

**BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.**

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

NOTICE OF PROPOSED RULEMAKING

**COMMENTS OF THE
AMERICAN SHORT LINE AND REGIONAL RAILROAD ASSOCIATION**

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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB DOCKET NO. EX PARTE 711 (Sub-No. 1)

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

**COMMENTS OF THE
AMERICAN SHORT LINE AND REGIONAL RAILROAD ASSOCIATION**

Introduction

The American Short Line & Regional Railroad Association ("ASLRRA" or "Association") is an international trade organization of approximately 1,030 members consisting of about 480 short line and regional small, locally-based railroads ("Small Railroads") in 49 states¹, as well as approximately 550 suppliers and contractors. These railroads operate about 50,000 miles of track constituting 32 percent of the nation's rail system connecting largely less populated, rural areas to the national rail network. These Small Railroads participate in 40 percent of all carload movements but earn only five percent of the revenue generated on the national rail system. Small Railroads frequently provide the first and last mile of service on rail movements.

Small Railroads play a vital role in maintaining rail service over hundreds of miles of light density lines throughout the country that in many cases were candidates for abandonment by their former Class I owners. These Small Railroads have short lengths of haul, high fixed costs, and large capital needs for infrastructure investment, including the task of upgrading bridges and track to handle heavier freight cars. They also face pervasive competition trucks, barges, and transloading operations for freight traffic.

Interest of the American Short Line and Regional Railroad Association

ASLRRA has participated in both Docket No. EP 705, Competition in the Rail Industry ("EP 705"), Docket No. EP 711, Petition for Rulemaking to Adopt Revised Competitive Switching Rules ("EP 711"), and now in Docket No. EP 711 (Sub-No. 1), Reciprocal Switching

¹ The ASLRRA also has railroad members in six Canadian provinces.

("EP 711, Sub-No.1"). In EP 705, ASLRRA submitted extensive comments, testimony, and evidence clearly delineating why forced reciprocal switching and other proposals made by some shippers in that proceeding were not in the best interests of railroads, shippers, and the public. In particular, ASLRRA showed how Small Railroads faced extensive competition, that no alternatives were needed to facilitate more competition, and the imposition of forced reciprocal switching was not needed or warranted.

Without waiting for action by the STB in Ex Parte 705, on July 7, 2011, the National Industrial Traffic League ("NITL") filed a petition seeking to modify the STB's standards for mandatory competitive switching. Its petition specifically exempted Small Railroads from the provisions of any such modified rules, however, the petition was ambiguous on such an exemption.

In Ex Parte 711, ASLRRA continued to vigorously oppose the imposition of a rule mandating reciprocal switching as injurious to the national rail system in EP 711. It also stated that if, however, the STB determined to proceed with proposing some sort of mandatory reciprocal switching, Small Railroads should in fact be exempted from the rule. It remains the position of ASLRRA that the proposed rule should not be adopted but if the STB determines to proceed with a new rule on mandatory switching, the Small Railroads must be exempted with specific, enforceable language.

Executive Summary

ASLRRA vigorously opposes the imposition of a rule mandating reciprocal switching as it would be extremely injurious to the national rail system. If, however, the Board determines to impose this force access rule, it must completely exempt short lines from the rule. The adverse effects of imposing the rule on Small Railroads would be a devastating financial blow to them and could force some out of business, which would be harmful not only to them but to the customers they serve.

Background

On June 22 and 23, 2011, the STB held a hearing in Ex Parte 705, to consider the state of competition in the railroad industry and what steps, if any, it should take to increase rail-to-rail competition. The ASLRRA submitted testimony at the hearing. Not content to await a decision by the STB in Ex Parte 705, on July 7, 2011, NITL submitted a proposal to modify the Board's standards for mandatory competitive switching and requested the Board to institute a

rulemaking proceeding.

NITL proposed that the Board change from a competitive-abuse standard regarding competitive switching toward what it described as a "market-power" standard. The proposal stated that competitive switching by a Class I rail carrier would be mandatory if four conditions were met:

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

NITL stated that its proposal would not apply to Class II and III carriers and proposed that the STB conclusively find that a shipper lacks effective intermodal or intramodal competition where the rate for the movement for which switching is sought has a revenue-to-variable cost ratio of 240% or more. It also proposed a shipper would be conclusively presumed to lack effective intermodal and intramodal competition where the Class I carrier serving the shipper's facilities for which switching is sought has handled 75% or more of the transported volumes of the movements at issue for the twelve-month period prior to the petition requesting that the Board order switching.

