HOUSE COMMITTEE ON THE JUDICIARY

SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

HEARING ON H.R. 233

RAILROAD ANTITRUST ENFORCEMENT ACT OF 2009

WRITTEN TESTIMONY OF

ASSOCIATION OF AMERICAN RAILROADS

PRESENTED BY

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Mr. Chairman and Members of the Subcommittee, my name is J. Michael Hemmer. I am the Senior Vice President - Law and General Counsel of Union Pacific Railroad Company. I am pleased to testify today on behalf of the Association of American Railroads and its member freight railroads on H.R. 233, the "Railroad Antitrust Enforcement Act of 2007." The AAR's members account for 75 percent of U.S. freight rail mileage, 92 percent of employees, and 95 percent of revenues.

At the outset, I want to be sure that everyone understands that the rail industry does not object to H.R. 233's stated goal of having the railroads conduct their affairs in accordance with the antitrust laws of the United States. They have done so for decades and continue to do so. The railroads strongly believe that their actions already comport with the antitrust laws in conjunction with applicable regulatory requirements.

The railroads are concerned about some aspects of H.R. 233, because we believe the bill is not simply about removing antitrust exemptions, although most of its supporters probably assume that it is. The aspects of the bill that remove antitrust exemptions are the least troubling provisions.

In many fundamental respects, the bill goes much further. It appears to represent an attempt to overturn long-established regulatory policies that have provided enormous benefits to shippers and American consumers. It even creates new regulatory law on matters unrelated to antitrust. And it consistently treats railroads differently than other regulated industries.

Accordingly, the bill would damage the public interest and severely distort the relationship between regulation and antitrust laws. Moreover, using an antitrust bill to achieve regulatory objectives will produce unintended consequences, and virtually guarantee confusion and disruptive litigation. We will illustrate numerous conflicts between this bill and existing or proposed economic regulation. If the United States Congress wants to address rail transportation policies, it should adopt a unified approach that coordinates economic regulation with antitrust law. They should not be at war.

I. A BRIEF HISTORY OF RAILROAD REGULATION AND ANTITRUST LAW

It is worth recalling that government policies drove railroads to the edge of ruin twice during the Twentieth Century. Early in that century, Congress passed a series of acts that imposed ever tighter regulatory restrictions on railroads in order to reduce shipping rates (prices) and inhibit price competition between U.S. railroads.[1] Investors almost immediately abandoned the railroads, as railroads lost the ability to earn reasonable returns on

[1] E.g., Elkins Act, ch. 708, 32 Stat. 847 (1903); Hepburn Act, ch. 3591, 34 Stat. 584 (1906); Mann-Elkins Act, ch. 309, 36 Stat. 539 (1910).

investments. In fact, a panic over rail securities in 1907 drove the entire economy into a recession.[2]

By the time the United States entered World War I, the railroads had to be nationalized. Nationalization was necessary, not because railroad managements were incompetent to meet the needs of the war, but because the railroads had been unable to invest and were falling apart. Moreover, federal pooling restrictions and antitrust law prohibited coordination to support the war effort. Finally, in 1920, Congress passed the Transportation Act of 1920 to revise regulation and provide the opportunity for the railroads to regain their financial health.

Over subsequent decades, an array of government policies again crippled the railroads. On the one hand, taxpayers subsidized competing forms of transportation—the airlines that took passengers off of private passenger trains and the trucks that took rail cargo onto an Interstate Highway system built with federal funds. On the other hand, the railroads were forced to maintain money-losing services, their rates could not respond to the marketplace, and their attempts to become more efficient were blocked by government action. No one in the railroad industry can forget the Interstate Commerce Commission's ("ICC") refusal to allow a railroad to <u>reduce</u> its rates for grain transportation when it bought larger, more efficient rail cars. Nor will we forget the regulatory nightmare of a rail acquisition proceeding that lasted so long that the intended patient—the weak Rock Island railroad—died on the operating table.

I began my railroad career working as a union employee for the Rock Island, a large midwestern railroad. It went bankrupt largely because of government policies and regulatory

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[2] In 1907, the railroads comprised one of America's largest industries and were a major engine of the American economy. Today, all of the Class I railroads combined are smaller than a number of rail customers.

delays. Many of my union co-workers lost their jobs. Around that same time, another midwestern carrier and all of the railroads in the Northeast also fell into bankruptcy, throwing tens of thousands of employees out of work. In 1972, the average return on investment of the rail industry was approximately two percent, less than a child's savings account at the time.

No recession and no financial crisis caused this collapse. Instead, one only needed to look to the government's policies for the explanation.

Today's growing desire to fundamentally increase governmental controls on the railroads, whether in the guise of antitrust legislation or new economic regulation, needs to be considered with 20th Century history as a cautionary tale. To the extent that the objective of any Congressional proposal is to reduce shipping costs for certain rail shippers, whether by regulation or antitrust, public officials should note the following facts:

- Railroads have lost some 20 percent of their revenues in the last three months.
- Congress recently imposed an unfunded government mandate for railroads to install at least $8 billion of Positive Train Control systems.
- The Government is requiring over $2 billion in new environmental controls, with carbon restrictions on the horizon.
- TSA and DOT have imposed hundreds of millions in added costs for secure handling of extremely hazardous chemicals—less than one percent of rail traffic.
- The new administration proposes—and the railroads do not oppose—federal programs to expand passenger train service, mostly on freight railroad tracks that will require additional investment.

The railroads can carry only so many burdens at one time before governmental policy forces them to retrench.

