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SERVICE DATE – LATE RELEASE JANUARY 11, 2011

SURFACE TRANSPORTATION BOARD

NOTICE

Docket No. EP 705

COMPETITION IN THE RAILROAD INDUSTRY

Decided: January 11, 2011

AGENCY: Surface Transportation Board.

ACTION: Notice.

SUMMARY: The Surface Transportation Board will receive comments and hold a public hearing to explore the current state of competition in the railroad industry and possible policy alternatives to facilitate more competition, where appropriate. The Board is seeking written comments prior to the hearing addressing the legal, factual, and policy matters described below.

DATES: Initial comments are due on February 18, 2011. Reply comments are due 28 days thereafter, on March 18, 2011. The hearing will begin at 9:30 a.m., on Tuesday, May 3, 2011, in the Board's hearing room at the Board's headquarters located at 395 E Street, S.W., Washington, DC. The Board plans to hold the hearing in a single day, but may extend the hearing if the number of participants or the breadth of submitted written testimony so requires. The hearing will be open for public observation. However, only parties who have notified the Board of their intent to participate will be permitted to speak. Any party wishing to speak at the hearing shall file with the Board a notice of intent to participate (identifying the party, the proposed speaker, and the time requested) no later than April 4, 2011. With the notice of intent, the party shall provide written testimony on the issues it will address at the hearing.

ADDRESSES: All filings may be submitted either via the Board's e-filing format or in the traditional paper format. Any person using e-filing should attach a document and otherwise comply with the instructions at the "E-FILING" link on the Board's "www.stb.dot.gov" website. Any person submitting a filing in the traditional paper format should send an original and 10 copies of the filing to: Surface Transportation Board, Attn: Docket No. EP 705, 395 E Street, S.W., Washington, DC 20423-0001.

Copies of written submissions will be posted to the Board's website and will be available for viewing and self-copying in the Board's Public Docket Room, Suite 131. Copies of the submissions will also be available (for a fee) by contacting the Board's Chief Records Officer at (202) 245-0236 or 395 E Street, S.W., Washington, DC 20423-0001.

FOR FURTHER INFORMATION, CONTACT: Amy Ziehm at (202) 245-0391. Assistance for the hearing impaired is available through the Federal Information Relay Service (FIRS) at (800) 877-8339.

**SUPPLEMENTARY INFORMATION:** The rail network in the United States is a series of interconnected lines owned by various rail carriers. Because of the high fixed cost associated with building a rail network, sometimes there is only one railroad serving a particular destination and origin. Some companies that either ship by rail, or would like to do so, have complained about being physically limited to a single rail carrier and would like to have greater access to competition from other railroads. Some shippers have suggested that mandated access by a second carrier to singly served businesses would be in the public interest. Railroads have responded that such an action would undermine their ability to price their services differentially based on demand and that, as a result, they would be unable to earn enough revenue to invest sufficiently in their networks. Over the years, various possible measures that would change the way rail shippers currently obtain access to rail service have been debated, including: (1) requiring railroads to quote a rate between any two points they serve to allow another railroad to serve the shipper from an intermediate point to the final destination; and (2) imposing new rules for competitive access, such as mandated reciprocal switching or mandated terminal use arrangements, including trackage rights.

It has been some time since the agency has conducted a thorough analysis of these issues. More than a decade ago, the Board conducted a comprehensive analysis of “captive shippers” and their available remedies for rate relief, as well as the incumbent railroad’s rights and obligations. This analysis culminated in a series of decisions collectively known as the “Bottleneck” cases. Cent. Power & Light v. S. Pac., et al., 1 S.T.B. 1059 (1996) (Bottleneck I), clarified, 2 S.T.B. 235 (1997) (Bottleneck II), aff’d sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir. 1999).

