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May 27, 2011

VIA ELECTRONIC FILING

Ms. Cynthia T. Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, S.W., Room 1034
Washington, DC 20423-0001

Re: **Ex Parte No. 705**
Competition in the Railroad Industry

Dear Ms. Brown:

Attached please find the Reply Comments of the American Short Line and Regional Railroad Association ("ASLRRA") in the above-referenced proceeding.

Very truly yours,

Myles L. Tobin

Myles L. Tobin
Attorney for the American Short Line and
Regional Railroad Association

MLT:tjl

Attachment

cc: Richard F. Timmons, President, ASLRRA
Michael Ogborn, Chairman, ASLRRA

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 705

COMPETITION IN THE RAILROAD INDUSTRY

REPLY COMMENTS OF
THE AMERICAN SHORT LINE AND
REGIONAL RAILROAD ASSOCIATION

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Dated: May 27, 2011

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 705

COMPETITION IN THE RAILROAD INDUSTRY

**REPLY COMMENTS OF
THE AMERICAN SHORT LINE AND
REGIONAL RAILROAD ASSOCIATION**

The American Short Line and Regional Railroad Association ("ASLRRA") hereby submits these reply comments regarding the current state of the railroad industry. In its initial comments, the ASLRRA described how its 550 Class II and III member railroads play a vital role in maintaining rail service over hundreds of light-density lines throughout the country that in many cases were candidates for abandonment by their former Class I carrier owners. These small railroads have short lengths of haul, high fixed costs, and large capital needs for infrastructure investment, including the looming task of upgrading their bridges and rail lines to handle heavier freight cars. They also face pervasive competition for their traffic, which characteristically can be handled by truck or by transloading options via other nearby railroads. "Market power, let alone market abuse, is not in the lexicon of the small railroads." ASLRRA Initial Comments at 2.

Changes to the current regulatory structure that would eliminate the consideration of market power and market abuse in granting access to a rail carrier's customers are unwarranted, and would jeopardize the customers and communities the small railroads serve as well as the viability of those small railroads. Small railroads have painstakingly invested in building an industry serving customers that were overlooked and in some cases abandoned by others.

Generally, only a few customers account for the vast majority of traffic on small railroad line segments (typically, three customers account for two-thirds of the rail traffic shipped by each small railroad. Martland V.S. at 18, 24). Loss of all or a portion of the revenues from any one of those shippers can have a dramatically adverse effect on the financial viability of a small rail carrier in view of the high infrastructure and fixed costs which must be supported by those revenues. Permitting these customers to be "cherry-picked" by the very railroads that previously divested their traffic - through competitive access, segmented rate relief or a prescribed short-haul for the benefit of one shipper -- would, therefore, have a cascading effect directly and adversely impacting all shippers on the rail line.

Unlike the Class I railroads, the small railroads' costs cannot be spread over a vast rail system or large customer base. Martland V.S. at 23-24. All of the freight revenues generated by customers on a small rail line are vitally necessary to sustain the financial viability of that line.

For this Board to depart from the traditional regulatory model, and ignore the absence of market power and the inability of small railroads to abuse market power which they to not possess, in a through-route prescription or competitive access analysis, serves no valid purpose and could have the very real effect of undermining the financial viability of many small railroads.

Nothing in the initial comments filed by various parties in this proceeding challenges this analysis. Those comments advocating substantial regulatory changes focus largely on rail-to rail competition between large Class I carriers; the reduction in the number of Class I railroads through the "mega-mergers" of the last two decades; and in some cases, allegations that the larger railroads have ceased competing even in markets where both are present. See, e.g., Joint Comments of Alliance for Rail Competition, et al.;[1] Initial Comments of Consumers United for Rail Equity; and Comments of the Western Coal Traffic League.[2]

These arguments are not applicable to the dynamics of the markets in which small railroads operate. Small railroads, for example, do not function in a "duopoly" setting or other circumstances where the conditions for "parallelism" would be present. See ARC, et al. Comments at 7, 14-15. They primarily serve truck-competitive general merchandise traffic rather than what is normally alleged to be "captive" traffic over which railroads are asserted to have market power. Martland V.S. at 10-15. They handle traffic over short distances to Class I connections and can frequently be bypassed by trucking movements to the nearest transload facility on a Class I rail system. While some comments made broad statements regarding the railroad "industry," no commentator identified either systemic or individualized competitive issues involving small railroads.

