Testimony of
Steve Strege, Executive Vice President
North Dakota Grain Dealers Association

Presented to
Senate Commerce Committee
Subcommittee on Surface Transportation and Merchant Marine
The Honorable John Breaux, Chairman
July 31, 2002

My name is Steve Strege, executive vice president of the North Dakota Grain Dealers Association, a 91 year-old voluntary membership trade association which seeks to represent the interests of the approximately 400 country grain elevators of our state. We also have members in surrounding states, and are affiliated with the National Grain and Feed Association, which is submitting its own written testimony in this proceeding. Personally, I am a farm kid who once hauled grain by small truck to local country elevators for further shipment by rail. Thus my attention to the importance of railroads goes back more than 40 years, the last 26 of those with this association.

Thank you for inviting me to testify on grain rail transportation issues. These are critical to farmers, grain elevator operators, food processors, the economies of our states and the nation, and all of us as consumers. All of us have an interest in a vibrant profitable rail system. But it seems we've gotten somewhat off the track in how to have such a network.

I will endeavor to cover these basic issues:

1. The imbalance of market power between large railroads and grain shippers.
2. Use of market power in treatment of shippers, especially captive shippers.
3. Oversight is inadequate.
4. Possible remedies for Congress and the STB to consider.

IMBALANCE OF MARKET POWER

This first point is easily explained. The nation's railroads have consolidated down to four gigantic companies controlling 90% or more of intercity freight. Some of them dominate geographic regions of the country.

On the other hand, grain shippers such as country grain elevators are many, and dispersed over the land to which they are tied for their grain volume. There are literally thousands of them. Some are fairly large companies; but most are relatively small. Originating and terminating locations of even the largest of these companies are most often dependent on <u>one</u> railroad. Some trucking to market for short hauls (250 miles or less) works. But across vast stretches of the Plains States and elsewhere the great distances and volumes make grain trucking unrealistic, and not a source of effective competition to rail.

It should be noted that Class I railroads have created shortline spinoffs. Degrees of success vary. In our area the shortlines are service-oriented. Shippers like that. But due to physical connections and/or paper barriers, most shortlines do not provide competition to their parent Class I's. In many instances the Class I's set the rate and service parameters.

An important part of the message I want to leave with you today is that this imbalance of power has given the large railroads the economic clout to:

- dictate unreasonable terms and charges to small and large grain companies alike,
- charge exorbitant rates to captive grain shippers who have no effective legal remedy,
- devalue shipper investments through changes in rates and service offerings,
- determine which grain industry participants will survive and which will not,
- force change in marketing methods that would not otherwise occur,
- make or break markets,
- jeopardize our foreign markets through unusual rate-making schemes,
- influence land values by limiting the income that land can produce, and
- take advantage of farmers, agribusinesses like ours, and the general public, with little fear of someone stepping in to stop them.

We believe that where effective competition exists, it can govern railroad practices and prices. Unfortunately effective competition does not exist for thousands of grain shipper locations, and it has been slipping away in a macro-sense as railroad mergers have proceeded over the past 20 years.

USE OF MARKET POWER

Market power is demonstrated by extremely high grain rail rates for captive shippers. Many revenue to variable cost ratios on wheat movements from North Dakota and adjacent areas are in the

250-350 percent range (some up over 400), as compared to a jurisdictional threshold of 180 percent. These rates exhibit the plight of captive shippers. Documentation of these ratios can be found in testimony presented by the Upper Great Plains Transportation Institute of North Dakota State University to a hearing chaired by Senator Dorgan in Bismarck, ND on March 27, 2002.

Market power is also exhibited by railroad attempts to shape the grain marketing industry and domestic grain processing industry into fewer larger locations that fit the railroad's definition of efficiency. This goes beyond what would occur in a competitive environment. Incentives are offered to selected shippers to build and operate a 110-car loading facility at a location selected or approved by the railroad, and the industry must go along or risk being on the outside looking in. In my state and region the Burlington Northern Santa Fe is the dominant rail carrier. Its game plan in the grain business is promotion of a few big shippers primarily on its mainlines, with much less regard for the rest of its shipping and receiving customers who have made substantial investments to meet that railroad's previous demands. This has serious ramifications for farmers, grain elevators, rural communities and the entire region as grain gathering costs are shifted from the railroad to the public sector or others in the private sector. We can appreciate the need for efficiencies, but larger trains are often a mismatch with the diversity of crops produced and the increased number of quality segregations buyers want. It's like the proverbial square peg in a round hole. And when car cycle time gains for larger trains come partially at the expense of letting other sizes of train sit, then purported efficiency gains are exaggerated.

