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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, October 25, 1984

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

BEFORE:

JAMES E. HOPKINS,

Administrative Law Judge

0026 0000

1 APPEARANCES AS HERETOFORE NOTED, WITH THE FOLLOWING  
2 ADDITION:

3 On behalf of Santa Fe Southern Pacific Corporation:

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## P R O C E E D I N G S

1  
2 JUDGE HOPKINS: Let's come to order, please.  
3 Let's call the next witness.

4 MR. TOMPKINS: Your Honor, my name is Joseph  
5 E. Tompkins, Jr., from Sidley and Austin in Washington,  
6 appearing on behalf of applicants.

7 I have entered an appearance with the  
8 reporter.

9 JUDGE HOPKINS: Thank you.

10 MR. TOMPKINS: Our next witness is Professor  
11 Baumol.

12 JUDGE HOPKINS: Mr. Baumol, please.  
13 Whereupon,

14 WILLIAM J. BAUMOL

15 was called as a witness, and having been first duly  
16 sworn, took the stand, was examined, and testified as  
17 follows:

## D I R E C T E X A M I N A T I O N

18 BY MR. TOMPKINS:

19 Q Would you state your name and address for the  
20 record, please?  
21

22 A Yes, my name is William J. Baumol. My address  
23 is 61 Jefferson Road, Princeton, New Jersey.

24 Q Dr. Baumol, have you prepared a verified  
25 statement consisting of 44 pages with an attachment of



1 curriculum vitae as part of the submission in this  
2 proceeding for the applicants?

3 A That's correct.

4 Q Do you have any corrections you would like to  
5 make to your verified statement this morning?

6 A Yes, there are a number of typographical  
7 errors.

8 Q Would you please go through those one by one?

9 A Yes. On Page 7, under the heading Part 2,  
10 penultimate line, the word "underlie" I am told is  
11 misspelled. I can't spell.

12 Page 12, the first line, the word "diminution"  
13 is misspelled.

14 Page 17, one, two, three, four, five, six,  
15 seven lines, there is an "l" missing in "corollary."

16 On Page 19, the second line, there is an "r"  
17 missing from "interpreted."

18 On Page 26, Line 3, I was not referring to an  
19 oil company. There should be an "e" at the end of  
20 "mobile."

21 On Page 28, about ten lines from the bottom,  
22 the word "knowledgeable" has an "e" missing.

23 And finally, the last of these vital changes  
24 is on Page 39, where there is a redundant "z" in  
25 "retaliation" on line 2.

1 Q Are there any other corrections you would like  
2 to make to your statement, Dr. Baumol?

3 A None that I am aware of.

4 Q With these corrections, is this statement true  
5 and correct to the best of your knowledge and belief?

6 A To the best of my knowledge and belief.

7 MR. TOMPKINS: Your Honor, the witness is  
8 ready for cross examination.

9 MR. MORSE: I will, Your Honor. My name is  
10 Robert Morse, M-o-r-s-e. I am with Gallin, Carish,  
11 Morse, and Garfinkel. We represent the MKT Railroad in  
12 this proceeding.

13 CROSS EXAMINATION

14 BY MR. MORSE:

15 Q Good morning, Professor Baumol.

16 A Good morning.

17 Q Would you please start off this morning by  
18 describing for us what you did to prepare the statement  
19 which you have submitted in this proceeding?

20 I discussed the general circumstances of the  
21 proposed merger with Mr. Weicker and one of my  
22 colleagues. I laid out the outline and on the basis of  
23 the outline I wrote it. I also drafted the relevant --  
24 well, I drafted it in effect in two parts.

25 The analytical material I drafted with



1 reference just to my own experience with the relevant  
2 economic considerations. The empirical statements,  
3 which in that testimony are highly limited and  
4 circumscribed, I based on materials derived from other  
5 witnesses as indicated in the footnotes.

6 Q All right. We will get into that in a moment,  
7 but first let me ask you to identify for the record the  
8 Mr. Weicker that you mentioned in your statement.

9 A He is attorney for Santa Fe.

10 Q You mentioned that preliminarily you had  
11 discussed this matter with one of your colleagues.  
12 Could you identify that colleague for the record?

13 A Yes. That colleague is Charles Berry, with  
14 whom I work frequently. He is professor of economics  
15 and associate dean at Princeton University, an economist  
16 of considerable repute.

17 Q Did he play any role in preparing any of the  
18 materials which are found in your statement?

19 A He may have suggested some corrections, put in  
20 a word or two, but the statement is for all practical  
21 purposes written entirely by me.

22 Q Did anyone else at Princeton, whether student  
23 or faculty, assist you in the preparation of any  
24 materials found in your statement?

25 A As far as I remember, absolutely not.

1 Q Did anyone, whether faculty or student, at New  
2 York University assist you in any materials found in  
3 your statement?

4 A Absolutely not.

5 Q How many drafts of your statement did you  
6 prepare before it was submitted in final form?

7 A As I remember it, two.

8 Q Did you submit your draft to anyone?

9 A Yes. Both Mr. Weicker and Professor Berry saw  
10 it.

11 Q And that was the first draft?

12 A Yes.

13 Q Did they also see the second draft?

14 A I believe so.

15 Q Do you recall any suggestions that Professor  
16 Berry made to your draft?

17 A He was unusually complimentary and, as I  
18 remember, unlike his usual procedure, did not suggest  
19 any particular changes.

20 Q Okay. What factual materials were presented  
21 to you by the attorneys for the Southern Pacific or  
22 Santa Fe?

23 A I do not remember any specific written  
24 materials. The oral materials were basically just a  
25 brief outline of the case and the issues and answers to



1 my questions about, A, the nature of the testimony that  
2 was in course of preparation, and B, a general  
3 description of the competitive circumstances.

4 Q Were there any other materials that were  
5 presented to you by way of a factual nature?

6 A Well, ultimately, I did receive a number of  
7 pieces of testimony, but those had not yet been prepared  
8 at the time I was first drafting my testimony.

9 Q Is it true therefore that prior to submitting  
10 your statement in final form, you had copies of other  
11 people's testimony in this case?

12 A I did not have the final drafts of anyone's  
13 testimony, because, as I remember it, and this is some  
14 months ago, mine was finished before anyone else's was.  
15 There were materials available in the course of  
16 preparation for the other pieces of testimony, and of  
17 course what became the final form was submitted as a  
18 tentative draft, all subject to change, on the basis of  
19 what would emerge from other people's associated  
20 research.

21 Q Did your statement change from this -- in  
22 ultimate form to the final form on the basis of any  
23 materials submitted to you from others?

24 A No, it did not.

25 Q Did you request any materials from the

1 attorneys for the Santa Fe or Southern Pacific that for  
2 one reason or another simply weren't made available to  
3 you?

4 A No.

5 Q Anything that you had thought of to ask for,  
6 they made available to you?

7 A That is correct.

8 Q Did you have occasion to discuss your  
9 statement or a draft of your statement with any person  
10 who also submitted a statement in these proceedings?

11 A No, sir.

12 Q You talked to no other witness who has put a  
13 statement in in this proceeding?

14 A That is correct.

15 Q Did you have any independent source materials  
16 of your own which you consulted in preparation of your  
17 statement?

18 A Not relating to this merger in particular,  
19 materials relating to the analysis certainly, materials  
20 relating to the industry in general. Basically I  
21 consulted some of my past testimony, but no, nothing  
22 relating in particular to this case.

23 Q Why don't you tell us what you did consult  
24 with regard to your past testimony?

25 A Oh, I looked at, for example, my testimony in



1 the CSX-ABL case. I don't recall any other -- any piece  
2 in particular that I looked at.

3 Q Did you look at your testimony in the UP  
4 case?

5 A I recall that testimony, but I did not review  
6 it, no.

7 Q But you do recall it?

8 A Yes. And I am not ashamed of a word of it.

9 Q The lady doth protest too much, me thinks.

10 Are there any materials relating to your other  
11 consulting assignments other than the testimony in CSX  
12 that you referred to in connection with your testimony?

13 A Not as I remember it.

14 Q Is it therefore true from what I am hearing  
15 that you have made no independent factual studies of  
16 your own in preparation of this statement?

17 A That is absolutely correct. I had a limited  
18 assignment. I was there to help to provide one piece of  
19 the puzzle. It was up to other witnesses to provide the  
20 other pieces. I provided what I think I was intended to  
21 provide, no more.

22 Q And all you are asked to provide, therefore,  
23 was the analytical framework, and not the underlying  
24 facts upon which that framework is based? Is that  
25 correct?

1 A That is absolutely correct.

2 Q At Page 23 of your testimony, if I could  
3 direct your attention there for a moment, you begin your  
4 analysis of the efficiency consequences of the merger,  
5 and you state, do you not, that you have to rely on the  
6 testimony of others more intimately experienced than you  
7 are in the workings of the railroad industry for the  
8 factual predicate for your conclusions. Is that  
9 correct?

10 A That is correct. I am also careful to point  
11 out that there are a number of inferences that can be  
12 drawn from general knowledge of the railroad industry,  
13 and I have been doing work on the railroad industry for,  
14 I think, over 30 years, and other things one can rely on  
15 on the basis of analytical principles, but you are  
16 nevertheless correct in interpreting my statement.

17 Q Professor, I have vowed today in light of  
18 reading previous transcripts to keep my questioning  
19 period substantially shorter than your testimony, and  
20 you will be able to help me if you will answer the  
21 questions precisely as I ask them, and I don't need to  
22 have the explanation as to why an answer is yes or no.  
23 All I need is a yes or no.

24 A Well, sometimes a yes or no, as we both no, is  
25 misleading, but I will try and comply with that request.



1 as much as possible.

2 JUDGE HOIKINS: I thank both of you.

3 BY MR. MORSE: (Resuming)

4 Q Isn't it also correct, Professor, that in the  
5 first part of your testimony, where you set forth the  
6 conclusions on the competitive aspect of the merger,  
7 that you also rely exclusively on the testimony of  
8 others more intimately experienced than you in the  
9 workings of the railroad industry for the factual  
10 underpinnings?

11 MR. TOMPKINS: Could I ask counsel to clarify  
12 what he means by the first part of the testimony? Do  
13 you have a specific page reference?

14 MR. MORSE: Yes. We are talking about Pages 1  
15 to 22.

16 THE WITNESS: In a word, no.

17 BY MR. MORSE: (Resuming)

18 Q You did not rely exclusively on the testimony  
19 of others for the factual underpinnings of your  
20 conclusions?

21 A That is correct. I did not rely exclusively  
22 on the testimony of others. I relied very heavily on my  
23 own experience and knowledge of the railroad industry in  
24 general, as well as the testimony of others.

25 Q All right. Is it fair to say, Professor, that

1 with regard to the various opinions that you have  
2 rendered in your statement, that by and large the  
3 factual predicate for those opinions are contained in  
4 the various statements that have been filed by the  
5 witnesses for Santa Fe and Southern Pacific in this  
6 proceeding?

7 A Absolutely.

8 Q In particular, Professor, isn't it true that  
9 at Pages 14, 17, 18, 19, 23, 26, 33, 34, 35, and 36 of  
10 your testimony, you rely on various statements which  
11 have been filed by witnesses for the Southern Pacific  
12 and Santa Fe in this proceeding for the factual  
13 predicate of your conclusions?

14 MR. TOMPKINS: Your Honor, I think it may be  
15 easier and more accurate if we took those one at a time,  
16 unless the witness is prepared to take all those page  
17 numbers and give an answer.

18 JUDGE HOPKINS: I would be inclined to think  
19 that this witness could handle it. If you can, go ahead  
20 and do it.

21 THE WITNESS: Subject to verification, I  
22 assume you have checked it correctly, and I am prepared  
23 to take your word for that assertion, because it is  
24 certainly true for at least several pages I have checked  
25 as you went along.



1 JUDGE HOPKINS: Thank you.

2 BY MR. MORSE: (Resuming)

3 Q Are there any other sources of data other than  
4 the verified statements and attached data which have  
5 been submitted by the witnesses that I have just  
6 referred to upon which you relied other than your  
7 general knowledge for the factual predicate of the  
8 opinions contained in your verified statement?

9 A No, sir.

10 Q Is it not a fact that you have made no attempt  
11 to check any of the factual assertions made in any of  
12 the statements upon which you have relied in coming to  
13 the conclusions presented in your statement?

14 A No attempt is somewhat of an exaggeration, but  
15 I have made no systematic study of any of the data.  
16 That is correct.

17 Q Have you made a nonsystematic study of the  
18 data?

19 A I have looked at some of the pieces of  
20 testimony, examined what sorts of evidence they  
21 provide. That is how one judges a professional piece  
22 anywhere. I don't normally go and as I read a piece in  
23 a journal and get a research assistant to check each  
24 datum in that piece.

25 In that sense, I have checked, as I check in

1 most of my reading of factual pieces, but you are still  
2 right. I have made no systematic study of them.

3 Q Well, in fact, sitting here today, you have no  
4 independent verification of the facts which are  
5 contained in the statements upon which you relied?

6 A Yes. I am not disagreeing with you.

7 Q Isn't it also a fact, Professor, that should  
8 these statements prove incorrect in any substantial way,  
9 that your opinion would be incorrect?

10 A Oh, absolutely. If it should prove that the  
11 two railroads were controlled by the Mafia, and that  
12 this were a serious plot to take over the United States,  
13 I would oppose it absolutely.

14 Q Well, Professor, that is indeed entertaining,  
15 but none of the verified statements that you relied upon  
16 deal in that area, do they?

17 A No, but the point I am making is correct.

18 JUDGE HOPKINS: Allow him to finish. Go  
19 ahead. On this I will allow you.

20 THE WITNESS: The point I am making is  
21 correct, and the point you are making is correct. That  
22 is, it is true that if the facts turn out to be  
23 diametrically opposite from what is shown by or claimed  
24 by the witnesses in question, then my opinion would no  
25 longer hold. I agree.



1                   But that can be made to sound very different  
2 from what it means, and that is the only point I am  
3 making, in addition to agreeing with you.

4                   BY MR. MORSE: (Resuming)

5                   Q     I think you stated a moment ago that you had  
6 seen at least some preliminary information relating to  
7 statements which have been submitted by other witnesses  
8 in this proceeding. Is that correct?

9                   A     I believe so. This is a long time ago, and I  
10 am not prepared --

11                  Q     Are you prepared to tell us which witnesses  
12 they related to?

13                  A     I don't remember.

14                  Q     You have no recollection today of what  
15 witnesses you looked at?

16                  A     No.

17                  Q     How long ago was this?

18                  A     This was, I would imagine, about nine months  
19 ago, but since then I have finished a book. I am  
20 working on a new edition of the second book. I have a  
21 lot of materials passed over my desk since then.

22                  Q     Did you make any suggestions for material to  
23 be either added or deleted from those draft materials of  
24 other witnesses?

25                  A     No, sir.

1 Q Did you ever indicate to anyone what kind of  
2 facts or categories of facts you needed to support your  
3 conclusions?

4 A That probably was -- was mentioned in my  
5 earliest discussions that I had already --

6 Q So in fact you indicated what facts you needed  
7 developed in order to support your conclusions?

8 A I am quite sure I didn't.

9 Q Did you ever so indicate to any of the  
10 attorneys representing the Santa Fe and Southern Pacific  
11 in this case?

12 A Yes, as best I remember. I mean, I am  
13 speaking from my normal procedure, and I have no reason  
14 to believe I deviated from it in this case.

15 Q Well, we went through some of the footnotes  
16 before, and you agreed with me that those are the  
17 statements upon which you relied for your conclusions.

18 I would like to direct your attention to Page  
19 9 of your testimony. See if you can help me find the  
20 factual support for the conclusion contained at that  
21 page of your testimony.

22 You state, "Typically trucks and barges will  
23 compete for the same traffic, and that competition will  
24 circumscribe the prices that the single railroad can  
25 charge."



1 Do you see that, Professor?

2 A Certainly.

3 Q Is there a statement or statements submitted  
4 by some witness in this proceeding upon which you base  
5 that conclusion?

6 A This is my own statement. I am talking about  
7 railroading in general.

8 Q Railroading in general?

9 A That's right.

10 Q Are you talking about this particular merger,  
11 or railroading in general?

12 A It says what this implies for the case of  
13 transportation. I think it is very clear that I am  
14 talking about railroading in general here, and  
15 discussing the logic of principles.

16 Q If you will give me a second to pick out a few  
17 questions I was going to ask later, but it seems  
18 appropriate now.

19 Professor, do you recall ever -- well, I will  
20 be more specific. Do you recall testifying in your  
21 verified statement submitted in the CSX case to which  
22 you referred earlier that, "There is very little or no  
23 direct competition between railroads and barges  
24 generally?"

25 MR. TOMPKINS: Let me ask, is counsel quoting

1 from the witness's statement in the CSX case, or is he  
2 paraphrasing?

3 MR. MORSE: I am quoting exactly. It is on  
4 Page 16 of the verified statement of William J. Faulstich.

5 THE WITNESS: I believe, subject to my looking  
6 at the testimony, that what I said was that there was  
7 very little point to point direct competition between  
8 the CSX Railroad and those barges.

9 I was not characterizing the industry  
10 generally, and I also went on to say, and this I am sure  
11 of, that there was plenty of indirect competition  
12 between them.

13 That is, even though they did not traverse  
14 exactly parallel routes, that there was competition in  
15 terms of origins, in terms of destinations, and in terms  
16 of commodities.

17 Here is a clear example where a yes or no  
18 answer would have been misleading.

19 BY MR. MORSE: (Resuming)

20 Q Well, we are glad to have your explanation,  
21 but you did say at Page 16 that there is very little or  
22 no direct competition between railroads and barges  
23 generally, and then you went on in that same sentence,  
24 and here I am paraphrasing, to talk about the specific  
25 situation in CSX.



1 MR. TOMPKINS: Your Honor, if counsel is going  
2 to ask about this quote, I would ask that he show the  
3 witness the testimony the quotes come from, so we can  
4 see it in context of what the testimony is.

5 MR. MORSE: I have no further questions on  
6 that, Your Honor.

7 JUDGE HOPKINS: You have no further questions  
8 on that? Go ahead.

9 BY MR. MORSE: (Resuming)

10 Q Professor, I notice attached to your statement  
11 is your curriculum vitae. It is dated January 19th,  
12 1984. And on Page 47 of your testimony is a list of  
13 books published.

14 Is that correct?

15 A Yes.

16 Q I notice that the last book listed is entitled  
17 Contestable Markets and The Theory of Industry  
18 Structure. Did you write that with J.C. Panzar and R.E.  
19 Willig?

20 A Yes, and I see there is another typographical  
21 error. Panzar will not forgive me for being  
22 misspelled.

23 Q How is that spelled?

24 A P-a-n-z-a-r.

25 Q Could you identify Mr. Panzar for us?

1 A Yes. He is professor of economics at  
2 Northwestern University.

3 Q Northwestern? Could you identify Mr. Willig  
4 for us?

5 A Yes, he is professor of economics at Princeton  
6 University.

7 Q Do you consider Professor Panzar to be a  
8 reputable economist?

9 A Absolutely.

10 Q Topnotch?

11 A Yes.

12 Q Do you consider Professor Willig to be a  
13 reputable economist?

14 A Outstanding.

15 Q Would you characterize his degree of  
16 reputation as outstanding?

17 A Yes.

18 Q Would you characterize Professor Panzar to be  
19 a colleague of yours?

20 A Oh, certainly.

21 Q Would you characterize Professor Willig to be  
22 a colleague of yours?

23 A Yes.

24 Q Do you generally agree with the conclusions of  
25 Professor Panzar in his writings and publications?



1 A Generally.

2 Q Do you generally agree with the conclusions of  
3 Professor Willig in his writings and publications?

4 A Generally.

5 Q Professor Willig is a co-author with you on  
6 several articles, is he not?

7 A That's correct.

8 Q And in fact has written extensively on your  
9 theory of contestable markets. Is that not correct?

10 A That's not -- on our theories of contestable  
11 markets. That's correct.

12 Q I didn't mean to shortchange Professor  
13 Willig.

14 A I am very glad. Thank you. You will get me  
15 into trouble otherwise.

16 Q Well, then, I will be super-careful on the  
17 next question that I ask.

18 Would you identify an Elizabeth Bailey for me?

19 A Yes. Elizabeth Bailey is dean, I believe, of  
20 the School of Industrial Administration at Carnegie  
21 Mellon University, a former vice chairman of the Civil  
22 Aeronautics Board, a former student of mine, and the  
23 first woman Ph.D. from the Economics Department at  
24 Princeton University, and I am very proud of her.

25 Q Well, it sounds like you have good reason to

1 be proud of Dean Bailey. Do you consider her to be a  
2 reputable economist?

3 A That is hardly worth answering. The answer is  
4 obviously yes.

5 Q This is outstanding plus then for Dean  
6 Bailey?

7 A Well, all of them.

8 Q Would you characterize Dean Bailey as a  
9 colleague of yours?

10 A Yes.

11 Q And do you generally agree with her  
12 conclusions in her writings and publications?

13 A Yes.

14 Q Let me switch tracks on you a little bit  
15 here. Most of your testimony addresses the parallel  
16 aspects of this merger where the anticompetitive  
17 concerns are more obvious. However, at Page 10 of your  
18 testimony, you state that, "The merger under  
19 consideration is to a considerable degree" -- why don't  
20 you turn to Page 10, and I will start the quote again.

21 At Page 10, you state that, "The merger under  
22 consideration is to a considerable degree characterized  
23 by elements which can be described as end to end or  
24 vertical in character." Is that correct?

25 A That's correct.



1 Q Have you made any attempt to determine as a  
2 quantitative matter what percentage of this merger is  
3 characterized by elements which can be described as end  
4 to end versus those which can be characterized by  
5 horizontal or parallel?

6 A A, I have made no such attempt. Secondly, I  
7 wouldn't even know how to define such a percentage.

8 Q Well, either as a percentage of total trackage  
9 in the system?

10 A I still don't know what that would mean.

11 Q Or as tons of commodities shipped, or on any  
12 other basis?

13 A I am quibbling now about a detail of wording.  
14 In substance, I can get you out of your difficulty by  
15 agreeing that I would have -- I have made no independent  
16 study to judge even qualitatively the degree to which  
17 the merger is horizontal or vertical.

18 Q All right. At Page 10 of your testimony  
19 again, you state, do you not, that an end to end merger  
20 with some exceptions will not usually enhance market  
21 power. Is that correct?

22 A That is correct.

23 Q What are those exceptions?

24 A There are a number of cases in which -- which  
25 are recognized in the literature where end to end

1 mergers either may enhance market power or, to save you  
2 the trouble of asking me, or facilitate its exercise.  
3 That is, in which it is considered to have objectionable  
4 features.

5 The most notable of those cases involves the  
6 ability to carry out successful predation by means of  
7 the end to end merger, that is, in which in one of the  
8 sectors in the vertical union the merger permits the  
9 merging railroad to drive out all competitors or most  
10 competitors and in which there is no realistic prospect  
11 of their returning.

12 That second feature is absolutely crucial for  
13 this basic case of the possibility of monopoly power  
14 emerging from a vertical merger because unless there is  
15 some way in which reentry can be effectively prevented,  
16 the predation becomes a suicidal act for the predator,  
17 since predation only works through a losing initial  
18 arrangement that makes life unviable for the rivals, and  
19 if those -- the losses that are incurred in the process  
20 of driving the rivals out can be recouped, and more,  
21 once the field has been emptied of competitors.

22 So, that is the first case. Two other cases  
23 that are fairly standard in the literature are not cases  
24 in which monopoly power emerges from the end to end  
25 merger, but in which its exercise is facilitated. The



1 one standard case is the case in which price  
2 discrimination is impractical for the railroad or the  
3 firm with the monopoly power.

4 That is, we assume that we have one firm that  
5 has monopoly or market power to begin with. That firm,  
6 in order to derive full advantage from it, must somehow  
7 be able to discriminate in price or service or some  
8 other way among customers it is prevented by legal  
9 impediments, institutional constraints, or something  
10 else from exercising that discrimination.

11 It acquires another firm which has no monopoly  
12 power itself, but through a vertical relationship is  
13 enabled to discriminate in prices. The standard example  
14 that is given is that of a manufacturer of computer  
15 equipment which must sell the equipment to everyone at  
16 the same price, but can overcharge for punch cards --  
17 this is ancient history -- and thereby derive more  
18 revenues from the larger, the heavier users of the  
19 equipment.

20 The third standard example of the sort of  
21 situation you are referring to is the case where the  
22 firm that would have market power is prevented from  
23 exercising it by the fact that it is closely regulated.  
24 Its rate of return is limited. It is able to acquire  
25 another firm which because it is competitive is

1 unregulated.

2 It is able to perform magic in its accounting,  
3 so that costs from the acquired firm are passed on to  
4 the acquiring firm in the parable, as I have told it.  
5 Thereby the acquiring firm is in fact able to disguise  
6 excess profits by passing them through to the acquired  
7 firm.

8 Those are illustrations. Those are the prime  
9 three cases that appear in the literature. There are  
10 undoubtedly other examples that have appeared here and  
11 there, but I think they illustrate the issue.

12 Q All right. I see you are getting warmed up.  
13 Let me go back, though, because you do raise some very,  
14 very important points, and I don't want to misinterpret  
15 the conclusions of your statement, and certainly we  
16 don't want that to happen in this proceeding.

17 So, let me go back, and I understand, then,  
18 that when you conclude that an end to end merger with  
19 some exceptions will not usually enhance market power,  
20 that is really not the end of the inquiry, is it?

21 A That is absolutely right.

22 Q We must go and take a look at whether or not  
23 some of the exceptions that you have pointed out to us  
24 apply in this acquisition.

25 Isn't that correct?



1 A And that is precisely what I have done.

2 Q In the end to end context?

3 A In the end to end context.

4 Q Okay. Have you addressed in your testimony  
5 that the end to end aspects of this acquisition may  
6 facilitate the exercise of market power even though it  
7 doesn't necessarily increase it?

8 A You see, here is another example where a yes  
9 or no answer will be completely misleading. Of course,  
10 I have not done it explicitly in terms of those three  
11 cases. What I have done, and that is logically  
12 equivalent, I think you will have to admit, is accepting  
13 the testimony of the other witnesses cited, and I am not  
14 retracting my reliance on them, but if one accepts their  
15 evidence.

16 And their evidence does claim that virtually  
17 throughout the system the merged railroad will face  
18 competition in a variety of forms, and in forms in which  
19 exit and entry is quick, cheap, and easy, that in all  
20 those cases, all three of my exceptions are immediately  
21 precluded.

22 Case 1 is precluded by ease of entry and  
23 reentry. I emphasize that that is a necessary condition  
24 for Case 1 to arise. Case 2, the firm in question must  
25 have market power, but if there is plenty of

1 competition, and there is plenty of ease of entry, and  
2 if incidentally these firms in question have such excess  
3 market power that they can barely earn enough to  
4 survive, where is that magnificent market power that  
5 they will be able to exercise either through price  
6 discrimination or through avoidance of regulation?

7           So, what I am saying is, no, I did not address  
8 myself to those cases in particular. The short answer  
9 to your question is no. But the illuminating answer to  
10 your question is that by examining on the basis of the  
11 materials that were provided by other witnesses, the  
12 degree of competition that is faced by the railroads in  
13 question now and that can be expected to be faced by  
14 them in the future.

15           In both ends of the end to end elements of the  
16 merger, I have effectively dealt with each and every one  
17 of those exceptions. I am aware, incidentally, that of  
18 course Professor Willig and others have written on such  
19 issues, and I think you will find that what they have  
20 written is entirely consistent with what I have just  
21 described to you.

22           Q       Well, I think that what we will find, because  
23 we are about to mark it as an exhibit for  
24 identification, that they agree that these factors must  
25 be taken into consideration. What I think is still an



1 open question, Professor, is whether you have done  
2 that.

3 A I have done precisely that.

4 MR. MORSE: I would like to have marked for  
5 identification at this time an article entitled  
6 Non-Price Anticompetitive Behavior By Dominant Firms  
7 Toward The Producers of Complementary Products, by J.A.  
8 Ordover, A.C. Sykes, and R.D. Willig, dated December,  
9 1983, and it is indicated that this paper, which is a  
10 paper at the present time, will be published by the MIT  
11 Press.

12 JUDGE HOPKINS: That will be marked for  
13 identification.

14 (The document referred to  
15 was marked for  
16 identification as Exhibit  
17 Number MKT-C-55.)

18 BY MR. MORSE: (Resuming)

19 Q Professor, would you please look at that  
20 exhibit?

21 A Certainly.

22 Q It is MKT-C-55, counsel's exhibit.

23 Is this the article, or one of the articles to  
24 which you had reference in your previous testimony?

25 A That's correct.

1 Q I would like to direct your attention to the  
2 first sentence of this article. "In a variety of market  
3 settings, dominant firms have an incentive to engage in  
4 anticompetitive practices that disadvantage the  
5 producers of complementary products."

6 Do you agree with that statement?

7 A I agree with everything but its grammar.

8 Q Well, for someone who has trouble spelling --

9 A "Disadvantage" is not a verb.

10 Q Well, perhaps after this proceeding is over,  
11 you and Professor Willig can get together, and he will  
12 teach you spelling and you can teach him grammar.

13 A Right. I would appreciate it.

14 Q I take it then that the answer is yes, you do  
15 agree with him?

16 A Yes.

17 Q The article indicates -- are you familiar with  
18 the article, what it contains?

19 A I received it yesterday, and I studied it last  
20 night with great admiration.

21 Q You generally approve of the conclusions that  
22 are reached in this article?

23 A Yes. I have not gone through every bit of the  
24 logic in as much detail as I would like, but I do.

25 Q I think at this time we will leave the article



1 the way it is and deal with it in other testimony down  
2 the line. Well, one more question. Again, from the  
3 same article, do you agree with this statement?

4 "Thus, contrary to conventional learning, a  
5 firm with market power at one stage of production or  
6 over one component of the product may nevertheless have  
7 an incentive to extend its market power to other stages  
8 of production or to other product components."

