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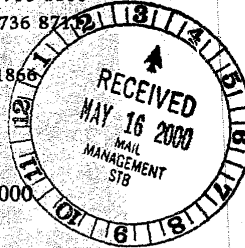
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May 16, 2000

By Messenger

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
Case Control Unit
1925 K Street, N.W.
Washington, D.C. 20423-0001

ENTERED
Office of the Secretary
MAY 16 2000
Part of
Public Record

Re: Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures

Dear Mr. Williams:

Enclosed for filing on behalf of Norfolk Southern Corporation and Norfolk Southern Railway Company in the above-referenced docket are a signed original and 25 copies of the "Comments of Norfolk Southern in Response to Advance Notice of Proposed Rulemaking." Also enclosed is a computer disk containing a copy of this filing in WordPerfect 7/8/9 format.

Please acknowledge receipt of these papers for filing by date-stamping the enclosed duplicate copy and returning it with our messenger. Thank you for your attention to this matter.

Very truly yours,

Vincent F. Prada

G. Paul Moates
Vincent F. Prada

Enclosures

cc: All Parties of Record (w/encls.)



BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

ENTERED
Office of the Secretary
MAY 16 2000

RECOMMENDATIONS OF NORFOLK SOUTHERN IN RESPONSE
TO ADVANCE NOTICE OF PROPOSED RULEMAKING

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DATED: May 16, 2000

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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

**COMMENTS OF NORFOLK SOUTHERN IN RESPONSE
TO ADVANCE NOTICE OF PROPOSED RULEMAKING**

Pursuant to the Board's Advance Notice of Proposed Rulemaking ("ANPR"), served March 31, 2000, Norfolk Southern Corporation and Norfolk Southern Railway Company (jointly, "NS" or "Norfolk Southern") respectfully submit these comments on the issue of proposed modifications to the Board's policies and rules governing proposed major rail consolidation transactions.¹ These comments are supported by the attached Verified Statement of James W. McClellan, Senior Vice President of Planning for Norfolk Southern.

INTRODUCTION AND SUMMARY

NS welcomes this opportunity to present its views regarding possible changes in the policies, standards and procedures under which the Board would assess all future major rail mergers for consistency with the "public interest." See 49 U.S.C. § 11324(c). Railroad mergers have played an important role in improving the financial health of the rail industry, fostering sound conditions for capital investment in needed rail infrastructure and making possible better and more competitive transportation service at lower cost to shippers. As the record of the recent hearings

¹ In places, NS uses the term "merger" as a shorthand reference to all mergers, consolidations, acquisitions of control and other combinations involving two or more Class I rail carriers, coming within the prior-approval requirements of 49 U.S.C. §§ 11321-11326.

in Ex Parte 582 makes clear, however, it is both appropriate and necessary that the Board now pause and take a fresh look at railroad merger policy and its impact on the future structure and health of the rail industry. This reassessment is particularly opportune in light of the changing structure of the North American rail system, the prospect of another, probably final, round of major consolidations creating two large, U.S. transcontinental railroad systems, and the serious service disruptions that have attended recent rail consolidation transactions.²

Norfolk Southern believes that, in order effectively to address the current conditions and challenges facing the U.S. railroad industry, a revised merger policy for major rail combinations should include the following key elements:

- **Raising the Bar** -- In light of the size and balanced structure of the major rail systems today and increased concern whether additional consolidation will deliver the same level of public benefits as those achieved from previous consolidations, it is appropriate for the Board to impose a higher threshold for approval of major rail consolidation proposals. The Board should establish as a general policy that it will approve major rail consolidation proposals only when the applicant carriers can persuasively demonstrate that the proposed transaction will generate net public benefits that are tangible, significant and likely.
- **Improving Rail Service** -- The disappointing service record of the rail industry, including the service disruptions that have occurred during the implementation of recent major rail consolidations, point to the need to give much greater emphasis to the effects of a proposed major rail consolidation on the quality of service to shippers, during both the short-term post-merger implementation period and beyond. It is widely acknowledged, and NS agrees, that the railroads as a group need to improve the service they provide to their customers. The Board's revised merger guidelines should incorporate this policy objective by requiring merger

² As Norfolk Southern's CEO, David Goode, testified during the recent hearings in Ex Parte 582, any major railroad consolidation proposal (such as the proposed BNSF/CN combination) would likely require prompt strategic responses by other railroads, thereby triggering in relatively short order another round of responsive major rail consolidation transactions. 3/7/00 Tr. 191-92, 196-97.

applicants to demonstrate that a proposed major rail consolidation will materially improve service.

- **Promoting Infrastructure, Capacity and Investment** -- Closely related to the issue of service is the imperative need for the Board to foster sound conditions for the railroads to maintain, expand and adjust the capacity of the rail network through adequate capital investment in the rail infrastructure constituting their core networks. Without adequate capital investment and expansion of capacity at the correct locations, the quality (even existence) of rail service over the longer term will be threatened. In reviewing a proposed major rail consolidation, therefore, the Board should examine the effects of the transaction on infrastructure, core capacity and investment, giving significant weight to transactions that will promote infrastructure investment and expansion of capacity and scrutinizing the applicants' capital investment plans. At the same time, the Board should assess whether a requested condition (to address claimed competitive harm or otherwise) would unreasonably diminish the railroads' incentive or ability to make needed capital investments.
- **Scrutinizing Claimed Merger Benefits** -- Consistent with the general approach of "raising the bar" to approval of major rail consolidations, the Board should give greater scrutiny to claimed merger benefits, and require that there be significant net public benefits before the Board will approve a proposed transaction. Recent changes in the evolving structure of the rail industry have raised concerns that some types of benefits previously relied on to justify a merger may in fact be achievable today by means short of formal merger (including inter-carrier alliance or marketing agreements). To address these concerns, the Board should apply more rigorously its existing policy that benefits achievable other than through formal merger or consolidation should not be considered as merger-related benefits in the public interest calculus.
- **Preserving Effective Rail-to-Rail Competition** -- The Board should continue and scrupulously apply its policy of imposing conditions to ensure that major rail consolidations will not result in a loss of direct rail competition for particular shippers. The Board should codify recent practice in dealing with so-called "2-1" shippers by requiring that, absent unusual circumstances, applicants proposing a major rail consolidation should present the Board with a plan to ensure that shippers whose facilities are directly served by two railroads prior to the proposed transaction will not be left with only one serving railroad following the transaction. Whether a merger-related reduction from three to two in the number of railroads serving a particular facility should be considered a transaction-related

competitive harm warranting relief should be an issue considered in individual cases based on the specific evidentiary record presented. Other competitive-impact issues, including attempted rebuttal of the "one-lump" doctrine, should similarly be open to evidentiary examination in individual proceedings.

- **Maintaining Efficient Gateways** -- As the railroad industry and shipping public face the prospect of transcontinental rail mergers that may leave the U.S. with only two large coast-to-coast systems, the issue of maintaining major gateways -- particularly at the traditional Midwest and Mississippi River interchanges (*i.e.*, Chicago, Kansas City, St. Louis, Memphis and New Orleans) -- has received renewed attention. In order to address these legitimate concerns while safeguarding against the re-introduction of the disastrous inefficiencies experienced with the now discredited *DT&F* gateway protective conditions of the past, NS proposes that major rail consolidation applicants be required to keep open certain efficient gateways used today for significant freight traffic flows. This goal could be accomplished by requiring that railroad applicants commit to establish, upon request by exclusively served rail shippers that made substantial pre-merger use of designated major connections with other carriers, common carrier or contract rates for interline service via the designated gateways in conjunction with another available railroad capable of moving the shipper's traffic beyond the gateway.
- **Facilitating Private Sector Resolution of Disputes** -- The Board should continue its practice of encouraging private sector resolution of disputes involving railroad services and operations, and minimizing regulatory intervention whenever possible. For this reason, the Board should not adopt new policies that would undermine the significant progress that the railroad industry has already made in addressing the concerns of rail labor over labor contract override issues and of short-line and regional railroads over "paper barriers" and service issues.

The purpose and proper focus of this rulemaking proceeding are to develop new policies and rules for assessing the effects of proposed major rail consolidations. It should not be used as a vehicle for effectuating fundamental changes in the economic regulation of railroad rates and services -- issues that go well beyond the subject of railroad mergers (and their effects) and implicate broader policy issues that are more appropriately addressed (if at all) by Congress. In

particular, the Board should resist efforts by some shipper interests -- already signaled in their testimony in the recent Ex Parte 582 hearings -- to use this rulemaking as a vehicle for reregulating the railroad industry through imposition of expanded competitive (or "forced") access requirements, "bottleneck" rate regulation and other similar measures designed to inject a form of additional rail competition that the market itself has not fostered and cannot support.

Sound public policy must be consistent with the fundamental principles of railroad economics recognized time and again by the Board and its predecessor. These principles reflect that railroads are a network industry, with fixed routes, large sunk investments in plant and facilities and a significant proportion of fixed and common costs (including capital costs); that, to minimize costs and promote efficient operations, railroads must strive to increase traffic density over particular lines, extend the length of their hauls, and reduce the large costs and service problems associated with inter-carrier switching and interchanges; and that, to maximize traffic densities and permit recovery of the large fixed and common costs of the network, railroads must be permitted to price their services differentially, charging proportionally higher rates to shippers with fewer competitive options (subject to regulatory protection for so-called "captive" shippers). The ratemaking and routing freedoms the railroads have enjoyed during the post-Staggers era gave proper effect to these economic principles, and the result has been a dramatic improvement in the industry's ability to provide competitive, efficient, viable transportation service.

The various forced access proposals that have been advanced, however, contradict these economic principles, and therefore represent bad policy. If applied to any significant body of railroad freight traffic, these access proposals would undermine the railroads' ability to achieve the traffic densities and scope of services needed for efficient, viable operations, and undermine (if

not destroy) their ability to price their services differentially in order to recover the huge fixed and common costs of the railroad network. By thus increasing inefficiency and the costs of railroad operations, while simultaneously reducing railroad rates and revenues, these proposals ultimately would undermine the railroads' ability and incentive to make the substantial capital investments in physical infrastructure that is essential to maintaining and improving rail service for all shippers. The Board and ICC have rightfully welcomed the creation of new rail-to-rail competition where it is supported by the marketplace (including the creation of new rail-to-rail competition through private rail line "build-out" projects). But the various forced access proposals advocated by some shipper groups would undermine long-term adequate service and the ability to invest, producing a sort of competition that, because it is ultimately unsustainable, is really no competition at all.

Such increased rail-to-rail "competition" can entail significant costs, both in increased operating expenses and service impairment. Trade-offs are unavoidable. Regulation-imposed "competition" increases the complexity of network operations, which overall can increase costs and decrease service quality.

DISCUSSION

The ANPR calls for comments on the Board's Railroad Consolidation Procedures codified at 49 C.F.R. § 1180 (subpart A). These regulations, which were developed during the late 1970's and early 1980's and have remained largely unchanged since that time,³ consist of two parts having very distinct purposes.

³ See *Railroad Consolidation Procedures*, 348 I.C.C. 770 (1977), 359 I.C.C. 195 (1978), 363 I.C.C. 200 (1980), 363 I.C.C. 767 (1980), 363 I.C.C. 784 (1981), 366 I.C.C. 75 (1982).

First, the regulations include a "policy statement" that sets forth policies the agency applies in reviewing proposed railroad consolidations and the criteria it considers in deciding if a particular proposal is consistent with the public interest. 49 C.F.R. § 1180.1. These policies and decisional criteria are expressed in broad terms, and are intended as guidance for the agency, railroad merger applicants, customers and the public. They establish a kind of roadmap of the policies that are important in assessing specific railroad merger proposals, while leaving to individual cases the determination of how those policy objectives (which are often in tension with one another) should be weighed and what specific requirements should be imposed on a proposed transaction before it may be approved.

Second, the Board's existing regulations set forth a number of procedural requirements to govern the processing and consideration of individual railroad consolidation proposals. 49 C.F.R. §§ 1180.2-9. These rules specify the required content of railroad consolidation applications and, in broad outline, the procedures to be followed in adjudicating them. The purpose of these rules is to ensure the development of a complete evidentiary record and the fair, orderly and efficient consideration of the issues raised in an application proceeding.

Norfolk Southern believes that this format has worked well over the past two decades, and should be the model for revised guidelines. Specifically, the revised guidelines should include an updated policy statement that generally describes the relevant policies and decisional criteria the Board will consider in reviewing specific merger proposals, while not prescribing rigid requirements and rules that preclude evidentiary consideration in individual cases. Major railroad consolidations, particularly the transcontinental merger proposals that are likely to come before the Board in the future, are not and should not be treated as "cookie cutter"

transactions. They can and do raise specific issues whose outcome is dependent on the particular evidence and circumstances of an individual case. Therefore, in fashioning new merger rules, the Board should strive to maintain a balance between, on the one hand, formulating new merger policies that apply prospectively and provide clear guidance to railroads and other parties and, on the other hand, preserving the ability of the Board and the parties to resolve disputed issues through individual case-by-case adjudication based on a concrete evidentiary record.

With this format in mind, Norfolk Southern offers the following comments on the proper elements of a revised general merger policy statement, and then suggests several desirable changes in the procedural rules governing major rail consolidation proceedings.

I. ELEMENTS OF A REVISED MERGER POLICY STATEMENT

A. Raising the Bar -- The Analytical Framework for Assessing the Public Interest

The Board's existing merger policy statement establishes an analytical framework under which the agency first identifies the public benefits and public harms likely to result from a proposed rail consolidation and then, in deciding whether the transaction as a whole is consistent with the public interest, weighs the public benefits against those public harms that cannot be remedied through conditions. 49 C.F.R. § 1180.1. Public benefits include merger-related operating efficiencies, elimination of redundant facilities and other cost-reducing operating changes, improvements in service (including extension of single-line or single-system service, elimination of costly interchanges, creation of more efficient routes), environmental benefits (including reductions in pollution resulting from diversion of freight traffic from truck to rail), improved carrier financial viability, strengthened competition between railroads and between

railroads and other transportation modes, and other factors. Public harms include merger-related reductions in existing competition or service and potential loss of essential rail services.

The evidence required to establish the existence of relevant public benefits and public harms associated with proposed major railroad consolidations, the relative weight to be accorded to such benefits and harms, and the appropriate measures the Board may take to achieve the benefits and remedy the harms associated with proposed transactions are all issues that warrant fresh examination in this rulemaking. Nevertheless, the basic analytical framework -- identifying and weighing the public benefits and public harms likely to result from a proposed rail consolidation -- of the existing policy statement is sensible and should continue to be used by the Board. The existing policy statement does not, however, specify how decisively the balance between public benefits and public harms must tip before a particular railroad consolidation should be approved as consistent with the public interest. If anything, the existing policy statement and the actual track record of ICC and Board merger decisions over the past two decades have embodied an implicit presumption that every proposed major rail consolidation will generate public benefits and that all but the most egregiously anti-competitive combinations should receive agency approval.⁴

Recent changes in the structure of the rail industry and experience with recent major rail consolidation transactions suggest that it may now be appropriate for the Board to articulate a somewhat higher threshold for approval of future major railroad consolidations. The large consolidation transactions of the past few years have created a stable, balanced railroad

⁴ During the past 20 years, only one major rail consolidation proposal has been disapproved. See *Santa Fe Southern Pacific Corp. -- Control -- Southern Pacific Transportation Co.*, 2 I.C.C.2d 708 (1986), *reopening denied*, 3 I.C.C.2d 926 (1987).

system in the U.S. and Canada, with two large, strong systems competing head-to-head in the western U.S. (Union Pacific and BNSF), the eastern U.S. (NS and CSXT) and Canada (Canadian National and Canadian Pacific), together with a large number of smaller regional and short-line railroads. It is universally acknowledged that one of the primary benefits of prior railroad consolidations (the elimination of duplicative facilities and consolidation of traffic on more efficient, denser routes) is now largely achieved, and that the problem today is not the existence of substantial excess capacity but a lack of core capacity and needed rail infrastructure, particularly on the most heavily used lines and yard facilities.⁵ Similarly, recent end-to-end rail consolidations created systems capable of providing extended single-line service over many of the significant truck-competitive freight corridors, thus eliminating many so-called "gateway watershed" problems that plague the rail industry.⁶ Reflecting the views of many parties that testified in the recent Ex Parte 582 hearings, the Board too has questioned whether opportunities remain for significant merger-related efficiency gains. ANPR at 4. Finally, some customers have questioned whether, in view of the serious service disruptions that have been experienced in recent consolida-

⁵ See ANPR at 3; STB Ex Parte No. 582, *Public Views on Major Rail Consolidations* (served Mar. 17, 2000) ("Suspension Order"), at 6.

