

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 705

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**ENTERED
Office of Proceedings**

COMPETITION IN THE RAILROAD INDUSTRY

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Comments of

The Fertilizer Institute

The Fertilizer Institute ("TFI") hereby submits these Comments in response to the Board's Notice in this proceeding served on January 11, 2011 ("Notice"), as modified by decision served on February 4, 2011. In the Notice, the Board requested comments on the current state of competition in the railroad industry and possible policy alternatives to facilitate more competition, where appropriate. The Notice, at page 5, broadly describes this proceeding as "a public forum to discuss access and competition in the rail industry, and with a view to what, if any, measures the Board can and should consider to modify its competitive access rules and policies; whether such modification would be appropriate given changes over the last 30 years in the transportation and shipping industries; the effects on rates and service these rules and policies have had; and the likely effects on rates and service of changes to these policies." Within that rubric, the Board has asked parties to focus their comments on multiple topics covering (1) the financial state of the rail industry; (2) alternative through routes; (3) terminal access; (4) reciprocal switching; (5) bottleneck rates; (6) access pricing standards; and (7) the impacts of any proposed change upon the rail industry, the shipper community, and the economy as a whole.

TFI is one of several organizations that, in addition to filing individually, are commenting jointly in this proceeding as the "Interested Parties." The Interested Parties' Comments describe

the strong financial state of the rail industry today; how and why changes in rail competition, along with the strengthened financial condition of the rail industry, warrant the adoption of new policies for the enhancement of rail competition; the Board's authority to adopt new policies; and the beneficial effects that such policies would have upon the U.S. economy. TFI incorporates those Joint Comments by reference rather than repeat them herein. These comments supplement the Interested Parties' Comments by addressing the issues in the Notice from the perspective of TFI member companies.

I. Statement of Interest.

TFI is the national trade association of the fertilizer industry. TFI, which traces its roots back to 1883, represents virtually every primary plant food producer, as well as secondary and micronutrient manufacturers, fertilizer distributors and retail dealerships, equipment suppliers and engineering construction firms, brokers and traders, and a wide variety of other companies and individuals involved in agriculture. Many members of TFI rely heavily upon rail

transportation. They have witnessed the changing state of competition in the rail industry and experienced its effects first-hand. As such, they are well-positioned to describe both the changes and impacts to the Board, and to suggest ways to facilitate greater competition.

II. Changes in Rail Competition.

Over the past 30 years, and particularly in the 1990's, the rail industry consolidated to the point of creating regional duopolies throughout the United States. Union Pacific ("UP") and BNSF Railway ("BNSF") dominate rail transportation in the west; Norfolk Southern ("NS") and CSX Transportation ("CSXT") dominate rail transportation in the east; the Canadian National ("CN") extends down the center of the country; and the Canadian Pacific ("CP") extends south

into the plains States. The premise of these mergers was that the consolidated carriers would be more efficient, financially stronger, and more competitive.

While these mergers may have created efficiencies for the railroads and vastly improved their financial condition, these have come at a substantial cost to competition. Starting just a few years after the division of Conrail by NS and CSXT, railroads began raising rates significantly, and have continued to do so through this nation's greatest economic downturn since the Great Depression, even while every other mode of transportation reduced rates. Whatever efficiencies the mergers had produced clearly were not being shared with customers.

The so-called "railroad pricing renaissance" has hit both captive and competitive shippers alike, although rate increases have been greater for captive traffic. For example, in just the past three years, one shipper of phosphates by unit train has seen its rates at a captive facility increase by 29.4%, while rates at another facility also owned by this shipper with both direct rail and barge options have risen only 8.2% over the same time frame.

As indicated in the attached Exhibit A, phosphate shippers, overall, have experienced rate increases of 60% from 2006-2010 for highly-efficient unit train shipments in railroad-owned cars, and a 61% increase in private cars. During this same period, the Consumer Price Index rose by only 6%. In other words, rail rates rose ten times faster than the rate of inflation.