The Board also conducted a review of its competitive access standards in Review of Rail Access & Competition Issues, 3 S.T.B. 92 (1998).<sup>1</sup> More recently, in response to a recommendation of the United States Government Accountability Office (GAO),<sup>2</sup> the Board commissioned Christensen Associates, Inc. (Christensen Associates), to perform an independent study to examine these issues. The resulting report, A Study of Competition in the U.S. Freight

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<sup>1</sup> The competitive access standards were originally adopted by the Interstate Commerce Commission (ICC), the Board’s predecessor agency, in the mid-1980s. Intramodal Rail Competition, 1 I.C.C. 2d 822 (1985), aff’d sub nom. Balt. Gas & Elec. v. United States, 817 F.2d 108 (D.C. Cir. 1987); and applied in Midtec Paper Corp. v. Chi. & Nw. Transp. Co., 3 I.C.C. 2d 171 (1986), aff’d sub nom. Midtec Paper Corp. v. United States, 857 F.2d 1487 (D.C. Cir. 1988).

<sup>2</sup> Government Accountability Office, Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed, GAO-07-94, October 6, 2006, pp. 1-2. The GAO stated: “We are recommending that STB conduct a rigorous analysis of the state of competition nationwide and, where appropriate, consider the range of actions available to address problems associated with the potential abuse of market power.”

Railroad Industry and Analysis of Proposals That Might Enhance Competition (November 2009), is available on the Board's website or at <http://www.Irca.com/railroadstudy/>.<sup>3</sup>

The United States railroad industry has changed in many significant ways since the Board's competitive access standards were originally adopted in the mid-1980s. Among the more salient developments have been the improving economic health of the railroad industry, increased consolidation in the Class I railroad sector,<sup>4</sup> the proliferation of a short line railroad network, and an increased participation of rail customers in car ownership and maintenance, as well as other activities previously undertaken by the carrier. Since 1980, railroad productivity improved dramatically, resulting in lower transportation rates. However, productivity gains appear to be diminishing and, since 2004, overall rail transportation prices have increased. See Christensen Update at i & 3-26. Taken together, these events suggest that it is time for the Board to consider the issues of competition and access further.

The Bottleneck Issue. A rail bottleneck rate issue arises when more than one railroad can provide service over at least a portion of the movement of a shipper's goods from an origin to a destination, but where either the origin or destination is served by only one carrier, i.e., the bottleneck carrier. In each of the Bottleneck cases, an electric utility company sought to require the bottleneck carrier to establish a "local rate" for a segment of the through movement that was served only by that carrier, so that the utility could combine that local rate with a rate for the

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<sup>3</sup> In addition to the original November 2008 report (which was revised as of November 2009), Christensen Associates has provided the Board with two supplemental reports: An Update to the Study of Competition in the U.S. Freight Railroad Industry (January 2010) (Christensen Update); and Supplemental Report to the U.S. Surface Transportation Board on Capacity and Infrastructure Investment (March 2009). These reports are also available in the E-Library on the Board's website under "Studies," and at the URL provided above. In this notice, "Christensen Study" refers collectively to the original and supplemental reports.

The Board solicited and received public comments on the Christensen Study, Supplemental Report on Capacity & Infrastructure Inv., EP 680 (Sub-No. 1) (STB served Apr. 8, 2009); Study of Competition in the Freight R.R. Indus., EP 680 (STB served Nov. 6, 2008). Many of the issues discussed in the Christensen Study are also relevant to the proceeding that is being initiated here. As such, parties are invited to discuss in EP 705 any aspect of the Christensen Study that is relevant to the topic of competition in the railroad industry. Because EP 680 and EP 680 (Sub-No. 1) have served their limited purpose of initiating a discussion on competition and capacity in the United States freight rail industry, and because a significant portion of that discussion can continue in the proceeding being initiated here, EP 680 and EP 680 (Sub-No. 1) will be discontinued on the service date of this decision.

