Senate Commerce, Science and Transportation Committee

Subcommittee on Surface Transportation and Merchant Marine Infrastructure, Safety, and Security

Railroad Regulation

Tuesday, October 23, 2007
10:00 a.m.
253 Russell Senate Office Building

Mr. Chairman and Members of the Committee:

My name is Glenn English. I am the Chief Executive Officer of the National Rural Electric Cooperative Association. I also serve as Chairman of Consumers United for Rail Equity (CURE), a rail customer advocacy group representing a broad array of vital industries – chemical manufacturers and processors; paper, pulp and forest products; farmers; cement and building material suppliers; and many more. Mr. Chairman, members of this coalition have experienced deteriorating service and sharply increased rates and appreciate the leadership shown by committee members Senators Dorgan, Rockefeller, Cantwell, Klobuchar,Vitter and Thune in the effort to address the longstanding problems facing rail customers.

As member-owned, not-for-profit organizations, the obligation of electric cooperatives is to provide an affordable and reliable supply of electricity to our consumers. We take our obligation to serve very seriously. The personal and economic health of our members and our communities depends on it.

Mr. Chairman, we believe there is also an overriding national public interest in the operation of the rail system. The railroad industry is not just another private sector industry. Railroads provide vital services important to a range of national interest activities from the movement of war material, to distribution of some of the most important domestic energy sources, to providing vital links in the supply chain that bring domestically produced commodities and manufactured products to domestic and international markets. Unfortunately, we believe the railroads are not as serious about their obligation to serve the public interest as is my industry. They have consistently failed to fulfill their basic "common carrier" obligation.

Mr. Chairman, we believe that the system established by Congress to ensure competition in the national rail system and to protect "captive" rail customers from railroad monopoly abuse is not working. The Surface Transportation Board (STB) is failing in its responsibility to rail customers and to the nation. We believe that the STB cannot and will not correct its mistakes in a timely manner and that legislation, such as S. 953, the Railroad Competition and Service Improvement Act of 2007, must be enacted if rail customers are to receive the access to competition and protections from monopoly abuse promised in the Staggers Rail Act of 1980.

The Staggers Rail Act of 1980 Today: Not What Harley Staggers Envisioned

Twenty-seven years ago, Congress passed the Staggers Rail Act of 1980. A review of the debate from this landmark legislation reveals that Members of Congress envisioned a far different regulatory regime and a far different national rail system than is in place today. Mr. Chairman, my then colleague in the House, Harley Staggers, spoke of a bill that would "assure a healthy vibrant system of railroads across the United States, and yet it would provide timely review to the Interstate Commerce Commission (ICC) by captive shippers who feel they are facing exorbitantly high rates charged by the railroads." Upon signing the Staggers Act, President Carter announced that the proposal would "benefit shippers throughout the country by encouraging railroads to improve their equipment and better tailor their service to shipper needs."

Unfortunately for the consumers in this country, these predictions have only partly become true. This nation's few remaining major railroads are exceedingly prosperous, thanks to their unrestrained ability to increase prices at will and transfer almost every imaginable cost to the shipper. But, clearly the railroads are not tailoring their service to shipper needs. In fact, high costs and unreliable service have become the accepted norm for most railroad companies, and shippers simply have nowhere to turn for relief.

Members of Congress need to be able to see their legislation carried out in the manner in which they intended. Many legislators talk about the Staggers Rail Act and the success it had in bringing back vitality to the rail industry, and there's a lot of truth to that. But, the provisions with regard to protecting captive rail shippers from abuse by monopoly railroads have not been in keeping with what Harley Staggers intended.

There is something to be said for understanding the intent of the law, and what was promised. When I was in Congress, I became very frustrated when a piece of legislation was passed and was sent over to the administration or some regulatory body, only to be interpreted differently than what was intended when it passed. That is what we have occurring here.

Captive shippers need the Staggers Rail Act carried out as intended by Congress. That means that we need the faithful implementation and enforcement of those protections that Harley Staggers and his colleagues wrote into the legislation. That is not taking place today. That's the bottom line.

