

FD 30400

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Pgs.

13501-13559

BEFORE THE

INTERSTATE COMMERCE COMMISSION

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In the Matter of: :

SANTA FE SOUTHERN PACIFIC CORPORATION : Finance Docket

-- CONTROL -- : 30400 et al.

SOUTHERN PACIFIC TRANSPORTATION :

COMPANY :

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Hearing Room A

12th & Constitution, N.W.

Washington, D.C.

Thursday, May 2, 1985

The hearing in the above-entitled matter was convened, pursuant to notice, at 9:00 a.m.

BEFORE:

JAMES E. HOPKINS,

Administrative Law Judge

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APPEARANCES:

(As heretofore noted.)

0066-0007

C O N T E N T S

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WITNESS

DIRECT CROSS REDIRECT RECROSS

Richard H. Klem

By Ms. Reed	13,503	
By Mr. Kharasch		13,507
By Mr. Livingston		13,689

E X H I B I T S

Exhibit No.

Identified Received

MKT-C-91	13,506	
MKT-C-93	13,506	
MKT-C-94	13,510	
MKT-C-95	13,545	
UP/M-C-79	13,704	

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P R O C E E D I N G S

1
2 JUDGE HOKKINS: Let's get back on the record.

3 Who is handling it, Mr. Smith or Ms. Reed?

4 MS. REED: Your Honor, we would like to call
5 -- the United States Department of Transportation would
6 like to call Richard H. Klem.

7 Whereupon,

8 RICHARD H. KLEM

9 was called as a witness, and having been first duly
10 sworn, took the stand, and was examined and testified as
11 follows:

DIRECT EXAMINATION

12
13 BY MS. REED:

14 Q Would you please state your name and address
15 for the record?

16 A My name is Richard Klem. My address is 400
17 7th Street, Southwest, Washington, D.C.

18 Q Have you previously submitted a verified
19 statement in this proceeding which has been marked as
20 DOT-3?

21 A Yes, I have.

22 Q And have you previously submitted an errata to
23 that statement which has been marked DOT-4 and DOT-6?

24 A Yes, I have.

25 Q Do you have any additional changes or

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1 corrections that you would like to make to your verified
2 statement at this time?

3 A Yes, I have.

4 On DOT-6, the last page, there is a new flow
5 number, 18. Directly underneath the 18 should be a 20.
6 This is on the last page of DOT-6. A flow number was
7 deleted. The information on that flow was contained,
8 but the flow number 20 is deleted. The 20 goes right
9 beneath the 18.

10 In the verified statement, Section 2, Page 15,
11 the first footnote, the number should be 146 flows.

12 MR. HYMSCN: Would you repeat that?

13 THE WITNESS: The number in footnote star Page
14 15 should be 146 flows. Appendix B, Page 3, Paragraph
15 3, Line 3, the number should be 29.

16 MR. RAKER: What page?

17 THE WITNESS: Appendix F, Page 3, Paragraph 3,
18 Line 3. It should be 29.

19 MR. KHARASCH: Last line on the page?

20 THE WITNESS: Yes, I believe that is correct.
21 I will look. That is correct. Page 4, same appendix,
22 Page 4, the next page, Paragraph 2, Line 8, the number
23 should be 62 and 73. The same page, Paragraph 3, Line
24 7, the number should also be 73. That is the very last
25 of the page.

1 Also on that page, Paragraph 2, Line 4, the
2 script 2 should be a script 5.

3 MR. KHARASCH: Sir, the original text read 3.
4 Then it was corrected to 2, and now it is recorrected to
5 5. Is that right?

6 THE WITNESS: That is correct. Finally, on
7 the notice to parties just prior to the confidential
8 appendix the number should read 69.

9 BY MS. REED: (Resuming)

10 Q Do you have any other corrections to your
11 verified statement?

12 A No.

13 Q With these corrections, is it true and correct
14 to the best of your knowledge?

15 A Yes, it is.

16 MS. REED: I tender the witness for cross
17 examination.

18 JUDGE HOPKINS: Who is first, Mr. Kharasch?

19 MR. KHARASCH: Your Honor, it might speed
20 things up if we could mark some of the counsel's
21 exhibits now and not interrupt later.

22 Could we have marked as MKT-C-91 the verified
23 statement of Edward B. Hymson, H-y-m-s-o-n, dated August
24 31, 1981, on behalf of United States Department of
25 Transportation?

1 JUDGE HOPKINS: It will be marked for
2 identification as MKT-C-91.

3 (The document referred to
4 was marked for
5 identification as Exhibit
6 Number MKT-C-91.)

7 MR. KHARASCH: Could we have marked as
8 MKT-C-92 a brief of the United States Department of
9 Transportation, March 8, 1982, in Finance Docket
10 3C,000?

11 JUDGE HOPKINS: It will be marked for
12 identification as MKT-C-92.

13 The document referred to was
14 marked for identification as
15 Exhibit Number MKT-C-92.)

16 MR. KHARASCH: May we have marked as Exhibit
17 MKT-C-93 five pages from Dr. Klem's work papers which
18 unfortunately are not paginated themselves. The first
19 page has some handwriting which is fully the equivalent
20 of mine, and it says gain equals 11,348.

21 JUDGE HOPKINS: It will be marked for
22 identification as MKT-C-93.

23 The document referred to was
24 marked for identification as
25 Exhibit Number MKT-C-93.)

CROSS EXAMINATION

1
2 BY MR. KHARASCH:

3 Q Let me also hand you a copy of MKI-C-89, some
4 helpful diagrams. Dr. Klem, let's start with Page 1 of
5 your statement. In Page 1, in Paragraph 1, you talk
6 about our review of the potential competitive impacts of
7 the proposed merger. Do you see that in Paragraph 1?

8 A Yes, I do see that.

9 Q And then in the footnote with three asterisks,
10 you give us four statutory issues that you are not
11 considering.

12 A That's correct. The statement was limited in
13 its analysis to the competitive analysis of the merger.

14 Q Now, I do not find on Page 1 the statutory
15 issue you are addressing. Is it the competitive,
16 potential competitive impacts of the proposed merger?

17 A This is a competitive analysis of the merger.

18 Q What is it that the statute directs the
19 Commission to consider other than the four items in the
20 footnote? Do you know?

21 A I cannot tell you the exact language. I can
22 say that Commission decisions, at least the ones that I
23 have worked on, have directed themselves at competitive
24 impacts of mergers.

25 Q What would you think of the Congress passing a

1 statute that directed the Commission to look in a rail
2 merger at the effect on competition among rail carriers
3 -- I emphasize among rail carriers -- in the region
4 affected? Is that a good idea?

5 A Language such as that is subject to a variety
6 of interpretations, but it appears to be a direction to
7 look at competitive impacts.

8 Q How about competition among rail carriers. I
9 am asking you, is it a good idea for the Congress to
10 pass such a statute?

11 A As I say, I believe that that language is
12 subject to a variety of interpretations. I am not a
13 lawyer, but I do think it is a good idea to address
14 competitive impacts of mergers.

15 Q We understand you think it is a good idea to
16 address competitive impacts. Now, my question to you
17 is, is it a good idea for the Congress to pass a statute
18 directing the Commission to look in a merger proceeding
19 to the effect on competition among rail carriers in the
20 affected region?

21 MS. REED: Your Honor, I object. That
22 question has been asked and answered. I also object on
23 the relevance to this proceeding.

24 JUDGE HOKKINS: I am going to allow it. Go
25 ahead.

1 THE WITNESS: As I said, I am not a lawyer,
2 but if forced to interpret that, I would interpret that
3 language to mean that the Commission should address the
4 competitive impacts of the merger. Therefore I would
5 think it is a good idea.

6 Q It is a good idea?

7 A Because it appears to instruct the Commission
8 to address the competitive impacts of the merger.

9 Q Did you tell me earlier that you knew what the
10 fifth and omitted section of the statute was that is not
11 covered by your footnote with the three stars?

12 A I did, yes. I said, well, I do know
13 approximately what it is. I don't recall the exact
14 language.

15 Q Let me read you the language. The Commission
16 shall consider at least the following, "whether the
17 proposed transaction would have an adverse effect on
18 competition among rail carriers in the affected
19 region."

20 Is that a surprise to you?

21 A No, I did expect that, given the earlier
22 question, and it does confirm my interpretation that the
23 language does mean that the Commission should address
24 the competitive impacts.

25 MR. KHARASCH: May we have one more exhibit

1 marked, Your Honor, as MKT-C-94? It is a four-page item
2 beginning on the top Legislative History, PI-96-448,
3 popularly known as the Staggers Act.

4 JUDGE HOPKINS: It will be marked for
5 identification as MKT-C-94.

6 (The document referred to
7 was marked for
8 identification as Exhibit
9 Number MKT-C-94.)

10 BY MR. KEARASCH: (Resuming)

11 Q Have you in your time at the Interstate
12 Commerce Commission or the Department of Transportation,
13 Dr. Klem, had reference to the legislative history of
14 the Staggers Act in order to understand what the
15 Congress meant when it provided this fifth statutory
16 subject for the Commission's investigation in merger
17 proceedings?

18 A I have certainly looked at the legislative
19 history of the Staggers Act a number of times. Whether
20 I looked at this particular item, I can't recall.

21 Q But is it not this particular item that your
22 testimony is directed to today?

23 A I haven't read this particular item.

24 Q No, no, is it not this particular item, this
25 particular section, the merger section of the Staggers

1 Act that your testimony is directed to today? That is
2 whether the proposed transaction would have an adverse
3 effect on competition among rail carriers.

4 A Would you direct me to that here?

5 Q Oh, would you like to see the Staggers Act
6 section?

7 A No, I just want to know what you are referring
8 to.

9 Q If you look at the last page of the exhibit,
10 Page 24,879 of the Congressional Record of the House,
11 look at the center paragraph, sir, part of the way
12 down.

13 A As I propose, where it is a new paragraph?

14 Q That is correct.

15 A This I have read, yes, actually.

16 Q Oh, you have read this page of the
17 Congressional Record?

18 A This page or an adjacent page. I am familiar
19 with this debate. As I recall, what they said in
20 essence was that they wanted to make the competitive
21 impacts of the merger formerly a part of the law.

22 Q Now, my question to you specifically is, is
23 your testimony that we are considering today testimony
24 directed to that part of the law which reads "whether
25 the proposed transaction would have an adverse effect on

1 competition among rail carriers in the affected
2 region."

3 A As I said, I am not a lawyer, but it would
4 appear to be directed at that. Whether or not it is
5 directed at some additional section, I could not tell
6 you.

7 Q During your time at the Interstate Commerce
8 Commission which is described in Appendix A to your
9 statement, you say you gave economic advice to the
10 Commission.

11 A That's correct.

12 Q Was your economic advice generally concerned
13 with rail or trucking or both?

14 A Both.

15 Q During your time at the Commission, were the
16 ICC guidelines in merger proceedings adopted?

17 A That is correct.

18 Q Did you have some input to that?

19 A I don't recall.

20 Q Have you read the guidelines in merger
21 proceedings?

22 A Yes, I have.

23 Q What do they say about parallel mergers?

24 A They express a concern about loss of
25 competition resulting from -- I am paraphrasing now,

1 because there are multipages, and I am not a lawyer, and
2 I don't remember legal language well, but what they said
3 was, they were concerned about the loss of competition
4 that could result from elimination of competition when
5 two carriers have parallel routes and cease to compete
6 with each other. They are concerned about, amongst
7 other things, a loss of such intramodal competition.

8 Q During your time at the Commission -- strike
9 that.

10 Do you see on Pages 4 and 5 of your statement
11 you are citing a lot of court cases and some ICC
12 decisions? I am sorry, you are citing ICC decisions.

13 A I believe both ICC decisions and court
14 decisions.

15 Q You cite CSX and Norfolk Southern and
16 Guilford.

17 A That's right.

18 Q Now, do you believe, did you believe in
19 preparing your testimony in this case that you should
20 follow the guidance given by the ICC in its merger
21 decisions to determine what factors should be examined,
22 what factors were important, and how one should proceed
23 in assessing a merger?

24 A That's correct. Having read a number of ICC
25 merger decisions, and having worked on some of them, I

1 can see that there is a pattern to them that needs to be
2 followed.

3 However, there is a considerable variance from
4 decision to decision, because each decision reflects the
5 individual facts of that particular case, which vary
6 considerably, and the Commission's thinking evolves from
7 case to case.

8 So, as a result, I built on what I knew about
9 earlier Commission decisions, and used that as a base.

10 Q Now, in your citations which you give us at
11 Pages 4 and 5 of your decision, I do not find the
12 Finance Docket 30,000 UP decision, UP/MP/WP. Do you not
13 consider that valuable guidance of the Commission?

14 A I definitely do consider that valuable
15 guidance of the Commission.

16 Q And is that not the biggest of recent mergers?

17 A It is not the most recent merger.

18 Q Now, let's look at a recent decision. During
19 your time at the ICC, the Commission gave its September
20 26th, 1984, decision in the Milwaukee acquisition cases,
21 one involving the Sioux Line, and the Northwestern, and
22 so on.

23 Is that correct?

24 A I can't remember the dates, but that sounds
25 correct.

1 Q Did you participate and give your guidance to
2 the Commission in that case?

3 A No.

4 Q Have you ever read that case?

5 A Yes. Indeed, I did take guidance from that
6 case. I think the one area in particular, I found that
7 case particularly useful.

8 JUDGE HOPKINS: Can you hear him over there?

9 MR. LEARN: Barely.

10 JUDGE HOPKINS: Would you please speak up?

11 BY MR. KHARASCH: (Resuming)

12 Q Do you agree with the Commission's statement
13 on Page 45 of that decision that this fifth section of
14 the merger section that we have been talking about was a
15 codification of the important role competition has
16 traditionally played in the Commission's decisionmaking.

17 MS. REED: Would counsel please show the
18 witness?

19 THE WITNESS: I would like to get it from my
20 box over there. Or you could give it to me.

21 JUDGE HOPKINS: Sure, go ahead.

22 MS. REED: What page was that?

23 MR. KHARASCH: Try Page 45.

24 THE WITNESS: Are you referring to the place
25 where it restates the fifth condition?

1 BY MR. KHARASCH: (Resuming)

2 Q Let's lock right up in the middle of the page,
3 right up above statutory policy, the first four factors
4 of the statutory criteria for many years. The fifth was
5 added by Section 228(a)(2) of the Staggers Act as a
6 codification of the important role competition has
7 traditionally played in the Commission's decisionmaking
8 regarding Section 11344 transactions.

9 A Yes, that is basically a more artful way of
10 saying what I was trying to say in describing this
11 section earlier.

12 Q That is right. Now, did you attempt to follow
13 the teaching of the Commission in this recent Finance
14 Docket 28,640 decision in making your testimony here?

15 A 28,640? Okay, that is this one.

16 Q Yes.

17 A Broadly I did that, yes. I tried to follow
18 all the teachings of the Commission.

19 Q Let's get a little more specific. Down in the
20 middle of the last paragraph on Page 45 of this
21 Milwaukee decision which you have in front of you, the
22 Commission quotes the Rail Transportation Policy and
23 says the Commission should ensure the development and
24 continuation of a sound rail transportation system with
25 effective competition among rail carriers, and with

1 other modes, and I have emphasized the words "among rail
2 carriers."

3 Have you followed that teaching in your
4 testimony here?

5 A That is correct, a substantial portion of my
6 testimony was directed at the issue of intramodal
7 competition, which is what the first half of that is,
8 and another substantial portion of it was directed at
9 intermodal competition, which is the second half of
10 it.

11 And the bulk of the remainder was directed at
12 geographic competition, which is in economic terms --
13 involves competition among railroads and with other
14 modes, so it encompasses both of them.

15 So, I would say that the vast majority if not
16 perhaps all of my testimony relates to these specific
17 issues.

18 Q What is the market that the Commission
19 considered in this recent Milwaukee case when they
20 define the market?

21 MS. REED: Your Honor, I am going to object to
22 questioning on this. Counsel did not inform us ahead of
23 time that he was going to be asking us questions about
24 probably a 150-page document that was issued by the
25 Commission, and I believe it is unfair to ask the

1 witness detailed questions on the Commission's analysis
2 in that case without having informed us as required
3 under the 24-hour rule.

4 MR. KHARASCH: I am content the witness says
5 he doesn't know what market the Commission considered in
6 that recent Milwaukee case.

7 JUDGE HOPKINS: Can you answer the question?

8 THE WITNESS: In a sense. I don't understand
9 what you mean.

10 BY MR. KHARASCH: (Resuming)

11 Q The relevant product market. Does that help
12 you?

13 A I understand the question, and I understand
14 that in rail mergers there is not a single market. Rail
15 firms do not compete in single markets. That was the
16 problem I was having. He asked me for the definition
17 of --

18 JUDGE HOPKINS: Have him explain. If you have
19 any questions, ask him for an explanation. Just don't
20 go ahead and answer. If you don't know, just say I
21 don't know.

22 BY MR. KHARASCH: (Resuming)

23 Q Do you know whether in the Milwaukee case the
24 Commission said the relevant product market is rail
25 freight transportation?

1 A I couldn't be certain. I don't remember any
2 language in there relating to the use of truck
3 transportation.

4 Q In discussing the relevant product market in
5 the UP/MP case, do you know whether the Commission
6 determined that the relevant product market is rail
7 freight transportation?

8 A I do know that is the case, yes.

9 Q And do you know that in the UP/MP case there
10 was sort of an economic appendix in which the Commission
11 discussed why it was considering rail freight
12 transportation?

13 A I am familiar with that appendix.

14 Q Did you contribute to that appendix?

15 A No, I did not.

16 Q Do you agree with this statement?

17 MS. REED: Excuse me, counsel. Could you
18 please inform the witness as to the page and paragraph
19 so that he can read it in context?

20 BY MR. KHARASCH: (Resuming)

21 Q Here is a copy of extracts, a copy of
22 MKT-C-70.

23 MS. REED: What page are we referring to?

24 MR. KHARASCH: Page 503 of the UP/MP decision,
25 the third page of that exhibit. The heading Market

1 Defintion.

2 BY MR. KFARASCH: (Resuming)

3 Q Do you see the Commission's statement -- let's
4 start with the first sentence, "The first step in
5 analyzing any consolidation is to define the markets
6 that the merger is likely to effect." Do you agree with
7 that?

8 A A sentence like that has also a lot of
9 interpretations because of the word "first step."
10 Certainly defining markets is an essential part of any
11 such analysis.

12 Q Let's turn down toward the bottom of Page 503,
13 under the heading Product Market. The Commission says
14 "A relevant product market requires a grouping together
15 of products that are reasonably interchangeable."

16 Do you agree or disagree?

17 A That is correct. In the history of this there
18 is a body of literature which is extremely substantial
19 which gets into the question of what is reasonably
20 interchangeable because of the fact that there is never
21 a bright line around the market.

22 There are always products and geography and so
23 forth which are an issue as to whether or not they are
24 in the market or out of the market, and very often it is
25 quite a close call as to whether a decision is made to

1 include a certain activity in the market or not in the
2 market.

3 Q Let's turn the page, please, so that we are
4 looking at the sheet that has Pages 504 and 505 of the
5 Commission's expressed wisdom. The first sentence on
6 Page 504, the first new paragraph says "The product sold
7 by railroads is the transportation of freight." Do you
8 agree with that or not?

9 A That is a short sentence to describe a
10 complicated product, one of the more complicated
11 products that any industry sells, but generally
12 speaking, yes.

13 A Now, let's go down to the paragraph just above
14 geographic market. Do you see where the Commission says
15 "Finally, evaluation rail freight transportation as a
16 separate product market is consistent with the mandate
17 to consider whether the proposed transaction will have
18 an adverse effect on competition among rail carriers in
19 the affected region."

20 Do you see that sentence?

21 A Yes.

22 Q Tell us if you know whether in the UP/MP
23 merger the Commission evaluated rail freight
24 transportation as a separate product market.

25 A It is my understanding and recollection that

1 the Commission has considerable power to interpret this
2 phrase, and in those two cases they chose to interpret
3 it in the way somewhat like you have described.

4 Q I have a very specific question for you. Tell
5 us if you know whether in the UP case the treatment
6 evaluated rail freight transportation as a separate
7 product market.

8 MS. REED: Your Honor, I object. That was
9 asked and answered.

10 JUDGE HOPKINS: No, it wasn't. Go ahead,
11 answer the question.

12 THE WITNESS: I think the point here is --

13 JUDGE HOPKINS: I am sorry. I know you are
14 objecting to these questions, but I am going to give a
15 lot of leeway on cross examining on all sides of this
16 witness. I think it is necessary. All right, go
17 ahead.

18 THE WITNESS: I had an answer and I forgot
19 what it was. Could you give me the question again?

20 B: MR. KFARASCH: (Resuming)

21 Q Yes, for the third time, tell me if you know
22 whether in the UP/MP merger the Commission evaluated
23 rail freight transportation as a separate product
24 market.

25 A I think the point here is that railroads

1 compete in a variety of ways, and that competing with
2 each other, intramodal competition is indeed an
3 important way that they do compete. It is appropriate
4 to look at that as the Commission has in the past.

5 However --

6 Q Sir, can't you answer my question instead of
7 telling me something I am not asking?

8 JUDGE HOPKINS: Finish the answer that you are
9 giving and then try to answer the specific question that
10 was asked by Mr. Kharasch.

11 THE WITNESS: I am laying a foundation --

12 JUDGE HOPKINS: Go ahead.

13 THE WITNESS: What I am saying is that
14 railroads compete in a lot of markets, and one of them
15 is intramodal competition, and it is widely known that
16 they also compete with trucks. It is not arguable any
17 more that railroads do in fact compete at some level
18 with trucks.

19 The issue is, which side of the dividing line
20 are they on at this point, and in the past the
21 Commission may have decided to draw the line on this
22 side of the trucks.

23 But with the Motor Carrier Act of 1980 being
24 fully implemented and the large number of new carriers
25 that are in existence, the larger size of trucks, the

1 higher weight limits on the highways, and so forth and
2 so on, I think that is a question that needs to be
3 evaluated in this merger and I have evaluated in this
4 merger.

5 And I have come up with an answer that I am
6 quite comfortable with, and I believe the Commission
7 should draw the line this time on the other side of
8 trucks.

9 MR. KHARASCH: Your Honor, I move to strike
10 that answer on the ground that --

11 JUDGE HOEKINS: No, I like that. I want to
12 hear the whole answer.

13 BY MR. KHARASCH: (Resuming)

14 Q Now may I have an answer to my question?

15 JUDGE HOEKINS: You had an answer. He said
16 yes. Didn't you say yes?

17 THE WITNESS: I said yes.

18 BY MR. KHARASCH: (Resuming)

19 Q Yes, the Commission evaluated rail freight
20 transportation as a separate product market in the UP
21 case?

22 A I said yes, that was one thing that they did
23 do.

24 Q Okay, now, let's move on to the Milwaukee
25 case. Did they evaluate rail freight transportation as

1 a separate product market in the Milwaukee case?

2 A Same answer.

3 Q Yes, they did?

4 A Yes, with all of the other preface.

5 Q Has the rail-truck competition situation
6 changed notably since September 26th, 1984?

7 A I don't think that is the right date to
8 choose.

9 Q That is the date I am choosing in my
10 question.

11 JUDGE HOPKINS: Why don't you answer the
12 question the way he has given it?

13 THE WITNESS: Okay. I can do the same as last
14 time, right?

15 JUDGE HOPKINS: Not as extensively.

16 THE WITNESS: No, I will do it as quick as I
17 can. Give me the date again.

18 BY MR. KEARASCH: (Resuming)

19 Q September 26, 1984.

20 A I would say that the competitive impact of the
21 changes in the Motor Carrier Act and the truck sizes and
22 weights are continuing to be felt during this period,
23 but that is not a very long period, so I can't quantify
24 how much the change has been.

25 But that is one period within which this

1 change has taken place. So the answer is, I can't say
2 how much it has changed since then, but it is only a
3 part of a period over which it has changed.

4 Can I say why I didn't think that was the
5 right date?

6 JUDGE HOPKINS: Go ahead.

7 THE WITNESS: I assume that is the date the
8 decision was served or something. And merger
9 proceedings take an extended period of time. This
10 decision is not going to be served today, so I don't
11 think it is a fair comparison to make of the time period
12 between which the changes have occurred.

13 MR. KHARASCH: Your Honor, if we are going to
14 have a discussion with the witness as to whether it is a
15 fair period --

16 JUDGE HOPKINS: I agree with Mr. Kharasch. We
17 can't go too far, Doctor. Try to limit your answers, if
18 you can, and don't have an argument back and forth with
19 Mr. Kharasch. We have got to finish some time within
20 the next year or so. Go ahead.

21 BY MR. KHARASCH: (Resuming)

22 Q Did the Commission issue a second decision in
23 the spring of this year in the Milwaukee case approving
24 the Sioux acquisition?

25 A Yes, that is right.

1 Q And did they approve the Sioux acquisition, if
2 you know, because the Sioux's proposal was less
3 anticompetitive than the Chicago North Western proposal,
4 if you know?

5 A That was an aspect of it certainly, a very
6 important aspect of it.

7 Q And since the spring of this year when the
8 Commission issued its second decision in the Milwaukee
9 case, is there any change in trucking competitiveness?

10 A As I said, it is a continuing process. I am
11 aware of the fact that a large number of truckers are
12 buying larger trailers, for example, and implementing
13 the twin trailer operation, so it is a progressive
14 progress. As time evolves, and as time evolves over the
15 next year, the truckers will continue to get more
16 competitive.

17 Q Would I gather from your earlier statements
18 that the reason you did not follow the Commission's
19 method in the UP case or in the Milwaukee case was that
20 you think facts have changed since the Commission was
21 considering the facts in those cases?

22 MS. REED: Your Honor, I object to his
23 characterization that the witness did not follow the
24 Commission's guidelines in those cases.

25 JUDGE HOPKINS: I agree. First of all, ask

1 him whether he did follow it. Now, I know your
2 questions are given in a certain way, but the
3 characterization might not be correct.

4 MS. REED: Secondly, Your Honor, I would
5 question counsel's characterization that the Commission
6 did not consider trucking in the Milwaukee case. If I
7 recall correctly, they considered it in looking at grain
8 transportation.

9 JUDGE HOPKINS: Now, you are testifying like
10 everybody else has in this case.

11 MS. REED: That is right, Your Honor.

12 JUDGE HOPKINS: Go ahead, Mr. Kharasch.

13 BY MR. KEARASCH: (Resuming)

14 Q In your investigations in this case, did you
15 follow the procedure in determining the relevant product
16 market that the Commission indicated in the UP case
17 which we were examining it would do in defining the
18 market?

19 A Yes, I believe that I did.

20 Q Let's turn to the preparation of your
21 statement, sir. Your statement has been corrected by an
22 extremely extensive set of errata circulated once and
23 then by a second set of errata, and then by an errata to
24 the errata. Why were there so many corrections?

25 A Basically I would say perhaps the majority of

1 the corrections resulted from the fact that the day
2 after I submitted the verified statement, I received a
3 call from Bob Hassek of the ICC saying that a new tape
4 was in the mail, that -- this, by the way, is the tape
5 which relates to the revenue to variable cost
6 analysis.

7 This is a tape from Ex Parte 399. And he told
8 me that the new tape differed from the old tape in that
9 a substantial number of TCFC way bills had been left off
10 the earlier tape inadvertently by the ICC, so at that
11 time I decided it was necessary to rerun all of the
12 analysis that relied on that tape. That meant
13 resubmitting -- perhaps it was 20 pages of printouts in
14 tables and so forth, and making a number of changes in
15 the text. That is the bulk of it, I would say probably
16 the bulk of the remainder was actually an error on my
17 part, a failure of communication between myself and the
18 computer programmer that one of these screens was
19 applied in the wrong order. The sequencing of screens
20 makes a difference in the results.

21 In this case it made a very small difference
22 in the results, and because the difference was so small,
23 it was not an easy thing to catch. And I only caught it
24 after the process of retracing each of my steps
25 throughout the analysis.

1 That was the bulk of the remainder. I might
2 add that because there are various numbers scattered
3 throughout the text, that those changes in the computer
4 analysis did require making various changes in the body
5 of the text.

6 Q Now, you arrived at the Department of
7 Transportation in December, 1984, Dr. Klem?

8 A The second time. I was employed there once
9 before, but the second time, yes.

10 Q What date?

11 A December 9th.

12 Q Did you immediately begin working on this
13 project, this case?

14 A That's correct.

15 Q And your testimony was filed the 21st of
16 March, 1985.

17 A That's correct. It is not quite correct to
18 subtract those two numbers and get a time period,
19 though, because I first discussed this position with
20 Chris Rooney, who hired me in September, and I expected
21 to be hired shortly after Labor Day.

22 So, during that period, on my own time, I did
23 read some of the record on that case to become more
24 familiar with it.

25 Q You were employed at the Interstate Commerce

1 Commission in September, October, November of 1984?

2 A That's correct. I was not working on this
3 case, of course, but I was employed by the Interstate
4 Commerce Commission.

