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October 26, 2016

**241888**

Ms. Cynthia Brown  
Chief, Section of Administration  
Office of Proceedings  
Surface Transportation Board  
395 E Street, SW  
Washington, DC 20423-0001

**ENTERED  
Office of Proceedings  
October 26, 2016  
Part of  
Public Record**

**Re: STB Ex Parte No. 711 (Sub-No. 1), Reciprocal Switching**

Dear Ms. Brown:

Enclosed for electronic filing in the above-referenced proceeding are the Opening Comments of BNSF Railway Company. Thank you for your attention to this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "AW", written over a set of horizontal lines.

Adam Weiskittel

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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

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**RECIPROCAL SWITCHING**

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**OPENING COMMENTS OF  
BNSF RAILWAY COMPANY**

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Dated: October 26, 2016

*Attorneys for BNSF Railway Company*

In its July 25, 2016 decision (“Decision”), as modified by a decision issued September 1, 2016, the Surface Transportation Board (“Board” or “STB”) asked interested parties to submit comments on a proposed change to existing reciprocal switching rules. BNSF Railway Company (“BNSF”) respectfully submits these Opening Comments regarding the Board’s proposed rule change. BNSF also joins in and supports the comments filed by the Association of American Railroads in this proceeding.

BNSF believes that the Board must allow market forces to govern the commercial relationships between railroads and their shippers, and must not create standards that allow unnecessary Board intervention in properly functioning markets. While important details of the Board’s proposed new rules are not yet clear, the new standards set forth in the Board’s Decision would appear to allow shippers to seek a reciprocal switching order even when markets are functioning properly. Congress did not intend for the Board to intervene in those situations without a compelling reason to do so, and the Board’s proposed rules do not reflect this strong congressional policy.

BNSF also provides its views on a few of the implementation issues raised by the Board. First, any switching order should include a time limit on relief. The shipper obtaining the switching order, not the railroad subject to it, should be required to show that continuation of the remedy is justified beyond the prescribed time period. Second, the Board should make it clear that shippers obtaining access to a new rail carrier through reciprocal switching would not be allowed to bring a rate reasonableness challenge to the rates for the transportation at issue. Once the Board has intervened in the market to create artificial competition through a switching order, there is no longer any justification for allowing a shipper to also challenge the rates charged for the transportation at issue.

Finally, the Board must consider its proposed change to the reciprocal switching rules in the context of the various other regulatory proposals that the Board is evaluating and the cumulative impact of these proposals. The Board is currently considering, among others, changes to existing regulation that would expand regulatory authority over previously exempt transportation, expand rate regulation through new small case rules, and create an aggressive new rate regulation framework for supposedly revenue adequate rail carriers. Taken together, these regulatory initiatives create substantial uncertainty and disincentives that will adversely affect railroads' ability to make the investments necessary to both address the major changes that are currently occurring in the rail transportation market, and enable the industry to handle future demand growth.

**I. The Board's Proposal Would Impermissibly Allow Regulatory Intervention In Properly Functioning Markets.**

The Rail Transportation Policy ("RTP") directs the STB to "minimize the need for Federal regulatory control over the rail transportation system" and "allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail." 49 U.S.C. § 10101(1)-(2). These congressional mandates require that Board action be limited to instances where it is necessary to protect shippers from competitive harm. As currently proposed, the Board's proposed switching rules are inconsistent with these mandates because they would allow the Board to interfere with the commercial relationships between railroads and shippers without any showing by the complaining shipper that there is a compelling need for regulatory intervention. This problem exists with respect to both prongs of the Board's proposed rules.

**Prong 1**

Prong 1 of the proposed rules—the "practicable and in the public interest" prong—lacks any defined standards to ensure that switching is ordered only when consistent with the de-

regulatory principles set forth above. The Board lists a number of factors that it will consider in addressing a request for mandated reciprocal switching, but none of the factors involve evaluation of the market dynamics or competitive situation facing the parties involved. To obtain access under Prong 1, a shipper would have to show only that its facility is served by one or more Class 1 carriers, there is or can be a working interchange between the serving carrier(s) and another Class 1 carrier, and the potential benefits from the proposed switching outweigh the potential detriments. The Board says that in performing the benefit-detriment analysis, it will consider several factors including efficient routing, possible access to new markets, and the impacts on capital investment, service quality, and employees. But none of these factors speak to the relevant market conditions impacting the railroad's service for that customer or answer whether there is a compelling need for Board intervention.<sup>1</sup> Prong 1 instead solely addresses operational practicality and possible damage to rail efficiency.

