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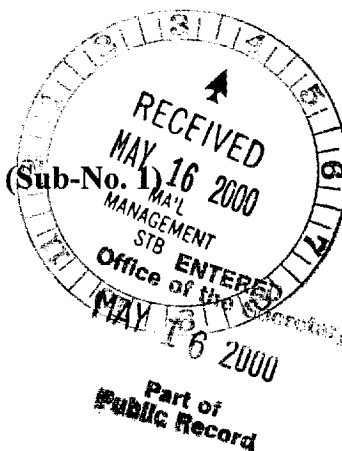
BEFORE THE
Surface Transportation Board

WASHINGTON, D.C. 20423

In the Matter of:

Major Rail Consolidation Procedures

STB Ex Parte No. 582 (Sub-No. 1)



**COMMENTS OF
THE SOCIETY OF THE PLASTICS INDUSTRY, INC.**

The Society of the Plastics Industry, Inc. (SPI) respectfully submits its comments and recommendations to the Surface Transportation Board in response to the Advance Notice of Proposed Rulemaking concerning the Board's procedures and policies governing the consolidation of Class I Railroads.¹

1. STATEMENT OF INTEREST

SPI is the national trade association of the plastics Industry, comprised of over 1500 members representing all segments of the industry in the United States. SPI's membership is comprised of plastics processors, raw material suppliers, machinery manufacturers, moldmakers and transportation providers. Founded in 1937, SPI serves as the official voice of the plastics industry. The plastics industry employs over 1.5 million people nationwide and is the fourth largest manufacturing industry in this country.

¹ 65 Fed. Reg. 18021 (Apr. 6, 2000) (hereinafter "ANPRM").

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Plastics resins, STCC 28211, constitute some 70 billion pounds of railroad traffic, amounting to more than 350,000 carloads of traffic and approximately 1.5 billion in freight revenue. Approximately 60% of plastics resins shipped are captive at the point of origin or destination to a single railroad, and more than 10% of additional production capacity is effectively captive due to the ability of one of the serving railroads to leverage its position based on sole service to a different plant of that same producer. Even where points of production may be open to competitive service, numerous processors, or downstream users, of plastics resins are captive to a single railroad.

The plastics industry is the largest rail dependent industry in the country. Approximately 85% of the primary plastics resins, polyethylene and polypropylene, are transported by rail, at an average length of haul exceeding 1,000 miles. The industry owns in excess of 40,000 covered hopper cars, utilized for the transportation of plastics resins from producers to fabricators. Railroads are the literal lifeline to the customer base of the plastics industry.

2. COMMENTS

A. Introduction

The landscape of the United States railroad industry has changed dramatically over the past 20 years. In 1980, there were more than 40 Class I railroads, each providing regional transportation, and many subject to intense competition, particularly in serving as bridge carriers for traffic originated and terminated by other railroads. Within certain industrial centers, there were multiple railroads operating, e.g., six carriers operated in the Houston terminal alone. The railroad industry of the 1970s and 1980s is best remembered for being in poor financial

condition. While a regulatory system characterized as not responsive to the needs of the transportation community often is cited as a major contributor to the railroad industry condition,² other factors also contributed, including poor management, mergers that degraded performance, and a growing motor carrier industry which eroded railroad market shares. The Staggers Act of 1980 revamped the regulatory processes, including the merger procedures. Those 40+ Class I railroads underwent significant consolidation, leading to the current U.S. rail structure which is comprised of seven Class I railroads, with four accounting for more than 95% of railroad revenues.

As the surviving Class I railroads continued to merge, the 1990s found the railroads experiencing escalating problems of integration following consolidation. The UP experienced integration problems following its 1995 acquisition of the Chicago and North Western Railway (CNW); and the 1995 merger of Burlington Northern and Santa Fe was beset with its own set of traffic movement problems. Despite having professed to have learned from the CNW experience, UP suffered a meltdown of unprecedented proportions in attempting to assimilate the Southern Pacific. Those integration problems spilled over to affect the BNSF, particularly considering that BNSF was granted extensive trackage rights over UP lines as remediation for the loss of the UP/SP competition.

