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BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 665

RAIL TRANSPORTATION OF GRAIN

STATEMENT OF
THE ALLIANCE FOR RAIL COMPETITION

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Dated: October 30, 2006

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INTRODUCTION

The Alliance for Rail Competition ("ARC") commends the Board for inquiring into the current state of rail transportation of grain, and welcomes the opportunity to comment.

IDENTITY AND INTEREST OF ARC

ARC is an association of shippers of freight that are captive to railroads. ARC represents captive shippers of varying sizes who ship a broad range of commodities. As relevant to this proceeding, a number of ARC's members are shippers of grain and other agricultural commodities.

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 ineffective rail regulation, little or no ability to invoke the antitrust laws, and the market power of monopoly railroads. 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,

especially since the railroads' financial health has improved significantly. Unrestricted railroad monopoly power does not serve the public interest.

ARGUMENT

Other participants in this proceeding are describing in detail the unique features of grain transportation that make shippers of grain and other agricultural commodities particularly vulnerable to abuses of railroad market power. Other shipper participants are also in a position to confirm that rail rates and charges on grain and other agricultural commodities have risen significantly, as reported by the Government Accountability Office in Report GAO-97-94, issued in October 2006. In its Statement, ARC will focus on obstacles to relief, many of which result from acts of commission and omission by the STB.

High rail rates, poor rail service and ineffective remedies are not unique to grain shippers. However, grain shippers tend to be small, tend to be isolated, and tend not to be able to increase their own prices to protect themselves from abuses by railroads. Perhaps because they are more vulnerable than other captive shippers, grain shippers have experienced greater exploitation than other captive shippers. While in theory the law offers numerous potential remedies, in actuality, relief has proved to be impossible to achieve.

I. RAIL RATES AND CHARGES

ARC will begin with rate issues because high rates were cited specifically in the Board's notice scheduling this proceeding. Although high rail rates and charges are not the only problem with rail transportation of grain, the huge transfers of funds from grain shippers to railroads are particularly problematic.

The Promise: The Act Prohibits Unreasonable Rates and Charges

There are three sections of the Interstate Commerce Act that appear to offer remedies to captive grain shippers against abusive rates and charges. The Long-Cannon Amendment, 49 U.S.C. 10701(d)(2), provides that STB rate regulation will consider whether railroads are carrying freight that doesn't contribute adequately (or at all) to railroad finances, and whether one commodity is paying an unreasonable share of overall railroad revenues.

The Act also provides in Section 10701(d)(1), that rail rates on captive traffic "must be reasonable."

In addition, Section 10701(d)(3) provides that the Board must establish "a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case."

Reality: There is No Effective Regulation of Grain Rates or Charges

These three provisions of the Act are essentially a dead letter for captive grain shippers (and other captive shippers).

The ICC effectively eviscerated Long-Cannon in its decision in Coal Rate Guidelines, 1 I.C.C. 2d 502 (1985). When shippers there argued that the railroads were carrying numerous commodities that were under-priced, the Commission held that rail rates well below variable cost are not unreasonable, and said of rates extracting revenues disproportionately from a single commodity that "A disproportionate share is not necessarily an 'unreasonable' share." 1 I.C.C. 2d at 540-41.

The ICC went on to claim that there were nevertheless three ways shippers could show violations of Long-Cannon, but all three ways are unavailable to grain shippers. One is to show that grain rates are not “Ramsey optional.” To make such a showing, a grain shipper would have to establish rate levels and elasticities of demand for every rail shipment and show that its own rates were out of line. There is not enough money in Fort Knox, let alone any grain shipper’s bank account, for such a showing.

Second, the shipper could show that its rate exceeds stand-alone cost. Coal shippers have occasionally managed this feat, but no grain shipper ever has. One grain rate case was litigated unsuccessfully under the SAC test: McCarty Farms, Inc. v. Burlington Northern, Inc., 2 S.T.B. 460 (1997). Even if this is not necessarily the fate of all grain shippers, it is indisputable that most grain shippers have no remedy under the SAC test. SAC “works,” if at all, only where the complainant can afford multi-million dollar litigation costs and the shipments involve huge volumes moving between a small number of points over high density main lines.

