

PUBLIC VERSION

BEFORE THE  
SURFACE TRANSPORTATION BOARD

_____	)	234566
TOTAL PETROCHEMICALS &	)	ENTERED
REFINING USA, INC.	)	Office of Proceedings
	)	July 24, 2013
Complainant,	)	Part of
	)	Public Record
v.	)	Docket No. NOR 42121
	)	
CSX TRANSPORTATION, INC.	)	
	)	
Defendant.	)	
_____	)	

REPLY TO PETITION FOR RECONSIDERATION OF  
CSX TRANSPORTATION, INC.

Jeffrey O. Moreno  
David E. Benz  
Thompson Hine LLP  
Suite 700  
1919 M Street N.W.  
Washington, D.C. 20036  
Phone: (202) 331-8800  
Fax: (202) 331-8330

*Attorneys for Total Petrochemicals &  
Refining USA, Inc.*

July 24, 2013

PUBLIC VERSION

Table of Contents

I. Preface and Summary of Argument..... i

II. The LPM Does Not Violate Governing Statutes..... 1

    A. The LPM is not barred by § 10707(d)(2). ..... 1

    B. The LPM is within the Board’s authority to determine market dominance..... 3

III. Notice and Comment Rulemaking Was Not Required for the LPM..... 4

    A. The LPM does not repudiate the existing market dominance guidelines..... 4

    B. The market dominance guidelines are not a legislative rule..... 6

    C. The LPM is not a legislative rule. .... 7

IV. The LPM Is Not Arbitrary or Capricious..... 8

    A. There is a rational connection between the LPM and the fact it presumes. .... 8

    B. CSXT’s Claim Of “No Meaningful Economic Content” Does Not Warrant Reconsideration Of The LPM..... 9

    C. CSXT’s fixation on “extreme hypotheticals” and “ridiculous” alternatives misses the point. .... 10

    D. The Board should reject CSXT’s contradictory positions. .... 12

    E. The LPM will simplify the market dominance inquiry..... 12

V. CSXT’s Other Arguments About the LPM Are Unpersuasive..... 14

    A. CSXT’s burden of proof argument is wrong..... 14

    B. It is irrelevant that the RSAM is different for each railroad..... 16

    C. Intangible features are not vague. .... 17

VI. {{ [REDACTED] }}..... 18

VII. Conclusion..... 20

## PUBLIC VERSION

### I. Preface and Summary of Argument.

Pursuant to 49 CFR § 1104.13(a), Total Petrochemicals & Refining USA, Inc. (“TPI”) responds to the Petition for Reconsideration (“Petition”) filed by CSX Transportation, Inc. (“CSXT”), on June 20, 2013, of the market dominance decision served by the Surface Transportation Board (“Board”) on May 31, 2013 (the “Decision”). CSXT alleges six material errors in the Decision. Five of the alleged errors pertain to the so-called “Limit Price Methodology” (“LPM”) used by the Board in the Decision. Those alleged errors mostly rehash arguments that the Board already has considered and rejected in the Decision. The sixth pertains to the Board’s reliance upon { [REDACTED] }. Congress has given the Board broad discretion to determine market dominance, and courts will afford particular deference to the Board’s decisions because market dominance is specifically within its expertise. CSXT has not alleged any errors in the Board’s exercise of its discretion.

A preliminary conclusion, such as that derived from the LPM, requires only that there be a rational connection between the fact proved and ultimate fact presumed, and that the inference of one fact from proof of another not be so unreasonable as to be purely arbitrary. See Part IV.A. It is rational for the Board to preliminarily conclude that, if matching the rail rate to the alternative rate produces a mark-up that is higher than the average mark-up required of all traffic over which the defendant may engage in differential pricing to achieve revenue adequacy, the alternative is not effectively constraining the rail rate. CSXT’s has not demonstrated otherwise.

First, CSXT wrongly asserts that the LPM violates a statutory prohibition, at 49 U.S.C. § 10707(d)(2), against using R/VC ratios to create a presumption of market dominance. See Part II. But this statute only refers to an R/VC ratio based upon the challenged rate, whereas the LPM employs a Limit Price (“LP”) R/VC ratio that is based on the price for alternative transportation. The rail R/VC and the LP R/VC are not the same, and CSXT’s attempt to equate them is

## PUBLIC VERSION

unpersuasive. CSXT also contorts the statute to create an alleged “surplusage” based upon the Board’s interpretation. A surplusage cannot be created by adding words that are not in the statute. Furthermore, courts will tolerate some degree of surplusage for a variety of reasons.

Second, CSXT’s claim that adoption of the LPM violates the Administrative Procedure Act (“APA”) because the Board did not employ notice and comment rulemaking procedures fails on multiple levels. See Part III. First, the LPM does not repudiate the Board’s market dominance guidelines, which continue to play the same role as always. At most the Board has given greater definition to their role in the context of determining whether alternative transportation is feasible and whether there is sufficient evidence to rebut the preliminary conclusions derived from the LPM. Nor does the fact that the Board previously repealed a different type of rebuttable presumption by rulemaking preclude it from adopting the LPM by adjudication. Second, the existing guidelines are not a legislative rule, and thus are not subject to the APA, because they are a policy statement that was never subject to public comment in the first place. Third, the LPM cannot be a legislative rule if CSXT is correct that the LPM creates a rebuttable presumption, because such presumptions leave an agency free to exercise its informed discretion.

Third, CSXT incorrectly asserts that the LPM seeks to solve a non-existent problem and would not simplify the market dominance analysis. See Parts IV.C. D. and E. The Decision creates a “set order of considerations” that gives focus to the market dominance analysis by clearly explaining how the Board will apply the market dominance guidelines. Decision at 21. It also provides the Board and the parties with a rational starting point for determining when an otherwise feasible alternative with a similar rate to the challenged rail rate may not be a truly effective pricing constraint. CSXT’s argument that this determination is unnecessary is merely an attempt to persuade the Board to evaluate market dominance solely on the basis of the

## PUBLIC VERSION

feasibility and price of the alternative transportation, which is contrary to established precedent.

Fourth, CSXT wrongly claims that the LPM has no meaningful economic content. See Parts IV.A. and B. CSXT presents this argument through the Verified Statements of Professor Robert Willig, and Drs. B Kelly Eakin and Mark Meitzen. Although they allege seven economic shortcomings of the LPM, five of them are repeated from their testimony in Docket No. 42123, which the Board addressed in the Decision. TPI has submitted the Verified Statement of Thomas D. Crowley, as Exhibit 2, in response to all seven allegations.

Fifth, CSXT alleges three catch-all reasons why the LPM is unlawful: (1) the LPM shifts the burden of proof on market dominance to the defendant; (2) the RSAM is different for each carrier; and (3) the term “intangible features” is vague and undefined. See Part V. The LPM does not shift the burden of proof, but is a rule of evidence that provides guidance as to the weight of the evidence required to determine whether a feasible alternative with similar or lower rates is providing an effective constraint upon the defendant’s pricing. It is irrelevant that each carrier has a different RSAM; indeed, the market dominance evidence should be railroad-specific. Finally, it is hard to envision how the Board could have provided any clearer guidance as to “intangible features.” See Decision at 18-19.

Sixth, CSXT’s arguments regarding {{ [REDACTED] }} are unfounded. See Part VI. As an initial matter, no corroborating evidence is necessary. Nevertheless, TPI provided ample corroborating evidence through testimony, data, and precedent consistent with the market dominance guidelines. CSXT’s other arguments were fully addressed and rejected in the Board’s July 15, 2011 decision in this proceeding.

For the foregoing reasons, the Board should deny CSXT’s Petition for Reconsideration of the May 31 Decision.

**HIGHLY CONFIDENTIAL – SUBJECT TO PROTECTIVE ORDER**

**II. The LPM Does Not Violate Governing Statutes.**

**A. The LPM is not barred by § 10707(d)(2).**

CSXT asserts that the Board is prohibited from using “an R/VC-based presumption to determine qualitative market dominance” because 49 U.S.C. § 10707(d)(2) states that there is no presumption about market dominance when the Board finds that the challenged tariff R/VC ratio “is equal to or greater than 180 percent.” Pet. at 1-2. CSXT’s assertion is incorrect.

First, the LPM is not barred by § 10707(d)(2), because the LPM applies an R/VC ratio based on the price for alternative transportation, not the challenged rail rate. Aware of this simple yet fatal flaw, CSXT contends that “there is no practical distinction.” Pet. at 3. But the alternative price and the challenged rail rate undeniably are two different figures, with no relationship to one another. As shown in Exhibit 1,<sup>1</sup> the LP R/VC ratio and the rail rate R/VC ratio are not fully related and do not necessarily move in lockstep: a rate with a low LP R/VC ratio can have a relatively high rail rate R/VC ratio (such as Lane 91) and vice-versa (Lane 89). With its “no practical distinction” assertion, CSXT is arguing that, even though the statute prohibits X, it also should be read to prohibit Y. This argument effectively acknowledges that the actual words of the statute do not prohibit the LPM.

Second, CSXT’s argument is wrong because, as the Board stated in the Decision, the statute only prohibits the use of a 180% R/VC ratio as the demarcation point for market dominance. Decision at 21 (n. 69). CSXT disputes this interpretation because it allegedly creates “surplusage” and would permit the “illogical conclusion” that a presumption at 181% would be permissible. Pet. at 2 and 3 (n. 7). The assertion of surplusage is based upon the alleged interaction of §10707(b) — which CSXT claims states that “qualitative” market

---

<sup>1</sup> Exhibit 1 summarizes, for each lane, the URCS variable cost, the challenged rate, the R/VC ratio for the challenged rate, the Limit Price, and the Limit Price R/VC ratio.

