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**UNITED STATES OF AMERICA
BEFORE THE
SURFACE TRANSPORTATION BOARD**

Reciprocal Switching | Docket No. EP 711 (Sub-No. 1)

**COMMENTS OF THE
AMERICAN ANTITRUST INSTITUTE**

The American Antitrust Institute (AAI) submits these comments in response to the Surface Transportation Board's (S.T.B.'s) request for comments in its Notice of Public Hearing on the matter of reciprocal switching in Docket No. EP 711 (Sub-No. 1).¹ The Notice of Public Hearing follows a hiatus in activity in the same docket that was initiated by the S.T.B.'s Notice of Proposed Rulemaking (NPRM) in 2016.² Under the proposed reciprocal switching regulations, the S.T.B. would exercise its statutory authority under 49 U.S.C. 11102(c) to require rail carriers to establish reciprocal switching arrangements under certain circumstances. The S.T.B.'s Notice of Public Hearing invites written comments from "any interested person" on new developments (i.e., occurring since the S.T.B. previously invited comments in this proceeding) that are relevant to a final decision and address any modification of a commenter's views since the previous round of comments."³

AAI did not file comments in the original NPRM in Docket No. EP 711. However, per the S.T.B.'s Notice of Hearing, AAI respectfully requests that the S.T.B. consider AAI's comments because they identify and discuss new developments affecting competition in the freight rail industry since the S.T.B. previously invited comments. These developments include, but are not limited to

¹ S.T.B., Notice of Public Hearing, Reciprocal Switching ("Notice of Public Hearing"), 87 FR 62 (Jan. 3, 2022).

² S.T.B., Notice of Proposed Rulemaking, Petition for Rulemaking to Adopt Revised Competitive Switching Rules; Reciprocal Switching ("NPRM"), 81 FR 51149 (Aug. 3, 2016).

³ Notice of Public Hearing, *supra* note 1, at 64.

the effect of the COVID-19 pandemic on creating and exposing bottlenecks in the U.S. transportation system, and in the freight rail system, in particular.

New developments also include two proposed mergers involving Class 1 railroads that are currently pending before the S.T.B.: (1) CSX and Pan American Railways and (2) Canadian Pacific and Kansas City Southern. These mergers, if approved, would further diminish competition in certain geographic markets in the U.S. AAI therefore submits that it is an interested person, that its comments address significant developments since the previous round of comments, and that its comments are both relevant and timely and should be considered in this proceeding.

I. Interest of the American Antitrust Institute

AAI is an independent, nonprofit organization.⁴ AAI's mission is to promote competition that protects consumers, businesses, and society. It serves the public through research, education, and advocacy on the benefits of competition and the use of antitrust enforcement as a vital component of national and international competition policy. AAI has provided legal and economic analysis, commentary, and testimony on mergers, market power issues, and competition policy involving the transportation sector since the organization's founding in 1998. This analysis spans the airline, railroad, natural gas pipeline, and electricity industries.

II. The S.T.B.'s Final Rule Should Eliminate the Requirement to Show Anticompetitive Conduct as a Condition of Reciprocal Switching

The provisions of 49 U.S.C. 11102 and 10705 make three competitive access remedies available to shippers and carriers: (1) the prescription of through routes, (2) terminal trackage rights, and (3) reciprocal switching.⁵ Under reciprocal switching, an incumbent carrier transports a shipper's traffic to an interchange point, where it switches its rail cars over to the competing carrier. This

⁴ For more information, please visit www.antitrustinstitute.org

⁵ Notice of Public Hearing, *supra* note 1, at 62.

enables a competing carrier to offer its own competitive single-line rate, even if its lines do not physically reach a shipper's facility.⁶ Under 49 U.S.C. 11102, the S.T.B. may require the establishment of a reciprocal switching arrangement when doing so is "practicable and in the public interest or necessary to provide competitive rail service."⁷ The Interstate Commerce Commission's (I.C.C.'s) 1985 rules included a requirement that switching is "necessary to remedy or prevent an act that is contrary to the competition policies of 49 U.S.C. 10101 or is otherwise anticompetitive."⁸

The *Midtec Paper Corp. v. Chicago & North Western Transportation Co. (Midtec)* decision elaborated on the foregoing requirement. There, the I.C.C. first applied its reciprocal switching regulations, requiring a showing that the incumbent carrier "...engaged in or is likely to engage in conduct that is contrary to the rail transportation policy or is otherwise anticompetitive."⁹ For obvious reasons, the burden of such a showing has resulted in few requests for reciprocal switching since that time.

Reciprocal switching is not a novel remedy for promoting competitive access in freight rail markets, thereby protecting shippers and the ultimate consumers of their commodities from the exercise of market power. Indeed, when it first promulgated reciprocal switching rules in 1985, the I.C.C. foresaw the need for the remedy in a rapidly consolidating U.S. rail system. Between 1980 and 1985, for example, seven major railroad mergers were consummated, most involving Class 1 carriers.¹⁰

Today, two Class 1 duopolies dominate the U.S. freight rail system: one in the western U.S. (Burlington Northern Santa Fe and Union Pacific) and one in the eastern U.S. (CSX and Norfolk

⁶ NPRM, *supra* note 2, at 51150.

