

BEFORE THE
SURFACE TRANSPORTATION BOARD

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DOCKET NO. EP 711 (SUB-NO. 1)

RECIPROCAL SWITCHING

REPLY COMMENTS OF

ALLIANCE FOR RAIL COMPETITION
MONTANA WHEAT AND BARLEY COMMITTEE
IDAHO BARLEY COMMISSION
IDAHO WHEAT COMMISSION
MONTANA FARMERS UNION
NORTH DAKOTA FARMERS UNION
SOUTH DAKOTA FARMERS UNION
MINNESOTA FARMERS UNION
WISCONSIN FARMERS UNION
NEBRASKA WHEAT BOARD
OKLAHOMA WHEAT COMMISSION
SOUTH DAKOTA WHEAT COMMISSION
TEXAS WHEAT PRODUCERS BOARD
WASHINGTON GRAIN COMMISSION
WYOMING WHEAT MARKETING COMMISSION
NORTH DAKOTA GRAIN DEALERS ASSOCIATION
IDAHO GRAIN PRODUCERS ASSOCIATION
US GLASS PRODUCERS TRANSPORTATION COUNCIL
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The Alliance for Rail Competition and the parties listed on the cover (“ARC, et al.”) hereby reply to opening comments filed in this proceeding, focusing particularly on the comments of major railroads attempting to defend the status quo with respect to rail-to-rail competition.

In opening comments filed October 26, 2016, ARC, et al. explained that we support proposals in the STB’s July 25, 2016 decision even though numerous members and constituents of ARC, et al. are unlikely to be able to invoke competitive switching remedies. Long distances in many Western States to an actual or potential interchange may make switching impracticable for many producers and shippers served by a single railroad, even assuming switching would lead to effective competition.

Not only are the Board’s proposals in the public interest, but they should be strengthened through removal of barriers to switching, including the requirement of showing market dominance, which finds no support in the statute or in sound policy considerations. Though not a panacea, competitive switching can offer qualifying shippers a new option for addressing pricing and service issues.

Relief from excessive rates is not the only benefit that may result from competitive remedies, though inadequate regulatory remedies make reductions in excessive rates resulting from captivity a legitimate goal. Service problems may also warrant switching remedies. Requiring expensive market dominance showings where switching might ameliorate poor rail service makes no sense and is antithetical to the public interest.

It comes as no surprise that the railroads oppose any change in the status quo. The railroads have benefitted enormously from older decisions like Midtec Paper

Corp. v. Chicago & N. W. Transp. Co., 3 I.C.C. 2d 179 (1986), aff'd., Midtec Paper Corp. v. United States, 857 F.2d 1487 (D.C. Cir. 1988). Such decisions, which effectively undermined the will of Congress in 49 USC 11102, were made in an earlier era under different circumstances.

Concerns over the financial strength of major railroads meant that, uniquely among American businesses, major railroads were allowed to make most pricing and service decisions unconstrained by effective competition or effective regulation. The result is that the four largest Class I railroads now dominate rail freight transportation and enjoy record revenues, with BNSF and UP significantly exceeding even the conservative revenue adequacy standards of the STB.

The railroads' defense of their ability to minimize competitive pressures, even when an interchange is nearby, rests on a number of legal, policy and operational arguments, all of which are unavailing. Before turning to those arguments, ARC, et al. would make one fundamental point. Railroads facing minimal competition from other railroads cannot legitimately expect that they will also be free from regulation, no matter how much they charge, no matter how high their revenues, and no matter how mediocre their service. The public interest is not synonymous with the private interest of railroads.

Put another way, to the extent that railroads are allowed to avoid market discipline in the form of competition, the need for effective regulatory remedies is increased. This is the fundamental premise of the Staggers Act, and increases in railroad industry financial strength means that the era of minimal competition and minimal regulation, at the expense of captive rail customers, needs to end.

Even if new switching remedies are adopted over railroad objections, more effective regulatory remedies are needed for producers and shippers who cannot

invoke, or benefit from, competitive switching. However, where effective competitive remedies can be implemented, they should be, as Congress intended.

