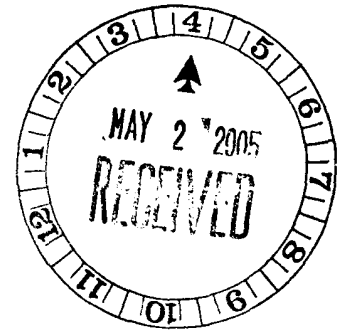




# ASSOCIATION OF AMERICAN RAILROADS

Law Department  
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## **BY HAND DELIVERY**

May 2, 2005

Honorable Vernon A. Williams  
Secretary  
Surface Transportation Board  
1925 K Street, N.W.  
Washington, D.C. 20423

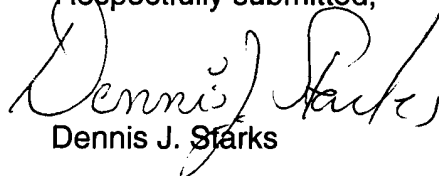
Re: Ex Parte No. 575, Review of Rail Access and Competition Issues

Dear Secretary Williams:

Enclosed for filing in this proceeding are an original and ten (10) copies of the Reply of the Association of American Railroads to Renewed Petition of the Western Coal Traffic League for Rulemaking to Eliminate Unreasonable "Paper Barriers" to Interchange.

Please date-stamp the extra copy of the Reply and return the same via the messenger hand delivering it.

Respectfully submitted,

  
Dennis J. Starks

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**STB EX PARTE NO. 575**

**REVIEW OF RAIL ACCESS AND COMPETITION ISSUES**

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**REPLY OF THE ASSOCIATION OF AMERICAN RAILROADS  
TO RENEWED PETITION OF THE WESTERN COAL TRAFFIC LEAGUE  
FOR RULEMAKING TO ELIMINATE UNREASONABLE  
“PAPER BARRIERS” TO INTERCHANGE**

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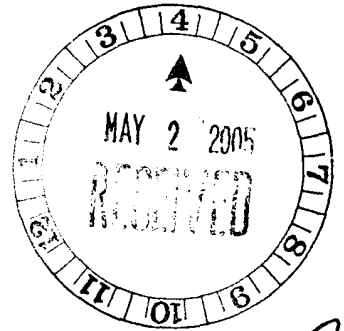
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Dated: May 2, 2005

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**STB EX PARTE NO. 575**

**REVIEW OF RAIL ACCESS AND COMPETITION ISSUES**

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**REPLY OF THE ASSOCIATION OF AMERICAN RAILROADS  
TO RENEWED PETITION OF THE WESTERN COAL TRAFFIC LEAGUE  
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The Association of American Railroads (“AAR”) hereby replies to the Renewed Petition of the Western Coal Traffic League for Rulemaking to Eliminate Unreasonable “Paper Barriers” to Interchange (“Petition”) filed with the Surface Transportation Board (“Board”) on March 21, 2005.<sup>1</sup> The AAR’s members include all of the Class I railroads, as well as certain smaller railroads, who have entered into line sale or lease transactions with so-called “paper barriers”.<sup>2</sup>

By decision served March 2, 1999, in this proceeding, the Board refused to grant a prior petition of the Western Coal Traffic League (“WCTL”) to establish rules which would essentially disfavor the use of “paper barriers”. Six months earlier, on September 10, 1998, the AAR and the American Short Line and Regional Railroad Association (“ASLRRA”) entered into a Rail Industry Agreement (“RIA”) which set forth guidelines for areas of cooperation between large and smaller railroads. With respect to the terms governing “paper barriers”, the subscribing large and smaller railroads “...agree[d] to work cooperatively to increase rail freight business.”

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<sup>1</sup> By order served April 8, 2005, the Board extended the deadline for filing replies to the Petition to May 2, 2005.

<sup>2</sup> As explained in the text at page 7, the term “paper barrier” evokes misconceptions about what is essentially an “interchange commitment” between rail carriers facilitating continued rail service. However, for ease of reference the term “paper barrier” will be used in this Reply.

(RIA, p. 4) Not wishing to chill the progress of a private sector agreement on the issue and not willing to take precipitous regulatory action without a record before it of the need for such action, the Board decided to hold WCTL's request for a rulemaking in abeyance and "...revisit the matter later based on experience under the RIA." (Decision, p. 3)

For the reasons detailed below, the AAR believes that there are no facts or circumstances which would warrant a change from the Board's decision in 1999 that a rulemaking proceeding to address "paper barriers" is unwarranted. Moreover, the railroads' experience with "paper barriers" since 1999 shows that there is also no need for the Board to continue to hold WCTL's request for a rulemaking in abeyance. Accordingly, WCTL's Petition should now be denied.

