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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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

**PETITION FOR RULEMAKING TO
ADOPT REVISED COMPETITIVE SWITCHING RULES**

**COMMENTS OF
HIGHROAD CONSULTING, LTD.**

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October 26, 2016

I. Background

My name is Sandra Dearden. I am founding President of Highroad Consulting, Ltd. (Highroad). Prior to starting our firm in 1996, I held positions with three Class I railroads. I started my railroad career with Illinois Central Railroad, and moved up through the ranks to a position as Pricing Administrator. Subsequently, I was recruited by Chicago & North Western Transportation Company (C&NW), initially as Assistant Rates Manager. I had a progressive career at C&NW; in 1992, I was promoted to General Manager Marketing & Sales for the Ag Commodities Strategic Business Unit. I continued to work for UPRR through the end of the year following the UPRR's acquisition of C&NW.

Highroad is a full-service transportation and logistics consulting firm that consults on all modes of surface transportation. However, rail transportation seems to be our niche; some of our clients include other consulting firms and third party logistics companies that sub-contract rail projects to Highroad. More than 70% of our projects are rail projects.

I have participated in numerous proceedings before the Surface Transportation Board (STB) and its predecessor agency, the Interstate Commerce Commission (ICC). I submitted comments in STB Ex Parte No. 711, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, on behalf of Diversified CPC International, Inc.¹, and separate comments submitted by Highroad with attached

¹ STB Ex Parte No. 711, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Comments of Diversified CPC International, Inc., March 26, 2014.

testimony submitted by Highroad's consultant, Neil Thurston, who had extensive experience with inter-switching rules and operations in Canada².

We applaud the Board's decision to adopt new rules for reciprocal switching, as it has become evident in recent years that there is a need to improve competition in the rail industry.

In the petition to the Board for a rulemaking proceeding, NITL proposed new rules under which competitive switching would be mandatory if four criteria were met³:

- (1) A shipper or group of shippers is served by a single railroad;
- (2) There is no effective intermodal or intramodal competition for which competitive switching is sought;
- (3) There is or can be a "*working interchange*" within a "*reasonable distance*" of the shipper's facility;
- (4) Switching is safe and feasible with no adverse effect on existing service.

NITL's proposal included some conclusive presumptions, including two presumptions with respect to the requirement that no effective competition exists, i.e., the rate for the movement for which switching is sought has a revenue-to-variable cost (RVC) ratio of 240% or more, or where the incumbent carrier serving the shipper's facility for which switching is sought has handled 75% or more of the transported volumes of the movements at issue for the prior 12-month period.⁴

² STB Ex Parte No. 711, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Comments of Diversified CPC International, Inc., March 1 2013.

³ Booth, Moreno, DiMichael, "Docket No. EP 711, Petition for Rulemaking to Adopt Revised Competitive Switching Rules", NITL (2011), 67

⁴ Booth, Moreno, DiMichael, "Docket No. EP 711, Petition for Rulemaking to Adopt Revised Competitive Switching Rules", NITL (2011), 44

In our comments filed in Ex Parte 711, it was our position that if the Board elects to include in the new rules and procedures the calculation of a R/VC as a regulatory benchmark, the benchmark should be fair to all parties, and the regulatory threshold should be consistent with what is in place for other STB proceedings, i.e., 180%. Also, it was our recommendation that the Board adopt a streamlined process that will not unnecessarily inflate costs of consultants and attorneys so competitive switching is a practical option for large *and* small shippers.

While granting NITL's proposal to initiate a rulemaking proceeding, the Board acknowledged the need to make reciprocal switching a practical solution for all shippers vs. a sub-set of shippers⁵, and the Board is proposing new reciprocal switching regulations using a two-pronged approach under which switching arrangements will be established if such an arrangement is either practicable and in the public interest, or necessary to provide competitive rail service. The Board also submitted that the imposition of reciprocal switching on a case-by-case basis will establish a greater degree of precision when mandating reciprocal switching.

We strongly support the Board's decision to adopt new competitive switching rules. However, we do have some questions and concerns. In this statement I will emphasize the need for streamlined procedures so that access to competitive switching is a practical solution for all shippers. I will also provide comments regarding other factors for the Board to consider when confirming the rules and procedures, specifically, the impact that the process proposed for the Competitive

⁵ Surface Transportation Board, "Docket No. EP 711 (Sub No. 1) Petition for Rulemaking to Adopt Revised Competitive Switching Rules", STB (2016) 13

Rail Service prong will have on the Board's objective to establish rules that will make reciprocal switching equally available to all shippers.

