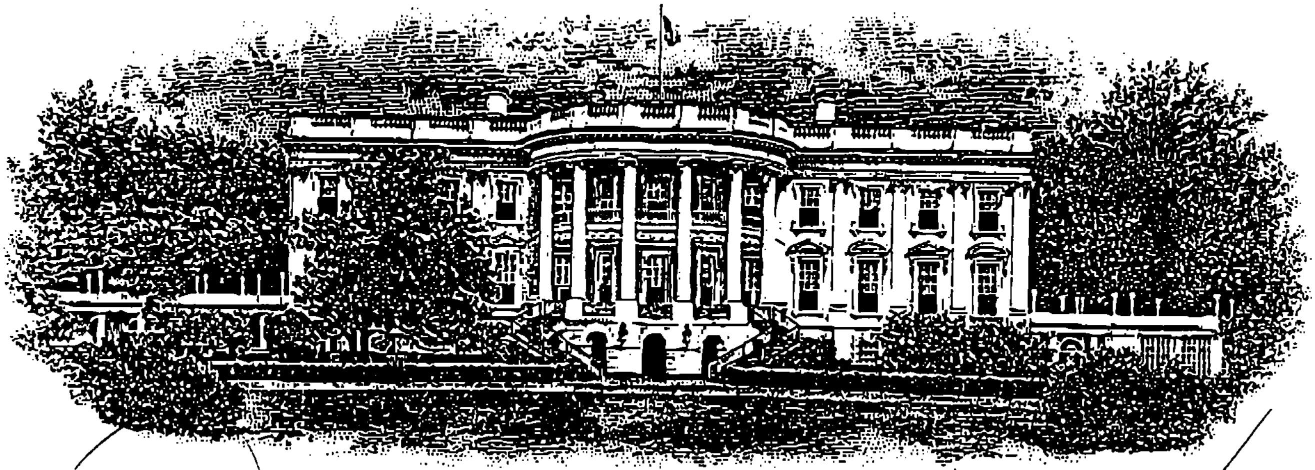


MS —
Anything I should know?
Tom

FAX Transmission

National Economic Council
The White House

To:
Howard Shelanski — David Beier — Russell Pittman
Bert Huang — Pieter Boelhouwer — Gene Conti
David Tornquist — Tom Freedman — Nancy McFadden
Victoria Wasserman — Mary Smith — Michael Dunn

Phone: ______________ **Fax:** ______________

From: Dorothy Robyn

Phone: 202-456-2801 **Fax:** 202-456-2223

Date: ______________ **Time:** ______________

Pages to follow: 13

Comments: ______________

THE WHITE HOUSE

WASHINGTON

November 18, 1998

MEMORANDUM FOR DISTRIBUTION LIST

FROM: Dorothy Robyn, NEC

SUBJ: Nov. 19 Meeting on STB Reauthorization

The purpose of tomorrow's meeting (9 am in Room 239 of OEOB) is to discuss the content of a possible STB reauthorization bill. Many economists, among others, have come to believe that inadequate competition in the railroad industry is a serious problem. I would like to discuss the pros and cons of the following ideas for promoting competition:

--"Mandatory interswitching" for captive shippers located within a short distance of a second railroad
--Reversal of STB's bottleneck decision
--Streamlining of rate relief procedures
--Granting DOJ joint authority to review railroad mergers and enforce competition laws affecting railroads
--Reopening of closed gateways and other steps to promote competition from short line railroads
--Elimination of the revenue adequacy test

I encourage you to bring other ideas to the meeting for discussion.

Attached are some background readings.

4TH STORY of Level 1 printed in FULL format.

Traffic World

October 5, 1998, Monday

SECTION: WASHINGTON ROUNDUP; Pg. 12

LENGTH: 1051 words

HEADLINE: Kahn Criticizes STB

BYLINE: BY FRANK N. WILNER

BODY:

