



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

General Counsel

**1200 New Jersey Avenue, S.E.
Washington, D.C. 20590**

July 2, 2008

Hon. Anne K. Quinlan, Acting Secretary
Surface Transportation Board
395 E St., S.W.
Washington, D.C. 20423

Re: Finance Docket No. 35081

Dear Secretary Quinlan:

Enclosed herein for filing in the above-referenced proceeding is the Brief of the United States Department of Transportation (designated as DOT-5). Please contact me should there be any questions about this matter.

Respectfully submitted,

A handwritten signature in black ink, reading "Paul Samuel Smith".

PAUL SAMUEL SMITH

Senior Trial Counsel
(202) 366-9280

Enclosure

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

Canadian Pacific Railway Company, et al.,)

-- Control --)

Dakota, Minnesota & Eastern Railroad Corp., et al.)

F.D. No. 35081

**BRIEF OF THE
UNITED STATES DEPARTMENT OF TRANSPORTATION**

Introduction

The Canadian Pacific Railway Company (“CP”) has applied to the Surface Transportation Board (“STB” or “Board”) for approval to acquire the Dakota, Minnesota & Eastern Railroad Corporation (“DM&E”) and its wholly-owned subsidiary, the Iowa, Chicago & Eastern Railroad Corporation (“IC&E”).¹ The United States Department of Transportation (“DOT” or “Department”) has previously addressed the major environmental, safety, and competitive issues in this proceeding. DOT-4, filed April 18, 2008. Subsequent pleadings from other parties concerning these subjects have not caused DOT to alter its position.² The Department accordingly submits that the proposed transaction meets the applicable standard for approval, provided the following conditions are imposed: (1) the Board should continue its restriction on the transport of coal from the Powder River Basin (“PRB”), pending an expeditious environmental review at the

¹/ The CP, DM&E, and IC&E are collectively referred to herein as “Applicants.” Consistent with the Application and the STB’s usage, references to DM&E include the IC&E unless otherwise indicated.

²/ In light of our prior discussion of the earlier-filed evidence and arguments, this Brief will focus primarily on the points raised in later filings. We incorporate DOT-4 by reference.

appropriate time, (2) the Board should adopt the standard requirement that Applicants carry out the terms of the Safety Integration Plan (“SIP”) and otherwise cooperate with the Federal Railroad Administration (“FRA”) until the consolidation is successfully implemented, and (3) the Board should hold the Applicants to the commitment they have made on the record with respect to keeping open rail gateways.

The Primary Application

The Applicants have consistently contended that their consolidation is in the public interest. They urge that approval of the merger would expand the geographic reach of the CP rail network, allowing it access to new traffic (such as ethanol and corn) and providing both extended single line service and more efficient routing options to shippers. They also assert that access to CP’s financial resources should increase DM&E’s efficiency and safety, and likely enhance the prospects for construction of a new rail line to the PRB. CPR-2/DME-2 at 8-10; CPR-14/DME-14 (Vol. 1) at 6-9.

The Applicants maintain as well that this transaction is strongly pro-competitive. They emphasize that it represents an almost entirely “end-to-end” combination of systems with minimal overlap, and that within the areas served by both CP and DM&E no shipper at any rail station that currently enjoys competitive rail service options will have fewer than two such options after the merger. They also deny there will be adverse impacts on short line carriers connecting with the Applicants. Id., Exhibit 12 at 7-15; Verified Statements (“VS”) of Ray Foot and John H. Williams. See also CPR-7/DME-7, Supplemental VS of Williams; CPR-14/DME-14 (vol. 1) at 13-17 and Reply VS of Williams.