II. Practicable and in the Public Interest Prong

This first prong provides that a party could obtain a reciprocal switching prescription by showing the proposed switching is practicable and in the public interest. The Board proposed three criteria that shippers must satisfy to demonstrate that switching is practicable and in the public interest: (1) that the facility of the shipper(s) and/or receiver(s) for whom such switching is sought are served by Class I rail carrier(s); (2) that there is or can be a working interchange between the Class I carrier serving the party seeking switching and another Class I rail carrier within a reasonable distance of the facilities of the party seeking switching; and (3) that the potential benefits from the proposed switching arrangement outweigh the potential detriments.⁶

We agree with the Board's proposed standards set forth in this prong. An example of a potential scenario includes giving shippers the opportunity to reach new customers and markets at destinations served by the second carrier. This is only one example, but it seems obvious that opening new markets to shippers would serve the public interest, as it would not only be improving competition in the rail industry, but other industries as well.

⁶ Ibid.

Again, we support the Board's proposal to address these types of situations by allowing shippers to demonstrate that switching would be in the public interest.

III. Necessary to Provide Competitive Rail Service Prong

Under this second prong a party could obtain a reciprocal switching prescription by showing that the proposed switching is necessary to provide competitive rail service. Again the Board is proposing three criteria that shippers must satisfy: (1) that the facilities of the shipper(s) and/or receiver(s) or whom switching is sought are served by a single Class I rail carrier; (2) intermodal and intra-modal competition is not effective with respect to the movements of the shipper(s) and/or receiver(s) for whom switching is sought; and (3) there is or can be a working interchange between the Class I carrier serving the party seeking switching and another Class I carrier within a reasonable distance of the facilities of the party seeking switching.⁷

Under this Competitive Service prong, the Board proposes to apply the market dominance test to determine if a movement is without effective intermodal or intra-modal competition. Under the quantitative component, if the rail carrier proves that the rate at issue results in a R/VC ratio less than 180%, the Board will find that the rate is subject to effective competition.⁸

We commend the Board for their intentions and this rulemaking proceeding in itself seems to be progressing in the right direction. However, knowing the devil can be in the details, I caution the Board against any rush to judgement as the process

⁷ Surface Transportation Board, "Docket No. EP 711 (Sub No. 1) Petition for Rulemaking to Adopt Revised Competitive Switching Rules", STB (2016) 13 - 14

⁸ Surface Transportation Board, "Docket No. EP 711 (Sub No. 1) Petition for Rulemaking to Adopt Revised Competitive Switching Rules", STB (2016) 16

and standards proposed in the Competitive Rail Service prong could develop into just another type of costly and cumbersome rate case.

In its decision, the Board explained that it already has a framework for conducting such individualized proceedings, requiring evidence of the absence of effective competition from other rail carriers or modes of transportation, which the statute describes as “market dominance” (see 49 U.S.C. § 10707), and under the quantitative component, if the R/VC ratio is less than 180%, the Board will find that the rate is subject to effective competition.⁹

This is not a rate case, and it should not develop into another rate case category. First of all, in several rate case proceedings, the market dominance portion of the rate cases alone was lengthy. In the Transportation Research Board (TRB) report to Congress, they cited shipper criticisms of the STB’s granting of rate relief centered on qualitative assessments of market dominance as being excessively costly and burdensome.¹⁰ In that same report, TRB included a lengthy discussion of the “fundamental flaws” with the Board’s Uniform Rail Costing System (URCS), and in their recommendations they asked Congress to repeal the 180% R/VC formula and to direct USDOT to develop, test, and refine competitive rate benchmarking methods to replace URCS.¹¹

Also, we are in agreement with the railroads that the R/VC ratio does not prove market dominance. Consultants Mark Israel and Jonathan Orszag, in their statement

⁹ Ibid.

¹⁰ Transportation Research Board Special Report 318, *Modernizing Freight Rail Regulation*, 2015, p 106.

