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BEFORE THE
SURFACE TRANSPORTATION BOARD

M&G POLYMERS USA, LLC	)	
Complainant,	)	
v.	)	**Docket No. NOR 42123**
CSX TRANSPORTATION, INC.	)	
Defendant.	)	

CSX TRANSPORTATION, INC.'S COMMENTS ON THE PROPOSED "LIMIT PRICE" APPROACH TO DETERMINING QUALITATIVE MARKET DOMINANCE

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CSX TRANSPORTATION, INC.'S COMMENTS ON THE PROPOSED "LIMIT PRICE" APPROACH TO DETERMINING QUALITATIVE MARKET DOMINANCE

Defendant CSX Transportation, Inc. ("CSXT") hereby comments on the Board's proposed new approach for making qualitative market dominance determinations in maximum rate reasonableness cases. *See generally, M&G Polymers USA, LLC v. CSX Transp., Inc.*, STB Docket No. 42123, (Sept. 27, 2012) ("Decision"); *see id.* at 4-5, 21 (soliciting comments on the proposed approach). As demonstrated below, the Board's proposal to adopt a formula involving the Revenue Shortfall Allocation Method ("RSAM") to establish a market dominance presumption in rate reasonableness cases is contrary to the requirements of the Interstate Commerce Act and the Administrative Procedure Act, illogical and arbitrary, and contrary to sound economic principles and policies established by the Staggers Act and implemented by the ICC and the Board over the last 30 years. The proposed new method is deeply flawed and must be rejected. Instead, the Board should continue to apply its established method of determining qualitative market dominance, employing its expertise to evaluate transportation alternatives and determine whether those alternatives constitute effective competition for the rail transportation to which a challenged rate applies. *See* 49 U.S.C. § 10707(a).

BACKGROUND[1]

On September 27, 2012, the Board issued a decision on market dominance, finding that CSXT lacked market dominance over six issue lanes but possessed market dominance over the

[1] M&G filed its original rate complaint on June 18, 2010. On January 27, 2011, CSXT moved for expedited consideration of market dominance evidence. After initially opposing CSXT's motion, M&G withdrew its opposition on April 15, 2011, and the Board bifurcated the case. *See M&G v. CSXT*, STB Docket No. 42123 (served May 6, 2011). M&G and CSXT submitted market dominance evidence in accordance with the Board's procedural schedule, concluding with the submission of M&G's rebuttal evidence on August 4, 2011.

remaining 36 lanes for which CSXT had challenged market dominance.[2] *See* Decision at 21. The Board's decision relies on its application of a proposed new rule and approach for determining whether feasible intermodal alternatives "represent competition sufficient to restrain rates effectively." *Id.* at 13. The proposed new rule, which the Board announced *sua sponte* in this individual adjudication without input from the parties, has three parts. First, for each challenged rate the Board proposes to "calculate the price that, if the railroad charged above that level, would result in a significant loss of traffic," which it calls the "limit price." *Id.* Second, the Board "will compare the limit price to the railroad's variable costs of providing the service at issue." *Id.* at 14. If the resulting ratio exceeds the railroad's most current RSAM figure, the Board will "preliminarily conclude that the alternative cannot exert competitive pressure sufficient to constrain rates effectively." *Id.* Third, the Board will "consider whether the alternative has any intangible features sufficient to overcome the applicable preliminary conclusion." *Id.*

Recognizing the novelty of its proposed new rule, the Board "strongly encouraged" parties to submit comments on it and on potential alternatives. *Id.* at 5 ("If there is a better general approach to this issue, if there is a superior benchmark that can be used to guide this inquiry, or if the application of the refined approach to the facts of this case is somehow flawed, parties are strongly encouraged to use this comment period to bring such concerns to our attention.").

CSXT believes the Board's proposed new market dominance rule is contrary to law and precedent, illogical, economically unsound, and ill-advised as a matter of policy, and would

[2] CSXT did not contest market dominance in 26 separate lanes, covering 18 of the challenged rates. *See* Decision at 20.

generate arbitrary results. If the Board determines that a change to its existing market dominance policy and rules may be appropriate, it should commence a full notice-and-comment rulemaking to consider possible alternatives and proposals. Below, CSXT submits more detailed preliminary comments on the Board's proposed new market dominance rule.

SUMMARY OF COMMENTS

The following comments are presented in four parts. Part I.A shows that the Board's proposed rule is contrary to the governing statute because it would use a revenue-to-variable cost ratio to establish a presumption regarding market dominance. Part I.B shows how the Board's proposal is contrary to congressional intent that the ICC (now the Board) abandon the use of quantitative presumptions to establish market dominance, because experience had shown such presumptions to be unsatisfactory, misleading, and unreliable determinants of market dominance. Part I.C discusses how the market dominance rules promulgated by the ICC to implement the changes enacted by the Staggers Act rejected the use of quantitative presumptions in market dominance determinations. Prior to the Staggers Act, the ICC had used a system of rebuttable quantitative presumptions, and found them to be inaccurate, excessively reliant on quantitative measures at the expense of consideration of more relevant factors, and generally poor measures of a carrier's market power in a given market. The Board's proposed approach disregards this experience by proposing a market dominance test whose central feature is an R/VC-based market dominance presumption. Part I.D shows that the Board's proposed test would impermissibly shift the burden of proof of market dominance to defendant carriers.

Part II, supported by the testimony of prominent economists, demonstrates that the Board's proposed new formula-based rule is economically irrational, relies on an irrelevant comparison, and provides essentially no information relevant to determining whether a carrier has qualitative market dominance in the specific market(s) in question. As Drs. Eakin and Meitzen of Christensen Associates explain, the proposed new rule also would not save time or cost because it merely inserts additional steps to the analysis without providing any additional relevant or useful information. The presumptions erected by the proposed new approach would be arbitrary and meaningless. As Professor Willig states, "RSAM is not an 'objective' indicator of monopoly pricing." Moreover, Professor Willig further warns that "[t]he 'limit price' method threatens revenue adequacy and the long-term health of the [railroad] industry."

Part III demonstrates that adoption of the proposed new market dominance rule in this individual adjudication would violate the Administrative Procedure Act ("APA"). The agency adopted the existing market dominance rules in a notice-and-comment rulemaking. The APA requires that substantive amendments to rules that were adopted in a rulemaking may themselves be adopted only through a rulemaking. The Board has at least implicitly recognized this requirement when it conducted rulemakings to amend these same market dominance regulations. If the Board were to apply the proposed new market dominance rules in this individual adjudication without undertaking a proper rulemaking, the resulting legal error would render any rate reasonableness determinations in this proceeding invalid.

Part IV shows that in many circumstances, the Board's proposed new test would yield absurd results. CSXT uses market dominance evidence and findings in prior cases to illustrate the irrationality and irrelevance of the proposed new rules. Those examples show that the proposed new rule would result in market dominance findings that are contrary to the Board's findings in actual cases, and contrary to basic market economics and experience in competitive markets. Finally, Part V shows that the Board's proposed rule seeks to "solve" a non-existent problem, would not be more objective than the existing rule, and would complicate rather than simplify the market dominance analysis. In sum, the proposed new rule would be contrary to the Interstate Commerce Act, agency experience and the APA, would rely on irrelevant and irrational quantitative calculations and comparisons, and would generate meaningless, arbitrary, and capricious results. The Board should withdraw this ill-advised proposed rule.

I. THE BOARD'S PROPOSED NEW MARKET DOMINANCE RULE WOULD VIOLATE THE INTERSTATE COMMERCE ACT BY ESTABLISHING AN R/VC-BASED PRESUMPTION OF MARKET DOMINANCE.

The Board's proposed new rule would violate the Interstate Commerce Act by using a revenue to variable cost ratio ("R/VC") to establish a presumption that a rail carrier has or does not have market dominance. The governing statutory provision prohibits the Board from establishing a presumption regarding market dominance based on a movement's R/VC ratio. Because this is precisely what the Board's proposed limit price method would do, the proposed new rule would violate the statute and may not be applied in this or any other case.

A. The Interstate Commerce Act Prohibits the Use of R/VC Ratios to Establish Market Dominance Presumptions.

The statute establishing the market dominance requirement for the Board's jurisdiction over challenged rail rates provides, in relevant part:

> A finding by the Board that a rate charged by a rail carrier results in a *revenue-variable cost percentage* for the transportation to which the rate applies that is equal to or greater than 180 percent *does not establish a presumption* that—
>
> (A) such *rail carrier has or does not have market dominance* over such transportation . . .

49 U.S.C. § 10707(d)(2) (emphasis added). This provision is the source of the Board's obligation to conduct a "qualitative" market dominance analysis. The first step in the market dominance inquiry is determination of whether the carrier has quantitative market dominance. *See, e.g.,* Decision at 2; 49 U.S.C. § 10707(d)(1)(A) (if challenged rate generates R/VC < 180%,

then the Board that the must find carrier does not have market dominance over the transportation to which the rate applies). If the Board finds the carrier has quantitative market dominance, it then conducts a *qualitative* analysis to determine if the carrier has market dominance over the transportation at issue. *See* Decision at 2 (qualitative analysis considers transportation alternatives including competition from other rail carriers and competition from other modes of transportation); Section 10707(d)(2). Thus, both the governing statute and the Board's consistent interpretation of that statute require two distinct steps in a market dominance analysis: a quantitative inquiry, in which R/VC ratios are dispositive; and a qualitative inquiry, which does not rely on quantitative R/VC ratios. *See* Decision at 2; 49 U.S.C. §10707(d); *Potomac Elec. Power Co. v. CSX Transportation,* 2 S.T.B. 290, 294 (1997) ("Apart from the 180% jurisdictional threshold, which has been set by law, we do not use rate-cost relationships as the basis for qualitative market dominance determinations.").

Section 10707(d)(2)—quoted above—expressly provides that a finding that a challenged rate generates an R/VC > 180% may *not* be used to establish a presumption that a rail carrier has market dominance over the transportation to which a challenged rate applies. It is important to note that the statutory language applies equally to *any* R/VC ratio in excess of 180%. Thus, an R/VC ratio of, say 575%, may no more be used to establish a market dominance presumption than may an R/VC ratio of 182%. The statute makes it very clear that while an R/VC ratio below 180% ends the inquiry and deprives the Board of jurisdiction, an R/VC ratio above 180% does not—and may not—raise any presumption of market dominance.[3]

[3] It is no answer that the R/VC ratio the Board proposes to use would be derived from a hypothetical rate that the Board would set at the highest level the defendant carrier "theoretically could charge . . . .without causing a significant amount of the issue traffic" to divert to alternative transportation. *See* Decision at 3-4. If Congress expressly prohibited the use of an R/VC ratio

The new rule the Board has proposed would violate the mandate of Section 10707(d)(2) by establishing a presumption that the defendant carrier has market dominance over the issue transportation if the "limit price" (defined as the highest rate the rail carrier could charge without significant diversion of traffic to a competitive alternative) would generate an R/VC ratio (what the Board calls the "limit price R/VC ratio") above the defendant carrier's most recent RSAM figure. *See* Decision at 3-4. The Board labels the presumption established by its new "limit price test," a "preliminary conclusion" and notes that "when appropriate [it] will consider whether the alternative has any intangible features sufficient to overcome the applicable preliminary conclusion." Decision at 14.[4] However, any purported distinction between a

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generated by the actual challenged rate to establish a market dominance presumption, it surely would not countenance the use of a theoretical rate set by the Board—and untethered to the actual rate—as the basis for such a presumption. The problem with using an R/VC ratio to create a rate reasonableness presumption is that it is simplistic and does not take into account the myriad market factors and variables that actually affect market power and market dominance. The problem of using an R/VC ratio to establish a market dominance presumption would be exacerbated by using a hypothetical "limit price" subjectively set by the Board instead of the actual challenged rate. The market dominance presumption directly prohibited by the statute at least has the virtue of being based on the actual rate in question. The theoretical "limit price" is even farther afield from any real world market factors or information. At best, the subjectively set limit price the Board proposes would have only a most attenuated relation to the actual rate. An R/VC ratio derived from such a hypothetical price would be a contrivance even further removed from actual market analysis, and would provide no probative information concerning whether the carrier has market dominance over the transportation service at issue. Congress has prohibited the Board from using R/VC-based presumptions of market dominance, and the Board cannot avoid that prohibition by removing the challenged rate from the formula and substituting an arbitrary "limit price" in its place.

[4] The Board's application of its proposed test in this case indicates that once application of the limit price formula establishes a presumption of market dominance, the Board will rarely find that presumption has been rebutted by so-called "intangible features." Indeed, the Board's discussion of other evidence beyond its R/VC—RSAM numerical comparison was generally both cursory and conclusory. *See, e.g.,* Decision Appendix at 38-43 (once presumption established, Board's "analysis" of other factors generally consists of a general conclusory statement that the Board "conclude[s] that this alternative has no intangible features sufficient to overcome our preliminary conclusion.").

"preliminary conclusion" that may in some instances be overcome and a prohibited presumption is a distinction without a difference.[5]

What the Board proposes to establish is an R/VC-ratio-based system of presumptions, a conclusive presumption of lack of market dominance analysis for R/VC ratios less than 180% and a (sometimes) rebuttable presumption of market dominance for R/VC ratios exceeding the defendant carrier's RSAM ratio. The former, quantitative market dominance presumption is mandated by statute. In contrast, the use of an R/VC-based presumption of qualitative market dominance is prohibited by the same statute. Because the Board's proposal would use an R/VC ratio to establish a market dominance presumption, it would violate the statute and therefore may not be applied to make qualitative market dominance determinations in a rail rate reasonableness challenge. *See* 49 U.S.C. § 10707(d)(2).

B. The Legislative History of the Staggers Act Shows Congress Clearly and Repeatedly Rejected the Use of Rebuttable Presumptions in Market Dominance Determinations.

1. In the Staggers Act, Congress Prohibited the Use of R/VC-Based Rebuttable Presumptions of Market Dominance.

The Board's proposed new rule for R/VC-based "preliminary conclusions," its label for presumptions of market dominance, would violate congressional intent and overturn the Board's implementing rules and policy. In developing the Staggers Act, Congress carefully considered then-existing market dominance rules, practices, and tests. Concluding that reform was necessary, Congress adopted market dominance reforms in the Staggers Act. The Board's

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[5] The Decision does not assert that there is a difference between a presumption and what it calls a "preliminary conclusion" of market dominance. Rather, it simply states that it believes its approach "does not implicate § 10707(d)(2)'s statutory directive." Decision at 17. Any assertion that there is a meaningful difference between that Board's R/VC-based "preliminary conclusion" and an R/VC-based "presumption" would be sophistry.

proposed new rule for qualitative market dominance presumptions would defy congressional intent and disregard the agency's own experience and policies.

2. Congress Established The Concept of Market Dominance in Rail Rate Cases in the 4R Act.

The concept of market dominance originated in the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. 94-210 (1976) ("4R Act"). For the first time, Congress limited the rate reasonableness jurisdiction of the Board's predecessor, the Interstate Commerce Commission ("ICC"), to circumstances in which the "carrier has market dominance" over the service for which the rate was charged. *See* 4R Act at § 202(b). Congress defined market dominance as "an absence of effective competition from other carriers or modes of transportation, for the traffic or movement to which a rate applies." *Id.* at § 202(c). The 4R Act gave the ICC the power to "establish, by rule, standards and procedures for determining...whether and when a carrier possesses market dominance over a service rendered or to be rendered at a particular rate or rates." *Id.* at § 202(d).

To implement the 4R Act, the ICC promulgated rules for determining whether a carrier had market dominance over a particular transportation service. *Special Procedures for Making Findings of Market Dominance as Required by the Railroad Revitalization and Regulatory Reform Act of 1976*, 353 I.C.C. 875 (1976) ("*Special Procedures*"). In *Special Procedures*, the ICC established three rebuttable presumptions it would use to determine market dominance. Market dominance would be presumed: "(1) where the market share of the proponent carrier is 70 percent or more; (2) where the rate in issue exceeds the variable cost of providing the service by 80 percent or more; and (3) where the shipper has made a substantial investment in rail-related equipment."[6] *Id.* at 886-887.

Although the rules were upheld on judicial review (*see Atchison, T. & S.F. Ry. v. ICC*, 580 F.2d 623 (D.C. Cir. 1978)), in practice they were problematic. As the ICC eventually conceded, "the rules have been misunderstood and have been perceived as being more restrictive than [the ICC] had originally intended." *Rail Market Dominance and Related Considerations*, 45 Fed. Reg. 3353 (Jan. 17, 1980). The ICC further found that those regulations were causing "unwarranted confusion" and "may be more complicated and burdensome than necessary." *Id.* In sum, neither parties to rate cases nor the agency were satisfied with the original market dominance rules enacted by the ICC.

