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April 15, 2003

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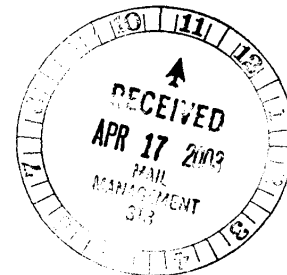
RE: Ex Parte No. 646

Gentlemen:

Enclosed for filing in this case are the original and 10 copies of written testimony submitted by the North Dakota Public Service Commission, the North Dakota Grain Dealers Association, and the North Dakota Wheat Commission in Ex Parte No. 646 – Rail Rate Challenges in Small Cases. A computer disk copy of our testimony (Windows format) is also enclosed.

Sincerely,

Jon H. Mielke
Executive Secretary

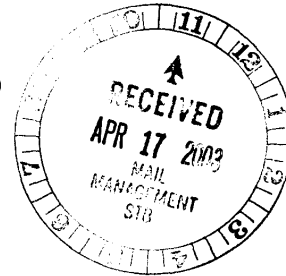


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**BEFORE THE
SURFACE TRANSPORTATION BOARD**



Ex Parte No. 646

RAIL RATE CHALLENGES IN SMALL CASES

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COMMENTS OF THE

NORTH DAKOTA PUBLIC SERVICE COMMISSION

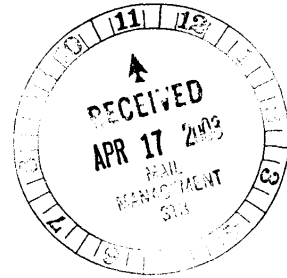
NORTH DAKOTA GRAIN DEALERS ASSOCIATION

NORTH DAKOTA WHEAT COMMISSION

Due Date: April 16, 2003
Hearing: April 22, 2003

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 646



COMMENTS OF THE

NORTH DAKOTA PUBLIC SERVICE COMMISSION

NORTH DAKOTA GRAIN DEALERS ASSOCIATION

NORTH DAKOTA WHEAT COMMISSION

Summary of Position

- North Dakota commends the Surface Transportation Board for initiating this proceeding. Changes to existing rate challenge rules are necessary if small shippers are to gain affordable and timely relief from excessive rail rates. Many wheat rates from North Dakota range from 230% - 400% of variable costs. The absence of rate complaints over the past twenty years is indicative of the fact that related procedures have been simply unworkable.
- The STB took steps, through its decisions in Ex Parte No. 627 (Market Dominance Determinations) to streamline the rate reasonableness process. While these rule changes improved the prospects for meaningful rate relief, more changes are warranted.
- Despite these recent improvements, even the simplest, most straightforward rail rate complaint proceeding remains extremely

uncertain, complicated, and costly, to the point of being prohibitive for small volume shippers.

- Before a complainant can use "small case" procedures, it faces the expensive and unpredictable threshold determination process associated with demonstrating the appropriateness of the "simplified" versus the "stand-alone cost" approach (SAC). If successful, the complainant then faces the unpredictability of the unmapped and untested "simplified" process. High costs and unpredictable outcomes discourage small volume shipper initiatives to seek warranted rate relief.
- Rate prescriptions achievable under the STB's "simplified" market pricing procedures appear to be considerably higher than might be obtainable otherwise. Small shippers might spend less money preparing a rate complaint case, but they have less to gain in the end since the resulting rate prescription would be a freight rate higher than might be achievable under SAC.
- The Board's "simplified" market pricing procedures are totally untested and the first such case would almost certainly face subsequent court appeals by the rail industry. The uncertain nature of this untested methodology may be deterring shipper complaint filings.
- Further steps must be taken to make the small rate complaint process accessible and affordable. Market dominance determinations must be straightforward and revenue to variable cost calculations must be easily calculated. These ratios should serve as the basis for rate reasonableness.
- Mechanisms that allow railroads to use their "deep pockets" and legions of attorneys to run small shippers out of time and money should be repealed in favor of processes that are predictable, simple, and affordable and which give shippers access to timely and justified relief.
- Almost certainly, the volume of rail traffic shipped by any grain elevator in North Dakota is "small" by rail rate complaint proceeding standards.

Identification

This statement is submitted jointly by the North Dakota Public Service Commission, the North Dakota Grain Dealers Association, and the North Dakota Wheat Commission (North Dakota).

