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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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**Docket No. EP 705**

**COMPETITION IN THE RAILROAD INDUSTRY**

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# REPLY COMMENTS OF
# CANADIAN PACIFIC RAILWAY COMPANY



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Dated: May 27, 2011

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**CANADIAN PACIFIC RAILWAY COMPANY**

Canadian Pacific Railway Company and its U.S. subsidiaries, Soo Line Railroad Company ("SOO"), Dakota, Minnesota & Eastern Railroad Corporation ("DM&E") and Delaware and Hudson Railway Company, Inc. ("D&H") (collectively, "CP") submit these Reply Comments in response to the Notice served in the above-captioned proceeding on January 11, 2011 (the "*January 11 Notice*").[1]

The Initial Comments filed in this proceeding reveal certain undeniable truths:

First, there is no broad-based support for making fundamental changes to the competition and regulatory policies that have guided the Board's oversight of the railroad industry in the post-Staggers era. To the contrary, the great majority of commenting parties agree that the Staggers Act, and this agency's regulations implementing the statute, have been highly successful in fostering an economically vibrant railroad industry that today delivers better service, at lower real rate levels, than it did under the heavy-handed regulatory policies that preceded them. Many shippers, and virtually all government officials and agencies that submitted comments, support continuation of those successful policies. Indeed, even those

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[1] CP and Canadian National Railway Company ("CN") are filing Joint Reply Comments that address issues relating to the inter-switching performed by Canadian rail carriers pursuant to Section 127 of the *Canada Transportation Act*, and suggestions by certain shipper commenters that the Board adopt a similar requirement in the United States. CP is also a party to, and endorses, the Reply Comments filed by the Association of American Railroads ("AAR").

parties who propose changes to the Board's competitive access and "bottleneck" rate rules acknowledge the benefits that resulted from the Staggers Act reforms.[2]

Second, the proponents of more intrusive regulation of railroad rates, routes and terminal access consist of a relatively small segment of the shipper community (primarily shippers of chemicals, coal and, to a lesser extent, grain) who do not presently have access to as many competitive options as other rail customers.[3] The central thesis of their comments is that the upward movement in rail rates beginning in 2004 reflects an abuse of "market power" by the railroads that justifies abandoning reliance upon market forces in favor of extensive new regulations. Those parties are, for the most part, the same parties who have complained for decades that their rates are "too high" and have sought (unsuccessfully) to roll back the policies embodied in the Staggers Act before Congress and in prior STB proceedings.[4] Their latest salvo in this proceeding is equally unavailing. The complaining shippers have failed to proffer persuasive evidence of "changed circumstances" that warrant a fundamentally different approach to railroad regulation. Rather, their initial comments focus almost exclusively on their parochial desire to pay lower rates, without making a serious effort to consider the potential adverse impacts of granting that relief on carriers, other shippers, communities and other stakeholders.

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[2] *See, e.g.* Arkansas Electric Cooperative Corporation Comments at 2, V.S. Nelson at 7-8 (railroads improved financial health "by taking advantage of the freedoms provided by the Staggers Act"); E.I. DuPont de Nemours and Company Comments at 2 (DuPont "applauded the improvements that followed passage of the Staggers Act"); National Industrial Transportation League ("NITL") Comments at 7 ("it is beyond dispute that the railroad industry has been revitalized and has achieved incredible financial success in the past thirty years.")

[3] As discussed below (at 5-9), the comments filed by grain shipper interests reflect a variance of opinion regarding the desirability of, and the benefits that might result from, modifying the Board's current competitive access and "bottleneck" rate policies.

[4] *See* CP Comments at 43-50 (documenting complaining shippers' unsuccessful efforts to persuade Congress to modify existing policies).

Third, and most tellingly, the initial comments reflect widespread concern that abandoning or modifying the policies that have revitalized the United States rail system in the post-Staggers era will undermine the financial health of the railroad industry and render it unable to make the massive capital investments that will be necessary to satisfy the future demand for rail service. The railroad parties are not alone in this regard – the vast majority of government officials and agencies, quasi-governmental entities (including state and local economic development agencies), as well as a large number of individual shippers all expressed concern that changes of the sort proposed by complaining shippers will inhibit investment in the nation's rail system. No Member of Congress who submitted written views in this proceeding supports abandoning or modifying the Board's current competition policies. Indeed, a joint letter submitted by the bipartisan leadership of the House Committee on Transportation and Infrastructure and the Subcommittee on Railroads, Pipelines, and Hazardous Materials admonished the Board to "maintain[] the existing regulatory balance between the railroads and shippers" and warned that "any policy change made by the STB which restricts the railroads' abilities to invest, grow their networks and meet the nation's freight transportation demands will be opposed by the Committee."[5]

In short, the initial comments fail to provide evidentiary support for abandoning or modifying the Board's current competition policies generally, or, in particular, granting any of the various forms of relief requested by the complaining shippers. Accordingly, the Board should reject proposals for a wholesale realignment of the regulatory balance established by Congress in the Staggers Act.

[5] *See* Letter dated January 24, 2011 from Rep. John L. Mica *et al.* to Daniel T. Elliott III at 1.

## I. COMPLAINING SHIPPERS HAVE NOT DEMONSTRATED THAT CHANGING THE BOARD'S HIGHLY SUCCESSFUL COMPETITION POLICIES WOULD BE IN THE PUBLIC INTEREST.

The parties who favor adoption of intrusive new regulatory remedies, including mandatory reciprocal switching and a requirement that rail carriers quote rates for transportation over any segment of their network upon request, consist largely of shippers of bulk commodities including chemicals, coal and grain products. These parties generally claim to be "captive" to rail service and complain that, because they lack access to the same competitive alternatives available to other shippers, they must pay higher rates than shippers with more competitive options. Notwithstanding the Staggers Act's explicit endorsement of such "differential pricing," these parties assert that the Board's current regulatory policies, including its *Midtec* and *Bottleneck* decisions, are contrary to Congress' intent in passing the Staggers Act.

Despite the similarities in the complaining shippers' presentations, the record shows that the positions of "captive" shippers are not entirely consistent. For example, support for major regulatory change is far from universal among grain shippers. Moreover, even those grain shippers who do endorse new competitive requirements like reciprocal switching candidly question whether such remedies would generate tangible benefits for them, given the vast distances between grain origin points and the lines of potential competing rail carriers and the relatively small volumes shipped by many grain shippers. While coal and chemical shipper groups support new competitive access regulations, their comments are characterized by strident rhetoric, flawed analysis of legal principles and precedents, and an utter failure to address the potential adverse effects of the regulatory changes they propose on the rail industry, non-captive shippers and other important stakeholders.

### A. Imposing New Competitive Access Remedies Is Not Likely to Provide Substantial Benefits to Grain Shippers.

Support for "open access" and bottleneck rate remedies is by no means universal among commenting grain shippers. For example, South Milford Grain Company, Inc. states that "[o]ur company requires and receives timely, competitive rail service for movement of unit grain trains to our customers in the Southeast."[6] For that reason, South Milford's President, Gale Shultz, testifies that "I think the wise old advise [sic] of 'if it ain't broke don't fix it' says it best and should certainly be considered before reregulating the rail industry." *Id. See also* Sunrise Cooperative Comments at 1 ("any attempts to re-regulate railroads will have an extremely negative impact on our country"); Topflight Grain Cooperative Comments (same). While the comments filed jointly by the Agricultural Retailers Association, National Association of Wheat Growers, National Barley Growers Association and various other agricultural interests suggest that the Board should reconsider its *Midtec* competitive access standards, those parties candidly acknowledge that "a fair assessment of the rail transportation situation that now exists in the U.S. indicates that there are many agricultural locations that have a reasonable degree of competition" and that "many rail rates are not an issue." Agricultural Retailers Assn. *et al* Comments at 2, 3. Because grain shipments "almost always start[ ] with a truck movement . . . . farmers have at least an initial opportunity to access competitive modes when grain first leaves the farm." *Id.* at 2.

Even the most ardent supporters of greater regulation among agricultural shippers acknowledge that competitive access remedies of the type that have been proposed in this proceeding would do little to benefit many grain shippers. As the comments filed jointly by the

[6] South Milford Grain Co. Comments at 1.

Alliance for Rail Competition, Montana Wheat & Barley Committee and various other wheat shippers (collectively, "ARC/Wheat Shippers") explain (at 2):

> "In many regions of the country, and particularly for shippers of agricultural commodities in large Western states that are predominately rural, rail-to-rail competition is non-existent for most shippers, and is likely to remain non-existent, no matter how much effort the Board puts into eliminating or reducing anticompetitive policies and precedents. <u>Distances are simply so great, and individual origin volumes so small, that attracting effective competitors for monopoly incumbent railroads is unlikely under any circumstances</u>." (Emphasis added)

For those reasons, ARC/Wheat Shippers conclude that the competitive access remedies proposed in this proceeding "are not likely to be helpful" to many grain shippers. ARC/Wheat Shippers Comments at 8.