Third, a grain shipper could show railroad management inefficiencies on its own traffic so great as to account for the entire gap between the railroad’s revenues and “long-term” revenue adequacy. This avenue to relief is foreclosed by (1) STB revenue adequacy standards under which no railroad, not even NS, has achieved long-term revenue adequacy, and (2) by the absence of any explanation of how the Board’s revenue adequacy constraint might someday work.¹

¹ ARC has called on the STB to address this issue sooner rather than later, to prevent a situation in which a railroad achieves long-term revenue adequacy (NS has been found revenue adequate for 2004 and 2005), but there are no meaningful procedures for implementing the revenue adequacy constraint. However, the Board has so far ignored this request.

As for the statutory command that rates on captive traffic must be reasonable, the Constrained Market Pricing methodology of Coal Rate Guidelines has often been described by the ICC and STB as offering shippers a choice of four “constraints” by which shippers may challenge the reasonableness of rates on captive traffic, but only one constraint – SAC – has ever been used even by coal shippers. The revenue adequacy constraint is undefined and irrelevant to any shipper absent a railroad’s attainment of revenue adequacy. The management efficiency constraint is doubly irrelevant, since it requires a massively costly showing of railroad inefficiency that would, at best, merely allow a shipper to invoke the undefined revenue adequacy constraint. The “phasing” constraint could theoretically serve to delay implementation of a rate increase, but is otherwise not a constraint at all.

In recognition of the limitations of CMP and SAC, Congress enacted 49 U.S.C. § 10701(d)(3), calling for an alternative to SAC for shippers, including grain shippers, foreclosed from relief under SAC. In response, the Board adopted a “three benchmark” approach in Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004 (1996). It has been used only once, in a case brought by a large oil company that was settled in a few weeks.

No grain shipper has even attempted to obtain rate relief under non-coal rate guidelines, and two developments since 1996 make it highly questionable that this methodology will serve its intended purpose.

First, the Board has adopted a “segment cross-subsidy” test for SAC cases under which shippers have essentially no chance of success unless they are located on, and their shipments move exclusively on, high density railroad main lines.

Second, the Board has recently proposed to replace the three benchmark test of its non-coal rate guidelines with what it calls a “simplified SAC” test, which will not work for grain shippers. See STB Ex Parte No. 646 (Sub-No. 1), Simplified Standards for Rail Rate Cases, decision served July 28, 2006. See also ARC’s opening comments in that proceeding, filed October 24, 2006 and incorporated herein by reference, for a fuller explanation of why the Board’s proposal to make SAC and simplified SAC the only available remedies for grain shippers will guarantee that grain shippers have no effective chance at reasonable rate prescriptions.

Two other defects in STB maximum rail rate regulation for grain shippers must also be discussed: cost shifting and railroad charges (as opposed to rates).

The railroads have steadily reduced the equipment and services that shippers receive as part of the rail service covered by line-haul rail rates. Instead, railroads have forced shippers to acquire rail cars at shipper expense, forced shippers to pay for track rehabilitation, and shippers have had no choice but to pay the resulting charges, and pay for the required equipment, or else receive no rail service or inadequate rail service.

Moreover, railroads have increased traditional charges and invented new ones that must be paid, over and above railroad freight rates. In addition, many grain shippers must arrange for truck transportation of their grain to distant 100 car loading facilities, because high rail rates have effectively eliminated 26-car and 52-car grain elevators as shipping points.

Neither SAC, nor simplified SAC, nor even grain shippers’ preferred three benchmark test, offers any means of challenging these non-rate charges and costs imposed by railroads on grain shippers.

II. RAIL SERVICE

Given the high rates and charges they must pay, grain shippers should receive good rail service. They don't.

The Promise: The Act Makes Railroads Common Carriers and Requires Service on Reasonable Request.

The Act provides in 49 U.S.C. Section 11101(a) that:

A rail carrier providing transportation or service subject to the jurisdiction of the Board under this part shall provide the transportation or service on reasonable request.

This provision is the source of the railroads' common carrier obligation. The section goes on to state that railroads may not divert so much of their service to contract carriage as to be unable to respond to reasonable requests for common carrier service.

In addition, railroads may abandon or discontinue service only with STB approval, and subject to statutory conditions.

Reality: There is No Effective Service Regulation

As explained above, there is no effective STB regulation of railroad grain rates and charges. Accordingly, the common carrier obligation can easily be nullified by a railroad.

