Interstate Commerce Commission*

The first independent regulatory agency created by the federal government, the Interstate Commerce Commission (ICC) regulated interstate surface transportation between 1887 and 1995. Over its 108-year history, the agency regulated and certified trains, trucks, buses, water carriers, freight forwarders, pipelines, and many other elements of interstate transportation.

The ICC was created by the Interstate Commerce Act of 1887 (24 Stat. 379 [49 U.S.C.A. § 1 et seq.]). The act created a five-person commission—later expanded to seven and then to eleven—to be appointed by the president and confirmed by the Senate. Among the commission's first actions was the election of its first president, Thomas McIntyre Cooley, a noted legal scholar who had been nominated by President Grover Cleveland.

Congress established the ICC to control the powerful railroad industry, then plagued by monopolistic and unfair pricing practices that often discriminated against smaller railroads and businesses as well as individual consumers. In its early years, the agency's regulatory effectiveness was severely limited by the courts, which in many cases retained the ability to review ICC rate rulings. The agency lost fifteen of its first sixteen lawsuits against the railroads, and the Supreme Court issued several decisions that hampered its regulatory powers.

Later laws gave the agency's rulings more teeth. The Elkins Act of 1903 (32 Stat. 847) allowed the ICC to punish shippers who practiced unfair competitive methods. The Hepburn Act of 1906 (34 Stat. 584) gave the agency wider powers to regulate railroad rates, making its rulings binding without a court order. The act also assigned to the ICC the oversight of all pipelines other than gas and water.

Over the years, Congress changed the focus and tasks of the ICC, gradually expanding its regulatory powers. In 1893, it entrusted the agency with the regulation of railroad safety. Later, the Motor Carrier Act of 1935 (49 Stat. 543) gave the ICC authority to regulate interstate trucking and other highway transportation. The agency even regulated telephone and telegraph communication from 1888 until 1934, when this task was transferred to the Federal Communications Commission.

Other tasks performed by the ICC included conducting hearings to examine alleged abuses; authorizing mergers in the transportation industry; overseeing the movement of railroad traffic in certain areas; granting the right to operate railroads, trucking companies, bus lines, and water carriers; and maintaining consumer protection programs that ensured fair, nondiscriminatory rates and services. At times, the agency participated in important social and political changes, as when it desegregated interstate buses and trains in the 1960s.

By the 1960s, the ICC had reached a peak size of twenty-four hundred employees, with field offices in forty-eight states. Its growth made it a target for those who sought to reduce the power and size of federal regulatory agencies. Critics claimed that ICC

ICC Actions Affecting Montana Railroads

- 1887 – Interstate Commerce Commission (ICC) was created, the first true federal regulatory agency.
  - Responsibilities
    - Control competition
    - Stabilize rates

- 1970 – ICC approves the Northern Pacific, Great Northern, and Chicago, Burlington, and Quincy Railroads to merge into the Burlington Northern Railroad.

- 1980 – Bankruptcy of the Chicago, Milwaukee/St. Paul and Pacific Railroad leads to the passage of the Staggers Act of 1980, which was to replace federal regulation with market competition.

- 1995 – the ICC voted unanimously to approve the $4 billion merger between Burlington Northern and Santa Fe Railroad.

- 1995 – ICC Termination Act of 1995 abolished the ICC and transferred the responsibility for regulating rail transportation to the Surface Transportation Board (STB). The Act, intended to streamline the remaining economic regulation of the railroads, also shortened time limits for proceedings in a number of areas, such as mergers and rate cases, and has eliminated the tariff filing requirement for railroads.

*Staggers Rail Act of 1980**

Staggers gave railroads the flexibility to set and publish rates and to negotiate confidential contracts with shippers with regard to services and rates. Furthermore, the Act directed the ICC to process abandonment requests more rapidly. These provisions were intended to improve the efficiency of railroads and facilitate their decision-making.

Staggers also permitted differential pricing, that is, pricing responsive to competitive conditions, as opposed to pricing according to cost of service. Staggers also allowed the railroads to pay relatively less attention to their common carrier obligation, with the result that railroad service now varies widely among customers.

