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BEFORE THE UNITED STATES
SURFACE TRANSPORTATION BOARD

STB DOCKET # EP 705

COMPETITION IN THE RAILROAD INDUSTRY

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WRITTEN TESTIMONY OF
Mr. ERIC S. STROHMEYER

VICE PRESIDENT, COO

CNJ RAIL CORPORATION

**WRITTEN TESTIMONY OF
ERIC S. STROHMEYER**

Good Afternoon, My name is Eric S. Strohmeyer. I am the Vice President, and COO of CNJ Rail Corporation, a small NJ based transportation firm. I have been blessed to have been able to have appeared previously before the Board on numerous occasions, and I am grateful to have the opportunity to appear before you again today.

It was my original intent to not participate in this proceeding today. Why? I felt strongly that the positions stated in the American Short-line and Regional Railroad Association's comments were more than adequate to express my principle concerns with the Board's inquiry into the status of competition in the railroad industry. In short, I certainly wish to adopt all the positions they, and the other ASLRRA presenters, took in this proceeding. While I might have gone a tad bit further in talking about the principles they brought to the Board's attention, I felt their stated positions were certainly adequate enough to address all of my concerns.

In addition, I have been heavily involved in some litigation¹ in the US Bankruptcy Court for the District of Maryland in Baltimore, which has taken up a large amount of my time. I have also been preparing our organization for CNJ Rail's return to active railroading, as we are finishing the agreements which will soon lead to a filing of a Petition for Exemption² with this Board for permission to acquire and operate a line of railroad in our home state of New Jersey. In short, I just didn't feel I'd have had the time to really address the issues the Board was seeking comment on.

¹ See *James Riffin, Debtor, Case No. 10-11248-DER (Chapter 7)*

² While not yet filed with the Board, a petition for exemption is expected to be filed in July of 2010. The following docket number was reserved and the petition is currently being prepared:

STB Docket # FD 35527- *Central Railroad Company of New Jersey, LLC - Notice of Exemption - Acquisition and Operation Exemption - Valstir, LLC - In Middlesex and Union Counties, New Jersey.*

So what changed so much that I felt a desire to talk to you directly? As I spent the better portion of this past weekend reading the many pleadings of the various interested parties, I began to notice the arguments breaking into two categories, neither of which seemed to address the concern that I felt the Board really wanted to get to. It wasn't until I read the oral argument exhibit of High-Roads Consulting that my old "shipper's agent" hat started to look really good to wear to this proceeding. In short, I found the point in which I wanted to address with you today.

The two positions

In short, there appears to be two simple positions. The first group appears to advocate for no changes at all in the current regulatory scheme. In various ways, and for various reasons, the first group appears to argue the system is not flawed, and all should be left alone. The second group, appearing to be lead primarily by captive shippers fed up with paying higher rates, who seem to be advocating that the Board undo years of regulatory policies and decisions in order to provide them some relief from what they feel to be excessive / oppressive rates.

For a number of years now, a significant amount of time and effort was put into a concerted push by certain shipper organizations to effect change to the way railroads are regulated by seeking new Congressional legislation. Many of the those same shipper groups are participating in today's hearing. In the later part of the last decade, these groups vigorously lobbied Congress for change. The American Association of Railroads (AAR) and others vigorously lobbied against the proposed changes. Legislation actually got introduced that might have led to changes. However, that legislation never got passed.

When Congress failed to act

In 2010, the voters in the country appeared to have signaled they wanted change in Washington. The election that year produced the current Congress, with both houses split, Republicans controlling the House, and Democrats controlling the Senate.

What is the correlation between the election and this proceeding?

It appears to CNJ that any hope of railroad regulatory reform (or re-regulation, as the AAR would have all believe) would appear to be incapable of getting approved in one house, or the other. The result? A stalemate, for lack of a better word, between those that want re-regulation, and those that don't. This Board, appearing to react to the potential impasse, appears to be investigating ways that the Board itself, if possible, might be able to address certain matters that the previous Congress was thinking about, but failed to act upon, before the 2010 elections.