North Dakota Public Service Commission - NDPSC is a three-member elected constitutional body that is charged with, among other duties, representing North Dakota's shipping interests in proceedings such as this. NDPSC and its predecessor, the North Dakota Board of Railroad Commissioners, have been active in Interstate Commerce Commission and Surface Transportation Board cases for well over one hundred years. This level of involvement is indicative of the state's historic and ongoing need for reliable, reasonably priced transportation services and of its lack of transportation alternatives.

North Dakota Grain Dealers Association - NDGDA is a 92 year-old voluntary trade association of grain elevators in North Dakota. More than 90% of the state's 420 grain elevators are members of NDGDA.

North Dakota Wheat Commission - The North Dakota Wheat Commission was created by the state legislature and exists to promote the use of wheat (flour) and durum (pasta) that is grown in the state. The Commission is financed through voluntary per bushel payments that are made by 19,500 North Dakota farmers when they sell the wheat that they produce each year.

Background

Agriculture is North Dakota's number one business. Without the ability to move its agricultural production to distant markets at reasonable and competitive rates, North Dakota's vast production capabilities lose all or part of their value. This proceeding is extremely important to North Dakota, its grain elevator industry, its economy, and individual farmers throughout the state.

North Dakota has 640,000 residents and over 70,000 square miles of land. Agriculture is the single largest industry segment within the state's economy. The state typically leads the nation in the production of spring wheat,

durum wheat, barley, sunflower, dry edible beans, and canola. Other major grain crops include corn and soybeans.

Farmers typically use their own trucks to haul grain from their farm to a nearby grain elevator / warehouse. Typical haul distances are 10 to 20 miles. Farm truck capacities range from 350 to about 850 bushels – between 1/10th and 1/4th of a single rail car.

Grain elevators serve as the primary market for farmers' grain. The state's 420 grain elevators purchase between 500 and 550 million bushels of grain per year. Elevators clean the grain and blend it with different qualities of grain to meet the exact specifications of domestic users and export markets. Many of the state's grain elevators are cooperatives that are owned by the farmers that they serve.

Over 80 percent of the grain sold by North Dakota's grain elevators each year is sent to out-of-state markets. North Dakota does not have direct access to any navigable waterways and almost all of its out-of-state markets are too distant to be effectively reached by truck. Trucks typically are not an effective way to move low value bulk commodities like grain over distances of more than 250 miles.

The average distance to North Dakota's nearest major out-of-state market (Minneapolis) is over 300 miles. Many markets, including the Pacific Northwest export market, are over 1,200 miles away. This level of captivity explains why nearly 80 percent of the grain that was shipped to out-of-state destinations during the last crop year was shipped by rail. North Dakota shippers simply have no other options. This also explains why many of the rates charged to move grain out of North Dakota generate revenue-to-variable cost ratios of 220%, 300%, or even 400%.

North Dakota's grain elevator industry is heavily dependent on rail service. Without rail, the industry would have no feasible means of transporting North Dakota grain to market. This near total reliance has a direct impact on farmers since grain is the only commodity grown by the majority of North Dakota farmers and local grain elevators are the only major market for this grain. North Dakota and its farmers and grain elevators are clearly dependent on railroads.

North Dakota is served by two Class I railroads and three affiliated short lines. The Burlington Northern Santa Fe (BNSF) operates about 1,980 miles of track in the state, including two east-west (Chicago to Seattle) main lines. Its short line affiliate, the Red River Valley & Western (RRVW) operates another 475 miles of track. Collectively, these two carriers serve about 66 percent of the North Dakota grain elevators that have direct access to rail service.

The Canadian Pacific (CP) is North Dakota's other Class I carrier. CP operates about 475 miles of track in the state, including its Chicago to Vancouver main line. Its two affiliated short lines, the Dakota, Missouri Valley & Western (DMVW) and the Northern Plains (NP) operate about 410 and 365 miles of track, respectively. Collectively, these three carriers serve about 34 percent of the North Dakota grain elevators that have direct access to rail service.

Only about three percent of the state's grain elevator locations are directly served by more than one rail carrier.

It is vitally important that the STB understand North Dakota's dependence on railroads. Like any commodity, farmers' grain is virtually worthless unless it can be delivered to buyers. Unfortunately, North Dakota farmers and grain elevators have very limited means of transporting their grain to distant markets. Given this lack of options, rail rates have a direct and immediate impact on shipper profitability and farmer income.

