



FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

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APPROVED**
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Honorable James J. Florio
Chairman
Subcommittee on Commerce,
Transportation and Tourism
United States House of
Representatives
Washington, D.C. 20515

Honorable Norman F. Lent
Ranking Minority Member
Subcommittee on Commerce,
Transportation and Tourism
United States House of
Representatives
Washington, D.C. 20515

Dear Mr. Chairman and Congressman Lent:

Thank you for requesting the views of the Federal Trade Commission on H.R. 1140, "The Railroad Antimonopoly Act of 1986." The Federal Trade Commission is pleased to provide its views on the bill's likely competitive impact. Commissioner Andrew J. Strenio, Jr. has recently completed a 15-month term as a member of the Interstate Commerce Commission and these comments also reflect his specific expertise in railroad regulation.

H.R. 1140 deals with situations in which a rail carrier owns or controls the only track or other railroad facility that can be used to move certain bulk commodities into or out of a particular area. Shippers located in these areas are sometimes referred to as "captive shippers." H.R. 1140 would amend the Clayton Act to make it a violation of the antitrust laws to deny to any shipper, receiver, or rail carrier the use of such a facility on "reasonable terms" if this denial will have the "effect of monopolizing." A denial is deemed to have the "effect of monopolizing" if, as a result of the facility owner's exercise of market power, however obtained, prices, rates, or other conditions of service exceed a competitive level.¹

The Federal Trade Commission opposes the proposed legislation. Although the revised version of H.R. 1140 corrects

¹ More precisely, "effect of monopolizing" is defined as: "Prices, rates, or other conditions of service resulting from the use of market power, however obtained, to establish such prices, rates, or conditions that could not otherwise be established if effective competition existed with operators of rail or nonrail modes of transportation between the terminal points of the sole railroad facility involved."

several of the problems that existed in the original version,² at least three serious problems remain. First, it conflicts with the antimonopoly provisions of the Sherman Act. Second, the bill could have significant adverse effects on the rail transportation system. Third, the proposed legislation deals with an issue that is addressed by existing regulatory law. These three points will be discussed in sequence.

In our opinion, a major problem with the bill is its proposal to amend the antitrust laws to provide what amounts to industry-specific price control legislation. This proposal is inconsistent with the antitrust laws' generally broad, flexible approach to the prevention of anticompetitive behavior and, more particularly, with appropriate enforcement of the antimonopoly provisions of the Sherman Act. The bill imposes monopolization standards that are radically different from those ordinarily applicable under Section 2 of the Sherman Act. The monopolization inquiry under Section 2 involves a two-step approach to determining whether particular conduct has, or is likely to have, anticompetitive effects: (1) the relevant market must be defined, taking account of all possible constraints on the exercise of market power; and (2) a determination then must be made of whether effective competition is present in that market and whether the practice or conduct at issue threatens that competition. Under the Sherman Act, unlawful monopolization requires proof of market power in the relevant market together with exclusionary or predatory conduct designed to maintain or increase that power.

The proposed legislation dispenses with this approach and adopts a concept of monopolization that is at odds with Section 2. By focusing on a single shipper's transportation options between two particular points, it establishes a novel definition of the relevant market and hence of market power. The market is defined in advance as competing rail and nonrail modes of transportation between the terminal points of the sole railroad facility serving a particular shipper. In the absence of "effective competition" from other rail or non-rail modes of transportation serving the same route, there is a presumption that exclusive control of such a facility confers market power. But even if a particular shipper has access to only one means of transportation between two points, that does not mean that the

² The Commission's opposition to S. 447, the Senate counterpart to the original version of H.R. 1140, was set forth in a May 15, 1985 letter to the Honorable Strom Thurmond, Chairman of the Senate Judiciary Committee.

owner of the rail facility has market power in any relevant transportation market. Geographic and product competition, both of which the revised bill ignores, must also be considered.

