



Proposed Rail Competition and Service Improvement Bills

H.R. 2125 and S. 953

Soy Transportation Coalition Briefing Paper

Prepared for the Soy Transportation Coalition and United Soybean Board by Market Solutions LLC

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Summary. Legislation being considered by the U.S. Congress is intended to address a variety of transportation challenges facing soybean producers and their customers, as well as a variety of other shipper and stakeholder groups. While a number of shipper groups are supporting the legislation, railroad industry representatives strongly oppose it. This briefing paper provides background information on what the proposed legislation seeks to accomplish. It summarizes what is known about the potential impacts on soybean producers and their customers, such as grain elevators, soybean processors and biofuels producers. It also identifies areas where planned analysis by the Soy Transportation Coalition (STC) can help stakeholders better understand potential costs and benefits of the proposals.

Introduction. *The Railroad Competition and Service Improvement Act of 2007* is intended to ensure competition in the rail industry, enable rail customers to obtain reliable rail service, and provide customers with a reasonable process for challenging rate and service disputes. The House bill (H.R. 2125) is sponsored by Rep. James Oberstar of Minnesota and currently (mid-September) has 50 cosponsors, including three added during September. The companion Senate bill (S.953) sponsored by Sen. Rockefeller (WV) has 11 cosponsors.

The bill is making its way through the committee process. The House bill, introduced on May 3, 2007, has been referred to the House Transportation Committee's Subcommittee on Railroads, Pipelines, and Hazardous Materials. The Senate bill, introduced on March 21, 2007, has been referred to the Senate Committee on Commerce, Science and Transportation.

Principal supporters of this legislation include The Alliance for Rail Competition (ARC), Consumers United for Rail Equity (CURE) and the United Transportation Union (UTU). These organizations have testified in support of similar bills previously and in mid-April sent a joint letter to members of the Senate urging them to cosponsor S. 953. The Association of American Railroads (AAR) strongly opposes the bills, arguing that they would re-regulate the railroads and would deprive them of billions of dollars in annual revenues, making it impossible for them to fund capacity improvements, ultimately leading to higher shipping costs, reduced service and gridlock.

The full House Transportation Committee held a hearing on rail competition on September 25, 2007. At the hearing shipper representatives argued for changes to ensure the rail rates and service needed to ensure future of American competitiveness but that this would not require re-regulation. Surface Transportation Board members argued that in the last 13 months they have become more aggressive in addressing the issues, including the rail rate complaints, fuel

surcharges, and cost of capital calculations that guide STB oversight. They also indicated that they have commissioned a year-long study of rail competition, as suggested by the GAO. Railroad representatives argued that change from the current system would reduce their profitability and result in less private investment in the capacity needed for the future. While there was considerable disagreement about how the current rail system affects different industries, there seemed to be general agreement that agriculture is paying more for rail service, even before considering costs that have been shifted to agricultural shippers and taxpayers.

Major Points of the Bills

In 1980 the Congress voted to deregulate the nation's railroad industry. One result has been consolidation of the industry. Today there are only four major Class I railroads serving the entire North American continent: two in the East and two in the West and they control over 95 percent of all railroad business, according to the sponsors. Shippers are paying the price for this consolidation in the form of higher prices and less reliable service. This bill includes the following provisions aimed at reducing current impediments to competition that adversely affect rail customers:

1. Eliminate bottlenecks
2. Create competitive rail service at switching points
3. Eliminate paper barriers
4. Establish new regulatory process for areas defined as having inadequate rail competition
5. STB to investigate and report on rail service problems
6. Create a "final offer" arbitration process for certain rail disputes related to agricultural products
7. Reduce Surface Transportation Board (STB) fees for filing rail rate complaint cases and amend and improve the rate reasonableness standard
8. Creates an Office of Rail Customer Advocacy in the Department of Transportation

More Detailed Provisions. The following provides background and analysis of elements of the proposals. It is intended to inform soybean producers about what is being proposed and what potential impacts the proposed legislation might have. As the briefing paper is being developed with checkoff funds, its role is purely educational. The paper reports some comments on the bill by different stakeholder groups. It also suggests opportunities for planned Soy Transportation Coalition analysis to help better understand potential implications of the bill for rail costs, service and capacity available to soybean producers and their customers.

