

Surface Transportation Board Issues New Rules Governing Major Railroad Mergers & Consolidations

Surface Transportation Board (Board) Chairman Linda J. Morgan announced today that the Board has issued new rules for major railroad mergers and consolidations involving two or more "Class I" railroads (railroads with annual revenues of at least \$250 million, as indexed for inflation). The new rules substantially increase the burden on rail merger and consolidation applicants to demonstrate that a proposed transaction would be in the public interest. The new rules require applicants to demonstrate that, among other things, a proposed transaction would enhance competition where necessary to offset negative effects of the transaction, such as competitive harm, and to address fully the impact of the transaction on service, including plans for service reliability.

Overall Approach. The new rules reflect a significant change in the way the Board will apply the statutory public interest test to any major rail merger application. The Board stated that, because of the small number of remaining Class I railroads, the fact that rail mergers are no longer needed to address excess capacity in the rail industry, and the transitional service problems that have accompanied recent rail mergers, future merger applicants will be required to bear a heavier burden to show that a major rail combination is consistent with the public interest. This shift in policy, the Board noted, will place greater emphasis in the public interest assessment on enhancing competition, while ensuring a stable, balanced, and reliable rail transportation system in a way that accounts for smaller railroads, ports, and passenger and commuter services.

Enhancement of Competition. The new rules reflect the Board's intent to offset, through the adoption of proposals made by merger applicants and as necessary through adoption of conditions for competitive enhancements, merger-related harms that cannot be directly or effectively mitigated. The Board indicated that such competitive enhancements could include, but would not be limited to, reciprocal switching arrangements, trackage rights, and efforts to eliminate restrictions on interchanges by shortline railroads. The Board also indicated that the quantity and quality of competitive enhancements that would be required relative to a particular transaction would depend upon a variety of factors, such as merger-related competitive harms for which feasible and effective remedies could not be devised, and the amount of public benefits that could be expected to flow from a particular transaction.

Benefit Assessment. The new rules also reflect the Board's view that, because the realization of benefits in recent mergers has been delayed or frustrated by transitional service problems, future merger proposals should be met with a more skeptical, "show me" attitude towards claims of merger benefits and towards claims that transitional service problems will not occur. The Board said that it will also consider the extent to which various claimed merger benefits can be achieved, short of merger, through cooperative agreements among railroads. The Board further indicated that, given the size of the transactions that may be proposed in the future, and, given the dangers involved should such transactions fail, the benefits claimed by future merger applicants will be very closely scrutinized.

Service Assurance Plans. The Board's new rules require merger applicants to submit a Service Assurance Plan with their initial application and operating plan. The Board stated that, given the importance of service to shippers and that implementation of any merger plan necessarily has an element of uncertainty, applicants' Service Assurance Plan for each major merger proposal must provide certain essential information, such as plans to deal with any potential adverse service effects during implementation and plans to accommodate such less-than-optimum operations. The Board indicated that, in particular, a Service Assurance Plan must include information about proposed operational integration, training, information technology systems, customer service, freight and passenger operations coordination, yard and terminal operations management, service disruption contingency plans, how traffic-level changes or increases will be accommodated by the combined system, infrastructure improvement, labor issues, service benchmarking, and timetables for the completion of implementation activities, as appropriate. The Board stated further that the Service Assurance Plan must provide for the establishment of problem resolution teams and describe specific procedures to be used towards problem resolution.

Downstream Effects. The new rules reflect the Board's determination to "look down the road" to ascertain whether approving not just the immediate proposal that may be before the Board, but also others like it, would ultimately result in a rail industry structure that would continue to provide at least the existing level of competitive options for shippers. The Board stated that merger applicants will not be required to present alternative benefit calculations based on specific alternative possible responses that could be filed by other railroads; yet, merger applicants will be required to initiate a commentary, to which other parties may respond, that would give the Board the information needed to rule on what would likely be the first step in an end-game situation in which only two or three competing transcontinental railroads would remain in North America. The Board made clear that it is also prepared to use its power to apply conditions to a transaction to repair conditions previously imposed on rail mergers that might be substantially impaired by a new major rail merger.

Employee Concerns. The Board indicated that it is extremely pleased with the privately negotiated "historic settlement agreement" on the issue of collective bargaining agreement (CBA) overrides recently signed by most of the Class I railroads and by unions representing most rail employees. The Board stated that, to the extent there is still any live issue relative to CBA overrides, the new rules, which reaffirm that the Board supports negotiated agreements wherever possible, respects the sanctity of CBAs, and looks with disfavor on overrides, properly implement the Board's statutory mandate concerning overrides.

Transnational Issues. The Board stated that, because future major transnational mergers are likely to raise novel jurisdictional, national interest, and public interest issues, it will be necessary to gather information about relevant facts, laws, and policies important to an accurate and comprehensive understanding of such merger applications. The new rules therefore provide that, in addition to full-system competitive analyses and operating plans required of applicants with transnational operations, all applicants will be required to address any ownership restrictions (by law or corporate initiative) and any pertinent governmental restrictions or preferences.

Kansas City Southern. The Board, with Chairman Morgan dissenting, granted a waiver to The Kansas City Southern Railway Company from the application of the new major rail merger rules. Parties may attempt to show in a particular case that this waiver should not be allowed.

Oversight and Monitoring. The new rules codify the Board's recent practice of formal oversight for a period of no fewer than 5 years following each merger. With respect to operational monitoring, the Board noted that, because its monitoring of previous transactions has proven vital to identifying and correcting operating deficiencies during implementation, the new rules also provide for expanded post-approval monitoring of the implementation of mergers to help ensure that adequate service is provided during the crucial transitional period, and beyond. The Board further indicated that, if substantial service disruptions occur as the result of a merger's implementation, the Board will consider alternative service arrangements.

The Board issued its new rules today in the case entitled *Major Rail Consolidation Procedures*, STB Ex Parte No. 582 (Sub-No. 1). Chairman Morgan issued a separate expression commenting and dissenting in part, and Vice Chairman Clyburn and Commissioner Burkes also issued separate expressions. A printed copy of the decision is available for a fee by contacting D~To~D~ Office Solutions, Room 405, 1925 K Street, NW, Washington, DC 20006, telephone (202) 293-7776, or via [http://Da_To_Da@Hotmail.com](mailto:Da_To_Da@Hotmail.com). The decision also is available for viewing and downloading via the Board's website at <http://www.stb.dot.gov>.

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