

SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 575

REVIEW OF RAIL ACCESS AND COMPETITION ISSUES
– RENEWED PETITION OF THE WESTERN COAL TRAFFIC LEAGUE

STB Ex Parte No. 575 (Sub-No. 1)

DISCLOSURE OF RAIL INTERCHANGE COMMITMENTS

Decided: October 29, 2007

The Western Coal Traffic League (WCTL) has asked the Board for rules of general applicability regarding so-called “paper barriers,” i.e., 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. WCTL has asked that the Board establish a rebuttable presumption that such an interchange commitment¹ is unreasonable and contrary to the public interest if it (a) lasts longer than 5 years, (b) includes any financial penalty for interchanging traffic with another carrier, or (c) includes a credit for interchanging traffic with the seller or lessor railroad that would provide a return in excess of the railroad industry’s cost of capital. The Board sought and obtained public comments on WCTL’s request, and held a public hearing on it as well.

As discussed below, we conclude that the propriety of such interchange commitments is best considered on an individual, case-by-case basis. To improve the effectiveness of that case process, we propose new disclosure requirements to assure appropriate advance regulatory scrutiny of any such agreements in connection with future proposed line sales or leases (or other changes in operators) to noncarriers and smaller Class II or Class III railroads. We also propose expedited discovery procedures for obtaining a copy of an existing interchange commitment as soon as a regulatory challenge is brought. The proposed rules, on which we seek public comment, will be published in the Federal Register in STB Ex Parte No. 575 (Sub-No. 1). The disclosure requirements will also be submitted to the Office of Management and Budget (OMB) under the Paperwork Reduction Act, 44 U.S.C. 3507(d) and OMB regulations at 5 CFR 1320.11.

In this decision, we first review the history and role of interchange commitments in the rail industry. We then discuss WCTL’s request. Finally, we discuss in more detail our own

¹ The Board will use the more neutral term “interchange commitment” suggested by the American Association of Railroads (AAR) instead of “paper barriers.”

proposal and provide general guidance regarding the factors the Board will consider in determining whether particular interchange commitments are permissible.

BACKGROUND

History and Significance of Rail Line Spin-offs

Prior to the Staggers Rail Act of 1980² (Staggers Act), it could be a lengthy and difficult process for a rail carrier to obtain the necessary regulatory approval to abandon, sell, or lease a line, even if that line did not generate sufficient revenue to cover the needed maintenance and infrastructure investments. The regulatory discouragement of such divestitures, in addition to regulatory policies and procedures that prevented railroads from adjusting their rates nimbly to reflect changing market or cost environments, led to financial strain in the industry, ultimately resulting in the bankruptcy of many domestic railroads by the 1970s. Facing severe resource constraints, rail carriers deferred investment on lighter-density lines, which in turn resulted in poorer service to shippers on those lines.

In partially deregulatory legislation enacted in 1976 and 1980, Congress provided for railroads to be governed more by market forces and to have more freedom to set rates for rail service. It also provided (directly or indirectly) for railroads to be able to sell, lease, or abandon rail lines more readily. Depending on their nature, transactions creating a short line or transferring ownership or a leasehold to an existing short line may now be authorized by the Board acting on a notice of exemption under 49 CFR 1150 or 1180; a request for exemption under 49 U.S.C. 10502 and 49 CFR 1121; or an application under 49 U.S.C. 10901 (noncarrier acquisition of a line), 49 U.S.C. 10902 (short line purchase by a Class II or Class III carrier) or 49 U.S.C. 11323 *et seq.* (multi-carrier consolidation, merger, acquisition, or acquisition of control).

These changes in the law led to a rebirth of the short line railroad industry. According to the American Short Line and Regional Railroad Association (ASLRRA), whereas in 1980 there were approximately 190 short lines operating some 8,000 miles of track, there are now more than 500 short lines operating nearly 50,000 miles of track, or approximately 30% of the national railroad system.³ They include local carriers (defined by ASLRRA as those that operate less than 350 miles of track and have annual revenues under \$40 million) and regional carriers (those that operate at least 350 miles of track and have revenues between \$40 and \$250 million), as well as switching and terminal carriers (those that provide only limited services). The following chart from ASLRRA shows the cumulative operations of the three types of short lines:

² Pub. L. No. 96-448.

³ ASLRRA, Short Line and Regional Railroad Facts and Figures at 6 (2005).

Type	Number	Miles	Employees
Local	314	22,713	5,340
Regional	31	17,805	7,422
Switching & Terminal	204	7,371	6,431
	549	46,889	19,193

The role of short lines continues to grow. From 2002 to 2004, the traffic carried by short lines increased from 6,489,401 rail cars annually to 8,083,579 rail cars, an increase of 24.6%.⁴ And the estimated number of intermodal trailers and containers handled annually by short lines increased over that same time period from 1,531,193 to 1,652,894, an increase of 15.5%. In fact, according to ASLRRA, short lines now originate or terminate one out of every four rail cars moved by the domestic railroad industry.⁵

The benefits of this growth in short lines have been substantial. Many short lines can operate their lines at lower costs than could the larger carriers from which they acquired or leased their lines. Reduced labor costs, which reflect a more flexible workforce and lower crewing requirements, contribute to the lower operating costs. Moreover, short lines can give specialized attention to the needs of the shippers on their lines, and they have an incentive to do so because, unlike the larger carriers that spun these lines off, short lines depend on small-volume traffic.⁶ Offering better service, the short lines have been able to attract new traffic to the lines. They have also been able to obtain government grants and tax benefits to rehabilitate their lines, assistance that was largely unavailable to the carriers that spun off the lines.

Since the Staggers Act, the health of the rail industry has improved dramatically and rail rates have declined.⁷ The proliferation of short lines was an integral part of the restoration and improved stability of the rail industry. The role of short line railroads will continue to be

⁴ Id.

⁵ Id. at 2.