⁶ See McClellan VS at 6. The "gateway watershed" problem refers to the phenomenon in which railroads that could serve a category of traffic (usually truck-competitive traffic) only on an interline basis often could not price their services competitively because of the interline nature of the service. The two participating railroads would have to negotiate over a through rate and a division of revenues between them. But, if one of the participating railroads was involved for only a short portion of the total haul, its potential share of the interline revenues would be so small that it would have little incentive to market and commit resources to the service, or it would be likely to insist on such a large revenue share that the through rate would become non-competitive. These incentives (as well as the need to engage in costly interline rate negotiations) are eliminated when the two participating carriers are brought under common ownership and the carriers are able to offer single-line service and rates. See, e.g., *CSX Corp. - Control - Chessie System, Inc.*, 363 I.C.C. 518, 554-55 (1980).

tion transactions, further major rail consolidations will generate the same amount of public benefits as past transactions and, indeed, whether they are likely to generate significant public benefits at all.

Norfolk Southern does not agree with those who have suggested that there are no significant operating efficiencies, service improvements or other public benefits to be gained from further major rail consolidations. Additional consolidations could potentially yield significant public benefits in the form of cost reductions (particularly involving overhead and other non-operating functions), extension of single-line service and elimination of costly and time-consuming traffic interchanges, more efficient traffic routing, greater financial strength and ability to generate capital needed to maintain and expand costly infrastructure, and improved ability to compete with other railroads and other transportation modes. The business operations of the railroads' major customers and competitors (especially trucks) are increasingly national, and even global, in scope. Railroads must match that scope of service in order to remain competitive. McClellan VS at 18-19. Yet these future public merger benefits might not be as clear or as readily achievable (particularly in the short-term) as those of the major railroad mergers of the 1980's and 1990's. At the same time, the service disruptions associated with recent mergers, and the prospect that similar problems in implementing future mergers could affect shippers even more given the increased size of the remaining major railroads (ANPR at 7), make it appropriate that the Board continue to demand an evidentiary record that permits it to be confident that the public benefits and public harms from a proposed major rail consolidation weigh strongly in favor of approval.⁷

⁷ Because the primary public benefits of future major rail consolidations are more likely to involve improvements in the level and scope of services offered to shippers than more conven-

(continued)

Accordingly, Norfolk Southern suggests that the Board "raise the bar" for approval of future major rail consolidation proposals by revising its merger policy statement to make it clear that it will approve a proposed combination only when the applicant carriers can persuasively demonstrate that the proposed transaction will generate net public benefits that are tangible, significant and likely. The identification and weighing of public benefits and public harms is not susceptible to mathematical precision, and it would therefore be both impracticable and unwise for the Board to bind itself and the rail industry with a more specific rule governing the burden of proof for approval of a major rail consolidation. The policy revision suggested here would, however, make it clear to prospective rail merger applicants and to the general public that the Board in the future will apply a more demanding standard for approval of major rail consolidations, and one that will not resolve all doubts about the proposed transaction's effects in favor of approval.

B. Merger-Related Public Interest Benefits

As the Board pointed out in the ANPR, many parties at the recent Ex Parte 582 hearings questioned the validity of recent railroad merger applicants' estimates of the synergies and other public benefits that would be produced by a proposed railroad merger. Some parties questioned if the claimed public benefits had been or could be achieved at all, while others suggested that some claimed benefits could be achieved by means short of merger and therefore should not be considered as a public benefit in the Board's "public interest" determination. Some

⁷(...continued)

tional operating cost efficiencies, the Board could appropriately give more weight in future cases to marketplace reaction to a proposed combination (including the general reaction of the shipper community to a proposed transaction), and somewhat less weight to the applicant carriers' testimony about claimed merger-related cost efficiencies and other quantifiable savings.

parties also urged the Board to conduct post-merger monitoring to help ensure that claimed benefits are actually realized. ANPR at 9.

With one important exception, Norfolk Southern does not believe that the Board should significantly change the manner in which it evaluates claimed merger-related public benefits. Estimates of merger-related public benefits necessarily involve predictions about the future effects of an often complex transaction that, by definition, has yet to be implemented. Moreover, both as a general matter and in the actual implementation of major consolidation transactions, railroads do not function in a static environment, but are affected -- often in significant and unanticipated ways -- by dynamic business and market conditions unrelated to a particular merger transaction. For this reason, no railroad merger applicant can possibly guarantee that the merger synergies and benefits it expects to achieve from a proposed rail consolidation will be achieved in precisely the same manner, to the same extent and under the same anticipated timing as described in the railroad consolidation application. Indeed, the purpose of merger-impact analyses submitted with the application is to isolate the anticipated effects of the proposed transaction by factoring out other real-world conditions that affect railroad traffic volumes, costs, revenues and overall financial performance.⁸ Similarly, any requirement that merger applicants achieve precisely those public benefits cited in their application would deny applicants the essential flexibility to respond to market changes. Even if the Board were to attempt to hold merger applicants to the precise merger benefit estimates made in an application, it would be virtually impossible without enormously complicated and difficult investigation to

⁸ See, e.g., STB Finance Docket No. 33388, *CSX Corp. -- Control and Operating Leases/Agreements -- Conrail Inc. ("Conrail Control")*, Decision No. 18 (served Aug. 5, 1997), at 4.

separate out which merger benefit shortfalls (or overages) are attributable to the applicants' own actions or failures to act and which are attributable to exogenous business conditions (*e.g.*, fluctuations in freight traffic volumes and shifts in traffic patterns since the application's "base year," changes in major expense items like fuel and labor, or changes in the business cycle or other macro-economic conditions). Even if the Board could make such determinations reliably, it is highly uncertain what, if anything, the Board practically could or should do about any identified deficiencies in the applicants' achievement of the projected benefits of an already consummated transaction.

For these reasons, the Board should continue to scrutinize carefully the evidentiary basis for claimed merger benefits, and should review such claims under a more rigorous burden of proof standard that calls for a persuasive showing by rail merger applicants. The Board could also usefully conduct post-merger monitoring of the applicants' achievement of claimed public benefits. Such monitoring might assist the Board in making more reliable judgments in subsequent cases about the kinds of claimed merger benefits likely to be achieved and in weighing those claimed benefits in its overall approval process. In deciding if it will approve a particular proposed railroad merger, however, the Board necessarily must rely on the best, albeit unavoidably imperfect, information available at the time of decision. Clairvoyance in predicting the future effects of a proposed railroad consolidation is obviously impossible, and no rail merger applicant could possibly (or fairly) be put to that standard.

Norfolk Southern does recommend one potentially significant change (or, perhaps more accurately, change in emphasis) in the way the Board evaluates claimed public benefits of a proposed major rail consolidation. The Board has suggested, and NS agrees, that the current

balanced structure of the railroad industry may make it possible for the major rail systems to achieve through inter-carrier marketing agreements, alliances and other coordination short of formal merger at least some of the benefits that previously may have been attributed to railroad mergers and therefore considered as a public benefit in the merger review process.⁹ For example, independent carriers may be able to reduce costs through joint purchasing even in the absence of a formal merger. Through inter-carrier marketing and operating agreements, independent railroads may also be able to offer joint-line service that has some of the features and advantages of single-line service. (In the recent CN/IC proceeding,¹⁰ for example, applicants touted their alliance with Kansas City Southern as making possible what they called "single-line like" service.) As Mr. McClellan explains in his verified statement (at 4-8), alliance and inter-carrier coordinations are becoming more common in the rail industry and, although difficult to negotiate and implement successfully, can provide some (but certainly not all) of the same kinds of benefits as a formal consolidation.

In light of the possibility that some types of benefits previously attributed to railroad consolidations could today be achieved by means short of merger, the Board should revise its merger policy statement to make clear that, in conducting its public-interest analysis, it will not consider as a merger-related public benefit any claimed synergies or other benefits that could reasonably be achieved by the parties without a formal merger or consolidation. The Board (and ICC) in the past have articulated this principle -- which is set forth in the existing merger

⁹ See *Suspension Order* at 9 n.13; STB Ex Parte No. 582, *Public Views on Major Rail Consolidations* (served April 7, 2000) ("Stay Order"), at 11.

¹⁰ See STB Finance Docket No. 33556, *Canadian National Railway Co. -- Control -- Illinois Central Corp. ("CN/IC")*, Decision No. 37 (served May 25, 1999).

policy statement (49 C.F.R. § 1180.1(c)) -- but have generally credited, without rigorous scrutiny, claims that particular merger benefits could only be achieved through formal merger. The kinds of major rail combinations likely to come before the Board in the future, however, will raise a host of significant issues relating to effects on competition, service and safety and other matters. In view of the challenges posed by future consolidations, it is appropriate for the Board to enforce a sort of "least restrictive alternatives" standard providing that a claimed benefit will justify approval of a major rail combination only if the benefit cannot be achieved by other means posing less risk to the public interest.¹¹ The Board should be satisfied that claimed merger synergies and benefits are not likely to be achieved by means short of merger, and the issue whether specific claimed merger benefits are properly treated as merger-related public benefits should be a matter for evidence and adjudication in individual major rail consolidation applications.

C. Safeguarding Rail Service

One of the most serious issues posed by recent major railroad consolidation transactions, and one raised by a host of parties during the recent Ex Parte 582 hearings, concerns the impacts of railroad mergers on the quality and reliability of rail service. Several recent major rail consolidation transactions -- including, unfortunately, the NS/CSXT/Conrail transaction

¹¹ Such a "least restrictive alternatives" requirement would be somewhat similar to the way claimed merger-related efficiencies are treated under the antitrust laws. In deciding whether merger-related efficiencies might justify an otherwise anti-competitive merger, the U.S. Department of Justice and the Federal Trade Commission require the merging parties to demonstrate that the claimed efficiencies are likely to be obtained with the merger and are unlikely to be obtained without the merger (or some other means that poses fewer competitive problems than the merger). 1992 Horizontal Merger Guidelines, § 4, 4 Trade Reg. Reporter (CCH) ¶13,104 (rev. ed. 1997). Of course, in contrast to the antitrust laws (which are addressed solely to competitive effects), merger-related efficiencies have independent relevance and weight under the public-interest standard administered by the Board.

-- have resulted in service disruptions. These service problems, while temporary in nature, have occurred during the initial implementation of approved mergers and have been a significant concern to some customers. These temporary service problems also have adversely affected the railroads (including NS) through loss of freight traffic to other modes and railroads, markedly increased operating expenses incurred to rectify service deficiencies and, not surprisingly, sharply reduced earnings.¹²

As the Board's ANPR notes, many parties during the recent hearings urged the Board to adopt new rules to ensure that future major rail consolidations would not cause these kinds of service disruptions and to protect shippers in the event they do. ANPR at 7. Regrettably, Norfolk Southern has had to deal with these vexing service issues, as have other railroads. Based on that experience, NS is convinced that merger-related service impacts should be a major consideration in the Board's review of proposed major rail combinations. But NS urges the Board to resist the temptation to impose short-sighted, burdensome and ultimately self-defeating remedial measures to deal with implementation service problems. Obviously, no merger applicant intends to create such service disruption. Furthermore, no single or clear planning steps would in every transaction prevent service problems.

1. Service Improvements as a Primary Factor in the Board's Public Interest Determination

One of the major issues facing the railroad industry today is the need to improve the quality of service provided to shippers. This issue has assumed greater immediacy in the wake

¹² Of course, the recent earnings record of the major railroads (including NS) have been affected by other factors unrelated to recent merger transactions. For example, NS's earnings have been affected by the sharp downturn in its export coal business, a development that had nothing to do with its implementation of the recent Conrail transaction.

of the disappointing service record of the railroad industry during the implementation of recent rail mergers, and the resulting effect on customer confidence in the industry's ability to deliver safe, timely and efficient service. But the service issue transcends the temporary dislocations associated with recent merger transactions. Accordingly, NS believes that the Board's revised merger policy should identify as a primary public interest consideration in the assessment of a major rail consolidation proposal the anticipated effects of the transaction on the adequacy of transportation service to the public.

Major railroad mergers should result in better, not worse, service to shippers. If a proposed merger cannot produce better service, it should not be approved. Merger proponents should therefore be required affirmatively to demonstrate that their proposed combination will materially improve rail service as a whole. Anticipated service improvements should not support approval of a proposed combination if they simply reflect the efforts of the separate applicants to do a better job running their freight operations or involve changes in business practices that could be implemented without the proposed merger. Rather, claimed merger-related service improvements should be predicated on identifiable structural changes made possible by the consolidation (such as expansion of single-line service, infrastructure and capacity investment, internal re-routing of traffic, and similar effects). In short, the Board should impose a requirement of a particularly strong showing of positive merger-related service impacts.¹³

¹³ In assessing the service impacts of a proposed major rail consolidation, the Board should focus on system-wide effects as a whole, and not solely on the impacts of the transaction on particular shippers. Changes in rail networks, traffic volumes, routings and operating practices caused by a proposed major rail consolidation will never affect all shippers equally. Some individual shippers may not enjoy merger-related service improvements to the same extent that other shippers will, and others may suffer a diminution in service. But if the beneficial service

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2. Requirement of a Service Integration or Merger Implementation Plan

Applicants in future major rail consolidation proceedings should also be put to a more exacting standard in demonstrating that shippers will not suffer significant service disruptions during the implementation of a proposed consolidation. NS recommends that the Board require merger applicants to include in their initial rail consolidation application a service integration or merger implementation plan, which would outline the applicants' plans for implementing the proposed transaction, describe steps to be taken to minimize the potential service disruptions associated with the merger implementation process and outline, to the extent possible, the measures the applicant carriers will take both to prevent and, if necessary, to remedy any such service problems. This plan, and the commitments the applicants are willing to make to prevent and remedy merger-related service disruptions, should be accorded substantial weight in the Board's public interest determination.¹⁴

Requiring merger applicants to develop and present for scrutiny by the Board and interested parties a plan for implementing the proposed transaction and minimizing the possibility of service disruptions would have a salutary purpose. It would permit the issue of potential merger-related service disruptions to be fully considered by the Board in evidentiary proceedings

¹³(...continued)
impacts of a proposed transaction far outweigh its harmful service impacts, the proposed transaction should be approved. A proposed combination that would benefit most shippers should not be disapproved simply because it may not benefit, or may even harm, a few shippers.

¹⁴ Thus, the extent to which applicants in particular major rail consolidation proceedings are willing to offer specific service commitments, or remedial measures in the event they experience merger-related service disruptions, should be an element in deciding whether the proposed consolidation should be approved.

before rendering its decision on the merits of a proposed transaction, and thereafter updated and reviewed as the merger implementation process is carried out.

Merger implementation is, by its nature, a fluid process. *See McClellan VS* at 14-17, 19-20. No planning process can anticipate every contingency or predict how the implementation process will work in practice. Economic factors unrelated to a particular merger can also significantly affect how a transaction is implemented, and how service patterns may be modified. The service integration or merger implementation plan suggested by NS here should, therefore, be subject to appropriate change in light of the actual course of merger implementation, and should serve as a guide to implementation rather than a set of binding requirements. Just as the operating plans submitted in railroad consolidation applications are designed to reflect the applicants' best judgment about the planned operation of the merged system but do not establish binding requirements for the merged system, so too a service integration or merger implementation plan should not be used to prevent the railroads from making appropriate or necessary changes in the way their consolidation is implemented and in the way their rail network is operated.

3. Remedies for Merger-Related Service Disruptions

Requiring the submission of more detailed merger implementation and service integration plans, however, cannot itself ensure or guarantee that a particular major rail consolidation transaction will not experience even significant service disruptions. Norfolk Southern knows this only too well. Despite the most intensive and lengthy merger planning effort in U.S. railroad history, NS experienced service problems in the period following the consummation of its assumption of operations over portions of the Conrail system. To be sure, the Conrail transaction (involving the joint acquisition of control and division of the former Conrail system into three

parts) was perhaps the most complicated rail consolidation transaction ever implemented, and even then the service problems NS experienced were relatively short-lived and, today, are largely behind it. Moreover, it is unlikely that any future major rail consolidation would face anything close to the "degree of difficulty" of the Conrail transaction unless, of course, a future transaction involves major changes in the applicant carriers' networks (such as, for example, significant changes required to implement any conditions the Board might impose to alter the competitive equation). Norfolk Southern's experience suggests, however, that even the most well-intentioned and most comprehensive merger planning efforts cannot guarantee that all contingencies can be anticipated or that problems will not arise.

Because advance planning cannot entirely eliminate the possibility of merger-related service disruptions, the question arises as to what responsibility the merging carriers should have in remedying unanticipated service problems and what role (if any) the Board should play in addressing service-related disputes. As the ANPR notes, various parties have suggested that the Board impose a new remedial system making railroads the guarantors of service levels through monetary penalties or access remedies for merger-related service degradation, possibly administered through a binding arbitration procedure with appellate review by the Board. ANPR at 7. Such proposals would be counterproductive and misguided, and the Board should not adopt them.

