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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 680

STUDY OF COMPETITION IN THE FREIGHT RAILROAD INDUSTRY

JOINT COMMENTS OF CERTAIN COAL SHIPPERS

**I.
INTRODUCTION**

These joint comments are submitted in response to the Surface Transportation Board's November 6, 2008¹ request for public comments on the study prepared by Laurits R. Christensen Associates, Inc. ("Christensen Associates"), entitled, *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals that Might Enhance Competition* ("the Study"). These comments are being submitted on behalf of The AES Corporation; Arkansas Electric Cooperative Corporation; Omaha Public Power District; Entergy Services, Inc.; and WE Energies (together "Jointly Commenting Coal Shippers" or "JCCS"). All are either investor owned or public power utility companies which ship coal by railroad to their coal-fired electric generating stations located throughout the United States. Each of the utilities participating in these joint comments is a member of one or more industry and trade groups, such as the Edison Electric Institute, Consumers United for Rail Equity, and the Western Coal Traffic League, which are also submitting comments in this proceeding. These joint comments supplement the comments of those organizations with views on several aspects of the Study that have particular relevance to coal transportation.

The JCCS believe the Study, while providing useful historical information on the nation's Class I railroads and presenting a large amount of mostly industry-wide and average statistical economic information on the overall state of the railroad industry as of 2006, ultimately does not directly answer the fundamental question it was directed to "rigorously" investigate, namely: What is the current state of competition in the railroad industry and in particular commodity transportation markets? These joint comments touch on several reasons for this conclusion:

- First, the Study's analysis and conclusions do not reflect the real world experiences of the JCCS and many other freight rail shippers over the past five years because the Study does not rigorously analyze the qualitative data the drafters of the Study collected in conjunction with the Study's extensive quantitative analysis. Those experiences have revealed that there currently is in fact little or no competition between Class I railroads for coal transportation.
- Second, the absence of 2007 and 2008 Class I railroad revenue and profitability data undercuts the Study's analyses and conclusions.
- Third, the Study's conclusions about competition in the coal transportation sector are based in part on a mis-application of the Board's "Bottleneck Rules."
- Finally, the Study did not include in its overall analysis data and information on several key indicia of whether competition currently exists, including railroad behavior regarding fuel surcharges, service issues, and cost shifting.

In summary, while the Study compiles an impressive amount of industry-wide, average rate and cost data that may be useful in a macro sense, the usefulness of the Study as a rigorous analysis of the current state of rail competition in particular sectors of the rail industry, particularly the coal transportation sector, is questionable.

II.

IDENTIFICATION OF JOINTLY COMMENTING COAL SHIPPERS

Each of the parties described below is an electric utility which has generating stations that have experienced various levels of competition between Class I railroads since the facilities

¹ The Board subsequently corrected the filing date for comments in a Notice served on November 7, 2008.

came on line, but substantial reductions in competition and service over the past five or six years. A brief description of each commenting entity is provided below:

A. The AES Corporation

The AES Corporation is a holding company with headquarters in Arlington, Virginia. It is a global power company with subsidiaries throughout the world. The AES Corporation, through its subsidiaries, operates approximately 20 generating facilities in the United States. Nine of the facilities are rail-served, coal-fired generating stations. Coal is delivered in single and joint-line service by the BNSF Railway Company ("BNSF"), Norfolk Southern Railway Company ("NS"), CSX Transportation Company ("CSXT") and the Kansas City Southern Railroad ("KCS").

B. Arkansas Electric Cooperative Corporation

AECC is a membership-based generation and transmission cooperative that provides wholesale electric power to electric cooperatives, which in turn serve approximately 460,000 customers located in each of the 75 counties in Arkansas. In order to serve its member distribution cooperatives, AECC has entered into arrangements with other utilities within the state to share generation and transmission facilities. AECC holds ownership interests (with Entergy – see below) in the White Bluff plant at Redfield, AR and the Independence plant at Newark, AR, each of which typically burns in excess of 6 million tons of Powder River Basin (PRB) coal annually. In addition, AECC holds an ownership interest in the Flint Creek plant, at Gentry, AR, which normally burns in excess of 2 million tons of PRB coal annually delivered to the plant by KCS.