BNSF refuses to allow grain elevators on its lines to co-load 110 car trains, instead pushing for multimillion dollar investments in new facilities to serve this railroad's latest concept. Co-loading is two or more locations contributing loaded cars to a train. The other Class I railroad and all three shortlines serving North Dakota accept co-loading. According to the testimony of the Upper Great Plains Transportation Institute referenced above, this co-loading between two stations would cost the railroad only about $50 more per car (less than two cents per bushel), which could be reflected in a higher freight rate. That way the existing elevators could participate in the available business to a greater extent.

Market power is also demonstrated by other policies of railroads. Penalties for not loading railcars in the prescribed time, without a similar penalty on the railroad for untimely performance, is one example. Site lease charges and one-sided lease provisions are others.

<u>Inverse Rates</u>

An example of rail market power in the northern plains started about a year ago when BNSF set up secret inverse contract rates on wheat to the Pacific Northwest (PNW). "Inverse" means the shorter haul pays a higher rate. Western North Dakota and Montana rates to the Pacific Northwest were kept high, while rates for a selected few large 110-car shuttle train loading grain elevators in eastern North Dakota and western Minnesota were lowered. This disadvantaged other grain elevators in areas surrounding the selected few, and westward across North Dakota and Montana, with spillover effects on markets from South Dakota. Of course we support lower rates, but let's spread the benefit around and be equitable among shippers. This was an exercise in its monopoly power to select grain industry participants that the BNSF wanted to promote, while continuing to milk excessively high rates from more captive shippers and putting in jeopardy the investments of those and many of its other shippers.

This rate action jeopardized our foreign markets by shipping non-traditional grain into them. Wheat from traditional source areas in western North Dakota and Montana mills differently than wheat from spring wheat growing areas several hundred miles to the east. Complaints and concerns have come back from those foreign buyers. Bottom line is that unusual railroad rate actions can damage both shippers and markets.

Another effect of this BNSF inverse rate action was short-circuiting normal grain market forces. BNSF's stated reason for the rates was to maintain its market share of PNW exports in the face of drought-reduced crops in Montana. But there were millions of bushels of wheat in storage in Montana and western North Dakota when BNSF took these steps. Instead of the PNW market bidding up the price to get more wheat, the BNSF's inverse rate scheme held down or reduced grain prices for traditional farmer and country elevator suppliers. This is market manipulation. Meanwhile BNSF advocates free markets and noninterference by anyone in its pricing and practices. This is a double standard. Later in this statement I address the difficulties we encountered when we sought to consider a legal remedy for BNSF's actions.

These inverse rates distorted normal marketing patterns to the point that a farmer from western North Dakota actually hauled 50,000 bushels of wheat 160 miles <u>east</u> for loading on a train to move back <u>west</u> right past his normal delivery point 20 miles from his farm, that did not have the special rate.

He reported driving approximately 16,000 miles to do this.

As of today the BNSF has discontinued these inverse rates. But BNSF CEO Matt Rose has left the door open to bringing them back.

NGFA

The National Grain and Feed Association is submitting written testimony for this hearing. NGFA expresses similar concerns over growing railroad market power and its implications on the marketplace. NGFA cites railroad demurrage charges ten times their car ownership costs. NGFA references costly penalties on shippers for nonperformance, without any penalty on the railroad or comparable compensation to the shipper when the railroad fails to perform. And can anyone justify a $200 per car penalty for a clerical error on a bill of lading? That's $10,000 in penalty for a 50-car train!

One NGFA example is of a shipper and his originating carrier agreeing on a reduced rate for a facility improvement making both parties more efficient. But when the connecting railroad to destination learned of this it raised its rail rates by the equivalent amount as rates were reduced by the originating carrier, thus extracting the entire rate benefit for itself. This clearly shows the market power railroads have to extract all additional revenues for their sole benefit.