3. Congress Modified Market Dominance Requirements in the Staggers Act.

In 1979, Congress and the Carter Administration embarked on a comprehensive rail regulation reform effort, ultimately resulting in the Staggers Act, seeking in large measure to reduce regulation of rail rates in those instances in which market competition could establish reasonable rates and terms and prevent undue exercise of market power. In significant part, this effort was a response to dissatisfaction with the ICC's market dominance rules. *See, e.g.*, Railroad Deregulation Act of 1979, S. 796 § 102 (Administration reform proposal establishing a "reasonable alternative" test for ICC jurisdiction over rates). In the Committee Report

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[6] *Special Procedures* also included a test stating that where "the rate in issue has been discussed, considered, or approved under a carrier ratemaking agreement approved by the Commission...it will be presumed that any carrier participating in the involved rate or in such discussion, consideration, or approval does not provide effective competition for the involved traffic." *Special Procedures* at 886. The ICC subsequently clarified that this was, in fact, an evidentiary tool and not a presumption. *Market Dominance Determinations and Consideration of Product Competition*, 365 I.C.C. 118, 127 (1981).

accompanying the bill passed by the House, Congress repeatedly expressed dissatisfaction with the ICC's approach to market dominance and the need for an alternative. *See, e.g.*, H. Rept. 96-1035, 96th Cong. at 38 ("In the 4R Act, Congress instituted the so-called 'market dominance' test in hopes of removing most traffic from rate regulation. Unfortunately, the rules promulgated by the Commission freed up less than 30 percent of the traffic from regulation.").[7] The Senate version entirely eliminated market dominance due to its displeasure with the ICC's approach and its concerns that it was "extremely complex to administer." S. Rept. 96-470, 96th Cong. at 1-2.[8] Many witnesses at the rail regulation reform hearings that culminated in the Staggers Act similarly raised concerns about market dominance rules promulgated and applied.[9] These concerns were summarized and echoed by key legislators. *See, e.g.*, Statement of Senator Long,

[7] *See also Id.* at 115 ("The initial market dominance test did little to free up pricing on a movement-by-movement basis."). The House bill included alternative market dominance presumptions. Those provisions were dropped from the law that Congress ultimately enacted. *See* H.R. 7235 § 202(c)(2).

[8] *See also Id.* at 7 ("[T]he Committee hopes to avoid many of the problems that arose in connection with implementation of the complex concept of market dominance."); *Id.* at 19 ("[T]he intent of this legislation is to simplify rate regulation and to avoid the difficulties and uncertainty that surrounded application of the market dominance concept.").

[9] *See, e.g., Railroad Deregulation Act of 1979*, Hearings Before the Subcommittee on Surface Transportation of the Committee on Commerce, Science and Transportation, 96th Cong. at 293 (May 22, 1979) ("We recognize that the presumptions we established for determining market dominance have created some problems") (Statement of Daniel O'Neal, Chairman, Interstate Commerce Commission); *Railroad Deregulation Act of 1979*, Hearings Before the Subcommittee on Surface Transportation of the Committee on Commerce, Science and Transportation, 96th Cong. at 466 (May 23, 1979) ("The Commission has implemented market dominance by establishing certain standards which create a presumption that there is market dominance ... We proposed to modify this situation.") (Statement of Ellis Cox, Executive Vice President and Chief Operating Officer, Potomac Electric Power Co.); *Railroad Mergers*, Hearing Before the Subcommittee on Antitrust, Monopoly and Business Rights of the Committee on the Judiciary, 96th Cong. at 80-81 (June 11, 1979) (Testimony of William Dempsey, President, Association of American Railroads).

Cong. Rec. S 15320 (Oct. 29, 1979) ("[W]e received testimony that the present concept of market dominance applied to protect the captive shippers was unworkable.").[10]

The final language of the Staggers Act retained the existing language from the 4R Act defining market dominance as "an absence of effective competition from other carriers or modes of transportation, for the traffic or movement to which a rate applies." 49 U.S.C. § 10709 (1982). Importantly, the Staggers Act also significantly modified the market dominance requirement by adding what has come to be known as the "quantitative" market dominance test. *See* H. Rept. 96-1430, 96th Cong. at 91. The quantitative market dominance test provided a bright-line rule that if a rate results in a R/VC percentage below a specified level a carrier is not market dominant over the transportation to which that rate applies. *See* Staggers Act, Pub. L. 96-448, § 202(d)(2); 49 U.S.C. § 10709(d)(2) (1982). Further, the Staggers Act provided that "[a] finding by the Commission that a rate charged by a rail carrier results in a revenue-variable cost percentage for the transportation to which the rate applies that is equal to or greater than the [specified percentage] does not establish a presumption that (A) such rail carrier has or does not have market dominance over such transportation, or (B) the proposed rate exceeds or does not exceed a reasonable maximum." Staggers Act, Pub. L. 96-448, § 202(d)(4); 49 U.S.C. § 10709(d)(4) (1982).

In sum, the legislative history of the Staggers Act demonstrates that reforming the ICC's market dominance regulations and eliminating the rebuttable presumptions approach was an important purpose of Congress in adopting the broad rail regulation reform law. The Board

[10] *See also* Section-by-Section Analysis: Railroad Transportation Policy Act of 1979, 125 Cong. Rec. 15314 ("Carriers and shippers alike are dissatisfied with the market dominance test; they point out that the concept is so complex as to be almost unworkable in view of the time available to the parties in the context of rate cases which must be completed within strict statutory deadlines.").

should be mindful of that congressional intent as it proposes major changes to the qualitative market dominance test. The Act's changes to the statute itself demonstrate that Congress intended to eliminate the R/VC-based rebuttable presumptions of market dominance. The legislative history further supports that congressional intent. *See Chevron v. NRDC*, 467 U.S. 837, 842-843 (1984) ("If the intent of Congress is clear, that is the end of the matter; for the court as well as the agency, must give effect to the unambiguously expressed intent of Congress."). Any new rule must be consistent with the Staggers Act, which rejected the use of rebuttable presumptions based on quantitative measures in the determination of qualitative market dominance.

C. The Board's Proposed Use of a Rebuttable Presumption in Market Dominance Determinations is Contrary to the ICC's Contemporaneous Rejection of Such an Approach in the Rulemaking Implementing Section 10707(d).

After Congress enacted the Staggers Act and the market dominance provisions at issue,[11] the ICC completed a notice-and-comment rulemaking to establish rules for market dominance determinations. *See Market Dominance Determinations and Consideration of Product Competition*, 365 I.C.C. 118 (1981) ("*Market Dominance Determinations*"). The ICC had originally commenced the proceeding largely to consider whether to eliminate the agency's use of rebuttable presumptions to make market dominance determinations.[12] The Staggers Act

[11] The market dominance provisions were re-codified in the present Section 10707 by the ICC Termination Act, but their substance was not changed.

[12] Recognizing the shortcomings of the rebuttable presumptions, the ICC had begun a rulemaking to refine the market dominance test prior to passage of the Staggers Act. *Rail Market Dominance and Related Considerations*, 45 Fed Reg. 3353, 3354 (Jan. 17, 1980) ("We think that the creation of 'presumptions' may have been confusing"). After Congress enacted the Staggers Act and confirmed the infirmity of the presumptions approach, the rulemaking began anew. *See Market Dominance Determinations and Consideration of Product Competition*, 365

passed during the pendency of the *Market Dominance Determinations* rulemaking, and the ICC's final rules also undertook to implement relevant provisions of that Act. *See id.,* 365 I.C.C. at 119. The Conference Committee Report accompanying the Act directed that because "other parts of the [Staggers Act] provide additional rate freedom for rail carriers beyond those found in present law or under existing or proposed Commission regulations, the Commission must revise its market dominance regulations." *Id.* at 88. While the ICC had a number of options in crafting new market dominance rules, the one that was explicitly prohibited by the statute was the one the Board now proposes—use of a R/VC ratio to establish a market dominance presumption.

Based on the ICC's experience making market dominance determinations, and the increased prominence of qualitative market dominance evidence in market dominance analysis following Staggers' simplification of quantitative market dominance determinations, the agency decided to eliminate use of rebuttable presumptions in market dominance determinations. In that final rule, the ICC eliminated the one presumption-based test that it originally had proposed to retain, based on its recognition that the Staggers Act prohibited the use of R/VC-based market dominance presumptions. *See Market Dominance Determinations* at 121-122 (eliminating "cost test" presumption which was effectively based on R/VC ratios greater than 160%, which at the time was the quantitative market dominance threshold).

The ICC rejected reliance on rebuttable presumptions because they relied too heavily on quantitative evidence and inflexible metrics that were not capable of capturing the complex circumstances that determine market dominance. The ICC's summary of its reasons for rejecting

I.C.C. 118 n.4 (1981) ("Passage of the Staggers Rail Act of 1980 required modification of that proposal.").

the use of rebuttable presumptions in determining qualitative market dominance is equally relevant today:

> Time has shown that the use of rebuttable presumptions has not enhanced the accuracy of market dominance determinations. While they did serve a useful purpose while we gained experience, *the factors determining the degree of competition faced by a rail carrier are too numerous and too varied to be gauged, with any reasonable degree of accuracy, by so few measures*. Further the measures themselves are often only approximations of the underlying conditions they are intended to reflect. . . .*[T]he use of rebuttable presumptions in market dominance determinations often placed too much emphasis on quantitative evidence* which did not fully reflect the circumstances of any given movement. This quantitative evidence was *frequently offered at the expense of other evidence which, though less subject to quantification, is more reflective of the degree of market power possessed by a rail carrier* over certain traffic.

Market Dominance Determinations, 365 I.C.C. 118 at 120 (emphasis added). The ICC replaced the rebuttable presumptions of *Special Procedures*, which were not useful, misleading, and disapproved by Congress, "with broader and more flexible guidelines. Such an approach would allow for more accurate market dominance determinations on a case-by-case basis." *Id.* at 119.

The ICC also developed and clarified the distinction between the quantitative and qualitative market dominance tests, which the Staggers Act brought into focus by precluding regulatory jurisdiction where rates did not exceed a specified R/VC percentage. *Id.* The Commission defined "qualitative" market dominance evaluation as "based on a variety of qualitative and quantitative evidence separate from the price/cost jurisdictional threshold test, and *not dependent on predetermined statistical measures*." *Id.* at n. 5 (emphasis added). The Board's proposed new rule, which is heavily reliant on a "predetermined statistical measure" (RSAM), would flatly contradict the definition promulgated by the ICC in a contemporaneous rulemaking implementing the Staggers Act's market dominance requirement.

The Fifth Circuit Court of Appeals upheld the ICC's revised qualitative market dominance determinations test. *See Western Coal Traffic League v. United States*, 694 F.2d 378 (5th Cir. 1983), *aff'd Western Coal Traffic League v. United States*, 719 F.2d 772 (5th Cir. 1983).[13] The Court observed that the ICC's "primary reason for adopting the new approach is the Commission's conclusion that the *presumptions* do not necessarily reflect railroad market power and, therefore, *yield inaccurate market dominance determinations*....[the] *presumptions are* found to be *poor indicators of market dominance in the widely varying fact situations to which they must be applied*." *Id.* at 387 (emphasis added). The Court endorsed the ICC's rejection of the suggestion that it adopt a higher R/VC cost ratio as the basis for a presumption of market dominance, agreeing that "there are a number of reasons why a high price/cost ratio may not be indicative of true market power." *Id.*[14] One judge on the appellate panel further noted that the ICC had "tak[en] the hint" from Congress and "abandoned market dominance presumptions and replaced them with broad, flexible guidelines" following passage of the Staggers Act. *Id.* at 394 (J. Brown dissenting).[15] The reasons cited by the ICC and the Court of Appeals for rejecting the use of quantitative presumptions remain equally strong today.

[13] A three-judge panel initially upheld the ICC's elimination of the presumptions and other modifications but struck down its use of product and geographic competition. On *en banc* review, the Fifth Circuit upheld the entirety of the revised market dominance rules. *See Western Coal Traffic League v. United States*, 719 F.2d 772 (5th Cir. 1983).

[14] *See also* Joint Verified Statement of B. Kelly Eakin and Mark E. Meitzen (Oct. 29, 2012) at 12 (noting weakness of R/VC as indicator of market power, concluding that "even if the limit price for a particular shipment is accurately calculated, the limit price R/VC ratio is not likely to be a reliable measure. . . "); Verified Statement of Professor Robert Willig at 6 ("The Board's assertion that a limit price R/VC ratio above RSAM is somehow an 'objective indicator' of 'monopoly pricing' is contrary to economic theory and common sense.").

[15] Judge Brown dissented from the panel's holding that allowing evidence of product and geographic competition in deciding whether a carrier has market dominance violated the statutory definition of market dominance. Judge Brown's position prevailed on *en banc* review.

However, the Board's new proposed market dominance rule would represent a step even further back than the multi-factor quantitative approach the ICC abandoned three decades ago as too simplistic, by reducing the qualitative market dominance determination to reliance on a single quantitative comparison. Prior to *Market Dominance Determinations,* the ICC had considered multiple different bases for potential rebuttable presumptions, including the "market share test," the "substantial investment test," the "long-term supply contracts" test, the "rate bureau test," and the "cost test." 365 I.C.C. at 121-127. In contrast, the Board now proposes to much further constrict the analysis by applying only one quantitative comparison to establish rebuttable presumptions of qualitative market dominance. Moreover, the single pre-Staggers test the Board's new proposed test resembles most closely, the cost test, was rejected by the ICC based on a cogent rationale that is apt today :

> There are any number of reasons why a high price/cost ratio may not be indicative of true market power on the part of the railroad. Reliance on such ratios will, therefore, not only be misleading, but will preclude more relevant information from being introduced.

Market Dominance Determinations, 365 I.C.C. at 122.[16]

The Decision offers no substantive justification for eliminating meaningful agency consideration of qualitative factors using its expertise developed over nearly 35 years, and retreating to a wooden application of an R/VC-based formula and presumption rejected by the ICC and prohibited by statute. Instead, the Board's primary justification for this simplistic and formulaic approach is to avoid complex analysis and the application of its judgment and

[16] While the use of the "limit price" presumption may not preclude the introduction of better, or more relevant evidence, it does appear likely to substantially reduce the likelihood that such evidence will be given careful consideration and serious weight in the market dominance determination. *See* Decision at 14 (indicating only that "*when appropriate*" the Board will consider whether an alternative has undefined "intangible features" that might "overcome" the limit price presumption.).

expertise to qualitative evidence, in favor of a quickly and easily applied "objective" quantitative test. *See* Decision at 3. In addition to the statutory prohibition on the use of an R/VC-based presumption, the Board's proposed approach would not properly discharge its responsibility to apply its expertise to make meaningful *qualitative* market dominance determinations, instead substituting a simplistic *quantitative* comparison that is only marginally relevant at best. The Board offers no persuasive explanation of how comparison of an R/VC ratio to a carrier's RSAM figure is a probative or reliable measure of whether that carrier has market dominance over a particular movement given all of that movement's unique, specific relevant attributes and surrounding circumstances.[17]

The Board should heed the experience-based findings and conclusions of the ICC, and resist the temptation to adopt an approach that while perhaps expedient, would be both inaccurate and contrary to the statute and its animating policies. While the Board's proposed approach may be simple, it is wrong as a matter of law, policy, and logic. There is no virtue in an approach that is simple, quick, and wrong.

D. The Board's Proposed Approach Would Impermissibly Shift the Burden of Proof Concerning Jurisdiction to Defendant Carriers.

The Board's proposal would effectively switch the burden of proof of market dominance from the complainant to the carrier. It has long been established that the complainant, as the party seeking to invoke the Board's jurisdiction, bears the burden of proving the carrier has

[17] As discussed below, a carrier's RSAM figure represents the average R/VC a carrier would have to earn from its higher-rated traffic in order to earn adequate revenues. That system-wide average estimate provides no specific information about any individual movement, let alone any information indicating whether there is effective competition for rail transportation of a specific movement. Moreover, the R/VC that would be generated by a competitor's rate provides no information about how the R/VC generated by the challenged rail rate compares with the carrier's RSAM figure. *See* Sec. III *infra*. Entirely apart from its prohibited use of a presumption, the Board's proposed approach is illogical and internally inconsistent.

market dominance over the transportation to which the challenged rate applies. *See, e.g., Market Dominance Determinations*, 365 I.C.C. at 132 (rate case complainants have "the burden of proving a lack of effective competition"); *Arizona Public Service v. United States,* 742 F.2d 644, 649, n.2 (D.C. Cir. 1984).[18] As demonstrated below, however, the Board's proposed rule and its creation of a rebuttable presumption would violate that longstanding allocation of burdens by placing the effective burden of proving lack of market dominance on the defendant carrier.

Under the Board's proposal, the Board itself determines and sets the "limit price." *See* Decision at 13. The Board then applies a multi-step quantitative formula involving that limit price and the carrier's RSAM figure to establish a "preliminary conclusion" —*i.e.* presumption—regarding market dominance. *See id* at 14. At no point in this proposed approach does the complainant have any meaningful burden of proof. It can simply assert that there are no feasible alternatives, and if the carrier does not come forward with contrary evidence, the Board will conclude the carrier has market dominance because there is no evidence of a feasible alternative.

If the Board's application of the proposed limit-price formula generates a presumption that the carrier has market dominance over the transportation in question, then "when appropriate," the Board will consider other factors to determine whether they are "sufficient to overcome" the presumption. *See id.*[19] Thus, if the Board's proposed quantitative formula

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[18] As a threshold matter, the defendant carrier has the burden of establishing lack of quantitative market dominance. *See* 49 U.S.C. § 10707(d)(1)(A). If the carrier does not show that a challenged rate generates an R/VC ratio of less than 180 %, then the burden is on the complainant to prove market dominance, in a phase often referred to as the "qualitative market dominance" test.

