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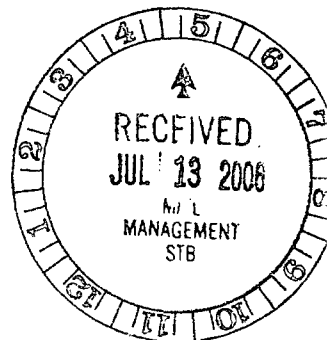
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*ADMITTED IN CA & NY

July 13, 2006

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

By Hand Delivery



Re: Ex Parte No. 575, Review of Rail Access and Competition Issues **ENTERED**
Renewed Petition of the Western Coal Traffic League **Office of Proceedings**

JUL 13 2006

Dear Secretary Williams:

**Part of
Public Record**

Enclosed for filing are an original and 10 copies of the Testimony of Michael E. Grisso, Executive Director, Alliance for Rail Competition, in connection with the hearing scheduled for July 27, 2006.

Sincerely,

A handwritten signature in black ink, appearing to read "John M. Cutler, Jr.".

John M. Cutler, Jr.

ORIGINAL

BEFORE THE
SURFACE TRANSPORTATION BOARD



EX PARTE NO 575

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

ENTERED
Office of Proceedings

JUL 13 2006

Part of
Public Record

SUMMARY OF TESTIMONY OF MICHAEL E. GRISSO, EXECUTIVE DIRECTOR,
ALLIANCE FOR RAIL COMPETITION

I. INTRODUCTION

The Board faces a clear choice in this proceeding. On one side of the scale is the interest of Class I railroads in spinning off lines of track they no longer want, subject to agreements that preserve their ability to raise prices, limit service, and otherwise exercise full market power over their short line connections. On the other side of the scale are Rail Transportation Policies, sound economic principles, antitrust requirements, all of which favor increased competition. On that same side are numerous public interest considerations, including much needed relief from capacity constraints and service shortfalls.

In the past, the ICC and Board have favored the Class Is, subordinating all other concerns to the perceived need of major railroads for higher revenues. Assuming that rationale ever made sense, it cannot justify business as usual today, when major railroads are enjoying record revenues and the need to maximize capacity is a key priority for rail transportation.

GAO recently called for additional analysis of rail competition. A good way for the Board to be responsive to this call would be to issue a notice of proposed rulemaking calling for additional evidence on paper barriers. At a minimum, the Board should also announce its intention to prohibit such barriers in future agreements, while encouraging continued sales of unused or underutilized line to short line operators. In addition, the Board should propose new procedures for the termination of paper barriers approved years ago, when Class I railroads' financial strength was less apparent, and when the railroad industry was characterized by excess capacity.

II. ARGUMENT

The Alliance for Rail Competition ("ARC") appreciates the opportunity to address the Board on the issue of paper barriers. ARC was formed in 1997 to promote competition among railroads as an alternative to regulatory remedies. We believe, and we believe all would agree, that where there is an absence of effective competition, regulation is necessary.

However, we also believe that competition is usually preferable to regulation. As we know from its effects in other industries, competition is healthy for consumers and producers, buyers and sellers, because it leads to optimal combinations of efficient operations, high quality service and rates and prices that are not unreasonably high. Regulation

may sometimes be able to prevent unreasonable prices, but it is difficult for regulators to mandate good service or efficient operations. Competitive forces are better at achieving these goals. These are basic truths from Economics 101. However, they have been applied too rarely to major railroads, four of which reportedly control over 90% of U.S. rail freight.

There are three main types of competition that Class I railroads face. The first is competition from other Class I railroads. This type of competition is inadequate because of mergers, and because of ICC and STB merger standards that have not even attempted to increase competition and in most cases failed even to preserve competition.

The second major form of competition is competition from motor carriers and other modes. This form of competition is vigorous, but it does not help shippers that are captive to railroads. In addition, the STB does not need to focus on shippers who enjoy effective competition for their business.

The third form of competition that Class I railroads face is competition from smaller railroads. Barriers to this form of competition are the reason for the Board's hearing. Such barriers may be legal provisions in sales contracts, or they may be physical, as when the selling Class I retains ownership of tracks on both sides of interchange points. The former are called paper barriers and the latter are sometimes called steel barriers, but ARC will use the term paper barriers to refer to all such barriers.

The major railroads defend such barriers. This is short-sighted but not surprising. The major railroads have fought hard for many years to limit competition, and they are much happier when the contestability of their markets is theoretical than when it is actual.

To the extent that they find support for their arguments in old ICC decisions, it is because those decisions were issued at a time when the major railroads' financial health was uncertain. Today, major railroads are enjoying record revenues and profits. Moreover, much of their current financial strength is the result of higher rates and charges paid by shippers that are not traditional captive shippers. Capacity constraints in the trucking industry have permitted major railroads to increase such shippers' rates without losing their business to trucks, as might have happened 5 or 10 years ago.

What then is the argument for new paper barriers? It seems that the major railroads would rather abandon lighter density lines, or price them out of reach, than sell them without paper barriers to short line competitors.

This, however, is at best a reason why it is in the Class I railroads' interest to preserve barriers to short line competition. The Board's statutory responsibility is the interest of the broader public, not just major railroads, and particularly not just major railroads' that do not need protection from competition. See the Rail Transportation Policy, and especially 49 U.S.C. Section 10101, subsections (1), (4) and (5):

- (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.

