ASSOCIATION OF
AMERICAN RAILROADS

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Ms. Cynthia T. Brown
Chief, Section of Administration
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423

Re: STB Docket No. 42121, *Total Petrochemicals & Refining USA, Inc. v. CSX Transportation, Inc.*

Dear Ms. Brown:

Please find attached the *amicus curiae* Comments of the Association of American Railroads for filing in the above proceeding. A petition to intervene is being filed simultaneously with these comments.

Respectfully submitted,

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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Docket No. 42121

TOTAL PETROCHEMICALS & REFINING USA, LLC

v.

CSX TRANSPORTATION, INC.

AMICUS CURIAE COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS

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TOTAL PETROCHEMICALS & REFINING USA, LLC

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AMICUS CURIAE COMMENTS OF THE
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On May 31, 2013, the Surface Transportation Board ("Board") issued a decision in this proceeding applying the new "limit price rule" for qualitative market dominance first applied in *M&G Polymers USA, LLC v. CSX Transp., Inc.*, NOR 42123 (STB served Sept. 27, 2012) (*M&G*). The parties to the proceeding, CSX Transportation, Inc. ("CSX") and Total Petrochemicals & Refining USA, LLC ("TPI") filed petitions for reconsideration of the May 31 decision on June 20, 2013. The Association of American Railroads ("AAR") hereby submits these *amicus curiae* comments in support of CSX's petition for reconsideration.[1]

The AAR is a trade association whose membership includes freight railroads that operate 82 percent of the line-haul mileage, employ 95 percent of the workers, and account for 97 percent of the freight revenues of all railroads in the United States. The AAR and its freight railroad members have a strong interest in ensuring that the Board adheres to the Interstate

[1] A petition to intervene under 49 C.F.R. § 1112.4 has been filed simultaneously with these comments. The AAR's comments focus solely on the legal and policy implications of the limit price rule. The AAR takes no position on the application of the rule to this dispute and will not address the specific rates at issue in the underlying complaint.

Commerce Act's mandate that it exert its rate reasonableness jurisdiction only in cases where the rail carrier truly possesses market dominance.

For the reasons discussed below, the AAR respectfully submits that applying the limit price rule to this adjudication without conducting a notice-and-comment rulemaking violates the Administrative Procedure Act ("APA"). Moreover, the limit price rule applied in this proceeding violates 49 U.S.C. § 10707(d)(2). Finally, the application of the limit price rule rests on a number of faulty assumptions that are not supported by law or sound economics. In short, the application of revenue to variable cost ratios ("R/VC") and the Revenue Shortfall Allocation Method ("RSAM") at the core of the rule does not reveal anything about the existence and extent of feasible transportation alternatives for the movement of a specific commodity in a specific lane and therefore R/VC ratios cannot shoulder the weight placed on them by the Board in the limit price test.

Discussion

I. The Use Of The Limit Price Rule In An Adjudication Without Notice And Comment Violates The APA

A. A rule adopted by notice and comment rulemaking can only be amended through notice and comment procedures

The APA requires that agencies follow certain specified procedures related to their rules. 5 U.S.C. § 553. When an agency engages in rule making proceedings, the agency must: (1) publish a general notice of proposed rulemaking in the Federal Register that includes "the terms or substance of the proposed rule or a description of the subjects and issues involved"; (2) give "interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments"; and (3) "[a]fter consideration of the relevant matter presented . . . incorporate in the rules adopted a concise general statement of their basis and purpose." 5 U.S.C. § 553(b), (c).

As noted recently by the U.S. Court of Appeals for the Fourth Circuit,

> The important purposes of this notice and comment procedure cannot be overstated. The agency benefits from the experience and input of comments by the public, which help "ensure informed agency decisionmaking." *Spartan Radiocasting Co. v. FCC*, 619 F.2d 314, 321 (4th Cir. 1980). The notice and comment procedure also is designed to encourage public participation in the administrative process. *See Chocolate Mfrs. Ass'n v. Block*, 755 F.2d 1098, 1103 (4th Cir. 1985). Additionally, the process helps ensure "that the agency maintains a flexible and open-minded attitude towards its own rules," *id.* (citation omitted), because the opportunity to comment "must be a meaningful opportunity," *Prometheus Radio Project v. FCC*, 652 F.3d 431, 450 (3d Cir. 2011) (citation omitted).