[19] The Board describes these factors as "intangible features," but presumably it would also consider tangible features and factors proffered to overcome the market dominance presumption. *See* Decision at 14.

created a presumption that the rail carrier has market dominance, the burden would fall to the rail carrier to produce evidence sufficient to rebut ("overcome") that presumption. When a presumption of market dominance is erected, the complainant would have no burden of proof. If the carrier does not present evidence and argument sufficient to rebut the presumption, the Board will find the carrier has market dominance.[20] Throughout this entire process, the complainant would have no burden of production or persuasion regarding the lack of effective competition for the transportation to which the challenged rate applies. *See* 49 U.S.C. § 10707(a) (market dominance defined as "absence of competition . . . for the transportation to which a rate applies."). Instead, the complainant may merely assert throughout that there is no effective competition, and force the carrier to attempt to prove there is effective competition. This would turn the statute and the longstanding allocation of burden of proof upside down—instead of requiring the complainant to prove the Board has jurisdiction, the Board's proposed approach would require the defendant carrier to prove the Board does not have jurisdiction. This is not only contrary to the longstanding and unquestioned placement of the burden of proof of jurisdiction on the complainant in STB rate cases, it contravenes the nearly uniform rule of American jurisprudence that the party invoking the jurisdiction of the tribunal must establish that jurisdiction. The proposed rule neither acknowledges this unprecedented transfer of the burden of proof nor offers any explanation or justification for such a change.

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[20] In circumstances in which the limit price test creates the presumption that the carrier lacks market dominance, then the burden would be on the complainant to attempt to rebut that presumption. However, the possibility that in some instances the proposed test would properly allocate the burden of proof to the complainant does not negate the fact that in many instances the Board's proposed new rule would shift the burden to the defendant carrier.

II. THE PROPOSAL IS ECONOMICALLY IRRATIONAL AND RELIES ON AN IRRELEVANT COMPARISON.

Even if the proposed new rule for evaluating qualitative market dominance were consistent with Section 10707(d) and had been proposed in a notice-and-comment rulemaking as required by the APA, it would remain a deeply flawed, irrational, and unreliable approach that would not provide any meaningful measure of a carrier's market dominance or market power in any specific transportation market. Expert economists who reviewed the Board's proposal at CSXT's request concluded that "the proposed methodology is neither objective nor a reliable measure of a defendant carrier's market dominance with respect to specific transportation markets, and is likely to add to the burden of determining market dominance without meaningfully informing the process." Joint Verified Statement of Christensen Associates' B. Kelly Eakin and Mark E. Meitzen) at 2 (November 27, 2012) ("V.S. Eakin/Meitzen"); *see generally* Verified Statement of Professor Robert Willig (Nov. 28, 2012) ("V.S. Willig").[21] For several reasons discussed below, the primary test the Board has proposed would provide virtually no probative information concerning the question of qualitative market dominance, and would substitute an irrelevant and unreliable formula for the fact-and-circumstance-specific analysis and expert judgments the agency has applied over the last thirty years.

A. A Carrier's Overall RSAM R/VC Ratio Provides No Information or Measure of Competition or Market Dominance in Any Specific Individual Market

As CSXT expert economists Professor Robert Willig, and Doctors Kelly Eakin and Mark Meitzen all emphasize, a carrier's "RSAM number" provides no information about transportation competition in any specific market and is simply irrelevant to a qualitative market dominance

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[21] The verified statements of Drs. Eakin and Meitzen and Professor Willig (copies attached as exhibits hereto) are incorporated in their entirety to these Comments, as if set forth in whole herein.

determination for any specific market or movement. *See, e.g.,* V.S. Eakin/Meitzen at 4-11; V.S. Willig at 6-7. As the Board describes it in the Decision, "a carrier's RSAM figure is a measure of the average markup that the carrier would need to collect from all of its potentially captive traffic (i.e. all traffic priced at or above the 180% R/VC level) in order to earn adequate revenues . . . . (*i.e.,* earn a return on investment equal to the cost of capital)." Decision at 15. The Decision further stated that a carrier's RSAM number "simply represents the system-wide average markup required to achieve revenue adequacy." *Id.*[22]

Because RSAM is a carrier's *system-wide average* number, it provides no information about any specific actual market, or competition in any such market. *See* V.S. Willig at 6 ("RSAM provides no basis for evaluating whether specific rates on individual moves are—or are not – subject to effective competition."). As Drs. Eakin and Meitzen explain, "RSAM does not contain...<u>any</u> market-specific information. . . . The RSAM ratio...does not incorporate any information about the competitive dynamics of any particular market" V.S. Eakin/Meitzen at 4-5. Because the RSAM provides no market-specific information about any particular transportation market or movement, "the use of RSAM to determine market dominance is arbitrary and unrelated to actual market situations." *Id.* at 3.

[22] As the Board has repeatedly admonished, revenue adequacy is a long term concept. *See e.g. C.F. Industries Inc. v. Koch Pipeline Co.*, 2 S.T.B. 257, 266 (1997) *citing Coal Rate Guidelines*, 1 I.C.C. 2d 520, 536 (1985). Thus, the Board's quotation is not entirely accurate as the relation of a carrier's average R/VC ratio on higher rated traffic to its cost of capital in a single year does not determine whether a carrier "achieve[s] revenue adequacy." A more accurate definition of the annual RSAM figure calculated by the Board would tie the number to the R/VC ratio that would be generated by the average rate the carrier would need to charge its customers with R/VC ratios greater than 180%, in order to earn a return on investment equal to its cost of capital in a particular year. *See Simplified Standards,* STB Ex Parte No. 646 (Sub-No. 1) slip op at 19-20, 80-82 (served Sept. 5, 2007) (describing RSAM benchmark as, *inter alia,* evaluating "how much the carrier needs to charge [] potentially traffic to earn a reasonable return on its investments" in a particular year).

Moreover, RSAM was neither designed nor intended to serve as a measure of whether a carrier has market dominance. Rather, its primary purpose is to gauge carrier progress toward an entirely separate and distinct statutory goal having nothing to do with the threshold determination of whether the Board has jurisdiction to hear a rate challenge. That statutory goal and directive is for the Board to maintain regulatory policies and procedures that allow efficiently managed carriers to earn revenues adequate to cover their costs plus a reasonable economic profit or return on capital. *See* 49 U.S.C. § 10704(a)(2); *id.* § 10101(3). The RSAM is a measure of the average R/VC ratio a carrier would have to charge in a given period to earn such adequate revenues. Whether the rate for a particular movement generates an R/VC above or a carrier's current RSAM ratio may indicate whether, on a per-unit basis, that movement is contributing more or less than the average amount needed to earn adequate revenues. But whether an R/VC ratio (whether based upon actual revenue or a hypothetical alternative revenue level) generated by rate for a particular movement is more or less than the carrier's overall RSAM number provides no relevant information about whether a rail carrier has qualitative market dominance in a specific transportation market.

Because rail carriers must engage in differential pricing and because of varying market conditions and circumstances, a carrier's R/VC ratios are broadly distributed, with some above the RSAM mean number and some below it. *See BNSF v.STB*, 453 F.3d 473, 481 (D.C. Cir. 2006) (noting that because RSAM is an average, the mere fact that an R/VC ratio generated by a particular rate for a movement is above or below the RSAM mean number has no relevance to the state of competition for transportation of that movement); *see also* Eakin/Meitzen at 4-5 (to same effect); V.S. Willig at 4.[23]

The use of RSAM as a one-size-fits-all formulaic standard for establishing a presumption regarding qualitative market dominance would result in many false negatives and false positives, *i.e.* presumptions that a rail carrier does not have market dominance when it does, and that a carrier has market dominance when it does not. The Eakin/Meitzen statement provides illustrations of each situation, demonstrating that the Board's proposed arithmetic test generates erroneous and contradictory market dominance conclusions because it does not consider specific market conditions and information. *See* V.S. Eakin/Meitzen at 7-9 (further noting that "[b]ecause it is completely disconnected from one of the most important indicia of competition—the relationship between the price charged by the railroad and the price charged by a transportation alternative – the proposed limit test does not reliably distinguish market dynamics bearing on the question of market dominance."); *see also id.* at V.S. Willig at 7 (limit price above R/VC "is not an indication that there is a lack of effective competitive alternatives for the issue traffic, but rather just an indication of the fact that different traffic is subject to different economic realities.").

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[23] While the Decision asserts that the relationship between a carrier's RSAM number and a movement's R/VC somehow "indicates" the presence or absence of effective competition, it offers no explanation or support for this assertion. *See* Decision at 15. The sole authority the Board cites in support of this contention is an elliptical quotation of a sentence in an appendix to the *Simplified Standards* decision. *See id.* at 15, n.42. However, the cited sentence was discussing use of the RSAM to adjust comparison rates in substantive rate reasonableness analysis, and made no mention of market dominance analysis, let alone the use of RSAM in making market dominance determinations. *See Simplified Standards* at 81.

B. The "Limit price" Concept is Ill-Defined, Imprecise, and Indeterminate.

The "limit price," as proposed by the Board, is vague and imprecise. Rather than making the market dominance evaluation "more objective," the limit price notion would inject more subjectivity to the analysis. The Board defines the "limit price" as "the highest price a carrier could theoretically charge a shipper without causing a significant amount of the issue traffic on a particular rail movement to be diverted to a competitive alternative . . ." Decision at 13. As defined, the limit price concept is vague, ambiguous, and imprecise, and its application depends upon undisclosed factors and on subjective judgments of the decisionmaker.

First, the Board does not define or explain what it means by a "*significant amount*" of traffic being diverted. *See* V.S. Eakin/Meitzen at 4. It offers no parameters or metrics that would be used to measure or determine what constitutes a "significant amount" of traffic. Without more explanation and standards, the term "significant amount" is imprecise and open to many divergent interpretations and applications. For example, does the Board intend to use a specific uniform percentage of the shipper's traffic as the determinant of whether the diversion is "significant?" If so, what percentage? How and based on what criteria would that percentage be determined or set? Will the percentage be constant in all cases, or will it vary for different cases? If it varies, what factors or analysis will be used to determine what is "significant" in each instance? Further, regardless of whether the Board uses a percentage or some other metric to determine whether potential diversion constitutes a "significant amount," is the "amount" in question the volume of traffic, the amount of revenue diverted, or some other measure of the "amount" of traffic diverted? Without answers to these and other questions concerning the meaning and application of the "significant amount" standard, it is an empty vessel that the decisionmaker can fill with any subjective judgment and measure it wishes. Such an ambiguous, imprecise, and standardless measure is a recipe for more subjectivity, not less, and could result in different determinations in similar situations.

Second, the limit price description creates a further substantial ambiguity because it does not indicate whether it would be based on traffic that may currently be moved by a competitive alternative or if it refers only to additional traffic that might be diverted. *See* V.S. Eakin/Meitzen at 4. Thus, for example, if 40 percent of a shipper's traffic for a given origin-destination pair already moves by truck and the other 60 percent is moved by the defendant rail carrier, would the "limit price" be the rate the shipper pays to truck that commodity or the price that would be necessary for the shipper to divert some additional "significant amount" of the 60 percent? Because the definition refers to traffic "diverted" to a competitive alternative, it may be that the Board intended the latter, to set the limit price at the level necessary to divert additional traffic beyond that already being moved by a competitive alternative. Further, this would appear to be the Board's intention because in this case it applied the proposed limit price approach to traffic that already move significant amounts of traffic using alternative transportation.

If the Board does propose to establish the limit price based only on the price that would be necessary to divert *additional* traffic, the "limit price" concept would be even more disconnected from a rational market dominance analysis. It is well established that a transportation alternative need not move a majority of the issue traffic in order to constitute an effective competitive alternative. *See, e.g., Amstar Corp. v. Atchison, Topeka & Santa Fe Ry. Co.*, ICC Docket No. 37478 (Nov. 23, 1987) (finding that trucks provided effective intermodal competition where 98.5% of issue movements had been by rail). If nearly half of the shipper's traffic is already moving on a competitive alternative at a particular rate, it would not be rational to set a hypothetical competitive "limit price" at a different price level necessary to entice a shipper to divert even more traffic to alternative transportation.

Third, the Board does not state how it would determine whether a given price for alternative transportation would cause a shipper to divert traffic from rail transportation. What evidence, analysis, or standard would the Board use to determine that a particular rate or price would cause the complainant to divert traffic to an alternative? Based upon the Board's application of its new approach in this case, it appears the Board does not propose to make any real determination of what price would cause diversion of traffic. Instead, the Board would simply select the lowest alternative transportation price in evidence—without regard to whether any of the issue traffic actually would be diverted from rail at that price—and automatically designate that alternative price as the "limit price." *See generally* Decision Appendix at 37-63.

Thus, the Board's stated intention to use the alternative rate that would result in diversion of traffic appears to be inaccurate. Rather, the Board would simply select the lowest alternative price in evidence and automatically deem it the price at which traffic would be diverted, without any actual assessment or analysis of whether the shipper would actually divert traffic to the alternative at that price. Such a mechanical, unanalyzed, and unsupported approach means the "limit price" would not reliably serve even the modest, limited purpose the Board asserts—to establish the highest price a carrier could charge before a significant amount of traffic would be diverted to a transportation alternative.

Fourth, the formulaic approach the Board proposes to use to establish a presumption of market dominance or lack thereof only considers the price of the alternative, and not any of the non-price factors that can determine whether alternative transportation provides an effective competitive constraint. For example, a shipper may prefer truck transportation over rail transportation because truck transportation is relatively faster than rail transportation, and because a truck can provide door-to-door service to locations not directly served by rail. In such circumstances, that shipper may choose to use trucks as its predominant or exclusive mode of transportation of its product, even when the truck price is significantly higher than the rate a rail carrier offers for similar transportation. Under the Board's proposed rule, this could lead to a presumption of rail carrier market dominance even if a substantial majority of the traffic moves by truck.

For example, say that a challenged rail rate is \$325 per car, the rail carrier's URCS system average cost for that movement is \$130, and the rail carrier's current RSAM figure is 280%. Further assume that the truck rate for (faster) movement of equivalent volume over the same lane is \$375. Finally, assume the shipper moves 85 percent of its traffic by truck and 15 percent by rail. In that situation, the Board would choose the truck rate as the "limit price" and calculate the limit price R/VC ratio as 289% (= \$375/\$130). Because the rail carrier's RSAM figure is 280%, the proposed rule would establish a presumption that the carrier is market dominant over the transportation in question, despite the fact that trucks move the overwhelming majority of the traffic subject to the challenged rate.[24]

[24] In this hypothetical example, the complainant might be given a chance to attempt to show that "intangible features" are sufficient to overcome the presumption established by the limit price formula. *See* Decision at 14 (noting that only "when appropriate," the Board will consider whether undefined "intangible features" of the alternative are sufficient to overcome the presumption). However, the Board's application of the proposed new rule to the evidence in this case suggests that it will be difficult and rare for a party to overcome the presumption established by application of the simplistic and formulaic limit price test. *See* Appendix. {{

}} Appendix at 58-59.

As Professor Willig summarizes in plain terms, "[t]he 'limit price' method as currently proposed by the Board is not an appropriate method for determinations of market dominance." V.S. Willig at 13.

III. ADOPTION OF THE BOARD'S PROPOSED RULE IN AN INDIVIDUAL ADJUDICATION WOULD VIOLATE THE ADMINISTRATIVE PROCEDURE ACT.

Because the ICC adopted its existing market dominance rule through notice-and-comment rulemaking, the Board may amend or replace that test only through a notice-and-comment rulemaking. The Administrative Procedure Act ("APA") requires that an amendment, change or repeal of a substantive rule adopted through notice-and-comment rulemaking may be effected only through notice-and-comment rulemaking. *See* 5 U.S.C. §§ 551(5), 553(b)(3)(A). Accordingly, the proposed amendment of the current market dominance rule in an individual adjudication, rather than in a required rulemaking, would violate the APA. The Board cannot avoid notice-and-comment rulemaking by summarily adopting a far reaching, substantive rules change through an individual adjudication, or by erroneously labeling the new proposed rule as a "refinement" to existing rules.[25]

As previously demonstrated, the Board's approach is inconsistent with the history of the Staggers Act and *Market Dominance Determinations* rulemaking. *See* I, *supra.* Both the

[25] The Board's characterization of its proposed new market dominance rule as a mere "refinement" of the existing rule does not pass the straight face test. The new test the Board proposes is radically different from the approach adopted by the ICC in a rulemaking and applied in rail rate cases in the intervening 30 years. As demonstrated in these Comments, the difference between the Board's existing rule and methodology and that proposed in the Decision is not a difference in degree, it is a difference in kind. The proposed rule would effectively repeal the Board's existing fact-and-circumstance specific totality analysis and replace it with an arbitrary mechanical formula that would create a presumption of market dominance without even considering the most relevant market information. The proposed approach would make a wholesale change in the Board's market dominance analysis, and labeling it a refinement does not obscure the wholesale substantive change embodied in the Board's proposed new rule.

rulemaking and the court decision affirming the rules cautioned against the siren song of rebuttable presumptions and excessive reliance on price/cost ratios. Yet that is exactly what the Board has now proposed. Even if the Board were legally allowed to create a quantitative-comparison-based rebuttable presumption regime for qualitative market dominance—and it is not—agency experience has shown such an approach would be ill-advised.