## PUBLIC VERSION

dominance must be evaluated in every case — and §10707(d)(1) — which states that market dominance cannot exist for rates below a 180% R/VC ratio. Hence, in CSXT’s view, this section requires the Board to evaluate “qualitative” market dominance for all rates that are equal to or above 180% R/VC, which would render the Board’s interpretation of §10707(d)(2) surplusage. Pet. at 2. CSXT’s argument fails for several reasons.

As a threshold matter, CSXT has injected the word “qualitative” into its interpretation of §10707(b), a word that is not to be found in the text of the statute, in order to create the alleged “surplusage.” Pet. at 2. But, § 10707(b) merely requires the Board to determine “whether the rail carrier proposing the rate has market dominance over the transportation to which the rate applies,” with the term “market dominance” defined in the preceding subsection. Section 10707(d), on the other hand, prohibits the Board from using one specific test as the sole means to determine “market dominance,” *i.e.*, through a presumption that all rates above a 180% R/VC ratio are determined to be market dominant. The LPM does not constitute such a test.

Moreover, even if the Board’s interpretation did result in surplusage, CSXT is wrong legally, because courts do tolerate some degree of surplusage, for a variety of reasons.<sup>2</sup> In Lamie, 540 U.S. at 536, the court used a “plain meaning” interpretation of the relevant statute even though it resulted in a word that “may well be surplusage.”<sup>3</sup>

---

<sup>2</sup> Lamie v. United States Trustee, 540 U.S. 526, 536 (2004) (“Surplusage does not always produce ambiguity and our preference for avoiding surplusage constructions is not absolute.”) (citation omitted) (“Lamie”); United States v. Atlantic Research Corp., 127 S.Ct. 2331, 2337 (2007) (“our hesitancy to construe statutes to render language superfluous does not require us to avoid surplusage at all costs”) (“Atlantic Research”).

<sup>3</sup> See also, Atlantic Research, 127 S.Ct. at 2337 (“It is appropriate to tolerate a degree of surplusage rather than adopt a textually dubious construction that threatens to render the entire provision a nullity.”); Western Coal Traffic League v. U.S., 719 F.2d 772, 778 (n. 10) (5th Cir. 1983) (“We are hesitant to rely heavily upon a vague congressional use of prepositions in determining the extent of the ICC’s jurisdiction to review rail rates.”).

## PUBLIC VERSION

### B. The LPM is within the Board's authority to determine market dominance.

Although CSXT asserts that the LPM violates the ICC Termination Act ("ICCTA"), the Board's existing authority is broad enough to permit adoption of the LPM. When the ICC adopted market dominance guidelines in 1981, it stated that other types of evidence would be permitted and could be considered. Market Dominance Determinations, 365 ICC 118, 133 (1981). The ICC also stated that its new guidelines "will encourage submission of more accurate costing information which may include *price-cost ratios* and lead to more appropriate market dominance determinations." Id. at 122 (*italics added*).

Furthermore, when Congress enacted the ICCTA, it emphasized that:

Although the conference provision does not disturb the existing statutory standard or the current agency regulations implementing the market-dominance standard, the Conference recognizes that the agency has broad discretion to consider additional factors such as the availability of other forms of transportation and other economic alternatives, and to revise and supplement its existing standards and regulations as appropriate.

H.Rep. 104-422 (1995) at p. 173 (*emphasis added*). In any review of the Board's exercise of its "broad discretion," particular deference is necessary because market dominance is specifically within the expertise of the Board. CF Industries, Inc. v. STB, 255 F.3d 816, 822 (D.C. Cir. 2001); Burlington N. RR Co. v. STB, 114 F.3d 206, 210 (D.C. Cir. 1997).

The agency long has used quantitative evaluations in its qualitative market dominance review.<sup>4</sup> In one such case, the defendant objected to use of quantitative figures and, in response, the Board stated that "we are not restricted from using any valid tool to assess whether a particular competitive alternative...effectively constrains a defendant's rates." CF Industries, Inc. v. Koch Pipeline, L.P., 4 STB 637, 650-651 (n. 43) (2000). That decision was affirmed on appeal, wherein the court stated that "[w]hile the Board's market dominance guidelines

---

<sup>4</sup> See, e.g., FMC, 4 STB at 717-718; McCarty, 3 ICC.2d at 831-832.

## PUBLIC VERSION

contemplate the use of...qualitative considerations, they do not exclude the application of quantitative analysis as well.” CF Industries, Inc. v. STB, 255 F.3d 816, 822 (D.C. Cir. 2001).

### III. **Notice and Comment Rulemaking Was Not Required for the LPM.**

Although agencies have wide latitude under the APA to proceed by adjudication or rulemaking, SEC v. Chenery Corporation, 332 U.S. 194, (1947), CSXT asserts that the LPM could only be adopted by rulemaking. CSXT argues that the LPM is an amendment or replacement of the existing market dominance guidelines, and, because the existing guidelines were adopted through the rulemaking process, the LPM must likewise be adopted in a rulemaking. Pet. at 5-10. CSXT is wrong on all counts.

#### A. **The LPM does not repudiate the existing market dominance guidelines.**

CSXT argues that the LPM “converts” and “transforms” the market dominance inquiry from a qualitative analysis to a quantitative one. Pet. 7. CSXT further asserts that the LPM is a “repudiat[ion]” of the traditional market dominance factors. Id. at 6. Hence, CSXT believes a rulemaking proceeding is necessary. But the Board clearly stated that the LPM is not a departure from prior market dominance rules, but, in fact, “encompasses the same factors described by the prevailing guidelines.” Decision at 22. The factors outlined in Market Dominance Determinations, 365 ICC 118, continue to play a significant role in determining the practical feasibility of alternative transportation options and in rebutting the preliminary conclusions of the LPM. Decision at 15-16, 18-19, 22-23. Indeed, CSXT’s fixation on the limit price analysis ignores the fact that the LPM calculation is but one part of the Board’s qualitative market dominance determination. Id.

CSXT further claims that the LPM involves a rebuttable presumption “of the very sort”

## PUBLIC VERSION

that was rejected in Market Dominance Determinations.<sup>5</sup> Pet. at 7. Consequently, CSXT believes that a rulemaking is necessary to adopt the LPM. But, the LPM is distinct from the rebuttable presumptions adopted in Special Procedures, 353 ICC 875 (1976), and repealed five years later in Market Dominance Determinations. Also, in the latter decision, the ICC did not state that it would never again use any rebuttable presumption in the market dominance analysis; the ICC merely repealed the four rebuttable presumptions that it had adopted in Special Procedures. Market Dominance Determinations does not preclude the agency from adopting new and different presumptions in an adjudicatory proceeding, and it is wrong for CSXT to imply that the Board may never use any rebuttable presumption in any market dominance decision before the Board first engages in notice-and-comment rulemaking simply because the ICC once repealed completely different rebuttable presumptions in a rulemaking.

CSXT also argues that rulemaking is required because the LPM involves an R/VC ratio and a “pre-determined statistical measure.” Pet. at 5. CSXT is wrong on both counts. The R/VC presumption from Special Procedures had to be repealed because it was set below the 180% level adopted in the Staggers Act. Market Dominance Determinations, 365 ICC at 121-22. Significantly, however, the ICC acknowledged that it could have chosen to just raise the level of the rebuttable presumption, but chose not to do so. Id. at 122. As for the phrase “pre-determined statistical measure,” that is an undefined phrase that CSXT has extracted from a footnote in Market Dominance Determinations, at 119, and misconstrued as an absolute prohibition against the use of any quantitative measures in the determination of market dominance.

Finally, CSXT’s claim that the LPM repudiates the market dominance guidelines because

---

<sup>5</sup> Although the Board has concluded that the LPM does not create a presumption (Decision at 21), TPI will use the term “rebuttable presumption” to address CSXT’s arguments because, regardless whether the preliminary conclusion is a presumption, the LPM is lawful as TPI explains throughout this Reply.

## PUBLIC VERSION

CSXT did not successfully rebut the preliminary conclusion of market dominance for any issue movement is disingenuous. Pet. at 4-5. CSXT did not rebut the preliminary conclusion for any issue movement because it did not present much, if any, of the evidence required to do so. As TPI pointed out in its Rebuttal, at pp. I-6 to 18 and II-B-46 to 48, CSXT attempted to distill the market dominance inquiry to just two questions concerning feasibility and price. *Id.* at 6 (quoting extensively from CSXT’s own Reply). This narrow scope of evidence focused on just two of the five factors identified in Market Dominance Determinations. CSXT chose to ignore factors such as why trucks are used, under what circumstances they are used, and the inherently higher cost of providing truck service, whereas TPI presented extensive evidence of these factors.<sup>6</sup> CSXT cannot fault the LPM for CSXT’s failure to present persuasive non-price reply evidence.

### **B. The market dominance guidelines are not a legislative rule.**

A necessary predicate to CSXT’s rulemaking argument is that the guidelines, adopted in Market Dominance Determinations, represent a legislative rule that can only be replaced or changed in a rulemaking. Pet. at 6. CSXT’s argument fails because the existing guidelines are not a legislative rule. The ICC adopted “evidentiary guidelines” for future market dominance review, not a rule or regulation. See 365 ICC at 131. Indeed, the Federal Register notice that announced the Market Dominance Determinations proceeding was termed a “Notice of Proposed Policy.” See 45 Fed. Reg. 83342 (Dec. 18, 1980). Agency policy is expressly excluded from APA requirements. See 5 U.S.C. §553.

If there were any doubt that the existing guidelines are not a legislative rule, one need only review the relevant Federal Register notice cited above, wherein Commissioner Clapp issued a concurring opinion stating that:

---

<sup>6</sup> About the only non-price evidence that CSXT presented was TPI’s occasional use of trucks in a few lanes, which TPI thoroughly explained through a holistic evaluation of all the market dominance guidelines. See TPI Reb. at II-B-39 to 48.