The Transaction's Effects on the Environment and Safety

The National Environmental Policy Act obliges the STB to assess the proposed transaction's impacts on the quality of the human environment. 42 U.S.C. §§ 4321 *et seq.* In this case the acquisition will not bring about changes in traffic or other rail-related activity sufficient to meet the STB's environmental regulatory thresholds, and thus the Board has determined not to conduct a general environmental review. Decision No. 9, served April 4, 2008. The only major exception to this determination is with respect to the impact of coal from the PRB (if the rail line into Wyoming that DM&E is authorized to construct is actually built). In that case, an existing Board condition will subject this traffic to an environmental review; until that process is complete no PRB coal from this new line may be carried on the IC&E or CP systems. *Id.*

DOT continues to support these determinations. DOT-2 at 4-5. We also urge, as we did recently in Finance Docket No. 35087, that when the STB considers the impacts of this traffic on the subject lines it should do so in a reasonably expedited, focused, and transparent manner, with a clear procedural schedule that avoids potentially needless or unproductive delay. The efficient movement of coal has always been important to the national interest, and an unnecessarily long review process ill serves that interest without appropriately advancing our interest in the environment.

Applicable regulations also require the Applicants, in coordination with the FRA, to prepare and implement a SIP in order to ensure that their operations are integrated safely. 49 C.F.R. Parts 244 and 1106. Over the course of this proceeding the Mayo Clinic has raised concerns about the transport of hazardous materials, particularly

ethanol, through its community of Rochester, Minnesota. These stem from such factors as the poor safety history of the DM&E and the need for significant maintenance on its infrastructure, which in turn gave rise to the Mayo Clinic's requests for conditions, *inter alia*, to limit the quantities and speed of hazardous materials traffic through Rochester and to install grade-separated crossings. Mayo Clinic-3. DOT addressed each of the Mayo Clinic's points and opposed imposition of the conditions sought. DOT-4 at 3-6.

The Mayo Clinic thereafter reiterated its concerns on the basis of new information showing likely increases in ethanol traffic on the DM&E line through Rochester beyond the very low level previously reported by the Applicants. Mayo Clinic-4 at 3-7, *citing* CPR-14/DME-14, Reply Verified Statements of Lynn A. Anderson and Vern Graham.³ These documents show that ethanol production and shipments are growing rapidly throughout the Midwest and that, although transportation patterns cannot be predicted accurately, it is likely that such traffic will also rise through Rochester. *Id.*

It is certainly true that ethanol shipments are growing in the Midwest at present, as a number of new facilities have been constructed to produce ethanol from corn and other agricultural products. But even if that trend continues (and it may not), neither it nor the prospect of additional ethanol transported through Rochester supports the conditions the Mayo Clinic seeks.

First and foremost, there should be no doubt of the Department's solicitude for basic safety concerns of the type that have motivated the Mayo Clinic. A comprehensive array of DOT regulations, augmented by inspection and enforcement resources, governs

³/ The Mayo Clinic suggests that CP's change in ethanol projections both evidences duplicity and flatly undercuts previous positions taken by the STB and DOT. Mayo Clinic-4 at 2.

the packaging, handling, and carriage of hazardous materials within the U.S. As a result of both this oversight and the efforts of railroads, shippers, and the chemical industry, the reality is that an absolutely overwhelming proportion of hazardous materials move across the nation by rail in complete safety.

In the year 2007, for example, out of approximately 1.7 million shipments of hazardous materials transported by rail there were 43 accidents in which a release of these materials occurred, a risk of release amounting to a tiny fraction of one percent (0.0043 percent).⁴ Most of the releases were small and caused no personal injury. Thus, the risk of a large release presenting the situation the Mayo Clinic fears is truly slight even on a national basis. The risk that such a release would occur in Rochester is smaller still by orders of magnitude.⁵

None of this is to belittle substantive safety concerns -- if Congress and DOT did not share them there would be no overarching, minutely detailed regulatory program in place -- or to deny that accidents do happen, but to emphasize the success that has met this concerted and ongoing effort. In carrying out its programmatic responsibilities, FRA has monitored both DM&E and CP to assure their compliance with all applicable provisions. The Department has also already noted in this proceeding recent and ongoing regulatory actions that will further advance the safe carriage of these materials by rail. DOT-4 at 5, note 3 (referencing proposed strengthening of tank cars and already adopted risk assessment and routing rules).