Under Prong 1, shippers may seek a reciprocal switching order even if they already have access to alternative transportation suppliers, their rates are reasonable, and they have adequate service. As a result, the potential scope of Prong 1 is extremely broad and the relief provided under Prong 1 could have nothing to do with market conditions. Vice Chairman Miller suggests that there would be little reason for a shipper to seek a reciprocal switching remedy if "a carrier meets the needs of its customers." Decision at 33. But if the Board's rules do not require a shipper to show a compelling need, shippers could use the new remedy to seek lower rates or advantages over their competitors even where market factors say their needs are already being met.

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<sup>1</sup> The Board does include a passing, non-substantive reference to "RTP factors" on the laundry list of factors to be considered in its benefit-detriment analysis. Decision at 18. But this "check the box" reference to the RTP provides no assurance that the Board would show restraint in ordering remedies under Prong 1 consistent with Congress's de-regulatory mandate.

## **Prong 2**

The Board's second proposed pathway to switching—the Necessary to Provide Competitive Rail Service prong ("Prong 2")—conceivably purports to address the competitive situation on the ground by limiting relief to movements where the rail carrier has market dominance, but ultimately Prong 2 suffers from the same defect that it would permit Board intervention into properly functioning markets. Under Prong 2, a shipper may obtain access to switching if it is served by a single Class 1 rail carrier, the shipper can prove that the incumbent carrier possesses market dominance, and there is or can be a working interchange within a reasonable distance. But neither the shipper's status of being served by only one Class 1 carrier nor the existence of a working interchange within a reasonable distance—the two basic requirements under Prong 2—speak to whether the market for transportation of that shipper's traffic is functioning properly.

A critical flaw in Prong 2 is the apparent assumption by the Board that the existence of market dominance alone, as defined and determined by the Board, is evidence that Board intervention is necessary. Market dominance is a threshold for determining if there might be a problem with the proper functioning of a market, not evidence that such a problem does indeed exist. When considering market dominance in rate reasonableness cases, Congress has made explicit that "a finding of market dominance does not establish a presumption that the proposed rate exceeds a reasonable maximum." 49 U.S.C. § 10707(c) & (d)(2). If the existence of market dominance alone cannot lawfully be presumed to indicate the unreasonableness of a rate, it makes no sense to assume that the existence of market dominance alone should nevertheless be a proxy for a compelling need for Board intervention or a demonstration that reciprocal switching is necessary to provide "competitive rail service."

The use of market dominance in this conclusive way is especially inappropriate considering that the possible consequences for the incumbent railroad of forced switching are potentially more significant than a rate reduction. In rate cases, after showing the existence of market dominance, a shipper must still show that the challenged rates are unreasonable. If the rates are unreasonable, the carrier is then required to reduce the rates charged to that particular shipper to reasonable levels. But under Prong 2 of the proposed rules, a reciprocal switch can essentially be ordered based on nothing more than the existence of market dominance. And when switching is ordered, all of the traffic at issue may be lost to a competitor. Moreover, the effect of a forced switching order is that the competitor will be allowed to use the incumbent's stranded investments that made it possible for the incumbent to access the shipper in the first place.

Prong 2 is also particularly untethered to market realities because of how the Board proposes to implement its market dominance inquiry. The Board proposes to expressly disavow any consideration of product or geographic competition. Whether in the context of a rate reasonableness inquiry or a request for reciprocal switching, BNSF strongly disagrees with that approach because it flatly ignores the complex market forces that have a real and substantial impact on BNSF's rates and service. One need look no further than the impact that low natural gas prices have had on coal rates to understand that a shipper's access to another railroad or to an alternative transportation mode may not indicate in the least whether massive competitive pressure is being placed on railroad pricing and service offerings.<sup>2</sup> Another example of the impact of product and

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<sup>2</sup> The AAR explained in detail in a recent proceeding that, because of low natural gas prices, many coal plants are now the marginal producers that provide power only if the delivered cost of coal is sufficiently low to compete with gas-fired generation plants. If a railroad increases coal transportation rates to a given solely served plant, that plant may no longer be cost-competitive. The shipper's demand for coal and for coal transportation will drop. The railroad obviously has no incentive to price itself out of the coal transportation business, and must carefully account for the competitive pressure from gas-fired plants that compete with its coal shipper. Petition of the Association of American Railroads to Institute a Rulemaking Proceeding to Reintroduce Indirect Competition As a Factor Considered in Market Dominance

geographic competition on rail rates and service can be found in BNSF's Agricultural Products franchise, where BNSF's market power is effectively constrained by complex and ever changing dynamics of domestic and foreign commodities markets.<sup>3</sup> Even if a shipper does not have access to another railroad or alternative transportation mode, the market can nevertheless exert massive competitive pressure on railroad pricing and service.

