

**Report To**  
**The Rail Service Competition**  
**Regarding Requested Research Concerning**  
**The Impact of Paper Barriers on**  
**Montana Rail Shippers' Competitiveness**

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**To:** Rail Service Competition Council

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**Title:** The Impact of Paper Barriers on Montana Rail Shippers' Competitiveness

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## **Background:**

This report was prepared in response to a request for research by the Rail Service Competition Council (RSCC), which was created in 2005 by the State of Montana Legislature to promote rail service competition in Montana.<sup>1</sup> RSCC works to promote rail service competition in the state, develop related plans, evaluate taxing practices, assess organizational structures to help facilitate development of rail services, coordinate with railroads, and promote expansion and construction of rail services. RSCC is defined, and its duties described in MCA 2-15-2511.<sup>2</sup>

The 2010 Montana State Rail Plan describes railroad interchange agreements which can serve as "*paper barriers*" to competition.<sup>3</sup> The U.S. Surface Transportation Board (STB) describes Paper Barriers. as "contractual provisions included with a sale or lease of a rail line that limit the incentive or the ability of the purchaser or tenant carrier to interchange traffic with rail carriers other than the seller or lessor railroad." <sup>4</sup>

The interchange agreement or "paper barrier" which concerns RSCC (and many freight shippers in Montana) is associated with the 1987 lease/purchase agreement between Burlington Northern Railway Company (BN, which later became BNSF Railway (BNSF)), and Montana Rail Link (MRL). Under the agreement, MRL agreed to BN imposed interchange supplement charges on movements over any railroad other than BN. An interchange with any railroad other than the BN would allow BN under the agreement to invoke a 'supplemental rent' charge on the shipment. These supplemental rent charges are known in the industry as "paper barriers" to movements.

A paper barrier is different from a "steel barrier." A steel barrier is where two railroads might cross but do not have an interconnection of their tracks. A paper barrier results from a contract between a selling railroad and a purchasing railroad, wherein the selling railroad charges a supplemental charge in event the purchasing railroad moves a shipment over a connection to a third party railroad. These paper barriers and procedures for application or waivers are usually set forth in agreements between the selling and purchasing railroad (which are usually short line railroads). The selling railroad's rationale for use of paper barriers is either that they do not want the purchasing railroad to short haul<sup>5</sup> the selling railroad or the statement by the selling

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<sup>1</sup> RSCC approved this research project on September 5, 2012.

<sup>2</sup> See: <http://data.opi.mt.gov/bills/mca/2/15/2-15-2511.htm>, or <http://www.mdt.mt.gov/business/rsc/duties.shtml>

<sup>3</sup> 2010 Montana State Rail Plan, page 7-11.

<sup>4</sup> STB Ex Parte No. 575 (Sub-No. 1), Disclosure of Rail Interchange Commitments, served October 30, 2007.

railroad that the sale of the line to the purchasing carrier was at a reduced price from market value on the premise that the selling carrier would receive revenue from all movements off the purchasing railroad.

Author's Note: When the MRL line was formed by the sale of part's of the Northern Pacific line, the seller was the Burlington Northern Rail Company, referred to in this report as BN. The BN in 1995 merged with the Atchison, Topeka and Santa Fe railroad and became the Burlington Northern Santa Fe Railroad. The corporation was incorporated in 1995 to facilitate the merger of Burlington Northern, Incorporated, parent of the Burlington Northern Railroad, and Santa Fe Pacific Corporation, which owned the Atchison, Topeka and Santa Fe Railway (Santa Fe). The corporate merger was consummated on September 22, 1995 at which point shareholders of the previous companies became shareholders of BNSF and the two companies became wholly owned subsidiaries of BNSF. In December 1996, the two holding companies and two railroads were formally merged, and in January 1998 the remaining intermediate holding company was folded into the railroad.

In this report, we have distinguished for the reader between BN and BNSF to reflect the time period of various transaction that impacted both the MRL as well as the Montana shippers by rail. It may be confusing when the report references BN and later BNSF but the reference is designed to provide historical introspection to the transactions.

The following map of Montana railroads shows MRL's lines in blue:

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<sup>5</sup> A term applied when a railroad accepts a shipment of goods to be hauled for a short distance over its own line and then transfers it to another, to be hauled to a point which the initial carriers also services.

## Montana Rail Link



Private contracts, such as the BN/MRL lease agreement, MRL rail shipper transportation contracts, may include non-disclosure clauses and/or confidentiality terms that limit the ability of the firms to disclose the conditions and pricing of interchanges between railroad lines.

To date, the MT RSCC has only been able to gather anecdotal information about rail rates for routings that include the MRL and the UP. RSCC seeks concrete data to determine if these paper barriers are material enough to actually affect Montana rail shippers' competitiveness.

### Scope of Work and Deliverables:

This research project involved contacting private companies and discussing actual shipping costs. Specific research topics and deliverables include:

1. Review historical documents from the creation of what is now MRL, to determine if any industries or specific origin/destination pairs were granted access to the UP via the intersection of BNSF and UP railroads at Silver Bow, and/or the intersection of BNSF and MRL railroads at Garrison.
2. Identify current rates and volume moved to determine and estimate the magnitude of impact under this historic arrangement. This may include contacting UP, BNSF and MRL to request this data, if it is not publicly available.
3. Research, identify, and contact rail shippers located along the MRL line to determine if they would benefit from improved access to the UP via interchange at Silver Bow. A minimum of eight different businesses will be contacted. This will include eight different firms in at least four industries, all of which are MRL-based and seek market expansion that could benefit from access to markets to the south via UP railroad service.
4. For each business, identify one or two major geographic markets that are served by both BNSF and UP (competitive markets). Examples that potentially could be reached advantageously include: Dallas or Houston, TX; Kansas City, MO; Denver, CO; Salt Lake City, UT; and Los Angeles, CA.
5. For each business, identify one or two of these competitive markets and document current shipping costs via MRL/BNSF. For these same markets, work with the business to determine actual rates for the move using the MRL/BNSF/UP routing via the Garrison-to-Silver Bow link.<sup>6</sup>
6. Summarize the research in a document and presentation that discusses findings about the existence and impact of paper barriers on Montana shippers and the next RSCC meeting.

## **Outreach for Background and Current Use of Interchange**

### **Shippers:**

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<sup>6</sup> a. Note that businesses may not be comfortable providing this information. b. Information gathered may be protected as trade secrets under the following provisions of Montana Code: i. MCA § 2-6-102(3) ii. MCA § 30-14-402(4) c. Accordingly, the report does not include data about specific businesses. Its aim is to provide information to inform discussions about the existence and magnitude of paper barriers in Montana. d. All data, contacts, and analysis was reviewed with MDT staff for purposes of assuring the quality and reliability of the analysis. Confidential data will be safeguarded by both the contractor and agency against disclosure.

Whiteside & Associates/G.W Fauth & Associates, Inc. (W&A Team) has endeavored in this report to protect and keep confidential the material shippers and carriers want protected. W&A Team also is in possession of many years of historical knowledge about the shippers in Montana, State of Montana, MRL and BN/BNSF as well as Montana commodity rail movements. W&A Team developed this report utilizing this knowledge to provide an accurate historical perspective. W&A Team surveyed 11 groups of shippers<sup>7</sup>, contacted 31 different companies that could be identified as utilizing MRL and Silver Bow interchanges based on identified shipment patterns. W&A Team received responses from 4 different firms. The 4 companies that did respond articulated they did not want to be identified but would assist W&A Team and the State of Montana in the analysis. All 4 companies indicated that they have, in the past, requested movements from Montana MRL origins over Silver Bow to points served by the UP. The companies also said that they felt that BNSF recognized in their requests for movements over Silver Bow, the BNSF routes were circuitous and out of the market when pricing into southern ID and UT markets, adding that even on those movements, the BNSF they would not price at levels that would move the traffic. It is important to note one should not conclude that no movements to UP locations are being moved over Silver Bow. It is clear that movements over the last 25+ years have occurred and are occurring between MRL and UP over Silver Bow interchange.

### **Railroads:**

W&A also made email contact with MRL (Jim Lewis), UP and BNSF (Barbara Ranf) for their input. Jim Lewis responded that due to the confidentiality of the information requested and the fact that the number of the shipments involved confidential transportation contracts, MRL could not provide the requested information. The BNSF (Barbara Ranf) also responded stating "the information requested encompasses customer and shipping information that BNSF consider proprietary, competitively and commercially sensitive, or subject to non-disclosure requirements through contractual confidentiality provisions or our statutory obligations to our shipping community, and thus BNSF is not in a position to provide." The Information requests to the railroads are outlined in Appendix 1 attached. However, the BNSF and UP subsequently did respond to the report and those responses are attached as exhibits Appendix 2 (BNSF) and Appendix 3 (UP) attached.

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<sup>7</sup> The eleven commodity groups represented by the outreach letters included grain, lumber, talc, steel, sulfur, asphalt, refined petroleum products, petroleum coke, clay, heavy equipment and the major refineries in the Billings's area.