² One example of the confluence of factors leading to deterioration of the railroads' financial posture was the practice of the railroad industry, in seeking general rail rate increases to offset increased costs, of asking for authority to increase rates to a lesser extent than the cost increases being experienced. Moreover, those rate increases often were structured in a discriminatory fashion with regard to specific commodities or regions. The ICC typically would approve a lower rate of increase than requested, and would provide remedial measures for the discriminatory aspects of the general rate increases. Neither the carriers nor the ICC ever addressed the effects of the shortfall, but rather simply proceeded to the next general rate increase.

The western railroads' experience was followed by the acquisition and division of Conrail by CSX and Norfolk Southern. First, however, CSX and NS engaged in a costly bidding war over the acquisition of Conrail. With every increase in bid price for Conrail, whichever railroad made the latest bid "reappraised" the merger benefits to find increased value thereby warranting the higher acquisition price. Those who questioned whether the price being paid reflected benefits to be gained, as opposed to the value of keeping Conrail from a competitor, were ignored; and little attention was paid to the impact on the financial aspects of the transaction of opening approximately 30% of Conrail traffic to competitive service as a condition for the division of Conrail. Accordingly, the division of Conrail found the acquiring carriers bearing a two-edged financial burden; and once integration was implemented, traffic disruptions again were experienced and continue today almost a year later. Moreover, one of the major benefits claimed for the Conrail acquisition and division, namely and the diversion of traffic from highway to rail through the expansion of single line service, not only has not been realized; but rather, the service problems associated with the integration of Conrail led to loss of substantial traffic from rail to motor carrier service.

Notwithstanding recent experience, the announced consolidation of Burlington Northern and Santa Fe Railway and Canadian National Railway has raised the prospect of a further and "final" round of rail industry consolidation. There is widespread speculation that any merger such as the one proposed could possibly lead to a reconfiguration of the railroad industry resulting in two transcontinental North American carriers. Even as they struggle to overcome their recent consolidation problems, the reaction of CP, CSX, NS and UP to the prospect of a BN/CN combination is that they necessarily will have to seek their own transcontinental merger

partners. Against this background, the Surface Transportation Board imposed a moratorium on Class I mergers and embarked upon this proceeding to reexamine its policies with regard to railroad industry consolidations.

The Board identified nine specific areas of rail merger policy for reexamination. The ANPRM requests parties to prioritize the changes they propose or endorse, and also to include specific draft rules for proposed changes. In the comments that follow, SPI identifies three priorities: (i) preserving, promoting and enhancing competition; (ii) safeguarding rail service, including maintenance of safe operations, and (iii) accountability for merger-related public interest benefits. As indicated in the second priority above, some of the nine issues identified by the Board are interrelated; and to the extent SPI finds such a relationship, it will comment in the appropriate section. Additionally, SPI submits herewith proposed revisions to section 1180.1 of the Board's regulations which address its priority concerns.

B. Preserving, Promoting and Enhancing Competition

Rail transportation is unique among American industry with regard to the consideration given to antitrust principles in merger proceedings. Whether a transaction "would have an adverse effect on competition among rail carriers in the affected region or in the national rail system" is one of five factors required to be considered by the Board; but it is not the primary or even the first-stated criteria.³ Moreover, in precedent established by the Interstate Commerce

³ 49 USC § 11324(b).

Commission and subsequently followed by the Board, an extremely narrow view has been given to whether a transaction may have an adverse effect upon competition. Consequently, abstract theoretical notions of what “could be” have been relied upon to approve transactions and otherwise to decline to impose conditions to preserve competition which actually exists in the dynamics of the marketplace. For example:

- The Board has rejected claims that merger of a bottleneck controlling carrier with a downstream carrier will cause a loss of competition between or among downstream carriers under its “one lump” theory. In doing so, the Board has rejected evidence of competition between and among downstream carriers as “anecdotal” which does not “disprove” the theory.⁴ Accordingly, rail mergers have been permitted to erode competition shippers have actually been able to enjoy given captivity at one end of the movement.
- Classic economic theory teaches that there needs to be a *sufficient number* of *significant competitors* in order for the market to be vigorous. Typically, a fully competitive market is defined as one involving five competitors, none of whom unilaterally dominates the market.⁵ As the railroad industry continuously shrank

4 In the Conrail acquisition preceding, the noted economist and “father of deregulation” Alfred Kahn, following a very limited examination of railroad pricing information concerning applicants’ movements from the Monongahela region before and after Conrail acquired sole control of the former Monongahela Railway, as permitted in discovery against the applicant carriers, concluded that the “one lump” theory is not followed by the railroads and explained that they do not do so due to the numerous interactions between carriers and their need to maintain comity in the relationship with their connecting railroads. This analysis and explanation, too, was rejected.

