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BEFORE THE  
SURFACE TRANSPORTATION BOARD

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Docket No. EP 711 (Sub-No. 1)

RECIPROCAL SWITCHING

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COMMENTS

submitted by

THE SHIPPER COALITION FOR RAILROAD COMPETITION

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Alliance of Automobile Manufacturers  
American Chemistry Council  
American Fuel and Petrochemical Manufacturers  
American Petroleum Institute  
Chlorine Institute  
The Fertilizer Institute  
Glass Packaging Institute  
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Dated: October 26, 2016

**TABLE OF CONTENTS**

	<u>Page</u>
<b>I. IDENTIFICATION AND INTEREST .....</b>	<b>3</b>
<b>II. SUMMARY OF POSITION .....</b>	<b>3</b>
<b>III. THE BOARD IS CORRECT THAT IT NEEDS TO REFORM ITS RECIPROCAL SWITCHING REGULATIONS .....</b>	<b>5</b>
A. The Board Is Correct That Its Current Reciprocal Switching Regulations and Its Decision in Midtec Have Improperly Acted As a Bar To Relief Rather Than As a Standard Under Which Relief Could Be Granted.....	5
B. The Board Is Correct That There Have Been Significant Changes in the Rail Industry Since the ICC’s Decision in Intramodal Rail Competition.....	9
C. The Pro-Competitive Policies of the Statute Require the Board to Re- Examine Its Switching Rules in Light of the Railroads’ Changed Circumstances and Justify a Change in the Agency’s Regulations .....	14
<b>IV. THE BOARD IS CORRECT THAT IT HAS THE AUTHORITY TO REVISE ITS INTERPRETATION OF THE RECIPROCAL SWITCHING STATUTE AND TO ADOPT NEW RECIPROCAL SWITCHING REGULATIONS .....</b>	<b>16</b>
A. The Plain Language of the Statute, Its Legislative History, and Precedent Affirm the Board’s Authority to Change Its Current Reciprocal Switching Rules .....	17
B. The Railroads’ “Ratification” Argument is Completely Erroneous .....	19
<b>V. THE SHIPPER COALITION SUPPORTS THE BOARD’S CASE-BY- CASE APPROACH FOR LITIGATING RECIPROCAL SWITCHING CASES BUT BELIEVES THAT IT MUST BE MODIFIED TO MITIGATE THE COMPLEXITY, LENGTH, AND COSTS OF SWITCHING PROCEEDINGS .....</b>	<b>20</b>
A. The Board’s Case-By-Case Proposal Is Consistent With the Intent of the Statute, But the Board Should Adopt Procedures To Avoid Unnecessarily Complicated, Lengthy and Expensive Proceedings That Will Discourage Use of the Rules .....	20
B. The Board Should Adopt Procedures That Clearly Define the Scope of a Reciprocal Switching Proceeding at the Outset of Each Case and Reflect the Parties’ Respective Burdens of Proof to Facilitate Efficient and Expedited Proceedings.....	23
C. The Board Should Establish a Procedural Schedule For Discovery, Submission of Evidence, and its Decision .....	29

<b>VI.</b>	<b>THE BOARD SHOULD MODIFY AND CLARIFY THE RECIPROCAL SWITCHING CRITERIA AND OTHER ASPECTS OF ITS PROPOSAL.....</b>	<b>31</b>
A.	Eligibility to Access a Shipper Through Reciprocal Switching Should Be Extended To Class II and III Carriers .....	32
1.	<i>Shortline Carriers Should be Permitted to Serve as the Competing Carrier .....</i>	<i>33</i>
2.	<i>The Board Should Allow for an Exception to the Rule Prohibiting Shortlines From Serving as the Incumbent Carrier if there is Evidence of Gaming the Rules to Avoid Reciprocal Switching Prescriptions .....</i>	<i>34</i>
B.	The Board’s Proposal That “There Is Or Can Be a Working Interchange Within a Reasonable Distance” Of A Shipper Facility is Rational and Supportable, But the Board Should Better Define What Constitutes a “Reasonable Distance” and Should Revise Its “Can Be” Requirement For a Working Interchange.....	35
1.	<i>The Board Should Clarify What Would Constitute a “Reasonable Distance” From a Working Interchange .....</i>	<i>36</i>
2.	<i>The Board’s Proposed Definition As To What “Is” a Working Interchange is Generally Sound But Its Definition As To What “Can Be” a Working Interchange Is Far Too Narrow .....</i>	<i>40</i>
C.	The “Necessary to Provide Competitive Rail Service” Prong Is Basically Sound, But the Board Should Define How the Agency Will Apply the Market Dominance Test To a Movement Seeking Reciprocal Switching.....	42
1.	<i>The Board Needs To Define the Movement and the Rate That Will Be Considered In Evaluating Qualitative and Quantitative Market Dominance. The Board Should Apply the Market Dominance Test To the Incumbent Carrier’s Bottleneck Segment and Not To the Whole Route Of a Joint Movement .....</i>	<i>43</i>
2.	<i>The Board’s Decision Not To Include a Standing Requirement In the Second Prong Of Its Proposal and Not To Consider Product and Geographic Competition Is Correct .....</i>	<i>46</i>
3.	<i>The Board’s Proposal On the Effect of a Reciprocal Switching Prescription On a Rate Reasonableness Case Is Consistent With the Statute and Fully Supportable.....</i>	<i>47</i>
D.	The Board Should Clarify That a Party May Pursue a Switching Remedy Under Either or Both Tests .....	48
E.	The Board Should Clarify the Identity of the Parties That Are Eligible To File a Request for Reciprocal Switching Under the Board’s Proposed Rules .....	48

<b>VII.</b>	<b>THE BOARD SHOULD UTILIZE A MODIFIED SSW APPROACH TO ESTABLISH FAIR AND REASONABLE STANDARDS FOR ACCESS PRICING AND IT SHOULD NOT CONSIDER LOST CONTRIBUTION WHEN SETTING ACCESS FEES .....</b>	<b>50</b>
A.	The Board Should Use Alternative 2, a Variant of the SSW Compensation Methodology, To Establish an Access Price.....	50
B.	The Board Should Not Consider Lost Contribution in Establishing an Access Price .....	53
<b>VIII.</b>	<b>THE BOARD SHOULD CLARIFY THE STANDARD THAT IT WILL USE IN DETERMINING WHETHER TO REOPEN AN ORDER FOR RECIPROCAL SWITCHING.....</b>	<b>54</b>
<b>IX.</b>	<b>THE BOARD’S PROPOSED CHANGES TO ITS RULES ON THE SEPARATION OF THROUGH ROUTES AND TECHNICAL CHANGES TO OTHER PROVISIONS IN PART 1144 ARE ACCEPTABLE FOR THIS PROCEEDING .....</b>	<b>54</b>
<b>X.</b>	<b>CONCLUSION .....</b>	<b>55</b>

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In a decision served July 27, 2016 in Docket No. EP 711 and EP No. 711 (Sub-No. 1) (“Decision”), the Surface Transportation Board (“Board” or “STB”) granted in part a petition for rulemaking filed by the National Industrial Transportation League (“NITL”) on July 7, 2011 (“NITL Petition”). The NITL Petition asked the Board to initiate a proceeding to facilitate rail-to-rail competition in the United States by adopting new competitive switching regulations that are consistent with the governing statute. In its Decision, the Board proposed new regulations that are derived directly from the switching statute codified at 49 U.S.C. § 11102(c). The proposed regulations would allow a party to obtain a reciprocal switching prescription if it shows that the requested reciprocal switching is either “practicable and in the public interest,” or “necessary to provide competitive rail service.” Decision at 16. The Board described in detail why new reciprocal switching regulations are needed and are consistent with the Rail Transportation Policy, and explained the rationale underlying its specific proposals. The Board requested comments on its proposal and will schedule ex parte meetings between Board

members and staff and interested stakeholders to assist the Board with its understanding of the complex issues involved in this proceeding. Decision at 2, 28.

These Comments are submitted in response to the Board's Decision by a broad coalition of organizations whose members strongly support revising the Board's current reciprocal switching rules to facilitate rail-to-rail competition in a manner that is consistent with the governing statute ("Shipper Coalition"). The Shipper Coalition is comprised of a group of associations that represent a large cross-section of manufacturers, producers and receivers across a broad array of American industry, including chemicals, petroleum, agricultural retailers, fertilizer, glass producers, and many others, who require competitive and efficient rail service in the receipt of raw materials and distribution of their products across the United States.

The Shipper Coalition commends the Board for opening this rulemaking to revise its outdated reciprocal switching rules, and overturn related precedent, which have prevented the use of reciprocal switching arrangements to facilitate rail-to-rail competition, as envisioned by the Staggers Act. The Board's decision to reform its current reciprocal switching policy is justified legally, and as a policy matter based on the substantial consolidation and vastly improved financial condition of the rail industry that have occurred over the past 30 years. The Coalition supports the Board's case-by-case, two-pronged approach for adjudicating requests for reciprocal switching. However, to ensure that the new rules are workable and accessible, the Coalition asks the Board to adopt procedures that will govern reciprocal switching proceedings, and to modify and clarify the two-prong criteria proposed by the Board. Further, as the issues underlying reciprocal switching policy reform have been thoroughly debated for more than five years, the Shipper Coalition urges the Board to move forward expeditiously to finalize the new rules.

## **I. IDENTIFICATION AND INTEREST**

Statements of interest for each of the organizations joining in these Comments are attached as Exhibit 1.

## **II. SUMMARY OF POSITION**

The Shipper Coalition strongly supports revising the Board's current reciprocal switching rules in order to facilitate rail-to-rail competition. In these Comments, the Coalition asserts the following:

1. The Board is correct that reform of its reciprocal switching regulations is needed because the current rules and related precedent effectively act as a bar to relief rather than as a standard under which relief can be granted. A change to the Board's reciprocal switching policy is clearly warranted to facilitate greater rail-to-rail competition in the present-day rail industry which is highly concentrated and financially strong, and is a far-cry from the weak and unstable rail industry that existed over three decades ago. Thus, changing the Board's reciprocal switching rules is aligned with the pro-competitive policies of the statute and the Board's duty to balance and weigh any conflicting policies in light of current market conditions.

2. The Board correctly determined that it has the authority to revise its reciprocal switching rules. The Board's rejection of the railroads' erroneous argument that Congress ratified the Board's current rules and precedent when it adopted the ICC Termination Act was carefully-considered and properly supported.

3. The Board's case-by-case, two-pronged approach for evaluating reciprocal switching prescriptions is consistent with the words and intent of the statute. However, the Shipper Coalition is extremely concerned that the Board's very general, case-by-case, fact-specific approach creates a high risk that reciprocal switching proceedings will require time-consuming, complex and expensive litigation. The Board's proposal provides no guidance or

rules as to how reciprocal switching proceedings will be conducted which creates substantial uncertainty as to how the rules will be implemented. Thus, to ensure that the rules are useful and accessible, especially for small shippers, the Coalition asks the Board to adopt specific procedures that will help ensure that proceedings are administered and decided expeditiously, as the statute requires.

4. Specifically, the Board should implement procedures to require the parties to define the scope of a switching case at its outset in order to facilitate and clarify any necessary discovery, and to adopt rules governing evidentiary submissions that reflect the parties' respective burdens of proof and persuasion. Additionally, the Board should establish a specific procedural schedule for reciprocal switching proceedings, including the timing for filing of the complaint and answer, serving discovery, submission of evidence, and issuance of the Board's decision. The Shipper Coalition has recommended herein specific procedures and a schedule that can be adopted by the Board. Finally, the Board should provide for procedures to resolve discovery disputes expeditiously.

5. In addition to procedural changes, the Board should modify and clarify certain aspects of its proposal. Most importantly, the Board should allow Class II and III carriers to access a shipper's facility through reciprocal switching by serving as the competing carrier, since such an expansion would benefit rather than harm the shortlines. However, the Shipper Coalition agrees that Class II and III carriers should generally be excluded from reciprocal switching proceedings as the incumbent carrier, unless there is evidence that a Class I railroad has divested a rail line to a shortline for the purpose of avoiding application of the rules.

6. The Board should better define what constitutes a "reasonable distance" from a working interchange to a shipper's facilities. Here, the Board should focus on the actual



operations of the carrier in determining what may constitute a “reasonable distance.” The Board should also broaden its definition of what “can be” a working interchange because the Board’s proposed restriction on any new construction is unduly narrow, particularly where the shipper or accessing carrier offers to pay for the new construction.

7. The Board should clarify how the agency will define the movement and the rate that will be considered in evaluating market dominance under the “necessary to provide competitive rail service” prong.

8. Regarding the access fee to be paid for the “switch” movement, the Board should utilize a modified SSW approach to establish a fair and reasonable standard for determining the fee and should adopt a 15-day time period for the carriers to reach agreement on the access fee once a reciprocal switching prescription has been granted. Under no circumstances should the Board consider “lost contribution” when setting an access fee.

### **III. THE BOARD IS CORRECT THAT IT NEEDS TO REFORM ITS RECIPROCAL SWITCHING REGULATIONS**

#### **A. The Board Is Correct That Its Current Reciprocal Switching Regulations and Its Decision in Midtec Have Improperly Acted As a Bar To Relief Rather Than As a Standard Under Which Relief Could Be Granted**

In its Decision, the Board set out the regulatory history of its current reciprocal switching regulations, noting that in 1985, the Board’s predecessor agency, the Interstate Commerce Commission (“ICC”), adopted regulations in Docket No. EP 445 pertaining to competitive access, including reciprocal switching, that are still in effect today. See, Intermodal Rail Competition, 1 I.C.C.2d 822 (1985), aff’d sub nom Balt. Gas and Elec. v. United States, 817 F.2d 108 (D.C. Cir. 1987) (“BG&E”). The ICC’s current regulations provide that reciprocal switching would only be prescribed if the agency determined that it would be “necessary to remedy or prevent an act that is contrary to the competition policies of 49 U.S.C. 10101 or is

otherwise anticompetitive” and “otherwise satisfies the criteria of . . . 11102(c).” 49 C.F.R. § 1144.2(a)(1).<sup>1</sup> Decision at 3. The Board also noted that in the following year, 1986, the ICC decided its first reciprocal switching case under the then-new regulations in Midtec Paper Corp. v. Chicago & North Western Transportation Co. (“Midtec”), 3 I.C.C.2d 171 (1986). In that case, the ICC denied the shipper’s petition for reciprocal switching, noting that “the key issue” was whether the incumbent railroad “has engaged or is likely to engage in conduct that is contrary to the rail transportation policy or is otherwise anticompetitive.” Decision at 4, quoting and citing Midtec at 181. The Board noted that the fundamental question in Midtec was “whether the railroad had used its market power to extract unreasonable terms or had shown a disregard for the shipper’s needs by furnishing inadequate service.” Decision at 4. In its Decision, the Board observed that since the ICC’s decision in Midtec, “few requests for reciprocal switching have been filed with the agency . . . and in none of those cases has the Board granted a request for reciprocal switching.” Id.

Having set out its predecessor agency’s original decision implementing the statutory reciprocal switching authority and its fundamental decision in Midtec, the Board then discussed the need to revisit the ICC’s interpretation of its statutory authority and its reciprocal switching regulations. Decision at 8. The Board noted that “many commenters in both this proceeding and in Docket No. EP 705 expressed the view that the agency’s decision to narrow its discretion under § 11102(c) – by requiring anticompetitive conduct – has proven, over time, to set an unrealistically high bar for shippers to obtain reciprocal switching . . .” Id. The Board further noted that “shippers have not filed petitions for reciprocal switching in many years, despite expressing concerns about competition [footnote omitted] . . .” Id. The Board concluded that

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<sup>1</sup> Formerly codified at 49 C.F.R. § 1144.5(a)(1).

“the sheer dearth of cases brought under § 11102(c) in the three decades” since the agency’s original decision in 1985 “suggests that part 1144 and Midtec Paper Corp. have effectively operated as a bar to relief rather than as a standard under which relief could be granted.” Decision at 8-9.

The Board is absolutely correct in its analysis. Indeed, if anything, the Board has understated the difficulties faced by shippers in obtaining reciprocal switching under the current rules and precedent. Even more importantly, the agency’s effective “bar to relief” under the current rules and precedent is directly at odds with the intent of Congress in granting the agency authority to prescribe reciprocal switching in the Staggers Rail Act of 1980.

Prior to the Staggers Act of 1980, the authority of the ICC to establish reciprocal switching arrangements or to decide the terms and conditions of reciprocal switching arrangements was not clear.<sup>2</sup> In adding a provision on reciprocal switching to the legislation that eventually became the Staggers Act, Congress indicated that reciprocal switching was to be a pro-competitive benefit for shippers. For example, the Senate Report noted, “[i]n areas where reciprocal switching is feasible, it provides an avenue of relief for shippers served by only one railroad where service is inadequate.”<sup>3</sup> Indeed, Congress, in clarifying the agency’s authority to prescribe reciprocal switching, fully expected the agency to utilize its new power in a pro-competitive manner. The House Report, for example, noted “[t]he Committee intends for the Commission to permit and encourage reciprocal switching as a way to encourage greater competition.”<sup>4</sup> In fact, the Staggers Act Conference Committee Report specifically noted that

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<sup>2</sup> See, S. Rep. No. 96-470, at 42 (1979); H.R. Rep. No. 96-1035, at 67 (1980).

<sup>3</sup> S. Rep. No 96-470, at 42.

<sup>4</sup> H.R. Rep. No. 96-1035, at 67.

the reciprocal switching agreement provision in the Act, among others, was “included to foster greater competition.”<sup>5</sup>

But Congress’ intent to “foster greater competition” simply did not take place under the agency’s rules as they were interpreted in Midtec. Indeed, in defending its Midtec decision in court, the agency argued, and the court held, that the ICC’s new competitive access rules substantially narrowed the agency’s discretion under the statute to grant competitive remedies.<sup>6</sup> That narrowing continued under the agency’s subsequent decisions. Three years later, in Vista Chemical Company v. The Atchison, Topeka and Santa Fe Railway Company,<sup>7</sup> the agency found that, where a railroad’s failure to provide competitive rates is cited as evidence of anticompetitive activity, the agency must address the issue of whether the rates are unreasonably high, thus seemingly requiring an inquiry into the agency’s unreasonable rate standards as well as its competitive access standards.<sup>8</sup> In the decision, the agency rejected assertions that the market was uncompetitive; that the carrier had offered uncompetitive rates; that the rates were unreasonably high; that the railroad’s behavior was uncompetitive; that the railroad’s behavior was discriminatory; or that the routing the shipper was forced to use was inefficient.<sup>9</sup> Vista Chemical appeared to erect barriers to relief that were even higher than the demanding tests outlined in Midtec.

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<sup>5</sup> H.R. Rep. No. 96-1430, at 80. See also, Cent. States Enters., Inc. v. ICC, 780 F.2d 664, 679 (7th Cir. 1985) (“The purpose of the Staggers Act was to encourage, under the appropriate circumstances, but not require, the Commission to approve railroad switching agreements.”).

<sup>6</sup> Midtec, 857 F.2d at 1500.

<sup>7</sup> Vista Chem. Co. v. Atchison, Topeka & Santa Fe Ry., 5 I.C.C.2d 331 (1989).

<sup>8</sup> Id. at 336.

<sup>9</sup> Id. at 337-42.

Just eight months later, in Shenango Incorporated, et al. v. Pittsburgh, Chartiers and Youghiogeny Railway Company,<sup>10</sup> the ICC again rejected a complaint seeking prescription of the terms for terminal trackage rights, applying its standards in Intramodal Rail Competition. The agency rejected claims of anticompetitive conduct; allegations that the rate was above stand-alone costs; claims of routing inefficiencies; and other allegations.<sup>11</sup>

Finally, in Golden Cat Div. of Ralston Purina Co. v. St. Louis SW. Ry.,<sup>12</sup> the last case construing its competitive access rules, the agency again denied relief, ruling that the determination of whether a terminal area exists requires a full inquiry into the nature and use of a facility, including switching or classification activities, the activities of other shippers, and other facts;<sup>13</sup> and that in order to obtain competitive access on the basis of poor service, the service failures have to be severe.<sup>14</sup>

Thus, in the last twenty years, *i.e.*, since the Golden Cat decision in 1996, in the face of this daunting precedent, no requests for reciprocal switching have even been filed, despite the dramatic losses of rail-to-rail competition following the rail mega-mergers of the 1990s.

B. The Board Is Correct That There Have Been Significant Changes in the Rail Industry Since the ICC's Decision in Intramodal Rail Competition

In its Decision, the Board noted that “there have also have been many changes that have occurred in the rail industry since Intramodal Rail Competition and Midtec Paper Corp.”

Decision at 9. Specifically, the Board noted that, in the 1980s, the rail industry was “reeling

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<sup>10</sup> Shenango Inc. v. Pittsburgh, Chartiers & Youghiogeny Ry., 5 I.C.C.2d 995 (1989).

<sup>11</sup> Id. at 1000-03.