## **Background: History and Role of Interchange Commitments:**

The Staggers Rail Act of 1980<sup>8</sup> (Staggers) provided the railroads with the ability to sell, lease, or abandon rail lines more readily. These changes in the law led to a virtual explosion in the number of non-Class I railroads. According to the American Short Line and Regional Railroad Association (ASLRRA), in 1980 there were approximately 190 short lines operating some 8,000 miles of track and now there are more than 500 short lines operating nearly 50,000 miles of track, or approximately 30% of the national railroad system.<sup>9</sup> Many short lines and regional carriers can operate the lines at lower costs than the larger Class I carriers from which they acquired or leased the lines. Reduced labor costs contribute to the lower operating costs. The BN created a number of short lines in the 1980's including the Red River Valley in ND, Winona Bridge in MN, Montana Western Railroad in Montana, CMR in Montana, and several in Washington State including the Central Washington. The MRL transaction<sup>10</sup> was one of the largest such post-Staggers Act railroad spin-offs which involved the old Northern Pacific line from Huntley, Montana to Spokane, Washington (see section below entitled History of the Formation of Montana Rail Link).

Many of the line spin-off transactions that created new short line railroads contained contractual provisions that limited the incentive or ability of the short line railroad to interchange traffic with other connecting carriers that could compete with the seller or lessor carrier for the long-haul portion of a movement. These interchange commitments took varying forms, including credits for cars interchanged with the seller or lessor carrier, a penalty for traffic interchanged with another railroad, or a total ban on interchange with any carrier other than the seller or lessor carrier.

During the past 30 years, these paper barrier restrictions have been the subject of numerous regulatory proceedings, litigations and proposed legislative changes. In 2007, the STB, after pressure from Congress, rejected numerous requests to adopt rules of general applicability to determine the lawfulness of paper barriers. The STB concluded that a determination of lawfulness is best made on an individualized, case-by-case basis that weighs the benefits of a particular paper barrier against its potential harm. In evaluating the lawfulness of a specific paper barrier, the STB will consider the following non-exclusive factors:<sup>11</sup>

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<sup>8</sup> Staggers Rail Act of 1980, Pub.L. No. 96-448, 94 Stat. 1895 (1980)

<sup>9</sup> STB Ex Parte No. 575 (Sub-No. 1), Disclosure of Rail Interchange Commitments, served October 30, 2007.

<sup>10</sup> ICC Finance Docket No. 31087, decided July 31, 1987, Montana Rail Link, Inc.--Exemption Acquisition and Operation--Certain Lines of the Burlington Northern Rail Company.

- Whether the paper barrier precludes adequate, efficient through service at reasonable rates;
- The duration of the paper barrier;
- The manner in which the paper barrier discourages interchange with other carriers; and
- The degree to which interchange is effectively foreclosed.

The STB revised regulations require the parties to future rail line sales and lease transactions to disclose whether their agreements contain a paper barrier, and to make those agreements available to affected parties. Similarly, for existing paper barriers, the STB would make the paper barrier agreements available to affected parties who either petition to reopen the STB proceeding that approved the original transaction, or file a complaint alleging that a carrier has violated its statutory obligations due to a paper barrier.

## **History of the Formation of MRL**

MRL was founded in 1987 by a “*spin off*” via a lease/purchase of over 900 miles of BN tracks in the states of Montana, Idaho and Washington.<sup>12</sup> The railroad runs between Huntley, Montana and Spokane, Washington, largely within Montana, and the main line passes through the towns of Missoula, Livingston, Bozeman, Billings, and Helena. Montana Rail Link connects with the BNSF (formerly BN) on both ends and also at Garrison, Montana. The original lease contemplated that MRL could purchase the railroad facilities at the end of the lease (scheduled for December 31, 2047) for the appraised price at that time.

MRL maintains a northern interchange with UP at Sandpoint, ID, which is 329 miles north of Silver Bow, however the 'paper barrier' in the sale/lease from the BN does not allow MRL to interchange with UP without the assessment of 'supplement rent' payments<sup>13</sup>. BN in hearings before the ICC (Interstate Commerce Commission -

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<sup>11</sup> STB Ex Parte No. 575 (Sub-No. 1), Disclosure of Rail Interchange Commitments, served October 30, 2007

<sup>12</sup> Most of the MRL route was originally part of the Northern Pacific (NP). In 1970, the NP, along with the Great Northern; Chicago Burlington & Quincy; and Spokane, Portland & Seattle, merged, forming the Burlington Northern Railroad. MRL was organized on July 1, 1987 and began operating the former BN trackage in Montana and Idaho on October 31, 1987. MRL is privately held and one of the independently operated Washington Companies, founded by Montana industrialist Dennis R. Washington. MRL is headquartered in Missoula.

forerunner agency to the STB) stated that it would pay MRL a base division for each car moved over the MRL system by the BN. Further it was understood, that BN would agree to move a minimum amount of traffic (estimated to be around 100,000 cars per year) over the 'mini-bridge' as the MRL movement became known or pay an amount as if they had moved that stated minimum amount. This became known as a 'take or pay' agreement.

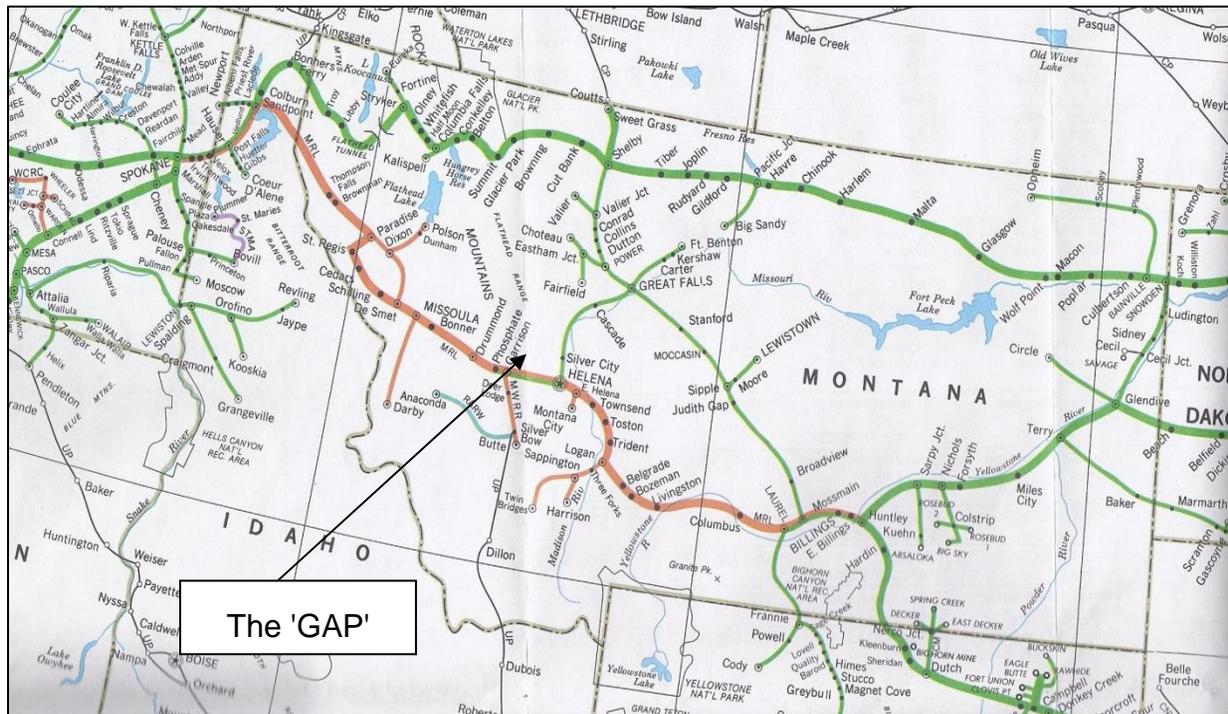
## **Discussion of the "GAP" Sale**

The discussion of the GAP and its effects on the MRL system today is important. It shaped how today BNSF and MRL deal with each other and also how the shippers interface with the railroads when they ship their goods to market over Silver Bow. The original lease between BN and MRL did not include a portion of the line between Helena and Garrison and that became known as the "GAP." (See map below) The GAP was still owned, after the formation of MRL by the BN and MRL was given trackage rights over the GAP rail lines in order to connect between its lines in Helena and its lines in Garrison.

The GAP issue played an important role in the rates and supplemental charges (aka known as paper barriers or supplemental rents) after the initiation of the lease in 1987 (discussed below).

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<sup>13</sup> Finance Docket No. 31087, decided July 31, 1987, Montana Rail Link, Inc.--Exemption Acquisition and Operation--Certain Lines of the Burlington Northern Rail Company.



The chart above shows the 1987 configuration of MRL. Notice that BN (green) shows the line from Helena to Garrison, MT (west of Helena). This is the area known as the "GAP". Thus on any movement over the MRL and/or over the MWRR (which MWRR had acquired from the BN the year before MRL came into existence), the BN participated in the movement and received revenue in the form of divisions on each movement.

