

BEFORE THE  
SURFACE TRANSPORTATION BOARD

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FINANCE DOCKET NO 35081

CANADIAN PACIFIC RAILWAY COMPANY, ET AL.  
- CONTROL -  
DAKOTA, MINNESOTA & EASTERN RAILROAD CORP., ET AL.

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**BRIEF OF ARKANSAS ELECTRIC COOPERATIVE CORPORATION**

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**If the Board grants this Application as submitted and allows Canadian Pacific to acquire control of the Dakota, Minnesota & Eastern, it will sound the death knell for DME's plans to introduce a new rail carrier into the Powder River Basin coal fields. Worse, it will create an impediment to other railroads seeking to enter that market.**

**These adverse consequences for the public interest can be avoided if approval of the Application is made subject to the reasonable conditions proposed by Arkansas Electric Cooperative Corporation. These conditions would not interfere with the public benefits claimed by Applicants and would eliminate the threats to the public interest presented by this Application.**

**I. Introduction And Summary**

Arkansas Electric Cooperative Corporation (AECC) 1/ submits this Brief in support of its request for conditions to be imposed on the proposed control by Canadian Pacific Railway

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1/ AECC is a membership-based generation and transmission cooperative, whose members serve approximately 460,000 customers throughout the State of Arkansas. Further information about AECC and its interest in this proceeding is provided in Opposition Evidence And Argument And Request For Conditions Of Arkansas Electric Cooperative Corporation (AECC-3, dated March 4, 2008) ("AECC's Opposition"), at pages 1-2.

Company, et al. (CP) of the Dakota, Minnesota & Eastern Railroad Corporation, et al. (DME) (jointly, Applicants).

If the Application were approved by the Board as submitted, it would severely injure the public interest, because it not only would effectively prevent construction of DME's proposed extension (the Project) into the Powder River Basin (PRB), but also would artificially impede other future efforts to create a new rail access to the PRB. This Brief shows:

- Construction of the PRB Project would benefit the public interest, as the Board determined when it approved the Project.
- The CP/DME Agreement and Plan of Merger would prevent construction of the Project by imposing on CP contingent payments of at least \$350 million, and up to more than \$1 billion, if CP constructed the Project.
- CP would not build the Project because doing so would threaten CP's existing and planned future cooperative relationships with UP and BNSF.
- CP has shown that it has no sincere interest in building the Project.
- If CP acquires control of DME and does not build the Project, its ownership of real estate acquired by DME for the Project would interfere with the ability of any other railroad to build a new line into the PRB.
- The conditions proposed by AECC would mitigate the adverse effects of the proposed transaction on the public interest.

## **II. CP Control Of DME Would Doom DME's Powder River Basin Project**

### **A. Building The DME Powder River Basin Project Would Serve The Public Interest.**

Ten years ago, the Board issued its decision on the transportation issues raised by DME's proposal to build a new rail line into the PRB. The Board found that construction of the proposed line would serve the public interest:

It is . . . clear that the current record provides evidence that the public interest would be well served by this construction. DM&E has documented various anticipated public benefits. Western coal shippers that would be able to receive DM&E service directly by joint line rail service or by joint DM&E and barge service should receive direct benefits from DM&E's proposed

service. An additional competitor in this marketplace would respond to the growing demands for the service in question. DM&E should bring a lower cost structure (including shorter mileage), faster and more reliable service, and additional capacity.

Dakota, Minnesota & Eastern RR Construction into the Powder River Basin, 3 S.T.B. 847, 893-94 (1998). Among the reasons cited by the Board for these conclusions were that the project was supported by coal customers that “collectively purchase and transport by rail well over 100 million tons of coal annually, most of which is from PRB mines, as well as almost all current shippers”, that establishing another PRB transportation competitor “should have a positive impact on rates and service for the increasing volumes of PRB coal”, and that the new DME service “should generate efficiencies and provide important benefits to PRB coal shippers.” Id. 2/

AECC has long been a supporter of DME’s PRB project. In 1998, AECC wrote to the Board, at DME’s request, urging Board approval because the Project would serve the public interest

AECC supports Dakota, Minnesota & Eastern (DM&E) Railroad’s application for approval of construction of a new rail line to the PRB. We believe there is a clear need for the additional capacity out of the PRB and that the increased competition will improve both the reliability and the economics of moving coal by rail.

The mines in the PRB are currently served by one railroad or at most two railroads. Additional competition would help maintain market pressure on rail transportation. Keeping coal transportation costs down will help keep the cost of electricity reasonable for our customers in Arkansas.

Letter dated Sept. 21, 1998, from Steve Sharp, P.E., Principal Engineer, Fuels & Civil, Arkansas Electric Cooperative Corporation, to Linda Morgan, Chairperson, Surface Transportation Board

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2/ After completion of its environmental review and further proceedings in accordance with the 8th Circuit’s remand, the Board reiterated that “the public interest would be well served by the construction project” Dakota, Minnesota & Eastern RR Construction into the Powder River Basin, STB Fin Dkt 33407, served Feb 15, 2006, at 17, 2006 WL 383507 (S T B ), \*13

AECC reiterated and expanded on these points in a letter dated Jan. 2, 2001, from Mr Sharp to the Board, Attn : Victoria Rutson, Environmental Project Manager Copies of these letters are attached to this Brief See Attachments 1 and 2

AECC was therefore disappointed to find that CP, in proposing to acquire control over DME, refused to commit to construct the approved line into the PRB 3/ Disappointment turned to dismay when analysis of the details of CP's proposed acquisition of DME revealed that approval of this acquisition would destroy all hope that the Project would ever be built.

