

HOUSE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
SUBCOMMITTEE ON RAILROADS

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ON REAUTHORIZATION: RAIL RATES, ACCESS AND REMEDIES

May 13, 1998

Introduction

My name is Linda J. Morgan, Chairman of the Surface Transportation Board (Board). I am appearing today on behalf of the Board at the request of the Subcommittee to discuss the reauthorization of the Board, and to focus specifically on issues related to rail rates, access, and remedies. Included in this discussion will be the Board's regulatory responsibilities for Amtrak. The Subcommittee held two prior hearings on the Board's reauthorization on March 12 and May 6, 1998, focusing specifically on funding, resources, and workload issues, and rail inter-carrier transactions, constructions and abandonments. Thus, my testimony today will not address those issues in any detail.

Background on the Board

As you know, on January 1, 1996, the Board was established pursuant to P.L. 104-88, the ICC Termination Act of 1995 (ICCTA). Consistent with the trend at that time toward less economic regulation of the surface transportation industry, the ICCTA eliminated the Interstate Commerce Commission (ICC) and, with it, certain regulatory functions that it had administered. The ICCTA transferred to the Board core rail adjudicative functions and certain non-rail adjudicative functions previously performed by the ICC. Motor carrier licensing and certain other

motor functions were transferred to the Federal Highway Administration within the Department of Transportation (DOT).

The Board is a three-member, bipartisan, decisionally independent adjudicatory body organizationally housed within DOT. As a quasi-judicial body, it makes decisions on matters before it based on the record compiled in the cases after adequate notice and full opportunity for participation and comment by interested parties. Pending its resolution of a matter, the Board must maintain complete objectivity and may not prejudge or speculate about the ultimate decision.

The rail oversight conducted by the Board encompasses, among other things, maximum rate reasonableness, car service and interchange, mergers and line acquisitions, line constructions and abandonments, and labor protection and arbitration matters. The jurisdiction of the Board also includes limited oversight of the intercity bus industry and pipeline carriers; rate regulation involving non-contiguous domestic water transportation, household goods carriers, and collectively determined motor rates; and the disposition of motor carrier undercharge claims. The substantial deregulation effected in the Staggers Rail Act of 1980 (Staggers Act) and the laws governing motor carriers of property and passengers was continued under the ICCTA. The ICCTA empowers the Board, through its exemption authority, to promote deregulation through administrative action.¹

¹ Attached to my prior testimony for both of the previous Subcommittee hearings was a summary of the accomplishments of the Board since its creation on January 1, 1996.

Reauthorization of the Board

The Board was authorized under the ICCTA through September 30, 1998, and thus its reauthorization is before Congress this year. The Board believes that it should be reauthorized for at least 3 years, and at least at its existing staffing and budget levels.

Congress created the Board as an independent adjudicative body. There continues to be an important regulatory role for such a body with respect to surface transportation. The need for such a body is no less today than it was when the Board was established. The resources allocated to the Board should reflect the fact that the Board's responsibilities continue at least at the level they were when the Board was created. Given the critical nature of the responsibilities being implemented by the Board in an ever-changing transportation marketplace, the certainty and stability made possible by continuing these functions in the same forum are paramount. A multi-year reauthorization period is important to that end.

Discussion of Rates, Access, and Remedies

Rate Reasonableness Complaints.

1. *Market Dominance Threshold.* The Board has jurisdiction to adjudicate complaints challenging the reasonableness of a railroad's common carriage rates only if the railroad has market dominance over the traffic involved. 49 U.S.C. 10701(c)-(d), 10704, 10707. Market dominance refers to "an absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies." 49 U.S.C. 10707(a). Under 49 U.S.C. 10707(d)(1)(A), the Board cannot find that a carrier has market dominance over a movement if the rate charged results in a revenue-to-variable cost percentage that is less than 180%. If this ratio is over 180%, then the Board determines whether there is effective intramodal, intermodal, geographic or product

competition. If there is not, then there is market dominance. Thus, in considering any rate reasonableness challenge, the first finding that the Board makes is whether the defendant carrier has market dominance over the traffic involved.

2. *Standard Guidelines for Assessing Rate Reasonableness.* To assess whether rates are reasonable, the Board uses a concept known as “constrained market pricing” (CMP) whenever possible. See Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520 (1985), *aff’d sub nom. Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987). CMP principles limit a carrier’s rates to levels necessary for an efficient carrier to make a reasonable profit. CMP principles recognize that, in order to earn adequate revenues, railroads need the flexibility to price their services differentially by charging higher mark-ups on captive traffic, but the CMP guidelines impose constraints on a railroad’s ability to price differentially.

