PUBLIC VERSION

BEFORE THE
SURFACE TRANSPORTATION BOARD

TOTAL PETROCHEMICALS & REFINING USA, LLC

Complainant,

v.

CSX TRANSPORTATION, INC.

Defendant.

Docket No. NOR 42121

CSX TRANSPORTATION, INC.'S PETITION FOR RECONSIDERATION

Peter J. Shudtz
Paul R. Hitchcock
John P. Patelli
CSX Transportation, Inc.
500 Water Street
Jacksonville, FL 32202

G. Paul Moates
Paul A. Hemmersbaugh
Terence M. Hynes
Matthew J. Warren
Hanna M. Chouest
Marc A. Korman
Sidley Austin LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000
(202) 736-8711 (fax)

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PREFACE AND SUMMARY OF ARGUMENT

Defendant CSX Transportation, Inc. ("CSXT") respectfully submits this Petition for Reconsideration of the Board's May 31, 2013 Decision in this proceeding ("*Decision*"). The Decision contains six material errors that warrant reconsideration under 49 C.F.R. § 1115.3(b).

The first five material errors stem from the Board's use of the so-called "limit price" approach to determine whether CSXT possesses qualitative market dominance over scores of lanes for which the Board found that truck transportation was a feasible alternative. As articulated by Congress, the existence of feasible and cost-competitive transportation alternatives should preclude a finding of qualitative market dominance.[1] But in a search for an "objective" method for assessing qualitative market dominance, the Board has adopted a formula that converts the qualitative market dominance inquiry into a second quantitative Revenue-to-Variable-Cost ("R/VC") test for market dominance. If a movement has a "limit price R/VC" above the carrier's Revenue Shortfall Allocation Method percentage ("RSAM"), the Board presumes market dominance unless some "intangible factor" disturbs that conclusion. This R/VC-based approach to qualitative market dominance is at odds with the statute, and the Board's reliance on it is material error that warrants reconsideration, for five reasons.[2]

<u>First</u>, the Board's approach violates the statutory prohibition against using R/VC ratios to create a presumption of qualitative market dominance, and the Board's attempt to read the statute

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[1] *See* H.R. REP. 96-1035 at 39 (1980):

> If a shipper can rely on a transportation alternative, which could include another railroad, a barge, or a truck, at a transportation cost which is not substantially greater than the rail transportation cost, then competition is present. Competition will serve to hold down rates, and the railroad involved would not have market power.

[2] Space does not allow full discussion of the reasons the limit price approach violates governing law. CSXT attaches as Exhibit 3 to this Petition for inclusion in the record of this case the previous comments it submitted in *M&G Polymers* regarding the limit price approach.

in a way that would permit its flawed approach is incompatible with the fundamental rule that every provision of a statute must be interpreted to have significance and effect. The Board's claim that 49 U.S.C. § 10707(d)(2) only precludes it from setting an R/VC presumption at 180% would make § 10707(d)(2) a surplusage, for other provisions of § 10707 require the Board to consider qualitative market dominance for movements with R/VC ratios over 180%. The only remaining reasonable interpretation of § 10707(d)(2) is that it precludes the agency from using qualitative market dominance presumptions from R/VC ratios "equal to *or greater than* 180 percent"—exactly what the limit price has the Board do. § 10707(d)(2) (emphasis added).

<u>Second</u>, the Board's use of the limit price approach violates the Administrative Procedure Act ("APA"). By adopting the limit price approach, the Board is substantively amending the agency's longstanding rules for assessing qualitative market dominance. Because the agency adopted the existing market dominance rules in a notice-and-comment rulemaking, the Board may amend those rules only through a notice-and comment rulemaking.

<u>Third</u>, the Board's new rule seeks to solve a non-existent problem and would not simplify the market dominance analysis. Concern about how to respond to "patently ridiculous transportation alternatives" does not warrant remaking the market dominance test. Decision at 3, 16. The Board has ample ability under its current rules to reject "patently ridiculous" alternatives. And the "patently ridiculous" scenario has little application here, where the Board is considering transportation alternatives that TPI uses today. And the limit price approach does not simplify the evidence that the parties must submit or the issues that the Board must consider. It rather increases arbitrariness without decreasing complexity.

<u>Fourth</u>, the limit price approach has no meaningful economic content, and the Board erred by using an approach that has no logical nexus to whether competition is "effective."

Reliance on RSAM to delineate limit price R/VCs that are "competitive" and those that are "noncompetitive" is not economically defensible. Exhibits 1 and 2 to this Petition for Reconsideration are verified statements from three respected economists with expertise in transportation markets—Professor Robert Willig of Princeton University and Drs. B. Kelly Eakin and Mark Meitzen of Christiansen Associates—who detail some of the significant economic shortcomings of the limit price approach.

Fifth, the limit price approach is unlawful for multiple other reasons, including the fact that it makes the effectiveness of competition depend upon the identity of the rail carrier and the fact that it would effectively switch the burden of proof of market dominance from the complainant to the railroad.

Sixth, the final material error in the Board's decision is its {{

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For these reasons, the Board should reconsider the May 31 Decision, abandon the limit price test, and evaluate the effectiveness of competition in each lane on a case-by-case basis in accordance with its existing market dominance rules. Moreover, the Board should {{

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PETITION FOR RECONSIDERATION

I. THE LIMIT PRICE APPROACH VIOLATES THE INTERSTATE COMMERCE ACT BY USING A QUANTITATIVE PRESUMPTION TO DETERMINE QUALITATIVE MARKET DOMINANCE.

The first material error in the Board's reliance on the "limit price" approach is the fact that the Interstate Commerce Act expressly bars the Board from relying on an R/VC-based presumption to determine qualitative market dominance:

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

49 U.S.C. § 10707(d)(2). The legislative context of § 10707(d)(2) is important: it was enacted as part of the Staggers Act by a Congress disappointed in the ICC's initial interpretation of the market dominance requirement—an interpretation that, among other things, created a rebuttable presumption of market dominance for traffic with an R/VC ratio over 180%.[3] Congress responded by creating a quantitative rule eliminating Board jurisdiction over movements with R/VC ratios below 180% and requiring a separate *qualitative* evaluation of market dominance for traffic with R/VC ratios above that threshold.[4] And Congress specifically prohibited the use

[3] *See Special Procedures for Making Findings of Market Dominance as Required by the Railroad Revitalization and Regulatory Reform Act of 1976*, 353 I.C.C. 875, 886-87 (1976); *see* H.R. REP. 96-1035, at 38 (1980) ("In the 4R Act, Congress instituted the so-called 'market dominance' test in hopes of removing most traffic from rate regulation. Unfortunately, the rules promulgated by the Commission freed up less than 30 percent of the traffic from regulation.").

[4] *See* H.R. CONF. REP. 96-1430, at 88 (1980) ("since other parts of the Conference Substitute provide additional rate freedom for rail carriers beyond those found in present law or under existing or proposed Commission regulations, the Commission must revise its market dominance regulations"); *see also Market Dominance Determinations and Consideration of Product Competition*, 365 I.C.C. 118, 119 n.4 (1981) (recognizing that "[p]assage of the Staggers Act

of R/VC ratios at or above 180% to "establish a presumption" that a defendant "has or does not have market dominance." 49 U.S.C. § 10707(d)(2) Using "limit price R/VCs" to establish a quantitative presumption of market dominance directly contravenes this statutory command.

None of the Board's three rationales attempting to reconcile the limit price approach with § 10707(d)(2) has merit. First, the Board argues that "a more reasonable interpretation is that the statute simply prohibits us from using 180% as the demarcation point for market dominance purposes." *Decision* at 21 n.69. That interpretation contradicts basic rules of statutory construction. For if § 10707(d)(2)'s only purpose were to prevent the Board from presuming market dominance from R/VC ratios over 180%, the clause would be entirely superfluous. The statute commands the Board both to determine whether the railroad has qualitative market dominance in every case (§ 10707(b)) *and* to find a lack of market dominance for transportation with an R/VC below 180% (§ 10707(d)(1)(A)). Thus, if § 10707(d)(2) were deleted from the statute, the remainder of § 10707 still would require the Board to consider qualitative market dominance for traffic with an R/VC over 180%. The Board's chosen interpretation would violate the "'cardinal principle of statutory interpretation' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.'" *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001).[5] Section 10707(d)(2) "must be doing something more"[6] than simply replicating other provisions of the statute, and to

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required modification" of an earlier ICC proposal that would maintain the use of a rebuttable R/VC presumption).

[5] *See also Burlington No.—Control & Merger—St. Louis-San Francisco Ry. Co.*, 360 I.C.C. 788, 948 (1980) ("In statutory construction, significance and effect shall, if possible, be accorded to every word. No clause, sentence, or word shall be superfluous, void, or insignificant.").

[6] *Agency for Int'l Dev. v. Alliance for Open Society Int'l, Inc.*, No. 12-10, slip op. at 11 (U.S. June 20, 2013).

give § 10707(d)(2) independent effect, the clause must be interpreted to forbid presumptions based on R/VCs "equal to or greater than 180 percent." § 10707(d)(2) (emphasis added).[7]

Second, the Board claims that the statute is not implicated because the limit price R/VC methodology is calculated from the rate for the alternative transportation and not the challenged rail rate. *Decision* at 21. But the whole analytical justification for the limit price approach is that the limit price equates to "the highest price CSXT theoretically could charge TPI" without losing a significant amount of traffic. *Id.* at 3, 17. Using R/VC presumptions based on hypothetical CSXT rates rather than the actual CSXT rates violates § 10707(d)(2). Moreover, this distinction makes no difference here. The transportation alternatives presented in this case all have rates comparable to the challenged CSXT rates. *See* CSXT Reply Ex. II-B-5. There is therefore no practical distinction between a "limit price R/VC" comparison to RSAM and an actual R/VC comparison. The Board cannot lawfully avoid the command of § 10707(d)(2) by substituting hypothetical R/VC ratios of similarly-priced alternatives in lieu of the actual rail rates.

Third, the Board asserts that § 10707(d)(2) is inapplicable because the limit price approach "establishes no presumptions of any kind." *Decision* at 21. On the contrary, the limit price test sets forth a classic presumption.[8] If the limit price R/VC is above the carrier's RSAM, the Board "will preliminarily conclude" that the alternative is not effective competition; if the limit price R/VC is below the carrier's RSAM, the Board will "preliminarily conclude" that the alternative is effective competition. *Id.* at 18. And in either case, the Board "will consider

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[7] Moreover, the Board's chosen interpretation leads to the illogical conclusion that § 10707(d)(2) poses no bar to the agency setting a presumption at 200%, 185%, or even 181%. It is not reasonable to assume that a Congress that was displeased with the ICC's original R/VC-based presumptions intended § 10707(d)(2) to have such a minimal effect on the agency's ability to substitute R/VC presumptions for case-by-case assessment of the effectiveness of competition.

