BEFORE THE

SURFACE TRANSPORTATION BOARD

DOCKET NO. EP 711

PETITION FOR RULEMAKING TO ADOPT REVISED COMPETITIVE SWITCHING RULES

OPENING COMMENTS OF

ALLIANCE FOR RAIL COMPETITION
MONTANA WHEAT & BARLEY COMMITTEE
COLORADO WHEAT ADMINISTRATIVE COMMITTEE
IDAHO BARLEY COMMISSION
IDAHO WHEAT COMMISSION
MONTANA FARMERS UNION
NEBRASKA WHEAT BOARD
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I. INTRODUCTION

Alliance for Rail Competition ("ARC") and the other shipper interests identified on the cover (collectively, "ARC, et al."), welcome the opportunity to provide these Opening Comments on the issues raised in this proceeding. ARC, et al. support increased competition in the railroad industry, and generally support the comments being filed in this proceeding by National Industrial Transportation League and other shipper interests, whose analysis suggests there are potential benefits for at least some shippers that are not being realized due to STB policies undermining statutory provisions calling for competition.

At the same time, as ARC, et al. have pointed out on prior occasions, there are many shippers who are likely to remain without effective competition even if relief is granted in this proceeding, and prior precedents are reversed or modified. For such shippers, the Board must remain available to address challenges to the reasonableness of rail rates, charges and practices. Continued recourse to the agency will also be needed by shippers who receive competitive switching holding out the hope of competitive benefits, but who are deprived of those benefits due to the unwillingness of railroads to respond adequately to competitive pressures.

It is a dangerous fallacy to assume that actual competitors, let alone potential competitors or monopoly railroads in theoretically "contestable" markets, will always or normally respond to competition by charging reasonable rates and striving for high service quality. For this reason, Congress was correct to define market dominance not as the absence of competition but as the absence of effective competition. 49 USC § 1070(a).

ARC is an association of captive shippers that has, for many years, participated in STB proceedings and legislative proceedings affecting rail shippers. Several ARC members, including PPL, Otter Tail Power Company and Western Fuels, ship large quantities of coal via market dominant railroads. Other members of ARC ship sand (including sand for fracking), glass products and ingredients, and agricultural commodities, or represent rail-dependent producers and shippers of agricultural commodities.

II. THIS PROCEEDING RAISES IMPORTANT ISSUES AT A CRITICAL JUNCTURE

This proceeding is one of several in which the Board is considering whether to adopt new initiatives in the way it regulates monopoly railroads. ARC, et al. believe that policies established years ago, or decades ago, when the financial health of the railroad industry was in question, need to be reconsidered in light of changed conditions. However, we look in vain for evidence that the Board takes as seriously as it should its statutory obligation to prevent abuses of market power by market dominant railroads.

There are two basic means by which the agency can curb abusive conduct by monopoly railroads:

- One way is to grant relief when unreasonable rates, charges and practices are challenged, and to adopt policies deterring or penalizing abuses.
- The other way is to reduce the opportunity for abuses of market power by increasing competition among railroads.

Both of these approaches are supported by the statute. Supporting regulatory remedies are, among other provisions, Subsection (6) of the Rail Transportation Policy[1] and 49 U.S.C. §

[1] "In regulating the railroad industry, it is the policy of the United States Government … (6) to maintain reasonable rates where there is an absence of effective competition and where rail

10701(d)(1).[2] Supporting competitive remedies are, among other provisions, Subsection (12) of the Rail Transportation Policy,[3] and 49 U.S.C. § 11102(c)(1).[4]

Of course, Congress also calls on the Board to regulate in recognition of the policy that rail carriers shall earn adequate revenues as established by the Board, and to permit rail consolidation, even if at the cost of reduced competition, where the result, on balance, is consistent with the public interest. However, hardly anyone contends that the Board, and the ICC before it, did not satisfy their statutory obligations as to railroad revenue adequacy and railroad consolidations. There are fewer Class I railroads today than ever before, they are more powerful and financially healthy than ever before, and they are subject to less competition than ever before.