5 Q During that time you were working on the
6 preparation of your statement that is now the exhibit in
7 this case?

8 A As I previously said, on my own time I read
9 some of the record.

10 Q What did you read of the record?

11 A The initial statements of some of the parties.

12 Q Which?

13 A I can't recall all that I did read.

14 Q In the exhibit called MKT-C-88, I have a
15 memorandum with blacked out pieces of paper, and that is
16 dated February 5, 1985. And it says "Our analytical
17 efforts are still under way. We anticipate circulating
18 a memo to principals by February 8, recommending a DOT
19 position."

20 First question: Did you receive a copy of
21 this memo?

22 MS. REED: Show the witness a copy.

23 THE WITNESS: May I see it? It looks
24 familiar, but I would like to have it in my hands. You
25 are referring to the one on the top of the stack?

1 MR. KHARASCH: Yes.

2 THE WITNESS: Yes, this is a regularly
3 scheduled regulatory filings coordination. I probably
4 did receive this one. I don't know.

5 BY MR. KEARASCH: (Resuming)

6 Q Did you see or do you know whether a memo was
7 circulated to principals by February 8th recommending a
8 DCT position?

9 A That did not occur.

10 Q That did not occur. Who are Reed, Tarleton,
11 Kedar, Bachner, Gelston, and Marvich?

12 A DCT staff. Reed is counsel.

13 Q Distinguished counsel.

14 A Others are economists and other analysts on
15 DOT staff.

16 Q The next memo is dated February 28th, 1985,
17 and that says a staff recommendation of the DOT position
18 in this proceeding will be circulated this week. We are
19 in process of preparing our verified statement which
20 will present the department's views.

21 Would you take a look at that one? Did you
22 receive a copy of that?

23 A Presumably I did. I don't recall seeing this
24 one, but it is another of the regulatory filings and
25 coordination memos, so I probably did.

1 Q Are you on the regular distribution list for
2 that stuff?

3 A Yes.

4 Q Now, is it true -- did it happen that a staff
5 recommendation of the DCT position in this proceeding
6 was circulated this week of February 28th?

7 A I don't believe that it did.

8 Q Let's turn over to a memorandum which is the
9 third page of MKT-C-88, and the black stuff is spreading
10 on us here, but it is headed Proposed Position of DOT
11 and SFSP Merger, and that is dated March 14, 1985.

12 Do you see that?

13 A Yes, I do.

14 Q Now, that memo says, "Attached is a rough
15 draft of the proposed verified statement of Richard
16 Klem." Did you receive a copy of that memo?

17 A I don't believe that I did.

18 Q Had you on March 14th prepared a "rough draft"
19 of your testimony?

20 A I can't remember the date, March 14th, but I
21 believe so. Somewhere in that time period.

22 Q It was pretty pushed that last week, wasn't
23 it?

24 A I can't remember the exact date of that
25 draft.

1 MS. REED: We will stipulate that it was quite
2 pushed.

3 JUDGE HOPKINS: Including counsel?

4 MS. REED: Yes, Your Honor, it was.

5 BY MR. KHARASCH: (Resuming)

6 Q Had you prepared a rough draft about seven
7 days before submitting your testimony?

8 MS. REED: Your Honor, I object, because it
9 says that a rough draft was circulated. That does not
10 mean that earlier rough drafts --

11 MR. KHARASCH: I am asking the witness a
12 question.

13 JUDGE HOPKINS: I don't see any problem.

14 THE WITNESS: I have to ask. There was a
15 rough draft that had been done prior to the 14th.

16 BY MR. KHARASCH: (Resuming)

17 Q Let me show you on MKT-C-88 a memorandum that
18 appears to be dated March 18th from Mr. Marquez to the
19 Secretary. Have you seen a copy of that document?

20 A I have seen a similar Xerox with the blacked
21 cut part which counsel showed me a few days ago, and I
22 believe I have seen drafts of that memo.

23 Q Drafts of this memo which was dated the 18th.

24 A That's correct.

25 Q And when did you see those drafts of the memo

1 dated the 18th?

2 A I don't recall.

3 Q Let me show you a memo which has now achieved
4 the distinction of having no contents at all that is
5 legible, dated Tuesday, March 19th. Do you see that
6 one?

7 A Right. That piece of paper or one similar to
8 it I have seen, but based on what I can see on there,
9 which is only really the to and from and subject, I am
10 certain I have not seen that memo.

11 Q Were there changes made in your testimony
12 between the 14th of March and the 21st of March?

13 MS. REED: Could counsel clarify what he
14 means by changes?

15 MR. KHARASCH: Let us have the witness answer
16 changes.

17 JUDGE HOPKINS: I am going to allow it the way
18 you asked. Go ahead. He is perfectly capable of
19 answering a question like that.

20 THE WITNESS: There were changes in the nature
21 of seeking out errors and so forth, not entirely
22 successful. That was the sort of change that was
23 made.

24 BY MR. KHARASCH: (Resuming)

25 Q You told me that you had seen at least, I

1 believe, a draft of the memorandum dated the 18th of
2 March. That specific memo you saw?

3 A That is correct. I saw a draft which I
4 reviewed for correctness of the summary of my
5 statement. In other words, the bulk of that memo as I
6 recollect is a summary of my statement, and I reviewed
7 it to verify that it was correct.

8 Q Now, other than changes which are changes of
9 grammar or changing -- wait, let me ask you a
10 preliminary question.

11 Some of the computer printouts which are in
12 your work papers which are apparently backups for
13 materials that appear as tables in your statement are
14 dated March 18th. That is three days before the 21st.
15 Is that correct?

16 A I don't recall.

17 Q Were you receiving at late as March 18th
18 computer printouts which became the basis for testimony
19 you filed the 21st?

20 A I received a stream of computer printouts.
21 Virtually every day I get at least a few, so it is hard
22 to say exactly on any particular date such as that.

23 Q We will heave up some for you to look at.
24 Here is a batch of copies, sir. Yes. Let's look at --
25 I will undo this pile, and I will ask you to look. Here

1 is a handsome computer printout, and it says that it was
2 6:31:51 Monday, March 15th.

3 Wculd you tell us what those papers found in
4 your work papers are?

5 A These are -- well, let me look at little more.
6 It appears there is more than one here. Okay. This is
7 the preparation of the actual ccopies that were sent out
8 in the confidential appendix.

9 In other words, this is the same analysis that
10 had been done previously. The cnly changes were to the
11 format to make it more visuually clear what was going
12 on.

13 For example, the flow number was moved to a
14 distinct place where you could see it easily, and the
15 EEA number was included to make it easy to find on a
16 map. That was purely a change in the graphics. It was
17 not a substantive change.

18 Q And those on March 5, are those the same sort
19 of thing?

20 A That is correct.

21 Q Now, let's return to the subject of this memo
22 of the 18th of March, stating that you participated in.
23 What else was in that memorandum? Was there a
24 statement of the -- a recommendation as to the position
25 the department should take?

1 MS. REED: Your Honor, I am going to object to
2 this question on the grounds that counsel when we had
3 our argument last week regarding the department's
4 internal documents, you indicated that it would be
5 restricted to only whether instructions were given. He
6 has already testified that it contained only a summary
7 of his verified statement.

8 JUDGE HOPKINS: Why are we getting to the
9 question we were talking about the other day, Mr.
10 Kharasch?

11 MR. KHARASCH: That is exactly what I am, Your
12 Honor. Did this memorandum that he was working on
13 contain recommendations as to the position the
14 department should take? The question is, was his
15 testimony affected by those recommendations?

16 JUDGE HOPKINS: I will allow the question. Go
17 ahead.

18 THE WITNESS: I am having a problem
19 interpreting what you mean by recommendations. The way
20 I interpret it, I would say no.

21 BY MR. KHARASCH: (Resuming)

22 Q So if Mr. Marquez writes to the Secretary and
23 says this memo contains our recommendation as to the
24 preliminary position the department should take in his
25 written testimony Mr. Marquez was wrong?

1 A You must have interpreted it differently,
2 because there was information in there describing my
3 statement --

4 Q That we understand.

5 A -- as being a position. Then there is
6 recommendation on the position.

7 Q What else is in there?

8 A The only other thing I can recall is
9 background information, positions of the parties, that
10 sort of thing.

11 Q You say that this statement consisted of your
12 -- a summary of your statement.

13 A Yes.

14 Q And some description of what is going on in
15 the case, and nothing else?

16 A That is all I can remember.

17 Q In preparing your statement, sir, were you
18 aware of the position the department had taken in the
19 UP/MP case?

20 A Yes, I certainly was.

21 Q Were you aware of the Commission's repeated
22 statements in its merger cases that it is concerned with
23 two kinds of effects, parallel effects and vertical
24 effects?

25 A Those are certainly two issues that have come

1 up. I think that the central thrust of the recent
2 analysis is on whether or not there is an impact on
3 competition, whether or not the horizontal relationships
4 and the vertical relationships --

5 MR. KHARASCH: Your Honor --

6 MS. REED: Your Honor --

7 JUDGE HOPKINS: He is not arguing now, Mr.
8 Kharasch. He is trying to explain. I think he is
9 perfectly correct.

10 MR. KHARASCH: Why can't he answer the
11 question? I have no objection to an explanation.

12 JUDGE HOPKINS: The best thing to do is answer
13 the question first, and then if you want to explain, do
14 it. We will get the answer, yes, no, or whatever.

15 THE WITNESS: I thought I did answer the
16 question.

17 BY MR. KEARASCH: (Resuming)

18 Q Yes, you were aware of the position in the
19 department in previous cases?

20 A Yes.

21 Q In the UF case?

22 A Yes.

23 Q And yes, you were aware of the Commission. I
24 described it as often repeated statement that it likes
25 to look at both parallel and vertical effects.

1 A And I said -- I may have not yet said flat
2 out, but I said something like, yes, the Commission does
3 look at horizontal and vertical effects in its analysis
4 of the effects on competition. In other words, it is
5 concerned about ways in which horizontal and vertical
6 relationships affect competition in markets.

7 Q And you are aware of that language of the
8 Commission in its recent cases.

9 A What language are you referring to?

10 Q That it is important to look at both parallel
11 effects and vertical effects, upstream and downstream.

12 A I am aware of the fact that parallel and
13 vertical relationships are considered.

14 Q Do the words "friendly connection" and "loss of
15 friendly connection" appear in Commission statements?

16 A They do.

17 Q Do the words "friendly connection" appear
18 anywhere, or "loss of friendly connection" appear
19 anywhere in your statement?

20 A It does not. They do not.

21 Q When the Commission is talking about friendly
22 connection and loss of friendly connection, is the
23 Commission talking about upstream and downstream or
24 vertical effect of the merger?

25 A A connection is a vertical relationship.

1 Q Now, let's get back to the question of what
2 changes were made in your March 14 draft. Let's start
3 by asking whether the March 14 draft was prepared by you
4 alone. Was it?

5 A I received research assistance from my staff.
6 Other than that, it was done by me alone.

7 MS. REED: Could you please let the witness
8 finish the answer, counsel, before you interrupt him?

9 BY MR. KFARASCH: (Resuming)

10 Q Other than research assistance from staff, did
11 you receive policy discussion views?

12 A No.

13 Q What happens at a monthly regulatory filing
14 meeting?

15 A I have only been to one of those. And it
16 contained an exceedingly brief discussion of dates and
17 so forth.

18 Q Who informed you in the course of your
19 preparation for this case what the position of the
20 Department of Transportation had been in previous rail
21 merger cases?

22 A I was already aware.

23 Q Did you discuss it with anybody?

24 A I can't recall discussing it with anybody
25 prior to submitting the statement. I have since

1 discussed it with counsel.

2 Q Was it necessary that your statement be
3 cleared before it could be submitted?

4 A That is correct.

5 Q Was the memorandum of March 18 which you say
6 you participated in drafting, at least, a statement
7 asking that your statement be cleared?

8 A I believe the March 18th was a statement -- it
9 certainly was a request made at some point.

10 Q Can you tell us at what point your request was
11 made for clearance of your statement?

12 A Could I see the 18th one again?

13 Q I believe the next -- the two pages go
14 together, sir, that page and the next.

15 A That is the one.

16 Q That is the clearance memo?

17 A Yes. I based that on the fact that it was
18 sent to the Secretary. The one that I saw didn't have
19 the from and to on it.

20 Q Were any parts of your draft statement
21 circulated before the 18th of March?

22 A I believe so.

23 Q Where did they go, sir?

24 A Well, there were certainly various parts that
25 were circulated widely within the department at the

1 staff level for any kind of ordinary research assistance
2 type of comments on it in the nature of this is not
3 clear, that sort of thing.

4 Q Did parts of the -- let's subdivide it. Did
5 the first part of your statement before you begin the
6 appendices, did that circulate before the 14th?

7 A The 14th or the 18th?

8 Q The 14th of March. Pieces of it.

9 A Well, yes.

10 Q It did. And where did that go?

11 A It went to the names you read off earlier, for
12 example.

13 Q Anybody else?

14 A I am not certain of the date, but there were
15 other analysts that read it for the same basic reason,
16 to see if they could say, you know, this isn't clear or
17 whatever.

18 Q During that time of circulation, did anybody
19 tell you that your position wasn't the same as that the
20 Department of Transportation took in other cases?

21 A I am not sure. I am not sure. It could have
22 happened.

23 Q Were there any indications of approval or
24 disapproval that you were or weren't following the
25 department's position in other cases?

1 A Oh, no, certainly not that.

2 Q Certainly not that?

3 A That is why I don't remember. This was never
4 a big issue.

5 Q Were there any parts of your statement that
6 were omitted? Plan parts that were omitted?

7 A I edited it myself, but other than that, no.
8 In fact, I guess the correct answer to your question is
9 no.

10 Q No?

11 A Yes.

12 MR. KHARASCH: Could we have another exhibit
13 marked, Your Honor? I guess it is MKT-C-95. It is
14 pretty pictures. It is called --

15 JUDGE HOPKINS: I will mark it for
16 identification now.

17 (The document referred to
18 was marked for
19 identification as Exhibit
20 Number MKT-C-95.)

21 BY MR. KHARASCH: (Resuming)

22 Q Do you have one, Mr. Witness?

23 A I do.

24 Q That is from your work papers, Dr. Klem, where
25 there appear to be -- the same thing appeared twice, one

1 stamped draft. Does this document, Major Players,
2 Gateways to Mexico, appear in your statement as
3 submitted?

4 A No, it was never intended for reproduction in
5 the statement. I believe this was done before I came to
6 the department.

7 Q It was done before you came to the
8 department?

9 A This is background information.

10 Q I don't think that statement is correct. Let
11 me explore with you, Dr. Klem. The figures you obtained
12 on carloads and tons to Mexico are figures from the 1983
13 way bill tape. Is that right?

14 A That's correct.

15 Q And the 1983 way bill tape became available
16 when?

17 A I believe it was on line when I got to the
18 department.

19 Q When you got to the department?

20 A It had not been on line very long, but I
21 believe it was on line.

22 Q And in order to obtain figures such as this
23 appearing on MKT-C-95 from the way bill tape it is
24 necessary to have a run made with a special sort, is it
25 not?

1 A Sort is a word that describes the nature of
2 the program, yes. Okay, yes.

3 Q And are you telling me that you had run and
4 had a sort of traffic to and from Mexico over these
5 gateways before you arrived at the department?

6 A If my recollection is correct, this is
7 something that was already there when I got there. At
8 least it was already there when I first saw it. I did
9 not ask for this to be made, but I felt it was useful
10 background information.

11 Q In your statement, there is indeed in Appendix
12 G a discussion of carloads moving to Mexico, and they
13 seem to match these figures in general. Is this the
14 source of that?

15 MS. REED: Could you tell us what page,
16 ccounsel, you are referring to?

17 MR. KHARASCH: Twelve.

18 THE WITNESS: That appears to be correct.

19 BY MR. KHARASCH: (Resuming)

20 Q Do you have your work papers with you, sir?

21 A Yes, I do.

22 Q Perhaps at the intermission you could -- we
23 won't stop the examination, but if at the intermission
24 you would be good enough to tell us on what date a
25 computer run was in your hands that gave any information

1 about gateways to Mexico.

2 A Certainly.

3 Q This draft was in your work papers?

4 A That is correct.

5 Q Why is it stamped Draft?

6 A Presumably because when it was initially done
7 it was a draft.

8 Q Was your draft of your testimony of March 14th
9 stamped Draft with that same stamp?

10 A As I recollect. I certainly tried to stamp
11 all drafts Draft.

12 Q Did your draft testimony as circulated have
13 this table attached to it?

14 A I didn't see it as circulated, so I can't see
15 what the attachments were.

16 Q You were not given an opportunity to see the
17 draft of your testimony that was circulated for policy
18 approval?

19 A I had a draft of my testimony, but when it
20 went out of my hands I don't know what was attached to
21 it. This was not attached to it when it went out of my
22 hands.

23 Q Do you have in your possession the March 14
24 draft of your testimony?

25 A I can't say for certain. I have a stack of

1 old drafts, but I can't say for certain.

2 Q Do you have the March 14th draft?

3 A I am not certain there even is a March 14th
4 draft.

5 Q Do you have the draft that was circulated in
6 the department of March 14th saying attached is a rough
7 draft?

8 A As I say, I am not certain.

9 Q When you circulated the March 14 draft of the
10 testimony, did it have in the upper righthand corner the
11 same stamped Draft that appears in MKT-C-95?

12 MS. REED: Counsel, I object to your
13 characterization that the draft was circulated by
14 counsel's office.

15 JUDGE HOPKINS: Who circulated it? It was
16 circulated by counsel probably, not by this gentleman.
17 That is my understanding of what he said. He said he
18 didn't circulate it.

19 BY MR. KEARASCH: (Resuming)

20 Q You gave counsel a draft on March 14th or the
21 day before?

22 A Some time prior to that.

23 Q And did that draft that you gave counsel have
24 stamped on it Draft with the same rubber stamp that
25 appears in MKT-C-95?

1 JUDGE HOPKINS: It could be a different rubber
2 stamp.

3 THE WITNESS: There is more than one. As I
4 said, I tried to stamp all drafts Draft, so I assume
5 that that was the case, but I don't know for a fact.

6 BY MR. KHARASCH: (Resuming)

7 Q Do you find MKT-C-95, do you find that
8 MKT-C-95 contains some relevant facts?

9 A It contains descriptive material as to, as it
10 says, the Major Players in Gateways to Mexico, so it is
11 useful in ordering the players and gateways, rank
12 ordering.

13 Q It also tends to tell you who is participating
14 in traffic, doesn't it?

15 A That is what I said.

16 MR. KHARASCH: Your Honor, I think we have
17 enough here to see whether between the March 14th draft
18 of the witness and the final draft of the testimony
19 there were policy changes made or indeed it may be
20 before there were policy directions given which would
21 enable the Commission in this case to determine whether
22 they are seeing the testimony of the witness or
23 testimony that the witness was in part directed to
24 give.

25 JUDGE HOPKINS: You haven't asked this witness

1 that particular question. Why don't you ask this
2 witness that particular question? You haven't asked him
3 that particular question.

4 BY MR. KHARASCH: (Resuming)

5 Q March 14 draft that you had given to counsel
6 before March 14th some time and the final draft differ,
7 sir?

8 A Not in any substantive way.

9 Q There is no substantive difference?

10 A That is correct.

11 Q How about the tables? Are they different?

12 A As I said, we went through a process of
13 examining the numbers and making any adjustments that we
14 found. I did that personally.

15 Q Now, how about the statements in the general
16 part of your discussion?

17 A What do you mean by general part?

18 Q The first part, before you get to the
19 appendices. Are there any changes in that part?

20 JUDGE HOPKINS: Are we talking about the prose
21 part?

22 THE WITNESS: The competitive analysis.

23 MR. KHARASCH: I think it is all prose, since
24 it ain't poetry. We are talking about the major part
25 instead of the appendices.

1 THE WITNESS: I believe you are talking about
2 the competitive analysis, what we call Section 1 and 2,
3 and there is no change in competitive analysis.

4 BY MR. KHARASCH: (Resuming)

5 Q There is no change. Words change between the
6 14th and the 21st?

7 A Unfortunately, there have been words changed
8 since the 21st. But other than changes of that nature,
9 there is no change in the competitive analysis.

10 Q Suppose I have a nasty and suspicious mind.

11 MS. REED: We will stipulate to that.

12 BY MR. KHARASCH: (Resuming)

13 Q And that mind is of assistance to the
14 Commission in getting a clear record in this case, and
15 my suspicious mind suspects that the reason MKT-C-95 was
16 stamped Draft is that it was intended to be a part of
17 the draft, and it was dropped, although factual, because
18 a policy decision was made to drop it.

19 Suppose I have that grave suspicion. How may
20 I check that?

21 A You could ask me.

22 Q I just asked you.

23 A I never considered putting that in the
24 statement.

25 Q You never considered putting that in the

1 statement?

2 JUDGE HOPKINS: In other words, you made the
3 decision. Is that right?

4 THE WITNESS: There never was a decision to
5 put that in there.

6 JUDGE HOPKINS: There was no decision to be
7 made because you didn't consider that it should be in
8 there. Is that right?

9 THE WITNESS: I considered that working
10 papers. And that is all. And it is working papers to
11 this day. I never considered it more or less than
12 working papers.

13 BY MR. KHARASCH: (Resuming)

14 Q Is there any paper you have ever declared, Dr.
15 Klem, that explain why you have taken a different
16 procedure in this case, followed a different procedure
17 in this case and taken different positions than the
18 department has taken in previous cases?

19 MS. REED: I object. Counsel has not
20 established a foundation for that.

21 JUDGE HOPKINS: Why don't you state the
22 specific points that you believe he differentiates from
23 prior department positions.

24 MR. KHARASCH: I am prepared to do that. That
25 was actually the next part of the examination.

1 JUDGE HOIKINS: Why don't you put the two of
2 them together, and then we can save some time.

3 MR. KHARASCH: All right.

4 BY MR. KEARASCH: (Resuming)

5 Q I want to get to this point. If I look at
6 your draft prior to March 14, 1984, that was circulated
7 for policy clearance, and I could tell whether any
8 changes had been made as a result of that clearance. Is
9 that right?

10 MS. RFED: Counsel has not established that
11 there was even a response. Is that what you are
12 saying? Is that the question that you are asking, that
13 you are implying, that there were changes made?

14 MR. KHARASCH: I say if I looked at what you
15 did at the beginning and what you filed, I would be able
16 to tell whether there were changes made. That is Number
17 One.

18 JUDGE HOPKINS: Because you have a suspicious
19 mind. Is that right, Mr. Kharasch?

20 MR. KHARASCH: Suspicious mind or not, I would
21 be able to tell if there were changes, and two, let's
22 put these two quick questions together, and two, if I
23 looked at the correspondence that you saw, not the
24 correspondence you didn't see, I would be able to tell
25 whether those changes, if made, were changes that were

1 made in response to the correspondence.

2 MS. REED: I object, because the witness has
3 already answered this question in various forms several
4 times.

5 JUDGE HOPKINS: I thought he had already
6 answered the specific question. Oh, you are saying how
7 you could if you looked at it, how you could tell?

8 MR. KHARASCH: That is right.

9 JUDGE HOPKINS: Even though they might not,
10 have been made for policy matters, as he says, they
11 weren't made, but just because changes were made, you
12 could tell that there were differences between the
13 original draft and the final verified statement that he
14 puts in. Is that what you are asking?

15 MR. KHARASCH: Yes.

16 JUDGE HOPKINS: Anybody could answer yes.
17 There is no question. I don't think that deserves an
18 answer one way or the other.

19 BY MR. KHARASCH: (Resuming)

20 Q Did you see any statements after March 14 in
21 which there were communications from higher up in the
22 department as to your -- the clearance of your
23 statement?

24 A I saw no such communication. I don't believe
25 any such communication existed. And all I heard was,

1 yes, go ahead. It was an affirmative answer. It was
2 essentially a one-word answer.

3 Q That came to you from whom?

4 A Chris Rocney.

5 Q Chris?

6 A Chris Rocney, Deputy Administrator, FRA.

7 Q Let's go on to the positions in the previous
8 case. At this point would you lay in front of yourself
9 the MKT-C-91 and 92. Have you read MKT-C-91, sir?

10 A Yes, I have.

11 Q Let's look at Pages 2 and 3. Would you agree
12 that there are possibly situations from proposed rail
13 consolidations involving competing parallel lines that
14 serve common markets?

15 MS. REED: Counsel, are you reading from the
16 document?

17 THE WITNESS: What are you referring to?

18 BY MR. KHARASCH: (Resuming)

19 Q Page 2, Exhibit 91. Dr. Hymson, who I think
20 is sitting behind me --

21 JUDGE HICKINS: He is smiling at you, too.

22 BY MR. KHARASCH: (Resuming)

23 Q -- describes in the new paragraph beginning on
24 Page 2, the second sentence, situations arising from
25 these proposed consolidations where reductions in

1 competition are likely to occur. First he has parallel
2 lines. Do you see that?

3 A Yes.

4 Q And do you agree that when parallel railroads
5 are being merged, competition may be reduced because of
6 the fact that the two railroads are parallel?

7 A Yes, and I interpret that to mean a parallel
8 economic relationship which is defined in the literature
9 as two firms competing in the same market.

10 Q In the Commission's numerous decisions, such
11 as the Milwaukee decision, you are agreeing then that
12 railroad consolidations may involve competitive problems
13 that can be identified in terms of parallel effects.
14 That is the first thing.

15 A That is correct.

16 Q And the second thing that can happen is, there
17 can be end to end effects. Do you agree with Dr.
18 Hymson, on Page 3, what we are looking at, that
19 intramodal competition can be foreclosed by turning
20 formerly friendly or neutral connections into hostile
21 ones?

22 A I don't always agree with Ed as to what is a
23 friendly or a hostile, and in this case I took my
24 guidance from the Department of Justice's guidelines on
25 vertical restraints, which is the closest thing I could

1 find to direct guidance in this area.

2 And the concern there which is the concern in
3 merger cases I have worked on at the Commission like the
4 large case is the impact of the vertical relationship on
5 competition in a market, and therefore I felt that if I
6 found a harm to competition in a market, then I would be
7 concerned about that vertical relationship.

8 Q Now, in the UP case, was the Commission not
9 concerned, sir, with the loss of friendly connections by
10 various railroads?

11 A I am not sure what you mean by concern.

12 Q Did the Commission in the UP case not grant
13 trackage rights because of the fact of loss of friendly
14 connections?

15 MS. REED: Do you have a specific page cite,
16 ccounsel?

17 JUDGE HOPKINS: He is looking for something.

18 MR. KHARASCH: Do you want to drag through the
19 UP case?

20 JUDGE HOPKINS: I think he can answer a
21 question like that.

22 THE WITNESS: What is the question?

23 BY MR. KHARASCH: (Resuming)

24 Q I will try to phrase it very specifically,
25 sir, and I would appreciate an answer in the terms

1 asked. In the UP merger case, was the Commission not
2 concerned with the loss by railroads of friendly
3 connections, and did the Commission not award trackage
4 rights as a result of that concern?

5 A That is not my interpretation of it. The UP
6 decision was one of the things I took guidance in in
7 evaluating my approach to this merger, and in looking
8 back on it, I think it provides good evidence as to the
9 right way to approach these things.

10 If you contrast, if you look at the six
11 trackage rights that the department recommended in its
12 brief, by my analysis three of them involve
13 fundamentally parallel relationships, and three of them
14 involve fundamentally end to end friendly connector type
15 issues. And the Commission approved three of them,
16 granted three of them, and did not grant three of them.

17 The three that they approved, the DRGW, the
18 Kansas City to Pueblo, the Katy from Kansas City to
19 Omaha, and the SP from Kansas City to St. Louis, all
20 involved a loss of competition as a result of what you
21 call parallel tracks, I believe.

22 Those were the three they approved of, and I
23 took that as guidance.

24 Q Now, did the Department of Transportation file
25 a brief with the Commission in the UP case, and have you

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1 read that?

2 A I have read it. I was just referring to it.

3 Q That is the piece of paper we have called
4 MKT-C-92, right?

5 A That is right.

6 Q Let's turn over to Page 4, sir.

7 A That is Arabic 4, I take it.

8 Q Yes. Can we agree from the first sentence of
9 text there that DOT believed in that case that
10 intramodal competition will be reduced either because
11 parallel routes will come under common control by
12 applicants or because a non-included carrier will lose
13 its last neutral or friendly connection to markets
14 reached prior to the consolidations?

15 A I think I answered that already. I said yes,
16 that the first three in my interpretation are based on
17 the loss of what you call the parallel lines, and those
18 are the three they approved, and the second three in my
19 interpretation are based on the second thing, and those
20 are the three that the Commission did not accept.

21 Q In that case, the DOT, however, was pressing
22 on the Commission that it should consider the loss of
23 friendly connections. Is that correct?

24 A I can't say quite that, but I certainly do
25 know there was considerable discussion about friendly

1 connections in there.