The two principal reasons that CP's acquisition of DME would have this effect are (1) that the Agreement and Plan of Merger includes huge "milestone payments" that would act as a "poison pill" to prevent CP from building the PRB line; and (2) that CP's existing and prospective business relationships with the other PRB carriers, UP and BNSF, create powerful incentives for CP not to spend billions of dollars to enter into the PRB market in competition with UP and BNSF These issues are discussed in the next two sections.

**B. The Contingent Payments Under The Agreement And Plan Of Merger Would Act As A "Poison Pill" To Prevent CP From Building The Project**

CP's acquisition of DME would practically ensure that the PRB Project will not be built, because the Agreement and Plan of Merger would require CP to pay "milestone payments" that could exceed \$1 billion if it builds a line into the PRB; DME as an independent railroad today has the right to build the Project without paying ransom to anyone

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3/ CP "has not committed to constructing the line." Decision No. 4 in this docket, at p 3 See Application, (CPR-2, DME-2, filed Oct 5, 2007), Vol II, Verified Statement of Fred Green, at pp 5-6

When AECC raised this concern in its Opposition, 4/ Applicants tried to dismiss it with the cavalier assertion that the milestone payments “are not triggered until various economically valuable benchmarks are met,” 5/ but this is false. As the Board observed in its Decision No. 4, at page 3, the first (and largest) contingent payment -- \$350 million -- would be triggered simply by CP starting to build the Project. See Agreement and Plan of Merger, Section 3.05 (b), Exh. 2 to the Application, Vol. I.

Payments ranging from \$350 million to over \$1 billion are huge in the context of a Project with capital costs of approximately \$3 billion (see V.S. Nelson (Public), at page 4). For the Project to be viable, CP would have to be confident that it would earn enough from the PRB business to amortize the construction cost plus an amount between \$350 million and \$1.057 billion (plus escalation).

The effects of these additional costs on Project finances can be seen in an illustration provided by AECC’s expert witness Michael A. Nelson:

Using the Board’s most recent finding of a rail industry cost of capital of 9.94%, a \$3 billion project with a risk profile and capital structure comparable to the industry average would prospectively have to yield sufficient contribution (above and beyond variable costs) to provide \$298.2 million per year of debt service and return on equity. If the Project were able to achieve an annual volume of 125 million tons, this equates to a required yield of approximately \$2.39 for each ton moved. Including the contingency payments, the required contribution would be \$403.3 million per year. This means if the Project were viable at the 125 million ton/\$2.39 yield per ton level, it would nevertheless have to achieve a yield of over \$3.22/ton (at the

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4/ Arkansas Electric Cooperative Corporation Opposition Evidence And Argument And Request For Conditions (AECC-3, filed Mar. 4, 2008) (“AECC Opposition”) (Public), at pages 6-7, and Verified Statement of Michael A. Nelson (“V.S. Nelson”) (Public), at pages 9-10

5/ Applicants’ Response To Comments And Requests For Conditions And Rebuttal In Support Of Application (CPR-14, DME-14, filed Apr. 18, 2008) (“Applicants’ Response”) (Public), at 41

125 million ton level) or a volume of over 168 million tons (at the \$2.39 yield level) to be viable in the presence of the contingency payments 6/

The problem is even worse if we assume that the Project does only enough business to require the minimum milestone payment of \$350 million, which applies to any volume up to 41 million tons. If the Project were able to achieve an annual volume of 37 million tons, 7/ only the initial \$350 million payment would be required, but this would mean that to pay the milestone payment, debt service, and return on equity, the Project would have to yield approximately \$333 million annually, or about \$9.00 per ton. By way of comparison, the rates used by the Board in its decision approving the DME Project implied a yield of \$0.28 per ton on competitive movements. R.V.S. Nelson, at pages 3-5. Obviously, there is no possibility that CP could achieve a level of profitability from the DME Project that would justify paying a \$350 million entry fee into the PRB.

The conclusion is inescapable that the milestone payments will prevent the construction of the Project if this Application is approved. We do not know what the parties' intention was for including the milestone payment provisions in the Agreement and Plan of Merger, but their effect is clear. They are a "poison pill" that would prevent CP from exercising the right, conferred by this Board on DME, to construct a line into the PRB.

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6/ Rebuttal Verified Statement of Michael A. Nelson ("R. V. S. Nelson") (Public), at pages 2-3, in Rebuttal In Support Of Request For Conditions By Arkansas Electric Cooperative Corporation (AECC-5, filed May. 19, 2008) ("AECC Rebuttal")

7/ Thirty-seven million tons represents a 38% share of the relevant market for Wyoming coal and reflects the impact of direct competition from UP and BNSF and the mileage advantage the Project line would enjoy over the incumbents for some of that traffic. See V. S. Nelson at 5-8.