It is generally acknowledged that Staggers brought about a major turnaround in the financial condition of the railroad industry. Released from burdensome restrictions and free to set rates, the financial performance of the railroad industry has substantially improved in the Staggers environment. Measuring Staggers against its stated purpose, the Act has been a success. Railroads have become more productive and more competitive and today enjoy considerably improved financial health. Also, railroad customers have gained in lower rail rates and improved service, in general. An estimated 60 percent of all U.S. rail traffic moves under contract as opposed to common carrier tariffs, or posted rates,[1] and contract rates are lower than posted rates.

On the other hand, *not all railroad customers have benefited equally.* As noted in a 2000 U.S. Department of Agriculture report, "Differential pricing allows railroads to extract higher prices from those shippers who cannot effectively use other modes of transportation."[2] This means that "captive shippers" – those without competitive transportation options – pay higher rates than do customers with competitive options.

Montana, North Dakota, and a number of "captive" railroad customers within other states are not satisfied because of the absence of railroad competition and competitive rates. Many railroad customers and their trade groups have expressed dissatisfaction with rates and rate relief procedures, describing the latter as burdensome, time-consuming and expensive. Dissatisfaction is especially acute among industries that are captive to one railroad and have no alternative to rail (for example, long distance shipments of bulk commodities, such as coal, grain or chemicals). Inasmuch as Staggers allows pricing based upon market value of service, or, "what the traffic will bear", an equity issue is raised: "Why should Montana (or any other captive shipper) pay more for transportation than other states?" Indeed, a further question is raised, since with its greater marketplace freedom a railroad is inclined to provide service to the shipper with a competitive option before it takes care of the captive shipper, "Why should Montana pay more for poorer service?"

---

[1] U.S. Congress, Subcommittee on Railroads, Hearing on the Status of Railroad Economic Regulation, "Background", March 31, 2004, www.house.gov/transportion/.

[2] Marvin Prater and Keith Klindworth, "*Long-Term Trends in Railroad Service and Capacity for U.S. Agriculture*", U.S. Department of Agriculture, Agricultural Marketing Service, November 2000, page 9.

State Authority in Railroad Abandonments

Other than some notification requirements and the involvement of state agencies in historic and environmental reviews, Federal laws do not provide states with any special legal authority during rail abandonments. However, states and other governmental entities have several opportunities to participate in the rail abandonment process.

The Interstate Commerce Commission Termination Act of 1995 provided the newly created Surface Transportation Board (STB) with the power to exempt rail lines from the normal abandonment process. This expedited process is known as the *Class Exemption Process for Out of Service Lines*. This process is much quicker and less expensive than the traditional abandonment process, which could take years to complete. BNSF Railway used this expedited process for the successful abandonment of the Kalispell to Balls Crossing, Glendive to Circle, and Moore to Lewistown Lines.

The only criteria that has to be met in order for a railroad to initiate the Class Exemption Process is certification that:

(1) no local traffic has moved on the line for the past 2 years;
(2) any overhead traffic that has moved over the line can be rerouted over other lines; and
(3) no formal complaint about lack of service is pending or has been decided in favor of the shipper.

Following is a summary of the key steps in the Class Exemption Process including opportunities for states or other entities to participate.

- Unlike the traditional abandonment process, no Notice of Intent to abandon, system diagram map, or narrative notice is required. However, 10 days before filing the exemption notice with the STB, the railroad must notify the affected State's Public Service Board or equivalent agency of its intention to do so. The railroad must also send an advance environmental notice to the State, in accordance with STB regulation 49 CFR 1105.11.

- The STB will publish the exemption notice in the Federal Register within 20 days after it is filed. Thirty (30) days after the Federal Register notice, the railroad may abandon the line, unless the board stays the exemption.

States and other entities can participate by:

- Filing stay requests that raise transportation concerns within 10 days after the exemption notice is published in the Federal Register.

- Filing stay requests based on environmental or historic preservation concerns. These requests can be filed at any time but must be filed sufficiently in advance of

AGENDA ITEM 9.2

Closing in on the Competition

DM&E coal line project waits on loan financing after getting go-ahead from STB

The Dakota, Minnesota and Eastern got closer to securing a $2.5 billion federal loan package and finding out if it will eventually be able to compete with the coal franchises of railroad giants Union Pacific and BNSF Railway.