1. Eliminate Bottlenecks

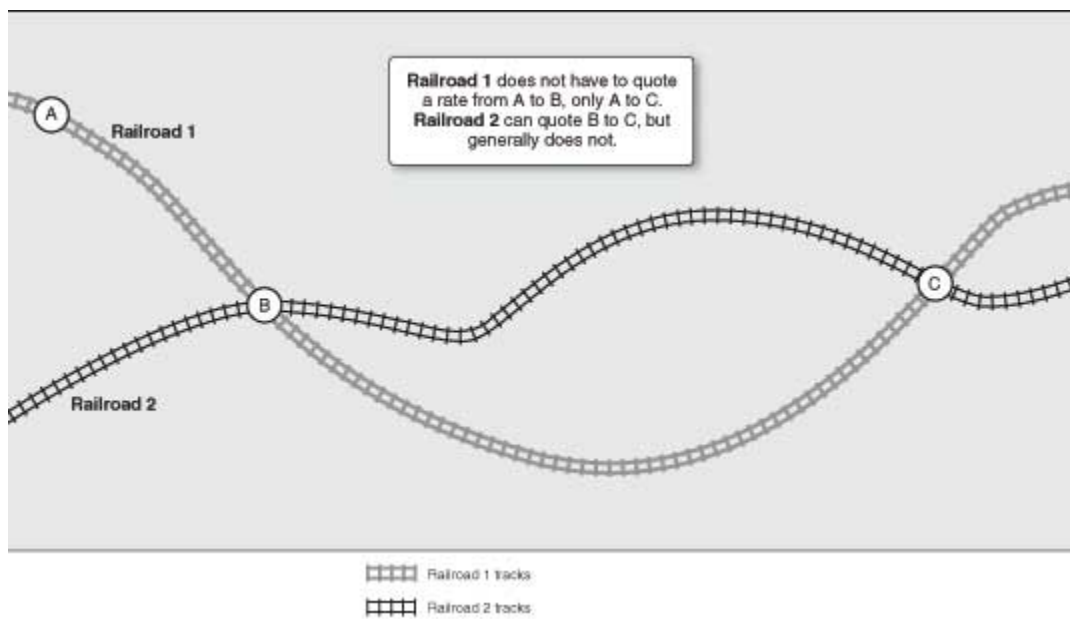
The U.S. freight network includes many situations in which only one railroad (the "bottleneck carrier") serves either an origin or a destination of a potential freight movement (the so-called "bottleneck segment"), but more than one railroad serves the rest of the line between origin and destination (the so-called "non--bottleneck segment"). Under current law, the "bottleneck carrier" has the option of either carrying cargo the entire length of the voyage or interchanging the cargo with another carrier over the non-bottleneck segment. The decision on routing is entirely up to

the bottleneck carrier. The shipper may not insist on a separate rate for the bottleneck segment. This situation enables the bottleneck carrier to charge a monopoly price for the entire trip.

H.R. 2125/S. 953 would overturn existing bottleneck policy and grant shippers the right to demand that the railroad offer service solely for the bottleneck segment. The rate for that segment would be subject to STB maximum rate regulation based on the costs associated with just that segment. Bill sponsors argue that competition among the railroads servicing the non-bottleneck segment would drive down rates for that segment, resulting in rate reductions of several billion dollars per year.

Previous analysis for soybean checkoff groups has suggested that the issue for grain and oilseed shippers is often not that railroads will not quote a rate for the bottleneck portion of a movement, but that they set that rate at such a high level that it eliminates any potential cost savings of using an alternate railroad for the non-bottleneck portion of the move. As a result, this provision may offer limited value to soybean and product shippers. Furthermore, if this provision does provide savings for shippers of coal and other products, it might actually result in shifting of costs to grain and oilseed shippers. A planned Soy Transportation Coalition (STC) survey of soybean producers' customers will assess the potential benefits of this and other provisions discussed below.

Example of Bottleneck Rates



Source: GAO, 2006

2. Create Competitive Rail Service at Switching Points through Mandatory Reciprocal Shipping

The U.S. rail system consists of a network of lines and terminal areas. Terminal areas are where freight is interchanged between railroads lines and railroad companies. Typically terminal areas are owned and operated by a single railroad but serve several rail customers. The railroad owning the terminal area may or may not also own the main line track on which the terminal area is located.