The most commonly used CMP constraint is the “stand-alone cost” (SAC) test. Under the SAC test, a railroad may not charge a shipper more than it would cost to build and operate efficiently a hypothetical new railroad, tailored to serve a selected traffic group that includes the complainant’s traffic. The Board used this test to resolve three rate complaints since the beginning of 1996, and this test is being used to evaluate the reasonableness of rates in several ongoing cases. Certain other rate complaint cases were settled.

3. *Specific Rate Decisions.* Specifically, in the West Texas Utilities Company decision served in May 1996, the Board, using the SAC test, found a Burlington Northern rate from a mine near Gillette, Wyoming, to a generating station in Vernon, Texas, to be unreasonably high, limited the rate that can be charged for that transportation in the future, and required payment of approximately \$11 million in reparations for past shipments. The Board’s decision, which was challenged by the railroad, was affirmed in court.

In the Arizona Public Service Commission decision served in July 1997, the Board, also using the SAC test, found that the rail rate charged by the Santa Fe for carrying coal from a mine near Gallup, New Mexico, to the Cholla electrical generating plant at Joseph City, Arizona, were unreasonably high. The Board ordered the railroad to reduce the rate by approximately 40% and to pay reparations of more than \$25 million to the complaining shippers. The Board recently denied, for the most part, the railroad's request for administrative reconsideration of that decision.

In August 1997, in the McCarty Farms case, the Board evaluated rail rates charged by Burlington Northern for transporting export wheat and barley from Montana to ports in the Pacific Northwest. Based on the SAC test, which the parties asked it to use, the Board concluded that the rates had not been shown to be unreasonable and dismissed the complaint. The shippers have sought judicial review.

4. New Simplified Guidelines for Assessing Reasonableness. Although the CMP guidelines provide the most economically authoritative procedures for evaluating the reasonableness of rail rates, a rate challenge using CMP (particularly SAC) can be quite complex and expensive to litigate. Thus, CMP can be impractical to use where the amount of money at issue is not great enough to justify the expense of such an evidentiary presentation. In the ICCTA, Congress directed the Board to develop a simplified, alternative procedure to CMP. 49 U.S.C. 10704(d). Accordingly, in December 1996, the Board adopted simplified guidelines that employ three revenue-to-variable cost benchmarks as starting points for a case-by-case reasonableness analysis. Subsequently, the Board adopted procedures for expediting those cases. The railroads sought judicial review of these guidelines, and oral argument was held before the United States Court of Appeals for the D.C. Circuit on May 8, 1998. No complaint cases have been filed by shippers

seeking application of these guidelines, and the one pending case to which these guidelines would have been applicable has been settled by the parties.

5. *Procedures For Expediting Rate Cases.* In October 1996, as part of its commitment to expeditiously resolve its pending caseload, and its complaint cases in particular, the Board adopted new rules and procedures to speed the processing of rail rate complaints, including bottleneck cases. In part, the new regulations are designed to ensure that SAC cases, which often had taken years to resolve, will be completed within 16 months following the filing of a complaint. These regulations also include other time limits, the provision for discovery without involvement of the Board, simultaneous review of market dominance and rate reasonableness issues, and the continued processing of the merits of a case even when a motion to dismiss is pending. In January 1998, the Board issued final rules for determining within a certain time period whether CMP or the simplified procedures should be applied in any particular case.

Competitive Access.

Under the current statute, three kinds of competitive access remedies are available to complaining shippers or carriers. The first, and least physically intrusive form of access, is an *alternative through route* under 49 U.S.C. 10705(a), whereby an incumbent railroad can be required to interline traffic with another railroad and provide a through route and through rate for that traffic. The second form of access is *reciprocal switching* under 49 U.S.C. 11102(c), whereby the incumbent railroad, for a fee, must handle the cars of a competing carrier, enabling the latter carrier, even though it cannot physically serve the shipper's facility, to offer a single-line rate to compete with the incumbent's single-line service. The third, most physically intrusive form of access is *terminal trackage rights* under 49 U.S.C. 11102(a), whereby the incumbent railroad, for a fee, must permit physical access over its lines to the trains and crews of a competing carrier.