The Surface Transportation Board gave its final environmental approval Feb. 15 to DM&E's rail construction project that includes building a 263-mile rail line into the low-sulfur coal fields of Wyoming's Powder River Basin.

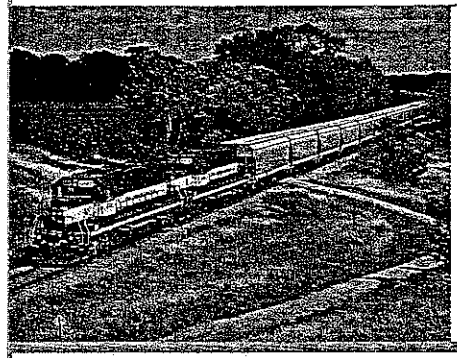

Photo courtesy DM&E

"This is a great day for DM&E. It's been a long time coming, but we are pleased with the end result"

The STB's decision clears the way for the Federal Railroad Administration to begin its own assessment of the project and decide whether to approve the multi-billion dollar loan, applied for under the FRA's Railroad Rehabilitation & Improvement Financing program, which will be used to finance the build-in. The loan application is considered incomplete until FRA determines whether it must conduct a separate environmental review under RRIF guidelines, FRA said. Once those requirements are satisfied, the FRA has 90 days to approve or reject the loan.

However, it could be a race against the clock with the RRIF program among the programs to be cut in President Bush's budget proposal.

"This is a great day for DM&E," said DM&E President and CEO Kevin Schieffer. "It's been a long time coming, but we are pleased with the end result. This project will have a tremendous positive impact on agriculture grain prices and economic development in our area. And it will help lower energy costs and expand rail capacity nationally. The STB's decision today affirms the project's overwhelming public benefits."

A change made last year to FRA evaluations of RRIF loans gives Schieffer reason to be confident about his chances. Instead of using the railroad's net liquidation value as the basis for the loan's collateral, FRA can now use the "going concern" value of the franchise to back up the loan in the event the applicant defaults.

"This means that if DM&E doesn't have the hard assets in the ground to cover the loan, they can in effect give the FRA a mortgage on the property which the FRA can sell on the open market," said Keith Hartwell, a short line industry lobbyist. "This is a much higher value than the net liquidation value, because it allows another railroad to buy it for its future earning potential as well."

Hartwell, who has been hired by the FRA to evaluate RRIF loans in the past, said the new guidelines have never been tested.

The change in the RRIF law, which was part of the federal transportation bill, was made by Sen. John Thune, R-S.D., specifically with the DM&E project in mind. Thune was also instrumental in increasing the amount available in the RRIF program from $3.5 billion to $35 billion, a change that had been on the table since 2002.

Looming in the background is the chance that the RRIF program could be scrapped altogether; the Bush administration proposed eliminating it from the 2007 federal budget. "There are several reasons to question the program's necessity, including that all railroads, regardless of size, are eligible for this credit assistance," the administration said. "Further, recent changes to the law blocked DOT's discretion over whether or not to issue a loan to an applicant."

The administration also stresses that railroads "already benefit from 2004 changes to the tax code, including relieving them from paying diesel taxes. There is not clear justification for the Federal government to extend such favorable loan terms to private rail companies."

Securing the financing to build a new line is one thing, but competing with UP and BNSF may prove to the be the DM&E's biggest hurdle.

"It's virtually impossible for anyone to guarantee the success of the project other than the utilities that purchase the coal and none have come forth as willing to commit to the DM&E," said investment firm Morgan Stanley in November. "If BNSF and UP were to lock up utility customers in long-term contracts, it might takes years even after the DM&E's track is built before it could secure a large utility contract."

While BNSF and UP likely would not suffer significant harm from the DM&E — Morgan Stanley said 80 percent of the two railroads' coal revenue would be safe from DM&E competition — industry observers still anticipate political opposition from the established railroads.

