BEFORE THE
SURFACE TRANSPORTATION BOARD

DOCKET NO. EP 714

INFORMATION REQUIRED IN NOTICES AND PETITIONS CONTAINING INTERCHANGE COMMITMENTS

REPLY COMMENTS OF ARKANSAS ELECTRIC COOPERATIVE CORPORATION

Michael A. Nelson
101 Main Street
Dalton, MA 01226
(413) 684-2044

Transportation Consultant

Eric Von Salzen
McLeod, Watkinson & Miller
One Massachusetts Avenue, N.W.
Suite 800
Washington, DC 20001
(202) 842-2345

Counsel for Arkansas Electric Cooperative Corporation

Dated: January 17, 2013

BEFORE THE
SURFACE TRANSPORTATION BOARD

DOCKET NO. EP 714

INFORMATION REQUIRED IN NOTICES AND PETITIONS
CONTAINING INTERCHANGE COMMITMENTS

REPLY COMMENTS OF
ARKANSAS ELECTRIC COOPERATIVE CORPORATION

In accordance with the Board's Notice of Proposed Rulemaking in its Decision served November 1, 2012, Arkansas Electric Cooperative Corporation (AECC) submits these reply comments in response to the opening comments of other parties.

Railroad parties argue in their comments that interchange commitments are not anticompetitive, and that the Board's proposed changes would impose unreasonable burdens that would interfere with future shortline spin-offs. In these reply comments, AECC demonstrates that railroads' complaints about the Board's proposals are unsound and often irrelevant to the specific changes the Board has proposed. However, AECC also points out how specific considerations raised by one of the railroad parties, RIWG, are consistent with recommendations advanced by AECC in its opening comments.

Interchange Commitments and Competitive Harms

AAR relies on its oft-repeated, but fundamentally flawed, argument that line sales with interchange commitments "do not diminish competition" because shippers "were served by one rail carrier before and are served by one rail carrier after the transaction." (AAR

Comments at 4) This argument ignores the Board's responsibility to limit the exercise of rail market power and mitigate its adverse impacts. Thus, AAR gives priority to the preservation of market power over its proper management, a proposition that the Board already has rejected.

As AECC showed in its opening comments, interchange commitments essentially lock into place the market power of the parent Class I railroad, regardless of its potential inconsistency with the public interest. AECC's opening comments specifically explained how the market power of the Class I railroad might be used to (a) alter the sourcing of commodities or products away from the low-density line to favor the railroad's private interests; (b) cause the low-density line to experience inadequate service relative to competitive standards; and/or (c) cause traffic from the low-density line to move via long or inefficient routes. Such manifestations of market power may occur individually or in combinations; all are inconsistent with the public interest. (AECC Comments at 4-5)

The Board has clear statutory mandates to address such issues. For example, Section 10101(12) of the national Rail Transportation Policy explicitly seeks "to avoid undue concentrations of market power". AAR may believe that it is acceptable for the railroads to alter commodity flow patterns to suit their own interests, but it is difficult to conceive of market power much more concentrated than that. Section 10705(a)(2)(B) specifically empowers the Board to introduce competitive through-route service to restrain carrier market power when a carrier's single line routes would be "unreasonably long" by comparison, while Section 10705(a)(2)(C) does the same in situations where the through route is needed to provide "adequate, and more efficient or economic, transportation." Section 11102 provides broad authority for the Board to enable competing carriers to serve terminal facilities, enabling market forces – rather than market power – to guide the routing of the traffic.

A mere contractual arrangement – such as an interchange commitment – between a Class I railroad and a shortline to which the Class I sells or leases a line – cannot evade these statutory provisions. For example, Entergy Arkansas Inc. v. Union Pacific RR, NOR 42104, Decision served 6/26/2009, involved a shortline, MNA, to which UP had spun off lines in a transaction that included an interchange commitment. UP claimed that it could enforce the interchange commitment to preclude MNA from interchanging certain traffic with BNSF. The Board ruled that "UP and MNA cannot contract away the statutory rights of a third party or neglect their own obligations under the statute." Id. at 7. The Board explained:

> Any shipper faced with a situation where a railroad refuses to interchange the shipper's traffic with another carrier may seek a Board order to compel the creation of a new interchange and through route. As a general matter, a railroad has a right to rationalize its system and to provide service over its most efficient routes. But a carrier may not defeat legitimate competitive efforts of other rail carriers and shippers by foreclosing more efficient service.

