

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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MARKET DOMINANCE STREAMLINED APPROACH

COMMENTS OF CSX TRANSPORTATION, INC.

CSX Transportation, Inc. (“CSXT”) respectfully files these comments in response to the Notice of Proposed Rulemaking proposed in the above-captioned docket on September 11, 2019 (“NPRM”). CSXT also joins the opening comments of the Association of American Railroads (“AAR”) in full.

In CSXT’s experience, market dominance need not be a complex or burdensome inquiry. For example, in 2008, CSXT was involved in three separate Three Benchmark cases with DuPont. In all three cases, the parties were able to submit evidence related to market dominance and the Board was able to make its determination within the streamlined timelines anticipated for in Three Benchmark cases.¹ Moreover, railroads have conceded market dominance in appropriate cases, demonstrating that this is not a topic that the railroads seek to overzealously litigate.² The market dominance inquiry has been more complex in some recent cases, but that is

¹ See *E.I. DuPont de Nemours & Co. v. CSX Transp., Inc.*, STB Docket Nos. 42099, 42000, 42101 (STB served June 27, 2008).

² See, e.g., *US Magnesium v. Union Pacific R.R. Co.*, STB Docket No. 42114 (STB served Jan. 28, 2010); *Sunbelt Chlor Alkali Partnership v. Norfolk Southern Ry. Co.*, STB Docket No. 42130 (STB served June 20, 2014).

often because those cases featured an unusually high number of traffic lanes³ or otherwise featured unique issues bearing on whether effective competition existed.⁴

That said, CSXT agrees with the Board that some measures can be taken to streamline the market dominance portion of rate reasonableness proceedings, and that it would be appropriate to allow such streamlined evidence in cases where a complainant can show that certain competitive indicators are not present. So long as a complainant retains the burden of proof and the railroad has the right to present its own evidence without any presumption in favor of the complainant, a streamlined market dominance approach shows promise.

As AAR explains, the proposed streamlined approach could be improved in several ways. AAR details several sensible changes to the Board's list of *prima facie* factors, including the addition of pipeline competition, recognition that trucks are often competitive at distances of over 500 miles, and consideration of indirect competition:

AAR's proposed amendments are consistent with CSXT's experience in the marketplace, which features fierce competition from multiple modes including long-distance trucking, water transportation, and pipelines, and substantial indirect competition from shippers who enjoy marketplace leverage from their ability to ship to different destinations.

³ For example, in *M&G* there were 70 origin and destination pairs at issue, and in *TPI* there were 104 origin and destination pairs. *M&G Polymers USA, LLC v. CSX Transp., Inc.*, STB Docket No. 42123; *Total Petrochemicals & Refining USA, Inc. v. CSX Transp., Inc.*, STB Docket No. 42121.

⁴ For example, the *Consumers Energy* case involved questions about the complainant's ability to access vessel transportation through constructing a dock or building a rail connection to a nearby facility with a dock, which required each party to address multiple issues about the cost and feasibility of these options. See *Consumers Energy Co. v. CSX Transp., Inc.*, STB Docket No. 42142.

Lastly, the Board should take this opportunity to explicitly eliminate the “limit price” test. Much of the complexities of market dominance evidence in recent cases are due to litigation over this test, which has been much criticized by both railroads and shippers,⁵ and which is plagued by uncertainty about the test’s applicability and potential impact on individual cases. Formal disavowal of the limit price test would remove this uncertainty and allow market dominance evidence to be focused on the core substantive questions of whether effective competition is present. Moreover, the legal flaws with this approach are well documented; CSXT has attached an appendix that summarizes some of the key problems with the limit price approach. In the interest of both expediting market dominance evidence and ensuring that market dominance determinations have a sound basis, the Board should affirmatively state in its final rule that it will no longer apply the limit price approach.

Respectfully submitted,

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⁵ *Total Petrochemicals & Refining USA, Inc. v. CSX Transp., Inc.*, STB Docket No. 42121, at 7 (STB served Jan. 2, 2014) (Board received “resoundingly critical comments” regarding the limit price test.”) (Begeman, concurring).

APPENDIX

The Substantial Flaws of the Limit Price Test

The application of the Limit Price Test is unlawful in two respects. *First*, the test violated the Administrative Procedure Act by departing from agency market dominance standards without notice and comment. The Board has claimed that this new test is not a legislative rule. CSXT respectfully disagrees with the Board's characterization of its prior standards and its attempt to explain how the transformational test announced in *M&G* can be consistent with guidelines that rejected any sort of mechanical test.

