S. HRG. 106–1098

OVERSIGHT HEARING ON THE STB'S MORATORIUM ON MAJOR RAIL MERGERS AND 15-MONTH RULEMAKING PROCEEDING ON FUTURE MERGERS

HEARING

BEFORE THE

SUBCOMMITTEE ON SURFACE TRANSPORTATION AND MERCHANT MARINE

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

MARCH 23, 2000

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ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

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OVERSIGHT HEARING ON THE STB'S MORATORIUM ON MAJOR RAIL MERGERS AND 15-MONTH RULEMAKING PROCEEDING ON FUTURE MERGERS

THURSDAY, MARCH 23, 2000

U.S. SENATE,
SUBCOMMITTEE ON SURFACE TRANSPORTATION AND MERCHANT MARINE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:30 a.m., in room SR–253, Russell Senate Office Building, Hon. Kay Bailey Hutchison, Chairman of the Subcommittee, presiding.

Staff members assigned to this hearing: Charlotte Casey and Ann Begeman, Republican Professional Staff; Carl Bentzel, Democratic Senior Counsel; and Debbie Hersman, Democratic Professional Staff.

OPENING STATEMENT OF HON. KAY BAILEY HUTCHISON, U.S. SENATOR FROM TEXAS

Senator HUTCHISON. Thank you for coming. I'm going to call the hearing to order because we do have votes at 11 o'clock, and unfortunately there will be two votes; so we'll get as far as we can and then I hope we'll be able to come back, because this is very important and very significant.

I called the hearing today because of the announcement made by the STB that it would impose a 15 month moratorium on any merger activity while it rewrites the rules that are applicable to future mergers. This is clearly a major decision.

I have read the Board's notice in the case and I believe the STB is rightly concerned about the factors to be considered in a merger. I also believe that Burlington Northern and Canadian National have been put in limbo, which could affect their willingness to make infrastructure investments, and could affect their business projects.

I convened the hearing because I believe very strongly that Congress has a role to play here. In fact, I think part of the reason that you are having to reassess the factors is because Congress has not given sufficient guidance. Sitting on the sidelines will not do. We are witnessing a rapid consolidation in the rail industry, as you said in your statement, and the number of Class I railroads has gone from sixty-three in 1976 to seven today.

The Board is looking at a situation that in a short time would result in the number of major railroads being reduced to perhaps two or three.

Service problems have erupted because of past mergers. There is less competition because of these mergers. I know firsthand the service meltdown that occurred in Houston following the Union Pacific-Southern Pacific merger, and some have estimated that this service disruption cost businesses across America $1 billion.

In the face of this, I do not think a straight reauthorization will pass muster with the majority in Congress. Congress must tackle the competitive issues that have resulted from consolidation when we reauthorize the STB.

There are many proposals on this. I have offered my own proposal in Senate bill 747; first and foremost to make it the policy of the STB to promote rail competition. My bill would also ease the plight of captive shippers by addressing the so-called bottleneck issue; simplify rate case complaints; and codify the Board's elimination of product and geographic competition in rate cases.

If Congress had adopted the standard to assure competition, the Board may not have had to invoke its moratorium.

We may also have to be creative in our thinking to determine if today's smaller railroads will be able to remain viable competitors. We must be cognizant of the needs of the major railroads to remain profitable. As you have pointed out, Ms. Morgan, this is essentially because they carry a need to invest nearly $1 billion in capital to keep their rail infrastructure sound for the future.

This is a challenge to Congress and to the Board, to develop a workable proposal to incorporate all of these concerns and issues into legislation that can pass this year. It's a tall order, but the STB's actions have sounded an alarm and now is the time for Congress to get moving.

I welcome Ms. Morgan to today's hearing, and before I call on you, I'd like to see if any of the other senators would wish to make an opening statement.

Senator LOTT. For now, Madam Chairman, I just want to thank you for having this hearing. Obviously it's timely, and I know we do have two votes at 11 o'clock. So I'd like to withhold any comments at this time to hear the Chairman's statement, and then when she completes that, I may have just a couple comments I'd like to offer. Thank you.

Senator HUTCHISON. Thank you.

And I turned to you because you were first, but I appreciate your showing the deference to the Major Leader. Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Madam Chairman. I do not want not to withhold my statement, and please forgive me for that.

Senator HUTCHISON. I suspected that you wouldn't.

OPENING STATEMENT OF JOHN D. ROCKEFELLER IV, U.S. SENATOR FROM WEST VIRGINIA

Senator ROCKEFELLER. It's been a remarkable couple of weeks for Linda Morgan, for the STB and for the railroad industry. It's very interesting that the result of the 150 witnesses that Linda Morgan listened to, it was the first time that the STB and the railroad industry both agreed that the railroad industry was in severe crisis

and that things are not working. That was the testimony, and that is the underlying aspect of the ruling.

I would like to make three points, and I will also have more questioning. First, I want to commend Linda Morgan and the STB Board for making a really bold decision on the 15 month moratorium on railroad mergers. I commend you for that, and I think it was excellent.

This was not an easy step to take; Burlington Northern and Canadian National have gone to court, as everybody always does, to seek a stay of the STB decision. The Board is likely to end up in litigation over the question. I'm not a legal expert I can tell you, but I certainly believe that you do have the legal authority reflected in the statutes to mandate the protection of the public interest and prevent irreparable harm, as they say.

Chairman Morgan noted in her own written comments that this was a tough decision, but she said, quote "the current problems facing the rail sector are so extraordinary that an unprecedented response is necessary." Close quote. As Ms. Morgan and many of my colleagues know, I've held that view now for 15 years.

I want Ms. Morgan and the Board to know at the outset how glad I am that we are together on this, and now I think we have to get on with it.

Secondly, I want to not yet share publicly a letter which I want to give to you, Madam Chairman, after I get a few more signatures during the course of the next couple of votes; but the gist of it will be that we have a choice here, we can say "Oh, we've got a 15 month moratorium and then let's just let the time go by and see what happens," or we can decide that the railroads have spoken very clearly about what they believe to be the condition of the railroad situation; the STB has spoken very clearly; and that we need to go ahead and do our work in Congress as the chairman herself suggests in her own very strong opening statement.

We cannot dump our work in Congress as we have done for years on the STB, when the STB is claiming it doesn't have the authority to do what the Staggers Act in fact called for. We're not talking about overhauling the Staggers Act, we're talking about a modification, and that is all.

Finally, I would point out that the underlying current debate seems to be based on an assumption that we are headed into the next round of mergers, and that the industry must inevitably settle into just two transcontinental railroads. I believe that is the direction that we are headed, from 50 to 2 in the sixteen years I have been in the Senate.

I want to be very clear in my own remarks that I, for one, am not prepared to accept that assumption, and will fight that assumption with every ounce of strength I have.

Already, recent mergers have concentrated 90 percent, Madam Chairman, of rail freight revenues into four hands: UP, CSX, NS and BNSF, and consolidation doesn't seem to have brought any of the promised consumer and financial benefits.

Based on recent stock prices, CSX and NS are worth less now than what they paid for Conrail 3 years ago, so that was not a very good business decision perhaps on their part. But merger mania has its own internal chemistry.

Mergers are supposed to result in growth, yet rail mergers have been accompanied by losses of more business to trucks. I don't think that was the purpose of all of this. Customers, employees and financial markets have lost faith in the industry, have lost all faith in the industry, the railroad industry, something I have not seen in any other industry in the time that I have served on this committee which, as I indicated, is now 16 years.

More than anything else, my experience with rail service in West Virginia makes me extraordinarily leery of having only two transcontinental railroads in this country. As recently as this month, I have been trying to facilitate a new dialog between chemical companies in West Virginia and the railroad to which they are captive, that being illegal under the Staggers Act.

The railroad has said, literally said, Madam Chairman, to these companies recently: "The only way you'll ever get competitive rail service and rates is through government intervention." I repeat that: The railroads say "Take a hike, we're doing nothing for you, we don't care what your situation is, we will only respond to congressional legislative action."

So it is that action, now more than ever I think that has to be called for. I think that is monopolistic behavior, I think that is outrageous behavior, it infuriates me, it is terrible for my state. There is an arrogance in the delivery of the message which is something I've heard before but I've never heard it so continuously, and it is something which as I say is flat out monopolistic. With the enormous advantage that the American Railroad Association has in keeping itself under the radar screen while doing great damage to many shippers all across this country, and passing out a lot of money.

Well, that is not the kind of dialog I had in mind, Madam Chairman, and I'm sorry about the length of the statement, but you can tell that I am not going to stop until I have finished it.

All rail customer captivity may not be as big a problem, for example in Texas, as it is in West Virginia. Some 90 percent of West Virginia chemical plants are captive shippers, and in Texas it is 50 percent. And there is a big difference between 50 percent and 90 percent, but then on reflection is there really that big a difference?

Senator HUTCHISON. Well, I think captive shippers are a real problem, and I don't think the percentages do make a difference.

Senator ROCKEFELLER. What you indicated in your opening statement, I thought, was very, very strong.

So 50 percent is too many, and if there were two railroads in this country you'd be at 90 percent in a very short time. So all I try to do is make my point: I implore my colleagues to join with some of us, an effort to try at last once and finally to do some legislative remedy for this absolutely disgraceful, under the radar screen, well-financed operation which is devastating the economy of my state, which has just slipped to number 50 in per capital income.

Senator Hutchison, Senator Byron Dorgan, Senator Burns, others and myself have been asking for legislative action and we have waited a long time, we really want it. We cannot simply leave this up to the STB. That is what we do. And this 15 month moratorium cannot be another excuse for us to do that.

I thank the Chairman for indulging me.

Senator HUTCHISON. I thank the Senator for his statement, and I want to say that you and I disagree on the remedy but we agree that something must be done to solve some of the captive shipper problems and the bottleneck problems; and I think the 15 month moratorium means we need to get in and do our jobs in providing Congressional guidance.

Senator ROCKEFELLER. And Madam Chairman, if you and I and others want to address the bottleneck problems, we are going to do enormous service to competition in this country.

Senator HUTCHISON. Senator Kerry, did you have an opening statement?

Senator KERRY. Just very, very brief if I may, Madam Chairman.

Let me thank you first of all for this opportunity, and I welcome Ms. Morgan here. I, like my colleague, just heard a brief earlier comment before I was visiting briefly with the Leader in support of your decision. I just want to express my support also for the decision that you have made, which I think is a very, very important one in order to get time to assess and to properly make some, create some structure for how these mergers may or may not occur in the future. I want to credit you with this thoughtful decision, I think it's a good one that you've taken.

We really need to update the standards. The profound implications of the downstream effect of these mergers is much more significant than people have allowed for. It has the capacity for great disruption, as you know. You've heard from a lot of people, 150 witnesses, and I think Massachusetts was one of those who commented and supported the moratorium, so we're grateful for that.

Let me just raise one other issue, if I may quickly. The willingness of the STB to modify or even break collective bargaining agreements in order to effectuate a rail merger which is known in the industry as cram-down strikes me as being inherently, fundamentally unfair.

Now I know the Supreme Court has affirmed the right to do it, but having a right to do something doesn't necessarily make it good policy. And it seems to me it is clear that while the right exists, there's no mandate that you do this; there's no requirement that this be the practice.

I would simply remind you that you are talking about our fellow citizens here, you are talking about people. People who are at a place in their lives, and in the economy where it is not as easy to make a transition, particularly in a world where we are having great difficulty providing some of the means to facilitate that transition—ongoing educational opportunities, transitional assistance and other kinds of things.

So what happens is, the cram-down practice has a profound impact on workers; some of them lose their seniority, others are forced to spend a lot more time away from home and family in order to work under conditions that are particularly disagreeable and complicated. But that is what they have to do because the size of the work area gets significantly increased. Others find wages significantly altered, and so they suffer financially at a time when other pressures have already existed on the economy in terms of wage appreciation measured against other increases. The gap is

really growing in our economy, between people who are touching the new economy and people who aren't.

I want to change the law that allows that. Now Senator Crapo has a bill, and I'm cosponsor with him of the bill, that would address the problem; but the STB can remedy the situation by itself in the rulemaking. I simply want to call that to your attention, that you can make mergers work without breaking worker's contracts, or even by showing, I think greater sensitivity to the existence of those contracts in the process. The rulemaking process, as you focus on the merger, provides you with a ready-made opportunity to do that and I hope that you will consider in fact ending that practice in the course of this, and we can continue a dialog on that.

I thank you for listening, and Madam Chairman, I thank you for the time.

Senator HUTCHISON. Thank you.

[The prepared statement of Senator McCain follows:]

PREPARED STATEMENT OF HON. JOHN MCCAIN,
U.S. SENATOR FROM ARIZONA

Thank you. When I was approached on Monday about holding an oversight hearing to consider the Surface Transportation Board's March 17th decision on rail mergers, I quickly consented. The Board's decision is bold and unprecedented. As such, it deserves Congressional oversight.

This morning's hearing was requested to discuss the STB's decision concerning future mergers. I also recognize other issues beyond the scope of the Board's merger moratorium may be raised.

But first, I want to commend Chairman Morgan and Commissioners Burkes and Clyburn for holding *their* hearings earlier this month on major rail mergers and the present and future structure of the rail industry. I have always supported the Board's efforts over the years to initiate these types of information-gathering proceedings and I'm confident the multi-day hearings provided very useful information.

I hope that the hearings also provided yet another wake up call to the railroad industry that many rail customers, quite simply, are not satisfied with the service they are receiving. This message has been delivered on other occasions and in other forums and as I have said before, I urge both the industry and shippers to work on ways to resolve these serious service gaps.

I also want to remind my colleagues on the Committee that I am not opposing additional hearings. At no time have I denied any request by Committee members to hold hearings on the Board or rail and shipper issues. Just like I did when I was approached about today's hearing, I will agree to members holding as many hearings as they deem necessary. All the members need to do is to specifically request a hearing, as Senator Hutchison did Monday.

Today, we will hear testimony from Chairman Morgan. But I caution the members to understand that Chairman Morgan will be under certain constraints in her ability to respond to certain questions. The Board's decision is under appeal with the D.C. Circuit Court and as such, we must understand her position.

According to the reports I have seen, the Board's decision to place a 15-month moratorium on the consideration of any rail mergers was based in large measure on the many comments expressed during its hearings. During the 15-month merger freeze, a Federal rulemaking to create new merger standards will be established that will guide how the Board will review the merits of future merger applications.

Again, according to the reports I have seen, some groups are very pleased with the Board's announcement while others are clearly not. This morning's hearing should provide the Board with a welcomed opportunity to further elaborate on the factors which led it to initiate the moratorium and to discuss what types of revisions it feels are needed in its merger application consideration procedures.

Let me conclude by reiterating my strong support for reauthorizing the Board. In the Senate, bipartisan compromises are always necessary to pass needed legislation and it is quite clear that none of the pending bills as currently drafted have the support necessary for passage. The bills have wide ranging provisions and policy goals and I remain hopeful that all the interested parties will meet to iron out their differences.

I look forward to hearing from Chairman Morgan and appreciate her accommodating the Committee's scheduling this hearing on such short notice.

[The prepared statement of Senator Hollings follows:]

PREPARED STATEMENT OF HON. ERNEST F. HOLLINGS,
U.S. SENATOR FROM SOUTH CAROLINA

As many of you know, Linda Morgan served as counsel for the Surface Transportation Subcommittee for eight years and then as General Counsel for the Full Committee for seven years. During that time, I found Linda Morgan to be one of the most erudite and thorough professionals. She is smart, she cares about the issues, and she knows how to respond to the pressures of overseeing our surface transportation industries at the Surface Transportation Board.

I would like to commend the Surface Transportation Board on its recent decision to consider downstream effects on overall railroad competition and service issues as part of future merger proceedings. Recently, the Board took the time to listen to four complete days of testimony on the state of the rail industry, and on the impact of previous mergers. I think that no one out there can deny that the rail industry has experienced significant change in the years after passage of the Staggers Act. Given the problems with service on recent rail mergers, and the poor financial status of the stock of railroad companies, I think it is important to review the landscape from a broader perspective.

While the Surface Transportation Board has plenary statutory authority to approve or deny any merger application, I believe that it is appropriate for the Board to consider cumulative impacts, crossover and downstream effects. Considering the number of mergers that has occurred in recent years and the ensuing service problems it is clear the STB has many challenges before it.

In December, the Canadian National Railway Company (CN) and the Burlington Northern Santa Fe Corporation (BNSF) announced their plans to file a merger application with the Surface Transportation Board. While we all may have different positions on the proposed merger, I feel that it is prudent for the Board not only to address the current state of the railroad industry, but the future landscape as well.

Linda Morgan has done a lot of heavy lifting during her tenure as Chairman of the STB, and she has a lot of heavy lifting yet to do. I want it to be known, however, that she has my full confidence and support. I look forward to her testimony this morning.

[The prepared statement of Senator Inouye follows:]

PREPARED STATEMENT OF HON. DANIEL K. INOUYE, U.S. SENATOR FROM HAWAII

I would like to commend the Chairwoman for holding a hearing on the Surface Transportation Board's decision to review existing merger rules in light of the massive industry consolidations in the past twenty years. In addition, I would like to thank Chairwoman Hutchison for her leadership and her quick attention to this major development, which was announced only last week.

I would like to applaud the Surface Transportation Board for its recent efforts to address prospective rail consolidations and the future of the railroad industry. Earlier this month, the Board held a four day hearing on the state of the rail industry. During this hearing the Board heard testimony from many parties on the impact of previous mergers and the potential issues that could arise with future mergers. The rail industry has experienced significant change in the years after passage of the Staggers Act. Given the service problems following recent rail mergers and the poor financial status of the stock of railroad companies, I think it is important to review the landscape from a broader perspective.

In December, the Canadian National Railway Company (CN) and the Burlington Northern Santa Fe Corporation (BNSF) announced their plans to file a merger application with the Surface Transportation Board. While we all may have different positions on the proposed merger, I feel that it is prudent for the Board not only to address the current state of the railroad industry, but to look forward in an effort to anticipate future problems or issues.

I support the Board's decision to consider downstream effects on overall railroad competition and service issues as part of future merger proceedings. Considering the number of mergers that has occurred in recent years and the ensuing service problems, I believe that it is appropriate for the Board to consider cumulative impacts and crossover and/or downstream effects.

I am pleased to welcome Chairman Morgan back to the Commerce Committee. As many of you know, Linda Morgan worked on the Committee for fifteen years prior to her appointment as Chairman of the STB. During the time that I worked with Linda Morgan, I observed her keen intellect, attention to detail and her commitment to the issues. I have great respect for her abilities and I am confident that she knows how to respond to the pressures of overseeing our surface transportation industries at the Surface Transportation Board. I look forward to her testimony this morning.

Senator HUTCHISON. Chairman Morgan.

STATEMENT OF HON. LINDA J. MORGAN, CHAIRMAN, SURFACE TRANSPORTATION BOARD

Ms. MORGAN. Thank you very much.

I am appearing today at the request of this Subcommittee. When I was notified on Monday that there would be a hearing and that I would be the only witness, I was told that I would be here to answer questions regarding the March 17th decision on rail mergers. I have submitted a short, written statement summarizing that decision, to which I have attached a copy of the full decision.

I ask that all of that be submitted into the record in full.

