BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 756

STREAMLINED MARKET DOMINANCE APPROACH

COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS

On September 12, 2019, the Surface Transportation Board issued a Notice of Proposed Rulemaking in this proceeding, seeking comments on streamlined procedures to expedite the market dominance inquiry in rate reasonableness cases. The Association of American Railroads respectfully submits these comments in response.

The freight railroad members of AAR account for the vast majority of North American freight railroad traffic, mileage, employees, and revenue. As such, the AAR has a strong interest in ensuring that the Board's rate reasonableness processes do not cause unnecessary delay and expense, while maintaining their foundation in sound economics consistent with the national Rail Transportation Policy ("RTP").[1] AAR supports reasonable streamlining of procedures associated with the submission of evidence related to market dominance in appropriate cases.

AAR believes that the NPRM proposal can be improved in several respects. Specifically, the Board should adopt the following modifications/clarifications in its final rule.

- These streamlined market dominance procedures should be available only for cases in which a full stand-alone cost presentation is too costly, given the value of the case;

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[1] *See* 49 U.S.C. § 10101(1).

- The Board should consider a distance longer than 500 miles, as rail and trucks are competitive for longer distances;

- The Board should make a *prima facie* finding of market dominance only if, in addition to the other factors, there is no *pipeline* competition;

- The complainant should be required to disclose the defendant and submit to the Board all studies of competitive alternatives that it has undertaken;

- Railroads should have an equal right to request an ALJ hearing;

- The page limitation should be 50 pages of narrative, excluding exhibits, and increase by 10 pages per additional lane included in the complaint (up to 100 pages of narrative);

- The Board should add a modest element of indirect competition by precluding use of these streamlined procedures where the complainant ships less than a specified percentage of the product to the destinations (or from the origins) at issue;

- The Board should not undermine the coherence of the *prima facie* factors by applying its recent interpretation of the *DMIR* case to the streamlined approach;[2] and

- The Board should expressly and formally abandon the Limit Price Test in any future rate reasonableness proceeding.

As explained below, the Board should make these identified modifications and issue a revised NPRM if necessary.

BACKGROUND

I. The Statutory and Regulatory Framework for Market Dominance

The Board only has jurisdiction to regulate rates where the rail carrier has "market dominance."[3] Congress limited the agency's authority "in hopes of removing most rates from rate regulation."[4] Market dominance means "an absence of effective competition" for the

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[2] *See E.I. du Pont de Nemours & Co. v. Norfolk S. Rwy.*, NOR 42125, slip op. at 10 (STB served on Mar. 14, 2014) (citing *Minnesota Power. Inc. v. Duluth. Missabe & Iron Range Railway*, 4 S.T.B. 64 (1999), and *Minnesota Power, Inc. v. Duluth, Missabe & Iron Range Railway*, 4 S.T.B. 288 (1999).

[3] 49 U.S.C. § 10701(d)(1), § 10707(b), (c).

[4] *See* H. Rept. No. 96-1035, Rail Act of 1980 at 38.

traffic.[5] The Board cannot find market dominance where the rate at issue generates a revenue-to-variable cost ratio ("R/VC") that is less than 180 percent.[6] Moreover, where the Board calculates an R/VC ratio that is equal to or greater than 180 percent, the Board may not presume that the rail carrier possesses, or does not possess, market dominance over such transportation.[7]

Under this statutory structure, the agency has established a two-step inquiry to determine market dominance.[8] The Board first examines quantitative market dominance to see if the challenged rates generate revenues that exceed the traffic's variable cost by 180% or more, using the unadjusted system average variable costs established by the Uniform Railroad Costing System ("URCS").[9] Second, the Board examines qualitative market dominance. In this analysis, the agency has traditionally determined "whether there are any feasible transportation alternatives that could be used for the issue traffic. . . . Even where an alternative mode or modes of transportation exists, a complainant can establish market dominance by demonstrating that the alternate modes of transportation are not effectively constraining the carrier's ability to increase the rates of the issue traffic."[10] In that context, the agency has stated that "[e]ffective competition for a firm providing goods or service means that there must be pressure on that firm to perform up to standards and at reasonable prices, or lose desirable business."[11]

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[5] 49 U.S.C. § 10707(a).

[6] 49 U.S.C. § 10707(d)(1)(A).

[7] 49 U.S.C. § 10707(d)(2)(A).

[8] *Market Dominance Determinations*, 365 I.C.C. 118 (1981).

[9] *See Major Issues in Rail Rates*, EP 657 (Sub-No. 1) (STB served Oct. 30, 2006) ("*Major Issues*").

[10] *E.I. du Pont de Nemours & Co. v. CSX Transp.*, Inc., NOR 42100, slip op. at 2-3 (STB served June 30, 2008).

[11] *Market Dominance Determinations*, at 129.

In three of the last four stand alone cost cases, the Board has employed the "limit price" rule on top of the traditional feasible transportation alternative test for qualitative market dominance, despite opposition from both railroads and shippers.[12]

II. The NPRM Proposal

The NPRM states that "[t]he market dominance inquiry is a costly and time-consuming undertaking, resulting in a significant burden on rate case litigants."[13] Citing provision of the Rail Transportation Policy and recent legislative provisions shortening the timelines within which the Board should decide stand alone cost cases, the NPRM concludes that "[i]n order to meet its statutory duty to ensure expeditious handling of challenges to the reasonableness of rail rates, it is important for the Board to consider ways to streamline the presentation of market dominance evidence, particularly in smaller cases where the cost of making a market dominance presentation can outweigh the value of the case."[14] To do so, the Board proposes the following six factors that, if shown by complainants, would make a *prima facie* showing of market dominance:

1. The movement has an R/VC ratio of 180% or greater;
2. The movement would exceed 500 highway miles between origin and destination;
3. There is no intramodal competition from other railroads;
4. There is no barge competition;
5. The complainant has used truck for 10% or fewer of its movements subject to the rate at issue over a five-year period; and

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[12] *DuPont v. Norfolk Southern*, slip op. at 67 (Begeman, concurring) ("The comments received were overwhelmingly critical from shippers, carriers, and economists.").

[13] NPRM at 3.

[14] *Id.* at 6.

