S. HRG. 110–199

AN EXAMINATION OF S. 772, THE RAILROAD ANTITRUST ENFORCEMENT ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST,
COMPETITION POLICY AND CONSUMER RIGHTS

OF THE

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UNITED STATES SENATE

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AN EXAMINATION OF S. 772, THE RAILROAD ANTITRUST ENFORCEMENT ACT

WEDNESDAY, OCTOBER 3, 2007

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS, COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:30 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Herb Kohl, Chairman of the Subcommittee, presiding.

Present: Senators Kohl, Feinstein, and Hatch.

OPENING STATEMENT OF HON. HERB KOHL, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Chairman KOHL. We will get started. Senator Hatch is on the way. We welcome one and all here this morning. Today we are meeting to consider an important piece of legislation to halt what I regard as anticompetitive practices harming businesses and consumers that do depend on freight railroads across our country. Our legislation, S. 772, is a bipartisan bill which passed the Judiciary Committee without dissent just 2 weeks ago. Nevertheless, we are holding this hearing today at the request of some members of the Committee who do want to further explore this issue.

Our legislation will eliminate obsolete antitrust exemptions that protect freight railroads from competition and result in higher prices to millions of consumers every day all across our country. The railroad industry—unlike every other form of freight transportation, including trucking and aviation—enjoys immunity from most aspects of antitrust law. No good reason exists for this antitrust exemption. The best argument that the defenders of the current antitrust exemption can make is that it is unfair to subject the railroads to antitrust law because they are already subject to regulation. We believe that this argument is without merit.

First, dozens of other industries in our economy are regulated and yet remain subject to antitrust law. Most importantly, all the other parts of the transportation industry are subject to extensive regulation—including aviation, under the supervision of the Department of Transportation, and trucking, under the supervision of the Surface Transportation Board. And yet they are also subject to antitrust law in almost every respect.

Other examples abound, ranging from telecom to energy. No other regulated industry possesses the total immunity from Justice Department merger review enjoyed by the railroad industry. And yet the need for antitrust enforcement is greatest in the case of

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railroads. Unlike the dozens of airline and trucking competitors that shippers may choose from, in many areas of our Nation only one freight railroad serves businesses that rely on railroad shipping. Defenders of the railroad antitrust exemption, therefore, bear a very heavy burden to explain why their industry should be treated any differently from other regulated industries.

Second, as railroad advocates themselves often point out, the railroad industry has, in fact, been substantially deregulated by legislation in recent decades. Most importantly, most railroad rate setting has been removed from the oversight of the Surface Transportation Board. Despite this deregulation, the obsolete antitrust exemptions remain in place, insulating a consolidating industry from obeying the rules of fair competition.

The effects of this unwarranted antitrust exemption are plain to see. Consolidation in the railroad industry in recent years has resulted in only four Class I railroads providing over 90 percent of the Nation's freight rail transportation. Just less than three decades ago, in 1979, there were 42. The lack of competition in the railroad industry was documented in an October 2006 GAO report. That report found that, shippers in many geographic areas "may be paying excessive rates due to a lack of competition in these markets." These unjustified cost increases cause harm throughout the economy. Consumers suffer higher electricity bills because a utility must pay for the high cost of transporting coal; manufacturers who rely on railroads to transport raw materials charge a higher price for their goods; and American farmers who ship their products by rail pass on these cost increases in the form of higher food prices.

The ill effects of this consolidation are exemplified in the case of "captive shippers"—industries which are served by only one railroad. Two of these captive shippers are testifying at our hearing today. Over the past several years, these captive shippers have faced spiking rail rates—price increases which they are forced to pass along into the price of their products, and ultimately, to consumers. In August of 2006, the Attorneys General of 17 States and the District of Columbia sent a letter to Congress citing problems due to a lack of competition and urged that the antitrust exemptions be removed. The letter stated that "rail customers in our States in a variety of industries are suffering from the classic symptoms of unrestrained monopoly power: unreasonably high and arbitrary rates and as well as poor service."

In my State of Wisconsin as well as around the Nation, victims of a lack of railroad competition abound. About 40 affected organizations in my State have told us that they are feeling the crunch of years of railroad consolidation and anticompetitive railroad practices. The reliability, efficiency, and affordability of freight rail have all declined, and consumers are feeling the pinch. For example, to help offset a 93-percent increase in shipping rates in 2006, Dairyland Power Cooperative in Wisconsin had to raise electricity rates by 20 percent. Similar stories exist across the country. Dozens of organizations, unions and trade groups—including the American Public Power Association, the American Chemistry Council, American Corn Growers Associations, and AFL–CIO and many more affected by monopolistic railroad conduct—have endorsed our legislation.

Adoption of our legislation will be an excellent first step to bring needed competition to the railroad industry. By clearing out this thicket of outmoded antitrust exemptions, railroads will be subject to the same laws as virtually every other industry throughout our country. Government antitrust enforcers will finally have the tools to prevent anticompetitive transactions and practices by railroads. And, likewise, private parties will be able to utilize the antitrust laws to deter anticompetitive conduct as well as to seek redress for their injuries.

On the Antitrust Subcommittee, we have seen that in industry after industry, vigorous application of our Nation's laws is the best way to keep prices low and the quality of service high. The railroad industry is no different. All those who rely on railroads to ship their products—whether it is an electric utility for its coal, a farmer to ship grain, or a factory to acquire its raw materials or ship out its finished product—deserve the full application of the laws to end anticompetitive abuses which are too prevalent in this industry today.

[The prepared statement of Senator Kohl appears as a submission for the record.]

So we are happy to have our witnesses here today. We look forward to your testimony, and we are delighted to have the co-Chairman of this Committee, Senator Hatch from Utah, and we welcome his comments.

STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM THE STATE OF UTAH

Senator HATCH. Well, thank you, Mr. Chairman. I appreciate you having these hearings, and I appreciate your leadership on this Committee.

Mr. Chairman, I am very concerned about the reports I received from a variety of Utah businesses. They believe that they are being charged excessive and unwarranted prices for the rail shipment of their goods. I am especially concerned that these same businesses believe that they would be charged considerably less in an environment free of railroad antitrust exemptions.

As a matter of legal principle, I have always been inherently suspicious of any special industry exemptions from our antitrust laws unless those exemptions served an important purpose in maintaining market competition or other significant public policy considerations.

The greatness and resilience of the American economy is based on the foundation of competition. Only through competition does the American economy renew itself to meet the challenges of the future.

Over the past 30 years, Congress has enhanced that notion by deregulating and removing antitrust exemptions for a number of industries, including airlines, trucking, and telephone industries.

Now, that being said, important questions remain regarding S. 772. Paramount among them is the inquiry into what effect this bill will have if enacted. Simply put, if the bill is passed, will the result be reduced prices for shippers? That is a central question that I hope can be answered today or will be answered today.

Now, Mr. Chairman, transportation costs are an important part of any business plan. When businesses choose where to locate their factories and operations, they make this choice based on the cost of shipping their products from the place of manufacture to the marketplace.

Now, I have been informed that when large manufacturers seek new locations to build factories, many of these companies stipulate that they will only choose sites that are serviced by two railroads. And why? Well, because manufacturers do not wish to be beholden to one railroad and find themselves held captive to a sole transporter.

This point was enforced by an August 17th letter written to the Judiciary Committee by the Attorneys General of several States. And I find this point to be particularly troubling since Utah is primarily served by only one large railroad corporation. Indeed, one of today's witnesses, Mr. Ken Vander Schaaf, will testify that ATK, Utah's largest defense contractor, has seen the shipping costs from its Promontory plant increase by 50 percent over the last 5 years.

I am also concerned about a practice that is currently permitted by the Surface Transportation Board called "bottlenecking." Under this practice, if a railroad owns the tracks for the last few miles of a shipment, that railroad is not required to quote prices for portions of the shipment that other railroads can offer. This creates what is referred to in the business as "captive shippers," and these corporations are justifiably concerned that they are paying higher rates because of the lack of competition.

Equally as disconcerting are the reports of paper barriers where short-line railroads are provided with overly discounted if not free access to railroad lines if the short-line operators agree only to transfer shipments through the major railroad that owns the lines, that particular line used by the short-rail operator.

Now, Mr. Chairman, these are troubling points that require close scrutiny. I appreciate your calling this hearing and the willingness of the distinguished panel of witnesses to come before us today and report on their knowledge of the transportation industry.

I might add there is another side to it, too, and that is, we are going to have to upgrade the railroads in this country, and we are going to have to create more of them. Just the energy costs alone and savings alone through railroad use are really substantial, and we cannot ignore that either. But if railroads are charging too much and taking advantage of their antitrust exemption in ways that really were not contemplated, then we have got to look at this very, very seriously, as I know you are doing.

So I want to thank you for your energy in this matter, and I want to thank you for holding this hearing and the willingness of these distinguished witnesses on this panel to come before us today to report on their knowledge of the transportation industry.

Thank you, Mr. Chairman.

Chairman KOHL. Thank you, Senator Hatch.

Before I introduce our witnesses, I would like to note that Senator Dianne Feinstein is with us today. She is from California, and we very much appreciate her presence at this hearing.

Our first witness today will be Charles Nottingham. Mr. Nottingham is the Chairman of the Surface Transportation Board. Since

2002, Chairman Nottingham has also served as the Associate Administrator for Policy and Governmental Affairs at the Federal Highway Administration.

Our next witness will be William Berg. Mr. Berg is President and CEO of Dairyland Power Cooperative in La Crosse, Wisconsin. He serves on a variety of boards and committees, including the Rail Energy Transportation Advisory Committee of the Surface Transportation Board.

Our next witness will be Ken Vander Schaaf. Mr. Vander Schaaf is the Director of Supply Chain Management at ATK in Radford, Virginia, where his responsibilities include management of transportation services. He is a member of the Institute for Supply Management of the Carolinas and Virginia.

Our next witness will be Bob Szabo. Mr. Szabo is a partner at the Van Ness Feldman law firm. He is also Executive Director of Consumers United for Rail Equity, or CURE, where he provides legislative and legal counsel as well as management services.

Our next witness will be Darren Bush. Dr. Bush is an Associate Professor of Law at the University of Houston Law Center, where his primary research interests are antitrust and regulated industries, energy, and intellectual property. Dr. Bush also served in the Transportation, Energy, and Agriculture Section of the Antitrust Division at the Department of Justice.

Our final witness will be G. Paul Moates, testifying on behalf of the Association of American Railroads. Mr. Moates is a partner at Sidley Austin LLP, where is head of the firm's transportation practice. Mr. Moates regularly represents railroads and the railroad industry's trade association, and he has served as lead counsel in a number of large railroad merger cases before the Surface Transportation Board.

We thank you all for appearing here, and we would like you to stand and raise your right hand and repeat after me. Do you swear and affirm that the testimony you are about to give before the Committee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. NOTTINGHAM. I do.

Mr. BERG. I do.

Mr. VANDER SCHAAF. I do.

Mr. SZABO. I do.

Mr. BUSH. I do.

Mr. MOATES. I do.

Chairman KOHL. We thank you so much.

Chairman Nottingham, we will take your testimony at this time.

STATEMENT OF CHARLES D. NOTTINGHAM, CHAIRMAN, SURFACE TRANSPORTATION BOARD, WASHINGTON, D.C.

Mr. NOTTINGHAM. Good morning, Chairman Kohl, Ranking Member Hatch, and Senator Feinstein. My name is Charles Nottingham, and I am Chairman of the Surface Transportation Board. I appreciate the opportunity to appear before this Subcommittee today to provide the Board's views on S. 772, the Railroad Antitrust Enforcement Act. I will briefly summarize my written testimony.

It is important to state at the outset that railroads today are already largely subject to the antitrust laws. For example, they face civil and criminal liability for violations of the Sherman Act, such as price fixing, market allocation, and bid rigging, and they have been successfully sued for violating that Act.

Where the railroads do have express statutory immunities, they are narrowly drawn, and in administering the Interstate Commerce Act, the Board vigorously enforces core antitrust principles. Rail carriers should be subject to the full weight of Federal antitrust laws, except where the enforcement of the antitrust laws may conflict with the need for single, uniform, and integrated economic regulation of the rail industry by the Board.

The Board does not believe that immunities once granted under particular economic and legal circumstances should remain in place regardless of changes in the economic and legal environment that occur over time. For example, in May of this year, the Board used its discretion to terminate antitrust immunities for motor carrier rate bureaus that had been recognized for more than 70 years. The Board's decision in the area of motor carrier rate bureaus demonstrates out commitment to the antitrust laws and our willingness not to be constrained by past policy decisions or jurisdictional turf considerations.

We are concerned that at least two provisions of the proposed legislation would interfere with the Board's ability to effectively regulate this Nation's interconnected rail network. First, let me address Section 2 of the bill.

Presently, only the Department of Justice or the STB may bring suit for injunctive relief against a common carrier subject to STB jurisdiction. The bill would permit private parties to obtain injunctive relief against rail carriers in individual Sherman or Clayton Act challenges. This proposal presents serious risks to centralized oversight of the National Rail Transportation System.

District courts are not responsible for meeting national rail transportation policy goals, nor do the district courts possess the institutional expertise to consider how a decision resolving one case will affect other carriers and shippers on that line, or on other lines in different parts of the country.

Unlike many other industries, the National Rail System, while comprising hundreds of individual railroads, nevertheless operates as a single, integrated, complex, and interdependent network. Operational changes or issues arising in one location can have significant operational ramifications hundreds of miles away, including effects on other freight carriers as well as on Amtrak and commuter lines. Only the Board is charged with looking at the rail industry from a national perspective and ensuring that remedies to resolve individual disputes comport with national rail policy objectives and do not cause unintended operational and service problems elsewhere.

Giving district court's injunctive power in rail-related disputes would also create a great potential for conflicting decisions from individual courts. The Board, and the ICC before it, has developed a consistent body of law that approaches competition issues with a viewpoint broadened by other rail transportation goals and that provides the basis upon which both carriers and shippers shape their conduct and assess potential remedies. In contrast, district courts looking solely at the antitrust laws without regard to the many public interest considerations mandatory in board review might well come up with different rules and different remedies to fix competition issues. Finally, many of the injunctive remedies that a district court might order in an antitrust case may themselves require board approval. In sum, we believe that Section 2 of the bill is antithetical to Congress' longstanding support for a rail regulatory system that charges a single economic regulatory body with oversight over the rail industry.

Let me now turn to the Board's concerns regarding Section 3 of the bill.

In 1995, Congress declined to repeal the antitrust exemption for rail mergers, acquisitions, and other transactions, choosing instead to keep that review with the agency that regulates the economic activity of the industry. Section 3 would subject rail mergers, acquisitions, leases, joint use, and trackage rights agreements to both the approval process and criteria of the Interstate Commerce Act and separate Clayton Act standards and procedures. We are concerned that this dual enforcement regime could result in some of the same problems raised by the potential for district court injunctions described above. We are also concerned that it would diminish the considerable benefits of a single, comprehensive review in which the views of all parties, including those of DOJ, and affected shippers are transparent and considered.

From a substantive viewpoint, there is very little disagreement between the Board and the antitrust enforcers on the outcome of mergers. Although critics of the Board make much of those few instances of disagreement between the Board and DOJ, there has only been one recent case, in 1996, where the Board did not follow DOJ's recommendation that merger authority either be denied or conditioned on expansive divestitures. The benefit of hindsight shows that the Board made the right decision in that one recent case, which was the UP–SP merger, a decision supported by the vast majority of impacted rail customers.

Further, the Board's new merger rules anticipate the types of major rail merger proposals we could see in the future, which would likely involve the creation of a transcontinental railroad, by merging one carrier from the West with another carrier from the East. Under traditional merger analysis by DOJ or the FTC, such a vertical integration of two partners with complementary, not overlapping, systems would not be perceived to carry as significant a risk of competitive harm as a horizontal merger of two direct competitors. However, under the new STB merger rules, to offset any harm that could not be mitigated merging carriers would need to show how the proposed merger would enhance competition. We are concerned that dual merger review would frustrate the Board's ability to fashion merger conditions based on public interest concerns.

The Board has also found that continued oversight of larger rail mergers is critical to ensuring that remedies are working effectively. These types of chores are best left to a single decisionmaker. That decisionmaker should be the one that is least limited in both what it can consider and what conditions it can and will impose, which in this instance would be the Board.

I am concerned, therefore, that this bill is not targeted to remove just those exemptions that have grown outdated or are no longer useful but, rather, is a sweeping change that removes them all. These changes would make it more difficult for the STB to perform its regulatory oversight responsibilities.

The Board understands and is sensitive to the concerns of rail customers about rail rates and service. During my 14-month tenure at the Board, we have implemented an unprecedented series of regulatory actions and reforms aimed at halting unreasonable rail industry practices, increasing access to the Board's dispute resolution procedures, and examining the accuracy of our industry cost-of-capital determination that impacts rates and affects many aspects of the relationship between railroad and their customers. We have also initiated a $1 million national study of rail competition being managed by Christensen Associates, an economic consulting firm based in Madison, Wisconsin.

In conclusion, S. 772 would make efficient, uniform regulation of the rail industry more difficult by creating duplicative and overlapping regulatory schemes. Likewise, subjecting the rail industry to a potential patchwork of judicial injunctions scattered across the country could cause a ripple effect of operational problems for freight, Amtrak, and commuter rail transportation. These complications could increase the cost of providing rail service—costs that likely would be passed on to rail customers in the form of higher rates. Therefore, I am concerned that the legislation may create more rate and service problems, not fewer problems.

Thank you for giving me the opportunity to testify here today, and I will be happy to answer any questions you may have.

[The prepared statement of Mr. Nottingham appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Nottingham.

Mr. Berg, you may commence, and I would like to request that the witnesses keep their comments to 5 minutes. Mr. Berg?

STATEMENT OF WILLIAM L. BERG, PRESIDENT AND CHIEF EXECUTIVE OFFICER, DAIRYLAND POWER COOPERATIVE, LA CROSSE, WISCONSIN

Mr. BERG. Chairman Kohl and members of the Subcommittee, my name is William Berg. I am President and CEO of Dairyland Power Cooperative, headquartered in La Crosse, Wisconsin.

Dairyland Power is a nonprofit generation and transmission cooperative supplying at wholesale the electricity needs of our 25 member distribution cooperatives, who in turn serve over 575,000 people living in Minnesota, Iowa, Illinois, and Wisconsin. As a relatively small electric utility serving mostly rural residences and farms, we are very concerned about holding down costs because, ultimately, all the costs that we incur in the generation and distribution of electricity flow through to our members. Our largest single cost item in generating electricity is rail transportation, and as I will explain, those costs have mushroomed.

We annually use about 3.2 million tons of coal in three coal-fired plants in western Wisconsin. Three-quarters of that coal comes from the Powder River Basin in Wyoming. For the delivery of that coal, we are captive to and dependent upon the only two railroads currently serving the Powder River Basin, or PRB, as it is called. Because of the virtually unrestrained market power that these railroads have over PRB movements, we are, in fact, paying more and receiving less. In 2005, Dairyland experienced a 13-percent shortfall of scheduled coal shipments, yet we were hit with rate increases averaging about 93 percent beginning in 2006—resulting in more than $35 million of increased annual costs.

These dramatic rate increases were the major factor in our board's decision to increase electricity rates to our members by over 20 percent during 2006. Our members are truly suffering as a result of the railroads' predatory price increases, and we cannot tolerate a virtual doubling of rates, especially at a time when our service quality is actually declining. Moreover, these rate increases came at the end of a short-term, 3-year contract that already included annual escalations and provided adequate cost recovery.

We are certainly not alone in this situation. BadgerCURE, an organization of over 45 Wisconsin groups, businesses, and organizations, has been formed to pursue sensible policies to help address railroad competition and service problems.

Since utilities have no viable alternative to rail in moving coal from the Powder River Basin to their power plants, and since the two railroads now appear to have no incentive to improve the existing demand/supply imbalance, we cannot protect ourselves through normal business negotiations. At our largest plant, we have rail access from only one provider. At our other plants, which receive coal by barge, we must still secure rail delivery to the barges. Although there may be more than one railroad for those hauls, the absence of competition and apparent allocation of markets have allowed the railroads to preserve market share even while eliminating performance guarantees and dramatically raising prices. The railroads seem to be able to exercise almost absolute market power, with little effective recourse by Dairyland or other, even much larger, railroad customers.

We strongly support S. 772, legislation that will provide for a more competitive landscape in the Nation's freight railroad industry. Along with S. 953, the Railroad Competition and Service Improvement Act of 2007, which has been referred to the Senate Commerce, Science, and Transportation Committee. With the enactment of S. 772, rail customers will have the full range of the Nation's antitrust laws to help deal with anticompetitive railroad actions, and the legislation may help serve as a deterrent to future anticompetitive behavior. For instance, S. 772 may help defer the following competitive problems:

Bottlenecks. Dairyland is a "bottleneck: utility, that is, the last segment of the trip to our unit-train plant is served by only one railroad. Railroads often refuse to quote rates for shipments to or on the bottleneck segment, denying the benefits of competition on the other segments.

Paper barriers. Major railroads have spun off or leased segments of their tracks to short-line carriers with contractual terms that prohibit the acquiring carrier from competing with the major railroads.

Public pricing. Dairyland traditionally received coal transportation via confidential contracts. Now, approximately two-thirds of our rail business moves under so-called "public pricing" documents manufactured by the railroads. We are concerned that high public rail prices provide signals between these western carriers regarding elevated pricing aspirations for Dairyland's traffic.

Refusal to bid. Even in what should be considered "competitive" situations where two railroads are able to serve a property, increasingly we do not see competitive bids. For example, coal we receive by barge is theoretically competitive, since there are several rail-to-barge transloading facilities in different locations. Our experience is that one railroad offers public pricing while the other railroad offers nothing or exceedingly high prices. Competition does not work in a duopoly market if one of the duopolists refuses to bid.

In response to recent regulation, rail representatives suggest that legislative relief is "re-regulation." We disagree. We have also heard the railroads state that the legislative relief would result in their decision not to add infrastructure. We understand that the railroads need a reasonable profit to operate, and they must have enough capital to make needed improvements. However, the rate increases to Dairyland have no correlation to improved service and infrastructure improvements. Of necessity, we are going to be partners for many decades to come, but I question whether the railroads will ever have an incentive to improve service, properly maintain and grow infrastructure, and effectively compete for service unless changes are made by Congress.

Railroads also aggregate numbers as they defend themselves from the issue of high rates. Those aggregate numbers really do not tell the real impact for an individual shipper like Dairyland Power. The bottom line is this: every month Dairyland has to pay millions of dollars more because of rail rates that have nearly doubled, and as a cooperative, every single cent of that has to come out of our members' pockets.

In light of the current consolidated state of the railroad industry and the problems we are experiencing in obtaining competitive rail service, Dairyland respectfully submits that the Committee got it right when it recently approved S. 772, and we urge the full Senate to pass this important bill as soon as possible.

Thank you again for the opportunity to testify.

[The prepared statement of Mr. Berg appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Berg.

Mr. Vander Schaaf?

STATEMENT OF KEN VANDER SCHAAF, DIRECTOR, SUPPLY CHAIN MANAGEMENT, ATK, RADFORD, VIRGINIA

Mr. VANDER SCHAAF. Chairman Kohl, Senator Hatch, and distinguished members of the Committee, thank you for the opportunity to discuss the issue of rail transportation costs and the quality of service experienced by a captive customer. I am Ken Vander Schaaf, the Director of Supply Chain Management at the Radford Army Ammunition Plant, operated by my employer, ATK Ammunition Systems, which is headquartered in Utah. ATK is an advanced weapons and space systems company headquartered in Edina, Minnesota, with 52 facilities in 21 States, including the States of Utah and Wisconsin. Given our large number of facilities spread across the country, our company has an overarching interest in the competitive transportation environment in general, including via rail.

ATK strongly supports S. 772, the Railroad Antitrust Enforcement Act. If S. 772 had been the law of the land over the last few decades, we would see a more competitive rail industry today, with fewer of the problems that I am here to discuss. Today I will address our captive customer status at two of our facilities. The first is ATK's Launch Systems facility near Promontory, Utah, a private facility that supplies large solid rocket boosters for NASA's Space Shuttle program, the Department of Defense's Minuteman and Trident strategic missile systems, and other large defense, commercial, and civil rocket programs. The second is the Army's Radford Army Ammunition Plant, which ATK operates under a Government-owned, contractor-operated agreement with the U.S. Army.

ATK's Promontory facility is a captive customer of the Union Pacific Railroad. The solid rocket motors manufactured here are loaded by ATK onto railcars at our facility in Corinne, Utah. Union Pacific then transports the solid rockets to Titusville, Florida, among other locations. Because of the enormous size of most of these rocket motors, there is no other way to ship these products.

In recent years, Union Pacific has instituted substantial price increases. In 2002, ATK Promontory paid about $14,000 per rail car to Union Pacific to move the shuttle's rocket boosters. By April 2007, the rate increased to over $21,000 per rail car, an increase of over 50 percent in 5 years.

Union Pacific cites two main reasons for these rate increases: a "special train" service and increased fuel costs. The special train service was initiated in 1994 by Union Pacific to facilitate the flow of traffic across their lines. The creation of the service was Union Pacific's decision, not ATK's, yet we are now paying for it. The second reason given for these rate hikes is that the Surface Transportation Board now requires all fuel surcharges to be based on transportation mileage. This now permanent rate hike is an added cost to previous fuel surcharges that were already in excess of the actual cost of fuel expended.

Our Promontory facility also experiences a lack of reliability by their rail carrier. Union Pacific often misses promised pick-up or delivery dates, and the transit times are routinely longer than promised. Because we are limited to only one rail carrier at each of our locations, we are forced to comply with the carrier's performance, prices, and attitude toward service.

A solid rocket booster shipping to Cape Canaveral in Florida is too massive to move in any other way than a railroad. These financial and schedule costs ultimately add excess cost and risk to our Government customers at NASA and the Department of Defense.

ATK and its heritage companies have continuously operated Radford Army Ammunition Plant in southern Virginia under the contract with the U.S. Army since the 1940's. Radford is the only domestic source of nitrocellulose, which is required in the production of all ammunition products, including those utilized by the military, law enforcement, and civilian sportsmen. At Radford, we annually produce 21 million pounds of nitrocellulose, 8.5 million pounds of propellant, and 4.5 million pounds of commercial powder. In other to produce nitrocellulose and the resulting propellants, significant quantities of chemicals must be safely transported to Radford. Radford has historically relied almost exclusively on rail shipments to receive these raw materials. The deliveries are critical to our ability to supply the Army and other customers with propellants.

Of increasing concern are rising transportation costs and the decreased quality of rail service experienced by ATK at Radford. Historically, the Radford Plant was served by two railroads—the Virginian and Norfolk Western. The Virginian was acquired by the Norfolk Southern, and we are now a "captive customer," relying on a single rail provider for the receipt of chemicals. We frequently experience rail schedule slips at Radford. We plan around those potential scheduled slips by building excess inventory into our business plans so that operations continue uninterrupted to meet the Department of Defense's required delivery schedules. This practice adds cost and overhead to our operations.

Norfolk Southern has raised transportation substantially. Prior to the last few years, we viewed Norfolk Southern's price increases as both realistic and relatively justified. However, in May 2006 things changed. Cherokee Nitrogen, ATK's supplier for ammonia, advised us that, effective June 1, 2006, Norfolk Southern's freight rate for ammonia shipments to Radford would increase from $39 per ton to $65 per ton—a 69-percent increase. This massive price increase demonstrates the ability of a monopoly railroad to levy price increases at will, with little if any notice.

In the last 15 months, the rail increases to move ammonia have increased from $39 per ton to $132 per ton in July 2007, an increase of over 330 percent.

Significant fuel surcharges have also added to the cost of shipments. Whenever the cost of oil increases, our rail carrier has unilaterally added the fuel surcharge to the cost of shipments. Our experience is that the railroads then quickly modify the tariff rates to incorporate the higher rates such that there is never a corresponding drop in cost of freight when the price of oil does fall.

At Radford, we believe that the Norfolk Southern Railroad is deliberately trying to price itself out of the business of shipping some chemicals. The end result of this strategy will be the movement of hazardous materials from the railroads to the highways. In ATK's perspective, movement by rail has several inherent safety advantages over shipping by truck on the highway: railcars are constructed of stronger materials than are tank trucks; rail traffic is more segregated from other modes of transportation; and the number of railcars required to transport the same quantity of material via highway increases by as much as a factor of five.

Likewise, there are significant advantages to the shipper and to the receiver when shipping with larger volumes. As the number of individual shipments increases—as it would if we were to ship via truck rather than rail—the potential exposure of our workers to these potential hazardous chemicals increases as well. While the chemical industry has a very good safety record in handling chemicals properly, each unnecessary transfer increases the opportunity for an incident or an accident

All of us at ATK are extremely proud of the role we play in support of our homeland security, law enforcement, space exploration, and outdoor sportsmen customers. However, our ability to perform those missions safely and economically for our customers is negatively impacted by the quality of the service we receive and the extremely high rates demanded by the monopoly rail carriers. There is also the larger issue of increased costs borne by NASA and the Department of Defense, and ultimately the U.S. taxpayer, as they annually transport by rail millions of tons of equipment, products, and supplies to and from depots, military bases, and ports.

Thank you again, Chairman Kohl and Senator Hatch, for your leadership on this issue, and for your Committee's continued interest in looking for ways to redress these important issues. We look forward to working with you in support of this and other possible legislation needed to solve the issues facing ATK and other companies held captive by this monopoly of railroad companies.

In closing, in addition to S. 772, I would like to direct your attention to S. 953, the Railroad Competition and Service Improvement Act, which seeks to improve the rate challenge process, provide for service complaint remedies by the Surface Transportation Board, and a more proactive STB in general. We hope that the Senate Commerce Committee before which this bill is pending will move this bill quickly and encourage members of this Committee to work with their colleagues there to move S. 953 rapidly to the floor.

I would be pleased to respond to any questions you might have. Thank you.

[The prepared statement of Mr. Vander Schaaf appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Vander Schaaf.

Mr. Szabo? And, again, I would like to request that you keep your comments to 5 minutes or less. Mr. Szabo?

STATEMENT OF ROBERT G. SZABO, MEMBER, VAN NESS FELDMAN, EXECUTIVE DIRECTOR AND COUNSEL, CONSUMERS UNITED FOR RAIL EQUITY (CURE)

Mr. SZABO. Mr. Chairman and Senator Hatch and Senator Feinstein, thank you for the opportunity to speak today. I am the Executive Director of CURE, which is a membership organization that advocates S. 772 and other remedies for the current rail customer problem. We strongly support your legislation. We strongly support this Committee's action in reporting the bill.

We believe if S. 772 becomes law, it will address three of the major problems confronting—would address the major problem confronting rail customers, which is a lack of access to competition. We think there are three specific problems that it will correct that lead to that lack of competition: the first one is overconcentration of the rail industry; the second one is the paper barriers or tie-in agreements that Senator Hatch mentioned; the third is the bottleneck or failure to quote rates, again that Senator Hatch mentioned. And, by the way, we are in complete agreement with both of your opening statements, and I believe you set forth the problem very clearly.

Mergers and acquisitions. Most of them are done. There are some that could still happen. We believe that some have not occurred properly. Some did not occur with the right conditions to address anticompetitive impacts. We do not agree with the Chairman that, in retrospect, the one that the Department of Justice opposed, which was the UP and the Southern Pacific, has worked out well. It has not worked out well for some rail customers. And, therefore, we believe that any further mergers and acquisitions should be both under the Board, which has the first call on these matters, but that the Department of Justice should have the right to go to Federal district court and enjoin the merger and acquisition if it violates the antitrust laws.

S. 772 will not prevent the STB from having a higher standard than the antitrust laws. We are happy that they are more vigilant today than they were once upon a time. They have a more progressive policy than they used to have, but it has not been tested by any merger. So that is the first issue.

The second issue, paper barriers, I would like to refer to a schematic that is on the back of my testimony which sets forth this problem. After partial deregulation, the railroad industry began to rationalize its system to meet the needs of the country, and 500 short-line railroads were created. In each case, that transaction had to be approved by the STB and was not subject to Department of Justice approval. What happened, shippers thought that this would be a means of competition. Unfortunately, what happened is most of these transactions creating the short line were not sales of track to the short line. They were leases of operating rights on the tracks.

The terms of these agreements were not made public during the public comment period. Later, we came to understand that in most of these lease agreements there are prohibitions that prevent the short line from doing business with any railroad other than the one from which they are leasing the track. This means that the customers on that track can only go to one major railroad, even though the track that is being operated by the short line may go to two major railroads. So we are prevented from competition.

The schematic that I have, Attachment A, is one example. It is a Union Pacific example, moving coal from the Powder River Basin. I do not mean to be picking on the UP, but this happens throughout the rail system. There are two railroads in the Powder River Basin that can move coal out of the basin. That is the Burlington Northern and the UP—the two major railroads in the West. But often there is only one railroad that can bring it to the power plant. In this case, the Red Railroad is the UP, and they can bring it to the plant. This line, which is not coming through very well, that goes down through Memphis is the Burlington Northern. But there is a short line that can intersect with the Burlington Northern and bring the coal to the power plant.

On a map, you would think that this power plant is in good shape, that it has competition. But if you look at the next page, this is a provision extracted from the lease agreement that basically says if the short line does 95 percent—unless the short line does 95 percent of its business with UP, it pays a confiscatory annual rent for the track. The first 5 percent, no annual rent; 95 percent, $10 million. It escalates to $90 million.

This lease was not made—agreement is not public, but it was filed on the record of the Securities and Exchange Commission and was found by a law firm. UP does not like us to talk about this, but we believe these are in many of the agreements that prevent competition. We think those are anticompetitive. We do not think they would stand under the antitrust laws.

The second mechanism is the one Senator Hatch mentioned previously-the bottleneck, or the failure to quote a rate. I have another schematic. This is, again, UP. We are not trying to pick on UP.

Chairman KOHL. Mr. Szabo, we are at 5 minutes. Would you conclude?

Mr. SZABO. I will. At any rate, this prevents access to competition. The utility in Lafayette testified that the captivity that they pay for their coal which passes through to the ratepayers is costing the school systems in Lafayette, Louisiana, $1.5 million extra a year.

We believe, Mr. Chairman, that antitrust laws will help with competition in the rail industry. Thank you.

[The prepared statement of Mr. Szabo appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Szabo.

Dr. Bush?

STATEMENT OF DARREN BUSH, ASSOCIATE PROFESSOR OF LAW, UNIVERSITY OF HOUSTON LAW CENTER, HOUSTON, TEXAS

Mr. BUSH. Mr. Chairman, Ranking Member Senator Hatch from my home State of Utah, and other distinguished members of the Subcommittee, I want to thank you for giving me the opportunity today to speak about competition policy in the context of a deregulated railroad industry. My remarks today are my own, as I, quite sadly, do not represent anyone in this matter.

As I and others have set forth in a fairly recent report to the United States Antitrust Modernization Commission, the burden of establishing the case for any immunity should fall on the proponents of the immunity who, at a minimum, should clearly explain why conduct within the scope of an immunity is both prohibited or unduly inhibited by antitrust liability and is in the public interest, make some estimation as to the effects of the proposed—of the immunity, what the immunity will have in addition to its intended effect—in other words, other external effects; and demonstrate that the immunity is necessary to achieve the desired policy outcome.

In the case of railroads, I find no clear benefit to the immunity except perhaps to the railroads and to the Surface Transportation Board in the form of exclusive jurisdiction. The benefits of such a regulatory scheme are dubious at best, and the conduct sought for continued immunization has characteristics that could lead and perhaps has led to serious consumer injury. I only have time today to talk about this in the context of mergers.

For example, it is fair to say that the Surface Transportation Board and its predecessor, the Interstate Commerce Commission, have rarely met a merger that they did not like. However, this is by design. As I mentioned in my written testimony, the purpose of the STB's merger authority harkening back to the 1920's was to consolidate the railroad industry. The formulaic requirements of balancing the total effect of the merger's cost and benefits naturally led to a pro-merger stance with immediate potential speculative efficiency gains and other potential benefits accruing to interested stakeholders such as the railroads and labor outweighing consumer injury.

Sadly, the goal of the policy, which was consolidation and increased investor returns, along with system stability, did not come to fruition. Some recent mergers have created service disruptions and spawned shipper complaints, some of which you have heard here today. And while the STB has revamped its merger policy to some degree, it is yet to be tested by any railroad merger. The question arises as to whether the STB will be able to resist its past practices of allowing mergers to come to fruition with Acela-like speed.

Moreover, in the context of today's discussion, I find no reason to conclude that there is something so special in the railroad regulation realm that should isolate it from other industries that exhibit similar issues, including potential natural monopoly conditions in some component of the industry, high coordination needs for purposes of providing service and protecting public safety, and where exists some modicum of competition. Absent such a showing, there appears little argument against concurrent jurisdiction. Rather, it is the case that much of railroad policy has moved away from regulation to market forces. In that instance, it is imperative that antitrust fill the gap left by regulators. Otherwise, we are left with the worst of all possible worlds: a business subject to neither competition policy nor regulation.

Because the world of railroads is one of extreme levels of market concentration, the anticompetitive stakes are high. Any future merger could potentially yield strong and persistent anticompetitive effects. The consideration of these effects might be lost in the STB's calculus of total benefits to consumers, the railroads, labor, or other stakeholders to the transaction. The antitrust laws, in contrast, do not necessarily consider transfers from consumers to stakeholders to be a good thing. Moreover, the antitrust agencies more readily consider the full spectrum of competitive harms.

I find it similarly disingenuous to argue that courts will likely cause disruption of national railroad policy in the wake of an antitrust suit brought by a private plaintiff or a State attorney general acting as parens patriae. Many agencies live with the potential of court action against a company subject to the agency's regulation. Unless there is something unique about railroads—and I do understand that there is something about a train that is magic—there is little justification for granting immunity here while embracing competition policy elsewhere. In most instances, historically such choices between immunity and antitrust law application were not made due to industry idiosyncrasies, but rather due to industry lobbying and political pressure.

Antitrust immunity without justification is merely special interest legislation transferring wealth from consumers, shippers and others to railroads. It is not just in the context of mergers that this exists, but you have also heard testimony with respect to paper barriers and other things. Therefore, the Surface Transportation Board has let a lot of anticompetitive effects take place without any justification.

I see that I am out of time, and I will play by the rules and entertain any questions afterward. Thank you.

[The prepared statement of Mr. Bush appears as a submission for the record.]

Chairman KOHL. Thank you very much, Dr. Bush.

Mr. Moates?