¹¹ Transportation Research Board Special Report 318, *Modernizing Freight Rail Regulation*, 2015, pp 205 - 206.

for the Association of American Railroads (AAR) in STB Ex Parte 704 (Sub – No. 1) referenced the results of two analyses submitted in Ex Parte 704 that demonstrated that R/VC is not a reliable indicator of market dominance.¹²

Highroad developed an analytical model, VIEWPOINT™, that we use on client projects to determine rates required for the client to be market competitive. When performing those studies, the rate analyses are based on benchmarking data which includes analysis of rates per ton-mile. While preparation of cost studies are included in the analytical process, we do not use the cost information to determine if rates are or are not reasonable. The cost information simply helps the analysts to gain an understanding of how the carriers view our clients' businesses based on contribution, not the R/VC ratios.

It has been our experience when preparing thousands of cost studies for client projects that longer distances drive down R/VC ratios. In some cases, where extremely short or long distances are involved, the R/VC ratios become skewed. For example, while a switch or line haul charge of \$250 - \$450 per car for a distance less than 20 miles may seem reasonable, the R/VC ratio can be higher than 400%.

In the TRB report, the Consultants submitted recommendations for regulatory change, and to dispense with all cost allocation schemes such as URCS.¹³ If the current procedures to measure rate reasonableness have been deemed by various

¹² STB Ex Parte 704 (Sub – No. 1, *Review of Commodity, Boxcar and TOFC/COFC Exemptions*, Israel/Orszag VS at 7.

¹³ Transportation Research Board Special Report 318, *Modernizing Freight Rail Regulation*, 2015, p 208.

parties including TRB's experts as flawed, then we believe it would not be prudent to use such procedures in the new reciprocal switching rules.

The rules to be confirmed in this proceeding require very careful consideration lest this process develop into another category of rate cases. We do not believe that is the Board's intent, but we respectfully submit that the Board should approach the rule changes applicable to the Competitive Rail Service prong with extreme caution. If the process proposed is adopted, then it is highly unlikely that the Board will achieve its objective to establish rules for access to reciprocal switching that will be available to all shippers.

One of the problems with using a market dominance test, which includes a R/VC threshold, is the analysis would be performed on a per-lane basis. It is difficult to understand what this will really mean if some lanes stand up to the test and others do not. It seems that by analyzing the reasonableness of rates for each and every lane that a facility could have a mix of lanes that are either open or closed. So the plant/facility would actually not be opened or closed to reciprocal switching. What could develop is an administrative nightmare for Traffic Managers and shipping clerks if they are required to adhere to a different switching status for every lane. Of course, under that scenario, the potential risk is the railroad could increase rates on those lanes that remain captive to make up for lost revenues for those lanes that are diverted to a second carrier.

Finally, since rates change, would shippers need to re-apply for those lanes that previously did not pass the test? It seems to me that what we should be trying

to accomplish is to secure a determination that a plant is either open or closed to reciprocal switching.

The procedures proposed for shippers and receivers to request Competitive Rail Service appear to be idealistic and they are not practicable. Again, we submit that decisions to impose reciprocal switching should not be limited by a market dominance test that includes an R/VC threshold. Under the proposed rules, a decision for a shipper to access competitive switching would be piece meal and the process would simply emulate a rate case that would not be a practical solution for all shippers.

We encourage the Board to find an alternative solution; the process should not include market dominance as a consideration to demonstrate the need for competitive switching. However, if the Board is to confirm in the new rules that confirmation of market dominance be included in the assessment, then standards need to be established and there should be limits to shorten the market dominance process, and R/VC ratios should not be used to confirm market dominance.

IV. Class I Carriers

In their decision, the Board proposed under both prongs of the proposed regulations, that prescriptions of reciprocal switching would be limited to Class I railroads, and they requested comments on this issue to consider whether the Board should now, or in the future, extend the rules to include smaller carriers.

In a report issued in 2005, there were 545 Class II and Class III railroads with 46,474 miles (one third of the US rail network).¹⁴ Also, the American Short Line and Regional Railroad Association (ASLRRA) reported a breakdown of regional and short line railroad shipments by traffic type in 2010:

- o Local 14%
- o Forwarded 33%
- o Received 34%
- o Bridged 19%¹⁵

Considering the important contribution Class II and Class III railroads make to rail transportation in North America, we submit that short line and regional railroads should have the opportunity to benefit from the rules by serving as interchange carriers.