It is therefore even more important that the Board carefully weigh how any regulatory changes it considers would affect small railroads and the important constituencies they serve. Small railroads cannot get lost in the shuffle of a "one size fits all" reconsideration of the

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1 The Joint Comments were filed by the Alliance for Rail Competition, The American Chemistry Council, American Forest and Paper Association, American Public Power Association, The Chlorine Institute, Colorado Wheat Administrative Committee, Consumers United for Rail Equity, Edison Electric Institute, Glass Producers Transportation Council, Idaho Barley Commission, Idaho Wheat Commission, Kansas Wheat Commission, Large Public Power Council, Montana Farmers Union, Montana Wheat & Barley Committee, National Grain and Feed Association, The Electric Cooperative Association, Nebraska Wheat Board, Oklahoma Wheat Commission, Portland Cement Association, South Dakota Wheat Commission, Texas Wheat Producers Board, The Fertilizer Institute, U.S. Clay Producers Traffic Association, and Washington Grain Commission.

2 Shipper groups also have complained that, after decades of decline, rail rates have increased in recent years. The STB has explained, however, that "it would appear that rising railroad input prices and declining productivity growth – not enhanced railroad market power -- accounts for the bulk of the rate increases." *Study of Railroad Rates: 1985-2007*, STB Office of Economics, Environmental Analysis and Administration, Section of Economics, January 16, 2009, at 2.

competitive access regime. The ASLRRA believes that ignoring the absence of market power and the inability of small railroads to abuse market power which they do not possess, when entertaining requests for reciprocal switching, terminal trackage rights or alternate through routes, would be a mistake in any event. That mistake would be compounded by a failure to appreciate the unique and consequential effects such expanded forced access remedies would have on small railroads.

ASLRRA briefly addresses below a number of additional issues raised by the initial comments in this proceeding.

I. RE-REGULATORY INITIATIVES SHOULD COME FROM CONGRESS

A number of commentators argue that the Board is not prohibited by law from reconsidering, inter alia, its competitive access standards codified at 49 C.F.R. § 1144, which apply by its terms to requests for alternative through routes under 49 U.S.C. § 10705, for reciprocal switching under 49 U.S.C. § 11102(c), and by extension, to requests for terminal trackage rights under 49 U.S.C. § 11102(a).[3] This position, however, ignores both the intent of Congress and its explicit directions contained in the legislation. Simply stated, the Board cannot exercise what discretion is has in a manner that ignores Congressional directives and intentions.

The current approach to competitive access questions was adopted by the Interstate Commerce Commission ("ICC") in the 1980s after passage and in light of the Staggers Rail Act of 1980, Pub. L. No. 96-448, 94 Stat. 1895. In 1995, Congress had a chance to reexamine these policies when it enacted the ICC Termination Act of 1995, Pub. L. No. 104-88,

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[3] *See Intramodal Rail Competition*, 1 I.C.C.2d 822 (1985) (adopting competitive access rules), *aff'd sub nom. Baltimore Gas & Elec. Co. v. U.S.*, 817 F.2d 108 (D.C. Cir. 1987); *Midtec Paper Corp. v. Chicago & N.W. Transp. Co.*, 3 I.C.C.2d 171, 178 (1986) (extending competitive access rules to terminal trackage rights cases), *aff'd sub nom. Midtec Paper Corp. v. U.S.*, 857 F.2d 1487 (D.C. Cir. 1988).

109 Stat. 83. Instead of adopting a re-regulatory stance, however, Congress did exactly the opposite: "[T]he bill continues the deregulation theme of the past 15 years by providing further regulatory reductions in the surface transportation industries." S. Rep. No. 176, 104th Cong., 1st Sess. 5 (1995). A court later concluded that "Congress enacted ICCTA in order to complete the railroad deregulation that the earlier statutes [*i.e.*, the 4R Act and the Staggers Act] had begun." *In re: Rail Freight Fuel Surcharge Antitrust Litigation*, 593 F. Supp. 2d 29, 37 n.3 (D.D.C. 2008) (citing Senate Report). A federal appellate court has explained that "[t]he purpose of the ICCTA is to 'build[] on the deregulatory policies that have promoted growth and stability in the surface transportation sector.'" *Elam v. Kansas City Southern Ry. Co.*, 635 F.3d 796, 804 (5th Cir. 2011) (quoting H.R. Rep. No. 311, 104th Cong., 1st Sess. 93 (1995), *reprinted in* 1995 U.S.C.C.A.N. 793, 805).