The marketplace is the best guarantor of adequate service. Railroads have ample economic incentives to do everything reasonably necessary to implement rail mergers in a manner that avoids any significant service disruptions. Again, Norfolk Southern's experience is instructive. The service disruptions experienced in the implementation of the Conrail transaction

imposed adverse consequences on NS. These consequences have included significantly increased expenses for additional locomotives, crews and other measures to improve service and diminished financial performance. No one can reasonably doubt that the economic and commercial pain inflicted by these adverse consequences is a more than adequate deterrent to reasonably avoidable service problems in the merger implementation process.

Given the compelling incentives that railroads already have to take all reasonable steps to prevent significant merger-related service problems, the imposition of additional monetary penalties on railroads for merger-related service deficiencies, as some have suggested, would do nothing to prevent service problems from happening, and are otherwise unnecessary or unsound. Shippers aggrieved by serious service deficiencies already have a right to obtain monetary relief to compensate for direct injuries to their shipments resulting from delay. Private transportation contracts negotiated between railroads and shippers may also provide for additional remedies, such as liquidated damages or premium transportation costs. Generally, such monetary or contractual relief excludes consequential damages, such as lost profits of shippers whose own business operations may be interrupted by a rail service deficiency.

Nor would it make sense for the Board to adopt a rule automatically granting an alternative rail carrier the right to serve a shipper that has experienced a significant disruption of service as a result of a major rail merger. The Board's existing regulations already provide for such relief (on a temporary basis) when access by an alternative rail carrier can effectively ameliorate a serious service interruption. See STB Ex Parte No. 628, *Expedited Relief For Service Inadequacies* (served Dec. 21, 1998) (codified at 49 C.F.R. §§ 1146-1147). Moreover, as the Board has previously recognized, granting another carrier access to serve a particular

shipper whose service has been disrupted may often aggravate, rather than relieve, the service problems.¹⁵ Most of the merger-related service disruptions the rail industry has experienced in recent times has been attributable to traffic congestion on particular lines and in particular yard facilities. Granting another railroad the right to operate its trains over the congested facilities typically would not solve, but would only add to, the congestion. And granting shippers some sort of automatic right to an access remedy for merger-related service problems would raise a host of administrative problems. In particular, an access remedy granted for the benefit of one aggrieved shipper might well produce service disruptions to the affected railroad's other shippers, or result in the petitioning shipper obtaining an undue preference in service.¹⁶ The Board's existing emergency service access rules are adequate to address these different considerations and to provide appropriately limited access relief tailored to particular service disputes.

Finally, a requirement that railroads submit service disputes to binding arbitration, with appellate review by the Board, would do little to remedy serious merger-related service problems. Existing procedures, including civil remedies, are sufficient to address shipper service claims. Shippers desiring an arbitral forum should seek to negotiate rail transportation contracts providing for such a remedy. In any event, it is unlikely that the Board would have sufficient personnel and resources to administer and supervise such a binding arbitration procedure.

¹⁵ See, e.g., 49 C.F.R. § 1146.1(b)(1)(C) (Board's service emergency access rules providing that access will be granted only if "the alternative service would be provided safely without degrading service to the existing customers of the alternative carrier and without unreasonably interfering with the incumbent's overall ability to provide service")

¹⁶ See, e.g., STB Service Order No. 1523, *Petition for Emergency Service Order* (served Nov. 23, 1999) (declining one shipper's request for an order compelling CSXT and NS to meet certain service standards where service problems were due to traffic congestion and operating changes affecting numerous shippers);

Norfolk Southern would not object to a rule requiring merging railroads to respond to shipper service claims on an expedited basis. But the creation of an entirely new remedial scheme to deal with merger-related service degradation would create more problems than it would solve.

D. Promoting Adequate Infrastructure and Capacity

Echoing the comments of many parties in the recent Ex Parte 582 hearings, the Board has correctly identified as one of the most pressing challenges facing the railroad industry today the need to maintain, expand and reallocate the physical infrastructure and capacity of the freight rail system. ANPR at 7. Railroading is an enormously capital-intensive business, and capital investment in physical plant and facilities is the virtual life-blood of the industry. Infrastructure investment and capacity also have a direct and immediate bearing on the issue of service. As the Board has noted, the congestion and service problems experienced in connection with recent major railroad mergers were certainly exacerbated by a lack of adequate rail infrastructure at key locations.¹⁷ If railroads (including NS) are to maintain and improve the level of service they provide their customers, and if they are to attract the additional freight traffic that holds the key to future growth and financial viability, they must invest heavily in maintaining, replacing and expanding their infrastructure and capacity. In order to raise the capital to make such investments, railroads (including NS) must improve their profitability. Regulation, including regulatory review of proposed railroad consolidations, must have as a central objective the goal of fostering sound conditions for such investment in adequate infrastructure and capacity.

¹⁷ See, e.g., STB Finance Docket No. 32760 (Sub-No. 26), *Union Pacific Corp. — Control & Merger — Southern Pacific Rail Corp.* (served Aug. 4, 1998), at 5.

Norfolk Southern believes that the policy of promoting adequate rail infrastructure and capacity should be reflected in the Board's revised merger guidelines in three ways.

First, the Board should revise its merger policy statement to provide that the impact of a proposed major rail consolidation on the preservation and expansion of core rail infrastructure and capacity will be treated as a significant factor in the Board's public interest determination. Because adequate rail infrastructure is a key determinant of the level and quality of service railroads are able to provide, focusing on a proposed merger's impact on essential infrastructure and capacity is simply a corollary to the more general principle that the Board should give more significant weight to service impacts in deciding whether to approve a particular railroad merger transaction. Proposed railroad consolidations that facilitate the carriers' ability and incentive to make needed capital investment in core rail infrastructure and capacity should be strongly encouraged.

Second, in order to assess the impacts of a proposed major rail consolidation on the preservation and expansion of rail infrastructure and capacity, the Board should amend its regulations to require the applicant carriers to include in their application a capital investment or infrastructure assessment plan. This plan should assess the applicant railroads' existing infrastructure and capacity needs, identify additional investments and capacity that may be needed to accommodate projected post-merger traffic volumes, explain how anticipated capital investment requirements will be funded and describe whether and how the proposed consolidation would facilitate such infrastructure investment.¹⁸ Such a plan would then be open to scrutiny by the

¹⁸ Such a requirement would be analogous to the infrastructure plans that the Board required Union Pacific to submit during the UP/SP merger oversight proceedings and investigation into the
(continued...)

Board and by interested parties, thus facilitating a more informed consideration of the long-term service impacts of the proposed rail consolidation.¹⁹

Third, the Board should make clear in its revised merger policy statement that impacts on adequate infrastructure and capacity will also be considered as an important factor in deciding whether to impose particular conditions to approval of a proposed rail merger. Parties requesting the imposition of a condition should be required to submit evidence assessing the likely impact of the requested relief on the applicant carriers' ability and incentive to maintain adequate rail infrastructure and capacity. This requirement would be just the flip side of the duty of the primary applicants to assess the impacts of their proposed combination. If a requested condition (such as a trackage rights or reciprocal switching or other access condition) would have the likely effect of reducing rail rates and revenues and undermining the ability of the applicant carriers to raise capital for needed investment in plant and facilities, that impact should be considered by the Board as a factor weighing against imposition of the proposed condition. Just as the Board should strongly encourage proposed rail mergers that would promote adequate rail infrastructure and capacity, it should strongly discourage requested merger conditions that would frustrate or impede this goal.²⁰

¹⁸(...continued)
service crisis that UP experienced following implementation of that transaction.

¹⁹ As with other forward-looking merger-impact studies submitted as part of a railroad consolidation application, the railroads' plans for infrastructure investment and capacity expansion should not become binding requirements, but should be subject to modification as circumstances, including conditions in the affected rail freight markets, change. Such modifications would not require Board approval.

²⁰ The Board emphasized precisely this point in deciding to deny requests to reopen its
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E. Competitive Effects

In assessing proposed major rail consolidations under the statutory public interest test, the Board and the ICC have always given careful, if not primary, consideration to the effects of the proposed transaction on competition. The governing statute directs the Board to consider impacts on rail competition, and the Board's existing merger policy statement similarly emphasizes impacts on competition as a key consideration in reviewing rail merger proposals.²¹

The Board and ICC have long recognized, however, that railroad mergers can have both positive and negative impacts on competition. By reducing existing competitive transportation alternatives available to shippers, rail consolidations (particularly parallel transactions) may increase the ability of the merged system to exercise undue market power by charging higher rates and/or providing degraded service. Such effects are correctly treated as transaction-related public harms and, unless remediable through conditions, weigh against approval of a proposed combination. But railroad mergers may also enhance or increase competition -- both between railroads and, importantly, between railroads and other transportation modes -- by enabling the merged system to offer improved service, reduce costs, achieve operating efficiencies and, generally, enhance the long-term financial viability that alone permits the railroad to maintain, replace and expand its infrastructure and provide safe, reliable and efficient service. This principle reflects the need for railroads (like any business) to earn adequate revenues and cover their full

²⁰(...continued)

UP/SP merger decision in order to impose open switching within the Houston terminal area. See STB Finance Docket No. 32760 (Sub-No. 26), *Union Pacific Corp. -- Control & Merger -- Southern Pacific Rail Corp. [Houston/Gulf Coast Oversight]*, Decision No. 10 (served Dec. 21, 1998) ("Houston/Gulf Coast Oversight").

²¹ See 49 U.S.C. § 11324(b)(5); 49 C.F.R. § 1180.1

costs of service if the competition they provide is to be sustainable. A significant issue in every railroad merger proceeding has been how to weigh these various effects to promote competitive, sustainable rail transportation.

In assessing the impacts of proposed rail consolidations on competition between rail carriers, the Board and ICC have long adhered to the principle that merger review should be focused on the preservation of pre-existing rail-to-rail competition and the imposition of conditions only to ameliorate merger-related reductions in rail-to-rail competition. The agency has also looked with favor on voluntary proposals by rail merger applicants to expand direct rail-to-rail competition, such as the Shared Assets Areas that were created in the recent Conrail transaction,²² just as it has welcomed competition-enhancing projects (such as rail line "build-outs" and other rail line construction projects) that are fostered by the market. But the agency has steadfastly resisted efforts to use the merger review process (much less regulation generally) as a vehicle for expanding or injecting, through various types of involuntary "open" access measures, rail-to-rail competition that the marketplace itself has not fostered.²³

The Board reaffirmed this rule less than two years ago when it rejected the requests of various parties to impose an "open access" merger condition that would have required Union Pacific to open up all solely served shippers within the entire Houston terminal switching district to access by other railroads:

²² See *Conrail*, Decision No. 89 (served July 23, 1998), at 133; *McClellan VS* at 15-16.

²³ See, e.g., *Conrail*, Decision No. 89 (served July 23, 1998), at 70-71 (rejecting requests by various shippers served solely by Conrail prior to the proposed joint CSXT/NS/Conrail transaction to receive post-transaction service from both CSXT and NS).

Well-established transportation law recognizes that some shippers are served by a single railroad. It also recognizes that such "captive shippers" may pay higher rates under "demand-based differential pricing" legal principles that govern the railroad industry, to reflect the economies of the railroad industry and the fact that some rail traffic is more captive and some more competitive. Because the railroad industry is not an open access industry, and because some shippers may pay more than others under the law that we administer, merger proceedings are not used as vehicles to equalize the competitive positions of shippers generally. The Board does adopt competitive conditions to ensure that a merger does not put shippers into a worse position than they were in before. . . . But a well-established principle of rail merger law is that the conditions the Board imposes in a merger proceeding are designed to ameliorate specific merger-related harm, not to simply add more competitors.

Houston/Gulf Coast Oversight, supra, at 2-3.

The Board also emphasized in that case that, because the requested "open access" condition (dubbed the "Consensus Plan" by its proponents) was unrelated to any actual merger-related harm, there was no principled basis for limiting the relief to the Houston terminal area. "The Consensus Plan is premised on the idea that shippers should, wherever possible, be served by more than one railroad If we adopt the Consensus Plan, then there is no basis on which we could refuse to provide for open access throughout the rail system." *Id.* at 2. The Board properly recognized that such a regime of open access could prevent the railroads from using differential pricing to recover their large fixed and common costs and undermine their ability to invest in needed plant and facilities. For this reason, the Board concluded that the requested "open access regulatory scheme" is "not provided for in the statute the Board currently administers, and thus, in our view, is a matter more appropriately debated in Congress." *Id.*

Notwithstanding these findings, the Board has now declared in its ANPR that "we believe that the time has come to consider whether we should alter our rail merger policy to place a greater emphasis on enhancing, rather than simply preserving, competition." ANPR at 7. The

Board outlined various proposals for such forced access conditions, and invited comment on these or any other proposals to use merger conditions to "promote and enhance competition in the rail industry." *Id.*

Norfolk Southern respectfully suggests that the radical change in rail merger policy raised in the ANPR would be unlawful for the reasons the Board itself articulated in *Houston/Gulf Coast Oversight*, unnecessary in light of competitive market forces and fundamentally bad public policy in any event. The Board's competitive-effects analysis of proposed major rail consolidations should continue to be focused on preserving rail-to-rail competition, not using regulation in a misguided attempt to manufacture an artificial, and ultimately unsustainable, form of rail-to-rail competition. Norfolk Southern recommends a number of changes in the way the Board assesses and remedies genuine merger-related competitive harms, but the reregulatory forced access proposals outlined in the ANPR should be rejected.

1. Preserving Rail-to-Rail Competition

In previous rail consolidation proceedings, the analysis of rail-to-rail competitive effects and of appropriate conditions to ameliorate merger-related competitive harms has tended to focus on several recurring issues, including (a) "two-to-one" issues, (b) "three-to-two" issues, (c) the "one-lump" doctrine, and (d) other vertical effects issues such as the maintenance of efficient gateways. The Board's ANPR invited comment on how some of these issues should be treated in revised merger rules. ANPR at 7-8.

(a) "2-to-1" Issues

Although all of the major rail mergers approved by the Board and ICC over the past 20 years have been largely end-to-end combinations, with little horizontal overlap in the merging carriers' lines, most transactions have involved some number of rail shippers that were directly served before the merger by both of the combining carriers and that, as a result of the proposed combination, would experience a reduction in the number of direct rail options from two to one. The Board and ICC have consistently concluded that such "2-to-1" shippers would suffer merger-related competitive harm and that such harm warranted remedial relief in the form of a merger condition granting an independent rail carrier the right to serve the affected shippers by means of trackage rights, reciprocal switching or other measure. This practice has become so common that most recent merger applicants have proactively identified such "2-to-1" shippers in their application and have proposed or even voluntarily negotiated a competitive remedy at or sometime after the filing of their railroad consolidation application.

In light of this consistent practice, Norfolk Southern suggests that the Board codify its recent practice by providing in its revised merger policy statement that, absent unusual circumstances, a major rail consolidation proposal should include voluntary arrangements (subject to Board prescription of reasonable terms in the event of disagreement) for trackage rights, switching or other appropriate access by an independent carrier to replicate two-carrier rail service for those individual shipper facilities whose direct rail alternatives would be reduced from two to one as a result of the proposed transaction. The Board's merger policy should require such a remedy whenever it is practicable, and should in any event impose a burden on the

applicant carriers to identify affected "2-to-1" shippers and attempt to come up with an appropriate plan to remedy merger-related competitive harm to these shippers.

(b) "3-to-2" Issues

In recent major rail consolidation proceedings, the Board and ICC have generally concluded that a merger-related reduction from three to two in the number of independent railroads serving a particular shipper facility does not result in a significant diminution in competition sufficient to warrant the imposition of conditions.²⁴ The agency has concluded that the remaining two-carrier rail competition was sufficient to prevent increased exercise of market power in the setting of rates and services and, in the case of the UP/SP merger, that the combination of two of the three serving railroads would actually enhance competition by strengthening the combining railroads' systems and long-term financial viability.

The Board's ANPR invites comment on how the proposed new merger policy should address such "3-to-2" shippers. ANPR at 9. Norfolk Southern believes that this issue should best be left to case-by-case examination based on the individual circumstances of each case. Few rail markets can support viable three-carrier rail service, while experience (including NS's experience in competing head-to-head with CSXT in numerous markets) teaches that two-carrier rail service will normally preserve effective, robust competition. In the relatively few situations where three-carrier service remains, the issue whether a merger-related reduction from three to two direct serving rail carriers causes harm to competition is likely to turn on the character of the particular services involved and the condition of the serving railroads. These

²⁴ See STB Finance Docket No. 32760, *Union Pacific Corp. - Control & Merger - Southern Pacific Rail Corp. ("UP/SP")*, Decision No. 44 (served Aug. 12, 1996), at 119-21.

issues are best left for case-by-case adjudication, especially because the specific infrastructure available will greatly determine whether a reduction in the number of carriers serving the market enhances or reduces rail service options.