The price that farmers receive for their grain is based on destination market prices minus transportation charges and grain elevator margins. Elevators typically hope to achieve a margin of ten cents per bushel. This amount is used to pay operating costs and to hopefully provide a profit at the end of the year. The following example illustrates how an elevator arrives at the price that it offers farmers for their grain:

Grain Elevator Offering Price on Wheat

Minneapolis Grain Exchange Price (Delivered to Mpls.)	\$4.00 / bushel
Minus Typical Rail Delivery Charge (\$2,129 / car)	- \$.63 / bushel
Minus Grain Elevator Margin	<u>- \$.10 / bushel</u>
Offering Price to Farmers	\$3.27 / bushel

Competition in the local grain market prevents elevators from taking a larger margin and low profit levels make it impossible for them to operate on a smaller margin. Therefore, there is a direct correlation between grain prices and rail rates. As rail rates increase, elevator offering prices decline and so does farmer income.

Ultimately, farmer income translates into the land's ability to produce income. If farmer income declines, so does the value of his land. This occurrence then influences lenders' willingness to provide operating loans that are necessary to finance farm operations – farmers borrow money in the spring to buy seed and fuel, plant crops, apply fertilizer and herbicides, and eventually to harvest. When grain is sold, loans are repaid.

The railroads' influence on North Dakota's economy is enormous.

“Small” Shippers

In Ex Parte No. 586, the STB asked shippers for help in defining “big” vs. “small” shippers. In that 1996 proceeding, the Board initially suggested that a “small” shipper might be one that ships in the range of up 200 to 500 carloads per year.

NDPSC replied that, for shippers who are dealing with low value bulk commodities such as grain, this range is too low.

As indicated earlier, North Dakota has about 420 grain elevators. About 90 percent of these elevators have direct access to rail service. During the most recent crop year, these 380 sites shipped about 365 million bushels of grain by rail. This equates to about one million bushels of grain per site. One million bushels of grain is equal to about 300 rail cars.

It is important to note that grain elevators are anything but “average” when it comes to grain volumes. There is considerable concentration in the industry within North Dakota, with the 50 largest firms handling about 50 percent of the grain.

But even with these concentrations, the 50 largest grain elevator locations still handle an average of only about 3.65 million bushel of grain per location. This volume still equals only between 1000 and 1100 carloads per year.

On this point, it is critical to recognize that North Dakota grain elevators typically handle a wide variety of grains and they typically sell these grains to many different markets; not all of their rail shipments go to the same place. Spring wheat may go to Minneapolis or Portland or Buffalo, durum wheat may go to Duluth or St. Louis, malting barley may go to eastern malt plants, and feed barley may go to feed lots in the Southwest.

Conversations with one of North Dakota's largest grain elevators indicate that of the 5,000 rail cars shipped in a year, 1,500 might go to a single receiver. The remaining 3,500 cars might go to any one of 50 different destinations.

If this firm decided to pursue a rate complaint case, it is unlikely that they would have what many people would consider a "large" volume of traffic moving between a single origin – destination pair. It is also unfortunate that if this shipper was successful in a rate complaint proceeding involving its largest volume destination, the outcome would influence only a small percentage of its shipments. Obtaining relief on other traffic would necessitate more complaint proceedings.

As indicated in the introductory section of this statement, grain elevators often operate on a gross margin of about 10 cents per bushel. An elevator with an annual volume of 2.0 million bushels and a 10-cent per bushel margin would generate about \$200,000 in annual gross, post transportation expense, operating income.

While this amount of money may sound significant, it must cover all the company's non-transportation expenses including salaries, utilities, maintenance, depreciation, railroad leases, etc. Anything that is left over is profit; or money that could be used to pursue a rate complaint case.

NDPSC has approached North Dakota's Legislature and requested funding to pursue the preliminary stages of a rate complaint proceeding. To develop a related budget, NDPSC sought estimates for legal and cost consulting fees from several attorneys who are experienced in rate proceedings before the

STB. Cost estimates for the initial stages of a rate complaint proceeding approach \$250,000 (full prosecution of a rate is estimated at \$1.0 - \$1.5 million or more). Obviously, these costs would be prohibitive for even the largest of North Dakota's grain shippers, especially given the fact that these expenditures would only cover the initial stages of a possible rate complaint proceeding.

Captive, small volume shippers should not need shipper association or state government funding to seek regulatory relief from unreasonable freight rates being charged by service providers with extreme market power. Administrative remedies should be straightforward and affordable to the extent that aggrieved shippers can seek relief on their own accord.

