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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 711

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

**COMMENTS OF
DIVERSIFIED CPC INTERNATIONAL, INC.**

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March 26, 2014

My name is Sandra J. Dearden. I am President and Executive Consultant for Highroad Consulting, Ltd. (Highroad). Highroad has managed rail transportation for Diversified CPC International, Inc. (Diversified CPC) for fifteen (15) years. Diversified CPC and Highroad presented comments in STB Ex Parte 705, *Competition in the Railroad Industry*, and I filed opening comments in this proceeding on behalf of Diversified CPC. I also filed opening comments in this proceeding on behalf of Highroad with a supporting analysis and report prepared by a Highroad consultant, Neil Thurston, *Assessing Canada's Regulated Interswitching Impact on Rail Operations and Service to Customers*. Highroad's comments and the Thurston report have been referenced in reply comments submitted by numerous participants in this proceeding.

Diversified CPC supports the NITL Competitive Switching Proposal (CSP), with some modifications. Today, I will present some recommendations for the Board's consideration when reviewing potential next steps. I will also address some of the railroads' comments and concerns, and I will include some discussion of Canadian inter-switching and some of the reasons why we believe the Canadian model can work in the United States.

I. Diversified CPC Believes the Board Has Adequate Evidence In the Records (Ex Parte 705 and Ex Parte 711) to Justify Opening of a Rulemaking Proceeding to Adopt Competitive Switching Rules.

Diversified CPC and other shippers and industry associations have produced evidence of the impact of the lessening of rail-to-rail competition on rates and service, and the need to find ways to increase competition. Further, in the Board's decision dated July 25, 2012, they commented that the NITL proposal has the potential to establish discipline and to reduce the number of regulatory

proceedings.¹ This would benefit all parties, including the agency, the shippers and the railroads who are currently required to commit time and resources to those proceedings.

The railroads contend "forced" switching will shift traffic flows and put capital investments in infrastructure at risk.² We believe the railroads will continue to invest in their systems simply to keep up with the dramatic growth forecasted by the US DOT. *"Congestion on the mainline railroad network is forecast to spread significantly by 2035.....Using volume-to-capacity comparisons similar to highway calculations, the Association of American Railroads reported that rail lines experiencing unstable flows and service break-down conditions will increase from 108 miles today to almost 16,000 miles (30 percent of the network) in 2035 if current capacity is not increased."* (Underscore for emphasis)³

Diversified CPC has invested more than \$2.2 million at its rail-served plants for infrastructure improvements required to maintain and increase rail shipments. Diversified CPC cannot pass infrastructure costs thru to their customers. These projects included:

- Rail infrastructure improvements and storage at the Petal, MS (Dragon, MS) plant.

¹ "This proposal has the potential to promote more rail-to-rail competition and reduce the agency's role in regulating the reasonableness of transportation rates. It 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." STB Decision, Docket No. EP 711, Petition for Rulemaking to Adopt Revised Competitive Switching Rules, pp. 1 – 2.

² Norfolk Southern Railroad comments, March 1, 2013, *"Forced Access Will Result in the Inefficient Allocation of Investment in Capacity"*, pp. 79 – 80.

³ U. S. Department of Transportation, Federal Highway Administration, *"Freight and Congestion"*, Railroad Congestion, July 8, 2013

- Installation of additional rail car unloading stations, rail risers, and bulk storage tanks at our Anaheim, CA; Miami, FL; and Sparta, NJ plants.
- At the Channahon, IL plant they added additional tank car loading and unloading stations, and bulk storage for a new product blend shipped exclusively by rail. The plant now has (16) tank car loading and unloading stations and can handle up to 24 tank cars on its four (4) sidings, effectively doubling the loading and unloading facilities of the original plant design.

While Diversified CPC has invested capital in infrastructure to increase rail shipments, the railroads seem to have a one-sided view of the need to earn adequate return on investments. In 2004, one of Diversified CPC's customers asked them to develop a new product for the customer's foam packaging operations. Diversified CPC developed the new product which was accepted by the customer, Diversified CPC acquired additional tank cars, and they invested more than \$500,000 for construction of a storage tank farm, blending system and associated pumps and piping for the new commodity.

During the three-year period when we had the business, the rail rate for this move increased more than 41%. The railroads disregarded our warnings and ultimately priced Diversified CPC and the railroads out of the business.

While we understand the need for the railroads to earn an adequate return, it was extremely unfair for railroads to encourage us to develop business that require capital investments, and subsequently chase the business away with irresponsible pricing practices.

This is only one example of inadequate competition in the railroad industry. For this particular lane, both origin and destination are classic bottlenecks. 100% of Diversified CPC's rail lanes have bottlenecks at origin and/or destination. While we have not developed a plan to request competitive access, we believe it possible

that simply having an option to open industries to reciprocal switching would create a competitive environment that will serve the public interest.