<sup>4</sup> The Board designates 3 classes of freight railroads based upon their operating revenues, for 3 consecutive years, in 1991 dollars, using the following scale: Class I – \$250 million or more; Class II – less than \$250 million but more than \$20 million; and Class III – \$20 million or less. These operating revenue thresholds are adjusted annually for inflation. 49 C.F.R. pt. 1201, 1-1. Today, there are 7 Class I carriers and approximately 550 short line carriers (i.e., Class II and Class III carriers) operating in the United States.

remainder of the movement by another carrier. The utilities further sought to be able to separately challenge the reasonableness of the rate for the bottleneck segment of the movement, rather than having to challenge the origin-to-destination rate in its entirety. Each of the utilities in the Bottleneck cases sought to divide the bottleneck carrier's long-haul and through rate into smaller portions that could be priced and, accordingly challenged, independently. The utilities believed that the total charges would be lower if the reasonableness of the rates were adjudicated only for the bottleneck portion of the movement (with the rate set by head-to-head rail competition for the remainder of the movement), rather than for the entire movement. Because the Bottleneck cases raised issues of broad importance, the Board provided for extensive public input and held an oral argument.

In the resulting decisions, the Board concluded that a shipper could not routinely direct a bottleneck carrier that was capable of providing origin-to-destination rail service for that shipper to "short-haul" itself by routing traffic over the lines of the non-bottleneck carrier. Rather, the Board held that a shipper could seek to force an alternative routing that would include the line of the non-bottleneck carrier only if it could show, under 49 U.S.C. § 10705 and the Board's "competitive access" rules developed in Intramodal Rail Competition, that there would be sufficient benefits associated with the alternative routing.<sup>5</sup> The Board also held that, under 49 U.S.C. §§ 11101(a) and 10742, a bottleneck carrier generally cannot refuse traffic from other carriers originating at sources that the bottleneck carrier *does not* serve, even if the bottleneck carrier can carry the identical commodity in its own single-line service from another source. Bottleneck I, 1 S.T.B. at 1063-64.

Finally, for either type of movement—same-source movements for which a shipper has successfully obtained an alternative routing, or different-source movements that the bottleneck carrier cannot handle in single-line service—the Board held that it could not force the bottleneck carrier to quote a separately challengeable rate for the bottleneck segment unless the requesting shipper had already entered into a rail contract for the non-bottleneck segment at the time that the bottleneck rate was requested. In so ruling, the Board relied on the Supreme Court decision in Great Northern Railway v. Sullivan, 294 U.S. 458, 463 (1935), which held that the reasonableness of through rates established by carriers should in general be evaluated from origin-to-destination, rather than on a segment-by-segment basis.<sup>6</sup>

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<sup>5</sup> Specifically, the Board's rules state that the shipper must, in such a case, demonstrate the requested alternative route "is necessary to remedy or prevent an act that is contrary to the competition policies of 49 U.S.C. § 10101 or is otherwise anticompetitive, and otherwise satisfies the criteria of 49 U.S.C. § 10705 . . . ." The Board will also consider several other enumerated factors, including efficiency, revenues, costs, and rates charged. The Board must further find that the complaining shipper (or carrier) would use the alternative route for a "significant portion of its current or future service . . . ." See 49 C.F.R. § 1144.2.

<sup>6</sup> The Board rejected the notion that the shipper could first request the bottleneck rate, and then enter into a contract for the remaining portion of the route. Rather, under Great Northern Railway, the Board considered the contract to be a condition antecedent to the request for the bottleneck tariff quote.

Competitive Access. Competitive access can take the form of mandated reciprocal switching, terminal use, or trackage rights. Reciprocal switching involves the incumbent railroad transporting traffic, usually for a short distance, over its own track on behalf of a competing railroad for a fee. Reciprocal switching thus enables the competing railroad to offer its own single-line rate, even though it cannot physically serve the shipper's facility, to compete with the incumbent's single-line rate. The agency has in the past held that reciprocal switching should not be ordered absent a showing of competitive abuse. More specifically, the complaining party must show that the incumbent railroad has used its market power to extract unreasonable terms or, because of its monopoly position, has disregarded the shipper's needs by rendering inadequate service. Midtec, 3 I.C.C. 2d at 181.