A. Market Dominance Rules Adopted Through Notice-and-Comment Rulemaking and May be Altered Only Through Such Rulemaking.

The ICC promulgated the current market dominance rules in *Market Dominance Determinations*, a thorough notice-and-comment rulemaking conducted over eighteen months.[26] For at least two related reasons, an agency like the Board may not amend through an individual adjudication a substantive rule adopted by notice-and-comment, like the market dominance rule. *First*, a legislative rule may be amended, modified or repealed only in a notice-and-comment rulemaking. *See* 5 U.S.C. §§ 551(5), 553(b)(3)(A). *Second*, the Board, like any federal administrative agency, may make a substantial change or amendment to a legislative rule initially adopted through rulemaking proceeding *only* in another rulemaking proceeding, and not in an individual adjudication.

[26] The ICC commenced the rulemaking with a notice of proposed rulemaking in January of 1980. *See Rail Market Dominance and Related Considerations*, 45 Fed. Reg. 3358 (Jan. 17, 1980). The ICC issued a modified notice after passage of the Staggers Act. *Rail Market Dominance and Related Considerations*, 45 Fed. Reg. 83302 (Dec. 18, 1980). Following consideration of comments from numerous parties, the Commission issued its final rules on June 24, 1981. *Market Dominance Determinations*, 365 ICC 118 (1981).

1. Legislative Rules May Be Amended, Modified or Repealed Only in a Notice-and-Comment Rulemaking.

Applying the APA, the D.C. Circuit has consistently held that an amendment to a legislative rule[27] requires a notice-and-comment rulemaking proceeding. *See, e.g., American Mining Congress v. Mine Safety & Health Administration et al,* 995 F.2d 1106, 1112 (D.C. Cir. 1993). A rule that "effectively amends a prior legislative rule" is itself a legislative rule requiring notice-and-comment rulemaking under the APA. *See United States Telecom Ass'n v. FCC,* 400 F.3d 29, 34-35 (new rules that make substantive changes to existing rules or regulations are legislative rules, subject to APA notice and comment requirements); *Sprint Corp v. FCC,* 315 F.3d 369, 374 (D.C. Cir. 2003).

The market dominance determination rule is a legislative rule (as opposed to an interpretive or procedural rule), because it has the force and effect of law and does not fit into the APA's narrow exception to the notice and comment requirement for interpretive rules and "rules of agency organization, procedure, or practice." *See James V. Hurson Assocs. v. Glickman,* 229 F.3d 277, 280 (D.C. Cir. 2000) (quoting 5 U.S.C. § 553(b)(3)(A)). Exceptions to the notice-and-comment rulemaking requirement are narrowly construed. *New Jersey v. Environmental Protection Agency*, 626 F.2d 1038, 1045 (D.C. Cir. 1980). The proposed change to market dominance is an amendment requiring notice-and-comment rulemaking because it seeks to make a substantive change to qualitative market dominance rules, which implement a crucial threshold

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[27] Some federal courts, including the Federal Circuit, use the term "substantive rule" instead of legislative rule. The terms are interchangeable. *See National Organization of Veterans Advocates, Inc. v. Secretary of Veterans* Affairs, 260 F.3d 1365, 1375 (Fed. Cir. 2001) ("Substantive rules [are] those that effect a change in existing law or policy or which affect individual rights or obligations. 'Interpretative rules,' on the other hand, clarify or explain existing law or regulation and are exempt from notice and comment under Section 553(b)(3)(A). An interpretative statement . . . . does not intend to create new rights or duties, but only reminds affected parties of existing duties.").

prerequisite to Board jurisdiction over a challenged rate. *See Sprint,* 315 F.3d at 374 ("new rules that work substantive changes in prior regulations are subject to the APA procedures ... [W]hen an agency changes the rules of the game...more than a clarification has occurred."); 5 U.S.C. §§ 551(5), 553(b)(3). The proposed new rule would modify the Board's preexisting market dominance rules in a manner inconsistent with the current rule, creating a new RSAM-based rebuttable presumption rule. *See American Mining Congress*, 995 F.2d at 1109 ("[i]f a second rule repudiates or is irreconcilable with a prior legislative rule, the second rule must be an amendment of the first," subject to notice and comment requirements) (*citing National Family Planning & Reproductive Health Ass'n v. Sullivan*, 979 F.2d 227, 235 (D.C. Cir. 1992)); *State of Alaska v. DOT*, 868 F.2d 441, 446-447 (D.C. Cir. 1989); *See also National Organization of Veterans Advocates, Inc. v. Secretary of Veterans* Affairs, 260 F.3d 1365, 1375 (Fed. Cir. 2001) (legislative or substantive rules "make new law or modify existing law").

There can be no serious question that the Board's proposed new qualitative market dominance rule would be a legislative/substantive rule. Plainly, qualitative market dominance determinations and governing rules and standards are *not* "rules of agency organization, procedure, or practice," like whether the STB Office of Proceedings includes the STB Office of Economics or how many copies of an abandonment application must be filed by the applicant. Rather, the market dominance rules directly affect substantive rights of parties by determining whether the Board has any power to consider and decide whether a rail transportation rate is reasonable, as well as whether it may prescribe a maximum rate or award reparations. This essential threshold determination of whether the Board may entertain a rate challenge at all is every bit as substantive—and every bit as central to the determination of the rights and obligations of carriers and shippers—as the SAC test or any other part of the Board's rate reasonableness regime.

The proposed change to the market dominance rule represents, at the very least, a significant modification of and amendment to that legislative rule. The Board's proposed change would radically transform its approach to assessing qualitative market dominance from: (i) a comprehensive consideration of numerous *qualitative* and market-specific factors and variables using the Board's knowledge, experience, and expert judgment; to (ii) calculation of an arithmetic formula and quantitative comparison of the result to a gross macro statistic (RSAM) that contains no market-specific information. This very substantial change from the present qualitative totality of the circumstances analysis, to application of an irrelevant statistic to an immaterial quantitative formula is a first order, major amendment to the Board's market dominance rule. As the courts have made clear, an agency may adopt a "modification" of a legislative rule that changes the rules of the game—like the rule amendment proposed here—only through notice-and-comment rulemaking. *See, e.g.*, *Sprint*, 315 F.3d at 374.[28] Indeed, the proposed rule would mark such a substantial and complete departure from the Board's existing rule and policies rejecting formula-based presumptions that it might be more accurately viewed as a *repeal* of the existing rule and substitution of an entirely new rule that is irreconcilable with the existing rule. *See, e.g., American Mining Congress*, 995 F.2d at 1109.[29] Consistent with the

[28] For the reasons set forth above, this rule change is not merely "interpretive" or a "clarification" of an existing rule. Rather, as proposed, it is a full-on substantive repeal and replacement of the existing rule and supporting policies and agency findings and conclusions developed in a prior rulemaking. Thus, this proposed amendments is not subject to the narrow exception to APA rulemaking requirements for interpretive rules. *See New Jersey v. Environmental Protection Agency*, 626 F.2d 1038, 1045 (D.C. Cir. 1980).

[29] The Fifth Circuit also explicitly found that the qualitative market dominance test is a rule, as opposed to guidelines, for purposes of the APA. *Western Coal Traffic League v. United States*,

APA, the Board may undertake the proposed amendment of the existing market dominance rule only in the context of a notice-and-comment rulemaking.

2. Administrative Agencies May Make a Substantial Change or Amendment to a Substantive Rule Adopted Through Rulemaking Only in Another Rulemaking.

Applying the APA, the D.C. Circuit has established that a federal agency may not adopt a new position that is inconsistent with an existing rule adopted in a rulemaking without conducting a notice-and-comment rulemaking. As the Court admonished, "an administrative agency may not slip by the notice and comment rule-making requirements needed to amend a rule by merely adopting a *de facto* amendment to its regulation through adjudication." *Marseilles Land and Water Co. v. FERC,* 345 F.3d 916, 920 (D.C. Cir. 2003); *See Shalala v. Guernsey Mem'l Hosp.,* 514 U.S. 87, 100 (1995) (an agency interpretation that "adopt[s] a new position inconsistent with . . . existing regulations" must follow APA notice and comment procedures). As demonstrated above, the proposed qualitative market dominance test would substantially amend and modify the current rules in a manner inconsistent with the existing rule by resurrecting a long abandoned and discredited approach, namely rebuttable presumptions based on quantitative formulas.

Such substantive amendment of a rule adopted in a rulemaking may itself be undertaken only in another full notice-and-comment rulemaking. The Board's prior use of rulemakings to propose, consider and adopt earlier substantive modifications of the *Market Dominance Determinations* rules with respect to product and geographic competition shows that the Board has previously recognized that both the law and sound policymaking require that significant

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694 F.2d 378, 392 (5^{th} Cir. 1983) ("The guidelines here involved are indeed rules...and the Commission's choice of nomenclature is without legal significance.").

changes to these broadly applicable rules should be undertaken—if at all—in a rulemaking proceeding. In *Market Dominance Determinations*, the ICC correctly concluded that geographic and product competition were significant factors relevant to the determination of market dominance, which therefore should be considered in market dominance determinations. *See Market Dominance Determinations* at 131. When the Board and its predecessor decided to reconsider this aspect of the rules, they properly acted through notice-and-comment rulemaking. First, in 1985, the ICC established new evidentiary guidelines for product and geographic competition in market dominance determinations, shifting the burden of proof to carriers. *Product and Geographic Competition*, 2 I.C.C. 2d 1 (1985). The change was accomplished through notice-and-comment rulemaking. *Id.* Subsequently, the Board eliminated consideration of product and geographic competition from its market dominance analysis through a notice-and-comment rulemaking, a necessary step to reverse existing rules established through notice-and-comment rulemaking. *See Market Dominance Determinations – Product and Geographic Competition*, 3 S.T.B. 937 (1998).

The overhaul of qualitative market dominance rules the Board has proposed here is even more far-reaching than those prior amendments and similarly requires formal notice-and-comment rulemaking. Thus, even if the Board's proposed rule change were sound, consistent with the statute, and adequately explained and supported—and as these comments demonstrate, it is not—it would violate the APA and thus be invalid if it were adopted in this individual adjudication.

B. The Board has Provided Inadequate Justification for Changing Course.

One of the benefits of notice-and-comment rulemaking is that it provides an opportunity for all interested parties to offer comments, ask questions and seek clarification. Notice-and-comment is an open process that improves the final outcome of agency decision-making. *See Riverbend Farms, Inc. v. Madigan*, 958 F.2d 1479, 1483-1484 (9th Cir. 1991) (The APA "ensures that the massive federal bureaucracy remains tethered to those it governs."); *N. Mariana Islands v. United* States, 686 F. Supp. 2d 7, 33 (D.D.C. 2009) ("The public interest is served when administrative agencies comply with their obligations under the APA."). In attempting to effect a major rule change in an individual adjudication, without notice-and-comment, the Board has proposed a flawed test and failed to adequately justify its change of course.

Failure to conduct notice-and-comment rulemaking to consider the proposed rule change could exclude many potentially interested or affected persons from a major, far-reaching change in the Board's qualitative market dominance test. Several interested entities raised this concern after the Board issued its proposed new rule in this adjudication.[30] The Board responded by providing interested persons a limited opportunity to submit comments as *amicus curiae*. The Board's decision acknowledges the broad importance and effects of its proposal, but still falls far short of a full notice-and-comment rulemaking where all non-parties can fully participate, not merely offer comments as *amicus curiae* that the Board may freely ignore. For example, the Board warned that *amici* "will not have access to confidential information; nor will they be allowed to broaden the issues in the proceeding." *M&G Polymers, USA v. CSX Transportation, Inc.*, STB Docket No. 42123, Decision at 3, n.10 (October 25, 2012). Thus, for example, any

[30] *See* Letter from Union Pacific to Surface Transportation Board (Oct. 9, 2012); Letter from Norfolk Southern to Surface Transportation Board (Oct. 9, 2012); Letter from Burlington Northern Santa Fe to Surface Transportation Board (Oct. 16, 2012); *see also* STB Ex Parte 715, Comments of Alliance for Rail Competition at 12-17 (Oct. 23, 2012) (providing comments in opposition to the Board's proposed market dominance rule change in a separate rulemaking proceeding because the "Board appears not to have invited comments in the *M&G Polymers* decision from anyone other than the parties to that proceeding.").

non-party submitting comments as *amicus curiae* would be unable to evaluate the Highly Confidential appendix showing how the Board would actually apply its new proposed rule.[31] *Cf. Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35 (D.C. Cir.) ("the opportunity to comment is meaningless unless the agency responds to significant points raised by the public").

To be sure, an agency may change its mind and alter its rules, and such alteration is not necessarily subject to heightened scrutiny or held to a standard above and beyond what is required in all APA notice-and-comment rulemakings. *See FCC v. Fox Television Stations, Inc.*, 129 S. Ct. 1800, 1810 (2009). But that does not mean the Board may reverse its rules with inadequate justification or without following proper administrative procedure. As the Supreme Court further explained, an agency must "display awareness that it *is* changing position...[and]...the agency must show that there are good reasons for the new policy." *Id.* at 1811 (emphasis in original). Here, the Board has failed to demonstrate that there are good reasons for the new policy or even that the new rule has a reasoned, rational basis. It has not adequately explained how or why a rule using R/VC-based rebuttable presumptions of qualitative market dominance—which it long ago abandoned as inconsistent with the statute and failing to "enhance[] the accuracy of market dominance determinations," (*Market Dominance Determinations* at 120)—has somehow been transformed into a sound, lawful, and appropriate approach in the context of this single adjudication.

The Supreme Court further admonished in *Fox* that any new rule reversing an old rule must be "permissible under the statute." *Fox Television Stations, Inc.*, 129 S. Ct. at 1811. Here,

[31] M&G's recent filing of a public version of the market dominance analysis Appendix to the Board's Decision—just two weeks (including a shortened holiday week) before the comment filing deadline—mitigates this particular limitation somewhat, but by no means provides the full and open opportunity to comment that is usually afforded participants in rulemaking proceedings.

the Board has not adequately explained how the Proposed R/VC-based qualitative market dominance presumption approach would be consistent with 49 U.S.C. § 10707(d)(2). *See* Decision at 16-17 (conclusory assertion that statutory prohibition on use of R/VC-based presumption of market dominance is not "implicate[d]."). Finally, as demonstrated, even if the Board were to demonstrate that a new rule is justified and consistent with the statute, which it has not yet done, it could undertake such a rule change through notice-and-comment rulemaking, *not* in this individual adjudication.

IV. THE BOARD'S PROPOSED LIMIT PRICE RULE WOULD LEAD TO ABSURD RESULTS.

The Board's proposed "limit price" test is disconnected from meaningful market power analysis and would lead to absurd results. The Board's proffered conclusion that the proposed test provides a "sufficiently reliable" method of concluding that a competitive alternative does or does not act as an effective constraint (Decision at 4), is erroneous as a matter of theory and as a matter of real world practice. The proposed new test would not consistently produce accurate or reliable results. On the contrary, the proposed approach would produce results that are simply not supported in the real world. <u>First</u>, the formulaic test is belied by real world practices in which competitive truck transportation alternatives move traffic at rates generating R/VC ratios well above a rail carrier's RSAM. <u>Second</u>, the proposed new rule would result in reversal of actual market dominance findings in prior cases where the Board concluded that effective competitive alternatives existed in the market place. <u>Finally</u>, this formulaic test would generate erroneous findings of market dominance in highly competitive markets—including markets where robust intramodal competition exists.

The following examples illustrate that the limit price test proposed by the Board in fact does not produce a reliable conclusion of market dominance. To the contrary, the limit price test produces illogical and inconsistent results and would contradict the Board's robust, well-reasoned, prior market dominance determinations.

A. Actual Current Truck Movements Show That The Board's Limit Price Concept Would Not Reflect Real World Competition.

Even more egregious, evidence in this very case demonstrates that the Board's limit price test does not accurately reflect real world competitive conditions. As CSXT demonstrated in its Market Dominance evidence, M&G relies heavily on trucks for the transportation of PET. *See* CSXT Reply Market Dominance Evidence at II-14. CSXT challenged market dominance on 43 issue movements based upon direct truck or truck-rail competitive alternative movements. On some of those routes, M&G presently trucks upwards of {{ }}[32] of its PET shipments. *See id.* M&G's own exhibits in its market dominance evidence demonstrate that M&G has shipped {{ }} of truckloads of PET across the country since 2006. From 2006 to 2010, M&G relied upon trucks for at least {{ }} shipments of PET, {{ }} over lanes at issue in this case. *Id.* In 2010 alone, M&G shipped almost {{ }} truckloads of PET—{{ }} of its overall total volume of PET shipments. *Id.* Clearly, not only is truck transportation feasible, it is integral to M&G's transportation of PET.

