

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 646 (Sub-No. 1)

RAIL RATE CHALLENGES IN SMALL CASES

COMMENTS OF
CARGILL INCORPORATED

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COMMENTS OF CARGILL INCORPORATED

Cargill Incorporated ("Cargill") hereby submits comments in the above-captioned proceeding. While this rulemaking is an important and long overdue step towards ensuring effective regulatory rate protection for all captive shippers, the Board's proposals fall far short of this goal and in fact may make the current bad situation even worse.

I. STATEMENT OF IDENTITY AND INTEREST.

Cargill, which is headquartered in Minnetonka, Minnesota, is an international provider of food, agricultural and risk management products and services. Founded in 1865 as a single grain elevator in the United States, today Cargill employs more than 152,000 people in 61 countries in the areas of crop and livestock, food, health and pharmaceutical, industrial, and financial and risk management.

Rail transportation is a critical part of Cargill's food and agriculture businesses and rail costs have a significant impact on their operations. Cargill ships commodities to or from 239 rail-served facilities in the United States, of which 150, or 63%, are captive to a single railroad.

In any given year, Cargill may tender between 300,000 and 500,000 car loads to destinations throughout the United States. Its largest volume moves are of wheat and grain to export facilities on the Gulf Coast. Significant volumes of other commodities also move from the Midwest to California, Texas, and the Southeast. Much of Cargill's rail volume, however, consists of fewer than 20 cars per year moving to a single destination. Most of Cargill's rail movements either are not truck competitive at all, or not at distances over 200 miles.

Cargill relies upon rail transportation to haul dozens of agricultural commodities. In addition, Cargill has a growing ethanol business. Some of the largest volume commodities handled by rail for Cargill are wheat, corn, corn syrup and soybeans, which account for nearly

half of Cargill's total rail volume. A little over half of Cargill's total rail volumes for all commodities is captive to a single railroad. Across all commodities individually, however, the level of captivity ranges from 0% to 100%. The revenue/variable cost ("R/VC") on most commodities is above 200%, and in some cases exceeds 400%.

Due to its high dependence upon rail transportation, Cargill requires meaningful and effective regulatory constraints upon the exercise of market power by rail carriers at Cargill's captive facilities. Currently, such constraints are non-existent.

The idea that existing regulations constrain rates on captive traffic is unrealistic, since the railroads know that the economics do not justify a rate case even at the exceedingly high levels of recent rate increases. For example, one major railroad recently increased its rates to Cargill from 135% R/VC to 221%. Moreover, there is no predictability in the current standards that would allow the parties to conduct a cost-benefit risk assessment based on the most predictable outcomes of a rate case. This rulemaking must address these issues in order to offer any effective regulatory options to most captive shippers.

II. INEFFECTIVENESS OF CURRENT RATE REGULATION.

The STB's current standards and procedures for regulating rail rates do not offer Cargill any protection from unreasonable rates on its captive traffic. They are too complex, consume too much time, and cost too much money. As such, the current standards are neither practical nor cost-effective, even at the significantly higher rate levels that Cargill has been quoted recently on its captive traffic.

Although the Board's preferred regulatory standard is stand-alone cost ("SAC"), Cargill cannot justify a SAC complaint due to the huge investment of time and money that is required. The cost of prosecuting a SAC case easily exceeds \$4 million and consumes 3-4 years. Cargill

can ill-afford to pay higher rail rates on top of its litigation costs for 3-4 years knowing that it may not obtain any relief at the end of the process. Because Cargill deals in large measure with true commodities, very small cost changes can make all the difference in whether or not Cargill retains a customer. Also, because much of Cargill's business is transactional, it can fluctuate with a high degree of volatility that is not amenable to a SAC case.

Although the Board has had small case guidelines (the "three-benchmark approach") in place for over a decade, those too have proven to be ineffective. The standards have been less than clear, which makes it extremely difficult to assess the value of a case and the risks. Eligibility to use the three-benchmark approach also has been uncertain. These factors have combined to render litigation costs highly speculative, as well. Overall, this state of uncertainty has discouraged cases under the three-benchmark approach and rendered that approach ineffective as a constraint on rail pricing by market dominant carriers.

