



**U.S. Department of
Transportation**
Office of the Secretary
of Transportation

ORIGINAL

General Counsel

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

February 24, 2004

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

**ENTERED
Office of Proceedings**

FEB 24 2004

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Re: Finance Docket No. 34424

Dear Secretary Williams:

Enclosed please find the original and twenty copies of the Reply Comments of the United States Department of Transportation (DOT-3) in the above-referenced proceeding. I have included a computer diskette containing the above document in WordPerfect, and an additional copy that I request be date-stamped and returned to the messenger delivering these materials.

Thank you for your assistance in this matter.

Respectfully submitted,

Paul Samuel Smith
Senior Trial Attorney
(202) 366-9280

Enclosures

cc: Parties of Record

ORIGINAL

Before the
Surface Transportation Board
Washington, D.C.

2/01/47



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Canadian National Railway Company, and Grand Trunk)
Corporation -- Control -- Duluth, Missabe, and Iron Range) Finance Docket No. 34424
Railway Company, Bessemer and Lake Erie Railroad)
Company, and the Pittsburgh & Conneaut Dock Company)

**Reply Comments of the
United States Department of Transportation**

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Introduction

The Surface Transportation Board ("STB" or "Board") in this proceeding is considering whether to approve the combination of the Canadian National Railway Company ("CN") and three other rail carriers, the Duluth, Missabe, and Iron Range Railway Company ("DMIR"), the Bessemer and Lake Erie Railroad Company ("B&LE"), and the Pittsburgh & Conneaut Dock Company ("P&C Dock") (collectively, the "GLT railroads").¹ See Decision No. 2, served December 1, 2003. The United States Department of Transportation ("DOT" or "Department") has reviewed the record compiled to date, which consists of the primary application, related environmental and safety filings, and the initial comments of interested parties. DOT believes that the

^{1/} CN actually seeks to acquire the Great Lakes Transportation Company LLC ("GLT"), which consists of these three railroads as well as the Great Lakes Fleet ("GLF"), a water carrier that owns and operates a fleet of vessels transporting iron ore and other bulk commodities on the Great Lakes. The purchase of the GLF is not subject to the Board's jurisdiction, but is under review by the U.S. Department of Justice. Decision No. 2 (served December 1, 2003) at 3-4. The Coast Guard and the Maritime Administration are separately considering whether CN's acquisition of the GLF would be consistent with the requirements of the Jones Act (specifically, 46 U.S.C. § 883) and corresponding portions of those agencies' regulations.

proposed transaction meets the applicable standard for approval, provided that the Board imposes whatever conditions it deems appropriate to ensure that the transaction will not substantially lessen competition, and provided that it holds the Applicants to their representations and commitments made on the record.

Safety

Before discussing the other aspects in this proceeding, DOT wishes to address the remaining safety-related issues. First, railroad labor unions have noted that Federal Railroad Administration ("FRA") regulations now govern foreign-based dispatching of trains operating in the U.S. IBEW, IAM, ATDA, NCFO-3 at 2; *see* 47 C.F.R. Part 241. These unions ask that the STB not take any action that would exempt the Applicants from these rules. *Id.* FRA rules do indeed address this subject, and they apply to the CN and the GLT railroads. DOT therefore also urges the Board to clarify that its decision herein will not in any way affect the continued application of these regulations. The STB's traditional condition -- that the combined carrier comply with all safety regulations -- should serve this purpose.

Second, the Department wants to advise the STB about the status of the Safety Integration Plan ("SIP") prepared by CN in this case. The FRA reported to the Board roughly one month ago that CN needed to satisfy thirteen conditions in order to obtain FRA's approval of the SIP. FRA-1 (letter dated January 22, 2004). CN has just submitted a revised SIP that it believes meets all of FRA's conditions. FRA will review that document and report to the Board in the near future.

The Legal Standard

With respect to matters other than safety, the applicable legal standard requires the STB to approve this transaction unless it finds that –

- (1) as a result of the transaction, there is likely to be substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States; and
- (2) the anticompetitive effects of the transaction outweigh the public interest in meeting significant transportation needs.