Prior to 2010, legislation which was previously contemplated, appeared to possibly alter the regulatory framework for dealing with railroad rate and other competitive access issues. Advocates for railroad regulatory reform were lead primarily by former House member - the Honorable James Oberstar (D-MN), and the Honorable Sen. John Rockefeller (D-WVa), in the Senate. The Board appears to be analyzing whether or not it can effect some of those changes previously contemplated by Congress. In certain circumstances it may very well be able to do so. However, I do feel the executive branch should not legislate, just as I feel the legislative branch should not administer the day to day operations of the country. I would simply ask that the Board clarify its motives and refrain from attempting to legislate.

I would simply like to point out to the Board that I do believe this agency can, in fact, do a lot more than it does within the current regulatory scheme. While I applaud the current policy of reviewing Board policies, I want to make sure the Board does not react to the wrong problem. In short, any change, especially those made in a vacuum, can produce unintended results which can be disastrous. At this point, the changes being proffered, if acted upon, would be disastrous to the rail industry.

In looking at the specific questions that the Board posed in its request for comments in this proceeding, it appears that the Board is also contemplating implementing a few of the changes suggested in the Board's recent study produced by the Christensen Associates, Inc. While those changes appear small, they can be truly devastating to small railroads if implemented haphazardly and without regard to real market power abuses. There is also doubt that those same changes would produce better results for shippers when the two carriers involved are both Class 1 carriers.

What CNJ Rail believes to be the real issue that the Board should be addressing at this time is not competition in the rail industry, but rather performing an adequate study and analysis of the **market power of Class 1 rail carriers**. In short, as stated by the ASLRRRA, the small carriers have no market power what so ever. There are many ways to reduce and curtail any market power a small carrier may have. However, the same can not be said for today's Class 1 railroads. Class 1 railroad's today, may in fact, have no real competition effectively able to curtail the railroad's market power. In addition, very few competing modes have the ability to compete with the railroads in many areas and for certain commodities there is no road, but the railroad.

What is the "true" market power of today's Class 1 railroads?

The stated purpose of this proceeding is to analyze competition in the railroad industry. This concept is a noble goal, but it may not be possible to ever achieve true "competition" in the rail industry. Consolidation in the rail industry has reduced the number of Class 1 carriers to just 7 carriers in total. Two carriers, Union Pacific, and BNSF Railway, cover two thirds of the nation with their respective rail properties. It would be virtually absurd to believe a third Class 1 carrier could ever be constructed from scratch to compete effectively with either of the western carriers. Trying to thread a new carrier through the east would also be extraordinarily difficult as well. With fuel costs rising, and numerous recent changes to Federal regulations regarding the trucking industry, there can be no doubt that the ability to curtail and restrain the market power

of Class 1 railroads by competition alone grows dimmer by the minute.

One person, who ironically was in a position to do something about the state of competition in the rail industry, produced one of the most blistering public commentaries on the idea of "competition" in the rail industry this presenter can recall hearing. Stating his belief that the idea of competition in the rail industry was the equivalent of "indulging in legal fiction", then STB commissioner W. Douglas Buttrey's commentary at the public hearing marking the completion of the Christensen study was actually quite surprising. Since the opening remarks from that hearing encompass 5 pages, I have included a copy of the transcript of his remarks, in its entirety, because I feel they do reflect the current state of competition, or lack thereof, in the rail industry. (See Exhibit #1)

While the Christensen study was truly comprehensive, its purported focus was on the state of competition in the rail industry. I felt the study lacked enough statistical data however to lead this Board toward reaching a complete understanding of the strength of the Class 1 railroads market power that exists today. While the Board seems to be toying with the idea of implementing some of the minor changes suggested in the report, I would like to direct the Board's attention to the following areas of the study I feel need to be addressed first, before trying to levy disastrous new regulations on the railroad industry.

The Christensen Study

This Board is certainly well aware of the findings and conclusions the study makes. I just wanted to point out a couple of critical points it made that seemed to have gotten lost in this proceeding. While I do admit I was not the best student of mathematics in school, I certainly was able to understand the implications of this one finding. The study found :

The ratio of revenue to URCS variable cost (R/VC) is weakly correlated with market structure factors that affect shipper

“captivity,” and is not a reliable indicator of market dominance. (Emphasis added)

I am not going to profess here today I understand completely just how URCS works. I will admit I have publicly referred to URCS as “voo-doo mathematics” for the Class 1 railroads. However, I’m not so ignorant that I do understand that this agency, as well as the ICC before it, relies very heavily on URCS in analyzing a wide variety of critical commercial transactions which are necessary to protect the shipping public from abuse, as well as other critical computations needed to administer proper oversight of the nation’s rail network. In short, its very important. Having said that, when a study, commissioned by this Board, finds that a portion of the URCS formula **“is not a reliable indicator of market dominance”**, it catches my attention.

