

CURE Key Messages

Defining the Problem

- The American railroad industry has consolidated to four major railroads which provide over 90 percent of the railroad transportation in the nation. These railroads have divided the country into their own regional monopolies with little to no competition available to rail customers.
- American railroads have exploited their monopoly power over freight shipping - driving up costs, failing to deliver critical commodities reliably and hurting American competitiveness.
- Meanwhile, the Surface Transportation Board (STB), the federal body charged with overseeing the railroad industry, has fallen asleep at the switch, allowing—and even reinforcing—the railroads’ monopoly power.
- Unrestrained monopoly power and an ineffective STB has led to a lack of fairness and competition in the **RAIL World** that would not be tolerated by policymakers, the media or public under **REAL World** circumstances
- Why hasn’t Congress addressed this issue yet? Unfortunately, freight railroads provide business to business service and they operate largely outside the view of Congress, as opposed to airlines, telephone service and other network industries that serve millions of Americans directly.

REAL World vs. RAIL World

FAIRNESS IN COMPETITION

REAL World:

- American private sector businesses are subject to federal anti-trust laws to prevent anti-competitive behavior and unfair business practices that can have detrimental effects on consumers and the economy as a whole.
- Companies suspected of breaking anti-trust laws face stiff scrutiny in criminal court, civil court and the court of public opinion. Consequences of conviction include steep fines and penalties as well as a loss of brand integrity and consumer confidence.
- In August 2007 for example, British Airways and Korean Air were fined \$300 million by the United States Department of Justice for anticompetitive behavior that included colluding with rivals over cargo rates and fuel surcharges that were added to fares in response to rising oil prices.
- In the case of British Airways, managers responsible for the company’s actions are also being investigated by the U.S. Department of Justice. The airline could also face a number of class action lawsuits filed on behalf of airline customers.

RAIL World:

- Railroads are exempt from anti-trust policies and the railroad industry is rife with anticompetitive practices and monopolistic abuses.
- In response to the detrimental effects railroad actions are having on consumers, industry and the economy, seven state Attorneys General sent a letter to Congress in 2006 urging the repeal of the railroad's immunity from federal anti-trust law.
- At least 30 percent of the nation's rail movements only have access to one railroad provider, making shippers "captive" to service at whatever price the railroad decides to charge. Rail customers with access to two railroads report a decline in robust competition between the railroads for their business.
- In lieu of antitrust protection, the Surface Transportation Board (STB) is supposed to restrain railroad monopoly practices and protect rail customers from monopoly abuse. As the GAO found in an October, 2006, the STB is not doing its job.
- Without competitive options or anti-trust protection or protection by the STB, rail customers continue to face unrestrained shipping costs coupled with unreliable service.
- As the pricing power of the railroad industry continues and expands, consumers are paying the price through higher costs for everything from electricity to two-by-fours.

FUEL SURCHARGES

REAL World:

- In August 2007, British Airways and Korean Air were fined \$300 million each by the Department of Justice for colluding with rivals over cargo rates and fuel surcharges that were added to fares in response to rising oil prices.

RAIL World:

- Earlier this year, the railroads were shown to have overcharged their customers by \$6.4 billion in illegal fuel surcharges. In January 2007, the STB banned railroads from continuing to collect the surcharges.
- However, the STB allowed the railroads to continue collecting fuel charges for an **additional three months**, making the ban effective in April, 2007..
- To date, no reimbursements for the overcharges have been ordered by the STB and no fines or punishments have been levied against the railroad companies for their misconduct.

REGULATORY OVERSIGHT

REAL World:

- Industry regulators are charged with ensuring that companies and industries do not take actions that would hurt consumers, the industry or the economy.
- For example in 1997, the Federal Trade Commission (FTC) blocked Staples, an office supply company, from merging with Office Depot. The FTC successfully argued in court that the merger of the two office supply giants would violate federal antitrust laws by substantially reducing competition.