(c) "One-Lump" Doctrine

The Board has invited comment on whether it should consider proposals to revise "the application of the 'one-lump' theory to rail mergers" by requiring that trackage rights be granted to another carrier when a railroad that exclusively serves a shipper merges with one of several connecting carriers. The argument is that, although the Board and reviewing courts have accepted the validity of expert economic evidence demonstrating that the exclusively served shipper in such situations does not suffer a reduction in competition for its traffic,²⁵ the Board should nonetheless impose a condition mandating trackage rights for another carrier to access the exclusively served shipper's facilities in order to promote or enhance competition.

In short, proponents of this "remedy" simply seek to use the fact of an end-to-end consolidation transaction as a convenient opportunity to force two-carrier rail access to exclusively served shippers whose situations would not change at all as a result of the transaction. In addition to consistently rejecting the economic theory on which these claims are based, the Board and ICC have found that the relief that shippers have sought in order to address this phantom competitive harm -- a grant of trackage rights over the lines of the carrier that provided exclusive

²⁵ See, e.g., *Conrail*, Decision No. 89 (served July 23, 1998), at 67-70, 78; ICC Finance Docket No. 32549, *Burlington Northern Inc. -- Control & Merger -- Santa Fe Pacific Corp.* ("BN/Santa Fe"), Decision No. 38 (served Aug. 23, 1995), *aff'd sub nom. Western Resources, Inc. v. STB*, 109 F.3d 782 (D.C. Cir. 1997).

rail service before the proposed consolidation -- would be enormously overbroad and would go far beyond simply restoring pre-merger rail competitive options.

The "one-lump" doctrine is not an immutable principle foreclosing all opportunity for relief to exclusively served shippers which claim that the merger of their serving railroad with a connecting carrier would cause competitive harm. The doctrine erects only a presumption, which is rebuttable in individual cases, that such end-to-end mergers do not harm competition. Shippers have the opportunity to rebut the theory and its applicability in individual cases. That rule should be continued. But there is no proper basis on which to declare the theory essentially "null and void" simply by ignoring what it demonstrates.

(d) Maintenance of Efficient Gateways

During the post-Staggers period, the ICC and Board have consistently found that vertical, or end-to-end, railroad consolidations generally have no adverse effects on competition but, to the contrary, strengthen competition by expanding single-line service opportunities and allowing railroads to provide better, more efficient service in competition with other rail carriers and other modes. Consistent with the agency's treatment of vertical effects claims subject to the "one-lump" doctrine, the Board and ICC have uniformly rejected arguments that an end-to-end rail merger would reduce competition through the foreclosure of independent connecting railroads. Specifically, the agency has rejected claims that railroads would have an incentive to close efficient interchanges with other carriers and favor the extended single-line routes created by an end-to-end merger over more efficient joint-line routes.²⁶

²⁶ See, e.g., *Rulemaking Concerning Traffic Protective Conditions in Railroad Consolidation Proceedings*, 366 I.C.C. 112 (1982), *aff'd sub nom. Detroit, Toledo & Ironton Railroad Co.* (continued...)

Despite these consistent rulings, various shipper interests continue to raise concerns about the potential effects of an end-to-end railroad merger in closing efficient gateways and requiring shippers to utilize a merged system's long-haul single-line routes in preference to other efficient interline routes. These concerns have assumed increased significance as consolidations have reduced the number of major railroad systems and as the railroad industry faces the imminent prospect of mergers creating the first transcontinental rail systems. For example, if one of the western carriers were to propose a combination with Norfolk Southern, shippers that are today exclusively served at origin by that western carrier and that could utilize either NS or CSXT to complete their freight shipments in the eastern U.S. (through an interchange at a gateway such as Chicago) might be concerned that, as a result of this hypothetical merger, they would be foreclosed from using CSXT on an interline basis with the merging western carrier and would be forced instead to use single-line NS service. This concern is sometimes expressed in terms of an end-to-end merger extending a "bottleneck" line segment.

Norfolk Southern believes that, although railroads have no incentives to close efficient gateways and interchanges, concerns about the merger-related closure of major gateways has assumed such significance in the light of the current structure of the railroad industry that it would be appropriate for the Board to include in its revised merger policy a provision to preserve,

²⁶(...continued)

v. ICC, 725 F.2d 47 (6th Cir. 1984); ICC Finance Docket No. 21215 (Sub-No. 5), *Seaboard Air Line Railroad Co. - Merger - Atlantic Coast Line Railroad Co. - Petition to Remove Traffic Protective Conditions* (March 27, 1995); *Guilford Transportation Industries, Inc. - Control - Boston & Maine Corp.*, 5 I.C.C.2d 202, 218 (1988); ICC Docket No. 39176 (Sub-No. 1), *Pittsburgh & Lake Erie Railroad Co. v. Consolidated Rail Corp.* (decided April 3, 1985), *aff'd sub nom. Pittsburgh & Lake Erie Railroad Co. v. ICC*, 796 F.2d 1534 (D.C. Cir. 1986); *CSX Corp. - Control - American Commercial Lines, Inc.*, 2 I.C.C.2d 490, 528 (1984), *aff'd sub nom. Crounse Corp. v. ICC*, 781 F.2d 1176 (6th Cir.), *cert. denied*, 479 U.S. 890 (1986).

for solely served interline rail shippers that today have rail alternatives for a portion of their freight movements, the post-merger availability of efficient pre-merger gateways that have actually handled the interchange of significant amounts of freight traffic. This measure would allay concerns about the potential adverse end-to-end effects of a possible future transcontinental rail merger and claims that such transactions may serve to extend "bottlenecks" to the competitive disadvantage of "captive" rail shippers.

The serious challenge in fashioning such a new rule to safeguard major efficient gateways, however, is to avoid unwittingly resurrecting the discredited *DT&I* traffic protective conditions of the past. Under those conditions, the ICC required as a condition to approval of railroad mergers that the combining railroads maintain, and keep commercially open, *all* pre-merger interchanges with other railroads. The concern about having too many interchange points is even more valid today. Then, the issue was too much capacity and too many expensive, low-volume points. Today's reality is that the infrastructure to support low-volume interchange points does not exist. And the increased switching which results from having more interchange points can cause deterioration in service for many other customers that use the rail network of the affected carriers. As the ICC long ago recognized, these gateway protection conditions had the effect of freezing inefficient gateways, insulating connecting railroads from competition from new, expanded single-line service offerings of the merged railroads and destroying the ability of the railroads to consolidate traffic on higher-density longer-haul routes and thereby to improve service and reduce costs.²⁷ The gateway protection conditions also had the anti-competitive effect

²⁷ See, e.g., *Rulemaking Concerning Traffic Protective Conditions in Railroad Consolidation Proceedings*, 366 I.C.C. 112 (1982); *Seaboard Air Line*, *supra*.

of freezing railroad rates over competing routes because the conditions locked railroads into maintaining all existing joint-line routes and adoption of market-based rates at different levels for different routes could be challenged as a "commercial closing" of the frozen interchanges.

For this reason, any measure to protect efficient gateways must take care to insure that it does not result in a requirement that every pre-merger interchange point, regardless of the level of its actual use and regardless of its relative efficiency, be kept open and frozen for all time. That would simply handcuff the railroads in modifying their traffic routing practices to take account of market conditions and, perversely, would retard rate and service competition between alternative single-line and joint-line routes. Rather, the new policy NS is suggesting should be focused on requiring the maintenance of truly important, major, operationally feasible and efficient gateways for those exclusively served shippers who could credibly claim that an end-to-end merger would extend a "bottleneck" and reduce the competitive rail alternatives they enjoyed pre-merger. As an initial proposal, Norfolk Southern suggests that, for possible future east-west U.S. transcontinental consolidations, such a gateway protection measure could appropriately apply to the major Midwestern and Mississippi River gateways of Chicago, Kansas City, St. Louis, Memphis and New Orleans. For other particular transactions, it could be extended to comparable major gateways that handle significant traffic volumes. Because this measure would be focused on *preserving* the competitive routing options that existed prior to a proposed major rail consolidation, moreover, the protection should be afforded only to individual shippers that are exclusively served at origin or destination by one of the combining railroads, that prior to the proposed merger could complete their freight shipment only through an interchange at a gateway served by another one of the railroads and at least one other independent railroad, and that

actually used the covered gateway for a significant volume of freight traffic prior to the proposed railroad consolidation.²⁸

Norfolk Southern suggests that this proposed gateway protection policy be implemented by requiring major rail consolidation applicants to establish, upon reasonable request by eligible solely served rail shippers, a common carrier or contract rate to apply to the movement of the shipper's traffic over the merged carriers' lines to/from a covered interchange point for use in conjunction with another railroad not involved in the proposed consolidation. The shipper would then be free to interchange its traffic with another connecting rail carrier at that connection and to use interline transportation service to complete the shipment. If the affected shipper were dissatisfied with the rate offered by the merged system, the shipper could bring a complaint seeking prescription of a reasonable rate to apply to the movement. This mechanism would have the effect of preserving the competitive routing options that existed pre-merger, and preventing the merger from extending the scope of the "bottleneck." To illustrate using the hypothetical example discussed previously, if a western rail carrier and Norfolk Southern merged, and a particular shipper that is solely served by the western carrier prior to the merger had used interline service via the western carrier and CSXT over Chicago for a significant volume of freight traffic, the gateway preservation provision would require the merged NS system to offer the shipper a common carrier or contract rate to apply over the former western carrier's lines to or via Chicago for use in conjunction with CSXT to complete the shipment. In this way, the shipper's pre-merger alternative of using either NS or CSXT service would be preserved, and it would do so

²⁸ Because the purpose of this measure would be to prevent reductions in competition resulting from a merger, it would be inappropriate to extend it to exempt traffic (such as intermodal and automotive traffic) that, by definition, is subject to effective competition.

without requiring (as the old *DT&I* conditions did) railroads to freeze or equalize their rates over competing routes or embroiling the parties (or the Board) in disputes over the establishment of joint rates and divisions.

Norfolk Southern believes that a provision, along these lines, to preserve major, efficient gateways would go a long way toward meeting the concerns of shipper interests that another major rail consolidation -- and especially a transaction that creates the first U.S. transcontinental rail system -- would reduce competitive routing options for shippers. At the same time, by confining the measure to the most important, heavily used (and unquestionably efficient) interchanges, the proposal strikes an appropriate balance between maintaining competitive routing options and the opportunity for efficient long-hauls for all involved carriers and avoiding the recreation of the disastrous mandated open-routing policies of the past.

2. Attempting to Inject New Rail-to-Rail Competition Through Forced Access

As noted above, the Board has announced that, contrary to its longstanding and consistent interpretation of rail merger standards, it may wish to consider in this rulemaking the imposition of various forced or open access, "bottleneck" rate or other reregulatory requirements designed to inject new rail-to-rail competition as a condition to approval of future major rail consolidation transactions. ANPR at 7-8. Such attempts to "remedy" perceived or claimed competitive imbalances that are not generated by a particular transaction would be unsound, both because they would work to discourage what might otherwise be meritorious transactions and because they are inherently suspect in terms of their legal and economic rationale. Forcing additional competition for the sake of competition, without appropriate consideration of the

ability of the market to sustain such artificial competition, is a formula guaranteed to undermine railroads' viability.

The Board and the ICC have had extensive occasion to consider and to observe the central economic tenets of railroading. Railroads are a network industry with very high capital requirements to construct, maintain and modernize their physical plant and their equipment fleets. Because of those tremendous capital requirements, railroads have substantial fixed and common costs which they must be able to recover from the entire mix of traffic they carry. In order to spread those high fixed and common costs over as many units of traffic as possible, and in order to achieve the significant economies of scale, scope and density available to railroads, they must be able to build and maintain density on their lines and expand the scope of their service. And, in order to maximize traffic and achieve that critical component of density, railroads must be able to price their services differentially, which means that shippers whose need for rail service is the highest must pay higher rates, and shippers whose options to use other modes are the most flexible must be charged lower rates if railroads are to enjoy their business.²⁹ All railroad regulation must proceed from these fundamental economic realities, and the Board's railroad merger review policies are no exception.

Each of the proposals summarized at pages 7-8 of the ANPR to "promote" or "enhance" rail-to-rail competition flies in the face of the fundamental economic principles

²⁹ For both regulatory (common carrier obligations) and economic (the sunk nature of their investment) reasons, moreover, railroads also have no practical ability to exit a market once they have made their large investments in plant and facilities. This compels them to lower their prices toward variable or incremental cost when faced with direct competition, even though such prices prevent recovery of the costs -- and ultimately the replacement -- of the physical infrastructure that is needed for continued rail service.

governing the railroad industry. Equally important, because these proposals have no logical connection with any direct merger-related competitive harm, there is no principled basis for limiting their application to particular shippers, groups of shippers or locations, as the Board itself clearly recognized in the recent *Houston/Gulf Coast Oversight* proceeding. Railroads might be able to survive the imposition of forced access in limited areas of their rail networks and for limited numbers of shippers. The Board would, however, have no logical basis for deciding which particular shippers or facilities should be extended such access and which ones should not. And, if these access measures were applied to all or any significant component of the railroads' business, the results would be catastrophic.

(a) General Defects in Forced Access Proposals

The Board has invited comment on several specific forced access proposals. These proposals include requirements that participants in a proposed major rail consolidation maintain open gateways, provide reciprocal switching for shippers located in or near terminal areas, establish on demand separately challengeable common carrier rates over "bottleneck" line segments (or enter into contracts that would enable shippers to demand such "bottleneck" rates from other railroads) and grant trackage rights to exclusively served shippers in end-to-end mergers (abrogation of the "one-lump" doctrine). ANPR at 7-8.

Each of these proposals, and others like them, share several key features. Each would have the effect of compelling railroads to interchange traffic to another railroad at intermediate points even if that is not the most efficient way of handling the traffic, and to either fragment traffic over different potential rail routes or require joint operations over a single route. Each would give "captive" shippers that pay differentially higher rail rates the ability to use

artificial rail-to-rail competition to drive down rail rates and transfer revenues from the rail industry to "captive" shippers. And each would do so for the benefit of shippers whose rates today (and pre-merger) are not unreasonably high under the Board's established maximum-rate standards and regardless of whether the railroad as a result is able to cover its costs (including fixed costs and cost of capital). There are three fundamental defects in all of these proposals.

(1) Increased Costs. First, these forced access proposals subvert the fundamental economic principles that, for the past 75 years, have been driving railroads toward the consolidation of freight traffic on fewer, higher-density routes and extending the length of their hauls. As Mr. McClellan explains from practical experience, railroads are a network industry characterized by significant economies of scale, scope and density. McClellan VS at 9-14. A very significant proportion of their overall costs of service are fixed and common -- which is to say that they do not vary with changes in traffic levels and are incurred in common for the benefit of shippers of more than one commodity. The costs of rail trackage and signals systems, for example, are incurred in common for all of the traffic moving over a particular line segment, and some of the costs do not vary (at least in the short run) as traffic levels change. Increasing the traffic volume over the line segment thus reduces such costs for particular shipments.

In response to these economic forces, railroads have strived to consolidate freight traffic on higher-density lines and to eliminate costly interchange and switching of traffic. These forces have also played a large part in causing the railroads to pursue end-to-end mergers. The various forced access proposals described in the Board's ANPR, however, would undermine these efforts, by requiring railroads to do more switching and more traffic interchanges, and to

fragment traffic over a variety of feasible, but ultimately less efficient, routings.³⁰ In the process, railroads' efforts to structure their networks and traffic routings to maximize service and minimize costs would be frustrated. In short, the forced access proposals would introduce significant additional costs into the railroad industry and breed operating inefficiencies.³¹

(2) **Reduced Revenues.** The various forced access proposals all have as their primary purpose a reduction in rates. This results in a regulation-induced erosion of the railroads' ability to recover their fixed and common costs through demand-based differential pricing. All businesses engage in this practice to some extent,³² but it is vital to the railroads' financial viability because of the confluence of (i) a cost structure characterized by a very high degree of fixed and common costs and (ii) the fact that railroads face effective competition for most of their freight traffic. The Board has succinctly summarized the basis for differential pricing as follows:

Inherent in the rail industry cost structure are large amounts of joint and common costs that cannot be attributed to particular traffic. Because railroads, under the current system, serve a mix of competitive and captive traffic, a carrier cannot recover an equal portion of those unattributable costs from all traffic. Accordingly, it has been generally accepted that a railroad must price its traffic differen-

³⁰ Proponents of forced access requirements often claim that their proposals would only require railroads to exchange traffic at feasible interchange points, but this does not solve the problem. An interchange point between two railroads may have physical facilities making it operationally feasible to exchange traffic. Because of traffic flow and density considerations, however, the use of that interchange may well detract from the railroad's overall ability to reduce costs for all of the traffic it handles and to improve the performance of the entire network.

