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Railroad Antitrust Reform—A Train To Nowhere?

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There is an obvious déjà vu quality in today's loudly promoted "Railroad Antitrust Enforcement Act of 2009" bills that have been introduced by Senator Herbert Kohl (D-WI) (S. 146) and his Wisconsin colleague, Congresswoman Tammy Baldwin (D) (H.R. 233). But it seems that they may well have arrived at the station quite a while after the antitrust train had pulled out.

In the first quarter century of the Sherman Act (1890-1915), the railroad industry was right at the center of the antitrust enforcement scene. The Justice Department's challenge to rate bureau practices produced the Supreme Court's initial decisions about what constituted unreasonable restraints of trade under Sherman Act Section 1; and in each case (*Tran-Missouri Freight Ass'n* and *Joint-Traffic Ass'n*,² the Court, reversing a lower court, found that a railroad rate-setting association was illegal. Six years later the Supreme Court sustained the Justice Department's effort under Section 1 to block the pending Northern Pacific/Great Northern merger in *Northern Securities*.³ When Justice Oliver Wendell Holmes dissented, President Theodore Roosevelt (who had recently nominated Holmes to the Court) is reported to have commented, "I could have carved somebody with more backbone out of a banana!"

In 1913, the Supreme Court decided another Justice Department railroad case under Section 1 in what is still a very important precedent concerning access to "bottleneck monopoly" facilities the *St. Louis Terminal RR* decision.⁴ In that case, the Court held that a dominant group of railroads that jointly controlled the terminal facilities must offer membership on equal terms to all other railroads connecting in the very important St. Louis gateway.

What makes these early landmarks so important is that the Supreme Court Justices were writing new rules on a very broad and largely still-empty blackboard in antitrust cases brought by the Justice Department. A century later, today's Justices and lower court Judges simply no longer have that breadth of opportunity; most of the antitrust cases they hear are brought by private parties rather than the Government. Moreover, the antitrust blackboard has become considerably narrower in the last 20 years as a result of a series of decisions by the conservative Supreme Court majority, often led intellectually by Justice Scalia.

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² *U.S. v. Tran-Missouri Freight Ass'n*, 166 US 290 (1897), and *U.S. v. Joint-Traffic Ass'n*, 171 US 505 (1898).

³ *Northern Securities v. U.S.* 193 US 197 (1904).

⁴ *U.S. v. Terminal RR Ass'n of St. Louis*, 245 US 675 (1913).

I. TODAY'S LEGISLATIVE GOALS?

Thus it is far from clear what the Senator Kohl, Congresswoman Baldwin, and their allies can really hope to achieve with their enthusiastic proposals to "put railroads under the same antitrust laws as all other businesses," as one Senate aide characterized the efforts of Senator Kohl. According to Senator Kohl's office, the senator introduced the bill "in response to concerns that freight railroads are abusing their dominant market power and raising rates for those who rely on them to ship dozens of vital commodities, including coal and agricultural products." This situation occurs, Senator Kohl seems to assume, because railroad operations are protected by a series of exemptions from the normal rules of antitrust law to which all other industries must abide. Thus, the sound-byte message is: "repeal the exemptions and everything will be fine for captive shippers of coal, agricultural products, and other heavy commodities."

Alas for the champions of these "reforms," the antitrust reality is very different from the sound-byte assumption. To start with, many railroad activities are not exempt. Moreover, it not an antitrust offense for a monopolist to charge a monopoly price for its goods or services (the situation is different in Europe where excessive pricing is an "abuse of a dominant" position that can constitute an antitrust violation).

II. ERRONEOUS ASSUMPTIONS ABOUT SUBSTANTIVE ANTITRUST RULES

In the United States, the offense of monopolization is based on efforts to exclude other rivals from a monopolized market. Thus, Microsoft did not get into antitrust trouble under Section 2 of the Sherman Act because it charged princely prices for Windows licenses, but because it took various steps to exclude Netscape from "browser" and "middleware" markets. Indeed, in a sometimes-criticized burst of enthusiasm for monopoly rents, Justice Scalia's majority opinion in *Trinko*⁵ praised monopoly pricing:

The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element in the free market system. The opportunity to charge monopoly prices—at least for a short period—is what attracts 'business acumen' in the first place; it induces risk taking that produces innovation and economic growth.

