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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 711 (Sub-No. 1)

RECIPROCAL SWITCHING

**REPLY COMMENTS OF
HIGHROAD CONSULTING, LTD.**

Date: January 13, 2017

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Highroad Consulting, Ltd. offers these reply comments in response to the opening comments filed in this proceeding, which the Board initiated to propose new rules under which competitive switching would be mandatory if certain criteria are met, See *STB Ex Parte 711 (Sub-No. 1) served July 27, 2016*.

We commend the Board for their decision to adopt new reciprocal switching rules, but there is a need for streamlined procedures so access to competitive switching is a practical solution for all shippers. In this document we will provide additional comments for the Board to consider when confirming the new rules, and we will comment on some points submitted in Opening Comments by other participants. Finally, we will re-emphasize the need to include rules to protect existing competitive switching.

I. Practicable and In the Public Interest Prong

The first prong proposed by the Board provides that a party could obtain a reciprocal switching prescription by showing the proposed switching is practicable and in the public interest. We agree with the proposed standards set forth in this prong as it will improve competition in the rail industry and it will allow for review of other potential public interest benefits, including the opportunity to gain access to new markets.

There is too much emphasis on rates on the part of the railroads. Instead they should acknowledge the fact that the purpose of this proceeding is to address the need for competitive rates and service.

AAR commented that they are concerned that this will simply allow for a transfer of wealth from the railroads to the shippers.¹ However, AAR seems to disregard the

¹ STB Ex Parte No. 711, Reply comments of AAR, May 30, 2013; Verified Statement of Mark Fagan, May 30, 2013.

potential for the carriers to also increase revenues by accessing new customers via reciprocal switching, and to work with their customers to gain access to new markets. This new paradigm shift would certainly benefit all parties and it will advance the public interest.

II. Necessary to Provide Competitive Service Prong

Under this second prong, a party could obtain a reciprocal switching prescription by showing the proposed switching is necessary to provide competitive rail service. Under this *Competitive Service* prong, the Board proposes to apply the market dominance test and, under the quantitative component, if the rail carrier proves the rate at issue results in an RVC ratio less than 180%, the Board will find that the rate is subject to effective competition.

We disagree with the proposed standards in this prong, and we encourage the Board to develop alternative methods. Our concern, and the concern of numerous parties including carriers and shippers participating in this proceeding,² is the proposed standards would simply develop into another rate case category which would be costly and burdensome, excluding all but the “most financially able shippers from even considering seeking relief from the Board”.³

Rate cases are lengthy and costly to litigate; the market dominance portion of those cases alone are lengthy and shippers are required to incur costs for attorneys and

² STB EP 711 (Sub-No. 1) Opening Comments, AAR “The RVC ratio on a particular movement does not establish the degree of competition...” p. 20; the need for streamline procedures, Cargill, Incorporated p. 5; G3 Enterprises, Inc. pp. 6 – 7; Sandy Creek Energy Associates, Brazos Sandy Creek Electric Cooperative, and Lower Colorado River Authority.

³ STB Ex Parte 711 (Sub-No. 1), Reciprocal Switching, Western Coal Traffic League and Minnesota Power Opening Comments, pp 17 – 21.

consultants to perform analysis and represent them through the market dominance process. In the Transportation Research Board (TRB) report to Congress, TRB's consultants cited shipper criticisms of the STB's granting of rate relief centered on the qualitative assessments of market dominance as being costly and burdensome.⁴ The TRB also included a lengthy discussion of the "fundamental flaws" with the URCS cost system, and they asked Congress to repeal the 180% formula to direct USDOT to develop, test, and refine competitive rate benchmarking methods to replace URCS.⁵ The Consultants submitted recommendations for regulatory change and they were consistent with their recommendations to dispense with all cost allocation schemes such as URCS.⁶

We concur with AAR and the railroads that the R/VC ratio does not prove market dominance and we support TRB's suggestion to replace the R/VC analysis with more meaningful benchmarking methods. Furthermore, benchmarking should not be limited to rates, but should also include an analysis based on rates-per-ton mile so decisions are more accurate and fair to all parties.

If the current rate case procedures to measure rate reasonableness have been deemed by various parties as flawed, then we do not believe it would be prudent to include those procedures in the reciprocal switching rules.