II. Railroad Parties Have Not Produced Evidence That Competitive Switching Will Have a Negative Impact On the Efficiency of Operations and Service.

One of the questions presented by the Board is the impact CSP would have on the efficiency of railroad operations and service. Railroad parties submit mandated switching will have a detrimental effect on service. However, their responses included a number of, *may (or may not), could (or could not)* qualifiers with no supporting evidence.

My railroad career started in 1969. As a railroad marketing officer I had the privilege to learn while working in a regulated industry and subsequently to compete aggressively in a de-regulated environment. We competed in a number of ways, developing marketing and pricing strategies, and we implemented strategies to improve the efficiency of the railroads' locomotive and rail car fleets, and there is no question that competition was a motivator to drive efficiency into the railroads' networks.

Based on my experience, I submit that one of the many benefits of CSP will be the continuing development of productivity initiatives that will result in more efficient operations and quality service. Reciprocal switching is an integral part of the railroads' traffic mix; Operating Managers and the line personnel are focused on operating efficiently and reciprocal switching occurs hundreds of times daily without interruption in service.

Some of the railroads in their reply statements observed that Highroad Consulting conceded that forced switching would inevitably increase rail operating

costs, referencing Neil Thurston's report which suggested Canadian inter-switching has had a negative impact on railroad operations.⁴ However, those statements were taken out of context. The remainder of this section of Thurston's report reads, "...such switching activities are part of the everyday life of railway operations. For without such operations, mainline functions would not occur in an efficient manner...One might consider such demands on the railway system would lead to inefficiencies and significant negative impacts on railway operations, but such outcomes do not appear to be apparent. Over the past 10 - 15 years, both CN and CP have driven forward and achieved significant productivity and efficiency gains..."⁵

Union Pacific Railroad stated they would not have proceeded with the series of consolidations that created the current UP system had they been conditioned at the time by the NITL proposal. (UP consolidated six railroads into a single system.)⁶ This statement supports a theory that consolidation of the rail industry and the creation of monopolies was strategic and intentional, and underscores the need for the Board to take corrective action.

The Railroad Parties' allegations that service will decline and costs will increase if CSP is approved is without foundation. First of all, a single line route is not always the most efficient route. If time permitted, I could relate a number of instances where more direct routes were developed by routing a portion of the move over a second carrier. Further, when selecting carriers and routes, shippers

⁴ STB EP 711, Kansas City Southern Reply Comments, May 30, 2013, p 30; Norfolk Southern Reply Comments, May 30, 2013, p. 22.

⁵ *Assessing Canada's Regulated Interswitching Impact on Rail Operations and Service to Customers*, Neil Thurston, p.27, Highroad Consulting, Ltd. opening comments, STB EP 711, March 1, 2013.

⁶ Opening Comments and Evidence of Union Pacific Railroad Company, STB EP 711, March 1, 2013, p. 21.

consider service and total costs which includes rates, the difference in fuel surcharges, car costs for private equipment, and inventory costs. Competitive Switching will still be optional – the railroads will have the option to compete and the shippers will have the option to select a preferred carrier. As a result, the competitive market forces will improve the efficiency of operations.⁷

III. Evidence Suggests Competitive Switching Can Work.

The report attached to Highroad Consulting's opening comments, authored by Neil Thurston, and NITL's witness Tom Maville presented a history of the development of inter-switching in Canada, and evidence that the Canadian railroads have thrived since inter-switching was established.

AAR contends that the rail system in the U.S. is different than the Canadian railway system; because the U.S. rail system is more complex, so Competitive Switching will not work in the U. S. Further, AAR witnesses Phil Ireland and Rodney Case stated, "regulated interswitching has been part of the Canadian regulatory system for 100 years... as a result, the Canadian interswitching does not lend any support to the proponents of mandated switching in the United States, which has never had a history of mandated switching."⁸

As discussed previously, reciprocal switching in the U.S. occurs on a daily basis with no negative impact on the efficiency of operations, so there is no reason to believe CSP will not work in the U.S. Also, I fail to see the point that regulated inter-switching has been part of the Canadian regulatory system for 100 years.

⁷ "The absence of effective rail-to-rail competition causes inefficiency, whereas competition fosters inefficiency.", Arkansas Electric Cooperative Corporation reply comments, STB EP 711, May 30, 2013, p. 2.

⁸ Reply Verified Statement of Phil C. Ireland Consultant Jexi, Inc. and Rodney E. Case Partner Oliver Wyman, AAR Reply Comments, STB EP 711, May 30, 2013, p. 14.

While the rules may have been in place, the first industry to actually access inter-switching in Canada was Cominco Fertilizer Company in 1993.