As indicated in the attached Exhibit B, a similar trend has occurred for unit trains of wheat, corn, and soybeans. Over a six year period from 2003-2009, rates (excluding fuel surcharges) rose by 45%. The major rate spike for wheat occurred in 2005 and rates have steadily risen since then. The major spike for corn and soybeans occurred in 2006, and those rates too have risen steadily since then.

A TFI member that ships urea, UAN, phosphates and anhydrous ammonia by rail has analyzed its rail rate increases over several key lanes for these commodities and compared those increases to changes in various cost indices. From 2004-2011, rail rates for urea increased by 114%, contrasted with changes over that same time period of 37% in the RCAF-U and 27% in the Producer Price Index ("PPI"). In key lanes for both UAN and phosphates, rail rates increased by 102% from 2004-2011. For anhydrous ammonia, the increases have been just as pronounced, but over a shorter time frame. This ability of railroads to increase rates at a pace several times greater than their costs have increased, while also increasing their traffic volumes, strongly suggests the exercise of substantial market power.

The fact that competitive shippers also are experiencing large rate increases is a particularly troubling sign. It calls into question a key assumption underlying the Board's prior merger approvals, which is that two rail carriers would aggressively compete with one another.

As early as the UP/SP merger, the Antitrust Division of the U.S. Department of Justice

challenged that assumption, but the Board chose not to heed DOJ's concerns over the ease with which just two competitors can engage in conscious parallelism, which is the unspoken imitation by a business of a competitor's action, such as changing prices up or down, without an active conspiracy between the business rivals. The same action that, when taken pursuant to an active conspiracy, would be a violation of the antitrust laws, is not unlawful when an active conspiracy is rendered unnecessary due to a very small number of competitors.

Over the years, railroads have unbundled charges and services in a way that demonstrates that rates have in fact risen even more than is revealed by examining just the line-haul rates. Many services that the railroads once performed as part of their line-haul are either billed separately today or are now performed by the shipper at its expense. For example, UP requires

some TFI members to pre-classify cars at their own facilities by destination so it is easier for UP's yard crews to assign the cars to outbound trains. In some cases, routing protocols have increased transit times, which requires shippers to invest in more rail cars to handle the same volume of traffic. Some carriers require that shippers submit rate disputes on-line, but they do not inform the shipper when the claim has been resolved or whether the claim has been granted or denied; rather, the shipper must maintain the claim for the carrier by continually checking the status of its claim on-line. All of these changes shift costs to the shipper that are above and beyond rail rate increases.

Intermodal competition has only been of limited effectiveness as a constraint on rail rates. Those TFI members with access to barge transportation have had the most success. However, barges have significant limits as to where they can serve, because rivers do not reach everywhere, and when barges are an option, because certain parts of the inland waterways shut down in the winter and locks frequently are closed for repairs. Trucks are an inherently higher cost alternative than rail and are not very practical for high volume lanes. Moreover, as fuel costs increase, trucks become even less efficient and competitive. New truck driver hours of service rules will only aggravate the situation by creating driver shortages. The effectiveness of truck competition also is highly dependent upon distance and volumes. As all of these factors reduce the already limited competitiveness of trucks, railroads will have even more room to continue raising their rates, unless greater competition among railroads themselves can be created.

By their pricing decisions, railroads also are dictating the markets that TFI members can reach with their commodities. For example, Gulf Coast export markets effectively have been closed to grain produced in Nebraska and the Dakotas because the railroads, through their rates,

have forced this grain towards the Pacific Northwest. In essence, the railroads are placing their thumbs on the scales of the grain markets to favor certain markets over others. This skews the ability of grain producers to compete globally and artificially distorts global markets.

