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March 27, 2000

VIA HAND DELIVERY

The Honorable Vernon A. Williams
Secretary, Surface Transportation Board
Mercury Building, Room 700
1925 K Street, N.W.
Washington, D.C. 20423

Office of the Secretary
MAR 27 2000
Public Record

RE: **Ex Parte No. 582; Public Views on Major Rail Consolidations**

Dear Secretary Williams:

Enclosed are an original and ten (10) copies of the "Reply of CSX Corporation and CSX Transportation, Inc. to Petition for Stay by Canadian National Railway Company" for filing in the above-referenced docket.

Please note that a 3.5-inch diskette containing a WordPerfect formatted copy of the filing (readable in or convertible into version 7.0) is also enclosed.

Kindly date stamp the enclosed additional copy of this letter and the enclosure at the time of filing and return them to our messenger.

Thank you for your assistance in this matter. Please contact me if you have any questions.

Respectfully yours,

Dennis G. Lyons
Counsel for CSX Corporation and CSX Transportation, Inc.

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Enclosures
cc Parties listed on the Certificate of Service
David M. Konschnik, Esq., STB

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 582

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

REPLY OF CSX CORPORATION AND CSX TRANSPORTATION, INC. TO PETITION FOR STAY BY CANADIAN NATIONAL RAILWAY COMPANY

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March 27, 2000

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SURFACE TRANSPORTATION BOARD

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If the Court of Appeals for the District of Columbia Circuit grants a stay, the STB would be required to accept the BNSF-CN merger filing and process it ***under existing rules*** *while the agency simultaneously develops a new merger policy and guidelines. We're ready to file.*

— MARK HALLMAN, SPOKESPERSON FOR CN,
AS QUOTED IN *THE JOURNAL OF COMMERCE*,
MARCH 22, 2000

* * * * *

It appears that through its Petition for Review in the United States Court of Appeals for the District of Columbia Circuit, and its application for a "stay" to the Board, Canadian National Railway Company ("CN") wishes to gun-jump the new rules and regulations for major rail combinations in the 21st Century, which the Board is committed to developing, and to have CN's merger filing "process[ed] . . . under existing rules." This is the reply of CSX Corporation and CSX Transportation, Inc. (collectively, "CSX"), in opposition to the CN Petition for a Stay ("CN Petition"), and in opposition to permitting this first proposed transcontinental rail merger involving a U.S. based railroad, between CN and BNSF, to be judged under a different set of rules from those which will apply to any other transcontinental merger or other mergers between the remaining Class I railroads.

INTRODUCTION AND SUMMARY

CSX's reply, filed on March 23, 2000, to the similar petition for a stay filed by BNSF, deals with most of the contentions contained in the CN Petition. In the same vein as the quotation from Mark Hallman, its spokesperson above, the CN Petition now says that its proposed merger is special (CN Pet. at 5) and that the Board should process it right away under the existing rules. CN thus seems to be treating as no longer "operative the challenge of M. Tellier,[1] its CEO, that CN would be prepared for a high "bar" to be applied to its transaction. The CN Petition apparently wants the Board, after accepting CN/BNSF's filing, to admonish the rest of the industry not to file merger applications, threatening them with rejection, if they are thinking about combinations in response to CN/BNSF. *Id.* at 6. The Board's even-handed action, applicable to all the Class I railroads in the industry, very properly avoids that sort of discrimination and the "claim-jumping" objectives of CN. The Board levels the playing field.

CN's assertions that the Board does not have the authority to control its own decision processes so that it can effectively deliberate upon the establishment of new rules for <u>all</u> the transcontinental mergers in the 21st Century, are based on a crabbed view of the Board's powers.[2] CN says that the Board's powers under Section 721(a) and (b)(4) are purely "ancillary" to other powers, and CN has trouble finding any other powers that those powers might be

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[1] Quoted in CSX Reply to BSNF at 6. A half-hearted attempt to say the new rules could be made applicable to it (except for those peculiar to transcontinental mergers (but see note 3, below)) is made by CN. Pet. at 6. How rules which will not be formulated for over a year can be applied, and their application argued pro and con, in an adjudicatory proceeding commenced forthwith, is not explained.

[2] Instead, CN claims that the Board should send a message to the rail industry "to constrain another 'round' of consolidations" (CN Pet. at 1) and that the industry would listen. Why is not CN listening to the March 17 message?