³¹ The forced access proposals would also increase infrastructure costs. Putting a second railroad with rights to operate over a particular line segment, or requiring additional interchange or switching activities, places additional strains on line and yard capacity. These capacity needs impose significant costs on the involved carriers.

³² The practice of differential pricing is illustrated by airlines that charge lower fares to travelers who book their flights in advance than to those who book just before a flight, and transit systems that charge higher tolls during rush hour.

tially so as to recover a greater percentage of its unattributable costs from traffic with a greater demand for (dependency on) rail transportation. Under demand-based differential pricing, shippers with greater transportation alternatives are offered lower markups to keep their traffic (and their contribution to the carrier's unattributable costs) on the rail network. As a result of this form of pricing, captive shippers may actually pay lower rates than would be necessary if competitive traffic were driven from the rail system by a purely cost-based pricing system.

STB Ex Parte No. 575, *Review of Rail Access & Competition Issues* (served April 17, 1998), at 2-3 n.2.³³

In markets in which the railroads face effective competition, therefore, rail rates are forced by competition down to a level close to the carrier's variable costs of service. To have any chance of recovering their fixed and common costs, therefore, railroads must charge higher-than-average markups above variable cost to less competitive (or so-called "captive") traffic, subject to an upward constraint based on the Board's stand-alone cost test (or its surrogate under the "simplified" non-coal rate standards).³⁴ The stand-alone cost standard, in turn, simulates a competitive market by ensuring that a railroad may not charge a "captive" shipper a rate that exceeds the amount that a hypothetical, efficient carrier operating in a perfectly competitive (or contestable) market would need to charge to cover its full costs of service and earn no excessive profit.

³³ See generally *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520 (1985), *aff'd sub nom. Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3rd Cir. 1987), *San Antonio Texas v. United States*, 631 F.2d 831, 850-53 (D.C. Cir. 1980), *Houston Lighting & Power Co. v. United States*, 606 F.2d 1131, 1148 (D.C. Cir. 1979), *cert. denied*, 444 U.S. 1073 (1980), *Potomac Electric Power Co. v. Consolidated Rail Corp.*, 367 I.C.C. 532, 538-39 (1983), *Volkswagen of America, Inc. v. Baltimore & Ohio Railroad Co.*, 367 I.C.C. 493, 501 (1983).

³⁴ See *Coal Rate Guidelines, supra*; STB Ex Parte No. 347 (Sub-No. 2), *Rate Guidelines -- Non-Coal Proceedings* (served Dec. 31, 1996).

All of the various forced access and "bottleneck" rate proposals would undermine the railroads' ability to recover their fixed and common costs through differential pricing. By introducing through various means an artificial form of direct rail-to-rail competition, these measures take away the railroads' ability to charge differentially higher rates to "captive" rail shippers (precisely by taking away their "captive" status), leaving the railroads unable to cover their fixed and common costs.

(3) Reduced Investment in Infrastructure and Capacity. As a combined result of the increased costs and reduced revenues that the various forced access proposals would inevitably produce, these measures would dissipate the railroad industry's ability and incentive to attract the capital necessary to maintain, replace and expand the physical infrastructure and capacity of the Nation's rail system. If the experience of the rail industry during the 1960's and 1970's teaches anything, it is that the railroad industry's service levels and ultimate financial viability are critically dependent on the continued ability to invest in the physical infrastructure of the system, and that to do so they must be afforded an opportunity to earn revenues that cover all of the economic costs of service (including recovery of fixed and common costs), and generate a competitive, cost-of-capital return. Otherwise, we will see again the awful cycle of depressed earnings resulting in reduced infrastructure maintenance and investment, producing service degradations, causing flights of traffic away from the rail system and further declines in earnings. Railroads as a group (and NS in particular) still are not earning revenues sufficient to cover their full costs (including cost of capital). Imposing large additional costs on the railroads, while simultaneously taking away their ability to charge less competitive shippers differentially higher rates, is a clear recipe for disinvestment and industry decline.

Proponents of forced access measures have never answered these arguments or explained how a system of open access could possibly enable the railroad industry to survive. As the Board has recognized, the challenge of rail freight transportation in the coming years is to foster conditions to stimulate more capital investment and creation of more capacity. Increasing railroad costs and taking away a large portion of their revenues, even while the industry persists with inadequate earnings, would leave the railroads with no chance of meeting this challenge.

(b) Defects in Specific Forced Access Proposals

The various forced access proposals described in the Board's ANPR suffer from all of these broad problems, and others as well. However, some of the concerns that have caused shipper groups to advocate these proposals would be addressed -- in a far more responsible, measured way -- by Norfolk Southern's proposal to preserve major efficient gateways as part of the rail merger review process.

(1) Mandatory Switching. The Board's suggestion that major rail merger applicants might be required to provide switching to all exclusively served shippers located within or adjacent to terminal areas (ANPR at 8) is literally boundless in scope. Imposition of mandatory switching requirements in and around terminal areas (however that imprecise term were defined) would vastly increase the complexity, and the costs, of rail operations. As Mr. McClellan explains in his testimony (at 14-17), Norfolk Southern's experience with the Conrail Shared Assets Areas only highlights the difficulty (and enormous costs) associated with the coordination of multi-carrier switching functions within often congested terminal areas. Expanding the scope of such an operation would take the industry in the wrong direction.

At the same time, requiring mandatory switching for all exclusively served shippers in and around terminal areas would deal a potential death blow to the railroads' ability to price differentially. For example, if a shipper exclusively served by UP in the Houston terminal area could require UP to switch its traffic to BNSF for alternative transportation beyond the terminal area, the artificially induced rail-to-rail competition between UP and BNSF for the full origin-destination through movement would drive the line-haul rates down toward the variable costs of through service.³⁵ Even if the switching charge were set at a level that fully covered the costs (including fixed costs) of the rail facilities used to perform the short switching services, the railroads would be left unable to charge a remunerative rate for the end-to-end through movement. UP's ability to charge a rate for the through movement at a level capped by stand-alone costs would be lost. Because the rail industry serves many shippers that have only one-carrier access in terminal areas, adoption of a requirement of mandatory switching could be financially ruinous to an industry whose earnings today are already too low to support the kind of infrastructure investment the shipping public needs.

³⁵ Railroads have high fixed and common costs, and most of its capital represents sunk investment -- it cannot be removed and deployed elsewhere even if prices are depressed below the levels needed to cover costs. Thus, when two railroads compete head to head for a particular traffic movement over a given route, rates tend to be pushed toward variable cost. If variable costs are \$100, for example, but the additional fixed and common costs of each railroad's network is \$150, the direct competition will push the rates toward \$100. If Railroad A tries to charge \$140, Railroad B will be forced to offer a lower rate, or else lose the traffic to A and be left with no contribution to its fixed costs. If Railroad B then offers a rate of \$120, Railroad A would lose the traffic and any positive contribution to fixed costs unless it offered an even lower rate. Eventually, this competition would force the rate down to the higher-cost carrier's variable costs -- even though the resulting rate level would be insufficient to cover the fixed and common costs. At some point, one railroad would be forced out of the market entirely, but only after a long period of service decline and disinvestment.

As the Board recognized in the recent *Houston/Gulf Coast Oversight* proceeding, moreover, there is no logical way to limit the scope of such a mandatory switching requirement. Mandatory switching could be required for a few otherwise solely served shippers without unduly threatening railroad viability, but granting such switching access everywhere could bankrupt the system. Under what criteria would the Board decide which solely served shippers deserve switching access and which do not? Clearly, the shipper or governmental interests that hire lawyers and consultants and complain the loudest about their condition are not for that reason more deserving than others of forced switching access. But, apart from that obviously illegitimate basis for distinction, there is no intelligible basis for deciding whether particular shippers or facilities should obtain mandatory switching access. Whether particular shipper facilities should be open to switching is a matter that should be left to the marketplace, subject to regulatory protection in the event of competitive abuses under the existing *Midtec* standard.³⁶

(2) **Open Gateways.** As explained previously, requiring rail merger applicants to keep open and interchange traffic upon request at all pre-merger interchange points, or even at all operationally feasible pre-merger interchange points, would recreate the inefficient and anti-competitive system of open routings that the ICC rightfully ended when it did away with the discredited *DT&I* gateway protective conditions. Nevertheless, Norfolk Southern's proposal above to require rail merger applicants to maintain major, efficient gateways for interchange of traffic with other connecting railroads would go a long way toward meeting any legitimate

³⁶ *Midtec Paper Corp. v. Chicago & North Western Transportation Co.*, 1 I.C.C.2d 362 (1985), modified, 3 I.C.C.2d 171 (1986), *aff'd sub nom. Midtec Paper Co. v. United States*, 857 F.2d 1487 (D.C. Cir. 1988); *Intramodal Rail Competition*, 1 I.C.C.2d 822 (1985), *aff'd sub nom. Baltimore Gas & Electric Co. v. United States*, 817 F.2d 108 (D.C. Cir. 1987); 49 C.F.R. § 1144.

concerns of shippers that further major rail consolidations will result in inefficient gateway closures and a reduction in the competitive routing options of shippers.

(3) **"Bottleneck" Rate Regulation.** The Board's ANPR describes two proposals that purport to expand and enhance rail-to-rail competition through modification of the existing regulatory rules governing "bottleneck" rates. The proposals include abrogation of the Board's decision that shippers generally are not lawfully entitled to demand the establishment of a separately challengeable common carrier rate over a "bottleneck" rail segment, and a requirement that rail merger applicants be required to offer contracts in certain circumstances so that shippers may invoke the Board's so-called "contract exception" to the "Bottleneck" holding against other non-applicant railroads. ANPR at 8.

These proposals are unsound, and should not be adopted, for all of the reasons set out above and by the railroads (including NS) in the Board's "Bottleneck" proceeding.³⁷ Specifically, a requirement that railroads establish segment rates to permit shippers to designate the interchange of traffic to another carrier at any reasonably feasible connection would introduce operating inefficiencies and, by fragmenting traffic over different rail routings, undermine the railroads' efforts to exploit traffic density to reduce costs. In addition, the imposition of a "bottleneck" rate requirement would drive rates down toward variable cost for service over the competitive non-"bottleneck" segment, and prevent the railroads from recovering their fixed and

³⁷ See STB Docket No. 41242, *Central Power & Light Co. v. Southern Pacific Transportation Co.* (served Dec. 31, 1996), *clarified* (served April 30, 1997), *aff'd sub nom. MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8th Cir. 1999), *cert. denied*, 120 S. Ct. 372 (1999), *Union Pacific Railroad Co. v. STB*, 202 F.3d 337 (D.C. Cir. 2000), STB Docket No. 41242, Comments of Association of American Railroads (Oct. 15, 1996), *id.*, Comments and Evidence of Norfolk Southern Corp. (Oct. 15, 1996).

common costs over such segments. The ability of the "bottleneck" carrier to charge a rate based on stand-alone cost principles for the "bottleneck" segment would not remedy the defect that rates for the non-"bottleneck" segment would not cover costs, and the forced "competition" injected by the "bottleneck" rate regulation would be ultimately unsustainable.³⁸

Although the "bottleneck" access proposals described in the Board's ANPR should not be adopted, Norfolk Southern's proposal to maintain major efficient gateways would address many of the same situations that would be covered by the "bottleneck" measures. Under NS's proposal, exclusively served shippers would be allowed to require merger applicants to establish contract or common carrier rates to apply over major gateways used pre-merger by those shippers for the interline movement of a significant volume of traffic. This relief would be available to eligible shippers regardless of whether the shipper has first secured a transportation contract from another carrier serving the non-"bottleneck" segment. In this sense, NS's proposal is similar to, and in some senses expands the scope of, the "bottleneck" contract exception.³⁹

(4) Abrogation of the "One-Lump" Doctrine. The Board's suggestion that revised merger rules might include a provision abrogating the "one-lump" doctrine is unsound for the reasons previously discussed. This proposal would appear simply to give exclusively served

³⁸ The idea of requiring merger applicants to offer, upon request, contracts for the competitive portion of joint-line routes when the joint-line partner has a bottleneck segment (ANPR at 8) has even less to commend it. The suggestion ignores how the terms of such a contract (in particular, agreed rate levels) would be established. If the parties could not agree on contract terms, the Board would have to prescribe them. But the Board has no legal authority to impose terms for transportation contracts.

³⁹ NS notes that it supported the lawfulness of the Board's decision adopting the "contract exception" to the "bottleneck" rule, and did not join in the appeal of the Association of American Railroads challenging that aspect of the "bottleneck" decision.

rail shippers an automatic right to obtain service from another independent carrier through imposition of a trackage rights condition unrelated to the actual competitive effects of a particular rail consolidation. The only point of such a requirement would be to enable the solely served shipper to secure reductions in rates that are not unreasonable, and to make it impossible for the railroad serving the shipper to use differential pricing principles (subject to the stand-alone cost constraint) to recover the fixed and common costs of its service.

Here too, however, NS's proposal to prevent the merger-related extension of significant "bottlenecks" by preserving major, efficient gateways in connection with future major rail consolidations would address many of the situations covered by the "one-lump" doctrine. Shippers which have opposed the "one-lump" doctrine claim that, when a railroad that exclusively serves a particular shipper merges with one of several connecting railroads that the shipper could use for a portion of its shipment, the transaction results in a loss of competition between the pre-merger connecting carriers. Under NS's proposal, the pre-merger competition between such connecting railroads would be preserved by the requirement that, at least for major gateways used by a particular solely served shipper for substantial traffic movements, the applicant carriers offer a rate to apply to interline service over a particular gateway using service beyond the gateway offered by another connecting railroad.

F. Downstream Effects

The ANPR states that one change the Board "definitely" intends to propose in its regulations governing major rail consolidations is the elimination of the so-called "one case at a time" rule. ANPR at 5. Under this rule, which was adopted in the early 1980's, the Board and the ICC disregarded the potential "downstream" or "cross-over" effects of a proposed rail

merger, including the effects of possible responsive consolidation proposals, leaving the consideration of such impacts for subsequent rail merger proceedings. 49 C.F.R. § 1180.1(g). The Board previously determined that it would waive this rule in connection with the *BNSF/CN* proceeding.⁴⁰ Norfolk Southern applauded the Board's action in that case,⁴¹ as did many other parties during the recent Ex Parte 582 hearings. All of the considerations that the Board cited in support of its decision to waive the "one case at a time" rule in the *BNSF/CN* proceeding would apply fully to future major rail consolidation proposals likely to come before the Board for review. The Board should therefore permanently repeal the rule and, in all future major rail merger proceedings, examine the likely "downstream" and "cross-over" effects of a proposed transaction.

G. Maintaining Safe Operations

Norfolk Southern agrees with the Board and other interested parties that the maintenance of safe rail operations is of paramount importance, and that the impacts of a proposed major rail consolidation on railway safety should be a primary consideration in weighing the public interest. NS also agrees, however, that there is no need for the Board to address safety issues in this rulemaking proceeding. In recent major rail consolidation proceedings (including the Conrail transaction), the applicant carriers have worked with the Federal Railroad Administration ("FRA") to formulate Safety Integration Plans ("SIPs") to ensure that safe operations would be maintained throughout the merger implementation process. The Board and FRA have jointly

⁴⁰ See STB Finance Docket No. 33842, *Canadian National Railway Co. -- Common Control ("BNSF/CN")*, Decision No. 1A (served Dec. 28, 1999).

⁴¹ See STB Finance Docket No. 33842, *Petition of Norfolk Southern For Clarification and Supplementation of Decision No. 1 (NS-2)* (Jan. 28, 2000).

proposed and received public comment on regulations dealing with these issues.⁴² Until that rulemaking is completed, safety issues (and the preparation of SIPs) should be handled on a case-by-case basis consistent with recent past practice.

H. Short-Line and Regional Railroad Issues

During the recent hearings in Ex Parte 582, the Board heard a number of complaints by short-line and regional railroads concerning their relationship with the major railroads. Some small carrier interests suggested that the Board respond to these complaints by amending its merger guidelines to require major rail consolidation applicants to submit plans for promoting the viability of smaller rail carriers and to require such applicants, as a condition to approval of their proposed combinations, to adhere to a variety of requirements based on the so-called "Bill of Rights" advocated by the American Short Line and Regional Railroad Association ("ASLRRA"). These measures include such things as the right to compensation for service failures, the elimination of so-called "paper barriers" that restrict the interchange of traffic with other railroads, and various pricing and car supply guarantees. The Board invited comment on these suggestions. ANPR at 8-9.

Norfolk Southern and the other major railroads have a strong interest in promoting the development of viable short-line and regional railroads whose operations are supported by market conditions. It is therefore entirely appropriate that the Board, in assessing the effects of a proposed major rail consolidation, consider potential adverse impacts of the transaction on smaller rail carriers -- just as it should consider possible adverse effects on large railroads, shippers,

⁴² See STB Ex Parte No. 574, *Regulations on Safety Implementation Plans Governing Railroad Consolidations, Mergers, Acquisitions of Control and Start Up Operations* (served Dec. 24, 1998).

employees, public authorities and any other affected parties. In this regard, there is nothing special or unique about short-line and regional railroads.