Geographic competition exists where a shipper of a commodity competes with other shippers of the same commodity but from different origins. For example, grain stored in a grain elevator served by a sole railroad facility may be sold at a common destination in competition with grain stored in elevators served by other railroads' lines. Product competition exists where a shipper of a commodity competes with sellers of other commodities that are substitutes for the shipper's commodity. For example, coal from a mine served by a sole railroad facility may compete with oil supplied by pipeline. The ability of an owner of a sole rail facility to charge supracompetitive rates is limited if either geographic or product competition is present. Because under such circumstances shippers' customers have alternative sources of supply, an owner railroad must be careful not to price its captive shipper out of the market. This would not be to the advantage of either the shipper or the railroad. Thus, even though a shipper has no rail or nonrail transportation alternatives, the owner railroad may nevertheless have no market power. In general, an owner railroad will have less market power than indicated by the extent of rail and nonrail competition between the terminal points of a sole railroad facility.³

The bill also dispenses with Section 2's requirement that there be proof of deliberate predatory or exclusionary conduct by the owner of the sole railroad facility. Under the proposed test of liability there would be a violation if the owner of such a facility merely restricted access to it by charging prices or rates that exceeded a competitive level. However, this would not be sufficient to violate Section 2. Section 2 condemns the willful acquisition or maintenance of monopoly power. Where a firm possesses legitimately acquired monopoly power, there must be proof that it engaged in predatory or exclusionary conduct

³ The process of defining a relevant antitrust market in a Section 2 monopolization case often reveals many sources of effective competition. There is no reason to believe that bulk commodity transportation markets are an exception. In this regard, we are pleased to note that the revised version of H.R. 1140 recognizes the potential importance of nonrail as well as rail carriers. Nonetheless, as discussed in the text, the proposed legislation's market definition procedure is inconsistent with the procedure used under Section 2 of the Sherman Act.

designed to maintain that power. In contrast to the bill's proposed standard of illegality, Section 2 does not condemn the exploitation of a lawfully acquired monopoly by means of charging supracompetitive prices. "[A] lawful monopolist [is not] ordinarily precluded from charging as high a price for its product as the market will accept." Berkey Photo, Inc., v. Eastman Kodak Co., 603 F.2d. 274 n.12 (2nd Cir. 1979). "[E]ven a monopolist is free to exploit whatever market power it may possess when that exploitation takes the form of charging uncompetitive prices." Kartell v. Blue Shield of Massachusetts, Inc., 749 F.2d. 922, 927-28 (1st Cir. 1984).

It has been argued that the proposed legislation does no more than authorize captive shippers to pursue two causes of action that are already well-recognized under Section 2 of the Sherman Act.⁴ These causes of action are: (1) the denial to competitors of access to so-called "essential facilities" and (2) a monopolist's refusal to deal. In fact, however, the bill's standard of liability is broader than the scope of either of these Section 2 offenses.

The "essential facilities" doctrine limits the freedom of a firm with market power to choose its own customers. Under certain circumstances, a firm with monopoly control of a facility necessary to its competitors' business may have a duty to make that facility available to those competitors on reasonable

⁴ Antitrust damage suits brought by shippers might be barred by the Keogh doctrine, in which event they could not proceed without either legislative authorization or legislative repeal of the doctrine. Injunctive actions are barred by the proviso to Section 16 of the Clayton Act which prohibits equitable actions against common carriers subject to the Interstate Commerce Act. The Keogh doctrine, attributable to Keogh v. Chicago & N.W. Ry., 260 U.S. 156 (1922), prohibits antitrust damage actions based upon rates filed by a common carrier as part of an I.C.C. tariff. The Supreme Court recently refused to overrule Keogh, leaving that decision to Congress. See Square D Co. v. Niagara Frontier Tariff Bureau, No. 85-21 (May 27, 1986). Because both Keogh and Square D involved horizontal price-fixing, it is not entirely clear that Keogh would operate to bar a suit based on the kind of unilateral, single-firm, conduct the bill addresses.