Although having more routing options could provide additional competition in some circumstances, the statute does not provide these access remedies on demand; a showing of need is required. Through the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act) and the Staggers Act, Congress ended the requirement that railroads provide service and rates over all possible routes, and instead gave carriers the discretion to choose the routes over which they will provide service, freeing them to maximize their use of efficient routes and to eliminate less efficient ones. The three access remedies in the statute were adopted principally to provide redress from a carrier's abuse of that discretion. Thus, to obtain any of these competitive access remedies, the current regulations require a demonstration that the incumbent rail carrier has engaged in anticompetitive conduct. 49 CFR 1144.5(a). The ICC, in case law that was affirmed in court, interpreted the regulations as requiring a showing that the carrier has either (1) used its market power to extract unreasonable terms or (2) because of its monopoly position shown a disregard for the shipper's needs by rendering inadequate service. Midtec Paper Corp. v. Chicago & N.W. Transp. Co., 3 I.C.C.2d 171 (1986), *aff'd sub nom*, Midtec Paper Corp. v. United States, 857 F.2d 1487 (D.C. Cir. 1988).

Bottleneck Cases.

In decisions served in December 1996 and April 1997, the Board established principles to govern the class of rail rate and service complaint cases known as "bottleneck" cases. Bottleneck cases arise where more than one railroad may be involved in providing service from one or more origins to a destination, but only one -- the bottleneck carrier -- can provide service over part of the

movement. Shippers have sought relief intended to minimize the bottleneck carrier's market power by limiting its ability to route its traffic.

In its decisions, the Board recognized that railroads under the law have the initial discretion as to how to rate and route their traffic. Nevertheless, the Board found that shippers may obtain substantial relief in three different ways. First, in light of the common carrier obligation of 49 U.S.C. 11101, a bottleneck carrier may not refuse to provide service to a shipper from a new origin that it does not serve. Instead, under 49 U.S.C. 10742, it must accept traffic from the origin carrier at a reasonable interchange and provide a route and whatever rate is necessary to complete the transportation.

Second, under the competitive access provisions of 49 U.S.C. 10705, a shipper may obtain the prescription of a new through route from an origin that is served by a bottleneck carrier, if the shipper shows that the carrier has used its market power in an inappropriate way, or that the service proposed by the shipper would in some way be more efficient, or "better," than the existing service. The Board noted that a shipper contract with the non-bottleneck carrier could be useful in making this showing.

Finally, the Board found that, notwithstanding prior precedent generally restricting rate reasonableness challenges to origin-to-destination rates, when the non-bottleneck segment of an established through route is covered by a rail/shipper contract over which the Board has no jurisdiction, the rate covering the bottleneck segment is challengeable separately.

Both the railroads and shippers appealed the Board's decision in court, and this appeal was argued in November of last year. Currently, two cases separately challenging bottleneck-segment rates are pending before the Board.

Service Issues.

Under the common carrier obligation, railroads must provide nondiscriminatory service upon reasonable request and must not engage in unreasonable practices. The Board has authority to address claims that carriers have violated the common carrier obligation. Cases currently pending before the Board on these issues and on car supply issues include complaints filed by DeBruce Grain, Inc., and Grain Land Coop. The Board has also addressed, in the Caddo Antoine case, a complaint alleging that a railroad had violated its common carrier obligation under 49 U.S.C. 11101(a) by embargoing track on a branch line in Arkansas while the railroad decided whether to abandon the line.

The Board may issue temporary service orders to address rail service emergencies, and may also direct a carrier to operate the lines of another carrier that has ceased operations, for up to 270 days. 49 U.S.C. 11123. This authority allows the Board to prevent the loss of needed rail services. (Compensation to a carrier providing directed service comes entirely from the revenues generated by that service.) My testimony submitted for the Subcommittee's May 6, 1998, hearing describes the Board's extensive service order, which remains in effect, addressing the rail service emergency in the West.

Amtrak Matters.

1. Overview. The Board does not have regulatory authority over Amtrak in most respects. See 49 U.S.C. 24301(c). The Board does have limited authority, however, to ensure that Amtrak can operate over the track of the nation's freight railroads. The Board is required to adjudicate disputes between Amtrak and individual freight railroads concerning shared use of tracks and other facilities and the terms and conditions of such use, if the carriers cannot reach a voluntary agreement. 49 U.S.C. 24308(a), 24904(c). The Board also issues emergency orders that enable

Amtrak to reroute passenger trains when its normal routes are temporarily unavailable. 49 U.S.C. 24308(b).

