BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

INITIAL COMMENTS OF
CONSUMERS UNITED FOR RAIL EQUITY

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In its Notice served January 11, 2011 in this proceeding, the Surface Transportation Board ("Board") sought comments on various issues of great importance to the railroad industry, rail shippers, and the nation. 76 Fed. Reg. 2748 (Jan. 14, 2011). Consumers United for Rail Equity ("CURE") hereby submits these Initial Comments in response to the Notice.

INTEREST OF CURE AND ITS MEMBERS

CURE is an incorporated, non-profit advocacy group with the single purpose of seeking rail policy favorable to rail-dependent shippers, many of which qualify as captive rail customers for at least some of their rail movements. CURE is sustained financially by the annual contributions of its members, who are individual rail-dependent rail customers and national trade associations. Included in CURE are electric utilities that generate electricity from coal, chemical companies, forest and paper companies, cement companies, agricultural entities, various manufacturers and national associations, including both trade associations and associations of governmental institutions whose members work to protect consumers. The issues that are the subject of this proceeding potentially affect all CURE members.

THE ISSUES

National rail policy is provided in the Staggers Rail Act of 1980 ("Staggers Act") as amended by the Interstate Commerce Commission Termination Act of 1995. The theory of current federal rail policy is that competition should determine rail rates, wherever possible, with government rate judgments restricted to those situations in which there is an absence of effective transportation competition. Thus, the nation's freight railroads are not required to seek agency approval of rates, but rather are free to charge rates at levels they deem appropriate.

Government agency action on rates occurs only when a rail customer proves that it lacks access to transportation competition, the rate is above the jurisdictional level established by statute and the rate is unreasonably high. In these challenges, the rail customer bears all burdens of proof and, at least in most instances, unless the customer can justify a stay of a rate increase, must pay the rate until the agency orders the rate to be reduced.

The government agency, the Surface Transportation Board ("Board") has jurisdiction to prevent "unreasonable rail practices", including violations of a railroad's "common carrier" obligation. This authority is not restricted to those situations in which the rail customer or customers subject to these practices are "captive rail customers."

The Board is directed to implement current statutory law on rail policy in accordance with the national rail transportation policy that is provided in the Staggers and ICC Termination Acts. That policy, in relevant part, is:

- ***"To ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes, to meet the needs of the public and national defense";***
- ***"... to ensure effective competition and coordination between rail carriers and other modes ..."; and***
- ***"... to avoid undue concentrations of market power...."***

(49 U.S.C. 10101 (4), (5) and (12))

We believe that three decades after partial deregulation of the national freight railroad industry, the Board is correct to review the national freight rail system to determine if the implementation of current law has resulted in:

> ***"a sound rail transportation system...with effective competition among rail carriers and with other modes...(that has avoided) undue concentration of market power."*** *(parenthetical added)*

OUR VIEW

The implementation of current law by the Board and its predecessor has resulted in a handful of major freight railroads that are financially robust and dominate the national freight rail system. However, the national rail transportation system is not "sound" because it lacks "effective competition among rail carriers" and has resulted in the "undue concentration of market power" in the hands of the remaining major freight railroads, particularly the four largest rail carriers that dominate the freight rail transportation market.

Domestic rail transportation customers generally report an abrupt change in the conduct of the major freight railroads in 2003: any remaining competition for market share between the major freight railroads seemed to cease at that time. This time frame coincides with the point at which Wall Street analysts began touting the “market power” of the major freight railroads, rail customer complaints began regarding railroad fuel surcharge practices and railroad rates began to rise sharply as reported by the United States Department of Transportation graph (See Attachment A) and the various L.R. Christensen and Associates Reports to the Board.

We believe the Board has the legal authority and the legal obligation to adjust its application of current law to respond to developments in the national freight rail system to ensure effective competition among rail carriers, where possible, and to avoid undue concentration of market power in the remaining freight railroads. We believe the time has come to make some simple adjustments in the Board’s regulatory practices.