At issue for Montana shippers are the rates and/or supplemental charges being assessed on movements from MRL onto to the UP at Silver Bow. After requests for information about Supplemental charges being assessed by BNSF to MRL movements onto UP, BNSF responded to our requests indicating these matters are confidential, and MRL has answered our requests by indicating that these matters are likewise confidential and they will not release them to us. That is understandable and W&A Team encountered the same wall from many of the major shippers it contacted requesting information. However, W&A Team was able to garner a good picture of the information from its own sources (clients of the firm) - albeit shippers whose information they wanted kept confidential which we will respect in this report combined with shipment data from public waybill samples. The GAP was the Northern Pacific Line between Phosphate (Garrison) and Helena and it was leased (or sold) to MRL on August 25, 1992. This was referred to as the 'closure of the GAP.'

The original lease between BN and MRL also did not include a 52-mile portion of track between stations at Garrison Junction and south to Butte, MT known as the Copper City Subdivision. This BN leased line (owned by UP<sup>14</sup> on a 99 year lease) was transferred to the Montana Western Railroad (MWRR) in 1986 the year before the MRL lease/purchase was consummated. This line served shipments that moved between Silver Bow (UP) and Garrison (BN) until the GAP was closed (the MRL leasing the BN line between Helena and Garrison). Then the MWRR served MRL at Garrison and UP at Silver Bow.

MWRR served as a bridge line connecting MRL and UP.<sup>15</sup> As a result, neither the MRL nor the BN had direct southern access to UP, which interchanged with MWRR near Butte at Silver Bow. It is apparent that BN pledged to MWRR, when it transferred the access to its lease of the Copper City Subdivision, that it would support and encourage shipments via MWRR. This kind of promise is present in most of the short line agreements that were consummated in 1980's with the BN. That promise became the center of the dispute between MWRR and BNSF after closure of the GAP. The BNSF reacquired the lines operated by MWRR in 2003<sup>16</sup> to settle the dispute with MWRR. MWRR ceased operations in 2003.

## **Supplemental Rents (Paper Barriers)**

One of the results from the Closure of the GAP was the increased importance and significance of the supplemental rents for traffic interchanged at Garrison with Montana Western (MWRR) Railroad. After the Closure of the GAP, the 52-mile line now only connects with MRL and MWRR and does not connect with any other BNSF line segments. Supplemental rent is usually a per car penalty (or source of supplemental revenue - depending on whether one is the shipper or the carrier) in this case, imposed by the BN, for traffic interchanged with MWRR at Garrison and subsequent movement to Silver Bow for shipment on the UP. This was paid by MRL to BN. This is also known as a paper barrier - the rent places a penalty for traffic interchanged at Garrison, MT with MWRR that the BNSF does not participate in.

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<sup>14</sup> MWRR actually leased the Line from the Oregon Short Line Railroad, which is a subsidiary of Union Pacific (UP).

<sup>15</sup> Like MRL, this 52-mile line was a 1986 spin-off of BNSF known as Montana Western Railway Company (MWR). In 2003, BNSF reacquired the MWR line (see STB FD 34330, The Burlington Northern And Santa Fe Railway Company--Acquisition And Operation Exemption--Montana Western Railway Company, Inc., served June 23, 2003).

<sup>16</sup> STB Finance Docket No.34330, The Burlington Northern and Santa Fe Railway Company - Acquisition and Operation Exemption - Montana Western Railway Company, Inc.

This penalty or supplemental rent effectively places a barrier for potential traffic that would have or could have historically moved over Silver Bow prior to the closure of the GAP or the lease by MRL of the BN lines formerly known as the Northern Pacific lines. How much are the supplemental rent levels? Since neither railroad will define the amounts of the rent levels, it remains a mystery. But best guess estimates based upon rate analysis and private conversations, it appears that the supplemental rates vary with the commodity but range from \$400 per car up to \$3,000 per car.<sup>17</sup> We have heard of estimates as high as \$5,000/car but the more usual numbers based upon rate analysis are lower. However, if a supplemental charge of amounts in the \$5,000 per car were being assessed it is doubtful that the movement would occur and rate analysis would not yield any information.

If BNSF does not want a commodity movement to occur (for their reasons such as loss of revenue, movement or volume, or penetration of a market that they feel would not be in BNSF best interests), the supplemental rents can be utilized to ensure a particular movement does not move over Silver Bow. One cannot criticize an owning railroad for wanting to keep control of the routes of traffic on lines that it previously owned. However, the STB in Ex Parte No. 575 (Sub-No. 1), Disclosure of Rail Interchange Commitments, served October 30, 2007 seeking more information about these Rail interchange commitments and their effect on the shippers ability to move product (see discussion about Ex Parte No. 575 above in the Background and History of Interchange section). One should be reminded that BNSF also controls all pricing on any movement off MRL onto any other carrier. Stated another way, MRL does not price any rail movement other than local movements on its system. They must, under their agreement with the BN/BNSF, request a rate from the BNSF for any movement beyond its system.

In 2003, after threat of litigation, and arbitration/negotiation between MWRR and BNSF, the BNSF reacquired the MWRR lines (Copper City Subdivision) between Garrison (MRL) and Silver Bow (UP). This action reinserted the BNSF back into movements off MRL destined for the UP wherein the BNSF now had direct southern access to UP at Silver Bow. The dispute between MWRR and BNSF showed that BNSF, according to MWRR, had been cancelling tariff and tariff routings over Montana Western on agricultural products - Item 22505 in BNSF tariff 4022 showing a MWRR route was eliminated according to MWRR in its complaints against the BNSF.<sup>18</sup>

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<sup>17</sup> Source: Professional Analysis of movement data and confidential conversations with shippers and carriers

<sup>18</sup> Source: confidential conversations with rail shippers

MWRR also showed that the tariff rates on MWRR routes had been raised and BN direct rates to common destinations had been lowered. As stated above, when the GAP was closed (sold to the MRL), the BN had little or no financial interest or gain to ship BN originated traffic over MRL/MWRR/UP. Reason - it no longer participated in the movement. After the BN merged with the Santa Fe, MWRR alleged that its routing to SW U.S. destinations over MWRR became even less useful to the BNSF<sup>19</sup>. Remember that according to the MWRR, BN was operating with an agreement that required BN to 'promote' movements over MWRR. These were standard clauses in the shortline agreements of that the 1980's. For example, routes to stations such as Oakland and Stockton, CA were once served exclusively by routing BN/MRL/MWRR/UP, but the purchase of the Santa Fe by the BNSF; BNSF cancelled the routes over Silver Bow and pushed the traffic to BNSF direct (BNSF tariff 4022).

The question is, after BNSF purchased the MWRR, has more traffic begun to move to the UP? W&A Team reviewed the public waybill samples of rail movements from BEA 132 district that includes Montana to ascertain possible movements. It is clear from our experience, that movements over Silver Bow to many markets are much shorter (less circuitous) but it is also clear that traffic that could move over Silver Bow is not moving. If the State of Montana wanted to look at the Confidential Way Bill sample in the future, a request would have to be made showing good cause to the Surface Transportation Board. The State of Montana, in its Petition For Declaratory Order STB Docket No. NOR 42124, State of Montana v. BNSF Railway Company did in fact request access to and receive permission to utilize the Confidential Waybill Sample. The access to the Confidential Way Bill data is limited to the case for which it is requested. The question of standing to open up the details of a paper barrier probably rests with an affected party, namely a shipper. The State of Montana may be able to pursue a case under the doctrine of *parens patriae*<sup>20</sup>. W&A Team did a cursory examination and did not find evidence that other states had projects to adjust paper barrier arrangements, but the STB has, as outlined at the end of this report, become more active in this area. The STB has indicated it will take up existing paper barrier cases on a case by case basis (Page 23 of this report).

However, for the purpose of this analysis, we utilized the Public Waybill Sample, which does not show interchange information at the specific sites.