NITL further proposed that the Board establish two conclusive presumptions to determine whether a workable interchange exists within a reasonable distance of a shipper's facility. First, that a workable interchange exists where a shipper's facilities are within the geographic boundaries of a terminal established by a Class I rail carrier (incumbent carrier) serving the shipper, and cars are regularly switched between the incumbent carrier and the carrier for which competitive switching is sought. Second that a reasonable distance between a shipper's facilities and the interchange at issue is 30 miles, provided that the interchange is one where cars are regularly switched between the incumbent carrier and the carrier for which switching is sought.

Proceedings in Sub-No 711

On July 25, 2012, the STB, without instituting a rulemaking proceeding, sought comments and further study about a number of issues with the proposal filed by NITL. Comments and replies were filed by the various parties, including ASLRRA. In addition, the STB received oral testimony in a hearing held on March 25 and 26, 2014.

A number of shippers submitted testimony and comments supporting the NITL's proposal. Most argued that the STB should revise its reciprocal switching regulations in order to make the remedy move widely available to shippers, to introduce more competition into the rail marketplace, to adopt the Canadian interswitching regime, and to improve rail service without undermining the rail network efficiency.

The railroads opposed the NITL petition, stating that the record in EP 705 did not demonstrate that changes to the Board's competitive access regulations are needed or justified. The railroads said that the shippers were more concerned about rates than access to additional carriers, that NITL's proposal amounted to a scheme of access on demand for many shippers served by a single railroad. NITL's proposal would replace the existing conduct-based standards for competitive access with a scheme based on conclusive presumptions of market power that have nothing to do with market power and are readily subject to manipulation. NITL's proposal was incomplete because it did not include a proposal on access pricing, and likewise failed to address the impact on investment in the rail network from loss of revenue caused by mandatory access.

ASLRRA argued that while the NITL petition expressly exempted Class II and III railroads, the petition is vague and ambiguous and needed to be clarified and strengthened. It said that if the STB determined to adopt the rule proposed by NITL, it should expressly limit the application of the rule to situations in which no Class II or III railroad participates at any point in the movement of the traffic whether or not the Small Railroad appears on the waybill.

The parties argued extensively about the need to revisit the STB's interpretation of §11102(c) to remove the requirement of a showing of anticompetitive conduct by a railroad in order for a shipper to obtain reciprocal switching. The shippers basically argued that requiring a showing of anticompetitive conduct resulted as a bar to relief.

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

In a decision served July 27, 2016, the Board granted NITL's petition in part to adopt revised reciprocal switching regulations. The Board proposed changes to the regulation that would allow a party to seek a reciprocal switching prescription that is either practicable and in the public interest or necessary to provide competitive rail service.

The STB determined that its interpretation of §11102, including its anticompetitive

conduct requirement may no longer be appropriate. It recognized that it has the authority to revise the reciprocal switching regulations, it had to balance the competing policy considerations in proposing new regulations. It then undertook to do so in the decision.

The Board said it had reviewed NITL's proposal and deemed it a valuable starting point but that it did not strike an appropriate policy balance. It stated that NITL's approach would lead to problems regarding fairness among different categories of shippers because of its reliance on conclusive presumptions. Rather, said the STB, it preferred a process that allowed it to examine reciprocal switching on a case-by-case basis.

After reviewing the legislative history of §11102(c), the various rail transportation policy factors, court decisions, and STB precedent, the Board said the law clearly intended to empower it to encourage the availability of reciprocal switching when appropriate. The Board said the two statutory prongs on which it could rely in ordering mandatory reciprocal switching were where reciprocal switching is practicable and in the public interest or where switching is necessary to provide competitive rail service. Based on this review, the Board determined to revise its rules on when it would order forced reciprocal switching.

What the Proposed Rule Changes and Proposes

The STB granted NITL's petition in part but rejected its approach of using presumptions to impose reciprocal switching and instead said it would look at each petition for such switching on a case by case basis. Currently, while the governing statute give the Board the authority to impose reciprocal switching on a carrier, the shipper seeking the imposition must show that imposition is necessary to remedy or prevent an act that is contrary to the rail transportation policy about competitive policies in 49 USC 10101 or is otherwise anticompetitive.