In addition, one Board member, ever since he was appointed to this Board, has repeatedly, for well over five plus years, stated his belief that URCS needed to be updated. Commissioner Mulvey has long appeared to have been the only champion of that cause on this Board. There can be no doubt of the importance of URCS to this Board. It is a critical component to many functions the Board undertakes in order to determine critical market power issues. All of this leads into my next question :

How can the Board start making changes to the competitive landscape without fully addressing completely, the issue of market power first?

In short, I can’t help but feel that we may in fact be putting the cart before the horse if we start making changes to the competitive landscape without addressing the market power questions first. The Christensen study , recalling an earlier GAO report made the following statement in its executive summary I thought was interesting. It said :

While the GAO posed the question of whether recent

performance of the U.S. freight railroad industry is indicative of “a possible abuse of market power,” our analysis provides evidence on whether there has been a change in the exercise of market power by U.S. railroads. By definition, the setting of price above marginal cost is what economists consider to be an exercise of market power, **but exercise does not imply abuse.** To address the question of whether there has been an “abuse of market power” would require **judgments as to the fairness of the distribution of value between the railroads and the shippers,** and on the distribution of the overhead cost collection among the shippers. **These judgments are policy questions and not resolvable through economic analysis alone.** Instead, we have answered the economic questions of the extent to which recent railroad pricing behavior reflects changing cost conditions, and the extent to which it represents an increase in the overall exercise of market power. Furthermore, our analysis sheds light on how recent railroad pricing behavior has shifted the burden of overhead cost collection among the different sets of shippers. (Emphasis added)

It would appear to this mathematically challenged individual that market power determinations may in fact be subjective, more than analytical, and would therefore require a lot more input into determining what appropriate balance might need to be struck between the competing sides. In addition, where issues become more subjective, it might be appropriate to consider such issues on a case by case basis. However, there is a significant downside to that approach. Without developing first a clearly stated policy for dealing with market power issues, future decisions of this Board could become quite arbitrary and capricious. In short, relief could be granted in one place, and not in another, yet the facts may be virtually identical. Add in the whims and politics of Washington DC and there can be no doubt that any changes, without a clear policy, will be fodder for legal challenges for years to come.

Without addressing the policy questions of how to address market power issues first, any changes made today to enhance competition, however minor, just are not appropriate at this time. In addition, if a critical tool (URCS) this Board uses is found not to be adequate enough to determine market dominance, how can the Board determine if a competitive remedy is even necessary with any degree of assurance?

It's not a lack of competition, it's the early signs of abuse of market power

As I mentioned earlier in my testimony, I was not planning on participating in today's hearing. However, as I read the various pleadings of both High Roads Consulting and the Wisconsin Central Group, I couldn't help but notice the issues they were raising. They refer to it as a lack of interest in "competing" for business. Their issues are not competition issues. They are market access and market power issues. It is those very issues that this Board must be vigilant in recognizing and remedying. I am seeing a lot more of these issues being raised in a larger number of pleadings before this Board .

I have seen for myself Class 1 railroads intentionally raising prices to push certain traffic out of the marketplace. For short-lines, the single carload shipper is their bread and butter. They have long enjoyed this traffic. It is essential for them to maintain this traffic. Yet, they watch the traffic they fought so hard to capture return back to trucks because the Class 1 carriers have made a number of strategic decisions to pursue other opportunities and forgo this traffic. This is beginning to lead to shipper resentment. Even the larger shippers are feeling these issues with the Class 1's.

I want to re-emphasize this point. These issues are not competition related issues. Its **MARKET POWER** driven. For many shippers, they appear to be misinterpreting the Class 1's refusal to handle their traffic as a competition issue. IT IS NOT. It is an abuse of market power and on this issue, the Board needs to be quite clear.

