

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte 704 (Sub-No. 1)

REVIEW OF COMMODITY, BOXCAR, AND TOFC/COFC EXEMPTIONS

**COMMENTS OF
THE INSTITUTE OF SCRAP RECYCLING INDUSTRIES, INC.**

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The Institute of Scrap Recycling Industries, Inc. ("ISRI") submits these comments in response to the Notice of Proposed Rulemaking ("NPRM") issued by the Surface Transportation Board ("STB" or "Board") on March 23, 2016 in this proceeding. In the NPRM, the Board has proposed to revoke existing class exemptions for five commodities, including iron or steel scrap (identified as STCC 40-211)¹ which is shipped by ISRI's members.² ISRI commends the Board for instituting this rulemaking and strongly supports its proposal to revoke the iron or steel scrap class exemption. ISRI appreciates the Board's initiative in conducting an independent analysis of the changes that have occurred in the dynamics of the ferrous metals transportation markets since the class exemption for iron or steel scrap was adopted more than twenty years ago in 1995. ISRI agrees with the Board's analysis set forth in the NPRM and believes that it has properly determined that substantially changed circumstances warrants the restoration of STB oversight of rail transportation of iron or steel scrap to protect against the railroads' exercise of market power. As explained herein, lifting the exemption to allow ISRI's members access to the Board's regulatory processes and remedies is wholly consistent with the Rail Transportation

¹ See 49 U.S.C. § 1039.11.

² Specifically, the Board has proposed to revoke the class exemptions for the following commodities: (1) crushed or broken stone or rip rap; (2) hydraulic cement; (3) coke produced from coal; (4) primary iron or steel products; and (5) iron or steel scrap, wastes or tailings.

Policy at 49 U.S.C. § 10101 and, thus, is justified under the revocation statute codified at 49 U.S.C. § 10502(d).

I. ISRI STATEMENT OF INTEREST

ISRI is the trade association of the scrap processing and recycling industry representing more than 1300 companies that process, broker, or industrially consume scrap commodities, including metals, paper, plastics, glass, rubber, electronics, and textiles. The majority of the scrap recycling industry is comprised of small family-owned businesses employing more than 140,000 workers throughout the United States. ISRI members recycle tens of millions of tons of ferrous scrap, and increased costs to scrap recyclers translate into increased costs for raw materials for the basic manufacturing which in turn result in increased costs to consumers. The U.S. scrap recycling industry is highly dependent upon rail service to transport recycled materials to both domestic and international markets.

II. ISRI STRONGLY SUPPORTS THE BOARD'S PROPOSAL TO REVOKE THE IRON OR STEEL SCRAP EXEMPTION

As noted in the NPRM, under the ICC Termination Act ("ICCTA") the Board may revoke an exemption "when it finds that application in whole or in part of a provision of this part to the person, class, or transportation is necessary to carry out the transportation policy of 10101 of this title."³ This statutory provision provides the Board with substantial discretion to decide the circumstances under which restoring regulatory oversight is necessary and consistent with the governing statute.

In order to determine if the application of regulation under ICCTA is necessary with regard to iron or steel scrap shipments, the Board reviewed railroad data included in the confidential Waybill Sample for the period 1992 through 2013 to evaluate changes in pricing

³ 49 U.S.C. § 10502(d).

practices for rail movements of this commodity. Specifically, the Board considered changes in the volumes of “potentially captive traffic”, i.e. traffic with revenue-to-variable-cost (“RVC”) ratios above the 180% threshold for determining market dominance in STB rate proceedings,⁴ and the average length of haul of iron or scrap rail movements.⁵ It also considered other available industry information regarding changes in the competitive landscape and oral testimony and written comments provided at its 2011 public hearing on the subject of the utility of existing class exemptions.⁶ After evaluating this data and information, the Board concluded that:

the dynamics of the particular transportation markets appear to have changed so significantly since the exemptions were first promulgated as to warrant application of the Interstate Commerce Act in order to carry out the Rail Transportation Policy....these changes point toward an increased likelihood of railroad market power for each of these specific commodity groups.⁷

A. Substantial Industry and Statutory Changes Have Occurred Since Adoption of the Iron or Steel Scrap Exemption in 1995, Which Support Revocation of the Exemption

The iron or steel scrap exemption was initially granted over twenty years ago in 1995,⁸ and much has changed since that time. Back in 1994, ISRI joined with the Association of American Railroads (“AAR”) in requesting that the ICC grant the exemption based on “real, substantial benefits to be achieved by the proposed exemption,” including “freeing the railroads from administrative and regulatory burdens that hinder and often prevent them from competing

⁴ See 49 U.S.C. § 10707(d)(1)(A).