In this decision, the STB proposes to eliminate the burden on shippers to show a carrier has acted in an anticompetitive manner. The Board says that while the competitive abuse standard was appropriate 30 years ago, changes in the rail industry mandate it be discontinued as a standard. In place of that standard, it proposes to establish a new rule pursuant to which it will look at each petition for reciprocal switching on a case-by-case approach in order to make the remedy more equally available to all shippers.

The Board said the statute allows it to mandate reciprocal switching where (1) it is practicable and in the public interest or (2) where it is necessary to provide competitive rail

service. In either case, the STB has to weigh and balance the various rail transportation policy factors in the §10101 – and it listed a few of the 15 factors in the decision.

Regarding the first prong, the proposed rule would require a shipper to show:

- (1) that the shipper's or receiver's facilities are served by a Class I;
- (2) that there is or can be a wording interchange between the serving Class I and another Class I within a reasonable distance of the shipper/receiver facilities;
- (3) that the potential benefit of from the proposed switching arrangement outweigh the potential detriments – including the operational feasibility and safety and potentially other detrimental effects on the Class I.

Regarding the second prong, the proposed rule requires a shipper to show:

- (1) that the shipper's or receiver's facilities are served by a single Class I;
- (2) intermodal or intramodal competition is not effective; and
- (3) that there is or can be a wording interchange between the serving Class I and another Class I within a reasonable distance of the shipper/receiver facilities

Under either prong, a railroad can offer affirmative defenses showing the proposed reciprocal switch is unsafe, not feasible or that it would hamper the ability of the carrier to serve its shippers.

The Problems and Infirmities of the Proposed Rules

Generally, a myriad of problems with the proposed rules are immediately apparent. First, the STB does not adequately explain why it has determined to do away with the long held precedent of requiring a showing of anticompetitive conduct by a railroad. It simply states in conclusory fashion without any substantive evidence in the record, that times have changed, that the anticompetitive conduct standard is too high a bar for shippers. That is not a sufficient finding to warrant such a wholesale change in regulatory policy.

Second, the Board did not give any real specifics regarding what it believes the parties should submit under either prong. Without even minimal guidance parties would spend endless time and boundless money and resources trying to litigate a proceeding brought by a shipper under these rules. Instead, the Board refers the parties to the current petition for exemption process as instructive – a process that carriers and shippers alike are not pleased with in yet another proceeding before the Board. Regarding the second prong, the only real guidance given is that if a railroad shows that the proposed switching is not feasible or is unsafe or that the presence of

such switching will unduly hamper the ability of the carrier to serve its shippers, then the STB will presumably not mandate the reciprocal switch. That guidance is too vague and amorphous.

Among the other problems with the proposed rule are:

- The Board does not define a “reasonable distance” or “working interchange” but rather invites the parties to comment on those two items.
- A shipper has to show that intermodal and intramodal competition is not effective. To show that, the proposed rules states that the parties will use the market dominance test it has adopted in rate reasonableness cases. Market dominance cases have proven to be long-drawn out, expensive cases.
- The proposed rule does not state what access rate would be imposed but rather asks the parties to comment on two possible approaches – the factors used in determining the level of absorption of switching charges the STB has historically used or a variant of what is used in establishing trackage rights fees.
- There is no proposed time limit for how long a mandated reciprocal switch would remain in place.

Adverse Effects on Small Railroads

Specifically, as this decision relates to Small Railroads, the STB says that while the proposed rules address only Class I railroads and thereby presumably exempt Small Railroads, there is little information in the record on the potential effects that would result to Class II and III railroads if they were made subject to the reciprocal switching prescriptions. That statement totally ignores two very significant facts. First, the NITL proposal specifically exempts Small Railroads and second, the evidence of record in Ex Parte 705, 711, and 711 (Sub-No1) contains substantial evidence and information about the adverse effect to Small Railroads if they are not exempt from these rules.

ASLRRRA submitted Comments and testimony in Ex Parte 705 that specifically addresses the differences between Small Railroads and Class I railroads and why imposition of forced access on the Small Railroads would have disastrous adverse effects on Small Railroads. If a mandatory switching scheme is adopted it will inevitably disproportionately hurt small railroads because small railroads play such a key role in short-haul and switching operations.