C. Entergy Services, Inc.

Entergy is a wholly owned subsidiary of Entergy Corporation and acts as agent for the various Entergy electric utility operating subsidiaries with respect to the acquisition and transportation of coal. Entergy co-owns and operates five coal-fired generating units located in Arkansas and Louisiana that total 3,887 MW of capacity. These units include the White Bluff and Independence Stations in Arkansas, and the Nelson Station in Louisiana. Entergy is also a co-owner of one of the Big Cajun Units located in Louisiana. All of these stations were designed to burn 100 percent PRB coal.

All of the Entergy operated coal units are served directly by railroad and have historically received virtually all of the coal that they burn via railroad. Entergy coordinates the transportation of approximately 15 million tons of coal per year to Entergy's various generating stations via UP and BNSF.

D. Omaha Public Power District

OPPD is a public corporation and political subdivision of the State of Nebraska with its principal place of business in Omaha, Nebraska. OPPD provides electrical service to more than 320,000 residential, commercial, industrial, and governmental customers in a 13-county territory in eastern and southeastern Nebraska that includes the Omaha metropolitan area. OPPD generates electricity to serve its customers from a mix of generating resources that includes the North Omaha Power Station, a 663-megawatt-capacity plant located in Omaha, Nebraska, and the Nebraska City Power Station ("NCPS"), a 646-megawatt-capacity plant located south of Nebraska City, Nebraska. Both plants burn PRB coal to produce electricity for OPPD's customers. Both plants have direct access to UP and BNSF. In May 2009, OPPD's new 663 MW Nebraska City Unit No. 2 is scheduled to commence commercial operation.

E. WE Energies

We Energies is a wholly owned subsidiary of Wisconsin Energy Corporation based in Milwaukee, serving more than 1.1 million electric customers in Wisconsin and Michigan's Upper Peninsula and more than 1 million natural gas customers in Wisconsin. We Energies owns and operates five coal-fired generating plants with a total capacity of 3,189 Megawatts and annual coal consumption of approximately 11.5 million tons per year. Two plants are served directly by rail and the remaining three plants are served by rail to either of two docks where coal is transloaded to Great Lakes vessels. Rail service is provided by UP and BNSF. Eighty-five percent (85%) of coal consumed originates in the Powder River Basin and 15% originates from the Uinta Basin in Colorado.

III.
COMMENTS

A. The Study does not Assess “the Current State of Competition in the U.S. Railroad Industry”

1. The GAO’s Recommendation

The Study is the result of a 2006 recommendation of the General Accountability Office (“GAO”) to the Board to conduct a “rigorous analysis of the state of competition nationwide, and, where appropriate, consider the range of actions available to address problems associated with the potential abuse of market power.”² In recommending that the Board undertake such a study, the GAO urged the Board to “conduct a rigorous analysis of competitive markets to identify the state of competition nationwide, inquire into pricing practices in specific markets, and consider

² US General Accountability Office, Report to Congressional Requesters, *Freight Railroads – Industry Health has Improved but Concerns about Competition and Capacity Should be Addressed* (October 2006) at 3-4. (“GAO Report”).

appropriate actions available to address problems associated with the abuse of market power.”³

By its terms, this recommendation necessarily entails an examination of whether, in particular markets or regions, Class I railroads are behaving in a manner in which they are effectively competing to secure a particular customer’s business, *i.e.*, seeking to take market share from another competitor by offering lower rates, service provisions that provide benefits to the prospective customer, and/or reasonable accessorial charges and surcharges.

