Defining Markets and Market Power in Freight Rail: A U.S. Perspective

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In the merger context, defining markets is relatively straightforward

- The hypothetical monopolist test (HMT): Would a hypothetical monopolist of this set of goods or services profitably impose a small but significant and non-transitory increase in price (SSNIP)?
  - Note that this is an increase from the *current* price
- An antitrust market is "that which may be monopolized"
- Candidate product market for freight rail: shipment by rail of good X from origin O1 to destination D1
- What would prevent the HM from (profitably) imposing a SSNIP?

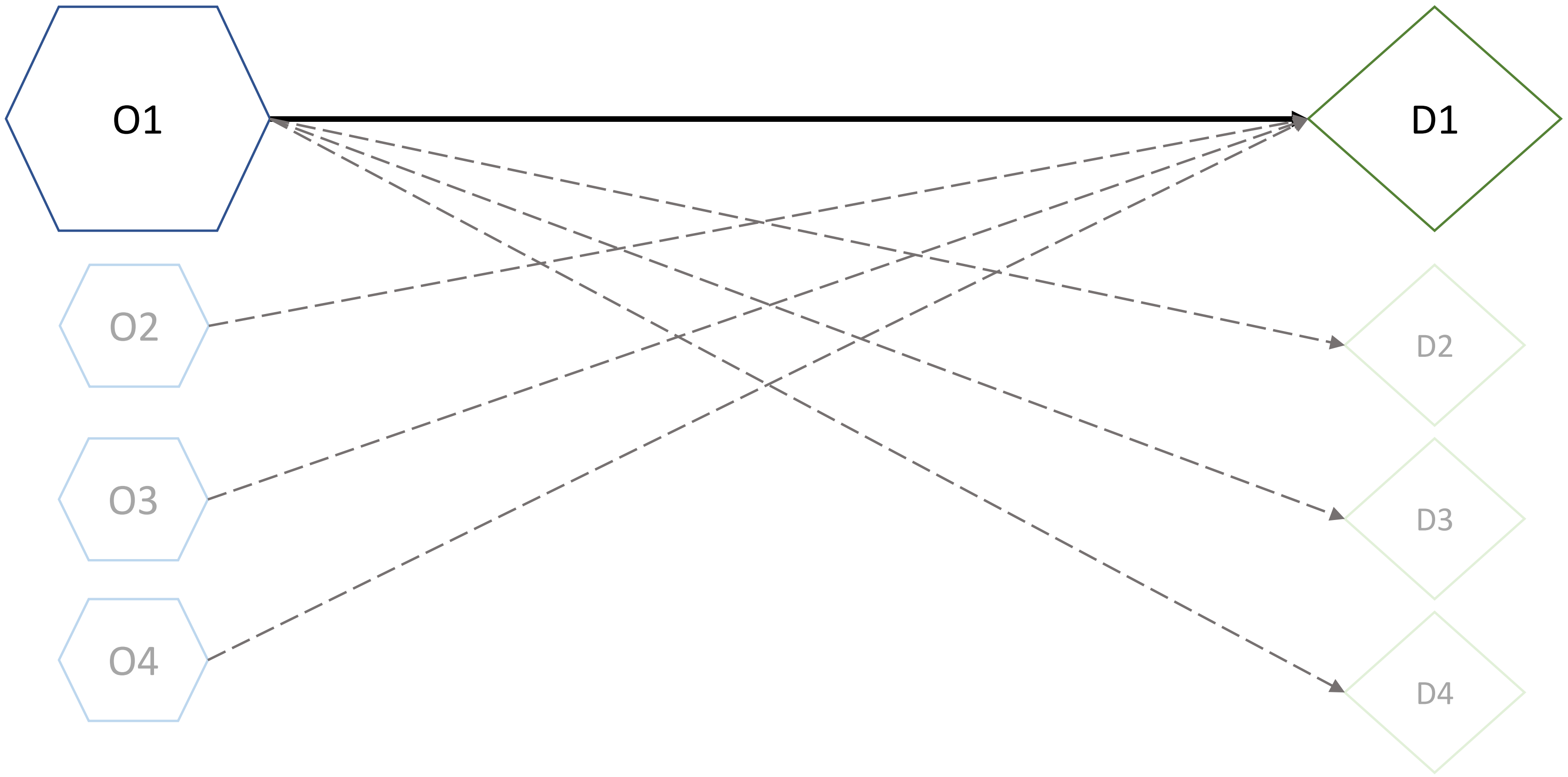
What would prevent the HM from profitably imposing a SSNIP?

