

INTERSTATE COMMERCE COMMISSION 07/01/96

FINANCE DOCKET # 32760

121-180 3+

1 quite a disparity between the applicant and the
2 Justice Department.

3 MS JONES: I wouldn't have an opinion
4 about that, Commissioner Owen. But I would suggest
5 that maybe it would -- we could urge you to take some
6 of their other positions with a grain of salt as well.

7 COMMISSIONER OWEN: I just proposed to
8 give you an opportunity to dance around a little bit.

9 MS JONES: Thank you.

10 CHAIRPERSON MORGAN: Thank you very much.
11 Next we will hear from Scott Stone, who is
12 representing the Chemical Manufacturers Association.
13 And Mr. Stone, you will have five minutes.

14 MR. STONE: Thank you madam Chairman.
15 Madam Chairman, Vice Chairman Simmons and Commission
16 Owen, I'd like to introduce Thomas e. Schick, who is
17 Assistant General Counsel of the Chemical
18 Manufacturers Association, and has served as inside
19 counsel in this matter.

20 Members of the Board, CMA's position today
21 is the same as that stated in its brief, filed early
22 in June, CMA 12. And perhaps I should just sit down

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 now, but I'd like to just spend two minutes outlining
2 CMA's position and how it came to it, and answer any
3 questions you may have.

4 In sum, CMA neither supports nor opposes
5 this merger. But if the merger is granted, strongly
6 urges the Board to adopt as condition the CMA
7 settlement which is incorporated into the second
8 supplemental agreement that was filed last Friday
9 between, by UP/SP in UP/SP 266. That agreement
10 between UP/SP and BNSF incorporated the terms of the
11 CMA settlement, at least most of them, as well as
12 making some additional provisions.

13 Now CMA originally filed comments on March
14 29 opposing the merger. The principal reasons were
15 that, in our view, the merger would reduce the
16 competition and the trackage rights agreement with
17 BNSF would not be adequate to remedy those problems.
18 We felt at that time that the main issue was whether
19 BNSF would have access to sufficient traffic and would
20 have the operational ability to compete aggressively
21 for the traffic available to it.

22 Nonetheless, CMA continued to study the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 issues and I should say, by the way, that a number of
2 CMA's members, independent of CMA, filed comments and
3 statements both supporting the merger and opposing the
4 merger, in different cases, and they remain able to do
5 that today.

6 But CMA's comments indicated that CMA
7 might not oppose the merger if a set of eight
8 conditions could be addressed. And those conditions,
9 which were Attachment A to the comments, dealt
10 principally with giving BNSF access to more traffic,
11 with making certain operational improvements that
12 would facilitate BNSF's ability and incentives to
13 compete.

14 There then followed a series of
15 negotiations between CMA and the applicants and BNSF.
16 Following which a proposed settlement addressing CMA's
17 eight points, was arrived at. And on April 16, 1996,
18 that agreement was approved. It was then signed -- I
19 should say that it was approved by CMA, who then
20 signed with the applicants and BNSF on April 18 and
21 submitted to the Board on April 19 in filing UP/SP
22 219.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 CMA has summarized the provisions on that
2 settlement in its brief, CMA 12 and I won't repeat
3 those points here.

4 So, at present in sum CMA does not oppose
5 or support the merger. CMA's settlement continued to
6 safeguard the rights of CMA's members to speak and
7 advocate remedies. And several of them, in fact, are
8 here today. And others have submitted statements.

9 So, if I could summarize what you need to
10 look at, sort of the ABCs of what we are recommending.
11 Number one, that if you do approve the merger you
12 approve the BNSF trackage rights as amended. Second,
13 that you look at the points that were part of the
14 settlement between CMA and the applicants, but which
15 were not included in the BNSF settlement, because BNSF
16 really didn't play a role in them. Those points are
17 set out by the applicants in filing UP/SP 266 on page
18 3 in the first footnote. And UP and SP have committed
19 to carrying through and complying with those
20 provisions of the CMA settlement.

21 And the third thing that CMA would submit
22 to the Board is that we strongly recommend five years

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 of scheduled annual oversight proceedings.

2 CHAIRPERSON MORGAN: Let me ask about
3 that. Obviously, as I indicated earlier in one of my
4 prior questions, there has been some concern about
5 whether that oversight has any teeth to it. Obviously
6 you represent shippers who would have an interest in
7 that particular issue. How do you feel about
8 oversight?

9 MR. STONE: Well, as Mr. Roach point out,
10 CMA Agreement specifically says, and I'll quote one
11 sentence of paragraph 14 of the CMA settlement. The
12 Board shall have authority to impose additional
13 remedial conditions. Now, I think the applicants feel
14 and we feel that if the market can fully do the job,
15 the market should do the job. If regulation is
16 needed, we should have regulation.

17 We believe that oversight is an important
18 element of this merger. You heard, and will continue
19 to hear for most of the rest of the day, a lot of
20 people spinning out horror stories of -- which are
21 really not horror stories, but predictions of what
22 they think may happen.

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 CMA has attempted in its settlement to put
2 in place the necessary conditions that will enable
3 BNSF to compete. But we can't predict whether BNSF
4 will compete. We think they will, but can't be sure
5 that they will. We believe that the oversight
6 proceeding is necessary.

7 And if, in fact, these horror stories or
8 predictions come to pass, I am sure that CMA members
9 will be here before the Board, letting the Board know
10 that the merger is not working. And I suspect, given
11 that specter, the applicants and the BNSF will not
12 allow that type of dissatisfaction to occur.

13 CHAIRPERSON MORGAN: So, I would, from
14 what I hear you saying then, if divestiture were not
15 ordered in this case, but seemed to be needed in the
16 future, that the shippers, particularly your group,
17 would intend to pursue oversight in an active way in
18 that respect. Is that --

19 MR. STONE: I believe that members of CMA
20 would participate. We have not developed any specific
21 triggering criteria that would bring us in the doors
22 of the Board, but I believe that if anything occurred

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 approaching the level of dire predictions that some of
2 the participants put forward, that you would see a lot
3 of shippers in this room.

4 VICE CHAIRPERSON SIMMONS: So I'm to
5 believe that a majority of your members with the BN
6 Santa Fe support a merger?

7 MR. STONE: I want to answer quite
8 precisely, Vice Chairman Simmons. CMA made its
9 decisions through its duly constituted committee
10 structures and processes. At no point did it open the
11 question, put to the question to a general plebiscite
12 of it's members. It just doesn't operate that way.

13 But, yes, a majority of the members of the
14 committee with authority over this matter voted to
15 approve the settlement.

16 VICE CHAIRPERSON SIMMONS: Okay.

17 CHAIRPERSON MORGAN: Now, in entering the
18 settlement agreement, I would expect that some of your
19 members, at least, if not more of them, saw some
20 benefits to this merger. Is that accurate?

21 MR. STONE: I believe they did, Chairman
22 Morgan. But, the discussion did not depend

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 specifically on those benefits. Some of CMA members,
2 I'm not speaking for them, have pointed out some of
3 the benefits they perceive. Mr. Roach has alluded to
4 some of those members.