RAIL World:

- The STB has consistently ruled in favor of mergers and acquisitions in the railroad industry, resulting in decreased competition and increased costs. Today, only four major U.S. railroads exist, carrying over 90 percent.
- Not only has the STB allowed the continuation and expansion of railroad monopolies, but it has also extended the power of the railroads to block customer access to competition.

Bottlenecks

- The STB has given railroads the authority to deny their captive customers access to competing railroads. Astoundingly, the STB ruled in 1996 that a railroad could refuse to quote customers a price for service across their track to a competing railroad,, thus defeating the very idea and only means of competition for many rail customers.

Tie-In Agreements

- The STB has consistently approved the creation of short line railroads that are allowed to lease track from a major railroad but only on the condition that they deliver and receive traffic from only that railroad.
- Many short lines have the ability to deliver traffic from or to more than one major railroad, but these agreements are a barrier, preventing rail customers from accessing competitive alternatives.

Competitive Access

- STB has the authority to order cooperation between the railroads concerning terminal facilities and interchange agreements when it is in the public interest.
- However, the Interstate Commerce Commission, now the STB, ruled in the mid-1980s that interventions are only in the “public interest” when the STB finds “monopoly abuse.” In effect, this ruling requires rail customers to prove a “mini-antitrust” case to achieve efficient interchange terms and conditions – Congress intended for these types of proceedings to be quick and efficient.

- Since this ruling, rail customers have not been successful in any competitive access complaint to the STB.

ACCESS TO JUSTICE

REAL World:

- The process for filing and deciding civil complaint cases in the nation's judicial system has been developed so that each party has an equal opportunity for justice in a fair forum.
- Filing fees are kept at a reasonable amount with federal courts only requiring a \$350 filing fee for civil complaints.
- The defense is required to answer the initial complaint in a specific time frame, and each side is allowed access to any documents or data they need in order to prove their side of the case.
- Cases that go to trial are decided on a standard called preponderance of evidence. In other words, the facts more likely than not support the successful party in a civil suit.

RAIL World

- By law, all railroad competition and rate issues can only be pursued at the Surface Transportation Board; rail customers cannot take these actions to federal or state courts.
- The STB has a procedure for rail customers to challenge what they see as unreasonable shipping rates. However, the rate challenge process is so complex, costly and time consuming that it provides no protection for rail customers; the October 2006 GAO report characterized this and other STB processes as "inaccessible" to rail customers.
 - Railroads are free to charge any rate they wish to any customer, without any prior approval by or even filing with the Surface Transportation Board. Rail customers pay this rate throughout any rate challenge, but have the possibility of a refund if they prevail in the case.
 - **Costly Filing Fees:** To initiate a full rate challenge case, rail customers must first pay a filing fee of \$172,800.
 - **Burden of Proof:** Rail customers bear all burdens of proof in a rate challenge. squarely on their shoulders to prove first that the rail customer, essentially, is subject to railroad monopoly power and is paying a rate above a minimum threshold and then that the railroad's rate is "unreasonably" high. In contrast, the railroad does not have to justify its rate. CURE knows of no other American regulatory process where the monopolist is not required to justify its rates.
 - **Stand Alone Costs:** The STB standard (not required by statute) is that a rail rate is not unreasonably high unless the rail customer can build and maintain, at current prices, a railroad to move its own freight. This is called "Stand Alone Cost". To determine if rates meet this definition of "unreasonable," STB requires rail customers to create their own hypothetical railroad model. To develop this model, rail customers must

retain lawyers, accountants, railroad economists and other such experts in a multimillion dollar exercise. STB will only rule in favor of the shipper if the hypothetical model railroad can ship the customer's goods at a lower rate than the actual railroad's rate. In order to create this model, shippers must obtain capital and operating cost data from a monopoly railroad using an expensive and time consuming legal "discovery" process. This rate standard is, in effect, a replacement cost rate standard – something Congress would reject immediately if it applied to electricity, natural gas, telephone or cable television rates.