<sup>12</sup> Golden Cat Div. of Ralston Purina Co. v. St. Louis SW. Ry., ICC Docket No. 41550, slip op. (served April 25, 1996).

<sup>13</sup> Id. at 7-8.

<sup>14</sup> Id. at 9.

from decades of inefficiency and serial bankruptcies.” Id. Since then, the Board noted in its Decision, there have been numerous “significant changes,” including the improved economic health of the railroad industry; increased consolidation of the Class I railroad sector; the creation of short lines that may have strong ties to particular Class Is; and increased railroad productivity and technological advances. Id. The Board concluded that the agency’s current regulations and precedent make “less sense in today’s regulatory and economic environment.”

The Board’s analysis is exactly correct – there have been massive changes in the rail industry in the thirty-one years since the Board issued its regulations in Intramodal Rail Competition. Indeed, the Board has made virtually this same finding in several proceedings over the last several years.<sup>15</sup> A brief examination of two of the factors noted by the Board in its Decision – rail consolidations and the rail industry’s improved economic health – confirms the Board’s conclusion.

It is without question that rail-to-rail competition has been reduced substantially since the passage of the Staggers Act of 1980 and since the ICC adopted the current reciprocal switching rules in 1985. In 1981, there were thirty-one Class I rail carriers; today, there are only seven – and only four dominate the industry. As of 2008, BNSF, UP, CSXT, and NS accounted for over 90% of Class I freight shipments and over 92% of the \$61 billion in Class I rail revenues.<sup>16</sup> The dominance of these four carriers is multiplied by the fact that only two of them serve the eastern

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<sup>15</sup> See, e.g., Ex Parte No. 705, Competition in the Rail Industry, slip op. at 3, served January 1, 2011; Review of Rail Access and Competition Issues, STB Docket No. EP 575, 3 S.T.B. 82, 98 (1998). The Board’s finding in Ex Parte No. 705 that the industry had “changed in many significant ways” was fully supported by the comments submitted by federal agencies, associations and individual companies in that proceeding.

<sup>16</sup> See, Office of Oversight and Investigations of the Senate Committee on Commerce Science and Transportation, “The Current Financial State of the Class I Railroad Industry,” September 15, 2010, p. 3, citing the Association of American Railroads Railroad Ten-Year Trends, 1999-2008 (Feb. 2010).

and two serve the western portions of the U.S. Moreover, the seven Class I railroads were responsible for nearly 95% of the rail industry's total revenue in 2013.<sup>17</sup>

There is no question that the rail industry is financially strong. This is shown by the Board's own revenue adequacy findings, as well as independent analyses by other parties.

In 1981, the first year that the agency decided to measure revenue adequacy by a return-on-investment standard, the ICC found that only three of thirty-five Class I railroads were revenue adequate.<sup>18</sup> Today, however, most Class I railroads have achieved revenue adequacy under the Board's standards, and more importantly, the rates of return as calculated by the agency for all railroads, have been above or close to the Board's standard.<sup>19</sup> Indeed, the two most recent years for which revenue adequacy results are available reveal the financial success of the Class I railroads. In 2014, three of the four major Class I railroads were revenue adequate, with CSXT close to revenue adequacy, and in 2015, two of the four major Class I railroads were revenue adequate, with NS' and CSX' rates of return both just slightly under the cost of capital

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<sup>17</sup> Freight Railroads Background, p. 1, Federal Railroad Administration, Office of Rail Policy and Development (April 2015).

<sup>18</sup> Standards for Railroad Revenue Adequacy, 364 I.C.C. 803 (1981).

<sup>19</sup> See Railroad Revenue Adequacy – 2015 Determination, STB Ex Parte No. 552 (Sub-No. 20) (served Sept. 8, 2016); Railroad Revenue Adequacy – 2014 Determination, STB Ex Parte No. 552 (Sub-No. 19) (served Sept. 8, 2015).. In 2014, four of the seven Class I railroads were revenue adequate. The ROI for Canadian Pacific Railway ("CP") was anomalous in 2014 due to a one-time charge associated with the sale of certain Dakota, Minnesota & Eastern Railroad rail lines. See, Railroad Revenue Adequacy – 2014, slip op. at 3 (n. 4). Omitting the ROI figure for CP, the simple average ROI for the six remaining Class I railroads was 11.93% in 2014, well above the rail industry cost of capital for the year, which was 10.65%. In 2015, four of the seven Class I railroads were revenue adequate, with NS's and CSX's rate of returns (9.03% and 9.00% respectively) just slightly below the cost of the capital for that year of 9.61%. The simple average of the seven Class I railroads return on investment in 2015 was 11.27%, or well above the industry's cost of capital for that year of 9.61%. Railroad Revenue Adequacy – 2015 Determination, slip op. at 3. Thus, for the past two years, the industry's average return on investment has substantially exceeded its average cost of capital. See also, S. Rep. No. 111-380, 111th Cong. 2d Sess. at 2 ("The average Class I railroad's return on investment increased from 1978 when it was 1.52 percent to 10.7 percent in 2008.").

for that year. In both years, the average rate of return for the industry was well above the industry's cost of capital.<sup>20</sup>

Independent analyses confirm the financial health of the industry. An independent study commissioned by Congress and published in 2015 by the Transportation Research Board (“TRB”) found that “[t]he Staggers Rail Act was successful in enabling the development of an efficient, innovative, and financially strong freight railroad industry.”<sup>21</sup> In support of this assessment, the TRB supplied a wide variety of data and analysis. For example, the TRB noted that revenue of the Class I railroads, in 2013 dollars, increased 59% between 1995 and 2013.<sup>22</sup> During the same time period, Class I railroads were able to increase capital expenditures (again in 2013 dollars) by 54%.<sup>23</sup> Given that “the railroad industry has been transformed,” the TRB was surprised by the way existing “regulatory provisions serve purposes that are now expired” and are “outdated” because they were “introduced decades ago when the railroads and associated policy concerns were much different from those of today.”<sup>24</sup> In short, the TRB found that the regulatory framework needed revision, with the remaining regulations “suited to the financially sound, modern railroad industry of today and not to the foundering one that required rescue 35 years ago.”<sup>25</sup>

Other recent assessments of the freight rail industry have come to similar conclusions. In 2010, the Office of Oversight and Investigations of the Senate Committee on Commerce,

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<sup>20</sup> Id.

<sup>21</sup> Modernizing Freight Rail Regulation, Special Report No. 318, at 116, Transportation Research Board, National Academy of Sciences (2015).

<sup>22</sup> Id. at 18.

<sup>23</sup> Id. at 18.

<sup>24</sup> Id. at 2 and 7.

<sup>25</sup> Id. at 7.



Science and Transportation issued a report titled “The Current Financial State of the Class I Railroad Industry,” September 15, 2010 (“Senate Financial Report (2010)”), in which it concluded that “[a] review of the Class I railroads’ recent financial result shows that the Staggers Act’s goal of restoring financial stability to the U.S. rail system has been achieved.”<sup>26</sup> The Senate Report noted that the four largest U.S. rail carriers had nearly doubled their collective profit margin in the ten-year period prior to 2010.<sup>27</sup> In 2008, the railroad companies’ profit margins placed the industry fifth out of 53 industries on Fortune’s list of “most profitable industries.” Senate Financial Report (2010), p. 5. Between 2001 and 2008, the railroad industry was ranked in the top ten on Fortune’s profitability list seven out of eight times and its growth in profitability had outpaced almost all other large industries. Id. All of this is a far cry from Congress’ finding in 1980 that the railroad industry’s profitability was the lowest of any transportation mode. In 2010, the Senate Financial Report concluded that freight railroads are “now some of the most highly profitable businesses in the U.S. economy.” Id. at 14.

In late 2013, the Senate Financial Report was updated, and similar conclusions were reached. The Office of Oversight and Investigations found that Class I railroads were “prospering” and that “the financial performance of these [railroad] companies is at its strongest since the passage of the Staggers Act.”<sup>28</sup> The 2013 Update found that the major Class I railroads have been able to increase dividends, engage in stock buy-backs, and otherwise provide benefits to shareholders.<sup>29</sup> The Commerce Committee reported that “[a] detailed review of the freight

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<sup>26</sup> Senate Financial Report (2010) at 1.

<sup>27</sup> Id. at 5.

<sup>28</sup> Update on the Financial State of the Class I Freight Rail Industry, pages i and 21, Office of Oversight and Investigations (Majority Staff), Senate Committee on Commerce, Science, and Transportation (Nov. 21, 2013) (“Update”).

<sup>29</sup> See Update at 14-20.

railroads' financial results over the past four years shows that the companies have been establishing record-low operating ratios, experiencing record growth in operating income, and posting record earnings-per-share figures.”<sup>30</sup> Specifically, between 2009 and 2013, “the three largest publicly traded Class I railroads broke quarterly operating ratio records in 29 of the 48 quarters Committee staff reviewed” and “the railroads have set new operating income records in 30 of the 48 quarters Committee Staff reviewed.”<sup>31</sup>

C. The Pro-Competitive Policies of the Statute Require the Board to Re-Examine Its Switching Rules in Light of the Railroads' Changed Circumstances and Justify a Change in the Agency's Regulations

The discussion in the two previous sections convincingly shows that the Board is correct in its Decision when it concluded that the agency's current regulations “set an unrealistically high bar for shippers to obtain reciprocal switching” and have “effectively operated as a bar to relief rather than as a standard under which relief could be granted,” Decision at 8-9; and that there have been significant changes in the railroad industry. Decision at 9. But there is an additional consideration, in light of these conclusions: the Board's decision to propose new regulations is not only desirable but is essentially demanded by the statutory policies that Congress intended to govern the Board's every action.

Specifically, under 49 U.S.C. § 10101, Congress declared that, in regulating the railroad industry, it was to be the policy of the United States Government:

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<sup>30</sup> Update at 2.

<sup>31</sup> Update at 5-6 (“A company that lowers its operating ratio is improving the productivity of its operations by keeping more income after operating expenses have been removed from revenues.”). Specifically, the 2013 Update examined the operating ratios of the three largest publicly traded Class I freight railroads. Between 4Q 2009 and 3Q 2013, the CSX's operating ratio declined from 74.9 to 71.5; NS' declined from 73.9 to 69.9, and UP's declined from 73.3 to 64.8. See, Update, Appendix I.

- “(1) to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail . . . ;
- (4) to ensure the development and continuation of a sound rail transportation system with effective competition . . . ;
- (5) to . . . ensure effective competition . . . between rail carriers . . . ;
- (6) to maintain reasonable rates where there is an absence of effective competition . . . ;
- (7) to reduce regulatory barriers to entry into and exit from the industry . . . ;
- (9) to encourage honest and efficient management of railroads. . . ;
- (12) to avoid undue concentrations of market power . . . .”

These policies, separately and together, demand change in the Board’s current regulations. The Board’s current reciprocal switching regulations, far from ensuring effective competition as required by 49 U.S.C. § 10101(1), (4), (5) and (6), frustrate the development of effective competition. The current rules are themselves a regulatory barrier preventing a new competitor from entering a market, flouting the intent of §10101(7). By effectively inhibiting competition between rail carriers, the current rules provide no incentives for efficient management under §10101(9) – rather, they simply reward complacent inefficiency. And far from checking “undue concentrations of market power” as required by §10101(12), the current rules treat such concentrations of market power as inevitable and unavoidable. Moreover, since the railroad industry has achieved revenue adequacy, the Board, consistent with the policies of 10101(3) and (6), can focus on implementing the pro-competitive policies of the Act that have not been achieved under the agency’s current reciprocal switching rules. Faithfulness to Congress’ policies governing rail regulation, therefore, requires the Board to implement those

policies by revising its current rules, thereby fulfilling Congress' specific desire in the Staggers Act for the new reciprocal switching provisions "to foster greater competition."<sup>32</sup>

#### **IV. THE BOARD IS CORRECT THAT IT HAS THE AUTHORITY TO REVISE ITS INTERPRETATION OF THE RECIPROCAL SWITCHING STATUTE AND TO ADOPT NEW RECIPROCAL SWITCHING REGULATIONS**

In its Decision, the Board concluded that it retained broad authority to revise its statutory interpretation of the switching statute and the current reciprocal switching regulations. Decision at 10. The Board correctly noted that it is an "axiom" of administrative law that an agency's adoption of a particular statutory interpretation at one point in time does not preclude later different interpretations where the language of the statute gives the agency discretion. *Id.* The agency analyzed both general precedent as well as precedent specifically dealing with the review of the agency's current reciprocal switching rules in concluding that it does in fact have that discretion. *Id.* at 10-11. Finally, in its Decision, the agency carefully considered and rejected the argument of the CSXT and the Norfolk Southern railroads that the STB was precluded from changing its rules because Congress had allegedly "ratified" them when it reenacted the statute's reciprocal switching language in ICCTA. *Id.* at 11-13.

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<sup>32</sup> H.R. Rep. No. 96-1430, at 80. Moreover, an independent study commissioned by the Board concluded that a reform of reciprocal switching is unlikely to harm the railroads and is likely to provide public benefits. In 2008, the Board commissioned Christensen and Associates, Inc. to perform an independent study to examine competitive access issues, and in 2009, that firm issued a report analyzing a variety of proposals that might enhance competition. Laurits R. Christensen Associates, Inc. A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals That Might Enhance Competition (rev. 2009), <http://Irca.com/projects/railroadstudy/> (hereafter Christensen Competition Report). The report indicated that reciprocal switching likely would result in potential gains with respect to the economies of density and only few effects with respect to other economic measures; would "most likely" result in competitive responses by rail carriers; and would "most likely" produce shipper gains. Reciprocal switching, the Christensen Competition Report concluded, would have a "lower potential of leading to adverse changes to industry structure, costs, and operations, and additionally have greater likelihood[] of resolving shipper concerns via competitive market responses." *Id.* at Table 22-1 and 22-13 and 22-14.

The Board’s conclusions are exactly correct. The statute, its legislative history, and applicable precedent give the Board wide discretion to change its current reciprocal switching regulations, and the railroads’ “ratification” argument is utterly specious.

A. The Plain Language of the Statute, Its Legislative History, and Precedent Affirm the Board’s Authority to Change Its Current Reciprocal Switching Rules

On its face, the wording of the statutory provision gives the agency wide discretion to change its current reciprocal switching rules. The statute indicates that the Board “may” require carriers to enter into reciprocal switching arrangements, under two broad standards, i.e. switching arrangements must be “practicable and in the public interest” or “necessary to provide competitive rail service.” The statutory wording underscores the Board’s discretion: the use of the term “may;” the broad requirement for “findings” determined solely by the Board; the use of the broad “public interest” standard as one alternative to establish reciprocal switching; and an alternative standard based on a finding that competitive rail service is “necessary” all are consistent with the exercise of discretionary authority.

Congress used the word “may” in this statute to indicate the Board has broad discretion. The United States Supreme Court has noted that the use of the term “may” “usually implies some degree of discretion.”<sup>33</sup> Similarly, Congress’ use of the broad concepts of “public interest” and “necessary” to provide competitive rail service—without any indication in the words of the statute or the legislative history as to how these broad terms were to be interpreted—strongly indicate that Congress wanted to give the agency broad discretion in implementing the statute. The Supreme Court and lower courts have consistently held that, where a statute is silent or ambiguous, an agency has broad discretion to resolve the ambiguity.<sup>34</sup>

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<sup>33</sup> United States v. Rodgers, 461 U.S. 677, 706 (1983).

<sup>34</sup> See, e.g., Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 844 (1984).

Even more importantly, the courts that have considered the very rules that the Board is now seeking to change have noted the wide discretion given to the Board under its statutory authority over reciprocal switching. Court review of the agency's decisions in Intramodal Rail Competition and Midtec both indicate that the Board has wide discretion in this area. In BG&E, the petitioner challenged the agency's decision in Intramodal Rail Competition to establish reciprocal switching arrangements only to remedy or prevent an "anticompetitive" act as inconsistent with the statute. The court noted that, while the petitioner's position might be a reasonable interpretation of the statute (a question the court did not decide), it was not the only reasonable interpretation because "the statutory directives under which the ICC operates do not all point in the same direction . . . Our task thus is only to determine whether the ICC has arrived at a reasonable accommodation of the conflicting policies set out in its governing statute . . . ." <sup>35</sup> Thus, the court was clear that, while the agency's interpretation of the statute was permissible, the agency might also come to some other permissible interpretation.

The same was true in the court review of the Midtec decision, in which the court noted the "permissive" language and "discretionary terms" of the statute. The court noted that it would review the agency's "exercise of discretion" by examining whether it had provided a "reasoned analysis that is not manifestly contrary to the purposes of the legislation it administers." <sup>36</sup> The court found only that the agency's interpretation of the statute was a "reasonable accommodation" of the fifteen different and not-entirely-consistent goals of the national rail transportation policy set out in the Staggers Act.

Thus, it is abundantly clear that the courts, both in the review of the agency's Midtec and the Intramodal Rail Competition decisions, recognized that Section 11102 gave the agency wide

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<sup>35</sup> BG&E, 817 F.2d at 115.

<sup>36</sup> Midtec, 857 F.2d at 1500.

discretion to interpret the provision in light of current circumstances and the need to weigh and balance the policies of the Act at a particular time. These court decisions further establish that any future court, in reviewing any future change to the agency's rules and precedent on reciprocal switching, would review any such action under the same broad parameters.

B. The Railroads' "Ratification" Argument is Completely Erroneous

In its Decision, the Board carefully considered the argument of CSXT and NSR that the Board lacks the authority to change its reciprocal switching rules because Congress "ratified" the Midtec standard when it reenacted the reciprocal switching language in ICCTA. Decision at 11-13. In a well-supported and carefully-considered discussion, the Board decisively rejected the railroads' argument. Id. The Board's reasoning and conclusions are correct. In determining that the railroad's argument is completely without merit, the Board took special account of the fact that Congress, in ICCTA, reenacted the reciprocal switching provision without change, and the CSXT and NSR did not cite "any legislative history in which Congress even mentioned the agency's interpretation" of the statute. As the Decision carefully discussed, mere reenactment of a statute is insufficient for the ratification doctrine to apply; Congress must have taken affirmative steps to ratify. See, Decision at 11-12, citing Isaacs v. Bowen, 865 F.2d 468, 473 (2d Cir. 1989) and Ass'n of Am. R.R.s v. ICC, 564 F.2d 486, 493 (D.C. Cir. 1977). Numerous other court decisions support the Board's conclusion. See, e.g., Bob Jones University v. United States, 461 U.S. 574, 596 (1983) (where there was an "affirmative manifestation" of Congressional approval through a specific Congressional enactment); and FDA v. Brown and Williamson Tobacco Corp., 529 U.S. 120, 133-139, 155 (2000) (where the Court noted that Congress had directly spoken to the issue in specific legislation). Indeed, under the logic of the railroads' theory, every agency decision dealing with any part of the statute reenacted by ICCTA would have been "ratified" by Congress, leaving little or nothing to future agency discretion. There is

not a shred of evidence that Congress, in enacting ICCTA, intended to strip the agency of its discretion and responsibility.

**V. THE SHIPPER COALITION SUPPORTS THE BOARD’S CASE-BY-CASE APPROACH FOR LITIGATING RECIPROCAL SWITCHING CASES BUT BELIEVES THAT IT MUST BE MODIFIED TO MITIGATE THE COMPLEXITY, LENGTH, AND COSTS OF SWITCHING PROCEEDINGS**

**A. The Board’s Case-By-Case Proposal Is Consistent With the Intent of the Statute, But the Board Should Adopt Procedures To Avoid Unnecessarily Complicated, Lengthy and Expensive Proceedings That Will Discourage Use of the Rules**

In its Decision, the Board noted that the statute sets out two standards by which the Board can order reciprocal switching: (1) where reciprocal switching is “practicable and in the public interest”; and, (2) where reciprocal switching is “necessary to provide competitive rail service.” 49 U.S.C. § 11102(c). The Board noted that the agency’s current regulations essentially consolidate those two prongs into a single, restrictive test, and the Board in its Decision proposed to “adhere more closely to the statutory language than the ICC did.” Decision at 16. The Board thus proposed a “two-pronged” approach under which it could order reciprocal switching, either: (1) “when it is practicable and in the public interest”; or, (2) “when it is necessary to provide competitive rail service.” Id. A decision by the Board under either of these two statutorily-based “prongs” would be based on a “case-by-case review” in which the Board would “evaluate a switching arrangement based on the specific circumstances at hand” and would make “factual determinations derived from the evidence provided by the parties.” Id. The Board’s decision then sets out various “criteria” under each of its prongs, which it would evaluate in determining whether to prescribe reciprocal switching, based on the prong selected by the petitioning party and the evidence submitted by all parties. Id., pp. 17-19.