⁷ *Id.*, at 51153.

⁸ *Id.*, at 51150 (citing 49 CFT 1144.2(a)(1)).

⁹ *Midtec Paper Corp., et al v. Chicago & North Western Transportation Co. (Use of Terminal Facilities and Reciprocal Switching Agreement)* 3 I.C.C.2d 171 (1986), at 181.

¹⁰ The Geography of Transport Systems, *Major North American Rail Mergers, 1980-2005*, <https://transportgeography.org/contents/applications/rail-deregulation-united-states/rail-mergers-north-america/>.

Southern). Competition under such market structures is severely limited. Economic theory supports the notion that duopolized markets are less likely to result in competitive prices, quality, or innovation, and more likely to tend toward monopoly outcomes, especially under circumstances present in network industries.¹¹ This overall lack of competition in rail freight is exacerbated by the fact that the western and eastern Class 1 duopolies have significant bargaining power over the many freight shippers that they serve.

The S.T.B.'s proposed regulations eliminate the need to show anticompetitive conduct, a burden imposed in the *Midtec* decision.¹² Rather, the proposed regulations would require a switching arrangement when it is practicable and in the public interest or necessary to provide competitive rail service.¹³ AAI strongly supports the elimination of any requirement under the proposed regulations to show anticompetitive conduct.

Reciprocal switching is only sought where the shipper typically has *no competitive option* because there is no head-to-head competition for carriers to deliver shipments from a shipper's facility to its final destination. This lack of competition moots the need for any regulatory requirement that a shipper show anticompetitive conduct in order for the S.T.B. to order reciprocal switching. This is because a monopoly is, by definition, the "absence" of competition. And a carrier that faces no competition does not have to engage in any "conduct" to achieve anticompetitive outcomes. Without a reciprocal switching remedy, whereby a carrier pays the incumbent a switching fee for bringing or taking the rail cars from the shipper's facility to an interchange point, competition simply will not exist.

¹¹ See, e.g., Jean Tirole, *THE THEORY OF INDUSTRIAL ORGANIZATION*, MIT Press (1988), Chapter 5.

¹² Notice of Hearing, *supra* note 1, at 63.

¹³ NPRM, *supra* note 2, at 51156.

While the instant S.T.B. proceeding specifically addresses reciprocal switching, AAI encourages the S.T.B. to approach *all* of its competitive access policies against the backdrop of greatly diminished competition in freight rail markets in the U.S. This includes anything in the S.T.B.'s vital arsenal of remedies for promoting competition, such as through routes, trackage rights, and reciprocal switching. Such remedies should be approached more generally as comprising a package of access regulation that is deployed, in full or in part, in highly concentrated or monopolized freight rail markets. Moving forward, AAI encourages the S.T.B. to revisit or eliminate any required showings by shippers upon which competitive access remedies may be conditioned that, like proof of anticompetitive conduct, are clearly incongruent with non-competitive market conditions.

III. Arguments Against Reciprocal Switching Defy the Economic Realities of Anticompetitive Market Structures

In assessing whether a switching arrangement would be practicable and in the public interest under its proposed regulations, the S.T.B. will consider whether the pro-competitive benefits of reciprocal switching would outweigh potential costs.¹⁴ The purported costs of competitive access remedies, including the S.T.B.'s current proposed regulations for reciprocal switching, have long been touted by public utilities and other dominant or natural monopoly operators of transportation networks. The S.T.B.'s NPRM generated voluminous comments from railroads asserting that reciprocal switching would interfere with a carrier's right to the long-haul and hamper their ability to raise capital. These purported outcomes would, according to opponents, disincentivize network operators from investing in rail infrastructure and imperil the efficiency, safety, and reliability (i.e., ability to serve customers) of rail network operations.

¹⁴ Notice of Hearing, *supra* note 1, at 63.

These well-worn arguments against reciprocal switching and other access remedies do not stand up to economic theory or reality. They would preserve a monopolist's or oligopolist's ability to exercise market power over independent (and often captive) shippers. They are a smokescreen for the economic reality that, in the absence of constraining regulation, a monopolist has little incentive to maintain or upgrade its network. More specifically, claims that reciprocal switching will interfere with carriers' discretion to engage in "differential pricing" (i.e., to charge rates that vary according to the elasticity of a shipper's demand) are fallacious, for the following reason.

Basic economics teaches that shippers' elasticity of demand for freight services will vary with the number of available substitutes. When a shipper on a network has no competitive shipping options, the elasticity of demand is low. And when elasticity of demand for freight services is low, a rail carrier is in a prime position to exploit a shipper with supra-competitive prices. Here again, the evidence is clear. Shippers that have no competitive freight options (e.g., trucking, barge, or choice of competitive rail carriers) are most likely to be those that would benefit from reciprocal switching. Those shippers have all submitted comments in support of the S.T.B.'s proposed regulations, thus indicating that their competitive options are highly limited.

AAI thus encourages the S.T.B. to reject arguments that the proposed reciprocal switching regulations are unduly costly and will interfere with incentives to invest in rail infrastructure.

Respectfully submitted,
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