In recognition of the GAO recommendation, the Study states as the very first of “five fundamental questions” it purportedly addresses: “What is the current state of competition in the U.S. railroad industry?”⁴ However, none of the 12 Study findings summarized in the Executive Summary directly supply an answer to this question, in whole or in part.⁵

2. The Study Summarizes and then Mostly Ignores Qualitative Input from Rail Shippers

In Volume 2 of the Study, which contains the Study’s “Analysis of Competition, Capacity and Service Quality,” the Study states that it “presents our *quantitative* analyses and results” on competition in the railroad industry.⁶ There is no comparable *qualitative* analysis of industry competition in Volume 2. Instead, Chapter 5 of Volume 1 of the Study – the volume containing overview material on the railroad industry - summarizes the real world input the researchers received from rail shippers during the qualitative evidence phase of the study. This input is then largely ignored in the quantitative analysis that follows in Volume 2. Some of the qualitative input summarized in Chapter 5 includes the following:

³ GAO Report at 5.

⁴ Study at ES-4.

⁵ See *Id.* at ES-5.

⁶ *Id.* at Vol. 2, 6-1 (emphasis supplied).

[s]ome shippers who had access to more than one railroad said that the advantages of having service from more than one railroad have diminished in recent years, *i.e.*, the competitive behavior of railroads has decreased.⁷

A number of shippers noted that railroads have moved away from confidential contracts with shippers to public tariffs for certain types of shipments. Some shippers state that both Western railroads use almost identical public pricing and appear to be happy with their market share and now refuse to compete. In fact, it has been alleged that such public pricing represents a signaling mechanism through which railroads can fix prices – *i.e.*, such pricing is a deterrent to true competition between railroads. It has been further alleged that the railroads now refuse to participate in private contracts or private contract negotiations.⁸

. . . [W]e heard that even when a shipper has access to two railroads, they cannot get the potential competitor to give them a bid against the incumbent railroad. This refusal to bid practice is viewed as an indication that the railroads are allocating markets among themselves. A variant on this view is the opinion expressed by some shippers that railroads don't seem to be hungry for new business.⁹

Much of the problem with service variability was attributed to reduction in rail competition. Moreover, since shippers stated that new contracts rarely include any performance standards or penalties for not meeting standards, so there is an increasing lack of railroad accountability.¹⁰

All of the JCCS can attest from their individual experiences that these and other issues summarized in Chapter 5 encapsulate the current state of competition for coal transportation. The Study states that the “extensive stakeholder input greatly assisted in the focus of our research efforts and also indicated areas where further investigation is warranted.”¹¹ However, there is no discernable, let alone rigorous, attempt by the Study to reconcile or explain the differences and inconsistencies between the qualitative input obtained by shippers and the quantitative data, formulas and assumptions utilized to estimate railroad competition in Volume 2. In fact, the Study in places indicates it was not designed to analyze or reach conclusions about

⁷ *Id.*
⁸ *Id.* at 5-10.
⁹ *Id.* at 5-11.
¹⁰ *Id.* at 5-12.
¹¹ *Id.* at ES-4.

whether railroads were engaging in anti-competitive behavior in any particular market. Specifically, the Executive Summary contains the initial disclaimer that “[t]o address whether there has been an ‘abuse of market power’ would require judgments as to the fairness of the distribution of value between the railroads and the shippers These judgments are policy questions and not resolvable through economic analysis alone. Instead, we have answered the economic questions. . . .”¹² As one example of this approach, the Study recounts that during the qualitative phase of the project “coal shippers often said that when a competing option is available they are not able to get bids from the potential competitor,” and that this raises a “possible question here [of] whether this practice is the result of anti-competitive behavior or the railroads rationing scarce capacity by prioritizing traffic”¹³ However, the Study does not address the actual question of whether anti-competitive behavior was taking place, even though the Study later concludes that railroad capacity is not “scarce” and therefore does not provide a justification for raising rates.¹⁴

Another example of this approach is in Chapter 8, where the Study conducts a quantitative analysis of railroad pricing practices and financial performance. This chapter confirms that railroad rates and profitability have significantly increased in recent years (*See e.g.* 8-15: “between 2004 and 2006, the rate increases were substantial”), and states that “market analysts and our stakeholder interviews all suggest that at least a portion of the improved profitability is due to increased pricing power,” *i.e.*, the diminishment of competition that would hold rates down.¹⁵ However, the Study then adds that its quantitative analysis of railroad pricing and financial performance in Chapter 8 “does not enable us to discern what portion, if any, of the

¹² *Id.* at ES-6.