As a general matter, the Shipper Coalition believes that the Board’s reliance on the statute’s “practicable and in the public interest” and “necessary to provide competitive rail



service” standards is a valid starting point. The Board’s alternative two-pronged test, which adheres closely to the statutory language, recognizes that Congress intended to provide for two independent bases for relief. As noted by the Board in the Decision, the two-pronged approach would enhance the ability of shippers and carriers to make a case for reciprocal switching, certainly compared to the current rules. Decision at 16. The two-pronged approach also is consistent with the legislative history of Section 11102—to enhance rail-to-rail competition. Finally, the two-pronged approach is consistent with the overall policies of the statute to encourage effective competition and avoid undue concentrations of market power. See, 49 U.S.C. 10101(1), (4), (5), (6) and (12).

Moreover, the Board is correct that its two-pronged, case-by-case approach would, by its nature not provide for “open access.” As a substantive matter, the case-by-case, factually-based approach clearly provides for grant of a reciprocal switching remedy only when specific standards set forth in the proposed regulations are met. As a further procedural check, the case-by-case approach would allow the Board to monitor the effects of reciprocal switching as the new policy is implemented when cases come to the Board and would permit the Board to adjust any particular request for reciprocal switching to meet particular circumstances. Operational concerns could be carefully vetted. As the Board noted in its decision, this case-by-case, factually-based approach would permit the Board to “exercise a greater degree of precision when mandating reciprocal switching, thus mitigating the chance of operational challenges in a given area.” Decision at 17.

However, there is a downside to the Board’s broad case-by-case resolution of the very general standards that the Board has outlined in its Decision. Specifically, the Shipper Coalition is extremely concerned that the Board’s proposal, without certain modifications and additions, is

likely to lead to lengthy, complex and expensive litigation that would unduly tax both the Board's and the parties' resources and make it difficult to access reciprocal switching, especially for small shippers. For example, the Board's generalized and fact-specific approach implies that extensive discovery likely will be necessary for the Board to accumulate a record sufficient to support a decision. But, in its Decision, the Board gives no guidance and establishes no limits as to what discovery will be permitted and how such discovery will be integrated into the claims presented. The possible need for extensive discovery is likely to lead to extended litigation and complex discovery disputes.

Additionally, and perhaps even more importantly, the Board's proposal gives no indication as to the procedural steps that will need to be taken to get from complaint to decision: the time and method for the presentation of claims; the time and schedule for the presentation of evidence; and the time for decision. The lack of definition for these procedural steps is again likely to lead to significant disputes between the parties that will take time and money to resolve. The lack of any procedural guidance or timeline will tend to lengthen proceedings as the parties try to work through each case on their own, without any formal guidance from the agency.

The Shipper Coalition strongly believes that the Board should establish clear procedures (i) that require the parties to identify upfront the issues and claims involved in the switching case; (ii) for discovery and any related disputes; (iii) for the submission of evidence by the parties; and (iv) for issuance of the Board's decision. The Board increasingly has recognized the need to streamline its adjudicatory proceedings to help mitigate their complexity and cost and has recently considered shortened procedural schedules, submission of initial disclosures at the

outset of a case, and limits on discovery and evidentiary submissions.<sup>37</sup> In the remainder of this Section V, the Shipper Coalition proposes specific procedures to address the concern that the Board's proposed rules could result in complicated and expensive proceedings. The Coalition urges the Board to carefully consider these suggestions. The Shipper Coalition strongly believes that the Board's new rules will quickly become ineffective at facilitating rail competition if the process and standards required to obtain the remedy involve millions of dollars and take years to litigate. Therefore, the Board should act now to ensure that its processes "provide for the expeditious handling and resolution of all proceedings," as required by 49 U.S.C. § 10101(15).

B. The Board Should Adopt Procedures That Clearly Define the Scope of a Reciprocal Switching Proceeding at the Outset of Each Case and Reflect the Parties' Respective Burdens of Proof to Facilitate Efficient and Expedited Proceedings.

As noted above, under the Board's proposal there are two "prongs" for obtaining reciprocal switching: the petitioner may show that the proposed switching is: (1) "practicable and in the public interest;" or (2) "necessary to provide competitive rail service." Decision at 16. Under either prong, a carrier can defeat the request for switching by showing that the proposed switching is unsafe, infeasible, or will unduly hamper the ability of that carrier to serve its shippers. *Id.* at 19. The Board's proposal fails to clarify how the criteria and defenses outlined in the Decision will be joined at the start of the proceeding for either prong. Nor does the Board propose a procedural schedule or attempt to address the number and sequence of evidentiary submissions. However, these are critical issues in light of the standards proposed by the Board and the need for the Board to make expeditious and cost-effective reciprocal switching determinations.

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<sup>37</sup> See Ex Parte No. 665 (Sub No. 1), Rail Transportation of Grain, Rate Regulatory Review and Ex Parte 665 (Sub No. 2), Expanding Access to Rate Relief, slip op. at 15-20, served August 31, 2016.

Although both prongs would benefit from clearly-established procedures and guidelines, the Shipper Coalition is most concerned with the “practicable and in the public interest” prong, which requires that a party seeking reciprocal switching show that the “benefits” of the proposed switching outweigh the “detriments.” Decision at 17. Because the second prong is based upon the existing market dominance standard for rate cases, stakeholders may obtain some guidance from those existing procedures and precedent. In contrast, the first prong is largely a blank slate, requiring a greater degree of guidance. Therefore, much of this section focuses upon the first prong, although many of the suggested procedures apply equally to the second prong.

The Decision lists a wide variety of “relevant factors” that the Board might consider in determining whether the benefits of switching outweigh the detriments under the first prong. These include the efficiency of the route; access to new markets; the impact on capital investment, service quality, employees, and the transportation network; and the amount of traffic that would use the proposed switching. *Id.* at 18. Moreover, the Board declared that this was a “non-exhaustive list of factors” and that it would “not attempt to formalize the precise showings.” *Id.* The Decision indicates that there is no “mechanical test” for determining what is practicable and in the public interest and that the totality of the circumstances should be considered. *Id.* at 17. Thus, at the outset of a reciprocal switching case under the first prong, there is a very broad canvas upon which the parties may paint their evidence.

The Board’s proposed balancing test for the first prong, however, creates a situation where the petitioner has the burden of proving that the benefits of reciprocal switching outweigh the detriments; but without knowing what detriments the carrier may assert, a petitioner cannot present meaningful opening evidence to address potential detriments. Moreover, it is clear that information on many of the factors listed by the Board likely will be in the hands of the

incumbent carrier and thus require discovery. These include the efficiency of the route; the impact on the carrier's capital investment; the impact on service quality of the carrier to other shippers; the impact on the carrier's employees; and the impact on the carrier's transportation network. This uncertainty over the alleged detriments of reciprocal switching that the petitioner must balance against the benefits will require the petitioner to pursue broad discovery of any and all detrimental factors that the carrier conceivably may assert, without knowing whether the carrier even will raise those factors. Moreover, petitioners will need to present extensive evidence to cover all potential detrimental factors, including matters that the carrier ultimately may not assert. Even then, the petitioner may not anticipate all of the detriments the carrier actually does assert. Thus, the procedural vagueness of the Board's proposals inevitably points to a need for extremely broad discovery, a strong potential for "mismatched" opening and reply evidence, and prolonged and costly litigation.<sup>38</sup>

The foregoing concerns can be mitigated, if not avoided, through clearly established procedures that require the parties to stake out their positions early in the case, restrict discovery to the facts pertinent to those positions, and impose an order upon the presentation of evidence based upon which party has the burden of proof and which party is asserting a benefit or detriment under Prong 1. Therefore, to minimize the length, complexity and cost of discovery and to enable each party's evidence to directly address the claims of the other party, the Shipper Coalition proposes the following procedures for the Board's consideration. Note that the Coalition discusses these proposals in the context of both prongs.

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<sup>38</sup> Carriers also will require discovery of petitioners on such factors as access by the shipper to new markets and the amount of traffic that would use the switching arrangement. Even so, at least carriers will know the scope of petitioners' evidence before having to submit their reply evidence, which will avoid the guesswork that this process imposes upon petitioners.

First, the Board should require the following:

- 1) The initial Petition of the party requesting reciprocal switching must make binding statements that:
  - a) identify the site of the shipper/receiver facility(ies) and working interchange(s) for the proposed switching;
  - b) identify the incumbent and the proposed interchange carrier(s);
  - c) identify which prong or prongs the party seeking access is invoking; and
    - i) if under the “necessary to provide competitive rail service” prong, the individual movements for which switching is sought; or
    - ii) if under the “public interest” prong, the expected benefits of the proposed switching; and
  - d) identify the affected commodity(ies) and projected shipment volumes.
- 2) The Answer of the incumbent carrier (or any other carrier affected by the proposed switching)<sup>39</sup> must make binding statements that:
  - a) identify other Class I rail carriers, if any, that the carrier contends serve the site of the shipper/receiver facility(ies) for which switching has been requested;
  - b) identify whether the carrier contests petitioner’s identification of a working interchange within a reasonable distance of the shipper/receiver facility(ies) for which switching is sought, and if so, the nature of such contentions;
  - c) identify whether the carrier contends that the proposed switching is infeasible, unsafe, or will unduly hamper its ability to serve its other shippers, and if so, the nature of such contentions;<sup>40</sup> and

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<sup>39</sup> The petitioner should serve its Petition on both the incumbent and alternate carriers. The alternate carrier should file an Answer stating whether it supports, objects, or takes no position on the petitioner’s request. If the alternate carrier objects, it should be subject to the same standards and procedures as the incumbent carrier.

<sup>40</sup> The Decision proposes that, under both prongs, either of the railroads which potentially would be subject to reciprocal switching may attempt to show, as an affirmative defense under its burden of proof, that the proposed switching is not feasible or is unsafe, or that the presence of such switching would unduly hamper the ability of that carrier to serve its shippers. Decision at 19. The Board’s Decision briefly discussed the case-by-case evidence that might be used. Id. If the railroad carries its burden in making this showing, the Board indicated that it would not order reciprocal switching. Id. This standard appears to be generally acceptable. However, the Board

- d) if the Petition seeks relief under the “public interest” prong, identify the expected detriments of the proposed switching.

The foregoing requirements will ensure that the Petition and Answer define and limit the scope of the proceeding at the very outset of a case. The effectiveness of those requirements depends upon precluding either party from altering its position, or asserting additional benefits or detriments under the public interest prong, from those in the Petition and Answer without the consent of the Board.<sup>41</sup> Most importantly, discovery would be limited to only the benefits and detriments identified and the petitioner’s evidence need not anticipate or address detrimental factors in the first prong that the carrier does not intend to assert. This binding information in the Petition and Answer would permit both parties and the Board to understand the basis for, and scope of, the proceeding and facilitate more focused discovery and evidence.

Second, the Shipper Coalition proposes that the Board adopt three rounds of simultaneous evidence (for both prongs), with the scope of each round defined as follows:

Opening Evidence

- 1) Petitioner submits Opening Evidence to show:
  - a) the facilities of the shippers(s) and or receiver(s) for whom switching is sought are served by Class I rail carrier(s);
  - b) there is or can be a working interchange between the Class I carrier and another Class I rail carrier within a reasonable distance of the shipper/receiver facilities;
  - c) if the petition is under Prong 1, the potential benefits of the switching arrangement; and
  - d) if the petition is under Prong 2, market dominance.

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should require railroads who assert this defense to make a binding statement to that effect and to generally describe the problem in their Answer. This will permit the party seeking access to focus its discovery and evidence on the relevant issues.

<sup>41</sup> A party might choose, after discovery, to eliminate a claimed benefit or detriment from those that it would include in its evidence.

- 2) Carrier submits Opening Evidence to show:
  - a) if the petition is under Prong 1, the potential detriments of the switching arrangement; and
  - b) the proposed switching is not feasible or safe, or will unduly hamper the carrier's ability to serve other shippers.

#### Reply Evidence

- 1) Petitioner submits Reply Evidence on:
  - a) if the petition is under Prong 1, the carrier's claimed detriments of the proposed switching and whether the benefits outweigh the detriments; and
  - b) whether the proposed switching is feasible or safe, or will unduly hamper the ability to serve other shippers.
- 2) Carrier submits Reply Evidence on:
  - a) whether the facilities of the shippers(s) and or receiver(s) for whom switching is sought are served by Class I rail carrier(s);
  - b) whether there is or can be a working interchange between the Class I rail carrier and another Class I rail carrier within a reasonable distance;
  - c) if the petition is under Prong 1, the shipper's claimed benefits of the switching arrangement and whether the detriments outweigh the benefits; and
  - d) if the petition is under Prong 2, market dominance.

#### Rebuttal Evidence

- 3) Petitioner submits Rebuttal Evidence on:
  - a) whether the facilities of the shippers(s) and or receiver(s) for whom switching is sought are served by Class I rail carrier(s);
  - b) whether there is or can be a working interchange between the Class I carrier and another Class I rail carrier within a reasonable distance;
  - c) if the petition is under Prong 1, whether the potential benefits of the switching arrangement outweigh the detriments; and
  - d) if the petition is under Prong 2, market dominance.



- 4) Carrier submits Rebuttal Evidence on:
  - a) if the petition is under Prong 1, whether the potential detriments of the switching arrangement outweigh the benefits,<sup>42</sup> and
  - b) whether the proposed switching is feasible or safe, or will unduly hamper the ability to serve other shippers.

The foregoing proposed sequence and scope of evidence reflects the fact that each party has different burdens of proof and it addresses the anomalous situation discussed above in which a petitioner under Prong 1 otherwise would need to present opening evidence balancing the benefits and detriments of the proposed switching without knowledge of what detriments the rail carrier will allege and the evidence in support of those alleged detriments. Specifically, because the rail carrier bears the burden to prove that the requested switching is infeasible, unsafe, or will unduly hamper service to other shippers, it should present opening and rebuttal evidence on those subjects. Similarly, because the rail carrier must identify and support the alleged detriments of the proposed switching arrangements before the petitioner can balance those factors against its alleged benefits, it is appropriate to require the carrier to present such evidence on opening. Then on reply, each party can respond to the benefits and detriments identified by the other and conduct the required balancing test, with each critiquing the other's balancing test on rebuttal.

C. The Board Should Establish a Procedural Schedule For Discovery, Submission of Evidence, and its Decision

In Section 1145.2(b)(3) of its proposed rules, the Board has stated that any proceeding under the terms of Section 1145.2 “will be conducted and concluded by the Board on an expedited basis.” The Shipper Coalition is pleased that the Board has recognized that requests

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<sup>42</sup> Although this sequence of evidence also contemplates that the incumbent carrier will present reply evidence on this same issue, i.e., the balancing of benefits and detriments, this schedule also permits the carrier to respond to the petitioner's reply evidence on that issue because that would be the first time petitioner has attempted to balance those factors.

for reciprocal switching should be conducted quickly and efficiently. However, the proposed language, general as it is, is not sufficient to ensure the prompt resolution of reciprocal switching requests – there are no standards, nor any indication, as to just what is meant by an “expedited basis.” To avoid extended litigation, the Board in its final rules should establish expeditious procedures for conducting discovery, presenting evidence, and issuing a decision.

The Shipper Coalition suggests the following overall procedural schedule, which adheres to the sequence of evidence presented in the preceding section:

- Day 0: Petition by shipper/alternate carrier for reciprocal switching (with binding information as discussed in Section V.B)
- Day 20: Reply by incumbent carrier and any other carrier affected by the request (with binding information as discussed in Section V.B)
- Day 21: Discovery begins
- Day 80: Discovery ends
- Day 100: Opening Evidence
- Day 130: Reply Evidence
- Day 150: Rebuttal Evidence
- Day 210: STB decision

This schedule reasonably permits a request for reciprocal switching to be adjudicated in seven months from start to finish.<sup>43</sup>

In addition, because discovery has the greatest potential to cause delay and otherwise unduly protract a reciprocal switching proceeding, the Board should adopt procedures for the expeditious resolution of any discovery disputes. The Board employs procedures in other types of proceedings that could be adapted to mitigate the length of discovery. First, the Shipper

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<sup>43</sup> Under Section 1145.1 of the proposed rules, a party seeking switching would have to seek to engage in negotiations at least 5 days prior to seeking switching. However, this does not waive a party’s right to file a timely request for the establishment of a switching arrangement.

Coalition urges the Board to appoint an Administrative Law Judge (“ALJ”) to address discovery disputes at the outset of the case. Second, the Board also should issue its standard protective order at the outset of a case so that the parties do not need to file a motion and wait for the Board’s response before producing information to the other side. If there are unique facts in a case that merit a modified version of the standard protective order, a party can file a motion for such modification, but such motion should not delay production of other information not affected by the requested modification. Third, the Shipper Coalition suggests that the Board adopt expedited dispute resolution procedures comparable to those at 49 C.F.R. § 1114.31(a)(2) through (4) for rate cases. Although the timelines could remain the same, the ALJ should decide the dispute after a hearing rather than the Director of the Office of Proceedings after a conference with the parties.

By adhering to the sequence of evidence proposed in the preceding section and expediting resolution of discovery disputes, the Board should be able to receive evidence and render its decision on requests for reciprocal within the time frame suggested above. Extensions of time should be the exception rather than the rule.

## **VI. THE BOARD SHOULD MODIFY AND CLARIFY THE RECIPROCAL SWITCHING CRITERIA AND OTHER ASPECTS OF ITS PROPOSAL**

Although the Shipper Coalition supports the two-pronged, case-by-case approach set out in the Decision, there are important areas that the Coalition believes the Board should modify or clarify.

First, the Coalition strongly believes that the Board should extend eligibility to access a shipper through reciprocal switching to Class II and Class III carriers. While the Coalition believes that the Board is correct in not making Class II and Class III carriers subject to a request for access through reciprocal switching by another carrier, there are strong policy reasons for

allowing a Class II or III carrier to seek access to a shipper served by an incumbent Class I carrier.

Second, the Board's proposal that "there is or can be a working interchange within a reasonable distance" of a shipper facility is rational and supportable, but the Board should better define what constitutes a "reasonable distance." Additionally, to incorporate sensible expansions of existing interchanges, the Board should broaden its requirement that there "is or can be a working interchange" within a reasonable distance.

Third, the Board should clarify and define how the agency will apply the second, "necessary to provide competitive rail service," prong in determining the "market dominance" element of that prong. The Board's Decision is not clear as to whether the market dominance test should apply to the whole route of a joint movement or just to the incumbent carrier's monopoly segment. The Shipper Coalition asserts that the proper market dominance inquiry should focus upon the incumbent carrier's monopoly segment.

Each of these three issues, as well as some other clarifications to the Board's substantive proposals, are discussed in this Section VI below.

A. Eligibility to Access a Shipper Through Reciprocal Switching Should Be Extended To Class II and III Carriers

Although NITL's proposal would have permitted Class II and Class III carriers to participate in reciprocal switching arrangements as the competing carrier, under both prongs of the Board's proposed regulations, "prescriptions of reciprocal switching would be limited to instances in which both the incumbent railroad and the competing railroad are Class I carriers." Decision at 20 (emphasis added). The Board's decision to limit the scope of reciprocal switching prescriptions to Class I carriers was based on "the lack of specific information on this matter and concerns raised by the ASLRRA." Decision at 20-21. However, due to the limited information

on this issue, the Board has requested comments as to whether the rules should be extended to apply to shortline carriers now or in the future. Decision at 21. The Shipper Coalition believes that limiting reciprocal switching prescriptions only to Class I carriers is unnecessarily restrictive. The Coalition, therefore, supports an expansion of the rules to allow Class II and III carriers to participate in reciprocal switching prescriptions as the competing carrier.

1. *Shortline Carriers Should be Permitted to Serve as the Competing Carrier.*

Excluding Class II and Class III carriers from serving as the incumbent carrier under the rules is rational due to their more limited size and reach as compared to Class I carriers. There are far fewer concerns regarding the exercise of market power by small shortline carriers, and excluding shortlines from mandated reciprocal switching as the incumbent carrier will protect them from the large economic power of Class I carriers that could seek to serve the customer of a Class II or III carrier.

However, the Shipper Coalition strongly believes that the Board should reconsider its decision to exclude Class II and Class III carriers from serving as the competing carrier. No clear reasons have been articulated as to how such performance would be harmful to Class II or III rail carriers. In fact, it can reasonably be expected that smaller carriers could benefit substantially from opportunities to expand their customer base and market share by participating in reciprocal switching as the alternate carrier. The Board itself has recognized that there is limited information regarding the impacts on shortline carriers. Absent clear grounds for exempting such carriers entirely, the Shipper Coalition urges the Board to expand the rule to permit shortlines to provide competitive rail service as part of a reciprocal switching prescription.

Moreover, the Board should reject the ASLRRRA suggestion in the prior proceeding that reciprocal switching should not apply to any movement in which a Class II or III railroad

participates at any point along the route regardless of whether or not such carriers serve the origin or destination, or are a bridge carrier. This proposal would eliminate reciprocal switching where the Class II or III carrier is hundreds of miles from the site of the grant of reciprocal switching, and would actually be harmful to shortlines by creating incentives for shippers to cut Class II and III carriers out of a movement.