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Freight railroads provide significant public benefits when government's hand is not too heavy. Since the Staggers Rail Act reforms in 1980 adopted national policy that railroads must be allowed to earn their cost of capital, railroads and their investors have delivered a revitalized rail network. We take traffic off of America's highways to reduce congestion and damage to roads. We carry cargo with one-third the carbon emissions of other forms of transportation. We reduce America's dependence on foreign oil by moving a ton of freight 436 miles on one gallon of fuel. We are also cost effective offering the low cost alternative for surface freight transportation. For example, it cost 54% less, in inflation-adjusted terms, to move freight by rail in 2007 than it did in 1981.

And we truly lay golden eggs for America, by doing all of this with <u>private</u> money instead of public funds. We attract private investors to invest billions of dollars in transportation infrastructure that benefits shippers and consumers and displaces taxpayer investment. But all of that private investment will be at risk if the lessons of the past are forgotten.

Much is at stake here. The government cannot force investors to loan money to the railroads. Without that investment, railroads may wither, as they did in the past, and Congress will then be left with the choice of bailing them out with taxpayer funds—or building even more highways. We ask the Subcommittee to be thoughtful about its actions and their potential, unintended consequences. In particular, we ask the Subcommittee to be mindful of the relationship between regulation and antitrust law and to ensure that those regimes work in harmony.

II. RAILROADS ARE ALREADY SUBJECT TO THE ANTITRUST LAWS

Let's return to 1980, when Congress rebalanced regulation with the antitrust laws to save a failing freight industry. Because of the railroad industry's dire straits, Congress removed layers of burdensome regulation when it passed the Staggers Act, under the leadership of the Democratic Representative from West Virginia, Harley O. Staggers. The Act's goals included: "to assist the rail system to remain viable in the private sector" and "to provide a regulatory process that balances the needs of carriers, shippers and the public." Pub. L. 96-488, 94 Stat. 1895, 1897 (1980). Wherever economic regulation was removed, antitrust law took its place. For example, the Act allowed railroads for the first time since the 1800s to enter contracts with shippers outside the purview of the ICC, and in that arena made clear that "[i]f anticompetitive behavior is alleged, under this section, the antitrust laws are the appropriate and only remedy available." Pub. L. 96-448, House Rep. 96-1035, 1980 USCAN 3978, 4003.

The often-asserted claim that railroads are "exempted from antitrust laws in most respects" (S. Rep. 111-9, The Railroad Antitrust Enforcement Act of 2009, p. 2) is a myth. Railroads cannot and do not get together to set prices for competing services. We cannot and do not allocate markets or customers. We cannot and do not engage in the unlawful tying of one product to the purchase of another to harm competition. All of those activities would violate the antitrust laws and would subject us to Department of Justice ("DOJ") action and private treble-damage litigation.

Indeed, at this very moment, certain shippers have brought billions of dollars of antitrust claims against the nation's four largest railroads for allegedly violating the Sherman Act in setting fuel surcharges. In re Rail Freight Fuel Surcharge Antitrust Litigation, D.D.C.,

MDL No. 1869, Misc. No. 07-489. We believe that those claims are without merit. Union Pacific did not coordinate its fuel surcharge programs with any other railroad, and it alone has employed 57 different fuel-surcharge programs. Nevertheless, the four largest railroads are being forced to spend many millions of dollars per year to defend against these claims. We do not assert in that case that we are exempt from the antitrust laws. Our defense is that we complied with the antitrust laws.

Only in limited areas where the railroads are subject to regulation do antitrust exemptions apply. Vestigial antitrust immunities remain because Congress wanted to retain economic regulation in specific areas in the ICC, renamed the Surface Transportation Board ("STB"). Congress chose to retain economic regulation to protect the public interest, because the agency had a century of experience with railroads and their customers. Congress expressly told that agency to consider a number of policy objectives in discharging its functions. 49 U.S.C. § 10101. Freight railroads are exempt from antitrust laws only where Congress decided that it wanted an agency to pursue those policies in regulating railroads.

Thus, there is no gap—no yawning hole—where railroad actions are exempt from antitrust laws but free of regulatory oversight. Some groups of shippers dislike the way that the ICC and the STB have applied this oversight. (Indeed, we understand that is why some support H.R. 233.) However, whatever may or may not have occurred in the past, the STB is today aggressively protecting shipper interests.[3] If Congress now wants to alter the balance between regulation and antitrust, it should act in a coordinated, not piecemeal manner. This is what Congress has always done to assure that the Nation's transportation policies are harmonized with antitrust laws: "Congress was faced with the duty of

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[3] For example, in a recent decision, the STB reversed a prior decision upholding rail charges and awarded the largest amount of relief in history in favor of a coal shipper and against the railroad. The award cost the railroad some $345 million.

harmonizing and reconciling the policy of the antitrust laws as applicable to common carriers with the national transportation policy." S. Rep. 94-499, 1976 USCAN 14, 28. Crossing the boundaries of committee jurisdiction, Congress should coordinate regulation with the antitrust laws. As we will demonstrate, H.R. 233 addresses antitrust exemptions and more without considering interactions with regulation, existing or future. That concerns us, and it should concern all policymakers.