In many of the lanes in which the Board would find that CSXT's rate fails the limit price test, the evidence demonstrates that, contrary the Board's conclusion that no alternative traffic would be competitive, M&G <u>currently ships PET by truck over those very lanes</u>. Despite this,

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[32] Highly Confidential information is marked with double braces, *e.g.*, ("{{}}"). Confidential information is marked with single braces, .*e.g.* ("{}").

under the proposed limit price construct, these lanes presumptively would not be competitive. This is yet another example of the irrational results of application of the Board's limit price test.

For example, in Lane J-19, M&G shipped {{ }} trucks and { } railcars in 2010. In that lane fully {{ }} percent of the volume of that traffic moved by truck. *See* M&G Opening Ex. II-B-96. And yet, the Board's formulaic quantitative test would erroneously presume that there is "an absence of effective competition . . . for the transportation to which [the challenged rate] applies." *See* 49 U.S.C. § 10707(a), (c). Based upon the contract rates provided by M&G, the competitive rates under which traffic actually moves by truck would generate a "limit price R/VC" that would exceed CSXT's RSAM. Thus, competitive truck rates that actually move substantial volumes of traffic would themselves be deemed to create a presumption of market dominance. This further illustrates the illogic and unreliability of the proposed new rule. *See, e.g.,* CSXT Reply WP "Truck rates actual and expired.xlsx."

Similarly, in lane J-32, Apple Grove, WV, to University Park, IL, M&G shipped {{ }} trucks and { } railcars of PET in 2010. *See* M&G Opening Ex. II-B-110. The fact that {{ }} percent of the PET shipped in this lane moved by truck is not reflected in the Board's mechanical assumption that, because the limit price R/VC ratio exceeds CSXT's RSAM figure, those shipments by a competing transportation provider would be rendered irrelevant to the proposed rule's presumptive market dominance determination. Particularly notable, in lane J-18, Apple Grove, WV, to Havre de Grace, MD, M&G shipped {{ }} PET by truck than by rail in 2010. *See* M&G Opening at Ex II-B-95. Heedless of this fact, the proposed limit price test would establish a presumption that the truck option does not exert competitive pressure on CSXT, and that CSXT possesses market dominance over transportation in that lane. *See* Decision at 46.

Finally, in lane S-5, Apple Grove, WV, to Devon, KY, M&G shipped PET by truck {{ }} times in 2010, relying on rail transportation { } times that same year. In total, {{ }} percent of the 2010 volume shipped by direct truck transportation between Apple Grove and Devon. *See* M&G Opening Ex. II-B-63. The Board's proposed limit price test would blithely ignore the fact that {{ }} of the issue shipments moved by truck in 2010.

Despite the Board's acknowledgment that "direct trucking generally is thought to provide certain customer-related benefits,"[33] the Board's application of its proposed test would disregard the fact that, {{ }} of the traffic over that lane moved by truck. *See* Decision at 60. Ignoring undisputed evidence of vibrant truck competition, the Board's application of its proposed new rule led it to conclude that CSXT has market dominance over the movement. *See id.*

In sum, the evidence in this case shows that Board's proposed approach would deem truck prices that actually move very significant volumes of traffic to be too high to exert competitive pressure. The fact that competing transportation providers move substantial traffic at prices that, under the proposed new test, would lead the Board to presume that CSXT has market dominance over that traffic provide practical illustrations of the ineffectiveness and unreliability of that approach as an accurate measure—let alone determinant—of market dominance. The proposed test is not only fundamentally flawed from as a matter of logic and theory—in practical application, it would be divorced from reality and essentially useless.

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[33] Trucks often provide relatively faster transit than trains; can access more shipper and customer facilities directly because rail tracks are not required; and are able to fit into smaller spaces, such as small loading docks, warehouses, and parking areas.

B. The Board's Proposed Rule Would Directly Contradict Market Dominance Findings In Prior Cases.

The Board's proposed limit price test would contravene its well-reasoned analysis and findings regarding market dominance in prior cases. Indeed, the limit price test would call into question some of the Board's clearest findings of lack of market dominance in recent decisions.

For example, in *E.I. DuPont de Nemours & Co. v. CSX Transportation, Inc.*, Docket No. 42100 (June 27, 2008) ("*DuPont Chlorine*"), the Board determined that intermodal competition via barge exerted effective competition over CSXT's rates for the movement of chlorine between Natrium, WV, and DuPont's New Johnsonville, TN, plant. *See id.* at 3. The record in this case was clear—DuPont shipped 90% of its chlorine between its New Johnsonville plant and Natrium via barge. *Id.* at 4. Barge was the dominant, preferred mode for these shipments. *Id.* In *DuPont Chlorine*, rail was a secondary transportation alternative to barge service, and DuPont was in no way captive to CSXT for the transportation of chlorine. The Board had little trouble finding that CSXT did not have market dominance for the transportation at issue. *See id.* However, had the Board applied its proposed rule in *DuPont Chlorine*, it would have presumed that CSXT had market dominance over this route, because the limit price was well above CSXT's current RSAM.

The facts of *DuPont Chlorine* further demonstrate that the limit price test is not an accurate or reliable indicator of market dominance. The challenged movement in that case had a variable cost of $1856.38 per car and an R/VC ratio of 323%. *See* Complaint at 5. The Board relied upon a CSXT RSAM of 242-281.[34] *See* Docket No. 42100 (June 27, 2008) at 13. While

[34] While the Board's subsequent decision to incorporate the effect of taxes in the RSAM calculation resulted in higher CSXT RSAMs than those used in the *DuPont (Chlorine)* decision, CSXT's tax-adjusted 4-year RSAM in 2007 was 311%, well below the R/VC of the 2007 rate

the price of the competitive barge service (and its corresponding limit price R/VC) cannot be determined from the public record, if the barge service were priced comparably to the rail rate then the limit price R/VC would be well over CSXT's RSAM. Thus, if the Board were to consider a similar scenario today—in which a competitive option carried the lion's share (90%) of the issue traffic but the limit price R/VC was higher than the carrier's RSAM—under the limit price test the Board would presume that the alternative transportation was not effective competition. A test that would disregard such a clearly effective competitive option—competition that the Board unequivocally found demonstrated that CSXT lacked market dominance over the issue transportation—would render the market dominance requirement nonsensical. This real-world example shows that the proposed limit price test would produce inconsistent, illogical results that are contrary to clear and well-reasoned market dominance determinations in prior cases.

Similarly, while the parties resolved the case before the Board ruled on market dominance in *Seminole Elec. Coop. v. CSX Transportation, Inc.*, application of the proposed rule to that case likely would have concluded that the Seminole dock option did not provide effective competition for CSXT rail transportation. The Board indicated its belief that market dominance was an important central issue to this case when it ordered oral argument to address that issue alone. *See Seminole Elec. Coop. v. CSX Transportation, Inc.*, STB Docket No. 42110 (June 30,

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challenged in *DuPont (Chlorine)*. *See Simplified Standards for Rail Rate Cases—2007 RSAM and R/VC>180 Calculations*, STB Ex Parte No. 689 (May 12, 2009). Indeed, CSXT's 4-year RSAM has not exceeded 323% in any year subsequent to 2007. *See Simplified Standards for Rail Rate Cases—2010 RSAM and R/VC>180 Calculations*, STB Ex Parte No. 689 (Sub-No. 3) (Feb. 24, 2012) (CSXT 4-year average RSAM of 293%); *Simplified Standards for Rail Rate Cases—2009 RSAM and R/VC>180 Calculations*, STB Ex Parte No. 689 (Sub-No. 2) (July 14, 2011) (CSXT 4-year average RSAM of 292%); *Simplified Standards for Rail Rate Cases—2008 RSAM and R/VC>180 Calculations*, STB Ex Parte No. 689 (Sub-No. 1) (July 27, 2010) (CSXT 4-year average RSAM of 299%).

2010). The only issue discussed during that focused oral argument was the feasibility of alternative transportation for coal being shipped to the Seminole Generating Station. *Id.* The primary alternative transportation at issue was an intermodal competitive option by barge over a navigable waterway. *Id.*

The evidence demonstrated Seminole's history of benefitting from alternative transportation options and its historic use of a combination of rail and barge transportation to meet its coal transportation needs. *Seminole v. CSXT*, CSXT Reply Evidence at II-18. Indeed, Seminole had historically shipped millions more tons of coal via rail-barge service than via all-rail service. *Id.* As CSXT demonstrated in its evidence and at oral argument, Seminole had feasible and available alternatives to rail transport. *See Seminole v CSXT*, Oral Argument transcript; *see also* CSXT Reply Evidence at II-16-50.

It appears likely that the Board's expert evaluation of the alternative rail-barge option would have been rendered moot had the Board employed its proposed limit price formula to that case. While confidentiality limitations under the governing protective order preclude discussion of the effective "limit price" and limit price R/VC of viable competitive options CSXT presented in that case, the Board has access to the information necessary to make those calculations and comparisons. Applying the proposed test to the evidence in the record in that case may further aid the Board in comparing the presumptive findings generated by mechanical application of the simplistic proposed test with the actual qualitative and quantitative evidence bearing on market dominance in the *Seminole* case.

C. The Board's Rule Would Lead To Incorrect Findings Of Market Dominance In Highly Competitive Markets.

Finally, the proposed limit price test would lead to erroneous findings of market dominance in markets that have highly competitive intramodal alternatives, such as direct rail-to-rail competition for a movement between the same origin and same destination. Indeed, such *See* Head-to-head intramodal competition is the clearest form of effective competition available. *See Market Dominance Determinations*, 365 I.C.C. at 132 (1981); *Metro. Edison Co. v. Conrail*, 5 I.C.C.2d 385, 411 (1989).

However, competitive rates charged by two rail carriers for a high rated move could very well generate a limit price R/VC ratio that exceeds one of the rail carriers' RSAM figure. In that case, applying the limit price test would deem a movement subject to direct intramodal competition presumptively noncompetitive. *See, e.g.,* UP Motion for Partial Dismissal or Expedited Determination of Jurisdiction, *SunBelt Chlor Alkali Partnership v. Norfolk Southern Ry. Co*, Docket No. 42130 at 6-7 (Sept. 26, 2011).

The fact that the limit price test could reject direct intramodal competition throws into stark relief the fundamental flaws of the limit price test. A test that would find such a classic, textbook example of competitive rail movements to be non-competitive is illogical and would contradict the purpose of the market dominance requirement—to limit STB intervention to cases in which market competition does not adequately protect a shipper from monopoly pricing by a rail carrier. The limit price test, which would not reliably or accurately determine market dominance, should be rejected.

In sum, the proposed limit price test is neither relevant nor reliable. The Board's proposal would reject uncontested evidence of actual head-to-head intramodal competition because the rates in question would generate R/VC ratios that exceeding the hypothetical limit price R/VC ratio. It would ignore real world intermodal competitive movements whose prices exceed the limit price, resulting in the nonsensical conclusion that despite competition, both the rail carrier and the competing transportation provider are "market dominant." And finally, it would apply a mechanical formula to contradict prior qualitative evidence-based decisions that found competitive intermodal options. A test that generates such absurd results would be a large step backward in the Board's market dominance inquiry. The proposed limit price rule should be rejected as irrational and contrary to the Board's statutory charge and duties.

V. THE NEW RULE IS INTENDED TO "SOLVE" A NON-EXISTENT "PROBLEM" AND WOULD NOT SIMPLIFY THE MARKET DOMINANCE INQUIRY.

Neither of the Board's two stated goals would be advanced by adoption of its proposed limit price approach. The Board's first concern is that the existence of similarly priced transportation alternatives may not always indicate that market pressures are adequately constraining a rail carrier's rates at or below a maximum reasonable level. *See* Decision at 12-13. The Board's second concern is that the qualitative market dominance inquiry is in danger of becoming too complex and too time-consuming. *See id.* at 3. As demonstrated below, however, the introduction of a subjective limit price and formula-based quantitative comparison would not address these concerns. Indeed, the Board's proposal would likely complicate the analysis while simultaneously reducing the accuracy and reliability of qualitative market dominance determinations.

A. The Board's Proposal Addresses a Hypothetical, Non-Existent "Problem."

The Board's proposed new methodology is a solution in search of a problem. For several reasons, the Board's concern—that comparison of prices charged by alternative transportation providers to the challenged rate may not be appropriate because it is theoretically possible that "patently ridiculous" transportation alternatives would constrain prices, but only at a greater than reasonable level—is not a real or significant problem in actual rate cases. *First*, this concern is almost entirely hypothetical. Although the Court of Appeals for the District of Columbia Circuit mentioned the theoretical possibility that, "[a]t some point the availability of an alternative such as the horse and buggy or even people carrying [freight] in buckets theoretically prevents railroads from raising their rates beyond an outer bound," CSXT is aware of no rate case in the intervening 28 years in which the Board has been faced with an assertion that some patently non-competitive or ineffective transportation alternative was exerting competitive pressure on rail rates. *See Arizona Public Service Company v. United States,* 742 F.2d 644 (D.C. Cir. 1984). Complainant M&G certainly has cited no such case.

The mere existence of a theoretical possibility that in a hypothetical case the cost of a far less efficient, effective, or desirable transportation alternative would not restrain a rail rate to a reasonable level does not demonstrate an actual real-world problem or flaw in the Board's existing qualitative market dominance rules and analysis. If price or R/VC ratio comparisons alone were determinative, and the Board did not carefully consider other factors, this concern might be more than hypothetical. Indeed, the Board's proposed rule would move the market dominance analysis much closer to such a simplistic and formulaic approach, thereby greatly enhancing the risk of erroneous market dominance determinations. Under the Board's current rules, however, it applies a multi-factored, fact-and-circumstance-specific qualitative analysis and its expert judgment to determine whether feasible transportation alternatives exert sufficient competitive pressure to constrain rail rates to a reasonable maximum level. *See, e.g., FMC Wyoming Corp. v. Union Pac. RR.*, 4 S.T.B. 699, 711-720 (2000) (individually analyzing each commodity for qualitative market dominance); *DuPont v. CSXT*, STB Docket No. 42100 at 2-6 (served June 30, 2008) (analyzing the different positions of the parties as to qualitative market dominance); *Total Petrochemicals USA, Inc. v. CSXT*, STB Docket No. NOR 42121 at 4 (served Apr. 5, 2011) (describing the qualitative analysis as the Board determining "whether there are any feasible transportation alternatives that could be used for the issue traffic, considering both intramodal (from other railroads) and intermodal (from other modes of transportation such as trucks, transload arrangements, barges or pipelines) competition."). Because the Board applies a multi-factor analysis in which no factor is necessarily determinative, evidence showing only that a rail rate is at the same level as a "patently ridiculous" or otherwise unviable alternative would be wholly inadequate to support a finding that the rail carrier lacked market dominance.

Indeed, the case that raised the "horse and buggy" hypothetical, *Arizona Public Service*, did not involve such a metaphorical alternative. In that case, the Court found that truck rates as little as 20% higher than the challenged rail rate did not exert competitive pressure on challenged rail rates and reversed the ICC's contrary finding of lack of market dominance. *See Arizona Public Service,* 742 F.2d at 651-52.[35] Contrary to M&G's purported concern, over three decades of SAC cases, rail carriers simply have not claimed that "patently ridiculous" or infeasible alternatives constrain them from charging prices in excess of a maximum reasonable

[35] The Court further relied upon *other* non-price evidence introduced by the complainant, showing that alternative truck transportation rates ranging from 20% to 60% greater than challenged rail rates, was sufficient to defeat the rail carrier's claim that it lacked market dominance. *Arizona Public Services,* 742 F.2d at 650. In making this determination, the Court partially relied on other qualitative factors, such as the lack of evidence of any other superiority of truck over rail transportation that would justify the difference in rail and truck rates. *See id.* at 651. Thus, the *APS* case itself shows that under the current, longstanding rule and methodology, the mere availability of alternative transportation is not sufficient to negate a showing of market dominance. Both the Board and reviewing courts have shown themselves to be fully capable and competent to distinguish between a viable competitive alternative and some non-feasible or plainly non-competitive alternative.

level. Nor is there any reason to believe that carriers would devote resources to presenting arguments concerning impractical or plainly inferior transportation alternatives, which the Board would readily and properly reject.

Instead, disputes regarding qualitative market dominance have involved feasible and practicable transportation alternatives whose costs to the complaining shipper are close to those of the challenged rail rates. Recent qualitative market dominance submissions have primarily involved either over-the-road truck transportation alternatives, combined rail-truck transportation alternatives, or water-borne alternatives. Disputes in those cases have generally revolved around matters such as whether a transportation alternative is actually effective and would serve the needs of the shipper and its customer, and whether cost comparisons fully consider the costs and logistical requirements and implications of transportation alternatives. *See, e.g., DuPont v. CSXT*, STB Docket No. 42101 at 3 (served June 30, 2008) ("DuPont points out that the [truck] quotes are much higher than CSXT's rate, further demonstrating a lack of effective competition … According to CSXT, the fact that it actually lowered its proposed rate based on an alternative service option demonstrates the presence of effective competition."); ("According to DuPont, given the lack of additional barge capacity, all chlorine that can move by barge already does and whatever residual traffic remains is then shipped by rail on CSXT … CSXT argues that the undisputed fact that DuPont ships 90% of the issue traffic via barge demonstrates that…CSXT does not have market dominance over this traffic."); *CSXT v. M&G*, STB Docket No. 42123 at 35 (served Sept. 27, 2012) ({{

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CSXT did not present evidence or argument that it lacked market dominance for 26 of 69 lanes whose rates M&G challenged, because CSXT believed that the cost of available transportation alternatives for those lanes might not be sufficient to meet the Board's existing standards for demonstrating that such competition necessarily prevented it from charging rates in excess of a maximum reasonable level. Although M&G has raised the specter of a hypothetical argument that a "horse and buggy" or similar alternative demonstrated lack of market dominance, CSXT presented no such evidence or argument in this case. Nor have such arguments been raised in other cases.

