

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (SUB-NO. 1)
MAJOR RAIL CONSOLIDATION PROCEDURES

COMMENTS OF THE
U.S. DEPARTMENT OF AGRICULTURE

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U.S. Department of Agriculture
Washington, D.C. 20250

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U.S. DEPARTMENT OF AGRICULTURE
WASHINGTON, D.C. 20250
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Post of
Public Hearing

AUTHORITY AND INTEREST

The Secretary of Agriculture is charged with the responsibility under the Agricultural Adjustment Act of 1938 and the Agricultural Marketing Act of 1946 to represent the interests of agricultural producers and shippers in improving transportation services and facilities by, among other things, initiating and participating in Board proceedings involving rates, charges, tariffs, practices, and services.

In 1999, American farmers produced more than 16 billion bushels of grain and oilseeds. Agricultural shippers pay more than \$3.5 billion annually in freight costs to U.S. railroads to transport agricultural products. Nearly half of all grain produced in the U.S. moves to market by rail. Nearly 80 percent of all interstate wheat shipments from Plains States are by rail, and rail accounts for 90 percent of all export traffic from the region. Rail is the dominant mode of transportation for interstate shipment of wheat, accounting for approximately 80 percent of such shipments in the Upper Great Plains States. Also, rail transportation accounts for more than 60 percent of the intrastate shipments in the Lower Plains States. These figures demonstrate that an adequate and efficient rail infrastructure is essential for the marketing of U.S. agricultural products.

This is particularly true in large areas of the Midwest, where inland waterways are not nearby and distances to market are great. Nine of the ten top wheat-producing states are more than 150 miles from barge transportation on the Mississippi River which typically provides the strongest intermodal competition to railroads on the long distance movement of grain for export.

Among agricultural shippers in the United States, wheat shippers in the Upper and Lower Great Plains have no cost-effective transportation alternatives to railroads. The wheat produced in these areas moves long distances to domestic markets for processing and consumption or to coastal ports for export. Shippers in these regions have little direct access to inland waterway transportation and the distances involved make truck transportation uneconomical.

Grain farmers are dispersed over the entire country. Unlike many other industries, grain producers are unable to move their operations to other locations – indeed, their operations are tied to the land and often to a particular climate. Rail and barge are the only two cost-efficient transportation modes for hauling bulk commodities long distances. To compete effectively in increasingly competitive world markets, U.S. farmers must have access to efficient, reliable and cost-competitive transportation. The rates agricultural shippers pay for rail transportation must be at a level which promote, not penalize, American competitiveness in world agricultural markets.

The present U.S. freight transportation system has evolved to move large quantities of undifferentiated bulk grains and oilseeds over long distances. The efficiency and cost effectiveness of this system rely upon the ability to standardize grains and oilseeds into just a few grades or classes. However, the emergence of genetically modified crops – which offer the potential to produce specialty grains and oilseeds having high-value traits designed for specific end uses – is resulting in a demand to preserve their identity from the farm to the end user. Recent railroad mergers have resulted in railroads having the ability to dictate the terms of rail

service – even though those service terms do not meet the present and future needs of many agricultural shippers. Class I railroads, for example, encourage unit-train movements of grain, even though the emergence of genetically modified crops will require identity-preserved handling in much smaller quantities. Another example of Class I railroads dictation of service terms involves their obligation as common carriers. Despite the retention of the Common Carrier Obligation in the Interstate Commerce Commission Termination Act of 1995 (ICCTA), many shippers have lost reliable and timely carload service while others have been required to meet railroad-determined volume requirements to receive rail service. Other changes have required substantial investments by agricultural shippers, even though railroads are able to change the requirements again shortly after those investments have been made.

BACKGROUND

Subsequent to the public hearings on Public Views on Major Rail Consolidations (Ex Parte 582), the Surface Transportation Board (Board) concluded that the rail community was not in a position to undertake further major railroad mergers and that the Board's current rules were not adequate for addressing the broad concerns associated with merger proposals that would likely lead to just two North American transcontinental railroads. Therefore, the Board imposed a 15-month moratorium on Class I railroad mergers and, in an Advance Notice of Proposed Rulemaking, sought public comment on modifications to regulations governing major rail consolidations. The U. S. Department of Agriculture (USDA) supports the Board's decision to impose a rail merger moratorium to consider more fully any changes in the regulations governing major rail mergers that may be needed to protect the public interest.