The U.S. Department of Agriculture ("USDA") urges the Board to "use mandatory reciprocal switching agreements as one means to increase rail-to-rail competition." USDA Comments at 6. Citing Canada's inter-switching requirement, USDA suggests that the Board require reciprocal switching "for a distance up to about 30 miles." *Id.* According to USDA, the zone within which reciprocal switching should be mandated "should not be greater than 30 miles" because such longer-distance switching "could have unintended consequences for railroad profitability and investment." *Id.*

USDA's proposal should be rejected, for several reasons:

<u>First</u>, as discussed below (at 26-27) and in the Joint Reply Comments filed by CN and CP, Canada's inter-switching practice is not an appropriate "model" for competitive access relief in the United States.

<u>Second</u>, imposing a 30-mile reciprocal switching requirement would not materially enhance the competitive options available to grain shippers. As the Agricultural Retailers Association explained, most grain shipments begin with a truck movement from the farm to an

elevator located along a rail line: "Assuming there are relatively nearby receiving locations to buy farm-trucked grain that offer competitive alternatives on out bound shipping, farmers at least have an initial opportunity to access competitive modes when grain first leaves the farm." Agricultural Retailers Assn. *et al* Comments at 2. In other words, where a second rail option is available within 30 miles of a grain origin, shippers already have "competitive access" to that carrier via a direct truck movement. Moreover, inserting an intermediate rail switch movement between the initial truck delivery to the incumbent carrier and the rail lines of a potential competing railroad would reduce the efficiency, and increase the overall cost, of grain shipments. That is why the concerns expressed by agricultural shippers are largely based upon the circumstances of farmers located a long distance from the closest alternate rail service.

Third, while USDA acknowledges that imposing a reciprocal switching obligation extending more than 30 miles from an origin point could impact "railroad profitability and investment incentives" (USDA Comments at 6), it fails to explain why a reciprocal switching requirement with a 30-mile limit would not have the same adverse consequences. As the railroad commenters have shown, requiring "forced access" even within terminal areas would undercut carriers' incentives to invest in additional facilities.

Finally, the comments of agricultural parties indicate that many grain shippers view existing regulatory remedies (including the Board's jurisdiction over rates and unreasonable practices), and informal dispute resolution procedures entered into voluntarily between carriers and shippers, as more likely to protect their interests than new "competitive access" rules. For example, based upon its misgivings regarding the efficacy of a new reciprocal switching obligation, ARC/Wheat Shippers state that "it is imperative that the Board continue to enforce the Act's prohibitions against unreasonable rates and unreasonable practices." ARC/Wheat

Shippers Comments at 8. The Agricultural Retailers Association *et al.* (at 6) likewise urge the Board to develop a "better approach" to unreasonable practices cases. Citing the success of the private arbitration system developed by the railroads and the National Grain and Feed Association ("NGFA"), the NGFA "supports the concept of developing other private remedies between [grain] shipper/receivers and carriers." *Id.* at 7.

The Montana Grain Growers Association ("MGGA") strongly endorses the resolution of carrier/shipper disputes through private initiative rather than regulatory intervention. MGGA laments its "[p]revious efforts to address our rail competition issues" through "complicated regulations and stalled policy solutions with lawyers and consultants hired by various groups of producers to propose new regulations and file lawsuits." MGGA Comments at 1. MGGA grew "weary of the lack of progress" in promoting its interests via the regulatory process, so it abandoned those efforts in favor of "honest and open discussions" with BNSF, the primary rail carrier serving Montana. *Id.* The result was a series of private initiatives that have fostered mutual understanding of carrier and shipper issues and concerns, and transparency in dealing with those matters. MGGA details several specific measures, including a 2009 Arbitration Agreement and the creation of a BNSF "Ombudsman" on-site locally, to deal with a variety of rate and service issues.[7] MGGA states that this "new way of doing business" has enhanced its members' status as rail customers and produced positive results. MGGA's Comments do not endorse the competitive access remedies proposed by other shipper commenters.

As these comments demonstrate, many agricultural shippers are pursuing ways to improve the level of cooperation with their rail carriers as an alternative to litigation and

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[7] CP has for many years maintained a network of marketing managers on-site in key States in which it originates grain traffic. CP's marketing managers perform functions similar to those performed by BNSF's Montana "Ombudsman."

regulatory proceedings. As the comments of MGGA and the Agricultural Retailers Association show, such private initiatives have produced significant benefits for both shippers and carriers. At the same time, the Board's jurisdiction to address unreasonable railroad rates and practices affords agricultural shippers access to the regulatory process to address rate and service issues that cannot be resolved via private negotiation and agreement. For the reasons discussed above, creating additional layers of regulation is not likely to produce significant benefits for most agricultural shippers.

### B. Chemical And Coal Shippers Have Not Demonstrated Any Factual Justification For The Substantial Policy Changes They Propose.

The remaining proponents of new competitive access remedies consist largely of certain coal and chemical shippers. It should be noted that the comments filed by those parties do not reflect the views of all coal and chemical shippers, a number of whom have urged the Board not to alter its current policies.[8] The shippers who do seek to change the Board's established policies tend to be multinational chemical manufacturers or large utility interests – in other words, major corporations who are able to protect their interests under current law. Indeed, many of those same parties have been litigants in recent rate reasonableness proceedings before the Board. While those commenters apparently believe that altering the Board's competition policies may enable them to obtain lower rail rates without needing to prove that their rates are unreasonable, they have utterly failed to establish a factual predicate for making the sweeping change they propose. There is no reason for the Board to reshape the regulatory landscape to serve the pecuniary interests of this subset of shippers.

[8] *See, e.g.*, Consol Energy, Inc. Comments at 1 ("I know that some customers believe that changing the regulatory structure will benefit their own specific interests. However, such a shift actually could harm many more shippers in the long run."); International Chemical Company Comments; James River Coal Company Comments; Murex N.A., Ltd. Comments; Robindale Energy Services, Inc. Comments; Rosebud Mining Co. Comments; TECO Coal Corporation Comments; Xcoal Energy and Resources Comments.

### 1. The Coal and Chemical Shippers Advocating Change Have Ample Resources and Access to Remedies, and There Is No Need To Remake the Regulatory System to Promote Their Interests.

Before addressing the merits of the arguments raised by commenters advocating increased regulation, it is worth pausing to consider precisely who these parties are. They are plainly not "small" shippers – to the contrary, most of them acknowledge that they are large and powerful companies with ample resources. For example, TOTAL Petrochemicals states that it is "one of the world's top five publicly-traded, integrated oil and gas companies, with operations in more than 130 countries." TOTAL Petrochemicals Comments at 1. TOTAL reported 2010 revenues of *over €15 billion* – more than triple the total revenues of the entire U.S. freight rail industry.[9] Other chemical company commenters like PPG,[10] DuPont,[11] and Dow[12] likewise possess vast resources and considerable market power, as do major utilities commenters like Duke Energy[13] and NRG Energy.[14] These firms are the antithesis of "captive" shippers – rather, they are multinational corporations with worldwide operations that are plainly not captive to any particular location or transportation supplier. Several chemical shippers admit as much when they claim that lower rail rates might cause them to move their production offshore.

Moreover, those shippers have demonstrated their ability to take advantage of the Board's existing regulatory processes. On the coal side, Intermountain Power Project and South

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[9] *See* TOTAL, S.A. Registration Document 2010 at 53, *available at* http://www.total.com/en/investors/publications/annual-publications-601436.html.

[10] *See* PPG Comments at 3 ("PPG operates in more than 60 countries with total sales in 2010 exceeding $13 billion.").

[11] *See* DuPont Comments at 2 ("DuPont has revenues of over $30 billion a year, with over 210 sites in more than 90 countries and over 60,000 employees.").

[12] *See* 2010 Annual Report of Dow Chemical Company at 26 (reporting 2010 revenues of over $53.6 billion), *available at* http://www.dow.com/financial/pdfs/annual-report-2010.pdf.

[13] *See* 2010 Annual Report of Duke Energy at 2 (reporting 2010 revenues of $14.72 billion), *available at* http://www.duke-energy.com/pdfs/Duke-Energy-2010-SAR.pdf..

[14] *See* 2010 Year in Review at 20 (reporting 2010 revenues of approximately $8.9 billion), *available at* http://www.nrgenergy.com/pdf/NRG_2010_YIR.pdf.

