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WRITTEN TESTIMONY
OF
DUANE RICHARDS
PRESIDENT, WESTERN COAL TRAFFIC LEAGUE

My name is Duane Richards and I am Chief Executive Officer of Western Fuels Association, Inc. I serve as President of the Western Coal Traffic League ("WCTL"). I am the same Duane Richards who presented Initial Comments on April 12, 2011. I appear here today on behalf of WCTL.

Due to a longstanding commitment, I will be out of the country and unable to attend the hearing in Washington on June 22, 2011. I have asked one of WCTL's counsel, Peter Pfohl, to appear in my stead. We appreciate the opportunity to present WCTL's testimony before the Board today.

In noticing the institution of this important proceeding, the Board announced its intention to "explore the current state of competition in the railroad industry." (Notice at 1). As we detailed in our Initial Comments, coal traffic is the number one source of rail revenue in the West. Accordingly, one cannot engage in an exploration of the state of rail competition without also conducting a thorough review of the subject of rail competition for coal traffic. In its Initial Comments, WCTL endeavored to bring to the attention of the Board facts and figures demonstrating that rail competition for coal transportation business ceased to exist in the West after 2004 – the year in which both BNSF Railway Company ("BNSF") and Union Pacific Railroad Company ("UP") embraced Public Pricing of all coal traffic. This astonishing turn of

events implicating the largest segment of western rail commerce and directly burdening millions of electric ratepayers with higher costs should trouble your agency, which is directly charged by Congress with the promotion of railroad competition.

Here in our written hearing testimony today, WCTL stands by and amplifies the basic positions we took in our Initial Comments; namely, that following the unprecedented decisions of both BNSF and UP in 2004 to signal their coal pricing and market allocation aspirations to one another through their newly adopted public pricing mediums, coal transportation competition in the West came to an abrupt halt culminating in:

1. A 300% + or - rise in the market level for unit coal train transportation rates (Initial Comments, Richards at 15);
2. The abolition of all meaningful rail service commitments and guarantees for coal shippers (Initial Comments, Richards at 18);
3. The *de facto* award of monopolist status to the incumbent carrier at every PRB coal-fired facility served by both BNSF and UP at origin and destination (Initial Comments, Richards at 18); and, finally the most illustrative circumstance of all indicating that competition does not exist;
4. Competitive rail coal rates at levels *higher* than captive rates (Initial Comments, Richards at 20).

WCTL also sponsored expert economic testimony from two highly qualified industrial economists, one of whom joins us today. These industrial market experts previously concluded, on the basis of circumstances Nos. 1 thru 4, that "strong

evidence” exists that BNSF and UP have agreed to stop competing in their pricing and provision of coal transportation service. (Initial Comments, Warren-Boulton/Baseman at 9). WCTL would also note that many other rail shippers are contending in other forums that BNSF and UP have engaged in similar conduct (*see In re Rail Freight Fuel Surcharge Antitrust Litigation*, MDL Docket No. 1869, *Oxbow v. UP and BNSF*, Docket No. 11-cv-01049, both pending in federal court in Washington, D.C.).

In their Reply Comments, both BNSF and UP strongly disagree that they have ceased to compete for western coal transportation business as charged by WCTL. In WCTL’s Initial Comments, we explained that for many years prior to 2004 WCTL members with service from both BNSF and UP frequently switched carriers based upon their different competitive price and service offers. However, beginning in 2004 the carriers stopped making competitive offers for new business, and accounts remained with the incumbent carrier. BNSF-sponsored Witness Lanigan accuses WCTL of making “categorically false” assertions when WCTL stated that no major competitive coal accounts have changed hands since 2004. (BNSF Reply Comments, Lanigan at 13).

Conspicuously, however, Witness Lanigan offers nothing in the way of factual evidence to support his accusations other than his “win some/lose some” explanation, which only references BNSF’s apparent loss of some intermodal traffic to UP. WCTL views BNSF’s reluctance to even attempt to refute with facts and figures WCTL’s well-documented allegation that BNSF no longer competes for coal traffic as further proof of the validity of WCTL’s claim. Surely BNSF would have come forward to this Board with some examples if it had any *bona fide* evidence to refute WCTL’s

claim that western coal transportation customers have been permanently allocated. The Board must be made to realize that Mr. Lanigan's "win some/lose some" view of the market is the exact opposite of what has happened in the western coal transportation market since 2004 where each customer is allocated to either BNSF or UP.