Justice Scalia's analysis has been reinforced by Chief Justice Roberts' 2009 opinion for a 5-4 majority in *linkLine*.⁶ The Chief Justice flatly concluded that "the reasoning of *Trinko* applies with equal force to price-squeeze claims...[A] firm with no [antitrust] duty to deal in the wholesale market has no obligation to deal under terms and conditions favorable to its [retail] competitors." For good measure, he adds later in the opinion, "[I]f AT&T can bankrupt the plaintiffs by refusing to deal altogether, *the plaintiffs must demonstrate why the law prevents AT&T from putting them out of business by pricing them out of the market.*"

Given this basic antitrust reality, it is hard to see how the antitrust exemptions that Senator Kohl and his allies are targeting have enabled the rail industry to abuse its market

⁵ Verizon Communication v. Law Offices of Curtis V. Trinko, 540 US 398, 407 (2004).

⁶ Pacific Bell Telephone Co. v linkLine Communications Inc., 129 S.Ct. 1109 (2009).

power and raise rates to monopoly levels. The truth is that a railroad may well have monopoly power vis-à-vis shippers, particularly in isolated areas. This monopoly power is not created by exploiting exemptions from the antitrust law, but rather by economies of scale and scope—which are an entirely legitimate source of power under the antitrust laws. Thus, removing the railroads’ exemptions is unlikely to provide a wonderful new antitrust remedy for victims of the alleged monopolistic abuses.

III. ERRONEOUS ASSUMPTIONS ABOUT THE SCOPE OF ANTITRUST EXEMPTIONS

The underlying premise for S. 146, H.R. 233 and the other “reform” bills is an often-repeated claim that the railroads are “exempted from antitrust laws *in most respects*.”⁷ This simplistic assumption simply does not survive even a cursory review of the case law since passage of the regulation-liberalizing Staggers Act in 1980.⁸ What such a review shows is that the railroads have been the subject of numerous antitrust suits, many of them quite successful. For example, in *Lower Lake Erie*,⁹ several railroads were found liable for blocking the use of certain iron ore unloading facilities. In another antitrust case, *Burlington Northern*,¹⁰ successfully brought by a potential coal-slurry pipeline company, the defendant railroads paid hundreds of millions of dollars in settlements, and a jury ultimately ruled that they had conspired to block new competition.¹¹ Indeed, numerous shippers are seeking billions of dollars against the nation’s four largest railroads for allegedly violating the Sherman Act in setting fuel surcharges.¹² In that litigation, the railroads are not asserting that their actions were exempt from the antitrust laws but rather that the antitrust laws were fully applicable with the railroad’s practices in full compliance with those laws.

Particularly illuminating is *Laurel Sand & Gravel* in 1991¹³ where the Fourth Circuit upheld the District Court’s dismissal on summary judgment, not because the local railroad monopolist was exempt from the antitrust laws, but because there was no antitrust remedy under Section 2 against the defendant’s refusal to deal with the plaintiff shipper (thus anticipating what the Supreme Court would later hold in *Trinko* and *linkLine*).

⁷ S. Rep. 111-9, The Railroad Antitrust Enforcement Act of 2009, p. 2.

⁸ Staggers Act in 1980, Pub. L. 96-488.

⁹ *In re Lower Lake Erie Iron Ore Antitrust Litigation*, 998 F.2d 1144 (3d Cir. 1993).

¹⁰ *ETSI Pipeline Project v. Burlington Northern, Inc.*¹⁰, 1989 U.S. Dist. LEXIS 18796 (E.D. Tex. June 5, 1989)

¹¹ *See also* *Springfield Terminal Ry. Co. v. Canadian Pacific Ltd.*, 133 F.3d 103 (1st Cir. 1997) (series of anticompetitive actions aimed at weakening a rival railroad in an attempt to eventually acquire that railroad is not immune from antitrust scrutiny); and *U.S. v. Bessemer & Lake Erie RR.*, 717 F.2d 593 (D.C. Cir. 1983) (ICC cannot exempt criminal conduct from antitrust scrutiny). Other District Court decisions include *Florida E. Coast Ry. v. CSX Transp.*, 1992 U.S. Dist. LEXIS 7739 (N.D. Ill. May 29, 1992) (denying motions for summary judgment and allowing antitrust claims to proceed if certain facts applied); and *Pinney Dock & Transp. Co. v. Penn Cent. Corp.*, 1983-2 Trade Case. (CCH) ¶ 65,607 (N.D. Ohio 1983) at 69,037 (“[s]ince the ICC has neither the jurisdiction nor the unique expertise to decide the antitrust issues before this court, reference to the Commission is deemed unnecessary and inexpedient”).

