

SURFACE TRANSPORTATION BOARD

DECISION

Docket No. EP 717

PETITION OF THE ASSOCIATION OF AMERICAN RAILROADS TO INSTITUTE A RULEMAKING PROCEEDING TO REINTRODUCE INDIRECT COMPETITION AS A FACTOR CONSIDERED IN MARKET DOMINANCE DETERMINATIONS FOR COAL TRANSPORTED TO UTILITY GENERATION FACILITIES

Digest:<sup>1</sup> This decision denies a petition filed by the Association of American Railroads asking the Board to institute a rulemaking proceeding to consider reintroducing indirect competition as a factor in determining the reasonableness of rail rates for coal transportation.

Decided: March 18, 2013

By petition filed on November 19, 2012, the Association of American Railroads (AAR) requests that the Board institute a rulemaking proceeding to consider the reintroduction of product and geographic competition as factors that may be considered in market dominance analyses under 49 U.S.C. § 10707 for complaints involving the transportation of coal to coal-fired generation facilities. For the reasons discussed below, the petition will be denied.

BACKGROUND

Under 49 U.S.C. § 10707, the Board may consider a challenge to the reasonableness of a rate only if the defendant rail carrier has market dominance over the traffic to which the rate applies. Market dominance is defined as “an absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies.” § 10707(a).

The Board’s current interpretation of “competition” means only direct competition, *i.e.*, competition from other railroads or other transportation modes, such as trucks or barges, to transport the same commodity between the same points. Accordingly, the Board does not consider evidence of indirect competition—product competition (*i.e.*, whether the complaining shipper can avoid using the defendant railroad by shipping or receiving a substitute product) or geographic competition (*i.e.*, whether the complaining shipper can avoid using the defendant

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<sup>1</sup> The digest constitutes no part of the decision of the Board but has been prepared for the convenience of the reader. It may not be cited to or relied upon as precedent. Policy Statement on Plain Language Digests in Decisions, EP 696 (STB served Sept. 2, 2010).

railroad by obtaining the same product from a different source, or by shipping the same product to a different destination)—in its market dominance analysis.

The Board’s rationale for excluding evidence of indirect competition in market dominance determinations was thoroughly considered and discussed in, Market Dominance Determinations—Product & Geographic Competition, Docket No. EP 627. In 1998, the Board instituted a rulemaking proceeding to reconsider whether product and geographic competition should be eliminated as factors in determining market dominance in rail rate cases.<sup>2</sup> The Board concluded that evidence of indirect competition should be excluded because such evidence was not required by § 10707(a) and because of the substantial burden its inclusion imposed on the parties and the Board.<sup>3</sup> Based on the record in the rulemaking proceeding and its experience in analyzing evidence of product and geographic competition in market dominance determinations, the Board found that an inordinate amount of time and resources were required of parties in presenting evidence on indirect competition alone, often including the need to respond to hundreds of discovery requests addressing product and geographic competition.<sup>4</sup>

Moreover, the Board found that consideration of indirect competition taxed its resources as well, requiring complex, in-depth analyses of non-transportation issues.<sup>5</sup> The Board pointed to its experiences in coal rate cases, which required the agency to educate itself on the shipper's industry and operations, and to “second-guess” shipper management decisions regarding the production and distribution of electric power.<sup>6</sup> As the Board noted, the time and resources required for it to analyze these non-transportation issues were exorbitant and prevented the agency from efficiently and expeditiously processing rate cases.<sup>7</sup>

The Board recognized the impact of its decision on rail carriers, having to defend challenges of some rates that may have been affected by indirect competition. But the Board found that any hardship would not be substantial because shippers that have effective indirect alternatives would be unlikely to pursue a rate challenge, and because a rate level constrained by effective indirect competition would be found to be reasonable.<sup>8</sup> In contrast, the harm of

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<sup>2</sup> Mkt. Dominance Determinations—Prod. & Geographic Competition, EP 627 (STB served Apr. 29, 1998). Prior to 1998, the Board and its predecessor agency, the Interstate Commerce Commission (ICC), considered indirect competition in its market dominance determinations. See Mkt. Dominance Determinations & Consideration of Prod. Competition, 365 I.C.C. 118 (1981); Special Procedures for Making Findings of Mkt. Dominance as Required by the R.R. Revitalization & Regulatory Reform Act of 1976, 359 I.C.C. 735 (1979).

