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Before the

SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 575

REVIEW OF RAIL ACCESS AND COMPETITION ISSUES – RENEWED PETITION OF THE WESTERN COAL TRAFFIC LEAGUE

REPLY COMMENTS OF READING BLUE MOUNTAIN AND NORTHERN RAILROAD COMPANY

Reading Blue Mountain and Northern Railroad Company ("RBMN") hereby files these Reply Comments in response to the various Comments filed previously in this proceeding. These Reply Comments are supported by the Verified Statement of Wayne A. Michel ("Michel VS") which is attached hereto.

As noted in its initial Comments, RBMN is a 315-mile Class III railroad operating in eastern Pennsylvania. *See* the map attached the Michel VS as Exhibit A. A portion of its rail lines known as the Lehigh Line were acquired in 1996 and is subject to a "paper barrier." RBMN is also a party to the Railroad Industry Agreement ("RIA").

RBMN acknowledges that paper barriers are designed to retain revenues for the selling carrier, and that as such they allow the selling carrier to make lines available for lease or acquisition at a lower price. However, as structured and enforced, paper barriers go beyond what is necessary to accomplish this goal.

- To the extent that the paper barriers extend for long periods of time (perpetuity in the case of RBMN's), they allow the selling carrier to recoup any reduced purchase price many times over.

- To the extent that the paper barriers are applied with respect to traffic that was not on the line at the time of the sale, they do not reflect the value of the franchise being sold and are merely a way to limit the competitive options of shippers that might otherwise wish to locate on shortlines with multiple Class I connections.

While the RIA purports to be a voluntary industry solution to the second problem raised above, its designed restrictions make its applicability and usefulness limited in a number of important situations, including all of those involving bulk commodities, when the new traffic is not competitive with motor carriers.

Thus, RBMN believes that it may be time for the Board to develop standards that will allow sales at reduced costs if that is what the selling and buying carrier desire, but that will end the paper barriers once the selling carrier has received an adequate return, and that will limit the applicability of paper barriers to traffic that is on the line at the time of the sale, leaving competitive options for new traffic that a shortline may be able to develop.

Respectfully submitted,

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Dated: March 28, 2006

VERIFIED STATEMENT
OF
WAYNE A. MICHEL

INTRODUCTION

My name is Wayne A. Michel. I am making this statement on behalf of the Reading, Blue Mountain and Northern Railroad Company ("RBMN").

Over my twenty-seven year career in the railroad industry, I have served as a senior policy attorney on rail finance matters at the Interstate Commerce Commission and as a senior marketing official at Conrail. In this later capacity I was responsible for designing and implementing the line sale and shortline programs under which RBMN purchased the Lehigh Line, including the "paper barriers" that were included as part of the sale.

Since the June 1, 1999 "Split Date," I have been a self-employed consultant to various shortlines including RBMN. In January, 2005, I was named President of RBMN.

RBMN'S PAPER BARRIERS

In 1996, RBMN purchased the 104 mile Lehigh Line from Conrail. This was RBMN's second major line purchase from Conrail, the first being the 124 mile Reading Cluster purchased in 1990. The Reading Cluster and the Lehigh Line were not connected at the time of the Lehigh Line purchase.

The Lehigh Line connected with Conrail (now Norfolk Southern ("NS")) at its southern end, Lehighton, and at its northern end, Mehoopany, and with Delaware & Hudson/Canadian Pacific ("CP") in the middle at Dupont and at Taylor (near Scranton).

CP and NS both have trackage rights over the Lehigh Line. A map of RBMN's lines is attached hereto as Exhibit A.

