CURE
PROMOTING RAIL COMPETITION

Hearing before the
Senate Judiciary Committee,
Subcommittee on Antitrust, Competition Policy and Consumer Rights

"An Examination of S. 772, the Railroad Antitrust Enforcement Act"

October 3, 2007

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Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear before you today. I am Bob Szabo, a member of the Washington, D.C. law firm, Van Ness Feldman. I also serve as Executive Director of, and Counsel to, Consumers United for Rail Equity (CURE), an incorporated membership group of rail customers who are dependent on railroad transportation. The membership of CURE consists of electric, utilities, chemical companies, agricultural interests, paper companies, cement companies and others dependent on the railroads for transportation. We strongly support S. 772, the Railroad Antitrust Enforcement Act of 2007, which was ordered reported by the Senate Judiciary Committee on September 20 and is the focus of this hearing. This legislation will ensure that rail customers have access to the nation's antitrust laws to seek remedies for anticompetitive conduct of the railroads. We also support S. 953, the Railroad Competition and Service Improvement Act of 2007, which is pending before the Senate Commerce, Science and Transportation Committee. This legislation seeks to improve the practices of the Surface Transportation Board, which is responsible for the continuing regulation of the railroad industry.

THE IMPORTANCE OF S. 772

Mr. Chairman, one of the greatest problems that confronts many rail customers today is the lack of access to competitive rail transportation. Rail customers who lack access to competitive rail transportation are often referred to as "captives" and face high rates and often inadequate service. When Congress partially deregulated the railroad industry through the Staggers Rail Act of 1980, the intent was to allow transportation competition to replace governmental regulation with respect to as many activities of the railroad industry as possible. The Interstate Commerce Commission (ICC), which has now been replaced by the Surface Transportation Board (STB), was charged with ensuring competition and protecting rail customers without access to competition from abusive railroad rates and practices.

Today, over a quarter of a century later, consolidation in the rail industry and two anticompetitive practices that are allowed under the policies of the STB have combined to reduce the competitive transportation options available to many rail customers. The Government Accountability Office, in an October 2006 report on the state of the freight rail industry, found that there is a lack of competition in the freight rail industry, that the STB is not using its powers to ensure rail customer access to competition and that the rail customer protections developed by the STB are "inaccessible" to most rail customers. ("Freight Railroads: Industry Health Has Improved, but Concerns About Competition and Capacity Should be Addressed," GAO-07-94 (October 6, 2007))

The enactment of S. 772, the Railroad Antitrust Enforcement Act of 2007, will refocus the STB on original congressional intent. It will increase rail customer access to competitive rail service by ensuring that any future consolidation of the railroad industry complies with the provisions of the nation's antitrust laws. The legislation also allows rail customers access to the federal courts to seek relief under the nation's antitrust laws from the two major anticompetitive railroad practices that are being allowed by the policies of the Surface Transportation Board: "paper barriers," or "tie-in agreements," and the refusal of monopoly railroads to offer rates for the transportation of captive customers' freight to competing rail systems.

RAILROAD CONSOLIDATIONS

The Staggers Rail Act of 1980 provides that the Interstate Commerce Commission, now the STB, has the exclusive power to approve a railroad merger or acquisition when it determines that the transaction is "consistent with the public interest" (49 U.S.C. Section 11324; covered transactions defined in 49 U.S.C. Section 11323). In 1976, there were 30 independent Class I, or major, railroad systems consisting of 63

Class I railroads. Today, there are seven of these railroads left, with four of the Class I railroads dominating the rail transportation market. The Union Pacific (UP) and the Burlington Northern Santa Fe (BNSF) railroads operate generally west of the Mississippi River. The Norfolk Southern and CSX operate generally east of the Mississippi. Many rail customers have access to only one of these rail systems.