9 MR. TOMPKINS: May I ask counsel, is that a  
10 quotation from this article?

11 MR. MORSE: Yes, it is.

12 MR. TOMPKINS: Would you point us to it?

13 JUDGE HOPKINS: Would you refer us to the  
14 page, please?

15 MR. MORSE: It is the first sentence on the  
16 top of Page 2.

17 BY MR. MORSE: (Resuming)

18 Q Do you agree with that sentence, Professor?

19 A I must quibble with it again, because I think  
20 that conventional learning does not disagree with it. I  
21 agree with the substance of the statement. I just don't  
22 agree with its attempted quarrel with conventional  
23 learning. I think lots of people would agree with that  
24 statement.

25 Q Including you?

1 A Including myself, yes.

2 Q Well, let's take a look a little more closely  
3 at that statement. Let's try to apply that statement to  
4 the railroad context. Would you agree that in the  
5 railroad context, this means that under certain  
6 circumstances there can be anticompetitive effects with  
7 regard to the end to end aspects of a rail merger?

8 A I don't agree, because one of the premises  
9 that underlies every case, as I remember it, in this  
10 article is an impediment to reentry.

11 That is, in a market in which railroads face  
12 competition by trucks, barges, ocean, water  
13 transportation, none of those cases apply automatically,  
14 because as the authors are careful to emphasize, these  
15 are real cases, these are important cases, that they are  
16 cases which apply in special circumstances which they  
17 list.

18 And as I remember it, in each case one of the  
19 necessary requirements is an impediment to reentry.  
20 They are all examples of my first case, where successful  
21 predation is in effect possible.

22 Q Well, with regard to the exercise, the  
23 facilitating the exercise of market power as opposed to  
24 increasing it, and with regard to the articles focusing  
25 in on the complementary product problem, wasn't the



1 predicate for the article's conclusion there the  
2 inability to have a perfect price squeeze vertically?

3 A That is correct, and then it goes on to say,  
4 as I remember it, that in order to use the vertical  
5 arrangement to remedy the limitations on the exercise of  
6 the market power in the models of this article, it is  
7 necessary for there to be effective impediments to  
8 reentry.

9 Q Well, I am not going to quibble with you.

10 A This is no quibble. It is the fundamental  
11 assumption of the argument. If you want me to agree  
12 with them, I have already done so. If you want me to  
13 judge the applicability of their results to the  
14 circumstances of the merger in question, you must be  
15 able to show me that the merger does in fact satisfy the  
16 premises of their cases, when in fact I am telling you  
17 that my -- to the extent my knowledge of railroads  
18 applies, those premises are distinctly violated.

19 Q Now I understand why I received a speech when  
20 I felt I didn't deserve one. I think you might have  
21 misheard my question. I wasn't talking about this  
22 merger. Let me ask you the question again that started  
23 this. I asked you whether you agreed that in the  
24 railroad context the sentence we read at the top of page  
25 2 means that under certain circumstances there can be

1 anticompetitive effects with regard to the end to end  
2 aspects of a rail merger.

3 A In theory, it is true, but what I said, I  
4 think, at the beginning of my answer was that to the  
5 extent that railroads' operations are competitive, to  
6 the extent that they compete with transport modes such  
7 as water and trucking, that no such problem arises.

8 Q All right. I think then that you would agree  
9 in this merger or in rail mergers generally that if we  
10 are talking about an end to end effect in which it can  
11 be demonstrated that there is no substantial competition  
12 from truck or barge, then there certainly do exist  
13 circumstances in which there can be anticompetitive  
14 effects with regard to that end to end aspect of a  
15 merger.

16 A That's correct. Or -- let me amend that. Or  
17 competition from other forms that have similar abilities  
18 to enter and exit.

19 Q Professor, do you agree with the following  
20 statement? "The majority of most railroads' traffic is  
21 involved in some sort of interconnection with another  
22 carrier." Do you agree with that?

23 A I don't know about the majority.

24 Q Excuse me. I thought that a large part of the  
25 first portion of your testimony in this case, Pages 1



1 through 22, was based on -- the factual predicate was  
2 based on your general knowledge of the railroad  
3 industry. Is that not correct?

4 A That's right.

5 Q Well, I took it for granted that you had a  
6 general knowledge of the railroad industry.

7 A That's correct, and I know that a substantial  
8 proportion of the traffic is correctly characterized by  
9 that statement. I don't know whether it's a majority.  
10 I am not a compendium of statistics on the railroad  
11 industry.

12 Q You do agree, though, that certainly a  
13 substantial portion of railroad traffic is involved in  
14 some sort of interconnection with another carrier? Is  
15 that correct?

16 A Certainly, that's correct.

17 Q Now, keeping that in mind, let me ask you  
18 whether you agree with the following statement, that  
19 "That factor is a key to understanding the consequences  
20 of major rail consolidation as wherever possible the  
21 combining carriers can be expected to reroute traffic  
22 interchanged with unaffiliated companies to the new  
23 combination."

24 MR. TOMPKINS: Can I ask counsel, is he  
25 quoting from a witness's statement in this proceeding,

1 or is that his own statement?

2 MR. MORSE: I am quoting from Exhibit  
3 KCS-C-1. It is a confidential exhibit where the precise  
4 quotation has been quoted to other witnesses in this  
5 proceeding.

6 JUDGE HOPKINS: Go ahead.

7 THE WITNESS: Can you read that again,  
8 please?

9 BY MR. MORSE: (Resuming)

10 Q Yes, I would be happy to. Sorry for the  
11 interruption.

12 A Not at all.

13 Q I want you to keep in mind your agreement with  
14 the fact that a substantial portion of most railroads'  
15 traffic is involved in some sort of interconnection with  
16 another carrier, and I ask you whether you agree with  
17 the statement that "That factor is a key to  
18 understanding the consequences of major rail  
19 consolidation as wherever possible the combining  
20 carriers can be expected to reroute traffic interchanged  
21 with unaffiliated companies to the new combination."

22 MR. TOMPKINS: If this is from an exhibit,  
23 Your Honor, could I ask that the witness be shown the  
24 exhibit or this portion of it so he can see it in  
25 context?



1 MR. MORSE: This is a confidential exhibit.  
2 Is there any objection to showing it to him?

3 JUDGE HOPKINS: No, let him see it. He is a  
4 witness here.

5 THE WITNESS: I promise not to give away any  
6 military secrets. You are on Page --

7 MR. MORSE: I don't have my marked up copy  
8 with me. I brought one for use by the witness. Let me  
9 try to locate the quote.

10 JUDGE HOPKINS: Go ahead.

11 (Pause.)

12 MR. MORSE: We are talking about Page 000024  
13 of KCS-C-1.

14 JUDGE HOPKINS: He is ready.

15 THE WITNESS: Your question was whether I  
16 agree with that statement?

17 BY MR. MORSE: (Resuming)

18 Q Yes.

19 A I agree with the first part of the statement,  
20 that this factor is a key to understanding the  
21 consequences of major rail consolidations, and I  
22 disagree absolutely and categorically with the second  
23 part of the statement, that wherever possible the  
24 combining carriers can be expected to reroute traffic  
25 interchanged with unaffiliated companies to the new

1 combination. That is suicidal. That is irrational.  
2 And that is what competitive pressures will not permit  
3 to happen.

4 Q Even if, Professor, the combined carrier  
5 cannot have a perfect price squeeze?

6 A Even if it cannot have a perfect price squeeze  
7 or any price squeeze at all.

8 Q Have you seen a copy of KCS-C-1 before today?

9 A No.

10 Q Have you been made aware of a confidential  
11 memorandum that was submitted to the board of directors  
12 of the Santa Fe?

13 A No.

14 Q Is it your conclusion, Professor, that  
15 railroads operate in a contestable market?

16 A That -- it is my conclusion that railroads  
17 operate in many markets which are highly contestable,  
18 because they operate in competition with trucks and  
19 barges.

20 Q If there are markets that exist in which such  
21 competition is not substantial, would that market be  
22 characterized by you as contestable?

23 A If such competition is possible, even if it  
24 does not occur now, then it is still effectively  
25 contestable. The major point in contestability is the



1 power of potential competition to constrain whether or  
2 not that competition is currently in existence.

3 Q Well, let's probe that a little bit. Isn't it  
4 true that your theory of contestable markets requires  
5 that there be no cost advantage to potential entrants?

6 A No cost disadvantage to potential entrants.

7 Q I am sorry. No cost disadvantage to potential  
8 entrants.

9 A It requires that there be no cost disadvantage  
10 other than disadvantages which occur from the scale or  
11 scope of their operations.

12 Q But no other cost advantages? Is that  
13 correct?

14 A That's right. That is that they must be able  
15 to utilize the same technological options. It doesn't  
16 mean they have to use them, but that they can.

17 Q Well, does not your conclusion that railroads  
18 compete in a contestable market require that trucks and  
19 motor carriers operate at similar cost levels and  
20 service attributes as railroads?

21 A No, sir.

22 Q I thought you said a moment ago --

23 A It requires them to have the option. I did  
24 not say it requires them to have the same costs. That  
25 is a world of difference.

1 Q I take it then that if it were shown to you  
2 that trucks for some commodities have a very severe cost  
3 disadvantage from railroads carrying that commodity,  
4 that that would have no effect on your theory of  
5 contestable markets for that commodity?

6 A No, I didn't say that. That could certainly  
7 have a consequence, and it could imply that for that  
8 commodity, the market is not contestable. I am  
9 conceding what you want me to concede, in brief.

10 Q Thank you.

11 Professor, would you agree with the following  
12 definition of the relevant market for evaluation of rail  
13 mergers, and to avoid an objection that will interrupt  
14 the answer, I am telling you that I am reading from the  
15 decision of the Interstate Commerce Commission in the UP  
16 merger, which is at 366 ICC, Page 504, at the margin:  
17 "Motor carriers are unlikely to be direct substitutes  
18 for rail transportation in the markets affected by the  
19 proposed transactions. In such circumstances, a rise in  
20 rail rates would not necessarily result in a significant  
21 amount of traffic shifting between modes, and the  
22 railroad could effectively increase its profits by  
23 raising its rates absent other competitive factors."

24 MR. TOMPKINS: Your Honor, may I ask counsel  
25 to show that to the witness so the witness can look at



1 it?

2 JUDGE HOPKINS: Would you, please?

3 MR. MORSE: I'd be happy to.

4 THE WITNESS: May I comment?

5 BY MR. MORSE: (Resuming)

6 Q Well, I would like to have an answer to the  
7 question, unless you think my question is confusing.

8 A I think your question is misleading, if you  
9 will excuse me for saying so.

10 Q Well, read as much of that opinion as you  
11 like, but the question is, I would like to know whether  
12 you agree with the statement that I quoted.

13 MR. TOMPKINS: Counsel, am I correct that the  
14 statement that you read began in the middle of a  
15 sentence?

16 MR. MORSE: Yes. I understand that.

17 MR. TOMPKINS: You didn't read the first part  
18 of the sentence. Is that correct?

19 MR. MORSE: Well, the witness has the whole  
20 thing in there. He can read it all.

21 JUDGE HOPKINS: Well, if he reads it all, he  
22 is going to have to say, after reading the whole  
23 sentence, he says such and such.

24 MR. MORSE: Well, I am making a statement,  
25 Your Honor, and asking whether the witness agrees with

1 it.

2 JUDGE HOPKINS: Well, which part of the  
3 statement are you going to make, the whole statement, or  
4 are you only going to make a part of the statement?

5 MR. MORSE: I am reading a statement and  
6 asking the witness whether he agreed with it. I am not  
7 asking him whether he agreed with the decision or with  
8 any part of the opinion. I am making a statement.

9 JUDGE HOPKINS: Well, if you can indicate  
10 whether you agree or disagree with what he said, go  
11 ahead. Then if you want to, you can explain.

12 THE WITNESS: All right. I don't agree, A,  
13 with what you have said, because this is not part of the  
14 decision. What it says here is that most other parties  
15 argue that, and then it goes on to the material you  
16 quoted, which is very different from the ICC having said  
17 that.

18 Besides, this is not to me a market  
19 definition. It is a statement of alleged fact, and that  
20 is something to be tested case by case.

21 JUDGE HOPKINS: Thank you.

22 BY MR. MORSE: (Resuming)

23 Q Well, isn't it a fact, though, Professor, that  
24 the ICC excluded truck competition in defining the  
25 relevant market for the UP merger? You testified in



1 that merger.

2 A I don't know that. If you tell me so, I will  
3 accept that as an assertion. I do not know that for  
4 myself.

5 Q Well, let's assume it for the moment. Do you  
6 agree with that decision by the ICC?

7 MR. TOMPKINS: Do you agree with what,  
8 counsel?

9 BY MR. MORSE: (Resuming)

10 Q Exclusion of truck competition.

11 JUDGE HOPKINS: If they did.

12 BY MR. MORSE: (Resuming)

13 Q The exclusion of truck competition in  
14 evaluating a rail merger.

15 A No, I do not agree, if that is what they  
16 said. I believe that truck competition in many cases  
17 effectively constrains railroad pricing, in other cases,  
18 it does not, and that this is something which cannot be  
19 handled in one blanket judgment.

20 Q Are you aware of the ICC decision about a  
21 month ago in the Milwaukee case?

22 A No.

23 Q In that case, the ICC, and I quote, held as  
24 follows, and this is not a repetition of what was  
25 argued, although it is a repetition --

1 JUDGE HOPKINS: Will you give us the reference  
2 so that we have the page, et cetera, et cetera?

3 MR. MORSE: Yes, Your Honor. This is Finance  
4 Docket -- I don't have an ICC cite. It is only a month  
5 ago.

6 JUDGE HOPKINS: I understand.

7 MR. MORSE: It is Finance Docket Number  
8 28-640, Sub Number 9, et al., and I am quoting from Page  
9 59 of the opinion.

10 JUDGE HOPKINS: Thank you.

11 BY MR. MORSE: (Resuming)

12 Q After saying what was argued in the case, the  
13 Commission found, "We are also limiting the relevant  
14 product market for consideration to rail freight  
15 transportation," and they go on to say that for the  
16 purposes of this proceeding, we agree with DOJ," meaning  
17 the Department of Justice, "as well as for GTC and Sco  
18 that the relevant product market is rail freight  
19 transportation."

20 MR. TOMPKINS: Your Honor, again I must insist  
21 that counsel show the witness what he is reading from.

22 JUDGE HOPKINS: He is coming up.

23 THE WITNESS: Thank you.

24 JUDGE HOPKINS: He is ready.

25 THE WITNESS: Once again, I think that the



1 context must be made clear. The context is not a  
2 general conclusion. There is a rather elaborate  
3 paragraph preceding it which I think on any fair reading  
4 will make it clear that this is a judgment given for a  
5 particular set of circumstances in this hearing.

6 I am in no position to agree or disagree with  
7 the judgment in those circumstances, but I certainly  
8 disagree with your inference that the rail market should  
9 exclude all but other rail competition in general,  
10 because that would be a distortion of the relevant  
11 logic, which is an examination of the constraining  
12 influences that inhibit the railroad's power to raise  
13 its prices to uncompetitive levels and keep them  
14 there.

15 BY MR. MORSE: (Resuming)

16 Q Well, Professor, I was hoping that presenting  
17 two points on this graph, I could let you draw a  
18 straight line, but I can see that that is not going to  
19 happen.

20 A When the path is crooked, it is not easy to  
21 draw a straight line.

22 Q Do you think the ICC in this proceeding should  
23 consider whether the proposed Santa Fe-Southern Pacific  
24 merger would have an adverse effect on competition among  
25 rail carriers in the affected region?

1 A If I heard you correctly, yes, I agree that it  
2 should consider the competitive effects.

3 Q And that it should consider whether this  
4 particular merger would have an adverse effect on  
5 competition among rail carriers in the affected region?

6 A Not necessarily, because if the markets remain  
7 competitive, it doesn't matter.

8 Q So what you are saying is that in this merger  
9 the ICC should not consider any adverse effect on  
10 competition among rail carriers in the affected  
11 region.

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1           A     I said not necessarily. My intentions I think  
2 are perfectly clear. The ICC should not prejudge the  
3 issue by examining the effects on competitiveness  
4 exclusively in one way or another. It should examine  
5 whether the bottom line -- whether the final consequence  
6 of the merger will be to open the consumer to the  
7 exercise of market power.

8                     And if that is constrained by other railroads,  
9 fine. If that is constrained by other types of carrier,  
10 fine. If it becomes unconstrained, not fine.

11           Q     In this merger, should the ICC consider an  
12 adverse effect on competition among rail carriers in the  
13 affected regions?

14                     MR. TOMPKINS: He's already answered that,  
15 Your Honor.

16                     JUDGE HOPKINS: Go ahead and answer it  
17 specifically. If he wants it that way, go ahead.

18                     THE WITNESS: It should consider that. But  
19 that to me is not a determining issue. The issue is the  
20 bottom line effect on the ability of the merging  
21 railroads to exercise market power.

22                     BY MR. MORSE: (Resuming)

23           Q     Well, is it therefore your opinion that there  
24 are certain commodities and certain kinds of movements  
25 which are present in the merger before us for which it

1 is appropriate to consider truck competition and other  
2 commodities and movements for which it is not?

3 A It is appropriate to consider it for all  
4 commodities. The facts may show that it is not highly  
5 relevant in some cases, but what neither you nor I want  
6 is to prejudge the facts.

7 Q Do you believe that in looking at the effect  
8 of truck competition that you should also look on the  
9 distance the commodity has moved?

10 A Certainly.

11 Q That is a substantial factor, is it not, in  
12 considering competition from trucks?

13 A Certainly.

14 MR. MORSE: I'd like to mark for  
15 identification at this time an article from the  
16 Economic -- the American Economic Review dated March  
17 1982. It's entitled "Contestable Markets: An Uprising  
18 in the Theory of Industry Structure," by William J.  
19 Baumol.

20 THE WITNESS: Fine art.

21 MR. MORSE: Your modesty is as extensive as  
22 your misspellings.

23 JUDGE HOPKINS: That will be marked for  
24 identification as counsel's Exhibit MKT-C-56.

25 (The document referred to



1 was marked Exhibit No.  
2 MKT-C-56 for  
3 identification.)

4 MR. TOMPKINS: May I ask, is counsel finished  
5 with KCS-C-1?

6 MR. MORSE: Yes. I don't want it lying  
7 around.

8 BY MR. MORSE: (Resuming)

9 Q Now, Professor, this is indeed your article,  
10 is it not?

11 A Yes, I confess.

12 Q You take full blame?

13 A Yes.

14 Q I'd like to direct your attention to a  
15 sentence on page 4, but I want to make sure you have an  
16 opportunity to refresh your recollection of what you  
17 wrote either before or after, to put that sentence in  
18 context. Take a moment, please.

19 A I hope I have page 4. Please give me the  
20 sentence. There are some blank pages here.

21 Q Well, the pages are marked. Let me come up  
22 and see if I can help you with it. The sentence begins  
23 "In short." The sentence says: "In short, it is a  
24 requirement of contestability that there be no cost  
25 discrimination against entrants." You see that

1 sentence, Professor?

2 A Yes.

3 Q You wrote that sentence?

4 A Yes.

5 Q Do you still agree with that sentence?

6 A Yes.

7 Q Thank you. Let me change tracks again.

8 MR. TOMPKINS: Are you finished with this  
9 exhibit, counsel?

10 MR. MORSE: Yes, I am.

11 BY MR. MORSE: (Resuming)

12 Q On page 15 of your testimony, could I direct  
13 your attention to page 15 of your testimony. And just  
14 so that you can have the full context of the question,  
15 at pages 37 and 38 of your testimony you pick up on the  
16 same theme again. You say in essence that the amount of  
17 capital needed to embark on a trucking or barge  
18 operation is negligible.

19 On page 14 of your testimony, you agree that  
20 the ease of entry into railroading is substantial.

21 A I'm sorry? Can you repeat what you just  
22 said? I think you misspoke.

23 Q Well, I certainly didn't mean to do that. I  
24 said that on page 14 of your testimony you agree that  
25 the ease of entry into railroading is substantial.



1 JUDGE HOPKINS: That doesn't sound right.

2 THE WITNESS: I think the difficulty of entry  
3 into railroading.

4 BY MR. MORSE: (Resuming)

5 Q Well, that's right, the barriers to entry are  
6 high.

7 A You said the opposite.

8 MR. TOMPKINS: Well, ease isn't substantial.

9 MR. MORSE: You're right.

10 BY MR. MORSE: (Resuming)

11 Q The difficulty of entry into railroading is  
12 substantial, do you agree?

13 A May I try and help you?

14 JUDGE HOPKINS: Go right ahead.

15 BY MR. LEARY: (Resuming)

16 Q No, you may not, but I do appreciate your  
17 offer.

18 I do want you to take a look at page 14.

19 A Yes.

20 Q And isn't the thrust of your testimony there  
21 that the barriers to entry into railroading are  
22 substantially high?

23 A It is difficult to enter railroading, yes.

24 Q And on pages 15 through 16 of your testimony,  
25 and then again more specifically at pages 37 through 38

1 of your testimony, you describe about the mobility of  
2 trucks and you describe a hit and run capability. Is  
3 that a fair characterization of your testimony?

4 A Yes.

5 Q Have you made any studies with regard to the  
6 amount of sunk costs any existing railroad, such as the  
7 Santa Fe or Southern Pacific, may have?

8 A I have at times examined the cost structure of  
9 railroads, not recently. And yes, I did find very  
10 substantial sunk costs.

11 Q Would you agree with us that the Santa Fe and  
12 Southern Pacific have substantial sunk costs?

13 A I'm quite sure of it, without having made a  
14 specific --

15 Q Isn't it also true with regard to almost every  
16 major railroad?

17 A That's right.

18 Q And every regional railroad?

19 A I'm glad you agree with me.

20 Q I'm glad you agree with me.

21 JUDGE HOPKINS: We love each other here, don't  
22 we.

23 (Laughter.)

24 BY MR. MORSE: (Resuming)

25 Q Have you done any studies of the amount of



1 sunk costs on a per mile basis or on any other basis  
2 which it would take for a railroad to open a new line?

3 A No.

4 Q You've done no such studies?

5 A No.

6 Q Are you aware of any statements or data  
7 submitted by any party to these proceedings that discuss  
8 the amount of sunk costs present in the railroad  
9 industry or in any particular railroad?

10 A No, I'm not aware of any.

11 Q Isn't it your understanding that the sunk  
12 costs of the railroad industry is overwhelmingly greater  
13 than the sunk costs of barges or trucks?

14 A Certainly. I never implied anything else.  
15 That was exactly the point in that statement that we got  
16 straightened out about page 14.

17 Q Well, now I'm puzzled. Isn't it a fact that  
18 if trucks do the same job at the same cost, without  
19 requiring the investor to sink costs over 40 years, that  
20 no one would invest in the rail industry and give up the  
21 hit and run feature of trucks?

22 A I am totally confused by the logic of that  
23 question. Why should no one invest in the railroad  
24 industry on that account? They would be out of their  
25 minds, probably, to invest in a railroad industry which

1 is confined to the sort of profits we're talking about  
2 and which, if this merger is denied, may really drive  
3 them to the wall.

4 But that has nothing to do with the need to  
5 sink costs. You may have very substantial need to sink  
6 costs in the electronic computer industry and you can  
7 produce in competition with them an abacus with  
8 virtually no sunk costs at all, and yet I would think  
9 that the computer industry is the more attractive  
10 investment.

11 The sunk costs feature is neither the  
12 precluding nor the deciding feature in choosing whether  
13 to invest or not.

14 Q I am amused a little bit by your analogy,  
15 Professor. Are you saying that the competition provided  
16 by abacuses to computers is similar to the competition  
17 provided by trucks to railroads?

18 A Hardly. Of course not. That's exactly the  
19 reason I would not invest in abacuses and I might very  
20 well invest in trucking, because one is a viable  
21 alternative and the other is not. But that's quite  
22 different from the point in your question, which was  
23 about the sunk costs.

24 Q Exactly. We're talking about not investing in  
25 either abacuses versus trucks; we're talking about



1 investing in railroads versus computers.

2 A In railroads versus trucks, please.

3 Q I'm taking your analogy.

4 Let's try to unscramble this egg. Is there  
5 any region in the country, anywhere in the country,  
6 where trucks cannot go?

7 A Not that I know of.

8 Q Isn't it a fact that it is therefore your  
9 position that every railroad market in this country is  
10 contestable?

11 A No, sir. If we read your questions and follow  
12 them through, they will tell you precisely why I do not  
13 agree. Where there are commodities which cannot be  
14 carried by truck, such as particularly wide loads, where  
15 there are commodities in which trucks have a marked cost  
16 disadvantage, those commodities may be in markets which  
17 are conceivably not contestable.

18 I'm not saying they aren't. I'm saying I  
19 would have to investigate the facts of the case, and I  
20 could not conclude from the fact that trucks can drive  
21 up and down those roads that their mere presence  
22 produces contestability.

23 Q Thank you.

24 Are there markets where the rail industry has  
25 advantages over trucks that offset the disadvantages of

1 having to sink costs?

2 A I am sure that they have advantages over  
3 trucks to the degree that in many cases it pays to share  
4 the activity. That is exactly why the railroads' rates  
5 are in many cases competitive.

6 Q Would you identify those markets for us?

7 A I'm not prepared to do that.

8 Q But they do exist, do they not?

9 A They exist. There are lots of markets in  
10 which both trucks and rail operate and operate more or  
11 less successfully.

12 Q Do you have a feel for, if you can't identify  
13 specific markets, what percentage of total volume of the  
14 rail industry these markets comprise?

15 A No, but I think that it's a very substantial  
16 percentage.

17 Q Isn't it a fact, Professor, that you have  
18 concluded that in situations of market dominance  
19 regulation should be continued in the rail industry?

20 A Yes.

21 Q Isn't it a fact that the airline industry is  
22 the best case of a contestable market that you can think  
23 of?

24 A I may have said that once. I've thought of  
25 others since then.



1 Q Well, are there any industries more  
2 contestable than the airline industry?

3 A I would think the barge line industry, for  
4 one. I can give you my reasons if you're interested,  
5 but I'm prepared, for brevity, not to.

6 Q I'm glad to hear that. I'm also glad to draw  
7 the correlation between finding contestable markets and  
8 consulting assignments.

9 A Yes. I hope to learn from them.

10 Q Well, despite the fact that the airline  
11 industry is one of the best examples of contestability  
12 anyone seems to be able to come up with, isn't it true  
13 that the contestability benchmark has not fully held  
14 sway in the first years after deregulation in that  
15 industry?

16 A You are of course referring to an article by  
17 Roy Panzar and Bailey, or was it Bailey and Panzar?  
18 I've forgotten.

19 Q Well, if you spell Panzar -- I know you  
20 misspelled it before, but if you spell it P-a-u-m-c-l,  
21 you'd be right.

22 A Well, all right, but that's based on an  
23 article by them.

24 Q By you?

25 A No. I'm basing my statement in that article

1 on the statement by the others I cited. But --

2 Q Well, why don't we get the question, though.  
3 Do you agree that, even though the airline industry is  
4 one of the best examples of a contestable market, that  
5 in the years -- in the first years after deregulation,  
6 that the benchmarks of contestability don't seem to be  
7 applying?

8 A That is correct in exactly the same sense --  
9 and I have used the analogy -- that even though farming  
10 is highly competitive, during years when there is a  
11 great disturbance, a change in crop conditions, a  
12 depression, whatever, that prices do not conform to the  
13 perfectly competitive ideal. Farmers lose money even  
14 though competitive equilibrium prices are supposed to  
15 cover the cost of capital, et cetera.

16 That is exactly the point I'm making, that  
17 neither perfect competition produces perfectly  
18 competitive prices in a disequilibrium circumstance, nor  
19 does aviation contestability yield perfectly contestable  
20 prices in a period of disequilibrium.

21 Q Well, if that statement is true with regard to  
22 the highly contestable airline industry, isn't it  
23 certainly true in the railroad industry?

24 A It's true anywhere.

25 Q All right. Have you found -- I realize that



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1 you may not, and certainly have not been asked to  
2 testify on this side of the issue. But have you found  
3 any industry not to be contestable?

4 A I would think there are lots of industries  
5 which are not.

6 Q I would, too. Name one.

7 A I would imagine -- and I say this without  
8 study -- that automobile production and airplane  
9 manufacturing are not contestable.

10 Q Have you found any service industries not to  
11 be contestable?

12 MR. TOMPKINS: Is the question whether the  
13 witness has done a study on this to see whether these  
14 industries are not contestable?

15 MR. MORSE: Is that an objection?

16 JUDGE HOPKINS: Could you answer that  
17 question, though?

18 MR. MORSE: I didn't hear the question. I'm  
19 sorry.

20 MR. TOMPKINS: It's just a clarification. Are  
21 you asking if the witness has done a study of these  
22 industries or are you asking based on his general  
23 knowledge?

24 MR. MORSE: What I'm trying to do is test the  
25 metes and bounds of this contestability theory that is



1 being proffered to the Commission in this case through  
2 the testimony of Professor Baumol.

3 JUDGE HOPKINS: You're talking about his  
4 general knowledge, though?

5 MR. MORSE: I'm talking about his general  
6 knowledge or, if he has specific support, let him point  
7 out out.

8 JUDGE HOPKINS: Go ahead.

9 THE WITNESS: I've made no specific studies,  
10 but I would think of -- that there are lots of service  
11 industries which don't, lawyering and college  
12 professing being two prime examples.

13 BY MR. MORSE: (Resuming)

14 Q Those are not contestable?

15 A I would think not. I think there's a lot of  
16 sunk costs involved with them and a lot of restriction  
17 on entry.

18 JUDGE HOPKINS: What about the medical  
19 profession?

20 THE WITNESS: Medical is even clearer.

21 BY MR. MORSE: (Resuming)

22 Q Any other service industries which you believe  
23 not to be contestable?

24 A I'm shooting from the hip. I have not done a  
25 survey of industries from that point of view, but I have

1 said repeatedly --

2 Q I wouldn't have thought that that was putting  
3 you at a disadvantage, Professor.

4 A Well, probably so. But again, let me help  
5 you. I have said again and again, I do not believe the  
6 world is perfectly contestable. There is a range of  
7 industries and a range of circumstances, and one cannot  
8 work on the Panglossian premise that everything is all  
9 for the best because it is all perfectly contestable.

