

White Paper & Briefing Paper For Governor's Schweitzer's Meeting With Vice Chairman Doug Buttrey, STB

Outline:

- 1. Federal Merger Policy at ICC/STB Has Ignored The Importance Of Maintaining Rail-to-Rail Competition, Especially In Montana**
- 2. Farm Producers Are Unique Transportation Users in the Transportation of Grain**
- 3. Montana is an Export State**
- 4. Montana Rail Transportation is predominated by one carrier**
- 5. Montana Filed A Major Rate Case In 1980 – A Section 229 Which Was Combined With A Court Case – Called the *McCarty Farms Case* at ICC/STB**
- 6. Our criticism of the Board Proceedings:** Most Board proceedings focus on a single issue and fail to consider the totality of rail regulation, past, present or future.
- 7. Montana Voices Need to Be Heard by This Board**
 - a. Do not continue down this path of ever increasing size and continued diminishment of rail customer choice
 - b. Montana rail customers are subsidizing the carriers who have rail-to-rail competition
 - c. Rail customers deserve competition first, and if necessary, regulatory protection from federally created monopolies that limit the customer's ability to participate in markets; we deserve a choice of railroad carriers
 - d. Open up the current railroad system to competition and allow rail customers a choice of rail carriers.
 - e. If the STB does not have the authority to promote competition in the rail industry independently, we have reached a crossroads where

this Board must recommend legislative changes that would grant it the authority to act

- f. In either case, look for Montana rail customers and Montana State Government to continue to look to Congress and other departments and agencies in the Executive Branch to seek relief from this federally-imposed rail concentration
- g. Also look for Montana to continue to seek increasing transportation competitive solutions to its federally mandated anti-competitive position to pull itself out of the anti-competitive mess this Board created

8. Car Supply Issues

9. Rail Rate Issues In Montana

- a. Rail rates in Montana as a percentage of the price of wheat has risen from 16% in 1980 to over 30% today.
- b. Rail rates in Montana and North Dakota run 250-450+% of variable cost. Those are among the highest freight rates in the nation.

10. STB Remedies for Captive Rail Customers Have Not Been Effective and Too Limited

11. Summary Position - Montana assumes that the absence of a level playing field with respect to rail regulation, as detailed above, reflects deliberate policy preferences adopted by the ICC and STB. The agency has plainly been reluctant to jeopardize progress toward railroad revenue adequacy, even where market dominance exists, and has been equally reluctant to second-guess railroad management as to service issues, despite repeated and severe instances of mismanagement.

12. Montana has a suggestion for the Board to consider. We think it would appropriate for the Board working together with Montana Government and its elected representatives to consider establishment of one or several demonstration projects to explore the impacts of various approaches of increasing rail competition in the State and possibly consider competitive access.

Background on Montana:

Federal Merger Policy at ICC/STB Has Ignored The Importance Of Maintaining Rail-to-Rail Competition, Especially In Montana

Rail customers in Montana have experienced the monopoly domination by a single railroad as a result of years of federal merger policy that largely ignores the importance of maintaining as much market competition as possible and avoids providing customers located in non-competitive markets with adequate economic regulatory protections. The announcement of the BN/CN merger on December 20, 1999, followed by the response of the nation's other large railroad carriers on January 11, 2000 indicating this merger will move them to defensively merge into a two monopoly system, demonstrates that we are collectively facing our final opportunity to return some measure of rail-to-rail competition in markets that desperately require it.

Montana has always been a natural resources state with its main economy built upon products of the mine, forest and land, and we expect these to remain the foundation of our economy in the future. In order for our bulk mineral, lumber and agricultural products to have value, they require bulk transportation (rail) to points outside Montana and, in many cases, outside the U.S. Therefore, the State's

economic survival depends on having access to good, affordable, and adequate rail transportation and attendant facilities, with published notice of rates and rules, so that its shippers can deliver a competitive priced product outside the state boundaries. However, Montana's shippers have one major railroad, the BNSF Railroad, operating as a monopoly in the transportation of bulk commodities from the farm to market.

Farm Producers Are Unique Transportation Users in the Transportation of Grain

Montana Wheat and Barley producers do not have economic alternatives to rail transportation. They are captive and tied to rail transportation with no viable alternatives. The Montana Wheat and Barley producers are unique because they bear the cost of freight transportation and cannot pass on increased transportation costs to their customers. Virtually every other industry has some capability of passing on some or all of its increased costs to its consumers or customers. The farm producer, however, operates in an environment where he/she does not have any control over the price received for the crop. He/she must bear every increase in all costs, including transportation costs, without any possibility to pass those higher costs on to anyone else.

OUTLINE OF INDUSTRY IN MONTANA

1. The wheat industry in Montana is characterized by an export-dominant rail movement.
2. The barley industry in Montana is characterized by both an export and domestic market dominated by rail.
3. The lumber industry in Montana is characterized by both an export and domestic market dominated by rail.