In contrast to BNSF's empty denials, UP goes to considerable lengths in an effort to demonstrate that competition still exists in the West for coal traffic. According to UP's Executive Vice President for Marketing, Mr. Jack Koraleski: "Union Pacific continues to compete vigorously for coal business." (UP Reply Comments, Koraleski at 22). To support the presence of this alleged competition, Witness Koraleski first references in some detail a number of coal-related capital investments which his company has made since 2004. (UP Reply Comments, Koraleski at 22-23). Quite frankly, WCTL fails to see how UP's willingness to spend money on its enormously lucrative coal traffic business has anything whatsoever to do with competition. Neither WCTL nor anyone else is arguing that the western roads are not investing in their coal routes. The railroads would be foolish not to invest given the enormous returns they are now enjoying from coal traffic.

Witness Koraleski then goes on to allege, like Witness Lanigan, that WCTL was "untruthful" when it represented to the Board, as it did in our Initial Comments, that competitive "big coal transportation accounts" no longer changed hands in the West after 2004. (Initial Comments, Richards at 18). Whereas BNSF had no examples to back up its claim that WCTL had made a false statement, UP references four (4) separate instances which it represents as examples of competitive coal accounts changing from

BNSF to UP or *vice versa*. According to Witness Koraleski, his four (4) examples refute our claim.

One of the four (4) examples is fully redacted. However, it is doubtful that it has any probity if it is similar in any way to his other three (3) examples. The other three (3) examples cited by Witness Koraleski as instances where competitive accounts have changed hands after 2004 mainly involve small amounts of traffic and more importantly do not involve coal movements in which BNSF and UP directly compete for traffic at both mine origin and plant destination. In other words, these are not the type of accounts we had in mind when we said large accounts do not change hands anymore.

Each of the three (3) examples involves participation in the movement by a second carrier not under the control of BNSF and UP. For example, we asked Wisconsin Electric Power Company ("WEPCO") to explain its situation at the water-served Valley Power Plant in Wisconsin, discussed by Witness Koraleski. The response from Randy Van Aartsen, WEPCO's Director-Fuel Supply and Market Operations, was as follows:

Our evaluation of coal supply options for the Valley Power Plant was the total delivered cost for a relatively small annual volume of coal (nominally 500,000 tons) between two very different options. One option was bituminous coal from underground mines in Colorado served by Union Pacific. This option would involve a more southerly railroad route to a lake terminal in Chicago, passing over and through the Rocky Mountains on the UP. Another option was for bituminous coal from the new Signal Peak underground mine in Montana served by BNSF, to be delivered by BNSF to Chicago using a northerly, less mountainous route. There were many variables and cost factors in the alternatives we evaluated, including coal costs, rail costs, lake vessel costs, terminal fees and more.

It should be evident from this that UP and BNSF do not compete head-to-head for the Valley coal movement. What Witness Koraleski's examples demonstrate is the little remaining competition that exists in the West is provided by carriers other than BNSF and UP. In short, UP's Witness Koraleski, like BNSF's Witness Lanigan, is unable to furnish a single example of traffic where BNSF and UP compete head-to-head which has changed hands since 2004.

To reinforce WCTL's claim that no coal transportation business moving to destinations served by both BNSF and UP has changed hands since 2004 we offer the following proof:

Chart VIII <u>Examples of Consumers of PRB Coal Where BNSF and UP Can Serve Both Origin and Destination</u> (Arrayed Largest to Smallest based on 2010 Coal Tons Received)				
<u>Utility</u>	<u>Plant</u>	<u>2010 PRB, WY Tons 1/</u>	<u>Carrier</u>	
(1)	(2)	(3)	<u>2004</u>	<u>2010</u>
1. NRG Texas Power LLC	W A Parish	10,412,001	BNSF	BNSF
2. MidAmerican Energy Co	Walter Scott Jr Energy Ctr.	7,452,275	UP	UP
3. San Antonio City of	J T Deely	7,300,067	UP	UP
4. Nebraska Public Power District	Gerald Gentleman	5,861,727	UP	UP
5. Omaha Public Power District	Nebraska City	4,653,573	UP	UP
6. Electric Energy Inc	Joppa Steam	4,540,446	UP	UP
7. Public Service Co of Colorado	Comanche	3,749,942	BNSF	BNSF
8. Southwestern Public Service Co	Harrington	3,624,509	BNSF	BNSF
9. Public Service Co of Oklahoma	Northeastern	3,479,607	UP	UP
10. Omaha Public Power District	North Omaha	2,169,771	UP	UP
1/ Source: 2010 EIA Form 923 Data (Note: Data reflects monthly respondents only, does not include annual respondents to EIA Form 923)				