- **Keeping Data Secret:** Even though rail customers bear the burden of proof to prove a rate is unreasonable, they are not allowed access to the railroad's information on captive vs. competitive rates. Unlike other industries that are required to publicly report this type of data, the STB actually restricts access to this information.
- **Minimum Rate for Captive Rail Customers:** Current law is that no railroad rate is subject to challenge unless the railroad rate is at least 80% higher than the direct cost to the railroad of moving the freight in question.. The STB has no jurisdiction to reduce the rate to less than the 80 percent return the railroad is receiving on its investment in shipping the freight. Thus, regardless of any relief they may obtain for rates higher than this threshold, captive rail customers must pay their railroad carrier at least 80% more than the direct cost to the railroad of moving their freight. The pending legislation does not change this minimum rate requirement.
- Those customers that do venture into the rail challenge process find themselves in an uphill battle with a STB that refuses to hold railroads accountable and has in many instances actually allowed railroads to block customer access to competition. Rail customer rarely win meaningful rate relief from the STB, despite spending millions of dollars in the effort.

FEDERAL TAX SUPPORT

REAL World:

- Industries that are prosperous and growing are not subsidized by the federal government with lucrative tax breaks that enrich shareholders at taxpayers' expense.

RAIL World:

- Railroad companies are claiming financial distress on Capitol Hill asking members of Congress for a tax credit for basic infrastructure improvements that the industry should be making on its own.
- This tax credit would provide billions of dollars in subsidies from American taxpayers at the same time that the railroads are spending billions to buy back their own stock, rather than invest that money in infrastructure.
- Railroads' pleas of poverty are belied by investors who are buying up railroad stock in bulk. Warren Buffet's Berkshire Hathaway is now the largest single investor in Burlington Northern Santa Fe (BNSF) and owns

large stakes in both Union Pacific and Norfolk Southern. Carl Icahn has also jumped into the sector, as have hedge funds like SAC Capital and Children's Investment Fund Management, LLP out of London.

- Meanwhile, railroad companies are taking out full advertisements in publications like the *Wall Street Journal* and *Washington Post* touting their record profitability and status as good investments.
- Indeed, the major railroads seek a \$5 billion tax benefit from Congress in addition to the \$6.4 billion in excess fuel surcharges that they have already extracted from their customers.

RAIL WORLD CONSEQUENCES FOR THE REAL WORLD

Energy Production

- In 2005 and 2006, continuing with respect to some deliveries in 2008, the two western railroads failed to deliver adequate and contracted for supplies of western coal to U.S. electric utilities.
- As a result, utility companies had to turn to other alternatives including natural gas and the importation of coal from China, Columbia, Indonesia and Venezuela.
 - Natural gas is a substantially more expensive source of electricity than coal. In fact, it is usually 5 times more expensive to generate electricity from natural gas than coal and in times of tight supplies can be even more expensive. This cost is passed on to consumers in the form of higher electricity bills.
 - At a time when the U.S. is trying to break its dependence on foreign energy sources, the country is on track to become a net importer of coal by 2013, in large part because U.S. railroads are failing to adequately transport domestic coal.

Ethanol/Alternative Energy Sources

- A June 2007 Government Accountability Office (GAO) report found that the rail industry will likely be unable to meet the growing demand to transport ethanol and other alternative energy sources.

Rural America

- During this decade, our farmers, rural manufacturers and family-owned businesses have continued to see huge increases in rail prices matched by a decline in rail service.
- Not only have the rail industry's business practices increased consumer prices, but they have also attacked the bottom line of many of America's hardworking farm families and small rural businesses. And the competitive position of U.S. manufacturers has eroded, resulting in the export of manufacturing jobs and capital from the U.S. to foreign countries.

SOLUTIONS

- Railroads have an obligation to serve rail customers, the nation and the nation's taxpayers that have nurtured and protected the railroad industry for more than 150 years.
- Current federal policies must be changed to hold the railroads accountable and create the freight rail infrastructure America needs in the 21st century.
 - Repeal the antiquated antitrust exemptions of the freight rail industry.
 - Reform the STB to ensure rail customer access to competition, reliable rail service for rail customers at reasonable costs and a pro-active STB that vigilantly oversees railroad monopoly power.
 - Ensure that the railroads invest in their infrastructure to meet the current and future needs of rail customers and the nation.