4. The coal industry in Montana is characterized by domestic rail movement.

MONTANA IS AN EXPORT STATE

Montana is nationally ranked in agricultural production. Montana ranks 3rd in all wheat production, 5th in winter wheat production, 4th in spring wheat production, 2nd in barley production, and 2nd in oats production in the U.S. (Source: Montana Agricultural Statistics Service)

For the farm producer, the cost of rail transportation of moving grain can represent as much as one third (1/3) the overall price received for the grain.

MONTANA RAIL TRANSPORTATION IS PREDOMINATED BY ONE CARRIER

Montana's rail infrastructure is dominated by the BNSF Railroad which controls over 96% of all rail miles, over 95% of all grain elevator and terminal sites, and which moves 98%+ of all wheat that moves by rail from the state. BNSF controls and dictates all rail rates covering all movements from Montana eastbound or westbound. Annually, Montana producers move about 150 million+ bushel production that is handled by rail from Montana and bear about \$200+ million in freight transportation charges per year.

HOW DID MONTANA BECOME DOMINATED BY A SINGLE MONOPOLY RAILROAD CARRIER?

Recently, an eastern newspaper reporter asked an interesting question, "You complain about the lack of rail competition out there in Montana, but you chose to live out there!" **But when we grew up here in Montana, and in the late 1960's, we had FOUR transcontinental railroads serving the state (NP, GN, CB&Q and MILWAUKEE ROAD). It is because of a failed Federal merger regulatory policy that we have NO RAIL-TO-RAIL COMPETITION, and thus, no options.**

In 1970, after many years of back and forth wrangling, the ICC allowed the Northern Pacific (NP), Great Northern (GN), and the Chicago, Burlington and Quincy (CB&Q) to merge, in the Northern Lines case, over objections of Montanans, northern plains agriculture, Congress and the Justice Department whose warning “of eroding intramodal railroad competition in the Montana arena” prove to be completely accurate. The premise was the Chicago, Milwaukee, St. Paul and Pacific (Milwaukee Road) would provide competition right through the middle of the newly formed BN system.

By 1978, the Milwaukee Road was in bankruptcy, unable to mount a competitive challenge to the BN, which competing for the same traffic, completely surrounded the Milwaukee Road on all sides. After the demise of the Milwaukee Road in 1980, the ICC refused to reopen the BN (Northern Lines) merger and reconstitute competitive balance, leaving Montana under the total dominance of a single monopoly railroad.

The result today is the highest grain freight rates in the nation. Montana rail customers experience car shortages that start earlier and last longer than anywhere else in the growing areas, essentially robbing the Montana grain producers of the ability to participate in price increases in the market. Today, over 1/3 of the price received by Montana grain producers goes to the monopoly railroad, and that percentage continues to rise.

Montana Filed A Major Rate Case In 1980 – A Section 229 Which Was Combined With A Court Case – Called the *McCarty Farms Case*

Faced with the effects of a railroad monopoly that was withering a key element of the state’s economy, Montana filed a class-action and formal complaint pursuing

the *McCarty Farms* case for 17 years, wherein the *ICC on December 14, 1984 found that the BN had market dominance and that its rates were unreasonable. The Administrative Law Judge (ALJ) further found that the rates were higher than 300% of variable cost! Yet, this Board in 1997, found that these rates were not excessive!* It was never anticipated by the ICC/STB that a whole state would be found captive to a single railroad. After all, that would admit failed national merger policy. Captive railroad customers' in Montana spent over \$3.2 million pursuing the *McCarty Farms* case, (excluding attorneys' fees) without success.

Yet, look at the record in the Northern Lines merger and at the Congress and the Justice Department warnings of the eroding intramodal railroad competition in the Montana arena.

The "Northern Lines" reached an agreement with the C&NW and the Milwaukee Road in which the proposed merged railroad agreed that it would not oppose the merger of the latter two, and vice versa. This major change in position by the C&NW and the Milwaukee Road met with very unfavorable reaction from the Justice Department. In fact, the Department of Justice curtly declared, "There is no basis for reconsideration of the Commission's decision."¹ Furthermore, the D&RGW Railroad charged, "Nowhere in the Interstate Commerce Act are the railroads given the right to contractually 'carve up markets' and utilize the Commission as a rubber stamp for such purposes, or, as is the case here, to ignore the Commission entirely."²

The full Commission considered the above positions and decided, by a 10-to-2, vote in *favor* of the proposed merger on November 30, 1967.