Finally, as mentioned in Highroad's Opening Comments, we submit the standards and methodology adopted should not be based solely on lane-by-lane analysis; the subject industries should be deemed open or closed to reciprocal switching. Any

⁴ TRB Special Report 318, *Modernizing Freight Rail Regulation*, 2015, p 106.

⁵ TRB Special Report 318, *Modernizing Freight Rail Regulation*, 2015, pp 205 - 206.

⁶ TRB Special Report 318, *Modernizing Freight Rail Regulation*, 2015, p 208.

determination that the second carrier only has access to some specific lanes from a single industry would be confusing, difficult to administer, and could result in costly mistakes. If the objective is to improve competition, then the industry should be designated as open or closed to reciprocal switching and, if open, it will allow the market to determine the carrier(s) that move the traffic.

III. The New Rules Should Include Class II and Class III Railroads as Interchange Carriers.

In the proposed rules, prescriptions of reciprocal switching would be limited to routes that do not include Class II or Class III railroads; however, the Board requested comments on this issue to consider whether the Board should now, or in the future, extend the rules to include the smaller carriers.

As it stands today if these rules are confirmed, they will only apply to a relatively small number of shippers and facilities as those exempt from regulation would not be included, including shippers with exempt commodities or shipment types, and traffic moving under contract rates. If the Board decides to go one step further and exclude Class II and Class II carriers from the new reciprocal switching rules, the new rules will only apply on an even smaller sub-set of rail traffic, considering Class II and Class III railroads control more than one-third of the US rail network.⁷

We submit the short line and regional railroads should be allowed to gain the benefits of additional traffic and revenues from being a new, competing railroad in a reciprocal switching situation. M & G Polymers, in their opening statement presented an excellent description of the potential benefits to the smaller carriers.⁸ The rules as

⁷ ASLRRRA Profile of the Regional and Short Line Railroad Industry, April 27, 2005.

⁸ STB EP 711 (Sub-No. 1), Opening Comments of M&G Polymers USA, Inc., pp 3 - 10

proposed will allow for mitigation of any potential harm to the short line or regional railroad, by reviewing the potential benefits on a case-by-case basis. Numerous other parties that are participating in this proceeding support inclusion of the Class II and Class III railroads.⁹

IV. Definition of Reasonable Distance and Working Interchange.

As submitted in our opening comments, we agree with the Board's proposal to assess requests for reciprocal switching on a case-by-case basis. "Miles" should be defined as practical miles since actual miles can increase distances due to routing protocols and other carrier decisions and policies adopted for "carrier convenience". We also agree with the Board's proposal to define a "*Working Interchange*" as an interchange that "*is or can be a working interchange.*"

Union Pacific Railroad (UP) in their opening comments suggested that reciprocal switching only be available in terminal areas.¹⁰ We strongly disagree with that recommendation. If applied, relief through reciprocal switching would only be available in 51 urban areas in the U.S. and shippers with facilities in rural areas, and some markets such as agricultural commodities, would not have access to the new rules.

V. Access Pricing

We object to including "lost contribution" in the access fee as proposed by UP. The access price, or switch charge, for reciprocal switching must be a reasonable charge or the access will not have any value. As detailed in Cargill's opening comments, this concept known as efficient component pricing (ECP) can, in fact, perpetuate the

⁹ STB EP 711 (Sub-No. 1), Opening Comments of Shell Chemical, p. 2; Western Coal Traffic League and Minnesota Power, p. 4; USDA, pp 8 – 9; Cargill Incorporated, pp 10 – 12; Northern Indiana Public Service Company, pp 5 – 6; National Mining Association, p. 2; G3 Enterprises, pp 8 – 9.

¹⁰ STB EP 711 (Sub-No. 1) Opening Comments of UPRR, at 54.

unreasonable exercise of market power by the incumbent carrier because it allows the incumbent carrier to recover their full opportunity costs including any monopoly profits.¹¹

We do not anticipate that there will be an onslaught of applications requesting access under the new reciprocal switching rules, but the new rules (if modified) will allow shippers to seek relief through reciprocal switching if needed. Also, if new standards and procedures are adopted that are practicable for all shippers to seek relief through reciprocal switching, it is likely that simply having new rules in place will bring some discipline to the industry and will result in an improved business environment under which carriers and shippers communicate and work together. On the other hand, if the incumbent carriers are allowed to maintain current contribution levels, there would not be any incentive for the incumbent carriers to compete to maintain business. In fact, if a second carrier is granted access and the incumbent carrier maintains contribution levels, the incumbent carrier will consider it a *“win”*, as they will hold onto their contribution for less work.