6. The complainant has no practical build-out alternative due to physical, regulatory, financial, or other issues (or combination of issues).[15]

DISCUSSION

I. The NPRM Proposal Appropriately Focuses on a Procedural Streamlining.

AAR continues to support Board efforts to streamline the procedures for rate reasonableness cases, while ensuring economically-valid outcomes.[16] The Board correctly notes in the NPRM that it has the authority to streamline market dominance procedures in appropriate circumstances as long as it maintains fidelity to the Rail Transportation Policy of 49 U.SC. § 10101 and the statutory standards of 49 U.S.C. § 10707. The Board cites to 49 U.S.C. § 10101(15) (the expeditious handling and resolution of all proceedings); § 10101(5) (foster sound economic conditions in transportation); and § 10101(6) (maintain reasonable rates where there is an absence of effective competition) as support for the rulemaking.[17] The NPRM also states that a streamlined approach to market dominance would be consistent with the policy at 49 U.S.C. § 10101(1) of allowing, to the maximum extent possible, competition and the demand for services to establish reasonable transportation rates.[18]

In addition to the provisions cited by the Board, there is arguably a more relevant RTP section that supports the rulemaking. Section 10101(2) sets as a policy goal "to minimize the need for Federal regulatory control over the rail transportation system and to require fair and expeditious regulatory decisions when regulation is required." The provision captures the tension that the Board must resolve in the market dominance inquiry: deciding, in a fair and

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[15] The first factor, R/VC greater than 180% is a statutory requirement, and must be part of any showing of market dominance. The remaining five factors can be understood as satisfying the elements of qualitative market dominance.

[16] *See, e.g.*, AAR Comments, EP 733, *Expediting Rail Rate Cases* (filed August 1, 2016).

[17] NPRM at 4.

[18] *Id.* at 5.

expeditious manner, whether regulation is necessary in a particular instance because of a market failure. Thus, a proper accommodation of all of the relevant RTP factors can only be achieved if expedition is balanced by accuracy.

Importantly, the NPRM does not propose to alter the substantive standard by which market dominance will be decided by the Board and does not propose to shift the burden of proof away from complainants. This is consistent with the statute, the Administrative Procedure Act ("APA"), and precedent. Section 10707 requires the Board to find that there is a lack of effective competition and that the challenged rate generates an R/VC in excess of 180%. The APA places the burden of proof for that showing on complainants.

Instead of changing those elements of the market dominance inquiry, the NPRM proposes six factors, that if demonstrated, would constitute a *prima facie* showing of market dominance. In this way, the Streamlined Market Dominance Approach could be an effective way to limit the time and expense of rate cases if it is tailored to appropriate circumstances, improved to encompass all relevant factors, and clarified to explain what evidence will satisfy each factor.

II. Any Streamlined Market Dominance Procedures Should Be Tailored to Appropriate Circumstances.

The NPRM makes reference to the importance of streamlined market dominance rules for "smaller cases," but does not limit the streamlined market dominance approach to such cases.[19] Instead, the NPRM offers a one-size-fits-all approach as to which factors would constitute a *prima facie* showing of qualitative market dominance, regardless of the size of the case.

[19] *See* NPRM at 6.

The proposal seems focused on recent cases, where large chemical companies sought to challenge in a single rate reasonableness proceeding the rates for 100 or more lanes of traffic for shipments that also often move by truck. Most prior cases involved much more manageable market dominance analyses, and in some cases market dominance was even stipulated.[20] AAR submits that, consistent with the Board's stated goals, the Board should implement the streamlined market dominance procedures only in cases where the cost of a full presentation is not warranted due to the value or complexity of the case. That is, the streamlined approach should be limited to: (1) small value cases heard under the simplified procedures; and (2) cases with fewer than 10 origin/destination pairs.

III. The Board Should Improve and Clarify Its *Prima Facie* Proposal.

The Board's *prima facie* approach to market dominance may help streamline the process in smaller, less complex cases. A few modifications to the proposal as included in the NPRM will make it an even more useful tool for the Board's market dominance analysis. The Board should integrate these modifications in its final rule or, if necessary, propose them as part of a revised NPRM prior to adoption of a final rule.

A. The NPRM Can Be Improved by Additional Considerations.

The NPRM notes that "[m]any of the facts to support these proposed *prima facie* factors are available to complainants at the pleading stages."[21] As a result, "the Board expects that complainants would be able to plead these factors in most cases and potentially negotiate stipulations with defendant carriers that would avoid costly discovery."[22] The NPRM proposes

[20] *See, e.g.*, *Sunbelt Chlor Alkali Partnership v. Norfolk S. Rwy.*, NOR 42130 (STB served June 20, 2014).

[21] NPRM at 11.

[22] *Id.*

that if complainants show the existence of all of the factors, "the Board would find by rule that a complainant that meets each of the required factors will have made a prima facie showing of market dominance."[23]

The logic of the NPRM proposal is straightforward. Complainants are in possession of most of the information that will inform the market dominance analysis. As such, if certain factors can be shown, market dominance is likely, and complainants can elect to use a streamlined procedure. The streamlined approach is not simply a pleading requirement. "Under the proposed streamlined approach . . . complainants would still be required to demonstrate, with sufficient evidence, the absence of effective competition."[24] Thus, the proposal allows complainants to plead the presence of six factors with their complaint and then submit evidence on opening to establish market dominance.

The NPRM is correct to take a holistic view of competition and require the showing of several factors to qualify for streamlined procedures. Certainly, no single factor could serve as an indicator of the presence or absence of effective competition. Moreover, the Board is generally asking the right questions in the NPRM, including looking at the complainants' length of haul, use of competitive alternatives, and build-out options.

With respect to length of haul, the Board has suggested that the movement in question be greater than 500 highway miles to qualify. AAR submits that the 500-highway-miles is a conservative threshold for use in these streamlined market dominance procedures. Of course, this threshold need not—and could not—identify the exact demarcation line whereby trucks do not provide effective competition to rail in every circumstance. No mileage threshold could ever

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[23] *Id.*

[24] NPRM at 5.

capture such a dividing line in dynamic, complex markets. The NPRM notes that carriers that transport shipments less than 500 highway miles may possess market dominance and that carriers that transport shipments in excess of 500 may not. Instead, this threshold is designed to identify a factual scenario where, along with when other factors are satisfied, complainants should be able to utilize streamlined procedures, after which the defendant carrier will have the "opportunity in its reply evidence to argue that . . . the carrier is not market dominant for the movement."[25]

Thus, the AAR generally supports the Board's determination that requiring a distance greater than 500 highway-miles strikes the right balance in today's competitive environment. The NPRM cites to the Board's previous statement that "[t]rucking becomes less viable when the length of haul exceeds 500 miles because any transport over that threshold, in many instances, could not be completed in one day."[26] Distances that can be traveled in a single day are increasing, however, as trucking companies experiment with platooning, remote operation, and autonomous trucks.[27] Moreover, trucking companies are continually trying to persuade Congress to liberalize truck size or weight limits on U.S. highways. As the technological and political landscape evolves, it is likely that trucks will become even more potent competitors to railroads at greater distances, meaning the 500 highway-mile threshold may need to be increased.

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[25] NPRM at 8.

[26] *Review of Commodity, Boxcar, TOFC/COFC Exemptions*, EP 704 (Sub-No. 1), slip op. 7 & n. 12 (STB served Mar. 23, 2016).