STATEMENT OF G. PAUL MOATES, ESQ., PARTNER, SIDLEY AUSTIN LLP, WASHINGTON, D.C., ON BEHALF OF ASSOCIATION OF AMERICAN RAILROADS

Mr. MOATES. Chairman Kohl, Senator Hatch, Senator Feinstein, my name is Paul Moates, and I am testifying here today on behalf of the Association of American Railroads. I am a senior partner in the Washington office of the international law firm of Sidley Austin, and I have approximately 30 years of experience in representing individual freight railroads as well as the AAR on antitrust and regulatory matters, including most of the major merger cases and rate cases that have occurred in the last 25 or 30 years. I thank the mt for this opportunity to present the railroad industry's views on S. 772, the Railroad Antitrust Enforcement Act of 2007.

Frankly, we believe this legislation is a solution looking for a problem. In developing that needless solution, it would subject railroads to an unwarranted dual system of regulation. Longstanding statutory schemes should be altered only if there is an identified problem and only if the proposed legislation would be effective in remedying that perceived problem.

With respect, neither condition exists with respect to this legislation. Indeed, it is based on a number of faulty premises. The first is that railroads enjoy broad antitrust immunities. That is simply not true. As Chairman Nottingham said before me this morning, railroads are generally subject to antitrust laws, and the immunities they do have are limited in scope and also subject to regulatory oversight by the STB.

In particular, the antitrust laws prohibit anticompetitive agreements among railroads to collude in the setting of rates, the allocation of markets, or otherwise unreasonably restraining trade. Railroads also continue to be subject to the STB's regulatory jurisdiction with respect to certain rates and services, the terms of entry and exit, and mergers and other restructurings. The statutory antitrust exemptions that remain exist because of the need to avoid dual and potentially conflicting regulation by the courts and the STB. Moreover, they allow the railroads to work together in a limited way, a very limited way, to efficiently address some of the issues created because of the industry's network characteristics.

The second faulty premise is that this legislation would benefit shippers by subjecting railroads to dual merger jurisdiction. It would attempt to do this by eliminating the STB's current exclusive jurisdiction over rail mergers while giving the antitrust enforcement agencies concurrent authority to review and challenge such mergers. Even more troubling, the bill would allow DOJ or the FTC retroactively to challenge mergers that were approved by the ICC or STB long ago and subsequently consummated. There is no reason to believe that this change in the law will provide shippers with additional relief in any possible future merger cases. Indeed, the Clayton Act standard of preserving competition does not in any way give shippers more protections than the STB standard for major rail mergers of requiring that merger applicants demonstrate that their proposed transaction would result in enhancements to competition.

Moreover, dating back at least to the passage of the Staggers Act, the STB and ICC before it have consistently used their authority to impose conditions on mergers to ensure that no customer has lost two-railroad service.

Another of the solutions in S. 772 looking for a problem is elimination of the limited exemption that railroads have under Title 49, Section 10706, establishing procedures for handling car hire payments, railroad car hire payments. That exemption, although severely limited, nonetheless remains important since it fosters coordination on matters that enhance network efficiency and are not controversial. It is also important to recognize that even those rules do not involve the setting of car hire rates. Such rates are established through bilateral negotiations between the owners and users of the equipment. In fact, let me emphasize again that under this exemption, competing railroads do not and have not for many years collectively set freight rates of any kind. That seems to be a very erroneous premise here this morning.

The third faulty premise is that this legislation would merely level the playing field and treat railroads like other industries. But I would submit this is belied by the very language in the bill. In several instances, the bill addresses specific antitrust exemptions that currently apply to a number of industries in addition to railroads, but eliminates them only with respect to railroads. One must ask why these exemptions are sound policies for other industries but not for railroads.

In addition, this legislation would not replace the existing STB regulatory scheme with antitrust remedies where limited immunities exist. Rather, it would superimpose antitrust remedies on top of STB regulation. Moreover, it will not provide rail customers with any new protections from allegedly high rates because high prices alone do not constitute an antitrust violation.

Finally, we have a major concern mentioned by Chairman Nottingham about Section 2 of the bill, which permits private injunctions and thereby introduces the very real possibility of dual but inconsistent regulation of railroads. So long as there remains a single regulatory body charged with oversight of the industry, it is imperative that the antitrust laws and national transportation policy be implemented in a harmonious fashion, and permitting courts to fashion equitable remedies in civil actions and also by discouraging courts from deferring to the STB's expertise, Section 4 of the bill threatens to disrupt that harmony.

My time is up. I will stop, sir. Thank you.

[The prepared statement of Mr. Moates appears as a submission for the record.]

Chairman KOHL. We thank you very much, Mr. Moates.

We will now start our questions, and I would request that the Senators keep to 7 minutes.

Mr. Berg and Mr. Vander Schaaf, how would repealing the railroad's antitrust exemption help you? What remedies would it give you that you believe you need and don't have under the current law? Mr. Berg first, and then Mr. Vander Schaaf.

Mr. BERG. I cannot help but feel that this is going to help. I am not an antitrust expert, so I do not know the intricacies involved. But clearly, as we have been dealing with the railroads recently, it is obvious to us that there are many anticompetitive practices going on, as I mentioned in my testimony. At least the net result of that is what I have declared, and it has increased our rates.

If we ask going forward will this help our rates, it would be easier for me to answer the question if we did not adopt this legislation what would happen to our rates. And I can only see things getting worse. I think the rates will go up in the future from the railroads. They dealt with us with pretty strong arms. And Dairyland, as I mentioned, is a small utility. We have to be considered, I would say, easy pickings. To try to do anything to counteract, bring cases to the STB and so on, it is a very daunting process for us.

So we are looking for any help we can get. We think that the elements described in here to make sure that the telegraphing of prices through these rate circulars or tariffs is not going to harm us in the future, that the railroads be able to bid on certain hauls that we have before us, all of this is going to help us in the future.

Chairman KOHL. Mr. Vander Schaaf?

Mr. VANDER SCHAAF. My answer is probably going to be a little strange because I suspect that S. 772 right now today will not do much for us at Radford or Promontory. The damage is already done. We are down to one railroad. Even though we had two at Radford, I do not see it going back to two railroads. But for our other locations around the country and as we expand and grow, we do see some of those locations potentially being positively impacted by this legislation. And I think it is a foundation for future legislation, for example, S. 953 in combination being able to make it more competitive and having better access for a level playing field rather than a monopolistic railroad situation where they truly have the upper hand; and it is not just what they can do to us today, it is the fear of what they can do to us tomorrow.

For example, the 300-percent increases that we have already experienced, our perception is that they want to get out of some of the freight business that they haul for us, and they could continuously increase that until we have a very unsafe or a less safe situation in moving it via truck rather than rail.

So it is a good foundation step. It is the right direction. We strongly support this and other legislation that will support leveling of the playing field for us in the manufacturing industry.

Chairman KOHL. Mr. Bush, and then Mr. Moates, the railroad industry argues that it should not be subject to antitrust regulation because the Surface Transportation Board already regulates the railroads, but many, in fact most industries, including transportation industries like aviation and trucking, are now under the jurisdiction of various regulatory bodies, and yet antitrust law applies to them.

So the question is: Why should railroads be any different?

Mr. BUSH. That is a very good question, Senator. I have yet to see any reason that the railroads should be different than any other industry which requires high degrees of coordination such as electricity markets. Other transportation sectors have high—portions of the transportation sector have high degrees of coordination as well. So there does not seem to be any reason why the railroads should be different.

The threat that a private plaintiff or some district court will somehow usurp national transportation policy has not appeared in any way, shape, or form in other industries as well. In fact, quite the contrary, when there is a regulatory body there, regardless of the degree of the immunity, the courts will be very reluctant to entertain any sort of action. There is judicial hesitation when there is even what I call "immunity by proximity." If the regulator is there and there appears to be an antitrust exemption, that exemption spreads out to other conduct within the industry to a degree not contemplated by Congress. So—

Chairman KOHL. OK. Thank you.

Mr. Moates?

Mr. MOATES. Senator Kohl, my first response is railroads are not that different. As I said in my prepared remarks, railroads are today and have for a very long time been subject to the vast preponderance of the antitrust laws, including Sections 1 and 2 of the Sherman Act and other provisions of the antitrust laws that you are familiar with.

The limited immunities that the industry has enjoyed and that are addressed in some respect by this bill have been put in there by Congress at different points in time for very sound reasons. They were put in there because there were certain efficiencies that were recognized that would result. I mentioned, for example, the Association of American Railroads has a Car Hire Committee that exists under an agreement approved by the Surface Transportation Board under Section 10706 for that committee to get together for the limited and express and very limited purpose of discussing the protocols for how railroads will charge one another for the railroad equipment that is on the national system. They do not set the rates. As I said, that is done on a bilateral basis. Just how are we going to make this clearinghouse work? You know, I am the Norfolk Southern and my car is in California. How do I track that and how do I get paid for it? That has served the industry well. It has served the customers of the industry, including shippers well, and I think those kind of limited immunities should remain.

If I could make one comment, too, about mergers. Mr. Vander Schaaf's prepared testimony included the statement that he has repeated here this morning that Radford Arsenal became a captive shipper as the result of a railroad merger. He cites the merger of the Virginia Railway with the Norfolk and Western. Well, he is technically correct, but it has to be pointed out that merger took place in 1959. In 1959. So we are not talking about some very recent development here that has caused Radford to become captive.

Chairman KOHL. Senator Hatch?

Senator HATCH. Well, thank you. This is an interesting hearing to me, and I am still very much concerned about what is the best way to go here.

Mr. Vander Schaaf, as an expert in supply chain management, if you were advising a company on where to build its next large-scale manufacturing factory, how important do you believe it is that the sites being considered be serviced by more than one railroad? And do you believe that when States are trying to attract businesses that companies will look less favorably because they only have one railroad provider? And if so, why?

Mr. VANDER SCHAAF. Prior to my time with ATK, I was working with Union Carbide and Dow Chemical, and with Union Carbide it was very much a serious consideration of do we have competitive access, especially in the Houston area. And we looked at building access through secondary lines to get to that second railroad at substantial cost.

So it is a very, very important part of a decision of where you are going to be putting your facilities, how you can take the facilities you have and there to create competitive advantage, or competitive access with the railroads, because when you are tied to any monopoly, you know that you are coming into the discussions at a disadvantage. And so we are—you know, take the example of if you wanted to move your rocket boosters from Utah to Florida, would you make the decision to build the rockets in Florida instead of Utah? I do not think that will ever be the decision for ATK, but it is definitely a consideration that becomes more and more as the freight becomes greater and greater. Now, I am not making any suggestion they are leaving Utah, Senator.

Senator HATCH. I understand. I have had enough burdens this morning without you making those suggestions.

[Laughter.]

Senator HATCH. Chairman Nottingham, I do not understand why the Surface Transportation Board would allow such bottlenecks to develop in the rail system. When I say “bottlenecks,” I am referring to the STB sanction practice of permitting railroads to quote only the price for an entire freight movement when the alternative carrier might compete for a portion of the shipment. Now, clearly if there was not an exemption from the antitrust laws, those engaging in this activity would be in violation of Section 2 of the Sherman Act for refusing to deal and Section 1 for using a tie-in arrangement.

Now, the question, I think, needs to be asked. What benefit do consumers receive when the STB permits these type of practices? And why do these practices not violate Interstate Commerce Act Section 10702, the prohibition of unreasonable practices?

Mr. NOTTINGHAM. Thank you for the question, Senator Hatch. The so-called bottleneck controversy is indeed one of the most controversial issues we face. I heard about it as a nominee as I made my rounds visiting with stakeholders and Members of the Senate and House. It is a policy adopted—its history goes back to the 1920’s, to be honest, I believe, in some Supreme Court case law, and it is not something that I have had the opportunity to get my figurative arms around in my first 14 months on the job. We have initiated enormous reforms, and one thing you have not heard today is why more shippers have not been taking advantage, although it has been recent changes in our expedited and much more accessible dispute resolution and rate review process. And we invite any shipper—what you are really hearing about today is concerns about rates and service. And, unfortunately, this bill will not actually fix that situation, but our new procedures which need to be taken advantage of will.

But getting to your question, to play out this scenario briefly, if this bill becomes law—and, of course, if it did, we would dutifully and energetically implement it. It presumes that there would then be litigation that would somehow result in a railroad quickly and cheaply parking basically rail cars and allowing for a switch to take place at no added cost and that that would actually all happen seamlessly and that there is a big amount of extra capacity at the freight yards around our country.

Having visited many of the freight yards around the country, I can tell you that we have a huge—the No. 1 problem we have is a lack of capacity. The No. 1 challenge we face is we need to build extensive, more rail infrastructure across this country. And, unfortunately, this bill will not help to do that, and it is not clear how this bill would actually result in—

Senator HATCH. You would prefer something that would give incentives to do that?

Mr. NOTTINGHAM. Absolutely. Yes, sir. I think that is where the focus of our agency is going to be over the coming years and should be for all of who care about transportation. As a highway person, by way of background, having run a large State highway department in Virginia and working at the Federal Highway Administration, I just know that the highway system is not standing there ready, willing, and able to take more and more freight. We have got to have the freight railroads pick it up.

It is also not completely clear to me—and I stand to be corrected by the experts here—as to whether or not the Justice Department can look into bottleneck problems. Justice has wide latitude to go into, and has in the past on occasion, the antitrust enforcement avenues vis-a-vis the rail industry.

Senator HATCH. Well, Mr. Moates—and I have questions for the rest of you, too, but let me ask Mr. Moates this: I understand that the railroad industry has taken the position that S. 772 will not solve the problem of dramatic shipping cost increases or price increases. They believe that the legislation is designed to penalize the railroad industry because prices have increased, yet the bill will not have any real effect on costs charged to shippers.

Now, how can that be? Does not S. 772 amend the Clayton Act so that shippers can seek injunctive relief against railroads? And granted that the STB currently has brought injunctive relief authority—but even some of STB's supporters concede that the Board needs to improve their handling of these matters. So why not permit the railroad's own customers the ability to seek injunctive relief?

Mr. MOATES. Well, Senator Hatch, a couple of points in response to your question.

First, the STB has broad injunctive authority; so does the Justice Department. Has not used it, has not had to use it for some time.

As I said during my prepared remarks, a high rate, as you well know, is not evidence of a monopoly. If any of the gentlemen here represent shippers today believe their rates are unlawfully high under the Commerce Act, they have an avenue of redress—that is, Chairman Nottingham's agency. They can complain about the level of those rates, and if they can successfully prevail in a maximum reasonable rate case, relief is available to them in the form of a prescribed reasonable rate and possibly reparations.

Tying back to your question of Chairman Nottingham on the bottlenecks, too, which I think is implied in what you just asked me, the Board does have procedures for complaining about bottleneck cases. Those procedures, for reasons best known to the shippers, have not been invoked. It is what is called Ex Parte No. 575, and it requires that the shippers show an anticompetitive purpose in the so-called bottleneck railroad not opening up its facilities.

If there is such an egregious situation, why haven't we seen those cases? Those procedures have not been tried.

Senator HATCH. OK. Mr. Chairman, could I ask two more questions? I have to leave, and I would like to just ask these two questions.

Chairman KOHL. Sure. Go ahead.

Senator HATCH. OK. I would like to ask Professor Bush—welcome to the Committee, and we are proud of you, and let me ask you this question: I was very interested in your testimony where you state that "the existence of an express immunity providing protection from the antitrust laws for some particular conduct may actually provide immunity for other types of antitrust conduct."

Now, could you explain in greater detail how that theory applies to the railroad antitrust exemptions and, in particular, the merger exemption?

Mr. BUSH. Thank you for the question. As you move away from a regulated world where portions of that regulation are sort of stripped away, as the STB has done in their ratemaking region—a lot of the rates are not set in sort of an STB realm, but are subject to the antitrust laws. The fact, for example, that there is a potential for re-regulation by the STB of deregulated—rates that the agency has deregulated may give pause to a judge who has a private plaintiff action before him. The judge will sit there and think: On the realm of my docket, do I want a case that could be potentially moot if the agency decides to re-regulate? In other words, the agency could walk away from regulation and then decide to come back to it later. So you can have reluctance by a judge and even private plaintiffs to bring an action because of what—this is immunity by proximity.

With respect to merger authority, while you may repeal the actual express immunity within the act, there is still the notion of implied immunity, which I have mentioned in my testimony, and the doctrine of primary jurisdiction. In the context of implied immunity, even if it is not express immunity, if the regulation is perceived as so pervasive a judge may find that it is impliedly immune because of the pervasiveness of the regulation, and you only need to look at two recent Supreme Court cases to have that notion even before the Supreme Court, the *Credit Suisse* case and Part 4 of the *Trinko* case.

Senator HATCH. Mr. Moates, you seem to disagree with that. Did you disagree with that comment?

Mr. MOATES. No. I was not in agreement with his reference to *Trinko.*

Senator HATCH. I am just wondering. You just looked a little dyspeptic there for a minute.

[Laughter.]

Mr. MOATES. I am sorry.

Senator HATCH. No. That is fine.

Mr. Szabo, how can one argue that the railroads are not scrutinized for antitrust violations? And is that not the responsibility of the Surface Transportation Board? And was not the largest civil antitrust judgment ever rendered or ever handed down really against a railroad by the 5th Circuit in re Burlington N., Inc. though admittedly the railroad subsequently settled the case? And shouldn't the Department of Justice be permitted to prosecute railroads that violate the Sherman Antitrust Act?

Mr. SZABO. I am not familiar with that case, Senator, but absolutely, we believe that the Department of Justice should be able to pursue Sherman antitrust violations. We believe the general policy that the Congress has set down for rail policy as contained in Title 49 of the U.S. Code, 10101, is very similar to what an antitrust court would look at if it has an antitrust issue before it. We believe the STB has not looked at that properly and has not included competition as an important element. So we believe they have not done their job, and that is why we want the antitrust laws to apply.

Senator HATCH. Mr. Chairman, I appreciate you letting me ask those two additional questions, and I want to express appreciation for this whole group of people. I appreciate all of you. I appreciate your being here, and I appreciate the concerns that you have raised. Let's keep looking at this and see what we can do that is best for all concerned.

Thank you.

Chairman KOHL. Thank you, Senator Hatch.

Senator Feinstein?

Senator FEINSTEIN. Well, thank you very much, Mr. Chairman. As you know, I am not a member of the Committee, but at the markup, I did say that there had not been a Committee hearing, and you agreed to have one, and I want you to know I very much appreciate that. I tried to listen as carefully as I could, and it seems to me a pretty clear case where you have shippers who feel one way and the people kind of in charge feeling another.

I have been reading the letter here from the Department of Justice, and this was a letter sent to James Sensenbrenner back in 2004. The issue of bottlenecks was raised. I want to just raise the paper barrier issue and then ask the Surface Transportation Board to respond to what DOJ says in this letter.

Let me just read it quickly. "Paper barriers are created when Class I railroads spin off of their trackage to short-line or low-density carriers with contractual terms that prohibit the acquiring carriers from competing with the Class I railroads for business. Since these contractual terms are part of an underlying sale transaction that is reviewed and approved by the Surface Transportation Board, they may be exempted from the reach of antitrust laws"—

that would be under the present situation—"depending on the scope of the approval language in each of the Board's relevant orders. If the paper barriers were subject to the antitrust laws, they would be evaluated under Section 1 of the Sherman Act. The Department would examine whether the restraint is ancillary to the sale of the trackage, i.e., whether the restraint is reasonably necessary to achieve the pro-competitive benefits of the sale."

What this is saying to me is that if the antitrust exemption were removed, it would clearly fall under the antitrust laws, and there would be the opportunity to find a remedy. Do you agree with that or disagree? And if so, why?

Mr. NOTTINGHAM. Senator, thank you for the question. I agree with some of what you said and disagree with others. We actively have before us at the Board—

Senator FEINSTEIN. Excuse me. I am not saying this. This is the Department of Justice.

Mr. NOTTINGHAM. Oh, DOJ.

Senator FEINSTEIN. I quoted exactly—

Mr. Smith. I saw the letter, and Will Moschella is an old friend. When he used to work for Congressman Wolf, I worked next door for both Congressman David and Congressman Goodlatte, both Mr. Wolf's neighbors, and he is a good man.

I have not heard anything in the last period of years from DOJ on this issue, but we welcome their input and would work with them on this issue. We have right before us now, it is important for the Subcommittee to know, a very important rulemaking consideration that is pending. We have told Congress in other venues, just last week on the House side, that we expect to have something finally out on the issue of paper barriers this month. And we do have some concerns in that area.

I will say it is important to understand what they really are, though. These are typically underused track that a railroad that is serving a group of customers—so one railroad serving a group of customers agrees to let another railroad serve that group of customers. It is not an effort or a technique to reduce competition. In fact, one of our concerns—and this will be addressed as we come out with final rules. What would the outcome be, in other words, if railroads Class I were to stop entering into these agreements? Would you actually have more competition or would you just be taking business away from short lines who are actually doing an excellent job at lower cost providing—meeting shippers' needs?

And so the issues are always a little more complicated than we can get in in a quick answer, but I do urge the Committee to look at our work when we come out in the next few weeks, and I would be happy to come up and brief the staff or the members on it.

Senator FEINSTEIN. All right. We have just begun a vote, so my time is limited. But is there a response from the shippers to this point?

Mr. SZABO. Senator Feinstein, we think paper barriers are bad. We think that without paper barriers, people would locate on these short lines, and they would have access to competition. Short lines would become more robust. Perhaps over time several short lines would unite to become another rail system. We think they are a blight on competition.

Senator FEINSTEIN. Thank you.

I very much appreciate this, Mr. Chairman. It has certainly given me a much clearer view of what the issues are and the legislation, so thank you very, very much. I appreciate it. Thank you, gentlemen, too.

Chairman KOHL. Thank you, Senator Feinstein.

We do not have a lot of time. There is a vote. But I would like to ask another question.

Mr. Szabo, railroads claim that regulation of their industry is so pervasive that applying antitrust is unnecessary. But hasn't the regulation of railroads by the STB been greatly reduced in recent decades by such legislation as Staggers and the ICC Termination Act?

Mr. SZABO. Mr. Chairman, that is not correct. The STB is supposed to allow a rate challenge process for rail customers who do not have access to competition. The GAO report you cited earlier says it does not work, that, in fact, it is inaccessible to most rail customers. The new rules that Mr. Nottingham referred to, when they were proposed, rail customers united, 36 groups said these were worse than current law. No changes were made to the proposed rules, and rail customers do not believe the STB is improving its process. So we disagree with that proposition.

Chairman KOHL. Mr. Berg and Mr. Vander Schaaf, what is your view? How effective is the STB for a shipper to challenge an excessive rate charge by a railroad or to get remedy? Mr. Vander Schaaf?

Mr. VANDER SCHAAF. From my experience we have never gone to the STB just from a standpoint of the challenges of doing it and the perception that the results will not be favorable. Seeing as we have not done it, I do not have an answer of proof that it did not work. But the perception is that it is one more act of futility.

Chairman KOHL. Mr. Berg?

Mr. BERG. I essentially share that. We are considering doing that based on our 2006 rate increases from the railroads. But we have to take into consideration the recent results that we have seen out of the STB, including a sister generation and transmission cooperative who did not get any relief and spent $6 million in the effort trying to do that.

Chairman KOHL. Mr. Nottingham?

Mr. NOTTINGHAM. Thank you, Senator. I would say Mr. Szabo needs to look at the record carefully. In our proceeding he just reference where he said no comments coming from shippers, including his coalition, were taken into consideration, I strongly object to that. I think the record is very clear that between the public comment period and the final rule, significant changes, including raising the bar to allow cases up to $1 million to be brought into our most simply dispute resolution process for only a $150 filing fee, were made, and many more. And I would urge him to look back at that record and try to correct his statement today.

But we are in the midst of enormous changes at the STB. We are conducting a vigorous oversight. We are being sued by the railroads as we sit here today. They object violently to some of our reforms. I am also happy to report we are being sued by many, many shippers. It seems that everybody is suing us, and we feel, if that is the case, we must be somewhere in the middle and doing our job.

Chairman KOHL. All right. Mr. Nottingham, in 1979, there were 42 Class I freight railroads in the United States, 42 in 1979. Today, only four railroads serve 90 percent of the Nation's railroad traffic, and there are only seven freight railroads remaining in total.

Chairman Nottingham, how many railroad mergers and acquisitions has the STB or its predecessor agency, the ICC, blocked among Class I railroads in the last three decades?

Mr. NOTTINGHAM. Mr. Chairman, I would like to be able to respond on the record to you for that to make sure I get it just right. I was a youngest in 1979, but in reading the history, I can say that the GAO report you cited last year stated very clearly that rates have come down overall over a 25-year period since the Staggers Act and now. There are not just seven railroads in the country, although there are seven Class I's. There are more then 500 short line, and they play an increasingly important role.

We are seeing some merger activity currently. Recently, the Canadian Pacific announced a significant—looking at a substantial merger with the DM&E. That is not before us yet, but it is coming very soon for our review. We have just seen the announcement by the Canadian National of an potentially important merger that may get them out of the Chicago gridlock situation. And we have seen some other significant short-line activity, the Florida East Coast case, recently a merger.

So there is a lot of merger activity out there. My understanding of the history, the Board has approved the vast, vast majority, but in recent years, being the last 20 or so years—that is important to understand the context—massive bankruptcies and massive underinvestment in the rail industry, not surprising that proposals to consolidate and invest more in basically dysfunctional railroads would be looked on with some approval by the agency charged with, in part, looking after the economic health of the network for the benefit of shippers. In most cases, shippers come to us and support mergers because they see the dysfunctional nature. They are paying the price of lack of investment pre-merger. But we look at each one independently, of course, on the merits.

Chairman KOHL. Should the Justice Department be able to review railroad mergers? Mr. Moates, Mr. Bush, Mr. Szabo.

Mr. MOATES. Senator Kohl, thank you for that question. It does, and indeed, if you will permit me, I am going to brag about one of the defeats of my career. I can help answer the prior question.

I was counsel to the Santa Fe Pacific in the Atchison, Topeka, and Santa Fe Railway in the mid-1980's when the Interstate Commerce Commission turned down our application for a merger between the Santa Fe and the Southern Pacific. It did that in large measure because of the forceful opposition of the Antitrust Division of the Department of Justice, which participates per statute as a party in all rail merger cases. So the Justice Department, believe me, plays a very significant role in all railroad merger cases, and the ICC and today the STB pays a lot of attention to its views.

So I know about one they got turned down because it was my case.

Chairman KOHL. Thank you.

Dr. Bush?

Mr. BUSH. There is a difference between participating in another agency's regulatory proceeding and actively investigating a transaction. When I worked at the Department of Justice, when I was investigating a transaction, I had all sorts of authority to engage in document requests, conduct depositions, engage in civil investigative demands of competitors, talk to customers, and all of these things that are not traditionally a good use of resources when another agency has exclusive jurisdiction.

Therefore, the Department of Justice's guesstimates as to the potential anticompetitive effects of a merger absent those powers does not suggest that the agency might have really concurred with those decisions had they had that authority.

Chairman KOHL. Mr. Szabo?

Mr. SZABO. Mr. Chairman, I think your bill has it right. There was the UP–SP merger that was approved by the STB in 1996. I believe it was 1996. The Department of Justice strenuously objected in comments. Those comments were ignored. They had no recourse. Your bill would allow them to go in and try to enjoin it if the STB had not done it properly. So I believe that is correct.

Chairman KOHL. Thank you. Well, gentlemen, I have to run to a vote. It has been a really good hearing. We will keep the record open for some additional questions and your comments. I would appreciate staying in touch with you if I can as we move along in this process. We will attempt to find a common ground and the right balance and justice in this matter, and your being here helps us a great deal.

Thank you so much for being here. This hearing is closed.

[Whereupon, at 11:57 a.m., the Subcommittee was adjourned.]

[Questions and answers and submissions for the record follow.]

QUESTIONS AND ANSWERS

WILLIAM L. BERG
President and CEO

DAIRYLAND POWER
COOPERATIVE

November 1, 2007

Senator Herb Kohl
Attention: Subcommittee on Antitrust,
Competition Policy and Consumer Rights
SH 308
Washington, D.C. 20510

Dear Senator Kohl:

Thank you again for giving me the opportunity to testify at the United States Senate Judiciary Committee hearing on S. 772, the Railroad Antitrust Enforcement Act. We at Dairyland are extremely appreciative of your efforts on this important issue, and I personally appreciated the honor of testifying before your committee. Your leadership on this issue has been outstanding, and our members certainly appreciate it as well.

I have enclosed written responses to the two questions you raised. If you have any questions or comments please feel free to contact me or Brian Rude, Director of External Relations, at 608-787-1320.

Sincerely,

DAIRYLAND POWER COOPERATIVE

William L. Berg /lae

William L. Berg
President and CEO

WLB:BDR:mkw

Enclosure

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Written Responses to the Senate

1. *How have increased rail rates impacted your customers?*

   As a cooperative, our customers are our owners and they end up paying for all our costs for supplying them electricity. We serve 255,745 meters in four states, representing power needs of 575,000 people. In 2005, we experienced a rate increase in our three rail contracts averaging 93%, which was the major factor in our Board's decision to increase rates by 20% in 2006, approximately $35 million. Since that time, we have continued to see increases in rail rates well above the rate of inflation. We have a heavy concentration of residential and agricultural members. Much of our utility system serves lower income areas. We believe this rate increase – the largest we have had to enact in two decades – negatively impacted the people who can least afford to pay higher rates, and was a significant issue for many of our members.

2. *In a recent letter to the editor of Roll Call newspaper, a representative of the railroad industry alleged that legislation such as the Railroad Antitrust Enforcement Act contains numerous provisions that the utilities "would never accept for themselves." We have also heard the railroads complain that being subject to both Department of Justice antitrust oversight and STB regulation would be too onerous. Yet, isn't it true that utilities such as yours are already subject to regulatory oversight from more than one agency? What state and federal regulatory bodies must utilities like Dairyland Power answer to? And isn't your industry subject to antitrust law as well?*

   Dairyland is a generation and transmission cooperative that supplies all of the wholesale electric power supply requirements of its 25 member distribution cooperatives, which are located in the states of Wisconsin, Minnesota, Iowa, and Illinois. Dairyland and many of its distribution cooperative members are borrowers from the United States Department of Agriculture Rural Utilities Service (RUS), as well as from other cooperative banking and financing sources. The RUS directly regulates Dairyland and its other borrowers through RUS regulatory programs as well as under lending agreements. Dairyland must obtain approval for significant new facilities and capital spending on power supply and transmission projects, and RUS regulates the requirements for Dairyland's business planning processes and the details of Dairyland's contracting practices for power-related projects. As a not-for-profit cooperative power supplier, Dairyland's rates are determined by its member cooperatives through their representatives on Dairyland's board of directors, subject to review by the RUS.

   Dairyland is subject to state public utility commission regulations over the siting and construction of major generation and transmission projects. As not-for-profit cooperative retail power suppliers, Dairyland's member distribution cooperatives are rate regulated by their boards of directors, which are elected from their electric cooperative member-consumers. The rates of Dairyland's members are not generally regulated by the state public utility commissions, but electric cooperatives in other states are commonly subject to state utility commission regulation over their rates and terms and conditions of service.

Dairyland remains generally subject to the federal and state antitrust laws in its operations. If and when Dairyland has excess power not needed to serve its members' needs, or when it needs to purchase additional power, it competes in the wholesale market and is subject to the same antitrust laws and restrictions as other competitors in that market. With the exception of the doctrine allowing the cooperative members to use the cooperative form of business for group purchasing or group marketing to serve member needs, there is no special antitrust exemption for cooperative forms of business. Dairyland's participation in the general wholesale power market remains generally subject to the antitrust laws. Due to a number of factors, including the strong policy of the Federal Energy Regulatory Commission (FERC) to push for a competitive power supply market, the vast majority of Dairyland's wholesale power transactions with persons other than its members are made at market-based rates in the competitive wholesale market. Moreover, under both FERC regulation and under the federal Energy Policy Act of 2005, commercial practices that involve price collusion or market manipulation in the electric power markets are strictly forbidden.

Dairyland's distribution cooperatives (and the other electric utilities in their respective states of operation) are generally subject to state regulation over service areas or electric service anti-duplication. For example, under the Wisconsin anti-duplication law, a retail electric supplier may not serve a retail customer if that prospective customer's facilities are already served by or are within a specified close distance to another electric supplier. However, where a customer's new facilities have not been previously served or are at a distance from competing suppliers, there is robust competition between the potential retail electric suppliers, and that competition is subject to the federal and state antitrust laws.

Follow-Up Questions for Hearing on
An Examination of S. 772, the Railroad Antitrust Enforcement Act
Professor Darren Bush

From Senator Kohl

1. The railroad industry argues that the antitrust exemption is actually quite limited and that the railroad industry is subject to antitrust law in many respects. What's your response to this contention? What remedies would repeal of the railroad antitrust exemption give shippers that they don't currently possess?

Response:

While it is true that the scope of the antitrust exemption has narrowed over the course of deregulation such that more railroad activity is subject to the antitrust laws, the ultimate question is whether the remaining scope of the immunity somehow implies that the immunity is narrowly tailored to serve an important societal purpose or whether the existence of the immunity still wields effects in the deregulated market that are unintended. It arguably does the latter.

First, the reduction in the scope of the immunity suggests that the immunity is not necessary to achieve any important societal goal. There was never any specific societal goal stated for the immunity. To the extent that there was any policy laid forth for antitrust immunity, it was in the context of regulatory authority designed to consolidate the railroad industry. Because there are limited opportunities for consolidation, the regulatory regime governing railroads to a large extent does not require the existence of a statutory immunity.[1]

[1] See question 2, *infra*. I am assuming for purposes of this paragraph that consolidation was the societal goal established by Congress for purposes of fostering antitrust immunity. However, assuming consolidation as a societal goal does not end the inquiry about the validity of the immunity and its net effect on society. See generally Darren Bush, Gregory K. Leonard and Stephen Ross, A FRAMEWORK FOR POLICYMAKERS TO ANALYZE PROPOSED AND EXISTING ANTITRUST IMMUNITIES AND EXEMPTIONS: REPORT PREPARED BY CONSULTANTS TO THE ANTITRUST MODERNIZATION COMMISSION, *available* at http://www.amc.gov/commission_hearings/pdf/IE_Framework_Overview_Report.pdf.

Where the immunity continues to exist, its effect is still significant. For example, in the context of the rate exemptions from antitrust, somewhere between 20 and 30 percent of all rail freight is still subject to Surface Transportation Board ("STB") jurisdiction.[2] For these rates, shippers may only obtain relief from the STB via an unwieldly rate relief procedure.[3] This procedure also serves to stand between a shipper and a monopolization claim under Section 2 of the Sherman Act.[4]

Such immunity may not only shield railroads from antitrust claims, but also foster anticompetitive activity. As the ABA has pointed out:

> [E]ven though a railroad need not file a tariff with the STB and must meet strict guidelines for approval to form a rate bureau, it could independently file a public price list that could signal other railroads to follow a pricing pattern. Even if evidence demonstrated that the railroads colluded in following this pricing program, shippers could only recover to the extent the STB found those collusive rates unreasonable.[5]

The STB has other powers to preempt the antitrust laws as well. It may approve joint divisions and pooling of revenues, including indirectly approving a rate arrangement for

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[2] These are 1997 figures.

[3] The STB's analysis of such claims requires the complaining shipper to produce a substantial economic study. The STBs hearings are also extensive and have dragged on for extended periods of time.

[4] This is due to the potential applicability of the filed rate doctrine (or *Keogh* doctrine). The *Keogh* doctrine was originally designed to preclude the bypassing of statutory damages granted under the Interstate Commerce Act. The Interstate Commerce Act provided for single damages as a remedy. The plaintiffs in *Keogh* sought to use antitrust to bypass statutorily conferred remedies. This approach was rejected by the Court. The case was not about the justness or reasonableness of rates, as has been increasingly the case with application of the *Keogh* doctrine. Keogh v. Chicago & Northwestern Railway Co., 260 U.S. 156, 162-163 (1922).

As has increasingly been the case, *Keogh* has been applied in the context of "regulated deregulation." However, the market clearing prices typically found in such industries bear no relation to the types of rates originally addressed by the *Keogh* progeny, namely, traditional cost of service rates set via tariff after review by an administrative agency. In contrast, market rates are only reviewed (in rare instances) and even then they are reviewed *ex post*. Courts nonetheless continue to hold that the filed rate doctrine applies to market based rates. *See, e.g.,* Public Utility Dist. No. 1 of Grays Harbor County Wash. v. IDACORP Inc., 370 F.3d 641, 651 (9th Cir. 2004)("[W]hile market-based rates may not have historically been the type of rate envisioned by the filed rate doctrine, we conclude that they do not fall outside of the purview of the doctrine."); Public Utility District No. 1 v. Dynegy Power Marketing, Inc., 384 F.3d 756 (9th Cir. 2004); Town of Norwood v. New England Power Co., 202 F.3d 408 (1st Cir. 2000).

[5] *See* ABA, FEDERAL STATUTORY EXEMPTIONS FROM ANTITRUST LAW 211 (2007)(noting that courts have sometimes adopted "expansive interpretations as to the scope of an exemption")(hereafter ABA Monograph).

shippers and precluding shippers from seeking antitrust remedies.[6] The limited exemption for rate bureau activities may also preclude application of the antitrust laws.

With respect to transactional immunity, the major anticompetitive agreement shielded from antitrust application is that of "paper barriers."[7] In many sales of secondary trackage to smaller regional players who wished to interconnect with the seller's (a major trunk line operator) main lines, the seller, in exchange for interconnection, often demanded that the regional player only interchange its traffic from the divested line to the seller, foreclosing any opportunity for the buyer to interchange with other operators. These "paper barrier" restraints were often permanent.

The ICC historically approved such restraints, finding that they had no anticompetitive effect. And, despite complaints from smaller railroad firms, shippers, and labor organizations, the STB has not changed course with respect to these restraints.[8]

The STB has thus endorsed a policy of allowing a railroad to have perpetual property rights in a business "sold" to another owner. As the ABA points out:

> While such restraints may have some relationship to the price the buying is willing to pay to operate the line and act as an incentive for the seller to dispose of the line to a buyer rather than abandon it, allowing paper barriers to run indefinitely from a line sale is inconsistent with the Rule of Reason approach the antitrust laws take with respect to restraints associated with the sales of businesses.[9]

Finally, the ICC and STB could authorize railroad interlocking directorates. Nothing has changed in this realm since the 1920s. The STB's rules establish a procedure for applying for such interlocking directorates, although smaller carriers are exempt from the application process. There appears to be no need for such a provision.

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[6] *See* 49 U.S.C. § 11322.

[7] My former colleague and coauthor Salvatore Massa has excellently described the paper barriers issue. *See* Salvatore Massa, *A Tale of Two Monopolies: Why Removing Paper Barriers Is A Good Idea*, TRANSP. J. Winter/Spring 2001, at 47.