North Carolina Growers Ass'n v. United Farm Workers, No. 11-2235, slip op. at 13 (4th Cir. Dec. 21, 2012). Reviewing courts are charged with ensuring that agencies comply with the procedural requirements of the APA,[2] in addition to overturning actions that are arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. 5 U.S.C. § 706(2). The courts "must be strict in reviewing an agency's compliance with procedural rules." *Chocolate Mfrs. Ass'n*, 755 F.2d at 1103 (quoting *BASF Wyandotte Corp. v. Costle*, 598 F.2d 637, 641 (1st Cir. 1979)).

Under these APA procedures, the Board cannot change its well-established approach to qualitative market dominance adopted by notice and comment rulemaking through a subsequent adjudicatory decision. *See, e.g., Comcast Cable Communications v. FCC*, No. 12-337 (D.C. Cir. May 28, 2013) (Edwards, concurring). By notice and comment rulemaking, the agency has interpreted 49 U.S.C. § 10707 to require a two-step inquiry to determine whether a rail carrier possesses market dominance over traffic to which a rate applies for the purpose of establishing whether the agency has jurisdiction to determine the reasonableness of that rate. *Market Dominance Determinations*, 365 I.C.C. 118 (1981). The Board first examines quantitative

[2] *Chrysler Corp. v. Brown*, 441 U.S. 281, 313 (1979).

market dominance under 49 U.S.C. § 10707(d)(1) to see if the challenged rates generate revenues that exceed the traffic's variable cost by 180% or more, using the unadjusted system average variable costs established by the Uniform Railroad Costing System ("URCS"). *See Major Issues in Rail Rates*, EP 657 (Sub-No. 1) (STB served Oct. 30, 2006) ("*Major Issues*"); 49 U.S.C. § 10707(d)(1). Second, the Board examines qualitative market dominance under 49 U.S.C. § 10707(d)(2) by considering whether any feasible transportation alternatives exist that constrain the rail carrier's pricing. *See, e.g., E.I. du Pont de Nemours & Co. v. CSX Transp., Inc.*, NOR 42100, slip op. at 2-3 (STB served June 30, 2008). In the *Market Dominance Determinations* rulemaking proceeding, the agency defined this qualitative investigation as "one based on a variety of qualitative and quantitative evidence separate from the price/cost jurisdictional threshold and not dependent on predetermined statistical measures." *Market Dominance Determinations*, 365 I.C.C. at 119 & n.5.

B. The limit price rule amends the rules adopted by notice and comment procedures in market dominance determinations

The limit price rule applied in *M&G* and in this case reverses these rules and adopts a presumption of market dominance based on a predetermined statistical measure – an R/VC ratio formula – radically redefining the substance of the qualitative market dominance rule. Such a change to a substantive, legislative rule can only be pursued via a notice-and-comment rulemaking proceeding. *See Broadgate Inc. v. U.S. Citizenship and Immigration Services*, 730 F. Supp. 2d 240, 244 (D.D.C. 2010) ("[An]agency's intent to exercise legislative power may be shown where the second rule effectively amends the previously adopted legislative rule, either by repudiating it or by virtue of the two rules' irreconcilability."). When the Board previously has modified its rules for qualitative market dominance established in *Market Dominance Determination*, it did so by a notice-and-comment rulemaking. *See Product and Geographic Competition*, 2 I.C.C.2d 1(1985); *Market Dominance Determinations – Product and Geographic*

Competition, 3 S.T.B. 937 (1998). An agency's attempts "to comply with APA notice-and comment procedures suggest that the agency believed them to be applicable," and support the conclusion that "those procedures were applicable." *North Carolina Growers Ass'n* (quoting *Manufactured Housing Inst. v. EPA*, 467 F.3d 391, 299 (4th Cir. 2006)).