Id.

Thus, if an interchange commitment violates the rights of a shipper it violates the statute, and it is appropriate for the Board to scrutinize any adverse public interest impacts associated with the market power a carrier seeks to exercise through interchange commitments. In the context of the present proceeding, it is likewise appropriate for the Board to establish a process for obtaining information needed to apply that scrutiny.

A Note on Competitive "Abuse" - In a subsequent decision in NOR 42104, the Board ruled that the shippers had not satisfied the requirements of 49 U.S.C. § 10705 for prescription of a through route. In doing so, the Board, as it has previously done, relied on the concept of competitive "abuse" to limit its application of statutory remedies for adverse impacts resulting from the exercise of rail carrier market power. However, the definition of competitive "abuse" applied by the Board in that case deviated critically from the definition established by a recognized, authoritative, independent source.

As the Board knows, the concept of Constrained Market Pricing (CMP) has been a centerpiece of the Board's and the ICC's regulatory regime for three decades. This concept was developed by several eminent economists and was adopted by the ICC shortly after the enactment of the Staggers Act. These and other economists endorsed the ICC's plans for implementing the CMP concept; in doing so, they defined the "abuse" of market power as being unfavorable changes in the characteristics of rail service provided by a carrier with market power relative to the characteristics shippers would experience "under effective competition". 1/

The Board did not apply the economists' definition of competitive "abuse" in NOR 42104 (or any other case involving the anticompetitive effects of interchange commitments). As AECC recommended in its opening comments, the Board needs to develop an effective policy related to shortline spin-offs, including interchange commitments. That policy ought to be consistent with the principles underlying the concept of Constrained Market

---

1/ See ICC Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines – Nationwide, "Verified Statement of Economists Supporting the Principles of Constrained Market Pricing" (June 1983) at page 6. A copy of this document is accessible in STB Docket No. EP 657 (Sub-No. 1), Major Issues in Rail Rate Cases, "Comments of BNSF Railway Company" (May 1, 2006), VS Willig, Exhibit RDW-2 at 6.

Pricing, and specifically measure harms relative to a standard of performance under effective competition.

In a competitive marketplace for an undifferentiated product, firms attract business by undercutting the price offered by competitors. All else equal, the difference need not be large, because customers have an obvious incentive to select the option with the lowest price. Through innovation, investment, or other means, firms strive to produce at the lowest possible cost to maximize their competitiveness (and profitability). If the Board applies lax criteria that permit incumbent carriers to retain their market power even when their routes are circuitous, their costs are high, their service is poor, etc., the Board creates a "preference" for the movement to remain with the incumbent that would not exist in the presence of effective competition. Even a cost difference of less than 2 percent could represent more than two years of productivity growth at the annual growth rate of 0.8 percent per year found in the Board's most recent productivity determination in Docket No. EP 290 (Sub-No. 4)(decision served February 6, 2012). In the real world, firms holding a cost advantage measured in years of productivity improvement generally would be highly successful competitors.

To avoid the harms to the public interest that can result from the exercise of rail market power, the Board should define market power "abuse" relative to a competitive market standard to preserve the incentives for efficiency, service quality, innovation, etc., that competition normally would create.

Threat to Future Spin-offs

A common theme among many of the comments supporting the status quo is that the Board's proposals are burdensome and threaten the prospects for future spinoffs.

While this concern is intuitively straightforward, it is not of overriding importance for at least two reasons. First, to the extent that the Board is increasing its sensitivity to possible competitive issues associated with interchange commitments, it is appropriate for the Board to move away from its past use of a rubber stamp, and now consider relevant information more closely. Obviously, this may increase information requirements, but so long as the Board ensures that information it requires is relevant to the issues it decides to consider, this will not impose an unreasonable burden on spin-off proponents.