[The prepared statement of Ms. Morgan follows:]

PREPARED STATEMENT OF HON. LINDA J. MORGAN, CHAIRMAN, SURFACE TRANSPORTATION BOARD

My name is Linda J. Morgan, Chairman of the Surface Transportation Board (Board). I am appearing at the request of the Subcommittee to discuss the decision served by the Board on March 17, 2000, in STB Ex Parte No. 582, *Public Views on Major Rail Consolidations*. For the record, I am including a copy of the Board's decision with my written statement.

Background

The Board's proceeding in STB Ex Parte No. 582 was triggered by the filing of a notice on December 20, 1999, that the Burlington Northern and Santa Fe Railway (BNSF) and Canadian National (CN) intended to file an application, on or shortly after March 20, 2000, seeking Board approval to bring their railroad systems under common control. Given the aggressive consolidation and associated disruptions that had occurred in the railroad industry during the past several years, and the likelihood that the BNSF/CN proposal would set off yet another full round of major rail consolidations, the Board issued an order on December 28, 1999, waiving the so-called "one case at a time" rule for the BNSF/CN proceeding and stating that, if the BNSF/CN proceeding went forward, the Board would consider not only the direct impacts of that combination, but also evidence of the cumulative impacts and crossover effects that would likely occur as other railroads developed strategic responses in reaction to the proposed combined new system. In addition, given the prospect of significant further consolidation within the railroad industry, and the Board's concern that the railroad industry and the shipping public have not yet recovered from the service disruptions associated with the previous round of mergers, the Board issued an order on January 24, 2000, opening the STB Ex Parte No. 582 proceeding to obtain public views on the subject of major rail consolidations and the present and future structure of the North American rail industry.

The March 17 Decision

As part of the STB Ex Parte No. 582 proceeding, the Board took written and oral testimony from all sectors associated with the rail industry, including large and small rail carriers; large and small shippers representing various commodity groups; intermodal and third party transportation providers; rail employees; state and local interests; financial analysts and economists; and Members of Congress (including Members of this Committee) and other federal agencies. The overwhelming weight of the testimony, particularly the testimony taken over the 4 days of oral hearings, was that, at a minimum, the Board's merger policy must be reexamined—and must be reexamined now—before any new major mergers are processed. The Board agreed, concluding in its March 17 decision that the rail community is not in a position to now undertake what will likely be the final round of restructuring of the

North American railroad industry, and that current Board rules are not appropriate for addressing the broad concerns associated with reviewing transactions that may well produce two transcontinental railroads.

In reaching the March 17 decision, the Board recognized that the Government is not in the business of drawing railroad maps, and that this agency is not attempting to do so in this proceeding. The Board also recognized that the law it administers generally contemplates private initiatives that are then subjected to regulatory scrutiny. But the Board is required to take actions and to fashion regulations that advance its mandate—under which it is to approve mergers only to the extent consistent with the public interest, and under which it is to promote a safe and sound rail system that runs smoothly and efficiently to provide service for rail customers—in a manner that is consistent with the overall rail transportation policy established by Congress. The Board found that it would be impracticable to try to act on a final round of mergers while in the process of developing new merger rules, and that such an approach would also be disruptive to the rail system and to rail service that remains well below acceptable levels in many areas. The disruption would go far beyond the specific interests of BNSF and CN and the carriers that compete with them; it could irreparably damage the entire industry, to the detriment of the interests of shippers, rail employees, and the national economy and defense.

Thus, in the March 17 decision, the Board announced that, over the next 15 months, it would initiate and complete a proceeding that will provide new merger rules. To permit the development of the new rules, and to ensure that the industry has had the opportunity to fully recover from service problems associated with recent mergers without the distractions associated with consideration of additional mergers, the Board decided that it could best maintain the status quo by ordering a suspension of all merger activity, categorized as major rail transactions, until after the final merger rules are issued, or a total period of 15 months.

Activity Stemming From the March 17 Decision

The Board is currently preparing an advance notice of proposed rulemaking (ANPR) to institute the process of reexamining its merger rules and policy. The Board expects to issue the ANPR to the public by April 6, 2000 (within 20 days of the March 17 decision).

BNSF, CN and the Western Coal Traffic League have appealed the Board's March 17 decision to the Court of Appeals for the District of Columbia Circuit. Also, BNSF has filed with the Board a petition for an administrative stay pending judicial review of the Board's decision.

This concludes my testimony. As I stated earlier, I am including a copy of the Board's March 17 decision, which fully explains the action taken by the Board. I will try to answer any questions that you may have regarding the March 17 decision, given the constraints that the pending agency and court proceedings impose on me at this time.

SURFACE TRANSPORTATION BOARD DECISION

STB Ex Parte No. 582

Public Views on Major Rail Consolidations

Decided: March 16, 2000

Overview

This proceeding was triggered by a notice filed on December 20, 1999, indicating that another major railroad merger application was imminent.[1] The railroad industry has consolidated aggressively in recent years; now that Consolidated Rail Corporation (Conrail) has been divided between CSX and NS, only six large railroads remain in the United States and Canada.[2] In an order issued on December 28,

[1] In particular, The Burlington Northern and Santa Fe Railway Company and Canadian National Railway Company filed a notice of intent to file, on approximately March 20, 2000, an application seeking Board authorization under 49 U.S.C. 11323–25 and 49 CFR part 1180 for a major transaction (referred to as the BNSF/CN transaction) under which the two railroads would be brought under common control.

[2] The six are: The Burlington Northern and Santa Fe Railway Company (BNSF); Union Pacific Railroad Company (UP); CSX Transportation, Inc. (CSX); Norfolk Southern Railway Company (NS); Canadian National Railway Company (CN); and Canadian Pacific Railway Company (CP). Two smaller U.S. Class I railroads (Grand Trunk Western Railroad Incorporated and Illinois Central Railroad Company (IC)) are affiliated with CN. A third smaller U.S. Class I railroad

Continued

1999,[3] we stated that, if the BNSF/CN proceeding went forward, we would consider not only the direct impacts of that combination, but also evidence of the cumulative impacts and crossover effects that would likely occur as other railroads developed strategic responses in reaction to the proposed combined new system. Additionally, given the prospect of significant further consolidation within the railroad industry, and our concern that the railroad industry and the shipping public have not yet recovered from the service disruptions associated with the previous round of mergers, we opened this proceeding to obtain public views on the subject of major rail consolidations and the present and future structure of the North American rail industry.

As part of this proceeding, we took written and oral testimony from all sectors associated with the rail industry: large and small rail carriers; large and small shippers representing various commodity groups; intermodal and third party transportation providers; rail employees; state and local interests; financial analysts and economists; and Members of Congress and other federal agencies. Certain parties expressed support for a radical overhaul of the entire regulatory scheme; some parties expressed support for a "business-as-usual" approach to rail regulation in general and rail mergers in particular; still others took the view that no more rail mergers should be permitted under any circumstances. But the overwhelming weight of the testimony, particularly the oral testimony, was that, at a minimum, our merger policy must be reexamined—and must be reexamined now—before any new major mergers are processed. Because we conclude that the rail community is not in a position to now undertake what will likely be the final round of restructuring of the North American railroad industry, and because our current rules are simply not appropriate for addressing the broad concerns associated with reviewing business deals geared to produce two transcontinental railroads, we agree.

We recognize that the Government is not in the business of drawing railroad maps, and we are not attempting to do so in this proceeding. We are also aware that the law that we administer generally contemplates private initiatives that are then subjected to regulatory scrutiny. But we are required to take actions and to fashion regulations that advance our mandate—under which we are to approve mergers only to the extent consistent with the public interest, and under which we are to promote a safe and sound rail system that runs smoothly and efficiently to provide service for rail customers—in a manner that is consistent with the overall rail transportation policy established by Congress.[4] Not only would it be impracticable for us to try to act on a final round of mergers while we are in the process of developing new merger rules, it would also be disruptive to the rail system and to rail service that remains well below acceptable levels in many areas. The disruption would go far beyond the specific interests of BNSF and CN and the carriers that compete with them;[5] it could irreparably damage the entire industry, to the detriment of the interests of shippers, rail employees, and the national economy and defense.

Therefore, through this decision, we are announcing that, over the next 15 months, we will initiate and complete a proceeding that will provide new merger rules. To permit the development of the new rules, and to ensure that the industry has had the opportunity to fully recover from service problems associated with recent mergers without the distractions associated with consideration of additional mergers, we will maintain the status quo by ordering a suspension of all merger activity, categorized as major transactions, until after the final merger rules are issued, or a total period of 15 months.[6]

(Soo Line Railroad Company) is affiliated with CP. A fourth smaller U.S. Class I railroad (The Kansas City Southern Railway Company (KCS)) remains independent but has entered into a comprehensive alliance with CN and IC.

[3] *Canadian National Railway Company, Grand Trunk Western Railroad Incorporated, Illinois Central Railroad Company, Burlington Northern Santa Fe Corporation, and The Burlington Northern and Santa Fe Railway Company—Common Control*, STB Finance Docket No. 33842, Decision Nos. 1 & 1A (STB served Dec. 28, 1999) (published in the *Federal Register* on Jan. 4, 2000, at 65 FR 318).

[4] The merger provisions of 49 U.S.C. 11324 direct the Board to consider the public interest in general and, in particular, the adequacy of transportation to the public; inclusion of other rail carriers in particular mergers; and financial, employee, and competitive issues. The rail transportation policy of 49 U.S.C. 10101, which guides us in our regulatory activities, directs us, among other things, to promote safety, efficiency, good working conditions, an economically sound and competitive rail transportation system, and the needs of the public and the national defense.

[5] We fully understand that our mandate is to protect competition, not particular competitors.

[6] In particular, within 20 days, we will issue an advance notice of proposed rulemaking (ANPR) suggesting areas in which new merger rules can be developed addressing the concerns that have been raised. (We are not in a position to propose specific rules at this time because, while several parties raised broad issues of concern, specific rule changes were not the focus

Background

As indicated, our hearing was triggered by the announcement that BNSF and CN seek to merge. This announcement came as the rail sector and the shipping public have been struggling to recover from the disruptions associated with the most recent round of mergers. Those consolidations regrettably have been accompanied by a number of serious service problems, and, while service levels have shown improvement in certain areas, overall, service is clearly not where it should be. Promised customer benefits have not yet been fully realized, and carrier relationships with customers, rail employees, and local communities have been strained. The performance of railroad stock market equities has been trending downward since the service problems developed in the East, taking a particularly sharp turn downward immediately after the BNSF/CN merger proposal was announced. If it continues, the downturn in the stock value, reflecting a loss of investor confidence, could threaten the capital investment that is needed by the rail industry to ensure that service improvements and growth can be sustained.

BNSF and CN have argued that their consolidation proposal should be examined on its own merits now, because it is a good one that will produce benefits for the shipping public. But regardless of the merits of the BNSF/CN proposal standing alone, many parties expressed concern that, if the BNSF/CN proceeding goes forward, that proposal will not go forward alone. Indeed, the Class I railroads have clearly stated that they would find it necessary to respond in kind, and there is a substantial possibility that, absent decisive action on our part, in the very near future, we will likely be left with the prospect of only two large railroads serving North America. We at the Board, like members of the shipping public, are seriously concerned about the competitive consequences of this level of industry restructuring, and, in any event, about whether it would be in the public interest at this time, while the industry is still recovering from service difficulties and other disruptions associated with the last round of major rail consolidations. And so we held a hearing to help us address the important issues relating to major rail consolidations and the present and future structure of the North American railroad industry.

At the hearing, several significant themes kept recurring. We heard from Members of Congress, federal and state government agencies, shippers, and employees about poor service; the threat that another round of proposed mergers would further degrade service; and the need to let some time pass so that railroads, their employees, and their customers can catch their breath before the industry embarks upon what will likely be the final round of mergers. We heard from shippers and Members of Congress about the threat that another round of mergers would pose to competition in the industry, and we heard from a significant number of participants about the need for new rules to govern future mergers. We heard from Department of Transportation Secretary Rodney Slater that the BNSF/CN transaction should not be reviewed under a "business as usual" approach. And we heard from railroads and from members of the financial community about the financial instability of the industry, which could be further threatened by a new round of major mergers. We will discuss each of those issues.

The Testimony

1. *Service Instability*. Rail mergers are pursued to increase efficiency and to improve service. At least at the beginning, however, service disruptions have accompanied the implementation of recent large mergers, and many shippers have experienced substantial adverse impacts in connection with the last round of mergers, beginning with the combination of the BN and SF systems, proceeding with the UP acquisition of the Southern Pacific (SP) system, and ending with the acquisition and division of Conrail by CSX and NS.[7] The overwhelming testimony at our hearing indicated that the shipping public has still not recovered from those disruptions. Shippers described the problems that they faced, and that many continue to face, as a result of their inability to obtain reliable service. Railroad chief executive officers (CEOs) involved in the last round of mergers testified how difficult merger implementation can be, even with the best planning and with the experiences of prior mergers to guide them. Small railroads testified that their ability to participate in the transportation business has been threatened by poor service. A senior rail equity

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of our hearing.) We will provide a total of approximately 60 days for comments and replies to the ANPR, and then, within an additional 120 days, we will issue a notice of proposed rulemaking (NPR). We will provide a total of 100 days for comments, replies, and rebuttal with respect to the NPR, and then, within an additional 150 days, we will issue final rules (a total of approximately 15 months from now).

[7] We have also recently approved CN's application to control IC, but that transaction, which is largely end-to-end, has not yet been fully implemented.

research analyst whose firm is not representing any railroad in the newly initiated round of rail merger negotiations reported on a survey that he had conducted of large institutional investors that he advises. He testified that poor service is partially responsible for the lack of investor confidence in the railroad industry, and that many investors do not want further mergers at this time, nor do they want the legislative changes (which they view as reregulation) that they fear further mergers will precipitate.[8] And the regular service performance reports provided by the railroad industry indicate that, while service is improving on some fronts, overall, it is still below where it needs to be.

That is why many of the shippers testifying—both large and small—asked us not to permit any further mergers at this time, and certainly not without a change in the way in which we evaluate mergers. Similar sentiments were expressed by Members of Congress, representatives of small railroads, and representatives of railroad employees.[9] Even the CEOs of the large eastern railroads stated that initiation of a new round of mergers would require them to focus on structural and management changes necessary to protect their own positions in the market, rather than on improving their below-par service. In short, in light of the service issues attending prior mergers and looming over future mergers, we heard widespread concern that any major consolidations at this time would not be in the national interest.

2. *Competitive Issues*. For several years, parties involved with the railroad industry have engaged in debate over competitive issues. Many shippers are of the view that prior consolidations have left large railroads with too much market power, and they seek various remedies to "level the playing field." In our hearing, there were repeated expressions—even from shippers with substantial market power, such as United Parcel Service and General Motors—of the view that the rail industry is becoming too concentrated.

Various remedies were suggested to address this concern about concentration. Some shippers asked us to revisit the issues that we studied in-depth 2 years ago in our proceeding in *Review of Rail Access and Competition Issues*, STB Ex Parte No. 575. They would like us to change the rules in a variety of ways so as to promote more rail-to-rail competition throughout the industry. But short of a complete overhaul of the existing regulatory system (which the financial analysts and economists testifying at the hearing suggested could introduce an additional level of uncertainty and risk into the industry, thereby harming shippers by lowering aggregate rail investment below those levels necessary for railroads to maintain and improve service), a significant number of shippers stated that we need to adopt new merger rules to ensure that competition will not be curtailed further in the event that the industry seeks to merge itself into a duopoly.

3. *New Merger Rules*. Thus, for a variety of reasons—some related to service, some related to competition, and some, such as those expressed by Transportation Secretary Slater and representatives of rail employees, related to safety—there was substantial support at our hearing for a broad review of and revision to the rules governing major rail mergers. We agree.

Our existing merger policy guidelines were adopted by the Interstate Commerce Commission soon after passage of the Staggers Act of 1980. At that time, good government required a merger policy that, while recognizing the importance of competition, would encourage railroads to formulate proposals that would help rationalize excess capacity in the industry.

The goals of that merger policy have largely been achieved. It does not appear that there are significant public interest benefits to be realized from further

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[8] Representatives of investment firms that are advising the applicants in the BNSF/CN proceeding (who also do not want what they describe as reregulation) pointed out that there is no way to know definitively what is driving rail stock prices downward, and that the drop in rail stock prices could simply be related to many of the same factors that are depressing the stocks of companies in other "old economy" industries. We do not doubt that the drop in rail stock prices is attributable to many sources, but it is clear that the current service disruptions and the announcement of the proposed BNSF/CN transaction have played a role. We believe that the potential for further disruption that would accompany the initiation of a final round of mergers at this time concern investors, who do not currently view railroad mergers as a positive because, overall, these mergers have not yet produced the good financial results that were promised.

[9] Clinton Miller, testifying on behalf of the United Transportation Union (the largest railroad union), alluded to both employee dislocations and service disruptions in support of his request for a hold on further mergers. Mark Filipovic of the International Association of Machinists expressed the view that recent mergers did not produce what was promised for railroads, shippers, or employees. Michael Wolly, representing three unions, requested a hold on further mergers until the issues associated with employee dislocations are resolved. And a number of the representatives of rail employees expressed concern about the fact that, under the BNSF/CN proposal, a major U.S. railroad would become foreign-controlled.

downsizing or rationalizing of rail route systems, as there is little of that activity left to do. Looking forward, the key problem faced by railroads—how to improve profitability through enhancing the service provided to their customers—is linked to adding to insufficient infrastructure, not to eliminating excess capacity.

The testimony convinces us that our rules need to be reexamined. Given the current transportation environment, and with the prospect of a transportation system composed of as few as two transcontinental railroads, we may wish to revisit our approach to competitive issues such as the "one-lump theory" and the "three-to-two" question; downstream effects; the important role of smaller railroads in the rail network; service performance issues; how we should look at the types of benefits to be considered in the balancing test, and how we monitor benefits; how we should view alternatives to merger, such as alliances; employee issues such as "cramdown;" and the international trade and foreign control issues that would be raised by any CN or CP proposal to combine with any large U.S. railroad. As Transportation Secretary Slater pointed out, the sheer size of these potential new mergers poses unique risks and leaves no margin for error: if these mergers were to fail, or lead to service problems, the effects could be devastating for both the rail industry and the shippers that depend on rail service. We must be sure that our merger review process takes these risks into account.

Discussion and Conclusions

Accordingly, we have concluded that we must revisit our merger rules, and that in the meantime we must maintain the status quo by directing large railroads to suspend merger activity pending the development of new rules. We understand those parties that argue that each case should be viewed on its own merits without regard to the prospect of future consolidation, but we cannot close our eyes to the fact that the mere consideration of any major merger now would likely generate responsive proposals that, if approved, could result in a North American duopoly.[10] Before proceeding down that path, we must make sure that we have the appropriate guidelines in place to assure that we can properly assess and fully protect the public interest in each individual case.

In their oral testimony, the CEOs of BNSF and CN recognized the argument that certain new requirements may need to be imposed on future merger proposals, but nevertheless urged us to proceed with consideration of their merger proposal now, developing any new requirements in the context of their application proceeding. We realize that administrative agencies can choose to develop new rules either by rulemaking or in individual adjudications, but in choosing which course to take, we consider what makes sense. Here, it simply makes no sense to attempt to develop new merger rules in the middle of what could likely be the final round of major railroad mergers.[11] New merger rules will be a major undertaking, and we will not know what the rules will look like until the process is over. Yet, under the BNSF/CN approach, we could be reviewing merger proposals involving at least four, and possibly all six, of the large North American railroads before we have had an opportunity to reexamine and reformulate our merger policy. The evidentiary filings in such cases are massive, and yet none of the parties would know what they would be expected to show until new rules are formulated. And then, at the end, once the rules are known, it is not only possible, but quite likely, that the merger process would have to start all over again. Thus, while BNSF and CN may see some benefit to themselves from such a procedure, the process would be inherently uncertain, could lead to substantial instability in the industry, and thus does not represent good government.