Why is that important to understand by the readers? When the original GAP was closed by the leasing of that line section to MRL in (October, 1992), effectively the line 'dropped off' the BN (later BNSF) system. BN no longer had a financial stake in

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<sup>19</sup> Ibid

<sup>20</sup> *Parens Patriae* - referring to the sovereign power of the State over persons of guardianship, in this case the citizens of Montana

movements from MRL points to UP. It was if the movement did not exist to the BN which gave it no incentive to allow movements to perceived competitive points. This apparently caused some disruptions in the granting of waivers for supplemental rent requests. For example, a movement of asphalt from one of the Billings refineries or from sulfur originating in Billings headed to a UP destination in ID or UT and routed over Silver Bow would never show up on the BN system thus producing no BN revenue for the system. There were points in Utah, California, Arizona, Colorado, Wyoming, Nevada and Idaho that could not move via BN because BN did not have competitive routes, rates and service to those destinations from MRL origins. Apparently, the BN and MRL worked on this issue and developed three lists of movements that categorized the Supplemental Rent process.<sup>21</sup>

- **Category 1** appears to have dealt with traffic moving before MRL commenced operations. It is W&A understanding that all supplement rent was waived for this traffic (Grandfathered traffic).
- **Category 2** which dealt with traffic that had moved between the commencement of MRL operations (which was October 31, 1987) and sometime in October of 1992. The commodities in the second list were given a period of time where supplement rent would not apply - W&A Team believe 5 years, and the commodities in the category were limited by some kind annual volume limit. These commodities appear to commodities that were moving to UT and ID but also could include AZ, NV, CA, OR and WY (BN was more circuitous to these locations). This second list may have required further analysis because traffic may have moved in the first several years.
- **Category 3** where the BN and MRL agreed that if a shipment could move competitively over a BN route and MRL would be required in this instance to route over BN direct. This list apparently was reviewed periodically to see if BN could provide competitive routings and/or rates. There was also apparently some kind of limited number of cars that could move under the waiver of supplemental charges. W&A Team has not been able to ascertain what those number of cars are or were.
- Lastly, resolution of disputes between MRL and BN on these issues, if one arose on any traffic or waiver subject to supplement rent, is via arbitration.

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<sup>21</sup> Source: Confidential conversations

Remember these shipments, subject to Supplemental rents, can be originating on MRL in Montana but can also be terminating on MRL from originations served by UP. Stated another way, the subject shipments can be applied on both outbound or inbound shipments.

## **Supplemental Rents - Commodities**

W&A Team has had confidential conversations with MRL based shippers about instances of BN (or later BNSF) applying pressure on MRL via application of supplemental rents that include stories of Asphalt movements, grain movements, sulfur, pulpwood chips, lumber, fiberboard, calcium or sodium (salt?), fertilizers such as phosphates, LPG (liquefied petroleum gas), paper, cement, and scrap iron. While this list is not all inclusive it does suggest that there were or are a number of commodities that are affected the assessment of supplemental rents. It is logical in discussions among shippers, to assume that the BN (today BNSF) is forcing their movements over BN rather than allowing movement over MRL/BN/UP at Silver Bow, but it remains difficult to delineate. Clearly it is financially advantageous to the BN (today BNSF) to move over its system and maximize its mileage haul and thus its revenue.

In the past there have been some disputes that became public that showed BN/BNSF was exerting pressure on MRL. Remember, however, that MRL's largest customer is the BN/BNSF for its run-through trains, and it would make little sense for MRL to address, in the press, issues it has with BN/BNSF over application of supplemental rents.

One of the disputes W&A heard about involved the beer distribution business in Montana. At the heart of the controversy which occurred in 1998 when the rates to MRL beer distributors were increased more than rates to other Montana distributors.<sup>22</sup> The beer distributors on the MRL felt they weren't being treated fairly. The issue was subsequently resolved after the rail carriers adjusted their rates downward. W&A have seen other examples of pricing disparities in Montana between MRL grain shipping points and BN grain shipping points over the years (see discussion under Montana Western RR section).

## **Current MRL Rail Traffic:**

The following table shows the 2011 carloads and tons for the major commodities handled by MRL:

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<sup>22</sup> Source: confidential conversations with shippers and carrier representatives

**2011 Carloads and Tons Handled By MRL**<sup>23</sup>

STCC	Commodity	Carloads	% Cars	Tons	% Tons
11	Coal	122,853	33.89%	14,589,755	39.08%
01	Farm Products	77,997	21.52%	8,547,500	22.90%
29	Petroleum & Coal Products	39,215	10.82%	3,469,801	9.29%
20	Food & Kindred Products	22,151	6.11%	2,151,318	5.76%
28	Chemicals & Allied Products	21,231	5.86%	2,014,141	5.40%
24	Lumber & Wood Products	19,242	5.31%	1,744,740	4.67%
32	Stone, Clay, Glass & Concrete Prod.	15,755	4.35%	1,557,960	4.17%
14	Nonmetallic Minerals Except Fuels	8,821	2.43%	808,138	2.16%
	All Other Commodities	35,227	9.72%	2,448,611	6.56%
<b>Total</b>		<b>362,492</b>	<b>100.00%</b>	<b>37,331,964</b>	<b>100.00%</b>

Although MRL originates and terminates a significant amount of rail traffic from and/or to rail stations on its line, the vast majority of the rail traffic handled by MRL is overhead or bridge traffic from BN/BNSF.

Coal (STCC (Standard Transportation Commodity Code) 11) represents is the largest commodity handled by MRL (122,853 carloads and 14,589,755 tons), yet does not serve any coal origins and the one major coal destination on MRL, PPL Montana's J.E. Corette generating station in Billings, is served by jointly with the BNSF. In 2011, the Corette generating station in Billings consumed 550,222 net coal tons.<sup>24</sup> The vast majority of coal handled by MRL originates from BNSF-served origins in the Powder River Basin (PRB) in Montana and Wyoming and moves north-west over MRL to destinations in the Pacific Northwest (PNW). MRL benefits from a shorter route to the PNW. MRL's route is approximately 100 miles shorter than BN/BNSF's route via Great Falls and Shelby.

Coal is an important and growing traffic segment for MRL. Currently MRL averages 5 coal trains per day (2.5 loaded coal trains and 2.5 empty) and indicates that, with significant infrastructure investment, capacity could increase by an additional 16 trains per day (an additional 8 loaded and 8 empty trains per day).<sup>25</sup> Currently, there

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<sup>23</sup> MRL 2011 Annual Report to Montana PSC.  
<sup>24</sup> U.S. Energy Information Administration (EIA), Form 923 data.

are plans for several PNW export coal terminals, such as the planned Cherry Creek and Longview coal terminals in Washington which could handle over 100 million tons per year.<sup>26</sup> This number has been confirmed by Matt Rose, CEO of BNSF in an interview with the Columbian paper in the summer of 2012. MRL should be a major beneficiary of this additional coal volume as a result of its shorter route to the PNW.

Farm Products (STCC 01), primarily wheat and barley, is the next largest commodity group handled by MRL (77,997 carloads and 8,547,500 tons). The following is a list of the grain elevators served by MRL:

**Montana Grain Elevators Served By MRL**

<b>City/State</b>	<b>Company</b>	<b>Track Capacity (Rail Cars)</b>
Billings, MT	Gavilon (Peavey)	110
Billings, MT	Cereal Food Processors, Inc.,	5
Bozeman, MT	Ag Depot, Inc.	2
Harrison, MT	Harrison Elevator Co.	18
Huntley, MT	Miller Coors, LLC	9
Ronan, MT	Westland Seed Inc.	4
Three Forks, MT	Columbia Grain, Inc.	4

As can be seen, with the exception of the 110-car shuttle elevator in Billings, most of the grain elevators served by MRL are very small (2 to 18 car capacity). Consequently, the vast majority of wheat and barley handled by MRL originates from BN/BNSF-served elevators in southern Montana and, like coal, moves north-west over MRL's shorter route to destinations in the PNW (primarily export grain terminals, such as Rivergate, OR (Portland), Kalama, WA and Vancouver, WA. Again, MRL benefits from a shorter route to the PNW.

Petroleum & Coal Products (STCC 29) is the third largest commodity group handled by MRL (39,215 carloads and 3,469,801 tons). A significant portion of this STCC 29 traffic moves from or to refineries in and around Billings (i.e., the ConocoPhillips and ExxonMobil refineries in Billings and the Cenex refinery in Laurel).

<sup>25</sup> <http://www.montanarail.com/coalfacts.php>

<sup>26</sup> See <http://www.heavytrafficahead.org/pdf/Heavy-Traffic-Ahead-web.pdf>

These STCC 29 commodities handled by MRL include: Gasoline (STCC 29-111); Petroleum Distillate Fuel Oil (STCC 29-113); Asphalt (STCC 29-116); Petroleum Residual Fuel Oil (STCC 29-117); Liquefied Petroleum Gas (STCC 29-121); and Petroleum Coke (STCC 29-913).

In addition to coal, wheat, barley and petroleum products, MRL handles a variety of other products, such as:

- Lumber (STCC 24-111) to mills in near Thompson River and Tricon in Big Timber, MT;
- Talc (STCC 32-954) from mines near Three Forks and Sappington, MT (Imerys); and
- Liquid or Molten Sulphur (STCC 14-716) from Laurel and Billings (Montana Sulphur Chemical Company).

### **Potential MRL Rail Markets Via The UP Silver Bow Interchange:**

It is difficult to determine the amount of rail traffic which currently moves to or from MRL points via the UP interchange at Silver Bow with the data available through the Public Waybill sample. Most of the sources indicate that only a limited amount of traffic currently moves over the 52-mile BNSF line between Garrison Junction and Butte.

Based on our review of the STB's 2011 Public Waybill Sample, we have been able to identify the following traffic which moved from the Billings area (BEA 144) and apparently interchanged with UP at Silver Bow:

- 700 carloads of Asphalt (STCC 29-116) moving from Billings area to the Salt Lake City, UT area (BEA 152) and the Boise, ID area (BEA 150); and
- 400 carloads of Liquid or Molten Sulphur (STCC 14-716) moving from the Billings area to the Casper, WY area (BEA 143) and the Idaho Falls, ID area (BEA 148).