V. Definition of Reasonable Distance and Working Interchange

We commend the Board for its proposal to consider reciprocal switching requests on a case-by-case basis. We agree that the definition of reasonable distance may vary based on markets and geography. If a mileage limit is established, there will always be industries that are located within a few miles outside the limit but under closer scrutiny, reciprocal switching for some or all of those industries may be judged as reasonable. Also, some states such as Idaho and Montana are basically captive to a single Class I Railroad. By judging a reasonable distance on a case-by-

¹⁴ ASLRRA Profile of the Regional and Short Line Railroad Industry, April 27, 2005.

¹⁵ ASLRRA Facts and Figures, Short Line and Regional Railroad Traffic.

case basis, the process will be improved as decisions will not be judged based not on a single number, but on specific market conditions and railroad operations.

Also, the definition of miles should be confirmed. Are the miles to be actual operating miles or practical miles? Railroads sometimes change operations and routing protocols, and we expect they will continue to do so in the future. Often those changes result in increased miles, but the railroads contend they make those decisions for "operating convenience." Those situations should be part of the Board's consideration when judging "*reasonable distance*" to a "*working interchange*." While the miles could appear on the surface to be potentially unreasonable, if the actual route of movement is operationally more efficient for the railroad, then judging a longer distance as reasonable may be the better decision.

Finally, we agree with the Board's proposed definition of a working interchange as, "an interchange that *is or can be* a working interchange"¹⁶. Again, this should be judged on a case-by-case basis and the process should allow for the consideration of existing and potential interchanges.

VI. Reciprocal Switching Rules Should Preserve Existing Competitive Switching

Currently, reciprocal switching is the result of an agreement between two rail carriers. Therefore, either party can make a decision to terminate that agreement. There are instances where reciprocal switching arrangements were terminated

¹⁶ Surface Transportation Board, "Docket No. EP 711 (Sub No. 1), Petition for Rulemaking to Adopt Revised Competitive Switching Rules", STB (2016), 18

without any advance notice to the rail customers because the house carrier simply did not want to compete with the second carrier.

This proceeding underscores the need to improve competition, so it is equally important to preserve existing competition. The new reciprocal switching 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 giving the rail customers the opportunity to participate in the process with the objective to preserve the switching arrangement. The customers' participation could include, for example, comments or testimony regarding the impact the proposed termination of reciprocal switching will have on their company/facility.

As stated, the Board will need to establish procedures and standards, perhaps using the rail abandonment procedures as a benchmark.

VII. Summary

In summary, we commend the Board for its decision to adopt competitive switching rules, and we support the Board's proposal to make decisions to impose reciprocal switching on a case-by-case basis. However, we are concerned about the proposed procedures set forth in the second prong to access competitive switching, and we have presented our views regarding several points to consider:

- a) The Board should continue to focus on its objective to develop streamlined processes so that access to reciprocal switching will be available to all shippers.
- b) We support the Board's approach for the Practicable and in the Public Interest prong.

- c) The proposed process for shippers and receivers to access competitive rail service (second prong), should not be adopted.
- The new reciprocal switching rules should not develop into another rate case category.
 - Decisions to impose reciprocal switching should not be based on per-lane analyses that includes proof of market dominance; R/VC ratios do not confirm market dominance.
 - The proposed process, which would require analysis of each lane, will divide shipper and receiver facilities. Some lanes will be open to reciprocal switching while others from the same facility will be closed to reciprocal switching.
 - There is risk associated with splitting shipper and receiver facilities; railroads could decide to increase rates that apply on lanes that are closed to reciprocal switching to make up for those that are open.
 - The proposed rules are not practical and it is likely they will not be used.
- d) Short line and regional railroads should have the opportunity to benefit from the rules by serving as interchange carriers.
- e) Definitions of "*Reasonable Distance*" and "*Working Interchange*":
- We strongly 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 adopted for "carrier convenience".
 - We agree with the Board's proposal to define a "*Working Interchange*" as an interchange that, "is or can be a working interchange".
- f) It is important to preserve competition. The new reciprocal switching rules should include a process for carriers to seek Board approval to terminate reciprocal switching arrangement(s); shippers and/or receivers should be able to participate in that process. The current rail abandonment rules may serve as a good benchmark when developing a process to address termination of reciprocal switching arrangements.

Again, we commend the Board for opening this rulemaking proceeding and we appreciate the opportunity to present the views submitted herein.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Sandra J. Dearden". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

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