## **BACKGROUND**

Since the passage of the Staggers Act in 1980, Class I railroads have reduced their operating network by over 65,000 route miles, paring down to a national system of approximately 100,000 route miles. Many of the route miles that the Class I carriers no longer retained were sold or leased to literally hundreds of new short line or regional railroad operators whose lower costs and closer ties to their customers and communities enabled them to operate at a profit in circumstances where Class I railroads could not. These new carriers have preserved railroad jobs and rail service – often in rural areas – that otherwise would have been lost.

At the time of some transactions creating the new short lines, the parties involved voluntarily agreed to a lower sales price or lease rate in exchange for an agreement by the new railroad to interchange future traffic solely or predominantly with the selling/leasing Class I railroad. These "interchange commitments" were part of the consideration for the sale or lease

of the line in the first instance and often were the only economic basis upon which a short line railroad operator could afford to take over the line. They allowed the new operator to pay less cash consideration to acquire the line and avoid carrying heavy debt burdens that would ultimately have to be paid by the shippers. Thus, notwithstanding the negative connotation associated with the term “paper barrier”, those “interchange commitments” had the positive effect of facilitating the preservation of otherwise threatened rail service.

Pursuant to the Board’s urging in an April 16, 1998 decision in this proceeding that the large and smaller railroads resolve inter-carrier differences – including those involving “paper barriers” – through private sector solutions, the AAR and ASLRRA negotiated the RIA. Excerpts from the RIA setting forth the principles by which the large and smaller railroads were to conduct their relationships regarding “paper barriers” are attached as Appendix A. Recognizing that “paper barriers” are “...designed as fair payment for the sale or rental value of the line that created the Short Line...” the Class I and short line subscribers to the RIA nonetheless agreed that “[s]uch barriers should not restrict the Short Line’s ability to develop New Traffic with another carrier if the selling or leasing Large Railroad cannot or will not participate in the New Traffic.” (RIA, p. 3) Thus, if potential new traffic were to be otherwise lost to the rail network, the “paper barrier” could be waived in order to realize the goal of “...improv[ing] shipper rail service while strengthening the rail industry.” (RIA, p. 4)

As described below and as also discussed in the separate replies in opposition to the Petition filed by the ASLRRA and the Rail Industry Working Group (“RIWG”)<sup>3</sup>, experience over the past six years shows that the implementation and application of the RIA with its “paper

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<sup>3</sup> As explained in its reply to the Petition, the RIWG is a committee of Class I and smaller railroad representatives formed to, in part, maintain and facilitate Class I/smaller railroad communications and to monitor RIA activities, including those involving “paper barriers”.

barrier” provisions have been effective in fostering stronger Class I/short line railroad relationships to the benefit of both the rail network and rail shippers.

The RIA is intended to be self-executing with respect to “paper barriers”. If a short line railroad identifies new traffic which its Class I connection is unable or unwilling to handle and that traffic would otherwise be lost to motor carrier competition but for an “interchange commitment”, the short line railroad is expected to request and the Class I carrier is expected to grant a waiver of the “paper barrier”. As discussed in the RIWG’s reply, that activity should be handled in the normal course of connecting carrier business relationships and never become a separately identifiable issue. However, the RIWG encouraged the submission of more formal waiver requests to assess the scope of “paper barrier” concern. Based upon information provided by the RIWG, there have been only approximately 55 RIA waiver requests since 2002 (not all of which even involved “paper barriers”); and, in most instances (i.e., approximately 45) the requests were granted. The remainder were either deemed to be not subject to the RIA or were handled in some other manner.

In the event of an unresolved “paper barrier” issue between a Class I and short line railroad, there are processes to provide guidance and facilitate resolution. The smaller railroad representatives on the RIWG are available to informally assist the short line in understanding its rights and obligations under the RIA and, subject to confidentiality considerations, by bringing the issue to the attention of the RIWG. For example, the recent Amendment to the RIA described in the RIWG’s reply to the Petition was drafted in response to questions presented to the RIWG as to how the term “new traffic” should be interpreted.

The AAR and ASLRRRA also have an informal, confidential and non-binding dispute mediation process to assist in resolving outstanding issues between parties in specific cases; and,

under the terms of the RIA, “paper barrier” disputes may be submitted to the Board for arbitration. However, since 2000, there have been only three requests for informal AAR/ASLRRRA mediation; and there has been only one request to the Board for arbitration.<sup>4</sup>

While a dispute between a Class I railroad and a short line railroad may arise from time to time over the application or interpretation of a specific “paper barrier”, rail industry experience in the aftermath of the RIA indicates that “paper barriers” in general are no longer contentious railroad issues.

