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STB Ex Parte No. 665 (Sub-No. 2)
Expanding Access to Rate Relief

Reply Comments of the
U.S. Department of Agriculture

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AUTHORITY AND INTEREST

The Agricultural Adjustment Act of 1938 and the Agricultural Marketing Act of 1946 charge the Secretary of Agriculture with the responsibility to represent the interests of agricultural producers and shippers in improving transportation services and facilities by, among other things, initiating and participating in Surface Transportation Board (Board) proceedings involving rates, charges, tariffs, practices, and services.

INTRODUCTION

The U.S. Department of Agriculture (USDA) appreciates the opportunity to respond to the Board's request for input on how to ensure its rate complaint procedures are accessible to shippers and provide effective protection against unreasonable rail transportation rates.

In this proceeding, the Board is seeking input on its Advanced Notice of Proposed Rulemaking (ANPR) where the Board proposed to move away from development of a rate review procedure for grain shippers to a procedure for small disputes of any commodity. The ANPR sets out the goal of creating a lower cost and streamlined rate review process. The process involves a set of eligibility criteria and a revised selection process for a comparison group, both intended to reduce the evidentiary burden on shippers and railroads. The ANPR also includes suggested limits on discovery, market dominance evidence, other relevant factor evidence, and relief values.

In these comments, USDA provides input on each of these aspects of the ANPR. USDA agrees with the goals of the proposal to provide a more accessible rate review procedure. The first section outlines the need and justification for an additional rate review process. The remaining sections describe USDA's perspective on how to improve the ANPR to accomplish the Board's stated goals. In the second section, USDA recommends the Board rely on abbreviated timelines to reduce costs and limit the complexity of evidence. Further, USDA recommends the Board use a final offer methodology, as in the Three-Benchmark (3B) test, but expand the process to include other pieces of evidence. In the third section, USDA provides its perspective on effective eligibility criteria. In the fourth section, USDA proposes a practical rate reasonableness standard to address some of the concerns from commenters and embraces recommendations from commenters and the recent Transportation Research Board (TRB) study. The fifth section discusses USDA's perspective on relief limits. The sixth section combines USDA's recommendations into a proposed procedural schedule. The final section concludes.

THE NEED FOR CHANGE IN RATE REVIEW

Contrary to the repeated claim from the Class I railroads and the Association of American Railroads (AAR) that the lack of rate cases from grain and agricultural shippers is merely evidence that their rates are reasonable, grain and agricultural shippers have many reasons to believe that their rates may be unreasonably high. Shipper testimony to the Board and third party studies document the legitimacy of these concerns. Shippers do not use the existing rate review procedures because they are too costly, lengthy, and uncertain.

It is important to remember the EP 665 proceeding was prompted by the 2006 Government Accountability Office (GAO) study which pointed out that grain shippers had benefited much less from the Staggers Act than other shippers. The GAO wrote, “[F]rom 1985 through 2004, coal rates declined 35 percent while grain rates increased 9 percent.”¹ Even still, coal shippers have been the most active users of the existing rate proceedings before the Board. That is somewhat unsurprising, given the design of the Stand Alone Cost (SAC) test was for concerns about the appropriateness of coal rates, but it emphasizes the fact that grain shippers need a rate review process that works for them. The recent Transportation Research Board (TRB) study highlighted similar trends when it noted, “None of the recent developments, all of which would seemingly favor lower rates (i.e., further shipment consolidation, dedicated trains), explains why rates for shipments of grain and oilseeds rose faster than rates for shipments of other commodities except coal.”² These studies make clear that grain shippers, more than many other shippers, deserve accessible rate review.

Railroads often make the valid and widely understood point that differential pricing is an essential part of the railroad industry. The question before the Board now, however, is how much differential pricing is reasonable.³ Yet, it is worth pointing out that railroads also claim that this is proceeding is unnecessary because railroads operate in competitive markets.⁴ Unfortunately, for the railroads it is not logical to both claim to operate only in competitive markets and to argue that differential pricing is essential. The theory of differential pricing, or so-called Ramsey pricing, applies only to firms with monopoly market power. If railroads only operated in competitive markets, economic theory says it is not possible for them to differentially price. Therefore, if railroads are relying on differential pricing to cover their fixed costs they can and sometimes do exercise market power. This is not a characteristic of a competitive market. This does not imply that railroads never compete, because they sometimes do, but rather it says that the argument of operating only in competitive markets is less than intellectually honest.

