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

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Record

Re: STB Ex Parte No. 711, Petition for Rulemaking to Adopt Revised Competitive Switching Rules

Dear Ms. Brown:

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

Sincerely,

A handwritten signature in blue ink, appearing to read "Jill K. Mulligan".

Jill K. Mulligan

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB EX PARTE NO. 711

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

**REPLY COMMENTS OF
BNSF RAILWAY COMPANY**

BNSF Railway Company (“BNSF”) joins in the reply evidence of the Association of American Railroads (“AAR”), which addresses in detail issues relating to the methodology and assumptions used by various commenting parties to estimate the impact of National Industrial Transportation League’s (“NITL”) proposed changes to the rules governing reciprocal switching. BNSF also supplements AAR’s evidence with the following additional comments.

I. NITL Improperly Relies On R/VC Ratios As A Measure Of Market Power.

BNSF explained in its opening statement that NITL improperly uses an R/VC benchmark of 240% as the basis for reaching a conclusive presumption that a rail carrier has market dominance. The NITL proposal presumes that if a shipper’s rate produces an R/VC ratio of 240% or more, that shipper does not benefit from effective competition and is therefore entitled to a reciprocal switching order if it is served only by a single Class I railroad and is within a specified distance from an interchange to another railroad.

As BNSF explained, however, R/VC ratios are not valid indicators of the existence or exercise of market power. Moreover, directly incorporating R/VC ratios into regulatory mechanisms discourages both efficient operations and capital investment. When a railroad improves its operations through capital investments or innovation in operating practices, variable costs typically go down. Indeed, a major reason that railroads make substantial investments of

time and resources into improving productivity is to reduce the costs of providing service. Lower variable costs, however, mean higher R/VC ratios, if revenues do not change. Using R/VC ratios in an attempt to measure market power can therefore give the false impression that market power is increasing when, in fact, only efficiency is increasing. Regulatory provisions that impose adverse regulatory consequences on railroads based only on R/VC ratios that may reflect only improving efficiencies clearly could have the perverse consequence of discouraging innovation and improvements in productivity.

NITL's opening evidence in this proceeding reflects NITL's continuing reliance on R/VC ratios as the basis for determining when a railroad has market power. NITL improperly uses R/VC ratios in several areas to assess the likely impact of the NITL proposal. NITL relies on its 240% R/VC benchmark as the primary means for identifying shippers who, according to NITL, lack effective competition. In assessing the impact of its proposal, NITL used the 240% R/VC benchmark to identify carloads at stations served by only one railroad that were supposedly without competitive alternatives. NITL also used the 240% R/VC benchmark, with a few minor adjustments, to identify carloads at stations served by more than one railroad that supposedly are closed to switching among the carriers serving the station.¹

This heavy reliance on the R/VC ratio to identify carloads with and without competitive alternatives is invalid. NITL offers no basis, and there is none, for the assumption that an R/VC ratio of 240% says anything about the existence of competitive constraints on the railroad's rates. Traffic with R/VC ratios below 240% could be found under existing market dominance standards to lack effective competition, and traffic with R/VC ratios above 240% could be found to have effective competitive alternatives to the incumbent's service. The R/VC ratios are not a

¹ NITL Opening Comments, Ex Parte No. 711, Roman V.S. at 22-23.

valid indicator of the existence, or lack thereof, of competition or competitive constraints on a railroad's rates.

NITL also relies on the R/VC ratio of 180% to distinguish between movements that NITL claims reflect "full competition" and movements that NITL characterizes as "captive."² NITL uses this R/VC approach as the basis for calculating what NITL claims is the "duopoly rate" that could be expected to result when a shipper served by a single railroad today has access to an alternative railroad through NITL's proposed rule change. Without getting into the details of NITL's "duopoly pricing" calculations, it is clear that those calculations are flawed and meaningless because they are based on NITL's assumption that traffic facing "full competition" and traffic that is "captive" can be distinguished solely based on whether the R/VC on the movement is above or below 180%. The statute prescribes the use of a 180% R/VC threshold in market dominance proceedings to identify traffic that *might* lack effective competitive options, *i.e.*, traffic with R/VC ratios above 180%. But contrary to NITL's presumption, the statute does not assume that traffic with R/VC ratios above 180% lack effective competition. Under the statute, if a movement has an R/VC ratio above 180%, an investigation must still then be made to determine whether the traffic lacks effective competition. And there are many instances where there is vigorous competition for traffic but the R/VC ratio is above 180%.