¹³ *Id.* at 5-11 (emphasis supplied).

¹⁴ *Id.* at 16-30 to 16-31.

¹⁵ *Id.* at 8-53.

increases in prices is due to increased exercise of market power versus increased competitive advantage of railroads over alternative transportation modes, or simply increases in overall demand that have allowed railroads to use price to ration its [sic] service.”¹⁶ In other words, this Chapter of the Study simply confirms that railroad rates have risen substantially, and that railroad profitability has improved. It cannot answer the primary question of what is the current state of railroad competition nationally or in particular markets. The Study’s failure to fully integrate the qualitative evidence of railroad market behavior into the quantitative analysis, combined with the Study’s decision not to make any informed judgments about railroad market behavior, seriously diminishes the value and usefulness of the Study as an assessment of the state of railroad competition.

B. The Study Undercuts its Credibility By Cutting off Railroad Revenue Data with 2006

The Study establishes a date range of 2000 to 2006 for its analysis, and the researchers accordingly collected railroad revenue data through 2006. However, cutting off railroad revenue data at 2006 creates several significant problems for the Study. The most obvious problem is that by being issued in November, 2008 and being limited to revenue data from 2000 to 2006, the Study is immediately nearly two years out of date and therefore incapable of accurately describing the “current state of railroad competition.” While it is impossible for any study to be 100% current on the date it is issued due to the need to stop collecting data and to conduct analysis and draft the study document, the failure of the Study to include any 2007 and 2008 revenue data, or even discuss 2007 and 2008 revenue trends and their potential impact on the Study’s conclusions, undermines the Study’s analysis and findings. First, using a 2000 to 2006 time frame to perform an overall, average railroad rate and cost analysis results in

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Id.

unrepresentative and skewed average data for the reason that until around the 2003 timeframe there was little concern among rail shippers, in particular coal shippers, that the Class I railroads were competing for business and market share. As noted by the GAO report, and by the anecdotal evidence received by researchers during the Study, the ramp up of rates and the other indicia that competition between Class I railroads was decreasing began in around the 2004 timeframe and accelerated in 2005 and into 2006. For this reason, data in the 2000-2003 timeframe is largely irrelevant to an assessment of the current state of rail competition in 2008 and only skews the Study's analysis of industry-wide market power.

The Study recognizes the 2003-04 line of demarcation to some extent, and contains some separate discussion and analysis confined to the 2004-2006 timeframe. However, this recognition should have increased the importance of including 2007 and 2008 data to the extent possible in order to maximize the revenue data upon which the Study's conclusions were based. It is even more compelling that the data collected by the Study, and the charts included in the Study in which revenues are compared to costs, demonstrate that the significant ramp up of railroad rates and revenues that began in the 2004 timeframe appears to continue, and even appears to increase, beyond 2006 into 2007.¹⁷ If in fact the revenue trend shown by the data in the Study was to increase into 2007 and beyond, this would appear to significantly impact several of the key Study findings:

1. It would undercut the conclusion that "overall, the railroad industry is pricing at levels generating earnings that maintain or slightly exceed those necessary to ensure financial viability."¹⁸
2. A continuation of the trend lines of Figure 18-4 on 18-4 into 2007 and 2008 would appear to show an increase in the differential between revenue per ton mile (RPTM) over marginal cost (MC) thereby indicating an increase in railroad

¹⁷ See e.g. figures ES-5, ES-10, ES-12, 8-5, and 8-6.

¹⁸ Study at ES-39.

“market power” even under the study’s formulaic, industry-wide definition of market power.

3. It would modify the Study’s theory that (a) rate increases for PRB coal transportation after the service problems on the Joint Line in 2005 were acceptable to first, ration capacity in the PRB, and then to recover capital costs from fixing the Joint Line; and (b) “the 2005 disruptions also suggest that the jumps in revenue, tonnage, and ton-miles in 2006 (over 2005) are byproducts of the return to normality in the coal transportation system”¹⁹
4. The entire discussion on “Economic Analysis of Policy Proposals” in Volume 3 of the Study is predicated on circumstances “as of 2006”, which the Study concluded meant “[t]here is little room to provide significant rate relief to certain groups of shippers without requiring increases in rates for other shippers or threatening railroad viability.”²⁰ Based on this conclusion, the Study opines that only “incremental policies” should be considered.