The question is rather whether the consumer protection function of the STB is being satisfied, either as to effective competition or as to effective regulation. ARC, et al. submit that the answer is no. Regulatory barriers preventing higher rail rates and charges on captive traffic, and regulatory remedies for poor service quality are almost nonexistent, and certainly do not govern Class I railroad pricing or operations. In the vast majority of situations, situations, Class Is do what they like, unconstrained by regulation or competition.

For more than 30 years, captive shippers have borne the brunt of the revitalization of the nation's largest Class I railroads. To some extent, this has been the result of differential pricing

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rates provide revenues which exceed the amount necessary to maintain the rail system and attract capital."

2 "If the Board determines, under section 10707 of this title, that a rail carrier has market dominance over the transportation to which a particular rate applies, the rate established by such carrier for such transportation must be reasonable."

3 "In regulating the railroad industry, it is the policy of the United States Government … (12) to prohibit predatory pricing and practices, to avoid undue concentrations of market power, and to prohibit unlawful discrimination."

4 "The Board may require rail carriers to enter into reciprocal switching agreements, where it finds such agreements to be practicable and in the public interest, or where such agreements are necessary to provide competitive rail service."

of captive traffic. However, it has also been the result of a decades-long record of ICC and STB decisions interpreting the Act in such a way as to limit effective regulation[5] and effective competition.[6] While many of these decisions, considered in isolation may be defensible, their cumulative effect has been to favor railroads and disfavor captive shippers.

Against this background, it is past time for the STB to show captive shippers that they can expect movement in the direction of a playing field that is less tilted against them, or even a playing field that is actually level. Unfortunately, that is not what we have seen in recent years.

On the contrary, shippers in recent years have had to devote considerable time, effort and resources to trying to oppose regulatory developments that would reduce captive shippers' chances of obtaining, or even seeking, relief. Put another way, at a time when captive shippers should see increasing leverage to use in negotiating reasonable solutions to disputes with monopoly railroads, or in obtaining relief from the Board, too many shippers see themselves losing ground.

Several proceedings, include EP 717, involving the AAR's attempt to reintroduce product competition, FD 35506, in which the Board is considering the BNSF acquisition premium, EP

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[5] Example of decisions reducing the effectiveness of regulatory remedies include decisions adopting an excessively conservative standard of revenue adequacy, declining to adopt a productivity adjustment to the RCAF until forced to do so by the D.C. Circuit (and then undermining the decision by adopting other RCAFs beyond the RCAF-U and RCAF-A), allowing consideration of product and geographic competition in market dominance determinations, declining to adopt any maximum reasonableness standard other than stand-alone cost for over a decade until forced to do so by Congress, and issuing the Bottleneck Decision, Central Power & Light Co. v. Southern Pacific R.R., 1 S.T.B. 1059 (1996), aff'd in part, MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir. 1999).

[6] Example of decisions reducing the effectiveness of competitive remedies include the Midtec decision, decisions approving paper barriers, decisions declining to order increased competition as a condition of approval of major mergers, defining the competition that must be preserved in major mergers too narrowly, allowing railroads to force shippers to supply cars, taking ineffective action during the UP-SP meltdown and Conrail acquisition, allowing cancellation of through routes and joint rates, and adopting ineffective Competitive Access rules.

431 (Sub-No. 4), the URCS update proceeding, and NOR 42123, in which the Board proposed its "refined" or "limit price" approach, threaten significant reductions in the number of shippers found captive, even if such shippers have no additional transportation alternatives to their current rail service, and even if their rail rates have gone up, as is the case with grain shipments in the upper Great Plains states. Such shippers need greater recourse to regulatory remedies, not less recourse due to artificially increased variable costs reducing their R/VC percentages.

In EP 715, the Board has proposed to expand relief for shippers bringing successful SSAC and Three Benchmark rate cases, but it proposes significant reductions in the effectiveness of SAC and SSAC remedies. It proposes no cure for the flaws of the Three Benchmark approach (other than a higher relief cap), even though the changes proposed for SAC and SSAC render those alternatives even less viable for smaller and more isolated shippers.