III. ONLY CERTAIN PROVISIONS OF H.R. 233 ACTUALLY REPEAL ANTITRUST EXEMPTIONS

The stated intent of this bill is to repeal antitrust exemptions. In four respects, it does that. First, it would repeal the so-called "Keogh Doctrine." Second, it would repeal provisions of 49 U.S.C. § 10706 that confer antitrust immunity for what were once known as "rate bureaus." Third, it would remove the exemption in 49 U.S.C. § 11321 that prevents DOJ from reviewing proposed railroad acquisitions and mergers. Finally, it would allow private parties, like the Government can today, to seek injunctions. The railroads see no reason to make these changes, some of which discriminate against railroads, but we recognize that they are consistent with the stated purpose of the bill, which is to repeal antitrust exemptions.

A. Eliminate the "Keogh Doctrine" for railroads, but not for utilities. Section 2(a), which would eliminate the Keogh Doctrine (also known as the "filed-rate" doctrine) would have little effect on railroads. Many years ago, the railroads filed their rates—their prices—with the ICC. The ICC reviewed them, opponents routinely filed protests, and the agency often suspended and revised rates. In a case called Keogh, the courts, quite reasonably, ruled that rates supervised by a regulator could not be attacked by shippers

seeking damages under the antitrust laws. Keogh v. Chicago & N.W.Ry., 260 U.S. 156, 43 S. Ct. 47 (1922).

While the railroads are still subject to rate regulation, for all practical purposes railroads no longer file their rates with regulators. Accordingly, what the courts would say about railroads and the Keogh Doctrine is far from clear. In any event, I can assure you that no railroad counsel tells a client to act contrary to the provisions of the antitrust laws in reliance on the Keogh Doctrine. Repealing the Keogh Doctrine will have little or no practical effect on railroad actions or shipper remedies.

Ironically, some electrical utilities actively support H.R. 233 even though the primary users of the Keogh Doctrine are electrical utilities. E.g., Utilimax.com, Inc. v. PPL Energy Plus, LLC, 273 F.Supp.2d 573 (E.D. Pa. 2003); aff'd 378 F.3d 303 (3d Cir. 2004). Recent assertions that the electric utility industry is "fully subject to the antitrust laws" are therefore mistaken. Thus, this provision of the bill is one of many that single out railroads for disparate treatment. The Subcommittee could easily modify Section 2(a) of H.R. 233 to level the playing field by repealing the Keogh Doctrine for all industries.

B Repeal antitrust immunity for "rate bureaus". Like repealing the Keogh Doctrine, Section 8(a)'s repeal of rate bureau immunity under 49 U.S.C. § 10706 would have minimal impact on the railroads. The railroads eliminated virtually all of the rate bureaus many decades ago.

As difficult as this may be to believe, railroads for decades were required by law to agree on prices and charge the same price regardless of which route a shipper choose between two points. In that regulatory environment, Congress essentially forced railroads to use rate bureaus to develop rates, and it conferred antitrust immunity on the process. But

Congress changed that policy in the Staggers Act and rebalanced the interface of regulation with antitrust law. The rate bureaus are gone, and railroads must compete on price and service—subject to the antitrust laws. This transition demonstrates that antitrust laws and regulation have long worked in tandem, not at cross-purposes.

For all practical purposes, Section 10706 continues to apply in only one modest respect, which is to establish the complex mechanics for paying rentals for use of rail cars ("car hire") between railroads and by railroads to other car owners. 49 U.S.C. § 10706(a)(d)(C). Railroads do not collectively establish the rental prices they pay each other. They must negotiate those bilaterally. The collective activity merely establishes the processes for payments, collections, adjustments, and the like. This activity is not controversial and is accepted by all stakeholders because it simplifies and therefore reduces transaction costs. It was approved by the STB's predecessor, which prescribed numerous protections, such as recording of all proceedings. The vestigial antitrust immunity for this minor activity facilitates significant efficiencies and should not be eliminated. This collective action might well survive antitrust review as a joint venture, but one of the unintended consequences of this legislation is that this activity may be called into question and the erratic results that emerge from district courts under the antitrust laws would create unnecessary risks and costs.

C. Authorize dual agency review of rail mergers. Section 8 of the bill provides that rail mergers would be reviewed by both the STB and the DOJ. We think dual reviews are unnecessary, and we do not understand what that added review would accomplish other than consuming governmental resources.

Indeed, the Justice Department is likely to impose a narrower competition test on future railroad mergers than would the Surface Transportation Board, which looks to the broader public interest. It is virtually inconceivable that the STB would today approve a major rail merger that the Justice Department, applying its narrower focus only on competition issues, would conclude is anticompetitive.

The STB has strengthened its standards for reviewing rail mergers for competitive effects. In the past, the ICC and the STB consistently ensured that shippers with competing rail service before the merger retained two competitive rail options afterward. The STB required continuation of prior competition through "conditions" on mergers. In 2001, the STB adopted new regulation governing major rail mergers, which would not only protect competition but would improve it. The new regulations elevated the importance of competition to an even higher level, and imposed a new requirement. In most future merger proposals between Class I railroads, the applicants must demonstrate that they have taken steps to enhance competition—to create competition that did not previously exist. 49 C.F.R. § 1180.1. This is a much tougher standard than that established by the antitrust laws, under which the DOJ must persuade a court that the effect of the transaction may be “substantially to lessen competition, or to tend to create a monopoly.” 15 U.S.C. § 18. The railroads do not understand the benefits of having additional agencies apply narrower antitrust standards to the same transactions with the attendant increase in administrative burdens on such transactions

D. <u>Allow private antitrust injunctions against railroads, but not other carriers</u>. Section 5 of the bill is yet another provision that would treat railroads differently from other regulated carriers. The Clayton Act contains a restriction on private (but not DOJ) injunction

actions against common carriers. 15 U.S.C. § 26. Section 5 would treat railroads differently from other common carriers by excluding only railroads from the ban on private injunctions.

