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STB Ex Parte No. 711 (Sub-No. 1)
Petition for Rulemaking to Adopt Revised
Competitive Switching Rules

Comments of the
U.S. Department of Agriculture

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Authority and Interest

The Agricultural Adjustment Act of 1938 and the Agricultural Marketing Act of 1946 charge the Secretary of Agriculture with the responsibility to represent the interests of agricultural producers and shippers in improving transportation services and facilities by, among other things, initiating and participating in Surface Transportation Board (Board) proceedings involving rates, charges, tariffs, practices, and services.

Introduction

The U.S. Department of Agriculture (USDA) appreciates the opportunity to provide comments on the Board's proposed two pronged approach to allow competitive switching that is either: (1) practicable and in the public interest, or (2) necessary to provide competitive rail service.

While USDA applauds the Board's decision to move away from the overly burdensome Midtec standard, it would be unfortunate if this decision just evolves into an alternative standard that in practice is just as illusive to shippers. USDA is concerned that, even with the best of intentions, this could indeed be the outcome. With some fine tuning, however, it is possible the Board's proposal could be used to enhance the efficiency of some rail routes and thereby provide a better balance between the needs of shippers and carriers in limited situations, as directed by the Stagger's Rail Act of 1980, and as USDA believes the Board intends.

If the Board finds workable procedures that shippers will use, USDA believes the impact would not be large because of the nature of the Board's proposal. That is, notwithstanding the claims of the rail industry in the proceedings leading up to the Board's proposal, it only allows limited switching in close proximity to origin or destination and only those approved by the Board on a case-by-case basis. Because of this, the impact should be small and therefore manageable by the Board and by railroads. Given the Board's concerns over the original NITL proposal, USDA believes it is possible the Board can meet the goals of efficiency and balancing shipper and carrier needs, but only by shifting a portion of the burden of proof in the proposed two-pronged approach from shippers to carriers and clarifying some of the evidentiary standards. Continued reliance of the Board on placing the majority of the burden on shippers will not result in the desired change, but rather a continuation of the status quo.

The rail industry is clearly different than it was 30 years ago and USDA lauds the Board for recognizing this fact and taking the effort to update its policies accordingly. Today, railroads face much less competition and are much more profitable than they were in the past. Both of these facts point to the need for regulation that better balances the needs of shippers and carriers. If implemented correctly, competitive switching can help provide that balance, while also increasing competition and enhancing efficiency in controlled and limited ways.

The purpose of these comments is to provide USDA's perspective on the Board's proposed competitive switching rules in order to represent shippers needs and help make the final rule better, with an accessible and cost-effective option for shippers. The first section of USDA's comments that follow outlines USDA's perspective on why shippers need competitive switching. Given that need, the second section discusses the principles upon which USDA believes the Board should structure the competitive switching evidentiary standards and legal procedures. The remaining sections discuss some of the issues for which the Board sought comments, such as

access pricing and the applicability to short line railroads. The final section sets forth USDA's conclusions.

The Need for Change

One of the explicit goals of the Staggers Act was to "provide a regulatory process that balances the needs of carriers, shippers, and the public."¹ Railroads are an essential component of making U.S. industries competitive, especially agriculture, and unreasonable rates and service can easily place U.S. producers at a competitive disadvantage on the world market. Railroads are required to provide Common Carrier service upon reasonable request, and in accordance with balancing needs, they must provide that service at reasonable rates.

There are two general ways of ensuring reasonable rates and service: competition and regulation. To the benefit of the rail system and the economy, the Staggers Act relied heavily on competition as a means to promote efficient rail service and to provide that service at reasonable rates, while allowing railroads to earn adequate revenue. However, Congress clearly recognized the possibility that competition would not always be an effective check on a railroads' pricing power. Where competition is ineffective, the only alternative for ensuring reasonable rates and service is some kind of regulation.