While the Board should consider merger impacts on smaller railroads, the specific requirements advocated by ASLRRRA should not be adopted. They represent blatantly protectionist measures that, as the Board has previously recognized,⁴³ have little or nothing to do with the actual effects of railroad mergers. Instead, proponents of these short-line protections are seeking to enlist the blunt hand of regulation to resolve longstanding commercial disputes that have been the subject of ongoing, but productive, dialogue between the larger and smaller railroads over the past several years and to insulate themselves from the rigors of competition. Specifically, ASLRRRA and the AAR negotiated a dispute resolution agreement with the encouragement of the Board. Such private initiatives would be chilled if agreements could be abrogated the first time a new proceeding appears. For example, the smaller carriers' suggestion that major rail consolidation applicants be required to eliminate so-called "paper barriers" is nothing more than an attempt to nullify contractual commitments that the smaller carriers voluntarily assumed when they purchased their rail lines from the larger railroads, and to impose this result for reasons having nothing to do with the actual effects of particular proposed rail mergers.⁴⁴ Many of these

⁴³ See, e.g., *Conrail Control*, Decision No. 89 (served July 23, 1998), at 76-77; STB Finance Docket No. 32760 (Sub-No. 21), *Union Pacific Corp. - Control & Merger - Southern Pacific Rail Corp. [General Oversight]*, Decision No. 13 (served Dec. 21, 1998), at 11.

⁴⁴ Many short-line railroads were created as a result of line sales by the major railroads. The contractual sale terms often included a requirement that the newly created short-line carriers interchange specified volumes of freight traffic with the seller carrier. Such interchange requirements formed an essential commercial term of the line sale agreement, because the revenues committed to the selling railroad from the required interchange of traffic made it possible for the seller to accept a lower purchase price for the rail line than would otherwise have been justified.

(continued...)

outstanding commercial issues were addressed in the 1998 Railroad Industry Agreement between the larger and smaller railroads, and negotiations on them are continuing. The Board should not allow the use of a major rail merger review process to preempt these private sector efforts to resolve business disputes that are unrelated to merger effects.

I. Employee Issues

The Board's ANPR also invites comments concerning certain "employee issues" addressed in the submissions and testimony of rail labor representatives. Much of the labor commentary, as the Board notes (ANPR at 8), relates to the core competitive and service issues addressed separately in the Board's notice and these comments. On a number of issues, including the appropriateness of a brief suspension of the Board's consideration of rail merger proposals, NS and labor commentators occupy common ground, reflecting their shared interest in the strength of the railroad industry. The interests of railroad employees ultimately will be better served by enabling railroads to operate safely, efficiently, and competitively than by any initiative addressed to narrower "employee issues."

By the same token, the public benefits that are to be gained from orderly regulation of future major rail consolidations would be at risk if misguided policies are adopted regarding the

⁴⁴(...continued)

By seeking to eliminate "paper barriers" on traffic interchanges, the short-line carriers are attempting to abrogate a key component of the consideration for the agreed purchase price of the rail line. Allowing such abrogation of private contracts would, ultimately, simply discourage otherwise beneficial future line sale transactions that result in the formation of new Class II and Class III carriers. As the Board and the ICC have previously found, however, there may be some instances in which the effect of a proposed rail merger may be to expand the reach of a "paper barrier" restriction on a short-line railroad's traffic interchanges. In such cases, which would involve genuine merger-related impacts, some limited relief in the context of a major rail consolidation proceeding may be warranted. See, e.g., *Conrail Control*, Decision No. 89 (served July 23, 1998), at 76-77; *BN/Santa Fe*, Decision No. 38 (served Aug. 23, 1995), at 94.

future of employee protection. The Board has asked for comments addressed to two such proposals: (1) that the Board require railroads to agree to forgo use of ICA-based mechanisms for modifying labor agreements (what rail labor termed "cram-down") in connection with implementation of future railroad consolidation transactions; and (2) that the Board enlarge the protective period under its *New York Dock* conditions from six to ten years. Neither proposal deserves any further consideration in this proceeding.

The first proposal is unlawful. It is stated that the exemption "from all other law" codified in 49 U.S.C. § 11321(a) is self-executing, and exempts railroads from collective bargaining agreement terms otherwise enforceable under the Railway Labor Act ("RLA"), as necessary to implementation of Board-authorized transactions. *Norfolk & Western Railway Co. v. American Train Dispatchers Association*, 499 U.S. 117 (1991). Likewise, the specific procedures that the ICC and Board have adopted and administered for resolving disputes over the necessity of agreement modifications (set forth in *New York Dock* Article I, Section 4) have long since been approved by the federal courts.⁴⁵ As a matter of law, the Board could no more deny railroads their statutory exemption from the RLA and labor agreements in all future railroad consolidation transactions than it could withdraw antitrust immunity for those transactions.

As a practical matter, eliminating Board-administered procedures for effecting necessary agreement changes would all but ban further transactions. Whatever shape it takes, future railroad consolidation will require the integration of operations and workforces -- the types

⁴⁵ *United Transportation Union v. STB*, 108 F.3d 1425, 1429 (D.C. Cir. 1997); *American Train Dispatchers Ass'n v. ICC*, 26 F.3d 1157, 1162-65 (D.C. Cir. 1994); *Railway Labor Executives Association v. United States*, 987 F.2d 806, 813-14 (D.C. Cir. 1993); *Railway Labor Executives' Association v. Southern Pacific Transportation Co.*, 7 F.3d 902, 906-07 (9th Cir. 1993).

of operating changes that almost always necessitate modification of labor agreements. Those labor organizations that call for the elimination of the *New York Dock* Article I, Section 4 procedures would have the Board condemn railroads to seeking necessary agreement modifications under RLA processes that are fundamentally inconsistent with the implementation of railroad consolidation transactions. The public benefits of future transactions would be all but lost if railroads could implement transaction-related operating changes only by exhausting the protracted RLA processes, in effect, purchasing from unions consent to make authorized operating changes or risking a system-wide work stoppage.

Nothing in the labor comments justifies considering such a proposal. Labor commentators used the occasion of the Board's Ex Parte 582 hearings to repeat their long-discredited contention that the Board lacks authority to modify labor agreements and to criticize the resolution of long-settled disputes over the implementation of prior transactions -- all in the hope of dismantling the *New York Dock* Article I, Section 4 framework. None of this merits serious attention. Labor interests have tried unsuccessfully for years to win support for the theory that railroads must use RLA procedures to obtain changes in labor agreements necessary to implement approved transactions. The very arguments that labor commentators offer here -- about the supposed history of the § 11321 exemption and the origins and development of *New York Dock* jurisprudence -- have been presented to, and rejected by, the ICC, the Board, and the courts time and time again.⁴⁶

⁴⁶ See, e.g., *Conrail Control*, Decision No. 89 (served July 23, 1998), at 126 n 198 (rejecting effort of labor organizations to "revive numerous arguments about the supposed primacy of the [RLA] over the *New York Dock* process, the immutability of rates of pay, rules and working conditions, and other arguments that have been consistently rejected by the ICC, the

(continued)

Labor commentators do not bolster their cause with new attacks on the outcomes of long-settled Section 4 disputes or by contending that the Article I, Section 4 procedures have somehow unduly favored railroad interests. The fact of the matter is that the vast majority of implementing agreements are reached through voluntary negotiation, usually before arbitration is invoked. Labor organizations should not be heard to complain about the terms of implementing agreements to which they voluntarily committed their members.

In the relatively few arbitrated cases, railroads have prevailed only by demonstrating, under the agency's established standards and subject to review by the ICC or Board, that agreement changes are necessary to achieve the benefits of authorized transactions.⁴⁷ There is no doubt that the Article I, Section 4 procedures have made possible agreement changes that never could have been obtained -- or could have been obtained only at a prohibitive price -- in RLA collective bargaining. But far from being a reason to change the procedures, that experience only confirms the fundamental need for the *New York Dock* Article I, Section 4 scheme.

Ultimately, those who would urge the Board to renounce the statutory override authority cannot get around the fact that the Board has only recently concluded a lengthy and comprehensive examination of the Article I, Section 4 procedures in STB Finance Docket No. 28905 (Sub-No. 22), *CSX Corp. -- Control -- Chessie System, Inc. (Arbitration Review)*

⁴⁶(...continued)
Board, and the courts.")

⁴⁷ For its part, NS has fashioned *New York Dock* proposals that satisfied the ICC's and Board's established standards. That fact, and not some bias in the *New York Dock* scheme, explains NS's successful record in Article I, Section 4 arbitration. In any event, it is simply not true, as several labor organizations contend, that Section 4 arbitrators always have accepted railroad proposals for modification of labor agreements.

(served Sept. 25, 1998) ("*Carmen III*"). In *Carmen III*, the Board took account of the same concerns that rail labor representatives have voiced here, and reaffirmed the Article I, Section 4 procedures for resolving disputes over necessary agreement changes. No party sought reconsideration or appealed the *Carmen III* decision when it was issued, and the Board has not reviewed an Article I, Section 4 award rendered in its wake.⁴⁸ In the circumstances, there is no conceivable justification for the Board to undertake yet a further reexamination of *New York Dock* standards or procedures.

It is clear that this is neither the time nor the forum for addressing the future administration and regulation of employee protection. As the labor commentators themselves acknowledge, there already are several proposals pending before Congress to change the ICA-based mechanisms for modifying labor agreements. Moreover, NS and the other Class I railroads have reached a voluntary agreement with the largest rail labor union, UTU, for resolving disputes that may arise in the future over proposals to modify labor agreements in connection with implementation of major railroad consolidation transactions. The UTU agreement expressly provides that the parties will seek congressional action to codify the terms to which they have agreed (and that the terms will not be prescribed as a condition imposed and administered by the Board). The agreement provides, *inter alia*, for the application of a single labor agreement to consolidated operations, and for necessary modification of seniority arrangements and other rules, subject to certain conditions and procedures for protecting employee interests. The agreement

⁴⁸ In connection with its implementation of the Conrail transaction, NS has been a party to three post-*Carmen III* Article I, Section 4 awards, only two of which were appealed to the Board. In both cases, the unions dismissed their petitions pursuant to voluntary settlements with the railroads before they were ruled on by the Board.

provides, for instance, that when work is consolidated or coordinated, the labor union(s) representing the affected employees will select the applicable labor agreement (from among the applicable pre-transaction agreements), or, failing agreement, that the agreement "most beneficial to the employees" will be prescribed in arbitration under the Article I, Section 4 procedures. The arrangement thus preserves the compulsory *New York Dock* dispute resolution mechanism, while addressing any supposed concern that the procedures could be used to override labor agreements that are considered favorable to employees.

The UTU agreement may well serve as the model for other private agreements and/or legislation covering railroad employees represented by other labor organizations. In the meantime, the Board has every reason to defer consideration -- as Board members have advocated -- in order to permit private negotiations and/or congressional action to drive any changes in the Board's longstanding policies and procedures in this area.

The proposal to enlarge the *New York Dock* protective period also warrants no serious consideration. The six-year protective period has been the standard for major railroad transactions for more than two decades, during which the ICC and Board consistently have denied requests for enhanced protective benefits (other than by agreement) in particular cases. *E.g.*, *Conrail Control*, Decision No. 89 (served July 23, 1998), at 124 & n.200. In the meantime, Congress has acted to reduce the protective benefits for employees affected by transactions involving Class II and Class III railroads, while reaffirming the appropriateness of *New York Dock* benefits for Class I transactions. ICC Termination Act, Pub. L. No. 104-88, 109 Stat. 803, codified at 49 U.S.C. § 1326(a); H.R. Conf. Rep. No. 104-422, 104th Cong., 1st Sess. 193 (1995), reprinted in 1995 U.S.C.C.A.N. 877.

It is sheer opportunism to suggest that the Board should consider enhancing *New York Dock* benefits in this proceeding. By any measure, *New York Dock* already is vastly more generous than benefits received by employees in other industries. Adding four years to the standard protective period would substantially increase railroads' protective costs, while serving no legitimate public policy interest. No one has suggested that the factual determinations or policy perspectives that informed the ICC's adoption of a six-year protective period in the *New York Dock* decision (*New York Dock Railway Co. -- Control -- Brooklyn Eastern District Terminal*, 360 I.C.C. 60, 72, *aff'd sub nom. New York Dock Railway Co. v. United States*, 609 F.2d 83 (2d Cir. 1979)), are no longer valid, or that the six-year protective period has proved inadequate in practice. And no one has suggested that changes in market conditions or economic policy have made a ten-year protective period necessary or appropriate for the future.

The most that can be said about the proposal is that CN and BNSF voluntarily agreed to such an enhancement as part of the price they were willing to pay to secure the support of certain unions for their proposed transaction. But it should go without saying that the fact that two railroads contemplating a particular type of transaction voluntarily agreed to commit themselves to a ten-year protective period in exchange for labor support for their Board application does not furnish any legitimate ground for subjecting all railroads in all future transactions to the same commitment.

If there is any serious sentiment for enlarging the *New York Dock* protective period, the proposal should be addressed to Congress or resolved through private negotiations between railroads and unions. The Board has no reason or occasion to address the matter in this rulemaking proceeding.

J. Cross-Border Issues

During the recent Ex Parte 582 hearings, a number of parties raised various concerns about the potential cross-border impacts of the proposed BNSF/CN consolidation and other possible major rail combinations involving Canadian rail carriers. Among other things, parties expressed concerns about the extra-territorial application of U.S. rail safety rules, potential merger-related shifts of traffic from U.S. to Canadian ports, national security and defense-readiness issues, and other matters. ANPR at 10. Norfolk Southern believes that all of these issues can be dealt with adequately on a case-by-case basis in the context of particular major rail consolidation proposals involving one of the two Canadian railroads, and need not be addressed in a revised merger policy statement.

One cross-border issue the Board's revised merger regulations should address, however, relates to the treatment of operating and other major rail merger impacts that take place outside the territorial borders of the United States. This issue was squarely presented in the recent BNSF/CN proceeding, in which the prospective applicants proposed to submit an Operating Plan and other merger-impact analyses that would exclude effects that (in their sole judgment) would be felt solely in Canada.⁴⁹ Norfolk Southern and other parties opposed this attempt to narrow the scope of the merger-impact analyses included in the proposed application, and urged the Board to require BNSF and CN to submit a full-system Operating Plan that would describe how the prospective applicants proposed to operate their entire combined system (including the significant portions of the system located in Canada) and assessing the impacts of

⁴⁹ See STB Finance Docket No. 33842, Petition for Waiver or Clarification of Railroad Consolidation Procedures and Related Issues (BN/CN-9) (Feb. 4, 2000), at 4-5.

the proposed consolidation on the entire rail systems of both carriers.⁵⁰ As explained in Norfolk Southern's prior submissions on this issue in the BNSF/CN proceeding, because of the interdependent nature of freight rail operations and the inevitable effects that a major rail consolidation transaction involving either of the major Canadian railroads would have on rail transportation services and operations in the United States, the Board's regulations should require that, in every major rail consolidation proceeding, the applicant railroads submit an Operating Plan and other merger-impact analyses that address the entirety of the applicants' combined rail systems, including operations and impacts that occur outside the United States. Only through the submission of such a full-system Operating Plan and other merger-impact analyses could the Board be confident that it has an adequate basis for assessing the full impacts of a proposed major rail consolidation on the public interest of the United States.

II. PROCEDURES IN MAJOR RAIL CONSOLIDATION PROCEEDINGS

The bulk of the Board's existing Railroad Consolidation Procedures consist of regulations governing the required content of rail consolidation applications and the procedures followed by the Board to consider them. Norfolk Southern suggests several changes in these procedural regulations.

⁵⁰ See STB Finance Docket No. 33842, Comments of Norfolk Southern on Applicants' Petition For Waiver or Clarification of Railroad Consolidation Procedures and Petition to Establish Procedural Schedule (NS-3) (Mar. 1, 2000), at 3-11; STB Finance Docket No. 33842, Petition of Norfolk Southern For Clarification and Supplementation of Decision No. 1 (NS-2) (Jan. 28, 2000), at 7-14.

A. Evidentiary Requirements for Major Rail Consolidation Applications

The Board's existing rail consolidation regulations strike an appropriate balance by specifying the general types of information and analyses that must be included in a rail consolidation application while giving individual applicants the flexibility to tailor their merger-impact analyses to the specific circumstances of a particular transaction. As a general matter, the Board should not change this approach. Nevertheless, current conditions in the rail industry call for new or heightened emphasis on certain types of merger impacts, and this changed focus requires appropriate changes in the Board's regulations governing the required content of major rail consolidation applications.