While the most evident changes wrought by reduced rail competition are front and center in rate increases, there also have been significant non-rate impacts. TFI members have experienced service reductions in the form of less frequent switching, even at high volume facilities. When bunching of cars occurs due to inconsistent railroad service, the railroads still will assess demurrage against a destination receiver that is not equipped to unload all the cars within the allotted time after they are constructively placed. TFI members that once had service commitments in their contracts can no longer get them. Contract terms have become much shorter, even at competitive locations, as railroads place greater value on their ability to increase rates more quickly than upon securing volume commitments for extended time periods. Even with these shorter contract terms, it is common for contracts also to have a 30-day cancellation

clause, which renders contracts of little more value to a shipper than a tariff. Railroads consistently cancel rates that have not been used in 12 months, even though the nature of many businesses is that a customer can be won and lost from one year to the next. When that rail rate is needed in order to regain the business, the railroad frequently does not respond in a timely manner, which causes the opportunity to be lost. Any railroad that has such confidence in its ability to continually increase rates while reducing service commitments is displaying confidence in its own market power.

So much of the focus on competition has been upon the degree of rail competition at origins where commodities are produced, because that is where so much of the volume is concentrated. But competition at the destination, or customer, is of equal importance. Some TFI

members are among the fortunate few that have rail-to-rail competition at their origin facilities. But even they notice significant rail rate differences between shipping to competitive destinations versus captive destinations.

In addition, reductions in competition are evident due to railroad mergers that had no direct impact upon TFI member origin production facilities. For example, the merger of Burlington Northern ("BN") with the Atchison, Topeka and Santa Fe ("ATSF") had consequences for TFI members whose production facilities are predominantly located on the UP. When shipping to customers on the BN prior to its merger with the ATSF, BN would quote higher through rates to destinations that it served, in order to protect its business with other TFI members located on BN's lines (thus preserving a longer single line haul for BN). However, the UP-served TFI members could be very competitive on a delivered price basis to customers on the ATSF, because the ATSF did not have production facilities on its lines to protect from competition. When BN and ATSF merged to create BNSF, the protectionist incentives of the BN were extended to ATSF destinations, and thereafter those destinations also were effectively closed to UP-served TFI members. These same anti-competitive incentives occurred with almost every major merger. The result has been a *de facto* division of the markets for rail transportation of certain commodities by those carriers with significant production capacity on their lines.

In summation, TFI members began to experience the effects of reduced rail competition shortly after each major rail merger. Much of the early effects were in the form of reduced access to markets served by the merged carriers and a gradual shifting of costs from the railroads to their customers. The full brunt of anti-competitive effects, however, appeared within just a few years after the last major merger that divided Conrail between NS and CSXT. That is when rates began increasing substantially across the board for both captive and competitive rail traffic,

contract terms were dramatically shortened, and service commitments all but disappeared. Also, railroads began to use routing protocols much more pervasively to force shippers out of some markets for their goods and into others. In other words, not only have railroads gained market power through reduced competition, but they also have used that market power in a way that renders their customers, such as TFI members, less competitive in their own markets.

III. Policies to Enhance Rail Competition.

Substantial reductions in rail competition over the past twenty years, coupled with inadequate intermodal competitive constraints, establishes a clear need for policy alternatives to enhance rail-to-rail competition. As the Interested Parties have demonstrated in their comments, the Board already has the tools it needs to adopt such policy alternatives. It merely needs to reconsider and re-evaluate past decisions that either declined to use those tools or severely constrained their utility. For TFI members, the most valuable tools would be reciprocal switching and bottleneck rates.

A. Reciprocal Switching.

It is time for the Board to revisit and revamp its competitive access rules for reciprocal switching. Although the statutory standard for reciprocal switching is where the Board “finds such agreements to be practicable and in the public interest, or where such agreements are necessary to provide competitive rail service,” 49 U.S.C. 11102(c)(1), the Board has layered additional standards on top that require shippers to also prove either competitive abuse or inefficient rail service. *Midtec Paper Corp. v. Chicago and North Western Transp. Co.*, 3 I.C.C.2d 171 (1986) (“*Midtec*”), *aff’d Midtec Paper Corp. v. U.S.*, 857 F. 2d 1487 (D.C. Cir. 1988).

