Comments of the International Center for Law & Economics

Before the Surface Transportation Board

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

Reciprocal Switching

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Ian D. Adams
Executive Director
International Center for Law & Economics
1104 NW 15th Ave
Portland, OR 9720-9425
(916) 761-5269
iadams@laweconcenter.org

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I. INTRODUCTION / SUMMARY OF COMMENTS

On behalf of the International Center for Law & Economics, a nonpartisan nonprofit that promotes the use of law & economics methodologies to inform public-policy debates, I offer the following comments to express concern about the potential finalization and promulgation of the Surface Transportation Board's (STB) 2016 Notice of Proposed Rulemaking (NPRM) regarding the imposition of a reciprocal-switching requirement for U.S. freight-rail operations.

The STB's renewed efforts on reciprocal switching have come as part of a push by the administration to spur competition in the U.S. economy.[1] This proceeding responds specifically to a call by President Joe Biden to: "strengthen regulations pertaining to reciprocal switching agreements."[2] Unfortunately, like much of the administration's broader effort, the regulatory solutions the STB offers are in search of competition problems, evidence of which remains conspicuously absent. Worse, the STB offers these new regulations on the basis of a docket that is now dated and that itself relied on even older data.[3] As a procedural and factual matter, the STB should use this proceeding to abandon consideration both of the 2016 NPRM, specifically, and of a reciprocal-switching mandate altogether.

Toward that end, these comments speak to the manifest infirmities of the proposal under consideration by examining how the STB has failed in its statutory duty to identify a problem suitable for regulatory redress; by identifying the proposed solution's most likely outcomes and exploring

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[1] Executive Order 14036, 86 FR 36987-36999, "Promoting Competition in the American Economy." July 9, 2021. https://www.federalregister.gov/d/2021-15069.

[2] Ibid.

[3] Docket No. EP 711, Docket No. EP 711 (Sub-No. 1), 81 FR 51149-51165,"Petition for Rulemaking To Adopt Revised Competitive Switching Rules; Reciprocal Switching." Aug 3, 2016. (NPRM). https://www.federalregister.gov/d/2016-17980.

how poorly they satisfy the Proposed Rule's stated goal; and by detailing the inevitable costs associated with promulgating the Proposed Rule.

Competition within the freight-rail sector and the larger U.S. economy is vital to the nation's economic health, and by the STB's most recent assessment, is robust.[4] But the role of regulation is to make markets regular in a manner that fosters efficiency, not to reflect the whims or will of a regulator to the detriment of a disfavored party.

II. THE PROPOSED RULE DOES NOT RESPOND TO A CLEAR PROBLEM, FAILS TO MAKE A CASE FOR MARKET INTERVENTION, AND POSITS AN ILLIGITMATE SOLUTION

As a matter of law, a proposed rule change must stem from a particularized problem. As a matter of policy, the solution posited must be appropriate for the identified problem. And, crucially here, the regulatory body must have authority to pursue the proposed solution to the particularized problem. The Proposed Rule fails to satisfy any of these requirements.

It is a well-settled point of administrative law that, in the course of reversing existing regulatory policy, a regulatory body must first concretely identify the issue that it seeks to address.[5] Since the Proposed Rule would modify competitive-access regulations that have existed since 1985, it is incumbent upon the STB to fulsomely explain what necessitates this action.[6] This is especially important in an instance like this, in which substantial reliance interests have developed.[7]

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[4] Laurits Christensen Associates report to Surface Transportation Board, "A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals that might Enhance Competition." November, 2009. https://www.stb.gov/wp-content/uploads/files/docs/competitionStudy/Executive%20Summary.pdf.

[5] *National Cable & Telecommunication Ass'n v. Brand X Internet Servs.*, 545 U.S. 967 (2005).

[6] Interstate Commerce Commission (ICC), see Intramodal Rail Competition, 1 I.C.C.2d 822 (1985), codified as 49 CFR 1144.1(a). https://www.ecfr.gov/current/title-49/subtitle-B/chapter-X/subchapter-B/part-1144.