The private interests of the railroad industry – but not the public interests of the nation – continue to be protected by a Surface Transportation Board that is unwilling to provide adequate oversight of the railroad industry or to restrain their unbridled exercise of market power over captive customers. Under the watch of the STB (and its predecessor the ICC) the railroad industry has been allowed to consolidate from more than 40 major railroads in 1980 to just four major railroads today that carry over 90 percent of the nation's rail freight. That's what this issue comes down to. Any entity that requires rail service, is not served by two of the remaining railroads and must rely on railroads for

transportation has no access to transportation competition. That rail customer must do business with the railroad that holds the customer captive on any terms dictated by the railroad. That's what's known as monopoly power.

The STB shows bias toward the railroad industry monopolies and against the legitimate interests of rail customers. Recent STB actions suggest that – without major reform – shippers and consumers will continue to be at the mercy of a greedy railroad industry. That, we believe, threatens the health of our economy and in many instances our national security interests.

Government Accountability Office: Concerns About Competition and Captive Rail Rates

The Government Accountability Office (GAO) issued a report last fall outlining a pervasive and increasing lack of competition in the rail industry. The GAO report, first issued in October 2006 and supplemented and updated on August 15, 2007, was requested by a number of Members on this Committee. The GAO found that rail prices are on the rise and a significant number of rail customers are paying more than three times what it costs the railroads to move their freight.

The GAO concluded:

"Concerns about competition and captivity (in the rail industry) remain as traffic is concentrated in fewer railroads."

"[The Surface Transportation Board's] rate relief processes are largely inaccessible and rarely used."

"We believe that an analysis of the state of competition and the possible abuse of market power, along with the range of options STB has to address competition issues, could more directly further the legislatively defined goal of ensuring effective competition among rail carriers."

"Significant increases in freight traffic are forecast, and the industry's ability to meet them is largely uncertain."

"Costs, such as fuel surcharges, have shifted to shippers, and STB has not clearly tracked the revenues the railroads have raised from some of these charges."

The GAO report showed that freight rail rates are continuing to rise, even as carriers shift more and more costs to rail customers. Railcars owned by freight railroads no longer carry the majority of tonnage. The GAO study concluded that railcar ownership has shifted by 20 percent since 1987, with rail company cars carrying only 40 percent of the load in 2005, compared with 60 percent in 1987.

Railroad Profitability: A Golden Age of Railroading

Opponents of any changes in railroad policy have said for at least 20 years that current rail policy is necessary to ensure the financial viability of the rail industry and that the rail industry will go broke if any constraints are put on its existing monopoly power. Now, the rail industry is not going broke, they're in the black and thriving on Wall Street. Obviously America's major railroads are doing very well financially. Meanwhile, rail customers have waited two decades to see the Surface Transportation Board, and its predecessor the ICC, carry out the promises that were made in the Staggers legislation. Rail customers need these promised benefits today.

Simply put, the railroads have turned the corner from the difficult days that led to the Staggers Act and are now clearly able to attract and retain the capital they need to run their railroads and run them profitably. What we actually have today are record profits, record share prices, and enough revenue in the rail industry for the major railroads to buy back billions of dollars worth of their stock. We're seeing that happen today. This mature, basic American industry has become the darling of hedge funds and other aggressive investors. Why? Because railroads enjoy pricing power over an ever-increasing number of their customers.

I have a chart that compares the difference in rail transportation prices paid by customers with access to competition and those rail customers without access to competition. The rates have declined steeply for rail customers with access to competition and are remaining relatively low. Where there is no competition, the rates are going up. The chart shows average competitive and captive rates for four different commodity groups in the first quarter of 2007. There is no way that this variation in rates between captive and competitive rail customers is meeting the intent of the law. The promise that was made twenty-seven years ago is not being carried out here. The blatantly defective implementation of the Staggers Rail Act by the STB is unacceptable to rail customers, and it should be unacceptable to Congress.

STB Process is Broken

The GAO study also concluded that the rate relief processes of the STB are largely inaccessible and rarely used. Now why would they be rarely used? Well, I would suggest that those who are captive shippers see little hope that the Surface Transportation Board will provide any meaningful relief from high railroad rates. The railroads say they are already subject to strict regulation and that shippers have a right to file complaints with the STB regarding rates. This – of course – is far from the truth. It is important to understand the very limited extent to which railroad rates are subject to any review by the STB.

