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BEFORE THE
SURFACE TRANSPORTATION BOARD

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

COMMENT OF
THE UNITED STATES DEPARTMENT OF JUSTICE

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The United States Department of Justice ("Department") appreciates this opportunity to share its views with the Surface Transportation Board ("Board") in the above-captioned proceeding. The Department commends the Board for working to improve competition in freight rail service by considering whether to require certain reciprocal switching agreements among railroads.[1] Although the proposed rule provides a judicious way to improve the competitive options for captive shippers, the rule is not a replacement for vigorous competition enforcement. The Department encourages the Board to take additional steps, including robust enforcement, to address consolidation and anticompetitive conduct in the rail industry.

As President Biden's Executive Order on Promoting Competition in the American Economy recently explained, "[a] fair, open, and competitive marketplace has long been a

[1] *See Decision*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), Surface Transportation Board, July 25, 2016; *Notice of Public Hearing*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), Surface Transportation Board, December 27, 2021.

cornerstone of the American economy, while excessive market concentration threatens basic economic liberties, democratic accountability, and the welfare of workers, farmers, small businesses, startups, and consumers." Reflecting on President Biden's Executive Order, Chairman Oberman has expressed concern about "significant consolidation in the rail industry" in particular, including the significant reduction in the number of class I railroads, and the resulting "potential for monopolistic pricing and reductions in service to captive rail customers."[2] To address these concerns, he encouraged the Board to improve freight rail competition by "reforming the Board's competitive access policies" and "increasing the practical accessibility of rate relief measures to shippers in market dominant situations."[3]

The Board's reciprocal switching proposal is a well-tailored first step to provide captive shippers[4] the benefit of some competition while reducing the need for complex rate regulation. For example, under the Board's proposal, a captive shipper could require railroad A to pick up cargo and then switch that cargo to railroad B at the point of the AB intersection so that railroad B could ship the cargo for the long haul.[5] Railroads A and B could then compete to offer the shipper the best rates over the long portion of the journey. Correspondingly, a shipper receiving cargo could require A to switch cargo that has traveled the long haul on B to A at the point of the

[2] Press Release, Surface Transportation Board, Statement from Chairman Martin J. Oberman on Executive Order on Competition (July 9, 2021), *available at* https://www.stb.gov/wp-content/uploads/PR-21-29.pdf.

[3] *Id.*

[4] "Captive shipper" refers to a goods shipper that lacks economic alternatives to the single railroad serving it, e.g., competition from other railroads or competition from carriers using other modes of transport like road or water. By definition, these shippers do not currently benefit from competition to the railroad serving them. And even if a captive shipper is within a short distance of a competing railroad, they have no economical way to bring freight to a competing railroad without using the single railroad serving it. Prior STB chairs have estimated that 15-20% of shippers are captive. *See* JOHN FRITELLI, CONG. RESEARCH SERV., Report No. RL34117, RAILROAD ACCESS AND COMPETITION ISSUES 1 (2008).

[5] *See Notice of Public Hearing*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), Surface Transportation Board, December 27, 2021.

AB intersection for the final short haul and delivery. In both cases, B would compensate A at a regulated rate for carrying the cargo the short distance to or from B's nearby line.

The Department supports the Board's proposed reciprocal switching rule because, although it does not substitute for continued regulatory and enforcement diligence regarding mergers and anticompetitive conduct in this industry, it likely will enhance competition and help make crucial supply chains more resilient for three overarching reasons.

1. <u>Expands access to and increases likelihood of direct competition</u>. A mandatory reciprocal switching rule could offer many captive shippers the benefits of direct railroad competition where there currently is none. For example, by regulating the price and availability of service over the short distance between the shipper and railroad B, the Board's proposal opens up a new possibility for railroad A and railroad B to compete to provide the best price and service over the vast majority of the distance to the cargo's destination. In its recent Notice, the Board noted that commenters also believe the Board's proposal would, among other things, "foster competition among rail carriers at a time when (due to mergers and acquisitions) shippers' rail transportation options are limited" and "promote competition and efficiency in the U.S. economy overall."[6]

Even with mandatory reciprocal switching, a shipper will receive competitive bids only if there is another railroad nearby willing to make a competitive offer to carry the freight. Shippers have raised concerns, however, that when they can obtain an offer for switching the proposed rate is often prohibitive. This is likely due to one of two possibilities. First, railroad A may set the costs for switching too high for railroad B to make a competitive offer. Second,

[6] *Notice of Public Hearing*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), Surface Transportation Board, December 27, 2021, at 5.