The following summarizes the 2011 rail carloads moving to Salt Lake City (BEA 152):

#### **2011 Rail Traffic to Salt Lake City, UT (BEA 152)**

STCC	Commodity	Carloads	% Cars	Tons	% Tons
01-132	Corn	2,017	1.91%	215,487	3.43%
<b>01-137</b>	<b>Wheat</b>	<b>2,472</b>	<b>2.34%</b>	<b>259,304</b>	<b>4.12%</b>
20-923	Soybean Meal	940	0.89%	101,156	1.61%
24-211	Lumber	1,240	1.17%	113,200	1.80%
24-991	Oriented Strand Board	1,000	0.94%	97,160	1.54%
26-111	Wood Pulp	800	0.76%	75,000	1.19%
26-311	Pulpboard	3,320	3.14%	262,720	4.18%
28-122	Sodium Alkalies (Caustic Soda)	600	0.57%	48,120	0.76%
28-123	Sodium Compounds (Soda Ash)	832	0.79%	65,600	1.04%
28-126	Bariums	280	0.26%	18,520	0.29%
28-181	Urea	520	0.49%	17,960	0.29%
28-184	Alcohols	3,860	3.65%	305,640	4.86%
28-193	Sulphuric Acid	1,308	1.24%	129,108	2.05%
28-194	Industrial Inorganic Acids NEC	600	0.57%	44,200	0.70%
28-197	Radio-Active or Nuclear Chemicals	15,620	14.76%	2,336,480	37.14%
28-198	Anhydrous Ammonia	500	0.47%	38,968	0.62%
28-199	Industrial Inorganic Chemicals NEC Plastic Materials or Synthetic	760	0.72%	61,760	0.98%
28-211	Resins	2,400	2.27%	215,760	3.43%
28-712	Superphosphates	360	0.34%	39,120	0.62%
28-991	Salt	360	0.34%	27,120	0.43%
28-999	Chemical Products, NEC	1,920	1.81%	41,400	0.66%
<b>29-116</b>	<b>Asphalt</b>	<b>2,436</b>	<b>2.30%</b>	<b>218,388</b>	<b>3.47%</b>
<b>29-121</b>	<b>Liquefied Gases, Coal or Petroleum</b>	<b>2,748</b>	<b>2.60%</b>	<b>184,128</b>	<b>2.93%</b>
33-122	Iron or Steel Plates	960	0.91%	79,640	1.27%
33-123	Iron or Steel Sheet or Strip	2,440	2.31%	218,400	3.47%
33-124	Iron or Steel Bars, Shapes or Rods Structural Shapes, Piling, Steel Mill Prod.	480	0.45%	41,640	0.66%
33-125	Iron or Steel Pip, Tubes or Fittings	1,120	1.06%	93,960	1.49%
33-126	Metal Shipping Containers	160	0.15%	3,200	0.05%
34-997	Freight Train Cars	1,582	1.49%	36,127	0.57%
40-291	Waste or Scrap, NEC	4,456	4.21%	237,640	3.78%
46-111	All Freight Trailer on Flat Car (TOFC)	47,000	44.40%	609,080	9.68%
	<b>Total</b>	<b>105,851</b>	<b>100.00%</b>	<b>6,291,322</b>	<b>100.00%</b>

As can be seen, 2,472 carloads of Wheat, 2,436 carloads of Asphalt, and 2,748 carloads of Liquefied Gases, Coal or Petroleum moved to BEA 152 in 2011. (Highlighted). Based on MRL's traffic base and the fact that it would involve a much shorter route, it appears that the most logical market for MRL to move traffic via the UP interchange at Silver Bow would be wheat (STCC 01-137) from MRL-served elevators (primarily Billings) and Petroleum & Coal Products (STCC 29) from the refineries in and around Billings to the Salt Lake City area (BEA 152).

BNSF direct route from Billings to Salt Lake City (BNSF Denver/Salt Lake City involves a circuitous 1,223 mile route through Denver, CO, whereas the route via MRL, BNSF and UP via the Silver Bow interchange involves a route of only 777 miles.

Because of this significant mileage advantage, Salt Lake City destined MRL traffic should be routed entirely over the Silver Bow gateway. The following table utilizes the STB's 2011 Uniform Railroad Costing System or URCS data to construct railroad rates for Asphalt shipments from Billings to Salt Lake City and Denver based upon the 180% STB jurisdictional threshold:

**Comparison of STB 2011 URCS Costs and Constructed Rates Per Car  
For Railroad Asphalt Movements (STCC 29-116) From  
Billings, MT to Salt Lake City, UT and Denver, CO  
(Based on 50 Cars Per Shipment and 100 Tons Per Car)**

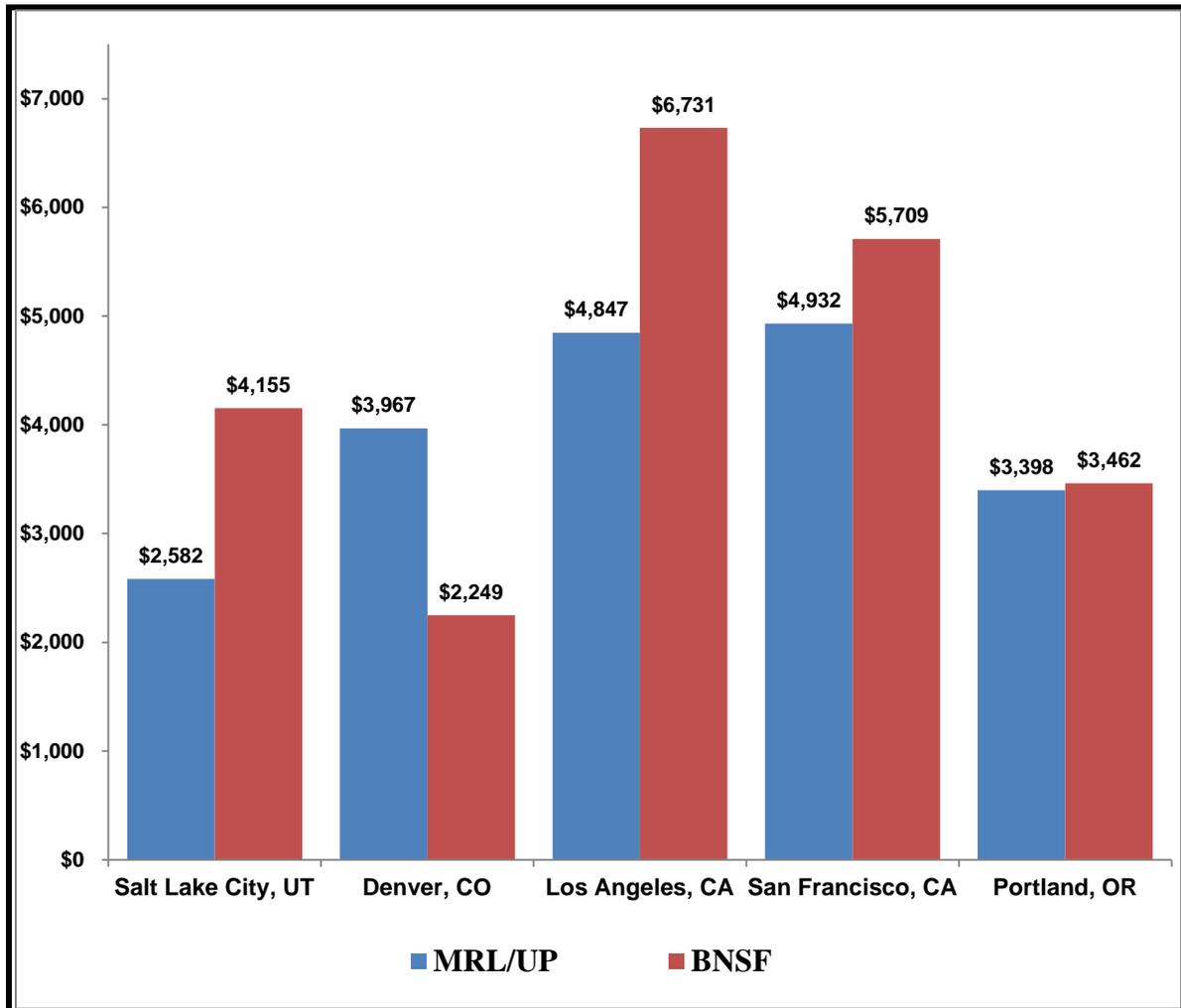
Item	Via MRL/UP	Via BNSF-Direct
<b>BILLINGS, MT TO SALT LAKE CITY, UT</b>		
<b>Railroad Line-Haul Miles</b>	<b>758</b>	<b>1,223</b>
<b>2011 URCS Cost Per Car</b>	<b>\$1,429.70</b>	<b>\$2,295.55</b>
<b>Rate Per Car Based on 180% RVC</b>	<b>\$2,573.46</b>	<b>\$4,131.99</b>
<b>BILLINGS, MT TO DENVER, CO</b>		
<b>Railroad Line-Haul Miles</b>	<b>1,246</b>	<b>652</b>
<b>2011 URCS Variable Cost Per Car</b>	<b>\$2,222.00</b>	<b>\$1,249.63</b>
<b>Rate Per Car Based on 180% RVC</b>	<b>\$3,999.60</b>	<b>\$2,249.34</b>

Based on this URCS analysis, it is evident that the MRL- Silver Bow - UP route to Salt Lake City is significantly shorter (only 62% of the distance) and thus produces STB-jurisdictional rates per car based upon this standard which are much lower than the all BNSF routing to Salt Lake City. Montana producers have reduced access to large markets to the south (ID, and UT) and the southwest (AZ, NV, and CA) because of paper barriers.