There are very serious risks associated with proceeding with individual merger proposals at this time, before we have new rules in place. The disruption that has

[10]The CEOs for BNSF and CN have stated that there is no reason why their merger should necessarily instigate any responsive action by any other railroad. But recent history shows otherwise; indeed, the UP takeover of the SP was a response to the BNSF merger. And CEOs of the other major railroads have stated that they would look to future mergers of their own as strategic responses to the BNSF/CN transaction. Indeed, Richard Davidson, CEO of UP, stated that his company strongly considered a merger with CP as a response to the recent CN takeover of the IC, but ultimately concluded that it would be better off focusing on issues other than mergers under the circumstances prevailing at that time. Given the size of the BNSF/CN transaction, we have no reason to doubt the assertions of the CEOs of the major railroads that if it goes forward, they would have no choice but to seek their own merger partners, and that in a short time, we could be faced with the prospect of a North American duopoly.

[11]We should note that the representatives of the Departments of Agriculture and Defense expressed the view that we should permit no major mergers at this time. Moreover, Transportation Secretary Slater urged us to make numerous and potentially complex changes to our merger rules that, if they are to be applied evenly to all future mergers, could not be practically effected in the middle of individual merger proceedings.

beset the railroad industry in connection with the last round of mergers could reach unprecedented levels. Carriers whose management should be focused on fixing their service problems would instead be fixated on finding merger partners, defending their proposals, and responding in the regulatory arena to other carriers' proposals. Investors, who have forsaken the railroad industry in favor of businesses that they have come to believe may have more favorable future prospects, could devalue the industry further. And railroads could find it more difficult to finance the capital improvements necessary to provide the better service that is key to their financial revitalization. In short, the already fragile rail industry could be further destabilized.

We understand BNSF/CN's view that holding up their merger application proceeding would itself be viewed negatively by the financial markets as creating uncertainty. We disagree, as we do not see how anything could be more uncertain than moving forward without appropriate rules in place at the beginning to govern the proceeding, particularly at a time when uncertainty already surrounds the rail sector. Furthermore, investors have come to view rail mergers in a less than positive financial light, and we can see proceeding with the BNSF/CN proposal at this time as only adding to that negative environment. In this regard, we should note that there is clearly sentiment within the financial community—from those analysts who closely followed our hearing—that a delay in merger activity, while new rules are developed, would tend to reduce uncertainty for rail investors, help to stabilize rail financial markets, and provide an impetus for increasing rail share prices.[12]

Notwithstanding the serious potential public harms that could result from going forward, BNSF and CN argue that they will suffer if consideration of their merger proposal is delayed.[13] Unless they expect to escape the new rules that will apply to everyone else, however, and to hold other mergers at bay until their own is completed, we do not see how their transaction will not be adversely affected by the disruption that it would produce throughout the industry. BNSF and CN suggest that it is not fair to "penalize" them for the failures of others.[14] But our action here addresses industrywide concerns that involve all railroads (including BNSF and CN), and in any event, should not in any way be construed to be punitive.

Under 49 U.S.C. 11324, we must consider the public interest in addressing rail mergers, taking into account, at a minimum, adequacy of transportation to the public; including other rail carriers in the area involved; competitive effects; financial impacts on the involved carriers; and impacts on employees. In addition, the rail transportation policy set out in 49 U.S.C. 10101 directs us, among other things, to promote safety, efficiency, good working conditions, an economically sound and com-

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[12] For example, a Credit Suisse First Boston Corporation rail stock analyst, in a March 6, 2000 note to investors, stated that our hearing might "provide some upside for the stocks if it appears that the risk of industry consolidation will be pushed further into the future by the Surface Transportation Board." Another analyst, from ING Barings, in a March 14, 2000 note to investors, predicted that the Board would impose a merger moratorium, and that, as a result, "the industry is full of many buying opportunities," including the shares of BNSF. A March 13, 2000 report by a J.P. Morgan analyst expressed the view that "rail stocks would react positively to" what the analyst believed was a likely "mid-term" (up to 2 years) hold on further mergers. A Donaldson, Lufkin, and Jenrette rail analyst, in a March 14, 2000 note to investors, explained that rampant pessimism has resulted in rail securities that "are selling at near recessionary levels. It is a reversal of some of this pressure that is exactly what we'd expect if we are allowed to gain some sense of the regulatory and structural outlook for the industry as a result of last week's STB hearings." A Morgan Stanley Dean Witter stock analyst, in a March 8, 2000 note to investors, suggested that a decision by the Board to delay the merger process would remove some near-term uncertainty and lead to near-term strength in a number of railroad stock prices, including those of BNSF and CN. Finally, the Chairman and CEO of Wasserstein, Parella & Co., in a March 10, 2000 letter to Chairman Morgan, explained that his firm "feels strongly that allowing the proposed merger to proceed would place the entire industry in jeopardy," since "the specter of another round of rail mergers [at this time], which Wall Street is convinced this transaction will precipitate, will accelerate the flight of capital" from the industry. He concludes that the prospect of moving forward with the BN/CN transaction at this time "is a serious threat to the industry's financial health, well being and long-term prospects."

[13] BNSF and CN also argue that delay will defer the public benefits, such as new single-line service, associated with their merger. But there are various alternatives to merger that can approximate those benefits. Indeed, CN and its partner IC currently participate in an alliance with KCS, a smaller Class I carrier, that provides all parties many of the benefits of a merger. We note that both General Motors and United Parcel Service (two of the largest customers of CN and BNSF), which would presumably reap the largest benefit from the new single-line service these railroads promise, have testified in no uncertain terms that they do not want a merger to go forward at this time, as has KCS, whose CEO stated that the carrier would not survive as an independent carrier if the BNSF/CN proposal is implemented.

[14] We note that the BNSF merger, which was characterized by many, when it was initially proposed, as a manageable "end-to-end" merger, had its own share of integration problems, and there was some testimony at the hearing concerning service issues on the CN/IC system, which has not yet been fully integrated.

petitive rail transportation system, and the needs of the public and the national defense. For the reasons we have discussed, we believe that we can best advance all of these objectives by promptly initiating a rulemaking proceeding to adopt new rules, as appropriate, and providing a short period for parties to adjust to the new rules before proceeding with merger proposals. This approach should provide a degree of stability for what is now a very fragile industry and permit vital public interest issues to be addressed on an evenhanded basis for all merger proposals. To go forward with any individual merger proceeding in the meantime would be unfair to customers, carriers, employees, and affected communities, and would disrupt and distract the industry to the detriment of all of the public interest concerns that we are charged with advancing.

We recognize that our action here is unprecedented. But these are not ordinary circumstances, and we see no way of adequately protecting the public interest short of the steps we have outlined here. Congress has directed us to take such actions as are necessary to carry out our statutory mandate, 49 U.S.C. 721(a), and has expressly authorized us to take injunctive-type action to prevent irreparable harm, 49 U.S.C. 721(b)(4).[15] After considering all of the circumstances, as elucidated through our extensive hearings, we find that changes in our merger regulations are necessary now and that no major rail merger proposals should be filed, or will be considered, until new merger rules have been established.[16]

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. Class I railroads are directed to suspend activity relating to any railroad transaction that would be categorized as a major transaction under 49 CFR 1180.2, pending development of new rules by the Board, as outlined in this decision. No filings relating to such a transaction will be accepted for 15 months.
2. This decision is effective on the date of service.

By the Board, Chairman Morgan, Vice Chairman Burkes, and Commissioner Clyburn. Chairman Morgan, Vice Chairman Burkes, and Commissioner Clyburn commented with separate expressions.

VERNON A. WILLIAMS,
Secretary.

Chairman Morgan, commenting:

This decision has been one of the most difficult ones that I have had to make since becoming a member of the Surface Transportation Board and the Interstate Commerce Commission before it. The Board's action here directing the suspension of all rail merger activity for a period of time is particularly difficult for me because, as my record demonstrates, I do not believe that the government should intervene into free market processes without a very good reason for doing so. And I also believe that parties should get fair and expeditious consideration of matters brought to the Board. But the current problems facing the rail sector are so extraordinary that an unprecedented response is necessary. Given the financial and service instability that exists in the rail sector as a result of the most recent round of major railroad consolidations, I cannot in good conscience allow further actions to occur that I believe would run the risk of creating more disruption and instability to the clear permanent detriment of the Nation's transportation system, rail employees, rail customers, and communities across the country.

In this regard, once I decided that a time-out from mergers was necessary, I proposed a 2-year waiting period before merger applications could be filed. I firmly believe that a period of that length is necessary to accomplish all of the goals set forth in the Board's decision. A lesser time, in my opinion, will simply block the BNSF/CN proposal without fully achieving the immediate and lasting stability for which I am striving by taking this unprecedented action. Nevertheless, although a 2-year

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[15] The legislative history accompanying section 721(b)(4) explains that the provision "explicitly authorizes the [Board] to issue unilateral emergency injunctive orders to prevent irreparable harm. This power has been asserted and used by the [Interstate Commerce Commission] in the past, although not specifically granted by statute. The Committee intends to confirm the scope of the former ICC power in this regard. . . ." H.R. Rep. No. 311, 104th Cong., 1st Sess. 124 (1995).

[16] Accordingly, for the reasons expressed herein, we hereby suspend the "Notice of Intent to File" filed in *Canadian National Railway Company, Grand Trunk Western Railroad Incorporated, Illinois Central Railroad Company, Burlington Northern Santa Fe Corporation, and The Burlington Northern and Santa Fe Railway Company—Common Control*, STB Finance Docket No. 33842, until such time as new merger rules have been promulgated and the period set forth in this Decision has expired.

period would do more to allow a thorough reexamination of our merger rules and would permit the rail sector to adapt to those rules and achieve a firm level of stability before processing any more major rail consolidation proposals, overall our action here is clearly on the right track.

While certain interests have favored moving forward with the proposed BNSF/CN transaction when filed, many others have been opposed to moving forward with any further consolidation at this time, and certainly not until our merger rules are revisited. In balancing all of these concerns in determining what action would be in the greater public interest here, I have focused on the long-term, as well as short-term, effects of our actions, and on my concern about what would be for the greater good of all railroads, rail customers, rail employees and communities across the country. In view of the instability in the rail sector, the great risk of further harm from continued instability and disruption, and the need to promote the greater public good, it is my strong belief that processing mergers at this time and for a significant period thereafter would not be in the public interest.

Vice Chairman Burkes, commenting:

This decision sets in motion a 15-month rulemaking proceeding to reevaluate the Board's merger guidelines and imposes a suspension on all major merger activity during this period. This upcoming proceeding will be extremely important. Much has changed in the railroad industry in the nearly twenty years since the majority of our current rules were established. I believe that it is long past time to step back and revisit those standards.

The BNSF/CN merger announcement may have triggered this proceeding, but it is long since overdue. However, it is unfortunate that it was not held prior to their announcement. Consequently, in addition to substantive merger rules issues, the application and timing of a rulemaking proceeding have also become issues.

In this proceeding, we have established a 15-month period to develop new merger rules. Although this is almost double the period of time associated with the Board's last two major rulemaking proceedings (Ex Parte Nos. 627 and 628), the issues here are significant and complex and will require additional time. Although this proceeding could be completed in a much shorter time period, 15 months should be more than adequate for a thorough review of our merger rules.

Several parties have argued for a longer suspension period or moratorium, i.e., two or more years. I believe this would be much too long of a period of time. After we have issued our final merger rules, there would be a minimum of an additional year before any additional major railroad mergers could be approved. Moreover, the evidence indicates that railroad service has started to improve after the disruptions resulting from the past mergers and it is clear that those problems started long before the BNSF/CN announcement. In addition, a longer period could add to uncertainty for shippers who are considering building or relocating facilities or planning to enter into long term contracts.

In terms of application, I believe that the new railroad merger guidelines should apply to the proposed BNSF/CN merger and all future major railroad mergers. I also believe that, in fairness to BNSF and CN, and to all parties, it is important to resolve these issues in a timely manner.

Commissioner Clyburn, commenting:

I stated in my opening remarks to Ex Parte 582 that this proceeding could be a defining moment concerning rail consolidation issues. Four full days of listening intently to comments from all sectors of the rail industry has only strengthened this belief. We have heard testimony from large railroads, small railroads, large and small shippers of all types of commodities, rail labor, economists, government agencies and Members of Congress. While diverse ideas regarding how the Board should address future consolidations emerged from the testimony, it was abundantly clear, however, that the time has come for a thorough review of the Board's current merger rules. Some did suggest that we proceed with future consolidation utilizing the same regulatory framework that currently exists, while some others have suggested that we "take a breath" and impose a moratorium on filing merger applications for two years, three years, or an indefinite period of time.

It is clear to me that the rail industry has changed dramatically within the past twenty years since the passage of the Staggers Rail Act of 1980. Rail consolidations have created a new paradigm in which we must now operate. Therefore, I support the Board's decision to institute the 15 month rulemaking process to revise our merger rules and suspend major merger transactions during this time. Others have called for longer periods of time to attempt to address uncertainties—real, perceived, or otherwise. However, my support of the 15 month suspension is based solely on what I believe to be an appropriate time frame in which the Board Members and

staff can address, appropriately, the plethora of complex issues the industry currently faces without unnecessarily suspending merger applications. I believe our approach is a reasonable one.

Ms. MORGAN. I will now make a few brief comments about the March 17th decision before I take questions.

That decision follows 4 days of hearings beginning on March 7th, with over 150 witnesses from all segments of the rail sector and from various branches of government. It focused on the issue of major rail consolidations.

The decision found that the rail industry is poised to move toward the final phase of consolidation. We concluded that the current merger rules are not appropriate, given the level of concentration that is likely to result if the next round of mergers is carried out.

For that reason, and because a new round of mergers at this time will aggravate the difficulties that the industry is already having in connection with the last round of mergers, the decision suspends for 15 months the filing of major rail consolidation proposals pending a reexamination of our rail merger rules.

The Board has pending before it two petitions to stay this decision, and the decision has been appealed by three parties to the U.S. Court of Appeals, D.C. Circuit. The Board is working on an advance notice of proposed rulemaking regarding changes to our rail merger rules, which will be issued by April 6th.

The decision itself is quite clear and speaks for itself, and I am proud of that decision. It would not be appropriate for me to engage in extensive dialog about it, given the suits in court and the fact that there are matters in deliberation at the Board pertaining to the decision. However, there are a few comments I wish to make about the decision.

First, there are those who argue that what we did by suspending merger activity was extreme and unnecessary. The Board's action was unprecedented, but bold action was necessary given the extraordinary circumstances presented to the Board and the decision lays that out in detail.

Secondly, there are those who question the Board's authority to have done what it did by suspending merger filings while the merger rules are being examined. In response, what I would say is that the Board believes very strongly that it has the authority to do what it did, and the decision is clear on that point.

Thirdly, there are those who argue that we should have handled the BNSF/CN merger while we reexamined our merger rules. The Board believes that it made no sense to consider new merger rules while considering what could be the final round of major rail consolidation. The Board also believes that the risk of creating more instability in an already unstable rail sector was too great. The decision lays all this out in detail.

Fourth, there are those who have argued that the decision was issued to protect railroads from competition. Our decision was clearly made to protect the broader public interest. The decision lays that out clearly.

As the decision clearly points out, the totality of the record compiled focused on clear concerns about the state of rail service and competition today, and about the negative impact of further con-

solidation on service and competition. The Board's March 17th decision responds to those concerns in a responsible, forceful, and appropriate manner.

The Board strongly believes that the greater public interest is served by a suspension of merger filings for 15 months pending reexamination of our rules.

In closing, let me say that I did not want to have to make this decision, and my commenting opinion clearly reflects the difficulty in making it. But in my 6 years at the Board and the ICC, we have been faced again and again with new challenges and we have always stepped up to the plate and done what was necessary.

I am proud to say that we met the challenge here and acted responsibly here. I am not sure how much I will be able to say today, but I am happy to answer any questions that you might have.

Senator HUTCHISON. Thank you, Chairman Morgan.

Before I start, the Majority Leader would like to make a statement or ask a question.

STATEMENT OF HON. TRENT LOTT,
U.S. SENATOR FROM MISSISSIPPI

Senator LOTT. Thank you, Madam Chairman. I wanted to give our friend and a person that's very familiar with this room an opportunity to make her statement first, and to hear from other Senators briefly. But I want to thank you again for having this hearing and I want to thank the members of the Board for being here today and for the important work that you do.

I certainly believe that deregulation of the railroad industry in 1980 turned the industry around. It went from a patchwork of undercapitalized, inefficient small railroads to a strong network of robust railroads in the space of a dozen years or so. More recently, though, I have become concerned that as the railroads become larger, the mergers become more complex and difficult.

In the short term, it appears to me that the mergers have drained the financial resources of the railroads and, as others have already noted, they have eroded service gains and efficiencies at various points in the railroads' service system.

I am concerned that the industry as a whole needs to be cautious in proceeding to the next round of mergers, certainly in the near term. The railroads have lost traffic during this post-merger service period due to breakdowns, and remaining customers have borne the brunt of some of the problems that have come from this.

Now, I think the situation is going to sort itself out as the railroads digest the previous mergers over the past 5 years. I certainly don't believe that we need to permanently end mergers; I have always felt that on a general basis, if mergers make good business sense, generally speaking, the government should be cautious about intervening.

But I do think we have to look at it broadly. I take railroad issues very seriously from both a national perspective as well as a Mississippi perspective, and the railroad industry is very important in my state.

So as the Board considers the narrow benefits to the requesting parties of the next proposed merger, I think that they certainly must also consider the probable response of the rest of the industry

and its overall impact on the industry and, very importantly, on its customers.

That is why I joined several members of this committee in commending the Board for its December decision to take a broader perspective on the effects of the railroad mergers when reviewing future mergers; and that's why I support the Board's recent decision on the moratorium. I believe the unanimous decision by all the members was the correct one, and I compliment you for your thoughtful approach to a difficult issue.

On the overall STB reorganization issue, I have cosponsored Senator McCain's bill. I think we need to be careful about rushing to a legislative solution to what can probably be handled by the industry itself and by the efforts of the Board. But I know the chairman of this Subcommittee is very interested in this area and has some proposals she would like for us to consider. I have the utmost respect for her, and quite often problems in her state are similar to the problems in my own state. I look forward to working with the Board in the future and with this committee to encourage the health of this industry and ensure that we maintain strong commercial railroad and Amtrak service in this country.

Thank you, Madam Chairman, for allowing me to enter these remarks in the record. I do have a very brief statement I'd like to be included in the record in its entirety at this point.

Senator HUTCHISON. Without objection.

[The prepared statement of Senator Lott follows:]

PREPARED STATEMENT OF HON. TRENT LOTT, U.S. SENATOR FROM MISSISSIPPI

Good morning. I'd like to thank Chairman Hutchison for chairing this hearing and Chairman Morgan for appearing before the Committee to discuss the Surface Transportation Board's recent decision.

I believe the deregulation of the railroad industry in 1980 turned that industry around. It went from a patchwork of undercapitalized, inefficient, small railroads to a strong network of robust railroads in the space of a dozen years or so.