5 A recitation of the literature setting forth the generally accepted principles of market competition is set forth, *inter alia*, in the verified statement of William G. Shepherd, Professor of Economics, University of Massachusetts, submitted in Comments Of The Society Of The Plastics Industry, Inc., in the UP/SP Merger, Finance Docket No. 32760 (SPI-11, March 29, 1996, at V.S.7).

through the 1980s and into the 1990s, however, the Interstate Commerce Commission came to view competition as an absolute: it either existed or it did not exist.

Consequently, reductions in competitors from 5-to-4, 4-to-3 and 3-to-2 did not serve to “eliminate” competition, and therefore railroad consolidation was not deemed to have had an adverse impact upon competition among rail carriers. Only complete elimination of competition, the so-called “2-to-1” situation, would warrant remedial relief. Neither the antitrust agencies nor any other regulatory agency having authority over industry consolidation has followed this absolutist position. Consequently, the quality of competition in the railroad industry has been allowed to continuously erode.

- The subjective factors impacting upon competition repeatedly have been interpreted to favor railroad industry consolidations. One such subjective factor entails product and geographic competition. Shipper interests have attempted to demonstrate the loss of product or geographic competition in the coal industry between coals having slightly different characteristics which nonetheless may be substitutable in utility plant operation (*e.g.*, Colorado coal versus Powder River Basin coal), and in the plastics industry between producers of plastics resins located on the lines of the two railroads having the two largest market shares for that commodity. These concerns have been overridden and mergers approved, leading to increased market concentration and consequential competitive losses. On the other hand, where the loss of competitive service could not be denied, the 2-to-1 situation, the Board has accepted trackage rights granted to a third carrier as an effective remedy. The practical effects of a trackage rights remedy for serving local points was all too

painfully demonstrated when, in the UP meltdown, BNSF was unable to provide effective alternative service due to its dependence upon operation over UP lines, and in many cases upon UP switching service.

SPI respectfully submits that the Surface Transportation Board should abandon the policies adopted by the Interstate Commerce and should adhere to generally accepted economic policies and recognize real-world competitive situations. As the Board notes in its ANPRM, whatever rationale there may have been for supporting policies “that would help rationalize excess capacity . . . [i]t does not appear that there are significant public interest benefits to be realized from further downsizing or rationalizing of rail route systems, as there is little of that activity left to do.”⁶ The statutory concept of protecting against “an adverse effect on competition” should be viewed literally, consistent with the merger policies followed by other government authorities, and not from a perspective that either recognizes economic theory over experience or that views the railroad industry as unique and therefore immune to the economic principles that apply to industry generally.

Providing remedial relief against the losses of downstream competition and of an effective carrier in a multi-carrier marketplace readily can be fashioned. For the former, the merging carriers should be required to offer rates to the former junction point on a proportionate or a mileage basis to the rates being offered for through service. For the latter, where a substitute carrier is available to serve the market, that carrier should be granted access via line divestiture or trackage rights, as most appropriate. If no substitute carrier is available, the Board should impose

⁶ ANPRM at P.2.

a rate cap on the merging carriers to limit rate increases over pre-merger levels to cost pass-throughs. For loss of product or geographic competition, the remedial effects of divestiture or trackage rights must be evaluated case-by-case.

The Board also raises the issue of requiring merger applicants to maintain open gateways for all major routings. Without question, this is a necessary condition. Merging carriers have represented they would do so, *e.g.*, CN/IC; however, the implementation of such a condition has not been defined. Gateways can be closed in two manners: through restrictions on routings and connections with other carriers, and also economically. Absolute closure of a gateway occurs through a “paper barrier,” *i.e.*, through removal of that gateway as an interchange point. Economic closure of a gateway occurs through pricing decisions. Pricing policies can be implemented through both increasing rates over the disfavored gateway and through reduction of rates over the favored gateway. Obviously, there should be no barrier prohibiting railroads which achieve operating efficiencies from passing on those efficiencies to customers through rate reductions. On the other hand, increasing prices in a manner which discriminates against a particular gateway or routing should be prohibited as a merger condition.