Faced with these facts and governing law, the May 31 decision attempts to skirt the issue by claiming that the limit price rule is "not a departure from [the Board's] rules."[3] But an agency may not circumvent the APA by characterizing its reversal of position in an adjudication as a "refinement." *See Marseilles Land and Water Co. v. FERC*, 345 F.3d 916, 920 (D.C. Cir. 2003) (holding that "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"). When an agency has given its regulation a definitive interpretation, and later significantly revises that interpretation, the agency has in effect amended its rule, something it may not accomplish without notice and comment. *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); *Syncor Int'l Corp. v. Shalala*, 127 F.3d 90, 94-95 (D.C. Cir. 1997); *Alaska Professional Hunters Association, Inc. v. FAA*, 177 F.3d 1030, 1033-34 (D.C. Cir. 1999). Moreover, "[o]nce an agency gives its regulation an interpretation, it can only change that interpretation as it would formally modify the regulation itself: through the process of notice and comment rulemaking." *Paralyzed Veterans of America v. D.C. Arena*, 117 F.3d 579, 586 (D.C. Cir. 1997); *see also SBC Inc. v. FCC*, 414 F.3d 486, 498 (3d Cir. 2005) ("[I]f an agency's present interpretation of a regulation is a fundamental modification of a previous interpretation, the modification can only be made in

[3] May 31 decision at 22.

accordance with the notice and comment requirements of the APA."); *Shell Offshore Inc. v. Babbitt*, 238 F.3d 622, 629 (5th Cir. 2001) ("[T]he APA requires an agency to provide an opportunity for notice and comment before substantially altering a well-established regulatory interpretation.").

The limit price rule is a substantive departure from the rule adopted by notice and comment. The approach to qualitative market dominance adopted in *Market Dominance Determinations* eliminated the use of rebuttable presumptions based on quantitative measures to adhere to the requirements of the then recently passed Staggers Act. *Market Dominance Determinations,* 356 I.C.C. at 120 (stating "the 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"). In the place of the presumptions, the ICC adopted a procedure of reviewing the totality of evidence submitted in rate cases of intramodal, intermodal, product and geographic competition.[4] The limit price rule reverses that position and establishes a rebuttable presumption based on a calculation of the limit price R/VC ratio. The Board's description of the presumption as a "preliminary conclusion" that can be rebutted by a showing of intangible factors simply defines what it means to be a "rebuttal presumption."[5]

Though the March 31 decision states that the new approach does not eliminate any factor previously considered through its evaluation of the feasibility of alternatives and other intangible features, the Board cannot dispute that its new rule reinstates the central role of a rebuttable

[4] The agency subsequently determined that it could not efficiently evaluate product and geographic competition evidence. *See Market Dominance Determinations – Product and Geographic Competition,* 3 S.T.B. 937 (1998).

[5] Black's Law Dictionary 1185 (a presumption is "a rule of law . . . by which finding of basic fact gives rise to existence of presumed fact, until presumption is rebutted").

presumption based on a predetermined statistical measure in its qualitative market dominance analysis. The centrality of the R/VC ratio to the Board's ultimate conclusions regarding market dominance is evidenced by the Board employing the "significant disparity between the lowest limit price R/VC ratio and the carrier's RSAM figure" as justification to ignore intangible benefits of alternatives. *See, e.g., M&G* at 39, 46.

The March 31 decision's claim that the limit price rule is not a departure from previous interpretations of the Board's regulation is contradicted by other statements in the decision. The very reason the Board gives for introducing the limit price rule in the first place is that the flexible evidentiary guidelines that examine the totality of the competitive market for the traffic at issue adopted in *Market Dominance Determinations* are no longer practicable, in the Board's view, because of escalating complexity in rate reasonableness cases.[6] The Board cannot maintain that the limit price rule transforms the qualitative market dominance determination from a subjective inquiry into one that is "objective"[7] and from one that is complicated into a more "practical"[8] inquiry while also claiming that the rule is not a departure from the previous rule."[9]

C. Limited public comment in another adjudication did not remedy the APA defects in this proceeding

Simply because the Board took a single round of *amicus curiae* comments in *M&G* did not transform that proceeding into a rulemaking and cure the APA defects. *See General American Transp. Corp. v. ICC*, 872 F.2d 1048, 1060 (D.C. Cir. 1989) (finding no authority "for [the] theory that an adjudication is converted into a rulemaking solely because an agency solicits

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[6] May 31 decision at 3-4.

[7] *Id.* at 5.

