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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

COMMENTS OF THE
U.S. DEPARTMENT OF AGRICULTURE

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AUTHORITY AND INTEREST

The Secretary of Agriculture is charged with the responsibility under the Agricultural Adjustment Act of 1938 and the Agricultural Marketing Act of 1946 to represent the interests of agricultural producers and shippers in improving transportation services and facilities by, among other things, initiating and participating in Board proceedings involving rates, charges, tariffs, practices, and services.

The Department of Agriculture (USDA) represents U.S. farmers and agricultural shippers, and the vitality of their livelihood is our primary interest. Agricultural producers benefit from a competitive transportation environment because the price they receive for their commodities is net of transportation costs. In addition, the transportation cost of agricultural products can be more than one-half of the landed cost. Our interest lies in preserving an efficient and competitive transportation sector that effectively serves U.S. agriculture.

USDA thanks the Board for requesting comments on the renewed petition of the Western Coal Traffic League for a rulemaking to address the use of paper barriers.¹ USDA is against unreasonable paper barriers as they needlessly restrict rail-to-rail competition and may violate the Sherman Act, which prohibits restraint of trade. Thus, a rulemaking on paper barriers is in the public interest and will allow issues regarding paper barriers to be thoroughly examined.

BACKGROUND

Since the Staggers Rail Act of 1980, large railroads have reduced the size of their

¹ Paper barriers are agreements to sell or lease a rail line that restrict the ability of the purchaser or tenant to interchange traffic with competitors of the seller or landlord railroad.

networks, often by selling or leasing unprofitable or marginally profitable lines. In addition, profitable lines have been sold as large railroads attempted to increase profits by developing low-cost feeder systems. Many of these lines were sold or leased to small, newly created short line or regional railroads that could operate them profitably in circumstances where the larger railroads could not.

These line sales or leases have preserved rail service, especially in rural areas, and have kept lines from being abandoned, benefiting both the communities served and the shippers. Short line and regional railroads now operate nearly 30 percent of the national railroad network and originate about 25 percent of the carloads.

The issue in this proceeding is whether the paper barriers contained in many line sale and lease contracts serve the public interests or unduly restrict trade. Since 1980, many of the rail lines were sold or leased at a low price that was based upon the inclusion of paper barriers. The low selling price was required because most independent small railroads are under-capitalized and unable to finance the line acquisition at market value. Small independent railroads often are able to borrow only the salvage value of a rail line and have no access to large equity markets. Thus, Class I railroads had a choice of selling at lower than market value—but with paper barriers to recover the fair market value—or abandoning these lines.

It appears, however, that what began as a financing mechanism for small railroad acquisition of divested rail lines has evolved into prohibited restraints on competition. When the Board initiated a broad review of railroad access and competition issues in 1998, shippers discussed the conflict between the public interests and the anti-competitive nature of these paper barriers. As a result of the Board review, the

Association of American Railroads and the American Short Line and Regional Railroad Association executed a Railroad Industry Agreement (RIA) that addressed paper barriers and other issues. On March 21, 2005, the Western Coal Traffic League renewed its 1998 request for a rulemaking on the paper barrier issue because it asserted that the RIA did not adequately deal with these barriers.

IMPORTANCE OF COMPETITION

One of the key assumptions underlying the deregulation of the rail industry was that there would be sufficient competition to improve allocative and technical efficiency, resulting in improved rail service. Competition, including rail-to-rail competition, must be preserved and promoted for this premise to be realized. Thus, the authors of the *Staggers Act of 1980* and the *Interstate Commerce Commission Termination Act of 1995* (ICCTA) included the preservation and promotion of competition in 4 of the 15 Rail Transportation Policy goals of the United States.²

The transportation policy goals also include the goals of allowing rail carriers to earn adequate revenues and to reduce regulatory barriers to entry into and exit from the industry. The Board is required to balance the latter goals with the goals of promoting competition and meeting the needs of the public. USDA commends the Board for placing greater emphasis in recent years upon enhancing competition.

