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**DAKOTA, MINNESOTA & EASTERN RAILROAD CORPORATION**

KEVIN V. SCHIEFFER • President & CEO

February 29, 2000

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Office of the Secretary**

**MAR 02 2000**

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Public Record**



Mr. Vernon Williams  
Secretary  
Surface Transportation Board  
1925 K Street NW  
Washington, DC 20423-0001

RE: STB Ex Parte No. 582, Public Views on Major Rail Consolidations

Dear Secretary Williams:

Enclosed for filing please find the original and ten copies of my written comments to be presented on behalf of the Dakota, Minnesota & Eastern Railroad Corporation at the above referenced public hearing. Also enclosed is a diskette of this document on a 3.5-inch IBM-compatible floppy diskette. It is my understanding that DM&E has been allotted time for comment to take place on Wednesday, March 8th. Thank you for your consideration in this matter.

Should you have any questions, please do not hesitate to contact me.

Sincerely,

Kevin V. Schieffer  
President and Chief Executive Officer

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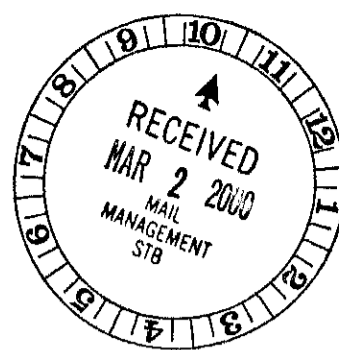
Enclosures

BEFORE THE  
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582

Public Views on Major Rail Consolidations

TESTIMONY OF  
KEVIN V. SCHIEFFER  
PRESIDENT & CHIEF EXECUTIVE OFFICER  
DAKOTA, MINNESOTA & EASTERN RAILROAD CORPORATION



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Dakota, Minnesota & Eastern Railroad is an 1,121-mile regional railroad operating in five states (WY, SD, MN, IA, & NE). It was created in 1986 from a line the former C&NW Railroad attempted to abandon. Recovering the infrastructure that was allowed to deteriorate through years of deferred maintenance remains our most significant challenge. Our primary commodities are grain and other agriculture related products, clay, wood and paper products, and cement. We currently have pending before the STB an application to construct and operate a third rail line into the Wyoming Powder River Coal Basin ("PRB") for the purpose of, among other things, (a) improving service and injecting new competition into the important PRB market, (b) preserving and improving service in DM&E's existing market area, and (c) relieving pressure on an overtaxed national rail infrastructure system (STB Finance Docket No. 33407). That project would also result in the complete rebuilding of our existing mainline. DM&E's testimony is intended to highlight the DM&E-specific impacts and broader industry concerns that, without adequate pro-competitive conditions, the imminent CN/BNSF merger and the inevitable round of mergers to follow will create. It will also outline the kinds of conditions that could protect and enhance competition within the industry.

I. DM&E-SPECIFIC IMPACTS. The following are examples of the kinds of effects the mega-mergers are expected to have on DM&E specifically:

(a) **Current Customer Service Threatened, Competition Lost.** The CN/BNSF merger and the inevitable mergers to follow will, without competitive safeguards, have a devastating impact on DM&E's current customer base -- which is primarily agriculture related.

(i) DM&E market access opportunities to the former IC (which CN just acquired in a merger approved by the STB last year) would be immediately lost to the CN/BNSF deal. This includes important agriculture markets for our customers such as the Gulf market, Iowa ag processors, Chicago markets, Omaha and Kansas City markets, and the Twin Cities market.

(ii) a probable follow up merger would involve the Union Pacific (UP) and -- either directly or indirectly -- the Canadian Pacific (CP). This would eliminate or diminish an existing competitive connection DM&E customers today enjoy with CP.

(iii) with both BNSF and UP acquiring basically all the properties that today serve as existing or potential DM&E competitive carriers, DM&E would have neither the reality of competitive alternatives nor the threat of any competitive response to unreasonable practices. This would eliminate effective competitive options for existing DM&E shippers today.