THE BOARD’S ACTIONS IN THIS PROCEEDING ARE IMPORTANT TO THE NATION

We believe that the Board’s action or inaction pursuant to this proceeding will have profound implications for our national economy, for the creation of American jobs, and for increasing American exports. The current lack of competition in the national freight rail system has the unintended consequence that foreign imported goods are receiving more favorable rail transportation prices and service in the United States than many domestically manufactured and produced goods that are struggling to compete against these foreign goods in our domestic market. Foreign goods normally arrive at our ports in containers whose shippers benefit as to both price and service by the fact that there normally is a choice of ports of entry served by different major railroad systems. Thus, foreign imported goods normally are assured of competitive rail rates and service for the movement of their goods inside the United States. Arriving in lots of up to 2000 containers per vessel, these containers are loaded onto double-decker unit trains at a port for efficient transportation to Chicago or New Orleans for distribution around the nation.

By contrast, many of our rail-dependent domestic manufacturers and producers are served by a single railroad system, often resulting in captive or at least very high rates and sometimes unreliable service. Moreover, no single manufacturing location in the United States is able to load a unit train of containers for movement to Chicago or New Orleans that is as efficient as the container unit trains assembled at our ports of entry.

Examples of the anti-competitive problems being faced by domestic manufacturers and producers, sometimes as they seek to enter our export market on competitive terms, are contained in the record of the Ex Parte No. 704 proceeding and similar examples may be forthcoming in this proceeding. Few of the filings in the Ex Parte No. 704 proceeding complained about rates that could not be challenged due to existing commodity exemptions, but rather about potentially unreasonable railroad practices disadvantaging domestic manufacturers and producers that cannot be brought to the Board for review so long as the existing commodity exemptions are in place.

If the Board completes its review and determines that no adjustments in policy are appropriate, the nation will continue to lack a sound national rail transportation system that, albeit unintentionally, favors foreign imports over domestic production. However, with a few simple adjustments in policy, which rail customers are convinced the Board has the legal authority to adopt, increased rail-to-rail competition will benefit at least some domestic manufacturers and producers by allowing them access to rail transportation competition, thus reducing the advantage of foreign imports in the current national rail transportation system.

OUR RECOMMENDATIONS

We incorporate by reference herein the joint rail customer comments to which CURE is a party.

We believe the consistently glowing Wall Street financial analyses of the major freight railroads, the purchase of all of the stock of Burlington Northern Santa Fe Railway Company at a premium by Berkshire Hathaway, and the excellent September 15, 2010 report on railroad financial health by the Majority Staff of the Committee on Commerce, Science and Transportation of the United States Senate all prove beyond a reasonable doubt that the major freight railroads are able to “attract and retain the capital needed to provide a sound transportation system in the United States”. (49 U.S.C. 10704 (a) (2) (B)) We believe the Board has the legal authority to adopt the policy modifications we recommend. Under the Chevron[1] doctrine, the Board generally has wide discretion in the implementation of the law entrusted to it for implementation.

BOTTLENECK RULE

Our View

One of the major impediments to rail-to-rail competition in the freight rail industry is the Board's December 31, 1996 decision in the "bottleneck" cases. In an industry where very few rail customers are served by more than a single railroad, it is hard to imagine how rail-to-rail competition can occur unless a rail customer can gain access to a second rail system that could offer an alternative route to the destination for at least part of the movement in question. In a national rail system that is so consolidated that virtually no rail-dependent customer has access to more than two railroads, the "savings clause" exception to the bottleneck rule has not occurred. Rarely, if ever, has a rail-dependent customer obtained a written contract for the potentially competitive portion of a movement that would support a Board order setting a bottleneck rate. That these contracts are not attainable is not at all surprising to rail customers and the reasons are so obvious as to warrant no further discussion. Thus, the competitive alternative that the Board in its 1996 decision may have contemplated has not developed. Whether this knowledge, if known then, would have changed the ruling of the Board cannot be known.

[1] *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837, 842-43 (1983).

Our Recommendation

No other at least partially deregulated network industry has been allowed to retain a similar power to the bottleneck rule to maintain its market power after deregulation. Indeed, in those industries serving the ultimate consumer/voter directly, such a retained power would be inconceivable.