2. *The Board Should Allow for an Exception to the Rule Prohibiting Shortlines From Serving as the Incumbent Carrier if there is Evidence of Gaming the Rules to Avoid Reciprocal Switching Prescriptions*

Further, it is not clear how reciprocal switching orders would interplay with existing “paper barriers,” which may prohibit a shortline from engaging in reciprocal switching with an alternate carrier altogether or impose a financial hardship for doing so. Shortline carriers potentially could face contractual and/or financial penalties unless the reciprocal switch order supersedes the paper barrier. Thus, as noted above, the Shipper Coalition agrees with the decision of the Board to require requests for switching access to be made only against incumbent Class I railroads at this time, but notes that there could be situations that would justify an exception to this general rule to address the potential divestiture of rail lines by such Class I carriers for the purpose of avoiding reciprocal switching prescriptions. The Shipper Coalition is concerned that Class I carriers conceivably could spin-off a rail line to a Class II or III railroad (and perhaps include a paper barrier) to immunize or exempt a major customer’s facility from reciprocal switching. The spin-off of the line serving the customer’s facility would prevent the customer from obtaining a reciprocal switching prescription since a Class II or III carrier now would serve the facility directly instead of the Class I carrier and thus would be exempt from the rule. The Board should ensure that any such “gaming” of the rules is not permitted. Therefore, the Shipper Coalition urges the Board to accept and evaluate challenges to the shortline

exemption on a case-by-case basis and to refuse to apply the exemption when it believes any such gaming may have occurred.

B. The Board's Proposal That "There Is Or Can Be a Working Interchange Within a Reasonable Distance" Of A Shipper Facility is Rational and Supportable, But the Board Should Better Define What Constitutes a "Reasonable Distance" and Should Revise Its "Can Be" Requirement For a Working Interchange

In its Decision, the Board proposes an element common to both of its "public interest" and "necessary to provide competitive rail service" prongs, namely, that there "is or can be a working interchange between the Class I rail carrier servicing the party seeking switching and another Class I rail carrier within a reasonable distance of the facilities of the party seeking switching . . ." Decision at 18, 19; see also p. 21. In discussing this requirement, the Board rejected the NITL's proposed 30-mile conclusive presumption as to what constitutes a reasonable distance from an interchange and what is or is not a working interchange. Decision at 21. The Board proposed that the determination as to what constitutes a "working interchange" within a "reasonable distance" "should be made on a case-by-case basis." *Id.* However, the Board invited comment on defining the term "reasonable distance" in an effort to provide guidance to parties that may seek switching under the proposed regulations. *Id.* The Board also deviated from the NITL's proposal insofar as the definition of what "can be" a working interchange is concerned by proposing that it could find that there "can be" a working interchange "only if the infrastructure currently exists to support switching, without the need for construction." *Id.* However, the Board specifically sought comment on its proposed definition of what "can be" a working interchange. *Id.*

As a general matter, the Shipper Coalition believes that the Board's proposed case-by-case determination of what constitutes a "working interchange" within a "reasonable distance" is rational and supportable, but subject to two modifications. First, the Shipper Coalition believes

that the Board should provide some guidance to the parties as to what might constitute a “reasonable distance” for a reciprocal switching arrangement. Second, the Shipper Coalition believes that the Board’s proposed limitation as to what “can be” a working interchange is far too narrow and restrictive.

1. *The Board Should Clarify What Would Constitute a “Reasonable Distance” From a Working Interchange*

The NITL’s proposal included a conclusive presumption in favor of reciprocal switching when there was an interchange at which cars are regularly switched within 30 miles of the shipper’s facilities. The Board proposes to replace the League’s 30-mile presumption with a more flexible “reasonable distance” requirement and has invited comments on defining that term to provide guidance to parties under the proposed regulations.

Although the phrase “reasonable distance” does not derive from Section 11102(c) which governs reciprocal switching, it does appear in Section 11102(a) with respect to terminal trackage rights as an alternative form of competitive access. Section 11102(a) states that “[t]he Board may require terminal facilities, including main-line tracks for a reasonable distance outside of a terminal, owned by a rail carrier...to be used by another rail carrier...” (emphasis added). The Board may look to its precedent interpreting this use of the phrase “a reasonable distance” as guidance in reciprocal switching cases, but accounting for differences in the nature of switching and trackage rights.

In terminal trackage rights cases, the agency has provided guidance both as to the statutory definitions of a “terminal” and “a reasonable distance outside of a terminal.” Both the STB, and the ICC before it have stated that the agency interprets these phrases “liberally,”<sup>44</sup>

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<sup>44</sup> See, CSX Corp. et al.—Control—Chessie and Seaboard C.L.I., 363 I.C.C. 518, 585 (1980) (“Chessie”); Rio Grande Industries, Inc. et al—Purchase and Related Trackage Rights—Soo Line R.R. Co. Line Between Kansas City, MO and Chicago, IL, Fin. Dkt No. 31505, Dec. No. 6



especially because the power to make terminal facilities of one carrier available to another is remedial in nature.”<sup>45</sup> In Chicago & Alton R.R. Co. v. Topeka, Peoria & Western Ry. Co., 146 I.C.C. 171, 179 (1928), the ICC declared that “[w]hether the distance necessary to be traversed over the line...is a reasonable distance is a question to be determined in the light of the facts in each case. It would be manifestly harsh and unsound to attempt to prescribe a definite limitation as to distance because that condition must depend primarily upon the extent of the terminal area to be served and the complexity of access to it.”

Terminal trackage rights permit an alternative carrier to operate over both the distance from the incumbent’s switching facilities within a terminal and the distance over the incumbent’s main-line track for a reasonable distance beyond the terminal. However, a reasonable distance between a shipper’s facility and a working interchange for the purpose of reciprocal switching should be longer than a reasonable distance beyond a terminal with respect to terminal trackage rights, because reciprocal switching is a less intrusive form of competitive access than actual operating rights granted to one carrier to use another carrier’s facilities. Therefore, “a reasonable distance” to a working interchange for reciprocal switching should be longer than the distances in the Board’s terminal trackage rights precedent, including both the distance within and beyond the terminals.

Furthermore, when the nearest interchange is within a terminal area, “a reasonable distance” should include any facility within that terminal area and a reasonable distance beyond it. “A ‘terminal area’...must contain and cannot extend significantly beyond recognized terminal

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(served Nov. 15 1989), 1989 ICC LEXIS 351, at \*26 (“RGI/Soo”); Dakota, Minnesota & Eastern R.r. Corp et al.—control—Iowa, Chicago & Eastern R.R. Corp., Fin. Dkt. No. 34178, Dec. No. 7, slip op. at 41, n. 65 (served Jan. 31, 2003) (“DME”).

<sup>45</sup> Chessie at 585, citing City of Milwaukee v. Chicago & N. W. R. Co., 283 I.C.C. 311, 314 (1951).

facilities, such as freight or classification yards or team tracks, and a cohesive commercial area immediately served by those facilities.” DME, slip op. at 41 (n. 65), quoting RGI/Soo, at \*27. The Board defines “terminal facilities” as “any property of a carrier which assists in the performance of the functions of a terminal.” Id. In addition, “the nature of the facilities and the character of the area in which they are located are as important as the use of the facility.” Id. Therefore, the geographic area of a terminal should be reasonably discernible from the surrounding commercial area served by trains that operate from the terminal facilities.

Based in significant part upon this precedent, the Shipper Coalition proposes that the Board be guided in its determination of “a reasonable distance” for reciprocal switching by the actual operations of the incumbent between the facility for which switching is sought and the nearest working interchange. The Shipper Coalition identifies two common scenarios where the distance covered by the incumbent railroad’s actual operations should be deemed reasonable for reciprocal switching: (1) when the incumbent serves the facility by a train that operates through a yard where there is a working interchange, or (2) when the incumbent serves the facility by a train that operates through a yard that is part of a larger connected network of yards where there is a working interchange.

In Scenario (1) above, the train that serves the customer facility, which would receive reciprocal switching, operates out of or through a classification yard that also is a working interchange. The train handles cars from this customer facility in the same manner regardless of whether or where these cars ultimately are interchanged with another carrier. At the yard where a working interchange exists, the incumbent either places the car on one of its own road trains or on the interchange track for transport to the alternative carrier’s classification yard. Because this is the simplest reciprocal switching operation and the distance involved is the same regardless of

the ultimate route, whatever that distance may be should be deemed reasonable. The rationale for this concept is that the incumbent is not required to change how it serves the customer and handles the switch traffic over the first-mile, last-mile segment; beyond that segment, the primary operational difference is whether the incumbent classifies a car to one of its own line-haul trains or an interchange train.<sup>46</sup>

Scenario (2) above addresses operations that are common to large metropolitan areas where carriers may interchange traffic and often have large terminal areas. Class I railroads may operate multiple yards within large metropolitan areas. However, they may interchange traffic at just one or two central classification yards and conduct most of their local train service to customers out of multiple satellite yards. For example, the incumbent may operate a local train out of a satellite yard to serve a customer facility. That train brings all cars from the customer facility to the satellite yard regardless of the ultimate destination. At the yard, the incumbent may build both road trains to haul traffic across its own network and trains to move cars between the satellite yard and the central classification yard where there is a working interchange. In a reciprocal switching operation, the incumbent would place the customer's traffic onto a train at the satellite yard headed to the central classification yard instead of a road train.

Thus, where the incumbent operates a network of central and satellite yards, which typically exist within a terminal area, the operations illustrated in Scenario (b) should be afforded the same presumption of a reasonable distance as Scenario (a) above. This is comparable to the scope of terminal trackage rights which apply to an entire terminal area plus mainlines for a reasonable distance outside the terminal. It also is consistent with the Board's definition of a

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<sup>46</sup> The incumbent remains free to argue that this change in handling is not feasible, is unsafe, or will unduly hamper its ability to serve other customers, as the Board has proposed. But that should not undermine the evaluation of a reasonable distance.

terminal area based on the nature of the facilities and the character of the area in which they are located, and in particular the Board's focus upon a "cohesive commercial area" served by those facilities. The design and operation of a core yard with a working interchange surrounded by satellite yards is highly indicative of a "cohesive commercial area."<sup>47</sup>

2. *The Board's Proposed Definition As To What "Is" a Working Interchange is Generally Sound But Its Definition As To What "Can Be" a Working Interchange Is Far Too Narrow*

Under the Board's proposal "there 'is' a working interchange if one already exists and is currently engaged in switching operations." Decision at 21. Further, "there 'can be' a working interchange only if the infrastructure currently exists to support switching, without the need for construction, regardless of whether switching operations are taking place or have taken place using that infrastructure." *Id.* The Shipper Coalition supports the proposed definition as to what "is" a current working interchange since it is clear that an existing interchange where on-going switching operations occur should be eligible to support a reciprocal switching prescription (assuming all other standards may be met). However, the Shipper Coalition believes that the Board's definition as to what "can be" a working interchange is unduly restrictive to the extent that it would disqualify an interchange from supporting a prescribed reciprocal switching arrangement if any new construction is needed to support the switching operations.

The Board apparently added the "no construction" requirement to its definition of a future working interchange due to its concern that permitting infrastructure construction to support the existence of a working interchange may "imply that railroads be required to construct brand new interchange facilities to satisfy a switching prescription." Decision at 21. The

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<sup>47</sup> In support of this focus on current actual operations in determining a reasonable distance from a working interchange, Messrs. Thomas D. Crowley and Daniel L. Fapp in their attached Verified Statement note that many large railroads operate local trains up to 100 miles from beyond their home yards. See Crowley/Fapp V.S., attached as Exhibit 2, at 31-32.

Shipper Coalition agrees that an incumbent railroad who currently serves a shipper's facility for which a switching prescription is sought should not be required to invest in infrastructure needed to establish a working interchange that could result in the transfer of rail traffic to another carrier. However, it is conceivable that there could be some situations where the investment needed is small and inexpensive, such as straight-forward facility repairs or upgrades to track. It is also possible that more extensive infrastructure may be desirable to support reciprocal switching, including the construction of additional yard capacity or other facilities needed to handle the additional traffic to be switched. In either situation, the Shipper Coalition believes that the shipper or the alternate carrier (or both) should have the option of paying for the necessary infrastructure enhancements to support reciprocal switching. In those situations, the Board should be able to determine on a case-by-case basis that there "can be" a working interchange. Thus, the Shipper Coalition requests that the Board modify its proposed definition of what "can be" a working interchange to allow for the construction of any necessary infrastructure when the investment is made by the shipper and/or the alternate carrier.

The Shipper Coalition also notes that both of the Board's proposed definitions as to what "is" and what "can be" a working interchange (subject to the proposed modification immediately above) would help to address an existing concern where carriers operate terminal facilities in a manner that "opens" the facility to switching for some industries but "closes" the very same facility to other industries, either because the carriers refuse to agree to switch certain traffic or the switch fees are set so high for certain industries that there is no benefit to the switching operation. Although a high access fee would need to be addressed separately (see Section VII below), a shipper whose facility has been closed to switching at an interchange location that is open to others should be able to establish under the Board's definitions that there "is" or "can

be” a working interchange, based in part on the very existence of on-going switching operations at the location.

C. The “Necessary to Provide Competitive Rail Service” Prong Is Basically Sound, But the Board Should Define How the Agency Will Apply the Market Dominance Test To a Movement Seeking Reciprocal Switching

The Shipper Coalition strongly supports the Board’s proposed criteria to determine whether reciprocal switching is “necessary to provide competitive rail service.” The Shipper Coalition also believes that market dominance is an appropriate criterion for evaluating the necessity of reciprocal switching to provide competitive rail service. As the Board aptly has observed, the market dominance test “answers the same question that the Board would address under the competition prong of the proposed reciprocal switching analysis: whether effective competition exists for an individual movement or movements.” Decision at 22. After all, if a carrier does not possess market dominance over a movement, reciprocal switching may not be necessary to provide competitive service for that movement. Conversely, reciprocal switching can provide competitive rail service for a movement that is subject to the market dominance of a single rail carrier.<sup>48</sup> In combination with the other three proposed criteria, the market dominance test defines a reasonable universe of rail traffic that would be eligible for reciprocal switching.

The Board, however, must be careful not to allow the market dominance test to become unduly burdensome, costly, and time consuming. The Board has expressed this very concern in several recent rate reasonableness cases.<sup>49</sup> Those concerns, and the Board’s resolution in those

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<sup>48</sup> However, the mere possibility of reciprocal switching does not automatically mean that the market is workably competitive. See Section VI.C.3. below.

<sup>49</sup> E.I. du Pont de Nemours and Company v. Norfolk Southern Ry. Co., Docket No. NOR 42125, slip op. at 17-21 (served March 24, 2014) (“DuPont”); Total Petrochemicals & Refining USA, Inc. v. CSX Transp., Inc., Docket No. NOR 42121, slip op. at 3-4 (served May 31, 2013) (“TPI”); M&G Polymers USA, LLC v. CSX Transp., Inc., Docket No. NOR 42123, slip op. at 3-4 (served Sept. 27, 2012).

cases, should apply equally to application of the market dominance test in reciprocal switching cases. The Shipper Coalition notes that proposals for initial market dominance disclosures in Docket No. EP 733, Expediting Rate Cases, also could facilitate a more expedited market dominance determination under the second, “necessary to provide competitive rail service,” prong.

1. *The Board Needs To Define the Movement and the Rate That Will Be Considered In Evaluating Qualitative and Quantitative Market Dominance. The Board Should Apply the Market Dominance Test To the Incumbent Carrier’s Bottleneck Segment and Not To the Whole Route Of a Joint Movement*

The Board should address a question that is left unanswered by the Decision, namely, whether the market dominance test should apply to the whole route of a joint movement or just to the incumbent carrier’s bottleneck segment. The Shipper Coalition asserts that the proper market dominance inquiry should focus upon the incumbent carrier’s bottleneck segment.

The Board recently held, in DuPont, slip op. at 21-29, that market dominance should be applied to the bottleneck segment rather than the whole route because the latter constitutes indirect “geographic” competition. Furthermore, in the Decision, the Board notes that it has excluded evidence of product and geographic competition from the market dominance inquiry in rate cases since 1998 and affirms that it would align the market dominance test for reciprocal switching with the same test for rate cases. Decision at 27. Therefore, the holding in DuPont should apply also to the market dominance inquiry for reciprocal switching.

There are potential variations in joint movement fact scenarios, however, that the Board needs to address. In rate cases, market dominance is a jurisdictional threshold required by law. The statute imposes the market dominance requirement upon “transportation to which the [challenged] rate applies.” 49 U.S.C. § 10707(b). See also, 49 U.S.C. § 10701(d)(1) and 10707(d)(1)(A). Thus, when the challenged rate is a Rule 11 rate for the bottleneck segment, the

DuPont holding restricts the market dominance inquiry to the portion of the through movement covered by that bottleneck rate. When the challenged rate is a joint rate, however, the DuPont holding extends the market dominance inquiry to the entire through movement. If the Board were to apply this precise standard to reciprocal switching, it would apply the market dominance test differently based upon whether the bottleneck segment was covered by a Rule 11 rate or a joint rate.

But this same distinction does not make sense for reciprocal switching cases. This distinction is necessary in rate cases because the Board lacks jurisdiction to regulate rail contract rates or the rates of other modes that may provide through transportation service in combination with the challenged rail tariff rate. A reciprocal switching case, in contrast, does not concern the rail rate from origin to destination, and thus should not depend upon whether the incumbent monopoly carrier has established a Rule 11 rate or a joint rate. Rather, the focus is upon whether reciprocal switching is “necessary to provide competitive rail service.” 49 U.S.C. § 11102(c)(1). That question should be answered in the context of the bottleneck segment for which the party seeking reciprocal switching desires to create rail competition. Indeed, the very point of reciprocal switching is to create competition for the incumbent carrier’s monopoly segment. The role of downstream carriers (or upstream carriers for destination monopoly segments) is irrelevant.

Applying the market dominance test for reciprocal switching to the whole route in joint-rate scenarios but only to the monopoly segment in Rule 11 rate scenarios is illogical. Whether a movement is eligible for reciprocal switching should not depend upon the form of the applicable rate, as the type of rate has nothing to do with the rail carrier’s ability to exert market power over its monopoly segment. Any such conclusion also could encourage “gaming” by rail carriers



seeking to protect their monopoly segment from reciprocal switching by choosing one form of rate over another based upon which analysis the carrier believes is more likely to avoid a market dominance finding.

A whole-route approach for joint rates also could produce anomalous results by finding market dominance for some movements but not others, even though all of the movements incur the same rate to move the same commodity over the same monopoly segment of the incumbent carrier. For example, an eastern Class I rail carrier may have a long-haul monopoly segment for transportation of a commodity from a captive customer facility to a gateway with multiple other Class I railroads. From the gateway, the customer's traffic moves to 10 different destinations on other rail carriers. Conceivably, a whole-route market dominance analysis could conclude that market dominance exists for some of those movements but not all of them, despite the fact that there is no difference in the transportation service provided, or rates charged, to the customer over the monopoly segment.

A whole-route analysis grows even more complicated and anomalous for transload movements. In those situations, the whole-route will include non-rail modes. But the Board cannot determine quantitative market dominance for non-rail modes. This would create an arbitrary situation in which the Board applies quantitative market dominance to just the rail transportation, but qualitative market dominance to the whole route.

Furthermore, for transload movements, the final destination for the product often is not known at the time of rail shipment. In addition, product in a single rail car may ultimately be delivered to more than one destination from the transload point. There simply is no way, therefore, to perform a whole-route market dominance analysis for such movements because the ultimate destinations are unknown at the time of rail shipment, and even if they were known, a

whole-route analysis could result in a finding of market dominance for one destination but not another even though both are supplied from the same rail car. There is no way to practically apply a whole-route market dominance analysis to transload movements beyond a rail destination that is just an intermediate bulk terminal within the whole-route construct.

For the foregoing reasons, the Shipper Coalition submits that the Board should apply its market dominance test to the incumbent carrier's monopoly segment in reciprocal switching cases regardless of whether the incumbent carrier's rate is a Rule 11 rate or a joint rate.<sup>50</sup> Just as the market dominance test, in the rate reasonableness context, applies to the "transportation to which the [challenged] rate applies," the Board should apply the test in the reciprocal switching context to transportation over the monopoly segment that is the subject of the reciprocal switching request.

2. *The Board's Decision Not To Include a Standing Requirement In the Second Prong Of Its Proposal and Not To Consider Product and Geographic Competition Is Correct*

In its Decision, the Board notes that its current regulations state that a reciprocal switching order requires a finding that the complaining shipper would use the proposed reciprocal switching to meet a significant portion of its transportation needs, a prerequisite referred to as a "standing" requirement. The Board proposes to remove that requirement under the second, "necessary to provide competitive rail service" prong. Decision at 26. The Board's Decision also notes that its current regulations state that the Board will not consider product competition at all in determining whether to grant a request for reciprocal switching, and places a "clear and convincing" burden on the carrier if the carrier wishes to rely on geographic

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<sup>50</sup> In joint rate scenarios, this will require the calculation of quantitative market dominance based upon the incumbent carrier's division of the joint rate, which should be part of the incumbent's initial disclosures in the case, subject to a protective order.

competition. *Id.* at 27. In its Decision, the Board proposes not to consider either product or geographic competition in evaluating a request for reciprocal switching.