That ban was adopted and applied to all common carriers for a sensible reason: it prevents trial courts and juries, which can reach a multiplicity of outcomes, from reaching different and conflicting outcomes than a regulator on matters subject to regulation. See, e.g., Central Transfer Co. v. Terminal R.R. Ass'n, 288 U.S. 469, 475, 53 S. Ct. 444, 446 (1933). Section 5 of the bill, therefore, would create another incompatibility between rail regulation and antitrust. If adopted, it would subject railroads to potentially conflicting obligations, with an agency telling them to behave one way and a jury telling them to pay treble damages for behaving that same way. An antitrust court would be called upon to address a specific set of facts without viewing the broader public-interest implications that a regulatory agency would consider.

IV. SEVERAL OF THE BILL'S PROVISIONS DO NOT REPEAL EXEMPTIONS, ARE DESIGNED TO OVERRIDE REGULATORY DECISIONS, WOULD HARM SHIPPERS, AND CREATE CONFLICTS WITH THE REGULATORY REGIME

Whether intended or not, several provisions of H.R. 233 appear to be designed for the primary purpose of overturning regulatory decisions. This is most obvious with respect to Section 8's directive to the STB to decide certain proceedings in a way that favors the interests of local communities. This provision has nothing to do with antitrust. Similarly, conferring new powers on the Federal Trade Commission (“FTC”), which would apply only to the railroad industry and not to any other type of common carrier, would create a frontal conflict with the STB's "exclusive" jurisdiction over the same subject matter. Finally, and most startlingly, the bill limits as to railroads only the doctrine of primary jurisdiction, which is not an antitrust exemption at all, but a judicially-made and essential accommodation

between regulatory regimes and all manner of proceedings in the courts. That provision in particular would have unintended consequences and would, in many contexts, put statutory blindfolds on the courts.

A. Give communities priority rights in some regulatory decisions. Two provisions of H.R. 233 would expressly require the Surface Transportation Board to consider impacts on “affected communities" in making certain regulatory decisions. Section 8(a), 8(b). These provisions are unrelated to the antitrust laws and are instead modifications of regulatory policy.

These provisions are also unnecessary and undesirable. They would adopt “NOT IN MY BACKYARD” as official federal policy for railroad industry transactions. This could block transactions with significant value to shippers and consumers. The rail industry needs to expand over time, and this provision could bar transactions that would be necessary to ensure adequate capacity in the future. Every shipper in America ought to oppose them.

No change in law is warranted. The Surface Transportation Board applies to the National Environmental Policy Act ("NEPA") to consider environmental effects of its decisions, including impacts on communities. The Board's regulations contain extensive rules requiring railroads to file environmental detail in connection with rail transactions. 49 C.F. R. § 1180.6. Far from ignoring those provisions, the Board applies them aggressively. In a recent, small-scale rail consolidation proceeding, for example, the applicants were charged more than $20 million in administrative costs to perform environmental analyses, not including the multi-million-dollar costs of environmental mitigation. Environmental analysis has become the most burdensome aspect of rail consolidation proceedings.

The railroads see no reason to subject the rail industry, or the Surface Transportation Board, to greater environmental review than applies to government action on highway projects, airport expansions, or any other part of the economy. NEPA is an effective law with a fully developed body of interpretations. Accordingly, we respectfully suggest that these provisions to favor local interests have no place in antitrust legislation.

B. Allow the FTC to regulate competition for rail carriers, but not for other carriers, under principles that extend beyond the antitrust statutes. Section 7 of H.R. 233 is yet another example of applying a different legal standard to railroads than Congress applies to other carriers. It also could create a glaring conflict with STB rail regulation.

Section 7 modifies the Federal Trade Commission Act (15 U.S.C. § 45(a)(2)) by excluding rail carriers from a general exclusion that deprives the FTC of jurisdiction over common carriers. Under Section 2(b), the FTC would gain authority over rail carriers under Section 5 of the Federal Trade Commission Act "to the extent such section 5 applies to unfair methods of competition." (See also Section 9(b)). Clearly, railroads would be treated unlike other common carriers, which are not subject to the jurisdiction of the FTC.

The conflict with STB jurisdiction is especially troubling. Indeed, H.R. 233 does not attempt to address an express statutory conflict that it would create with 49 U.S.C. § 10501(b), which grants the STB "exclusive" jurisdiction over rail transportation, rates, classifications, rules (including car service, interchange, and other operating rules), practices, routes, services, and facilities of railroads. Id.

The STB regulates railroad conduct through two primary sources of authority, as well as its general authority. First, the STB has exclusive jurisdiction to determine the scope of a rail carrier's "common-carrier obligation." 49 U.S.C. 11101(a). Indeed, the STB is

adjudicating a common-carrier dispute involving Union Pacific today. Union Pacific Railroad Co. -- Petition for Declaratory Order, STB Finance Docket No. 35219. In such matters, the Board's charge is to determine whether a request for transportation is "reasonable" and must be satisfied by the railroad. Granite State Concrete Co. v. STB, 417 F.3d 85, 92 (1st Cir. 2005). As parties in the pending proceeding have argued, this determination involves issues of rail competition. Second, a significant STB role is to determine the reasonableness of railroad "practices," which encompass a wide range of conduct that relates to competition. 49 U.S.C. § 10701.