In numerous filings in this proceeding, participants have qualified statements with *coulds*, *cans*, and *mays*, and AAR stated, "It is impossible to know in advance how much switching would occur if the NITL proposal were adopted..."⁹

AAR is correct from the standpoint we will be forging new ground; also, the incumbent railroads will influence the number of shippers that will access competitive switching. However, we have learned from experience that we can predict behavior based on history. Canadian inter-switching has been successful – it has established discipline in the industry without any apparent negative impact on railroad efficiency, and it has not decreased customer satisfaction.

IV. The Board Should Modify the Proposal Before Issuing Proposed Competitive Switching Rules.

- i. Access to Competitive Switching should be automatic and customers should not be required to prove market dominance and a designated RVC threshold.**

If it is the Board's objective to increase competition and to rely on competitive market forces to discipline railroad pricing and service, then shippers should not be required to pass a "test" to access competitive switching. A process that would require shippers to assume the costs to retain transportation attorneys and consultants to initiate proceedings that will require proof of market dominance and proof that rates exceed a designated RVC threshold would not be a practical alternative for small to medium sized customers like Diversified CPC. This should not be a privilege reserved for very large industries that have significant financial

⁹ AAR Reply Comments, STB EP 711, May 30, 2013, p. 22.

resources to take on such an initiative. Instead, the process should be simple and automatic as it is in Canada.

Also, we question if the proposed process is even practical. From any given facility, some shipments could pass the test proposed by NITL, while others would not. The need to prove market dominance and to present rail costs on each and every movement further complicates the process and increases the costs (for the shippers and the defending railroads) of the proceeding. Then once the decision is made regarding which lanes are open to reciprocal switching (and those that are not) it would be confusing and difficult to administer, especially for large industries that ship thousands of cars each year. Further, the mix would no doubt change in future years as the shipper's traffic mix changes, and railroad pricing policies and rates change.

There is no question that shippers should have the ability to seek relief from unreasonable rates and unreasonable practices at the STB. However, when they do, they are required to accept up front that they will be perpetuating adversarial relationships with the carriers and even if they win the case, there are no clear winners because of the damage it can do to the shipper/carrier relationships. Our goal should be to develop a process that is not adversarial.

- ii. **The proposal should adopt a more liberal determination of when a shipper facility is deemed to be a "reasonable distance from a working interchange point.**

The 30-mile reasonable distance proposed by NITL appears to be a good benchmark to start. However, since the industry will experience a learning curve with the new rules, and since the railroads will have the right to show proposed switching is not feasible or safe, or that the presence of reciprocal switching will

hamper the ability to serve current customers, we believe a more liberal approach is appropriate.

iii. The CSP should include exempt traffic, except intermodal traffic.

The premise behind this proceeding is the landscape of the railroad industry in the United States has changed significantly since 1980 when the exemptions were established, and there has been a significant loss of competition. Again, if the objective is to increase competition, Competitive Switching should be a right for all shippers, not just a segment of the shipping industry.

iv. Shippers should maintain the right to seek relief from unreasonable rates and practices.

Adoption of mandatory switching rules should have no effect on determination of whether the Board has jurisdiction over the reasonableness of line haul rates. Some participants are concerned that some railroads may decide not to compete if a Competitive Switching Proposal is approved. If railroad(s) do not compete, and shippers are precluded from seeking relief at the STB, this would result in reduced competition and, therefore, would be adverse to the objectives of the CSP.

v. If the CSP requires shippers to prove market dominance and to pass a designated RVC threshold, the RVC standard should be changed to 180%.

If the Board elects to include in the new rules and procedures calculation of a regulatory benchmark, the benchmark should be fair to all parties. The problem with URCS continues to exist; URCS needs to be updated or replaced as it produces costs that are not accurate and the costs are grossly over-stated.

If the shippers are required to prove the rates exceed a designated RVC, the regulatory threshold should be consistent with that in place for other STB proceedings, i.e., 180%.

V. We Encourage the Board To Amend the CSP and to Expeditiously Initiate a Rulemaking Proceeding.

The Canadian Board of Railway Commissioners in 1918 ruled that Inter-switching is a *right* not a *privilege*. We encourage the Board to initiate a Rulemaking Proceeding and to amend the NITL proposal to simplify the process with the objective to increase competition in the rail industry for all shippers, not just a privileged few.

- A. Shippers and industry associations in STB Ex Parte 705 and Ex Parte 711 have produced evidence of the impact of the lessening of rail-to-rail competition on rates and service, and the need to find ways to increase competition.
- B. Railroad Parties have not produced evidence that CSP will have a negative impact on the efficiency of rail operations in the United States. In fact, we submit competition promotes efficiency.
- C. Evidence has proved that Competitive Switching can work. Canadian inter-switching has been successful and the Canadian model can work in the U.S. It has established discipline in the industry in Canada without any apparent negative impact on railroad efficiency, and it has not decreased customer satisfaction.
- D. The Board should modify the proposal before issuing proposed Competitive Switching Rules as presented in Section IV herein.