The Board is completely correct on both counts. Regarding the Board's proposed elimination of the "standing" requirement under the second prong, the Board is correct that the purpose of reciprocal switching is to encourage competition, and that requiring the shipper to use the competing carrier for a significant amount of its traffic would both limit the shipper's flexibility and be contrary to the goal of the switching statute.

The Board is also correct to eliminate entirely the consideration of product and geographic competition. The Board rationally explained that it has long excluded evidence of product and geographic competition from its market dominance inquiry under 49 U.S.C. § 10707(a) both because the statute does not require such evidence and because of the substantial burden its inclusion imposed on the parties and the Board. *Id.* These same considerations exist here: the reciprocal switching statute does not require a showing of formal market dominance, much less a consideration of product and geographic competition; and the inclusion of such a requirement would unreasonably increase the time, cost and burden involved in the adjudication of a reciprocal switching request.

3. *The Board's Proposal On the Effect of a Reciprocal Switching Prescription On a Rate Reasonableness Case Is Consistent With the Statute and Fully Supportable*

In its Decision, the Board discussed the position of the AAR and the BNSF to the effect that, if a shipper is successful in obtaining a reciprocal switching order from the Board, such an order should automatically preclude a finding of market dominance in a rate case. See Decision at 23. In its Decision, the Board rejected such a blanket rule, instead ruling that a reciprocal switching prescription would be treated in the same way as any other transportation alternative that would be assessed on a fact-specific basis in the agency's market dominance inquiry. *Id.*

The Board is clearly correct that the mere presence of reciprocal switching should not automatically result in a conclusion that market dominance does not exist. Numerous facts and factors, such as the level of the access fee, oligopoly decisions not to compete, and unforeseen operational challenges, could render reciprocal switching ineffective. As the Board noted in its decision, agency precedent establishes that, even where possible transportation options are shown to exist, those alternatives may not provide “effective” competition as required by the statute. Id. Therefore, the Board must consider whether a reciprocal switching alternative effectively constrains the incumbent carrier’s rates as a predicate to finding no market dominance based upon the availability of reciprocal switching.

D. The Board Should Clarify That a Party May Pursue a Switching Remedy Under Either or Both Tests

It appears from the text of the Board’s Decision and the text of section 1145.2 of the Board’s proposed rules that the two prongs of the Board’s approach are not mutually exclusive, and that a petitioner might pursue a switching remedy under either or both of the agency’s proposed prongs. However, this is not explicitly stated anywhere in the decision or in the proposed rules. Thus, as a technical matter, the Board should clarify this point in its final decision.

E. The Board Should Clarify the Identity of the Parties That Are Eligible To File a Request for Reciprocal Switching Under the Board’s Proposed Rules

The Shipper Coalition notes a discrepancy in the terminology of the proposed rules that should be clarified. In both proposed sections 1145.2(a)(1)(i) and (a)(2)(i), the Board refers to “the party seeking such switching” and “the facilities of the shipper(s) and/or receiver(s) for whom such switching is sought...” This language appropriately recognizes that the party seeking switching need not be the same as the shipper or receiver for whom such switching is sought. For example, the alternative railroad could request reciprocal switching, as has occurred

in the past.<sup>51</sup> In addition, the entity arranging the transportation should be able to request reciprocal switching, regardless of whether it owns or operates the facility, because it would be a direct beneficiary.

In both proposed sections 1145.2(a)(1)(ii) and 1145.2(a)(2)(iii), however, the Board uses identical language which suggests that the party seeking switching also must own or operate the facilities for which it seeks switching:

“The party seeking such switching shows that there is or can be a working interchange between the Class I carrier servicing the party seeking switching and another Class I rail carrier within a reasonable distance of the facilities of the party seeking switching...” [underline added]

By referring to Class I carriers “servicing the party seeking switching” and “within a reasonable distance of the facilities of the party seeking switching,” the foregoing text implies that the party seeking switching must own or operate the facilities that would be affected by the requested reciprocal switch order.

To remedy this ambiguity, the Shipper Coalition asks the Board to revise sections 1145.2(a)(1)(ii) and 1145.2(a)(2)(iii) as follows:

“The party seeking such switching shows that there is or can be a working interchange between the Class I carrier servicing the ~~party seeking switching~~ facilities of the shipper(s) and/or receiver(s) for whom such switching is sought and another Class I rail carrier within a reasonable distance of the facilities of the ~~party seeking switching~~ shipper(s) and/or receiver(s) for whom such switching is sought ...”

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<sup>51</sup> See, Delaware and Hudson Railway Company v. Consolidated Rail Corporation – Reciprocal Switching Agreement, 366 I.C.C. 845 (1982); Midtec Paper Corporation, et al. v. Chicago and North Western Transportation Company (Use of Terminal Facilities and Reciprocal Switching Agreement), 1 I.C.C.2d 362 (1985).

The revised text harmonizes these sections with sections 1145.2(a)(1)(i) and (a)(2)(i). In adopting these changes, the Board will make clear that the party seeking switching need not be the same as the shipper or receiver for whom such switching is sought.

**VII. THE BOARD SHOULD UTILIZE A MODIFIED SSW APPROACH TO ESTABLISH FAIR AND REASONABLE STANDARDS FOR ACCESS PRICING AND IT SHOULD NOT CONSIDER LOST CONTRIBUTION WHEN SETTING ACCESS FEES**

Under the statute, it is clear that the Board may establish an access price for reciprocal switching if the carriers cannot agree. 49 U.S.C. § 11102(c) (“The rail carriers entering into [a reciprocal switching] agreement shall establish the conditions and compensation applicable to such agreement, 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.”). In addition, it is clear that under 49 U.S.C. § 10701, the Board may determine the reasonableness of a reciprocal switching charge.

In its Decision, the Board proposed two alternative methodologies for resolving a dispute over an access price. The Shippers Coalition believes that the Board should adopt a modified version of Alternative 2 as its methodology for establishing an access price where the carriers cannot agree or where the shipper challenges an access price agreed to by the carriers as unreasonable.

A. The Board Should Use Alternative 2, a Variant of the SSW Compensation Methodology, To Establish an Access Price

In its Decision, the Board has requested public comment on two alternative methodologies to establish an access price for reciprocal switching. Decision at 25-26. Under Alternative 1, the Board has proposed to determine access pricing based on a specified set of facts, which could include the geographic area where the proposed switch would occur, the distance between the shipper/receiver and the proposed interchange, the cost of service, the

capacity of the interchange facility, and other case-specific factors. Id. at 25. Under Alternative 2, the Board proposed a variant of the agency’s SSW Compensation methodology, which is a methodology used by the Board in trackage rights cases. Id. Under this alternative, the fee would compensate the incumbent for the expenses incurred to provide the service, plus a fair and reasonable return on the capital employed. Id. at 25-26. The Board invited comment on both methodologies and on other potential access fee methodologies. Id.

Attached to these Comments as Exhibit 2 is the Verified Statement of Thomas D. Crowley and Daniel L. Fapp, President and Senior Vice-President, respectively, of L.E. Peabody and Associates, Inc. (“Crowley/Fapp V.S.”). The Shipper Coalition asked Messrs. Crowley and Fapp to evaluate the Board’s two proposed access fee alternatives for reciprocal switching. In their Verified Statement, Messrs. Crowley and Fapp have evaluated the two access fee alternatives and determined that the STB Alternative 2 is the superior approach, with modifications to adjust the methodology from its traditional use in trackage rights cases to one that can be used to calculate a fair and reasonable reciprocal switching fee.

At the outset, Messrs. Crowley and Fapp reviewed the sources of the two alternatives proposed by the Board, including principles for the establishment of fair and reasonable trackage rights and reciprocal switching fees discussed by the Railroad Accounting Principles Board. Crowley/Fapp V.S. at 5-6. Messrs. Crowley and Fapp note that a reciprocal switching fee must be fair and reasonable both to the incumbent carrier, by enabling the carrier to recover its operating costs and a return on its employed capital, as well as to the shipper whose traffic will be switched. A fair and reasonable reciprocal switching fee is determined by calculating a fee not in excess of the costs to the railroad in providing the requested switching services, plus a reasonable return. Id. at 6-7. Finally, Messrs. Crowley and Fapp emphasize that there must be

fair, reasonable and timely procedures for calculating an access fee since regulatory delays inflict real-world costs on both a carrier and a shipper. Id. at 7-8.

Messrs. Crowley and Fapp conclude that the agency's Alternative 1 is unworkable and outdated, and therefore should not be used. Alternative 1 would require expensive and time-consuming special switching studies. Id. at 10-12. Moreover, recent agency precedent suggests that such special studies do not provide substantially more accurate results than the use of system average costs, which are readily available. Id. at 12-13.

Messrs. Crowley and Fapp conclude that the STB's Alternative 2 is the superior approach. Id. at 9, 14. Messrs. Crowley and Fapp discuss in detail the three cost components involved in the developing trackage rights fees under the SSW Methodology and the modifications required to calculate a reciprocal switch fee. Id. at 14-27. They analyze two different alternatives for estimating the fixed and variable cost components of a railroad's reciprocal switching operation, using either the URCS 100% variable option or URCS variable and an allocation of the railroad's fixed costs to the switching movement. Id. at 15-17. Messrs. Crowley and Fapp also discuss the calculation of a fair return on investment, analyzing the strengths and weaknesses of the agency's various methodologies discussed in the SSW case and a possible alternative. Id. at 17-25. They suggest that the ROI component of the SSW Compensation methodology be applied on a system average basis. Id. at 25-27.

The Shipper Coalition believes that the Board should give strong consideration to the analyses of Messrs. Crowley and Fapp in its determination of a fair and reasonable access fee for reciprocal switching.

Finally, the Board should establish a procedure for adjudicating a dispute over the access price. There are at least two aspects that the Board should consider: (1) the procedure for the carriers' attempt to agree on an access price; and, (2) the procedure for determining an access price if the carriers cannot



reach an agreement or if the shipper wishes to challenge an access price agreed to by the carriers. The Board should clearly set a time within which the carriers must agree on the access price. This is necessary and appropriate since the need for carrier discussion and agreement will come after a detailed process in which the Board determined that a switching prescription should be granted, and all parties will have had substantial time to consider the facts of the proposed switching. Thus, the time period within which the carriers should attempt to agree on an access price should be short. The Shipper Coalition suggests that carriers be given fifteen (15) days after the Board grants a request for reciprocal switching to agree upon an access price.

With respect to the procedure for determining an access price if the carriers cannot agree or if the shipper challenges an agreed upon access price, the Board should establish a short and efficient procedure. . The methodology for determining an access price that is explained by Messrs. Crowley and Fapp utilizes publicly available information and would be easy to calculate. Thus, use of the Crowley/Fapp methodology would permit the Board to set a fair and reasonable access price expeditiously.

B. The Board Should Not Consider Lost Contribution in Establishing an Access Price

In its Decision, the Board noted that, during its consideration of the NITL Petition, UP argued that the access price must cover the serving railroad's actual cost of providing the switching service, as well as the serving railroad's lost contribution from the long-haul. The Board sought comment on whether the list of factors under Alternative 1 should include any portion of the incumbent rail carrier's lost contribution or opportunity costs.

In the attached Verified Statement, Messrs. Crowley and Fapp discuss this matter in detail, showing that UP's call for "lost contribution" is a call for the use of Efficient Component Pricing ("ECP") in developing reciprocal switch access fees. *Id.* at 28. Messrs. Crowley and Fapp note that ECP works only if a stringent set of assumptions hold –assumptions that do not

apply to the railroad industry. *Id.* at 29. Moreover, application of lost contribution or ECP would prevent shippers from benefitting from the competition provided by reciprocal switching—a point that a recent report commissioned by the STB in reviewing existing rate reasonableness methodologies has confirmed. *Id.* Messrs. Crowley and Fapp conclude: “[i]n simple terms, ECP locks in an incumbent carrier’s monopoly rent, and would make a reciprocal switch fee unusable by another railroad.” *Id.* The Board should flatly reject UP’s suggested use of lost contribution in developing a fair and reasonable access fee.

**VIII. THE BOARD SHOULD CLARIFY THE STANDARD THAT IT WILL USE IN DETERMINING WHETHER TO REOPEN AN ORDER FOR RECIPROCAL SWITCHING**

The Board has proposed that a reciprocal switching prescription lasts as long as the criteria for either prong are met, unless otherwise ordered by the Board in a particular circumstance. Decision at 19-20 (n. 21). The Shipper Coalition supports this proposal so long as the Board clarifies that the party seeking reopening must satisfy the standards in 49 C.F.R. § 1115.4 for petitions to reopen administratively final actions. This appears to be the Board’s intent when it states that a party is “free to petition the Board for reopening if there are substantially changed circumstances.” *Id.* No party should be subject to repeatedly defending a reciprocal switching prescription anew absent such circumstances.

**IX. THE BOARD’S PROPOSED CHANGES TO ITS RULES ON THE SEPARATION OF THROUGH ROUTES AND TECHNICAL CHANGES TO OTHER PROVISIONS IN PART 1144 ARE ACCEPTABLE FOR THIS PROCEEDING**

At page 26 of its Decision, the Board explained that its current regulations in Part 1144 addresses not only reciprocal switching but also through routes under 49 U.S.C. § 10705. The Board proposes to separate the reciprocal switching standards from those applicable to through routes. It also indicates some changes to Part 1144, some of which are discussed above. The Board is correct that, from a theoretical perspective, some of the issues addressed with respect to

reciprocal switching could arguably apply to through routes. While the Shipper Coalition believes that a reevaluation of the Board's rules on through routes is desirable, the Coalition has no objection to the Board's technical separation of the two issues presently.

**X. CONCLUSION**

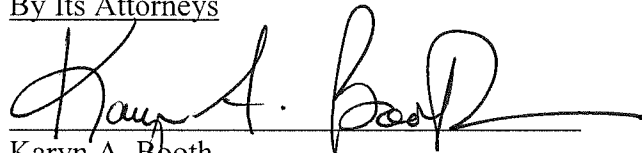
For the foregoing reasons, the Shipper Coalition respectfully requests that the Board move forward promptly to adopt new reciprocal switching rules that are consistent with the proposed modifications and clarifications to the Board's proposal as set forth herein.

Respectfully submitted,

THE SHIPPER COALITION FOR  
RAILROAD COMPETITION

The Agricultural Retailers Association  
Alliance of Automobile Manufacturers  
American Chemistry Council  
American Fuel and Petrochemical Manufacturers  
American Petroleum Institute  
Chlorine Institute  
The Fertilizer Institute  
Glass Packaging Institute  
National Association of Chemical Distributors  
The National Industrial Transportation League

By Its Attorneys

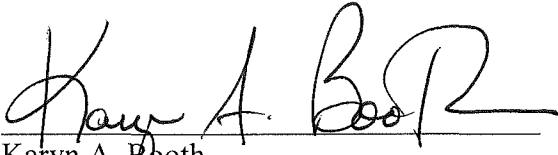


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October 26, 2016

**CERTIFICATE OF SERVICE**

I hereby certify that on this 26th day of October 2016, I served a copy of the foregoing upon all parties of record via U.S. first-class mail, postage prepaid.

  
Karyn A. Booth

# **Exhibit 1**

## **EXHIBIT 1**

### **STATEMENTS OF INTEREST OF THE SHIPPER COALITION FOR RAILROAD COMPETITION**

#### **The Agricultural Retailers Association**

The Agricultural Retailers Association (ARA) is a not-for-profit trade association that represents America's agricultural retailers and distributors. ARA members provide goods and services to farmers and ranchers which include: fertilizer, crop protection chemicals, seed, crop scouting, soil testing, custom application of pesticides and fertilizers, and development of comprehensive nutrient management plans. Retail and distribution facilities are scattered throughout all 50 states and range in size from small family-held businesses or farmer cooperatives to large companies with multiple outlets.

#### **Alliance of Automobile Manufacturers**

Alliance Members account for 75 percent of annual new car and light truck sales by revenue in the United States. The Alliance includes amongst its diverse membership companies headquartered in the U.S., Europe and Asia, including the BMW Group, Fiat Chrysler Automobiles US, Ford Motor Company, General Motors Company, Jaguar Land Rover, Mazda, Mercedes-Benz USA, Mitsubishi Motors, Porsche, Toyota, Volkswagen Group of America and Volvo Car Group.

#### **American Chemistry Council**

ACC represents the leading companies in the business of chemistry. ACC members apply the science of chemistry to provide innovative products and services that make people's lives better, healthier and safer. As an \$812 billion enterprise, the business of chemistry is a key element in the nation's economy. It is also one of the largest exporting sectors, with \$189 billion in 2013 exports that accounted for 12 percent of the U.S. total. The chemical industry is one of the largest customers of the U.S. freight rail system. Thanks to the shale gas revolution, the industry is projected to grow significantly in the coming years, with more than \$140 billion in new factories, expansions, and restarts already announced, meaning that its reliance on the U.S. freight rail system will only increase in the future.

#### **American Fuel and Petrochemical Manufacturers**

The American Fuel & Petrochemical Manufacturers (AFPM) is a national trade association representing more than 400 companies that encompass virtually all U.S. refining and petrochemical manufacturing capacity.

#### **American Petroleum Institute**

The American Petroleum Institute (API) represents over 625 oil and natural gas companies, leaders of a technology-driven industry that supplies most of America's energy, supports more than 9.8 million jobs and eight percent of the U.S. economy and, since 2000, has invested nearly \$2 trillion in U.S. capital projects to advance all forms of energy, including alternatives. API and its members are dedicated to meeting environmental requirements, while economically developing and supplying energy resources to meet consumer needs.

### **Chlorine Institute**

The Chlorine Institute (CI) is a 189 member, not-for-profit trade association of chlor-alkali producers worldwide, as well as packagers, distributors, users, and suppliers. CI's North American Producer members account for more than 93 percent of the total chlorine production capacity of the U.S., Canada, and Mexico. Chlorine and related chemicals, such as caustic, bleach and hydrochloric acid, are used throughout the U.S. economy and are key to the protection of public health. One of CI's key transportation goals is to maintain the ability to transport chlorine and other mission chemicals in a safe, secure and cost-effective manner, which includes advocating for fair and reasonable competitive rail transportation options.

### **The Fertilizer Institute**

The Fertilizer Institute (TFI) is the national trade association of the fertilizer industry. TFI, which traces its roots back to 1883, includes fertilizer producers, wholesalers, retailers and trading firms. TFI's full-time staff, based in Washington, D.C., serves its members through legislative, educational, technical, and economic information and public communications. TFI's members depend heavily on railroads to transport their fertilizers to the farming regions where they are consumed. Fertilizer shippers are customers of all Class 1 railroads and many shortline railroads. Many members of TFI rely heavily upon rail transportation, and thus have a strong interest in enhancing competition among rail carriers through reciprocal switching.

### **Glass Packaging Institute**

The Glass Packaging Institute (GPI) is the trade association representing the North American glass container industry. On behalf of glass container manufacturers, GPI promotes glass as the optimal packaging choice, advances environmental, energy and recycling policies, advocates for industry standards, and educates packaging professionals.

### **National Association of Chemical Distributors**

The National Association of Chemical Distributors (NACD) is an international association of nearly 440 chemical distributors and their supply-chain partners. NACD members are vital to the chemical supply chain, providing products to over 750,000 end users. They make a delivery every six seconds while maintaining a safety record that is more than twice as good as all manufacturing combined. NACD members are leaders in health, safety, security, and environmental performance through implementation of Responsible Distribution, established in 1991 as a condition of membership and a third-party verified management practice.

### **The National Industrial Transportation League**

Founded in 1907, the National Industrial Transportation League (League) is one of the oldest and largest national associations representing companies engaged in the transportation of goods in both domestic and international commerce. These company members range from some of the largest users of the nation's and the global transportation systems, to smaller companies engaged in the shipment and receipt of goods. The majority of the League's members include shippers and receivers of goods; however, third party intermediaries, logistics companies, and other entities engaged in the transportation of goods are also members of the League. Rail transportation is vitally important for many League members and especially for those who ship chemicals, petroleum, agricultural, cement, and paper and forest products. Some of the League's

members are “captive shippers” operating facilities or shipping to customers that have access to only a single rail carrier.

The League initiated the Board’s Ex Parte 711 proceeding on Reciprocal Switching when it filed a Petition for Rulemaking on Revised Competitive Switching Rules on July 7, 2011. The League’s Petition was filed in response to the Board’s prior Ex Parte No. 705 proceeding on the state of rail competition in the United States and was based on input from the League’s diverse Rail Committee members to determine what competition policies are most important to their company, and what policies should be changed by the Board. Although several policy changes were supported by the League’s rail members, changes to reciprocal switching were rated as the most important and the one that would most help their companies achieve more efficient, reliable and cost-competitive rail transportation.