Our recommendation is that major railroads be required to provide a rate to any interchange point on a competing rail system when requested by a rail customer. If the rail customer in question has access to effective transportation competition, these rates likely are already being provided. If the rail customer is captive, the rate should be subject to the rate reasonableness challenge process of the Board.

We believe any "problems" that could be conceived by the rail industry or the Board resulting from such a simple and obviously pro-competitive policy will sort themselves out in the market or through the Board's established processes. Some rail customers have become sufficiently cynical as to believe the major railroads will not compete for the segment of the movement where alternative rail routes are available. Perhaps they are right, but if that is so, it would put the entire concept of freight railroad partial deregulation in question. We are not yet so cynical. We believe access to a potentially competing railroad must be tried. Since the circumstances envisioned by the Board in its December 1996 decision have not occurred, we believe the Board is well within its rights to revisit and modify its policy on bottleneck rates.

RECIPROCAL SWITCHING AND TERMINAL ACCESS

<u>Our View</u>

Rail-to-rail competition cannot occur in the national rail system as long as a railroad can deny access across a switch or to a terminal area for other than operational reasons or charge rates that have the same effect. In the Staggers Act, the Congress addressed this issue, providing that railroads "...shall provide reasonable, proper and equal facilities that are within its power to provide for the interchange of traffic...." (49 U.S.C. 10742) The implementation of this fairly straight forward provision became much more difficult when the Board's predecessor interpreted this provision to require a showing of "competitive abuse". A simple review of the Board's records since this requirement was adopted in the *Midtec*[2] decision in the late 1980s indicates that this strict test has prevented the free flow of traffic in a competitive national freight rail system except where the railroad controlling the facilities is a willing participant in the movement.

<u>Our Recommendation</u>

The Board should remove the "competitive abuse" requirement that was adopted in the *Midtec* decision. The Board's predecessor adopted this interpretation of the statute; the Board can and should remove the test to ensure "effective competition among rail carriers". Changing this test is essential if the Board is to ensure a "sound" national transportation system that includes "effective competition among rail carriers". For example, if the Board requires a

[2] *Midtec Paper Corp. v. Chicago and North Western Transportation Company*, 3 I.C.C.2d 171 (1986), *aff'd Midtec Paper Corp. v. United States*, 857 F.2d 1487 (D.C. Cir. 1988).

rate to be quoted to a point of access to a competing railroad, but the switching facility at that point is controlled by the incumbent carrier, the failure to remove the “competitive abuse” requirement could defeat the potential increased access to competition.

ACCESS FEE

Our View

Rail customers believe that the freight railroads have a right to be compensated appropriately for the use of their switching and terminal area facilities. This is an issue that has been confronted by other federal regulatory agencies that oversee partially deregulated network industries. We encourage the Board to look to the solutions adopted by the other federal regulatory agencies.

Our Recommendation

We believe there are two elements to a solution to the access fee issue. First, each railroad should adopt and post an access fee that it must use for all access situations, whether voluntary or involuntary. Second, the access fee that the railroad adopts cannot be higher than what it would charge itself, an affiliate or another railroad in a voluntary transaction. This rule should be subject to the “unreasonable rail practice” complaint process and the Board’s own authority to act to prevent such practices in the rail industry.

ADDITIONAL THOUGHTS AND RECOMMENDATIONS

Although the Board has not solicited the following comments, we offer these comments for possible consideration by the Board.

PAPER BARRIERS

Rail customers believe “paper barriers” that last longer than a relatively finite period of time are unconscionable and often prevent the achievement of rail to rail competition and a sound national freight rail transportation system. One important mechanism for injecting competition into the national freight rail system was and is the transfer, to a smaller railroad, of operating rights over track that previously belonged to a major railroad. Often this track could provide access to more than just the major railroad that owns the track. That these new competitive transportation opportunities often have been blocked by the unilateral and undisclosed actions of the major railroads, without the opportunity for agency review, is simply unconscionable.