""An abomination'' is what the father of deregulation calls policies of the Surface Transportation Board that permit railroads to block competition at essential facilities called bottlenecks. Economist Alfred E. Kahn, whose views were instrumental in coaxing Congress to deregulate the airline, trucking and railroad industries two decades ago, said railroads operate today in a netherworld of insufficient competition and inadequate economic regulation. Even where railroads compete, he said, capacity constraints often insulate the rate structure from downward pressure. The STB, he said, is failing in its mission to provide a remedy for railroad market abuse. ""You can't get effective competition unless there are assurances of fair and equal access to essential facilities,'' Kahn told Traffic World in an exclusive interview. ""I'm of the powerful persuasion that the rail industry is not capable of being deregulated. Where we have cartelization of an entire industry and competition is not viable, we may have to go back and regulate, '' although that would not be his first choice. It is 56 years since Kahn earned his Ph.D. at Yale, but his two-volume treatise on ""The Economics of Regulation,'' first published in 1970, remains as recommended reading for students in most university economics programs. At age 80, Kahn still pops into Washington, D.C., every few months to testify before Congress on regulatory issues affecting airlines, telecommunications and railroads. Currently a professor emeritus of economics at Cornell University, Kahn was chairman of the New York Public Service Commission during the mid-1970s, the last chairman of the now-defunct Civil Aeronautics Board and chairman of President Carter's Council on Wage and Price Stability. Interestingly, Kahn was a walk-on to the rail captive shipper cause rather than a draft choice. He said he independently became aware of the captive-shipper dispute and wrote several electric utility CEOs offering to assist them as an expert witness in STB and court cases. Kahn observed that as the number of competing major railroads has been reduced from dozens to just four today, it is not uncommon for rail-dependent shippers to have access to only one railroad at either origin or destination - the so-called bottleneck. Where this occurs, the railroad holding the monopoly typically prices the bottleneck portion of the route so high that it discourages the shipper from using a competing railroad at the other end of the haul. ""Railroads are saying the only way shippers may use their monopoly segment is to specify that single railroad for the through route,'' he said. ""In any other industry this tying arrangement would violate the antitrust laws.'' Kahn criticized the STB for refusing to permit shippers to challenge bottleneck rates or to require competitive access. A captive shipper appeal of the STB's bottleneck decision is pending in the 8th U.S. Circuit Court of Appeals. Separately, congressional attempts at legislative relief are gaining support, but railroad lobbyists so far have successfully derailed the efforts. ""If railroads controlling bottlenecks are totally able to exploit demand,'' said Kahn, shippers are entitled either to protection under the antitrust laws or regulation - but they are receiving neither. ""People who grew up with railroads,'' said Kahn, ""are so scarred by the experience of genuinely inadequate revenue and deteriorating plant (as occurred during the 1970s) that they continue to be influenced by fears of destructive competition and thus refuse to force railroads to compete. Historically, regulators are blamed if an industry is not financially healthy, so regulators' identify financial interest with the public interest.'' ""I don't think anybody can argue that railroads are an industry that can't compete,'' said Kahn, who agrees with captive shippers that the STB has put too much emphasis on helping railroads achieve adequate revenue and not enough on ensuring adequate competition. He rejects completely a railroad-advanced argument that if railroads are forced everywhere to compete, their prices will be driven so low as to discourage any further investment. ""Those who predict economic behavior bear a heavy burden of proof,'' said Kahn. ""Are railroads somehow unique,'' he wondered aloud, that they should be free of both regulatory and antitrust constraints? Deregulation assumes the antitrust laws'' protect the public from market abuse, said Kahn. But with rare exception - such as an alleged conspiracy against coal-slurry pipelines more than a decade ago - railroads exploiting their increased market power either are immune by statute or are not prosecuted under the antitrust laws. Kahn compares the railroads' bottleneck ratemaking with airline predatory pricing, a practice of major airlines to drive competitors out of a market by temporarily rolling back prices to a level less than cost recovery. In both instances, he said, essential facilities are monopolized. Rather than restoring rate caps and other methods of traditional economic regulation that Kahn called "" ridiculous and imbecilic, he prefers ""structural remedies'' such as mandated competitive access, which he said assures rail-to-rail competition and permits market forces - not bureaucrats - to determine rate and service levels. Indeed, before the Interstate Commerce Commission (the STB's predecessor) was given authority in 1920 to approve railroad mergers and insulate them from the antitrust laws, the Supreme Court in 1912 chose a structural remedy to cure a Justice Department complaint. As a remedy to the monopolization of Mississippi River crossings by the Terminal Railroad Association of St. Louis, the court ordered the equivalent of competitive access. To cure airline predatory pricing, Kahn suggests the ""Department of Transportation be given independent statutory authority to act against exclusionary behavior.'' Kahn said DOT authority to act against railroad bottlenecks by imposing competitive access could be an effective alternative to railroad reregulation. Capitol Hill sources said Kahn's proposal for structural remedies already has the ear of Senate Commerce Committee Chairman John McCain, R-Ariz. ""No one ever said this is easy,'' said Kahn.