Greater clarity and predictability in regulatory standards actually helps to prevent rate cases. When there are meaningful standards that are applied consistently, shippers and carriers can predict at least a narrow range of probable outcomes from a rate case. This provides incentives for them to reach a negotiated commercial agreement based upon that range, their anticipated litigation costs, and various risk factors. As a result, a rate case should be the exception rather than the rule. Because the three-benchmark approach offers neither consistency nor predictability, it does not constrain rail rates. Nor does the SAC approach, which is too costly and time-consuming for most captive shippers.

The STB must address these flaws in the current rate standards if this rulemaking is to have any positive impact upon captive shippers. Otherwise, the Board's efforts are wasted if it merely replaces one ineffective regulatory regime with another equally ineffective regime.

III. THE BOARD'S PROPOSALS FALL FAR SHORT OF OFFERING EFFECTIVE REGULATORY OPTIONS.

The Board's proposed guidelines fall far short of establishing meaningful and effective regulatory standards that address the complexity, cost and timing issues that exist in the current guidelines. Indeed, Cargill believes that the Board has proposed a regulatory regime that will leave captive shippers in a worse position than they are today.

A. There Are Substantial Problems With Both The SSAC And Three-Benchmark Proposals.

There are many elements in the Board's proposal that concern Cargill. Due to the complexity of the substantive standards proposed by the Board for the three-benchmark and Simplified-SAC ("SSAC") approaches, Cargill will only comment briefly on them and defer to the more thorough review and assessment that various trade associations, including the National Grain and Feed Association, have prepared and presented in joint comments.

Overall, Cargill believes that the Board's proposal to adopt a three-tiered regulatory approach to replace the current two-tiered approach is unnecessary and unjustified. Currently, the SAC approach is the Board's preferred, and thus its default, standard for large cases and the three-benchmark approach is applicable to qualifying small cases. In this rulemaking, the Board has proposed to adopt a middle tier for so-called "medium-sized" cases, based on an approach called "Simplified-SAC." The Board also has proposed to modify its three-benchmark standard. While Cargill commends the Board for its attempt to improve the three-benchmark standard, the SSAC does not offer any meaningful and effective regulatory constraint and should be abandoned altogether.

1. SSAC is too complex, costly, and time consuming.

SSAC appears to be anything but simple, timely and inexpensive. To begin with, 18 months is much too long to obtain a Board decision. Any rate process should conclude within

six months in order to be effective for the highly competitive commodities markets in which Cargill must function. Furthermore, because SSAC requires annual “true-up” calculations, there is a substantial likelihood of having to relitigate many issues each year throughout the 5-year rate prescription period, consuming more time and more money that the Board has failed to factor into its proposals.

SSAC sacrifices accuracy for a dubious claim of simplicity. Moreover, it mandates a rate higher than SAC. By depriving the complainant in an SSAC case of the ability to optimize the stand-alone railroad, the traffic on the SSAC will make less of a revenue contribution than Full-SAC traffic to the same fixed investment and operating costs. Also, because the SSAC costs are not adjusted for operating inefficiencies, costs are likely to be greater than a Full-SAC analysis. Therefore, at best, SSAC will produce a result equal to Full-SAC, but in all probability much higher.

In light of this result, why should there be any eligibility threshold for SSAC? If a complainant truly finds SSAC to be simpler and less costly than Full-SSAC—which Cargill doubts—and further concludes that this benefit outweighs the higher rate compared to a Full-SAC analysis, then that complainant should have the option to use SSAC at *any* case value. There is no reason to establish a maximum threshold for SSAC, since there is no risk that the rate will be below SAC, which is the Board’s preferred standard.