[7] *FCC v. Fox Television Stations, Inc.* 556 U.S. 502 (2009).

The Proposed Rule neglects to assert a baseline of appropriate conduct against which subsequent developments could be evaluated. In real terms, there is no metric for success, nor is there a hypothetical market outcome that could address the generalized grievances articulated in the NPRM. The STB asserts that "captive" shippers are subject to unreasonably poor-quality mainline service and pricing,[8] which it attributes to a reduction in "naturally occurring"[9] reciprocal switching in the wake of consolidation spurred by the Staggers Rail Act of 1980 (notably, the NPRM omits to mention that these mergers were approved by the STB itself). The STB further points to a "dearth of cases"[10] under the existing framework as evidence of a larger problem, which is as close as the NPRM comes to offering an objective metric to justify the Proposed Rule.

But the reasoning the NPRM offers is flawed. The relative paucity of litigation alleging anticompetitive conduct in the wake of the *Midtec Paper Corp. v. United States, 857 F.2d 1487 (D.C. Cir. 1988)* decision is not a problem, in and of itself. Indeed, it may indicate that the current regulatory model is effective, that there are adequate levels of access, and that prices are reasonable. Noting that there have been relatively few reciprocal-switching cases does not represent a legally sufficient basis for the Proposed Rule to move away from the existing framework.

Yet, *ex parte* commentary suggests that the STB's real ambition is broader: to make an end run around standards of anticompetitive conduct that have facilitated tremendous efficiency gains in the rail sector, in order to benefit certain shippers who are unhappy with the rates they are being

[8] NPRM at 51162

[9] NPRM at 51153

[10] NPRM at 51152

asked to pay.[11] Compulsory reciprocal-switching arrangements would represent extreme regulatory interventions in the operations of private enterprise, even where such business must be conducted in accordance with public-interest[12] and common-carrier[13] obligations. Such interventions can only be justified where they seek to correct meaningfully disruptive anticompetitive conduct, based on the established market dominance standard.

But, importantly, findings of market dominance—both quantitative and qualitative—are meant to trigger investigatory proceedings, not to dictate their outcome. Merely asserting that market power exists, or that the specific railroads are profitable, does not justify the level of intervention contemplated by the Proposed Rule. It certainly would not justify upending the current system, in which the STB has duties, prescribed by statute, to review and revise rates, and in which shippers may readily pursue redress through such rate proceedings.[14]

Moreover, the Proposed Rule does not comport with the broad intent and strictures of congressional guidance as interpreted by federal courts. The plain language of the government's policy is clear: *"it is the policy of the United States Government…to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail (and) to minimize the need for Federal regulatory control over the rail transportation system."*[15] It is on that basis that efforts to achieve rate relief via a prayer for switching orders in the courts have understandably foundered.[16]

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[11] NPRM at 51162

[12] 49 U.S.C. § 10101

[13] 49 U.S.C. § 11101

[14] 49 U.S.C. § 10707(c), (d)

[15] 49 U.S. Code § 10101

[16] *Midtec Paper Corp. v. United States*, 857 F.2d 1487 (D.C. Cir. 1988)

A rule that would frustrate the purpose of the rate-review system and the statutes on which it is based, as the Proposed Rule does, is illegitimate and should be considered invalid on its face.

III. FORCED SWITCHING DOES NOT RESULT IN ENHANCED COMPETITION

The STB's enabling statute concerns itself with outcomes, not particular regulatory modalities. Thus, when the STB asserts that industry consolidation in the wake of the Staggers Act has led to a reduction in "naturally occurring" reciprocal switching, it bears interrogation whether that matters. Consolidation may have reduced the need for switching agreements but, in the process, it also has undoubtedly improved the efficiency of single-line service. That there has been less naturally occurring switching is meaningless in the context of the market as a whole, where rail access and fares are – again – competitive.

