



U.S. Department of
Transportation

Office of the Secretary
of Transportation

ORIGINAL

GENERAL COUNSEL

400 Seventh St., S.W.
Washington, D.C. 20590

July 25, 2001

Vernon A. Williams, Secretary
Surface Transportation Board
Suite 700
1925 K Street, N.W.
Washington, D.C. 20423-0001



Re: Fin. Dkt. No. 34000

Dear Secretary Williams:

Enclosed herewith are the original and twenty-five copies of the Reply Comments of the United States Department of Transportation in the above-referenced proceeding. There is also a computer diskette of this document, convertible into Word Perfect. I have included as well an additional copy of the Department's comments that I request be date-stamped and returned with the messenger.

Respectfully submitted,

Paul Samuel Smith
Senior Trial Attorney

Enclosures

cc: Parties of Record

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DOT-3

Before the
Surface Transportation Board
Washington, D.C. 20590

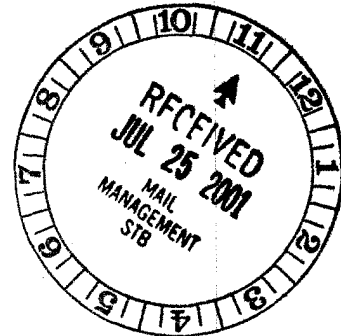
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Canadian National Railway Company, Grand Trunk Corporation)
And WC Merger Sub, Inc. – Control – Wisconsin Central)
Transportation Corporation, Wisconsin Central Ltd., Sault Ste.)
Marie Bridge Company, and Wisconsin Chicago Link)

Fin. Dkt. No. 34000



Reply Comments of the
United States Department of Transportation

Introduction

The Surface Transportation Board (“Board” or “STB”) in this proceeding is considering the application of the Canadian National Railway Company and related entities (collectively referred to herein as “CN”) and the Wisconsin Central Transportation Corporation and related entities (collectively referred to herein as “WC”) ¹ pursuant to which CN would acquire control of WC. *See* Decision No. 2, served May 9, 2001. The initial comments of interested parties have raised various issues relating to competition and other subjects.

The United States Department of Transportation (“DOT” or “Department”) hereby submits its reply comments and its views on the merits of the transaction. In sum, we believe that the Board should approve the transaction, monitor competitive and other developments arising therefrom, and hold the Applicants to their commitments, including the terms of their settlement agreement with the National Industrial Transportation

¹/ CN as used herein encompasses the Canadian National Railway Co., Grand Trunk Corporation, and WC Merger Sub, Inc. WC as used herein encompasses the Wisconsin Central Transportation Corporation, Wisconsin Central Ltd., Fox Valley & Western Ltd., Sault Ste. Marie Bridge Co., and Wisconsin Chicago Link Ltd. We refer to CN and WC jointly as the “Applicants.”

League ("NITL"). Another commitment to which the Applicants should be held as a condition of approval is their representation to consult with the Federal Railroad Administration in advance of any possible transfer of dispatchers out of the U.S. DOT-1 at 3-5. Beyond these, we do not believe that the STB should approve or impose additional conditions at this time.

The Position of the Department

The Department has considered the record in its entirety in reaching its conclusion about the merits of the transaction. Based upon the application itself and on the pleadings filed by interested parties, DOT believes that the proposed transaction warrants approval. It is largely an end-to-end merger that deprives no shipper of intramodal competition. See Canadian National Railway Co., et al. – Control – Illinois Central Corp., et al., Finance Docket No. 33556, Decision No. 37 (served May 25, 1999) slip op. at 22-23. The Applicants have also pledged to maintain gateways and all interchanges on reasonable terms and have entered into a settlement agreement with the NITL in an effort to address shipper concerns. CN/WC-2, Verified Statement of Foote and Schauer at 8. Although it is possible that the combined CN/WC may deviate from the operating plans submitted herein, and that such changes could introduce consequences -- competitive, essential service, or environmental -- that require the Board's attention, as will be discussed below, the record does not now support adoption of a specific condition to address this possibility. The record at this point simply suggests that the STB should acknowledge this potential for harm, and indicate its willingness to consider evidence demonstrating such harm and identifying appropriate mitigation measures.