VI. Competitive Switching Rules Should Preserve Existing Reciprocal Switching.

Currently, reciprocal switching is the result of an agreement between two rail carriers. Therefore, either railroad can make a decision to terminate that agreement and to close the industry to reciprocal switching. I know of numerous instances where reciprocal switching arrangements were terminated without notice to the rail customers

¹¹ STB EP 711 (Sub-No. 1), Opening Comments of Cargill, Inc. pp 7 – 8.

simply because the incumbent carriers did not want to compete with the second carriers.¹²

If the objective of the new rules is to improve competition with new reciprocal switching rules, it is equally important to preserve existing competitive switching. The new rules should include procedures and standards that will allow the railroads to file an application with the Board to terminate reciprocal switching if they meet certain criteria (similar process that is established for abandonment proceedings), while allowing the railroad's customer the opportunity to participate in the process with the objective to preserve the switching arrangement. The customer's participation could include, for example, submitting comments or testimony regarding the impact the proposed termination of reciprocal switching will have on their company and facility.

Also, BNSF in their opening comments suggests reciprocal switching prescriptions should have a term. We disagree. It is understood that competition needs to be improved so it makes no sense to go one step forward, then two or three steps back. We submit that once a facility is established as open to reciprocal switching, that competition should be preserved and the market should control which carrier handles the business.

VII. Other Railroad Comments.

A. "The Board should deny the NITL petition and discontinue further consideration of NITL's proposal."¹³

¹² Note initial comments filed into this proceeding by G3 Enterprises, Inc., STB EP 711 (Sub-No. 1) G3 Enterprises, Inc.

¹³ STB EP 711, AAR Reply Comments, May 30, 2013, p. 1.

From the very beginning and throughout this proceeding, AAR has responded passionately to any and all suggestions of change. AAR is resisting any potential change, yet they have failed to present any conclusive evidence supporting a position that the current reciprocal rules are adequate and new rules are not needed.

The fact remains, change has already occurred and competition has been reduced due to the rationalization of the railroad industry since Staggers. The current regulations and precedent in which the public interest and competition statutory bases for reciprocal switching were consolidated into a single competitive abuse standard does not make sense in today's regulatory and economic environment.

Still, AAR's message came through loud and clear - they are content with the status quo. This seems to be unfair, and it defies logic. If the current rules are not adequate and shippers have no viable recourse, then the reciprocal switching rules need to be changed. AAR, while resisting any change is, in effect, opposing any changes to the rules that will give shippers the opportunity to seek relief via competitive switching.

B. Comments submitted by the railroads.

The railroads seemed to respond to the opportunity to have input into the new rules proposed by the Board, and they presented some suggestions for the Board's consideration.

Again, we are in agreement that R/VC ratios do not prove market dominance and the new rules should include procedures that do not develop into major proceedings similar to a rate case, so access to reciprocal switching will be available to all shippers.

1. Potential impact on railroad operations.

However, the carriers did express concern regarding “complex operating issues” that may vary from location to location, and the inherent uncertainty in predicting how markets and market participants may react.

Reciprocal switching is not necessarily inefficient. Reciprocal switching exists today; all of the Class I railroads have reciprocal switching agreements (some that have been in effect for decades), and the participating railroad operating personnel work together collaboratively to maintain fluid operations and to provide efficient service to the customers.

We submit this is not a valid concern, but if there are instances where the operations will be impacted, the process proposed by the Board will give the railroad(s) the opportunity to present potential impacts on operations, and the assessment of public interest on a case-by-case basis.

AAR’s witness, William J. Rennie, commented that the Board cannot adequately identify problems that could arise from switching on a case-by-case basis; that operational failures are inherently unpredictable, and network effects could arise almost anywhere.¹⁴ Rennie cited as examples, service meltdowns arising after mergers and service failures from a major weather event.