Concerns that caused the Board to initiate this proceeding include: The possibility that further major mergers would curtail competition, the possibility of major service disruptions which could spread throughout the entire rail network, the possibility that rail safety would be degraded, and the existence of transnational trade and operational issues arising due to the merger of Canadian and U.S. railroads.

The Board's merger regulations should advance its mandate – which is to approve mergers only to the extent they are consistent with the public interest and promote a safe and sound rail system that runs smoothly and efficiently to provide the service needed by rail customers. The Board adopted the current regulations governing major rail consolidations in 1982 and they reflect the circumstances of that time: Financial distress of railroads, deteriorating railroad infrastructure, excess railroad capacity, deteriorating service levels faced by rail customers, and the recognition that pervasive railroad regulation unduly limits the ability of railroad management to adjust to changing circumstances. The present merger regulations encourage railroad mergers as a means to rationalize excess rail capacity, so long as competition, access to essential service, and other public interest goals are not compromised.

In a proceeding which involves the merger or control of at least two Class I railroads, the Board is currently required to consider: (1) The effect of the proposed transaction on the adequacy of transportation to the public; (2) the effect on the public interest of including, or failing to include, other rail carriers in the area involved in the proposed transaction; (3) the total fixed charges that result from the proposed transaction; (4) the interest of rail carrier employees

affected by the proposed transaction; and (5) whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region or in the national rail system.¹

Under current regulations, the Board is required to approve and authorize a transaction when it finds that the transaction is consistent with the public interest. In approving a transaction, the Board also may impose conditions governing the transaction, including the divestiture of parallel tracks or requiring the granting of trackage rights and access to other facilities. Any trackage rights and related conditions imposed to alleviate anti-competitive effects of the transaction must provide for operating terms and compensation levels to ensure that such effects are alleviated.²

The Board is also required to regulate the railroad industry in a manner that is consistent with the overall rail transportation policy established by Congress.³ Among the fifteen policy goals which the Board must consider are the need: To minimize Federal regulatory control over the rail transportation system; to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues; to ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes to meet the needs of the public and the national defense; to foster sound economic

¹ U.S.C. § 11324(b).

² U.S.C. § 11324(c).

³ As enumerated in 49 U.S.C. 10101.

conditions in transportation and ensure effective competition and coordination between rail carriers and other modes; and to prohibit predatory pricing and practices to avoid undue concentrations of market power and to prohibit unlawful discrimination.

Since many of these rail transportation policy goals conflict with each other – particularly those seeking adequacy of railroad revenues and those protecting the interest of shippers by ensuring effective competition – the Board is required to seek a reasonable balance. Due to the past financial and infrastructure problems of the rail industry, the Board, and the Interstate Commerce Commission before it, has traditionally placed a greater emphasis upon those rail transportation policy goals relating to the financial health of the railroad industry rather than on those policy goals protecting shippers. Under the circumstances of the late 1970s through the early 1990s, the ICC's choice to emphasize railroad industry profitability was a reasonable choice.

However, conditions in the railroad industry have changed greatly since 1980. Instead of needing to rationalize excess capacity to attain profitability, railroads today are constrained in many cases by insufficient capacity. Instead of improving profitability by increasing efficiency, the task for railroads now is to improve profitability by enhancing the service provided to their customers. Instead of customer service deteriorating because of the inability of railroads to adequately maintain their physical infrastructure, many agricultural shippers complain that service has deteriorated due to the lack of adequate inter-railroad (railroad-to-railroad) competition and service disruptions resulting from railroad mergers. Instead of many Class I

railroads facing bankruptcy, Class I railroads today are financially viable and able to attract enough capital to pay large market premiums for the acquisition of other railroad firms and to make large infrastructure investments. Instead of effective inter-railroad competition (as well as competition from competing transportation modes) protecting shippers from the market power of Class I railroads, many shippers who rely on rail transportation have been left without effective inter-railroad competition due to recent Class I railroad mergers. The increased geographic reach of the remaining Class I railroads also has limited the effectiveness of product and geographic competition in constraining railroad prices.

Since future major rail mergers will almost certainly be end-to-end rather than parallel in nature, additional efficiencies obtained through the elimination of excess capacity or through operating efficiencies will tend to be limited. Thus, the public benefits associated with further major railroad mergers will be increasingly more difficult to achieve. However, the potential costs of these mergers upon shippers, communities, and other railroads – as well as the probability of those costs occurring – will become increasingly large, particularly to rural communities.