5 And CMA, perhaps more helpfully, never
6 submitted evidence of the benefits.

7 CHAIRPERSON MORGAN: So there's more --

8 MR. STONE: It never challenged the
9 benefits, it never submitted evidence on that. So I
10 think you should look to other parties to --

11 CHAIRPERSON MORGAN: But it was more than
12 certain issues that were important to your members.
13 Obviously this agreement is intended to address those
14 concerns, address those concerns --

15 MR. STONE: Yes, the agreement focuses on
16 the anticompetitive concerns, and we believe
17 adequately addresses those concerns.

18 COMMISSIONER OWEN: Excuse me, are most of
19 your members, members of the Met League, also?

20 MR. STONE: I'm not sure. I suspect that
21 a good portion are. I don't know the precise
22 percentage.

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 COMMISSIONER OWEN: An assumption on my
2 part from being a businessman, that if a group such as
3 yours would vote on something of this nature, then
4 they expect the quality of service and the price to be
5 commensurate with the marketplace. They must think
6 they are getting a fairly decent deal, or else they
7 wouldn't be moving ahead. I just make an observation,
8 I --

9 MR. STONE: We were trying to take account
10 of the real world. That's right.

11 COMMISSIONER OWEN: Thank you.

12 CHAIRPERSON MORGAN: Thank you very much.

13 MR. STONE: Thank you very much.

14 CHAIRPERSON MORGAN: Next we will hear
15 from Charles White, Jr., representing Utah Railway
16 Company.

17 MR. WHITE: Good afternoon Madam Chairman.
18 My name is Charles White. I have the privilege of
19 representing Utah Railway in this proceeding.

20 Utah Railway strongly supports its
21 settlement agreement, strongly supports the Burlington
22 Northern settlement agreement to which it is linked.

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 And as a corollary strongly opposes the inconsistent
2 application filed by Montana Rail Link on the central
3 corridor as being both unnecessary and more important
4 deleterious to competition on that corridor.

5 Utah Railway is an historic bringer of
6 competition to the Utah coal fields. It has moved
7 over 30 percent of coal mined in Utah over its
8 lifetime. And it is a living example of how trackage
9 rights work.

10 A fact that has been overlooked by many
11 parties in this proceeding is that Utah Railway is a
12 co-owner with Southern, with Southern Pacific, of the
13 very significant portions of the central corridor at
14 issue in the inconsistent application. Moreover, it
15 is intertwined with Southern Pacific with trackage
16 rights agreements running through the coal fields in
17 Utah.

18 As a result of that very close
19 relationship, Utah Railway has been able to cooperate
20 with Southern Pacific and its predecessor the Rio
21 Grande, while it competed head on with them. And as
22 our brief shows, in the latter years it is winning the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 competition and developing new coal moves.

2 The fact of the interlaced relationships
3 between the Utah Railway and Southern Pacific has
4 caused two important aspects that have matured in this
5 case. One was the negotiations with the applicants.
6 They realized early on that the Burlington Northern
7 settlement agreement had a rather large obstacle to
8 cross were it to work, and that is to have access to
9 Utah Railway's trackage. And they do not have access,
10 except with the written consent of Utah Railway.

11 So our negotiations with the applicants
12 began on a technical level at this stage, but quickly
13 moved into a very procompetitive settlement. As a
14 result of that settlement agreement, Utah Railway will
15 have access to Grand Junction Colorado, an extension
16 of over 170 miles to the east, and will have access to
17 important new high Btu, high quality coal mines.

18 And with that access to the east, Utah
19 Railway is already working with Burlington Northern,
20 I want to underline that for the Board, to develop new
21 movements of high quality, low sulphur, high Btu Utah
22 coal to new eastern and mid-western destinations. We

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 feel we are in a perfect position, with the
2 cooperation of Burlington Northern and with the new
3 service of an extended UP/SP system, to reach out and
4 send the premium Utah coals on an expedited basis to
5 utilities in the central segment of the country.

6 We are in a perfect position to compete
7 with Appalachian coals of similar Btu and the sulphur
8 content, and I can vouch for my colleagues who are in
9 the room with me, intend to vigorously compete and to
10 move that coal.

11 The second part of the aspect of our
12 interrelationship with the ownership of the central
13 corridor, of course, touches Montana Rail Link.
14 Montana Rail Link, as an inconsistent applicant,
15 neither acknowledged our ownership of their sought
16 property, nor consulted with us during the building of
17 the case. But that aside, that's not at all the
18 important aspect of what I would like to talk about.
19 The real deleterious affect of what Montana Rail
20 Link's alternative to BN on the central corridor is
21 the simple fact that they are not sufficient in terms
22 of reach, in terms of their own market destinations.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 And in fact because of that they would be a less
2 qualified competitor for us than Southern Pacific is
3 today, and certainly a far less competitive force than
4 the combination of a BNSF and a UP/SP alternative.

5 Furthermore, their proposal would have
6 overhead trackage rights given to the two large
7 carriers on the corridor, and as rent payers that
8 would only invite them to find other routes for their
9 service, lowering the density on the corridor and
10 leading to its ultimate demise.

11 I agree in closing with the Department of
12 Transportation that Montana Rail Link's solution to
13 the central corridor problem is no solution and there
14 is no problem. There is more competition than ever
15 under the settlement agreements on the corridor.
16 Thank you, your Honor.

17 CHAIRPERSON MORGAN: Now, in this record
18 we have much concern expressed by the western coal
19 shippers that this merger could hurt the
20 competitiveness of Colorado Utah coal. How does your
21 entering into this picture respond to that concern?

22 MR. WHITE: We have precisely the opposite

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 apprehension, of course, and we are acting on our
2 apprehensions. Utah Railway, in conjunction with the
3 two major systems, is in the process now of opening
4 new markets towards the east for Utah coal. We feel
5 with the reach provided by the two supersystems, if I
6 may use that word, and the quality coal coming off of
7 our origins, we will be highly competitive. In fact,
8 so competitive that one of our colleagues, one of the
9 coal companies in Colorado, Colowyo, has asked this
10 Board for protection against the new competition they
11 feel coming eastward from Utah.

12 It's quite contrary to the hypothetical
13 fears of the coal shipper groups. We have an 80 plus
14 year history of being a low cost, high quality coal
15 mover, and that, in combination of the reach of the
16 two supersystems, should provide extraordinary
17 marketing opportunities that will be capitalized upon
18 by Utah.

19 We feel it's highly competitive. The
20 support we have from our mines, our shippers has been
21 unanimous. And if you will allow me to just bring one
22 example to the Board's attention. I think this tells

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 in the strongest way the feeling of competition for
2 Utah coal shippers. And that is there is a very
3 important new mine facility being developed at Willow
4 Creek, which is technically not exactly on our line,
5 but off of it by a short distance. As part of the
6 settlement agreement, the Cypress AMAX people agreed
7 to allow Utah Railway to have exclusive access to that
8 new facility. And, allows us to be something like an
9 honest broker between the two giant systems for
10 through movements both to the east, to the new market
11 targets, and to the Pacific Rim. Utah Rail --

12 VICE CHAIRPERSON SIMMONS: Is that the
13 midwestern --

14 MR. WHITE: And to the midwest, of course,
15 your Honor. And, if I can close by also saying that
16 western movements, Utah Railway today generates the
17 majority of coal moving to the Pacific Rim through the
18 ports in California.