[27] *See* McKinsey & Co., Distraction or Disruption? Autonomous Trucks Gain Ground in U.S. Logistics *available at* https://www.mckinsey.com/industries/travel-transport-and-logistics/our-insights/distraction-or-disruption-autonomous-trucks-gain-ground-in-us-logistics ("We may see a shift in volumes from rail to road as the cost of trucking declines and the point of parity for shippers' costs between rail and road extends from today's 500 miles or so to nearly 1,000 miles.").

The Board also omits a factor in the NPRM that should be included in the streamlined approach. In addition to the barge and truck competitive alternatives contained in the proposal, the Board should also include a showing that there is no effective pipeline competition for the transportation at issue. While many commodities transported by rail cannot be transported by pipeline, some can, and in those instances, complainants should not be allowed to exploit a loophole and qualify for the streamlined procedures. As with other intermodal competitive alternatives, shippers of those commodities that are transported by pipeline that elect to use the streamlined market dominance approach should be required to support assertions of lack of effective competition with support.

The Board should also add a factor to limit the streamlined approach to instances where the complaining shipper has shipped more than a significant percentage of the commodity at issue to the destination in the case, such as 75% over the last five years, to demonstrate a lack of effective competition at destination. Though the Board does not currently consider evidence of indirect competition, the agency has long recognized that a wide range of competitive forces constrain railroads' pricing power and has noted that the statute permits, but does not require, the consideration of indirect competition.[28] The Board acknowledged that product and geographic competition can be effective competitive constraints on rail pricing, but, in its discretion, chose to balance the interest of exploring all forms of competition against the burden, time, and expense of performing such an investigation.[29] By adding a clean, easily applied factor based on information already in the shipper's possession, the Board can more accurately consider the competitive market realities without imposing any additional burden on parties.

[28] *Mkt. Dominance Determinations – Prod. & Geographic Competition*, 3 S.T.B. 937, 946 (1998).

[29] *Mkt. Dominance*, 3 S.T.B. at 946-48 ("We have no doubt that in certain circumstances product and geographic competition effectively limit railroad pricing, as the ICC in fact found in several cases.").

B. The Board Should Clarify Certain Aspects of the NPRM Proposal.

AAR submits that the Board can also improve its proposal by making several clarifications regarding the stated factors. First, with respect to some of the factors, the NPRM suggests that "a verified statement from an appropriate official(s) with knowledge of the facts would be sufficient to meet the complainant's *prima facie* showing."[30] The Board should clarify what information must be contained in such verified statements. For example, the final proposed factor, that there is no practical buildout option, highlights the need for the Board to clarify that complainants must include evidentiary support for conclusions asserted by company officials.[31] Conclusory statements regarding the feasibility of build-out options would not be sufficient to satisfy the proposed requirement. To make a *prima facie* showing, complainants should be required to show how the possibility of a buildout was evaluated, including submission of any studies it has undertaken. Similarly, the absence of intramodal and barge competition—as well as pipeline competition under AAR's proposal—factors should require complainants to disclose what steps it has taken to evaluate those competitive options and submit all studies that it has undertaken, subject to confidentiality protections. Moreover, election of the streamlined approach should trigger a requirement that a complainant disclose all of this information to the defendant along with its complaint. Such disclosure would limit the need for discovery and reduce the number of disputes to be resolved.

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[30] NPRM at 11.

[31] The NPRM states, "[t]o demonstrate this factor of a market dominance prima facie showing, a complainant would need to submit a short plain statement in a verified statement by an appropriate official, or otherwise demonstrate, that it has no practical build-out alternative. For example, the complainant must state whether the impracticality is due to physical, regulatory, financial, or other issues (or combination of issues). If that showing cannot be made, the complainant would be required at the outset to address in some detail in its opening, through the non-streamlined market dominance presentation, why any potential build-out(s) would not provide effective competition." *Id.*

C. <u>The Board Should Not Apply Its Interpretation of the *DMIR* Case to the Streamlined Approach.</u>

Imagine a hypothetical scenario where Railroad A provides service from Milwaukee to Chicago, and Railroad B provides service from Chicago to Indianapolis. If another pair of railroads also provides rail service from Milwaukee to Indianapolis—or there were a pipeline, truck, or barge that provided competitive service from the same origin to the same destination—then it is obvious that there is no market dominance. Competition from the other rail option, the pipeline option, the trucking option, or the barge option will place competitive constraints on the railroad and Congress plainly did not contemplate the STB regulating the rates in those circumstances.

Consistent with this logic, the *prima facie* factors proposed by the Board are all attempts to tease out whether these forms of direct competition preclude the Board from regulating the challenged rates. Specifically, the Board is proposing the following four factors that speak directly to the presence, or absence, of competitive transportation alternatives.

1. There is no intramodal competition from other railroads;
2. There is no barge competition;
3. The complainant has used truck for 10% or fewer of its movements subject to the rate at issue over a five-year period; and
4. The complainant has no practical build-out alternative due to physical, regulatory, financial, or other issues (or combination of issues).

In the hypothetical, one would expect that if there were evidence of intermodal competition (between Milwaukee and Indianapolis), or barge competition (between Milwaukee and Indianapolis) or the complaint has used truck for more than 10% of shipments (between Milwaukee and Indianapolis) or a buildout option to another railroad with direct access to

Indianapolis, then there is no market dominance. That would be logical, as a matter of economics and common sense.

Yet, if the Board applied the *DMIR* decision as it was interpreted in *Dupont v. Norfolk Southern*, the STB would ignore whole-route transportation alternatives if the challenged rate is only to an intermediate point in a joint-rate situation. If a customer were challenging just the rate of Railroad A from Milwaukee to Chicago, then the *only* transportation alternatives the STB would consider are from Milwaukee to Chicago. A direct rail route to Indianapolis, or direct trucking to Indianapolis, or a direct pipeline or barge to Indianapolis, would be labeled "geographic" competition and could be arbitrarily excluded from the analysis.

The Board must clarify that whole-route competitive options will qualify for consideration when applying the four factors announced above, for several reasons. First, the treatment of whole-route competitive alternatives as "geographic" competition is absurd. The same product would move from the same origin to the same destination. This is not geographic competition, and the agency's precedent does not support that label.[32] Second, consideration of whole-route truck movements is simple. True geographic competition is difficult to measure. For example, the rate for transportation of wheat to a US port for export will be constrained by competition from a Canadian movement of wheat to a Canadian port, because both are competing into the same global marketplace. But that form of indirect competition, while real, is difficult to measure. Direct competition from whole route transportation alternatives is not just simpler, it is perhaps the simplest form of competition to measure. Third, the *prima facie* factors would not make sense if applied only from the origin of a movement to a point of interchange with another railroad. A point of interchange can be a remote rail yard in a location where

[32] *See* NS Reply Evidence, *Dupont*, NOR 42125, at II-B-62 – II-B-67.

freight is never loaded on or delivered by a truck, there are no pipelines, and no barges and little likelihood of alternative rail service to the precise same interchange location. If the Board applies its *DMIR* precedent to these factors, this simplified market dominance process will not be workable as it applies to challenges to a portion of a joint-rate movement.