[8] *Cf.* BLACK'S LAW DICTIONARY 1185 (a "presumption" is "a rule of law . . . by which finding of a basic fact gives rise to existence of [the] presumed fact, until presumption is rebutted").

whether the alternative has any intangible features sufficient to overcome the applicable preliminary conclusion." *Id.* In other contexts the Board has recognized that such a framework creates rebuttable presumptions,[9] and using the label "preliminary conclusion" cannot avoid the reach of § 10707(d)(2)'s prohibition.

Moreover, the Board's claim that the limit price R/VC does not establish a "presumption" is disproven by its approach in this case, where the limit price R/VC was dispositive for every lane for which the Board found a feasible option. The Board claims that the limit price methodology does not apply "a rigid and single-minded focus on the limit price R/VC ratio to the exclusion of other evidence." *Decision* at 24. But in this case the Board's market dominance decision matched the limit price "preliminary conclusion" in {{ }} out of {{ }} lanes. Indeed, the limit price presumption controlled even when the margin between the limit-price R/VC and RSAM is razor-thin.[10] And the presumption was unaffected by significant real world factors such as actual, historical truck usage; the Board found CSXT to be market dominant on several lanes with a history of substantial truck shipments and found a lack of market dominance on several lanes with no recent truck shipments.[11] Not only is the limit price R/VC a presumption, it is an exceptionally powerful presumption that the Board has found to be rebutted

[9] *See, e.g.*, *Simplified Standards for Rail Rate Cases*, STB Ex Parte No. 646 (Sub-No. 1), at 21-22 (Sept. 5, 2007) (discussing "rate reasonableness presumption" in Three Benchmark cases and ability to rebut that presumption through other relevant factors).

[10] For example, the Board found CSXT market dominant on {{ }} lanes with limit price R/VCs less than fifteen percentage points higher than its RSAM. *See* Lanes {{ }} And it found a lack of market dominance where a limit price R/VC was just 3% less than RSAM. *See* Lane {{ }}.

[11] For example, Lane {{ }} had {{ }} truck shipments between 2008 and 2010 and Lane {{ }}had {{ }} truck shipments in that period, but the Board did not even mention that history when concluding that the alternatives "had no intangible features sufficient to overcome the preliminary conclusion." *See Decision* at 60, 71; TPI Opening at II-B-46 & II-B-69. In the same vein, the Board found that CSXT was not market dominant on {{ }} lanes that had no recent truck shipments. *See* Lanes {{ }}

just 2% of the time.[12] Because § 10707(d)(2) precludes the Board from relying on this type of presumption, the Board's use of this test is a material error warranting reconsideration.

II. ADOPTION OF THE LIMIT PRICE RULE WITHOUT A RULEMAKING VIOLATES THE ADMINISTRATIVE PROCEDURE ACT.

Because the existing *Market Dominance Determinations* rule is a legislative rule adopted through notice-and-comment rulemaking, the Board may amend or replace that rule only through a notice-and-comment rulemaking. Indeed, *Market Dominance Determinations* expressly rejected two main pillars of the Board's new approach: (i) the use of rebuttable presumptions based upon revenue-to-variable-cost ratios; and (ii) the use of "pre-determined statistical measures" such as RSAM. *See Market Dominance Determinations,* 365 I.C.C. at 119 n.5. The APA requires that an amendment, change or repeal of a substantive rule adopted through notice-and-comment rulemaking may be effected only through notice-and-comment rulemaking. *See* 5 U.S.C. §§ 551(5), 553(b)(3)(A). Accordingly, amendment of the *Market Dominance Determinations* rules in this individual adjudication would violate the APA.

A. Rules Adopted Through Notice-And-Comment Rulemaking May Be Amended Only Through Notice-And-Comment Rulemaking.

An agency like the Board may not amend in an individual adjudication a substantive rule adopted through notice-and-comment. The qualitative market dominance rule is a legislative (substantive) rule because it has the force and effect of law and does not fit into the APA's narrow exception to the notice and comment requirement for interpretive rules and "rules of agency organization, procedure, or practice." *See James V. Hurson Assocs. v. Glickman,* 229 F.3d 277, 280 (D.C. Cir. 2000) (quoting 5 U.S.C. § 553(b)(3)(A)).

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[12] In *M&G* the Board found the presumption to be rebutted for two of 42 rates, so combining *M&G* and *TPI* results in two out of {{ }} limit price applications in which the Board has found sufficient "intangible features" to rebut its "preliminary conclusion" of market dominance.

The D.C. Circuit has consistently held that an amendment to a legislative rule requires a notice-and-comment rulemaking proceeding. *See, e.g., American Mining Congress v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1112 (D.C. Cir. 1993). A rule that "effectively amends a prior legislative rule" is itself a legislative rule requiring notice-and-comment rulemaking under the APA. *Id.*[13] Exceptions to the notice-and-comment rulemaking requirement are narrowly construed.[14] The limit price requires notice-and-comment rulemaking because it would make substantive changes to rules determining whether the Board has jurisdiction over a challenged rate.[15]

The new qualitative market dominance rule the Board purports to adopt in this case plainly is a legislative rule. Indeed, the Board does not claim otherwise. *See Decision* at 22. The threshold determination of whether the Board may entertain a rate challenge at all is every bit as substantive—and every bit as central to the determination of the rights and obligations of carriers and shippers—as the SAC test or any other part of the Board's rate reasonableness regime. The new rule would amend the Board's existing market dominance rules substantively by creating a new formula-based rule that repudiates the existing qualitative market dominance rule and analysis.[16] The Board's assertion that the new limit price test is merely a "refinement"

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[13] *See also United States Telecom Ass'n v. FCC,* 400 F.3d 29, 34-35 (new rules that make substantive changes to existing rules or regulations are legislative rules, subject to APA notice and comment requirements); *Sprint Corp v. FCC,* 315 F.3d 369, 374 (D.C. Cir. 2003).

[14] *N.J. Dep't of Envtl. Prot. v. U.S. EPA*, 626 F.2d 1038, 1045 (D.C. Cir. 1980).

[15] *See Sprint,* 315 F.3d at 374 ("new rules that work substantive changes in prior regulations are subject to the APA procedures ... [W]hen an agency changes the rules of the game...more than a clarification has occurred."); 5 U.S.C. §§ 551(5), 553(b)(3).

[16] *See, e.g., Am. Mining Cong.*, 995 F.2d at 1109 ("[i]f a second rule repudiates or is irreconcilable with a prior legislative rule, the second rule must be an amendment of the first," subject to notice and comment requirements) (internal quotation marks omitted); *Alaska v. U.S. Dep't of Transp.*, 868 F.2d 441, 446-47 (D.C. Cir. 1989).

of the existing market dominance rules, and not a new rule or amendment of the existing rules, cannot withstand scrutiny.

The limit price change to the market dominance rule represents, at the very least, a significant amendment to that legislative rule. The Board's proposed change would radically transform its approach to assessing qualitative market dominance from: (i) a comprehensive consideration of numerous *qualitative* and market-specific factors and variables using the Board's knowledge, experience, and expert judgment; to (ii) computation of an arithmetic formula and *quantitative* comparison of the result to a gross macro statistic (RSAM) that contains no market-specific information. This very substantial change from the present qualitative totality of the circumstances analysis, to application of an irrelevant statistic to an immaterial quantitative formula is a major amendment to the Board's market dominance rule.

The primary change wrought by the *Market Dominance Determinations* rulemaking was rejection of the very sort of rebuttable presumptions that lie at the heart of the new rule the Board has adopted in this case. *See* 365 I.C.C. at 120 (primary discussion captioned "Elimination of Rebuttable Presumptions"). First and foremost among the rebuttable presumptions rejected by the qualitative market dominance rule was an R/VC-ratio-based presumption. *See id.* at 121-22 (explaining some of the reasons that an R/VC ratio does not "reliably indicate the presence or absence of market dominance."). In the same rule, the agency expressly rejected reliance on "predetermined statistical measures" to evaluate qualitative market dominance. *See id.* at 118, n.5. The limit price test represents a 180 degree departure from the principles established in the *Market Dominance Determinations* rule. The new rule announced in this case would rely on a presumption (theoretically rebuttable but found unrebutted in every instance in the present case) based on comparison of an R/VC ratio and a predetermined statistical measure (RSAM), the very measures rejected and "eliminated" by the existing rule.

Given this stark about-face to adopt the very type of approach rejected in *Market Dominance Determinations*, the Board's characterization of its new rule as a mere "refinement" of the existing rule does not withstand scrutiny. The new test the Board proposes is radically different from the approach adopted by the ICC in a rulemaking and applied in rail rate cases in the intervening thirty years. The difference between the Board's existing rule and the new rule imposed here is not a difference in degree, it is a difference in kind. The new rule would effectively repeal the Board's existing fact-and-circumstance-specific totality analysis and replace it with an arbitrary mechanical formula that would create a presumption of market dominance without even considering the most relevant market information. Labeling a wholesale rule change a "refinement" does not make it so—the limit price test is a new rule, or at the very least a substantial amendment to the existing rule.

Consistent with the APA, the Board may only amend the existing market dominance rule in a notice-and-comment rulemaking. An agency may not adopt a new position that is inconsistent with an existing rule adopted in a rulemaking without conducting a notice-and-comment rulemaking. As the D.C. Circuit admonished, "an administrative agency may not slip by the notice and comment rule-making requirements needed to amend a rule by merely adopting a *de facto* amendment to its regulation through adjudication."[17]

Moreover, the Board itself previously recognized that a rulemaking proceeding is necessary to adopt substantive modifications to these same rules. The Board eliminated

[17] *Marseilles Land and Water Co. v. FERC,* 345 F.3d 916, 920 (D.C. Cir. 2003); *see Shalala v. Guernsey Mem'l Hosp.*, 514 U.S. 87, 100 (1995) (an agency interpretation that "adopt[s] a new position inconsistent with . . . existing regulations" must follow APA notice and comment procedures).

consideration of product and geographic competition from its market dominance rules through a notice-and-comment rulemaking, a necessary step to amend or replace existing rules established through notice-and-comment rulemaking. *See Market Dominance Determinations – Product and Geographic Competition*, 3 S.T.B. 937 (1998). The overhaul of qualitative market dominance rules the Board would impose here is at least as far-reaching as those prior amendments and similarly requires notice-and-comment rulemaking. Thus, even if the Board's new rule change were otherwise sound, consistent with the statute, and adequately explained and supported—and it is not—its adoption without a rulemaking renders it invalid.