⁶ According to the chief operating officer of a short line holding company, “[o]ne car at a time is what we’re all about.” A regional railroad officer who had previously worked for Class I railroads echoed this view, saying that the threshold volume of business necessary to motivate a Class I railroad to provide equipment and take the other steps needed to service a customer can be as high as \$500,000 per year, but that, for a regional or short line, the threshold is one carload. Tom Murray, “A Different Way to Run a Railroad: Regional Versus Network Carriers,” J. of Transp. Law, Logistics and Policy (Vol. 71, No. 3, Spring 2004).

⁷ See United States Government Accountability Office, Freight Railroads, GAO 07-94, Oct. 2006 (noting that freight rates are generally down post-Staggers).

important to the national rail network system. For example, it is expected that short line railroads will provide a vital role in the distribution of ethanol.⁸

Role of Interchange Commitments

Many of the line spin-off transactions that created or built up these new short line railroads contained contractual provisions that limited the incentive or ability of the short line railroad to interchange traffic with other connecting carriers that could compete with the seller or lessor carrier for the long-haul portion of a movement. These interchange commitments took varying forms, including credits for cars interchanged with the seller or lessor carrier, a penalty for traffic interchanged with another railroad, or a total ban on interchange with any carrier other than the seller or lessor carrier.

According to representatives of short line railroads, these interchange commitments played an important role in the rebirth of the short line industry by providing valuable consideration by the short line to acquire or lease the rail facilities, thereby permitting start-up or very small companies to purchase or lease rail facilities with little or no upfront capital investment. The large railroad was willing to sell or lease these lighter-density lines at reduced prices because it was assured of retaining a portion of the revenues from the traffic on those lines. AAR describes interchange commitments as being “core requirements without which [spin-off] transactions would not and could not take place.”⁹ Accordingly, without interchange commitments many of today’s short lines might not exist and, as a result, many shippers might not have access to the same rail service they have today.¹⁰

The record reflects significant diversity among interchange commitments. Some were associated with sales; others with leases of varying duration. Apparently, many interchange commitments do not have fixed termination dates. Some permit limited interchange with other Class I carriers; some do not. Some have relatively harsh penalties for interchanging with other

⁸ See Argus Rail Business, New England Sees Boom in Biodiesel Moves, Vol. 13 (March 2007) (reporting on boom in new biodiesel refineries and storage facilities and that short lines will make most of the deliveries to and from those facilities as the primary connection to the Class I railroads).

⁹ See AAR Reply Comments at 3.

¹⁰ Several shippers have taken issue with the railroad argument that without interchange restrictions, the larger railroads would have abandoned the lines rather than sell them at below market prices. For example, Ameren Energy Fuels and Services Co. (Ameren) argues that interchange restrictions are inappropriate on lines that were eligible for abandonment because there would have been no “franchise value” or revenue stream for the selling railroad to protect. See Comments of Ameren at 9.

carriers while some have comparatively lighter consequences for non-sanctioned interchange. Some agreements contain procedures that allow a short line to seek waiver of the interchange restrictions. The specific provisions differ, as do their effect, depending on the economic situations of the particular railroads, the affected shippers and the competitive options available before and after the interchange restrictions were executed.¹¹

WCTL's Request for Rulemaking

WCTL sought Board action to curb or eliminate interchange commitments in 1998 in the context of a broad umbrella proceeding initiated by the Board to examine various competition issues in the rail industry.¹² WCTL objected to interchange commitments on the grounds that they foreclose competitive long-haul options and that many of these restrictions continue in perpetuity.

In September 1998, the AAR and ASLRRA entered into a broad "Railroad Industry Agreement" (RIA) to address paper barriers (as well as other issues).¹³ The RIA established some general principles regarding the enforceability of paper barriers with respect to "new" traffic (traffic that did not exist when the line involved was spun off). It also provided for non-binding arbitration between the short line and the seller or lessor carrier where a short line seeks

¹¹ In its comments, Union Pacific Railroad Company (UP) discusses the types of interchange commitments that UP and its predecessor companies have entered into. For example, the UP/Missouri & Northern Arkansas Railroad Company (MNA) lease provides that MNA pay no rental fees to UP for leasing a line so long as MNA interchanges 95-100% of non-local traffic (with some exceptions) with UP. If MNA fails to interchange at least 95% of its traffic with UP, a schedule of rental fees is initiated. See Statement of Warren C. Wilson, Senior Director-Rail Line Planning, Union Pacific R.R. Co., filed Mar. 8, 2006, at 6-7. In contrast, Southern Pacific Transportation Company, prior to its merger with UP, had a practice of leasing or selling track to short lines with SP reserving the underlying real estate. SP then charged the short line a "Going Business Concern" charge for any traffic interchanged with another Class I carrier. The Chicago & Northwestern Transportation Company tended to retain sections of track in selected locations and then grant the short line trackage rights. Id. at 8-10.

¹² See Review of Rail Access and Competition Issues, 3 S.T.B. 92, 100 (1998).

¹³ The Board approved the rate-related provisions of the RIA. See Ass'n of American Railroads et al. – Agreement – 49 U.S.C. 10706, 3 S.T.B. 910 (1998). Board approval was not sought for any other aspect of the RIA, including the provisions dealing with paper barriers.

a less restrictive arrangement than originally agreed to. A Rail Industry Working Group (RIWG) has also been created to interpret the RIA and provide a forum for further discussion.¹⁴

In 1998, WCTL argued that the RIA did not adequately address the problems raised by interchange commitments. WCTL asked the Board to institute a rulemaking to restrict the enforceability of such contracts. The Board, however, decided to defer action on WCTL's petition in order to allow for industry experience under the RIA.¹⁵

In March 2005, WCTL renewed its request for a rulemaking, arguing that there has been enough experience under RIA to show that Board action is necessary. WCTL also asserts that there have been significant changes since 1999 in Board policies regarding competition, including the Board's revised merger guidelines for Class I railroads.¹⁶

The Board sought and received public comments on WCTL's request for a rulemaking,¹⁷ and held an oral hearing on this subject on July 27, 2006. A number of individual shippers supported WCTL's petition and urged the Board to initiate a proceeding to develop general guidelines regarding interchange commitments. Many argued that interchange commitments are inherently anticompetitive and more particularly, that their own plant operations were negatively impacted by interchange commitments.¹⁸ Although shippers were unable to quantify the precise

¹⁴ The original 1998 version of the RIA is included in Attachment 2 of the renewed petition of WCTL that is the subject of this decision. The Board made no findings as to the "paper barrier" and other non-rate provisions of the broad RIA. There have been two amendments to the "paper barrier" provisions—an amendment refining the definition of the "new traffic" where interchange restrictions may be removed and an amendment establishing the RIWG.