Efforts by BNSF to hold shippers responsible for coal dust, by UP to hold shippers responsible for lading debris, and by NS to hold shippers responsible for snow or ice accumulations in transit are under way, notwithstanding shipper challenges, as are railroad efforts to restrict their common carrier obligation or increase shipper liability exposure even absent shipper fault.

And in this proceeding, instead of proposing to reverse the ICC's Midtec decision,[7] the Board has called on shippers to do extensive and expensive cost-benefit analyses, which are apparently needed to reassure the Board that more competition among major railroads would not be undesirable.

Long-suffering captive rail shippers need some good news from the STB. We are seeing more bad news, and no good news. Meanwhile, the rates and profits of major railroads hit record

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[7] Midtec Paper Corp. v. Chicago & N.W. Transp. Co., 3 I.C.C. 2d 171 (1986), aff'd sub nom. Midtec Paper Corp. v. United States, 857 F.2d 1487 (D.C. Cir. 1988).

levels. The need for more effective competition, and for more effective regulation where competition does not exist or does not work, has never been greater or clearer. This Board has consistently chosen courses of actions that do not enhance competition and thereby do not serve to protect captive shippers from exercise of monopoly power by the railroads. The railroads are showing record profits, the railroads are clearly in possession of market dominance in their marketplace and yet the Board continues to fall short of meeting shippers' ever growing need for relief.

Now is the time for progress on these fronts, but if not now, when is the Board going to act? The response of the Board has led many shippers and shipper groups to conclude that statutory protections are, except in the most egregious cases of railroad overreaching, a sham, useful only to insulate the railroad industry against antitrust exposure.

III. RAIL-TO-RAIL COMPETITION NEEDS TO INCREASE, EVEN IF SHIPPER BENEFITS ARE UNCERTAIN

This proceeding is an outgrowth of EP 705, Competition in the Railroad Industry, and the NITL comments in that proceeding and its follow-up petition for initiation of a rulemaking proceeding to deal with competitive switching. Simply stated, NITL asserts, and many other shipper groups, including ARC, et al., agree, that access remedies made available by 49 U.S.C. § 11102 have been neutralized due to prior ICC and STB precedents.

In its Decision served July 25, 2012 in this proceeding, the Board summarizes (at pp. 1-2) several potential benefits of the less restrictive approach to Section 11102 of the Act proposed by NITL:

> This proposal has the potential to promote more rail-to-rail competition and reduce the agency's role in regulating the reasonableness of transportation rates. It could permit the agency to reply on competitive market forces to discipline railroad pricing from origin to destination, and regulated only the access price for the first (or last) 30 miles.

However, instead of initiating a proceeding, the Board called on parties to bear the cost of producing empirical evidence detailing impacts on potential beneficiaries, on captive shippers who might be unable to benefit, and on the railroads. This evidence is not sought to support, oppose, or refine a proposal. Rather, the Board will review the evidence and decide what to do next. The next step could be to maintain the status quo, seek additional evidence, issue an advance notice of proposed rulemaking or issue a notice of proposed rulemaking. At worst, there may be no increase in rail competition. At best, there might be some increase in rail competition after many years go by and hundreds of thousands of dollars in legal and consultant charges are incurred.

ARC, et al. are among the shipper groups that have warned the Board not to assume that potential competitive access will be practicable for all shippers, and not to assume that potential competition equals effective competition within the meaning of the statute. Unfortunately, the Board appears to make the mistake of confusing possible access with effective competition rendering rail service non-jurisdictional in the passage quoted above. The ability to shift freight from the original railroad to a potential competitor does not guarantee <u>any</u> reduction in rail rates, much less a reduction in rail rates to reasonable levels.[8]

A more fundamental mistake appears in the Board's apparent concern that more rail competition could be a bad thing. While it is possible to conceive of situations in which compe-

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[8] In any event, PPL sought a version of this approach in Docket No. 41296, <u>Pennsylvania Power & Light Co. v Consolidated Rail Corp.</u>, where CSX and NS competed to bring low sulfur coal to the interchange point with Conrail at the border between Pennsylvania and Maryland, and Conrail delivered the coal to PPL's large generating stations in Pennsylvania. In the <u>Bottleneck Decision</u>, the Board refused to regulate only the Conrail leg, requiring PPL to expand its rate case to include NS and CSX, despite the competition between the two originating railroads. The <u>Bottleneck Decision</u>, too, should be revisited.

tition becomes excessive, leading to price wars, unsafe operations or inadequate investment, these dangers should not head up the Board's list of concerns in this proceeding.