The Board raises the issue in its ANPRM of whether it should alter rail merger policy to place a greater emphasis on enhancing, rather than simply preserving, competition. As quoted above, the statute specifically requires the Board to consider whether a proposed consolidation would have an adverse effect upon competition. The enumerated factors, however, are not exclusive; and additionally, the Board has an overall “public interest” standard to apply. SPI endorses the concept that the enhancement of competition is a public interest benefit.

Introducing rail competition in the East was so cited by both applicant carriers and the Board in the Conrail transaction in conjunction with the establishment of the Shared Assets Areas and otherwise in opening certain points to competitive service.

One means of promoting competition would be to require merging railroads to provide bottleneck rates between captive points and the first junction in the direction of the other end of the movement. The rail industry is the only network system which today is immunized from competition through protection of bottlenecks. As a condition of consolidation, merging carriers should be required to open captive points to downstream competition. If, as CP, CSX, NS and UP publicly have stated that a BN/CN merger (or likely any other Class I consolidation) would compel each of them to seek their own merger partners, there would be no “unfairness” in imposing a bottleneck condition on merging carriers but not imposing the condition generally.⁷ Whatever timing disparity there may be as between applicant and other carriers simply must be considered a cost of the transaction.

C. Safeguarding Rail Service and Maintaining Safe Operations

Maintaining safe rail operations and safeguarding rail service from merger-related service disruptions are two sides of the same coin. As evidenced by UP/SP, integration problems lead to safety problems. On the other hand, derailments and accidents impede timely service.

As discussed in the introductory comments in section A above, notwithstanding prior integration problems, either of its own or of other carriers, the recent major rail consolidations in the West and the East have led to massive service disruptions. These integration problems have

caused coal stockpiles at various utility plants to run dangerously low, and have disrupted production at industrial plants.

The Board has imposed a Safety Integration Plan requirement upon merger applicants. In addition, SPI recommends that the Board secure an independent review of the SIPs filed by merger applicants. Just as in line construction cases the Board requires applicants to underwrite the cost of the environmental assessment, so to the Board should require merger applicants to underwrite the cost of an independent consultant to evaluate and report to the Board on their SIPs, including measures to assure proper integration of the consolidating carriers.

In addition to the foregoing, SPI submits that the Board impose a condition on merging railroads which prohibits the carriers from increasing rates during, and for a subsequent period equivalent to, any merger related service disruptions. Railroads claim that substantial benefits will flow from their mergers. At the very minimum, they should be held accountable not only to causing no harm but also for assuring customers do not pay for what now appears to be inevitable service integration problems. As matters now stand, and as evidenced by recent public announcements from the eastern railroads, shippers who have suffered from service degradation now will have the “privilege” of paying for that degradation through rate increases. If merging carriers cannot at least maintain an equivalent level of service to pre-consolidation conditions, they should not be allowed to increase rates (including accessorial and other changes such as for track leases and terminal services) while service is degraded; nor should they be allowed to foist

⁷ Additionally, once imposed as a merger condition, the Board may wish to reexamine its “Bottleneck” policy from the standpoint of whether it should be applied generically.

their costs from their integration problems onto the shipper community immediately after the service is stabilized. Rate stabilization should last at least as long as the service disruption to assure the shippers are not doubly penalized for the inability of the merging railroads to manage their integration process effectively.

Another element in the context of safeguarding rail service is assuring that regional and short line railroad operations are not adversely impacted. As the Class I railroad industry has moved toward becoming a long-haul “pipeline,” carriers have shed much of the pickup and delivery function to short line railroads. With the railroad consolidations and the accompanying disaggregation of the local lines which have occurred over the past two decades, railroads no longer are viewed as operating an integrated, industry-wide system. Rather, the Class I carriers prioritize, and understandably so, on their long-haul business; and those customers served by regional and short lines become a mere afterthought. This situation can only be exacerbated as the Class I railroads further consolidate. Accordingly, the Board must assure that the regional and short line railroads are protected from adverse impacts.