B. The Board's Receipt of Comments in M&G Does Not Cure the Flaw in the Board's Adoption of a New Legislative Rule in This Individual Adjudication.

When the Board first proposed its limit price approach in *M&G*, it allowed limited comments by interested non-parties, but only as *amici curiae* who lacked standing to participate in the case or to challenge any rule the Board might have adopted. *See M&G v. CSXT*, STB Docket No. 42123, at 3 n.10 (Oct. 25, 2012). Thus, even the interested non-parties who submitted comments were not afforded a full and fair opportunity to provide input and have that input fully taken into account in the development of a new rule. In this case, however, the Board has further closed the process by expressly refusing input from interested persons other than the Complainant and Defendant. This constricted approach denies numerous affected non-parties the right to comment on the new rule.

Nor does the Board's superficial and incomplete discussion of a limited subset of the comments filed in the *M&G* case satisfy the requirements of the APA. In the first instance, consideration in this individual adjudication of comments submitted in a prior adjudication is a poor substitute for the APA-mandated notice-and-comment rulemaking. Even if the Board considered non-party comments in the context of this individual adjudication, such an approach would fall well short of the required rulemaking proceeding. However, the Board's current approach is even further removed from reasonable notice-and-comment because it afforded non-parties no opportunity whatsoever to comment in this proceeding. *See Decision* at 29 n.83 (claiming there is "no need" to allow interested non-parties to comment on the new rule adopted in this case).

In any event, the *Decision*'s discussion of comments submitted in *M&G* failed to address many of the comments and criticisms submitted in that proceeding. Moreover, the Board's summary responses to the few selected comments to which it did respond are insubstantial and inadequate.[18] As Commissioner Begeman indicated in her dissent, it is telling that despite overwhelmingly negative comments and opposition from shippers and carriers alike in *M&G,* the Board majority adopted the new Limit Price rule in this case without any modification. *See* Decision at 31.

III. THE LIMIT PRICE TEST SOLVES A NON-EXISTENT PROBLEM AND DOES NOT SIMPLIFY THE QUALITATIVE MARKET DOMINANCE INQUIRY.

Not only is the limit price approach legally flawed, the Board's justification for the approach is misguided. The Board's overarching answer to the many substantive critiques of the limit price approach that were submitted in *M&G* is to conclude that the limit price approach is the best available response to "the compelling need to develop a more objective approach for resolving the issue of effective competition, given the rapidly escalating complexity of the

[18] For example, in response to comments overwhelmingly showing that RSAM is an entirely inapt gauge of market dominance in specific situations and is neither intended nor suited to serve such a function, the Board states that the measure is "sufficiently accurate for our purposes here." *Decision* at 25. To "demonstrate" the accuracy of RSAM for that purpose, the Board posits that an R/VC near the jurisdictional threshold suggests that market forces constrain a carrier's prices, while an R/VC in excess of 500% suggests market forces are not constraining the carrier's pricing. *Id.* Conspicuously absent from this explanation is any mention of a specific RSAM, or any role of RSAM in the crude R/VC comparison.

market dominance inquiry in a number of our rate cases." *Decision* at 26. But the solution the Board proposes does not simplify the market dominance inquiry. The Board is required to consider all the evidence that it must consider under the traditional test; the only "simplification" is to substitute a mechanical presumption for a considered expert judgment based on all the evidence. Indeed, the problem that the limit price test purports to address is mostly a hypothetical one that the Board can readily address on a case-by-case basis.

The Board's belief that the limit price approach will simplify the market dominance inquiry is a false hope. To be sure, the market dominance process in this case has been complex. But that is a function of 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." The limit price test would do nothing to eliminate this inherent complexity, as the *Decision* illustrates. Applying its "simplifying" approach required the Board to address each of TPI's arguments concerning the feasibility of rail alternatives and to consider what "intangible features" could overcome the "preliminary conclusion" established by the limit price formula. And in future cases, parties litigating under the limit price test would have every incentive to submit evidence bearing on the feasibility of alternatives or "intangible features" that might rebut or bolster he results of the limit price analysis. Indeed, the Board admits that the limit price test "is not intended to exclude any factor the Board has previously stated it will consider in the qualitative market dominance context," a concession that makes it hard to understand how the limit price test is any simpler than a traditional market dominance analysis. *Decision* at 23 n.74.[19]

[19] If the Board is concerned about the complexity of the market dominance inquiry, that concern should be alleviated by the fact that the many issues the Board resolved in the *Decision* and in

The Board also claims that the limit price test is necessary to determine whether feasible and comparably-costed transportation alternatives are "effective" competition and not evidence of a railroad pricing up to a "patently ridiculous transportation alternative." *Decision* at 16. But the "horse and buggy" hypothetical posited in *Arizona Public Service* can be addressed under the existing rules and provides no reason to adopt a patently arbitrary methodology.

In the first place, a hair-splitting analysis of whether a feasible, cost-competitive alternative that is used in the real world is sufficiently "effective" competition is not consistent with congressional intent. On the contrary, the legislative history of the Staggers Act suggests that in Congress's view the existence of feasible and cost-competitive transportation alternatives should preclude a finding of market dominance:

> If a shipper can rely on a transportation alternative, which could include another railroad, a barge, or a truck, at a transportation cost which is not substantially greater than the rail transportation cost, then competition is present. Competition will serve to hold down rates, and the railroad involved would not have market power.

H. REP. 96-1035 at 39. But even assuming that there may be instances where a feasible and cost-competitive transportation alternative is not effective competition for market dominance purposes, those situations would be the exception, not the rule. As the *Arizona Public Service* court held, cost comparability with patently ridiculous alternatives may not demonstrate effective competition, for "[a]t some point the availability of an alternative such as the horse and buggy or even people carrying oil in buckets theoretically prevents railroads from raising their rates beyond an outer bound." *See Arizona Pub. Serv. Co. v. United States*, 742 F.2d 644, 651 (1984). But these extreme hypotheticals are no reason for the Board to assume that cost-comparability with a feasible alternative is not powerful evidence of a lack of market dominance in ordinary

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M&G will clarify what evidence will and will not constitute evidence of feasible market dominance alternatives and thus should narrow the issues and simplify future cases.

circumstances. And they are certainly no reason for the Board to develop a quantitative presumption to address a scenario that would rarely arise.

The Board's long-established market dominance rules give it the discretion to determine whether a transportation alternative is effectively constraining rail rates as part of a considered, fact-specific judgment that accounts for all the relevant circumstances. For example, in *DuPont (Plastics)*, the Board concluded that CSXT's tariff rate for an 820-mile movement of plastic powder was not effectively constrained by direct truck competition because of the length of the haul, because the physical characteristics of the issue commodity significantly complicated truck transportation, and because truck transportation was somewhat more expensive. *See DuPont v. CSXT*, STB Docket No. 42099, at 7 (June 30, 2008). While CSXT disagreed with the Board's judgment that this direct truck alternative was not effective competition under § 10707(d), the *DuPont (Plastics)* decision illustrates that the Board's established case-specific methodology for determining whether a competitive alternative is effectively constraining the defendant's rates is more than adequate for the Board to avoid finding a lack of market dominance based on "patently ridiculous transportation alternatives."

The Board's concern about the effectiveness of competition for "rates above 500% of variable costs" is both misplaced and irrelevant. *Decision* at 25. As detailed below and in the Verified Statements of Professor Willig and Drs. Eakin and Meitzen, higher R/VC ratios are not a reliable means of identifying ineffective competition. Even if they were, the Board does not need to adopt a quantitative presumption to account for the relationship between price and variable costs in its analysis. But the meat-cleaver approach of using RSAM as the dividing line between what competition is effective and what competition is ineffective is not reasonable. Even if the Board thinks that "rates above 500% of variable costs" indicate ineffective competition, that cannot mean that rates generating R/VC ratios that happen to be slightly above CSXT's RSAM warrant a presumption of market dominance over movements of high value commodities like plastics. {{ }} of the movements for which the Board found market dominance generate limit price R/VC ratios below 350%. The Board's decision that CSXT must possess market dominance on these lanes because of limit price R/VCs slightly above RSAM cannot be justified by concerns over "patently ridiculous transportation alternatives," particularly in light of the extensive evidence in this case that trucking and transloading are viable and commonly-used options for TPI's traffic.

IV. THE LIMIT PRICE APPROACH IS ARBITRARY AND CAPRICIOUS BECAUSE IT HAS NO MEANINGFUL ECONOMIC CONTENT.

Even if the limit price approach were permissible as a matter of law, it is an economically incoherent and unreliable methodology for determining the effectiveness of competition. Prominent economists Professor Robert Willig and Drs. Kelly Eakin and Mark Meitzen of Christensen Associates have submitted Verified Statements documenting some of the flaws in this approach, which are attached as Exhibits 1 and 2 to this Petition.[20] The shortcomings of the limit price approach as a matter of economic theory discussed in Professor Willig's and Drs. Eakin's and Meitzen's statements include the following:

- The test completely ignores the relationship between the rail rate and the competitor's rate, which is the most relevant market information for determining whether a railroad's pricing is constrained.[21]
- RSAM is a fundamentally flawed benchmark for measuring the effectiveness of competition in a particular market.[22]

[20] Professor Willig and Drs. Eakin and Meitzen also submitted Verified Statements in the *M&G* proceeding, which are appended to Exhibit 3.

[21] *See* Ex. 2 at 1; Ex. 3, V.S. Eakin & Meitzen at 4-6.

[22] *See* Ex. 1 at 6 ("There is nothing inherent in the calculation of a railroad's RSAM percentage that provides any insight into questions of whether a railroad is market dominant with respect to

- High revenue-to-variable cost ratios do not equate to ineffective competition, particularly in an industry like the rail industry with high fixed costs.[23]
- Because RSAM is the average markup necessary for a carrier to achieve revenue adequacy, presuming market dominance from anything above that ratio is inconsistent with differential pricing principles and with the goal of revenue adequacy.[24]
- Even if an R/VC-to-RSAM comparison were economically defensible, the Board's use of URCS variable costs rather than actual marginal costs impairs the reliability of the methodology.[25]
- The limit price methodology is not supported by the Lerner Index, which is not a reliable indicator of market dominance for policy purposes in industries with significant fixed costs.[26]
- Comparing a movement's limit price R/VC to RSAM is not relevant to the qualitative market dominance determination.[27]

V. THE BOARD'S ADOPTION OF THE LIMIT PRICE TEST IS UNLAWFUL FOR THREE ADDITIONAL REASONS.

The Board's adoption of the limit price approach is arbitrary and capricious for three additional reasons: (1) it shifts the burden of proof from the complainant to the railroad; (2) it

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a given move or whether rates for that move reflect an exercise of any such dominance."); Ex. 2 at 7-9.