More recently though, I've become concerned that, as the railroads became larger, the mergers became more complex and difficult to execute. In the short term, this has drained the financial resources of the railroads and eroded the service gains and efficiencies they built up through previous mergers. I am concerned that the industry as a whole is not healthy enough to undertake another round of mergers in the near term. The railroads lost traffic and their remaining customers were stressed by rail service breakdowns as a result of the past several mergers.

Now, I believe this situation will sort itself out as the railroads digest their mergers of the past five years. I certainly don't believe we need to permanently end further railroad mergers. I don't take Government intervention in the marketplace lightly, but I take railroad issues very seriously from both a national perspective and a Mississippi perspective. I believe the industry has now reached the stage where, as the Board considers the narrow benefits to the requesting parties of future proposed mergers, it also must consider the probable response by the rest of the industry, and the overall impact on the industry and its customers.

That is why I joined several of my Commerce Committee colleagues in commending the Board for its December decision to take a broader perspective on the effects of railroad mergers when reviewing future mergers. That is why I support the Board's recent decision to impose a 15-month moratorium. I believe the unanimous decision by the Board was the correct one. I complement the Board for its thoughtful approach to a difficult issue.

I cosponsored Chairman McCain's straightforward STB reauthorization bill because I saw the rush to legislate specific service improvements as short-sighted. The railroad industry should be given time to fix its service problems. I believe the Board's moratorium will help in this regard. Legislating prescriptive service requirements would only reduce the industry's ability to fix its service problems on its own and impose inefficiencies and unnecessary costs throughout the railroad system.

I thank Chairman Hutchison, again, for her interest in this Nation's rail service concerns. I look forward to working with her to address these concerns. Also, I thank Chairman Morgan for her continued good stewardship of the Surface Transportation Board and willingness to discuss this issue with us today.

Senator HUTCHISON. I want to thank the Leader for the statement and say that I think that the important thing here is balance. We wall want to have healthy railroads, because having heavy railroads creates competition in transportation.

I also think we need to protect competition in the railroads to make sure that the shippers are not gouged in the future. So I think a balance is what is needed, and I hope that the Leader will work with us to make sure that Congress has set the guidelines to keep competition as a factor in any future mergers.

Senator LOTT. That's why I added that last "but I look forward to working with the Subcommittee chairman," because I know her views and I share a lot of her concerns and desires to make sure that the service to the customers is also considered in this whole process.

Senator HUTCHISON. Thank you. Thank you for attending.

I would like to start the questioning, Ms. Morgan.

Senator DORGAN. Madam Chairman, I wonder if I might make just a very brief statement.

Senator HUTCHISON. Yes, I'd be happy for you to make a statement, and then we will go to the Senators in the order in which they arrived.

Senator DORGAN. Thank you, and I'll be mercifully brief.

Senator HUTCHISON. That would be merciful.

Senator DORGAN. That was my intention. Thank you.

Let me say that I think the action by the Board was bold and it was action that I supported; and as you heard from the Majority Leader, there seems to be wide support for the action; and perhaps for different reasons, but nonetheless wide support. We have had our differences, I have had my differences with the Surface Transportation Board but this is an action that is supportable; and I think incidentally it's my impression and it's not of great note that I think you have the authority to do this, and I have every expectation you will prevail in court.

The period of time during which this moratorium will be in place, however, should not be viewed by anyone as a period in time in which some of us will go away; we fully intend to continue to push on these other issues.

It is true that we all want a healthy rail industry in this country. This country needs a healthy rail industry. It is also true that we need fairness for shippers. And frankly, I would say to the Majority Leader, there is not a lot of room left for mergers, you know; we are about merged out in this industry.

I don't know how many additional mergers could be accommodated in any event, without obliterating virtually every semblance of competition that exists; and our market system works only when there are competitive elements and of course monopolies produce monopoly pricing which injures shippers.

This is a long, steady circle that all of us continue to move in; but I did just want to say that I want to work with the Subcommittee chairman, with the chairman of the full committee, and

the Majority Leader and others, and I want to work with my friends who have joined in cosponsoring the Rail Shipper Protection Act. We have people on both sides of the aisle here in this committee, and it's our intention even during this moratorium, to continue to push that legislation. We hope very much we get a hearing on it and be able to have a vote and move that legislation, even during this moratorium.

The moratorium itself, of course, deals with the question of conditions under which future mergers might be evaluated. But again, let me finish by saying I don't—there's not much room for additional mergers in this industry; this industry has gone from forty-some Class I railroads to about seven or eight, and there's not much room left for additional mergers.

Thank you, Madam Chairman, for your courtesy.

Senator HUTCHISON. Thank you, Senator.

Chairman Morgan, I want to start with the basic decision to impose the moratorium. What was your legal authority for imposing the moratorium and how will you make sure that there is a fairness to all sides in the handling of this merger? What are the potential factors that will be considered for future mergers.

I ask that because I am well aware of the problems with the most recent merger. Clearly this hurt all of our states, and I think the caution is certainly justified. On the other hand, now we have all of the other railroads coming in and asking for the moratorium, and I want to make sure that we are playing fair with everyone.

Ms. MORGAN. First of all, let me say that all of the questions that you are asking will be extensively litigated, and so I will try to present my case in such a way that I will be able to win this case on appeal as we go forward.

First of all, let me say with respect to our authority, on page 10 of the decision we discussed that; we believe we have authority under a section of the statute that allows us to provide injunctive-type relief, where there is irreparable harm. The decision goes into great detail as to what we consider in this case to be irreparable harm; and we felt very strongly that given our authority to promote the public interest as it relates to rail mergers and the rail sector in general, that we did have the authority to institute a suspension of merger filings for 15 months.

Now with respect to fairness, clearly that is always an element in any decision that the Board makes, and we were presented with a situation in which we had a hearing record that clearly raised many concerns about future consolidation and the impact that it would have on service and competition. We were presented with a record in which people very clearly wanted new merger rules before we move forward, as we move forward. At the same time we had notification that there could be a filing regarding another merger proposal.

The question I think you are asking is why did we suspend merger activity in order to do our reexamination of merger rules? And the Board felt very strongly that it would not make sense to proceed ahead with what could be the final found of rail consolidation before you had rules in place. And that furthermore, processing what could be the final round of consolidation while you were working on new rail merger standards also did not make sense; and fur-

thermore, the instability that could be created by processing rules and processing what could be the final round of rail mergers was not a risk that we wanted to undertake, given the instability that already existed in the rail sector.

Senator HUTCHISON. Let me just followup quickly and ask, why 15 months? Is that absolutely necessary before you take up the pending merger? Do you need to have that long a time to set the standards?

Ms. MORGAN. Again, I can assure you that the time period of 15 months will be litigated quite heavily. I myself was in favor of a 2-year moratorium as opposed to a 15 months' suspension. The consensus on the Board, however, was 15 months, which was the time that all three of us agreed would allow us to do merger rules. We also agreed that a suspension of merger activity, as I indicated previously, would be appropriate while we were processing our examination of new merger rules.

Senator HUTCHISON. Last question on this round. What guidance do you think you need from Congress, or do you think you have enough authority to set a different standard?

Ms. MORGAN. What I would say to that is that I believe we have the authority to do what we have done here, very clearly. I believe we have the authority to proceed ahead with a reexamination of our merger rules. Whatever we ultimately decide in that proceeding, we will feel confident that we have the authority to decide. That will be taken to court, and if a court decides that we didn't have the authority to do what we did, then we'll have a different situation.

But at this point we are proceeding along, using the authority that we have, and feel very strongly that we have that authority, and we will continue to use the authority we have as we move ahead.

Senator HUTCHISON. But do you think you have the authority to factor in competition, for instance, without congressional action?

Ms. MORGAN. Well, that clearly will be part of the examination of our merger rules. When we put out our advance notice of proposed rulemaking by April 6th, in that will be discussions about various issues that were presented to us during our 4 days of hearings, and we will put that out for comment and I'm sure that issue will be one of those issues discussed, and we will take the comments and see where we go from there.

Senator HUTCHISON. Senator Lott?

Senator LOTT. I will pass.

Senator HUTCHISON. Senator Rockefeller.

Senator ROCKEFELLER. Chairman Morgan, as you know when Senator Dorgan and I testified before, at the marathon 4 day procedure you had to go through, I pulled out a thick book with my usual massive orange-yellow-green-red-pink-purple underlinings that I had done for exactly this same subject in 1987, and none of the issues had changed. I could have used that briefing book for any current discussions.

I read partly to you a letter that I wrote then to Chairman Heather Gradison of the ICC, and two of the specific requests in that letter were for the ICC at that time to quote, "assure that captive shipper rate reasonables process is not so complex, costly and

time-consuming in that it fails to provide protection intended by Congress and assure the commission is discharging its responsibility to preserve and provide competitive railroad transportation alternatives."

I am just curious, and I want to phrase this in a way that you can answer it: Not based upon your future judgment, but based upon what you heard at these 4 days of hearing from 150 people.

How would you characterize the current level of competition among Class I railroads? As being sufficient, too little, too much? No. 1. Did you hear from witnesses what they think is the appropriate number of Class I railroads for North America to ensure competition, financial health, and/or efficient railroad transportation?

Ms. MORGAN. Well, let me try to answer that. I have here the transcripts of the 4-days of hearings, and I brought them with me because I wanted people to understand that this was a lot of testimony that you are asking about. I will try to answer your question, but there's a lot in there, and we spent a lot of time looking at each and every piece of testimony that was submitted.

The second point I want to make before answering your question is that these hearings were on major rail consolidations. So in terms of broader issues outside of the issue of rail consolidations, there is testimony in there, but that was certainly not the focus of the hearing.

With respect to the testimony we received, I think a couple of things came out of it which we reflect in our decision here; and that is a concern about service and about competition, and particularly as we move forward, grave concerns about service and competition. That is why this decision was issued, to reflect the concerns that had been raised and the care and the caution that was advised as we move forward.

Senator ROCKEFELLER. Was that based upon the fact of mergers in and of themselves? What they do to competition, to bottlenecks, to whatever; or were some of those comments coming from people who were simply complaining about the state of the situation, as I am.

Ms. MORGAN. Well again, I think the focus of the hearing was on mergers, and where we are as far as mergers. So the comments focused on how people felt about mergers to date and how people felt about mergers going forward.

Now we did get some testimony that reflected the broader interests——

Senator ROCKEFELLER. That is what I am asking about.

Ms. MORGAN. —and those are obviously some of the individuals that you are reflecting; but that was focused in the context of the discussion of mergers.

Senator ROCKEFELLER. When you say that bottlenecks and that massive, massive problem which is so devastating across America will be a part of your proposed rulemaking considerations I hear that, and of course in the hearing of it it sounds to be good. The question is, how important do you think that is, and to what depth will you take that as a consideration, while you consider mergers and other things?

Ms. MORGAN. Well, again, these issues are under deliberation at the board. We are working on an advance notice of proposed rulemaking that will address the issues that were raised at the hearing.

One of the issues raised at the hearing of course was bottlenecks and how that would be addressed in the context of the review of future mergers. I do not want to avoid your question. It is in deliberation; it will be an issue, it was an issue raised in the hearings. I'm sure that it will be an issue raised as we move along.

How it will be ultimately resolved I cannot tell you because obviously the resolution of these matters will be based on the record that we accumulate as we go from the advance notice of proposed rulemaking to the proposed rulemaking, to the final rules.

Senator ROCKEFELLER. When you hear that, what I said in my opening testimony, that a railroad executive told some chemical companies in West Virginia quite recently that there would be no increase in competition, no change in competition, no move away from captive shipping, no change in pricing absent Federal legislation. Do you find that a surprising statement? Do you find that a true statement? What is your reaction to that?

Ms. MORGAN. Well, I can't speak to the truth of it because I didn't hear it myself, but I presume it was said, so I presume whoever reported it is being truthful. I certainly don't like the tone of that, I'm surprised by it; but I can't say any more than that.

Senator ROCKEFELLER. Thank you, Madam Chairman.

Senator HUTCHISON. Senator Dorgan.

Senator DORGAN. Madam Chairman, I understand there's a vote underway, I think to be followed immediately by a second vote. So let me just ask a brief question in sort of the direction that Senator Rockefeller asked.

Can you give me your subjective evaluation of the state of competition in the railroad industry today in the United States?

Ms. MORGAN. My subjective. Well, we have approved several mergers, as you know; you and I may not have agreed on those——

Senator DORGAN. Did not.

Ms. MORGAN. I certainly did not approve mergers that I felt were anticompetitive. There are those out there who may feel that that's the case, but I as a decisionmaker did not feel that that was the case. Having said that, I believe we are now entering another round, a heightened round, a very serious round that could raise different issues as it relates to competition, and I think the Board has responded to those concerns appropriately.

Senator DORGAN. Is it your feeling that competition is diminished in the last dozen years or so in the railroad industry? In other words, is competition still a healthy, wholesome element in that industry, or is the element of competition diminished in that industry?

Ms. MORGAN. Well, let me answer that two ways. First of all, again with respect to the mergers for which I was responsible, I believe that we did not diminish competition with those mergers. Now you and I will likely disagree on that, but that is what I believe.

Now, having said that, there are shippers who are quote "captive" unquote. There have been captive shippers for a while, and

I think the effort that you all have undertaken is to try to provide some sort of competition for captive shippers.

I do not believe—and again we may disagree on this as well—that the mergers that we approved in the past created captivity. As a matter of fact, we wanted to make sure that service to shippers did not go from two carriers to one carrier. So I do not believe that we created captivity, nor do I believe that those mergers diminished competition.

I think though where you're coming from is there are captive shippers that have been there, that will be there, and is there something we need to do to address that? And I think that's what your legislation effects.

Senator DORGAN. Yes, and also the fact that while there are captive shippers, and that's a fact of life, there is not an effective remedy for them. It's one thing to be a captive shipper; it's quite another thing to have an avenue with which you can use to redress grievances.

But as you know we have not in recent years had a circumstance where a captive shipper can adequately complain and receive some satisfaction from the complaint. In fact, in one of our hearings a year or two ago we talked about the Montana case that took 16 years? Captive shippers are captive with—there's no door out of that room.

That's enough; I don't want to ruin the day here. I came to say that I thought the decision you made was a bold decision.

Ms. MORGAN. That's all right.

Senator DORGAN. But I thought the decision you made was a bold decision, I think it's appropriate. I think a study of mergers and their impact on this country and the rules by which we make judgments about mergers is very important at this point. We have much more to do.

I just want to finally say again, some viewed your decision with elation saying, "Well, that'll stop those folks that want to do a captive shippers bill." That's not the way we view the decision. We still intend to push our legislation here in the Congress even as you proceed with the moratorium. Thank you.

Ms. MORGAN. May I just—and you and I have had dialogs on this in the past, and I and the rest of this committee have had this on three occasions prior to this.

I understand your concern about access to the process for captive shippers, particularly as it relates to rate cases. And I continue to process them, simplify the process as best I can. I communicated to this committee in December 1998 that the small rate cases perhaps could be handled differently, and I would need some sort of authority to handle them differently; and I don't want anyone in the room to think that this is not something I'm sensitive to. I have worked on it as best I can.

Rate cases are complicated, but we have tried to streamline them; shippers have won some rate cases. The 16 year old case is one that I'm sorry had been there 16 years, but when I got to the Commission I did resolve it. And I will continue to try to expedite as best I can.

Senator HUTCHISON. Thank you. I'm going to try to end this so that we can vote and not make you wait for 30 minutes.

I would just like to say first of all that in my STB reauthorization bill, we do deal with the small shippers' complaints and expedite the procedure, which I think would be very helpful. I just hope that Congress will do its part in giving you the legislative authority you need on the key issues that have been raised this morning.

Secondly, I am going to call on the railroad industry and the shipping industry to try to be helpful to Congress in fashioning an STB reauthorization bill that does produce, if not a win-win for both groups, at least a partial win for both groups that would alleviate the necessity for the Board perhaps to have the 15 month moratorium.

Having said that, I want to say to you that you have I think been very deferential to Congress; you have tried in your dealings not to overstep your authority. I think we need to do our part to give clear guidelines, and I would just finish by saying that in my view, what we need is balance. The key word is balance. We need relief for captive shippers, we need competition, and we need a healthy railroad industry.

So those are my goals. I feel like I am an honest broker; in my state I have shippers, I have railroads. I want all of them to thrive and prosper and create new jobs for our country. So that's where I'm coming from, and I just hope that we can get the parties together, hammer something out, and give the necessary guidelines.

With that, I want to thank you for coming.

Senator HUTCHISON. There has been a statement submitted by Rob Krebs, the CEO of Burlington Northern Santa Fe, which I'm going to put in the record. [Refer to Appendix.]

I am also going to leave the record open for 5 days so that anyone else who wants to put a statement in the record may do that. I don't want to in any way have only one statement, and the only reason that I asked you to be the only witness is because I didn't feel that we needed to hear from the parties. But Mr. Krebs has asked for this; I will give it to him, but I will give everyone else the right as well to see his statement and to submit statements.

So we will have—let's see, today is Thursday—5 days including today should give people time to respond if they so choose. [Refer to Appendix.]

With that, I will adjourn the hearing, and thank you very much, Chairman Morgan.

(Whereupon, at 11:20 a.m., the hearing adjourned.)

APPENDIX

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN F. KERRY TO LINDA J. MORGAN

Question 1. Can we get assurances from you today that you will address the cram-down issue as you consider the new merger rules?

Answer. The Surface Transportation Board (Board) issued an Advance Notice of Proposed Rulemaking (ANPR) on March 31, 2000, instituting the proceeding in STB Ex Parte No. 582 (Sub-No. 1) in which the Board proposes to revisit its rules for major rail consolidations. In the ANPR, the Board specifically requested comments on the concerns of rail employees, including their suggestions that the Board require railroad merger applicants to agree to forgo any effort to "cram down" post-merger changes in collective bargaining agreements under the auspices of 49 U.S.C. 11321(a) and/or 11326, and/or under the auspices of Article I, Section 4 of the Board's standard *New York Dock* labor protective conditions. Thus, the Board will consider the cram-down issue as part of its merger rule review.

Question 2. Do you believe that the authority of the Surface Transportation Board regarding cram-down can be properly addressed with new merger rules?

Answer. Because the issue you raise is now subject to the STB Ex Parte No. 582 (Sub-No. 1) rulemaking proceeding pending before the Board, it would be inappropriate for me to comment on that issue at this time. As I testified before the Subcommittee, however, I do support a legislative solution to the problem of cram downs in railroad merger proceedings.

Question 3. To your knowledge, is there any governmental agency other than the STB that has the authority to undermine collective bargaining agreements?

Answer. Congress passed a unique statutory scheme providing for the implementation of major rail consolidations and protection for adversely affected rail employees. In doing so, Congress recognized that, when larger railroads consolidate, the individual collective bargaining agreements (CBAs) and protective arrangements into which the merging railroads entered earlier are not always compatible. The law that the Board administers provides for the imposition of the so-called *New York Dock* conditions upon such transactions. The *New York Dock* conditions provide: 1) substantive benefits for adversely affected employees (including moving and retraining allowances, and up to 6 years of wage protection for employees dismissed or displaced as a result of the consolidation); and 2) procedures under which carriers and employees are to bargain to effectuate changes to their CBAs if necessary to carry out the transaction, with resort to arbitration and, as a last resort, limited Board review, if bargaining is not successful. Additionally, in 1991, the Supreme Court confirmed that the law provides that agency approval of a consolidation automatically overrides all other laws, including obligations under a CBA, to the extent necessary to permit implementation of the approved transaction. To the best of my knowledge, these statutory provisions are unique to the rail industry, which is otherwise subject to the Railway Labor Act with regard to collective bargaining.