terms.⁵ The function of the doctrine is to prevent the use of market power in one market or at one stage of production to distort or eliminate competition in an adjacent market or stage of production.⁶ In the captive shipper context, however, the fact that a railroad is able to exclude competing carriers from its track, making it the exclusive source of transportation for a particular shipper along a particular route, does not necessarily mean that the railroad is able to control competition in any properly-defined transportation market. A carrier's exclusive access to one shipper does not automatically translate into the ability to exclude competitors from the relevant transportation market so as to increase the carrier's power over rates in that market.⁷ But without an increase in market power in the transportation market there can be no violation of Section 2 based on the essential facilities doctrine or any other theory of

5 The reasonableness requirement is ordinarily interpreted only to mandate non-discriminatory terms. For example, in MCI Communications v. AT&T, 708 F. 2d 1081, 1132 (7th Cir. 1983), the Seventh Circuit recently held that "the antitrust laws have imposed on firms controlling an essential facility the obligation to make the facility available on non-discriminatory terms." (emphasis added). The essential facilities doctrine has not been extended to compel prices that yield only a competitive return, as the bill apparently contemplates.

6 As the Seventh Circuit observed in MCI, the reason for holding monopolistic control of an essential facility unlawful is that the monopolist can use such control to "extend monopoly power from one stage of production to another, and from one market to another." MCI Communications v. AT&T, 708 F.2d 1081, 1131 (7th Cir. 1983).

7 In United States v. Terminal Railroad Assoc., 224 U.S. 383 (1912), a group of railroads acquired ownership of the bridges and other facilities constituting the only feasible terminal for rail traffic entering the city of St. Louis from the east. The Court ruled that the terminal owners had to make the facility equally accessible to other railroads. It appears that the owner group had been able to successfully extend its monopoly control over the terminal facilities to the local transportation market. In any event, the group's activities obviously had a much greater competitive impact than that likely to result from any particular carrier's exclusive access to a single shipper.

liability. The bill's standard of liability is thus broader than the essential facilities doctrine.

The second cause of action that the bill would supposedly authorize, refusals to deal in violation of Section 2, ordinarily involve a monopolist's use of its market power to eliminate an otherwise viable competitor by inducing some or all of its customers not to purchase from the would be competitor. For example, in the leading case of Lorain Journal v. United States 342 U.S. 143 (1951), a monopolist newspaper that was an indispensable source of advertising to local businesses refused to sell advertising space to any customer who bought advertising on a new local radio station. The monopolist unlawfully used its market power in the local advertising market to prevent a would-be rival from obtaining access to customers who, in the absence of coercion by the monopolist, would presumably have been interested in purchasing advertising from the new entrant.

It is possible that an owner railroad might attempt to exclude competing railroads from its tracks by inducing shippers not to deal with the competitors. This behavior would seem unlikely, however, since an owner railroad will not ordinarily require the cooperation of shippers if it already controls a facility to which competing railroads desire access. Nevertheless, should such a case arise, then as in any Section 2 inquiry into the captive shipper situation the real issue would be whether the denial of access enables the owner railroad to increase its market power in a relevant transportation market. Because the bill would not require such a showing, it cannot accurately be characterized as merely authorizing suits under any established Section 2 theory.

H.R. 1140 also fails to recognize the possibility that, under certain circumstances, an owner railroad might have legitimate business reasons for restricting access to a sole railroad facility. In other words, exclusive use by the owner railroad may occur for efficiency reasons rather than for the purpose of monopolization. For example, exclusive use may entail lower signalling and train control costs. An owner railroad may deny trackage rights to reduce these costs while maintaining a desired level of safety. Denial of trackage rights may also enable an owner railroad to take advantage of economies of density, lowering its costs by concentrating traffic on its own trains over the sole rail facility. A refusal to interchange freight at a terminal point of a sole rail facility may also be efficiency-increasing by reducing switching and other transfer costs. By lowering costs, a denial of access may lead to lower rates to shippers in such instances. Because H.R. 1140 does not recognize this possibility, it risks discouraging owner railroads

from attempting to operate more efficiently, and it may, as a result, harm shippers and the U.S. economy.