railroad B may choose not to make a competitive offer against one of its few rivals to minimize competition between railroad A and railroad B.[7] It is a well-established principle in economics that a small number of competitors may be able to coordinate, either explicitly or tacitly, to charge higher prices than would arise in a competitive market.[8] The rail industry is particularly susceptible to this kind of coordination because there are often only two class I railroads in a given region. As a result, railroads can easily monitor the actions of their competitors and "punish" competitors that make competitive offers to carry freight by competing aggressively for that railroad's customers. Thus, even if the Board adopts the reciprocal switching proposal, it is no substitute for remaining vigilant against consolidation and other conduct that harms competition or further reduces the number of alternatives available to shippers.

2. Class I railroads can support reciprocal switching. The proposed rule is not burdensome. Canada uses a requirement similar to the Board's proposal to protect its captive shippers, requiring reciprocal switching when the connection to railroad B is within a specified distance of the captive shipper.[9] As a result, Canadian Pacific and Canadian National are subject

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[7] For example, the STB's 2016 decision noted shipper Olin Corporation's contention "that NITL's proposal [for reciprocal switching orders] is flawed because it is 'premised on the false assumption that the railroads are actually interested in competing for business,'" as well as the Chlorine Institute's argument "that NITL's proposal would not ensure that any rate offered by a second carrier would be reasonable or competitive." Decision, Petition for Rulemaking to Adopt Revised Competitive Switching Rules, Docket No. EP 711, Reciprocal Switching, Docket No. EP 711 (Sub-No. 1), Surface Transportation Board, July 25, 2016, at 7.

[8] U.S. Dep't of Justice and Fed. Trade Comm'n, Horizontal Merger Guidelines § 7 (2010) (describing a "range of conduct" that constitutes coordinated interaction, and discussing how market consolidation can make such conduct easier and more likely). *See also generally* GEORGE STOCKING & MYRON WATKINS, CARTELS IN ACTION (1947); George Stigler, *A Theory of Oligopoly*, in STIGLER, THE ORGANIZATION OF INDUSTRY (1968); F.M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE, 3rd ed. (1990), at ch. 8; Louis Kaplow & Carl Shapiro, *Antitrust*, in A. MITCHELL POLINSKY & STEVEN SHAVELL, HANDBOOK OF LAW AND ECONOMICS, vol. 2 (2007), at sec. 3.2.

[9] In 2018, the distance was increased from 30 km (about 18 miles) to up to 1,200 km (745 miles), depending on the circumstances. Switching involving this longer distance has not yet been tried. *See* Canada Transportation Act § 127; Bill C-49 (2018); Allison Padova, RAIL SHIPPER PROTECTION UNDER THE CANADA TRANSPORTATION ACT, Library of Parliament, PRB 05-73E, 2007; JAMES NOLAN, ET AL., PARALLEL OR CONVERGING? A COMPARATIVE ANALYSIS OF THE GRAIN AND RAIL TRANSPORTATION SYSTEMS IN CANADA AND THE UNITED STATES (October 2020); Michael Cairns, DEVELOPMENTS IN CANADIAN RAIL, PART 1: FREIGHT, slide presentation to the Railway Association of Canada, July 7, 2021.

to reciprocal shipping requirements on much of their track. A number of shippers with facilities in Canada have reported using this mechanism to enjoy the benefit of rate competition on long-haul routes.[10] There is every reason to believe a similar system would benefit captive shippers in the United States along with their customers, suppliers, and ultimately the American public.

Railroads in this proceeding have argued that mandatory reciprocal switching would be too burdensome, would harm rail traffic, and would decrease incentives for investment.[11] These concerns are exaggerated, and the potential competitive benefits of the proposed rule outweigh the costs. U.S. railroads already provide each other with reciprocal switching on a bilateral, voluntary basis with regularity and without the railroads' asserted parade of horribles coming to pass.[12] Expanding an activity railroads perform hundreds of times daily is not a serious threat to the operation or financial health of the rail industry. In fact, following the adoption of the

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[10] *See, e.g.*, *Reply Comment*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), American Chemistry Council, May 30, 2013, at 14 ("The Canadian example shows that competitive switching can be successful"); *Comment, Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), Highroad Consulting, Ltd., March 26, 2014, at 8 ("Canadian inter-switching has been successful – it has established discipline in the industry without any apparent negative impact on railroad efficiency, and it has not decreased customer satisfaction."); *Reply Comment*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), U.S. Department of Agriculture, May 30, 2013, at 3 ("Canadian interswitching has neither impeded railroad efficiency nor decreased customer satisfaction").