The sale of the Lehigh Line was made by Conrail subject to a paper barrier in the form of "additional consideration" that would be due to Conrail if traffic originating or terminating on the line were diverted to a carrier other than Conrail. As originally designed by Conrail, the paper barrier in the Lehigh Line sale (as well as in other line sales at the time) was intended to preserve for Conrail the profits from existing traffic on the line, and to discourage the diversion of such traffic to other carriers.[1]

The paper barrier imposed on RBMN as a condition to its purchase of the Lehigh Line runs in perpetuity and was incorporated into the deed for the Lehigh Line. RBMN concurs with the Comments made by the USDA and NGFA - in our experience, the paper barriers agreed to in 1996, no longer have any relationship to the alleged discounted sale price. Indeed, based on the formula developed by the selling carrier, RBMN estimates that the selling carrier and its successor have earned IN EXCESS OF $70 MILLION IN

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1 The Conrail paper barrier was determined by looking at the actual traffic moving over the line being sold in the year prior to the sale. Conrail then broke the traffic down into various commodity groups. It then looked at the total above the rail profit in those commodity groups and divided that amount by the number of carloads in that commodity group. That process led to the additional consideration amount which is based on commodity. Conrail determined that the additional consideration amount was the potential "profit" that would be lost if the traffic were diverted. No consideration was given by Conrail to new traffic, traffic growth or the possibility that it (or a successor) would expand, thus increasing the profit it would earn on each car.

PROFITS SINCE THE LINE WAS SOLD.[2] Clearly the continued existence of the paper barrier no longer has anything to do with reimbursing the selling carrier for the fair market value of the property. The bottom line is that every year the paper barrier remains in effect, NS reaps in excess of $13 million in PROFIT based on the 1996 calculation done by Conrail.[3]

The effect of the paper barrier has been to eliminate rail competition options for RBMN and its customers. It may be true, as the AAR and UP Comments have noted, that *existing shippers* on a line that is sold subject to paper barriers have not lost any competitive options as a result of the sale – they may have had only one realistic rail option before the sale, and they have only one rail option after the sale. However, what about new shippers or new commodities that a shortline may be able to attract to the line? What about traffic from adjacent lines that may become connected to the line subject to the paper barriers? The selling carrier never enjoyed that traffic, and the value of that

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2 Obviously this is excessive for a 104 mile low density line for which RBMN paid substantial cash and other valuable consideration (including certain switching services). At the time of sale, approximately 3,200 carloads of traffic originated or terminated on the line.

3 Moreover, as a result of Class I consolidations and RBMN's own expansion, the paper barrier could actually be more expansive than when designed. RBMN has been told by NS that it views the paper barrier as including traffic moving from RBMN's Reading Cluster although those lines were purchased six years earlier with no paper barrier and did not physically connect with the Lehigh Line at the time of the sale. RBMN has now restored a long abandoned connection to connect its lines. In effect, RBMN is being told that the result of its spending millions of dollars to restore the connection is to expand the reach of the paper barrier. The effect of such an expansion, if effective, would be to increase the effect of the paper barrier by more than an additional $6 million in annual profits for NS, for a total of over $13 million a year.

traffic could not have gone into the calculation of the value of the line or have been considered in the establishment of the paper barrier.

The Board should keep in mind that elimination or limitation of the effects of paper barriers would not mean that the selling carrier would lose all of the future revenue from traffic on the line being sold. For much or most of the traffic, the selling Class I would continue to be the logical partner for the traffic because of the existing traffic patterns and/or because it has the superior route.

Frankly, RBMN believes NS is an excellent partner, and we believe that NS would retain almost all of the business WITHOUT A PAPER BARRIER. It is most likely that if NS were to lose traffic, it would be traffic moving to or from points located on the alternative connecting carrier. It is also possible that NS could experience some reduced revenues on other traffic if it were required to offer a competitive package of rates and service in order to retain the traffic. However, NS not only would enjoy most of the traffic that existed at the time of the line sale; it would also enjoy most of the substantial new traffic that RBMN has been able to develop since it acquired the Lehigh Line.

As several Comments have pointed out, it is unlikely that the elimination of paper barriers will have a significant effect on line sale decisions. Line sales are driven by numerous internal factors including the access to capital to maintain and upgrade branch lines and secondary main lines. *See, for example,* Wheat & Barley Commissions Comments. A Class I will either have to put money into these facilities, or it can sell them.[4] As noted in the USDA Comments, Class I dispositions of lines will continue if they make economic sense. If a Class I decides to retain the property, and maintain it, it has the right to retain the traffic. However, once a carrier decides to sell a line, and once it has been fairly compensated for that sale, the paper barrier should fall.