Rate-Making

This same take-it-all rate-making approach was confirmed in testimony to a hearing chaired by Senator Dorgan in my state in March. A BNSF Ag Commodities VP said BNSF sets rates through the following process: "What we do as a rail transportation provider is look at the difference between value of the grain at the origin and value of the grain at destination, and try to determine the level of charges for transportation with margin for the elevators to operate and make money." The only reference is to how much the railroad can extract from the customers' margins and from the system. Only a monopolist can price that way.

The railroad attitude displayed to shippers who complain is horrible. In one instance in my state the president of the board of one cooperative elevator stated it had recently spent close to $2 million to upgrade its facility to meet what was then the BNSF's optimum train size. Then suddenly, because of the inverse rate given to a competitor, this elevator was losing business from part of its trade area. BNSF's Ag Commodities Vice President said this shipper was "a victim of its own poor planning".

(Bismarck (ND) Tribune Feb 3, 2002)

Governors Speak Out

The situation with rail transportation in the northern plains is so serious that five governors recently wrote to the BNSF President and CEO about it. Attached to my testimony is the text of that May 10 letter initiated by North Dakota Governor John Hoeven and signed by governors from South Dakota, Montana, Nebraska and Wyoming. It cites excessive rates charged by a market dominant carrier, inverse rates, preferential rates for a few, effects on grain markets, communities, and highway infrastructure of the states.

About six weeks went by before our governor received any reply from BNSF. That itself says something about BNSF. When the reply came, it was not what we had hoped for. A portion of Governor Hoeven’s public statement in response follows: "I regret BNSF's decision, and I pushed Mr. Moreland (BNSF Executive Vice President) to lower prices in western North Dakota, rather than raise them in the eastern part of the state. The railroad's decision, moreover, fails to address the larger, underlying problem, which is a lack of shipping competition in North Dakota. BNSF must create a level playing field, with reasonable rates for all producers, to ensure that farmers get a fair market price for their commodities.

"In addition, BNSF's action yesterday still fails to address the extreme rate differential between large and small shippers, which BNSF could partly remedy by making co-loading available to middle-sized shippers. BNSF's action will not cause us to step back from pursuing federal regulation and other measures that address a lack of competition in the grain-shipping railway industry. In the coming weeks, we will continue to explore all avenues to ensure that BNSF does not exploit its dominant position as the sole railway grain shipper in North Dakota to manipulate markets and grain prices. BNSF must respond to market forces, rather than distort them."

Alliance to Keep Rural America on Track

In November 2001 a group of agricultural organizations up our way formed the Alliance to Keep Rural America on Track. This includes our association, Farmers Union, Farm Bureau, all the major commodity promotion groups in our state, the rural electric and telephone cooperatives associations, insurance agents association, and more. The Alliance has members from other states as well. Purpose was and remains to raise public awareness of what railroad dominance means to farmers, grain elevators, and other businesses in both rural and urban settings, and to communicate our needs to the railroads from a broader platform. The involvement of farm and business groups demonstrates that what's going on with our railroads is of concern to more than grain elevator operators.

OVERSIGHT IS INADEQUATE

While these abuses go on, government oversight and protection, is ineffective. Complaint remedies, if you can even call them that, are havens for railroad lawyers to frustrate shipper interests with delays and expense. The railroad can drag out proceedings in the hope that the shipper will simply give up. Here are three examples.

The first example is the McCarty Farms grain rail rate case in Montana that went on for 17 years in front of the Interstate Commerce Commission and Surface Transportation Board before ending a few years ago with no payment to the aggrieved parties and no prescribed reduction in rates. At one time during this process the complainants had actually received a favorable ruling. Then the railroad lawyers went to work and stretched it out an additional 15 years. In the years immediately following enactment of the Staggers Act in 1980, it seems the ICC went out of its way to protect railroads instead of shippers.

The second example goes back to 1988 when some organizations and companies in the grain industry filed a complaint with the ICC against the Burlington Northern's Certificate of Transportation program. We went through a thorough discovery process. At one point the BN filed a motion for dismissal, which took the ICC many months to decide. It took four years to get an unfavorable ruling from the ICC in that case. A federal court later reversed portions of the ICC decision.