## ARGUMENT

In January 1999, the AAR filed a reply to WCTL’s initial petition for a rulemaking to address “paper barriers.” In its reply, the AAR described the then recent RIA which offered, *inter alia*, a private sector process to address “paper barrier” issues. The AAR urged the Board to allow time to see if this private sector solution would work, noting that the Board itself had indicated in its April 16, 1998 decision in this proceeding that “private sector solutions are generally preferable” (Decision, at 8); that any precipitous regulatory action could frustrate the creation of new short lines; and that shipper interests were appropriately taken into account in the RIA. The Board responded to the AAR’s concerns and held WCTL’s initial petition in abeyance pending the development of experience under the RIA. (Decision served March 2, 1999)

As explained above, rail industry experience since 1999 shows that the RIA has facilitated and provided an effective process for addressing Class I and short line railroad “paper barrier” issues. Moreover, WCTL has presented no new facts or circumstances in its Petition

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<sup>4</sup> The request for arbitration was subsequently withdrawn and the Board dismissed the proceeding with prejudice in STB Docket No. 42076, *Albany & Eastern Railroad Company v. The Burlington Northern and Santa Fe Railroad Company* (Decision served January 9, 2004).

which would warrant the institution of a rulemaking proceeding on those issues at this or any other time. Accordingly, WCTL's request need no longer be held in abeyance and its Petition should now be denied.

As in 1999, since the AAR believes that the initiation of a rulemaking proceeding would be inappropriate and counterproductive, it will not address in this reply the specific elements of the rules proposed by WCTL. (If the Board were to initiate such a rulemaking proceeding, the AAR will address the merits of any proposed rules in that proceeding.)

**I. EXPERIENCE UNDER THE RIA INDICATES THAT A RULEMAKING PROCEEDING ON "PAPER BARRIERS" IS UNNECESSARY AND WOULD BE COUNTERPRODUCTIVE.**

WCTL states that "...after six years of experience under the RIA, the problems that precipitated the filing of WCTL's 1998 Petition have persisted and grown..." (Petition, p. 14), but notably absent is any specificity as to what those problems may be. WCTL only repeats, with some elaboration, the same arguments it made in its initial petition in 1999 that shippers should be entitled to intramodal rail competition after a line sale/lease transaction between a Class I and short line railroad (although such intramodal competition did not exist before the transaction), and the Board's failure to grant shippers that additional rail access is "anticompetitive".

In fact, "paper barrier" arrangements reflect a private sector success story that offers a "win-win-win" result for large and small railroads, shippers, and the public. Large railroads are afforded the opportunity to divest themselves of unprofitable and burdensome rail operations while retaining the long-haul revenues from the traffic involved. Short line railroads are

afforded the opportunity to acquire and operate a rail line where they otherwise would not have the financial capability to do so. Shippers are afforded continued, and usually enhanced, rail service where that service was otherwise in danger of elimination. The public is afforded the economic, environmental and other public benefits that derive from the retention of portions of the national rail network.

Moreover, “paper barriers” do not result in any reduction in the competitive options for rail transportation that a shipper had before the transaction. The shipper on the affected line retains access to the same Class I carrier both before and after a “paper barrier” transaction. The only difference is that access before the transaction is direct and after the transaction, it is through the Class I railroad’s short line connection.

Unfortunately, it seems that allegations that paper barriers are anticompetitive may stem partly from the term “paper barrier” itself. That term fosters a misplaced negative impression suggesting some sort of rigid and unyielding restriction. The RIA has clarified that paper barriers will not, in fact, impose absolute restrictions on interchange. Under the RIA, Class I and short line railroads “...agree to work cooperatively to increase rail freight business” (RIA, p. 4); and the RIA requires that paper barriers be waived in order to ensure that new traffic is not lost to the rail network. The goal remains to “...improve shipper rail service while strengthening the rail industry.” (RIA, p. 4)

Also, the RIA contains a provision acknowledging that “paper barrier” terms in a line sale or lease agreement could be voluntarily renegotiated at any time; and the paper barriers could be waived if the acquiring short line railroad was willing to pay the “additional compensation” due to the selling/leasing Class I carrier reflecting the economic and marketing assumptions upon which the “paper barrier” provision was based. (RIA, p. 4) However, there

have been no transactions renegotiated under the RIA where a short line railroad has agreed to pay a Class I railroad full compensation for a line in return for removal of a “paper barrier”. In instances where “paper barriers” were agreed upon and where they remain in effect, it is because they are the only way the sale/lease transaction is feasible .