Railroads have very sophisticated Operations Planning professionals and they frequently make changes to operations for various reasons, including opening or closing

¹⁴ STB Ex Parte 711 (Sub-No. 1 Reciprocal Switching, Opening Comments of William J. Rennie, “Risk of cumulative service problems”, p. 3

yards and maintenance facilities, interchange/routing protocols, and adjustments to their service plans. Rennicke's statement appears to be nothing more than a scare tactic. We agree, sometimes things may not progress according to plan but during my forty plus years in the industry, I have not heard of any service failures that were the result of reciprocal switching operations. If the railroads decided not to make any changes out of concern that some unanticipated failure could occur, nothing would happen and the railroads would miss out on potential opportunities.

The process proposed by the Board that will allow the railroads to perform their analysis and to determine how the new reciprocal switching arrangement may impact on their operations is practical and fair. Again, the impact on the railroads' operations should be one of the topics reviewed by the Board on a case-by-case basis.

2. The Railroads contend "Forced Switching" will reduce incentives for the railroads to invest in infrastructure.

We submit the railroads will continue to invest so they can plan for capacity that will be needed and so they will be positioned to achieve dramatic growth that is forecasted by the US Department of Transportation (DOT).

Several years ago, DOT forecasted a 60% growth in freight volumes that would develop in the United States between then and 2035. In 2016, DOT revised the forecast, citing a 40% growth; because of the shortage of truck drivers and regulatory changes in the trucking industry; DOT projected 90% of that growth will move via rail. The paradigm shift has already commenced and shippers that do not currently have rail sidings are looking for ways to access rail. The railroads are responding to the growth; they are increasing their infrastructure by double tracking, opening yards previously closed, and expanding intermodal terminals or constructing new terminals. The railroads will continue

to invest and they will continue to conceive and implement productivity initiatives as required to confirm capacity for the future.

3. The Canadian Inter-Switching model is not a good benchmark for Reciprocal Switching in the United States.

When making his argument against the effectiveness of reciprocal switching, Mark Fagan, on behalf of the AAR, urges that, “The STB should learn from the failings of mandated access in Australia.”¹⁵, further stating “Mandated access had been in place for over a decade in Australia at the time of my study. There were some rate reductions but social welfare gains were questionable at best. The rate reductions appeared to be small relative to the increased coordination problems and costs associated with access including increased handlings, wheel-rail interface issues, access prioritization, etc.”.

However, this statement runs counter to the AAR’s position as presented in their testimony dated May 30, 2013 in which they stated, regarding Canada’s reciprocal switching law, “...when examined at a superficial, aggregate level, as NITL proposes, the Canadian experience is meaningless in predicting the effect of mandated switching in the United States. Canadian geography and railroad configurations are so different from those in the United States that the impact of mandated switching in Canada says nothing about what would happen in the United States.”¹⁶. Their testimony goes on to say “The effect of inter-switching on such a low-volume, east-west rail network as in Canada says nothing about the disruptions that would occur in a high volume high-density, complex web-like network that exists in the United States.”.

¹⁵ Mark Fagan. STB Ex Parte No. 711 (Sub-No.1), Reciprocal Switching, Verified Statement of Mark Fagan, October 26, 2016, Pg 5.

¹⁶ Warchot, Sipe. STB Ex Parte No. 711, Petition for Rulemaking to Adopt Revised Competitive Switching Rules, Reply Comments and Evidence of the American Association of Railroads. May 30, 2013. Pgs 31-32.

In their 2013 testimony, the AAR appears to be claiming that simpler, lower-volume rail networks would be much better at accommodating inter-switching rules than complex, higher-volume networks. However, this logic does not explain how Australia, who has a 20% smaller rail network than Canada (in terms of kilometers of track) and moves only 2,308 tonne-kilometers per capita of freight per year compared to Canada's 10,517 tonne-kilometers per capita¹⁷, can have a failing reciprocal switching system (according to Mr. Fagan) while Canada's can be deemed a success. While the "smaller equals easier" argument may sound logical on the surface, the Australia/Canada comparison shows that the logic is flawed. Rather than ignore the Canadian inter-switching model simply because Canada has a smaller network, their model should serve as proof that a successful reciprocal switching system is possible. While the US freight rail network may be larger and more complex, it also boasts the most sophisticated practices and technologies in the world, as well as some of the most knowledgeable industry experts that can ensure the success of the system.