Such opposition doesn't faze Schieffer, however, who is touting the project as a means to increase freight capacity at a time when the industry is starving for more.

BY JOHN GALLAGHER

Schieffer's Railroad Empire*

	Revenue	Profits
DM&E	$89.3 million	$18.3 million
IC&E	$126.4 million	$26.6 million
Total	$215.7 million	$44.9 million

	Assets	Long-term debt
DM&E	$240 million	$108 million
IC&E	$221 million	$150 million
Total	$461 million	$258 million

*Financial standing as of year-end 2004

Source: Company reports

South Dakota

South Dakota owns about 800 miles of railroad, some of which is rail-banked. These lines include: BNSF operated (Core Line)-- 368.6 miles, Dakota Southern operated-- 189.7 miles, D & I operated-- 66.6 miles, and New line Aberdeen north to Geneseo Junction in North Dakota-- 77.48 miles. The rail banked lines include: Kadoka to Rapid City: 98.5 miles and Napa to Platte: 82.4 miles. The South Dakota Department of Transportation's Fiscal and Public Assistance Division, Office of Railroads manages the state rail programs with a staff of four. The office is funded with revenue from leases of state-owned railroad property. The South Dakota State Railroad Board, a seven-member board appointed by the Governor, oversees activities involving rail lines controlled by the state including funding distribution decisions.

State Rail Funding Programs

The Revolving Railroad Trust Fund provides grants or loans for rehabilitation or new construction on state-owned rail lines. Eligible applicants are regional railroad authorities. In most cases, the state provides loans for new industrial development such as shipper-oriented projects like track expansion at grain elevators but also provides funds for track rehabilitation. The program is principally for industries and short line railroads.

The program distributes about $6.5 million annually in loans to approximately half a dozen applicants. There is no cap on loan amounts, which are decided on a case-by-case basis. The largest loan amount to date was $1.8 million. Matching fund requirements are typically 80% state and 20% from the applicant.

Applications must include financial statements, benefit-cost analysis, and an operating/business plan that demonstrates the applicant's ability to repay the funds.

North Dakota

The North Dakota Department of Transportation's Rail & Planning Division manages North Dakota's rail program. State law specifically prohibits the state from purchasing rail lines and provides the North Dakota Public Service Commission with the authority to represent North Dakota on rail rate and service issues.

State Rail Funding Programs

North Dakota's Freight Railroad Improvement Program (FRIP) provides low-interest loans to railroad companies and other entities wishing to establish or improve rail freight service. The revenue to support this program comes from interest earnings on the revolving loan account (that portion determined to be state funds) from the federal Local Rail Freight Assistance (LRFA) Program. Any revenue generated from low-interest loans from the FRIP is reinvested for future support of the state program.

based upon immediacy of need, funding availability, economic analysis (benefit/cost), financial participation by other sources, and other identifiable benefits to the state. This program requires 20% in matching funds.

Rail Economic Development Program

Funding from Iowa's Rail Economic Development Program may be used to restore, improve or construct new rail lines based upon creation of new jobs and capital investment, or retention of existing jobs and capital investment that otherwise might be lost. These projects usually involve rehabilitation or construction of spur tracks needed to serve a new industry, or improve facilities at an existing industry. Cities and counties are the only eligible applicants for these funds. A total of 60 projects have received funding approval since inception of the program in 1986. The projects have been financed with over $5 million in state funds. There are no matching fund requirements.

Iowa Railway Finance Authority

Created in 1981, the Iowa Railway Finance Authority offers financial assistance for acquisition, refinancing or improvement of essential rail lines with low interest loans, grants, limited partnerships, or state ownership and operation. This program requires 20% in matching funds for rail line acquisitions and 10% in matching funds for rehabilitation projects.

Kansas

The Kansas Department of Transportation does not own any rail lines and is not planning to purchase any in the near future. The Rail Affairs Office of the Department of Transportation's Bureau of Transportation Planning manages Kansas' rail program.