49 U.S.C. § 11324(d)

The Primary Application

The primary application describes in detail the proposed combination of the CN and the GLT railroads. CN-2. CN has always contended that this transaction would have no adverse competitive effects, and would in fact strengthen carriers whose owners have not been wholly committed to railroad service, consolidate CN's own network by enabling it to acquire an important part of its route into Chicago, and allow CN to deepen and improve its relationship with the steel industry. *Id.*

CN maintains that no shipper would lose competitive rail service if the transaction is approved, with one possible exception, and it has promised to allow another railroad to replicate the service provided in that case. *Id.* at 11, note 14. CN not only discounts the notion of negative “vertical” effects on competition, but also has promised to keep open all existing active rail gateways on “commercially reasonable” terms. *Id.* at 12 and note 15. Finally, CN has agreed to waive any defenses it might otherwise have as a result of this transaction under the “contract exception” in bottleneck rate cases. *Id.* at 12.

The record shows that the Applicants' rail systems would join in “end-to-end” fashion in almost all pertinent respects. There is only one shipper of record that is now

served only by CN and a GLT railroad (the DMIR) and that therefore stands to lose actual or potential competitive options through this merger. This shipper has now reached an agreement with CN and has withdrawn its objection to the transaction. There is one other shipper that has opposed the merger, fearing that it poses a loss of substantial service. We address these matters below. Subject to the imposition of the conditions noted, the proposed combination meets the applicable statutory standard and should be approved.

Cleveland-Cliffs

The primary application notes that until May of 2003 EVTAC Mining operated a plant at Fairlane, Minnesota, that processed iron ore into taconite pellets (the primary raw material used in the production of steel). CN-2 at 11, note 14. CN acknowledges that this facility, if operating, would lose competitive rail service for general freight as a result of the merger. CN has stated that it is prepared to offer competitive access to another railroad to the same extent should the facility reopen. Id. CN also notes that this location would not lose a rail option for either iron ore or taconite pellets because assertedly only DMIR “was physically capable” of carrying these commodities to and from Fairlane. Id.

Cleveland-Cliffs, Inc. (“Cleveland-Cliffs”) reported in its initial comments that it had purchased the assets of EVTAC Mining, which as here relevant consist of the Fairlane plant and an iron ore mine (the Thunderbird North Mine) near Virginia, Minnesota, and that it resumed operations in December of 2003. CC-3 at 5. It confirmed that DMIR was the only railroad with physical access to the Fairlane plant. Id. at 5-6. Cleveland-Cliffs also asserted, however, that additional competitive options

enjoyed at both facilities by EVTAC would be lost unless this merger was appropriately conditioned.

Cleveland Cliffs has documented the feasibility of its build-in/build-out options with substantial evidence of EVTAC's 1998 plans for construction of track and facilities for build-outs to CN's line, as well as details of negotiations with, and offers of contracts from, CN and the Burlington Northern and Santa Fe Railway Company ("BNSF") acting in concert to handle the firm's transportation requirements. CC-3, Verified Statement ("V.S.") of Howard Hilshorst.² Three distinct rail moves were contemplated in these arrangements; two would entail only action by railroads seeking to compete with DMIR, while the third would require action by the Board.

The first would use build-outs to CN from the Thunderbird North mine and the Fairlane plant, in order to move iron ore from the mine to the plant. *Id.* at 5, Exhibit HH-4 at 1; *also*, CC-3 at 12, V.S. of James A. Trethewey at 6. In the second, CN would move taconite pellets north from the Fairlane plant to a connection with the BNSF (using BNSF trackage rights over a DMIR line) in order to create a second (if more circuitous) route to docks on Lake Superior that would compete with the DMIR route. CC-3, V.S. of Hilshorst at 5, Exhibit HH-4 at 2.