## PUBLIC VERSION

One also must question whether it is wise to propose issuance of a mere policy statement, which theoretically is subject to change without notice, when adoption of specific rules would avoid this uncertainty.

45 Fed. Reg. at 83345. His concern was understandable, because there was no mention in the Federal Register notice of the proposed guidelines. In other words, there was no public notice of the guidelines and, consequently, they are not the product of notice-and-comment rulemaking. A review of Market Dominance Determinations confirms that the existing guidelines were not subject to comment. While the ICC repeatedly responded to parties' specific comments about elimination of the four presumptions and the role of product and geographic competition — the topics addressed in the Federal Register notice (see 365 ICC at 120-131) — the ICC never referred to any comments on the market dominance evidentiary guidelines: no comments were received because no proposal was ever made. See 365 ICC at 131-135.

In an appeal of Market Dominance Determinations, although the court described the ICC's decision as a legislative rule, it did so solely within the context of the Board's repeal of the four presumptions that had been adopted in Special Procedures, and the Board's discussion of product and geographic competition, which were the only topics covered in the Federal Register notice. Western Coal Traffic League v. U.S., 694 F.2d 378, 392-393 (D.C. Cir. 1983). The court made no reference to the evidentiary guidelines, which were not the subject of its review.

### C. **The LPM is not a legislative rule.**

CSXT asserts both that (1) the LPM creates a rebuttable presumption, and (2) notice and comment rulemaking was required. Pet. at 4-5. But, these twin assertions cannot coexist. Under well-established precedent, a rebuttable presumption necessarily leaves an agency with

## PUBLIC VERSION

discretion and, therefore, is not a legislative rule.<sup>7</sup> “An agency pronouncement is not deemed a binding regulation merely because it may have some substantive impact, as long as it leaves the administrator free to exercise his informed discretion. . . . Presumptions, so long as rebuttable, leave such freedom.”<sup>8</sup> Moreover, an agency may develop and rely upon a rebuttable presumption in the course of an adjudication.<sup>9</sup>

### IV. The LPM Is Not Arbitrary or Capricious.

CSXT repeatedly argues that the LPM is arbitrary and capricious. CSXT’s arguments, however, are contrary to both law and economics, and often are inherently contradictory.

#### A. There is a rational connection between the LPM and the fact it presumes.

The Supreme Court tests presumptions involving matters of economic regulation against the standard articulated in Mobile, J. & K.C.R. R. Co. v. Turnipseed, 219 U.S. 35, 43 (1910), which requires only “that there shall be some rational connection between the fact proved and the ultimate fact presumed, and that the inference of one fact from proof of another shall not be so unreasonable as to be a purely arbitrary mandate.” Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 28 (1976), quoting Turnipseed. In determining whether a feasible transportation alternative with comparable pricing to rail is truly an effective constraint, it is reasonable to preliminarily conclude that an LP R/VC ratio above the defendant’s RSAM is a rational indicator that the alternative price is not an effective constraint. Indeed, the RSAM is a conservatively high benchmark for merely drawing a preliminary conclusion.

---

<sup>7</sup> Catawba County v. EPA, 571 F.3d 20, 34 (D.C. Cir. 2009); Alliance for Bio-Integrity v. Shalala, 116 F.Supp.2d 166, 172-173 (D.C. Cir. 2000); National Association of Broadcasters v. FCC, 569 F.3d 416, 425 (D.C. Cir. 2009).

<sup>8</sup> Panhandle Producers and Royalty Owners Association v. Economic Regulatory Administration, 822 F.2d 1105, 1110 (D.C. Cir. 1987) (internal citation and quotation omitted).

<sup>9</sup> E.g., American Forest and Paper Association v. FERC, 550 F.3d 1179, 1183 (D.C. Cir. 2008); NLRB v. Baptist Hospital, Inc., 442 U.S. 773, 788-789 (1979); Rice v. NTSB, 745 F.2d 1037, 1039 (6th Cir. 1984); Republic Aviation Corporation v. NLRB, 324 U.S. 793, 803-805 (1945).

## PUBLIC VERSION

The RSAM represents the average level of differential pricing required of just the defendant's potentially captive traffic (i.e., all traffic with an R/VC above 180%) to achieve regulatory revenue adequacy. The RSAM measure excludes traffic with an R/VC below 180% because it is conclusively presumed a the railroad does not possess market dominance over that traffic. By definition, then, the RSAM calculation is based on the group of traffic over which the railroad is likely to possess market dominance. Thus, an LP R/VC ratio above the RSAM means that, by matching the alternative transportation price, the defendant would be pricing in the upper half of the range that would be expected for captive traffic. Furthermore, it is reasonable to find that this already quite strong preliminary conclusion of no effective competition grows even stronger as the amount by which the LP R/VC exceeds the RSAM increases.

The results in this case also confirm that the Board acted reasonably. Of the 78 contested lanes, the Board found market dominance for 65.<sup>10</sup> Only two of these 65 lanes have rail rates with an R/VC ratio less than CSXT's RSAM, and most of the lanes have rates with R/VC ratios far in excess of the RSAM. See Exhibit 1. In other words, application of the LPM has identified challenged rates that are mostly far above the average level of differential pricing that CSXT needs to exercise in order to be declared revenue adequate. Because one would not expect the Limit Price for truly competitive traffic to generate revenues at the upper level of differential pricing for captive traffic, the Board's preliminary conclusion of market dominance for similarly-priced alternative transportation is hardly irrational, arbitrary or capricious.

**B. CSXT's Claim Of "No Meaningful Economic Content" Does Not Warrant Reconsideration Of The LPM.**

Through the Verified Statements of Robert Willig, Kelly Eakin and Mark Meitzen, CSXT asserts that the LPM has no meaningful economic content. Pet. at 14-15. TPI has submitted the

---

<sup>10</sup> Additionally, the Board found market dominance over one customer in three other lanes.

## PUBLIC VERSION

Verified Statement of Thomas D. Crowley, attached as Exhibit 2, in response to each of the seven economic shortcomings alleged by CSXT's witnesses.<sup>11</sup> The first five bullet points in CSXT's Petition summarize old arguments that CSXT previously raised in Docket No. 42123, and which the Board has addressed in the Decision. CSXT also presents two new arguments: (1) that the LPM is not supported by the Lerner Index, and (2) comparing the LP R/VC ratio to RSAM is not relevant. Mr. Crowley explains why none of these seven arguments show that the LPM is arbitrary and capricious.

As addressed in Part IV.A above, the LPM has a fundamental rational economic link to market dominance. It indicates whether a railroad can match the lowest alternative transportation rate and still impose differential pricing to achieve rate levels above the level it must impose, on average, to be revenue adequate. Even CSXT's own witnesses concede the relevance of that factor. *Cf. Pet., Willig V.S. at 14 (n. 25)* ("a better indicator of market power may be long-run excess profits"). If by matching the alternative rate, the defendant would be pricing at levels above the average level of differential pricing that is needed from just its potentially captive traffic to be revenue adequate, the Board can reasonably conclude that the alternative rate is not a very effective rate constraint, and that the defendant railroad has the ability to exercise, *and is exercising*, its market dominance over the issue move.

### **C. CSXT's fixation on "extreme hypotheticals" and "ridiculous" alternatives misses the point.**

CSXT incorrectly portrays the LPM as designed solely to address "patently ridiculous alternatives" and "extreme hypotheticals." *Pet. at 12-14*. The spectre of "extreme hypotheticals" is not the reason that consistent agency and court precedent require looking beyond the mere

---

<sup>11</sup> CSXT's Verified Statements violate the Board's limits on the length of Petitions for Reconsideration. 49 C.F.R. § 1115.3(e). Rather than move to strike the Verified Statements, TPI has responded in kind so as to avoid any potential appeal by CSXT on the grounds that it was not afforded a reasonable opportunity to challenge the LPM before the Board.

## PUBLIC VERSION

price of an alternative when evaluating market dominance. The precedent on this subject has couched the issue in terms of whether the alternative transportation has higher costs (as opposed to prices) than rail, which permits rail to reap excess profits even while matching the alternative prices.<sup>12</sup> To the extent that there are significant costs, in addition to price, before a shipper can use the alternative (*e.g.*, infrastructure, equipment, labor, inventory), a rail carrier may even be able to set prices above its competition and still retain the traffic.

As the Board plainly stated in the Decision, the Limit Price “is intended to reflect the highest price the rail carrier theoretically could charge the shipper without causing a significant amount of the issue traffic on the particular rail movement to be diverted to the proffered alternative....” Decision at 25. By comparing the Limit Price R/VC ratio to the RSAM, the Board has selected a reasonable indicator of whether the Limit Price is an effective competitive constraint, because truly competitive traffic (*i.e.*, traffic over which the railroad does not possess pricing power) presumptively would not be priced above the average R/VC needed from all potentially captive traffic (*i.e.*, traffic exclusive of the traffic over which the railroad is presumed not to possess pricing power) in order to achieve revenue adequacy. Therefore, the LPM does more than simply determine if an alternative is “patently ridiculous;” it facilitates the Board’s determination as to whether alternatives “constrain the railroads from charging rates far in excess of the just and reasonable rates that Congress thought the existence of competitive pressures would ensure.”<sup>13</sup> Decision at 26-27, quoting Ariz. Pub. Serv., 742 F. 2d at 651.

---

<sup>12</sup> See, *e.g.*, Arizona Public Service Company v. United States, 742 F.2d 644, 650-651 (D.C. Cir. 1984); McCarty Farms v. Burlington Northern, Inc., 3 I.C.C.2d 822, 831-832 (1987); FMC Wyoming Corp. v. Union Pacific RR Co., 4 STB 699, 718 (2000); E.I. du Pont de Nemours and Company v. CSX Transp., Inc., STB Docket No. 42099, slip op. at 7-8 (served June 30, 2008).