Mississippi Electric Power Association are currently pursuing SAC cases challenging the reasonableness of rates for coal transportation. Several other members of the "Concerned Captive Coal Shippers" and "Western Coal Traffic League" have been complainants in other past SAC cases. Similarly, DuPont, TPI and M&G Polymers all are currently pursuing SAC cases challenging the reasonableness of rates for their chemicals shipments. DuPont was the complainant in the first three cases brought under the Board's "Three Benchmark" procedures for small cases. PPG recently filed an unreasonable practices complaint against RailAmerica that resulted in the withdrawal of a tariff that was the subject of that complaint. In short, the parties who most vociferously argue that the Board's competition policies should be changed are both able and willing to pursue relief under the Board's existing regulatory processes.

These shippers have also expended considerable time and effort to make Congress aware of their desire for a different regulatory regime. Indeed, many of the commenters in this proceeding continue actively to lobby Congress for legislation that would achieve the same regulatory changes they ask the Board to impose in this proceeding. For example, the Alliance for Rail Competition lists "passage of rail shipper reform legislation in the 112th Congress, first session 2011 " as its singular strategic objective for 2011.[15]

In short, the shippers clamoring for the Board to change its competition-related policies are large, sophisticated corporations who already have access to and experience with the Board's rate reasonableness procedures. They have also demonstrated ample ability to pursue regulatory change via the legislative process. The fact that those parties have been unable to persuade Congress to adopt regulatory policies more to their liking is no reason for the Board to abandon the successful policies of the last quarter-century.

[15] *See* ARC Strategy Plan, *available at* http://www.railcompetition.org/mission_strategy_2011_plan.

### 2. The Complaining Shippers Have Failed to Demonstrate A Factual Justification for Altering the Board's Competition Policies.

The initial comments submitted by complaining shippers do not come close to providing a factual predicate for abandoning or modifying the policies adopted by the ICC and STB in the post-Staggers era. Instead, those shippers offer unsubstantiated allegations of supposed "duopolies" and assertions that their rates are simply "too high." The parochial desire of those shippers to obtain lower rates by replacing the Board's current rate regulations with an "open access" regime is no reason for the Board to refashion the regulatory landscape in a manner that risks undoing the substantial progress that has been made since the Staggers Act.

The Interested Parties devote much of their comments to a discussion of whether the Board has the "discretion" to change its policies, and they suggest that federal courts would uphold a Board decision to alter the competitive landscape. *See, e.g.*, ARC Comments at 20-46 (extensive argument that Board has "discretion" to change its policies). For the reasons discussed in CP's Initial Comments, the Board does <u>not</u> have unfettered discretion to replace its current competition policies with an "open access" regime because there is powerful legislative evidence that Congress's reenactment of ICCTA ratified the ICC policies and statutory interpretations that form the basis of the Board's current regulations. *See* CP Comments at 43-51; *see also* Norfolk Southern Comments at 14-29. Congress's repeated rejection of legislation that would have altered those policies is further evidence that Congress approves of the Board's interpretations. *See* CP Comments at 48-51 & nn. 66 & 70.

The complaining shippers conspicuously ignore the effect of ICCTA on the Board's ability to adopt different competitive access rules. Indeed, one major shipper group presents a fifty-page summary that purports to recount the 124-year history of relevant provisions of the Interstate Commerce Act but <u>does not even mention ICCTA</u>. *See* Concerned Captive Coal

Shipper Comments at 17-72 & Appendix A. The Alliance for Rail Competition is scarcely more credible when it claims that ICCTA "was intended not to make substantive changes to the Interstate Commerce Act." *See* ARC Comments at 40. The Interstate Commerce Commission Termination Act clearly made sweeping changes to the Interstate Commerce Act, not the least of which was to eliminate the Interstate Commerce Commission and many of its regulatory functions. What is significant is that, in the course of making those substantial changes to the regulatory framework, Congress specifically declined to alter the agency's competitive access rules, and indeed rejected calls for the kind of revisions that ARC and its allies ask the Board to adopt in this proceeding. *See* CP Comments at 44-46. Indeed, the Senate Report on ICCTA explicitly stated that Congress was refusing to adopt proposals for broader "market access" because Congress believed that "such additional measures would necessarily cast an overly broad regulatory net." S. Rep. No. 104-176, at 6 (1995). Congress's refusal to alter the *Midtec* rules in ICCTA is a classic case of legislative ratification, in which "the congressional failure to revise or repeal the agency's interpretation is persuasive evidence that the interpretation is the one intended by Congress." *Federal Deposit Ins. Corp. v. Philadelphia Gear Corp.*, 476 U.S. 426, 437 (1986). In short, the Board does not have authority to make sweeping changes to its congressionally-ratified competitive access policies unless and until Congress indicates its desire that the Board do so.[16]

[16] ARC's claim that the Board's 1998 decision in *Market Dominance Determinations – Product and Geographic Competition*, 3 S.T.B. 937 (1998), proves that the agency has unfettered authority to revisit pre-ICCTA competition-related policies misconstrues both the foundation of that decision and the legislative ratification doctrine. *See* ARC Comments at 40-41. The reason that the legislative ratification doctrine applies to the *Midtec* rules is that Congress explicitly considered proposals to alter those rules, rejected those proposals and re-enacted the statute without change. *See* CP Comments at 43-47. None of those circumstances applies to *Product and Geographic Competition.* The legislative history of ICCTA contains little discussion of the ICC's rules on product and geographic competition evidence, and therefore provides no basis to

Even if the Board did have legal authority to modify its competition-related policies, prudence demands that the Board not act without Congressional direction. Shippers advocating the adoption of "open access" are seeking nothing less than a sea change in U.S. rail transportation policy, one that would allow widespread forced access and forced interchange in a concerted effort to create artificial "competition" that (certain shippers hope) would drive down rail rates. Such a momentous change in transportation policy would have wide-ranging impacts not only on the rail industry but on other surface transportation modes (by driving rail traffic to other capacity-constrained modes); on passenger transportation (by degrading freight infrastructure on lines over which passenger trains operate); on the environment (by increasing carbon emissions); and in a host of other areas. These policy issues are most appropriately debated and decided by Congress, and the Board would be wise to defer any action to alter current policies unless and until Congress directs such a policy change. Indeed, legislation is currently pending that would accomplish the same changes that certain shippers would have this Board impose by administrative fiat.

The more fundamental question, however, is not the extent of the Board's authority to change its competition-related policies. The question is: should the Board make such changes, even if it could? In light of the universally-recognized success of the Staggers Act and the ICC's and Board's implementation of those policies, the Board should require a very strong showing that deviation from those policies is necessary to protect the public interest before even

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assume that Congress ratified those rules. In contrast, the *Midtec* standard was the subject of considerable debate. *See id.* at 45-46. Moreover, the Board made clear in *Product and Geographic Competition* that its decision was predicated on its interpretation of new provisions of ICCTA, specifically "the statutory directive to find ways to expedite rail rate cases." 3 S.T.B. at 942. The Board's determination that ICCTA's mandate that the Board expedite rail rate cases required a revision to an ICC rule of evidence that Congress did not explicitly consider when re-enacting ICCTA provides no support for ARC's position that the Board can effectively ignore Congress's explicit decision to leave *Midtec* in place.

considering such a change. The complaining shippers have demonstrated no persuasive reason for making wholesale changes to the regulatory system. Instead, those shippers make a variety of unsupported allegations, most of which fall into one of the following categories: (1) that the (supposedly) excessive rail rates that they pay demonstrate a need for change; (2) that mergers approved by the ICC and STB more than a decade ago have created a "duopoly" rail system that is anticompetitive; and (3) that the current regulatory regime is somehow harming the global competitiveness of U.S. rail shippers. None of these claims has merit.

**a. The Complaining Shippers' Rail Rates Provide No Basis For Changing the Board's Current Rules.**

Complaining shippers assert that the current regulatory system permits railroads to charge unfairly high rates for rail transportation. *See, e.g.*, ARC Comments at 15. Relatedly, some shippers cite the fact that railroads have achieved a measure of financial success as evidence that they are earning excessive revenues (and that those revenues should be redirected to "captive" shippers in the form of lower rates). *See id.* at 16-20. But these assertions are not backed up by any quantitative showing that railroads are systemically charging rates that exceed the amounts necessary for them to earn adequate revenues. To the contrary, the quantitative evidence indicates that coal and chemical shippers are paying <u>lower</u> overall rates today than they did prior to the Staggers Act.