Clearly, both of these potential competitive options would be lost should CN's acquisition of DMIR be approved as originally proposed and without conditions. CN acknowledges the loss of the first competitive option above, for the movement of iron ore from the Thunderbird North mine to the Fairlane taconite plant, and it has committed to

² The EVTAC board chose not to go forward with the project, accepting instead lower rates offered by DMIR when confronted with the plan -- a clear indication of the competitive leverage provided by indirect build-in/build-out options.

providing competitive access to an independent railroad. CN-2, V.S. of Gerald P. Radloff at 12-13. CN makes no mention of the second option. It is nonetheless certain that a consolidated CN/DMIR would not “shorthaul” itself in order to provide a connection to a competitive BNSF route unless required to do so by a condition on the merger.

The third move contemplated by EVTAC and CN was to transport taconite pellets south on CN’s more direct line from the Fairlane plant to Lake Superior using the CN’s trackage rights over the DMIR “Spirit Lake” line between Nopeming Junction, Minnesota, and South Itasca, Wisconsin. CC-3, V.S. of Hilshorst at 8. Execution of this alternative would have depended on removal of an exclusion in the CN trackage rights that prohibit it from moving iron ore and taconite pellets over the DMIR’s line. Cleveland-Cliffs submitted evidence, however, that this exclusion might well be vulnerable in any challenge before the Board. *Id.* at 9-10 (Highly Confidential (“HC”)).

Had the build-outs been completed, and/or had the Board agreed to strike the restriction from the CN/DMIR trackage rights agreement, Cleveland-Cliffs facilities would have enjoyed competitive rail options for the movement of taconite pellets to Duluth/Superior for Great Lakes transportation. Those competitive options -- to pursue build-outs and/or to seek removal of the trackage rights restrictions -- remain today. However, the proposed merger would extinguish them. CN would have absolutely no incentive to explore such options following its acquisition of the DMIR. It is just such reductions in competition, including competitive opportunities, that the statute requires the Board to address.

Cleveland-Cliffs has since entered into a settlement with CN. CC-4. The record, however, contains neither that settlement nor any explanation of it. In the absence of this information, it is impossible to determine whether the public interest in maintaining competition has been served.³ The Department accordingly urges the STB to inquire into the particulars of the settlement and determine whether this private agreement sufficiently serves the public interest in preventing substantial reductions in competition arising from this merger, or whether further conditions by the Board are required to ensure the statutory standard is met. The Board should impose whatever condition(s) might be appropriate for the transaction to warrant approval.⁴

Ispat Inland

Ispat Inland, Inc. ("Ispat") is a large integrated steel producer. It owns the Minorca Mine near Virginia, Minnesota, from which it ships taconite pellets to its steel plant in East Chicago, Indiana. ISP-2 at 2-3. The Minorca Mine is served by both DMIR and (via trackage rights) the Burlington Northern and Santa Fe Railway Company ("BNSF"). For years Ispat has moved pellets by rail to Duluth or Two Harbors, Minnesota, pursuant to contracts with DMIR. During the Lake Superior shipping season, water carriers then take the pellets to East Chicago; during the winter, the Wisconsin Central railroad ("WC") takes the pellets from DMIR at Duluth and carries them to Escanaba, Michigan, for water transport to East Chicago. Id. at 5.

³/ Particularly in light of the settlement, DOT is also uncertain about the intent or impact of a request made by both Cleveland-Cliffs and CN that the Board retain jurisdiction to provide access to independent rail carriers at various points, which access would apparently further limit the restrictions on CN's trackage rights to carry taconite pellets and iron ore. CC-4; CN-2 at 24.

⁴/ For example, CN's operating plan contemplates "directional running" on the DMIR and CN lines extending south from Shelton Junction to the Duluth area. CN-2 at 162. Implementation of remedial conditions the Board may impose to preserve the potential loss of competition discussed above should take this into account to ensure that the competition provided by a trackage rights carrier would be effective.

After years of favorable experience with these arrangements, Ispat extended them by entering into “multi-year” contracts with both DMIR and WC in 2001. Id. at 6. It is Ispat’s experience since CN acquired WC later the same year that gives rise to its concern in this proceeding.