[8] ABA Monograph, *supra* note 5 at 208.

[9] See ABA Monograph, *supra* note 5 at 216. *See also* Salvatore Massa, *A Tale of Two Monopolies: Why Removing Paper Barriers Is a Good Idea*, TRANSP. J., Winter/Spring 2001, at 47.

In every other regulated industry, the need for coordination is fulfilled through arms length transactions. It could be affected as well in the context of railroads through trackage rights agreements.

These transactions are shielded from antitrust scrutiny. In other industries, such agreements or agreements of a similar nature are subject to the scrutiny of the antitrust laws. To remove the immunity would potentially yield the ability of shippers to challenge such conduct under the antitrust laws, with the caveat that other immunities and defenses may halt such a challenge.[10]

Even where the immunity is not present, however, there is potential for conduct to be shielded from antitrust attack. For example, the ICC and STB have moved to exempt many rates or other activities from regulation under the Staggers Rail Act of 1980.[11] The effect of an order from the STB stating that certain conduct is no longer subject to regulation is to open that conduct to antitrust attack. However, because the STB has the option of re-regulating the conduct, courts have appeared reluctant to allow plaintiffs to challenge exempted conduct.[12]

Thus, while regulation has drastically reduced the scope of the antitrust immunity, several issues still arise due to the existence of the immunity. If it is the case that much of railroad policy has moved away from regulation to market forces, then it is imperative that antitrust fill the gap left by regulators. Otherwise, we are left with the worst of all possible worlds—a business subject to neither competition policy nor regulation. As one of my coauthors on the ABA Monograph so firmly put it:

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[10] *See* Reponse to Senator Specter's question. *See also supra* note 4.
[11] *See* Staggers Rail Act § 213, 94 Stat. at 1912-13 (codified at 49 U.S.C. § 10502).
[12] *See, e.g.,* G. & T. Terminal Packaging Co. v. Consolidated Rail Corp., 830 F. 2d 1230 (3d Cir. 1987).

> [R]egulatory policies regarding exemptions from regulation are fundamentally troublesome. They allow regulators to effectively walk away from reviewing the competitive effect of certain conduct, but leave uncertainty as to whether the exempted activity remains shield from the reach of antitrust law. If anything, activities exempted from regulation should become subject to antitrust scrutiny even if it is potentially subject to re-regulation by the agency. Finally in this late stage of deregulation, perhaps Congress should no longer delegate authority to the STB to decide what should and should not be regulated in the first place.[13]

The upshot is that while the scope of antitrust express immunity is eroding, there is still much conduct and activity protected by its scope. Many of these issues strike at the heart of barriers to competition that have been fostered by the STB, and for which shippers have little or no remedy.

2. In your opinion, is there any reason for the railroad industry to enjoy the broad antitrust immunity that it does, when other transportation industries like aviation, and other regulated industries like telecom, do not have such sweeping immunity?

<u>Response:</u>

All industries are idiosyncratic, particularly those that have been subject to regulation. Such regulated industries have common characteristics that play out in different ways depending upon the industry. For example, railroads, natural gas, and electricity all have in common issues related to high fixed costs for some component of the industry, natural monopoly conditions and the potential for bottlenecks, high coordination needs to ensure reliability and safety, and typically some modicum of competition.

In each industry mentioned above, and many others with similar issues that are not, the industries exist under concurrent jurisdiction between the regulatory agency (e.g., the Federal Energy Regulatory Commission) and the federal antitrust enforcement agencies. Thus, absent a showing that railroad regulation is somehow inherently different

[13] ABA Monograph, *supra* note 5 at 210.

in a meaningful way that would foster conflict between the two agencies and impinge upon STB authority, antitrust immunity is not justified.

The arguments posited for continued antitrust immunity thus far have been weak. Indeed, the STB argues that the Department of Justice and the STB have only been in disagreement on one particular case in the past. One wonders, then, why the STB would not think that past is prologue.

Of course, one should not read too much into the DOJ's agreement with the STB. Absent the ability to conduct an independent investigation, including the issuance of Second Requests, Civil Investigative Demands, and the utilization of other investigative tools, the DOJ's agreement with the STB constitutes no more than a guess as to the merger's competitive outcome.[14]

It is similarly disingenuous to argue that courts will likely cause disruption of national railroad policy in the wake of an antitrust suit brought by a private plaintiff or by a state attorney general as *parens patriae*.[15] Many agencies live with the potential of court action against a company subject to the agency's regulation. As before, unless there is something unique about railroads, there is little justification for granting immunity here while embracing competition policy elsewhere.

Historically such choices between immunity and antitrust law application were not made due to industry idiosyncrasies, but rather due to industry lobbying and political

[14] Railroads, in fact, are at such extreme levels of market concentration and the anticompetitive stakes are high. Any future merger could potentially yield strong and persistent anticompetitive effects. The consideration of these effects might be lost in the STB's calculus of total benefits to consumers, the railroads, labor, or other stakeholders to the transaction. The antitrust laws, in contrast, do not necessarily consider transfers from consumers to stakeholders to be a good thing. Moreover, the antitrust agencies more readily consider the full spectrum of competitive harms.

[15] *See* 15 U.S.C. § 15c.

pressure.[16] Express immunities in the context of specific industries were not typically conferred due to any meaningful fear of conflict between antitrust and regulation, or for any fear of economic ripple effects throughout the economy from antitrust litigation.

Finally, where regulatory action is in place, there are a plethora of potential antitrust exemptions at the defendant's disposal. As mentioned in my original testimony, the doctrines of implied immunity and primary jurisdiction might still come into play. And plaintiffs challenging any rates subject to STB authority would likely find that the filed rate doctrine is alive, well, and growing.[17]

For these reasons, there appears to be little justification for the notion that courts handling antitrust litigation will somehow turn national railroad regulatory policy on its head. There is also no justification for the notion that there is something peculiar about the railroad industry that separates it from other regulated industries subject to the antitrust laws.

3. The Antitrust Modernization Commission's April 2007 Report stated:

Statutory immunities from the antitrust laws should be disfavored. They should be granted rarely, and only where... [the immunity] is necessary to satisfy a specific societal goal that trumps the benefit of a free market to consumers and the U.S economy in general.

Do you agree with this principle? If so, is there any "societal goal" warranting an antirust exemption that "trumps the benefit of a free market" in the railroad industry?

<u>Response:</u>

[16] *See generally* ABA Monograph, *supra* note 5. Moreover, courts should be credited for innovative actions that have brought revolutionary changes to regulated industries. As an example, the compulsion of wheeling in *U.S. v. Otter Tail* gave rise to a whole regulatory wave of open access, particularly in but not limited to the electricity industry. *See* Otter Tail Power Co. v. United States, 410 U.S. 366 (1973). Judge Greene's breakup of AT&T yielded remarkable changes in the telecomm industry as well. United States v. American Tel. & Tel. Co., 552 F. Supp. 131 (D.D.C. 1982), *aff'd mem. sub nom.* Maryland v. United States, 460 U.S. 1001 (1983).

[17] *See supra* note 4.

I agree with the general principle quoted from the Antitrust Modernization Commission's Report that statutory immunities should be disfavored. Implicit in the quotation concerning the granting of an immunity only where it is necessary to satisfy a specific societal goal is a deeper analysis as to the legitimacy of the societal goal, the relationship of the immunity to the societal goal, and the potential for less restrictive alternatives in furtherance of that societal goal.

The only such goal found in the context of railroad regulation is Congress' desire to consolidate the industry. Congress believed that in order to enhance the financial returns of investors and to promote better service, it was necessary to promote consolidation within the industry with the help of the Interstate Commerce Commission (ICC), the predecessor to the Surface Transportation Board (STB). This argument is akin to a "ruinous competition" argument. Namely, in order to preserve the national railroad system, it was necessary to foster consolidation and reduce competition to increase rates.

Economists have long argued that keeping firms in business is not a valid justification as far as economic efficiency is concerned. Thus, if an immunity is to be justified, it must be on the basis that the wealth transfer associated with highly concentrated industries is otherwise socially desirable, either as a matter of congressional views on a just distribution, or based on non-competition policies such as the preservation of jobs in a particular region or the need to protect specified creditors or shareholders.

It is not clear whether such an argument was on the minds of Congress in passing the railroad antitrust immunities. Indeed, there appears to have been little or no Congressional debate about the antitrust immunity at the time of its passage. Courts have thus taken the position of simply accepting the language as it stands without inquiring as to its purpose.[18] The immunity itself has remained virtually unchanged, despite reforms in railroad legislation and the disbanding of the ICC.[19]

Regardless, it is difficult to characterize the overall theory of thwarting ruinous competition as a legitimate goal for Congress. While the theory was popular in economics in the early 1900s,[20] it has fallen out of favor everywhere except for those seeking to preserve or obtain antitrust immunity. As a recent ABA publication states, while

> [i]t is true that during the dramatically changing economic times of the late nineteenth and early twentieth centuries, competition in many sectors was fierce, industry saw massive consolidations, and business failures were common. But in retrospect a better explanation for these events might be that market expansions associated with technological advances or social changes went too far, and were followed by efficiency enhancing market corrections.[21]

Thus, it is not at all clear that the railroad antitrust immunity promotes any specific societal goal established by Congress.

Even if such a specific societal goal were unearthed, it is an insufficient condition for establishing an immunity. According to a recent report submitted to the Antitrust Modernization Commission, the immunity must be *necessary* to achieve the societal goal set forth by Congress.[22] In other words, if the societal goal were achievable absent the immunity or by some alternative less restrictive

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[18] *See, e.g.,* Denver & Rio Grande W. R.R. Co. v. United States, 387 U.S. 485 (1967); *In Re* REA Express Private Treble Damage Antitrust Litig., 412 F. Supp. 1239, 1261-63 (E.D. Pa. 1976).
[19] *See ICC Termination Act of 1995,* H.R. REP. NO. 104-311, at 83 (1995).
[20] *See* Eliot Jones, *Is Competition in Industry Ruinous?*, 34 Q. J. Econ. 473 (1920); O.W. Knauth, Capital and Monopoly, 31 Pol. Sci. Q. 245 (1916).
[21] ABA Monograph, *supra* note 4 at 66-67. See also NAOMI R. LAMOREAUX, THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895-1904 (1985). Cf. Charles P. KINDLEBERGER & ROBERT ALIBER, PANICS AND CRASHES: A HISTORY OF FINANCIAL CRISES (5TH ED. 2005)(noting relationship between technological innovation and market bubbles during past several centuries).
[22] *See* Darren Bush, Gregory K. Leonard and Stephen Ross, A FRAMEWORK FOR POLICYMAKERS TO ANALYZE PROPOSED AND EXISTING ANTITRUST IMMUNITIES AND EXEMPTIONS: REPORT PREPARED BY CONSULTANTS TO THE ANTITRUST MODERNIZATION COMMISSION, *available* at http://www.amc.gov/commission_hearings/pdf/IE_Framework_Overview_Report.pdf (attached as Appendix A).

to competition, the immunity is not necessary to achieve the societal goal and should be disfavored.

Should the immunity be necessary to achieve the specific societal goal such that no less restrictive alternative is feasible, the analysis does not end. The question becomes whether or not the immunity on net creates benefit to society. To reiterate, the burden of proving that the immunity creates a net positive effect for society falls upon the proponents of the immunity.

In other words, it is a necessary but insufficient condition that the immunity be necessary to satisfy some specific societal goal that trumps the benefit of the free market. The balancing that must take place to determine if the antitrust immunity on net makes a positive contribution to society includes balancing all costs and benefits, including any potential reduction caused to other societal goals by the immunity.

In the case of a preexisting immunity, it is important to determine whether or not the immunity actually promoted its societal goal. In the case of railroads, even if one were to assume (wrongly) that protection against ruinous competition is a noble societal goal, the evidence is mixed as to the role the immunity played in promoting that goal. As the ABA points out in a recent book, "Prior to the 1970s, the ICC approved many mergers and the industry nonetheless experienced significant financial difficulties."[23] And while there is a body of economic literature that suggests that mergers improved the

[23] ABA Monograph, *supra* note 5 at 214-215.

efficiency of the merging parties,[24] the essential question is whether any efficiencies achieved were outweighed by significant anticompetitive effects.

From Senator Specter

I agree with your testimony that the antitrust laws should apply where there is no confliction regulation. However, I am concerned that S. 772 is drafted in such a way that the doctrine of implied immunity would not apply, even where there is a direct, irreconcilable conflict between the regulation and application of the antitrust laws. In other words, it appears that S. 772 could require the STB to give way to the antitrust laws even though its congressionally mandated regulatory regime gives it the ability to approve or require conduct that might otherwise violate the antitrust laws. Do you believe that S. 772 could have such an impact on STB regulation?

Response:

My take on S. 772 is that one of its weaknesses is that it does nothing to eliminate issues arising from implied immunity and primary jurisdiction. Moreover, S. 772 does nothing to address some of the real challenges plaintiffs face in the context of an antitrust suit post-passage, such as the misapplication of the Filed Rate Doctrine.[25] In other words, S. 772 cannot require the STB to yield to the antitrust laws. In a direct conflict between antitrust and regulation, it is typically antitrust that yields.

To review, broad delegations of power to a regulatory agency may lead to instances where agency directives are in tension with antitrust law. As Judge Greene's opinion in an early phase of the Antitrust Division's suit against AT&T seeking dissolution of the company on the ground of unlawful monopolization points out, however, such instances are relatively narrow. In response to AT&T's motion to dismiss

[24] Denis A. Breen, *The Union Pacific/Southern Pacific Rail Merger: A Retrospective on Merger Benefits*, 3 REV. NETWORK ECON. 283 (2004); Wesley Wilson, *Cost Savings and Productivity in the Railroad Industry*, 11 J. Reg. Econ. 21 (1997). Cf. Christopher A Vellturo et. al., *Deregulation, Mergers, and Cost Savings in Class I Railroads*, 1 J. ECON. & MGMT. STRATEGY 339 (1993)(arguing efficiency gains attributable to deregulation efforts).
[25] *See supra* note 4.

the suit claiming that Congress had committed regulation of the activity in question to the F.C.C. under the Communications Act of 1934, Judge Greene wrote:

> Regulated conduct is . . .deemed to be immune by implication from the antitrust laws in two relatively *narrow* instances: (1) when a regulatory agency has, with congressional approval, exercised explicit authority over the challenged practice itself (as distinguished from the general subject matter) in such a way that antitrust enforcement would interfere with regulation . . . and (2) when regulation by an agency over an industry or some of its components or practices is so pervasive that Congress is assumed to have determined competition to be an inadequate means of vindicating the public interest.[26]

As was recently decided by the Supreme Court in *Credit Suisse Securities v. Billing*,[27] the doctrine of implied immunity favors the regulatory agency:

> This Court's prior decisions also make clear that, when a court decides whether securities law precludes antitrust law, it is deciding whether, given context and likely consequences, there is a "clear repugnancy" between the securities law and the antitrust complaint-or as we shall subsequently describe the matter, whether the two are "clearly incompatible." Moreover, Gordon and NASD, in finding sufficient incompatibility to warrant an implication of preclusion, have treated the following factors as critical: (1) the existence of regulatory authority under the securities law to supervise the activities in question; (2) evidence that the responsible regulatory entities exercise that authority; and (3) a resulting risk that the securities and antitrust laws, if both applicable, would produce conflicting guidance, requirements, duties, privileges, or standards of conduct. We also note (4) that in Gordon and NASD the possible conflict affected practices that lie squarely within an area of financial market activity that the securities law seeks to regulate.[28]

While one could interpret this case as limited to securities regulation, one finds similar language in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP.*[29] In Part IV of that decision, Justice Scalia expresses doubt as to the role of antitrust in instances where there exists a pervasive regulatory scheme.

Even where there is no direct regulatory oversight, courts have found implied immunity merely due to *potential* regulatory oversight.[30] The scope of judicially created

[26] U.S. v. Amer. Tel. & Tel. Co., 461 F.Supp. 1314, 1322 (D.C.D.C. 1978)(emphasis supplied).
[27] 127 S.Ct. 2383 (2007).
[28] 127 S.Ct. at 2392.
[29] 540 U.S. 398 (2004)
[30] Credit Suisse Securities (USA) LLC v. Billing, 127 S. Ct. 2383 (2007).

exemptions and immunities has waxed even as regulation has waned.[31] What remains is a gap between regulation and antitrust, where neither serve to provide essential oversight to an industry.

The doctrine of primary jurisdiction also may play a crucial role where there is any regulatory oversight at all even in the absence of express or implied immunity.[32] While primary jurisdiction is *not* a methodology by which to grant immunity or exemption, but rather a method by which courts might rely on an agency's expertise in order to resolve a dispute before them, the doctrine has been misused as a grant of immunity in the past.[33]

In instances in which the doctrines of express or implied immunity are applied, the agency's action is reviewed on the standards set forth in the regulatory statute, and usually with the judicial deference to the agency's fact finding. As a practical matter, the initial determination of which doctrine applies in a particular case is of great significance in deciding what law applies, the degree to which antitrust considerations may or may not be accorded weight, and whether the antitrust remedies of criminal sanctions or treble damages are available in a particular case. An express or implied exemption finding precludes the application of antirust standards and remedies, while an application of the primary jurisdiction doctrine does not necessarily preclude use of antitrust standards and

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[31] *See generally* Darren Bush, *Mission Creep: Antitrust Exemptions and Immunities as Applied to (De)regulated Industries,* 2006 UTAH L. REV. 613 (Attached as Appendix B).
[32] For a discussion of historical misuse of the doctrine, *see* Louis B. Schwartz, *Legal Restriction of Competition in the Regulated Industries: An Abdication of Judicial Responsibility*, 67 HARV. L. REV. 436 (1954). *See also* Louis Jaffe, *Primary Jurisdiction Reconsidered,* 102 U. PA. L. REV. 577 (1954); JUDICIAL DOCTRINE OF PRIMARY JURISDICTION AS APPLIED IN ANTITRUST SUITS, STAFF REPORT TO THE ANTITRUST SUBCOMMITTEE OF THE HOUSE COMMITTEE ON THE JUDICIARY, 84TH CONG., 2D SESS. (1956).
[33] Schwartz, *supra* note 32 at 470-471 ("The lesson taught by [the expansion of primary jurisdiction doctrine from a procedural rule to a judicial exemption] is this: if a primary jurisdiction does not already exist, it may be advisable for an industry to create one as a means of avoiding the compulsion to compete which is embodied in the antitrust laws as administered by the federal courts.")

remedies to adjudicate the dispute but may only defer the adjudication pending an initial decision by the agency.

Careful consideration ought to be given to the potential exemptions and immunities that may exist even after repeal of express immunity. Such immunities and exemptions typically are a result of the statutory authority conferred upon the regulatory agency and the execution of that authority by the agency. However, where regulation and competition collide (or increasingly in cases before the court, even where they do not collide) it is increasingly the case that antitrust law yields to regulation.

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November 1, 2007

By Fax and Post

Senator Herb Kohl
Chairman, Subcommittee on Antitrust,
Competition Policy and Consumers Rights
Senate Judiciary Committee
United States Senate
Washington, D.C. 20510-4903

Re: Responses to Questions re Railroad Antitrust Enforcement Act of 2007

Dear Senator Kohl:

Enclosed with this letter are my responses on behalf of the Association of American Railroads ("AAR") to the written questions from you and other Committee members regarding my testimony during the October 3, 2007 hearing which you Chaired regarding "An Examination of S. 772, the Railroad Antitrust Enforcement Act".

Thank you for the opportunity to appear and to testify on behalf of AAR. If you have any further questions, I would be pleased to respond to them.

Sincerely,

Paul Moates

G. Paul Moates

Enclosure

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Follow-Up Questions for Hearing on
An Examination of S. 772, the Railroad Antitrust Enforcement Act
Paul Moates

From Senator Kohl

1. a) The Antitrust Modernization Commission's April 2007 Report stated:

Statutory immunities from the antitrust laws should be disfavored. They should be granted rarely, and only where . . . [the immunity] is necessary to satisfy a specific societal goal that trumps the benefit of a free market to consumers and the U.S. economy in general.

Do you agree with this principle? If so, please specify the "societal goal" warranting an antitrust exemption that "trumps the benefit of a free market" in the railroad industry?

AAR Response

We agree that antitrust immunities should be rarely enacted and only when they promote specific beneficial goals that might not otherwise be achieved in their absence. Those conditions are satisfied with respect to the limited antitrust immunities that apply to the railroad industry. As explained more fully in the Association of American Railroads' (AAR) written testimony, the railroad antitrust immunities are in place to advance the societal goals embodied in the national rail transportation policy established by Congress and currently set forth at 49 U.S.C. § 10101. This policy, which has evolved (along with the antitrust immunities) for over a century, is intended to promote a viable and efficient rail transportation network. Inasmuch as railroads are not immunized from antitrust challenge to such matters as price fixing, market allocations and group boycotts, the limited immunities facilitate Congressional policy goals but do not serve to hinder generally the effective operation of the free market in the railroad industry.

From Senator Kohl

b) On October 3, 2007 the Federal Trade Commission sent us a letter regarding S. 772 explaining that they were against antitrust exemptions in general, citing to their "long standing view that antitrust exemptions should bear a heavy burden of demonstrating, with factually-supported reasons, the need for a departure from the nation's competitive model." Likewise, in 2004, the Justice Department wrote a similar letter to the Congressman Sensenbrenner regarding the appropriateness of the railroad antitrust exemption stating "such exemptions can be justified only in rare instances, when the fundamental free-market values underlying the antitrust laws are compellingly outweighed by a clearly paramount and clearly incompatible public policy objective. Shouldn't the fact that the nation's antitrust enforcement agencies oppose antitrust exemptions like this one carry great weight with us?

AAR Response

Concern over antitrust exemptions as a general matter by the Federal Trade Commission (FTC) and the Department of Justice (DOJ) certainly should not preclude maintaining limited exemptions that are tailored to serve specific beneficial purposes. It should be noted that neither the FTC nor DOJ specifically stated in their letters that all of the railroads' antitrust exemptions should be eliminated.

From Senator Kohl

2. Do you agree with the recommendation of the Antitrust Modernization Commission, that "even in industries subject to economic regulation, the antitrust agencies generally should have full merger enforcement authority under the Clayton Act"? If so, why shouldn't the Justice Department have the right to independently go to court to block mergers it judges to be anti-competitive under the Clayton Act?

AAR Response

Failure to adhere to the Antitrust Modernization Commission's (AMC) recommendation, which is made as a general proposition, does not necessarily result in all cases in a diminution of competition. The AMC acknowledged that regulatory agencies with relevant expertise in a specific industry play an important role in merger review in those industries. When considering merger enforcement policy, the relevant factors as they relate to each regulated industry must be considered on a case-by-case basis. The AMC noted that mergers in the banking industry are handled differently from mergers in the telecommunications and electric industries. AMC also noted that dual merger review can impose "significant and duplicative costs." Given the continued importance of promoting the national rail transportation policy, and the heightened emphasis that the Surface Transportation Board puts on competitive issues when reviewing rail mergers (as more fully described in the AAR's testimony, pp. 11-12), no change in the current STB merger review process (including the significant input received from DOJ to ensure sufficient consideration is given to antitrust principles) is warranted.

From Senator Kohl

3. a) Why should the railroad industry be treated differently than a competing transportation industry like aviation, which possesses no antitrust exemption?

AAR Response

When evaluating the appropriateness of a particular antitrust immunity, each industry must be considered on a case-by-case basis, with due consideration given to the nature and structure of the industry, the host of federal policies which apply to the industry, and whether the existence of an antitrust immunity creates a gap whereby market conduct is not subject to government oversight. The fact that two industries might not be treated in an identical way from a regulatory or antitrust perspective does not necessarily mean that a problem exists with respect to either industry's regulatory or antitrust oversight. For example, the economics of the railroad and aviation industries differ in significant regards, including the relative impact of fixed and variable costs and the publicly-funded and publicly-operated nature of many airports and the national air traffic control system. In addition, there are limited antitrust immunities that apply to the aviation industry (49 U.S.C. §§41308-09, 42111) which do not apply to railroads.

From Senator Kohl

b) The railroad industry argues that the pervasive nature of regulation by the STB makes full application of antitrust law unwarranted. But why should railroads be treated any differently than the telecommunications industry, which is subject to pervasive regulation by the FCC yet is fully subject to antitrust law and enforcement by the Justice Department and private parties, including Justice Department actions to enjoin anti-competitive mergers under the Clayton Act?

AAR Response

As indicated in the response to part (a) of this question: the fact that two industries might not be treated in an identical way does not necessarily mean that a problem exists with respect to the regulatory or antitrust oversight of either industry. As explained in the AAR's testimony, the interdependence among rail carriers which, of necessity, interchange freight and equipment constantly, makes the rail network unique in certain respects. While that does not mean current antitrust laws should be ignored, it also does not mean that somewhat different approaches to antitrust enforcement in the rail and telecommunications industries are not warranted.

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4. You testified on behalf of the Association of American Railroads (AAR). You argued that the railroad industry is subject to extensive regulation by the STB, and therefore should be immune from antitrust law. Yet, your association's public position appears to be to the contrary. On the AAR website appears a prominent advertisement arguing against "re-regulating" the railroad industry, implying that the industry is currently not subject to regulation. This advertisement states "Freight rail works. Re-regulation doesn't. In 1980, Washington got out of the freight rail business." This advertisement has appeared in Roll Call, among other publications.

Why does the rail industry claim one thing about regulation when testifying before our Subcommittee and another in its public advertisements? Did regulation end in 1980 or not?

AAR Response

I not only did not argue on AAR's behalf that the railroad industry is immune from antitrust law, but in fact stated that citing such a claim as the premise for this legislation (as several of the other witnesses did) is flatly incorrect. Moreover, the AAR's position with respect to regulation of the rail industry is entirely consistent. For nearly a century, the rail industry was pervasively regulated. In 1980, Congress recognized the adverse and crippling effects that that regulation had on the industry and *partially* deregulated the industry through the Staggers Act. That legislation has been remarkably effective in restoring health and vitality to the industry. (See the AAR's testimony pp. 3-4.) However, the rail industry is far being entirely free of regulation, and AAR has never stated otherwise. Today, the STB retains jurisdiction over rail service, market entry and a wide range of rate-related conduct, including the level and structure of rates where there is no effective competition. Some shipper interests are seeking legislation that would re-regulate the rail industry by essentially returning the industry to the pre-Staggers Act days of pervasive regulation, a result that would be to the great detriment of both the railroads and their customers. The AAR strongly opposes those efforts and will continue to do so.

From Senator Kohl

5. In August 2006 the Attorneys General of 17 states and the District of Columbia wrote to the Senate and House Judiciary Committees in support of our legislation to repeal the railroad antitrust exemption. The letter stated that "rail customers in our states in a variety of industries are suffering from the classic symptoms of unrestrained monopoly power: unreasonably high and arbitrary rates and poor service."

What is your response? Are the Attorneys General of 17 states and the District of Columbia misinformed?

AAR Response

To the extent that the letter signed by a minority of States Attorney Generals supporting S.772 suggests that rate and service problems allegedly suffered by some shippers in their states will be remedied by S.772, the AAR respectfully suggests that the predicate is inaccurate. High rates in themselves are not an antitrust violation (nor is poor service), and railroads are not immune from suits challenging illegal price-fixing conspiracies. And we are constrained to point out that when the three shipper witnesses (Messrs. Berg, Vander Schaaf and Szabo) were asked at the October 3, 2007 hearing how S.772 would relieve the problems they claimed to be having with railroads, they could not provide a substantive answer.

From Senator Specter

In your testimony, you state that "[t]he statutory antitrust exemptions that remain exist to avoid dual and potentially conflicting regulation by the courts and the STB."

i. In most cases, however, the doctrine of implied immunity would resolve any potential conflict between STB regulation and the antitrust laws in favor of the regulation, correct?

ii. With that said, are you concerned that the language of S. 772 could prohibit operation of the doctrine of implied immunity and require that STB regulation give way to the antitrust laws?

AAR Response

The question aptly summarizes the main point of the AAR's opposition to S.772: that the limited statutory immunities that apply to railroads exist to avoid dual and potentially conflicting regulation. Were S.772 enacted, there is great potential for such conflicting regulation to occur with regularity. As a general matter, courts look with disfavor on implied immunities. It is likely that the enactment of S.772 would cause many courts to take the position that in all cases Congress intended for private antitrust enforcement to trump STB policy, regardless of the adverse impact this would have on the efficiency and effectiveness of the rail network.

Surface Transportation Board
Washington, D.C. 20423-0001

Office of the Chairman

November 1, 2007

The Honorable Herb Kohl
Chairman, Senate Judiciary Subcommittee on
Antitrust, Competition Policy and Consumer Rights
308 Hart Senate Office Building
Washington, DC 20510

Dear Chairman Kohl:

This responds to your letter of October 18, 2007, which asks several follow-up questions regarding my testimony at the October 3, 2007 hearing on S.772, the Railroad Antitrust Enforcement Act of 2007. I appreciate the opportunities you have given the Surface Transportation Board to weigh in on these very important issues. Below, please find the answers to your questions.

1. In 1979, there were 42 class I freight railroads in the United States. Today, less than three decades later, only four railroads serve 90% of the nation's railroad traffic and there are only seven freight railroads remaining in total. Are you concerned about this level of consolidation?

As Chairman of the Surface Transportation Board, I am concerned about the effect any further consolidation of Class I railroads could have on the competitive environment in the rail industry. And my predecessors also shared these concerns. In 2000, after Class I carriers Burlington Northern Sante Fe and Canadian National proposed to merge, the Board temporarily halted all Class I merger reviews so that it could adopt new guidelines that better reflect the current competitive and economic impact such mergers could have. *See, e.g., Public Views on Major Rail Consolidations*, 4 S.T.B. 546 (2000); *Major Rail Consolidation Procedures*, 5 S.T.B. 539 (2001). The Board explained that "additional consolidation in the industry is [ ] likely to result in a number of anticompetitive effects, such as loss of geographic competition, that are increasingly difficult to remedy directly or proportionately." 5 S.T.B. at 553; 49 CFR § 1180.1(c).

There is no doubt that serious service disruptions and implementation problems were associated with some of the more-recent Class I mergers and may be more pronounced in future major rail transactions. Therefore, under the Board's 2001 merger guidelines, to offset any negative aspects of a proposed Class I merger, merger applicants will now be required to prove that "substantial and demonstrable gains" will flow from the merger, such as improved service and safety, enhanced competition, and greater economic efficiency.

No Class I merger has been proposed since the 2001 rules were promulgated. Some suggest that this means that the Board's rules are untested, and therefore not to be relied upon. I prefer to believe that the rules sent the proper signal to industry – that mergers will be approved by the Board only to the extent that they bring significant public benefits.

Finally, there is a slight inaccuracy in your question, which indicates that there are only 7 freight railroads in the United States today. In fact, there are 7 Class I's and hundreds more other railroads operating in the United States today than existed in 1980. In 1980, there were approximately 190 short lines operating only 8,000 miles of track. Short line railroads are local and regional carriers with annual revenues of less than $250 million, in 1991 dollars. *See* 49 CFR § 1201.1-1. There are now more than 500 short lines operating nearly 50,000 miles of track, or approximately 30% of the national railroad system. And the rebirth of the short line industry has benefited many rail customers, as these short lines can often operate their lines at lower costs than could the larger carriers and can give specialized attention to the needs of the shippers on their lines.

Does the STB, or its predecessor agency, the ICC, bear any responsibility for this level of consolidation?

Yes.

How do you respond to your critics who argue that this drastic consolidation shows that the STB has been ineffective in preventing anti-competitive mergers in the railroad industry?

The short answer is that I do not believe that the agency has authorized a single anticompetitive merger. Let me elaborate.

To appreciate the full context of rail consolidation over the last 30 years, one must consider the state of the railroad industry prior to 1980. By the 1970s, the railroad industry was in dire financial straits. More than one-third of the Nation's railroads had gone into bankruptcy, including the Penn Central, the Erie Lackawanna, the Lehigh Valley, the Reading, Central of New Jersey, the Rock Island and the Milwaukee.

The Rail Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, 90 Stat. 31 (1976) (4R Act) and Staggers Rail Act of 1980, Pub. L. No. 96-448, 94 Stat. 1895 (1980) (Staggers Act) were intended to improve the financial health of the railroad industry by allowing carriers to take steps to become more efficient and productive. More liberal rules on abandoning unprofitable lines and greater flexibility in setting rates were key components of this deregulatory effort. Consolidation of rail lines was also a major part of the industry's effort to become more efficient. The 4R Act encouraged a more lenient treatment of rail mergers with its general deregulatory thrust, the time limits it placed on ICC merger review, and its requirement that DOT participate more actively in rail mergers and facilitate them when possible. While observers may debate the

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optimal number of large railroads, few can argue that the consolidation was the result of market forces – a result directly encouraged by the deregulation of the late 1970s and 1980s.

Moreover, permitting the 42 Class I railroads (arranged in a jigsaw fashion around the nation) to slowly merge into larger, stronger, and more efficient networks had a tremendously positive impact on the railroad industry and its customers. In constant 2005 dollars, the numerous Class I railroads that operated in 1985 reported operating expenses of $40.8 billion, which permitted them to handle only 19.4 million carloads and generate 876 billion revenue ton-miles. Yet by 2005, the admittedly fewer but financially stronger Class I railroads reported operating expenses of $37.8 billion, which permitted them to handle 31.1 million carloads and generate 1,696 billion (1.7 trillion) revenue ton-miles. As such, since 1985 railroad productivity improved 130%, as measured annually by the Board in Ex Parte 290 (Sub-No 4), *Railroad Cost Recovery Procedures-Productivity Adjustment.*

And as the Board's Office of Economics reported in 2000, the bulk of the productivity improvements created by railroads were passed along to shippers in the form of lower transportation rates. This is the strongest possible evidence that competition in the railroad industry was working precisely as the framers of the Staggers Act had hoped. I am mindful that shippers themselves may not always have "enjoyed" the benefits of these lower rates; shippers, too, were forced by competitive pressures to pass along the bulk of these savings to consumers in the form of lower prices. Thus, at the end of the day, the ultimate beneficiary of railroad productivity improvements was the American consumer.

Without those improvements, the only way the railroads could have achieved stronger financial health would have been to dramatically increase transportation rates. Fortunately, that did not happen. Rather, the vast majority of rail shippers (and their customers) have benefited from transportation rates that are lower than they were in 1985, adjusted for inflation. While other costs for rail customers were rising (such as labor, fuel, and electricity costs), rail rates simply did not keep pace. Permitting the industry to consolidate and evolve from a patchwork of smaller, financially weakened Class I railroads into the current system was a large part of this story.

The fact that the industry has consolidated does not mean that any of the approved mergers were anticompetitive mergers. Similar consolidation has taken place over the past 25 years in countless industries under the watchful eye of the Department of Justice Antitrust Division or the Federal Trade Commission. Industries consolidate to take advantage of natural economies of scale and scope, the benefits of which are passed back to consumers in lower prices and better service. When an agency stands in the way of *beneficial* consolidation – as the ICC may have before the Staggers Act – it only harms the industry and the general public.

I have seen no evidence of an *anticompetitive* merger that has occurred under the Board's watch. DOJ has participated in every major rail merger since Staggers and

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provided its informed merger analysis to guide the agency. In that 25-year period, DOJ has recommended denial of merger approval authority only twice: the proposed Southern Pacific/Sante Fe merger (where the ICC denied merger authority) and the Union Pacific/Southern Pacific merger (where the Board granted merger authority with significant conditions and 5-year post-transaction oversight). And in the single instance of disagreement between the two agencies, DOJ did not challenge the STB's decision in court. (The Board's UP/SP decision was challenged by other parties and was upheld by the court of appeals.) One disagreement over a 25-year period can hardly constitute evidence that the existing merger review process is flawed or that the agency has been ineffective in preventing anticompetitive mergers. Moreover, as I observed in earlier testimony, the Board imposed significant conditions with the UP/SP merger that addressed the competitive issues raised by the transaction. The merger has been intensely studied, with elaborate pricing information provided to DOJ every year for 5 years during the Board's oversight period. During that oversight period, no party presented evidence that that merger was anticompetitive. Rather, the evidence showed the Board acted prudently in permitting UP to acquire the SP before that struggling carrier descended into financial ruin.

2. At the hearing, you stated that you would respond later to my question about how many mergers or acquisitions between class I railroads the STB (or its predecessor the ICC) had blocked since 1979. Please provide this information and identify any mergers or acquisitions blocked, and their dates.

The ICC denied the application for a proposed SP/SF merger in June 1986. *See Sante Fe Southern Pacific Corp. – Control – Southern Pacific Transportation Co.*, 2 I.C.C.2d 709 (1986). The agency's decision found that the transaction's anticompetitive effects on the West Coast, Central and Southern corridors outweighed the substantial public benefits. The ICC also concluded that the conditions proposed by the parties, including rate freezes and trackage rights agreements with other carriers, would not sufficiently have addressed the near "absolute monopoly" that would result in a number of geographic areas.

While the STB has heavily conditioned virtually all of its merger approvals to mitigate potential competitive harm, the agency has also taken less traditional actions that served to effectively discourage two other major rail mergers. For example, shortly after the Board's 15-month moratorium on mergers – imposed in 2001 to revise the merger rules – the Burlington Northern Sante Fe and Canadian National rail lines abandoned their proposed merger. In 1996-1997, CSX and Norfolk Southern were submitting bids to Conrail's shareholders, with both companies competing to acquire Conrail. In January 1997, then-Board Chairman Linda Morgan gave a speech that was perceived as suggesting that any proposed acquisition of Conrail by a single Eastern railroad would face significant hurdles at the agency because of the anticompetitive effects such a merger would have. *See Feds Prepared to Split Conrail, Official Says but a Settlement Between CSX and Norfolk Southern Preferred*, VIRGINIAN-PILOT, Jan. 21, 1997 at A1. CSX and Norfolk Southern subsequently submitted a merger application to the Board that would split Conrail among the two carriers, which was approved in 1998.

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3. What would be wrong with the Justice Department having the authority to review railroad mergers, and the ability to take action to block them by filing suit under the Clayton Act, just as the Justice Department has such authority for other transportation industries, such as aviation and trucking, and with respect to other regulated industries, such as telecommunications?

In my written testimony, I have identified what I believe to be the practical problems inherent in a dual review scheme. However, should Congress determine that dual merger review under both the Interstate Commerce Act and the Clayton Act is appropriate, I am confident that the Board and the Justice Department would work together to minimize those problems and coordinate our competitive analysis and remedies.