To be sure, shippers may be able to complain successfully about an outright cessation of service or refusal to serve. However, railroads can easily avoid service they would rather not provide through rates and charges so high as to force shippers to accept service limitations up to and including effective embargoes, as in the case of 26-car and 52-car grain elevators discussed above. As a result, service that is abysmal but not non-existent is relatively easy for railroads to impose.

Instead of using its jurisdiction over unreasonable railroad practices to mitigate the harm done by its failure to provide effective regulation of rates and charges, the agency has exacerbated grain shipper service problems.

For example, in a trilogy of decisions on car service, the ICC enhanced the ability of railroads to price adequate service out of reach for many grain shippers. In the first of these decisions, it decided to stop prescribing the compensation railroads must pay private car owners who supply over half the nation's grain car fleet.² Then it allowed railroads to assign second class status to private cars, discouraging utilization.³ Third, it allowed the railroads to exploit the shortage they created by under-investing in cars through car auctions like BNSF's "COT" program.⁴

Similarly, during the "meltdown" following the UP/SP merger, the Board's use of its emergency powers was too little, too late. And when similar problems arose in the east after the Conrail merger, the Board opted for "informal remedies."

More recently, visits by STB members to states like Montana and North Dakota, where service problems for grain shippers are particularly acute, have had little or no impact. A few grain shippers, having no effective recourse through formal Board procedures have sought help through the Board's Consumer Assistance Program. However, this program depends on "private sector resolution." Captive grain shippers are, by definition, without leverage in such situations so long as recourse to formal regulatory remedies is nonexistent or illusory. Moreover, we fail to see why the Board is so reluctant to implement the Act in a more balanced way.

² See, Lo Shippers Action Committee v. ICC, 857 F.2d 802 (D.C. Cir. 1988), cert. denied, 109 S.Ct. 2429 (1989).

³ See, Shippers Committee OT-5 v. ICC, 968 F.2d 75 (D.C. Cir. 1992).

⁴ See, National Grain & Feed Ass'n. v. Burlington Northern R. Co., et al., 8 I.C.C. 421 (1992), aff'd in part and rev'd in part, sub nom National Grain & Feed Assn. v. United States, 5 F.3d 306 (8th Cir. 1993).

In effect, railroads are being allowed to ration service unilaterally, through a combination of high rates and charges and STB inaction. Economists might regard rationing on economic grounds as rational, at least in a free market. However, there is no free market for rail transportation of captive grain and agricultural commodities. In any event, ARC and its members are concerned that leaving all service decisions up to railroad self-interest will permit distortions of the market, and may mean grain shipments move only when, and to the extent that, railroads have first taken care of intermodal shippers and large utility coal shippers. Disfavored commodities and regions may be left out.

III. RAIL COMPETITION

ARC was founded to promote the idea that rail rate and service problems like those discussed above can be ameliorated through increased competition among railroads. Competition in the trucking industry after that industry was deregulated in 1980 has led to excellent and improving service for shippers at rates that almost never reflect the multiples of cost that are common when captive grain shippers must ship by rail. Unfortunately, here again, the STB has been part of the problem rather than part of the solution.

The Promise: The Rail Transportation Policy and the Act Provide for Rail Competition

In the Rail Transportation Policy, 49 U.S.C. § 10101, there are several subsections addressing the Congressional goal of increased competition among railroads. These include subsection 7, calling for reduced barriers to entry, and subsection 12, calling for the prohibition of predatory pricing, undue concentrations of market power and unlawful discrimination. In addition, 49 U.S.C. § 10101(1) calls for allowing, to the “maximum extent possible,” competition to establish reasonable rail rates.

Congress gave the Board various tools to create competition among railroads where none exists. These include terminal trackage rights and reciprocal switching. And, of course, the most fundamental change of all was the mandate of Congress that the agency may regulate rates only where there is market dominance, and must allow competition to set rates where competition exists.

The Reality: The Board has Turned its Back on Competitive Remedies

The fundamental command of Congress that competition set rail rates where competition exists was undermined by the Board in the Bottleneck Decision.⁵ The Board there elected not to allow competition to set rates over that portion of a shipment (usually the majority of the haul) where competition is available. Instead, citing equivocal case law from the 1930s that was decided forty years before market dominance became a limitation on agency jurisdiction, the Board decided that a railroad with market dominance over 20 miles of a haul should be allowed to leverage that monopoly power over the remaining 1000 miles of the haul. The fact that there is no market dominance over 980 miles of the haul was brushed aside, in order to maximize the ability of one railroad to monopolize the shipper in question and keep other railroads from competing for the freight.