¹ " 'Northern Lines' and C&NW – Milwaukee Will Support Each Others' Merger Plans," *Traffic World* (Oct. 29, 1966), p. 72

² "ICC Asked to Probe Pact Between 'Northern Lines' and C&NW – Milwaukee," *Traffic World* (Nov. 26, 1966), p. 57

The majority said they approved the merger because: “We believe that the overall effect of the conditions imposed here will portend for a strong degree of intramodal rail competition in the affected territory; promote the effective development of improved transportation services to the shipping and receiving public, and comport generally with the purposes and objectives of the national transportation policy as declared in the interstate commerce act.”³ Commissioners Paul J. Tierney and Virginia Mae Brown based their dissents primarily on the issue of lessened rail competition in the Northwest.⁴

History has shown the ICC was wrong in the Northern Lines Merger and that the Northern Lines’ newly-created Burlington Northern, Inc. became a total monopoly and eliminated all intramodal rail competition in the area.

Why do Montana grain producers pay the highest freight rates in the nation? Simple. The ICC/STB’s national merger policy has allowed this nation’s railroads to become total monopolies dominating not just individual rail customers, but now whole states and entire industries.

The STB/ICC has chosen to foster bigger and bigger railroads at the expense of captive rail customers. The ones most adversely affected by the development of larger and larger railroad monopolies in this country are the railroad customers.

Our criticism of the Board Proceedings

Most Board proceedings focus on a single issue and fail to consider the totality of rail regulation, past, present or future. Montana and its rail customers, like many

³ Great Northern Pac. & B. Lines, Merger – Great Northern, 331 I.C.C. 228, 283 (1967).

⁴ Ibid, pp. 292-299

other shipper groups and shippers, are concerned that captive shippers today have been placed in an untenable position by increasing railroad monopoly and market power, ineffective rail regulation, and little or no recourse under the antitrust laws. **We know of no other industry with the freedom that major railroads enjoy to pursue their own self-interest without fear of regulatory, legal or competitive challenges. For these reasons, the status quo is unacceptable, even if railroad financial health has improved. Unrestricted railroad monopoly power does not serve the public interest.**

In addition to seeking legislative change, Montana calls on the STB to revisit key aspects of current rail regulation. In too many cases, contested issues have been resolved in ways that leave captive shippers remediless. And the cumulative effect of these actions, which has received too little attention from the ICC and STB, has left captive shippers vulnerable to abuse on many fronts.

Montana Voices Need to Be Heard by This Board:

The voices from Montana need to be heard by the Board – we Montanans are dominated by a single monopoly railroad carrier:

- Do not continue down this path of ever increasing size and continued diminishment of rail customer choice. “Bigger” does not necessarily result in “better” and in fact, “bigger” has only offered rail customers in Montana a monopoly railroad that offers poor service at an exorbitant rate.

- Montana rail customers are subsidizing the rail and rail customers who have rail-to-rail competition.
- Rail customers deserve competition first, and if necessary, regulatory protection from federally created monopolies that limit the customer's ability to participate in markets; we deserve a choice of railroad carriers.
- Open up the current railroad system to competition and allow rail customers a choice of rail carriers. If STB doesn't change its approach to rail mergers in a way that promotes a resurgence of competition among railroads, the legislative changes required in the future will be far more invasive than anything being proposed today.
- If the STB does not have the authority to promote competition in the rail industry independently, we have reached a crossroads where this Board must recommend legislative changes that would grant it the authority to act.
- In either case, look for Montana rail customers and Montana State Government to continue to look to Congress and other departments and agencies in the Executive Branch to seek relief from this federally-imposed rail concentration.
- Also look for Montanans to continue to seek increasing its transportation competitive solutions to its federally mandated anti-competitive position.

Car Supply Issues:

In the area of rail service, neither the ICC nor the STB has been a reliable or effective defender of minimal standards of performance by railroads.

- When grain car shortages became a serious problem in the 1980s, the ICC responded in several ways, each of which favored the railroads. First, it deprescribed the

compensation the railroad industry must pay private car owners who supply well over half the nation's grain car fleet.⁵ Second, it allowed the railroad industry to assign second class status to private cars, discouraging utilization.⁶ Third, it allowed the railroads to exploit the shortages they created by underinvesting in cars and by giving preference to railroad owned cars through car auctions like the Burlington Northern "COT" program.⁷

- Today, the railroads provide no tank cars, less than 40% of covered hoppers, and a fraction of the nation's coal cars. Not only have shippers been forced to provide cars in order to obtain service, but erratic rail service has necessitated acquisition of more cars than would otherwise be needed. Having caused these conditions, the railroads now seek to exploit them by imposing "congestion pricing," increased demurrage charges, and new empty car storage charges.
- During the "meltdown" that followed the UPSP merger, the Board's exercise of its emergency powers was too little, too late.

⁵ See, Lo Shippers Action Committee v. ICC, 857 F.2d 802 (D.C. Cir. 1988), cert. denied, 109 S.Ct. 2429 (1989).

