SURFACE TRANSPORTATION BOARD

Ex Parte 711 (Sub-No. 1)

Summary of Ex Parte Meeting held by video conference August 10, 2021 between Shipper Associations and Surface Transportation Board Member Michelle Schultz

Shipper Association Attendees:

- Karyn Booth, Counsel to the National Industrial Transportation League (NITL)
- Jill Brubaker, Director, Federal Government Affairs, American Chemistry Council (ACC)
- Ross Corthell, Vice President-Transportation, Packaging Corporation of America
- Connor Hamburg, Manager of Government & Industry Affairs, Nutrien
- Brad Hildebrand, Vice President and Global Rail and Barge Lead, Cargill
- Justin Louchheim, Director, Government Affairs, The Fertilizer Institute (TFI)
- Jeffrey Moreno, Counsel to the ACC and TFI
- Randy Mullett, Senior Policy Advisor, NITL
- Jeffrey Sloan, Senior Director, Regulatory & Technical Affairs, ACC
- Jason Tutrone, Counsel to the ACC and TFI

STB Attendees:

- Michelle Schultz, Member
- Michael Small, Attorney Advisor

Meeting Summary:

The Shipper Associations began the meeting by explaining that the meeting's purpose was: to answer questions about the Board's options for advancing Ex Parte 711, especially in light of President Biden's recent executive order on competition; and to help educate Member Schultz on the Shipper Associations' position in Ex Parte 711.

The Shipper Associations explained that their preference is for the Board to proceed with completing Ex Parte 711 on the current record, which is extensive. They explained that, although the proposal is not perfect, it is good and feasible, provided the Board considers proposed modifications in the record.

The Shipper Associations also explained that moving forward on the existing record is appropriate because the need for competitive switching has grown; railroad economic arguments opposing competitive switching are largely theoretical; railroad financial arguments are not dependent on factors that have changed and railroad finances have continued to improve; railroad operations have not changed in a way that would impact the competitive switching proposal, except that the implementation of precision scheduled railroading has led to service issues that demonstrate the need for competitive switching; and the issues related to switch pricing have not changed.

The Shipper Associations stated that, if the Board chooses to reopen the record in Ex Parte 711, it should seek comments on specific issues to avoid the need to rehash issues already thoroughly addressed in the record. The Shipper Associations also stated that, in lieu of soliciting additional written comments, the Board could hold a hearing that would provide an opportunity for the newest Board members to interact with interested parties and ask questions directly.

The Shipper Associations then proceeded to provide background on competitive switching and the proposed rule in Ex Parte 711. They explained that the Staggers Act makes clear that Congress intended for reciprocal switching to address railroad market power. They also stated that competitive switching would allow competition to address service and rate issues where competitive switching is practical. NITL's proposal for reciprocal switching was a direct response to the Board's request for a solution to an ongoing debate over rail competition.

The Shipper Associations stated that, although the intent of the reciprocal switching statute is to encourage competition to the maximum extent possible, the Board's current switching rules do not do this. Member Schultz asked Shipper Associations to summarize the key reasons for this. Shipper Associations responded that, in the mid-1980s, to help railroads achieve revenue adequacy, the Interstate Commerce Commission (ICC) set the bar for reciprocal switching artificially high by requiring anticompetitive conduct. Given the greatly improved financial health of the railroads, the original ICC concerns about the impact of reciprocal switching no longer exist.

Next, the Shipper Associations explained that mergers have reduced competition over time by extending bottlenecks, and the Board has not addressed this reduction through the merger conditions it has placed on past mergers. The Shipper Associations explained that competitive switching is deregulatory because it would enable shippers to rely on competition rather than the Board's rate regulation to establish rates on the portion of an incumbent carrier's bottleneck over which competitive switching provides access to a competing carrier's line. They also explained that competitive switching can help avoid lengthy and expensive rate regulation proceedings that are impractical for the vast majority of captive shippers. Additionally, they explained that competitive switching provides service benefits by enabling a shipper to access a competing carrier when the incumbent is experiencing service issues.