The NITL petition for competitive switching arose during EP 705, Competition in the Rail Industry. Between that proceeding and EP 711, many shippers persuasively argued that competition in the rail industry has declined significantly in recent decades. The Board itself recognized this change in its initiation of EP 705 where it stated, "The United States railroad industry has changed in many significant ways since...the mid-1980s. Among the more salient developments have been the improving economic health of the railroad industry, [and] increased consolidation in the Class I railroad sector..." Additionally, a coalition of largely shipper-groups, including the Alliance for Rail Competition, the American Chemistry Council, and many others pointed to the increased financial health of the railroads and that the merger rounds of the 2000s did not lead to increased rail-to-rail competition as intended.² Consolidation in the rail industry has not only meant fewer carriers, but less track and fewer routes. For decades, railroads have been reducing their total track and increasing the density of traffic on the remaining track. Total track mileage in 1980 was around 271,000, while in 2014 it was only about 161,000.³

This trend toward fewer carriers and fewer routes has left shippers with drastically fewer options in terms of which railroad to use and which markets to reach. The world's agricultural markets are highly competitive and highly variable. The highest producing regions and highest demanding countries often change on a year-to-year basis. Agricultural shippers, therefore, need flexibility in their transportation options, much of which has been lost over the past few decades.

As the railroads point out, there are existing voluntary opportunities to use competitive switching, which in principle could give agricultural shippers the flexibility they need, however shippers have argued that the loss of competition in some areas for some shippers has resulted in not just high, but unreasonably high rates. Unreasonably high rates imply that switching rates

¹ Staggers Rail Act of 1980.

² Joint comments of the Alliance for Rail Competition, the American Chemistry Council, American Forest and Paper Association, et al. (EP_705_0_229197, April 12, 2011).

³ Association of American Railroads, *Railroad Facts: 2015 Edition*.

could also be unreasonably high, because an incumbent railroad would want to be compensated for its opportunity cost to voluntarily agree to a switch.

While revenue per ton-mile is lower on average compared to pre-Staggers, the story is very different when looking at recent years or at specific commodities. Rail rates have increased significantly more than costs since 2000, following a long string of rail mergers.⁴ This is especially true for particular commodities like grain, which not only already pay higher rates than other shippers pay, but have seen exceptionally higher rate increases since 2000.⁵ While competition in the rail industry as a whole may still exist, railroads face little to no competition on some of their routes, especially agricultural routes in remote areas. On those routes, there are fewer market forces checking the reasonableness of rail rates. Without some means to check unreasonable rail rates, it seems shippers may only be left with unreasonably priced switching options, which does not help the issue of concern. While available in principle, voluntary competitive switching is not viable for shippers without effective competition, with railroads that are willing to compete with one another on routes as needed by shippers to reach alternative markets. Therefore, these shippers need a workable regulatory mechanism to review rates in general, or at least as an alternative have access to reasonable switching options.

Unfortunately, as recognized in this proposed ruling and in the Board's proceeding on Grain Rate Regulation Review (EP 665), the existing regulatory mechanisms for reviewing the reasonableness of rates are expensive and simply unusable for many shippers. Even if existing rate review procedures were more accessible, they are still not ideal. Regulatory rate setting is at best unavoidable, because regulators do not have the information to get the prices right as compared to prices established by market forces. Further, the recent Transportation Research Board study on freight rail regulation emphasized the fact that many of the costing tools the STB uses can be highly misleading.⁶ Because of this, the Board's reliance on those tools should be minimized. Nonetheless, without effective rate review, there needs to be some option available to shippers who cannot rely on competitive market forces.

Competitive switching can be a limited, but effective way to balance the needs of carriers and shippers by relying as much as possible on competition to incentivize reasonable rates and service, while also providing shippers the flexibility they need to reach their markets. The railroads talk about competitive switching as if it means open-access to their entire track and a return to the pre-Staggers regulatory era, but this is simply not true on multiple accounts. Competitive switching should only affect a small portion of the railroads' total track, especially so, given the Board's structuring of the proposal as a case-by-case system that limits cases to shippers who are within a reasonable distance of a switching point. Moreover, competitive switching avoids much of the concern that exists with regulatory rate setting. The Board's influence over rates would be limited only to the switch, which, importantly, would be a small fraction of the full haul and therefore only a fraction of the full haul revenue. Moreover, while the full haul would be switched from one railroad to another, it would be preserved for the rail industry in total and not damage overall railroad economics of cost recovery over long distances. The influence of URCS-type costing systems on rates would be minimal, and the vast majority of

⁴ Transportation Research Board, Special Report 318, *Modernizing Freight Rail Regulation*, 2015.

