

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB EX PARTE NO. 575

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

**OPENING COMMENTS OF
THE ALLIANCE FOR RAIL COMPETITION**

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I. INTRODUCTION

The Alliance for Rail Competition (“ARC”) supports the renewed petition of Western Coal Traffic League for initiation of a proceeding addressing rail access and competition issues. ARC hereby calls on the STB to revise its approach to line sales by major railroads to short lines, and in particular, to use its authority over such sales to promote increased rail-to-rail competition. “Paper barriers,” i.e., contractual provisions allowing the selling Class I railroads to control the short lines’ pricing and use of the acquired tracks, can no longer be left to “self-regulation” by railroads under the current Railroad Industry Agreement.

II. IDENTITY AND INTEREST OF ARC

ARC is an association of shippers that are captive to railroads for significant portions of their freight shipments. ARC members include shippers of agricultural commodities, coal, chemicals, glass, rail customers and other bulk commodities, consisting of Fortune 500 companies, small businesses, shipper associations and groups.

ARC was founded in 1997 by shippers who were concerned that ICC and STB regulation under the Staggers Rail Act and subsequent legislation had fallen short of meeting the needs of captive shippers. ARC's goal was to help such shippers, as well as competitive shippers and the railroads themselves, by pursuing increased rail-to-rail competition as an alternative to regulatory remedies. ARC and its members believe that the railroad industry's limited exposure to competition accounts in large part for the poor service, high rates and lack of responsiveness to customer needs that characterize rail

transportation. Greater competition would discourage these characteristics, benefiting the public interest, railroads and railroad customers.

In ARC's view, increased rail-to-rail competition was called for by Congress in the Staggers Rail Act. However, implementation of the relevant provisions by the ICC and STB has resulted in less competition. ICC and STB decisions approving Class I mergers have limited rail-to-rail competition among major railroads, and regulatory approval of paper barriers has limited the ability of smaller railroads to compete with the Class I railroads.

ARC's main focus has been and continues to be on its legislative efforts. ARC is a leading member of a coalition of shipper groups and shippers supporting the Railroad Competition Act of 2005, S. 919, and the Railroad Competition Improvement and Reauthorization Act of 2005, H.R. 2047. However, ARC has also followed regulatory developments, and has filed comments on several occasions with the STB.

ARC and its members, like many other shipper groups and shippers, are concerned that captive shippers today have been placed in an untenable position by the combined effects of increasing railroad monopoly and market power, ineffective rail regulation, and little or no recourse under the antitrust laws. We know of no other industry with the freedom that major railroads enjoy to pursue their own self-interest without fear of regulatory, legal or competitive challenges. For these reasons, the status quo is unacceptable, even if railroad financial health has improved. Unrestricted railroad monopoly power does not serve the public interest.

In addition to seeking legislative change, ARC therefore calls on the STB to revisit key aspects of current rail regulation. Specifically the STB should focus on Title 49, Subtitle

IV, Part A, Chapter 101: Section 10101. - Rail transportation policy: “In regulating the railroad industry, it is the policy of the United States Government:

(1) to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail;...

(4) 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 the national defense; ...

(5) to foster sound economic conditions in transportation and to ensure effective competition and coordination between rail carriers and other modes;...”

In too many cases, contested issues have been resolved in ways that leave captive shippers remediless. And the cumulative effect of these actions, which has received too little attention from the ICC and STB, has left captive shippers vulnerable to abuse on many fronts. See the Comments filed in October 2005 by ARC in Ex Parte No. 658, The 25th Anniversary of the Staggers Act of 1980: A Review and Look Ahead.

ARC notes that at least one Class I railroad achieved revenue adequacy in 2004, and more may do so in 2005, even under revenue adequacy standards that clearly favor railroads efforts to obtain special consideration in rate cases and rulemaking proceedings. These developments, as well as the elimination of excess rail capacity and the demonstrated falsity of claims that rates cannot be increased on the traffic of non-captive shippers, provide additional grounds for new approaches to rail regulation, and for new measures to enhance rail competition.