¹⁵ Review of Rail Access and Competition Issues, STB Ex Parte No. 575, slip op. at 3-4 (STB served Mar. 2, 1999).

¹⁶ See Major Rail Consolidation Procedures, 5 S.T.B. 539 (2001).

¹⁷ See notice served on February 1, 2006, published in the Federal Register on February 6, 2006, at 71 FR 6130. Comments were received from the AAR; Entergy Services, Inc.; ALSRAA; the RIWG; Arkansas Electric Cooperative; Albany & Eastern Railroad Co.; BNSF Railway Co.; Reading Blue Mountain and Northern Railroad; Nasstrac, Inc.; U.S. Department of Agriculture; Montana Wheat & Barley Committee et al.; Alliance for Rail Competition; Ameren; National Grain and Feed Association; United Transportation Union General Committee of Adjustment; Rail for Roseburg Forest Products Co.; John D. Fitzgerald; UP; and Marshall Durbin Companies et al.

¹⁸ See, e.g., Comments of the Marshall Durbin Companies, Odom Industries, Inc., Southeast Ready Mix, Inc. and Wayne County Economic Development District (expressing (continued . . .)

financial impact they believe interchange restrictions have, most indicated that they believe they paid higher rates than they would if there were no restriction.¹⁹ Several shippers argued that interchange commitments can also inhibit a short line's ability to earn adequate revenue to rehabilitate and properly maintain their lines, because the short line is foreclosed from seeking a better rate division from a competing long haul carrier.²⁰ Most shipper comments indicated that the RIA was ineffective because it only governs "new" traffic and does not allow shippers to challenge the enforcement of the restrictions.

The U.S. Department of Agriculture (USDA), representing the interest of farmers and agricultural shippers, argues that interchange commitments interfere with the ability of agricultural shippers to obtain the best prices for their products, and otherwise increases their transportation costs.²¹ USDA advocates clear guidelines regarding the legality of interchange commitments and modification of existing interchange commitments to permit unrestricted interchange.

PROPOSED ACTION

Having carefully considered all of the evidence and argument, we conclude that the lawfulness of the terms of interchange commitments is best considered on an individualized, case-by-case basis. Generally, interchange commitments have facilitated the creation and growth of short line railroads, which in turn has benefited the public by lowering transportation costs, improving service, and in some cases preserving rail transportation to localities and communities that might otherwise have seen service over their lighter-density line deteriorate or be lost altogether.

However, not all situations are the same, nor are all agreements. A particular interchange commitment may be contrary to the public interest because it is unduly restrictive or unwarranted

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concern about apparent interchange commitments between the Kansas City Southern Railway and the Meridian Southern Railway on a 50-mile line in Mississippi); Comments of Ameren (expressing concern about interchange commitments between UP and Missouri Central Railroad affecting its Labadie Plant in Missouri); Comments of Arkansas Electric Cooperative Corp. (AECC) (describing interchange commitment limiting the MNA's ability to interchange with carriers other than UP).

¹⁹ See AECC comments at 6.

²⁰ See Comments of the Marshall Durbin Companies, Odom Industries, Inc., Southeast Ready Mix, Inc. and Wayne County Economic Development District.

²¹ Comments of USDA.

under the circumstances. Therefore, to assess the public interest, we must weigh the benefits of a particular interchange commitment against its potential for harm. The inquiry into whether a particular interchange commitment represents more harm than good is necessarily fact-specific. Therefore, no single rule of general applicability seems appropriate, and we will not attempt to establish such a rule.

A case-specific review would be facilitated by having in place better procedures for the disclosure of interchange commitments in future proposed sales or lease arrangements. This should better equip the Board to monitor their usage and effect over the short and long term, and better equip shippers to challenge an agreement before it takes effect. To this end, we are proposing to require parties seeking authorization for the sale or lease of a railroad line to: (a) identify the presence of any interchange commitment and the interchange points that are affected by it; and (b) submit a copy of the full agreement to the Board. We are also proposing an expedited discovery procedure for an affected party to obtain a copy of an existing interchange commitment in connection with a challenge to that agreement. The proposed regulations are set forth in the Appendix.

In this decision, we first discuss in more detail why we have concluded that broad rules of general applicability are not appropriate. Next, we provide general guidance regarding factors the Board will consider in determining the reasonableness of individual interchange commitments. We then set forth the proposed new disclosure requirement and discovery procedure.

1. Rules of General Applicability Are Not Warranted

WCTL and some shippers argue that interchange commitments are inherently anticompetitive and contrary to the public interest because they discourage or prevent short lines from offering existing shippers competitive through routes with third-party carriers. Inclusion of these terms in sale or lease agreements can have effects on shippers, but affected shippers may not have had competitive options before the sale or lease and thus may be no worse off as a result of the interchange commitment. To illustrate, assume that Carrier X sold or leased to Short Line Y a rail line extending from Point A to Point B, subject to an interchange commitment favoring Carrier X for connecting service from Point B to Point C. Also assume that Carrier Z could provide competing service from B to C were it not for the interchange commitment.