In the unlikely event that a party to a future case were to assert that some unviable, ineffective, or "ridiculous" alternative effectively constrained its market power, the non-price factors the Board considers under its current market dominance rules and analysis no doubt lead it to reject that claim. Speculation about the possibility that an argument that has never been raised might theoretically be raised at some time in the future—particularly when other elements of the Board's analysis are demonstrably more than adequate to address such an argument—is a wholly inadequate basis for the proposed radical departure from sound established qualitative market dominance rules and methods.

Second, the Board already has an effective threshold screen against "patently ridiculous" alternative transportation arguments. If in some future case a defendant were to present an argument that an unrealistic, non-competitive alternative constrained challenged rates, the Board's existing qualitative analysis would find the proffered alternative infeasible and give it no further consideration. Although the Decision makes more explicit that a feasibility determination would be the threshold requirement under the Board's proposed new rule and methodology, feasibility has always been an essential element of the Board's qualitative market dominance analysis. *See, e.g., E.I. DuPont de Nemours v. CSX Transportation,* STB Docket No. 42099, Decision at 2 (June 30, 2008); *see also,* Decision at 14-15 (finding that threshold feasibility analysis of proposed rule is a factor already encompassed in the ICC *Market Dominance Determinations & Considerations of Product Competition* rule and applied in subsequent cases). If, for example, a defendant asserted that horse and buggy transportation constrained its rates for long haul transportation of large volumes of coal, the Board would reject the argument because the proposed alternative would not be feasible to meet the transportation needs of the shipper.

Because in order to be further considered in a market dominance analysis, a proffered alternative must be feasible—considering factors including "whether and to what extent such alternatives might involve prohibitive transport distances, product integrity concerns, capacity/infrastructure constraints, and the presence of any transportation requirements imposed by the complaining shipper's customers," Decision at 12—the Board would reject as infeasible, impractical, or ineffective, any proposed alternatives that could not provide practical, effective, and efficient transportation services required by the shipper. This assessment not only eliminates the possibility of "ridiculous" alternatives, it effectively screens out any proffered alternatives that do not meet the demonstrated needs and requirements of the shipper. *See, e.g., DuPont v. CSXT.* STB Docket No 42099 at 7 (June 30 2008). Thus, the feasibility requirement precludes the use of inadequate transportation alternatives (real or theoretical) to find lack of market dominance, thereby eliminating this theoretical concern.

B. The Board's Proposal Would Not Reduce the Complexity of its Market Dominance Analysis.

The second objective the Board seeks to address with its new proposed qualitative market dominance rule is to reduce the complexity of its analysis while enhancing the objectivity of the analysis. *See, e.g.,* Decision at 3, 14-15, 17. The proposed new rule would achieve neither aim.

1. The Proposal Would *Increase* The Complexity of the Market Dominance Analysis by Inserting Additional Steps.

The Board's proposed approach does not reduce complexity because it would *add* steps to the analysis. Under the proposed approach, the Board would conduct all of the analysis it conducts under its current rule *plus* conduct the new multi-step limit price analysis. Appropriately and conscientiously applied, the new analysis would simply add more layers of complexity to the analysis, thereby complicating the analysis and the effort required to conduct that analysis—precisely the opposite of the Board's goal.

The current approach conducts essentially a two-step analysis. First, the Board determines whether there exists one or more feasible alternatives to rail transportation for each lane. *See* Decision at 12. Then, considering a variety of relevant factors, the Board determines where feasible alternatives exert effective competitive pressures "sufficient to restrain [the challenged rail] rates effectively," and thus require the rail carrier to provide good services at reasonable prices or lose the shipper's business. *Id.* at 12-13. The two steps in the existing approach appear to correspond with the first and last steps of the Board's proposed approach. *See id.* at 12-15 (first step is determining feasibility, and final step is determining whether alternative has other "features sufficient to overcome the applicable preliminary conclusion" established by the second and third steps). The Decision states that the Board's proposed approach "encompasses the same factors" and considerations that the Board considers under the existing rule. *See* Decision at 14-15. Thus, under the Board's own logic, its proposed rule would create at least a four step process for an analysis it currently conducts in two steps.[36]

Once the Board completed the three steps necessary to arrive at a preliminary conclusion, it would then conduct the fourth step, considering various qualitative factors to determine whether the preliminary conclusion—generated quantitative comparison of a formula-generated number with a statistic—is sustained by a qualitative review. *See id.* at 14. As Drs. Eakin and Meitzen explain, "this step alone would require [the Board] to undertake essentially the same qualitative market dominance analysis it conducts under the existing, established approach." V.S. Eakin/Meitzen at 12.

Far from simplifying the market dominance analysis, the Board's proposed new rule would expand the analysis from two qualitative steps to at least four steps—the two existing qualitative steps and at least two additional quantitative steps. In addition to the myriad other legal, economic, and logical problems inherent in the Board's proposal (several of which are discussed above), it plainly would not achieve the Board's stated goal of simplification of the market dominance analysis. Rather, it "simply adds more layers to the process." V.S. Eakin/Meitzen at 13.

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[36] The first additional step is the subjective identification of a "limit price," which the Board defines as a price that "if the railroad charged above that level, would result in a significant loss of traffic." *See* Decision at 13. The second additional step would be to convert the limit price to a "limit price R/VC ratio" by dividing the limit price set by the Board by the defendant carrier's variable cost of providing the service at issue. *Id.* at 14. Then, as further added component of this new step, the Board would compare the limit price R/VC ratio with the carrier's most recent overall average RSAM R/VC figure. *Id.* Arguably, the second new step consists of two steps: (i) calculation of the limit price R/VC for each movement; followed by (ii) comparison of those limit price R/VCs to the carrier's RSAM figure. Thus, the Board's proposed approach could be viewed as introducing *three* additional steps, creating a five-step process where today it conducts a two-step process.

2. The Proposal Would Not Make the Analysis More Objective.

The proposed approach also would fail to achieve the Board's aim of making the market dominance analysis more objective. Indeed, the proposal would make the process more arbitrary without any reduction in subjectivity. As discussed above, the Board must make a subjective, standardless determination of "the *highest price* a carrier could *theoretically charge* a shipper without causing a *significant amount* of the issue traffic on a particular rail movement to be diverted to a competitive alternative . . . " Decision at 13 (emphases added). The Board offers no explanation of how it proposes to determine which among multiple potential transportation alternatives would establish the *highest* price a rail carrier "could theoretically charge" or what standards it would use to make that determination. *See id.* Nor does it provide any standards or metrics whatsoever to define what it means by diversion of a "significant amount" of traffic. *See id.*

Thus, the determination of the limit price would be entirely subjective and committed to the decisionmaker's unguided discretion, with no basis for ensuring that such determinations would be based on uniform standards and their consistent application.[37] Because the result of the

[37] Even if the Board were able to establish meaningful, reasonable, and objective standards and measures it would consistently use to determine the "highest price a carrier could theoretically charge" without losing "a significant amount of the issue traffic . . . to a competitive alternative," comparison of the "limit price R/VC" to the carrier's "RSAM figure" would remain an illogical and arbitrary way to establish market dominance presumptions. As Drs. Eakin and Meitzen, and Professor Willig explain, a rail carrier's systemic RSAM figure is irrelevant to whether it faces competition in a particular market because it provides no market-specific information. *See, e.g.*, V.S. Eakin/Meitzen at 9-11; V.S. Willig at 12-13. By definition, a differentially pricing carrier whose aggregate R/VC ratio on its higher rated traffic meets or exceeds its RSAM ratio will have some movements generating an R/VC in excess of the ratio and some movements that generate an R/VC below the RSAM ratio. That fact says nothing about whether a rail carrier does or does not have market dominance over specific transportation in a particular individual market. And, the fact that the Board uses a "theoretical" price rather than the price actually charged by the

limit-price test depends entirely on the selected limit price, the standardless discretion the Board proposes to exercise in setting a limit price would render the entire limit price comparison utterly subjective.[38] Further, application of a wooden formula may make calculations easier and more simplistic, but there is nothing about the Board's proposed formulas that make the test more objective or more accurate.

In sum, evaluated against its own goals, the Board's proposal would do substantially more harm than good. It would make the market dominance analysis more complex, time-consuming, and costly while undermining the accuracy and reliability of its results. And, far from making the analysis more objective, the proposed limit price test would introduce more subjectivity, disconnect the analysis from any actual market-specific information, and erect arbitrary presumptions of market dominance.

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carrier further exacerbates the arbitrariness of the proposed test. *See* V.S. Eakin/Meitzen at 6-9; V.S. Willig at 12-13.

[38] Stated differently, she who sets the limit price determines the result of the limit price analysis. If the decisionmaker has essentially unguided and unlimited discretion to set the limit price, the limit price test is not only subjective, it is arbitrary. Any purported objectivity would be wholly illusory.

CONCLUSION

For the foregoing reasons, CSXT requests that the Board reject the new market dominance rule it has proposed in this case. Instead, the Board should evaluate market dominance under the existing market dominance rules, which were the rules at all relevant times in this case and thus the rules upon which both parties reasonably relied. New market dominance rules are not necessary because the Board's existing rules, which rely upon a qualitative analysis of the totality of relevant circumstances and the Board's expert judgment, are adequate and appropriate. If, however, the Board determines it is necessary or appropriate to reconsider its existing qualitative market dominance rules, it should commence a notice-and-comment rulemaking to do so.

Respectfully submitted,

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Dated: November 28, 2012

CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of November, 2012, I served a copy of the foregoing CSX Transportation, Inc.'s Comments On The Proposed "Limit Price" Approach To Determining Qualitative Market Dominance by U.S. mail or more expeditious method of delivery, upon:

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and upon *amici curiae* counsel.

Joseph T. Zaleski

Joseph T. Zaleski

VERIFIED STATEMENT OF ROBERT D. WILLIG

Before the
Surface Transportation Board

Docket Number NOR 42123
M&G Polymers USA, LLC
v.
CSX Transportation, Inc.

Verified Statement of

Robert Willig
Professor of Economics and Public Affairs
Princeton University

November 28, 2012

Witness Introduction

My name is Robert Willig. I am Professor of Economics and Public Affairs in the Economics Department and the Woodrow Wilson School of Public and International Affairs of Princeton University. I also serve as a senior consultant to the economics consulting firm Compass Lexecon.

I have done extensive research and economic analysis of the railroad industry over the course of my career.[1] I have also testified before the Surface Transportation Board, and its predecessor, the Interstate Commerce Commission about issues affecting the rail industry on many occasions.

In general, my academic area of focus for teaching and research is microeconomics, with particular specialization in the field of industrial organization, including competition and regulatory policy. I have extensive experience analyzing such economic issues arising under the law. While on leave from Princeton, I served as Deputy Assistant Attorney General in the Antitrust Division of the United States Department of Justice, and in that capacity served as the Division's Chief Economist. I have consulted to international public agencies, national governments, private companies and law firms, and appeared as an expert witness before Congress, federal and state courts, federal administrative agencies, and state public utility commissions

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[1] See, for example, "Competitive Rail Regulation Rules: Should Price Ceilings Constrain Final Products or Inputs?" (with W. J. Baumol); Journal of Transport Economics and Policy, vol. 33, part 1, pp. 43-53 ; "Restructuring Regulation of the Rail Industry," (with Ioannis Kessides), in Private Sector, Quarterly No. 4, September 1995, pp. 5 – 8; "Competition and Regulation in the Railroad Industry," (with Ioannis Kessides), in Regulatory Policies and Reform: A Comparative Perspective, C. Frischtak (ed.), World Bank, 1996; "Railroad Deregulation: Using Competition as a Guide," (with W. Baumol), Regulation, January/February 1987, vol. 11, no. 1, pp. 28-35; "Pricing Issues in the Deregulation of Railroad Rates" (with W. Baumol), in Economic Analysis of Regulated Markets: European and U. S. Perspectives, J. Finsinger (ed.), 1983.

on subjects involving microeconomics, competition and regulation, in a wide variety of sectors including transportation and railroading specifically.

Purpose and Summary of Findings

I have been asked by CSX Transportation, Inc. ("CSX") to provide comments on the analytical framework for evaluating qualitative market dominance that the Surface Transportation Board ("STB" or "the Board") used as the foundation for its September 27, 2012 decision in the rate case brought by M&G Polymers USA, LLC against CSX Transportation, Inc.[2]

That decision introduced the concept of the "limit price R/VC ratio" as a new standard for determining whether a railroad possesses market dominance over the transportation to which a challenged rate applies. Specifically, the Board's proposed test compares each route's "limit price R/VC ratio" (which it defines as the highest price a railroad could charge without losing significant business to a competing alternative) to the railroad's most recent Revenue Shortfall Allocation Method ("RSAM") percentage. If the "limit price R/VC ratio" on the move is above the defendant railroad's most recent RSAM percentage, the Board makes a preliminary determination of market dominance—that is that the identified competitive alternatives do not effectively constrain the railroad's rates on that route—subject to consideration of mitigating factors unique to the proposed alternative transportation (what the Board

[2] Surface Transportation Board; Docket No. NOR 42123 - M&G Polymers USA, LLC v. CSX Transportation, Inc.; "Decision – Public Version" (hereafter, M&G Decision).

describes as "certain intangible qualities that bear on the alternative's ability to effectively constrain the rate at issue").[3]

In summary form, my conclusions regarding the Board's proposed new standard for evaluating qualitative market dominance are as follows:

RSAM is not an "objective" indicator of monopoly pricing. The Board's stated central rationale for its new standard is its assertion that a limit price revenue to variable cost ratio above RSAM provides an objective indication of monopoly pricing. This is an asserted proposition that is false as a matter of economic theory as well as common sense. Simply put, if the carrier's other potentially "captive traffic" (in the sense employed by the Board -- traffic with revenue above 180% of its variable cost) on average have their "limit price R/VC ratio" below RSAM, then it is plain that the issue traffic must move at an actual R/VC above RSAM, and thus must have a "limit price R/VC ratio" above RSAM, in order for the carrier to attempt to approach revenue adequacy. Thus, under these circumstances, a "limit price R/VC ratio" above RSAM is not at all an indication of monopoly pricing. Rather it could be consistent with the carrier's inability to cover its costs with its revenues due to the competitive alternatives available for all its traffic, or it might be consistent with the possibility that the carrier could actually reach revenue adequacy, but no more, by pricing the issue traffic at its "limit price R/VC ratio" level. Neither of these circumstances in which the "limit price R/VC ratio" might exceed RSAM are in any way consistent with what economics properly characterizes as instances of monopoly pricing.

[3] M&G Decision at 4.

The "limit price" method threatens revenue adequacy and the long-term health of the industry. The Board's proposed new standard for evaluating qualitative market dominance would act as a new systematic impediment to the attainment of rail carrier revenue adequacy, and thus an additional threat to the long-run healthy sustainability of the nation's rail network. It is well recognized by the Board that there is significant variance among the levels of "limit price R/VC ratios" among shippers' traffic that is potentially "captive," with significant traffic having "limit price R/VC ratios" below RSAM. Consequently, in order to approach revenue adequacy, a rail carrier must price some significant amount of traffic with limit and actual R/VC levels above RSAM. But under the "limit price" method, any such attempt opens the carrier to a finding of market dominance and the launch of a maximum rate challenge under the proposed new standard. Thus, the very pricing decisions of a carrier that are necessary for attempts to attain adequate revenues are systematically penalized by the regulatory process that would emerge from adoption of the new proposed standard.

Reliance on the "limit price R/VC ratio" rather than the railroad's actual R/VC requires more detailed consideration. The Board places a great deal of weight on the feature of its proposal that selects the "limit price R/VC ratio" rather than the railroad's actual R/VC as the ratio to be compared with RSAM. However, I find this economically suspect and in need of further consideration. For this distinction to be meaningful, it must be the case that there are significant differences between actual and limit R/VC levels. It is a crucial question why the Board implicitly thinks this is the case. It may be the case because the methodology by which the Board foresees assessing the "limit price R/VC ratio" would generally omit forms of competitive pressure that keep actual prices below the levels that the Board would find to be the limit levels. If that is the case, the Board's rationale for its method would be founded on expectation of its systematic inaccuracy.

A more detailed analysis of the proposal is required. Such a fundamental change in the Board's approach to market dominance determinations calls for a detailed analysis of alternative proposals. I would hope and expect that the Board would treat such a significant change with careful deliberation, encouraging comments from all interested parties and engaging in careful debate of alternative approaches before implementing a new standard.