Whether or not "long-term revenue adequacy" has been achieved – and ARC believes several railroads would have been found revenue adequate for many years under more accurate standards – the Board should move forward with new approaches tailored to new circumstances. Revenue adequacy and the elimination of excess capacity mean

that high rates and poor service for captive shippers can no longer be excused. The Board therefore needs to analyze alternatives to business as usual.

III. ARGUMENT

A. There Is Too Little Rail-to-Rail Competition

The proceeding has been initiated against the backdrop of a rail transportation system in which the four largest Class I railroads handle some 95% of rail freight. This statistic is alarming enough considered in isolation, but there are and continue to be other areas of concern for captive rail shippers. For example:

- Rail capacity is tight, and the problem is exacerbated by congestion.
- Railroads are “demarketing” freight by declining to provide service or by imposing high rates to discourage requests for service by disfavored customers.
- Railroads have shifted the burdens of supplying most railcars to shippers, and often auction car supply.
- Captive and “non-captive” rail customers (shippers) complain of poor rail service.
- Captive and “non-captive” rail shippers complain of high rates.
- Captive and “non-captive” rail shippers complain of excessive fuel surcharges and other charges.
- Motor carriers and rail customers seeking intermodal service complain of poor rail service.
- Railroads are widely criticized for being less responsive to customer needs and concerns than motor and air carriers.

Many of the foregoing problems could be ameliorated if there were more rail-to-rail competition. Unfortunately, the ICC and STB have for many years been unwilling to use the authority Congress provided to promote rail competition – again see Title 49, Subtitle IV, Part A, Chapter 101: Section 10101, U.S. Transportation policy. For example, in merger proceedings, the ICC and STB have conceded that their policy is only to preserve rail competition and not to create more competition. However, even the limited goal of not reducing competition has not been achieved. Under the “one-lump” theory, it is assumed that a merger cannot make a captive shipper more captive. Therefore, the loss of upstream or downstream competition due to lost or impaired access to markets is ignored.

To illustrate this example further, eastern coal-fired power plants captive to NS may nevertheless be able to choose coal from mines served by UP or BNSF, and thereby enjoy competition among such mines. If BNSF and NS merge, the “one-lump” theory would not recognize the danger that the merged railroad would price its services so as to eliminate coal mines served only by UP as competitors for mines served by BNSF.

Where the Board fails to promote or even adequately preserve rail competition, it should come as no surprise that major railroads limit their own exposure to competition in numerous ways. One of these ways is through provisions in line sale agreements and through other contractual provisions that permit major railroads to limit the competition they face from short lines. These limitations may include full or partial control of the short line’s pricing, full or partial control of the services the short line may render, the customers it may serve and the railroads with which it may interchange freight. Major railroads may also retain, explicitly or implicitly, the ability to use control over physical

facilities to exercise control over a short line's operations. Collectively, these arrangements are referred to as "paper barriers."¹

B. Relief from Paper Barriers is Necessary to Increase Rail-to-Rail Competition

ARC and its members do not believe that relief from unreasonable paper barriers, by itself, would resolve all problems caused by anticompetitive conduct among major railroads. Even complete relief allowing full competition by short lines would fall short of that goal, primarily because of the relatively small market share of short lines. Moreover, the removal of barriers to competition does not necessarily lead to competition. Short lines, like major railroads, could find themselves in situations where they regard their commercial interests as best served by refraining from competing, either to avoid retaliation by major railroads or to avoid reducing their rates.²

However, this is a period when major railroads are extremely powerful, and few regulatory remedies are available to shippers. STB action reducing paper barriers to increased competition for major railroads is needed and warranted, even if not a complete solution to the problems caused by excessive railroad market power.

Potential benefits include increased rail capacity, in that short lines would no longer be prevented from offering services currently foreclosed to certain shippers and under certain circumstances. Congestion could be reduced if traffic that major railroads now keep for themselves is allowed to move via short lines. In addition, if a short line is allowed to interchange with two or more railroads rather than just one, the short line, or a

¹ Sometimes potential or actual physical barriers to competition have been called "steel barriers" to distinguish them from legal rights and obligations set forth in contract provisions.