As noted by the Board, our country’s rail transportation policy (RTP) (49 U.S.C. § 10101) requires careful balance between the sometimes conflicting goals of assuring reasonable rates and preserving the ability of railroads to achieve adequate revenues. The railroads point to SAC as the only valid implementation of RTP, but this is a slanted interpretation of the goal of the RTP and the SAC test.

The value of SAC itself is questionable. As discussed by Dr. Russell Pittman during the recent STB roundtable on the issues and conclusions of the Board’s commissioned study of rate case methodologies, SAC is not an obviously effective way to promote fairness, prevent inefficient

¹ Government Accountability Office, *Freight Railroads: Industry Health has Improved, but Concerns about Competition and Capacity Should be Addressed*, 2006, pg. 9.

² Transportation Research Board, *Modernizing Freight Rail Regulation*, 2015, pg. 65.

³ For instance, the Association of American Railroads (AAR) noted, “the question for the Board in regulating rates simply is what *degree* of differential pricing should be allowed on traffic without effective competition.” (AAR, *Comments to the Surface Transportation Board*, EP_665_2_242040, November 14, 2016, pg. 12.)

⁴ For example, AAR wrote, “Most railroad customers have competitive options when considering rail transportation, either by shipping by other railroads, shipping by other modes, utilizing a combination of both by transloading, substituting different products with different transportation costs or shipping to or from different markets. ... The record compiled in EP 665 (Sub-No. 1) does not support the conclusion that there are a significant number of shippers whose traffic is not subject to effective competition and who are being charged unreasonable rates.” AAR, *Comments*, pg. 9.

entry, replicate competitive markets, or prevent cross-subsidization.⁵ Nevertheless, the Board seems to view SAC as the “gold standard” of rate reasonableness. However, an indisputable deficiency of SAC is that it is too costly and complex for all but a few shippers and rate disputes. The point behind having a rate reasonableness standard is to put some kind of limit on differential pricing when needed. No matter how accurate a test is, if it is inaccessible, it is a poor limit on unreasonable rates and differential pricing.

USDA recognizes this proceeding is not an evaluation of SAC, but the weaknesses of SAC are important for two reasons. First, those weaknesses, along with the fact that multiple independent studies point to the possibility of unreasonable rates, justify the need for alternative rate reasonableness standards. Second, those weaknesses question the appropriateness of modeling alternative rate reasonableness tests after SAC. Under the auspices of STB’s historical decisions, both Simplified SAC (SSAC) and 3B were designed to tradeoff accuracy of measuring SAC for accessibility. Agricultural shippers among others have not seen either test as accessible or as a particularly good measure of reasonable rates. It is not clear that the current ANPR, which goes further down this hierarchy, will be able to accomplish the goals of RTP and provide a rate review process that acts as a truly effective check on unreasonable rates. It is worth thinking about truly new alternative approaches instead of attempting to develop more “mini-SAC” tests.

To devise an effective new procedure, it is essential to understand why the existing procedures are ineffective. Given the strong possibility of unreasonable rates, USDA’s comments in 2014 (EP 665-1) explained why grain shippers have not used the existing rate review methodologies. To do so, USDA used an expected value model. The expected value of the case is a function of the value gained by the shipper upon winning, costs of litigation, and the probability that a shipper assigns to winning or losing the case. A shipper will only bring a case forward if there is a positive expected value to doing so. USDA’s contention is that, while some shippers face unreasonable rates, the structure of the rate review processes results in: (1) a relatively low value to winning a case, (2) a relatively high cost of litigation, and (3) a relatively high degree of uncertainty regarding case the case outcome.

The Board has rightly recognized that the existing rate review processes are ineffective for rate disputes with smaller values. Regardless of the uncertainty of a case outcome, under the current rules, grain and agricultural shippers with smaller disputes cannot expect a high enough case value to cover the costs of litigation. For this reason, USDA appreciates the Board’s purpose of trying to devise a lower cost proceeding.