2 Q And in the Commission decision there was
3 discussion of friendly connections?

4 A I remember at least one reference to it. It
5 was not in the same nature as in our brief, but there is
6 at least one reference to it.

7 Q And indeed as late as last week, on April
8 26th, 1985, in the same case, the Commission's most
9 recent decision in that case again discusses friendly
10 connections and loss of friendly connections.

11 MS. REED: You haven't established whether the
12 witness read that document, counsel.

13 BY MR. KHARASCH: (Resuming)

14 Q Have you?

15 A I have read that document.

16 Q Doesn't that discuss loss of friendly
17 connection?

18 A My recollection of that is that it discusses
19 that issue, and in my view all these difficult questions
20 about are they friendly or are they not, and essentially
21 says there was no harmful effect on competition as a
22 result of whatever was going on there, and did not grant
23 the trackage rights.

24 Q My first question, sir, is whether the
25 Commission discussed the issue of loss of friendly

1 connection.

2 MS. REED: Counsel, I object. It is a public
3 document. The Commission can take official notice of
4 what it has said in that document. Asking the witness
5 whether or not the Commission has said something in a
6 document, a Commission decision has no relevance to this
7 proceeding.

8 JUDGE HOPKINS: Well, it has relevance
9 probably if he has other questions that relate to that
10 particular point. I will allow it. What is the
11 particular question, now, Mr. Kharasch?

12 MR. KHARASCH: Let me read him a sentence and
13 see if he thinks that is the proper way to read a merger
14 case.

15 BY MR. KHARASCH: (Resuming)

16 Q I read you from the April 26th decision of the
17 Commission in Finance Docket 30,000. "The
18 anticompetitive effects the Commission found would arise
19 from DRGW's loss of a friendly connection with its
20 largest eastern interchange MP at Pueblo."

21 Now, does that impress you as the Commission
22 discussing the loss of a friendly connection?

23 A Could you tell me what page that is on?

24 Q First page.

25 A At the bottom?

1 Q Yes. Remember, my question is first are we
2 agreed. I am trying to see if you think or don't think
3 that the Commission discussion of friendly connections,
4 A, took place, and I shall next ask you if you think it
5 is important.

6 A Oh, I already said that there was some
7 discussion of the issue of friendly connection in my
8 previous answer.

9 Q Now let's turn to Page 3 of that decision,
10 which you seem to have a copy of in your hand. Let's
11 look under the heading Harm to Public, where the
12 Commission in the second sentence says, referring to
13 anticompetitive problems, "These problems arise
14 primarily as a result of elimination of competition
15 between UP and MP over their parallel lines in the
16 midwest, and as a result a vertical foreclosure at
17 Pueblo, Colorado, because of DRGW's loss of MP as a
18 friendly connection."

19 Do you see that sentence? The next sentence
20 says, "These problems were addressed by imposing
21 trackage rights conditions on the transaction."

22 Do you agree, A, that the Commission is
23 discussing friendly connection?

24 A Yes.

25 Q Do you agree, B, that in this case, in the

1 Milwaukee case, and in its railroad merger cases the
2 Commission has talked about friendly connection
3 losses?

4 MS. REED: Excuse me. For point of
5 clarification, you are talking about the railroad merger
6 guidelines, counsel?

7 MR. KHARASCH: No, in decisions or merger
8 cases.

9 THE WITNESS: I will go you one better. I
10 will volunteer that not only do they talk about it here,
11 but they have talked about it in the way that I think is
12 appropriate.

13 What they said was that in effect there is a
14 loss of parallel routings, in other words, a parallel
15 effect, and the parallel effect causes a loss of
16 competition and the vertical foreclosure, but the
17 driving force according to this language and my
18 recollection of the case is the parallel routes of the
19 two carriers.

20 That was the way I believe it's correct to
21 approach these things, to look at the parallel
22 effects.

23 BY MR. KHARASCH: (Resuming)

24 Q Now, just for a moment, since we have looked
25 at it earlier, would you look at MKT-C-95, which is

1 major players to Mexico? Does the MKT through the Tex
2 Mex not have a friendly connection today to Mexico?

3 A What this indicates somewhere, which I am
4 already aware of, is the fact that the two carriers do
5 exchange a significant amount of freight.

6 Q Right, and in the sense that the Commission
7 uses the terms "friendly connection," is the MKT not
8 losing a friendly connection to Mexico as a result of
9 the SFSP merger being here considered?

10 A To answer that, I need to know what your
11 definition of a friendly connector is.

12 Q My definition is the definition that the
13 Commission used in the UP case, sir, of friendly
14 connection when it said that they weren't going to give
15 the MKT trackage rights to Mexico over the MP because
16 the MKT would still have the SP left as a friendly
17 connection.

18 A In that case, the answer is clearly no,
19 because there is no situation comparable to the one you
20 have just read to me from the UP latest decision. There
21 is no loss of parallel competition. The UP decision,
22 there was a parallel routing between the UP and the MP.

23 There is no comparable situation going to
24 Mexico between the -- especially to Laredo, where the
25 Tex Mex operates, there is no comparable parallel

1 situation between the applicants here, so if that is
2 your definition, the answer is clearly no.

3 Q Wait a minute. Are you saying that there is a
4 parallel, that the applicants are parallel to El Paso,
5 for example?

6 A I believe the correct way to define parallel
7 is in a corridor-specific manner. Therefore I can't
8 answer that question. You didn't give me a corridor, so
9 I can't give you an answer.

10 Q Houston to El Paso.

11 A What is the commodity?

12 Q Is there not parallel competition by the two
13 merging railroads here to Mexico?

14 A In my verified statement I make it clear that
15 if we are talking pure intramodal competition, siding to
16 siding, a carrier has to have access not only to
17 Houston, which is after all a very spread out area, but
18 to the actual siding.

19 Q Is that what the Commission did in the UP
20 case, look at actual siding to siding competition?

21 A The Commission in a more recent UP case
22 confirms --

23 Q Why can't you answer me about the Docket
24 30,000 case? That is the question.

25 A I can't recall. I have not read the whole

1 record on UP. But I have recently read a decision on
2 the UP efforts to get into the Fremont GM plant where
3 they recognize a long -- where they acknowledge a long
4 recognized feature of the railroad industry that you can
5 be -- if you have parallel lines, you can be so parallel
6 that you are contiguous.

7 So, in some circumstances if a shipper is on
8 one side of a line, they have access to one carrier, and
9 if they are on the other side of the line, they have
10 access to the other carrier.

11 So in some circumstances it is essential to be
12 very specific as to the geography, which is not
13 universally the case, and I did not treat it
14 universally, but there are circumstances where that does
15 occur.

16 Q Have you had reference recently to the portion
17 of the UP decision where the Commission discussed Mexico
18 access?

19 A I can't recall the last time I looked at
20 that.

21 Q In discussing Mexico access in the UP case, is
22 there any discussion of what you seem to be calling
23 siding to siding competition?

24 A Mexico is an unusual situation in that they
25 have a national railroad.

1 MR. KHARASCH: I move to strike that. Just
2 answer.

3 JUDGE HOPKINS: Just first answer the
4 question.

5 THE WITNESS: I would say no, and then I would
6 say why, which is that Mexico is an unusual situation
7 where they have a national railroad. Therefore any
8 carrier who accesses Mexico, a border point, therefore
9 accesses Mexico and can get to any point inland.

10 The earlier discussion, you were discussing
11 Houston.

12 MS. REED: Please let the witness finish
13 answering the question.

14 JUDGE HOPKINS: But not too far. Go ahead.

15 THE WITNESS: I was done.

16 JUDGE HOPKINS: Good.

17 BY MR. KHARASCH: (Resuming)

18 Q I cannot see, sir, what the existence of a
19 national railroad has to do with what the Commission was
20 -- the meaning of the Commission's decision in the UP
21 case.

22 JUDGE HOPKINS: Is that a question?

23 THE WITNESS: I have a shorter answer. I
24 didn't do it that way for Mexico either.

25 BY MR. KHARASCH: (Resuming)

1 Q Good. Let's look at the department's brief on
2 Page 21, MKT-C-92, Page 21.

3 A Ninety-two is the department's brief?

4 Q Page 21. See if you can answer this crisply.
5 The first sentence of that brief says, "In considering
6 the costs or detriments of the proposed consolidations,
7 the Commission must be concerned with the effects of the
8 transactions on their level of intramodal competition."
9 Agree or disagree?

10 A Wholeheartedly agree.

11 Q The second sentence, "Generally maintaining
12 intramodal competition is necessary because there is not
13 sufficient intermodal competition to provide a
14 competitive restraint on a railroad's market power for
15 some movements of certain commodities.

16 Agree or disagree?

17 A Other than the word "Generally" -- let me
18 rephrase that. Part of that I agree with. I think that
19 this doesn't take into account the increased
20 competitiveness of the motor carrier industry, and I
21 believe that where the Commission drew that bright line
22 on one side of motor carriers in this case, this UP
23 case, and I hope will draw it on the other side of motor
24 carriers in this case, but I do acknowledge that there
25 are some situations where motor carriers may not provide

1 sufficient competition, and I did so analyze those
2 situations in my verified statement.

3 Q The third sentence. "Recent Congressional
4 enactments and Commission policies make the maintenance
5 of intermodal competition critical in determining
6 whether to approve the proposed consolidations."

7 Do you agree or disagree?

8 A I would like to read the whole sentence.

9 Q Agree or disagree with the whole sentence?

10 A The part you left out was --

11 JUDGE HOPKINS: You don't need to repeat it.
12 Just go ahead and look at the sentence and tell us
13 whether you agree or disagree and why.

14 THE WITNESS: The way I interpret this, I
15 agree with it because what it says is, there is more
16 competition now than there was before. That is the part
17 you left out. And --

18 BY MR. KEARASCH: (Resuming)

19 Q What?

20 A There is more competition now than there was
21 before, and the policies set forth by Congress in these
22 Acts and some others is to rely on competition rather
23 than regulation, and that if competition is to be relied
24 on, competition must be effective, and one important
25 aspect of competition is intramodal competition, and as

1 I said in my earlier answer, I analyzed intramodal
2 competition for probably the vast majority of a verified
3 statement, so the way I look at it, I agree with that
4 sentence.

5 Q Now let's go down to the second paragraph. Do
6 you agree that intramodal competition will be reduced in
7 cases where the consolidation brings parallel lines of
8 applicants under common control?

9 A I agree with that in the sense that when
10 applicants have parallel lines and they do merge, then
11 it can no longer be assumed that they will compete with
12 each other. In fact, it can safely be consumed that
13 they will not compete with each other.

14 They will act as a single firm, and the
15 question then becomes, will the loss of that competition
16 between those two carriers have an adverse effect on
17 competition in the marketplace?

18 Q Let's look at the second case, then. Do you
19 believe that the number of alternative routes and the
20 level of competition will be reduced in cases where
21 applicants as a result of competition no longer have an
22 interest in working with a non-included carrier to
23 provide competitive joint line service?

24 A The answer is yes, but the rest of the answer
25 is that it relates to that issue of an interest in

1 working with the non-included carrier. It goes back to
2 the one you read me a minute ago about the Pueblo to
3 Kansas City situation, that that analysis is parallel to
4 the Justice Department's reasoning in the vertical
5 restraints issue, that if there is a problem in the
6 marketplace by the parallel relationships, then that is
7 the driving force, so that I agree with them,
8 especially, for example, in that Pueblo to Kansas City
9 case, because of the economics of that particular
10 market.

11 Q You agree in the Pueblo to Kansas City case
12 that the D&RGW had to get some rights because of the
13 result of the loss of its friendly connection? Is that
14 right?

15 A That is not what I said.

16 Q Do you agree with that, with what I just
17 said?

18 A I would say provided that you are defining
19 friendly connection to mean what I interpreted it to
20 mean a minute ago, which relates it to the parallel
21 routes on MF and UF. Then the answer is yes.

22 Q Do you agree that the number of alternative
23 competitive routes and the level of competition will be
24 reduced when a non-included carrier has no other neutral
25 or friendly connection available to provide joint line

1 service?

2 A These phrases of neutral and friendly
3 connection are widely used, but they are not precisely
4 defined. The definition that you gave me a minute ago
5 is not as good as we are going to do here, and I assumed
6 that that would go for neutral as well as for friendly.

7 And I do believe that, as I said a minute ago,
8 that the neutral and friendly connection issue only
9 really legitimately comes up when you have the problem
10 in the marketplace which typically is caused by the loss
11 of parallel relationships.

12 Q Now, let me see, because I am still having a
13 definitional problem with you. If we go back to the
14 Mexico situation, today one can get cargo to eastern
15 Mexico via the Santa Fe to the border. Is that right?

16 A Which point are you referring to?

17 Q The eastern points, not the west coast
18 points. Can you go via the Santa Fe? Is that correct?
19 One can go via the MP and one can go via the SP or the
20 SF Tex Mex? Is that right?

21 A I think what you have given me are segments of
22 routings rather than entire routings.

23 Q What we are looking at at the moment is
24 crossing into Mexico. There are three carriers that are
25 crossing into Mexico.

1 A So what you in effect did was look at Laredo
2 and El Paso?

3 Q There is another place there, isn't there?

4 A What this document gives you is the carrier
5 that interchanges the traffic at the border or really
6 the carrier which terminates at this point, like
7 Laredo. When it says Tex Mex 22,700 tons, it is not all
8 local traffic.

9 Q We understand that. I say there are three
10 carriers today that have access to Mexico. Is that
11 right?

12 A The three you are referring to are?

13 Q The Missouri Pacific, the Santa Fe, and the
14 SP. I am not including the Tex Mex, because it connects
15 only with the SP and the MP.

16 A In that case, that is what I said in my
17 verified statement.

18 Q There are only three carriers?

19 A Right, and I expressed a concern in my
20 verified statement about the reduction from three
21 carriers serving Mexico to two carriers serving Mexico,
22 and did an analysis of that, which found actually some
23 problems.

24 Q Let's go to Page 31 and 32 of the department's
25 brief, MKT-C-92. Consider this sentence appearing on

1 the last paragraph on Page 31. Tell me if you agree or
2 disagree.

3 "The existence of intermodal or source
4 competition does not eliminate the need to maintain
5 intramodal competition."

6 A I don't see that here. Could you tell me
7 where it is?

8 Q It is the second sentence in the last
9 paragraph on Page 31. Do you agree or disagree that the
10 existence of intermodal or source competition does
11 eliminate the need to maintain intramodal competition?

12 A I don't want to take the time to read the
13 whole context here, but my point is that --

14 Q I am not asking you to agree with the
15 context. Do you agree with that sentence?

16 A I can't agree with the sentence without
17 knowing what the context is. Like if you said it was
18 raining outside and we were in a room with no windows, I
19 couldn't agree or disagree. But I am willing to not sit
20 here and read the whole context. That requires a little
21 bit of interpretation on my part.

22 Q All right. Let's have your interpretation of
23 whether the existence of intermodal or source
24 competition does not eliminate the need to maintain
25 intramodal competition.

1 A I interpret that to mean that those other
2 forms of competition may not be so universal and so
3 consistent in their effectiveness that there is no need
4 for any intramodal competition. And that I agree with.
5 We don't know.

6 These forms of competition are so universal
7 that there is no longer any need for intermodal
8 competition, and indeed, as I have said several times
9 here, I spent an awful lot of time looking at intramodal
10 competition.

11 JUDGE HOPKINS: Mr. Kharasch, I think we ought
12 to take a break now. Let's take 15 minutes.

13 (Whereupon, a brief recess was taken.)

14 JUDGE HOPKINS: Back on the record.

15 Mr. Kharasch.

16 BY MR. KHARASCH: (Resuming)

17 Q Let's hurry through this so we can get to the
18 substance of your statement. I am anxious to get the
19 preliminaries over.

20 Page 34, please.

21 A Of my statement?

22 Q Page 34 of MKT-C-92. Do you agree, and I am
23 reading from the middle of the page, so that you can
24 follow along, "In situations where the number of
25 alternative competitive routes is reduced because

1 applicants are no longer a friendly connection, trackage
2 rights over applicants to restore the non-included
3 carriers' access to markets it previously reached in
4 joint line service can be required to ameliorate
5 reductions in competition."

6 Do you agree or disagree with that
7 statement?

8 A Yes, I do agree because of the context of it
9 and the clear meaning of it, which, if you read the
10 second sentence of that same paragraph, it says, "Where
11 parallel lines come under applicants' common control,"
12 et cetera, et cetera, et cetera.

13 I interpret that, and I have only read it real
14 fast here, but I do interpret that to be consistent with
15 the analysis that I gave you two or three times
16 earlier. I might add that I don't see any such parallel
17 lines.

18 Q You do not see in the applicants' access to
19 Mexico any parallel lines?

20 A In the earlier statement I was thinking of a
21 particular situation. In the broader question that you
22 just asked, I would say I did indeed, because I did
23 analyze in my section on Mexico the three into two
24 issue.

25 Q Do you agree at the top of Page 35 of Exhibit

1 MKT-C-92 that trackage rights are a superior type of
2 pro-competitive condition?

3 A Yes, I do agree in the sense that trackage
4 rights are superior to the old conditions which were
5 granted years ago to constrain applicants' rates, et
6 cetera, et cetera, and the way those old conditions were
7 applied at that time, in the particular ways that they
8 were applied they were anticompetitive, whereas trackage
9 rights are not as large a problem as that.

10 Q Do you agree or disagree that trackage rights
11 provide a non-included carrier with the opportunity to
12 be a full-fledged competitor in the market by offering
13 alternative rates and services?

14 A I agree in the sense that trackage rights
15 under certain circumstances can cause a carrier to be a
16 full-fledged competitor in some markets.

17 Q Do you agree with Dr. Hymson that intramodal
18 competition is important to ensure that the marketplace,
19 not the government is the regulator of rail rates and
20 service, that is, intramodal?

21 A As I said at least a dozen times, I think,
22 yes. By that I mean, as I have said at least a dozen
23 times, intramodal competition is indeed important, and I
24 did spend the bulk of my analysis on that issue.

25 Q Do you find that there are some commodities

1 for which truck service and rail service are full
2 substitutes?

3 A In my appendices C and D, I found that TCFC
4 service and truck service are in effect what you called
5 full substitutes, and also boxcar service and truck
6 service are full substitutes.

7 Q Does it follow from that statement that there
8 would be no harm to the public interest if only one
9 trucker were allowed to operate between any points where
10 the applicants offer TOFC service?

11 A That sounds like a non sequitur. Can you
12 explain it to me? That sounds like a non sequitur.

13 Q But it seems to me that is what you said.
14 Rail and truck are full substitutes, and I asked you for
15 an example, and you give TOFC traffic, TOFC. Is that
16 right?

17 A That is correct. What I said was, I didn't
18 understand the question. Can you explain the question
19 to me?

20 Q If rail and truck are full substitutes for
21 TCFC traffic, would there be any harm to the public
22 interest by providing that there may be only one truck
23 line operating between any points where these applicants
24 offer TCFC service? It is quite a hypothetical. Take
25 it as a hypothetical.

1 A That is quite a hypothetical, but I think what
2 you just said was, if we reduced the number of
3 competitors from thousands down to one, would there be
4 an adverse impact.

5 Q Yes, sir.

6 A And my answer is, that would be what one would
7 expect in many cases.

8 Q An adverse impact?

9 A (Nods affirmatively.)

10 JUDGE HOPKINS: You said yes?

11 THE WITNESS: I said yes, but meaning what I
12 just described it as.

13 JUDGE HOPKINS: Well, you nodded your head.
14 You didn't say yes.

15 BY MR. KHARASCH: (Resuming)

16 Q Please explain what the adverse impact would
17 be if truckers were reduced from thousands to one
18 trucker in the TOFC type traffic.

19 MS. REED: Counsel, for clarification, are you
20 assuming that there is no opportunity for new entry into
21 trucking?

22 MR. KHARASCH: I was inquiring into the
23 meaning of the witness's last statement. He said there
24 would be a harm to the public interest if the number of
25 truckers were reduced from thousands to one. I want him

1 to explain, please, what that harm is.

2 THE WITNESS: Well, when I said that, I said
3 under certain circumstances or whatever. So to be more
4 specific I would have to expand on your hypothetical,
5 and I would say if competition was limited to truckers,
6 and there was no other aspect of competition in that
7 particular hypothetical, under those circumstances, if
8 the Commission or some other body reduced the truckers
9 to one and made that a permanent condition, then you
10 would have a monopoly. That is a pretty extreme
11 hypothetical, but it sounds like what you are getting
12 at.

13 BY MR. KHARASCH: (Resuming)

14 Q You have fallen off the hypothetical. Let us
15 assume markets where today the applicants are providing
16 TCFC service. In those markets where they are providing
17 TOFC service, would there be any harm to the public
18 interest if the number of truckers in those markets were
19 reduced to one?

20 A Okay, let's do the hypothetical in the other
21 direction, which I think is what you are getting at.

22 Q No. Please, Mr. Witness. We will be here
23 forever.

24 JUDGE HOKINS: Why don't you start with the
25 one that he did? If you can't do it, then say you can't

1 do it.

2 THE WITNESS: There is no answer to that
3 without more factuals. In other words, the hypothetical
4 has to have more detail in it in order to have an
5 answer. I am prepared to take any detail, but they have
6 got to be in there.

7 I think the detail that you are getting at
8 which is missing is, and I think you won't mind this
9 hypothetical, is just hypothesize that we are talking,
10 say, Phoenix to Los Angeles, and all of a sudden every
11 trucking firm that operated on that market and every
12 trucking driver that drove in that market either went
13 out of business or had a heart attack and died one
14 night.

15 BY MR. KEARASCH: (Resuming)

16 Q No, that is not what I am assuming, sir. I
17 asked you to assume that all the trucking, if you wanted
18 to take Phoenix to Los Angeles today, Phoenix to Los
19 Angeles, all the truckers are consolidated into one
20 truck firm.

21 A Okay, that is effectively the same thing.

22 Q No, it is not the same as all the drivers
23 dying.

24 JUDGE HOPKINS: He wasn't saying just
25 drivers. He is talking about owner-operators who are

1 probably owners of the trailers and owners of the
2 transportation units.

3 THE WITNESS: Yes, so that in effect there is
4 only one firm, one trucking firm in that market, but
5 nothing else has changed from what we know about it
6 today.

7 I would say that would not have any
8 significant adverse effect on the public interest
9 because the supply response is so rapid in the trucking
10 business, it depends a little bit on whether it is
11 regulated or unregulated.

12 But in an unregulated commodity, for example,
13 they respond to changes in demand and move trucks around
14 in a daily manner.

15 BY MR. KHARASCH: (Resuming)

16 Q Thank you. Now, sir --

17 A I am not done yet.

18 Q But you are not talking about my
19 hypothetical.

20 JUDGE HOPKINS: What is the difference? I
21 don't understand, Mr. Kharasch, either, what are you
22 saying different than what he is saying?

23 MR. KHARASCH: I wish to restrict in the
24 Phoenix to Los Angeles market -- let's talk about
25 that.

1 JUDGE HOPKINS: That is what he was doing.

2 MS. REED: You are not letting him answer his
3 question.

4 JUDGE HOPKINS: I will handle it, Ms. Reed,
5 please.

6 BY MR. KHARASCH: (Resuming)

7 Q May we please consider this? Let's take the
8 Phoenix to Los Angeles market, if you wish, and let us
9 assume that all the trucking companies are put into one,
10 and only that trucking company is allowed to operate, no
11 more entry.

12 JUDGE HOPKINS: That is different. That is a
13 different statement than you made previously, Mr.
14 Kharasch.

15 THE WITNESS: You added a new fact to the
16 hypothetical. That is why I said we needed some more
17 facts. There's still not enough facts for me to
18 answer.

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1 Q What other facts do you need to know to tell
2 me whether public interest is affected by restricting
3 Phoenix to Los Angeles TOFC type trucking to one
4 trucking firm?

5 A Other sources of competition and the
6 particular commodities involved, all the other factors
7 that influence the market like that.

8 Q Let us assume that the other source of
9 competition is railroads.

10 A For clarification, you are saying there are
11 only two sources of competition. There is no geographic
12 competition, all these other things we know to exist in
13 the real world are assumed away?

14 Are you saying that the only source of
15 competition here is just one trucking company and one
16 railroad and no trucking company is allowed to enter?

17 How about pipelines? Are they allowed to
18 enter?

19 Q We are talking about TOFC type traffic.

20 A I'm sorry. My question, though, is is any
21 other means of transportation allowed to enter?

22 Q Railroads that exist.

23 A So all we have is one railroad and one
24 trucker, and for all time there will be two competitors
25 and no other source of competition?

1 Q No, I believe there are two railroads, are
2 there not, sir?

3 A You said one railroad a minute ago.

4 Q Are there not two railroads between Phoenix
5 and Los Angeles?

6 A In your hypothetical I am speaking.

7 Q Are there not today two railroads?

8 A Let me finish the hypothetical, okay? I will
9 answer that. Believe me I will answer it.

10 JUDGE HOPKINS: Mr. Kharasch, in your
11 hypothetical --

12 MR. KHARASCH: Let us stop.

13 JUDGE HOPKINS: Just a second. In your
14 hypothetical, are you stating that you are going to say
15 that there are two railroads? He is going on the basis
16 that you were saying there was one railroad and one
17 trucker. Now, let's just get to the point.

18 Are you saying there are two or one?

19 BY MR. KHARASCH: (Resuming)

20 Q There is the present railroads operating today
21 between Phoenix and Los Angeles.

22 The question is, if all the trucking companies
23 are reduced to one, by which I mean that no more
24 trucking companies are allowed to enter, and we were to
25 consider the effects on TCFC traffic for which you say

1 railroads and trucks are full substitutes, my question
2 is, for that traffic, is there a bad effect on the
3 public interest from restricting all the trucks to one
4 and now allowing any other one to enter?

5 A I hope I understand this now. You've got two
6 railroads and the assumption is all the trucking
7 companies are melded into one trucking company, and
8 there can never be any other trucking company, and the
9 additional assumption I think you are making is there
10 can never be any other source of competition, and given
11 those assumptions, it is a pure thousands of competitors
12 down to three competitors and no other source of
13 competition, and that I would be concerned about. It is
14 not remotely the way the world works, but that
15 hypothetical situation I would be concerned about.

16 Q Let's turn to your statement at pages 5 and 6
17 and 7.

18 Are you explaining at pages 5, 6, and 7 that
19 in your methodology farther on in this statement no rate
20 can be above competitive levels unless it is 180 percent
21 of variable costs or more?

22 A My methodology is that -- I am sorry, yes. My
23 methodology is that the concept of market dominance or
24 really the lack of market dominance is economically
25 identical to the concept of effective competition, and

1 that I analyzed to see where competition was effective,
2 and I found -- my methodology is that wherever
3 competition remains effective after the merger, there is
4 no adverse effect on competition and there is no need
5 for any remedy, and I used the legislative guidance
6 which, by my recollection, was supported by a large
7 number of economists, that the railroad business is of
8 the nature such that -- and I am not sure if I am going
9 too long here, but it is of a nature that some prices
10 are of necessity below average cost and some prices are
11 of necessity above average cost, and that as a matter of
12 fact, no railroad markets in which the prices are below
13 180 percent are ones where competition is ineffective.
14 There are some presumably that are above that rate where
15 competition is also effective, but as a cutoff, that it
16 was safe to assume that in no market where rates are
17 below 180 percent of variable cost, competition is
18 ineffective.

19 Q And if competition is effective, as you define
20 it, rates can rise to at least 180 percent of variable
21 cost without any harm, is that right?

22 A If I understand that question correctly, the
23 answer is yes.

24 I think what you just said is that as long as
25 the rates are below 180 percent of cost, variable cost,

1 then competition is still effective, and that is
2 certainly true.

3 Q And that is the way you use it in your
4 statement. Competitive price to you means a price 180
5 percent of variable cost or less?

6 A A competitive price to me means a price where
7 there is a lack of market dominance.

8 Q I am trying to ask you to be very clear.

9 A The answer to that one is no.

10 Q Let us say that we have a price and there is
11 in this -- this price is 179 percent of variable cost,
12 price for rail service.

13 In your definition, is that price necessarily
14 a price which is competitive?

15 A That is correct.

16 Q And therefore, if this merger were in a
17 particular movement to result in the raising of the
18 price from, say, 140 percent up to 180 percent of
19 variable cost, you would consider that there had been no
20 anticompetitive effect of the merger, is that right?

21 A Almost. Is that a legitimate answer?

22 JUDGE HOPKINS: Go ahead.

23 THE WITNESS: We are trying to draw a bright
24 line here. That is the problem, and what I am saying is
25 that there is no significant anticompetitive effect

1 provided that competition remains effective after the
2 merger.

3 BY MR. KHARASCH: (Resuming)

4 Q And competition remains effective after the
5 merger as long as the postmerger rate is below 180
6 percent of variable cost?

7 A That's right. The point I think here is that
8 competition either is effective or it is not effective.
9 I mean, if you are an economist, if you look at a
10 market, you can't say that one circumstance is the exact
11 same facts, allow you to say it is competitive, and in
12 some other circumstances, the exact same facts allow you
13 to say it is not competitive.