Since 1980, only one proposed merger has been rejected by the ICC or the STB as being inconsistent with the public interest. In 1986, the ICC rejected a proposed merger between the Southern Pacific Railroad and the Santa Fe Railroad. Ten years later, in 1996, the STB ruled that the merger of the Union Pacific and the Southern Pacific was "consistent with the public interest" despite a strong demonstration by the Department of Justice that the merger would inflict grave competitive injury to rail customers. Rail customers believe that the Department of Justice was correct in its analysis: the Union Pacific/Southern Pacific merger resulted in anticompetitive markets. Many rail customers have suffered the abuses that result from being captives of dominant carriers.

Perhaps the STB belatedly realized it had gone too far. In December 1999, when the BNSF and the Canadian National filed with the STB a "notice of intent" to file a merger application, the STB imposed a fifteen month "moratorium" on major rail mergers. During the moratorium, the STB adopted new "major merger guidelines" (June 2001) that attempted to ensure that future mergers of two Class I railroads were "pro-competitive." Since the adoption of the guidelines, no proposed major rail mergers have been brought to the Board, so the guidelines have not been tested.

Rail customers believe that S. 772 would ensure that future rail mergers will comply with the nation's antitrust laws. We understand that S. 772 allows the STB to continue to determine whether the proposed transaction is "consistent with the public interest." S. 772 does not prevent the STB from applying a standard for merger approvals that is more strenuous than the standard in the nation's antitrust laws. The

Department of Justice and the Federal Trade Commission may continue to file comments with the Board regarding the proposed merger. Under S. 772, unlike under current laws, the Department of Justice or the Federal Trade Commission could seek to enjoin the approved merger in federal district court if the merger, as approved, fails to meet the minimum standards of the nation's antitrust law.

PAPER BARRIERS/TIE IN AGREEMENTS

One of the major barriers to rail competition for many rail customers is the so-called "paper barriers" or "tie in agreements" included in many lease agreements between Class I and smaller Class II and Class III railroads regarding the operation of track owned by a Class I rail carrier. One of the intended results of the Staggers Rail Act of 1980 was that the major railroads would "rationalize" or "right size" their systems for the traffic requirements of the nation. Major rail carriers "rationalized" their systems through track abandonment and the transferal of operating rights to "short line" or "regional railroads" (Class II and III railroads). The ICC, and later the STB, was given authority to approve such transfers of operating rights in 49 U.S.C. Section 10902.

Since 1980, approximately 500 short line railroads have been created. Each of these new rail carriers received a certificate of authorization from the ICC or the STB, although the terms of the agreements between the two rail carriers were not made public during the proceedings of the federal regulatory agency. In the case of many of these new short line carriers, Class I track now operated by the short line railroad intersects with more than one major rail carrier. Such intersections should, from the standpoint of efficient and competitive rail system, allow the customers of the short line to have access to competing major rail systems.

Rail customers have been disappointed to learn, however, that many of these agreements contain "paper barriers" or "tie in agreements" that prevent the short line railroad from doing meaningful business with any major rail carrier other than the rail carrier from which it is leasing its track. To illustrate the anticompetitive effect of "paper barriers," I have attached as Attachment A a schematic of the "paper barrier" that prevents competitive rail service to the Independence Generating Station in Arkansas and the "paper barrier" provision extracted from the lease agreement between the Class I railroad and the short line railroad in this case.

Rail customers believe that "paper barriers" or "tie in agreements" clearly violate the antitrust laws of the nation and would not have been allowed had the railroad industry been subject to the full jurisdiction of the nation's antitrust laws. Other than the general policy of ensuring "the development and continuation of a sound rail transportation system with effective competition among rail carriers…" (49 U.S.C. Section 10101 (4)), neither the Staggers Rail Act of 1980 nor the ICC Termination Act of 1995 addresses the "paper barrier" issue.

S. 772 ensures that similar future transactions will not, we believe, contain these restraints on competition, but S. 772 also provides a mechanism for addressing these restraints in existing lease agreements. Section 8 of S. 772 provides that rail carriers have 180 days after the date of enactment to bring their agreements and practices into compliance with the nation's antitrust laws. After that date, an aggrieved party may seek prospective injunctive relief in the federal district court.

Access through short line carriers to competing major rail carriers will result, rail customers believe, in competition, which should result in market rates and improved service.