- Intermodal competition
  - Usually motor carriers, sometimes water carriers
  - Motor carriers unlikely to be competitive for a) bulk products, b) traveling long distances, c) in large quantities
- Geographic competition
  - Source competition: Customer at destination D1 can economically acquire product X from alternative origin O2, via another rail carrier or another mode
  - Destination competition: Shipper at origin O1 can economically ship product X to alternative destination D2, via another rail carrier or another mode
- Product competition
  - Competition from other products Y and Z prevent HM from raising rates on X
  - Difficult to investigate, in practice least important of the 3

Alternative product markets in freight rail?

- Again, an antitrust market is “that which may be monopolized”
- Freight rail product markets may also (or alternatively) be based on geographic competition
  - Shipment by rail of product X from origin O1 to all destinations
  - Shipment by rail of product X to destination D1 from all origins
- USDOJ: Santa Fe/Southern Pacific merger vs. Conrail/Norfolk Southern merger
- This especially likely for homogeneous, non-differentiated products
  - A manufacturer of Toyota parts may need to have its parts sent to a particular Toyota assembly plant, while …
  - A coal mine may have many potential generation plant customers, and a generation plant may have many potential coal suppliers
  - However, if the origin or destination is served by one railroad only, either market definition alternative likely yields the same outcome

Origin-Destination markets and geographic markets



Geographic markets in freight rail

- If “shipment by rail” is the product market – either “from O1 to D1” (origin-destination pairs) OR “from O1” and “to D1” – what railroad companies are included in the market?
- Another way of saying this: How close must a railroad be to a shipper’s facility to act as a competitive alternative?
- For some shippers of some commodities, direct service required
- For others, a “nearby” railroad may act as a competitive alternative
  - “Transloading” potential – for example, grain
  - “Build-out” threat
  - Fact-specific: Varies by commodity and geography
  - In US rail mergers, has varied from “station” (SPLC-6) to county to BEA

BUT defining markets is NOT relatively straightforward in the monopolization/dominance context

- Does a firm have market power/monopoly power/dominance?
- This question seems to imply a second question: In what market?
- The problem: If a firm has market power, the hypothetical monopolist test is inappropriate for market definition
- The reason: A firm with market power should already be charging a high price, so that a SSNIP would NOT (necessarily) be profitable
- This goes by the name "the cellophane fallacy," from the US Supreme Court decision in *U.S. v. E.I. du Pont* (1956)

So how determine if a firm has market power/monopoly power/dominance?

- And by the way, is this the same issue as the "absence of competition" (Ley Reglementaria del Servicio Ferroviario, amended January 2015)? I defer to others on that.
- Use other, "direct" evidence of market power, lack of economic alternatives.
    - Lack of history of shipping by other carriers or modes
    - Objective reasons for lack of history of shipping by other carriers or modes
    - High prices and/or mark-ups compared to otherwise similar shipments facing competition (similar to Wilson/Wolak)
    - Persistence of high firm-level profitability (similar to "revenue adequacy")

In summary

- Market definition is hard when evaluating the presence or absence of market power
- However, more “direct” indicators of market power may be straightforward to look for and evaluate
- Is market power like pornography?
  - “I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description [‘hard-core pornography’], and perhaps I could never succeed in intelligibly doing so. But I know it when I see it….” (U.S. Supreme Court justice Potter Stewart, in *Jacobellis v. Ohio* [1964])

Recommended Reading

- George W. Stocking and Willard F. Mueller, "The Cellophane Case and the New Competition," *American Economic Review* 45 (1955), 29-63
- Russell Pittman, "Railroads and Competition: The Santa Fe/Southern Pacific Merger Proposal," *Journal of Industrial Economics* 39 (1990), 25-46
- Gregory J. Werden, "Market Delineation under the Merger Guidelines: Monopoly Cases and Alternative Approaches," *Review of Industrial Organization* 16 (2000), 211-218
- Lawrence J. White, "Market Power and Market Definition in Monopolization Cases," in ABA Section on Antitrust Law, *Issues in Competition Law and Policy*, 2008, https://www.justice.gov/atr/market-power-and-market-definition-monopolization-cases-paradigm-missing-0
- ABA Section on Antitrust Law, *Market Definition in Antitrust: Theory and Case Studies*, 2012, chapter 6, "Transportation Markets"