In 1996, a majority of the Board declined an invitation to revisit the agency's revenue adequacy standards, finding that Congress had completed an exhaustive review of the Interstate Commerce Act in adopting ICCTA and did not amend or even suggest that the agency amend the regulatory standard at issue. *Railroad Revenue Adequacy -- 1995 Determination*, 1 S.T.B. 167, 168-169 (1996) (Morgan, Chairman, joined by Simmons, Vice Chairman, commenting). A later wide-ranging review of rail competition matters in Ex Parte No. 575, *Review of Rail Access and Competition Issues*, 3 S.T.B. 92 (1998) ended with the Board informing Congress that policy shifts with respect to the competitive access rules should be initiated by Congress rather than the agency. *See* ARC, et al. Comments at 35 n.82. As one of the current commentators notes, this deference to Congress was based on reasons of comity and national policy. *Id.*

As the ASLRRA previously explained, "The Board should not be imposing what Congress did not want and shippers do not need." ASLRRA Initial Comments at 17. Congress was well aware of how the ICC had implemented the various competitive access provisions of the Staggers Act and, in adopting ICCTA, chose to follow a continued *deregulatory* path rather than a revised *regulatory* one. Those legislative and policy choices should inform the Board's action here, and counsel against significant diversions from the Board's current regulatory policies.

The ASLRRA also notes that, with respect to potential changes in the rules governing bottleneck rates, the Board faces a further constraint in the form of the Supreme Court's determination that "[t]he shipper's only interest is that the charge [from origin to destination] shall be reasonable as a whole." *Great Northern Ry. Co. v. Sullivan*, 294 U.S. 458, 463 (1935). In concluding in the *Bottleneck* decision that *Great Northern* "has continuing 'vitality,'" the Board explained that "[o]ur decision is, in our view, mandated by the law." *Central Power & Light Co. v. Southern Pac. Transp. Co.*, 1 S.T.B. 1059, 1073 & n.21 (1996), *on reconsideration*, 2 S.T.B. 235 (1997), *aff'd sub nom. MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8th Cir. 1999).

The Board thus did not develop the current *Bottleneck* rule as a matter of policy or regulatory interpretation, but in accordance with the dictates of legal precedent. That precedent remains binding on the agency, and no intervening statutory enactment since the time of the *Bottleneck* decision has negated *Great Northern's* applicability. The Board's discretion to reexamine the *Bottleneck* precedent appears extremely limited.

II. ANY RE-REGULATORY ACTION MUST ACCOMMODATE THE UNIQUE ATTRIBUTES OF SMALL RAILROADS

A number of commentators -- specifically the Concerned Captive Coal Shippers ("CCCS") and Western Coal Traffic League ("WCTL") – have made wide-ranging proposals to modify existing regulatory policies. In neither instance do the changes seem targeted toward small railroads.[4] If, however, the Board did entertain those proposals, it must carefully and specifically consider the impacts of adopting any or all of the proposals on small railroads.

To be clear, the ASLRRA is not suggesting the Board should adopt any of those proposals and, in fact, the ASLRRA urges, for the reasons outlined herein and in the ASLRRA's Initial Comments, that it would be unwise public policy for this Board to depart from the current regulatory framework. If, however, the Board opts to increase railroad regulation, it would have to determine how to mitigate the adverse effects on the customers and communities the small railroads serve as well as the harm that would be imposed on those small railroads.

For example, CCCS' proposal regarding through routes includes a requirement that divisions be based on a straight mileage proration if the railroads involved in a prescribed alternative route cannot reach agreement. That proposal essentially assumes that cost structures are essentially interchangeable among all railroads. Yet it is one of the defining characteristics of small railroads that they have significantly higher fixed costs per car-mile than Class I's. Use of a straight mileage prorate divisions arrangement would therefore prevent the small railroads from recovering their full costs of serving their customers. This proposal would be inappropriate and highly destructive for the small railroads.

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[4] Indeed, the comments filed by CCCS and WCTL confirm what their names imply -- that they are concerned primarily if not exclusively with the transportation of western coal provided by Union Pacific Railroad Company and BNSF Railway Company.

Similarly, CCCS proposes that the STB allow prescription of through routes based on revenue/variable cost ("R/VC") measures that are derived from the Uniform Rail Costing System ("URCS") costing model and that are published annually for the Class I railroads. URCS does not contain any costs from small railroads and is thus totally unsuitable for determining the profitability or revenue adequacy of small railroads. URCS is based on data provided by Class I railroads that do not reflect the different cost structures of small carriers. *See Variable Costs in Rate Complaint Proceedings – Non-Class I RR.*, 6 S.T.B. 798, 799 (2003).

Equally important is the fact that the R/VC measures were intended to be applied to origin-destination rates, not the small segment of a movement served by a small railroad. Those measures are ill-suited to light density operations and terminal operations where fixed costs are very high. Certainly, significant issues regarding URCS data, reporting, and revenue adequacy would need to be addressed before any such model could be applied to small railroads.

