



Consumer Federation of America

**TESTIMONY OF DR. MARK COOPER
DIRECTOR OF RESEARCH**

on the

RAILROAD ANTITRUST ENFORCEMENT ACT OF 2009

before the

**JUDICIARY COMMITTEE
U.S. HOUSE OF REPRESENTATIVES**

May 19, 2009

Mr. Chairman and Members of the Committee,

My name is Dr. Mark Cooper. I am Director of Research at the Consumer Federation of America (CFA).¹ As described in the lengthy document attached to my testimony, CFA has been involved in public policy affecting the rail sector for almost thirty years. Our long-standing involvement stems from the fact that consumers shoulder the burden of excessive rail rates in the price of goods and services they consume, particularly electricity. Two thirds of the coal shipped by rail is captive to a single railroad and excessive coal rates end up in the electricity bills consumers pay every month. Excessive rail rates paid by captive shippers in other sectors, like agriculture and chemicals, distort the economy, lowering output and employment.

The report, entitled “Bulk Commodities and the Rails: Still Crazy After All these Years,” also demonstrates the pervasive abuse of market power that afflicts the rail sector today. Today, the vast majority of rail markets are highly concentrated. Abusing their market power the railroads have accumulated billions of dollars of excess profits and cross subsidies on massive quantities of traffic that they carry at non-compensatory rates. Today the rail industry is a textbook case of market power run amok.

Combining the fact that we warned Congress this would happen even before the Staggers Act was passed, with the dramatic increase in abuse in recent years, we conclude that, as implemented by the Interstate Commerce Commission (ICC) and the Surface Transportation Board (STB), the Staggers Rail Act is among the first and worst examples of

¹ The **Consumer Federation of America** is a nonprofit association of over 280 pro-consumer groups with a membership of 50 million people founded in 1968 to advance consumers’ interests through advocacy and education.

the irrational exuberance for deregulation that has brought our economy to the brink of disaster. We must reaffirm our commitment to competition and the prevention of the abuse of market power, if we are to rebuild our economy.

The Staggers Rail Act is a particularly pernicious example of excessive deregulation because at the same time that Congress deregulated the rails, it also exempted the sector from the antitrust laws, entrusting the protection and promotion of competition to a regulatory agency that is thoroughly captured by the industry it is supposed to oversee. The result has been a double whammy for captive shippers and consumers. The STB has allowed the railroads to increase their market power through mergers and anticompetitive tactics, while simultaneously failing to implement the residual regulation contained in the Staggers Act to prevent the abuse of that market power.

ABANDONING COMPETITION AND ANTITRUST

The failure of the ICC/STB to promote and protect competition in the rail sector is evident in three primary ways.

First, the ICC/STB allowed a merger wave to engulf the industry, reducing it from a state of vigorous competition, to a state of near monopoly. While some consolidation in the rail industry was certainly necessary, by the mid-1990s the benefits of consolidation had been captured. Over the opposition of the Department of Justice, the STB allowed mega-mergers to take place in the mid-1990s that rendered much of the nation captive to, at best, duopolies in the east and west. Vast swaths of America's heavy industries, raw materials and agricultural heartland are now captive to one or two railroads.

Second, the ICC/STB failed to implement the most fundamental principles of antitrust in connection with essential or "bottleneck" facilities. Captive shippers, who are within a few miles of a competitive alternative, are denied access to competition by the refusal of the railroads to allow movement of traffic that they monopolize to a competing railroad.

Third, to add insult to injury, the STB has allowed the railroads to erect paper barriers to competition. These are among the most blatantly anticompetitive contrivances that the U.S. government has allowed to be written into the routine practice of any sector in American history. As the mega-mergers were taking place, the dominant freight roads, desiring to specialize in the long haul transport of bulk commodities, found it convenient to spin-off short lines to service individual facilities or local areas. However, in order to ensure that the long haul freight railroads would be able to exploit their newly minted market power, the dominant railroads forced the new short lines to sign contracts that said in essence, "thou shalt not compete or do anything that promotes competition." Through these "paper barriers" the short lines are not allowed to traffic to or receive traffic from a competing major railroad.

In short the proposition that competition should be the organizing principle of economic activity in the rail sector – the principle upon which Congress enacted the Staggers Rail Act of 1980 - was abandoned by the ICC/STB.

THE FAILURE TO PROTECT CAPTIVE SHIPPERS

Having allowed the railroads to consolidate so dramatically, captive shippers implored the STB to exercise its regulatory authority to prevent the abuse of market power, but the STB turned a deaf ear.

First, the STB clings to a rate threshold that allows the railroads to charge exactly what the monopolist would charge. It allows the railroad to charge up to what it would cost the shipper to build his own stand-alone railroad at current costs. No other regulatory agency in American history has ever adopted this standard. To make matters worse, the burden is on the shipper to calculate the stand-alone cost, in a proceeding that can take years and cost millions of dollars.

Second, the STB has taken an approach to the calculation of the rate of return necessary for revenue adequacy that vastly overstates the railroads' need for revenue. The STB's weighted average cost of capital is one-fifth higher than the cost of capital calculated by Wall Street analysts. This inflated figure makes the railroads appear to be less profitable, thus encouraging a sympathetic STB to allow railroads to increase charges on their captives in pursuit of an absurdly high revenue target.

Third, the STB has failed to require that the railroads operate their business in an efficient manner. In particular, more than a quarter of a century after the passage of the Staggers Act, one fifth of all rail traffic does not cover its variable cost. In other words, there is a shortfall of \$2 billion per year on a large part of rail traffic. If the railroads shed this traffic, their costs would go down by \$2 billion. If they raised their rates to at least cover their direct costs, their revenues would go up by \$2 billion. In either case, the railroads would be shown to be more than revenue adequate and, in theory, captive shipper rates would come down. The Long Cannon Amendment, which enabled the Staggers Act to gain passage in 1980 and was intended to prevent this type of abusive pricing, by requiring the railroads to maximize the contribution from competitive traffic, has been ignored by the STB.

POLICY RECOMMENDATIONS

If this Congress and this administration cannot quickly restore the commitment to vibrant competition as the cornerstone of American economic policy, we will be doomed as a nation to economic mediocrity. All across the economy Congress is beginning to repair the damage that excessive deregulation has done in the financial sector and the energy sector, but antitrust has a special place in American economic policy. It establishes the basic principle across all sectors. Since the Staggers Rail Act was one of the early examples of excessive deregulatory legislation early in the age of market fundamentalism, it is fitting for it to be among the first mistakes to be corrected.

In some areas restoring the vitality of antitrust requires administrative actions or court cases, which will take time. The rail sector is one area where Congress can act quickly and decisively to correct a mistake that Congress made. We urge you to reverse that error and pass H .R. 233, the "Railroad Antitrust Enforcement Act of 2009." Restoring antitrust scrutiny in

the rail sector will eliminate paper barriers quickly because they are a blatant affront to the antitrust laws. The threat of antitrust action will also put pressure on the railroads to behave more reasonably with respect to bottleneck facilities and reciprocal switching rates.

However, antitrust alone will not solve the problem of market power in the rail sector because the fabric of competition has been so severely damaged by more than a quarter of a century of neglect. But restoring antitrust oversight of the sector is a critical first step in addressing the problem of market power. We must use antitrust to drive competition as deeply as possible into our economy and then rely on regulation where market power cannot be addressed or where market failure is likely. In the rail sector we really do not know how far competition will carry us because it was never allowed to operate under the implementation of the Staggers Act. The railroads preferred to pursue a monopoly path and the STB, and the ICC before it, was more than willing to aid and abet them. Now is the time to give competition a chance.