14 Q Now, sir, at the moment, please, I am not
15 asking you either to tell me something about economists
16 generally or to anticipate what I am getting at. I am
17 simply questioning the usage of the words in your
18 statement after page 7, and after page 7, where you
19 refer to rates above competitive levels or competitive
20 level of rates, you mean 180 percent of variable cost,
21 is that right?

22 A That's not right.

23 Q What's not right? What do you mean by raising
24 rate above competitive level?

25 A As I said, if a rate -- the concept I am using

1 is market dominance, that a lack of market dominance
2 means that competition is effective, and that if
3 competition is effective in a market, then to an
4 economist it has to be effective regardless of what the
5 question is that you are asking. If a market has
6 effective competition with a given set of facts, then it
7 just plain is effective competition. Therefore, I am
8 saying that if a market -- if there is no market
9 dominance, there is a lack of market dominance, then
10 competition is effective.

11 Q The definition of market dominance you choose
12 however is a definition where if the ratio of rate to
13 variable cost is below 180 percent, there cannot be
14 market dominance, is that right?

15 A That's not a definition of effective
16 competition, but the last half of what you said was
17 true. Can you break it up?

18 Q Let me see. Later in your statement, after
19 page 7, you talk about competitive levels of rates, and
20 your inquiry to determine whether there is a chance of
21 rates being raised above competitive levels.

22 A Where on page 7 do I say that?

23 Q No, I said after page 7.

24 A Where do I say that exactly?

25 Q All right, on page 8 and running over, you say

1 my analysis is directed to determining where competition
2 would be reduced to such an extent that rates could be
3 raised above competitive levels.

4 Now, sir, please listen very carefully to my
5 question. My question is, if a rate is below 180
6 percent of variable cost in your usage, is that rate
7 necessarily not above a competitive level?

8 A That is correct, as I think I have said
9 before.

10 Q Have you ever calculated how much money would
11 be earned by these applicants if they did raise their
12 rates to 180 percent of variable cost?

13 MR. MARTIN: Excuse me, Your Honor. This is
14 just so I understand what the word was.

15 Did he say did or could? I just didn't hear.

16 MR. KHARASCH: Have you.

17 MR. MARTIN: Whether they did raise or could
18 raise, was that the question?

19 THE WITNESS: You didn't use either one?

20 MR. KHARASCH: Neither one.

21 JUDGE HOIKINS: Why don't you restate it?

22 Sorry, Mr. Kharasch, but it happens. Go
23 ahead.

24 BY MR. KHARASCH: (Resuming)

25 Q The question is have you calculated how much

1 money the applicants would make if they made 180 percent
2 of their variable cost?

3 A I have never calculated that number because I
4 knew such a thing could not happen.

5 Q Have you read a most interesting document
6 called KCS-C-1 in this case?

7 A If it is what I think it is, I certainly
8 have.

9 Q It is an interesting document to an economist,
10 is it not, sir?

11 A Yes.

12 Q Is it often that economists get to read in the
13 case of a merger what is recommended to the board of one
14 of the merger partners as a reason for the merger?

15 A Actually, my earlier answer was based on a
16 misunderstanding of what KCS-1 was.

17 Q Oh, I'm sorry. KCS-C-1, sir, is a May 16,
18 1983 report to the Board of Directors of the Santa Fe
19 Industries. It is confidential.

20 A I now understand what it is, and I did receive
21 that Monday, and I did look at it last night. Actually,
22 I looked at it this morning. It was after midnight. So
23 I can say I have at least looked at each page, but I
24 can't guarantee 100 percent comprehension.

25 Q You did not read that document prior to Monday

1 of this week?

2 A I didn't receive it until Monday of this
3 week.

4 Q When were you given a copy of my letter of
5 April 19, 1985, which was the long document notice for
6 your cross examination, sir?

7 A I don't recall that letter. Could I see it to
8 look at it?

9 Q Sure.

10 A I'm sorry, I can't answer the question.

11 Q Oh, you've never seen that?

12 A I may not have.

13 Q Did you note in KCS-C-1 in your perusal a
14 calculation by the people presenting this analysis of
15 merger benefits a calculation of the amount of money the
16 Santa Fe would earn in addition if it got itself to 170
17 percent of variable cost?

18 A I recollect some issues like that related to
19 specific freight. I don't remember one that was the
20 whole business.

21 May I ask a clarifying question? Somebody
22 made a lot of pencil marks on this. Was that done --

23 Q By your counsel.

24 I will read to you from page 000032 and 33.
25 "Were Santa Fe able to reach the current Staggers Act

1 permitted revenue/cost ratio level of 170 percent, a
2 revenue increase of roughly 30 percent would result.
3 Based on 1981 freight revenue levels, this would amount
4 to almost \$700 million of allowable but unrealized
5 profit."

6 MS. REED: Is there a question pending,
7 Counsel?

8 JUDGE HOPKINS: He is going to ask one.

9 BY MR. KHARASCH: (Resuming)

10 Q Did you see that?

11 A No, I didn't see that.

12 What page is that on?

13 Q 32 and 33. They are numbered on the bottom.

14 A They are also numbered at the top.

15 Q Read the bottom.

16 (Pause)

17 Have you read that sentence?

18 A Yes, I read that sentence and the next
19 sentence where it says, "Of course, a major portion of
20 this unrealized profit is not attainable due to
21 constraints imposed by competitive railroads and other
22 modes of transportation," etc., etc., etc.

23 Q But a significant portion may be available,
24 does it not say?

25 A That's correct, it says, but a significant

1 portion may be available.

2 Q Right.

3 Now, do you consider -- again, we are
4 referring to you standard of competitive price -- do you
5 consider, let's say -- let's take twice the \$700
6 million, and we will add something because we have gone
7 from 170 to 180 percent -- do you consider \$1.6 billion
8 additional revenues to the applicants from higher
9 freight rates, if that were to be the effect of a
10 merger, would you consider that \$1.6 billion in the
11 public interest or not in the public interest?

12 A The answer is yes.

13 Q Which?

14 A It would not be in the public interest.
15 Without having the opportunity to carefully analyze
16 that, let me make the following assumptions which I
17 think are realistic. The amount is saying that that
18 assumption would conflict with what I knew to be facts
19 when I made this analysis. It would make the analysis
20 no longer appropriate. 180 percent of variable cost,
21 170 percent, for that matter, is more than average
22 cost.

23 Q More than average cost?

24 A That's correct. If they had no traffic, it
25 was below average cost. If they had all traffic, it was

1 above average cost. And some traffic presumably would
2 be substantially above average cost. They would be
3 making monopoly profits, and the assumptions which are
4 realistic in the railroad business but not in this
5 hypothetical which I made in my analysis, would no
6 longer hold. You would have to have a different model,
7 and in that model I would be concerned.

8 Q Now, is your 180 percent definition -- we are
9 just talking about your definition in your statement --
10 is your 180 percent definition a definition that applies
11 to rates for particular commodity movements, or are you
12 talking about 180 percent earned by the enterprise as a
13 whole?

14 A It relates to particular movements.

15 Q Particular movements.

16 A As I said a minute ago, it was 180 percent
17 earned by the institution as a whole, you would have a
18 completely different economic reality, and you would
19 have monopoly profits, whereas in reality what we have
20 is most traffic, very much traffic moves under 180
21 percent, and we don't have economic profits or monopoly
22 profits. What we have is economic losses. It is widely
23 recognized that firms make less than normal profits
24 which to an economist is called losses.

25 Q Did you also read the portions of KCS-C-1

1 where the authors were discussing the flexibility of the
2 railroads to set their rates after the merger?

3 A Yes.

4 Q Would you look at page 00032 at the bottom
5 there, and look up at the paragraph numbered 1, sir.

6 Do you agree that as a consequence of the
7 Staggers Act and the new deregulation environment
8 railroads have enhanced opportunity to favor their own
9 single-line routes between origin and destination
10 pairs?

11 A Yes, and by that I mean that one problem that
12 was widely recognized at the time the Staggers Act was
13 being debated was rate equalization between routes, and
14 prior to Staggers Act there were large numbers of routes
15 that all had the same rate, regardless of how
16 economically efficient they were, and one purpose of the
17 Staggers Act was to allow the pricing mechanism to be
18 used as it should be, to induce the freight to move over
19 the most efficient route. So my answer is yes, because
20 what this sounds like to me is they are allowed to use
21 mechanisms, presumably prices, to cause the traffic to
22 move over their efficient routes, and I note a support
23 for that, that it says two conditions have to be met.
24 One of them is the carrier can handle the movement on a
25 single line basis without any great circuitry.

1 Q That is one of the conditions.

2 Now I wish to ask you a question.

3 One of the conditions for a railroad to set
4 its single line rates is that it be the only carrier
5 serving either or both the origin or termination, do you
6 agree with that?

7 A I'm not sure I understand the significance of
8 that one.

9 May I think about that for a second?

10 (Pause)

11 One way of looking at that -- and I can't
12 swear that this is the way they looked at it because I
13 don't really know what they were thinking, but one way of
14 looking at that is that if they don't serve either the
15 origin or the destination, it is a triple line move,
16 likely to be -- and I am not done yet -- and triple line
17 moves are not noted for their efficiency, and the last
18 line I looked at a frequency distribution of the whole
19 waybill data, most moves were in fact single line or
20 double line, and few were four lines. So I think that
21 also relates to efficiency, but I can't swear to it.

22 Q If a railroad is the only carrier serving the
23 origin or destination, it can require the traffic to
24 move on its route, is that right?

25 A No. The shipper has the option of routing the

1 traffic.

2 Q Yes. But if I am the only carrier between two
3 points, let's say that we are serving both the origin
4 and termination, if I am the only carrier serving the
5 points, then my route must be used, is that right?

6 A No, it is not.

7 Q Oh, what would happen?

8 A It is not unusual for a situation where one
9 carrier serves the origin and the destination for there
10 to be a multiple of routings available.

11 Q That is correct, but if I am in that case the
12 only carrier serving one or both ends, I can favor my
13 own single line route by cancelling all other routes,
14 can I not?

15 A No, that is not true.

16 Q Why not?

17 A There are restrictions on cancellations.

18 Q Oh, whose restrictions?

19 A There are restrictions in the law, and the
20 Commission has procedures for approving those things.

21 I think the important fact here -- and I
22 wanted to explain -- you asked me a question.

23 MR. KHARASCH: The question is which
24 conditions, and Your Honor, he wants to give another
25 speech about the important fact. It is a simple

1 question.

2 JUDGE HOPKINS: Answer his question. I don't
3 think you need to go any farther on that.

4 THE WITNESS: I think the question was can
5 they do it without restraint, and my answer was there
6 are restraints, but nevertheless, there is a substantial
7 ability to cancel joint rates, and in fact numerous
8 joint rates have been cancelled.

9 BY MR. KHARASCH: (Resuming)

10 Q Do you agree with the statement that after
11 major rail consolidations, wherever possible, the
12 combining carriers can be expected to reroute traffic
13 interchange with unaffiliated companies to the new
14 combination?

15 A This is another one where it depends on the
16 context and the definitions of the words. It is not
17 unusual to use words like "possible" meaning relating to
18 efficiency.

19 Q Do you think there are instances, sir, where
20 rail-to-rail competition keeps rail rates down?

21 A Not only do I think that, I identified
22 circumstances where I thought a reduction in such
23 intramodal competition would be a problem.

24 Q Is TOFC traffic handled by rail growing in
25 volume?

1 A Up until this year it has been.

2 Q Would you look, please, at the top of page
3 00031 in KCS-C-1? Would you look at the paragraph at
4 the top of the page? It is just three sentences.

5 A Yes, I have looked at that.

6 Q Would you agree that entry of another railroad
7 into a TOFC market, TOFC market, may cause a reduction
8 in rail rates because of rail-to-rail competition?

9 A I would say that that would depend on a
10 variety of facts, but the general answer is no. The
11 general answer is no. This paragraph does not support
12 the question you just asked. This paragraph is an
13 ordinary description of a competitive market. When you
14 put a new competitor in a market, there is often either
15 a temporary or often a temporary price reduction as they
16 get into the market. If it happened to be that that
17 temporary price reduction occurred at a time when there
18 were a lot of price reductions, it could well be that
19 the equilibrium price in that market went down.

20 I think this was since 1980 we know that there
21 have been a lot of new competition since 1980 from
22 trucks and between railroads. So I wouldn't be
23 surprised if -- in fact, I am aware that a lot of TOFC
24 rates have gone down, sometimes by more than 15
25 percent. And the fact that the new entrant was the one

1 that happened to put that in is not surprising. But it
2 doesn't remotely prove that it wouldn't have gone down
3 the same 15 percent even absent the new entrant.

4 Q Do you know the use of the phrase "pricing
5 snug up against" someone else's price?

6 A I have heard the phrase.

7 Q Would you interpret that to mean if my price
8 is \$10, you might price at \$9.90, snug up against my
9 price?

10 A Under certain assumptions. You would have to
11 make additional assumptions to make that a true
12 statement.

13 Q We are just talking about the meaning of "snug
14 up against." It means a price very close to a
15 competitor's price, doesn't it?

16 A No, it does not.

17 Q It means a price very close to the point at
18 which the customer might shift to the competitor?

19 A That's closer. Congratulations.

20 JUDGE HOPKINS: We are having school here, Mr.
21 Kharasch.

22 BY MR. KHARASCH: (Resuming)

23 Q Now, it is not surprising in a competitive
24 market to look and to find rates of competitors close
25 together, is that right?

1 A Under certain conditions, yes.

2 Q Again, the conditions being that what they are
3 providing is reasonably interchangeable?

4 A A stronger condition than that is required.

5 Q Give it to me.

6 A They have to be viewed as being equally
7 valuable. For example, if you are talking trucks and
8 TCFC, as I said in my verified statement, TCFC has
9 service disadvantages so that in order to be
10 competitive, which it is, it has to offer lower prices
11 and in addition, there are some aspects of the pricing
12 which are done different for trucks than for TOFC, that
13 the waybill data includes essentially the line haul
14 rates, generally, anyway. It doesn't include the
15 variety of other charges such as have been demonstrated
16 by Forrest Baker in his recent statement.

17 Q Oh, you read Forrest Baker's material, did
18 you?

19 A Yes.

20 Q Have you read his latest material?

21 A I think so.

22 Q Where he started pricing things like plastic
23 pellets and kaolin clay?

24 A I have read that one, yes.

25 Q Let me hand you Mr. Baker's Case Study No. 6

1 from his testimony in SFSP-44.

2 Let's look over to what is the third page of
3 this little extract from Case Study No. 6, page 28 of
4 Mr. Baker's testimony.

5 On this page, would you agree Mr. Baker seems
6 to be pricing bulk plastic pellets?

7 A That certainly does appear to be the case.

8 Q From Gulf Coast to the west, Fresno and Los
9 Angeles.

10 A I see New Orleans to Fresno and New Orleans to
11 Los Angeles.

12 Q Right.

13 Under the TOFC rate, he has carefully figured
14 in the rate and some service charges and cartage and that
15 sort of thing?

16 A That is correct.

17 Q That's the sort of thing you were just
18 referring to in TOFC, that you have to think about those
19 charges, right?

20 A That's an issue that has to be addressed,
21 yes.

22 Q Then he also has truck rates.

23 Now, do you observe with me that the rail
24 charge Mr. Baker has found per ton in covered hopper
25 cars is substantially below the rates that would be the

1 truck rates?

2 A I observe a number here that says rail charge,
3 which is lower than the other number, the total number
4 for TOFC, etc.

5 Q And there are today two competing railroads,
6 are there not, running New Orleans to Los Angeles?

7 A It depends on the nature of the specific
8 situation. There are two railroads that do run between
9 those cities, but as I have said before, I am not
10 prepared to accept that you can always use a broad
11 definition of a city to another broad definition of a
12 city and assume that the two carriers are competing in
13 every instance.

14 Q When you say the broad definition of the city,
15 you mean because there may be points within Houston, for
16 example, where one railroad does not get to the plant
17 and another railroad does?

18 A That's right. Earlier I mentioned the example
19 where it could even be that there would be two parallel
20 tracks contiguous, and one carrier would have access to
21 shippers on one side, and the other carrier would have
22 access to shippers on the other side.

23 Q Really, in order to determine, then, whether
24 there is rail to rail competition, one would have to
25 know, I think you are saying one would have to know

1 whether the shipper's siding and the destination siding
2 is open to reciprocal switching, is that right?

3 A That is certainly an issue. There are more
4 issues than that.

5 Q Let's stick with that first.

6 A Railroads compete in a lot of other ways in
7 addition to the one that you are talking about.

8 Q If we are talking about something moving from
9 a plant to another plant, we want to talk about direct
10 rail movement competition for the moment.

11 A What I call siding to siding.

12 Q Yes. We would have to know whether the
13 railroad could get to one side, and whether they can get
14 to the other siding, is that right? That means not only
15 physically, but whether it is allowed to.

16 A That is correct.

17 Q And is it correct that there are some places
18 like Kansas City, for example, where in general most of
19 Kansas City is open to reciprocal switching?

20 A I haven't studied the question of whether or
21 not "most" of Kansas City is open to reciprocal
22 switching.

23 Q You don't know?

24 Do you know whether there are places in the
25 United States where reciprocal switching tends to be the

1 rule?

2 A I have heard that said before, but I am not
3 prepared to accept that as fact because you said as the
4 rule, and my observation has not been that you can make
5 a broad statement like that. You have to look at the
6 particulars.

7 Q Now, when you talk about siding-to-siding
8 competition, as you have, if one railroad says no one
9 can come here because it is closed to reciprocal
10 switching, no one can get here but me, it is my track,
11 then you say there is no siding-to-siding competition,
12 is that correct, a correct use of one of the uses of
13 your siding-to-siding?

14 A That's the correct use of my
15 siding-to-siding.

16 Q Have you in your studies for this case made
17 any examination of what movements are movements that are
18 open to reciprocal switching or not open to reciprocal
19 switching?

20 A Yes, I have.

21 Q Where is that in your statement?

22 A As it says in the statement, the SPLC 6 to
23 SPLC 6 analysis is from -- I can't remember the name of
24 it, what we call the SPIC book, which lists carriers
25 serving particular SPLC 6s. That includes, it is coming

1 up to me now, and I can give you the name, if you want,
2 but that includes carriers served by reciprocal
3 switching.

4 One example -- there are lots and lots of them
5 in here, but one example would be Texas City, near
6 Galveston. The only railroad tracks to Texas City are
7 the Texas City Terminal Company Railroads, but our
8 analysis showed I think it was four or five carriers
9 that served Texas City, and my presumption is it is by
10 some sort of either reciprocal switching or other
11 agreement. But the point is that that book is the best
12 information available as to who does really serve these
13 points.

14 Q And if there is no reciprocal switching, you
15 are saying a competing rail carrier cannot compete
16 because it is not allowed to by the carrier that has the
17 siding under its control, is that right?

18 MS. REED: Are you assuming in that question
19 that it is not truckable, TCFC --

20 MR. KHARASCH: We are talking about
21 rail-to-rail competition for the moment.

22 THE WITNESS: Not necessarily. Even if it is
23 such a commodity that siding-to-siding competition is
24 the appropriate view, I don't believe what you said
25 follows.

1 BY MR. KEARASCH: (Resuming)

2 Q I thought you told me that if there is no
3 reciprocal switching at a point, there cannot be
4 siding-to-siding rail competition.

5 MS. REED: Excuse me. Are you excluding
6 another railroad serving that point directly, Counsel,
7 not via reciprocal switching?

8 MR. KHARASCH: Yes.

9 BY MR. KEARASCH: (Resuming)

10 Q Let's start with the presumption that we are
11 talking about a plant served by only one railroad.
12 There are some plants in the United States that are
13 served by two, aren't there?

14 A There are.

15 Q Or even three.

16 A Presumably.

17 Q But generally they are served by only one.

18 A That's my understanding.

19 Q And for those that are served by only one
20 carrier, unless there is reciprocal switching in effect,
21 you are saying there cannot be siding-to-siding rail
22 competition.

23 A You are using the word "served" differently
24 than I do, but the point is a carrier cannot compete
25 without having unimpeded access to the traffic.

1 Q In other words, the carrier that decides
2 whether to give or not to give reciprocal switching has
3 considerable power over the rail transport of that
4 commodity, does it not?

5 A I believe that depends on the circumstances.

6 Q We are only talking about the rail transport.
7 Wouldn't he have considerable power over the
8 rail transport if he can say I won't let it move?

9 MS. REED: Are you assuming, Counsel, that
10 there is no geographic or source competition at work?

11 JUDGE HOPKINS: I thought he was talking about
12 out of this particular plant.

13 MR. KHARASCH: That's right.

14 JUDGE HOPKINS: What has that got to do with
15 it?

16 THE WITNESS: If there was source competition
17 there, that would be a factor, but I was assuming there
18 was no source competition, that the only kind of
19 competition was for purposes of this hypothetical,
20 siding-to-siding competition, and generally,
21 siding-to-siding competition works with, in addition to
22 other kinds of competition, like source competition, you
23 don't have either one or the other typically, but
24 strictly for purposes of this hypothetical, I was
25 assuming away all of these other important aspects of

1 competition.

2 Q And if you assume away all of this source
3 competition, and we are talking about a particular
4 movement, the railroad, if it is closed to reciprocal
5 switching, the railroad that has that station can
6 dictate the movement of the cargo because it can or
7 cannot let someone else come in.

8 A So part of your hypothetical is --

9 Q Is that right?

10 A I have to have a clarification first. Part of
11 your hypothetical is that the terminal railroad, for
12 example, has the ability to cancel reciprocal switching
13 at will.

14 Is that part of your hypothetical?

15 Q I am talking about a particular railroad that
16 is not a terminal railroad, a particular railroad that
17 is not a terminal railroad has considerable power over
18 the movement of a rail shipment, does it not?

19 A That is not a terminal railroad, you mean, like
20 a Class I railroad, for example?

21 Q Yes.

22 A They do have considerable power, yes.

23 Q Right.

24 Now, let's say on a Class I railroad -- and I
25 have more than just a particular point. I have a whole

1 little string of points, a little line that is mine,
2 Class I railroad, the RNK Railroad, has some mileage on
3 which I am the only railroad, and I extend beyond that
4 100 miles to another destination today. I can, as that
5 RNK Railroad today, say that I will make rates and
6 routes to the 100 mile away point only if I am allowed
7 to carry all the way to that 100 mile away point, is
8 that right?

9 A Not strictly. It is not as simple as that.

10 Q What is the complication?

11 A Well, there are two restraints. One of them
12 is economic, and the other is regulatory.

13 Q What is the economic restraint?

14 A Efficiency. If your 100 mile line is going in
15 the wrong direction, adds circuitry, then it is not in
16 your interest to do that. It is not in your interest if
17 you want to make money.

18 Q And railroads do not carry traffic over
19 circuitous routes, is that what you are saying?

20 A I am not sure what you mean by circuitous, but
21 if by that you mean that the least distance route is not
22 always the route that is being taken, that is correct,
23 and partly that is correct because there are other
24 factors besides mileage involving efficiency.

25 Q Now, you said there is an economic.

1 What is the regulatory restraint on the RNK
2 Railroad which has, let's say, the first ten miles of a
3 haul, saying I want to carry all the rest of the 90 mile
4 haul to destination? what is the regulatory restraint?

5 A They have to go through a Commission
6 proceeding and get the Commission to approve it.

7 Q To approve what?

8 A The cancellation.

9 Q Cancellation of what?

10 A Reciprocal switching. Isn't that your
11 hypothetical?

12 Q I have to go through -- no, I am saying, let's
13 start out with the RNK Railroad today. I have a rate --

14 A Oh, I think I understand why you are confused.

15 Q Take a piece of paper --

16 A I think I understand why you are confused.

17 Q I am not confused. Take a piece of paper.

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1 JUDGE HOPKINS: There's some question as to
2 who is confused. I think we all are.

3 BY MR. KHARASCH: (Resuming)

4 Q Put an O on that piece of paper and draw a
5 line to D, from O to D. That line represents 100
6 miles. In between O and D there's a point called I,
7 intermediate.

8 I am the only railroad from O to I. I am not
9 the only railroad from I to D. My question to you is,
10 in that circumstance may I not say I will publish rates
11 from O to D only by my railroad?

12 A It's the same answer. The reason it was
13 confusing the last time is that I neglected to state --

14 Q What's the same answer?

15 A No. The reason they are not totally
16 unfettered is, the way they presumably would accomplish
17 the retention of the traffic for the entire distance
18 would be to create some incentive for the shipper to be
19 willing to route it that way, and that would involve
20 either adjusting prices or cancelling joint routes or
21 whatever.

22 And those things would have to be approved by
23 the Commission. It's not as if it could never happen,
24 because that does happen. But there is a regulatory
25 constraint.

1 Q The regulatory constraint that you talk about
2 is if in order to get that shipment to move only on my
3 line I have to cancel some joint rate with some other
4 railroad between intermediate point and destination, you
5 think the Commission would come in and prevent me from
6 cancelling?

7 A I'm saying the Commission would assess that
8 situation and make a decision.

9 Q And prevent me from cancelling maybe?

10 A Maybe.

11 Q Suppose the only rate in effect is the rate
12 from O to D that I have published by my own railroad.

13 A The local rate?

14 Q Local to my own railroad, right.

15 Are you saying the Commission could force me
16 to make a rate with some other railroad?

17 A That wasn't what I said.

18 Q Do you say that the Commission could force me
19 to make a rate with another railroad?

20 A I'm not a lawyer and I don't remember having
21 seen that happen, but I think it is possible. I
22 couldn't swear to that one way or the other.

23 Q Could you swear one way or the other that the
24 Commission has in recent years prevented any joint rate
25 cancellations?

1 A I'm aware that there is a proceeding going on
2 now on this issue.

3 Q Can't you answer my question for once?

4 MS. REED: He's answering.

5 JUDGE HOPKINS: First answer the question and
6 then if you want to explain.

7 THE WITNESS: I forgot. I should say yes or
8 no first.

9 Can you repeat the question?

10 MR. KHARASCH: Let's have it read back.

11 THE REPORTER: Question: "Could you swear one
12 way or the other that the Commission has in recent years
13 prevented any joint rate cancellations?"

14 THE WITNESS: I cannot so swear.

15 BY MR. KHARASCH: (Resuming)

16 Q Now, in our difficult example from O to D with
17 an intermediate point I, suppose I the railroad acquire
18 a point beyond D. Let's call it D-1. It goes beyond
19 D. So it goes O, I, D, and now I go on to D-1.

20 Because of my control of the movement from O
21 to I, which is exclusive to me, do I not now have the
22 power to control the movement of the shipment from O to
23 D-1?

24 A The way I interpret that -- and again, I'm not
25 sure I understand the question totally, so let me say

1 what I think. But I'm saying, my answer is yes, because
2 if they do control the origin totally then they do have
3 the ability to raise the rate. I'm talking now about
4 market power. We are discussing how much market power
5 there might be.

6 And if there's hypothetically any market power
7 in that market, then this carrier, unnamed, which has
8 the sold access to C has the power to raise the rate to
9 that level if he is unconstrained by regulation. So
10 that they have the market power, that's the point. They
11 have that even before they acquired this new
12 destination, D-1.

13 Q Now, let us talk for one minute about the
14 power to say whether the shipment would physically move
15 by rail from O to new destination D-1 beyond. Do I not,
16 if I have the power over the origin, have the power,
17 subject to this regulatory restraint that you mentioned,
18 to move to D-1?

19 A I would say whatever power you have in that
20 area you had prior to the acquisition of the route from
21 D to D-1.

22 Q Now let's go back to the market pricing power,
23 and I would ask you to look at the helpful diagrams,
24 MKT-C-89. Turn to page 2 of that, would you, and look
25 at diagram number 8. Do you see the O, the I, the D,

1 and railroads 1, 2 and 3? Is this called the rat's tail
2 in transportation economist parlance?

3 A Some people have called it that.

4 Q If railroad 3 did not exist here, railroad 1
5 and railroad 2 would have a bargaining about the
6 division of the rail rate from O to D, would they not?

7 A That's correct.

8 Q And if railroads 2 and 3 -- and these are
9 independent from railroad 1. In the situation shown in
10 helpful diagram number 8, railroad 1 can try to bargain
11 with 2 and 3 to see who will give him the cheapest price
12 in terms of share of division going from intermediate
13 point to D?

14 A That's correct. That's the point I was making
15 a minute ago, that if railroad 1 has the sole access to
16 C then it can use that power to bargain these other
17 carriers down. And at the same time, absent regulatory
18 constraints, it can raise its own rate to a level that
19 hits the equilibrium rate for the market, which is O and
20 D.

21 Q Now, in order for railroad 1 to get its
22 fullest share of the division in the diagram illustrated
23 in number 8, 2 and 3 have to compete rather vigorously
24 in their offering of divisions to 1, do they not?

25 A I don't think I would say that exactly. But

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1 they would under this diagram be forced to compete. The
2 causality is different from the way you said it, but
3 with this diagram it would cause them to have to
4 compete.