10 Q Have you reached the conclusion that the  
11 railroad industry is not perfectly contestable?

12 A No industry is perfectly contestable, just as  
13 no industry is perfectly competitive. Those are ideals,  
14 those are limiting cases. But to answer substantively,  
15 I think that much of railroading is subject to the  
16 pressures of contestability.

17 Q Much subject?

18 A That's right. That's a guarded statement and  
19 that's all I can give you.

20 Q Well, I appreciate your candor on that.

21 Let me ask you this: The writings that you  
22 have made, the book you have written on contestable  
23 markets, is highly theoretical and describes perfect  
24 contestability. Yet in this case, in which we have much  
25 of that subject, of that theory, applying to this



1 merger, I have to ask this question: In your theory of  
2 contestability, have you made a determination of how far  
3 off you can be from perfect contestability and still  
4 have your underlying analytical assumptions apply?

5 A The answer is, I have made no such explicit  
6 determination and no one has made such a determination  
7 anywhere for competitiveness, either, for perfect  
8 competitiveness. The situation is perfectly analogous.  
9 The inferences are that it is a matter of degree, that  
10 the further off you go the less the assurance you have.

11 And let me say that, lest it be thought that  
12 this is a peculiar doctrine which only a few of us hold,  
13 that this is basically an old idea for which I have  
14 given full credit, an old idea which we find, for  
15 example, reflected as recently as the Department of  
16 Justice merger guidelines, which refer to the  
17 restraining influence of potential competition, of ease  
18 of entry, et cetera.

19 It is precisely those features of  
20 contestability analysis and not the esoterica of the  
21 multi-product vector analyses that are at stake in this  
22 proceeding. Would you have anyone believe that ease of  
23 entry of competitors who can price effectively against  
24 you are not a constraining influence on monopoly power?  
25 Because it is that which you will have to deny if you

1 are to deny the relevance of contestability and its  
2 logic to the issues in this merger.

3 Q Well, Professor, it's not important what I  
4 think. I'm only a poor dumb lawyer. But the ICC does  
5 think that it's irrelevant and they did so in the UP  
6 case and they did so in the Milwaukee case.

7 But getting back to my question, I take it  
8 from your answer that, with regard to this theory of  
9 contestability, you have no idea how precipitously your  
10 model falls off from your -- your analytical model falls  
11 off as you move away from perfect contestability; is  
12 that correct?

13 A That is correct.

14 Q Thank you.

15 Do you agree with the following statement --  
16 excuse me. Let me mark an exhibit and let me let you  
17 read it. Let me point out the sentences that I'm going  
18 to ask you whether you agree to.

19 JUDGE HOPKINS: Thank you.

20 MR. MORSE: I learn slowly, Your Honor, but I  
21 do learn.

22 JUDGE HOPKINS: Thank you.

23 THE WITNESS: You can see why I'm wary of poor  
24 dumb lawyers.

25 MR. MORSE: I'd like to mark two exhibits at



1 this time, to save some time. The first is an argument  
2 -- excuse me, an article; it may be an argument --  
3 published in the Yale Journal on Regulation. The  
4 authors are Elizabeth E. Bailey, an outstanding-plus  
5 economist, and William J. Baumol, whom history will  
6 judge.

7 The article is entitled "Deregulation and the  
8 Theory of Contestable Markets."

9 JUDGE HOPKINS: That will be marked for  
10 identification as MKT-C-57.

11 (The document referred to  
12 was marked Exhibit No.  
13 MKT-C-57 for  
14 identification.)

15 MR. MORSE: And the second article that I  
16 would like to mark is an article by Elizabeth E. Bailey,  
17 an outstanding-plus economist, which is entitled  
18 "Contestability and the Design of Regulatory and  
19 Antitrust Policy."

20 JUDGE HOPKINS: That will be marked for  
21 identification as MKT-C-58.

22 (The document referred to  
23 was marked Exhibit No.  
24 MKT-C-58 for  
25 identification.)

1 BY MR. MORSE: (Resuming)

2 Q Professor Baumol, let's start with MKT-C-58,  
3 which is the article by Elizabeth Bailey. And let me  
4 direct your attention to page 79. Can you locate page  
5 79? It's in the upper right-hand corner.

6 A It's 179.

7 Q 179.

8 A I've got it.

9 Q The first full sentence in the first column  
10 begins "Potential." Do you see that?

11 A Yes.

12 Q Down to the end of the paragraph. I'd like to  
13 consider whether you agree with the following  
14 statement. Do you want to read it first? I'll read it  
15 out loud:

16 "Potential competition becomes an ever more  
17 effective force as the extent of large irretrievable  
18 entry costs declines. Similarly, incumbent firms, even  
19 those who have borne the burden of acquiring the sunk  
20 cost facility, are a problem for public policy only to  
21 the extent that they have permanent or exclusive access  
22 to that facility. Consequently, the single most  
23 important element in the design of public policy for  
24 monopoly should be the design of arrangements which  
25 render benign the exercise of power associated with



1 operating sunk facilities."

2 Do you agree with those statements?

3 A In general. I don't know whether it's the  
4 single most important consideration, but it is certainly  
5 important.

6 Q But it is important?

7 A Yes.

8 Q Certainly policymakers should be considering  
9 those very factors; is that correct?

10 A For monopoly.

11 Q For monopoly.

12 A That's right.

13 Q And dealing with monopoly.

14 A That's right.

15 Q And any agency that has as part of its mandate  
16 dealing with monopoly should consider those factors, is  
17 that not correct?

18 A Certainly.

19 Q Jump one full paragraph to the paragraph that  
20 begins "The theory tells us." You can, of course, read  
21 anything in between to get the context.

22 Do you agree with that paragraph, the one that  
23 begins, "The theory tells us that when sunk costs are  
24 borne exclusively by a serving natural monopoly, as are  
25 railroad tracks in this country and as are local

1 telephone loops, then there may be a need for some form  
2 of Government intervention to assure society that no  
3 excessive monopoly rents are earned from those  
4 facilities. By detaching sunk costs from the service  
5 firm, much of the need for traditional economic  
6 regulation of the service industry disappears, even if  
7 the industry is still a natural monopoly. Instead,  
8 Government intervention can often be limited to ensuring  
9 fairness of access to the sunk facility."

10 Q Do you agree with that?

11 A I agree with it in substance. I don't  
12 necessarily agree that a railroad is a natural monopoly,  
13 but that's another story. In fact, in general it is  
14 not.

15 Q It may be an unnatural monopoly?

16 A Unnatural it may be, but not a monopoly.

17 Q Well, leaving that point aside, do you  
18 generally agree with the conclusions of the paragraph I  
19 just read to you?

20 A Certainly.

21 Q Now I'd like you to skim ahead to the very end  
22 of the article, but of course skim over the intervening  
23 materials.

24 A I've done that.

25 Q You have. I admire your preparedness.



1           Let's take a look at page 182, the first  
2 column, the second full paragraph that begins "A fourth  
3 rule." You may want to refresh on rules one through  
4 three, but I want to see whether you agree with rule  
5 number four:

6           "A fourth rule for the enhancement of  
7 contestability is that entry and exit should be made as  
8 easy as possible. Expedited procedures based on written  
9 pleadings, rather than an oral process, can enhance this  
10 process. Another idea is to shift the burden of  
11 proof -- to shift the burden of proof -- of showing that  
12 entry is in the public interest" -- I'm sorry.

13           "Another idea is to shift the burden of proof  
14 so that new entrants do not have the burden of showing  
15 that entry is in the public interest, but rather  
16 incumbents must argue that it is not. Both of these  
17 policy ideas have played important roles in the reform  
18 of aviation and transportation policy."

19           Do you agree with these conclusions?

20           A     Let's leave out the last sentence.

21           Q     Let's leave out the last sentence.

22           A     Where I don't disagree and --

23           Q     I understand.

24           A     I agree.

25           Q     You agree that the burden should properly be

1 placed on the incumbent rather than the new entrant to  
2 show that access is --

3 A Oh, I would certainly say -- I mean, I'm not  
4 arguing -- let me make clear, I'm not arguing as a  
5 lawyer here the terms "burden of proof."

6 Q Yes, I understand that.

7 A I'm talking substance, not legal  
8 arrangements. And I think that where you're going to  
9 exclude entrants you have a heavy social  
10 responsibility.

11 Q So someone who is before an agency, and which  
12 that agency has as one of its mandates to look into the  
13 monopoly of the situation, the sunk costs of the  
14 situation, the incumbents' possession of exclusive  
15 facilities, that that agency should properly put the  
16 burden of proof on the incumbent who is trying to  
17 exclude the new entry; is that correct?

18 A No, wait one second. You're talking about  
19 trackage rights. We know that you're talking about  
20 trackage rights. You're heading there.

21 Q You're so clever.

22 A Let's get right down to the point.

23 Q I feel unfrocked. But let me ask you, sir,  
24 not to give me a speech on trackage rights. I have  
25 carefully prepared questions. Even a poor dumb lawyer



1 like me spends lots of time working on questions. I'd  
2 like to have my questions asked and answered. If you  
3 need to give a speech in the context of one of those, I  
4 may not be able to stop you, but at least I have a  
5 question on the record.

6 A Sir, I have no speech in mind. Your question  
7 was longer than my intended answer. I merely meant to  
8 say that freedom of entry is a different matter from  
9 requiring an incumbent to give up a valuable asset. It  
10 is not equivalent to saying that entry should be free  
11 and saying that potential entrants should have free  
12 access to an incumbent's home property and marital  
13 partner.

14 Q You were wrong. I think they were about equal  
15 length.

16 JUDGE HOPKINS: That's adding to the record,  
17 too. Let's go on.

18 BY MR. MORSE: (Resuming)

19 Q Without getting into specifics, you are aware  
20 are you not, that several regional railroads, including  
21 my client the MKT Railroad, have applied for trackage  
22 rights should the Santa Fe-Southern Pacific merger be  
23 approved?

24 A I understand that.

25 Q You do. Speaking as an economist and not as

1 an advocate, you agree, do you not, with Elizabeth  
2 Bailey that the burden of proof should be on the Santa  
3 Fe-Southern Pacific to show why any of these  
4 applications for trackage rights should be denied?

5 MR. TOMPKINS: Your Honor, I have to object at  
6 this point as to further questions about trackage  
7 rights. This witness in his testimony did not address  
8 trackage rights. It's my understanding that trackage  
9 rights are an issue that is going to be addressed by  
10 both sides in this case later on in the proceeding.  
11 This is not something the witness has gotten to in his  
12 testimony here.

13 MR. MORSE: Your Honor, my response is that  
14 the witness didn't address very much in his statement  
15 except his theory of contestable markets. I am using as  
16 an example to test that theory --

17 JUDGE HOPKINS: I'm going to allow it. Go  
18 ahead.

19 BY MR. MORSE: (Resuming)

20 Q Would you like me to repeat the question?

21 A Yes, please.

22 Q Speaking as an economist and not as an  
23 advocate, you would agree, wouldn't you, with Elizabeth  
24 Bailey that the burden of proof should be on the Santa  
25 Fe-Southern Pacific to show why any of these



1 applications for trackage rights should be denied?

2 A I would agree with Elizabeth Bailey that she  
3 would not agree to that statement. I'm not talking as  
4 an advocate. I'm trying to make very clear that there  
5 is a distinction between absence of impediments to entry  
6 and the requirement that an incumbent give away a piece  
7 of his property.

8 Q Professor, I have read your articles well  
9 enough to know that you are apparently hung up on the  
10 price of trackage rights. I want you to understand that  
11 my questions are not geared to the price of trackage  
12 rights. Otherwise, counsel's objection might be  
13 proper.

14 I am simply trying to test the metes and  
15 bounds of your contestable theory market -- your  
16 contestable market theory. And I'm asking you whether  
17 or not, leaving out how much should be paid for those  
18 trackage rights, whether or not the burden of proof  
19 should be on the Santa Fe-Southern Pacific to show why  
20 these applications for trackage rights should be  
21 denied.

22 A Without price, that question has no meaning.  
23 I confess I am hung up on price, because the question  
24 has no meaning without price being specified.

25 Q Let's assume a fair price, whatever that may

1 he. Let's assume a fair price. Now can you answer my  
2 question, if the Santa Fe-Southern Pacific should  
3 nevertheless oppose these applications for trackage  
4 rights at a fair price?

5 A At a fair price, the Santa Fe would not oppose  
6 the applications for trackage rights.

7 Q Any of the applications?

8 A That's right.

9 Q And neither would the Southern Pacific?

10 A That's right.

11 Q You have talked to their management?

12 A No. I'm talking about what it would pay them  
13 to do.

14 Q That would be your strong recommendation?

15 A That's right.

16 Q And should they not follow your  
17 recommendation, shouldn't they have the burden of proof  
18 here to show why those applications should be turned  
19 down, despite the excellent advice of Professor Baumel?

20 MR. TOMPKINS: That sounds like a legal  
21 question to me.

22 MR. MORSE: I don't think so.

23 JUDGE HOPKINS: I'll let him proceed. Go  
24 ahead.

25 MR. TOMPKINS: Burden of proof, I mean,



1 assuming it's from an economist's point of view.

2 BY MR. MORSE: (Resuming)

3 Q Who has to make the argument?

4 JUDGE HOPKINS: The Commission's going to make  
5 the final decision on that, anyway. Go ahead.

6 THE WITNESS: I would say that if the price  
7 that was offered was fair on the market criteria which I  
8 have proposed in other testimony, that it would be --  
9 that refusal would be difficult to explain. What  
10 procedure should then be used is up to the Commission.

11 BY MR. MORSE: (Resuming)

12 Q Isn't it a fact that if the Santa Fe-Southern  
13 Pacific thought it could gain a competitive advantage by  
14 denying trackage rights to MKT and thus entry into a  
15 particular market by MKT, would this be inconsistent  
16 with your assumption that railroads participate in a  
17 contestable market?

18 A If it were rational for these railroads to  
19 deny an application for trackage rights at what I  
20 consider to be a fair price, that would indeed mean that  
21 they could in fact clear the market by predatory  
22 behavior and the market would indeed not be  
23 contestable.

24 But I would first like to see an offer of a  
25 price I would consider fair.

1 Q Isn't it a fact, though, that if a railroad  
2 market is truly contestable there's absolutely no reason  
3 why eliminating a legal barrier to entry, such as  
4 granting trackage rights, would lessen the  
5 contestability of a railroad market?

6 A Oh, it could very easily if, as usually  
7 happens, trackage rights are granted at uncompetitive  
8 prices.

9 Q We are assuming a fair price of the trackage  
10 rights. I'm trying to take you out of your price  
11 considerations and trying to use the trackage rights to  
12 test the metes and bounds of your contestability  
13 theory.

14 A Can you repeat the question?

15 Q Yes. Isn't it a fact that if the railroad  
16 market is truly contestable there is absolutely no  
17 reason why eliminating a legal barrier to entry, such as  
18 by granting trackage rights, would lessen the  
19 contestability of the railroad market?

20 A Granting of trackage rights at a fair and  
21 compensatory price would not lessen the contestability  
22 of the market.

23 Q In fact, under your theory it might very well  
24 improve it?

25 A Certainly.



1 JUDGE HOPKINS: I think this might be a good  
2 time for a 15-minute recess.

3 (Recess.)

4 JUDGE HOPKINS: Let's get back on the record.  
5 Mr. Morse.

6 MR. MORSE: Thank you, Your Honor.

7 BY MR. MORSE: (Resuming)

8 Q Professor, isn't it a fact that you and other  
9 economists who support the theory of contestable markets  
10 have argued strongly for overcoming barriers to entry,  
11 in particular by giving equal access to scarce  
12 facilities for all competitors as a means of achieving  
13 contestability in a particular market?

14 A Very much so. But we have also argued against  
15 cost subsidy, and it is my experience that in the past  
16 when people have applied for trackage rights what  
17 they've been applying for is not equal access, but for a  
18 cost subsidy. That's why I keep emphasizing the issue  
19 of full, fair and compensatory pricing.

20 Q Yes, you can assume that. But I wasn't  
21 talking about trackage rights here. We were talking  
22 about overcoming barriers to entry.

23 Let me ask the question again, because I think  
24 you may have felt we were still back on trackage  
25 rights. Isn't it a fact that you and other economists

1 who support your theory of contestability have argued  
2 strongly for overcoming barriers to entry, in particular  
3 by giving equal access to scarce facilities for all  
4 competitors as a means of achieving contestability in a  
5 particular market?

6 A Certainly.

7 Q Don't you in fact take the position that  
8 regulators and policymakers should seek policies that  
9 promote contestability?

10 A That's right.

11 Q Can I direct your attention now to MKT-C-57,  
12 which is the article by you and outstanding-plus  
13 Elizabeth Bailey. It's printed in the Yale Journal on  
14 Regulation. Do you have that in front of you, sir?

15 A Yes. But may I put in the record that the  
16 "plus" is yours. I've very glad you have granted it.

17 Q Well, I take that as a compliment. I will put  
18 a "plus" next to my name henceforth. That shows how you  
19 can misinterpret almost any answer, Professor.

20 Can I direct your attention to what is marked  
21 page 115. And I have to confess that the copies we had  
22 did not bear page numbers, so they were handwritten on  
23 so that we could refer to them together. And I'm going  
24 to ask you whether you agree with certain statements  
25 that you and Dean Bailey wrote.



1 Under Roman II, "The implications of  
2 contestability theory for regulatory policy," do you see  
3 that?

4 A Which page are we on?

5 Q 115.

6 A This is in the Yale Journal?

7 Q Hold on. Looks like my copy got numbered  
8 differently.

9 A Sorry to be an uncooperative witness.

10 JUDGE HOPKINS: We're all having that  
11 trouble.

12 BY MR. MORSE: (Resuming)

13 Q I apologize. We're talking about page 123.  
14 I'd like you to go down three sentences under Roman II  
15 with the sentence that begins "Regulators should seek."  
16 Do you agree with the statement that "Regulators should  
17 seek policies that promote contestability"?

18 MR. TOMPKINS: That's been asked and  
19 answered.

20 BY MR. MORSE: (Resuming)

21 Q "If an industry behaves as if it is  
22 contestable, most of the benefits of perfect competition  
23 can be obtained without Government intervention." Do  
24 you still agree with that statement?

25 A That's right.

1 Q Going down to the next full paragraph,  
2 beginning with the sentence "Short of doing everything  
3 possible," do you agree with the following statement:

4 "Short of doing everything possible to foster  
5 contestability, regulators should certainly cease doing  
6 those things that work against it. Direct regulatory  
7 attempts to impede entry or exit or to interfere with  
8 the timing or manner of entry must, at the very least,  
9 be questioned severely. Moreover, regulators should  
10 keep their eyes open for entry barriers erected by firms  
11 and should take steps to discourage the maintenance of  
12 those barriers."

13 Do you agree with that?

14 A Certainly, enthusiastically.

15 Q Overwhelmingly?

16 A If you like.

17 Q Enthusiastically is enough.

18 I direct your attention to page 124, the first  
19 full paragraph on page 124. Do you agree with the  
20 following statement:

21 "In these cases, regulators are just beginning  
22 to experiment with new methods to ensure that no  
23 excessive profits are earned from sunk cost facilities.  
24 Rather than relying exclusively on traditional rate and  
25 entry regulation, they have turned to two rather noble



1 approaches.

2 The first of these entails Government  
3 intervention to ensure equal access to the sunk  
4 facility. If the facility is privately owned, the  
5 Government requires that all firms seeking to use the  
6 facility be given access to it, that the access price be  
7 reasonable, and that all users be charged the same  
8 price. If the sunk facility is in the hands of a local  
9 public authority, then that authority is encouraged not  
10 to discriminate among private users in its access  
11 policies."

12 Do you agree with that still today?

13 A Absolutely, and I emphasize again the phrase  
14 that the price be reasonable, which of course cuts both  
15 ways. It precludes prices which are excessive and it  
16 precludes prices which are uncompensatory and therefore  
17 entail a cross-subsidy.

18 Q I'd like to direct your attention, before we  
19 are finished, to your testimony at the bottom of page  
20 6. I have read that argument with certain amusement. I  
21 note your argument that if a merger is likely to enhance  
22 market power, competitors will usually have little to  
23 lose and perhaps even a great deal to gain, and  
24 therefore you would expect them to remain relatively  
25 silent and not oppose the merger. But if the merger is

1 likely to yield efficiency gains, this would make it  
2 harder for competitors and they could be relied upon to  
3 object vociferously to the proposed merger.

4 Is that a fair representation of your  
5 argument?

6 A I think it's a quotation and therefore fair.

7 Q Isn't it the fact that the same argument could  
8 be made with regard to trackage rights applications in  
9 this case?

10 A The same argument? Not necessarily, no,  
11 because if a trackage rights proposal is in effect, as  
12 it has been historically, an attempt to get a  
13 cross-subsidy at the expense of the landlord railroad,  
14 then that is not at all analogous to the argument on  
15 page 6.

16 Q Well, isn't it a fact -- we're assuming a fair  
17 price for the trackage rights.

18 A Ah, but that's not what is the relevant  
19 assumption here.

20 Q Well, relevant or not, it's my assumption.  
21 You're an expert and I'd like to have you consider that  
22 assumption, relevant or not, and answer the questions.  
23 It's the only way that I can get to apply your arguments  
24 in one context, to test them in another context.

25 A All right.



1 Q Isn't it a fact that if the acquisition of  
2 trackage rights by, let's say, the MKT would result in  
3 an enhancement of market power to the MKT, the Santa  
4 Fe-Southern Pacific would have little to lose and would  
5 expect not to protest?

6 MR. TOMPKINS: We're back on trackage rights  
7 again, and this time it has nothing to do with  
8 contestability, the witness' theory of contestability.

9 MR. MORSE: Again, Your Honor, that is  
10 correct. I'm using the trackage rights example to test  
11 the metes and bounds of a statement made by this witness  
12 at the bottom of page 6.

13 JUDGE HOPKINS: I'm allowing it.

14 THE WITNESS: It depends on whether the  
15 relationships between the two railroads in this case are  
16 horizontal or vertical. But it's probably true that if  
17 the price were fair and compensatory and the incumbent  
18 railroad then -- that is, the potential landlord  
19 railroad -- then protested, it would certainly suggest  
20 that there are problems of monopoly, of market power.

21 BY MR. MORSE: (Resuming)

22 Q Now furthermore, if the acquisition of these  
23 trackage rights by, let's say, the MKT would result in  
24 efficiency gains to the MKT, wouldn't it also follow  
25 that the Santa Fe-Southern Pacific would surely object

1 to the acquisitions of those trackage rights?

2 A Not at all, not if the price were fully  
3 compensatory, because in that case it would be more  
4 profitable in a competitive market for the landlord  
5 railroad to share in those efficiency gains from the  
6 revenues it got from the trackage rights than to use its  
7 perhaps inferior efficiency to get what it could out of  
8 that space on its tracks.

9 I can go into much more detail in that and  
10 perhaps on a future occasion I will, but that is the  
11 essence of the matter. It is only when the trackage  
12 rights payments is not fully compensatory that the  
13 problem you suggest arises.

14 Q By the way, Professor, isn't it a fact that  
15 the Santa Fe and Southern Pacific objected very strongly  
16 to the merger between the Union Pacific and the MP  
17 railroads?

18 A It may very well be true. I don't remember.  
19 I take your word for it.

20 Q Let's assume for a moment that it is true.  
21 Does that indicate to you that the Southern Pacific or  
22 the Santa Fe felt that the merger between the UP and the  
23 MP would result in little or no market power  
24 enhancement?

25 A I suspect that they feared the efficiency



1 gains it would produce. Look, lawyers and professors  
2 also object when the competition gets tougher. It's a  
3 perfectly understandable and natural reaction. It's a  
4 human frailty and I am not surprised if that happened in  
5 this case.

6 Q In which case?

7 A In the case you cited.

8 Q Well, does it indicate to you that the Santa  
9 Fe and the Southern Pacific felt that the merger between  
10 the UP and the MP would result in great efficiencies?

11 A I suggest that that's what they feared, at  
12 least subconsciously.

13 MR. MORSE: We have no further questions of  
14 this witness.

15 JUDGE HOPKINS: Who's next? Mr. Leary.

16 CROSS EXAMINATION

17 BY MR. LEARY:

18 Q Professor, my name is Tom Leary. I'm with the  
19 firm of Hogan and Hartson, representing the Rio Grande  
20 Railroad in this proceeding. And my colleague Susan  
21 DeSanti from that same firm is here with me.

22 If memory serves me right, I may have taken  
23 some economics from you at Princeton a number of years  
24 ago.

25 A You look familiar, and if so I'm delighted to

1 meet you again.

2 JUDGE HOPKINS: Did you give him an A?

3 THE WITNESS: If not, I may live to regret  
4 it.

5 BY MR. LEAHY: (Resuming)

6 Q If I display a lamentable weakness in my  
7 knowledge here this morning, you can draw your own  
8 conclusions.

9 A I see I can't win.

10 Q Anyway, on page 23 of your statement you said  
11 that: "Based on economic analysis, there are strong  
12 grounds for the expectation that this merger will indeed  
13 enhance efficiency significantly." Is that correct?

14 A Will enhance efficiency -- will enhance  
15 efficiency, I would say substantially.

16 Q "Substantially" is all right.

17 A Yes.

18 Q And you also state, don't you, that there are  
19 likely to be efficiencies related to both end-to-end and  
20 horizontal aspects of the merger, do you not?

21 A I state that, partly on the basis of general  
22 inference, partly in the evidence of witnesses cited.

23 Q Have you examined any maps that show the  
24 routes of the Southern Pacific and the Santa Fe?

25 A I've seen some of the maps, but I would not be



1 prepared to reconstruct them.

2 Q I'm not going to question you in any detail.  
3 You are aware of the fact in a general way, are you not,  
4 that there are some areas where the Santa Fe and the  
5 Southern Pacific serve identical points at both ends?

6 A That's right.

7 Q And there are other areas, are there not,  
8 where one carrier serves a particular origin and another  
9 carrier may serve a particular destination? Are you  
10 generally familiar with that?

11 A That's right.

12 Q And one example, I suggest to you, though you  
13 may not be familiar with it, is the Southern Pacific  
14 serves northern California and Oregon and the Santa Fe  
15 does not, whereas on the other end the Santa Fe serves  
16 Chicago directly and the Southern Pacific does not. Are  
17 you aware of that?

18 A I seem to remember that and I am confident  
19 that you are describing it with extreme accuracy.

20 Q I believe you testified earlier that you have  
21 not made any study of the extent to which the Santa Fe  
22 and the Southern Pacific interline traffic today, is  
23 that right?

24 A That's correct.

25 Q Have you made any study to determine whether

1 right now these carriers might be able to achieve at  
2 least some end-to-end efficiencies by interline  
3 arrangements that fall short of a merger?

4 A No, I have made no such studies. However, my  
5 analysis leads me to conclude that, while there may be  
6 such opportunities, there is more to be gained by  
7 merger. And I think in this case I must expand my  
8 answer a little bit, if you will bear with me.

9 Q Fine.

10 A The point is this. If my logic and the  
11 evidence of the witnesses on whom I rely are valid, so  
12 that there is no gain in market power of any substantial  
13 degree to be expected from the merger -- let's just  
14 assume this as a hypothesis -- then the only reason such  
15 a merger should be desired by the railroads is that it  
16 offers them gains in efficiency which they could not  
17 achieve by other means.

18 That is to say, the very fact that they are in  
19 here going through this procedure only makes sense,  
20 unless if they are making a terrible mistake, on the  
21 assumption that their analysis of the situation, their  
22 evaluation of the situation, leads them to believe, A,  
23 that they can gain in efficiency, and B, they can gain  
24 more than they could without -- without a merger, but  
25 simply by contracts and other forms of negotiation.



1           Of course, firms do make mistakes in their  
2 mergers, but then who can second guess the firms  
3 themselves? Surely that is the nature of our faith in  
4 the general workability of the market process.

5           Q     In all seriousness, there was no implication  
6 in my question that there may or may not be additional  
7 efficiencies to be gained by a merger. I really wasn't  
8 challenging that. And what I was asking you was whether  
9 or not you made any kind of an inquiry as to whether or  
10 not there might be some efficiencies that they could  
11 achieve right now by arrangements that fall short of a  
12 merger.

13          A     The answer is I have made no inquiry, but I  
14 would be amazed if there weren't some.

15          Q     Are you aware of the fact that there is  
16 relatively very little exchange of traffic between the  
17 Southern Pacific and the Santa Fe right now,  
18 notwithstanding the fact that there are some substantial  
19 end to end connections, as you recognize?

20          A     No, I was not aware of that.

21          Q     On page 28 through 33 of your statement, you  
22 present, do you not, a hypothetical example of the  
23 benefits to be gained by coordinated pricing of carriers  
24 that are joined end to end?

25          A     Benefits that can be gained, that might be

1 gained.

2 Q Benefits that might be gained. Incidentally,  
3 is that an example that is taken from -- is there an  
4 assumption of contestability in that example?

5 A There's an assumption of imperfect  
6 contestability. If it were perfectly contestable, the  
7 example would not apply, because the market pressures  
8 would force those benefits to be achieved without the  
9 merger.

10 Q In your opinion, is a merger the only way by  
11 which parties could accomplish the coordinated pricing  
12 to which you refer in that hypothetical example?

13 A In general, it need not be. It depends on how  
14 complex the price structure is, how much conversation,  
15 how complex the contracting that is required, et  
16 cetera. So there can be cases in which merger is not  
17 required and other cases in which it is.

18 Q In terms of your hypothetical, sir, couldn't  
19 they get together right now and say: Look, everyone  
20 will be better off if we just set a joint rate of \$20  
21 and split it evenly?

22 A Assuming that they were permitted to do so, it  
23 may very well be that that would suffice, depending, as  
24 I say, on the complexity of the rate calculations that  
25 would be involved.



1 Q Right. From an economist's point of view,  
2 would this possibility hold true even if carriers A and  
3 B were bitter competitors in other areas?