GRAPHIC: Photo - Kahn;

LANGUAGE: ENGLISH

LOAD-DATE: October 9, 1998

The Economic Effects of Surface Freight Deregulation

Clifford Winston
Thomas M. Corsi
Curtis M. Grimm
Carol A. Evans

See esp. pp. 55-57

The Brookings Institution | Washington, D.C.
1990

Chapter Five

Railroad and Motor Carrier Policy Issues

ÉREGULATION has enhanced the efficiency of railroad and trucking op-ations and produced substantial benefits for shippers. The aim of public licy now should be to preserve and even increase the welfare gains from ch industry. A number of the issues we touch upon in this chapter have eady received much attention and could by themselves be the subject a book. Our objective is to indicate policy directions consistent with main thrust of our findings.

Railroad Policy Issues

Any vision of public policy toward the railroad industry must address undamental dilemma. Further efforts to help those shippers who are, pite deregulation, still forced to pay high rates could put the railroads financial jeopardy. Indeed, whether the railroad industry will survive reasonable size is still a question. Our findings show, however, that rket forces can address both these concerns. Given negotiating flexi-ty, shippers can and have obtained reasonable rates and improved vice. Given operating freedom, railroads can and have eliminated gross ficiencies and earned a higher return. Further progress needs to be le. The role of public policy should be to preserve and enhance Staggers benefits by encouraging greater railroad efficiency and by promoting competition.

nhancing Railroad Efficiency

ublic policy should encourage railroads to further reduce excess ca-ty, improve labor productivity, and increase the efficiency of freight itilization. These areas are still a source of conspicuous inefficiencies. f paramount importance is that there be no new restrictions on rail-s' ability to abandon routes. Recent legislative proposals to restrict

abandonment, mainly prompted by Midwestern agriculture states where the excess capacity problem is most severe, must be resisted. Railroads should continue to have freedom to downsize.[1]

Railroads have increasingly spun off unprofitable lines to new short-line or regional railroads, thus preserving service to the communities involved while simultaneously eliminating a financial burden. The key to the success of the short lines is their ability to operate without restrictive work rules. So far the ICC has not imposed labor protection conditions on short-line sales. But unions have attempted to challenge this ICC action in court and have pressed for new legislation that would impose union rules on short lines. It is important that short lines continue to be allowed to use labor efficiently and without restrictions.

Use of market forces could improve the efficiency of freight car use. A railroad must pay a set per diem charge when another railroad's car is on its line. To minimize these charges, railroads will frequently try to get another railroad's car off its line as quickly as possible. As a result, circuitous routing of cars and the number of empty freight car miles increase. Greater use of market forces to determine freight car rates and usage could enhance efficiency, especially because rail cars would be directed to locations where they are most needed to haul freight.[2]

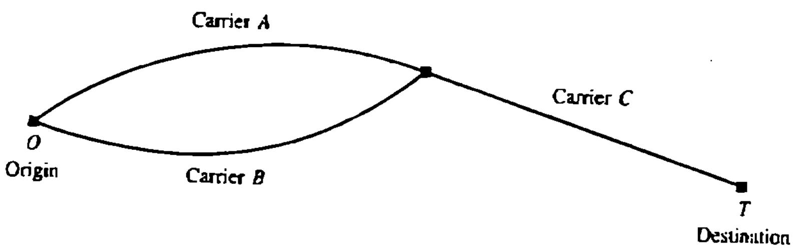
Promoting and Preserving Competition

Our findings in chapter 4 show that increased competition within the rail industry itself is important in preserving and extending the benefits from railroad deregulation. As a result of more than fifty railroad mergers since 1957, the seven largest rail systems now account for approximately 80 percent of Class I mileage and revenues. Past ICC rail merger policy has not effectively preserved rail competition. In the 1960s and 1970s, the ICC approved several major parallel mergers (for example, Seaboard

1. The only desirable restriction should be to continue to offer first priority of acquisition to persons seeking to operate the abandoned rail line.