Member Schultz asked whether the Shipper Associations had information about the competitiveness of switch rates where competitive switching exists today. The Shipper Associations responded that: for competitive switching arising under merger conditions, the merger conditions set the switch rates and an escalation mechanism; and for legacy switches, the rates can vary but they appear sufficiently competitive for traffic to move under them.

Member Schultz asked whether competitive switching results in a competitive rate and, if so, what the difference is between that rate and the rate that would otherwise apply. The Shipper Associations explained that there is a marked difference between the rate increases at their members' captive facilities and competitive facilities over the last 5 years.

The Shipper Associations explained that, although the Board currently limits the availability of competitive switching to behavior that would violate the antitrust laws, it ignores the railroad use of bottleneck protections to foreclose competition, which is an antitrust behavior.

The Shipper Associations walked through the "Reciprocal Switch Scenarios" slide in the handouts with Member Schultz. They explained that railroads have focused on a single worst-case switching scenario (represented by figure 1 on the slide), made this scenario as complicated as possible, and presented it as representative of a typical competitive switch.

The Shipper Associations explained that figures 2 and 3 on the "Reciprocal Switch Scenarios" slide represent more common switch scenarios, and they merely involve a change in the location of a switch, not the addition of a switch.

The Shipper Associations explained that competitive switching would not involve additional trains or operations, because switches would occur at existing interchange points where the necessary trains and operations already exist.

The Shipper Associations explained that competitive switching would not result in reduced investment. They stated that a railroad has little need to invest in noncompetitive traffic because the risk of losing the traffic is low. They also stated that actual experience shows that railroads have made extensive investments in highly competitive traffic, such as intermodal and automotive, and in areas where competitive switching already exists today.

The Shipper Associations explained that competitive switching will have little benefit unless the Board adopts a switch fee standard that ensures fees will be at levels that promote competition. They have proposed a standard that is a slight variation of the Board's SSW compensation framework, which is workable and compensatory.

Member Schultz asked how a competitive switching rule that involved case-by-case determinations would provide fair and consistent judgments and how it would affect network predictability. The Shipper Associations responded that a case-by-case approach does not have to result in inconsistency because the Board can still establish consistent precedent based upon the facts presented. They also explained that the Board's current reciprocal switch rules require case-by-case determinations.

The Shipper Associations briefly discussed the Canadian interswitching rules and noted that the record includes a verified statement from a Canadian expert that provides additional background on interswitching.

In response to a question from Member Schultz, the Shipper Associations stated that a time limit on reciprocal switch grants would not be advisable because shippers and carriers need sufficient certainty around the availability of competitive switching so that they can enter transportation contracts based on a competitive switch. They noted that the Board has procedures that railroads can invoke to reopen a switch determination based upon changed circumstances, if that should prove necessary or desirable.