The promotion of adequate competition is particularly important to agricultural producers because the price they receive for their commodities is net of transportation costs. In addition, the transportation cost of agricultural products can be more than one-half of the landed cost. In many agricultural regions of the Nation, truck and barge

² ICC Termination Act of 1995, §10101.

transportation provide competition that helps constrain rail prices. Barge transportation, however, is not available to those agricultural producers located in the western portions of the Plains States, and truck transportation is not cost-effective for longer hauls to market. Thus, for agricultural producers, competition in transportation—including rail-to-rail competition—must be preserved and promoted for there to be effective competition among producers and global competitors.

PAPER BARRIERS AND ANTITRUST LAW

USDA is concerned that many existing paper barriers may violate the Sherman Act,³ which prohibits restraint of trade, because they limit the market access of shippers and restrict rail-to-rail competition. Antitrust law prohibits businesses from selling a portion of their business and then restricting the buyer as to whom they can do business with, how they conduct business, or how they price the service.

Unlike many other businesses in the United States, railroads have partial antitrust immunity. This immunity appears to be limited to: Mergers as approved by the Board; actions necessary to implement these mergers; the authority to engage in car pools; joint ownership of track and dispatching facilities; discussion of tariff rates for joint hauls; and actions to allow rate discrimination for movements on a railroad's own line.⁴ This antitrust immunity does not appear to extend to anticompetitive provisions in the sale or lease of rail lines to other railroads.

Limited exceptions to antitrust law have been allowed by the courts in the past, but require the barriers to be reasonable, as limited as possible, and that the public

³ Sherman Act; 15 U.S.C. §1

⁴ ICCTA Termination Act of 1995; §10501(b); §10706; §11321

benefits must outweigh the anti-competitive effects. Many sale and lease contracts of rail lines containing paper barriers appear to contain unreasonable restraints to trade. USDA contends that some of the unreasonable aspects include: A lack of shipper involvement in negotiating the terms of the barriers and a lack of shipper recourse; unreasonably long terms for contracts; and line values that may be set unreasonably high.

Lack of shipper involvement and recourse

The lack of shipper involvement in the negotiation of these paper barriers is troubling to USDA. Many of the terms of sale or lease appear to unlawfully tie a shipper's traffic to the railroad that sold or leased the line to the smaller railroad. For these sale or lease agreements to conform to antitrust regulations, USDA asserts that it is essential for shippers to have input and recourse to these agreements.

Since these paper barriers are usually confidential, shippers often are not aware of their existence until they attempt to ship products using the connection the smaller railroad has to a competing railroad. When attempting to ship on a competing rail line, the shipper often discovers that the penalties in the paper barrier are designed to preclude that option. Due to the public interests of shippers and affected communities, the contents of sale and lease agreements containing these barriers should be a matter of public record.

Railroads contend that shippers do not need separate standing to challenge paper barriers because their interests are fully represented by the short lines serving them. Although this may be correct for new traffic, it is not true for existing traffic. Should the traffic continue to move by rail, the short line would earn its revenues whether it routed

through the seller/lessor railroad or through a competitor of that railroad. Thus, for most traffic, the short line railroad would have no incentive to act in the interests of the shipper regarding paper barriers.

Unreasonably long contract terms

Many line sale and lease agreements contain paper barriers that continue into perpetuity or for excessively long terms. The Western Coal Traffic League suggests a term of no more than 5 years, which may be too short relative to the length of life of rail assets. Courts have ruled that constraints to competition that endure for long periods of time are unreasonable and a violation of antitrust law. Consequently, the term of paper barriers should be limited to the minimum duration necessary to recover the fair market value of the line.

Although public interests can tolerate temporary restrictions to a buyer's ability to compete freely as an independent entity, it cannot tolerate these constraints indefinitely. If allowed to continue indefinitely, the harm to competition would soon outweigh the public benefits of preserving rail service. As long as these competitive constraints exist, they cause artificially high rail rates that reduce the income of agricultural producers and damage the economic health of their communities.