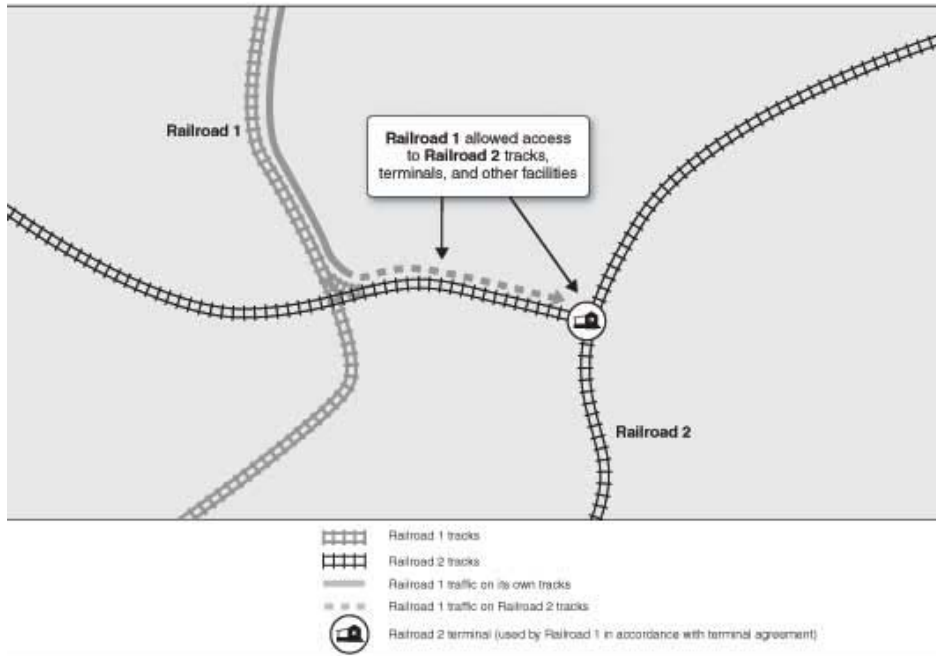
Under existing policy refusing to switch cars for another railroad is not considered anticompetitive. The STB must determine that a railroad with terminal operations has engaged in some other anticompetitive conduct before it may order that railroad to switch another railroad's traffic or grant another railroad the right to use the terminal facilities. Bill sponsors charge that the fact that failure to grant such rights will result in the owning carrier being the sole railroad serving the terminal area has never been found by the STB to be "anticompetitive behavior". The result has been monopoly, "captive shipper" situations, with higher prices and less reliable service for shippers.

Under H.R. 2125/S.953 at shipper request, the STB would be required to order a terminal operator to:

- Allow other railroads to use the terminal, and/or
- Enter into "reciprocal switching agreements" with other railroads.