⁵ Christensen Associates, *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals that Might Enhance Competition*, 2009.

⁶ Transportation Research Board, Special Report 318, *Modernizing Freight Rail Regulation*, 2015.

rail revenue would still derive from market-based rates. In no way does any of this add up to a return to the pre-Staggers era nor does it add up to even a moderate threat to railroad revenues.

USDA believes that the costs of competitive switching would be minimal and that the benefits from shipper access to new markets and added competition outweigh these costs. In its comments to the NITL petition, the Department of Transportation found that only a small subset of total traffic would be eligible for competitive switching, only 1.3 percent of the carloads and 2.1 percent of the revenue.⁷ In its March 2013 comments, USDA analysis showed that between 0.8 and 2.2 percent of railroad revenue from grain and oilseed shipments would be affected, and likely less because of the strict assumptions of the model.⁸

In a study commissioned by the Board, Christensen Associates analyzed how reciprocal switching might affect efficiencies in the length of haul. They concluded, “Of the various open-access policies proposed in recent legislation, those policies that propose incremental changes – e.g., reciprocal switching and terminal agreements will be the least costly in terms of loss of economic efficiency and, in our opinion, the most likely to produce competitive responses by railroads.”⁹

Railroad concerns about length of haul efficiencies may have some validity, but are overblown. As the Board laid out, switching would only occur on a relatively small portion of the full shipment distance. The effect on length of haul efficiencies will therefore be minimal. Additionally, the Board’s case-by-case proposal implies that each of these assessments overestimate the costs of competitive switching. The absence of bright-line, rule-based presumptions of need lowers the universe of potential changes and the impact to the rail industry.

USDA believes the Board should not be overly concerned about changes this small. While obviously the Board needs to be thoughtful and careful about the impact of any changes competitive switching might bring to the rail industry, changes as small as those suggested by USDA, DOT and Christensen, should not be the reason for maintaining the status quo, especially because the Board will continue to have discretion on a case-by-case basis.

Finally, USDA believes that instead of being a cost to the railroad industry, competitive switching might well represent a great opportunity. In the absence of effective competition, industries become stagnant. Competition forces firms to innovate and discover new and better ways to meet their customers’ needs. Such innovation is essential for the contemporary rail system that is hurting from the loss of coal and other traffic. Competitive switching is a potential opportunity to invigorate the rail industry to start rethinking what it means to be an efficient railroad. Without effective competition, there will be less innovation and little change.

USDA recognizes the Board’s concern regarding the original NITL proposal and the possibility of a 30-mile bright-line-rule being both over and under inclusive. It is commendable and appreciated that the Board is taking a balanced approach on a case-by-case basis and will consider appropriate nearby distances based on the merits and needs of the shippers and the circumstances they individually face. As discussed, USDA believes the Board’s discretion can be

⁷ Comments of the U.S. Department of Transportation. (EP_711_0_233874, March 1, 2013).

⁸ Reply comments of the U.S. Department of Agriculture (EP_711_0_234310, May 29, 2013).

⁹ Christensen Associates, pg. 22-13.

an effective screen to grant competitive switching only in the cases where the benefits outweigh the costs.

Nevertheless, the problems in the case-by-case approach are two-fold. First, it becomes less clear to shippers whether their circumstances qualify them for reciprocal switching consideration, and second, it becomes much more costly for shippers to litigate their case. The Board noted in its proposal that following Midtec, “Few requests for reciprocal switching have been filed with the agency since then, and in none of those cases has the Board granted a request for reciprocal switching.”¹⁰ USDA’s primary concern is in avoiding more of the same.

Simplified Case Requirements

USDA appreciates the Board’s move away from the unusable Midtec standard, and proposing an alternative two-pronged approach. This potentially could be a move towards improving the rail system and increasing the options available to shippers. However, USDA believes that, while this could be a step in the right direction, a few changes to the proposal are required.

USDA’s general recommendation is that with flexible and case-by-case review of competitive switching requests, the Board should, to the extent possible, place the burden of proof on the party that is most capable of providing the evidence. Shippers should be required to provide only evidence that is readily available to them in their domain as a shipper or is publically available, and the standards that qualify evidence as sufficient for a case should be clear and as simple as possible. Upon receiving such evidence, if the Board agrees the shipper has a reasonable request worth considering, it should then be up to the railroad to refute the request and explain to the Board why competitive switching should not be allowed.