A third and continuing example is the Surface Transportation Board's attempt to eliminate product and geographic competition as factors to consider in the market dominance test. (A shipper must prove that a railroad is market dominant before the rail rate can be challenged.) The STB initiated this proceeding in April 1998 and decided to eliminate product and geographic competition in December 1998. The railroads quickly appealed. The DC Circuit Court of Appeals found for the STB, but remanded a portion back to the STB. When the STB issued its decision on that the railroads appealed again. That's where it stands today.

An extremely troublesome regulatory impediment to much of the grain industry in the Upper

Great Plains is the absence of any adequate recourse for rates that appear to be unreasonably high. The Upper Great Plains Transportation Institute, an independent organization associated with North Dakota State University, calculates roughly that BNSF wheat rates from North Dakota range between 270 percent and 400 percent of variable costs. Virtually all of these wheat shipments originate from country elevators, which individually do not have the shipment volumes necessary to justify the million-plus dollars expense of a rate case under the so-called Stand-Alone-Cost (SAC) methodology commonly used by large volume, high density shippers such as coal-burning electric utilities.

<u>Simplified Rate Procedures</u>

The "simplified" procedures mandated by Congress are anything but simplified and do not solve the problem they were aimed at; the creation of a useable remedy for unreasonably high rates where the traffic volumes involved are not large enough to justify the huge expenditures necessary for a stand-alone cost case. Here are some of the reasons why the "simplified" procedures don't do the job.

As directed by Congress, the "simplified" procedures are not available to any small shipper for use in any rate complaint, but instead are only available 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." This qualification led the STB to rule that, in each case where a shipper seeks to invoke the "simplified" procedures, there must be a showing that the case qualifies for treatment under the "simplified" rules. To make that showing, a shipper will have to retain experts who can prove that "a full stand-alone cost presentation is too costly, given the value of the case."

A "simplified" case cannot go forward unless there is a showing of "market dominance." The burden of proving "market dominance" is no different for a small volume shipper than for the largest coal-receiving shipper in the nation and will involve the use of cost consultants, attorneys, and discovery.

Use of the "simplified" methodology is far too complex to be attempted without lawyers and cost experts. The test involves the application of three "benchmarks." The first is known as RSAM and is intended to assess the extent of a carrier's revenue needs that can and should be recovered through differential pricing. The second component, known as R/VC > 180, is designed to measure the degree of differential pricing actually being practiced by that carrier. The third component is $R/VC_{comp.}$ This benchmark measures the markup taken on traffic priced at more than 180 percent of variable cost that involves "similar commodities moving under similar transportation conditions." Data to meet the first of these two tests is published by the STB. The third test requires extensive discovery. The STB concedes that there "may well be some cases in which there is no readily identifiable traffic that is truly comparable." Thus, the ability of the shipper to even find data with which to satisfy the "simplified" test is questionable.

The outcome of a "simplified" case is uncertain even if the three benchmarks can be satisfied. Published STB data indicate that maximum rates prescribed under the first two benchmarks would be at approximately 230-250 percent of variable costs. Just how the $R/VC_{comp.}$ would impact that position has never been made clear by the STB.

I am by no means an expert on the "simplified" rules adopted by the STB, but I have been advised by cost consultants and others that the use of those rules is highly likely to result in a maximum rate prescription that is not below 230-250 percent of variable costs, depending on the railroad involved. By contrast, large, high density shippers, whose traffic volumes justify use of the expensive SAC cost method, have been successful in reducing their rates to a 180 percent of variable cost level. Small volume shippers accordingly appear to be relegated to a decidedly inferior status for the correction of unreasonably high rail rates if using the STB's "simplified" methodology.

Senator Dorgan asked Chairman Morgan about this problem, as appears in the attached correspondence. Her answer acknowledges the disparity between the type of rate remedy available to a large volume shipper as compared to that available to a small volume shipper. We suggest that this disparity needs to be corrected. There is no reason why a small volume shipper, shipping wheat over the same line of railroad that carries coal, for example, should be governed by a regulatory standard that virtually guarantees that the small volume shipper will pay 50 percent more than the large volume shipper, and we question whether that is what Congress intended.

