Concerns Regarding Freight Rail Transportation and Regulation

Marvin E. Prater, Ph.D.
US Department of Agriculture
Transportation Services Division
Staggers Act Benefitted All Parties

• Average real rail rates decreased 43.2% between 1985 and 2004.
• Grain handling efficiencies increased with unit trains.
• Railroad-Shipper contracts were allowed.
• Railroads were allowed to innovate.
• Railroad productivity increased.
• Railroad profits increased.
Railroad Industry is Now Close to Revenue Adequacy

Class I Railroad Cost of Capital and Return on Net Investment, 1997--2011

Sources: AAR, Railroad Facts; Surface Transportation Board
Increased Rail Concentration

• Competition helps to maintain affordable transportation options and constrain the market power of individual railroads.
• The rapid consolidation of railroads has resulted in a decrease in the unrestricted interchange of traffic, routing choices, and the level of competition among railroads.
Increased Rail Concentration (cont’d)

- The U.S. is served by only 7 Class I railroads.
- Almost 75% of agricultural areas lost rail competition from 1992 to 2007.
- The areas in which only a single Class 1 railroad transported grain and oilseeds increased from 10% to 15%.
- The revenue-to-variable-cost ratio increased in 83% of these areas.
Rapidly Increasing Rail Rates

Grain and oilseeds up 87%; 2012 over 2003;
All other commodities up 72%; 2012 over 2003.

Source: Association of American Railroads, Freight Commodity Statistics
Real Rail Rates Increased 46.8%

Average revenue per carload

Revenue per carload

Real revenue per carload (2011$)

Source: Association of American Railroads, Railroad Facts
But Adjusted Rail Costs Rose 28.6%

<table>
<thead>
<tr>
<th>Year</th>
<th>RCAF (adjusted)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>0.517</td>
</tr>
<tr>
<td>2004</td>
<td>0.528</td>
</tr>
<tr>
<td>2005</td>
<td>0.558</td>
</tr>
<tr>
<td>2006</td>
<td>0.571</td>
</tr>
<tr>
<td>2007</td>
<td>0.565</td>
</tr>
<tr>
<td>2008</td>
<td>0.659</td>
</tr>
<tr>
<td>2009</td>
<td>0.554</td>
</tr>
<tr>
<td>2010</td>
<td>0.614</td>
</tr>
<tr>
<td>2011</td>
<td>0.665</td>
</tr>
</tbody>
</table>

Source: Association of American Railroads, *Railroad Cost Indexes*
Rapidly Increasing Rail Rates (cont’d)

• In order for railroads to recover high fixed costs, shippers without competitive options pay a higher share of these fixed costs.
• In an era of record rail profitability, why should captive shippers be charged rates substantially higher than costs?
• It is neither appropriate nor the law that captive shippers should face unlimited differential pricing.
• As rail revenues become persistently adequate, high rates paid by captive shippers should be reviewed and lowered if deemed unreasonable.
Rail Rate Appeals Procedures

- Agricultural shippers believe STB rail rate appeals procedures are too lengthy and expensive, preventing effective access to relief.
- The SAC procedure is too complex and costly for agricultural shippers (McCarty farms case).
- Simplified SAC has not been used by agricultural shippers.
3-Benchmark Rail Rate Appeals

• Cost ranges from $250,000 to $500,000.
• Award limitation of $4 million over 5 years.
• Chemical companies have used successfully.
• No agricultural shipper has used.
• Allows rail company to raise rates across the board.
• Because of high costs and low expectations of meaningful results, agricultural producers have not used any of the STB’s rail rate appeals procedures (since McCarty Farms).
Possible Role for Rate Arbitration

• Rail rate arbitration could reduce the costs of appealing high rail rates.
• Montana Grain Growers Association, Montana Farm Bureau Federation, and BNSF Railway Company (BNSF) have developed rail rate mediation/arbitration procedures that can be accessed by producers.
• So far, no other major railroad has agreed to rail rate arbitration.
Need for Competitive Switching

Agricultural shippers believe:

• Greater rail concentration, railroad antitrust exemptions, and record rail profits have increased the need for rail-to-rail competition.

• Rail-to-rail competition should not be further sacrificed to ensure railroad profitability.

• Increased rail-to-rail competition is a means to preserve the benefits of railroad economic deregulation.
Competitive Switching

To PNW

Shipper location

Railroad A

30-mile radius for reciprocal switching

To Southeast poultry markets

To the Mississippi Gulf

Railroad B
NIT League Proposal

• Shipper served by only 1 major railroad.
• Movements have a R/VC ratio exceeding 240.
• Shipper shows that there is or can be a working interchange between the 2 major railroads.
• Competitive switching would not be imposed if either rail carrier shows it is not feasible, is unsafe, or unduly hampers operations.
Effects of NITL Proposal

- USDA and DOT estimate of impacted carloads ranged from 1 to 6%.
- The most likely impact of competitive switching is a 1% reduction in grain revenues and a 6.4% reduction in railroad grain net income assuming duopoly competition, 30 mile threshold distance, and 240 R/VC.
Factors Limiting Effects of Proposal

• Short line railroads are exempt from the NITL proposal, but their movements are often recorded as Class I railroad movements.
• Contract movements are about 24% of agricultural traffic.
• Lower rates from competitive switching would increase traffic.
• Not all eligible shippers will use competitive switching.
Conclusions

• Rapidly increasing rates above costs should be reviewed for reasonableness.
• STB’s current rate appeals procedures do not work for agricultural shippers.
• The new era of rail profitability may require some rebalancing within the priorities of Staggers, such as fairness to shippers.
• Within the construct of the Staggers Act, alternative mechanisms, such as competitive switching, need to be explored to infuse a slightly greater degree of rail-to-rail competition.