⁶ See, Shippers Committee OT-5 v. ICC, 968 F.2d 75 (D.C. Cir. 1992).

⁷ See, National Grain & Feed Ass'n. v. Burlington Northern R. Co., et al., 8 I.C.C. 2d 421 (1992), aff'd in part and rev'd in part, sub nom. National Grain & Feed Assn. V. United States, 5 F.3d 306 (8th Cir. 1993).

- In the face of similar problems in the Northeast, the Board opted for "informal remedies," and excluded operational problems from the scope of its Conrail Oversight proceedings.
- The Board's answer to shipper service concerns appears to be that railroads need to invest more, at the expense of captive shippers. However, the Board has no policies in place to require or even to encourage the railroads to use additional profits extracted from captive shippers to improve service quality for those shippers, or even for shippers as a whole. Exorbitant captive shipper rates appear to be funding service improvements for intermodal freight, but railroads could divert excess profits away from rail service entirely without fear of STB regulatory action.
- Today in Montana, we are experiencing troubling car shortages again for the fourth straight year. The BNSF is allocating less than 10% of its car fleet for single, 26 car and 52 car classes of service. In fact in the last tariff lottery (for October, 2005), they allowed only 1820 cars for the tariff lottery and received over 10,300 car requests for car orders.
 - BNSF announced 9/1/05 that it was adding 800 cars to the October tariff lottery, bringing the total from 1020 to 1820. That compares to 2766 last year in Oct.

- On September 9th, the BNSF finally had to face the music...- be mindful that supplying cars is their day-to-day business – they are shorting (by 90%) all of the non-shuttle shippers. This company is choosing to short the tariff lottery program in favor of the shuttle loaders.
- Now the shippers have spoken.....there will be a huge shortage of cars in the next few months and yet the shuttle service shippers indicated they are not having a problem getting.
- This is the BNSF announcement.

First Part October Lottery Announcement

TO ALL CONCERNED:

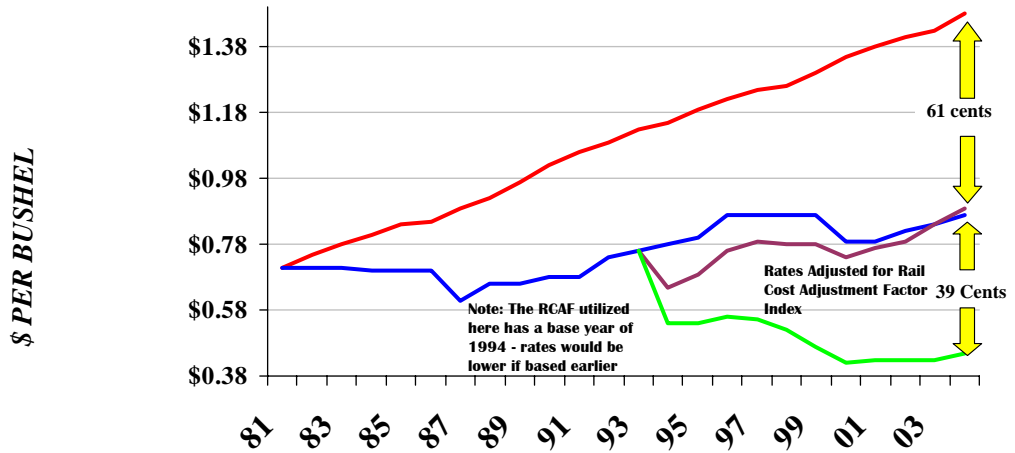
Wednesday, September 7, 2005, we received an unprecedented 10,300 order requests for our FP October Tariff Lottery. We recognize that this demand is the result of this year's simultaneous northern wheat harvest & old crop grain movement, the high secondary market for cars and the market effect of Hurricane Katrina. Given the total number of requests, we will not be able to process them in time to notify our customers today. We expect to begin customer notification late Monday, September 12.

Rail Rate Issues

The rail rates in then Northern plains have increased 40% faster than the Rail Cost Adjustment Factor including productivity Unadjusted.