ancillary to. This seems to be because the only part of Subchapter II of Chapter 113 of the Interstate Transportation statute administered by the Board that CN can find is the procedural section (captioned "Consolidation, merger and acquisition of control: procedure"), 49 U.S.C. § 11325. There is more to the Board's jurisdiction over rail combinations than a procedural schedule. Indeed, the Board's powers over rail mergers are, as the statute has meant since the early part of the twentieth century, "exclusive and plenary." It is unlawful to carry out a rail combination transaction without the Board's prior approval and authorization. 49 U.S.C. § 11323. The Board is given the power to begin proceedings to approve and authorize transactions: "[T]he Board may begin a proceeding to approve and authorize a transaction referred to in Section 11323." 49 U.S.C. § 11324 (emphasis supplied). The Board's authority is "exclusive." *Id.* at § 11321. The Board's powers with regard to combinations override the antitrust laws and "all other law, including State and municipal law," necessary to effectuate an approved combination and to hold, maintain and operate property acquired through the transaction and to exercise the control authorized by the transaction. 49 U.S.C. § 11321. The Board has power to make regulations in connection with the powers just discussed. 49 U.S.C. § 721(a). It is guided by a public-interest standard, partly sketched by Congress, but with the main part of the picture to be filled in by itself. 49 U.S.C. § 11324(b), (c). The statutory authority granted the Board over combinations is not that of a clerk required to receive, stamp, and push papers, but is one of the broadest charters of an administrative agency to be found in the United States Code. While deregulation has come to much of the text of the Board's statute, the powers of the Board and its predecessor over rail combinations have remained substantially unchanged for over sixty years.

The Board in its Decision served March 17, 2000, acted decisively and promptly. The provisions of CN's favorite section of the statute, the procedural provisions of § 11325, are not

designed to prevent decisive action, but are the result of Congressional response to proceedings that were launched and went on interminably, including the classic case in which after the better part of a decade, merger proceedings involving the Rock Island Railroad were terminated because of the bankruptcy liquidation of that carrier.

The Board's action is amply justified by the need to rethink and reform the basic rules governing major rail combination proceedings. It would be impossible to adjudicate prospective transcontinental mergers in a fair and equitable manner by allowing the CN/BNSF merger to proceed, before the ground rules are established. There are only six large railroads left on the North American continent, and with a limited number of entities left, in order for there to be true competition, balance must be achieved. The attempt of CN and BNSF to have their merger considered under the old rules and other responsive mergers postponed, if not calculated to create an unbalanced result, is likely to achieve one. To promote such an unfair process, and criticize the Board's action, under the name of fostering "competition" is pure cant. The CN/BNSF effort to stay the Board's Decision seeks a hasty unbalanced outcome in which there would not be the balance in market power and size that would be advisable in a highly concentrated industry.

The parade of horribles (CN Pet. at 7) as to the consequences of the Board's Decision is a simple diversion. Clearly it was not the intent of the Board to tread on First Amendment rights, or, indeed, to restrict private activity that does not involve engaging the Board's merger authorization processes. And clearly, challenging the Board's Decision, in any forum, seeking interpretations of the Decision, participating in the rulemaking procedure, and the like, are not inhibited. We do not understand the Board's order to touch any of the eight hypotheticals mentioned at page 7 by CN. These red herrings are an effort to divert the focus from the centerpiece of

what the Board has done, which is to launch an orderly even-handed rulemaking procedure before any transcontinental[3] and other major rail combinations are to go forward.

Most of these points require no further discussion; we will expand on a few of them.[4]

DISCUSSION

The Board's Decision in essence provides for a suspension of the processing of major rail combination proposals while the Board's Statement of Policy and other regulations relating to rail combinations are deliberately reexamined, rethought, and to the extent necessary, reformed, all in a public process in compliance with the Administrative Procedure Act. On their face, the Board's existing regulations for rail combinations appear to be out of date. The "General Policy Statement for Merger or Control of at Least Two Class I Railroads," with which the present regulations begin (49 C.F.R. § 1180.1(a)) states that the basic goal of rail combinations is "the rationalization of the nation's rail facilities and reduction of its excess capacity." But it was common ground at the Board's hearings in this matter that there was little or no excess capacity in the present rail system; that the system was, in fact, hobbled by capacity constraints; and that

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[3] CN appears to suggest that its merger is not transcontinental. CN Pet. at 6. The system's Western end would be in Los Angeles, Oakland, Portland, Seattle, and Vancouver; on the Pacific; its Eastern end would be in Halifax, on the Atlantic, and indeed the nearest Atlantic port to Europe. A joint press release of CN and BNSF, announcing an SEC registration statement filing, referred to CN's spanning "from the Atlantic and Pacific oceans" and referred to its service to the Port of Halifax. Press Release of Jan. 11, 2000. The transaction has been recognized in the press as transcontinental, *see N.Y. Times*, Dec. 26, 1999, sec. 4, p. 2 ("a mighty transcontinental railroad, North American Railway"). It surely is transcontinental.

[4] We do not analyze further herein the balance of irreparable harm and the other factors, such as the public interest and likelihood of success on the merits, as to granting or denying stays, other than incidentally; these have been treated in our response to BNSF and are treated in the responses being filed by Norfolk Southern ("NS") and Union Pacific ("UP")

those capacity restraints were part of the cause of the service failures that followed recent Class I combinations.

There was also common acceptance of the proposition that a set of regulations and principles that worked when there were dozens of Class I carriers might not work when the total number of large railroads in the North American continent had been reduced to six. Thus, there was little or no dissent from the action taken by the Board in December 1999 to suspend the "one merger at a time" rule which ignored the possible downstream and cumulative effect of transactions which might follow the transaction under review; all seemed to agree that it was right that the Board take into account the likely consequences of its authorizations.