However, while grain and agricultural shippers might benefit to some degree from a small dispute proceeding involving multiple commodities, the current proposal ignores the fact that existing processes are *particularly* ineffective for agricultural shippers. Agricultural markets are highly variable. The opening comments of the National Grain and Feed Association (NGFA) in this proceeding illustrate multiple ways in which agricultural markets have dramatically changed

⁵ Surface Transportation Board, *Economic Roundtable Discussion: Issues, Conclusions of the Independent Study (the “InterVISTAS study”) on Railroad Rate-Case Methodologies*, October 25, 2016. For more, see Pittman’s published paper, “Against the stand-alone-cost test in U.S. freight rail regulation” (Journal of Regulatory Economics, 2010).

in just the past decade.⁶ Agricultural shippers face a significantly lower value of winning a case because a case can take years to complete and prescribe a remedy over routes that the shipper is no longer using. A lower expected case value combined with high costs explains why agricultural shippers have not brought a case.

As in our opening comments, USDA encourages the Board to go back to the original idea of developing a new methodology to ensure grain and agricultural shippers have meaningful ways to challenge the reasonableness of their rates, rather than shifting to try to devise a small dispute procedure that is available for all shippers. As will be discussed throughout these comments, the Board could create a more effective rate review procedure by tailoring the specifics of the method to the needs of agriculture, similar to the development of existing procedures for coal and its unique needs. USDA encourages the Board to see agriculture as a test case or “pilot project.” If it works, it can then serve as a model for a dispute procedure that can be adapted for use by other shippers. This could be a way to innovate and experiment with an important sector with a demonstrated need, but reduce the chances of larger impacts from other sectors if it does not work as expected. Such a pilot may also shed light on improvements that can be adapted for other shippers.

SIGNIFICANTLY TIGHTEN THE PROCEDURAL SCHEDULE

Ultimately, reducing the cost of rate review is going to involve some limitations on either procedure or substantive evidence, or both. The current ANPR is a mix of the two. Based on our review of the opening comments, the most disagreement from shippers and railroads appears to be over substantive limitations, like the references to an abbreviated market dominance test, to the issue of “other relevant factors,” and to specifics of the comparison group selection. However, shippers and railroads generally agree on the Board’s suggestion of trying to find appropriate procedural limitations as a way to streamline and expedite the process.

USDA hopes the Board can build from this general commonality and at the same time embrace some of the recommendations from the recent TRB study. In that study, TRB looked at and discussed aspects of the Canadian rail regulation system that worked there. They found one important aspect of that system to be the reliance on procedural limits as a substitute for explicit substantive limits, which TRB recommended for use by STB in the United States.⁷ At the same aforementioned Board roundtable, Dr. Richard Schmalensee of MIT referred to the lessons learned from that study as “not lessons of outcome, but lessons of process.”⁸

In general, USDA is recommending a short procedural timeline. In addition to these deadlines, USDA also believes that the Board could further control the process by imposing page limits or presentation time limits, depending on how the Board decides to structure the proceeding.

⁶ National Grain and Feed Association, *Comments to the Surface Transportation Board*, EP_665_2_242044, November 14, 2016.

⁷ TRB, pg. 196-197.

⁸ Surface Transportation Board, *Economic Roundtable Discussion: Issues, Conclusions of the Independent Study (the “InterVISTAS study”) on Railroad Rate-Case Methodologies*, October 25, 2016.

A lower cost and streamlined rate review process through a significantly tightened schedule would be an important step toward making the rate review process workable for agricultural shippers. According to TRB, the Canadians have brought forth an estimated 30 cases since 1988.⁹ This is the kind of access agricultural shippers need. A similar magnitude in the United States would not overly burden the Board, or the railroads.

An additional benefit of tight procedural deadlines is that they effectively represent substantive limitations as well. A limited amount of time to collect and present evidence forces parties to focus their time on only the clearest and most important evidence. These limitations could partially alleviate shipper concerns over “other relevant factors”, because neither party could draw out the proceeding by continually raising evidence that is ever more complicated. Additionally, this could eliminate the concern of railroads that specific substantive limitations would prevent important evidence from coming forth. The argument applies equally to potential evidence shippers might provide. The suggested approach strongly incentivizes both railroads and shippers to present only their best evidence in a concise manner. This leaves them the discretion to determine which evidence best makes their case. In this way, these implicit limitations on substantive evidence could be more effective than the current *ex ante* restrictions because the decision of what evidence to use or leave out is contextualized within each case, and because the decisions are made by those with the most incentive to select very carefully.