**(b) PRB Construction Project Undermined, Remaining Viability Threatened.** For the same reasons, the CN/BNSF merger and the inevitable mergers to follow will, without competitive safeguards, make implausible any prospect of accomplishing our proposed PRB expansion and reconstruction project. The two major US carriers likely to compete for supremacy coming out this new round of mergers (i.e., BNSF and UP) coincidentally are the only two carriers currently serving the PRB today. They also both are our major connections today. As such, neither of them would have any realistic incentive to accept traffic at the east end of the DM&E system for delivery to the markets beyond. And both of them have every incentive to constrain our market access via competing carriers on the eastern end of our line (e.g., CN or CP). The mergers themselves would have the effect of eliminating the vast majority of competitive connections on the east end of our system. The project relies on a competitive marketplace for delivery beyond DM&E's system. That exists today, but would be eliminated by the mergers. For the STB to approve these mergers without strong pro-competitive conditions -- significantly more aggressive than has been applied in the more recent mergers -- would have the same effect as denying DM&E's PRB construction permit application. Without competition, the project would no longer be feasible.

The mega-mergers would also hasten an inevitable demise of the current DM&E system as it exists today. That would equally have a devastating impact on agriculture and other rail-based industries in DM&E's service area. DM&E's infrastructure is in serious need of major overhaul. This project is the only known opportunity for that to be possible. With the lost PRB opportunity, so too is our opportunity to improve dramatically service to our existing customers -- or even to sustain existing service in the long run.

II. INDUSTRY IMPACTS. We believe the mega-mergers will also have broad regional and shortline industry impacts, including:

(a) **Existing Competition Lost.** Clearly, mega-mergers have the immediate impact of eliminating existing competition. An obvious example from the CN/BNSF case for illustration purposes is the Sioux City, IA to Chicago route in our own market area, which is important to agriculture. Both the BNSF and the CN today have competing routes between those two cities. After the merger, there would be redundant routes

between those two rail hubs, owned by a single entity. Competition would be immediately eliminated. Regarding rail access from our region, the same is true for the Gulf market, the Chicago gateway, Kansas City, Omaha and Iowa. For the industry in the midwest, this is not the end-to-end transaction advertised. It has real and immediate anti-competitive impacts.

(b) **Future Competitive Opportunities Lost.** As significantly, the mega-mergers eliminate prospective competitive connections for many regional and short-line railroads. This is a very significant issue for smaller lines. Most regional and shortline railroads today were created as feeder lines to the railroad from which we came. Many of those deals included provisions tying traffic we originate to the "mother" railroad. Whenever there were foreign railroads crossed by the new shortline, there often existed prohibitions against interchange with the foreign railroads. These "paper barriers" by definition were anti-competitive, and had to be drawn very carefully so as to not blatantly run afoul of legal prohibitions regarding anti-competitive practices. Accordingly, many of these "paper barriers" technically permit interchange with foreign carriers, but establish legal or economic restraints. In other cases, physical blockages from retained track ownership require significant capital expenditures to overcome. But if a traffic base could be developed -- or if the "mother" railroad became too unreasonable -- there were alternatives that could be pursued with foreign carriers. In isolated cases DM&E has done this in the past, such as constructing a new physical interchange track with CP. And the PRB construction project allows us the opportunity to do it in the future -- with CN and CP, for example. As stand-alone railroads not merged into the BNSF or UP, they have every market incentive to be competitive. But as part of BNSF or UP, they have every incentive to block us out of the market -- and the market power to accomplish the task. In the world of increasing consolidation of the Class I's, competitive remedies for anticompetitive barriers are already evaporating. The rate of that evaporation will increase exponentially with the round of mega-mergers that loom on the horizon today.

(c) **Fundamental Alteration of the "Feeder" Concept Justification.** As the real and potential competitive options are eliminated for shortlines, the original feeder concept has been lost. We no longer have an agreement with the railroad from which we came. Indeed, it is not even recognizable in many cases. In our case as an example, we were created from the C&NW. The original 1986 agreement envisioned us in part as a "feeder" line to the C&NW, with the rest of the world potentially open to us as competitive connections. Since then, in 1995 the 5,200-mile C&NW has been folded into the 17,500-mile UP, which in 1996 acquired the 14,000-mile SP. Additionally, indirect connections to terminating carriers dwindle for us as mergers east of the Mississippi continue to limit our alternatives. The CN/BNSF proposal is the most serious example that we have faced to date, but it is a pattern repeated throughout the industry as our competitive alternatives continue to shrink.

It is also noteworthy that the short-line relationship can be significantly changed by the newly merged carrier. As the "mother" road gets bigger and changes hands, shortlines

are increasingly inconsequential step-children in the new step-mother's corporate strategies. The mega-mergers will inevitably exacerbate this problem. In the recent BNSF merger we lost significant revenue because of an abrogation of car hire rates. We sized and purchased an expensive set of cars based in part on a BN commitment to permanent car hire rates. Following the merger with Sante Fe, the combined entity used AAR rules to simply vitiate the agreement. The rules change with each restructuring. Up to this point it is only the Class Is who have been allowed to change them. The original feeder concept has been so diluted with the mergers from the last decade that any round of mega-mergers to follow should take a serious look at an across-the-board review of the blatantly anti-competitive paper barriers that prevent improved rail service and greater competitive options to our customers.