The effects of additional truck traffic upon highway maintenance costs due to inadequate rail service is increased due to the fact that the roads in many rural agricultural production regions were not designed for heavy truck traffic. The damage a loaded semi-truck does to a major rural collector highway is approximately 13.5 times the damage the same truck causes to a rural interstate. For a minor rural collector highway, the damage ratio increases to 21 times that

done to a rural interstate.⁴ Since rural regions typically have lower population densities, they are less able to pay for increased highway maintenance costs or increased road capacities required by increased truck traffic.

The substantial service disruptions associated with many of the recent railroad consolidations suggest that the integration of two large railroad firms is a particularly complex task. These service disruptions may also suggest that returns due to the size of the rail network operated by a single firm may be decreasing in nature – at least in the integration phase of the merger if not in the fully implemented merger. It is also possible that Class I railroads are becoming too large to manage efficiently.

USDA believes the Board has made a wise decision to consider modifying its regulations governing major railroad consolidations. Since any modifications to these regulations may result in major consequences to shippers, rural communities, and the railroad industry, any changes should be made only after careful consideration of the comments made by all the participants in this rulemaking. USDA appreciates this opportunity to propose changes to the regulations governing major rail consolidations.⁵

⁴ Denver Tolliver, presentation at the *Agricultural Transportation Summit*, Kansas City, Missouri, July 27-28, 1998. His calculations were based on data contained in the *Highway Cost Allocation Study*, Federal Highway Administration, 1997.

⁵ Major railroad consolidations are defined as a control or merger involving two or more Class I railroads. USDA's comments in this rulemaking are meant to apply only to the regulations governing major transactions.

In these comments, USDA addresses those issues most related to its mandate and expertise, i.e.: downstream effects; safeguarding rail service; promoting and enhancing competition; short line and regional railroads issues; merger-related public interest benefits; and cross-border issues.

DOWNSTREAM EFFECTS

USDA supports the Board in its decision to review its "one case at a time" rule. Future major railroad mergers may be larger than previously attempted, may result in greater railroad industry concentration, and could have much greater consequences for both the railroad industry and shippers. Since the railroad industry is a network industry, the Board should develop regulations for major railroad mergers which place more importance upon the effects the merger would have upon the entire railroad transportation system rather than upon the merged entity itself. Although firms in the railroad industry compete with each other, they also rely upon each other for cooperation and access to the rail network.

The Burlington Northern-Santa Fe merger was soon followed by the Union Pacific-Southern Pacific merger and the division of Conrail between CSX Transportation and Norfolk Southern. Even prior to this last round of mergers, railroads responded to mergers involving competing railroads. Since the railroad industry has shown a tendency toward responsive mergers, further major rail mergers may lead to only two Class I railroads serving the North American continent. A failure of one of those two railroads would then result in a single railroad having a monopoly over large regions of the United States, while other regions would suffer the

interruption or loss of rail service. As the U.S. Department of Transportation (DOT) suggests, every major rail consolidation should be examined for both long-term and short-term consequences on the rail industry itself and on the rail industry's role in the national transportation systems of the 21st century.

USDA proposes that the Board incorporate possible downstream and crossover effects of all future major railroad mergers upon the railroad industry, other railroad firms, other transportation modes, shippers, and communities into its revised merger guidelines. These regulations should place more importance upon the effects the merger would have upon the entire transportation system rather than upon the merged entity itself.

SAFEGUARDING RAIL SERVICE

As major railroad consolidations have increased in both size and complexity, the potential for widespread service problems has increased substantially, the costs to shippers and other railroads due to the service problems engendered have increased markedly, and the service problems that are incurred have lasted longer. Due to the huge costs borne by shippers and other firms in the railroad network in the event of railroad service disruptions, USDA believes the bar should be raised for all future major railroad consolidations and mergers. Rather than shippers being required to disprove the benefits of a proposed merger, the railroad firms proposing consolidation should be required to prove the public benefits of the consolidation and that those benefits cannot be obtained by means short of merger.

USDA suggests that the Board institute a rebuttable presumption against future major railroad mergers unless the merging railroads come up with a plan that mitigates any adverse consequences of the merger upon shippers and other railroad firms, prove the existence of merger-related benefits, and demonstrate that those benefits cannot be achieved by other means short of merger.