D. Merger Related Public Interest Benefits

Railroad merger applications recite at length the substantial benefits which will accrue from consolidation of the applicant carriers. SPI respectfully submits that carriers which have been granted merger approval publicly account for their progress in achieving the benefits projected, as well as whether they are improving or even maintaining service. Conditions then could be developed around the merger applicants’ representations. For example, had such an approach been in place at the time of the Conrail acquisition, CSX and NS would have been

required to report on their progress in taking 1 million trucks off the highways, and a condition imposed prohibiting rate increases other than those caused by increases in the cost of labor, fuel, and other operating expenses in order to hold the applicants to their representation that the merger would not be paid for by shippers.

Similarly, from a service standpoint, the Board should require consolidating railroads to publish “before-and-after” transit times for major corridors. Statistics such as terminal dwell time and average train running speed, while perhaps useful to identify trends and certain problem areas, are meaningless to the shipper community. Shippers want to know how long it takes for their freight to move from origin to destination, and the variability in that average transit time. While shippers can and do compile this information on an individual basis, the Board also needs to know how the carriers are performing in providing service to their customers.

* * *

In conclusion, The Society of the Plastics Industry, Inc., commends the Surface Transportation Board for undertaking this comprehensive reevaluation of railroad consolidation policies. SPI urges the Board to follow through on the promise implied in the ANPRM that a fresh look, with likely revision of policies observed in the past, is required to address future railroad mergers. The core focus of any service provider must be the consumer public. For too long that focus has been neglected by railroads which have considered captive customers as entitlements, and by the Interstate Commerce Commission which viewed its mission as promoting railroad consolidation in order to rationalize route structures rather than assuring the adequacy of a viable and fully competitive railroad industry which would promote service and

innovation. This proceeding holds promise to being the first step to interject accountability and customer focus into the future consolidation of Class I railroads.

WHEREFORE, THE PREMISES CONSIDERED, The Society of the Plastics Industry, Inc., respectfully urges the Surface Transportation Board to issue a Notice of Proposed Rulemaking, and to proceed to final regulations and policies, in accordance with the views set forth above.

Respectfully submitted,

A handwritten signature in black ink, reading "Maureen Healey" with a stylized flourish at the end.

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May 16, 2000

Appendix A

§ 1180.1 General policy statement for merger or control of at least two Class I railroads.

(a) *General.* The Surface Transportation Board ~~encourages private industry initiative that leads to the rationalization of the nation's rail facilities and reduction of its excess capacity. One means of accomplishing these ends is~~ has statutory authority to review and to approve, deny or condition applications for rail consolidation. ~~However~~ The Board does not favor consolidations through the exercise of managerial and financial control if the controlling entity does not assume full responsibility for carrying out the controlled carrier's common carrier obligation to provide adequate service upon reasonable demand. Furthermore, the Board does not favor consolidations that substantially reduce the transport alternatives to natives available to shippers unless there are substantial and demonstrable benefits to the transaction that cannot be achieved in a less anticompetitive fashion. Our analysis of the competitive impacts of a consolidation is especially critical in light of the Congressionally mandated commitment to give railroads greater freedom to price without regulatory interference.

(b) *Consolidation criteria.* The Board's consideration of the merger or control of at least two class I railroads is governed by the criteria prescribed in 49 U.S.C. 11324 and by the rail transportation policy set forth in 49 U.S.C. 10101.

(1) Section 11324 directs the Board to approve consolidations which are consistent with the public interest. In examining a

proposed transaction, the Board must consider, at a minimum:

(i) The effect on the adequacy of transportation to the public;

(ii) The effect of including, or failing to include, other rail carriers in the area involved in the proposed transaction;

(iii) The total fixed charges that would result

(iv) The interest of affected carrier employees; and

(v) The effect on competition among rail carriers in the affected region.

(2) The Board must also consider the impact of any transaction on the quality of the human environment and the conservation of energy resources.

(c) *Public interest considerations.* In determining whether a transaction is in public interest, the Board performs a balancing test. It weighs the potential benefits to applicants and the public against the potential harm to the public. The Board will consider whether the benefits claimed by applicants could be realized by means other than the proposed consolidation that would result in less potential harm to the public.