In Ex Parte No. 445 (Sub-No. 1), Intramodal Rail Competition, 1 I.C.C. 2d 822 (1985), the Commission adopted rules intended to prevent anticompetitive route cancellations (the so-called "Competitive Access Rules") at 49 C.F.R. Part 1144. These regulations have been useless, and the railroads have steadily used their power to foreclose shipper access to any routings other than those preferred by the railroads.

⁵ Central Power & Light Co. v. Southern Pacific Transp. Co., 1 S.T.B. 1059 (1996), aff'd., Mid-American Energy Co. v. STB, 169 F.3d 1099 (8th Cir. 1999).

The Board's Competitive Access Rules, as well as the pro-competitive remedies of 49 U.S.C. § 11102, have essentially been nullified by the decision in Midtec Paper Corp. v. Chicago and North Western Transportation Co., 3 I.C.C. 2d 171 (1986). The agency first required a showing of railroad market dominance, and then said a showing of anticompetitive conduct is a prerequisite to relief. The GAO discussed the Section 11102 options and other options the Board has for enhancing competition in its recent Report GAO-04-97, at pp. 38-52. Noting that the Board has not taken advantage of the tools available, GAO called for an investigation of competition and captivity, in part because so many grain shippers have seen such dramatic increases in their rail rates.

Unfortunately, the Board responded that it preferred to focus on rate remedies and ignore competitive remedies. As has been seen, the rate remedies the Board has proposed will not work.

In merger cases, the Board clearly has the power to condition merger approval on actions by the merging carriers that would enhance rail to rail competition. Instead, the Board's view has been that it should do nothing to promote competition, but should merely attempt to avoid a reduction in pre-merger competition. Even this modest goal has not been met because the Board has adopted the narrowest possible definition of pre-existing competition.

If a shipper was served by three railroads prior to a merger and would be served by two afterwards, the Board assumes, erroneously, that there is no diminution of competition. Even worse is the Board's one-lump theory, under which it is assumed that if a shipper is captive pre-merger, it cannot be hurt by a merger.

When shippers have complained about reduced competition resulting from mergers, the Board's response has too often been that they should file a rate case (which grain shippers have no effective means of doing, as detailed above) or that they should proceed under the Competitive Access Rules (which don't work for anyone).

A theoretical source of effective competition for monopoly railroads is short line railroads, but they are generally kept under the major railroads' thumbs by (1) paper barriers, and (2) fear of retaliation by Class I railroads that have the power to put short lines out of business. ARC is glad the Board has taken up this issue, but it remains to be seen whether any change will result.

CONCLUSION

The picture that emerges from the foregoing is understandably dismaying for grain shippers. At every turn, they face Board-created barriers to reasonable rates, adequate service, and rail to rail competition that the STB shows little inclination to remedy. In these and other respects, the promise of the Act is belied by the way its provisions have been interpreted by the ICC and STB, so as to insulate the railroad industry from effective regulatory oversight and from marketplace discipline.

ARC understands and accepts the need for healthy railroads which require adequate revenues, and we accept the principle of differential pricing so long as railroads fall short of revenue adequacy. However, the railroads have now had over a quarter of a century in which to charge whatever they like to grain shippers, and to provide the barest minimum of service, or sometimes no service to grain shippers, and to be free of the competition that might provide true self-help remedies to grain shippers.

If the Board believes it is striking a reasonable balance between railroads' revenue needs and shippers' need for protection against abuses of railroad market power, the Board should review the barriers discussed above. Grain shippers have no effective rate remedies under SAC or Simplified SAC, no effective service remedies, and no effective competitive remedies. As a completely unsurprising result, grain shippers pay high rates for poor service, and see their competitive options shrinking.

Enough is enough, and neither the Board nor the railroads should be surprised that ARC and its members, along with many other shippers and shipper organizations, are backing legislative change. We are tired of playing with a deck that is thoroughly stacked in favor of railroads and against grain shippers.

The status quo clearly does not work for grain shippers, and ARC does not believe it is healthy for the railroads. ARC therefore calls on the STB to dismantle the barriers that provide railroads with a uniquely privileged position in the American economy. Those barriers were not erected overnight and ARC understands that they cannot be

swept away at a stroke. However, the time has come to begin the task of restoring balance to railroad-grain shipper relationships.

Respectfully submitted,

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