**C. CP's Interdependence With UP And BNSF Makes CP Less Likely To Build The Project.**

If I was in a position to get to the Powder River Basin, I would not be thrilled about driving into town after making a huge investment and meeting up with UP or BN in the alley. 8/

Ironically, in proposing to enter the PRB market, DME had less need to worry about meeting UP and BNSF in the alley than does the much larger CP. In the highly concentrated environment of the Class I rail industry, each large railroad knows that it needs cooperation from the other large railroads to survive and prosper. Each large railroad must weigh the benefits of undertaking an initiative that upsets existing competitive relationships against the risks of upsetting existing cooperative relationships. For a regional carrier like DME, however, the risk-benefit analysis was easy: If DME could attract the volume of PRB coal traffic it projected, that business would dwarf its entire existing traffic base; no possible loss of existing interchange traffic with UP or BNSF could offset the benefits of the Project to DME.

For CP, the exposure to loss of cooperation on traffic other than PRB coal is comparatively much more significant. Virtually any traffic handled by CP between points in the western U.S. and any competitively-served point would be subject to diversion away from CP if CP were to undertake the Project. 9/ In deciding whether to build the PRB Project, CP would have to take into account not only the new revenues it would hope to obtain from PRB coal traffic, but also the loss of contribution from traffic interlined with UP and BNSF.

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8/ Canadian National CEO E. Hunter Harrison, May 2007, quoted in National Bank Financial advisory on Canadian Pacific Railway (November 6, 2007) at page 31, copy attached to V.S. Nelson

9/ CP's interline business with UP and BNSF was discussed by CP's Vice President-Marketing & Sales (Merchandise), Ray Foot, in his deposition. See Deposition of Ray Foot, Feb. 28, 2008, at 112-13, see also id., at 21, 24-27, 35-37. Although Mr. Foot was presented by CP as its marketing witness in support of the Application, he was unable to say how much traffic CP interchanges with UP or BNSF.

The existing cooperative relationships between CP and UP are described in the Reply Verified Statement of CP witness Bob Milloy ("R.V.S. Milloy") in Applicants' Response (Public). CP and UP have established cooperation via three so-called "Can-Am" routes. The "Pacific Can-Am Service" involved upgrading interchange and cooperation between UP and CP for movements via Kingsgate, BC. According to information supplied by Applicants, this interchange is used by approximately 95 percent of the corn originated in the U.S. by CP (which moves to export markets via port facilities in the Pacific Northwest), 10/ as well as significant volumes of other products moving between western Canada and North Dakota on the one hand and the Pacific Northwest, California, the U.S. southwest, and Mexico on the other hand. 11/ The "Midwest Can-Am Service" (via St. Paul, MN) carries industrial/chemical products, grain products and forest products moving between western Canada on the one hand and the central/south-central U.S. and Mexico on the other hand. CP describes the past growth in traffic moved over this route as "very strong" 12/ The "Eastern Can-Am Service" (via Chicago) carries automotive, industrial products, forest products, and intermodal traffic moving between eastern Canada and the northeastern U.S. on the one hand and the U.S. west, south, and Mexico on the other hand. 13/ In addition, CP moves traffic in joint-line service via BNSF involving various points. 14/

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10/ Applicants' Response (Public), Volume 1, Reply Verified Statement of Don Smith (R.V.S. Smith), at page 3

11/ Applicants' Response (Public), Volume 2, Appendix C at page C-2. See also Applicants' Response (Highly Confidential), Volume 2, Appendix B at page B-12. For convenience and where relevant, we provide references in this Brief to materials that the Applicants have designated Highly Confidential or Confidential. However, this Brief does not disclose any information so designated.

12/ Applicants' Response (Public), Volume 2, Appendix C at page C-2

13/ Applicants' Response (Public), Volume 2, Appendix C at page C-2

14/ See CPR-DME-HC001565 for details.

CP has more at stake in its interline relationships with UP and BNSF than does DME, and UP and BNSF likely would not hesitate to withdraw their cooperation with CP if CP were to undertake the Project. CP's own data and evidence confirm that this is so. CP's density chart shows that as of 2005, its line to the Kingsgate interchange with UP handled in the range of 15-30 million gross tons (MGT) annually. <sup>15/</sup> On an order of magnitude basis, this is comparable to the entire traffic base of DME. <sup>16/</sup> Adding in the CP volumes moving over the other Can-Am routes and via BNSF, future expected growth in CP interline volumes, <sup>17/</sup> the fact that CP has made significant infrastructure investments to increase capacity and service, and DME's limited interchange with the western railroads, there can be no doubt that CP's exposure to loss of cooperation from the western railroads is much greater than that faced by DME.

AECC showed in its Rebuttal that CP's management is keenly aware that pursuit of the Project would put at risk CP's substantial cooperative relationships with the western railroads, as disclosed in several highly confidential documents produced by CP. <sup>18/</sup> CP would not build the Project unless it could confidently expect profits from the Project that not only justified the required capital investment, but also compensated for the inevitable losses of contribution on its interline

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<sup>15/</sup> See [www.cpr.ca/cms/NR/rdonlyres/epcwub5tmdw5ishzrtlbevutabzchn3uhhmsg3pecx63gh2t4atp5b4cdlzbobvubvvr6pbcbobvgqveg7gkn5ssk4xa/Assets.pdf](http://www.cpr.ca/cms/NR/rdonlyres/epcwub5tmdw5ishzrtlbevutabzchn3uhhmsg3pecx63gh2t4atp5b4cdlzbobvubvvr6pbcbobvgqveg7gkn5ssk4xa/Assets.pdf). See also, Applicants' Response (Highly Confidential), Volume 2, Appendix O at pages O-18-19

<sup>16/</sup> See CPR-DME-HC001532 for details

<sup>17/</sup> See Applicants' Response (Highly Confidential), Volume 2, Appendix O at pages O-15-16 for details.