<sup>3</sup> Mkt. Dominance Determinations—Prod. & Geographic Competition, 3 S.T.B. 937 (1998) (1998 decision).

<sup>4</sup> Id. at 946.

<sup>5</sup> Id. at 947.

<sup>6</sup> Id. at 947.

<sup>7</sup> Id. at 948.

<sup>8</sup> Id.

including indirect competition in the market dominance inquiry could be “substantial and irreparable” to the shipper community, in that shippers would be dissuaded from bringing valid rate complaints to the Board so as to avoid the substantial burdens associated with litigating indirect competition issues.<sup>9</sup>

By decision served July 2, 1999, the Board denied AAR’s petition for reconsideration of the 1998 decision.<sup>10</sup> The Board again explained its policy rationale for excluding evidence of indirect competition in the market dominance inquiry, stressing the inordinate burden it placed on complainant shippers, who not only devoted substantial time and resources responding to massive discovery requests, but also bore the substantial burden of preparing evidentiary presentations in response to allegations of product and geographic competition and educating the Board, which generally lacked expertise in non-transportation matters, on their industry and operations.<sup>11</sup> The Board also reiterated the heavy burden it faced in analyzing industrial operations far removed from transportation industries: “[W]ith enough time and resources, we can educate ourselves on the nuances surrounding a particular shipper’s business, but such analyses are seldom simple . . . and they severely tax our limited resources.”<sup>12</sup> The Board also stressed its concern that, by allowing evidence of product and geographic competition, captive shippers with legitimate rate complaints may be deterred from challenging such rates.<sup>13</sup>

AAR sought judicial review of the 1998 decision before the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit), asserting that the statutory definition of market dominance required consideration of all types of competition, including product and geographic competition.<sup>14</sup> AAR also argued that, in deciding to exclude consideration of product and geographic competition, the Board had failed to address the statutory rail transportation policy (RTP) to “allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail.” 49 U.S.C. § 10101(1) (RTP-1).<sup>15</sup> The D.C. Circuit remanded the case to the Board, “to weigh the effect, if any, [RTP-1] has on the statutory definition of market dominance set out in 49 U.S.C. § 10707(a).”<sup>16</sup> Notably, however, the D.C. Circuit agreed with the Board that the market dominance provisions of the statute did not on their face require consideration of product and geographic competition,<sup>17</sup> and also recognized that consideration of such competition had complicated rail rate cases and made

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<sup>9</sup> Id.

<sup>10</sup> Mkt. Dominance Determinations—Prod. & Geographic Competition, 4 S.T.B. 269 (1999).

<sup>11</sup> Id. at 276-77.

<sup>12</sup> Id. at 276-77.

<sup>13</sup> Id. at 277.

<sup>14</sup> Ass’n of Am. R.R. v. STB, 237 F.3d 676, 679 (D.C. Cir. 2001).

<sup>15</sup> Id. at 680.

<sup>16</sup> Id.

<sup>17</sup> Id. at 679-80.

it difficult to comply with the statutory mandate in 49 U.S.C. § 10704(d) to expedite the handling of challenges to rate cases.<sup>18</sup>

On remand, the Board reaffirmed that its determination to exclude indirect competition from the market dominance analysis was consistent with RTP-1, because, under its revised market dominance procedures, a competitive rate is unlikely to be challenged, and even if challenged, is unlikely to be disturbed.<sup>19</sup> The Board went on to state that consideration of product and geographic competition has a demonstrable negative effect on other relevant RTP goals, which it must weigh and balance, in particular the policy under 49 U.S.C. § 10101(6) that requires rates to be limited to reasonable levels in the absence of competition.<sup>20</sup> The Board stressed that “shippers must have practical, not merely nominal, access to the rate review process,” and found not only that “procedures that thwart a shipper’s ability to pursue a valid complaint are clearly inconsistent” with this policy,<sup>21</sup> but that the costs associated with litigating product and geographic competition posed “a substantial, potentially insurmountable, barrier to rate complaints.”<sup>22</sup>

