

GCP: The Antitrust Chronicle

Competition Come Full Circle? Pending Legislation to Repeal the U.S. Railroad Exemptions

Chris Sagers
Cleveland State University

Competition Come Full Circle? Pending Legislation to Repeal the U.S. Railroad Exemptions

Chris Sagers¹

The single oldest and probably most convoluted story in American antitrust is its relationship with the railroads. Railroads were among the first business entities in the United States to be perceived as social problems in and of themselves, regardless of any aid or preference gotten from government. The “populism” that had been a part of American politics since colonial times shifted from fear of government-supported aristocracy to fear of private economic power in its own right, and the railroads were among the first to embody that free-standing power. Perceived railroad abuses were chief motivations for the first state and federal antitrust statutes, and railroads were defendants in many of the earliest antitrust decisions. Even before there was a federal antitrust law, the Interstate Commerce Commission (“ICC”), the first federal regulator of an economic sector, was set up to constrain their power.

And yet the railroads were also among the early beneficiaries of a new kind of economic thinking that arose around the turn of the twentieth century, which led to near consensus that railroads and the other heavy infrastructure industries simply could not function on a competitive basis. And so was born a period of regulation under which government controlled entry, exit, and prices in the American transportation, communications, and energy industries. Because competition was displaced, those industries were also exempted from most antitrust scrutiny. Thus, not that long after their perceived wrongdoing precipitated the first antitrust legislation, the railroads managed to escape it more or less entirely by statutory exemption, and they have retained some degree of exemption ever since.²

In all of these industries, though, the regime of rate-and-entry regulation has largely been dismantled, as a result of a complex series of deregulatory steps begun during the Carter administration and continuing ever since. In part this was the result of poor economic performance, and in the case of the railroads it was drastic. The 1970s saw a rash of railroad bankruptcies and the government takeover of the northeastern railroads that would become Conrail. Among the chief target of blame was the regulation of rates, entry, and exit. The

¹ Chris Sagers is an Associate Professor of Law on the faculty of Cleveland-Marshall College of Law, Cleveland State University.

² On the history of the railroads, their relationship to antitrust, and their regulation, see JAMES W. ELY, JR., *RAILROADS AND AMERICAN LAW* (2001), SECTION OF ANTITRUST LAW, ABA, *FEDERAL STATUTORY EXEMPTIONS FROM ANTITRUST LAW* 8-13, 193-216 (2007), and RICHARD D. STONE, *THE INTERSTATE COMMERCE COMMISSION AND THE RAILROAD INDUSTRY: A HISTORY OF REGULATORY POLICY* (1991). On the history of traditional regulation in the infrastructure industries, see ANTITRUST MODERNIZATION COMMISSION, *REPORT AND RECOMMENDATIONS* 333-42 (2007) [*hereinafter* “AMC REPORT”], Joseph D. Kearney & Thomas W. Merrill, *The Great Transformation of Regulated Industries Law*, 98 COLUM. L. REV. 1323 (1998), and Robert L. Rabin, *Federal Regulation in Historical Perspective*, 38 STAN. L. REV. 1189, 1197-1229 (1986).

railroads were partially deregulated by legislation in 1976 and 1980, the predominant effects of which were to deregulate entry and exit and to give railroads pricing freedom over most of their traffic.³

Critically, though, deregulation in most industries left at least some antitrust protection in place. The railroads retain a complex bundle of protections that together add up to a fairly potent immunity, and by some accounts they have used it to anticompetitive ends. The immunities fall into basically four types:

1. Railroad mergers are subject to review only by the ICC's successor, the Surface Transportation Board ("STB"), and if approved cannot be challenged under Clayton Act § 7.⁴ The Board, according to its critics, has been too forgiving in its review, and for better or worse consolidation has been dramatic. Over the course of about forty years the ICC and STB oversaw and approved a series of mergers that reduced the number of Class I railroads⁵ from sixty-three to seven, a mere four of which now carry 90 percent of the nation's rail traffic.⁶ Nowhere else in U.S. law may a regulatory agency approve a merger without DOJ or FTC approval,⁷ and the STB has approved mergers over strenuous agency objection.⁸
2. While the railroads are no longer free to establish outright price-fixing cartels, they have a fairly broad immunity to enter into collaborative arrangements involving rate setting. The Secretary of Transportation may also convene conferences for the "unification or coordination of at least two rail carriers," at which participants enjoy immunity for "any discussion . . . [or] agreements" reached there and approved by the Secretary.⁹

³ For discussion of railroad deregulation and the industry economic suffering that precipitated it, see GEN. ACCOUNTING OFF., RAILROAD REGULATION: ECONOMIC AND FINANCIAL IMPACTS OF THE STAGGERS ACT OF 1980, at (1990) [*hereinafter* "GAO Report"].