However, the Study’s drafters also included a significant caveat with its analysis, namely “does 2006 represent a new trend?”²¹ This can only be referring to the significant increases of revenues over costs the data revealed for 2006, and that a continued upward slope of the revenue graph into 2007 and 2008 could alter the conclusions to expand the policies for resolving shipper issues beyond “incremental,” since the need to increase rates to other shippers or the threat to railroad viability would both diminish. This express acknowledgement, coupled with a lack of any discussion of rate and revenue trends into 2007 and 2008 undercuts the entire analysis of the policy proposals.

Of course, railroad rates and railroad profits did in fact continue to substantially increase into 2007 and 2008 on a percentage basis at least comparable to or even in excess of 2006 levels. This information was available to the Study drafters through industry publications and other public sources, even if it was not provided directly to them by stakeholders during the qualitative phase of the project, which extended into August, 2008.²²

¹⁹ *Id.* at 12-4.

²⁰ *Id.* at 23-4.

²¹ Christensen Associates November 2008 PowerPoint presentation to STB, at page 25.

²² See, e.g., Study at 5-4, note 5 (stating that the qualitative research phase of the project “also involved performing literature searches, reviewing STB proceedings, and researching trade publications;” and *Id.* at 5-5 (stating that “our last interview occurred in late August, 2008”). Examples of publicly available information discussing rail rate and profitability trends in 2007 and 2008 include: (1) a 2008 Rail Industry Rate Outlook, issued on February 29, 2008 that stated railroad carload pricing increased an average of 8.6% annually for the years 2005-2007; (2) “The Price of Challenge; could the Economy – and the government – Change the Momentum of Railroad Pricing,” *Traffic World*, August 27, 2007 (railroads still raising rates 7% annually on average); and (3) “Shipping

In summary, given the Study's overall conclusions and their susceptibility to change in the event rail rates and profitability continued to exceed costs heading into 2007 and 2008, the lack of such data, or even a general discussion of the obvious revenue data trends heading into 2007, significantly undermines the findings and conclusions of the entire Study. This absence is magnified further by the fact that the Study collected and incorporated into the analysis other 2007 and 2008 data, such as input costs and prices through the second quarter of 2008.²³

C. The Study Misunderstands the Operation and Effect of the Bottleneck Rules on Competition

In Chapter 11 the Study uses Carload Waybill Sample data and economic models and formulas to estimate "the effects of two factors which may limit a railroad's ability to exert local market power: the availability of water-transportation alternatives and the presence of railroad competition."²⁴ This analysis essentially begins with a "profit-maximizing model" and then adjusts the model to estimate how the profit maximization motive might be held in check by these two competitive forces. As stated above, this quantitative analysis was not tested against the qualitative evidence collected for the Study. It also contains certain assumptions that are contrary to the real world commercial aspects of transporting of coal by rail, and basic legal rules applicable to the establishment of railroad rates, in particular the so-called "Bottleneck Rules" adopted by the Board in 1996.²⁵ Specifically, the analysis starts from the general underlying assumption that "[m]ore commonly, the shipper has a number of options. For example, it could use a different mode, a different railroad, or a number of different modal combinations and

Rates Swell Tab for Utilities Coal Deliveries" Platts Coal Outlook, August 13, 2007. More recently, the December 2008 version of Rail Price Advisor, characterized 2008 carload rate increases of BNSF(22.6%), UP (21.9%), NS (23.9%) and CSX (21.2%) as "staggering," and that they made "even the highest change in rates over the 2002 to 2007 time period seem tame when compared to the increases in 2008."

²³ *Id.* at ES-17.