4 A Oh, certainly.

5 Q Do you believe that there are natural  
6 suspicions which competitors may have of one another  
7 that could carry over and make it more difficult to  
8 negotiate with one another, even in situations where it  
9 might be legal and mutually profitable to do so?

10 A Of course.

11 Q In economic terms, would you say that the fact  
12 of competition would impose perhaps a higher transaction  
13 cost on that kind of a negotiation?

14 A That's a legitimate way of interpreting it.

15 Q The fact of the natural suspicion that  
16 competitors may feel for one another?

17 A Certainly.  
18  
19  
20  
21  
22  
23  
24  
25

1 Q And is it possible that this is the phenomenon  
2 which railroad people recognize when they refer to  
3 friendly or unfriendly connections?

4 A I'm not prepared to speak for the railroad  
5 people.

6 Q You're not familiar with those terms.

7 A I've heard the terms, but I do know that  
8 railroad people have mentioned precisely the point  
9 you're making now, and I believe them.

10 Q Isn't it possible that this negotiating  
11 problem which you, as an economist, recognize may  
12 account in part for a railroad's preference for its own  
13 long line service over an interline connection, even  
14 when that interline connection would be otherwise  
15 efficient?

16 A That there are imperfections in a market is  
17 indeed possible, and that imperfections of the sort you  
18 cite, bitter rivalries inability to stand one another's  
19 management, et cetera, may lead people to do things  
20 which are expensive to themselves and their  
21 stockholders.

22 MR. TOMPKINS: I'm not sure the witness had  
23 finished his answer. I think the witness was continuing  
24 his answer.

25 BY MR. LEAHY: (Resuming)



1 Q I'm sorry, I didn't mean to interrupt you.

2 A And can conceivably lead merged firms to favor  
3 their own over rivals' facilities. I would think,  
4 however, that the scope for that would be limited in an  
5 industry which is subject to competitive pressures and  
6 which is having difficulties earning adequate revenues  
7 and covering its cost of capital.

8 Q Would this problem of suspicion that carries  
9 over into negotiations, which you recognize as an  
10 economist, also account for a railroad's concern when it  
11 has to rely upon a competitor for access to a market?

12 A Oh, it could very well.

13 Q On page 15 of your statement, Professor, you  
14 state at the top that although railroading may be an  
15 extreme example of an industry in which entry and exit  
16 are not easy, the opposite is clearly true of at least  
17 barge and truck transportation.

18 Is that correct?

19 A That's correct.

20 Q And then you go on to say that the record of  
21 actual entry into and exit from the truck and barge  
22 industries confirms the ease with which they can be  
23 carried out; is that correct?

24 A Yes.

25 Q Before we go on, have you made any study of

1 the potential for barge transportation over the western  
2 mountains and deserts?

3 A No, I haven't.

4 Q What sources did you consult to refer to the  
5 "actual entry into and exit from trucking operations in  
6 1983?"

7 A I have not examined the data from 1983.

8 Q Well, have you examined any data with respect  
9 to actual entrance into and exit from operations?

10 A I have seen some data over the years. I do  
11 not recall exactly what they were.

12 Q You don't claim, do you, that a record of  
13 frequent entry and exit necessarily demonstrates that  
14 people are engaged in hit and run forays into  
15 contestable markets, do you?

16 A No, sir. Nor are hit and run forays necessary  
17 for contestability. It is merely the possibility that  
18 is needed.

19 Q I understand.

20 In other words, if the records show no entry  
21 and exit, that might also reflect a fact of  
22 contestability because there are no opportunities. Is  
23 that correct?

24 A Sure. But the existence of exit and entry is  
25 a sufficient but not a necessary condition for a showing



1 of contestability.

2 Q Well, then maybe I misunderstood your answer.  
3 Are you saying that a record which shows simply  
4 statistics as to entry into or exit from a particular  
5 industry is evidence, by itself, of contestability?

6 A Oh, I would need, in addition, evidence on the  
7 amount of sunk costs that are involved. Remember, in  
8 the -- at one point I said, I think in something that  
9 was cited today, that contestability requires entry to  
10 be quick, cheap, and easy.

11 Of course, by cheap I don't mean that it  
12 requires a small investment. It merely requires a small  
13 sunk investment.

14 Q I heard that, and I don't need that now. My  
15 only question is whether or not statistics as to entry  
16 and exits themselves demonstrate contestability. And I  
17 believe your answer was no.

18 A That's right. They establish a presumption,  
19 but no more.

20 Q Establish a presumption?

21 A Yeah.

22 Q All right. Have you made any studies to  
23 determine whether there are specific examples in the  
24 railroad industry where trucks have seen a profit  
25 opportunity entered, skimmed off a substantial amount of

1 business, and then got out again before railroads could  
2 react by lowering rates?

3 A No. I have made no such study.

4 Q Are you familiar with any other studies of  
5 this phenomenon, if it exists?

6 A I know of none.

7 Q Can you give us one example of the kind of hit  
8 and run entry by trucks that you say exerts a pervasive  
9 discipline on rail prices in the vast areas affected by  
10 this merger?

11 A No, but you yourself pointed out that all that  
12 is necessary for the purpose is the possibility. I  
13 would, in fact, expect very little of that as long as  
14 the railroad industry is not earning excess profits.

15 It is precisely the excess profits that act as  
16 the lure for that sort of entry and exit. Remember, the  
17 name of the game here is the prevention of monopolistic  
18 behavior by the railroads.

19 One way to prevent that sort of punishment is  
20 not to engage in the monopoly pricing in the first  
21 place.

22 Q Will you turn to page 3 of your statement,  
23 please? You state there, there are two ways a merger  
24 can enhance profits. Isn't that correct?

25 A Yes.



1 Q It can introduce or enhance market power, or  
2 it can enhance profit by contributing to efficiencies.  
3 Is that right?

4 A That's correct.

5 Q And it's possible, isn't it, that a merger  
6 could add to profits, both by contributing efficiency  
7 and by contributing market power?

8 A Certainly.

9 Q On page 4 of your statement, you have stated,  
10 have you not, that "showing that a merger will lead to  
11 no enhancement of market power is sufficient grounds for  
12 the removal of any public sector impediment to its  
13 consummation."

14 Is that correct?

15 A That's certainly my view.

16 Q And then you go on to say -- and this is on  
17 page 20 -- and I'm going to telescope a little bit here,  
18 and I don't want to do it unfairly -- that it's simply  
19 not possible for this merger to serve as a source of  
20 market power if the factual evidence presented by  
21 Temple, Parker & Sloane and by Beebie Associates is  
22 accurate.

23 Is that right?

24 A I believe that's --

25 Q If I'm doing it --

1           A     No, I think that is not unfair. I think  
2 without some of the preceding points that it comes out a  
3 little more extreme than that.

4           Q     In other words, what you're saying is you  
5 don't rely exclusively on Reebie or TBS, but primarily  
6 as support for your statement.

7           A     I do, and I certainly can imagine that in a  
8 very limited number of routes or for a limited set of  
9 commodities, that there would be some need for  
10 regulatory attention.

11          Q     I see.

12                     These witnesses break down the product  
13 categories which they study into the various aggregates  
14 for study, don't they?

15          A     That's correct.

16          Q     And to refresh your recollection, I believe  
17 that the TBS people used two-digit SIC codes and the  
18 Reebie people used four broad commodity groupings. And  
19 I guess, whether that's correct or not, the question is  
20 have you made any independent inquiries to determine  
21 whether the groupings used by these witnesses are  
22 appropriate, or have you just relied upon their  
23 opinion.

24          A     The answer is that I have not made an  
25 independent study. I have gone over the logic of their



1 classification and, for example, the second study which  
2 you cite -- and it's four independent categories --  
3 essentially uses what to me is the right criterion,  
4 which is substitutability in transportation of different  
5 commodities.

6 That is, if you can take a trailer and put it  
7 on a railroad car, it doesn't matter which commodity is  
8 inside that trailer as far as competitiveness is  
9 concerned.

10 So that I have at least considered the logic  
11 of their procedure, though I have not made an  
12 independent study.

13 Q Is it your testimony that, as a general  
14 proposition, that substitutability to which you refer,  
15 occurs within the full span of a two-digit SIC  
16 category?

17 A Not necessarily; no.

18 Q Did you make any independent test to verify  
19 the appropriateness of the geographical groupings  
20 contained in the Reebie study?

21 A No, I did not.

22 Q I take it, then, that you would not be prepared  
23 to say that a different geographical grouping is wrong?

24 A No, I'm not prepared to say that.

25 Q You state on page 8 of your statement: "Two

1 firms are in the same market if the presence of either  
2 constrains the price setting options of the other. But  
3 that constraint is always a matter of degree."

4 Is that correct?

5 A That's correct.

6 Q And then you go on to say: "In reality, there  
7 is never a clear boundary with all firms within that  
8 boundary limiting one another's price setting powers  
9 equally, and all firms outside the boundary doing so  
10 only minimally, if at all."

11 Correct?

12 A Correct.

13 Q In deciding this case, the Commission has to  
14 draw some kind of boundary, doesn't it?

15 A No, sir. In deciding any case, the Commission  
16 does not have to use distortions of reality which rely  
17 on the invention of bright lines and imaginary  
18 boundaries.

19 The realities of the world are complicated,  
20 but incorrect decisions are made when those  
21 complications are assumed away. The reality of the  
22 world is exactly as I describe it here, and it is that  
23 which the Commission should take into account.

24 Q Is there not a boundary implicit in the  
25 tabulations of, say, Reebie Associates on which you



1 rely?

2 A There is a boundary, and it is very explicitly  
3 drawn to be incorrect because inadequate. If they have  
4 done what they claim to do -- and I cannot take  
5 responsibility for them -- what they have done is to  
6 include only competitors which, on their criteria, are  
7 very strong and clear-cut competitors of the railroads  
8 in question and have left out other, weaker constraining  
9 forces.

10 In other words, they have adopted deliberately  
11 two narrow a definition of the market on the grounds  
12 that if they could demonstrate that even within those  
13 narrow markets, there is plenty of competition, then in  
14 a market properly envisaged, there would certainly be  
15 adequate competition.

16 But that's quite different from saying that  
17 that is the "true boundary" of a market.

18 Q I suppose if you had direct evidence as to  
19 elasticities, you could dispense with all this market  
20 stuff, couldn't you?

21 A Well, it certainly would help.

22 Q Have you ever suggested that it might be more  
23 appropriate for a tribunal like the Commission to look  
24 at elasticities directly, rather than getting into this  
25 market analysis?

1           A     I have certainly suggested that where such  
2 data can be obtained reliably and without too much cost,  
3 that it would be an appropriate procedure. But  
4 sometimes the cost is not worth the gain in accuracy,  
5 and then you engage in what Frank Knight once described  
6 as an irrational passion for dispassionate rationality.

7           Q     Did you make any studies of demand  
8 elasticities in connection with this case?

9           A     No, sir.

10          Q     Did you familiarize yourself with any of the  
11 literature on that subject in connection with this  
12 case?

13          A     No, sir.

14          Q     On page 36 of your testimony, you state that  
15 in contestable markets, the sort of traffic diversion  
16 projected for the -- I am again paraphrasing, and I  
17 don't want to do it unfairly -- the sort of traffic  
18 diversion projected for the merged carrier will occur  
19 only in response to an increase in the relative  
20 efficiency of the merged railroad.

21                   Do you see those statements?

22          A     Yes, I recall them. This is on page 36?

23          Q     That's on page 36.

24          A     Okay. I see it.

25          Q     I notice the starts, "In contestable



1 markets." Would it make a difference if the market were  
2 not contestable?

3 A Oh, certainly.

4 Q So your statement that diversions necessarily  
5 reflect efficiencies is key to your opinion about  
6 contestability. Is that correct?

7 A That's right.

8 Q Would you turn to page 12 of your statement  
9 for a moment? You state there, do you not, that a  
10 reduction in the number of competitors in the market  
11 will not contribute to market power if there is a large  
12 number of competitors.

13 Is that right?

14 A That's one sufficient condition.

15 Q And isn't the converse also true, that there  
16 are greater grounds for concern as the number of  
17 competitors grows smaller?

18 A That's carefully and well-stated, but it is  
19 not the converse, because while there are greater  
20 grounds for concern, it does not follow that there will  
21 necessarily be a problem as the number of firms  
22 decreases.

23 I said it was carefully and well-stated and I  
24 meant it.

25 Q So was your answer, sir.

1 In fact, the Department of Justice merger  
2 guidelines even indicate there is concern if, say, ten  
3 roughly equal sized competitors are reduced to nine,  
4 don't they?

5 A In a market that is not contestable, that may  
6 well be grounds for concern.

7 Q And under the Department of Justice  
8 guidelines, a market with five roughly equal sized  
9 competitors is described as highly concentrated, isn't  
10 it?

11 A But the same guidelines also tell you that  
12 ease of entry can change things.

13 Q I understand. Have you made any studies to  
14 determine the extent to which truck market shares would  
15 vary in any of the commodities or any of the geographic  
16 groupings, assuming the hypothetical 5 percent price  
17 increase that the guidelines talk about?

18 A No, I have not.

19 Q Let me direct your attention now to the last  
20 page of your testimony. You talk there about the  
21 formation of a body of "mega-systems."

22 Do you see that, four lines down?

23 A Yes.

24 Q What railroads do you define as mega-systems?

25 A Well, I'm not prepared to give a list of



1 those, but it is clear that there have been a number of  
2 mergers in recent years, and that they have -- some of  
3 those have produced larger networks than were previously  
4 available, and that's what I'm referring to.

5 Q Is it clear to you that neither the Santa Fe  
6 nor the Southern Pacific, as they exist today, are  
7 mega-systems?

8 A That's a term of art. I cannot offer you a  
9 borderline between "mega" and "mini" systems.

10 Q Do you have any evidence which suggests that  
11 these mega-systems, however, defined, are more efficient  
12 than other railroads?

13 A In cases where the -- there was no evidence  
14 that the systems offered any significant increase in  
15 market power, it is clear to me that management must  
16 have expected improvements in efficiency, and I am  
17 prepared to accept them as the best judges of the  
18 matter, as we generally do.

19 Q Do you know of any evidence that would  
20 demonstrate that efficiency is correlated with an  
21 increase in the size of a railroad?

22 A Not always. Naturally not. In many cases,  
23 one might have inefficiencies grow from size. That's  
24 exactly why I believe that where there is no issue of  
25 market power, one should let the market judge for

1       itself.

2                   I am not in a position, nor are you, even  
3 though you took my course, I gather, to judge case by  
4 case, in advance, better than management whether it is  
5 more efficient for that particular circumstance to grow  
6 larger or to grow smaller, to combine or to divorce.

7           Q       Are you suggesting that managers sometimes  
8 know the potential possibilities of their own business  
9 better than we do?

10          A       I am suggesting that in general they do, even  
11 though they make mistakes.

12          Q       And are you suggesting that sometimes managers  
13 may have a better idea of whether they can achieve some  
14 market power as a result of a course of action than we  
15 do?

16          A       I am sure they do.

17                   MR. LEARY: I think that's it, Your Honor.

18                   JUDGE HOPKINS: Thank you.

19                   Who's next?

20                   MR. BLEAKNEY: I think I'm next, Your Honor.

21                   Professor Baumol, Robert Bleakney. I'm with  
22 Sullivan & Worcester, and I'm counsel for the Kansas  
23 City Southern Railway.

24                   Your Honor, I distributed earlier today four  
25 sheets as counsel exhibits. I trust Professor Baumol



1 has a set. I did give them to counsel.

2 MR. TOMPKINS: We did get these this morning.  
3 But I will say Professor Baumol hasn't had a chance to  
4 study these.

5 MR. BLEAKNEY: Do you prefer that we proceed  
6 after lunch with our examination? If you do, that's  
7 fine.

8 MR. TOMPKINS: I'm not sure what you are going  
9 to ask him on hypotheticals, but they do seem to be  
10 fairly complex. It might be better and more efficient  
11 if Professor Baumol has a chance to look at them.

12 JUDGE HOPKINS: He hasn't had a chance to look  
13 at them?

14 MR. BLEAKNEY: That's fine. Why don't I defer  
15 my cross-examination until after lunch, Your Honor.

16 May I have them marked now, or should we just  
17 defer them until after lunch?

18 JUDGE HOPKINS: Why don't we have them marked  
19 anyway? Have you got the next number? I don't have  
20 it.

21 MR. BLEAKNEY: I was advised, it seemed to be  
22 with a caveat, that the last MCS number was 13. That  
23 would make the next one 14. Someone else might have  
24 better information, but that's the best information I  
25 have.

1 JUDGE HOPKINS: I left my others upstairs.  
2 Which one are you starting with? Case No. 1?

3 MR. BLEAKNEY: Case No. 1 will be 14 on that  
4 basis.

5 JUDGE HOPKINS: That would be KCS-C-14 marked  
6 for identification.

7 Case 2 would be KCS-C-15 for identification.

8 Case 3 will be KCS-C-16 for identification.

9 Case 4 will be KCS-C-17 for identification.

10 (The documents referred to  
11 were marked Exhibits  
12 KCS-C-14 through 17 for  
13 identification.)

14 MR. BLEAKNEY: It makes sense for me to defer,  
15 then, all my cross-examination.

16 JUDGE HOPKINS: Is there anybody else that's  
17 ready for a short cross-examination? We can come back  
18 to yours after lunch.

19 Anybody else ready?

20 MR. LIVINGSTON: Your Honor, I'd prefer to go  
21 after lunch.

22 JUDGE HOPKINS: Well, I'd like to get -- what  
23 about Mr. White? I was counting on going until 12:30 so  
24 we could get something --

25 MR. LIVINGSTON: I'm a little concerned that I



1 would be split up if I were to start now.

2 CROSS EXAMINATION

3 BY MR. WHITE:

4 Q Good afternoon, Professor Baumol. My name is  
5 Charles White. I represent Texas Mexican in this  
6 proceeding.

7 First of all, sir, do you know what Texas  
8 Mexican Railway is?

9 A No, I don't.

10 Q Have you heard it before?

11 A I've heard of it, but I would love to be  
12 illuminated.

13 Q Well, it's a line that connects Corpus Christi  
14 for port to Laredo, which a rather important  
15 international gateway linking the Mexican railways with  
16 the U.S. rail system.

17 A Thank you.

18 Q Sir, I had the privilege of working with you  
19 on the CSX case on the barge side of the equation, and I  
20 recall that the most important lesson that you taught us  
21 as counsel was that your contestability market theory  
22 depended on ease of entry and mobility of assets  
23 within the market.

24 Am I correct in that recollection?

25 A That's certainly right.

1 Q I also recall that the contestability theory  
2 depended on effective competition being presented by  
3 barge lines and truck lines to the rail system involved.

4 Is my recollection correct?

5 A Either competition or potential competition.

6 Q Yes.

7 Sir, on page 14 of your testimony, you  
8 indicate that where a transportation market is served  
9 only by railroads, even if it includes a substantial  
10 number of such carriers, it is not to be expected that  
11 the market will be contestable.

12 Sir, did counsel advise you that Mr.  
13 Fitzgerald of Santa Fe testified here that trucking does  
14 not provide a competitive force for rail traffic moving  
15 to Mexico?

16 MR. TOMPKINS: Does counsel have a reference  
17 to the transcript where Mr. Fitzgerald said that?

18 MR. WHITE: I don't have a transcript page.  
19 But I'm just asking if counsel advised you that Mr.  
20 Fitzgerald, on cross-examination, testified to that  
21 effect.

22 A No, I was not advised of that. But, of  
23 course, it needn't be truck transportation. I admit my  
24 ignorance on the subject.

25 Q Have you studied at all, sir, the



1 characteristics of international traffic moving between  
2 the United States and Mexico in this assignment?

3 A No, sir.

4 Q Are you aware, sir, that the Reebie study  
5 specifically -- we were talking about boundaries with  
6 Mr. Leary -- but are you aware that the Reebie study  
7 specifically declined to study traffic crossing the  
8 international boundary into and out of Mexico?

9 A No, I'm not aware of that.

10 Q Do you have a feel, sir, or do you have any  
11 knowledge of what the commerce flows are by rail into  
12 and out of Mexico?

13 A I haven't any idea.

14 Q Would you agree, sir, that the international  
15 traffic aspect of this case is a legitimate,  
16 identifiable market to study?

17 A It's certainly a legitimate subject for  
18 study. I don't want to get into market definition.

19 Q I believe Mr. Leary also asked you, sir, if  
20 you were familiar with the maps of the Southern Pacific  
21 and Santa Fe systems.

22 Are you familiar with your own recollection to  
23 the degree that they serve the boundaries into and out of  
24 Mexico?

25 A No, I'm not.

1 Q If I posed a question, sir, to the effect that  
2 as a result of the merger, Santa Fe Southern Pacific, as  
3 a consolidated entity, would control by direct access  
4 all of the Mexican border crossings with the exception  
5 of one, would you view that as a concentration of market  
6 power with respect to international traffic?

7 MR. TOMPKINS: I take it that's a hypothetical  
8 question?

9 MR. WHITE: I began it with an "if."

10 THE WITNESS: I would say it certainly would  
11 require looking -- justify looking into. It would  
12 depend on whether, for example, other modes were  
13 available and could effectively carry much of the  
14 traffic.

15 BY MR. WHITE: (Resuming)

16 Q But I take it, sir, in the course of your  
17 assignment, you didn't focus on international traffic at  
18 all?

19 A No, sir. That is, I agree with you.

20 MR. WHITE: Well, that's all I have. Thank  
21 you, sir.

22 JUDGE HOPKINS: Are there any other short ones  
23 that we could get in before 12:30?

24 Who else is going to cross-examine?  
25 Department of Justice? You will be some length?



1 MR. RATNER: We'll be longer than 15 minutes.  
2 JUDGE HOPKINS: Were there any others?  
3 Well, then, we'll be in recess now until --  
4 let's make it 1:15.

5 (Whereupon, at 12:15 p.m. o'clock the hearing  
6 in the above-entitled matter recessed, to reconvene at  
7 1:15 p.m. o'clock, this same day.)  
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## AFTERNOON SESSION

(1:15 p.m.)

1  
2  
3 Whereupon,

4 WILLIAM. J. BAUMCL

5 the witness on the stand at the time of the recess,  
6 resumed the stand and, having been previously duly sworn  
7 by the Administrative Law Judge, was further examined  
8 and testified as follows:

9 JUDGE HOPKINS: Let's get back on the record.

10 Mr. Bleakney, are you ready?

11 MR. BLEAKNEY: Yes, Your Honor.

12 JUDGE HOPKINS: Are you ready, Dr. Baumcl?

13 CROSS EXAMINATION

14 BY MR. BLEAKNEY:

15 Hello again, Dr. Baumcl. How are you?

16 I'd like to address to you a few questions  
17 concerning the KCS exhibits which I assume you looked at  
18 over noon.

19 A I don't have them in front of me, but I guess  
20 the ritual is that you have to hand them to me.

21 Q Just so we don't have any misunderstandings, I  
22 want you to understand at the outset, that in any of  
23 these questions I'm not asking you to reach any specific  
24 conclusions about this specific case or do anything  
25 other than deal with these as hypotheticals.



1 A Absolutely.

2 Q First, would you look at Exhibit KCS-C-14, and  
3 I think you will note on it the various assumptions  
4 built into that exhibit as to geography, competitive  
5 options, cost, demand, and price.

6 Would you agree that the conclusions shown on  
7 that exhibit, based on the assumptions shown of a \$4 per  
8 ton price, is a correct conclusion?

9 A That's correct.

10 Q Now, let us move on to the next exhibit,  
11 KCS-C-15 and I think you will recognize we've now added  
12 trucking competition to the hypothetical. Is that your  
13 understanding?

14 A That's right.

15 Q And again, on the other assumptions shown,  
16 could you give your estimate of what the price would be  
17 that Railroad A would charge under these circumstances?

18 A Certainly under the assumption that there is  
19 no other constraining competition, I would expect it to  
20 charge \$3.50 or \$3.49 a ton.

21 Q Yes. \$3.50 or a shade below.

22 A Exactly.

23 Q And that would be to either meet or get  
24 slightly below the long run marginal cost of the motor  
25 carrier competition; is that correct?

1 A That's right.

2 Q So much for that exhibit. We're moving  
3 quickly.

4 Now let us turn to Exhibit KCS-C-16 and here  
5 again I am sure you recognize that besides the motor  
6 carrier, we've introduced another railroad operating  
7 between the two points X and Z.

8 You recognize that, do you not?

9 A That's correct.

10 Q And based upon the other assumptions to the  
11 hypothetical on that page, what would be your estimate  
12 of the price that would be charged by Railroad A?

13 A The answer is that it might very well end up  
14 charging \$2 a ton, and that Railroad A might very well  
15 go broke in the process because, assuming there are  
16 fixed costs and assuming, just for simplicity, that  
17 there is only one product carried, so there is no  
18 ambiguities about what is meant by total and average  
19 cost, I would expect that the \$2 a ton cost, long run  
20 marginal cost, would be below the long run average cost,  
21 so that a price, the equilibrium price of \$2 or short  
22 run equilibrium price of \$2 a ton would be destructive  
23 to both railroads.

24 Q So on that basis, would you not expect both  
25 railroads to price somewhat above \$2 per ton?



1           A     Well, it depends. What would happen under  
2 those circumstances is not clear, but they might very  
3 well, depending on the magnitude of the fixed cost, end  
4 up pricing at \$3.50. I don't know.

5           Q     Can we then agree that the price would be  
6 perhaps -- strike perhaps -- would be somewhere between  
7 \$2 and \$3.50?

8           A     That's right. It couldn't be above \$3.50, nor  
9 could it be below \$2.

10          Q     Yes. And if A and B did, in fact, as  
11 railroads engage in intense competition, it would not  
12 doubt be closer to the \$2 than the \$3.50?

13          A     That's right. And you might end up with  
14 exactly the sort of situation you have now where neither  
15 of them is able to pay its cost of capital.

16          Q     And if one of them went out of business, we'd  
17 be back to hypothetical No. 2, would we not?

18          A     That's right, and that might very well restore  
19 a healthy arrangement. I'm not saying it would. I am  
20 saying it is perfectly consistent with a situation in  
21 case 3 in which the railroads are destroying one  
22 another, and their capital stock is deteriorating,  
23 whereas after a merger where price is permitted to go  
24 closer to \$3.50, one might end up with a viable railroad  
25 in which both trucks and railroads were able to serve

1 the public.

2 So the conclusion is not clear.

3 Q Yes. But on the hypothetical, assuming both  
4 railroads priced to meet their long run marginal costs,  
5 we don't necessarily need to conclude that pricing with  
6 that in mind would put either one out of business, do  
7 we?

8 A Oh, no, sir. We have to conclude precisely  
9 that, because as long as there are fixed costs -- and  
10 surely in railroading there are fixed costs -- then  
11 pricing at long run marginal cost will inevitably  
12 produce rates of return less than the cost of capital --  
13 not sometimes, but certainly and always.

14 Q Now, will you, however, on the premise that  
15 both of these railroads price sufficiently high to keep  
16 themselves at least in business, on Exhibit 16 the  
17 railroad prices would be lower than the \$3.50 per ton we  
18 talked of with only the truck competition?

19 A No, sir. I can no longer conclude that. All  
20 I can agree is it won't be any higher.

21 Q I see.

22 Now, if Railroads A and B merged, on  
23 hypothetical case 3, is it not true that whatever  
24 influence the existence of the two railroads had on  
25 keeping the price below \$3.50, if there were any such



1 influence, it would evaporate?

2 A That is correct. And that might, for the  
3 first time, permit a viable, healthy railroad operation  
4 there maybe. I'm just trying to emphasize that neither  
5 of us has a clear-cut conclusion about the benefits or  
6 costs of that.

7 Q I'm not trying to suggest to the contrary.

8 A Oh, of course.

9 Q I am suggesting that perhaps capital costs  
10 would add \$1.50 a ton over long run marginal of only \$2  
11 is as hypothetical as any other hypothesis. Isn't that  
12 correct?

13 A Certainly.

14 Q Now, let's lock to case 4, if you will, and  
15 here we've added or changed case 3 so that the competing  
16 railroad operation previously performed by Railroad B is  
17 now performed jointly by Railroads B and C.

18 Do you see that?

19 A That's correct.

20 Q And let's assume -- again you made  
21 qualifications on this -- let's assume for the moment  
22 that Railroad A in this market is transporting some of  
23 the traffic at \$2.50 a ton. Do you have that assumption  
24 in mind?

25 A All right.

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1 Q And would you also assume that the remainder  
2 of the traffic moves over the combined operation of B  
3 and C at the same rate, so we're talking a single line  
4 rate for Railroad A of \$2.50 and a joint line rate of  
5 Railroads B and C of \$2.50.

6 Do you have those facts in mind -- assumed  
7 facts, if you will?

8 A Yes.

9 Q Would you also please assume that Railroads B  
10 and C equally divide the rate. The division is \$1.25  
11 apiece for simplicity. Thank you.

12 Now, with these assumptions in mind, would you  
13 consider a merger between Railroad A and Railroad B? In  
14 other words, a single line railroad and one of the joint  
15 line railroads.

16 In your opinion, would the merged carrier have  
17 an incentive to divert traffic from the former B-C joint  
18 line route to its own single line route?

19 A On the assumption that each was just covering  
20 its cost of capital?

21 Q Only on the assumptions I've given you here,  
22 and I've given you no assumptions on that point. Can  
23 you reach a conclusion on the assumptions on this  
24 exhibit?

25 A I cannot reach a conclusion on that.

1 Q Now, let's add your assumption that each of  
2 these railroads is just meeting its cost of capital and  
3 let's proceed to your assumption.

4 A In that case, the answer is it would have no  
5 incentive to divert traffic from B-C to A.

6 Q Let's assume, notwithstanding either your  
7 assumption or on the possibility that assumption does  
8 not prove out in real life, that there were such  
9 diversion. And let's assume then that all of the  
10 traffic was diverted to the single line service.