I absolutely urge the Board to make the following statement to all the Class 1 carrier's. Instruct them to **HANDLE ALL THE TRAFFIC** reasonably presented to them and stop playing games. It is my opinion that 99.9% of all the issues related to railroad re-regulation will disappear the minute the Class I carrier's either fully recommit themselves to handling loose car freight or this Board swiftly moves to punish those carriers that do not fulfill their common carrier obligations to move such freight.

In addition, I do want to urge the ASLRRA to wake up and take a stronger stand against the Class 1's when it comes to allowing the Class 1's to continually run off their members bread and butter traffic. We, the small railroad industry are small ourselves. We do a great job serving the small market shipper. The more small shippers start complaining to Congress about the Class 1's refusal to handle their traffic, the more likely disastrous re-regulation will occur. I can appreciate my fellow short line companies desire to work with their Class 1 partners, but there comes a point in time when you have to put your foot down and question the wisdom of certain decisions of the Class 1's, especially when they turn you into a one or two customer railroad because they, the Class 1's, only want to deal with your largest customers and the rest be dammed.

Course of action the Board should take

It is the opinion of this presenter today that before the Board considers any changes to enhance competition, it should first adequately study, and determine the extent and form of the Class 1 carriers market power. Reiterating the question asked earlier, how can the Board say that changes to competition need to be made, without first determining the scope and extent of the Class 1 carrier's market power?

It should be fairly obvious that today's Class 1 railroad's indeed have tremendous market power. It is also fairly obvious today that motor carrier transportation is experiencing considerable upward pressure on their costs. Waterway transportation service options are only

available in certain parts of the country. Air transportation is not a viable option for many shippers. As a result, there can be no doubt that today's Class 1 railroads' market power is considerable. Interestingly, it was recently brought to the Board's attention in a couple of high profile abandonment cases that a couple of Class 2 rail carrier's may in fact have some limited market power as well. However the vast majority of small railroads have no market power what so ever.

While some of the shippers today have made a number of compelling cases that there are issues in the rail industry, a fairly large number of them are really complaining about abuses of market power, not necessarily a lack of adequate competition. Many of the shipper respondents seem to be directly pointing a finger at the Class 1 railroads. It is my hope, that this Board decides not to implement those minor little changes proposed in the Christensen study, but rather decides to tackle the tough job of determining the extent and scope of the Class 1 carrier's true market power. Only then can a true dialogue about competition and rate relief be had with all the stake holders.

I thank the Board for the opportunity to speak with you today.

On Behalf of CNJ Rail Corporation

Respectfully Submitted by

Eric S. Strohmeyer

Eric S. Strohmeyer
Vice President, COO
CNJ Rail Corporation
Dated: June 21st, 2011

Written Testimony of

Eric S. Strohmeyer

STB Docket # EP 705

Competition in the Railroad Industry

EXHIBIT # 1

U.S. DEPARTMENT OF TRANSPORTATION

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SURFACE TRANSPORTATION BOARD

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STUDY OF COMPETITION IN THE
FREIGHT RAILROAD INDUSTRY

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PUBLIC MEETING

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THURSDAY,
NOVEMBER 6, 2008

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The meeting was convened in the first floor hearing room at 395 E Street, SW, Washington, D.C. at 10:00 a.m., Charles Nottingham, Chair, presiding.

SURFACE TRANSPORTATION MEMBERS PRESENT:

CHARLES NOTTINGHAM, Chairman
FRANCIS MULVEY, Vice Chairman
W. DOUGLAS BUTTREY, Commissioner

PANELISTS:

MARK MEITZEN, Christensen Associates, Inc.
KELLY EAKIN, Christensen Associates, Inc.

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(202) 234-4433

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Adjourn	

1 to replicate what you've done and check it can do
2 so. Everything is laid out, including all the
3 econometric methodologies of how things were
4 done, and the results. It's just a first class
5 piece of work, so I want to thank you.

6 And with that, I'll turn it back over
7 to you, Mr. Chairman.

8 CHAIRMAN NOTTINGHAM: Commissioner
9 Buttrey.

10 COMMISSIONER BUTTREY: Thank you, Mr.
11 Chairman. Good morning, everyone. The long
12 awaited Christensen Association study competition
13 of the freight rail industry is on the street and
14 I might add that it's so popular it's also
15 available in DVD already, so you can it get it
16 either way.