Broadly speaking, concerns about competition in the rail sector are overblown and misdirected. The White House notes that the number of Class I railroads has declined from 33 in 1980 to just seven today.[17] While that is technically true, what the observation fails to acknowledge is that the STB has changed the category's definition over the years; many of 1980's Class I operators would not be classified as such today. More importantly, the number of smaller railroads has boomed over the past four decades, while the share of track under Class I control has declined.[18] In real terms, concentration in the rail sector actually has fallen.

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[17] White House, Fact Sheet: "Executive Order on Promoting Competition in the American Economy." July 9, 2021. https://www.whitehouse.gov/briefing-room/statements-releases/2021/07/09/fact-sheet-executive-order-on-promoting-competition-in-the-american-economy.

[18] Christensen Report.

There is vanishingly little evidence that the freight-rail industry suffers from insufficient competition. Shippers pay appropriate market rates,[19] innovation is pursued aggressively,[20] and infrastructure is maintained.[21] If regulators act on the belief that a certain minimum number of Class I railroads is needed to foster competition, they risk undercutting benefits to end-customers and shippers alike.

As discussed in the previous section, it is not a legitimate goal of STB regulation to seek to lower the rates paid by shippers by artificially increasing the number of individual railroads that may serve a given route. Nor would such a change be likely to relieve the competition problem posited in the NPRM. Rather, mandated reciprocal switching would diminish railroads' flexibility to seek the efficiencies that have allowed the industry's capacity to grow dramatically since the turn of the 21st century. No doubt, other comments will further detail the notable practical hurdles that a reciprocal-switching mandate would impose throughout the nation's rail network.

The Proposed Rule's mandate would fail in its stated purpose of spurring competition, not only because of the operational burden it would impose, but also because it fails to grapple with the basic dynamics intrinsic to first-mile and last-mile service. That is, it ignores the fact that such service is nearly always limited to a single market participant. Compulsory switching would press these carriers into one another's service in ways that may encourage uneconomic delays, as was

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[19] Pociask, Steve. American Consumer Institute, "Veering Off the Rails: How the Recent Push to Reregulate Railroads Threatens Consumer Welfare." Oct 20, 2021. https://www.theamericanconsumer.org/wp-content/uploads/2021/10/Final-Reciprocal-Switching.pdf.

[20] OliverWyman, "Disruption: the Future of Rail Freight." 2017. https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2017/sep/The_Future_of_Rail_Freight.pdf.

[21] Ford, George. Phoenix Center, "Infrastructure Investment in the Railroad Industry: An Econometric Analysis." Dec 9, 2019. https://www.phoenix-center.org/perspectives/Perspective19-07Final.pdf.

frequently alleged during the telecommunications industry's "unbundling" saga discussed below, and act as a drag on the network as a whole.

Moreover, the raw number of railroads catering to a given shipper is a particularly poor indicator of a market's competitiveness. It certainly does not constitute dispositive evidence of the market dominance or anticompetitive conduct that the NPRM alleges is rife in the rail sector. The Proposed Rule's mandate would not enhance competition, but would rather compel development of uneconomical and redundant lines.

Shippers long have had the option to bring suit alleging abuses of market power but have instead opted for regulatory relief, because the prevailing prices and the alleged service deficiencies do not meaningfully undermine shippers' ability to compete. Their concerns about competition in the freight rail sector would be better directed at the need for a new comprehensive study, along the lines of the STB commissioned Christensen report from 2009, than toward an over-broad and prescriptive rule making process.

IV. PROPOSED REGULATION WILL RESULT IN SUBSTANTIAL MARKET UNCERTAINTIES

Lessons from other venues about the perils of compelled interoperability exist throughout the economy, but the "unbundling" of telecommunications services that occurred as a part of the 1996 Telecommunications Act warrant particular attention owing to that industry's similar reliance on the development and maintenance of private infrastructure.[22]

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[22] Jamison, Mark A., "Effects of Prices for Local Network Interconnection on Market Structure in the U.S.." Mark A. Jamison, GLOBAL ECONOMY AND DIGITAL SOCIETY, ed. Erik Bohlin, Stanford L. Levin, Nakil Sung, and Chang-Ho Yoon, pp. 301-320, Amsterdam: Elsevier, 2004. https://ssrn.com/abstract=1082844

Under the 1996 Act, "dominant" telecommunications carriers were compelled to make parts of their network available to other carriers at, in effect, below cost terms. Subsequently promulgated regulatory efforts to implement the unbundling standards were subject to near constant litigation. Attempts by the Federal Communications Commission (FCC) to develop and enforce access and switching rules were repeatedly struck down based on their ambiguity.