Only an extremely small set of rail rates are eligible to be considered for any relief by the STB and these rates are not "regulated" in the classic sense of that term. Classic regulation requires regulators to protect the public interest over the private interest. In this case, the STB has turned into an agency that protects the private railroad monopoly interests. Here is how they do it.

Any rail movement for which there is a rail contract is exempt from the STB's jurisdiction altogether. In addition, the STB has exempted from its jurisdiction much other traffic (including inter-modal traffic) from its regulation. STB Chairman Nottingham testified to the House Transportation and Infrastructure Committee on September 25th that only 10 percent or less of rail rates are subject to review by the STB.

For rail traffic that is "captive" and thus subject to regulation, the railroads have the initial flexibility to impose any rate they want without seeking any form of "prior approval" from the STB. The rail customer may then challenge the rate, but only if the rail customer can prove to the STB that the customer has no economically viable option but to use the railroad in question (an absence of effective competition) and the rate is at least 80 percent higher than the direct cost to the railroad of moving the customer's freight (the rate exceeds the jurisdictional threshold of 180 percent of variable costs).

The rail customer then has the right to seek rate relief from the STB, but only if the rail customer can prove to the STB that the rate exceeds a reasonable maximum. This reasonable maximum is called "stand alone cost" – what it would cost the customer at current prices to build and operate its own railroad to move its own freight. Since the STB cannot reduce a rate to a level below 180 percent of variable costs, captive rail customers will always pay at least 80% more than it is costing the railroad to move their freight. The rail customer in a "stand alone cost" case must pay a filing fee to the STB of $178,200 to begin this process.

Congress did not provide in legislation this rate standard or this process in which the rail customer bears all burdens of proof. This process was developed by the STB and the Interstate Commerce Commission before it. The Staggers Rail Act simply directs the regulatory agency to ensure "reasonable rates" for those rail customers without access to competition while allowing the railroads the chance to generate sufficient revenues to attract and retain capital.

In recent years, it has been impossible for shippers to obtain meaningful relief at the STB. While the jurisdictional threshold (or minimum a rail customer must pay) is set at 80 percent above the railroads' direct cost, shippers have been unable to get any rate relief when their rates amount to 3 to 5 times – or more – the direct cost of moving the freight in question. Extracting margins of 300 to 500 percent from rail customers, who have no alternative but to use a single monopoly railroad for transportation, is not in any sense "reasonable" and is not what Congress intended. These enormous rates on individual rail customers are not fair and are simply not in the best interests of the nation.

The STB's September 10th decisions in the Basin Electric and AEP West Texas cases underscore that the STB process is fundamentally broken. After Basin's long term contract with its rail carrier expired, the rail carrier – Basin's only option for moving coal to its power plant in Wyoming – doubled its rates to Basin and refused to provide a long term contract. Basin brought a rate complaint to the STB. After Basin and the other owners of the plant invested three years and more than $6 million, the STB on September

10th ruled that Basin should receive no relief from these rates. In the case, Basin proved that the new rate (as of today) is more than 6 times the direct cost to the railroad of moving the coal and, if the rate were to remain in place for twenty years, would escalate to over 8 times the direct cost to the railroad. Mr. Chairman, in this case the STB essentially sanctioned a $1 billion transfer from electricity customers of the owners of this plant to Burlington Northern over the next 20 years.

Basin played by all of the rules. They submitted volumes of evidence supported by dozens of expert witnesses – the most comprehensive rate case ever presented to the STB. They responded promptly and completely to the STB's every request and filed multiple rounds of supplemental information. They had a strong case and met all of the evidentiary requirements for establishing the unreasonableness of the involved rates.

After Basin had submitted mountains of evidence in this case and the evidentiary record was closed, the STB implemented new rules it claimed will improve the rate challenge process. The STB promised these changes would not prejudice Basin's case and, over the objections of Basin and all other rail customers with pending rate cases, applied these new rules to pending cases, including Basin's case. The STB was wrong. In its final decision the Board admitted the new rule changes were prejudicial to Basin and may have destroyed any prospects for this non-profit electric cooperative to obtain rate relief.