<sup>13</sup> This is even more important today than it was thirty years ago. Enormous consolidation in the rail industry, to the point of duopolies in the eastern and western U.S., has increased railroad market power and made it much more likely that railroads can create the appearance of

## PUBLIC VERSION

### D. **The Board should reject CSXT's contradictory positions.**

In a desperate attempt to upset the market dominance findings in the Decision, CSXT appears to have included virtually any possible critique, no matter how incoherent or internally inconsistent. For example, at pages 1-9 of the Petition, CSXT argues that the LPM is improper because it replaces an evaluation of market dominance factors with a quantitative formula. Just a few pages later, however, CSXT changes course, and claims that the LPM “does not simplify” the market dominance inquiry because parties in a rate case “would have every incentive to submit evidence bearing on the feasibility of alternatives or ‘intangible features’.” Pet. at 11. In other words, CSXT’s second argument plainly acknowledges that the premise of its first argument is incorrect. The Board should reject CSXT’s circular arguments.

In contrast to CSXT’s attempt to argue both sides of the issue, the Board clearly stated that the LPM is not a departure from prior market dominance rules, but, in fact, “encompasses the same factors described by the prevailing guidelines.” Decision at 22. Evaluation of factors such as those outlined in Market Dominance Determinations can and does still occur during the feasibility analysis and the intangible features analysis. Decision at 23 (n. 74).

### E. **The LPM will simplify the market dominance inquiry.**

CSXT’s assertion that the LPM does not simplify the market dominance inquiry is wrong. Until now, the only guidance that parties have had in developing market dominance evidence was an outline of general factors set forth in Market Dominance Determinations as interpreted by subsequent case law. The Decision, at 21, establishes “a set order of considerations” that enables prospective complainants to better assess the merits of their position before deciding to file a case. Even though the parties still submit the same types of evidence, competition by increasing rates to match the prices of higher cost alternatives that previously had much higher prices than rail between the same points. This is precisely what TPI’s Opening Exhibit II-B-7 demonstrated.

## PUBLIC VERSION

they now have a better sense as to how the Board will review and evaluate that evidence.

Furthermore, the LPM will facilitate the Board's evaluation of that evidence. The need for a process that facilitates less complex and more expedient market dominance determinations by the Board is illustrated by this very case, in which the Board required 20 months to issue a decision. Contrast this with the 9 months in which Congress has required the Board to issue rate reasonableness decisions based upon the highly complex stand-alone cost methodology, 49 U.S.C. § 10704(c)(1), and it becomes self-evident that there is a strong need for the LPM. Without the simplification offered by the LPM, carload shippers such as TPI would be without an effective regulatory remedy for unreasonable rates simply because the process would be too long, complicated, and expensive. Such a result would be contrary to the national rail transportation policy "to provide for the expeditious handling and resolution of all proceedings...." 49 U.S.C. § 10101(15).

While CSXT acknowledges that the market dominance process in this case has been complex, it blames that on "TPI's decisions to challenge rates for a very large number of relatively low-volume carload lanes that are regularly and readily transported by truck and to raise a host of novel arguments why that real-world truck competition is 'ineffective.'" Pet. at 11. CSXT is wrong. As discussed in Part IV.B above, the LPM attempts to address a complex issue that, although very real, has arisen in only a handful of prior cases. Because that issue — when is a feasible alternative not an effective competitive constraint — has become more prevalent as shippers of non-coal commodities have pursued regulatory rate remedies, the Board identified a need for a better way to address it. CSXT's attempt to blame TPI for the complexity of the market dominance determination is akin to blaming the victim of a crime, and it amounts to an assertion that TPI and similarly situated shippers of carload traffic should just shut up and

## PUBLIC VERSION

pay unreasonable rates for low volume lanes.

Ultimately, whether or not the LPM simplifies the market dominance process is a determination for the Board to make. Congress has directed the Board, at 49 U.S.C. § 10704(d), to “establish procedures to ensure expeditious handling of challenges to the reasonableness of railroad rates,” including “appropriate measures for avoiding delay in the discovery and evidentiary phases of such proceedings....” The Board has explained that the LPM “will help to better guide” its market dominance review (Decision at 19) given the “complicated” issues in this proceeding (Decision at 3) and the need to ensure that the rate case process is available to parties other than coal shippers (Decision at 4). This is a rational explanation that is consistent with Congressional direction and far in excess of what is needed to survive a claim of arbitrary and capricious action. AT&T Corporation v. FCC, 220 F.3d 607, 616 (D.C. Cir. 2000).

### V. **CSXT’s Other Arguments About the LPM Are Unpersuasive.**

#### A. **CSXT’s burden of proof argument is wrong.**

CSXT erroneously claims that the LPM is improper because it would shift the burden of proof “by forcing the defendant to present evidence sufficient to overcome the presumption.” Pet. at 16. The LPM, however, merely provides guidance as to the weight of the evidence required to determine whether a practical transportation alternative with similar or lower rates is providing an effective constraint upon the defendant’s pricing.

The Board has not previously provided guidance as to how it would weigh the multiple market dominance factors in Market Dominance Determinations. In this case, CSXT has attempted to make rate comparisons the primary, if not sole, relevant factor, whereas TPI contends that, because alternative prices can be less than the rail rate and still not be an effective competitive constraint, other factors also must be considered. The Board, consistent with its precedent, has agreed with TPI and adopted the LPM as a means to preliminarily determine

## PUBLIC VERSION

when an otherwise feasible transportation alternative does not exert sufficient competitive pressure to restrain the defendant's rates effectively. Decision at 16-18. If the LP R/VC ratio exceeds the defendant's RSAM, the complainant has established a *prima facie* case, unless the defendant presents other, non-price, factors to rebut that evidence. Conversely, if the LP R/VC ratio is below the RSAM, the complainant must submit evidence of additional factors in order to carry its burden. The Board has not shifted the burden of proof; but rather, it has provided guidance as to how it will weigh the various market dominance factors.<sup>14</sup>

Because evidence of intangible features includes all the same factors as a traditional market dominance analysis, the evidentiary process remains unchanged, except for the addition of the LP R/VC calculation. There is no burden-of-proof problem here because the complainant must submit its evidence on the alternative transportation rate and variable costs on opening, along with intangible features. Even when a movement has an LP R/VC ratio greater than the carrier's RSAM, a complainant still has every incentive to submit evidence of intangible features, since it cannot be sure whether the defendant will submit evidence of countervailing factors and/or perhaps come up with a lower Limit Price that would push the LP R/VC below the RSAM.<sup>15</sup> Moreover, if the defendant submits evidence of other factors that would defeat market dominance on reply, the burden would be on the complainant to show on rebuttal that such evidence does not overcome the preliminary conclusion.

The foregoing analysis also is consistent with the law when dealing with rebuttable presumptions. In the seminal case on the use of presumptions, the Supreme Court held that,

---

<sup>14</sup> This is comparable to a court's evaluation of the four factors that are relevant to requests for injunctive relief. Washington Metropolitan Area Transit Comm'n v. Holiday Tours, 559 F.2d 841 (D.C. Cir. 1977). A very strong showing as to one factor can compensate for a weaker showing as to other factors. Estate of Coll-Monge v. Inner Peace Movement, 524 F.3d 1341, 1349 (D.C. Cir. 2008); CSX Transp., Inc. v. Williams, 406 F.3d 667, 670 (D.C. Cir. 2005).

<sup>15</sup> As demonstrated in Part IV.D, CSXT has taken conflicting positions on this issue.

## PUBLIC VERSION

“[I]n legislation providing that proof of one fact shall constitute prima facie evidence of the main fact in issue is but to enact a rule of evidence, and quite within the general power of government.” Turnipseed, 219 U.S. at 42. The only legal effect is to create an inference that casts the duty of producing some evidence to the contrary upon the party against whom the presumption is applied. Id. at 43.<sup>16</sup> “[A] presumption that shifts only the burden of production does not shift the ‘burden of proof’ as that phrase is used in the APA.” Garvey v. NTSB, 190 F.3d 571, 580 (D.C. Cir. 1999).<sup>17</sup>

### **B. It is irrelevant that the RSAM is different for each railroad.**

CSXT asserts that the LPM is arbitrary because the RSAM is different for each railroad and, consequently, an alternative transportation price might be effective competition for one railroad but not for another. Pet. at 17. CSXT has completely ignored the fact that, because each railroad has different URCS variable costs, a given alternative transportation price will nearly always have different LP R/VC ratios for different railroads. Therefore, it is flatly incorrect for CSXT to state that, if Canadian Pacific were the defendant in this proceeding rather than CSXT, {{█}} lanes would have switched from market dominance to effective competition simply because CP’s RSAM is higher. Id.

Also, market dominance should be railroad-specific. The statute requires the Board to determine “whether the rail carrier proposing the rate has market dominance over the transportation to which the rate applies,” 49 U.S.C. § 10707(b), not over transportation that another rail carrier may provide. Moreover, the Board must determine whether alternatives effectively constrain the defendant’s pricing, not the pricing of another carrier. See, e.g., McCarty, 3 ICC.2d at 825 (“In general, we look to see if there are any alternatives sufficiently

<sup>16</sup> See also, W. & Atlantic R.R. v. Henderson, 279 U.S. 639, 642 (1929).

<sup>17</sup> See also, St. Mary’s Honor Center v. Hicks, 509 U.S. 502, 507-508 (1993); ITC Limited v. Punchgini, Inc., 482 F.3d 135, 147-149 (2nd Cir. 2007); Fed. Rule of Evid. 301.

## PUBLIC VERSION

competitive...to bring market discipline to BN's pricing.") (underline added).