REFUSAL BY RAILROADS TO PROVIDE RATES

A second major barrier that prevents a number of rail customers from reaching competition is the refusal of major rail carriers to provide their captive customers rates to points where the rail customer can gain access to a competing railroad. Again, as with the "paper barriers" issue, this issue was not addressed directly by Congress in either the

Staggers Rail Act of 1980 or the ICC Termination Act of 1995. Rather, this barrier derives from the STB's interpretation of these Acts in the "bottleneck" case of December 1996.

Many rail customers have access to only one rail carrier at origin or destination. However, often the lines of a competing rail carrier may be only a few miles away and have a switching facility that can transfer rail cars to or from the system to which the rail customer is captive. The rail customer cannot get to that competing carrier, however, if its "captor" rail carrier refuses to offer a rate to transport the customer's cars to or from that competing system or refuses to receive the customer's cars from that competing system.

An example of this problem was presented to the House Transportation and Infrastructure Committee on September 25, 2007, by Terry Huval, Director of Utilities, City of Lafayette, Louisiana, and currently Chairman of the Board of the American Public Power Association. A schematic of the problem confronting the City of Lafayette is attached as Attachment B.

The City of Lafayette owns half of a large coal-fired electric generator in Louisiana that is 1500 miles from the source of its coal, the Powder River Basin of Wyoming. The electric ratepayers of Lafayette, Louisiana, pay rates that are based on the delivered cost of fuel to the plant, including both the cost of the coal itself and the cost of transporting the coal to the plant.

The utility is responsible for the transportation of the coal it purchases at the "mine mouth" in Wyoming to its plant in Louisiana. The two remaining major western rail systems, the BNSF and the UP, both operate in the Powder River Basin and either can "originate" the coal transportation. However, the last twenty miles of track into the power plant are owned by the UP. A rail map would suggest that the City of Lafayette should have competition for 1480 miles of its coal movement. The UP can transport the coal all the way to the Lafayette plant. The BNSF can move the coal trains to Kansas City where they can be transferred to the Kansas City Southern (KCS), which can pull the coal cars over its tracks to a point 20 miles from the Lafayette plant where the UP has a switching facility to transfer the cars to the UP system for the final 20 miles to the plant.

Under the pro-competitive national rail policy that is contained in the Staggers Rail Act (49 U.S.C. Section 10101), the City of Lafayette expected that it would have competition for all but the last 20 miles of its movement. For the last 20 miles, it would pay higher "captive" rates. Unfortunately, the 1996 STB decision in the "bottleneck" case held that the UP is not required to provide a rate for that last 20 miles from the switching facility to the power plant – and of course the UP does not provide such a rate. Without this rate, the option of moving across the BNSF/KCS system is not available. Therefore, instead of having competitive rates for 1480 of 1500 miles, the City of Lafayette is paying captive rates for the entire 1500 miles of its coal transportation,

Mr. Huval testified on September 25 that the "cost of captivity" to the Lafayette education system through the higher electric rates that result from these captive rail rates for moving coal to Lafayette is $1.52 million a year.

We believe that if the antitrust laws of the nation applied to the railroads they would not be allowed to refuse to provide rates to move a customer's cars to a competing rail system. Under S. 772, after the 180 day grace period provided in Section 8, the City of Lafayette and other like situated rail customers would have access to the federal courts to test whether this conduct on the part of the UP would violate the nation's antitrust law – an option rail customers do not have today.

STB CONCERNS WITH S. 772: RAIL CUSTOMER RESPONSE

In a September 13, 2007, letter to the leadership of the Senate Commerce, Science and Transportation Committee, the three Commissioners of the STB set forth their concerns regarding S. 772. The Commissioners expressed two concerns: (1) that S. 772

could create a difficult regulatory environment since rail customers would have access to private civil suit injunction relief, and (2) that S. 772 could lead to dual enforcement concerns with respect to mergers. I will respond to the second concern first.