As revealed in columns (4) and (5) of Chart VIII, not a single major competitive account has changed hands since 2004. The list could have been longer, but the voluminous

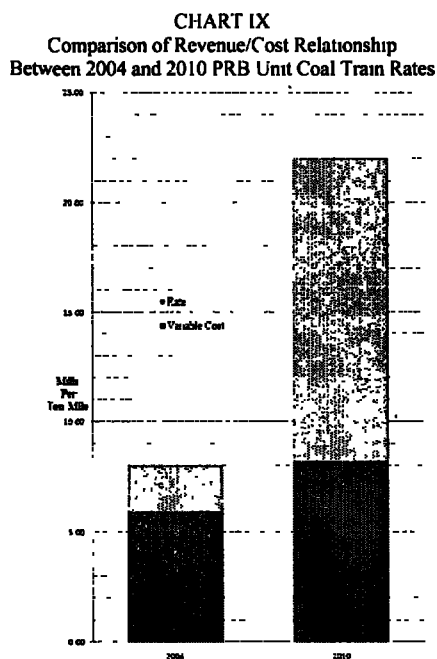
traffic covered in Chart VIII is more than sufficient to make our point. WCTL reiterates before the Board today the claim that the proven failure of any major coal transportation account for which BNSF and UP engage in head-to-head competition to change hands since 2004 provides a forceful indicator that something happened in 2004 that eliminated rail competition for western coal traffic.

Perhaps WCTL's most compelling proof that a new era of railroad monopoly behavior exists in the West is revealed through a look at the comparative price picture for western coal transportation. The representation of the price history since 2004 (300% increases) in WCTL's Initial Comments stands unchallenged in the railroad presentations. This is a truly astounding statistic. For a typical 2 million ton movement travelling 1,000 miles the carriers have seen their revenues zoom from \$16 million dollars a year in 2004 to \$42 million in 2011 or a price increase of \$26 million and rising! When you multiply this by the many customers the two carriers serve jointly – many of whom are shown on Chart VIII – the dollars involved are overwhelming.

In their Reply Comments, UP and BNSF would have the Board believe that their enormous and undeniable price increases on coal traffic somehow simply reflect their increased costs in fuel, maintenance, "steel," etc. etc. etc (UP Reply Comments, Koraleski at 20-21). According to BNSF's Witness Lanigan, "[a]ll of these costs and expenses must be reflected in our rates." (BNSF Reply Comments, Lanigan at 3). By confining their justifications for their enormous price increases to very generalized representations to the Board, the carriers studiously avoid confronting the unassailable and uncontradictable story told by the actual rail cost and revenue data

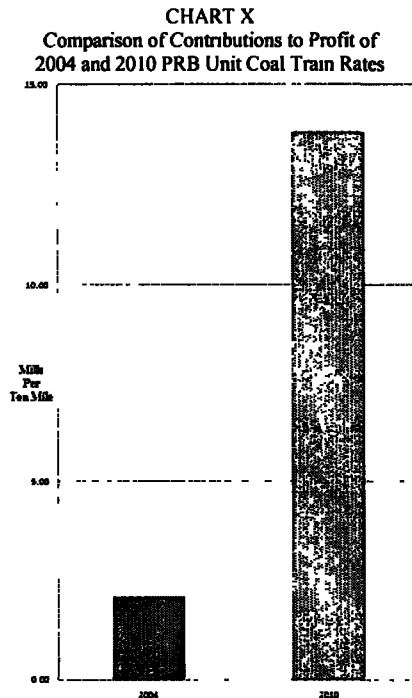
which we presented in our Initial Comments; namely, that profits on coal transportation have gone ballistic since 2004. (Initial Comments, Richards at 19).

While BNSF and UP have made no attempt to challenge our numerical evidence demonstrating the enormous profitability of their coal pricing after 2004, we must reemphasize this windfall today because it provides the most persuasive confirmation to our claim that BNSF and UP have ceased competing. To do so we present our last two charts. Chart IX is a cost/revenue comparison of 2004 and 2010 market rate levels on unit train movements of coal.