Unreasonable line values

USDA recommends that the selling or leasing railroad be allowed to recover no more than the fair market value of the sold or leased rail lines at the current cost of capital. This value should not include the value of traffic that will travel over the selling railroad's lines after the short line tenders traffic to the selling or leasing railroad.

Neither should selling or leasing railroads be allowed to inflate this value in order to tie

traffic on the line to the selling railroad. When the fair market value of the line is inflated, shippers and producers pay tariff rates higher than warranted.

ECONOMIC EFFECTS OF PAPER BARRIERS

Paper barriers that limit the ability to interchange traffic with other railroads restrict the access of shippers and producers to all available markets. Limited market access interferes with the ability of agricultural producers and shippers to obtain the best price for their produce and increases their transportation costs. This may result in reduced producer income and negatively impact the economic well-being of nearby communities. Restrictions to market access can also result in inefficient transportation of agricultural products. When access to nearby markets is limited, producers are forced to ship to more distant markets while more distant producers serve nearby markets.

In addition, since railroads are a network industry, smaller railroads are forced to cooperate with the Class I railroads. Consequently, the social and economic benefits arising from the rail network, as a whole, can be reduced by unreasonable paper barriers because rail carriers not only compete with, but complement, one another. Thus, unnecessary restrictions on interchange, which may be in the private interest of two railroads, are rarely in the interest of the network as a whole.

RAILROAD INDUSTRY AGREEMENT

USDA asserts that the implementation of the Railroad Industry Agreement (RIA) has not resolved all of the unreasonable restraints to trade due to paper barriers.

Although it addresses some of the problems with interchange penalties for new traffic, it fails to address unreasonable interchange penalties for existing traffic.

First, the shippers and communities involved still have no input in determining the reasonableness of the paper barriers, and shippers are denied remedies. Furthermore, the terms of the paper barriers are kept confidential, preventing stakeholders from evaluating the impacts of the barriers upon their businesses.

In addition, the RIA is not enforced by a truly neutral party. Enforcement is limited to negotiations and private arbitration between the carriers, ignoring the difference in market power between the Class I railroad and the smaller railroad purchasing or leasing the line. Furthermore, the RIA does not specify how the sale or rental value of the rail line is to be determined nor does it limit the duration of the paper barriers.

RECOMMENDATIONS

USDA recommends that the Board develop clear guidelines for reasonable paper barriers that would satisfy the requirements of antitrust law. USDA also recommends that the Board modify unreasonable paper barriers that are contained in the terms of existing sale and lease agreements, or give the railroads the option of nullifying the paper barriers in the agreements. These agreements, although many are old, should conform to the requirements of antitrust law and the Rail Transportation Policy.

USDA also believes that prohibition of unreasonable paper barriers will not result in abandonment of rail lines that otherwise would have been preserved. Class I railroads would continue to sell lines rather than abandoning them as long as it makes economic

sense. In addition, reasonable paper barriers would still allow railroads to profit by selling or leasing lines—they would just remove the ability to extract monopoly rents.

CONCLUSION

USDA recommends that the Board conduct a proceeding to address unreasonable paper barriers and develop clear guidelines for reasonable paper barriers that would satisfy the requirements of antitrust law. USDA also recommends that the Board modify unreasonable terms in paper barriers that are contained in existing sale and lease agreements, or give the railroads involved the option of nullifying the paper barriers in the agreement.

The guidelines for paper barriers should provide for the Board's careful examination of paper barriers in line sale and lease agreements. Approval of paper barriers should be granted only on evidence that they are no more restrictive than necessary in order to achieve benefits in the public interest and that those public benefits outweigh the harm to competition. In order for these paper barriers to be reasonable, they must be structured to minimize the impact on competing carriers' ability to compete.

Respectfully submitted,

A handwritten signature in cursive script, reading "Charles D. Lambert".

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