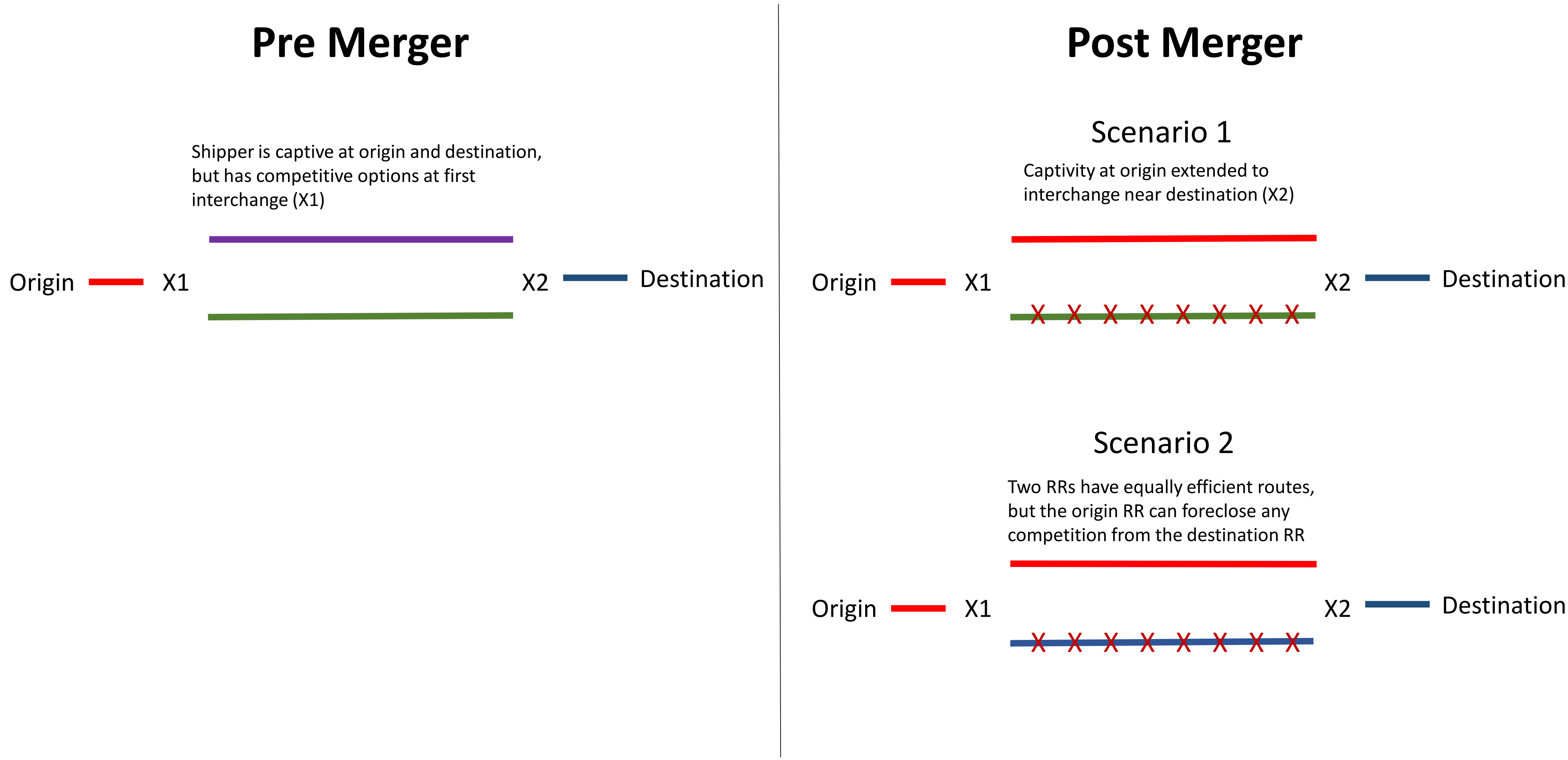
Member Schultz asked for an estimate of the expected number of filings seeking competitive switching. The Shipper Associations explained that there are likely to be few filings until a number of principles embodied in the rule are fleshed out in initial cases. Additionally, Shipper Associations commented that the threat of competitive switching may lead to negotiated settlements and, thus, a competitive-switching case may not be necessary for a shipper to obtain the benefits of competitive switching.

Member Schultz sought comments on what constitutes a reasonable distance. The Shipper Associations stated that their comments suggest that a reasonable distance should be equivalent to the distance that the incumbent operates local serving trains out of the relevant terminal today. This would avoid a change in the incumbent's operations and discrimination between competitive-switch traffic and other traffic.

Member Schultz asked what the potential impact of competitive switching would be on traffic that would not be eligible for it. The Shipper Associations responded that, from a service perspective, the traffic would still benefit because traffic that uses competitive switching to avoid congestion would move off the incumbent carrier and, thus, provide a network fluidity benefit for shippers without that option. In addition, they explained that this is a distinction that exists today between captive and competitive traffic, and reciprocal switching will merely increase the volume of competitive traffic, which is a net benefit even though some shippers will continue to be captive.

Member Schultz thanked the Shipper Associations and stated that the meeting was helpful. The meeting concluded.