Before the transaction, Carrier X had a right to favor its long haul.²² Unless a shipper obtained a rail transportation contract with Carrier Z for service from B to C, Carrier X was not

²² See Central Power & Light Co. v. Southern Pac. Transp. Co., 1 S.T.B. 1059, 1064 (1996), clarified 2 S.T.B. 235 (1997), aff'd sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir. 1999).

required to provide a rate for a through movement with Carrier Z for transportation from A to C absent a showing that Carrier X had abused its market power to extract unreasonable terms, or, because of its monopoly position, had shown a disregard for the shipper's needs by rendering inadequate service.²³

After the transaction, the competitive situation remains the same. Carrier X can retain the traffic, in combination with Short Line Y, for as far as those two railroads combined can handle the traffic, unless a shipper located on the short line enters into a rail transportation contract with Carrier Z. And, just as before the sale or lease, if the shipper enters into a contract with Carrier Z, it would have the right to use the competing through route, notwithstanding any private interchange commitment.

Moreover, just as before the lease or sale, a shipper without effective transportation alternatives can challenge what it believes to be an unreasonable through rate and seek rate relief from the Board. Prior to the lease or sale, a shipper would have sought rate relief from the through rate of Carrier X. After the sale or lease, the shipper can seek relief from the combined through rate of Carrier X and Short Line Y. The Board has revised its guidelines to make pursuing rate cases more practical for affected shippers. Major Issues in Rail Rate Cases, STB Ex Parte 657 Sub-No. 1 (STB served Oct. 30, 2006); Simplified Standards for Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1) (STB served Sept. 5, 2007).

Thus, what WCTL seeks here is not to restore a competitive option lost due to a sale or lease with an interchange commitment, but rather to create a new competitive option that did not exist prior to the sale or lease. In other words, in arguing that these agreements are always anticompetitive, WCTL takes an entirely *ex post* view of the restrictions. But viewed *ex ante* (i.e., before the sale or lease of the facilities), the agreements may have been beneficial and furthered the public interest in a number of ways, including better service and/or better rates, and the creation or strengthening of short line railroads that have the potential to expand into other markets, and thereby ultimately add to competition.²⁴

²³ See Midtec Paper Corporation v. CNW et al., 3 I.C.C.2d 171, 181 (1986). A carrier is not required to open a through route simply because a shipper asks it to do so.

²⁴ WCTL's reliance on the revised merger rules is misplaced. Those rules reflect the Board's concern that future mergers or acquisitions involving more than one Class I carriers could lead to serious service disruptions during their implementation. Accordingly, to offset such impacts, the agency adopted a policy encouraging Class I carriers proposing such a major merger or acquisition to include proactive measures that promote competition. In contrast, when a short line acquires or leases a line previously operated by a large carrier, the expectation is that service will improve even without additional procompetitive measures, because the short line will be able to devote more attention to the needs of the shippers on the line.

Indeed, in the antitrust context, agreements between two companies that do not compete with each other, but rather provide services at different points in a distribution chain (so-called “vertical” agreements) usually do not raise the same kinds of competition concerns as agreements in restraint of trade between direct competitors (“horizontal” agreements).²⁵ As the Supreme Court has observed, the “market impact of vertical restrictions is complex” and “[s]uch restrictions, in varying forms, are widely used in our free market economy.” Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 53 & 57 (1977). Accordingly, when a court reviews such vertical restraints under the antitrust laws, it “must ordinarily consider the facts peculiar to the business to which the restraint is applied; *its condition before and after the restraint was imposed*; the nature of the restraint and its effect, actual or probable.” Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918) (emphasis added).

Some shippers maintain that interchange commitments that last longer than 5 years are likely to over-compensate the seller or lessor carrier. But a carrier considering a line sale or lease of line with traffic that makes a revenue contribution presumably calculates the net present value of the stream of revenue contribution from the traffic it would be forgoing and either (a) demands an equivalent value in the sale price or rental fee, or (b) includes interchange limiting provisions in the sale or lease. The revenue stream resulting from the agreement should be no more than what the carrier would have received had it not divested or leased the rail facilities in question, or had it demanded more in the sale price or rental fee.²⁶ So long as that is

²⁵ In the antitrust context, the Supreme Court has characterized the choice between bright-line prohibitions (*per se* rules) and case-by-case adjudication (rule of reason) as follows: “there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.” Northern Pac. R. Co. v. United States, 356 U.S. 1, 5 (1958). Very few agreements in restraint of trade are considered *per se* unreasonable. Such treatment is generally restricted to price-fixing, bid-rigging, or market-allocation agreements between direct competitors. Most agreements are reviewed under a rule-of-reason analysis, where the benefits of the agreements are balanced against the possible harms.

²⁶ Shippers argue that, due to the passage of time, the value (at the time of the transaction) to a railroad of an interchange commitment that lasts 20 years is not materially different than that of an agreement lasting forever. For example, assume that if it sells or leases the facilities to the short line without an interchange commitment, the selling/lessing carrier expects to lose \$1 million in revenue contribution every year. With a discount factor of 10%, this stream of possible lost revenue has a net present value of \$10 million. Most of that \$10 million flows from the value of the lost revenue in the first two decades. Specifically, in this example, the value of the revenue in years 20 and beyond is equal to roughly \$1.3 million of the \$10 million (or 13%).

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the case, the interchange limiting provision would not overcompensate the carrier and may shift the risk of unexpected traffic loss to the selling or leasing (Class I) carrier -- the party that was more able to assume the risk. We will not presume that short line railroads, in negotiating arms-length and voluntary contracts, are unable to protect their own financial interests or properly assess the value of an asset that they are considering for purchase. As regulators, the Board must be very wary of the temptation to override the determination of reasonable compensation as negotiated by informed private parties.

Comments by shippers describing how interchange commitments can impact service raise important issues. Shippers argue that restrictions make it impossible to shift traffic efficiently when there is a service disruption on the main line of the railroad to which their short line is tied.²⁷ And shippers (not the short lines themselves) argue that interchange restrictions diminish short lines' earning power, thereby reducing the revenue available for track maintenance and rehabilitation.