An additional problem is that the Board proposes to use its "existing market dominance test to determine the intramodal/intermodal competition element under the competition prong." Decision at 23. Presumably this incorporates the Board's Limit Price Test.<sup>4</sup> Shippers and railroads alike have condemned the Limit Price Test as logically and economically unsound in the rate reasonableness context.<sup>5</sup> There is nothing about applying the Limit Price Test in the reciprocal switching context that would cure any of its flaws.

The primary flaw of the Limit Price Test is that it determines market dominance while ignoring the prevailing market conditions for the traffic at issue. Under the Limit Price Test, the Board ignores the price actually charged by the railroad, focuses on the relationship between the

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Determinations for Coal Transported to Utility Generation Facilities, STB Ex Parte No. 717, at 14-15, 17-22 (filed Nov. 19, 2012).

<sup>3</sup> Comments of BNSF Railway Company, *Rail Transportation of Grain, Rate Regulation Review*, STB Docket No. EP 665 (Sub-No. 1), Verified Statement of John H. Miller, at 8-14 (June 26, 2014).

<sup>4</sup> See *Total Petrochemicals & Refining USA, Inc. v. CSX Transportation, Inc.*, STB Docket No. 42121, slip op. at 4-5 (served May 31, 2013); *M&G Polymers USA, LLC v. CSX Transportation, Inc.*, STB Docket No. 42123, slip op. at 12-18 (served Sept. 27, 2012).

<sup>5</sup> See, e.g., Reply Evidence of CSX Transportation, Inc., *Total Petrochemicals & Refining USA, Inc. v. CSX Transportation, Inc.*, STB Docket No. 42121, at II-B-51 to 76 (filed Mar. 7, 2016); Comments of BNSF Railway Co., *M&G Polymers USA, LLC v. CSX Transportation, Inc.*, STB Docket No. 42123, at 1-4 (filed Nov. 28, 2012); CSX Transportation, Inc.'s Comments on the Proposed "Limit Price" Approach to Determining Qualitative Market Dominance, *M&G Polymers USA, LLC v. CSX Transportation, Inc.*, STB Docket No. 42123, at 21-29 (filed Nov. 28, 2012); Comments of *Amicus Curiae* Western Coal Traffic League, *M&G Polymers USA, LLC v. CSX Transportation, Inc.*, STB Docket No. 42123, at 6-7 (filed Nov. 28, 2012); Comments of the Association of American Railroads, *M&G Polymers USA, LLC v. CSX Transportation, Inc.*, STB Docket No. 42123, at 8-14 (filed Nov. 28, 2012).

price of an alternative transportation option and the railroad's variable costs, and ultimately compares that "Limit Price R/VC" to the carrier's Revenue Shortfall Allocation Method ("RSAM") figure. But the Limit Price R/VC is a cost-based regulatory construct bearing no practical relationship to the market dynamics impacting the relevant shipper and railroad. Similarly, RSAM, which is the average markup a railroad would need to charge its traffic with R/VC ratios greater than 180% in order to achieve Revenue Adequacy (as defined by the Board) on a company wide basis, contains no information on the market conditions actually faced by the railroad and the individual shipper seeking to demonstrate market dominance. As CSX witnesses Messrs. Eakin and Meitzen explained in the *M&G Polymers* case:

[T]he RSAM measure does not include any information from the particular market under analysis. Nor does the RSAM measure contain any information about the railroad's aggregate demand. The information contained in RSAM is disconnected from any specific market and void of any demand content, and therefore has no bearing as to whether a rail price in a specific "captive market" is effectively constrained by competition.<sup>6</sup>

Prong 2 thus will conceivably provide shippers an access remedy just because they can show market dominance under a flawed and inadequate standard that was never intended to be used to determine whether a market was functioning properly or there is a compelling need for Board intervention. While BNSF believes that incorporating RSAM into the rate reasonableness context is inappropriate, its impact there is at least more indirect because a complaining shipper must still demonstrate the unreasonableness of the challenged rate. But, as described above, under the Board's proposed Prong 2, a finding of market dominance in and of itself might trigger the

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<sup>6</sup> CSX Transportation, Inc.'s Comments on the Proposed "Limit Price" Approach to Determining Qualitative Market Dominance, *M&G Polymers USA, LLC v. CSX Transportation, Inc.*, STB Docket No. 42123, Joint Verified Statement of B. Kelly Eakin and Mark E. Meitzen, at 6 (filed Nov. 28, 2012).

grant of a switching remedy. Shifting RSAM into this more prominent and outcome-determinative position undermines the validity of the Board's approach.