⁵ NPRM at 3.

⁶ *Id.*

⁷ NPRM at 4.

⁸ See Ex Parte No. 346 (Sub-No. 35), *Rail General Exemption Authority—Exemption of Ferrous Recyclables*, 10 I.C.C.2d 635 (1995) (“*Ferrous Recyclables*”).

effectively with other carriers for this ferrous recyclables traffic.”⁹ Specifically, ISRI and the AAR jointly petitioned for the exemption to relieve the railroads from tariff and contract summary filing obligations, and other then-existing regulatory requirements that impeded the railroads’ responsiveness to the market.¹⁰ Evidence submitted with the joint petition also included aggregate data showing a decline over the prior 10-15 years in inflation-adjusted rail revenues.¹¹

The ICC granted the exemption finding that there was extensive intramodal and geographic competition for the transportation of these commodities, based on the numerous origin/destination pairs indicating extensive movement of iron or steel scrap across the United States.¹² An important factor in the ICC’s decision was that the average RVC ratio for iron or steel scrap traffic was well below the statutory 180% RVC threshold that triggers the agency’s jurisdiction over the reasonableness of rail rates. Specifically, the agency determined that in 1991 and 1992 the average RVC ratios for this traffic was 139.5% and 138.6%, respectively.¹³ Other evidence considered was the mean length of haul and percentages of tons moving less than 600 miles.¹⁴ This data led to the ICC’s conclusion that continued regulation was not necessary to protect iron or steel scrap shippers from potential abuses of market power and that the exemption would promote several statutory policy objectives by removing regulation, encouraging effective competition, and allowing railroads to earn adequate revenues.¹⁵ However, based on major

⁹ *Ferrous Recyclables*, 10 I.C.C.2d at 636.

¹⁰ *Id.* at 636-637.

¹¹ *Id.* at 636.

¹² *Id.* at 641.

¹³ *Id.* at 642-643.

¹⁴ *Id.*

¹⁵ *Id.* at 639-640.

changes that have occurred to the transportation markets for iron and steel scrap shipments and to the governing statute, the findings made by the ICC back in 1995 no longer apply or are simply not relevant more than two decades later.

1. Recent Waybill Analyses Evidence An Increasing Exercise of Railroad Market Power Over Iron and Steel Scrap Shipments

Although ISRI has not performed its own Waybill analysis, the Board's recent analysis of the Waybill rate data for the period 1992 through 2013 indicates that railroads have increased their market power over iron and steel scrap movements, and that truck and water competition appears to have become less effective. This conclusion is based on the Board's finding that the volume of potentially captive iron and steel scrap traffic has increased substantially from 22.1% to 44%—**revealing that in 2013 almost one-half of all rail shipments of this commodity was priced at captive rate levels, i.e. the traffic had RVC ratios above the agency's 180% jurisdictional threshold for determining railroad market dominance; and that in 2013 the average RVC ratio for this captive traffic was 229.8%—also well above the 180% threshold.**¹⁶ The Board also found that increased pricing power over iron and steel scrap shipments is evidenced by an increase in the average length of rail movements for this traffic from 306 miles in 1992 to 420 miles in 2013.¹⁷ This conclusion is consistent with the practice of ISRI members who generally use rail instead of truck when the movement exceeds a certain distance. However, there is no single distance trigger for this shift in mode, since some members will choose rail when the distance exceeds 100 or 200 miles and for others the trigger may be closer to 500 miles.

¹⁶ NPRM at 8.

¹⁷ NPRM at 7.

