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

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**DOCKET NO. EX PARTE 711**

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

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**TESTIMONY OF RICHARD F. TIMMONS**

**PRESIDENT**

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

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March 25, 2014

**BEFORE THE  
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**TESTIMONY OF RICHARD F. TIMMONS, PRESIDENT, AMERICAN SHORT LINE  
AND REGIONAL RAILROAD ASSOCIATION**

My name is Richard F. Timmons and I am the President of the American Short Line and Regional Railroad Association ("ASLRRA"). ASLRRA is a national trade organization of approximately 1,000 members consisting of 550 Class II and Class III railroads, most of which are small and locally based, as well as about 450 vendors and suppliers to the railroad industry. On behalf of our members, I thank the Surface Transportation Board ("STB" or Board") for inviting interested parties to testify at the hearing today.

**Introduction**

The ASLRRA has participated in every stage of this proceeding as well as the proceeding in Ex Parte 705 because the issues involved in both proceedings are of vital importance to Class II and III railroads ("Small Railroads"). In summary, the three major concerns of the Small Railroads are as follows:

- ASLRRA continues to oppose the National Industrial Transportation League ("NITL") proposal as being injurious to the national rail network. As explained by the Class I railroad participants in this proceeding in significant detail, the NITL proposal is likely to cause substantial issues with the fluidity and efficiency of the rail network, including Small Railroads. Class I service issues directly impact the services that Small Railroads can provide to their customers and Small Railroads have limited ability to manage their own recovery from network issues. It is ASLRRA's position that the STB should deny the relief NITL seeks in its proposal and retain its current competitive access rules codified at 49 C.F.R. § 1144.
- The imposition of the NITL proposal on Small Railroads would be harmful to them, their customers, and the communities they serve due to the fact that the Small Carriers' traffic

is particularly subject to diversion already and allowing Class I's to "cherry pick" traffic would greatly exacerbate that.

- While the NITL proposal that is the basis for this hearing provides that Small Railroads would be exempted from the provisions of any revised competitive switching rules, the proposal is ambiguous on that point and if its proposal is adopted by the STB, any such rule must specifically exempt Small Railroads from any new rules on this subject. The ASLRRRA submits that if any new competitive access rules are adopted by the STB, those rules should specifically and unequivocally exempt Small Railroads whether they are part of the routing of the traffic or not.

The balance of my testimony will address these points in more detail.

### **Background**

The Small Railroad segment of the national rail system is largely the product of deregulatory initiatives started with the Staggers Rail Act. That act allowed small, entrepreneurial companies to purchase or lease light density lines from Class I carriers, thus preserving rail operations rather than having those lines fall victim to abandonment. As of 2012, there are 560 Small Railroads operating over 43,131 miles or approximately or 38%<sup>1</sup> of the nation's rail lines. The traffic base of the Small Railroads is largely made up of general merchandise traffic highly susceptible to diversion to other modes and, if the NITL proposal is adopted, to Class I carriers.

For Small Railroads, the average route mile distance is 91 and the median route mileage is only 34.<sup>2</sup> Small Railroads provide competitive service to more than 10,000 rail dependent employers, participate in about 44% of all carload movements other than coal and intermodal<sup>3</sup>, and play a critical role in the communities those carriers serve – particularly to those in rural areas. The shippers served by Small Railroads employ on average 100 employees and nationwide more than a million people are employed at facilities served by Small Railroads.<sup>4</sup> Small Railroads employ approximately 20,000 employees, of which more than half are

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<sup>1</sup> Short Line and Regional Railroad Facts and Figures, 2014 Edition, p. 50 ("ASLRRRA 2014 Facts")

<sup>2</sup> ASLRRRA 2014 Facts, pp. 10 – 12

<sup>3</sup> ASLRRRA 2014 Facts, p. 19.

<sup>4</sup> ASLRRRA 2014 Facts, p. 23.

represented by unions.<sup>5</sup> Small Railroads transport shippers' traffic over relatively short distances to interchanges with Class I carriers – this part of the rail industry is known to provide service on the first mile and the last mile of freight movements. Their traffic densities are light and their fixed costs are high, and competition from trucks, intermodal operations, barges, and transloading operations is fierce. Moreover, relatively few customers account for the majority of traffic on the Small Railroads' lines. It is not unusual for three or four customers to account for two-thirds of a small carrier's rail traffic. Loss of all or a portion of the revenues from those moves would be devastating on Small Railroads. Permitting a Class I to take that traffic away by virtue of the imposition of the rule proposed by NITL would not only deprive the Small Railroad of its ability to survive but also harm other shippers on a line that the Class I divested in the first place because it was a money-losing proposition.