BNSF believes that the de-regulatory congressional directives contained in the Rail Transportation Policy are not reflected in the revised reciprocal switching rules as currently proposed by the Board. Any revised reciprocal switching rules must make clear that switching will not be ordered in situations where markets are functioning properly and not unless the complaining shipper can demonstrate a compelling need.

## **II. Any Switching Prescription Should Have A Defined Term.**

The Board proposes that a reciprocal switching prescription would last "for as long as the criteria for each prong are met...with the parties free to petition the Board for reopening if there are substantially changed circumstances." Decision at note 21. This proposal would unfairly shift onto the incumbent railroad the burden of instituting a Board proceeding and proving "changed circumstances" to justify rescission of the switching order and gain back the exclusive use of its own facilities. This would be particularly burdensome because the incumbent carrier would have little access to marketplace information possibly needed to prove "changed circumstances" once the customer has entered into a confidential commercial relationship with its new carrier.

Under the Board's proposed rules, a reciprocal switching order could effectively become permanent relief for a shipper. As discussed above, the central flaw in the Board's proposed rules is that they enable Board intervention in properly functioning markets. The result is that a shipper could obtain relief simply because the shipper sees a competitive advantage in switching or seeks lower rates. But if there is no required showing of a compelling need to obtain relief in the first place, it would be difficult, if not impossible, for a railroad to later establish that circumstances have changed such that the switching order should be removed.

The Board should define a reasonable time period for the effectiveness of a switching order, after which the shipper, not the incumbent railroad, should have the burden to demonstrate that switching remains appropriate.

### **III. A Shipper Should Not Be Permitted To Pursue Both Access And Rate Remedies.**

The Board's 2012 Notice initiating Ex Parte No. 711 acknowledged that the National Industrial Transportation League's ("NITL") objective in seeking a change in reciprocal switching rules was to produce lower rates through the competition introduced by switch access. As the Board noted, a change in reciprocal switching rules "could permit the agency to rely on competitive market forces to discipline railroad pricing from origin to destination, and regulate only the access price for the first (or last) 30 miles."<sup>7</sup> Indeed, NITL and the shippers supporting the NITL proposal in EP 711 presented no evidence of benefits to be expected from a change in reciprocal switching rules *other than* reduced rates. Shippers clearly see a more widely available reciprocal switching remedy to be an alternative to achieving rate relief under existing procedures that some shippers believe are either too complicated or insufficiently favorable to the shippers.

But the shippers supporting new reciprocal switching rules cannot have it both ways. A shipper who obtains a competitive access remedy with the intent of securing a lower rate should not later be able to pursue rate reasonableness relief against its serving carrier(s). Once the Board has issued a switching prescription, there can be no further justification for the Board's intervention in that market situation through a rate reasonableness review. Congress clearly sought to minimize regulatory intervention, not to give the Board multiple and overlapping tools to interfere with market forces.

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<sup>7</sup> *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, STB Ex Parte No. 711 (Notice Served July 25, 2012, at 2).

In its Decision, the Board suggests that it would allow shippers that are the beneficiaries of a reciprocal switching order to also pursue a rate reasonableness case by expressly declining to include a provision stating that the existence of a reciprocal switching order would preclude a finding of market dominance. Instead, the Board said a switching order would just be one consideration in determining whether multi-carrier service “effectively constrains” the incumbent railroad’s pricing under its market dominance analysis, citing the case in which the Board adopted the “Limit Price” test. Decision at 23.

For the reasons stated above, BNSF believes the Limit Price Test is flawed and inappropriate for use in judging either rate reasonableness or requests for reciprocal switching. As such, to employ the Limit Price Test successively in both proceedings would exponentially increase the harm flowing from those flaws. If the Board does permit a shipper to bring a rate reasonableness challenge after already having obtained a switching order, BNSF believes that shipper should not be permitted to use the flawed Limit Price approach but instead must satisfy a traditional qualitative market dominance test. In addition, if the Board were to allow rate reasonableness challenges in cases involving reciprocal switching orders, the Board should, at a minimum, preclude that shipper from pursuing rate relief for some reasonable period of time after entry of the switching prescription so that the parties and the Board can fully assess the true impact of that switching prescription on the shippers and railroads involved.