Another Waybill analysis submitted in this proceeding is consistent with the Board's finding that there has been an increase in the railroads' market power over scrap shipments, although this other analysis was performed at a more macro-2-digit STCC level. Attached to the Comments of the Rail Customer Coalition ("RCC Comments"), submitted on July 25, 2016, is an Analysis of 2014 Freight Rail Rates for U.S. Shippers, prepared by Escalation Consultants, Inc. ("EC"). This analysis shows that **69%** of all scrap commodities shipped under STCC 40 (Waste or Scrap Materials) are priced at captive levels based on RVC ratios above 180%.¹⁸ Further, EC compared the change in the volume of carloads and the pricing for STCC 40 traffic in the years 2005 to 2014. This comparison established that, while the volume of total carloads decreased by 25.3%, **the amount of traffic that was priced above the 180% RVC threshold increased by 51.4%.**¹⁹ This plainly illustrates a substantial increase in the pricing power of the railroads as to STCC 40 traffic, which includes iron or steel scrap.

2. Changes to the Transportation Markets are Consistent with Increasing Railroad Market Power

The substantial increase in the pricing of iron or steel scrap at captive rate levels is not surprising following the extensive consolidation of the rail industry from more than 40 class I rail carriers in 1980 when the Staggers Rail Act was adopted to only seven class I railroads today. Notably, of the seven remaining class I rail carriers, only four dominate the nation's rail market, with two mega-carriers operating in the east and two operating in the west. The dramatic reduction in the number of rail service providers has increased substantially the number of iron or steel scrap movements that are captive to only one railroad at either origin or destination. Indeed, some ISRI members have reported that 90-100% of their rail traffic is currently captive.

¹⁸ RCC Comments, EC Study at 7.

¹⁹ RCC Comments, EC Study at 8.

Moreover, information from ISRI's members collected 10 years after the exemption was adopted, and more recent information collected via an informal survey, are also consistent with an increase in the exercise of railroad market power. Specifically, data collected in 2005 showed that 71% of ISRI members reported rail price increases between 10%-30% between the single year of 2004-2005 alone. More recently, members have reported anecdotally that rail rates have continued to rise steadily over the past decade. While some shipments of iron and steel scrap can move via truck, the simple fact is that for most ISRI members a portion of their traffic is rail-dependent. The reasons why some traffic must move by rail includes factors such as the distance of the movement (with some members needing to ship via rail at distances of 100 or 200 miles, whereas for others its 500 miles), customer requirements, loading and unloading infrastructure at facilities, as well as the availability of sufficient truck capacity.

High railroad prices are not the only concern for ISRI members. Indeed, service reliability, equipment shortages, and a lack of investment in the gondola fleet has been problematic for ISRI members. Rail car shortages make it extremely difficult for the scrap recycling industry to meet their customers' needs and time sensitive supply chains. The railroads' market power is also evidenced by their refusal to negotiate reasonable contract rates and terms. Instead, the railroads often impose take-it or leave-it contract terms onto iron and steel scrap shippers. This lack of contract negotiating leverage is plain evidence of unequal bargaining power. Accordingly, it is ISRI's strong belief that the Board should re-establish its regulatory oversight over iron and steel scrap shipments.

3. Changes to the Statute Nullify Key Benefits of the Exemption

As explained above, one of the primary reasons that ISRI and the AAR asked the ICC to grant the iron or steel scrap exemption twenty years ago was to eliminate certain regulatory

burdens, including the filing of tariffs and contract summaries, that hindered the ability of railroads to effectively compete with trucks. However, when Congress passed ICCTA in late 1995, it further deregulated the rail industry and removed burdensome rate and contract requirements for shippers of **all** commodities. Among other changes, ICCTA eliminated the requirements for rail carriers to file with the government tariffs, contracts, and contract summaries except for agricultural contracts.²⁰ Carriers could also implement rate decreases immediately.²¹ Thus, ICCTA completely eliminated a number of regulatory requirements that the ICC had relied on to support the grant of the iron and steel scrap exemption. Thus, as a legal matter, the ICC's conclusion that the elimination of these unnecessary regulatory requirements through the grant of an exemption, along with their concomitant cost savings and efficiency gains, would advance the Rail Transportation Policy, no longer holds true. In fact, in the post-ICCTA environment, a shipper of exempt iron or steel scrap receives **no** regulatory benefits or advantages. Rather, these shippers are only disadvantaged by the loss of access to regulatory protections at a time when the railroads have clearly increased their market power over shipments of iron and steel scrap as shown above.

