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Before the U.S. Surface Transportation Board

STB Ex Parte No. 714
Information Required in Notices and Petitions Containing
Interchange Commitments

Comments of the
U.S. Department of Agriculture

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Date: December 18, 2012

Authority and Interest

The Secretary of Agriculture is charged with the responsibility under the Agricultural Adjustment Act of 1938 and the Agricultural Marketing Act of 1946 to represent the interests of agricultural producers and shippers in improving transportation services and facilities by, among other things, initiating and participating in Surface Transportation Board (Board) proceedings involving rates, charges, tariffs, practices, and services.

Introduction

The Department of Agriculture (USDA) recognizes that interchange commitments are a controversial subject matter. On the one hand, they were beneficial in encouraging the sale or lease of light density rail lines to short line railroads, saving them from abandonment by Class I railroads. This allowed service to continue and even improve in some areas, especially benefitting rural grain-production areas. This further promoted the rebirth of the short line rail industry, which has been a positive development for shippers. On the other hand, certain provisions contained in interchange commitments have restricted shippers' access to competing markets. This prevents shippers from receiving the best price for their product, leading to potential economic harm.

Allowing competition to the maximum extent possible is within the Board's statutory responsibility under the Rail Transportation Policy¹ as well as in the best interest of the broader public welfare. While the degree of financial health for the railroad industry remains debated, the structural characteristics of the industry and their effects on the market are greatly different now than they were 32 years ago. As such, the Board's rulemaking is welcomed as a necessary adjustment in rail policy to reflect the changed state of competition in the rail industry.

Comments

USDA supports the Board's rulemaking to revise its rules concerning interchange commitments. USDA believes substantial evidence filed under previous proceedings warrants these revisions and the Board's undertaking. USDA believes the Board's proposed revisions should largely address shippers' concerns of unwarranted and anti-competitive provisions being included in new interchange commitments. USDA also recommends that the Board go further and that any anti-competitive provisions already embedded in existing interchange commitments also be addressed by this rulemaking.

While it is difficult to predict, it is reasonable to assume there will not likely be a large number of new interchange commitments in the future. First, the extent of track mileage controlled or leased by short line and regional railroads has been stable since the 1990's following the initial high level of sales, leases, and abandonments by the Class I railroads beginning in 1980. This pattern suggests that a significantly larger number of interchange commitments were put in place between 1980 and 1995, when short line and regional track mileage increased 150 percent, compared with the 5-percent decrease that has occurred since 1995. Second, and perhaps even more telling, is the fact that Class I

¹ 49 U.S.C. § 10101

railroads have begun to show interest in reacquiring some of their former light density lines. If this trend were to continue, there may be fewer new interchange commitments brought before the Board as the Class I railroad trend of selling and leasing turns to repurchasing and reacquisition. Thus, the opportunity to meaningfully address concerns about any anti-competitive provisions that might be embedded in interchange commitments is for the Board to review the provisions that are already in place. USDA believes such an undertaking is especially important because so little is publically known about the terms of the existing agreements, such as the length of agreement terms or the existence of provisions that unreasonably limit competition.

Ideally, in addition to this rulemaking, the Board would use its authority to strike a middle ground that is fair to both railroads and shippers concerning existing interchange agreements.

USDA supports measures involving interchange commitments that ensure adequate rail-to-rail competition as listed in the Rail Transportation Policy of the Staggers Rail Act and the Interstate Commerce Commission Termination Act (ICCTA). Shippers continue to seek ways by which the Board may fulfill its obligation “to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail.”² As laid out by the Rail Transportation Policy, competition is in the best interest of all parties. In an absence of competition, both shippers and railroads operate in a sub-optimal environment. Shippers’ access to markets is limited, potentially causing economic harm to them and their communities.

Addressing existing interchange commitments offers the Board a chance to increase rail-to-rail competition, thereby increasing competitive options for shippers. Interchange commitments may create barriers to increased competition in order to favor the seller or lessor railroad. Limiting competition in order to allow the seller or lessor to recover the fair market value of a line should not be discouraged, but the terms by which this is accomplished should be subject to STB and shipper scrutiny, given the sensitive nature surrounding anti-competitive provisions.

Recommendations

The Board already recognizes two forms of potential economic harm contained in interchange agreements—those that last in perpetuity and those that effectively eliminate the ability of the purchaser or lessee railroad from interchanging with a third-party carrier. USDA shares the Board’s concern for these anti-competitive provisions and believes the Board should prohibit them in both proposed and existing interchange commitments.

USDA believes that in the sale of a line, term limits should be considered for existing interchange commitments. Interchange commitments lasting many years, and especially those lasting into perpetuity, may overcompensate the seller railroad. While for some period, interchange commitments may be necessary for recovering the full market value

² 49 U.S.C. § 10101(1)

of a rail line sold at a discount, the full market value of the transaction will eventually be realized by the seller. Therefore, any line sale containing an interchange commitment lasting into perpetuity, at some point, ceases to provide fair market compensation to the seller and remains solely as a barrier to increased competition.