⁴ 49 U.S.C. § 11321(a). Line sales are also subject only to STB review, and upon approval are immune from antitrust. 49 U.S.C. § 10901(c).

⁵ The ICC and STB have classified railroads by size for purposes of the accounting system the agencies used for carrier financial reporting. In that classification system, "Class I" railroads are the largest and are currently defined as those having annual operating revenue of \$250 million or more. See 49 C.F.R. Part 1201, subpart A, general instruction 1-1.

⁶ GOV'T ACCOUNTABILITY OFF., FREIGHT RAILROADS: INDUSTRY HEALTH HAS IMPROVED, BUT CONCERNS ABOUT COMPETITION AND CAPACITY SHOULD BE ADDRESSED 19-21 (2006) [*hereinafter* "GAO REPORT 2006,"].

⁷ AMC REPORT, *supra* note 2, at 363-64.

⁸ See, e.g., Antitrust Section, Dept. of Just., Press Release, Justice Department Has Antitrust Concerns About Union Pacific/Southern Pacific Railroad Merger, Apr. 12, 1996. The Board approved that particular merger, expressly rejecting DOJ's views, see *Union Pac. Corp.—Control and Merger—Southern Pac. Rail Corp.*, 1 S.T.B. 233, 73-75, 169 (1996), and its decision was affirmed by the D.C. Circuit in *Western Coal Traffic League v. STB*, 169 F.3d 775 (D.C. Cir. 1999).

⁹ Railroad agreements relating to rates and other matters form what were traditionally known as "rate bureaus," and subject to statutory limitations they are immune from antitrust upon STB approval. 49 U.S.C. § 10706. The Transportation Secretary's authority is in 49 U.S.C. § 333.

3. Railroads subject to STB jurisdiction are largely immune from private antitrust litigation. As mentioned, STB-approved mergers and acquisitions cannot be challenged by any party under Clayton Act § 7, and private parties may not sue for any antitrust injunction under Clayton Act § 16.¹⁰ Private parties are also barred by the *Keogh* or “filed rate” doctrine from money damages where the gravamen concerns rates regulated by government.¹¹
4. The Federal Trade Commission (“FTC”) is removed entirely from oversight of the railroads. Section 5 of the FTC Act applies to railroads, but may be enforced against them only by the STB.¹²

Thus, as the law stands, the railroads are subject to antitrust only as to: a) conduct that is not common carriage,¹³ b) horizontal conduct among themselves that is not part of an STB-sanctioned collaboration or DOT-convened conference agreement, and c) dealings with third parties.

The nub of essentially all current criticism of railroad behavior is the exploitation of captive shippers—those who have access to only one carrier. There is no doubt that such shippers have suffered. While rail rates generally fell for more than twenty years following deregulation, significant pockets of charges of 300 percent or more over costs have persisted, are now fairly widespread, and bear some correlation with captivity.¹⁴ While the STB’s underlying legislation requires that common carrier rates be “reasonable,” and provides a remedy where those charged by a “market dominan[t]” carrier are not,¹⁵ the complexity and expense of the process has rendered it useless to most shippers.¹⁶ Moreover, proponents of repeal legislation have complained about two specific practices in particular, “bottleneck” pricing and “paper barriers.”¹⁷ Theoretically, the STB is empowered to correct such abuses, but it has explicitly approved of bottleneck pricing¹⁸ and has granted easy approval of paper barrier agreements.

¹⁰ 15 U.S.C. § 26 (providing that only United States may seek antitrust injunction against common carriers subject to STB jurisdiction).

¹¹ See *Square D Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409 (1986); *Keogh v. Chicago & N.W. Ry. Co.*, 260 U.S. 156 (1922).

¹² 15 U.S.C. § 45(a)(2).

¹³ That is to say, involving movements under private contract. The statutory exemptions apply only to conduct within the Board’s jurisdiction, which is over common carriage of persons or freight entirely by rail (or by rail and water if the waterborne assets are under the railroad’s control). 49 U.S.C. § 10102(5), (9) (defining “rail carrier” and “transportation”), § 10501(a) (setting out Board’s jurisdiction over “transportation by rail carrier”).