However, the proposed legislation provides more than just concurrent review by DOJ, but would open these rail transactions to challenge by private parties in any of the more than 90 federal district courts throughout the country. If Congress believes it is prudent to have DOJ provide a backstop to the agency's own merger analysis, I would recommend it consider the Federal Reserve model for bank mergers. Under that model, the initial analysis is performed by the agency with the advice and input of DOJ. Then, if DOJ is not satisfied with the agency's decision, it may seek to block the merger in district court within 30 days of the decision. (It should be clearly stated, however, the DOJ already has the ability to challenge a STB decision to approve a rail transaction in any of the federal courts of appeals).

The public comments of the Federal Reserve and DOJ before the Antitrust Modernization Commission (AMC) suggest this model works well and would have multiple benefits. This approach would permit the agency to seek to address DOJ's competition concerns without forcing the carriers to participate in the expensive Hart-Scott process. And if Congress limited the second merger review to just DOJ, this approach would not open the door to duplicative review by private parties who may seek to use the antitrust laws as a tool to block or delay rail transactions that might increase traffic flows in their neighborhood, but which are in the larger public interest. Also, by permitting DOJ exclusive authority to seek to block a Board-approved transaction, Congress would dramatically reduce the potential for conflict between district-court injunctive orders and the integrated economic regulation of the rail industry by the Board.

However, even that model carries with it a major transportation policy change that would result from dual review. The Board is required to consider a variety of public interest factors when reviewing Class I mergers, including, but not limited to, competition. *See* 49 U.S.C. § 11324(b). The other factors that must be considered by the Board include (1) the effect of the proposed transaction on the adequacy of transportation to the public, (2) the effect of including or failing to include other rail carriers in the area involved in the proposed transaction, (3) the total fixed charges that result from the transaction, and (4) labor issues. *Id.* Although Congress did not explicitly indicate that competition should be weighed more heavily than other factors, analysis of competitive

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effects is the cornerstone of Board merger review. Assume that the Board determined in a particular merger that the other public interest factors outweighed any potential anticompetitive effects or that such anticompetitive effects were sufficiently remedied by Board-imposed conditions. Presently, if the Justice Department disagrees with the competitive analysis or remedial provisions, it can go to court (under the Interstate Commerce Act) and argue that the Board got the competitive analysis wrong. The court would then decide whether the Board properly considered the evidence, properly weighed the competitive harms against the other public interest benefits, and properly determined that its conditions would alleviate the competitive problems. In that scenario, I expect that the Board would get far less deference from a court than it does in cases where DOJ is not the petitioner.

Under the dual review scheme, if the Justice Department disagreed with the Board's competitive analysis, it could seek to block the merger strictly on competition grounds under the Clayton Act. That means that evidence on all of the other public interest factors, which must *by statute* be considered by the Board, would be irrelevant to the reviewing court for determining whether the merger can go forward. Thus, the entire notion of balancing of competitive harm against other public interest factors would disappear. This major policy shift is clearly for Congress to decide and the Board takes no position on whether such a change is preferable.

4. Do you agree with the recommendation of the Antitrust Modernization Commission, that "even in industries subject to economic regulation, the antitrust agencies generally should have full merger enforcement authority under the Clayton Act?" If not, why not? If you do agree with this recommendation, explain how your position with respect to Justice Department merger authority in the railroad industry is consistent with this recommendation?

Yes. I agree with the recommendation, which states that antitrust agencies "generally" should have full merger authority. This suggests AMC believed there would be exceptions based on countervailing policies and statutory goals. The STB's merger review authority would be an example of one of these exceptions, where duplicative review may make it more difficult to maintain a uniform regulatory policy for regulating the railroad industry.

5. (a) The Antitrust Modernization Commission's April 2007 Report stated:

> **Statutory immunities from the antitrust laws should be disfavored. They should be granted rarely, and only where . . . [the immunity] is necessary to satisfy a specific societal goal that trumps the benefit of a free market to consumers and the U.S. economy in general.**

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Do you agree with this principle? If so, please specify the "societal goal" warranting an antitrust exemption that "trumps the benefit of a free market" in the railroad industry?

I agree with this principle. As indicated in my written testimony, the STB supports the elimination of several of the immunities currently enjoyed by rail carriers, including immunity flowing from the *Keogh* doctrine and immunity for collective rate-related agreements.

From my perspective, the societal goal that should be considered when determining whether to terminate other immunities is the desire for efficient and centralized economic regulation of the rail industry. Because market competition is not always possible in the rail industry, Congress created a regulatory body that is charged with protecting captive shippers, while still allowing the railroads to earn sufficient revenues to re-invest and attract capital. *See* 49 U.S.C. §§ 10101(3) and (6). The Board's charge is intimately connected to, but broader than, the goals of the antitrust laws. Congress must decide whether further splitting up competition enforcement responsibilities is consistent with or preferable to centralized monitoring of the industry by the Board.

(b) On October 3, 2007 the Federal Trade Commission sent us a letter regarding S. 772 explaining that they were against antitrust exemptions in general, citing to their "long standing view that antitrust exemptions should bear a heavy burden of demonstrating, with factually-supported reasons, the need for a departure from the nation's competitive model." Likewise, in 2004, the Justice Department wrote a similar letter to Congressman Sensenbrenner regarding the appropriateness of the railroad antitrust exemption stating "such exemptions can be justified only in rare instances, when the fundamental free-market values underlying the antitrust laws are compellingly outweighed by a clearly paramount and clearly incompatible public policy objective." Shouldn't the fact that the nation's antitrust enforcement agencies oppose antitrust exemptions like this one carry great weight with us?

Yes, the views of the Justice Department and the Federal Trade Commission should always carry great weight with Congress as it determines how to best assign competition-related enforcement duties in any industry, including rail. Likewise, we appreciate the Committee's consideration of the Board's views on how repeal of certain immunities will affect the administration of the Interstate Commerce Act.

I note that both letters acknowledge the need for narrow exceptions in the public interest. I believe that several of the existing, narrow exemptions are in the public interest, such as the limitation on injunctive relief, which traces back to the original Section 16 of the Clayton Act of 1914. As the Supreme Court itself explained, that provision's "obvious purpose is to preclude any interference by injunction with any business or transaction of interstate carriers of sufficient public significance and importance to be within the jurisdiction of the [agency], except when the suit is brought by the Government itself." *Central Transfer Co. v. Terminal R.R. Ass'n*, 288 U.S. 469, 475 (1933).

6. Many captive shippers complain that it is ineffective and excessively expensive for a captive shipper to go to the STB for relief from rail rates they believe are expensive or unjustified. A recent Government Accountability Office Report appears to support this complaint. The October 2006 GAO Report on the freight railroad industry found that, according to the shippers it surveyed, it cost on average about $3 million to adjudicate a rate case at the STB. It also found that only ten cases have been filed since 2001, and these cases took an average of 3.3 years to complete. The GAO found that "only high volume shippers . . . have the money to afford the STB rate relief process. In addition, shippers said that they do not use the process because it takes so long for the STB to reach a decision." GAO Report 07-94 at 41.

Doesn't the great expense and long time delays demonstrate that the STB's rate relief process in an ineffective remedy for shippers victimized by excessive rates? What are you doing to remedy this situation?

The current Board recognizes that the former rail rate dispute resolution procedures were not adequately accessible and affordable to many shippers. We have replaced those procedures and remedied that situation.

In particular, in the past year, the Board has completed two large rulemakings to reform its rate review process and ensure that the rate review process at the agency provides an effective constraint on unreasonable pricing by carriers. *See Simplified Guidelines for Rail Rate Cases*, STB Ex Parte No. 646 (Sub-No. 1) (STB served Sept. 5, 2007) (*Simplified Guidelines*); *Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1) (STB served Oct. 30, 2006) (*Major Issues*).

In *Simplified Guidelines*, which have been challenged in court by the railroads, the Board greatly simplified the rail rate dispute resolution process for small and medium sized shipments. The Board's simplified guidelines allow freight rail customers with small shipments to obtain an award of up to $1 million in relief within 8 months of filing a complaint. The filing fee for such a complaint is $150. Shippers with mid-size shipments can pursue another simplified alternative that can provide up to $5 million in relief within 17 months of filing a complaint. The filing fee for the new procedures opened the doors to the more than 70% of challengeable rail traffic that had been effectively blocked from Board review due to the complexity and high costs of the Board's previous procedures.

In *Major Issues*, the Board similarly simplified its procedures for large rate cases. This decision is expected to reduce by 30% the cost of litigating coal rate cases. Because of the inherent complexity in determining rate reasonableness in such cases, I do not

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believe that they will ever be easy, quick, or cheap. However, I think the Board has made great strides in streamlining the process and making our procedures more efficient.

Any analysis of the reasonableness of rates will involve some litigation costs by the party seeking relief. But, while I am no litigation authority, I would expect that the litigation costs of pursing relief before the agency under our simplified procedures will pale in comparison to the litigation costs of an antitrust lawsuit.

7. In August 2006 the Attorneys General of 17 states and the District of Columbia wrote to the Senate and House Judiciary Committees in support of our legislation to repeal the railroad antitrust exemption. The letter stated that "rail customers in our states in a variety of industries are suffering from the classic symptoms of unrestrained monopoly power: unreasonably high and arbitrary rates and poor service."

What is your response? Are the Attorneys General of 17 states and the District of Columbia misinformed?

Yes, the referenced letter appears to be premised on an inaccurate understanding of federal rail regulation and policy. Numerous studies have concluded that since deregulation, shippers have in general enjoyed significant price reductions and improved service. It is a fact that "captive shippers," those with access to a single rail line and without other effective transportation options, are subject to pricing by a monopoly carrier. Imposition of the antitrust laws would not alter this fact, nor would the antitrust laws preclude a monopolist from charging monopoly rents in the absence of acts by the carrier to unlawfully maintain that monopoly. Rather, it is the Interstate Commerce Act that was enacted by Congress to protect captive shippers from the "classic symptoms of unrestrained market power." We routinely review such complaints and, where the facts support the allegations, will require the railroad to lower its rates and reimburse the shipper (with interest) for past shipments. *See, e.g., Public Serv. Co. of Colo. d/b/a Xcel Energy v. Burlington N. & Sante Fe Ry.*, STB Docket No. 42057 (STB served June 8, 2004), *aff'd sub nom. BNSF Ry. v. STB*, 453 F.3d 473, 484 (D.C. Cir. 2006) (ordering BNSF to pay millions in damages and prescribing the maximum lawful rate it can charge until the year 2020).

I appreciate the Committee's interest in the Board's processes. If I can be of further assistance, please let me know.

Sincerely,

Charles D Nottingham /RDC

Charles D. Nottingham
Chairman

11/01/07

**RESPONSES OF ROBERT G. SZABO
TO QUESTIONS PROPOSED BY
SENATOR KOHL AND SENATOR SPECTER**

RESPONSES TO QUESTIONS BY SENATOR KOHL

1. The railroad industry argues that the antitrust exemption is actually quite limited and that the railroad industry is subject to antitrust law in many respects. What's your response? What remedies would repeal of the railroad antitrust exemption give shipper that they need and don't have today?

ANSWER:

The railroad industry is subject to the antitrust laws where a matter has been deregulated or is otherwise exempt from the regulation of the Surface Transportation Board (STB). However, where a matter is subject to the jurisdiction of the STB, the matter may be exempt from the antitrust laws by statute, whether or not the STB has exercised its jurisdiction consistently with the pro-competitive policies of the antitrust laws and the Rail Transportation Policy (49 U.S.C. Section 10101). We believe that S.772, by eliminating the principal railroad antitrust exemptions, will ensure that the implementation of the Rail Transportation Policy will be aligned with the pro-competitive policy of the United States as expressed through the antitrust laws of the nation. We also believe, based on the history of rail regulation since enactment of the Staggers Act, that competition has been largely ignored as a priority objective of the implementation of the Rail Transportation Policy by the STB and its predecessor, the Interstate Commerce Commission. As a result, many rail customers and consumers have suffered poor service and monopolistic behavior by regulated railroads. In light of this history, the normal judicial deference to regulatory functions expressed in the primary jurisdiction doctrine is not appropriate in the context of the STB's regulation of railroads.

With the enactment of S.772, rail customers would gain the right to challenge in federal district court, under the antitrust laws of the nation, two practices that we believe to be clearly anti-competitive but are allowed by the Surface Transportation Board.

The first practice is referred to as the "bottleneck" situation. In this situation, the rail customer is dependent on railroad transportation and a single railroad provides transportation either at the origin or the destination or both. However, a second railroad, which interconnects with the first railroad, can provide competitive rail service for a meaningful part of the distance between the origin and the destination. The first railroad, however, will not "quote a rate" to the rail customer for the

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segment of the transportation to or from the interconnection point with the competing railroad. Due to this "bottleneck" controlled by the first railroad, the rail customer is not able to obtain competition from the second railroad. In a 2004 letter to the Chairman of the House Judiciary Committee, the Department of Justice strongly suggested that, but for the railroad industry's antitrust exemption, this practice could be a violation of the Sherman Act. The enactment of S.772 would provide rail customers and state attorneys general access to the federal courts to challenge the "bottleneck" practice as violating the Sherman Act.

The second practice is referred to as the "paper barrier" or "tying agreement" situation. These phrases refer to a prohibition contained in track lease agreements between short line railroads and Class I railroads. Since partial deregulation of the railroad industry in 1980, there have been as many as 500 new short line railroads created to operate track formerly owned by Class I railroads. In each case, the STB or its predecessor, the ICC, had to approve the transaction, but the transactional documents were kept confidential as proprietary financial and business documents. Rail customers have learned, however, that many if not most of these transactions were long term track lease agreements under which the short line obtained the right to operate the track owned by the Class I railroad. Many of these short line railroads operate track that interconnects with more than one Class I railroad, which would appear to provide competitive transportation alternatives to the customers of the short line. However, again in many, if not most, of these track lease agreements, the Class I railroad placed a prohibition on the short line doing a meaningful amount of business with any Class I railroad other than the Class I railroad from which it leases its track.

In the 2004 letter from the Department of Justice to Chairman Sensenbrenner, the Department indicated that, but for the railroad exemption from the antitrust laws, this prohibition imposed on short line railroads might be a violation of the Sherman Act. The Railroad Antitrust Enforcement Act of 2007 will provide the opportunity for rail customers of these short line railroads and, perhaps, state attorneys general, to bring antitrust actions in federal district court to enjoin these anticompetitive arrangements.

In addition, rail customers welcome the opportunity S.772 provides to the Department of Justice and the Federal Trade Commission to challenge future rail mergers in federal district court if the Department or the Commission finds that the merger, as approved by the STB, would create anticompetitive markets in violation of the nation's antitrust laws. Today, railroad mergers or acquisitions are exempt from the nation's antitrust laws.

2. The railroad industry claims that regulation of their industry is so pervasive that applying antitrust law to them is unnecessary. But hasn't the regulation of railroads at the STB been greatly reduced in recent decades by such legislation as the Staggers Rail Act of 1980 and the ICC Termination Act of 1995?

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ANSWER

The regulation of the nation's railroads under the Staggers Rail Act of 1980 and the ICC Termination Act of 1995 is anything but pervasive. Prior to 1980, railroads were required to seek prior approval for almost any proposed transaction with another railroad or a customer. Rail transportation was offered only under tariffs that were filed with and prior approved by the Interstate Commerce Commission. Railroads and rail customers could not enter into a long-term contract for rail transportation.

Under the Staggers Rail Act of 1980 and the ICC Termination Act of 1995, the federal regulatory system for railroads moved from a system requiring prior approval for almost all railroad actions to a system in which prior approval by the federal regulatory agency was the exception, not the rule. For example, proposed abandonment of track continues to require the prior approval of the federal regulatory agency, now the Surface Transportation Board (STB), but the rates for rail service not only do not require prior approval by the STB, they also need not be filed with the STB. If a rail customer is "captive", meaning that the rail customer depends on rail service and only one railroad serves the customer and the resulting lack of competition has resulted in a tariff rate that exceeds a very high jurisdictional minimum, the rail customer can challenge the rate at the STB. No other rail customer can even challenge a rate at the STB. The rate challenge process is so burdensome and expensive that only nine cases have been filed at the STB since 2000. The rail customer bears all burdens of proof in a rate challenge and must pay a very high filing fee that is calculated to cover at least half of the costs to the STB of processing the rate challenge.

The railroads seem to agree that the railroad industry is largely deregulated and not at all pervasive. Any legislation that proposes to improve any part of the federal regulation that has been preserved to restrain the railroads' monopoly power is greeted by the railroad industry's cry of "re-regulation"- suggesting of course that the railroads believe they are not subject to regulation today.

3. The railroad industry contends that captive shippers can always bring a case to challenge railroad rates before the Surface Transportation Board. Is challenging a rate increase at the STB an effective remedy for shippers? Why or why not?

ANSWER

The Government Accountability Office (GAO) issued an October, 2006 report on the freight rail industry and the operation of the Staggers Rail Act of 1980. One of the findings of that report is that the STB process for challenging the reasonableness of rates is "inaccessible" to most captive rail customers. We agree with that finding.

The STB maintains two different sets of rules for rate reasonableness cases. One set of rules is for so-called "large rate cases" which usually involve unit train

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movements of coal or some other such commodity. A second set of rules is for so-called "small shipment" cases.

Under both sets of rules all burdens of proof are on the rail customer, who must continue to pay the challenged rate throughout the rate challenge process. The railroads, of course, under the partial deregulation act of 1980, are able to charge rail customers whatever they wish without any prior approval from the STB and in fact are not even required to post their tariff rates with the Board.

In the "large rate case" process, the complainant rail customer pays a filing fee of \$178,200 to initiate the rate challenge at the STB. The STB, by statute, has exclusive jurisdiction over all rate challenges. The rail customer must then prove it is "captive", which means that it is dependent on rail transportation and has access to only one railroad for its transportation. The rail customer must also prove that the rate it is challenging is within the jurisdiction of the Board. The minimum level of rate that is within the jurisdiction of the Board is a rate that is 80% above the direct cost to the railroad of providing the transportation (locomotive cost, labor cost, fuel cost, rail car use fee if the rail customer is using a rail car owned by the railroad) – a healthy mark-up indeed.

Once the rail customer has proven that the rate in question is jurisdictional to the STB, the rail customer bears the burden of proving that the rate is "unreasonably high". The standard used by the STB for a rate being "unreasonably high" is called "stand alone cost". "Stand alone cost" means that the rail customer can build and maintain, at current costs, its own railroad to move its freight. If the rail customer proves that the price of providing its own rail service is less than the rate being charged by the railroad, the STB will reduce the rate to the "stand alone cost" rate.

Obviously, this is a most unusual rate standard, which was not legislated by Congress, but rather was developed by the Interstate Commerce Commission, and continued under the Surface Transportation Board. Last year, the STB adopted changes to its large rate case methodology and, over the uniform objections of rail customers, applied these changes to pending rate cases. When the STB decided against rail customers in two of those pending cases on September 10, 2007, the STB admitted that changing the large rate case methodology mid-way through the pending rate cases hurt the plaintiffs.

Based on testimony provided to Congress, these cases take two to three years to resolve, cost the plaintiffs from \$3 to \$5 million to prosecute and rarely result in victory for the rail customer. In the two cases decided on September 10th, the STB found reasonable captive rail rates that were five and six times higher than the direct cost to the railroad of providing the transportation. Testimony at a September hearing in the House Transportation and Infrastructure Committee was that the last time a rail customer won any meaningful relief from the STB on a rate was in 2001. Rail customers do not think the large rate case process of the STB provides an effective remedy for rail customers.

The "small shipment rate case" process offers even less hope for rail customers. These rules have been in place for over ten years and during that time only two cases were filed, both by chemical companies, and both were settled before any rulings were issued by the Board. In an attempt to make this process more user friendly for rail customers, the Board in September of this year issued new rules for small shipment rate cases. The forty-one rail customer groups that participated in the rulemaking have all asked the STB to revisit the final rule to include changes that would make the small shipment rate case process more accessible to rail customers. So, at this stage, rail customers do not believe that the small shipment rate case process offers an effective remedy for rail customers.

4. In 2006 the Government Accountability Office released an extensive study of competition in the freight railroad industry. In August, 2007, the GAO updated its 2006 report with data that had become available since the publication of its initial report. In that update, the GAO found that in 2005, industry rail rates increased 7 percent over their 2004 levels, the largest annual rate increase over the past twenty years. Do you believe that without further action, this trend of price increases will continue? How could that potentially impact consumers?

ANSWER

Captive rail customers believe that the 7% rate increase figure does not capture the full impact of the increases that captive rail customers have experienced in 2005 and since. The GAO figure is the average of all rate increases, many of which are for competitive rail movements and some of which may be at a level that is even less than the direct cost to the railroad of providing the transportation. We know that rail rates for some captives, such as Dairyland Power of Wisconsin, increased 93% from 2005 to 2006.

Yes, captive rail customers believe that rail rates will continue to rise rapidly unless Congress acts to ensure increased rail customer access to competitive rail transportation. We also are very supportive of legislation pending in the Senate Commerce, Science and Transportation Committee, S.953, the Railroad Competition and Service Improvement Act of 2007, that will improve the rate challenge process at the STB.

High freight rail rates operate as an unseen tax on American consumers. High rail rates for moving coal to electricity generators are passed along to American electricity consumers in the form of higher costs of electricity.

At the Committee's October 3d hearing on this issue, William Berg, CEO of Dairyland Power in Wisconsin, testified that the 93% rate increase on rail coal movement to Dairyland's coal-fired electricity generating plants resulted in a 20% rate increase to the electricity customers served by Dairyland.

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In testimony before the House Transportation and Infrastructure Committee on September 25th and in a letter submitted into the record of an October 23d hearing by the Senate Commerce, Science and Transportation Committee, Terry Huval, Director of Public Utilities for the City of Lafayette, Louisiana, testified that the coal-fired electricity generating facility of the City is captive to a single railroad for its 1500 miles of coal transportation to the plant. The annual "cost of captivity" for the schools served by the City of Lafayette public utility is $1.52 million.

In addition, high rail rates on the cost of grain result in both higher prices for baked goods and lower income for farmers. Innumerable other goods used by American consumers are carrying in their ultimate retail price high rail rates caused by captivity at some point in the supply chain.

RESPONSES TO QUESTIONS BY SENATOR SPECTER

1. I agree with you that the railroads should not enjoy express antitrust exemption where they are not subject to regulation. You also correctly note that many other regulated industries are subject to both the antitrust laws and regulation. However, under normal circumstances the antitrust laws give way to a conflicting, congressionally mandated regulatory scheme where there is active supervision by the regulator. I am concerned that S. 772 is drafted in such a way that it would require the regulator, in this case the STB, to give way to the antitrust laws, possibly in contravention of a congressionally mandated regulatory scheme.

ANSWER

We do not believe that the regulation of the railroads by the STB constitutes a congressionally mandated scheme that necessarily conflicts with the antitrust laws of the nation. A principle objective of the Rail Transportation Policy that Congress entrusted to the STB to implement is rail customer access to competition. We believe that the STB has failed to implement the Rail Transportation Policy in a pro-competitive manner. Numerous other regulated industries are comprehensively regulated, but the antitrust laws apply nonetheless, to the benefit of competition and consumers.

Experience in other regulated industries involving transportation networks confirms that the backstop of civil antitrust decrees against anticompetitive conduct does not conflict with regulatory responsibilities. No antitrust exemptions exist for the transmission of electricity, the transportation of natural gas, or the transportation of oil by common carrier pipelines (whose rates are regulated under the Interstate Commerce Act, 49 U.S.C. App.(1)((b) (1988)). In these network transportation industries vigorous competition occurs within a framework of regulatory oversight, but with the safeguard of antitrust remedies, including private civil antitrust remedies, in the background. There has been no significant conflict between the antitrust courts and effective regulation by the over-seeing agency, the Federal Energy Regulatory

Commission. Rather, the Supreme Court contemplates that the roles of the antitrust courts and regulatory agencies like the FERC and the STB will complement each other. The regulatory agency "serves the important function of establishing a first line of defense against those competitive practices that might later be the object of antitrust proceedings." *Gulf States Utilities v. Federal Power Commission*, 411 U.S. 747, 759 (1973). See e.g. *Otter Power Co. v. United States*, 410 U.S. 366 (1973); *California v. FPC*, 369 U.S. (1962). Similarly, Congress expressly preserved antitrust remedies as applied to telephone networks in §601(a) of the Telecommunications Act of 1996, 47 U.S.C. §152 note.

2. Your written testimony suggests you believe it is unlikely that S. 772 would interfere with the congressionally mandated regulatory scheme administered by the STB, but given the way S. 772 is drafted, it certainly could interfere, correct?

ANSWER

We do not anticipate any conflict between the STB and the antitrust courts because competition is one of the factors the STB must consider in performing its regulatory functions. Both under the Rail Transportation Policy contained in 49 U.S.C. §10101, and in the Supreme Court's decisions on which this policy is based, the national policy of competition embodied in the antitrust laws has been deemed to be an integral element of the public interest. See e.g. *Denver & R.G. W. R.Co. v. United States,* 387 U.S. 485 (1967); *McLean Trucking Co. v. United States*, 321 U.S. 67, 80 (1944). One of the distinctive aspects of the American system of economic regulation is "the requirement that the Commission consider matters relating to both the broad purposes of the Act and the fundamental national economic policy expressed in the antitrust laws. *Gulf States Utilities v. Federal Power Commission*, 411 U.S. 747, 759 (1973). A major benefit of this legislation will be to assure that this principle is honored by the STB.

Under S. 772 the STB would continue to exercise all of its current regulatory powers over the railroads. Antitrust actions will be brought only when the STB has failed to protect competition and rail customers, as it has been directed to do by the Rail Competition Policy. Whatever may be the case for express or implied exemptions in other industries, the STB's failure to protect consumers from anticompetitive actions by regulated railroads, including through mergers and acquisitions, warrants making the antitrust courts the primary protectors of competition in all aspects of the rail freight industry. In Justice Holmes' famous words: "Upon this point a page of history is worth a volume of logic." *New York Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921).

3. **Would you support legislation that simply repeals the express antitrust exemptions enjoyed by the railroads—rather than restricting the ability of the STB to regulate the industry? If not, why?**

ANSWER

As indicated above, we do not believe that S. 772 restricts the ability of the STB to regulate the industry. We certainly support repeal of the express antitrust exemptions enjoyed by the nation's railroads. But we do not see any need, in the regulation of railroads, for implied exemptions of the kind the courts have found in certain effectively regulated industries. Such implied exemptions depend on the industry and the regulatory scheme. As the Supreme Court recently explained: "Where regulatory statutes are silent in respect to antitrust, however, courts must determine whether, and in what respects, they implicitly preclude application of the antitrust laws. Those determinations may vary from statute to statute, depending upon the relation between the antitrust laws and the regulatory program set forth in the particular statute, and the relation of the specific conduct at issue to both sets of laws." *Credit Suisse Securities (USA) LLC v. Billing* 127 S. Ct. 2383, 2389 (2007). Implied exemption from the antitrust laws is inappropriate in the regulated railroad industry for the same reasons that express exemptions should be repealed.

For similar reasons, the primary jurisdiction doctrine should not be available to the STB. There is no question that without Congressional action, the primary jurisdiction doctrine would apply in the antitrust cases that S. 772 would make possible. First, the lead case on the general primary jurisdiction doctrine involved the ICC: *U.S. v. Western Pacific R. Co.*, 352 U.S. 59, 64-65, 65-66 (1956). Second, the doctrine is applicable in antitrust cases. See e.g. *Ricci v. Chicago Mercantile Exchange*, 409 U.S. 289 (1973). The *Ricci* case tries to reconcile cases in which the Supreme Court has held that the doctrine does not apply in some antitrust cases (e.g. *California v. Federal Power Commission*, 369 U.S. 482 (1962); *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963)), but does apply in others. Thus, the primary jurisdiction doctrine has become a minefield for antitrust plaintiffs in regulated industries.

If the STB retains primary jurisdiction, then the whole purpose of S. 772 would be undermined because antitrust courts would be required to refer key issues in antitrust cases to the STB for initial resolution. Railroads would be able to use the STB's primary jurisdiction as a kind of "stealth preemption" of the antitrust courts' newly-restored role. Ignoring the STB's history of putting railroad interests ahead of consumer interests would invite the railroads' very skilled lawyers to manipulate antitrust cases back to the STB. That is why this legislation needs a provision eliminating the STB's primary jurisdiction-- to make effective the bill's repeal of the antitrust exemptions for regulated railroads.

4. **Would S. 953 be a better way to go about changing the way the STB regulates the railroad industry?**

ANSWER

We consider S 953 to be another essential reform. S. 772 and S. 953 are complementary, not alternatives to each other. S.772 can address only railroad

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competition issues. S.953 seeks to improve the STB's rate challenge process and augment the Board's authority over service issues. Together these two bills will assure far greater benefits to rail customers and consumers than if one were enacted without the other.

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Responses to Follow-Up Questions for Hearing on S. 772, the Railroad Antitrust Enforcement Act

1. How have increased rail rates impacted your customer?

   If the contracts with our customers are cost-plus, the rail rate increases have been passed on to them immediately. Where the contracts are firm-fixed-price, as is the case with most of our Department of Defense contracts, the rate increases will be absorbed temporarily by our suppliers or Alliant Techsystems Inc. However, as the current contracts expire the total costs of freight increases will be included in any future pricing proposed to our customers.

2. In a recent letter to the editor of Roll Call newspaper, a representative of the railroad industry alleged that legislation such as the Railroad Antitrust Enforcement Act contains numerous provisions that the utilities "would never accept for themselves." We have also heard the railroads complain that being subject to both Department of Justice antitrust oversight and the STB regulation would be too onerous.

   a. Yet, isn't it true your company is already subject to regulatory oversight from more than one agency?

      Alliant Techsystems Inc. is subject to the regulatory oversight from more than one federal and state agency.

   b. What state and federal regulatory bodies must your company answer to?

      Alliant Techsystems Inc. must comply with the regulations from or agreements with the Department of Justice, The Bureau of Alcohol, Tobacco, Firearms and Explosives, Department of Defense, Department of State, Department of Transportation, Department of Commerce, Customs Department, Environmental Protection Agency and many other federal and state entities that have jurisdictions over various ATK facilities and activities.

   c. And isn't your industry subject to antitrust law as well?

      Yes.

SUBMISSIONS FOR THE RECORD

William L. Berg, President and CEO, Dairyland Power Cooperative
Statement to the Senate Judiciary Subcommittee on
Antitrust, Competition Policy and Consumer Rights
"An Examination of S. 772, the Railroad Antitrust Enforcement Act"
October 3, 2007

Chairman Kohl and members of the Subcommittee, my name is William Berg. I am President and CEO of Dairyland Power Cooperative, headquartered in La Crosse, Wisconsin. I appreciate the opportunity to testify today on the issue of railroad competition and S. 772, the Railroad Antitrust Enforcement Act.

Dairyland Power is a non-profit Generation and Transmission Cooperative supplying at wholesale the electricity needs of our 25 member distribution cooperatives, who in turn serve over 575,000 people living in Minnesota, Iowa, Illinois and Wisconsin. As a relatively small electric utility serving mostly rural residences and farms, we are very concerned about holding down costs because, ultimately, all the costs that we incur in the generation and distribution of electricity flow through to our members. Our largest single cost item in generating electricity is rail transportation, and, as I will explain, those costs have been increasing dramatically in recent years as dominant rail carriers have been imposing significant rate increases on us.

We annually use about 3.2 million tons of coal in three coal-fired plants in western Wisconsin. Three-quarters of that coal comes from the Powder River Basin in Wyoming. For the delivery of that coal, we are captive to and dependent upon the only two railroads currently serving the Powder River Basin, or PRB, as it is called. Because of the virtually unrestrained market power that these railroads have over PRB movements, we are in fact paying more and receiving less. In 2005, Dairyland experienced a 13% shortfall of scheduled coal shipments, yet we were hit with rate increases averaging 93% beginning in 2006 -- resulting in more than $35 million of increased annual costs.

These dramatic rate increases were the major factor in our Board's decision to increase electricity rates to our members by over 20% during 2006. Our members are truly suffering as a result of the railroads' predatory price increases, and we cannot tolerate a virtual doubling of rates, especially at a time when our service quality is actually declining. Moreover, these rate increases came at the end of a short-term three-year contract that already included annual escalations and provided adequate cost recovery.

We are certainly not alone in this situation. BadgerCURE, an organization of over 45 Wisconsin groups, businesses and organizations, has been formed to pursue sensible policies to help address railroad competition and service problems. The Government Accountability Office (GAO) is also concerned. In a report issued on August 15, 2007, the GAO found that rail prices are on the rise, and an increasing number of rail customers are paying more than three times what it costs the railroads to move their freight, a finding that was based on data through 2005 and prior to the many more recent rail rate increases.

Since utilities have no viable alternative to rail in moving coal from the Powder River Basin to their power plants, and since the two railroads now appear to have no incentive to improve the existing demand/supply imbalance, we cannot protect ourselves through normal business negotiations. At our largest plant, we have rail access from only one provider. At our other plants, which receive coal by barge, we must still secure rail delivery to the barges. Although there may be more than one railroad for those hauls, the absence of competition and apparent allocation of markets have allowed the railroads to preserve market share even while eliminating performance guarantees and dramatically raising prices. The railroads seem to be able to exercise almost absolute market power, with little effective recourse by Dairyland or other, even much larger, railroad customers.

We strongly support S. 772, legislation that will provide for a more competitive landscape in the nation's freight railroad industry. Along with S. 953, the Railroad Competition and Service Improvement Act of 2007, which has been referred to the Senate Commerce, Science and Transportation Committee, we feel that true competition can once again be the driving force of the freight railroad industry. With the enactment of S. 772, rail customers will have the full range of the nation's antitrust laws to help deal with anticompetitive railroad actions, and the legislation may help serve as a deterrent to future anti-competitive behavior. For instance, S. 772 may help deter the following competitive problems:

- Bottlenecks. Dairyland is a "bottleneck" utility: that is, the last segment of the trip to our unit-train plant is served by only one railroad. Railroads often refuse to quote rates for shipments to or on the bottleneck segment, denying the benefits of competition on other segments of the journey.
- Paper barriers. Major railroads have spun off or leased segments of their tracks to short line carriers with contractual terms that prohibit the acquiring carrier from competing with the major railroads. These "paper barriers" are a further barrier to real competition, thereby increasing costs.

- Public pricing. Dairyland traditionally received coal transportation via confidential contracts. Now, approximately two-thirds of our rail business moves under so-called "public pricing" documents manufactured by the railroads. We are concerned that high public rail prices provide signals between these western carriers regarding elevated pricing aspirations for Dairyland's traffic.
- Refusal to bid. Even in what should be considered "competitive" situations where two railroads are able to serve a property, increasingly we do not see competitive bids. For example, coal we receive by barge is theoretically competitive, since there are several rail-to-barge transloading facilities in different locations. Our experience is that one railroad offers public pricing, while the other railroad offers nothing. Competition does not work in a duopoly market if one of the duopolists refuses to bid.

In response to recent legislation, rail representatives suggest that legislative relief is "re-regulation." We disagree. We have also heard the railroads state that this legislative relief would result in their decision not to add infrastructure. We understand the railroads need a reasonable profit to operate, and they must have enough capital to make needed improvements. However, the rate increases to Dairyland have no correlation to improved service and infrastructure improvements. Of necessity, we are going to be partners for many decades to come but I question whether the railroads will ever have an incentive to improve service, properly maintain and grow infrastructure, and effectively compete for service unless changes are made by Congress.

Railroads also use aggregate numbers as they defend themselves from the issue of high rates. Aggregate numbers do not show the real individual impact to captive shippers like Dairyland who have had their rates dramatically increased and who have been scrambling to get deliveries of a vital resource. The bottom line is this: every month Dairyland has to pay millions of dollars more because of rail rates that have nearly doubled, and as a cooperative, every single cent of that has to come out of our members' pockets.

In light of the current consolidated state of the railroad industry, and the problems we are experiencing in obtaining competitive rail service, Dairyland respectfully submits that the Committee got it right when it recently approved S. 772, and we urge the full Senate to pass this important bill as soon as possible.

Thank you again for the opportunity to testify.

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"The Intersection of Competition Policy and Surface Transportation Regulatory Policy: An Examination of S. 772, the Railroad Antitrust Enforcement Act"

BEFORE
THE SENATE JUDICIARY SUBCOMMITTEE ON
ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS
UNITED STATES CONGRESS

ON

OCTOBER 3, 2007

Introduction

Mr. Chairman, Ranking Member Senator Hatch from my home state of Utah, and other distinguished members of the Judiciary Subcommittee on Antitrust, Competition Policy, and Consumer Rights, I want to thank you for giving me the opportunity today to speak about regulation and competition policy in the context of the railroad industry. But more importantly, I would like to thank you for asking the hard questions about the direction of railroad policy in light of the United States' experiences with the railroad industry over the past several decades. My remarks here today are my own, as I do not represent anyone. I speak today based upon my experience as an Antitrust Division trial attorney focused on deregulated industries, as an economist, and as a law professor whose research and writing has focused on antitrust issues arising in the context of regulated/deregulated industries.[1]

[1] The term "deregulation" is a bit of a misnomer. See Harry First, Regulated Deregulation: The New York Experience in Electric Utility Deregulation, 33 LOY. U. CHI. L. J. 911 (2002)(noting that New York's electricity market was not deregulated, but in fact replaced "one regulatory system with another.").

Antitrust Immunities and Exemptions in General

In consideration of the repeal of any statutory immunity from the antitrust laws, it is important to consider the realm of possible other immunities and exemptions that may give rise to unforeseen antitrust immunity.

To review some basics, an express antitrust immunity may be justified when a regulatory agency has been expressly empowered by Congress to displace competition in an industry. Congress may expressly confer upon the regulator the exclusive power to control competitive issues within that industry by providing the industry with antitrust immunity.

Traditionally, such grants of authority were for the purpose of displacing competition with rate and entry regulation while providing the firm with a monopoly, albeit a regulated one.[2] The agency would confer upon the industry the right to some reasonable rate of return and an exclusive right to provide service within its territory in exchange for the provision of service to all comers, agency review of rates and costs associated with providing that service, and other hurdles that limited the ability of the firms within that industry to expand into other realms or charge higher rates.

In this realm, the common notion was that antitrust had little to say. Indeed, notions of competition were antithetical to this arrangement.[3] After all, there was little

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[2] *See generally* Darren Bush, *Mission Creep: Antitrust Exemptions and Immunities as Applied to (De)regulated Industries,* 2006 UTAH L. REV. 613.