<sup>18/</sup> See Rebuttal In Support Of Request For Conditions By Arkansas Electric Cooperative Corporation (AECC-4, filed May 19, 2008) ("AECC Rebuttal"), at pages 11-15, discussing Applicants' Response (Highly Confidential), Volume 2, Appendix Q at page Q-21 (transcript page 96), Applicants' Response (Highly Confidential), Volume 2, Appendix I at page I-16; and Applicants' Response (Highly Confidential), Volume 2, Appendix I at page I-9

business with UP and BNSF. As discussed in Part II.B, above, such profits are not attainable from the Project.

**D CP Has Virtually Conceded That It Has No Interest In Constructing The PRB Project.**

The obvious conclusion from the foregoing facts is that CP has no serious interest in building the PRB Project, and it agreed to the “poison pill” provision because it is not planning to take any action that would trigger it. Applicants have offered no evidence that CP has made any commitment to undertake the PRB Project.

Applicants argue that the Board should not be concerned, because DME has spent a decade trying to develop commitments from shippers, financiers, and strategic partners, without success, implying that the Project is not viable. Applicants’ Response (Public), Volume 1, at page 41. But this is not an appropriate proceeding to revisit the viability of the PRB Project, which has been approved by the Board. As long as DME holds authority from this Board to construct the Project, the parties must take it as a given that the Project is in the public interest, and that destroying the possibility of building the Project would be contrary to the public interest.

Although the Applicants have presented no evidence to refute the evidence cited by AECC on the “poison pill” or interdependency issues, they assert that CP’s acquisition of DME would “enhance – not detract from – DME’s ongoing efforts to bring the PRB Project to fruition”, because of CP’s “greater financial capability, its demonstrated expertise in designing and constructing new rail lines, and its extensive coal hauling experience” Applicants’ Response (Public), Volume 1, at page 41. Yet even a cursory scrutiny of CP’s claims reveals that there is no possibility that CP’s “enhancements” could even begin to mitigate the substantial detrimental impacts on the PRB Project identified by AECC.

CP’s “financial capability” is unlikely to be of great use in undertaking the Project in light of the fact that the financial community has threatened CP’s credit with a downgrade to “junk

bond” status if it undertakes the Project. 19/ As for coal-hauling experience, DME has at least as much relevant experience as CP does. DME/ICE already handles volume movements of PRB coal (to plants served by ICE), and through such operations and Project planning is thoroughly versed in the infrastructure and operating issues associated with PRB coal movements. In contrast, CP has divested its ability to originate U S coal, 20/ and there is no reason to believe that its other coal-moving experiences will provide guidance more useful than that DME has already obtained.

CP’s most recent significant experience in “building new rail lines” apparently occurred in the 1980’s 21/ In contrast, DME has spent over 10 years on the planning and development of the Project. 22/ Certainly CP’s involvement would not enhance the economic viability of the Project. In the primary DME service area there is only one (1) PRB coal-burning

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19/ A representative of Moody’s Investment Services has indicated that the acquisition of DME will place downward pressure on CP’s credit ratings, but that CP will remain investment grade as long as the PRB expansion project is not undertaken. This is echoed by a representative of UBS Investment Research, who has highlighted the remote probability that the economics of the expansion project would be favorable. Originally reported at [www.canadaeast.com/rss/article/66461](http://www.canadaeast.com/rss/article/66461), now archived at [www.dmetraintruth.com/pdf/headache\\_95.pdf](http://www.dmetraintruth.com/pdf/headache_95.pdf).

20/ Indiana Railroad Company – Acquisition -- Soo Line Railroad Company, Fin Dkt. No. 34783, served April 11, 2006, authorized CP’s divestiture to Indiana Railroad (INRD) of the entirety of its line between Chicago and Louisville, KY, which formerly enabled CP to originate coal from mines in western Indiana.

21/ See CP’s Corporate Profile and Fact Book (2006) available from CP’s website at [www.cpr.ca/cms/NR/rdonlyres/epcwub5tmdw5ishzrlbevutabzchn3uhhmsq3pecx63gh2t4atp5b4cdlzbvubvv6pbcobvggveq7gkn5ssk4xa/Assets.pdf](http://www.cpr.ca/cms/NR/rdonlyres/epcwub5tmdw5ishzrlbevutabzchn3uhhmsq3pecx63gh2t4atp5b4cdlzbvubvv6pbcobvggveq7gkn5ssk4xa/Assets.pdf). The only other significant rail capacity investment cited in this source is \$160 million spent to increase achievable throughput (by 4 trains per day) within CP’s established western corridor route. This investment is not known to have involved construction of any “new rail lines”. But see CPR-14 DME-14 (Highly Confidential), Volume 2, Appendix Q at page O-3, and Section II C, below.