The *Midtec* standards have proven so difficult to meet that shippers simply gave up even trying to do so over twenty years ago. The competitive abuse standard is comparable to an antitrust showing. But with so few Class I rail carriers remaining in this country, the rail industry can effectively foreclose rail competition through conscious parallelism without engaging in the types of anti-competitive activities needed to satisfy *Midtec*. Moreover, carrier inefficiencies rarely are so long-term and detrimental as to warrant relief under the *Midtec* standard. For near-term problems, the Board has emergency service rules that provide a different standard to address such matters. See 49 C.F.R. Parts 1146 and 1147.

When Congress enacted Section 11102(c)(1) as part of the Staggers Act, it specifically noted that reciprocal switching was “included to foster greater competition.” H.R. Rep. No. 96-1430, 96th Cong. 2d Sess., p. 80. The intent of this provision was “to permit and encourage reciprocal switching as a way to encourage greater competition.” H.R. Rep. No. 96-1035, 96th Cong. 2d Sess, p. 67. The *Midtec* decision, by contrast, has turned reciprocal switching into a provision to be invoked only in the rarest and most exceptional circumstances. The Board needs to recognize that, whatever the merits of *Midtec* 25 years ago, those standards are not appropriate today and should be relaxed in order to fulfill Congressional intent.

Reciprocal switching has the potential to reverse the loss of rail competition over the past two decades. Not only can it create two-carrier competition at production facility origins, it also can open new markets at destinations that are currently closed due to rail pricing.

It is important for the Board to keep in mind that true rail competition can only occur if both the origin and destination have competitive options. For example, even if a shipper served by Railroad A at the origin can access Railroad B via reciprocal switching, that will not make any difference if the destination remains captive to Railroad A. Therefore, in order to make a

substantial difference in rail competition, the Board needs to adopt a standard that will enable shippers to obtain reciprocal switching at a sufficiently broad array of locations.

The potential for greater competition through reciprocal switching can be illustrated by a simple example. Assume that the origin is captive to Railroad A and the destination is captive to Railroad B, but that both railroads operate within the terminal areas of the origin and destination. In the absence of reciprocal switching, Railroad A, as the origin carrier, is entitled to its long-haul, and thus will transport the traffic almost the entire distance to the destination. *See* 49 U.S.C. 10705(a)(2). With reciprocal switching at both ends, however, both Railroads are able to compete to handle the entire transportation. Because in a competitive environment the more efficient carrier is likely to earn the business, this places competitive pressure on both carriers to operate more efficiently that does not exist today for rail service to captive customers.

Even if reciprocal switching creates two-carrier competition at both the origin and destination, however, TFI members are concerned that conscious parallelism may mean that that the carriers will not truly compete because the rail industry has become so consolidated. But that is not a sufficient reason for the Board not to try. Indeed, it suggests that the Board should implement multiple measures to broadly enhance rail competition so that there are simply too many competitive locations for conscious parallelism to work effectively.

The Board, however, cannot simply stop at the creation of reciprocal switching; it must ensure that the switch rates are reasonable. There are terminals with reciprocal switching today that are effectively closed because the rates have become too high. In the 1990's, grain products had a nearly universal switching fee of just over \$100 per car. Today, those fees are \$500-600 per car. The Board also should consider different switch fees based upon whether the railroad is switching a single car, multiple cars, or unit trains. Because reciprocal switching is for relatively

short distances, a switch fee set at 180% R/VC offers a simple and fair measure of a reasonable charge. At the very least, switch fees should not be any greater than what the railroads themselves charge each under their various voluntary arrangements for handling another railroad's cars.