On the policy front, the first point to make is that US economic and legal policies generally favor competition, even if railroads disfavor it. Competition is a key goal of the antitrust laws, and antitrust policies are often considered in STB decisions. See, e.g., the Board's decision served January 11, 2012 in Docket No. MC-F 21035, Stagecoach Group PLC, at page 6, n. 10 ("The Board can and does consider antitrust principles in its consideration of public interest factors.").

More fundamentally, increased competition has led to widespread benefits for the economy and the nation, including improved technology, reduced waste, enhanced safety and increased responsiveness to the needs of customers and the marketplace, including changes in those needs. When Conrail was acquired, the benefits of competition were extolled. In an April 17, 1998 letter to shippers, CSXT Vice President John Anderson wrote "I know of no market for goods and services where increased competition hasn't produced better offerings and better value." (As detailed below, a few years earlier Conrail sought to subvert competitive forces.)

The national policy in favor of competition is not limited to the antitrust laws, but also finds expression in the Rail Transportation Policy of 49 USC§ 10101. See in particular Section 10101(1), stating that it is part of the policy of the United States "to allow, to the maximum extent possible, competition and the demand for rail service to establish reasonable rates for transportation by rail."

In their opening comments, the railroads make the Orwellian argument that this section of the RTP supports their efforts to oppose more competition. The Board

was far more faithful to the intent of Congress when it said of the NITL proposal to overturn Midtec and implement 49 USC§ 11102:

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 destination, and regulate only the access price for the first (or last) 30 miles.

Decision served July 25, 2012 in EP 711, Petition for Rulemaking to Adopt Revised Competitive Switching Rules, at pages 1-2.

The railroads' take on the RTP is transparently self-serving, and inconsistent with the Congressional goal of promoting competition, and preserving regulation primarily for those situations in which effective competition is absent. More fundamentally, if there were ambiguity in the RTP, it is the STB, and not the railroad industry, which is charged with defining national policy, under the familiar principles of Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984).

Turning from policy to law, the railroads' arguments in favor of the status quo reflect further overreaching. In essence, the railroads argue that past decisions by the ICC and STB cannot be revisited or modified because they are part of an established regulatory structure. The arguments are understandable; the railroads have spent decades successfully petitioning this agency for decisions on issue after issue that are favorable to their interests. Examples include revenue adequacy, rate reasonableness tests, unreasonable practices, the Bottleneck decisions, paper barriers, contracts, switching remedies and other issues.

It does not follow, however, that these precedents cannot be changed, especially in rulemaking proceedings like this one. Where the ICC or STB decision at issue was not the only permissible result under the statute, the Board can and should modify past rulings to meet changed circumstances, so long as the Board explains its departure from past precedent. Based on the record in this proceeding, the STB will be able to do just that.

Many of the railroads' arguments amount to asserting that efficiency is more important than competition, and that single line service should therefore be maximized. By this reasoning, the railroads seek to insulate their monopoly power from any change in what they assert is a "reliance interest".

This same reasoning would support an argument by Walmart that it should not be subject to competition from Target if Walmart spends significant amounts building a superstore. The argument could also be mounted in opposition to decisions by FERC under which utilities allow their transmission systems to be used (at reasonable cost) so competitors and customers can transmit their own power. Single line service would be maximized if there were only one railroad in North America, but this would not be in the public interest.

In none of these situations is the railroads' preferred monopoly model of commerce made the rule, to be deviated from only where the incumbent has been found to be derelict in its pricing or service. Rather, the laws of this country favor competition, recognizing that competitive forces are better at producing efficiency than monopoly.

Another fallacious argument for the status quo is that Wall Street would rather invest in monopolies than in businesses subject to competition. No doubt there are investors (and managements) that look favorably at a large captive customer base

for railroads combined with ineffective or inadequate regulation. The implication that national regulatory and legal policies should therefore preserve and promote monopolies is not just wrong but nonsensical.

The railroads supplement their arguments based on reliance claims and the preferences of Wall Street with arguments about the operational chaos that they predict will result if 49 USC§ 11102 is interpreted as if it means what it says. This is another “sky is falling” contention by the railroads, and ignores some inconvenient facts.