2. *Compensation Dispute.* After applying for a Board order to settle the terms for Amtrak's use of the facilities of the BNSF railroad system, Amtrak reached a voluntary agreement with the carrier, and Amtrak's application was dismissed in October 1996. In addition, during FY 1997, the Board worked to resolve a compensation dispute between Amtrak and the Springfield Terminal (ST) railroad system regarding the use by Amtrak of a new route over an ST line in New England. A decision in this matter is expected before the end of May 1998.

3. *Express Traffic.* In September 1997, the Board instituted a proceeding to determine the nature and extent of the duty of the Union Pacific/Southern Pacific (UP/SP) railroad system to allow Amtrak to use its tracks and facilities for the carriage of express traffic. Amtrak contends that it is authorized to transport any commodities as express traffic so long as Amtrak is providing expedited service at premium rates. Freight carriers object to the expansion of Amtrak's express business, arguing that much of this traffic constitutes general freight and, thus, under the law, is not appropriate for carriage by Amtrak. The Board required UP/SP to allow Amtrak to operate up to nine express cars per train while the Board proceeding is pending. A decision in this matter is expected before the end of May 1998.

Board Action on Access and Competition

Overview. At the request of Senator John McCain, Chairman of the Senate Committee on Commerce, Science, and Transportation, and Senator Kay Bailey Hutchison, Chairman of the Subcommittee on Surface Transportation and Merchant Marine, the Board conducted two days of informational hearings, on April 2 and 3, 1998, to examine issues of rail access and competition in

today's railroad industry. The Board reviewed both written statements and 15 hours of oral testimony presented by over 60 witnesses -- representing a broad spectrum of shippers; ports; Federal, state, and local government officials; rail labor; and railroads, both large and small -- about the state of the industry and its regulatory oversight, and about any changes that may be needed.

At the hearings, rail-dependent shippers complained that, as a result of consolidation in the industry, their competitive options have not been expanded, and that available remedies, particularly for service failures and rate relief, are burdensome, costly, and unresponsive. The relief they requested varied from shipper to shipper. Some advocated broad "open access" of one form or another, while others advocated less expansive remedies. One common theme of the rail-dependent shippers, however, was that adding rail competitive options would reduce rates and improve service.

The railroad interests also addressed the state of the industry. They recalled the regulatory framework of 30 years ago, when the government micromanaged the railroads and was viewed as having contributed to the industry's financial and operational collapse. They expressed concern that fundamental changes in the current regulatory framework would force rates down to the point that needed infrastructure and capacity investment would not be available, and that the level and quality of service performed would deteriorate over time.

The April 17 Decision. The Board took the positions of all of the parties seriously, concluding that while more extreme proposals could not be pursued without further review, the legitimate concerns of rail-dependent shippers could not be ignored and the status quo is not acceptable. Although the Board did not adopt all of the shippers' recommendations, it addressed many of them in a comprehensive decision issued on April 17, supplemented on May 4 (of which copies are attached), in which the Board required action on two fronts: (a) regulatory changes proposed by the Board now; and (b) private-sector dialogue among railroads, shippers, and

employees, with a view toward finding at least some common ground that could result in private-sector initiatives and resolution, as well as further Board action.

1. *Regulatory Changes.* Two recurring shipper complaints that arose during the hearings involved burdensome regulatory barriers to filing a rail rate complaint, and service inadequacies, and in particular those in the West. Regarding procedural barriers, shippers complained that the rules for determining market dominance -- by permitting railroads to defeat rate complaints by showing that the availability of substitute products or alternative locations could hold down rail rates -- make it virtually impossible for them to seek appropriate regulatory relief from unreasonably high rates. Having concluded in a recent Board decision that discovery regarding product and geographic competition had become a source of process abuse, the Board initiated a rulemaking proceeding proposing to repeal the product and geographic competition tests of the market dominance rules. Market Dominance Determinations — Product and Geographic Competition, Ex Parte No. 627 (STB served April 29, 1998) (copy attached). With respect to service inadequacies, the Board is about to initiate a rulemaking proceeding proposing ways to provide shippers that have concerns about poor service the opportunity to obtain service from an alternate carrier.