This discussion hopefully illustrates that shipping 500 or even 5,000 carloads of grain does not make a shipper "big." In fact, it is probably more reasonable to make the "big" vs. "small" threshold in the range of 1,500 cars between a single origin – destination pair. Even a shipper with that volume would still be a small volume shipper and have relatively limited financial resources compared to the railroad that it would be litigating against.

Achievable Results

The STB has indicated that constrained market pricing (CMP) is the preferred procedure for evaluating the reasonableness of challenged rates. It has also developed guidelines for handling rate complaint cases where CMP guidelines would be too costly, given the value of the case. These are the guidelines that would be applied in small rate challenges.

When the Board adopted its small rate case guidelines, it declined to implement a firm set of rules so a potential complainant could determine beforehand whether its case qualified for the "simplified" procedures. Instead, the Board instructed small rate case complainants to proceed with a case-by-case demonstration of why they regard their case as being too costly for the CMP guidelines. As a result, there is at least a perception, if not a reality, that small rate cases may begin with a costly dispute regarding the eligibility of the

complaining party.

CMP guidelines and the provisions of the Staggers Act make rate prescriptions of as low as 180 percent of variable costs achievable in such cases. Small volume shippers could not hope to achieve similar results if they pursue rate relief through a non-CMP complaint process.

As outlined by the STB, non-CMP proceedings may look to at least three indicators to determine reasonable rate levels: "Revenue Shortfall Allocation Method" (RSAM), "Average Revenue-to-Variable Cost > 180" (R/VC >180), and "Average Revenue-to-Variable Cost Ratios on Comparable Traffic." The Board published related carrier-specific, regional, and national percentages in its May 2, 2002, Notice in Ex Parte No. 347 (Sub-No. 2) – Rate Guidelines – Non-Coal Proceedings.

In that Notice, Burlington Northern Santa Fe's 4-year average RSAM was determined to be 210-282 (without and with efficiency adjustments). Its 4-year average R/VC >180 for traffic above 180% R/VC was pegged at 264.

The lower RSAM number reflects an efficiency adjustment in which the STB throws out consideration of all shipments with R/VC ratios of less than 1.0. Theoretically, the R/VC ratio of a shipment could be lowered to 210 without jeopardizing the revenue adequacy of the railroad. That would be the lowest rate achievable if this indicator was used in a small shipper rate challenge proceeding. The railroad would, however, argue strongly for using the higher number, without the efficiency adjustment. No one knows how the STB would rule on this issue, so the complaining party, rather than having a chance at achieving rate prescription at a 180% R/VC rate level, may see prescription at somewhere between 210 and 282.

When determining rate reasonableness in non-CMP cases, the Board has indicated that it will also use revenue-to-variable cost ratios on all captive traffic as an indicator. Under this approach and using the BNSF 4-year average of 264, if the R/VC ratio on the contested traffic is found to be below 264, then the R/VC ratio for that shipper would be lower than the average for all of the carrier's captive traffic. Again, no one knows how the STB would interpret this finding but one outcome might be that, if the complaining shipper is less captive than this

average, no rate relief is warranted.

The Board has also identified a third indicator that might be used to determine the reasonableness of rates charged to a complaining captive shipper – average revenue-to-variable cost ratios on comparable traffic. Like the two already-discussed indicators, this approach is laden with uncertainties and inevitable debates over “comparable” traffic determinations.

In its December 27, 1996, Decision in Ex Parte No. 347 (Sub-No. 2), the Board said, “. . . each of the benchmarks will be introduced and can be subjected to scrutiny . . . the benchmarks serve merely as the starting point of an analysis that should be further developed and tailored to the individual case.” Potential complainants must, therefore, be ready to argue all of these benchmark approaches in proceedings before the Board.

Obviously, all these givens and unknowns put a great deal of risk into a shipper's deliberations concerning the possible filing of a rate complaint case. Rather than obtaining rate prescription in the 180 RVC range, prescription in the range of 245 to 265 might be expected.

At this point, a real world risk-reward example may be appropriate. At the present time it costs the equivalent of about \$3.07 per mile to ship a carload of wheat from north central North Dakota to the Pacific Northwest export market. It costs about \$2.64 per mile to ship a carload of wheat from western Nebraska to the same destination.

Let's assume that we are dealing with one of North Dakota's largest grain shippers that sends 1,500 carloads of wheat to a single PNW destination each year. At \$4,030 per car, the annual freight bill for these shipments is just over \$6 million.