²⁴ *Id.* at 11-1.

options. It could also ship to or receive from different locations Thus, the other options serve as constraints on the railroad's pricing."²⁶ In reality, most coal shippers have no modal option other than railroad, are limited to receiving coal from very limited locations, and coal shippers cannot move their power plants. As such, for most coal shippers, the relevant analysis, in the absence of a water-transportation option, is whether there are effective alternative railroad options. On this point, the Study proceeds from the assumption that "the presence of additional railroads would be expected to reduced rail rates," and then tests this assumption and estimates constraints on rail rates by separately examining railroad competition at origin and railroad competition at destination.²⁷ This basic approach is carried forward to Chapter 12 – Analysis of Competition: Coal, where the Study concludes that "[i]ncreasing railroad competition for coal shipments at the origin modestly reduces rates, whereas increasing competition at the destination is expected to lead to larger rate reductions for coal shipments."²⁸ These conclusions on estimated competition levels are later applied to the Study's conclusions on the overall state of rail competition.²⁹ However, estimating rail competition for coal transportation by segregating competition at origin and competition at destination ignores the reality of the current rail industry and the Bottleneck Rules, which permit a railroad with a monopoly over any portion of the movement to eliminate any of the benefits of competition on other segments of a through route by refusing to supply a rate for just its segment. For coal movements, this means that, for example, even if competition between railroads existed at an origin mine, the Class I railroad with a monopoly over the track leading to a coal-burning facility at the destination can decline

²⁵ *Central Power & Light Co. v. Southern Pacific Transp. Co.*, STB Docket No. 41242, *et al* (STB served December 1, 1996), *clarified* (STB served April 30, 1997), *aff'd*, *MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8th Cir. 1999).

²⁶ Study at 11-4.

²⁷ *Id.* at 11-5, 11-18.

²⁸ *Id.* at 12-11.

²⁹ See *e.g.*, *id.* at 18-7 to 18-13.

the shipper's request to quote a rate to a point of interchange between that railroad and the competing origin railroad, and instead quote only a rate for the entire movement from origin to destination over the monopoly railroad's system. In this way, the bottleneck railroad is permitted to favor its long haul movement and eliminate any competitive benefits that would otherwise have occurred along the through route, subject only the STB's rate reasonableness procedures.

The only potential means for the shipper to gain the benefits of competition where dual rail service exists along the through route(s) above a bottleneck is to first enter into a contract for the movement of coal from the origin to the interchange point, and then request a rate over the bottleneck segment. But even this exception to the Bottleneck Rules is limited: the ultimate arbiter of whether the contract interchange point selected by the shipper is appropriate is the Board, and where the bottleneck railroad and the potential competitor to the interchange point serve the same origin, the shipper must first enter into a contract, and then meet the STB's competitive access standards under 49 C.F.R. § 1144.2 to establish the new routing.³⁰ None of the JCCS know of any instance where the "contract exception" to the Bottleneck Rules has been utilized for a coal transportation movement since the rules were adopted in 1996, which in and of itself is a qualitative fact that the Study should have taken into account in examining the current state of railroad competition. The Study contains no discussion of how its quantitative models estimating coal transportation competition are affected by the Bottleneck Rules and indeed, the respective benefits of origin and destination competition discussed in the Study have simply not occurred in the current coal transportation market, where the Class I railroads routinely refuse to

³⁰ *Central Power & Light Co. v. Southern Pac. Transp. Co.*, STB Docket No. 41242, et al, (STB Served April 30, 1997) (decision on petition for clarification on "same origin" and "contract exception" aspects of Bottleneck rules, and denying a petition for reconsideration).

quote bottleneck rates and to negotiate contracts over non-bottleneck segments, and favor their respective long haul movements for coal movements.³¹

D. The Study Does not Address other Key Factors that Bear on the Question of the Current State of Competition in the Railroad Industry

Finally, the Study admittedly does not include data or analysis pertaining to several key indicia of the current state of railroad competition, and states that some of these are areas where “future research and analysis would improve the understanding of the U.S. freight railroad industry.” A few of the key areas are discussed below:

1. Market Share

An analysis of the state of competition in any market should entail an examination of whether the market participants are seeking to expand market share by offering lower prices or service terms to attract new business. As stated above, the qualitative evidence collected during that phase of the Study included statements by shippers that they believed that the Class I railroads had stopped competing because they had divided up the relevant markets, and therefore were not interested competing for new business.³² These statements are supported by public documents, such as, for example, a September 28, 2008 market report issued by Merrill Lynch on Burlington Northern Santa Fe Corp. that stated BNSF Railway “reiterated that it is not engaging in competitive pricing to win business”³³ However, the Study contains no analysis or discussion of how Class I shares of the markets for transportation of different

³¹ In addition to not correctly factoring in the Bottleneck Rules, Chapters 11 and 12 of the Study contain no discussion of how the “Inferences for Competition” contained on 12-11, which conclude competition exists at mine origins and destinations, can be reconciled with the qualitative input summarized in Chapter 5, in particular that . . . [W]e heard that even when a shipper has access to two railroads, they cannot get the potential competitor to give them a bid against the incumbent railroad. . . .” and “the opinion expressed by some shippers that railroads don’t seem to be hungry for new business.” Study at 5-11. Rather quantitative analysis and conclusions, the Study simply appears to conclude such statements are not credible.

³² *Id.* at 5-10 to 5-11.

³³ Burlington Northern Santa Fe Corp., Confidence in Business Growth Remains, Merrill Lynch (September 29, 2008) at 5.

commodities have changed over time, and whether there are facts supporting the claims that the Class I railroads are no longer interested in expanding their market share for particular commodities. Relevant market share data for the 2000-2007 that should have been collected and incorporated into the overall analysis included, but was not limited to:

- a. All traffic held by the Class I railroads, on a carload basis for each year of the study period;
- b. The extent to which transportation available to two or more Class I railroads changed from one railroad to another, and what were the resulting rates and charges;
- c. BNSF's and UP's respective shares of PRB coal tonnages;
- d. CSXT's and NS's respective shares of eastern coal tonnages; and
- e. The extent to which BNSF has used, or not used, the trackage rights it was granted in the Central Corridor as a condition for approval of the merger of UP and Southern Pacific in 1996 to effectively replace pre-merger competitive options for the movement of western bituminous coal.

2. Fuel Surcharges

The Study contains some data on railroad fuel surcharges, but for the most part fuel surcharges are listed as a "Future Research Direction," because STB data on fuel surcharges "have not been collected long enough at this point in time to perform a reasonable analysis."³⁴ However, the Study misses the relationship of railroad fuel surcharges to the overall question of the current state of competition in the railroad industry. Specifically, that the Class I railroads' unilateral imposition of fuel surcharges that over compensated them for actual fuel,³⁵ on

³⁴ *Id.* at ES-43; see also 5-21 ("the data are not sufficient to examine a number of issues related to these surcharges.")

³⁵ There should be no residual argument that Class I railroad fuel surcharges assessed in the years covered by the Study did not over recover fuel costs for the particular movements for which they were assessed. This was demonstrated by the substantial record compiled by the STB in Ex Parte 661, *Rail Fuel Surcharges*, which commenced in March, 2006 and continued into 2007. The record in that proceeding was replete with testimony and factual evidence submitted by a wide variety of captive and dual served railroad shippers about the assessment by the Class I railroads of nearly identical fuel surcharge formulas, on a "take it or leave it basis." A study

essentially a "take it or leave it" basis industry-wide, is a strong indicator that competition is lacking in the railroad industry. This is because in a truly competitive environment in any industry, all other things being equal, the attempt by one competitor to assess a surcharge or fee that over recovered the costs it was trying to recoup would lose the business to another company that established a surcharge that more closely tracked those costs. The Study also makes no mention that starting in May, 2007 a series of class action lawsuits were commenced by numerous rail shippers that accused the Class I railroads and the Association of American Railroads of price fixing in establishing railroad fuel surcharge formulas in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, resulting in alleged damages measuring in the billions of dollars.³⁶

3. Service Quality and Cost Shifting

The precipitous decline of competition in the railroad industry since the 2003 timeframe, and in the coal transportation sector specifically, has been marked in part by the elimination of measurable and enforceable railroad service standards in contracts, and the shifting of tasks and costs formerly performed and paid for by the Class I railroads to their shipper customers.³⁷ This shift has in recent years even occurred for dual-served shippers, which in the past were able to obtain more favorable service standards, and to resist cost shifting attempts through competition between the railroads that could provide the service. Some examples of unilateral terms imposed on shippers in new contracts and tariffs include the following:

commissioned by the American Chemistry Council estimated in July 2007 that rail shippers were overcharged for fuel costs approximately \$6 billion between 2003 and 2007.