RAILROAD INDUSTRY AGREEMENT

The Railroad Industry Agreement ("RIA") is promoted by AAR, ASLRRA and RIWG in their Comments as a voluntary industry solution that addresses the concerns parties have raised with respect to paper barriers. While the RIA has the potential to address many of these concerns, its interpretation – despite its broad principles – severely limits its effectiveness in this regard.

The RIA provides:

> [Legitimate paper barriers] should not restrict the Short Line's ability to develop New Traffic with another carrier if the selling or leasing Large Railroad cannot or will not participate in the New Traffic.
>
> If the requested Access or routing helps the connecting Short Line and does not harm the Large Railroad, then the request should be approved as it will improve shipper rail service while strengthening the rail industry.

See AAR Comments, Appendix A (excerpts from RIA), and Appendix B (RIA).

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4 The alternatives would be to keep the line and allow it to deteriorate, or to abandon the line. If a carrier were to elect to deliberately downgrade a route, it would open itself up to a feeder line sale which would occur without paper barrier restrictions. If the carrier were to seek abandonment, it would open itself up to offers of financial assistance, again without paper barrier restrictions.

RBMN believes that paper barriers should never apply to "New Traffic," because by definition New Traffic did not exist at the time the paper barriers were created and could not have been considered in the value of the line. Further, the Large Railroad is never "harmed" by New Traffic moving over another carrier because it never had the benefit of the New Traffic in the first place. If New Traffic were not subject to paper barriers, Short Lines would be able to compete for new customers that are looking for multiple carrier rail service, and this would benefit the Short Line as well as strengthening the rail industry by creating more opportunities for freight to move by rail.

Unfortunately, the Class I's and the recent Amendment to the RIA make it clear that the Class I's do not intend the RIA to be so broadly interpreted. They do not want to have to compete for rail traffic unless they are competing with motor carriers. For example, Example 3 under Exhibit C to the RIA appears on its face to allow a Short Line to take New Traffic from a point on its line to a point on a connecting railroad (not the selling carrier) if the selling Large Railroad does not establish a competitive package (rates, service and supply) and the connecting railroad does. However, the Class I's are taking the position (and the language of the Amendment seems to concur) that the selling Large Railroad only needs to provide a package that is competitive with *motor carrier alternatives,* and not a package that is competitive with the connecting railroad.[5] This is true even in the case where the routing over the selling Large Railroad would clearly be

[5] Attachment 1 to the Amendment provides: "In all instances the identification of "New Traffic" on a rail line shall not require the waiver of a 'paper barrier' unless the Large Railroad that sold or leased the rail line in question, and has the contract with the Short Line, cannot offer a transportation package for the traffic which is competititve on a rate, service, and car supply basis with motor carrier alternatives." *See* AAR Comments, Appendix B.

more circuitous, time consuming and expensive for the customer. *See* the diagram accompanying Exhibit C, Example 3. In practice this means that the selling Large Railroad does not have to provide a competitive package for bulk commodities that are unlikely to move by motor carrier, and it is less likely that a Short Line will be able to attract new shippers of bulk commodities to its lines.

For these reasons the Board should look skeptically at the RIA as a "solution" to the problems posed by paper barriers.

CONCLUSION

The fact that the AAR and the ASLRRA have joined to fight this proposal appears to be an effort of certain shortlines to stay on good terms with the Class I's so they can buy additional properties. The ultimate question for the Board is whether it sees its role as preserving or promoting rail competition, or as preserving the ability of certain shortlines and Class I railroads to effectuate line sales on discounted terms

Paper barriers are not needed to preserve the financial well-being of the railroad system. Effective rail competition will increase rail share in the marketplace and as such will benefit all of the industry.

For all of these reasons, RBMN believes that the Board should take the necessary action to limit the time for which paper barriers may be imposed, and should limit their application to traffic that was on the line at the time the paper barrier was imposed, so that the potential anti-competitive effects of the paper barriers are minimized.

VERIFICATION

I, Wayne A. Michel, President of Reading Blue Mountain and Northern Railroad Company, verify under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file the foregoing document.