IV. The Proposed Procedures Should be Modified to Ensure Defendants' Due Process Rights.

The NPRM anticipates that even the streamlined procedures may produce disputes that the Board will need to resolve. As a result, the proposal includes a new delegation of authority to an Administrative Law Judge to "hold an on-the-record telephonic market dominance evidentiary hearing".[33] The NPRM states that "[t]he ALJ's role would be to allow the parties to clarify their market dominance under oath, and to build upon issues presented by the parties through critical and exacting questioning."[34] The NPRM limits such hearing to "complainant's option" without explanation.[35] In light of the significant weight the proposed process places on the complainant's initial submissions, defendant railroads should be afforded equal access to an ALJ hearing at their request. The Board should also clarify that the ALJ will not rule on any market dominance issues and that his or her role would be limited to presiding over the examination of witnesses. The Board would retain authority to rule on market dominance. It is also unclear from the NPRM which ALJs the Board would use and whether those judges would have any substantive expertise in market dominance issues.

In addition, the Board should not allow complainants to produce new evidence on rebuttal or at the administrative hearing to bolster its initial showing when it has elected to use

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[33] NPRM at 12.

[34] *Id.*

[35] *Id.*

the streamlined approach. An important corollary of the NPRM's logic that the complainant possesses most of the information regarding competitive options is that complainants must produce all relevant evidence in its submission and not be rewarded for obscuring probative evidence. Of course, if a defendant railroad introduces evidence unrelated to the prima facie factors in its market dominance submission, complainants should be allowed to provide appropriate rebuttal evidence.

With respect to the Board's proposed page and time limits in the NPRM, AAR generally supports page and time limits to focus the parties on relevant issues. However, if the Board chooses not to limit the use of the proposed streamlined procedures to small cases, as discussed above, then the Board should more carefully tailor the limitations on evidence to the complexity of the case. Instead of a 50-page limit, inclusive of exhibits and verified statements, on reply and rebuttal submissions being applied across the board to cases with one origin/destination pair and 100 origin/destination pairs, the Board should meter the limitation based on the complexity of the case.

Moreover, the NPRM's reference to final briefs in rate cases as a relevant benchmark for length of evidentiary submissions is misplaced. Briefs summarize evidence and argument that is already in the record. But the NPRM would limit the only record evidence that defendants are allowed to submit. This is particularly troubling in light of the limitation on exhibits. Relevant evidence has often been studies of competitive alternatives that approached or exceeded 50 pages. As a result, the Board should consider a tiered approach to evidentiary limits, expanding the 50-page limit in cases with multiple lanes. AAR suggests a 50-page limit of narrative, excluding exhibits, for a one-lane case, with the limit increasing by 10 pages for each additional lane, up to a maximum of 100 pages.

V. The Board Should Affirmatively State that it Will Not Apply the "Limit Price Test" in Any Future Rate Case.

The Board's traditional market dominance inquiry has been unnecessarily complicated by the Limit Price Test.[36] The massive controversy surrounding this approach vastly complicates market dominance litigation. Parties must present evidence on the traditional feasible alternative test in addition to running the calculations for the Limit Price Test.[37] Railroads include detailed descriptions of the legal, economic, and policy defects with that approach, and complainants must respond to those challenges (although many also dispute the legality and reasonableness of that test). As such, expressly and formally eliminating the Limit Price analysis in all future cases would expedite the market dominance inquiry by obviating unnecessary evidence and argument, consistent with the overarching goal of this proceedings.

The AAR is concerned, however, that the agency is traveling in the wrong direction, and inadvertently *endorsing* the Limit Price Test with this rulemaking. In the NPRM, the agency declared that in the qualitative analysis, "the Board determines whether there are any feasible transportation alternatives sufficient to constrain the railroad's rates for the traffic to which the challenged rates apply (the issue traffic)."[38] The NPRM then cites as support *M&G Polymers USA, LLC v. CSX Transp., Inc.*, NOR 42123, slip op. at 2, 11-18 (STB served Sept. 27, 2012). The *M&G* decision was the first to apply the Limit Price Test and the cited pages (11-18) lay out

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[36] Pursuant to the Limit Price Test, where the Board found "feasible alternatives" to the transportation at issue it would determine if it "effectively constrained" the challenged rate by calculating the limit price, calculating the limit price Revenue to Variable Cost ("R/VC") ratio, and comparing that figure to the carrier's Revenue Shortfall Allocation Method ("RSAM"). If the former was less than the latter, the Board presumed that the competitive alternative effectively constrains the rate at issue.

[37] *See, e.g.*, Consumers Opening Evidence, NOR 42142 (filed Nov. 2, 2015).

[38] NPRM at 2.

the test in detail. By citing specifically and directly to the Limit Price test, the NPRM may be seeking to ratify this profoundly flawed test by rulemaking.

Accordingly, the AAR urges the Board to take this opportunity to definitively declare that it will no longer apply the Limit Price test. The AAR has set forth in detail the deficiencies of the test in comments filed in other proceedings and those filings are attached as an appendix.[39] To recount these flaws here in brief, the Board violated the APA by replacing the qualitative market dominance approach adopted through notice-and-comment rulemaking with the Limit Price Test adopted in an adjudicatory proceeding.[40] As a substantive matter, the Limit Price Test rests on a number of faulty assumptions that are not supported by law or sound economics and is thus not the product of reasoned decisionmaking.[41] The Limit Price Test reveals nothing about the existence and extent of feasible transportation alternatives for the movement of a specific commodity in a specific lane. The test violates the statutory prohibition against presumptions of market dominance based on revenue-to-variable cost ratios in Section 10707(d)(2). And the use of RSAM as a measure of market dominance has no rational basis. Far from sanctioning this approach, the Board should expressly state that it will abandon the Limit Price Test.

[39] AAR Amicus Comments, NOR 42123 (filed Nov. 28, 2012); AAR Amicus Comments, NOR 42121 (filed July 24, 2013).

[40] *See, e.g., United States Telecom Ass'n v. FCC*, 400 F.3d 29, 34-35 (D.C. Cir. 2004).

[41] *See, e.g., Burlington N. R.R. v. ICC*, 985 F.2d 589 (D.C. Cir. 1993).

CONCLUSION

The Board should modify the proposal as described above.

Respectfully submitted,

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November 12, 2019

APPENDIX

ASSOCIATION OF
AMERICAN RAILROADS

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July 24, 2013

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

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

Dear Ms. Brown:

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

Respectfully submitted,

Louis P. Warchot

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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Docket No. 42121

TOTAL PETROCHEMICALS & REFINING USA, LLC

v.