The Surface Transportation Board developed specifically for U. S. Railroads a Rail Cost Adjustment Factor which is utilized in measuring Rail Rates and has an adjustment for Productivity Gains. The Montana 52 Car PNW Wheat Rates would be 39 cents/bushel lower today than they are if the BNSF had shared the productivity gains adjustments with Montana farm producers. Comparing rail rates to RCAF has far more relevance than to CPI

MONTANA 52 CAR PNW WHEAT RATES

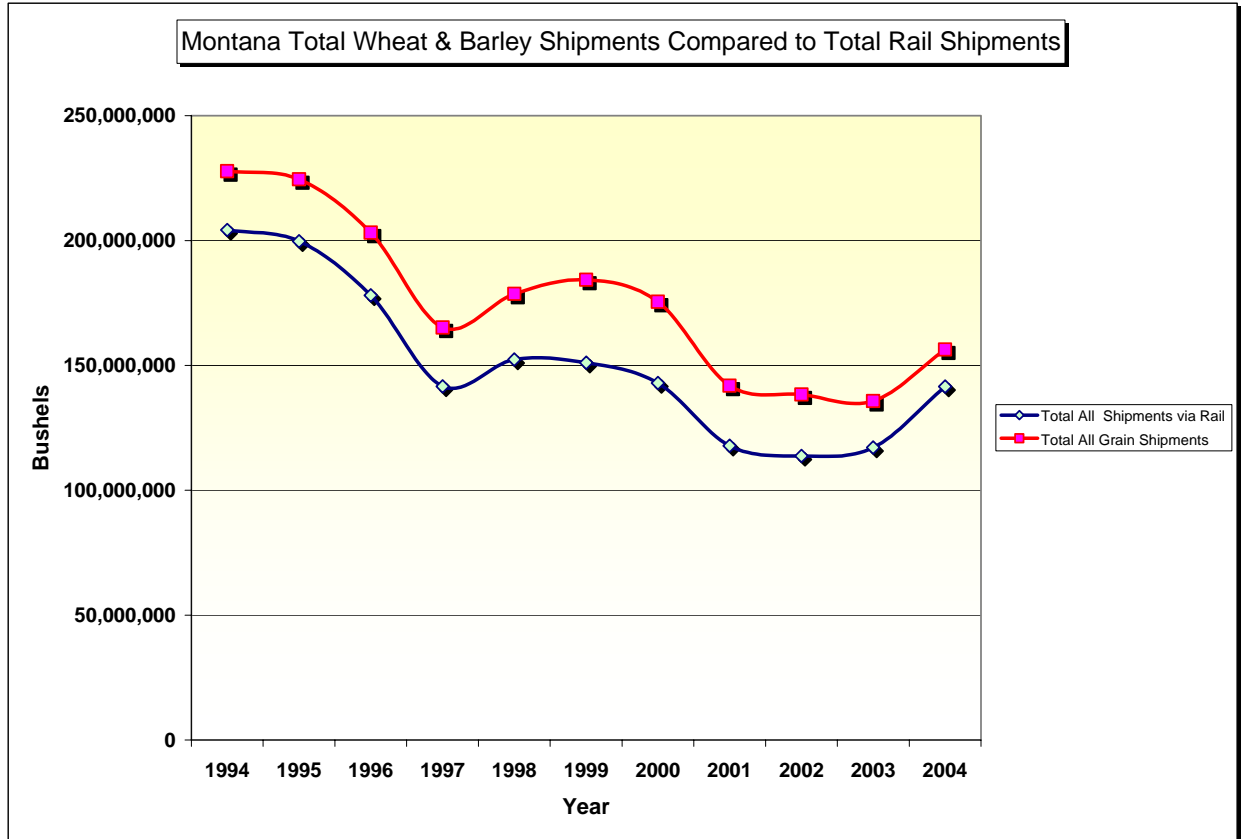


	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04
Inflation Adjusted Rate	\$0.7	\$0.7	\$0.7	\$0.8	\$0.8	\$0.8	\$0.8	\$0.9	\$0.9	\$1.0	\$1.0	\$1.0	\$1.1	\$1.15	\$1.1	\$1.2	\$1.2	\$1.2	\$1.3	\$1.3	\$1.3	\$1.4	\$1.4	\$1.4
Actual 52 car rate	\$0.7	\$0.7	\$0.7	\$0.7	\$0.7	\$0.7	\$0.6	\$0.6	\$0.6	\$0.6	\$0.6	\$0.7	\$0.7	\$0.7	\$0.8	\$0.8	\$0.8	\$0.8	\$0.8	\$0.7	\$0.7	\$0.8	\$0.8	\$0.8
Rail Cost Adj Factor Adjusted Rate													\$0.7	\$0.6	\$0.6	\$0.7	\$0.7	\$0.7	\$0.7	\$0.7	\$0.7	\$0.7	\$0.8	\$0.8
RCAF Adjusted for Productivity Gains													\$0.7	\$0.5	\$0.5	\$0.5	\$0.5	\$0.5	\$0.4	\$0.4	\$0.4	\$0.4	\$0.4	\$0.4

Inflation Adjusted Rate calculated utilizing Consumer Price Index (CPI) factor multiplied by rates with base year of 1981 compared to the RCAF adjusted for productivity. 12/31/04 Rates from Great Falls and Collins MT,

Rail rates in Montana as a percentage of the price of wheat has risen from 16% in 1980 to over 30% today. Rail rates in Montana and North Dakota run 250-450+% of variable cost. Those are among the highest freight rates in the nation.