11 Would that not mean that Railroad C would then  
12 lose \$1.25 a ton it previously had been receiving?

13 MR. TOMPKINS: I'm not sure what the  
14 assumptions are now about -- does the witness  
15 understand?

16 THE WITNESS: I may have gotten a little lost  
17 in the very last go-around. May I just ask a clarifying  
18 question?

19 BY MR. BIEAKNEY: (Resuming)

20 Q Surely.

21 A I take it we are still dealing with the case  
22 where C -- where both railroads or all three railroads  
23 were earning only the cost of capital?

24 Q Well, right now, I'm not even dealing with  
25 that. I'm just going to my assumptions as to long run



1 marginal cost.

2 Can you answer any question about this exhibit  
3 on that basis?

4 A The answer is that in the long run, the  
5 marginal cost is not enough to give you a basis for that  
6 judgment. I have to know something about the return on  
7 capital. If the return on capital is exactly equal to  
8 the cost of capital, then as far as Railroad C is  
9 concerned, it's a wash.

10 Q Let's assume that in earning the difference  
11 between its division and its long run marginal cost,  
12 which on this hypothesis is 25 cents a ton -- do you  
13 have that in mind? This is Railroad C, \$1.25 versus  
14 \$1.

15 A Yeah.

16 Q That Railroad C is earning over its cost of  
17 capital. Do you have that assumption?

18 A Yep.

19 Q And assume also that the merger did cause  
20 diversion from Railroad C. Would you agree that  
21 Railroad C was justified in opposing the merger of  
22 Railroads A and B?

23 A From the social point of view, on the  
24 contrary. The fact that it was earning more than the  
25 cost of capital is indefensible, and I would say no, it

1 was hardly justified at all.

2 It would be confessing its guilt.

3 Q Now, let's assume it were earning precisely  
4 its cost of capital. Is it then justified to protest  
5 the merger?

6 A No, because it's a wash as far as it is  
7 concerned.

8 Q Let's assume it's not a wash in terms of the  
9 savings it would achieve versus the revenues it would  
10 lose; that it would lose more revenues than the savings  
11 it would achieve.

12 A Now I'm puzzled how that comes about. See, if  
13 we're dealing with a competitive case in which you're  
14 confined to your cost of capital, then I have problems  
15 accepting that assumption.

16 Q Well, it's assume its capital costs are sunk  
17 in that line that C operates.

18 A You brought in the long run, and in the long  
19 run costs are not sunk. You see, in the short run, all  
20 that is possible, but you rightly brought in the long  
21 run because that's the relevant issue.

22 I agreed with the problem as you stated it as  
23 the relevant problem.

24 Q Yes.

25 A And as soon as we get to the long run, there



1 is no sunk cost. Sunk cost, by the definition of the  
2 long run, is that period of time in which sunk  
3 commitments come to an end.

4 Q So you are saying that under no circumstances  
5 here should -- that you can think of -- could Railroad C  
6 oppose the merger of A and E?

7 A I would never go that far. I keep citing an  
8 important exception, and that is when there is a  
9 predatory possibility, a case where the railroad by  
10 forming a merger, either horizontal or vertical, can  
11 clear some portion of its markets of competitors and  
12 then earn the fruits of predation, then of course the  
13 undertaking is not harmless.

14 Certainly, you can damage a viable  
15 enterprise. Certainly, there is room enough for  
16 complaint. And I have never denied -- on the contrary,  
17 I will emphasize that there are cases in which there is  
18 room for complaint. But you have to put in more than  
19 what you have here.

20 Then you have to show its relevance for a  
21 particular case.

22 Q And I take it, or do I take it correctly, that  
23 it is your view that long run marginal cost is not an  
24 adequate standard for the pricing of railroad services?

25 A I have many times testified that -- that's

1 why, for example, I have testified many times about the  
2 relevance of Ramsey pricing -- Ramsey pricing is long  
3 run marginal cost pricing -- when those prices cover  
4 total costs. When they do not, then you must depart  
5 from marginal cost prices, and must do it in such a way  
6 that it is consistent with efficiency and social  
7 welfare, and that's what Ramsey pricing is all about.

8 Q Now, going back to my case 4, let's assume  
9 that the long run marginal costs were, in fact, more  
10 than the long run average cost, which I believe is  
11 your --

12 A Diseconomies of scale.

13 Q In the case of this particular railroad, under  
14 that hypothesis, would you not agree that Railroad C is  
15 quite understandably opposed to the merger of Railroads  
16 A and B?

17 A Quite understandably, and it would be earning  
18 more than the cost of capital. We're back at your  
19 previous case.

20 MR. BREAKNEY: I have no further questions.  
21 Thank you.

22 JUDGE HOPKINS: Mr. Livingston.

23 CROSS EXAMINATION

24 BY MR. LIVINGSTON:

25 Q Mr. Baumol, my name is Bill Livingston. I



1 represent the Union Pacific Railroad. I have only a few  
2 questions.

3 In markets where the Applicant railroads today  
4 compete, in order for those markets to be contestable by  
5 trucks, is it necessary in your theory for the trucks to  
6 have costs comparable to those of the railroads for  
7 serving the market?

8 A I'd certainly expect that they'd have to be  
9 closely comparable if that were the only source of  
10 contestability.

11 Q Well, for the trucks to make the market  
12 contestable, their costs must be comparable to rail?

13 A Yes, certainly

14 Q And it seems to me, then, that if in fact in a  
15 particular market the truck costs are appreciably higher  
16 than the railroads, then in that situation the trucks  
17 cannot make the market contestable or competitive.

18 A Certainly.

19 Q And I think you may have said this before.  
20 But just to be clear in my own mind, it is not  
21 sufficient for contestability, is it, that the trucks  
22 represent a logistically feasible option for the shipper  
23 if it is an appreciably higher cost option?

24 A I agree. Or to put it in other words, it must  
25 be an economically feasible option.

1 Q In looking at the definition of markets in  
2 this case, as I understand it, you have not sought to  
3 define markets.

4 A Oh, on the contrary, I have sought to indicate  
5 what the correct definition of a market is, and  
6 unfortunately it says reality is vague and has no clear  
7 borderlines.

8 Q Well, let me ask a few questions to clarify  
9 things.

10 It is not your view that these two railroads  
11 compete only in one market, is it?

12 A No. I'm not even sure precisely what that  
13 means, but probably correct.

14 Q Well, would you recognize that transportation  
15 service between Houston and Los Angeles, to take an  
16 example, would involve things that are in a different  
17 market from service between Kansas City and Texas?

18 A Not necessarily. They may very well be. I'm  
19 not arguing they are, but it may well be that there are  
20 plants deriving products from both those routes and that  
21 the two plants for finished products are in close  
22 competition, and that forces rates on the two routes to  
23 be comparable.

24 Q Well, if, therefore, there are products moving  
25 between California and Texas subject to source



1 competition from the Midwest, then I take it you would  
2 say the Midwestern traffic and the California traffic is  
3 in the same market.

4 A To a degree. Remember, this is all subject  
5 to understanding that the degree of competition shades  
6 off.

7 Q But you would recognize that there is likely  
8 traffic between California and Texas not subject to such  
9 source competition, which by itself would constitute a  
10 relevant market?

11 A Which by itself would not be in the same  
12 market as the other. Whether it constitutes a relevant  
13 market is another story.

14 Q And it seems to me from what you have said  
15 that different commodities could represent different  
16 markets for analysis.

17 A They could, certainly.

18 Q And that, therefore, these railroads compete  
19 against each other in numerous different markets.

20 A They may well be.

21 Q And you have not attempted to define those.

22 A That's right.

23 Q Is it your belief or view on the basis of the  
24 information set forth in the Anderson and Reebie studies  
25 that there are no markets where this merger will result

1 in an increase in market power on the part of the merged  
2 railroad?

3 A It is my impression by looking -- from looking  
4 at these studies -- that there are a few markets, how  
5 important I cannot judge, though what I have seen  
6 suggests they are unimportant, in which that possibility  
7 has not been ruled out by their data.

8 What their data, if correct, and correctly  
9 analyzed, show is that the vast preponderance of the  
10 markets are highly competitive.

11 Q Did the data show you that the vast  
12 preponderance of the markets are contestable by trucks?

13 A They certainly suggest that they are  
14 contestable by something, not necessarily --

15 Q I understand that. I'm just focusing now on  
16 trucks, motor carriers.

17 A I don't remember whether trucks in particular  
18 are available in most of the markets or in the vast  
19 preponderance of the markets. They are certainly  
20 available in a very substantial proportion of the  
21 markets, but I can't define precisely what that means.

22 Q In so many of these markets where the  
23 Applicants compete, that are in fact contestable, I take  
24 it it is your view that the elimination of competition  
25 between these two railroads will have no adverse



1 competitive harm to the shippers in those markets.

2 A I had trouble hearing the first part of the  
3 question. I'm sorry.

4 Q In those markets where the Applicants compete  
5 and where the market is contestable by other modes or  
6 sources, I take it it is your view that elimination of  
7 the competition between Santa Fe and Southern Pacific  
8 would have no adverse competitive effect on the shippers  
9 in the market.

10 A That's right.

11 Q And am I correct then that if, for instance,  
12 in those markets tomorrow, Southern Pacific were to  
13 announce that it was closing its doors and rippin up its  
14 tracks, that, too, would cause no competitive harm to  
15 the shippers in those markets?

16 A That's correct.

17 Q And, in fact, in these markets where the  
18 Applicants compete, if both Santa Fe and the Southern  
19 Pacific were to cease doing business, that would have no  
20 adverse competitive effect on the shippers in that  
21 market?

22 A If the markets are sufficiently contestable.

23 Q And if -- and the shippers in those markets,  
24 therefore, should be indifferent in terms of their own  
25 economic self-interest as to whether the merger occurs

1 or not, except that they may favor it if they accept the  
2 benefit side of the case.

3 A That's the important proviso, but there's a  
4 second proviso. I mean, clearly, if there are  
5 substantial benefits and those result in better service  
6 or lower costs, and the market is contestable, then a  
7 good part of those benefits will be passed on to  
8 consumers.

9 Furthermore, a market may be highly  
10 contestable. The railroads may offer service which is  
11 either marginally better or marginally cheaper or better  
12 for some customers and works for others, and the  
13 availability of the combination of the railroad and the  
14 trucks, assuming it's the trucks that make it  
15 contestable for the sake of simplicity, may be better  
16 for customers taken customer-by-customer than is the  
17 market in which there are only trucks.

18 That is to say, customers are not perfectly  
19 homogeneous. Their requirements are not perfectly  
20 identical, and there may be efficiency advantages for  
21 some to have a railroad available and for others to have  
22 a truck available, and yet both may be forced to charge  
23 prices that earn them no excessive returns.

24 Q I'm assuming now that the merger is going  
25 through, that the railroad remains in the market;



1 they're not closing their dcors.

2 A Yes.

3 Q And in that circumstance again, all of the  
4 markets where the Applicants compete, where there is  
5 contestability, in your view it would not be in the  
6 shipper's economic interest to oppose the merger.

7 A That's right. And it might be in their  
8 interest to advocate the merger if my inference and the  
9 evidence provided by a number of witnesses is right,  
10 that that will provide some ecncmies and some  
11 improvements in service.

12 Q And for those shippers in these contestable  
13 markets where Santa Fe and Southern Pacific compete,  
14 assuming the merger went through, those shippers would  
15 receive no competitive benefits, would they, if any  
16 trackage right applications were granted?

17 A Once again, I'm terribly sorry. I'm having  
18 difficulty hearing you.

19 Q Okay, let me try again.

20 Assuming that the merger goes through and  
21 looking at these shippers who are in the contestable  
22 markets where Santa Fe and Southern Pacific now compete,  
23 in your theory those shippers would receive no  
24 competitive benefits from the grant of trackage rights  
25 applications.

1                   Isn't that correct?

2                   A     They would receive no competitive advantage  
3 unless some efficiency improvement resulted, provided  
4 that the price were fully compensatory.

5                   On the other hand, if the price, as so often  
6 happens in these cases, were not compensatory, then the  
7 shippers would benefit through a cross-subsidy because  
8 the tenant railroad would now be able to traverse the  
9 tracks at a less-than-adequate compensation for its  
10 inputs.

11                   And, of course, that would mean the shippers  
12 would benefit at the expense of the rest of society  
13 because there is a cross-subsidy at the heart of the  
14 arrangement.

15                   Q     Assuming that the trackage rights compensation  
16 will be full and fair, then in your theory, the shippers  
17 in these contestable markets receive no competitive  
18 benefit simply by virtue of having access to a second  
19 railroad.

20                   A     Only if the choice leads to increased  
21 efficiencies, either in the form of cost savings or  
22 increased options in terms of convenience of service.  
23 Then, indeed, they would receive some benefits.

24                   It's the same as the answer for the merger.

25                   Q     I believe you indicated that there may be some



1 markets where the Applicants compete that are not  
2 contestable, where the Applicants will be able to  
3 exercise a degree of market power.

4 A There may be some such markets. I didn't say  
5 that there are such markets or that it will be able to.

6 Q Okay. And you have not attempted either to  
7 identify them or to determine the importance of any such  
8 market?

9 A That's right. I only know that if the  
10 testimony that is cited in my statement is correct, then  
11 those markets will be relatively a small proportion of  
12 the total and will be relatively among the smaller of  
13 the markets in terms of volume of traffic.

14 Q Now, if I were to ask you whether the problems  
15 are concentrated in the southern corridor or the Phoenix  
16 area or some such, a specific example, you would be  
17 unable to respond.

18 A I would have to confess ignorance.

19 MR. LIVINGSTON: That's all I have. Thank  
20 you, Your Honor.

21 JUDGE HOPKINS: Mr. Patner.

22 MR. PATNER: Your Honor, I would like to know  
23 if I could have one or two minutes to review what I've  
24 got and see what's already been asked and what hasn't.

25 (Pause.)

## 1 CROSS EXAMINATION

2 BY MR. RATNER:

3 Q Professor Baumol, my name is James Ratner.  
4 I'm from the United States Department of Justice.5 As we've been going along here, I've been  
6 trying to eliminate things that have already been asked  
7 of you. But if I ask you something that you've already  
8 gone over, I ask your indulgence.9 A Of course. I understand and I appreciate  
10 that.11 Q To start with some definitions on page 8 where  
12 you define market power, you define it as the ability to  
13 raise the price above the competitive level and to  
14 retain those high prices for some substantial period.15 I don't know if you're familiar with it or  
16 not, but the institutional term the Department of  
17 Justice has chosen is "significant" rather than  
18 "substantial."19 Do you see any difference between those two  
20 terms?21 A I see no significant difference between them.  
22 I interchange them with I get bored with either of  
23 them.24 Q I always use "non-trivial." I assume that's  
25 the same point.



1 A Yes.

2 Q And you also referred in the last part of that  
3 sentence to the price level that would prevail without  
4 commensurate losses in sales volume.

5 Out of an abundance of caution here, I assume  
6 you are referring to losses additional to losses in  
7 sales volume that would occur anytime somebody prices  
8 above the competitive level.

9 A Of course.

10 Q On page 18, down where you refer to the  
11 competitive cap on rail pricing, you say it's important  
12 to consider whether the merger will permit the combined  
13 railroad to charge more for some or all of its services  
14 than its constituent firms can formally charge.

15 And then at the bottom you say, if no such  
16 rise in price is possible by the merger, it can entail  
17 no market power.

18 When you are referring to a price rise, is it  
19 fair to say implicit in that is an assumption about the  
20 service levels and service quality?

21 A Certainly. This is an "all other things being  
22 equal" proposition. And it's implicit.

23 Q I think on pages 36 and 37 in the footnote,  
24 you indicate that point regarding benefits.

25 A Yes.

1 Q Am I right?

2 A I'm quite sure of it.

3 Q And that same point applies to harm from  
4 market power as well?

5 A Absolutely. I'm grateful for these  
6 clarifications.

7 Q Is it correct to say that market power  
8 increases from a merger can result from an increased  
9 ability of the merged firm to hold price at a level  
10 that's above the competitive level?

11 A I would say that that's the manifestation of  
12 it usually.

13 Q Is it also correct to say that another  
14 manifestation would be that a merger might result in the  
15 ability of the merged firm to have an increased ability  
16 for them to hold price at a higher level above the  
17 competitive level than before the merger?

18 A Certainly.

19 Q Is it correct to say that a merger can  
20 increase market power by increasing the likelihood of  
21 collusion among firms in the industry?

22 A Certainly. I think have I said so.

23 Q I think so, too.

24 The decisionmakers trying to determine whether  
25 the Santa Fe and Southern Pacific merger is going to



1 increase market power -- the decisionmaker obviously  
2 must first consider whether the two firms actually  
3 compete. Is that correct?

4 A Certainly.

5 Q And if the two firms do compete with each  
6 other, then an issue that the decisionmaker needs to  
7 evaluate is whether trucks will be effective constraints  
8 on the ability of the merged firm to exercise market  
9 power.

10 A Certainly. That's one of the considerations.

11 Q I think you may have been asked this, but have  
12 you done, either in the process of preparing your  
13 testimony here or at any time at all, have you done any  
14 econometric analysis of the substitutability of rail and  
15 truck at either competitive or at prevailing prices?

16 A No, sir. And I have been asked that before.

17 Q Is it fair to say that econometric analysis of  
18 modal substitutability in surface freight transportation  
19 industries is not your particular field of emphasis?

20 A That's correct.

21 Q I think you've been asked this, too. Did you  
22 review in any way the economic literature on modal  
23 substitutability as part of your preparation for your  
24 testimony?

25 A No, I did not.

1 Q Is it correct to say that unless it can be  
2 demonstrated that a motor carrier is an effective  
3 constraint to the merged firm on routes where the merged  
4 firm is operating, that contestability of the trucking  
5 industry is not a particularly relevant issue, going  
6 toward the question of whether the merged firm will have  
7 increased market power?

8 A If the market is one in which firms -- trucks  
9 neither compete nor have the economic likelihood of  
10 competing, then you are right. Their contestability  
11 will neither make nor break the contestability of the  
12 railroad's market.

13 Q So unless it can be shown, then, that the  
14 motor carrier will effectively constrain the merged  
15 firms, then contestability is not something that comes  
16 into play for the most part, contestability of the  
17 trucking industry?

18 A That's right. But the contestability of large  
19 or ocean transport might.

20 Q Sure.

21 Is it correct to say that on routes where a  
22 motor carrier can properly be considered to be an effect  
23 constraint on the merged firms' ability to exercise  
24 market power, but that the current number or the share  
25 of the trucking firm is either small or zero, it is at



1 that point that the ability of trucks as contesters to  
2 constrain the merged firm becomes an issue for the  
3 decisionmaker to decide?

4 A That's right.

5 Q On page 12 of your testimony, you talk about  
6 collusion. The second line from the top.

7 A Yes.

8 Q Collusion, as you use it, need not involve an  
9 explicit or illegal agreement, does it?

10 A I'm no expert on the legality, but it may not  
11 involve an explicit agreement.

12 Q If a merger makes it more likely that there  
13 will be successful explicit coordination or collusion,  
14 that may be of concern to society. Is that correct?

15 A Certainly.

16 Q And collusion, as you use the term, also may  
17 just apply to firms recognizing their interdependence  
18 and independently coordinating their price and service  
19 levels. Is that correct?

20 A If the merger makes that more possible and  
21 action on it more effective, yes. I'm just expanding on  
22 that and trying to make clear on what I think we agree.

23 Q I appreciate that.

24 Does conventional industrial organization  
25 literature conclude that collusion would be unlikely in

1 a market with three firms where those firms have similar  
2 cost structures and have had a history of rate and  
3 service collusion?

4 A I would say that, subject to some caveats,  
5 that by and large the conventional industrial  
6 organization literature says that where there is a  
7 history of collusion, where there are three firms where  
8 the products are homogeneous, where there is little  
9 product innovation, you get a whole list of these  
10 conventional criteria, then you do have a source of  
11 concern for collusion.

12 And I would agree with it.

13 Q I think this has been covered, but, very  
14 briefly, is it correct to say that if the price and  
15 service offerings of the closest substitute to the  
16 merged firm's products are inferior to those of the  
17 merged firm, then the merged firm may be able to raise  
18 prices or dilute quantity considerably?

19 A If the difference is considerable, they may be  
20 able to raise prices considerably. So it's a statement  
21 about the best available substitute, the tightness of  
22 the cap on the merged firms' prices, which is precisely  
23 what I have talked about before.

24 Q And it follows from that that it's important  
25 for the decisionmaker to compare the price and service



1 levels of various substitutes with those price and  
2 service levels that are offered with the merged firm?

3 A It's certainly important to take that into  
4 account. I mean sometimes the evidence may be so clear  
5 that the case is open and shut. Other times, very  
6 careful calculation and investigation of the data is  
7 necessary.

8 Q Do you think that a market that is defined to  
9 include only the merged firms and all other firms that  
10 fully constrain the ability of the merged firm to  
11 exercise market power is a helpful tool for evaluating  
12 whether the merger will increase market power?

13 A Yes, it is, if you consume it knowing that it  
14 may be dangerous to your health. That is, the point is  
15 such a definition definitely, by your description, a  
16 very legitimate description, excludes things which are  
17 imperfect substitutes.

18 Suppose that we don't know whether those  
19 imperfect substitutes are very close or very distant.  
20 That means that, at worst, if the overly tight market  
21 definition exonerates the merger from any odor of  
22 monopoly power, then it is a convincing case by itself  
23 because all that can happen is when one extends the  
24 market that one considers, that one takes into account,  
25 that case will be strengthened.

1           On the other hand, if one considers such a  
2 limited market definition and one finds that there is in  
3 adequate constraint within those boundaries upon the  
4 merging firms, that is not conclusive.

5           It certainly doesn't exonerate that firm or  
6 the merger, but it means further study is needed.

7           Q     Is it fair to say that the other side or part  
8 of what you are describing is also correct, which is,  
9 that in trying to draw lines to define a market you  
10 include firms which cannot effectively constrain the  
11 merged firm as being in the market, then you might come  
12 to the conclusion that there was effective constraint  
13 and effective competition when in fact there was not?

14          A     Oh, certainly.

15          Q     On page 19 of your testimony, you discuss  
16 various possible constraints that the merged firm might  
17 face. And one of them that you mention is the services  
18 of another railroad in the third line there.

19          A     Yes.

20          Q     You don't mean to be suggesting by this that  
21 the presence of one additional railroad by itself would  
22 be adequate to eliminate increases in market power  
23 coming from a merger, do you?

24          A     It might be. I'm not suggesting it generally  
25 is. I am saying that I can think of circumstances, as



1 in the hypothetical illustrations we had just a few  
2 minutes before you started to cross examine me, in which  
3 the availability of one additional railroad was enough  
4 to eliminate all market power.

5 So I can construct cases in which that is  
6 true. I am saying the availability of another railroad  
7 must be taken into account in judging the contestability  
8 of the market, not that that settles the issue.

9 Q Also on page 19 of your testimony, you refer  
10 to source and product competition as a possible  
11 constraint on the merged firm. Is that right?

12 A Yes.

13 Q Is it correct that in order to be effective  
14 constraint, the alternative source of product must be  
15 closely substitutable to the source or the product that  
16 is currently being transported by the merging firms?

17 A That's right. Some sort of substitutability,  
18 albeit very indirect and not obvious sometimes, but  
19 nevertheless close.

20 Q It must be close is the point I was getting  
21 at.

22 A Yes. But close -- I'm again not disagreeing,  
23 just hoping to clarify. Close is not a synonym for  
24 obvious.

25 Q I understand that close and obvious are

1 different things.

2 Is it also correct that the alternative source  
3 or product, to be an effective constraint, has to be  
4 capable of expanding its quantity to meet all of the  
5 quantity currently being moved by the merging firms?

6 A I'm not sure that's right. I think that it  
7 could expand sufficiently just to cause a lot of damage  
8 to the incumbent.

9 Q Well, then it would only be a constraint for  
10 the portion of the quantity that could expand. Isn't  
11 that correct?

12 A No. But the prices are affected by marginal  
13 conditions. I mean let's assume you have available a  
14 substitute that could take away half your business, but  
15 only half, but you would go broke if you lost that half.

16 And suppose you did not have the opportunity  
17 to discriminate in price. You know and I know that in  
18 that case, the competitive price will emerge. So, no.  
19 I'm sorry. This is the first time I'm forced to  
20 disagree with you.

21 Q Well, it's perfectly acceptable for you to  
22 disagree with me if you're so inclined.

23 A Oh, no. It's just that I like agreeing with  
24 you.

25 Q Is it fair to say that the conditions of



1 determining the price for the merged firm may affect how  
2 much quantity the alternative will have to produce  
3 before it becomes a constraint on the merged firm?  
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1           A     Certainly. What is adequate quantity in one  
2 set of circumstances is not adequate for another.

3           Q     Is it correct to say that in order to be an  
4 effective constraint, the alternative source or product  
5 must be capable of being transported to the shipper by a  
6 method other than that which uses one of the merging  
7 firms?

8           A     Not necessarily, no. It may be that one of  
9 the merging firms -- let me give you an illustration.  
10 If the merging firm has some sort of service which is  
11 highly regulated and which is -- remains effectively  
12 available for substitute products, that may serve as an  
13 adequate constraint.

14          Q     Assuming there is no constraint on the merged  
15 firm other than market forces, is my statement correct?

16          A     I suppose so. I would like to hear it again.

17          Q     All right. Is it correct that in order to be  
18 an effective constraint, the alternative source or  
19 product must be capable of being transported by the  
20 shipper using a method other than that of the merged  
21 firms?

22          A     If there are no constraints, whether by market  
23 or regulation or anything else, of the merged firm, that  
24 is correct, but it then becomes an empty statement,  
25 because the point is, if there exists some other



1 substitute commodity in which there is competition, and  
2 in which the merged firm must adhere to a competitive  
3 price because of the pressures of the market, then that  
4 is plenty of competitive pressure, or can be, and of  
5 course we can rule that out, but then we can say we can  
6 rule out all sorts of possibilities.

7 Q Well, that would mean, then, the answer to my  
8 question is, if there is a method other than using the  
9 merged firm to transport the product to the shipper,  
10 then that method may constrain the merged firm. Is that  
11 correct?

12 A It is not the product. It is some other  
13 product.

14 Q The alternative product.

15 A There has got to be some constraint  
16 somewhere. No constraint is no constraint. Look, we  
17 are not differing that much.

18 Q I agree with that. I would like to go over my  
19 question again and have you listen to it, and I don't  
20 think we disagree on this at all.

21 In order to be an effective constraint, is it  
22 correct that the alternative source or product must be  
23 capable of being transported by the shipper using a  
24 method other than that of the merging firm?

25 A Yes, unless the merging firm itself has some

1 other constraints on other of its services.

2 Q Given that you regard source or geographic  
3 competition as a possible constraint, isn't it correct  
4 that what you have described in your testimony as end to  
5 end mergers can in some ways enhance market power by  
6 reducing that competition?

7 A I don't see how it per se would reduce that  
8 competition unless there were an opportunity for real  
9 predation.

10 Q Well, let me give you an example. Suppose  
11 that a merger enables the merged firm to control 100  
12 percent of the originations of all of the borax in the  
13 United States such that no borax shipper could transport  
14 its product without using the merged firm. Could that  
15 have an anticompetitive result?

16 A How could the merged firm control 100 percent  
17 of the borax shipments after the merger and yet not one  
18 component of it control them beforehand?

19 Q Speaking purely hypothetically, assume 50  
20 percent of them right now originate on Southern Pacific,  
21 and the other 50 percent right now originate on Santa  
22 Fe.

23 A And there is no other alternative, there is no  
24 alternative source? Then of course your conclusion  
25 follows.



1 Q So is it correct, then, that end to end  
2 mergers can foreclose source competition and thus may  
3 pose a problem which could result in an increase of  
4 market power to the merged firm?

5 A It is not the source competition there, I  
6 think, that has been foreclosed. What has been  
7 foreclosed -- well, I guess you are right. In that case  
8 it is source competition. Sorry.

9 Q So is the answer to my question yes -- that  
10 the merger forecloses source competition and source  
11 competition is a constraint of some kind on the merged  
12 firm's activities? Then an end to-end merger could pose  
13 an anticompetitive problem?

14 A That's right, if it either permits collusion  
15 among all of the sources or it effectively monopolizes  
16 all of the sources.

17 Q The standard reasons for why we wouldn't be  
18 concerned about a merger? Is that correct?

19 A Yes.

20 Q So is it fair to say that on Page 10 of your  
21 testimony where you indicate that end to end mergers are  
22 not usually considered a source of enhanced market  
23 power, and also on Page 32, where you say that end to  
24 end elements constitute no possible threat of price  
25 raising through the exercise of market power, that those

1 statements should be amended to reflect an assumption  
2 that there is no significant foreclosure of important  
3 source of geographic competition?

4 A No, because those statements -- first of all,  
5 I think at least one of them is guarded, and I hope both  
6 of them are. They don't say there never is any concern  
7 about end to end mergers. Second -- and I had precisely  
8 in mind, for example, the list of exceptions I recited  
9 this morning.

10 So, I am happy to include yours as well.

11 Q Well, that's all I was looking for is, you  
12 would include that as another possible exception?

13 A Sure.

14 Q Fine. Thank you very much. I think you have  
15 been asked this. In determining whether trucks or other  
16 modes in reality as distinct from in theory effectively  
17 constrain the merged firms from exercising market power,  
18 my understanding is that you have made no factual  
19 analysis for the most part other than reading the  
20 application. Is that correct?

21 A Reading the application and reading the  
22 testimony -- other pieces of testimony that have been  
23 submitted.

24 Q Is it fair to say, then, that for the most  
25 part you relied on, among other things, the TBS studies



1 considering shares and things like that?

2 A That's right, and my general knowledge of the  
3 railroad industry, as I have indicated before.

4 Q Based on your general knowledge of the  
5 railroad industry, are you satisfied with the accuracy  
6 and the methodology that was used by TBS?

7 A My judgment, not having studied the methods in  
8 detail, is that they seem reasonable, but I am not  
9 prepared to give a good housekeeping seal of approval  
10 without having done careful study of the methods.