Railroads already engage in switching voluntarily, without suffering from frequent switching-caused train wrecks. The idea that they cannot absorb even a handful of additional switches based on a Board finding favoring switching as a competitive remedy is not credible. For this reason, railroads also argue that any change in current law will lead to switching that is extensive rather than rare, and that such widespread switching will be imposed on them with no notice. In fact, assuming the Board implements its proposals here, switching will be infrequent, and the railroads involved will almost always receive ample notice of any change in movement patterns.

The railroads’ advocacy on this point is reminiscent of their arguments in EP 722, Railroad Revenue Adequacy, in which they act as if any revenue adequacy constraint would freeze all rail rates forever, even though the real goal there is to let captive rail customers seek reasonable limits on future excessive differential pricing of their traffic, once revenue adequacy is achieved or exceeded. Exaggeration is relied on in place of rational discussion of the issues presented.

To the railroads and their witnesses, we live in the best of all possible worlds. Rail service quality is superb, and no captive producer or shipper ever needs to

worry about excessive rail rates thanks to SAC. Accordingly, switching should never be ordered, and if it is ordered, the incumbent should be “made whole” through collection of access fees that cover not just the cost of the switching, but also preserve the incumbent’s monopoly markups.

In this regard, the court of appeals decision in Delaware & Hudson Ry. Co. v. Consolidated Rail Corporation, 902 F.2d 174 (2d Cir. 1990) is instructive. The issue there was access under trackage rights charges imposed on D&H by Conrail rather than access through switching, and the Second Circuit was considering the D&H’s appeal from a lower court’s dismissal of its antitrust challenge to Conrail’s “make or buy” program. Under that program, Conrail, which had agreed to a contribution of \$1250 for D&H’s use, in joint line service, of a Conrail line, demanded a new contribution of \$10,000, reflecting the full amount Conrail would receive if D&H did not participate in the haul.

The record showed that this 800% increase in contribution would make D&H’s profit “ludicrously low”, and a Conrail Vice President had written, in support of make or buy, “I’m for monopoly in total!” Under the circumstances, the court of appeals held that D&H should get its day in court under the essential facilities doctrine and under the anti-monopolization provisions of the antitrust laws.

Other railroads may have officers who use email more carefully, but the industry’s antipathy to competition, by short lines or by other Class Is, continues. In addition, Conrail’s “make whole” pricing of trackage rights, which the court found potentially violative of the antitrust laws, is similar if not identical to the switching charges the railroads seek in this proceeding. If the Board cannot penalize anti-competitive conduct by the railroads, it can at least restore a measure

of balance by permitting shippers and producers to obtain switching in appropriate circumstances, at fees that do not nullify 49 USC§ 11102.

If good faith negotiations and STB regulatory remedies could be counted on to assure all captive rail customers that they would never face excessive rates or inadequate service, the need to overturn Midtec and restore the proper role of Section 11102 would be less urgent. Captive producers and shippers would be more comfortable with the status quo despite decades of ill-advised restrictions on rail-to-rail competition.

However, that is not the situation in which captive producers and shippers find themselves. On the contrary, despite its theoretical appeal to the railroads' economists, SAC does nothing to guarantee the statutory right to reasonable rates for 99% of captive rail customers. SSAC and Three-Benchmark, for their part, do more to protect than to prevent excessive pricing by market dominant railroads.

For these reasons, competitive switching charges that preserve what are essentially unregulated monopoly markups disserve the public interest. Indeed, the effect is to import SAC complexity into a context – the setting of access fees – where a “full stand-alone cost presentation” will necessarily be “too costly, given the value of the case”.

The status quo as to rail service quality, like the status quo as to rates, benefits the railroads far more than it benefits the public or the nation's economy. Even when there is one of the too frequent rail service meltdowns we have experienced, the STB has little ability to provide relief. Micro-managing railroad operations from the STB's offices is done only rarely, and sparingly. The ability to order switching at reasonable costs would significantly expand the Board's toolkit during service slumps.

The bottom line is that, 30 years after Midtec was decided, the railroads persist in demanding that any diminution of their industry's economic interests be seen as an assault on the public interest, as if what's best for them is best for the rest of us. One looks in vain through 1500 pages of railroad industry opening comments for any acknowledgement of two fundamental facts.