B. Restoring STB Oversight With Respect to Iron and Steel Scrap Shipments is Consistent with the Rail Transportation Policy

As previously noted, the Board has authority to revoke a class exemption if it determines that regulation, in whole or in part, is necessary to carry out the Rail Transportation Policy at 49 U.S.C. § 10101.²² In its NPRM, the Board has determined that revoking the iron and steel scrap

²⁰ 49 U.S.C. § 10709 and § 10709(d)(1) (1996).

²¹ 49 U.S.C. § 11101 (1996).

²² 49 U.S.C. § 10502(d).

exemption would satisfy this statutory standard. Specifically, the Board determined that reestablishing regulatory oversight is necessary:

- to foster sound economic conditions in transportation;²³
- maintain reasonable rates where there is an absence of effective competition;²⁴ and
- to prohibit predatory pricing and practices, avoid undue concentrations of market power, and prohibit unlawful discrimination.²⁵

Based on the Board's Waybill analysis, supplemented by the experiences of ISRI's members and the comments herein, the Board's decision to revoke the iron and steel scrap exemption is entirely justified under the statute. The Board's own analysis shows that nearly one-half of iron and steel scrap traffic, i.e. 44%, is priced at captive rate levels and that the average RVC for such traffic is well above the statutory threshold of 180%. Thus, it would be entirely appropriate to allow iron or steel scrap shippers who are facing increasing rate levels to potentially challenge before the Board any rail rates that are believed to be unreasonably high, without first having to litigate the exemption revocation issue. Clearly, the application of such regulation is consistent with all of the rail transportation policies described above.

Likewise, based on ISRI's members' experiences with lackluster rail service and limited bargaining power vis-à-vis the railroads, providing the mere opportunity for iron and steel scrap shippers to bring a service complaint before the Board, again without having to first litigate the exemption revocation issue, would simply place iron or steel scrap shippers on equal footing with other non-exempt shippers who can readily seek redress at the Board when necessary. Currently, ISRI members can only pursue an STB remedy if they are willing to litigate the

²³ 49 U.S.C. § 10101(5).

²⁴ 49 U.S.C. § 10101(6).

²⁵ 49 U.S.C. § 10101(12).

exemption revocation issue at the outset, which only adds to the cost and complexity of the proceeding and discourages such exempt shippers from seeking relief at the Board. Thus, revoking the iron or steel scrap exemption would also be consistent with the policy “to require fair and expeditious regulatory decisions when regulation is required.”²⁶

Presumably, the railroads may oppose the Board’s proposed exemption revocation by asserting that the revocation is inconsistent with the statutory policies to promote the earning of adequate railroad revenues,²⁷ and “to minimize the need for Federal regulatory control over the rail transportation system,”²⁸ which were the focus of the ICC back in 1995. However, the resounding financial strength of the railroad industry today, as compared to two decades ago when the exemptions were granted, renders the policy to promote adequate rail revenues significantly less relevant. Indeed, the changed financial condition and incredible financial success of the present-day rail industry is evidenced by a recent Congressional study, as well as the Board’s own findings of railroad revenue adequacy in recent years.²⁹ The policy which

²⁶ 49 U.S.C. § 10101(2).

²⁷ See 49 U.S.C. § 10101(3).

²⁸ 49 U.S.C. § 10101(2).

²⁹ 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 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.”).

focuses on minimizing the need for regulation is also insignificant here, since it is directly at odds with the Board's authority to revoke an exemption provided under 49 U.S.C. § 10502(d).

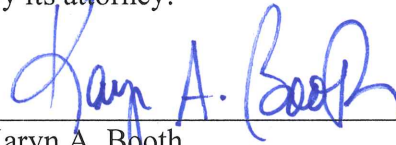
III. CONCLUSION

For the foregoing reasons, ISRI respectfully requests that the Board adopt its current proposal to revoke the existing class exemption for iron or steel scrap.

Respectfully submitted,

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