As CP observed in its Initial Comments, multiple studies confirm that real rail rates have declined substantially in the post-Staggers era. *See* CP Comments at 12-14. For example, the Board has found that average rail rates declined by 46.4% in real dollars between 1982 and 1996, and by 34.5% between 1985 and 2007.[17] The GAO similarly concluded that rail rates declined across the freight railroad industry following the Staggers Act.[18]

Coal and chemical shippers shared in those post-Staggers rate reductions. The Christensen report found that Revenue Per Ton Mile ("RPTM") for both coal and chemicals traffic decreased from 1987 through 2006. For chemicals traffic, RPTM in 2006 was only 75 percent of 1987 levels. *See 2010 Christensen Report* at 14-3-4. ("RPTM fell 29 percent between 1987 and 2001, increased in 2002, subsequently decreased slightly below the 2001 level by 2004, then increased again to 75 percent of its 1987 level in 2006."). Coal rates likewise decreased substantially over the 1987 to 2006 period. *See id.* at 12-4 ("Despite the large increases in coal tonnage and ton-miles [from 1987 to 2006], revenue remained nearly constant through 2003, as RPTM fell by half from 1987 to the early 2000s.").

Complaining shippers ignore this overall decline, focusing instead on the short-term rise in average rail rates during the mid-2000s. *See, e.g.*, ARC Comments at 15; Fertilizer Institute Comments at 4; Occidental Chemical Corp. Comments at 2. But the independent studies cited above (and in CP's Comments at 12-15) demonstrate that these increases were the result of higher input costs, declining productivity gains and constrained capacity – not the abuse of market power. The FRA's Preliminary National Rail Plan found that the increase in rail rates in the mid-2000s "can be attributed to a booming economy that placed capacity constraints on the

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[17] *See* Surface Transp. Bd., *Rail Rates Continue Multi-Year Decline* at 3 (Feb. 1998), *available at* http://www.stb.dot.gov/stb/docs/Rate_Index_96.pdf; Surface Transp. Bd., *Study of Railroad Rates: 1985-1987* at 2 (Jan. 15, 2009), *available at* http://www.stb.dot.gov/stb/industry/1985-2007RailroadRateStudy.pdf.

[18] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-07-94, FREIGHT RAILROADS: INDUSTRY HEALTH HAS IMPROVED, BUT CONCERNS ABOUT COMPETITION AND CAPACITY SHOULD BE ADDRESSED 11 (2006).

transportation network [and to] rising fuel prices."[19] In the same vein, the *Christensen Report* concluded that "recent increases in revenue per ton-mile appear to be largely the result of increases in fixed and marginal costs – related to increases in the railroad industry's input prices and diminishing productivity growth – and not due to an increased exercise of market power." *See 2010 Christensen Report* at 4-13, 5-20, 6-3, 6-17; *see also 2009 Christensen Report* at ES-38. Indeed, the fact that average rail rates declined once again in the recessionary year of 2009 is compelling evidence that rate increases during the 2004-2008 period were the product market forces, not railroad market power. *See 2010 Christensen Report* at i, 2-5.

Several shippers assert that the mere fact that a plant served by multiple railroads may enjoy lower rail rates than a plant served exclusively by one railroad is "evidence" that there is something unfair about the current regulatory system. *See, e.g.*, M&G Comments at 8 (complaining that R/VC ratios for rates from plant served by a single railroad are higher than those from plant served by two railroads); PPG Comments at 4 (complaining that rates for shipments from plant served by single railroad are substantially higher than rates for shipments from plant served by three railroads); *cf.* Fertilizer Institute Comments at 3 (complaining that rate increases have been greater at a "captive facility" than at "another facility . . . with both direct rail and barge options"). But there is nothing more "unfair" about railroads differentially pricing their rail services than there is about a chemical company charging its customers higher prices for scarce chemicals than it does for more fungible commodities. Pricing that reflects the demand for a commodity or service is not an "abuse of market power" – rather, it is precisely how differential pricing is supposed to work. In enacting the Staggers Act, Congress explicitly endorsed differential pricing – indeed, the Board has observed that differential pricing is a "core

[19] FED. R.R. ADM'R, PRELIMINARY NATIONAL RAIL PLAN: THE GROUNDWORK FOR DEVELOPING POLICIES TO IMPROVE THE UNITED STATES TRANSPORTATION SYSTEM 17 (Oct. 2009)

regulatory principle" that "follows the directive from Congress in the Staggers Rail Act of 1980." *Major Issues in Rail Rate Cases*, STB Ex Parte 657 (Sub-No. 1), at 20 (Oct. 30, 2006). If every rail shipper were able to obtain the same rates as those shippers who enjoy access to multiple competitive options, rates would be driven below levels needed to enable railroads to recover their full costs, investment funds would dry up, and the rail industry would be forced back into the same "death spiral" of decreasing rates, deteriorating infrastructure and declining traffic that drove it to the brink of financial collapse before Staggers.

Moreover, railroads are utilizing their revenues in precisely the manner Congress hoped they would – by re-investing those revenues to maintain and expand the rail network. No shipper seriously contests that substantial additional investment will be needed to increase rail capacity in the coming decades. *See* CP Comments at 33-35 (explaining that up to $148 billion of additional capital will need to be invested in the U.S. rail network to meet capacity demands, and that nearly all of this capital will be supplied by railroads). CP expects to invest between 16% and 18% of gross revenues in capital expenditures, *see id.* at 36-37, and other rail carriers will be devoting similarly substantial percentages of their gross revenues to capital expenditures in coming years. *See, e.g.*, AAR Comments at 8-10.

In short, the parochial concern of certain shippers that their railroad rates are too high is not grounds to reinvent the entire regulatory system. The Board already offers robust rate reasonableness remedies for shippers whose rates are, in fact, above reasonable levels. In recent years, the Board has made substantial efforts to improve access to those remedies by reducing filing fees, simplifying procedures for SAC cases,[20] and creating new simplified standards to

[20] *See, e.g., Major Issues in Rail Rate Cases*, STB Ex Parte 657 (Sub-No. 1) (Oct. 30, 2006) (among other things, eliminating consideration of movement-specific adjustments to variable costs in an effort to simplify proceedings).

govern smaller rate cases.[21] These existing remedies are more than sufficient to deal with any allegations that rates are unreasonably high.

### b. The Board's Previous Merger Approvals Provide No Reason to Change the Regulatory Landscape.

Lacking quantitative evidence that rail rates have systemically risen to unreasonably high levels, some shippers offer fanciful theories about competitive problems allegedly created by mergers that the Board approved a decade or more ago. For example, ARC claims that three "mega-mergers" – UP/SP, BN/SF, and Conrail – resulted in a substantial reduction in competition. *See* ARC Comments at 6-15. The claim that those mergers reduced competition rewrites history and is plainly wrong. As CP's Initial Comments (at 20-26) showed, no shipper has ever been rendered captive to a single railroad by a Board-approved merger.

The Board's approval of the UP/SP, BN/SF and Conrail transactions was not granted lightly. In each case, the Board weighed extensive evidence and conducted thorough and exhaustive studies of the potential competitive effects of the proposed transaction. Each transaction was ultimately approved because the Board found that, on balance, it would <u>not</u> result in a substantial lessening of competition. In each case, the Board adhered to its policy of preventing any merger from reducing a shipper's rail options from two to one. *See Major Rail Consolidation Procedures*, 5 S.T.B. 539, 548 (2001) ("Since 1980 at least, we have consistently imposed merger conditions to preserve two-railroad service where it existed."). Thus, none of those approved consolidations resulted in any shipper becoming captive to the merged carrier. Indeed, one beneficial consequence of the Conrail merger was "a substantial increase in rail-to-rail competition" for shippers who had previously been served only by Conrail and are today served by both CSXT and NS. *Conrail*, 3 S.T.B. 196, 248 (1998).

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[21] *See Simplified Standards for Rail Rate Cases*, STB Ex Parte 646 (Sub-No. 1).

Some shippers contend that the increase in rail rates during the 2005-2008 period represents a lingering anticompetitive effect of past mergers. This assertion is fatally undermined by the fact that rail rates continued to <u>decline</u> after the supposedly anticompetitive consolidations took place. The proponents of this bizarre theory offer no explanation to why carriers would have waited for nearly a decade to impose rate increases supposedly made possible by the merger. Moreover, as explained above, the upward movement in rail rates between 2004 and 2008 was caused by increasing costs and declining productivity gains, not any abuse of market power.

At bottom, the argument that Board-approved mergers produced anticompetitive results appears to be predicated on the fallacy that a reduction in the absolute number of independent Class I railroads is *ipso facto* "anticompetitive." What matters is not how many Class I rail carriers exist nationwide, but rather how many transportation options are available at a particular origin or destination. Moreover, the fact that some locations are served by only one rail carrier was not caused by any Board merger decision. Rather, such circumstances are the result of geography and longstanding investment decisions. *See Major Rail Consolidation Procedures*, 5 S.T.B. at 548 ("[The] structure of the rail industry was created by the marketplace, not by recent mergers or by ICC or STB regulation.")