State Rail Funding Programs

The State Rail Service Improvement Program was established to provide short line railroads low interest, 10-year revolving loans to be used primarily for track rehabilitation. The Kansas program began in 1999, is similar to the federal Local Rail Freight Assistance program, and provides $3 million in loans per year for eight years. At that time the program will become self-sufficient through repayment of principal and interest by the railroads. Fifteen rehabilitation projects and one acquisition project were completed in 2002 and 2003.

The Kansas program matching ratios mirror those for the federal Local Rail Freight Assistance (LRFA) Program that was last funded by Congress in 1995. The state provides 70% for projects with a 30% railroad match. However, the state has made loans of 40%, requiring a 30% match, and provided the remaining 30% as a grant.

Most loans have been in the $500,000 range. The overall amount in the program is slightly over $3 million annually. The program will discontinue in 2006 unless it is extended.

Applicants must submit a basic two page application that outlines information such as type of work to be done, estimated cost of rehabilitation (breakdown of materials and labor), number of carloads and trains on the section to be rehabilitated, commodities carried and communities served and number of

The loans are limited to a total of $5 million annually and are funded directly from the Railroad Maintenance Revolving Fund with the total amount of the loans limited to no more than 50% of the total amount in the Railroad Maintenance Revolving Fund.

The Railroad Revitalization Act had an initial appropriation of $22 million. The primary funding source for the Railroad Maintenance Revolving Fund is the Oklahoma Freight Car Tax. This tax, which generates approximately $800,000 annually, is 4% of the gross revenue derived from the use or operation of freight cars within the state. The tax is levied on owners or operators of freight cars other than railroad companies. These combined funds have allowed the state to acquire railroads worth over $34 million, and direct over $11 million to rail rehabilitation projects.

Minnesota

The Minnesota Department of Transportation does not own any rail lines. However, although the state cannot purchase rail lines directly it can assist regional rail authorities in obtaining rail lines.

The Minnesota Department of Transportation's Office of Rail Planning and Program Development manages the state rail program.

State Rail Funding Programs

The Minnesota Rail Service Improvement (MRSI) Program was created in 1976, funding was authorized in 1978, and bonds were authorized in 1982 to assist in program funding.

These funds are loaned or granted to rail users and rail carriers to rehabilitate deteriorating rail lines, to improve rail-shipping opportunities, and to preserve and maintain abandoned rail corridors for future transportation use. Recently, funds have been used for improving, extending and moving rail sidings, construction of grain storage bins, fertilizer storage, building warehouses along the rail siding, and improving the speed of loading into rail cars. The success of the program has enabled it to fund itself for the last 25 years.

MRSI Capital Improvement Loans with a maximum of $200,000 loan amount and a ten-year repayment schedule are available for projects that increase rail usage.

MRSI Rail Line Rehabilitation loans are made where rail lines do not comply with FRA Class 2 track standards or do not have the structural capacity to support 263,000-pound railcars. Minnesota Department of Transportation, rail users and railroads must participate financially in rehabilitation projects, and comply with terms of a negotiated contract.

For Capital Improvement Loans, applicants who have invested $10,000 or more towards the rehabilitation are eligible for interest free loans. Other applicants will pay a one-time fee equal to 10% of the loan. This fee will be prorated over the life of the loan.

In Rail Line Rehabilitation loans, the state may loan up to 70% (80% if the line is owned by a regional rail authority) of the total project cost. Rail users must loan at least 10 percent, and the carrier must provide at least 20%.

There is no statutory requirement for matching funds for the program. However, the state attempts to obtain at least a 20% match from the applicant. The state has required a range of 10-30% in matching funds.

WSDOT has received $7 million for freight rail planning and projects since state funds were first authorized in 1991. The 2004 legislature has allocated $2.8 million for discretionary freight rail assistance projects.

Since funding is limited, the state has adopted a screening process to select lines for detailed analysis. The process contains criteria that provide a means of screening the universe of rail lines eligible for assistance in such a fashion that the State's resources are devoted only to those most likely to result in desirable projects.

Project applications are scored using a point system, which gives highest numbers to preservation of the rail line and safety and emergency situations. Next highest ratings go to benefit-cost ratio, local funding contribution, "gain to economic vitality", and economic need.

The state uses the Federal Railroad Administration's LRFA benefit-cost methodology.