To minimize merger-related service disruptions, some have suggested that merging railroads be required to submit more detailed service integration or implementation plans to the Board. Although protections need to be built into future mergers to prevent service disruptions, USDA suspects that increasing the present requirements of the implementation plan may not be particularly useful. Norfolk Southern Railroad and CSX Transportation presented the Board with detailed plans for their acquisition of Conrail – applying lessons learned by Union Pacific in its acquisition of Southern Pacific – and still continue to have substantial merger-related service disruptions.

USDA believes the market place (merging railroads) would allocate more efficiently the cost-effective level of resources used in implementation planning than more rigid government regulations would – if railroads were required to reimburse shippers and other railroads for losses incurred by shippers and other railroads due to merger-related service disruptions. This would require consolidating railroads not only to identify and quantify those losses, but also to identify an economical means for shippers and other railroads to obtain reimbursement.

USDA suggests that the Board require that railroads involved in major railroad consolidations indemnify shippers and other railroads (during the merger implementation period) for costs incurred due to merger-related service interruptions and require binding arbitration of all claims which the consolidated railroad disputes.

The consolidation of the railroad industry has resulted in the abandonment of rail lines. This, combined with increased railroad carloadings and tonnage since 1980, has resulted in the rail industry operating at or near capacity on many of its main lines. Since many secondary routes have been abandoned, railroads have much less ability to adjust to periodic operational difficulties and spikes in demand. This results in a fragile rail system where disruptions in operations can quickly spread beyond the area causing the problem. In addition, many rail yards are operating at or beyond capacity and are badly in need of modernization. Newly merged railroads have had to make significant investments to increase capacity in key corridors and rail yards, as well as temporary investments in equipment and personnel.

USDA suggests that the Board continue to consider the ability of the merged firm to make the necessary infrastructure improvements before approving any major rail consolidation.

PROMOTING AND ENHANCING COMPETITION

Since the passage of the Staggers Rail Act of 1980, the concentration of market power held by Class I railroads has increased markedly – probably far beyond what the authors of the Staggers Rail Act anticipated. Large regions of the United States now are served by only one

Class I railroad and most other regions are served by only two Class I railroads. Further major rail mergers could result in there being only two transcontinental North American railroads.

When four railroads compete, collusion (implicit or explicit) requires six two-party agreements; when three railroads compete, collusion requires only three two-party agreements; and when only two railroads compete, collusion requires only one two-party agreement.

Although the United States currently has a Class I railroad duopoly in the East and a Class I railroad duopoly in the West, consolidation into only two transcontinental railroads will result in shippers losing the option to choose the connecting carrier. The Board should not ignore the potential of the two remaining railroads interacting with just a "wink and a nod" to "manage" the markets. Also, because of prohibitive entry barriers, the contestability of rail transportation markets – which is key to providing the competition necessary for the success of railroad deregulation – is extremely limited.

Due to increased concentration in the Class I rail sector, as well as the greatly improved financial condition of the railroad industry, the Board should rethink the criteria by which major rail consolidations are judged so that the public interest will be protected and enhanced. The Board, in formulating new regulations governing major rail consolidations, should place much more weight on achieving competition. Rather than just preserving competition, the Board should use enhancement of competition as a deciding factor.

To USDA, effective competition "to meet the needs of the public" must include effective inter-railroad competition – the kind that minimizes the number of captive shippers and the need for regulatory control over rates and services. Effective competition promotes reasonable rates and encourages honest and efficient management of railroads. Competition is also important because it is the force which drives process and product innovation. Unfortunately for agricultural shippers, effective inter-railroad competition has been allowed to disappear in the Plains States, the very regions in which intermodal competition is not effective. As a result, agricultural shippers in Montana and North Dakota pay the highest rail rates in the United States, even though they also receive the worst rail service.

Efficiency benefits, in contrast to benefits which shippers derive from effective competition, are speculative. Based upon the results of recent mergers, even stockholders may never realize the promised efficiency benefits of a merger. Also, market power possessed by railroads can prevent efficiency benefits from being passed through to shippers in the form of lower prices. Conversely, should the merger result in a loss of efficiency, captive shippers will bear the increased costs. As USDA has already suggested, the Board should institute a rebuttable presumption against future major railroad mergers.

Thus, USDA strongly urges that the Board, before approving any future major railroad consolidations, require the railroads involved to offer specific proposals to enhance competition and to mitigate any adverse competitive consequences of the consolidation upon shippers. In

addition, the Board should use its broad conditioning powers aggressively to impose any other conditions necessary to preserve competition.