### **Background of this Proceeding**

This proceeding arose out of the hearing held by the Board in Ex Parte 705, Competition in the Railroad Industry. ASLRRRA participated in the proceeding, providing extensive testimony at the hearing and submitting supplemental information. After the record was completed in that hearing, NITL filed a petition with the Board seeking to have the Board institute a rulemaking proceeding to mandate competitive switching. Notably, NITL's petition asked that the STB limit the rule to apply only to Class I railroads.

In a decision served August 13, 2013, the STB issued a notice of public hearing in this matter. The ASLRRRA filed the required notice and summary on September 23, 2013, and appear here today to provide you with our testimony.

### **Position of the ASLRRRA in this Proceeding**

As stated in Ex Parte 705 and again in its Reply Comments in this proceeding, the ASLRRRA does not believe that changes in the current regulatory structure would serve any valid or justifiable purpose. The current standard, that in order for competitive access to be forced on a serving carrier, the party seeking the imposition of forced access must show that the serving carrier has used its market power to extract unreasonable terms or has shown a disregard for the

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<sup>5</sup> ASLRRRA 2014 Facts, p. 26.

shipper's needs by providing inadequate service. In short, the complainant has to show that the serving carrier has engaged in anticompetitive behavior.

While the NITL petition exempts Class II and Class III railroads from the provisions of the proposed rule, the NITL petition is ambiguous. If the STB adopts the proposed rule, it must specifically exempt Class II and III railroads to ensure that the Small Railroads, that have no market power in the first place, are not collaterally damaged under the proposal's terms and under any future imposition of it. For example, 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.

Absent the addition of a specific exemption described above to the proposed rule, an 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 negotiates its own pricing for the final few miles of transportation to and from the customer. As written, if the Small Railroad's connecting Class I railroad must offer a competing Class I access to a shipper, the connecting carrier may be forced to grant access over the Small Railroad's route. Though unintended by the proposed rule, the Small Railroad would involuntarily exchange its compensatory short haul rate for a modest government-imposed access fee that would certainly impact the overall viability of the Small Railroad. To be clear there is no access fee which could adequately compensate the Small Railroad for the loss of customers and corresponding revenue.

Another example of an additional adverse effect that imposition of the proposed rule on Small Railroads is 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 either (a) is required to provide another Class I 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 ASLRRRA submits that the STB should retain the current regulatory structure that has promoted the development of a viable and sustainable national rail network. To change the current regime without a clear understanding of the implications and without a clearly established benefit for all customers would be detrimental to the Small Railroads by virtue of the

potential damage to the rail industry. The NITL proposal could add unnecessary switching activity on the rail network, decrease the efficiency of already complicated operations, with the potential to disrupt traffic patterns, produce congestion in rail yards, and drive down switching costs paid to Small Railroads, which as explained below will undermine the long-term viability of the rail service provided by Small Railroads.

In addition, the reduced efficiency of any one rail carrier, Class I or otherwise, impacts connecting Small Railroads, to the detriment of customers. With these risks in mind, and without clearly established benefits for all customers, ASLRRRA continues to oppose the NITL proposal as being injurious to the national rail network, with particularly adverse consequences for 560 Small Railroads operating in 49 states, their customers, and the communities they serve.

While a Class I carrier could, as a result of re-regulation of switch charges, absorb a reduction in overall revenues that generally compensate the Class I for long haul moves, it is a far different matter for Small Railroads. The average length of haul for switching and terminal Small Railroads is 14 miles and their median length of haul is only five miles.<sup>6</sup> Switching operations would represent a disproportionately high amount of Small Railroad revenues if switching is defined as movements of less than 30 miles, as proposed in the NITL petition. In fact, about 45% of the nation's Small Railroads (245 short lines) are less than 30 miles in length.

Moreover, unlike Class I carriers, Small Railroads have virtually no bargaining opportunity to enter into reciprocal switching agreements, since they typically operate at only one or two interchange locations. The ability of the Small Railroads to maximize revenues from their single, limited operating territories is critical to their viability.

None of the analyses submitted by advocates of the NITL petition identified 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 ASLRRRA 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. Thus, the advocates of the NITL petition fail to acknowledge both the frequency with which Small Railroads would be involved in moves subject to the proposed rule and the disproportionately adverse effect a government-imposed fee would have on Small Railroads' revenues.