We do not believe that rules of general applicability are appropriate to address these particularized service concerns. Due to the variety of interchange restrictions, the condition of short lines, and the intermodal options available to shippers, we cannot devise a single rule that would address each service problem that may relate to an interchange commitment. Shippers who believe that a rail carrier is not providing adequate service due to the condition of its lines or certain other service problems have recourse before the Board, including, among other things, the emergency and alternative service rules, the feeder line provisions, and enforcement of the statutory common carrier obligation.²⁸ Shippers may argue in such cases that an interchange commitment contributes to the service problem.

Some shippers, going a step beyond particularized service and rate issues, argue that interchange commitments have long-term economic impact with regard to resource usage (e.g., that forced inefficient routing causes increased fuel usage), resource misallocation (including

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This argument does not reflect the fact that the time value of money is a two-way street: while \$1 million in 20 years is not worth as much today, \$1 million forgone 20 years ago would have grown into a considerable fortune today. So if the Board were to declare that any interchange commitment in existence for longer than 20 years were now unenforceable, it would diminish the value of the consideration provided by the short line when it acquired or leased the facilities. And the current value of that forgone consideration is not simply \$1.3 million, which is only how much more the carrier would have demanded to sell or lease the facilities 20 years ago.

²⁷ See, e.g., Ameren comments at 6.

²⁸ See 49 U.S.C. 11123(a); 49 CFR parts 1146, 1147.

over- and under-production by plants to deal with capacity shortages), and economic development.²⁹ However, the nexus between these potential harms and particular interchange restrictions are tenuous and, in any event, do not lend themselves to quantification. At the same time, there is very little dispute that short lines, as a general matter, have benefited the overall health of the rail industry.

Perhaps as important as our theoretical concerns, there are also practical problems with WCTL's suggested presumptions and some of the other "sunset provision" recommendations made by commenters. If there were a presumption that any interchange commitment that lasts longer than 5 years is unreasonable, the practical impact of the presumption would be to call into question all of the ongoing business relationships that have been created by agreements containing interchange commitments.³⁰ This is because most existing interchange commitments were part of sales or leases that occurred more than 5 years ago. Universal application of such a presumption could have significant negative and unintended consequences not only for the railroads involved, but for their customers. According to ASLRRA, many short line sale or lease agreements include clauses allowing the entire transaction to be rescinded if the Board were to find the interchange limiting provision unlawful.³¹ If such provisions were invoked, shippers could find themselves being served by the former operator and losing the benefits provided by the short line carrier.

For transactions not completely undone, there could be significant problems regarding adjustment of the compensation between the parties to the original transaction on an *ex post* basis. Because of the multifaceted, interdependent nature of provisions in sale/lease agreements, a determination of adjustments could be complex and prone to litigation, which, depending on the contracts, could take place at the Board, before an arbitrator or in the courts. In the meantime, ongoing business relationships could be disrupted *en masse*, and critical investment and marketing decisions might be put on hold. Moreover, some short lines operate with marginal cash reserves and could be significantly weakened if they had to operate under less favorable terms or provide compensatory adjustments to the seller/lessor carrier.³²

²⁹ See AECC comments at 9.

³⁰ According to ASLRRA, most of its 425 member carriers are "affected in a variety of ways by paper barriers." Comments of ASLRRA, filed Mar. 7, 2006, at 1. See also, Reply Comments of WCTL, filed Mar. 28, 2006, at 5-6.

³¹ Opening comments of ASLRRA, filed on March 7, 2006, at 3.

³² According to ASLRRA, an opponent of WCTL's approach, "[m]any class II and class III railroad companies are viable solely because of their lower cost structures." *Id.* at 4.

With regard to future transactions, a “one size fits all” rule for future interchange commitments could deter spin-offs of lighter-density lines. Under WCTL’s approach, a seller/lessor carrier likely could not justify any interchange limiting provision that did not fall within WCTL’s suggested narrow confines as to form, duration, and type of compensation, regardless of the specifics of the situation.³³ Also, were we to restrict to a particular time period all future interchange commitments in leases, parties might simply limit the lease itself to that time period. This would expose short lines to more frequent revaluation of the cost to operate, thereby heightening the risk of the transaction for the short line and decreasing the likelihood that the transaction would take place. For those transactions that did take place under shorter-term leases, we would artificially reduce the incentives of the short line to make long-term capital improvements to these lines, since they would lack the protections associated with longer-term leases.

Moreover, some line sales or leases have included both light-density segments with little traffic and segments that move more substantial and profitable traffic that the seller/lessor railroad did not want to lose. By including the more profitable segments in the track leased or sold to the short line, the seller/lessor railroad provides the short line with a reliable source of revenue to help the short line while it attempts to attract new traffic to, and rehabilitate, the remainder. This benefits the shippers that are located on, or attracted to, the less profitable line segments, while leaving other shippers no worse off competitively than they were before the lease or sale. Were we to adopt a policy that would discourage a carrier from divesting the entire line in such circumstances, larger (Class I) carriers might be encouraged to retain the profitable segments and to abandon the less profitable segments, to the detriment of the communities they serve.³⁴

The foregoing should not be understood as a suggestion that all current and future interchange commitments are necessarily reasonable and in the public interest, and we emphasize that Board approval of a line sale or lease does not relieve any carrier of its statutory obligation to provide adequate service at reasonable rates, fulfill common carrier obligations, or otherwise comply with the Interstate Commerce Act.³⁵ But we cannot make the broad, sweeping

³³ See WCTL’s renewed petition filed Mar. 21, 2005, V.S. of Paul S. Dempsey.

³⁴ See, e.g., UP Reply, V.S. Wilson, at 7.