The clear message from the STB to Basin customers is that the STB will protect the private economic interests of the monopoly railroads no matter the costs to the public. A second message may be even more troubling: the STB doesn't really understand the implications of its rules and its rules changes.

Will the STB Correct its Implementation of The Staggers Rail Act Without Legislation? No! Three Examples:

Mr. Chairman, some Members of Congress and others acknowledge that the STB processes are not operating properly – as the October 2006 GAO report verifies – but want to believe that the STB can and will make adjustments in its policies to get back on track implementing the Staggers Rail Act properly. Rail customers have heard this argument before. In fact, we have heard it for at least a decade since the last major rail merger left the nation with essentially four major railroad systems. We see no evidence that the STB is on track to correct its implementation of the Staggers Rail Act.

I. The Rate Process Does Not Work

Rail customers have complained that the rate process doesn't work. The GAO report says it's "inaccessible" to most rail customers. I just discussed the changes the STB recently made to its "large rate case" rules – which hurt rail customers. The STB also had "small rate case" rules. The rules that have been in place for 10 years have been used twice, with both cases being settled. Three "small rate cases" were recently filed by DuPont. Currently, 36 rail customer groups oppose the new "small rate case" rules and have asked the STB to reconsider these rules.

II. Rulings Block Access to Rail Competition

Rail customers point out two rulings of the STB sanctioning railroad practices that artificially prevent rail customers from accessing rail competition.

In the "bottleneck" decision of 1996, sometimes referred to as the "quote-a-rate provision," the STB decided that a railroad is not required to move a customer's cars to a junction where that customer could reach competition on another railroad. This ruling has resulted in captivity for many rail customers. Chairman Nottingham, in his testimony to the Senate Judiciary Committee on October 3rd, said that the "bottleneck" issue was the issue he heard the most about during his pre-confirmation visits with stakeholders and others. But in the 14 months since becoming Chairman, he hasn't had time to "get his arms around" this issue. Without congressional directive, this issue will not be resolved fairly by the STB.

The STB also sanctions a second anti-competitive practice that allows major railroads to include in their track lease contracts with short line railroads provisions that prevent the short line from doing meaningful business with any railroad other than the railroad from which it obtains its track. These provisions are called "paper barriers" or "tie-in agreements." Since many short line railroads interconnect with more than one major railroad, these "paper barriers" are major impediments to competition. The STB held a hearing on this issue and indicates that it will issue a decision before the end of October. There is no indication of whether the STB will ban these types of agreements at all, only ban them for the future, or allow them conditionally. Since there are several hundred short line railroads operating under these contractual limitations, rail customers are extremely interested in what the STB will rule with regard to existing agreements.

The fact, Mr. Chairman, is that more than a year after GAO's recommendation that the STB study rail competition has the STB agreed to a study of competition issues. The study will take at least a year Meanwhile, the STB has taken absolutely no action on the second part of the GAO's recommendation that they act to ensure competition – and rail customers suffer from lack of competition every day while the STB ponders.

III. Fuel Surcharges

The STB has not moved from its passive position to a more pro-active regulatory oversight position even though the rail system has consolidated to four major carriers – consolidations that were all approved by the STB, sometimes over the objections of the Department of Justice. An example of the problems caused by this passivity is the abuse of fuel surcharges by the major railroads.

Last summer, when this Subcommittee conducted its last STB oversight hearing, fuel surcharge abuses were a focal point of the hearing. At this Subcommittee's hearing, the Acting STB Chairman testified that the Board couldn't determine who was right on the issue: the major railroads or their customers. Seven months later, the STB finally

ruled that the customers were right. In January of this year, the STB held that the railroads were abusing the fuel surcharge program and often "double dipping" on fuel costs. The STB ordered the railroads to change their practices by the end of April 2007.

The STB did not, however, fine the railroads, order refunds or credits to rail customers for overcharges or act early to enjoin this practice until the railroads could justify its fuel surcharges to the STB. The result: a recent study performed for the American Chemistry Council put the price tag on fuel overcharges at $6.4 billion.