III. SOLUTIONS. Meaningful competition in a post-merger world after this round of mergers will require the STB to take a fresh look at providing meaningful pro-competitive relief for us remaining lilliputians if it determines it must create new and vastly bigger giants. To a significant extent, the solution already exists. The regional and shortlines that have been created in the last two decades could formulate a considerable functional system if they were allowed to work together rather than restrained through paper barriers and strategic infrastructure blockades. If the STB will allow us, the regional and shortlines working together could offset many of the problems created and exacerbated by the increasing industry consolidation.

(a) **Shortline Alliances.** First, the STB should be commended for its sensitivity to date and its proactive approach to this issue. But the only way to prevent the inevitable anticompetitive environment envisioned by the new round of Class I mergers is to either deny the merger application(s) or impose more effective pro-competitive relief than has been demonstrated to date. This requires no new legislation. Existing statutory authority allows the STB to build on existing caselaw for effective relief in today's super-saturated world of Class I concentration. Specifically, more pro-active efforts to eliminate paper barriers, grant trackage rights and require limited divestiture are critical. An over-arching goal ought to be to allow the very significant confederacy of regional and shortline railroads to work together in union, to interchange traffic and form alliances in ways that are today prevented by artificial "paper barriers" and strategically placed "steel blocks" of rail which physically preclude interchange. Those need to be identified and eliminated in the merger proceedings as they apply to the merger candidates. One of the conditions of entering the world of mega-carriers ought to be allowing the little guys to work together without interference. Shortlines can utilize the considerable resources and ingenuity that is out there, but not if we continue to be held back by these anti-competitive barriers that no longer serve a legitimate purpose in the post-merger world.

(b) **Eliminate "paper barriers" and "steel blocks".** This does not require re-regulation. There are marketplace solutions. The innovative marketplace of the shortlines and regionals is the solution, if it is allowed to function. The STB needs to allow the smaller lines enough flexibility to form effective networks of their own, relying on elimination of paper barriers and/or granting minimal trackage rights over -- or segment divestitures of -- small pieces of the merging mega carriers' systems. One significant problem in this regard is the uncertainty

as to "who" is going to be the next merger pair, and how its impacts can be effectively addressed before we know who is going to join next or what correlation that pairing has to the last merger approved. If the exact solution has to be formulated during the pending merger preceding, it is always going to be too early to see what happens next. And when it does, it will be too late to address the corollary impacts of the merger just approved. Another problem is that the mind-numbing detail involved in each paper barrier and each strategic route block will not allow the STB to effectively oversee each and every case. A possible solution to both problems is to place a generic condition on future mega-merger roads to the effect that they must make accommodations for an effective regional and shortline network, within defined criteria. Where the two roads cannot reach agreement after a defined time, it could be a matter for arbitration, subject to full STB review. There are numerous other means to this end, but the key ingredient is to provide for the effective coordination and interconnection of regional and shortlines so that we can effectively work together. Some reasonable definition as to what constitutes a mega-merger will prevent interfering with appropriate feeder line concept agreements that remain true to the original signatories. This will have the combined effect of both regenerating ingenuity in the marketplace and ameliorating the anti-competitive impacts of the mergers.

IV. CONCLUSION. The industry is already too concentrated for a truly vibrant shortline and regional railroad industry. The already excessive concentration that has occurred among Class Is since most shortlines were created has placed us at a significant competitive disadvantage from the time the "feeder line" concept was created. The competitive relief valves that made that system bearable a decade ago are disappearing. The inevitable round of mega-mergers triggered by CN/BNSF will render the once vibrant shortline success stories into helpless pawns with no options.

For DM&E specifically, going forward with this round of mergers likely will kill the most encouraging shortline success story for a railroad that is trying to use some ingenuity to rebuild and make dramatic improvements in the rail industry -- unless the STB determines to take a more aggressive pro-competitive role in granting conditions than was applied to the last round of mergers. The early indications in that regard -- including this opportunity for hearing the concerns throughout the industry -- are very positive and encouraging. Thank you for the opportunity to present our views at this preliminary stage, and the sensitivity you have demonstrated for this issue.