19 VICE CHAIRPERSON SIMMONS: And that's
20 because of your Btu content?

21 MR. WHITE: That's because of the high
22 quality coal we have, yes, your Honor. And this is

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 the most procompetitive development in the central
2 corridor that I can imagine. We have access to the
3 new quality coal and access to the two preeminent
4 systems with reach throughout the United States. And
5 this can be nothing but procompetitive for everybody
6 concerned.

7 COMMISSIONER OWEN: Now you will be
8 competitive with the east coast coal also out of
9 Appalachia and --

10 MR. WHITE: Absolutely, your Honor, and
11 that's precisely the target we are looking at because
12 of the similarities of the coal and the new reach that
13 we can get going eastward. We will go head on head
14 with the Appalachian coal for the utilities in the mid
15 section of the country.

16 VICE CHAIRPERSON SIMMONS: That's a long
17 haul.

18 MR. WHITE: It's a long haul, but we can
19 do it. There is no reason why we can't do it. We are
20 going to do it.

21 COMMISSIONER OWEN: Even with the
22 additional mileage there, you are going to be

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 competitive with Appalachia?

2 MR. WHITE: We are intending to be
3 competitive with Appalachian coal in that mid section
4 of the country.

5 COMMISSIONER OWEN: What rail line service
6 is Appalachia for their --

7 MR. WHITE: It would be CSX, but I'm
8 talking about the utilities in the Mississippi River
9 Basin. So --

10 COMMISSIONER OWEN: I was just trying to
11 bring up the competitive nature of the rail lines,
12 that we are still able to move at that distance and
13 still really do a good job of it.

14 MR. WHITE: It would be CSX and it would
15 be Norfolk Southern, of course. But the utilities
16 that we are targeting in the, really, the mid section
17 of the country. So that the rail rates won't be
18 completely prohibitive, they will be adjustable and
19 contestable and competitive.

20 In sum, we feel that we have a very
21 competitive settlement agreement and we respectfully
22 ask for your approval of that agreement should the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 merger be approved.

2 CHAIRPERSON MORGAN: Thank you very much.
3 What I would like to do now is to recognize the
4 Honorable Ann Bingaman who has joined us. I
5 understand that she has a tight schedule. So, if you
6 could come up and make your presentation now, then we
7 will go back to the regular schedule and we will hear
8 from DOT and then we will go back and hear from the
9 Justice Department again, if that would be all right.

10 MS BINGAMAN: Chairman Morgan, that is
11 very generous of you and I appreciate it very much.
12 I did not seek it, but I accept it. Thank you very
13 much.

14 I heard someone say a minute ago that they
15 took our position with a grain of salt, and I guess I
16 would say to you, I am the salt. And the Department
17 is the salt.

18 CHAIRPERSON MORGAN: We've been the salt,
19 too.

20 MS BINGAMAN: We take this with extreme
21 seriousness. I have personally devoted many hours to
22 this as have the top deputies in the antitrust

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 division and the staff has devoted enormous time for
2 many months. We do not take the positions we take
3 lightly. We take them with the greatest seriousness
4 and the greatest sternness, and with some regret we
5 wish we could be before you in a happier mode.

6 I would say simply that this merger is of
7 enormous importance. It is of enormous importance to
8 the country and to competition in this most
9 fundamental of industries, rail transportation.

10 The merger is unlike any other merger, I
11 think, that this Board or its predecessor has ever
12 considered. It is larger. It involves more parallel
13 lines. And it would affect competition in many more
14 markets. It is also a merger which has a remedy of
15 unprecedented scope, the trackage rights which you
16 have under consideration.

17 It is the Department's considered view
18 that the applicants here are asking this Board to do
19 something that is in fact extremely radical, allow the
20 most anticompetitive rail merger in our history. And
21 a merger which would harm prices for consumers
22 nationwide.

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 I would say the Board should take into
2 account the fact that there will not be other
3 railroads built in the west, or elsewhere. There is
4 no argument about the proper product market here,
5 which is rail transportation, and we believe, in fact,
6 there really is not much argument because of the
7 extensive trackage rights proposed to solve the
8 problem. That approval of this merger would result in
9 a monopoly in many markets, and rail monopoly
10 throughout the west forever.

11 The trackage rights agreement which is
12 proposed to solve these immense competitive problems
13 is itself unique, extreme. It is a trackage rights
14 agreement which would cover thousands of miles of the
15 UP/SP system. This arrangement in its scope and
16 magnitude, and length of the trackage rights proposed
17 to try to solve the tremendous monopolies created here
18 is an arrangement without precedent in the industry.
19 Because of that the effectiveness of the immense
20 trackage rights proposal is highly uncertain, and even
21 then it does not cover all the competitive problems.

22 Finally, the applicants have asked this

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 Board to adopt a novel rule of law, that this
2 anticompetitive transaction can be justified by the
3 financial condition of SP, a company that is
4 admittedly not failing, whose assets will not leave
5 the industry absent the merger, and this also is a
6 unique aspect of what is sought here in remedy.

7 The Department has taken an active role in
8 these proceedings because of the fundamental
9 importance of rail transportation and costs in so many
10 segments of the economy, the ripple effect we believe
11 this merger would have.

12 After reviewing all of the evidence and
13 after months and months of work, we have concluded
14 that the public interest dictates in our view that the
15 application be denied. We believe denial of the
16 application would restore competition immediately and
17 allow SP to get on with the business of strengthening
18 itself or coming up with an alternative transaction
19 that does not raise these immense competitive concerns
20 that are present on this application.

21 If the Board does decide to approve this
22 merger, we believe it should be conditioned on

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 divestiture of the lines we have identified, and that
2 these divestitures must be to a party other than BNSF.
3 Nothing less could possibly protect competition.

4 We believe, however, that because of the
5 complexity of the issues here and the scope of this
6 merger, by far the better course is simply to deny the
7 application outright and let the parties come up with
8 a better proposal.

9 I repeat, we have not come to this
10 lightly. We have devoted months and months of work to
11 it. I would say to the Board that of the many rail
12 mergers we have participated in in the last 20 years,
13 the Department has opposed only two of them outright,
14 as we do here. Both of which were disapproved by the
15 ICC.

16 We are forced to conclude that the
17 applicants have not met their public interest burden
18 and that the merger should be disapproved. Roger
19 Fones, the Chief of of the Transportation, Energy and
20 Agriculture Section will make the major presentation.
21 I'd be glad to answer any questions.

22 VICE CHAIRPERSON SIMMONS: Before you

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 leave, it seems to be the basic premise of the
2 Department of Justice that the prices become higher as
3 the competitors decrease, is that your feeling?