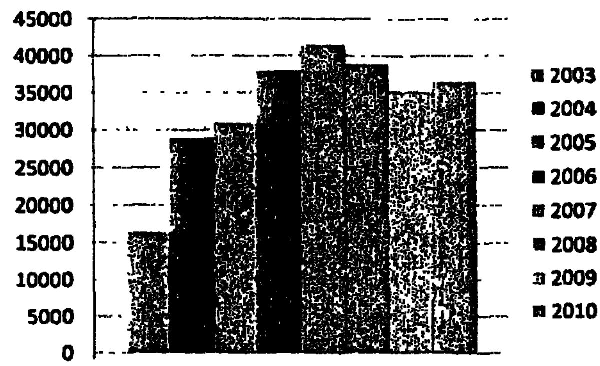
A related argument offered by complaining shippers is that, as a result of Board-approved mergers, the United States rail industry now consists of two "duopolies" (one in the East and one in the West), and that this structure has facilitated "price signaling" that has effectively eliminated competition between the Class I carriers. *See, e.g.* ARC Comments at 6-9; DuPont Comments at 3. This simplistic characterization of the United States rail industry completely overlooks the significant competitive role played by CP, CN, Kansas City Southern ("KCS") and literally hundreds of regional and short line railroads.

In particular, ARC (erroneously) asserts that there exists only "a limited amount of competition" between U.S. and Canadian railroads, and that the Canadian carriers do not have a significant impact on competition for U.S. freight traffic. ARC Comments at 46 n. 119. This assertion is plainly wrong. Both CP and CN offer effective competitive options to a broad spectrum of U.S. rail shippers. CP and CN compete actively with NS, CSXT, UP, and BNSF for business in both north-south and east-west transportation corridors.

For example, competition between CP and CN, on the one hand, and the other Class I railroads, on the other hand, for intermodal business is intense. Intermodal service via the Canadian West Coast ports of Vancouver and Prince Rupert is an effective competitive alternative to service via the ports of Seattle/Tacoma and Los Angeles/Long Beach for shipments between Asia and the U.S. Midwest. CP service (via Montreal) and CN service (via Halifax) are likewise viable competitive options to intermodal shipments via the East Coast ports of New York/New Jersey, Philadelphia and Baltimore.

Competition between U.S. and Canadian carriers is not limited to intermodal traffic. CP moves substantial volumes of grain traffic from Upper Midwest origins to export terminals in the Pacific Northwest via an interline route involving CP's Canadian lines and an interchange with UP at Kingsgate, Washington. As the table below demonstrates, this grain traffic has more than doubled since 2003.

## Historical PNW Grain Volumes




Powder River Basin coal has also begun to move over the lines of CP (or CN) for export through Canadian West Coast ports.

These are but a few examples of the significant role that CP and CN play every day in providing competitive options to U.S. rail shippers. The Canadian carriers also compete with their U.S. counterparts for shipments of automobiles and auto parts, forest products and a variety of other commodities. Further competition to the major U.S. carriers is provided by KCS, by hundreds of regional and short line railroads operating across the country, and by waterborne and truck transportation options. The "duopoly" theory advanced by certain coal and chemical shippers conveniently ignores this reality.

**c. Shippers' Claims That Railroad Rates Are Harming The Global Competitiveness of U.S. Industry Are Not Credible.**

Some complaining shippers argue that the Board must "create" more competition between railroads because current rail rates are impairing the global competitiveness of U.S. industries. *See, e.g.*, ARC Comments at 46-47; DuPont Comments at 4-5; TPI Comments at 5; PPG Comments at 6. In particular, several chemical shippers assert that their rail rates are making it impossible for them to compete with offshore producers. Indeed, several make not-soveiled threats to move their production overseas unless the Board imposes new remedies that enable them to obtain lower rail rates.

The notion that the rates (or service) offered by North America's railroads are harming the competitiveness of American industry in global markets is ludicrous. The United States freight rail network is uniformly recognized as the most efficient and cost-effective rail system in the world. *See* FRA, Preliminary National Rail Plan, Oct. 2009 at 4 ("[T]he U.S. freight rail system is the safest, most efficient and cost effective in the world.").[22]

> "As the World Bank's Lou Thompson has noted, 'Because of a market-based approach involving minimal government intervention, today's U.S. freight railroads add up to a network that, comparing the total cost to shippers and taxpayers, gives the world's most cost-effective freight service."[23]

Moreover, U.S. freight rail rates are among the lowest in the world – indeed, they are half of those in Japan and Europe.[24] The USDA's 2010 Rural Transportation Issues study found that "rates for land transportation of agricultural commodities in the United States remain among the lowest in the world."[25]

As CP's Initial Comments (at 16-20) show, the efficiency and effectiveness of the freight rail network enables U.S. businesses to compete more effectively in foreign markets. What the shippers advocating "open access" in this proceeding appear to want is the ability to pay below-market rates for world-class rail service. However, that position is simply untenable as a long-

[22] *See also* High-speed Railroading, The Economist, July 22, 2010 ("America's freight railways . . . are universally recognized as the best in the world."); American Association of State Highways and Transportation Officials, Transportation Vision and Strategy for the 21st Century Summit, Freight and Passenger Rail Panel, *available at* http://www.transportationvision.org/docs/vision_FreightRail.pdf, at 1 ("U.S. freight railroads form the world's most cost-effective freight rail system.")

[23] America's Freight Railroads: Global Leaders, Association of American Railroads, June 2010 *available at* http://www.aar.org/~/media/aar/backgroundpapers/americasfreightrailroadsgloballeaders.ashx

[24] High-Speed Railroading, The Economist, July 22, 2010.

[25] USDA, Study of Rural Transportation Issues, 240 (2010).

term policy. The efficiency of the North American rail network today is the direct result of massive investment by the rail industry in capacity and infrastructure. Those investments were made possible by the regulatory freedom (including the ability to price services differentially) granted to railroads by the Staggers Act. However, the rail industry cannot maintain (much less expand) the kind of high-quality network that U.S. businesses need to deliver their goods to the global marketplace unless carriers are allowed to earn the returns necessary to support those investments.

Assertions by multinational chemical companies that a remaking of the regulatory landscape for their benefit is necessary to prevent them from moving their production overseas are simply not credible. As an initial matter, transportation costs are typically a much smaller percentage of the total delivered cost of most chemicals than they are for lower-value commodities. A single carload of chemicals can have a value of more than one hundred thousand dollars; the cost of transporting that car is, in most cases, a small fraction of that total value. The profitability of U.S.-based chemicals production plants is impacted far more significantly by factors such as the prevailing market prices for those chemicals and the cost of feedstocks used in producing them than by the rates paid to ship the chemicals by rail.

The real-world actions of chemical shippers belie their claim that rail rates are requiring them to move production offshore. For example, M&G Polymers filed comments in which it suggested that the allegedly unreasonable rail rates that it is forced to pay are causing it to shift production of polyethylene terephthalate ("PET") overseas. *See* M&G Comments at 8. Yet, just a few weeks after it filed its Comments in this proceeding, M&G announced plans to construct a new PET plant in the United States.[26] M&G's marketplace behavior undermines the credibility of its assertion that it will be forced to move operations overseas unless the Board reshapes its regulation of railroads to M&G's liking.

The true threat to U.S. global competitiveness is the prospect that a return to the heavy-handed regulatory philosophy of the pre-Staggers era will render the rail industry unable (or unwilling) to commit the capital required to expand the rail network to accommodate future traffic volumes safely and efficiently. No commenter seriously disputes that massive further investment in rail facilities will need to be made in the coming years, or that the lion's share of that investment must come from the railroads themselves. If the Board chooses to adopt intrusive new regulatory remedies in response to the supposed "captive shipper problem," the rail industry will experience a loss of revenue that threatens its ability to expand and improve the rail network. The inevitable consequences of such a policy change will be inadequate capacity, deteriorating rail infrastructure and long-term impairment of the ability of railroads to provide the safe and efficient service upon which future economic growth depends. Such developments will have a severe adverse impact on the ability of <u>all</u> rail customers to compete in the global marketplace.

* * *

The shipper commenters who advocate adoption of an "open access" regime have utterly failed to justify the radical changes they propose. At bottom, those shippers have a single, parochial concern: they believe that their rates are too high. To the extent that their concerns are legitimate, the Board's existing regulations afford those shippers an adequate remedy – a multi-tiered process for determining rate reasonableness that is both simpler and less time-consuming

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[26] *See* "M&G to Launch Next Generation PET and PTA Plants in the U.S. Gulf Coast Region" (May 11, 2011 press release), available at http://www.gruppomg.com/news.php?newsid=26.

than the ratemaking procedures available to shippers in the pre-Staggers era. The record in this proceeding offers no justification whatsoever for the Board to discard its successful post-Staggers regulatory policies for the sake of providing additional remedies to a small segment of the shipper community that would prefer "open access" to the balanced regulatory approach mandated by Congress in the Staggers Act.