Using the same URCS-based methodology, the following chart shows graphically that MRL/UP is considerably less expensive (due primarily to significant mileage difference) and more efficient to move asphalt from Billings to Salt Lake City, Los Angeles, San Francisco and Portland. The routes via the UP Silver Bow interchange to and from western destinations such as San Francisco and Los Angeles, CA would also be significantly shorter than the BNSF routes and could represent potential markets.

Only movements from Billings to Denver show an advantage over the MRL-Silver Bow-UP routing.

**Comparison of Developed Rates Per Car Based On 180% R/VC  
For Asphalt Movements From Billings, MT**



The evidence clearly suggests that paper barriers harm Montana producers and production by limiting access to markets that are natural trading partners and routes for Montana. Confidentiality lends a speculative quality to the direct primary data. However, the authors believe the bulk of the evidence is more than suggestive that paper barriers over Montana Rail Link constitute the limiting of access by Montana producers and production to these markets.

## **SUMMARY**

In Summary, if the Montana movements were being routed based strictly on railroad economics (shorter distances providing lower costs), movement to states south of Montana (except Colorado) such as ID, UT, NV, AZ, and CA would all logically move over the Silver Bow Gateway. Thus, it can be assumed that the presence of paper barriers assessed by the BNSF on MRL movements is contributing to this inefficiency and lack of Montana originated and or terminated movement over Silver Bow.

Looking at it from a different perspective, if a railroad such as the BNSF, owned all of the lines of the UP from Silver Bow to Salt Lake City as well as the lines it currently owns over the Denver gateway, based upon the shorter distance, the railroad would move over the shorter distance (Silver Bow/Salt Lake City) for every movement. They would not move from Montana MRL origins to Denver and then onto Salt Lake City because of the increase in circuitry (miles) and higher costs. Rather they would move over Silver Bow to increase the efficiency and lower the costs of the movements.

What does this tell us? Given all of the data developed in this report, and given that the distances to Idaho, UT and into southwestern destinations are all shorter and more direct via Silver Bow, the bulk of the evidence lends one to the conclusion that Montana producers have reduced access to large markets to the south due to the exercise of the paper barriers and Montana producers would be better served if the paper barriers did not exist.

The BNSF has indicated to the RSCC that they intend to review this report and hopefully that review will provide an opportunity for the RSCC and BNSF to open a dialogue about Paper Barriers and their effects on Montana shipments.

## **STB PAPER BARRIER CHRONOLOGY**

- 1998 Senate Commerce Committee holds hearings; STB initiates proceeding to study issue; docketed as Ex Parte No. 575
- April 17, 1998, STB issues decision on issue, declines to take action in light of proposed Railroad Industry Agreement (“RIA”) which our next speaker will address
- December 21, 1998, Western Coal Traffic League (“WCTL”) asks STB to eliminate “unreasonable” paper barriers, those that last more than 5 years, limit interchange even if they don’t reduce traffic to seller, or provide seller with “excessive” benefits
- March 2, 1999, STB declines to grant WCTL petition; wants to see if RIA provides adequate relief \
- March 21, 2005, WCTL renews its petition to the STB, complains that RIA is inadequate because it does not prescribe remedies for *pre-existing traffic* and does not provide a remedy for adversely affected shippers
- October 30, 2007, STB issues decision concluding that interchange commitments are best considered on a case-by-case basis; STB declines to issue a rule prohibiting the enforcement of existing interchange agreements; STB suggests a higher level of scrutiny for commitments that ban interchange or those that continue in perpetuity
- May 29, 2008, STB issues final rules on interchange commitments; rules require disclosure of any interchange commitment limitations or restrictions and provides a mechanism for affected parties to obtain copies

## PAPER BARRIER LITIGATION

- STB Docket No. 42076, *Albany & Eastern Railroad Company v. Burlington Northern and Santa Fe Railroad Company* A complaint proceeding initiated by AERC, a class III railroad, against BNSF in 2003 challenging a restriction on its ability to interchange with the Union Pacific Railroad as an unreasonable practice. Complaint dismissed by AERC with prejudice in 2004. BNSF is currently suing AERC in Federal Court for damages for diverting traffic.
- STB Docket No. 42104, *Entergy Arkansas, Inc., Et Al v. Union Pacific Railroad Company and Missouri & Northern Arkansas Railroad Company, Inc.*
- A complaint proceeding filed by a coal shipper and a coal burning utility company challenging the legality of the paper barrier imposed on the 1992 lease of lines from the Union Pacific Railroad to the Missouri & Northern Arkansas Railroad Company ("M&NA"), a RailAmerica and former Rail-Tex regional railroad subsidiary.
- Seeking access to BNSF, the complainants argued that the paper barrier acted as a *de facto* ban on interchange with BNSF, was an unreasonable practice under the ICC Termination Act, and was an unauthorized pooling agreement.
- UP argued that it had previously provided exclusive service to Entergy before the commencement of the lease and never would have entered into this lease without preserving for itself this revenue stream.
- The Board found that the shippers had sought relief under the wrong statutory provision and directed them to refile their complaint under a provision allowing the Board to establish a through route and rate division.
  - In its June 2009 Decision (at 7), the Board explained that a through route would be prescribed in this proceeding if the complainants show "the bottleneck railroad has exploited its market power by (1) providing inadequate service over its lines or (2) foreclosing more efficient service over another carrier's line . . . [I]f Entergy or AECC can demonstrate that, due to this interchange commitment, UP and MNA are providing inadequate service or foreclosing more efficient service over another carrier, we may direct that a new route be opened and order MNA to establish a common carrier rate for interchange with that other carrier." (June 2009 Decision at 7)
- The Board held an oral argument in the fall of 2011 and issued a decision on November 26, 2012, describing the demonstration required to carry the Board. Namely the dominant railroad would have to shown as "foreclosing more efficient service over another carrier." The Board has the power to direct that a new route be opened and establish a common carrier rate over the interchange.

## **Appendix I**

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# ***Whiteside & Associates***

Transportation & Marketing Consultants  
3203 Third Avenue North, Suite 301 Billings, Montana 59101  
Phone: (406) 245-5132  
FAX: (406) 252-3778  
email: [twhitesd@wtp.net](mailto:twhitesd@wtp.net)

May/June, 2013

Name

Address

City state zip

Dear \_\_,

I am doing a review and study of paper barriers for the MT DOT in conjunction with the work at MT Rail Service Competition Council. My assigned work tasks include (taken from contract language):

"Montana Rail Link (MRL) is a Class II railroad carrier. Most of its track is leased from BNSF Railway (BNSF). The lease between BNSF and MRL does not include a portion of track between stations at Garrison Junction and Silver Bow. One effect of that is that MRL does not have direct access to track operated by the Union Pacific (UP) Railway which provides service from Silver Bow to the south; both MRL and UP must interchange with BNSF via that railroad's Copper City Subdivision.

Private contract(s) may include non-disclosure and confidentiality terms that limit the ability of the firms to disclose the conditions and pricing of interchanges between railroad lines. To date, the RSCC has only been able to gather anecdotal information about rail rates for routings that include the MRL and the UP. The RSCC seeks concrete data to determine if these paper barriers are material enough to actually affect Montana rail shippers' competitiveness.

### **Scope of Work**

This research project will involve contacting private companies and discussing actual shipping costs. Because of the proprietary nature of these discussions, it is believed that an independent consultant will be best able to make these contacts and most likely to get the information needed.

