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DOCKET NO. EP 711:  
PETITION FOR RULEMAKING TO ADOPT REVISED COMPETITIVE  
SWITCHING RULES

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REPLY COMMENTS OF  
THE AMERICAN SHORT LINE AND REGIONAL  
RAILROAD ASSOCIATION

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The American Short Line and Regional Railroad Association ("ASLRRA") respectfully submits the following Reply Comments on the National Industrial Transportation League's ("NITL's") Petition for Rulemaking to Adopt Revised Competitive Switching Rules.

**Clarification of Small Railroad Exemption**

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 to avoid decimating the small railroad industry. 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. 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.

Similarly, consider 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 NITL petition must be clarified as described above to ensure that a shipper served by a small railroad, in any capacity, is not subject to mandated competitive switching under the NITL proposal. Since up to 90% of small railroad traffic is subject to competition from trucks or barges<sup>1</sup>, 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.

In both cases described above or in countless others that will arise 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. It is one thing to expect a Class I carrier to 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, but a far different matter for small railroads. The median length of haul for Class III railroads is only 15 miles,<sup>2</sup> 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. Indeed, none of the analyses submitted by advocates of that petition 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

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<sup>1</sup> See ASLRRRA Comment, EP 705: Competition in the Railroad Industry, Martland Verified Statement at pp. 13-14.

<sup>2</sup> *Short Line and Regional Railroad Facts and Figures*, 2012 Ed. p.10.

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.<sup>3</sup>

### **Current Consequences from Future Threat**

Even if the Petitioners or the current Board could guarantee that the NITL proposal's exemption for small railroads would completely insulate them from financial harm – which neither can realistically do – it is unlikely that the exemption would last. It will prove harder and harder to maintain an exemption for small railroads because of the inevitable anomalies such an exemption will create over time. Once a government pricing scheme is imposed on Class I carriers, shippers and others looking to reduce their costs of shipping will question the fairness of having to pay more for small railroad service. Even if they don't, they will slowly 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 railroad industry, thereby lessening 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.

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

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<sup>3</sup> See ASLRRA Comment, EP 705: Competition in the Railroad Industry, Martland Verified Statement at p.11

ability of Class Is to continue the process of transferring lines to small railroads when it makes operating or financial sense to do so. Further, with the eventual downward pressure on short-haul rates, it is very unlikely that a small railroad would be able to profitably operate these labor-intensive switching operations. As a consequence, the short line process that has saved rail infrastructure will cease to exist, and abandonments and fewer service options for shippers will be the end result.

The prospect of any of these future possibilities means financial harm to small railroads right now. 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 today's 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. The likelihood of immediate financial harm despite a nominal exemption in regulatory text, and the prospect of future inclusion in some kind of mandated switching, means that small railroads and the Board must look at the NITL Petition for Rulemaking as if it applies immediately to small railroads in fact, if not in law. The application of the NITL petition would be ominous for the small railroad industry sector.

### **Practical Implications of Proposed Mechanisms**

Some Comments call for the Board to adopt a regimen similar to the "Inter-switching" rules administered by Transport Canada because they appear simple and easy and are in their view fair and reasonable.<sup>4</sup> Those Canadian 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

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<sup>4</sup> See, Comments of Highroad Consulting, Ltd., Report of Neil Thurston, Assessing Canada's Regulated Interswitching Impact on rail Operations and Service to Customers, p. 17.

Canada there are only two large, transcontinental railroads and very few independent short-line carriers. When one large Canadian carrier must accept a government-mandated switch charge, it can be largely offset by the fact that it is receiving an offsetting low rate from the other large carrier in another of the multitude of places where both regularly interchange.

Reciprocal switching agreements may provide large U.S. carriers a private way of achieving the same offsetting savings in any given location. Small railroads, however, have virtually no bargaining opportunity to enter into reciprocal switching agreements, since they typically operate at only one or two local interchange locations. They also have extremely limited negotiating power in those rare instances where the opportunity for reciprocal switching occurs. The ability of the small railroads to maximize revenues from their single, limited operating territories is critical to their viability.

During the era of the Northeast railroad bankruptcies, many studies on the costs and profitability of light-density rail lines established that such a property is viable only if the railroad's total contribution from the traffic *on the line* is sufficient to cover the total costs of operation. When the Class I carriers spun off those segments to become short lines, the new operator needed sufficient revenue to cover its total costs, because it had no source of contribution from a low-cost, longer-distance, line-haul movement. The notion that there could be a single 'fair and reasonable' price for all situations would have been considered absurd. To this day, a single fee schedule imposed upon small railroads would be an insurmountable calamity for most of them. 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.<sup>5</sup> 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.

Further, 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, as Rennie points out in his analysis.<sup>6</sup> Since 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.

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<sup>5</sup> See, Joint Opening Submission of the National Grain and Feed Association et al.

<sup>6</sup> See Opening Comments of the Association of American Railroads, Verified Statement of William J. Rennie, p. 10-18.

Finally, the NITL Submission suggests that the potential loss of railroad revenue would be small – in the low single digits as a percent of overall carrier revenues<sup>7</sup>. The implication is that the proposal is not a major threat to the rail industry. If true, then the benefit to the shipper interests is hardly worth considering, amounting to a tiny fraction of a percent to, for example, chemical producers, whose revenues dwarf those of the rail industry. 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.

### **CONCLUSION**

It is impossible by fiat to exempt small railroads from the practical operation of the proposed rules. They will inevitably be affected, and the consequences will be a devastating financial blow to most of ASLRRA's members. If the NITL Petition is adopted by the Board, many small railroads will be injured and the national rail infrastructure weakened in exchange for very little financial benefit to shippers.

Respectfully submitted,

American Short Line and Regional Railroad Association, by



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<sup>7</sup> Opening Submission of the National Industrial Transportation League, pps 56-57.