This entire problem could have been avoided if the STB had acted pro-actively, as they are empowered to do, to enjoin this practice early until the railroads could justify their practices. As it is, the railroads have pocketed their ill-gotten gains before the STB acted with no penalties for their past unreasonable practices.

IV. Conclusion

Mr. Chairman, these examples illustrate why the STB is not on track to correct its misapplication of the Staggers Rail Act. Moreover, even if the Board were to suddenly decide to correct its practices, it will take years of agency action and further years of litigation while the railroads test the legality of any "improvements" before any new concepts of the STB are tested fully. For these reasons, enacting S.953 is a more certain and faster avenue to ensure that the STB is implementing the Staggers Rail Act as intended by Congress.

Implement the Staggers Act or Repeal It

If Congress doesn't believe there is a compelling crisis for captive shippers under the status quo, then the honest thing to do is to repeal the Staggers Act. Either Congress should insist on its will being carried out, or it should repeal the law that was intended to ensure competition and protect rail customers. Rail customers have heard the worn refrain before: give the STB a little more time, they are trying to correct their problems, "next year, next year." How many years do we have to go before the Congress says enough is enough? The STB gets interested in rail customer issues only when Congress is interested in this issue. If Congress says we will not do anything but give the STB a little more time, the STB's interest in reforming its practiceS will cease as the focus of Congress moves on to other issues.

Rail customers are in crisis and we need action now.

S. 953 is the Solution: Reform Is Not "Re-Regulation"

S.953, the Railroad Competition and Service Improvement Act of 2007 puts the STB back on track to implement the Staggers Rail Act of 1980 as it was intended. This legislation is a constructive and balanced approach to correcting the problems at the Surface Transportation Board.

I want to address two allegations that are being made by opponents of this important legislation. First, many opponents charge that the legislation "re-regulates" the nation's railroads. This allegation of "re-regulation" is flat wrong, as the CEO of Union Pacific conceded in his testimony to the House Transportation and Infrastructure Committee on September 25th on the House companion legislation to S.953. What the railroads call "re-regulation" refers only to requiring that the STB serve – as Congress intended – the public interest rather than only the private monopoly interests of the railroads.

Here Are the Facts:

No railroad rate that is not subject to regulation by the STB today will become subject to regulation under S.953. No provision of S.953 empowers the STB to take any action that could be termed as "re-regulatory" under the most generous interpretation of that term.

However, S. 953 does improve the process for determining if a railroad rate to a rail customer without access to competition is reasonable. But this legislation does not broaden the universe of rates eligible for this review process. The bill also does not reduce the minimum level of rate that qualifies for review by the STB. That minimum is a rate that is 80 percent more than the direct cost to the railroad of moving the freight in question.

The bill overturns the "quote-a-rate" and "paper barrier" decisions of the STB - two improper interpretations of the Staggers Rail Act that allow the railroads to prevent their customers from reaching a competing railroad. These provisions are "pro-competitive" and will extend competitive deregulated rail service to more rail customers.
Efforts to ensure competition in the freight rail industry are to ensure that the STB's rate challenge process works are not re-regulatory.

Second, opponents of S.953 use a graph that shows railroad rates declining significantly since 1980. This graph confuses the issue by introducing irrelevant information. The data represents ALL railroad rates, not just the rates paid by rail customers without access to competition. Until the last few years, the majority of rail customers did have access to competition and their rates have declined significantly. The rates of the minority of customers without access to competition were not declining, but were "averaged out" by the declining overall competitive rates. If the railroads were to show a graph of captive rates over the last two decades, that graph would go in exactly the opposite direction from the graph showing declining rates.

Mr. Chairman, S.953 will provide the tools necessary for the STB to ensure that there is competition in the rail industry and that captive rail customers have a fair process for challenging rates. The bill will achieve the goals envisioned by Harley Staggers in 1980. Rail customers need an equitable forum to voice their concerns and a regulatory agency that operates in the public interest rather than for the private interests of the nation's Class I railroads.

Conclusion

Mr. Chairman, thank you for conducting this hearing today. We look forward to working with this committee and with all of the other stakeholders involved to resolve these critical rail transportation issues in an objective and constructive manner.