(1) *Potential benefits.* Both the consolidated carrier and the public can benefit from a consolidation if the result is a financially sound competitor better able to provide adequate service on demand. This beneficial result can occur if the consolidated carrier is able to realize operating efficiencies and increased marketing opportunities. Since consolidations can lead to a reduction in redundant facilities and thereby to an increase in traffic density on underused lines, operating efficiencies may be realized. Furthermore,

consolidations ~~are~~ may be the only feasible way for rail carriers to enter many new markets other than by contractual arrangement, such as for joint use of rail facilities or run-through trains. In some markets where there is sufficient existing rail capacity the construction of new rail line is prohibitively expensive and does not represent a feasible means of entry into the market.

(2) *Potential harm.* There are two potential results from consolidations which would ill serve the public—reduction of competition and harm to essential services. In analyzing these impacts, we must consider, but are not limited by, the policies embodied in antitrust laws.

(i) *Reduction of competition.* If two carriers serving the same market consolidate, the result would be the reduction or elimination of the competition between the two. Even if the consolidating carriers do not serve the same market, there may be a lessening of potential competition in other markets. ~~While~~ The reduction in the number of competitors serving a market is not may in itself be harmful, and thus a lessening of competition resulting from the elimination of a competitor may be contrary to the public interest. Consolidation of carriers providing end-to-end service may result in a loss of upstream or downstream competition. The Board recognizes that rail carriers face not only intramodal competition, but also intermodal competition from motor and water carriers. The Board's competitive analysis depends on the relevant market(s). In some markets the Board's focus will be on the preservation of effective intermodal competition, while in other markets (such as long-haul movements of bulk commodities) effective intramodal competition may also be important.

(ii) *Harm to essential service.*

Consolidations often result in shifts of market patterns. Sometimes the carrier losing its share of the market may not be able to withstand the loss of traffic. In assessing the probable impacts, the Board's concern is the preservation of essential services, not the survival of particular carriers. A service is essential if there is a sufficient public need for the service and adequate alternative transportation is not available. Maintaining service levels post-consolidation and avoiding implementation related service disruptions are essential to avoid harm to essential railroad service.

(d) *Conditions.* (1) The Board has broad authority to impose conditions on consolidations, including those that might be useful in ameliorating potential anticompetitive effects of a consolidation. However, While the Board recognizes that conditions may lessen the benefits of a consolidation to both the carrier and the public, Therefore, in a highly concentrated market avoiding adverse effects on competition and harm to essential service is paramount. Where the harm is to another carrier, however, the Board will not normally impose conditions on a consolidation to protect a carrier unless essential services are affected and the condition: (i) Is shown to be related to the impact of the consolidation; (ii) is designed to enable shippers to receive adequate service; and (iii) would not pose unreasonable operating or other problems for the consolidated carrier; ~~and (iv) would not frustrate the ability of the consolidated carrier to obtain the anticipated public benefits.~~ Moreover, the Board believes that indemnification is ordinarily not an appropriate remedy in consolidation proceedings. Indemnification conditions can be anticompetitive by requiring the consolidated carrier to subsidize carriers who

are no longer able to compete efficiently in the marketplace.

(2) As of July 1, 1982, Conditions previously imposed are revoked unless the parties to specific consolidation proceedings demonstrate a public interest in continuing the Conditions in those proceedings.

(e) *Inclusion of other carriers.* The Board will consider requiring inclusion of another carrier as a condition to approval only where there is no other reasonable alternative for providing essential services, the facilities fit operationally into the system, and inclusion can be accomplished without endangering the operational or financial success of the new company.

(f) *Labor protection.* The Board is required to provide applicants' employees affected by a consolidation with adequate protection. Similarly situated employees on the applicants' system should be given equal protection. Therefore, absent a negotiated agreement, the Board will provide for protection at the level mandated by law (49 U.S.C. 11326), unless it can be shown that because of unusual circumstances more stringent protection is necessary to provide employees with a fair and equitable arrangement. The Board will review negotiated agreements to assure

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CERTIFICATE OF SERVICE

I Carolina Moore, a secretary in the law firm of Keller and Heckman, LLP do hereby certify that a copy of the foregoing COMMENTS was served this 16th day of May, 2000 on all parties of record by mailing, U.S. First Class mail, postage prepaid:

By: Carolina Moore

K:/Data/Transp/SP07063/comments ex parte sub-1 5-16-2000