The clash between FTC jurisdiction over "unfair methods of competition" and STB exclusive jurisdiction over rail common carriage and rail practices is foreseeable and would undermine public policies that matter. The STB is required by law to discharge its exclusive jurisdiction in the public interest and in accordance with the framework of a Rail Transportation Policy that Congress imposed on the agency. 49 U.S.C. § 10101. Its statutory responsibility therefore is to consider an array of public-interest factors. In contrast, the FTC has an entirely separate body of precedent and policy that extends into matters of policy. Although the FTC's focus is on promoting competition, the Supreme Court has made clear that the prohibition in Section 5 of the FTC Act against "unfair methods of competition" encompasses "not only practices that violate the Sherman Act and other antitrust laws, but also practices that the Commission determines are against public policy for other reasons." FTC v. Ind. Fed'n of Dentists, 476 U.S. 447, 454 (1986). The current

Chairman of the FTC has also stated that he regards the FTC as "an agency with authority that extend[s] well beyond the limits of the antitrust laws."[4]

It seems virtually inevitable that the standards applied by these two agencies would diverge, even if both were giving consideration to competitive effects as a principal component of their public interest determination. The nation could be at risk if the STB were to conclude, in the exercise of its wisdom and expertise as regards national transportation policy, that certain conduct furthers the public interest and should be encouraged, whereas an inquiry by the FTC more narrowly focused on its competition-based standards might find that the conduct should be enjoined, thereby thwarting the STB's policy objectives.

This additional, likely conflict underscores the need for coordination between antitrust policy and regulatory policy.

C. Restrict primary jurisdiction for railroads, but no other regulated entities.

Section 6 of H.R. 233 restricts the doctrine of "primary jurisdiction," which balances regulation with all other types of law for every regulated industry. Under the primary jurisdiction doctrine, a court will normally defer to an expert agency when the agency has jurisdiction over the subject matter of a legal dispute.

The primary jurisdiction doctrine is not an antitrust exemption at all. As one court explained, the doctrine is properly invoked where there is: "(1) the need to resolve an issue that (2) has been placed by Congress within the jurisdiction of an administrative body having regulatory authority (3) pursuant to a statute that subjects an industry or activity to a comprehensive regulatory scheme that (4) requires expertise or uniformity in

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[4] "'Tales from the Crypt' - Episodes '08 and '09: The Return of Section 5 ('Unfair Methods of Competition in Commerce are Hereby Declared Unlawful')," Remarks of Commissioner Leibowitz at FTC Section 5 Workshop (Oct. 17, 2008).

administration." United States v. General Dynamics Corp., 828 F.2d 1356, 1362 (9th Cir. Cal. 1987). Discouraging primary jurisdiction would be a major change in jurisprudence that would reach far beyond the antitrust laws. It would leave courts without the benefit of a regulatory agency's expertise when regulation is involved.

Section 6 would give trial courts the power to disregard agency action, but only with respect to railroads. Accordingly, the many public statements that H.R. 233 is intended to treat railroads like other industries is again not correct. Section 6 would treat railroads uniquely, leaving electrical utilities and other regulated industries with the important doctrine of primary jurisdiction.[5]

Section 6 also proves that H.R. 233 is intended to override regulation, and not merely to remove antitrust exemptions. Exemptions could be removed without touching the primary jurisdiction doctrine. The railroads believe that this overreaching provision is in the bill for the purpose of allowing antitrust attacks to overturn regulatory decisions of the types described below.[6]

1. Allow lawsuits for "bottleneck" rates. Thirty years ago, shippers could dictate railroad routing of each shipment, spreading rail shipments over innumerable routes, increasing costs and preventing railroads from using economies of density. Some shippers took advantage of this power by using railroads as rolling warehouses. They achieved this by requiring railroads to route shipments over the slowest possible routes using the largest possible number of handoffs ("interchanges") between railroads. I recall interchanging transcontinental lumber shipments to the out-of-the-way, 90-mile Oklahoma City, Ada &

[5] Because of ambiguous drafting, a trial court might be unsure whether to defer to the agency. Section 6 says that the court "shall not be required" to defer, suggesting that courts limit deference. It might or it might not. No one can predict what individual courts will do.
[6] The Committee Report on H.R. 1650 outlined this intent. H.R. Rep. 110-860.

Atoka Railway because shippers wanted to delay the shipments until they could find a buyer somewhere in the South or East.

For the last three decades, federal policy has allowed railroads to act like rational businesses instead. Railroads were given the opportunity to offer faster and more reliable service with fewer handoffs. As a result, railroad productivity has flourished. This productivity saved many billions of dollars, most of which were either passed along to shippers in the form of lower rates and improved utilization of shipper-supplied cars or reinvested in the railroads' physical plant to continue to improve rail service.

However, H.R. 233 would attempt to use the antitrust laws to reverse this successful policy and throw the industry 30 years backward. In the scenario envisioned by the bill, shippers could force railroads to quote rates and reroute rail shipments to any interchange point that the shipper chooses, under threat of treble-damage antitrust lawsuits. This would yield unintended consequences.

The goal, as confirmed by the draft Judiciary Committee Report for last session's bill, is to overturn 1996 STB decisions known as the "Bottleneck Rate" cases.[7] Those decisions, based on longstanding ICC case law, held that, under most circumstances, a railroad that is the only railroad serving a location is not required to compete against itself by delivering shipments to a competing rail carrier over a so-called "bottleneck segment." Instead, the carrier that serves the entire route is allowed to carry the shipment all the way from origin to a destination on its own route.[8] Some shippers believe that this decision deprived them of

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[7] E.g., Central Power & Light Co. v. Southern Pacific Transportation Co., 1 S.T.B. 1059 (1996), aff'd sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir. 1999)

[8] The originating carrier must, of course, interchange a shipment to another carrier if the originating carrier cannot serve the destination.

competition between two carriers over portions of rail routes where there is more than one available rail line.