³⁵ Citing cases where the Board or ICC have voided contractual provisions that unduly interfere with common carrier obligations, Ameren argues that interchange restrictions may also frustrate the acquiring railroad’s ability to fulfill its common carrier obligations under 49 U.S.C. 11101(b) because the short line is inhibited “from providing service to shippers along its line.” Ameren comments at 15. Although the Board takes no position on how a particular interchange commitment may affect common carrier obligations, as a general matter, if a short line is

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generalizations about the lack of social utility of interchange commitments that would be a necessary predicate for the type of rules WCTL advocates.

We believe that this case-by-case approach to interchange commitments strikes the best balance with regard to the Rail Transportation Policy goals set out at 49 U.S.C. 10101. A case-by-case approach minimizes the need for Federal regulatory control over the rail industry (see section 10101(2)) by restricting contracting freedom only when a particular interchange commitment can be shown to constitute (or contribute to) a violation of the Interstate Commerce Act or can be shown to be contrary to the particular statutory provision under which transaction approval was, or is being, sought. In such case-by-case reviews, the Board will be able to examine any other implicated regulatory policies such as the fostering of sound economic conditions, the maintenance of reasonable rates in the absence of effective competition, and competition. See sections 10101(1), (4), (5), (6).

For all these reasons, we conclude that the Board should consider the propriety of interchange commitments on a case-by-case basis.³⁶ Depending on the particular statutory provision under which they are challenging an interchange restriction, affected parties may seek to show that enforcement of a particular interchange commitment either would violate the Interstate Commerce Act, or that a proposed sale or lease with such a commitment should not be approved unless the transaction is restructured. But we will not proscribe such commitments altogether or place generalized restrictions on their terms.

2. Factors the Board Will Consider When Determining the Propriety of an Interchange Commitment

Although interchange commitments helped foster the revitalization of the rail industry and the rebirth of the short line sector, the need for interchange commitments may diminish in future leases or sales. In the 1980s and 1990s, interchange commitments often provided an incentive to otherwise reluctant, and in some cases, cash-strapped buyers/lessees to enter into a

(. . . continued)

providing service to a destination, the mere existence of an alternative long-haul carrier with which the short line does not interchange does not amount to a section 11101(b) violation.

³⁶ In Illinois Railnet, Inc. – Acquisition and Operating Exemption – BNSF Ry., STB Finance Docket No. 34549 (STB served Feb. 1, 2006), the Board suggested that it might be better to address questions about interchange commitments more broadly with the benefit of public comments. After reviewing the public comments in STB Ex Parte No. 575, we are persuaded that the best course is to review the propriety of agreements with interchange commitments on a case-by-case basis.

rail industry that was struggling financially and experiencing excess capacity.³⁷ Today, the improved health of the rail industry as a whole is not in dispute. As a result, the ability of Class I railroads to find smaller carriers willing to invest up-front money into viable short lines may also have improved, thus reducing the desirability of interchange commitments.

Even though we are not prohibiting the use of existing interchange commitments across the board, shippers may, on a case-by-case basis, attempt to show that a particular interchange commitment is causing, or would cause, a violation of the Interstate Commerce Act or that it is, or would be, contrary to a particular statutory provision under which approval was, or is being, sought. For example, a shipper may allege that a particular interchange commitment precludes, or would preclude, the provision of adequate, efficient through service at reasonable rates.³⁸ Shippers may also move, under 49 U.S.C. 722(c), to reopen a proceeding authorizing a prior transaction or to partially revoke an exemption granted under 49 U.S.C. 10502. The existence of the RIA, the private industry agreement between Class I railroads and short line railroads, does not preclude or otherwise affect the ability of shippers to seek relief from the Board.

When the Board considers whether a proposed interchange commitment is in the public interest, we will examine the relevant facts and circumstances surrounding that agreement. We will consider whether the interchange agreement is part of a lease or a sale of a line, and we will look at the duration of the restriction. We will examine the manner in which the interchange commitment discourages interchange with other carriers and the degree to which interchange is effectively foreclosed. Parties should expect a higher level of scrutiny on agreements that contain a total ban on interchange with other carriers or go on in perpetuity.

Given the diversity among transactions, interchange commitments, and affected parties, we cannot identify every factor that the Board might consider in future cases. The factors to be considered will also depend upon the type of challenge brought before the Board. Under our case-specific review, we will examine the particular facts, the competitive conditions before and after the interchange commitment, the nature of the commitment, and its actual or likely effects. The parties to the transaction and other concerned parties will have ample opportunity to present their views.

3. Proposed Disclosure Requirements

To facilitate a more informed case-by-case analysis of interchange commitments, we propose to impose a disclosure requirement for any new agreement and provide a discovery procedure for existing agreements. For future sales or leases that would include an interchange

³⁷ See Marshall Durbin comments at 14 (recognizing that interchange commitments “may have had some benefit to Class I railroads and undercapitalized short line railroads”).

³⁸ See 49 U.S.C. 10703, 10705, 10742, and 11101(a).

commitment, we propose to require the parties to the transaction to give notice of them when they seek Board authorization for the sale or lease.³⁹ Specifically, parties seeking Board authorization would be required: (a) to identify the presence of any interchange commitment (whether containing restrictions or incentives) and the interchange points affected; and (b) if such a commitment is present, to file with the Board a confidential, unredacted copy of the sale or lease agreement and any related documents containing the terms of the commitment. Relevant portions of those agreements could then be obtained by affected parties subject to appropriate protective orders to preserve their confidentiality. Obtaining this information should better equip the Board and affected parties to assess a particular agreement before the transaction can proceed.

For existing interchange agreements, it appears from the comments received in this proceeding that shippers on lines subject to such agreements are generally aware of the existence of such commitments, even if they do not know the precise terms. Therefore, we do not believe it necessary for carriers to gather and file with the Board information about all of their current interchange commitments. Rather, we propose to create an expedited procedure for an affected shipper to obtain a copy of such an agreement (subject to our normal protective orders) once the shipper files either (a) a petition under 49 U.S.C. 722(c) to reopen the proceeding in which the sale or lease was originally authorized or to revoke an exemption under 49 U.S.C. 10502, or (b) a complaint alleging that a carrier is violating a statutory obligation under the Interstate Commerce Act due to an interchange commitment. At that point, the shipper may file a motion seeking prompt access to the documents containing the interchange commitment, together with a signed protective order. The carrier (or carriers) involved would have an appropriate opportunity to respond, and the Board would then rule on such motions on an expedited basis.