Due to the geographic configuration of current Class I railroads, and the low probability of the Board approving any parallel merger that would create a near total rail monopoly over half of the United States, future Class I railroad mergers will likely be end-to-end mergers. Even though many economists consider end-to-end mergers to be relatively free of anti-competitive impacts, they still allow the vertical foreclosure of markets through the denial of competitive access by the elimination or cancellation of joint-line rates, through routes, reciprocal switching agreements, as well as the closing of gateways. The possibility of vertical foreclosure, as well as the impacts of that foreclosure, may increase as the number of Class I railroads decreases to only two.

Thus, USDA suggests that the Board, in approving further major railroad mergers, require the merging railroads to keep all existing rail gateways open. Furthermore, USDA suggests that the Board require the merging railroads to open those gateways previously closed, should shippers so request, and to remedy any reductions in route or service options before approving any merger.

SHORT LINE AND REGIONAL RAILROADS ISSUES

By the end of 1998, short line and regional railroads operated 49,985 route miles, which is more than 29 percent of the U.S. rail network, and accounted for nearly 9 percent of all

railroad freight revenues in the U.S.⁶ In many agricultural states, the importance of these smaller railroads is even greater – by the end of 1998, they operated 58 percent of the rail network in Wisconsin, 52 percent in South Dakota, 49 percent in Michigan, 43 percent in Iowa, and 42 percent in Kansas. In addition, short line and regional railroads in the U.S. are also estimated to participate in the movement of 33 percent of the total carloads, 45 percent of the lumber carloads, 34 percent of the farm product carloads, 23 percent of the food product carloads, and 19 percent of the chemical carloads.⁷

The viability of smaller railroads is vital to the grain gathering process. Since increased transportation costs are absorbed by the agricultural producer, the loss of these smaller railroads impacts directly the net income of agricultural producers. Rail and barge are the only cost-efficient transportation modes for hauling bulky products long distances. Since agricultural producers must absorb any increase in transportation costs, the preservation of rail transportation becomes more important as the distance to water transportation increases. Preservation of cost-competitive rural rail service is also important since it affects the ability of U.S. agricultural producers to compete in world markets.

Thus, USDA strongly urges the Board to carefully analyze the impacts of future major railroad consolidations upon short line and regional railroads since significant quantities of

⁶ *Railroad Facts, 1999 Edition*, Association of American Railroads, Washington, D.C.

⁷ *The Importance of Short Line and Regional Railroads to Agricultural and Rural America*, United States Department of Agriculture, forthcoming publication.

grain and food products originate or terminate on these smaller railroads and because of the damages that diversion to truck transportation causes to the rural road infrastructure.

MERGER-RELATED PUBLIC INTEREST BENEFITS

Because service disruptions and increased rail tariffs have followed recent railroad mergers, many shippers suspect that these mergers benefit only the railroads at the expense of shippers. In reality, it appears that some of these mergers may have been as disruptive to the railroads involved, at least during the implementation stage and a substantial time thereafter, as they have been for shippers. Thus, it appears that both shippers and shareholders of merging railroads have lost in many of the recent mergers.

Large railroad mergers have become very complex undertakings because they now involve the coordination of traffic across thousands of origin-destination pairs, integration of complex information systems, and often major shifts in traffic patterns. Thus, many of the more recent mergers have required as much as three years before the railroads and shippers involved began to benefit from the merger. It is only in the last year or two that the Burlington Northern Santa Fe has made major strides beyond pre-merger overall customer service levels, even though the merger occurred in 1995. It was the second half of 1999 before Union Pacific, which absorbed Southern Pacific in 1996, began to attain pre-merger service levels and profitability – and this only after severe merger related losses. Moreover, the division of Conrail between Norfolk Southern Railroad and CSX Transportation in 1997 is still plagued with service disruptions and the profitability of both railroads has plummeted. The stock prices of both

Norfolk Southern and CSX Transportation also have plummeted – in fact the recent market capitalization value of these firms is now less than what they paid for Conrail.

Since the railroads have an "incentive" to sell the proposed merger, they often tend to use the most optimistic estimates of the benefits derived by the transaction and minimize those costs borne by other railroads, communities, and shippers. In selling the proposed mergers to shippers, railroads promise lower rates and faster service due to single-line service. However, since railroads set their tariffs according to the value-of-service rather than according to the cost of the service, the only shippers that ever benefit from lower prices are those that are now able to convert to rail from other transportation modes.