Years of debate about the "Bottleneck Rate" cases have yielded an abstract, dry discussion about regulatory theory. This debate has lost sight of a critically important, real-world fact. If H.R. 233 were passed in its current form, and if railroads were required by antitrust courts to provide service on any "bottleneck" segment a shipper selects,[9] the physical operations of the nation's rail network would be severely disrupted, returning the industry to the lower productivity of the pre-Staggers Act era.

Requiring "bottleneck" service on demand would change the physical routing of rail cars. It would undermine railroad productivity built under three decades of public policy. It would increase railroad costs. It would impair service quality and reduce asset utilization. It would strand railroad assets in which railroads invested billions of private capital in recent years. It would require new investments to support new routings (assuming railroads could raise money from investors), yet shippers could change their minds about those routes on a whim. It would create new impacts on local communities and negative environmental impacts by forcing traffic through little-used connection points and over little-used rail lines throughout the nation.

What is important to recognize, which H.R. 233 does not, is that any evaluation of "bottleneck" practices needs to address two fundamental concerns, i.e., the impact on rail network operations and the appropriate level of compensation for the "bottleneck" carrier. These issues are properly within the purview of regulatory, not antitrust, policy. Also often forgotten when "bottleneck" issues are discussed is that the STB retained and still has the

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[9] The railroads do not concede that an antitrust court would find a refusal to quote a bottleneck rate unlawful. Recent Supreme Court decisions reject an antitrust duty of one firm to aid a competitor under most circumstances. See Trinko, Linkline, cited below.

power to regulate the originating carrier's rate to ensure that it is "reasonable," thereby protecting the shipper, and the STB is very active today.[10]

No one has studied, or could comprehensively study, the full operational or environmental effects of a “bottleneck rate” requirement on the national rail system, and the Subcommittee has no way of knowing how disruptive and damaging it would ultimately be. Evaluating the public interest in a network industry is inevitably a regulatory function. By turning the question over to individual courts, none of which would take into account the total rail network concerns, H.R. 233—if attacks on regulatory policy succeed—would produce inconsistent and disruptive decisions by the courts. As a reminder, the railroads would strongly contest any attempt to use the antitrust laws in this way.

Note also that the objective of the proponents of these lawsuits – lower rates – could not be achieved through resort to the antitrust courts alone. Even if such courts did order a railroad to provide service and quote a rate, they would not have a basis for establishing a rate at any particular level. Courts are not equipped to engage in ratemaking, and the Supreme Court has instructed that they not engage in this activity in antitrust cases. As the Supreme Court reiterated only a few months ago, "Courts are ill suited 'to act as central planners, identifying the proper price, quantity, and other terms of dealing.'" Pacific Bell Telephone Co. v. Linkline Communications, Inc., ___ U.S. ____, 129 S. Ct. 1109, 1121 (2009) (quoting Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 408, 124 S. Ct. 872, (2004).). The Court endorsed the view that antitrust courts should not get involved "when compulsory access requires the court to assume the day-to-

[10] In addition to handing down the biggest rate award in its history, the STB recently mediated a “small shipper” case to a satisfactory settlement. Another shipper filed another such case this month against Union Pacific.

day controls characteristic of a regulatory agency." Id. at 415. Yet Section 6 ironically cautions them against deferring to any agency for assistance.

2. Allow attacks on "paper barriers." Similarly, another principal objective of H.R. 233's restriction on primary jurisdiction, as shown by last session's Committee report, is to overturn so-called "paper barriers." What is a "paper barrier"? It is a provision of a sale or lease from a larger railroad to a smaller rail purchaser or a lessee of a rail line that was previously operated by the larger railroad, but which both parties agree can be operated more efficiently by the smaller railroad. The "paper barrier," in one way or another, provides that the majority of the rail traffic that originates or terminates on the segment operated by the smaller railroad would continue to flow over the larger railroad's network, as it did before the transaction.

Why do large railroads and smaller railroads enter into contracts with "paper barriers"? They do so because the smaller railroad could not otherwise afford to acquire or lease the rail line at all, and because the traffic handled by the smaller railroad continues to be important to supporting the larger railroad's network. Most of these short rail lines are barely economical to operate, even with their lower cost structures afforded by these transactions. Therefore, a "paper barrier" is simply a very efficient financing mechanism, allowing both the smaller and larger railroad to share in the benefits of the transaction by sharing traffic, rather than requiring the smaller railroad to pay the large railroad money up-front or make annual rental payments. To illustrate the point, no lessee of a Union Pacific rail line has within memory—if ever—paid any rent for the use of Union Pacific's properties. They pay "rent" by routing traffic over Union Pacific.