CSX TRANSPORTATION, INC.

AMICUS CURIAE COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS

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July 24, 2012

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Docket No. 42121

TOTAL PETROCHEMICALS & REFINING USA, LLC

v.

CSX TRANSPORTATION, INC.

AMICUS CURIAE COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS

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

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

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

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

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

Discussion

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

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

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

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

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

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

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

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

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

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

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

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

Faced with these facts and governing law, the May 31 decision attempts to skirt the issue by claiming that the limit price rule is "not a departure from [the Board's] rules."[3] But an agency may not circumvent the APA by characterizing its reversal of position in an adjudication as a "refinement." *See Marseilles Land and Water Co. v. FERC*, 345 F.3d 916, 920 (D.C. Cir. 2003) (holding that "an administrative agency may not slip by the notice -and -comment rule- making requirements needed to amend a rule by merely adopting a de facto amendment to its regulation through adjudication"). When an agency has given its regulation a definitive interpretation, and later significantly revises that interpretation, the agency has in effect amended its rule, something it may not accomplish without notice and comment. *See Shalala v. Guernsey Mem'l Hosp.*, 514 U.S. 87, 100 (1995) (an agency interpretation that "adopt[s] a new position inconsistent with ... existing regulations" must follow APA notice-and-comment procedures); *Syncor Int'l Corp. v. Shalala*, 127 F.3d 90, 94-95 (D.C. Cir. 1997); *Alaska Professional Hunters Association, Inc. v. FAA*, 177 F.3d 1030, 1033-34 (D.C. Cir. 1999). Moreover, "[o]nce an agency gives its regulation an interpretation, it can only change that interpretation as it would formally modify the regulation itself: through the process of notice and comment rulemaking." *Paralyzed Veterans of America v. D.C. Arena*, 117 F.3d 579, 586 (D.C. Cir. 1997); *see also SBC Inc. v. FCC*, 414 F.3d 486, 498 (3d Cir. 2005) ("[I]f an agency's present interpretation of a regulation is a fundamental modification of a previous interpretation, the modification can only be made in

[3] May 31 decision at 22.

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

The limit price rule is a substantive departure from the rule adopted by notice and comment. The approach to qualitative market dominance adopted in *Market Dominance Determinations* eliminated the use of rebuttable presumptions based on quantitative measures to adhere to the requirements of the then recently passed Staggers Act. *Market Dominance Determinations,* 356 I.C.C. at 120 (stating "the use of rebuttable presumptions in market dominance determinations often placed too much emphasis on quantitative evidence which did not fully reflect the circumstances of any given movement"). In the place of the presumptions, the ICC adopted a procedure of reviewing the totality of evidence submitted in rate cases of intramodal, intermodal, product and geographic competition.[4] The limit price rule reverses that position and establishes a rebuttable presumption based on a calculation of the limit price R/VC ratio. The Board's description of the presumption as a "preliminary conclusion" that can be rebutted by a showing of intangible factors simply defines what it means to be a "rebuttal presumption."[5]

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

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

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

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

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

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

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

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[6] May 31 decision at 3-4.

[7] *Id.* at 5.

[8] *Id.*

[9] *Id.* at 22.

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

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

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

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

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

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

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

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

[13] May 31 decision at 25.

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

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

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

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

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[14] *See, e.g., Potomac Elec. Power Co. v. CSX Transp., Inc.*, 2 S.T.B. 290, 294 (1997) ("Apart from the 180% jurisdictional threshold, which has been set by law, we do not use rate-cost relationships as a basis for qualitative market dominance determinations."); *Market Dominance Determinations*, 365 I.C.C. at 122 (questioning whether actual R/VC ratios "reliably indicate the presence or absence of market dominance" because there "are any number of reasons why a high price/cost ratio may not be indicative of true market power on the part of the railroad").

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

[16] May decision at 25.

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

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

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

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

[18] May 31 decision at 24.

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

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

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

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

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

[21] May 31 decision at 4.

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

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

A. RSAM does not indicate the presence of market power

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

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

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

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

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

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

[23] May 31 decision at 25.

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

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

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

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

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

[25] May 31 decision at 25-26.

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

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

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

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

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

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

[27] *Id.* at 26.

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

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

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

Conclusion

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

Respectfully Submitted,

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CERTIFICATE OF SERVICE

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

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Ms. Cynthia T. Brown
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Surface Transportation Board
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Re: STB Docket No. 42123, *M & G Polymers USA, LLC v. CSX Transportation, Inc.*

Dear Ms. Brown:

Pursuant to the Board's Decisions served on September 27, 2012 and October 25, 2012, attached please find the *amicus curiae* Comments of the Association of American Railroads for filing in the above proceeding.

Respectfully submitted,

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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Docket No. 42123

M& G POLYMERS USA, LLC

v.

CSX TRANSPORTATION, INC.

COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS

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November 28, 2012

BEFORE THE
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M& G POLYMERS USA, LLC

v.

CSX TRANSPORTATION, INC.

COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS

Pursuant to the decisions of the Surface Transportation Board ("Board") served on September 27, 2012 ("September Decision") and October 25, 2012 ("October Decision"), the Association of American Railroads ("AAR") hereby submits comments as *amicus curiae* on the new test for qualitative market dominance announced in this proceeding.[1]

Introduction

Reflecting the policy adopted by Congress to "allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation," 49 U.S.C. § 10101(1), the Board's jurisdiction over railroad rates is limited to those rates that apply to traffic over which the rail carrier is found to possess "market dominance." 49 U.S.C.

[1] Consistent with footnote 10 of the October Decision, the AAR's comments focus on the legal and policy implications of the Board's new rule. The AAR takes no position on the application of the rule to this dispute and will not address the specific rates at issue in the underlying complaint.

§ 10701(d)(1), § 10707(b), (c). As defined in the statute, market dominance means "an absence of effective competition" for the traffic. 49 U.S.C. § 10707(a). The Board cannot find market dominance where the rate at issue generates a revenue-to-variable cost ratio ("R/VC") that is less than 180 percent. 49 U.S.C. § 10707(d)(1)(A). Moreover, where the Board calculates an R/VC ratio that is equal to or greater than 180 percent, the Board may not presume that the rail carrier possesses market dominance over such transportation. 49 U.S.C. § 10707(d)(2)(A).

