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BEFORE THE
SURFACE TRANSPORTATION BOARD

Docket No. EP 711 (Sub-No. 1)

RECIPROCAL SWITCHING

COMMENTS

submitted by

DIVERSIFIED CPC INTERNATIONAL, INC.

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Dated: February 14, 2022

My name is Sandra Dearden; I founded Highroad, Consulting, Ltd. (Highroad), a transportation and logistics consulting firm that addresses all modes of surface transportation, in 1996. Highroad has managed transportation for Diversified CPC International, Inc. (Diversified CPC) since 1998.

I hereby submit these comments on behalf of Diversified CPC in accordance with the Surface Transportation Board ("STB" or "Board") decision served on December 28, 2021 ("Hearing Notice"). That decision scheduled a public hearing for March 15 and 16, 2022, and called for written testimony to be submitted by February 14, 2022.

Diversified CPC strongly supports the Board's proposal to revise the current reciprocal switching rules; however, we are extremely concerned that any inclusion of proof of market dominance will require time-consuming analysis and costly litigation, making it inaccessible for most shippers.

The Board is correct that there have been significant changes in the rail industry since the ICC's decision in Intramodal Rail Competition, and major capacity issues have developed since the Board previously invited comments in this proceeding. I will cite some examples and respond to the Board's questions, while offering some suggestions for potential change. including the need to add consideration of the term, Reciprocal Switching.

In this statement, I will reference the term "*shipper*" throughout. However, the definition of shipper is to include railroad customers (shippers or receivers), or a group of industries served by a single carrier.

I. DIVERSIFIED CPC SUPPORTS THE TWO-PRONG APPROACH BUT BELIEVES IT MUST BE MODIFIED TO UNNECESSARILY MITIGATE THE COMPLEXITY AND COSTS OF SWITCHING PROCEEDINGS.

The Board has proposed a two-prong approach. Prong One is *If Practicable and In the Public Interest*, which is a common sense, case-by-case approach to confirm that the shipper's facility meets certain stated criteria.¹ Nonetheless, reciprocal switching will not be approved if not practicable and in public interest, if not feasible or unsafe, or if it will unduly hamper the ability for a railroad to serve other shippers.

Prong Two is *If Necessary to Provide Competitive Rail Service*. Again, applicants will be required to meet certain criteria, but they will be required to initiate a proceeding which will include a requirement to apply a market dominance test to determine effective competition.² A market dominance analysis is a lengthy and costly process that will prohibit most shippers from even considering this option. I have covered the pitfalls of market dominance analyses and the irrelevance of Revenue to Variable Cost ratios (RVC's) when judging market dominance in numerous filings, so I will not overelaborate here. However, the remaining question for this proceeding is whether or not it can have a practical application to a Reciprocal Switching arrangement.

Diversified CPC has five manufacturing plants; all served by a single railroad except one plant at Sparta, NJ. Located in the former Conrail "*shared asset area*," Sparta is served by a short line railroad, NYSW, which connects with CSX Transportation and Norfolk Southern.

¹ Practicable and in the Public Interest Prong, STB Decision, Docket No. EP 711, Petition for Rule Making to Adopt Revised Competitive Switching Rules, pp. 17 – 18.

² Necessary to Provide Competitive Rail Service Prong, STB Decision, Docket No. EP 711, Petition for Rule Making to Adopt Revised Competitive Switching Rules, p. 19.

In recent years, the railroads have transitioned to Rule 11 rates, which gives us some opportunities to select destination carriers for outbound shipments from the other four plants that might be considered as captive. However, when a railroad has the option to control the traffic with single line service, competition is eliminated. As a result, the RVC's are influenced by the existence or absence of competition.

When performing a lane analysis for any one of the four plants that are single served, some lanes from a plant could pass a market dominance test, while other lanes would not, making it complex to determine if a plant is to be open or closed to reciprocal switching. Would a competing carrier be given access only to certain lanes, or would the industry simply be designated as open or closed to reciprocal switching? If lane specific, it would be difficult to administer and for the incumbent carrier to control. Also, how will new lanes or new markets be judged? Will the shipper be required to apply again when new business opportunities in new lanes surface?

We submit this is not practicable nor manageable, and the cost to litigate will preclude Diversified CPC and other shippers from using Prong Two. Prong One will still be a feasible option, but Prong Two as presented, does not seem to be a practical option causing one to wonder why Prong Two is needed in the first place.