Bottleneck Extensions Through Mergers

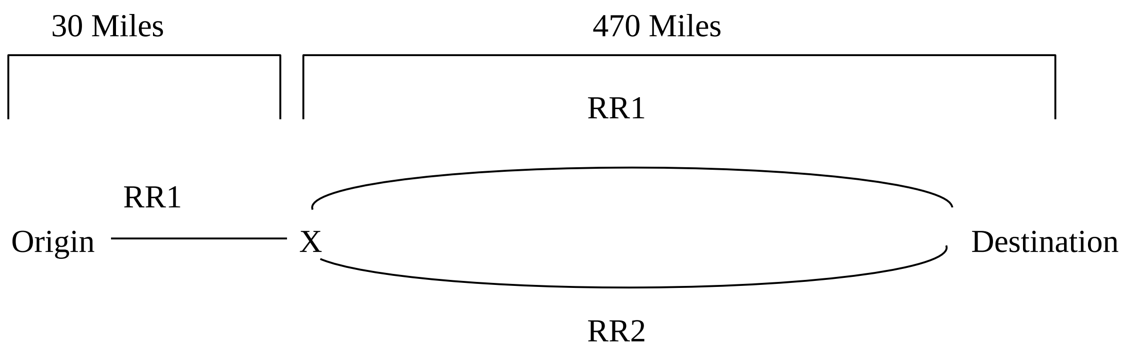


The STB's Ex Parte No. 711 Rulemaking Proceeding Is Deregulatory And Pro-Competitive

Objective: Allow competition to replace regulation of the rail industry when a competing railroad is accessible within a reasonable distance of an origin or destination that is captive to a single railroad.

How It Works: Upon a shipper's demonstration of a need for competitive rail service, the STB will grant a request for reciprocal switching, which requires a railroad to interchange the shipper's rail cars to a competing railroad within a reasonable distance of the captive origin or destination, provided that the interchange is safe and feasible.

Illustration:



Deregulatory Impact: Today, existing regulations require the captive shipper to use RR1, in the above illustration, for the entire 500 mile distance, despite the ability of RR2 to compete for 470 miles. Therefore, to protect the captive shipper from monopoly pricing by RR1, the STB must regulate RR1's rate for the entire 500 mile distance.

Under EP 711, reciprocal switching will allow the STB to regulate just the first 30 miles of physical captivity to RR1, in the above illustration, and allow competition between RR1 and RR2 to determine the rate for the remaining 470 miles.

Additional Benefits: Competition through reciprocal switching, instead of regulation, provides greater incentives for railroads to improve service and invest in new infrastructure that will make American businesses more competitive.

Competition through reciprocal switching will reduce reliance upon existing STB rate regulation, which requires incredibly complex litigation over several years and costs millions of dollars for an uncertain result. Because most captive shippers do not tender sufficient volumes between the same points over a sufficiently long time period to economically justify this time and expense, competition is a more effective constraint upon rail market power than rate regulation.

RECIPROCAL SWITCH SCENARIOS

Fig. 1

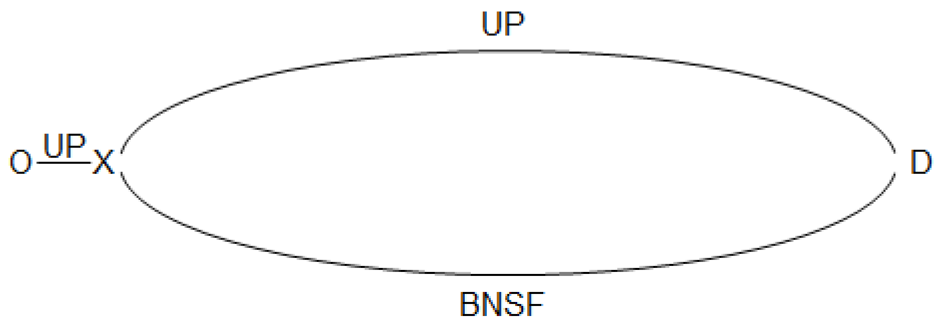


Figure 1, which is the only scenario the railroads address, converts single-line service to two-carrier service as a result of a reciprocal switch. Shippers are likely to request switching in this circumstance only when the competitive carrier offers other efficiencies to offset the additional handling.