After years of consolidations leading to reduced competition between Class Is, and after years of paper barriers reducing the ability of short lines to compete with Class Is, excessive rail-to-rail competition cannot be a serious concern for the STB. "Inadequate" is a far better descriptor for rail competition today than "excessive". Two railroads dominate rail transportation in the East and two railroads dominate the West. The four largest Class Is control over 94% of U.S. rail traffic.

Moreover, the NITL proposal does not entail universal access, or access on demand; it seeks rather to give effect, for the first time, to the intent of Congress in 49 U.S.C. § 11102. Railroads seeking access can confidently be expected to resist such requests, necessitating recourse to the Board, which would therefore be in a position to rein in, if necessary, any explosion of destructive competition of the kind the railroads might predict in their comments in this proceeding. In fact, as ARC, et al. understand the results of the empirical evidence NITL has gathered, there would be shippers that would gain access to potential competitors, but the overall impact is likely to be modest rather than dramatic.

Equally disturbing in the Board's July 25, 2012 Decision here is the suggestion that competition is to be feared rather than welcomed. As detailed in the opening comments filed April 12, 2011 by the U.S. Department of Agriculture in Ex Parte No. 705, <u>Competition in the Railroad Industry</u>, concentration in the railroad industry has led to significant reductions in rail-to-rail competition for grains, including wheat, barley 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 that should be welcomed, not resisted or delayed.

The Railroads need not fear that the sky will fall with more rail-to-rail competition. 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, concerns that Wall Street will abandon the Railroads in the wake of even the slightest increase in competitive exposure are pure hyperbole. The future of the railroad industry is bright. It is time to protect the shippers from market abuses by allowing increased competition.

More fundamentally, increased competition can have enormous benefits, 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. 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. The Board should consider moving toward a "running rights" approach to competitive switching like the system implemented successfully in Canada. Granting the NITL petition for a rulemaking proceeding would be a good first step.

Arguing that monopoly is preferable to competition is not sustainable in 2013. A policy favoring 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 profit 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.

As discussed further in the next section of these comments, ARC, et al. do not regard competitive switching as a panacea. But if competition among Class I railroads will be insufficient, even if implemented vigorously, to cure all abuses of railroad market power, more competition is nevertheless necessary.

Congress preserved regulatory remedies in the Staggers Act and the ICCTA in order to protect shippers who do not enjoy effective competition. Inherent in that fundamental policy is the need to maximize effective completion. For this reason, and for reasons set forth more extensively in the comments of NITL, et al., the Board should proceed with a rulemaking implementing competitive switching.

IV. ADOPTION OF COMPETITIVE SWITCHING WILL NOT OBVIATE THE NEED FOR STB REGULATORY REMEDIES

As discussed above, ARC, et al. regard competitive switching as a necessary but not sufficient response to the need of captive shippers for protection against abuses of railroad market power. Some shippers may be able to use the threat, or the reality, of access to more than one railroad as a way of obtaining better service and/or lower rates, possibly even obtaining needed rail transportation service at rates producing R/VCs that are at or near the threshold of STB jurisdiction. Some shippers may be able in this way to transition out of captive status and enjoy effective competition by virtue of competitive switching.

However, many shippers, including many members of ARC, et al., have little or no hope of taking advantage of competitive switching. They are too far from a potential competitor to qualify, or cannot offer freight volumes high enough to attract service by a second railroad, even assuming low access fees.

In many regions of the country, and particularly for shippers of agricultural commodities in large Western states that are predominantly 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. Distances are simply so great and individual origin volumes so small that attracting effective competitors for monopoly incumbent railroads is unlikely under any circumstances.