II. PROGRESSIVE CHANGES IN THE TRANSPORTATION INDUSTRY ARE IMPACTING SUPPLY CHAINS, NECESSITATING SIGNIFICANT CHANGE.

In 2011, Highroad conducted a seminar called *Future Shock*. Presenters included industry experts that demonstrated the need for shippers and carriers to review their supply chains to prepare for a developing problem, i.e., a capacity shortage due to the shortage of truck drivers, regulatory changes, population growth, and the increase of freight volumes forecasted by the Department of Transportation. This is

not a short-term problem. The current capacity crisis has been developing for more than a decade and freight volumes will continue to grow. There is no single solution; however, significant changes are required, and we all need to plan and work smarter, lest we face a total service meltdown.

The railroads point to operating efficiencies that have occurred since implementation of Precision Railroading (PSR). However, it seems the only benefactors of PSR are the railroads as rail service has progressively declined. PSR has been sensationalized by the railroads as Wall Street's darling, citing higher profits and operating efficiencies which included mass force reductions. Layoffs were compounded when shipments declined due to COVID. However, when business rebounded faster than forecasted, some furloughed personnel did not return to work and the railroads experienced a labor shortage. That was in 2021, and we still have not seen any improvement in service.

For example, during the months of January and February of 2022, the railroad that serves Diversified CPC's highest volume plant, which is their headquarter plant, failed to provide scheduled switching service eight times. This is disruptive to Diversified CPC's manufacturing operations; when challenged, the railroad's excuse is a shortage of personnel.

We would like to think that service will improve but unless the railroads shift their primary focus away from Wall Street, towards understanding and satisfying the service requirements of their customers, we believe that to be unlikely.

Reciprocal Switching provides shippers with competitive alternatives when rail service problems surface.

A. Reciprocal Switching is a Remedy for Capacity Constrained Carriers.

Reciprocal Switching presents opportunities to plan and manage capacity, for all of the stakeholders, including shippers and carriers.

In recent negotiations with a Market Manager and Group Manager of a Class I railroad, they attempted to justify a 20%+ rate increase by stating the subject lane was congested, and they were simply trying to determine which shippers wanted capacity in the lane. I explained that Diversified CPC already has capacity in the lane, that it is called Common Carrier Obligation. This was an important conversation that took place over three days for more than four hours. Our position was straight forward, i.e., that Diversified CPC not only needs competitive rates, but we also need reliable and competitive service for shipments to our customers, and for inbound shipments of raw materials. There is an existing interchange with another Class I railroad, that is less than ten miles from Diversified CPC's plant, and that railroad could provide competitive routes to and from Diversified CPC's plant.

Demarketing business due to lack of capacity benefits no one. More important, it potentially jeopardizes the future viability of the plant and the welfare of its employees. In this case, the addition of a second serving carrier through Reciprocal Switching, would add transportation capacity which would relieve stress on the capacity constrained incumbent carrier, while ensuring competitive service to Diversified CPC and other shippers in the area.

B. Operational Impacts Cited by the Railroads Are Greatly Exaggerated.

Reciprocal switching is performed efficiently on a daily basis. The railroads are well-equipped with technology, and they have highly experienced personnel who plan

and adjust operations in response to changing traffic volumes and patterns. This is something the railroads know how to do. While marketing personnel may compete, and should compete, railroad personnel on the line in transportation operations know how to cohabitate and manage fluid operations with alternative carriers.

III. THERE SHOULD BE NO TERM ON RECIPROCAL SWITCHING ARRANGEMENTS.

There should be no term on new reciprocal switching arrangements. It is not our objective to add further delays to this proceeding; however, some railroads' practices regarding termination of reciprocal switching should be addressed in a separate proceeding, and procedures for potential termination should be established. For this proceeding terms for new reciprocal switching arrangements should be infinite.

I have heard of numerous instances where a Class I railroad terminated a reciprocal switching arrangement with no advance notice to the shippers served. One can only imagine the turmoil that this caused with some cars already enroute. More important, though, the railroads virtually eliminated competition with the stroke of a pen.