¹⁴ GAO REPORT 2006, *supra* note 3, at 30-36.

¹⁵ 49 U.S.C. § 10701(a) (requiring rate reasonableness); § 10707 (“market dominance” proceedings).

¹⁶ See Anthony Johnstone, **Captive Regulators, Captive Shippers: The Legacy of McCarty Farms**, 70 MONT. L. REV. 239, 258-59 (2009) (noting that because rate challenges can cost up to \$5 million, few complaints are brought and virtually all of them fail).

¹⁷ The former is practiced by railroads that own the final segment of trackage that reaches some group of captive shippers. Though the carrier might be able to exchange traffic from that bottleneck segment to other carriers for longer shipments, it can avoid that long-haul competition by simply refusing to exchange or refusing to quote prices other than for the entire long-haul. The latter arises when a large railroad spins off some terminal trackage, usually to fairly low-traffic destinations, to create a so-called “short line” railroad. In many cases the major carriers to have done

The empirical evidence on rail competition is somewhat mixed. On the one hand, there is little doubt about the dramatic increase in concentration. Rates also began to rise in 2004, after an almost uninterrupted twenty-year decline,¹⁹ and some captive shippers pay inflated rates. The industry has also enjoyed gradually increasing profits, and critics attribute these profits to market power.

On the other hand, there is consensus that concentration was needed to correct the severe problems of overcapacity and inefficient organization of the regulated era, and that during the period of consolidation costs have fallen and productivity has risen. There also is evidence that overcharges have resulted merely from periodic bouts of undercapacity, and that recently rising rates are at least partly explained by the oil crisis of the past few years.

Still, concern over competitive abuses and a chorus of shipper complaints has driven a flurry of congressional investigations and other government study. In 2006 GAO found sufficient evidence of market power and competitive abuses to call on the STB for a comprehensive study. In reply, the Board commissioned a third-party study that rebutted most criticisms, arguing that railroad profits have been “normal” and that captivity has not been closely correlated with market dominance.²⁰

A handful of reforms have recently been proposed for rail transportation, and among them is repeal of the antitrust exemption.²¹ The currently pending Railroad Antitrust Enforcement Act of 2009²² would make railroad mergers and acquisitions fully subject to § 7 enforcement, would give the FTC enforcement authority for § 5 of the FTC Act, would permit private injunctive and monetary damages enforcement, and would repeal the *Keogh* and primary jurisdiction doctrines as to railroads. All along the motivating force appears to have been the Wisconsin congressional delegation. The bill’s chief sponsors have been Rep. Tammy Baldwin, a Democrat representing the Madison, Wisconsin area, and Senator Herb Kohl, both of whom introduced the same legislation in the prior Congress. This presumably reflects the

so have conditioned the transactions on the short lines’ adoption of contracts that impose prohibitive penalties on them if they exchange traffic with competing long-haul carriers.

¹⁸ *Central Power & Light Co. v. S. Pac. Transp. Co.*, 1 S.T.B. 1059 (1996). The Board’s decision was affirmed in *MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8th Cir. 1999).

¹⁹ There is also some suspicion that rates have been understated in various ways. Railroads in recent years have begun shifting some functions to shippers, like loading and unloading, or the purchase and maintenance of equipment. They also began assessing fuel surcharges in 2003, in response to rising fuel costs, and shippers have complained. See GAO REPORT 2006, *supra* note 3, at 16-18; OFF. OF ECON., ENV. ANALYSIS & ADMIN., SURF. TRANS. BD., STUDY OF RAILROAD RATES: 1985-2007, at 6 (2009) [hereinafter “STB RATE STUDY 2009”].

²⁰ The evidence discussed here appears in GAO REPORT 2006, *supra* note 3, a Congressional Research Service study of coal transported by rail, CONG. RES. SERV., CRS REPORT TO CONGRESS: RAIL TRANSPORTATION OF COAL TO POWER PLANTS: RELIABILITY ISSUES (2007), STB RATE STUDY 2009, *supra* note 19, and in the STB-commissioned third-party study, LAURITS R. CHRISTENSEN ASSOCS., INC., A STUDY OF COMPETITION IN THE U.S. FREIGHT RAILROAD INDUSTRY AND AN ANALYSIS OF PROPOSALS THAT MIGHT ENHANCE COMPETITION (2008) (study commissioned by STB).