The Position of Other Parties

Initial comments were filed by shippers, labor unions, railroads, public agencies, and others.² Most of these pleadings relate to the proposed merger's potential effects on competition. It is these that we will discuss below, by party.

^{2/} E.g., AK Steel Corporation, Wisconsin Department of Transportation, Brotherhood of Locomotive Engineers, and Rail America, Inc.

A. National Industrial Transportation League

The National Industrial Transportation League supports the merger on the basis of a settlement agreement it has entered into with the Applicants. Pursuant to this agreement the Applicants have pledged to protect rates and services through existing WC interchanges, to offer assurances against deterioration in service, and to resolve merger-related disputes with shippers via arbitration. NITL Statement of Support, dated April 27, 2001, at 5. NITL notes as well that the Applicants have committed to waive any defenses that might arise as a result of this transaction under the "contract exception" in the STB's bottleneck decisions. *Id.* NITL believes these provisions will protect shippers from any anticompetitive effects that may result from the merger. *Id.* NITL requests that the Board impose the terms of the settlement and hold the Applicants to their contract exception commitment as conditions of approval.

The Department begins with the proposition that the instant merger does not present anticompetitive problems. In addition, the Applicants' have committed to maintain open gateways and all interchanges on reasonable terms. CN/WC-2, Verified Statement of Foote and Schauer at 8. In these circumstances we do not believe that the terms of this settlement are necessary to warrant the Board's approval of the underlying transaction. However, we commend the Applicants and NITL for voluntarily negotiating in order to alleviate shipper concerns. We agree with the NITL that these terms are consistent with the Board's recent decision in Ex Parte No. 582 (Sub-No. 1).³ DOT believes that the availability of arbitration in place of regulatory procedures will prove particularly attractive to many shippers.⁴ Accordingly, the Department supports adoption of the NITL agreement as a condition of the merger's approval.

^{3/} We note that other shippers consider the settlement to be inadequate. *See* Comments of Wisconsin Manufacturers and Commerce.

^{4/} We are uncertain whether in contract exception cases the arbitration provision contemplates substituting an arbitrator for the STB, or whether in such cases CN has simply agreed to waive otherwise available defenses before the Board. If the former is contemplated, the STB may wish to monitor arbitration results.

B. Great Lakes Transportation LLC

Great Lakes Transportation LLC (“GLT”) during much of this proceeding repeatedly voiced concerns about the ability and intent of the merged CN/WC to divert vast amounts of taconite traffic from its current rail-water routing to an all-rail route. *See* GLT-1, *passim*; GLT-5 at 3-4; GLT-9 at 6-11. This outcome, GLT reported, would not only have significant environmental impacts, but would also seriously threaten the water carriage transportation option and its infrastructure in the Great Lakes region, to the detriment of water carriers, shippers, workers, and communities. *Id.* The Applicants responded just as consistently that they had no intention of diverting this traffic and that, more importantly, there was no realistic prospect of such diversion. *See, e.g.,* CN/WC-13, *passim*.

Subsequently these parties entered into a settlement agreement resolving their differences. GLT-14. The central feature of this settlement is the establishment of an agency relationship between the Applicants and the Duluth Missabe & Iron Range Railway Company (“DMIR”), a small railroad within the GLT corporate structure that serves taconite mines in northeastern Minnesota.⁵ As DOT understands the arrangement, the merged CN/WC would appoint DMIR as its exclusive agent for the marketing of certain all-rail movements of taconite.

GLT believes this agreement is in the public interest because it preserves for shippers the current all-rail and rail-water transportation options, it expands those options insofar as it makes another port available in winter (Escanaba, Michigan), and it enables the participants to compete with other carriers for taconite traffic. *Id.* at 7-8. GLT has asked the Board to adopt this settlement agreement as a condition of its approval of the merger. GLT states that it is “confident” that the agreement’s competitive and other benefits would enable it to withstand antitrust challenge, but to avoid resource-consuming litigation it seeks to insulate the settlement from such attacks through the protection afforded by the STB’s approval. *Id.* at 10; 49 U.S.C. § 11321(a).