[23] *See* Ex. 1 at 7-8 ("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 or common costs may well far exceed the variable or marginal costs incurred by the traffic.").

[24] *See* Ex. 1 at 8-10 ("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"); Ex. 2 at 4-5.

[25] *See* Ex. 2 at 5-7 (divergence between limit price and rail rate, and between actual marginal cost and URCS variable costs, "reveal problems with the limit price framework"); Ex. 1 at 10-13.

[26] *See* Ex. 1 at 13-15 (Lerner Index "is not viewed as a reliable indicator of market dominance for policy purposes where there are fixed costs"); Ex. 2 at 3-4 (Lerner Index "is not a test of the effectiveness of competition").

[27] *See* Ex. 2 at 9-10 (observing that "the false sense of precision" created by the "quantitative nature" of the limit price approach may have misled Board to use test results as "a hard and fast point of demarcation for determining market dominance").

makes the effectiveness of competition depend upon the identity of the railroad; and (3) it fails to define what "intangible features" could overcome the limit price presumption.

First, the Board's new rule would shift the burden of proving qualitative market dominance from the complainant to the defendant, by forcing the defendant to present evidence sufficient to overcome the presumption established by the comparison of RSAM to the R/VC generated by a transportation alternative. The complainant, as the party seeking to establish the Board's jurisdiction to evaluate the reasonableness of challenged rates, has the burden of establishing qualitative market dominance. *See, e.g., Market Dominance Determinations,* 365 I.C.C. at 132 (affirming that the complainant retained the same burden of proving lack of effective competition that it had prior to the 1981 rule). This standard allocation of the burden of proof to the party seeking relief is the reason the complainant is allowed to file both opening and rebuttal evidence on market dominance, while the carrier is confined to a single reply filing.

The Board's new rule, however, would impermissibly shift the burden of proof of lack of qualitative market dominance to the carrier. Once the Board establishes a presumption of market dominance based on the limit price comparison, the new rule would find the carrier market dominant unless the carrier produces evidence of "intangible features sufficient to overcome" that presumption. *See Decision* at 18. Because the complainant has no reason or incentive to produce evidence of such "intangible features," the only possible source of such evidence is the defendant carrier. Indeed, it is not clear when the defendant would have the opportunity to offer such evidence, because under the Board's framework it considers intangible features after it has calculated the limit price results. Once the Board applies the limit price formula, the burden is on the defendant carrier to prove a negative—that it lacks qualitative market dominance. Assigning the carrier the burden of showing the Board lacks jurisdiction is contrary to governing rules stretching back at least to the 4R Act. Here again, even assuming *arguendo* that the Board would have authority to shift the burden of establishing market dominance to the carrier, it certainly may only adopt such a rule change through notice-and-comment rulemaking.[28]

Second, the arbitrariness of the limit price approach is demonstrated by the fact that RSAM is different for each carrier. Whether a specific transportation market is competitive does not vary based upon a particular rail carrier's system-wide average revenue needs. Indeed, many of the movements for which the Board found market dominance would have had the opposite limit price presumption had the Board used the RSAM of a different carrier. For example, had CP been the defendant, {{ }} of the lanes on which CSXT was found market dominant would have been deemed to be subject to effective competition, simply because CP's RSAM is 343% and not 284%. It makes absolutely no sense to say that the same competitive option at the same price would be effective competition for one carrier but ineffective for another.

Third, the Board's new rule is arbitrary and capricious because it fails to define the vague term "intangible features" or to provide meaningful guidance as to its substance, meaning, and

[28] *See* 5 U.S.C. §§ 551, 553(b). The agency's prior practice shows that a rulemaking is required to change the assignment of the burden of proof of qualitative market dominance. Under the *Market Dominance Determinations* rule, the complainant had the burden of proving all types of qualitative market dominance. *See, e.g.,* 365 I.C.C. at 132. Later, the ICC convened a rulemaking to consider, *inter alia,* re-assigning the burden of proving effective product or geographic competition. At the conclusion of that notice-and-comment rulemaking (which included a hearing and additional post-hearing comments), the ICC amended the existing rule by shifting the burden of proof of product or geographic competition from the complainant to the defendant carrier. *See Product and Geographic Competition,* 2 I.C.C.2d 1, 12, 17 (1985). The agency made clear that the burden of proving inter- and intra- modal competition remained with the carrier. *Id.* at 12. That burden allocation has been the governing rule for more than 35 years. At an absolute minimum, the Board may change that rule only through notice-and-comment rulemaking, not in an individual adjudication. CSXT does not concede that it would be lawful for the Board to change the burden of proof even in an individual rulemaking, and reserves the right to challenge any such change at the appropriate time. Presently, however, the Board has not even satisfied the threshold requirement for consideration of such a rule change—convening a rulemaking proceeding in which all interested persons have an opportunity to participate.

application. The Board states that "when appropriate" it "will consider whether the alternative [transportation] has any intangible features sufficient to overcome the" limit price presumption. *See* Decision at 18. But the Board fails to define or otherwise flesh out the vague term "intangible features," how and under what circumstances[29] it will consider such undefined evidence, and what if any objective standard it will apply to determine whether "intangible features" are sufficient to overcome the presumption. This vague, undefined standard is no standard at all. It provides no meaningful guide to how the Board might evaluate whether the limit price presumption has been rebutted, and invites subjective, inconsistent, and standard-less decisions. Without further substance and explanation, the vague and ambiguous "intangible features" prong of the limit price test is arbitrary, capricious, and contrary to law. A proper rulemaking could give content to that term and establish a meaningful objective standard.

VI. {{ }}

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[29] The Board further muddies the waters by indicating that it will make the nebulous "intangible features" assessment only "when appropriate," without any explanation of when such an evaluation may be deemed "appropriate" or how the Board will determine in any given instance that such an evaluation is or is not appropriate.

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CONCLUSION

For the reasons described above, the Board should reconsider the May 31 Decision, abandon its reliance on the limit price test, and consider the effectiveness of competition in each lane on a case-by-case basis. Moreover, the Board should {{

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Respectfully submitted,

G. Paul Moates
Paul A. Hemmersbaugh
Terence M. Hynes
Matthew J. Warren
Hanna M. Chouest
Marc A. Korman
Sidley Austin LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000
(202) 736-8711 (fax)

Peter J. Shudtz
Paul R. Hitchcock
John P. Patelli
CSX Transportation, Inc.
500 Water Street
Jacksonville, FL 32202

Counsel to CSX Transportation, Inc.

Dated: June 20, 2013

CERTIFICATE OF SERVICE

I hereby certify that on this 20th day of June, 2013, I served a copy of the foregoing CSX Transportation, Inc.'s Petition for Reconsideration by email and hand-delivery upon:

Jeffrey O. Moreno
Thompson Hine LLP
1919 M Street, N.W., Suite 700
Washington, D.C. 20036

Matthew J. Warren

EXHIBIT 1

VERIFIED STATEMENT OF ROBERT WILLIG

HIGHLY CONFIDENTIAL EXHIBIT REDACTED

Before the
Surface Transportation Board

Docket Number NOR 42121
Total Petrochemicals & Refining USA, Inc.
v.
CSX Transportation, Inc.

Verified Statement of

Robert Willig

Professor of Economics and Public Affairs

Princeton University

June 20, 2013

Witness Introduction

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

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

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

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

federal administrative agencies, and state public utility commissions on subjects involving microeconomics, competition, and regulation, in a wide variety of sectors including transportation and railroading specifically.

Purpose

I have been asked by CSX Transportation, Inc. ("CSXT") to provide comments on the analytical framework for evaluating qualitative market dominance that the Surface Transportation Board ("STB" or "the Board") used as the foundation for its May 31, 2013 decision in the rate case brought by Total Petrochemicals & Refining USA, Inc. ("Total") against CSXT.[2]

Summary of Findings

In the Total decision the Board again endorses the "limit price methodology"[3] test for market dominance that was first introduced by the Board in its September 27, 2012 decision in the rate case brought by M&G Polymers USA, LLC against CSXT ("the M&G case"). The "limit price methodology" adopted in the Total case appears to be identical to the method articulated by the Board in the M&G case.

The "limit price methodology" is a three-step process: (1) the Board calculates the "limit price," or "the highest price a carrier could theoretically charge a shipper without causing a significant amount of the issue traffic on a particular rail movement to be diverted to a competitive alternative"; (2) the "limit price" is compared to the railroad's variable cost of providing the service at issue to arrive at a "limit price R/VC

[2] Surface Transportation Board; Docket No. NOR 42121 – Total Petrochemicals & Refining USA, Inc. v. CSX Transportation, Inc.; "Decision – Public Version", May 31, 2013 (hereafter, "Total Decision").

[3] Total Decision at 21.

ratio"[4]; and (3) the "limit price R/VC ratio" is compared to the railroad's most recent RSAM (Revenue Shortfall Allocation Method) figure.[5] If the "limit price R/VC ratio" is above RSAM, the Board makes a preliminary finding that the "alternative cannot exert competitive pressure sufficient to restrain rates effectively."[6] If such a preliminary determination is made, the Board may consider whether there are any "intangible features sufficient to overcome the applicable preliminary conclusion."[7]

In the M&G case, I submitted a Verified Statement outlining a number of shortcomings of the "limit price methodology" as conceived and implemented by the Board. I have reviewed my statement in the M&G case and find that the "limit price methodology" as described by the Board in the Total matter suffers from the same concerns and deficiencies I articulated in that statement. I renew articulation of my concerns here. Specifically, I find that:

- Contrary to assertions by the Board, RSAM is not an "objective" indicator of monopoly pricing, nor does the methodology described by the Board "gauge objectively" whether a given railroad's prices have been "effectively constrained."[8]
- Rather than "...ensur[ing] that...market dominance analysis balances the revenue needs of the carrier with the need to protect captive shippers from the

[4] Total Decision at 17.

[5] Total Decision at 17. As the Board notes several times, RSAM is "a measure of the average markup that the carrier would need to collect from all of its potentially captive traffic (i.e., all traffic priced at or above 180% R/VC level) in order to earn adequate revenues as measured by the Board under 49 U.S.C. § 10704(a)(2) (i.e., earn a return on investment equal to the cost of capital)." (Total Decision at 19)

[6] Total Decision at 17-18.

[7] Total Decision at 18.

[8] Total Decision at 4, 25.

abuse of market power,"[9] the "limit price" method *threatens* railroads' ability to achieve revenue adequacy and imperils the long-term health of the industry.