For the reasons discussed above, the Board's merger regulations should be revised to require applicants to submit: (1) a service integration or merger implementation plan (pages 19-20, *supra*); (2) a capital budget or rail infrastructure assessment plan (pages 25-26, *supra*); (3) a safety implementation plan prepared in accordance with the procedures followed in recent major rail consolidation proceedings (as modified by any final regulations adopted by the Board and FRA dealing with this subject); and (4) a full-system Operating Plan (pages 62-63, *supra*). In addition, NS recommends that, in light of the key role that integration of information technologies plays in successful merger implementation, the Board should require major rail consolidation applicants to submit (as part of the Operating Plan or merger implementation plan) a description of their plans for integrating the information technology systems of the combining railroads.

The Board should also amend its procedural regulations to conform to the waivers and clarifications that it has routinely granted in most recent rail consolidation proceedings.⁵¹

Based on these now standard waivers and clarifications, the Board should revise its regulations to:

- (1) Define the term "applicants" to exclude non-operating affiliates of the parties initiating a proposed transaction and entities created solely for purposes of effecting the proposed transaction (49 C.F.R. § 1180.3(a));
- (2) Define the term "applicant carriers" to exclude non-rail carriers related to the applicants as well as all rail carriers in which either set of applicants holds a direct or indirect interest of 50 percent or less (49 C.F.R. § 1180.3(b));
- (3) Permit applicant carriers to submit financial data on a consolidated basis when they report data on that basis in the regular course of business;
- (4) Specify the class or crafts of employees to be covered by the required employee impact exhibit and the format of such exhibit (49 C.F.R. § 1180.6(a)(2)(v));
- (5) Make clear that applicants need not submit SEC Form S-14s, or SEC Form 10-K's or annual reports for applicant carriers that do not submit such reports on a regular basis, but to require submission of other SEC reports (such as proxy statements or tender offer materials) submitted to the SEC (or similar non-U.S. government authorities) in connection with the proposed transaction (49 C.F.R. § 1180.6(b));
- (6) Substitute, for the list of changes in officers not indicated on a carrier's most recent Annual Report Form R-1, a list of the principal six officers of the operating applicants (49 C.F.R. § 1180.6(b)(3));
- (7) Require submission of a corporate chart that lists only directors and officers that are common to (i) both of the two applicant railroads or (ii) either applicant railroad and another rail carrier outside either applicant railroads' systems (49 C.F.R. § 1180.6(b)(6)); and
- (8) Require identification of only significant intercorporate or financial interests involving ownership by the applicants or their affiliates of more than

⁵¹ See, e.g., *CN/IC*, Decision No. 4 (served June 23, 1998)

five percent of a non-affiliated rail carrier's stock (49 C.F.R. § 1180.6(b)(8)).

These modification of existing regulations would eliminate the parties' need to prepare and submit, and the Board's need to decide, waiver and clarification petitions that for the most part have become entirely routine and a waste of time and resources.

B. Procedural Schedule

The past practice of the Board and the ICC has been to establish an appropriate procedural schedule on a case-by-case basis at a relatively early stage of a particular rail consolidation proceeding. To provide more certainty in future major rail consolidation cases, and to minimize the resources that the parties and the Board have previously been required to devote to the determination of an appropriate procedural schedule, Norfolk Southern recommends that the Board include in its revised merger rules a "default" procedural schedule that will govern all future major rail consolidation proceedings unless revised by the Board in particular cases.⁵² In light of the probable size and complexity of future major rail consolidation proposals, NS suggests that the "default" schedule should provide for a one-year schedule, roughly corresponding to the schedule recently proposed by NS for the BNSF/CN proceeding.⁵³ This "default" schedule would be open to revision by the Board for good cause.

⁵² The Board has adopted similar "default" procedural schedules for other types of agency proceedings. See, e.g., 49 C.F.R. § 1111.8 (procedural schedule for stand-alone cost maximum rate complaint proceedings).

⁵³ See STB Finance Docket No. 33842, Comments of Norfolk Southern on Applicants' Petition For Waiver or Clarification of Railroad Consolidation Procedures and Petition to Establish Procedural Schedule (NS-3) (Mar. 1, 2000), at 12-19.

C. Production of Applicants' Traffic Data

With the increasing use of sophisticated traffic diversion and operating plan models by railroad merger applicants, access to computerized railroad traffic data has become essential to proper analysis of proposed rail consolidations. Because of the inherent superiority of internal railroad traffic data, most merger applicants in recent years have developed their merger-impact analyses on the basis of 100 percent traffic tapes of the applicant carriers rather than the Waybill Sample data maintained by the Board. While the Waybill Sample data are available to applicants and other parties alike well before the filing of a major rail consolidation application, non-applicants generally have not been able to obtain access to the applicants' internal traffic data until after the filing of the application.

Because of the critical importance of actual rail traffic data in performing sound merger-impact analyses and the time-intensive nature of such studies, Norfolk Southern recommends that the Board adopt a rule requiring prospective major rail consolidation applicants to make their 100 percent traffic tapes available to qualified parties (subject to an appropriate protective order) as soon as practicable after the filing of a notice of intent to file a major rail consolidation application. This requirement would permit interested parties to begin their own independent merger-impact analyses, and to formulate their own positions on the proposed application, before it is actually filed. Such pre-application access to critical traffic data would minimize pressures to extend the "default" procedural schedule and enable parties to prepare and present to the Board better merger-impact testimony.

D. Protective Order

In every recent rail consolidation proceeding, the Board and the ICC have adopted at a relatively early stage a protective order to govern the handling of confidential information that is exchanged during the discovery process or filed with the agency. The Board could helpfully reduce litigation costs to all interested parties by including in its revised merger guidelines a standard protective order that would include provisions similar to those contained in recent protective orders in major rail consolidation proceedings, and that would relieve the parties and the Board of the need to expend time and resources to a motion for protective order.⁵⁴

With one exception, Norfolk Southern believes that the protective orders entered in recent major rail consolidation proceedings could serve as a model for such a "default" protective order. Most recent protective orders have established a two-tier scheme of confidentiality protection, in which proprietary or commercially sensitive business information designated "highly confidential" by the producing party may be disclosed to and used only by outside counsel or outside consultants to the receiving party. In Norfolk Southern's experience, this "highly confidential" designation has often been abused by producing parties,⁵⁵ with the result that in-house counsel for a recipient party have been effectively foreclosed from active involvement in and supervision of outside counsel with respect to a railroad consolidation proceeding. Norfolk Southern therefore recommends that the Board amend its merger regulations to make clear that

⁵⁴ See, e.g., *BNSF/CN*, Decision No. 2 (served Jan. 12, 2000); *CN/IC*, Decision No. 1 (served Feb. 26, 1998).

⁵⁵ The Board recently expressed a similar concern about parties' confidentiality designations. See STB Docket No. 41685, *CF Industries, Inc. v. Koch Pipeline Co.* (served May 9, 2000), at 2 n.3.

in-house counsel shall be granted access to "highly confidential" discovery materials unless their employment duties include commercial decision-making on matters related to pricing and marketing of rail services.

CONCLUSION

For all of the foregoing reasons, the Board should propose amended major rail consolidation procedures consistent with Norfolk Southern's comments in this proceeding.

Respectfully submitted,



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DATED: May 16, 2000

ATTACHMENT A

**VERIFIED STATEMENT
OF
JAMES W. McCLELLAN**

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

VERIFIED STATEMENT

OF

JAMES W. McCLELLAN

My name is James W. McClellan. I am Senior Vice President of Planning for Norfolk Southern Corporation (NS). I have held marketing positions at Southern Railway, New York Central, Penn Central and Amtrak and planning or policy positions at the Federal Railroad Administration, the United States Railway Association, the Association of American Railroads, Southern Railway and Norfolk Southern.

Prior to joining the railroad industry, I served in the United States Navy. I am a graduate of the Wharton School of the University of Pennsylvania.

Currently, I am responsible for mergers, acquisitions and alliances; line rationalization; new capacity projects; public funding for infrastructure (grade crossings excepted); and passenger policy and negotiations. I chair NS's infrastructure team, which consists of senior marketing, operating, finance and planning officers and supervises a number of capacity, passenger and line rationalization efforts.

Restructuring Experience

During my career, I have participated in numerous railroad-restructuring efforts, including the separation of freight and passenger operations and the spin-off and abandonment of over 12,000 route miles. I negotiated numerous track-sharing agreements designed to *reduce excess* capacity through sharing of infrastructure, including the BNSF-NS rationalization in the Des Moines market and the sharing of local service with CSXT in the Carolinas.

With the rebound of eastern rail traffic in the 1990's, I planned and negotiated numerous infrastructure projects designed to *increase* capacity. Before the recent Conrail transaction was underway, I obtained trackage rights for Norfolk Southern over Conrail lines in the Cincinnati area and handled the acquisition of a surplus Conrail mainline in Indiana. I negotiated arrangements providing joint investments in clearance programs that created clearance routes between Atlanta and Newark (also with Conrail) and to New England (with Canadian Pacific (CP) and Guilford (GTI)).

I negotiated numerous alliance agreements designed to provide seamless service, including NS's sale to Conrail of a 50% interest in its Triple Crown intermodal subsidiary to CR, as well as market extensions through haulage arrangements with Florida East Coast (FEC) in Florida, with Kansas City Southern (KCS) to Texas and with Guilford (GTI) and Canadian Pacific (CP) to New England. These are the very types of transactions that the Board should consider as alternatives to future rail mergers.

In terms of mergers, I participated in the creation of Conrail in the 1970's, a largely "parallel" merger aimed at eliminating duplicate carriers and infrastructure. Conrail, after experiencing a rough start, was successful in transforming eight bankrupt carriers into a financial

and service success. During the early 1980s I was deeply involved in the creation of Norfolk Southern, an end-to-end transaction that created significant new single-system service. Most recently, I was involved in negotiating the split of Conrail, which restored rail-to-rail competition to a number of important northeastern markets. Like the start of Conrail itself in 1976, the 1999 division of its operations between NS and CSXT experienced a poor start but is now beginning to deliver some of the promised results.

Thus, my experience covers a wide range of restructuring techniques. These transactions served various ends; some were aimed at both removing overcapacity and duplicate carriers and facilities, and some added capacity, competition, or both to the rail system. Most of these actions were very "site specific" in that they were geared to a specific piece of geography or market in which NS was a minor participant or to which we wanted better access. Most were very much driven by such factors as amount and quality of available infrastructure, financial resources, and size or significance of involved markets.

Summary of Conclusions

Any modifications in the Board's rules for alliances and mergers must recognize both the dynamics and complexity of the railroad business in the 21st century. The world is moving very fast, and while a brief breather is altogether appropriate at this time, we must avoid the kinds of rigid rules and bad economic theory that came close to destroying the railroad industry just a few decades ago. We also must recognize that alliances and mergers each have their appropriate place in the future U.S. rail system but that those places are not always interchangeable. Finally, if the Board elects to revise its merger and alliance rules to facilitate rail-to-rail competition, it can and

should do so in a manner that recognizes the economic and operational realities of the rail industry.

In this statement I will focus on these three issues: alliances as an alternative to merger; opportunities for rail-to-rail competition; and lessons of prior rail regulatory regimes. My testimony will draw heavily on my recent experience with the Conrail breakup transaction.

Alliances

Alliances are hard to create and manage and easily come undone. Still, they can be an effective alternative to mergers. NS and its predecessors have long used alliances (both commercial and operating) to provide "virtual" single system service. For example, two Norfolk and Western subsidiaries, Nickel Plate and Pittsburgh and West Virginia, banded together with other small eastern carriers to provide through service between the East Coast and the Midwest that was competitive with single system service offered by the Pennsylvania Railroad. Incidentally, this joint line service was called "The Alphabet Route" as an indication of its complexity.

Despite its now substantial market coverage, the "new" NS lacks the market reach of its principal rail competitor, CSXT. So NS depends on alliances with FEC to reach the east coast of Florida between Jacksonville and Miami and with CP and GTI to reach New England.

These and other major alliance services involve much more than a simple integration of train schedules. NS's haulage on FEC gives NS the ability to make its own rates to FEC points, in effect contracting with FEC for underlying train and terminal services. In addition NS has its own terminal facilities on FEC for handling automotive and transload traffic and leases space at FEC intermodal facilities in Florida.

In the case of New England, NS jointly invested with both CP and GTI to upgrade track and increase clearances to provide a competitive New England route. NS's investments were not limited to its own lines.

Before the recent division of Conrail, NS also established several innovative arrangements with Conrail, including joint funding of double-stack clearances between Atlanta and Newark and sale of a 50% interest in NS's Triple Crown intermodal company to Conrail. The first project was designed to improve north-south intermodal services; the second designed to extend Road Railer® service into the Northeast.

NS and CR also tried to negotiate deals for cost sharing and cost reduction through joint usage of system facilities such as locomotive and car backshops and rail welding plants. We were unsuccessful in these efforts, due to both labor issues and issues of "merging" methods and procedures, including getting agreement on best practices.

Unfortunately, most of these initiatives took months to negotiate; several required years. Some have been successful, some have not. The FEC automotive and carload transload arrangements have met expectations, but the intermodal initiative did not, producing neither the volume expected by FEC nor the efficiencies desired by NS. The Triple Crown initiative with Conrail survived until the recent acquisition by NS and CSX; however, the relationship always was contentious. Triple Crown was perceived by some at Conrail as a direct threat to certain existing high value business, and operationally, it was difficult to integrate the Triple Crown network into Conrail and obtain the required service levels. However, this initiative did place Triple Crown in the important Harrisburg and Newark markets for both north-south and east-west business.

While the north-south lane never achieved the potential desired, the east-west service remains an important part of the Triple Crown network.

Similarly, the double-stack clearance route between Atlanta and Newark has yet to achieve its market potential. When the route was jointly operated, Conrail's short-haul revenue needs north of the junction at Hagerstown and limited capacity into the Northeast were barriers to competitive pricing and service. This was a classic example of the "watershed" problem. Conrail's revenue needs, infrastructure, and historical preference for its long haul, east-west markets made this joint route non-competitive. Although this watershed problem was eliminated by the Conrail transaction, service will not become fully implemented until NS's Rutherford Yard (near Harrisburg, Pennsylvania) and Austell Yard (near Atlanta, Georgia) are fully operational in 2001. At that point, the capacity and operating efficiency needed to be totally competitive in this lane will be available.

Perhaps the most ambitious NS alliance effort is the one between NS, CP's Delaware and Hudson subsidiary and GTI for New England service. This arrangement required offline investment, with NS and CP sharing the cost of upgrading the line between Harrisburg and Albany, NY to handle domestic double-stacks and 286,000 lb. weights and GTI and NS clearing the GTI route between Albany and Maine to "high-low" double-stack standards. These joint infrastructure improvements permit handling of tri-level automobile carriers and double-stacking two international boxes or one domestic and one international box.

CP and GTI participated in this transaction with the hope of seeing a far larger rail market. NS sought to leverage its operation of part of Conrail with "seamless" service to New England. While NS was successful in gaining substantial coal traffic to New England, initially, NS failed to

get any vehicle traffic or any sustainable intermodal business. Start-up service problems on NS caused some carload business to be diverted to truck. As service improves, the partners continue to gain new business and are in the process of adding new services and restructuring existing services. Relations among the involved railroads have improved, but neither CP nor GTI was very happy with NS's service problems. New intermodal service, inaugurated in May 2000 will boost New England traffic levels. Carload service restructuring into eastern Pennsylvania is expected to regain much of the paper and other traffic lost to trucks.

Conclusions on alliances. My experience with alliances leads me to several observations:

The good news:

1. Alliances have an important role in creating improved service offerings and, in some instances, improving efficiencies. They are especially useful in dealing with localized marketing and operating opportunities.
2. Even if the rail industry consolidates into two major carriers, alliances will be a necessary tool. Railroads increasingly deal in global commerce and the need for effective alliance building will grow over time (though the partners in the future are more likely to be non-rail carriers).
3. The current round of consolidations has made alliances more manageable. The complexity of the deal increases with the number of partners; most North American markets can now effectively be reached with a single alliance partner.

And the not so good news:

1. They are difficult to negotiate and maintain. Each railroad is very protective of its existing traffic base and capacity.

2. In most cases, one alliance partner stands to gain more than the other partner, and therefore, is normally more interested than the other. Unless an alliance promises and delivers a big payoff for *both* partners, it is likely to simply fizzle out as one or both partners move on to other opportunities.

3. The parties generally have different financial, marketing and operational goals. For example, NS was prone to blame Conrail for failure of the north-south double-stack route to attract traffic. In reality Conrail and NS simply had different corporate priorities.

4. Circumstances change, and the entire point of an alliance can be undermined by internal or external developments. Our Triple Crown joint venture with Conrail was jeopardized when CSX reached a merger agreement with Conrail in late 1996.

5. NS has learned from experience that although an alliance is negotiated and signed, it still might not be executed effectively. In such circumstances there is little that the aggrieved partner can do. Legal action to enforce an alliance contract cannot compel good service and certainly would not make for a good relationship between the partners.

