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April 8, 2016

Ms. Cynthia T. Brown  
Chief, Section of Administration  
Office of Proceedings  
Surface Transportation Board  
395 E Street, S.W.  
Washington, D.C. 20423-0001

ENTERED  
Office of Proceedings  
April 8, 2016  
Part of  
Public Record

Re: Finance Docket No. 36004 --Petition for Expedited Declaratory Order  
-- Canadian Pacific Railway Limited; Reply of FirstEnergy Corp.

Dear Ms. Brown:

Introduction and Summary

FirstEnergy Corp. ("FE") hereby submits its Reply in opposition to the Petition for Expedited Declaratory Order ("Petition") filed herein by Canadian Pacific Railway Company ("CP") with respect to a possible merger agreement Canadian Pacific may enter into with Norfolk Southern Railway Company ("NS"). Of course, CP has not yet entered into such an agreement to merge with NS, but apparently CP believes that approval of its voting-trust proposal is essential to its ability to proceed with a merger with NS.

If the Surface Transportation Board ("STB") commences a declaratory proceeding in response to CP's Petition (which is not necessary, given that the Petition addresses a situation that may arise only if CP and NS agree to merge), the STB should decline to institute a declaratory proceeding because it is not clear that CP and NS will ever agree to merge. If the STB institutes a proceeding and reaches the merits, the proposed voting-trust structure CP proposes is contrary to the "control" statute and the STB's voting-trust regulation because it would allow some of CP's current management to control NS before the STB could complete its review of a proposed CP-NS merger, and would otherwise be harmful to the public interest. FE believes that the STB should deny CP's Petition without prejudice to CP and NS seeking a different structure of voting trust if they should agree to merge.

Interests of FirstEnergy

FE, through its various subsidiaries, including FirstEnergy Generation, LLC and FirstEnergy Service Company (collectively, "FE") is one of the largest investor-owned electric utilities in the United States. FE's headquarters are in Akron, Ohio. It serves

millions of electricity customers in much of Ohio, as well as in substantial parts of Pennsylvania, Maryland, West Virginia, and New Jersey. FE ships a substantial amount of coal via NS, and therefore has a substantial interest in the outcome of this proceeding.

### Factual Background

Much of the electricity generated by FE comes from coal-fired generation facilities. Even though in recent years FE (and many other utilities) have reduced the percentage of electricity that comes from coal, and increased the amounts that come from natural gas and renewable sources (such as wind), for various reasons not at issue herein, coal is still responsible for a substantial amount of the electricity generated by FE.

On a national basis, in addition to coal-fired and natural gas-generated electricity, nuclear and hydroelectric generating facilities also generate substantial amounts of base-load, reliable electricity. While usage of coal to generate electricity has diminished in recent years, coal is still the fuel source for over 30 percent of the electricity generated in the United States. Accordingly, rail transportation of coal to electricity generating stations is still a vital service to the nation.

While some coal is delivered by barge to FE's power plants, most of the coal that FirstEnergy uses is transported to FE's coal-fired plants in whole or in part by railroad. FirstEnergy no longer ships coal on CSX Transportation, Inc. ("CSX") but it does ship millions of tons of coal annually on NS, which at times may originate in the west (from the Powder River Basin). The western coal used by FE is transported to interchange with NS (typically in Chicago, IL) by BNSF Railway Company ("BNSF"). Other coal used by FE originates in the east on the lines of NS. Nearly all of the coal shipped by FE by rail is transported by rail carriers under rail transportation agreements, and that transportation is, therefore, generally not subject to regulation by the STB.

FE has not always seen eye-to-eye with the railroads transporting coal for it, but FE has generally resolved its disputes with the railroads through commercial means, rather than in regulatory proceedings at the STB. Even when FE, like so many other rail shippers, was having substantial rail service issues with various railroads in 2013-15, it did not resort to the STB for relief, relying instead on commercial means to deal with those issues.