Source: L.E. Peabody & Associates, Inc.

Note the slight rise in costs from 2004 to 2010 and the astounding rise in revenues. This phenomenon in turn accounts for the enormous profitability of today's western coal transportation pricing, which we illustrate in our final chart:



Source: L.E. Peabody & Associates, Inc.

The profit levels that appear in Chart X for 2010 are simply incompatible with a competitive market.

CONCLUSION

There is one matter as to which WCTL, BNSF and UP are in agreement. The rail duopoly in the West, which the agency authorized over WCTL's repeated opposition, and which has enabled the current circumstances and conditions in the coal transportation market to transpire, cannot now be undone. In other words, the agency is now powerless to meet its statutory obligation to foster railroad competition. Because competition does not and cannot be made to exist by the STB, if railroads refuse to compete when they have the opportunity to do so, the goals of the Staggers Act to protect the interests of the carriers, the shippers, and the public must be realized by other means.

It is for these reasons that the Board must instead clarify that for the purposes of Section 10707(a) of the Act, given the clear lack of *effective* competition for the movement of coal from western mines, even dual-served shippers may bring a rate case to the Board and have their coal transportation services furnished at agency-prescribed reasonable rates, as determined pursuant to the *Coal Rate Guidelines*.

WRITTEN TESTIMONY

Frederick R. Warren-Boulton

Kenneth C. Baseman

We are Frederick R. Warren-Boulton and Kenneth C. Baseman. We appear here on behalf of the Western Coal Traffic League (WCTL). We previously filed a statement in this docket on behalf of WCTL on the current state of railroad competition and possible policy alternatives to facilitate more competition. In that statement, we concluded that the rapid increases in prices for the transportation of Western coal after 2004 were likely due to collusion, either tacit or explicit, between BNSF and UP, the railroad duopolists serving the Powder River Basin. We also found that the pricing pattern was not explainable by normal market factors such as growing demand, increasing marginal costs, or capacity constraints. We concluded by endorsing WCTL's proposal to clarify that the STB's "market dominance" protections extend to non-captive shippers. In this written testimony, we summarize our findings and provide additional analysis of the state of the market/competition for Western coal transportation based on the railroad replies made in response to our initial statement.

We have now reviewed the reply comments filed by BNSF Railway Company (BNSF), Union Pacific Railroad Company (UP) and the Association of American Railroads (AAR). In particular, we have reviewed the statements of Dr. Robert Willig (for AAR), Mr. John Lanigan (for BNSF), and Mr. John Koraleski (for UP). Nothing in these statements causes us to modify our opinion. As a general matter, these statements were almost completely devoid of useful evidence. Dr. Willig proposes an empirical test for whether abusive conduct has occurred that makes no economic sense. Mr. Lanigan offers assertions, but no evidence. Mr. Koraleski

attempts to provide evidence, but his evidence actually reinforces the case that normal competitive market factors cannot explain the magnitude of the price increases for transporting Western coal.

We have also reviewed the written testimony to be filed by Duane Richards. This testimony contains additional evidence on the absence of significant customer switching between BNSF and UP. He also provides additional evidence that modest increases in variable costs are not remotely plausible as explanations for the massive price increases for transporting Western coal over the period.

In our previous statement, we concluded that collusion provides the best explanation for the magnitude of the price increases for transportation of Western coal, and that changes in variable costs, capacity constraints, and demand were not remotely plausible explanations. In particular, we noted that:

- Prices for new contracts trebled between 2004 and 2011.
- In 2004, BNSF and UP announced “public pricing” for new coal contracts, with large price increases under the new tariffs. The railroads also implemented new policies under which the contract length to which they would agree was sharply reduced. These policies allowed a reset of pricing at much higher levels.
- Before 2004, BNSF and UP routinely won Western coal shipping business at the expense of the other. After 2004, this pattern stopped, and the incumbent almost always retained the business. When an analyst asked UP’s CEO in 2009 whether a recent case where UP displaced BNSF at a customer indicated that pricing discipline might be

breaking down, he indicated that this was a special case, where a third party had rights to service from UP, and had won the bid without UP's prior knowledge.