^{5/} The settlement also includes a variety of related matters as well as resolution of independent disputes. GLT-14 at 6, and Attachment C.

The Department believes that GLT's participation in this proceeding has raised an important issue not usually present in rail consolidation cases: the effects of a transaction on the viability of another important mode of transportation in the region. The GLT settlement with the Applicants introduces its own questions. We address each in turn.

1. The viability issue

Fundamental statutory policies require the Board to consider whether transactions before it pose a significant threat to the viability of important transportation options and infrastructure. 49 U.S.C. §§ 10101 (4), (5), (8); 11324(d). The Department believes that water carriage in the Great Lakes region and the infrastructure that maintains and is nourished by Great Lakes water traffic are within the purview of these provisions. What is unclear to DOT at this juncture is the true extent of the threat, if any, presented by the instant merger.

For example, the record does not clearly establish whether the Applicants seriously hope to attract significant volumes of taconite traffic to their all-rail routings, or, if they were successful in such an endeavor, what the consequences would be for the Great Lakes water carrier industry. Prior to the announcement of their settlement with GLT, however, the record does indicate that CN and WC had pointed out the historic dominance of the rail-water option, the considerable cost advantage of that option, and the ability of the DMIR as the sole railroad serving the relevant taconite mines to exercise "bottleneck" pricing power over all-rail movements. *See, e.g.,* CN/WC-13 at 2 and Appendix I. The merger changes none of these facts.

The record thus suggests that this transaction is unlikely to lead to the diversion of taconite to all-rail routings in volumes sufficient to pose a realistic threat to water transportation in the Great Lakes region, at least in the foreseeable future. DOT believes that competition between the different modes is beneficial to shippers and to the economy generally, and should be encouraged in these circumstances.

The belated appearance in this case of a major taconite shipper may indicate at least the possibility that one or more of these important conditions may change, however. United States Steel LLC ("US Steel") until recently owned DMIR, the docks it serves, and the Great Lakes water carrier that transports the taconite from those docks. GLT-1, Verified Statement of Peter D. Stephenson at 1-2. It therefore likely has a depth of

experience with the overall economics of the traffic at issue. US Steel has expressed “significant concern” about the settlement agreement, but as yet has provided no elaboration. Motion for Leave to File Notice of Intent to Participate dated July 16, 2001, at 2.

Because of the importance of Great Lakes water carriage to the country’s transportation infrastructure, the Department urges the Board to indicate its willingness to consider evidence of harm arising from this merger.⁶ DOT does not specifically recommend a formal oversight proceeding of the type commenced after recent combinations of Class I railroads. Nor do we suggest an open-ended period of time for consideration of any such information. We simply propose that the STB announce that it will monitor developments in this area for a period of three to five years. During that time parties would be invited to submit evidence of any harm to Great Lakes water carriage caused by this transaction. Interested parties could contribute to the record, and the Board would thereby be assured of an informed basis for decisionmaking.

2. The settlement issue

The agency arrangement embodied in the settlement agreement between GLT and the Applicants is problematic in the Department’s view. Prior to the announcement of this agreement, the Applicants expressed doubt as to whether the public interest required the preservation of GLT in order to assure continuation of the Great Lakes rail-water transportation system. CN/WC-13 at 3-4. The Applicants opined that there was “only one way” to guarantee that GLT would not lose the taconite movements: “Directly or indirectly, the Board would have to preclude Applicants from competing for those movements.” *Id.* at 4 (footnote omitted). CN and WC acknowledged that because they did not realistically expect to obtain this traffic they could agree not to compete for it without any real cost – except that “antitrust principles might prevent us from entering into such an agreement with GLT.” *Id.*

The Department believes that the agency agreement that is at the heart of the settlement does indeed present antitrust concerns. The signatories to the settlement are the parties most likely to compete against each other for the movements in question. As

⁶/ This is consistent with our recommendation with respect to the transaction’s potential for adverse environmental or community consequences. DOT-1.