⁴/ These statistics are from the FRA safety database at: <http://safetydata.fra.dot.gov/officeofsafety/>

⁵/ It also bears noting that as a statistical matter rail transport is notably safer than motor carriage, the most likely alternative if use of rail is unavailable for whatever reason.

Finally, there are several other factors that tend to mitigate the risk to Rochester in particular. One is that the volume of ethanol predicted to transit through the community under any scenario is small in absolute terms and significantly below the Board's regulatory thresholds.⁶ Another is that in the evolution of this case, including the development of the SIP, the Applicants have agreed to make additional improvements in their track and infrastructure that further enhance safety in the Rochester area. Track in that vicinity will be upgraded to FRA Class 3 and FRA has been advised that wayside detectors will be installed both east and west of Rochester to more closely scrutinize operating safety.⁷ FRA will continue to work with the Applicants as their consolidation is implemented to assure safe operations throughout the merged systems, including Rochester. Under the circumstances, there is no basis to impose the conditions sought by the Mayo Clinic.⁸

^{6/} The Mayo Clinic ventures that the historically miniscule level of anhydrous ammonia (a nitrogen fertilizer) shipped on the DM&E will grow with ethanol movements. Mayo Clinic-4 at 7, note 3. We find this prediction far too speculative, for it depends upon various other extraneous factors such as decisions made pursuant to the Department of Agriculture's crop support program. Regardless of quantity, of course, the merged railroad will of course have to comply with applicable DOT hazardous materials rules, including the PHMSA rules cited by the Mayo Clinic. *Id.* at 17.

^{7/} The Mayo Clinic appears to oppose such improvements on the grounds that they merely enable carriage of more hazardous materials in the first place, *Id.* at 5-7, 13-14, but -- short of substantially restricting this traffic -- it cannot deny that they will lower the risk of harm. The Mayo Clinic also seems to be of two minds about whether the authorized PRB line should be built and the effect of the proposed combination on that project. *Id.* at 8-12. As noted below, however, that question is not germane to this proceeding.

^{8/} The Minnesota Department of Transportation also believed detrimental effects on safety within that State would flow from the proposed transaction, and it sought a broad condition to remedy perceived harms. DOT considered the record on this point and opposed the condition. DOT-4 at 7-8. There was no subsequent filing by the Minnesota Department of Transportation, and thus we are unsure of that party's current view. DOT in any event adheres to its previously expressed position.

The Transaction's Effects on Competition

With respect to matters other than safety and the environment, the applicable legal standard focuses on competition and 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)

Two parties challenged the pending consolidation on competitive grounds, the Kansas City Southern Railroad Company (“KCS”) and Muscatine Power and Water (“Muscatine”).⁹ The Department considered the evidence and argument marshaled by both and found no basis for concern. DOT-4 at 8-14. Each party then submitted additional material. KCSR-3 and Muscatine Rebuttal in Support of Request for Conditions (“Muscatine Rebuttal”). After review of these pleadings we still conclude that the pending merger meets the pertinent standard and should be approved without conditions designed to remedy competitive losses.

KCS has alleged that shippers and receivers of corn originated on the DM&E will likely see “adverse competitive effects” resulting from the proposed merger “in the form

⁹/ The Arkansas Electric Cooperative Corporation (“AECC”) opposed the application on the ground that it would make construction of a third rail line into the PRB less likely and would thus reduce prospective intramodal competition. AECC-3. AECC has renewed that opposition. AECC-4. DOT did not address this point because the Board has made clear that whether the third PRB line is built is not a factor to be considered in a consolidation proceeding. *DM&E – Control – IC&E*, 6 S.T.B. 511, 525-26 (2003).

of reduced market access for shippers and higher prices for receivers[.]” KCSR-2, Verified Statement (“VS”) of Thad Jones at 2. KCS charges that the pending combination threatens competitive harm because CP will terminate or refuse to renew pivotal agreements that KCS has with DM&E. The first allows KCS to publish rates and enter into contracts for certain movements on the IC&E, which has resulted in major corn movements to receivers served by KCS. KCSR-2, VS of Michael R. Bilovesky at 3-4. The second provides KCS with ratemaking authority between Kansas City and Chicago; although it has never been used to move traffic, KCS has contended that this arrangement underpins an important competitive alternative for traffic to and from Mexico independent of the UP. KCSR-2, VS of George C. Woodward at 21-24. KCS would have the Board remedy these perceived competitive losses by making these agreements permanent.