Finally, this is no different from the situation that arises when applying the 180 percent Jurisdictional Threshold in the quantitative market dominance analysis for all railroads. Assume two railroads with parallel 100 mile moves, identical challenged rates of \$5.00 per ton, but the URCS variable costs is \$2.00 per ton for Railroad 1 and \$3.00 per ton for Railroad 2. Under the quantitative test, Railroad 2 would not possess market dominance over the movement because of an R/VC of 167% ( $\$5 \div \$3$ ), while Railroad 1 could be market dominant because its R/VC ratio of 250% ( $\$5 \div \$2$ ) exceeds the Jurisdictional Threshold. Contrary to CSXT's argument, it is entirely logical for the LPM to produce different results when applied to similar movements over different railroads, because of each railroad's unique cost structure and revenue needs.

### C. **Intangible features are not vague.**

CSXT also contends that the Board has failed to define or provide guidance about the intangible features that could overcome the preliminary conclusion. Pet. at 17-18. This contention does not withstand scrutiny. The Board explained that certain benefits or costs might be involved in the alternative transportation or the challenged transportation sufficient to rebut the preliminary conclusion, and that the strength of the preliminary conclusion would depend upon the scale of divergence between the RSAM and LP R/VC ratios. Decision at 18. The Board provided two examples of intangible features. *Id.* at 18 (n. 60 & 61). The Board also explained that the overall approach in the Decision – a feasibility analysis, comparison of LP/VC to RSAM, and evaluation of intangible features – involves “the same factors described in the market dominance guidelines” set forth in Market Dominance Determinations. Decision at 19.

CSXT further argues that the intangible factors inevitably lead to “subjective” decisions. Pet. at 18. Yet, as CSXT itself recognizes, the current market dominance test also is inherently subjective. CSXT describes the current approach as a consideration of various factors and

## PUBLIC VERSION

variables “using the Board’s knowledge, experience, and expert judgment” *Id.* at 7. CSXT cannot complain that the LPM is a quantitative test and then credibly complain that it is too “subjective” in the same breath.

VI. {{ [REDACTED] }}

CSXT asserts multiple specious arguments regarding the {{ [REDACTED] }}. First, CSXT asserts that {{ [REDACTED] }} are “supported by no corroborating evidence whatsoever.” *Pet.* at 19. As an initial matter, the alleged existence or not of “corroborating evidence” is irrelevant. Under the APA, the Board may receive “[a]ny oral or documentary evidence” as long as it is not irrelevant, immaterial, or unduly repetitious. 5 U.S.C. § 556(d). Furthermore, just like any decision-maker, the Board must rely on its judgment to weigh the evidence presented to it.<sup>18</sup>

It is also incorrect to say that no corroboration exists. TPI cited to prior railroad employee testimony that polymer end-users usually have “limited on-site storage capability” and utilize the rail car as their “rolling silo/warehouse.”<sup>19</sup> TPI explained the value of using rail cars as storage.<sup>20</sup> TPI also submitted evidence showing the amount of time that each customer holds a rail car after delivery.<sup>21</sup> Significant agency and court precedent also recognize that consignees, including those in the polymer industry, frequently use private rail cars for storage purposes.<sup>22</sup>

---

<sup>18</sup> See, e.g., Echostar Communications Corp. v. FCC, 292 F.3d 749, 753 (D.C. Cir. 2002) (court finds “no support” for a party’s claim that “uncorroborated and untested testimony...cannot constitute substantial evidence”).

<sup>19</sup> TPI Reb. Ex. II-B-31 at 14-15. See also TPI Reb. Ev. at II-B-16-17.

<sup>20</sup> See, e.g., TPI Op. Ev. at I-2; TPI Reb. Ev. at I-18-20 and II-B-16-17.

<sup>21</sup> See TPI Opening workpaper “2010 Cust Hold Days” in “Ex. II-B-5 & 6 Workpapers” folder.

<sup>22</sup> E.g., GWI Switching Services, LP – Operation Exemption – Lines of Southern Pacific Transportation Company, STB Docket No. 32481, slip op. at 2 (served Aug. 7, 2001); Union Pacific Corporation, et al. – Control and Merger – Southern Pacific Rail Corporation, et al., 1 STB 233, 426 (1996). See also Shippers Committee, OT-5 v. The Ann Arbor Railroad Company, 5 I.C.C.2d 856, 859 (1989); Turner, Dennis & Lowry Lumber Company v. Chicago, Milwaukee & St. Paul Railway Company, 271 U.S. 259, 262 (1926); Illinois Central Railroad

PUBLIC VERSION

Lastly, TPI submitted extensive historical traffic and rate data of exactly the type requested by the agency and from which market dominance can be “deduced.”<sup>23</sup>

{{ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] }} Such small

percentages are well within established agency precedent showing that occasional shipments via another mode do not defeat market dominance.<sup>26</sup>

{{ [REDACTED]

[REDACTED]

[REDACTED] }} CSXT complains that the Board did not

---

Company v. Texas Eastern Transmission Corporation, 533 F.2d 272, 274 (5th Cir. 1976); Car Service Compensation – Basic Per Diem Charges, 358 ICC 716, 762 (1977); Joint Line Cancellation on Soda Ash by Union Pacific Railroad Company, 365 ICC 951, 959 (1982); Allied Corporation v. Union Pacific Railroad Company, 1 I.C.C.2d 480, 481 (1985)

<sup>23</sup> See TPI Op. Ev. at II-B-13-14; TPI Reb. Ev. at I-7 and II-B-39-40.

<sup>24</sup> See TPI Op. Ev. at II-B-20-21; TPI Reb. Ev. at II-B-15-17, 25-28, 36, 49, 51-54.

<sup>25</sup> See TPI Opening workpaper “Truck and Rail Volumes” (sheets “Ex. II-B-11” and “Pivot with Truck Origin”) in folder “Ex. II-B-11 Workpapers”.

<sup>26</sup> See, e.g., The Dayton Power & Light Company v. Louisville and Nashville Railroad Company, 1 I.C.C.2d 375, 382 (n. 28) (1985); E.I. du Pont de Nemours and Company v. CSX Transportation, Inc., STB Docket No. 42099, slip op. at 7 (served June 30, 2008); Allied Chemical Corporation, et al. v. Ann Arbor Railroad System, et al., 1 I.C.C.2d 492, 507 (1985); McCarty Farms, 3 I.C.C.2d at 830-832; FMC, 4 STB at 717; Arizona Public Service Company v. United States, 742 F.2d 644, 650 (D.C. Cir. 1984); Consolidated Papers, Inc. v. Chicago and North Western Transportation Co., 7 I.C.C.2d 330, 340-341 (1991).

**PUBLIC VERSION**

sufficiently address its broker argument, but the Board explained that none of the customers at issue received over 10% of its commodity via truck, and the Board further explained the relevance of the 10% figure. See Decision at 45 and 46 (n. 176).

CSXT's concern about due process rehashes arguments that the Board rejected in its decision regarding TPI's confidentiality designations. See Board decision, slip op. at 4 (served July 15, 2011). The fact that CSXT's internal personnel cannot see the entirety of certain evidence is not unusual. In any SAC case, there is voluminous evidence that is designated Highly Confidential and, consequently, off-limits to internal personnel of the other party. Nevertheless, the party's due process rights are fulfilled because outside counsel and consultants are able to evaluate and respond to information.

{{ [REDACTED]

[REDACTED]

[REDACTED]

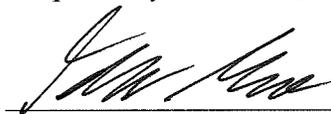
[REDACTED]

[REDACTED]}}

**VII. Conclusion.**

For the foregoing reasons, the Board should deny CSXT's Petition for Reconsideration.

Respectfully submitted,



---

Jeffrey O. Moreno  
David E. Benz  
Thompson Hine LLP  
1919 M Street, N.W., Suite 700  
Washington, D.C. 20036  
(202) 331-8800  
*Attorneys for Total Petrochemicals &  
Refining USA, Inc.*

July 24, 2013

**PUBLIC VERSION**

**CERTIFICATE OF SERVICE**

I hereby certify that this 24th day of July 2013, I served a copy of the foregoing upon counsel for defendant CSXT via electronic mail, and first-class mail postage pre-paid at the address below:

G. Paul Moates  
Paul Hemmersbaugh  
Sidley Austin LLP  
1501 K Street, NW  
Washington, DC 20005  
pmoates@sidley.com  
phemmersbaugh@sidley.com

*Counsel for CSX Transportation, Inc.*



---

Jeffrey O. Moreno

**Exhibit 1**  
**(Redacted from Public Version)**

## **Exhibit 2**



**TABLE OF CONTENTS**

**PAGE**

I.	Introduction.....	1
II.	The Limit Price Methodology Is Supported By The Lerner Index.....	3
	A. Fixed Costs And Scale Economies Do Not Automatically Eliminate The Usefulness Of The Lerner Index .....	3
	B. Other Studies Have Applied The Lerner Index To The Railroad Industry.....	5
	C. The LPM Uses Appropriate Market Based Rates.....	5
III.	Alternative Rate Versus The Railroad’s Overall Revenue Requirements .....	8
IV.	RSAM Is An Appropriate Benchmark Rate Level .....	11
V.	The Limit Price Methodology Is Used To Make A Preliminary Determination .....	15
VI.	High Limit Price R/VC Ratios Signal The Lack Of Effective Competition.....	16
VII.	The LPM Test Has No Bearing On A Railroad’s Ability To Attain Revenue Adequacy .....	18
VIII.	URCS Average Variable Costs Are A Reasonable Proxy For True Marginal Costs.....	20

## I. INTRODUCTION

I am Thomas D. Crowley, an economist and the President of L. E. Peabody & Associates, Inc., an economic consulting firm that specializes in solving economic, transportation, marketing, financial, accounting and fuel supply problems. I am the same Thomas D. Crowley who filed opening market dominance evidence in this proceeding on behalf of Total Petrochemicals & Refining USA, Inc. (“TPI”) on May 5, 2011. My qualifications and experiences are included in Part IV of that opening market dominance evidence.

