

# Interchange Commitments: A Win-Win-Win Situation

ASSOCIATION OF AMERICAN RAILROADS

JANUARY 2009

## WHAT SHOULD BE DONE?

Continue to allow the use of interchange commitments in the sale or lease of rail lines.

## WHY?

Interchange commitments create a true “win-win-win” situation. **Small railroads win**, because they are often able to acquire and operate rail lines they otherwise could not afford. **Larger railroads win** because they are freed to concentrate their resources on higher-priority lines. **And shippers win** by obtaining responsive rail service on rail lines that could otherwise receive low investment and service priority — or simply be abandoned. Everyone benefits from the current policy.

## What Are Interchange Commitments?

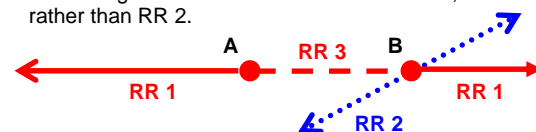
- Over the past 25 years, America’s large railroads have shed tens of thousands of miles of rail lines. Rather than being abandoned, many of these mainly low-density miles were sold or leased to hundreds of new short line railroads.
- As part of these sales or leases, the buyer and seller often voluntarily agreed to a low up-front price in exchange for a commitment by the buying railroad to interchange future traffic mostly or solely with the selling railroad (see Figure 1). In essence, the total price for the rail line included an up-front cash component and a future carload component.

**Figure 1: A Hypothetical Example of an Interchange Commitment**

1. RR 1 owns a rail line that includes a segment from A to B. There is a connection to RR 2 at B.



2. RR 1 sells the segment from A to B to RR 3. In return for a lower purchase price, RR 3 agrees to interchange all or most of its traffic with RR 1, rather than RR 2.



## With Interchange Commitments, Everybody Wins

- Some rail industry critics are pushing legislation that would ban interchange commitments and allow the Surface Transportation Board (STB) to nullify those already in place. These critics claim that interchange commitments are “anti-competitive.” The facts prove otherwise:
  - ✓ The competitive position of shippers **is not changed** by an interchange commitment. In Figure 1, for example, nothing in the interchange commitment

would cause a shipper served by RR 3 to pay higher rates, or receive poorer service, than it would have if it were still served by RR 1.

- ✓ If anything, **shippers will receive better service**, because the buyer will likely have more flexibility and closer ties to the local community than the seller. As the Congressional Research Service noted in a January 2008 report, “Most agree that short-line railroads have a good track record for improving service because their customers are central to the viability of their enterprise.”
- ✓ **Shippers are still protected** against rate and service abuse, because rail lines with interchange commitments are subject to the same regulatory protections as all other rail lines.
- If interchange commitments were banned, many sale or lease transactions **would simply not take place**. The buying railroad would often be unable to afford the line if it had to come up with more up-front cash in lieu of the interchange commitment. Meanwhile, the deal might no longer make economic sense for the selling railroad, since it would no longer receive adequate compensation.
- Why does this matter? If the sale or lease did not occur, the rail lines in question would become **even more marginalized** as their owners concentrated their resources on more viable, higher-priority lines. Ultimately, many of these lines would be abandoned and rail service on them would end completely.

### **Nullifying Existing Interchange Commitments Would Create Daunting Problems**

- Interchange commitments are legal, voluntary agreements between willing buyers and willing sellers. Would you want bureaucrats in Washington to decide that the price you sold your house for 10 years ago was too high, and order you to return some of the sales price to the buyer? Of course not. But that’s what critics of interchange commitments want to do by nullifying past interchange commitments.
- If interchange commitments were retroactively banned, the original transaction would have to be renegotiated so that the selling railroad could receive a higher cash payment to compensate for the loss of the interchange commitment. The STB would have to decide who should pay the added compensation if the buying railroad was unwilling or unable to afford it. This would be changing the rules in the middle of the game — and that’s never a good idea.