The Department was not persuaded that the merger would have these effects and thus opposed the condition. DOT-4 at 10-12. In our view the subject agreements may have promoted effective marketing between the parties, but their absence represented no loss of competition. That remains the case.

KCS’s rebuttal submission contains some additional information but makes the same underlying arguments as before, and DOT remains unconvinced. KCSR-3, Rebuttal VS of Bilovesky at 18-20; Woodward at 23-34. The record shows that the proposed combination of CP and DM&E will likely open new options for growers and not close existing ones for receivers. CPR-14/DME-15, Reply VS of Anderson at 2-14; Reply VS of Williams at 2-24; Reply VS of Don Smith at 2-8. Many corn growers in the relevant regions support the merger for much the same reason. Comments of the

Southern Minnesota and Northern Iowa Shippers Association at 1. Also, CP will presumably have to fulfill the terms of the agreements in question to the same extent as DM&E. Beyond that, CP must be presumed to act rationally and to continue these or other arrangements to the extent they promote efficiency. As we noted previously, merged carriers must ordinarily be allowed flexibility in pursuing newly available routing options for the same reason. DOT-4 at 10-12. The changes in prospect do not represent reductions in competition.

Finally, the Applicant's commitment to "keep open all gateways affected by the proposed transaction on commercially reasonable terms" and to accept a regulatory condition to that effect has not satisfied KCS. CPR-14/DME-14 at 4, 24; KCSR-3 at 42-47 and VS of Bilovesky at 13-20. KCS considers this commitment vague and inadequate in light of commitments undertaken and conditions imposed in other rail consolidations. KCSR-3, *supra*. It wants CP to identify specifically the "gateways affected" within the meaning of the commitment, and it notes that car supply and other important service considerations can affect whether gateways are actually used, but are not explicitly contained within the definition of "commercially reasonable terms." *Id.*

The Department finds no unacceptable ambiguity in the Applicants' pledge as an initial matter. First, it is difficult to imagine that "all gateways affected" can reasonably be interpreted to exclude major cities like Kansas City and Chicago, the two points expressly mentioned by KCS. "All" means "all." Second, the phrase "on commercially reasonable terms" has never been precisely defined because to DOT's knowledge there has never been any need to do so. What is "commercially reasonable" is and must be a flexible concept to allow railroads and shippers to adjust to changing market conditions,

much like newly merged carriers must be allowed to use more efficient routings. *See Canadian National – Control – Wisconsin Central Transportation Corp.*, 5 S.T.B. 890, 903-04 (2001) (no prescribed terms for use of gateways that merging railroads committed to keeping open on “commercially reasonable” terms).

At the same time, the phrase is not without content or consequence. Merging railroads commonly make this and other commitments in order to secure support and assuage any lingering regulatory concerns. To the extent KCS or a shipper believes CP is not dealing in a commercially reasonable fashion, they may bring their complaints to the Board. *See Canadian National – Control – Illinois Central*, 4 S.T.B. 122, 158-59 (1999); *also Ex Parte No. 529 (Sub-No. 1), Major Rail Consolidation Procedures*, 5 S.T.B. 539 at 563 (case-by-case approach is best when reviewing alleged “economic” closing of gateways) (2001).¹⁰

Muscatine is a power utility headquartered in Muscatine, Iowa, served by the IC&E. The IC&E has historically received PRB coal for Muscatine’s generating facilities from either the Union Pacific Railroad Co. (“UP”) or BNSF Railway (“BNSF”) via one of four interchange points. During the pendency of the *DM&E/IC&E* merger, Muscatine expressed concern about the possible loss of these interchange points, but withdrew its opposition following execution of a settlement agreement with the DM&E. Muscatine did so, it reports, because it believed that this agreement maintained both those interchange points and the protection offered by the “contract exception” to the Board’s “bottleneck”