The proposed changes to the Board's rules to implement these procedures are set forth in the Appendix attached to this decision. The Board is publishing in the Federal Register a separate notice, docketed as STB Ex Parte No. 575 (Sub-No. 1), on the service date of this decision. The notice requests public comment on the proposed rules and related matters and sets forth when and how to file comments.

³⁹ We believe that notice and disclosure of interchange commitments should be provided for all proposed sales and leases, regardless of the size of the carrier or the procedure by which Board authorization is sought. Most short line transactions are accomplished under one of our exemption procedures under 49 U.S.C. 10502, but carriers may seek Board authorization for short line transactions by application. It is not necessary to propose changes to the application requirements under 49 U.S.C. 11323 *et seq.* or 49 U.S.C. 10901 because those requirements already include provisions that would encompass disclosure of interchange commitments. See 49 CFR 1180.6(a)(7)(i) and (ii), 1150.4(a), (e). Although we do not have specific regulations governing the content of applications under 49 U.S.C. 10902, we would expect applications under that section to provide the same interchange commitment information.

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

It is ordered:

1. The petition of WCTL is granted to the extent set forth in this decision.
2. The regulations proposed in STB Ex Parte No. 575 (Sub-No. 1) as set forth in the Appendix will be published in the Federal Register and submitted to OMB.
3. The STB Ex Parte No. 575 proceeding is discontinued.
4. This decision is effective on its date of service.

By the Board, Chairman Nottingham, Vice Chairman Buttrey, and Commissioner Mulvey. Commissioner Mulvey commented with a separate statement.

Vernon A. Williams
Secretary

COMMISSIONER MULVEY, commenting:

I concur in the relief the Board had voted to propose here, although I rely on a differing rationale as the basis for this relief.

As I have expressed through my dissents in several recent lease and acquisition cases,⁴⁰ as well as through the July 2006 hearing we held in this proceeding, I generally view so-called

⁴⁰ Paducah & Louisville Ry. – Acquisition – CSX Transp., Inc., STB Finance Docket No. 34738 (STB served Nov. 18, 2005) (Comm'r Mulvey dissenting, at 6-7); Columbus & Ohio River R.R. – Acquisition and Operation Exemption – Rail Lines of CSX Transp., Inc., STB Finance Docket No. 34540 (STB served Nov. 18, 2005) (Comm'r Mulvey dissenting, at 9); Indiana & Ohio Centr. R.R. – Acquisition and Operation Exemption – CSX Transp., Inc., STB Finance Docket No. 34536 (STB served Aug. 23, 2005) (Comm'r Mulvey dissenting, at 9-10); Buckingham Branch R.R. – Lease – CSX Transp., Inc., STB Finance Docket No. 34495 (STB served Nov. 5, 2004) (Vice Chr. Mulvey dissenting, at 13).

interchange commitments as fundamentally anti-competitive. I believe the Board should review these from a public interest standpoint when they form part of the basis for large railroad spin-off transactions to new or smaller carriers. I support our statutory charge to ensure that railroads earn adequate revenues, but I do not think that permitting traffic to be locked up in perpetuity is the proper vehicle for doing so.

Several sections of our governing statute permit or require that the Board *preserve* competition in the rail industry. 49 U.S.C. 10101(4) & (5) (Rail Transportation Policy); 11102(c)(1) (reciprocal switching); 11324 (standards for approval of consolidation transactions); see also 10709(g)(2)(B)(ii) (challenge of agricultural commodity contract); 11322(a)(2) (pooling). In addition, we have the discretion to adopt policies that *promote* competition. See, e.g., Major Rail Consolidation Procedures, 5 S.T.B. 539 (2001). The Board's current position on interchange commitments, however, *prevents* competition from developing by protecting these arrangements and presuming their propriety.

That the record before us includes only anecdotal evidence of shippers' suffering harm from interchange commitments,⁴¹ with only one shipper attempting to quantify this harm, demonstrates to me the need for the relief we propose today. While in 1998 the Board may not have had enough experience with interchange commitments to determine whether or not to preclude them, by 2007 parties have had substantial experience – but not enough disclosure of these provisions.

I do not believe that interchange commitments are the *sine qua non* of the shortline renaissance since the Staggers Act of 1980 -- despite the verified, but otherwise unsubstantiated, assertions to the contrary in the record before us. See Decision at 12, 25. Shortlines existed prior to the Staggers Act. Shortlines could have been spun into existence afterward without interchange commitments, or with commitments of limited duration, albeit under different financial terms. Shortlines could also have purchased lines slated for abandonment under our Offer of Financial Assistance provisions, 49 U.S.C. 10904.

Further, I do not agree with the Decision's characterization of the Class I-shortline relationship as "vertical." Decision at 16-17. A vertical relationship between firms generally refers to firms in different stages of the production or distribution process.⁴² But both shortlines and Class I carriers provide rail haulage of freight. They are not in different stages of production but produce the same service. Because they interchange the traffic rather than compete for it does not change the fact that they engage in the same fundamental service. I would classify this

⁴¹ I note that it may not only be shippers who have suffered harm from interchange commitments, but rail labor as well.

⁴² See, e.g., Paul A. Samuelson & William D. Nordhaus, Economics 356-57 (McGraw-Hill/Irwin 2005) (definitions of horizontal and vertical mergers).

relationship as a “horizontal” one because both carriers are providing rail service – they are in the same industry – even if they are providing this service over different line segments. I also do not agree with the Decision’s characterization of the relative equality in bargaining positions of shortlines and Class I carriers with respect to spin-off transactions. Decision at 18.