Specific research topics and deliverables are:

1. Review historical documents from the creation of what is now MRL, to determine if any industries or specific origin/destination pairs were granted access to the UP via the intersection of BNSF and UP railroads at Silver Bow, and/or the intersection of BNSF and MRL railroads at Garrison.
2. Identify current rates and volume moved to determine and estimate the magnitude of impact under this historic arrangement. This may include contacting UP, BNSF and MRL to request this data, if it is not publicly available.
3. Research, identify, and contact rail shippers located along the MRL line to determine if they would benefit from improved access to the UP via interchange at Silver Bow. A minimum of eight different businesses will be contacted. This will include eight different firms in at least four industries, all of which are MRL-based and seek market expansion that could benefit from access to markets to the south via UP railroad service.
4. For each business, identify one or two major geographic markets that are served by both BNSF and UP (competitive markets). Examples that potentially could be reached advantageously include: Dallas or Houston, TX; Kansas City, MO; Denver, CO; Salt Lake City, UT; and Los Angeles, CA.
5. For each business, identify one or two of these competitive markets and document current shipping costs via MRL/BNSF. For these same markets, work with the business to determine actual rates for the move using the MRL/BNSF/UP routing (via the Garrison-to-Silver Bow link).
  - a. Note that businesses may not be comfortable providing this information
  - b. Information gathered may be protected as trade secrets under the following provisions of Montana Code: i. MCA § 2-6-102(3) ii. MCA § 30-14-402(4)
  - c. Accordingly, the report will not be able to include data about specific businesses. Its aim is to provide information to inform discussions about the existence and magnitude of paper barriers in Montana.

d. All data, contacts, and analysis will be reviewed with MDT staff for purposes of assuring the quality and reliability of the analysis. Confidential data will be safeguarded by both the contractor and agency against disclosure.

6. Summarize the research in a document and presentation that discusses findings about the existence and impact of paper barriers on Montana shippers and the next RSCC meeting. "

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I am not sure who in BNSF can help with this request to assist for this analysis. The purpose of my email is to share with BNSF what I am doing, what I am charged to report on, and see if any information (confidential or non-confidential) can or will be provided by BNSF to assist in the completion of this study. I have five main questions:

1. When MRL was formed, were there grandfathered movements (that were classified as non-paper barrier) over Silver Bow to UP originated on BNSF or MRL allowed by BNSF? In other words, were any shipments allowed to continue that had moved before the sale not subject to supplemental charge? If so what commodities and state destinations were they? Second part of this question - are they still grandfathered today, or were some of them cancelled if they were not utilized on a regular basis?
  2. Does the BNSF set all rates on movements beyond Silver Bow when a movement request is made to MRL by a shipper? Does BNSF assess supplemental charges to movements destined to Silver Bow or only to points beyond Silver Bow?
  3. When the Montana Western Railroad was sold back to the BNSF - did that effectively change the relationship between BNSF and MRL with respect to the how rates beyond Silver Bow were set? If so, to what destinations and commodities are involved.
  4. Will BNSF share with the MT RSCC the commodity groups and state destinations of shippers that are or have in the past requested movements beyond Silver Bow on UP? How many requests by MRL to BNSF have been denied by BNSF because of alternative routing via BNSF being available. For example on asphalt movements from Billings to SLC has the BNSF ever denied a request for waiver over Silver Bow to a Montana shipper based upon the reasoning that an alternative routing over BNSF was available? Even though a shipper requests movement over Silver Bow have those requests by denied? If so how many requests and how many denials have been executed in the last 10 years?
  5. Would your railroad provide information about how many requests by MRL shippers have been made to move over Silver Bow by year for the last 10 years (movements subject to supplemental payments)? If possible, could your railroad provide the commodity descriptions encompassed by those requests?
- Please Note: if your railroad requires a confidentiality agreement to be executed between Whiteside and Associates and your railroad in order to explore these areas, please let me know.

Sincerely,

Terry C. Whiteside  
TCW:jgg

# Appendix 2 Page 1 of 5

## BNSF Response to Invitation to Comment on Paper Barriers Report



Don Karls  
NW Region Ombudsman  
Manager Ag Operations Support

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October 16, 2013

VIA ELECTRONIC MAIL

Montana Rail Service Competition Council  
Attn: Mary Vandebosch  
RSCC Administrative Support  
Headwaters Policy/Planning Partnership, LLP  
737 5th Ave  
Helena, MT 59601

**RE: BNSF Comments to Rail Service Competition Council re: Whiteside/Fauth  
September 10, 2013 Report**

BNSF Railway appreciates the Council's interest in understanding the transportation options available to businesses within Montana. We also appreciate the opportunity to respond to the September 10, 2013 Draft Report by Messrs. Whiteside and Fauth ("W/F") entitled "The Impact of Paper Barriers on Montana Rail Shippers' Competitiveness" (hereinafter "Draft Report") and the assertions contained therein that interchange commitments in the lease agreement between BNSF and the Montana Rail Link ("MRL") hinder market engagement in the region. For reasons we will outline below, including the lack of any evidence that meaningful amounts of traffic are being prevented from a UP routing as a result of MRL interchange commitments to BNSF, we oppose the Draft Report's recommendation to pursue the funding of formal action before the Surface Transportation Board. We believe that it would be a more constructive use of the Council's time and resources to follow the example set forth by the Montana producer community's focus on the facts of both agricultural shippers and railroad economics. BNSF believes that neither the Draft Report nor more importantly the real-world markets for Montana's rail shippers warrant what amounts to a costly fishing expedition by W/F.

**Role of Interchange Commitments in Preserving and Improving Rail Service to Local Communities.** Interchange commitments (what W/F refer to as "paper barriers") play an important role in the evolution of a strong shortline industry. "Interchange commitments" are voluntary contractual assurances in shortline lease or sale agreements that the incumbent carrier would continue to participate in longhaul traffic coming off the shortline. They are negotiated with the acquiring entity, come in many forms, and may provide for additional payments when a shortline interchanges with another carrier. The lack of density may make it difficult for a large railroad, with its higher cost structure, to justify the resources to provide adequate service to a small shipping communities. Rather than abandoning a rail line, in some cases, it has made more sense for a Class I to enter into a contractual arrangement with a small railroad in order to leverage their lower cost structure, greater flexibility, and direct connectivity that match the service needs of a small shipper.<sup>1</sup> The interchange commitments that

<sup>1</sup> There are currently more than 450 shortlines which today operate and maintain about 30 percent of the U.S. rail network. As Montana well-knows, line abandonments became commonplace in the late 1970s and into the early

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accompany these agreements provide the small railroad with the certainty of ongoing service, and a long-term interchange commitment that contain the economic basis for a short line's long term viability. Interchange commitments *make the economics work* by keeping acquisition or ongoing lease costs low, often well below the fair market value, which leaves more money for shortline capital upgrades and maintenance while continuing to support the arterial vitality of the established class 1 traffic corridors<sup>2</sup>

There is no reduction in competition incurred by a shipper located on a branchline being converted to shortline service through a lease or sale. This is true *even when the interchange commitment requires an absolute restriction on interchange with any carrier other than the incumbent*, since both before and after a shortline transaction, the branchline customers may receive single-carrier service from the incumbent railroad.<sup>3</sup> Many interchange commitments do not require that all interchanges take place with the incumbent Class I. While there are provisions included in the MRL/BNSF agreements that may restrict certain categories of traffic from being routed away from BNSF, the parties have identified large categories of commodities that have been wholly exempted from that requirement. As will be explained below, the BNSF/MRL agreement and the practices between the parties provide significant options for routing over MRL and UP.

**BNSF/MRL Work Together to Provide Service to MRL-Based Shippers Over All Interchange Points, Including Silver Bow.** While some provisions of the MRL/BNSF agreements may in the first instance require that certain categories of traffic continue being routed on BNSF, the reality is that large categories of commodities have been wholly exempted from that requirement. The list of exemptions covers more than 300 commodity and lane combinations and means that their routing can occur without any further interaction between BNSF and MRL. In addition, the parties have routinely added commodities to the exempt list when meaningful opportunities arose. This does not mean that MRL and BNSF will always be in full agreement about the market logic of a proposed wholesale exemption, but we are not aware of any traffic identified through this process that has been precluded from moving to any destination – whether the route was via Silver Bow, Laurel or Spokane. Finally, BNSF and MRL are parties to the 1998 Railroad Industry Agreement (RIA) between the Association of American Railroads (AAR) and the American Short Line Regional Railroad Association (ASLRRRA). The RIA provides a platform for private-sector, market-based resolutions to many issues between large and small railroads, including those involving interchange commitments. The RIA includes a formal waiver process that allows a shortline to seek a waiver of interchange commitments and includes specific instances in which such a waiver must be granted. While this avenue is available to MRL for issues relating to serving new traffic, it has never had the need to use it.

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1980s as railroads shed lines that were unprofitable. Many of those shortlines operate over lines that would have been subject to curtailed service or abandoned by the large railroad historically operating them because the commercial opportunities present on the light-density line could not sustain the significant maintenance and operating costs associated with Class I railroad service. In the mid-1980s, railroads began converting marginal or declining routes into shortlines that could operate profitably under a different cost structure.

<sup>2</sup> The vital role of interchange commitments in the revitalization of the rail industry beginning in the 1980s has been repeatedly acknowledged by the Surface Transportation Board ("STB"), the federal agency with exclusive jurisdiction over the rates, practices and transactions of the national rail industry. See, e.g., STB's November 1, 2012 decision in *Ex Parte No. 714: Information Required in Notices and Petitions Containing Interchange Commitments* at p. 2.