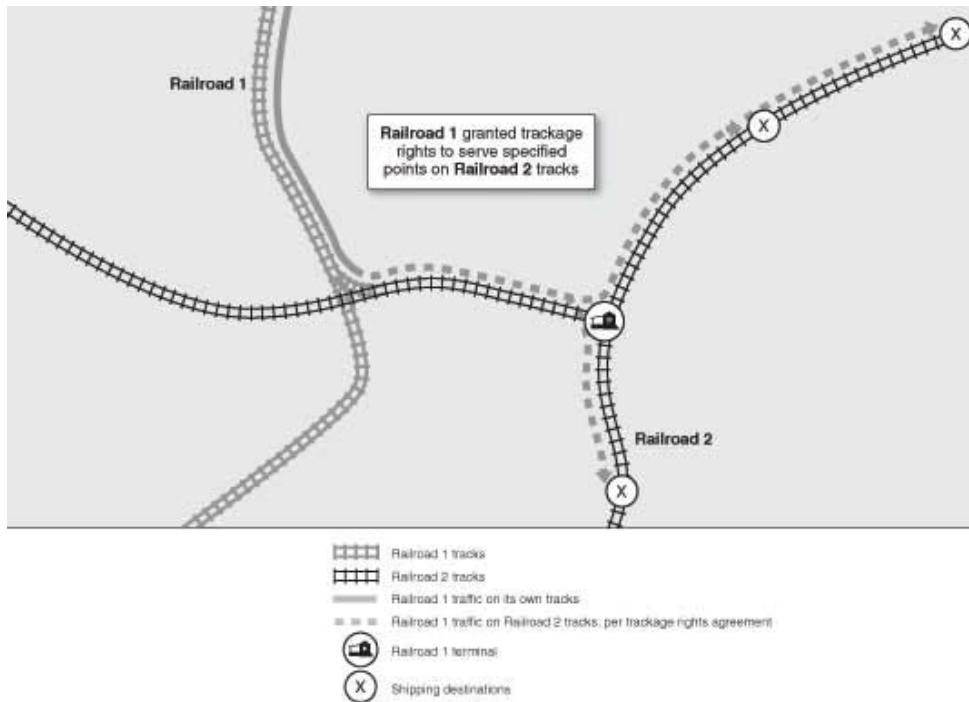
Reciprocal switching agreements are agreements between two terminal area operating railroads to switch each other's traffic in their respective terminal areas. Sponsors expect the resulting rail-to-rail competition in the terminal area to lead to lower prices and better service for shippers. *Railroads argue that reduced returns would reduce their incentives to invest in maintaining and upgrading terminals. Planned STC analysis will seek to determine how much of a problem this issue is for soybean producers' customers such as crushers and grain elevators, and develop case examples if it is a major problem.*

Example of Terminal Agreements



Source: GAO, 2006

Example of Trackage Rights



Source: GAO, 2006

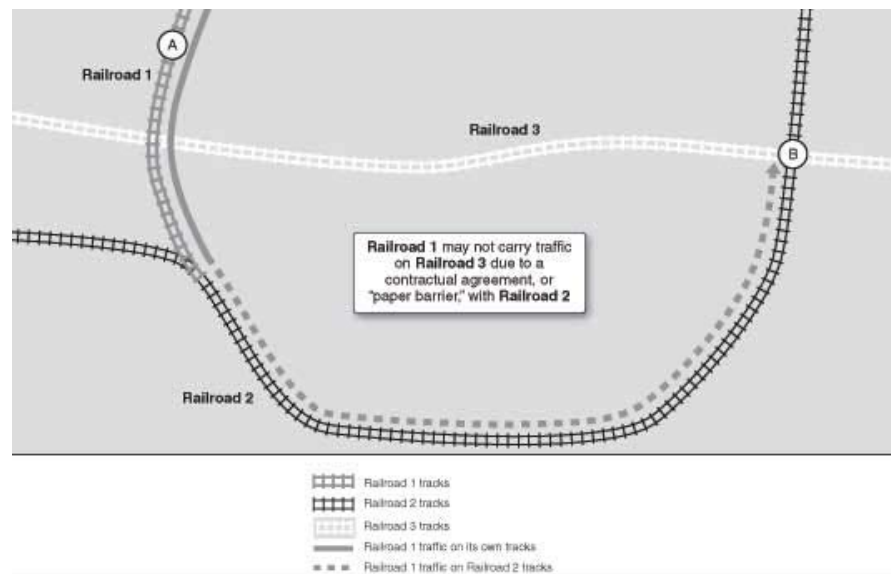
3. Eliminate Paper Barriers restricting Short Line Interchange Options

Class I railroads have significantly reduced the amount of track they operate since the Staggers Act deregulated the railroads in 1980. Some of this track has been abandoned, while some has been leased or sold to companies that create new “short line” Class II or Class III railroads. Lease and sales agreements, many of which are confidential, sometimes require that the new short line railroad only interchange freight with the Class I railroad from which it acquired the track, even if there are interchange points that would otherwise allow freight to be shipped via other carriers. These restrictions are called “paper barriers.”

H.R. 2125/S. 953 would prohibit the STB from authorizing the sale or lease of a line from a Class I to a Class II or III railroad if it included restrictions on the ability of the Class II or III carrier to interchange traffic with other rail carriers. Additionally, at the request of any shipper affected by a prior sale or lease containing such a restriction the STB must terminate the restriction.