- Reliance on the "limit price R/VC ratio" rather than the railroad's actual R/VC ratio continues to require more detailed consideration. For this distinction to be meaningful, it must be the case that there are significant differences between actual and "limit price" R/VC ratios. The use of limit prices implies that the Board believes this to be the case, but it has offered no explanation to support that determination. If it is because the methodology used by the Board to determine the "limit price R/VC ratio" systematically omits some forms of competitive pressure (relatively low value of service, for example) that keep actual prices below the Board's calculated limit levels, then this methodology is founded on an expectation of systematic inaccuracy and is inherently flawed.
- The Board has asserted that the "limit price framework generally comports with accepted economic representations of market power such as the Lerner Index – a figure calculated by subtracting marginal costs from the market price and dividing the result by the market price – which has been described as 'the best-known measure of monopoly power.'"[10] The fact is that the economic theory behind the Lerner Index offers no support for the "limit price framework" advanced by the Board.
- The "limit price methodology" is not an improvement over the standards in place (established in Market Dominance Determinations & Consideration of Product Competition) prior to the introduction of the "limit price framework." The "limit price methodology" is a significant departure from established regulation and any such change requires careful consideration independent of pending rate cases.

The "Limit Price Methodology" is Not an "Objective" or "Reliable" Indicator of Monopoly Pricing

In the Total decision, the Board defends the "limit price methodology," stating, "we believe this comparative approach [the "limit price methodology"] offers a sufficiently reliable indicator of whether effective competition exists for several reasons."[11] The Board goes on to say:

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[9] Total Decision at 5, 25-26.

[10] Total Decision at 23, fn 72.

[11] Total Decision at 19.

> As a carrier's RSAM number represents the average level at which the carrier would achieve system-wide revenue adequacy, the fact that a rate involving certain potentially captive traffic produces an R/VC ratio that falls below the carrier's RSAM number indicates that competitive transportation alternatives likely exist and are exerting downward pressure on the rate governing that traffic. Likewise, the fact that a rate involving other potentially captive traffic produces an R/VC ratio that falls above the carrier's RSAM number is a useful indicator that competitive transportation alternatives—whether intermodal or intramodal—do not exist and are not effectively constraining the rate charged by the carrier for that traffic....Thus, comparing the limit price R/VC ratio for a given movement to the carrier's RSAM number will be indicative of either the presence or absence of effective competition for that movement.[12]

The Board's assertion that a "limit price R/VC" ratio above RSAM is somehow a "useful indicator" of "the presence or absence of effective competition" is inconsistent with economic theory and common sense. Contrary to the Board's assertion, R/VC ratios that are above RSAM are not "indicator[s] that competitive transportation alternatives...do not exist,"[13] but rather are just a mathematical necessity for a sustainable rail carrier.

RSAM is a formulaic mathematical calculation that yields a system-wide needed average markup for potentially "captive" traffic: "As an initial matter, a carrier's RSAM figure is a measure of the average markup that the carrier would need to collect from all of its potentially captive traffic ...in order to earn adequate revenues."[14] Stated differently, it is the *average* amount by which revenues must exceed variable costs on potentially "captive" shipments to permit the railroad to earn revenues adequate to cover the full costs of building, maintaining, and operating its overall rail network. Given

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[12] Total Decision at 19-20.

[13] Total Decision at 20.

[14] Total Decision at 19.

expected variations in demand for the railroad's services, therefore, some traffic will need to move at rates above the RSAM percentage, and some will only be able to move at rates below RSAM. Rates will be determined based not on anything related to the RSAM calculation, but rather based on the markets' competitive conditions associated with each individual move. If, for competitive reasons, some so-called "captive" traffic (*i.e.*, traffic with R/VC above 180%) must move at rates with markups well below the RSAM percentage then, by definition, other traffic must move at rates with markups well above the RSAM percentage. There is nothing inherent in the calculation of a railroad's RSAM percentage that provides any insight into questions of whether a railroad is market dominant with respect to a given move or whether rates for that move reflect an exercise of any such dominance.

The STB states: "Likewise, the fact that the highest price the carrier theoretically could charge to move the potentially captive traffic falls above the average point at which the carrier could achieve revenue adequacy indicates that effective competition for that movement likely does not exist." This statement reveals a crucial, and incorrect, assumption at the center of the "limit price methodology," namely that a "limit price R/VC ratio" above RSAM is unlikely to be consistent with circumstances other than market dominance. This is false. In many circumstances a particular move could have a "limit price R/VC ratio" above RSAM for reasons completely unrelated to monopoly pricing. A carrier may need to price certain traffic at R/VC levels above RSAM because the competitive circumstances relevant to other potentially "captive" traffic imply that the railroad cannot recover average fixed and common infrastructure costs on those moves. This is not an indication that there is a lack of effective competitive alternatives for the issue traffic, but rather just an indication of the fact that different traffic is subject to different economic realities. High fixed costs are not necessarily unique to direct rail transportation. Alternative modes of transportation for a given movement may also face high fixed costs. It would not be surprising, therefore, if a high R/VC ratio for rail service still were constrained effectively by transportation alternatives with correspondingly high prices due to their high costs.

The fundamental flaw with using the "limit price R/VC ratio" as somehow indicative of market dominance is that the Board has essentially equated "high" margins (as measured by R/VC ratios) with monopoly returns gained through market dominance. As discussed in the Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, this is simply incorrect.[15] Monopoly pricing, or pricing that exhibits market dominance, must exceed marginal costs by enough to generate sustained revenues significantly above economic costs, inclusive of fixed and common costs and a competitive return on necessary invested capital. Thus, 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. Further, RSAM cannot

[15] Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, 2010, at 4, fn 3: "High margins commonly arise for products that are significantly differentiated. Products involving substantial fixed costs typically will be developed only if suppliers expect there to be enough differentiation to support margins sufficient to cover those fixed costs. High margins can be consistent with incumbent firms earning competitive returns."

provide aid in determining the presence or absence of market dominance for a particular commodity in a particular lane because, as noted, it is only an average across many different rail services, requiring some moves to be priced at levels above RSAM and some below.

Where competition from any alternatives, including transportation alternatives, stops pricing from generating revenues that exceed total economic cost, that is effective competition. It is not the case that competition fails to be effective in limiting monopoly power just because it permits R/VC to be relatively high, since for services like many provided by railroads, fixed and common costs far exceed variable or marginal costs, and recovery of those economic costs requires differential pricing both above and below average levels. Determining the presence and efficacy of competing alternatives requires a more detailed examination than the formulaic comparison of the "limit price R/VC ratio" to an RSAM number.

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

The Board asserts that "using RSAM ensures that our market dominance analysis balances the revenue needs of the carrier with the need to protect shippers from the abuse of market power." [16] The Board apparently has concluded that using an RSAM benchmark adequately preserves railroads' ability to attain revenue adequacy because "the RSAM methodology 'takes into account the key economic and equity principles embodied in the Interstate Commerce Act. It provides for differential pricing and a

[16] Total Decision at 25-26.

railroad's need to earn adequate revenues by directly linking its 'revenue need shortfall' to a benchmark markup for captive traffic."[17]

This interpretation of RSAM reveals a confused application of the concept and its relationship to differential pricing. By definition, RSAM is a mathematical calculation that reports the *average* markup on "captive traffic" that is necessary for the railroad to attain revenue adequacy. As with any average, actual individual markups will necessarily be both *above* and below this average. It is well understood that such variations in markups are nothing more than a reflection of the differential pricing that characterizes sustainable and healthy railroad operations.[18] However, in the "limit price methodology" the STB uses RSAM as a rate ceiling for non-dominance, with any lane with moves at a "limit price R/VC" above RSAM subject to a finding of market dominance.

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

[17] Total Decision at 19.

[18] See Rate Guidelines – Non-Coal Proceedings, 1 S.T.B 1004, at 1033-34 (1996): "How a particular carrier's revenue requirements can and should be allocated within its traffic base – i.e., the proper markup to be applied to individual traffic components – is affected by such factors as the mix of competitive and captive traffic handled by that carrier [and] the degree of competition that it faces on its competitive traffic." See also BNSF Ry. v. STB, 453 F.3d 473, 481 (D.C. Cir 2006) ("because the average derived by RSAM is the average for captive shippers only…the ratios for some captive shippers must be above and some below that figure").

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

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

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

A measured difference between actual prices and the limit prices calculated by the Board may be indicative of a mistake in the concept or in the calculation of the limit prices. It may be the case that the Board anticipates that "limit price R/VC ratios" will differ significantly from the railroad's actual R/VC ratios because the Board's intended method for determining the "limit price R/VC ratio" does not properly account for all sources of potential competitive pressure that are reflected in the level of actual prices.

Indeed, in several places the Board seems to signal its intent to limit its investigation to assessing competitive pressure from *transportation* alternatives, stating: "in this analysis the Board determines whether there are any feasible transportation alternatives that are sufficient to constrain the railroad's rate to competitive levels, considering both intramodal competition—competition from other railroads—and intermodal competition—competition from other modes of transportation such as trucks, transload arrangements, barges, or pipelines."[19] Economically, however, there are sources of potential competitive discipline that do not fall under the umbrella of *transportation* alternatives, and therefore are not clearly incorporated into the "limit price methodology" as currently proposed. As such, the Board's uses of the "limit price methodology" are endemically subject to distortions and systematic bias in favor of findings of market dominance, with impacts on the industry that the Board has neglected to recognize or consider.

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

Also, evidence on the role of head-to-head competition between carriers must be considered carefully. Actual prices are often the result of significant head-to-head

[19] Total Decision at 3.

competition (or potential competition) between existing suppliers in the market. A limit price calculation that does not properly consider the disciplining power of all existing competitors would yield inaccurate and unreliable results.

If the Board calculates "limit price R/VC ratios" without taking proper account of these and any other relevant competitive pressures restraining given rates, then the method it proposes is fundamentally flawed and necessarily premised on systematic inaccuracies. For example, based on the Highly Confidential workpapers provided by the Board, there are several instances where the "limit price" as calculated by the Board is substantially higher than the actual price charged by the railroad.[20] In these cases, it is necessary to ask why a railroad that the Board has preliminarily concluded is not constrained by "effective competition" is charging a customer significantly less than the Board-determined "highest" price they could charge without losing business. The answer may lie in disciplining competition from sources not considered by the Board's "limit price methodology." Disregarding actual evidence on prices from the marketplace in favor of relying on the calculation of a "limit price R/VC ratio" raises the likelihood that the "limit price" test will return results at odds with actual market outcomes.