It is an accepted fact that competition has been eliminated due to the consolidation of the railroad industry. The primary objective of this proceeding is to establish competition, but it is also important to protect new and existing competition. I submit that it should be stated that any new reciprocal switching arrangements do not have terms. Concurrently, in a separate rulemaking proceeding, standards and procedures should be established for carriers that want to terminate a reciprocal switching arrangement.

IV. CANADIAN INTERSWITCHING SERVES AS A GOOD BENCHMARK FOR RECIPROCAL SWITCHING IN THE U.S.

Throughout this proceeding I have encouraged the Board to review Canada's success with interswitching. The railroads gave no credence to interswitching, citing network differences in Canada versus the U.S. AAR, in the ex parte meetings, submitted that interswitching regulations forced traffic to move against the flow of the network over facilities that were not designed to accommodate the traffic and, as a result, service problems developed.³

In Canada, access to competitive switching, i.e., interswitching, is automatic, while the Board's proposed rules for approval of Reciprocal Switching will require shippers to present evidence to the Board that will be considered on a case-by-case basis that meets specific criteria. This case-by-case approach for potential approval of Reciprocal Switching accounts for any differences, and negates the railroads' claims that the Canadian experience is irrelevant to the Board's assessment of Reciprocal Switching applications.

V. EFFICIENT COMPONENT PRICING (ECP) MUST NOT BE A FACTOR WHEN SETTING RECIPROCAL SWITCHING FEES.

While the railroads have not submitted specific methodology for setting Reciprocal Switching Rates, they contend any methodology must apply the economic principle of ECP, which would set switching charges equal to the railroad's direct cost to provide switching service plus lost contribution by not providing line-haul service.⁴

It is not reasonable for the railroads to expect to earn contribution for shipments they do not handle. Also, this methodology would result in artificially high

³ Ex Parte 711 (Sub No. 1) Reciprocal Switching Ex Parte meeting between AAR and Acting Chair Ann Begeman at 2, February 15, 2018.

⁴ Ex Parte 711 (Sub. No. 1) Reciprocal Switching Ex Parte meeting between Union Pacific Railroad and Michelle Schultz, Summary served November 18, 2021, p.2; Ex Parte meeting between Norfolk Southern and Patrick Fuchs, Summary served January 4, 2022, p.1.

switch charges that would undermine the competition desired from Reciprocal Switching. Finally, taking into consideration that incumbent capacity constrained railroads may benefit by working with a second carrier under a Reciprocal Switching arrangement, as mentioned in Section II(A) herein, including ECP when setting switch charges could result in double dipping.

VI. SUMMARY

Diversified CPC commends the Board for its efforts and insight behind development of its proposal for new Reciprocal Switching rules. "*Reciprocal Switching*" is an extremely important topic, and we understand the need for the Board to hear the comments of all of the stakeholders. However, Ex Parte 711 has been a very lengthy proceeding and transportation capacity has recently developed into a national crisis, so we encourage the Board to proceed as expeditiously as possible.

Summarized below is a list of topics presented in this testimony for the Board's consideration:

- Diversified CPC requests that the Board consider modifying the proposed rules to mitigate the complexity and costs of Reciprocal Switching proceedings, so such relief will be an option for Diversified CPC and other small to mid-sized shippers.
- Including a Market Dominance Analysis in a Reciprocal Switching proceeding to measure competition is not practical nor manageable as some lanes from or to the same shipper facility may pass the test, while other lanes may not.
- Railroads are de-marketing some lanes that are operating at capacity. Reciprocal Switching presents opportunities to add capacity in lanes to, from and at shipper facilities that are single served.
- Operational impacts cited by the railroads are grossly exaggerated. Reciprocal Switching is currently managed efficiently in the United States by professionals employed by the railroads.
- The new rules should include a provision that new Reciprocal Switching arrangements will be established with no term.

- Termination of Reciprocal Switching arrangements, constitutes elimination of competition. We respectfully suggest that the Board open a rulemaking proceeding to consider establishment of procedures for railroads to follow when they want to terminate any reciprocal switching arrangement.
- Interswitching has been successful in Canada. The proposed Reciprocal Switching rules proposed by the Board for case-by-case consideration, negates the railroads' concerns about network differences in Canada versus the U.S.
- Efficient Component Pricing (ECP) must not be a factor when setting Reciprocal Switching Charges.
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Respectfully submitted:



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On Behalf of:
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