VIII. Summary

The transportation landscape of the railroad industry has changed dramatically since Staggers and the rail industry is clearly different than it was years ago. The dynamics of some markets have changed and competition has been reduced. Railroads have reduced track miles from 271,000 miles in 1980 to 161,000 miles in 2016.¹⁸

One of the explicit goals of the Staggers Rail Act was to, "provide a regulatory process that balanced the needs of carriers, shippers, and the public."¹⁹ Staggers has

¹⁷ International Union of Railways, *Railway Statistics 2014 Report*. May 15, 2015.

¹⁸ Association of American Railroads, *Railroad Facts: 2015 Edition*.

¹⁹ Staggers Rail Act of 1980.

been good for the railroad shippers and their customers. The railroads are financially healthy and the rail system in North America is recognized as the most sophisticated and efficient rail system in the world. However, Staggers' objective to establish balance for carriers, shippers and the public has become distorted. While competition in the rail industry as a whole may still exist, railroads face little or no competition on numerous routes, especially in remote areas. Some states, e.g., Idaho and Montana, are served by a single Class I railroad. A Class II railroad is headquartered in Montana, but their market reach and ability to compete is limited/precluded by a paper barrier agreement with the Class I railroad.

Thus, the time has come to review regulatory processes to determine if changes are required to restore the balance desired when the Staggers Rail Act was enacted. When the Board initiated this rulemaking proceeding, it was an important step towards achievement of the goals and objectives of Staggers.

When President Obama issued Executive Order No. 13,563, January 18, 2011, he explained that his goal was to, "remove outdated regulations that stifle job creation and make our economy less competitive." In the order itself, the President ordered that, "each agency shall identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public."²⁰

²⁰ Barack Obama, *Toward a 21st – Century Regulatory System*, The Wall Street Journal, January 18, 2011 at A17 (Obama Op. Ed). Executive Order No. 13563, January 18, 2011.

That is precisely what the Board is doing here. They have dedicated time and resources to address the outdated Reciprocal Switching rules that impact on the freedom of choice from the public, and preclude shippers' ability to access competitive switching.

The time has come to change the rules and we support the Board's proposal with modifications recommended herein. Those changes include:

1. For the second prong, develop and establish alternative standards to replace the RVC analysis with more meaningful benchmarking methods, and develop a process that will be practical for all shippers. The benchmarking analysis should be based on rates per ton-mile. We submit the standards and methodology adopted should not be based solely on lane-by-lane analysis; the subject industries should be deemed open or closed to reciprocal switching. Any determination that the second carrier only has access to some specific lanes would result in an administrative nightmare. If the objective is to improve competition, then the industry should be open which will allow the market to determine the carrier(s) that move the traffic.
2. Access Pricing - We object to including "lost contribution" in the access fee as proposed by UP. The access price, or switch charge, for reciprocal switching must be a reasonable charge or the access will not have any value.
3. Existing reciprocal switching should be preserved. The new rules should include procedures and standards that will allow the railroads to file an application with the Board to terminate reciprocal switching if they meet certain criteria, while allowing the railroad's customer the opportunity to participate in the process with the objective to preserve the switching arrangement.
4. Class II and Class III railroads should be allowed to gain the benefits of additional traffic and revenues from being a new, competing railroad in a reciprocal switching situation.
5. We agree with the Board's proposed rules and approach to judging "*reasonable distance*" and "*working interchange*" on a case-by-case basis.
6. We disagree with the railroads' position that the new Reciprocal Switching rules will have a negative impact on railroad operations. Railroads operate efficiently under reciprocal switching agreements today and comments submitted by the railroads and their witnesses are anecdotal in nature and they have not produced any compelling evidence that it is likely to change.

It has often been said that one thing we can always count on is change. While some people attempt to hang on to status quo, changes occur around them and while those changes are developing, they do not keep pace with change. As a result, status quo no longer exists as status quo is sliding backward sometimes at an alarming rate.

BNSF President and CEO, Carl Ice, in his presentation at the winter meeting of the Midwest Association of Rail Shippers in Oak Brook, IL on January 11, 2017, talked about change and the need to address change. He further commented that some people embrace change, while others resist change.

We support the Board's initiative to develop new Reciprocal Switching rules, and we encourage the Board to continue to embrace change and to conceive changes that are needed to serve the public interest.

Respectfully Submitted,

A handwritten signature in cursive script, appearing to read "Sandra J. Dearden", with a long horizontal flourish extending to the right.

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