[8] *Id.*

[9] *Id.* at 22.

and entertains the comments of those who have an interest in prospective application of the principle under study"). The violation of the APA cannot be ignored because the Board took comments in separate adjudication that settled before the Board issued a final decision that could be appealed. The prohibition against amending rules through adjudication is grounded, in part, in principles of due process, that an agency cannot change its interpretation of a regulation so as to cause "unfair surprise" to regulated parties. *Christopher v. SmithKline Beecham Corp.*, 132 S. Ct. 2156, 2167 (2012); *see also FCC v. Fox Television Stations, Inc.*, 132 S. Ct. 2307, 2317 (2012). In the May 31 decision, the Board only generally characterized the comments received in *M&G* and responded to its characterization of the broad contours of the arguments presented. More importantly, the decision in *M&G* and the subsequent critical public comments filed by shippers and railroads were not filed until after the market dominance record was closed in this proceeding. Not only did the Board's actions foreclose evidence and arguments by the parties to this proceeding, but other parties with interest in the limit price rule were never afforded an opportunity to respond to the comments filed or offer alternatives to address the Board's concerns.

II. The Limit Price Rule Establishes Presumptions Of Market Dominance Based On R/VC Ratios Contrary To 49 U.S.C. § 10707(d)(2)

Congress and the ICC have previously concluded that rail carriers should not be presumed to possess market dominance based on R/VC ratios. The May 31 decision that applied a presumption of market dominance based on such a quantitative analysis of a limit price R/VC ratio violated 49 U.S.C. § 10707(d)(2) and reflects a flawed formulaic approach to market dominance rejected by the Staggers Act and the ICC. Section 10707(d)(2) states that the Board cannot presume that a rail carrier possesses market dominance because the rate it charges generates an R/VC ratio that is greater than or equal to 180% of its variable costs. This reflects the Congressional intent that the agency engage in a qualitative examination of market dominance separate and apart from the quantitative examination of the R/VC ratio required by 49 U.S.C. § 10707(d)(1).

Indeed, the agency has long recognized that the Interstate Commerce Act, as amended, precludes a finding of market dominance if the challenged rate generates an R/VC ratio of less than 180% and it otherwise requires a qualitative analysis of whether or not traffic with a higher R/VC ratio is subject to effective competition. *See, e.g., Market Dominance Determinations*, 365 I.C.C. at 119. The limit price rule's presumption of market dominance based on a quantitative R/VC measure would defeat Congress's intent that the agency look at all of the circumstances regarding a movement of rail traffic to determine whether there is effective competition for the traffic.[10] That determination stems from the fact that an analysis of markup over variable cost, particularly in an industry with large fixed costs such as the railroad industry, reveals little about market power.[11] Railroads, like other businesses, price their services according to market realities, not regulatory determinations of cost,[12] and if railroads are to have any hope of recovering their total costs, including a reasonable return on their investment, some rates will reflect substantial mark-ups over variable costs.

Though the May 31 decision asserts without explanation that "the costs of transportation are undeniably relevant to the qualitative market dominance inquiry,"[13] the agency has long

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[10] *See* H.R. Conf. Rep. 96-1430, at 88 (1980). While the limit price rule includes an analysis of whether an alternative is physically feasible, it ignores the behavior of actual market participants it considering whether those alternatives provide effective competition.

[11] *See* Kenneth Elzing & David Mills, *The Lerner Index of Monopoly Power: Origins and Uses*, AMERICAN ECONOMIC REVIEW: PAPERS AND PROCEEDINGS, Vol. 101 Number 3 (May 2011) at 559; *see also* Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, 2010, at 4 & n.3 ("Products involving substantial fixed costs typically will be developed only if suppliers expect there to be enough differentiation to support margins sufficient to cover those fixed costs. High margins can be consistent with incumbent firms earning competitive returns.").

[12] *See, e.g., Amicus Curiae* Comments of BNSF Railway, NOR 42123 (filed November 28, 2012).

[13] May 31 decision at 25.

recognized that R/VC ratios reveal little about market power. In 1981, the ICC rejected R/VC ratios as indicative of qualitative market dominance, *Market Dominance Determinations*, 365 I.C.C. at 122, and since then the Board has consistently ruled that a high R/VC ratio is not a reliable indicator of market power.[14] Moreover, as cited by the Board, independent economists recognize the limited usefulness of R/VC ratios for determinations of qualitative market dominance:

> The weak relationships between R/VC ratios and market structure factors illustrated in Table ES-4 imply that correctly assessing the presence of market-dominant behavior requires direct assessment of relevant market structure factors. Thus, regulatory reforms that would establish R/VC rules as the sole quantitative indicator of a railroad's market dominance are not appropriate.

Laurits R. Christensen Associates, Inc., *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals That Might Enhance Competition—Revised Final Report* at ES-14 (Nov. 2009).