The most effective form of reciprocal switching would be to adopt a system that closely resembles Canadian inter-switching. That system automatically grants reciprocal switching access to any carrier within a 30 kilometer radius and prescribes a tiered flat rate system based upon average railroad costs across their entire rail system. Several TFI members have facilities in Canada that benefit from inter-switching. They unequivocally report positive experiences in Canada where they believe that inter-switching has enabled them to compete more effectively, and has made their Canadian facilities more competitive than their captive U.S. facilities. Just as importantly, the sky has not fallen upon the Canadian railroads as a consequence of inter-switching. Rather, they have thrived in that environment and are just as financially healthy as the U.S. carriers, if not more so.

The Board should keep these facts in mind when it weighs railroad opposition to reciprocal switching as a throw-back to regulation that would destroy the "fragile" progress that the U.S. rail industry has made towards revenue adequacy. Reciprocal switching means less, not more, regulation because it will allow competition to set rates that otherwise would be subject to regulation due to a lack of effective competition. The only rates that the Board would need to oversee are the switch rates at the origin and destination, which is far less intrusive and less complex than regulating rates over the entire route. Competition has helped other monopoly industries with high capital costs to thrive and it can do the same for the rail industry. Just as

importantly, rail competition can help American businesses to thrive by throwing off the shackles of railroad captivity.

B. Bottleneck Rates.

Bottleneck rates are another means by which the Board can foster greater rail competition. Indeed, one way to view a bottleneck is as a long distance reciprocal switch. The Board's current policy that permits railroads to refuse to quote bottleneck neck rates actually prevents shippers from reaping the benefits of competition where it in fact already exists. This isn't competition that the Board needs to create; it is competition that the Board simply needs to unlock.

Specifically, many shippers are captive to a single railroad for only small portions of the entire transportation route at either the origin, destination, or both. For the vast majority of the route beyond those origin and destination bottlenecks, captive shippers actually have a choice of rail carriers. In order to exercise that choice, however, a shipper must have a rate from the bottleneck carrier(s) for transportation over just the bottleneck segment(s). But, in the "Bottleneck Decisions," the Board artificially suppressed that existing competition by permitting bottleneck carriers to refuse to quote bottleneck rates.¹ By simply reversing the "Bottleneck Decisions," the Board could allow existing rail competition to work the way that was intended.

Of course, even if a shipper can obtain bottleneck rates, the competitive benefits will not flow through if the bottleneck rate itself is unreasonably high. Therefore, shippers need the ability to challenge unreasonably high bottleneck rates. The Board's current rail rate reasonableness procedures would apply to such challenges under the current statute. Therefore,

¹ *Central Power & Light Co. v. Union Pacific R.R. Co.*, Nos. 41242 et al., 1996 STB LEXIS 358 (served Dec. 31, 1996), clarified 1997 STB LEXIS 91 (served May 1, 1997), aff'd in part, *MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8th Cir. 1999).

if the rail carrier possesses market dominance over “the transportation to which a [bottleneck] rate applies,” 49 U.S.C. 10707(a), the Board may determine the reasonableness of that rate pursuant to either *Coal Rate Guidelines, Nationwide*, 1 I.C.C. 2d 520 (1985), or *Simplified Standards for Rail Rate Cases*.

Bottleneck rates would be particularly beneficial where competition already exists at either the origin or the destination, and the other end is not eligible for reciprocal switching (e.g. outside a terminal area). For example, a shipper facility that has two carrier competition probably ships to destinations that are mostly captive, but only for a short distance relative to the total length of haul (e.g. 100 miles of a 1000 mile haul). If Railroad A serves both the origin and destination, under current Board precedent, it is entitled to the entire haul. A bottleneck rate at the destination, however, would permit Railroad B to haul the traffic to an interchange with Railroad A near the destination for final delivery.