Executed on March 28, 2006.

Wayne A. Michel

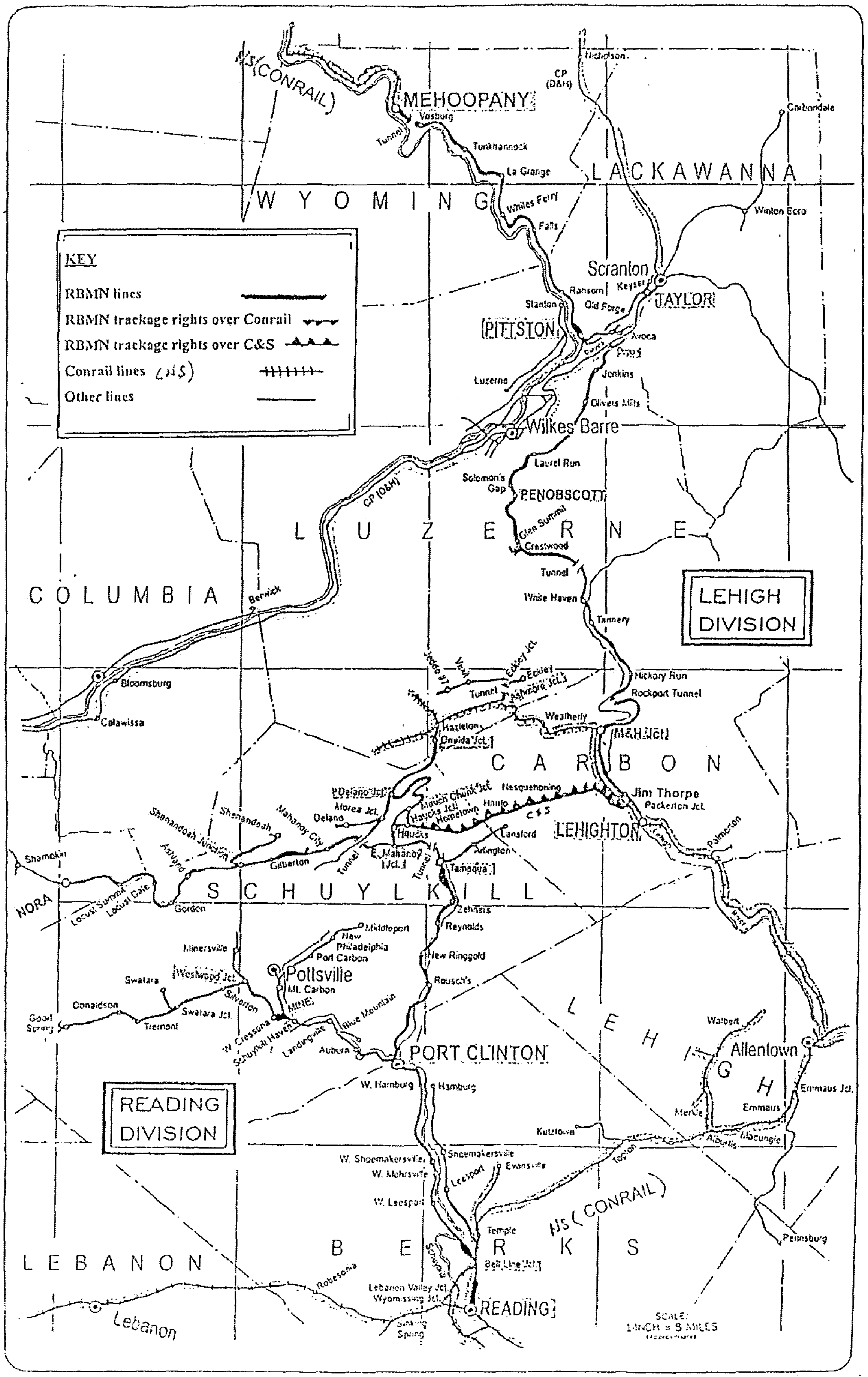

EXHIBIT A
MICHEL V.S.