2. The three-benchmark standard still lacks timeliness and predictability.

Cargill applauds some of the Board’s modifications to the three-benchmark approach as a step in the right direction, but many elements of the proposed modifications continue to concern Cargill. First, 9 months for a decision continues to be too long for Cargill’s practical business needs. A proper time frame, at the outside, should be 180 days.

Second, The Board's decision to deny complainants access to the unmasked Waybill data until the end of a case undermines the principal objective of reasonable predictability and is fundamentally unfair to the shipper. As Cargill has stated above, a rate case should be the exception rather than the rule. If a standard is meaningful and predictable, carriers and shippers alike will be able to negotiate contract rates around that standard without resorting to the Board at all. But, without access to the unmasked Waybill data, the shipper will have no ability whatsoever to make this assessment, since it will not have access to critical data that the Board would use to determine a reasonable rate. The carrier, on the other hand, will have full access to that data from the start, giving it a significant advantage and enabling it to manipulate the regulatory process.

B. The Proposed Eligibility Guidelines Are Flawed.

It does not matter how effective a substantive standard the Board adopts if no one qualifies to use that standard. Cargill believes that the Board's eligibility thresholds are unrealistically low by a tremendous margin and that its methodology for determining eligibility is prone to manipulation by the railroads. Thus, the Board's proposed eligibility test will continue to leave most captive shippers without regulatory protection from monopoly rates.

1. MVC overstates the actual value of a case and invites carrier manipulation.

The Board has proposed to determine eligibility to use the SSAC and three-benchmark approaches based on the "Maximum Value of the Case," or "MVC." This proposal stems from the statutory mandate that the Board "establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full-stand-alone cost presentation is too costly, *given the value of the case.*" 49 U.S.C. §10701(d)(3) [emphasis added]. But, MVC, rather than considering the actual value of a case as required by statute,

substantially overstates the actual value of the case to the complainant and is subject to manipulation by the railroads.

MVC measures the difference between the challenged rate and 180% of revenue/variable cost ("R/VC"), based on the premise that the Board cannot prescribe a rate below that level. But this "maximum" value will almost never be the "actual" value of a case, since it is highly unlikely that any of the potentially applicable rate standards will prescribe a rate at or even near 180% R/VC. Furthermore, the prescribed rate may exceed 180% R/VC by widely divergent margins depending on the commodities at issue, thereby offering regulatory protection to some captive shippers, but not others.

Cargill would never use MVC to decide whether to bring a rate complaint. Rather, Cargill would estimate the actual value of the case based on a prediction of the probable outcome.¹ MVC has no significance other than as a statutory floor on potential relief. But, when the actual relief is far less than the maximum potential relief, there is no rational connection between these amounts that could justify using MVC as a surrogate for the actual value of a case. Because MVC lacks any connection to the actual value of a case, it does not comply with the statutory requirement for eligibility to use small case standards.

Railroads also can easily manipulate the MVC by setting tariff rates at levels that exceed the designated thresholds. If contract negotiations between a shipper and carrier break down over rate levels, the shipper must request common carrier rates in order to challenge them as unreasonable before the Board. It will be quite clear to the railroad that the shipper is requesting a common carrier rate so that it can file a rate complaint. The railroad will have both the ability and the incentive to set the tariff rate sufficiently high to force the shipper into a Full-SAC case,

¹ The Board's refusal to grant complainants access to the unmasked waybill data, however, makes it extremely difficult for a shipper make this assessment with any degree of confidence.

even if the contract rate previously offered by the railroad would have qualified for a lesser standard.

Under this scenario, the actual value of the case in reality will be the difference between the contract offer (rather than the tariff rate) and the prescribed rate. But, the shipper's eligibility to use a lesser standard would be based on the artificial MVC measure that the railroad has inflated by quoting a higher tariff rate. Thus, even though a Full-SAC case would be too costly given the actual value of the case, the shipper will not qualify to use a lesser standard because of the inflated MVC.

The Board should abandon the MVC concept altogether and focus on criteria that bears a more rational connection to the actual value of a case to the shipper. A good starting point is the annual freight spend of the shipper on the issue traffic. Whatever methodology the Board ultimately adopts, however, it must include all cost factors, including a risk premium.