In 2004, the Supreme Court heard a case directly on the terms under which access must be granted in *Verizon v. Trinko*.[23] In its decision to dismiss the antitrust claims that Verizon had failed to offer sufficient access to its network, Justice Antonin Scalia, writing for the majority, highlighted that efficiency-based error-cost sensitive analysis is particularly appropriate while evaluating competition concerns in a highly technical regulatory environment.[24] In other words, Justice Scalia counseled caution where efforts to curb seemingly anticompetitive conduct could retard legitimate business interests.[25]

Eventually, the FCC did develop a particularized cost-based metric for evaluating switching and access requests, but the broader legacy of this effort is better understood as a lost decade of

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[23] *Verizon Communications Inc. V. Law Offices of Curtis V. Trinko, LLP.* (02-682) 540 U.S. 398 (2004).

[24] Abbot, Alden. Truth on the Market, "Justice Scalia, Monopolization, and Economic Efficiency" Feb. 17, 2016. https://truthonthemarket.com/2016/02/17/justice-scalia-monopolization-and-economic-efficiency/; Verizon, 540 U.S. at 407 ("But just as the 1996 Act preserves claims that satisfy existing antitrust standards, it does not create new claims that go beyond existing antitrust standards.").

[25] Verizon, 540 U.S. at 407-08 ("The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices—at least for a short period— is what attracts "business acumen" in the first place; it induces risk taking that produces innovation and economic growth. **To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct. Firms may acquire monopoly power by establishing an infrastructure that renders them uniquely suited to serve their customers. Compelling such firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities.**") (emphasis added).

costly regulatory delays, costly litigation, and costly uncertainty that stymied investment in the field. Worse, all of these outcomes occurred in a market that was already competitive.[26]

The parallels between the FCC's unbundling experience and the STB's proposed approach to switching and access are uncanny. As a policy matter, the STB would do well to weigh the caution counseled by Justice Scalia in his *Trinko* opinion. But, as a more pressing practical matter, the glaring lesson for the STB is that, despite the unbundling effort's tremendous challenges, at least the FCC undertook the proceeding in direct response to Congressional action. The STB enjoys no such novel statutory mandate, and so any ultimately promulgated rule, and particularly the Proposed Rule from the 2016 NPRM, will be subject to a level of scrutiny not even the FCC had to endure. The nation's supply chains can hardly sustain such uncertainty, nor its associated disruption, in this moment.

V. CONCLUSION

Consumers win when freight rail moves efficiently. Developments in automation and scheduling are poised to usher in new opportunities in that regard. Reciprocal switching would preclude railroads from realizing the benefits of these developments by forcing them to run shorter trains more irregularly, in order to accommodate access requirements. The benefits to shippers, and to labor unions would come at the expense of inevitable environmental, safety, and productivity losses – to say nothing of compounding now well-documented issues with supply-chain vulnerability.

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[26] Ford, George. Federal Communications Law Journal. "Competition After Unbundling: Entry, Industry Structure, and Convergence." 2005. https://www.ftc.gov/system/files/documents/public_comments/2018/08/ftc-2018-0049-d-0019-151056.pdf

As the STB decides whether to move forward with its 2016 NPRM, begin a new rulemaking process, or defer action entirely, the last of these is the only course of action that comports with market realities and the nation's infrastructure needs. There is simply no other course of action that is entirely consistent with the procedural, legal, and policies imparities bearing on this proceeding. Yet, barring that, the STB should recognize how the world has changed in the last decade, and go back to the drawing board with a new NPRM reflective of an entirely up-to-date factual record.