[3] Darren Bush & Carrie Mayne, *In (Reluctant) Defense of Enron: Why Bad Regulation Is to Blame for California's Power Woes (or Why Antitrust Law Fails to Protect against Market Power when the Market Rates Encourage Its Use)*, 83 OR. L. REV. 207, 207 (2004)(noting the historical perspective that regulation and antitrust are substitutes); see Richard D. Cudahy, *The Wearing Away of Regulation: What Remains*, PUB. UTIL. FORT., Oct. 12, 1989, at 9, 9–12; *Consolidation in Telecommunications Industry—Senator*

ability to compete between franchises as entry was highly restricted.[4] Moreover, the terms, conditions, and prices of the services offered in such industries were actively overseen by administrative agencies. Thus, with few exceptions, antitrust was required to remain silent.

However, current notions of regulation focus on market mechanisms that are not necessarily antithetical to the antitrust laws.[5] "Regulated" industries today are typically regulated only in the parameters under which competition takes place. Agencies do not to the same degree restrict entry—they encourage it. They no longer to the same degree review rate schedules and tariffs—they allow the market constructed by administrative rules and statutes to determine the rates and prices charged. They also do not to the same

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Metzenbaum's Views, 7 TRADE REG. REP. (CCH) ¶ 50,126 ("[F]ederal and state regulation of the telecommunications industry has been and will continue to be a poor substitute for aggressive antitrust review."); Leslie W. Jacobs et al., *Panel Discussion, Deregulation and Expanding Antitrust Liability: A New Battleground for Private Antitrust Litigants*, 53 ANTITRUST L. J. 221, 222 (1984) ("When I was involved with getting the airline industry deregulated, we were quite hopeful that competition would substitute for regulation and that much of the antitrust enforcement would be done by private litigation." (statement of Marvin S. Cohen, Member, D.C. Bar)); Alfred E. Kahn, *Deregulatory Schizophrenia*, 75 CAL. L. REV. 1059, 1059 (1987) ("I agree thoroughly with Judge Breyer that the antitrust laws are not just another form of regulation but an alternative to it—indeed, its very opposite." (footnote omitted)); cf. Peter C. Carstensen, *Evaluating "Deregulation" of Commercial Air Travel: False Dichotomization, Untenable Theories, and Unimplemented Premises*, 46 WASH. & LEE L. REV. 109, 116 (1989) (noting dichotomy of regulation/deregulation "is false with respect to analysis of regulation and deregulation of any industry, and is extremely so with respect to commercial air travel").

[4] One notable exception was competition for larger industrial and commercial customers in the electricity industry.

[5] *See* Herbert Hovenkamp, *Antitrust and the Regulatory Enterprise*, 2004 COLUM. BUS. L. REV. 335, 341 (2003). Professor Hovenkamp states:

> One consequence of regulation is a reduced role for the antitrust laws. When the government makes rules about price or output, market forces no longer govern. To that extent antitrust is shoved aside. A corollary is that as an industry undergoes deregulation, or removal from the regulatory process, antitrust re-enters as the residual regulator. Since our fundamental criterion for determining antitrust immunity in regulated industries is the extent of unsupervised private discretionary conduct, the natural result of deregulation is an increased role for the antitrust laws. In general, the more extreme the deregulation--that is, the more that the market is opened to ordinary competitive forces--the greater the role for antitrust.

Id.

degree guarantee a rate of return, instead allowing the market to winnow out losers and reward winners.

Thus, antitrust law and regulation may serve complementary purposes[6] in industries subject to what my colleague Harry First and others have called "regulated deregulation."[7] Under these "new" regulatory schemes common today, express exemptions from the antitrust laws generally will be inappropriate and, therefore, should be rare. In other words, the "default" rule should always be that competition and its enforcement agent, the antitrust laws, prevail.[8]

Linked closely with the notion of express immunity is the doctrine of implied immunities, or claims that Congress "intended" to exempt regulatory conduct from antitrust even though it did not do so by express statutory language. Historically, courts have viewed implied immunities with extreme skepticism. As one group of commentators has stated:

> [T]wo grounds--and only two grounds--will support an implied repeal: the first is irreconcilability and the second is an affirmative showing of legislative intent to repeal by implication. The latter criterion has only been satisfied in cases in which the repealing act contains a directive to the regulatory agency to police the interplay of

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[6] For a discussion of the complementary nature of regulation and antitrust, *see* Darren Bush & Carrie Mayne, *In (Reluctant) Defense of Enron: Why Bad Regulation Is to Blame for California's Power Woes (or Why Antitrust Law Fails to Protect Us Against Market Power When the Market Rules Encourage Its Use),* 83 OR. L. REV. 207 (2004).

[7] *See* Harry First, *Regulated Deregulation: The New York Experience in Electric Utility Deregulation,* 33 LOY. U. CHI. L. J. 911, 924 (2002)(discussing "regulated deregulation" as the replacement of cost of service regulation with state and federal regulation of "the mechanism put into place to manage competitive markets.")

[8] It follows that antitrust "savings clauses" should not be required. A savings clause, in contrast to establishing competition as the default rule, places the burden upon Congress to actively declare (and redeclare) that the antitrust laws apply. *See, e.g.,* Telecommunications Act of 1996, sec. 601(b)(1), (c)(1), § 152 note, 110 Stat. 56, 143 (1996)(" SAVINGS CLAUSE ... nothing in this Act or the amendments made by this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws. NO IMPLIED EFFECT ... This Act and the amendments made by this Act shall not be construed to modify, impair, or supersede Federal, State or local laws unless expressly so provided in such Act or amendments.").

> competitive forces. The irreconcilability criterion requires, at a minimum, that the statutes [antitrust and regulatory] produce differing results. This finding alone is not sufficient however. Rather, to find 'irreconcilability' there must be a determination that repeal of the antitrust laws is necessary to make the regulatory act work. This requires an appreciation of the nature of the various regulatory acts.[9]

Broad delegations of power to a regulatory agency may lead to instances where agency directives are in tension with antitrust law. As Judge Greene's opinion in an early phase of the Antitrust Division's suit against AT&T seeking dissolution of the company on the ground of unlawful monopolization points out, however, such instances are relatively narrow. In response to AT&T's motion to dismiss the suit claiming that Congress had committed regulation of the activity in question to the F.C.C. under the Communications Act of 1934, Judge Greene wrote:

> Regulated conduct is . . .deemed to be immune by implication from the antitrust laws in two relatively *narrow* instances: (1) when a regulatory agency has, with congressional approval, exercised explicit authority over the challenged practice itself (as distinguished from the general subject matter) in such a way that antitrust enforcement would interfere with regulation . . . and (2) when regulation by an agency over an industry or some of its components or practices is so pervasive that Congress is assumed to have determined competition to be an inadequate means of vindicating the public interest.[10]

Particularly in light of the current trend towards "regulated deregulation," it is increasingly unlikely that the roles of regulation and antitrust serve antithetical purposes. Rather, the creation and fostering of competition might indeed be best served by the complementary potential of regulation and antitrust.[11]

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[9] Robert Balter and Christian Day, Implied Antitrust Repeals: Principles for Analysis, 86 DICK. L. REV. 447 (1982). *See also* United States v. National Association of Security Dealers, 422 U.S. 694, 719 (1975)("Implied antitrust immunity is not favored, and can be justified only by a convincing showing of clear repugnancy between the antitrust laws and the regulatory system"); Gordon v. New York Stock Exchange, Inc., 422 U.S. 659 (1975).
[10] U.S. v. Amer. Tel. & Tel. Co., 461 F.Supp. 1314, 1322 (D.C.D.C. 1978)(emphasis supplied).
[11] Similar arguments might be made in favor of a limited state action doctrine and the filed rate doctrine. The original state action doctrine arose out of principles of federalism and a concern that the federal government not intrude upon state created and sanctioned regulation. Again, the most common type of industry regulation was rate and entry regulation. However, "regulated deregulation" has come onto the

However, the caselaw is going in the opposite direction.[12] Even where there is no direct regulatory oversight, courts have found implied immunity merely due to potential regulatory oversight. What remains is a gap between regulation and antitrust, where neither serve to provide essential oversight to an industry.

One reason for the gap is that express immunities tend to "creep." That is, they not only protect the world they were designed to protect, but their shield extends to conduct which the express immunity was not seeking to protect. In other words, the existence of an express immunity providing protection from the antitrust laws for some particular conduct may actually provide immunity for other types of antitrust conduct.[13]

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state scene in many instances. In such instances, it is unlikely that the clearly articulated state policy seeks to displace competition with regulation. Rather the purpose of the policy would be that regulation creates competition. The creation of competition cannot be said to be in contradiction with the purposes of antitrust. *See* Darren Bush, *Mission Creep, supra* note 2. For examples of state policies creating competition in the context of traditionally regulated industries, *see* United States v. City of Stillwell, Oklahoma, Case No. CIV 96-196 B, government filings available at http://www.usdoj.gov/atr/cases/stilwe0.htm (Oklahoma statute allowed municipal electric cooperatives to compete with one another for new customers); United States v. Rochester Gas & Elec. Corp., 4 F.Supp.2d 172 (W.D. N.Y. 1998)(New York statute allowing retail sales of electricity by cogeneration plants) .

Similarly, the *Keogh* doctrine or filed rate doctrine was originally designed to preclude the bypassing of statutory damages granted under the Interstate Commerce Act. The Interstate Commerce Act provided for single damages as a remedy. The plaintiffs in *Keogh* sought to use antitrust to bypass statutorily conferred remedies. This approach was rejected by the Court. The case was not about the justness or reasonableness of rates, as has been increasingly the case with application of the *Keogh* doctrine. Keogh v. Chicago & Northwestern Railway Co., 260 U.S. 156, 162-163 (1922).

As has increasingly been the case, *Keogh* has been applied in the context of "regulated deregulation." However, the market clearing prices typically found in such industries bear no relation to the types of rates originally addressed by the *Keogh* progeny, namely, traditional cost of service rates set via tariff after review by an administrative agency. In contrast, market rates are only reviewed (in rare instances) and even then they are reviewed *ex post*. Courts nonetheless continue to hold that the filed rate doctrine applies to market based rates. *See, e.g.,* Public Utility Dist. No. 1 of Grays Harbor County Wash. v. IDACORP Inc., 370 F.3d 641, 651 (9th Cir. 2004)("[W]hile market-based rates may not have historically been the type of rate envisioned by the filed rate doctrine, we conclude that they do not fall outside of the purview of the doctrine."); Public Utility District No. 1 v. Dynegy Power Marketing, Inc., 384 F.3d 756 (9th Cir. 2004); Town of Norwood v. New England Power Co., 202 F.3d 408 (1st Cir. 2000).

[12] Credit Suisse Securities (USA) LLC v. Billing, 127 S. Ct. 2383 (2007).

[13] See ABA, FEDERAL STATUTORY EXEMPTIONS FROM ANTITRUST LAW 17 (2007)(noting that courts have sometimes adopted "expansive interpretations as to the scope of an exemption")(hereafter ABA Monograph).

The doctrine of primary jurisdiction also may play a crucial role where there is any regulatory oversight at all even in the absence of express or implied immunity.[14] While primary jurisdiction is *not* a methodology by which to grant immunity or exemption, but rather a method by which courts might rely on an agency's expertise in order to resolve a dispute before them, the doctrine has been misused as a grant of immunity in the past.[15]

The doctrine of "primary jurisdiction" is not, as is sometimes thought, an implied immunity. "Primary jurisdiction" addresses the question of whether the antitrust court should *suspend* the resolution of some questions of fact or law over which it possesses antitrust jurisdiction, until passed upon by the regulatory authority whose jurisdiction encompasses the activity involved. Although infrequent, such initial deference can be the practice when (1) resolution of the case involves complex factual inquiries particularly within the province of the regulatory body's expertise; (2) interpretation of administrative rules is required; and (3) interpretation of the regulatory statute involves broad policy determination within the special ken of the regulatory agency. This deference to statutory interpretation extends even to questions of jurisdiction.[16]

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[14] For a discussion of historical misuse of the doctrine, *see* Louis B. Schwartz, *Legal Restriction of Competition in the Regulated Industries: An Abdication of Judicial Responsibility*, 67 HARV. L. REV. 436 (1954). *See also* Louis Jaffe, *Primary Jurisdiction Reconsidered*, 102 U. PA. L. REV. 577 (1954); JUDICIAL DOCTRINE OF PRIMARY JURISDICTION AS APPLIED IN ANTITRUST SUITS, STAFF REPORT TO THE ANTITRUST SUBCOMMITTEE OF THE HOUSE COMMITTEE ON THE JUDICIARY, 84TH CONG., 2D SESS. (1956).

[15] Schwartz, *supra* note 11 at 470-471 ("The lesson taught by [the expansion of primary jurisdiction doctrine from a procedural rule to a judicial exemption] is this: if a primary jurisdiction does not already exist, it may be advisable for an industry to create one as a means of avoiding the compulsion to compete which is embodied in the antitrust laws as administered by the federal courts.")

[16] *See Sourthern Railway Co. v. Combs*, 484 F.2d. 145 (6th Cir. 1973). *See also* Alpharma, Inc. v. Pennfield Oil Co., 411 F.3d 934, 938 (8th Cir. 2005)("The contours of primary jurisdiction are not fixed by a precise formula. Rather, the applicability of the doctrine in any given case depends on "whether the reasons for the existence of the doctrine are present and whether the purposes it serves will be aided by its application. . . .

The effect of judicial reference of a question to an administrative agency should be agency action on the question referred and then further court action in the antitrust case, although agency action might be dispositive. Unlike a finding of express or implied immunity, however, where primary jurisdiction doctrine is applied, the trial court's action is reviewed and that review is on antitrust standards. However, primary jurisdiction is a doctrine that is typically applied at the discretion of the court. Thus, statutory language that suggests that a court shall "not be required to defer to the primary jurisdiction of the Surface Transportation Board" does nothing to prevent a court from doing so.

On the other hand, in instances in which the doctrines of express or implied immunity are applied, the agency's action is reviewed on the standards set forth in the regulatory statute, and usually with the judicial deference to the agency's fact finding. As a practical matter, the initial determination of which doctrine applies in a particular case is of great significance in deciding what law applies, the degree to which antitrust considerations may or may not be accorded weight, and whether the antitrust remedies of criminal sanctions or treble damages are available in a particular case. An express or implied exemption finding precludes the application of antirust standards and remedies; while an application of the primary jurisdiction doctrine does not necessarily preclude use of antitrust standards and remedies to adjudicate the dispute but may only defer the adjudication pending an initial decision by the agency.

Among the reasons and purposes served are the promotion of consistency and uniformity within the areas of regulation and the use of agency expertise in cases raising issues of fact not within the conventional experience of judges or cases requiring the exercise of administrative discretion.")(internal quotations and citations omitted).

A court may find none of these doctrines apply in a case involving activity by a regulated industry—even where the agency has some jurisdiction over the activity in question. As Judge Greene pointed out in the AT&T case, in such cases antitrust policy and regulatory policy are seen as compatible and not antagonistic.

I raise these issues to point out that repeal of express antitrust immunity is insufficient to eliminate the potential for judicially created immunities through the doctrines of implied immunity, primary jurisdiction, or limitations of antitrust law's applicability through the filed rate doctrine or other such exemptions.[17] Careful consideration ought to be given to the potential exemptions and immunities that may exist even after repeal of express immunity. Such immunities and exemptions typically are a result of the statutory authority conferred upon the regulatory agency and the execution of that authority by the agency.

[17] See *supra* note 12.

The Railroad Antitrust Immunities

I now turn more specifically to the substance of today's hearing. To discuss the impact of repealing express antitrust immunity upon surface transportation policy, it is necessary to bifurcate my discussion into impacts of repealing the transactional immunity and repealing immunities related to rates.

The Effect of Repeal of Transaction Immunity

A little history is in order to more fully understand how the railroad industry got where it is today. Transactional immunity (immunity for mergers, acquisitions, and related agreements) arose during the 1920s due to increasing concern over the financial health of the railroads and government experience at managing the railroads during World War I.[18] Such experiences led Congress to believe that in order to enhance the financial returns of investors and to promote better service, it was necessary to promote consolidation within the industry with the help of the Interstate Commerce Commission (ICC), the predecessor to the Surface Transportation Board (STB). The ICC adopted a plan that balanced competition against other concerns that were sometimes inconsistent with competition policy.

Congress required that the ICC approve any agreement between railroads, including mergers and acquisitions. Law required that any merger application be in harmony with the policy of consolidating the industry. ICC approval of these transactions immunized the transactions from antitrust scrutiny.

[18] ABA Monograph, *supra* note 13 at 196. *See also* THEODORE E. KEELER, RAILROADS, FREIGHT, AND PUBLIC POLICY 25 (1983)

There appears to have been little or no Congressional debate about the antitrust immunity at the time of its passage. Courts have thus taken the position of simply accepting the language as it stands without inquiring as to its purpose.[19] The immunity itself has remained virtually unchanged, despite reforms in railroad legislation and the disbanding of the ICC.[20]

Current merger review by the STB, by statutory design and by regulatory obedience to that design, has favored consolidation. The STB is required to determine whether a transaction is in the public interest. While competitive considerations are central to the analysis, they are only one of five factors which the STB is statutorily required to consider.[21] The overall balancing of these factors means that a merger that is grossly anticompetitive should be permitted if the transaction on net yields greater benefits to the stakeholders in the merger (labor, the companies involved, etc.) than are lost by the public.

It is no surprise, therefore, that the STB has only rarely encountered a merger that it did not like.[22] While the STB has imposed conditions upon many mergers, those conditions are not consistently about competitive effects arising from the transaction.

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[19] *See, e.g.,* Denver & Rio Grande W. R.R. Co. v. United States, 387 U.S. 485 (1967); *In Re* REA Express Private Treble Damage Antitrust Litig., 412 F. Supp. 1239, 1261-63 (E.D. Pa. 1976).

[20] *See ICC Termination Act of 1995,* H.R. REP. NO. 104-311, at 83 (1995).

[21] *See* 49 U.S.C. § 11324.

[22] *See* Salvatore Massa, *Injecting Competition in the Railroad Industry Through Access,* 27 TRANSP. L.J. 1, 2 n. 5 (2000). Mr. Massa points out:

> Furthermore, federal policy has favored railroad mergers for quite some time. As Surface Transportation Board Commissioner Gus Owen has observed "[s]ince 1920 it has been the public policy, as enunciated by Congress, to reduce the number of competing railroad systems." See Central Power & Light Co. v. Southern Pac. Transp. Co., Fin. Docket No. 31242 at 19 (Surface Transp. Bd. Dec. 27, 1996) (Comm'r Owen commenting) [hereinafter CP&L], aff'd sub. nom., No. 97-1081, 1999 WL 60501 (8th Cir. Feb. 10, 1999). During the period 1956 to 1971, regulatory authorities approved ten of fourteen

It is not at all clear that the move toward consolidation has yielded stability in service and the higher investor returns sought by Congress in the 1920s. Some recent mergers have created service disruptions and spawned shipper complaints.[23] As a result, the STB created a 15 month moratorium on mergers and promulgated a detailed statement concerning its merger review policy that in part created a much higher hurdle for merging parties in demonstrating efficiencies from the transaction. In it, the STB requires that "substantial and demonstrable gains in important public benefit" outweigh any "anticompetitive effects, potential service disruptions, or other merger-related harms."[24] It is unclear what this new standard will yield, if anything, as it has yet to be tested by a major railroad consolidation. And while the STB has declared that it will "consider the policies embodied in the antitrust laws,"[25] it is not clear what weight such policies will be afforded in the overall public interest calculus.

However, mergers are not the only transactional issues that arise in the context of railroads. One major issue is that of "paper barriers."[26] In many sales of secondary trackage to smaller regional players who wished to interconnect with the seller's (a major

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> merger applications. . . . Since 1980, regulatory agencies have approved twelve of thirteen merger applications. See Salvatore Massa, *Are All Railroad Mergers in the Public Interest? An Analysis of the Union Pacific Merger with Southern Pacific*, 24 TRANSP. L.J. 413, 431 n.96 (1997) (listing ten of eleven); CSX Corp.-- Control--Conrail Inc., Fin. Docket No. 33388, 1998 WL 456510 (Surface Transp. Bd. July 23, 1998) (approving the eleventh merger); Rip Watson, *Deal Creates First Large Cross-Border Rail System*, J. COM., Mar. 26, 1999, at A1 (announcing approval of twelfth merger).

Id.

[23] *See* Massa, *supra* note 22 at 12 (detailing service issues arising from the Union Pacific-Southern Pacific merger and the Union Pacific-Chicago & Northwestern Railway merger); Daniel Machalaba, *CSX, Norfolk Southern Find Breaking Up is Hard to Do*, WALL ST. J., June 28, 1999 at B4 (discussing issues with CSX and Norfolk Southern's acquisition and division of Conrail).

[24] 49 C.F.R. § 1180.1(c).

[25] 49 C.F.R. § 1180.1(c)(2).

[26] My former colleague and coauthor Salvatore Massa has excellently described the paper barriers issue. See Salvatore Massa, *A Tale of Two Monopolies: Why Removing Paper Barriers Is A Good Idea*, TRANSP. J. Winter/Spring 2001, at 47.

trunk line operator) main lines, the seller, in exchange for interconnection, often demanded that the regional player only interchange its traffic from the divested line to the seller, foreclosing any opportunity for the buyer to interchange with other operators. These "paper barrier" restrains were often permanent.

The ICC historically approved such restraints, finding that they had no anticompetitive effect. And, despite complaints from smaller railroad firms, shippers, and labor organizations, the STB has not changed course with respect to these restraints.[27]

Finally, I should point out that both the ICC and STB could authorize railroad interlocking directorates. Nothing has changed in this realm since the 1920s. The STB's rules establish a procedure for applying for such interlocking directorates, although smaller carriers are exempt from the application process.

To summarize: Under the STB, the railroad industry has been largely consolidated. Only four major domestic carriers existed after 2000, while two Canadian carriers operate subsidiaries in the U.S. that interconnect to their Canadian lines. In this realm of extreme consolidation, it can hardly be said that the railroads' financial stability has improved. It is unclear whether the mergers and the antitrust immunity have indeed improved the health of the merging parties. And the STB has continued to bless what are traditionally anticompetitive agreements without any clear justification for their existence.

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[27] ABA Monograph, *supra* note 13 at 208.

Given this history, I wonder what would be lost if the antitrust laws would be able to come into play in the context of transactions. There appear three identifiable areas in which antitrust law might conflict with railroad regulation by the STB.

First, Section 7 of the Clayton Act does not have a statute of limitations. Thus, any repeal of antitrust immunity should be on a prospective basis only. Otherwise, private plaintiffs may sue to undo mergers long since passed. In most instances, operations have already been consolidated, and unscrambling the eggs would be next to impossible. In this instance alone does it make sense to defer to the prior findings of the STB and only make merger review prospective.[28]

Second, the STB's position on paper barriers runs in contrast to the antitrust laws. There appears to be no justification for these restraints. Under antitrust law rule of reason analysis, permanent barriers associated with the sale of a business which are without a specific and reasonably short duration run afoul of Section 1 of the Sherman Act, and may be subject to Section 2 scrutiny as well. The position of the Sherman Act case law is reasonable here, as no company should have a permanent interest in assets it has sold.[29]

Third, there is no justification for interlocking directorates which run afoul of the antitrust laws yet are approved by the STB. Coordination to the extent necessary to ensure reliability may take place in the railroad industry as it does in other industries, namely through arms length agreements. There is no demonstration that railroads are

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[28] ABA Monograph, *supra* note 13 at 215.
[29] Id. at 216.

uniquely in need of interlocking directorates when compared to other industries such as electricity or natural gas.[30]

To my knowledge, the repeal of the antitrust immunity raises no other transactional concerns.

The Effect of Repeal of Immunity Related to Rates

While deregulation has expanded the application of the antitrust laws in the context of the railroads, there is much room for debate as to the effect of deregulation on the willingness of courts to impose antitrust remedies. For example, the STB continues to have authority over the setting of maximum rates, which could preempt a shipper's monopolization claim for treble damages and force the shipper to seek remedies exclusively before the STB.[31]

In contrast, much has already been opened to antitrust scrutiny. In 1995 Congress repealed the provisions that gave the ICC authority to review and remedy predatory rates, effectively opening such rates to antitrust attack.[32] Congress also deregulated traffic moving between shippers and rail carriers under private contract.[33] The ICC and STB have also moved to exempt many rates or other activities from regulation under the Staggers Rail Act of 1980.[34] The effect of an order from the STB stating that certain conduct is no longer subject to regulation is to open that conduct to antitrust attack.

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[30] Id.
[31] ABA Monograph, *supra* note 13 at 198. *See also supra* note 12 discussing the filed rate doctrine.
[32] *See* 49 U.S.C. § 10701(c); H.R. REP. NO. 104-311, at 82-83 (1995).
[33] *See* 49 U.S.C. §§10709 (c), (g).
[34] *See* Staggers Rail Act § 213, 94 Stat. at 1912-13 (codified at 49 U.S.C. § 10502).

However, because the STB has the option of re-regulating the conduct, courts have appeared reluctant to allow plaintiffs to challenge exempted conduct.[35]

Moreover, while regulators still may immunize rate bureaus from antitrust scrutiny, statutory provisions have curtailed much of the rate bureaus' activities.[36] Other provisions have foisted upon these bureaus other impediments, including substantial reporting requirements. Still, the Department of Justice is on record as being opposed to any antitrust immunity in this realm.[37]

Thus, while regulation has drastically eliminated what is subject to antitrust immunity, several issues arise. If it is the case that much of railroad policy has moved away from regulation to market forces, then it is imperative that antitrust fill the gap left by regulators. Otherwise, we are left with the worst of all possible worlds—a business subject to neither competition policy nor regulation. As one of my coauthors on the ABA Monograph so firmly put it:

> [R]egulatory policies regarding exemptions from regulation are fundamentally troublesome. They allow regulators to effectively walk away from reviewing the competitive effect of certain conduct, but leave uncertainty as to whether the exempted activity remains shield from the reach of antitrust law. If anything, activities exempted from regulation should become subject to antitrust scrutiny even if it is potentially subject to re-regulation by the agency. Finally in this late stage of deregulation, perhaps Congress should no longer delegate authority to the STB to decide what should and should not be regulated in the first place.[38]

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[35] *See, e.g.,* G. & T. Terminal Packaging Co. v. Consolidated Rail Corp., 830 F. 2d 1230 (3d Cir. 1987).
[36] ABA Monograph, *supra* note 13 at 202.
[37] See H.R. Rep. No. 96-145 at 431 (1979)(statement of Donald L. Flexner, Deputy Assistant Attorney General)("[A]ntitrust immunity is not needed for those rate bureau activities that might benefit the public interest.")
[38] ABA Monograph, *supra* note 13 at 210.

The Effect of Repeal on National Railroad Policy

It could be argued that the imposition of antitrust laws upon the railroad industry would create serious issues with respect to regulatory policy. For example, the potential for a private plaintiff challenge in federal court could expose the defendant to the full panoply of powers possessed by the court under Section 4 of the Sherman Act.[39] The potential for such relief might have ripple effects throughout the national railroad system. In addition to these private civil suit concerns, concern might be expressed about the potential for concurrent jurisdiction in the realm of merger review. I shall address the latter issue first.

As a threshold matter, I am on record that those proposing an immunity should have the burden to demonstrate its need.[40] In the context of today's discussion, I find no reason to conclude that there is something so special in railroad regulation that should isolate it from other industries that exhibit similar issues, including potential natural monopoly conditions in some component of the industry, high coordination needs for purposes of providing service and protecting public safety, and where exists some

[39] 15 U.S.C. § 4 states in part, "The several district courts of the United States are invested with jurisdiction to prevent and restrain violations of sections 1 to 7 of this title; and it shall be the duty of the several United States attorneys, in their respective districts, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain such violations."

[40] *See* Darren Bush, Gregory K. Leonard and Stephen Ross, A FRAMEWORK FOR POLICYMAKERS TO ANALYZE PROPOSED AND EXISTING ANTITRUST IMMUNITIES AND EXEMPTIONS: REPORT PREPARED BY CONSULTANTS TO THE ANTITRUST MODERNIZATION COMMISSION, *available* at http://www.amc.gov/commission_hearings/pdf/IE_Framework_Overview_Report.pdf. *See also* Darren Bush, *Supplemental Written Testimony submitted to the Antitrust Modernization Commission*, *available* at http://www.amc.gov/commission_hearings/pdf/Bush_Supplemental_Statement.pdf.

modicum of competition. Absent such a showing, there appears little argument against concurrent jurisdiction.

Indeed, the STB argues that the Department of Justice and the STB have only been in disagreement on one particular case in the past. One wonders, then, why the STB would not think that past is prologue.

A more serious argument in favor of concurrent jurisdiction is that because the world of railroads is one of extreme levels of market concentration, the anticompetitive stakes are high. Any future merger could potentially yield strong and persistent anticompetitive effects. The consideration of these effects might be lost in the STB's calculus of total benefits to consumers, the railroads, labor, or other stakeholders to the transaction. The antitrust laws, in contrast, do not necessarily consider transfers from consumers to stakeholders to be a good thing. Moreover, the antitrust agencies more readily consider the full spectrum of competitive harms.

I find it similarly disingenuous to argue that courts will likely cause disruption of national railroad policy in the wake of an antitrust suit brought by a private plaintiff or by a state attorney general as *parens patriae*.[41] Many agencies live with the potential of court action against a company subject to the agency's regulation. As before, unless there is something unique about railroads, there is little justification for granting immunity here while embracing competition policy elsewhere. In most instances, historically such choices between immunity and antitrust law application were not made

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[41] *See* 15 U.S.C. § 15c.

due to industry idiosyncrasies, but rather due to industry lobbying and political pressure.[42]

Finally, where regulatory action is in place, there are a plethora of potential antitrust exemptions at the defendant's disposal. As mentioned previously, the doctrines of implied immunity and primary jurisdiction might still come into play. And plaintiffs challenging any rates subject to STB authority would likely find that the filed rate doctrine is alive, well, and growing.[43]

For these reasons, there appears to be little justification for the notion that courts handling antitrust litigation will somehow turn national railroad regulatory policy on its head.

Conclusion

The realm of railroad regulation does not generally appear to be at loggerheads with the realm of antitrust laws. Because the STB's role in the railroad industry has waned due to efforts to deregulate the industry, antitrust should step in to fill the void.

The difficulty is that the role the STB plays in the realm of railroads may send mixed signals to courts faced with railroad antitrust cases. Repeal of the express immunity addresses only part of the problem. Issues arise as to the scope of the repeal in

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[42] *See generally* ABA Monograph, *supra* note 13. Moreover, courts should be credited for innovative actions that have brought revolutionary changes to regulated industries. As an example, the compulsion of wheeling in *U.S. v. Otter Tail* gave rise to a whole regulatory wave of open access, particularly in but not limited to the electricity industry. See Otter Tail Power Co. v. United States, 410 U.S. 366 (1973). Judge Greene's breakup of AT&T yielded remarkable changes in the telecomm industry as well. United States v. American Tel. & Tel. Co., 552 F. Supp. 131 (D.D.C. 1982), *aff'd mem. sub nom.* Maryland v. United States, 460 U.S. 1001 (1983).
[43] *See supra* note 12.

a realm where the STB retains some regulatory jurisdiction. And, in a world with expanding judicially created antitrust exemptions, it is worthwhile for us to consider what a potential antitrust plaintiff, who the proposed legislation would purportedly seek to encourage in order to help foster and police competition policy, might gain in a post-express immunity world.

Rather than the dire predictions that the STB might have about such a world, I suggest that the bill might not change much if the courts continue on their current path of embracing broad and bold interpretations of judicially created exemptions such as implied immunity and the filed rate doctrine. On the other hand, I would welcome a full and true repeal of the antitrust immunity here, if carefully done. It is imperative that the gap created via deregulation of the railroads be filled. Where regulation gives way to markets, regulation must also give way to antitrust and competition policy. And where the old policies of regulation such as fostering of consolidation through merger are at odds with more recent policies seeking to foster competition via deregulation, it is the old policies that should yield. Otherwise, we are truly left with the worst of all possible worlds.

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Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

September 27, 2004

The Honorable F. James Sensenbrenner, Jr.
Chairman
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Sensenbrenner:

This responds to your letter of July 15, 2004, to the Department of Justice regarding the application of the antitrust laws in the railroad industry. You note that the various statutory antitrust exemptions for railroad industry activities were enacted many decades ago, and you question whether continuing this antitrust immunity serves the public interest. The Department appreciates having the benefit of your perspective on this important issue of competition policy.

The antitrust laws are the chief legal protector of the free-market principles on which the American economy is based. Experience has shown that competition among businesses, each attempting to be successful in selling its products and services, leads to better-quality products and services, lower prices, and higher levels of innovation. The antitrust laws ensure that businesses will not stifle this competition to the detriment of consumers. Accordingly, the Department has historically opposed efforts to create sector-specific exemptions to the antitrust laws. The Department believes such exemptions can be justified only in rare instances, when the fundamental free-market values underlying the antitrust laws are compellingly outweighed by a clearly paramount and clearly incompatible public policy objective.

In the first decades of the past century, for example, Congress enacted antitrust exemptions in industries in which it believed normal free-market competition to be unworkable. These industries included the railroad, airline, trucking, and telephone industries. In lieu of competition protected by the antitrust laws, Congress established comprehensive regulatory regimes that regulated prices, service offerings, and market entry as well as other aspects of these industries. These regulatory regimes often included statutory antitrust exemptions for conduct approved by the regulatory agency. And if the regulatory regime was sufficiently pervasive, the courts could hold that it had implicitly displaced private damages recovery under the antitrust laws. *See* Keogh v. Chicago Northwestern Railway, 260 U.S. 156 (1922); Square D Co. v. Niagara Frontier Tariff Bureau, 476 U.S. 409 (1986).

In the last decades of the past century, policymakers began to reconsider whether competition was truly unworkable in these industries, and efforts were undertaken to replace market regulation with competition where possible. As these industries became deregulated, antitrust exemptions no longer made sense. In the case of airlines, for example, the antitrust exemption for mergers approved by the Civil Aeronautics Board was repealed and, after a transition period, merger enforcement in the airline industry reverted to the Department of Justice under the antitrust laws.

In 1995, when Congress abolished the Interstate Commerce Commission and created the Surface Transportation Board to retain some of the ICC's old regulatory authority, the Department urged Congress to turn over review of railroad mergers to the antitrust enforcement agencies, as it had done with airlines. *See* Statement of Steven C. Sunshine, Deputy Assistant Attorney General, Antitrust Division, Before the House Transportation Subcommittee on Railroads, January 26, 1995 (attached). Congress opted instead to leave that responsibility with the Surface Transportation Board, with an accompanying antitrust exemption, with the Justice Department limited to an advisory role before the Surface Transportation Board. *See* 49 U.S.C. § 11321(a).

Your letter also describes three specific practices in the railroad industry about which concerns have been raised about possible anticompetitive effects.

The first practice is the refusal by a railroad that controls one segment of a freight movement to quote rates separately for that "bottleneck" segment, instead quoting rates only for the entire freight movement. You note that this practice denies shippers the benefits of competition on segments of the move where an alternative carrier might compete for the business. Because of the Surface Transportation Board's involvement in approving these rates, and its acceptance of this practice, relief may not be available under the antitrust laws. If this practice were subject to the antitrust laws, it could be evaluated as a refusal to deal in possible violation of section 2 of the Sherman Act, or as a tying arrangement in possible violation of section 1 of the Sherman Act. Whether it would constitute an antitrust violation would depend on the particular facts.

The second industry practice you describe is "paper barriers." Paper barriers are created when Class I railroads spin off segments of their trackage to short-line or low-density carriers with contractual terms that prohibit the acquiring carriers from competing with the Class I railroads for business. Since these contractual terms are part of an underlying sale transaction that is reviewed and approved by the Surface Transportation Board, they may be exempted from the reach of the antitrust laws, depending on the scope of the approval language in each of the Board's relevant orders. If paper barriers were subject to the antitrust laws, they would be evaluated under section 1 of the Sherman Act. The Department would examine whether the restraint is ancillary to the sale of the trackage – i.e., whether the restraint is reasonably necessary to achieve the pro-competitive benefits of the sale.

The Honorable F. James Sensenbrenner, Jr.
Page 3

The third industry practice you describe is the practice by both of the major western Class I railroads of publicly disclosing tentative prospective shipping rate offerings. Under the antitrust laws, the public disclosure of pricing information among competitors can, under some circumstances, facilitate collusion and result in increased prices, in violation of section 1 of the Sherman Act. *See, e.g.*, United States v. Airline Tariff Publishing Co., 1994 Trade Cas. (CCH) ¶ 70,687 (D.D.C. 1994). Publicly announcing prospective rates outside the confines of a rate approval proceeding at the Surface Transportation Board is likely to be subject to review under the antitrust laws. If you know of anyone who has information that you believe might be useful for evaluating this practice under the antitrust laws, please encourage them to contact the Antitrust Division.

Thank you for bringing your interest in these issues to our attention, and for soliciting our views as you consider these issues. If we can be of further assistance, please do not hesitate to contact us.

Sincerely,

William E. Moschella

William E. Moschella
Assistant Attorney General

Enclosure

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

THE CHAIRMAN

October 3, 2007

The Honorable Herb Kohl
Chairman
Subcommittee on Antitrust, Competition Policy,
and Consumer Rights
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of September 26, 2007, requesting the views of the Antitrust Division and the Federal Trade Commission on S. 772, the Railroad Antitrust Enforcement Act of 2007, which you introduced with nine co-sponsors. The Commission is responding to your request as an official request of the Subcommittee, *see* 16 C.F.R. § 4.11(b).

The bill would repeal the antitrust exemption for common carrier railroads -- and for parties to and participants in certain agreements and transactions involving common carrier railroads – found in the Clayton Act and the Transportation Act, and also would repeal the exemption of these entities, agreements, and transactions from Federal Trade Commission jurisdiction under the FTC Act and the Clayton Act.

As you point out, the Antitrust Modernization Commission reiterated what most scholars have believed for years, that exemptions from the antitrust law should be disfavored. That finding was anticipated in my testimony before the Antitrust Modernization Commission:

> Fundamentally, antitrust exemptions typically are inconsistent with a central premise of U.S. economic policy – that vigorous competition in a free market, protected by the sound application of the antitrust laws, is the best approach to promote consumer welfare and efficiency. . . . If there is one thing that modern antitrust thinking recognizes, it is that markets are not static. Yet, many exemptions are several decades old and likely were based on market or regulatory justifications that probably are no longer valid. Innovations in communications and transportation and other technologies have improved capital markets and

increased the ability of consumers and business customers to evaluate competitive alternatives without the assistance of government regulation.[1]

In general, it has been the Commission's long-standing view that antitrust exemptions should be disfavored and that proponents of continuing an exemption should bear a heavy burden of demonstrating, with factually-supported reasons, the need for a departure from the nation's competitive model. The FTC thus concurs with the Antitrust Modernization Commission's finding that an exemption should not be continued without a compelling, factually-supported demonstration of its need.