5 Q In traditional railroad arrangements, was it
6 not true that there were general divisions in force and
7 that the shipper would choose a 1-2 or a 1-3 routing in
8 the case shown in number 8?

9 A That's a problem I alluded to before. I'm
10 saying yes. That's a problem I alluded to before under
11 the Staggers Act, where there were innumerable joint
12 line routes which were rate equalized, that they all had
13 the same rates regardless of the efficiency.

14 Q In the traditional arrangements there was a
15 set division which would go either to 2 or 3, depending
16 on the routing choice, is that right?

17 A That's correct.

18 Q Now, in order for railroad 1 in helpful
19 diagram 8 to get its biggest share of the O to D rail
20 transportation, 2 and 3 have to be forced to bid against
21 each other to lower their share of divisions, is that
22 right?

23 A No. The causality is wrong.

24 Q Give me the right causality.

25 A The arrangement in the diagram causes them to

1 be in competition with each other. It doesn't require
2 any bidding or anything. They just have to be aware of
3 the competitive realities.

4 Q Yes?

5 A That's my answer.

6 Q They are aware of the competitive realities.

7 Suppose the railroads 2 and 3 -- worst case --
8 they conspire and say, we're not going to take any less
9 than the good old-fashioned division sheet division
10 here. Then they are not competing, is that right? One
11 can't get a bigger share of division?

12 A That's correct.

13 Q And in the most competitive case, 2 and 3
14 would vigorously offer railroad 1 competing shares of
15 divisions until railroad 1 selected one of them and
16 shipped all the product via one of the 2 or 3, that is,
17 one railroad to destination?

18 A I couldn't subscribe to all of those details.

19 Q If railroads 1 and 2 merge, then they can
20 carry the stuff all the way to destination by the merged
21 railroads, correct?

22 A That's correct.

23 Q What is the condition -- see how precisely you
24 can state it -- that you say they will hand the traffic
25 at I off to railroad 3?

1 A Your hypothetical is railroad 1 merges with
2 railroad 2, and under what conditions would it hand off
3 the traffic to railroad 3?

4 Q 1 to 3.

5 A When it was more profitable to do so,
6 probably.

7 Q Let's talk in terms of your variable costs.
8 Can you state the condition that would cause them to
9 find it more profitable?

10 MS. REED: Could counsel clarify what you mean
11 by referring to revenue to variable cost? Are we
12 talking about rates now?

13 JUDGE HOPKINS: Are you talking about the
14 carrier's return? Which is it?

15 THE WITNESS: I don't understand the
16 question.

17 BY MR. KHARASCH: (Resuming)

18 Q Let's say under present rates railroad 1, 2,
19 and 3 under their divisions each earn 145 percent of
20 variable cost on their shares O to I, I to D. Each is
21 earning 145 percent.

22 A Yes.

23 Q All right, and now we have a merger of
24 railroad 1 and railroad 2. Under what condition will
25 the merged railroad give railroad 3 some traffic from I

1 to D?

2 A The addition of the 145 percent revenue to
3 variable cost really doesn't add anything to this
4 example. The point is that they will do that -- the
5 point is there will still be competition between
6 railroad 2 and railroad 3.

7 It's what economists call a make-or-buy
8 decision. It's like if you're General Motors and you
9 have a casting factory and you're trying to decide
10 whether or not you want to continue building castings in
11 your factor or out-source them, say buy them in Japan or
12 whatever.

13 That factor places a considerable competitive
14 restraint on the actions of the vertically integrated
15 element. So I'm saying that there remains competition
16 between railroads 2 and 3.

17 Q At what price does railroad 3 have to offer to
18 carry from I to D in order to induce the merged railroad
19 to use railroad 3's joint service?

20 A Well, you need to have more information to
21 answer that question. I can answer it if you will allow
22 me to fill in a few things as I go along. But in the
23 short run, the incentive is to use railroad 2 unless
24 railroad 3 provides a division which is lower than
25 railroad 2's short-run marginal cost.

1 In the long run, however, there's an entirely
2 different consideration, because of the possibility that
3 one of these two groups might be eliminated. That is a
4 long run type of consideration. So in the long run, you
5 would have to use long-run marginal cost, which is much
6 closer to average cost.

7 Q Short-run marginal cost bears what relation to
8 variable cost, as you use variable cost?

9 A Variable cost is essentially an approximation
10 of marginal cost, but it has general applicability,
11 whereas marginal cost has specific applicability. But
12 some years ago when the Commission defined Rail Form A
13 marginal costs, they used regression analysis and a
14 variety of cost factors to determine what portion was
15 variable, and in essence that is similar to the analysis
16 that an economist does in measuring marginal cost,
17 except they did it once, whereas ideally you do it for
18 each specific situation.

19 Q You said short run marginal cost. You used
20 that in the previous answer. Does short run marginal
21 cost mean the same as variable cost as you've used it in
22 your testimony or not?

23 A No. Short-run marginal cost is actually
24 closer to what the Commission calls directly variable
25 cost. That's why I wanted to draw the distinction

1 between short run and long run, that in the short run
2 you have one situation, but a wise profit-maximizing
3 firm considers the long run as it goes along in making
4 its everyday decisions.

5 Q In the short run, railroad 3 would have to
6 offer to carry at what the Commission calls directly
7 variable costs, and that would have to be lower than
8 railroad 2's directly variable costs?

9 A If I heard you correctly, that wasn't
10 correct.

11 Q You said in the short run railroad 1 and 2
12 merged would use the 1-2 route. What's the
13 relationship?

14 A The relationship is between the division paid
15 to railroad 3 and the marginal cost of using railroad
16 2. That's the relationship in the short run only,
17 because in the long run you can't afford to live just on
18 directly variable costs.

19 A large part of my statement is directed at
20 that general question, and if this make-or-buy decision
21 was based solely on short-run marginal costs and
22 short-run marginal cost was very low, then they would in
23 effect be losing a great deal of money by overusing in
24 this case our RR-2.

25 So that's why I said a minute ago that a wise

1 profit-maximizing railroad has to consider the long run
2 even in its day to day actions. It's not as if we're
3 going to operate in the short run for years and then all
4 of a sudden they get to the long run. Those are
5 decisions that are made every day.

6 Q Now, in the short run, after the merger in
7 this diagram they would only use railroad 3, if they're
8 looking at short-run costs, if railroad 3 offered a
9 short-run marginal cost below that of railroad 2?

10 A I don't think that came out straight. Can you
11 say it again? I think you said it wrong.

12 Q You said in the short run 1 and 2 would run,
13 because if we looked at short run, not at long run,
14 railroad 1 and railroad 2 would use the 1-2 route after
15 they merged. Now, what relation did that decision to
16 use that have to do with short-run variable cost,
17 marginal cost?

18 A Well, it relates to the short-run marginal
19 cost of railroad 2. I think you were talking about
20 railroad 3 short-run marginal cost.

21 Q Railroad 3 has to offer in a sense a price,
22 doesn't it?

23 A A division, that's right.

24 Q A division. In order to get some movement
25 from I to D, what would that price be in terms

1 railroad 2's cost?

2 A Once again, the way you ask that question, it
3 depends on whether short-run or long-run factors
4 dominate. No railroad can make money operating solely
5 on short-run factors. But as long as the short-run
6 factor is the one that happens to operate -- it's like a
7 back haul situation. If all you care about is the very
8 short run, then you're talking the cutoff or the
9 division is the directly variable cost of railroad 2.

10 For example, in this case the two -- if the
11 two are equally efficient, then it would drive railroad
12 2 down to its bottom line sort of, where they would have
13 no gain from operating this way.

14 However, if railroad 3 was more efficient than
15 railroad 2, there would be an incentive, a continuing
16 incentive to use railroad 3, and that incentive is
17 measured by the difference between the marginal cost of
18 railroad 2 and railroad 3.

19 Q Railroad 3, being more efficient, will not
20 survive, however, unless it receives its full variable
21 cost? Or does it need more than that?

22 A The question of the survival of the
23 railroad --

24 Q This segment.

25 A This segment. Relates to long-run costs.

1 Survival is a long-run issue. It is not related to
2 short-run costs.

3 JUDGE HOPKINS: Mr. Kharash, before you start
4 something else --

5 MR. KHARASCH: We're going on to screening
6 after lunch.

7 MS. REED: Your Honor, could I ask how much
8 time?

9 JUDGE HOPKINS: We will recess until 1:45.

10 (Whereupon, at 12:37 p.m., the hearing in the
11 above-entitled matter was recessed, to reconvene at 1:45
12 p.m. the same day.)
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AFTERNOCN SESSION

(1:45 P.M.)

JUDGE HOPKINS: Let's get back on the record.

Have at it, Mr. Kharasch.

Whereupon,

RICHARD H. KLEM,

the witness on the stand at the time of recess, having been previously duly sworn, resumed the stand, and was examined and testified further as follows:

CROSS EXAMINATION - RESUMED

BY MR. KHARASCH:

Q Dr. Klem, let's slip over to Page 12 of your statement and get into the question of screens. Let's talk first about your 50-10 screen on Page 12. In applying the 50-10 screen, we are not at this point using your definition of competitive price as being 180 percent of variable cost. Is that right?

A This is in effect trying to predict -- this is one part of an analysis that attempts to predict what impacts on competition will be, so it is independent of the other issue.

Q Right. You say on Page 12, the initial SPLC-4 analysis identified 406 bidirectional flows. I am not understanding bidirectional.

A By that I mean from A to E and also back from

1 B to A. As I explained in here, that was done in order
2 to aggregate, increase the number of observations, and
3 it was also done on the basis that if a carrier had the
4 ability to compete from A to B, then it is unlikely they
5 would be unable to compete from B to A.

6 Q Now, what you started off with was all
7 standard point location code four digit served by the
8 two applicants, and you tried to -- what is the
9 identification of 406 bidirectional flows, 406 out of
10 what?

11 A As I said, it was out of 9,561 here three
12 lines down, flows in which one or both applicants
13 participate.

14 Q Now, what initial analysis -- is the initial
15 analysis the 50-10? Is that the identification of 406?

16 A The 406 is done prior to any 50-10.

17 Q All right. Tell me how 406 bidirectional
18 flows were selected out of 9,561.

19 A They are flows in which both applicants
20 participate.

21 Q To any extent?

22 A To any extent, any commodity.

23 Q All commodities are put together, and the
24 balance of the 9,561 flows are flows in which only one
25 applicant participates and not the other. Is that

1 correct?

2 A That is correct.

3 Q Now, when you say bidirectional flow, you mean
4 you added up the both way participation by the
5 applicants and by other railroads.

6 A That is correct. For example, if one railroad
7 participated from A to B and the other railroad
8 participated from B to A, that would be counted as a
9 member of the 406 flows provided that they participated
10 independently of each other.

11 Q When you talked about a participation, did you
12 include a participation by a joint line origination, a
13 joint line bridge, or a joint line termination?

14 A Yes, if you look in the appendix, you will see
15 examples of those.

16 Q The answer is yes, it included each of those
17 three?

18 A That is correct.

19 Q And did you separate so as to avoid double
20 counting those flows in which the two applicants
21 happened to participate in the joint line movement?

22 A That is correct. If you turn to the summary
23 sheets in the confidential appendix, at the front of the
24 confidential appendix you would see that it says -- the
25 column is entitled, for example, SP Tons Ex-SF. What

1 that means is SP tons that are exclusive of any SF
2 participation. So those are tons where SP participates
3 independently of SF.

4 Q And then you have an SF ex-SP?

5 A Right, there is also a total tons there, and
6 those two numbers may not necessarily add up to the
7 total because of the third category where they do
8 participate in a joint line movement.

9 Q Now, your first step was to apply this 50-10
10 test. The 50 percent test meant that the applicants had
11 to carry more than 50 percent of the bidirectional
12 flow. Is that right?

13 A That is correct.

14 Q And the reason for that was that if you don't
15 carry more than 50 percent, then even combined you could
16 not dominate the market?

17 A That's correct.

18 Q And market dominance in that sense means more
19 than 50 percent. Yes?

20 A This is not market dominance.

21 Q Dominance.

22 A Market dominance is, I understand, a term of
23 art, and this is something else.

24 Q This is domination of the market?

25 A It has a broader meaning, a general meaning.

1 It is not the term of art.

2 Q What is this general meaning that if they have
3 less than 50 percent of the total flow, railroad flow in
4 the market, they could not dominate the market? What
5 does that mean, dominate the market? Operationally,
6 perhaps?

7 A That in effect means that other -- in this
8 case we are talking only of -- at this point in the
9 analysis we are talking only of rail market shares. We
10 haven't yet expanded the market to consider other
11 possibilities, and that means that other railroads would
12 in fact have a larger amount of share than the
13 applicants, and would constrain them.

14 It is worth noting that we are not talking
15 about 50 percent market share here. If you look on the
16 next page, I mention that the average share of the
17 applicants -- this is their combined share -- was not 50
18 percent in these markets, it was 17 percent. And I
19 think that gives you a better flavor for what is going
20 on here. Many of these markets, the applicants have had
21 only 2 or 3 percent, 10 percent, or some other small
22 amount.

23 MR. KHARASCH: Your Honor, I am trying to
24 proceed question by question, and I am getting from the
25 witness it is worth noting this, and it is worth noting

1 that. Can't we please have direct answers to the
2 questions?

3 JUDGE HOPKINS: Doctor, would you just answer
4 the question the way he asks it? We will get through a
5 lot faster.

6 BY MR. KEARASCH: (Resuming)

7 Q Now, within a market where the applicants
8 carry less than 50 percent of the rail traffic, they
9 could have carried all of the rail traffic of a
10 particular commodity. Is that correct?

11 A Conceivably.

12 Q Within a market in which the applicants carry
13 less than 50 percent of the rail traffic, there could be
14 within the four-digit SPLC portions of the four-digit
15 SPLC which the applicants were not allowed to serve
16 because they were not open to reciprocal switching. Is
17 that true?

18 A Definitely that is true.

19 Q For example, before lunch you mentioned the
20 case of the General Motors new plant where the Southern
21 Pacific has rail service and they won't let the Union
22 Pacific in.

23 Do you recall mentioning that?

24 A The General Motors old plant, you mean?

25 Q Yes.

1 A Yes.

2 Q That plant could be shown in a SPIC where the
3 Union Pacific appears as a carrier but Union Pacific
4 can't serve that plant today.

5 A You mean a SPIC-4 or a SPIC-6?

6 Q SPIC-4 in this case.

7 A Oh, for certain.

8 Q Indeed, within a SPIC-6 it is possible that
9 Union Pacific would be in the same SPIC-6.

10 A That's correct. As I mentioned in my
11 statement, this was --

12 Q I really don't need more than "That's
13 correct."

14 JUDGE HOPKINS: You don't need to say any
15 more. Thank you. He is only interested in getting the
16 direct answer.

17 THE WITNESS: It seems, if he says, did I do
18 something, I should be allowed to say a little bit about
19 why I did it.

20 JUDGE HOPKINS: You said a lot of things. He
21 will probably get to some of those, or somebody else
22 will get to some of those questions that you want to
23 answer, but the thing is, answer his direct question.
24 There are times when you have to explain, but there are
25 times when you don't. Thank you.

1 BY MR. KEARASCH: (Resuming)

2 Q Now let's turn to the 10 percent within the
3 SPIC-4 flows. A second condition that is remaining in
4 your screen was that one of the applicants had to have
5 10 percent of the traffic. Is that correct?

6 A That's correct.

7 Q Excuse me. Each of the applicants.

8 A That is correct.

9 Q Now, again, as in the case of the 50 percent
10 screen, it is possible that for a particular commodity
11 or for a particular location within the SPLC-4, the
12 screen may be eliminating a flow where the applicant had
13 100 percent of the traffic.

14 A That's correct.

15 Q Suppose we have a SPLC-4 in which there is a
16 power plant. The carrier serving the power plant is
17 likely to carry quite a lot of coal. Let's assume
18 that. Is that a reasonable assumption?

19 A You are assuming there is one carrier serving
20 the power plant?

21 Q Yes.

22 A That is a reasonable assumption.

23 Q And then coal traffic to that plant will
24 affect the application of the screen, will it not?

25 A That is correct.

1 Q Now, after the 50-10 screens, you say on Page
2 13 you eliminated TOFC and boxcar movements and called
3 this a screen also. Isn't that right?

4 A Not strictly.

5 Q Let me tell you what I don't understand, and
6 then I would be grateful for your explanation. It is my
7 understanding that the screens -- the flows that were
8 left after your 50-10 screens were flows of all
9 commodities in two directions between two pairs of
10 SPLC-M's. So far am I right?

11 A That is correct in the 406 flows.

12 Q Right. Now, I don't understand. You take out
13 TOFC and box car movements. Then what causes the flow
14 to drop out of your puddle for analysis, your puddle of
15 data for analysis because you took out TOFC and box car
16 movements?

17 JUDGE HOPKINS: Here is your chance.

18 THE WITNESS: First of all, the order of the
19 flows -- excuse me, the order of the screens that are
20 applied in each situation is, for example, in my
21 analysis of the case when TOFC was excluded, for
22 computer runs where TOFC was excluded, I went back to
23 the basic way bill data and excluded all TOFC
24 movements.

25 Then I looked only at flows in which not only

1 both applicants participated, but also they each had at
2 least 10 percent of the non-TOFC movement, and combined,
3 they had 50 percent of the -- the combined share was 50
4 percent of the non-TCFC movements.

5 Now, the purpose of that was to focus on what
6 I believe is the relevant market.

7 Q We will assume that all of this had a purpose,
8 but I am just trying to find what happened physically at
9 this point. Am I correct that what you did is go back,
10 take out all TOFC movement from the -- did you take out
11 all TOFC from the 406 bidirectional flows?

12 A That's correct.

13 Q And then you applied the 50-10 screen again.

14 A No.

15 Q No?

16 A The 406 does not have any 50-10 screen applied
17 to it, so that for these runs where TOFC was excluded
18 the 50-10 screen is applied once, and it is after the
19 TCFC is excluded.

20 Q Well --

21 A I would be happy to say why if you would ask
22 me.

23 Q You went through one screening leaving TOFC
24 and COFC in, and that got you to the material the
25 results of which you are discussing in the first old

1 paragraph at the top of Page 13.

2 A The one that starts out about the 406 flows?

3 Q Thirteen.

4 A I am sorry.

5 Q The continuing paragraph where you say "These
6 screens eliminated 92 flows."

7 A That's right. Now, what was the question
8 about those?

9 Q Did that actually take place, that analysis
10 that you described there, the 50-10 screening of traffic
11 with TOFC and COFC in?

12 A That's correct.

13 Q It did happen? What you were describing
14 there, is that with TOFC and COFC in?

15 A All of this happened.

16 Q Then you go on and say you are going to take
17 ICFC and COFC out. Let's not inquire as to the reasons
18 for the moment. And you say such movements were
19 eliminated from the flow analysis. Did you go back to
20 the 406 bidirectional flows?

21 A I went back to the 406 bidirectional flows
22 prior to the application of the screen, and in fact to
23 do that you have to go back to the way bill records,
24 which are part of the 406 flows, and eliminate all these
25 way bills which are TOFC.

1 Q Okay. You did that, and then you applied a
2 50-10 screen again?

3 A It is not again, though. It was applied only
4 once to each analysis.

5 Q But in that you a second time applied the
6 50-10 screen.

7 A That is correct. There were two independent
8 applications of the 50-10 screen, once in the first
9 analysis, including all traffic, and then again in the
10 second analysis, after TCFC was excluded. There are two
11 separate applications of it. Both of them went back to
12 the 406.

13 Q Were TCFC, COFC, and box car pulled out at the
14 same time?

15 A No.

16 Q So you have applied the 50-10 screen three
17 times, once to all traffic, once to all traffic less
18 TOFC, and once to traffic less box car.

19 A No.

20 Q I am honestly baffled by -- that is what I
21 didn't understand when I read it, and I still don't
22 understand. You refer to, on Page 13, to the TOFC-COFC
23 screen eliminated 95 flows, and the box car screen 73
24 flows. Now, if you read up at the previous paragraph,
25 are you telling us that your 50-10 screens eliminated 92

1 flows?

2 I am not understanding. Are these additive,
3 subtractative?

4 A Would you like me to explain it to you?

5 Q Yes, please. Just physically what happened?

6 A What happened was the language here in the
7 paragraph you are referencing on Page 13 relates to the
8 logic of the analysis. There were three units in the
9 analysis.

10 There was first the unit where it looked at
11 all kinds of traffic. There was second the unit where I
12 looked at traffic excluding TOFC. And there was finally
13 the unit where I looked at traffic excluding both TCFC
14 and box.

15 Now, that is the way the analysis worked, in
16 that order, and that is why I did the numbers in this
17 order. If you start with 406 and you subtract these
18 various numbers, you get down to the 146 flows at the
19 bottom.

20 Now, that is the economics of it. But in
21 order to apply the screens, you can't apply the screens
22 in any order. It makes a difference what the order is.
23 Each of these three separate analyses required
24 consideration of the appropriate application of the
25 screens.

1 And as I said earlier on, that was one of the
2 sources of the errata that the screen on the final
3 section was in fact applied in the wrong order, but the
4 correct order was for the final unit, the third unit,
5 which is the unit where TCFC is excluded and box car is
6 excluded is to apply the screen to first exclude TCFC,
7 then to apply the 50-10 screen, and finally to apply the
8 box car screen.

9 And I am happy to explain why that is the
10 right order if you ask me.

11 Q You have 406. First you apply the 50-10
12 considering all traffic.

13 A That's correct.

14 Q Then you take out TOFC and examine those that
15 pass the 50-10 with all traffic. When you take out
16 TCFC, do you go back to everything before you applied
17 the 50-10 screen?

18 A I answered that question a couple of times
19 already, that the first unit, the analysis of the
20 situation where all traffic is included is a separate
21 unit. The second unit, the analysis after TCFC is
22 excluded, is another separate unit.

23 When I did the second, separate unit, I went
24 back to all the traffic in the 406 flows, which means
25 prior to any application of any 50-10 screen, and

1 excluded TOFC. So, in the second unit, the analysis
2 excluding TOFC, the order of the screens was box car,
3 and then 10-50.

4 I am sorry, I misspoke. The order of screens
5 was TCFC and then 10-50.

6 Q Do you think that a railroad that carries box
7 car traffic into a SPLC-4 has the capability of carrying
8 non-box car traffic into a SPLC-4?

9 A Not necessarily.

10 Q In what circumstances would a railroad not
11 have the ability to carry non-box car traffic if it
12 could carry box car traffic?

13 A If the location of the non-box car traffic was
14 such that it did not access the shipper, for example.
15 That would be one case.

16 Q Now, let's go on to the next step. This is
17 your SPLC-6 step. Is that right?

18 A (Nods affirmatively.)

19 Q Of what is remaining, you said let's get
20 narrower here. I have eliminated myself down to a
21 certain number of flows, and within these let's get to a
22 narrower point and ask whether the two applicants serve
23 the same SPLC-6. Right?

24 A That is correct.

25 Q And if they don't both serve the same SPLC-6,

1 that will be eliminated for further analysis. Is that
2 right?

3 A That's correct. If it was a flow from one
4 SPLC-6 to another SPIC-6, and there was not an
5 independent routing which had the SF in it and another
6 independent routing which had SP in it, and therefore
7 there would not be the loss of a routing, I did not
8 consider that.

9 Q Did you apply your SPIC-6 screen back to the
10 total analysis of bidirectional flows which is described
11 on Page 12?

12 A What do you mean, the total analysis?

13 Q Well, have you tried to apply the SPLC --
14 let's take it in steps. Have you applied the SPLC-6
15 screen to the traffic that was eliminated by your 50-10
16 screen?

17 I don't believe so.

18 Q Let's call the SPIC-4's counties. That is not
19 too bad a way to designate them, is it?

20 A No, that is perfectly fine.

21 Q Is it possible that within a SPLC-4 county
22 that failed your 50-10 screen there are locations, let's
23 call them towns or stations, that would show more than
24 50 percent participation by the two applicants?

25 A No. As I said in the statement, application

1 cf the screen in that way would be inappropriate.

2 Q It may be inappropriate, but is it possible
3 within a county where you say, let's say the applicants
4 carried 49 percent, that there may be stations within
5 the county where the applicants indeed carried 99
6 percent of the traffic.

7 A When you are looking at actual flows from
8 SPLC-6 to SPLC-6, the market shares can be anything, and
9 not mean anything

10 Q But whether it is meaningful or not, can't you
11 answer my question?

12 A I did.

13 Q There can be such cases?

14 A They can be anything.

15 Q Let's say we have one of these counties
16 divided by the mountain range. The west half of the
17 county may be served by the two applicants, and they may
18 have all the railroad traffic in that half, and the east
19 half may be served by the Union Pacific. Is that
20 possible?

21 A I think that is unlikely. SPLC-4's are
22 smaller units of measure than counties in that the large
23 counties are broken up, and they are considerably
24 smaller than, for example, FEA's.

25 Q Did you have a statistical advisor while these

1 runs were being made?

2 A No.

3 Q How many different point to point flows are
4 theoretically possible between the SPLC-6's served by
5 the applicants?

6 A I have not done that calculation.

7 Q Do you have any idea how many different
8 SPLC-6's are served by the applicants?

9 A I have not done that calculation.

10 Q More than 10,000?

11 I am recalling that one of the SP witnesses
12 said that they served 20,000 stations.

13 A I will take your word for it.

14 Q Is that reasonable or not?

15 A It is not unreasonable. It could be. I am
16 saying I have never calculated the number.

17 Q When you were looking at a SPIC-6 to SPLC-6
18 movement, could you have as many as 100,000 of those
19 pairs, do you think? If there are 10,000, could you not
20 have as many as a million point pairs?

21 A Are you talking about theoretical ones or
22 actual ones?

23 Q Theoretical first.

24 A Theoretical, I think, is 10,000 square. Of
25 course those aren't real ones, but that is the

1 conceivable number.

2 Q Do you know how many observations there are of
3 the way bill sample?

4 A You were using 236,000.

5 Q 236,000. Is the way bill sample statistically
6 reliable to find whether two railroads had a movement at
7 the SPLC-6 level?

8 A That is exactly why I didn't do it. That is
9 the thing I was trying to get into a minute ago, and
10 thank you for asking me that.

11 The point is, if you do -- you did ask me, and
12 I was trying to say a minute ago there is no legitimate
13 basis for doing SPLC-6 to SPLC-6 analysis. And I tried
14 to explain in the verified statement why that was true.

15 What you have done is, you have uncovered a
16 tip of that iceberg, that there are not enough way bills
17 in the world to do such an analysis. When the
18 theoretical -- even when you had a 100 percent sample,
19 it could conceivably be a problem.

20 If you have conceivably 10,000 OD pairs, you
21 don't really have 10,000, but you have a very large
22 number of OD pairs, you don't have enough data to do
23 that.

24 When you don't have enough data, shares of the
25 script you have been asking about for the last empty-ump

1 minutes don't mean anything.

2 Q But does it mean anything to say whether you
3 can find whether they actually have independent
4 competing routings?

5 A It certainly does. As I tried to say in the
6 verified statement, I aggregated the flows together as
7 much as possible in order to overcome the very problem
8 they seemed to be concerned about, and I feel that they
9 did adequately overcome it.

10 And then at the SFIC-6 level I used the kind
11 of analysis which is appropriate, which is to look who
12 is not only an actual competitor, but a potential
13 competitor, to look and see who could serve. And that
14 is not affected by the statistical issues that you are
15 raising.

16 Q Now, if you are just determining potential
17 competitors, there are a lot more than 69 flows where
18 the SF and the SP are potential competitors. Isn't that
19 right?

20 A I think that is not right.

21 Q Well, if you applied -- if you are determining
22 whether applicants have independent access to origin and
23 termination points, aren't you going to find a lot more
24 than 69 SPLC-4's within which the applicants have
25 independent access, single or joint line, to the origin

1 and termination?

2 A But that is only a portion of the analysis.

3 Q Sir, just answer my question.

4 JUDGE HOPKINS: Answer the question.

5 THE WITNESS: The way I understood it, the
6 answer was no. If I recollect the question properly.

7 BY MR. KEARASCH: (Resuming)

8 Q We are going to be here all day if you argue
9 with me.

10 MS. REED: He is trying to explain his
11 methodology.

12 JUDGE HOPKINS: Go ahead.

13 THE WITNESS: Can I hear the question again?

14 BY MR. KEARASCH: (Resuming)

15 Q I will restate it. If we look at all the
16 SPIC-4's within which both of the applicants had
17 independent access, single or joint line, to actual
18 origin or termination points of traffic, SPIC-6 points,
19 we are going to have more than 69 SPIC-4 to SPIC-4
20 combinations, are we not?

21 A That is correct. The number would be very
22 large. It would be a number in the order of magnitude
23 that you were speaking of earlier. In fact, it would be
24 that number.

25 Q Page 16, the last sentence of the first new

1 paragraph, that is, the second paragraph, beginning,
2 "The economic implication."