22/ Even if current CP management did have expertise that might help the Project, the structure of the proposed transaction undermines the ability of the Project to benefit from such expertise. For example, if CP used its expertise to develop a new and better alignment for the route into the PRB and obtained from the Board new authority to build the improved alignment, building such a newly-designed line would trigger the prohibitive “poison pill” payments, because the Agreement and Plan of Merger provides that “New Construction” includes any “modified” line extension. Agreement And Plan Of Merger (Exh 2, CPR-2 DME-2), at page 9.

powerplant that is exclusively-served by CP (i.e , for which CP could effectively ensure movement from the PRB via the Project).

Even if CP participation would materially improve the financing, operation, and/or management of the Project – which it would not – the incentives for CP not to build the Project – the “poison pill” and the potential alley fight with UP and BNSF – would still be overwhelming

Thus, Applicants are forced to fall back on the argument that if the PRB Project is never built, that should be of no concern to the Board, because it “would not lead to a reduction in competition – rather it would maintain the competitive status quo in the PRB.” Applicants’ Response at page 41. This is a specious argument. The Board frequently considers the effect of proposed transactions on potential competition as well as actual current competition.

For example, in the UP/SP merger proceeding, the operators of the White Bluff Steam Electric Station near Redfield, AR, argued that the merger would eliminate potential competition, even though the plant at the time was served only by UP: The merger as proposed would eliminate the possibility of “a build-out to a nearby SP line, located about 21 miles away at Pine Bluff, [which] would enable White Bluff to enjoy a BNSF-SP routing . . . .” The Board did not rule, as Applicants here apparently think it should have, that this loss of potential competition was of no concern because it would “maintain the competitive status quo”. On the contrary, the Board granted the build-out relief requested. See Union Pacific Corp , et al. – Control and Merger – Southern Pacific Rail Corp , et al. , 1 S.T.B. 233, 303 (1996), aff’d sub nom. Western Coal Traffic League v. STB, 169 F. 3d 775 (D.C. Cir. 1999) (“UP/SP Merger”).

Union Carbide Corporation made a similar argument in the same case with respect to potential competition at its Seadrift, TX plant, which was solely served by UP, but where the potential for a build-out to SP acted as a constraint on UP’s exercise of market power. The Board

did not respond that there was no cause for concern because the merger would “maintain the competitive status quo” Rather, the Board conditioned the UP/SP merger on trackage rights to BNSF to preserve the potential for competition even though no actual competition then existed. UP/SP Merger, at 475. See also, Burlington Northern & Santa Fe Rwy – Construction and Operation Exemption – Seadrift and Kamey, TX, STB Fin. Dkt 34003, served June 19, 2001, at 1-2, 2001 WL 684312 (S.T.B.), \*1. In San Jacinto Rail Limited Construction Exemption, et al – Build-Out To the Bayport Loop, STB Fin. Dkt 34079, served July 9, 2003, at 3-4, 2003 WL 21542058 (S.T.B.), \*2, the Board approved another build-out to fulfill a condition imposed in the UP/SP merger to “preserve[ ] the potential for the creation of competitive rail service . ” 23/

Improving the status quo is one of the core features and benefits of a competitive marketplace. Therefore, Applicants are plainly wrong in arguing that the Board should ignore the adverse effect that this transaction would have on potential competition in the PRB.

### **III. CP Control Of DME Would Interfere With Other Initiatives To Obtain Access To The Powder River Basin**

The adverse effect of the proposed transaction on potential rail competition for PRB coal extends beyond the DME Project Not only would the transaction prevent the construction of

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23/ In evaluating the competitive effects of mergers and other transactions, the Board frequently considers potential competition as well as actual current competition See, e.g., Review of Rail Access and Competition Issues – Renewed Petition of Western Coal Traffic League, STB Ex Parte 575, served Oct 30, 2007, at 9-10, 2007 WL 3170981 (S T B ), \*6 (potential for short lines to expand into other markets and add to competition), Norfolk Southern Corp et al – Control and Consolidation Exemption – Algiers, Winslow & Western Rwy, STB Fin Dkt 34839, served Feb 15, 2007, at 11-12, Fed Carr. Cas P 37229, 2007 WL 482682 (S T B ) \*8 (trucks and barges as competitive alternatives to rail service); Canadian Pacific Rwy. et al – Control – Duluth, Missabe & Iron Range Rwy. et al, STB Fin Dkt 34424, served April 9, 2004, at 17-18, Fed Carr Cas P 37139, 2004 WL 761305 (S T B ) \*13 (describing build-in/build-out options and transload options as “potential competitive options”)

the DME Project, it would also substantially interfere with other prospective efforts to create a rail outlet for coal from the PRB

DME has been busily engaged in assembling land rights for the Project. If CP acquires control of DME it will thereby acquire this real estate, although, for the reasons described in Section II (above), CP will conclude, if it has not already done so, that it should not proceed with the Project