Under its longstanding agreement with the Antitrust Division, the Commission and the Antitrust Division coordinate their actions to avoid duplication and maximize the effectiveness of federal antitrust enforcement. As a result, the Commission does not have specific recent experience with the railroad industry. Because the Antitrust Division does have experience with the industry, the Commission will defer to the Antitrust Division as to the specific merits of the proposal to remove the railroad antitrust exemptions. Nonetheless, the Commission does support the principle of eliminating exemptions to the antitrust laws.

This letter does not contain material exempt from disclosure under the Freedom of Information Act, 5 U.S.C. § 552, and the Commission accordingly does not request confidential treatment for the letter.

By direction of the Commission.

Deborah P. Majoras

Deborah Platt Majoras
Chairman

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[1] Statement of Deborah Platt Majoras, Chairman, Federal Trade Commission, Before the Antitrust Modernization Commission (March 21, 2006), at 6-7.

Statement of Senator Russell D. Feingold
"An Examination of S. 772, the Railroad Antitrust Enforcement Act"
Subcommittee on Antitrust, Competition Policy and Consumer Rights
October 3, 2007

Mr. Chairman, first, I would like to thank you for calling a hearing on rail competition and antitrust exemptions. As you well know, this is a vitally important issue for rail customers and ultimately consumers both in Wisconsin and across the country. I am proud to have been a cosponsor of the Chairman's legislation addressing this issue for the past two Congresses. Let me also thank our distinguished panel. I look forward to hearing more about their perspectives on the state of competition in the rail industry and this legislation.

For several years now, the din of comments and concerns from freight rail customers have been steadily increasing at my town hall meetings in Wisconsin and my meetings in Washington. The concerns have come from constituents who rely on freight railroads to transport their goods or receive raw materials. The comments I have heard have been diverse by industry, ranging from forestry, energy, farming, and petrochemical companies to various manufacturers, and by size, from family owned enterprises to large corporations. The problems they have described do not seem to be isolated incidents, but instead suggest a systematic continuing problem.

There are several general concerns that seem to apply no matter which class of railroad is discussed. While outright refusals of transport may be rare, several of my constituents have found it difficult to get timely estimates of costs for carriage for their cargo. This seems to especially be a problem for short distances, small loads, or if the cargo is only on the originating railroads' tracks for a short distance. Many have said that they feel like second-class citizens, denied the better service and dedicated trains that the long-haul receive.

I have also heard about problems with changes to transportation schedules, and problems with rail car delivery and ancillary services such as scales. Many rail customers seem to feel that as railroads continued to merge over the past two decades, service, especially for small customers, has declined dramatically. Again, this seems to especially affect small railroad customers who are especially dependant on rail transport, but face difficulty in receiving cars to fill, moving filled cars in a timely manner or weighing their loads.

Of course cost is also an issue, but it is not just the cost of transportation. Some rail customers feel that the Surface Transportation Board (STB) complaint process is too costly, slow and tilted in favor of the railroads over the customers. They contend that these hurdles to exposing anti-competitive practices have the effect of perpetuating the unfair treatment and excessive rates.

In addition to supporting the senior Senator from Wisconsin's legislation, I shared these concerns with the Surface Transportation Board in late 2005 and again in 2006. While I was glad to learn that some outreach had been conducted to Wisconsin rail shippers, the concern about the decline in service and increased rates have continued. I look forward to hearing more from the Surface Transportation Board Chairman, Mr. Nottingham, about these issues and some changes being contemplated at the STB. Even if we enact the antitrust changes in the legislation we are considering today, ensuring that rail customers, small and large, receive fair treatment and a reasonable rate may take additional steps at the STB. I will closely follow the reforms currently being contemplated, but believe this issue might ultimately need Congressional involvement as well through changes such as those proposed by Senator Rockefeller and others in the Railroad Competition and Service Improvement Act of 2007 (S. 953).

But let me turn to the legislation being considered. Chairman Kohl's proposal would remove the current railroad antitrust exemptions so that railroads would be covered like other segments of industry. The Department of Justice and the Federal Trade Commission would then have the authority to review mergers and block anti-competitive mergers. The legislation would also expand the ability of State Attorney Generals and private parties to halt anti-competitive behavior and seek up to treble damages for any such violations.

I understand that the railroads have some concerns about these changes and look forward to hearing in more detail about them. But I believe this is a very reasonable and measured proposal. It seems that the class I railroads should have nothing to fear from it unless they are conducting anti-competitive practices in their operations. As for the charge of redundancy with the current STB oversight, I am not sure that this is completely the case, but even if it is, considering the importance of ensuring fair competition on the rails to our nation, maybe a belt-and-suspenders approach is a good idea. Thank you, Mr. Chairman.

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Statement

United States Senate Committee on the Judiciary

An Examination of S. 772, the Railroad Antitrust Enforcement Act

October 3, 2007

The Honorable Herbert Kohl
United States Senator , Wisconsin

Good morning. Today we meet to consider a vital piece of legislation to halt anti-competitive practices harming businesses and consumers that depend on freight railroads across the country. Our legislation -- S. 772, The Railroad Antitrust Enforcement Act -- is a bipartisan bill which passed the Judiciary Committee without dissent two weeks ago. Nonetheless, we are holding this hearing today at the request of some members of the Committee who want to further explore this important issue.

Our legislation will eliminate obsolete antitrust exemptions that protect freight railroads from competition and result in higher prices to millions of consumers every day. The railroad industry – unlike every other form of freight transportation – including trucking and aviation -- enjoys immunity from most aspects of antitrust law. No good reason exists for this antitrust exemption. The best argument that the defenders of the current antitrust exemption can make is that it is unfair to subject the railroads to antitrust law because they are subject to regulation. This argument is entirely without merit.

First, dozens of other industries in our economy are regulated yet remain subject to antitrust law. Most importantly, all the other parts of the transportation industry are subject to extensive regulation – including aviation, under the supervision of the Department of Transportation, and trucking, under the supervision of the Surface Transportation Board. Yet they are subject to antitrust law in almost all respects. Other examples abound, ranging from telecom to energy. No other regulated industry possesses the total immunity from Justice Department merger review enjoyed by the railroad industry. And yet the need for antitrust enforcement is greatest in the case of railroads. Unlike the dozens of airline and trucking competitors that shippers may choose from, in many areas of the nation only one freight railroad serves businesses that rely on railroad shipping. Defenders of the railroad antitrust exemption therefore bear a very heavy burden to explain why their industry should be treated any differently from other regulated industries.

Second -- as railroad advocates themselves often point out -- the railroad industry has in fact been substantially deregulated by legislation in recent decades. Most importantly, most railroad rate setting has been removed from the oversight of the Surface Transportation Board. Despite this deregulation, the obsolete antitrust exemptions remained in place, insulating a consolidating industry from obeying the rules of fair competition.

The effects of this unwarranted antitrust exemption are plain to see. Consolidation in the railroad industry in recent years has resulted in only four Class I railroads providing over 90 percent of the nation's freight rail transportation. Less than three decades ago, in 1979, there were 42. The lack of competition in the railroad industry was documented in an October 2006 GAO report. That report found that, shippers in many geographic areas [QUOTE] "may be paying excessive rates due to a lack of competition in these markets." These unjustified cost increases cause harm throughout the economy. Consumers suffer higher electricity bills because a utility must pay for the high cost of transporting coal; manufacturers who rely on railroads to transport raw materials charge a higher price for their goods; and American farmers who ship their products by rail pass on these cost increases in the form of higher food prices.

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The ill-effects of this consolidation are exemplified in the case of "captive shippers" – industries served by only one railroad. Two of these captive shippers are testifying at our hearing today. Over the past several years, these captive shippers have faced spiking rail rates -- price increases which they are forced to pass along into the price of their products, and ultimately, to consumers. In August 2006, the Attorneys General of 17 states and the District of Columbia sent a letter to Congress citing problems due to a lack of competition and urged that the antitrust exemptions be removed. The letter stated that [QUOTE] "rail customers in our states in a variety of industries are suffering from the classic symptoms of unrestrained monopoly power: unreasonably high and arbitrary rates and poor service."

In Wisconsin and around the nation, victims of a lack of railroad competition abound. About 40 affected organizations in my state alone have told us that they are feeling the crunch of years of railroad consolidation and anti-competitive railroad practices. The reliability, efficiency, and affordability of freight rail have all declined, and consumers are feeling the pinch. For example, to help offset a 93 percent increase in shipping rates in 2006, Dairyland Power Cooperative had to raise electricity rates by 20 percent. Similar stories exist across the country. Dozens of organizations, unions and trade groups – including the American Public Power Association, the American Chemistry Council, American Corn Growers Associations and AFL-CIO and many more affected by monopolistic railroad conduct have endorsed S. 772.

Adoption of S. 772 will be an excellent first step to bring needed competition to the railroad industry. By clearing out this thicket of outmoded antitrust exemptions, railroads will be subject to the same laws as virtually every other industry in the rest of the economy. Government antitrust enforcers will finally have the tools to prevent anti-competitive transactions and practices by railroads. Likewise, private parties will be able to utilize the antitrust laws to deter anti-competitive conduct and to seek redress for their injuries.

On the Antitrust Subcommittee, we have seen that in industry after industry, vigorous application of our nation's antitrust laws is the best way to keep prices low and quality of service high. The railroad industry is no different. All those who rely on railroads to ship their products – whether it is an electric utility for its coal, a farmer to ship grain, or a factory to acquire its raw materials or ship out its finished product – deserve the full application of the antitrust laws to end the anti-competitive abuses all too prevalent in this industry today.

STATEMENT OF G. PAUL MOATES

ON BEHALF OF

THE ASSOCIATION OF AMERICAN RAILROADS

BEFORE THE U.S. SENATE

COMMITTEE ON THE JUDICIARY

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

HEARING ON AN EXAMINATION OF S. 772, THE RAILROAD ANTITRUST ENFORCEMENT ACT

OCTOBER 3, 2007

Association of American Railroads
50 F Street NW
Washington, DC 20001
202-639-2100

The Association of American Railroads submits this testimony to express its opposition to S. 772, the "Railroad Antitrust Enforcement Act of 2007."

In short, this legislation is a solution looking for a problem. It is premised on the incorrect assumption that a gap exists between the scope of economic regulation and the antitrust laws where rail competition and market conduct are subject to neither antitrust scrutiny nor government oversight. In fact, there is no such gap. All aspects of railroad conduct that are exempt from the antitrust laws are subject to the regulatory jurisdiction of the Surface Transportation Board (STB). Rather than filling any void in the law, this legislation would only provide a dual remedy to shippers and interfere with STB's implementation of national transportation policy.

S.772 would effect a number of changes to current law. It would remove the prohibition against private injunctions against railroad common carriers subject to the STB's jurisdiction, while retaining the prohibition with respect to other common carriers (amending 15 U.S.C. §26). It subjects certain STB-approved railroad transactions to section 7 of the Clayton Act relating to corporate acquisitions, while leaving intact an exemption from the reach of section 7 for several other industries (amending 15 U.S.C. §18). In certain types of antitrust actions against railroads, it curtails the judicial doctrine of primary jurisdiction, under which courts typically defer to the expertise of the regulatory agency, in this case the STB, questions within the agency's expertise. While retaining STB's jurisdiction over rail mergers, consolidations, acquisitions and rate agreements, it eliminates the STB's existing authority to enforce certain provisions of the antitrust laws with respect to STB-approved agreements in those areas, conferring that authority on the Federal Trade Commission (FTC) (or DOJ) (amending 15 U.S.C. §21(a)). It confers the FTC with authority over railroads, but not other types of common carriers (amending 15 U.S.C. §45(a)(2)). It eliminates the filed rate doctrine with respect to railroads only. It eliminates the current exemption from the antitrust laws that applies to certain STB-approved agreements under 49 U.S.C. §10706 and STB-approved transactions under 49 U.S.C. §11321. Finally, by virtue of its effective date provision, the bill would subject to antitrust scrutiny railroad agreements approved by the STB (or its predecessor, the Interstate Commerce Commission (ICC)) before the bill was enacted that remain in effect more than 180 days afterwards.

In sum, while leaving intact the STB's regulatory regime, S. 772 eliminates antitrust exemptions and carve-outs that apply to railroads, but retains those same exemptions to the extent they apply to other parties.

Long-standing statutory schemes should be altered only if there is an identified problem calling for remedial legislation, and only if the proposed legislation would be effective in remedying the perceived problem. Neither condition exists with respect to S.772. To the contrary, the legislation is built on several faulty premises. Railroads generally are subject to the antitrust laws and do not enjoy broad antitrust immunities; the existing immunities are limited and apply to conduct over which there remains close regulatory oversight. Moreover, while the bill's proponents argue otherwise, S.772 is unlikely to provide avenues of relief to shippers that are foreclosed today. Finally, S.772 does not simply "level the playing field" — it is built on top of, not as a replacement to, regulation by the STB. In short, the case for S.772 does not hold up under examination.

1. Background

Certainly, the antitrust immunities that apply to railroads were not created in a vacuum. In the years since passage of the Sherman Act, Congress has enacted a host of antitrust exemptions applying to a wide array of industries and conduct, typically in order to promote a public policy that might not be realized under full exposure to the antitrust laws. The exemptions that apply to railroads came about as a complement to the comprehensive regulatory regime that governs the railroad industry. And, as that regime has evolved over time, so too has the role of the antitrust laws in the railroad industry.

In 1887, before the first antitrust laws were enacted, Congress undertook comprehensively to regulate the economic, operational, and safety aspects of the railroad industry. This policy first was effected with enactment of the Interstate Commerce Act of 1887, c.104, 24 Stat. 379 (1887), under which the ICC, an independent federal agency, was given broad authority to regulate practically every aspect of railroad operations. The railroads were the first U.S. industry subject to such a comprehensive scheme of regulation. This regulatory scheme developed against the backdrop of a common law common carrier obligation, which required a common carrier to carry for all persons who applied, at reasonable charges. *See I.C.C. v. Baltimore & Ohio R.R.*, 145 U.S. 263 (1892). Today, that common carrier obligation is carried forward in the statutory requirement in the Interstate Commerce Act, as it has been amended, that railroads provide transportation or service on reasonable request. 49 U.S.C. §11101(a).

With the passage of the Interstate Commerce Act, the railroads became the first U.S. industry subject to regulatory oversight by an administrative agency. Over time, rigid and arcane regulation came to control nearly every aspect of railroad operations. By the 1970s, the cumulative effect of decades of stifling government control, combined with strong competition from other modes and changing shipping patterns, crippled the rail industry. Freight rates and accident levels were rising, rail infrastructure was deteriorating, much of the nation's rail mileage was in bankruptcy, and the industry's rate of return on investment averaged only 2.0 percent.

Because the status quo was untenable, Congress passed the Staggers Rail Act of 1980. Pub. L. 96-448, 94 Stat. 1895. In the Staggers Act, Congress recognized that railroads faced intense competition for most freight traffic, but prevailing regulation prevented railroads from earning adequate revenues and competing effectively. Accordingly, the Staggers Act allowed the railroads to establish their own routes, tailor rates and services to market conditions, and differentiate rates on the basis of demand. And, of course, rate regulation remains where effective competition is found to be absent.

The Staggers Act has been a tremendous success. Average inflation-adjusted rail rates have declined 55 percent since 1980. Rail safety has been improved as a direct result of more than $400 billion being invested in infrastructure and equipment since 1980. And rail industry financial performance has also been improved, although it continues to lag behind Fortune 500 average return on equity.

The Staggers Act did not completely deregulate railroads. In addition to retaining authority over a variety of non-rate areas, the ICC (now the STB) retained the authority to set maximum rates or take other actions if a railroad was found to have market dominance or to have engaged in anti-competitive behavior.[1] The Staggers Act established a safety net, which still exists, to address the needs of rail customers for whose traffic there is no effective competition. In situations in which railroads have market dominance — *i.e.*, situations in which there is an absence of effective competition from other rail carriers or modes of transportation for the traffic at issue — railroads must establish rates that are reasonable. The

[1] The ICC Termination Act of 1995 eliminated certain regulatory provisions, abolished the ICC, and created, in its stead, the STB to maintain continued regulatory oversight of railroad rates and operations.

STB will award reparations and prescribe appropriate rates if a railroad's rates are determined to be unreasonably high.

The end result is that today, railroads are subject to the antitrust laws as well as extensive economic regulation by the STB. The STB has jurisdiction over rail service, market entry, and a wide range of rate-related conduct, including the level and structure of rates where there is no effective competition.

2. Railroads Are Subject to Both the Antitrust Laws and Regulatory Oversight: The Antitrust Exemptions That Still Apply Are Limited in Scope

There is a perception that railroads enjoy broad exemptions from the antitrust laws and that those exemptions result in an anticompetitive market that harms consumers. In fact, railroads are subject to federal antitrust laws. The antitrust laws prohibit anticompetitive agreements to set rates, allocate markets, or otherwise unreasonably restrain trade in the railroad industry. None of the extant antitrust exemptions that apply to railroads would immunize such conduct if it were to take place. *E.g.*, *In re Lower Lake Erie Iron Ore Antitrust Litigation*, 998 F.2d 1144 (3d Cir. 1993).

A few statutory antitrust exemptions apply to railroads, but they are very limited and narrowly applied. Moreover, railroad activities that are exempt from the antitrust laws are subject to regulation by the STB. When Congress has deregulated railroad activities, it has removed the corresponding antitrust exemptions. Railroads continue to be subject to the STB's regulatory jurisdiction with respect to certain rates and services, entry and exit, and mergers and other restructurings. The statutory antitrust exemptions that remain exist to avoid dual and potentially conflicting regulation by the courts and the STB. Moreover, they allow railroads to work together in a limited way to efficiently address some of the issues raised by the industry's network characteristics.

Section 10706 of Title 49, a target of S.772, provides that certain rate agreements that have been reviewed and approved by the STB are exempted from the antitrust laws. However, the scope of the exemption is severely limited (*e.g.*, the exemption does not apply to collective discussions of or agreements upon single-line rates, nor does it apply to any joint-line rate discussions between railroads unless they can practicably participate in the movement underlying the rate). More importantly, railroads' pricing for their transportation services is not covered by this exemption as a practical matter because the so-called rate bureaus that once addressed such rates no longer exist. The exemption remains important, however, to foster coordination on matters that enhance network efficiency (and are not controversial), such as rules governing administration of compensation for rail car use.

A history of this provision can be illustrative to show that changes to the antitrust laws should be considered only in the context of the regulatory environment. As noted above, this provision exempts railroads from the antitrust laws with respect to making and carrying out certain agreements which have been approved by the STB. Agreements which are to be submitted for STB approval under this provision include agreements between at least two rail carriers which relate to rates (including charges between rail carriers and compensation paid or received for the use of facilities and equipment), classifications, divisions, or rules related to them .

In its original form, 49 U.S.C. §10706 goes back to 1948, a period of far more active and comprehensive regulation of the railroad industry than exists today.[2] Initially, when enacted, this provision granted antitrust immunity for the railroads to meet together in rate bureaus and collectively set rates with antitrust immunity. However, when Congress passed

[2] This provision was originally enacted as section 5b of the Interstate Commerce Act by the Reed-Bulwinkle Act of 1948, 62 Stat. 472.

the Staggers Act and provided a level of regulatory relief for the railroads, it also severely limited the scope of the statutory exemption under this provision. As noted above, the exemption does not apply to collective discussions or agreements upon single-line rates. Nor does it apply to any joint-line rate discussions between railroads unless they can "practicably participate" in the movement underlying the rate. 49 U.S.C. §10706(a)(3)(A)(i) &(ii).

There is currently in effect an industry agreement approved under §10706 that permits joint consideration and establishment of rates of compensation for both railroad and shipper furnished freight cars and other transportation equipment, and rules and regulations pertaining thereto. This agreement, which is administered by the AAR, was first approved by the ICC in 1950 (Section 5a Application, *Association of American Railroads, per Diem, Mileage, Demurrage and Storage — Agreement*, 277 I.C.C. 413 (1950).[3] Any common carrier by railroad subject to the jurisdiction of the Interstate Commerce Act may become a party to the agreement.

Today, this Agreement provides a framework for the rail industry only to establish rules and regulations that pertain to the charges, known as car hire, that railroads pay each other when using the equipment of other railroads.[4] These rules, known as the AAR Code of Car Hire, establish procedures for the administration and accounting of car hire payments. Virtually all railroads, including many non-AAR members, subscribe to the Code. The Agreement sets forth the procedures to be utilized for consideration and establishment of the rules that make up the Code.

[3] The Agreement initially covered demurrage and storage charges, rates paid by shippers for the detention of freight cars or for use of other transportation equipment or facilities. However, that authority was subsequently withdrawn by the ICC.

[4] This Agreement also is occasionally used to take up matters related to allowances provided when non-railroad cars are used.

Again, it is important to note that under the Code, the railroads do not collectively establish the rates that users of freight cars pay to the car owners. These rates are established through bilateral negotiations between the owners and users of the equipment, or through binding arbitration if agreement cannot be reached, pursuant to the ICC's deprescription orders. Ex Parte No. 334 (Sub-No. 8) *Joint Petition for Rulemaking on Railroad Car Hire Compensation*, 9 I.C.C.2d 80 (1992); 9 I.C.C.2d 582 (1993); 9 I.C.C.2d 1090 (1993). The car hire rules are promulgated, amended, and enforced through the actions of committees, designated by the approved Agreement, which are composed of representatives of AAR member railroads and small railroads (which generally are not AAR members). Committee meetings where substantive discussions occur are open to all interested parties, typically are attended by representatives of several non-railroad car owners and lessors, and serve as a forum for all parties to express their views and concerns on matters related to the rules.

This process works effectively to assure that there is a uniform set of rules — not rates — pertaining to the payment of car hire. Given the large number of railroads and car owners, the rules, and the process under which they are promulgated, administered, and enforced, provide an orderly and accepted system for (1) apportioning financial responsibility for making payment in various situations; (2) governing collection; (3) adjustment of accounts; and (4) handling of claims. While not all parties always favor all proposed rule changes, the process is well-accepted, not controversial, and is seen as beneficial by all participants.

AAR believes the conduct undertaken today pursuant to the industry §10706 agreement would pass muster under a rule of reason analysis. Nonetheless, the statutory immunity is beneficial because it enables railroads collectively to address matters that arguably relate to rates without fear that they will be subject to antitrust lawsuits aimed at disrupting that conduct. STB oversight pursuant to the statute, 49 U.S.C. §10706(a)(3)(C), as well as the fact that all meetings are sound recorded or transcribed and are available to the STB, assures that the conduct under §10706 remains within the confines of the Agreement and is consistent with transportation policy. Eliminating the exemption that immunizes the making and implementing of car hire rules from antitrust challenge would discourage the railroads' efficiency-enhancing coordination activities without providing any conceivable relief with respect to any alleged deficiencies in the rail transportation market.[5]

3. The Purported Benefits of the System of Dual Regulation That S.772 Would Bring About Are Dubious and Illusory

A. Railroad Consolidations

In amending both section 7 of the Clayton Act and The Federal Trade Commission Act, S.772 does not so much eliminate an antitrust exemption as establish a system of dual regulation. Though the STB's authority over rail mergers is not eliminated by S.772, the bill would also make applicable the Clayton Act standards and permit antitrust enforcement agencies to challenge rail mergers — even, it appears, those that were approved by the STB (or ICC) long ago. There is little reason to believe that this change in the law will provide the relief some shippers insist they need. In fact, we fail to understand how subjecting a major rail merger to the less stringent DOJ standard to only preserve competition gives shippers more protection than the STB standard of enhancing competition.

Under existing law, the STB closely regulates railroad consolidations and cannot approve them without considering any potential adverse effect on competition and ensuring that they are consistent with the public interest. Since Staggers, the STB and its predecessor,

[5] As originally drafted, S.772 also would have eliminated the limited antitrust immunity for STB-approved pooling agreement under 49 U.S.C. §11322. That immunity, which now appears to remain intact under S.772, permits the industry to operate highly efficient pools of multilevel railcars and boxcars and is another example of the procompetitive outcomes of the coupling of STB oversight with limited antitrust immunity.

the ICC, have consistently used their statutory authority to impose conditions on railroad consolidations to ensure that no customer has lost two-railroad service due to a consolidation. The STB regulatory process for assessing mergers, consolidations, and pooling agreements provides for the development of a detailed record, with affected parties (including DOJ) having the opportunity to participate. Where rail customers are served by only one railroad today, it is not the result of consolidations permitted since 1980, it is because the market cannot support the presence of more than one carrier.

When the STB considers a proposed merger of two or more Class I railroads, it must consider, among other things, (1) the effect of the proposed transaction on the adequacy of transportation to the public; (2) the effect on the public interest, and (3) whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region or in the national rail system. In that regard, the STB is guided by traditional Clayton Act Section 7 analysis. *See Santa Fe Southern Pac. - Control – Southern Pac. Transp. Co.*, 2 I.C.C. 2d 709, 727 (1986). In fact, since 1980, the ICC/STB has approved only one rail merger that the Justice Department opposed. In an order approving a transaction, the STB may impose conditions on the applicants, including divestiture of tracks, the granting of trackage rights,[6] or access to other facilities.

The STB having exclusive jurisdiction over approval of consolidations is an outgrowth of Congress' decision to have rail consolidations considered in the context of the national transportation policy which, while most certainly including the interest of promoting competition, also includes other important considerations. The railroad consolidation provisions originated in the Transportation Act of 1920, 41 Stat. 456. Under that law, Congress sought to balance the policies embodied in the antitrust laws with those embodied in

[6] Trackage rights are the rights of one carrier to use the track of another carrier.

the national transportation policy. Given the context in which railroad consolidations are to be considered, Congress determined that the regulatory agency with substantive expertise and responsibility for implementing national transportation policy is in the best position to evaluate proposed consolidations in the railroad industry.

In recent years, with the competitive environment in which the railroads operate, the focus of the national transportation policy has reflected a greater reliance on competition and market forces. See 49 U.S.C. §10101(1) & (2). As a result, STB oversight of the railroad industry permits railroads far greater flexibility with respect to their rates and services than was the case in the past. This change has also been recognized by the STB with respect to its consolidation policy.

In 2001, the STB revised its regulations pertaining to railroad mergers to elevate the importance of preserving competition as a condition for approval of a transaction. *See generally* 49 C.F.R. Part 1180. The STB's stated policy is to ensure "balanced and sustainable competition in the railroad industry." 49 C.F.R. §1180.1(a). The regulations further state that the STB does not favor consolidations that reduce the transportation alternatives available to shippers unless there are substantial and demonstrable public benefits to the transaction that cannot otherwise be achieved. *Id.* The STB requires that major merger applications include provisions for enhanced competition. §1180.1(c). Moreover, the STB is prepared to use its authority to "preserve and/or enhance competition." *Id.* Applicants seeking approval of a transaction are required to explain how they would, at a minimum, preserve competition and market options and to propose remedies to mitigate and offset competitive harms. §1180.1(c)(2)(I). Thus, while the STB retains exclusive jurisdiction to approve rail mergers, the agency continues to take into account — indeed, now emphasizes — policies embodied in the antitrust laws along with other public interest factors.

The STB has authority, which it has frequently exercised in the past and maintains today, to impose conditions on merging railroads and to exercise significant oversight when it approved rail consolidations. See 49 U.S.C. §11324(c). The Board may impose conditions governing the transaction, including the divestiture of parallel tracks or requiring the granting of trackage rights and access to other facilities. At least since 1980, the Board has consistently imposed merger conditions to preserve two-railroad service where it existed. *E.g., Union Pac. Corp., Union Pac. R.R. Co., and Missouri Pac. R.R. Co. Control and Merger Southern Pac. Rail Corp., Southern Pac. Transp. Co., St. Louis Southwestern Ry. Co., SPCSL Corp., and Denver and Rio Grande Western R.R. Co.* [General Oversight], STB Finance Docket No. 32760 (Sub-No. 21), Decision 13 (1998).

In addition, the Board has exercised its authority by maintaining oversight of transactions for a period of time after approval. For example, a five-year oversight period was made a condition of approval of the acquisition of Conrail by CSX and Norfolk Southern. *See CSX Corp. And CSX Transp., Inc., Norfolk Southern Corp. and Norfolk Southern Ry. Co. Control and Operating Leases/Agreements Conrail, Inc., and Consolidated Rail Corp.*, Decision No. 89, Finance Docket No. 33388 (3 S.T.B. 196) (1998). *aff'd., Erie-Niagara Rail Steering Comm. v. Surface Transp. Bd.*, 247 F.3d 437 (2nd Cir. 2001).

Because of STB's imposition of conditions on mergers and its emphasis on preserving competition, there is probably more effective price competition today than there was in the "idyllic" days of long ago. The greater number of Class I railroads that existed then were subject to heavy-handed ICC rate regulation which made it difficult for railroads to respond to

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changed market conditions and tended to leave rates at a level designed to protect the most inefficient carriers. In addition, as described above, rates were often made by immunized rate bureaus, legalized price-fixing cartels that no longer exist today. The assigning of jurisdiction over railroad consolidations to the STB is an outgrowth of the longstanding regime of economic regulation. As a result, the agency that is charged with carrying out the national transportation policy, and which, along with its predecessor, possesses well over 100 years of accumulated expertise, continues to have the final say over rail consolidations. It is not clear what benefits introducing dual merger authority would bring, or that such dual authority, in the few industries where it now applies, has resulted in a more competitive market than would otherwise exist.

B. Primary Jurisdiction and Injunctive Relief

Also of questionable benefit is the provision in S.772 that reverses judicial precedent under which federal courts have referred matters to the STB involving its "primary jurisdiction" in four types of antitrust challenges. Not technically an antitrust exemption, the doctrine of primary jurisdiction is concerned with promoting proper relationships between courts and administrative agencies charged with particular regulatory duties. Under long-standing precedent, courts may defer to the regulatory agency on otherwise antitrust-related contentions. Primary jurisdiction, which by no means is limited to application in the railroad industry, applies where a claim is originally cognizable in the courts, and comes into play whenever enforcement of a claim requires resolution of issues which, under a regulatory scheme, have been placed within the special competence of an administrative body. *See U.S. v. Western Pac. R.R.*, 352 U.S. 59, 64 (1956). The purpose of this court-developed doctrine is to avoid potential conflicts between that oversight and the outcome of private litigation. *Id.*

Similarly, in order to avoid inconsistent results as between courts and the STB, private parties are prohibited from seeking to enjoin alleged antitrust violations by common carriers related to matters that are within the STB's jurisdiction. 15 U.S.C. §26; *See e.g., Central Transfer Co. v. Terminal R.R. Ass'n,* 288 U.S. 469, 475 (1933). S.772 would open the door to private injunctions against railroads, but not other common carriers. This immunity which is being eliminated does not prevent a private party from seeking antitrust damages against a railroad; nor does it prohibit the federal government from seeking injunctive relief. It simply prevents a civil court, which does not posses the expertise to consider how a decision involving a discrete dispute between a single railroad and single plaintiff might affect other railroads and shippers on other parts of the rail network. The STB, on the other hand, is charged with the responsibility for looking at the railroad network as a whole, taking into account the national, regional, and local aspects of the system. Thus, the STB is in a much better position to ensure that remedies to resolve individual disputes comport with national rail policy objectives.

Permitting private injunctions introduces dual regulation which will often be at cross purposes. So long as there remains a single regulatory body that is charged with oversight of the rail industry, it is imperative that the antitrust laws and national transportation policy be implemented in a harmonious fashion. In permitting courts to fashion equitable remedies in individual civil actions (Section 2), and by discouraging courts from deferring to the STB's expertise (Section 4), S.772 threatens to disrupt that harmony. While individual plaintiffs might find satisfaction in pursuing injunctions, or in having courts ignore (to the plaintiff's benefit) STB resolution of relevant issues, such outcomes could well have ripple effects to the detriment of other shippers and the rail network as a whole.

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It is fair to say that part of the motivation behind S.772 (and in particular elimination of the primary jurisdiction doctrine and allowance of private injunctions) is dissatisfaction on the part of some rail shippers with decisions of the STB on certain market practices. One example is concern over the STB's refusal to require railroads to quote "bottleneck" rates, a term that refers to rates that would apply to segments of a railroad's network used to reach individual shippers or receivers that are served by only one railroad. Even in the absence of any antitrust exemptions, it is dubious whether this, and other unilateral railroad conduct, would be subject to antitrust relief. *See Verizon Comm. v. Trinko*, 540 U.S. 398 (2004).[7]

Similarly, repeal of the filed rate, or *Keogh,* doctrine,[8] which S.772 would accomplish, is unlikely to offer any real benefits to rail shippers. The continued viability of that doctrine as it related to railroads is dubious, as most rail rates are no longer subject to filing requirements. AAR is unaware of the filed rate doctrine being used in recent times to absolve railroads of conduct that otherwise would have constituted an antitrust violation. Interestingly, S.772 would eliminate this "immunity" only with respect to railroads. It apparently would remain intact for other regulated industries, which, in recent times, have utilized it to defend antitrust actions. *E.g., Utilimax.com, Inc. v. PPL Energy Plus, LLC*, 273 F.Supp.2d 573 (E.D. Pa. 2003)(rates filed with the Federal Energy Regulatory Commission) AAR would recommend that rather than repealing the Keogh doctrine in a piecemeal fashion, the Committee consider a comprehensive review of Keogh for all affected industries.

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7 In *Verizon*, despite the antitrust savings clause in the Telecommunications Act, the Court explained that "[a]ntitrust analysis must always be attuned to the particular structure and circumstances of the industry at issue. Part of that attention to economic context is an awareness of the significance of regulation." The Court further explained that "[o]ne factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm."

8 *See Keogh v. Chicago & NW Ry.*, 260 U.S. 152 (1922).

4. The Premise That S.772 Only Levels the Playing Field and Treats Railroads Like All Other Industries is False

The notion that S.772 merely seeks to level the playing field and treat railroads like all other industries is belied by the very language of the bill. In several instances, S.772 addresses specific antitrust exemptions that currently apply beyond just railroads, but eliminates them only with respect to railroads.

For example, STB-regulated common carriers other than railroads remain immune to private injunctions, 15 U.S.C. §26; and, only STB-approved railroad transactions, but not transactions consummated pursuant to the authority of other named federal regulatory agencies, are made subject to section 7 of the Clayton Act. 15 U.S.C. §18. Motor carrier agreements that are approved by the STB retain antitrust immunity. 49 U.S.C. §13703.

Beyond the obvious question of why these antitrust exemptions remain sound policy for other industries, is the continued reality of STB economic regulation to which railroads remain subject. S.772 would not replace the STB's regulatory regime with application of the antitrust laws in the areas where limited immunities currently exist. Rather, S.772 would superimpose antitrust remedied on top of STB regulation. As described above, the STB has full authority to review proposed railroad mergers and similar transactions and gives full consideration to competitive issues. Moreover, the STB retains jurisdiction over rail service, market entry, and a wide range of rate-related conduct, including the level and structure of rates where there is no effective competition. As a result, rail customers continue to enjoy protection against unreasonably-high rates. In the limited circumstances in which a railroad's service is not subject to competition from other railroads or other modes of transportation, rail customers are protected by regulatory constraints on their rates. Moreover, the elimination of the antitrust immunities that are proposed will not provide rail customers with any protection from high rates, because high prices alone do not constitute an antitrust violation. So long as the regime of economic regulation remains in effect, S.772 cannot be justified as simply treating railroads like all other industries.

In sum, S. 772 is flawed on several counts. It fails to recognize the public benefits from the limited antitrust exemptions that allow the railroad industry to undertake certain activities subject to expert oversight using a public-interest standard rather than solely the antitrust laws. It also fails to recognize that railroads are subject to antitrust scrutiny where there is no regulatory oversight. Consequently, eliminating the limited antitrust exemptions that apply to the railroad industry would not fill any void in the law. More likely, it would discourage activities that are in the public interest and subject railroads to dual, and potentially inconsistent, standards in areas that are being addressed as effectively, if not more effectively, through regulatory oversight. The AAR urges Congress not to embrace such an ill-advised result.

TESTIMONY OF
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BEFORE THE

U.S. SENATE JUDICIARY COMMITTEE
SUBCOMMITTEE ON ANTITRUST, COMPETITITION POLICY AND CONSUMER RIGHTS

AT A HEARING ENTITLED

"AN EXAMINATION OF S. 772, THE RAILROAD ANTITRUST ENFORCEMENT ACT"

OCTOBER 3, 2007
10:30 A.M.

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Testimony of Charles D. Nottingham
Chairman of the Surface Transportation Board before the Senate Judiciary Committee, Subcommittee on Antitrust, Competition Policy and Consumer Rights
At a Hearing Entitled
"An Examination of S. 772, the Railroad Antitrust Enforcement Act"

October 3, 2007

Good Morning Chairman Kohl, Ranking Member Hatch and Members of the Subcommittee. My name is Charles Nottingham, and I am Chairman of the Surface Transportation Board (Board or STB). I appreciate the opportunity to appear before this Subcommittee today to provide the Board's views on S. 772, the Railroad Antitrust Enforcement Act.

Before providing the Board's views on the proposed legislation, I will first provide an overview of the Board, its responsibilities with respect to competition, and the current limited immunities from the antitrust laws that apply to rail carriers.

OVERVIEW OF THE SURFACE TRANSPORTATION BOARD

The STB is charged by statute with resolving railroad rate and service disputes and reviewing railroad restructuring transactions (including mergers, line sales, line constructions and line abandonments). The Rail Transportation Policy in the Board's governing statute addresses the role of competition; it requires, among other things, that the Board regulate in such a manner "to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail," and, while "minimiz[ing] the need for Federal regulatory control over the rail transportation system," acting so as to "maintain reasonable rates where there is an absence of effective competition." *See* 49 U.S.C. § 10101.

When Congress passed the Staggers Act in 1980, the Nation's rail system was in desperate financial straits. It was burdened with unproductive assets, forced to provide unprofitable services, and hampered by excessive government regulation. The industry consisted of many independent systems throughout the Nation, none of them particularly healthy or efficient. Since that time, the Board and its predecessor, the Interstate Commerce Commission (ICC), have approved mergers with competition-protecting conditions – almost always with the concurrence of the U.S. Department of Justice (DOJ) – that reduced the number of large (or Class I) U.S. railroads to seven. But those seven systems are far healthier and more efficient than the more numerous carriers that existed in 1980. Indeed, the railroad industry's financial condition has steadily improved and today the industry is considered by most independent analysts to be relatively healthy. In addition, more that 500 smaller "shortline" railroads currently operate in the U.S. and often enhance competition in the market for freight transportation.