Some soybean customers report that paper barriers represent significant challenges to their operations. However, according to the Class I railroads, paper barriers result in lower sale or lease prices to short line companies. They argue that eliminating paper barriers would mean higher sale or lease costs and higher costs for shippers. Planned STC analysis will be aimed at documenting the extent to which paper barriers are considered a problem to grain and feed handlers, soybean processors, and biofuels producers and developing case examples to look at potential tradeoffs.

Example of Paper Barriers



Source: GAO, 2006

4. Areas of Inadequate Rail Competition

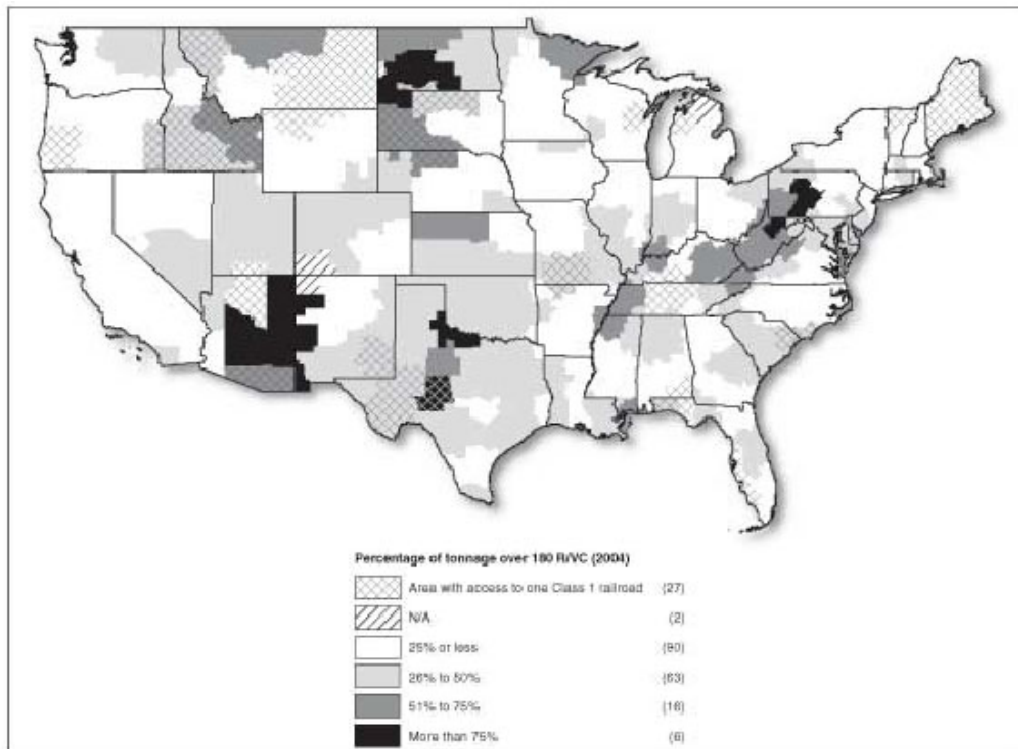
Rail competition is uneven across the US. Bill sponsors argue that in all of some States and parts of others, rail competition is particularly low, resulting in high rates and poor service for shippers in those areas.

The bill provides that whenever an entire State or “substantial portion” is served exclusively by one Class I railroad and shippers suffer from high costs and/or poor quality rail service, the governor may petition the STB to designate the area as one of “inadequate rail competition.” The STB would be required to provide remedies to improve the competitive situation within 60 days.

The Government Accountability Office (GAO) released a report on rail competition in 2006 that provided preliminary analysis of the extent to which shippers in different parts of the country are “captive” to a single railroad as well as estimates of the share of freight traffic that moves at rates above the threshold that would permit a rate complaint under STB guidelines. GAO recommended that the STB conduct a more in-depth analysis of rail competition nationally.

Proposed STC analysis can help to document the importance of inadequate competition, captive shipper problems, non-competitive rates and inadequate service among soybean customers, and develop case examples. The STC also plans to work on developing measures of costs, service and capacity that can be used to track progress over time. As presented in the bill, important questions are how “inadequate rail competition” will be measured and what remedies can realistically be imposed by the STB.