# **Exhibit 2**

BEFORE THE  
SURFACE TRANSPORTATION BOARD

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**Ex Parte 711 (Sub-No. 1)**

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RECIPROCAL SWITCHING

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Verified Statement

Of

Thomas D. Crowley  
President  
L.E. Peabody & Associates, Inc.

And

Daniel L. Fapp  
Senior Vice President  
L.E. Peabody & Associates, Inc.

On Behalf Of  
The Shipper Coalition For Railroad Competition

Due Date: October 26, 2016

<b><u>TABLE OF CONTENTS</u></b>	<b><u>PAGE</u></b>
I. Introduction.....	2
II. Access Fees Must Be Fair and Reasonable.....	5
III. The STB Alternative No. 1 is Flawed.....	9
A. Alternative No. 1 is Unworkable and Outdated.....	10
IV. The STB’S Alternative No. 2 is the Superior Approach .....	14
A. Variable and Fixed Costs .....	15
1. URCS 100% Variable Costs .....	15
2. URCS Variable/Allocated Fixed Costs.....	15
B. Return On Investment .....	17
1. Capitalized Earnings .....	18
2. RCNLD and SAC Reproduction Costs.....	20
3. Market Comparable Approach.....	23
4. The Railroads’ Gross Investment Values Provide an Acceptable Alternative .....	24
5. The ROI Component of the SSW Compensation Methodology Should Be Applied On a System Average Basis .....	25
V. The STB Should Not Consider a Railroad’s Lost Contribution .....	28
VI. Reasonable Distance .....	31

### **LIST OF EXHIBITS**

<b><u>EXHIBIT NO.</u></b>	<b><u>EXHIBIT TITLE</u></b>
1	Thomas D. Crowley Qualifications
2	Daniel L. Fapp Qualifications
3	Railroad Estimated Market Value , Gross Investment Value and Net Investment Value - 2015
4	Comparison of AAR%’s Estimated 2006 Railroad Replacement Values to Actual 2006 Railroad Market Values
5	Pre-Tax Required Return On Investment Per Car-Mile - 2015

## I. INTRODUCTION

We are Thomas D. Crowley and Daniel L. Fapp. We are economists and, respectively, the President and a Senior Vice President of L. E. Peabody & Associates, Inc., an economic consulting firm that specializes in solving economic, transportation, marketing, financial, accounting and fuel supply problems. Mr. Crowley has spent most of his consulting career of over forty (40) years evaluating fuel supply issues and railroad operations, including railroad costs, prices, financing, capacity and equipment planning issues. His assignments in these matters were commissioned by railroads, producers, shippers of different commodities, and government departments and agencies. A copy of Mr. Crowley's credentials is included as Exhibit No. 1 to this verified statement ("VS").

Mr. Fapp has been with L. E. Peabody & Associates, Inc. since 1997. During this time, he has worked on numerous projects dealing with railroad revenue, operations, and financial issues. Prior to joining L. E. Peabody & Associates, Inc., Mr. Fapp was employed by BHP Copper Inc. in the role of Transportation Manager - Finance and Administration, where he also served as an officer of the three BHP Copper Inc. subsidiary common carrier railroads. A copy of Mr. Fapp's credentials is included as Exhibit No. 2 to this VS.

We have been asked by Counsel for the Shipper Coalition for Railroad Competition, which includes the National Industrial Transportation League ("NITL"), the American Chemistry Council ("ACC"), and other shipper groups (hereafter the "Shipper Coalition") to evaluate the Surface Transportation Board's ("STB" or "Board") Notice of Proposed Rulemaking ("NPR") in Ex Parte No. 711 (Sub-No. 1), *Reciprocal Switching*, served July 27, 2016 ("*EP 711-1*") as it pertains to the STB's two (2) proposed access fee alternatives for reciprocal switch moves.

Under Alternative No. 1, the STB proposes determining access pricing based on a specified set of factors, in the event that the STB is called upon to establish compensation. These factors could include the geography where the proposed switch would occur, the distance between the shipper/receiver and the proposed interchange, the cost of the service, the capacity of the interchange facility and other case-specific factors. The STB also seeks comment on whether the list of factors under its Alternative No. 1 should include any portion of the incumbent rail carrier's lost contribution or opportunity costs.

The STB's Alternative No. 2 for developing reciprocal switching access fees is a variant of the trackage rights compensation methodology used in Finance Docket No. 30,000 (Sub-No. 16), *St. Louis Southwestern Railway Company – Trackage Rights Over Missouri Pacific Railroad Company – Kansas City to St. Louis*, (“SSW Compensation Methodology”). Although SSW Compensation Methodology is used primarily in trackage rights cases, the STB believes many of the principles that inform the methodology would apply in the reciprocal switching fee context as well.

We have evaluated the STB's two access fee alternatives, and determined that STB Alternative No. 2, based upon the SSW Compensation Methodology, is the better of the two approaches, with modifications appropriate to reciprocal switching.

The Shippers' Coalition also requested that we address certain operational considerations related to the issue of what would be considered a “reasonable distance” between a shipper/receiver and an interchange location under the proposed regulations.

The results of our evaluation are summarized in the remainder of this VS and accompanying Exhibits. Specifically, our comments are organized under the following topical headings:

- II. Access Fees Must Be Fair and Reasonable
- III. The STB Alternative No. 1 Is Flawed
- IV. The STB's Alternative No. 2 Is the Superior Approach
- V. The STB Should Not Consider a Railroad's Lost Contribution
- VI. Reasonable Distance

## **II. ACCESS FEES MUST BE FAIR AND REASONABLE**

From an economic perspective, a fair and reasonable access fee for competitive access involving reciprocal switching is one which provides the incumbent firm sufficient revenue to recover its variable and fixed operating costs (including maintenance), and to provide a sufficient return on and of its capital investment.<sup>1</sup> The principle of a fair and reasonable access fee applies whether the access being considered is a trackage rights situation where a tenant railroad operates over the rail lines of a landlord railroad, or whether the access is granted through a reciprocal switching arrangement in which an incumbent carrier provides originating or terminating services for another carrier.

The development of both the trackage rights fees and reciprocal switch fees involves the identification of the costs incurred by the incumbent carrier in providing direct or indirect access to another railroad. As noted by the Railroad Accounting Principles Board (“RAPB”), both the establishment of trackage rights fees and reciprocal switching fees involve the identification and quantification of costs associated with the use of specifically identified facilities and services.<sup>2</sup> The RAPB observed that the Interstate Commerce Commission (“ICC”) had established trackage rights fees by looking at: 1) the variable costs incurred by the railroad as a result of the tenant’s operations; 2) the tenant’s share of maintenance and operating expenses; and 3) the tenant’s share of the required return on road property investment.<sup>3</sup> Similarly, in looking at the establishment of reasonable switching charges, the RAPB stated that the ICC reviewed the

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<sup>1</sup> See, Finance Docket No. 30,000 (Sub-No. 16), *St. Louis Southwestern Railway Company – Trackage Rights Over Missouri Pacific Railroad Company – Kansas City to St. Louis*, 1 ICC 2d 776 (1987) (“SSW I”) at page 782. This approach is also consistent with the STB’s direction to consider a railroad’s revenue adequacy which seeks revenues to cover a railroads’ total operating expenses, including depreciation and obsolescence, plus a reasonable economic profit or return (or both) on capital employed in the business.

<sup>2</sup> See, RAPB, Final Report Volume 2, September 1, 1987 (“RAPB Final Report”) at page 71.

<sup>3</sup> See, RAPB Final Report at page 76.

carrier's cost of providing various switching services within a particular terminal, including the carrier's variable costs and allocated fixed costs and returns on investment.<sup>4</sup> In other words, both the development of the trackage rights fees and switching fees relied upon the development of variable and fixed operating costs, and the calculation of an appropriate return on investment ("ROI") to develop the competitive access fees.

In *SSW 2*,<sup>5</sup> the ICC articulated the general terms for establishing fair and competitive access fees. The ICC stated that a landlord railroad was entitled to recover its costs of operations stemming from another railroad operating on its track, and to rent from an allocated share of the return on the value of the property.<sup>6</sup>

The economic precepts included in the ICC's *SSW Compensation Methodology* would also hold true when determining the reasonable price for a reciprocal switch. While another carrier would not be operating over a carrier's line in a reciprocal switching case, the incumbent carrier would still be entitled to recover its operating costs from providing the switching operations. The incumbent carrier would also be entitled to a return on its deployed capital used in the switching operation, which is analogous to the rental component paid as part of a trackage rights fee.

In addition to any access fee being fair and reasonable to the incumbent railroad from an economic perspective, the fee, and how and when it is developed, must also be fair and reasonable to the shipper whose traffic will be switched. The ICC stated in developing its *SSW*

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<sup>4</sup> *Id.* The RAPB notes that the ICC at one time used the now defunct Terminal Form F to develop the estimated switching costs.

<sup>5</sup> See, Finance Docket No. 30,000 (Sub-No. 16), *St. Louis Southwestern Railway Company – Trackage Rights Over Missouri Pacific Railroad Company – Kansas City to St. Louis*, ("SSW 2") 4 ICC 2d 668 (1987).

<sup>6</sup> See, *SSW 2* at page 669.



Compensation Methodology that an access fee would not be reasonable if it were so high as to preclude its use by the tenant carrier (and by extension the shipper).

Finally, we noted that, since the purpose of the trackage rights was to maintain a competitive balance...any terms so onerous to the tenant as to defeat the purpose of the trackage rights cannot be considered just and reasonable.<sup>7</sup>

To keep a reciprocal switch fee reasonable, therefore, the shipper (or the alternative carrier) must not be forced to pay more than the costs for the railroad to provide the requested switching services, plus a reasonable return on the investment.

It would also be unfair and unreasonable to a shipper if the time it took to develop and agree upon an access fee precluded the shipper's use of the reciprocal switch in a timely manner. Regulatory delay, or the time it takes for regulators such as the STB to come to a decision, has real world costs to the parties involved in the proceeding, a point recognized by the railroads. As the BNSF Railway ("BNSF") explained in Ex Parte No. 582 (Sub-No. 1),<sup>8</sup> regulatory delay inflicts real world costs on the parties involved. BNSF stated that parties placed in regulatory limbo are unsure how to plan for the future or how to respond to other opportunities. Regulatory delays also have impacts on capital markets as markets cannot tolerate uncertainty or delay. Given the time value of money, a long delay in gaining a decision can turn a good deal into bad deal.

While addressing the impact of regulatory delays on railroads, BNSF's statements apply equally to shippers impacted by delays. A shipper cannot effectively plan if the shipper does not know if a movement is available to it, or it may incur higher capital costs. The shipper may even

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<sup>7</sup> See, *SSW 2* at page 669 (internal quotes omitted).

<sup>8</sup> See, Rebuttal Comments of the Burlington Northern and Santa Fe Railway Company in Ex Parte No. 582 (Sub. No. 1), *Major Rail Consolidation Procedures*, Filed January 11, 2001 at page 7.

lose out on access to capital altogether if the determination of a reciprocal switching rate is delayed.

It would be unfair for a shipper to wait in regulatory limbo for the STB to determine a reasonable reciprocal switching access fee. As noted above, there are real-world costs associated with such a delay. Therefore, any access fee procedure that the STB adopts must allow the STB to set the fee in a timely and expedited manner.

### **III. THE STB ALTERNATIVE NO. 1 IS FLAWED**

The STB asked parties in this proceeding to provide comments on two (2) approaches for developing reciprocal switching fees. Under the STB's Alternative No. 1, the STB proposes to determine access pricing based on a specified set of factors, including, but not necessarily limited to, "the geography where the proposed switch would occur, the distance between the shipper/receiver and the proposed interchange, the cost of the service, the capacity of the interchange facility and other case-specific factors."<sup>9</sup> Under the STB's Alternative No. 2, the reciprocal switch fee would be based on the STB's SSW Compensation Methodology, which sets fees based on the incumbent's expenses incurred for providing the service, plus a fair and reasonable return on capital employed.<sup>10</sup>

We believe that the STB's Alternative No. 2 provides a superior method for developing a reasonable access fee when compared to the STB's Alternative No. 1 and we discuss the reasons for our position in the next section of our VS. The remainder of this section of our VS describes the reasons why the STB's Alternative No. 1 is unworkable.

Many of the aspects of the STB's Alternative No. 1 are unworkable in today's regulatory environment and have been surpassed by more current thinking on regulatory economics. In addition, many of the analyses included in the STB's Alternative No. 1, including potential special switching and capacity studies, are time consuming and would only serve to extend the time required to develop the switching fee. We address these limiting issues in greater detail below.

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<sup>9</sup> See, *NPR* at page 25.

<sup>10</sup> *Id.*, at pages 25-26.

**A. ALTERNATIVE NO. 1 IS  
UNWORKABLE AND OUTDATED**

The STB's Alternative No. 1 would set an access fee based on a set of operating and cost factors, including, but not limited to, geography,<sup>11</sup> distance traveled, the cost of service and terminal capacity.<sup>12</sup> The STB cites as precedent for these factors two prior access fee decisions where the ICC/STB established or endorsed switching fees because the parties could not agree on the appropriate level of compensation. The *Shreveport Switching* case<sup>13</sup> involved testing the reasonableness of switching fees in the Shreveport Terminal area. The *Conrail 1998*<sup>14</sup> case addressed the reasonableness of the switching fee Canadian Pacific Railway ("CP") would pay for switching in the New York Terminal area. Both cases, cited by the STB, involved the actual or potential use of a special switching study to establish the switching rates.<sup>15</sup>

The types of special switching studies suggested in *Shreveport Switching* and *Conrail 1998* are extremely time consuming and expensive to develop, making them unworkable in today's regulatory environment. To conduct a proper switching study, both sides must agree upon the specific factors to include in the study, how those factors will be observed and recorded, and how the data will be verified and validated. Coming to agreement on these factors can be expected to result in lengthy delays and will add costs to the process.

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<sup>11</sup> We believe that including geography as a component of the access fee is unnecessary. The primary geographical issue in developing an access fee is the distance between the origin/destination location and the interchange point. However, distance is accounted for when developing costs using the STB's Uniform Railroad Costing System ("URCS") formula, so a separate geographic consideration is not necessary.

<sup>12</sup> See, *EP 711-1* at page 25.

<sup>13</sup> Investigation and Suspension Docket No. 8569, *Switching Charges and Absorption Thereof at Shreveport, LA.*, 339 I.C.C. 65 (1971) ("*Shreveport Switching*").

<sup>14</sup> STB Finance Docket No. 33388, *CSX Corporation and CSX Transportation, Inc. Norfolk Southern Corporation and Norfolk Southern Railway Company – Control and Operating Leases/Agreements – Conrail Inc. and Consolidated Rail Corporation*, 3 STB 955 (1998) ("*Conrail 1998*").

<sup>15</sup> See, *Shreveport Switching* at page 75 and *Conrail 1998* at page 966.

Once the study approach is developed and agreed upon, the parties must then perform the study itself. *Shreveport Switching* used a one week study as the basis of its development and validation of the switching fees.<sup>16</sup> However, in the years since the ICC issued its *Shreveport Switching* decision, the STB has averred that a one week study may not be long enough to truly evaluate and assess switching activities and costs. In *FMC*,<sup>17</sup> both FMC and the defendant Union Pacific Railroad Company (“UP”) performed special one week switching studies of UP’s switching operations at FMC plants in Idaho and Kansas.<sup>18</sup> The STB found that it had no reason to doubt the accuracy of either FMC’s or UP’s data, but also could not confirm that any particular day or week was truly average in operating norms.<sup>19</sup> In simple terms, one week was not a long enough period to truly study the switching operations at the FMC facilities. This implies that the STB would require a longer period to reliably develop an “average” switching cost.

Requiring a more extensive time period to perform an acceptable switching study is supported by the STB’s *Conrail 1998* decision. The STB granted CP certain operating and access rights around New York as part of CSX Transportation’s (“CSXT”) and Norfolk Southern Railway Company’s (“NS”) joint acquisition of Consolidated Railroad Corporation (“Conrail”), including the so-called east-of-the-Hudson operations. These rights included reciprocal switching rights in the New York Terminal area, for which CP proposed to pay \$250 per carload.<sup>20</sup> CSXT, the operating carrier in the New York Terminal area, contested CP’s proposed fee as being too low. The STB determined that CSXT had not supported its belief that CP’s

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<sup>16</sup> See, *Shreveport Switching* at page 86.

<sup>17</sup> See, STB Docket No. 42022, *FMC Wyoming Corporation and FMC Corporation v. Union Pacific Railroad Company*, 4 STB 699 (2000) (“*FMC*”).

<sup>18</sup> See, *FMC* at page 753.

<sup>19</sup> *Id.*

<sup>20</sup> See, *Conrail 1998* at page 966.

proposed \$250 per carload rate would not cover CSXT's actual switching costs, but offered CSXT the opportunity to perform a special six-month switching study to determine a more precise switching cost.<sup>21</sup>

Based on the *FMC* and *Conrail 1998* decisions, it is abundantly clear that any special study used to develop an acceptable switching fee will have to be much longer than one week, and could take up to six months to complete. More importantly, this is the time required to simply complete the switching study, and does not include the time to process and evaluate the collected data, and then to go through the complete STB rate setting process. Getting to the point where the STB actually sets the rate would undoubtedly take significantly longer than six months. Selecting a methodology that requires many months to study and set a reciprocal switching rate is unreasonable and would discourage shippers from pursuing a switching remedy. Therefore, making the use of special studies as proposed under the STB's Alternative No. 1 unworkable.

In addition to taking much too long, the STB generally regards special studies as not providing substantially more accurate results than simply using system average costs. The ICC and STB had historically allowed the parties to use special studies in developing movement-specific adjustments in determining the variable cost of service in rate reasonableness proceedings.<sup>22</sup> In its *Major Issues* decision,<sup>23</sup> the STB decided that making movement specific adjustments based on special studies provided no more accurate cost data than using the

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<sup>21</sup> *Id.*

<sup>22</sup> See, for example, *FMC* where the UP and FMC used the switching studies discussed earlier to make movement specific adjustments to the switching costs. Another example can be found in STB Docket No. 42056, *Texas Municipal Power Agency v. The Burlington Northern and Santa Fe Railway Company*, 6 STB 573 (2003) ("*TMPA*"), and STB Docket No. 42057, *Public Service Company of Colorado D/B/A Xcel Energy v. The Burlington Northern and Santa Fe Railway Company*, 7 STB 589 (2004) ("*Xcel*") where the shippers and the railroad utilized a special study of fuel consumption to develop fuel expenses.

<sup>23</sup> See, Ex Parte No. 657 (Sub-No. 1), *Major Issues in Rail Rate Cases*, served October 30, 2006 ("*Major Issues*").

railroads' system average costs.<sup>24</sup> The STB also found that as a matter of econometric theory, piecemeal or incomplete adjustments to variable costs were suspect. Moreover, the STB determined that as a practical matter, most of the movement-specific adjustments accepted by the STB based on special studies resulted in very small overall changes in costs.<sup>25</sup> The idea that parties would need to perform special studies to develop the costs for reciprocal switch movements simply does not comport with the STB's current position on developing railroad costs.

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<sup>24</sup> See, *Major Issues* at page 51.

<sup>25</sup> See, *Major Issues* at page 53

#### **IV. THE STB'S ALTERNATIVE NO. 2 IS THE SUPERIOR APPROACH**

The STB's Alternative No. 2 centers upon the use of the STB's SSW Compensation Methodology, which develops an access fee based on the carrier's operations and return on capital. As we discussed in Section II above, while the SSW Compensation Methodology was initially used to develop trackage rights fees, the methodology's underlying logic can also be applied to develop a reciprocal switching fee, and is a preferable approach to the STB's proposed Alternative No. 1.

Since a reciprocal switch access fee will reflect the costs for a railroad operating over its own rail line and not the costs of another carrier operating over a landlord's lines, adjustments to the SSW Compensation Approach must be made to develop reciprocal switching fees. The primary modification is the development of the incumbent railroad's incremental fixed and variable costs associated with transporting the traffic. In *SSW I*,<sup>26</sup> the ICC outlined the three (3) cost components involved in developing trackage rights fees. These include:

1. The fixed and variable costs incurred by the landlord railroad as a result of the tenant railroad's operations on the landlord's rail line;
2. The tenant railroad's share of the landlord's fixed and variable "below the wheel" maintenance and operation costs; and
3. The tenant railroad's share on a usage basis of an interest rental component representing the required ROI.<sup>27</sup>

We discuss each of these components and their required modifications in the context of a reciprocal switch fee below.

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<sup>26</sup> See, *SSW I* at page 776.

<sup>27</sup> See, *SSW I* at pages 779 and 780.



## **A. VARIABLE AND FIXED COSTS**

Unlike a trackage rights access fee, a reciprocal switch fee will involve capturing both the incumbent carrier's "below the wheel" and "above the rail" fixed and variable costs, and not just the "below the wheel" costs, as is the case in a trackage rights situation. We propose two different alternatives for estimating the fixed and variable components of a railroad's reciprocal switching operation.