Accordingly, the experience of the rail industry under the RIA shows that if a rulemaking proceeding as WCTL requests were instituted discouraging “paper barriers”, it would effectively foreclose many future line sales/leases. Interested parties would no longer be able to voluntarily use a legitimate tool that has helped preserve rail service all over the country. It would become more difficult to keep marginal rail lines in operation, since buyers’/lessees’ up-front costs would increase. Thus, an increasing portion of the rail network would likely be lost rather than transferred to short line carriers for continued operation.

## **II. THERE HAS BEEN NO CHANGE IN THE BOARD’S REGULATORY POLICY THAT WOULD WARRANT A CHANGE IN THE TREATMENT OF “PAPER BARRIERS”.**

WCTL asserts that there have been “significant” Board policy changes regarding rail competition since the Board’s 1999 decision holding WCTL’s initial petition in abeyance. (Petition, p. 12) But the two Board proceedings WCTL cites do not support that assertion.

It argues that the Board’s rules involving Class I railroad mergers, adopted in Ex Parte No. 582 (Sub-No. 1), *Major Rail Consolidation Procedures*, (Decision served June 11, 2001) which require that the merging carriers offer conditions that would enhance, rather than only maintain, competition reflect a Board policy favoring intramodal competition which should be extended to “paper barrier” transactions. However, the Board’s requirements cited by WCTL

have application only to mergers of large Class I railroads. The Board based those additional requirements on its conclusions that a merger of two large railroads could have a negative long-term and transitional network effect on competition and explained its additional requirements as follows:

“The Board anticipates that mergers of Class I carriers would likely create some anticompetitive effects that would be difficult to mitigate through appropriate conditions, and that transitional service disruptions might temporarily negate any shipper benefits. To offset such potential harms and improve the prospect that their proposal would be found to be in the public interest, applicants should propose conditions that would not simply preserve but also enhance competition.” (Decision, at 73)

The Board’s decision in Ex Parte No. 582 (Sub-No. 1) regarding enhanced competition was clearly limited to specific Board concerns arising from the possible effects of mergers between large Class I railroads.<sup>5</sup> This “policy” was not extended to any other type of rail transaction or situation subject to Board jurisdiction. Thus, WCTL’s assertion that the Board’s action in Ex Parte No. 582 (Sub-No. 1) somehow reflects a “significant” policy departure that has application to “paper barriers” is both overreaching and misplaced.

The *Buckingham Branch Railroad Company* case cited by WCTL likewise does not represent any Board policy change regarding rail competition. In the *Buckingham* case, the Board *approved* a lease transaction, with a “paper barrier”, between a Class I railroad and a short line. The “paper barrier” was not raised as an issue on the record of the proceeding and was not briefed by the parties. The proposed lease transaction, with the “interchange commitment”, was supported by 14 shippers as well as four public entities. No shipper or public entity opposed the arrangement. The “paper barrier” was only raised in a question during oral argument. In its

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<sup>5</sup> In fact, the Board did not impose the same “enhancing competition” requirements on comparable transactions between a Class I railroad and a smaller railroad, such as the lease transaction subject to review in FD No. 34495, *Buckingham Branch Railroad Company—Lease—CSX Transportation, Inc.* (Decision served November 5, 2004) cited by WCTL in support of its Petition and discussed in the text at page 9-10.

decision, the Board held that "...there is no claim that competition would be reduced or a monopoly created." and that the lessee short line railroad "...would simply replace CSXT..." with respect to moving traffic subject to the "paper barrier." Rather than using any enhanced competition test, the Board noted that it was governed in the proceeding by statutory criteria requiring that the Board must approve the transaction unless "...there is likely to be a substantial lessening of competition..." (Decision, p. 6-7)

### **III. SHIPPER CONCERNS HAVE BEEN PROPERLY ADDRESSED THROUGH THE RIA PROCESS.**

In its Petition, WCTL complains that shippers were excluded from the deliberations regarding the RIA, as well as from its ongoing interpretation and implementation. However, the RIA was an inter-carrier agreement covering a wide range of rail carrier relationships, including "paper barriers"; and, therefore, shippers were properly excluded as parties. Nonetheless, shippers' interests are not ignored in RIA related deliberations. As previously noted, a goal of the RIA is to "...improve shipper rail service..." and the RIA provides that rail carriers "...agree to work cooperatively to increase rail freight business." (RIA, p. 4) If the railroads are to achieve those objectives, they have to offer shippers commercially attractive packages; and because of their local relationship with shippers on the line, short line railroads have an especially critical role to play in representing shippers' views in commercial negotiations. In fact, short line requests for "paper barrier" waivers are made because of the desire to provide shippers with competitive rail service packages.