USE AN EXPANDED FINAL OFFER SYSTEM

The Board uses a final offer system under the 3B procedure in order to choose a comparison group. Under a final offer system, the Board chooses an offer of evidence from only one of the parties, rather than choosing a middle-ground blend of the two positions. The Board’s role in a final offer system is to choose the evidence that they deem is most reasonable. The benefit of this system is that to be selected it incentivizes each party to present the most reasonable evidence, which is presumably the evidence that is closest to the truth. In contrast, where the Board chooses a blend of each party’s offer, the incentive is for each party to present extreme and tenuous evidence with the hope of moving the middle-ground-blend closer to their preferred position.

USDA agrees with the American Chemistry Council’s (ACC) assessment in their opening comments that the ANPR’s proposed selection process of the comparison group is not obviously quicker or more effective than the 3B approach. ACC’s comments indicate the loss of the final offer system means that when parties rebut the Board’s proposed comparison group, they are likely to have the incentive to take extreme positions. This incentive could result in more time and more litigation expense than under 3B.¹⁰

In consideration of the new rate review process for small disputes, USDA believes the Board should continue to use a final offer system. However, USDA does not see any reason why the offer should be limited to only the comparison group. Instead, USDA recommends the Board structure the procedure such that parties submit their market dominance evidence, comparison group evidence, and other relevant factor evidence in a single evidentiary package offer. The

⁹ TRB, pg. 138.

¹⁰ American Chemistry Council (ACC), *Comments to the Surface Transportation Board*, EP_665_2_242033, November 14, 2016, pg. 9.

Board could structure the proceeding so that each party submits an initial offer of evidence and then submits an adjusted, final offer of evidence in order to allow each party to refine their case. The Board would then choose one of the final offers as the most reasonable presentation of evidence.

Aside from the positive incentive effects of such a system on the quality of evidence, such a structure would also enable the Board to implement an abbreviated timeline. The Board would essentially be making the market dominance and rate reasonableness decisions in a single determination. Doing so would shorten the procedural timeline. The procedural limits incentivize efficient evidentiary proceedings, and USDA believes the final offer system is an important complement to an abbreviated schedule, in order to incentivize each party make a balanced case.

MARKET DOMINANCE

An additional benefit of the suggested modified procedural approach is that the parties, and ultimately the Board, could weigh the market dominance and rate unreasonableness evidence against each other. For example, consider an instance where the rate reasonableness calculation demonstrates clear unreasonableness. The Board might be willing to accept abbreviated market dominance evidence because the unreasonableness of the rate is so apparent. Similarly, shippers might believe that abbreviated evidence is strong enough to make a market dominance case. On the other hand, railroads might appreciate the opportunity to discount the comparison group and rate reasonableness evidence by presenting an especially strong case that market dominance does not exist.

Again, the point of the procedural limits is to allow parties to choose how to make their strongest case in as cost effective a manner as possible. Based on their opening comments, the railroads are clearly concerned about a substantive limit on market dominance evidence. Shippers, in contrast, clearly believe that abbreviated evidence is often sufficient to make the market dominance case. USDA believes that the case structure it is proposing could help negotiate these contrary positions. If the Board is willing to implement a significantly abbreviated procedural schedule, then it would not need to implement the more controversial substantive market dominance limits. However, if the Board is unwilling or unable to implement an abbreviated timeline, then USDA believes an abbreviated market dominance test is necessary to reduce costs.

REMEDIES

The Board should also consider requiring both shippers and railroads to include offered remedies in the package of evidence they file in a case. Assuming the Board determines rates are unreasonable in a case, they could either rely on the remedy offered in the selected evidentiary package to develop or the Board could determine a remedy independently themselves. USDA believes either method will work, but the former system will result in remedies that are more reasonable, and a process that is more cost-effective. Either way, determining remedies will likely not be a mechanical calculation or easy. In addition to the reasonableness calculation, the Board would also need to consider the strength of the market dominance evidence and the importance of the 'other relevant factors' evidence in deciding a remedy.