AAR again sought judicial review of the 2001 remand decision before the D.C. Circuit, challenging the agency’s decision to preclude evidence of product and geographic competition. The D.C. Circuit denied the petition for review, finding the Board’s decision to be a reasonable exercise of its discretion. *Ass’n of Am. R.R. v. STB*, 306 F.3d 1108, 1112 (D.C. Cir. 2001) (“It appears then, that the [AAR] is not only asking us to substitute our policy wisdom for that of the Board, but is also essentially requesting that we overrule our prior determination that the Board’s decision to exclude evidence of indirect competition from the market dominance analysis was not arbitrary or capricious. We are not in either business.”).

#### AAR’S PROPOSAL

AAR proposes that the Board once again consider evidence of product and geographic competition in its market dominance determinations, here, for coal rate cases only. AAR states that changes in the wholesale power and natural gas markets have significantly increased the impact of indirect competition on rail rates used for coal for electric power generation. AAR describes how several factors, including the falling cost of natural gas production and the resulting increased supply of natural gas, have intensified competition between natural gas-fired generation and coal-fired generation across many geographic markets. With similar short-run marginal costs, AAR asserts that utilities may rapidly shift from coal-fired to natural gas-fired power generation. AAR states that, under these market conditions, a rail carrier’s rate for

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<sup>18</sup> *Id.* at 680.

<sup>19</sup> *Mkt. Dominance Determinations—Prod. & Geographic Competition*, 5 S.T.B. 492, 498 (2001).

<sup>20</sup> *Id.* at 498.

<sup>21</sup> *Id.* at 498-99.

<sup>22</sup> *Id.* at 499.

transporting coal, which significantly impacts a coal-fired plant's short-run marginal cost, is constrained by indirect competition, as small increases in its rate and thus increases in the short-run marginal costs for coal-fired generation, could result in losing sales. In light of this head-to-head competition between natural gas and coal, and the resulting impact it has on coal transportation rates, AAR submits that the Board should consider indirect competition in its market dominance analysis.

Although AAR acknowledges that the Board and its predecessor have previously found the analysis of indirect competition to be overly burdensome and time consuming, AAR submits that developments in the wholesale electric power and natural gas markets and in public access to readily available data now make it relatively simple and inexpensive to identify the impact of indirect competition on coal transportation rates. AAR further argues that consideration of indirect evidence would "deter some clearly meritless challenges."<sup>23</sup>

By way of example, AAR provides two approaches to indicate whether and to what extent rail rates for a particular coal-fired generation resource are constrained by indirect competition exerted in the wholesale power market, based on publicly available information. The first approach examines changes in the output of an individual coal-fired generation resource in response to changes in market conditions. A change in the generation output of a coal-fired power plant as natural gas prices and natural gas-fired generation output change would demonstrate, AAR asserts, the competitive constraint on rail transportation rates exerted by competition between a particular coal-fired plant and other generation resources (*e.g.*, natural gas-fired generation).<sup>24</sup>

The second approach examines the wholesale power supply curve which compares the short-run marginal costs of competitive alternatives. By examining where a particular resource's short-run marginal costs fall among its competitors, AAR states that one can see how small changes in short-run marginal costs can lead to a significant change in location on the supply curve, and thus, how the resource and its upstream suppliers are competitively constrained by indirect competition.

## REPLY COMMENTS

Norfolk Southern Railway Company (NSR) submitted comments in support of AAR's petition to reintroduce product and geographic competition in market dominance determinations. NSR describes the impact of changes in the wholesale power and natural gas markets in the eastern United States, where power plants expect to scale back production of coal-fired electricity in the wake of the newly abundant supply of natural gas and low gas prices. Compounding this impact, NSR explains, is the higher cost of coal-fired electricity production in the eastern United States due to heightened enforcement of existing environmental and safety regulations, particularly regulations targeting mining methods used in some Appalachian coal fields. NSR asserts that these factors have led to a substantially higher cost of coal produced in

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<sup>23</sup> AAR Petition at 10.