- Variable costs increases over the 2004-2011 period are not remotely plausible as an explanation for the observed price increases.
- Between the mid 1990s and 2004, prices for new Western coal transportation contracts remained roughly constant, but volumes increased by 80%. The margins the railroads earned over this period were thus clearly sufficient to support investments necessary to expand output. A financial requirement to cover the costs of new investments cannot explain the observed post-2003 price increases.
- Continued price increases after traffic fell during the current recession directly contradict the theory that the price increases are the result of increased demand during a period of temporarily tight capacity.

Faced with this collection of evidence in support of tacit or explicit collusion, and despite the clear lack of any evidence in support of normal market explanations for the massive price increases, the railroad witnesses in their reply statements adopt a mantra that prices increased because demand increased, capacity was tight, higher prices were necessary to cover the costs of investments in new capacity, productivity improvements were declining, and variable costs were increasing. Importantly, none of the railroad witnesses makes any attempt to provide a quantitative link between these factors and the enormous price increases observed over the period. The reason is clear. These explanations, alone or in combination, do not pass the laugh test as explanations for the observed price increases.

We will organize our discussion around Mr. Koraleski's statement, since he at least attempts to offer an empirical assessment of the issues. We will then turn to Dr. Willig's

proposed test for collusion. To start with, however, we first want to make a couple of conceptual points.

First, the mere fact that a seller incurs costs for new capacity does not imply that prices must increase. If capacity is scalable (i.e. constant returns to scale), then per unit capacity costs do not change when capacity is expanded, and prices do not have to rise to elicit the necessary investment. Producers will require higher expected future prices in order to justify investment to serve additional volumes only if incremental capacity is more expensive than infra-marginal capacity (i.e. decreasing returns to scale). If, as appears to be the case for Western coal transportation, incremental capacity was less expensive than infra-marginal capacity after 2003 (i.e. economies of scale), then competing sellers will make the incremental investments even if, all else equal, they expect prices to be lower in the future. A numerical example may help illustrate this point. Suppose that the first 100 units of capacity required an investment of \$1000. Using standard financial tools, one can calculate the required annual contribution (revenues less variable costs) necessary to recover this investment. The required annual contribution will be higher for higher costs of capital, and lower for longer lived assets. Suppose we solve the financial arithmetic, and the answer is that an annual contribution of \$200 is required to justify the investment. If customers buy 100 units of output, and variable costs are \$1 per unit, the required price is \$3 per unit. Suppose that an additional 100 units of capacity can be acquired for \$500 (perhaps by debottlenecking choke points in the system), and this capacity has the same useful life as the initial capacity. Since the cost of this capacity is only one half that of the initial capacity, and everything else is held constant, the required annual contribution will also be cut in half, to \$1 per unit. The required price falls to \$2 per unit. It is simply not the case that prices must go up in order to elicit investment. None of the

railroads' witnesses has made a cursory attempt to explain why incremental investment undertaken after 2003 was more expensive per unit of capacity than the investments made earlier.

Second, there is conceptual double counting in the discussions by the railroads' witnesses of declining rates of productivity improvements. When productivity improvements decline, this implies, all else equal, that costs will be higher than they otherwise would be. But if one is measuring cost changes there is no reason to separately analyze productivity. Productivity affects costs, but once you measure costs, there is no reason to go back and tack on a separate "adder" for productivity.

UP's Koraleski paints a gloomy picture of his company's coal business in 2003, stating that "[b]y 2003, rates were at rock-bottom levels," and that while "life was good for coal shippers in 2003 . . . the pattern of growing volumes and declining rates was not sustainable."¹ Koraleski asserts that "[o]ur SPRB coal traffic was generating returns significantly below other commodities and well below the level needed to maintain existing capacity, let alone add capacity."² Koraleski also states that "[w]e were faced with the need to make substantial investments in new capacity to accommodate growth in traffic." He concludes, "[i]n the old environment, shippers got what they wanted: low rates. The railroad got volume. However, when demand for rail services increased and capacity tightened, the railroad was in a position to set new prices at reinvestable levels." "In short, Union Pacific's rate increases do not reflect a lack of competition – they reflected a changed market environment."³

¹ Koraleski, p. 19.

² Ibid., p. 20.

³ Ibid., p. 20, 22.

Koraleski's "2003 market environment" explanation to the STB stands in direct contrast with UP's CEO and other top managers' contemporaneous statements made in 2003.

Koraleski's version of history is also inconsistent with the substantial growth in shipping of Powder River Basin coal in the years before 2003. Obviously, UP and BNSF were making sufficient incremental investments then to accommodate rapid growth, even though prices were stable and low, at least by today's standards.