The AAR cited one weakness of such an R/VC approach to qualitative market dominance in its *amicus* comments filed in *M&G*: a reliance on system-average variable costs established by the Uniform Railroad Costing System ("URCS") without recognition of the unique characteristics of the move to determine the state of competition for a particular movement of rail traffic.[15] The discussion in the May 31 decision mischaracterized the AAR's concern regarding the use of URCS in this manner.[16] Rather than criticizing URCS, the AAR expressed

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[14] *See, e.g., Potomac Elec. Power Co. v. CSX Transp., Inc.*, 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 a basis for qualitative market dominance determinations."); *Market Dominance Determinations*, 365 I.C.C. at 122 (questioning whether actual R/VC ratios "reliably indicate the presence or absence of market dominance" because 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").

[15] AAR *Amicus Curiae* Comments, NOR 42123 (filed Nov. 28, 2012) at 9.

[16] May decision at 25.

concern that any system-average costing effort will be inaccurate to some degree[17] and that, to the extent such a calculation is relevant to determining market dominance at all, other, qualitative methods of evaluating competition for particular traffic must be utilized to satisfy 49 U.S.C. § 10707(d)(2).

The May 31 decision restates the Board's belief expressed in *M&G* that a limit price rule comparing the price of the *alternative form* of transportation, rather than the challenged rate, to the variable costs of the defendant carrier somehow "does not implicate § 10707(d)(2)'s statutory directive or the concerns previously expressed by the Board."[18] But the very nature of the limit price rule implicates all of the Congressional concerns stated above. Simply stated, the limit price rule purports to examine the highest R/VC ratio the carrier could charge without losing the traffic. If that R/VC, in the Board's subjective view, is too high (i.e., if it is higher than RSAM), the limit price rule presumes market dominance. That is, the Board is establishing a presumption of market dominance based on its evaluation of the highest R/VC the railroad could charge without losing a significant amount of traffic.[19] This is the same fundamental determination prohibited by 49 U.S.C. § 10707(d)(2).

Moreover, the May 31 decision's attempts to interpret the statute in such a way as to allow a presumption based on an R/VC ratio fails to adhere to traditional rules of statutory interpretation. Reducing section 10707(d)(2) to a mirror of 49 U.S.C. § 10707(d)(1)(A), claiming that "the statute simply prohibits [the Board] from using 180% as the demarcation point for market dominance purposes," would effectively read section 10707(d)(2) out of the statute. Section 10707(d)(1)(A) already provides that demarcation line. Section 10707(d)(2) must be

[17] *See* CSX Petition for Reconsideration, Exh. 3, Eakin & Metitzen V.S. at 11-12.

[18] May 31 decision at 24.

[19] *Id.* at 3, 17.

read as something more than a superfluous repetition of Section 10707(d)(1)(A). *See Duncan v. Walker*, 533 U. S. 167, 174 (2001); *see also United States v. Menasche*, 348 U. S. 528, 538-39 (1955) ("It is our duty 'to give effect, if possible, to every clause and word of a statute.'") (quoting *Montclair v. Ramsdell*, 107 U. S. 147, 152 (1883)). Section 10707(d)(2) unambiguously tells the Board that it cannot presume market dominance from a high R/VC ratio.[20]

III. The Limit Price Rule Rests On A Number Of Faulty Assumptions That Are Not Supported By Law Or Sound Economics

The fundamental premise of the limit price rule is that it is possible to determine whether feasible transportation alternatives "effectively" constrain railroad pricing by looking at the "limit price" or "the highest price [the railroad] theoretically could charge . . . without causing a significant amount of issue traffic on a particular rail movement to flee to a particular competitive alternative."[21] But there is no basis for assuming that the limit price determined using the methodology set out in the May 31 decision identifies the highest price a railroad could charge without causing a diversion of traffic. The actual point at which a railroad's traffic would divert to a competitive alternative could only be determined by examining actual market conditions. For example, if a railroad's price is significantly below the "limit price" identified by the Board, the actual price at which diversion of traffic might occur could be well below the "limit price" identified by the Board. Determining the price at which significant amounts of traffic would switch to an alternate form of transportation requires an analysis of actual railroad

[20] *See* 49 U.S.C. § 10707(d)(2) (prohibiting a presumption of market dominance based on an R/VC ratio "equal to _or greater than_ 180 percent")(emphasis added).