³⁶ The class action suits were eventually consolidated into the District Court for the District of Columbia in Multi-district Litigation ("MDL") Docket No. 1869, *In re Rail Fuel Surcharge Antitrust Litigation*, and the defendants were reduced to CSXT, NS, UP and BNSF. On November 7, 2008, the D.C. District Court denied the railroad defendants' motion to dismiss the class action complaint filed by Direct Purchasers of railroad services, stating that the plaintiffs had sufficiently alleged that the defendant railroads acted in an anti-competitive manner that violated the federal antitrust laws by conspiring to fix prices on fuel surcharges. The consolidated case has now moved into the discovery and class certification phases.

- a. New contracts feature no performance obligation or cycle time standard for the railroad, but the shipper is penalized for delays in loading and unloading even with private car movements.
- b. Along with no performance standard, there is no remedy for poor performance by the railroad. For instance, a shipper's failure to ship a minimum annual volume results in an obligation for the shipper to pay liquidated damages, but the railroad has no reciprocal requirement to pay liquidated damages for its failure to ship the minimal annual volumes.
- c. While shippers are obligated to tender specified volumes, the railroad has no binding obligation to actually ship all of those tons, even if the lack of shipment in a current year is the fault of the railroad.
- d. Shippers are expected to indemnify railroads for damages caused by "latent defects" in railcars, an obligation that goes beyond obligations under AAR railcar rules.
- e. Shippers are required to perform 1500 mile inspections of railcars and other Federal Railroad Administration ("FRA") regulatory responsibilities that are the railroad's responsibility under FRA rules.
- f. Prior to the 2003-04 timeframe, contract rates were, for the most part, adjusted using the Rail Cost Adjustment Factor developed by the AAR and approved by the STB. However, in today's environment the Class I railroads dictate in some cases rates escalated at fixed percentages that can be as high as 7% annually.
- g. Volume discounts have been replaced with surcharges for shipping above a specified maximum level.
- h. Contracts no longer include audit provisions that allow shippers to verify the validity of charges billed by the railroad.

As with fuel surcharges, however, the Study does not delve into these and numerous other critical indicia of the current state of railroad competition, and instead also includes them in the category of "Future Research Directions."

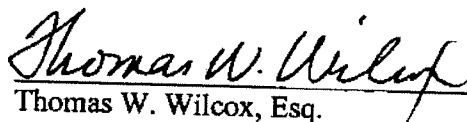
IV. CONCLUSION

In conclusion, the JCCS commend the Board for heeding the recommendation of the GAO to conduct a study on railroad competition, and also commend Christensen Associates for

³⁷ See Study at 5-12, 5-14.

its collection of general information on the U.S. freight railroad industry and its analysis of such data. However, in the view of the JCCS, for the reasons discussed above, the Study falls short of the overall goal of rigorously analyzing and assessing the current state of competition in the railroad industry. In particular, the Study contains several key deficiencies that prevent such a determination, and it generally declines to rigorously assess and opine on the extent to which the data and statistics compiled and analyzed in the Study demonstrate that railroads are, or are not, acting in an anti-competitive manner in particular markets or particular commodities. In the view of the JCCS, these deficiencies significantly undercut the usefulness of the Study as a tool for the Board and other policymakers. That being said, the JCCS also believe that even the general data compiled and analyzed by the Study demonstrate that there is a lack of sufficient effective competition in the railroad industry today, and provide sufficient grounds for the Board to explore regulatory and legislative measures that would increase competition between the Class I railroads.

Respectfully submitted,



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