Shippers and shipper organizations are increasingly seeking to have the Board rely on R/VC ratios to justify regulatory intervention. But there is an abundance of evidence, including from economists the Board itself hired to study rail competition, that R/VC ratios are not valid indicators of market power.³ The Board should use this opportunity to make clear that, while

² *Id.*, Roman V.S. at 36.

³ See, e.g., Laurits R. Christensen Associates, Inc., *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals that Might Enhance Competition: Revised Final*

R/VC ratios may be necessary tools in applying certain rate reasonableness methodologies, they cannot legitimately be used as determinants of market power.

II. Mandated Switching Cannot Cover Exempt and Contract Traffic.

In our opening comments, BNSF explained that movements that are not subject to STB regulation, including contract and exempt traffic, cannot lawfully be made subject to mandated switching orders. BNSF acknowledged that it would be appropriate to include such traffic in estimating the potential scope of the NITL proposal since NITL itself appears to expect that such traffic would be covered. The object of this proceeding is to assess the potential scope of the specific proposal that NITL has asked the Board to adopt, not to assess the impact of some alternative version of a mandatory switching regime that the Board might contemplate or that would be supported by the existing legal regime.

As BNSF anticipated, various parties adopted different approaches to how they treated such traffic in developing their impact analyses. AAR's opening analysis included contract and exempt traffic but excluded intermodal traffic. NITL took the same approach. USDA, whose analysis was performed by the same firm used by NITL, Escalation Consultants, took the same approach as NITL, but noted that it "presumes that contract movements are 'locked in' and are not subject to competitive switching during the term of the contract."⁴ USDOT took a mixed approach, excluding intermodal and exempt commodity traffic, but including contract traffic and traffic moving under equipment exemptions, *e.g.*, boxcars.⁵

The variety of approaches taken by different parties to assessing the impact of the NITL proposal reinforces BNSF's concern that the Board must acknowledge in reviewing the evidence

Report, at ES-14 (Nov. 2009) ("regulatory reforms that would establish R/VC tests as the sole quantitative indicator of a railroad's market dominance are not appropriate").

⁴ United States Department of Agriculture Opening Comments, Ex Parte No. 711, at 14.

⁵ United States Department of Transportation Opening Comments, Ex Parte No. 711, at 3-4.

submitted in this proceeding that it would not be lawful to extend mandated switching to traffic that is not subject to the Board's jurisdiction.

III. Allegations that Railroads Do Not Vigorously Compete Are Unfounded.

A number of shippers and shipper organizations raised questions in their opening evidence about the extent to which railroads compete for traffic.⁶ Even NITL asserts that "railroads no longer compete."⁷ These claims are empty rhetoric. If NITL truly believed that "railroads no longer compete," then it would not be pushing vigorously for an expansion of reciprocal switching, which NITL advocates precisely because NITL believes it would create new competitive options for shippers served today only by a single rail carrier.

Similar allegations were made by shippers in *Competition in the Railroad Industry*, STB Docket No. Ex Parte No. 705. As BNSF and other railroads showed in that proceeding, the spurious claims that railroads do not vigorously compete for business are totally unsupported. BNSF's Executive Vice President and Chief Marketing Officer at the time, John Lanigan, explained that BNSF competes for traffic in every commodity group. Lanigan EP 705 Reply VS at 2. Mr. Lanigan noted that shipper claims about a lack of vigorous competition are based on supposed increases in rail rates in recent years. But Mr. Lanigan explained that "prices often increase even where there is vigorous competition, particularly when demand exceeds capacity and costs increase," conditions that existed recently in rail transportation markets. *Id.* at 3. Mr.

⁶ See, e.g., Comments of the Chlorine Institute, Inc., at 2 (filed Mar. 1, 2013) (NITL proposal may be ineffective because railroads will not "depart from their current non-competitive conduct"); Opening Submission of Entergy Arkansas, Inc., et al., at 11 (filed Mar. 1, 2013) (competition "via mandatory switching very well may be far from robust") ("Coal Shipper Comments"); Joint Opening Submission of the National Grain and Feed Association, et al., at 15-16 (filed Mar. 1, 2013) (asserting that EP 705 demonstrated substantial decrease in competition between railroads); Initial Comments of Olin Corporation, at 6 (filed Mar. 1, 2013) (NITL proposal "premised on the false assumption that the railroads are actually interested in competing for business").

⁷ NITL Opening Comments, Ex Parte No. 711, at 14-15.