How captive is Montana to rail movement for wheat movements? Fact, the quantity of wheat Montana has cannot be moved in truck or other conveyances. The quantities are too large and the highway systems would crumble under the traffic. About 92+% of Montana wheat that moves via rail moves via one railroad – the BNSF. Remember in 1970 – Montana farm producers and industrial base had four transcontinental railroads serving Montana – today they have only one.

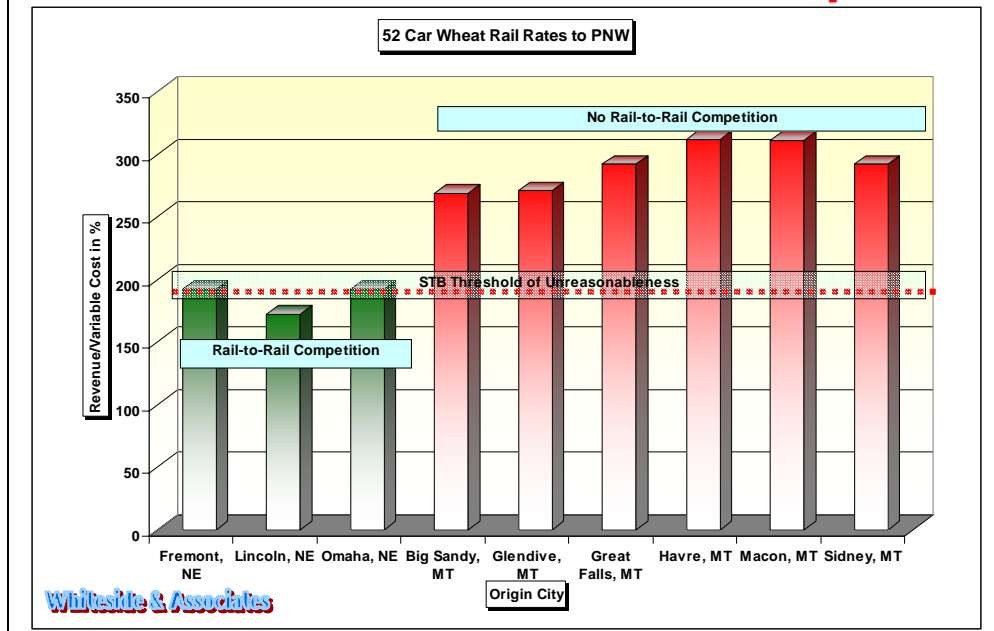


The captive rail customers in the United States are subsidizing shippers that have rail-to-rail or water transportation alternatives.