Consider the following from UP's 3Q03 Earnings Conference Call transcript. UP's Chairman, President, and CEO was queried about coal transportation contracts rolling back and forth between UP and BNSF, and about pricing strategy. Dick Davidson responded that UP's coal contracts were bid out "based on our all in cost, capital requirement, whatever else goes into it to meet an acceptable profitability standard for us. As I said many, many times coal was the second most profitable commodity we handle. That's our strategy pure and simple."⁴ There is obviously no hint here that prices in 2003 were too low to cover UP's total, "all in cost."

Later in the transcript, UP's top executives were asked about new capacity costs for coal transportation, and whether contribution for coal covered increasing capital investment costs. The President of UP, Ike Evans responded that the coal contributions covered all capital costs. Also, he further elaborated, capacity and increased capital investments were not an issue for UP "well into the future." Mr. Davidson further responded that UP was so well situated on the capacity front, that "on a straightforward basis it will take less capital investment to grow the business."

⁴ Q3 2003 Union Pacific Earnings Conference Call – Final, NewsRoom, Fin. Disclosure Wire (Oct. 23, 2003), p. 8.

GREGORY BURNS (ph): Just following up on the question about coal being higher contribution next year, is that an all in contribution including capital costs, sort of return on capital allocated coal will be higher next year?

IKE EVANS: Yes.

GREGORY BURNS (ph): Okay.

IKE EVANS: Actually, you know, one thing we ought to point out there is that the capital cost to do coal is going to be a declining issue for us going forward. If you are not familiar with it Greg because you just started following the railroads here recently but we had enormous costs early on building up capacity into the powder river basin and as of the end of this year our coal line is running from northwest Nebraska up to the joint territory will be 100% double track CPC [sic] railroad concrete ties and we'll have enough capacity there now to take us well into the future. We can accommodate a lot of growth with very little incremental capital. That's really a good news for us. We have a great property now connecting us with the joint track in Wyoming.

GREGORY BURNS (ph): If we looked at those as single business cap ex will continue to fall below depreciation in that business line essentially?

DICK DAVIDSON: I don't think about things in those terms. Just on a straightforward basis it will take less capital investment to grow the business.⁵

To sum up, UP's assessment in 2003 was that the then current prices were sufficient to cover its "all in" costs, including a return to capital. Further, it had just completed major investments to expand capacity, and anticipated that future capacity expansions would be far cheaper – circumstances under which 2003 rates, all else equal, would be more than sufficient to justify continued investment after 2003.

Koraleski identifies approximately \$376 million dollars in capacity-enhancing investments made by UP for SPRB coal since 2003.⁶ He also reports a total of \$525 million in total coal capacity investments over the period, "most of it directed to SPRB coal corridors."⁷ Even if one believed, contrary to the evidence, that the new capacity was more expensive per

⁵ Ibid., p. 10.

⁶ Koraleski, p. 23.

⁷ Ibid., p. 22.

unit than capacity added earlier, one must ask, could the increase in market prices possibly be explained by the required return to recover these investments? The answer is clearly no. In our initial statement, we reported UP's and BNSF's combined annual contribution margin from transporting PRB coal has increased by about \$2 billion between 2003 and 2010.⁸ Since the companies have approximately equal shares of PRB coal traffic, UP's share is about \$1 billion. It doesn't take a financial genius to determine that one does not need a billion dollar annual return to pay off a \$376 million investment in long-lived assets.

Koraleski, and other railroad witnesses, also stress that marginal or variable costs were increasing over the period, which would put upward pressure on price. Again, however, none of these witnesses attempts to address whether pass through of increased marginal costs can explain the magnitude of the price increases. In fact, the price increases far outpace the increases in marginal or variable cost. Mr. Richards reports the relationship between price and marginal costs for Western coal shipments in 2004 and 2010.⁹ In 2004, the prevailing rate was 8 mills per ton mile, and variable costs were about 6 mills per ton mile. By 2010, the rate had increased to 22 mills per ton mile, while variable costs had only increased from 6 to 8 mills per ton mile. 100% pass through of the increase in variable costs would have increased rates by 2 mills per ton mile, or only about one-seventh of the actual rate increase. The observed price increases simply cannot be explained as representing the typical operation of a reasonably competitive market experiencing an increase in variable costs.