Examples of the evidence presented to the STB in both Ex Parte 705 and 711 regarding how Small Railroads are different and cannot be subject to these proposed rules are the following:

- Generally, only a few customers account for the vast majority of traffic on Small Railroads. Typically, three customers account for two-thirds of the rail traffic shipped on each Small Railroad. Loss of all or a portion of the revenues from any one of those shippers would have a dramatic adverse effect on the financial viability of a Small Railroad in view of the high infrastructure and fixed costs

that must be supported by those revenues.

- Unlike Class I railroads, the costs of Small Railroads cannot be spread over a vast rail system or large customer base. All of the freight revenues generated by customers on a line of a Small Railroad are vitally necessary to sustain the financial viability of that line.
- Small railroads handle single car traffic in large measure that is subject to severe competition from trucks and barges.
- While a Class I carrier will absorb a token reduction in overall revenues that generally compensate the Class I for long haul moves as a result of re-regulation of switch charges, it is a far different matter for small railroads. The median length of haul for Class III railroads is only 15 miles and switching operations represent almost all Small Railroad revenues if switching is defined as movements of less than 30 miles, as proposed in the NITL petition.
- Up to 90% of small railroad traffic is subject to competition from trucks or barges, the presence of the small railroad is strong evidence that competition to the interchange already exists. Thus, limiting the application of the rule to movements where no Class II or Class III participates should not have any adverse implications for shippers.
- None of the analyses submitted by advocates of the proposal could identify shipments involving small railroads at the origin or destination that are not shown on the waybill. Thus, the small railroads' role in those movements is likely much greater than realized. In the ASLRRA study conducted for EP 705, 40% or more of the carloads in many commodity classifications were handled by small railroads at either origin or destination.
- When a Small Railroad is merely providing contractual switching services to a Class I carrier as its "first mile/last mile" switch carrier, if the Class I is either (a) required to provide another Class I carrier access or (b) reduces its switching charge to meet the requirements of a mandated switching rule as a practical matter the Class I carrier will pressure the small railroad to renegotiate its contract to a lower rate reflecting the regulatory limitation applicable to the Class I carrier.
- In practice, simple market dynamics will eventually drive the price paid to the small railroad providing the actual terminal delivery or originating the rail shipment to the government mandated rate. It will be impossible to insulate the small railroad from the pressure to reduce switching rates to the level of a government-mandated access fee.
- The uncertainty that a future Board may have less concern or understanding for the role of Small Railroads will make it more difficult immediately for current small railroads to obtain capital to build and maintain their systems at a

reasonable price as the market quickly marks down their future cash flows to account for that uncertainty.

- While reciprocal switching agreements between or among Class I carriers may provide a private way of achieving the same offsetting savings in any given location, small railroads have virtually no bargaining opportunity to enter into reciprocal switching agreements, since they typically operate at only one or two local interchange locations. The ability of the small railroads to maximize revenues from their single, limited operating territories is critical to their viability.
- A single fee schedule imposed upon small railroads would be an insurmountable calamity for most small carriers. It would inevitably be much lower than the revenue generated now and there would be no place to find an offsetting increase in revenue or a matching reciprocal arrangement.
- In fact, any notion that revenue over variable cost might be appropriate for limiting the price of a movement between a customer facility and an interchange point would be extremely harmful to small railroads. First, URCS costs are based on Class I operations and have no relevance to Small Railroad costs. Second, the nature of terminal operations equates to high fixed costs. A regulatory limit based on any kind of variable-cost analysis would deprive small railroads of any recovery of the real cost driver for terminal or switching movements. In fact, the pricing model for most Small Railroads is completely different than for Class I railroads whose rates are based in part on length of haul. Most small railroad rates are not. The issue of "cost variability" is completely different for Class I carriers and Small Railroads.
- Class I railroads have been able to reduce the overall fixed costs associated with terminals and interchanges by closing many of them, thus achieving great efficiencies by increasing the percentage of traffic moving in streamlined single line service. Because small railroad operations consist almost solely of those switching movements the Class I railroads have so effectively reduced or reassigned, there is no opportunity for their successors to wring out any savings. In the face of limits tied to the revenue-over-variable-cost formula, small railroads would have no option to adjust. Under this scenario, many small railroads would likely close if forced to cut their switch charges below current market rates, since there is not corresponding opportunity to cut costs or increase revenues elsewhere.
- The potential loss of railroad revenue would be small in the low single digits as a percent of overall carrier revenues. The problem for small railroads is that a significant revenue reduction from even one large customer has an outsized impact, since two or three customers typically generate the majority of a Small Railroad's revenues. To dismiss those

concerns by nominally exempting the small railroads from the requirements of the NITL Petition may be facile, but it is also false.