2. The proposed thresholds are unrealistically low.

In addition to MVC being an unsuitable proxy for the actual value of a case, the Board has proposed thresholds to submit a three-benchmark or SSAC case that are far too low. These thresholds are based upon unreasonable assumptions and fail to account for numerous important cost and risk factors.

The proposed thresholds are based upon unrealistic assumptions of the litigation costs associated with each of the three proposed standards. For Full-SAC cases, the Board assumes a \$3.5 million estimated litigation cost based upon a figure that is two years old, and the Board assumes unrealistically that this cost will decline based upon changes that it has proposed in Ex Parte No. 657 (Sub-No. 1). But, experience shows that the complexity of SAC cases continues to increase as the analysis becomes more sophisticated and new issues continue to surface. Even

if the STB's proposals in Ex Parte No. 657 simplify *some* past complexities, there is no reason to believe that new issues will not continue to arise as SAC presentations evolve.

The Board also unreasonably assumes that an SSAC case will cost only \$200,000 to prosecute. The Board bases this assumption upon an untested estimate of \$25,000 to \$85,000 submitted by railroad witnesses over 10 years ago. The shipping community has never accepted the railroad estimates. Moreover, the SSAC proposal submitted back then, which was a computer model that calculated a final answer, does not bear any resemblance to the SSAC approach proposed by the Board, which requires substantial litigation to resolve disputes over the evidence submitted by the parties. The level of complexity that still exists in the SSAC standard leads Cargill to believe that the true cost of an SSAC case is many times greater than the Board assumes.

Moreover, the Board's proposed eligibility thresholds ignore additional costs incurred by a complainant beyond its fees for counsel and consultants. These include both out-of-pocket costs, such as discovery compliance and travel, and internal costs, such as management time. In addition, the Board has not included a risk premium in its litigation cost assumptions. The potential return from a rate case must recover more than just litigation costs; it must recover a factor sufficient to compensate for the risk that the case will be unsuccessful and for the opportunity cost associated with the time, money, and resources dedicated to a rate case. These are real costs that Cargill would consider in addition to its legal and consulting fees. In addition, by setting thresholds at estimated litigation costs, the Board assumes that a shipper would bring a rate case even if its prospects, at best, were to break-even. The absurdity of this conclusion is self-evident.

The Board gives no consideration to the high probability that the railroads will strive to make rate cases as complex, and therefore costly, as possible. Railroads clearly have every incentive to do so in order to discourage shippers from filing rate cases and to undermine the assumptions underlying the MVC thresholds. It is unrealistic for the Board to assume otherwise, because that is precisely what has occurred in Full-SAC cases. Therefore, the MVC thresholds should be several factors greater to reflect much higher litigation costs and to include other costs that the Board has neglected in its assumptions.

The Board further constrains the value and effectiveness of any small case standard by requiring complainants to aggregate multiple O-D pairs when calculating the MVC. This will require many of the cases that might qualify for a lesser approach to be filed as either SSAC or Full-SAC cases. The impact will be greatest on large shippers, such as Cargill, which have tremendous numbers of small cases, but will be required to aggregate them into larger cases as a consequence of this rule. In essence, the aggregation rule is an "end-run" around the statutory requirement that the Board develop alternatives to SAC for small cases, not small shippers. The effect of the aggregation rule would convert the "small case" rule into a "small shipper" rule, in violation of the statute.

While the Board justifies the aggregation rule as necessary to preclude "gaming" by shippers, it is the railroads which have the incentive and ability to game the proposed process. The railroads have access to much more information than the shippers and they control more of the factors that determine the eligibility thresholds. Shippers, on the other hand, would incur additional time, expense and effort to pursue separate rate cases, as opposed to aggregating them into a single case, for speculative gain. The Board has expended way too much effort trying to prevent gaming by shippers that is not really gaming under statute, while ignoring the

unquestionable incentive of railroads to game the MVC in a way that contravenes the statute's objectives.