CONSUMERS UNITED FOR RAIL EQUITY,
Washington, DC, March 31, 2000.

Hon. KAY BAILEY HUTCHISON,
Chairman, Subcommittee on Surface Transportation and Merchant Marine,
Committee on Commerce, Science and Transportation,
United States Senate,
Washington, DC.

Dear Chairman Hutchison:

On behalf of the members of Consumers United for Rail Equity (C.U.R.E.), I would like to express our appreciation for the oversight hearing that you held on March 23rd regarding the Surface Transportation Board's (STB) recent decision to

issue a 15 month moratorium on rail mergers and the STB's proposed rulemaking proceeding to address possible modifications to its regulations governing proposals for major rail consolidations.

As you know there has been a significant amount of interest expressed in this issue. The hearings that the STB held in early March attracted close to 150 witnesses and the STB received statements from twice that number of interested parties. Rail customers, like those represented by C.U.R.E., are concerned about the consolidations occurring in the rail industry and the impact that these consolidations are having on competition in the industry.

We encourage the Committee to schedule a series of hearings on these important issues to build upon the record established in the March 23rd oversight hearing. Much of the testimony received by the STB earlier this month focused on concerns that rail customers have with rail service. For those entities that have no option but to ship by rail, this is a very serious concern. We believe that increased competition in the rail industry will help to address many of these service problems. Additional hearings will help the members of the Committee determine the best way to address the concerns of rail customers while considering the best policy for our nation regarding rail mergers and consolidations.

C.U.R.E. would welcome the opportunity to participate in further hearings the Committee may schedule.

Sincerely,

BRUCE A. BEAM,
Chairman.

PREPARED STATEMENT OF RICHARD K. DAVIDSON, CHAIRMAN AND CEO, UNION PACIFIC CORPORATION

Thank you for giving Union Pacific the opportunity to present our views on the Surface Transportation Board's (STB) decision to suspend Class I rail mergers for 15 months while it writes new merger rules.

My career in the railroad industry began 40 years ago. I started out as a brakeman and worked my way through the ranks to the position I hold today. I have been with this industry when it was on the brink of bankruptcy as well as when it was in its renaissance period. In short, I have seen its many ups and downs, but I'm not sure I have seen a situation like we have today. This is a critical and dangerous time for the railroad industry, and we are clearly at a major crossroads. Which path we take will dictate not only our future, but also the future of many of our customers and the regions we serve. That is why we support the Board's decision to suspend mergers for 15 months as well as the development of new rules that will govern all future consolidations.

I sat through all four days of the Board's hearings on the rail industry, and sadly, I wasn't surprised by what I heard. Many of our customers are frustrated with service—from all railroads—that they consider to be inadequate. Moreover, to a person, our customers will tell you that large railroad mergers have exacerbated these problems. Service problems followed all of the big mergers of the 1990s. I am sorry to say that perhaps the worst followed our merger with the Southern Pacific. However, none of the mergers were immune to problems, not even the BNSF merger or the CN/IC merger, as the STB's hearing record indicated. Union Pacific's problems are well behind us now. We turned the corner in the spring of 1998, and our performance levels are equal to or better than pre-merger levels. Even so, our customers are not ready for more mergers. They want better service. Customer after customer testified to this at the Board's hearings. Companies like General Motors, United Parcel Service, Huntsman Chemicals, Hampton Lumber, Arizona Grain, Ball-Foster Glass Container Co., Superior Lumber, Westvaco, and many, many more told the STB we need a time out on rail mergers to give the industry a chance to stabilize and work on service. (By way of example the GM and UPS testimony is attached.)

It is understandable that service problems have led to a call for no more rail mergers. What is worse, and more alarming, is that this last merger announcement has poured gasoline on the fires of those who want to re-regulate the industry. Mergers have not created a single "captive" shipper, or reduced in any way rail-to-rail competition where it existed prior to a merger. Still, there are groups who believe mergers have reduced competition, and are using the service disruptions as leverage to change our regulatory structure to their benefit. Re-regulation, competitive access, open access, forced access—whatever name you care to use—it is nothing more than a governmentally imposed revenue shift from one industry to another. Yes, it will reduce rates, but it will cripple our industry, and require us to

shrink our networks, cut service, and lay-off employees.[1] There will be some very large shippers that will initially benefit, but everyone will ultimately suffer as we lack the ability to invest in our system.

We heard about this too at the STB's hearings. Investment bankers like Morgan Stanley Dean Whitter and Goldman Sachs, as well as world-renowned economists such as Nobel Prize winning Kenneth Arrow all testified about the perils of re-regulation. Their testimony was very clear; the financial community does not favor re-regulation. The Staggers Act created the appropriate balance providing protections for shippers while allowing the railroads to price differentially. Their message to the Board was, among other things, don't change the balance of power between shippers and railroads. Doing so will drive the capital markets away from the rail industry. Since the rail industry reinvests on average 19% of its earnings, the lack of capital will make it virtually impossible for the rail industry to ever earn its cost of capital or provide the level of investment necessary to give the quality service our customers' demand.

I know the BNSF and the CN will say we are afraid of competition or that we want to delay their merger while we prepare one of our own, but this is far from true. Under other circumstances, UP would not be very concerned about the BNSF/CN merger. We do not expect this merger to have a major effect on our ability to compete, and we know we can compete effectively with a combined BNSF/CN. In fact, we considered the possibility of a Canadian merger ourselves, but we decided that proposing a big merger would be irresponsible because of the risk of re-regulation and because our customers would not want a merger. We think any big merger would be unwise and dangerous in today's environment. Of course, if BNSF/CN were to be approved, that would have a destabilizing effect and force us to take a fresh look at mergers.

Yes, today we are at a crossroads. The announcement of the BNSF/CN merger has created tremendous instability in the rail industry. Our customers are irate that we would even contemplate more mergers, the threat of re-regulation has been increased, and this lack of stability has caused all of our stock prices to sink dramatically.[2] As a result, we believe the Board's decision was appropriate and responsible—not radical or ill conceived as the BNSF or CN would have you to believe. The Board has a tremendous undertaking before it. Trying to determine what is right for the rail industry and the shipping community it serves will be a complex, time-consuming task. Rushing to conclusions is not the order of the day, caution and prudence are. I think Secretary Slater said it best when he said, "There is no room for error." We also believe the Board has the authority to take this type of action, and we will be full participants as this case winds its way through the legal system.

Does Congress have a role? Yes it does. When the STB is reauthorized, Congress must also decide what path to take. Again, we would urge caution, not a rush to judgment based on short-term service problems. We would also urge Congress to take the path toward stability and viability, and not the path toward access and the financial stress and instability it would cause.

BEFORE THE SURFACE TRANSPORTATION BOARD

Ex Parte No. 582

Public Views on Major Rail Consolidations

Summary of Statement on Behalf of United Parcel Service, Inc.

I. Introduction

United Parcel Service, Inc. ("UPS") welcomes the opportunity to participate in this important public hearing on major rail consolidations. UPS commends the Board for convening this nationwide forum.

UPS has a vital interest in the present operations, and future direction, of the North American rail industry. UPS is the largest corporate customer of intermodal rail services in the United States. Since the 1960s, railroads have moved UPS packages over long distances (more than 500 miles) as an alternative to highway movement by truck. In 1999, we spent approximately $680 million on intermodal rail services. UPS is also in the forefront of the rapid evolution of logistics and global

[1] Re-regulation would cost UP nearly three-quarters of a billion dollars in annual operating revenues.

[2] At the time of the STB's hearings, railroad stocks had lost approximately $15 billion in value, or 25%, since the BNSF/CN merger announcement.

supply chain management. The role of railroads in this evolution is critically important.

Due to our large intermodal presence, UPS experienced the considerable difficulties, and shouldered the enormous costs, caused by prior major rail consolidations. We also have learned a few lessons.

II. Any Benefits are Costly, Disruptive and Delayed

Rail carriers justify mergers on two bases: (i) lower rates; and (ii) better service. Our experience has been: (i) no lower rates result; and (ii) rail service is seriously problematic for an extended two to three year post-merger period. Incompatible rail systems, equipment shortages and confused personnel all contributed to the congestion. Unfortunately, the congestion did not remain isolated among the individual railroads merging, but spread across the entire rail network. UPS has found that—only after this prolonged post-merger period—service does return to, or slightly exceeds, pre-merger service levels. For what is ultimately achieved, the cost to UPS of rail consolidations is extremely high.

UPS's system relies on hundreds of trucks and trains arriving at a sorting center as scheduled. Disruptions and delays caused by rail consolidations required UPS to take every possible measure to ensure its service commitments to its shippers. Due to rail mergers over the past four years, UPS has diverted trailers from the rails to the roads. During the summer of 1999, for example, after exhausting all possibilities of having eligible union employees drive these unanticipated truck loads, over 700 union employees were turned into tractor trailer drivers. Additionally, UPS was forced into short term use of subcontractors on an emergency basis. Such disruptions caused a strain in labor relations. Absent such subcontracting, UPS would not have met its service commitments during the merger consolidation period.

Late trains also caused UPS to extend the duration of sorting operations, to add Saturday sorts, and to pay substantial overtime. UPS has tried to reschedule on a daily basis placement of trailers on trains to ensure as much as possible early departures and the avoidance of congestion. For all these reasons, the cost to UPS of providing service during a rail merger soared dramatically.

Due to UPS's relationship with the railroads, they made significant efforts to accommodate UPS's service needs. However, notwithstanding these efforts, UPS still lost customers due to the substantial rail service disruptions caused by the mergers.

III. Lessons Learned From the Past

1. The nationwide rail system undergoes severe and costly disruptions when major rail consolidations occur.

2. Significant costs are imposed on shippers like UPS to address these disruptions so that service commitments are not irrevocably jeopardized.

3. Rail carriers need a minimum two-to-three year period to digest a merger before service returns to the pre-merger level.

IV. Guidance for the Future

1. Consistent with the Board's notice, UPS takes no position on the proposed BNSF/CN merger. However, UPS would like to acknowledge the efforts BNSF has taken to improve its service levels.

2. UPS's fundamental concern is that if the proposed BNSF/CN merger is consummated, it will trigger mega-rail mergers of an unprecedented size and scope.

3. Disruptions across the entire rail system from any such mega-mergers will be innumerably worse than anything yet experienced. Digestion will take substantially longer, and at a much greater cost, than previous mergers.

V. Recommendation

The integrated nationwide rail system is still digesting the June 1999 Norfolk Southern/CSX carve up of Conrail. UPS, for example, was forced at times to divert up to 50% of the traffic, previously handled on the rails by Conrail, to trucks due to the delays and disruptions caused by the integration of Conrail into the Norfolk Southern/CSX operations. Clearly, any additional consolidation of the industry appears premature. Based on past experience, and without commenting on the merits of any such merger, no further rail consolidation should be contemplated until June 2002 at the earliest.

BEFORE THE SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582

General Motors Corporation

Statement on Rail Consolidation

General Motors Corporation ("GM") is one of the largest shippers in North America. GM produces over five million cars and trucks a year in North America and ships approximately 24,000 per day. In addition to its engine and component plants, GM has 31 vehicle assembly plants at 29 locations throughout North America. GM spends over $4 billion annually for transportation services, and $1.2 billion of that is for rail-related service. GM is totally dependent on reliable, economical transportation service, both for the delivery of an enormous volume of parts and materials used in production and assembly, and for the delivery of its finished vehicles and other products to market.

GM appreciates the opportunity to appear before the Board to offer its perspective on the structure and performance of the North American railroad industry. At the outset, GM states that it favors competition over regulation and supports competition in all forms, including service-oriented competition. In a market in which competition occurs on the basis of service, better service will win a firm more business. GM's view is that deregulation of the railroads has served the economy well; however, as this statement illustrates, the railroads have not sustained a level of service performance that meets the reasonable requirements of customers like GM. Competition certainly provides the railroads the incentive to attain this service level, but GM's experience is that rail consolidation has recently been associated with deterioration of the railroads' service performance. The Board should challenge the railroads collectively to raise their standard of performance for all shippers.

In recent years, the declining quality of rail service has forced GM to switch to higher-cost alternative modes of transportation in North America. In the last year, the amount of rail service GM purchased was approximately $270 million *less* than it purchased in 1997; this was largely because merger-related problems made it necessary for GM to switch from rail to costlier truck transportation. In 1997, for example, 70% of GM's outbound vehicle shipments were by rail. GM would have held to or increased that level of usage if we could have relied on rail for our requirements. Unfortunately, over the last two years the percentage of vehicle shipments that move by rail has been reduced by 7 percentage points to 63% of the outbound total. GM has had no choice but to substitute other modes at premium cost in response to unreliable rail service.

As the largest manufacturer in North America, GM has designed state-of-the-art systems for efficiently moving parts to the point of assembly and for quickly moving finished vehicles to consumers. For example, GM has invested extensively in the establishment and operation of "just-in-time" ("JIT") manufacturing methods, in which parts are delivered to the right place on the production line at precisely the right time, minimizing inventory and handling costs, among other benefits. JIT is far more than a delivery system—it is an entire production process of which shipping and receiving are only a part. Two components are essential to this process: one component is parts suppliers who consistently build to schedule. The other component is consistent transit. JIT production is not possible without stability of parts delivery, and stability of parts delivery is not possible without reliable transportation service.

Another time-and-transportation sensitive system is GM's Fast-to-Market initiative to deliver new cars and trucks to customers promptly. Reliable transportation service is essential to the success of this program, just as it is to ITT manufacturing. GM's requirement is for fast, flexible and reliable service across the national network.

Obviously, no system such as JIT production or Fast-to-Market can function properly if the rail delivery of parts is reliable only 70% of the time, but 70% reliability has been GM's recent experience with rail delivery of parts. This poor level of reliability results from a variety of failures, including late deliveries, missed connections, deliveries to incorrect locations, and unavailability of rail cars to receive product when scheduled.

The facts clearly demonstrate that the railroads have failed to live up to their customers' reasonable service expectations. Premerger representations and expectations that the railroads could avoid disruptions have not been met, and specified benefits of consolidations have taken entirely too long to be realized; so-called "short-term" dislocations of transactions have become entirely too lengthy and costly. In par-

ticular, GM has experienced significant disruptions and overall service deterioration from the 1995 Burlington Northern/Santa Fe consolidation, the merger of the Union Pacific and the Southern Pacific systems in 1997, and the 1999 division of the Conrail system between Norfolk Southern and CSX Transportation.

The BNSF consolidation was the least harmful to GM, in part because it serves the fewest GM facilities; however, BNSF's own data shows that customer service deteriorated or at best was unimproved in the first three years following its consolidation. Although the BNSF consolidation did not significantly disrupt the inbound flow of material to GM's manufacturing and assembly facilities, bottlenecks and delays did adversely impact the outbound shipment of vehicles.

The UP/SP transaction caused an unprecedented degree of disruption, uncertainty and cost for GM, in both inbound and outbound transportation. The total costs incurred by GM as the result of poor railroad performance following that transaction exceeded $100 million. Because the UP/SP failed to function effectively, GM lost production at plants, was forced to purchase trucking and air charter services at a premium, experienced delays of rail cars in transit for the transloading of components, and was required to acquire additional returnable shipping containers to correct the imbalance created in GM's normal use of such containers.

These custom-designed containers and racks warrant a general comment without reference to any specific rail consolidation. They have been developed by GM for the safe and effective transportation of many kinds and shapes of parts, from engines to body panels. The containers not only protect the parts in transit, but also are moved directly to the assembly line as an integral part of the JIT assembly process. These containers are required for transporting the parts to the assembly plants, but also must be returned efficiently and reliably to the locations where they are needed for parts shipment; without the containers available, GM must ship parts in less efficient, more costly expendable packaging or not ship parts at all. A number of recent rail consolidations have created disruptions and delays in the return of these containers. And in the past year, scheduled container returns by rail have failed to arrive on time as frequently as they have arrived on time—in other words, across the board, this critical service is reliable only 50% of the time!

As the result of the UP/SP consolidation, in August 1997 GM was required to establish its own rail operations control center, operating seven days a week in order to make up for the lack of information available from the railroad about GM's shipments and vehicle locations. Examples of problems handled by the operations control center include the failure of rail cars to arrive at plants as scheduled and the resultant buildup in inventory of outbound vehicles, the failure of parts to arrive at the right plants, and the delay and "loss" of vehicles in transit. Other extraordinary measures that needed to be taken with respect to the outbound delivery of vehicles included the creation of off-site storage areas, the holding of vehicles at origin and intermediate points, the double handling of vehicles (which exacerbated transit quality hazards), and the devotion of extensive resources to the tracking of vehicles.

One noteworthy example of disruption of GM's shipment of finished vehicles by the UP/SP merger involved Mexican assembly plants. Unable to secure reliable rail transportation across the border following that transaction, GM resorted for the first time in its history to the use of ocean-going vessels to move vehicles assembled in Mexico to the United States: between August 1997 and July 1999, sixty-two shiploads were made to the east coast ports of Jacksonville, Florida and Brunswick, Georgia; and forty-one shiploads were made to the west coast ports of Port Hueneme and Benicia, California. And to reach the ships, GM was required to truck vehicles 600 miles to the west coast of Mexico and 500 miles to the east coast. This ocean transportation necessitated by the UP/SP consolidation imposed a premium cost (that is, above normal rail cost) of approximately $20 million on GM.

The adverse effects caused by the division of Conrail between Norfolk Southern and CSX Transportation have also been significant. GM has been required to operate its control center seven days a week to deal with the problems created by failures in the railroads' information systems. The cost of operating the control center alone in connection with the Conrail division has already exceeded $1 million and is continuing to mount. In addition, GM has been forced to arrange extraordinary and costly substitute transportation whenever rail performance failures have occurred. These substitutes have included 248 special trains, 30,000 truckloads of finished vehicles, and thousands of additional air charters for parts to keep the assembly plants operating. The additional truck transportation alone has cost over $15 million to date. Suppliers of materials like metal stampings, fascia and plastic parts, which were already expensive to ship by rail, have now switched away from rail to even more expensive truck delivery service simply because of the inconsistency and

unreliability of rail transit times. Such increased trucking costs for parts are now becoming imbedded in GMs' cost structure.

One example of this diversion occurred at GM's vehicle assembly plant in St. Therese, Quebec, which obtains metal stampings—door and rear-end panels—from two major suppliers in Indiana. Shortly after the Conrail division, the plant could no longer depend on rail service for parts delivery. Rail service has now deteriorated to the point that no rail shipments of these parts, which are otherwise ideally suited to rail transport, are being made; these Indiana suppliers are using trucking exclusively in order to meet the St. Therese assembly plant's needs. GM must pay a premium for this trucking, of course, which has been about $1.4 million to date.