Unlike the former Midtec standard, the Board can ensure that shippers actually use the proposed system by shifting some of the burden of proof from shippers to railroads and clarifying the evidentiary requirements. Each of the two prongs proposed by the Board have pieces of evidence that would be more easily provided by the railroad than by shippers, because railroads have access to information that shippers do not. If the Board grants a shipper’s case based upon information that is readily available to them, shippers will be much more willing and able to use the competitive switching option because they will not be responsible for the economic burden of proving information that is not readily available to them.

In the public interest prong, the Board has laid out three pieces of evidence that shippers need to provide in order to be granted competitive switching. The first two requirements—Class I carrier service is available and a working interchange exists—are both pieces of evidence that shippers will certainly have some general information about, but the railroads will have more and better information about those requirements. The third requirement—that the potential benefits from the proposed switching arrangement outweigh the potential detriments—places an inappropriate evidentiary burden on shippers. The benefits of the switch are something that shippers ought to provide, but information about railroad costs, safety and the impact on other railroad customers would not be readily available to them. It would be a more effective process to have shippers only provide information about why they need the switch and how it would benefit them, like the new markets that could be reached. If the Board deems the request has merit and is worth

¹⁰ Surface Transportation Board. Decision. Docket No. EP 711 (Sub-No. 1). Petition for Rulemaking to Adopt Revised Competitive Switching Rules. Decided: July 27, 2016.

considering, it should then require the railroad to show that the costs are greater than the benefits or why the switch is not practicable. If the railroad disagrees, the shipper could then use discovery to obtain information about the validity of the railroad's assertions.

Under the competitive prong, the Board could simplify for shippers the showing of ineffective competition by quantifying the requirements for the market dominance test. USDA encourages the Board to consider relying on some of the alternative screening mechanisms it recently outlined in EP 665. For example, some clearly defined screening measures, like R/VC ratios, the length of the proposed haul, and revenue-per-ton-mile could provide strongly suggestive evidence of market dominance, without the ambiguity and cost of a more qualitative market dominance test. If the Board finds the evidence to be sufficient, the defending railroad could then prove why these quantitative measures do not reflect qualitative market dominance. The point is to avoid the scenario where quantitative measures strongly suggest market dominance, but the costs of a qualitative test preclude a shipper from initiating a case.

If the Board believes that the quantitative market dominance measures are too inclusive, it can raise the threshold to ensure that only those cases are initiated where the evidence most strongly suggests market dominance. In this way, the Board can raise or lower the inclusiveness of the screen while still making that screen unambiguous for shippers who would like at least a little more clarity in what is necessary to make a successful case.

In order to provide simplicity and lower the costs on shippers, USDA encourages the Board to consider using a procedural system similar to what it suggests in EP 665. Shippers could submit an initial complaint along with the evidence necessary for the Board to grant a case. The Board then would initiate or deny a case based on the sufficiency of the preliminary evidence. Filings of evidence could then take place sequentially, with limits on discovery. In the first round, in a public interest case, if the defendant railroad disagrees, it would provide evidence that the costs of the switch are greater than the estimated benefits and/or evidence against the proposed benefits. In a competitive case, the railroad would provide evidence for why the preliminary screens do not reflect market dominance and/or why the costs of the switch outweigh the benefits to enhanced competition. In either case, the shipper could then reply to the railroads' evidence. The Board could issue a preliminary decision to grant or deny competitive switching based on the evidence presented in the first round. Finally, the Board might use an evidentiary hearing for final rebuttals and briefs, as well as to sort out access pricing issues. Strict procedural deadlines and limits on discovery could also help to keep the case-by-case costs down.

Access Pricing

On access pricing, USDA recommends some general principals to the Board. USDA supports the Board's "Alternative 1" methodology, where certain cost factors determine the access price, but does not recommend the access price compensate the incumbent railroad its full opportunity cost. The suggestion that railroads should be compensated their full opportunity cost is contrary to the major purpose behind the Board's proposal, which is to facilitate shippers' access to alternative markets. USDA believes the access fee should cover the accounting costs incurred by the railroad for switching to the alternative railroad. Under competitive switching cases, requiring shippers to compensate railroads for their opportunity cost could mean that shippers are subject to uncompetitive rates and service. Additionally, shippers would effectively be double-charged, as they would be contributing the fixed-costs of both the incumbent and competing railroad. If

this occurs, it could reduce the shipper's competitiveness and negate the reason for requesting the switch in the first place.