¹² *In re Rail Freight Fuel Surcharge Antitrust Litigation*, MDL No. 1869, Misc. No. 07-489 (D.D.C.).

¹³ *Laurel Sand & Gravel, Inc. v. CSX Transportation, Inc.*, 924 F.2d 539 (4th Cir. 1991) cert. denied, 502 U.S. 814 (1991),

IV. CLOSING THE BARN DOOR DECADES TOO LATE

It is true that railroad mergers are exempt from the antitrust law if such activities have been reviewed and approved by the Surface Transportation Board (“STB”), a three member independent regulatory body that became the successor to the Interstate Commerce Commission (“ICC”) in 1995. If the ICC or the STB had not been around, it is unlikely that several railroad mergers that were approved by those agencies would have passed muster under the antitrust laws.

No antitrust agency or court would have approved the *Northern Lines Merger* (in 1970) or the *Union Pacific-Southern Pacific* merger (in 1996). The *Northern Lines* decision overturned in effect the Supreme Court 1904 *Northern Securities* antitrust landmark and thereby created a lot of monopoly control across the Northern Tier of western states, and the Justice Department strenuously opposed the *Union Pacific-Southern Pacific* merger due to what it perceived as granting Union Pacific too much monopoly power in the West. Likewise, the creation of Conrail out of the ICC-approved *Penn Central* merger resulted in significant monopoly power in the Northeast—monopoly power that was mitigated somewhat three decades later when a 1997 bidding war between CSX and Norfolk Southern for Conrail eventually resulted in Conrail being divided between them.

Given the STB’s new merger rules and the limited remaining opportunities for future mergers creating substantial new market power for any one particular railroad in a major market, one has to wonder what good, if any, would result from placing future railroad merger review under both DOJ and STB while leaving prior mergers in place, as the antitrust reform bills do. Would this be anything more than a cheerful antitrust gesture?

What Senator Kohl and his allies have to accept is the political reality that Congress clearly gave the ICC and the STB the powers to balance competition concerns against other “public interest” values and thereby approve mergers that would have been illegal under a pure antitrust analysis. This included the power to approve mergers that created monopoly power in a region (as the earlier *Penn Central* and *Northern Lines* approvals illustrate).

While today, in 2009, antitrust advocates may not approve of the ICC’s and STB’s prior choices, it is simply too late for Congress to do anything effective vis-à-vis the resulting situation—much as Senator Kohl and his friends might wish that they could turn the clock back 105 years to the *Northern Securities* decision and the antitrust enthusiasm of President Theodore Roosevelt.

V. WHAT ELSE IS EXEMPT?

In addition to railroad mergers, certain other rail activities are exempt from the antitrust laws if they have been reviewed and approved by the STB. These include line purchases, sales, and closures, as well as certain other transactions involving rail car usage, car hire rates, and equipment pools.

The reason for these exemptions arises out of the reality that the rail transportation business is a highly interdependent network industry. Even railroad competitors that are not

competitors have to cooperate closely because they are constantly interchanging traffic and equipment in order to provide shippers with seamless service. It is efficient and appropriate that carriers should, with STB approval and oversight, be able to enter into certain agreements over the terms on which traffic is exchanged or cars are used and paid for when on a foreign railroad. Antitrust litigation could be highly disruptive to this and other collective efficient processes—as so lamentably illustrated by the almost endless antitrust litigation over interchange fees in banking networks.¹⁴

Such “exemptions” from the antitrust law have long been accepted in many industries and situations where ongoing supervision of conduct—particularly monopoly conduct—is needed and an independent regulator with a staff that has industry experience is in place.

VI. CONCLUSION: IS THE GOAL OF THIS EFFORT MORE POLITICAL THAN PRACTICAL?

Senator Kohl, Congresswoman Baldwin, and their friends might feel good about enacting some version of their “Railroad Antitrust Enforcement Act of 2009”—but they cannot turn the clock back a hundred years. In the process, they may well generate more confusion than progress, while doing little to help the shippers whom they say they are trying to help. Passing the antitrust bill while leaving (or even enhancing) the current regulatory environment in place, which is what the current political proposals would do, is more likely to generate regulatory confusion and duplication—while having little, if any impact, on the practical ability of shippers to use the antitrust laws as a tool to obtain relief against what they believe to be “monopolistic rates.”