First, market dominant railroads have an obvious incentive to maximize rates, charges and burdens on their captive customers. Absent a switching option, those customers' freight will move via the incumbent railroad until such time as the customer goes out of business, and the freight may continue to move via the incumbent railroad even after an individual customer folds, so long as the goods are handled by another captive successor. This has happened repeatedly when high rates and/or poor service drove smaller grain elevators under. It has also happened all over the northern plains when elevators located on branch lines were driven out of business by railroad rates and/or practices which forced the former branch line railroad traffic to elevators on the mainline of the monopoly railroad.

Second, the service offerings most beneficial to the railroads and their investors are not always the same as the service offerings most needed by rail customers. When the service interests of railroads and their customers conflict, there is an obvious danger that service to such customers will be provided at levels or costs that do not meet customers' needs, or will not be provided at all (i.e., demarketing may occur). This can lead to situations in which producers, customers or markets that should do well in the competition for sales end up doing poorly because railroads prefer other routings or patterns of movement more conducive to railroad operations and/or marketing.

It is these incentives to elevate railroad self-interest over the public interest that should be the main focus of the STB, now that railroad industry financial health appears secure. The railroads would rather have the Board focus instead on non-problems, like too many rate cases and too many switching cases being brought in order to obtain unreasonably low rate levels. Such scenarios are fantasies concocted to distract the Board from problems that are real and fundamental to sound regulation of a powerful and important industry.

The railroads may argue that most businesses sometimes pursue self-interest over the interest of their customers. We would offer two rebuttals. First, the railroad industry is subject by law to public interest regulation that has not been imposed on other industries. Second, and not coincidentally, other industries are far more subject to competition than the federally franchised railroad industry.

It is precisely the railroad industry's residual monopoly power that led Congress to adopt partial rather than total economic deregulation in the Staggers Act. And it is precisely their residual monopoly power that the railroads seek to preserve in this proceeding. In this proceeding, as in so many others, the railroads argue that government intervention is necessary to ensure that they earn "adequate revenues," while at the same time arguing against any government intervention that might limit their monopoly power! The railroads' preference for "heads we win, tails captive shippers lose" regulation can no longer be tolerated.

ARC, et al. do not have unlimited resources, and we are participating in numerous other STB proceedings. Relatively few of our members and constituents are likely to benefit from the new switching remedies the Board has proposed. We therefore do not attempt to match the extraordinary volume of railroad filings here,

with their diagrams of rail yard traffic jams and predictions of disaster if a handful of shippers become a little less captive through better access to switching.

ARC, et al., do submit, however, that there is less substance than bulk to the railroads' filings, and that this proceeding presents a less difficult choice than the railroads claim. Over 35 years have passed since 1980, and the major railroads have consolidated into Eastern and Western duopolies subject to minimal regulation and minimal competition. The major railroads are also enjoying record revenues and are charging record rates to many of their captive customers.

A number of past precedents the railroads support are now decades old, and were never mandated by the statute. Midtec is one such decision. (The Bottleneck decisions should also be revisited.) The slight increase in competition proposed here is consistent with the Act and the public interest. It should not be abandoned due to railroad opposition. Rather, it should be improved through measures like those urged in our October 26, 2016 opening comments.

For the foregoing reasons, for the reasons set forth in previous filings by ARC, et al. in EP 711 (which are incorporated herein by reference) and EP 711 (Sub-No. 1), and for reasons set forth in comments in these proceedings by other captive shipper and producer interests, the Board should strengthen, and then implement, its proposals for switching remedies as an alternative, in appropriate cases, to regulatory remedies.

Respectfully submitted,

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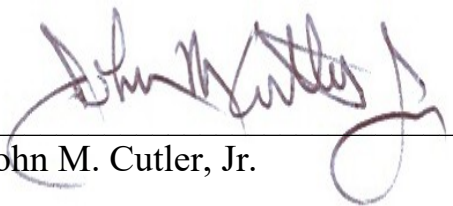
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A handwritten signature in dark ink, appearing to read "John M. Cutler, Jr.". The signature is cursive and somewhat stylized, with the last name "Cutler" being the most legible part.

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CERTIFICATE OF SERVICE

I hereby certify that I have this 13th day of January, 2017, caused copies of the foregoing document to be filed on parties of record by electronic means or first class mail.



John M. Cutler, Jr.