Ispat asserts that under CN’s ownership WC has reduced service, failed to meet contractual volume commitments, and tried to extract higher rates. Id. at 8-11. This alleged course of conduct has threatened Ispat’s East Chicago steel production during the winter months. Id. Ispat is now very concerned that CN’s impending ownership of DMIR would extend this problematic “service attitude” to that railroad, affecting Ispat’s rail transportation year round for the duration of its contract with DMIR. Id. at 9, 15-16.

CN’s representations to provide equal or better service to DMIR shippers provide no comfort to Ispat, because the CN made these same commitments when it acquired the WC. Id. at 14. Ispat therefore opposes the pending consolidation. In the alternative, although Ispat insists that it does not seek to involve the STB in a contract dispute,⁵ the shipper requests that the Board condition any approval of the pending merger by allowing it to terminate its multiyear contract with DMIR should that carrier fail to meet its contractual obligations in any calendar quarter. Id. at 15-16.⁶

The Department opposes the adoption of Ispat’s suggested condition. We agree with Ispat that the STB should not involve itself in a contractual dispute that is not relevant to the issues presented by this consolidation. Contract law and the terms of the

⁵/ Id. at 8, note 7 and at 10, note 8.

⁶/ This would enable Ispat to turn to BNSF for service.

Ispat/WC agreement should determine the existence of any breach and, if so, appropriate remedies. However, these do not include a condition imposed in this proceeding.

It is, however, entirely appropriate for the Board to enforce the conditions it imposes on any railroad consolidation, including the CN/WC proceeding.⁷ The remedy for any shipper who believes that CN or WC has violated a condition or failed to live up to representations made on the record in the prior proceeding is to take their case to the Board under the auspices of that proceeding.⁸ It is also possible that Ispat comes within the terms of a settlement agreement in that proceeding between CN and the National Industrial Transportation League (“NITL”). Id. at 12.⁹

The prospect of such proceedings in another docket, without more, does not amount to grounds either to deny or condition the instant application. We also note that CN has made commitments and representations in this proceeding, and some may concern services to rail shippers. *See* ISP-2 at 13. DOT has long supported the Board’s policy of holding rail merger applicants to their commitments and formal representations, and we do so again here. Any such condition would also provide some protection to shippers.

⁷/ In the CN/WC case, the STB required CN and WC to adhere to representations they made, including those concerning rail services. CN/WC Decision at 8, 21, 28 (ordering paragraphs 5 and 6).

⁸/ The issue in that circumstance would not be whether contractual terms have been breached, but whether STB-imposed conditions have been satisfied. The Board could also determine whether Ispat is entitled to the protections of the CN/NITL settlement agreement, and, if so, Ispat could pursue the remedies afforded it thereunder. *See* note 9, *infra*.

⁹/ This agreement, *inter alia*, addressed service levels and provided for arbitration of disputes. Although the STB did not adopt this agreement as a condition of approval, it did hold CN and WC to their representations “about the meaning and reach” of the agreement, including its extension to shippers “whose facilities are not physically located on CN’s or WC’s lines, but whose movements originate or terminate on WC.” Id. at 12.

Conclusion

This minor transaction poses only isolated competitive losses, but in the absence of information about the settlement between CN and Cleveland-Cliffs, the Board must carefully review that agreement and impose whatever conditions are necessary to satisfy the statutory mandate that competition not be substantially lessened by the proposed merger. No conditions in this proceeding are necessary to address Ispat's concerns, although the Board should continue its policy of holding rail merger applicants to their commitments and representations made on the record, and enforce those conditions when necessary.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Jeffrey A. Rosen", is written over the printed name.

JEFFREY A. ROSEN
General Counsel

February 24, 2004

CERTIFICATE OF SERVICE

I hereby certify that on this date I have caused a copy of the Reply Comments of the United States Department of Transportation ("DOT-3") in STB Finance Docket No. 34424 to be served by first class mail, postage prepaid, upon all Parties of Record in this proceeding.

A handwritten signature in cursive script, reading "Paul Samuel Smith".

Paul Samuel Smith

February 24, 2004