⁸ Richards Initial Statement, p. 5.

⁹ Written Testimony of Duane Richards, p. 7.

Koraleski objects to WCTL's claim that up until 2003, competition between UP and BNSF would frequently result in business switching from one railroad to the other, but that this process largely stopped after 2003. He states that:

WCTL and certain coal shippers argue that Union Pacific and BNSF are not actively competing for coal business because contracts are not shifting between carriers as frequently as they once did. However, the examples provided above refute that claim. (p. 25)

He provides four examples (one of which is completely redacted) of customers switching between UP and BNSF since 2004. Four examples of customers switching over seven years do not "refute" the claim that "contracts are not shifting between carriers as frequently as they once did." To support that claim, Koraleski would need to report data about the actual incidence of switching before 2004. Interestingly, Koraleski, who has access to far better data than we do on the actual incidence of customer switching before 2004, reports no information on the incidence of switching before 2004. His examples of customer switching are for relatively small volumes, and all involve either intermodal traffic, or traffic where another railroad serves part of the end-to-end route. This suggests that the switching that does occur is minor, entails another carrier whose interests might influence the outcome, or involves circumstances where BNSF and UP are serving the ultimate customer from different coal sources. This latter factor introduces an independent reason for customer switching between rail carriers beyond their control.

We now turn to Dr. Willig's objections to the collusion hypothesis. First, he lumps our analysis with that of witnesses for shippers of other commodities, and asserts that we merely count railroad competitors, which is a "deeply flawed" measure of competition or market structure. With all due respect, whatever the merits of Dr. Willig's claim with regard to other witnesses who represent shippers with intermodal alternatives, exactly what source of

competition does Dr. Willig see, other than BNSF and UP, for shipping PRB coal to the mid-west? We know how to count. We counted to two, and saw no more competition from any source. On this, at least, we and Mr. Lanigan agree. "The PRB has never been served by more than two railroads—first, BN and the Chicago and North Western Transportation Company ("CNW"), and then BNSF and UP (as a result of the BN/ATSF merger and the UP/CNW merger)." ¹⁰ Moreover, the fact that UP and BNSF found it profitable to treble prices is strong evidence that competition from either other railroads or other transportation modes was not sufficient to prevent very large price increases. If competition from other sources was capable of preventing a massive price increase unrelated to costs, it would have done so, and the trebling of prices would not have occurred.

Dr. Willig appears to propose a new test for the presence of abusive conduct, such as collusion: if output is expanding, collusion or other abusive conduct can't be occurring. He states

The conduct at the heart of market power abuse is withholding supply to drive up price. Therefore perhaps the most compelling piece of evidence refuting claims of abusive conduct is that the upticks we see in rail rates starting in 2003-04 occurred during a period of rapidly *growing* overall rail traffic volumes. ¹¹

Dr. Willig's test for collusion is flatly wrong. It is seriously prone to error, i.e. a false finding that collusion has been "refuted" when in fact it is present. He is right that the exercise of market power entails an output restriction, *everything else held constant*. But in the real world, and certainly in the real world for transportation of Western coal, everything else was not held constant over the 2004 – 2011. In particular, demand was growing rapidly. Outward shifts in demand will generate growth in sales volumes. If collusion also starts when demand is shifting

¹⁰ Lanigan, p. 8.

¹¹ Willig, pp. 9-10. We find amusing Dr. Willig's suggestion that a trebling of prices is an "uptick."

out, then collusion results in lower market volumes than would occur under competition. But there is simply no reason that the output-reducing effects of collusion should necessarily outweigh the output-increasing effects of higher demand. Dr. Willig's test for collusion is deeply flawed, and the STB should not use it.

Conclusion

Our analysis finds that there have been excessive increases in the prices for transporting Western coal since 2004, that these increases are consistent with tacit or explicit collusion, and that these price increases cannot be reconciled with the ordinary working of reasonably competitive markets. None of the railroads' arguments or evidence refutes our findings, and in fact, the railroads' statements actually confirm and clarify that the state of railroad competition for western coal is bleak, at best. We remain dubious that "access regulation" remedies will offer any significant prospects for improved performance in this particular duopoly market. We suggest that the STB adopt WCTL's proposal to clarify that the Board's market dominance rules apply to non-captive shipments of Western coal. This clarification would provide modest, but improved assurance against further price increases than the status quo competition between UP and BNSF, since that competition is so obviously lacking.