## II. CANADA'S INTER-SWITCHING PRACTICE IS NOT AN APPROPRIATE SOLUTION TO THE CONCERNS RAISED BY "CAPTIVE" SHIPPERS.

Several commenting shipper parties urge the Board to impose a mandatory reciprocal switching requirement based upon the "inter-switching" performed by Canadian railroads pursuant to Section 127 of the *Canada Transportation Act*. CP and CN are filing separate Joint Reply Comments that address the claims made by certain shipper parties regarding Canada's inter-switching statute and its suitability as a "model" for enhanced competitive access in the United States. As those Joint Reply Comments dèmonstrate, the complaining shippers' reliance upon Canada's inter-switching practice is misplaced, for several reasons:

First, Canadian inter-switching is a statutory requirement imposed by Parliament, not by administrative action. In the absence of a similar statutory mandate from Congress, any Board-initiated universal switching requirement would be contrary to law.

Second, Canada's inter-switching statute was not adopted for the purpose of providing rate relief for "captive" rail shippers. Rather, it was intended to improve shipper access to rail service and to avoid unnecessary duplication of facilities. Indeed, for the first 80 years in which the inter-switching requirement was in effect, Canadian law effectively prohibited price competition between CP and CN. The inter-switching requirement is a vestige of the heavily-regulated environment in which Canadian rail carriers operated prior to the *Transportation Act,* *1987*. Current regulatory policy in Canada recognizes that "Government should be involved in regulating commercial relationships only when one party is abusing monopoly power."[27]

Third, the suggestion that Canada's inter-switching regime could readily be implemented in the United States ignores fundamental differences in the size, scope and structure of the U.S. and Canadian rail networks.

For those reasons, Canada's inter-switching experience provides no support for the notion that a mandatory reciprocal switching requirement in the United States would be desirable or effective.

## III. THE RECORD REFLECTS WIDESPREAD CONCERN THAT ALTERING THE EXISTING REGULATORY BALANCE BETWEEN CARRIERS AND SHIPPERS WILL THREATEN FUTURE INVESTMENT IN RAIL INFRASTRUCTURE.

Perhaps the most noteworthy theme permeating the initial comments is the widespread concern that adopting the competitive access remedies proposed by certain shippers will deprive railroads of both the revenue and the incentive to make the capital investments required to maintain the rail network and to expand capacity to meet future demand. This concern was expressed not only by railroad parties, but by a broad spectrum of stakeholders, including Members of Congress, state and local government officials and economic development agencies, and shippers of a wide variety of commodities. Indeed, more than 100 parties urged the Board not to take any action that might impair the ability of railroads to continue making substantial investments in service-enhancing capacity and infrastructure.

Eight individual United States Senators, nine individual Members of the House of Representatives, and the leaders (of both parties) of the House Committee on Transportation and Infrastructure all cautioned the Board against adopting policy changes that could adversely

[27] *Vision and Balance: Report of the Canada Transportation Act Review Panel* (June 2001) at 63 (emphasis added).

impact private investment in the rail network. Senator Mark Warner (D) of Virginia observed that "[f]reight rail is the most capital intensive industry in the nation, and it is imperative that continued reinvestment be encouraged." In order to promote such investment, "it is important that balanced economic regulation be maintained."[28] Senators Johnny Isakson (R) and Saxby Chambliss (R) of Georgia noted that railroads are a "vital industry" for their state, and expressed concern that "any attempts to re-regulate railroads will have an extremely negative impact on Georgia."[29]

The concerns expressed by Senators were echoed in comments submitted by Members of the House of Representatives. Congressmen Jason Altmire (D) and Tim Holden (D) of Pennsylvania cautioned that "[the] real success story [of the Staggers Act] should not be forgotten in the debate about rail competition." They observed that "it is critical to our continued economic recovery and growth that railroads in Pennsylvania and elsewhere have an ability to invest in their infrastructure," and warned that the ability of rail carriers to make such investments "is dependent on their continued profitability."[30] Congressman Lee Terry (R) of Nebraska opined that the policies implemented by the ICC and STB in the post-Staggers era have helped to create "the world's best freight rail system." He urged the Board to "continue to maintain the [regulatory] balance in a way that will not restrict this industry's ability to invest and grow."[31] Representative Scott Rigell (R) of Virginia cited the rail industry's plans to invest more than $12 billion in their infrastructure this year, and stated that "[t]he positive impacts of

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[28] Letter dated April 11, 2011 from Sen. Mark Warner (D-VA) to Hon. Daniel Elliott at 1.
[29] Letter dated March 22, 2011 from Sens. Johnny Isakson (R-GA) and Saxby Chambliss (R-GA) to Hon. Daniel Elliott at 1.
[30] Letter dated March 10, 2011 from Reps. Jason Altmire (D-PA) and Tim Holden (D-PA) to Hon. Daniel Elliott III at 1.
[31] Letter from Rep. Lee Terry (R-NE) to Hon. Daniel Elliott III at 1.

these investments to job creation cannot be overlooked in the current economic climate."[32] Congressman Mario Diaz-Balart (R) of Florida stressed the importance of "implement[ing] policies that encourage private capital spending and much needed job creation." He expressed concern that imposing burdensome new regulations on rail carriers "will restrict rail earnings, threaten private investment, and result in job losses."[33]

Members of Congress emphasized that the availability of private capital to fund the nation's rail infrastructure needs is especially crucial in the current economic climate. Senator Mike Johanns (R) of Nebraska cautioned that "because federal and state budgets are in crisis, significant public sector funding is unlikely to replace privately funded improvements." He expressed "concern[ ] that additional regulation will threaten the continued investment necessary to prepare the rail network for forthcoming expansions of commercial traffic."[34] Senator Jerry Moran (R) of Kansas noted that the railroad industry is "unique" in its ability to "operate almost exclusively on infrastructure that they own, build, maintain, and pay for themselves." His letter sought to "impress upon [the Board] the importance of maintaining the current regulatory environment," and he urged the Board "not [to] adopt policies that would discourage private investment" in rail facilities.[35] *See also* Letter dated March 31, 2011 from Rep. Scott Rigell (R-VA) to Hon. Dan Elliot at 1 ("adopt[ing] policies that would discourage private investment should be avoided").

The message from Congress is clear: the regulatory balance struck by the Board's current competition policies correctly reflects Congress' statutory mandate to the Board. Adopting the

[32] Letter dated March 31, 2011 from Rep. Scott Rigell (R-VA) to Hon. Dan Elliott at 1.
[33] Letter dated April 15, 2011 from Rep. Mario, Diaz-Balart (R-FL) to Hon. Daniel Elliott III at 1.
[34] Letter dated April 12, 2011 from Sen. Mike Johanns (R-NE) to Hon. Daniel Elliott III at 1.
[35] Letter dated April 7, 2011 from Sen. Jerry Moran (R-KS) to Hon. Daniel Elliott III at 1.

competitive access proposals advocated by certain shippers, which would reduce the revenues available to support continued private investment in the rail network, would be contrary to Congress' intent. Indeed, the leaders of the House Committee on Transportation and Infrastructure explicitly cautioned that "[a]ny policy change made by the STB which restricts the railroads' abilities to invest, grow their networks and meet the nation's freight transportation demands will be opposed by the Committee."[36] (Emphasis added). Other committee members filing individual comments echoed that warning. Congressman Sam Graves (R) of Missouri concurred with the Committee's letter, urging the Board to "maintain the current regulatory balance" and indicating his intention to "oppose any policy change made by the STB which would restrict the railroads' abilities to invest, grow their networks and meet our nation's freight transportation demands."[37] (Emphasis added) Representative Gary Miller (R) of California opined that "the railroad industry's commitment to directly invest a quarter of their revenue back into their networks, and the projected need for rail freight, illustrates that the existing regulatory environment is working."[38] Congressman Jeff Miller (R) of Florida stated that "[t]he regulatory balance set forth under the Staggers Act is the proper standard for the rail industry, and I oppose any policy changes by the STB that would limit railroads' ability to invest in Florida or their company's continued success."[39] (Emphasis added)

State and local government officials share these sentiments. For example, Georgia Governor Nathan Deal stated that "it is imperative that continued reinvestment be encouraged" and cautioned that "any action by the Surface Transportation Board to adopt policies that would

[36] Letter dated January 24, 2011 from Rep. John L. Mica *et al.* to Daniel T. Elliott III at 1.
[37] Letter dated April 7, 2011 from Rep. Sam Graves (R-MO) to Hon. Daniel R. Elliott III at 1.
[38] Letter dated April 7, 2011 from Rep. Gary G. Miller (R-CA) to Hon. Daniel R. Elliott III at 1.
[39] Letter dated April 15, 2011 from Rep. Jeff Miller (R-FL) to Daniel R. Elliott III at 1.

discourage private investment would be counterproductive."[40] Pennsylvania Governor Tom Corbett opined that "[n]ow is not the time for regulators to promote policies that restrict rail earnings and threaten private investment that is so earnestly needed to pull this country out of the worst recession in more than 80 years.[41] The Chairmen of the Pennsylvania Senate Transportation Committee expressed concern:

> about discussions in Washington regarding changes to the regulatory structure that might limit the freight railroads' ability to continue investing their private capital to improve the rail network. With our transportation systems under significant strain, in part due to the significant growth of freight traffic, we believe that government should be encouraging, not discouraging, private investment in our nation's transportation infrastructure.[42]

*See also* Florida Department of Transportation Comments at 1 (urging the Board to "balance any perceived need for additional regulations on the railroad industry with the industry's ability to invest in additional capacity to efficiently move people and goods."); Kentucky Transportation Cabinet Comments at 1 ("As freight transportation demand is expected to rise, Kentucky and the nation will look even more to railroads to meet this demand. Therefore, it is important that continued reinvestment be encouraged and imperative that the balanced regulatory framework created with the Staggers Act of 1980 be preserved.").