11 Q If you could describe it for me very briefly,  
12 if you were going to undertake that project, how would  
13 you have designed the analysis that TBS did?

14 A I haven't thought about it, but let me try. I  
15 would certainly attempt -- one way to go about it would  
16 be simply to investigate costs of substitutes for  
17 railroading, the availability of alternative modes, that  
18 is, the extent of their coexistence, both geographically  
19 and in terms of commodities carried.

20 I would examine whether the cases of  
21 coexistence precluded the entry of still other carriers  
22 of the same sorts, and if so, in what way, and whether  
23 those impediments to entry could be overcome at high  
24 cost or low cost.

25 I would examine in cases where there were no

1 substitute modes actually operating whether there were  
2 any impediments to their operation in the event that the  
3 incumbent turned out to begin to operate inefficiently  
4 or to price excessively.

5 Q A quick question on that. You indicated -- I  
6 think the first thing you indicated that you would like  
7 to look at is the cost of substitutes for railroads. Do  
8 you mean the cost to the shipper or the cost structure?

9 A The cost structure.

10 Q Would you want to look at the cost to the  
11 shipper?

12 A Well, first of all, in many of these cases,  
13 you have methods of observation from which you can  
14 deduce costs. That is, if these -- if several modes are  
15 operating simultaneously, providing the same service,  
16 carrying along the same routes the same commodities, and  
17 neither of them manifests any excessive profits, I could  
18 from that deduce something about the costs.

19 In fact, I would deduce from it that the costs  
20 are probably comparable.

21 Q I think you have answered my question, but I  
22 asked you if you would want to look at the cost to the  
23 shippers, and you said, well, in many ways you could  
24 deduce it.

25 I take it that it is important to consider the



1 cost to the shippers of the various modes?

2 A Oh, certainly. In other words, the pricing,  
3 which of course is the heart of the issue.

4 Q If you had been doing your own analysis, do  
5 you think you would have wanted to take a slightly more  
6 disaggregated approach than the approach used by TBS?

7 A It depends. It is always a matter of weighing  
8 costs and benefits, availability of data, time. You have  
9 done studies, I am sure, and one always makes  
10 compromises.

11 Q Are you fully satisfied that TBS thoroughly  
12 and completely evaluated the price of service levels  
13 that the various modes they looked at can offer, and  
14 that they compared them adequately to the offerings of  
15 the merging firms?

16 A I am not in the position to answer that  
17 question.

18 Q On Page 20 of your testimony, the third  
19 sentence of the second paragraph, it says, as is shown  
20 by studies prepared by TBS, there is only a small  
21 portion -- small proportion of the expected traffic of  
22 the combined railroad which will not continue to be  
23 subject to substantial intramodal rail competition.

24 A Yes.

25 Q Do you see that?

1 A Yes. I think that should be read --

2 MR. TOMPKINS: I am not sure there is a  
3 question pending.

4 THE WITNESS: Do I see it? The answer is  
5 yes.

6 JUDGE HOPKINS: He is trying to correct it if  
7 there is a correction.

8 BY MR. RAINER: (Resuming)

9 Q I have no problem if there is something you  
10 have to offer on this point before I ask my question.  
11 Please go ahead.

12 A Well, the question is read, do I see that?  
13 The answer is, yes, I do see it, and I would say for the  
14 purpose of clarity that it should be read along with the  
15 following sentence, that is, were I writing it over  
16 again, I would not put the weight on rail competition  
17 exclusively.

18 Q All right. That was the main focus of my  
19 question. That is, it is correct to say, then, it  
20 should not be concluded that, from the rail IBS analysis  
21 by itself, that there would be adequate intramodal  
22 competition?

23 A That's right. I would certainly not suggest  
24 that. Mea culpa.

25 Q On Page 21, and I think on through Page 22 of



1 your testimony, you describe one benefit of the merger  
2 may be stimulation of the intensity of competition that  
3 could result from efficiency enhancements after the  
4 merger. Is that correct?

5 A That's correct.

6 Q The same stimulation effect occurs any time  
7 there is an efficiency enhancement in a market, and not  
8 just when it is done through a merger. Is that  
9 correct?

10 A Absolutely. Any form of efficiency  
11 enhancement is procompetitive, including those which  
12 emerge from a merger if in fact there is reason to  
13 expect it from a merger.

14 Q It is correct, isn't it, that assuming that a  
15 firm is profit maximizing, all participants and all  
16 firms are under constant pressure to earn more money by  
17 engaging in efficiency enhancements where possible?

18 A Oh, absolutely, but they may not be able to  
19 achieve them without obtaining the opportunities for  
20 economies of scale, scope, and integration that merger  
21 permits, maybe. I am not saying that is generally so.  
22 But it may be so.

23 Q On Page 5 of your testimony, I think you are  
24 making basically the same point in the second  
25 paragraph. You say, "For increased efficiency of any

1 one firm, an industry forces its rivals to try harder."  
2 Isn't it true that that is only correct to the extent  
3 that the merged firm responds to efficiency improvements  
4 by expanding its capacity or its output?

5 A Oh, I think that assuming rationality, some  
6 degree of rationality in this operation, that if a  
7 merged firm does achieve economies, it will try to keep  
8 some or other types of efficiency.

9 It will obviously try to keep some for itself,  
10 but it will generally try to pass some of them on, not  
11 out of a sense of justice and virtue and Boy Scout  
12 honor, but because in that way it can increase profits.

13 Even the most protected of monopolists, if its  
14 costs go down, will pass on some of those savings, not  
15 because it loves the consumer, but because in that way  
16 it can expand its volumes and make profit higher than  
17 was previously possible.

18 Q Professor Baumol, it is not that I disagree  
19 with you. I think you can assume that even attorneys  
20 from the Department of Justice understand why a firm may  
21 sometimes want to decrease their prices to make more  
22 profits.

23 The point I was getting at is, again, if a  
24 firm or merged firms obtain efficiencies from that  
25 merger, and choose to not increase their output or



1 increase their capacity, and instead solely take the  
2 gain in terms of producer surplus, will there be  
3 pressure on the other firms to improve their  
4 efficiencies as a result of that merger?

5 A First, let me protest that I have the highest  
6 respect for attorneys from the Department of Justice,  
7 with whom I have worked in the past. And I am merely  
8 concerned that something I said which is obvious to you  
9 will be misunderstood on the record.

10 Q That is fair enough.

11 A So that is why my reservation, and the answer  
12 is, yes, you are right, but I would normally not expect  
13 that to happen.

14 Q On Page 26 of your testimony, you refer to  
15 transactions costs associated with having two firms  
16 improve efficiencies through contract. Is that  
17 correct?

18 A That's right.

19 Q And is it correct to say, then, that the  
20 primary benefit of an end to end merger in terms of  
21 efficiencies would be the reduced transactions cost that  
22 would occur because you don't have to enter those  
23 transaction costs through contracts?

24 Is that correct?

25 A Well, the elimination of those transactions

1 costs may in fact be multiplied through the  
2 rearrangements that then become possible.

3 Q Do you agree with the following statement?

4 "The economies and efficiencies to be gained from a  
5 vertical consolidation are inherently less likely to  
6 produce huge savings than a horizontal consolidation,  
7 where, for example, a parallel rail line or a duplicate  
8 terminal may make it end to end, the amount of  
9 efficiency gains resulting from a vertical consolidation  
10 depends on the magnitude of the transactions costs which  
11 would have to be incurred in order for independent  
12 entities to achieve economies in question without  
13 recourse to a consolidation.

14 "Where those transactions costs are small the  
15 vertical elements of the merger cannot be expected to  
16 provide substantial efficiencies. Where those  
17 transactions costs are significant, the operating  
18 efficiency payoff of the consolidation is apt to be  
19 correspondingly greater."

20 In case you are not familiar with that, that  
21 is a verbatim quote from your CSX barge line  
22 testimony.

23 MR. TOMPKINS: Would the witness like to look  
24 at that?

25 THE WITNESS: I suppose so. It is nice to



1 meet an old friend. But I was going to agree with it.

2 BY MR. RATNER: (Resuming)

3 Q Would you like to look at it for a moment?

4 A Certainly.

5 (Pause.)

6 A Yes, I still agree.

7 Q You still agree?

8 A Yes.

9 Q Thank you. Are you aware that there is any  
10 place in the application which analyzes the transactions  
11 costs savings that will occur due to the merger of the  
12 Santa Fe and the Southern Pacific?

13 A No, I am not, but I consider that to be  
14 unnecessary if the evidence that there are no  
15 impediments to efficiency stands up, because in that  
16 case it must be true that in management's judgment there  
17 are sufficient transactions economies to make the merger  
18 worthwhile.

19 As I have said before, they could be wrong,  
20 but who are you and I to second guess them?

21 Q I understand, but your statement that you just  
22 made to me is predicated on the if, that there is no  
23 anticompetitive harm that will occur from the mergers.

24 A I agree, but I am saying that if one, as I  
25 hope you will, goes through a careful cross examination

1 of the witnesses who have provided that evidence, and if  
2 they convince you that that evidence has stood up, my  
3 point I am making is that that should be the end of the  
4 story, and I think the merger guidelines in fact  
5 indicate that it should be the end of the story.

6 Q I understand that. So, to clarify, though,  
7 are you saying anything other than the fact that if  
8 there is nothing harmful from a merger and there is a  
9 possibility that there is something good, we should  
10 allow the merger?

11 A Fine. That's a good way of putting it.

12 Q Is it fair to say that the transactions costs  
13 of implementing a significant rail merger may not be  
14 trivial?

15 A Certainly, but once again, the logic I  
16 indicated before, the decision of management to  
17 undertake it denies that possibility, I mean, denies the  
18 possibility that those substantial costs will be greater  
19 than the savings that emerge on the other side.

20 Q Is it fair to assume that you did not compare  
21 the transactions costs associated with merging with the  
22 transactions costs of achieving efficiencies through  
23 contract?

24 A More than fair. It is correct.

25 Q On Page 27 of your testimony, you refer to end



1 to end marketing efficiencies.

2 A Yes.

3 Q I don't want to overly simplistically sum up  
4 this portion of the testimony, but am I correct in  
5 saying that the primary benefit occurs because one  
6 person or one firm will do all the promoting instead of  
7 two separate ones?

8 A That is certainly a prime source of  
9 efficiency.

10 Q Is there any significant source of efficiency  
11 associated with some aspect other than what I have just  
12 described?

13 A It may, for example, save advertising costs,  
14 and I also cite the possibility of improved pricing.

15 Q On Page 33 of your testimony, you talk about  
16 horizontal efficiencies. Is it correct that you have  
17 not evaluated which facilities and which physical plant  
18 used by Southern Pacific and Santa Fe are not currently  
19 being utilized efficiently?

20 A That is correct.

21 Q Are you aware of any significant literature  
22 that suggests that Southern Pacific and Santa Fe are  
23 operating fairly close to the level to where the long  
24 run cost curve is flat?

25 I am sorry? The answer was no?

1 A The answer was no.

2 Q On Page 6 and 7 of your testimony, you discuss  
3 the fact that what parties oppose and what parties  
4 support a merger might be a telling sign indicating  
5 whether a merger is likely to increase market power and  
6 increase efficiency?

7 A That's correct.

8 Q How many truck firms are you aware of that are  
9 opposing this merger?

10 A I don't know of any, but truck firms are not  
11 the ones who are -- they are already engaged in such  
12 competitive operations that for them it is not likely to  
13 make much obvious difference.

14 Q Aren't you making a prediction in your  
15 testimony that if the merger is efficient and a firm  
16 competes with that merged firm, that they might be the  
17 ones that are likely to oppose the merger, because the  
18 merger will make it harder for them to compete?

19 A Sure. But just as individual trucking firms  
20 don't advertise because each is such a small proportion  
21 of the market that it really cannot achieve much effect,  
22 but oligopolies do advertise, I would expect that the  
23 bulk of the opposition will come from the big firms,  
24 just as that is what we find, for example, in cases like  
25 the proposed Toyota-General Motors joint venture.



1           There, there are big firms who stand to lose,  
2 and there you do get the predictable response. Small  
3 firms generally don't engage in that sort of thing.  
4 There are exceptions.

5           Q     Is it your opinion that trucking firms do not  
6 oppose particular measures at the ICC?

7           A     No. But it is a very different sort of  
8 situation. Look. What I am saying and what your  
9 experience will surely confirm is that just as in  
10 lobbying operations, the first to arrive at the big or  
11 medium-sized firms, and in the protests I would expect  
12 the medium or large firms involved to be the first to  
13 object.

14          Q     Well, the last sentence of the paragraph on  
15 Page 7 says, "If the proposal is greeted with silent  
16 acquiescence by competitors, that may be indeed the time  
17 for government agencies to grow concerned."

18                 Given the Department of Justice is a  
19 government agency, and the fact that this merger has  
20 been greeted so far by silent acquiescence by what the  
21 application describes as one of the major competitive  
22 forces, trucks, isn't this the time for the Department  
23 of Justice as a government agency to grow concerned?

24           A     Oh, come now. Now we are playing games,  
25 because, look, if you have a market which is so

1 obviously competitive as trucking, say if you were  
2 dealing with farmers, and you found that they were not  
3 behaving -- they were not objecting to a merger that was  
4 related to farming, you would not propose that the  
5 Department of Justice allocate a large portion of its  
6 budget to breaking up the farm monopoly.

7           What is relevant here -- come on, let's take a  
8 view of the matter with a sense of proportion. First of  
9 all, I did not say that the department -- that was a  
10 very measured statement, and I am glad you read it as it  
11 stands, but what I am suggesting is that where there are  
12 no other circumstances that assure you that the market  
13 is operating competitively and appropriately, then that  
14 is -- the lack of response is a worrisome sign.

15           But there I am not suggesting that each and  
16 every participant in the market should respond. I never  
17 suggested that.

18           Q     So is it fair to say, then, that the responses  
19 of various firms in terms of who supports and who  
20 opposes is strongly secondary to an analysis of the  
21 indicia in the market as to whether it is competitive or  
22 not?

23           A     I was very careful not to suggest this as a  
24 conclusive test.

25           Q     So the answer to my question is that it is



1 strongly secondary to an analysis of indicia?

2 A I am sorry. I didn't mean to interrupt.

3 Q I just asked whether it is fair to say that  
4 any reaction by particular parties as to whether they  
5 oppose or support a merger in considering that as  
6 information about whether the government should be  
7 concerned should be considered strongly secondarily to  
8 information about the competitive nature of the markets  
9 that are affected by the merger?

10 A It should be considered along with it. I have  
11 not given you a ranking. In some cases it would worry  
12 me a great deal. In others, it might not.

13 MR. RATNER: One moment, Your Honor.

14 (Pause.)

15 BY MR. RATNER: (Resuming)

16 Q It is correct that certain conditions must be  
17 met in order to accept that a market is perfectly  
18 contestable and then perform efficiently because of  
19 that. Is that correct?

20 A That's correct. In fact, I'd go further. I'd  
21 say I don't know of any market that is perfectly  
22 contestable.

23 Q I agree with that. Is one of those conditions  
24 for contestability the condition that entry and exit  
25 must be unrestricted?

1 A Must be relatively unrestricted.

2 Q Unrestricted relative to what?

3 A Well, sunk costs, for example, must be a small  
4 proportion of total investment costs. There must be  
5 some sort of either inhibition of retaliatory  
6 responsiveness by other -- by incumbents, or it must be  
7 possible to have contracts. There are a whole variety.

8 Q Well, is it a condition then that entry and  
9 exit must be associated with zero sunk costs and, as  
10 well, must not be otherwise restricted?

11 A I just said small sunk costs, because I  
12 started off confessing that there is no perfectly  
13 contestable market.

14 Q Okay.

15 A I am sorry. We have already moved off of  
16 perfectly contestable.

17 Q I think you have answered this, but is it fair  
18 to say that it is unlikely that an entry and exit can  
19 occur without some sunk costs?

20 A That is virtually certain. The question is  
21 whether they are de minimis or whether they are huge.  
22 And that will vary from industry to industry.

23 Q I think you have also said this earlier, and I  
24 am sorry to go over it, but just to make it clear, is it  
25 correct that you testified this morning that it hasn't



1       been proven, and so we are not sure whether the further  
2       we get away from zero sunk costs, whether that will act  
3       as a continuous constraint, or whether the entire  
4       process of contestability will fall apart and the  
5       incumbents will be unrestrained entirely?

6           A       That is right, but I remind you of my answer  
7       of this morning, which is that all the wisdom, received  
8       wisdom in the area, including the Department of Merger  
9       guidelines -- the Department of Justice guidelines --

10          Q       Sometimes we are the Department of Mergers.

11          A       It is getting to be a long time. Forgive me.  
12       The Department of Justice merger guidelines indicate  
13       clearly that ease of entry and exit are an important  
14       consideration restricting the ability of a firm to  
15       acquire market power even when numbers are small.

16          And that is all we are saying. That is, while  
17       it is conceivable that small deviations from perfect  
18       competition will lead to highly deviant behavior, and it  
19       is conceivable that small deviations from perfect  
20       contestability will lead to highly deviant behavior, all  
21       the received wisdom in the area, all the evidence I have  
22       seen suggests that the department's guidelines and the  
23       other discussions that I see in most of the  
24       precontestability literature is right on that score, and  
25       agrees with the conclusions that emerge on this score.

1 alone from the contestability literature.

2 Q Do you think it has been empirically  
3 demcnstrated that entry factors dictate the performance  
4 of a market as conclusively as has been demonstrated in  
5 the internal conditions that affect market performance?

6 A I don't think it has been demcnstrated  
7 conclusively, no.

8 Q Is it a correct statement that if there is any  
9 amount of nontrivial sunk costs associated with entry  
10 that would be incurred by the entrant, and the incumbent  
11 can respond very quickly to the entrant's prices, that  
12 the incumbent may be virtually unconstrained by the  
13 entry?

14 A If there is any amount of sunk costs?

15 Q If there is any nontrivial amount of sunk  
16 costs associated with entry, and incumbents can  
17 implement countermeasures very quickly.

18 A No. It is not necessarily true. In  
19 particular, it is not true when contracts can be made by  
20 entrants and customers. Then the speed of response  
21 becomes irrelevant. Let me explain that point.

22 Q I think I understand. Isn't it correct that  
23 that is only true of the contract as a requirements  
24 contract?

25 A No.



1 Q If it is not a requirements contract, what  
2 keeps the incumbent from simply responding with a lower  
3 price?

4 A If the customers know that that lower price is  
5 a temporary matter which will be rescinded the moment  
6 the entrant leaves and have been taught that by past  
7 history, then it will pay customers to deal with the  
8 entrant because -- and take the lower prices that the  
9 contract offers them.

10 Q I am not disputing that that is a possibility,  
11 but isn't it correct that what you have just described  
12 is just one of many possible scenarios that may occur  
13 when an entrant attempts to contract with a shipper in  
14 advance and the incumbent is available to institute  
15 countermeasures quickly?

16 A It -- certainly as an alternative scenario is  
17 conceivable, but your question, as I recall, asked  
18 whether all things fall apart when there is not a  
19 requirements contract, and I denied that. And I still  
20 do.

21 Q In other words, when there is not a  
22 requirements contract, we don't know whether the entrant  
23 will be an effective constraint on the incumbent or  
24 not.

25 A The entrant is giving a powerful weapon that

1 inhibits the incumbent. The incumbent has to fear  
2 already that he won't be able to get away with murder.

3 Q Do you agree with the proposition made by  
4 Professor Shepherd that if the railroad incumbent  
5 pursues a strategy of announcing that it will meet all  
6 credible offers by entrants, that such a strategy could  
7 render all entrants' offers not credible and therefore  
8 weightless, and that would then negate the contract  
9 strategy of entry?

10 A In a word, no. And I just explained why.

11 Q Again, I think you have been asked this. Is  
12 it correct that for an entrant to constrain an  
13 incumbent, the entrant must be able to enter at a scale  
14 which enables the entrant to completely match the  
15 incumbent's output?

16 A The answer is no.

17 Q If the entrant is unable to enter at the same  
18 scale, and that results in the entrant facing a higher  
19 per unit fixed cost than the incumbent, doesn't that  
20 mean that there is an entry barrier associated with  
21 entry?

22 A No. That is not an entry barrier in itself.  
23 That is a confusion of the basic difference between  
24 fixed and sunk costs. I mean, there may be an entry  
25 barrier there if, say, the entrant is, say, threatened



1 if he matches the incumbent's output, but the mere  
2 existence of economies of scale is not an entry barrier  
3 in the sense of protecting the incumbent.

4 Q Is it incorrect that if the entrant has a  
5 higher per unit fixed cost, that it will not be able to  
6 -- that the incumbent will always maintain an advantage  
7 over that entrant?

8 A What you are saying is, an efficient firm is  
9 always a worse competitor than an inefficient firm, and  
10 so be it.

11 Q I am not trying to trap you or trick you or  
12 anything. I am puzzled by what you said a little  
13 earlier this morning, and I think what you said was that  
14 an entrant must have or must be able to enter under the  
15 same cost structure as the incumbent. Is that a  
16 mischaracterization of what you said this morning?

17 A No, that's not.

18 Q Very briefly, could you describe for me the  
19 difference between this statement which you agree is  
20 correct and what I was just describing to you about an  
21 entrant having higher per unit --

22 A A higher fixed cost?

23 Q That's correct.

24 A Oh, that's a special case of what I stated. I  
25 didn't disagree with your statement about fixed costs.

1 Q Is it a fair statement that during the short  
2 run period where incumbents have not responded to an  
3 entrance price that sunk costs are likely to be higher  
4 than during a period that is longer when the incumbents  
5 would have time to respond to entry prices?

6 A Oh, almost by definition, the longer the  
7 period, the less the proportion of costs that is sunk.  
8 That is how we define the long run and the short run.

9 Q Is it correct to say that one key to  
10 contestability is that entrants must be able to perceive  
11 that they will be able to earn something positive by  
12 entering?

13 A Certainly. I am sorry. Let me hear the  
14 question again.

15 Q The question was, is it correct to say that  
16 one key to contestability is that entrants must be able  
17 to perceive that they will be able to earn something  
18 positive by entering?

19 A I think I don't disagree, but let me make  
20 clear, because there is an ambiguity in my mind. I am  
21 sorry. It is important that if there is a profit  
22 opportunity, entrants should be able to see it, but it  
23 is not important that there be a profit opportunity.  
24 That is, if the incumbent chooses to behave in an  
25 exemplary manner, there will be no profit opportunity



1 for entry. That is exactly what the virtue of  
2 contestability is, and therefore, though there is  
3 contestability, the potential entrant will see no profit  
4 opportunity because there isn't any.

5 Q All right, then. The key is that if there is  
6 a profit opportunity they will be able to perceive it?

7 A That's right.

8 Q Is it correct, then, to say that what is  
9 important is the entrant's perception about the  
10 post-entry conditions of the market?

11 A That is correct. That can be assured, for  
12 example, by contracts.

13 MR. RATNER: Could I have one more moment,  
14 Your Honor?

15 JUDGE HOPKINS: Sure.

16 (Pause.)

17 BY MR. RATNER: (Resuming)

18 Q You may already have been asked this. Have  
19 you done any analysis of what is necessary for trucks to  
20 enter on routes served by Southern Pacific and Santa Fe,  
21 and how much of what is required to enter would be a  
22 sunk cost?

23 A No, I have not.

24 MR. RATNER: Thank you very much, Professor  
25 Baumol.

1 I have no further questions, Your Honor.

2 JUDGE HOPKINS: Thank you.

3 Any redirect?

4 MR. TOMPKINS: Your Honor, we have no  
5 redirect.

6 I would move Professor Baumol's statement into  
7 evidence.

8 JUDGE HOPKINS: Any objection?

9 (No response.)

10 JUDGE HOPKINS: It will be received in  
11 evidence. And the other?

12 MR. BLEAKNEY: KCS-14 through 17.

13 JUDGE HOPKINS: Any objection?

14 (No response.)

15 JUDGE HOPKINS: They will be received in  
16 evidence.

17 (The documents referred to,  
18 previously marked for  
19 identification as Exhibits  
20 Number KCS-C-14 through 17,  
21 were received in evidence.)

22 MR. MORSE: Your Honor, I would like to move  
23 into evidence MXT-C-54, 55, 56, and 57.

24 JUDGE HOPKINS: Any objection?

25 (No response.)



1 JUDGE HOPKINS: They will be received in  
2 evidence.

3 (The documents referred to,  
4 previously marked for  
5 identification as Exhibits  
6 Number MKT-C-54 through 57,  
7 were received in evidence.)

8 JUDGE HOPKINS: We will be in recess for 15  
9 minutes. Is somebody scheduled? Have you got the  
10 witnesses available? Thank you.

11 (Whereupon, a brief recess was taken.)  
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1 JUDGE HOPKINS: Let's get back on the record.

2 MR. LEARY: Your Honor, before we begin with  
3 the additional witnesses, could I raise a very minor  
4 procedural point which I would like to have on the  
5 record?

6 JUDGE HOPKINS: Sure.

7 MR. LEARY: On September 17, the Rio Grande  
8 filed a motion for leave one week late to file six  
9 shipper statements, additional shipper statements. The  
10 motion has been greeted with a thundering silence all  
11 the way around, and I am just wondering if a motion  
12 might be granted in view of the lack of opposition  
13 thereto?

14 MR. STEPHENSON: We oppose it, Your Honor.  
15 (General laughter.)

16 JUDGE HOPKINS: You have received nothing from  
17 the Commission on it? Since they haven't, I grant you  
18 the motion.

19 MR. LEARY: Thank you, sir.

20 JUDGE HOPKINS: There's one in every crowd, as  
21 I said yesterday.

22 Would you call your next witness?

23 MR. LANE: Your Honor, I have not had the  
24 opportunity to appear before in this case.

25 My name is Ronald Lane, appearing for the



1 Applicants. We call Messrs. Frestel and Peifer at this  
2 time.

3 Whereupon,

4 JOHN F. FRESTEL, JR.

5 and

6 KENNETH R. PEIFER

7 were called as witnesses by counsel for Applicant and,  
8 having been duly sworn by the Administrative Law Judge,  
9 were examined and testified as follows:

10 DIRECT EXAMINATION

11 BY MR. LANE:

12 Q Would each of you please state your name,  
13 address and present occupation for the record?

14 A (WITNESS FRESTEL) My name is John Frestel. I  
15 am Vice President of Personnel and Labor Relations for  
16 the Atchison, Topeka & Santa Fe Railway, 80 East Jackson  
17 Boulevard, Chicago.

18 A (WITNESS PEIFER) My name is Kenneth Peifer.  
19 I am Assistant Vice President, Labor Relations, for the  
20 Southern Pacific Transportation Company, One Market  
21 Plaza, San Francisco.

22 Q Have you had an opportunity to prepare and  
23 submit a verified statement in connection with this  
24 case?

25 A (WITNESS FRESTEL) I have.

1 A (WITNESS PEIFFER) Yes.

2 Q And except for the errata which has already  
3 been submitted to the Commission, do you have any other  
4 changes that need to be made in that verified  
5 statement?

6 A (WITNESS FRESTEL) There is one change,  
7 counsel.

8 I refer your attention to page 7 of the  
9 verified statement.

10 Q Would you identify the correction?

11 A (WITNESS FRESTEL) In the second full  
12 paragraph on that page, the second line, and I'll read  
13 from the outset, "We estimate total relocation costs at  
14 approximately," it states, "\$42,863,000." That should  
15 be changed to "\$37,912,000," and continuing with that  
16 sentence, "which constitutes," instead of "53.4  
17 percent," it should read "51.6 percent," and this was an  
18 oversight, and those figures reflect the total on page 2  
19 after the errata was submitted.

20 For example, the total cost of relocation as  
21 appears on page 6 of the verified statement, Table 2, is  
22 \$37,912,000.

23 Q And with that correction, is your verified  
24 statement, as corrected in the errata, true and correct  
25 to the best of your knowledge?



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1 A (WITNESS FRESTEL) Yes, it is.

2 A (WITNESS PEIFER) Yes, it is.

3 MR. LANE: Your Honor, we tender the witnesses  
4 for cross examination.

5 JUDGE HOPKINS: Thank you.

6 Who is going to start?

7 MR. BIRNEY: I think we are going to start,  
8 Your Honor.

9 Just as a matter of clarification, Your Honor,  
10 with regard to the correction on page 6, Table 2, I did  
11 not get the correction.

12 WITNESS FRESTEL: Forgive me, Counsel, there  
13 was no correction on page 6 at this time. When the  
14 errata was submitted, there were some changes, and you  
15 should have a corrected copy in your possession. But at  
16 that time we neglected to make a change on page 7 as  
17 indicated which would make it consistent with the  
18 changes which appear at page 6, Table 2.

19 MR. BIRNEY: I understand. Thank you very  
20 much.

21 Your Honor, my name is Bill Birney. I am from  
22 the lawfirm of Highsaw & Mahoney, and that firm  
23 represents the Railway Labor Executives' Association in  
24 this proceeding. Also present today from the firm is  
25 Kimberley Madigan.



1           As a preliminary matter, Your Honor, I would  
2 like to inform the Court that we were advised yesterday  
3 of a change in schedule which advanced the cross  
4 examination of these witnesses until this afternoon.  
5 Because of that sudden change, we have asked the  
6 Applicant carriers if Ms. Madigan and I could split the  
7 cross examination of these gentlemen, and it is my  
8 understanding that they agreed to that procedure, if  
9 that is agreeable with the Court.

10           JUDGE HOPKINS: It is agreeable to me, too.

11           MR. BIRNEY: Thank you very much, Your Honor.

12           Your Honor, my cross examination of these  
13 witnesses will be directed principally to the nature and  
14 extent of the employee impact due to consolidation and  
15 merger, and that constitutes approximately the first  
16 five pages of the verified statements of Mr. Frestel and  
17 Mr. Peifer.

18           For the information of the witnesses, that  
19 examination will be based largely on your verified  
20 statement.