GAO Findings of Areas of the Country with Only One Railroad and High Rates Share of Freight Moving at Rates That Could be Challenged



Source: GAO analysis of BNA, DOT, and STB data.

5. Rail Service Problems

Bill sponsors claim that the STB currently is largely unaccountable for its failure to address poor rail service that results in economic losses to shippers. This bill would require that the STB follow up on shippers' complaints over rail service and provide a remedy whenever the allegation has merit. It would further mandate that the STB submit an annual report to Congress regarding rail service complaints together with a description of what the STB has done to resolve them.

Planned STC analysis will document the extent and types of service problems that are most important to soybean customers, grain elevators, crushers and feed manufacturers and what types of problems are most costly and have the largest impact on farm prices and competitiveness. The STC plans to begin work on an index to measure changes in service problems over time. This may be useful in helping to understand the potential value of this provision of the bill as well as priorities to be addressed.

6. Binding Arbitration to Resolve Disputes Over Rail Rates and Service

Currently many disputes between shippers and railroads over rates and service remain unresolved. This bill would create a procedure pursuant to which a shipper of any agricultural product may submit a dispute to "final offer" binding arbitration.

Canada has a system of "baseball style" final offer arbitration. The STB solicited comments on this system in recent hearings. The planned STC survey of soybean customers can assess the potential tradeoffs involved in adopting this proposal.

7. Rail Rate Complaint Cases

The current system for shippers seeking to challenge rail rates is skewed against shippers. The bill focuses on the facts that shippers must pay an exorbitant fee, \$178,200, to file a case with the STB and the STB uses hypothetical rather than actual costs in evaluating the rate. This bill would require the STB to use the railroads' actual costs and would reduce the filing fee to the nominal level required to file complaints in Federal District Court.

Filing fees are high, but represent only a small portion of the total cost of filing a rail rate complaint with the STB. In recent hearings it was suggested that costs of \$3-4 million are the norm in the large rate cases that have so far been the only viable option despite the fact that more than ten years have elapsed since Congress instructed the STB to develop alternative complaint processes. The STB recently held rather contentious hearings over new options for filing complaints where the volume of freight involved is considered "small." The most critical issue to be addressed related to establishing workable guidelines for "small rate complaints" seems to be to ensure that the potential value of relief exceeds the likely costs of filing and supporting a complaint. Addressing filing fees alone is not likely to solve the problem.

The bill would require that rail rate reasonableness standards be based on railroads' actual, rather than "stand-alone" costs of a hypothetical new railroad that are currently the standard used in STB rail rate complaint cases. It also requires that decisions be rendered by the STB

within nine months. These would both represent major changes from the system of recourse that is currently available. *The process for determining a railroad's actual costs would be likely to be complicated and contentious at the outset. There was substantial discussion of the implications of alternatives to the STB's stand alone cost methodology in recent STB hearings on the rail rate complaint process. As there has been significant discussion of related issues in testimony at recent STB hearings, it may be useful for the STC to develop a separate analytical briefing paper on rail costs and rates.*

7. Office of Rail Customer Advocacy

The bill indicates that little government assistance is currently available to help shippers address problems with rail transportation. The bill would establish an Office of Rail Customer Advocacy in the Department of Transportation. The head of the office is to be named by the Secretary of Transportation in consultation with the Secretary of Agriculture. The office would receive and collect rail customer complaints, and maintain information regarding the cost and efficiency of rail transportation. Most importantly, it would be empowered to petition the STB for action and to participate as a party in all STB proceedings.

The Surface Transportation Board (STB) is already under the Department of Transportation, and already has an office that is supposed to address these issues. It is not clear whether the creation of a new office in the Department of Transportation would be of much benefit. Much depends on other efforts to force changes in the STB so that its decisions provide more even consideration to shipper and railroad interests.



This briefing paper produced for educational purposes only. The Soy Transportation Coalition receives support from the soybean checkoff through the United Soybean Board and State Soybean Checkoff organizations in Iowa, Illinois, Indiana, North Dakota, South Dakota, Nebraska and Ohio.