2. For a full critique of this perverse system, see Christopher C. Barnekov, "The Track Record," *Regulation*, no. 1 (1987), pp. 19–27. See Alain L. Kornhauser, "Quantified Opportunities for Centralized Nationwide Management of Empty Freight Cars," *Transportation Research Forum*, Proceedings of the Twenty-fourth Annual Meeting, vol. 24, no. 1 (1983), pp. 140–53, for further information on potential cost savings from more efficient freight car management. The ICC has initiated *Ex Parte* 334 Sub. 6 to solicit comments on reforming the present system of per diem car hire charges.

Figure 5-1. *Vertical Foreclosure*



Coast Line, Penn Central, and Burlington Northern) that resulted in rail monopolies or near monopolies in large regions of the country.[3] Recent years have seen another round of rail consolidations. Four major end-to-end mergers were approved by the ICC in the early 1980s. The ICC did deny, however, a largely parallel merger between the Santa Fe and Southern Pacific railroads.

As Alfred Kahn and others have noted of the airline industry, it is important to recognize that deregulation did not authorize the government to abdicate its antitrust responsibility and to fail to take actions to preserve competition. To the extent that mergers can enable railroads to improve service and reduce costs without concomitant anticompetitive effects, they should be encouraged. It is the ICC's responsibility to scrutinize carefully potential anticompetitive effects from both parallel and end-to-end mergers. In particular, a policy of continuing to discourage parallel mergers appears to be in order. Analysis by Russell Pittman confirms that the loss of competition from the Santa Fe/Southern Pacific merger would have been substantial, with deadweight losses in the range of $75–100 million.[4]

Although end-to-end consolidations do not have the salient anticompetitive effects of parallel mergers, they may nonetheless pose competitive problems, namely vertical foreclosure of nonmerging carriers. Figure 5-1 illustrates this issue. If carriers *A* and *C* merge, carrier *B* may be foreclosed

3. Theodore E. Keeler, *Railroads, Freight, and Public Policy* (Brookings, 1983), p. 37.

4. Russell Pittman, "Railroads and Competition: Why the Santa Fe/Southern Pacific Merger Had to Die," Department of Justice Economic Analysis Group Discussion Paper, EAG 88-10, August 26, 1988. Evidence of increased rates from parallel mergers is also provided in Curtis M. Grimm, "Horizontal Competitive Effects in Railroad Mergers," in Theodore E. Keeler, ed., *Research in Transportation Economics*, vol. 2 (1985), pp. 27–53.

from participation in movements from *O* to *T* or may be price squeezed by the merged carrier.[5] Our empirical findings in chapter 4 indicate that effectively eliminating an interline carrier from the *O–T* market would cause a substantial loss in welfare to shippers. In recent decisions, the ICC has attached very few conditions to allow nonmerging carriers to compete effectively with merged rivals. One desirable condition would be to allow carrier *B* to have trackage rights over carrier *C*'s line, thus preserving carrier *B*'s ability to compete in the *O–T* market.[6] We recommend more vigorous application of procompetitive conditions to ameliorate vertical foreclosure in subsequent end-to-end merger cases.

The vertical foreclosure issue also arises with regard to joint rate and route cancellations. A flurry of such cancellations occurred in the first few years after passage of the Staggers Act, with Conrail, Southern Pacific, and the Seaboard System most active. The ICC's policy has been quite liberal, allowing proposed cancellations in almost all situations. Because interline competitors have an important impact on rates and economic welfare, the ICC should pursue a more restrictive policy, weighing possible anticompetitive consequences if carriers with little bargaining power are disadvantaged or eliminated from providing effective competition.[7]

A third area where the ICC should more aggressively promote competition under existing legislation involves reciprocal switching. A reciprocal switching agreement allows traffic originating on a rival carrier's tracks to be switched to another carrier in the area. Local monopoly, in which a shipper is served by only a single railroad, is perhaps the most serious structural feature that limits rail competition. Congress recognized

5. For a more extensive discussion of the vertical foreclosure issue, see Curtis M. Grimm and Robert G. Harris, "Vertical Foreclosure in the Rail Freight Industry: Economic Analysis and Policy Prescriptions," *ICC Practitioners' Journal*, vol. 50 (July–August 1983), pp. 508–31; and Curtis M. Grimm and Robert G. Harris, "A Qualitative Choice Analysis of Rail Routings: Implications for Vertical Foreclosure and Competition Policy," *Logistics and Transportation Review*, vol. 24 (March 1988).