6. If large investments are required, alliances are unlikely to provide the necessary security needed to justify such investments.

Lessons of Regulation

Virtually all rail customers at the Ex Parte No. 582 hearings in March 2000 took the opportunity to call for the STB to require increased rail-to-rail competition as a condition of approval of any future rail consolidations. Most customers also deplored the reduction in the number of rail carriers, although few, if any, experienced or remember the horrible service

provided historically by a rail industry dominated by many smaller carriers. Many witnesses seemed to believe that the price for rail mergers is a renewal of economic regulation.

To understand the implications of prior rail regulation to the current merger debate, it is useful first to review the pluses and minuses of our technology and some rail corporate history. Railroads operate on a fixed guideway. Compared to the highway or even the airway systems, the rail network has relatively few paths and few nodes where these paths connect. Thus, the ability to shift traffic from one route to another is often limited. This constraint is compounded by the fragmented corporate history of the rail industry. Railroads, unlike highways, were not planned or built as an integrated network, so shifting traffic from one rail system to another also is often difficult and sometimes impossible. These connectivity constraints explain why most rail mergers involve construction of new connections; those connections are vital if the new network is to function as a whole.

These network limitations are exacerbated by the different signal or control systems on different rail links, even on the same company; once again, historical industry fragmentation is the usual culprit. Train operations thus require a skilled, experienced workforce qualified to operate each specific route. Operating a train, which often weighs in excess of 10,000 tons, requires precise knowledge of the terrain to be traversed. In contrast, truck drivers can essentially function anywhere on the highway system under a "national" driver's license, and pilots can fly anywhere in the network. The rail workforce is not nearly so flexible.

When and for whatever reason (maintenance, natural disasters, wrecks, grade crossing accidents, etc.) a rail route is blocked, finding an alternative path can be difficult. Connections may not exist where needed, crews may not be qualified, the alternative route may be quite

circuitous (especially in the Western U.S.), or the other line may have inadequate capacity. All of these factors would come into play even if the networks were publicly owned and subject to universal access.

Most importantly, to achieve the low cost of rail transport, individual shipments (container, trailer or freight car) must be consolidated into our basic production unit -- the train -- and de-consolidated at destination. In reality, the consolidation and de-consolidation process -- switching -- can occur many times during a car's journey. The higher volume between two specific points, the less consolidation/de-consolidation is needed and vice versa.

Consolidation/de-consolidation is costly, resource intensive, and time-consuming. Only hub airports and "super" parcel hubs, such as Willow Springs (UPS) or Memphis (FedEx), represent similar levels of complexity and investment for other modes.

In short, railroads are superbly efficient when moving large volumes of freight between one point and another point, almost irrespective of length of haul. (NS has movements of stone and wood chips in trainload service that are highway-competitive even though the length of haul is less than 100 miles.) The ideal railroad operation, in terms of both service and cost, is achieved when no switching is required.

As origin-destination traffic volumes decline, more switching is required. System efficiency declines from the "perfect" model.

Obviously, these economic and service realities create a tension between high volume and lower volume users. Railroad technology, unlike truck technology, is not "egalitarian." One reason railroads were regulated in the first place was to create a "fairer" system for all users (another reason was that 19th century railroad managers of the day sought economic regulation to

"protect" them from destructive competition). One unintended and delayed consequence of economic regulation ultimately was widespread financial and service failure.

After thirty-five plus years of experience in the rail industry, I have learned that the physical and operational realities of our technology simply cannot be ignored, no matter how convenient that might be for a particular point of view. If we again ignore the realities of rail technology -- a technology that thrives on point-to-point volume -- we could return the industry to its condition when I joined it. At that time the rail industry was dominated by smaller companies, those "40" railroads so often mentioned with longing by some opposed to the current concentration in the industry. I would urge those who look backward for a model for the North American rail industry of the 21st century to look carefully. Can they name more than a few of the many railroads with decent track? with a decent balance sheet? with decent service? Would any of those many competing rail carriers have had the funds or the market reach to justify the enormous private infrastructure investments made by the large railroads during the last two decades? While this fragmented model is outside the memory of many participants in this proceeding, it was reality, and it was ugly.

There is no doubt that current rail management, that of NS included, failed to deliver many of its claimed merger benefits, at least in the time frame proposed. But we must be mindful not to throw the baby out with the bath water. The risk is that in the zeal to "get even" for these merger shortcomings, we also will undermine the economics of the business. Balance, rooted in sound economics and a sense of history, is important in these deliberations by the Board.

Expanded Access

Many rail customers testifying at the Ex Parte No. 582 advocated expanded rail access as the appropriate method of creating rail-to-rail competition. No issue is likely to be more vigorously debated during this proceeding.

While expanded access has many advocates, there is often misunderstanding about how such access is to be accomplished. Increasingly, rail customers also have extensive experience with motor carriers, where competing services are readily available. The multiple access required for rail competition is more difficult and costly to achieve and often creates unintended cost and service consequences.

Truckload motor carriers, rail's most direct competition, are not a network business; railroads are. Moreover, rail is the most complicated and inflexible of transportation networks. Most network characteristics of rail cannot be eliminated simply by making railroads, like highways, an "open access" system, although that is precisely what many expanded access proponents seem to think. Based on my experiences in the creation of Conrail and in the recent split of Conrail operations between NS and CSXT, I strongly believe that expanded access must be approached with a high degree of caution. At a minimum, no call for expanded access should be divorced from the hard fact that such access comes at a price and that overall system performance may actually decrease and overall costs increase.

Conrail was formed in the mid-1970s at a time of serious over-capacity in the Northeastern rail network. There were too many carriers, too many yards and too many tracks chasing a declining traffic base. The goal of the United States Railway Association (USRA) was to reduce the number of carriers, eliminate redundant facilities, rebuild what remained, and then increase rail

volumes with improved services. Continued rail-to-rail competition was still a goal, but only in the higher volume markets, and even there, it was believed that two-carrier competition would be sufficient.

Ultimately, even the "two carrier competition in major markets" goal was not achieved in practice. Neither the Chessie System nor Norfolk and Western saw enough economic value in the Northeast to justify the risks of entering that market. The "competition" that finally evolved, extension of D&H, never became meaningful.

Subsequently, Conrail was launched, and tracks and services rebuilt. Traffic did not rebound as projected, and further rationalization occurred in the early 1980s. In fact, the financial rebound achieved by Conrail was not the result of gains in market position but rather from continued dramatic cost cutting coupled with shifts in traffic to more trainload and intermodal services. One of the key ingredients in Conrail's cost cutting effort was elimination of low volume lines, low volume yards, and small interchange points. The Conrail network was greatly simplified when compared to that of its predecessor companies. Gateways were closed, and supporting tracks and yards downgraded or eliminated. This necessary restructuring came with a reduction in the competitive alternatives available to shippers -- alternatives that were very costly and that required the network complexities that Conrail had to shed to survive. While some shippers clearly lost competitive options, and some any rail service at all, Conrail was widely hailed as a success.

The more complicated the rail network, the higher the operational costs and the greater the expensive infrastructure needed to support that complexity. One does not go without the others.

These operational and economic realities have been confirmed by the recent experience of CSX and NS as we sought to reintroduce rail-to-rail competition in a number of northeastern markets, most large but some small. Both CSX and NS understood that this would be a costly process, requiring as it did the restoration of significant infrastructure and creation of duplicative operations. Further, it was recognized that the Shared Assets Areas (SAAs), the primary vehicle for restored rail-to-rail competition, would be difficult to manage. However, both NS and CSX expressed great confidence that the challenges could be overcome.

Our confidence has been somewhat reduced, based on our recent experiences. Although a final accounting must await restoration of normal operations and completion of current cost containment initiatives, the task of adding competition appears to be more difficult and costly than we anticipated.

Our recent experiences with increased competition have been very "site specific." In most locations where competition was reintroduced, rates declined. But in those same locations, rail costs increased.

North Jersey Shared Assets Area The competition and infrastructure puzzle in northern New Jersey has two components: intermodal and carload. Each was handled differently from the initial planning stage. Intermodal terminals operated or used by Conrail were divided between NS and CSX, to the extent possible. Croxton and E-Rail serve NS; N. Bergen and Kearny serve CSX (with some residual use of Kearny by NS); Portside serves Triple Crown and Dockside (also known as Express-Rail) serves both NS and CSX, with loading performed by Maher Terminals. The terminals by and large have functioned well with the exception of Dockside. At that terminal both CSX and NS have experienced delays to arriving and departing trains due to line of road

congestion, especially on the "Chemical Coast," and due to the capacity constraints of Express-Rail itself. Overall, intermodal terminal operations now function fairly well, including access and egress.

Both disposition of and the report for the carload business are different. Conrail largely eliminated redundant yards and facilities used for carload traffic in the northern New Jersey area, and many facilities that remain intact were transferred to passenger entities or otherwise sold. In addition, Conrail also eliminated a major East Coast yard (Enola Yard at Harrisburg) several years before the NS/CSX/Conrail transaction. NS and CSX were committed to recreation of competitive rail service in the area. Therefore, both NS and CSXT have access to most of Conrail's North Jersey carload facilities, and they are operated by the SAA. We thought that the remaining infrastructure was robust enough to accommodate dual operations, but it failed under the initial pressure of congested line haul operations and increased volume caused by the information systems problems experienced after Day 1. Operations have improved and I am certain that the North Jersey SAA ultimately will perform as well as promised.

Southern Jersey/Philadelphia and Detroit Shared Assets Areas. Both the South Jersey/Philadelphia and Detroit SAA operations also experienced initial service problems, but neither proved as pervasive as the North Jersey SAA. Neither has passenger or significant intermodal operations; neither has through train operations (CSXT operates Southeast to New England trains through North Jersey SAA) and neither is as large as North Jersey. Still, the results for these operations have been better only when compared with North Jersey, they have not been as good as we expect them to be.

While SAA service quality has been a disappointment to us and our customers, the cost of SAA operations is an even larger issue. For tax, political and operational reasons, Conrail/SAA is a very high cost operation. Teams currently are deployed from CSX, NS and Conrail to attack this cost problem. In the meantime, CSX and NS are absorbing the high cost of SAA operations, but these costs will be reflected in the NS and CSXT rates to the extent these costs cannot be reduced. To a certain extent, both higher costs and thus higher revenue requirements may occur where two competing roads each provide service, but formerly only one was present.

Certain other former Conrail markets not in a Shared Assets Area also saw increased rail-to-rail competition after Day 1.

The Monongahela This coal originating area in Pennsylvania generates unit train movements. While this area is included in the Conrail properties operated and dispatched by NS, CSXT has full and equal access through haulage. New infrastructure was required, CSXT expanded the yard at Newell. By and large this competitive service has operated efficiently, and cooperation is good. The relative simplicity of unit train operations is believed to be the key to this result.

Indianapolis NS reaches Indianapolis on a reciprocal switch basis, with NS road trains arriving and departing at a CSXT yard, where NS traffic is classified and switched to/from customers by CSXT. However, the limited infrastructure has proven a challenge to providing the type of service intended.

Buffalo/Niagara Falls Service to Buffalo area customers remains a problem. Significant industries located on South Buffalo Railroad are now open to both CSXT and NS. Former Conrail-served industries open before Day 1 remain open and at a lower switching charge.

However, as in Indianapolis, the available rail infrastructure proved to be inadequate for two-carrier competition. Before Conrail was created, much of the infrastructure in the Buffalo area was controlled by three Conrail predecessor carriers, which provided competing service to some customers. Conrail removed duplicate facilities, partly in response to very high (relative to other states) railroad real estate taxes.

Most former Conrail facilities in the Buffalo area were allocated to CSXT, and initially, NS was slow to add infrastructure. However, with NS's sublease and rehabilitation of the B&P Yard and reopening of Conrail's former Bison Yard at a cost of \$13 million, NS is beginning to make progress. Again, the reintroduction of competitive service has been a slow and costly process.

Conclusions on competitive access. Clearly, providing effective and efficient competitive access through the Conrail transaction has proved to be more complex and costly than NS and CSX thought. The difficulties are especially severe for "loose car" railroading. Just as Conrail was able to reduce its infrastructure and lower its costs as it simplified its carload network, so have CSX and NS been forced to go in the other direction to revive competition. While our efforts to create rail competition in the Northeast is very much a "work in progress," the CSX and NS experience suggests several questions for the Board to consider when evaluating other expanded access proposals.

1. Is the infrastructure truly adequate for the competitive services proposed, and if not, how long will it take to make the necessary improvements, what will they cost, and who will pay? Much of the rail system is operating to capacity, as it should (too much idle capacity simply means assets are being wasted). Many who testified in the Ex Parte 582 proceedings seemed to

think that a simple legal order would magically solve problems; that is simply wishful thinking given the reality of the network we have today. Environmental and community, as well as economic, impacts must be part of the infrastructure equation, as NS found in its reactivation of Bison Yard.

2. Do the usage charges truly reflect the long term costs of the proposed local operation? In the Northeast, charges and costs often were de-linked in response to political and other pressures. The unintended consequence of that de-linking may be de facto withdrawal of services by the carriers. Without profits there will be no effort on the part of the owning carrier to upgrade the infrastructure to handle competitive operations.

3. Do the usage charges truly reflect overall *system* costs? Introduction of competitive services for low volume operations means that more switching is done somewhere in the rail network. The result can be more complexity, higher costs and poorer service overall for all rail users.

In future transactions, we must take a more holistic view. Changes do not occur just in the relevant markets; they often cascade through the entire network. Some changes "go with the flow" and can make use of existing facilities and services. They are relatively easy to accommodate. Others "go against the grain" and may be impossible from an operational, efficiency or commercial perspective. In all cases, the benefits from a specific action must be balanced against the impacts on other users of the system.

Conclusions

While NS has argued that a pause in the merger process would be beneficial, it does not believe that the process can, or should, be terminated. With the increasing globalization of

commerce, and the increasing size and power of rail customers, it seems to me that a rail system forever organized on a regional basis may not be responsive to customer demands. This is especially true given the level of new investment in infrastructure that will be needed in the coming years; investment that will be often market and lane specific and investment that will vary depending on how the rail networks are aligned in the long run.

That said, the indisputable fact is that merger benefits are difficult and costly to achieve. Given the potential complexity of future rail mergers, these difficulties likely will grow. There are several reasons for this likely increase in complexity of obtaining future merger approvals, let alone benefits: merged carriers will result in a much larger span of control; environmental and community impacts, with attendant costs of mitigation, will increase; and the new "rules of engagement" that are likely to come from these proceedings almost inevitably will increase barriers to merger and increase merger costs and delays. Already, successful negotiation and conclusion of a major rail merger is a very long process, and recently, the up-front costs have become higher than anticipated. The net present value of merger benefits must thus be appropriately discounted.

At the same time, no single rail carrier can hope to reach all relevant markets, which are increasingly global, with single-system service. The need for some joint services, especially with other modes of transportation, always will exist. By necessity, railroads will have to learn to manage alliances, and from this necessity will come better techniques for alliance management. With only six major rail carriers in the U.S. and Canada and growing resistance to more rail mergers, the dynamics of alliances may change. The number of essential relationships to be

maintained has been vastly reduced by mergers. The Internet and other improvements in communication will aid that task.

Alliances certainly are and will continue to be one tool for railroads to adjust to a rapidly changing marketplace. Still, the problems that customers, regulators, and carriers have with more rail mergers must be weighed against the degree of difficulty of alliances.

All requests for better access, be they from customers, short-lines or government, must be balanced against the realities that someone must pay for added network complexity and that overall service quality may deteriorate in the process. Service degradation is not a certainty, and there are ways to work around many network problems. However, ignoring the network realities of any change can cause very serious problems, especially when resources are stretched thin and when, more than ever, railroads must provide the resources needed for growth. Protecting existing customers and the nation's need for a high capacity, high service network must be balanced against the localized benefits of expanded access.

The future of the North American rail system is simply too uncertain to say what approach will work best. That will depend on future market economics, future service requirements, future management techniques, and the regulatory environment. The regulatory scheme must emphasize flexibility, not limited options, for rail service to thrive and grow.

VERIFICATION

COMMONWEALTH OF NORFOLK)
) SS:
CITY OF NORFOLK)

JAMES W. McCLELLAN, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the facts stated therein are true and correct to the best of his knowledge, information and belief.

James W. McClellan

Subscribed and Sworn to Before Me
This 12th Day of May, 2000.

Sandra J. Kirby
Notary Public

My Commission expires: **MARCH 31, 2002**

CERTIFICATE OF SERVICE

I hereby certify that, on this 16th day of May, 2000, I served the foregoing
"Comments of Norfolk Southern in Response to Advance Notice of Proposed Rulemaking" by
causing a copy thereof to be delivered by first-class mail, postage prepaid, to each of the persons
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