21                           CROSS EXAMINATION

22           BY MR. BIRNEY:

23           Q     Before I begin, I would like to ask you  
24 however if you both have copies of the statement.

25           A     (WITNESS PEIFER) Yes, we do.

1 A (WITNESS FRESTEL) Yes.

2 Q Do you have copies of both the original  
3 statement as submitted on March 15, 1984, as well as the  
4 corrected copies which were submitted on September 20,  
5 1984?

6 A (WITNESS PEIFER) I have only a corrected  
7 copy. I don't have the original.

8 Q You do not have the original?

9 A (WITNESS PEIFER) I do not.

10 A (WITNESS FRESTEL) I have a copy of the  
11 corrected copy with, I believe, one of the pages which  
12 was from the original, but I don't know if that was the  
13 only change.

14 MR. BIRNEY: Your Honor, I think we can  
15 proceed with the corrected copy. In the event it  
16 becomes necessary, we may need to supplement the  
17 materials that the witnesses have.

18 BY MR. BIRNEY: (Resuming)

19 Q In addition, gentlemen, I have also provided  
20 to counsel in this matter an exhibit which has been  
21 previously admitted into evidence which is entitled  
22 MKT-C-21. We have provided counsel with enough copies  
23 for you as well.

24 Have you gotten those copies?

25 A (WITNESS FRESTEL) Just now.



1 A (WITNESS PEIFFER) Just now.

2 Q Just now?

3 It will not be necessary for you to look at  
4 those right away. That part of my examination won't  
5 come until the end.

6 So if you could also enlighten me as to how  
7 you propose to proceed in this cross examination, I have  
8 never had the opportunity to examine two witnesses at  
9 the same time. Since my cross examination is going to  
10 be limited to the nature and extent of employee impact,  
11 is it possible to designate one of you two gentlemen as  
12 the first witness to respond and then the second witness  
13 respond only if it is necessary?

14 A (WITNESS FRESTEL) I think my preference is  
15 that either one of us answer a particular question as we  
16 think either is the more qualified.

17 JUDGE HOPKINS: They can look at each other  
18 and make the decision after you ask the questions, I'm  
19 sure. It's worked before.

20 Just go ahead and ask the question, and then  
21 one of them will take it.

22 WITNESS FRESTEL: Hopefully.

23 BY MR. BIRNEY: (Resuming)

24 Q Mr. Frestel, I note in your verified statement  
25 that you state you are the Acting Vice President for

1 Personnel and Labor Relations.

2 A (WITNESS FRESTEL) Yes.

3 Q This afternoon you testified that you were the  
4 Vice President.

5 Have you now been -- taken that position  
6 permanently?

7 A (WITNESS FRESTEL) Yes, as of May 1 of this  
8 year.

9 Q When was the final version of this verified  
10 statement completed prior to filing in May of 1984?

11 A (WITNESS FRESTEL) I would say shortly before  
12 it was dated.

13 Q Approximately how many times was the statement  
14 revised before it was finally submitted in March?

15 A (WITNESS FRESTEL) I don't know that it was  
16 revised seriatim. I think that as we went over it we  
17 made a number, a myriad of minor changes. So I don't  
18 think that there were a set number of revisions. That's  
19 my recollection.

20 Q When did you begin the task of preparing the  
21 statement?

22 A (WITNESS FRESTEL) I don't recall  
23 specifically, Counsel.

24 Q Was it more than a month before it was filed?

25 A (WITNESS FRESTEL) Probably.



1 A (WITNESS PEIFFER) Yes.

2 Q More than two months?

3 A (WITNESS FRESTEL) I just don't recall.

4 Q Was there more than one draft prepared by you  
5 before this final submission was filed with the  
6 Commission?

7 A (WITNESS FRESTEL) I think that's fair to say,  
8 yes.

9 Q Approximately how many drafts were prepared?

10 A (WITNESS FRESTEL) I'd say two or three.

11 A (WITNESS PEIFFER) I would agree with that.

12 Q To whom were those drafts submitted?

13 A (WITNESS FRESTEL) I think it's best to say  
14 that the verified statement was a cumulative effort on  
15 the part of Mr. Peifer and myself, consultation with  
16 members of our staff, consultation with our lawyers.

17 Q What prompted revisions, if any, to be made in  
18 those drafts?

19 A (WITNESS FRESTEL) Oh, advice, opinions,  
20 second thoughts. Many of the changes were style in  
21 nature.

22 Q Advice from whom?

23 A (WITNESS FRESTEL) We sought clarity --

24 Q Advice from whom?

25 A (WITNESS FRESTEL) Any one of the individuals

1 I mentioned. It was truly a collaborative effort.

2 Q Which would be an effort of your staff as well  
3 as your counsel?

4 A (WITNESS FRESTEL) Yes.

5 Q Was there anyone else who assisted you in the  
6 preparation of the statement?

7 A (WITNESS FRESTEL) I have covered a number of  
8 people.

9 Q Are you satisfied with the statement as it now  
10 starts with the corrections you have made as of  
11 September and the additional correction you made today?

12 A (WITNESS FRESTEL) Yes, I am.

13 A (WITNESS PEIFER) Yes.

14 Q Is it correct in each and every respect?

15 A (WITNESS FRESTEL) I believe so.

16 A (WITNESS PEIFER) As far as we know, it is.

17 Q Do you wish to make any further changes?

18 A (WITNESS PEIFER) Not at this time.

19 A (WITNESS FRESTEL) No, sir.

20 Q If you would, I would like you to turn first  
21 to page 2 of your verified statement.

22 At that page, in the first full paragraph, you  
23 state as follows: you ascertained the number of  
24 employees who will be affected by the consolidation.  
25 Each team relied on experience-based estimates of the



1 manpower required in each craft or classification for  
2 projected traffic levels.

3 Who provided you with the experience-based  
4 estimates to which you refer in that sentence?

5 A (WITNESS PEIFER) The numbers primarily came  
6 from two sources. They came from Mr. R. M. Champion,  
7 Jr., who provided us with the numbers on the staff  
8 department consolidations as well as some of the  
9 miscellaneous clerical numbers with respect to the  
10 operating department.

11 They also came to us through Mr. Neil Owen,  
12 from Booz, Allen, Hamilton who was working under the  
13 guidance of both Mr. Fitzgerald and Mr. Lacy in the  
14 operating department to develop the operating plan.

15 Q Did you see any of the data on which those  
16 estimates were based?

17 A (WITNESS PEIFER) We received information  
18 from -- we received the numbers directly from Mr. Owen  
19 as to the impact on operating craft employees by  
20 geographical locations. We were also given information  
21 from Mr. Champion as to the effect on employees for  
22 those areas which he covered in his verified statement.

23 Q Do you know how those estimates were reached?

24 A (WITNESS PEIFER) They were reached as  
25 described on page 2 by information that was given by

1 various teams, teams made up of individuals such as Mr.  
2 Masch and Mr. Lively, mechanical officers for the  
3 respective companies, Mr. Pottorff and Mr. Lynch,  
4 engineering officers for the respective companies,  
5 Messrs. Fitzgerald and Lacy for the operating  
6 department, and there were teams like that.

7 Q When were those teams created?

8 A (WITNESS PEIFER) Early on in the planning  
9 stage. I don't recall the specific dates.

10 Q By early on, do you mean in 1983?

11 A (WITNESS PEIFER) It would have been sometime  
12 late 1983.

13 Q So they had been in existence for some time  
14 before you prepared your report and the data had been  
15 submitted to you?

16 A (WITNESS PEIFER) When you said they were in  
17 existence, what do you mean?

18 Q I'm talking about the teams to which you  
19 refer?

20 A (WITNESS PEIFER) There were certain  
21 individuals assigned to the merger case, and they knew  
22 who they were, and they were in existence before we  
23 prepared the labor impact study, that's correct.

24 Q Do you know by whom those teams were  
25 selected?



1 A (WITNESS PEIFER) Specifically, no.

2 Q Did you have a hand in selecting members of  
3 those teams?

4 A (WITNESS PEIFER) We did not.

5 Q Did you previously know the members of the  
6 team before their selection?

7 A (WITNESS PEIFER) I think we certainly knew  
8 the people who worked for our respective companies. In  
9 my case, I knew several of the Santa Fe people.

10 A (WITNESS FRESTEL) And vice versa.

11 Q Did you give the members of the teams any  
12 instructions with regard to the estimates they were  
13 going to prepare?

14 A (WITNESS PEIFER) We did not.

15 Q Do you know what instructions, if any, they  
16 were given?

17 A (WITNESS PEIFER) We do not.

18 Q Is that correct, Mr. Frestel?

19 A (WITNESS FRESTEL) That's also correct.

20 Q Approximately how many teams were there, do  
21 you know?

22 A (WITNESS PEIFER) Offhand, I don't know the  
23 exact number. That's a question that probably is better  
24 directed to Mr. Champion because he was the recipient of  
25 most of the information, with the exception of that

1 which came directly to us from Mr. Owen.

2 Q What was the composition of these teams?

3 A (WITNESS PEIFER) Excuse me?

4 Q What was the composition of these teams, what  
5 kind of people, and what were their backgrounds who were  
6 selected to be a member of the team?

7 A (WITNESS PEIFER) I can't state specifically  
8 what their backgrounds were. The composition usually  
9 involved one Santa Fe person and one Southern Pacific  
10 person in the specific area involved, whether it was  
11 mechanical engineering or operating. We were designated  
12 representatives from each of the companies for those  
13 areas.

14 Q Then in each area that was to be investigated  
15 there were two members, one from each carrier?

16 A (WITNESS PEIFER) Generally that's true, but  
17 again you ought to ask Mr. Champion that question.

18 Q To the best of your knowledge, were there  
19 teams that existed of more than two people?

20 A (WITNESS PEIFER) To my knowledge, there was  
21 at least one that was involved in the operating plan.  
22 There were a number of individuals involved in the  
23 operating plan although insofar as our involvement with  
24 the operating people was concerned, the information came  
25 primarily from Mr. Owen.



1 Q Was there any method established for verifying  
2 the estimates you were given by the tears?

3 A (WITNESS PEIFER) Do you mean insofar as  
4 looking at the numbers?

5 Q Yes.

6 A (WITNESS PEIFER) No.

7 Q So the statement that you have submitted is  
8 prepared based on the estimates you received, and you  
9 have not done anything to verify the accuracy of those  
10 estimates?

11 A (WITNESS PEIFER) It is strictly a compilation  
12 of the numbers that were given to us from the two  
13 sources I have described.

14 Q Do you know whether or not those estimates  
15 were independently verified by anyone else?

16 A (WITNESS PEIFER) I do not.

17 Q Mr. Frestel?

18 A (WITNESS FRESTEL) I do not.

19 Q If the estimates that you received are  
20 incorrect, then in fact the statement you have submitted  
21 may well be incorrect also?

22 A (WITNESS PEIFER) If the numbers were  
23 incorrect, the statement is incorrect, that's correct.

24 Q Referring again to the first sentence on page  
25 2, you say that the experience-based estimates of

1 manpower required in each craft or classification were  
2 provided for projected traffic levels.

3 With regard to the projected traffic levels  
4 referred to in that sentence, can you tell us how those  
5 levels were arrived at?

6 A (WITNESS PEIFER) I can tell you to the best  
7 of my understanding that the traffic study that was done  
8 influenced to a certain extent the operating plan.  
9 Beyond that, I can't give you any specifics.

10 Q I'm not really sure that was responsive to my  
11 question.

12 What I meant to say was do you know how the  
13 projected levels were arrived at, and by whom, if you  
14 know?

15 A (WITNESS PEIFER) Specifically, no. I know  
16 there are a number of people involved in the traffic  
17 study. Who those people were, I can't name them all for  
18 you.

19 A (WITNESS FRESTEL) I do not know.

20 Q So again, as with the estimates you received  
21 from the teams who were -- which were prepared, or which  
22 were gathered to prepare the estimates of manpower, the  
23 information you received with regard to projected levels  
24 also came from individuals, and you are not even going  
25 to testify about how that information was obtained?



1           A       (WITNESS PEIFER) Again, I have already told  
2 you that our information came primarily from the two  
3 sources, the sources of Owen and the sources of  
4 Champion.

5           Q       And you don't know where they got the  
6 information?

7           A       (WITNESS FRESTEL) I think we indicate that  
8 they received information as a result of the traffic  
9 diversion studies. If you are asking if I have specific  
10 information who worked on it, I do not. I do know they  
11 incorporated the results of the traffic diversion  
12 studies with those of the operating plan.

13          Q       I understand, and all I'm trying to do is  
14 establish whether or not you independently verified the  
15 estimates and the projected levels that you received.

16                   As I understand your testimony, you did not do  
17 so.

18          A       (WITNESS PEIFER) You've asked the question  
19 once, and we have already answered it. We did not.

20          Q       I am clarifying my question for Mr. Frestel,  
21 and I believe in the clarification he has responded  
22 positively, that there was no independent verification,  
23 is that correct?

24          A       (WITNESS PEIFER) That's correct.

25          A       (WITNESS FRESTEL) There was no independent

1 verification.

2 Q The second sentence of that paragraph states  
3 that the impact on operating employees was determined  
4 primarily by the results of the operating plan, which is  
5 Exhibit 13 to the application, and traffic diversion  
6 studies, Exhibit 12 to the application, which  
7 accompanes the testimony in volume SFS-14. I believe  
8 you have already referred to that.

9 Have there been any further changes in those  
10 documents which would cause you to revise your manpower  
11 requirements in light of those changes, if any?

12 A (WITNESS FRETEL) Not to my knowledge.

13 Q Mr. Peifer.

14 A (WITNESS PEIFER) To my knowledge there were  
15 some minor adjustments made in the numbers of  
16 individuals at certain locations. There is at least one  
17 location that comes to my mind.

18 Q Which location is that?

19 A (WITNESS PEIFER) Tracy, California, where the  
20 labor impact exhibit had shown there would be a number  
21 of positions added at that point. I have not seen the  
22 errata that was filed by the operating department, so I  
23 don't know whether or not that errata includes the  
24 changes. I assume that it does, and if so, it would  
25 show that those jobs which were shown initially on cur



1 labor impact exhibit to be established at Tracy,  
2 California were in fact established at Fresno,  
3 California.

4 Q Would that result in the creation or abolition  
5 of any jobs?

6 A (WITNESS PEIFER) I think it was just a  
7 transference of numbers from one location to another  
8 location.

9 Q Would tha fall under the category of jobs  
10 transferred?

11 A (WITNESS PEIFER) No. It would fall under the  
12 category of jobs to be established.

13 A (WITNESS FRESTEL) If I may clarify, counsel,  
14 it is my understanding the errata did pick up that  
15 change specifically involving Tracy and Fresno.

16 Q But that change doesn't cause any change in  
17 the conclusions you have reached here.

18 A (WITNESS FRESTEL) No, because our conclusions  
19 incorprate the errata.

20 Q In the last paragraph of that sentence you  
21 state with respect to nonoperating and staff departments  
22 the total amount of work projected for the combined  
23 enterprise was compared to the number of existing  
24 employees of the respective railroads.

25 How did you arrive at the amount of work

1 projected for the combined system for reorganizing and  
2 staff departments?

3 A (WITNESS PEIFER) Those were done by the  
4 various teams who reported to Mr. Champion.

5 Q You don't know how that was arrived at?

6 A (WITNESS PEIFER) They were done individually  
7 by those teams, and Mr. Champion provided the  
8 information for us as to the number of positions to be  
9 affected.

10 Q Well, I understand the source of the  
11 information. My question to you is are you aware of the  
12 method that was used to arrive at the work projected for  
13 the combined system?

14 A (WITNESS PEIFER) In no case were we involved  
15 in the actual methodology with any of the teams or with  
16 Mr. Champion.

17 Q If you could turn to page 3 of the corrected  
18 version of your statement, as the first full paragraph  
19 on that page indicates, the table on that page  
20 constitutes a summary of the employee impact which  
21 summarizes studies set forth in the labor impact  
22 exhibit.

23 Now, I have gone through the summary of  
24 employment impact and drawn from that summary a number  
25 of figures which would serve as the basis of a



1 comparison.

2 Have you done that task as well?

3 Let me give you an example before you answer.

4 Are you able to tell me with regard, for instance, to  
5 agreement positions in the operating crafts which  
6 appears in the beginning of your summary as the total  
7 amount of jobs abolished at the end of the three-year  
8 period?

9 A (WITNESS PEIFER) We are aware of the fact  
10 that there are no operating craft positions, agreement  
11 positions, that are projected to be abolished.

12 Q With respect to jobs created, can you tell me  
13 the total number of jobs that would be created over the  
14 three year period?

15 A (WITNESS PEIFER) The jobs to be created  
16 should be the total of these three columns, 1, 2, and  
17 3.

18 Q Now, what I am trying to do is to explain to  
19 you that according to my calculations, that is a total  
20 of 1,029 jobs.

21 A (WITNESS PEIFER) That's correct.

22 Q Have you arrived at similar calculations?

23 A (WITNESS PEIFER) Have we gone through and  
24 verified the 1,029?

25 Q Yes.

1           A       (WITNESS PEIFER) I don't remember that we  
2 matched up specifically, but I think generally we did.

3           A       (WITNESS PRESTEL) I don't know if I  
4 understand you.

5                   Are you asking if we did the mathematical  
6 calculation of adding the jobs created for operating  
7 crafts for years one, two and three?

8           Q       Yes, that's what I'm asking you because during  
9 the course of this examination it may be necessary for  
10 me to refer to those numbers.

11                   I can tell you that I have made those  
12 calculations and will refer to them. I am asking you  
13 whether or not you have any similar calculations which  
14 would, for instance, total the columns of year one, year  
15 two, and year three for agreement positions, operating  
16 crafts, and jobs created. You do not have that  
17 information readily available at this moment as I  
18 understand it.

19           A       (WITNESS PRESTEL) If you mean whether or not  
20 we have done the mathematical computation of adding  
21 columns in our Table 1, we have not.

22           Q       You have not.

23                   Very well.

24                   I have done it. If you will accept for the  
25 purposes of this examination the numbers I give you,



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subject to verification by your counsel, I think we can proceed with the next line of cross examination.

A (WITNESS FRESTEL) That would be fine.

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1           Q     With regard to these figures and not the  
2 calculations that I have just referred to, have you  
3 yourself performed an independent verification of the  
4 figures set forth in this summary?

5           A     (WITNESS FRESTEL): No.

6           A     (WITNESS PEIFER): No.

7           Q     Has anyone performed such a verification?

8           A     (WITNESS FRESTEL): Again, I'm going to ask  
9 you to clarify that, counsel. Do you mean a  
10 verification of the numbers which were supplied to us  
11 regarding positions as to whether we independently  
12 verified that they were accurate, or do you mean  
13 mathematical verification of the numbers you see in the  
14 summary here?

15          Q     No, no. You were exactly correct in the first  
16 portion of your question. Have you verified the numbers  
17 that appear in the summary?

18          A     (WITNESS FRESTEL): I submit to you your  
19 question is ambiguous. We did not independently verify  
20 the numbers of positions which were supplied to us by  
21 these various teams and which we refer to.

22                     If you mean whether or not we have verified  
23 these numbers, whether these numbers accurately reflect  
24 the numbers which are reflected by the labor impact  
25 exhibit, the answer is yes.



1 Q I understand your answer.

2 A (WITNESS FRESTEL): Okay.

3 Q Now, when you submitted your statement on  
4 March 15, 1984, that statement included an identical  
5 summary. But when you submitted your revised statement  
6 on September 20, 1984, there were numerous changes in  
7 these figures.

8 And if I may give you an example, under the  
9 topic "agreement positions, operating crafts, jobs  
10 created in year one," you state that will be 628 jobs  
11 created. That is derived from the corrected statement  
12 submitted to the ICC on September 20.

13 In the statement submitted to the ICC on March  
14 15th, you stated that there would be 702 jobs created.  
15 According to my calculations, that represents a  
16 difference of some 74 jobs.

17 Are you able to explain to me why it was  
18 necessary to revise your summary?

19 A (WITNESS PEIFFER): I don't specifically  
20 remember why it was.

21 A (WITNESS FRESTEL): I don't either.

22 Q That's a fairly substantial change, isn't it?

23 A (WITNESS FRESTEL): I think the numbers speak  
24 for themselves.

25 Q Well, 10 percent of the affected jobs created,

1 wouldn't you agree that that's fairly substantial?

2 A (WITNESS FRESTEL): I agree it's 10 percent.

3 Q The same is true of the category "jobs  
4 transferred" under operating crafts. In your March 15th  
5 statement, you submitted that there would be 544 jobs  
6 transferred, whereas you stated there would be 470 jobs  
7 transferred, again a difference of 74 positions.

8 Are you able to explain why there is a  
9 difference?

10 A (WITNESS FRESTEL): Let me try. If I  
11 understand it correctly, the original summary of data,  
12 when it was prepared, they looked at each location for  
13 each craft, for each of the three years following the  
14 merger.

15 In doing so, they considered, for example, a  
16 yardman as in a different craft than a trainman, and  
17 then it considered a locomotive, a yard locomotive  
18 engineer, as in a different craft than a road locomotive  
19 engineer, and the same with the fireman.

20 The same is true with respect to a yardman  
21 versus an engine foreman. These are all titles of  
22 employees in the operating crafts on each of our  
23 railroads.

24 When they saw that a position -- let me give  
25 you an example -- of yardman was abolished, and they



1 looked to where that individual could go, they  
2 transferred them or counted that as a transfer to the  
3 road.

4 What they did not understand or mistake was  
5 that on both of our railroads, those employees have what  
6 we refer to as dual seniority. So in the ordinary  
7 exercise of seniority, wholly independent and  
8 preexisting to the merger, such individuals were free to  
9 exercise seniority and go from yard to road and vice  
10 versa.

11 So, in reality, the number of jobs transferred  
12 would be the number indicated, less than we originally  
13 indicated.

14 Consequently, the relocation costs would be  
15 similarly reduced.

16 Q That explains the reduction in the amount of  
17 jobs transferred.

18 Do you have any recollection at all as to why  
19 there was a change in the amount of jobs to be created?

20 A (WITNESS FRESTEL): I don't. Maybe Mr. Deifer  
21 does. I do recall that here and there, there were just  
22 mathematical mistakes or what have you, but I don't  
23 think they added up to that number, and I just don't  
24 recall.

25 Q I can pursue this with each and every one of

1 the figures because there are differences, regardless of  
2 whether you call them substantial or not, in all but  
3 just a handful of these figures.

4 If I understand your testimony, you're not  
5 going to be able to explain why in the six months  
6 between March 1984 and September 1984 these exchanges  
7 occurred?

8 A (WITNESS FRESTEL): I guess I'm going to just  
9 disagree with you some. As I look at the original  
10 version in the errata, for example, non-agreement  
11 positions, I see there was a change in jobs abolished  
12 from 286 to 285.

13 I'm sure you wouldn't call that substantial.

14 And jobs created and job transferred have  
15 remained, respectively, 245 and 237. So there were not  
16 changes throughout the exhibit.

17 My understanding was most of the changes  
18 referred to jobs transferred. Again, more specifically,  
19 most of those would refer to changes in the operating  
20 crafts. There were some changes with clerical positions  
21 for similar reasons.

22 Q Well, with regard to the agreement positions  
23 in particular, I think you will note that there are  
24 changes in each and every category, for each and every  
25 year, for all except the jobs abolished in years one,



1 two, and three, and operating crafts and under  
2 non-operating crafts, jobs created in year three.

3 So there were changes in that six-month period  
4 in each and every figure submitted to the ICC except  
5 those three.

6 A (WITNESS FRESTEL): I'm sorry, I can't agree  
7 with you, counsel. As I just visually scan the two  
8 tables, I see a number of entries which are identical.  
9 I'll be specific. Jobs created in year 3 for  
10 non-operating crafts. As I read it, it's 63 in each of  
11 the tables.

12 And I've already alluded to the fact that in  
13 the non-agreement positions, jobs created and  
14 transferred, year one, are respectively 245 and 237 in  
15 each table, and I'll run out those entries. In years  
16 two and three, the numbers are identical, as I read  
17 them.

18 Now, maybe you're looking at something else.

19 Q I may be because, as I said, they are  
20 identical with regard to jobs abolished in operating  
21 crafts for all three years. The only other identity I  
22 see is, as I stated, jobs created in non-operating  
23 crafts for year 3.

24 Now, can you point again to me to where you  
25 find them identical?

1           A       (WITNESS FRESTEL): I'd be glad to. Let's  
2 lock at non-agreement positions, which is the last  
3 category.

4           Q       Now, I prefaced my question to you by pointing  
5 to the agreement positions. I asked you in the  
6 agreement positions, I see there have been changes in  
7 each and every category except for four.

8                   Whether you call the changes substantial or  
9 not, I pointed out that there have been changes in each  
10 and every one.

11                   My question to you is, if you can answer the  
12 question as to why these changes were made, I'll pursue  
13 this line of cross-examination. If you can't, I'll drop  
14 it.

15           A       (WITNESS FRESTEL): I have answered the  
16 question insofar as the changes regarding jobs  
17 transferred, and that applies to whether they are  
18 agreement positions or non-agreement, operating or  
19 non-operating crafts.

20                   You will notice there are a number of changes  
21 where there is a change in one number. For example,  
22 jobs abolished, non-operating crafts, year 3, went from  
23 378 to 379. As I indicated, there were a number of  
24 situations where at different locations, there were  
25 changes of one or two as a result of mathematical



1 errors, or whatever.

2 Q As a result of math? Do you know whether or  
3 not that change is mathematical there?

4 A (WITNESS FRESTEL): I do not.

5 Q So I take it, the fact remains that you are  
6 not able to explain the reasons for the changes except  
7 in the one isolated instance?

8 A (WITNESS FRESTEL): It is not one isolated  
9 instance. I've explained the changes with respect to  
10 jobs transferred, and that applies to any of the three  
11 categories: agreement operating, agreement  
12 non-operating, or non-agreement.

13 Q Are you able to explain the differences in the  
14 jobs created or jobs abolished categories for either the  
15 operating crafts or non-operating crafts for the premium  
16 positions?

17 A (WITNESS FRESTEL): Other than my general  
18 statement that there were a number of mathematical  
19 errors which made very slight changes in a number of  
20 entries.

21 Q Well, let me invite your attention, if you  
22 would, to non-operating crafts under jobs created. In  
23 year one, in your initial statement, in March of 1984,  
24 you state there's 357 jobs created. That is reduced in  
25 your September 20, 1984 statement to 315, which is,

1 according to my calculations, a difference of 42  
2 positions.

3 Is that a mathematical or inconsequential  
4 change?

5 A (WITNESS FRESTEL): I don't know the answer to  
6 that.

7 Q With regard to the last sentence at the bottom  
8 of page 3, moving onto page 4, you state that the  
9 results from the operating plan projection of increased  
10 traffic -- this results from the operating plan  
11 projection of increased traffic, which more than offsets  
12 reduction in crews resulting from planned consolidations  
13 in yard and local service.

14 Can you identify that increased traffic on  
15 which these estimates are based?

16 A (WITNESS FRESTEL): I cannot.

17 A (WITNESS PEIFER): No, I can't.

18 Q Where did that information come from? Mr.  
19 Champion?

20 A (WITNESS PEIFER): No, it would have come from  
21 Mr. Owen.

22 Q Also on page 3, just below the table, in the  
23 second sentence, you state among agreement employees,  
24 operating craft employment is expected to increase  
25 overall.



1                   Why is there such an increase in the number of  
2 employees in the operating crafts when there is such a  
3 decrease in the number of employees in non-operating  
4 crafts?

5           A       (WITNESS FRESTEL): I think that's because of  
6 the expected increase in traffic levels following the  
7 merger.

8           Q       Does any of the increase which you project in  
9 operating crafts arise out of temporary positions that  
10 you perceive, for instance, in construction that might  
11 not be considered permanent?

12          A       (WITNESS FRESTEL): You're referring to  
13 operating crafts?

14          Q       Yes, I am.

15          A       (WITNESS FRESTEL): No, I do not.

16          A       (WITNESS PEIFER): Let me understand the  
17 question. Are you talking about work train service or  
18 things of that nature that would be temporary as opposed  
19 to permanent positions, operating positions?

20          Q       Anything that might be identified as part of  
21 the operating crafts which, although would result in the  
22 creation of a position, would be considered temporary as  
23 opposed to permanent.

24          A       (WITNESS PEIFER): None of the numbers that  
25 were furnished by Mr. Owen were couched in terms of

1 temporary positions. We assumed that they were all  
2 going to be permanent positions, as permanent as any  
3 position is in the railroad industry.

4 Q I'm sorry?

5 A (WITNESS PEIFER): As permanent as any  
6 position is in the railroad industry.

7 Q I understood and gave as an example the  
8 possibility that a merger might result in some  
9 construction, and I wanted to verify that in fact these  
10 figures don't include positions that might be necessary  
11 to complete that construction if the employees were  
12 actually employed directly by the railroad as opposed to  
13 by an independent contractor.

14 And as I understand what you've told me, it is  
15 to the best of your knowledge, there is no temporary  
16 positions included in these figures.

17 A (WITNESS PEIFER): There are no temporary  
18 positions included within the labor impact exhibit.

19 Q Thank you.

20 On page 4, if you would turn the page to the  
21 first full sentence, you state: "In non-operating  
22 crafts employment will decrease over the three-year  
23 period."

24 Do you expect any further decrease at the end  
25 of the three-year period?



1           A       (WITNESS PEIFER): We didn't do any studies  
2 beyond the three years, so there's no way we can answer  
3 that question.

4           Q       When you say "we," do you mean you and Mr.  
5 Frestel, or the railroad?

6           A       (WITNESS PEIFER): I'm talking specifically  
7 about Mr. Frestel and myself and the people in our  
8 respective departments.

9           Q       Do you have any opinion as to whether or not  
10 there is going to be a decrease beyond the three-year  
11 period?

12          A       (WITNESS PEIFER): I do not.

13          A       (WITNESS FRESTEL): Nor do I.

14          Q       Why is that?

15          A       (WITNESS FRESTEL): I just don't. I haven't  
16 thought about it.

17          Q       You haven't given any thought to the fact that  
18 beyond this three-year period, there could be additional  
19 reductions in the labor force that could result in  
20 increased labor costs, increased labor protection costs,  
21 but perhaps increase the labor costs of the work force?