However, it will still be in the public interest for a third rail carrier to serve the PRB, for the reasons given by the Board in its decision approving the DME Project Michael Nelson describes one potential new route for coal from the PRB, running southeast from the PRB towards Kansas City and St. Louis. Mr. Nelson shows that such a route would serve the high-volume core of the PRB market, and could be constructed with a profile that produces significant efficiency improvements in comparison with the operations of UP and BNSF. Such a route would be of great benefit to coal users in the lower Mississippi valley, the southeast, and the entire south-central region of the U.S. V.S. Nelson, at pages 13-18 Obviously, other routes are also possible, but the important point is that any rail route from the PRB to coal users located east or southeast of the PRB would necessarily overlap and cross portions of the land being acquired by DME in Wyoming, particularly those portions associated with establishing access to the mines from the east

This means that CP would sit in the way of basically any new PRB route that seeks to serve the high-volume core of the PRB market. Although a railroad seeking to build such a route could use the power of eminent domain to acquire needed real estate interests from non-railroad landowners (as DME has been doing), the Board's recent decision in HolRail LLC – Construction and Operation Exemption – In Orangeburg & Dorchester Counties, S.C., STB Fin Dkt 34421, served Feb 12, 2007, raises substantial doubt that it would be able to do so with respect to right of

way owned – but not used – by CP for the DME Project Notwithstanding 49 U.S.C § 10901 (d), which prohibits an incumbent carrier from blocking the construction of a Board-authorized line by refusing to permit the constructing carrier to cross its property (absent interference with the operation of the crossed line, and provided fair compensation is paid), in HolRail the Board held that the incumbent could block access to its right of way where the applicant sought to use it to construct a significant portion of its proposed line. This could well be the problem faced by any railroad seeking to build a new route into the PRB, if the CP/DME merger is approved

AECC is not suggesting that DME's current land acquisition program is intended to block access to the PRB by a new route. However, just as CP's interdependency with UP and BNSF would cause it not to construct the DME line-extension into the PRB, the same interdependency considerations would encourage CP not to cooperate with alternative new lines, which, if built, would compete with UP and BNSF for PRB traffic. Nothing would compel CP to divest the right-of-way, and nothing would stop CP from pursuing non-rail uses of the land that would increase costs and otherwise impede prospective future rail use

If CP/DME determines that it does not have the ability – or even the intention -- to construct the Project, it would be contrary to the public interest for CP/DME to make non-rail use of the corridors assembled pursuant to rail construction authority, or to use possession of those corridors to obstruct development of a viable new line.

#### **IV. The Conditions Proposed By AECC Are Reasonable And In The Public Interest**

The conditions proposed by AECC are narrowly tailored to address the problems that CP's acquisition of DME would cause with respect to new entry into the PRB

First, we propose a condition that would eliminate the “poison pill” milestone payments that virtually guarantee CP will not undertake the Project Second, we propose a series of

conditions that would come into play only if/when CP decides not to build the Project. (Even with the elimination of the “poison pill”, other impediments to the Project, including CP’s relations with UP and BNSF, are likely to prevent CP from proceeding with the Project.) These conditions would prevent CP from using land holdings acquired for the abandoned PRB project to block another entrant into the PRB.

**A     The Board Can And Should Condition Its Approval On The Elimination Of The “Poison Pill”.**

AECC proposes that the Board condition any approval of CP’s acquisition of control over DME on the elimination of the “poison pill” provision of the Agreement and Plan of Merger.

Applicants claim that this condition would violate an alleged “well-established principle that the Board will not, in considering a proposed transaction, rewrite the underlying transaction documents.” Applicants’ Response at page 43. For this supposedly “well-established” rule, Applicants cite only a single case, St. Louis Southwestern Rwy – Purchase (Portion) – Gibbons, Trustee, 363 I.C.C. 323 (1980), 1980 WL 14102 (I.C.C.) (“Tucumcari”), which does not even come close to supporting Applicants’ argument.

Tucumcari involved, among other transactions, the proposed assignment to the St Louis Southwestern Railway of a portion of the Chicago, Rock Island & Pacific Railroad’s operating rights under an 1887 trackage rights agreement with UP. UP objected to this assignment on the ground that the rights were not assignable, but the ICC rejected that argument. In the alternative, UP argued that, if the agreement were assigned, it should be substantially reformed. The ICC rejected that argument, too. The ICC observed that it had statutory authority to fix the terms and conditions of trackage rights agreements approved under former section 5(2)(a)(ii) of the Interstate Commerce Act, which was enacted in 1940, but this trackage rights agreement long predated that statute, so “we do not have jurisdiction to reform the terms of that agreement for the parties.” Id. at 367. Further,

even if the ICC had jurisdiction to reform the agreement, “such reformation would not be warranted here” Id

Thus, Tucumcari has nothing to do with the issue in this case. AECC is not asking the Board to “reform” an agreement, as UP asked in Tucumcari. AECC is asking the Board to conclude that a particular provision of the Agreement and Plan of Merger – this “poison pill” provision – would have unacceptable anticompetitive effects, and to condition its approval of the transaction (if the Board finds it otherwise approvable) on the parties eliminating that provision. Of course the Board has the authority under 49 U.S.C § 11324(c) to condition the transaction in this manner if the Board determines, as it should, that the public interest so demands.

The Applicants do not even claim, much less prove, that they would be unable to amend their Agreement to meet the proposed condition. After all, under the current Agreement the milestone payments would never be paid anyway, because they are payable only if the Project is built, and the milestone payments themselves assure that the Project will not be built, as discussed in Part II B. The Applicants have shown no legitimate objection to the proposed condition.