[21] May 31 decision at 4.

pricing over the lane in question. Because it is focused on hypothetical limit prices rather than actual rates, the Board's reliance upon its limit price assumption is flawed.

Use of a hypothetical limit price R/VC ratio based on the price of alternative transportation to determine market dominance ignores the most crucial data available to the Board for determining whether or not a rail carrier is exerting market power: the defendant railroad's rates and other potential competitive alternatives in the real world. Rather than examining real world behavior and real world rates charged by the defendant railroad, the focus of the Board's test is on the relationship of a hypothetical limit price to the railroad's revenue need. The fact that the limit price rule could presume a rail carrier to be market dominant even where the railroad has responded to potential competition by setting its prices near, at, or below a competitor's price illustrates that the Board's limit price rule is no substitute for analysis of competitive conduct.[22]

A. <u>RSAM does not indicate the presence of market power</u>

There is no rational basis in the record for the Board to conclude that a limit price R/VC ratio above RSAM demonstrates anything about whether there is effective competition for a particular movement of rail traffic. RSAM is defined as the measure of the average markup that a railroad would need to collect from all of its regulated traffic with R/VC ratios in excess of 180 to earn a return on investment equal to the railroad industry cost of capital. *Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1) (STB served Sept. 5, 2007).

There is no basis for the claim in the May 31 decision that a comparison of the limit price R/VC ratio to RSAM "provides the necessary objective guidance in gauging whether or not a

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[22] *See* CSX Petition for Reconsideration, Exh. 3, Eakin & Metitzen V.S. at 8-9.

particular feasible alternative is effectively constraining the railroad's pricing."[23] RSAM is not a measure of whether there is actual competition or how robust that competition is for any particular movement. The RSAM value for a carrier is unrelated to any specific market and does not incorporate any information on customer demand. It has not been shown to have any bearing on whether a rail price in a specific market is effectively constrained by competition.

As discussed above, a railroad's ability to price above variable cost does not directly correlate with whether or not competition is effective for particular movements. *See* CSXT Petition, Exh. 2, V.S. Meitzen & Eakin at 3-4; *id.*, V.S. Willig at 6-8. To the contrary, in a high fixed cost industry like the rail industry, railroads need to price above variable cost in order to recover those fixed costs. Even in competitive markets, rail traffic may have a relatively high R/VC to ensure recovery of large fixed and common costs if shipper demand factors, including the value of rail service to the shipper, warrant rates at such a level. Indeed, the RSAM represents the *average* markup necessary for a railroad to achieve revenue adequacy. Thus, the RSAM benchmark is based on a recognition that railroads must be able to charge relatively high R/VC rates – i.e., rates above the RSAM – to be financially viable in the long term. To presume that pricing above RSAM implies a lack of effective competition thus runs counter to the economics of the railroad industry and undermines the statutory objective of revenue adequacy. *See id.*, V.S. Willig at 8-10; *id.*, V.S. of Meitzen & Eakin at 4-5.

Further, RSAM reflects a particular carrier's revenue adequacy status in the Board's annual determination; thus, whether or not a particular movement of rail traffic was found to be facing effective competition would not be based on market conditions for a particular movement but rather on the average mark-up over variable cost that the railroad needed to charge to shippers with R/VC ratios over 180% in order to recover all of the railroad's costs, including its

[23] May 31 decision at 25.

cost of capital, during four earlier years.[24] That means that two rail carriers in identical situations could have different market dominance results based solely on their revenue adequacy determinations and RSAM calculations. And an individual carrier could be presumptively constrained in pricing one year and presumptively market dominant the next depending on the carrier's RSAM calculations, even if the cost of competitive alternatives and its variable cost for the move remained unchanged.

The May 31 decision does not even seek to address these and other arguments leveled against the use of RSAM in the market dominance determination by both railroads and shippers.[25] The chart on page 27 of May 31 Decision acknowledges that RSAM is not an objective bright line rule of effective competition and that, instead, the demarcation line between effective competition and the lack thereof, if it exists as an R/VC ratio at all, would actually fall somewhere in a "gray area" that the Board guesses would include RSAM somewhere near the middle. The fact that no party in *M&G* provided a workable alternative measure[26] to serve as a benchmark against which to compare a flawed limit price R/VC ratio does not in any way justify the Board applying an arbitrary formula that does not measure what it purports to measure in this proceeding.

