THE
NATIONAL
INDUSTRIAL
TRANSPORTATION
LEAGUE

July 26, 2016

The Honorable Daniel R. Elliott III
Chairman
Surface Transportation Board
395 E Street S.W.
Washington, DC 20423

Re: Ex Parte No. 704 (Sub-No. 1)—REVIEW OF COMMODITY, BOXCAR, AND TOFC/COFC EXEMPTIONS

Dear Chairman Elliott:

The National Industrial Transportation League (NITL or League) respectfully submits these comments in response to the Notice of Proposed Rulemaking (NPRM) issued by the Surface Transportation Board (STB or Board) in a decision issued on March 23, 2016 in Ex Parte No. 704 (Sub-No. 1) *REVIEW OF COMMODITY, BOXCAR, AND TOFC/COFC EXEMPTIONS.* The League was founded in 1907 and represents companies engaged in the transportation of goods in both domestic and international commerce. The majority of the League's members include shippers and receivers of goods; however, third party intermediaries, logistics companies, and other entities engaged in the transportation of goods are also members of the League. Rail transportation is vitally important to League members and their customers, and many League members depend highly upon efficient and effective rail service for the transportation of their goods.

In its NPRM, the Board requested comments on its proposal to revoke the existing class exemptions under 49 C.F.R. Part 1039 for (1) crushed or broken stone or rip rap; (2) hydraulic cement; and (3) coke produced from coal, primary iron or steel products, and iron or steel scrap, wastes or tailings. Likewise, the Board invited comments on the possible revocation of other commodity class exemptions. The League commends the Board on its decision and encourages the Board to adopt a final rule which extinguishes the exemptions for the named commodity groups. In addition, the League encourages the Board to proactively examine opportunities to revoke the exemptions of other commodity classes and service types where available data and information shows that the exemption revocation standard included in the ICC Termination Act of 1995 ("ICCTA") has been satisfied.

Congress provided the Board with clear authority to revoke an exemption when the application of regulation is necessary to carry out the Rail Transportation Policy set forth at 49 U.S.C. §

10101.[1] We agree with the Board's determination that substantially changed dynamics in the transportation markets since the adoption of the exemptions that demonstrate a likelihood of the exercise of railroad market power justifies the extension of STB oversight over the rail transportation of such commodities.[2]

I. Background of the Commodity Exemptions

The League has participated in this proceeding from the outset, submitting written testimony and appearing as a witness at the Board's hearing on February 24, 2011. Our support for the Board's decision in this proceeding flows from the testimony we offered then. In our testimony we noted that exemptions from regulation were greatly facilitated by the Staggers Act in 1980. Prior to enactment of Staggers, exemptions could only be granted by the Interstate Commerce Commission (ICC) if it found that the application of a provision of the law was not necessary to carry out the transportation policy; the statutory provision would be an "unreasonable burden" on a person or persons or interstate or foreign commerce; and application of the statute would "serve little or no public purpose."[3] Staggers significantly changed these standards by requiring only that the agency find that continued regulation was "not necessary" to carry out the transportation policy; and either that the transaction was of "limited scope" or that the application of the act was "not needed to protect shippers from the abuse of market power."[4]

Basing their decisions on those new standards, the ICC granted many exemptions between 1981 and 1993. The exemptions were seen as tools to foster efficient pricing and railroad management flexibility. The ICC frequently cited the reduced overhead and administrative burdens on railroads, and the benefits to shippers from receiving fast, competitive rate quotes without the delays caused by statutory notices of rate changes and/or cancellations. The agency often noted that the exemptions would result in cost savings for the railroads since they would no longer have to file tariffs on the exempted commodities and services.

Additionally, in granting the exemptions, the ICC focused on the Staggers Act requirement that an exemption would not result in an "abuse of market power" by railroads. Such findings were typically based on the existence of strong intermodal competition from trucks, intramodal competition from other railroads, and substantial product and geographic competition.

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[1] See 49 U.S.C. § 10502(d).

[2] NPRM at_4.

[3] 49 U.S.C.A. § 10505(a) (1978).

[4] Staggers Rail Act, Pub. L. 96-448, § 213 (Oct. 14, 1980), amending 49 U.S.C. § 10505.

II. Substantial Regulatory and Market Changes Have Occurred that Nullify the Findings of the ICC in Granting the Exemptions

More than thirty years have passed since the ICC began adopting the commodity class exemptions and substantial changes have occurred to both the scope of rail regulation and the state of competition which question the foundation of the ICC's determinations in granting the exemptions. The beneficial results of eliminating several "regulatory burdens" that were relied upon by the ICC to support the granting of exemptions were conveyed to all rail-moved commodities when Congress enacted ICCTA in 1995. The cost savings and efficiencies that had previously supported the grant of exemptions for some commodities became a cornerstone of the nation's new approach to railroad regulation with the passage of ICCTA. ICCTA eliminated the very regulatory requirements of tariff and contract summary filings, among others, that were the focus of the ICC's exemption decisions.