On close examination the bill seems to be addressed more to providing shippers with another form of rate relief than to assuring that the antitrust laws are applied to protect rail competition and to promote efficient rail operations that benefit shippers. Although we are pleased to note that the revised version of the bill omits its predecessor's requirement that a court set rates on a sole railroad facility according to an arbitrary formula, the bill continues to require rail carriers to offer their sole railroad facilities to competitors on "reasonable" terms. But deciding what constitutes a "reasonable" price is a difficult and critical task. In Sherman Act cases, the courts have abstained from such efforts, recognizing the theoretical and practical difficulties of arriving at "reasonable" rates.⁸ Under the proposed legislation, the federal courts would be required to become involved in the process of setting "reasonable" terms for the use of sole facilities -- the terms which, in the language of the bill, would have prevailed if the owner railroad had faced "effective competition" from other forms of rail and nonrail transportation. The courts would be injected into individual rate disputes on an ad hoc basis and forced to determine the terms on which one carrier should be allowed to operate over the lines of another. Indeed, a single owner might actually find itself facing conflicting standards set by different courts for different shippers on its lines. Moreover, inconsistent court decisions could give some shippers an artificial rate advantage over other shippers with which they compete.

If, in the long run, railroads are forced to share facilities at court-determined rates which, on average, do not fully reflect their opportunity cost, incentives for new capital investment to maintain or improve existing facilities or to construct new facilities will be reduced. An excellent example of what happens when property owners are unable to retain all the benefits of investments in capital assets can be found within the rail industry itself. The requirement that freight cars be interchanged among railroads at non-market-determined rates

⁸ See II P. Areeda & D. Turner, Antitrust Law, §§512-14 (1978). As previously explained in note 5, the courts limit their review in this context to whether a price is non-discriminatory, not whether it is "competitive."

caused the railroads to purchase low quality freight cars and hindered technological advance in freight car design.⁹

In addition, inflexibility of regulated rates in response to cyclical or seasonal demand fluctuations is likely to impose significant costs on the U.S. economy. When the demand for transportation increases, rates set too low would result in shortages of railroad capacity. During periods of reduced demand, rates that are too high would increase the amount of railroad capacity that remains idle. Even if the courts were able to set rates that were socially optimal at the time of trial, in order to avoid the problems associated with demand fluctuations it would be necessary for them to periodically readjust these rates. This would further increase the expenditure of time and effort that the courts would be required to devote to captive shipper cases.¹⁰

Another problem in the setting of rates results from the desirability of permitting railroads to price partly on the basis of the demand for their services. Some variation in markups of rates over marginal costs to reflect differences in elasticities of demand may be needed to provide sufficient revenues to cover railroads' fixed costs and a competitive rate of return on overall railroad investment. If adequate markups are not permitted on traffic moving over sole railroad facilities, owner railroads may be unable to earn a competitive return on their system-wide investments. This may occur because some of the owner railroad's fixed costs are common to both its sole railroad facility and to the rest of its system, for example, the costs of locomotives and cars that run over both segments of the system.

⁹ According to one study, "an investment in the improvement of quality will not pay off to the owner of the car because the additional returns that are generated by the improvement are collected by other roads." Yehuda Grunfeld, "The Effect of the Per Diem Rate on the Efficiency and Size of the American Railroad Freight Car Fleet," Journal of Business, January 1959, p. 73.

¹⁰ Since the mid-1970's regulated freight car per diem charges have exceeded a market clearing level and have caused an inefficient over-investment in box cars, many of which have been idle. Before that time regulated charges were below a market clearing rate causing car shortages. James Sloss and Carl D. Martland, "Government Intervention In Railroad Freight Car Per Diem: An Historical Perspective," Transportation Journal, Summer 1984, pp. 83-95.

Markups that vary with elasticities of demand provide railroads an opportunity to cover such common costs while pricing efficiently.¹¹ If regulated markups are inadequate, the owner railroad may fail to maintain and replace its capital, which may eliminate portions of the rail network, reduce service quality and reliability, and increase shippers' transportation costs.