2. *Railroad Industry Discussions.* Another issue that arose at the hearings was how to ensure more effective utilization of smaller railroads in addressing the concerns raised by the shippers. The Board was told by both large and small railroads that general industrywide discussions had been initiated to address impediments to the smaller railroads being able to fully compete. Therefore, the Board directed the railroads to focus those discussions more specifically and to report back to the Board by May 11, 1998, on the resolution of the concerns raised. The Board indicated in its April 17 decision that it will take action as appropriate in this area.

3. *Railroad/Shipper Discussions.* Three other shipper complaints that were raised at the Board involved railroad “revenue adequacy,” the competitive access rules in general, and inadequate communications between railroads and their shippers. The Board concluded that each of these issues could be better addressed at this time in a private-sector rather than governmental forum.

Thus, as to revenue adequacy, the Board, based on suggestions from railroad and shipper representatives at the hearing, directed railroads to meet with shippers with a view toward selecting a panel of three disinterested experts to make recommendations as to an appropriate revenue adequacy standard, and to name a panel and report back to the Board by May 15, 1998. The panel was then to report back with a final recommendation on July 15, 1998. In its May 4, 1998, decision, the Board, in response to shipper concerns about this process, held in abeyance the directives regarding the designation of a panel to allow the railroads and shippers to meet directly to resolve the issue, and directed the parties to report back to the Board by August 3, 1998.

As to competitive access, the Board directed railroads and shippers, in order to find common ground, to meet, negotiate, and report back to the Board by August 3, 1998. Finally, the Board directed railroads to report back to the Board by May 11, 1998, on their progress in establishing formalized dialogue with their shippers and their employees, particularly about service issues in general, small shipper issues, and any other relevant matters.

4. *Approach in the April 17 Decision.* Two common threads run through the Board’s recent decisions in this area. First, the Board’s actions are responsive and appropriately measured. In this regard, the Board is not pursuing at this time without more study more extensive open access proposals that could negatively alter investment patterns and the extent of service provided today. Second, as to certain of these issues, the Board is of the view that private-sector solutions can be

more effective than immediate government fiat. The Board felt that revenue adequacy, about which the ICC had already expended considerable time arriving at a determination, could be more productively handled in what would be perceived as a more neutral forum. Regarding competitive access, as to which different shippers may have different views and needs, and which the railroads may view in all facets too one-dimensionally as a slippery slope toward complete open access, the Board concluded that it would have been difficult and impractical at this time for it in a litigative setting to move this issue to resolution expeditiously or effectively. Thus, the Board asked the parties themselves to meet and find at least some common ground before attempting to put the issue before the Board.

The Board believes that we are at a critical juncture with respect to the rail industry and its regulatory oversight, and the Board's April 17 decision, as amended and specifically implemented, reflects that awareness. The decisions that we make on the various issues that have been presented are fundamental and difficult, and will have a significant effect on what the rail industry will look like in the future, and whether the needs of the various users of the rail system will be adequately met. The Board takes very seriously its responsibilities in ensuring that those issues are moved forward in the appropriate direction and will continue to exercise its important role in this regard.

The Board's Challenge

Since its inception, I believe that the Board, pursuant to Congressional directive in eliminating the ICC, has been a model of doing more with less -- of putting its limited resources to the most efficient use in handling its caseload expeditiously and resolving matters before it in an effective and responsible manner in accordance with the ICCTA. I also believe that the Board has approached its work with fairness, balancing the many varied and often conflicting interests under

the statute in reaching its decisions on the record. While not everyone agrees with all of the decisions rendered by the Board since its creation, I believe nevertheless that the Board has compiled an impressive record of tackling complex issues and moving matters before it to resolution.

I know that some concerns have been raised as to whether Board actions have done enough to more actively promote competition, ensure quality service at reasonable rates, or provide appropriate access to the regulatory process for relief. I can only respond by saying that the ICCTA reaffirmed the statutory tenets of the Staggers Act directing the Board to continue the regulatory approach that had been followed in implementing that law. This, I believe, the Board has done. Nevertheless, as its April 17 decision demonstrates, the Board does respond as appropriate to the legitimate needs and concerns of shippers and other interested parties, and it does whatever it can to address and advance those needs in implementing the statute. The balance and the care with which the Board approaches its responsibilities are intended to assure that the decisions it reaches can produce a system in which rail carriers will be able to provide, at reasonable rates, service that meets shipper needs.

I look forward to working with Congress and all interested parties to ensure that the Board carries out the law as intended, and the multi-year reauthorization of the Board with the provision of adequate resources is critical to that end. I would be happy to address any questions that you might have.