"Paper barriers" have been a huge success for the nation's shippers and consumers. They spawned an entire industry of hundreds of short-line railroads, which have a reputation for providing high quality, customer-oriented service. These transactions also have avoided the unpleasant alternative: in many instances, the larger railroad would otherwise have abandoned service on the rail line, eliminating rail service altogether and also eliminating the opportunity for new shippers to locate on that rail line. In addition, some of the transactions create new competitive opportunities that did not previously exist. Some transactions allow a portion of the shipments to be routed via a competing carrier—new competition that might not have existed without the transaction. Finally, the railroad industry has developed a process to allow service over a competing rail carrier for new shippers who locate on a short line under most conditions where the shippers' traffic would otherwise be lost to rail transportation if the "paper barrier" was not waived.[11]

For decades, the ICC and the STB strongly supported these spin-offs, including their financing arrangements. Proponents of H.R. 233 hope to overturn "paper barriers" using the same mechanism that would be applied to overturn the Bottleneck Rate cases. Under Section 6, the courts would be guided not to defer under primary jurisdiction to the regulatory agency that approved the transactions and instead to allow attacks on regulatory decisions. The railroads do not believe that antitrust attacks would succeed, but they would have undesirable effects if they did. (The railroads also believe that any successful attacks would raise Constitutional issues.)

Meanwhile, this has become a solution looking for a problem. The STB has already revised its policies to effectively discourage future transactions that use "paper barriers," and

[11] Rail Industry Agreement between the larger railroads and the American Short Line and Regional Railroad Association.

it has opened up the opportunity to challenge existing transactions. STB Ex Parte No. 575, Review of Rail Access and Competition Issues – Renewed Petition of the Western Coal Traffic League (Decision served Oct. 30, 2007). That STB decision has already had the unfortunate result of ending the creation of new short lines by my railroad. If a purchaser cannot pay rent on our assists, we have no motivation to make the assets available for free. If H.R. 233 passes, an unintended consequence will be that the "short line movement," as it is called, will end. No railroad would risk an antitrust case when it can retain its lightly-used rail lines—or abandon them—and avoid the risk.

* * * *

The railroads are not aware of any effort to reconcile proposed changes in the application of antitrust law to railroads with either existing railroad regulation or with proposed changes to regulation that both Houses of Congress are considering. Indeed, some advocacy groups are explicitly supporting this legislation, while simultaneously pursuing separate legislation that would address the same topics by regulation.

We are not aware of any study of the effects of the inevitable interactions between these regimes on the railroads, on shippers, or on consumer welfare. Many assume, automatically, that more antitrust exposure automatically advances the public interest, but, hundreds of times in the past, Congress has reached the opposite conclusion. It has expanded economic regulation and created immunities to allow regulation to function. No one can be certain what effects a new mix might have if it comes to pass, but they would surely be inefficient, uncoordinated, and likely contrary to the Nation's vital transportation needs.

Finally, in many ways, if antitrust law remains as it is today, this legislation does not even solve its proponents concerns. But the bill's unintended consequences for rail

investment, because of the uncertainty it creates and the potential for conflicting court decisions, and the impacts to rail efficiency are large.

IV. H.R. 233 RAISES SIGNIFICANT CONCERNS ABOUT RETROACTIVE APPLICATION

Jurisprudence dating back over 200 years establishes that laws normally apply only prospectively. As the Supreme Court explained in its most recent decision on the subject:

> "Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly; settled expectations should not be lightly disrupted. For that reason, the 'principle that the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place has timeless and universal appeal.'"

Landgraf v. USI Film Products, 511 U.S. 244, 265 (1994) (citations omitted). We assume that the Subcommittee intends H.R. 233 to apply only prospectively. The language of Section 9, however, leaves ample room for an antitrust agency or plaintiff to bring a case attacking past conduct—conduct that has been expressly immunized from the antitrust laws.

Section 9(b) prohibits antitrust actions based on behavior that: (1) occurs after the 180th day after enactment of H.R. 233; and (2) was previously immunized from the antitrust laws. This leaves open the possibility that transactions previously approved as in the public interest, immunized from the antitrust laws, and fully implemented may be challenged as unlawful, if the conduct that is the essence of the approved transaction continues on the 181st day. This, in turn, could lead to antitrust attacks on the continuing operation of every ICC-approved or STB-approved transaction in railroad history.

To take an example involving my company, Union Pacific received ICC authorization in 1982 to acquire the Missouri Pacific Railroad Company and Western Pacific Railroad Company, two other western railroads. Pursuant to the governing statute, the ICC's approval

order gave UP full and unrestricted authority to take all steps necessary to implement that merger, including combining the three companies and unifying their operations. Union Pacific—Control—Missouri Pacific, Western Pacific, 366 I.C.C. 462 (1982). All of that happened, and the three former railroads are no longer distinguishable. Nevertheless, under Section 9, an antitrust plaintiff could argue that the ongoing conduct made possible by the acquisition, although lawful in every respect at the time and implemented with antitrust immunity, violates antitrust standards on the 181st day after enactment.

This problem, of course, is not limited to the Union Pacific-Missouri Pacific-Western Pacific transaction. It applies with equal force to hundreds of rail mergers and line sales from the past. Logically, the same claim could be raised against other rail mergers and line sales approved 20, 40, or even 60 years ago, involving railroads we hardly remember today, as well as many other approved transactions.

In the event such antitrust actions proceeded, and succeeded, the railroads would probably raise due process claims under the United States Constitution, given the regulatory framework that exempted these transactions from antitrust scrutiny when the parties elected to consummate them. Railroads also could assert massive "takings" claims under the Tucker Act, which could end up costing taxpayers billions of dollars. This is just another unintended consequence of the legislation of which policy makers should be aware.

We respectfully suggest that the Subcommittee take a very close look at the language of Section 9 and eliminate this potential retroactive application.