Second, the test violates the statutory prohibition against presumptions based on revenue-to-variable-cost ratios. Congress has instructed the Board that:

(2) A finding by the Board that a rate charged by a rail carrier results in a revenue-variable cost percentage for the transportation to which the rate applies that is equal to or greater than 180 percent does not establish a presumption that --

(A) such rail carrier has ***or does not have*** market dominance over such transportation; or

(B) the proposed rate exceeds ***or does not exceed*** a reasonable maximum.⁶

Congress understood the danger of drawing inferences about the presence or absence of market dominance based on R/VC ratios, given the high fixed costs that prompted Congress to promote demand-based differential pricing with the Staggers Act.

But the Board has resurrected the prohibited presumptions with its Limit Price Test. Assume the RSAM for a hypothetical railroad were 190%. Under the Limit Price Test, the Board reasons that the railroad has market dominance over the transportation at issue if the competitive constraint permits the railroad to enjoy a revenue-to-variable cost (R/VC) ratio above 190%. The Board asserts that “the fact that a rate involving certain traffic produces an

⁶ 49 U.S.C. § 10706(d)(2) (emphasis added).

R/VC ratio that falls below the carrier's RSAM number indicates that competitive transportation alternatives likely exist and are exerting downward pressure on the rate governing that traffic.”⁷ From this flawed premise, the Board then infers the opposite must also be true: that R/VC ratios above RSAM “[are] a useful indicator that competitive transportation alternatives—whether intermodal or intramodal—do not exist and are not effectively constraining the rate charged by the carrier for that traffic.”⁸ As discussed below, agency precedent relied on for these assertions offers no support for them, and in fact proves the opposite. But in any event, Section 10706(d)(2) prohibits the Board from drawing precisely this kind of inference based on R/VC ratios.

The Board has offered three defenses. *First*, the Board believes that the plain language of the statute only prevents the Board from creating a presumption of market dominance based on the fact that the challenged rate produces a markup at or above 180% of variable cost. The statute is silent, so the Board believes, “as to whether a presumption could be drawn from a higher markup (*e.g.*, above 500% of variable cost or above RSAM).”⁹ *Second*, the Board claims that the Limit Price Test “establishes no presumptions of any kind.”¹⁰ *Third*, the Board claims it is not violating Section 10706(d)(2) because—if there is a presumption—the presumption is not based on the fact that the challenged rate exceeds RSAM but rather on the fact that the competitive constraint exceeds RSAM.¹¹

⁷ *Total Petrochemicals & Refining USA, Inc. v. CSX Transp., Inc.*, STB Docket No. 42121, at 20 (STB served May 31, 2013) (“*TPI Market Dominance*”).

⁸ *Id.*

⁹ *Id.* at 21.

¹⁰ *Id.*

¹¹ *Id.*

The Board's first claim is wrong, for the statute is not silent or ambiguous about the sort of presumptions drawn from the Limit Price Test. The key to unlocking the true nature of the prohibition lies in the words "does not have." The statute says:

A finding by the Board that a rate charged by a rail carrier results in a revenue-variable cost percentage for the transportation to which the rate applies that is equal to or greater than 180 percent does not establish a presumption that such rail carrier . . . **does not have** market dominance over such transportation.¹²

The Board's strained reading renders this language superfluous. The Board believes that the statute only prohibits a presumption based on the rate being above 180%, but permits a presumption based on a higher markup above 180%. Yet Congress already compels the Board to find no market dominance where "the rate charged results in a revenue-variable cost percentage for such transportation that is less than 180 percent."¹³ It would be passing strange for Congress to write into the statute a meaningless prohibition on a presumption of no market dominance based **only** on the fact that the challenged rate produces a markup at or above 180% of variable cost, while permitting a presumption if the markup were below 190% of variable cost.

Rather, the statute is clear. First, if the rate produces an R/VC ratio below 180%, then the Board must find no market dominance.¹⁴ Then, if the rate produces an R/VC ratio "at or above 180%" the Board cannot presume market dominance exists, or does not exist, based on that R/VC ratio. Congress prohibited presumptions that run either way. Yet the Limit Price Test would here create a presumption of no market dominance if a feasible constraint is below 190%

¹² 49 U.S.C. § 10706(d)(2) (emphasis added).

¹³ 49 U.S.C. § 10706(d)(1)(A).