Last month the Board initiated a $1 million national study on the state of competition in the rail industry. The study will also assess various policy issues, including current and near-future capacity constraints in the industry; how competition and regulation impact capacity investment; how capacity constraints impact competition; and how competition, capacity constraints, and other factors affect the quality of service provided by railroads. The economic consulting firm Christensen Associates, based in Madison, Wisconsin, has contracted to deliver this study in the Fall of 2008.

What we already know is that in 2005 (the most recent year for which adequate data are available), over 71% of the traffic that the railroads carried moved at rates less than 180% of variable cost and is thus deemed by statute to have been the result of a competitive market. Of the remaining 29% of rail traffic that moved at revenue-to-variable cost ratios above 180% that year, some was traffic that was exempted from regulation pursuant to 49 U.S.C. § 10502, based on findings that the particular commodities and services involved have competitive transportation alternatives available, and some was traffic that moved under contract and was therefore, by statute, outside of the Board's jurisdiction. Thus, the rail industry is now governed by a hybrid system of partial regulation when shippers have competitive options and extensive economic regulation where such competition is not present.

When enforcing competition policy under the Interstate Commerce Act (ICA), the Board is guided by, but not limited to, the traditional antitrust principles in the Sherman and Clayton Acts. Congress has delegated to the Board discretionary authority to enforce certain provisions of the Clayton Antitrust Act, including Section 7, which governs mergers. In practice, the Board reviews acquisitions under its own statutory standard and merger guidelines, typically with comments from DOJ in major cases. The main difference between the Board's review of mergers and those of DOJ or the Federal Trade Commission (FTC) is that the Board, under the broad public interest standard, is required to consider other factors in addition to competition, including: the adequacy of transportation to the public, the effects on other carriers, rail labor issues, environmental issues, and whether the rail industry can earn adequate revenues to support capital infrastructure investment. Thus, the Board's oversight of competition and mergers in the freight rail industry takes into account both traditional antitrust principles and special characteristics of the rail industry.

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Although the Board does not have the authority to directly enforce the Sherman Act, many of the *per se* violations of Section 1 of that Act, including horizontal price-fixing and bid-rigging, would likely also violate provisions of the ICA, including section 10702's prohibition of unreasonable practices. The Board has exclusive jurisdiction to enforce those provision of the ICA, and upon the filing of a complaint has broad investigative and remedial powers to enforce the provisions against the railroads.

RAILROAD ANTITRUST EXEMPTIONS

There is a wide-spread misconception that the railroads are not subject to the antitrust laws. That is not so. For example, in the 1980s, a massive civil antitrust lawsuit was brought against numerous railroads by a civil plaintiff.[1] In that case, a jury returned a $1 billion verdict in treble damages against the only railroad that elected not to settle that litigation, which I understand was, at the time, the largest civil, antitrust jury verdict in U.S. history. The railroad subsequently settled the case. Moreover, DOJ can investigate and prosecute the railroads for civil or criminal sanctions if they violate the Sherman Act (e.g., price-fixing, market allocation, bid-rigging). In 2005, the New York Times reported that two large railroads were under investigation by DOJ for possible violations of the antitrust laws.[2] And the railroads can be and have been sued by private parties in federal district court for violating the Sherman Act.[3]

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[1] *See In re Burlington N., Inc.*, 822 F.2d 518 (5th Cir. 1987).

[2] *See Two Railroads Under Antitrust Investigation for Rates*, N.Y. TIMES, Feb. 17, 2005.

[3] *See In re Lower Lake Erie Iron Ore Antitrust Litigation*, 998 F.2d 1144 (3d Cir. 1993); *Laurel Sand & Gravel v. CSX Transp.*, 924 F.2d 539 (4th Cir. 1991); *Transkentucky Transp. R.R. v. Louisville & Nashville R.R.*, 581 F. Supp. 759 (E.D. Ky. 1983). The Class I railroads are currently defendants in dozens of class actions alleging that the railroads colluded in establishing fuel surcharge programs. *See, e.g.*, *Dust Pro,*

Rail carriers do, however, enjoy several limited express statutory and judicially-created immunities from the antitrust laws. In this regard, the railroad industry is no different than numerous other industries that have narrow immunities created by Congress designed to serve a particular public purpose, such as air transportation (49 U.S.C. §§ 41308-09), insurance (15 U.S.C. §§ 1011-15), natural gas (15 U.S.C. § 3364(e)), or labor (15 U.S.C. § 17, 29 U.S.C. §§ 52, 101-15, 151-69). Recently, the Antitrust Modernization Commission identified more than 30 exemptions created by statutes or the courts.

In brief, relevant exemptions addressed in S. 772 are:

- **Express immunity for certain transactions approved by the STB.** A rail carrier participating in a transaction approved by the STB under 49 U.S.C. § 11321 et seq. is exempt from the antitrust laws to the extent necessary to carry out the transaction. 49 U.S.C. § 11321(a); 15 U.S.C. § 18. Such transactions include consolidations, mergers, acquisitions, leases, trackage rights, pooling arrangements and agreements to divide traffic. This immunity is part of a broader set of preemptions in the statute designed to protect the national, public interest in ensuring the free flow of interstate commerce by preventing parties that do not want to see an increased rail presence in their communities from blocking or delaying those transactions with hundreds of individual suits in every local jurisdiction affected by the transaction.
- **Express immunity for certain rate-related agreements approved by the STB.** Under 49 U.S.C. § 10706, the STB has the authority to grant antitrust immunity for certain agreements related to rates or charges. For example, the STB has approved an agreement between the railroads that establishes rules governing the charges that railroads pay each other when using the equipment (typically rail cars) of another railroad. The authority is narrow and the Board cannot authorize rail carriers to discuss or participate in agreements related to single-line rates, or to interline rates of a particular movement unless the rail carrier can practicably participate in the movement.
- **Express immunity from injunctive relief in private civil actions.** Only the federal government, not private parties, may bring suit for injunctive relief against any common carrier subject to STB jurisdiction. DOJ has broad powers to pursue injunctive relief against the railroads. The purpose of this prohibition is to ensure

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Inc. et al. v. CSX Transp. et al., Civ. Action No. 07-2251 (D.N.J., complaint filed May 14, 2007).

that the national, public interest in protecting the efficient operation of the national rail network is not stymied by a patchwork of narrow, parochial interests.

- **Express immunity from the Federal Trade Commission Act.** The FTC Act creates no private right of action, and provides that the FTC has no jurisdiction over common carriers, including but not limited to rail carriers. Thus, the prohibition in Section 5 of the FTC Act against "unfair methods of competition" does not apply to the railroads. Other common carriers (a category that includes airlines, telecommunication firms, and pipelines) are also not regulated by the FTC. Some are also regulated by specialized federal agencies (such as the Federal Energy Regulatory Commission (FERC)), but most common carriers operate with much less federal regulatory oversight than the freight railroad industry.
- **Judicially Created Immunity from Treble Damages.** Historically, the railroads have enjoyed immunity from rate-related antitrust civil damages suits under the *Keogh* doctrine. Created by the courts in 1922, the doctrine is premised on the idea that tariffs filed with the ICC should be immune from challenge, except before the agency. But because railroads no longer file tariffs, a leading antitrust treatise has questioned whether the *Keogh* doctrine still applies to the railroads.[4]

The Board has already provided its initial views on two provisions of S. 772 at the request of the Senate Committee on Commerce, Science and Transportation and the Subcommittee on Surface Transportation and Merchant Marine Infrastructure, Safety and Security. I am glad to expand on those comments below and to provide my views on other parts of the proposed legislation. I have attached that September 13, 2007 letter to my written testimony before this Subcommittee.

ANALYSIS OF THE PROPOSED LEGISLATION

The STB believes that railroads should be governed by and subject to our Nation's antitrust laws. The core premise underlying antitrust policy – "that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material

[4] *See* ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS at 1402 n.1135 (5th ed. 2002) (questioning "future relevance" of *Keogh* after ICCTA).

progress"[5]– is certainly applicable to the rail industry. The concerns I express today about S.772 relate not to whether that maxim should apply in greater or different force to rail carriers. Rather, there are practical problems that can arise when the antitrust laws are layered atop a regulatory regime. The ICA shares the same core purpose of promoting free market competition whenever possible and protecting rail customers from market power abuses. But we must also take into account the other public policy issues set forth in the national rail transportation policy (49 U.S.C. § 10101) in providing a single, overarching public interest view in regulating the complex national rail system.

The STB does not believe that immunities once granted under particular economic and legal circumstances should remain in place regardless of changes in the economic and legal environment that occur over time. I agree with the suggestion by the Antitrust Modernization Commission in its April 2007 report to Congress and the President that it is critical to reassess existing antitrust immunities and consider whether the original justifications for them continue to hold true and whether they serve a public interest that cannot be furthered by the imposition of the antitrust laws.

In May of this year, the Board did just that with regard to motor carrier rate bureaus, using our discretion to terminate antitrust immunities that had been routinely granted since 1948.[6] The motor carrier industry has long operated with collective ratemaking as its backbone, in which regional rate bureaus develop collective rates and suggest general rate increases to its members. The collectively set rates are not the actual

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[5] *Northern Pacific Ry. v. U.S.*, 356 U.S. 1, 4 (1958).

[6] *Motor Carrier Bureaus – Periodic Review Proceeding,* STB Ex Parte No. 656 *et al.* (STB served May 7, 2007) (the decision becomes effective January 1, 2008).

market prices charged by the motor carriers, but served as a baseline for negotiations between individual shippers and carriers.

In the Board's review proceeding, the motor carrier bureaus urged continuation of their antitrust immunities based on a set of familiar arguments: that there could be no harm to consumers because carriers routinely discount from the collective rates, that the rate bureau system "simplified" transactions, and that continued Board conditioning and monitoring of rate bureau agreements was the best way to protect the public interest. The Board rejected each of these arguments, finding that the motor carrier industry had become so deregulated and so competitive as to make the antitrust-immunized collective ratemaking system obsolete and contrary to free-market principles. Thus, the original justification for rate bureau immunity, which centered on a pervasive regulatory environment, no longer made sense when that regulatory environment disappeared. The Board also concluded, as did the DOJ and Department of Transportation (DOT), that the bureau system likely leads to higher rates than might otherwise be charged.

With this decision, the STB ended more than 70 years of antitrust immunity for motor carrier rate bureaus, demonstrating its commitment to and respect for the antitrust laws. As Congress now takes a new look at rail regulation issues, it makes sense to reassess antitrust immunities as well, including how these long-standing immunities fit in with today's regulatory environment and whether the public interest would be better served by repealing or adjusting certain immunities.

The Board's analysis of S. 772 is set forth in three parts. First, I will go through the sections of the bill that I believe have either no impact or a positive impact on the STB's regulatory efforts. Second, I will discuss those parts of the bill that would make

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effective integrated economic regulation of the rail industry more difficult and complicated. Third, I will discuss those parts of the bill that raise significant questions.

I. Immunities That Can Be Repealed With A Positive Or Neutral Effect On The Board's Statutory Responsibilities

A. The *Keogh* Doctrine's Limit on Treble Damages

Section 6 of the bill would repeal the *Keogh* doctrine, derived from the Supreme Court's 1922 decision in *Keogh v. Chicago & N.W. Railway.*[7] *Keogh* held that a filed tariff was the only legal rate, and that the rate could only be adjusted by the regulator. The Court stated that even a rate that was the result of a conspiracy under the antitrust laws was not illegal if it had been filed and approved by the regulatory agency. The Court believed that permitting treble damages would create "unjust" price discrimination and would give the antitrust plaintiff (the rail customer) a trade advantage over its competitors. *Keogh* has been interpreted as an absolute bar to antitrust treble damages actions that involved rates or tariffs filed with a regulator.

However, since 1995, the railroads are no longer required to file rates and tariffs with the Board. Moreover, rates are not subject to advance approval by the Board, and even after-the-fact rate complaints are limited to those circumstances where the railroad has market dominance over the movement at issue. Indeed, as discussed above, approximately 90% of all rail traffic falls outside the rate review jurisdiction of the agency. Simply put, the *Keogh* doctrine has been overtaken by the partial de-regulation of the freight rail industry that has ended the practice of filing rates.

There is, however, a concern with the current legislation as it relates to the *Keogh* doctrine. If the legislation passes in its current form, it would overrule the *Keogh*

[7] 260 U.S. 156 (1922)

doctrine, but *only* as it applies to the rail industry. The *Keogh* doctrine currently is applied in a wide range of industries, including pipeline, energy, and water carriers. By targeting only the rail industry, the federal courts could assume that Congress has endorsed the continued application of this doctrine in all other industries where the doctrine may apply. This would mean, for example, that if water carriers subject to our jurisdiction (who still file tariffs with the STB) were to collude and then file the agreed-upon rates with the STB, the carriers would continue to be protected from treble damages in a civil suit.

B. 49 U.S.C. § 10706 Approvals By The STB

The bill proposes to eliminate the antitrust immunities for agreements approved by the STB under 49 U.S.C. § 10706. By its own terms, section 10706 is extremely limited and could not be used to approve a traditional rate-bureau agreement of the sort that used to exist prior to the Staggers Act. Moreover, the Board may only approve agreements that will further the Rail Transportation Policy. The Board also has broad conditioning power to ensure that any approved agreement, as implemented, furthers national transportation goals. The FTC is required to periodically assess any anticompetitive impacts of agreements approved under section 10706. *See* 49 U.S.C. § 10706(e).

In practice, there are very few section 10706 agreements in place today. In 1998, the Board approved certain rate-related aspects of the Rail Industry Agreement (RIA) between Class I carriers and short lines railroads.[8] Another section 10706 agreement is

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[8] *See Association of American Railroads and American Short Line and Regional Railroad Association – Agreement – Application Under 49 U.S.C. 10706*, 3 S.T.B. 910 (1998). The rate-related provisions of the RIA are a series of bilateral agreements

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the Association of American Railroads Code of Car Hire. Under the Code, the railroads collectively establish rules governing the charges that railroads pay each other when using the equipment (typically rail cars) of another railroad.[9] The railroads do not, however, collectively establish the rates for car hire under the Code or any other section 10706 agreement. In 1996, the Board withdrew approval for carriers to collectively establish demurrage and storages rates.[10] The ICC also approved the agreement of the National Railroad Freight Committee, which has in the past published the Uniform Freight Classification for its members.

No parties have asked the Board to use its Section 10706 powers in almost a decade. And the power should not, in any event, be used by parties as a tool to shield anticompetitive agreements that would otherwise violate the antitrust laws. Given that this authority is almost never used, I do not believe that repealing section 10706 antitrust immunity would have a negative effect on the Board's ability to regulate the industry.

II. Provisions That Would Hamper the Board's Ability to Regulate the Industry

A. Injunctive Relief in Private Antitrust Cases

The section of the bill that would have the greatest negative impact on the Board's ability to effectively regulate this Nation's interconnected rail network is Section 2, which would permit injunctive relief to be ordered by any of the more than 90 district courts in private civil actions. I believe that implementation of this section would

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between a larger carrier and the short line with which it interchanges governing switch charges and interline rates between those carriers.

[9] *Railroad Car Hire Compensation Rulemaking*, 9 I.C.C.2d 80, 9 I.C.C.2d 582 (1993), 19 I.C.C.2d 090 (1993), *appeal dismissed Southern Pacific Trans. v. I.C.C.*, 69 F.3d 583 (D.C. Cir. 1995).

[10] *Exemption of Demurrage from Regulation*, Ex Parte No. 462 (STB served Mar. 29, 1996).

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undermine the STB's ability to achieve the regulatory objectives set forth by Congress. Shippers and rail carriers are best served by centralized oversight and the harmonization of rail related injunctive relief.

As the Board stated in our September 13 letter, the purpose of the injunction exemption traces back to the original Section 16 of the Clayton Act of 1914. As explained by the Supreme Court, the "obvious purpose" of the prohibition on district court injunctions in private suits was to "preclude any interference" when a carrier was regulated by the ICC, the STB's predecessor. *See Central Transfer Co. v. Terminal R.R. Ass'n*, 288 U.S. 469, 475 (1933). Although regulation is now less burdensome, the rail industry is still subject to substantial economic regulation. Thus, my concern about section 2 of the bill is threefold: (1) district courts do not have a broad policy oversight mandate; (2) there is a great potential for conflicting decisions between courts and between the STB and courts; and (3) the implementation of rail-related competition remedies typically requires long-term oversight.

The Board has "broad authority over the operation of railways" and rail transportation issues.[11] With that authority comes the responsibility to consider how regulatory actions affect the rail industry from both a national, regional and local perspective and to ensure that remedies resolving individual disputes comport with national rail policy objectives. The Board's policies in adjudications are guided not just by the facts presented in the individual matter, but also by rulemaking records, comprehensive industry studies, public hearings, and a long history of considering competitive behavior in the rail industry.

[11] *See, e.g., City of Lincoln v. STB*, 414 F.3d 858 (8th Cir. 2005).

District courts simply do not have the same mandate. They are not responsible for meeting the policy goals of the rail transportation policy. When deciding an antitrust case, a district court ***must reject*** the same kind of non-competition related public interest factors and policy goals that the Board ***must consider*** under the ICA. *See FTC v. Superior Court Trial Lawyers' Association*, 493 U.S. 411 (1990) (holding that proffered non-economic public interest justifications were not relevant to the question of whether a restraint of trade is unlawful under the antitrust laws). Nor do the district courts possess the institutional expertise to consider how a decision resolving one case will affect other carriers and shippers on that line, or on other lines in different parts of the country. Unlike many other industries, the national rail system – while comprising hundreds of individual railroads – nevertheless operates as a single integrated, complex, and interdependent network. Operational changes or issues arising in one location can have significant operational ramifications hundreds of miles away, including effects on other freight carriers as well as on Amtrak and commuter lines. The docket of a district court is necessarily varied and contains hundreds of cases from numerous industries. Moreover, because the courts of appeals, and not the district courts, review decisions of the STB pursuant to the Hobbs Act,[12] I expect that district courts have even less familiarity with the rail industry than they otherwise would. District courts do not conduct generalized studies or rulemaking proceedings that provide critical information about how the industry is performing or how certain regulatory policies have affected it.

Allowing district courts to order injunctive relief in individual private antitrust actions would create a potential for conflicting decisions from individual courts, as well

[12] 28 U.S.C. §§ 2321(a), 2342.

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as for creating a ripple effect of unforeseeable operational and service problems outside of a particular court's jurisdictional territory. Many national companies already find it challenging to comply with the antitrust laws when there is a "split" in the courts about the legality of certain behavior; but conflicting decisions in a physically networked industry such as rail could be devastating. A single rail line may extend hundreds of miles through many federal judicial districts and circuits, creating a possibility for different rules and injunctive relief governing identical behavior on different parts of the line. It is also possible that competing carriers could be subject to different rules for identical behavior merely because one has been sued and is subject to a district court injunction and the other has not. Add to this already complicated picture the possibility that the Board may also have existing rules and remedies to fix those same competitive issues and you quickly have an unworkable system that leads to confusion and additional expense for shippers and ultimately consumers as carriers pass on the costs of complying with multiple regulatory and judicial standards. Another layer of complexity arises from the fact that carriers may need STB approval to carry out potential district court remedies. For example, if a district court in a Sherman Act Section 2 essential facilities case required Carrier A to allow Carrier B to operate over its lines, such a trackage rights agreement could not be implemented without Board approval. Likewise, divestitures of rail lines to another operator would also require Board approval.

Finally, the Board knows from experience that some rail disputes do not lend themselves to one-time remedies, but rather require continuing supervision and oversight. The ability and willingness to retain jurisdiction over a matter for a longer term is a hallmark of regulation and the Board is well-suited to retain jurisdiction to resolve long-

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term network issues as they arise. A case still pending at the Board is a good example. In mid 2006, the Board authorized one carrier to operate over the lines of another carrier due to certain service inadequacies. The parties have been litigating over operating protocols, access, switches, interchange, and other issues ever since. It is difficult to see how a district court could monitor and resolve these disputes without stepping into the role of regulator.

B. Dual Merger Review

Section 3 of S. 772 would subject rail mergers and acquisitions to both the approval process and criteria of the Interstate Commerce Act and to Section 7 of the Clayton Act. Congress considered this question 12 years ago in enacting the law sunsetting the ICC and establishing the Board. At that time, Congress decided to retain the merger exemption, keeping rail merger review with the same agency that regulates the economic activity of the industry. However, Congress clarified and modified the contours of that review to encompass features associated with merger review under the antitrust laws: a broad, national outlook on the relevant markets to be examined; use of divestiture as a remedial condition; and the ability to discuss a proposal directly with interested parties.[13]

Before I discuss the problems that could arise from a dual review scheme, I would like to discuss some of the current features of the STB specialized rail merger review process. The STB's merger review process is conducted on an open record, with opportunities for comment, evidence and counter-proposals from all interested parties, including the DOJ, DOT and other interested federal entities. Because the Board

[13] H.R. Conf. Rep. No. 104-422, at 191 (1995).

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monitors and supervises the industry full-time, its decisions are suffused with knowledge about the industry; its customer segments; its past, present and future competitive landscape; and the impact of the merger on the Board's other regulatory policies and goals. When deciding whether to approve, disapprove, or impose conditions on a proposed merger, the Board's public interest analysis goes beyond competitive concerns and considers operational/services issues as well as a host of other issues. This understanding is key to devising remedies that will work in the real world. And, as I discussed earlier, the Board actively monitors the results of mergers and can impose post-merger conditions as needed to address competitive, operational, and environmental issues. For example, in the Southern Pacific/Union Pacific merger, which I will discuss in more detail, the merged firm was required to submit quarterly and annual reports for 5 years to allow the Board to analyze the impact of the approved transaction.

I am also concerned that dual enforcement could result in some of the same problems raised by the potential for district court injunctions, including inconsistent Board conditioning and DOJ consent decree provisions, differences in the statutory review deadlines and the public availability of evidence and data. Moreover, proposed merger parties would incur substantial additional costs to comply with both review processes.

From a substantive standpoint, possibility for disagreements between the antitrust regulatory agencies and the Board on merger competitive issues is not a major concern. Under section 11324(d), the Board must accord "substantial weight" to any recommendation of DOJ. The Board is also guided in its competitive impact analysis by cases decided under Section 7 of the Clayton Act and Section 1 under the Sherman Act.

Critics of the current review scheme cite to the much-discussed but rare cases where the Board declined to follow the DOJ's recommendation that merger authority be either denied or conditioned on expansive divestitures. When the Board approved the acquisition of Conrail by CSX and Norfolk Southern and the division of Conrail's assets between the two carriers, there was general agreement that the transaction was largely pro-competitive. I understand that there were only modest differences of opinion between the Board and DOJ on the number and type of conditions that should be attached to the Board's approval.

The differences of opinion were more pronounced in the Board's review of the Union Pacific/Southern Pacific merger, where the Board declined to follow DOJ's recommendation that the merger either be denied or conditioned on expansive divestitures. The Board concluded that, on balance, the merger would be in the public interest, as it would permit the financially weak Southern Pacific (SP) to become part of a large, financially healthy rail system that would sustain efficient operations and invest in the SP's deteriorating infrastructure. The Board also concluded that a divestiture requirement would be problematic for ensuring adequate service levels for many of SP's customers, and that a trackage rights remedy, in combination with continuing Board oversight, would be sufficient to preserve competition for those shippers that would otherwise have lost a choice of carriers. Finally, the Board also disagreed with DOJ about whether the significant efficiency benefits claimed by the merging parties were likely and merger-specific.

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Significant differences between the Board's and DOJ's competition analysis are rare, however. And in such cases, the DOJ may challenge a Board merger decision in the courts of appeals.

Finally, a dual merger scheme overlooks the impact of the Board's new merger rules. These new rules were put into place following the Board's merger moratorium that forestalled what was widely expected to be the final round of mergers, which would have resulted in two (or three) large transcontinental systems.[14] Under traditional merger analysis by DOJ or FTC, such vertical integration of two partners with complementary systems (e.g. a western railroad merging with an eastern railroad) would not be perceived to carry as significant a risk of competitive harm as a horizontal merger of two direct competitors (e.g. two western or two eastern railroads). However, under the new STB rules, a Class I merger would be in the public interest "only when substantial and demonstrable gains in important public benefits – such as improved service and safety, enhanced competition, and greater economic efficiency – outweigh any anticompetitive effects, potential service disruptions, or other merger related harms."[15] To offset any harms that could not be mitigated, merging carriers would need to show how the proposed merger would enhance competition.[16]

Although a Class I merger has not been proposed since the Board adopted the new rules, the Board has in place a comprehensive review scheme that would address both competition and service issues and the interplay between them. It is difficult to see how the imposition of Section 7 would enhance the collective ability of the federal

[14] *See Western Coal Traffic League v. STB*, 216 F.3d 1168 (D.C. Cir. 2000).

[15] 49 CFR § 1180.1(c).

[16] 49 CFR § 1180.1(c)(2)(iv).

government to protect consumers from potentially anticompetitive and disruptive transactions.

III. Provisions That Raise Significant Questions

A. Limitation on Primary Jurisdiction

Section 4 of the bill would instruct district courts that they need not defer to the primary jurisdiction of the STB in antitrust civil actions. The doctrine of primary jurisdiction provides that a district court may stay a civil action in order to refer a complex matter to a regulatory agency for preliminary findings. Courts refer such matters "when the protection of the integrity of the regulatory scheme dictates preliminary resort to the agency that administers the scheme."[17] Although the factors under which a district court decides to refer a case differ by circuit, when determining whether to make a referral under the primary jurisdiction doctrine, courts generally consider whether there is "(1) the need to resolve an issue that (2) has been placed by Congress within the jurisdiction of an administrative body having regulatory authority (3) pursuant to a statute that subjects an industry or activity to a comprehensive regulatory scheme that (4) requires expertise or uniformity in administration." *U.S. v. General Dynamics*, 828 F.2d 1356, 1362-63 (9th Cir. 1987). Once district courts have preliminary findings from the administrative agency, the findings may be upheld or rejected.

It is not clear what the effect of section 4 would be on the primary jurisdiction doctrine, nor do I understand the problem that exists with the existing primary jurisdiction doctrine that this provision seeks to remedy. My interpretation is that it would permit district courts to decline to refer a matter to the Board even if all of the

[17] *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 353 (1963).

primary jurisdiction factors were present. If the bill is intended to achieve this outcome, then I question whether it is prudent to restrict the judiciary from gathering information and expertise that the court decided is necessary for the effective administration of justice, or "when the protection of the integrity of the regulatory scheme" dictates seeking the guidance of the Board.[18]

B. Duplicative Regulation By The FTC

Section 5 of the bill would permit broad regulation of the rail industry by another regulatory body, the FTC. It would amend the Federal Trade Commission Act (FTC Act) to permit the FTC to investigate and adjudicate "unfair methods of competition" by rail carriers. This provision of the FTC Act, however, is to our understanding largely duplicative of the federal antitrust laws in the Sherman Act that are already enforced against the railroads by DOJ.

Moreover, there is also considerable overlap between the FTC's unfair competition authority under 15 U.S.C. 45 (were it to apply to railroads) and the Board's unreasonable practices authority under 49 U.S.C. 10702. Both statutory provisions could be used to assess behavior that reduces competition, etc. However, the Board considers unreasonable practices through its broader public interest lens while the FTC's review is limited to competitive issues. As always, there is the possibility that the different statutory mandates could lead to different and conflicting results, particularly with regard to cases that consider the responsibilities of a monopolist rail carrier.

Competition issues are already subject to regulation by the Board and DOJ. While I appreciate that many industries are subject to overlapping economic regulation

[18] *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 353 (1963).

under two or more regulatory regimes, I am concerned that introducing a third regulator would make it more difficult to administer any sort of uniform regulatory approach to the national rail system.

CONCLUSION

The railroads have been subject to the federal antitrust laws since those laws were first enacted by Congress in 1890. And for the most part, those competition laws and the economic regulatory scheme that governs the railroads have co-existed for decades without serious conflict. Yet Congress has, over time, carefully created a few narrow immunities or exemptions to the federal antitrust laws. I believe most of those exemptions were designed to permit the STB to carry out its statutory obligations to protect the public when competition does not exist, while also promoting a safe and efficient rail system by adopting policies that will permit the carrier to earn sufficient returns to make the critical investment in their infrastructure.

Some of those exemptions may no longer be needed, and the judicially created *Keogh* doctrine is a fine example of a judicially created antitrust immunity that has no valid purpose in the current regulatory environment. This bill is not, however, targeted to remove just those exemptions that have grown outdated or are no longer useful, but rather is a sweeping change that removes them all. I am concerned that doing so will make it more difficult for the STB to perform its regulatory oversight responsibilities required by Congress under the Interstate Commerce Act. Moreover, there has not been a pattern of antitrust complaints or anti-competitive conduct in the railroad industry. And the bill seems premised on the inaccurate notion that the railroads presently are broadly immune from antitrust liability, which is not the case.

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The Board understands, and is sensitive to, the concerns of rail customers about rail rates and service. That is why we have taken, or are taking, a number of initiatives related to those issues, including: modifying our major merger rules to promote enhanced competition; streamlining our major rate case procedures; revising our procedures for small and medium-sized rate cases to make them more accessible and affordable; examining our methodology for calculating the rail industry's cost of capital; examining issues related to "paper barriers;" and sponsoring a million-dollar, yearlong study of the state of rail competition throughout the country.

It is doubtful, however, that rail customers would benefit from the changes proposed in the present legislation; indeed, the legislation may well make rate and service concerns worse rather than better. The bill would make efficient, uniform regulation of the rail industry more difficult by creating duplicative and overlapping regulatory schemes. Subjecting the rail industry to a patchwork of judicial injunctions at the behest of localities scattered across the country could cause a ripple effect of operational problems for freight, Amtrak, and commuter rail transportation. District courts are not equipped to anticipate, monitor, or remedy such problems, and those problems could impede the railroads' ability to provide efficient and timely freight and passenger rail service and raise the cost of providing those services—costs that likely would be passed on to rail customers in the form of higher rates.

I appreciate having the opportunity to discuss this legislation with the Subcommittee today.

Surface Transportation Board
Washington, D.C. 20423-0001

September 13, 2007

The Honorable Daniel K. Inouye
Chairman
Committee on Commerce, Science, and Transportation
United States Senate
Washington, DC 20510

The Honorable Ted Stevens
Ranking Member
Committee on Commerce, Science, and Transportation
United States Senate
Washington, DC 20510

The Honorable Frank Lautenberg
Chairman
Subcommittee on Surface Transportation and Merchant Marine Infrastructure, Safety, and Security
United States Senate
Washington, DC 20510

The Honorable Gordon Smith
Ranking Member
Subcommittee on Surface Transportation and Merchant Marine Infrastructure, Safety, and Security
United States Senate
Washington, DC 20510

Dear Chairman Inouye, Ranking Member Stevens, Chairman Lautenberg, Ranking Member Smith:

The Surface Transportation Board (the Board or STB) has been asked to provide its analysis of the potential impact of S. 772, the Railroad Antitrust Enforcement Act of 2007. That bill would eliminate certain rail carrier exemptions to the antitrust laws.

It is this Board's view that rail carriers should be subject to the full weight of federal antitrust laws, except where the enforcement of the antitrust laws may conflict with the need for single, uniform, and integrated economic regulation of the rail industry by the Board. In that vein, we are concerned that at least two provisions of the proposed legislation would interfere with the Board's ability to effectively regulate this nation's interconnected rail network. These include Section 2 of the bill, which would permit injunctive relief to be ordered by district courts in private civil actions, and Section 3, which would subject certain agreements and mergers approved by the Board to separate challenge in court under the antitrust laws at any time. Both of these sections would undermine the STB's ability to achieve the regulatory objective set forth by Congress to ensure a sound rail transportation system.

To put our concerns in context, we will first outline the narrow antitrust exemptions that currently apply to rail carriers and the Board's consideration of traditional antitrust principles in its administration of the Interstate Commerce Act. We will then discuss the portions of the proposed legislation that may make effective, integrated economic regulation of the rail industry more difficult.

Current Exemptions and the Board's Enforcement of Antitrust Principles

It is important to state at the outset that railroads today are already subject to much of the antitrust laws. They face civil and criminal liability for violations of the Sherman Act (e.g., price-fixing, market allocation, bid rigging), and have been successfully sued for violating that Act, with one price-fixing case resulting in a $1 billion jury verdict and a settlement in the range of $600 million.[1] Moreover, the survival of the judicially created *Keogh* doctrine,[2] which had long immunized the railroads from certain antitrust civil suits involving rates that were filed with the Board's predecessor, the Interstate Commerce Commission (ICC), is in serious doubt.[3] And although rail carriers may argue that a court in a particular case should find implied antitrust immunity, courts do not favor implied immunities and require a showing of "clear repugnancy" between the regulatory regime and the imposition of the antitrust laws.[4]

However, the railroads do have several express statutory immunities. First, rail transactions reviewed and approved by the Board under 49 U.S.C. §§ 11321-11328 (which include consolidations, mergers, acquisitions, some leases, trackage rights, pooling arrangements and agreements to divide traffic) cannot be separately challenged in federal court under the antitrust laws. Second, pursuant to 49 U.S.C. § 10706, the Board may grant antitrust immunity to certain types of agreements related to rates or charges. However, this provision cannot be used to immunize something akin to a price-fixing agreement between competing railroads, because the Board cannot authorize rail carriers to discuss or participate in agreements related to single-line rates, or to interline rates of a particular movement unless the rail carrier can practicably participate in the movement. *See* 49 U.S.C. § 10706(a)(3)(A)(i), (ii).

There are also two main categories of express immunities in the Clayton Act. Section 16 provides that only the federal government may bring suit for injunctive relief against any common carrier subject to the Board's jurisdiction. 15 U.S.C. § 26. Second, railroads, as common carriers subject to the Board's jurisdiction, are expressly immune from the Federal Trade Commission (FTC) Act, which bans methods of unfair competition. 15 U.S.C § 45(a)(2); *Cf.* 49 U.S.C. § 10702 (which bans unreasonable practices in the rail industry).

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[1] *See In re Burlington N., Inc.*, 822 F.2d 518 (5th Cir. 1987). *See also, e.g., In re Lower Lake Erie Iron Ore Antitrust Litigation*, 998 F.2d 1144 (3d Cir. 1993); *Laurel Sand & Gravel v. CSX Transp.*, 924 F.2d 539 (4th Cir. 1991); *Transkentucky Transp. R.R. v. Louisville & Nashville R.R.*, 581 F. Supp. 759 (E.D. Ky. 1983).

[2] *See Keogh v. Chicago & Nw. Ry.*, 260 U.S. 156 (1922); *Square D Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409 (1986).

[3] *See* ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS at 1402 n.1135 (5th ed. 2002) (questioning "future relevance" of *Keogh* doctrine after the ICC Termination Act).

[4] *Credit Suisse Securities, LLC v. Billing*, 127 S. Ct. 2383 (2007).

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These narrow rail antitrust exemptions do not mean, however, that rail carriers are not subject to the national antitrust policy. Quite to the contrary, in administering the Interstate Commerce Act, the Board is charged with, and in fact vigorously enforces, core antitrust principles.[5] As the Ninth Circuit recently stated, the Board is "empowered to step in and regulate [ ] anticompetitive conduct as part of its statutory responsibilities."[6]

We now turn to our chief areas of concern with regard to S. 772. (We will continue to study other aspects of the bill.)

<u>Private Civil Suit Injunction Concerns</u>

Presently, only the United States Department of Justice (DOJ) or the STB may bring suit for injunctive relief against a common carrier subject to STB jurisdiction. 15 U.S.C. § 26. This limitation traces back to the original Section 16 of the Clayton Act of 1914. The Supreme Court explained that the provision's "obvious purpose is to preclude any interference by injunction with any business or transaction of interstate carriers of sufficient public significance and importance to be within the jurisdiction of the [STB's predecessor, the ICC], except when the suit is brought by the Government itself."[7]

Section 2 of S. 772 would permit private parties to obtain injunctive relief against rail carriers in individual Sherman or Clayton Act challenges. This proposal presents serious risks to centralized oversight of the national transportation system. District courts are not responsible for, nor do they possess the expertise to consider, how a decision resolving a discrete dispute between a single carrier and a single shipper will affect other carriers and shippers on that line, or other similarly situated lines in other parts of the country. Only the Board is charged with looking at the rail industry from both a national, regional, and local perspective and ensuring that remedies to resolve individual disputes comport with national rail policy objectives. This broad policy oversight, guided not just by individual adjudications but also by rulemaking records and comprehensive industry studies, is critical to ensuring that the implications of a policy reflected in a decision in one case are appropriate and in the overall public interest.

Giving district courts injunctive power in rail-related disputes would also create a great potential for conflicting decisions from individual courts. The Board (and the ICC before it) has developed a consistent body of law that approaches competition issues with a viewpoint broadened by other rail transportation policy goals, and that provides the basis upon which both carriers and shippers shape their conduct and assess potential remedies. In contrast, district courts looking solely at the antitrust laws – without regard to the myriad of public interest considerations mandatory in Board review, including

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[5] *Gulf States Utilities v. Federal Power Commission*, 411 U.S. 747, 759-60 (1973) (regulatory agencies must consider the "fundamental national economic policy expressed in the nation's antitrust laws").

[6] *DHX, Inc. v. STB*, No. 05-74592, slip op. at 7 (9th Cir. Aug. 30, 2007).

[7] *Central Transfer Co. v. Terminal R.R. Ass'n*, 288 U.S. 469, 475 (1933).

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adequacy of rail revenues to support capital investment, public safety and health, a sound rail transportation system to meet public needs, fair wages for rail employees – might well come up with different rules and different remedies to fix competition issues. Indeed, given that a single major rail line may extend through many federal districts and circuits, it is quite possible for there to be different rules and injunctive remedies governing identical behavior in different jurisdictions. In a network industry like rail transportation, such a result is unworkable and would lead to confusion and, ultimately, added expense for shippers (and, in turn, consumers) as carriers shift the costs associated with complying with multiple standards.

Moreover, some rail disputes tend not to lend themselves to one-time remedies that need never be revisited. For example, if a district court were to craft an injunction whereby a rail carrier were required to provide a competitor access to its lines, there could be significant service disruption to shippers other than the litigant, long-term problems with operating protocols as carriers disagree over access-related issues and compensation, and effects on third parties such as switching carriers and interchange partners. The Board is well-suited to, and does in fact, retain jurisdiction over such disputes in order to resolve these long-term network issues. Antitrust courts, on the other hand, eschew such long-term involvement, recognizing that it is not the role of courts to substitute for regulators.[8]

Finally, many of the injunctive remedies that a district court might order in an antitrust case may themselves require Board approval. For example, a requirement that a carrier that has violated the antitrust laws provide trackage rights over its line would be subject to the requirement in the Board's governing statute of Board approval. Divestitures or spinoffs of lines to remedy a competitive problem would likewise be subject to the approval requirement of the Board's statute. Because the parties could not legally effectuate a remedy ordered by the district court without Board approval, yet another layer of complexity and expense would be added to rail disputes.