² In ARC's judgment, the shortcomings in the AAR/ASLRA Railroad Industry Agreement are largely attributable to the power of the major railroads and the short lines' fear of retaliation if they pushed too hard to compete with the Class Is.

Class I with which the short line cannot now interchange freight, may be able to use such routing flexibility to avoid the most congested routes.

Rates and charges may or may not be affected if there is new short line competition. Under the Bottleneck Decisions, major railroads might raise their divisions of rates to offset any rate reductions by short lines, and might use their greater bargaining power to insure that they receive revenues no lower than those received on longer hauls. This is exactly what Conrail demanded from the Delaware & Hudson in a matter that led the Second Circuit to find a potential violation by Conrail of the antitrust laws. See Delaware & Hudson Railway Company v. Consolidated Rail Corp., 902 F.2d 174 (2d Cir. 1990).

However, where short lines have more freedom to serve shippers, there is an increased opportunity for shippers to enter contracts for short line services, and invoke the contract exception to the Bottleneck Decision. ARC is unaware of any case in which that exception has been useful, but it cannot be ruled out as one more potential benefit of STB action to address paper barriers.

C. Paper Barriers Are Inconsistent
with Antitrust Laws and Policies

Absent STB approval, there can be little doubt that many paper barriers would be vulnerable to challenge under the antitrust laws, and would subject the Class I railroads that demanded them to civil and possibly to criminal remedies.

To the extent that the Class I line seller reserves the right to control short line rates and charges over the transferred line, the practice appears vulnerable as price fixing, a per se violation of the antitrust laws. To the extent that the Class I line seller and the short line agree on the markets where the two will not compete, e.g., by permitting the

Class I to foreclose short line access to new business the Class I wants to keep for itself, the arrangement appears vulnerable as a division of markets, another per se violation.

The fact that the weaker party – the acquiring short line – may have agreed to these arrangements as a quid pro quo for the Class I’s willingness to sell, or for the Class I’s willingness to sell at a particular price, is not a defense under the antitrust laws.

While the Board does not have jurisdiction to enforce the antitrust laws as such, it has long been recognized that the overarching public interest standard the Board is charged with implementing includes recognition of antitrust policies. See, e.g. McLean Trucking Co. v. United States, 321 U.S. 67, 86-87 (1944):

Congress however neither has made the anti-trust laws wholly inapplicable to the transportation industry nor has authorized the Commission in passing on a proposed merger to ignore their policy

* * * *

Hence, the fact that the carriers participating in a properly authorized consolidation may obtain immunity from prosecution under the anti-trust laws in no sense relieves the Commission of its duty, as an administrative matter, to consider the effect of the merger on competitors and the general competitive situation in the industry in the light of the objectives of the national transportation policy.

D. The Board has Authority to Address Unreasonable Paper Barriers

The STB has authority under various theories to deal with unreasonable paper barriers. First and most obviously, it can disapprove future line sales that are subject to anticompetitive paper barriers. See 49 U.S.C. Sections 11321-11328 and 10902.

Notably, the foregoing specific authority concerning lines sales explicitly requires recognition of anticompetitive effects. See., e.g., 49 U.S.C. Section 11324(d), citing a

“substantial lessening of competition” or “creation of a monopoly” as grounds for disapproving a transaction between a Class I and a Class II or III railroad, along with whether “the anticompetitive effects of the transaction outweigh the public interest in meeting transportation needs.”

In its February 1, 2006 decision requesting comments on WCTL’s petition for rulemaking, the Board asked about its statutory authority to address pre-existing paper barriers. In effect, the Board is asking whether prior ICC and STB decisions approving transactions including paper barriers must be regarded as permanent. The answer is no.

Just as the Board may entertain railroad requests to reopen market dominance findings and rate prescriptions in rate cases due to changed circumstances, it may entertain requests to reopen line sale proceedings involving paper barriers due to changed circumstances.