Another illustration of costs incurred as the result of the Conrail transaction involves engines for GM's Lansing, Michigan assembly complex, which produces some of GM's best-selling cars. The engines come from a plant in Mexico. Within days of the June 1999 Conrail division, rail service for the shipment of these engines from Mexico became so unreliable that GM had to switch to trucking the engines, including their specialized containers, from Mexico to Lansing. The freight penalty incurred as a result was $1.3 million as of December. It is, of course, better to incur the premium cost of trucking than to incur the greater penalty of a plant shutdown, but reliable rail service is the correct and most cost-efficient answer. GM continues to run test loads on the railroad to see if a return to rail is warranted, but so far it is simply too risky to the Lansing plant operations to consider relying on rail delivery of these engines.

Outbound shipments have also been adversely affected by the Conrail division. Particularly noteworthy is the added delay. GM has experienced a 20% increase in the number of vehicles that are in transit at any given time—in the transportation pipeline, so to speak. Furthermore, over the last three years, the weighted average vehicle transit time has increased to an all-time high, due mainly to deteriorating rail service. The increase in vehicle transit time is totally incompatible with GM's focus on faster delivery of finished vehicles to customers, and it has an adverse effect on goodwill and sales. During a time when overall productivity in our country is increasing, this deterioration in the time it takes the railroads to deliver a vehicle is unacceptable.

Rail inefficiencies have adversely affected GM's work force as well. The truck docks at plants are more congested where the more reliable truck service must be used instead of unreliable rail service, which heightens safety risks to employees. Also, movement of parts from trucks to the assembly lines results in the increased use of fork lifts in the aisles of plants, which increases safety concerns. And, more overtime has been required to deal with transportation disruptions. These effects must be counted along with the societal burdens imposed when truck transport is used to replace rail transport which has failed to provide satisfactory service.

In advance of recent rail consolidations, the railroads have offered general assurances of benefits; examples are that the acquisition of particular lines or operations would reduce delivery times, eliminate congestion, improve rail car turn-around, and improve overall trip transit time and car utilization. Such benefits have not been promptly forthcoming following most recent rail consolidations; rather, post-consolidation dislocations have lasted for years.

An assurance was given to GM in connection with the UP/SP consolidation that delays in and out of Mexico would be few and far between because alternative routings would be available after the transaction. As noted above, however, the disruption of service following the UP/SP consolidation forced GM to resort to trucking and ocean shipping in order to get vehicles from Mexico to the United States. This example offers a striking illustration of both the failure of consolidating railroads to deliver benefits of a transaction and the kind of adverse impact that consolidation has had on GM. On the basis of GM's experience, unless there are substantial advances in railroad information technology, improvements in the allocation of human resources, and detailed operational planning on the part of the railroads, it is naive to believe that any future consolidation alone will result in better rail service. The railroads' record of failure to provide improved service makes GM wary of any future assurances.

Although long-term efficiency gains have been achieved in some rail consolidations, a high price has been paid by GM and others as the result of "short-term" dislocations and inefficiencies such as those described. In GM's view, the length of such "short-term" post-merger adjustment periods has grown entirely too long, and the effects have grown too severe to be tolerated. In the UP/SP merger, for example, the so-called "short-term" inefficiencies persisted for at least three years. No shipper, including GM, should have to accept a substantial risk of repetition of these post-merger scenarios. GM ships approximately 24,000 vehicles a day—including the first day following any rail merger—and it cannot willingly accept years of disrup-

tion and uncertainty in order to reap the promise of long-term benefits of rail consolidations.

GM favors competition and disfavors any movement toward re-regulation of the railroads. Our opinion is that the public interest has generally been well served since rail deregulation. Nevertheless, GM expects reliable service from its transportation service providers. And GM would buy more service from the railroads if the railroads could bring their level of reliability up to reasonable levels—on-time service at least 90% of the time would satisfy our industry's requirements. Not only would the improved service gain the railroads more business from GM and others, but the increased business volume would strengthen their financial viability.

The marketplace demands speed, quality and reliability from GM as conditions of its own competitiveness. As a shipper, GM must also demand speed and reliability from its transportation service providers. Service competition among rail transportation providers is vital to GM, and GM believes that the competitive market should motivate the railroads to improve their level of service performance. What was acceptable performance two years ago, by definition, will be noncompetitive in today's and tomorrow's marketplace. GM submits that a minimum standard of service should prevail throughout the railroad industry. The Board should challenge the railroads to focus their efforts to bring industry-wide performance up to levels which will meet the reasonable needs and expectations of their customers and which will support North American economic growth. Rail consolidations must not detract from the achievement of this goal.

GM's view of the future of the rail industry is not one of mergers, less competition, more regulation, and an industry focus diverted from customer service. Rather, we would expect the industry, individually and collectively, to focus their leadership energy and resources on providing transportation service that meets and exceeds our expectation for speed, flexibility and reliability. It is our view that this is a collective challenge, one that requires the current rail providers to work together in the interest of customer service. There is little value in "pockets of excellence" when the customer view is of total network performance.

ALLIANCE FOR RAIL COMPETITION,
Washington, DC, March 30, 2000.

Hon. KAY BAILEY HUTCHISON, *Chairman,*
Surface Transportation Subcommittee,
Committee on Commerce, Science and Transportation,
U.S. Senate,
Washington, DC

Dear Madam Chairman:

Pursuant to the Subcommittee's hearing on March 23, 2000 reviewing the Surface Transportation Board's Ex Parte 582 decision to impose a 15-month moratorium on rail mergers, I would like to submit the Alliance for Rail Competition's (ARC) testimony from that proceeding and this letter for inclusion in this Subcommittee's official hearing record.

Since 1980, national rail transportation policy has featured competition as a prominent element of regulatory responsibilities, but competitive issues have clearly taken a back seat to other considerations. The very purpose of having economic regulation is to control an industry in such a way that its behavior will resemble that of a competitive industry. However, in the case of rail policy, something is obviously amiss. The kinds of service problems documented over the past five to ten years could never have prevailed in competitive industries, nor would they likely have been tolerated in other industries subject to economic regulation such as electric utilities or telecommunications. Furthermore, in competitive industries, individual companies do not price similar services so that they make an infinitesimal margin on some business while pricing other business at more than twice the level of costs.

The members of ARC have long believed that Congress must act to address rail policies as a whole if we ever expect true market-based competition among rail carriers to be reintroduced to the industry. *The issues that have been the subject of debate before Congress for the last several years must be resolved to address the industry as it is currently composed, regardless of whether and/or when additional rail mergers may be considered.* Then, should any further consolidation or other structural changes occur in the rail industry at anytime in the future, our national rail policy must be dynamic enough to evolve along with the industry. That is the only way that we can ensure that adequate levels of competition are available to all rail customers.

Adequate competition and, in the absence of such, effective regulation, would go a long way toward resolving rail customers' concerns. Unfortunately, this has never been the centerpiece of regulatory interpretation for rail mergers or any other element of rail policy, and as a result, we have a highly concentrated rail industry where the handful of remaining carriers rarely competes against each other. Although we applaud the Board for undertaking a merger policy review, that review alone cannot and will not resolve concerns about already poor rail service, monopoly pricing and discriminatory practices. We do question why such a lengthy timeframe is necessary for undertaking such a review when previous rulemakings have been completed in as few as six months. Extending this process for the purpose of providing rail customers with a "breather" is unlikely to have much effect since rail customer confidence will never return to the rail industry so long as rail carriers are allowed to freely exercise their growing monopoly power.

It is for this reason that, as you so eloquently stated in your remarks at the March 23rd hearing, the Board's actions on this front should not—and must not—preclude the Congress from acting to redirect rail policy interpretation toward developing more rail-to-rail competition. While we will likely participate in the Board's efforts to review and possibly modify merger policy, ARC remains committed to working with you and the other members of the Commerce Committee to review rail policy as a whole and to find the balanced solution for how to best bring more competition to the rail industry through legislative action.

If you have any questions about ARC's testimony, please feel free to call me. Thank you for the opportunity to submit this information into the official hearing record.

Sincerely,

DIANE C. DUFF,
Executive Director.

Attachment

Statement of the Alliance for Rail Competition

BEFORE THE SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582

Public Views on Major Consolidations

March 7, 2000

The Alliance for Rail Competition (ARC) commends the Surface Transportation Board (STB) for initiating this review of major railroad consolidations and the present and future structure of the North American railroad industry. For the past several years, ARC has represented the diversity of the rail customer community before Congress and the Board, pressing for significant pro-competitive changes to rail policy in recognition of the dramatically different appearance of today's rail industry compared to that which previously existed. Our organization and its mission have been defined by rail customers who have had growing concerns about deterioration in service performance, increases in rail transportation costs, monopolistic railroad behavior in both pricing and service, and the inability of captive rail customers to get *either* competitive choices among major rail carriers *or* adequate regulatory protection from monopolistic behavior.

Without any further consolidation activity among the remaining rail carriers, these issues would continue to be of tremendous concern to rail customers. However, the December announcement that Burlington Northern and Santa Fe Railway (BNSF) and Canadian National Railways (CN) intend to merge has raised the stakes. The subsequent reactions from other Class I railroads and from this Board make it very clear that the next merger to be approved—regardless of the merger partners—will inevitably cause a domino effect, the outcome, in all likelihood, being a two-railroad system throughout North America, with extension of each system's monopoly power over that which is exercised today.

That is a frightening proposition considering that in today's system of two major eastern and two major western railroads, there is little true competition among carriers for a significant portion of their business and that economic regulation has not been sufficiently revised to compensate for what has become an exponentially increasing competitive void.

So long as today's configuration remains in existence, the opportunity to address these problems with changes in the *interpretation* of existing rail policy is possible. However, should today's Class I rail industry undergo any further consolidation—

regardless of who the merger partners might be—rail policy, and the rail system itself, would require more far-reaching changes than those considered by ARC to date. No major merger—whether it's the proposed BNSF-CN merger or two other Class I carriers—should be considered without system-wide changes to rail policy that would address what has now become an extensive record of customer complaints and widespread dissatisfaction. In other words, merger conditions that apply only to the merging carriers will not address the breadth of concern, and would most likely put one carrier at a significant disadvantage to the few remaining carriers. We need no further imbalances.

If this Board refuses to recognize that policies set 20 years ago, applied in an environment significantly different from the one we face today, are inadequate, the legislative debate over policy will undoubtedly move away from the problems with regulatory interpretation we have been trying to address—such as whether a customer should be allowed to get a rate over a segment of a movement, or whether a customer could choose between two carriers in a terminal area where both those carriers operate—and move toward a more comprehensive public interest debate about how to best open the access to the railroads' track structures and related plant so as to reintroduce universal competition. At this moment, a debate over pervasive access is not one that rail customers generally, or ARC specifically, relishes entering. Nonetheless, the prospect of further consolidations among any of the remaining major rail carriers without adoption of system-wide policy changes would leave rail customers with little choice. These are options that the Alliance for Rail Competition will continue to study thoroughly so we are prepared to enter such a debate should the need arise.

* * * * *

Status of the Rail Industry

The discussion of downstream impacts of mergers must be based upon a brief review and assessment of the current composition and behavior of the rail industry.

A. Four Mega-Railroads Overwhelmingly Dominate Railroad Traffic and Offer Extremely Limited Transportation Choice To Customers

The first basic element of this foundation is the increasing concentration of market power among Class I railroads. As shown in Table No. 1, attached to the end of this statement, the number of railroads has steadily declined throughout the 20th century, while at the same time, the percentage of traffic handled by the four largest railroads has steadily increased. Even since the Staggers Act—legislation which was to encourage and rely on market competition—the number of Class I railroads has declined by over 80% to just seven today, with four of those railroads dominating the industry. In fact, the four largest railroads handle 95% of Class I railroad ton-miles, and undoubtedly control an even greater percent of the traffic. Thus, many rail-dependent customers are faced with either no choice of carriers, or a limited choice between two railroads. While, in the short run, a two-carrier choice might provide some competitive advantages to some, basic economic theory holds that in the long run, oligopolists and/or dual monopolists decide that an activity such as competitive (marginal) pricing is self defeating because it will be matched by the other supplier. Thus, a conscious parallelism of action results with customers, such as railroad shippers, having little or no choice of prices and service levels.

Another concern in regard to the increased concentration of railroad market power is that two railroads will comprise a majority in votes over such centralized intra-industry matters as car-repair billing rates, interline agreements, accounting rules, and policy positions. For example, even though shippers now supply more than half of all railroad cars, the railroad industry already *requires* private car owners to agree to be bound by the AAR Interchange Rules as a prerequisite to private car operation, and those rules are effectively set by the remaining Class I railroads. Individualism can be lost in a two-railroad collective that is adorned with significant assets, strong financial means, and inordinate staying power. The result is an uneven regulatory arena between railroads and their non-collective, rail-dependent customers.

B. Cost Savings of Mergers Have Been Overstated

The second element of any objective assessment must acknowledge that railroad cost savings attributed to mergers have been significantly overstated. Such an acknowledgment will provide the proper perspective to prospective claims of merger savings, and allow regulatory determinations to be made on the basis of more credible estimates of economic efficiencies versus the adverse impact of less railroad competition.

Table No. 2 shows that the railroad industry has been in the throes of a long-term, downsizing trend. Quite simply, the industry was substantially over-built, and the miles of road owned and number of employees would have been significantly reduced even without mergers. Mergers were not responsible for crew reductions from four or more personnel down to two on-train employees. Mergers were not responsible for the elimination of cabooses. And mergers were not entirely responsible for the abandonment of light-density lines and related service. There is no dispute that railroad mergers have resulted in the realization of certain economies of scale and, to an even greater degree, density, but this is only one component of railroad unit-cost reductions. At the same time, the shrinkage of railroad competition associated with mergers has had an adverse impact on rail-dependent customers in the form of higher rates, and especially, service deficiencies.

C. Service Deficiencies and Price Distortions

The purpose of economic regulation is to control an industry in such a way that its behavior will resemble that of a competitive industry. Something is obviously amiss in regard to railroad regulation because the kinds of service deficiencies which have been documented over the past five years or so, following large mergers of Class I railroads, could never have prevailed in competitive industries. Furthermore, in competitive industries the individual companies do not price similar services so that they make an infinitesimal margin on some business while pricing other business at more than twice the level of costs. This is not to say that differential pricing is not practiced by virtually all businesses in the United States, but rather to suggest that the span of profit margins in the railroad industry is much wider than in industries in competitive markets.

What is of major concern to rail-dependent shippers is that the railroad mergers were supposed to *correct* service deficiencies, rather than exacerbate them. Yet, we hear from railroad executives that the service problems are to be blamed on satiated yards and terminals. But, (rhetorically speaking), isn't this a railroad management problem? After all, consider the cost savings enjoyed by railroads as shown in Table No. 3. Railroad unit costs have declined dramatically over the past 60 years. Even since 1980, as Table No. 3 shows, "real" (constant-dollar) costs have declined by 63% from 5.32 cents per ton-mile to 1.98 cents per ton-mile. At the same time, as Table No. 4 shows, railroad traffic, measured in ton-miles, increased—going from 919 billion ton-miles in 1980 to 1.4 trillion ton-miles in 1998. With such enormous savings and constant traffic growths, why is there not enough capacity at terminals to adequately handle the traffic? Whose fault is this? Why do rail-dependent customers have to suffer? Adequate competition and, in the absence of such, effective regulation, would have gone a long way in ensuing adequate railroad service standards. This is not a matter of inadequate railroad earnings. The railroad industry has not been short of capital for many years.

D. Economic Regulation Has Not Compensated for the Growing Competitive Void

Some of the regulatory problems resulting in railroad pricing and service deficiencies are fairly obvious to rail-dependent customers. Maximum rate proceedings tend to go on for many years and are enormously costly and time consuming. The railroad revenue-adequacy determination has little, if any, credibility as both debt and equity capital is readily available to allegedly revenue-inadequate railroads. And such measures as stand-alone costs, the Uniform Rail Costing System, and the cost of capital are laden with complexities, judgments, and questionable data. In short, there is no effective regulatory backstop for most rail-dependent customers.

This portion of the assessment is clearly supported by the outcome of the General Accounting Office analysis completed last February. According to their extensive surveying of rail customers, more than 70% noted that time, complexity and costs of filing complaints with the STB were such a barrier to regulatory intervention that they generally didn't even consider it to be an option. Similar findings were the result of an analysis completed by the American Enterprise Institute and Brookings Institute in December of 1999.

Experience with Mergers

In considering further consolidation in the rail industry, it is impossible to ignore rail customers' recent experiences with other recent mergers that were supposed to offer tremendous improvements in service. In and of themselves, mergers are neither inherently good or bad. Their desirability depends on their impact on their customers and their benefits to society. In turn, the impact on customers depends on the economic characteristics of the merger, the level of railroad competitiveness in the marketplace, and the ensuing merger conditions established by the STB.

The *customer* is the focus for most other federal regulators as they evaluate a proposed merger. For example, consider the policy of the Federal Energy Regulatory Commission:

> "Rather than requiring estimates of somewhat amorphous net merger benefits and addressing whether the applicant has adequately substantiated those benefits, we will focus on ratepayer protection. The merger applicant bears the burden of proof to demonstrate that the customer will be protected. This puts the risk that the benefits will not materialize where it belongs—on the applicants."[1]

As another example, Federal Trade Commission Chairman Robert Pitofsky recently announced a tightening of merger reviews. While this tightening is not being characterized by the FTC as a "dramatic shift" in policy, Pitofsky has noted that the FTC's actions are intended to "make transparent" agency procedures as they apply to divestiture proposals. These provisions include provisions that "would allow certain 'crown jewel' assets of a company to be seized if the company fails to make good on an FTC consent decree."[2]

Unfortunately, no similar level of attentiveness to customer impact has been demonstrated in railroad merger situations. In fact, history shows us that, in the case of railroads, neither consumer protection nor competitive interests have been the litmus test for federal approval. Rather, the financial benefits to the railroads in question appeared to be the determining factor. In addition, there has never been an effort to assess a rail merger's impact on customer service measures after the transaction has been complete. In the October 19, 1998 issue of Traffic World, former ICC general counsel Fritz Kahn wrote:

> "The proponents of railroad mergers and acquisitions can be counted on to contend that their proposals will lead to improved transportation—better service and reduced costs—and, just as surely, the agency can be counted on to accept uncritically the railroads' assurances. The question, however, is whether the railroads' representations have been realized. Have the railroad mergers and acquisitions yielded the better service and reduced costs, and hence, lower rates which were the premise of the ICC's or STB's approval of the transaction? The STB doesn't know, just as the ICC didn't know. Neither one of them ever has studied the effects of a railroad merger or acquisition approved by it."

Nonetheless, a cursory review of the last several mergers clearly demonstrates that the projected benefits that supported proposed—and approved—mergers, generally have not been realized.

In summary, the rail customer's experience has been that railroad mergers have traditionally and consistently been proposed as being the panacea for all ills. Projected benefits typically range from huge cost savings to substantially improved service, and sometimes include the enhancement of competition. It is not surprising that, given such expectations, railroad customers often support such mergers, only to be disappointed with the ensuing reality. But then, another proposed merger comes along and the cycle is repeated. What occurs is that the expectations of the "next" merger outweigh the disappointments of the past merger. When a railroad virtually guarantees that the benefits from a proposed merger will provide shippers with the type of service they require, it is difficult to deny railroads the opportunity to fulfill their stated intentions. Yet, as previous merger opportunities have now come and gone, it has become clear that there is a significant gap between expectations and results. This gap can be illustrated by comparing the projected benefits of such mergers with the state of the railroad industry that currently exists. The following three examples demonstrate the point.