V. THE BILL AND ANY COMMITTEE REPORT SHOULD NOT PREJUDGE ANTITRUST CASES OR ATTEMPT TO ALTER ANTITRUST JURISPRUDENCE

The railroads understood that H.R. 233's purpose is to remove exemptions and open the courts for antitrust complaints. As we have already noted, the bill does much more than that.

Neither the language of the bill nor any accompanying report should prejudge how a court should decide a case. The railroads are concerned, because the Report for last Congress's H.R. 1650 strongly suggested that the railroads had already been put on trial and lost.

Regarding "bottleneck rates," long-established Supreme Court precedent, cited earlier, holds that firms must aid, or provide their assets to, competitors under only rare and unusual circumstances. In general, firms, including firms with monopolies, are free under American law to decide with whom they will do business. See Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 408 (2004) ("as a general matter, the Sherman Act 'does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise [its] own independent discretion as to parties with whom [it] will deal'") (quoting United States v. Colgate & Co., 250 U.S. 300, 307 (1919)). That right is not entirely unqualified, but the Supreme Court has instructed extreme caution in basing antitrust liability on a "refusal to cooperate with rivals." Id., 540 U.S. at 408-10 (noting, for example, that the Aspen Skiing case, Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985), which found liability on facts where an alleged monopolist discontinued a prior course of cooperation, is "at or near the outer boundary of §2 liability"). An antitrust court would be even less likely to rule for a plaintiff in an industry structure where a regulatory agency offers a remedy for unreasonable prices and also has the authority to grant the kind of competitive access that seekers of bottleneck rates desire. See id., 540 U.S. at 411-12 (noting that regulatory structure that enabled a regulator to grant access counseled strongly against applying the antitrust laws).

Regarding "paper barriers," sales and leases to shortline railroads do not reduce competition in any way. The transactions preserve service on a rail line that might otherwise

be abandoned and preserve the competitive situation that existed before the transaction. Contractual provisions that are a central part of the consideration for such transactions, and which address the basic terms of the ongoing traffic-interchange relationship between the large railroad and the smaller railroad it created, should not be found unreasonably anticompetitive by antitrust courts.

We have been told that the objective of H.R. 233 is simply to open antitrust courts to shippers by removing exemptions. However, the report that accompanied last session's H.R. 1650 went further, strongly suggesting that the drafters had already tried and convicted the railroads. We respectfully ask that the report remain neutral regarding how antitrust courts should decide any new case.

It would come as a major surprise if H.R. 233 were intended to revise decades of antitrust jurisprudence or to make substantive changes in those laws. Similarly, it would be quite surprising if this bill, directed at one industry, were to be viewed as overturning Supreme Court decisions. Accordingly, we respectfully suggest that the bill should include a "savings provision" stating that the bill has no such intent. The bill should not create any presumption or inference that any conduct or activity is in violation of the antitrust laws.

VI. CHANGES IN ANTITRUST LAW AND RAIL REGULATION MUST BE COORDINATED

Congress should address the interaction of antitrust laws with the regulatory regime it has already established or that it may establish in the future. Because parts of H.R. 233 are designed to override regulatory decisions, they would inevitably create conflicts and uncertainty for railroads, railroad customers, and courts. That same uncertainty may cause investors to be cautious about the railroad industry, increasing borrowing costs and reducing the railroad industry's ability to draw capital from the private sector. The railroad industry

urges this Subcommittee not to act in isolation, but to work with colleagues in other committees of jurisdiction to craft a coherent, national rail policy that integrates regulation with antitrust jurisprudence.

Conflicts with regulatory regimes become especially evident if one contrasts H.R. 233 with H.R. 2125, introduced during the last Congress. H.R. 233 is designed to allow shippers to challenge so-called "paper barriers" in antitrust courts. Section 103 of H.R. 2125 addressed the same matter, granting the STB the authority to review future "paper barriers" under specific standards and to make policy decisions about whether terminating the "paper barrier" would "materially impair the ability of an affected rail carrier to provide service to the public or would otherwise be inconsistent with the public interest." Antitrust courts are not equipped to apply those specific standards or to make the policy decisions that H.R. 2125 would have imposed.

Similarly, H.R. 233 is designed to allow shippers to bring antitrust claims to force railroads to provide "bottleneck" service on demand. Section 102 of H.R. 2125, however, gave that power explicitly to the Surface Transportation Board, eliminating any role for antitrust courts. H.R. 233 creates yet another direct conflict with existing and future regulatory policy by authorizing the FTC to regulate practices that the STB also regulates, creating conflicting results.

As noted earlier, Section 6 of H.R. 233 would confuse matters still further by directing that courts "shall not be required to defer to the jurisdiction of the Surface Transportation Board." Section 6. Thus, while district courts are discouraged from deferring, they may defer. As a result, different courts and the regulatory agency could well reach opposite conclusions about the same type of dispute or even the very same actions. For

example, a district court might conclude that a particular railroad practice is unreasonable under the antitrust laws, but the Surface Transportation Board might decide that the practice is in the public interest. Congress should not allow such conflicts to arise, much less induce them.

In both Houses of Congress, we believe legislation is likely to be introduced that would propose to alter regulation of our rail industry. Antitrust laws should be carefully and thoughtfully integrated with existing regulation or whatever legislation is proposed from the commerce committees. Pushing forward with laws that address the same subject matter can only produce confusion for all stakeholders in rail transportation, and involve the courts and agencies in years of litigation to unwind the confusion. Throughout that uncertainty, investors would be reluctant to invest their dollars in an industry with an uncertain future. We urge this Subcommittee to pursue rational coordination, not a flawed partial solution that may be undermined by future legislation.