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Bill Sponsors and Cosponsors as of Mid-September, 2007

H.R. 2125

Rep James Oberstar [MN-8] – introduced 5/3/2007
Rep Alexander, Rodney [LA-5] - 5/3/2007
Rep Andrews, Robert E. [NJ-1] - 6/12/2007
Rep Baker, Richard H. [LA-6] - 5/3/2007
Rep Baldwin, Tammy [WI-2] - 5/9/2007
Rep Berry, Marion [AR-1] - 5/3/2007
Rep Boren, Dan [OK-2] - 5/9/2007
Rep Boustany, Charles W., Jr. [LA-7] - 5/3/2007
Rep Braley, Bruce L. [IA-1] - 9/4/2007
Rep Cubin, Barbara [WY] - 5/9/2007
Rep Delahunt, William D. [MA-10] - 9/20/2007
Rep Franks, Trent [AZ-2] - 5/3/2007
Rep Frelinghuysen, Rodney P. [NJ-11] - 9/4/2007
Rep Garrett, Scott [NJ-5] - 7/12/2007
Rep Gillmor, Paul E. [OH-5] - 6/28/2007
Rep Grijalva, Raul M. [AZ-7] - 5/9/2007
Rep Hare, Phil [IL-17] - 5/9/2007
Rep Herseth Sandlin, Stephanie [SD] - 5/3/2007
Rep Hinojosa, Ruben [TX-15] - 6/7/2007
Rep Hirono, Mazie K. [HI-2] - 5/3/2007
Rep Holden, Tim [PA-17] - 5/9/2007
Rep Holt, Rush D. [NJ-12] - 6/12/2007
Rep Hooley, Darlene [OR-5] - 8/3/2007
Rep Inglis, Bob [SC-4] - 6/20/2007
Rep Jefferson, William J. [LA-2] - 5/9/2007
Rep Jindal, Bobby [LA-1] - 5/9/2007
Rep Kagen, Steve [WI-8] - 6/7/2007
Rep Kind, Ron [WI-3] - 5/3/2007
Rep McCollum, Betty [MN-4] - 5/9/2007
Rep McNulty, Michael R. [NY-21] - 6/5/2007
Rep Melancon, Charlie [LA-3] - 5/9/2007
Rep Miller, Brad [NC-13] - 6/12/2007
Rep Mollohan, Alan B. [WV-1] - 6/13/2007
Rep Murphy, Patrick J. [PA-8] - 7/12/2007
Rep Musgrave, Marilyn N. [CO-4] - 5/9/2007
Rep Obey, David R. [WI-7] - 6/5/2007
Rep Paul, Ron [TX-14] - 6/20/2007
Rep Peterson, Collin C. [MN-7] - 6/5/2007
Rep Pomeroy, Earl [ND] - 5/3/2007
Rep Ramstad, Jim [MN-3] - 5/21/2007
Rep Rehberg, Dennis R. [MT] - 5/15/2007
Rep Renzi, Rick [AZ-1] - 5/9/2007

Rep Ross, Mike [AR-4] - 5/9/2007
Rep Simpson, Michael K. [ID-2] - 5/3/2007
Rep Sires, Albio [NJ-13] - 6/6/2007
Rep Snyder, Vic [AR-2] - 5/9/2007
Rep Space, Zachary T. [OH-18] - 5/21/2007
Rep Towns, Edolphus [NY-10] - 6/5/2007
Rep Udall, Mark [CO-2] - 5/9/2007
Rep Walz, Timothy J. [MN-1] - 5/3/2007
Rep Wamp, Zach [TN-3] - 5/21/2007

S. 953

Sen Rockefeller, John D., IV [WV] introduced 3/21/2007
Sen Baucus, Max [MT] - 3/21/2007
Sen Cantwell, Maria [WA] - 3/21/2007
Sen Craig, Larry E. [ID] - 3/21/2007
Sen Crapo, Mike [ID] - 3/21/2007
Sen Dorgan, Byron L. [ND] - 3/21/2007
Sen Johnson, Tim [SD] - 5/7/2007
Sen Klobuchar, Amy [MN] - 3/21/2007
Sen Landrieu, Mary L. [LA] - 3/21/2007
Sen Tester, Jon [MT] - 3/21/2007
Sen Thune, John [SD] - 5/8/2007
Sen Vitter, David [LA] - 3/21/2007