Under this statutory structure, the agency has established a two-step inquiry to determine market dominance. *Market Dominance Determinations*, 365 I.C.C. 118 (1981). The Board first examines quantitative market dominance to see if the challenged rates generate revenues that exceed the traffic's variable cost by 180% or more, using the unadjusted system average variable costs established by the Uniform Railroad Costing System ("URCS"). *See Major Issues in Rail Rates*, EP 657 (Sub-No. 1)(STB served Oct. 30, 2006) ("*Major Issues*"). Second, the Board examines qualitative market dominance. In this analysis, the agency has traditionally determined "whether there are any feasible transportation alternatives that could be used for the issue traffic. . . . Even where an alternative mode or modes of transportation exists, a complainant can establish market dominance by demonstrating that the alternate modes of transportation are not effectively constraining the carrier's ability to increase the rates of the issue traffic." *E.I. du Pont de Nemours & Co. v. CSX Transp.*, Inc., NOR 42100, slip op. at 2-3 (STB served June 30, 2008).

In this proceeding, M&G Polymers USA, LLC, ("M&G") filed a complaint on June 18, 2010, challenging the reasonableness of rates established by CSX Transportation, Inc. ("CSXT") for the transportation of polyethylene terephthalate. By a decision served on May 6, 2011, the Board bifurcated the proceeding to consider the issue of market dominance separately before accepting evidence on stand alone cost. *See M&G Polymers, Inc. v. CSX Transportation, Inc.*, NOR 42123 (STB served May 6, 2011).

On September 27, 2012, the Board issued a decision on market dominance, announcing a new approach to qualitative market dominance. In this new approach, the Board broke the qualitative analysis into two parts. First, the Board considered whether there were "feasible alternatives" to the transportation at issue. Second, where the Board concluded that there were feasible alternatives, the Board weighed whether those alternatives "effectively constrained" the challenged rates.

The "effectively constrained" test, in turn, was comprised of three steps. First, the Board calculated a "limit price," which the Board defined as, "the highest price the railroad theoretically could charge . . . without causing a significant amount of the issue traffic on a particular rail movement to be diverted to any particular competitive alternative." September Decision, at 3-4. The Board concluded, without discussion, that the limit price should be set at the lowest price offered by the identified transportation alternative. *See id.* at 14 & n. 40. Second, the Board calculated the "limit price R/VC ratio" by comparing the revenue that would be generated by the limit price to the defendant railroad's variable costs of providing the service at issue. That is, this R/VC ratio compared the price of the alternative transportation with the defendant's variable cost of providing rail service for that movement. The Board apparently assumes that this R/VC ratio would be the result of the highest rate the rail carrier could charge the issue traffic without losing significant amounts of the business to the identified alternative.

In the third and final step, the Board compared this limit price R/VC ratio to the defendant's most recent Revenue Shortfall Allocation Method ("RSAM") figure—the measure of the average markup that the railroad would need to collect from all of its potentially captive traffic to earn a return on investment equal to the railroad industry's cost of capital, as calculated by the Board. If the limit price R/VC ratio exceeded the most recent RSAM figure, the Board presumed that the alternative cannot exert competitive pressure sufficient to effectively constrain the rate at issue. If the limit price R/VC ratio fell below the RSAM figure, the Board presumed that the competitive alternative effectively constrains the rate at issue. Finally, the Board stated that these presumptions could be overcome by evidence demonstrating that the transportation alternative upon which the limit price is based has certain unquantifiable qualities that bear on the transportation alternative's ability to effectively constrain the rate at issue.

The Board "strongly encouraged" parties to submit comments on the new approach 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."). In the October Decision, the Board clarified that interested parties other than CSXT and M&G could file comments as *amicus curiae* regarding the new methodology.

The AAR is a trade association whose membership includes freight railroads that operate 82 percent of the line-haul mileage, employ 95 percent of the workers, and account for 97 percent of the freight revenues of all railroads in the United States. The AAR and its freight railroad members have a strong interest in ensuring that the Board adheres to the Interstate Commerce Act's mandate that it exert its rate reasonableness jurisdiction only in cases where the rail carrier truly possesses market dominance.

For the reasons discussed below, the AAR respectfully submits that the Board's replacing the qualitative market dominance approach adopted through notice-and-comment rulemaking in an adjudicatory proceeding has violated the Administrative Procedure Act ("APA"). Moreover, the Board's approach to market dominance establishing a presumption based on R/VC ratios is flawed and, in fact, was properly rejected in 1981. Finally, the use of RSAM as a measure of market dominance has no rational basis.

Discussion

I. The Adoption Of A New Test For Qualitative Market Dominance Without Notice And Comment Violates The Administrative Procedure Act.

The Board's existing and longstanding guidelines on qualitative market dominance were adopted through notice-and-comment rulemaking by the Interstate Commerce Commission ("ICC") in *Market Dominance Determinations*, 365 I.C.C. 118 (1981). That choice to adopt market dominance rules via notice-and-comment rulemaking has consequences. One consequence is that substantive changes to those rules can be completed only through a subsequent notice-and-comment rulemaking consistent with the provisions of the APA. Here, the Board's actions have impermissibly circumvented the APA's procedural requirements by modifying rules adopted by notice-and-comment rulemaking in this adjudicatory proceeding.

Where an agency modifies a rule adopted through its quasi-legislative role of promulgating rules, it may not later change that rule through the quasi-judicial function of adjudication. *See Am. Mining Congress v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1109 (D.C.Cir.1993) (holding "[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). Instead, changes to a rule that "effectively amend[] a prior legislative rule" require notice-and-comment rulemaking under the APA. *See United States Telecom Ass'n v. FCC*, 400 F.3d 29, 34-35 (D.C. Cir. 2004). As such, the Board's decision to adopt a new approach to qualitative market dominance in this case was an impermissible amendment of prior legislative rules adopted through notice-and-comment rulemaking to implement the market dominance requirements of 49 U.S.C. § 10707. Indeed, when the Board previously modified its approach to qualitative market dominance established in *Market Dominance Determination,* it did so by a notice-and-comment rulemaking. *See Product and Geographic Competition*, 2 I.C.C.2d 1(1985); *Market Dominance Determinations – Product and Geographic Competition,* 3 S.T.B. 937 (1998).

The limited exceptions to the APA's procedural requirements cannot justify the Board's action here. The Board's modification of its guidelines for qualitative market dominance cannot be understood to fit within the APA's narrow exception to the notice-and-comment requirement that applies to "interpretive rules" or rules of "agency organization, procedure, or practice." 5 U.S.C. § 553(b)(3)(A). The September Decision reverses the 1981 decision in *Market Dominance Determinations* and adopts a presumption of market dominance based on an R/VC ratio formula, redefining the substance of qualitative market dominance. Such a change to a substantive, legislative rule can only be pursued via a notice-and-comment rulemaking proceeding. *See Broadgate Inc. v. U.S. Citizenship and Immigration Services*, 730 F.Supp.2d 240, 244 (D.D.C. 2010) ("[An]agency's intent to exercise legislative power may be shown where the second rule effectively amends the previously adopted legislative rule, either by repudiating it or by virtue of the two rules' irreconcilability."). While the Board may have discretion to change its mind and even revert to a previously rejected prior rule if it notices a proposal, receives public comment, and establishes a reasoned basis for doing so, it may not circumvent the APA by characterizing its reversal in an adjudication as a "refinement." *See Marseilles Land and Water Co. v. FERC*, 345 F.3d 916, 920 (D.C. Cir. 2003) (holding that "an administrative agency may not slip by the notice -and -comment rule- making requirements needed to amend a rule by merely adopting a de facto amendment to its regulation through adjudication "); *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).