Thus, USDA recommends that the Board examine more closely merger applicants' estimates of the synergies and other public interest benefits when balancing the benefits of proposed major railroad mergers against societal costs.

CROSS-BORDER ISSUES

The Board should adopt guidelines which consider the effects of different commercial, regulatory and trade environments on the international beneficiaries of any proposed transnational railroad merger. For example, because a merger has been proposed which would integrate a U.S. and a Canadian railroad, differences in the U.S. and Canadian grain merchandising and transportation environments become directly relevant to U.S. agricultural producers who compete with Canadian producers in international markets. Even though the

Canadian government is considering significant changes to its regulations governing the grain distribution system, including rates and railcar allocation, the Board should carefully consider that national advantages may be conferred by any transnational railroad merger.

Although the U.S. grain merchandising system is relatively free of government involvement, a hallmark of the Canadian grain merchandising system is the centralized, government-sponsored state trading enterprise (the Canadian Wheat Board). The Canadian rail regulatory regime is also dramatically different than in the United States, especially as it affects export wheat movements. Canadian export wheat rates are much less than U.S. rail rates for export grain movements over comparable distances, because the Canadian rail rates are capped at a certain percentage above cost. U.S. shippers are charged commercial rates that are set at what the market will bear. Therefore, U.S. grain cannot be shipped at those much lower Canadian rail rates.

Overall, while the U.S. grain merchandising and transportation systems are relatively open to Canadian grain, U.S. grain companies do not have the same access to Canada. Moreover, U.S. grain sellers believe that this gives Canadian grain producers an advantage over U.S. grain producers, even in the United States. Consequently, when considering the approval of proposed transnational railroad mergers, USDA requests that the Board carefully review the differences in the commercial, regulatory and trade environments which exist between countries and incorporate conditions so that shippers in both countries are assured of equal access to rail transportation.

Because future North American rail mergers will likely involve the combination of U.S. and Canadian firms, USDA urges the Board to consider the effects that different commercial and regulatory regimes between the two countries can have upon cross-border trade and the potential international beneficiaries of a proposed transnational rail merger. Thus, the Board should condition any transnational railroad merger so that shippers in both countries are assured of equal or the same access to rail transportation.

Since a transnational railroad merger could result in a newly formed railroad being controlled by Canadian interests, USDA is concerned that railcar supply between the two countries could be unfairly administered to the disadvantage U.S. producers and shippers. This is particularly true since railcar allocation in Canada is controlled by the Canadian Wheat Board rather than by the railroad. Also, USDA is concerned that the profits earned on U.S. rail lines could be invested to improve Canadian rail lines rather than improving U.S. rail lines.

Therefore, USDA urges the Board, when considering major transnational rail mergers or combinations, to analyze the effect of a foreign government's jurisdiction on the rail operations of the resulting railroad and the influence of state trading enterprises [the Canadian Wheat Board], particularly on the distribution of railcar capacity among U.S. and Canadian agricultural shippers which could have impacts in world markets. The Board needs to condition transnational mergers to ensure equal and fair treatment for shippers in both countries.

Conclusion

USDA believes that the current regulations governing major railroad consolidations are inadequate to protect agricultural producers, shippers, rural communities, and the public interest should any of the Class I railroads consolidate further. To preserve inter-railroad competition and the adequacy of rail transportation to the public, as required by the Board's mandate,⁸ the Board should revise those regulations to reflect changes in the railroad industry that have occurred since 1982. In addition, the current regulations do not provide adequately for the possible merger of U.S. and Canadian railroads. Therefore, current regulations need to be amended to reflect cross-border trade and service availability issues. For these reasons, USDA supports the Board in their decision to review its regulations governing major rail consolidations.

Recent major rail consolidations have resulted in significant service disruptions which have created particular hardships on agricultural producers, shippers, and communities. These service disruptions suggest that the complexity of railroad consolidation increases substantially with the size of the firms involved. Not only is agriculture dependent upon cost-efficient rail service, but agricultural shippers have received discriminatory service from Class I railroads. An example of this occurred during the Western rail crisis, when over 100 million bushels of grain were stored on the ground due to the railroads' inability to provide service and due to service discrimination.

⁸ As required by both the regulations governing consolidation, U.S.C. § 11324 and the rail transportation policy goals enumerated in 49 U.S.C. § 10101.