Clearly, developing a remedy is a difficult and potentially ambiguous task, but having offered remedy information from the parties could help make a hard task easier in a couple of ways. First, if the parties offer a remedy as part of their evidentiary package, it would alleviate or partially alleviate the Board from having to calculate and determine the appropriate remedy themselves. Second, the final offer process generates an effective incentive mechanism to drive claims towards reasonableness, and the system would only benefit from also subjecting remedies to that incentive system.

For example, imagine a case where both the shipper and railroad make compelling cases with no obvious winner. Each party would be incentivized to offer the most reasonable remedy. In this way, the final offer process is a means to ensure that the remedies are reasonable and that they cohere with the complete evidentiary package.

USDA encourages the Board to extend the final offer system to the entire evidentiary package and seek remedies proposed by shippers and railroads.

LIMIT DISCOVERY

USDA supports the Board's suggestion to use initial disclosures by both shippers and railroads to reduce the need for discovery. However, USDA also recognizes the concerns from railroads that completely eliminating discovery or using substantive limits on the kinds of discovery evidence may prevent both parties from seeing important evidence prior to filing.

USDA's recommendation is that the Board should avoid substantive limitations on discovery as much as possible and opt for procedural limitations instead. In addition to a narrow discovery period, the Board could also consider limits on total requests. The Board's recent resumption of using Administrative Law Judges to decide discovery disputes could provide a means to quickly identify and address any disputes and complete the discovery process.

In order to implement a streamlined discovery process, the Board could require shippers to serve discovery along with the complaint and initial disclosure. The railroad could then serve its response and discovery along with its initial disclosure. Each party could have 10 days to confer and file motions to compel. The Board would then have 10 days to decide, and parties would finally have 10 days to produce necessary evidence.

Again, the benefit of these limitations is that they still allow both shippers and railroads the opportunity to discover the evidence that each believes is most important to their case, while limiting the overall discovery burden in terms of costs and time.

ELIGIBILITY CRITERIA (SCREENS)

The point of preliminary screens is to identify cases in which the allegation of unreasonable rates needs serious evaluation. Establishing such criteria is a natural component of a more streamlined and less costly approach. Therefore, USDA generally supports the Board's proposed approach of using preliminary screens, but offers specific suggestions and modifications to the proposal.

As conveyed earlier, USDA believes the Board should begin by first structuring the proposed methodology to evaluate the reasonableness of *grain and agricultural commodity* rates. This

would serve at least two very worthwhile purposes. First, a smaller “pilot project” could serve as an experimental subset of the overall market of all shippers, helping limit the number of cases before the Board as it considers a workable process for all shippers. Second, captive grain and agricultural shippers, especially those in remote areas far from other competitive options, are among the most likely to complain of unreasonable rail rates. As noted in the GAO, Christensen, and TRB studies, these shippers have seen substantial rate increases in recent years, more so than other commodities. Therefore, this could be a worthwhile action step toward solving a real world problem identified by many shippers as well as several objective third party onlookers.

Furthermore, under strict procedural deadlines and time limits, specific screening criteria such as “length of haul” are not necessary. As CSX noted in its initial comments, cases have particular and varying characteristics.¹¹ In an abbreviated timeframe, bringing forward unique circumstances of the traffic at issue is a part of the proceeding and therefore does not exclude shippers with potentially unreasonable rates *ex ante*.

STB also proposed including a revenue per ton-mile (RPTM) screen to determine if rates were “significant outliers.” USDA does not support the use of this screen because it encompasses information not known to the shipper at the outset of a case. A screen of this nature is also illogical because it requires a shipper to pursue a complete case in order to determine initial eligibility for rate relief. As described by AAR, “the proposed revenue per ton-mile screen would not allow a complainant to know if its traffic would qualify for the proposed methodology until after it has filed its complaint and the Board has released the default traffic group.”¹²

Further, the RPTM screen as currently proposed by the Board is potentially problematic and ineffective because a shipper’s eligibility against the screen can change as the proceeding progresses. As ACC noted, “The most troubling aspect of the Board’s eligibility determination is the proposal to revisit eligibility in the final decision based upon modifications to the initial comparison group. This means that the parties could incur the time and expense of litigating the entire case only to have the Board, at the very end, say ‘never mind.’ Such a result would be anathema to the stated objectives of the ANPR.”¹³ While flawed, if a preliminary screen of this kind is applied, the Board should not make use of a “top percentage” of any amount, and instead rely on standard deviations. AAR added, “Every group of rates will have a top 10 or 15 percent.”¹⁴

In addition, as shipper groups persuasively point out, there is no reason to prevent on an *ex ante* basis a shipper from bringing cases until after a certain number of years pass. Such a “prior litigation” screen risks significantly hampering shippers’ ability to obtain relief from unreasonable rates, especially in the case of agriculture where shippers frequently face a new set of routes and new set of potentially unreasonable rates before the prior litigation timeline expired. The costs would likely outweigh the benefits.