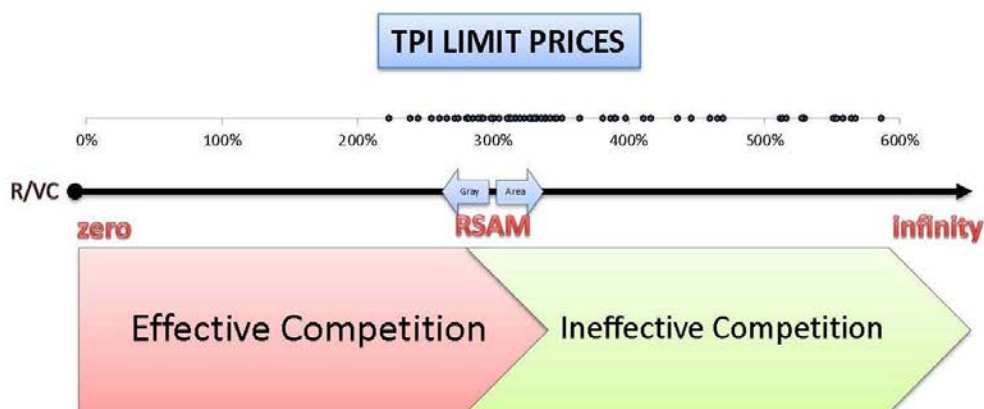
¹⁴ 49 U.S.C. § 10706(d)(1)(A).

of variable cost and a presumption of market dominance if the constraint is above 190% of variable cost. Such a presumption is unlawful.

The Board's other two defenses provide thin reeds of support. It is clear that the Limit Price Test creates a presumption based on whether the constraint falls above or below RSAM. The Board cannot change the nature of its test by replacing the term "presumption" with a neologism like "initial conclusion." The two terms are synonymous. And the defense that the presumption is based on a hypothetical rate priced at the level of the competitive constraint—not the challenged rate itself—is a shell game. Congress's instruction that the Board not make presumptions based on the R/VC ratio of a challenged rate was not an invitation for the Board to instead make presumptions based on hypothetical rates. That is particularly so when the hypothetical Limit Price R/VC is a transparent proxy for the actual R/VC—as it will be in any case where the price of an alternative is in the range of the challenged rate.

In addition to being unlawful, the Limit Price Test is irrational. At the heart of the test lies the RSAM benchmark. RSAM measures the average markup a carrier would need to charge traffic with R/VC ratios above 180% to earn a return on investment equal to the industry average cost of capital. The Board will presume that any constraint that lies above this RSAM benchmark is ineffective competition, and vice versa. The importance of RSAM is revealed by this chart, reproduced from *TPI Market Dominance* (at 27).

Figure II-B-8



The Board believes that comparing the limit price R/VC ratio for a given movement to the carrier’s RSAM number “will be indicative of either the presence or absence of effective competition for that movement.” *Id.* at 20.

CSXT has long maintained that the Limit Price Test lacks any coherent economic foundation. To put a finer point on it, the linchpin of the Board’s new test is a hopelessly imprecise measure of market dominance: the RSAM benchmark. This benchmark was created for an entirely different purpose, to be used together with two other benchmarks as an “imprecise” and “crude” means of gauging the reasonableness of rail rates when the value of the case cannot justify a Full-SAC or Simplified-SAC presentation.¹⁵ It was not designed to simplify the market dominance inquiry.

More specifically, RSAM only captures the **average** markup needed by a carrier to earn returns equal to the industry average cost of capital. It is a mathematical truism that half of all observations must lie above the average. Rates above RSAM are not presumptively unreasonable, just a natural consequence of demand-based differential pricing where traffic with

¹⁵ It only cited *Simplified Standards for Rail Rate Cases*, STB Ex Parte No. 646 (Sub-No. 1), at 28 (STB served Sept. 5, 2007) (“*Simplified Standards*”)

less elastic demand will bear a larger share of joint and common costs. The fact that our hypothetical railroad must earn **on average** a markup of 190% is thus irrelevant to the question of whether it has market dominance over a particular movement. The Board and the federal courts have long concluded that this measurement of system-wide revenue needs provides “no guidance” on the reasonableness of a particular rate.¹⁶ It can offer no guidance on the presence of market dominance either.

Moreover, RSAM only captures the average R/VC ratio needed to earn a return equal to the industry average cost of capital, based on historic, depreciated book values. However, this is a flawed measurement. Competitive prices are based on the real value of assets, not historical values. As such, any market dominance benchmark that is based on historical values—which understate the true value of railroad facilities—will create dangerous false positives and invite the Board to regulate rather than rely on competitive market forces.

Finally, no agency precedent supports the use of this profoundly flawed benchmark to gauge the presence, or absence, of effective competition. The Board understands that RSAM only measures the average markup needed to achieve revenue adequacy. But it attempted to set forth its logic and defense for using RSAM in the market dominance inquiry in *TPI*:

Effective competition likely exists if the highest price the carrier theoretically could charge to move that potentially captive traffic falls below the average point at which the carrier could achieve revenue adequacy. Likewise, the fact that the highest price the carrier theoretically could charge to move the potentially captive traffic falls above the average point at which the carrier could achieve revenue adequacy indicates that effective competition for that movement likely does not exist.¹⁷

¹⁶ *BNSF Ry. Co. v. STB*, 453 F.3d 473, 481 (D.C. Cir. 2006) (quoting *Burlington N. R.R. Co.*, 985 F.2d 589, 596 (D.C. Cir. 1993)).