The central role given to private plaintiffs and juries in the United States has understandably bred long-term caution among both politicians and judges about reading the antitrust laws broadly vis-à-vis monopolists—particularly regulated monopolists. That is why there is no Section 2 remedy for overcharges by an indisputable monopolist (such as Microsoft or AT&T in the old days). Rather, the U.S. politicians, enforcers, and courts seem to have implicitly made the broad judgment that, when recurring *monopoly abuses* are likely to occur, an independent regulator (such as the STB) should be created to police the affected situation(s)—rather than trying to rely on courts applying the Sherman Act. The underlying political assumption seems to have been that a regulator tends to be more cautious about disrupting the status quo than independent judges and juries can sometimes be. Moreover, most judges do not like the idea of courts having to become ongoing regulators of “reasonable prices” or other discretionary conduct by a defendant monopoly.

This “risk of private litigation” rationale seemed especially clear in the recent *Trinko* and *Credit Suisse*¹⁵ decisions, where the Supreme Court recently introduced much greater deference to industry regulators because:

¹⁴ See e.g., *NaBanco v. VISA USA*, 779 F.2d. 592 (11th Cir.), cert. den. 107 S.Ct. 329 (1986); *Financial Interchange*, 55 Antitrust & Trade Reg. Rep. (BNA) 340 (arbitration 1988); *Brennan v. Concord EFS*, 369 F.Supp. 1127 (N.D. Cal. 2005); *Paycom Billing Services Inc. v. MasterCard International, Inc.*, 467 F.3rd 283 (2nd Cir. 2006)

¹⁵ *Credit Suisse Securities v Billing*, 127 S.Ct 2383 (2007) (“*Credit Suisse*”).

Antitrust plaintiffs may bring lawsuits throughout the Nation in dozens of different courts with different non-expert judges and different non-expert juries. In light of the nuanced nature of the evidentiary evaluations necessary to separate the permissible from the impermissible, it will prove difficult for those many courts to reach consistent results.¹⁶

This new judicial caution toward the antitrust laws is particularly relevant to some of the goals of the proposed antitrust reform bills. A major driving force behind these bills is the shippers' desire to be able to obtain an unbundled rate for the so-called "bottleneck segment," *i.e.* a rate for the A to B segment of an A to C route, when Railroad 1 controls the segment from A to B, but from B to C, Railroad 1 competes against Railroad 2. Under the current regulatory environment, Railroad 1, in most cases, needs only to quote a through rate from A to C. Another driving force is the desire by the shippers to force dual railroad access at a given shipper location, usually within a terminal complex, but where that location (or terminal) is currently only being served by one railroad. Yet, under the Supreme Court's *Trinko* and *linkLine* decisions, antitrust relief for a shipper in either of these situations would be improbable.

In *Trinko*, the Supreme Court opined by way of dicta that "essential facility claims should be denied ... where a state or federal agency has effective power to compel sharing and to regulate its scope and terms." This would reverse what is generally regarded as the leading modern "essential facilities" decision, MCI's celebrated 1983 victory against AT&T,¹⁷ as well as overturning at least two of DOJ's important Supreme Court victories compelling access relief against monopolies created by regulated entities.¹⁸

In the end, removal of the few antitrust exemptions currently granted to the rail industry is unlikely to result in the type of antitrust relief required to curtail what the shippers view as an abuse of market power, and will do little, if anything, to reduce rail rates, given the state of modern Section 2 jurisprudence.

What practical change then would passage of S. 146 or a similar bill actually bring about? Do the champions and opponents not understand modern antitrust laws, or do they have other goals and concerns? The reality is that its passage might well encourage disgruntled shippers to bring more private antitrust cases about allegedly excessive rates. However, without fundamental changes in the substantive antitrust law, Senator Kohl's "shipper victims" are unlikely to be able to prevail in litigated cases challenging a monopolistic railroad's overcharges or refusals to deal under the antitrust laws. Thus, the legislation is probably more about class action settlements and attorneys' fees than anything else. For the rail industry, more private suits would be likely to mean having to pay more in antitrust settlements and larger legal bills for defense attorneys' firms. Some shippers could benefit where their attorneys worked on contingent fees and were obliged to share some of their "litigation cost avoidance" settlements

¹⁶ *Id.* at 2395.

¹⁷ *MCI Communications Corp. v American Tel. & Tel. Co.*, 708 F.2d. 1081 (7th Cir. 1983).

¹⁸ Notably *U.S. v Terminal R.R. Ass'n of St Louis*, 224 US 383 (1912); and *Otter Tail Power v U.S.*, 410 US 366 (1973).



with their clients. But creating more of these kinds of practical, largely principle-free results would hardly be a commendable model for public policy!