¹¹ CSX Transportation, Inc., *Comments to the Surface Transportation Board*, EP_665_2_242038, November 14, 2016.

¹² Association of American Railroads (AAR), *Comments to the Surface Transportation Board*, EP_665_2_242040, November 14, 2016, pg. 14-15.

¹³ ACC, *Comments*, pg. 5.

¹⁴ AAR, *Comments*, pg. 15.

The Board proposed implementing a “prior litigation” screen over fears that complainants would divide large disputes into multiple smaller ones. However, as ACC pointed out in their opening comments this has not happened in 3B cases and USDA believes it would be unlikely in the newly proposed processes for smaller disputes. ACC wrote, “Nothing of the sort has occurred in Three-Benchmark cases. In fact, complainants who have had large numbers of small volume lanes have done precisely what the Board encouraged them to do, which was to aggregate their lanes into SAC cases.”¹⁵

In addition, the Board itself serves as a check against dividing a larger case into smaller ones. The Board has already acknowledged such by saying, “The Board has ample discretion to protect the integrity of its processes from abuse, and we should be able to readily detect and remedy improper attempts by a shipper to disaggregate a large claim into a number of smaller claims, as the shipper must bring these numerous smaller cases to the Board.”¹⁶

RATE REASONABLENESS STANDARD

The ACC comments rightfully pointed out that much of the existing ANPR is not that different from the 3B procedure, especially not different in a way that is obviously streamlined or more accessible to shippers. The only reason the Board should rely on screens is to balance a simplification elsewhere in the proposal, but as of now it is unclear where the Board finds that simplification. The proposal suggests that maybe the Board is considering the screens as the abbreviated market dominance test. However, as discussed, USDA believes that an abbreviated market dominance test may not be necessary if an abbreviated timeline is implemented. Instead, the Board should make changes to the rate reasonableness standard that better justifies the eligibility screens.

Multiple shipper groups pointed to the severe problem of the 3B comparison group approach. In that test, the Board compares a contested rate to a similar group of traffic that also has revenue to variable cost (RVC) ratios above 180 percent. There are multiple problems with this approach. As TRB and Christensen point out in their studies, URCS and RVC ratios have no economic grounding and variable cost assignments are inherently arbitrary.¹⁷ Ideally, neither shippers nor railroads would be subject to the arbitrary nature of RVC ratios, but there are statutory limitations and regulatory realities to consider. USDA believes the Board should limit its reliance on RVC ratios and URCS as much as possible. USDA also recognizes that this would be a big step for the Board, but reiterates the point that the Board could minimize its risk and concern by using a limited rate review process for grain as a pilot program.

In addition to the concerns over RVC ratios and URCS, multiple shippers also pointed to the problem of across-the-board pricing. Even if the problems with URCS could be resolved, the problems with across-the-board pricing still completely invalidate the comparison group

¹⁵ ACC, *Comments*, pg. 5.

¹⁶ STB decision, Ex Parte No. 646 (Sub-No. 1), *Simplified Standards for Rail Rate Cases*, served September 5, 2007, pp. 32-33, pointed out by ACC in their opening comments.

¹⁷ TRB, pg. 107-119; Christensen and Associates, *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals that Might Enhance Competition*, pg. 11-15. For example, TRB wrote, “In short, comparing the arbitrarily defined URCS variable cost with an actual rate is not a sound basis for screening shippers for eligibility for relief. It cannot be justified on economic grounds and has led to the development of a rate relief system that is characterized by large inequalities in shipper access to relief.” (TRB, pg. 141.)

approach. The heart of the problem is that the Board has chosen as a benchmark a variable over which Class I railroads have a significant degree of control. The result is that a railroad can charge the same potentially unreasonable rates to a whole group of its shippers of a particular commodity and/or region so that the comparisons then show little deviation. When this occurs, it increases the railroad's revenue, but in the process makes an entire class of shippers less competitive in their respective market, which is not in the public interest or a result the Board should support or allow.