**B     If CP Is Allowed To Acquire Control Of DME And Does Not Build The PRB Project, The Board Can And Should Condition Its Approval To Prevent CP From Using Land Acquired For The Project To Block Another Company From Building A Line Into The PRB.**

AECC also proposes that approval of CP’s control of DME be conditioned to prevent CP from using the land acquired by DME and CP for the PRB Project to block another railroad from building a line into the PRB if CP does not build the Project. These conditions are even more important than the elimination of the “poison pill”, because even without the “poison pill” it still remains very unlikely that CP would build the Project.

Applicants argue that these conditions would constitute “an impermissible ancillary attack” on the Board’s prior approval of the PRB Project. Applicants’ Response at pages 43-44

This contention is wrong because these conditions would only come into play if CP elects not to proceed with the Project, as CP itself concedes appears likely. See Applicants' Response (Public), Volume 1, at page 41. At that point, the Board's "approval" of the Project would become moot, and the question remaining would be what to do in the aftermath. If the land that DME (and possibly CP) acquired for the purposes of the Project were used to block another party from building a third access into the PRB, that clearly would be contrary to the public interest, which would benefit from additional rail capacity and competition for PRB coal transportation.

Applicants argue that this Board lacks authority to address this problem, because DME has acquired this real estate under state laws. Applicants' Response at pages 43-44. This argument has it all backwards. DME was able to use state condemnation laws (or negotiations under the threat of such laws) to acquire the land because the Board had granted DME authority to build the Project. If Applicants now decide not to build the Project, it would be a complete perversion of the public interest for them to use that land to block access by another party that wants to build a line into the PRB. Applicants would have no basis for complaint if they are required to sell that land for fair market value to another party that wants to build a rail line into the PRB, in light of the fact that DME was able to force the prior owners of the land to sell it to DME because of DME's plan to build a rail line into the PRB.

Applicants also argue that requiring CP to report to the Board by a date certain whether or not it will proceed with the Project is an "impermissible collateral attack" on the Board's prior approval. Applicants' Response at page 43. This is not correct. At the time CP announced its purchase of DME, CP's Fred Green told the press that it would probably take less than 36 months

for CP to decide whether or not to proceed with the PRB Project 24/ The Board plainly has the authority under 49 U S C § 11324 to hold the merging carriers to their representations, and routinely does so when necessary to protect the public interest. Applicants do not claim that CP will be unable to reach a decision by September 2009. If CP finds that it needs more time, and the Board agrees that this is reasonable, it can grant an extension of time under 49 U S C. § 722(c).

Therefore, if the Board approves this merger, it should condition that approval as proposed by AECC

## **V. Conclusion**

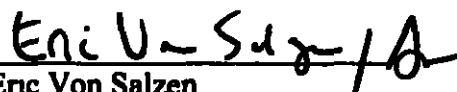
Acquisition of DME by CP as proposed by the Applicants would be contrary to the public interest because the Agreement as it now stands would prevent CP from constructing a new rail line into the PRB. Furthermore, the transaction would interfere with other railroad initiatives to build a new line into the PRB. If the Board finds that the proposed transaction is otherwise satisfactory and should be approved, the Board should condition that approval so as to reduce the adverse effects of the merger on PRB rail competition. The conditions proposed by AECC would do that. Therefore, if the CP/DME merger is approved, it should be conditioned as proposed by AECC

Respectfully submitted,

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Transportation Consultant

Dated July 2, 2008

  
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Counsel for Arkansas Electric Cooperative Corporation

24/ See [www.winonadailynews.com/articles/2007/09/06/news/00lead.txt](http://www.winonadailynews.com/articles/2007/09/06/news/00lead.txt)

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## **ATTACHMENT 1**



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**Arkansas Electric  
Cooperative Corporation**

P. O. Box 194208  
Little Rock, Arkansas 72219-4208  
(501) 570-2200

September 21, 1998

Ms. Linda Morgan, Chairperson  
Surface Transportation Board  
1925 K. Street, N.W.  
Washington, D.C. 20423-0001

Re. Support for STB Approval of the DM&E Construction Application

Dear Ms. Morgan

Arkansas Electric Cooperative Corporation(AECC) is a generation and transmission cooperative that is the power supplier for 16 of Arkansas' electric cooperatives. With 1,940 megawatts of generation resources, those 16 electric distribution cooperatives serve more than 360,000 homes, farms, businesses and industries in Arkansas. Out of our total generation resources, 1,432 megawatts come from coal-fired plants that burn low-sulfur coal from the Powder River Basin(PRB) in Wyoming. The transportation of this coal by railroad is a major portion of the cost of the delivered fuel. Providing a reliable and economical fuel supply for our powerplants is my primary responsibility at AECC.

AECC supports the Dakota, Minnesota & Eastern(DM&E) Railroad's application for approval of construction of a new rail line to the PRB. We believe that there is a clear need for the additional capacity out of the PRB and that the increased competition will improve both the reliability and the economics of moving coal by rail.

The mines in the PRB are currently served by one railroad or at most two railroads. Additional competition would help maintain market pressure on rail transportation. Keeping coal transportation costs down will help keep the cost of electricity reasonable for our customers in Arkansas.