Fig. 2

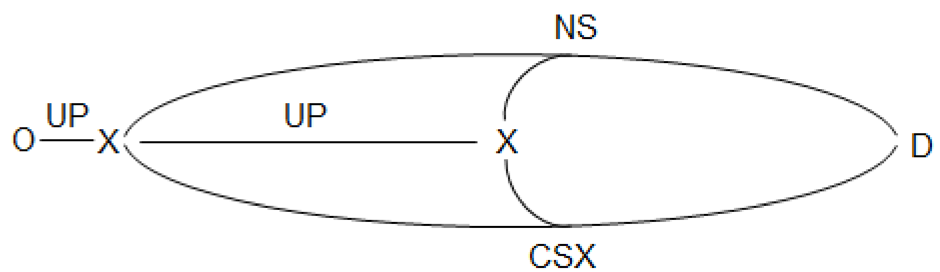
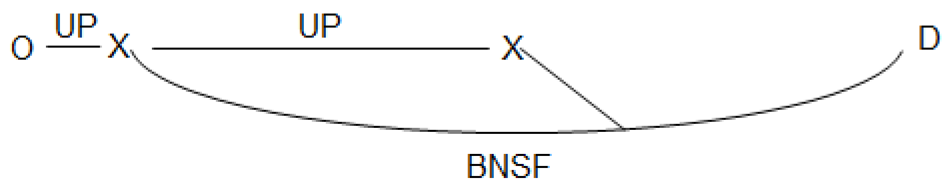


Fig. 3



Figures 2 and 3 reflect more common scenarios where reciprocal switching does not increase the number of interchanges or carriers in the route, but merely changes the interchange location.

- Figure 2 is a movement that occurs on east-west (and vice-versa) gateway movements where the origin carrier achieves its long-haul by handling the traffic in the north-south direction (and vice versa) for the longest distance that is practical before interchanging to the east-west carrier.

- Figure 3 is common in the west between BNSF and UP, in the east between NS and CSX; and along the Mississippi River between BNSF, UP, CN and KCS.

- In both Figures, reciprocal switching allows the destination railroads that participate in the route to claim a longer haul when they can be more efficient, without any additional handling.

EP 711 Ex Parte Meetings: Key Messages

1. **Congress intended reciprocal switching to address railroad market power where (1) practical and in the public interest, or (2) necessary to provide competitive rail service. (Op. at 14-16; Reply at 14-17, 37-42)[1]**

2. **There is a strong need for reciprocal switching to address the exercise of railroad market power over captive shippers (Op. at 5-14; Reply at 19-37, 55-67).**

3. **Reciprocal Switching is Deregulatory (Reply at 55-60).**

   a. Reciprocal switching is not "artificial" competition created through reregulation, but a statutory tool to prevent carriers from foreclosing competition that otherwise exists on large portions of routes beyond a short distance bottleneck segment.

   b. Competition would limit the need for rate regulation to the shortest captive distances.

4. **Operational impacts are greatly exaggerated (Reply at 60-61, 96-116).**

   a. Railroads have created "worst case" scenarios and misrepresented them as typical.

      i. There will be zero operating impacts when the incumbent retains the traffic.

      ii. Reciprocal switching does not impose additional operating steps on the incumbent when it occurs at an <u>existing</u> interchange.

      iii. Case-by-case approach allows STB to deny switching in the "worst case" circumstances posited by the railroads.

   b. Operating plans are not static, inflexible, plans as portrayed by the railroads.

5. **Competition does not discourage investment (Reply at 116-22).**

   a. Competition will spur investment by creating powerful incentives for each railroad to attract and retain <u>competitive</u> traffic, whereas the incumbent otherwise would have little need to make such investments to retain <u>captive</u> traffic.

   b. Railroads have made extensive investments in highly-competitive traffic, including in areas with large concentrations of reciprocal switching.

6. **Including lost contribution (i.e. "Efficient Component Pricing") in the switch fee would nullify the benefits of reciprocal switching reform (Op. at 53-54; Reply at 131-33).**

7. **The Board has ample information to act on reciprocal switching.**

8. **Case-by-case approach enables the Board to consider cumulative impacts (Op. at 20-23; Reply at 86-89).**

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[1] References are to Shipper Coalition Op. Comments (filed Oct. 26, 2016) and Reply Comments (filed Jan. 23, 2017).