[11] *See generally Comment*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), Union Pacific Railroad Company, March 1, 2013; *Comment*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), BNSF Railway Company, March 1, 2013; *Comment*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), Kansas City Southern Railway Company, March 1, 2013; *Comment*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), Norfolk Southern Railway Company, March 1, 2013; *Comment*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), CSX Transportation, Inc., March 1, 2013.

[12] *See, e.g.*, *Reply Comment*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), National Grain & Feed Association et al., May 30, 2013, at 8. ("[R]eciprocal switching is extremely common in the railroad industry today, and occurs hundreds of times on a daily basis without mishap or service breakdowns.").

interswitching regime in Canada, both Canadian National and Canadian Pacific enjoyed increased freight revenue and higher net income while service also improved.[13]

Moreover, concerns about the effects of industry concentration justify seeking avenues to further competition in the industry. Since the last wave of class I consolidation in the 1990s, railroad markets are more concentrated, railroads have more pricing discretion, and railroad rates have more than doubled since 2002, rising twice as fast as general inflation.[14] As Chairman Oberman recently recognized, "since 2010, the [class I railroads'] owners have taken home more than *an astounding $183 BB* ($196 BB in inflation adjusted dollars) in buybacks and dividends, far more than the $138 BB ($150 BB in inflation adjusted dollars) spent on the [railroads'] infrastructure."[15] Injecting competition through this reciprocal switching rule may require additional investment and may trim these profits, dividends, and stock buybacks, but it will hardly constitute a serious threat to the operation and financial health of the rail industry.

3. <u>Reciprocal switching minimizes the need for complex rate regulation</u>. Increased implementation of switching should increase competition and reduce the need for time-consuming and costly rate cases or the imposition of more complicated rate-ceiling methodologies.[16]

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[13] *See Comment*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), Highroad Consulting, Ltd., Mar.1, 2013, at 18.

[14] *See* U.S. Bureau of Labor Statistics, Producer Price Index by Industry: Rail Transportation [PCU48214821], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/PCU48214821, February 8, 2022.

[15] Remarks of Chairman Martin J. Oberman to the North American Rail Shippers Association Annual Meeting (Sept. 8, 2021), at 1, 19 (emphasis in original), *available at* https://www.stb.gov/wp-content/uploads/NARS-Speech-9-8-21.pdf.

[16] *See, e.g.,* Russell Pittman, *Against the Stand-Alone-Cost Test in U.S. Freight Rail Regulation*, 38 J. REG. ECON. 313 (2010); TRANSPORTATION RESEARCH BOARD, MODERNIZING FREIGHT RAIL REGULATION, SPECIAL REPORT 318 (2015).

For shippers to enjoy the benefit of this competition, however, railroad B cannot be hamstrung by onerous and opaque reimbursement requirements that turn a true alternative into a false choice. Although the Department defers to the Board's superior rate-regulation expertise, we strongly encourage the Board to develop a transparent, streamlined rate structure along the lines proposed by the National Industrial Transportation League that would compensate railroad A sufficiently and protect the investments railroad A has made in its physical infrastructure without rendering railroad B offers uncompetitive.[17] A simple and predictable regime for the imposition of switching orders would facilitate implementation, uptake, and oversight. Otherwise railroads may continue to exaggerate the burden reciprocal switching imposes on their networks, the impact of increased traffic from reciprocal switching, and/or the additional maintenance and investment costs incurred to balloon any compensation owed, and, in so doing, minimize reciprocal switching and deprive shippers of the benefits of competition.

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The record in this proceeding provides persuasive evidence that the current regulatory regime does not adequately protect captive shippers from the lack of a competitive marketplace. The record also demonstrates that the Board's proposed rule may allow captive shippers to enjoy some of the benefits of competition without imposing an undue burden on railroads. Although the proposed rule is no replacement for robust and vigorous enforcement aimed at addressing consolidation and anticompetitive conduct in the rail industry, the rule provides a judicious way to improve the competitive options for captive shippers.

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[17] *See, e.g.*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), National Industrial Transportation League, July 7, 2011, at 32; *Comment*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, Docket No. EP 711, *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), U.S. Department of Agriculture, March 1, 2013, at 20.

We appreciate this opportunity to offer our views to the Board, and look forward to continuing participation as the Board addresses these important issues.

Respectfully Submitted,

/s/ Jonathan Kanter

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