During the past several years, the demand for coal from the PRB has exceeded the existing railroads' capacity. While trying to meet this increased demand, the existing railroads have not met the service expectations of their existing coal transportation customers. We believe the project proposed by DM&E would increase rail capacity for PRB coal, a very important national resource, and would result in better and more reliable service on the rail transportation system in general.

Every forecast indicates that more and more coal will be needed from the PRB for electric generation. With the existing railroads struggling to deliver the amount of coal presently needed, we believe they will be unable to handle the large increases that are forecast. We believe it is in the public interest that the reliability of rail transportation for coal not deteriorate and that the consumer not be asked to pay higher rates for electricity. Even with construction of the DM&E project it appears that there will be enough demand for rail transportation that the existing railroads will need to increase their capacity significantly to keep up with the demand.

AECC supports DM&E's application for approval of construction of a new rail line from the Powder River Basin.

Sincerely,

A handwritten signature in black ink, appearing to read 'Steve Sharp', with a stylized flourish at the end.

Steve Sharp, P.E.  
Principal Engineer-Fuels and Civil

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**ATTACHMENT 2**



## **Arkansas Electric Cooperative Corporation**

A Touchstone Energy® Partner 

8000 Scott Hamilton Drive  
PO Box 194208  
Little Rock, Arkansas 72219-4208  
(501) 570-2200

January 2, 2001

Office of the Secretary  
Case Control Unit  
STB Finance Docket No 33407  
Surface Transportation Board  
1925 K Street N W  
Washington, D C 20423-0001

Attn: Victoria Rutson  
Environmental Project Manager  
Environmental Filing

Re: Support for the DM&E Project-Environmental Filing

Dear Secretary

Arkansas Electric Cooperative Corporation(AECC) is a generation and transmission cooperative and is the power supplier for 16 of Arkansas' electric cooperatives. With 1,940 megawatts of generation resources, those 16 electric distribution cooperatives serve more than 360,000 homes, farms, businesses and industries in Arkansas. Out of our total generation resources, 1,432 megawatts come from coal-fired plants that burn low-sulfur coal from the Powder River Basin(PRB) in Wyoming. The transportation of this coal by railroad is a major portion, as much as two-thirds, of the cost of the delivered fuel. Providing a reliable and economical fuel supply for our powerplants is my primary responsibility at AECC.

AECC supports the Dakota, Minnesota & Eastern(DM&E) Railroad's project to construct a new rail line to the PRB. We believe that there is a clear need for the additional capacity out of the PRB and that the increased competition will improve both the reliability and the economics of moving coal by rail.

The mines in the PRB are currently served by one railroad or at most two railroads. Having only two railroads that can transport these hundreds of millions of tons of fuel for the nation's power plants is not enough. Many of the power plants that burn PRB coal can only be served by one of the two large railroads that have access to the PRB. Even though AECC's power plants could not be directly served by the DM&E project, its successful implementation would

**The Electric Cooperatives of Arkansas**  
*Your Local Energy Partner*

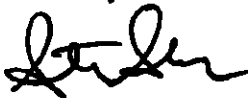
free up capacity on the railroads that do serve our area. This might create enough unused, incremental capacity that the railroads would offer lower rates. Also, if the DM&E is constructed, it would create a short, direct route from the PRB to the upper Mississippi River. Two of our power plants could take delivery of coal by barge. We do have potential future sites for coal-fired power plants that could accept coal delivered by barge from the Mississippi River. Also, there may be another railroad that interconnects with the DM&E that could deliver directly to our area. Through such interconnections, a third rail option might be possible. We believe that anything that increases competition for our coal transportation business will help to lower the cost. Keeping coal transportation costs down will help keep the cost of electricity reasonable for our customers in Arkansas.

During the past several years, the demand for coal from the PRB has exceeded the existing railroads' capacity. While trying to meet this increased demand, the existing railroads have not met the service expectations of their existing coal transportation customers. We believe the project proposed by DM&E would increase rail capacity for PRB coal, a very important national resource, and would result in better and more reliable service on the rail transportation system in general.

We believe it is in the public interest that the reliability of rail transportation for coal not be allowed to deteriorate and that the consumer not be asked to pay higher rates for electricity due to constraints on the transportation of fuel. Even with construction of the DM&E project, it appears that there will be enough demand for rail transportation that the existing railroads will need to increase their capacity to keep up with the demand.

AECC supports DM&E's project to construct a new rail line from the Powder River Basin. We urge the STB to allow the timely completion of this project as it will promote competitive transportation of coal. Many shippers will benefit, as well as the large portion of the public whose electrical service comes from coal-fired generating plants.

Sincerely,

A handwritten signature in black ink, appearing to read "Steve Sharp".

Steve Sharp, P.E.  
Principal Engineer-Fuels and Civil

## **CERTIFICATE OF SERVICE**

I hereby certify that I have caused the foregoing Brief Of Arkansas Electric Cooperative Corporation to be served by first class mail, postage prepaid, this 2d day of July 2008, on all parties of record and the following persons as specified in the Board's Decision dated December 27, 2007.

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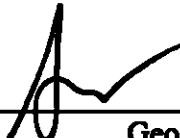
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