¹⁰ In the *CN/IC* merger case the Board established a formal oversight period with reporting obligations on the merging carriers. DOT sees no need for such a construct in the instant circumstances; the STB should simply indicate its ongoing availability to consider allegations that conditions are being violated.

decision. Comments and Request for Conditions of Muscatine Power and Water (“Muscatine Comments”) at 3-7.¹¹

Muscatine in this proceeding seeks to preserve the continuing availability of these interchange points and the “contract exception” by means of a condition on the merger because it is concerned CP has a different interpretation of the settlement agreement. *Id.* DOT opposed the condition sought in order to preserve the Applicants’ post-merger routing flexibility and because the DM&E/IC&E merger posed “no cognizable harm” to Muscatine. DOT-4 at 14.

Muscatine’s subsequent pleading expresses surprise at the Department’s conclusion, but does not offer any different information or argument. Muscatine Rebuttal at 4. Some clarification is in order.

DOT appreciates that the loss of the ability to challenge the reasonableness of a bottleneck rate via the “contract exception” constitutes harm in the sense that it reduces the shipper’s ability to discipline the bottleneck carrier’s ratemaking authority. Note 12, *supra.*; *Major Rail Consolidation Procedures*, 5 S.T.B. at 564 (“the ability to challenge a bottleneck rate can provide shippers with leverage”). Our point was that by the close of the record in the DM&E/IC&E merger this prospective loss was no longer cognizable

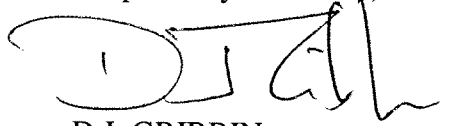
¹¹/ In sum, that decision protects the discretion of bottleneck carriers with respect to route and rate options, and generally prevents shippers from challenging the reasonableness of the rate attributable only to the segment of transportation provided by a bottleneck railroad. The “contract exception” allows for such challenges where shippers contract with the originating carrier to transport freight to a particular interchange point on the bottleneck railroad’s system. *Central Power & Light v. Southern Pacific Transportation Co. et al.*, 1 S.T.B. 1059 (1996), *clarified in* 2 S.T.B. 235 (1997). In Muscatine’s case, the shipper could have contracted with either the UP or BNSF and thereby gained the ability to challenge a bottleneck rate levied by IC&E. This exception does not exist when a single railroad provides transportation from origin to destination. *Id.* Thus, the merger of the DM&E and IC&E, combined with DM&E’s construction of the PRB line, would eliminate the availability of the contract exception for Muscatine.

because Muscatine's settlement with DM&E had removed that as an issue for the Board's consideration. STB policy in such circumstances is to refuse to inquire into the particulars of a settlement. *See* F.D. No. 34424, *Canadian National – Control – Duluth, Missabe and Iron Range Railway Co.* (April 9, 2004) slip op. at 16. In any event, at this point in the case not only have the Applicants committed to keep open affected gateways, but Muscatine has at best an inchoate dispute with CP that may or may not actually affect the shipper's access to the contract exception. Any regulatory action now would be premature.

Conclusion

The proposed consolidation of the CP and DM&E meets the statutory standard for approval. Conditions in place to ensure a review of the impacts of PRB coal traffic on IC&E and CP lines should a third rail route to the PRB be built protect prospectively affected communities in the interim. Such an environmental review should be conducted in a reasonably expedited manner pursuant to a clear procedural schedule. The Applicants must continue to cooperate with FRA to assure a safe implementation of their merger. Otherwise, existing and/or proposed Departmental programs and regulations properly address all significant safety-related concerns. The instant merger will not substantially reduce competition, and thus there is no reason to impose conditions on this basis. The Applicants should be held to their commitment regarding open gateways.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'D.J. Gribbin', written over a horizontal line.

D.J. GRIBBIN
General Counsel

July 2, 2008

CERTIFICATE OF SERVICE

I hereby certify that on this date I have caused a copy of the Brief of the United States Department of Transportation in Finance Docket No. 35081 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

July 2, 2008