6. It should be noted that such conditions could entail loss of density economies in the market, in that such economies result from lower operating costs as well as the spreading of fixed facility costs over a larger traffic base. For further details, see Robert G. Harris, "Economies of Traffic Density in the Rail Freight Industry," *Bell Journal of Economics*, vol. 8 (Autumn 1977), pp. 556–64.

7. We are not advocating a return to the overly restrictive DT&I-type conditions, wherein all interline routes, even extremely circuitous ones, were protected by ICC fiat. For more details on the dimensions of a rational, case-by-case approach to analyzing vertical foreclosure concerns in route cancellations and end-to-end mergers, see Grimm and Harris, "Vertical Foreclosure in the Rail Freight Industry," pp. 522–31.

that local monopoly power could limit the benefits of rail deregulation and included the following provision in the Staggers Act (section 223):

> The Commission may require rail carriers to enter into reciprocal switching agreements, where it finds such agreements to be practicable and in the public interest, or where such agreements are necessary to provide competitive rail service. The carriers entering into such an agreement shall establish the conditions and compensation applicable to such agreement, but if the carriers cannot agree upon such conditions and compensation within a reasonable period of time, the Commission may establish such conditions and compensation.

The ICC, however, has been reluctant to impose reciprocal switching under the Staggers Act.[8] We advocate a more active policy to promote competition in the face of local monopoly power.

Although a full discussion of ICC policy in this area is beyond the scope of this monograph, two comments are in order. First, we are advocating that reciprocal switching be imposed only when a shipper has access to just one railroad and when a second railroad is present a short distance away. Second, it is clear that imposing reciprocal switching is meaningless unless a reasonable rate for access is mandated by the ICC. However, determining such charges, based on marginal costs and an appropriate percentage of fixed costs, would not be unduly onerous and certainly would be far easier than assessing stand-alone costs under present maximum rate standards.

Contingency Plan

The preceding actions to preserve and promote competition under existing legislation could protect and enhance the benefits of deregulation. In addition, they could reduce the scope of ICC maximum rate regulation, replacing ICC mandated maximum rates with market determination of prices.[9] The captive shipper problem would also be expected to diminish

8. See in particular the Midtec Decision, Interstate Commerce Commission no. 39021, *Midtec Paper Corporation et al.* v. *Chicago and North Western Transportation Company*, decided December 2, 1986.

9. The ICC has in recent years abandoned Fully-Distributed-Cost pricing for coal and other captive traffic and replaced it with Ramsey pricing in principle, subject to the Stand-Alone Cost Test. As of this writing, it is still unclear precisely how the ICC will implement

over time as shippers adjust to deregulation. For example, a coal-burning electric utility might retool to use alternative fuels, thus using product competition to bargain for lower transportation rates. In addition, a utility contemplating a new plant location or expansion could sign long-term transportation contracts before committing to new investment, thus exploiting ex ante competitive alternatives.

But if the captive shipper problem becomes unexpectedly more severe, it may be appropriate to enact new legislation that separates ownership of the track from provision of service to a far greater degree than currently envisioned. One approach, recently taken by Canada, would be to guarantee blanket competitive access. Canada's National Transportation Act of 1987 provides an interswitching zone of thirty kilometers, whereby a shipper captive to railroad *A* but located within thirty kilometers of railroad *B* can ship via railroad *B*. Railroad *B* would pay railroad *A* a predetermined access charge, which varies according to distance and number of cars, thus eliminating the need for case-by-case determination of access costs. The Canadian legislation also provides for so-called competitive line rates, which allow for establishment by the national regulatory agency of a rate to the nearest interchange point. The aim of the legislation is to ensure that all shippers effectively have service by at least two competing railroads.[10]

A more serious contingency under which government action would be required is financial collapse of the railroad industry. Current trends in earnings are positive for the industry, and all but a few weak carriers should be able to withstand a moderate recession.[11] Nonetheless, a future

this complex new test. In any event, reducing the scope of maximum rate regulation would appear to be the best long-term solution to the current problem of implementing the Stand-Alone Cost Test. For example, according to data from a recent study on the location of coal-powered utility plants, 77 percent of those plants are located within twenty-five miles of more than one railroad. Moreover, 23 percent of these utilities are served by only one railroad but have at least one other railroad within twenty-five miles, suggesting that greater competitive access through reciprocal switching could significantly reduce the captive shipper problem.