Regulatory changes that threaten private investment in the rail industry are also vigorously opposed by numerous local government entities, port authorities and economic development agencies. The Mobile Area Chamber of Commerce expressed opposition to "any policy or regulatory changes that would hinder the freight railroads' ability to continue investing billions of dollars annually in private capital to grow and modernize the nation's rail

[40] Letter dated March 14, 2011 from Governor Nathan Deal to Hon. Dan Elliott at 1.
[41] Letter dated May 17, 2011 from Governor Tom Corbett to Hon. Dan R. Elliott at 1.
[42] Letter dated March 31, 2011 from PA Sens. John C. Rafferty and John N. Wozniak to Hon. Daniel R. Elliott III at 1.

infrastructure." The Miami County Economic Development Authority opined that "[a]s America finally begins to pull itself out of the Great Recession, we do not need to reverse progress by damaging the ability of the rail industry to reinvest and continue to provide strong service." *See also* Ohio Department of Development (same); Roanoke Regional Chamber of Commerce ("The Chamber respectfully requests that no regulatory or policy changes be pursued at this time by the Surface Transportation Board."); South Carolina State Ports Authority (same).[43]

A number of state government parties expressed particular concern that a reduction in private rail investment could shift more traffic to, and place increasing strain upon, the nation's highway system. The Alabama State Port Authority stressed the importance of rail service in the

[43] Other commenters who share these concerns and oppose changes to regulation of the rail industry include: Altoona-Blair County Development Corp.; Berk Economic Partnership; Birmingham Business Alliance; Broward County, Port Everglades Dept; Bucks County, Pa, Transportation Management Assoc.; Cherokee County Development Board; City of Danville Office of Economic Development; Columbus Regional Airport Authority; Decatur and Macon County Economic Development Corp.; Franklin County Area Development Corp.; Georgia Ports Authority; Grant County Economic Growth Council; Great River Economic Development Foundation; Greater Hazelton Area of Northeast Pennsylvania (CAN DO, Inc.); Hampton Roads Economic Development Alliance; Harnett County Economic Development Commission; Harrison County Economic Development Corp.; Jackson County Economic Development Authority; Jacksonville Port Authority; Jacksonville Regional Chamber of Commerce; Joint Industrial Development Authority; Judge Organization (Port Elizabeth Terminal & Warehouse Corp.); KC SmartPort; Knoxville Chamber of Commerce; Monroe County Industrial Development Corp.; New Castle-Henry County Economic Development Corp.; New River Valley Economic Development Alliance; Ohio Rail Development Commission; Pittsylvania County Department of Economic Development; Port of Miami; Project Future: Economic Development for South Bend, Mishawaka and St. Joseph County; Putnam County Community Improvement Corp.; Putnam County Development Authority, Inc.; Shenandoah Valley Partnership; S.M.A.R.T. Regional Rail Transit; Southern Tier Economic Growth, Inc.; Southwestern Michigan Economic Growth Alliance; St. Louis Regional Chamber & Growth Assoc.; Steuben County Industrial Development Agency; Sunrise Cooperative; Team Lorain County; The Columbus Region; Tri-State Development Summit; Upstate SC Alliance; U.S. Development Group; Virginia's Gateway Region Economic Development Org.; Warren County Board of Commissioners; Warren County (Ohio) Office of Economic Development; Waterfront Coalition; Wisconsin Industrial Energy Group.

face of the "shortage in highway funds" and opposes regulation that might increase dependence on truck traffic. The Iowa Department of Transportation noted that:

> In 2008, railroads spent $435 million to maintain and upgrade their facilities in Iowa. This private investment was nearly equal to the amount of federal highway funds that Iowa received that year. If loss of income left railroads unable to invest in their Iowa network, an additional 665,000 trucks per year could travel Iowa's roadways, accelerating the need for taxpayer-funded roadway maintenance. This is an unacceptable and unsustainable model for [the] state.

As these comments indicate, any Board action that results in reduced private investment in rail capacity will put severe pressure on a highway system that already suffers from the effects of inadequate public funding. As CP's Initial Comments showed, diverting massive volumes of future freight traffic to the nation's highways will increase congestion, threaten motorist safety and generate carbon emissions that harm the environment. (CP Comments at 35.) Moreover, given the severe budgetary challenges faced by both federal and state governments, the availability of public funding to create transportation capacity (rail or highway) to move the nation's growing freight volumes is, at best, problematic. Making fundamental changes to the regulatory landscape to satisfy the parochial desire of certain shippers to pay lower rail rates would inevitably harm all stakeholders (including "captive" shippers themselves) who depend upon a safe and efficient rail transportation system.

Finally, while a highly vocal minority of bulk shippers urge the Board to adopt a more intrusive approach to increasing rail competition, the record demonstrates that most other shippers support retaining the current regulatory scheme and fear the negative impacts of re-regulation of the industry. The views of these shipper parties is exemplified by the testimony of Murex, N.A., which stated that:

> "Attempts to re-regulate the freight rail industry will have catastrophic results. When the prospects of earning returns on investment decrease and railroads are faced with huge revenue shortfalls, spending on infrastructure and equipment will cease. Existing track and equipment will deteriorate and plans for new capacity will be scrapped. Inevitably, rail service will become slower, less responsive, less affordable and less efficient. We feel this will lead to disastrous consequences for businesses and consumers alike."

Murex, N.A., Ltd. Comments at 1.

Richard Hegemeyer, President of Agmark Intermodal Systems, Inc., expressed his company's concerns in similarly stark terms:

> "I spend millions of dollars each year shipping with railroads. I oppose the re-regulation of railroads. . . . My company is massively better off with a modern railroad that makes a profit and invests in its business." Agmark Intermodal Systems, Inc. Comments at 1.

The comments of many shippers echo the railroad parties' concerns that the competitive access proposals championed by certain shippers will divert scarce capital that could otherwise be used to expand capacity to the construction of interchange facilities to support additional switching. Such a result would mean less investment in the types of facilities that provide the greatest benefit to the most shippers, such as track expansion, new cars and additional locomotives. *See* Rosebud Mining Company Comments at 1 (noting that while regulatory changes may benefit certain shippers, "such a shift actually could harm many more shippers in the long run" as railroads are forced to build additional infrastructure to support joint operations or segmented routes); Teco Coal Corporation Comments at 1 ("We are very concerned that allowing customers to segment routes or forcing railroads to provide access to one another will have adverse consequences on our shipments . . . [including] railroads [having to] spend an excess amount of their capital resources trying to build additional infrastructure to make these operations work . . .").

A significant number of shipper parties expressed the belief that the Board's current regulatory policies benefit not only the rail industry, but shippers as well. Despite the fact that it views itself as a "captive" shipper, Rosboro, a manufacturer of lumber, plywood and other forest products, is "satisfied that present regulations are sufficient to protect the interests of both railroads and their customers." Rosboro Comments at 1. Rosboro believes that "[t]he nation's shipping public and the national economy need the railroads to continue earning an adequate return to attract capital that will be applied toward further capacity expansion, thus supporting economic growth for all industries, railroads and their customers alike." *Id.* at 3. More importantly, Rosboro views the competitive access proposals proffered by certain shippers in this proceeding as "<u>the ongoing efforts of a few organizations to obtain, through new regulations, an economic advantage that would be limited to their members at the expense of the general shipping public and the productivity of the nation's transportation system</u>." *Id.* (emphasis added) Other shipper commenters echo Rosboro's support for retaining the Board's existing regulatory approach.[44] A variety of firms engaged in businesses related to the movement of freight traffic also support the current regulatory regime.[45]

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[44] Other shippers who expressed support for retaining current regulatory policies include: Associated Asphalt; Beasley Forest Products, Inc.; Big River Industries, Inc.; Cagle's Inc.; Central Sales & Service, Inc.; Circle S. Ranch; CONSOL Energy, Inc.; Corner Stone Systems; FGDI; Hanjin Shipping Co., Ltd.; Hartwell Warehouse, Inc.; Interstate Commodities, Inc.; James River Coal Company; JIMCO; J.T. Russell & Sons, Inc.; Koppers; Mulch Manufacturing, Inc.; Robindale Energy Services; South Milford Grain Co., Inc.; Southern Co.; Sysco Corp.; Teco Coal Corp.; Topflight Grain Coop; Xcoal Energy & Resources.

