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Railroading ag: The return of the ‘robber baron’ triggers cries of monopoly from rural shippers

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Matt Bewley

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Monopoly is anything but a game to elevator managers in the Upper Midwest. Not when they feel as if they’re being raked over the pricing coals by a railroad industry gone berserk while the responsible oversight agency has been asleep at the switch for years.

The power of the railroads to slice up the Lower 48 into four territorial servings rivals even that of the 19th-century railroad barons, according to Bob Szabo, executive director of Consumers United for Rail Equity, one of several coalitions of freight rail customers seeking changes to federal laws that would require railroads to provide more competitive pricing and reliable service.

“The railroads today have more monopoly power over shippers than they did in the late 1800s when they passed the first anti-trust law,” he says. “They’ve divided up the country.”

Empire builders

The day in 1869 that the famous golden spike was driven to complete the first transcontinental railroad saw the advent of modern transportation across the continental United States. Stage coach travel and Pony Express mail stepped aside, giving way to the speedy, high-tech mass transportation provided by the original iron horses.

The railroads laid thousands of miles of east-west rail, paving the way for the builders of the new West. But historic battles between the railroad owners, characterized by some of the earliest and nastiest hostile takeovers in U.S. history, left the growing nation with just a handful of transcontinental railroads. The owners of these carriers carved up the 36 existing states and the remaining territories, including the Dakota Territory, until each of them enjoyed absolute pricing and scheduling control over its slice of the country.

Competitive rail service virtually disappeared, leaving the West with sky-high rail rates for bringing men and materials west of the Mississippi River. Public opinion began turning on the railroads. Names such as Gould, Vanderbilt and Carnegie soon became synonymous with empire and monopoly, and “robber baron” became a new term in the American vocabulary.

In 1887, the federal government stepped in. Bowing to public outcry, it created the first U.S. regulatory agency, the Interstate Commerce Commission. Though mandated to divest the monopolies of the railroad barons, the new ICC initially was too weak in regulatory powers to effect real change. In response, Congress enacted the Sherman Anti-Trust Act in 1890, steering American free enterprise toward competition and away from the influence and manipulation of the barons. Passage of the Hepburn Act in 1906 under President Theodore Roosevelt gave the ICC long-awaited price control over the railroads. Carriers around the country suddenly were

required to compete with each other for their customers' business. Prices leveled off and shippers gained more evenhanded access to rail transportation.

Reversing reform

The early years of the 20th century saw railroads growing into a competitive, vigorous industry, crucial to the U.S. economy. But the Great Depression of the 1930s and increasing competition from trucking and air freight began to take their toll, and profit margins began to shrink. Even with the unprecedented rail use during World War II, followed by a revitalized U.S. economy, the rail industry found itself with far more rolling stock than it could fill and a growing list of marginal service routes.

With the Railroad Revitalization and Regulatory Reform Act of 1976, Congress began the reversal of much of the reforms established by the ICC. Through it, rail carriers gained greater flexibility in setting rates while ICC's ability to enforce evenhanded pricing for shippers was weakened. Later legislation also allowed ICC to require that railroads grant access to another railroad's track, eliminating traffic bottlenecks, but enforcement of this legislation was largely ignored.

A last result of this legislation was a series of railroad mergers that reduced the number of competing major railroads from more than 40 to seven. Four of these now control more than 90 percent of the nation's rail transportation.

Nearly a century of regulation, begun with the establishment of the ICC in 1887, passed into history, and U.S. shippers were confronted with a fresh set of monopolistic practices.

Bottlenecks and oligopoly

In 1996, the Surface Transportation Board handed down a decision that said railroads are not required to move a customer's cars to a junction or terminal where that customer could reach competition on another railroad. This bottleneck decision, sometimes referred to as the "quote-a-rate provision," resulted in a form of captivity for many rail customers. Though their goods could be delivered to yards where other carriers might offer competitive rates, their local carrier did not have to comply, so the customer and their goods were "captives" of that railroad and its noncompetitive prices. These prices often were double or even triple of comparable competitively priced routes.

The STB decision was not outwardly monopolistic. It says that if a shipper could get a contract with a competing railroad, the other railroad then would be bound to move the shipper's goods to them. But since 1996, no one has been able to get such a contract from the major railroads.

Szabo says this is because the railroads all have people behind their own bottlenecks. If railroad A offered competitive rates to shippers coming out of railroad B's territory, then railroad B likely would feel free to do the same in return.

"I guess the railroads decided if they started poaching on each other, it would be chaos," he says. This may be why competitive contracts dried up.

According to economic doctrine, an oligopoly exists when an industry is dominated by a small number of sellers. In the cases of the northern and westernmost of the Lower 48 states, those railroads are BNSF and Union Pacific. If BNSF and Union Pacific ceased to write competitive

contracts after the Surface Transportation Board's bottleneck decision, as more than one shipper has claimed, then it could be argued that they are in collusion with each other, violating anti-trust law.

Because there are few participants in this type of market, each is aware of the actions of the others, according to Wikipedia's definition of oligopoly: "Strategic planning always takes into account the likely responses of the other market participants, causing oligopolistic industries to be at the highest risk for collusion."