Moreover, the limited opportunity for the public to comment on the adoption of the rule in this proceeding, *ex post*, as *amicus curiae* does not cure the violation of the APA and does not transform this adjudicatory proceeding into a notice-and-comment rulemaking. Among other things, the APA requires that an agency publish notice of changes to a rule in the *Federal Register* and provide opportunity for public comment before adopting the rule. *See* 5 U.S.C. § 553. In this proceeding, however, no notice was filed in the *Federal Register.* Furthermore, the comment process the Board has established in this proceeding raises issues of fundamental fairness. The Board specifically stated in the October Decision that interested parties would "not be permitted to intervene" in this proceeding and interested parties have been given only a short window of time to submit a single round of comments on the new rule. Though the Board invited alternative approaches be submitted, a single round of comments does not allow interested parties to respond to anything contained in other parties' filings. In addition, the Board's limit price rule has already been adopted, indicating the Board's preference to move ahead with the rule change. Allowing interested stakeholders to comment on the rule as *amicus curiae* only after a new rule has been adopted does not satisfy the notice-and-comment requirements of the APA. *See General American Transp. Corp. v. ICC*, 872 F.2d 1048, 1060 (D.C. Cir. 1989) (finding "no authority for [the] theory that an adjudication is converted into a rulemaking solely because an agency solicits and entertains the comments of those who have an interest in prospective application of the principle under study").

II. Presumptions Of Market Dominance Based On R/VC Ratios Are Contrary To The Statute, Agency Precedent, And Sound Economics.

Congress and the ICC have previously concluded that rail carriers should not be presumed to possess market dominance based on R/VC ratios. The Board's September Decision that adopted a presumption of market dominance based on a quantitative analysis of a limit price R/VC ratio violated 49 U.S.C. § 10707(d)(2) and reflects a flawed formulaic approach to market dominance rejected by the Staggers Act and the ICC. Congress has expressly precluded the Board from presuming that a carrier possesses market dominance based on an R/VC ratio in Section 10707(d)(2). That section states that the Board cannot presume that a rail carrier possesses market dominance because the rate it charges generates an R/VC ratio that is greater than or equal to 180% of its variable costs. This reflects the Congressional intent that the agency engage in a qualitative examination of market dominance separate and apart from the quantitative examination of the rate required by 49 U.S.C. § 10707(d)(1). Indeed, the agency has long recognized that the Interstate Commerce Act, as amended, precludes a finding of market dominance if the challenged rate generates an R/VC ratio of less than 180% and it otherwise requires a qualitative analysis of whether or not traffic with a higher R/VC ratio is subject to effective competition. *See, e.g.*, *Market Dominance Determinations*, at 119. The agency has defined this qualitative investigation as "one based on a variety of qualitative and quantitative evidence separate from the price/cost jurisdictional threshold and not dependent on predetermined statistical measures." *Id.* at 119 & n. 5.

Although the ICC originally relied on rebuttable presumptions of market dominance, including one based on R/VC ratios, the agency rejected their use in 1981, after the passage of the Staggers Act. The reasons for rejecting presumptions still resonate today:

> [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.

Id. at 120. A single-minded focus on quantitative measures of market dominance would defeat Congress's intent that the agency look at all of the circumstances regarding a movement of rail traffic to determine whether there is effective competition for the traffic. While the Board now cites its need for objective measures of market dominance to be able to process its docket more efficiently, it should not adopt formulaic solutions to questions that require its expert judgment weighing lane-specific qualitative evidence especially where the formulaic solution itself is of limited economic usefulness as explained below.

Any qualitative market dominance approach based on a quantitative analysis of R/VC ratios would suffer from a number of deficiencies. One weakness of the newly adopted approach is its reliance on system average URCS costs without recognition of the unique characteristics of the move to determine the state of competition for a particular movement of rail traffic. Even before URCS was adopted, the agency recognized the weakness of relying on standard costing measures in capturing movement-specific characteristics of traffic subject to a rate challenge. The ICC explained:

> Since the simplicity of the cost test requires that a standard costing methodology be used, there is no way of avoiding the distorting inaccuracies of such a test. Many rates falling above a designated revenue-to-variable cost ratio would, on that basis of more accurate cost estimates, in fact be below it.

Market Dominance Determinations, at 122.

Even if costs could be accurately measured, however, the agency has long recognized that R/VC ratios reveal little about market power. In 1981, the ICC rejected R/VC ratios as indicative of qualitative market dominance, *Id.* at 122, and since then the Board has consistently ruled that a high R/VC ratio is not a reliable indicator of market power. The September Decision acknowledges that "the Board has in the past expressed a reluctance to rely on the actual R/VC ratio, standing alone, to demonstrate a carrier's exercise of market dominance over a particular movement." September Decision, at 16. Footnote 46 provides some examples of that reluctance:

> *See Potomac Elec. Power Co. v. CSX Transp., Inc.*, 2 S.T.B. 290, 294 (1997) ("Apart from the 180% jurisdictional threshold, which has been set by law, we do not use rate-cost relationships as a basis for qualitative market dominance determinations."); *Mkt. Dominance Determinations*, 365 I.C.C. at 122 (questioning whether actual R/VC ratios "reliably indicate the presence or absence of market dominance" because there "are any number of reasons why a high price/cost ratio may not be indicative of true market power on the part of the railroad"). *See generally* Laurits R. Christensen Associates, Inc., *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals That Might Enhance Competition—Revised Final Report* at ES-12 to ES-20 (Nov. 2009) (in independent study of competition in U.S. freight railroad market commissioned by the Board, noting relative weakness of R/VC ratio as indicator of market power abuse), *available at* http://www.stb.dot.gov/stb/elibrary/CompetitionStudy.html.

As the parenthetical descriptions reveal, the agency has not only had a reluctance to rely on R/VC ratios standing alone to determine market dominance, it has rejected that approach outright. Moreover, as cited by the Board, even independent economists recognize the limited usefulness of R/VC ratios for determinations of qualitative market dominance:

> The weak relationships between R/VC ratios and market structure factors illustrated in Table ES-4 imply that correctly assessing the presence of market-

> dominant behavior requires direct assessment of relevant market structure factors. Thus, regulatory reforms that would establish R/VC tests as the sole quantitative indicator of a railroad's market dominance are not appropriate.