Assessment of the "limit price methodology" must consider whether the new policy effectively addresses the Board's stated mandate. In rate cases, the Board has articulated that mandate to be determining whether "...there are any alternatives sufficiently competitive (whether singly or in combination) to bring market discipline to the carrier's

[20] "TPI v CSXT 42121 STB 5-31-13 Decision Market Dominance Highly Confidential Workpaper.xlsx." See, for example, Lanes {{ .}} It should be noted that before reviewing these Highly Confidential materials, I reviewed the Protective Order issued by the Board in this proceeding and executed the appropriate confidentiality Undertakings.

pricing – *i.e.*, whether there is effective competition adequate to restrain rates at or below a maximum reasonable level."[21] By excluding consideration of all sources of potential competitive discipline, the "limit price methodology" does not meet this standard and instead introduces the potential that erroneous findings of market dominance will result in unnecessary, time-consuming, and costly maximum rate reasonableness proceedings.

The "Limit Price Methodology" Does Not "Generally Comport" with the Lerner Index or Other "Accepted Economic Representations of Market Power"[22]

In defense of the "limit price methodology," the Board notes that "the limit price framework generally comports with accepted economic representations of market power such as the Lerner Index—a figure calculated by subtracting marginal cost from the market price, and dividing the result by the market price—which has been described as 'the best known' measure of monopoly power."[23] This statement is wrong as a matter of basic economics for several reasons.

The Lerner Index, by definition, measures the percentage deviation between a product or service's market price and its marginal cost. This does not "comport" with the Board's "limit price methodology" that deliberately eschews reliance on the market price in favor of its definition of the "limit price," which may well be quite different than the market price. The Lerner Index compares the market price to the marginal cost of a given product or service, which does not "comport" with the comparisons to RSAM at the core of the Board's "limit price methodology." After all, RSAM is driven in part by measurement of fixed and common costs, not marginal costs, and these are averaged across all "captive"

[21] Total Decision at 15.

[22] Total Decision at 23, fn 72.

[23] Total Decision at 23, fn 72.

services, rather than focused on a given product or service, as is the Lerner Index. Even the measure of variable costs employed in the Board's "limit price methodology" is not reliably indicative of the marginal costs that are employed in the Lerner Index, according to the Christensen Report on Competition in the Rail Industry noted by the Board.[24]

It is most important to recognize that while the Lerner Index — based on actual price, not some version of limit price, and on true marginal cost — has its own valid uses in economic analysis, it is not viewed as a reliable indicator of market dominance for policy purposes where there are fixed costs.[25] This is a point made clear in the very same paper cited by the Board in support of the assertion that its framework "comports" with the Lerner Index:

> The most important limitation of the Lerner Index...is that the Index 'does not recognize that some of the deviation of P from MC comes from either efficient use of scale or the need to cover fixed costs.' When using the Index to assess departures from the social optimum of

[24] Total Decision at 24, fn 77. "Captivity measures based on categorizing the shipment-level R/VC (or markup) data are dependent on good alignment of actual and measured costs, particularly for extreme values of R/VC, but the large shares of tons and ton-miles with R/VC below 100 percent suggest that measured and actual variable costs are not well-aligned in the tails of the R/VC distribution." The Christensen study goes on to note that "the R/VC ratio does not appear to perform well as a proxy for conceptually more appropriate market structure measures."

[25] See Janusz Ordover, Alan O. Sykes, and Robert Willig, "Herfindahl Concentration, Rivalry, and Mergers," Harvard Law Review, V. 95, No. 8, June 1982, p. 1859, n. 14: "The difference between price and marginal cost is not always an appropriate measure of market power. ... In many market situations, prices must remain above marginal cost if a firm is to earn a normal rate of return. Thus a better indicator of market power may be long-run excess profits. .... a finding that an industry is characterized by pervasive economies of scale does indicate that prices must exceed marginal costs for total cost to be covered by revenues and that the Lerner index may misestimate market power."

> firms with increasing returns to scale, it is misleading to attribute the entire departure to the exercise of monopoly power.[26]

It is clear from economics that prices must exceed marginal costs in the presence of fixed costs in order for operations to be sustainable, and that the sizes of margins will vary on the basis of the demand properties of products and services rather than indicate monopoly or supra-competitive returns.[27] Thus, the Lerner Index does not support the Board's "limit price methodology," and in fact the construction and reliable uses of the Lerner Index actually indicate the reasons why this new methodology is unreliable and without foundation in economics.[28]

The "Limit Price Methodology" Is Not an Improvement Over the Board's Previous Approach To Market Dominance Determinations

The Board repeatedly mentions the need to develop an "objective" approach to market dominance cases, citing the complexity of market dominance inquires.[29] Although the Board's intention in adopting the "limit price methodology" is to improve the handling

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[26] Kenneth G. Elzinga & David E. Mills, The Lerner Index of Monopoly Power: Origins and Uses, 101(3) Am. Econ, Rev. 558, 560 (2011), at 5.

[27] As explained in the Horizontal Merger Guidelines,U.S. Department of Justice and the Federal Trade Commission, 2010: "High margins commonly arise for products that are significantly differentiated. Products involving substantial fixed costs typically will be developed only if suppliers expect there to be enough differentiation to support margins sufficient to cover those fixed costs. High margins can be consistent with incumbent firms earning competitive returns." (p. 4 n.3.)

[28] See Kenneth G. Elzinga & David E. Mills, The Lerner Index of Monopoly Power: Origins and Uses, 101(3) Am. Econ, Rev. 558, 560 (2011) at 9: "If the operative benchmark for measuring a firm's departure from the social optimum were not Lerner's hypothetical competitive equilibrium, but a welfare-maximizing equilibrium that is attainable given actual conditions of technology and demand, and given the practical limitations on securing subsidies necessary to sustain marginal-cost pricing, much of the market power indicated by the Lerner Index has nothing to do with a lessening of competition. This makes the Lerner Index an unreliable stand-alone indicator of the "degree" to which a firm's market power represents a genuine monopoly problem."

[29] See, for example, Total Decision at 3, 4, 5, 19, and 25.

of market dominance cases, not only is the method as currently conceived not an improvement, it is actually an analytically inferior approach to market dominance analysis.

The Board points out that the "limit price method" encompasses all of the factors embraced by the market dominance guidelines.[30] Therefore, in assessing whether the current approach is an improvement we are left to consider how (or whether) the additional analytical components adopted by the Board, namely the calculation of a "limit price R/VC" and the use of RSAM as a benchmark for the effectiveness of competition, advance the analysis of market dominance. My conclusion is that they do not improve the Board's analysis and, indeed, may lead the Board to draw incorrect conclusions about market dominance. As detailed above, using RSAM as some sort of benchmark of "effective competition" is a complete misapplication of the RSAM concept. The RSAM number provides no information relevant to assessing the competitive alternatives available to any individual shipper. Further, given the real potential that the method used to calculate the "limit price" does not properly account for all relevant sources of competition, the "limit price methodology" is likely to yield unreliable results that cause the Board to reach erroneous conclusions.

Rather than improving the Board's approach to market dominance analysis, the "limit price methodology" as proposed and implemented by the Board is likely to have significant effects on outcomes in the industry and threaten core regulatory values of economic efficiency and sustainability. Even the Board seems to have difficulty mustering a convincing defense of its own methodology in this respect, noting with regard to the RSAM benchmark, "While the comments we received in other proceedings provide several

[30] Total Decision at 19 and 22.

arguments against the use of the RSAM benchmark, they offer no workable alternative solution to the underlying problem we have identified."[31]

The adoption of the "limit price methodology" represents a significant new regulatory standard. Certainly any such major policy change should be evaluated against a standard that carefully considers all arguments and should be the result of detailed analysis of this and other competing proposals.

Conclusion

The "limit price" method as currently proposed by the Board is not an appropriate method for determinations of market dominance. First, the assertion that a "limit price R/VC" above RSAM is indicative of monopoly pricing is wrong as a matter of basic economics. Further, the "limit price R/VC" does not generally comport with other accepted methods of analyzing market dominance.

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

Third, the Board's reliance on "limit price R/VC ratios" rather than actual R/VC ratios warrants more detailed examination and comment From an economic perspective, it is far from clear that the use of limit prices that differ from prevailing market prices constitutes an appropriate benchmark for determinations of market dominance, avoiding

[31] Total Decision at 26.

systematic inaccuracy and bias. In short, the Board's test does not examine the actual level of competition in a given traffic lane or market.

Fourth, the "limit price methodology" as described and implemented by the Board is not an economically reliable method for assessing monopoly power or non-competitive returns from pricing, and is not akin to the Lerner Index or any other "accepted representations of market power."[32]

Finally, as a general matter, the proposed "limit price" method would constitute a significant new element of the Board's procedures for its regulation of rail carriers' businesses, and an element that offers no apparent benefit over the market dominance guidelines adopted in Market Dominance Determinations & Consideration of Product Competition.

[32] Total Decision at 23, fn 72.

VERIFICATION

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

Robert D. Willig

Executed on this 17th day of June, 2013.

EXHIBIT 2

JOINT VERIFIED STATEMENT OF

B. KELLY EAKIN

&

MARK E. MEITZEN

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB DOCKET NO. NOR 42121
TOTAL PETROCHEMICALS & REFINING USA, INC.
v.
CSX TRANSPORTATION, INC.

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

CHRISTENSEN ASSOCIATES

June 20, 2013

I. Introduction

We are B. Kelly Eakin and Mark E. Meitzen of Christensen Associates. We have previously filed Verified Statements on the Board's proposed limit price methodology in NOR 42123[1] and NOR 42125.[2] We have been asked by CSX Transportation, Inc. (CSXT) to review the Board's Decision in this case regarding the application of its proposed limit price methodology ("Total Decision").[3]

II. Summary of Comments

We have reviewed the Total Decision and find no reason to deviate from our previous analysis of the proposed limit price methodology as spelled out in the M&G Polymers decision.[4] To summarize, our previous conclusions were:

- The proposed limit price methodology is not an objective or reliable indicator of market dominance because:
  - the concept is ambiguously defined;
  - it uses incomplete market information and information irrelevant to the existence of competition;
  - it does not distinguish between different market situations; and
  - its use of RSAM to determine market dominance is arbitrary and unrelated to actual market situations.
- The proposed methodology does not overcome the acknowledged weakness of R/VC as an indicator of market power abuse in specific markets.
- The proposed methodology is unlikely to simplify the accurate determination of market dominance.

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[1] Joint Verified Statement of B. Kelly Eakin and Mark E. Meitzen, STB Docket No. NOR 42123, M&G Polymers USA, LLC v. CSX Transportation, Inc., November 2012.

[2] Joint Verified Statement of B. Kelly Eakin and Mark E. Meitzen, STB Docket No. NOR 42125, E.I. du Pont de Nemours and Company v. Norfolk Southern Railway Company, November 2012.

[3] Surface Transportation Board, Decision, Total Petrochemicals & Refining USA, Inc. v. CSX Transportation, Inc, Docket No. NOR 42121 May 31, 2013.