In 2006, then-incoming STB chairman Charles Nottingham, in his confirmation testimony to the Senate Judiciary Committee, said the bottleneck issue was the one he heard about most often during his pre-confirmation visits with stakeholders. Yet since becoming chairman, Nottingham claims he hasn't had time to "get his arms around" this issue, according to an industry source who declined to be named.

If he had, a coal-fired power plant in Louisiana would not have to pay captive rates for coal shipments from Montana's Powder River. While the vast majority of track between Montana and Louisiana is served by both BNSF and Union Pacific, the last 20 miles of track are considered "captive." Because of this, the entire 1,700 mile route can be and is charged at captive rates.

Got bucks?

To top it all off, getting rates issues resolved through STB can be an expensive proposition. With application fees topping \$140,000, just getting started is not an option for shippers without access to lots of cash. That means that the majority, if not all, of elevators in the Upper Midwest have almost no access to rate relief.

Shippers that can afford those kinds of filing fees are typically the power and chemical companies. Regardless of who applies, their expenses wouldn't stop there.

"Let's say an ag elevator wants to challenge a rate that the railroads have imposed on him," Szabo says. "He has to prove that he could build his own railroad and operate it at a price cheaper than what it's costing the railroad."

Before deregulation, it was the railroads' responsibility to prove that its prices were reasonable and in keeping with regulations.

"When they deregulated, they just shifted everything over to the shipper," he says. "I don't think they were anticipating that, but that's what they did."

Shippers say it costs \$6 million to \$7 million to prosecute a rate challenge.

"They've got to get all this discovery from the railroads about what their costs are and then they have to build a replica railroad," he says. "They have to have economists to put together a railroad and cost out all this stuff."

Szabo says the Surface Transportation Board admits to the high costs, which seldom pay off.

"Since 2000, there have been about 15 cases filed, all by utilities and a couple chemical companies," Szabo says. "One shipper (the Wisconsin Public Service utility) has won meaningful relief. So your chances are one in 15 of getting relief."

New legislation designed to make the appeal process more reasonable will go before Congress in 2009, but the railroads are against it.

A statement from the Association of American Railroads says, “Freight railroads are subject to most anti-trust laws, including those that prohibit agreements among railroads to set rates, allocate markets, or unreasonably restrain trade. The few, very limited anti-trust exemptions applicable to railroads pertain only to conduct for which the Surface Transportation Board has regulatory authority over the railroads.”

The new robber barons

Why would the Surface Transportation Board, charged with oversight of the rail industry in the public’s name, just sit by and watch all this happen?

Many say there are lucrative jobs to be had in the rail industry for those leaving the Surface Transportation Board and that this is leading to preferential treatment while they are still with STB. Frank Wilner, a former chief of staff at the STB, has authored four books on public policy rail issues. In August 2007, he compiled and published a list of migrations since deregulation, which was meant to explain why “shippers perceive a bias in decision making, and why Congress is advancing legislation to force the STB to protect shippers from rail monopoly power as promised by the Staggers Rail Act of 1980.”

According to his information, the previous two chairmen of the STB were hired by the railroads they regulated.

“Linda Morgan became UP principal outside legal counsel at Covington & Burling, filling a vacancy created when UP hired her predecessor to head its law department in Omaha,” Neb., he states in the article. “Meanwhile, Roger Nober departed the STB to become outside legal counsel to BNSF (and other railroads) at the firm of Steptoe & Johnson; and, one year later, was hired directly by BNSF to head its law department in Ft. Worth.”

His article goes on to name more than 20 people who transitioned from STB offices to the rail industry.

“Captive shippers have felt abused for some time,” says Glenn English, chairman of CURE and CEO of the National Rural Electric Cooperatives Association. They “do not feel that they are able to get a fair deal out of the Surface Transportation Board. The captive shippers believe that we have regulators who are biased — that’s our belief — and certainly captive shippers are very uneasy with the fact that the intent of the deregulation of the railroads . . . is not being carried out.”

This may be partially responsible for a widespread reluctance by shippers to speak out against the railroads.

“We’ve had numerous stories from shippers that are very fearful,” English says. “They fear retaliation from the rail industry. They are well aware of the fact that in the past, the railroads have been very heavy-handed and certainly have not taken a favorable view of critics who are shippers.”

Indeed, his opinions go a step further.

“The fact that we started out with over 40 railroads that were competing in 1980 and now we’re down to four or five major railroads in this country and the fact that the anti-trust laws don’t apply to railroads — we certainly feel that the days of the robber barons are back.”

Regaining control

More than 120 years after public opinion forced the federal government to step in against the old railroad barons, public outcry is again being heard on Capital Hill. Several members of Congress, especially from areas such as the Upper Midwest, where captive shippers are the norm, are supporting a pair of transportation bills designed to reign in the railroads.

The bills, which are set to go before Congress in 2009, modify some STB decisions that have denied rail customers access to railroad competition. Its intent is to address the inadequacies in STB’s rate reasonableness processes, improve service to rail customers and provide new remedies for rail carriers where inadequate remedies exist.