noted, through the agreement the proponents of all-rail carriage (the Applicants) have appointed the representative of the water-rail option as their exclusive agent for marketing the all-rail routing from DMIR-served mines to named destinations in Ohio, Indiana, and Pennsylvania. GLT-16 at 3. The Applicants have also promised that they will neither solicit this traffic themselves nor set prices to shippers for their portions of such movements unless “legally required to do so.” *Id.*⁷

It is difficult to imagine that DMIR would seriously seek to lure taconite traffic away from its affiliates in the GLT corporate structure when those affiliates (if not the entire structure) depend upon that traffic continuing in the rail-water mode. Thus, it appears in principle, at least, that this aspect of the settlement resembles either a *de facto* agreement not to compete or a *de facto* agreement among competitors to divide a market. Such agreements are *per se* violations of section 1 of the Sherman Act, 15 U.S.C. § 1. See *U.S. v. Topco Associates*, 405 U.S. 596 (1972). Arrangements that arguably would lead to such anticompetitive results are not generally in the public interest, and the parties have offered no convincing reason why it should be otherwise in the context of a settlement of their differences in this case.⁸

Regardless of the existence of conditions that seem to favor the rail-water option at this time, therefore, the Department opposes adoption of the settlement agreement by the STB as a condition of approval of this merger. Rather, the settlement should be freestanding and subject to the antitrust laws like other contractual agreements between competitors, and the Applicants and GLT should decide whether they wish to proceed with it on that basis.

C. Canadian Pacific Railway Company

The Canadian Pacific Railway Company (“CP”) first outlines its competition with CN for traffic moving to and from points in WC’s current service territory. CPR-3 at 3-5. CP then expresses concern that if the combined CN/WC closes the relevant gateways,

⁷/ Another provision bars disclosure of “any further agreement or other document contemplated by this Agreement.” *Id.* at 15.

⁸/ DOT is also uncertain about the effect, if any, of the provision in the GLT settlement agreement barring Applicants from offering rates for their segments of all-rail movements on the Applicant’s commitment in the NITL agreement to waive all defenses in “contract exception” bottleneck cases.

this intramodal and source competition would be diminished. Id. CP takes no position on whether the Board should approve the transaction, but maintains that conditions are necessary to avoid these competitive losses. Id. at 1-2. CP believes that the Applicants' original undertaking to keep gateways open is highly qualified, and it also believes that the NITL agreement is too narrowly drawn to preserve competitive options. Id. at 5-10. CP therefore requests that the STB (1) require the Applicants to provide unqualified assurances that existing gateways and interchanges will be preserved with reasonable rates, (2) extend the NITL protections to cover not just shippers but also the Applicants' interline arrangements with connecting railroads, and (3) keep in place an existing CP/WC haulage agreement for a term of twenty years. Id.

The Department does not support CP's proposed conditions. It bears repeating the initial point that this is an end-to-end transaction that does not directly threaten competition. Moreover, DOT believes that the Applicants have not made illusory promises to shippers; rather, through their application they have committed unequivocally "to keep all existing gateways [and interchange points] affected by the transaction open on commercially reasonable terms." CN/WC-2, Verified Statement of Foote and Schauer at 8. We believe they should of course be required to adhere to these representations as a condition of approval. Finally, the terms of the NITL agreement offer additional benefits to shippers. Together these provisions should assure shippers of workable negotiations on joint line arrangements with connecting carriers. There is thus no basis for CP's claim of cognizable anticompetitive harm that demands redress.

DOT also wishes to note that by attempting to obtain for itself the benefit of arbitration allowed shippers under the NITL settlement, CP's second condition seeks to alter the traditional means by which carriers arrive at joint routes and rates. These are a matter of negotiation between willing railroads, and in the absence of any demonstrable effect on competition, this transaction provides no basis for the Board to impose mandatory arbitration on carriers that have not agreed between themselves to resolve their disputes in this manner.

CP's third condition would have the Board waive the cancellation provision of an existing haulage agreement between CP and WC for the movement of intermodal traffic between Green Bay and points in the Northeast served by CP's affiliate, the Delaware and

Hudson Railway Company. This provision allows for either party to terminate the agreement on ninety days notice. CPR-3 at 11. CP submits that following the consolidation CN will likely cancel the agreement, and as a result these shippers will lose the only direct rail-to-rail competitive option that they would have to a merged CN/WC. Id. at 2.