Bottleneck rates can also be beneficial when both the origin and destination are captive to different railroads. For example, a TFI member that is captive to UP in Louisiana ships to a customer on NS in Indiana. Under existing routing protocols, UP interchanges the traffic with NS at East St. Louis, IL. However, if UP were to interchange this traffic with NS at New Orleans, the NS might provide a better rate for this long-haul than UP currently offers, particularly if the NS route is more efficient. Currently, however, this is not even an option because UP knows that, as the origin carrier, it is entitled to its long-haul. Therefore, the Board would have to change its policy and require UP to publish a bottleneck rate to the already existing New Orleans gateway that the TFI member can separately challenge if the rate is unreasonable. In this manner, the Board can enhance rail competition without any form of competitive access (e.g. trackage rights, reciprocal switching).

C. Rate Reasonableness Policies.

A third policy modification that is often overlooked as a means to create competition is how the Board determines reasonable rates for captive traffic. As noted above, bottleneck rates alone could simplify large rate cases, thereby making them more accessible to a broader array of shippers. However, large cases still would only make economic sense to shippers that transport large volumes over the bottleneck segments. Therefore, it is equally important to revisit the Board's small and medium rate case methodologies.

The principal deficiencies in the small and medium case methodologies are the relief caps. From the outset, shippers argued that the caps were set way too low. The cost of litigation consumes too large a share of the potential relief available under the cap. In order to ensure that it receives the maximum recovery under the caps, shippers can only afford to bring cases where they are likely to leave money on the table as a result of the caps. Yet, due to the significant gap between the costs of litigating small, medium and large cases, it seldom if ever makes economic sense to use a methodology with a higher relief cap.

The Board should especially reconsider whether relief caps are appropriate at all for small rate cases. Unlike the stand-alone cost methodology for large and medium cases, the small rate case methodology determines reasonableness based upon revenue/variable cost comparisons with similarly situated movements. In an environment of steadily increasing rates, a rising tide of rates lifts all rates together. Therefore, small rate cases inevitably produce higher rates than medium and large cases. This means that most shippers cannot obtain much, if any, rate relief in a small rate case, and those that can find relief will be the extreme outliers at the highest end of the rate spectrum. If a rate is an extreme outlier, the shipper is highly likely to exceed the relief

caps. Consequently, only the most disadvantaged shippers benefit from a small rate case at all, and their relief is most often capped.

An effective rate reasonableness remedy is an important competition policy because a regulatory remedy is a surrogate for competition. If a railroad knows that a captive shipper cannot avail itself of a regulatory remedy because it is too costly or relief is capped, the railroad is given a "safe harbor" in which it can earn monopoly rents.

III. Effects of Rail Competition on TFI Members.

The commodities that TFI members produce are essential to our country's agriculture production. Greater rail competition will enable them to get their products into the market place more efficiently. The transportation market place is not working properly when the high cost of rail transportation means that TFI members can export product to overseas markets for less cost than selling them right here at home.

TFI members must invest in their business infrastructure just like the railroads invest in theirs. They constructed current production facilities in the United States under the assumption that there would be a competitive rail system on which to transport their products to market. Skyrocketing rail rates are jeopardizing those investments and putting new investments in jeopardy. It is not in their interest to invest in new or additional production capacity when they cannot economically get their product to market. Through their pricing decisions, the rail industry has taken a very short term view by milking the sunk investments of existing production capacity at the cost of lost future investments in additional capacity and infrastructure.

As a consequence, this country will lose the jobs associated with the construction and subsequent operation of new facilities. Although the rail industry touts the jobs that it creates,

the customers that railroads service are responsible for many more jobs. When those jobs start to disappear, so will the rail industry jobs.