²¹ Bills also have been proposed to reverse some STB decisions, such as its approval of bottlenecks and paper barriers, see, e.g., The Railroad Competition and Service Improvement Act of 2007, S. 953, 110th Cong., 1st Sess. (2007), and on a broader level to re-frame the goals of national transportation policy, see, e.g., The Federal Surface Transportation Policy and Planning Act of 2009, S. 1036, 111th Cong., 1st Sess. (2009).

²² H.R. 233, 111th Cong., 1st Sess. (Jan. 7, 2009); S. 146, 111th Cong., 1st Sess. (Jan. 6, 2009).

states' agricultural economy and the fact that portions of Wisconsin are dependent on coal-fired electricity. Shippers of coal and grain have suffered unusual degrees of captivity and have little recourse to other transport modes; they complain of dramatic rail cost increases.²³

The pending bills did not progress particularly far during the first session. The House version was approved by the Judiciary Subcommittee on Courts and Competition Policy, but awaits consideration by the full Judiciary Committee. The Senate companion was unanimously approved by committee, but has been stalled since early June, when key committee chairs agreed to incorporate it as part of a larger effort to reform the STB. In the prior Congress the bill was reported favorably by the House Judiciary Committee in September of 2008,²⁴ but advanced no further.

The industry's opposition to repeal is familiar both from its own opposition to prior deregulation and from the arguments of the other traditionally regulated industries. Its thrust is that the railroads suffered economically during the 1970s, a fact that by general consensus resulted from poor government regulation, but that in its current partially regulated state it has begun to prosper. The industry warns that pending repeal legislation would hamper it too severely and cause it to revert to the economic under-performance of the 1970s.²⁵

So would the railroads face major antitrust challenges following repeal of their exemptions? Superficially it might seem so. Shippers scattered throughout the country have access only to monopoly or duopoly lines and little meaningful intermodal competition. However, much of that concentration resulted from ICC- or STB-approved acquisitions, which themselves would plainly be exempt from antitrust challenge,²⁶ and the mere unilateral pricing by monopolists and oligopolists is not ordinarily illegal merely because it exploits market power. Further consolidation would be open to § 7 challenge, but given the present level of concentration one wonders how much more there will be on any large scale.

Some practices, however, including some that remain highly profitable to the railroads, seem in more jeopardy. Bottleneck pricing might plausibly be subject to refusal-to-deal or essential facilities liability under Sherman Act § 2, and paper barriers agreements could conceivably be challenged as illegal exclusive contracts. Other agreements currently employed

²³ See STB RATE STUDY 2009, *supra* note 19, at 7.

²⁴ H.R. 1650, 110th Cong., 1st Sess. (Mar. 22, 2007); see H.R. REP. NO. 110-860 (Sep. 18, 2008).

²⁵ See J. Michael Hemmer, Written Testimony of the Association of American Railroads Before the House Subcommittee on Courts and Competition Policy, House Committee on the Judiciary (May 19, 2009).

²⁶ The pending bills might raise a minor issue of statutory interpretation concerning retroactivity, and the railroads have stressed this argument in opposition, warning that scores of fully consummated transactions would be opened to challenge. See Hemmer, *supra* note 25. The argument seems very weak. All bills that have been proposed have contained the same explicit clause providing for prospective effect and a 180 day grace period following enactment for any conduct previously begun. Such legislative history as exists stresses this fact extensively. Admittedly, the pending bills would remove a proviso in current Clayton Act § 7, which provides that "[n]othing contained in this section shall be held to affect or impair any right heretofore legally acquired" and that it "shall [not] apply to transactions duly consummated pursuant to authority given by the . . . Surface Transportation Board . . ." 15 U.S.C. § 18. It seems plain, however, that the purpose of that repeal would be to expose *future* mergers and acquisitions, approved by the STB after enactment. to § 7 review.

could also be challenged, though their risks of liability seem smaller. Interline rate agreements, for example, are currently immune if approved by the STB.²⁷ But since they involve the collaborative production of a service and not merely naked price fixing, they might legitimately be defended on ancillarity grounds,²⁸ and might also receive a measure of statutory protection as joint ventures.²⁹