10. Maria Rehner, "An Overview of the Rail Provisions in the National Transportation Act, 1987," *Transportation Practitioners' Journal*, vol. 55, no. 4 (1988), pp. 328–41, provides further details on the Canadian legislation. More radical proposals would allow access over all rail lines to any qualified user, including motor carriers and shippers. Recent legislation by the state of West Virginia declares railroads in the state to be public highways free to all.

11. Returns on investment for 1988 for the six largest rail systems, calculated on a consistent basis with previous year's revenue adequacy cases, are as follows: Norfolk-

financial collapse of a large portion of the railroad industry is not beyond the realm of possibility. A combination of developments, including an extended economic downturn, a serious decline in the demand for coal, major new improvements in motor carrier efficiency (perhaps from legislation easing size and weight restrictions), dramatic structural changes in the economy away from manufactured goods, and widespread implementation of new technologies such as coal slurry pipelines, could spell serious financial difficulty for the industry that should not simply be resolved by bankruptcy proceedings.[12] Such a contingency would require consideration of a more radical proposal: separating ownership of the rail infrastructure from railroad operations and allowing open access to all carriers.[13]

Under this emergency contingency plan, the government would purchase the track and set up a private corporation to administer access operations.[14] Open access could transform the cost structure of the industry, exhausting economies of density at the firm level and creating a competitive industry similar to trucking. Railroads would not face any infrastructure entry or exit barriers and would be free to serve any markets they wish. Rail rates should be fully deregulated, and the increase in competition resulting from these drastically lower entry requirements should drive rates to marginal cost.

At the same time, relieving railroads of their infrastructure obligations would reduce their costs, even though they would pay efficient access charges, by enabling them to optimize their network, which will lead to higher traffic densities and longer lengths of haul. Increased competition would force further concessions by unions and put downward pressure on labor costs. The result of these changes in cost structure, technology, and competition is that railroads should earn a normal profit in the long run.

Southern, 12.4 percent; Burlington Northern, 11.0 percent; Union Pacific, 10.9 percent; CSX, 5.8 percent; Conrail, 5.2 percent; and Southern Pacific, −2.3 percent. Thus, only Southern Pacific would appear to be in any serious financial difficulty in the event of an economic downturn.

12. The costs of preserving a private rail industry will be exceeded by the benefits. According to our shipper welfare models, the annual loss to shippers from eliminating rail as an alternative approaches $50 billion (1977 dollars).

13. A similar system—public ownership of railroad infrastructure with private companies operating with open access—has been proposed in Britain as a means of privatization. See "The Great Rail Sale," *Local Transport Today*, July 26, 1989, pp. 8–9.

14. This option was considered by the United States Railway Association, *Preliminary System Plan*, vol. 1 (Washington, February 26, 1975), in the case of Conrail. The separate rail facilities were to be called Confac.

Finally, a radically transformed railroad track network, in which unprofitable and lightly used lines were sold off, could enable the enterprise that manages the rail infrastructure to break even by setting efficient marginal cost track user charges. Thus, under the contingency of wholesale industry financial collapse, separating track ownership and rail operations may provide an attractive alternative to industry nationalization.

To be sure, a number of problems would need to be addressed before such a policy could be implemented. These include:

—financing the purchase of the railroads' infrastructure assets, whose market value was recently estimated by the ICC at $154 billion for track and physical structure and $60 billion for right-of-way;

—overcoming political opposition to increased government involvement in the economy and railroad opposition to confiscation of property;

—determining proper investment and disinvestment policies;

—pricing railroad infrastructure efficiently;

—ensuring efficient management of the infrastructure, including maintenance and construction of new track; and

—coordinating operations of multiple users safely and efficiently.

Although these problems are not to be taken lightly, solutions could be found. Future research should investigate this option in more detail so that it could be implemented if it were to become necessary.

Motor Carrier Policy Issues

Our findings suggest no compelling need for policymakers to enhance performance in the deregulated motor carrier industry. But public policy could generate benefits by ensuring that all motor carrier rates are set under fully competitive conditions, by promoting motor carrier safety, and by instituting efficient pricing of and investment in highways.