Unlike reciprocal switching, forced terminal arrangements (including some forms of trackage rights) involve the physical presence of a competing carrier on a host carrier's facilities owned by the incumbent railroad. Under terminal agreements, an incumbent railroad grants access to its terminal facilities or tracks to another carrier's trains for a fee so that the non-incumbent can serve traffic it would otherwise be unable to access.

Interchange Commitments. Interchange commitments can also fall under the broad rubric of competition and competitive access in the railroad industry. These are contractual provisions included with a sale or lease of a rail line that limit the incentive or the ability of the purchaser or tenant carrier to interchange traffic with rail carriers other than the seller or lessor railroad. The Board has addressed interchange commitments in Review of Rail Access and Competition Issues—Renewed Petition of the Western Coal Traffic League, EP 575, et al. (STB served Oct. 30, 2007), and Disclosure of Rail Interchange Agreements, EP 575 (Sub-No. 1) (STB served May 29, 2008). There are also several pending cases before the Board that will continue to develop, on a case-by-case basis, the Board's policies. Because we will continue to consider these issues and look to improve the processes associated with transactions involving interchange commitments, this hearing will not focus on interchange commitments or the approach adopted in EP 575.

## PROCEDURES:

This proceeding is intended as a public forum to discuss access and competition in the rail industry, and with a view to what, if any, measures the Board can and should consider to modify its competitive access rules and policies; whether such modification would be appropriate given changes over the last 30 years in the transportation and shipping industries; the effects on rates and service these rules and policies have had; and the likely effects on rates and service of changes to these policies. The Board is providing an opportunity for any person or entity that wishes to participate to file written prepared comments in advance of the hearing, and the Board will provide an opportunity to parties to file replies to those comments. Subsequently, the Board will hold an oral hearing at the agency to explore the issues in more depth.

In particular, we urge the parties to focus their comments, and subsequent testimony and statements for the hearing, as follows:

1. **The Financial State of the Railroad Industry.** Parties are invited to comment on the evolving economic state of the railroad industry. The industry has changed significantly since 1980, when Congress passed the Staggers Act of 1980, Pub. L. 96-448, 94 Stat. 1895 (1980) (Staggers) and the ICC began the process of devising the current competitive access rules and policies. Today, the industry is in substantially stronger condition financially. In this regard, parties should address both the findings and conclusions of recent studies of the railroad industry, including (but not limited to) the Christensen Study and the joint study of United States Departments of Agriculture and Transportation.<sup>7</sup>
2. **49 U.S.C. § 10705** (alternative through routes). Parties are invited to discuss how to construe this provision in light of current transportation market conditions. In this regard, parties may address pre-Staggers practice, Staggers' effect on this issue, and whether there are statutory constraints on the Board's ability to change policy at this time. Parties are specifically invited to comment on the differences between §§ 10705(a)(1) and 10705(a)(2), the circumstances under which carriers may seek to protect their long hauls under § 10705(a)(2), and whether § 10705(a)(2) should apply where multiple carriers can originate the traffic, but only a single carrier can deliver the traffic to its destination.
3. **49 U.S.C. § 11102(a)** (terminal facilities access). Parties are invited to discuss how to construe the terminal access provision in light of current transportation market conditions. Again, parties may address pre-Staggers practice, Staggers' effect on this issue, and whether there are statutory constraints on the Board's ability to change policy at this time. The Board is also interested in how the definition of "terminal facility" evolved over time.
4. **49 U.S.C. § 11102(c)** (reciprocal switching agreements). Parties are invited to discuss, separately from the terminal facilities access provision, how to construe this provision in light of current transportation market conditions. Again, parties may address pre-Staggers practice, Staggers' effect on this issue, and whether there are statutory constraints on the Board's ability to change policy at this time. In particular, parties should address whether the broad "practicable and in the public interest" standard in the statute should be constrained by the provision permitting relief "where . . . necessary to provide competitive rail service." Finally, parties may discuss the distance limitations, if any, associated with this provision.
5. **Bottleneck Rates.** Parties are invited to discuss whether the Board could and should change its precedent finding only narrow authority to compel a railroad to quote a separately challengeable rate for a portion of a movement. Parties are also asked to comment on how the Great Northern Railway decision—holding that the reasonableness