Simply put, we believe that Section 2 of S. 772 is antithetical to the reason for charging a single economic regulatory body with oversight over the rail industry. In order for the national rail system to remain efficient, the decision-maker with regard to injunctive relief should also be charged with ensuring that the ripple effects of any single injunction do not negatively affect the rail system elsewhere. With large dockets, resource constraints, and a lack of personnel with rail expertise, federal district courts would not be in a position to ensure this in every case.

Merger Dual Enforcement Concerns

In 1995, Congress declined to repeal the antitrust exemption for rail mergers, choosing instead to keep rail merger review with the agency that regulates the economic activity of the industry. Congress did, however, import some features of Section 7

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[8] *See* Stephen G. Breyer, *Antitrust, Deregulation, and the Newly Liberated Marketplace*, 75 CAL. L. REV. 1005, 1043 (1987).

merger review into the STB process, including the requirement that the Board employ a broad national outlook on the competitive impacts in relevant markets; it highlighted the Board's ability to use divestiture as a remedy; and it provided for informal communication between the Board and interested parties.

Section 3 of S. 772 would subject rail mergers and acquisitions to both the approval process and criteria of the Interstate Commerce Act and traditional Clayton Act standards and procedures. We are concerned that this dual enforcement regime could result in some of the same problems raised by the potential for district court injunctions described above. We are also concerned that it would diminish the considerable benefits of a single comprehensive review in which the views of all parties, including those of the Antitrust Division of DOJ and affected shippers, are transparent and considered.

From a substantive viewpoint, there is very little disagreement between the Board and the antitrust enforcers on the outcome of mergers. Although critics of the Board make much of those few instances of disagreement between the Board and DOJ, there has only been one recent case where the Board did not follow the DOJ recommendation that merger authority either be denied or conditioned on expansive divestitures.[9] The Board has more often followed the recommendation of DOJ because the Board is also guided by traditional Clayton Act Section 7 analysis.[10]

The Board's new merger rules anticipate the types of major rail merger proposals we could see in the future, which would likely involve the creation of a transcontinental railroad (by merging one carrier from the West with another carrier from the East). Under traditional merger analysis by the DOJ or the FTC, such vertical integration of two partners with complementary systems (e.g. BN/CN) would not be perceived to carry as significant a risk of competitive harm as a horizontal merger of two direct competitors (e.g. NS/CSXT). However, under the new STB rules, a Class I merger would be in the

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[9] *See Union Pacific/Southern Pacific Merger*, 1 S.T.B. 233 (1996), *aff'd sub nom. Western Coal Traffic League v. STB*, 169 F.3d 775 (D.C. Cir. 1999) (where the Board concluded that merger would be in the public interest because it would permit a weak Southern Pacific to join a financially healthy rail system that would invest in Southern Pacific's deteriorating infrastructure). Although the DOJ disagreed with the Board, DOJ did not challenge the Board's decision in court. There have been subsequent studies by economists at the Government Accountability Office and the Federal Trade Commission which have validated the Board's findings in that case. *See* Denis A. Breen, *The Union Pacific/Southern Pacific Rail Merger: A Retrospective on Merger Benefits*, Bureau of Economics, Federal Trade Commission, Working Paper No. 269, at 1 (March 2004); John Agyei Karikari, Stephen M. Brown, and Mehrzad Nadji, *The Union Pacific/Southern Pacific Railroads Merger: Effect of Trackage Rights on Rates*, 22:3 J. Reg. Econ. 271 (2004).

[10] *See Sante Fe Southern Pacific – Control – Southern Pacific Trans. Co.*, 2 I.C.C.2d 709, 727 (1986) (Board "is not an antitrust tribunal, although the principles of the antitrust laws, particularly section 7 of the Clayton Act and sections 1 and 2 of the Sherman Act, provide us with guidance").

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public interest "only when substantial and demonstrable gains in important public benefits – such as improved service and safety, enhanced competition, and greater economic efficiency – outweigh any anticompetitive effects, potential service disruptions, or other merger related harms."[11] To offset any harms that could not be mitigated, merging carriers would need to show how the proposed merger would enhance competition.[12] Although a major merger has not been proposed since the Board adopted the new rules, the Board has in place a comprehensive review scheme that would address both competition and service issues and the interplay between them.

We are concerned that dual merger review would frustrate the Board's ability to fashion merger conditions based on public interest concerns. For example, the Board might conclude that the public interest would best be served by certain types of conditions, whereas the district court or a federal antitrust enforcement agency could fashion other conditions that could work at cross purposes with those found appropriate by the Board. The STB has found that continued oversight of larger rail mergers is critical to ensuring that remedies are working effectively. In recent large rail mergers, the merging railroads have, as a condition of approval, been required to submit both quarterly and annual reports, for up to 5 years, so that the Board can analyze the impact of the transaction. This is not the role courts or federal antitrust agencies have taken in most recent antitrust mergers conditioned under the Clayton Act.[13] These types of chores are best left to a single decision-maker and that decision-maker should be one that is least limited in both what it can consider and what conditions it can and will impose – which in this instance would be the Board.

Please let us know how we can be of further assistance.

Sincerely,

Charles D. Nottingham
Chairman

W. Douglas Buttrey
Vice Chairman

Francis P. Mulvey
Commissioner

[11] 49 CFR 1180.1(c).

[12] 49 1180.1(c)(iv).

[13] *See* ANTITRUST DIVISION GUIDE TO MERGER REMEDIES (Oct. 2004) (disfavoring conduct remedies in merger cases because they tend to "entangle the [Antitrust] Division and the courts in the operation of a market on an ongoing basis and impose direct, frequently substantial, costs").

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CURE

Hearing before the
Senate Judiciary Committee,
Subcommittee on Antitrust, Competition Policy and Consumer Rights

"An Examination of S. 772, the Railroad Antitrust Enforcement Act"

October 3, 2007

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Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear before you today. I am Bob Szabo, a member of the Washington, D.C. law firm, Van Ness Feldman. I also serve as Executive Director of, and Counsel to, Consumers United for Rail Equity (CURE), an incorporated membership group of rail customers who are dependent on railroad transportation. The membership of CURE consists of electric, utilities, chemical companies, agricultural interests, paper companies, cement companies and others dependent on the railroads for transportation. We strongly support S. 772, the Railroad Antitrust Enforcement Act of 2007, which was ordered reported by the Senate Judiciary Committee on September 20 and is the focus of this hearing. This legislation will ensure that rail customers have access to the nation's antitrust laws to seek remedies for anticompetitive conduct of the railroads. We also support S. 953, the Railroad Competition and Service Improvement Act of 2007, which is pending before the Senate Commerce, Science and Transportation Committee. This legislation seeks to improve the practices of the Surface Transportation Board, which is responsible for the continuing regulation of the railroad industry.

THE IMPORTANCE OF S. 772

Mr. Chairman, one of the greatest problems that confronts many rail customers today is the lack of access to competitive rail transportation. Rail customers who lack access to competitive rail transportation are often referred to as "captives" and face high rates and often inadequate service. When Congress partially deregulated the railroad industry through the Staggers Rail Act of 1980, the intent was to allow transportation competition to replace governmental regulation with respect to as many activities of the railroad industry as possible. The Interstate Commerce Commission (ICC), which has now been replaced by the Surface Transportation Board (STB), was charged with ensuring competition and protecting rail customers without access to competition from abusive railroad rates and practices.

Today, over a quarter of a century later, consolidation in the rail industry and two anticompetitive practices that are allowed under the policies of the STB have combined to reduce the competitive transportation options available to many rail customers. The Government Accountability Office, in an October 2006 report on the state of the freight rail industry, found that there is a lack of competition in the freight rail industry, that the STB is not using its powers to ensure rail customer access to competition and that the rail customer protections developed by the STB are "inaccessible" to most rail customers. ("Freight Railroads: Industry Health Has Improved, but Concerns About Competition and Capacity Should be Addressed," GAO-07-94 (October 6, 2007))

The enactment of S. 772, the Railroad Antitrust Enforcement Act of 2007, will refocus the STB on original congressional intent. It will increase rail customer access to competitive rail service by ensuring that any future consolidation of the railroad industry complies with the provisions of the nation's antitrust laws. The legislation also allows rail customers access to the federal courts to seek relief under the nation's antitrust laws from the two major anticompetitive railroad practices that are being allowed by the policies of the Surface Transportation Board: "paper barriers," or "tie-in agreements," and the refusal of monopoly railroads to offer rates for the transportation of captive customers' freight to competing rail systems.

RAILROAD CONSOLIDATIONS

The Staggers Rail Act of 1980 provides that the Interstate Commerce Commission, now the STB, has the exclusive power to approve a railroad merger or acquisition when it determines that the transaction is "consistent with the public interest" (49 U.S.C. Section 11324; covered transactions defined in 49 U.S.C. Section 11323). In 1976, there were 30 independent Class I, or major, railroad systems consisting of 63

Class I railroads. Today, there are seven of these railroads left, with four of the Class I railroads dominating the rail transportation market. The Union Pacific (UP) and the Burlington Northern Santa Fe (BNSF) railroads operate generally west of the Mississippi River. The Norfolk Southern and CSX operate generally east of the Mississippi. Many rail customers have access to only one of these rail systems.

Since 1980, only one proposed merger has been rejected by the ICC or the STB as being inconsistent with the public interest. In 1986, the ICC rejected a proposed merger between the Southern Pacific Railroad and the Santa Fe Railroad. Ten years later, in 1996, the STB ruled that the merger of the Union Pacific and the Southern Pacific was "consistent with the public interest" despite a strong demonstration by the Department of Justice that the merger would inflict grave competitive injury to rail customers. Rail customers believe that the Department of Justice was correct in its analysis: the Union Pacific/Southern Pacific merger resulted in anticompetitive markets. Many rail customers have suffered the abuses that result from being captives of dominant carriers.

Perhaps the STB belatedly realized it had gone too far. In December 1999, when the BNSF and the Canadian National filed with the STB a "notice of intent" to file a merger application, the STB imposed a fifteen month "moratorium" on major rail mergers. During the moratorium, the STB adopted new "major merger guidelines" (June 2001) that attempted to ensure that future mergers of two Class I railroads were "pro-competitive." Since the adoption of the guidelines, no proposed major rail mergers have been brought to the Board, so the guidelines have not been tested.

Rail customers believe that S. 772 would ensure that future rail mergers will comply with the nation's antitrust laws. We understand that S. 772 allows the STB to continue to determine whether the proposed transaction is "consistent with the public interest." S. 772 does not prevent the STB from applying a standard for merger approvals that is more strenuous than the standard in the nation's antitrust laws. The

Department of Justice and the Federal Trade Commission may continue to file comments with the Board regarding the proposed merger. Under S. 772, unlike under current laws, the Department of Justice or the Federal Trade Commission could seek to enjoin the approved merger in federal district court if the merger, as approved, fails to meet the minimum standards of the nation's antitrust law.

PAPER BARRIERS/TIE IN AGREEMENTS

One of the major barriers to rail competition for many rail customers is the so-called "paper barriers" or "tie in agreements" included in many lease agreements between Class I and smaller Class II and Class III railroads regarding the operation of track owned by a Class I rail carrier. One of the intended results of the Staggers Rail Act of 1980 was that the major railroads would "rationalize" or "right size" their systems for the traffic requirements of the nation. Major rail carriers "rationalized" their systems through track abandonment and the transferal of operating rights to "short line" or "regional railroads" (Class II and III railroads). The ICC, and later the STB, was given authority to approve such transfers of operating rights in 49 U.S.C. Section 10902.

Since 1980, approximately 500 short line railroads have been created. Each of these new rail carriers received a certificate of authorization from the ICC or the STB, although the terms of the agreements between the two rail carriers were not made public during the proceedings of the federal regulatory agency. In the case of many of these new short line carriers, Class I track now operated by the short line railroad intersects with more than one major rail carrier. Such intersections should, from the standpoint of efficient and competitive rail system, allow the customers of the short line to have access to competing major rail systems.

Rail customers have been disappointed to learn, however, that many of these agreements contain "paper barriers" or "tie in agreements" that prevent the short line railroad from doing meaningful business with any major rail carrier other than the rail

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carrier from which it is leasing its track. To illustrate the anticompetitive effect of "paper barriers," I have attached as Attachment A a schematic of the "paper barrier" that prevents competitive rail service to the Independence Generating Station in Arkansas and the "paper barrier" provision extracted from the lease agreement between the Class I railroad and the short line railroad in this case.

Rail customers believe that "paper barriers" or "tie in agreements" clearly violate the antitrust laws of the nation and would not have been allowed had the railroad industry been subject to the full jurisdiction of the nation's antitrust laws. Other than the general policy of ensuring "the development and continuation of a sound rail transportation system with effective competition among rail carriers..." (49 U.S.C. Section 10101 (4)), neither the Staggers Rail Act of 1980 nor the ICC Termination Act of 1995 addresses the "paper barrier" issue.

S. 772 ensures that similar future transactions will not, we believe, contain these restraints on competition, but S. 772 also provides a mechanism for addressing these restraints in existing lease agreements. Section 8 of S. 772 provides that rail carriers have 180 days after the date of enactment to bring their agreements and practices into compliance with the nation's antitrust laws. After that date, an aggrieved party may seek prospective injunctive relief in the federal district court.

Access through short line carriers to competing major rail carriers will result, rail customers believe, in competition, which should result in market rates and improved service.

REFUSAL BY RAILROADS TO PROVIDE RATES

A second major barrier that prevents a number of rail customers from reaching competition is the refusal of major rail carriers to provide their captive customers rates to points where the rail customer can gain access to a competing railroad. Again, as with the "paper barriers" issue, this issue was not addressed directly by Congress in either the

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Staggers Rail Act of 1980 or the ICC Termination Act of 1995. Rather, this barrier derives from the STB's interpretation of these Acts in the "bottleneck" case of December 1996.

Many rail customers have access to only one rail carrier at origin or destination. However, often the lines of a competing rail carrier may be only a few miles away and have a switching facility that can transfer rail cars to or from the system to which the rail customer is captive. The rail customer cannot get to that competing carrier, however, if its "captor" rail carrier refuses to offer a rate to transport the customer's cars to or from that competing system or refuses to receive the customer's cars from that competing system.

An example of this problem was presented to the House Transportation and Infrastructure Committee on September 25, 2007, by Terry Huval, Director of Utilities, City of Lafayette, Louisiana, and currently Chairman of the Board of the American Public Power Association. A schematic of the problem confronting the City of Lafayette is attached as Attachment B.

The City of Lafayette owns half of a large coal-fired electric generator in Louisiana that is 1500 miles from the source of its coal, the Powder River Basin of Wyoming. The electric ratepayers of Lafayette, Louisiana, pay rates that are based on the delivered cost of fuel to the plant, including both the cost of the coal itself and the cost of transporting the coal to the plant.

The utility is responsible for the transportation of the coal it purchases at the "mine mouth" in Wyoming to its plant in Louisiana. The two remaining major western rail systems, the BNSF and the UP, both operate in the Powder River Basin and either can "originate" the coal transportation. However, the last twenty miles of track into the power plant are owned by the UP. A rail map would suggest that the City of Lafayette should have competition for 1480 miles of its coal movement. The UP can transport the coal all the way to the Lafayette plant. The BNSF can move the coal trains to Kansas City where they can be transferred to the Kansas City Southern (KCS), which can pull the coal cars over its tracks to a point 20 miles from the Lafayette plant where the UP has a switching facility to transfer the cars to the UP system for the final 20 miles to the plant.

Under the pro-competitive national rail policy that is contained in the Staggers Rail Act (49 U.S.C. Section 10101), the City of Lafayette expected that it would have competition for all but the last 20 miles of its movement. For the last 20 miles, it would pay higher "captive" rates. Unfortunately, the 1996 STB decision in the "bottleneck" case held that the UP is not required to provide a rate for that last 20 miles from the switching facility to the power plant – and of course the UP does not provide such a rate. Without this rate, the option of moving across the BNSF/KCS system is not available. Therefore, instead of having competitive rates for 1480 of 1500 miles, the City of Lafayette is paying captive rates for the entire 1500 miles of its coal transportation,

Mr. Huval testified on September 25 that the "cost of captivity" to the Lafayette education system through the higher electric rates that result from these captive rail rates for moving coal to Lafayette is $1.52 million a year.

We believe that if the antitrust laws of the nation applied to the railroads they would not be allowed to refuse to provide rates to move a customer's cars to a competing rail system. Under S. 772, after the 180 day grace period provided in Section 8, the City of Lafayette and other like situated rail customers would have access to the federal courts to test whether this conduct on the part of the UP would violate the nation's antitrust law – an option rail customers do not have today.

STB CONCERNS WITH S. 772: RAIL CUSTOMER RESPONSE

In a September 13, 2007, letter to the leadership of the Senate Commerce, Science and Transportation Committee, the three Commissioners of the STB set forth their concerns regarding S. 772. The Commissioners expressed two concerns: (1) that S. 772

could create a difficult regulatory environment since rail customers would have access to private civil suit injunction relief, and (2) that S. 772 could lead to dual enforcement concerns with respect to mergers. I will respond to the second concern first.

DUAL MERGER ENFORCEMENT CONCERNS

The Commissioners argue that the new merger rules could result in dual merger enforcement regimes. Rail customers foresee no such dual merger enforcement concerns, as long as STB policies and judgments comply with the antitrust laws of the nation. The STB will continue to have first call on whether a merger should be approved as being "consistent with the public interest." The Department of Justice and the Federal Trade Commission can be expected to file comments with the Surface Transportation Board on the proposed merger, as they have in the past. The STB will be informed by those comments and can accommodate or ignore the comments. The only difference under S. 772 is that the Department of Justice and the Federal Trade Commission would have the power to ensure minimum compliance with the nation's antitrust laws by testing the approved merger, with the conditions added by the Surface Transportation Board, in federal district court. We anticipate that these three arms of the federal government would communicate and reach agreement on the merger that would prevent last minute litigation. In short, there should be no dual enforcement problem as long as the actions by the Surface Transportation Board meet the minimum standards set forth in the nation's antitrust laws.

PRIVATE CIVIL SUIT INJUNCTION CONCERNS

The Commissioners also state the concern that the application of the nation's antitrust laws to the railroads will make it difficult for the STB to implement a logical regulatory regime. Rail customers do not share this concern. First, the nation's rail transportation policy, as set forth in 49 USC Section 10101, contains the same objectives that a federal district court would consider in formulating an injunctive remedy under the

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antitrust laws. Rail customers believe that if the STB ensures that its actions conform with the policies set forth in 49 USC Section 10101, there will be no grounds for injunctive relief under the nation's antitrust laws. Indeed, the GAO report cited previously suggests that the STB to date has not implemented policies that are faithful to the national rail transportation policy.

Second, other regulated network transportation industries are subject to both a federal regulatory regime and the nation's antitrust laws with no resulting confusion. No antitrust exemptions exist for the transmission of electricity, the transportation of natural gas, or the transportation of oil by common carrier pipelines (whose rates are regulated by the Federal Energy Regulatory Commission under the old Interstate Commerce Act, 49 U.S.C. App.(1)((b) (1988))). In these network transportation industries, vigorous competition occurs within a framework of regulatory oversight, but with the safeguard of antitrust remedies, including private civil antitrust remedies, in the background. There has been no significant conflict between the antitrust courts and effective regulation by the Federal Energy Regulatory Commission. Rather, the Supreme Court contemplates that the roles of the antitrust courts and the Commission will complement each other. See e.g., *Otter Power Co. v. United States*, 410 U.S. 366 (1973); *California v. FPC*, 369 U.S. (1962).

Finally, under contemporary antitrust standards, a private civil plaintiff seeking to enjoin a railroad's antitrust violations faces very heavy burdens, as this subcommittee is well aware. Moreover, neither the Department of Justice nor the Federal Trade Commission is easily persuaded to initiate antitrust actions.

For these reasons, rail customers believe that the Board's concerns that civil antitrust injunctions will disrupt its regulatory functions or subject the railroads to conflicting standards is not a likely scenario under current antitrust law.

CONCLUSION

Mr. Chairman, rail customers are grateful to you and the Senate Judiciary Committee for ordering S. 772 reported to the full Senate. This is the first time since 1980 that a committee of either house of Congress has reported pro-competitive rail legislation that will ensure that the pro-competitive national rail policy contained in the Staggers Rail Act of 1980 will be realized. We stand ready to work hard for the enactment of S. 772 in the 110th Congress.

Thank you.

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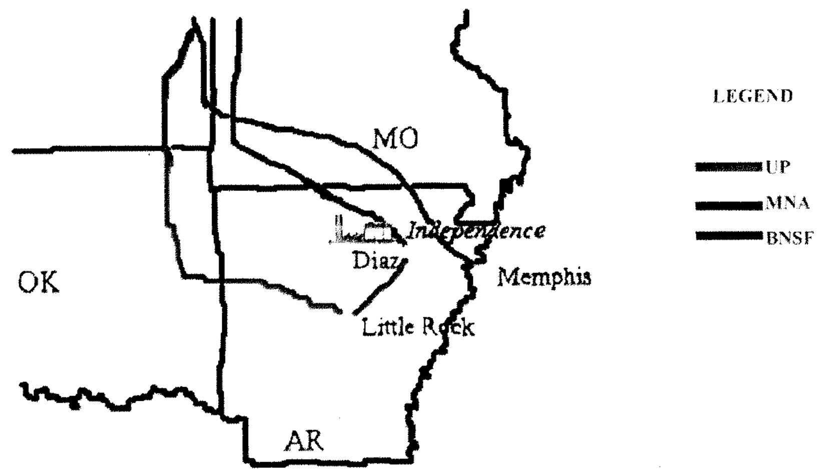
Attachment A

PAPER BARRIERS
SHORT LINE TIE IN AGREEMENTS



Result of these decisions by the ICC/STB: The Class I Railroad, through the Paper Barriers in agreements with Short Lines, can deny the customer access to railroad competition

CURE

VanNess Feldman 1

LEASE AGREEMENT BETWEEN MISSOURI PACIFIC RAILROAD CO. (NOW UNION PACIFIC) AND MISSOURI & NORTHERN ARKANSAS RAILROAD CO. (MNA)

Section 4.01 "In consideration of this Lease, and subject to the terms and provisions set forth herein, Lessee agrees to pay Lessor rent for the Leased Premises in the amount of Ninety Million Dollars ($90,000,000) per year payable annually in advance on the 1st day of March; PROVIDED, HOWEVER, that subject to the provisions of Section 4.02 hereof, for each lease year that 95% or more of all traffic originating or terminating on the Leased Premises is interchanged with Union Pacific Railroad Company, Missouri Pacific Railroad Company and any affiliated company, their successors and assigns, Lessor agrees that it will waive or partially waive the rent for that particular year in accordance with the schedule set forth in Section 4.03. segments."

Schedule in Section 4.03

PERCENTAGE OF THE TOTAL TRAFFIC THAT WAS INTER CHANGED WITH LESSOR	RENT DUE LESSOR
100 –95%	$-0-
94 – 85%	$10,000,000
84 – 75%	$20,000,000
0 - 4%	$90,000,000

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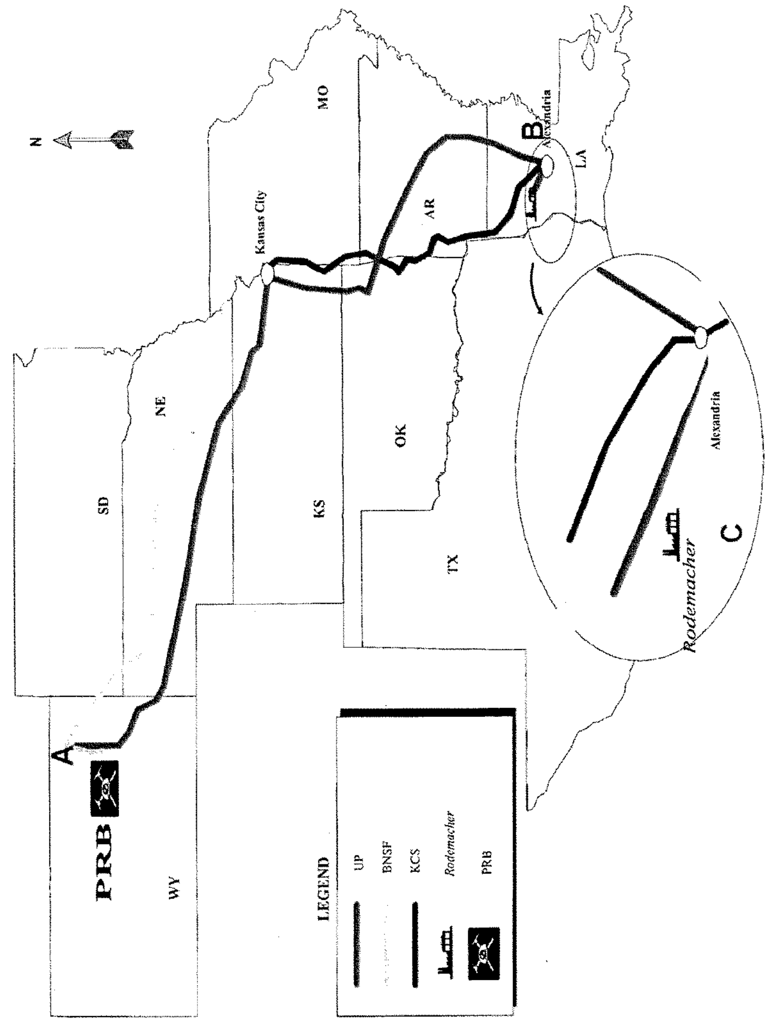
Attachment B

Selected Routes For PRB Coal Moving to Rodemacher



Railroad Antitrust Issues

NOT FOR PUBLICATION UNTIL

RELEASED BY THE SENATE JUDICIARY COMMITTEE

Statement of Ken Vander Schaaf

Director, Supply Chain Management

Alliant Techsystems Ammunition and Energetics Systems

Before the

Senate Committee on the Judiciary

Subcommittee on Antitrust, Competition Policy and Consumer Rights

United States Senate

October 3, 2007

Version 10/09/2007 11:25 AM

Chairman Kohl, Senator Hatch, and distinguished Members of the Committee, thank you for the opportunity to appear before you today to discuss the issue of rail transportation costs and the quality of service experienced by a captive customer. ATK (Alliant Techsystems, Inc.) is the captive customer at two of our locations: Radford Army Ammunition Plant in southwestern Virginia, and ATK Launch Systems in and around Promontory, Utah. I am Ken Vander Schaaf, the Director of Supply Chain Management at Radford Army Ammunition Plant. In my testimony today, I will address the captive customer issues at these two facilities. The first is the Army's Radford Army Ammunition Plant, which ATK operates under a GOCO (Government Owned Contractor Operated) arrangement with the U.S. Army. The second is the ATK Launch Systems facility in Promontory, Utah, a private facility that supplies large solid rocket boosters for the National Aeronautics and Space Administration's (NASA) Space Shuttle program, the Department of Defense's Minuteman and Trident strategic missile systems, and other large defense, commercial, and civil rocket programs.

Radford Army Ammunition Plant, Radford, Virginia

Alliant Techsystems, and its heritage companies, has continuously operated the Army's Radford Army Ammunition Plant under contract with the U.S. Army since the 1940s. The Radford facility is a large chemical plant, covering over 6,700-acres astride the New River in southwestern Virginia.

Radford is the nation's sole producer of single-base propellants for all military, law enforcement, and civilian ammunition. We annually produce 21 million pounds of nitrocellulose, eight and a half million pounds of propellant and four and a half million pounds of commercial powder. These products are used in the production of all small and medium caliber ammunition, tank ammunition, artillery and tactical rocket motors, explosives, and a variety of other ammunition products. Radford is the only domestic source of nitrocellulose, which is required in the production of all ammunition products, including those utilized by the military, law enforcement, and civilian sportsmen.

In order to support the production of propellants, significant quantities of chemicals must be safely transferred, stored, and processed while ensuring strict compliance with environmental standards. Since the plant was first opened by the Army during World War II, Radford has relied almost exclusively on rail shipment to receive needed chemicals. The Army and ATK have established and implemented procedures to ensure the safe receipt and handling of these chemicals from the railhead throughout the production cycle. Those deliveries are critical to the ability of the facility to supply the Army and other services with propellants to support operations and training, and for ATK to meet the delivery requirements of its firm fixed price contracts with the Army in its role as the single manager for conventional ammunition.

Of increasing concern, and one that is directly addressed by this hearing on the pending legislation (S. 772), are rising transportation costs and the decreased quality of rail service experienced by ATK at Radford. Over the years, Alliant Techsystems has had a fairly constant relationship with our sole rail carrier, the Norfolk Southern Railroad. Historically the Radford Army Ammunition Plant was served by two railroads, the Virginian and Norfolk Western. As you know, the Virginian was acquired by the Norfolk Southern, and we are now a "captive customer," relying on a single rail provider for the receipt of large quantities of chemicals.

Rail Service at Radford: Over time, we frequently have experienced rail schedule slips due to weather, equipment breakdowns, and competing rail priorities. As a result, we plan around these potential schedule slips by building excess inventory into our business plans so that operations will continue uninterrupted, and so that we can meet the Department of Defense's expected delivery schedules. This practice is not atypical for many companies that rely on rail service for their inbound raw materials, but it adds cost and overhead to those operations.

However, given these service issues, we have looked for alternatives. ATK ships out finished propellants by tractor-trailer; for that reason, we have also considered inbound shipments of chemicals into the plant via highway as an option. Although via highway shipments occur occasionally when rail service is interrupted or delayed, there are a number of considerations that make this an undesirable option in regular practice. First, the plant lacks a facility for the regular receipt and transfer of large chemical shipments by tractor trailer. In order to pursue that option, the Army would have to fund and construct such a terminal. In addition, for every single rail car of ammonia, five tractor trailers are required to transport an equivalent amount of chemical. This translates to increases in loading and shipping time, increasing the possibility of accidents, potentially requiring additional hazardous materials facilities along highways and delivery routes, and incurring added environmental and safety concerns. In summary, for large chemical shipments to Radford, we prefer to rely primarily on rail shipment. For this reason, we strongly advocate measures to address our rail carrier's sometimes ambivalent attitude towards schedules, costs, and customer needs. For mostly environmental and safety reasons, we would strongly prefer that highway shipment remain an occasional exception to the rule, rather than become our primary means of transportation.

Rail Pricing at Radford: While suffering from decreased quality of service by our rail carrier, Norfolk Southern, price increases at rates substantially higher than inflation have also given our Radford facility cause for concern. Over the last three years, rail tariffs have changed and commodities have shifted within the railroad's groups, resulting in multiple, new pricing rules, each within a consistent pattern of increased costs to the customer – and leaving the customer with no means of seeking redress. For example, prior to three years ago, although pricing generally increased on an annual basis, mostly consistent with inflationary patterns, we viewed those price increases as both realistic and relatively justified. However, in May 2006, Cherokee Nitrogen, ATK's supplier for ammonia, advised us that they had just been notified by Norfolk Southern that their "zero mileage rates" had been cancelled. Effective June 1, 2006, Cherokee, which simply passes on the rail increases, was forced to raise its freight rate for shipments to our Radford facility from 39-dollars per ton to 65-dollars per ton for all future shipments of ammonia. Our first notification of this 69 percent rate increase came within 30 days of its effective date. This massive price increase demonstrates the ability of the railroad to levy price increases with little if any notice, and virtually no time for an effective rebuttal or discussion by a captive shipper (in this case, Cherokee Nitrogen), or captive customer (ATK).

We understand that Norfolk Southern's rationale for rate increases relies in part on the liability risks associated with transport of toxic inhalants. In 2006, ATK was advised that those liability risks would continue to drive rail rates upward by seven to ten percent annually. While we began to adjust our planning accordingly, that rate increase estimate has proven to be significantly understated. On December 15, 2006, Norfolk Southern Railroad increased rates by 15 percent. On June 6, 2007, new rates added another 15 percent. In the last 15 months, rates have increased by over 330 percent from 39-dollars per ton (May 2006), to 132-dollars per ton (July 2007). Although we understand liability exposure, we believe that an accounting audit would demonstrate that these rate increases are excessive in comparison to actual liability-related costs.

Significant fuel surcharges have also added to the cost of shipments, far out of line with any associated increases in the cost of fuel. Whenever the cost of oil increases, our rail carrier has unilaterally added a "fuel surcharge" to the cost of shipments. Norfolk Southern has then almost always then adjusted its tariff rates to incorporate the new fuel surcharges. This compounding of fuel surcharges far exceeds actual increases in fuel costs. Our experience is that railroads modify the tariff rates to incorporate the higher rates such that there is never a corresponding drop in cost of freight when the price of oil decreases.

To summarize ATK's situation at our Radford facility, we believe that Norfolk Southern Railroad is deliberately trying to "price itself out" of the business of shipping chemicals at all, the end result of which will be the shifting of those hazardous materials from the railroad to the highways. Our company has several concerns with this forced path. In ATK's experience, railroad has several inherent safety advantages over trucks: railcars are constructed of stronger materials than are tanker trucks; rail traffic is more segregated from other means of transportation, whereas trucks travel on the same roads and thoroughfares with civilians; and, the number of railcars required to transport the same quantity of material as a tractor trailer differs by as much as a factor of five.

Expanding on this last point, in our experience, there are significant advantages to the shipper and to the receiver when shipping with larger railcars. Each time a shipment is loaded or unloaded, the people involved are potentially exposed during the sampling process and connecting of transfer hoses. As the number of individual shipments increases – as it would if we were to ship via truck rather than rail – then the exposure time of our workers increases as well. While the chemical industry has a very good safety record in handling chemicals properly, each unnecessary transfer increases the opportunity for an incident, or an accident. For these reasons, it is the practice of our Radford facility to minimize the use of tractor trailers and truck shipments for chemicals. We use highway shipping only emergency situations, for the protection of our workers and facility, as well as the communities surrounding our facilities and through which our purchases and products travel. However, we are concerned that we may be soon forced to reconsider this practice by the policies and practices of our captive rail carrier.

ATK Launch Systems, Promontory, Utah

The Norfolk Southern Railroad is not the only railroad on which Alliant Techsystems is a captive customer. Our sister location in Promontory, Utah, is a captive customer of Union Pacific Railroad. As stated earlier, ATK's Promontory facility supplies the U.S. government the solid rocket boosters for the Space Shuttle program, the solid rocket motors for both the Trident and Minuteman strategic missile programs, plus multiple other rockets configurations. The rocket motors manufactured at Promontory are loaded by ATK onto railcars at our facility in Corinne, Utah. Union Pacific then transports those rail freights to locations as divergent as Titusville, Florida, Vandenberg Air Force Base, California, and Seattle, Washington; and, in the future, we will be shipping to Huntsville, Alabama. Because of the associated safety setbacks and the enormous size of the products, there is no other way to ship these products. Our Promontory facility is not only held captive by Union Pacific because of a lack of competition amongst railroad carriers, we are also captive because there is no other physical means of transport.

Like Norfolk Southern, Union Pacific has also demonstrated similar radical pricing trends, though our Utah carrier does not cite the risks of handling chemicals as justification for their rate increases. In 2002, ATK Promontory paid about 14,000-dollars per rail car to Union Pacific. In 2003, the rate increased by three and a half percent. In November 2005, the rate grew by another eight percent. On January 1, 2007, the rate increased by another 13 percent. In April 2007, the rate increased yet again to over 21,000-dollars per rail car, an increase of yet another 12 percent, and an increase of over 50 percent in five years.

Union Pacific cites two main reasons for these rate increases: a "special train" status, and increase in fuel costs. Union Pacific recently began charging us to provide "special train" service between the shipping point and the interchange to Kansas City Southern Railway at Kansas City. However, ATK never requested this service. Rather, it was initiated in 1994 by Union Pacific to facilitate the flow of traffic across their lines. "Special train" was Union Pacific's decision, not ATK's, yet they now expect us to pay for it. The explanation given for the rate increases in April was that the Surface Transportation Board mandated that all fuel surcharges be based on transportation mileage. This increase is now permanent regardless of any future changes in fuel costs, and is on top of previous fuel surcharges that were already in excess of the actual cost of fuel expended to facilitate shipment of goods. The reasons given for rate increases reflect either services never requested by our company, or fuel surcharges in excess of rises in actual fuel costs.

Similar to Radford's experiences, our Promontory facility also experiences a lack of reliability by their rail carrier. Union Pacific often misses promised pick up or delivery dates, and transit times are routinely longer than promised. For this reason, extra time is built into schedules as a matter of regular practice at our Promontory facility in order to reduce customer complaints over late deliveries.

Unfortunately, because we are captive to only one rail carrier at each of our locations, we are forced to tolerate that carrier's performance, prices and attitude toward service. In addition to not having choice among rail carriers, we often do not have alternatives to rail in general. As stated earlier, a solid rocket booster shipping to Cape Canaveral in Florida is too massive to move on anything other than a railcar. The combined effect of uncertainty in rail service coupled with unreasonable price increases has proved to be a burden on our operations and our customers, and has added to ATK's cost of operation at

Promontory. Those financial and schedule costs ultimately add cost and risk to our government customers at both NASA and the Department of Defense. The problem quite simply is that there is no other transportation service to use, and our observations of the feasibility of obtaining redress through the Surface Transportation Board leave us with few if any alternatives.

Conclusion

All of us at ATK are extremely proud of the role we play in support of our war fighting, homeland security, law enforcement, space exploration, and outdoor sportsmen customers. However, our ability to perform those missions safely and economically for our customers is negatively impacted by the quality of the service we receive, and extremely high rates demanded by monopoly rail carriers. We understand that ATK's experience at our facilities in Radford, Virginia, and in Promontory, Utah, is paralleled by the experiences of many others in the chemical industry, as well as those in the agriculture, energy, and national security industries. ATK's experience also calls into question that larger issues of increased costs born by NASA and the Department of Defense – and ultimately the U.S. taxpayer – as it annually transports by rail millions of tons of equipment, products, and supplies to and from depots, military bases, and ports.

Thank you again, Chairman Kohl and Senator Hatch, for your leadership on this issue, and for your Committee's continued interest in looking for ways to redress these important issues. We look forward to working with you in support of this legislation, and other possible legislation needed to solve the issues facing ATK and other companies held captive by the monopoly railroad companies. I would be pleased to respond to any questions you might have.