TRB and NGFA have proposed a solution for the Board in the form of a competitive benchmark.¹⁸ The essential difference between the existing methodology and the proposed competitive benchmark is that the TRB and NGFA suggestions rely on broader competition to produce an *exogenous* benchmark, that is, one that is not as susceptible to manipulation by a defendant railroad. Similar methodologies could accomplish the same goal, as highlighted by the different approaches taken by TRB and NGFA.

USDA will suggest one such methodology. First, however, it is worth pointing out that a different rate reasonableness standard would not be wholly new for the Board. While 3B is ostensibly an inaccurate measure of CMP, it does not actually measure SAC in any way. In fact, it exists as its own rate reasonableness standard. The problem, as discussed previously, is it is not an effective rate reasonableness standard. Nonetheless, 3B "measures" CMP by merely attempting to allow for differential pricing and account for revenue adequacy. USDA contends that the Board should not be afraid to institute a different, though more effective, rate reasonableness standard, as long as it too allows for differential pricing and attempts to account for revenue adequacy, if necessary.

The methodology suggested by USDA would still start by selecting a comparable group of traffic based on variables that the Board believes are correlated with cost, such as mileage, train type, commodity, railroad, and/or tonnage. The Board would then look at the average revenue per ton-mile (RPMT) for competitive traffic in that group. By looking at a competitive market, the Board would get an estimate of the short-run marginal cost of these movements.

As AAR cogently recognized, "the question for the Board in regulating rates simply is what degree of differential pricing should be allowed on traffic without effective competition."¹⁹ With a competitive benchmark estimated, the Board merely needs to determine the degree to which variation around that average is deemed reasonable. The Board could rely on a percentage markup above the competitive benchmark (as suggested by TRB) or the Board could use a multiple of the standard deviation of the comparison group. If the Board deemed necessary, it could make the percentage or multiplier a function of some measure of revenue adequacy, so that revenue inadequate railroads were allowed to differentially price more than revenue adequate railroads.

SELECTING COMPARABLE AND COMPETITIVE TRAFFIC

As discussed, there is a lot of controversy in the comments over the substantive rules the Board has proposed regarding how to determine comparable traffic. USDA persists in its belief that the Board has a better option in relying on tight and strict procedural timelines, and leaving the

¹⁸ TRB, pg. 141; NGFA, *Comments*, pg. 14.

¹⁹ AAR, *Comments*, pg. 12.

question of substance up to the parties in making their best case. It is unclear that any combination of defendant/non-defendant railroad traffic, STCC levels, mileage bands, and others will be the most appropriate combination in all cases. Instead, USDA believes that the combination of a brief timeline and the final offer system will enable parties to propose a context-relevant comparison traffic group in a cost effective and reasonable way.

The same is true for deciding how to define competitive traffic. There are multiple methodologies that parties could use to determine competitive traffic or to determine comparable traffic. Parties could rely on geospatial data or elasticity analysis or RVC ratios. Each methodology will come with a unique set of costs and benefits that likely depends on the context of a particular case and claim, and on the rest of the evidence being presented. USDA believes that this evidence should be packaged together with market dominance and other relevant factor evidence so that each party has to weigh the costs and benefits of supplying a particular piece of evidence in the context of supplying a whole case and in the context of making the case as reasonable as possible.

It is worth recognizing that limiting the comparison benchmark to competitive traffic may add complexity to a case. However, there are at least two reasons why USDA believes this approach is still a significant improvement over current procedures and those in the ANPR. First, as the TRB emphasized, URCS is not just imprecise, it is conceptually invalid. While any methodology to assess the reasonableness of rates will be imperfect, it is better to imperfectly estimate an economically sound variable than to imperfectly (or even perfectly) estimate a value without economic meaning. Second, whether it is under 3B, the ANPR, or USDA's proposed procedure described herein, the comparison group methodology always requires some abstraction from the specifics of a disputed rate. The relevant question is "which abstractions are appropriate." USDA believes that its aforementioned proposal is an effective means of incentivizing reasonable and cost effective abstraction, two features that are not obviously present in the 3B or ANPR processes.

