BEFORE THE

SURFACE TRANSPORTATION BOARD

EX PARTE NO. 705

COMPETITION IN THE RAILROAD INDUSTRY

REPLY COMMENTS OF

ALLIANCE FOR RAIL COMPETITION
MONTANA WHEAT & BARLEY COMMITTEE
COLORADO WHEAT ADMINISTRATIVE COMMITTEE
IDAHO BARLEY COMMISSION
IDAHO WHEAT COMMISSION
KANSAS WHEAT COMMISSION
NEBRASKA WHEAT BOARD
OKLAHOMA WHEAT COMMISSION
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Alliance for Rail Competition, et al. ("ARC, et al.") submit the following comments in reply to the comments of the Association of American Railroads, Class I and other railroads, and their supporters in the opening round. ARC, et al. are also parties to and supporters of the joint shipper reply comments being filed in this proceeding by ARC, American Chemistry Council, and other shipper associations.

The Railroads make clear in this proceeding, as they have on Capitol Hill, that they favor the status quo. In defending the status quo, the Railroads argue that the Board is powerless to modify past decisions unless Congress amends the Interstate Commerce Act, that competition among railroads is undesirable, and that loss of any of their monopoly power will jeopardize if not destroy the Railroads' incentive to invest in their facilities. Plainly, the Railroads' goal is to prevent the Board from considering, let alone proposing for public comment, any changes in current rules and policies that limit rail competition.

As detailed in the Reply Comments of ARC and ACC, et al., the contention that past decisions insulating the Railroads from more competition cannot be reexamined is specious. The law not only permits administrative agencies to depart from past precedent if they provide good reasons for doing so, but the modernization of regulation to address changed circumstances is an important function of administrative agencies.[1]

The Railroads argue that there are no new circumstances warranting reconsideration, contending that their improved financial health, with revenue adequacy achieved or imminent for the Class Is, is unrelated to the effectiveness (or absence) of rail competition. They argue further

[1] In Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520, 535-36 (1985) the ICC anticipated that major railroads would eventually achieve revenue adequacy, and recognized that policies tailored to conditions in 1985, including differential pricing of captive traffic, would no longer be justifiable in such a future. Similarly, ICC and STB policies enabling financially weak railroads to avoid competition are ripe for reconsideration under today's changed conditions.

that rate regulation is, in any event, the way the Board should address the railroad industry's improved financial condition.

ARC, et al. certainly agree that STB jurisdiction over unreasonable rail rates is important, as discussed in our opening comments. However, the Railroads' claims that rail rate remedies are adequate, or obviate the need for increased competition, are untenable.

Rate remedies are far from perfect even for coal shippers, the captive shippers which have received virtually all of the rate relief ordered by the ICC and STB since 1980. The ICC and STB remedies for non-coal shippers have been non-existent for much of that period, and often unused even when theoretically available.

From 1980 until 1996, when the STB issued Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004, there was no counterpart to Constrained Market Pricing for non-coal shippers, and the SAC test of CMP was too complex and expensive for almost all shippers other than electric utilities.[2]

It took the Board another ten years to acknowledge the shortcomings in its Rate Guidelines, especially for smaller shippers and shippers with goods moving via market dominant railroad from multiple origins or to multiple destinations. See the Board's Decision served July 28, 2006 in Ex Parte No. 646 (Sub-No. 1), Simplified Standards for Rail Rate Cases, at 3: "A decade has passed without any shipper presenting a case that has been decided under Simplified Guidelines" [i.e., Rate Guidelines – Non-Coal Proceedings]. And the simplified procedures the Board adopted – Three Benchmark and SSAC – have proved too costly and too unlikely to be productive, given relief caps and other considerations, to make recourse to STB rate regulation effective for many shippers.

[2] Notably, Rate Guidelines was decided because Congress imposed a deadline in 49 U.S.C. § 10701(d)(3) for a conclusion in the long-running Ex Parte No. 347 (Sub-No. 2) proceeding.