The USDA/DOT Study of Rural Transportation Issues issued in April 2010 helps illustrate the problem. In Chapter 6, at pp. 214-224, maps indicate that crop reporting districts in many Western states have lost the equivalent of 4.25 to 2.58 competing railroads serving grain and oilseed markets. Crop reporting districts with R/VCs from 180-240 increased from 10 in the period 1985-92 to 24 in the period 2003-2007, and significantly higher R/VCs have been calculated on grain rates in areas of the West, including Montana and North Dakota.

The Report also provides inverse Herfindahl-Hirshman Index (HHI) values for crop reporting districts, explaining (p. 217) that an inverse HHI below 1.25 indicates weak rail-to-rail competition with one of two railroads dominant, and figure of 1.00 “indicates a rail monopoly.” In the map on page 221, large swaths of Montana, the Dakotas, Idaho, Washington, Utah, Colorado and Nebraska are depicted as having inverse HHIs of 1.00, and much of the West shows values of 1.00-2.00.

The central premise of the Staggers Rail Act of 1980, which ARC, et al., support, is that where competition is present and effective, much economic regulation may be unnecessary. These principles underlie not just rail deregulation but also deregulation of other industries, and much of American economic policy. Equally important, however, is the proposition that where competition is absent or ineffective, regulatory remedies against abuses of market power must be preserved. It is time for the Board to focus on regulatory remedies against abuses of market power.

Isolated shippers aside, there are also certain to be shippers whose locations and freight volumes qualify them for competitive switching, but who do not thereby enjoy effective competition. Nothing in the competitive switching rules proposed by NITL in the original petition giving rise to this proceeding compels a second railroad that is able to reach the facility of an otherwise captive shipper to do so. Nor is a second railroad offering to transport freight from or to such a facility under any obligation to charge lower rates, or provide better service, than the incumbent. The shipper could simply have the choice of two railroads, both of which impose excessive rates, add new charges, provide poor service, and force the shipper to absorb costs and burdens formerly borne by railroads. It therefore follows that captive shippers will require continued recourse to the Board for regulatory remedies even if current competitive remedies are expanded to include competitive switching.

It is a safe bet that the railroads' comments in the proceeding will not reflect broad, deep or any support for increased rail-to-rail competition. More likely is a call for access fees that guarantee the <u>inability</u> of second railroads to provide effective competition for incumbent railroads that now enjoy market dominance, high rates, high revenues and the freedom to provide poor service quality.

And while it might be hoped that potential competitors, who could see an increase in freight volumes and revenues, would compete vigorously with incumbents, the Board must recognize that the same fear of retaliation that makes some shippers reluctant to challenge market dominant railroads may make potential competing railroads reluctant to compete vigorously.

This concern is particularly acute where the potential competitor is a short line, but there was testimony in Ex Parte No 705, Competition in the Railroad Industry, about a major utility shipping millions of tons of coal annually constructing build outs to a potential Class I competitor of a Class I incumbent. The reported result was a refusal by the second Class I to compete in a sustained way as to price or service with the incumbent Class I. See the comments filed April 12, 2011 in Ex Parte No. 705 by Ameren Corporation.

Ultimately, what captive shippers need from railroads is reasonable service at reasonable rates, consistent with a financially healthy railroad industry. That is also what Congress called for in the Board's governing statute. These goals must be promoted through a combination of competition and regulation. No one wants a return to pervasive regulation, and no one can honestly contend that competition, by itself, is enough, particularly if no distinction is made between the appearance of competition and effective competition optimizing rates and service quality.

V. CONCLUSION

For the foregoing reasons, the Board should find that the evidence being submitted in this proceeding in support of reversing Midtec and adopting other measures to facilitate competitive switching is compelling, and that claims of adverse impacts from more rail-to-rail competition are overblown or specious. The Board should initiate the requested rulemaking proceeding.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this 1st day of March, 2013, caused copies of the foregoing document to be served on all parties of record by first-class mail.

John M. Cutler, Jr.

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