The Board's Assertion that the "Limit Price" Method is an "Objective" Indicator of Monopoly Pricing

In the M&G decision, the Board asserts that its use of RSAM as an indicator of the presence of competitive discipline is valid for "several reasons."[4] Most prominently, the Board asserts: "However, a finding that the limit price R/VC ratio generated by the limit price of a given transportation alternative falls above RSAM—again, a measure of the average markup that the railroad would need to collect from all of its potentially captive traffic to be considered revenue adequate—provides an objective indication of monopoly pricing."[5]

The Board explains its interpretation of the RSAM threshold as follows:

> As a carrier's RSAM number represents the average level at which the carrier would achieve system-wide revenue adequacy, the fact that a rate involving certain potentially captive traffic produces an R/VC ratio that falls below the carrier's RSAM

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[4] M&G Decision at 17.
[5] Id.

> number indicates that competitive transportation alternatives likely exist and are exerting downward pressure on the rate governing that traffic. Likewise, the fact that a rate involving other potentially captive traffic produces an R/VC ratio that falls above the carrier's RSAM number is a useful indicator that competitive transportation alternatives – whether intermodal or intramodal – do not exist and are not effectively constraining the rate charged by the carrier for that traffic.[6]

The Board's assertion that a "limit price R/VC" ratio above RSAM is somehow an "objective indicat[or]" of "monopoly pricing" is contrary to economic theory and common sense. Contrary to the Board's assertion, R/VC ratios that are above RSAM are not "indicator[s] that competitive transportation alternatives...do not exist..."[7] Rather, R/VC ratios above RSAM are just a mathematical necessity for a sustainable rail carrier.

RSAM is a formulaic mathematical calculation that yields a system-wide needed average markup for potentially "captive" traffic: "As an initial matter, a carrier's RSAM figure is a measure of the average markup that the carrier would need to collect from all of its potentially captive traffic (i.e., all traffic priced at or above the 180% R/VC level) in order to earn adequate revenues as measured by the Board under 49 U.S.C. § 10704(a)(2) (i.e., earn a return on investment equal to the cost of capital)." Stated differently, it is the *average* amount by which revenues must exceed variable costs on potentially "captive" shipments to permit the railroad to earn revenues adequate to cover the full costs of building, maintaining, and operating its overall rail network. Given expected variations in demand for the railroad's services, therefore,

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[6] Id. at 15.
[7] Id.

some traffic will need to move at rates above the RSAM percentage, and some will only be able to move at rates below RSAM. Rates will be determined based not on anything related to the RSAM calculation, but rather based on the markets' competitive conditions associated with each individual move. If, for competitive reasons, some traffic must move at rates with a markup well below the RSAM percentage then, by definition, other components must move at rates with a markup well above the RSAM percentage. There is nothing inherent in the calculation of a railroad's RSAM percentage that provides any insight into questions surrounding either whether a railroad is market dominant with respect to a given move or whether rates for that move reflect an exercise of any such dominance.

Embedded in the STB's "limit price" test is the assumption that a "limit price R/VC ratio" above RSAM cannot be consistent with circumstances other than market dominance. This is false. It is straightforward to foresee circumstances where a particular move has a "limit price R/VC ratio" above RSAM for reasons completely unrelated to monopoly pricing. For example, a carrier may need to price certain traffic at R/VC levels above RSAM because the competitive circumstances relevant to other potentially "captive" traffic imply that the railroad cannot recover average fixed and common infrastructure costs on those moves. This is not an indication that there is a lack of effective competitive alternatives for the issue traffic, but rather just an indication of the fact that different traffic is subject to different economic realities. For example, consider certain chemical shipments that tend to be high-value movements that travel long distances. Because of the long distances and the expensive difficulties of handling chemicals, these movements tend to move at rail rates that are relatively high, and potentially well above the RSAM level. Under the "limit price R/VC" test, the STB would find the railroad to be market dominant. Nonetheless, many of the traffic lanes with relatively high rail rates also benefit from competitive truck options, as can be seen in the evidence presented by CSX in the M&G case.[8] Determining the presence and efficacy of competing alternatives requires a more detailed examination than the formulaic comparison of the "limit price R/VC ratio" to an RSAM number.

Indeed, the limitations of the test can be seen with reference to the current case between M&G and CSX. The conclusions on market dominance reached by the Board on the basis of the "limit price" method do not follow from evidence of a lack of competition presented in the case. To the contrary, in its discussion of the facts of the dispute between M&G and CSXT, the Board notes that:

> "...feasible truck or truck/rail alternatives to CSXT's service exist for most of the challenged movements. This is demonstrated most obviously by the fact that a not insignificant portion of M&G's PET shipments from 2006-2010 were transported via truck or a truck/rail combination."[9]

The Board acknowledged that the record contained "not insignificant" evidence that CSX faces viable competition for M&G's business for "most" of the challenged movements. However, the Board then stated that it was "not satisfied" that the alternatives are able to "restrain rates effectively."[10]

Using the "limit price" method, the Board determined that CSX was market dominant on 36 of the 42 challenged rates *despite* evidence the Board itself describes as demonstrating "feasible" alternatives for "most" challenged routes for a "not

[8] See M&G Decision at 13.
[9] M&G Decision at 13.
[10] M&G Decision at 13.

insignificant portion" of M&G traffic.[11] A test that leads to results that are directly contrary to demonstrated market outcomes due to a comparison with irrelevant formulaic averaging is not reliable and cannot become the foundation of reasonable public policy.

The "Limit Price R/VC Ratio" Test Poses a Threat to Revenue Adequacy and the Long-Term Health of the Rail Industry

The "limit price" method for determining market dominance threatens the principles of differential pricing and revenue adequacy that are at the heart of rail regulation. The economic health of the rail industry today is due to a series of regulatory reforms that are grounded in the principles that railroads should be given the freedom to price in accord with market forces and be afforded the opportunity to earn revenues adequate to cover their costs of building, operating, and maintaining their network.[12] The "limit price" method at issue here would be in direct conflict with carriers' attempts to price at levels that are necessary to attain revenue adequacy.

Under the proposed "limit price R/VC ratio" test, a railroad would only be able to avoid a finding of market dominance in a world where *all* of the carrier's potentially "captive" traffic had "limit price R/VC ratio" levels at or below RSAM. It is well recognized by the Board that in order to have any hope of attaining revenue adequacy, railroads must be able to recover a larger share of their costs from traffic with fewer competitive alternatives – that is, railroads must be able to price some traffic at R/VC levels above RSAM to make up for traffic that must be priced at R/VC levels below

[11] M&G Decision at 1.

[12] See, for example, The National Rail Transportation Policy: "In regulating the railroad industry, 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." (49 U.S.C. § 10101.)

RSAM. A carrier that is unable to price *any* traffic at R/VC levels above RSAM because of the threat of market dominance findings and maximum rate regulation would never be able to fully recover its costs and would never be able to attain revenue adequacy. Under the "limit price R/VC ratio" test as currently conceived, any carrier with any hope of attaining adequate revenues by pricing certain moves above the RSAM threshold would find itself subject to findings of market dominance and consequent hearings to regulate its rates.

The Board's Reliance on the "Limit Price R/VC Ratio" Rather Than the Actual R/VC Ratio Requires Further Consideration

In outlining the "limit price" method, the Board is clear that, rather than considering the railroad's actual R/VC ratio in comparison to RSAM, it views the proper basis of comparison to be the "limit price R/VC ratio." Notwithstanding the limitations of using the RSAM number in the manner proposed, focusing on the "limit price R/VC ratio" rather than the railroad's actual R/VC ratio implies that the Board believes there to be a meaningful difference between the two metrics. As a matter of economics, it is not clear why the Board believes this to be the case. I find the use of the "limit price R/VC ratio" rather than the actual R/VC to be economically questionable and an issue that requires far more detailed consideration.

A measured difference between actual prices and the limit prices calculated by the Board may be indicative of a mistake in the concept or the calculation of the limit prices. It may be the case that the Board anticipates that "limit price R/VC ratios" will differ significantly from the railroad's actual R/VC ratios because the Board's intended method for determining the "limit price R/VC ratio" does not properly account for all sources of potential competitive pressure that are reflected in the level of actual prices. Economically, there are at least three sources of potential competitive discipline that would need to be factored into the "limit price" calculation that are not obviously addressed by the Board in the "limit price" test as currently proposed.

First, inherent limitations on the value of the traffic itself may provide a source of discipline on rail rates. A shipper seeking to move traffic that has relatively low value would not be willing to pay rail rates that would exhaust the commercial benefit of the transportation of the goods. In such a case, it is the relatively low commercial value of the movement itself that limits rail rates. An accurately calculated limit price would need to properly account for whether, and how much, the characteristics of the traffic itself provide discipline on a railroad's rates.

Second, evidence on the role of head-to-head competition between carriers must be considered carefully. Actual prices are often the result of significant head-to-head competition between existing suppliers in the market. A limit price calculation that does not properly consider the disciplining power of all existing competitors would yield inaccurate and unreliable results.

Third, product and geographic competition are well-established sources of competitive discipline on rail rates. Shippers who can take advantage of substitute products or alternative geographies via alternative transportation options will be able to bargain for lower rail rates than those without such competitive alternatives. However, because the Board no longer considers evidence on product and geographic competition for purposes of making market dominance determinations, evidence of product and geographic competition is no longer permitted during these proceedings and, therefore, was not accounted for in the Board's calculation of limit prices.

If the Board calculates "limit price R/VC ratios" without proper account of these and any other relevant competitive pressures restraining given rates, then the method it proposes is fundamentally flawed and necessarily premised on systematic inaccuracies.

Disregarding actual evidence on prices from the marketplace in favor of relying on the calculation of a "limit price R/VC ratio" raises the possibility that the "limit price" test will return results at odds with actual market outcomes. Again, this can be seen in the M&G case. The Board dismissed both CSXT's and M&G's proposed methods for looking to actual rates to determine whether they are subject to effective competition.

M&G proposed that "effective" competition is demonstrated when rates are below the variable cost of providing the alternative service. The Board correctly rejected that approach, and noted "...this figure [variable cost of the alternative] does not represent a constraint on a railroad's pricing. A carrier is constrained by the market prices charged by its competitors for an alternative transportation service, not the variable costs incurred by those competitors when providing the alternative service."[13] However, when CSXT proposed just such a standard—that is, comparing rail rates to the price of the competing alternative—to determine the efficacy of competition, the Board rejected that approach as well, opting instead for its "limit price" method. [14]

Relying on the "limit price R/VC ratio", the Board determined that CSX was market dominant on 36 of the 42 challenged routes despite evidence that, in many

[13] M&G Decision at 13.
[14] Id.

cases, the rail rate in question is essentially consistent with the price of a competing alternative. At a minimum, the fact that the "limit price R/VC ratio" resulted in findings seemingly at odds with actual experience is indicative of the need for a more detailed assessment of the "limit price" methodology.

Conclusion

The "limit price" method as currently proposed by the Board is not an appropriate method for determinations of market dominance. First, the assertion that a "limit price" R/VC above RSAM is indicative of monopoly pricing is wrong as a matter of basic economic logic.

Second, the proposed "limit price" method threatens railroads' ability to achieve revenue adequacy. If railroads cannot price some traffic at R/VC levels above RSAM to make up for traffic that must be priced at R/VC levels below RSAM for competitive reasons without risking rate challenges and findings of market dominance, carriers will be systematically impeded from the opportunity to achieve revenue adequacy.

Third, the Board's reliance on "limit price R/VC ratios" rather than actual R/VC ratios is a topic that requires more detailed examination. From an economic perspective, it is not clear that the use of limit prices that differ from prevailing market prices can be appropriate and can avoid systematic inaccuracy. In short, the Board's test does not examine the actual competition.

Finally, as a general matter, the proposed "limit price" method would constitute a significant new element of the Board's procedures for its regulation of rail carriers' businesses. In general, it would likely have significant effects on outcomes in the industry, and it seems to threaten core regulatory values of economic efficiency and sustainability. The adoption of any such significant new regulatory standard should be carefully considered and should be the result of detailed analysis of this and other competing proposals.

VERIFICATION

I declare under penalty of perjury that the foregoing statement is true and correct to the best of my knowledge, belief, and information. Further, I certify that I am qualified and authorized to file this statement.

Robert Willig

Robert D. Willig

Executed on this 20 day of November, 2012.

JOINT VERIFIED STATEMENT
OF
B. KELLY EAKIN
&
MARK E. MEITZEN

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB DOCKET NO. NOR 42123
M&G POLYMERS USA, LLC
v.
CSX TRANSPORTATION, INC.

JOINT VERIFIED STATEMENT
OF
B. KELLY EAKIN
AND
MARK E. MEITZEN

CHRISTENSEN ASSOCIATES

November 27, 2012

I. Introduction

We are two of the principal authors of the Christensen Associates' railroad competition studies. With our colleagues, A. Thomas Bozzo, Douglas W. Caves, Laurits R. Christensen, Philip E. Schoech and Joseph A. Swanson, we produced *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals that Might Enhance Competition* in November 2008 (revised November 2009) for the Surface Transportation Board. We produced two other studies for the STB, the *Supplemental Report on Capacity and Infrastructure* in March 2009, and *An Update to the Study of Competition in the U.S. Freight Railroad Industry* in January 2010. More recently, our article, "Railroad Performance Under the Staggers Act," was published in the Winter 2010-2011 volume of *Regulation*. Our biographies appear in the Appendix.

We have been asked by CSXT to analyze the "limit price" methodology outlined by the Board in its September 27, 2012 Decision in this proceeding for use in assessing qualitative market dominance.[1] We understand the Board's concern with the "rapidly escalating complexity of the market dominance inquiry in rate cases," (*Id.*, p. 3), but we do not believe the proposed methodology provides an economically sound means of "quickly" resolving market dominance issues. By its very nature, determination of market dominance is often a fact-intensive exercise. If anything, rather than simplify the process, the proposed methodology adds additional steps to an already complex process without adding meaningful information about market performance.

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[1] Surface Transportation Board, Decision, M&G Polymers USA, LLC v. CSX Transportation, Inc., Docket No. NOR 42123, September 27, 2012 ("September 27 Decision").

We first outline the Board's proposed methodology before proceeding to discuss our major criticisms of it. We conclude that the proposed methodology is neither objective nor a reliable measure of a defendant carrier's market dominance with respect to specific transportation markets, and is likely to add to the burden of determining market dominance without meaningfully informing the process.

II. The Board's Proposed Methodology

The Board has expressed concern that because of "rapidly escalating complexity," the market dominance inquiry "will soon dwarf the rate reasonableness inquiry" without a more objective means of resolving market dominance issues. (*Id.*, p. 3) In response to this concern, the Board has proposed a four-step methodology to "objectively" determine whether transportation alternatives are effectively constraining rail prices.

The first step is to calculate the "limit price" which, in this case, is defined as:

> [T]he highest price CSXT theoretically could charge M&G without causing a significant amount of the issue traffic on a particular rail movement to be diverted to any particular competitive alternative. (*Id.*, pp. 3-4)

Next, the "limit price R/VC ratio" is computed as the ratio of this limit price to the "variable cost of providing the service at issue." (*Id.*, p. 4) This limit price R/VC ratio is then compared to the railroad's most recent Revenue Shortfall Allocation Method (RSAM) figure. If the limit price R/VC ratio exceeds RSAM, "we preliminarily conclude that the alternative cannot exert competitive pressure sufficient to effectively constrain the rate at issue." (*Id.*, p. 4) If the limit price R/VC ratio is less than RSAM, "we preliminarily conclude that the competitive alternative effectively constrains the rate at issue." (*Id.*, p. 4) As a final step, this preliminary conclusion:

> [C]ould, in certain circumstances, be overcome by evidence demonstrating that the alternative upon which the limit price is based has *certain intangible qualities* that bear on the alternative's ability to effectively constrain the rate at issue. (*Id.*, p. 4, emphasis added)

These intangible qualities are characterized as "certain unquantifiable benefits" or "certain unquantifiable costs." (*Id.*, p. 14)

III. The Proposed Methodology is not an Objective or Reliable Indicator of Market Dominance

The proposed test to determine whether a railroad is market dominant for particular issue traffic (*i.e.*, the "limit price test") is not founded on a sound economic base. We disagree with the Board's assertions that:

> [A] finding that the limit price R/VC ratio generated by the limit price of a given transportation alternative fall above RSAM ... provides an objective indication of monopoly pricing. (*Id.*, p. 17)

And we also disagree that, somehow, the distance between the limit price R/VC ratio and RSAM strengthens the conclusion regarding market dominance:

> The further the limit price R/VC ratio is above or below the RSAM figure, the stronger the preliminary conclusion that the alternative is either effectively constraining or not effectively constraining the rate governing the issue traffic. (*Id.*, p. 14)

There is simply no economic foundation for these assertions.

Among the problems with the proposed limit price test that we demonstrate below are: the limit price is an imprecise concept; the results of the limit price test are determined by incomplete and irrelevant information; the test does not distinguish between different market situations; and the use of RSAM to determine market dominance is arbitrary and unrelated to actual market situations.

The Limit Price is an Imprecise Concept

The limit price is defined as the highest price the railroad could charge without causing a significant amount of traffic to be diverted to a competitive alternative. At least two factors contribute to the ambiguity of this definition. First, "a significant amount" is not a precise term. Second, it is not clear whether the limit price concept means the highest price before *additional* traffic is diverted or it means the highest price before *any* traffic is diverted. We presume the latter as it is more consistent with a literal reading of the September 27 Decision (*Id.*, pp. 3-4), and because the facts indicate that alternative transportation modes have a market share in many origin-destination pairs.