<u>Discriminatory Rates</u>

There is also an inadequate remedy for unreasonably discriminatory rates. Before passage of the Staggers Act, inverse rates that favored some shippers over others might have been attacked under the anti-discriminatory provisions of the statute. The Staggers Act, however, made the anti-discrimination provisions absolutely inapplicable to "rail rates applicable to different routes." While the ICC might have interpreted that provision in any number of different ways, it chose the broadest interpretation possible, ruling in one case that rates that applied over the same line of railroad to neighboring communities were rates that applied over different "routes". STB Chairman Morgan, asked recently by Senator Dorgan to comment on the possibility of removing the "different route" prohibition so that railroads once again could be called upon to justify disparate rate treatment, suggested that such a statutory change might be "harmful" because it "might reduce the revenues flowing into the rail network." The text of the relevant exchange of correspondence between Senator Dorgan and Chairman Morgan is attached to my statement. We suggest, however, that it would not be in the least bit harmful to permit shippers to bring an unreasonable discrimination claim against disparate rates controlled by the same railroad so long as the railroad retains the ability to defend itself, as it could prior to Staggers. There is no need to altogether bar such claims from being brought.

POSSIBLE REMEDIES FOR CONGRESS AND THE STB TO CONSIDER

My organization and I personally are among those who believe strongly that effective competition not only is healthy economically, but far preferable to government regulation. However, when an industry has become characterized by excessive concentration of market power, some measure of regulation is necessary as a surrogate for competition. That was the theory of the Staggers Act. But today, it appears to us that the STB, and the ICC before it, is more focused on railroad economics than shipper economics. Many decisions have followed that track

During the last two decades, while STB policies endorsed the elimination of rail routes through mergers, they simultaneously were authorizing the accumulation of vast market power in the hands of a few railroads and the decline of competition, at least for the 30 percent or so of rail business that appears to be captive to rail service. Most of that 30 percent consists of bulk commodities, including grain.

Although railroads contend that they exist largely in a competitive environment and must be free to extract what the market will allow from their captive customers, we believe that Congress should not overlook the fact that railroads are, in effect, government franchisees who enjoy substantial benefits as a result of that status. Every STB approval of a railroad merger is, in effect, a government license or franchise, which carries with it valuable antitrust immunity unavailable to industries that are truly in the unregulated marketplace. Under present law, a railroad unilaterally, and with very limited notice, can impose new charges and terms on its customers through "tariff" publication -- a prerogative available only to a franchised industry. The application of many state and even federal laws to railroads is preempted by the Interstate Commerce Commission Termination Act, narrowing their exposure for violations of the antitrust laws, or other activities that would be recognized as actionable under ordinary civil law. Railroads can implement their franchises through the right of eminent domain. Finally, at least some railroads currently are asking the government to use public money to subsidize railroad infrastructure projects.

Given the substantial market power now enjoyed by the remaining Class I railroads and the fact that they acquired that market power through government-issued franchises and exercise -- dare I say abuse -- it with the aid of government-bestowed regulations, we respectfully suggest that Congress should now act to make regulation the effective tool originally intended by the Staggers Act to moderate railroad excesses where competition does not do so. We suggest the following remedies for your consideration.

1. Adopt a resolution discouraging further mergers between Class I railroads and mandating that, in the event of any such mergers, necessary gateways must be kept open both physically and economically.

2. Legislate simplification of the market dominance standard, at least to the extent recently recognized by the STB in eliminating product and geographic competition as considerations.

3. Mandate "bottleneck" relief by requiring the monopoly carrier to quote rates on request to interchange points.

4. Simplify rate reasonableness proceedings for small volume shippers and eliminate the disadvantage apparently imposed on those shippers by the STB's "simplified" maximum rate rules (a disadvantage which Chairman Morgan seems to acknowledge). There is absolutely no reason why small volume shippers should bear a larger burden of rail deregulation than large volume shippers. If no other substantive standards can be devised under which rate complaints for small volume shippers can be simplified, then Congress should direct an appropriate government agency to develop an objective, reliable computerized version of stand-alone-costs adaptable in small volume rate cases for use by small volume shippers.