See, ASLRRRA Comments and Testimony in Ex Parte 705 and 711. That evidence shows in great detail the differences and the adverse effects that would arise if Small Railroads are not exempted from these rules.

In Ex Parte 705 and 711, ASLRRRA provided examples of why Small Railroads should be exempted. One example of how small railroads would be adversely effected by mandatory switching rules involves movements in which the small railroad is not shown on the waybill, but still sets its own pricing for the final few miles of transportation to and from the customer. In this circumstance, the small railroad effectively is operating as a switch carrier. If its connecting Class I railroad must offer a competing Class I access to the small railroad (as a function of its relationship with the original Class I railroad, which must comply with the rules), it may be forced to grant access over the small railroad route. Though unintended by the currently proposed rules, the small railroad would involuntarily exchange its compensatory short haul rate for a modest government-imposed access fee that would impact the overall viability of the small railroad.

Another example provided involved a small railroad merely providing contractual switching services to a Class I carrier as its “first mile/last mile” switch carrier. If the Class I is either (a) required to provide another Class I carrier access or (b) reduces its switching charge to meet the requirements of a mandated switching rule, as a practical matter the Class I carrier will pressure the Small Railroad to renegotiate its contract to a lower rate reflecting the regulatory limitation applicable to the Class I carrier.

The Exemption Must be Clarified and Enforceable

A premise of the NITL petition for government-mandated inter-carrier access is that 550- odd small Class II and Class III railroads shall be exempt from its provisions. Despite the presumed intent to exclude Class II and Class III railroads, the NITL petition is ambiguous as written and needs to be clarified the avoid decimating the small railroad industry. The STB should expressly limit the application to situations in which no Class II or Class III railroad participates at any point in the movement of the traffic regardless of whether the Small Railroad appears on the waybill.

Further, the experience and the Comments of the various interested parties in this

proceeding reveal additional issues with the NITL petition for the small railroads. The distinctive characteristics of countless railroad interchange and switching operations guarantee that a rigid set of government regulations imposed upon some participants will inevitably generate unintended and unforeseeable consequences for all, but particularly for the small railroads. When and if a mandatory switching scheme is adopted, it will inevitably disproportionately hurt small railroads, regardless of an exemption in a rulemaking petition, because small railroads play such a key role in short-haul and switching operations. As a practical matter, it is impossible for small railroads to remain exempt when they are such ubiquitous and active participants in the activity to be otherwise regulated. As described below, they will be regulated by default to the detriment of the industry.

As a threshold matter, absent the addition of clarifying language described above to the NITL petition, one likely example of how small railroads would be drawn inadvertently into any mandatory switching rules involves movements in which the small railroad is not shown on the waybill, but still sets its own pricing for the final few miles of transportation to and from the customer. In this circumstance, the small railroad effectively is operating as a switch carrier. As written, if its connecting Class I railroad must offer a competing Class I access to the small railroad (as a function of its relationship with the original Class I railroad, which must comply with the rules), it may be forced to grant access over the small railroad route. Though unintended by the rules, the small railroad would involuntarily exchange its compensatory short-haul rate for a modest government-imposed access fee that would likely impact the overall viability of the small railroad.

While the NITL proposal says that Class II and Class III railroads would be exempted from its provisions, the NITL petition is ambiguous and at best, needs to be clarified to ensure that Class II and III railroads are exempted under the proposal's terms and under any future imposition of it. Specifically, if the Board decides to adopt the NITL petition, it should expressly limit the application to situations in which no Class II or Class III railroad participates at any point in the movement of the traffic whether or not the small railroad appears on the waybill.

Conclusion

ASLRRA submits that the proponents of the rule have not shown any cogent reasons to change a system that works well for railroads and shippers. The proposal would result in costly

and lengthy litigation before the Board, and would be injurious to the national rail system. If, however, the Board determines to impose this force access rule, it must completely exempt short lines from the rule. The adverse effects of imposing the rule on Small Railroads would be a devastating financial blow to them and could force some out of business, which would be harmful not only to them but to the customers they serve.

Respectfully Submitted,

A handwritten signature in cursive script that reads "Linda Bauer Darr". The signature is written in black ink and is positioned above the typed name.

Linda Bauer Darr
President
American Short Line and Regional Railroad Association