It should also be noted that the Railroads have hardly welcomed the rate regulation they now point to as preferable to more competition. The Railroads have consistently fought to prevent the Board from offering effective rate remedies for captive shippers, and have consistently driven up litigation costs in the few rate cases that have been brought, thus further deterring challenges by shippers with potentially meritorious claims.

The Railroads argue that they will not invest in their systems unless they can engage in differential pricing, and that a rail competition might undermine differential pricing. Of course, many other industries invest heavily even without monopoly rents, and rail competition has proved, in many cases, to be more apparent than real.

Moreover, the Railroads are increasingly using pricing to affect the competitiveness of goods in the marketplace, especially for shippers the Agriculture Department characterizes as "price takers." At a Senate Commerce Committee hearing in April 2002, a vice president with authority over grain service for a major railroad in the West stated:

> What we do as a rail transportation provider is look at the difference between the value of grain at the origin and value of grain at the destination and try to determine the level of charges for transportation with margin for the elevators to operate and make money.

The vice president went on to explain that railroads can charge more to transport grains, such as hard Spring wheat, that command higher market prices, appropriating to themselves additional value that would otherwise go to elevators and farmers.

This is monopoly pricing, and carries the possibility, if not probability, that railroads may misjudge, or elevate their own interests above the survival of marginal shippers or receivers, destroying or distorting markets that should reflect the efficiency and quality of the goods transported rather than railroad manipulation of delivered prices.

In any event, regulatory remedies against unreasonable rates, even if they were to be made more effective, would not, in themselves, prevent all abuses of railroad market power. The Railroads have in recent years increased the pervasiveness and amount of their ancillary charges. ICC and STB precedents offer very little guidance to captive shippers who regard these charges as excessive in amount, or otherwise oppressive or punitive. Shippers can and do challenge some charges as unreasonable practices, but if the level of the charge is excessive, STB precedent offers no way of knowing how high is too high.[3]

Cutting back on service, or making it more erratic or subject to new shipper burdens, and "gaming," are additional tactics Railroads are able to employ, over and above excessive rail rates, with impunity. These rate, charge and service abuses are particularly likely when shippers have no effective transportation alternatives, as is too often the case for ARC, et al.

Removing artificial barriers to increased rail-to-rail competition will not remedy these problems for all shippers, particularly in the West, where the closest alternative railroad may be too far away to offer competition for an incumbent even absent such barriers. Moreover, increasing railroads' ability to compete with one another is not the same as increasing effective rail-to-rail competition, as many comments in this proceeding prove. For these reasons, the Board must be prepared to facilitate, and improve, its remedies for unreasonable rail rates and unreasonable rail practices even assuming it moves forward after this proceeding to propose changes increasing competition in the railroad industry.

The Railroads go on in their opening comments to argue that revisions to past ICC and STB policies and precedents on competition, to increase the opportunities for Class I railroads to compete with each other and for short lines to compete with Class Is, should be avoided as un-

[3] The Board's decisions imposing limits on fuel surcharges are helpful, but a general rule that charges must be cost-based is needed.

wise, even if such changes would be lawful. Despite our concerns about limits on the effectiveness of such changes for many shippers, ARC, et al. fully agree with ACC, NGFA, NITL, EEI, TFI, CURE and other shipper associations that the Board can and should proceed with efforts to promote more rail competition.

As detailed in the opening comments of the U.S. Department of Agriculture, concentration in the railroad industry has led to significant reductions in rail-to-rail competition for grains, including wheat, and oilseeds in recent decades. Railroad monopolies have become more prevalent. USDA's recommendation of mandatory access remedies with access charges based on cost, not monopoly rents, is an example of the kind of change deserving further consideration.

See also the opening comments of the Agricultural Retailers Association, calling for alternative dispute resolution procedures that will give smaller shippers more hope of relief in the event that increased opportunities for railroad competition do not always lead to reasonable rates, charges, practices and service quality.