3 A Page 16 of my verified statement?

4 Q Yes, sir.

5 A The first full paragraph begins, "Such
6 shippers."

7 Q Yes. The last sentence. Please address
8 that. When you say in the absence of SPSF competition
9 the applicant's TOFC rates would be constrained to
10 competitive levels, is the competitive level that 180
11 percent competitive level that you had defined earlier
12 on Page 7, or 6?

13 A No.

14 Q At what point during your analysis or your
15 statement are we to understand that competitive level
16 means 180 percent of variable cost, and at what point
17 are we to understand that it has some other meaning?

18 A As I said this morning, at no point does
19 competitive levels mean 180 percent. I think I said
20 that three times this morning.

21 Q What does competitive level mean on Page 16 in
22 that paragraph?

23 A It means competition is effective. Or I have
24 also said that there is an absence of market dominance.

25 Q In the sense you are using the word on Page

1 16, is there any quantification, a percent of variable
2 cost?

3 A I don't understand the question.

4 Q Is there any percentage of variable cost in
5 that constraint to competitive language in the sense you
6 used the word on Page 16?

7 A Not really.

8 Q There is no quantification in that statement?
9 Excuse me. Is there any quantification of any sort in
10 that statement?

11 A In this statement? This is not a quantitative
12 statement, no.

13 JUDGE HOIKINS: That answers the question.

14 BY MR. KHARASCH: (Resuming)

15 Q Over on Page 17 where you refer to geographic
16 competition that will restrain the applicant's rates to
17 competitive levels, is there a quantification of that?

18 A If I understand the question correctly, the
19 answer is, once again, this is not a quantitative
20 statement on Page 17.

21 Q Now, on Page 17, you are discussing sorghum
22 and wheat. You make a note that the SF originated only
23 2 percent of total rail originations of wheat. Do you
24 see that?

25 A Yes, I do.

1 Q Do you think that rail originations of wheat
2 in, say, Georgia have much relevance to the discussion
3 of the issues in SFSP merger?

4 A Yes. As I made clear in my agricultural
5 appendix, the individual rates in agricultural markets
6 are influenced by a broader geographic market than, say,
7 back in the old siding to siding, and that the scope of
8 that market is broader.

9 I don't know if Georgia is in it or not. I
10 haven't looked at Georgia. But the point is that it is
11 broader than just the specific points that are served by
12 the applicants. And that is just the nature of the
13 market.

14 Q Is geographic competition from a point so far
15 away that it would be uneconomical to move the product
16 from a point that far away, significant geographic
17 competition?

18 MS. REED: Are you assuming that it is not
19 moving to the same destination market?

20 MR. KHARASCH: That is right.

21 THE WITNESS: In some circumstances, that can
22 be true. It is widely established in economics. It is
23 based on principles that are widely established.

24 BY MR. KHARASCH: (Resuming)

25 Q What is the name of that principle?

1 A I said principles. I don't have a name for
2 them, but they are described at some length in my work
3 papers, in several pamphlets, like spatial relations of
4 grain, that sort of thing.

5 Q Spatial.

6 Let's look if we can at Appendix F, sir.
7 Would you be good enough, sir, to lay before you the
8 helpful diagrams at this point? Do you see in Appendix
9 F, in the first sentence where you refer to intense
10 competition between railroads and between railroads and
11 exempt agricultural trucking?

12 A Where is that?

13 Q You don't see it in your first paragraph?

14 A I do now, yes.

15 Q Do you see the reference to intense
16 competition, sir? Now, are you saying that there is
17 intense competition railroad to railroad, and that there
18 is also intense competition between railroad and
19 trucking?

20 A That is correct.

21 Q Let's look at Page 5. Page 5 in the first
22 sentence of text below the table, you say that truck
23 moved more than 3 percent of the wheat shipped from
24 Kansas to Gulf ports is moving 3 percent or even 4
25 percent of a product flow intense competition, in your

1 terms?

2 A That fact by itself does not demonstrate
3 whether it is intense or not intense. It is not
4 sufficient.

5 Q If one were to apply a 10 percent screen such
6 as you applied, would you say that a 3 percent flow by a
7 carrier would fail your 10 percent screen? That it is
8 not a significant presence in the market?

9 A Which application of the 10 percent are you
10 referring to?

11 Q The first time when you threw out from your
12 consideration of applicants' competition all cases in
13 which one of the applicants did not move 10 percent of
14 the flow.

15 A That was a different situation where we were
16 dealing with a siding to siding market, and the 10-50
17 screen was developed by the Justice Department to deal
18 with those very specifically railroad sort of issues
19 where you have substantial market shares.

20 If you apply the 10-50 screen, for example, to
21 the trucking industry, you might find there wasn't a
22 single competitor in the whole market, but in fact there
23 are thousands of competitors in the market. A screen
24 such as that is a useful tool, provided that it is a
25 applied in a reasonable manner.

1 Q You said that the 3 percent truck competition
2 for wheat from Kansas to Gulf ports may be intense
3 competition for railroading. Is that right?

4 A I am saying that that number by itself doesn't
5 give you enough information to answer a question about
6 whether or not there is intense competition between
7 trucks and railroads.

8 Q Would it be useful in that market to know the
9 cost of truck transportation and the costs of rail
10 transportation?

11 A It would not likely be sufficient. Whether or
12 not it would be useful, I am not sure. I don't know the
13 answer to that question. But it would certainly not be
14 sufficient.

15 Q If you find over a period of years that in the
16 market truck is moving less than 3 percent of a
17 commodity, and the balance is moving by rail, can you
18 draw any conclusion as to truck competitiveness in that
19 market?

20 A In that hypothetical you may because you have
21 speculated that there is a market here. Now, this one
22 is not a market. It is not a reasonable definition of a
23 market. But in your hypothetical you said it is a
24 market, and if it really is a market as economists and
25 antitrust lawyers define it, then a 3 percent market

1 share might have some meaning.

2 Q Do you know how much it costs to move by truck
3 grain, say, 100 miles?

4 A I have seen numbers on that, but I don't
5 recall.

6 Q Did you use any such numbers in your
7 discussion in this case?

8 A I did not.

9 Q Let's look at Page 2 of the same appendix and
10 spend a minute on the agricultural products appendix.
11 Look at Page 2, and look at the footnote with two
12 asterisks.

13 A Page 2?

14 Q I am about to quote a piece of that and ask
15 you whether you believe the statement is true. "The
16 price paid at the country elevator for wheat is the Gulf
17 export price less transportation costs and elevator
18 margins incident to movement to the Gulf."

19 A That is a direct quote from here, and I do
20 continue to believe that in the context that I used it.

21 Q Let us use an example we have used earlier in
22 this case. We have set the Gulf export price of wheat
23 at \$4 at, say, Houston. Let's just accept that. Are
24 you saying -- does that sentence mean, which is true,
25 that \$4 less elevator margin less rail cost of

1 transportation is what the farmer in southwest Kansas is
2 going to be paid for his wheat?

3 A I believe that is correct.

4 Q And if the railroad price goes down, the
5 farmer in southwest Kansas is going to get more money?

6 A Which railroad?

7 Q If the railroad rate, that is, the
8 transportation cost goes down from, say, \$1 to 80
9 cents --

10 A This is the railroad they actually use?

11 Q They actually use. The railroad price goes
12 down, and the farmer will get 20 cents more.

13 A That's correct.

14 Q Have you read enough in this record to know
15 whether there is an example of that happening in this
16 record, indeed?

17 A I don't recall reading it, but I have heard
18 about such examples. In fact, there are many examples
19 of rates going down in response to increases in
20 competition, but what counts is whether or not
21 competition is increased or decreased.

22 MR. KHARASCH: I move to strike the last half
23 of that because it was not responsive to my question.

24 MS. REED: Your Honor, he was explaining his
25 earlier response.

1 JUDGE HOIKINS: I will allow it.

2 BY MR. KHARASCH: (Resuming)

3 Q Now, in your analysis, Dr. Klem, does it
4 matter whether the farmer is getting more or less for
5 his grain?

6 A I didn't do it quite as directly as that, but
7 generally that is certainly a relevant issue.

8 Q So you are concerned with the distribution of
9 the final price of grain between the transporter and the
10 farmer?

11 A I think the answer is yes. But a competitive
12 analysis such as this one is based on -- and antitrust
13 in general is based on economic efficiency, and you used
14 the word "distribution," which has some meaning in
15 economics. I am taking -- what you mean is -- the
16 question is, do the relative prices matter? And the
17 relative prices do matter when they influence
18 competition and efficiency.

19 Q Now let's flip over to Page 6. Excuse me. It
20 is Page 7. Page 7, five lines down, you are saying
21 there is a reference to truck rates were not far above
22 base railroad rates even under this scenario. Is it
23 surprising when two modes of transportation compete that
24 their rates will be close?

25 A We went through that this morning, and I think

1 I said then and I would still agree that if two firms
2 compete, and the products are evaluated as being of
3 equal basic utility to the customer, then they will
4 likely have similar prices.

5 Q Now may we turn, sir, to the useful diagrams
6 for a moment at Page 2, and we will look at, let's say,
7 useful diagram 5. Here we have a farmer growing wheat
8 in southwest Kansas. Is it correct, and I believe you
9 have noted that farmers generally have to truck their
10 wheat to a railroad if it is going to move by railroad.

11 A Most do truck it to wherever it is going.
12 Typically it goes to an elevator.

13 Q All right. If Railroad 1 and Railroad 2 are
14 accessible to the farmer, I think our earlier discussion
15 about the pricing of wheat means that the farmer is
16 going to get more money if he goes to the elevator on
17 Railroad 1 if Railroad 1 has a lower rate than Railroad
18 2. Is that right?

19 A What is your assumption about the truck rate
20 again?

21 Q Let's assume for the moment in Number 5 that
22 the truck cost to Railroad 1 and to Railroad 2 is very
23 close or identical. He will go where he gets the best
24 price. The farmer will sell where he gets the best
25 price, will he not?

1 A The farmer will sell where he gets the best
2 price.

3 Q And if Railroad 1 offers a lower price than
4 Railroad 2 for transportation to the Gulf as explained
5 in your footnote and discussion on Page 2 of this
6 appendix, then the farmer is going to get more net for
7 his wheat by going to Railroad 1 if that is the railroad
8 with the lower rate.

9 A Not necessarily.

10 Q Why is that?

11 A You can't evaluate prices and net effects like
12 that outside of a market context. It is widely
13 established that if you want to find out what is
14 happening to prices, you have to do it in a market, and
15 there is no reason to believe that this little diagram
16 represents a market. What it is is two railroads, and
17 two dotted lines representing trucks, and that is not a
18 market.

19 Q All right, but did you not tell us on Page 2
20 that the price paid at the country elevator for wheat is
21 the Gulf export price less transportation costs?

22 A I did say that. That's correct.

23 Q And therefore if the transportation cost of
24 Railroad 1 is lower, the farmer is going to get more
25 money because he is going to get a higher price. Is

1 that not true?

2 A That is not true. That is not enough facts to
3 make a conclusion as to what the farmer is going to
4 get.

5 Q What is wrong with the statement that the
6 price paid at the country elevator for wheat is the Gulf
7 export price less transportation cost?

8 A Not a thing.

9 Q And if the beginning of Railroad 1 and
10 Railroad 2 in the diagram is a place where there is an
11 elevator for the farmer to deliver, isn't that a price
12 paid at a country elevator for wheat, and isn't that
13 price going to be the Gulf export price less the
14 transportation cost on railroad 1?

15 A The way I understood that, it is not, because
16 you said it is the price the farmer gets, and unless you
17 have got a market here, you don't know what the price is
18 the farmer gets. You know that that is one price that
19 is available to him. You know under this assumption
20 these are two prices that are available to him.

21 You don't know that they are the best prices
22 that are available to him. Unless you have the whole
23 market, you don't know what the best price is that is
24 available to the farmer, and you don't know what he is
25 going to do, and you don't know how well off he is going

1 to be.

2 Q Oh, you are saying the farmer might do
3 something else with the wheat. He might ship it to a
4 flour mill or something? Is that right?

5 A I am saying that these two movements here, as
6 I described in my verified statement, take place in a
7 larger competitive environment where the actions of
8 these two railroads and also whatever truckers are
9 involved there, whether it is a farmer or some for hire
10 trucker, are affected by other railroads and other
11 truckers, so that to understand what is going to happen
12 anywhere for this particular farmer you have to consider
13 the whole market.

14 Q I am not asking you, sir, to speculate as to
15 what would cause Railroad 1 to lower its costs. I am
16 just saying from your statement on Page 2 the price paid
17 at the country elevator, and I want to look at the
18 country elevator first on Railroad 1, is the Gulf export
19 price which we will assume is \$4 less transportation
20 costs and elevator margins.

21 Now, if Railroad 1's transportation costs are
22 less to the Gulf, then Railroad 2, doesn't that
23 statement that you put on your statement on Page 2 mean
24 that the price on Railroad 1 will be better for the
25 farmer if that railroad charges less?

1 A I think I answered that question before when I
2 said that you can't evaluate what is good for the farmer
3 without looking at a market, and any time you evaluate
4 changes in prices, you have to look at a market.

5 It is like if you were trying to evaluate the
6 effect of a merger and you weren't looking at a market.
7 It is not meaningful unless you are looking at market.
8 The first step in any such analysis is to define a
9 relevant market.

10 Q Is your statement on Page 2 of your Appendix F
11 designed to talk about the wheat market?

12 A The statement on Page 2, Appendix F?

13 Q That is the footnote that we have been looking
14 at that tells me what the price is that the elevator
15 pays.

16 A That is correct.

17 Q Is that price paid to be understood as the
18 price the elevator posts and says to the farmer, I will
19 give you that money?

20 A It is the price such as you describe which is
21 also the equilibrium price. This is based on the
22 fundamental economics I described earlier about the
23 agricultural market. It doesn't describe any one
24 particular little segment of it. It describes the
25 market.

1 So, the statement is relevant as an
2 equilibration process.

3 Q And if in that equilibration process a
4 railroad gets into the market and lowers its rate, does
5 that not tend to raise the price of wheat at that
6 elevator?

7 MS. REED: Your Honor, I object. This has
8 been asked and answered several times.

9 JUDGE HOPKINS: No, I am going to allow it.
10 One of the problems is a question of definition of
11 terms, Mr. Kharasch, from what I can see. He is going
12 one way; you are going the other way, and the two of you
13 can't define the terms.

14 So he is answering one way and you are not
15 defining your terms enough, I think, to meet what he is
16 saying. I think that is one of the problems.

17 BY MR. KHARASCH: (Resuming)

18 Q Let's look at diagram number 7. Let's make a
19 simplifying assumption. For this particular product
20 there are only two regions, 01 and 02. And the product
21 price at destination has been fixed at \$4.

22 Let's fix it at \$4 by even the fact that it is
23 a port and there is foreign competition. You might
24 bring in our product from abroad. You have the world to
25 play with. That is the price today at that port.

1 Now, if there is a region such as O2 where the
2 product is moving by rail to destination, and I will
3 give you another assumption, it is moving at below any
4 price truck can quote, if at that origin there are
5 elevators, would the price to suppliers at that Origin 2
6 not go up if Railroad 3 cuts its price?

7 A I still need more information to answer that
8 question.

9 Q What do you need?

10 A I need to know the scope of the relevant
11 market. I can't really answer questions like this
12 without knowing what the scope of the relevant market
13 is.

14 Q In this particular example, sir, the market is
15 the market at D. There are other markets in the world,
16 but D is a port, and that is the only place we are going
17 to be able to sell this economically.

18 A O2 is not in the market?

19 Q O2 is supplying the consuming market at D.

20 A What I need to know is the full encompass of
21 the market.

22 Q As far as the United States is concerned, it
23 is farms around Origin 1 and farms around Origin 2.

24 A So there are two markets?

25 Q The place it is being sold is at D, and there

1 are two competing origins, 01 and 02. The price at D is
2 fixed by the fact that there is plenty of grain
3 elsewhere in the world that could come into D.

4 A I am sorry, but I am having a hard time
5 understanding, because I can't translate your words into
6 a relevant market.

7 Q What is missing?

8 A Well, a market is something where buyers and
9 sellers interact with each other, buy and sell to each
10 other. So it has got to have both the buyers and
11 sellers in it, and it has got to encompass all of the
12 relevant buyers and sellers.

13 Q At D where the product is consumed there are
14 lots of buyers, okay?

15 A Okay.

16 Q And there are sellers from 01 and 02, and
17 there are also sellers from other places in the world.
18 Let's fix the price at \$4. We can't change that price.
19 That is \$4.

20 A So it is a world market?

21 Q Yes.

22 A So the scope of the market is worldwide?

23 Q D can be supplied from worldwide, but the only
24 places we are going to supply it from in the United
25 States are 01 and 02. We are going to supply it by

1 rail.

2 A Okay, I have that.

3 Q Now, I say in my little diagram that if
4 Railroad 3 cuts its rates, won't the farmers who are
5 making this product get more money from the buying
6 elevators at 02?

7 A There is still not enough information because
8 you defined the relevant market as being worldwide, but
9 you only gave me evidence on these three little points.

10 Q Now, you talk about geographic competition.
11 Does one in geographic competition have to look at the
12 cost of transporting the product to the place where it
13 is supposed to compete in the final consumption market
14 to determine whether an origin is geographically
15 competitive?

16 A What do you mean by whether an origin is
17 geographically competitive? I have not heard that
18 phrase.

19 Q You have used the word "geographic
20 competition." We started off talking a little about
21 Georgia. Now, let's say that it costs -- let's say the
22 price in Houston is \$4, and let's say it costs \$4.10 to
23 move something from Maine to Houston. Does Maine
24 competition have anything to do with the price at
25 Houston? Are they competitive there?

1 A There is not enough information to answer that
2 question.

3 Q I see. Suppose you have a major city, and
4 hard as it is, I want you to assume that in this major
5 city there are products arriving and departing that
6 could only be economically carried by rail, that the
7 prices of transportation would go up a good deal if
8 trucks had to be substituted, okay?

9 A Let me ask a question for explanation. What
10 you are saying is, within the entire relevant market
11 rail is the only transportation?

12 Q That's right. Now, let's assume we have rail
13 to rail competition, and that keeps rail rates -- rail
14 to rail competitor keeps rail rates at, let's say, an
15 index of 100.

16 A Okay.

17 Q And if the two railroads merge, in my
18 hypothetical instance, will there not be an effect on
19 price of rail transportation?

20 A You haven't given me enough information to
21 answer that.

22 Q Suppose that the commodity that we are talking
23 about, the price of rail transportation, the commodity
24 that we are talking about has to move by rail.

25 A I heard that.

1 Q And if it has to move by rail, if it is going
2 to get to the city or from the city, doesn't it matter
3 whether there is rail to rail competition in pricing the
4 cost of transportation, pricing transportation?

5 A There is still not enough information there to
6 answer. There are many cases where rail to rail
7 transportation does make a lot of difference, and as I
8 said several times, I spent a large part of my verified
9 statement analyzing rail to rail. That is too broad to
10 say whether it is going to be a factor or not.

11 Q What difference does it make in the example I
12 gave you, the city that is served by railroads only and
13 the commodity that is moving by railroads only, what
14 difference does it make that there are alternate sources
15 of the commodity?

16 Suppose it is wheat moving to Phoenix. What
17 does it matter that if wheat could come from Kansas, or
18 it could come from Oklahoma?

19 A Well, the reason it matters is that, take your
20 wheat example. It is a competitive industry, so that in
21 effect each wheat farmer is competing with each other
22 wheat farmer, and they have a vertical relationship with
23 a transportation company, and in effect you have a team
24 arrangement where one farmer or really a large number of
25 farmers is competing with this other group of farmers,

1 and the first group may be served by one railroad
2 carrier, and the second group may be served by another
3 railroad carrier, and in order to compete in this
4 marketplace, they may have to have that complementary
5 relationship so they can be in two entirely different
6 locations.

7 For example, if it is an export product like
8 wheat, one could be in this country and one could be
9 some place else. It could be a South African or
10 Australian railroad. And because they have to team up
11 in order to compete in a competitive world market, any
12 action by any one member of that team can cause them to
13 lose their sale.

14 Q That is true, but what effect does the fact
15 that there are several competing farmers have to do with
16 the price the railroad can charge when the railroad has
17 a destination monopoly?

18 A Well, I thought I just said that, but I will
19 say it again, that even if the railroad has a
20 destination monopoly, if they have this vertical
21 relationship, it starts out on the farm and then it goes
22 to an elevator, it goes to a railroad, it goes to
23 another terminal elevator perhaps, and then goes by ship
24 and whatever, that is a vertical chain.

25 And if this is a competitive business, any

1 step along that chain, if it is broken by one player not
2 behaving competitively, it can cause that chain to be
3 excluded from the market.

4 Therefore, if one of those railroads raises
5 its rates above competitive levels, it runs a risk of
6 losing a sale to some other nearby railroad or some
7 Australian railroad. They are all in this case, in this
8 example, in the same market.

9 Q Well, they are all pricing wheat, but we are
10 not concentrating now on the price of wheat. We are
11 concentrating on the constraints on railroad pricing.
12 Let's look at your Page 2 again which I found
13 illuminating.

14 You say approximately 70 percent of the hard
15 winter wheat marketed moves to ports on the Texas Gulf
16 for export, right?

17 A That's correct.

18 Q Now, we have got some farmers, and we are
19 going to talk about an origin monopoly for a minute.
20 These farmers indeed are in a vertical relationship with
21 the railroads, and have to move their wheat to market,
22 to the Gulf. I think you have provided figures that
23 show 97 percent of wheat goes to the Gulf by railroad,
24 correct?

25 A No, I did not say that.

1 Q Where farmers are in Kansas, 97 percent of
2 their wheat goes to --

3 A Yes. I might add that there is a big
4 difference. This is another example of how railroads
5 and trucks compete with each other geographically even
6 where they have different cost structures, that you have
7 got trucks moving to the Gulf from places that are
8 closer to the Gulf, and you have got railroads moving to
9 the Gulf from places that are far away from the Gulf,
10 and they do compete with each other, even though they
11 have different cost structures. They are all part of
12 the same market.

13 Q Yes, they are all part of the same market but
14 that is the market for their product. Is that right?
15 They are all part of the market for supplying
16 transportation from the farms in southwest Kansas to the
17 Gulf.

18 A I am speaking of the transportation market.

19 Q Who is in the transportation market from
20 southwest Kansas to the Gulf?

21 A There is no such thing as a transportation
22 market from southwest Kansas to the Gulf. That is too
23 narrow. That is a subsector of a market.

24 Q I see. Do you think, Mr. Klem, or does your
25 expertise tell you whether some railroads are more

1 efficient than other railroads?

2 A I am aware that some railroads are thought to
3 be more efficient than others.

4 Q And is a more efficient railroad able to quote
5 a lower price if it so chooses?

6 A Not necessarily. You have to give me more
7 information.

8 Q Other things being equal between two railroads
9 competing point to point, may the more efficient
10 railroad quote a lower price if it so chooses without
11 losing money?

12 A If one railroad has a lower cost in that
13 particular movement from point to point for any reason,
14 whether it is an overall better railroad or has a better
15 route, they have the possibility of quoting a lower
16 price.

17 Q Do you consider these seven pages at Pages 1
18 to 7 of your farm commodities, Appendix F, to be an
19 in-depth analysis of wheat?

20 A Yes.

21 Q Would not an in-depth analysis include an
22 investigation of truck costs so we could find for what
23 distances trucks are competitive with rail?

24 A My definition of in-depth analysis is one that
25 is in sufficient depth to answer the question in a

1 reasonably definitive manner. I am answering your
2 question. That is not necessary. That information is
3 not necessary to answer the question in a reasonably
4 definitive manner.

5 Q If it were the fact that truck costs for 100
6 miles were 25 percent or more of the rail cost from
7 Kansas to the Gulf, would that affect your analysis?

8 A That is not enough context to evaluate
9 something like that. As I said a minute ago, you can't
10 say what is going to happen in a market without talking
11 about a market. What we are trying to say is what
12 happens in the market, and yet you are only giving me
13 one little tiny corner of the market.

14 Q Do you need more than seven double spaced
15 pages which would appear in Appendix F from Pages 1 to 7
16 to have an in-depth analysis of a market?

17 A As I said, my definition of an in-depth
18 analysis is one that is in sufficient detail to answer
19 the question that needs to be answered with some degree
20 of authority.

21 Whatever I said at the end there. And the
22 point is that I didn't answer every question there is
23 about the wheat market, but I answered every question
24 which appeared to be of necessity to be answered in
25 order to address the issues which were essential to this

1 merger.

2 People write dissertations about the wheat
3 market or even just about the substitution of sorghum
4 for corn. But we don't need to do a dissertation on the
5 substitution of sorghum for corn.

6 Q Is it good or bad in terms of allocative
7 efficiency of resources for products to be carried
8 additional and unnecessary distances?

9 A The way you stated the hypothetical, yes,
10 because it is always bad to do anything that is
11 unnecessary.

12 Q If it is, for example, we have a source that
13 is 500 miles, and we have another source that is 1,500
14 miles away, and we have equally efficient producers at
15 those two sources, is it not true that it is better for
16 society in general to use the closer source?

17 A It is not true in general. That is another
18 example of a tiny little fraction of a complicated
19 question. You can't answer a question like that without
20 having more information.

21 There are many cases, for example, when you
22 might find something that is 500 miles away, something
23 that is 1,500 miles away, but because there is a general
24 flow in one direction, because these things are
25 concentrated geographically, the one that is 500 miles

1 away may be going in the exact opposite direction.

2 It may be going for export, say, and that may
3 actually minimize overall costs. So once again you have
4 to look at the whole market to make statements like
5 that.

6 Q Do you believe, as other witnesses in this
7 case have stated, that competition is generally good
8 because it increases allocative efficiency?

9 A Absolutely.

10 Q And is that true even below 180 percent of
11 variable cost?

12 A As I said in my statement -- I can't answer
13 that one yes or no.

14 JUDGE HOKKINS: Go ahead.

15 THE WITNESS: As I said in my statement, there
16 is no allocative efficiency interest in constraining
17 rates to be below competitive levels.

18 BY MR. KHARASCH: (Resuming)

19 Q And in that statement you mean by competitive
20 level 180 percent or not, in your last statement on the
21 stand?

22 A Let me be a little more precise. The last
23 language was a little sloppy. I am saying that there is
24 a range of competitive rates, and that if you find a
25 rate, say, that is 180 percent, and another one that is

1 140 percent, and another one that is, say, 80 percent of
2 variable cost, and we know a lot of these are about 80
3 percent of variable cost, then there is no allocative
4 efficiency interest.

5 In other words, you don't help efficiency by
6 constraining the rate that is, say, for example, at 80
7 percent of variable cost.

8 Q I hear what you say but I don't understand
9 what relation that has to my question. My question was,
10 in answer to my earlier question, what you meant by a
11 competitive price. You mean a price set by competition
12 or a price that is some relation to variable cost?

13 A I mean a price set by effective competition.

14 Q And if a particular mode is the most efficient
15 way of moving the cargo, is that a price set by
16 competition among carriers in that particular mode?

17 A I couldn't understand the question.

18 Q Let's turn to your comments on trackage
19 rights, sir. I have a general question to ask you.

20 MS. REED: Are you in Appendix G, counsel?

21 MR. KHARASCH: Yes.

22 BY MR. KHARASCH: (Resuming)

23 Q Suppose the figures you publish in Appendix G
24 about Mexico are wrong by a factor of 100 percent or
25 more. Are your conclusions so robust that they will

1 survive that?

2 A There is not enough information to answer the
3 question.

4 Q Do you have up there MKT-C-93? It is your
5 work papers.

6 A I have that now in front of me.

7 Q Let's look at the last page of those work
8 papers. Tell us what this page is, sir.

9 A This page and the page previous to it, I
10 think, and the one before that, perhaps the whole thing,
11 relate to an analysis which was done to determine the
12 major commodities moving from the United States to the
13 border points of Mexico.

14 Q I am looking at the last page. What appears
15 in the column labeled Cars?

16 A Numbers. What do you mean?

17 Q Numbers of cars? Or thousands of cars? Or
18 what?

19 A I don't recollect. That doesn't make any
20 difference in this analysis. This analysis is not
21 affected by the absolute number of these cars. This is
22 a ranking, so that if that was, say, tens of cars or
23 thousands of cars or single cars, it wouldn't make any
24 difference.

25 The whole function of this analysis was to

1 rank the commodities. That is independent of such
2 things.

3 Q You mean rank by what?

4 A By cars and by tons.

5 Q Look at your last page here. I don't see any
6 particular order of cars or tons. I see record numbers
7 and things being printed up.

8 A I have forgotten exactly the arithmetic aspect
9 of this, but if you notice there is some handwriting
10 here which discusses the total amounts of various
11 things. And my recollection is that the output of this
12 finally was a ranking which selected the top 20
13 commodities.

14 Q On the last page of MKT-C-93, we are looking
15 at a commodity which seems to have a STCC Code 01136,
16 and that appears on Page 14 of your final appendix in
17 Table II.