As noted in CSX's Reply to BNSF's Petition for a stay, a number of other issues were raised at the hearing with respect to which the Board's existing regulations and the Board's decisions and those of its predecessor leave substantially unanswered or provide answers which may have been useful in the past but are no longer useful: Would a merger which might be good in itself, be contrary to the public interest because a merger which might be desirable in order to offset an imbalance in the competitive situation caused by the first merger might itself cause a degree of concentration in the industry that would have a negative effect? Are there periods of time when industry attitudes and political attitudes are such that <u>any</u> major merger should be viewed as contrary to the public interest because it could lead to a public reaction and a political and legislative change that would be adverse to the interests of a sound transportation system and a violation of the principle of minimizing the need for federal regulatory control of the industry (*see* 49 U.S.C. § 10101(2), (4))? To what extent should assurances of effective implementation of a transaction be required from the applicants in a major combination proceeding? What changes in the regulatory system, to be brought about by exercise of the conditioning power or

otherwise, should attend large railroad mergers? Because a Canadian-based entity is involved in the present proposal, and the entities involved in the transaction would on its consummation all be controlled by a Canadian-majority board of directors, and because other transactions may also involve a Canadian carrier and may financially require a similar structure, what additional controls and assurance will be required to ensure consistency with the public interest of the United States, which is the Board's lodestar?

All these questions, and many more, were raised by the hearings. It would be premature to speculate on the answers, and there will be considerable disagreement. The point is that there should be a resolution before the merger process can be permitted to proceed.

As developed above, CN does not want to have its transcontinental merger judged under the revised set of rules that would come out of this process, but wants to file forthwith and be judged under the old rules.[5] The Board recognized within a week after the Notice of Intent for the CN/BNSF merger was filed that at least some changes in the old rules were necessary, since this first proposal for a transcontinental combination brought the industry to a watershed situation from which there was a distinct possibility that only two carriers would emerge. So Decision No. 1 in the CN/BNSF docket came. The exhaustive hearings that were held by the Board in Ex Parte No. 582 only confirmed the Board's initial view and indicated that a broader reexamination of the rules was necessary.

CN wants to be exempted from being subject to that process. CN wants the Board to say that its proposed transaction, sight unseen, is so good and so harmless that it can go forward,

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[5] Alternatively, CN seems to want to have its own set of additional rules immediately promulgated without a full process, instead of a formal rulemaking. *See* CN Pet. at 5-6.

possibly subject to some cosmetic changes in the rules of CN's own devising, while all other transactions should be halted until the rules are revised. How the Board is to analyze the "down-stream" effects of the CN/BNSF transaction -- the decision to do which has not been challenged by CN/BNSF -- without having the rules in place that will govern those downstream transactions is not stated by CN, and appears impossible.

We demonstrated in our Reply to the BNSF Petition that the "stay" requested in fact would negate the Board's decision and permit CN to prosecute its Application. CN has identified that as its objective -- avoiding being subject to the new rules. There is no basis to give the first transcontinental merger, which is apt to trigger others, a free pass from the new rules. The only way to proceed is the way in which the Board has proceeded. The "Stay" Petition filed by CN, like that filed by BNSF, seeks a substantial nullification of the Board's action, and requires the Board to act in a way that is contrary to the public interest in orderly procedure, as the Board has determined.

The position taken by CN that the Board's action is anticompetitive is a flight of fancy. The rail industry is highly concentrated. The CN/BNSF proposal will not break up any rail monopoly as the division of Conrail did. It will simply create a bigger system, with longer routes.[6] *Prima facie*, there will be more concentration. While creation of a larger system and increased opportunity for single-line service can be a public benefit, a substantial part of that benefit can be achieved by other means, and, interestingly enough, the Combination Agreement between CN and BNSF provides processes for doing that, and a commitment to do that, in

[6] It will suppress some horizontal competition unless conditioned, but that issue can be dealt with under the existing rules.

advance of any consolidation, to the fullest extent permitted by law.[7] But a larger system formed by a consolidation only invites similar competitive response; and competition may be hurt if that response is prevented and a larger system with greater market power stands alone. The rules for the first transaction and any response should be known before the process starts.

A glance at the railroad map indicates that, taking the Untied States and Canada as a whole, there could be only two balanced transcontinental railroads, and that the CN/BNSF transaction and the next one, if the CN/BNSF transaction takes place, will determine the shape of what those two systems would be. To let the first system be adjudicated under anything less than a fully thought-out set of rules would be to lose control of the process and risk the creation of an unbalanced duopoly. The CN Petition seeks to subject the public to that risk. The Board should not permit it.

CONCLUSION

For the reasons stated, the CN Petition for Stay should be denied.

Respectfully submitted.

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March 27, 2000

[7] *See* CSX Reply to BNSF Petition at 3 n.2.

CERTIFICATE OF SERVICE

I, Dennis G. Lyons, certify that on this 27th day of March, 2000, I have caused the foregoing "REPLY OF CSX CORPORATION AND CSX TRANSPORTATION, INC. TO PETITION FOR STAY BY CANADIAN NATIONAL RAILWAY COMPANY" to be served by first-class mail, or by a more expeditious form of delivery, upon the persons identified in the attached service list.

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