But a bigger and murkier question remains. Assuming some repeal legislation is passed, substantive antitrust would have to be harmonized with the economic regulatory rules that would still exist in federal railroad law. The courts' chief guidance on that problem would be *Trinko*.³⁰ There the Court refused to find a violation of § 2 on the part of an incumbent local telephone company that allegedly frustrated entry by would-be competitors, despite the fact that federal communications law required them to provide reasonable access to their proprietary infrastructure. The Court so ruled even though the underlying legislation contained a very explicit antitrust savings clause. The Court offered this general guidance:

Antitrust analysis must always be attuned to the particular structure and circumstances of the industry at issue. . . . One factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm. Where such a structure exists, the additional benefit to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny. Where, by contrast, “[t]here is nothing built into the regulatory scheme which performs the antitrust function,” the benefits of antitrust are worth its sometimes considerable disadvantages. Just as regulatory context may in other cases serve as a basis for implied immunity, it may also be a consideration in deciding whether to recognize an expansion of the contours of § 2.³¹

There remains some question about just what effect *Trinko* will have,³² but if its thrust is that the presence of an economic regulatory regime counsels against aggressive antitrust, then enforcement against the railroads may be curtailed. The STB's underlying legislation expressly mandates the Board's concern for railroad “revenue adequacy,”³³ and one way the railroads

²⁷ 49 U.S.C. § 10706.

²⁸ Under the doctrine of ancillary restraints, a restraint that otherwise would violate Sherman Act § 1 *per se* will be judged only under the rule of reason if it is merely ancillary and reasonably necessary to an otherwise pro-competitive arrangement. See *Polk Bros., Inc. v. Forest City Enters.*, 776 F.2d 185, 188-89 (1986); DEPT. OF JUSTICE & FTC, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS § 1.2 (2000).

²⁹ Under the National Cooperative Research and Production Act, 15 U.S.C. §§ 4301-06, participants in a joint venture can ordinarily ensure rule-of-reason treatment for their activities, exposure only to single damages, and an award of costs and fees in case of defense victory, by making disclosure of the venture to the Department of Justice. The Act requires that parties to the venture be U.S. persons.

³⁰ 540 U.S. 398 (2004).

³¹ 540 U.S. at 411-12 (internal citations omitted).

³² See, e.g., AMC REPORT, *supra* note 2, at 340 (acknowledging disagreement over *Trinko*'s import, but urging that it is “best understood only as a limit on refusal-to-deal claims under Section 2 of the Sherman Act; it does not displace the role of the antitrust laws in regulated industries.”).

³³ 49 U.S.C. § 10101(3). See also 49 U.S.C. § 10701(d)(2) (requiring that even in the one area in which the Board can regulate rates, challenges to the “reasonableness” of rates of a market dominant carrier—i.e., a monopolist—the Board must “recogniz[e] the policy of this [statute] that carriers shall earn adequate revenues”).

have traditionally been permitted to achieve adequacy is through “differential pricing.” In other words, policy has always contemplated that carriers would exploit market power where they have it to subsidize operations in competitive markets, in order to cover total costs.

The federal courts have long recognized a congressional mandate to balance shipper protection and competition, on the one hand, and against the carriers’ fiscal health, on the other.³⁴ Also likely, the courts in their reconciliation of antitrust with railroad policy will be influenced by the availability of regulatory remedies specifically designed to address anticompetitive abuses—the STB rate relief power for captive shippers and the competitive access remedies. It seems unlikely to matter that these remedies have been singularly burdensome and difficult for shippers, because the courts have already recognized as much and have done nothing about it.³⁵

In short, there is no particular reason yet to believe railroad exemption repeal will occur in this Congress. The pending bills have not progressed far and have failed before, and they are opposed by the industry. But if they progress, and assuming there is not also some significant change to the overall railroad regulatory framework, it seems unlikely that antitrust litigation will be very successful or that it will much change the status quo in rail competition.

³⁴ *MidAmerican Energy Co. v. STB*, 169 F.3d 1099, 1106 (8th Cir. 1999) (“[T]he Act protects both shippers and carriers. . . . [A]n important part of achieving revenue adequacy is differential pricing.”); *Midtec Paper Corp. v. United States*, 857 F.2d 1487, 1506-07 (D.C. Cir. 1988); *Coal Exporters Ass’n v. United States*, 745 F.2d 76, 80-81 (D.C. Cir. 1984)

³⁵ *See, e.g., MidAmerican Energy*, 169 F.3d at 1108.