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<sup>7</sup> Study of Rural Transportation Issues, <http://www.ams.usda.gov> (follow "Publications" hyperlink; then follow "Agricultural Transportation" hyperlink; then follow "Congressional Studies" from the dropdown menu; then follow "04-10: Study of Rural Transportation Issues" hyperlink).

of a through rate established by carriers is only relevant to the shipper as to the total rate charged, and thus should be evaluated from origin to destination rather than on a segment-by-segment basis—can reasonably be applied in today’s transportation world. In particular, we want to explore how the agency would evaluate the reasonableness of the more elaborate through rates used in today’s global transportation industry including, for example, a local truck movement at origin, a transload to rail for shipment to a port, an international water movement, and finally a foreign rail or truck movement to destination. In such an example, do Great Northern Railway and other precedent require the agency to evaluate the reasonableness of the rates exclusively from origin to destination? If so, how could the agency evaluate the entire through rate when a portion of that rate includes transportation outside the Board’s jurisdiction? Or does the agency have the discretion to permit the shipper to challenge just the rail carrier’s division of the international through rate? Does the agency have discretion in other purely domestic settings? Participants may also address the role that short lines play in through rates, and whether the reasoning in Great Northern Railway encompasses “bottleneck” situations and a more highly concentrated rail industry. Should freight rail customers be allowed to determine intermediate origin and destination points that would enable a competing carrier or mode to serve the shipper’s final destination?

6. **Access Pricing.** If the Board were to modify its competitive access rules, it would also need to address the access price. The Board seeks comments on what tools it can and should consider using (within statutory and constitutional limits) in evaluating how the carriers can assess terminal access prices, reciprocal switch fees, or segment rates, such as Constrained Market Pricing principles, or an alternative set of principles, such as cost-based pricing principles or Efficient Component Pricing. What role, if any, should a carrier’s current financial standing and future prospects bear in this determination?<sup>8</sup>
7. **Impact.** Finally, we invite comments from all interested parties on the positive and negative impact any proposed change would have on the railroad industry, the shipper community, and the economy as a whole. The introduction of greater rail-to-rail competition could improve service and lower rates for captive shippers. But a loss of revenue could lead to less capital investment, constraining capacity and deteriorating service for future traffic. Any party advocating a change should address these impacts.

In addition to the guidance provided above, parties are welcome to offer their comments on any other aspect of our competitive access rules. Parties are also invited to comment on the specific questions in our prior order on this similar subject. Policy Alts. to Increase Competition in the R.R. Indus., EP 688 (STB served Apr. 14, 2009).

BOARD RELEASES AND LIVE VIDEO STREAMING AVAILABLE VIA THE INTERNET: Decisions and notices of the Board, including this notice, are available on the Board’s website at

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<sup>8</sup> A basis for the Board’s historic pricing policy under Staggers and ICCTA was to permit demand-based differential pricing and allow captive shippers to bear a greater share of the carriers’ fixed and common costs to help the railroads achieve revenue adequacy.

“www.stb.dot.gov.” This hearing will be available on the Board’s website by live video streaming. To access the hearing, click on the “Live Video” link under “Information Center” at the left side of the home page beginning at 9:00 a.m. on May 3, 2011.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. A public hearing in this proceeding will be held on Tuesday, May 3, 2011, at 9:30 a.m., in the Surface Transportation Board Hearing Room, at 395 E Street, S.W., Washington, DC, as described above.
2. Initial comments are due on February 18, 2011.
3. Reply comments are due on March 18, 2011.
4. By April 4, 2011, parties wishing to speak at the hearing shall file with the Board a notice of intent to participate identifying the party, the proposed speaker, and the time requested. With the notice of intent, the party shall provide written testimony on the issues it will address at the hearing. Written submissions by interested persons who do not wish to appear at the hearing are also due by April 4, 2011.
5. This decision is effective on the date of service.

By the Board, Rachel D. Campbell, Director, Office of Proceedings.