DUAL MERGER ENFORCEMENT CONCERNS

The Commissioners argue that the new merger rules could result in dual merger enforcement regimes. Rail customers foresee no such dual merger enforcement concerns, as long as STB policies and judgments comply with the antitrust laws of the nation. The STB will continue to have first call on whether a merger should be approved as being "consistent with the public interest." The Department of Justice and the Federal Trade Commission can be expected to file comments with the Surface Transportation Board on the proposed merger, as they have in the past. The STB will be informed by those comments and can accommodate or ignore the comments. The only difference under S. 772 is that the Department of Justice and the Federal Trade Commission would have the power to ensure minimum compliance with the nation's antitrust laws by testing the approved merger, with the conditions added by the Surface Transportation Board, in federal district court. We anticipate that these three arms of the federal government would communicate and reach agreement on the merger that would prevent last minute litigation. In short, there should be no dual enforcement problem as long as the actions by the Surface Transportation Board meet the minimum standards set forth in the nation's antitrust laws.

PRIVATE CIVIL SUIT INJUNCTION CONCERNS

The Commissioners also state the concern that the application of the nation's antitrust laws to the railroads will make it difficult for the STB to implement a logical regulatory regime. Rail customers do not share this concern. First, the nation's rail transportation policy, as set forth in 49 USC Section 10101, contains the same objectives that a federal district court would consider in formulating an injunctive remedy under the antitrust laws. Rail customers believe that if the STB ensures that its actions conform with the policies set forth in 49 USC Section 10101, there will be no grounds for injunctive relief under the nation's antitrust laws. Indeed, the GAO report cited previously suggests that the STB to date has not implemented policies that are faithful to the national rail transportation policy.

Second, other regulated network transportation industries are subject to both a federal regulatory regime and the nation's antitrust laws with no resulting confusion. No antitrust exemptions exist for the transmission of electricity, the transportation of natural gas, or the transportation of oil by common carrier pipelines (whose rates are regulated by the Federal Energy Regulatory Commission under the old Interstate Commerce Act, 49 U.S.C. App.(1)((b) (1988))). In these network transportation industries, vigorous competition occurs within a framework of regulatory oversight, but with the safeguard of antitrust remedies, including private civil antitrust remedies, in the background. There has been no significant conflict between the antitrust courts and effective regulation by the Federal Energy Regulatory Commission. Rather, the Supreme Court contemplates that the roles of the antitrust courts and the Commission will complement each other. See e.g., *Otter Power Co. v. United States*, 410 U.S. 366 (1973); *California v. FPC*, 369 U.S. (1962).

Finally, under contemporary antitrust standards, a private civil plaintiff seeking to enjoin a railroad's antitrust violations faces very heavy burdens, as this subcommittee is well aware. Moreover, neither the Department of Justice nor the Federal Trade Commission is easily persuaded to initiate antitrust actions.

For these reasons, rail customers believe that the Board's concerns that civil antitrust injunctions will disrupt its regulatory functions or subject the railroads to conflicting standards is not a likely scenario under current antitrust law.