#### **IV. The Board’s Notice Fails To Consider The Cumulative Impact That This Proposal And Other Recent Board Proposals Will Have On Railroad Investment.**

This proceeding is one of several current proceedings in which the Board is considering expanding its regulatory footprint without any directive or authorization from Congress. The Board is simultaneously considering, among others, draft rules and shipper proposals that would make reciprocal switching more readily available (Ex Parte 711-1), impose new rate constraints

based on a railroad's overall revenue adequacy status (Ex Parte 722), expand shipper access to rate cases (Ex Parte 665-2), and increase the realm of traffic that would be subject to this revamped and expanded regulatory framework (Ex Parte 704). The Board is thus proposing to expand the available regulatory tools and at the same time expand the number of shippers that can use those tools, including shippers that operate in properly functioning markets with no apparent need for regulatory intervention. The cumulative effect of this new regulatory agenda could have a serious impact on railroads' ability to make infrastructure and other investments, their incentives to make such investments, and their ability to properly direct investment to areas where the market forces would otherwise justify them.

Comments by individual shippers and shipper trade associations in the above-referenced proceedings make clear that their primary goal is to achieve lower rates, whether in the form of rate caps for revenue adequate carriers, rate cases that are easier to win, or the injection of artificial competition via reciprocal switching.<sup>8</sup> The inevitable result of that goal, however, will be that railroads will earn less revenue, and thus have less ability to make new investments. In evaluating

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<sup>8</sup> See, e.g., Joint Opening Comments of the Western Coal Traffic League Consumers Energy Co. and South Mississippi Elec. Power Assoc., *Railroad Revenue Adequacy*, STB Docket No. EP 722, at 27-33 (filed Sept. 5, 2014) (proposing that the Board prohibit revenue adequate rail carriers from increasing rates on captive shippers); Opening Comments of Alliance for Rail Competition, *Rail Transportation of Grain, Rate Regulation Review*, STB Docket No. EP 665 (Sub-No. 1), at 11-20 (filed June 26, 2014) (proposing that any new rate relief procedures or methodologies permit "[r]ate reductions, and not just limits on future rate increases"); Reply Comments of Olin Corp., *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, STB Docket No. EP 711, at 3 (filed May 30, 2013) (asserting, in support of the Board's proposed competitive switching rules, that "[i]t is now past time for the Board to provide shippers with actual relief from unreasonable rates" and that the Board's proposed competitive switching rules are justified "because shippers are not being charged reasonable rates"); Comments of Texas Crushed Stone Company, *Review of Commodity, Boxcar/ And TOFC/COFC Exemptions*, STB Docket No. EP 704 (Sub-No. 1), Highroad Consulting Report at 7 (filed July 27, 2016) (citing "triple-digit rate increases" on shippers of crushed stone as justification for the revocation of the exemption on STCC 142).

those investments that are still possible, railroads would then face greatly increased regulatory uncertainty, making it difficult to establish an effective investment strategy to deal with changing market conditions. In addition to creating uncertainty, expanding Board intervention into areas where markets are functioning properly (as the Board's proposed reciprocal switching rules would do) will limit a railroad's ability to earn the returns on investments that market forces would otherwise permit and, as a result, create artificial disincentives to railroads investing in those markets. And to the extent Board rules incorporate cost-based metrics (such as revenue-to-variable cost ratios or RSAM), they layer on perverse disincentives against railroads investing to innovate and become more cost-efficient. The cumulative impact of this expanded regulatory approach would thus ultimately have a negative impact on BNSF's customers in the form of reduced capacity and service degradation.

As set forth in the RTP, the Board is required to facilitate rail investment by helping carriers earn revenues adequate to promote the development of a safe and efficient rail network that will meet the needs of the public. 49 U.S.C. §10101. Congress re-affirmed this critical policy directive last year by directing the Board to assist carriers in attaining revenue levels that are adequate "for the infrastructure and investment needed to meet the present and future demand for rail services[.]" 49 U.S.C. § 10704(a)(2). The STB cannot satisfy these Congressional mandates without fully considering the cumulative impact that its various proposals, including its competitive switching proposal, will have on the ability of railroads to make the investments needed for future growth.

**V. Conclusion.**

In its Decision, the Board recognizes that it must “strike the appropriate policy balance” between the needs of shippers, railroads and the public, while operating within the confines of Congressional de-regulatory policy as embodied in the RTP. Decision at 15-17. BNSF understands that in certain situations a shipper might be able to demonstrate a compelling need that calls for Board intervention in the form of a reciprocal switching order. However, BNSF believes that, as currently proposed, the Board’s new reciprocal switching rules fail to strike the appropriate balance because they would permit Board intervention into otherwise properly functioning markets without a demonstration of shipper need. Further, any appropriate balancing of policy considerations in this proceeding cannot occur in a vacuum, but must instead consider and account for the cumulative impact that this and other proceedings currently under consideration will have on railroad investment.

Respectfully submitted,



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