### **1. URCS 100% Variable Costs**

The first approach for calculating the variable and fixed cost components of the reciprocal switching fee is to develop the costs of the movement assuming 100 percent URCS variability. Under this approach, the costs for the issue switching movement are developed using the STB URCS Flow-Through Option, which computes all costs under the assumption that they are 100 percent variable. In this fashion, both the variable and allocated fixed costs are assigned to the switching movement. The STB accepted the 100 percent URCS flow-through approach to develop the "below the wheel" fixed and variable costs in *Conrail 1999*.<sup>28</sup> The STB noted:

The Flow-Through Option corrects for the fact that the variability percentages of many of the "below-the-wheel" cost components are less than the reciprocal of the Ratio. We conclude that this approach is the most accurate method available for calculating full costs for the selected group of activities (below-the-wheel costs) at issue.<sup>29</sup>

### **2. URCS Variable/Allocated Fixed Costs**

A second potential approach to calculating the variable and fixed costs involved in a reciprocal switching movement is the use of the STB's URCS Phase III variable costs and an

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<sup>28</sup> See, STB Finance Docket No. 33388, *CSX Corporation and CSX Transportation, Inc. Norfolk Southern Corporation and Norfolk Southern Railway Company – Control and Operating Leases/Agreements – Conrail Inc. and Consolidated Rail Corporation*, 4 STB 75 (1999) ("*Conrail 1999*").

<sup>29</sup> See, *Conrail 1999* at page 78.

allocation of the railroad's fixed costs to the switching movement. Parties to the switching movement would calculate the variable costs of the movement using URCS Phase III variable costs. The parties would then calculate the allocated fixed costs using the fixed cost approach in the STB's Average Total Cost ("ATC") revenue division methodology applied to crossover traffic in maximum rate cases. The STB's ATC division methodology estimates the fixed costs per movement by first developing the switching railroad's average fixed cost per mile from the railroad's URCS Phase II cost data, and the miles of track owned and operated from the carrier's Annual Report Form R-1, Schedule 700. Next, the switching movement's average fixed costs are calculated by multiplying the carrier's average fixed cost per mile by the miles between the interchange point and the origin/destination location. The average total fixed costs over the route are next divided by the average tons moving on the route as identified from a railroad's traffic density data to develop an average fixed cost per ton. Finally, the switching movement's tons are multiplied by the route's average fixed cost per ton to estimate the movement's allocated fixed cost.

Both the 100 percent flow-through approach and the ATC division approach to fixed costs estimate the incumbent carrier's total fixed and variable costs per movement, and are consistent with STB precedent and procedures. However, under either approach, the URCS costs must be adjusted to remove the ROI and station clerical components of the fixed and variable costs. As indicated above, the STB's SSW Compensation Methodology already includes a rental component that compensates the incumbent carrier for the use of its capital. Not adjusting the fixed and variable costs to remove the ROI component would lead to a double-count of the railroad's required return.

Similarly, station clerical costs must also be removed from the URCS fixed and variable costs to avoid a double count of costs. This is because the switching railroad will only be physically originating or terminating the movement, and will not be billing the shipper for the movement and will not be incurring the clerical costs associated with originating or terminating the traffic. Therefore, the serving carrier will not be incurring any station clerical costs.

## **B. RETURN ON INVESTMENT**

The interest rental component of the SSW Compensation Methodology compensates the incumbent railroad for the cost of capital inherent in its road and equipment investments used during the reciprocal switch operation. The ICC/STB developed the return on investment (“ROI”) component of the SSW Compensation Methodology by applying the railroad industry’s pre-tax nominal cost of capital to the estimated value of the rail line over which the trackage rights traffic operated, and then spread the ROI costs evenly over each car-mile moving on the issue rail line.<sup>30</sup>

The primary issue with the development of the ROI component is the estimation of the value of the rail line. In *ATSF Trackage Rights*,<sup>31</sup> , Southern Pacific Transportation Company (“SP”) asked the ICC to determine the appropriate trackage rights fee the Atchison, Topeka & Santa Fe Railway Company (“ATSF”) should pay under the SSW Compensation methodology for ATSF’s use of SP’s Tehachapi line in Southern California. The ICC indicated in *ATSF Trackage Rights* that there could be four (4) ways to estimate the fair market value of the rail line for use in the SSW Compensation Methodology:<sup>32</sup>

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<sup>30</sup> See, *Conrail 1999* at page 78.

<sup>31</sup> Finance Docket No. 22218, *Atchison, Topeka & Santa Fe Railway Company – Operating Agreement – Southern Pacific Transportation Co.*, 8 I.C.C. 2d 297 (1992), (“*ATSF Trackage Rights*”)

<sup>32</sup> See, *ATSF Trackage Rights* at pages 304 and 305.

1. A capitalized earnings approach that develops the line value based on the overall market value of the railroad. The estimated overall railroad market value is then allocated to the specific line segment used for competitive access based on the line's relative earnings as compared to the railroad's total earnings. This was the ICC's preferred methodology;
2. A Reproduction Cost New Less Depreciation ("RCNLD") approach. This was the ICC's second alternative if the capitalized earnings approach was unavailable;
3. A market comparable approach that based the estimated value on the market value of comparable lines. The ICC stated that the drawback to this approach was finding a truly comparable similar rail line; and
4. A SAC approach that developed the replacement costs of the line that eliminated any inefficiencies. The ICC stated the drawback of this approach was determining the line inefficiencies.

There are issues with each of the ICC/STB's approaches for developing the estimated market value of the reciprocal switch route that could make them unusable in developing a reasonable access rights fee. However, we believe there is a consistent and readily available valuation approach that could be applied that would overcome the flaws in the ICC/STB's historic valuation methodologies. The issues with the STB's current approaches and a potential alternative are discussed below.

### **1. Capitalized Earnings**

The STB's capitalized earnings approach for a line segment valuation is based on allocating the railroad's overall enterprise value to the rail line used for the switching operation based on the proportion of the subject rail line's pre-tax earnings to the railroad's pre-tax earnings. This requires not only the development of the estimated earnings of a specific rail line on the railroad, but also the railroad's total market value.

The ICC/STB have used two different approaches to develop the railroad market values under the SSW Compensation Methodology. In SSW 2, the ICC relied upon the purchase price UP paid for the Missouri Pacific Railroad ("MP"), the railroad over which SSW would operate

via trackage rights. This value was based on purchase accounting values developed as part of the acquisition. Under purchase accounting, the assets of the acquired company, MP in this case, are placed on the books of the purchasing company (UP) at their estimated current fair market value. The estimated current market value for the MP was determined through accounting and engineering studies of the acquired assets.

The STB used a different approach in *Conrail 1999* to develop the estimated market value of Conrail's asset. Instead of using the purchase accounting value that they advocated in the *SSW 2* case, the STB relied upon the prices CSXT and NS paid for the Conrail common stock, and the market value of the assumed Conrail debt. This is a form of enterprise valuation that is commonly used in valuation practices, and assumes that the prevailing stock price and market value of debt is the market's best estimate of the value of the company's assets on a going concern basis.

The ICC/STB were able to estimate the total railroad values in these two cases because they had either a relatively recent railroad asset valuation (in the case of *SSW 2*), or a recent stock and debt valuation that reflected the entire railroad (in the case of *Conrail 1999*). Neither is currently available for all of the current Class I railroads. While we have current common equity and debt values for the UP, NS and CSXT, we do not have current stock or debt values for the BNSF, which is now a wholly owned subsidiary of Berkshire Hathaway, Inc.

In addition, the equity and debt valuation approach used in *Conrail 1999* would not work in the case of the Canadian National Railway ("CN"), CP and the Kansas City Southern ("KCS") since a majority, or near majority in the case of KCS, of the parent companies' assets and revenues, lie or are generated outside the United States ("U.S."). This means the stock price

of the publicly traded holding companies reflect presumed value of assets outside the U.S. and outside the regulation of the STB.

Exhibit No. 3 to this VS compares the estimated market values of the Class I railroads (except BNSF) based on their 2015 equity market cap and debt levels to the gross-value of the railroad companies' assets as reported in each railroad's Annual Report Form R-1. The comparison shows that the estimated fair market values for the CN, CP and KSC are significantly larger than the gross book values of their U.S. rail operations due to their significant operations in Canada, in the cases of CN and CP, and in Mexico, in the case of KCS. Attempting to use the CN, CP and KCS's overall market values would improperly impute foreign valuations on U.S. regulated operations, which the STB has held is inappropriate.<sup>33</sup> Because of these significant operations outside the U.S., and the complete lack of current valuation information for the BNSF, another valuation approach should be used to place carriers and shippers on a level playing field.

## **2. RCNLD and SAC Reproduction Costs**

The ICC stated that RCNLD and SAC approaches may be used in developing the estimated values of specific rail lines.<sup>34</sup> RCNLD is a form of replacement cost which uses an estimate of the cost of replacing or reproducing the existing facilities as a measure of value. This amount is then reduced to reflect the amount of depreciation that has accrued to the assets being valued. SAC is a different form of replacement costs that looks at the current costs to replace the existing facilities, while removing any inefficiencies from the existing infrastructure and operations.

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<sup>33</sup> See, Ex Parte 458, *Railroad Cost of Capital – 1984*, 1 I.C.C. 2d 989 (1985) at pages 1003 and 1004.

<sup>34</sup> *ATSF Trackage Rights* at page 305.

The RCNLD and SAC approaches should not be used to establish switching fees because these approaches develop reproduction or replacement costs for the rail line rather than the rail line's estimated market value. In addition, both RCNLD and SAC require an excessive amount of time to develop the estimated market value.

The RCNLD approach seeks to estimate the value of an asset or group of assets by estimating the cost to replace the asset(s), and then accounting for any obsolescence in the assets based on its age and use.<sup>35</sup> The SAC approach seeks to estimate the value of an asset by determining the replacement cost of the assets taking into consideration the removal of any inefficiencies in the assets.<sup>36</sup> Both approaches are types of replacement costing that seek to develop the value of an asset based on the estimated cost of the asset's replacement. The primary problem with replacement cost approaches is that they may not come close to accurately reflecting the true market value of the asset. This is easily seen by comparing the replacement costs of assets developed by railroads in prior STB proceedings, and comparing these replacement costs to their actual market values.

In Ex Parte No. 679,<sup>37</sup> the AAR sought to change the approach the STB used in the Board's annual railroad revenue adequacy determination from using an historic value approach to reflect railroad assets<sup>38</sup> to a replacement value approach of asset valuation. The AAR developed its railroad replacement cost valuations based upon the STB's Simplified-SAC valuation approach for developing road property investment ("RPI") values, which relies on the average RPI values from recent SAC cases to estimate the value of a specified rail line or

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<sup>35</sup> See, *ATSF Trackage Rights* at 305.

<sup>36</sup> *Id.* The ICC described the accounting for inefficiencies under the SAC method as removals of "frills."

<sup>37</sup> See, Association of American Railroads – *Petition Regarding Methodology For Determining Railroad Revenue Adequacy*, filed May 1, 2008 ("EP 679"),

<sup>38</sup> See, for example, Ex Parte No. 552 (Sub-No. 20), *Railroad Revenue Adequacy – 2015 Determination*, served September 8, 2016.

network.<sup>39</sup> As support for its *EP 679* position, the AAR calculated the replacement costs for the four primary U.S. based railroads – BNSF, CSXT, NS and UP – based on the replacement costs developed in the Board’s most recent SAC decisions. As shown in Exhibit No. 4 to this VS, the AAR’s 2006 replacement cost valuations for the four railroads ranged between \$66.8 and \$93.3 billion.

The major flaw in a replacement cost approach is demonstrated by comparing the AAR’s 2006 railroad replacement values to the actual 2006 railroad market values calculated by the STB in its 2006 cost of capital proceedings. The STB’s cost of capital procedures develops each railroad’s equity market capitalization and market debt value for use in determining the railroad industry capital structure.<sup>40</sup> Exhibit No 4 shows the STB determined market values for the BNSF, CSXT, NS and UP which ranged from \$19.3 billion to \$34.9 billion in 2006. This means the replacement values developed by the AAR overstated the true market value of the railroads’ assets by 129 to 245 percent.

The problem with replacement value approaches, including those that attempt to adjust the values for obsolescence or inefficiencies like the RCNLD and SAC approaches, is that they may not truly reflect the market’s current or even historic values of the assets. As demonstrated in Exhibit No. 4, the discrepancy between actual market values and estimated replacement values can be significant.

In addition to producing questionable values, RCNLD and SAC approaches can be complex and time consuming. Both approaches require the identification of the specific assets along the route being reproduced and the condition of the specific assets. This requires, in most cases, physical inspections of the track and infrastructure by engineers and land appraisers in

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<sup>39</sup> See, AAR *EP 679* Opening at page 18.

<sup>40</sup> See, Ex Parte No. 558 (Sub-No. 10), *Railroad Cost of Capital – 2006*, served April 15, 2008, at page 16.



order to determine the number and conditions of the assets. This is not a simple process, and can take months to resolve.

### **3. Market Comparable Approach**

The market comparable approach uses sales of comparable properties to determine the value of the property to be acquired. The standard used in this type of valuation is the amount that would be paid for the rail facilities in their highest and best use as determined in a competitively structured market. A competitively structured market is a market with a large number of buyers and sellers where no buyer or seller is sufficiently large relative to the size of the market to be able to affect the market price, and new buyers and sellers are free to enter and exit the market.

While providing a current market value for the target assets, this approach for appraising the value is challenging, and not usable in the current situation. First, because there is typically not an active market for the sale of rail systems, it is difficult to determine what the current market value is for large rail systems like the Class I railroads at any particular time. Second, when rail systems do sell, they are often sold for reasons that impact their selling price. For example, the Class I railroads will many times sell low-density branch lines to short-line operating companies for below their estimated current market value in return for guaranteeing to interchange traffic only with the selling carrier. Third, it is extremely difficult to find a truly comparable recently sold asset. A rail line with a single line and little traffic will sell at vastly different price than a rail network with multiple rail lines and a large traffic group.

For these reasons, we believe that a market comparable approach is not justified in developing the ROI component.

#### **4. The Railroads' Gross Investment Values Provide an Acceptable Alternative**

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Each of the STB's preferred methodologies has issues or flaws that make their use in developing the ROI component of the SSW Compensation Methodology problematic. A potential alternative to the STB's current approaches to developing an estimated market value is the use of the railroads' gross investment values which we identified in the railroads' Annual Report Form R-1 filings. While we acknowledge that the use of historic values has not been a preferred approach to valuation, we believe the advantages of using the gross book value outweigh the disadvantages.

First, each of the railroad's gross book values are readily available for all of the railroad holding companies' U.S. operations, including the BNSF, CN, CP and KCS. As discussed above, it is not possible to develop an estimated market value for the BNSF using the common stock and debt valuation approach used by the STB in the Conrail acquisition because BNSF's common stock is not actively traded. The common stock for the CN, CP and KCS is publicly traded, but the implied market value inherent in each of these company's common equity reflects a majority or near-majority of assets outside the U.S., and may not be reflective of the asset values used in a reciprocal switching movement within the U.S. Using gross investment values provides a valuation common to all of the railroads, and focuses only on the U.S. portion of the rail systems which are subject to STB jurisdiction.

Second, unlike the RCNLD and SAC approaches, the gross investment values can be developed in a short time. Both the RCNLD and SAC approaches require extensive discovery to obtain the information necessary to develop the replacement costs of the rail line in question. Shippers then need to hire outside engineers, economists, land appraisers and railroad operating

experts to estimate the market value of the rail line and equipment used in the reciprocal switching operation. The railroads may not need to hire outside experts to develop their valuations, but diverting in-house engineering and operating staff to develop these values does come at a cost. One need only look at the time it takes to develop evidence in maximum reasonable rate cases brought under the SAC constraint to see the time required to develop valuations under the RCNLD and SAC approaches. The extensive time and costs needed to develop this type of valuation can be easily avoided by using each railroad's gross book value.

**5. The ROI Component of the SSW Compensation Methodology Should Be Applied On A System Average Basis**

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The STB developed the required ROI component of the SSW Compensation Methodology in *Conrail 1999* on a segment specific basis.<sup>41</sup> To do this, the STB calculated the market value of the trackage rights segment over which CP would operate, and divided the market value by CSXT's share of Conrail's pre-tax earnings to develop what the STB termed a Times Earning Multiplier. The STB then multiplied the Times Earnings Multiplier by pre-tax earnings associated with the trackage rights segment to develop an estimated line segment market value.<sup>42</sup>

The primary issue with the SSW Compensation Methodology's approach for developing the value of the line segment is its requirement to estimate line-specific earnings. Developing the line-specific earnings requires the identification of several specific economic factors that are not readily available. To start, parties would have to identify all of the traffic moving over the line segment, and the revenue associated with that traffic to begin developing line specific

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<sup>41</sup> See, *Conrail 1999* at pages 80 - 84.

<sup>42</sup> The approach the STB took is mathematically the same as dividing the line segment's pre-tax earnings by the railroad's total pre-tax earnings and multiplying by the railroad's estimated market value.

earnings. This information can only come from the railroad's traffic and revenue records, and, as shippers in maximum reasonable rate cases have testified, collecting this information is a time-consuming and expensive process.<sup>43</sup> Next, parties would need to develop the operating costs associated with operating the line segment, including the line segment's depreciation expenses, associated with the traffic moving on the line segment. While these costs could be developed using STB URCS costs,<sup>44</sup> this is still a time-consuming process as the URCS costs must be applied to each piece of traffic operating over the line segment.

We believe an alternative approach for developing the ROI component for the access fee would simplify the process without distorting the outcome. Specifically, instead of attempting to calculate line specific earnings in order to allocate the railroad's estimated market value to a specific rail line, we believe that using a system average ROI per car-mile, and multiplying this ROI cost per car-mile by the movement miles provides an alternative with several advantages.

First, calculating a system average ROI per car-mile is a straight forward calculation. As shown in Exhibit No. 5 to this VS, we have calculated the 2015 system average ROI per car-mile for the seven Class I railroads based on their 2015 gross investment. These calculations produced ROI costs ranging from \$1.29 to \$2.58 per car-mile.<sup>45</sup> These costs can then be applied to the miles involved in the switching movement to develop an allocated ROI per carload.

Second, the use of a system average ROI cost is consistent with the STB's use of system average URCS variable costs used in the SSW Compensation Methodology and in other STB

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<sup>43</sup> See, for example, STB Docket No. NOR 42130, *Sunbelt Chlor Alkali Partnership v. Norfolk Southern Railway Company*, Opening Evidence and Argument, Exhibit III-A-2 (2012) and STB Docket No. NOR 42125, *E.I. Dupont De Nemours & Company v. Norfolk Southern Railway Company*, Opening Evidence, Exhibit III-A-2 (2012).

<sup>44</sup> Under the STB's Simplified Stand-Alone Cost ("Simplified SAC"), operating costs for the traffic group are developed using the STB's URCS cost. See, *Simplified Standards* at page 50.

<sup>45</sup> To place these figures in perspective, the STB estimated CSXT's portion of the Conrail ROI in the east-of-the-Hudson lines was \$0.318 per car-mile in 1999. See, *Conrail 1999* at page 85.

regulatory proceedings. In calculating the “below the wheel” costs for the derivation of the trackage rights fee in the *Conrail* decision, the STB accepted the use of Conrail’s system average cost.<sup>46</sup>

The STB also uses system average costs in other regulatory proceedings. The STB uses system average URCS variable costs to determine quantitative market dominance in rate reasonableness proceedings. It also uses system average costs when developing ATC revenue divisions and the Maximum Markup Methodology (“MMM”) rates in SAC cases, as well as system average URCS costs in developing the comparison revenue to variable cost ratio benchmark under the STB’s Three-Benchmark (“3BM”) methodology.

In sum, the use of a system average ROI per car-mile provides an efficient way to develop the ROI component of a reciprocal switch fee calculated under the SSW Compensation Methodology.

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<sup>46</sup> See, *Conrail 1999* at page 77.

## V. THE STB SHOULD NOT CONSIDER A RAILROAD'S LOST CONTRIBUTION

In its March 2013 Ex Parte No. 711 filings, UP took the position that any access fee imposed by the STB should not only recover the incumbent railroad's cost of providing the reciprocal switch, but also any of the incumbent's lost contribution associated with the movement.<sup>47</sup> UP asserted that including lost contribution in any reciprocal switching access fee was required because not including it would allow an inefficient tenant railroad to take business from a more efficient incumbent. UP asserted that this would make the entire rail network inefficient, and effectively require the incumbent railroad to subsidize the tenant railroad's operations.

What UP is actually proposing is the use of Efficient Component Pricing ("ECP") in developing reciprocal switch access fees. ECP calls for access prices to be set equal to the direct cost of providing the upstream access service, in this case the cost to switch, plus the net contribution foregone (opportunity cost) in not providing the downstream line-haul service.<sup>48</sup> Contrary to UP's claim that not using ECP would make the entire network inefficient, ECP has been shown to make networks inefficient and lead to higher prices for customers. ECP also can lock in a railroad's monopoly pricing, further reducing pricing efficiency.