The Department is not convinced that the Board should override this contractually agreed-to cancellation term in order to protect shippers' from a loss of competition. Not only does the underlying transaction pose no threat to competition generally, but the terms of the NITL agreement and the Applicants' own waiver of defenses in "contract exception" cases should address the specific concerns of shippers that would otherwise benefit from this haulage agreement. We also wish to point out that the haulage agreement is unrelated to the merger. In 1993, CP and WC voluntarily entered into the agreement to provide service to these shippers. Although DOT has not seen the specific provisions of the agreement, it is clear from CP's comments that both parties negotiated and agreed to cancellation by either party on ninety days notice. That has always been the case and after the merger it would remain so. With CN's purchase of WC, the merged firm remains responsible for fulfilling WC's contractual commitments and exercising its contractual options. There is nothing in this transaction that changes this, and in the circumstances of this case there is no basis for the Board to impose conditions different from those agreed to by the parties.

D. Vulcan Chemicals

Vulcan Chemicals ("Vulcan") operates a plant in Port Edwards, Wisconsin that is solely-served by WC. Prior to the merger Vulcan had arranged for the interchange of shipments with the Union Pacific railroad through a switching agreement that Vulcan negotiated with WC. VUL-2 at 3-4. A large portion of Vulcan's traffic moves to the Chicago gateway by both carriers. Currently WC provides the switching service for \$300 per car, and under the agreement Vulcan has certain volume commitments to WC for a period of five years. Id.

Vulcan seeks assurance that the Chicago gateway and other interconnections will remain open and competitive if the proposed merger is approved. Vulcan has also

requested that the Board impose a special condition on the merger mandating that future increases in the switching charge be limited to the demonstrable increase in cost for performing those services. VUL-3 at 5-6.

The Department believes that the Applicants' representations and the NITL agreement satisfactorily address Vulcan's concerns about open gateways and interchanges.⁹ The NITL agreement also answers, at least in part, Vulcan's request for a condition limiting cost increases in the switching fee. Under Section 3(b) of the agreement, for five years the merged CN/WC can increase its portion of the rate on interlined traffic by no more than the change in the Unadjusted Rail Cost Adjustment Factor.¹⁰ Finally, Vulcan has the right under the NITL agreement to seek arbitration if it disputes these cost increases or charges. Vulcan apparently would have switching charge increases limited to costs in perpetuity rather than for five years, but this is another instance in which there is no basis to override the bargain struck by the parties. DOT opposes imposition of this condition.

Conclusion

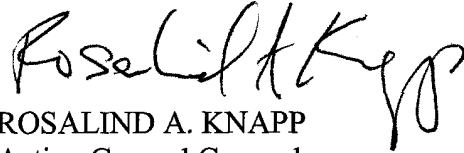
The merger proposal before the Board is essentially an end-to-end transaction that generally poses no competitive problems. The Applicants' commitments and the NITL settlement offer additional protections against adverse impacts. There remains the possibility, however, that in some circumstances competitive or other harms could result. The STB should therefore monitor developments and indicate its willingness to consider

^{9/} According to Vulcan, these interchanges and gateways are active and have been so for the past twelve months, a necessary condition under the NITL agreement.

^{10/} The Unadjusted Rail Cost Adjustment Factor is calculated and published quarterly by the STB. It reflects changes in railroad cost based upon an index of railroad input prices.

evidence of such consequences as well as appropriate mitigation measures. The Board should not approve and extend antitrust immunity to the GLT settlement agreement, which appears to embody an anticompetitive arrangement.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Rosalind Knapp", with a stylized, flowing script.

ROSALIND A. KNAPP
Acting General Counsel

July 25, 2001

CERTIFICATE OF SERVICE

I hereby certify that I have on this day caused to be served on all Parties of Record by first-class mail, postage prepaid, a copy of the foregoing Reply Comments of the United States Department of Transportation filed in Finance Docket No. 34000.

A handwritten signature in cursive script, reading "Paul Samuel Smith", written in black ink. The signature is fluid and stylized, with the first and last names being more prominent.

Paul Samuel Smith

July 25, 2001