CSXT filed a Petition for Reconsideration in Response to the Surface Transportation Board’s (“STB” or “Board”) Market Dominance Decision served May 31, 2013 in STB Docket No. NOR 42121 (“*Market Dominance Decision*”). CSXT contends that the Board’s newly adopted qualitative model (based on the STB’s “Limit Price” construct) for preliminarily determining the existence of market dominance is both flawed and applied improperly. CSXT’s position is supported by the Verified Statements (“VS”) of economists Dr. Robert Willig (“Willig”) and Doctors Kelly Eakin and Mark Meitzen (“Eakin/Meitzen”). The VS submitted on behalf of CSXT included several arguments that were raised by the same parties in response to the STB’s proposal to implement the same methodology in the M&G<sup>1</sup> rate reasonableness proceeding. However, the VS filed in the instant case are expanded and include a new argument related to the extent to which the Lerner Index supports the Board’s use of its Limit Price Methodology (“LPM”) as a means to determine market dominance.

Below, I discuss the arguments presented by CSXT and its experts under the following topical headings:

### II. The Limit Price Methodology Is Supported By The Lerner Index

---

<sup>1</sup> STB Docket No. NOR 42123, *M&G Polymers USA, LLC v. CSX Transportation, Inc.*

- III. Alternative Rate Versus The Railroad's Overall Revenue Requirements
- IV. RSAM Is An Appropriate Benchmark Rate Level
- V. The Limit Price Methodology Is Used To Make A Preliminary Determination
- VI. High Limit Price R/VC Ratios Signal The Lack Of Effective Competition
- VII. The LPM Test Has No Bearing On A Railroad's Ability To Attain Revenue Adequacy
- VIII. URCS Average Variable Costs Are A Reasonable Proxy For True Marginal Costs

## **II. THE LIMIT PRICE METHODOLOGY IS SUPPORTED BY THE LERNER INDEX**

The Board stated in its *Market Dominance Decision* that its LPM "... generally comports with accepted economic representations of market power such as the Lerner Index..."<sup>2</sup> Willig and Eakin/Meitzen disagree with the Board's position that LPM generally comports with the Lerner Index, and instead argue that the Lerner Index is not a reliable indicator of market dominance for policy purposes, particularly in high-fixed-cost industries with notable economies of scale.<sup>3</sup> They further claim that the Lerner Index is merely one of many measures that can be used to measure the exercise of market power, but it is unreliable for determining market dominance because it is incapable of discerning other relevant forces such as the need to price above marginal costs to recover fixed cost and efficient use of scale economies. I believe Willig and Eakin/Meitzen overstate the issues, as I discuss below.

### **A. FIXED COSTS AND SCALE ECONOMIES DO NOT AUTOMATICALLY ELIMINATE THE USEFULNESS OF THE LERNER INDEX**

Both Willig and Eakin/Meitzen cite to the same journal article noted by the Board in its *Market Dominance Decision* as support for their claims that the Lerner Index is not an appropriate metric to use in determining market dominance in railroad rate cases. According to Willig and Eakin/Meitzen, the Lerner Index cannot be used to measure market power in the railroad industry because the Elzinga and Mills's article cited by the STB, *The Lerner Index of Monopoly Power: Origins and Uses*,<sup>4</sup> ("Elzinga/Mills") states that the Lerner Index has limited applicability for industries with high fixed costs and economies of scale.<sup>5</sup>

---

<sup>2</sup> See *Market Dominance Decision* at page 5, note 72.

<sup>3</sup> See Willig VS at pages 13 to 15 and Eakin/Meitzen VS at pages 3 to 4.

<sup>4</sup> See Kenneth G. Elzinga & David E. Mills, *The Lerner Index of Monopoly Power: Origins and Uses*, 101(3) *Am. Econ. Rev.* 558, 560 (2011)

<sup>5</sup> See Willig VS at pages 14 to 15 and Eakin/Meitzen VS at page 3.

While Willig and Eakin/Meitzen are correct that Elzinga/Mills make this initial statement, both Willig and Eakin/Meitzen disregard the authors' caveat that this limitation may not apply in certain situations present in the railroad industry. As noted by Elzinga/Mills:

“Endogenous scale economies and fixed costs that merely erect barriers to entry must be excluded from this generalization.”<sup>6</sup>

In other words, the generalization that departures of price and marginal costs are equally attributable to the absence or infeasibility of arrangements to secure subsidies from buyers to bridge the gap between average cost and marginal cost may not be truly applicable in today's railroad industry because of the universally acknowledged entry barriers to the industry.

Moreover, the Board and its predecessor, the Interstate Commerce Commission (“ICC”), have long noted that the railroad industry is characterized by barriers to entry brought about by high fixed costs. As noted by the ICC in *Coal Rate Guidelines*:<sup>7</sup>

“Common sense \*\*\* indicates that the railroad industry is not contestable: entry entails a long and tedious process of buying up parcels of land, generally requiring powers of eminent domain (which, in turn, requires some government intervention). Engineering and building a railroad line also require considerable time and expenses. So entry into the industry is anything but easy.”<sup>8</sup>

There is little doubt that the railroads leverage these barriers to entry in order to extract monopoly rents from certain shippers. Given these barriers to entry present in the US freight railroad industry, the Elzinga/Mills caveat is clearly applicable in this instance.

---

<sup>6</sup> See Kenneth G. Elzinga and David E. Mills, *The Lerner Index of Monopoly Power: Origins and Uses*, *American Economic Review: Papers and Proceedings*, 2011, 101:3, 558 to 564, note 6.

<sup>7</sup> See STB Ex Parte 347 (Sub-No.1), *Coal Rate Guidelines, Nationwide*, 1 ICC 2d 521 (“*Coal Rate Guidelines*”).

<sup>8</sup> See *Coal Rate Guidelines* at page 529.

## **B. OTHER STUDIES HAVE APPLIED THE LERNER INDEX TO THE RAILROAD INDUSTRY**

Notwithstanding Willig's and Eakin/Meitzen's assertion that the Lerner Index should not be used in evaluating market dominance in the railroad industry, other economists have used the Lerner Index, and derivatives thereof, to examine railroad industry market dominance. In his paper *Legislated Market Dominance In Railroad Markets*, Dr. Wesley W. Wilson ties the Lerner Index directly to a railroad's market dominance, in this case the Burlington Northern Railroad in the McCarty Farms case.<sup>9</sup>

In a different study, Ivaldi and McCullough looked at the structure of rail rates that have evolved in the years since the Staggers Rail Act. Their paper did this by defining a set of Lerner indices across commodity groups identified by car types.<sup>10</sup> Similarly, Kunce, Hamilton and Gerking examined the efficiency of low-sulfur coal markets in a three-sector model of mines, railroads, and utilities by deriving Lerner indices for individual mine-utility pairs along individual railroad routes using data on freight revenues and costs.<sup>11</sup>

## **C. THE LPM USES APPROPRIATE MARKET BASED RATES**

Willig and Eakin/Meitzen state that the STB's LPM does not comport with the Lerner Index because the Board's approach eschews reliance on true market prices and instead substitutes the estimated price for alternative transportation.<sup>12</sup> As discussed in Sections III and IV below, this is not a shortcoming because the LPM test is not meant to determine the

---

<sup>9</sup> See Wesley W. Wilson, "Legislated Market Dominance in Railroad Markets," *Research in Transportation Economics*, Volume 4, 1996, pages 49 to 67. Wilson's paper is most revealing because it relied upon ICC determined railroad variable costs in its analysis.

<sup>10</sup> See Marc Ivaldi and Gerard J. McCullough, "Railroad Pricing and Revenue-to-Cost Margins in the Post-Staggers Era," *Research in Transportation Economics*, 2007, vol. 20, issue 1, pages 153-178.

<sup>11</sup> See Mitch Kunce, Steve Hamilton and Shelby Gerking, "Marketable Permits, Low-Sulfur Coal, and the Behavior of Railroads" *American Journal of Agricultural Economics*, 2008, 90(4), pages 933 to 950.

<sup>12</sup> See Willig VS at page 13 and Eakin/Meitzen VS at page 6.

reasonableness of the challenged rate, but rather to determine whether alternatives exist that place pricing pressure on the railroad's rate setting exercise.

Willig also states the Board's LPM approach differs from the Lerner Index because comparing limit price R/VC to RSAM is not the same as the Lerner Index's approach of comparing market prices to marginal cost.<sup>13</sup> Specifically, Willig states that because the Lerner Index compares market prices to the marginal costs of a given movement, comparing the limit price R/VC to the RSAM ratio is inappropriate.

Willig's position is confused, and his criticism, that "comparing" a single movement's limit price R/VC to the RSAM creates a disconnect between the Board's test and the Lerner Index is misplaced. The Board's LPM test does depend upon a comparison of an individual movement's characteristics to averages across all potentially captive shippers, but only after developing the limit price R/VC ratio. In other words, only the first step in the LPM analysis, the calculation of the limit price R/VC, is relatable to the Lerner Index. The calculation of the movement-specific limit price R/VC ratio takes into consideration only an estimated market price for an alternate transportation option and a marginal cost surrogate for the specific studied movement, similar to how the Lerner Index compares a movement's price to its marginal cost. In other words, it is the movement-specific limit price R/VC that is analogous to the Lerner Index, not the entire LPM analytical framework.