Second, this concern ignores the massive divestiture of rail assets that the Class I's already have achieved. Since the time of the Staggers Act, on the order of 2/3 of rail trackage in the U.S. has been abandoned or placed in the hands of operators other than Class I's. During this time, the Class I's, by their own descriptions, have focused primarily on the high-density operations of their core networks. After the Class I's have had more than 30 years of freedom to engage in divestitures largely free of scrutiny by the ICC and the Board, the commenters who purport to worry about the effect of the proposed information requirements on future spin-offs give no reason why large numbers of future divestitures should be expected.

This supposed concern about the effect of the Board's proposals on future spin-offs is also refuted by NS witness Kirchner, who says that NS offers prospective lessees FMV rent, but lessees ask for lease credits so they have money available to improve the line and service; NS may accept such a proposal. (VS Kirchner at 1-2) This is consistent with AECC's observations about interchange commitments that have come before the Board, (AECC Comments at 6) and refutes directly AAR's claims that if interchange commitments were limited, no spin-offs would occur. (AAR Comments at 9)

If anything, the look to the future advocated by many parties suggests that any new reporting requirements developed by the Board likely would apply to only a small amount of trackage and traffic. For any new substantive requirements envisioned by the Board to achieve broad application, they would need to be applicable to existing interchange commitments (e.g., at the time of lease renewals) 2/ as well as new divestitures.

RIWG

AECC notes with interest the overlap between portions of the recommendations presented in its opening comments, and the description provided by RIWG 3/ of the process for obtaining waivers of interchange commitments pursuant to the RIA. In particular, AECC's opening comments recommended, among other things, that interchange commitments be disapproved or limited in cases where the incumbent carrier had demarketed the traffic, or where a facility or resource would be more effectively utilized if service via an alternative connecting carrier were available. These recommendations parallel closely the RIWG description of waivers for "new business", including situations where new facilities are constructed, traffic moves by modes other than rail, and rail traffic doesn't move from given facilities absent a waiver. 4/ The principal difficulty with the process described by RIWG is its

---

2/ If, as some have proposed (e.g., Comments Of The U.S. Department Of Agriculture at second and third pages), the Board were to establish time limitations on interchange commitments, so that there would be no interchange commitment in the renewed lease, this might eliminate the need for such a periodic review.

3/ AAR notes that the "RIWG has . . . established a process under the RIA whereby a shortline railroad can request a waiver to a previously agreed to interchange agreement." AAR Comments, at 6. See, also Id. at 6 n 4, referring to a mediation process established by AAR and ASLRRA.

4/ Verified Statement on Behalf of the Rail Industry Working Group at 3.

reliance on voluntary cooperation by carriers whose market power prospectively is being put at risk. To remedy this, the Board's role in assessing interchange commitments should be expanded to include review of situations where waiver requests made under the RIA are denied.

Synthesis

As AECC observed in its opening comments, the Board's proposals to require additional information about proposed interchange commitments should be regarded as tools to support an effective policy related to shortline spin-offs. (AECC Comments at 9) Elements of such a policy are identified in those comments. (Id. at 9-10)

The Board should establish a process for reviewing interchange commitments that ensures the terms of existing leases are fully subject to scrutiny, particularly at the time of any renewal. The process should provide for an automatic Board review of any instance in which a Class I denies a request for a waiver under the RIA. It should also rely on the competitive market standard for identifying market power abuse recommended by the economists who testified in support of the ICC's planned implementation of CMP, and not on any arbitrary or ineffectual definition of abuse that fails to apply the competitive market standard. The information requirements implemented should be tailored to those needed to support that process.

Respectfully submitted,

Eric Von Salzen
McLeod, Watkinson & Miller
One Massachusetts Avenue, N.W.
Suite 800
Washington, DC 20001
(202) 842-2345

Counsel for Arkansas Electric Cooperative Corporation

Michael A. Nelson
101 Main Street
Dalton, MA 01226
(413) 684-2044

Transportation Consultant

Dated: January 17, 2013