22          A       (WITNESS FRESTEL): We were asked to compare  
23 this and compile the data which we received for the  
24 three-year period and ascribe costs to it, and that's  
25 what we did.

1                   We did not receive data beyond the three-year  
2 period.

3           Q       And your inability to give opinion as to  
4 whether there would be a further decrease is based on  
5 the fact that you don't have data?

6           A       (WITNESS FRESTEL): It's further complicated  
7 by the fact that the farther you get in time, the more  
8 difficult it is to make forecasts.

9           Q       Well, I understand that. But as we went over  
10 this summary, it seems to me that you've testified in  
11 some specificity with regard to what the reduction is  
12 going to be.

13                   Are you telling us there's been no thought  
14 given to whether or not there is going to be further  
15 decreases after the end of this three-year period?

16           A       (WITNESS FRESTEL): I think what we're telling  
17 you is we reported the numbers as given to us by the two  
18 sources. Beyond that, we haven't done anything else for  
19 the purposes of the labor impact exhibit.

20                   Anybody could give you an opinion about  
21 something, and I don't think the opinion would be very  
22 valid, for the reasons that Mr. Frestel described and  
23 other reasons, any number of reasons.

24           Q       And you're not capable of giving us any  
25 opinion?



1           A       (WITNESS PEIFER): I think anybody could give  
2 you an opinion. If you want an opinion, we can give you  
3 an opinion. I don't think the validity of the opinion  
4 is going to be --

5           Q       To give you an example, I can't give you an  
6 opinion because I'm not qualified. That's why you're  
7 here, the Vice President in Charge of Labor Relations on  
8 these carriers.

9                   I'm asking you in your position as Vice  
10 President of the carriers in Charge of Labor Relations,  
11 whether or not, based on what you now know, you can give  
12 us an opinion as to whether there is going to be further  
13 decreases beyond this three-year period.

14           A       (WITNESS PEIFER): Well, first let me correct  
15 that. That's not why we're here. Why we're here is to  
16 stand cross-examination on the labor impact exhibit  
17 which portrays the effect on positions over a specific  
18 three-year period. That's why we're here.

19           Q       Well, it's been my understanding in sitting  
20 through this cross-examination, that the Court has  
21 allowed cross-examination beyond the scope of the very  
22 limited verified statements.

23                   JUDGE HOPKINS: Well, can you give an opinion  
24 for what it's worth?

25                   WITNESS PEIFER: It would be very difficult.

1 I could give two opinions. One would be that there  
2 would be more employees required. The other would be  
3 there would be less employees required. It's going to  
4 depend on the level of business at that given time.

5 BY MR. BIRNEY: (Resuming)

6 Q This whole merger is based on the fact that  
7 you project an increase in traffic levels, as I  
8 understand it. And I assume that you expect this  
9 increase in traffic levels to continue beyond this  
10 three-year period.

11 Is it safe to assume that that increased  
12 traffic level is going to continue beyond this  
13 three-year period?

14 MR. NELSON: I would like to interpose an  
15 objection. I think counsel has mischaracterized what  
16 the merger is all about. I also think that this line of  
17 questioning is becoming very argumentative, and the  
18 Commission's regulations call for a three-year planning  
19 period for the labor impact exhibit. It doesn't call  
20 for opinions beyond that.

21 And I think the gentlemen have explained why  
22 it is difficult to go any further.

23 JUDGE HOPKINS: Well, it appears these men  
24 have stated that they have no opinion past the  
25 three-year period, Mr. Birney.



1 BY MR. BIRNEY: (Resuming)

2 Q Moving on to the next sentence, you state:  
3 "However, we examined the number of employees expected  
4 to be furloughed each year, and in every instance the  
5 number is smaller than the annual attrition for that  
6 craft on constituent railroads."

7 How much smaller?

8 A (WITNESS PEIFER): What we did was examine  
9 attrition, the number of people who actually left  
10 service, based on EOC reporting, which broke down the  
11 reports on employees into nine separate categories.

12 We did that for years 1980, 1981, and 1982 and  
13 we came up with percentages of employees who actually  
14 left service that varied anywhere from over 8 percent to  
15 below 19 percent, depending on the particular craft  
16 involved.

17 Q So with regard to each craft or class  
18 involved, the amount of attrition varies anywhere from 8  
19 to 19 percent?

20 A (WITNESS PEIFER): If you look at the full  
21 spectrum of all the classifications involved, that's  
22 correct.

23 Q Based on that, are you able to give us any  
24 indication of how much smaller the annual -- or how much  
25 smaller the furloughed employees would be in those

1 categories?

2 A (WITNESS PEIFER): I guess we'd have to do it  
3 specifically by class, but we did observe one thing, and  
4 that was pretty much what is stated here; that in every  
5 case, based on what we had seen, the number of people  
6 who would become surplus was significantly less than what  
7 the true attrition had been for any given craft.

8 Q What do you mean by "significantly"? More  
9 than five?

10 A (WITNESS PEIFER): Let's say 2 percent  
11 compared to 17 percent; 3 percent compared to 16  
12 percent. I think that's a significant difference.

13 Q Have you further examined those figures in  
14 light of your recent revisions to ensure that the annual  
15 attrition in each one of those craft and classes is  
16 going to be less than anticipated furloughs?

17 A (WITNESS PEIFER): Specifically, no; but it  
18 would take an awful lot to have an impact on the  
19 percentages involved. You'd have to decrease a hell of  
20 a lot of employees because you got into that  
21 percentage.

22 There would have to be a significant change in  
23 the number of employees that you added or abolished  
24 that would have an impact on the comparison of  
25 percentage of people that are actually going to be



1 surplus by this transaction as compared to the people  
2 who actually leave service.

3 Did you understand that?

4 Q I think I do.

5 A (WITNESS PEIFER): Okay.

6 Q Moving on, you state that: "We expect all  
7 furloughed and displaced employees to be reabsorbed into  
8 the combined work force within the first year after they  
9 are first affected.

10 Do you expect your recent revisions to affect  
11 these figures at all?

12 A (WITNESS PEIFER): No, I don't.

13 Q What do you mean by "reabsorb"?

14 A (WITNESS PEIFER): It means they will be able  
15 to come back to work for the company. They will be  
16 recalled to service.

17 Q How many employees do you expect to be  
18 furloughed?

19  
20  
21  
22  
23  
24  
25

1 A (WITNESS PEIFER) I don't have the exact  
2 number.

3 A (WITNESS FRESTEL) Nor do I.

4 Q Do you know where that figure can be derived?

5 A (WITNESS PEIFER) You would have to go back  
6 through the work papers, all of the work papers  
7 involved.

8 Q So you can't tell me today categorically how  
9 many employees are going to be furloughed, displaced, or  
10 transferred by craft or class?

11 A (WITNESS PEIFER) We can tell you what the  
12 assumptions were for protection based on people being  
13 dismissed, people opting for separation allowances,  
14 people subsequently being recalled, people electing not  
15 to take any protection.

16 Q The reason I am asking the question obviously  
17 is, you come to the conclusion here that all these  
18 people who have been furloughed and displaced are going  
19 to be reabsorbed, and my question to you is, can you  
20 provide me with the figures showing how many of these  
21 people will in fact be furloughed, displaced, or  
22 transferred by craft or class, and as I understand your  
23 answer, you are telling me those figures can be obtained  
24 from the work papers, and I will be quite candid with  
25 you, I am not familiar with the work papers.



1           Is there any way, just to make my question  
2 clearer, that I can obtain that information if it is not  
3 available right now?

4           A       (WITNESS PEIFER) It would be very difficult  
5 for you. As I understand it, the work papers have been  
6 available in the depository, both the work papers of Mr.  
7 Frestel and myself, as well as other people's.

8           Q       I am not disputing that. I am just telling  
9 you for the purposes of the questioning right now that I  
10 am not familiar with them, and I don't have them here.

11                   And my question to you was simply, could you  
12 assist me in telling me where I can find them? And I  
13 think your answer is that I can find them in a  
14 depository, and they are available.

15           A       (WITNESS PEIFER) That is correct.

16           Q       And the information I sought in my question  
17 can be obtained from those papers?

18           A       (WITNESS PEIFER) I think it could, yes.

19           A       (WITNESS FRESTEL) I believe so, yes.

20           Q       If you could turn to Page Number 5, the first  
21 full paragraph, you state, "Substantial reductions in  
22 employment are anticipated along non-agreement  
23 employees."

24                   Do you know what the extent of those  
25 reductions are?

1           A       (WITNESS FRESTEL) I believe they are set  
2 forth in the table.

3           Q       Now, going back to my calculations, based on  
4 the revised statement you provided in September of 1984,  
5 there would be a reduction in non-agreement positions of  
6 215. As I calculate it, the number of jobs abolished  
7 over that three-year period would be a total of 470.  
8 The number of jobs created would be 275. The difference  
9 I come to is a figure of 215, which of course doesn't  
10 take into account the number of jobs transferred.

11          A       (WITNESS FRESTEL) That's correct.

12          Q       Assuming that's correct, would you agree that  
13 there was also a substantial number of non-operating  
14 craft positions abolished in this merger?

15          A       (WITNESS FRESTEL) What do you mean by  
16 substantial? In the context, I think I have to disagree  
17 with you.

18          Q       Well, I suppose that if you used the word  
19 "substantial" to mean 215, and the figures from the  
20 summary at Page 3 indicate that 573 non-operating crafts  
21 are going to be abolished as you use that term, that  
22 would be a substantial number.

23          A       (WITNESS FRESTEL) Counsel, numbers are  
24 relative. Two hundred and fifteen may be a larger and  
25 in fact is a larger percentage of the approximately



1 eighty-two or three hundred non-agreement employees than  
2 573 is of the approximately 35,000 non-operating  
3 employees.

4 Q So those 573 --

5 A (WITNESS FRESTEL) My rough calculation is,  
6 that is about 1.5 percent spread over a three-year  
7 period.

8 Q So in your view, the positions that have been  
9 abolished for non-operating crafts are therefore  
10 insubstantial?

11 A (WITNESS FRESTEL) No, I said it is not a  
12 substantial number taken in context.

13 Q They are not substantial?

14 A (WITNESS FRESTEL) It is not a substantial  
15 number taken in context of the number of non-operating  
16 employees and the fact that it is spread over a  
17 three-year period.

18 Q Well, both are spread over a three-year  
19 period. Is that not correct?

20 A (WITNESS FRESTEL) Yes.

21 Q So that factor doesn't have anything to do  
22 with the comparison.

23 A (WITNESS FRESTEL) It has to do when you  
24 compare the two numbers, 573 and 35,000.

25 Q But it doesn't have anything to do with the

1 comparison of 215 and 537.

2 A (WITNESS FRESTEL) They would both be spread  
3 over a three-year period. That is correct. Which  
4 would, of course, ameliorate the impact.

5 Q With regard to each of the two?

6 A (WITNESS FRESTEL) Yes, exactly.

7 Q So it doesn't serve as any distinguishing  
8 feature between the two, does it?

9 A (WITNESS FRESTEL) Counsel, my point was  
10 directed to the fact that if you are considering the  
11 base from which we are dealing, respective bases of  
12 non-operating and non-agreement, and the numbers of  
13 employees that would be involved in this context, and  
14 the fact that it is spread over a three-year period, I  
15 do not regard the numbers as substantial. They are more  
16 substantial with respect to the non-agreement employees  
17 because it is a smaller base.

18 Q Moving down the page to the third full  
19 paragraph, the first sentence, you state that combined  
20 rail systems will handle more traffic but will do so  
21 with somewhat smaller and much more efficiency -- excuse  
22 me, and much more efficiently deployed work force.

23 A (WITNESS FRESTEL) Yes.

24 Q I may be misreading the summary. That is  
25 entirely possible. But it seems to me that based on the



1 figures you have projected, and I am perfectly willing  
2 to accept the correction if I am wrong, that there would  
3 in fact be, under the figures you provided, a somewhat  
4 larger work force.

5 According to my analysis of the figures, and  
6 as I state, I am perfectly willing to accept contrary  
7 information if you are able to provide it, according to  
8 your figures on Page 3, the number of operating crafts  
9 and agreement position is going to increase by 1,029  
10 jobs, whereas the number of non-operating craft  
11 positions is going to decrease by 573.

12 Even if you add in the number of non-agreement  
13 positions, as I see it, it appears to me that the work  
14 force that you project based on this merger is not going  
15 to be somewhat smaller, but is going to be somewhat  
16 larger. But as I say, I may be reading those figures  
17 incorrectly.

18 A (WITNESS FRESTEL) That could be, counsel.  
19 That's the way I look at it. It could be. Ken?

20 A (WITNESS PEIFER) I agree.

21 Q So then the statement that I just read from  
22 Page 5 is incorrect?

23 A (WITNESS FRESTEL) Substitute the word  
24 "larger" for "smaller," and it would be correct. At  
25 least that is how I read it. There may be another

1 explanation.

2 Q Turning now to Page 6, which will be my last  
3 question from your verified statement, you state there  
4 will be a good deal of transferring employees and some  
5 temporary furloughs, and I will stop there, because that  
6 is what I am interested in asking you about. Can you  
7 tell us how many employees will be transferred?

8 A (WITNESS FRESTEL) I think you can arrive at  
9 that total by computation from Table 1.

10 Q That would be derived from Table 1 on Page 3?

11 A (WITNESS FRESTEL) Yes, sir.

12 Q What do you mean by temporary furloughs?

13 A (WITNESS FRESTEL) We mean temporary because  
14 of the fact that we do not expect them to last, I think  
15 our assumption was any longer than one year, due to the  
16 fact that the attrition rates for all of the crafts and  
17 non-agreement employees were greater than the numbers we  
18 expected of positions that would be furloughed.

19 Q So by temporary you mean no longer than one  
20 year?

21 A (WITNESS FRESTEL) Yes, sir.

22 Q I have no further questions with regard to  
23 that portion of the verified statement that I was  
24 examining on, which deals with the labor impact  
25 exhibit. Do you wish to add anything to your testimony



1 that relates to the questions that I have asked?

2 A (WITNESS FRESTEL) I don't.

3 A (WITNESS PEIFER) No.

4 Q I would like you to turn if you would, then,  
5 to the exhibit that I think you have been given by  
6 counsel, which is identified as MKT-C-21.

7 Your Honor, I apologize. I am not sure you  
8 have a copy. Do you have a copy?

9 JUDGE HOPKINS: I haven't got it with me. It  
10 is upstairs.

11 BY MR. BIRNEY: (Resuming)

12 Q I realize that your counsel gave you copies of  
13 this document just before you took the stand, and so  
14 before you delve down into it, let me just ask you some  
15 preliminary questions. I might save you some time. Are  
16 you familiar with the exhibit, without referring to any  
17 of the contents? It is identified as an exhibit  
18 underneath the date on the first page. Have you -- Are  
19 you familiar with the exhibit at all as it is  
20 constituted and stapled together in this form?

21 A (WITNESS PEIFER) This document?

22 Q Yes.

23 A (WITNESS PEIFER) I am not.

24 A (WITNESS FRESTEL) I am not either.

25 Q What I am principally interested in asking you

1 about is the last document which appears among these  
2 documents which begins on Page 000525.

3 If you will look to the bottom righthand  
4 corner of each of those pages, you will see they are  
5 numbered, and the document I am interested in asking you  
6 about is, at the bottom righthand corner, begins with  
7 000525, and at the top it says Santa Fe-Southern Pacific  
8 Merger Considerations, Operating Department.

9 Do you find that?

10 A (WITNESS PEIFER) Yes.

11 A (WITNESS FRESTEL) Yes, I do.

12 Q If you would please turn to the very last page  
13 of that five-page document, which is Page 5 of the  
14 document, there are two paragraphs there I would like to  
15 invite your attention to. They are entitled Labor  
16 Agreements and Recommendation.

17 Have you had an opportunity at any time in the  
18 past to read those two paragraphs?

19 A (WITNESS FRESTEL) I have not had an  
20 opportunity to read them. I have been advised that  
21 earlier in the testimony, and I believe it was witnesses  
22 J.R. Fitzgerald and W. Lacy, the respective operating  
23 vice presidents, that this matter came up. That is the  
24 extent of my knowledge.

25 Q Very well.



1                   With the Court's permission, I would like you  
2 to read those two paragraphs now, if that is agreeable  
3 with the Court.

4                   JUDGE HOPKINS: Individually?

5                   MR. BIRNEY: If they could just have the  
6 opportunity to read the two paragraphs.

7                   JUDGE HOPKINS: Sure.

8                   (Pause.)

9                   JUDGE HOPKINS: Have you read them?

10                  BY MR. BIRNEY: (Resuming)

11                  Q     Have you had a chance to read the paragraphs?

12                  A     (WITNESS FREESTEL) Yes.

13                  A     (WITNESS PEIFER) Yes.

14                  Q     The first question is a very broad one,  
15 addressed to each of you, if you would. What does this  
16 have to do with this merger?

17                  A     (WITNESS PEIFER) I am not even sure when this  
18 was written and who wrote it. I read these totally in  
19 abstract.

20                  Q     Well, given that it has been written, I am  
21 asking you, after having read it, what, if anything, do  
22 these two paragraphs have to do with this merger?

23                  MR. LANE: Your Honor, I believe the question  
24 calls for some speculation on the part of these  
25 witnesses, the role of an unknown author at this point

1 of a document they have been shown --

2 JUDGE HOPKINS: Go ahead. I am sorry.

3 MR. LANE: That is okay.

4 JUDGE HOPKINS: Are you first asking them  
5 whether they know anything about this document? I think  
6 you ought to first ask them that.

7 BY MR. BIRNEY: (Resuming)

8 Q Very well. Have either of you -- I thought I  
9 had asked them that, Your Honor.

10 JUDGE HOPKINS: I mean, about these two  
11 paragraphs in particular.

12 BY MR. BIRNEY: (Resuming)

13 Q Have you ever seen these two paragraphs  
14 before?

15 A (WITNESS FRESTEL) I have not.

16 A (WITNESS PEIFER) I don't recall ever having  
17 seen them.

18 Q Have you ever heard the substance of these  
19 paragraphs ever discussed?

20 A (WITNESS FRESTEL) Earlier I mentioned that it  
21 was my understanding that questions were asked of the  
22 witnesses I mentioned, and I believe it was with  
23 reference to this document, and it had to do with  
24 restrictive agreements and possible -- call it a buyout  
25 or separation allowances or something like that of



1 necessary employees. That was the description which I  
2 received of the nature of the question.

3 Q I would suggest to you that that seems to  
4 indicate that this merger could be used as a means of  
5 the carriers, and I haven't attributed the authorship to  
6 anyone. All I am saying to you is that the paragraph  
7 seems to suggest that the merger could be used as a  
8 means of eliminating what in the view of someone these  
9 agreements are unduly restrictive. Is that the meaning  
10 you derive from these two paragraphs?

11 A (WITNESS FRESTEL) I don't know what the  
12 meaning is, but I suggest to you that the author  
13 obviously does not have experience in labor relations in  
14 this industry.

15 Q So this does not represent the position of the  
16 carriers in this application?

17 A (WITNESS FRESTEL) No, sir, it does not.

18 Q In fact, it would be contrary to the intent  
19 that you proceeded with this application. Is that  
20 correct?

21 MR. LANE: Your Honor, I think the question  
22 needs to be refined a little more closely. That is an  
23 awfully broad question.

24 WITNESS FRESTEL: What do you mean by intent?

25 JUDGE HOPKINS: Why don't you be specific?

1 MR. BIRNEY: I don't know how I can be more  
2 specific, Your Honor. It just seems to me that I am  
3 asking the two representatives of these carriers who are  
4 in charge of labor relations whether or not in their  
5 view such a position would violate the intent of the  
6 carrier in seeking the merger.

7 JUDGE HOPKINS: What particular position? Why  
8 don't you be specific as to what particular item you are  
9 talking about?

10 MR. BIRNEY: Well, as Mr. Frestel has  
11 testified, I believe, Your Honor, that it indicates that  
12 there should be a buyout of unneeded personnel, and that  
13 is the recommendation.

14 JUDGE HOPKINS: Are you asking whether they  
15 agree with this position, or whether this is the  
16 supposed merged carrier's position, or what? What is  
17 your question?

18 MR. BIRNEY: My question was whether or not  
19 this position would be contrary to the intent of the  
20 carriers in this application.

21 WITNESS FRETEL: I don't know that it is  
22 contrary. I can read this as being independent of. Let  
23 me be specific. The last sentence of the first  
24 paragraph, with reference to labor agreements, makes the  
25 statement, "SF has no crew consist agreement." It is my



1 understanding, and I am sure Mr. Peifer can testify in  
2 detail, that they now have such a crew consist  
3 agreement. Obviously, it has nothing to do with the  
4 merger. Santa Fe has had one for over three years now,  
5 as most other major carriers.

6 So I guess what I am saying is, I see nothing  
7 wrong with the statement that we should seek to change  
8 labor agreements which we regard as restrictive or  
9 unduly so, nor do I see anything wrong with an attempt  
10 to buyout or separate employees who are regarded as  
11 redundant.

12 This has been widespread in our industry for  
13 the last three years, in fact, earlier than that of  
14 merged carriers, but independent of any merger, because  
15 of the economic conditions we have all experienced.

16 What I would submit to you is, none of these  
17 statements have been --

18 BY MR. BIRNEY: (Resuming)

19 Q If I may interrupt you for a second, you have  
20 come to, I think, probably the heart of my question, and  
21 I would like to go forward with it.

22 A (WITNESS FRESTEL) Go right ahead.

23 Q You have just referred essentially to the  
24 first sentence of the recommendation, but I would like  
25 to point out to you that it says, "Suspend the

1 appropriate funds required at the onset of the merger to  
2 buy out unneeded personnel and get rid of overly  
3 restricted labor agreements."

4 My question to you is, as I understand your  
5 answer, such an independent tack should not be part of  
6 this merger.

7 A (WITNESS FRESTEL) My earlier statement was  
8 that whoever wrote this, and I really don't know who  
9 did, does not have experience in labor relations,  
10 because when I first read that I took that to mean that  
11 perhaps the individual thought that there would be  
12 merger-related costs such as employee protection and  
13 relocation, and that is quite frankly how I read that  
14 first sentence of Paragraph 2.

15 But I guess what I was trying to say before  
16 was, it is my understanding that there is nothing in the  
17 operating plan, and there is nothing in the employee  
18 impact statement or the numbers generated by the  
19 operating plan which contemplates anything which is set  
20 forth in any of these paragraphs.

21 Q That would be consistent with the testimony of  
22 Bruce McPhee, who testified as the treasurer of the SPT  
23 and Southern that he knew of no such plan to reduce  
24 labor costs in the future by decreasing labor outside of  
25 the merger, and what your answer just leads me to



1 confirm is that you know of no such plan, either. Is  
2 that correct?

3 A (WITNESS FEESTEL) I have to be careful  
4 there. Let me back up. I know of no such plan  
5 coincident or related to the merger to reduce employment  
6 levels. From time to time in the past several years, I  
7 have considered various avenues of reducing employment  
8 on the Santa Fe Railroad. I have chosen not to pursue  
9 them. I am talking about buyout or early retirement and  
10 that sort of thing.

11 So, when you say that there have been no such  
12 plans, we have considered some. There are none  
13 presently in existence, but let me perhaps ease your  
14 mind. To my knowledge, and I would know if there was  
15 such a plan, there is no plan coincident or related to  
16 the merger and independent of it to reduce employment.

17 MR. BIRNEY: Thank you, Your Honor. No  
18 further questions.

19 JUDGE HOPKINS: Thank you.

20 Ms. Madigan?

21 MS. MADIGAN: Thank you, Your Honor.

22 CROSS EXAMINATION

23 BY MS. MADIGAN:

24 Q Good afternoon. As Mr. Birney indicated to  
25 you earlier, my name is Beverly Madigan.

1           Gentlemen, are you familiar with the labor  
2 impact exhibit which details by location and by job  
3 classification where the employees will be relocated or  
4 where jobs will be abolished?

5           A     (WITNESS PEIFER) We are, but it doesn't say  
6 where they will be relocated to. It gives the detail on  
7 positions that will be established or abolished or  
8 transferred.

9           Q     Is this labor impact exhibit representative of  
10 what will actually occur following the merger, or is it  
11 merely a projection?

12          A     (WITNESS FRESTEL) It is our best estimate, as  
13 I understand it. I don't know what you mean by, is it  
14 an estimate or is it an estimate. It is an estimate.

15          Q     Well, is this actually what you are going to  
16 implement?

17          A     (WITNESS FRESTEL) I can't say that.

18          Q     You can't say that?

19          A     (WITNESS FRESTEL) No.

20          Q     When will you be able to say what you will  
21 actually --

22          A     (WITNESS FRESTEL) My point is this, counsel.  
23 Between now and the time of the merger, we may be into,  
24 God forbid, another recession the likes of which we are  
25 not quite out of, so it is very difficult to tell what



1 we will be doing then. It could be totally different  
2 economic conditions.

3 Q What factors or what circumstances would  
4 account for the changes?

5 A (WITNESS FRESTEL) I just named economic  
6 conditions.

7 Q Well, what else?

8 A (WITNESS FRESTEL) Technological changes. Our  
9 industry is constantly in a state of flux in terms of  
10 employment.

11 Q So you are not committed to put this into  
12 effect when you consummate the merger?

13 A (WITNESS FRESTEL) This is the best estimate  
14 of the employee impact as a result of the operating  
15 plan.

16 Q Do either one of you gentlemen know how many  
17 employees attrite per year on your individual carriers?

18 A (WITNESS PEIFER) You mean the actual<sup>50</sup> number?

19 Q The actual number, or your best estimate.

20 A (WITNESS PEIFER) We have done it on a  
21 percentage basis, and I have already explained that. We  
22 did it for the years 1980, '81, and '82, so we could  
23 answer that question on a percentage basis, if we had an  
24 opportunity to look at our work papers.

25 Q But you have no idea how that would relate to

1 numbers of employees?

2 A (WITNESS PEIFER) Number of employees that  
3 have actually left service? No, but it is something  
4 that could be calculated.

5 A (WITNESS FRESTEL) We do have those numbers  
6 available. They are available in our work study. I  
7 raised that point because we extrapolated from them the  
8 various attrition levels for the different crafts. So  
9 those totals are available.

10 Q If I went to the document depository and  
11 reviewed your work papers, would I be able to ascertain  
12 that figure?

13 A (WITNESS FRESTEL) Yes, I believe so.

14 Q And your documents are included in the  
15 document depository?

16 A (WITNESS PEIFER) That is our understanding.

17 Q Could you turn to Page 4 of your verified  
18 statement, please?

19 In the first full paragraph, approximately  
20 one-third of the way down, the sentence begins, "If they  
21 are unable to secure such a position, these employees  
22 would be then expected to exercise the seniority to  
23 obtain the highest rated position available requiring  
24 relocation for which relocation costs would be paid by  
25 the merged railroad."



1 Can you tell us what you mean by highest rated  
2 position?

3 A (WITNESS FRESTEL) The position that pays the  
4 most.

5 Q In comparison to that employee?

6 A (WITNESS FRESTEL) Yes, positions are paid  
7 rates, those that are subject to cooperative agreements  
8 as opposed to salaries or wages, if you will.

9 Q Now, in the sentence, are you referring to  
10 transfer to anywhere on the system?

11 A (WITNESS PEIFER) Well, you really have to go  
12 back and read the paragraph. The first part of the  
13 paragraph says that they would be obligated to take a  
14 position producing the highest rate of pay at that  
15 location, or if necessary, move, in which case they  
16 would be paid relocation expenses.

17 Q What if these individuals hold point  
18 seniority? Would they still be required to relocate  
19 anywhere on the merged system?

20 A (WITNESS PEIFER) We have assumed that if  
21 there is a position available for an employee in the  
22 merged company, that the employee would be obligated to  
23 go to that position, and if required to move, he would  
24 be entitled to relocation expenses.

25 Q That is what your study and that is what your

1 figures are predicated on, that understanding of your  
2 obligation?

3 A (WITNESS PEIFER) That assumption, that was  
4 the assumption that was made.

5 A (WITNESS FRESTEL) That statement is directly  
6 made in the sentence following the one which you are  
7 referring to, counsel.

8 Q I was going to ask you what the sentence  
9 following means. I can read it for the record. Why  
10 don't I do that? The following sentence is, "Those  
11 unable to obtain such positions will be offered  
12 transfers to other jobs elsewhere in the combined system  
13 for which relocation costs also will be paid."

14 What exactly does that mean?

15 A (WITNESS FRESTEL) It means an employee who is  
16 unable to find a position in the exercise of seniority  
17 as described in the first sentence without relocation or  
18 is unable to find a position described in the second  
19 sentence, which is through exercise of seniority with  
20 relocation, will be expected to go to a position  
21 anywhere on the combined system and receiving, of  
22 course, relocation costs.

23 Q Now, is this a position that could be outside  
24 his or her craft or class?

25 A (WITNESS FRESTEL) We have not made that



1 assumption in any of our data, of our figures. That  
2 could be, and there is arbitration support for that. We  
3 have not made that assumption in our labor exhibit.

4 Q Now, you understand, don't you, that your  
5 interpretation of the employee's obligations to relocate  
6 are different from rail labor's, don't you?

7 A (WITNESS FRESTEL) I wouldn't know.

8 A (WITNESS PEIFER) We don't understand that.

9 A (WITNESS FRESTEL) It might be a fair  
10 assumption, but if you are telling me they are  
11 different, I will take your word for it.

12 Q Would you agree, though, that this kind of  
13 disagreement would be subject to arbitration under the  
14 New York dock conditions?

15 A (WITNESS FRESTEL) Which agreement are you  
16 referring to?

17 Q Let me rephrase the question then. Would you  
18 agree that the dispute concerning the employee's  
19 obligations to relocate under the New York dock  
20 conditions would be subject to arbitration under the New  
21 York dock conditions?

22 A (WITNESS PEIFER) Not necessarily. No.

23 Q What reasons do you have for not agreeing with  
24 that?

25 A (WITNESS PEIFER) I guess you would have to