4 MS BINGAMAN: yes.

5 VICE CHAIRPERSON SIMMONS: Well, how do
6 you explain that in the Powder River Basin you only
7 have two railroads, the Burlington North and the Union
8 Pacific, and in the east you only have two, you have
9 Norfolk Southern and CSX, and the prices are going
10 down, in both cases?

11 MS BINGAMAN: We think the scope of this
12 merger is unprecedented. We think the Powder River
13 Basin precedent is too small, and too narrow, and too
14 recent to be applied to the facts of this case. I am
15 actually not familiar with the prices in the east, but
16 Mr. Fones can address it if you want to.

17 VICE CHAIRPERSON SIMMONS: Okay.

18 COMMISSIONER OWEN: The Department of
19 Justice predicts that if this merger is approved there
20 will be a collusive behavior between the applicants
21 and their principal competitor, BNSF. For the past
22 quarter century, there have been dozens of rail

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 mergers and many have resulted in duo-opoloies in the
2 various markets. Where duo-opolies have occurred in
3 the past, can you provide any evidence at all of
4 collusive behavior?

5 MS BINGAMAN: We have evidence of
6 collusive behavior in many industries, in many
7 circumstances where there are duo-opolies, and that's
8 the Department's concern. I don't know if there is a
9 railroad case specifically, but it is a fundamental
10 tenet of merger law that collusion, where there are
11 only two parties, is much more possible. And we've
12 seen it in many cases. It's part of the merger
13 guidelines, and it's part of the Department's
14 experience.

15 COMMISSIONER OWEN: We haven't had
16 anything presented to us, I don't believe, in the
17 history of this Agency here in the rail industry as
18 such, but it may occur in others. But, do you agree
19 with that in the indication of railroads, the Surface
20 Transportation Board serves the role of an alert
21 policemen and has the powers to guard against future
22 collusive behavior? Such as this five year agreement

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 that we have working on this now?

2 MS BINGAMAN: I would say to you with
3 respect Commissioner that it is a fundamental tenet of
4 the antitrust laws, that the way to stop collusion is
5 to keep the market structure from being put in place
6 that would allow it, or encourage it or set the stage
7 for it. That's a fundamental premise of our merger
8 laws.

9 Frankly, Commissioner, in our, in the job
10 I've had, many parties come to you and say, let us
11 merge. We understand there are competitive problems.
12 Let us put an agreement in place to either control
13 prices. I see it quite a bit to tell you the truth.
14 Parties come forward because they understand there are
15 potential problems.

16 We have rejected that out of hand. We
17 prefer a structural approach. It is the Department's
18 long standing view, embodied in the merger guidelines
19 put in in 1982 in the Reagan Administration and
20 continued in force in several iterations and enforced
21 by us, that the best protection for competition is a
22 market structure that allows for competition and not

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 agreements that enforcement agencies essentially have
2 to police and chase and chase the parties.

3 So that's our fundamental concern in many
4 other industries.

5 COMMISSIONER OWEN: But in the case of
6 consumers throughout our nation, and the
7 transportation industry is the lifeblood of our nation
8 as a whole, the prices have gone down since 1980 after
9 the Staggers Act and a number of mergers have taken
10 place and benefitted considerably from those mergers
11 and such.

12 MS BINGAMAN: I don't think you can point
13 to the past necessarily as a predictor of the future.
14 I think it is a fact that this merger is unprecedented
15 in its scope, it's unprecedented in its effects on the
16 West, the very trackage rights that are proposed to
17 solve the problem are unprecedented, and I think are
18 a recognition by the parties of the scale of the
19 problem that they have. And I think honestly that to
20 point to other precedents in this, and I really do
21 think it's unique, situation is maybe misleading.
22 That's our view.

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 CHAIRPERSON MORGAN: If I could just ask
2 you a little bit broader question related to the whole
3 area of mergers. In May of this year, as you know,
4 the Federal Trade Commission came out with a report
5 that was entitled Competition Policy in the New High
6 Tech Global Marketplace. And this report suggests
7 that with the increase in global competition that U.S.
8 businesses face, the FTC in evaluating the mergers
9 within its direct purview, should focus more attention
10 on the extent to which transactions are likely to
11 achieve efficiencies.

12 And, recently, FTC Chairman Petovsky was
13 quoted as saying it's important for antitrust laws not
14 to put needless barriers in the way of companies
15 looking to get more efficient.

16 Now as you know our statute directs us
17 specifically to look at transportation benefits. And,
18 an important part of transportation benefits is
19 efficiencies that are realized in the transportation
20 arena. Now, I know we all in the Administration and
21 else where are concerned about global competitiveness,
22 and I think that's impacts railroads as well as other

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS .
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 industries. I just would like to get your thoughts on
2 how, given this increased global competition, should
3 we be attentive to efficiencies that transactions
4 realize?

5 MS BINGAMAN: We are working right now, we
6 are appointing three people to work with the FTC to
7 examine the efficiencies section of the merger
8 guidelines. I think I would caution that that
9 statement not be taken for more than it might be.

10 Number one, the staff today of both the
11 FTC and the divisions, looks carefully at efficiencies
12 when they are presented to us. We are not unmindful
13 of them. But it is also a fact that experience has
14 taught us, and this is experience going back many,
15 many years, decades, that once an anticompetitive
16 structure is in place, it is very difficult to control
17 prospective price increases. When that, the whole,
18 the fundamental premise of the antitrust laws, 106
19 years old now, is that you want to protect the market
20 structure. And, if you have a structure in place that
21 permits either collusion or increased prices because
22 of insufficient competition, merger to monopoly or

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 otherwise duo-opoly, you have a potential problem.
2 That is the basis for our entire merger jurisprudence.

3 And so, while efficiencies are important
4 and we look at them carefully, we also look at market
5 structure carefully. And its been our conclusion in
6 this case, based on this structure and an examination
7 of the entire industry, the, we believe the
8 infeasibility of the trackage rights solution to the
9 monopoly problems, that we have come to the conclusion
10 we have.

11 CHAIRPERSON MORGAN: But I guess at the
12 same time we need to be mindful of not discouraging
13 transactions that might assist business as well.

14 MS BINGAMAN: Chairman, I would say it is
15 all a matter of judgement. Judgement is paramount.

16 Here where you have our judgement on this
17 record, and we respectfully submit it to you, our
18 judgement is where you have a merger to monopoly that
19 is unprecedented in scale, no chance of new entry,
20 trackage rights is the only possible solution. Many
21 users of these railroads, shippers greatly concerned
22 over the problems. Many other agencies concerned, and

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 a structure set in place for decades and decades going
2 forward. We actually think, when you talk about the
3 global economy and the U.S. price, this could be
4 harmful to U.S. participation in the global economy.
5 Because to the extent our shipping costs are
6 increased, getting out to coast, to ship to foreign
7 markets through rail transportation which is often
8 crucial and the essential way shipping has to be done,
9 it could actually harm our ability to compete in
10 global markets by increasing prices.

11 So that's our concern, that's part of the
12 concern. That is the --

13 CHAIRPERSON MORGAN: Well the other
14 recommendation that I noted in that report was one
15 that related to efficiencies not being excluded
16 because they could be attained some other way. And I
17 think the specific quote from the report was that it
18 was not for antitrust enforcers to require some
19 imagined alternative business arrangement.