WAYBILL SAMPLE SIZE FOR DETERMINING RATE REASONABLENESS

One of the problems acknowledged by the Board and where there is likely wide consensus is in terms of expanding the sample size used in the rate reasonableness evaluation. Doing so would increase the accuracy of constructed comparison groups. For instance, with a larger sample size, shippers and railroads may not need to rely on five-digit STCC, which would be less precise. USDA supports an effort to move forward with expansions to the sampling rate.

RATE RELIEF LIMITS

USDA believes the rate relief limit should be set at \$5 million, which is the estimated cost of a full SAC presentation. USDA understands the hierarchy of rate review procedures that the Board has structured, but does not believe that the proposal in these comments should fall within that hierarchy.

It is reasonable to set the relief limits on SSAC and 3B at, or at least near to, the cost of estimating the next highest case, since they are "cruder" versions of SAC and its CMP-based rules. Doing so effectively sorts disputes by size into the appropriate test, because large

disputes, where accessibility is not an issue, should use the most accurate test of CMP, while smaller disputes should be able to use the less accurate but more accessible tests.

However, what USDA is proposing is merely a different standard of reasonableness. As such, it is not meaningful to compare it to the accuracy of the other tests. RTP (§10701(d)(3)) requires that the Board “maintain 1 or more simplified and expedited methods for determining the reasonableness of challenged rates in those cases in which *a full stand-alone cost presentation is too costly, given the value of the case.*” (Emphasis added.) Therefore, a rate relief limit would still be a necessary and effective sorting mechanism to put high value disputes into a SAC test and lower value cases in the proposed process, where the separating value is at the estimated cost of a Full SAC case of \$5 million.

SUGGESTED PROCEDURAL SCHEDULE

Shipper files initial complaint, disclosure, and discovery	Day 0
STB determines whether shipper meets screens (i.e. grain, >180 RVC) and supplies the unmasked waybill sample	Day 7 (1 Week)
Railroad initial disclosure, and discovery/responses	Day 21 (2 Weeks)
Shipper/Railroad Discovery Period	Day 21-Day 49 (4 Weeks)
Shipper/Railroad prepare and simultaneously submit initial offer of market dominance evidence, comparison group and rate un/reasonableness evidence, and other relevant factor evidence	Day 77 (4 weeks)
Shipper/Railroad submits revised and final offer of evidence	Day 91 (2 weeks)
STB chooses either shipper or railroad offer of evidence	Day 105 (2 weeks)

CONCLUSIONS

USDA appreciates the Board’s efforts to create a more accessible rate review standard for shippers. USDA encourages the Board to go back to a grain and agricultural shipper proceeding and embrace the limited nature of such a standard as an opportunity to pilot new ideas that might help the Board improve all of its rate review procedures for all shippers.

USDA has proposed to the Board a workable alternative to existing simplified procedures, one that effectively balances concerns from both railroads and shippers. The existing ANPR is an effort directed toward the right goals. However, USDA believes that, as it is currently proposed, the ANPR will not achieve the Board’s stated goals of providing a more accessible rate review alternative, not for small disputes, and especially not for grain and agricultural shippers.

USDA contends that the cost and time involved in existing procedures bars shippers with small disputes, and especially grain and agricultural shippers from rate review. The Board needs to significantly reduce the cost and time involved in a case. USDA recommends the Board use the abbreviated timelines and final offer system proposed in these reply comments.

While USDA supports the principle behind appropriate eligibility screening criteria, the screens need to be simple and based on information that is available to shippers prior to initiating a case. USDA points out that a rate review process that is only for grain and agricultural rates has a built in screening ability that effectively narrows the eligible universe of shippers to those most likely to be captive.

USDA urges the Board to revise its rate reasonableness standard. There needs to be a balance in terms of accessibility to justify the use of eligibility screens. USDA recommends that the Board take this opportunity to implement some form of the competitive benchmark methods recommended by TRB and NGFA. That method has value beyond application to a rate review pilot for grain, but this proceeding represents a cautious way to experiment with the new ideas.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I, Bruce Blanton, certify that on this 19th day of December, 2016, caused a copy of the foregoing document to be served by first-class mail, postage prepaid, on all parties of record in STB Docket Number EP 665 (Sub-No. 2).



Bruce Blanton
Director
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