17 Those working on the study should be
18 commended for documenting an impressive number of
19 interview responses and producing some very
20 interesting graphic presentations. While I had
21 no input into the study, I have read the
22 Executive Summary and appreciate the effort that

1 went into its completion. In fact, I think it is
2 quite remarkable.

3 With this in mind and while I have a
4 somewhat captive audience, I thought I might
5 share some purely personal thoughts about the
6 presumed subject of the study. In my humble
7 opinion, the thought of a study conducted to look
8 into the state of competition in the freight rail
9 industry strikes me as almost humorous.

10 Now, why is that you say? Because in
11 my view to say that there is or is likely to be
12 competition, real classical competition in the
13 freight rail industry, is to indulge in a legal
14 fiction. The fact is that freight rail has
15 become so efficient that it has virtually no
16 effective competition.

17 So we're presuming to study something
18 that essentially in my view doesn't exist. Only
19 in Washington would we be studying something that
20 does not exist. This is one of the reasons why
21 the Christensen study is so remarkable to me.

22 We actually have before us a document

1 whose unstudied conclusion is that the subject of
2 the study does not exist. Are we in New Mexico?
3 The basic conclusions I have drawn from the study
4 are three.

5 That competition in the classical
6 sense does not exist in the current freight rail
7 industry and when there is market dominance there
8 is the potential for misbehavior in the
9 marketplace. And when there is misbehavior there
10 should be an accessible process to address that
11 misbehavior.

12 That process resides here at the
13 Surface Transportation Board. In a perfect
14 world, there would be no need for the STB, but we
15 do not live in a perfect world. And as the
16 Austrian economists, often quoted economist,
17 Joseph Schumpeter, warned, "There is always the
18 temptation for monopolies to act like
19 monopolies."

20 So what is monopolistic behavior?
21 Mr. Justice Potter Stewart was once asked,
22 "What's hard core pornography?" He responded by

1 saying, "Well, it's hard to define, but I know it
2 when I see it."

3 So when is monopolistic behavior in
4 the rail industry? Well, there are a lot of
5 folks running around town who say they know what
6 it is and they've seen it and someone needs to
7 stomp it out before it spreads, like Smokey Bear
8 stomping out a forest fire.

9 But they have another name for it and
10 that name is "profit," but profit is not a bad
11 word. How much profit is enough? How much
12 capital investment is enough? How much in
13 dividends is enough? How many dedicated railcars
14 is enough? How much liability limitation is
15 enough? How many customers on the line is
16 enough? How much coal or grain or intermodal
17 traffic is enough?

18 Do we really want the Congress
19 answering these questions? I don't think so. I
20 think a lot of folks are asking the wrong
21 question. The question is not how do we get more
22 competition, it's how do we get more

1 infrastructure and more efficiency where we need
2 it and thereby get better results for everyone?

3 So how do we get better results?

4 Well, one answer is this. We have a process at
5 the Surface Transportation Board where applicants
6 can come in and get authority to build a new rail
7 line to compete with existing rail line.

8 And I can assure you that any entity
9 that avails itself of that process will get a
10 fair hearing. That is not pie in the sky. It is
11 reality evidenced by recent Board actions.

12 The regulatory barriers to entry are
13 minimal and there are not regulated rates of
14 return like those in other regulated industries.
15 Is that a feasible answer to the lack of
16 competition in the freight rail industry?
17 Perhaps, although the cost is high.

18 Short of that, I would suggest that
19 the parties who feel they are aggrieved by
20 monopolistic behavior, that is market dominate
21 behavior, would be much better off working
22 together with their rail partners for the common

1 good rather than conducting guerilla warfare,
2 which is just dilutes everyone's financial
3 resources and energy.

4 But, of course, the problem is that
5 the rail competition issue has been very good
6 business for lobbyists. The patient never dies
7 and it never gets well. On the other hand, I'm
8 beginning to sound like an economist, there is a
9 process in place at the STB.

10 It is being used and it is working.
11 If you are a shipper that has problems with your
12 rail provider that cannot be worked out through
13 private negotiations, come see us. Of course, if
14 you are happier spending your hard earned money
15 to hire lobbyists to run around pursuing remedies
16 which have virtually no hope of being
17 implemented, go for it.

18 But if you have the courage of your
19 convictions, which means to me that you actually
20 have an evidentiary case, then file it. In the
21 meantime, we have yet another study. Thank you,
22 Mr. Chairman.