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<sup>6</sup> ASLRRRA 2014 Facts, p. 21.

The NITL assertion that the potential loss of railroad revenue would be small – in the low single digits as a percent of overall carrier revenues for Class I railroads – is inaccurate concerning Small Railroads. The problem for Small Railroads is that a significant revenue reduction from even one large customer has an outsized impact, since three or four customers typically generate the majority of a Small Railroad's revenues. And while there are positive indicators of continued short line growth, the Board should be aware that the Small Railroad industry has not returned to the 2006 peak year for carload volume and Small Railroads earn barely six percent (6%) of national freight rail revenues.

The modern Small Railroad industry sector has been created largely by Class I railroad system rationalization, whereby lines that did not meet return-on-asset standards were divested to new operators. In the future, the unintended consequence of downward pressure on short-haul rates through either mandated switch charges or government-set access fees may minimize the ability of Class I's to continue the process of transferring lines to Small Railroads when it makes operating or financial sense to do so not to mention disrupting the negotiated economics of those already in existence. With the eventual downward pressure on short haul rates, it is very unlikely that a Small Railroad would be able to profitably operate labor intensive switching operations. As a consequence, the short line model that has saved rail infrastructure will cease to exist, and abandonments and fewer service options for shippers will be the end result. Moreover, imposition of the NITL proposal will immediately make it more difficult for Small Railroads to obtain capital to build and maintain their systems at a reasonable cost as the market quickly marks down their future cash flow.

Another impact not addressed in the NITL proposal is the degree of disincentive future rail shippers or receivers would have to locate on a Small Railroad. Currently, rail customers are attracted to locations served by Small Railroads as a result of superior local service and, where available, unbiased access to multiple Class I carriers. Imposition of the NITL proposal would provide a potentially serious, artificially induced disincentive against future customers locating on Small Railroads.

Regarding the various fee proposals that have been suggested by advocates of the NITL proposal none of them works for Small Railroads. A single fee schedule imposed upon Small Railroads would present an insurmountable economic obstacle for most Small Railroads. 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.

Some comments suggest that, in lieu of a rigid fee schedule an URCS-based limit on revenue over variable cost such as 180% would be a reasonable alternative. 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 of operating light density, labor intensive properties delivering carload traffic over short distances. 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. In the face of limits tied to the revenue-to-variable-cost formula, Small Railroads would have no option to adjust. Under this scenario, many Small Railroads would likely shut down if forced to cut their switch charges below current market rates, since there is no corresponding opportunity to cut costs or increase revenues elsewhere. Of necessity, these costs would be passed to other customers.

The proposal to adopt inter-switching rules such as those administered by Transport Canada is the wrong approach, as those rules are largely inapplicable to the U.S. rail industry as a whole and are wholly irrelevant to the operations of Small Railroads in this country. In Canada there are only two large, transcontinental railroads and very few independent short line carriers.

The concern of Small Railroads about the ambiguity of the current NITL proposal is based on a number of factors. Without a specific exemption written into any new rule, it will prove hard to keep the new rule from being imposed on Small Railroads because of the inevitable anomalies the ambiguousness of the language proposed by NITL will create over time.

Even if the shippers do not focus on fairness, they will begin to shift their business from perceived high-cost switching carriers to locations where a cheaper government-mandated access fee prevails, to the detriment of the Small Railroads. This logical strategy would lessen competition over the longer term and the availability of rail infrastructure that is currently maintained by Small Railroads for the benefit of those shippers that are not within a "reasonable

distance" of a "working interchange." This is a critical issue for shippers because keeping rail transportation options available on the light-density fringes of the national rail network is the very essence of the Small Railroads' role.

On the other hand, by imposing the exemption in the rule the interests of the public, the shippers, and Small Railroads would be protected from the unintended consequences of the NITL's proposed rule. Up to 80% of Small Railroad traffic is subject to competition from trucks or barges, and 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 Small Railroad participates should not have any adverse implications for shippers.

In conclusion, the ASLRRRA believes that little good and significant harm would be risked by adopting the NITL proposal. But, in any event, we implore the STB to include a clear and unambiguous exemption in any rule to protect the Small Railroads from the unintended consequences of any regulatory changes. This will continue to allow the short line rail industry to function effectively for the benefit of shippers, the Small Railroads, and their employee and community stakeholders.

Mr. Chairman and Commissioner, I thank you for your time and attention.