[45] *See, e.g.,* Agmark Intermodal Systems, Inc.; All South Warehouse D/C Inc.; Ames Construction, Inc.; Ansaldo STS USA, Inc.; Associated Terminals; Bulk Service; Capital Cargo, Inc.; Custom Freight Sales, Inc.; D&I, LLC; FreightCar America, Inc.; Grand Worldwide Logistics, Corp.; Grand Worldwide Logistics, Corp.; Hapag-Lloyd (America) Inc.; Hub Group, Inc.; Independent Dispatch, Inc.; Interdom Partners, Ltd.; New York Air Brake Corp.; OOCL (USA) Inc.; PENN Warehousing & Distribution; Plasser American Corp.; Progress Rail Services; ReTrans Precision Logistics; Wabtec, Corp.; Werner Enterprises.

As the foregoing discussion demonstrates, the record in this proceeding reflects a broad-based consensus – on Capitol Hill, in state and local governments across the country, and among the majority of rail shippers – that the Board should continue the regulatory policies that enabled the nation's railroads to survive the financial crisis that plagued the industry in the 1960s and 1970s, to deliver major improvements in rail service and to invest hundreds of millions of dollars to maintain and expand the rail network, all while handling increasing volumes of freight at rate levels lower than those that prevailed in the pre-Staggers era of heavy regulation. The comments also reflect widespread concern that a change in regulatory course will halt the progress that railroads have made in positioning themselves to meet the growing demand for service, by depriving them of the revenues needed to invest in rail capacity and infrastructure. The views expressed by these stakeholders should be accorded substantial weight by the Board in considering whether jettisoning the successful regulatory policies of the post-Staggers era would be consistent with the broader public interest.

## IV. THE PUBLIC INTEREST WOULD BE BEST SERVED BY RETAINING THE BOARD'S CURRENT COMPETITION POLICIES AND ENCOURAGING RAIL INVESTMENT.

The Board has a statutory responsibility to exercise its jurisdiction in a manner that carries out the Staggers Act's policies of enabling carriers to earn revenues adequate to attract capital to renew and expand their networks, allowing market forces to determine rates and services to the maximum extent possible, and regulating carrier rates and services only to the extent necessary to protect shippers from abuses of market power. The Board's existing competition policies are fully consistent with the regulatory balance struck by Congress in the Staggers Act and ICCTA, and those policies have undoubtedly benefited carriers, shippers and other stakeholders.

The railroad industry today is financially vigorous, highly competitive (both intramodally and with other modes) and well-positioned to face the challenge of moving ever-increasing volumes of rail freight in the coming decades. Over the past 30 years, North America's railroads have invested hundreds of millions of dollars in private capital to maintain and upgrade the rail network and to increase capacity, and their current plans call for even greater levels of investment in the future. Most rail traffic moves under privately-negotiated transportation contracts, and shippers pay less (in real dollars) to transport their goods by rail today than they did prior to enactment of the Staggers Act. In short, the policies implemented by the Board pursuant to the Staggers Act have been enormously successful.

Nevertheless, a minority of shippers, consisting primarily of large companies who ship chemicals and coal (and, to a lesser extent, grain) by rail, have called for the Board to abandon its current policies and to grant them new "competitive access" remedies, including mandatory reciprocal switching and rules that would require carriers to offer segmented rates via any physically available route or interchange. Those parties have not proffered evidence in this proceeding demonstrating that railroads are systemically abusing market power, or are otherwise behaving in an anticompetitive manner. Rather, their demands are based on self-serving assertions that the rates they pay are "too high" and the (erroneous) premise that it is contrary to the public interest for shippers who do not enjoy access to multiple rail carriers to pay higher rates than those who do.

At bottom, these arguments represent an attack on the concept of "differential pricing" that is at the heart of the Staggers Act's regulatory reforms. However, as CP's Initial Comments (at 7-10) showed, Congress has explicitly endorsed differential pricing as a necessary element of a regulatory regime that promotes the long-term economic health of the rail system by making it possible for carriers to recover all of their fixed costs. The complaining shippers are fully aware of this policy choice – indeed, they have appealed to Congress on an almost annual basis, seeking legislative reversal of the bedrock principle of differential pricing in favor of the same remedies that they ask the Board to impose in this proceeding. *See* CP Comments at 43-51. Congress' repeated failure to act on those proposals is compelling proof that the Board's current competition policies are consistent with Congressional intent. No Member of Congress has submitted comments supporting adoption of the complaining shippers' proposals in this proceeding – to the contrary, the written submissions clearly indicate that Congress would oppose such action by the Board.

Even if the Board had authority to adopt the complaining shippers' competitive access proposals in the face of Congress' contrary mandate – and, for the reasons set forth in CP's Initial Comments (at 4-11), it does not – the record in this proceeding does not support any fundamental change to the Board's competition policies. To the contrary, the initial comments filed by CP, other railroads, Members of Congress, state and local government officials and agencies, and a wide variety of shippers reflect a broad-based consensus that the Board's current regulatory approach is working and should be continued. The Board's existing regulations facilitate the goals of promoting a financially sound rail industry and creating incentives for carriers to invest in capacity and infrastructure, while providing processes by which shippers can challenge rates that exceed a reasonable level. Indeed, the Interested Parties' Comments (at 47-50) tout multiple recent cases in which the Board granted relief to coal and chemical shippers who challenged their rates under the Board's existing standards.

What the complaining shippers seek in this proceeding is a fundamentally different regulatory approach, under which limited government intervention to remedy market power abuses or excessive rates on a case-by-case basis would be replaced by an "open access" regime giving every shipper access to multiple rail carriers, and all but doing away with differential pricing. While such a change might enable a relatively small group of shippers to obtain lower rates, it would come at a very heavy cost to railroads, non-captive shippers and other constituencies. Railroads would be faced with a difficult choice between earning less revenue or seeking to replace lost revenue by attempting to charge higher rates to shippers who possess more competitive options. The latter course of action would be self-defeating, as it would result in the loss of traffic to other modes of transportation and the need to charge even higher rates on remaining rail shipments. The former course – collecting less revenue and reducing investment in the rail network – would have even more dire consequences. The potential revenue loss resulting from complaining shippers' proposals, estimated by AAR witness Rennicke to be as much as $5.2 billion annually, or 30 percent of the contribution currently earned by the rail industry, would cripple the rail industry's ability to create the additional capacity that will be needed to accommodate future growth in rail traffic.[46]

The danger that the competitive access proposals put forth by certain shippers might impair future investment in the rail network is a matter of grave concern on Capitol Hill, with state and local governments and among the broader shipping public. The risk associated with those proposals was described in a recent report by the Congressional Research Service:

[46] *See* AAR Comments, V.S. Rennicke at 19.

> "The captive shipper issue has wider economic implications than just the division of revenue between railroads and their customers. Higher fuel prices, congestion on certain segments of the interstate highway system, and rising domestic and international trade volumes are driving shippers to demand more rail capacity. Freight revenues are a significant means of financing rail capacity because the railroads receive negligible public financing. If it acts in this area, Congress would face consideration of how a legislated or regulatory solution to the 'captive shipper' problem would affect the development of a more robust and efficient railroad system."[47]

The threat presented by any reduction in the rail industry's ability and willingness to invest in additional capacity is especially serious in light of the severe budgetary constraints faced by both Federal and state governments. In their initial comments, complaining shippers either dismiss that threat (*see, e.g.*, PPG Comments at 12, characterizing the railroads' claims about future investment as an "empty threat") or ignore it altogether. The cynical and self-serving pursuit of lower rail rates by a relatively small group of shippers is vastly outweighed by the pubic interest in maintaining economic conditions that are conducive to continued private investment in the rail network.

[47] *Railroad Access and Competition Issues*, John Fritelli, Congressional Research Service, April 4, 2011, Summary at 1.

## V. CONCLUSION

For the foregoing reasons, and those set forth in CP's Initial Comments, CP respectfully requests that the Board retain its current competition-related policies and discontinue this proceeding.

Respectfully submitted,

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Dated: May 27, 2011

## CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of the foregoing Reply Comments of Canadian Pacific Railway Company to be served by first class mail, postage prepaid, this 27th day of May 2011, to all parties of records.

Terence M. Hynes