Lanigan further explained that shippers' claims about a lack of vigorous competition are belied by the fact that from 1996 to 2010, BNSF's traffic volume and efficiency of operations increased substantially, while BNSF made over \$39 billion in capital investments. *Id.* at 4-5. Other railroads addressed shippers' vague and unsupported claims about a lack of competition in railroad markets with extensive evidence of strong competition in rail markets.⁸

The shippers in this proceeding have added nothing to the empty claims they have previously made on this subject, and their claims here should similarly be disregarded.

IV. Shippers' Desire to Maintain The Option Of Pursuing Rate Reasonableness Claims As Well As Reciprocal Switching Undermines The Grounds For NITL's Proposal.

In its July 2012 Decision, the Board speculated that a benefit of the NITL proposal would be that it "would reduce governmental intervention by limiting regulation to the access price."⁹ The Board reasoned that introducing a second railroad that could provide origin-destination service through mandated switching would mean that "there may be no market dominance, and hence the Board may not regulate the reasonableness of those rates."¹⁰

Several shipper commenters responded to the Board's observation that adoption of a reciprocal switching regime might reduce the Board's role in regulating rail rates. Led by Entergy, these shippers urge the Board to allow shippers to pursue rate reasonableness cases even if the shipper would be eligible for mandated switching under NITL's proposal. Entergy's argument is that even if mandated switching were to become available, the resulting competition "very well may be far from robust."¹¹ The Chlorine Institute characterizes the Board's conclusion that "it might no longer need to address and regulate rate reasonableness" as

⁸ See e.g., CSX Reply Comments, Ex Parte No. 705, at 17-18; UP Reply Comments, Ex Parte No. 705, at 7-22.

⁹ *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, STB Docket No. EP 711, slip op. at 6 (served July 25, 2012).

¹⁰ *Id.*

¹¹ *Id.* at 11.

“troubling” because it assumes that “competitive market forces [would] discipline railroad pricing.”¹² Olin argues that access to a second railroad through mandated switching should be irrelevant to the market dominance inquiry since “there is no certainty that the [alternative carrier’s] bid will be competitive.”¹³ As noted above, even NITL baldly asserts that “railroads no longer compete.”¹⁴

Shippers’ desire to have it both ways – on the one hand to have access to mandated switching and on the other hand to maintain the availability of a rate reasonableness case – is inconsistent with the statutory structure and undermines the premises of the NITL proposal in two important ways. First, the NITL proposal is based on an assumption that the availability of an alternative carrier through mandated switching will create competitive pressure that will lead to substantial rate reductions. Indeed, NITL’s evidence on the potential impact of the NITL proposal assumes dramatic rate reductions will occur if mandated access becomes available to shippers served today only by a single railroad. But if these shippers actually believed that railroads would not compete, then there would be no reason to implement mandated switching, since it would not bring about the desired rate reductions.

Second, the Board understood NITL to be seeking an expansion of reciprocal switching as a means of reducing regulatory intervention in the market and thereby streamlining the Board’s regulation of rates. But any simplification rationale for the NITL proposal is completely destroyed by the shippers’ proposal that the availability of mandated switching should not affect the ability of a shipper to bring a rate reasonableness challenge under existing standards and

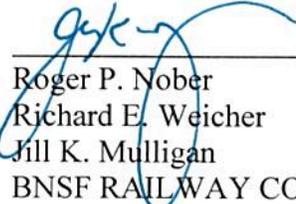
¹² Chlorine Institute Opening Comments, Ex Parte No. 711, at 2.

¹³ Olin Opening Comments, Ex Parte No. 711, at 7 (rules “must specifically provide that where an otherwise captive shipper utilizes the revised rules to obtain two rates from railroads, the existence of the non-litigated rate shall not be considered as “effective completion’ for purposes of 49 U.S.C. § 10707”).

¹⁴ NITL Opening Comments, Ex Parte No. 711, at 14-15.

procedures. If there is mandated reciprocal switching, that would create an effective competitive alternative that would preclude a finding of market dominance under the statute. Indeed, the shippers not only propose to maintain the availability of a rate reasonableness challenge, contrary to the statutory structure, but they also would add substantial complexities to the existing market dominance inquiry by litigating over the degree of competition between the incumbent railroad and the new alternative carrier whose service would become available through mandatory switching. NITL and the supporters of NITL's proposal cannot seek to justify the adoption of a new mandatory switching regime as a simplification of rate regulation when their intent is to expand and further complicate regulatory options available to them.

Respectfully submitted,



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