The changed circumstances may be specific to the transaction in question, e.g., a showing that any anticompetitive effects of the transaction are no longer outweighed by public transportation needs, or that an insubstantial lessening of competition has, over time, become substantial. If this were not the case, a Class I could enhance its monopoly power through the simple expedient of multiple transactions involving multiple paper barriers, no one of which, seen in isolation, was unreasonable.

However, the Board may also reopen past transactions based on more general considerations, such the current railroad industry capacity shortage. When circumstances change in such a way as to vitiate the rationale for past agency action, the Board has inherent authority to adjust its policies. See also 49 U.S.C. § 11327: “When cause exists,

the Board may make appropriate orders supplemental to an order made in a proceeding under sections 11322 through 11326 of this title.”

No doubt the railroads will cite their reliance interests as grounds for treating past line sales sacrosanct. ARC does not regard such reliance interests as irrelevant. However, the better policy is not to elevate such interests above the public interest. It is rather to weigh such reliance interests as against the public interest in a flexible, responsive and competitive national and regional rail transportation system. Based on that balancing of interests, the Board may grant full, partial or no relief from paper barriers, as circumstances warrant.

There are also indirect forms of relief the Board could consider. For example, in its decision in Midtec Paper Corp. v. Chicago and North Western Transportation Co., 3 I.C.C.2d 171 (1986), the Commission held that a showing of anticompetitive conduct by an incumbent railroad is a predicate to relief under 49 U.S.C. § 11102. A showing that competition from a short line has been foreclosed by a paper barrier could and should be accepted as evidence of anticompetitive conduct by the railroad that imposed the paper barrier. There may be similar measures that could mitigate the anticompetitive effect of the Bottleneck Decisions, where a Class I railroad’s ability to leverage its segment monopoly rests on a paper barrier.

E. The Railroad Industry Agreement
Does Not Obviate the Need for a Rulemaking

In their May 2, 2005 replies in opposition to the WCTL petition for rulemaking, the Association of American Railroads (“AAR”) and the American Short Line and Regional Railroad Association (“ASLRRA”) argued that their Railroad Industry

Agreement adequately addresses shippers' concerns about paper barriers. They are wrong.

As those replies acknowledge, short lines are able to compete only for new traffic, and even then, only for new traffic the major railroad line seller does not want. In other words, the major railroads that impose paper barriers have a free hand to insulate themselves from short line competition except as to freight in which the major railroad has no interest. This is a division of markets imposed by the major railroad line seller.

Where the dominant party to a transaction controls the service, rates and customers available to the smaller, weaker party, the result is not competition at all. Indeed, where the Class I permits a short line to provide service, the shipper may simply be substituting captivity to the short line for captivity to the Class I, with none of the benefits rail competition should provide.

Another argument the railroads are certain to raise is that if the major railroad line-sellers do not retain an unrestricted right to impose anticompetitive paper barriers, there will be no more line sales. Put another way, the argument may be that, despite its shortcomings, the Railroad Industry Agreement is the only basis on which surplus Class I trackage is kept in service, as opposed to being allowed to deteriorate through high Class I pricing and poor Class I maintenance.

This "dog in the manger" policy on the part of major railroads provides further evidence of the need for new Board policies to increase rail-to-rail competition. The public interest has for too long been equated with the railroad industry's interest.

In the rest of the economy, anticompetitive conduct cannot be tolerated based on claims by colluding parties that their self-serving arrangements supplant even worse

alternatives. If the railroads' position is truly that line sales will not be allowed to increase rail competition, the answer cannot be regulatory approval of blatantly anticompetitive conduct. Rather, the Board should consider other measures, such as adverse abandonments and new merger conditions, that limit the ability of Class I railroads to keep track they do not intend to use.

At a minimum, the Board should not assume that the status quo is optimal, but should institute a rulemaking proceeding to consider how the public interest can best be served.

IV. CONCLUSION

For the foregoing reasons, the Board should institute a rulemaking proceeding to address the marketplace distortions and other problems caused by paper barriers.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Terry C. Whiteside", is written over a light gray rectangular background.

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