20 In this particular case the Justice
21 Department has indicated that the benefits asserted
22 here could be attained some other way and that that

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 further supports your position that the merger should
2 not be approved. How would you square that position
3 with the, this latest report?

4 MS BINGAMAN: Well, again, Chairman
5 Morgan, I think I would say, for better or worse, and
6 I think it is overwhelmingly for the better, for over
7 100 years now our jurisprudence has put antitrust
8 enforcement in the center of business transactions.
9 That is often not at all to the liking of the parties
10 involved. In fact, I can testify personally it's
11 often to the dislike of the parties involved. But the
12 outcome for the public interest and in keeping the
13 economy competitive, has been, has made this economy
14 the most competitive in the world. I think that's
15 true. I think our antitrust enforcement has protected
16 the dynamism and the openness of this market to all
17 comers, U.S. and otherwise.

18 So, I think I would say when people say
19 you can't be second guessing. We are not second
20 guessing the business arrangement. We are second
21 guessing, or we are judging, as the law requires us to
22 do, we are exercising our function as you have to

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 exercise yours. We are judgement as best we humanly
2 can the competitive impacts of this transaction.

3 We are not telling the parties what other
4 transaction to engage in. We are simply saying, this
5 transaction, we believe, is anticompetitive and will
6 increase prices. And the solution you propose, these
7 trackage rights, are so vast in scope, so untested, so
8 untried, we don't have confidence remotely that they
9 will work. And we think disapproval outright is the
10 proper course. If not that, broad divestitures to
11 protect competition. Thank you.

12 CHAIRPERSON MORGAN: Thank you very much.

13 MS BINGAMAN: I appreciate your
14 consideration, I appreciate it.

15 CHAIRPERSON MORGAN: Now, if we could
16 return to the schedule. We now will hear from Paul
17 Samuel Smith, representing the Department of
18 Transportation.

19 MR. SMITH: Madam Chairman and members of
20 the Board, good afternoon. With me today is Mr. Frank
21 Krusee, the Assistant Secretary of Transportation
22 Policy of the Department.

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 CHAIRPERSON MORGAN: If you could get just
2 a little closer to that mike.

3 MR. SMITH: Okay.

4 CHAIRPERSON MORGAN: Thank you.

5 MR. SMITH: This is a merger between two
6 largely parallel railroads, that would result in
7 substantial competitive harm, even as modified by the
8 various trackage rights agreements before you. The
9 results would remain seriously anticompetitive. For
10 that reason, the United States Department of
11 Transportation opposes the merger as proposed.

12 However, we also believe the merger's
13 competitive problems can be solved. Because the
14 merger promises significant public benefits, we think
15 those problems should be solved. This can be done by
16 means of substantial conditions to remedy the
17 competitive harms that the merger brings.

18 After this merger, only two Class 1
19 railroads will provide service between the west coast
20 and midwestern gateways. While the Department
21 considers the two railroads can provide vigorous
22 intermodal competition, the existence of two railroads

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 is a necessary, but not sufficient condition, for that
2 outcome. Providing assurance that the only two
3 remaining rail carriers will compete vigorously must
4 be the basis for conditions imposed by this Board.

5 The paradigm of intermodal competition is
6 found in railroads that are ready, willing and able to
7 compete on a roughly equal basis throughout their
8 service areas. Historically, trackage rights have
9 sufficed to maintain competition loss through
10 consolidations.

11 But the circumstances of this case are
12 unprecedented. Trackage rights have never been used
13 to remedy competitive problems of the extensive scope
14 presented by this transaction. The volumes of freight
15 and the distances involved in this case magnify the
16 inherent shortcomings facing the railroad in such a
17 relationship.

18 The control of dispatching, various
19 incentives arising from traditional compensation
20 structures, limited, if any, access to new customers,
21 and such similar factors exacerbate the differing
22 postures of railroads so as to handicap the BN Santa

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 Fe or any other railroad that must compete as tenant
2 with emerged UP/SP.

3 The ability of one of the only two
4 remaining Class 1 carriers across the western two
5 thirds of this country, to constrain in some measure
6 the competitive threat posed by the other, but
7 necessarily diminish post merger competition in the
8 west.

9 Our proposed remedies in this case are
10 designed to remove or reduce this disparity and to
11 introduce a basic comparability between the two
12 remaining railroads in order to assure aggressive
13 competition between them. In short, the Department
14 seeks to add to the necessary condition of two
15 railroads the sufficient conditions required to assure
16 continued vigorous competition in the West.

17 The Board can assure that rail competition
18 in what we call the Texas corridors will be vigorous
19 by making sure the competitors are on the same
20 operational clime. As landlords or owner railroads in
21 command of their own destinies. That can only be
22 fully accomplished by requiring full divestiture of

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 the affected lines. The number and proximity of other
2 Class 1 rail networks to the affected areas, including
3 the Burlington Northerns, and the volume and
4 attractiveness of the traffic in this area, gives the
5 Department confidence in the degree of post merger,
6 post divestiture competition one could expect.

7 The merger also presents substantial
8 competitive problems in the central corridor. The
9 central corridor, however, does not as readily lend
10 itself to duplicating the competitive ideal. First,
11 although the distances are long and the traffic
12 substantial, as in Texas, the problem areas in the
13 central corridor are significantly removed from the
14 lines of any other Class 1 railroad, save from the
15 Burlington Northern.

16 Second, other than the applicants, only
17 the BN Santa Fe has the gathering lines that can
18 supply the volume of overhead traffic necessary to
19 maintain competition throughout the central corridor
20 between the west coast and the midwestern gateways.
21 A consideration that was always important to the ICC.

22 Third, much of the merger's public

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 benefits arise in the central corridor. Divestiture
2 here would likely eliminate those benefits.

3 These factors therefore raise questions
4 about the ability of other railroads than the
5 Burlington Northern to effectively restore competition
6 lost by the merger in this area. To satisfy
7 traditional criteria for imposing merger related
8 conditions, and to retain the merger's benefits, in
9 the circumstances of the central corridor, therefore,
10 the best solution in the Department's view is trackage
11 rights that were tailored to approximate competition
12 conditions between two landlords or owner railroads.

13 The conditions we urge on the Board would
14 do this by modifying the original trackage rights
15 agreements between the BN Santa Fe and the applicants
16 in two major respects. First, the Board should
17 incorporate the essential elements of the CMA
18 Agreement, such as the dispatching protocols, the
19 opening of existing, excuse me, contracts.

20 Second, it should include the additional
21 modifications contained in the Department's brief,
22 such as the two tier compensation structure, unlimited

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 build in and build out transloading options, and so
2 forth. These modifications aim to place these two
3 railroads in roughly comparable competitive positions.
4 Only then would each of them have the capability and
5 incentive to compete as aggressively as the public
6 interest demands in return for approval of this
7 transaction.

8 Anything less invites a range of scenarios
9 from huddled competition to a comfortable duo-opoly.
10 And the risk of any of those is unacceptable.