3. The proposed thresholds will continue to leave most captive shippers without effective regulatory rate constraints.

The proposed eligibility thresholds still would deprive most captive shippers of a cost-effective regulatory constraint on rail rates. While many movements may qualify for SSAC, Cargill believes that very few will qualify for the three-benchmark approach, particularly after application of the aggregation rule. Cargill finds the Board's eligibility estimates on page 37, Table 2, to be implausible. However, because the Board has refused to provide the workpapers underlying this Table, there is no way for anyone to verify or challenge these estimates.

Common sense demonstrates that, at the proposed eligibility cap of \$200,000, the three-benchmark standard will never be used by any shipper. Very few shippers will ever qualify to use this standard, and the few that do qualify would never expend the time, money and effort to pursue a case. An MVC threshold of \$200,000 over 5 years would permit only the very occasional shipper to use the three-benchmark approach. But \$200,000 is likely to be the cost of just litigation. Under this set of facts, it would be impossible for a complainant to do better than break-even, and then only if the MVC truly equals the actual case value. If the actual value is less than MVC (which is a virtual certainty), the shipper actually would lose financially even if it won the case. Moreover, even if one generously assumes that litigation costs are as low as \$50,000, the potential financial gain hardly justifies the time, effort, expense, and risks associated with prosecuting a three-benchmark case.

Cargill analyzed the following five high fructose corn syrup movements of varying annual volumes to illustrate its concerns with the proposed MVC thresholds:

Origin	Destination	Annual Cars	R/VC	MVC
Dayton, OH	Twinsburg, OH	11	247	19,356
Memphis, TN	McDonough, GA	24	224	44,187
Dayton, OH	Discovery Park, OH	52	426	195,147
Chicago, IL	Kendallville, IN	381	320	1,015,293
Decatur, AL	Hapeville, GA	625	258	1,407,064

While the three smallest movements of approximately 50 cars or less would qualify for the three benchmark approach (the third one just barely), Cargill would not consider the benefits to outweigh the costs even on the movement with the highest R/VC of 426%. Cargill believes that the true value of that case would be much less than the MVC, rendering this a marginal case despite its extremely high R/VC. The most troubling aspect of this example, however, is that this movement is on the very cusp of the far more costly SSAC approach, even though a rate case would be marginal under the three benchmark approach.

The two larger volume movements would fall within the SSAC approach. But their MVC is very close to what Cargill believes would be its actual litigation costs. Furthermore, as discussed above, the MVC clearly overstates the actual value of these cases to Cargill, since a rate prescription is unlikely to be as low as 180% R/VC. These movements present marginal rate cases even under the three benchmark approach, and never would be considered at all under SSAC.

Although the eligibility thresholds are rebuttable presumptions, that response would miss the point. Presumptions should be rebuttable to address the exceptional circumstances. The Board's proposals, however, would require almost every shipper to rebut the presumption, which adds even more cost and uncertainty to the process. This would leave shippers with precisely the

same uncertainty they face as to their eligibility to use the current three-benchmark standard.

Thus, nothing will have improved over the current situation, and probably will be worse.

IV. Conclusion.

Although Cargill welcomes this proceeding, it is discouraged by the proposals. The Board should abandon the SSAC concept altogether as too costly, complex and time consuming, which is contrary to the statutory requirement for small rate case standards. Instead, the Board should reform the three-benchmark approach and significantly raise the eligibility criteria, using an approach other than MVC that is predicated on the actual case value. The Board must ensure that *all* captive shippers for whom a SAC presentation is too costly given the actual value of the case are eligible to use the three-benchmark approach. Without such assurances, this rulemaking will accomplish nothing other than to confirm the irrelevance of regulatory rate protections to the vast majority of captive shippers.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that I have on this 24th day of October, 2006, served a copy of the foregoing Comments on all parties of record, by first-class mail, postage prepaid.

A handwritten signature in black ink, appearing to read 'Aimee DePew', written over a horizontal line.

Aimee DePew