¹⁷ *TPI Market Dominance*, STB Docket No. 42121, at 20.

Given the central role this benchmark plays in the Limit Price Test, the Board offered startlingly thin support for this key assumption. It only cited *Simplified Standards*, STB Ex Parte No. 646 (Sub-No. 1), at 81, which the Board mistakenly repeated as authority for the proposition “that a rate which falls below RSAM is ‘being constrained by . . . market forces.’”¹⁸

The discussion of RSAM in *Simplified Standards* offers no support for the idea that rates above RSAM “indicate that effective competition for that movement likely does not exist.” Ironically, it supports the opposite assumption for a railroad that is revenue inadequate.

As its name suggests, the Three-Benchmark approach uses three benchmarks as a crude measure of the reasonableness of a particular rate. The approach begins with a comparison group of movements with similar characteristics and demand elasticity. However, the Board declined to use the average markup from this comparison group to set the maximum lawful rate when a railroad is not earning adequate revenues. “If there is a shortfall,” the Board reasoned, “this indicates that the carrier is not engaging in the full spectrum of demand-based differential pricing that the law permits ***because market forces prevent it from doing so.***”¹⁹ “As the goal of this comparison approach is to gauge where that legal limit is (rather than the market limit), the shortfall should be allocated only to the potentially captive traffic, thereby increasing the degree of permissible demand-based differential pricing.”²⁰

The Board then used two benchmarks together to adjust the rates in the comparison movements to reflect better the maximum lawful rates the carrier can charge. It is the

¹⁸ *M&G*, STB Docket No. 42123, at 4, n.6; *Id.* at 15, n.42; *TPI Market Dominance*, STB Docket No. 42121, at 4, n.10; *Id.* at 20, n.64; *TPI Market Dominance Reconsideration*, STB Docket No. 42121, at 11, n.27 (Dec. 19, 2013).

¹⁹ *Simplified Standards*, STB Ex Parte No. 646 (Sub-No. 1). at 81 (emphasis added).

²⁰ *Id.*

relationship between RSAM and $R/VC_{>180}$ that shows the presence, or absence, of a revenue shortfall. The Board explained that if there was a revenue shortfall, this means the carrier is not engaging in the full degree of differential pricing that the law permits:

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.***²¹

The Board now latches onto this language about “being constrained by other market forces” and incorrectly characterizes this statement as referring only to rates below RSAM. That is wrong. ***The Board was referring to all comparison rates.*** Where there is a revenue shortfall, then all the comparison rates are adjusted upwards because none reflects the maximum lawful rates the carrier can charge, “but rather are apparently being constrained by other market forces.”

This natural reading of the agency’s precedent is confirmed by every single rate case decided under *Simplified Standards*. In every case, the defendant carrier had a revenue shortfall. In every case, the comparison group R/VC ratio exceeded the defendant carrier’s RSAM benchmark. And in all these cases, the Board adjusted the comparison group R/VC ratio upwards based on the logic set forth in *Simplified Standards* that those comparison rates did not reflect the legal limit, but rather the market limit.

The error that crept into the Board’s justification for the Limit Price Test was to equate “shortfall” with RSAM. The Board did suggest that, where there is a shortfall, the carrier’s distribution of rates were below the lawful limit because the carrier was being constrained by

²¹ *Id.* (emphasis added).

market forces. But notwithstanding its name (Revenue Shortfall Allocation Method), “RSAM was never designed to measure the revenue ‘shortfall’ or how to allocate such a shortfall.” *Id.*

In sum, the legal support for the use of RSAM in the Limit Price Test is premised on a flawed description of agency precedent. The STB “cannot rely on an erroneous description of its precedent.”²² That precedent supports the idea that where there is a system-wide revenue shortfall, the proper assumption is that the carrier is not engaged in the full degree of demand-based differential pricing permitted by law. Absent specific evidence to the contrary, the Board assumes that all rates (not just those above RSAM) are being constrained below the maximum lawful levels, to different degrees, by competitive market forces. RSAM thus provides no intellectual basis for distinguishing among rates constrained by competitive market forces.

The Limit Price Test should be abandoned as an unlawful, flawed, and ultimately misguided experiment.

²² *Burlington Northern and Santa Fe Ry. Co. v. STB*, 403 F.3d 771, 778 (D.C. Cir. 2005) (vacating decision that overlooked binding ICC precedent from 1912).