Full Deregulation of Inter- and Intrastate Freight Rates

Under the provisions of the Motor Carrier Act of 1980, interstate motor carriers are still regulated to the extent that they must still file tariffs with the ICC. Because deregulation has essentially produced the optimal level of motor carrier rates, it is difficult to argue that full deregulation of interstate rates could produce much additional benefit. Nonetheless, filing tariffs at the ICC involves unnecessary administrative work that should

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TAILORED ACCESS

Could railroad industry open access be limited and designed to respect a railroad's property rights while providing a surgical strike on behalf of frustrated, captive shippers? Could selective access enhance competition without re-regulation?

In other industries and countries, open access was motivated by a desire to substitute market competition for government regulation or ownership. On U.S. railroads, pressure towards open access comes from shippers pessimistic about redress of their reasonable rate or service grievances. The Alliance for Rail Competition (ARC) sees railroads enjoying the benefits of the Staggers Act deregulation while competitive discipline declines with each merger or consolidation. They do not look to regulation to resolve their frustrations because the current competitive climate was created under the watchful eye of the regulators. Competition through build-ins is possible in only limited circumstances, is costly, and consumes years of litigation. Midtec (1 I.C.C. 2d, p. 362) suggests that the Surface Transportation Boards (STB) is unlikely to require rail carriers to enter into reciprocal switching arrangements involuntarily.

The rate regulation road is peppered with potholes. The STB's modified and restrictive perception of what it takes to pass the market dominance test came with the winter thaw. The final rules for Simplified Rate Guidelines require that ten (10) factors be addressed before a shipper may proceed without use of the costly constrained market pricing procedures. The confidential waybill access rules denying shipper consultants access prior to filing a complaint, make it difficult for shippers to determine the strength of their case or the potential value of proceeding.

Jack Schenendorf, Chief of Staff of the House Transportation and Infrastructure Committee, believes that there are not enough votes to pass a legislative open access fix. Absent legislation, a regulatory approach that tailors increased access to specific problem areas is the best solution. Under this approach, regulators would first, identify the sites requiring added access (particularly from problems flowing out of the recent round of mergers), second, work to find a reasonable remedy for shippers, and third, protect the affected railroad's property rights. This tailored approach would address the cries of anguish of those shippers most aggrieved, avoid the specter of re-regulation, and build on the Staggers foundation.

Union Pacific's service meltdown, centered in Houston, Texas, is receiving current press focus. Economists say that UP's problems have cost Texas more than $1.4 billion. UP estimates that congestion cost them $567 million in 1997's fourth quarter alone. Capacity and competition are problems. Shippers charge that lack of competition leaves them with no relief from Union Pacific service failures. In spite of its problems, Union Pacific prevents other railroads from providing assistance. On January 30, 1998, Tex Mex had to petition for expedited enforcement of Emergency Service Order No. 1518 allowing Tex Mex to serve Chocolate Bayou and Lolita, TX.

1220 L STREET, NW, SUITE 410, WASHINGTON, DC 20005-(202) 371-9148, FAX (202) 842-4966

1471 CASTILLO DEL MAR, CAROLINA, PR 00979-(809) 783-7683, FAX (809) 783-7559

Believing that two (2) railroads provide adequate competition even if the region is dominated by one of the railroads, the STB has overseen a decrease in Houston's rail competition from 5 Class I railroads in 1988 to 2 today. In the UP/SP merger, BNSF was granted access to 2-to-1 shippers in the Houston area, but Union Pacific stifled BNSF's attempts to utilize this access. UP disputed BNSF's right to access certain shippers, refused to honor its pledge to assure unbiased track access, and prevented its competitors, BNSF and Tex Mex, from providing competitive service. A tenant's competition over the landlord's long-distance trackage rights is no competition at all when the landlord controls the quality of the tenant's service.

Houston stands alone among the ports of the country in its domination by a single railroad. BNSF serves Houston, but its market share is paltry. No other port is so dominated by a single railroad. In contrast to Houston's domination by Union Pacific, New Orleans, Houston's primary port competition, has more rail competition (six (6) Class I railroads) than any other port.