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

A belief, as the Board seems to hold, that a limit price rule comparing the price of the *alternative form* of transportation, rather than the challenged rate, to the variable costs of the defendant carrier somehow "does not implicate § 10707(d)(2)'s statutory directive or the concerns previously expressed by the Board," September Decision, at 17, does not withstand scrutiny from an economic standpoint. The Board's new rule is an R/VC ratio level (RSAM) that establishes a presumption of market dominance. The fact that the limit price R/VC ratio is based on a theoretical railroad price level rather than a real one is of no consequence. All of the previously identified problems with using an R/VC ratio to determine market dominance are still present. In essence, the question the Board is now posing is, "What is the maximum R/VC ratio the carrier could charge without losing significant amount of the traffic to a competitive alternative?" Fundamentally, that remains a determination of a rail carrier's rate generating an R/VC ratio that establishes a presumption of market dominance, a determination prohibited by 49 U.S.C. § 10707(d)(2). It is the same inquiry premised on the assumption that a high R/VC ratio must mean that a carrier is market dominant that has been rejected in the examples cited above and others.[2]

[2] Indeed, the Board admits twice that it assumes, without explanation, that an R/VC ratio of 190% must mean that there is effective competition and an R/VC ratio of 500% must mean there is not. *See* September Decision, at 4, 17.

III. A Limit Price R/VC Ratio Greater Than RSAM Does Not Demonstrate A Lack of Effective Competition.

Following on the unfounded assumption that a high R/VC ratio would necessarily mean the presence of market dominance, the Board elected to compare the limit price to the carrier's RSAM to judge whether the limit price R/VC ratio was "too high." But there is no rational basis in the record for the Board to conclude that a limit price R/VC ratio above RSAM demonstrates anything about whether there is effective competition for a particular movement of rail traffic.

RSAM is one of the three benchmarks developed in *Rate Guidelines, Non-Coal Proceedings*, 1 S.T.B. 1004 (1996) and modified in *Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1)(STB served 5, 2007). RSAM is defined as the measure of the average markup that a railroad would need to collect from all of its potentially captive traffic (traffic priced above the jurisdictional threshold of 180% of variable cost) to earn a return on investment equal to the railroad industry cost of capital. The September Decision claims that a comparison of the limit price R/VC ratio to RSAM "provides an objective indication of monopoly pricing." September Decision, at 17. The September Decision is silent, though, on why the Board believes this to be true.

RSAM is not shown to be a measure of whether there is actual competition or how robust that competition is for any particular movement. The information contained in RSAM is unrelated to any specific market and does not incorporate any information on demand. It has not been shown to have any bearing as to whether a rail price in a specific market is effectively constrained by competition.

Ignoring what RSAM is and what it is not, the Board states that "effective competition likely exists if the highest price the carrier can theoretically charge to move that potentially captive traffic falls below the average point at which the carrier could achieve revenue adequacy," September Decision at 16 (citing *Simplified Standards*, at 81). That conclusion apparently rests solely on the following statement discussing the calculation of RSAM for use in the adjustment factor in Three-Benchmark cases:

> If for example, the railroad is not yet charging traffic enough to earn a reasonable return on its investment, this means the carrier is not engaging in the full degree of differential pricing that the law permits. The comparison rates must therefore be adjusted upwards, as they do not reflect the maximum lawful rates the carrier can charge, but rather are apparently being constrained by other market forces.

Simplified Standards, at 81. However, the Board's assertion that if a carrier is not revenue adequate, setting maximum lawful rates based on averages of what it currently charges would doom it to be revenue inadequate forever is not the same as proof that any rate below RSAM is necessarily facing effective competition or that all rates above RSAM are not. And that cited statement provides absolutely no support for a conclusion about market dominance based on an R/VC ratio that exceeds RSAM. There is no basis in the record for the Board to conclude anything about an R/VC ratio above RSAM other than it is above the average amount the Board calculates that that particular carrier would need to charge its traffic that currently moves at rates above 180% of its system average variable costs, as calculated by URCS, to be considered revenue adequate in a given year under the Board's annual determination of revenue adequacy.

Moreover, the Board does not in its decision affirmatively conclude that the limit price rule measures what the Board hopes it measures. Instead, it only states that the limit price "is intended" to capture the price point at which the carrier would lose significant amounts[3] of the traffic to an alternative and the limit price comparison to RSAM is "an effort" to determine whether alternatives are sufficient to deter the railroad from charging monopoly prices. September Decision, at 17.

Finally, because RSAM reflects a particular carrier's revenue adequacy findings in the Board's annual determination, the Board's new rule would mean that whether or not a particular movement of rail traffic was found to be facing effective competition would be based on how well that particular carrier recovered all of its costs, including its cost of capital, during four earlier years.[4] That is, two rail carriers in identical situations could have different market dominance results based solely on their revenue adequacy determinations. And an individual carrier could be presumptively constrained in pricing one year and presumptively market dominant the next depending on the carrier's financial performance and the Board's calculations of the rail industry cost of capital for the previous year, even if the cost of competitive alternatives and its variable cost for the move remained unchanged. As these examples illustrate, the results of the limit price test are driven by factors totally unrelated to the presence or absence of "effective competition" in the marketplace, and therefore, the test fundamentally fails to accomplish its designated purpose.[5]

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[3] The September Decision does not quantify what "significant amount" of traffic would divert to an alternative where the limit price R/VC ratio exceeds the carrier's RSAM figure.

[4] Due to the time lag in calculating the RSAM figure, the determination of the market dominance of rates established now would depend on the RSAM figures calculated for the years 2007 through 2010.

[5] The Board's reliance on "intangible features" to overcome the presumption of market dominance does not save the new "limit price" test. *See* September Decision, at 14 ("Finally, when appropriate, we will consider whether the alternative has any intangible features sufficient to overcome the applicable preliminary conclusion."). Likely, the Board will only look to the "intangible features" in close cases, inappropriately eliminating the qualitative market dominance analysis in most cases in exchange for this

Conclusion

As discussed above, the AAR respectfully submits that the limit price test was adopted in contravention of the APA. The Board's adoption of an approach to market dominance establishing a presumption based on R/VC ratios is flawed for the reasons set forth above. The limit price test is further flawed because RSAM has no rational connection to market dominance.

Respectfully Submitted,

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faulty new quantitative test. On the other hand, if the Board does intend to consider "intangible features" in the majority of cases, then the new quantitative filter would serve no purpose, and therefore in addition to being unsound, it also would be pointless.

CERTIFICATE OF SERVICE

I, Rosita M. N'Dikwe, hereby certify that on this date I served by first-class mail, postage prepaid a copy of the Comments of the Association of American Railroad in STB Docket No. 42123, *M & G Polymers USA, LLC v. CSX Transportation, Inc.* on all parties of record.

Rosita M. N'Dikwe

Rosita M. N'Dikwe

Dated: November 28, 2012