11 I'd like to make clear at this point, the
12 Department has no doubts about the capability and the
13 incentive of an unconstrained BN Santa Fe to compete
14 vigorously. We consider the BN one of several
15 suitable purchases for the Texas corridor lines, and
16 under the competitive conditions urged in our brief,
17 as an operator of the appropriately modified trackage
18 rights in the central corridor.

19 In conclusion, the Board now faces a rail
20 industry populated with ever fewer Class 1 carriers.
21 As each railroad comprises a larger portion of the
22 industry as a whole, its actions have consequences for

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 more shippers and for more of the nation's economy.
2 So too, then, must the decisions of this Board that
3 affect those carriers. As it contemplates a further
4 concentration in the industry, it is therefore
5 critical that the Board be mindful of the true reach
6 and the true risks of its decisions in this case.

7 The Department of Transportation urges the
8 Board to reject this merger unless it is prepared to
9 reduce those risks by imposing conditions that ensure
10 truly vigorous competition along the thousands of
11 miles and for the billions of dollars of traffic that
12 are at issue. Independent railroads can provide this.
13 Constrained ones cannot. That concludes my prepared
14 remarks and I'll be happy to answer any questions that
15 you have.

16 CHAIRPERSON MORGAN: Obviously one of the
17 issues that we have been discussing this morning
18 relates to benefits from this merger. And as the
19 Department of Transportation, you, like us, watch what
20 has occurred since the passage of the Staggers Rail
21 Act in terms of benefits that have been derived from
22 deregulation in rail restructuring.

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 I presume that in looking at this
2 particular transaction you have kept in mind what has
3 occurred since the Staggers Act. Do you agree with
4 what has occurred since 1980?

5 MR. SMITH: We certainly have. Our brief,
6 in fact, recites a study of the ICC's last year, we
7 indicated in view of the Staggers Act with increasing
8 rail concentration, nonetheless railways have declined
9 substantially in real terms over that period of time.
10 So long as the competition between those carriers is
11 maintained, the precise number, of course, not less
12 than two, is less important.

13 VICE CHAIRPERSON SIMMONS: Are you for or
14 against trackage rights as a competitive remedy?

15 MR. SMITH: In the circumstances of this
16 case --

17 VICE CHAIRPERSON SIMMONS: In this case
18 you are?

19 MR. SMITH: We are against traditional
20 trackage rights.

21 VICE CHAIRPERSON SIMMONS: Were you ever
22 for trackage rights?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 MR. SMITH: In prior merger cases the
2 Department of Transportation has found trackage rights
3 to be an acceptable recommendation to the ICC where we
4 have found a competitive problem.

5 VICE CHAIRPERSON SIMMONS: What is it
6 that's bothering you? Is it the length of the
7 trackage right, or the whole scope of it or --

8 MR. SMITH: Well, the length is one aspect
9 of it, the volume of traffic that is involved. The
10 fact that with only two railroads left, the risks of
11 being less than confident about the more, rather than
12 less competitive outcome, those give us great problems
13 both in the central corridor and in Texas.

14 The fact that in Texas you have several
15 large rail networks immediately adjacent to the area.
16 You have the type of traffic that will track them,
17 gives us reason to believe that divestiture not only
18 is theoretically the best means of solving that
19 problem, but as a practical matter would certainly
20 work there.

21 In the central corridors, I mentioned
22 there are particular problems that we think would make

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 highly augmented form of trackage rights the initial
2 best bet the fix the problem. But even then we do
3 request that there be some oversight to make sure that
4 indeed we are not wrong.

5 CHAIRPERSON MORGAN: Now under the CMA
6 Agreement, there is a provision for build outs, build
7 ins and build outs. Now, in reading your brief, it
8 appeared to me that the CMA Agreement, on that
9 particular issue, was not quite enough as you saw it
10 in terms of the, of the competitive changes that would
11 take place if this merger were approved. Is that
12 correct?

13 MR. SMITH: That's right. It's time
14 limited, it's subject to the discretion of a third
15 party arbitrator. And a landlord or an owner railroad
16 doesn't face anybody else's judgement or anybody
17 else's time constraints on when or whether it will
18 build in or build out. And we don't think the two
19 railroads that will exist here, that one should have
20 even that kind of indirect control placed over its
21 commercial decisions. It's just impossible to tell in
22 the future whether something that's wholly not viable

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 now wouldn't be viable five or ten years from now.

2 CHAIRPERSON MORGAN: So how could the CMA
3 Agreement be altered to respond specifically to that
4 concern?

5 MR. SMITH: Well, if I didn't think -- if
6 I were going to apply that to the central corridor, I
7 would take, as we have, parts of it. We do like a
8 more refined dispatching protocol. Someone is always
9 going to have to control the dispatching on a track,
10 where you don't have two independent railroads.

11 They have gone farther than ever in the
12 past as far as we can tell to reduce the potential for
13 problems there. We would also like very much the idea
14 of opening up the contracts of a large volume of the
15 business along a line that long.

16 But again, and the central corridor, that
17 is provides you a basis. But even so, there isn't any
18 -- the compensation structure remains the same between
19 the BN Santa Fe and the applicants under the CMA
20 Agreement. Well we think that not having a separate
21 fixed cost component doesn't allow a tenant the same
22 kind of incentives and flexibility as the landlord

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

(202) 234-4433

(202) 234-4433

1 has. And that's very important to us. We think that
2 you need to have your competitive decisions not driven
3 by a variable cost based, or usage fee that allows you
4 kind of the option where to compete or how much to
5 compete for given traffic. We don't want there to be
6 that kind of option.

7 A landlord has an investment of fixed
8 costs in the ground, so to speak, to get any of that
9 back out, it's got to be very vigorously -- and that's
10 what we want to have happen for the two carriers in
11 the central corridor.

12 CHAIRPERSON MORGAN: Well, given your
13 position on that, how do trackage rights that are in
14 place today work as a competitive fix? Clearly there
15 are, there is a lot of trackage rights --

16 MR. SMITH: Clearly there are, and
17 collectively or in the aggregate, I'm sure there are
18 many, many miles of them. But, the only case in which
19 I am aware in which there were extraordinary lengths
20 of trackage rights given in the merger context was
21 with Burlington Northern Santa Fe. And as all the
22 parties and as the ICC then saw, that was far in

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 excess of anything necessary to fix the real
2 competitive problems caused by that merger.

3 It never went beyond, it was necessary it
4 was simply commercial calculations made the SP and the
5 BN and Santa Fe in that case. In this case we don't
6 think that the 4,000, roughly 4,000 miles is far in
7 excess of anything. We think that that's precisely
8 tailored to the competitive problems posed by the
9 merger and is not generous in any respect.

10 VICE CHAIRPERSON SIMMONS: So it's the
11 length of the trackage rights that's bothering you.

12 MR. SMITH: That's a huge part of it.
13 It's also the billions of dollars of traffic there at
14 issue. And again the fact that you've only got two
15 left. You can't, the risk of being wrong would be
16 horrendous. You've got to do everything you can to
17 eliminate or narrow that risk.