18 A Final appendix. That is G. Table II?

19 Q Yes.

20 A I do believe, if my recollection is correct,
21 that this computer run was used to create a ranking.
22 You will notice these commodities in Table II are ranked
23 by tonnage.

24 Q They are ranked in Table 2 by tonnage. Now I
25 am looking at MKT-C-93. I see in the lower right hand

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1 corner under Tons the numbers 3701. Do you see that?
2 At the foot of the column? And then I see over at Page
3 14, Table 2 of your statement, Appendix G, sorghum,
4 indeed, as 370,100 tons listed.

5 A That is correct.

6 Q Now, sir, it is my belief that all figures in
7 your table on Page 14 are wrong by a very, very wide
8 margin, and I ask you first, does that matter? Is your
9 discussion so robust that there is truck competition
10 everywhere that it matters whether the figures are wrong
11 by a factor of two and a half times?

12 A Are you saying that they are all off by a
13 factor of two and a half?

14 Q No, I am saying that they are wrong by factors
15 of 250 percent.

16 A But what you are saying is, they are all wrong
17 by a 250 percent factor?

18 Q No.

19 A What are you saying?

20 Q Your total figure at the bottom is wrong by
21 250 percent. That is my information. Does that
22 matter?

23 A As I said before, that is not enough
24 information to say. To answer that question I would
25 direct you to the analysis which was done of some of

1 these commodities and the decision whether or not there
2 was a competitive problem in one of those commodities
3 was independent of the number in this table.

4 At least that is my recollection. The
5 analysis was such that we looked at the tonnages to
6 identify the major commodities. I am not aware that
7 there is any problem with these numbers. But your
8 allegation is, there is a problem. And I am not done
9 with my answer yet.

10 What I am saying is that these numbers were
11 used to rank and to select the major ones, so to the
12 extent that these numbers are wrong, I would be
13 wondering, if I was trying to find out if they were all
14 off, if your allegation is that they are all off by the
15 same factor, because that would be the only thing that
16 would affect the ranking, but in general, the analysis
17 of whether or not there is a competitive problem in that
18 particular commodity was based on other factors rather
19 than the absolute magnitude of the tonnage.

20 Q Now, look at the last page, if you would, of
21 MKT-C-93. Look at the very first record at the top of
22 the page. Do you see where it says 30 cars by the SP,
23 76 tons?

24 A I do see that.

25 Q That must be 7,600 tons. And we could find

1 that by our inspection of the total figure at the bottom
2 and the total figure in your table?

3 A You are assuming that that is 7,600 tons. I
4 don't really remember.

5 Q I will tell you one indication that something
6 has gone wrong here. Is that 30 cars or 300 cars or how
7 many cars for 7,600 tons?

8 A I can't remember. It is conventional in doing
9 this kind of analysis to truncate numbers, and I can't
10 remember if those are truncated or not.

11 Q What I am telling you is, it doesn't matter
12 how you truncate it. It isn't two and a half tons or it
13 isn't 25 tons or it isn't 250 tons per car of sorghum,
14 is it?

15 A I don't understand that.

16 Q Sorghum moves in cars of what, 75 to 100
17 tons?

18 A That is plausible, yes.

19 Q And so where you see cars 30 it can't be
20 either 30 or 300.

21 A I can't see that reasoning. Can you explain
22 to me what you mean?

23 Q Sure. If that is 30 cars and 7,600 tons, the
24 ratio of cars to tonnage is not correct. If it is 300
25 car to 7,600 tons, it is not correct. And if it is

1 three cars to 7,600 tons, it can't be correct. The
2 relationship of the numbers is not equal to the
3 relationship of tons in a railroad car of grain.

4 JUDGE HOPKINS: Mr. Kharasch, do you want him
5 to come up with corrected numbers? Do you want him to
6 go back and put it in the record later or something as
7 to whether he is incorrect or not, or what? Because
8 otherwise we are wasting a lot of time here.

9 THE WITNESS: I don't accept that these
10 numbers are incorrect, and I have not accepted the
11 reasoning that was just done. The reasoning is
12 fallacious.

13 JUDGE HOPKINS: I understand. But there is
14 some question about it. I don't think we need to spend
15 all this time.

16 MS. REED: Your Honor, we will go back and
17 double check the numbers, and if there is a problem we
18 will submit it.

19 JUDGE HOPKINS: Thank you.

20 BY MR. KEARASCH: (Resuming)

21 Q Now, you say in your discussion that it
22 doesn't particularly matter what the numbers are as long
23 as the rankings are the same. First, are you clear that
24 there is no truck transportation of grain to Mexico?

25 A I do not know that for a fact. However, I in

1 effect took a conservative assumption on that.

2 Q Now, you have noted that you have seen some
3 figures that show water as a significant competitor of
4 grain to Mexico, correct?

5 A That is correct.

6 Q What do you know about the buyer, Conasupo's
7 reason for moving grain by water or rail?

8 A I know that they have recently, in the last
9 few years, expanded their ports and increased their use
10 of the water mode.

11 Q Do you know whether in fact rail is the
12 cheapest way to get grain to Mexico, but the Mexican
13 system can't handle the grain hauled by rail? That is
14 not testimony. The question is, do you know whether
15 that is true or not?

16 A I don't know it for a fact. I do have an
17 opinion on it, though.

18 Q Do you know whether when Conasupo issues a
19 purchase order for grain it specifies whether it is to
20 come by rail and if it is to come by rail, it specifies
21 what Mexican entry point it is to come to?

22 A That is my understanding.

23 Q Did you have an opportunity over the lunch
24 recess to get the date of the computer run which gave
25 you the information on the carloads that were moving to

1 Mexico shown in that fine draft diagram, Major Players
2 in the Market?

3 A The date was November 1, 1984.

4 Q Ncvember 1, 1984?

5 A That's correct.

6 Q Is that one that is in your work papers?

7 A It is not.

8 Q Would you explain why you think the fact that
9 there is one railrcad in Mexico means that the whole
10 Mexican -- that all traffic in Mexico should be
11 considered together in making your analysis?

12 A Any analysis of such a market must be based on
13 the ease with which a buyer can switch around to
14 differert parts of the market. It is a substitution
15 effect.

16 And your earlier statement demcnstrate that
17 Ccnasupc has the ability to not only decide whether to
18 use water or rail, but to specify the rail point of
19 access to the country.

20 So, if they want to accept a shipment of grain
21 relatively farther to the west or to the east or by
22 water, that is within their power, and they have
23 demonstrated a willingness to do this by their increased
24 use of water, which is 60 percent of the total, so any
25 other conclusion would have been unfounded.

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1 Q What has that got to do, my question is, with
2 the fact that there is one railroad in Mexico?

3 A That wasn't your question. Your question was
4 why this particular railroad. This particular railroad
5 is owned by the government. It is a national railroad.
6 Conasupo is also an agency of the government.

7 So in effect we have a shipper here which owns
8 its own railroad and reaches all the border points, and
9 in effect it can also control the water routes, so it
10 can absorb grain by water as well.

11 So the shipper has control over all of that.
12 It is like the shipper has premises that are as large as
13 that.

14 Q Would you disagree with witnesses who have
15 said, railroad witnesses who have said that they
16 consider central and eastern Mexico to be one market for
17 goods coming in and west coast Mexico to be another
18 market?

19 MS. REED: Counsel, are you asking that
20 assuming that to be the case, subject to check?

21 JUDGE HOPKINS: Let's do it that way.

22 BY MR. KEARASCH: (Resuming)

23 Q Suppose railroad witnesses said that. Would
24 you agree or disagree?

25 A I would want to know why he said it before I

1 made a decision on agreeing or disagreeing. My analysis
2 does not lead me in that direction.

3 Q Has your analysis shown you anything about the
4 cost or distances involved in moving products within
5 Mexico by rail?

6 A No, as I have said a lot of times, I have used
7 the market approach rather than the cost approach.

8 Q You considered Mexico one market for that
9 purpose? One receiving market in that sense?

10 A For analytical purposes I used the movement of
11 these various commodities to Mexico as a market, though
12 I recognized that in fact you could make a case for an
13 even broader market, because you are dealing with bulk
14 commodities that are shipped for export, and many of
15 these commodities may go, for example, to Houston or
16 some other port in the Gulf.

17 And until they are actually put on a ship for
18 export to Mexico, they don't know to what country it is
19 going to be exported to, so you can make a case for a
20 broader one. But I chose not to, because this more
21 cautious approach seemed warranted.

22 Q Do you agree or disagree -- would you agree or
23 disagree with an economist who said I worry when the
24 number of competitors shrinks from three to two, because
25 of the dangers of increased collusion?

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A That is another hypothetical that requires more information to answer. Sometimes I would and sometimes I wouldn't. It would depend on other factors in the market.

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1 MR. KHARASCH: That's enough, thank you.

2 JUDGE HOIKINS: Thank you.

3 Let's take a recess now.

4 We will take fifteen minutes.

5 (A brief recess was taken.)

6 JUDGE HOIKINS: Back on the record.

7 Mr. Livingston?

8 BY MR. LIVINGSTON: (Resuming)

9 Q Good afternoon, Mr. Klem. My name is Bill
10 Livingston, and I represent Union Pacific.

11 I want to ask a number of questions about the
12 technical aspects of your work here.

13 Were you the person who designed the computer
14 studies that were done for your statement?

15 A That is correct.

16 Q You made the judgments as to how the screening
17 procedure should work and things of that character?

18 A That is correct.

19 Q I want to look first at what I would call your
20 point-to-point study in which you ultimately conclude
21 that there are approximately 1,200,000 tons where there
22 may be competitive problems.

23 On page 12 of your statement, you state that
24 you analyzed all of the traffic of the two applicants
25 and found only 406 SPLIC 4 pairs where they both carried

1 traffic independent of one another.

2 A That is correct.

3 Q If you found a SPIC 4 pair where the
4 applicants carried traffic in joint line service and
5 didn't otherwise carry traffic, that would not be
6 included in your 406?

7 A That is correct. I did find some where they
8 both participated, but only in joint line service with
9 each other, and I did exclude those.

10 Q And getting down to this 406 SPIC 4 flows,
11 that in a sense was your first screen, correct?

12 A That is correct.

13 Q And you eliminated 88 percent of the
14 applicants' traffic at that point, is that correct?

15 A I believe so, yes.

16 Q You used the figure of 12 percent passing
17 through this screen.

18 A I can't recollect whether that was 12 percent
19 of applicants' traffic or 12 percent of the total
20 traffic in those markets. But it is about the same.

21 Q The sentence says 12 percent of their traffic,
22 the last sentence of that paragraph.

23 A It says 12 percent of all traffic they carried
24 on their combined system, yes, that's right

25 Q So you have eliminated 88 percent of the

1 applicants' traffic because it didn't show up as being
2 where they both were carrying traffic between two SPLC
3 4s.

4 Did it surprise you that such a small
5 percentage of the applicants' traffic made it through
6 your first screen?

7 A I wouldn't say surprise, but if I would have
8 guess prior to doing the analysis, I might not have
9 guessed this number.

10 Q Would you have guessed a higher number?

11 A Probably.

12 Q When you saw this number, in view of your
13 surprise, did you make any check to see whether you
14 might have done something wrong?

15 A As I said, I wasn't surprised.

16 Q Strike the word "surprised."

17 Did you make any check to see whether in fact
18 the applicants carried more than 20 million tons in
19 head-to-head, siding-to-siding competition?

20 A Yes.

21 Q What check did you make?

22 A I essentially reviewed the programs and
23 discussed the program.

24 Q You went back to see if you did your own
25 computer work correctly?

1 A I thought that was the question you asked.

2 Q Did you check by going to other sources to
3 find data about the applicants' traffic to see if your
4 figure was correct?

5 A I have never seen another source that would
6 answer this particular question. As far as I know,
7 going to the data directly is the only way.

8 Q Now, in dealing with these 9,561 SPLC 4 pairs,
9 which you cut back to 406, how many of those pairs were
10 represented by a single waybill?

11 A How many of the 406?

12 Q No, of the 9,561 flows that you started with.

13 A I didn't look for that.

14 Q Do you know whether there were any that were
15 represented by a single waybill in your sample?

16 A I do know that many of these flows were ones
17 where one applicant had perhaps one or a small number of
18 waybills, and yet there would be a large number of other
19 waybills in that same market. That was a fairly common
20 occurrence. You would see a large market and there
21 would be one or two or a small number of one of the
22 applicants' waybills in there, and I interpreted that to
23 mean that this was a large market, but it was not a
24 market that even that one applicant was n.

25 Q Focus again on my question.

1 Did you have any SPLC 4 pairs where in your
2 sample you had only one waybill?

3 A I said I don't remember that there was one,
4 but I do remember that there were some where the
5 applicants, one of the applicants had a small number of
6 waybills.

7 Q Let's deal with the situation where your flow
8 is represented by a single waybill in the 1 percent
9 waybill sample. Assume that that occurred.

10 In that case, you would automatically have,
11 would you not, a situation where one carrier had 100
12 percent, one applicant had 100 percent and the other
13 applicant had zero percent?

14 A That is correct.

15 Q And it would drop out of your analysis and
16 would not be analyzed further?

17 A It's true that if an applicant had 100
18 percent -- wait a minute. I might have answered your
19 earlier question wrong.

20 Q You are dealing with a 1 percent waybill
21 sample, isn't that correct?

22 A That's true, but I did answer your earlier
23 question wrong. You said if there's only one waybill
24 from the applicants in there, then clearly one would
25 have 100 and one would have zero, and that doesn't

1 follow.

2 Q Well, one would clearly have zero.

3 A That does follow.

4 Q And therefore, it would drop out of your
5 analysis and not be analyzed further.

6 A That is correct.

7 Q And even though in the real world that SPLC 4
8 pair may be served independently by both of the
9 applicants and they both may carry 50 percent of the
10 traffic that is moving between those SPLC 4 points, it
11 would still drop out of your analysis.

12 A Any point which had no sampled waybill in it
13 from the applicants would imply that the applicants had,
14 from one applicant, would be one such that the
15 applicants would be very likely, that particular
16 applicant, I mean, would be very likely to have an
17 exceedingly small movement in that market, so that a
18 zero market share based on a total absence of waybills
19 is a plausible assumption.

20 Q I am not asking whether the assumptions are
21 plausible. I am just trying to figure out what you
22 did. In situations where you had only one waybill for a
23 SPLC 4 pair, that SPLC 4 pair didn't make it through
24 your first screen even though in the real world the
25 applicants may split the available traffic.

1 A It is true that if there was only one waybill,
2 then it didn't make it through the screen, but I don't
3 have any reason to know that the applicants split the
4 traffic.

5 Q But you wouldn't have any idea of what the
6 applicants' market shares were in the case where you
7 only had one waybill.

8 A I would have an estimator of -- I would have
9 an idea in the sense that I would have an estimator of
10 the market share. It would not be the best estimator in
11 the world because of the paucity of data, but it is an
12 estimator on a statistical sense.

13 Q If I randomly pick a SPIC 4 pair and pick a
14 single waybill from it, am I acting rationally to
15 conclude that the railroad that shows up on that waybill
16 has 100 percent of all of the traffic?

17 A Under your hypothetical you said you took a
18 movement and took only one waybill. That is not what
19 they do in the waybill sample. They have a sampling
20 probability, so that the fact that only one waybill
21 turned up or the fact that no waybill turned up does
22 mean something. It is not a case where you took --

23 Q Mr. Witness --

24 A It is not the case that you just described
25 where you take a flow and go in and pull out one

1 waybill. That is not descriptive of what the waybill
2 process does.

3 Q When you have one waybill from a SPLC 4 pair,
4 you don't have any idea, do you, whether in the real
5 world one carload moved between those points in the year
6 in question or 40 carloads moved between those two
7 points in the year in question, isn't that right, given
8 that choice between one and 40?

9 A That's not right.

10 Q You are able to say, given one waybill
11 between -- and this is a one in a hundred sample, is it
12 not?

13 A No, it is not.

14 Q The one percent waybill sample, is the one
15 percent waybill sample a one in a hundred sample?

16 A No, it is not.

17 Q What is it?

18 A It is a stratified sample with a variety of
19 different sampling probabilities that can go as high as
20 .5.

21 Q Which is what, one in twenty?

22 A No, one in two. If there were two waybills
23 there, they would take one of them.

24 Q In situations where you have two waybills and
25 they both showed up as being from the same railway, say

1 the Santa Fe, and no other waybills representing the
2 SPLC 4 pair, that SPLC 4 pair would have dropped out of
3 your study, isn't that right?

4 A I'm sorry, I didn't get that.

5 Q You have a SPIC 4 pair, one of these 9,561,
6 and you had only two waybills, both of which were Santa
7 Fe, you would drop that out of your study and not
8 consider it further, isn't that correct?

9 A That is correct.

10 Q Now, do you know how many of your movements
11 are represented by only two waybills?

12 A No, I do not.

13 Q Let me show you some of your work papers. I
14 have handed you a thick volume of work papers. It
15 appears to me that that is a listing of all of the 9,561
16 SPLC 4 pairs that you referred to in your text.

17 A That is correct. At least that is what it
18 appears to be.

19 Q And looking down, you report on there the
20 number of waybill records you have for each SPLC 4
21 pair. Now, you see quite a number there, do you not,
22 you can turn to any page you choose, that are
23 represented by a single waybill.

24 A That is correct.

25 Q And in all those instances, because it was

1 represented by a single waybill, you stopped studying
2 the traffic, isn't that correct?

3 A I stopped studying the traffic because there
4 was no evidence of direct, point to point competition
5 between the applicants. I interpret that to be a
6 question of why I did that, so I would like to answer
7 that.

8 JUDGE HOPKINS: Go ahead.

9 BY MR. LIVINGSTON: (Resuming)

10 Q You had one waybill.

11 A I'm not done yet.

12 I explained in my verified statement that this
13 problem you are getting at is a real problem. My
14 characterization of it is a lot different than the way
15 you characterized it, but it is a real problem, and I
16 dealt with that problem by aggregating the flows to the
17 extent it was economically logical, and therefore, I did
18 not use SPLC 6-to-SPLC 6 analysis, which someone has
19 suggested here, because if you look at SPLC-6-to-SPLC 6,
20 you would find many, many more of them would be in this
21 category. And by aggregating into SPLC 4s and looking
22 at it both ways, I have a situation where there are a
23 multitude of shippers in each SPLC 4, and I minimized
24 the problem that you are mentioning.

25 My reasoning is that given the sampling

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1 probabilities in the waybill sample, that if a carrier
2 can't get enough traffic in a SPIC 4 to SPIC 4
3 bidirectional aggregated movement, there is no evidence
4 that they have any substantial amount of business in
5 that movement.

6 Q Mr. Witness, let me ask you this. If we went
7 through your work papers there, we could count up all of
8 the SPIC 4 pairs that were represented by a single
9 waybill and thus automatically showed 100 percent-zero
10 market shares between the applicants, isn't that right?

11 A I don't agree with the characterization of
12 it. That's not a fair characterization.

13 JUDGE HOPKINS: Say yes or no.

14 THE WITNESS: No.

15 BY MR. LIVINGSTON: (Resuming)

16 Q You cannot count the number of single waybill
17 movements in those work papers?

18 A That you can do.

19 Q And in all those cases, one of the applicants
20 would be shown as having a zero market share and you
21 would not have studied the traffic further, isn't that
22 correct?

23 A That is correct.

24 Q Now, how many of the 88 percent of the total
25 tons of the applicants you have filtered out in this

1 first screen are represented by the one-waybill
2 entries?

3 A I don't know. Can I say why it is not
4 relevant?

5 JUDGE HOPKINS: I wouldn't now because we will
6 never finish here. If you want to indicate that, we
7 will be here for the next five or six days.

8 BY MR. LIVINGSTON: (Resuming)

9 Q Do you recognize that it would be in the
10 hundreds of thousands of tons?

11 A I do not.

12 Q Do you know?

13 A I don't know.

14 Q Do you recognize the possibility that it might
15 be in the millions of tons?

16 MS. REED: The witness has already indicated
17 that he doesn't know.

18 JUDGE HOPKINS: He doesn't know.

19 BY MR. LIVINGSTON: (Resuming)

20 Q Now, there are quite a number of entries, not
21 just one waybill entry, where you show a zero to 100
22 percent market share split between the applicants in
23 these 9,651 SPLC 4 pairs, am I correct?

24 A That is correct.

25 Q Indeed, more than half show up as zero and

1 100, don't you --

2 MS. REED: That question has already been
3 answered.

4 MR. LIVINGSTON: No, it hasn't.

5 THE WITNESS: I don't know the answer.

6 BY MR. LIVINGSTON: (Resuming)

7 Q Where that did show up as a zero-100 market
8 share split between the applicants, it didn't make it
9 through your first screen, is that correct?

10 MS. REED: That question has been asked and
11 answered.

12 JUDGE HOPKINS: That has been asked and
13 answered also.

14 BY MR. LIVINGSTON: (Resuming)

15 Q You would recognize the possibility, wouldn't
16 you, that where it is reported as a zero-100 market
17 share in the waybill sample, that in fact both
18 applicants physically serve the origin and the
19 destination and are in a position physically to
20 compete?

21 A I answered that this morning. I said that
22 there are many situations where they do serve both
23 origin and destination, and the purpose of this analysis
24 was to get evidence, the best evidence that is available
25 as to whether or not they have a practical ability to

1 compete in that market, and this is that.

2 Let me finish.

3 If you have tonnage in this market, that
4 implies you have the ability to compete in this market.

5 Let's look at some of the examples of ones you
6 want me to include. Let's look at Cumberland, Maine to
7 Douglas, Oregon, or Cumberland, Maine to Coos, Oregon.
8 If I included in flows like that, it would vitiate the
9 whole analysis.

10 Q If you have a SFHC 4 pair that shows a zero
11 and a 100 percent market share, and yet a sizeable
12 number of waybill records indicating there's a large
13 flow of traffic, you would recognize the possibility,
14 wouldn't you, that in fact the two railroads are
15 competing but that one of the railroads, by contracts or
16 otherwise, has obtained for the short term all of the
17 business in that SFHC 4?

18 A As I said in my verified statement, that was
19 the purpose of -- the answer is no.

20 Q You don't recognize that possibility? You
21 think that is impossible?

22 A I interpret impossibility as being something
23 other than essentially zero probability. As I said in
24 my statement, the flows were aggregated to eliminate
25 that risk. If you had one shipper that could ship

1 between A and B, and if the railroad did sign a contract
2 with that shipper, the very problem that you are raising
3 here would in fact be a serious problem, and that is why
4 I aggregated it.

5 MR. LIVINGSTON: Your Honor, I would like to
6 offer and mark as UP/MP-C-79 some excerpts from Mr.
7 Klem's work papers. They come from the volume that he
8 was just looking at. This is a confidential exhibit,
9 and as I understand it, it is covered by the protective
10 order.

11 MS. REED: If Counsel is going to discuss a
12 specific commodity or flow data, then we are going to
13 have to have that portion of the record be under seal.
14 These will have to be in the sealed section of the
15 docket because they do contain confidential
16 information.

17 Counsel have signed a protective order.
18 Anybody else who is a marketing person, if you are going
19 to get into a detailed discussion of flows, we will have
20 to clear the hearing room.

21 JUDGE HOPKINS: Are you going to?

22 MR. LIVINGSTON: No, I don't think so. She
23 should alert me if I start to trespass.

24 JUDGE HOPKINS: We will put these in the
25 confidential section of the docket.

1 I haven't gotten a copy yet.

2 BY MR. LIVINGSTON: (Resuming)

3 Q Let me focus on --

4 JUDGE HOPKINS: I will mark this for
5 identification as UP/MP-C-79.

6 (The document referred to
7 was marked Exhibit No.
8 UP/M-C-79 for
9 identification.)

10 BY MR. LIVINGSTON: (Resuming)

11 Q Let me focus on the third page of this
12 exhibit. There is a listing there of one of the SPLC 4s
13 in Fresno.

14 Do you see that, and the SPLC 4 I am
15 interested in is 8786, which is a location in Fresno.

16 Do you see that, Mr. Witness?

17 A I do see that.

18 Q What you there have listed, I take it, in your
19 work papers, is all of the movements from that SPLC 4 in
20 Fresno to various terminations around the country, is
21 that correct?

22 A That's right. These are sorted by the first
23 point, so this shows all of the flows that have Fresno
24 as an origin.

25 I have to clarify something here. These are

1 no bidirectional flows. In other words, these have not
2 gone through the full aggregation process.

3 Q Now, this paper, let me take an example.
4 There is a shipment to -- traffic being reported to
5 Guilford County, North Carolina.

6 Do you see that?

7 A Yes, I do.

8 Q One of the applicants is listed as having 100
9 percent of that traffic, so it falls out. You don't
10 study it further.

11 A One applicant has 16 records.

12 Q You are looking at the wrong one.

13 MS. REED: Would you like a ruler?

14 BY MR. LIVINGSTON: (Resuming)

15 Q These are fairly simple questions. The third
16 entry from the bottom of that page shows shipments to
17 Guilford in North Carolina, and it shows one applicant
18 as having 100 percent of that tonnage, isn't that
19 correct?

20 A That is correct. According to this, there are
21 21 --

22 Q We don't need -- that was not the question.

23 The next entry shows Forsyth, North Carolina,
24 it shows that the other applicant has 100 percent of the
25 traffic. So you don't study it further, isn't that

1 right?

2 MS. REED: Is Counsel assuming that -- the
3 witness has stated that this is not a bidirectional
4 flow. Therefore, are you assuming there is not a flow
5 going in the opposite direction?

6 BY MR. LIVINGSTON: (Resuming)

7 Q Can you answer the question?

8 A My answer, I guess, is that I don't know if I
9 studied this or not for certain. I have to think about
10 that just for a second. This could be well one that I
11 did study. I can't look in any one of these and say
12 whether or not I did study it or not. This is an
13 exhaustive list of all of the individual
14 monodirectional, in other words, origin to destination
15 points. I can't look at any one of these and tell you
16 just from here whether or not I studied it.

17 Q Let me see if I can approach this
18 conceptually. This indicates that the applicants served
19 the same SPIC 4 in Fresno, isn't that correct?

20 A Yes, I believe it does.

21 Q Isn't it a reasonable judgment that they have
22 the equal ability, equal ability to compete for all
23 traffic from Fresno, the SPIC 4 to Fresno to anywhere in
24 North Carolina?

25 A No, it is not.

1 Q Do you think they have equal ability to
2 compete from Fresno to anyplace in Georgia?

3 A I don't know the answer to the question of
4 whether or not they have equal ability.

5 Q Isn't it unreasonable to insist in the case of
6 traffic that either originates or terminates in the east
7 that the applicants have shares of the same SPLC 4
8 flow?

9 A No, it is not.

10 Q Do you think if one of the applicants has all
11 the traffic from Fresno to Baltimore and the other one
12 has all the traffic from Fresno to Washington, that that
13 indicates that you don't need to study either of those
14 flows because they are both 100 and zero percent market
15 shares?

16 A That one is a tough one because of the
17 particular geography involved, but the point, the
18 answer --

19 JUDGE HOPKINS: Why is it a tough one?

20 Answer it that way. Don't go into some other
21 explanation, but answer it that way. Why is it a tough
22 one?

23 THE WITNESS: The reason it is a tough one is
24 the answer requires, if you want me to get into the
25 details of that particular movement, would require

1 looking at the routings, analyzing the various
2 possibilities and considering the time, the transit
3 times and all the other variables that affect railroad
4 service. That is an approach. That is not the approach
5 that I adopt. That is not the approach many economists
6 would adopt.

7 Rather than trying to do an engineering
8 approach which would be required to answer your
9 question, I took a market approach.

10 Q Let's be specific as to what you did. If you
11 had traffic from Fresno to Baltimore, 100 percent Santa
12 Fe, and from Fresno to Washington, 100 percent Southern
13 Pacific, that traffic didn't make it through your first
14 screen.

15 MS. REED: Your Honor, I object, because as
16 the witness has previously testified, this is a
17 one-directional flow. He looked at the total traffic in
18 both directions, and counsel is mischaracterizing his
19 testimony.

20 JUDGE HOPKINS: That is true, as I understand
21 it from what he said and what has been stated before. I
22 agree.

23 I will sustain the objection.

24 BY MR. LIVINGSTON: (Resuming)

25 Q Then let's take it on a bidirectional basis.

1 Assume the records show that Santa Fe has all the
2 traffic between Baltimore and Fresno, and Southern
3 Pacific has it all between Washington and Fresno. That
4 traffic wouldn't make it through your screen, and you
5 wouldn't study it further, isn't that right?

6 A That's right.

7 Q The pages in the exhibit I have given you have
8 numbers in the right hand corner. I would like you to
9 turn to page 249. The largest entry on the page is
10 between Los Angeles and Cook County. Do you see that?

11 MS. REED: Counsel, are you referring to the
12 third one from the top?

13 MR. LIVINGSTON: Fourth one from the top.

14 THE WITNESS: That's correct.

15 BY MR. LIVINGSTON: (Resuming)

16 Q That is by far the largest entry on the page.

17 A Yes, on this page.

18 Q And bearing in mind the bidirectional problem,
19 let's just assume that the bidirectional figures going
20 the other way are identical to these. That would not
21 have made it past your 50-10 test, would it?