The proposed test requires using a qualitative judgment about "a significant amount" to conduct a quantitative screen. The result may be a false sense of objectivity and precision.

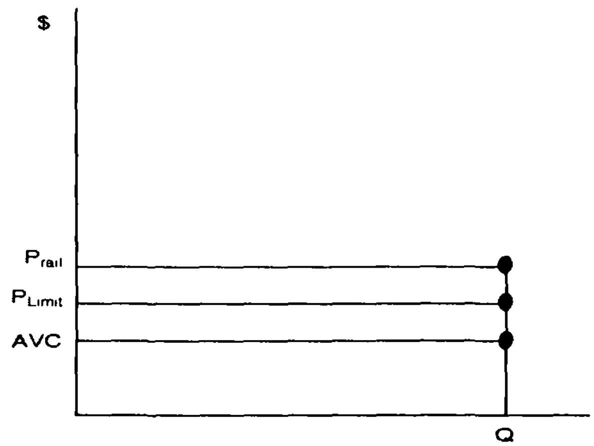
The Limit Price Test Uses Incomplete Market Information and Information Irrelevant to the Existence of Competition

The fundamental flaws in the proposed limit price test are that it seeks to make "objective" determinations about the effectiveness of competition on the basis of: (i) incomplete market information; and (ii) information that has nothing to do with the available market information. These flaws cause the limit price methodology to be an inaccurate and unreliable test.

The limit price methodology derives a preliminary conclusion of market dominance from a comparison of the limit price R/VC with the defendant carrier's RSAM figure. But the RSAM figure does not contain—and is not intended to contain—*any* market-specific information. On the contrary, RSAM is designed to measure "the average markup that [a carrier] would need to collect from all of its potentially captive traffic to earn a return on investment equal to the cost of capital." (*Id.*, p. 4) This average markup (*i.e.*, R/VC ratio) is based on all of a carrier's traffic that generates an R/VC in excess of 180%. In attaining this average R/VC (or any average R/VC for that matter), the R/VC ratios of some traffic will fall above the average and the R/VC ratios for other traffic will fall below the average. The RSAM ratio is a system-wide average R/VC goal for all movements generating ratios greater than 180%, which does not incorporate any information about the competitive dynamics of any particular market. Nonetheless, the Board's proposed approach would use the RSAM figure as the determinant of whether a particular limit price R/VC for an individual movement in a specific transportation market indicates effective competition. As discussed, however, the RSAM figure provides no movement-specific information about the relevant market or competition in that market. Furthermore, specific market information that is available—namely, the price charged by the railroad—is not used in the Board's proposed test.

Figure 1 illustrates the disconnect between the Board's proposed test and actual specific market information. The available market information consists of: (1) the price the railroad is charging (P_{Rail}); (2) the quantity of services the railroad is providing (Q); (3) the railroad's variable costs for providing the service (AVC); and (4) the price of a selected competitive alternative to the railroad's service (*i.e.*, the limit price) (P_{Limit}).

FIGURE 1



The one data point in Figure 1 that directly reflects information about demand is the intersection of Q and P_{Rail}. But that market information plays no role in the Board's proposed limit price analysis. Instead, the only market information the Board would use in the proposed limit pricing test is P_{Limit} and AVC. The determination of P_{Limit} does not depend on P_{Rail}, and, as a result, the most direct actual information from the market is discarded and not considered in the establishment of the preliminary conclusion regarding market dominance.

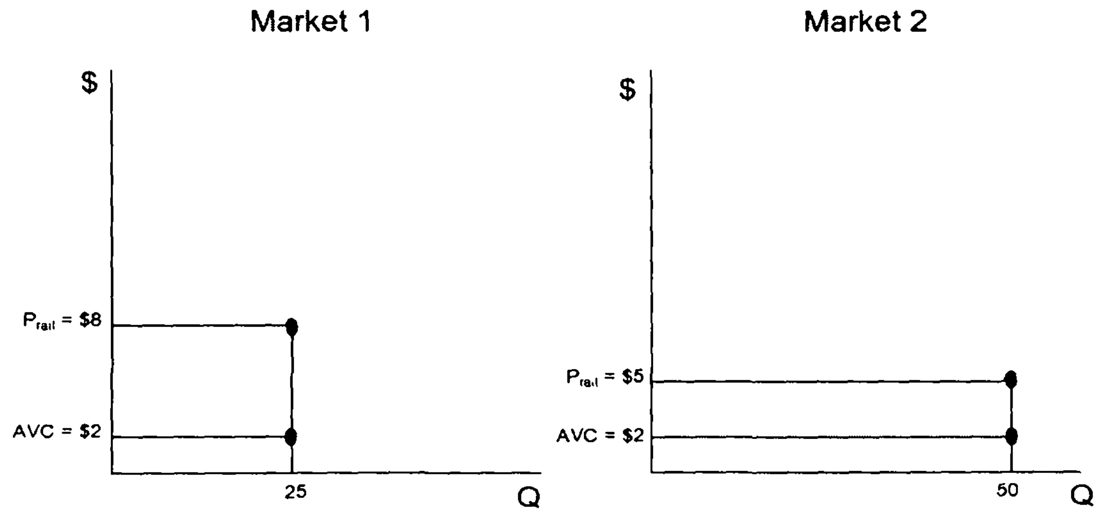
Moreover, RSAM does not appear in Figure 1 at all because the RSAM measure does not include any information from the particular market under analysis. Nor does the RSAM measure contain any information about the railroad's aggregate demand. The information contained in RSAM is disconnected from any specific market and void of any demand content, and therefore has no bearing as to whether a rail price in a specific "captive market" is effectively constrained by competition.

The Proposed Market Screen Does Not Distinguish Between Different Market Situations

Because it is completely disconnected from one of the most important indicia of competition – the relationship between the price charged by the railroad and the price charged by a transportation alternative—the proposed limit price test does not reliably assess market dynamics bearing on the question of market dominance. Indeed, the limit price test would conclude that "market dominance" exists in many situations where the railroad charges prices below its competition, and it would conclude that the railroad was not market dominant in many situations where the railroad was charging substantially more than its competition.

The disconnect between the proposed limit price test for market dominance and the underlying market conditions is illustrated by the simplified example depicted in Figure 2. In this example, it is assumed that a railroad operates in only two "captive markets" and needs to recover from these two markets $300 in revenue shortfall. The railroad sells 25 units of its services at $8 per unit in Market 1 and 50 units at $5 per unit in Market 2. The average variable cost is $2 per unit in both markets. The resulting total revenues of $450 across both markets exceed the $150 of variable costs across both markets by exactly the $300 needed to cover the revenue shortfall. Thus, the RSAM measure in this example is 300% (= $450/$150). Now, consider two cases.

FIGURE 2



First, let us assume that the price of the alternative to the railroad's service in both markets is $5. If the limit price is $5, then the limit price R/VC for both markets is 250% ($125/$50 and $250/$100), which is less than the railroad's RSAM of 300%. Thus, in this scenario the proposed test reaches the preliminary conclusion that the railroad is not market dominant in either market, despite the fact that in Market 1 the railroad's price is considerably more than the limit price.

Second, let us assume that the price of the alternative is $8. If the limit price were $8 in each market, the limit price R/VC would be 400% in both markets ($200/$50 and $400/$100), which is greater than the railroad's RSAM of 300%. The preliminary conclusion of the limit price test would be that the railroad is not effectively price constrained in either market. Thus, the fact that a railroad was offering prices equivalent to the price of the competitive alternative (in Market 1) and significantly lower than the price of the competitive alternative (in Market 2) would be irrelevant to the market dominance inquiry. All that matters for the limit price test is how the limit price R/VC compares to RSAM. As shown in this case, a property of the proposed limit price test is that a railroad reacting to potential competition by lowering price to match or beat a competitor's price does not influence the determination of whether there was an effective price constraint in the market, regardless of the amounts by which the railroad reduced its prices.

This example shows crucial market information, namely the difference between the rail price and the price of the transportation alternative, is not considered by the limit price test and how this can lead to incorrect conclusions regarding market dominance. The only information considered by the Board's proposed test is the estimated R/VC of an alternative transportation option and the average markup a carrier would have to earn across all of its captive traffic in order to earn its cost of capital. Under the proposed test, the limit price R/VC would be the only determinative variable in each of the markets to which the test is applied, despite the fact that markets may be very different with respect to the extent of price competition and characteristics of customers' demand. This is the necessary result of predicating market dominance conclusions on comparisons of prices which are not charged by the railroad to an RSAM figure that has no relationship to conditions in the market(s) in question.

Using RSAM to Determine Market Dominance is Arbitrary and Unrelated to the Actual Market Situation

Regardless of whether the Board were to use the limit price R/VC or the rail movement's R/VC, comparison of either of these ratios to RSAM does not provide an appropriate or meaningful test of whether the carrier has market dominance over specific rail movements. Comparing the limit price R/VC to a carrier's RSAM figure indicates whether pricing at the limit price in a particular market would result in a markup above or below the average needed by the railroad on all traffic over 180% R/VC to earn its cost of capital. This comparison sheds no light on the extent to which the railroad is constrained in its pricing decision in that market.

Because differential pricing is a key feature of railroad economics and constrained market pricing, there will be a distribution of R/VCs across markets. Likewise, there will be a distribution of limit price R/VCs across markets. Consequently, as a matter of arithmetic, there will be many markets whose transportation alternatives generate R/VCs above the relevant RSAM and many that generate R/VCs below RSAM.

Consider the extreme case where all markets were effectively price constrained by competitive alternatives. The proposed limit price market dominance test would falsely flag a number of the markets as having ineffective price restraint. Now consider the other extreme where all of a railroad's "captive markets" were pure monopolies. In this case the proposed test would erroneously conclude that a number of those markets were effectively price constrained. Thus, as a matter of arithmetic, the proposed test is prone to produce numerous "false positive" (*i.e.*, finding market dominance where there is none) and "false negative" (*i.e.*, finding no market dominance where it does exist) conclusions. In short, the test would be unreliable.

In sum, the Board's proposed test would not provide a meaningful or reliable measure of market dominance in a specific transportation market. The limit price measure would not identify a competitive constraint on railroad pricing and the railroad's system-wide average RSAM figure does not provide any market-specific information that would provide insight into the distribution of rates (and R/VC ratios) around this average. Thus, a comparison of the limit price R/VC ratio to the railroad's most recent RSAM would fail to provide relevant and reliable information about whether the railroad has market dominance in particular cases. The test does not provide a meaningful screen for determining market dominance or any reliable basis for establishing a "preliminary conclusion" regarding market dominance. Furthermore, we do not believe the subsequent consideration of intangible qualities resolves this problem. In short, the proposed methodology is an arbitrary standard that adds complexity and unreliability to the process of determining market dominance.

IV. The Proposed Methodology Does Not Overcome the Acknowledged Weakness of R/VC Ratio As An Indicator of Market Power Abuse.

The Board acknowledges Christensen Associates' assessment of the relative weakness of the R/VC ratio as an indicator of market power abuse, (*Id.*, p. 16, footnote 46) but opines that its limit price R/VC ratio may not suffer from the same infirmities as the actual R/VC ratio (*Id.*, p. 17).[2] However, our main indictment of the R/VC ratio as an indicator of shipper captivity was not the measure of revenue in the numerator, but the inability of the URCS-based VC measure in the denominator to accurately measure shipment-level variable costs:

> [C]aptivity measures based on categorizing shipment-level R/VC (or markup) data are dependent on the alignment of actual and measured costs in the tails of the R/VC distribution. Our analysis suggests that URCS costs have limitations in adequately reflecting shipment-level, cost-causing factors.[3]

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[2] Also see p. 16, footnote 43: "the limit price R/VC ratio differs from the typical R/VC ratio in that the former utilizes the postulated limit price in the numerator while the latter utilizes the actual revenue generated by a particular traffic rate in the numerator."

[3] Christensen Associates, A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals that Might Enhance Competition—Revised Final Report, November 2009, p. 22-21, footnote 30.

Thus, even if the limit price for a particular shipment is accurately calculated, the limit price R/VC ratio is not likely to be a reliable measure of the true limit price to the true variable cost for that shipment.

V. The Proposed Methodology is Unlikely to Simplify the Accurate Determination of Market Dominance

The Board distinguishes two phases of the qualitative determination of market dominance: whether a transportation alternative is practically feasible; and whether a practically feasible alternative is effectively constraining the rate at issue (September 27 Decision, p. 3, footnote 5). In our opinion, many of the factors that have typically been considered in the qualitative determination of market dominance would still need to be considered under the proposed methodology. For example, to determine whether feasible transportation alternatives exist, much of the same kinds of analyses employed under the current framework will still presumably need to be performed. Then, once the limit price R/VC ratio is compared to RSAM to arrive at a *preliminary* conclusion of whether the feasible alternative(s) effectively constrain railroad pricing, the Board indicates that it will consider "intangible qualities" (which are either "certain unquantifiable benefits" or "certain unquantifiable costs") before arriving at a final determination of market dominance.

In this regard, the Board notes that the proposed methodology "encompasses the same factors described by the market dominance guidelines originally set forth in Market Dominance Determination & Consideration of Product Competition ..." (*Id.*, pp. 14-15) If the Board were to conduct a thorough review of these same factors, this step alone would require it to undertake essentially the same qualitative market dominance analysis it conducts under the existing, established approach. Thus, the proposed methodology simply adds extra layers to an already complicated procedure and offers no procedural cost or time savings.

VI. Conclusion

In our opinion, the Board's proposed methodology outlined in its September 27 Decision is neither an objective nor a reliable indicator of market dominance. The proper determination of market dominance is typically a fact-intensive exercise. Attempting to transform the qualitative market dominance determination into a quantitative exercise does not provide the degree of economic analysis required in such a determination or the necessary degree of economic certainty in the results. The proposed method conveys a false sense of precision where none exists and is likely to render a high proportion of "false positives" (*i.e.*, finding market dominance where none exists) and "false negatives" (*i.e.*, finding no market dominance where it does exist). Moreover, because many of the factors that have gone into the determination of market dominance would still presumably need to be considered under the proposed procedure, it does not offer a simpler or quicker determination of market dominance, but rather simply adds more layers to the process.

Appendix

Biographies of B. Kelly Eakin and Mark E. Meitzen

B. Kelly Eakin is Senior Vice President at Christensen Associates. Dr. Eakin is an expert in industrial organization, specializing in the economic analysis of competitive and regulated markets. He served as project manager and was a principal author of the November 2008 and the January 2010 Christensen Associates' studies of the U.S. freight railroad industry commissioned by the Surface Transportation Board. He has also provided written evidence in other proceedings before the Surface Transportation Board, and provided written and oral testimony in regulatory hearings before the Postal Rate Commission. In addition, Dr. Eakin manages the energy practice at Christensen Associates Energy Consulting, LLC. a wholly owned subsidiary of Christensen Associates. Prior to joining Christensen Associates in 1994, Dr. Eakin worked for the U.S. Department of Agriculture from 1992 to 1994. From 1985 to 1992, he was an assistant professor of economics at the University of Oregon where he taught graduate courses in cost and production theory, industrial organization, regulation, and productivity measurement. Dr. Eakin's scholarly work has been published in a number of prestigious journals including *The Review of Economics and Statistics*, *Journal of Human Resources*, *Regulation*, and *The Southern Economic Journal*. He has also co-edited two books, *Pricing in Competitive Electricity Markets* and *Electricity Pricing in Transition*. Dr. Eakin has a B.A. in history from the University of Texas at Austin and a Ph.D. in economics from the University of North Carolina at Chapel Hill.

Mark E. Meitzen is a Vice President at Christensen Associates, where he has been employed since 1990. Dr. Meitzen was a principal author of the November 2008 and the January 2010 Christensen Associates' studies of the U.S. freight railroad industry commissioned by the Surface Transportation Board. He was also the project manager and one of the principal authors of the supplemental report to the STB on railroad capacity and investment issues. Dr. Meitzen was the principal investigator on the Transportation Research Board project, *Preserving and Protecting Freight Infrastructure and Routes* (NCFRP 24). Dr. Meitzen has expertise in the economic analysis of network industries including telecommunications, railroad, electricity and postal. In addition to the recent STB study, his work in the railroad industry includes analysis of railroad mergers and application of the STB's Constrained Market Pricing standards, including its Stand Alone Cost methodology. Dr. Meitzen also serves as an economic expert in regulatory proceedings on incentive regulation, pricing and economic costing matters. He also has experience in civil litigation matters as an expert witness on antitrust, intellectual property and employment issues. Prior to joining Christensen Associates, Dr. Meitzen was a regulatory economist at Southwestern Bell Telephone Company, and was an assistant professor of economics at Eastern Michigan University and the University of Wisconsin-Milwaukee. Dr. Meitzen has a Ph.D. in economics from the University of Wisconsin-Madison.

VERIFICATION

I, Mark E. Meitzen, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on this 15th day of November, 2012.

Mark E. Meitzen

VERIFICATION

I, B. Kelly Eakin, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on this 15th day of November, 2012.

B. Kelly Eakin

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