Respectfully submitted,

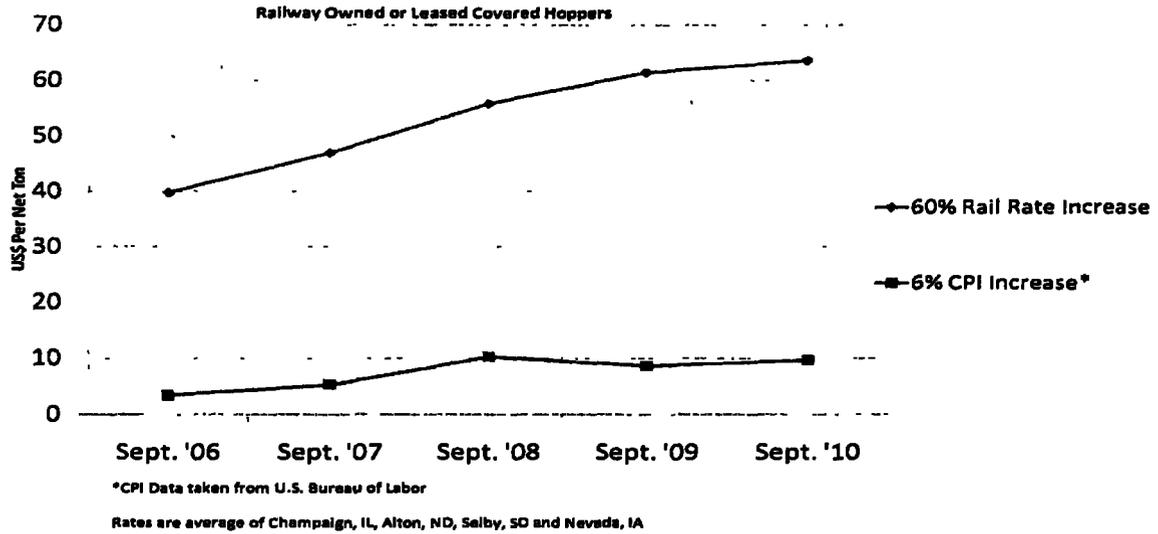


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Exhibit A

5 Year Comparison of Phosphate Unit Train Rates vs. CPI (Minimum 65 Cars Per Train)



Comparison of Phosphate Unit Train Rates vs. CPI (Minimum 65 Cars Per Train)

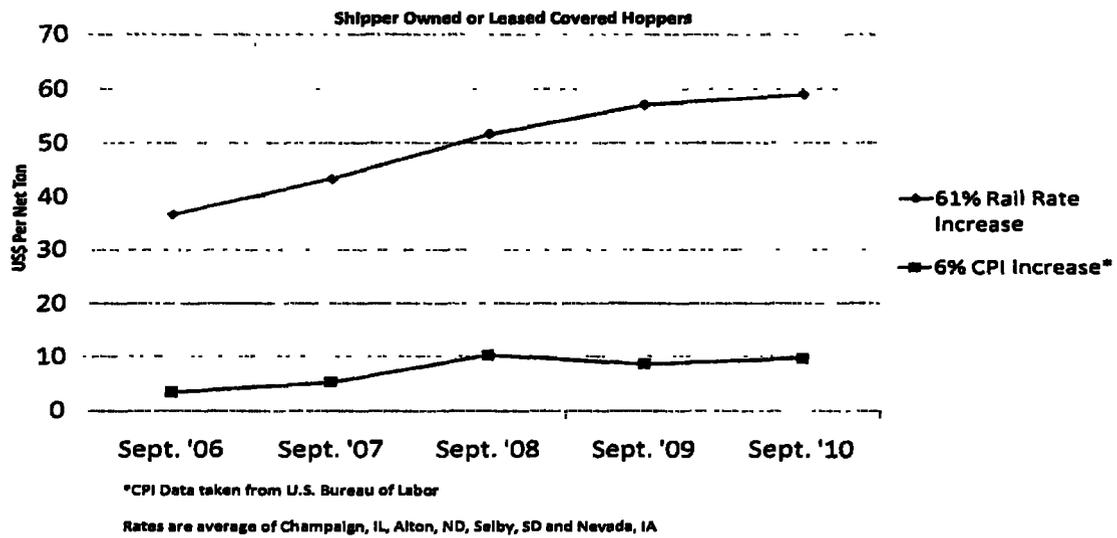


Exhibit B

Average Unit Train Tariffs (\$/Car) for Select Crops

(not adjusted for fuel surcharge)

6 Year Comparison