Second, excessive penalties on traffic interchanges need to be reviewed and, if warranted, should be modified to enable reasonable interchange opportunities with third-party carriers. Railroads state that penalties are imposed on traffic interchanges with third-party carriers to compensate them for the accompanying loss in income, and that without these penalties there would be no incentive to lease a line for below its fair market value. However, penalties that result in supra-normal payments in excess of a line's fair market value may be anti-competitive by constituting an effective ban on traffic interchanges with competing third-party carriers. Consequently in cases with an agreement into perpetuity or for many decades, a shipper's access to markets may be arbitrarily restricted regardless of market demand, limiting their ability to seek the best price for their products.

It is conceivable to imagine a scenario under which market demand is stymied by excessive penalties, which are eventually borne by the shipper. For example, suppose there were market demand for a shipper's product at Points A and B. Point A is willing to pay \$800 for the product while point B is willing to pay \$1,000. The shipper is located on a section of track leased by a shortline from Railroad 1. The shipper can pay \$500 to ship his product to Point A through a joint rate between Railroad 1 and the shortline. The shipper can alternatively pay \$500 for a joint rate between Railroad 2 and the shortline to ship his product to Point B plus an additional \$100 lease penalty to Railroad 1 that will be passed along.

For illustration purposes, assume the \$100 lease penalty is the fair market compensation to Railroad 1. Under this scenario, the shipper would choose to ship to Point B, receiving \$400 after transportation costs versus \$300 from Point A. However, if Railroad 1 sets the lease penalty above fair market compensation, at \$500 for example, then any interchange movements with a third-party carrier become effectively prohibited. This interferes with market demand for the shipper's product by distorting the price incentives that occur in a competitive market.

In the above example, the railroads' argument that they should be compensated for lost revenue is without merit when scenarios are considered under which traffic interchanged with a third-party carrier represents traffic creation instead of just traffic diversion. In the scenario above if, instead, Point A is willing to pay \$400 for the product while Point B is willing to pay \$1,000. Railroad 1 is not losing any traffic to Railroad 2 because the interchange with Railroad 2 creates a brand new market opportunity that did not exist prior to the lease. If Railroad 1 charged a reasonable lease penalty, \$100 for example, it would stand to benefit from the traffic creation along with the shipper, the shortline, and Railroad 2. Thus, the Board should be diligent in examining the incentives associated with traffic interchanges to ensure they allow reasonable third-party interchange

opportunities while preserving the lessor's ability to recover a fair market compensation for the lease.

Moreover, under present interchange commitment rules, the overall economy is not producing maximum economic benefits because of each railroad's attempt to maximize its own returns through preventing competition. Interchange commitments which limit market opportunities and/or raise rates above the competitive price leave shippers, the primary businesses that depend on shippers, and the secondary businesses that are dependent on shippers worse off. To deliver the greatest maximum benefit, competition would have to be imposed on interchange commitments. Because the railroads would be competing with each other for traffic lost or gained, the overall change in returns to railroads would be negligible. Traffic lost by one railroad would be picked up by another and vice versa. Yet, through traffic creation, as discussed above, railroads would see an increase in traffic and revenues beyond what they receive under the current rules governing interchange commitments. Furthermore, the overall economic benefit to the economy would increase through traffic creation, competitive prices, and increased market opportunities for shippers.

USDA recognizes the potential for unintended consequences resulting from an amendment to any alleged anti-competitive provisions existing in the interchange commitments. In extreme cases it might nullify previous lease or sale contracts, effectively terminating a short line's right to operate on the contested rail lines. In addition to harming the short line, this could cause economic harm to shippers through a deterioration of service. USDA understands that such proposals may pose problems between the sellers or lessors and the purchasers or lessees, and ultimately upon shippers. This is not the outcome that USDA wants. USDA believes it is within the Board's ability to strike the balance between railroads and shippers that preserves market incentives for all involved and promotes the overall well-being of the economy. Based on the record from past proceedings, USDA believes that a careful examination of existing interchange agreements is warranted and presents a good opportunity to meaningfully address ways to increase rail-to-rail competition for the benefit of shippers and railroads.

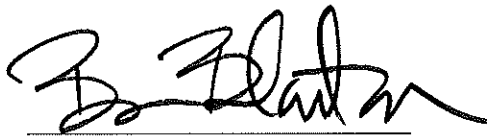
Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Edward Avalos", with a horizontal line drawn through the middle of the signature.

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CERTIFICATE OF SERVICE

I, Bruce Blanton, certify that on this 18th day of December, 2012, caused a copy of the foregoing document to be served by first-class mail, postage prepaid, on all parties of record in STB Docket Number EP 714.

A handwritten signature in black ink, appearing to read "Bruce Blanton", written over a horizontal line.

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