It is only after a movement-specific ratio is developed that it is compared to the RSAM. The comparison of an index to a defined benchmark provides context relative to the specific question being asked. The STB chose to use RSAM as its benchmark because it represents the average markup over variable costs required on potentially captive traffic to enable a railroad to

---

<sup>13</sup> See Willig VS at page 13.

earn a return on investment equal to the current cost of capital. Therefore, the RSAM comparison sheds light on where the studied movement would fall in the railroad's overall contribution spectrum if it were priced at the limit price rate level, or, the extent to which the railroad would be able to impose differential pricing.

In addition, Willig claims that RSAM is driven in part by the measurement of fixed and common costs, not marginal costs, and, therefore, the LPM approach must be disregarded. Willig fails to make the distinction that the fixed and common cost elements of the RSAM calculation only directly impact the revenue component of the RSAM ratio, which is used in the numerator, and not the cost portion of the RSAM, which is in the denominator. As the STB explains in *Simplified Standards*,<sup>14</sup> the RSAM benchmark is calculated by adding the carrier's revenue shortfall (or subtracting the overage) shown in the STB's annual revenue adequacy determination, adjusted for taxes, to the numerator of the R/VC>180 benchmark. The variable cost portion of the calculation, which is used as a surrogate for marginal costs is not directly impacted by the fixed and common cost adjustment.

---

<sup>14</sup> See STB Ex Parte Ex Parte No. 689 (Sub No. 4), *Simplified Standards for Rail Rate Cases – 2012 RSAM and R/VC>180 Calculations*, served February 11, 2013 (“*Simplified Standards*”).

### III. ALTERNATIVE RATE VERSUS THE RAILROAD'S OVERALL REVENUE REQUIREMENTS

CSXT and its witnesses claim that the STB's test improperly evaluates the relationship between the alternative ("competitive") rate and the defendant railroad's overall revenue requirements. They posit that the Board instead should evaluate the relationship between the challenged rate and the competitive rate.

The Board has explained why the comparison CSXT advocates is meaningless and cannot be used to determine market dominance.<sup>15</sup> Under the framework CSXT proposes, the railroad would be free to price up to (and above) a patently absurd alternative, and make the perverse claim that the railroad does not possess market dominance over any move with a challenged rate exceeding the patently absurd alternative rate.

Eakin/Meitzen claim that the RSAM figure, "does not incorporate any information about the competitive dynamics of any particular market," and that, "information contained in RSAM... is void of any demand content."<sup>16</sup> They opine that "specific market information that is available—namely, the price charged by the railroad," does, "directly reflect information about demand," and consequently should be considered in the Board's test. Similarly, Willig states that, "[g]iven expected variations in demand for the railroad's services ... some traffic will need to move at rates above the RSAM percentage, and some will only be able to move at rates below RSAM."<sup>17</sup>

CSXT's experts' focus on demand as it relates to pricing reveals a fundamental misunderstanding of the purpose of the Board's LPM test. They completely ignore the most basic economic principle that, when there is a sole supplier (i.e., a monopoly market), the

---

<sup>15</sup> See, e.g., STB's *Market Dominance Decision* served May 31, 2013, p. 3.

<sup>16</sup> See Eakin/Meitzen VS in *M&G*, pp. 5-6.

<sup>17</sup> Willig VS., pp. 5-6.

monopolist may set high rates where sufficiently high demand is present. The Board's test does not evaluate the rate set by the railroad, or the demand characteristics that may place limits on the rates even a monopolist could charge. Rather, it evaluates the rate the railroad could set before losing traffic to an alternative transportation provider assuming there is adequate demand to support the limit price rate level.

To be clear, the Board's test purposely and correctly ignores the demand associated with the movement being studied. By assuming sufficient demand exists, the Board is able to correctly focus on determining whether any alternative supply options exist. The level of demand is irrelevant to the market dominance inquiry. Whether a monopolist moves one unit per year or one million units per day, it is still a monopolist, regardless of the rates it charges.

Furthermore, even if it were appropriate to consider the demand characteristics of the studied movements, CSXT's experts completely ignore all other factors, besides demand, that affect pricing in general, and monopoly pricing in particular. The price charged by a railroad in a monopoly market does not by itself identify the extent to which the railroad holds monopoly power. This is because, in a monopoly market, the supplier may grant concessions on price in order to dictate other service terms. Both low and high prices are possible in monopoly markets, and they are possible at all demand levels.

“A true monopoly supplier has no fear of new entrants increasing the aggregate supply of transport services and has the freedom *either* to set the price *or* to stipulate the level of service he is prepared to offer. The effective constraint on the monopolist is the countervailing power of demand which prevents the joint determination of both output and price.”<sup>18</sup>

---

<sup>18</sup> See Button, Kenneth J., *Transport Economics: 2<sup>nd</sup> Edition*, Edward Elgar Publishing, Inc., Northampton, MA, 1993, p. 123, emphasis in original.

Although demand influences the price charged by a monopolist supplier, it is not the sole determining factor. Therefore, a monopoly market price does not *by itself* provide any demand context. Eakin/Meitzen's claim that the price charged by the railroad identifies the level of demand is a gross oversimplification of a very complex railroad pricing exercise, and their claims that railroad price should be considered in the Board's LPM test is misplaced.

The purpose of the Board's test is to determine whether the alternative rate is one that could compete effectively with the defendant railroad given the railroad's cost structure and overall revenue requirements. There is no doubt that the railroad exercises market power over a significant portion of its traffic base. The RSAM calculation is a measure of the extent to which that market power must be exerted on average for the railroad to achieve revenue adequacy.<sup>19</sup> The RSAM ratio is calculated based on a subset of the railroad's traffic that excludes all traffic moving at rate levels for which there is a presumption that the railroad does not possess market dominance.<sup>20</sup>

If the alternative rate is relatively low compared to RSAM, the railroad has relatively less flexibility to dictate its terms (i.e., price and/or level of service offered). By definition, the less flexibility the railroad has to dictate its terms due to competitive pressures, the less market power it holds. Conversely, the higher the alternative rate is relative to RSAM, the greater the flexibility the railroad has to dictate its terms in the absence of competitive pressures, and the more market power it holds.

---

<sup>19</sup> Based on the STB's definition of revenue adequacy.

<sup>20</sup> Movements where the R/VC ratio is below 180%.

#### **IV. RSAM IS AN APPROPRIATE BENCHMARK RATE LEVEL**

Willig opines that an LP R/VC exceeding RSAM is not a valid indicator that competitive alternatives do not exist. To support his position, he states that, “R/VC ratios that are above RSAM... are just a mathematical necessity for a sustainable rail carrier.”<sup>21</sup> This statement mixes two distinct concepts and misses the Board’s point. First, the Board’s test does not consider the movement R/VC ratio, nor does the Board ever state that it believes movement R/VC ratios exceeding RSAM are unnecessary. On the contrary, the Board acknowledges that differential pricing is necessary for a healthy railroad industry. However, differential pricing can only occur where the railroad holds pricing power. As noted by economist William B. Tye “... a high R/VC is not a sufficient condition for an unreasonable rate, ... but this assertion does not gainsay the fact that such high ratios in the rail industry are a necessary condition for market dominance.”<sup>22</sup>

RSAM represents the average rate level required to achieve revenue adequacy when differential pricing is employed on all moves over which the railroad is presumed to possess some level of market dominance. The LPM test attempts to answer the question of whether (and the extent to which) the railroad holds pricing power sufficient to permit it to implement differential pricing in specific lanes. If the alternate transportation option price were matched by the incumbent railroad (assuming there was sufficient demand to support pricing at that level), and the resulting rate were to exceed RSAM, then it can logically be presumed that the studied lane affords the railroad an opportunity to exert market power and impose substantial differential pricing. In other words, the railroad can logically be presumed to hold market dominance, even if other market forces (such as demand) hold the actual rail rate below the limit price level.

---

<sup>21</sup> See Willig VS, p. 5.

<sup>22</sup> See William B. Tye, “Revenue/Variable Cost Ratios and Market Dominance Proceedings,” *Transportation Journal*, Volume 24, No. 2, 1984, pages 15-30 (“Tye”), at page 23.

The quantitative market dominance analysis is identical to the first step of the RSAM calculation: A determination of which movements move under rates with R/VC ratios below 180%. Therefore, both the quantitative market dominance test and the first step of the RSAM calculation divide all of the railroad's traffic into two strata at the same demarcation point. In both analyses, the railroad is presumed not to possess market dominance over movements with R/VC ratios below 180%. In the RSAM analytical framework, all movements with R/VC ratios at or above 180% are considered potentially captive traffic, but no further analysis is conducted to determine which of the potentially captive traffic is actually captive (i.e., traffic that is market dominant). In the LPM analytical framework, all movements with R/VC ratios at or above 180% are further evaluated to determine whether the railroad possesses market dominance over them.

The Board's LPM, which compares the LP R/VC to the RSAM benchmark, results in grouping all of the railroad's movements into three strata: (1) movements over which the railroad is presumed not to possess market dominance (excluded from the RSAM calculation), (2) movements over which the railroad potentially possesses market dominance (included in the RSAM calculation) with alternate options that move at rate levels that imply R/VC ratios below the average markup required to achieve revenue adequacy, and (3) movements over which the railroad potentially possesses market dominance (included in the RSAM calculation) with alternate options that move at rate levels that imply R/VC ratios above the average markup required to achieve revenue adequacy.

When the three strata of movements described above are plotted on a horizontal axis, the Board's model is shown to be reasoned and logical. Figure 1 below shows the stratification.