As noted by scholars, ECP has a certain logic. It ensures that another producer of the complementary component can provide service only if that producer is at least as efficient as the monopolist. In other words, ECP attempts to ensure that production will not be diverted to an

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<sup>47</sup> See, Opening Comments and Evidence of Union Pacific Railroad Company, entered March 1, 2013 at page 61.

<sup>48</sup> See, "*The Efficient Component Pricing Rule: Friend or Foe*," Dennis L. Weisman, Department of Economics, Kansas State University, 2002 at page 1.

inefficient producer.<sup>49</sup> However, it is now well established that ECP only works if a stringent set of assumptions hold. These assumptions include the monopolist's price for the complementary service has been based on a marginal-cost pricing rule; the monopolist's and rival producer's components are perfect substitutes; the production technology of the component experiences constant returns to scale; the rival producer has no market power; and the monopolist's marginal cost of production of the component can be accurately observed.<sup>50</sup> Many, if not all, of these assumptions do not hold for railroads.

In addition, application of ECP would prevent shippers from benefitting from the competition provided by reciprocal switching. ECP could work if the incumbent carrier's prices were driven by marginal cost pricing principals. However, if the incumbent carrier's price reflects the exercise of market power in setting rates, then ECP will protect the market power and prevent consumers from benefiting from the presence of another carrier.<sup>51</sup>

This point is confirmed in the recent report commissioned by the STB reviewing existing rate reasonableness methodologies. One of the rate methodology approaches reviewed by InterVISTAS<sup>52</sup> was ECP. In rejecting the use of ECP to develop rates, the InterVISTAS Report stated a major flaw of ECP is its preservation of any existing unreasonable exercise of market power by an incumbent operator in a non-competitive situation.<sup>53</sup> In simple terms, ECP locks in an incumbent carrier's monopoly rent, and would make a reciprocal switch fee unusable by another railroad.

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<sup>49</sup> See, "Access and Interconnection Pricing: How Efficient Is The 'Efficient Component Pricing Rule' ?" N. Economides and L. J. White, *The Antitrust Bulletin*, Fall 1995, at page 557.

<sup>50</sup> See, *Id.*, at pages 559 - 560.

<sup>51</sup> See, *Id.*, at page 574.

<sup>52</sup> See, September 2014 Report "An Examination of the STB's Approach to Freight Rail Rate Regulation and Options for Simplification" ("InterVISTAS Report").

<sup>53</sup> See, InterVISTAS Report at pages 109 - 110.

UP's suggested use of ECP to set reciprocal switching access fees is simply a way to ensure the reciprocal switching services are not used, and to lock in the railroads' monopoly rents.



## VI. REASONABLE DISTANCE

NITL proposed that the Board conclusively presume that there is a working interchange within a reasonable distance if either: (1) a shipper's facility is within the boundaries of a "terminal" of a Class I carrier in which cars are "regularly switched"; or (2) there is an interchange at which cars are regularly switched within 30 miles of the shipper's facilities.<sup>54</sup> The STB decided not to use NITL's distance parameters in its proposed rules, but instead asked parties to comment on defining a reasonable distance. To help determine what would be considered a reasonable distance, we reviewed regulatory sources and industry practices for what may be deemed a reasonable distance for a reciprocal switch.

From a regulatory perspective, Canada has required what it calls "interswitching," e.g., reciprocal switching, on rail movements originating or terminating at certain locations for well over 100 years. Regulated in Canada since 1904, interswitching is a commercial agreement between railway companies whereby one railway company will carry traffic for the other railway company to ensure that captive shippers have fair and reasonable access to the rail system.<sup>55</sup> The rates charged are based on distance zones, with the longest zone being Zone 5, which covers movements in Manitoba, Saskatchewan or Alberta up to 160 kilometers or 99.4 miles.<sup>56</sup>

The requirement for interswitching up to 100 miles between the origin/destination and interchange is consistent with how many large railroads operate their local trains. Local trains provide pick-up and set-out at stations between their origins and destinations.<sup>57</sup> This would mean that in most cases local trains or road switchers would provide the pickup and delivery

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<sup>54</sup> See, *NPR* at page 21.

<sup>55</sup> See, Canadian Transportation Agency interswitching rules at <https://www.otc-cta.gc.ca/eng/interswitchingrates>.

<sup>56</sup> See, <http://laws.justice.gc.ca/eng/regulations/sor-88-41/page-1.html#h-6>.

<sup>57</sup> See, for example, UP's definition of a local train at <https://www.up.com/customers/glossary/i-o/index.htm>, and BNSF's definition of local train at <https://www.bnsf.com/customers/pdf/glossary.pdf>.

services for reciprocal switch movements. Because most of the Class I railroad operate the majority of their local trains less than 100 miles per day,<sup>58</sup> it would seem reasonable to assume that traffic within 100 miles of an interchange point could be served by a local train designed to originate and deliver along a route. The Board should consider these operational issues when evaluating whether a switch move is within a reasonable distance.

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<sup>58</sup> Not all local trains operate 100 miles per day. Many operate less than 100 miles while some operate more. However, many of the railroads' collective bargaining agreements with their train and engine personnel use 100 miles as the basis of pay for local train operations. We have included in our workpapers a copy of the United Transportation Union's January 1, 2015 rate sheet which shows pay for locomotive engineers, fireman, conductors and trainmen, including pay for local trains operating up to 100 miles per day.





**THOMAS D. CROWLEY**  
**STATEMENT OF QUALIFICATIONS**

My name is Thomas D. Crowley. I am an economist and President of the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, Virginia 22314, 760 E. Pusch View Lane, Suite 150, Tucson, Arizona 85737, and 7 Horicon Avenue, Glens Falls, New York 12801.

I am a graduate of the University of Maine from which I obtained a Bachelor of Science degree in Economics. I have also taken graduate courses in transportation at George Washington University in Washington, D.C. I spent three years in the United States Army and since February 1971 have been employed by L. E. Peabody & Associates, Inc.

I am a member of the American Economic Association, the Transportation Research Forum, and the American Railway Engineering and Maintenance-of-Way Association.

The firm of L. E. Peabody & Associates, Inc. specializes in analyzing matters related to the rail transportation of all commodities. As a result of my extensive economic consulting practice since 1971 and my participation in maximum-rate, rail merger, service disputes and rule-making proceedings before various government and private governing bodies, I have become thoroughly familiar with the rail carriers and the traffic they move over the major rail routes in the United States. This familiarity extends to subjects of railroad service, costs and profitability, cost of capital, railroad capacity, railroad traffic prioritization and the structure and operation of the various contracts and tariffs that historically have governed the movement of traffic by rail.

As an economic consultant, I have organized and directed economic studies and prepared reports for railroads, freight forwarders and other carriers, for shippers, for associations and for state governments and other public bodies dealing with transportation and related economic

**THOMAS D. CROWLEY**  
**STATEMENT OF QUALIFICATIONS**

problems. Examples of studies I have participated in include organizing and directing traffic, operational and cost analyses in connection with single car and multiple car movements, unit train operations for coal, grain, oil and other commodities, freight forwarder facilities, TOFC/COFC rail facilities, divisions of through rail rates, operating commuter passenger service, and other studies dealing with markets and the transportation by different modes of various commodities from both eastern and western origins to various destinations in the United States. The nature of these studies enabled me to become familiar with the operating practices and accounting procedures utilized by railroads in the normal course of business.

Additionally, I have inspected and studied both railroad terminal and line-haul facilities used in handling various commodities. These operational reviews and studies were used as a basis for the determination of the traffic and operating characteristics for specific movements of numerous commodities handled by rail.

I have frequently been called upon to develop and coordinate economic and operational studies relative to the rail transportation of various commodities. My responsibilities in these undertakings included the analyses of rail routes, rail operations and an assessment of the relative efficiency and costs of railroad operations over those routes. I have also analyzed and made recommendations regarding the acquisition of railcars according to the specific needs of various shippers. The results of these analyses have been employed in order to assist shippers in the development and negotiation of rail transportation contracts which optimize operational efficiency and cost effectiveness.

I have developed property and business valuations of privately held freight and passenger railroads for use in regulatory, litigation and commercial settings. These valuation assignments

**THOMAS D. CROWLEY**  
**STATEMENT OF QUALIFICATIONS**

required me to develop company and/or industry specific costs of debt, preferred equity and common equity, as well as target and actual capital structures. I am also well acquainted with and have used the commonly accepted models for determining a company's cost of common equity, including the Discounted Cash Flow Model ("DCF"), Capital Asset Pricing Model ("CAPM"), and the Fama-French Three Factor Model.

Moreover, I have developed numerous variable cost calculations utilizing the various formulas employed by the Interstate Commerce Commission ("ICC") and the Surface Transportation Board ("STB") for the development of variable costs for common carriers, with particular emphasis on the basis and use of the Uniform Railroad Costing System ("URCS") and its predecessor, Rail Form A. I have utilized URCS/Rail form A costing principles since the beginning of my career with L. E. Peabody & Associates Inc. in 1971.

I have frequently presented both oral and written testimony before the ICC, STB, Federal Railroad Administration, Federal Energy Regulatory Commission, Railroad Accounting Principles Board, Postal Rate Commission and numerous state regulatory commissions, federal courts and state courts. This testimony was generally related to the development of variable cost of service calculations, rail traffic and operating patterns, fuel supply economics, contract interpretations, economic principles concerning the maximum level of rates, implementation of maximum rate principles, and calculation of reparations or damages, including interest. I presented testimony before the Congress of the United States, Committee on Transportation and Infrastructure on the status of rail competition in the western United States. I have also presented expert testimony in a number of court and arbitration proceedings concerning the level

**THOMAS D. CROWLEY**  
**STATEMENT OF QUALIFICATIONS**

of rates, rate adjustment procedures, service, capacity, costing, rail operating procedures and other economic components of specific contracts.

Since the implementation of the *Staggers Rail Act of 1980*, which clarified that rail carriers could enter into transportation contracts with shippers, I have been actively involved in negotiating transportation contracts on behalf of shippers. Specifically, I have advised shippers concerning transportation rates based on market conditions and carrier competition, movement specific service commitments, specific cost-based rate adjustment provisions, contract reopeners that recognize changes in productivity and cost-based ancillary charges.

I have developed different economic analyses regarding rail transportation matters for over sixty (60) electric utility companies located in all parts of the United States, and for major associations, including American Chemistry Council, American Paper Institute, American Petroleum Institute, Chemical Manufacturers Association, the Chlorine Institute, Coal Exporters Association, Edison Electric Institute, the Fertilizer Institute, Mail Order Association of America, National Coal Association, National Grain and Feed Association, National Industrial Transportation League, North America Freight Car Association and Western Coal Traffic League. In addition, I have assisted numerous government agencies, major industries and major railroad companies in solving various transportation-related problems.

In the two Western rail mergers that resulted in the creation of the present BNSF Railway Company and Union Pacific Railroad Company and in the acquisition of Conrail by Norfolk Southern Railway Company and CSX Transportation, Inc., I reviewed the railroads' applications including their supporting traffic, cost and operating data and provided detailed evidence supporting requests for conditions designed to maintain the competitive rail environment that



**THOMAS D. CROWLEY**  
**STATEMENT OF QUALIFICATIONS**

existed before the proposed mergers and acquisition. In these proceedings, I represented shipper interests, including plastic, chemical, coal, paper and steel shippers.

I have participated in various proceedings involved with the division of through rail rates. For example, I participated in ICC Docket No. 35585, *Akron, Canton & Youngstown Railroad Company, et al. v. Aberdeen and Rockfish Railroad Company, et al.* which was a complaint filed by the northern and mid-western rail lines to change the primary north-south divisions. I was personally involved in all traffic, operating and cost aspects of this proceeding on behalf of the northern and mid-western rail lines. I was the lead witness on behalf of the Long Island Rail Road in ICC Docket No. 36874, *Notice of Intent to File Division Complaint by the Long Island Rail Road Company.*

**DANIEL L. FAPP**  
**STATEMENT OF QUALIFICATIONS**

My name is Daniel L. Fapp. I am a Senior Vice President of the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, VA 22314; 760 E. Pusch View Lane, Suite 150, Tucson, Arizona 85737; and 7 Horicon Avenue, Glens Falls, New York 12801.

I received a Bachelor of Science degree in Business Administration with an option in Marketing (cum laude) from the California State University, Northridge in 1987, and a Master of Business Administration degree from the University of Arizona's Eller College of Management in 1993, specializing in finance and operations management. I am also a member of Beta Gamma Sigma, the national honor society for collegiate schools of business.

I have been employed by L. E. Peabody & Associates, Inc. since December 1997. Prior to joining L. E. Peabody & Associates, Inc., I was employed by BHP Copper Inc. in the role of Transportation Manager - Finance and Administration, and where I also served as an officer and treasurer of the three BHP Copper Inc. common carrier subsidiary railroads, The San Manuel Arizona Railroad, the Magma Arizona Railroad (also known as the BHP Arizona Railroad) and the BHP Nevada Railroad. I have also held operations management positions with Arizona Lithographers in Tucson, AZ and MCA-Universal Studios in Universal City, CA.

While at BHP Copper Inc., I was responsible for all financial and administrative functions of the company's transportation group. I also directed the BHP Copper Inc. subsidiary railroads' cost and revenue accounting staff, and managed the San Manuel Arizona Railroad's and BHP Arizona Railroad's dispatchers and the railroad dispatching functions. I served on the company's Commercial and Transportation Management Team and the company's Railroad Acquisition Team where I was responsible for evaluating the acquisition of new railroads,

**DANIEL L. FAPP**  
**STATEMENT OF QUALIFICATIONS**

including developing financial and economic assessment models. While with MCA-Universal Studios, I held several operations management positions, including Tour Operations Manager, where my duties included vehicle routing and scheduling, personnel scheduling, forecasting facilities utilization, and designing and performing queuing analyses.

As part of my work for L. E. Peabody & Associates, Inc., I have performed and directed numerous projects and analyses undertaken on behalf of utility companies, short line railroads, bulk shippers, and industry and trade associations. Examples of studies which I have participated in organizing and directing include, traffic, operational and cost analyses in connection with the rail movement of coal, metallic ores, pulp and paper products, and other commodities. I have also analyzed multiple car movements, unit train operations, divisions of through rail rates and switching operations throughout the United States. The nature of these studies enabled me to become familiar with the operating procedures utilized by railroads in the normal course of business.

Since 1997, I have participated in the development of cost of service analyses for the movement of coal over the major eastern and western coal-hauling railroads. I have conducted on-site studies of switching, detention and line-haul activities relating to the handling of coal. I have also participated in and managed several projects assisting short-line railroads. In these engagements, I assisted short-line railroads in their negotiations with connecting Class I carriers, performed railroad property and business evaluations, and worked on rail line abandonment projects.

I have been frequently called upon to perform financial analyses and assessments of Class I, Class II and Class III railroad companies. I have determined the Going Concern Value

**DANIEL L. FAPP**  
**STATEMENT OF QUALIFICATIONS**

of privately held freight and passenger railroads, including developing company specific costs of debt and equity for use in discounting future company cash flows. My consulting assignments regularly involve working with and determining various facets of railroad financial issues, including cost of capital determinations and enterprise valuations. In these assignments, I have calculated railroad capital structures, market values, cost of railroad debt, cost of preferred railroad equity and common railroad equity. I am also well acquainted with and have used financial industry accepted models for determining a firm's cost of equity, including Discounted Cash Flow Model ("DCF") models, Capital Asset Pricing Model ("CAPM"), Farma-French Three Factor Model and Arbitrage Pricing Models. Based on these assignments, I have frequently spoken and provided guest lectures on cost of capital, corporate structure and corporate valuation to undergraduate and graduate level finance and economic classes.

In my tenure with L. E. Peabody & Associates, Inc., I have presented stand-alone cost evidence in numerous proceedings before the STB, and presented evidence in several STB Ex Parte proceedings, including proceedings addressing railroad fuel surcharges and railroad industry cost of capital. In addition, my reports on railroad valuations have been used as evidence before the Nevada State Tax Commission.

**Railroad Estimated Market Value , Gross Investment Value and Net Investment Value - 2015**

<u>Item</u> (1)	<u>Source</u> (2)	<u>BNSF</u> (3)	<u>CSX</u> (4)	<u>Canadian National</u> (5)	<u>Canadian Pacific</u> (6)	<u>Kansas City Southern</u> (7)	<u>Norfolk Southern</u> (8)	<u>Union Pacific</u> (9)
<b><u>Estimated Market Value</u></b>								
1. Equity Market Cap	Compustat	<u>1/</u>	\$28,786,500,000	\$50,991,400,000	\$22,681,500,000	\$9,968,900,000	\$28,447,900,000	\$81,196,700,000
2. Long-Term Debt	Compustat	<u>1/</u>	<u>10,683,000,000</u>	<u>6,468,000,000</u>	<u>6,426,000,000</u>	<u>2,045,000,000</u>	<u>9,673,000,000</u>	<u>13,607,000,000</u>
3. Estimated Fair Market Value	Line 1 + Line 2	<u>1/</u>	\$39,469,500,000	\$57,459,400,000	\$29,107,500,000	\$12,013,900,000	\$38,120,900,000	\$94,803,700,000
<b><u>Gross Investment In U.S. Operations</u></b>								
4. Gross Road Property	Schedule 200, Line 24	\$50,255,263,000	\$27,577,862,000	\$12,207,966,000	\$3,826,716,000	\$4,342,889,000	\$28,604,117,000	\$51,859,689,000
5. Gross Equipment Property	Schedule 200, Line 24	<u>12,088,367,000</u>	<u>9,690,333,000</u>	<u>1,928,579,000</u>	<u>1,001,295,000</u>	<u>1,441,369,000</u>	<u>10,301,786,000</u>	<u>13,004,555,000</u>
6. Total Gross Road and Equipment	Line 4 + Line 5	\$62,343,630,000	\$37,268,195,000	\$14,136,545,000	\$4,828,011,000	\$5,784,258,000	\$38,905,903,000	\$64,864,244,000

1/ Since BNSF is a wholly owned subsidiary of Berkshire-Hathaway, Inc., the estimated market value cannot be calculated based on the current market price of its common equity.

**Comparison of AAR's Estimated 2006 Railroad  
Replacement Values To Actual 2006 Railroad Market Values**

<u>Railroad</u>	<u>AAR Railroad Replacement Value 1/</u>	<u>STB Railroad Market Value 2/</u>	<u>Replacement as a Percent of Market 3/</u>
(1)	(2)	(3)	(4)
1. BNSF Railway	\$79,904,900	\$34,870,009	129.2%
2. CSX Transportation	66,769,000	19,322,592	245.5%
3. Norfolk Southern Railway	68,106,900	26,777,836	154.3%
4. Union Pacific Railroad	93,281,200	30,062,733	210.3%

1/ Verified Statement of Michael R. Baronowski filed in *Ex Parte 679* at page 28.

2/ Ex Parte No. 558 (Sub-No. 10), *Railroad Cost of Capital - 2006*, served April 15, 2008 at page 16.

3/ (Column (2) ÷ Column (3) - 1) x 100

**Pre-Tax Required Return On Investment Per Car-Mile - 2015**

<u>Item</u> (1)	<u>Source</u> (2)	<u>BNSF</u> (3)	<u>CSX</u> (4)	<u>Canadian National</u> (5)	<u>Canadian Pacific</u> (6)	<u>Kansas City Southern</u> (7)	<u>Norfolk Southern</u> (8)	<u>Union Pacific</u> (9)
1. Gross Road Property	Schedule 200, Line 24	\$50,255,263,000	\$27,577,862,000	\$12,207,966,000	\$3,826,716,000	\$4,342,889,000	\$28,604,117,000	\$51,859,689,000
2. Gross Equipment Property	Schedule 200, Line 25	<u>12,088,367,000</u>	<u>9,690,333,000</u>	<u>1,928,579,000</u>	<u>1,001,295,000</u>	<u>1,441,369,000</u>	<u>10,301,786,000</u>	<u>13,004,555,000</u>
3. Total Gross Road and Equipment	Line 4 + Line 5	\$62,343,630,000	\$37,268,195,000	\$14,136,545,000	\$4,828,011,000	\$5,784,258,000	\$38,905,903,000	\$64,864,244,000
4. 2015 Pre-Tax Cost of Capital	Ex Parte No. 558 (Sub-No. 19)	14.4%	14.4%	14.4%	14.4%	14.4%	14.4%	14.4%
5. Required Return On Investment	Line 3 x Line 4	9,002,420,172	5,381,527,358	2,041,317,098	697,164,788	835,246,855	5,618,012,393	9,366,396,834
6. Loaded Car-Miles	Schedule 755, L. 30 + L. 64	6,990,381,000	2,939,599,000	791,793,000	461,016,000	375,608,000	2,653,584,279	6,277,364,000
7. ROI Per Car-Mile	Line 3 ÷ Line 4	\$1.29	\$1.83	\$2.58	\$1.51	\$2.22	\$2.12	\$1.49