If the Board looks beyond the narrow self-interest of the railroads, it will face considerations like the following:

- 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 unreasonably 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.
- U.S. companies and agricultural interests continue to cite rail service and rate issues as one major reason for losing competitive edge and position in world markets.

It is only through an end to paper barriers that short lines will have the ability and the resources to contribute to solving these problems. Improvements will come both be-

cause some of the burdens now borne by Class Is can be shifted to short lines, and because short line competition will result in greater efficiency and better service by Class Is themselves. This is the rule in every other industry when large companies face competition from smaller companies. There is no reason to expect any other result in the railroad industry. Competition is the bedrock of American economic policy.

Competition is also favored in American law. The railroads claim the right to withhold unwanted track except on anticompetitive terms, and evidently consider captive shippers a resource to be exploited by the market dominant Class I. But while antitrust laws do not necessarily prohibit the existence of monopolies, those laws do prohibit monopolization, or the enhancement of monopoly power.

Monopoly power is the power to raise rates or exclude competition.¹ This is, of course, the very purpose of paper barriers, and when Class I railroads impose these barriers on short lines, they are engaging in conduct that increases their monopoly power.²

Because of their size and power, Class I railroads are the railroads whose treatment of competitors and competition is most likely to raise antitrust issues, and the railroads are not immune from the antitrust laws, as illustrated by such decisions as Delaware & Hudson Ry. Co. v. Consolidated Rail Corp., 901 F.2d 174 (2d Cir. 1990), cert. denied, 500 U.S. 928 (1991), Otter Tail Power Co. v. United States, 410 U.S. 366 (1973), and United States v. Terminal Railroad Association, 224 U.S. 383 (1912).

These decisions found monopolization as to facilities the monopolists owned. It is therefore absurd for the Class I railroads to argue that monopolization cannot be found as to facilities they have sold to other entities which could and should be competitors but

¹ See, e.g., United States v. E. I. du Pont, 351 U.S. 377 (1956).

² See United States v. Grinnell Corp., 384 U.S. 563 (1966) and United States v. Alcoa, 148 F.2d 416 (2d Cir. 1945).

for paper barriers. Nor is it a defense under the antitrust laws that the short lines accepted the barriers. Major railroads cannot use contracts to override antitrust laws or antitrust policies, even assuming the short lines' acquiescence was truly voluntary. The Board's obligation to honor antitrust policies in its decision making is well-established.³

When it reviews agreements between railroads that cannot be consummated without STB approval, the Board should avoid activism that undermines free market principles and the needs of shippers and the U.S. economy.

The major railroads routinely deny that they have artificially restricted capacity. In recent testimony before the Federal Energy Regulatory Commission, they took credit for extensive investments in double and triple tracking, and blamed shippers and receivers for shortfalls in deliveries. However, conspicuous by its absence was any acknowledgement that an entire segment of the rail industry – short lines – has not been allowed to pursue full capacity utilization due to paper barriers imposed by Class Is.

ARC recognizes that the lion's share of coal hauling in the U.S. is done by Class Is. However, the railroad industry is a network industry, and improvements at one location or over one line segment can permit efficiency gains elsewhere on the system, including lines hundreds of miles away. For this reason, ARC believes that the Board should not focus on isolated locations in this proceeding. Instead, it should explore whether the rail transportation system as a whole suffers from reduced capacity and efficiency when service and competition from short lines is circumscribed. In ARC's view, the answer is clearly yes.

GAO apparently agrees. In its June 21, 2006 Report entitled "Freight Railroads: Preliminary Observations on Rates, Competition, and Capacity Issues," GAO stated:

³ See McLean Trucking Co. v. United States, 321 U.S. 67, 86-87 (1944).

“[T]here has been little assessment by any federal agency of the state of competition nationally and where specific areas of inadequate competition and the inappropriate exercise of market power might exist.” Report at 3. For the Board to terminate this proceeding without further consideration of anticompetitive paper barriers would be a step in the wrong direction.

The Board should not fall for railroad claims that their “Railroad Industry Agreement” adequately protects the public interest. By the Class I railroads' own admission, it has hardly ever been used, and the incentive of the short lines to avoid confrontation with Class Is is obvious. In any event, the RIA only applies to “new” business, which appears to exclude additional volumes of existing traffic.

This proceeding has produced more than enough evidence of a problem requiring corrective action for the Board to proceed to the next step, and issue a Notice of Proposed Rulemaking on paper barriers. In that NPR, the Board should announce its intention to abandon its policy of approving paper barriers in future line sale transactions. It should also use its authority to preclude the avoidance of competition and capacity enhancement for short lines through dog in the manger tactics by Class Is such as discontinuances of service or planned obsolescence of track segments that short lines could operate more efficiently.

The Board should also propose regulations phasing out paper barriers in previously-approved line sale agreements. Those decisions cannot be seen as sacrosanct at a time when Class I railroads are earning record revenues and capacity concerns are front and center for shippers, receivers, carriers, governmental interests and the larger public which depends on the national transportation system.

ARC and its members appreciate the opportunity to appear, and I'll be happy to respond to your questions.

Dated: July 13, 2006

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