22 A Which 50-10 test?

23 Q The first one.

24 A Not the first one.

25 Q Not having made it past 50-10, the first 50-10

1 test, you would not have studied it further.

2 A No, that's not correct.

3 Q We will get to that in a minute.

4 The next two entries below that, though, there
5 is a shipment from the same SPLC 4 in Los Angeles to a
6 different SPLC 4 in Cook County, Illinois in which the
7 other applicant has all the traffic, and that is the
8 second largest entry on the page, isn't it?

9 A Which one is that?

10 Q Los Angeles to Cook County. It is on the same
11 page. It is two lines down.

12 Do you see that?

13 A The one that is two lines down is not a large
14 flow.

15 Q Excuse me, the third largest on the page,
16 336.

17 JUDGE HOPKINS: Off the record.

18 (Discussion off the record.)

19 JUDGE HOPKINS: Back on the record.

20 BY MR. LIVINGSTON: (Resuming)

21 Q Cook County has several SPLC 4s according to
22 your report, isn't that right?

23 A That is correct.

24 Q And if you had shipments from the same SPLC 4
25 in Los Angeles by Southern Pacific and Santa Fe, and

1 they went to different SPLC 4s in Cook County, you
2 treated those as separate markets and calculated the
3 market shares separately, didn't you?

4 A Strictly speaking, I did not count the SPIC 4s
5 as markets.

6 Q Well, in applying your 50-10 percentages and
7 your 100-zero percentages, we wcn't call them market
8 shares, you treat it as different markets, shipments
9 from the same SPLC 4 in Fresno to different SPLC 4s in
10 Cook County, is that right?

11 A I treated them separately, yes.

12 Q And if it turned out that one of the
13 applicants had all of the traffic in one of those flows
14 and the other applicant had all the traffic in the other
15 flow, you would not analyze the traffic further, isn't
16 that right?

17 MS. REED: Again, Counsel, are you talking
18 about a bidirectional flow now?

19 ME. LIVINGSTON: Yes.

20 THE WITNESS: That's correct.

21 BY MR. LIVINGSTON: (Resuming)

22 Q Isn't it likely in the real world that traffic
23 moving in such parallel corridors would have a
24 competitive relationship and that the prices of one of
25 the applicants would be affected by the prices of the

1 other?

2 A The answer is no. The reason is that the
3 competition we are talking about here is only
4 siding-to-siding competition. We are not talking about
5 all aspects of competition. We are talking about
6 siding-to-siding competition.

7 Q Let me understand again this 50-10 test. I
8 had thought from reading your testimony that it was
9 applied only once, after you had isolated the 406
10 flows. Was it applied at that point?

11 A It was applied at that point.

12 Q Just tell me what screen was applied next.

13 A I can't answer that yes or no or the way he
14 wants.

15 Q No, there's no way you can answer it that
16 way.

17 Go ahead.

18 THE WITNESS: As I said this morning, there
19 were three separate analyses. There was first the
20 analysis with all of the traffic. There was second the
21 analysis with TOFC excluded, and there was finally the
22 analysis that dealt with only traffic after TOFC and box
23 were excluded. So the runs that resulted in the 144
24 bidirectional flows, and finally, the 69 flows, and the
25 bulk of the analysis, those were done with the screens

1 in the following order: first, the TOFC; second, the
2 10-50; and third, the boxcar.

3 Q 10-50 is only applied once?

4 A The 10-50 is only applied once in each
5 analysis. For that analysis it was applied once. I am
6 saying that for the computer work that generated the 146
7 flows, the screens were applied in that order, and each
8 of them was applied once.

9 Q And once traffic was screened out, it was
10 permanently screened out, isn't that correct? You
11 constantly were dealing with a smaller and smaller body
12 of traffic as a result of your screening techniques?

13 A In that final computer run which is actually,
14 I think, one run that generated the 146 flows, those
15 three screens were applied once each, and after they
16 were applied, I did not go back and look at the flows
17 that were excluded, if that is what you mean. They were
18 no longer included in the analysis.

19 Q Let me take the 50-10 test for a minute. I
20 have a couple of questions about that.

21 If, for instance, a SPLC # showed a 91 and 9
22 percentage split, it would fall out at that screen and
23 would not be studied further, correct?

24 A If it showed a 90 to one, say, percentage
25 split, it would fall out.

1 Q Now, if Santa Fe had 91 percent, in this
2 example, and Southern Pacific had 9 percent, if in fact
3 you went and looked at the actual situation in that SPIC
4 4, you might find that where Southern Pacific had its 9
5 percent share, it was competing siding-to-siding with
6 Santa Fe and that at that siding they each had 50
7 percent of the traffic.

8 You might find that, right?

9 A I have to think about that. I see no reason
10 to believe that you would find that.

11 Does that answer you?

12 Q If you have a SPIC 4 pair where both railroads
13 have some traffic, but one of them doesn't have 10
14 percent and therefore it flunks your 50-10 test, you
15 don't know how that traffic is distributed among the
16 stations and the sidings within the SPIC 4.

17 A Not only do I not know, I don't care. Any
18 numbers that are calculated on that fine a basis, there
19 is not enough data for them to be of any large meaning.

20 Q I understand.

21 And so when you apply your screen, for all you
22 know in a situation like that, you are eliminating the
23 siding where each of the applicants has 50 percent of
24 the traffic and competes on a siding-to-siding basis.

25 A I don't see any rationale for all of the

1 conclusions in that statement.

2 Q What is it that troubles you?

3 A Suppose, for example, you did find some SPLC 6
4 pair where there was one waybill from each and you did
5 have an estimator of the market share that was 50-50.
6 It is an estimator, but it is not a great estimator
7 because there is such a paucity of data. That estimator
8 is not of sufficient weight to offset the better
9 estimator which you have, which is the SPLC 4-to-SPLC 4
10 analysis. The whole process is to get the best
11 estimator of the true market share and the true market
12 situation, and the SPLC 4 number is a far better
13 estimator than a SPLC 6-to-SPLC 6 number.

14 Q When you have a SPLC 4 pair where both
15 applicants have traffic but it flunks the 50-10 test, it
16 would be reasonable to assume, would it not, that at
17 particular sidings, one applicant or another would have
18 varying percentages of the traffic and you would have no
19 idea, looking at SPLC 4 data, how those percentages
20 would exist from station to station within a SPLC 4.

21 A That is correct.

22 Q And using the data that you relied on, there
23 is really no way of telling when you applied the 50-10
24 test whether or not you were eliminating instances where
25 there is siding-to-siding competition between the

1 applicants, where they each have half the traffic in the
2 real world.

3 A There is no reason to believe that I
4 eliminated any traffic that has the problem that you are
5 alleging, but what you are saying is if it happened to
6 be that there were two waybill records in there for the
7 same SPIC 6, that would be evidence of a problem, and I
8 am saying it is not very good evidence of a problem,
9 that the better evidence, the more reliable evidence is
10 the shares at the SPLC 4 level. Analysis of flows at
11 the SPLC 6 level is not an appropriate analysis. It
12 would give you false conclusions in many cases.

13 Q You keep talking about the analysis of the
14 SPLC 6 flows on the basis of waybill data, but there is
15 real world data about what is going on at the SPLC 6.
16 We can talk to the shippers, can't we, go into a
17 particular county and find the shipper and get his
18 views, find out whether there is siding-to-siding
19 competition?

20 A We could survey every shipper that ships on
21 these two railroads, but I doubt if you could get good
22 results from that. I doubt if the response rates would
23 be sufficient to give you a meaningful result.

24 Q When you got your problem flows, the 69
25 problem flows, am I correct that you regarded as a

1 nonproblem any flow where either of the applicants was
2 either the exclusive originator or the exclusive
3 terminator?

4 A No, you are not.

5 Q Do you regard as a nonproblem where one of the
6 applicants could access the origin or termination only
7 by interchanging with the other applicant?

8 A That is correct.

9 Q If you had -- if one of the SPIC 6s was in New
10 York and it was an exclusive, captive ConRail station,
11 am I correct that you regarded that flow as a nonproblem?

12 A That is correct.

13 Q So it could be a shipment from Los Angeles to
14 a point in New York exclusively served by ConRail, and
15 if it were one of your problem flows, at that point you
16 would say this is not a problem because it is exclusive
17 to ConRail, correct?

18 A What I would say about that is that there
19 would be no reduction in competition for that flow.

20 Q Not a competitive problem.

21 A Right.

22 Q Have you read the shipper testimony in the
23 case?

24 A I read a lot of shipper testimony. I have no
25 read all of it.

1 Q Let me turn now to a different study, a
2 geographic study which is described at pages 21 through
3 23 of your testimony.

4 Correct me if I am wrong, but as I understand
5 it, what you did here was on a commodity-by-commodity
6 basis look at the applicants' shares of total origins of
7 a particular commodity or total terminations on a
8 national basis, is that correct?

9 A That is correct.

10 Q Did you have some test for determining when
11 their percentage of the origins of a commodity or the
12 terminations of commodity would represent a problem?

13 A Initially, I considered a 50-10 rule thereto,
14 but then I toughened it up a bit and went below 50.

15 Q Was there a rule, or is it just something
16 below 50?

17 A I actually looked at all of them that went
18 down to 40 and 5.

19 Q Would you regard 40 and 5 as a problem for
20 your geographic study?

21 A Not necessarily. I normally think that 50-12
22 is a more appropriate ratio, but I felt that it would be
23 a good idea to go a bit beyond that just for caution's
24 sake.

25 Q Looking at the table you have here on page 23,

1 which states the conclusions, one of the entries on
2 there is for special paper. I take it the figures there
3 represent percentages of all the special paper origins
4 in the United States, is that correct?

5 A No.

6 Q Don't I read this correctly as saying that
7 Southern Pacific has 45 percent of all the rail and
8 truck origins of special paper in the United States?

9 A That is correct. I took that to be a generic,
10 that all of these numbers here were entire. The paper
11 special is based on what amount to rail originations
12 because the Transearch data showed no truck movements.

13 Q Why did you restrict yourself to origins
14 within the United States? Why didn't you look at
15 worldwide origins?

16 A This analysis is directed at determining
17 potential problems, and it would be legitimate in some
18 cases to consider worldwide competition as well. In
19 fact, I have acquired some new information on that since
20 the verified statement was written, but my conclusion
21 was that if I found some evidence that there may be a
22 problem, it would be in effect my duty to provide that
23 evidence even though I recognize that there is a
24 possibility that there are other factors that I have not
25 taken into account, and as far as this analysis had

1 gcne, of the factors that I was able to incorporate into
2 this analysis, these were potential problems.

3 To the extent that additional, additional
4 factors are put in the record, I would certainly
5 consider them.

6 Q Let's assume for the moment, just take it as
7 an assumption that this paper that is listed here is
8 heavily rail dependent, and let's further assume that
9 the applicants account for 100 percent of the
10 terminations of that commodity in Phoenix.

11 Would you regard that as a potential problem
12 competitively?

13 MS. REED: Is Counsel also assuming there is
14 no import competition?

15 BY MR. LIVINGSTON: (Resuming)

16 Q You can answer my question.

17 A You are assuming that there is no truck
18 competition, that there is no import competition, and
19 what was the other? There was another assumption there,
20 too, right?

21 Q I am taking your data here, Mr. Witness.

22 A It sounded like a hypothetical. If it is my
23 data, I can answer it.

24 Q What I want to focus on --

25 A Wait a minute. Can I answer?

1 JUDGE HOPKINS: Let him ask in particular.
2 What is it that you want, Mr. Livingston?

3 BY MR. LIVINGSTON: (Resuming)

4 Q Let me tell you what I am focusing on. You
5 have national figures here. Take shipments of paper to
6 Phoenix. People presumably use that paper in Phoenix
7 and want to buy it, right? Isn't that correct?

8 A Presumably.

9 Q Today there are two railroads that can bring
10 it to them.

11 Why wouldn't you want to look at the shares of
12 terminations in Phoenix in order to see whether there is
13 a competitive problem with this merger rather than
14 looking at the applicant's share of worldwide or United
15 States terminations of paper?

16 MS. REED: Excuse me. Counsel, did you
17 misspeak by saying applicant's terminations, because
18 this is originations.

19 MR. LIVINGSTON: I am talking about
20 terminations.

21 MS. REED: Oh, excuse me.

22 BY MR. LIVINGSTON: (Resuming)

23 Q Did you follow the question?

24 A We are back into a hypothetical?

25 Q Can you answer the question?

1 A I need to know if it is hypothetical.

2 JUDGE HOPKINS: We have to be in a
3 hypothetical.

4 MR. LIVINGSTON: I don't think this is a
5 hypothetical. He has used national figures.

6 JUDGE HOPKINS: But he is talking about
7 originations here.

8 MR. LIVINGSTON: He has also done
9 terminations. He reports in the footnote that he found
10 no terminating problems, and I am trying to find out why
11 he looked at these things on a national basis rather
12 than on a local basis. I was using as an example
13 shipments of paper to Phoenix.

14 JUDGE HOPKINS: Can you answer that?

15 THE WITNESS: I think I heard that it is a
16 hypothetical, is that correct?

17 JUDGE HOPKINS: Go ahead, answer it however
18 you wish.

19 THE WITNESS: I think it is inappropriate to
20 look at a particular point terminations in assessing
21 geographic competition. What you are doing in effect
22 there is focusing not on geographic competition but on
23 intramodal competition. What you are really saying is
24 the shipper in Phoenix may have only two choices. In
25 fact, the shipper in Phoenix may have only one choice.

1 It may be located on only one railroad.

2 If you look at intramodal competition, then it
3 is appropriate to look at -- you could look at one end
4 to see how many railroads the shipper has access to,
5 provided it is part of a broader analysis. But if you
6 are considering geographic analysis, you have to look at
7 the product markets. The geographic analysis, to a
8 considerable extent, is addressed at product markets,
9 and we are talking hypothetically here. If we have some
10 receivers, you said, I believe, in Phoenix that are
11 competing in competitive product markets, then the only
12 circumstances I can imagine where that would be
13 appropriate would be if those competitive product
14 markets were limited to the Phoenix area, and that does
15 not sound like a plausible assumption. That is not the
16 kind of assumption I would want to make and have to
17 defend.

18 Consider the other alternative, that these
19 receivers in Phoenix, in your hypothetical, are
20 competing in broader product markets. Suppose this is
21 some kind of special wrapping paper on some computer
22 that goes to Japan. That is a worldwide market, that
23 for that analysis it may well be more appropriate to use
24 a worldwide market. But I was not able, nor would I be
25 able now to specify the exact dimensions of every

1 product market. There are a number of product markets
2 here, but I reasoned that this analysis was an
3 appropriate compromise. I know from my earlier
4 experiences that I have encountered, and I think most
5 people know now-a-days, that very many product markets
6 are in fact worldwide, and that probably in the majority
7 of cases your earlier complaint would be more accurate,
8 that I should be talking worldwide rather than just
9 nationwide.

10 Q Let's take a commodity like beer being shipped
11 to Phoenix, and it is being shipped there to be
12 consumed, but not so that beer drinkers can compete with
13 other beer drinkers.

14 Shouldn't we, at least for those
15 commodities --

16 JUDGE HOPKINS: Mr. Livingston, speak up
17 because I can't hear you sometimes. You lower your
18 voice and then you put your hand in front of your mouth,
19 so please speak up so everybody, especially the
20 reporter -- she can't hear you.

21 BY MR. LIVINGSTON: (Resuming)

22 Q Let's assume a commodity that is going to
23 Phoenix for consumption, not to help other businesses
24 compete with other businesses worldwide.

25 Shouldn't for those commodities we look at all

1 terminations of that commodity in Phoenix in order to
2 assess this merger's impact on source competition rather
3 than looking at all terminations of that commodity in
4 the United States or the world?

5 A That doesn't sound like a relevant market.
6 What you are saying is this is beer that goes for
7 consumption. As a matter of fact, I have never known a
8 single beer consumer -- there may be such things, but I
9 never knew anybody that bought their beer in carloads
10 lots. Most of them buy it at a store.

11 JUDGE HOPKINS: You don't know Mr.
12 Livingston.

13 (General laughter.)

14 JUDGE HOPKINS: I'm sorry, Mr. Livingston.

15 THE WITNESS: And even if there was such a
16 consumer of beer, that wouldn't be a market.

17 BY MR. LIVINGSTON: (Resuming)

18 Q Let me turn to Appendix C, Table 1, page 5 of
19 that appendix. These are national figures, are they
20 not?

21 A That's correct.

22 Q Did you look at the figures for the applicants
23 and their territory?

24 A I have. Actually, I instructed my staff to do
25 that.

1 Q You have figures in here on the variable cost
2 of TOFC traffic.

3 Were you -- did those figures come from the
4 Commission? I am talking generally, that you have a
5 number of tables in your TOFC appendix showing variable
6 ccst.

7 A No, I don't.

8 Q For rail traffic, showing the relationship
9 between revenue and variable cost for TOFC traffic?

10 Do you know what I am referring to, Table 4 on
11 page 19 of Appendix C is one example.

12 A That is correct. These show --

13 Q I'm not asking you what the table shows.

14 You had information about variable costs for
15 TOFC traffic, is that correct, and you reported it in
16 your testimony.

17 A I had information about revenue-to-variable
18 ccst ratios that I reported.

19 Q Did you get that information from the
20 Commission?

21 A That is correct.

22 Q Were you involved in the preparation of that
23 information when you were at the Commission?

24 Q Do you know the details of how these variable
25 costs are calculated by the Commission?

1 A I was involved in the preparation of the same
2 material for earlier years, and therefore, I do have a
3 considerable familiarity with this tape.

4 Q Are these revenue-to-variable cost ratios and
5 variable cost figures that you relied on, are they
6 national averages?

7 A That's not descriptive of what they are.

8 Q Well, they are not the costs of a particular
9 railroad, are they?

10 A That is correct.

11 Q They are not?

12 A These are all railroads.

13 Q It is an average of all the railroads' costs,
14 is that correct?

15 A No, it is not correct.

16 Q Well, is it one particular railroad's costs
17 that are being used by you here?

18 A It's the cost of -- wait a minute. For very
19 many railroads, the cost is their own railroad cost.
20 For other railroads it is an average cost.

21 Q Looking at this Table 4, the information on
22 variable costs that is reflected in the left hand
23 column, would that be from a single railroad or from an
24 average of railroads?

25 A There is no information on variable costs in

1 the left hand column.

2 Q Well, the information shows that you had,
3 looking at the first entry, two records where 1300 tons,
4 \$6000 in revenue, which was 10 percent of variable cost,
5 isn't that right?

6 A That information is there.

7 Q You had to have variable cost information to
8 put that left hand column down here.

9 A I had variable cost information on the tape,
10 but variable cost information on the tape is specific,
11 but these numbers are a frequency distribution of
12 revenue-to-variable cost ratio. There is no information
13 on this table that relates specifically to variable
14 cost.

15 Q But there is information on this table that
16 came from the variable cost tape.

17 A That is correct.

18 Q In the left hand column.

19 A That is correct.

20 Q I still don't think I have an answer to my
21 question.

22 Is that information the average of all
23 railroads or specific to individual railroads?

24 A It is both of those things. The costing
25 information, as I said earlier, on the tape is largely

1 specific to the railroad, but these numbers are a
2 frequency distribution. That means that any railroad
3 could be, for example, on any particular line of this
4 table.

5 Q Do the variable costs in this table include
6 capital costs?

7 A I believe so. I could lock it up for you if
8 you would like. I am not absolutely certain.

9 Q Do they include equipment costs?

10 A Yes.

11 Q Are allowances made if the equipment is owned
12 by a third party? Is that reflected in these figures?

13 A In these they are. Earlier that was not the
14 case, but in these that is true.

15 Q Are these figures developed following a Rail
16 Form A format?

17 A That is correct.

18 Q The variable cost data that you relied on in
19 putting together these tables at the end of Appendix C,
20 I take it you haven't isolated situations that solely
21 involve the applicants, but you have taken entries from
22 around the nation, traffic from around the nation?

23 A No. As I have said before, it is essential to
24 do this at a market level. If you subset the market,
25 you get less meaningful information.

1 Q Let's look at Table 3, page 17 of Appendix C.
2 Now, there is a fairly small percentage of the
3 traffic on this page, according to your figures, moving
4 at a ratio of revenue to variable cost in excess of 180.

5 A That is correct, something on the order of 1
6 percent.

7 Q Now, that traffic, that 1 percent, whatever it
8 is -- actually I think it is closer to 2 percent --
9 would you recognize the possibility that that traffic
10 might be moving in corridors where there was only one
11 rail TOFC competitor, and therefore, virtually all of
12 the other traffic on the page, there is more than one
13 rail TOFC competitor?

14 Do you recognize that as a possibility?

15 A That's not a plausible possibility.

16 Q Do you know whether that is true or not?

17 A I have evidence that it is untrue.

18 Q Can you tell me, or do you have any idea where
19 the traffic is on this table where the
20 revenue-to-variable cost ratio exceeds 180?

21 A I have done various explorations of that, but
22 I don't believe any of them would quite allow me to
23 answer that question yes. The answer is no.

24 Q The railroads' revenue-to-variable cost ratio
25 depends in a particular year in part on demand?

1 A That is correct.

2 Q And in years where demand is high, profits go
3 up, ratios go up, is that correct?

4 A That's true of all competitive prices.

5 Q And so if you look at a single year's data,
6 you would want to know what the demand in that year was,
7 wouldn't you, to see how it affected the numbers?

8 A You would want to know something about the
9 competitive conditions.

10 Q I asked whether you would want to know about
11 the demand conditions in that year because that would
12 affect the revenue-to-variable cost situation.

13 A Demand conditions alone would not necessarily
14 have any particular --

15 Q I did not ask you whether alone.

16 A I think I have to answer no, then. I only can
17 interpret your question and answer it as best I can.
18 Demand conditions alone wouldn't tell you what you want
19 to know. I think that means I have to say no.

20 Q You talked, in discussing here, the various
21 service advantages that you see that trucks have over
22 TOFC and I guess over rails generally. The value of
23 those service advantages would vary greatly among
24 shippers, would it not?

25 A It would vary among shippers, certainly.

1 Q It could vary greatly among shippers, couldn't
2 they?

3 A What do you mean by greatly?

4 Q For some shippers, an extra two hours going by
5 rail would be a tremendous penalty whereas another
6 shipper would be indifferent to a delay of two hours or
7 even two days, isn't that correct?

8 A I don't imagine many TOFC shippers would be
9 indifferent to a delay of two days, no.

10 Q Nonetheless, the value of the truck services
11 varies greatly from shipper to shipper.

12 A It varies from shipper to shipper.

13 Q Wouldn't you regard it as likely that there
14 are quite a number of shippers for whom the service
15 advantages of truck are not significant?

16 A I have no reason to believe that, no. The
17 whole trend today is to make these things more
18 important. If you read anything in economic literature,
19 it is all towards increasing the service quality to
20 minimize other production costs.

21 Q Let me ask you this. Wouldn't you regard it
22 as likely that there are some shippers, TOFC shippers,
23 whose shipping and receiving points are located near the
24 ramps of the railroad on high volume routes, would
25 regard rail TOFC as being very substantially superior to

1 truck service?

2 A The answer is yes, and the reason is that many
3 shippers in the market today will regard something as
4 very superior for a very small difference in economic
5 cost.

6 Q For those shippers, the choice and the ability
7 to have two competing railroads for their TOFC business
8 would be important, would it not?

9 A Yes, but only in the sense that those are
10 shippers, it sounds like, who are in a sense squeezing
11 every last dollar out. They could be talking about a
12 very small sum of money, but because of the competitive
13 pressures in the economy today, they might feel that is
14 important. It is important in the sense that to do well
15 in a competitive economy they have to do that, but it
16 doesn't mean that it would necessarily be a large amount
17 of money involved.

18 Q Just to make sure we are on common ground,
19 there are a number of shippers using TOFC service for
20 whom rail TOFC competition is important, and for which
21 trucks are not regarded by them as an adequate
22 substitute?

23 A That doesn't follow. No, that doesn't follow
24 from the earlier analysis at all. There could just as
25 well be other shippers with exactly the same physical

1 needs and economic needs that could be just as enamored
2 of the trucking business. That is typical in
3 competitive markets, that each one is protected by the
4 competition.

5 Q Let's turn to your Appendix D, Table 8, which
6 is on page 15.

7 Now, the left hand column there is a ratio
8 between revenue and variable cost.

9 A That is correct.

10 Q Are you using the same ICC cost of waybill
11 sample?

12 A That is correct.

13 Q You show on this table a fairly sizeable
14 percentage of the traffic being carried at less than 100
15 percent ratio of revenue to variable cost.

16 A That is certainly correct.

17 Q Does that mean that the railroads are out of
18 pocket on this traffic, losing money?

19 A No, it does not.

20 Q Does it mean they are actually making a profit
21 on some of that traffic that you are reporting as 80 to
22 percent of cost?

23 A The answer is yes, provided that you mean by
24 making a profit that you mean that they are making a
25 contribution to overhead. I believe they are making a

1 contribution to overhead on that traffic, yes. It
2 could, for example, be backhaul traffic where it makes a
3 small contribution to overhead, covers more than the
4 directly variable costs, and is therefore very useful to
5 the railroad, and yet it could be priced way below their
6 average cost.

7 Q What costs do you have in these variable costs
8 that are not directly variable?

9 A That's not a question I can answer, not from
10 lack of knowledge, that is not an answerable question.
11 No one could answer that question. Directly variable
12 varies from circumstance to circumstance.

13 Q I am looking at the data you used, this tape
14 that you used. What costs on there are not directly
15 variable with traffic?

16 A That's a non sequitur. That is not how
17 directly variable works. Directly variable is a
18 specific situation. You can't look at aggregated
19 shipments and talk about directly variable costs without
20 speaking nonsense.

21 Q Is there a charge in here for various overhead
22 accounts in the variable cost tape?

23 A It is essentially, what they did -- I can't
24 answer that one as shortly as I would like to.

25 JUDGE HOPKINS: Go ahead.

1 THE WITNESS: In essence, they did an estimate
2 of marginal costs. They looked at a variety of cost
3 categories, effectively all of them, and they did a
4 regression analysis and found how much varied with
5 output, and they postulated that that was marginal
6 cost. They call it variable cost for who knows what
7 reason, but that is an average sort of way of looking at
8 marginal cost. But it is an average sort of approach.
9 It is not shipment-specific. It may be
10 railroad-specific now-a-days. It wasn't even
11 railroad-specific in the old days, but now it is not
12 shipment-specific, whereas directly variable cost is
13 shipment-specific.

14 Q Did you study what the applicants' costs for
15 moving boxcar traffic are, or for moving TOFC traffic?

16 A I did runs that looked at their
17 revenue-to-variable costs. I did not look at anybody's
18 costs directly.

19 Q I'm talking about the applicants'
20 revenue-to-variable costs?

21 A As I said a minute ago, I had my staff look at
22 this sort of analysis for the applicants' movements,
23 just out of curiosity. Early on I made a decision, do I
24 look at the applicants, do I look at the market, and I
25 took the obvious answer. If you are going to analyze

1 prices and competition, you are going to look at the
2 market

3 Q Did you put that in your work papers, the work
4 you staff did on that subject?

5 A No, it was done since the verified statement
6 was written, and it was just out of curiosity and to
7 anticipate questions.

8 Q Was there a significant difference between the
9 SF and the Santa Fe costs?

10 A I don't believe --

11 MS. REED: Referring to variable costs?

12 MR. LIVINGSTON: Yes.

13 THE WITNESS: I don't believe I looked at
14 that.

15 BY MR. LIVINGSTON: (Resuming)

16 Q Page 8 of Appendix E, you refer back to the
17 middle of that page to a movement from Oakland to New
18 Orleans moving UP-EN-UP via Denver and Dallas.

19 Do you see that?

20 A It wasn't a movement. It was not an actual
21 movement. It was a hypothetical movement, but there is
22 a sentence like that there, yes.

23 Q Do you know whether there is an actual
24 movement, UP-BN-UP from Oakland to New Orleans?

25 A I don't know whether or not freight has moved

1 on that routing or not.

2 Q Do you know if there is a tariff, any tariff
3 for that routing that is in existence today?

4 A I don't know and I don't care.

5 Q Would you regard that as a triple line move?

6 A Since it has two railroads in it, and since in
7 my hypothesis it was really a runthrough train, I think
8 it has really more similarity to a single line move.

9 MR. LIVINGSTON: That's all I have. Thank
10 you.

11 JUDGE HOPKINS: Thank you.

12 Off the record for a minute.

13 (Discussion off the record.)

14 JUDGE HOPKINS: We will recess until 9:00
15 o'clock tomorrow morning.

16 (Whereupon, at 4:55 o'clock p.m., the hearing
17 in the above-entitled matter recessed, to reconvene at
18 9:00 o'clock a.m., Friday, May 3, 1985.)

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