With respect to rail service offered under the provisions of the RIA, shippers retain all of the regulatory protections that they had prior to a transaction creating a "paper barrier". There is

the same regulatory oversight by the Board of the reasonableness of the rail rates and the rail practices provided by the carriers for shippers on lines subject to “paper barriers” as for all other shippers. They have no less recourse to the Board because they are on a line with a “paper barrier”. Therefore, WCTL is not seeking regulatory protection for shippers that is lost due to a “paper barrier”. Instead, WCTL is seeking the creation, by regulatory fiat, of artificial intramodal rail competition. (WCTL’s request would also create the regulatory anomaly of imposing artificial intramodal rail competition only for shippers on lines with “paper barriers”.) There is no policy or factual justification for such regulatory intervention displacing successful private sector arrangements and creating such artificial intramodal rail competition.

The AAR believes that the facts and circumstances regarding “paper barriers” lead to the inescapable conclusion that WCTL’s Petition is unnecessary and counterproductive. If, however, the Board believes that there should be further inquiry into the issue, rather than instituting a formal rulemaking proceeding, the Board could consider holding a public hearing to obtain the views of any interested parties. The Board has utilized this process, for example, in Ex Parte No. 646, *Rail Rate Challenges in Small Rate Cases*, (Hearing on July 21, 2004) and in Ex Parte No. 657, *Rail Rate Challenges Under the Stand-Alone Cost Methodology*, (Hearing on April 26, 2005). The AAR wishes to make clear that it does not believe that any further Board action is necessary with respect to “paper barriers” and that WCTL’s Petition should be denied at this time. However, if the Board wishes to explore the issue further, a public hearing would allow all interested parties to present their views and provide additional substantiation for a record upon which the Board could make a final determination denying WCTL’s Petition.

## CONCLUSION

For the reasons set forth above, the AAR believes that a rulemaking proceeding regarding “paper barriers” is both unnecessary and counterproductive. Accordingly, the AAR requests that the Board deny WCTL’s Petition.

Respectfully submitted,

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Dated: May 2, 2005

**RIA EXCERPTS REGARDING PAPER BARRIERS**

**Paper Barriers**

Only legitimate “paper barriers” should be enforceable. Paper barriers are restrictions on interchange imposed by contract at the time of the creation of the Short Line. Legitimate paper barriers are those that are designed as fair payment for the sale or rental value of the line that created the Short Line. Such barriers should not restrict the Short Line’s ability to develop New Traffic with another carrier if the selling or leasing Large Railroad cannot or will not participate in the New Traffic. Excessive per car charges or other penalties imposed if a car is interchanged to another Large Railroad (other than legitimate paper barriers) are unreasonable and should not be permitted. (RIA, p. 3)

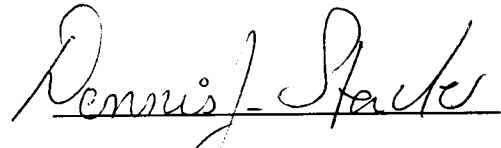
**Paper Barriers and New Routes** (applies to participating Class I and III Railroads)

- a) **General Premise:** If the requested Access or routing helps the connecting Short Line and does not harm the Large Railroad, then the request should be approved as it will improve shipper rail service while strengthening the rail industry.
- b) **Paper Barriers and New Routes:** The Large and Short Line Railroads agree to work cooperatively to increase rail freight business. Joint initiatives designed to increase Short Line freight business under certain circumstances include, but are not limited to, waiver of contractual interchange restrictions and Large Railroad haulage of Short Line traffic.

In other cases, Large and Short Line Railroads may voluntarily agree at any time to renegotiate the terms of sale agreements including, but not limited to, terms relating to limitations on interchange (legitimate paper barriers). The renegotiations of limitations on interchange shall include consideration of additional compensation due to the Large carrier reflecting changes to the economic and market assumptions made by the Large and Short Line carriers at the time of original sale based upon the limitations on interchange at the time of such sale as well as all other relevant factors. (RIA, p. 4)

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document was served on all Parties of Record by first class mail or more expedited means of service on this 2<sup>nd</sup> day of May, 2005.

  
Dennis J. Starks