18 CHAIRPERSON MORGAN: You mentioned in the
19 central corridor that there are indeed benefits that
20 you wanted to make sure that we do not undermine in
21 some way if we were to approve this merger and impose
22 some sort of conditions. Now, the central corridor

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 benefits, why are they unique as compared to the
2 benefits that might occur in the Gulf Coast area?

3 MR. SMITH: Well, I don't know that they
4 are unique. I think that -- although there is the
5 directional flow traffic plan in the Texas corridor
6 that doesn't exist in the central corridor. I don't
7 know that they are unique, other than that there are
8 quantitatively more of the public benefits promised by
9 the merger taking place outside the Texas corridors.

10 Even if they weren't, that isn't
11 absolutely critical to us. We share the view that the
12 Antitrust Division has and that the ICC has had for
13 years, which is that you fix it first. If there is a
14 problem, try to get what benefits you can from the
15 merger, but always fixing the problem comes first.

16 We think, in this merger where there are
17 certainly some benefits in the Texas corridor where
18 the problem can be readily, structurally once and for
19 all resolved without doing harm to the other
20 traditional merger condition criteria, which always
21 go, essentially against overreaching on one way,
22 shape, or form, that they should be honored.

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 And here in the central corridor, we think
2 that honoring those conditions requires first resort
3 to a high leverage form of trackage rights to the
4 carrier that's best now in position to fix the
5 problems and not do more than that. And we think
6 that's the BN Santa Fe.

7 CHAIRPERSON MORGAN: Now with respect to
8 divestiture, if the Board were to approve the merge
9 and impose some sort of divestiture requirement, how
10 would you envision that that process would work?

11 MR. SMITH: I think the broad outlines
12 would flow from the model in the SP/SF case where the
13 Commission ordered, disapproved the merger and ordered
14 the holding company that owned both the SP and the SF
15 to divest itself of one of them. Thereafter, when
16 that was accomplished there was a subsequent
17 proceeding whereby the Commission and interested
18 parties could review the proposed divestiture to
19 ensure that in fact it carried out the intent of the
20 Commission in the first place. And that's what I
21 would envision here.

22 You would have to have some kind of

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 opportunity to review whatever might be proposed to
2 make sure that it did what it was proposed to do in
3 the first place.

4 VICE CHAIRPERSON SIMMONS: Well, I was
5 here then, a particular case that you recall, and here
6 we are back here today worrying about the health of
7 the SP. What do you have to say about that? The
8 Southern Pacific?

9 MR. SMITH: It was soldiered on --

10 VICE CHAIRPERSON SIMMONS: That was a
11 divestiture.

12 MR. SMITH: That was a divestiture and it
13 was soldiered on since then and they are, I suppose
14 financially, less well off than the other two carriers
15 in the west. But this is such a totally different
16 merger with problems in different areas of the country
17 that, again, this is a commercial decision that BC has
18 anticompetitive ramifications that the Board can in
19 short, fix.

20 COMMISSIONER OWEN: Excuse me. You have
21 been talking an awful lot but somehow I haven't
22 figured out what your problem is with the central

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 corridor there and the divestiture. I'm trying to be
2 a little more specific about it. Is it shippers in
3 the central corridor you are concerned about, or what?

4 MR. SMITH: Well, we are concerned, of the
5 shippers in the central corridor, we are concerned
6 about those --

7 COMMISSIONER OWEN: How many shippers are
8 there in the central corridor then?

9 MR. SMITH: I don't --

10 COMMISSIONER OWEN: That's a pretty
11 interesting question when you take a look at that.
12 Most of the shippers come from the west coast.

13 MR. SMITH: Right, for the --

14 COMMISSIONER OWEN: That's through traffic
15 there, pretty much so --

16 MR. SMITH: That's right and I think --

17 COMMISSIONER OWEN: More shippers in Texas
18 probably and the Gulf Coast and the Gulf states than
19 there are in that central corridor.

20 MR. SMITH: And one of our concerns is
21 that if you don't fix the central corridor problem
22 correctly then the shippers of that overhead traffic

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 going to the midwest won't have what the ICC has
2 striven over the to provide them with which is
3 independent competitive routes all the way through.
4 There is a large segment of that corridor around the
5 Nevada and east -- should be western Utah that doesn't
6 generate a lot of its own traffic. And we are
7 concerned very much about the possible atrophy of
8 that.

9 COMMISSIONER OWEN: But it seems pretty
10 obvious to me anyway that if you start fragmenting the
11 line that all of a sudden you are going to give
12 interchanges and so forth. So really your shipping
13 cost goes up rather than down. And the more you wrap
14 the line for some of those areas, the better your
15 shipping cost is for the consumers and for the
16 shippers.

17 MR. SMITH: We wouldn't propose to parcel
18 out that line at all. We would propose that as
19 augmented, the Burlington Northern Santa Fe operate
20 the rights and have a single line service along the
21 central corridor.

22 CHAIRPERSON MORGAN: The Vice Chairman

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 raised a question about the SP and its financial
2 health. In thinking about this merger, if we were to
3 disapprove this merger, what do you think would happen
4 to SP?

5 MR. SMITH: I have seen published reports
6 that indicate some doubt as to whether the current
7 owners of the Southern Pacific would continue in the
8 railroad business, at least as that railroad is
9 presently constituted.

10 VICE CHAIRPERSON SIMMONS: The Department
11 of Justice said they were doing fine.

12 MR. SMITH: In some respects they have
13 done fine. But as an operational matter they have
14 generally been kept afloat only by resources from
15 other components of the SP corporate structure.

16 VICE CHAIRPERSON SIMMONS: You are talking
17 about real estate?

18 MR. SMITH: I beg your pardon?

19 VICE CHAIRPERSON SIMMONS: Are you talking
20 about real estate?

21 MR. SMITH: Primarily, yes, I am. At some
22 point that runs out. Again, it doesn't necessarily

1 have to have any views that whatever could happen to
2 SP would necessarily be a bad thing. I mean, I -- we
3 don't know about that --

4 VICE CHAIRPERSON SIMMONS: So them going
5 out of business is not necessarily a bad thing?

6 MR. SMITH: It would almost entirely
7 depend upon what transactions were presented to you.
8 There are certainly some scenarios that could be very
9 bad from any number of perspectives, from labor to
10 competitive. And some that might not be at all.

11 CHAIRPERSON MORGAN: But, as we both are
12 responsible for transportation, looking at the SP
13 situation now, is there cause for some concern about
14 what will happen to it in the future? Whether we,
15 whether it's going to go bankrupt sooner or later, or
16 whether it's just going to peter along some minimal
17 level?

18 MR. SMITH: I guess I'd say perhaps some
19 greater concern over the UP ought to begin, but not to
20 the level or degree that would cause me to think that
21 this was their last best hope of continuing as a rail
22 entity or a viable competitor.

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 CHAIRPERSON MORGAN: Now, in your brief
2 you talk about the three to two markets and the two to
3 one markets. And, obviously there is a lot on the
4 record about competitive harm in those markets. Do I
5 understand the conclusion of the Department to be that
6 with respect to three to two that the evidence is,
7 would not lead us to conclude that there is harm there
8 that we must address if we were to approve this
9 merger?