5. Consider granting shippers the option to utilize arbitration to resolve disputes with

railroads, available with safeguards to insure that small volume shippers are not overwhelmed by railroad discovery requests.

6. Put the teeth back into the anti-discrimination provisions of the statute.

7. Require complaint case filing fees be kept within reach of shippers.

8. Visit the paper barriers issue as a possible way to create more competition.

This agenda must be started on soon. The clock is ticking on many shippers and segments of our industry as railroads flex their muscles. Railroads have the power to make or break shippers, receivers and, markets for what they see as gains for themselves. Once the economic landscape has been changed because of railroad actions not necessarily related to competitive economics, there is no turning back.

s/ Steven D. Strege, Executive Vice President, North Dakota Grain Dealers Association,
118 Broadway, Suite 606 Black Bldg Fargo, ND 58102 Phone: 701-235-4184

May 10, 2002

Mathew Rose
President and Chief Executive Officer
Burlington Northern Santa Fe Railway
2650 Lou Menk Drive
Fort Worth, TX 76161-0057

Mr. Rose:

As governors of states with prominent agriculture industries, we urge the Burlington Northern Santa Fe Railway to find an equitable solution to its preferential grain shipping rates policy.

We recognize the importance of an efficient and vital rail shipping system; however, we believe that in some corridors BNSF is using its market dominance to charge excessive rates to captive shippers and to provide advantageous preferential rates to a handful of large-scale shippers. BNSF is also using its market power to impact grain markets by offering a discounted inverse rate for shippers that move grain greater distances. We request that your company immediately evaluate the negative consequences of selective grain shipping rates and commit to adjusting them.

Our states are not opposed to shuttle shipment of agriculture products; however, we ask that the rate spreads be consistent and equitable. Your current business practices have the potential to negatively impact grain markets and rural communities as smaller elevators struggle to compete. These practices also shift the burden of shipping the bulky commodities to the states' highway infrastructure, which contributes to road deterioration and distorts longstanding traditional grain movement patterns.

We ask BNSF to administer its pricing methods in a way that is fair to all of our railroad customers and grain elevators. In the absence of reasonable rate adjustments, we will have no other recourse but to look for alternatives that will provide equitable resolution of this issue, including support of federal regulatory intervention.

Signed,

John Hoeven, Governor of North Dakota

Judy Martz, Governor of Montana

William J. Janklow, Governor of South Dakota

Mike Johanns, Governor of Nebraska

Jim Geringer, Governor of Wyoming

May 3, 2002

The Honorable Byron Dorgan
United States Senate
Committee on Commerce,
Science, and Transportation
Washington, D.C. 20510

Dear Senator Dorgan:

You recently sent to me questions as a follow-up to the Senate Commerce Committee field hearing that you chaired in Bismarck, North Dakota, on March 27, 2002. For that hearing, I provided a written statement outlining the Board's jurisdiction over rail rates. Your questions relate to that written testimony.

Attached please find the responses to your questions. Do not hesitate to contact me if you need anything further.

Sincerely,

Linda J. Morgan

Enclosures

Questions from Senator Dorgan to Linda Morgan regarding her submitted written testimony to the March 27 hearing in Bismarck, ND.

1. The March 27 hearing focused to a large extent on the inverse export wheat rates of BSNF; that is, rates to the west coast which are lower from certain points in eastern North Dakota or western Minnesota than from points in western North Dakota or Montana, even though the rail line that carries the cheaper eastern wheat passes through the communities, or over main lines just a short distance from the communities, where there is wheat that could have been shipped to the west coast but for the inverse rate structure.

Your testimony points out that "current law . . . prohibits unreasonable discrimination (49 U.S.C. 10741), but the prohibition does not apply to the cancellation of joint rates, rail rates applicable to different routes, or different rates that result from different services," and you observe: "Shippers have not made substantial use of the anti-discrimination prohibition in litigation before the Board."

A. Do you think that the anti-discrimination provision was or is available to wheat shippers who believe they were injured by the BNSF inverse rates in North Dakota?