Houston stands out as the site with severely disrupted service and inadequate capacity. Tailored access via a neutral terminal switching company, with BNSF and Tex Mex acquiring the required assets and access to Houston shippers free from UP control of service, would provide competition in the face of UP dominance. This solution would return Houston to pre-UP/SP merger levels of competition. A terminal switching company is a time-honored solution for competitive access to an entire market. Consistent with the introduction of terminal railroads into other major U.S. cities, public entities (such as the Railroad Commission of Texas and the Greater Houston Partnership) want to assure that Houston has the service capacity needed to compete against other cities and ports in the U.S. and the rest of the world. With neutral dispatching, customer service, not profits, would be the driving force. Capacity would be increased because efficiency of the terminal, not of a single railroad, would be optimized. Shippers need a service outlet when a railroad experiences problems.

Joseph J. Plaistow

November 18, 1997

The Railroad Shipper Protection Act, S.1429
Section by Section Analysis

Section 1. Short Title—"The Railroad Shipper Protection Act of 1997"

Section 2. Findings. Since passage of the Staggers Rail Act of 1980, the railroad industry has consolidated dramatically while its financial health has improved substantially. Unfortunately, rail consolidation has created fewer competitive options for shippers and may have increased the number of captive rail shippers, despite the findings of the Surface Transportation Board in merger applications. Moreover, the Board seems focused primarily on the financial needs of the railroad industry to the detriment of the national goal of promoting effective competition between rail carriers.

Section 3. Definitions. The term "Secretary" means the Secretary of Transportation. The term "Surface Transportation Board" or "Board" means the Surface Transportation Board established under 49 U.S.C. § 701.

Section 4. Purposes. The purposes of this Act are: (1) to clarify the rail transportation policy of the United States Government; (2) to ensure rail competition for shippers where such competition is physically available; (3) to ensure reasonable rates for captive rail shippers; and (4) to remove unnecessary regulatory requirements in the Board's rate reasonableness process.

Section 5. Clarification of Rail Transportation Policy. This section clarifies the rail transportation policy of the United States Government by giving priority to two of the current policy objectives contained in 49 U.S.C. § 10101. The section requires the Board to give priority consideration to: (1) ensuring effective competition among rail carriers and (2) maintaining reasonable rates where there is an absence of effective competition.

Section 6. Requirement of Railroads to Establish Rates to Facilitate Rail to Rail Competition. This section requires rail carriers, when requested by a shipper, to quote a rate for transportation between any two points on the rail carrier's system where traffic either originates, terminates or can be interchanged. The rate will apply to the requesting shipper regardless of whether the rate is for part of a through route between origin and destination or whether the shipper has made other arrangements for transportation over any other part of that through route. At the STB, shippers may challenge the reasonableness of that rate or the aggregate rate between origin and destination.

This section effectively overturns the Board's December 1996 "bottleneck" decision by requiring a rail carrier to establish a rate for the bottleneck segment alone. After establishing a bottleneck rate, the shipper can then challenge the reasonableness of that bottleneck rate in a rate reasonableness challenge before the Board.

Section 7. <u>Simplified Standard for Market Dominance</u>. Rail shippers may only challenge the reasonableness of a rate if the Board finds that the shipper is subject to railroad market dominance. This section simplifies the market dominance standard of the Board to eliminate the regulatory burdens confronting captive rail shippers.

Under new section 10707(d)(1), the rail carrier will be presumed to have market dominance if the shipper is served by only one rail carrier at origin, destination or interchange and the rail carrier fails to prove that its rate results in a revenue to variable cost ratio below 180 percent.

Where the shipper is served by two or more rail carriers at origin or destination, market dominance will be determined only by considering transportation competition. Product and geographic competition will not be considered.

Section 8. <u>Revenue Adequacy Determinations</u>. This section repeals the current flawed revenue adequacy test of the Board and eliminates the requirement that the Board make annual determinations of the revenue adequacy of the Nation's railroads.

Section 9. <u>Reduction of Procedural Barriers Faced by Small Shippers</u>. This section requires the STB, within 180 days of enactment, to review its rules and procedures for rate reasonableness challenges and other shipper complaints and identify and take action to reduce or eliminate any rules or procedures that are unduly burdensome to small shippers. The STB is required to notify and make recommendations to Congress regarding any statutory changes necessary to achieve a reduction in the procedural hurdles faced by small shippers.