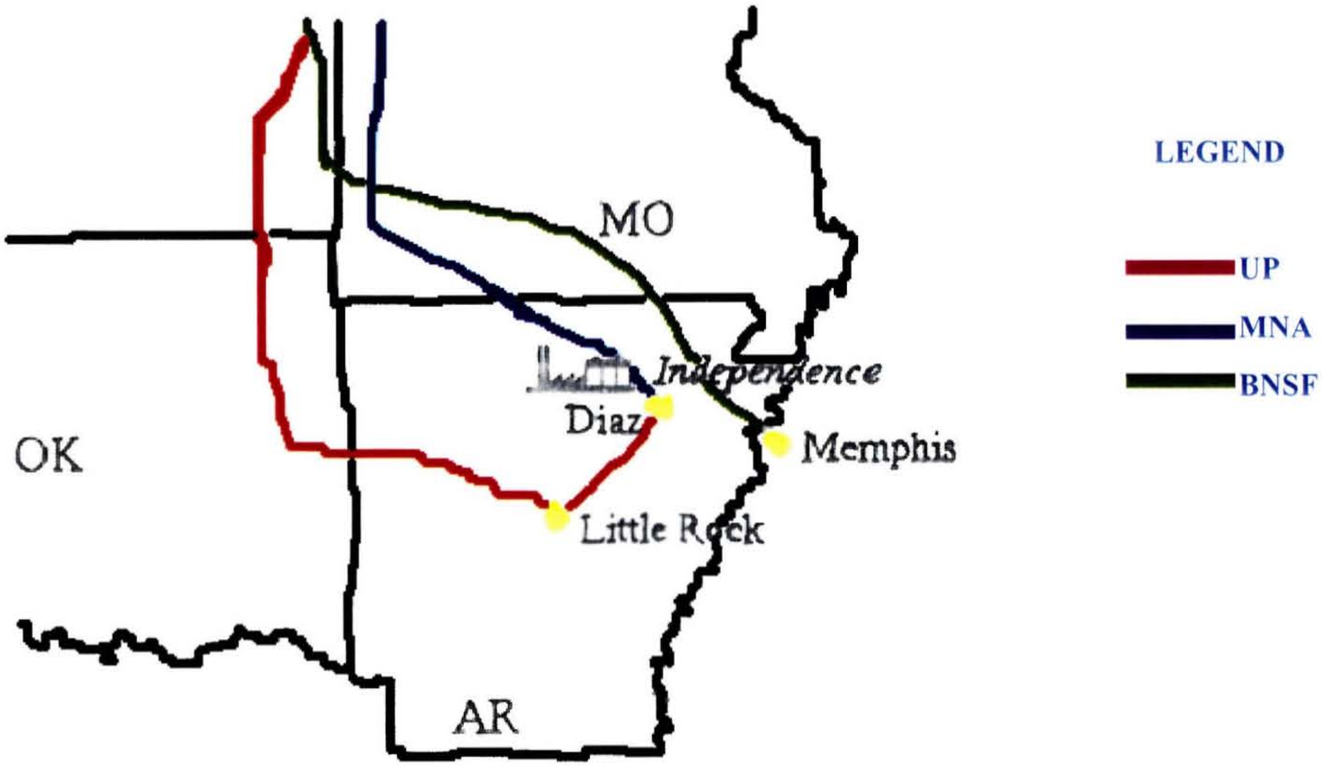
CONCLUSION

Mr. Chairman, rail customers are grateful to you and the Senate Judiciary Committee for ordering S. 772 reported to the full Senate. This is the first time since 1980 that a committee of either house of Congress has reported pro-competitive rail legislation that will ensure that the pro-competitive national rail policy contained in the Staggers Rail Act of 1980 will be realized. We stand ready to work hard for the enactment of S. 772 in the 110th Congress.

Thank you.

Attachment A

PAPER BARRIERS
SHORT LINE TIE IN AGREEMENTS



Result of these decisions by the ICC/STB: The Class I Railroad, through the Paper Barriers in agreements with Short Lines, can deny the customer access to railroad competition

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LEASE AGREEMENT BETWEEN MISSOURI PACIFIC RAILROAD CO. (NOW UNION PACIFIC) AND MISSOURI & NORTHERN ARKANSAS RAILROAD CO. (MNA)

Section 4.01 "In consideration of this Lease, and subject to the terms and provisions set forth herein, Lessee agrees to pay Lessor rent for the Leased Premises in the amount of Ninety Million Dollars ($90,000,000) per year payable annually in advance on the 1st day of March; PROVIDED, HOWEVER, that subject to the provisions of Section 4.02 hereof, for each lease year that 95% or more of all traffic originating or terminating on the Leased Premises is interchanged with Union Pacific Railroad Company, Missouri Pacific Railroad Company and any affiliated company, their successors and assigns, Lessor agrees that it will waive or partially waive the rent for that particular year in accordance with the schedule set forth in Section 4.03. segments."

Schedule in Section 4.03

PERCENTAGE OF THE TOTAL TRAFFIC THAT WAS INTER CHANGED WITH LESSOR	RENT DUE LESSOR
100 –95%	$-0-
94 – 85%	$10,000,000
84 – 75%	$20,000,000
0 - 4%	$90,000,000

Attachment B

Selected Routes For PRB Coal Moving to Rodemacher