Westbound 52 Car Wheat Rates to PNW

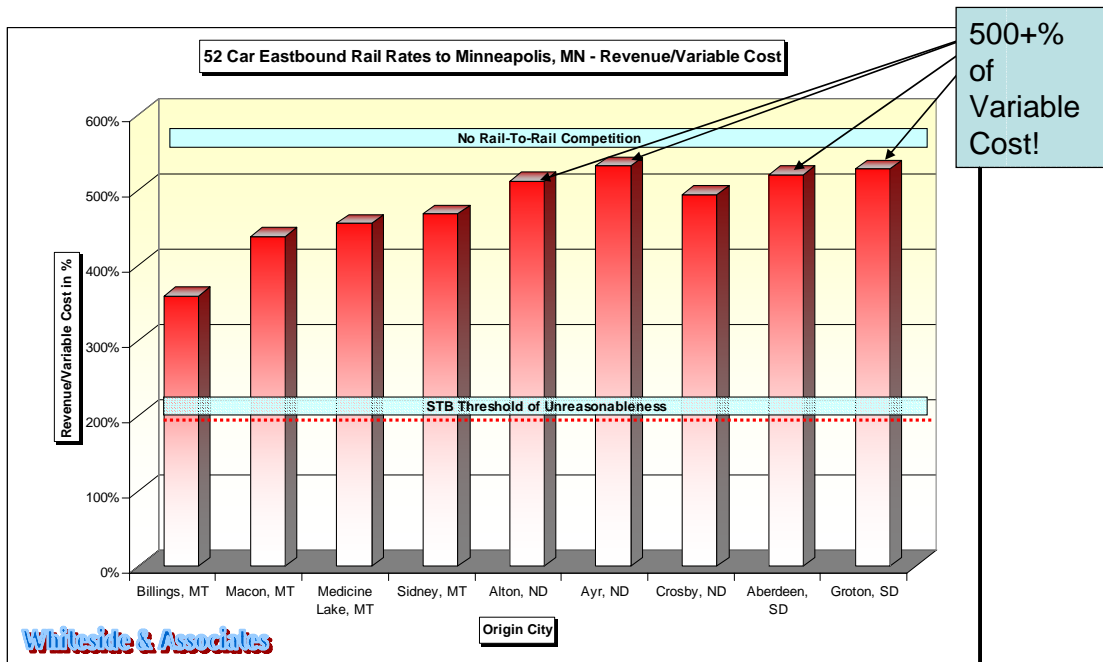
52 Cars	rate	Rate + Fuel Surcharge	miles	\$ per mile	\$ per Bushel	RVC
Montana						
Big Sandy	\$ 3,194.00	\$ 3,529.37	911	\$ 0.26	\$ 1.05	376%
Billings	\$ 3,026.00	\$ 3,343.73	1017	\$ 0.30	\$ 0.99	321%
Conrad	\$ 2,979.00	\$ 3,291.80	811	\$ 0.25	\$ 0.98	393%
Fort Benton	\$ 3,069.00	\$ 3,391.25	917	\$ 0.27	\$ 1.01	359%
Great Falls	\$ 2,979.00	\$ 3,291.80	873	\$ 0.27	\$ 0.98	366%
Havre	\$ 3,194.00	\$ 3,529.37	884	\$ 0.25	\$ 1.05	388%
Moccasin	\$ 3,069.00	\$ 3,391.25	1140	\$ 0.34	\$ 1.01	292%
Plentywood	Removed from the tariff					
BNSF 4022K Item 43600 ---Effective 8-15-05 thru 12-31-05						
Nebraska						
Alliance	\$ 4,240.00	\$ 4,685.20	1554	\$ 0.33	\$ 1.39	298%
Beatrice	\$ 4,557.00	\$ 5,035.49	2148	\$ 0.43	\$ 1.50	217%
Crete	\$ 4,513.00	\$ 4,986.87	2118	\$ 0.42	\$ 1.48	235%
Fremont	\$ 4,591.00	\$ 5,073.06	2192	\$ 0.43	\$ 1.51	231%
Grand Island-UP	\$ 3,462.00	\$ 3,825.51	1631	\$ 0.43	\$ 1.14	218%
Lincoln	\$ 4,535.00	\$ 5,011.18	2139	\$ 0.43	\$ 1.49	233%
North Platte-UP	\$ 3,279.00	\$ 3,623.30	1491	\$ 0.41	\$ 1.08	225%
Omaha	\$ 4,620.00	\$ 5,105.10	2206	\$ 0.43	\$ 1.52	231%
Superior	\$ 4,535.00	\$ 5,011.18	2097	\$ 0.42	\$ 1.49	238%
Fuel Surcharge for August 2005 is 10.5%						
BNSF 4022K Item 43581 Revision 9 Effective 6-1-05						
UP 8043 D Effective 7-15-05						

Look at Rail-To-Rail Competition and Then Look At Areas Where There is No Rail-to-Rail Competition



When compared to areas of the U.S. that have rail-to-rail competition, it is evident that Montana and the Northern Plains states are paying inordinately more for the rail service. Similarly, when compared to Canadian freight rates on wheat westbound north of the border (which also has a system of only two railroads – each of which are very profitable) the rates from Canadian points moving westbound into export are only 2/3 of the rail rates (in U.S. \$) being charged the captive rail farm producers south of the border. The high rates being charged the captive farm producers in the northern Plains vs. the much lower rail rates being charged their competitors in Canada, the northern plains producers of some of the best quality wheat in the world has been rendered residual suppliers against their Canadian counterparts.

How About Northern Tier States – Multi-Car



NOTE: These are the highest Revenue/Variable Cost Levels in the U.S.!

STB Remedies for Captive Rail Customers Have Not Been Effective and Too Limited

Twenty-five years after enactment of the Staggers Act, too many shippers paying high rail rates (i.e., rates well above the threshold of regulatory jurisdiction) have no remedy whatsoever. Remedies are available only for a minority of captive rail shippers, and even these remedies are limited. Consider the following:

- When the ICC first developed regulations governing market dominance determinations, it developed workable rules relying on presumptions. Those were quickly discarded in favor of an approach that made market dominance determinations as costly as rate reasonableness determinations. The statutory requirement that competition be "effective" was ignored, and many shipper complaints were rejected based on vague allegations of "potential" competition.
- Three of the four constraints in "constrained market pricing," the maximum reasonable rate methodology adopted in Coal Rate Guidelines – Nationwide,⁸ have never been used in a rail rate case.

⁸ 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).