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

We stand by these conclusions, and it is our opinion that in its current Total Decision the Board has not addressed these flaws. Below, we focus on some of the major shortcomings of the proposed methodology that are highlighted by the Total Decision. Our assessment of these shortcomings leads to the following conclusions:

- The limit price approach continues to suffer from fundamental theoretical flaws, including the following:
  - The limit price approach confuses two distinct concepts: the effectiveness of competition (*i.e.*, the market dominance issue) and a railroad's ability to price above variable cost. In a high fixed-cost industry like the rail industry, the ability to price above variable cost is a necessity which does not directly correlate with the effectiveness of competition.
  - The limit price approach's presumption that pricing over a particular R/VC level implies lack of effective competition runs counter to the economic efficiency principles underlying differential pricing.
  - Even if a railroad's ability to price above variable cost were relevant to the effectiveness of competition, the limit price R/VC is an imprecise and inaccurate measure of a railroad's market power.
  - The comparison of the limit price R/VC to RSAM to determine market dominance is arbitrary and unrelated to the actual market situation.
- Moreover, the application of the limit price test in this case is problematic, for it suggests that the test is conclusive in the Board's market dominance determinations. The determination of lane-specific market dominance in the Total Decision appears to rely solely on the limit price test to the exclusion of other information.

III. Major Theoretical Flaws of the Proposed Limit Price Test

The proposed limit price test is seriously flawed as a matter of economic theory. The basic presumption of the test that pricing above marginal costs implies a lack of competition is incorrect and contrary to the principles of differential pricing. And even if it were true that pricing above marginal costs were an indicator of the lack of effective competition, the limit price R/VC is an inaccurate measure of market power (also called pricing power). Moreover, the use of RSAM as a demarcation line between effective and ineffective competition is unsupported.

A. Effective Competition and the Ability to Price Above Marginal Cost are Distinct Concepts

The Board's adoption of the limit price test in this case rests on a fundamental confusion between two distinct concepts: (1) the extent to which a railroad can price its services above marginal cost; and (2) the effectiveness of competition from other transportation modes for those services. The Board argues that its approach is reasonable measure of the effectiveness of competition because "the limit price framework generally comports with the accepted economic representations of market power such as the Lerner Index."[5] But the Lerner Index is a measure of pricing above marginal cost (which is a necessity in high fixed-cost industries) and its value is not an indicator of a lack of competition in a specific market.

The Lerner Index is a measure of the ability to price over marginal costs and, thus, a measure of the exercise of market power. But it is not a test of the effectiveness of competition. While in some markets the ability to impose prices in excess of marginal costs may indicate a lack of competition, that conclusion cannot be drawn for the railroad industry. Indeed, the very article that the Board cites for this point about the Lerner Index recognizes that "[t]he most important limitation of the Lerner Index. . . is that the Index 'does not recognize that some of the deviation of *P* from *MC* comes from either efficient use of scale or the need to cover fixed costs.'"[6] Moreover, the Lerner Index has not been typically used as the sole measure of monopoly in a market. As Professors Elzinga and Mills write:

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[5] Total Decision, footnote 72, p. 23.

[6] Kenneth G. Elzinga and David E. Mills, "The Lerner Index of Monopoly Power: Origins and Uses," *American Economic Review: Papers and Proceedings,* Vol. 101 Number 3 (May 2011), p. 559.

> While antitrust scholars have recognized the value of the Lerner Index as a conceptual tool, the Index has not been used extensively in antitrust enforcement. In antitrust, the degree of monopoly is not *measured* by an index so much as it is *indicated* by a variety of factors – such as market concentration, barriers to entry, and the particular conduct of the firm in question. Antitrust enthrones no single quantitative measure.[7]

The Total Decision's attempt to link the proposed limit price test to the Lerner Index reveals the fundamental shift that this test represents in the determination of market dominance. Market dominance (*i.e.*, the effectiveness of competition) and the exercise of market power are distinct concepts. One does not imply the other. It is possible to face no effective competition while pricing at levels close to marginal cost—for example, if a shipper's low margins mean that the railroad would lose the business entirely if it raised prices. It is also possible for a firm to price at levels well above variable costs and face robust competition—for example, if competitors are also pricing above marginal costs to recover their fixed costs or if they are pricing to recover marginal shipment-specific costs not well-reflected in average variable costs. The fact that the limit price R/VC measure has an algebraic structure similar to the Lerner Index has little relevance to the validity of the limit price R/VC in determining the question of whether competition is effective. In short, there is no magic number or threshold that ties pricing over marginal cost to a lack of effective competition.

B. Differential Pricing Implies "Above-Average" and "Below-Average" Markups.

The limit price methodology is also inconsistent with the framework of differential pricing. As competitors in a network industry, railroads need to exercise some degree of "market power" in the form of pricing over marginal costs to generate

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[7] *Id.* at 560 (emphasis in the original).

revenues sufficient to recover their costs. Specifically, scale, density and other network economies make marginal cost pricing by a railroad insufficient to cover its costs. Pricing above marginal cost is, by definition, an exercise of market power. Thus, the exercise of some market power is a necessity for revenue sufficiency.

Demand differences require different percentage markups across markets in order to achieve economically efficient recovery of costs. Consequently, differential pricing in railroad markets has long been accepted as appropriate. As a result, and as a matter of arithmetic, some markets will have above-average markups while other markets will have below-average markups. However, there is no connection between the observed markup in a market and whether the railroad is market dominant. Consider a railroad that in one market is a pure monopolist, unconstrained by competition, facing a relatively elastic demand and in another market is one of two equal-sized competitors. The unconstrained price in the monopoly market might have a relatively low markup compared to the markup in the duopoly. By definition, the unconstrained monopolist is market dominant while the duopolists are not. But the limit price R/VC-based test could reach the reverse conclusion.

As long as there is differential pricing across markets, above-average limit price R/VC ratios are a matter of arithmetic. The presumption that an above-average limit price R/VC implies market dominance exposes a fundamental shortcoming of the proposed test.

C. Problems with the Limit Price R/VC Ratio

Even if the degree to which price exceeds marginal cost (*i.e.*, market power) could shed light on the effectiveness of competition (*i.e.*, market dominance), the limit price R/VC is an inaccurate measure of that market power. The limit price R/VC is equivalent to the price of the transportation alternative divided by the railroad's URCS-determined average variable cost, or P_{ALT}/AVC. But the exercise of market power is reflected in a completely different ratio: the actual rail rate divided by the actual shipment-specific marginal costs, or P_{RAIL}/MC.[8] Both the divergence between P_{ALT} and P_{RAIL} and the divergence between AVC and MC reveal problems with the limit price framework.

First, because the limit price method does not use the railroad's rate, the limit price R/VC loses any theoretical connection to the Lerner Index. Presumably, the railroad is already setting its optimal price reflecting all market constraints. Thus, whenever the limit price is greater than the railroad's optimal price, the limit price R/VC overstates the railroad's actual potential market power. In such a case, changes in limit price would result in corresponding changes to the market dominance test measure, even though, in actuality, neither the railroad's behavior nor market position has changed.

Second, the actual marginal cost of an individual movement (MC) is not the same as the URCS-provided average variable cost (AVC). For example, variable cost may not change proportionately with the shipment size. To the extent that there are such lane-specific economies or other variations in cost by shipment or shipper, AVC will differ from the marginal cost of any given shipment.

The Board appears to acknowledge the relative weakness of the R/VC ratio as an indicator of market power abuse, but states that "the costs of providing transportation at issue are undeniably relevant to the qualitative market dominance inquiry."[9] The

[8] P/MC is a rearrangement of the Lerner Index and, assuming profit maximizing behavior is equal to the $\varepsilon_D/(1+\varepsilon_D)$ where ε_D (the elasticity of demand perceived by the provider) is a negative number.

[9] Total Decision, pp. 24-25.

relevance of cost is not the point. Our criticism is that the URCS-based VC measure is an unreliable measure of cost. As we have stated elsewhere,[10] our main criticism of the R/VC ratio as an indicator of shipper captivity was not the measure of revenue in the numerator, but the inability of the URCS-based VC measure in the denominator to accurately measure shipment-level variable costs:

> [C]aptivity measures based on categorizing shipment-level R/VC (or markup) data are dependent on the alignment of actual and measured costs in the tails of the R/VC distribution. Our analysis suggests that URCS costs have limitations in adequately reflecting shipment-level, cost-causing factors.[11]

Even if the limit price for a particular shipment were accurately calculated, the limit price R/VC ratio would not be a reliable measure of the ratio of true limit price to the true variable cost for that shipment. Thus, even if it were true that pricing above marginal costs were an indicator of the lack of effective competition, the limit price R/VC is an inaccurate measure. The result is that, regardless of the relevance of cost to a *qualitative* market dominance inquiry, the Total Decision has established a *quantitative* test using an acknowledged inaccurate cost measure.

D. Problems with the Comparison of Limit Price R/VC to RSAM

A fourth fundamental problem with the limit price test is its use of an arbitrary dividing line between limit price R/VC ratios deemed to be "competitive" and ratios deemed to be "uncompetitive." RSAM is the average markup a carrier would need to collect from all of its potentially captive traffic to achieve revenue adequacy. As we have

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[10] Joint Verified Statement of B. Kelly Eakin and Mark E. Meitzen, Docket No. NOR 42123, M&G Polymers USA, LLC v. CSX Transportation, Inc., Nov. 2012, at 11-12.

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

previously noted, the information contained in RSAM is disconnected from any specific market and void of any demand content, and therefore has no bearing as to whether a rail price in a specific "captive market" is effectively constrained by competition.[12] Thus, including RSAM adds nothing relevant to the determination of market dominance and does not remedy any of the flaws associated with the limit price R/VC.

Because differential pricing is a key feature of railroad economics and constrained market pricing, there will be a distribution of R/VC ratios across markets. Likewise, there will be a distribution of limit price R/VC ratios across markets. As a matter of arithmetic, there will be many markets whose transportation alternatives generate R/VC ratios above the relevant RSAM and many that generate R/VC ratios below RSAM. There is no basis to connect this distribution to the underlying concept of which movements face effective competition and which do not. Consequently, the proposed test will be unreliable in that it is prone to produce numerous "false positive" (*i.e.*, finding market dominance where there is none) and "false negative" (*i.e.*, finding no market dominance where it does exist) conclusions.