Even though the distance to market from Nebraska is about 150 miles farther (about 225,000 car miles per year), a comparable Nebraska shipper would have an annual freight bill that is about \$200,000 less than its North Dakota counterpart. If the North Dakota shipper had the same per mile rate as the Nebraska shipper, its rate would decline from \$4,030 per car to about \$3,466 per car. Annual savings would equal \$846,000. If these savings were passed on to farmers in the form of high offering prices for their grain, per bushel prices

would increase by \$.16 or about 5%. This price increase goes directly to the farmers' bottom line as net income.

If the North Dakota shipper wanted to pursue rate relief to obtain a comparable, more reasonable rate, it would first have to prove market dominance. Related costs would be incurred.

Assuming success, the shipper would then proceed with the rate reasonableness phase of the proceeding before the STB. If the shipper chose to pursue relief under the CMP process in order to achieve maximum possible rate relief, costs might exceed \$1 million. For a small shipper with limited resources, this approach is simply impractical.

The shipper's next option would be to consider the non-CMP approach. Unfortunately, as discussed earlier, the rewards that might result from this approach could be far less, especially if the R/V/C ratio on the Nebraska traffic is in the 180 to 200 range. With untried processes before the Board and huge uncertainties relative to possible returns, possible rewards hardly warrant the risks of pursuing rate relief.

With high known costs, probable procedural delays, uncertain STB approaches concerning non-CMP methodologies, and a wide range of prescriptive relief possibilities, it should not be surprising that no small shippers have approached the STB seeking rate relief. As mentioned earlier, a shipper should not have to appeal to an entity like state government for help to access the levers of relief to which they are entitled under the law. But we are concerned that is precisely the type of system we currently have in place. Something has to change or shippers and, in this case, farmers, will continue to pay unreasonable rates with very little prospect of relief.

Railroad Tactics

Rules and procedures in small shipper rate complaint proceedings must be simplified or the challenged railroad will merely run the challenging shipper out of money before the matter is resolved.

The rail industry's primary tactics in the past has been to erect hurdles in the adjudicatory process and to drag proceedings out as long as possible. Being the "biggest dog in the fight" and having the "deepest pockets," the rail industry is typically able to wear the other side down or to simply run its opponents out of money. Ironically, the shipper also pays for both sides in these cases – it pays for its own plus it pays for the railroad's via unreasonable rates.

The rail industry's tactics in this regard were described especially well in The Western Coal Traffic League's filing in STB Ex Parte No 638 – Procedures to Expedite Resolution of Rail Rate Challenges to be Considered Under the Stand-Alone Cost Methodology. Unfortunately, these tactics are even more effective in cases involving small shippers. By nature, these entities are small, they are not represented by well-funded associations, and they do not participate in STB rulemaking proceedings because doing so is simply cost-prohibitive. As a result, the Board's primary source of input is from the rail industry and the resulting rules disproportionately reflect the interests of only one of the eventual combatants.

The Board should not allow such occurrences to continue. As is the case in many state jurisdictions, the Board should establish a consumer advocacy office to represent small shippers in pending rulemaking proceedings. The creation of such an office would ensure representation of the interests of entities that are virtually incapable of representing themselves.

The Board should also modify existing rules and promulgate new ones, if necessary, to level the playing field and ensure that justice, in the form of reasonable rail rates, would be available in both an affordable and timely manner. Unaffordable and untimely justice is justice denied.

Conclusion

The Surface Transportation Board has made significant strides towards making rate relief more achievable. The foregoing discussion illustrates, however, that the Board's procedures regarding the processing of small shipper

rate complaints should be modified even further to ensure that small volume shippers are provided the meaningful access to the relief intended by Congress. The existing "simplified" approach is overly complex, cost prohibitive, and untested. Board decisions appear to be incapable of yielding rate prescriptions near the reasonableness standards recognized by the Staggers Act and they are likely to be appealed.

The Board should establish a consumer advocacy office to represent small shippers in agency rulemaking proceedings.

If the Board feels that existing statutes preclude it from developing mechanisms that will provide small shippers with timely and affordable access to reasonable rates, it should aggressively work with Congress to craft legislation that will provide small shippers with relief from monopolistic railroad practices. The economic well being of vast regions of the country are dependent on this occurrence.



Tony Clark, President
North Dakota Public
Service Commission

Date: April 15, 2003