- For 16 years after enactment of the Staggers Rail Act, shippers of commodities other than coal had no remedy other than stand-alone cost, which is not even theoretically practicable for shippers who do not ship large volumes between a small number of origins and destinations. The methodology adopted in Ex Parte No. 347 (Sub-No. 2), Rate Guidelines -- Non-Coal Proceedings, has never been applied in a litigated rate case. The statutory requirement that where there is an absence of effective competition, rates "must be reasonable," is meaningless for most captive shippers.⁹
- Even if the small rate case methodology "works," it appears unlikely to produce rate prescriptions at revenue levels below 200% of variable cost, and may result in far higher rates being found reasonable.
- In implementing the statutory requirement of a mechanism for quarterly rail cost adjustments, the ICC adopted procedures that produced windfall profits for railroads. The initial RCAF suffered from a ratchet effect (i.e., rates went up with RCAF increases but not down with RCAF decreases). This was corrected, but the ICC then resisted for nine years

⁹ In testimony before Congress, STB Chairman Nober stated: "[I]f no small cases are brought, this means that, in practice, only about 75 shippers have a meaningful opportunity to challenge rail rates. This is unacceptable."

the adoption of a productivity adjustment to the RCAF. As a result, the railroads were able to base unchallengeable rate increases on increases in hourly wage rates, while ignoring the fact that their labor force was being cut in half. When a productivity adjustment was finally adopted, the RCAF-U was preserved, relegating many contract shippers to unjustified rate escalation. These arrangements were so generous that for a decade, hardly any rail tariff rate increases were published.

- In the Bottleneck Decision, shippers were required to litigate the reasonableness of entire through rates, even where market dominance exists only for part of the route. The Board created a contract exception based on its lack of jurisdiction over contract rates, but held that its lack of jurisdiction in the absence of market dominance was trumped by equivocal 80 year old case law on railroad routing initiatives. As a result, rates for short stretches or for switching may exceed the threshold of jurisdiction by a factor of 10 with no remedy.
- Even the rate stability theoretically offered by contracts is unavailable where railroads refuse to enter contracts. BNSF

resists using contracts for grain shipments. CSX recently announced that it would reduce its use of contracts.

- Switching to tariffs permits a railroad to increase its rates at will. Tariff (or common carrier) rates are subject to challenge, but the railroads clearly regard the risk of a successful challenge as negligible. This view is reportedly shared by Wall Street, which has interpreted recent STB coal rate case decisions as signaling a "green light" for massive rail rate increases.
- Rising rail rates on non-captive traffic have not led to smaller rate increases for captive shippers. On the contrary, market dominant railroads have "gamed" the system by publishing unprecedented rate increases on captive traffic with impunity at a time when their need for differential pricing is declining.

Summary Position:

Montana assumes that the absence of a level playing field with respect to rail regulation, as detailed above, reflects deliberate policy preferences adopted by the ICC and STB. The agency has plainly been reluctant to jeopardize progress toward railroad revenue adequacy, even where market dominance exists, and has been equally reluctant to second-guess

railroad management as to service issues, despite repeated and severe instances of mismanagement.

Montana does not believe these positions were correct on legal or policy grounds, and we believe further that the railroads' problems have been largely self-inflicted. Surely no one can seriously contend that the railroad industry's failure to achieve greater financial health resulted from excessively vigorous ICC and STB rate regulation.

However, even if it is assumed that the ICC and STB have, on balance, done more good than harm in allowing major railroads a free hand in adapting to post-Staggers changes, enough is enough.

Montana Suggestion For the Board To Consider:

Montana has a suggestion for the Surface Transportation Board to consider. We think it would be appropriate for the Board working with Montana Government and its federally elected representatives to consider establishment of one or several demonstration projects to explore the impacts of various approaches to competitive access. Since the state of Montana is completely captive to one railroad, it may be the perfect area in which to experiment with ways to return competition to an industry where the numbers of industry players are extremely limited. Other areas of the country might be identified according to unique situations as well. In Montana, for example, a demonstration project of some defined duration might allow an open access system to operate, allowing Montana Rail Link (Class II) and Central Montana Railroad (Class III) and the BNSF (Class I) to compete for Montana customers. The STB could monitor service, etc. over a defined period, we'd suggest 2-4 years, and prepare a report

on each project that could be the subject of further public hearing and debate. This sort of creative, yet gradual and controlled approach to restoring competitive access and this would fulfil the competitive balance that the ICC/STB fostered to create in the design of the Northern Line Merger in 1970 (creation of BN). It would start to tell us a great deal about potential benefits and adverse impacts. It would also allow the Board the opportunity to better assess the implications of the rail industry's configuration in the future.

Montana notes that at least one Class I railroad achieved revenue adequacy in 2004, and more may do so in 2005, even under revenue adequacy standards that clearly favor railroads looking for special consideration in rate cases and rulemaking proceedings. These developments, as well as the elimination of excess rail capacity and the demonstrated falsity of claims that rates cannot be increased on the traffic of non-captive shippers, provide additional grounds for new approaches to rail regulation, and for new measures to enhance rail competition.

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