<sup>3</sup> The STB and its predecessor, the Interstate Commerce Commission have found that transactions with interchange commitments can in fact be pro-competitive. See, e.g., STB's September 17, 1987 decision in Finance Docket No. 31094, *Grainbelt Corporation—Acquisition and Operation Exemption—Burlington Northern Company*, at p. 21.

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**Whiteside/Fauth Draft Report Findings Unsupported by Facts.** Because BNSF and MRL have a history of working cooperatively to address new traffic as it arises, W/F have not identified any significant traffic that is being forced over illogical interchange routes to avoid the UP's Silver Bow Gateway. Despite the lengthy history of the MRL and surrounding rail lines that comprises the bulk of the Draft Report, W/F provide nothing to support their conclusion, preferring to assert "it is logical to assume that BNSF is forcing their movements over BNSF rather than allowing movements over MRL/BNSF/UP at Silver Bow." (p. 15). While W/F were not privy to confidential and commercially-sensitive information to craft their case, the information that was available to them contradicts their conclusion. W/F report that they surveyed 11 groups of shippers and contacted 31 companies that they identified as using MRL and Silver Bow interchanges. Of that number, only 4 firms even responded to W/F's inquiries, and gave only general comments about circuitry of BNSF's principal routes and pricing to limited geographic markets. In fact, these shippers seem to contradict W/F's conclusions by confirming that traffic does indeed move over the Silver Bow junction, despite the presence of the MRL-BNSF interchange commitments.<sup>4</sup>

In the absence of factual data, W/F attempt to create a snapshot of disadvantaged conditions under the MRL-BNSF interchange commitment by replacing market forces and real world rail economics with reverse engineered R/VC rates<sup>5</sup> and an equation that [shorter distance = lower cost = lower freight rates = the proper market]. From this tenuous platform, W/F leap to conclusions like "Montana producers have reduced access to large markets to the south (ID, UT) and the southwest (AZ, NV, and CA) because of paper barriers." Not only is this conclusion unassisted by evidence, but the premise itself is also incorrect. BNSF establishes market-based prices and competes for business on the basis of that price and the level of service we provide—not on costs. A shorter route does not mean superior service, lower costs and/or lower rates for the shipper. There are many places across our network where BNSF successfully competes on price and service, despite having a mileage disadvantage. For example, in wheat markets, the truck lanes between Silver Bow and UT/ID, with their interstate highway and backhaul economics are fast, efficient, and robust to say the least; in addition, destination demands are often satisfied by production in other regions of Montana and the rest of the country. The fact is that rail movements off the MRL are subject to significant truck and geographic competition. Montana shippers benefit from BNSF's response to Silver Bow truck and rail options through competitive pricing to the PNW and SOCAL over our strong lanes. Depending on the markets, you may see greater quantities of commodities like asphalt routed via MRL-UP Silver Bow due to a rail equipment advantage over truck, a better destination market on the UP, or a satiated demand at BNSF destinations.

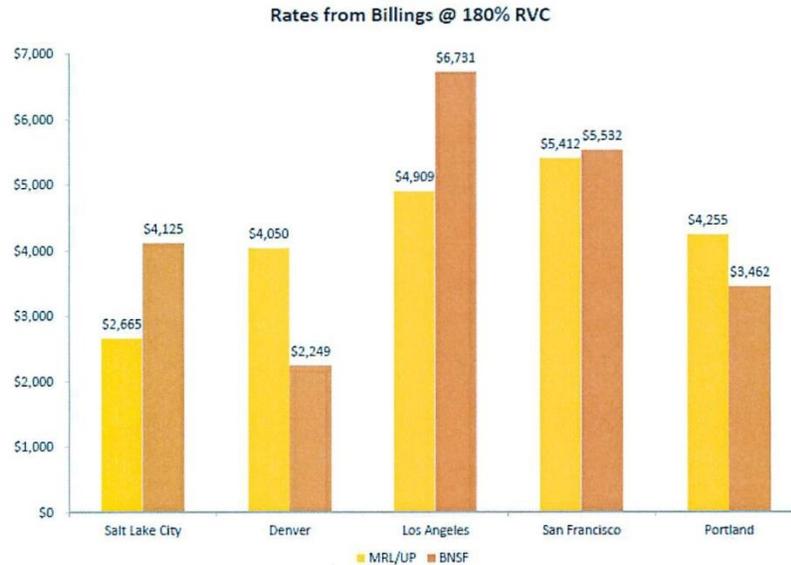
It is also worth noting that we encountered unexplained discrepancies in the W/F costing exercise. BNSF was only able to replicate three of the ten costs that W/F included in the bar chart on page 22 of the Draft Report. When we ran the same URCS cost exercise, we found that the costs for the BNSF movement in the Billings-Portland lane were actually lower, and the cost difference between BNSF and UP on the Billings-San Francisco lane was much smaller than W/F claim (a wash at around \$100). In addition, the rates for Billings-Salt Lake City and

<sup>4</sup> The only specific dispute that W/F describe from their years of "confidential conversations" with MRL-based shippers does not appear to even involve the Silver Bow question, and instead dealt with the spread between BNSF direct rates from locations on MRL and those not on MRL. By W/F's own account, that dispute was successfully resolved by the parties, and, in any event, occurred in 1998.

<sup>5</sup> The reliance on R/VC's derived from the STB URCS, which is a cost system used by the agency to calculate system average variable costs, means that those costs are not at all specific to the actual route of movement and completely ignores the real-world operating environment for individual shipments, such as whether a movement is traveling through, for instance, an area with superior local yard infrastructure and operations, more robust delivery windows, or other efficiencies built around more regular volumes.

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Billings-Denver that W/F include in their table on page 20 are largely not consistent with the rates for the same lanes on W/F's bar chart on page 22. BNSF's calculations are shown in the chart below.<sup>6</sup>



**W/F's Vague Allegations Repeat Many of the Same Arguments that the STB/ICC Reviewed In Approving the MRL/BNSF Transaction**

Without any specifics, all W/F have are vague allegations. The STB has exclusive jurisdiction to review the terms and conditions arrived at between the parties and to ultimately grant approval for the transaction. When an existing rail line is being transferred to another operator through a lease or sale, the parties involved are required to seek approval for the specific transaction from the Surface Transportation Board. In fact, the ICC and/or STB has approved every transaction between MRL and BNSF, and between MWRR and BNSF, discussed by W/F in the Draft Report. W/F neglect to mention that the ICC/STB specifically considered and rejected concerns about MRL's and BNSF's incentives to route traffic efficiently expressed in those proceedings by parties opposing the transactions at the time.

**Summary**

<sup>6</sup> It should also be noted that the rates in W/F chart on page 20 (and that we have re-calculated here) are a hypothetical exercise and do not correspond to any actual rates that have been established by BNSF, MRL or UP in any gateway.

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We appreciate the opportunity to weigh in on this important discussion in evaluating the structures around these fully vetted and voluntary commercial arrangements. Interchange commitments are necessary to secure common benefits for railroads, shippers, and the communities alike. More importantly, it is the marketplace that drives products to the preferred market in the preferred mode, and our evaluation indicates that today we offer competitive packages in response to both truck and rail in the Silver Bow region, where products find their demand points via BNSF corridors. In those instances where BNSF does not effectively connect to a given market or provide an alternative BNSF-served demand point, we see rail traffic readily flowing MRL-UP. Again, we have a demonstrated history of open and inclusive dialogues directly with our Montana customers and producers about service and rate issues. We hope that we will be invited to positively engage with the members of the Council in the future.

Sincerely,



Don Karls  
Ombudsman for the State of Montana

## Appendix 3 - Page 1 of 1 Union Pacific Comments on Paper Barriers Report

UNION PACIFIC RAILROAD  
280 South 400 West  
Salt Lake City, Utah 84101

Dan Harbeke Director Public Affairs

October 14, 2013

Rail Service Competition Council  
Attn.: Ms. Mary Vandenbosch  
RSCC Administrative Support  
Headwaters Policy/Planning Partnership, LLP  
737 5th Avenue  
Helena, MT 59601

RE: Union Pacific Objection to the Rail Service Competition Council's "The Impact of Paper Barriers on Montana Rail Shippers' Competitiveness"

Dear Ms. Vandenbosch:

On behalf of Union Pacific Railroad, I am writing to inform you of our company's objection to the general premise laid out in the Rail Service Competition Council's document entitled "The Impact of Paper Barriers on Montana Rail Shippers' Competitiveness" by Messrs. Whiteside and Fauth.

Several years ago, the Class I carriers and the short line carriers entered into the Railroad Industry Agreement (RIA) to address short line railroad Interchange Commitments, which the authors of the paper refer to as "paper barriers." The RIA preserves legitimate Interchange Commitments while giving short line railroads the ability to access new routes with new traffic.

It is our common understanding that the Railroad Industry Agreement provides a fair framework for achieving a reasonable balance that does not put the needs of the few ahead of the overall needs of the many who benefit from the rail network.

We truly appreciate your invitation to comment on the document and hope you will take a fair minded approach to this issue.

Sincerely,



Dan Harbeke

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