<sup>24</sup> AAR Petition, V.S. Reishus at 72.

the eastern United States versus coal from other regions. According to NSR, under such market conditions, utilities are taking advantage of competitive options to coal, namely natural gas. NSR asserts that, as a result, such indirect competition constrains coal transportation rates to certain coal-fired power plants.

The Concerned Captive Coal Shippers (CCCS)<sup>25</sup> submitted comments in opposition to AAR's petition. CCCS challenges AAR's interpretation of the market dominance standard, asserting that proper analysis of "effective" competition must consider whether railroad rates are constrained to reasonable levels. CCCS also argues that AAR mischaracterizes the agency's rationale for excluding evidence of indirect competition. Lastly, CCCS asserts that AAR's proposed methods for determining the existence of indirect competition would lead to complex litigation as shippers challenge the underlying assumptions behind the analyses put forth by AAR.

The Western Coal Traffic League and National Mining Association (collectively, WCTL/NMA) also oppose the petition. These commenters discuss the Board's reasons for not admitting evidence of indirect competition in a market dominance analysis and how coal cases, in particular, were impacted by massive litigation costs and excessive delay. WCTL/NMA further assert that AAR's sample approaches greatly oversimplify the analysis needed to determine whether rail rates are effectively constrained by indirect competition. Finally, WCTL/NMA argue that AAR's claim that allowing evidence of indirect competition is necessary to deter meritless cases is unsubstantiated.

The American Public Power Association, Edison Electric Institute, and National Rural Electric Cooperative Association (collectively, APPA/EEI/NRECA) jointly oppose AAR's filing. Among other things, APPA/EEI/NRECA assert that AAR has not provided any specific evidence of effective, indirect competition that has reduced even a single existing rail rate. Rather, these commenters note that rates are set by fixed contracts or tariffs, neither of which contains mechanisms that would allow rail rates to respond to short-term changes in electricity markets. APPA/EEI/NRECA further argue that AAR's "simple" approach to determining if indirect competition exists would likely result in costly, protracted litigation that would entail substantial discovery and complex analysis of non-transportation matters.

In opposition to AAR's petition, Consumers United for Rail Equity (CURE) notes that AAR has not shown any instance in which the wholesale electricity market has constrained the existing rate a railroad charges for moving coal to a captive coal-fired electricity generator. CURE adds that, to the contrary, many of its members have experienced an increase in rail rates.

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<sup>25</sup> CCCS includes the following entities: Alliant Energy Corporation, Dairyland Power Cooperative, Duke Energy Corporation, Grand River Dam Authority, Intermountain Power Project, Seminole Electric Cooperative, Inc., South Carolina Public Service Authority, South Mississippi Electric Power Association, and Wisconsin Electric Power Company.

Finally, Alliance for Rail Competition and several of its members<sup>26</sup> agree with many of the concerns raised by other opposition commenters. They are also concerned, however, about the implications of this proposal for shippers of commodities other than coal, noting that nothing in AAR's reasoning would preclude a railroad from making similar arguments as to any other commodity sold in the competitive marketplace.

## DISCUSSION AND CONCLUSIONS

The Board has devoted extensive consideration to its policy for limiting its market dominance inquiry to only evidence of direct competition. AAR has not persuaded us that the Board should depart from its existing policy and reconsider evidence of product and geographic competition. Having reviewed AAR's proposal, we find that AAR has not presented a practical framework that could be developed in a rulemaking proceeding for determining the existence of effective indirect competition and that the sample analyses it offers fail to overcome the practical difficulties the agency has identified in previous decisions. Accordingly, we will deny AAR's petition to institute a rulemaking proceeding.

Indirect competition may, in certain circumstances, effectively constrain rail rates for transportation of coal for electric power generation. The Board has recognized as much.<sup>27</sup> And while AAR has provided a compelling portrait of changes in the wholesale power industry where indirect competition may well have an impact on coal transportation rates, it has not presented evidence of rail rates that have been constrained by indirect competition or even offered a workable process for presenting and analyzing evidence of indirect competition. Instead, AAR has only provided two approaches or methods for applying publicly available information to evaluate indirect competition exerted by wholesale electric power markets on rail transportation of coal.