B. <u>The limit price rule, if applied to other cases, will only complicate the market dominance inquiry</u>.

The largely irrelevant inquiry required by the limit price rule will only serve to complicate the market dominance process. Parties to future rate cases will still need to brief the issue whether there are feasible transportation alternatives. And because the formula the Board

[24] Due to the time lag in calculating the RSAM figure, the determination of the market dominance ofrates established now would depend on the RSAM figures calculated for the years 2008 through 2011.

[25] May 31 decision at 25-26.

[26] *Id.* at 26-28.

has adopted has so little to do with whether those alternatives exert competitive pressure on the railroad's pricing, there will be substantial dispute over intangible factors for specific lanes to avoid obviously absurd results. Thus, the limit price rule fails to meet the goal that the Board has articulated as the reason for adopting the limit price rule in the first place: providing a practical and workable method of evaluating market dominance.

The ICC has previously rejected a similar scheme to add a quantitative presumption to the qualitative market dominance determination. In *Product & Geographic Competition*, the ICC, rejected the use of the Herfindahl-Hirshman Index ("HHI") above a certain threshold as a rebuttable presumption of market dominance because it "would create a rebuttable presumption, and evidence of the four present forms of competition would still be admissible in rebuttal, the HHI would merely add an additional layer of required evidence, and thus could substantially lengthen the time it takes to resolve the issue of market dominance, and increase the expenses involved in the determination." 2 I.C.C.2d 1, 16 (1985).

Finally, by stating that "[i]n future cases, parties may advocate alternative benchmarks or methods for determining whether a particular feasible transportation alternatives provides effective competition,"[27] the Board further muddies the waters as to how the limit price rule will be applied in the future.

C. <u>The limit price rule does not "generally comport with accepted economic representations of market power such as the Lerner Index."</u>

Both *M&G* and the May 31 Decision seek to cloak the limit price rule with economic respectability by invoking the Lerner Index. *See* May 31 Decision at 23 n.72 ("the limit price rule generally comports with accepted economic representations of market power such as the Lerner Index"). The Lerner Index seeks to assess market power by measuring the percentage

[27] *Id.* at 26.

difference between the price of a product or service and the marginal cost of that product or service. While the limit price rule also divides a "limit price" by an average cost measure, any resemblance between the limit price rule and the Lerner Index is purely superficial. The limit price rule does not "generally comport" with the Lerner Index, for two reasons.

First, the inputs to the limit price rule do not match the inputs to the Lerner Index. The Lerner Index seeks to assess market power by examining the price that has actually been established by a firm based on market constraints. As explained by the expert economists who submitted testimony in support of CSXT's Petition, "because the limit price method does not use the railroad's rate, the limit price R/VC loses any theoretical connection to the Lerner Index." CSXT Petition, Exh. 2, V.S. Meitzen & Eakin at 6. Similarly, the Lerner Index considers actual marginal costs; the limit price rule, on the other hand, uses URCS system-average costs which are not reasonably indicative of a railroad's marginal costs for a given movement. *See id.* Accordingly, there is no theoretical connection between the limit price method and the Lerner Index.

Second, the limit price rule's reliance on a comparison to RSAM does not "comport" with the Lerner Index. While the Lerner Index focuses on the margin above variable costs, the RSAM is an R/VC ratio that looks in part at the revenues needed to cover fixed and common costs—not just marginal costs. *See* CSXT Petition, Exh. 2, V.S. Willig at 13-14. And while the Lerner Index focuses on a particular product or service, RSAM is an R/VC ratio that is calculated based on all traffic with an R/VC over 180%. *See id.* Moreover, comparing a hypothetical limit price R/VC to an RSAM in no way indicates the presence or absence of market power, as discussed above. In short, the limit price rule does not "comport" with the Lerner Index.

Conclusion

As discussed above, the limit price rule was applied in this proceeding in contravention of the APA; the Board's use of an approach to market dominance establishing a presumption based on R/VC ratios violates 49 U.S.C. § 10707(d)(2); and the limit price rule is based on assumptions that are not supported by law or sound economics. In light of the foregoing, the Board should grant CSX's motion for reconsideration.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I, Rosita M. N'Dikwe, hereby certify that on this 24th day of July 2013 I served by first-class mail, postage prepaid a copy of the Association of American Railroads' *amicus curiae* Comments in STB Docket No. 42121, *Total Petrochemicals & Refining USA, Inc. v. CSX Transportation, Inc.* on the parties of record at the addresses below:

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