Thus, USDA strongly encourages the Board to reject the suggestion to compensate the full opportunity cost. The shipper should not have to compensate the incumbent railroad its foregone revenue. Instead, USDA maintains that the Board should base the switch fee on the accounting costs of the switch, as outlined in "Alternative 1," including long-term costs like investment and maintenance.

It is clear that railroads oppose competitive switching and do not want to do it. Therefore, USDA is concerned that railroads could possibly use access pricing to prevent competitive switching from occurring. As pointed out in the decision, under the law, "[t]he rail carriers entering into [reciprocal switching ordered by the Board] shall establish the conditions and compensation applicable to such [switching], but, if the rail carriers cannot agree upon such conditions and compensation within a reasonable period of time, the Board may establish such conditions and compensation."¹¹ If the railroads involved agree upon an unreasonably high access fee, it could discourage or prevent the movement. USDA is concerned such an outcome is possible, and therefore the Board should take steps to eliminate such a possibility.

While USDA recognizes the Board only has jurisdiction over access fees in the instance when railroads cannot agree, USDA believes that the Board can influence the outcome when they do agree by making its position on access pricing methodology clear, understandable and fair to all concerned. A clear and unambiguous methodology for establishing the access fee could reduce the instances of railroads agreeing to an arbitrarily high price. A clear methodology provides information to the marketplace and reveals what railroads and shippers could expect for the access fee if the railroads do not agree. That information will provide guidance to both, giving incentive to the competing railroad to not accept the proposed fee at face value, and pause to the incumbent railroad on what they propose. It could serve as a "check" against the competing railroad, which might want an unreasonably low switch fee (even one that might be too low to cover the incumbent railroad's costs sufficiently), and against the incumbent railroad, which might want an unreasonably high switch fee to generate extra revenue or thwart the switch.

USDA encourages the Board to make their access fee methodology as clear, fair, and predictable as possible.

Short Lines

Each of the prongs in the Board's two-pronged approach requires that shippers show "the facilities of the shipper(s) and/or receiver(s) for whom such switching is sought are served by Class I rail carrier(s)." The interpretation by one commenter was that this meant the entire move must be accomplished exclusively by Class I rail carriers. Therefore, their interpretation was that moves by short line railroads at the origin or destination would disqualify the use of competitive switching. USDA is concerned that if implemented in this way, this could be an overly exclusive requirement, preventing many justifiable competitive switching cases where the benefits outweigh the costs. The Board should not *ex ante* exclude Class II or Class III railroads. There is no reason to believe that switches involving traffic handled by non-Class I railroads will never be in the public interest or could never be used to address an issue of inadequate competition. While smaller railroads may require special consideration, the structure of the Board's proposal as a

¹¹ 49 U.S.C. § 11102(c)(1),

case-by-case system ensures that short line railroads can be given the necessary consideration to avoid placing upon them an excessive burden. USDA encourages the Board to remove any short line exclusions.

Conclusions

USDA is grateful that the Board has moved forward in this important proceeding. Changes within the rail industry, like consolidation and loss of competition, the move towards revenue adequacy, and the costliness of existing rate remedies, all point towards the need for change in rail regulation. The Board is taking steps in the right direction, and USDA is optimistic that, with the right approach, the Board can more fully accomplish the goals of Staggers to rely on competition to provide reasonable rates and service and balance the needs of shippers and carriers. The Board needs to ensure that the evidentiary burden it places on shippers is clear and within their reach. With that, the process can be an effective remedy for shippers that actually is used. With the Board's discretion, that process will enhance the efficiency and fairness of the rail industry.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Elvis S. Cordova", with a long horizontal flourish extending to the right.

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CERTIFICATE OF SERVICE

I, Bruce Blanton, certify that on this 26th day of October, 2016, caused a copy of the foregoing document to be served by first-class mail, postage prepaid, on all parties of record in STB Docket Number EP 711 (Sub-No. 1).



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