The possible consolidation of Class I railroads into only two North American transcontinental railroads would result in less inter-railroad competition and a reduction in routing choices for shippers. Although the United States currently has a Class I railroad duopoly in the East and a Class I railroad duopoly in the West, consolidation into only two transcontinental railroads will result in shippers losing the option to choose the connecting carrier. Furthermore, past railroad consolidations have often resulted in Class I railroads refusing to quote tariffs for shorter hauls, denying service to carload shippers, closing gateways, denying competitive access, and canceling joint-line rates. The net result of these Class I railroad policies has been increased transportation costs to agricultural shippers which decrease their access to world markets. Thus, when approving major railroad consolidations, the Board should act to enhance competition, not just preserve it.

Due to the erosion of inter-railroad competition and deficiencies in present rail service, USDA believes that large railroads should be required to improve competition and service to their existing shippers before they are allowed to become larger. Due to the occurrence of service disruptions during most of the more recent Class I railroad mergers and anti-competitive actions of the Class I railroads, USDA requests that the Board require significant protections for shippers and rural communities before approving future major railroad consolidations.

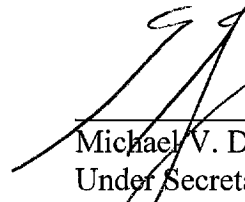
USDA has made the following ten recommendations, which are designed to protect the interests of agricultural producers, shippers, and rural communities:

- The Board should incorporate possible downstream and crossover effects of all future major railroad mergers into its revised merger guidelines, placing more importance upon the effects the merger would have upon the entire transportation system rather than upon the merged entity itself.
- The Board should institute a rebuttable presumption against future major railroad mergers unless the merging railroads come up with a plan that mitigates any adverse consequences of the merger upon shippers and other railroad firms, prove the existence of merger-related benefits, and demonstrate that those benefits cannot be achieved by other means short of merger.
- The Board should require that railroads involved in major railroad consolidations indemnify shippers and other railroads (during the merger implementation period) for costs incurred due to merger-related service interruptions and require binding arbitration of all claims which the consolidated railroad disputes.
- The Board should continue to consider the ability of the merged firm to make the necessary infrastructure improvements before approving any major rail consolidation.
- The Board should require the railroads involved to offer specific proposals to enhance competition and to mitigate any adverse competitive consequences of the consolidation upon shippers. In addition, the Board should use its broad conditioning powers aggressively to impose any other conditions necessary to preserve competition.
- The Board should require the merging railroads to keep all existing rail gateways open, to open those gateways previously closed, and to remedy any reductions in route or service options.

- The Board should carefully analyze the impacts of future major railroad consolidations upon short line and regional railroads.
- The Board should examine more closely merger applicants' estimates of the synergies and other public interest benefits when balancing the benefits of proposed major railroad mergers against societal costs.
- The Board should consider the effects that different commercial and regulatory regimes can have upon cross-border trade and condition any transnational railroad merger so that shippers in both countries are assured of equal or the same access to rail transportation.
- The Board should analyze the effect of a foreign government's jurisdiction on the rail operations of the resulting railroad and the influence of state trading enterprises [the Canadian Wheat Board], particularly on the distribution of railcar capacity among U.S. and Canadian agricultural shippers which could have impacts in world markets. The Board needs to condition transnational mergers to ensure equal and fair treatment for shippers in both countries.

USDA hopes that the Board will carefully consider these recommendations when developing its new regulations governing major railroad consolidations. USDA applauds the Board's initiative in this extremely important rulemaking and appreciates this opportunity to participate.

Respectfully submitted,



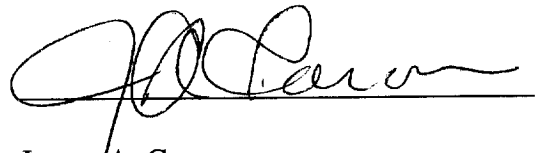
Michael V. Dunn
Under Secretary

Marketing and Regulatory Programs

U.S. Department of Agriculture
Washington, D.C. 20250

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on May 16, 2000, he caused a copy of the Department of Agriculture's comments to be served by first-class mail, postage paid, on all parties of record in STB Ex Parte 582 (Sub-No.1).

A handwritten signature in black ink, appearing to read 'James A. Caron', written over a horizontal line.

James A. Caron
Acting Associate Deputy Administrator
Transportation and Marketing Programs
Agricultural Marketing Service