10 MR. SMITH: I think that's right. We have
11 seen a great deal of effort expended on the record on
12 that point. But, from our point of view it is
13 conflicting from both sides. Economic literature
14 indicates there can be a wide range of outcomes when
15 you have two participants in the marketplace. The
16 study that I mentioned some time ago indicates that
17 industry concentration has not led to increased rail
18 rates at all. Your own precedent in the BN Santa Fe
19 and UP/KD indicate your belief that two independent,
20 unconstrained railroads can and do supply vigorous
21 competition.

22 And with all that we concluded that that

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 is indeed the case. Two independent competent
2 railroads can do it, and there should be enough in our
3 view, whether they are in the Texas corridor or in the
4 central corridor.

5 VICE CHAIRPERSON SIMMONS: With regard to
6 trackage rights, you have, DOT argues about the
7 disadvantages of the tenant versus the landlord. What
8 specific cases are you making reference to when you
9 talk about the tenant and the landlord in the railroad
10 business?

11 MR. SMITH: I am not making a specific
12 reference to a merger case, if that's what you are
13 referring to. I'm making reference to --

14 VICE CHAIRPERSON SIMMONS: With regard to
15 trackage rights. That's what you say the tenant is
16 always at a disadvantage. I mean are there specific
17 cases that you are making reference to?

18 MR. SMITH: Well, just the traditional
19 elements of it with the control of dispatching, a
20 compensation structure which is overwhelmingly on a
21 usage basis, inability to access new shippers. Those
22 are all constraints facing the tenant, not facing the

1 landlord.

2 VICE CHAIRPERSON SIMMONS: But you have no
3 particular cases on which you are basing your
4 particular concern?

5 MR. SMITH: We haven't done any kind of a
6 systematic study to indicate to what degree those
7 features of trackage rights --

8 VICE CHAIRPERSON SIMMONS: That's okay.

9 MR. SMITH: -- quantify the problem.

10 VICE CHAIRPERSON SIMMONS: Okay.

11 CHAIRPERSON MORGAN: The Justice
12 Department suggests that perhaps an agreement related
13 to this merger might include some sort of penalties
14 provision as a way of monitoring how UP and others
15 behave in the context of any post merger activity.
16 Obviously, the Department has some experience given
17 that the Amtrak freight railroad agreements do have
18 incentives or penalty provisions that allow for
19 certain relief if certain goals are not met.

20 If we were to consider some sort of
21 penalty provision, how do you think that could work?

22 MR. SMITH: Well, of course, from our

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 institutional provision, if you have divestiture there
2 wouldn't be any follow-on penalties appropriate.

3 CHAIRPERSON MORGAN: Under your position,
4 you would have trackage rights in the central
5 corridor?

6 MR. SMITH: That's correct.

7 MR. SMITH: In other words, you
8 divestiture is only going to the Gulf Coast area, but
9 under your position, we would have trackage rights.
10 And there is some, obviously, concern on the record
11 that that needs to be beefed up and a penalty
12 provision has been discussed in that context.

13 MR. SMITH: I don't think that a penalty
14 provision would be appropriate, how one would arrive
15 at either a financial or an operational consequence
16 following some triggering condition, event, or series
17 of events, is not something that we have considered.
18 We think that the oversight should be, that we have
19 proposed for the central corridor, should be designed
20 to determine whether the trackage rights have worked,
21 whether a little bit more fine tuning is necessary, or
22 whether it's simply notwithstanding the best efforts

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 of those involved inadequate and therefore require
2 divestiture.

3 CHAIRPERSON MORGAN: And then one final
4 question, following up on the three to two discussion
5 that we had earlier. Then your conclusion is that you
6 do not agree with the Justice Department and other
7 parties with respect to conclusions about three to two
8 harm?

9 MR. SMITH: That's correct.

10 CHAIRPERSON MORGAN: Anything else?

11 COMMISSIONER OWEN: If I could just make
12 an observation, it seems like there is sufficient
13 penalty on it if we have the oversight and be able to
14 call them back in here. The attorney fees alone will
15 kill them.

16 CHAIRPERSON MORGAN: He's not an attorney
17 so --

18 COMMISSIONER OWEN: Well, well --

19 CHAIRPERSON MORGAN: It's always non-
20 attorneys that --

21 MR. SMITH: To make one final point. I
22 think someone once said, perhaps it was in the BN

1 Santa Fe merger which was in other exhibits, compare
2 with the benefits of the merger both private and
3 public what it costs to throw a cordon of lawyers in
4 Washington at the ICC or the Board is nothing. It
5 wouldn't cost them anything. Thank you.

6 CHAIRPERSON MORGAN: Thank you very much.

7 COMMISSIONER OWEN: I'd like to thank you
8 for your presentation because you can see that there
9 are ways of putting on all these aspects of the case.
10 Thank you.

11 CHAIRPERSON MORGAN: I think what I'd like
12 to do since it is 1:00, I would like to take a 45
13 minute break for lunch and reconvene at 1:45. We will
14 then take Roger Fones, representing the Department of
15 Justice and then proceed along with the rest of our
16 schedule.

17 (Whereupon, the foregoing matter went off
18 the record at 1:02 p.m.)
19
20
21
22

1 A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

2 (1:55 p.m.)

3 CHAIRPERSON MORGAN: Okay, I hope
4 everybody got a little bite to eat or a little rest.
5 But anyway, before I turn to you, Mr. Finest, if I
6 could just continue what I did this morning, which is
7 as I get congressional statements, I insert them into
8 the record. And I have gotten two additional
9 statements, one from Senator Hatch. And again, I will
10 just read the first paragraph of that.

11 "I appreciate the opportunity to express
12 my views to the Board regarding the proposed merger of
13 the Union Pacific and the Southern Pacific Railroads.
14 My home state of Utah has a proud heritage in
15 railroading. The golden spike, joining two great
16 railroads and joining a continent, was driven at
17 Promontory, Utah in 1869. Railroads played a critical
18 role in opening the American West."

19 The rest of that will be included in the
20 record.

21 (Laughter.)

22 I have to read the first paragraph. I

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701

1 didn't write it. I'm just reading it.

2 (Laughter.)

3 The next statement is from Senator Burns,
4 and the first paragraph of that reads as follows.

5 "Madame Chairwoman and Board members, I
6 appreciate this opportunity to provide a statement
7 regarding the Union Pacific and the Southern Pacific
8 rail merger proposal pending before the Surface
9 Transportation Board. I urge the Board to seriously
10 consider every aspect of this proposed merger,
11 including the effects on competition, the national
12 rail system, and the future of the rail industry."

13 The rest of that statement will be
14 included in the record. Thank you. Now we will
15 proceed with you, Mr. Finest, representing the
16 Department of Justice.

17 MR. FINEST: Thank you, Madame Chairman,
18 Vice Chairman Simmons, Commissioner Owen. I want to
19 start with the duopoly issue. The map that
20 Representative Doggett brought this morning, I think,
21 was quite dramatic. It showed the area affected by
22 the three to two problem in this case. And it's

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701