Additionally, the limit price R/VC test is inconsistent with the use of differential pricing to achieve revenue adequacy. The finding of market dominance and enforcement of rate reductions in markets with markups above a railroad's RSAM will result in a reduction in the railroad's revenue, threatening revenue adequacy or causing prices in below-average markup markets to increase to offset the revenue loss, or both. Given that revenue adequacy remains a statutorily-embraced goal, the logical conclusion to this

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[12] Joint Verified Statement of B. Kelly Eakin and Mark E. Meitzen, STB Docket No. NOR 42123, M&G Polymers USA, LLC v. CSX Transportation, Inc., Nov. 2012 at 6.

process would be uniform R/VC ratios equal to RSAM across all captive markets. While the actual outcome might stop short of this logical conclusion, the direction of this new rule would work against the established principle of using differential pricing for efficient collection of adequate revenues. Professor Willig states this point in another way:

> Thus, the very pricing decisions of a carrier that are necessary for attempts to attain adequate revenues are systematically penalized by the regulatory process that would emerge from adoption of the new proposal standard.[13]

IV. The Board's Application of the Limit Price Test Appears to be the Determinative Factor.

The 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. The quantitative nature of the proposed test may lead to a false sense of precision that encourages the Board to rely on it as a "simplified" test for market dominance. Using the limit price test as a strong presumption of market dominance is misguided.

The Board states in the Total Decision that the limit price test is one of many tools to be used in determining market dominance:

> Calculation of the limit price R/VC ratio is but a single component of the refined approach, which is specifically structured to consider a variety of other factors relevant to the qualitative market dominance inquiry separate and apart from the limit price R/VC ratio[14]

> [T]he refined approach is not intended to exclude any factor the Board has previously stated it will consider in the qualitative market dominance context.[15]

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[13] Verified Statement of Robert Willig, STB Docket No. NOR 42123, M&G Polymers USA, LLC v. CSX Transportation, Inc., November 2012, p. 4.

[14] Total Decision, p. 23.

[15] Total Decision, footnote 74, p. 23.

The Board made similar claims in its M&G Decision.[16] However, a review of the lane-specific highly confidential information in this case reveals that all lane-specific determinations of market dominance were arrived at by a comparison of the limit price R/VC to CSXT's RSAM, and in every instance there were "no intangible features sufficient to overcome this preliminary conclusion."[17] Even in cases where the limit price R/VC ratio was very close to RSAM (both above and below), other evidence was apparently deemed insufficient to overturn this "preliminary conclusion." However, no further explanation or illumination of these assessments is provided. Despite the Board's claims that the limit price R/VC ratio is but one of many tools used to assess market dominance, actual application of the limit price test to this case suggests that the limit price R/VC ratio is the primary, if not the sole, means of assessing market dominance. Indeed, the Total Decision does not explain what "intangible features" were considered in each lane and why they were insufficient to overcome the results of the limit price test in each of the lanes.

Thus, even though it is only supposed to be one of the tools used by the Board, it appears that the limit price test has become a hard and fast point of demarcation for determining market dominance. We believe this is a dangerous precedent given the serious shortcomings of the test. Reliance on the limit price test to the exclusion of other evidence or even use of it as a "starting point" that will stand absent contrary evidence can significantly alter conclusions about market dominance.

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[16] Surface Transportation Board, Decision, M&G Polymers USA, LLC v. CSX Transportation, Inc., Docket No. NOR 42123, September 27, 2012, pp. 14-15.

[17] We reviewed the Protective Order governing this proceeding and executed appropriate confidentiality Undertakings before reviewing these highly confidential materials.

V. Conclusion

The limit price R/VC test implemented in the Total Decision represents a fundamental change in how the Board assesses market dominance (*i.e.*, the lack of effective competition). The imposition of this new test redefines market dominance into a measure of relative market power rather than a determination of the absence of effective competition. Effective competition and market power are distinct concepts which the limit price R/VC test confuses and conflates.

The Board has stated, in the Total Decision and elsewhere, that the limit price R/VC test is not meant to be determinative because many market-specific factors must be considered. But it has always been the case that these other factors are crucial to the determination of market dominance. Thus, despite the desire for simplification, the limit price R/VC test does nothing to simplify and, in fact, adds an extra layer to the process. This extra layer adds no new relevant information, is structurally flawed, and introduces inaccuracies and a bias that must be "overcome" by other evidence, increasing the likelihood of reaching an incorrect conclusion.

Despite the Board's statement of the importance of other considerations, the simplistic and quantitative nature of the proposed limit price test can create a false sense of objectivity and precision. The presumptive weight given the limit price test coupled with the Board's desire for a simplified process will likely lead to the test becoming the predominant factor, if not the sole factor, in determining whether or not effective competition exists. Indeed, the Total Decision in this case seems to confirm that prediction.

Appendix

Biographies of B. Kelly Eakin and Mark E. Meitzen

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

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

VERIFICATION

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

Executed on this 17th day of June, 2013.

B. Kelly Eakin

B. Kelly Eakin

VERIFICATION

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

Executed on this 17TH day of June, 2013.

Mark E. Meitzen

EXHIBIT 3

HIGHLY CONFIDENTIAL EXHIBIT
REDACTED

PUBLIC VERSION

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

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

Peter J. Shudtz
Paul R. Hitchcock
John P. Patelli
CSX Transportation, Inc.
500 Water Street
Jacksonville, FL 32202

G. Paul Moates
Paul A. Hemmersbaugh
Matthew J. Warren
Hanna M. Chouest
Marc A. Korman
Sidley Austin LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000
(202) 736-8711 (fax)

Counsel to CSX Transportation, Inc.

November 28, 2012

PUBLIC VERSION

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PUBLIC VERSION

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

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

BACKGROUND[1]

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

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

PUBLIC VERSION

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

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

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

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

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

SUMMARY OF COMMENTS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

}} Appendix at 58-59.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

PUBLIC VERSION

CONCLUSION

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

Respectfully submitted,

G. Paul Moates
Paul A. Hemmersbaugh
Matthew J. Warren
Hanna M. Chouest
Marc A. Korman
Sidley Austin LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000
(202) 736-8711 (fax)

Peter J. Shudtz
Paul R. Hitchcock
John P. Patelli
CSX Transportation, Inc.
500 Water Street
Jacksonville, FL 32202

Counsel to CSX Transportation, Inc.

Dated: November 28, 2012

PUBLIC VERSION

CERTIFICATE OF SERVICE

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

Jeffrey O. Moreno
Thompson Hine LLP
1919 M Street, N.W., Suite 700
Washington, D.C. 20036

and upon *amici curiae* counsel.

Joseph T. Zaleski

Joseph T. Zaleski

VERIFIED STATEMENT OF ROBERT D. WILLIG

Before the
Surface Transportation Board

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

Verified Statement of

Robert Willig

Professor of Economics and Public Affairs

Princeton University

November 28, 2012

Witness Introduction

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

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

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

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

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

Purpose and Summary of Findings

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

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

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

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

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

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

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[3] M&G Decision at 4.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[11] M&G Decision at 1.
[12] See, for example, The National Rail Transportation Policy: "In regulating the railroad industry, it is the policy of the United States Government...to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail." (49 U.S.C. § 10101.)

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

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

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

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

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

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

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

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

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

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

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

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

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

Conclusion

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

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

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

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

VERIFICATION

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

Robert Willig

Robert D. Willig

Executed on this 20 day of November, 2012.

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

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

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

CHRISTENSEN ASSOCIATES

November 27, 2012

I. Introduction

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

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

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

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

II. The Board's Proposed Methodology

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

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

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

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

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

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

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

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

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

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

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

There is simply no economic foundation for these assertions.

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

The Limit Price is an Imprecise Concept

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

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

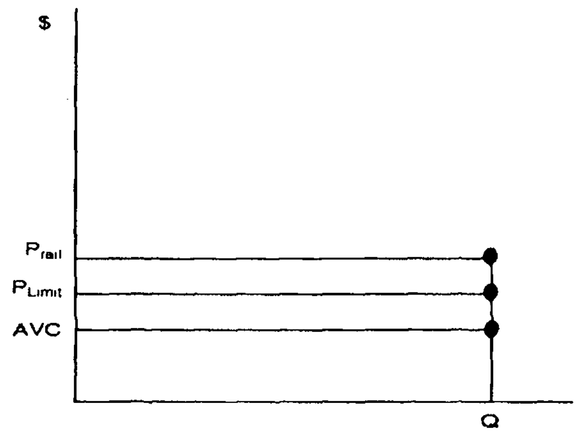
The Limit Price Test Uses Incomplete Market Information and Information Irrelevant to the Existence of Competition

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

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

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

FIGURE 1



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

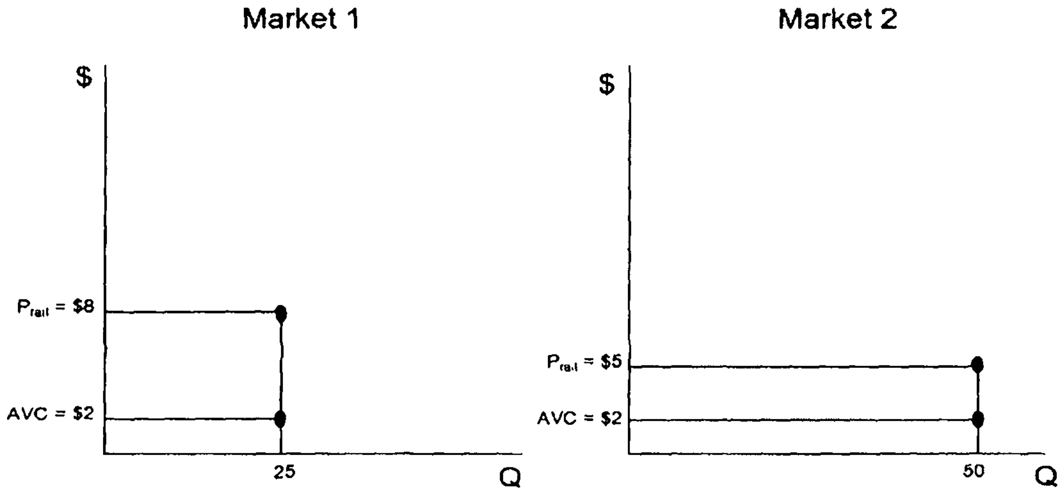
Moreover, RSAM does not appear in Figure 1 at all because the RSAM measure does not include any information from the particular market under analysis. Nor does the RSAM measure contain any information about the railroad's aggregate demand. The information contained in RSAM is disconnected from any specific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

The Proposed Market Screen Does Not Distinguish Between Different Market Situations

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

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

FIGURE 2



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

VI. Conclusion

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

Appendix

Biographies of B. Kelly Eakin and Mark E. Meitzen

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

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

VERIFICATION

I, Mark E. Meitzen, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this statement. Executed on this 15th day of November, 2012.

Mark E. Meitzen

VERIFICATION

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

Executed on this 15th day of November, 2012.

B. Kelly E

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