A final problem with the bill is that it addresses an issue already covered by other legislation. Portions of the Interstate Commerce Act already deal with access to rail facilities by competing railroads.¹² In addition, the Interstate Commerce Commission has recently issued decisions in two proceedings dealing with market dominance and intramodal rail competition.¹³ These decisions essentially implement compromises negotiated by shippers and railroads and directly address the issues raised in the proposed legislation. They also significantly reduce the burden of proof on shippers who allege market dominance.¹⁴ However, because these decisions are of such recent origin, it would be premature at this time to draw any final conclusions about their adequacy to address any legitimate market dominance problems that captive shippers may experience. Accordingly, rather than creating an entirely new procedure now that would enmesh the federal courts in railroads' daily operations, we believe it would be more prudent to give the

11 The need for demand-based pricing or "differential pricing" of rail services was explicitly recognized by the ICC, for example, in establishing its maximum rate guidelines for rail transportation of coal. Interstate Commerce Commission, Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines, Nationwide (decided August 8, 1985), pp. 7-8.

12 See e.g., 49 U.S.C. § 11103.

13 Interstate Commerce Commission, Ex Parte 320 (Sub-No. 3), Product and Geographic Competition, 50 Fed. Reg. 46,189 (November 6, 1985); Ex Parte 445 (Sub-No. 1), Intramodal Rail Competition, 50 Fed. Reg. 46,066 (November 6, 1985). Ex Parte 445 has been challenged in the District of Columbia Court of Appeals. See, Baltimore Gas & Electric Co. v. United States, No. 85-1761 (filed November 19, 1985).

14 For example, in proceedings to determine whether or not a railroad has market dominance, the ICC decision in Ex Parte 320 adopts a shipper-railroad compromise which shifts the burden of proof of effective geographic or product competition to the railroad.

recently modified ICC process an opportunity to address these issues and to provide appropriate relief.

In conclusion, we are opposed to this kind of industry-specific antitrust legislation, especially when it would impose new substantive standards that conflict with sound prevailing antitrust doctrine. If it is the intent of Congress to give shippers a source of relief in addition to that which is now available, we believe that legislative repeal of the Keogh doctrine, which would remove whatever obstacle it may now pose to captive shipper antitrust suits, together with repeal of the proviso to Section 16 of the Clayton Act which prevents injunctive actions against common carriers subject to the Interstate Commerce Act, would be a better response than would H.R. 1140. Shippers would then be free to pursue antitrust actions on the same basis as other private litigants.

Of course there are important questions that we suggest should be carefully addressed before any legislative decision is made to adopt this alternative. When the owner of a sole rail facility has in fact used its control of that facility to increase its market power in the relevant transportation market, what form should relief take? If relief is to take the form of ordering that access be permitted at a "reasonable" rate, who should determine this rate and how? In light of its ratemaking expertise, the ICC would seem to be the logical arbiter. If the ICC were to be sunsetted, regulatory oversight might be transferred to the Department of Transportation. A legislative provision permitting the courts to refer the reasonable rate issue to the ICC might thus be worth considering. Moreover, given the ICC's specialized expertise and its ability to act faster, at lower cost, and with greater certainty than the courts on rate-setting issues, Congress might want to consider other ways of retaining some of the ICC's present role in their resolution. Given the lure of treble damages in private antitrust actions, injured parties will almost surely pursue court actions where at all feasible. Thus Congress might, for example, want to limit successful litigants in such cases to actual damages, thus reducing the incentive to pursue a remedy in the courts rather than at the ICC.

In any event, we suggest that careful consideration needs to be given to the general workability of a system of dual redress. Other problems, such as the standards for temporary restraining orders and preliminary injunctions based on allegations of unreasonable rates also warrant consideration. The questions raised here are by no means exhaustive, but are intended solely to illustrate the complexity of the captive shipper issue. From our brief examination of this alternative it

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would appear to involve some of the same difficult issues raised by H.R. 1140. For the reasons discussed in this letter, however, we believe that, on balance, H.R. 1140 is more problematic and we reiterate our strong opposition to it.

By direction of the Commission,

A handwritten signature in dark ink, appearing to read "Daniel Oliver". The signature is written in a cursive, somewhat stylized script.

Daniel Oliver
Chairman