Proposals to set reciprocal switching and terminal access fees at an amount equal to fully allocated costs, while sounding equitable, also have significant potential to distort the economic viability of small railroads. Small railroads often have only a few major customers, who together must cover most of the fixed costs of their operation. As discussed above and in the ASLRRA's Initial Comments, it is those customers who are the largest shippers on a small railroad that would be most likely to be "cherry-picked" by nearby railroads under a re-regulatory reciprocal switching/terminal trackage rights scheme. Limiting rates for the largest customers to the average fully allocated cost would put a greater burden on the small railroads' other customers, who could instead shift to other modes. The resulting "downward spiral" of increasing costs, reduced service and lost traffic is an all-too-familiar story in the pre-Staggers history of light-density lines in this country and is not a history that the country can afford to repeat.

In any case where the Board considers departures from the existing regulatory regime, it must assure that any new rules and standards are adapted to the special characteristics of the nation's smaller railroads and strengthen rather than weaken the ability of small railroads to serve their customers, invest in needed infrastructure improvements, and compete in challenging markets.

III. PAPER BARRIERS

In its notice initiating this proceeding, the Board explained that its policies regarding interchange commitments – also known as "paper barriers" – had been addressed in recent proceedings before the agency, and would continue to be developed on a case-by-case basis in several pending matters. *Competition in the Railroad Industry*, Ex Parte No. 705 (STB served January 11, 2011) at 5. The Board accordingly determined that such matters would not be a subject of this proceeding. Nonetheless, several commentators provided views or recommendations regarding paper barriers. *See* Initial Comments of Consumers United for Rail Equity at 14-15; Comments of the Western Coal Traffic League, Legal Argument at 16-18.

Interchange commitments are not as widespread as may be perceived, ASLRRA Initial Comments at 12. Further, the landmark Railroad Industry Agreement ("RIA") adopted in 1998 and expanded in 2004 has been effective in assuring the availability of alternative routes for new traffic. During the last six years, an average of 71% of paper barrier waiver requests submitted to Class I railroads were granted. ALSRRA Initial Comments at 13. As the ASLRRA has advised this Board on numerous prior occasions, inclusion of paper barriers in line sale contracts between the Class I's and small railroads can be fundamental to the establishment of those small railroads. Elimination of paper barriers, as a general matter, would be an unwise policy since paper barriers facilitate the creation of new Class III railroads as well as the continued operation of small line segments which the Class I's spin off.

Ultimately, however, ASLRRA believes that Board was correct in not seeking to re-examine paper barrier issues yet again in this proceeding. It should decline the invitation by some to revisit that determination.

IV. CONCLUSION

The conclusions reached by railroad economic expert Carl Martland bear repeating here:

- Allowing other railroads to access a small railroad's customers will not reduce the fixed costs of the small railroad's operation, but will divert traffic from the small railroad, reduce its revenues, and increase its unit costs of handling remaining business.
- Requiring lower rates – whether by reducing rates charged by small railroads or by reducing rates charged by Class I carriers that share revenues with small railroads – will damage the financial position of any small railroad that is struggling to cover fixed costs and earn an acceptable return to the owner.
- Legislation or regulations that allow open access or that limit small railroad revenues will hinder the ability of small railroads to handle time-sensitive, service-sensitive or price-sensitive traffic. Small railroads typically receive more than half of their revenue from their top two or three customers. Enabling other carriers to capture even one of these

customers would severely hurt even the healthiest of the small railroads. Regulatory actions that require small railroads to accept substantially lower revenue from one or more of their largest customers would similarly imperil the carriers' ability to survive.

- Dividing low density operations among two carriers through increased regulation may reduce rates for one or two customers in the short run, but will certainly increase costs in the long run and threaten the ability of the small railroad to continue to serve all of its customers. Verified Statement of Carl Martland attached to ASLRRA Initial Comments.

The nation's small railroads transport their customers' traffic over relatively short distances to interchanges with Class I connections. Their traffic densities are light and their fixed costs are high. The extensive capital necessary to maintain and upgrade rail infrastructure is a significant drain on freight revenue resources. Intramodal and intermodal competition is intense, and railroads struggle on a daily basis to maintain and grow their traffic base. Small railroads' rates are constrained by their competition and they rarely, if ever, have rate flexibility. For this Board to depart from the traditional regulatory model, and ignore the absence of market power and the inability of small railroads to abuse market power which they do not posses serves no valid regulatory purpose, and could have the very real effect of undermining the financial viability of many small railroads.

ASLRRA continues to believe that the marketplace in which it operates does not need the intrusion of further regulatory constraints to function competitively and efficiently. The revitalization of a light-density rail line network in this country which began thirty-five years ago should not be cut off in the name of controlling market power that small railroads do not have.

Congress plainly intended no such change when it adopted what is now the Board's governing statute, and this agency should be vigilant in assuring the continued viability of service to the customers and communities that rely on the nation's small railroads.

Respectfully submitted,

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Dated: May 27, 2011