B. Would the inapplicability of that remedy to "different routes" be likely to defeat a discrimination claim?

C. If you think the answer to the latter question is affirmative, then, where all of the rates and routes involved are under the control of the same carrier, would you see any substantial harm in changing section 10741 so that it would be inapplicable to different carriers, rather than different routes, bearing in mind that the defendant carrier could still defend by arguing that the rate disparity was due either to different services provided under the different rates, or for performing services that are not "like and contemporaneous" or applicable under "substantially similar circumstances"?

Answer. I am not in a position to attempt a definitive answer to the first two parts of your question, as it could prejudge an issue that could come before the Board in a formal proceeding. However, it is virtually certain that, if such a complaint were brought, the railroad would raise as a defense the argument that the anti-discrimination remedy is expressly precluded by the statute because the services at issue involve different routes. That, I suspect, is why a formal complaint has not been brought before the agency by North Dakota wheat shippers.

Changing the statute by repealing the categorical exclusion of a discrimination remedy for services over different routes, as you suggest in the third part of your question, would not completely foreclose a carrier from defending itself in a discrimination case: a carrier could still prevail by showing that the services or circumstances at issue are not similar, and thus that the different rate treatment is not unlawful. Whether or not such a statutory change would be harmful depends upon the interest that is being considered. The existing statutory scheme reflects a delicate balance of competing interests. Certain statutory changes could upset that balance, and could restrict the ability of rail carriers to respond to market forces. This, in the long run, might reduce the revenues flowing into the rail network to cover capital needs and have a negative effect on the service to be provided overall.

2. Your testimony also reviews the methods available for challenging unreasonably high rail rates. You observe that there is a "simplified, alternative procedure" but that it has not been used and that rail customers remain concerned that even the simplified procedure is still too burdensome. You note that, to "address this continuing concern, the Board recently issued a decision seeking comments on the idea of legislation mandating the use of arbitration to resolve these small rate cases."

As you know, one of the criticisms leveled at the "simplified" procedure is that the three "benchmarks" it relies upon appear destined to produce a maximum reasonable rate well in excess of 200% of variable cost – some say in the vicinity of 240% of variable cost – while the stand-alone methodology, utilized in large volume cases, is capable of achieving a maximum rate as low as 180% of variable cost.

A. Do you agree that the simplified methodology is likely to result in a maximum rate that is higher than 200% of variable costs or, in general, higher than the lowest maximum reasonable rate obtainable under the stand-alone methodology? If so, why should one of the Board's recognized rate case methodologies be more likely to produce a higher maximum reasonable rate than the other methodology?

B. If an arbitration system either relies on or allows the use of existing maximum rate case methodologies, won't arbitration virtually compel shippers in cases suitable for arbitration to engage in the costly proofs required under the Board's litigation methodologies or run the risk of being overwhelmed by railroad arbitration presentations that rely on approved methodologies?

Answer. A. The simplified maximum rail rate procedure, like the stand-alone cost (SAC) methodology, was designed to give effect to all of the considerations that the statute directs the agency to consider in rail rate cases. As we do not have much experience in applying the simplified guidelines, I cannot project the range of results that the methodology would likely produce. But even if the simplified methodology did produce ratios above 180%, comparing a small rail rate case to a case involving high-density rail movements of a commodity such as coal does not seem to me to be a valid exercise. The stand-alone methodology is designed to determine the lowest cost at which a hypothetical, efficient railroad could provide the transportation service needed by the complaining shipper. High-density coal movements, which have been the subject of most of the SAC cases handled by the agency, tend to produce efficiencies of scale that in many cases would not likely be generated by the traffic associated with a small rate case. Thus, under the economic principles underlying the statute that the Board administers, it would not be surprising or inappropriate if the rates set in a coal case were lower than those that would be set if the SAC methodology were applied to the traffic involved in a small rate complaint.

B. Although we do not believe that the small rail rate case process need be particularly burdensome, it is true that an arbitration system based on SAC could involve elaborate presentations comparable to those currently made before the Board. With this concern in mind, if Congress decided to adopt an arbitration remedy, it could prescribe a standard other than those currently used by the Board. If it proceeds along those lines, however, whatever standard or approach is adopted should recognize that most railroad traffic is competitive, and that if rates on captive traffic are held down too far, carriers will not be able to meet their capital needs or make appropriate investments in their facilities.