale. In contrast, the AAR opening comments, as well as those of railroad commenters, reminded the Board of the valid economic reasons that traffic moving below 180% of variable costs or on other railroads provide no insight to the amount of

³⁶ *ARC et al.* Opening Comments at 23.

³⁷ See, e.g., *Consolidated Rail Corp. v. United States*, 812 F.2d at 1448-49; *Potomac Electric Power Co. v. ICC*, 744 F.2d 185, 193 (D.C. Cir. 1984) (in enacting the Staggers Act, Congress understood the "necessity of such differential pricing"); *Potomac Electric Power Co.*, 744 F.2d at 194 (the "concept of differential pricing . . . necessarily contemplates that the carrier will maximize its profits on traffic for which it has no competition so as to offset its lower earnings on competitive traffic"); *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1) (STB served Oct. 30, 2006) ("The need for such demand-based differential pricing is due to the presence of traffic with competitive alternatives. If the carrier were required to charge all its shippers the same markup over cost, the competitive traffic with lower-cost alternatives would be diverted to those other transportation alternatives").

contribution to fixed and common costs a given rate should make and therefore have caused the Board to reject such proposals in the past.

Similarly, according to the shipper comments, contract traffic should be included with no adjustment to reflect the myriad of commercial factors that lead to the fact that contract rates are often lower than common carrier rates. Agricultural shippers oppose a common carrier adjustment to reflect the differences between common carrier and contract rates, even though ARC *et al.* notes that “there is no shortage of Waybill Sample data on ag shipment tariff rates.”³⁸ But lack of comparable movements traveling under common carrier rates is the fundamental basis for consideration of comparison groups that include contract movements.³⁹ The Board should see these comments for what they are and, to the extent there are sample size issues to be corrected in the Three Benchmark test, address those sample issues in the Waybill Sample.

NGFA and ACC also express support for the notion of a commodity specific RSAM, but offer no economic justification for the concept.⁴⁰ The AAR opening comments explained that even if average R/VC ratios may vary by commodities in the aggregate, they also vary within each commodity by market and by customer. Different shippers of the same commodity can and do have different demand characteristics. The Board should not abandon its correct conclusion that “[h]ow a particular carrier’s revenue requirements can and should be allocated within its traffic base - i.e., the proper markup to be applied to individual traffic

³⁸ ARC *et al.* at 21.

³⁹ See *U.S. Magnesium v. Union Pacific*, NOR 42114, slip op. at 18 (STB served January 28, 2010); *Simplified Standards*, at 83 (stating “holding everything else constant, a comparison group that consists of just common carrier traffic will be selected over a group that includes contract traffic.”).

⁴⁰ NGFA Opening Comments at 18-19; ACC Opening Comments at 12.

components - is affected by such factors as the mix of competitive and captive traffic handled by that carrier, the degree of competition that it faces on its competitive traffic, and the relative density of the routes that it operates.”⁴¹

Conclusion

Based on the foregoing, the Board should discontinue this proceeding.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'K. Kirmayer', is written over a horizontal line.

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December 19, 2016

⁴¹ *Simplified Guidelines*, 1 S.T.B. at 1033-34.