**Figure 1**  
**STB's Market Dominance Strata**

<i>Strata:</i>	1	2	3
		<i>R/VC=180</i>	<i>LP R/VC=RSAM</i>
<i>Test:</i>	Quantitative	LPM	LPM
<i>Presumption:</i>	No MD	No MD	MD
<i>Subject to Validation/</i>			
<i>Further Analysis:</i>	No	Yes	Yes

*Note: MD = Market Dominance*

The preliminary finding based on the comparison of the LP R/VC to the RSAM benchmark is simply a determination of whether a railroad rate that matches the alternate rate would imply a mark-up that is higher than the average mark-up that would be required to be applied on traffic over which the railroad has the ability to price differentially in order to achieve revenue adequacy. If so, the logical but still rebuttable conclusion is that the railroad is likely to possess market dominance over the strata 3 moves. Conversely, the logical but still rebuttable conclusion is that the railroad is not likely to possess market dominance over the strata 2 moves. Furthermore, the Board's framework logically concludes that the railroad is far more likely to possess market dominance over strata 3 moves that plot on the right side of the strata 3 group than strata 2 moves that plot on the left side of the strata 2 group in the figure above.

RSAM is a measure of the average price point at which all potentially captive traffic moving over a railroad system would collectively provide sufficient revenue for the railroad to achieve regulatory revenue adequacy. As a rational business, the railroad is logically presumed to strive for revenue adequacy.

For specific lanes in which potentially captive traffic moves, if alternate transportation options exist and move under rates that, if matched by the railroad, would result in railroad

pricing below the RSAM level, one can logically conclude that the railroad's market power is constrained by the alternative. Conversely, in specific lanes where alternate transportation options exist and move under rates that, if matched by the railroad, would result in railroad pricing above the RSAM level, one can logically conclude that the movement is a target for differential pricing aimed at recovering some of the revenues that are "lost" on the traffic moving in competitive lanes. For these lanes, the STB logically reaches the preliminary conclusion that the railroad possesses market dominance over the move, even if other market forces restrict it from imposing rates at the limit price level.

**V. THE LIMIT PRICE METHODOLOGY IS USED TO  
MAKE A PRELIMINARY DETERMINATION**

Eakin/Meitzen opine that, “[T]he Board’s use of the limit price approach is particularly troubling because its application of the test in this case suggests that it is being used as a *de facto* determination of market dominance.”<sup>23</sup> Eakin/Meitzen claim that the Lerner Index does not *by itself* definitively indicate the presence of market dominance, citing Elzinga/Mills, in support of their argument that the Lerner Index cannot be relied upon as the sole measure of monopoly power within a market, and that the Board’s use of the Lerner Index represents a fundamental and impermissible shift in qualitative market dominance determinations.<sup>24</sup> But the Board’s methodology accounts for the fact that there is no sole measure of monopoly power. The STB’s Decision expressly affirmed that its LPM test is not the sole determinant of market dominance. As the Board described in its *Market Dominance Decision*, the comparison of the limit price R/VC ratio to the RSAM ratio is only the initial step in the process.<sup>25</sup> After making the initial comparison, the STB then considers other relevant factors. Simply stated, the Board’s LPM is not a “one and done” test.

As shown in Figure 1 above and confirmed by the Board, the LPM results do not serve as the sole and the final determining factor regarding whether the railroad possesses market dominance over an individual movement. Although they criticize the Board’s process, it is conceptually sound. Eakin/Meitzen simply do not like the *results* of the Board’s process in this case.

---

<sup>23</sup> See Eakin/Meitzen VS at, page 9.

<sup>24</sup> See Eakin/ Meitzen VS at page 4.

<sup>25</sup> See *Market Dominance Decision* at page 4.

## VI. HIGH LIMIT PRICE R/VC RATIOS SIGNAL THE LACK OF EFFECTIVE COMPETITION

Willig opines that:

“[A] ‘limit price R/VC ratio’ that *seems* very high only has reliable implications for market dominance judgments if the revenues that would be generated by prices near the limit price were significantly above economic costs. The level of the ‘limit price R/VC ratio’ itself offers no insight regarding the presence or absence of market power because the amount of fixed and common costs may well far exceed the variable or marginal costs incurred by the traffic.”<sup>26</sup>

There are two problems with Willig’s argument. First, the railroad industry is characterized by substantial scale economies. Even with high total fixed costs, the fixed cost allocable to individual units is relatively small in comparison to the variable cost attributable to a unit of traffic. Second, the scenario described by Willig, although theoretically possible, is simply not common in the real world in *any* industry.

“[G]iven the absence of competition and the degree of freedom enjoyed by the monopolist, it is almost certain that a profit-maximizing price will result in charges above marginal and average cost (the only exception being the most unlikely situation of a perfectly elastic *market* demand curve).”<sup>27</sup>

Willig’s irrelevant hypothetical examples are red herrings. In addition, the argument completely ignores the concept of sunk costs. The argument that fixed or common costs may exceed variable costs in high fixed cost industries is another red herring and largely irrelevant to the US freight rail industry. Although the rail industry is land and infrastructure intensive, the network and operations are mature and the fixed costs are not as high as Willig implies.<sup>28</sup> This

---

<sup>26</sup> See Willig VS at page 7.

<sup>27</sup> See Button, Kenneth J., *Transport Economics: 2<sup>nd</sup> Edition*, Edward Elgar Publishing, Inc., Northampton, MA, 1993, p. 123, emphasis in original.

<sup>28</sup> This fact was also noted by Tye “With substantial barriers to entry, allegedly substantial economies of scope and substantial sunk costs in the rail industry, a rail carrier facing no competition from incumbents and charging prices substantially in excess of marginal costs would presumably qualify as a prime candidate to be considered for regulatory oversight.” See Tye at 22.

fact has been repeatedly demonstrated through the application of the STB's ATC methodology to allocate revenues on cross-over movements in maximum rate reasonableness cases. The ATC methodology identifies the variable costs (based on URCS) and the fixed cost component (based on the incumbent's fixed costs and densities) attributable to every cross over movement segment, and allocates revenues based on a ratio of the total (variable and fixed) costs attributable to each movement segment. The variable cost component of total costs dwarfs the fixed cost component in all instances.

## **VII. THE LPM TEST HAS NO BEARING ON A RAILROAD'S ABILITY TO ATTAIN REVENUE ADEQUACY**

Willig and Eakin/Meitzen assert that, because RSAM is the average mark-up required for the railroads to achieve revenue adequacy, using it to identify the point at which market dominance exists ignores differential pricing principles and conflicts with the goal of achieving long-term revenue adequacy. I disagree with their conclusions.

First, Willig includes the following statements:

“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 a 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 price some traffic at R/VC levels above RSAM to make up for traffic that must be priced at R/VC levels below RSAM.”<sup>29</sup>

Both of these statements are factually correct, but they are unrelated. The first sentence deals with the Board’s LPM test, which, as discussed above, is meant to evaluate the available alternate transportation option rates in the context of the defendant carrier’s revenue needs and cost structure. It does not consider the challenged rate or the R/VC associated with the challenged rate. A limit price R/VC can be either substantially greater than, or substantially less than, the challenged rate R/VC. The second sentence introduces the movement R/VC out of context. The LPM test is blind to movement R/VC, so it makes no judgment as to whether the movement is helping or hurting the railroad in its quest to achieve revenue adequacy.

After sufficiently confusing the two unrelated concepts of the LP R/VC and the movement R/VC, Willig concludes:

---

<sup>29</sup> See Willig VS, pp. 9-10.

“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.”<sup>30</sup>

This argument is faulty at its core, because, as discussed above, the carrier’s rate level (and R/VC) has no bearing on the LPM test findings. Stated differently, the “threat of market dominance findings” is the same for a given movement regardless of the rate level set by the carrier.

---

<sup>30</sup> *Id.*, p. 10.

### **VIII. URCS AVERAGE VARIABLE COSTS ARE A REASONABLE PROXY FOR TRUE MARGINAL COSTS**

Willig and Eakin/Meitzen claim that the measure of variable costs used in the limit price methodology is not a reliable indicator of marginal costs used in the Lerner Index.<sup>31</sup> This is simply a smoke screen as it is common practice in economic studies to use readily available variable costs as a surrogate for marginal costs. For example, in their paper *Tobin's q Ratio and Industrial Organization*, Lindenberg and Ross assume average variable costs equal marginal costs:

“Lerner indices can be constructed using firm-specific data alone. Because we lack adequate marginal cost data, we assume that average variable cost equals marginal cost.”<sup>32</sup>

Similarly, Wilson also makes the same simplifying assumption:

“Implicit in this analysis is the assumption that the variable cost measurement used in these proceedings was a reasonable approximation of marginal cost.” Given this assumption, the percent markdown from the monopoly price can be calculated.”<sup>33</sup>

This wide and accepted use of variable costs as a surrogate for marginal costs within the railroad industry is reiterated by Dr. William B. Tye:

“‘Variable cost’ in the rail industry generally refers to average variable costs as computed by the Interstate Commerce Commission’s Rail Form A methodology. It is conceptually equivalent to ‘average variable costs’ in economic theory, albeit adjusted for the multiservice enterprise by use of disaggregated output measures applied to variability percentages measured for the various cost accounts by regression analysis. Variable cost is often used as a proxy for marginal cost in the rail industry...”<sup>34</sup>

---

<sup>31</sup> See Willig at page 14 and Eakin/Meitzen at page 6.

<sup>32</sup> See Eric B. Lindenberg and Stephen A. Ross, “Tobin’s q Ratio and Industrial Organization,” *Journal of Business*, Volume 54, No. 1, 1981, pages 1-32, at page 27.

<sup>33</sup> See Wilson at page 59. Wilson’s paper is most revealing because it relied upon ICC determined railroad variable costs in its analysis.

<sup>34</sup> See Tye at page 15.

The ICC/STB has replaced Rail Form A with the Uniform Railroad Costing System (“URCS”) as its methodology for calculating a movement’s variable costs. This formula change does not alter the fact that variable costs are routinely used by economists as a proxy for marginal cost.