The Railroads' fears that the sky will fall with more rail-to-rail competition are wildly exaggerated. Truck competition is receding, not increasing, as capacity constraints, driver shortages, limits on Gross Vehicle Weights and other barriers to trucking industry productivity gains enable railroads to increase their market share. The Railroads are hardly ignorant of these developments, having lobbied in favor of many of them.

Since goods must move somehow if the economy is to grow, predictions that Wall Street will abandon the Railroads in the wake of even the slightest increase in competition exposure are pure hyperbole. The future of the railroad industry is bright.

More fundamentally, the Railroads fail to give any weight at all to the benefits of competition, including incentives to improve efficiency, adopt new technology, eliminate waste, and increase responsiveness to the needs of customers and the marketplace, including changes in those needs. Yet, when Conrail was acquired, the benefits of competition were extolled. In a letter to shippers dated April 17, 1998, CSXT Executive Vice President John Anderson wrote "I know of no market for goods and services where increased competition hasn't produce better offerings and better value."

These benefits should not require extended discussion. They drove the great wave of deregulation in the 1980s and 1990s that included the trucking, natural gas, airline, telecommunications and natural gas industries, among many others. The contrast between trucking deregulation, universally recognized as a success, which has led to superior service quality at reasonable and competitive rates, and partial rail deregulation in the same year, which has led to eastern and western duopolies, and barriers neutralizing short lines as competitors, could not be starker. An instructive exception is rail intermodal service, where competition has forced railroads to improve service quality to such a degree as to produce record growth.

In implementing trucking deregulation, the Board acted commendably to eliminate the last vestiges of anticompetitive conduct when it terminated antitrust immunity for motor carrier collective ratemaking in 2007. See Ex Parte No. 656, Motor Carrier Bureaus – Periodic Review Proceeding, at page 15:

> In assessing the public interest, we must give significant consideration to the interests of disadvantaged shippers – the parties least able to self-protect and therefore most likely to have artificially high rates set by collective action. Termination of Board approval is the best way to protect their interests. As the Board has explained, "[o]ne feature of more competitive markets is that the benefits of low prices are broadly spread among the entire market of consumers, regardless of the fact that submarkets of consumers would, in the absence of competition, be willing to pay more for a good or service rather than do without it."

On the rail side, the Board has attempted to make do with inadequate measures such as the "management efficiency constraint" of CMP, which has no theoretical utility outside SAC rate cases, and little practical utility in such cases. Increased rail competition should be a far more effective remedy for managerial inefficiency by monopoly railroads.

Finally, the Board must recognize the extent to which the Railroads' opposition to a fair shake for captive shippers is driven not by law or policy, or even by sound economics, but by a desire to preserve the extraordinary market power they have acquired since 1980. Over 200 years ago, Adam Smith, a champion of free markets, addressed competition and markets as follows in The Wealth of Nations:

> To widen the market may frequently be agreeable enough to the interest of the public; but to narrow the competition must always be against it, and can serve only to enable the dealers, by raising their profits above what they naturally would be, to levy, for their own benefit, an absurd tax upon the rest of their fellow-citizens. The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, which have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.

Arguing that monopoly is preferable to competition is not sustainable in 2011. Preferring monopoly would support a single railroad in North America, or support subordinating the transportation needs of shippers and receivers to operational efficiency and supra-competitive profits for the Railroads. Products that should gain share in a competitive market might lose ground purely because a monopoly railroad's interests would be better served by the success of inferior products from preferred origins, or by reducing the number of participants in a market, with winners determined by location and railcar flow patterns. The Board therefore needs to move toward a new balance between the interests of railroads and shippers that better realizes the long term goals of the Staggers Act and the ICCTA.

For the foregoing reasons, ARC, et al. join other shipper groups and shippers in urging the Board to initiate further proceedings leading to more effective rail competition where achievable, with strong regulatory remedies available where necessary.

Respectfully submitted,

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Texas Wheat Producer Board
Washington Grain Commission
Montana Farmers Union

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