AAR's two approaches are not workable, formal proposals. For example, AAR offers no guidance as to how the Board actually would gauge the data presented in generation output charts or wholesale power supply curves other than by making rough observations of shifts in generation output or of whether a particular coal-fired generator "is along the 'flat' portion of the supply curve."<sup>28</sup> AAR even concedes that its examples "do not represent specific proposals for the implementation of definitive screens for indirect competition exerted by the wholesale

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<sup>26</sup> Montana Wheat & Barley Committee, Colorado Wheat Administrative Committee, Idaho Barley Commission, Idaho Wheat Commission, Montana Farmers Union, Nebraska Wheat Board, Oklahoma Wheat Commission, South Dakota Wheat Commission, Texas Wheat Producers Board, Washington Grain Commission, and the National Association of Wheat Growers.

<sup>27</sup> See Mkt. Dominance Determinations, 3 S.T.B. at 946 n.49 ("We have no doubt that in certain circumstances product and geographic competition effectively limit railroad pricing, as the ICC in fact found in several cases.").

<sup>28</sup> AAR Petition, V.S. Reishus at 76.

electric power markets.”<sup>29</sup> And AAR has also acknowledged that “while these examples demonstrate that competition from natural gas-fired generation can effectively constrain rail rates for coal transported to certain coal-fired generation resources, a number of factors have so far muted the effect of the displacement of coal-fired generation on railroads and rail pricing.”<sup>30</sup>

Indeed, we conclude that no meaningful determination can be made as to whether indirect competition effectively constrains rail rates to reasonable levels by using the methods put forth by AAR. In determining effective competition, the Board looks to whether there are competitive market pressures on railroads that deter them from charging monopoly prices for transporting goods.<sup>31</sup> AAR asserts that its analyses can be used to evaluate the indirect competition exerted by the wholesale electric power markets on rail transportation of coal, but, as CCCS points out, neither of AAR’s proposed methods provides any indication as to whether rates are set at reasonable levels, and thus whether indirect competition serves as an effective constraint on rates.<sup>32</sup> This agency has long recognized that the mere existence of a competitive alternative does not in itself constrain the railroads from charging rates far in excess of just and reasonable levels.<sup>33</sup> As the Board and ICC before it have held on numerous occasions, even a monopolist could price its services so high that patently absurd alternatives would eventually serve to constrain rates.<sup>34</sup> Rather, the agency examines whether any feasible transportation alternatives are sufficient to constrain the railroad rates to reasonable levels. Merely asserting that rail transportation of coal is subject to indirect competition by demonstrating that some coal-fired generation has been displaced by gas-fired generation in certain circumstances is not sufficient to determine whether *effective* indirect competition exists.

AAR also fails to demonstrate how its suggested methods would overcome the practical difficulties that the agency has identified in its previous decisions. AAR does not address the undue burdens and obstacles an analysis of indirect competition would impose upon the parties, particularly on complainant shippers. As CCCS notes, AAR’s approach does not consider the burdens of actual litigation before the Board.<sup>35</sup> While AAR alludes to this burden, noting that “a complainant shipper may rebut this indication [of indirect competition] with particularized facts

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<sup>29</sup> Id. at 71.

<sup>30</sup> Id. at 64. Factors identified as muting the effect of indirect competition on rail rates include long-term contracts that often include minimum volume commitments, market conditions that favor shippers, and the private nature of rail transportation contracts for coal. Id.

<sup>31</sup> See McCarty Farms v. Burlington N., 3 I.C.C. 2d 822, 832 (quoting Ariz. Pub. Serv. v. U.S., 742 F.2d 644, 650-51 (D.C. Cir. 1984); M&G Polymers USA v. CSX Transp., NOR 42123, slip op. at 11 (STB served Sept. 27, 2012).

<sup>32</sup> CCCS Comments at 7-14. See also, WCTL/NMA Comments at 20-21.

<sup>33</sup> See Ariz. Pub. Serv., 742 F.2d at 650-51; W. Tex. Util. v. Burlington N. R.R., 1 S.T.B. 638, 646 (1996).

<sup>34</sup> See Ariz. Pub. Serv., 742 F.2d at 651.