Moreover, and as the Board well knows, the dramatic consolidation of the nation's railroads into a mere handful of large Class I carriers has reshaped the competitive landscape while notably improving the financial performance of the remaining few very large carriers. Indeed, there were more than 40 class I railroads when the exemptions were first adopted as compared to only seven today, with only four major carriers now controlling the vast majority of the U.S. domestic rail market. Competition from other rail lines has disappeared entirely in many markets, offering considerable opportunities for railroads to assert market power in pricing their services. This is shown by the Board's own analysis of the confidential waybill showing large increases in the amount of captive traffic (i.e. traffic with revenue-to-variable cost ratios above the agency's 180% threshold for market dominance determinations which trigger possible rate regulation) for the commodities included in its proposal.[5]

The ICC relied heavily on the prospect that by ordering an array of exemptions, the then fragile freight rail industry would be aided and hopefully strengthened. Now more than three decades later, it is without question that today's Class I railroads have achieved an enviable record of superior financial performance and strong returns for stockholders. This is evidenced by the findings of Congress, as well as the Board's own findings of railroad revenue adequacy in recent years.[6] As such, another key foundation argument for the grant of these exemptions has been removed.

[5] NPRM at 5-10.

[6] *See Update on the Financial State of the Class I Freight Rail Industry, pages i and 21, Office of Oversight and Investigations (Majority Staff), Senate Committee on Commerce, Science, and Transportation (Nov. 21, 2013);* and *Railroad Revenue Adequacy – 2014 Determination*, STB Ex Parte No. 552 (Sub-No. 19) (served Sept. 8, 2015); *Railroad Revenue Adequacy – 2013 Determination*, STB Ex Parte No. 552 (Sub-No. 18) (served Sept. 2, 2014). In 2013, five of the seven Class I carriers were revenue adequate, and the simple average return on investment ("ROI") for all seven carriers was 12.00%, which was above rail industry cost of capital (11.32%). Similarly, in 2014, four of the seven Class I railroads were revenue adequate. The ROI for Canadian Pacific Railway ("CP") was anomalous in 2014 due to a one-time charge associated with the sale of certain Dakota, Minnesota & Eastern Railroad rail lines. *See Railroad Revenue Adequacy – 2014*, slip op. at 3 (n. 4). Omitting the ROI figure for CP, the

III. Revoking the Exemptions Is Consistent with the Statute and Would Merely Provide Access to the Board's Oversight Not Actual Regulatory Relief

The League strongly agrees with the Board's findings that reapplying regulation to the classes of traffic identified in its decision would carry out the Rail Transportation Policy by promoting sound economic conditions in the rail market, maintaining reasonable rates where there is an absence of effective competition and protecting shippers from predatory pricing, undue concentrations of market power and discrimination.[7] As noted by the Board, if the proposed rule is adopted then shippers of the cited commodities would again have access to the statutory regulatory protections against the adverse consequences of railroad market power.

Given the dramatic changes in governing law and the complete reshaping of the nation's freight rail industry since adoption of the exemptions, an essential consideration by the Board for continuation of any exemption is whether or not the transportation of a commodity (or a service type) is potentially subject to an abuse of market power. In the analysis presented in this decision it is clear the Board focused on this factor. The Board relied on analyses of railroad pricing behavior as evidenced by revenue to variable cost (R/VC) ratios and the increases in the amount of potentially captive traffic, the length of railroad hauls, and other market information demonstrating apparent limits on truck competition.[8] We agree with the basis of these analyses and the Board's reliance on them. However, we urge the Board not to arbitrarily reject other relevant measures of railroad market power which may be brought before the Board in this or other proceedings, including, for example, evidence of service deficiencies, refusals to reasonably negotiate contract terms, or the shifting of typical railroad operating costs to the shipper. Stated otherwise, R/VC ratios and market shares are not the only means by which market power may be illustrated. Indeed, we would note that while the exemption statute specifically includes railroad market power as one factor to be considered when the Board *grants* an exemption it is not a required factor when the Board considers whether to *revoke* an exemption.[9]

Moreover, access to potential regulatory relief for shippers of these commodities is not a decision that such relief is warranted or mandated. On the contrary, decisions to grant relief to shippers would only result from entirely separate proceedings in which the shipper complainant is able to successfully prove that it is entitled to a regulatory remedy. However, shippers of the

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simple average ROI for the six remaining Class I railroads was 11.93% in 2014, well above the rail industry cost of capital for the year, which was 10.65%. See also, S. Rep. No. 111-380, 111th Cong. 2d Sess., p. 2 ("The average Class I railroad's return on investment increased from 1978 when it was 1.52 percent to 10.7 percent in 2008.").

[7] NPRM at 4. *See also*, 49 U.S.C. §§ 10101(5), (6), and (12).

[8] NPRM at 5-10.

[9] Compare 49 U.S.C. § 10502(a) and § 10502(d).

named exempt commodities have been denied the opportunity to seek regulatory relief without first having to jump through an additional regulatory hoop to revoke the exemption. This added regulatory burden, which carries with it added costs, time and uncertainty, reasonably can be expected to have a chilling effect on an exempt shipper's use of the Board's processes, even as their transportation markets evolved over time to their disadvantage with demonstrable market power accrued by railroads.[10]

The Board has decided correctly in its proposal to vacate the exemptions for the handful of commodities named in this decision. We strongly encourage the Board to restore to those industries the one avenue of redress from market power and competitive abuse that is available to non-exempt shippers: access to the Board's remedies. Likewise we encourage the Board to move forward aggressively to assess the current market conditions of the remaining exempt commodities and services to determine if any merit having their exemption terminated.

We greatly appreciate the opportunity to provide these comments.

Yours sincerely,

Jennifer Hedrick
Executive Director

[10] We appreciate especially Commissioner Miller's spotlight on the five years during which potentially affected shippers awaited a decision in this proceeding, since the Board's decision provides those and other exempt shippers long-awaited increased clarity on this important issue of revocation of obsolete class exemptions.