1. The merger of the Burlington Northern (BN) and Santa Fe (SF) railroads in mid–1995 was based on projected annual savings of $450 million in operating and administrative expenses, and the realization of another $110 million in operating income on new revenue to be earned. After increasing its offer for the SF from $2.6 billion to just over $4.0 billion, BN reiterated the advantages of the merger which included: single-line service to all four major West Coast ports; the merging of Santa Fe's market strength in intermodal with BN's coal, grain and commodities traffic; and, administration efficiencies that will, among other things, allow the elimination of some 2,750 jobs. At the same time, BNSF was saddled with significant new debt that ultimately would have to be passed on to customers.

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[1] Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, III FERC Stats. & Regs. Para. 30,044, at 30,123 (1996).

[2] "FTC to Get Tough on Merger Reviews." By James V. Grimaldi, Washington Post, page E1, February 17, 2000.

2. The merger between the Union Pacific (UP) and Southern Pacific (SP) railroads was consummated in September of 1996. UP claimed that the merger would "provide dramatic service improvements to shippers, greatly strengthen western rail competition, and help position American industry to be fully competitive domestically and internationally in the 21st Century." The merger was somewhat of a defensive action, as SP Chairman Anschutz acknowledged: "A combination with UP was inevitable for SP, after BN and Santa Fe agreed to merge." More specifically, the expected benefits of the merger were identified in the 1996 annual report of the Union Pacific Corporation (UPC), as follows:

> The benefits flowing from this consolidation are multifold: routes will be shortened, often dramatically, congestion will be eliminated; and traffic flows will become more efficient on every major western corridor. The total annual operating income benefit to Union Pacific could reach more than $820 million by the year 2001.

UPC went on to tout the expectation of improved on-time performance for shippers, much faster transit times, expanded single-line service, significantly reduced operating costs, shorter routes, better equipment and more reliable service, a significant reduction in congestion and delays, faster and more dependable intermodal service, stronger rail competition in the West, and specialized use of parallel routes to improve traffic flow, transit times and reliability.

This Board does not need to be educated about the aftermath of this merger, but during its implementation, even UP President Ron Burns stated: "many shippers are experiencing unprecedented problems with service provided by our railroad." At one point, Dr. Bernard Weinstein of the University of North Texas estimated the economic impact of that service crisis exceeded more than $2 billion in the state of Texas alone, and that was long before service in the West improved.

3. The acquisition of Conrail by the CSX and Norfolk Southern (NS) railroads went into effect on June 1, 1999. While some cost savings were expected to be realized from the joint acquisition in spite of a $20 billion acquisition premium, there were two major favorable expectations: (1) improved service to shippers due to increased direct-line competition between two railroads, and (2) traffic diversion from motor carriage. It's worth noting that as CSX and NS increased their respective bid prices for Conrail, the anticipated benefits were "recalculated," and magically, as the price of the acquisition increased, so did the anticipated benefits. Instead, rail customers have experienced system-wide service problems on both CSX and NS that, despite promises to the contrary, continue to this day. In some regions, such as Buffalo, service has been so bad that customers have been forced to shift production to other regions. Reports of rail customers being forced to divert rail traffic onto motor carriers would support the notion that the carriers have not only failed to take truck traffic off the road, but have more likely contributed to at least a short-term increase in truck traffic.

Representatives of both CSX and NS have acknowledged their troubles and, despite having two years to prepare, both carriers have chalked up their problems to "poor planning" and the fact that they "didn't anticipate their customer's needs." Despite the system-wide service problems, both CSX and NS are in the process of increasing their rates, and cite shortages of track and equipment as providing the opportunity for them to do so.

* * * * *

It is important to note that the recent CN merger with IC has been identified as having "gone off without a hitch." However, this statement cannot be applied to operational changes required by the merger, as those changes didn't begin until approximately two weeks ago. In fact, a key computer switchover has been postponed. In some previous mergers, service problems didn't begin to be evident for as long as six months. Thus, no one can legitimately classify the relatively small CN-IC merger as an indication that mergers in this highly concentrated market can still be done without harming service or competition.

Merger Policy Recommendations

In considering any merger from this time on, the Board would more appropriately serve the public interest by responding to broader fundamental questions: What does our national economy require of its railroad system? How does the merger in question impact the ability of the rail system as a whole to meet the national need? What policy changes are necessary to ensure that the nation's rail system is best positioned to live up to those requirements? Answering those kinds of questions would more appropriately focus this Board on protecting and forwarding the inter-

ests of the consumers of railroad services—who provide the reason that railroads exist at all.

Thus, sound public policy toward future railroad mergers should be based on the following principles:

1. A Viable Freight Railroad Industry is in the Public Interest

Freight railroads are a national asset which have the ability to provide relatively low-cost, energy-efficient, and environmentally benign transportation service. Further, these railroads have a duty to serve all of their customers, without whom railroads would cease to exist. The best means for ensuring the railroad industry's viability is to encourage rail carriers to compete among themselves, as well as with other modes of transportation. Competition is the engine that drives the free enterprise system. It pressures suppliers (railroads) to be efficient and can help railroads grow traffic.

2. The Net Impact on Customers Should be the Key Merger Criterion

Even where economies of density are expected to be realized, railroad mergers should not be approved if the prospective cost reductions are offset by adverse service and/or rate impacts on railroad customers due to a diminishment of competition.

3. Competitive Access is the Preferred Protection for Customers

Railroad customers can be protected from the adverse effects of mergers through additional competitive access to captive customers served by the merged railroad, and/or by implementing effective economic regulation. Competitive access is preferable to regulation because it motivates carriers to be responsive to customer needs. Competitive access would benefit railroads in that the incumbents: (1) could charge adequate user fees, (2) would experience traffic growth, and (3) would in turn realized newly-found economies of traffic density.

4. Railroad Customers Need Safe Harbor Protection

In the absence of effective railroad competition, economic regulation is necessary to insure that service is adequate and freight rates are reasonable. Opening access and economic regulation is not an either-or choice; they are parts of a whole.

5. Railroad Mergers Are Not the Only Way to Lower Operating Costs

Traffic growth is a key to economies of railroad track density. Aside from traffic growth, railroads can reduce costs through a wide variety of managerial and technological means. Railroads have controlled their costs by eliminating inefficient service, reducing crew sizes, changing operating and work rules, and employing new technology.

6. Post-Merger Performance Must be Closely Monitored

The STB shall establish procedures to measure post-merger performance and should issue an annual report of its findings for a period of ten years.

7. Where Desirable Adjustment will be Made

When railroad mergers cause unanticipated adverse impacts on customers, the situation can be rectified post-merger, by opening competitive access and/or making economic regulation more effective.

* * * * *

ARC fully understands that the remedy for defective railroad markets is to be partially found in legislative change. However, the extent of that legislative remedy will be largely determined by the actions—or lack thereof—of this Board in reviewing further consolidations. ARC also believes that the present railroad market distortions would not have occurred if an adequate public policy regarding mergers would have been developed and followed. It is not too late; the time to begin the change is now, and the STB has the power and authority to start the process. Thus, it is ARC's firm belief that the STB should undertake the following four steps before even considering any further major rail consolidations, again, regardless of the merger partners:

1. Adopt a merger policy similar to that advocated in this statement.
2. In light of the market power held by today's rail system configuration, re-examine the issues of so-called "bottleneck" rates and decisions relating to access in terminal areas.
3. Change the revenue-adequacy criterion to a simple measure of "allowable return-on-equity," similar to the public utility industry, and
4. Work with rail customers and Congress to develop an appropriate method for providing protections for small captive shippers that can be passed into law.

ARC stands ready to work with the members of this Board in support of such pro-competitive, consumer-oriented changes.

Table No. 1. Downsizing of the Railroad Industry

(Class I Railroads)

Year	Miles of Road Owned (000)	No. of Railroads	No. of Employees (000)
1907		230	
1916	254		
1920			2,148
1929	230	162	1,661
1980	165	36	458
1985	146	23	302
1990	120	14	216
1995	108	11	188
1998	101	9	178
1999		7	

Source: Association of American Railroads, *Railroad Facts* (annual publication) and *Railroad Transportation, A Statistical Record,* 1911–1951. Interstate Commerce Commission, *Statistics of Railways in the United States, For The Year Ended 1929,* 1930 and annual reports.

Table No. 2. Increasing Market Concentration Within the Railroad Industry

(Class I Railroads)

Year	Number of Railroads	% Ton-Miles Carried By Four Largest Railroads
1929	162	23%
1940	134	27
1950	129	25
1960	109	25
1970	73	34
1980	36	43
1985	23	47
1990	14	66
1995	11	69
1998	9	87
1999	7	95

Source: Association of American Railroads, Analysis of Class I Railroads (annual publication). Interstate Commerce Commission, Statistics of Railways in the United States, For The Year Ended 1929, 1930.

Table No. 3. Declining Railroad Operating Expenses

(Class I Railroads)

Year	Operating Expense Per Ton-Mile	Railroad Inflation (1998 = 100)	"Real" Expense Per Ton-Mile
1939	1.04 cents	3.2	32.5 cents
1980	2.75	51.7	5.32
1985	2.74 [1]	67.9	4.04
1990	2.37	81.4	2.91
1995	1.99 [2]	93.4	2.13
1998	1.98 [3]	100.0	1.98

[1] 2.85 cents adjusted for $809 million of special charges taken as operating expenses.
[2] 2.12 cents adjusted for $1.7 billion of special charges taken as operating expenses.
[3] 2.02 cents adjusted for $520 million of special charges taken as operating expenses.

Table No. 4. Increasing Railroad Traffic
(Class I Railroads)

Year	Tons Originated (Millions)	Revenue Ton-Miles (Billions)
1929	1,339	447
1955	1,396	624
1970	1,484	765
1980	1,492	919
1985	1,320	877
1990	1,425	1,034
1995	1,550	1,306
1998	1,649	1,377

PREPARED STATEMENT OF DAVID R. GOODE, CHAIRMAN, PRESIDENT & CEO, NORFOLK SOUTHERN CORPORATION

My name is David R. Goode and I am Chairman, President and Chief Executive Officer of Norfolk Southern Corporation ("NS"). I welcome this opportunity to comment in support of the critical and important decision issued by the Surface Transportation Board ("STB") on March 17, 2000 in Ex Parte No. 582, *Public Views on Major Rail Consolidations*. In that decision, the STB announced the commencement of a rulemaking proceeding to develop new standards and procedures for railroad mergers and suspended the processing and consideration of major rail consolidation proposals for 15 months in order to give the STB and the rail industry a much-needed respite from further rail merger activity while those new rules are being promulgated.

The STB deserves the thanks of all of us who are part of the rail industry and who are concerned about the difficulties and challenges facing our Nation's railroads, our customers, our employees, and the many others whose lives are affected by and intertwined with our industry. As this Committee knows full well, the past several years have been difficult and challenging ones for the railroad industry, as we have struggled to implement major mergers and consolidations of rail systems both in the East and the West. We at Norfolk Southern have been challenged in our assimilation of the substantial portion of Conrail we began to operate last June. I am happy to report that we have made great progress toward providing the fast, efficient and reliable transportation service our customers need and deserve. Still, we have much more to do to achieve fully the promised benefits of the Conrail transaction and to deliver these benefits to our customers and our stockholders. The STB decision provides valuable time to accomplish that goal without the disruptions, uncertainty and necessary loss of focus that another round of major rail consolidations would inevitably bring.

The STB recognized what we and our customers, our employees, and our partners need most: time—time to make our service the best that it can be; time to develop with our interchange partners cooperative and reliable interline services to obtain maximum advantage from the existing North American rail network; and time to restore the confidence of investors in the industry.

During the four days of hearings held by the STB earlier this month, the Board received testimony from more than 150 witnesses, including myself and the CEO's of the other major North American railroads. The Board heard an overwhelming appeal from all sides—from railroads, from government agencies, from ports and municipalities, from large automobile manufacturers to small agrarian interests, and from chemical shippers to one of the industry's largest intermodal customers (UPS)—for a breather from further rail merger activity. The Board obviously listened, and it courageously acted by finding that the public interest required a respite from rail merger activity while it modernized and revised its rail merger regulations. I am convinced this is a valuable pause, which will enable us to concentrate our efforts on improving service and improving the financial health of the industry. We need that time and I will do my part to see we use it wisely.

In short, Norfolk Southern believes that the STB's actions were entirely consistent with its broad public interest mandate and were fully supported both by the record compiled in its Ex Parte No. 582 proceedings and by the Board's experience. We look forward to participating in the Board's rulemaking to revise its merger regulations and look forward to continuing our efforts to improve the quality and reliability of

our transportation services, develop cooperative arrangements with our interline partners and enhance our overall financial results.

PREPARED STATEMENT OF ROBERT D. KREBS,
BURLINGTON NORTHERN SANTA FE CORPORATION

On behalf of Burlington Northern Santa Fe Corporation, I appreciate the opportunity to present this testimony for the record of this oversight hearing.

I offer these comments as you evaluate the manner in which the Board is carrying out the mission entrusted to it by Congress, particularly in the area of considering private sector proposals for mergers and consolidations.

As the Surface Transportation Board has stated, its decision to initiate its Ex Parte Proceeding on Public Views on Major Rail Consolidations was spurred by the announcement that Burlington Northern Santa Fe and Canadian National intend to file an application with the Surface Transportation Board seeking approval of the common control of The Burlington Northern and Santa Fe Railway Company and the railroad companies controlled by the Canadian National Railway Company. In announcing its intention to hold hearings on Major Rail Consolidations, the Surface Transportation Board noted that it was aware that, in the wake of the filing of the BNSF/CN notice of intent, there has been a great deal of speculation that the strategic responses of the remaining North American carriers . . . will lead to a new round of major railroad consolidations. Much of the speculation referred to by the Board was spurred by our railroad competitors, a number of which had recently engaged in railroad mergers that resulted in serious service problems that affected not only their customers, but users of adjacent systems and other railroads, as well. These competitors even went so far as to take out an advertisement in the Wall Street Journal, the Washington Post, the Journal of Commerce, and Traffic World, which consisted of an Open Letter to Railroad Customers from four railroad CEOs. The gist of the letter was that they were not ready for another railroad combination, because, unlike BNSF and CN, they had not yet put their houses in order following their own mergers. Remarkably, despite their professed lack of readiness to enter into merger transactions of their own, they threatened to initiate their own mergers if our combination were to go forward.

In the four days of hearings before the Board on Public Views of Major Rail Transactions, numerous shippers and shipper organizations, such as the National Industrial Transportation League, shortline railroads and municipalities, leading economists and members of the investment community, the Secretary of Transportation, and other stakeholders testified that they thought a moratorium would be a bad idea. In addition, much of the testimony presented in those hearings focused on the service problems associated with other railroads mergers (and not with the way BNSF or CN had managed our own mergers), and many of the witnesses stated that they thought our merger would enhance competition and service to shippers. Despite these facts, the Board nonetheless accepted the anti-competitive, self-serving arguments of our competitors, ordering an unprecedented 15-month moratorium on major rail consolidation filings and activities, and suspending the BNSF/CN proceeding. It is inexplicable that the Board would believe that it has the extraordinary power to block the filing of our control application and yet believe itself powerless to block the merger of applicants who could not implement a merger effectively without creating a service crisis.

The Board's decision is illegal and in clear violation of the policies and terms of the ICC Termination Act.

We have filed a petition for judicial review of the Board's radical decision in the United States Court of Appeals for the District of Columbia Circuit. We also have petitioned the Board to stay its decision pending judicial review.

The Board's moratorium decision is inconsistent with both the policies and the plain terms of the ICC Termination Act and, for that reason, cannot stand. The decision contravenes the Board's statutory authority and duties. In the ICC Termination Act, Congress addressed the long history of interminable ICC merger proceedings by imposing strict deadlines on the acceptance and review of rail merger control applications. These deadlines were intended to further the Congressional policy favoring pro-competitive rail consolidations and to reduce the delays in achieving merger benefits that had characterized ICC practice.

In our view, the moratorium simply cannot be squared with the law-governing merger and control proceedings. As Chairman Morgan herself noted in her confirmation hearings before this Committee just a few months ago, "[w]hen market conditions motivate two class I railroads to want to merge, our statute tells us to review the proposal presented to us, applying certain statutory standards, and to approve

the merger if it is in the public interest." Testimony of Linda J. Morgan, Hearing On Reappointment, Sen. Committee on Commerce, Science, and Transportation, Sept. 28, 1999. Even if the moratorium could be squared with applicable law, it could not survive judicial scrutiny because the procedures used by the Board in deciding to issue it were grossly improper and unfair.

We have a number of complaints about the Board's procedures in imposing the moratorium, which we set forth in our stay petition. These procedural flaws are serious matters, because the essence of our complaint is that the Board's moratorium constitutes a pre-judgment on the merits of our application and, as a Board member noted in the closing comments at the end of the Ex Parte No. 582 hearing, "not to decide is, in fact, to decide." 3/10/00 Tr. at 225. Because the economy and our competitors will not stand still during the pendency of the moratorium, a fifteen month delay in the filing and processing of our application would irreversibly deprive both our shippers and stockholders of the benefits that our combination would have provided if not so delayed, and could preclude us from going forward with the combination at all.

The Board's decision, which vaguely directed railroads "to suspend activity relating to any railroad transaction," also is striking because it could be interpreted as preventing a wide variety of protected discussions, the pursuit of judicial review, and even this testimony here today. If, interpreted so broadly by the Board, the decision would clearly be an overbroad and flagrantly unconstitutional prior restraint on the exercise of First Amendment rights.

Needless to say, we are extremely disappointed with the Board's moratorium decision. By accepting the self-serving arguments and threats of our competitors this decision pre-judges our application before that application was even filed and subject to review. As I recently stated, if the Board's decision were to survive judicial review, it would penalize BNSF and CN—the two major railroads who are taking care of their customers—because of the failures of other railroads whose mergers have resulted in debilitating and costly service failures for shippers.

If given the opportunity to go forward with our combination application, we would prove that our combination will be in the public interest and would offer our customers unparalleled service. Over the past four years, BNSF has spent about $9.5 billion to improve its network, locomotive and car fleet, and to build and expand terminals and intermodal facilities. These investments, which would not have been possible had the ICC not approved the merger of Burlington Northern Railroad and The Atchison, Topeka and Santa Fe Railway Company in 1995, have enabled BNSF to provide customers with on-time service year-to-date in the 94% range—a superb performance that is the best that I've seen in this industry. A combination with CN would further enhance our service and provide our owners with better financial performance.

Therefore, we are frankly puzzled about how the STB could so radically and unfairly change the rules and deny us the forum established by law, to have our case heard in accordance with the deadlines established by Congress in the ICC Termination Act. Based on the existing criteria for approving rail mergers, our combination passes with flying colors. In fact, we have indicated that we are prepared to raise the bar ourselves to ensure that there would be no service disruption resulting from our combination and that greater competition would be injected into the industry.

The STB should not be permitted to stop a good merger in its tracks because of concerns about bad mergers coming down the road. And our competitors should stop frightening shippers with threats that, if our combination is not halted, they will carry out their own ill-considered mergers, once again saddling their customers (and ours) with service crises and breakdowns.

In conclusion, we hope that the Board will take the reasonable course, issue a stay of its moratorium, and permit our application to be filed and reviewed pending judicial review. If not, we are confident that the result of that judicial review will be the overturning of the Board's radical moratorium decision. And we appreciate the opportunity to offer for the record our views about the Board's precipitous and ill-considered moratorium decision.