<sup>35</sup> CCCS Comments at 40.

unique to the coal-fired generation resource at issue,”<sup>36</sup> AAR fails to consider or discuss how its approach would avoid the costly, time-consuming litigation that would likely ensue, as parties challenge (and defend) the assumptions underlying any allegation that effective geographic or product competition exists.<sup>37</sup> By limiting the market dominance inquiry to evidence of direct competition, the Board set out to eliminate this sort of lengthy, complex litigation, and AAR has given us no reason here to depart from that approach.

In the same vein, the Board found that allowing evidence of indirect competition placed a substantial burden on the agency to analyze and address matters outside its expertise. The Board noted that the time required to examine the non-transportation aspects of a shipper’s business in order to assess the feasibility of a shipper changing its operations was inordinate and impeded efforts to expedite the market dominance determination. AAR contends that, even when shippers dispute the railroad’s argument that indirect competition exists, the Board could “quickly and accurately . . . identify the likely existence and effectiveness of indirect competition . . . without undue delay or burden.”<sup>38</sup> However, analyzing and adjudicating a contested allegation of indirect competition is rarely straightforward and would require a substantial amount of the Board’s resources to examine matters far removed from its transportation expertise and to determine if indirect competition effectively constrains rates to reasonable levels, particularly in light of the shortcomings of the sample analyses discussed above.

Any allegation of indirect competition would require the Board to delve deeply into non-transportation matters, such as examining the economics associated with wholesale power markets and considering the various factors that affect power supply choices.<sup>39</sup> Such an analysis would require the Board to second-guess the business determinations of utilities. To develop the necessary expertise, the Board would have to dedicate a significant amount of its limited

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<sup>36</sup> AAR Petition at 26.

<sup>37</sup> See CCCS Comments at 42 (“[T]he complaining shipper would be required to engage in a protracted analysis and demonstration of the many factors that undermine the railroad’s arguments); WCTL/NMA at 17-22 (describing the significant time and cost associated with performing additional analyses and discovery); APPA/EEI/NRECA Comments at 13 (stating that AAR’s methodology would result in substantial discovery regarding numerous issues, including wholesale electricity prices, the characteristics, operations and costs of coal-fired plants, and reasons why coal-fired power plants may be required to run regardless of cost).

<sup>38</sup> AAR Petition at 26.

<sup>39</sup> See, e.g., AAR Petition, V.S. Reishus at 74 (suggesting that the wholesale power supply and capacity curves “may not capture other aspects of a generator’s operations that may affect its dispatch into the grid”); WCTL/NMA Comments at 15 (noting the numerous factors besides competition that may cause changes in generation output levels); CCCS Comments at 46-47 (asserting that AAR’s wholesale supply curve analysis, which represents only a single day’s power supply curve, “ignores substantial complexity,” and would require the Board to consider several other factors, such as “any timing issues associated with the fact that natural gas prices change on a daily basis but coal shippers maintain coal inventories sufficient to cover weeks or months of generating load”).

resources. In excluding indirect competition from its market dominance analysis, the Board sought to eliminate the inordinate amount of time and resources it spent analyzing evidence as to whether it would be feasible for a utility to readily switch from coal-fired generation to natural gas-fired generation.<sup>40</sup> If the Board were to reintroduce product and geographic competition into the market dominance analysis, even only with regard to certain coal-fired utilities, the agency's limited resources could be unduly taxed analyzing matters far removed from the transportation industries it regulates.

In conclusion, we find that AAR's proposal fails to provide a practical means of determining the absence or presence of effective competition for coal transportation. Nor does AAR's proposal overcome the administrative burdens that underlie the Board's rationale for excluding indirect product and geographic competition from its market dominance determinations. For these reasons, we will deny AAR's petition.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. The petition to institute a rulemaking is denied.
2. This decision is effective on its date of service.

By the Board, Chairman Elliott, Vice Chairman Begeman, and Commissioner Mulvey.

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<sup>40</sup> See, e.g., APPA/EEI/NRECA Comments at 18 (asserting that individual characteristics of a power plant must be examined in assessing how easily a coal-fired plant could be replaced by gas-fired generation).