Our proposed rules should enable shippers who believe they are aggrieved by interchange commitments to challenge these restrictions in a more direct and expeditious manner. I expect the Board to administer these rules in such a way that they offer meaningful, as opposed to elusive, relief. This Decision is a good first step toward alleviating the anti-competitive situations perpetuated by or resulting from interchange commitments, although more might be needed in the future.

APPENDIX

For the reasons set forth in the preamble, parts 1114, 1121, 1150, and 1180, of title 49, chapter X, of the Code of Federal Regulations are proposed to be amended as follows:

§ 1114 [Revised]

1. Revise § 1114.30 by the addition of the following:

(d) Agreements Containing Interchange Commitments. In any proceeding involving the reasonableness of provisions related to a rail carrier sale or lease agreement that serve to induce a party to the agreement to interchange traffic with another party to the agreement, rather than with a third-party connecting carrier, whether by outright prohibition, per-car penalty, adjustment in the purchase price or rental, positive economic inducement, or other means, a party to the proceeding may obtain a confidential, complete version of the agreement, with the prior approval of the Board. The party seeking such approval must file an appropriate motion containing a draft protective order and undertaking(s) that will ensure the agreement is kept confidential. The motion seeking approval may be filed at any time after the initial complaint or petition, including before the answer to the complaint or petition is due. A reply to such a motion must be filed within 10 days thereafter. The motion will be considered by the Board in an expedited manner.

§ 1121 [Revised]

2. Revise § 1121.3 by the addition of the following:

(d) Transactions Imposing Interchange Commitments. (1) If a proposed acquisition or operation of a rail line involves a provision or agreement that may limit future interchange with a third-party connecting carrier, whether by outright prohibition, per-car penalty, adjustment in the purchase price or rental, positive economic inducement, or other means (“interchange commitment”), the following additional information must be provided: (i) the existence of that provision or agreement and the affected interchange points must be identified; and (ii) a confidential, complete version of the document(s) containing or addressing that provision or agreement, which may be filed with the Board under 49 CFR 1104.14(a) and will be kept confidential without need for the filing of an accompanying motion for a protective order under 49 CFR 1104.14(b).

(2) To obtain information about an interchange commitment for use in a proceeding before the Board, a shipper or other affected party may be granted access to the confidential documents filed pursuant to (1), above, by filing, and serving upon the petitioner, a “Motion for Access to Confidential Documents,” containing (i) an explanation of the party’s need for the information and (ii) an appropriate draft protective order and confidentiality undertaking(s) that will ensure that the documents are kept confidential.

§ 1150.33 [Revised]

3. Revise § 1150.33 by the addition of the following:

(h) Transactions Imposing Interchange Commitments. (1) If a proposed acquisition or operation of a rail line or change of operators involves a provision or agreement that may limit future interchange with a third-party connecting carrier, whether by outright prohibition, per-car penalty, adjustment in the purchase price or rental, positive economic inducement, or other means (“interchange commitment”), the following additional information must be provided: (i) the existence of that provision or agreement and the affected interchange points must be identified; and (ii) a confidential, complete version of the document(s) containing or addressing that provision or agreement, which may be filed with the Board under 49 CFR 1104.14(a) and will be kept confidential without need for the filing of an accompanying motion for a protective order under 49 CFR 1104.14(b).

(2) To obtain information about an interchange commitment for use in a proceeding before the Board, a shipper or other affected party may be granted access to the confidential documents filed pursuant to (1), above, by filing, and serving upon the petitioner, a “Motion for Access to Confidential Documents,” containing (i) an explanation of the party’s need for the information and (ii) an appropriate draft protective order and confidentiality undertaking(s) that will ensure that the documents are kept confidential.

§ 1150.43 [Revised]

4. Revise § 1150.43 by the addition of the following:

(h) Transactions Imposing Interchange Commitments. (1) If a proposed acquisition or operation of a rail line or change of operators involves a provision or agreement that may limit future interchange with a third-party connecting carrier, whether by outright prohibition, per-car penalty, adjustment in the purchase price or rental, positive economic inducement, or other means (“interchange commitment”), the following additional information must be provided: (i) the existence of that provision or agreement and the affected interchange points must be identified; and (ii) a confidential, complete version of the document(s) containing or addressing that provision or agreement, which may be filed with the Board under 49 CFR 1104.14(a) and will be kept confidential without need for the filing of an accompanying motion for a protective order under 49 CFR 1104.14(b).

(2) To obtain information about an interchange commitment for use in a proceeding before the Board, a shipper or other affected party may be granted access to the confidential documents filed pursuant to (1), above, by filing, and serving upon the petitioner, a “Motion for Access to Confidential Documents,” containing (i) an explanation of the party’s need for the information and (ii) an appropriate draft protective order and confidentiality undertaking(s) that will ensure that the documents are kept confidential.

§ 1180 [Revised]

5. Revise § 1180.4(g)(4) by the addition of the following:

(4) Transactions Imposing Interchange Commitments. (i) If a proposed acquisition or operation of a rail line involves a provision or agreement that may limit future interchange with a third-party connecting carrier, whether by outright prohibition, per-car penalty, adjustment in the purchase price or rental, positive economic inducement, or other means (“interchange commitment”), the following additional information must be provided: (A) the existence of that provision or agreement and the affected interchange points must be identified; and (B) a confidential, complete version of the document(s) containing or addressing that provision or agreement, which may be filed with the Board under 49 CFR 1104.14(a) and will be kept confidential without need for the filing of an accompanying motion for a protective order under 49 CFR 1104.14(b).

(ii) To obtain information about an interchange commitment for use in a proceeding before the Board, a shipper or other affected party may be granted access to the confidential documents filed pursuant to § 1180.4(g)(4)(i) of this section by filing, and serving upon the petitioner, a “Motion for Access to Confidential Documents,” containing (i) an explanation of the party’s need for the information and (ii) an appropriate draft protective order and confidentiality undertaking(s) that will ensure that the documents are kept confidential.