BNSF NEWS RELEASE

BNSF's Krebs Says STB Moratorium Will Prevent BNSF and CN—Rail Industry's Best Service Providers—From Giving Shippers Even Better Service

FORT WORTH, Texas, March 17, 2000—Burlington Northern Santa Fe Corporation (NYSE: BNI) (BNSF) Chairman and Chief Executive Officer Robert D. Krebs said,

in response to today's Surface Transportation Board announcement, that, "We are extremely disappointed with the STB's decision to impose a 15-month moratorium on proposed rail consolidations. We have reviewed the decision, and while Chairwoman Linda Morgan's action may be well-intentioned, as it stands, it has the effect of denying our proposed combination with Canadian National Railway Company (CN) before receiving our application and giving it a proper review."

Krebs pointed out that, "If the STB decision survives judicial review, the result of the STB's decision is to penalize BNSF and CN, the two major North American railroads who are taking care of their customers, because of the failures of other railroads whose mergers have resulted in debilitating and costly service failures for shippers."

During the four-day hearing held last week by the STB to consider the future structure of the rail industry, Krebs said, "There was no clear consensus for imposing a moratorium. In fact, there was significant support from the Secretary of Transportation, shipper associations such as the National Industrial Transportation League, numerous individual shippers, short line railroads and municipalities for BNSF and CN to file their common control application without delay."

Krebs indicated that "BNSF will thoroughly review today's decision to determine what appropriate legal action we can take. If Chairwoman Morgan's radical decision stands, the effect would be something unheard of in any industry: For a period of 15 months, industry participants will be denied the opportunity to realize service and efficiency improvements that a carefully conceived and well executed combination can provide shippers, shareholders, employees and the public."

Krebs said that "Over the past four years, BNSF has spent about $9.5 billion to improve its network, locomotive and car fleet, and to build and expand terminals and intermodal facilities. These investments have enabled BNSF to provide customers with on-time service year-to-date in the 94 percent range—the best rail transportation service I've seen in my 34 years in the industry. We believe a combination with CN is the next step to providing our customers with even better service and our owners with better financial performance."

"It is hard to believe that a federal agency can change the rules and deny us a forum, established by law, to have our case heard. Based on all existing criteria for approving rail mergers, our proposed combination passes with flying colors. We have indicated that we are prepared to raise the bar ourselves to ensure that there is no service disruption and that greater competition is injected into the industry," Krebs noted.

Through its subsidiary, The Burlington Northern and Santa Fe Railway Company, headquartered in Fort Worth, Texas, BNSF operates one of the largest rail networks in North America with 33,500 route miles of track covering 28 states and two Canadian provinces.

North American Railways, Inc. and CN have filed a registration statement on Form F–4/S–4 with the Securities and Exchange Commission (SEC) in connection with the securities to be issued in the combination. This filing also includes the proxy statement for the shareholders' meetings to be held for approval of the combination. Investors should read this document and other documents filed with the SEC by CN, BNSF, and North American Railways, Inc. about the combination because they contain important information. These documents may be obtained for free at the SEC's Web site, *www.sec.gov*. Other filings made by BNSF on Forms 10–K, 10–Q and 8–K may be obtained for free from the BNSF Corporate Secretary's office. For information concerning participants in BNSF's solicitation of proxies for approval of the combination, see "Certain Information Concerning Participants" filed by BNSF on Schedule 14A under Rule 14a–12.

SELECTED EXCERPTS FROM WITNESSES WHO TESTIFIED BEFORE THE SURFACE TRANSPORTATION BOARD AND COMMENTS FROM THE JOURNAL OF COMMERCE

Here we hasten to note, though, that we do not believe a moratorium is the right response.

(The Honorable Rodney Slater, U.S. Secretary of Transportation—March 7, 2000)

We are disappointed that the Board ordered a 15-month suspension of all merger activity, including a proposed consolidation of the Burlington Northern Santa Fe/ Canadian National Railroads.

(The Honorable Rodney Slater, U.S. Secretary of Transportation—Press Statement—March 17, 2000)

First, it would be a huge mistake if the Federal Government were to take on a central economic planning role for railroads that would dictate and regulate the timing of when corporate transactions in the rail industry could even be considered. No other industry in the U.S. has to receive the government's permission to propose a corporate transaction. In addition, from a practical standpoint, undue delay or the enactment of a "moratorium" on when transactions should even be considered can be tantamount to a denial of a transaction, without the benefit of an actual and fair hearing on the merits of a proposal.
(Robert Krebs, Chairman/CEO, BNSF—March 7, 2000)

A fair hearing delayed is a fair hearing denied. For that reason, our railroad opponents hope that you will delay a fair hearing on our combination, at least until they feel they are more ready to respond to it. They would prefer not to tighten their operations with an eye towards increasing efficiency; delay will free them from the need to meet our new efficiencies with new efficiencies of their own. That is protectionism on its face, and you ought to reject it as such.
(Paul Tellier, President/CEO, Canadian National Railway—March 7, 2000)

This is why I believe strongly that the proposed merger should not be subject to any sort of moratorium. The public interest would be served better by a complete airing of the issues surrounding a major combination such as is being proposed. The League stands ready to fully participate in the merger process. To cut short the legitimate merger process would be a mistake, we believe.
(Ed Emmett, President, The National Industrial Transportation League—Letter to STB Chair Morgan—March 14, 2000)

But's it's a little ironic that the railroads who have botched their mergers the most, now don't want the two that did pretty well in theirs to go forward. There is a certain irony in that.
(Ed Emmett, President, The National Industrial Transportation League)

The STB has an important role to play here. That role should not be to frustrate a beneficial merger and deny benefits to its proponents and their customers due to a fear of "downstream effects" from others. Such a miscarriage of justice would deny basic economic freedom to the proponents of the merger. BNSF and CN and customers supporting the merger should not be penalized for the difficulties of others. This is a basic issue of fairness and due process . . . The BNSF and CN merger should not be held hostage to the ability of other railroads to participate in mergers of their own at the same time.
(J. Reilly McCarren, President and CEO of Wisconsin Central—March 8, 2000)

A more restrictive approach to the analysis of consolidation, considered in isolation of other factors, would likely diminish the willingness of companies to engage in such combinations, even in circumstances where such combinations would be in the interest of the railroads, their customers and employees and the public.
(Robert S. Kaplan, Goldman Sachs—March 7, 2000)

The government should not delay making decisions on real-world transactions. Such delays are more likely to harm consumers and producers, and hinder innovation by deferring the benefits of "good" consolidations. . . . Regulators cannot, however, determine when capital markets will find opportunities for efficiency gains—these opportunities come and go . . . the Board should encourage competition; it should not allow any competitor to delay the introduction of increased efficiency and competition while that competitor resolves its current problems.
(Robert W. Hahn, AEI-Brookings STB—March 9, 2000)

It is hard to see why the difficulties of some railroads in implementing the improved connections that should have come with consolidation should be used to prevent others from achieving these gains. To allow this argument would have perverse incentives; service failures would be rewarded by shelter from competition.
(Kenneth Arrow, Professor Stanford University—March 8, 2000)

STB policy follows one of the basic tenets of antitrust/competition policy: protecting competition, not competitors. As long as competitive alternatives are preserved, then the STB lets market forces determine where in the system there are efficiencies to exploit, and lets shareholders and business decision-makers suggest both the scope and timing of such transactions . . . The STB should avoid letting rail industry players dictate the pace of action of their competitors.
(Joseph Kalt, Amy Candell, Kennedy School of Government)

Capital-intensive, mature industries are undergoing consolidation. Railroads, steel, aluminum, chemicals—you name it—are under pressure to use their capital more efficiently. A merger that increases the density of traffic on rail lines is one way of accomplishing that. Neither the STB nor any other government agency can change that for long.
(The Journal of Commerce—March 1, 2000)

I am in favor of allowing the BNSF/CN merger to go forward. This combination will give numerous shippers and communities on the C&G and throughout a significant portion of Mississippi more efficient access to some of the longest, single line service in North America.
(Roger D. Bell, President and CEO, Columbus and Greenville Railway—March 8, 2000)

Delaying the benefits of a good transaction is not in the interests of anyone, other than competitors.
(Robert Grossman, Chairman and President, Emons Transportation Group, Inc.—March 8, 2000)

PREPARED STATEMENT OF JOHN W. SNOW, CHAIRMAN AND CEO, CSX CORPORATION AND CSX TRANSPORTATION, INC.

Thank you for the opportunity to present this statement for the record on behalf of CSX Corporation and CSX Transportation, Inc.

I wholeheartedly support the Surface Transportation Board's (the "Board") very important, bold and correct decision in Ex Parte No. 582, Public Views on Major Rail Consolidations, to suspend for 15 months any activity that would be characterized as a "major transaction" by the nation's Class I railroads pending development of new rules by the Board.

This decision is a strong recognition by the STB that a BNSF/CN merger, or any other rail merger, is not in the public interest at this time.

While a longer pause would have been preferable, the Board's action clearly reflects the unstable nature of the industry and the overwhelming concern expressed by rail customers, railroad employees, the financial community and the public—all of whom are critically dependent upon a financially strong and stable freight rail system.

By proceeding with a rulemaking at this time, the Board has accomplished two very important things. It has recognized the need, first, to assess and update the standards by which mergers are reviewed by the STB given the current state of the nation's freight railroad industry, and second, to apply those standards to any future rail mergers in an orderly and rational way. To redefine merger standards while at the same time considering merger applications would invite chaos.

Many public officials, including members of this Committee, have voiced strong support for the Board's decision noting the unstable nature of the nation's freight rail system and the need for a period of calm, free from the diversion of an ill-timed merger. I too share those sentiments and firmly believe that the Board's decision gives the industry the opportunity to focus on resolving merger-related service issues, and effectively bringing recent rail mergers to a successful conclusion for the benefit of our customers and the public.

It should be noted that the Board arrived at its decision after having conducted an exhaustive review of the issue, which included several hundred statements from shippers, rail labor, financial analysts and public officials, as well as a four-day hearing during which the Board heard from more than 160 witnesses. The overwhelming majority acknowledged the industry's instability and the need for a respite from merger activity. Large customers like United Parcel Service and General Motors were clear in their positions. In fact, a vice president with UPS suggested during the four-day hearing that no new mergers be considered until at least 2002.

These companies, along with Wall Street, recognize that any merger at this time would have very negative consequences. Much-publicized rail congestion and delays resulting from recent rail mergers in the eastern and western U.S. have shaken customer confidence. A merger at this time would only add to the current instability and result in more ill timed mergers. Railroad attention would be diverted from the main task at hand—that of fixing the existing system. Finally, the industry would be destabilized even further by an almost-certain return to greater government regulation.

The net effect would be a stranglehold on our efforts to rebuild the country's railroads by destroying our ability to raise the necessary capital to maintain the health of the industry and restore shipper and investor confidence.

We must put the country's railroads on a stronger financial footing if we are going to be in a position to make the capital infusions necessary to give shippers what they need most—reliable rail transportation. I believe the Board's decision paves the way for achieving that goal.

As I stated in my testimony before the Board during the March 7 hearing, "Before we decide to take any giant steps, we should finish what we have started, learn the lessons of our mistakes, and only then proceed. . . . Collectively, we owe it to our customers, our employees, our shareholders and the public to get this one right."

It is because of this that CSX has filed in opposition to the two stay requests filed with the Board and will seek to have the Board's decision upheld in the Court of Appeals.

On behalf of CSX, I thank you for the opportunity to submit this statement for the record.

PREPARED STATEMENT OF PAUL M. TELLIER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CANADIAN NATIONAL RAILWAY COMPANY

Madam Chairman and Members of the Subcommittee:

On behalf of the Canadian National Railway Company (CN) and its affiliates, I appreciate the opportunity to submit this testimony for the record of the Subcommittee's March 23 hearing on the Surface Transportation Board's (STB's) railroad merger moratorium policy.

The STB's policy with respect to mergers of the largest railroads, the Class I carriers, is a matter of the utmost importance to CN, and we commend the Subcommittee for its examination of this important issue. Given recent events, CN is in a unique position to comment on the STB's merger policy and the Board's recently-imposed 15-month moratorium on new rail mergers. After providing a brief description of our situation, CN would like to comment on two major aspects of the Board's recent activities in this area.

General Background

On December 20, 1999, CN and The Burlington Northern Santa Fe Railway Company (BNSF) filed at the STB a notice of intent to file, on approximately March 20, 2000, an application seeking STB authorization to bring our two railroads under common control. This combination will afford competitive transportation advantages to our customers at lower cost and enhance the safety and efficiency of our operations—without service disruption, without additional corporate debt, without interfering with the operations of our connections, without adverse effects on the environment, and with minimal impact on employees. This essentially end-to-end transaction is good for shippers, competition, the economy, and the shareholders of CN and BNSF.

Shortly after we filed our notice of intent, the STB issued an order on December 28, 1999, announcing that, in the course of our control proceeding, the Board would break with its long-standing precedent of reviewing each merger case on its own merits, and instead would consider not only the direct impacts of our combination but also evidence of "the cumulative impacts and crossover effects that would likely occur as other railroads developed strategic responses in reaction to the proposed combined new system." Later, on January 24, 2000, the STB initiated its STB Ex Parte No. 582 proceeding, Public Views on Major Rail Consolidations, to examine these consolidations and the present and future structure of the North American railroad industry. The STB's notice of this hearing said nothing about the possibility of a moratorium, but it did say that the hearing would not result in any prejudgment of the CN/BNSF transaction.

Earlier this month, the STB conducted four days of hearings in the STB Ex Parte No. 582 proceeding. During the hearings, many witnesses supported a reexamination of the STB's merger rules. However, there was no clear consensus for imposing a moratorium on STB consideration of rail merger applications. In fact, the only unanimity in support of a moratorium came from the major competitors of CN and BNSF. If people had known beforehand that the STB would seize upon a moratorium as a result of this hearing, the STB may have heard a lot more opposition to that concept. Even so, most witnesses filing statements or letters, or testifying in person at the hearings, supported proceeding with consideration of the merits of the CN/BNSF transaction without delay. For example, Secretary of Transportation Rodney Slater stated that any type of STB-imposed moratorium on consideration of our transaction would be inappropriate. Shipper associations (such as the National Industrial Transportation League), short line railroads, municipalities, academics, and a majority of individual shippers, also supported prompt consideration by the STB

of the CN/BNSF application. In addition, more than 200 shippers wrote to the STB in support of fair and prompt consideration of our transaction.

Despite this support for moving forward, the STB issued a decision on March 17 imposing a moratorium for 15 months on activity related to mergers of Class I rail carriers and announcing the initiation of a rulemaking proceeding to consider new rail merger rules. By taking this action, the STB suspended its review of the proposed CN/BNSF combination, without allowing us to file our formal application or make our case on the merits.

CN wishes to raise concerns about two aspects of the Board's activities.

Moratorium on Class I Railroad Mergers

When it initiated the STB Ex Parte No. 582 proceeding, the Board declared, "we intend no prejudgment of the yet-to-be filed BNSF/CN application." Yet, without receiving our formal application, or giving any consideration to the merits of our proposed transaction, the STB last week precluded any consideration of our application by refusing to accept Class I merger filings for 15 months and suspending the notice of intent filed by CN and BNSF.

The STB's purported authority to take this action was 49 U.S.C. § 721(a) and § 721(b)(4). The first allows only those regulations for "carrying out" the STB's statutory duties, such as holding proceedings to consider transactions. The second is intended to allow the STB to issue injunction-like orders to prevent irreparable harm in specific matters, such as a rate reasonableness hearing. It was never intended to authorize general orders, like the moratorium order, freezing the competitive structure of the rail industry. That is a power that Congress did not give to the Board, explicitly or implicitly. The STB, in issuing this order, has repudiated its statutory duty under 49 U.S.C. § 11323–5 to promptly review the CN/BNSF consolidation proposal. In failing to attend to its duties, it has committed a legal error. Under current law and STB regulations, we are entitled to a decision on the merits of our proposal within 16 months of the date we file our application, which the moratorium improperly prevents us from doing.

The STB's decision is not only unauthorized by Congress, it is also a de facto amendment or rescission of the STB's regulations, applied retroactively to prevent the filing of the CN/BNSF application and a subsequent decision on the merits by the STB. The decision's illegality is compounded by its blatant unfairness.

We maintain, therefore, that the Board lacks the statutory authority to impose this moratorium. On March 17, CN and BNSF filed notices of appeal with the U.S. Court of Appeals for the District of Columbia Circuit, and we have filed with the STB a petition for a stay—pending judicial review and prior to seeking, if necessary, a judicial stay pending that review—of the Board's decision. We intend to vigorously pursue all avenues available to us under applicable law.

The STB repeatedly cites the service problems of the rail industry. However, the mere pendency and hearing of the CN/BNSF application will not threaten irreparable harm to railroad service or contribute to further service problems. This will only happen if railroad executives ignore their own problems, and if the Board then fails to make them remedy such problems. Over the longer term, the Board could consider future potential service problems during its consideration of the downstream effects of the CN/BNSF combination, as it already announced that it intended to do.

In any event, the STB has the power, by proper application of the public interest standard, to prevent future mergers from happening before the prospective merger partners are ready to implement them without significant risk of service problems. It makes no sense to hold up good mergers, like the CN/BNSF combination, out of a misconceived notion that the STB is powerless to stop bad transactions.

Prolonged Proceeding on New Merger Rules

In its decision last week, the Board also announced that it would institute an approximately 15-month proceeding to consider new merger rules. Given the record that has been developed in the STB's recent STB Ex-Parte No. 582 proceeding, as well as in the course of the STB's consideration and oversight of recent rail mergers, it is unclear why such a lengthy process is necessary.

The Board's schedule for a reevaluation of its merger rules is considerably longer than the time periods allotted for other recent major STB proceedings, including STB Ex Parte No. 627, Market Dominance Determinations—Product and Geographic Competition, and STB Ex Parte No. 628, Expedited Relief for Service Inadequacies, both of which addressed significant rail policy issues.

Further, in its March l7 decision, the STB expressed its concern about uncertainty and instability in the railroad industry as part of the rationale for new merger rules. If such uncertainty and instability do indeed exist, the Board should feel even

more compelled to move expeditiously to reexamine its merger rules, so that rail carriers, their customers and employees, and the financial markets will know what to expect in the future with respect to the structure of the rail industry.

A prolonged rulemaking proceeding, combined with the 15-month moratorium on consideration of Class I rail mergers, will do nothing to strengthen the competitive viability of the railroad industry. Rather, it will have the opposite effect. The U.S. economy is dynamic and the transportation sector must continue to grow and redefine itself to meet new market challenges. Rather than allowing railroads to become more efficient and effective competitors—both intermodally and intramodally—the Board's March 17 decision will reduce competitive pressures and, hence, reduce incentives to improve service and keep prices down. In protecting railroads that would have to face the increased competition that would result from the CN/BNSF combination, the STB is not doing the job that Congress intended.

In sum, CN strongly disagrees with the STB's March 17 decision, which we believe exceeds the scope of the Board's statutory authority. The STB's decision deprives CN and BNSF of our statutory right to a prompt and fair hearing. It is also contrary to the public interest in efficient rail transportation. In fact, if the STB's consideration of our proposed transaction does not proceed, the public benefits of the CN/BNSF transaction, which could be in excess of $500 million annually, will be either delayed or lost forever.

Thank you again for the opportunity to submit this statement for the record. We stand ready to assist the Subcommittee as it considers this vital issue.

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