Rail customers can accept a paper barrier for a finite period of time to allow the recovery of the value of the operating rights by the major railroad. However, a paper barrier that lasts for up to sixty years, as per the one example that has become public, is for no other purpose than to extend a railroad’s market power over the traffic in a specific geographic area after partial deregulation. Such sustained market power in a system of presumed deregulation clearly adversely affects the national economy and the public interest and violates a specific provision of the national rail transportation policy contained in 49 U.S.C. 10101.

PHYSICAL CONNECTION TO TWO RAILROADS

Presumed Access to Competition

As stated previously, the idea that a rail customer with physical connection to two major railroads at origin or destination has access to competition has been questionable since about 2003. It is appropriate for the Board to presume access to competition in such a situation, but the Board should be attentive to rail customer showings that one of the two railroads is not competing for the rail customer's business. When such a showing is made, the fact of physical connection to more than one major railroad system should not defeat a finding that the rail customer is subject to "market dominance". Rail customers do not approach the Board lightly; their presentations to the Board on this issue should not be taken lightly.

RATE REASONABLENESS STANDARD

The current rate reasonableness standard of the Board is both unique and difficult to apply, regardless of the soundness of its theoretical basis. When the Board's predecessor adopted the test in its 1985 *Coal Rate Guidelines, Nationwide,*[3] the predecessor recognized that the standard was highly unusual and generous to the freight railroads. Thus, the predecessor promised to move to an unspecified different standard when the major freight railroads achieved financial health. Clearly, the remaining major freight railroads have achieved financial health, so we encourage the Board to begin the process of identifying and adopting a different rate reasonableness standard.

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[3] 1 I.C.C.2d 520 (1985), *aff'd sub nom. Consolidated Rail Corp. v. United States,* 812 F.2d 1444 (3rd Cir. 1987).

We do not ask for a reduction in the level of the jurisdictional threshold of the Board. Furthermore, rail-dependent customers accept the concept of differential pricing. However, we believe that the time has come for the Board to begin to work to identify a rate reasonableness standard that can be applied more easily and provides more realistic upper limits on captive rail rates.

In the meantime, we strongly encourage the Board to remove its damage limitations on its simplified rate challenge procedures. These alternatives, as surrogates for the stand-alone cost test, result in "reasonable rates" that generally are significantly higher than the level of rate that would result from a successful stand-alone cost case. With damage limits removed, all captive rail customers would have a choice: undertake a costly, complicated, time consuming rate challenge that might result in a rate that is as low as 180% R/VC or undertake a less costly, complicated and time consuming challenge under one of the simplified procedures that might result in rate relief, but at a higher reasonable rate than might be established through a successful stand alone cost case. This new choice might reduce the number of stand-alone cost cases being filed at the Board, which would decrease the drain on Board resources that occur with full stand alone cost cases.

CONCLUSION

Mr. Chairman and Members of the Board, thank you for undertaking this review. We are keenly aware of the criticism and pressure you are receiving from those who wish to preserve the *status quo.* Our nation was not born through blind observance of the *status quo* nor did we become a great nation by following this philosophy nor has our national economy advanced through blind obedience to the *status quo.* Changed circumstances always require changed responses. Those that respond appropriately to change succeed; those that refuse to change fail

The rail customer community believes that it is beyond question that the national freight rail system is changed enormously since 1980 and since many of the policies discussed herein were adopted by the Board or its predecessor. Clearly there are problems with the *status quo.* We encourage you to recognize the lack of competition in the national freight rail system and call on you to make the measured, modest improvements to the *status quo* we have recommended herein, all of which are the construct of current law and consistent with the principles of the Staggers and ICC Termination Acts. The national economy will benefit from increased competition in the national freight rail system, rail customers will benefit and we believe that the increased competition will make the major freight railroads better and stronger over time. Our national economy is based on competition. Other free market American industries have benefited from intra-industry competition and the freight railroads would benefit as well.

With modest policy changes by the Board, the nation can come closer to achieving the “sound” national freight rail system envisioned by Congress in 1980.

Respectfully submitted,

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