However, FE is fully aware that, as a result of past rail merger and acquisition proceedings involving "Class I" railroads, such as the mergers of (a) Union Pacific Railroad ("UP") and Chicago & North Western Railway and (b) UP and Southern Pacific Railroad, and (c) the acquisition and subsequent division of Conrail by NS and CSX, substantial service problems resulted. Those service problems were both serious and, in some instances, persistent.

As a result of such experiences, and because of the STB's concern that the next merger of "Class I" railroads would trigger the final round of mergers of Class I railroads, resulting in two Class I railroads in North America, the STB substantially modified its rail merger policy in 2001,<sup>1</sup> after the BNSF and Canadian National Railway ("CN") proposed to merge. As a result of the STB's merger moratorium, the proposed BNSF-CN merger did not occur. The STB's new rail merger policy has not, therefore, ever been applied.<sup>2</sup>

In addition to causing other changes in STB merger policy, such as a "pro-competitive" approach required for mergers, STB consideration of other rail mergers that are likely to occur as a result of the proposed merger at issue, and additional safety and rail-service considerations required of the merging carriers, that 2001 STB rail merger policy included a new policy, reflected in a revision in 49 C.F.R. §1180.4(b)(iv), with respect to "voting trusts" that are typically used in nearly all rail mergers while the railroads involved seek authority to merge from the STB. In that new policy concerning voting trusts, the STB's regulation states in relevant part: "In each proceeding involving a major transaction, applicants contemplating the use of a voting trust must explain how the trust would insulate them from an unlawful control violation and why their proposed use of the trust, in the context of their impending control application, would be consistent with the public interest."

The STB's new voting-trust policy, and the application of that policy to CP's Petition, are the primary subjects of this Reply to the Petition.

### CP's Petition

In its Petition, CP seeks to have the STB institute a declaratory proceeding<sup>3</sup> to consider the form of its proposed voting trust, which apparently it would use if it reaches agreement with NS to merge. CP, the acquiring company, proposes that *its stock* would be put into trust, rather than the stock of NS, the *target railroad* (as has been customary in all prior voting trusts approved by the STB and ICC since the passage of the Staggers Rail Act of 1980). This arrangement, in CP's view, would then permit its Chief Executive Officer, Mr. E. Hunter Harrison, to resign his positions with CP, sell all of his CP stock promptly, and soon thereafter become the CEO of NS. Petition at 2; Harrison V.S. at 4-5.<sup>4</sup> This unusual arrangement would, in CP's view, permit Mr. Harrison to

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<sup>1</sup> 49 C.F.R. §1180.1; 66 Fed. Reg. 32,583 (June 15, 2001).

<sup>2</sup> Petition at 7.

<sup>3</sup> Of course, the STB is not obligated to institute a declaratory proceeding; whether to do so is committed to the agency's discretion under 5 U.S.C. §554(e). In re Georgia-Pacific Corp. – Petition for Declaratory Order, No. MC-C-30202 at \*1 (I.C.C., Sept. 16, 1992).

<sup>4</sup> CP also states that a small number of additional CP personnel could accompany Mr. Harrison to NS. Petition at 2 n.3.

begin immediately to achieve the supposed “benefits” (in CP’s view) of the merger, by instituting what Mr. Harrison calls his “precision railroading model” at NS (Harrison V.S. at 3) rather than to wait until the STB could conclude its consideration of the application CP and NS hypothetically may file.<sup>5</sup> Given past experience, the STB’s consideration of any proposed CP-NS merger would take the approximate amount of time allowed for the STB’s decision, or 16 months following filing of the application (including one month to determine if the application is complete, one year to complete the record, and 90 days for the STB to issue its decision after close of the evidentiary record.<sup>6</sup>

To the best of FE’s knowledge, all prior voting trust arrangements approved by the Interstate Commerce Commission (“ICC”) or STB have seen the stock of the *target railroad* placed in the voting trust.<sup>7</sup> That is important, because, in the past at least, it has been widely understood that the purpose of the voting-trust structure is to permit the *acquiring railroad* to acquire the *target railroad* and place its stock into the voting trust *without taking control of the target railroad* before the STB has passed judgment on whether such control should be permitted.

In its Petition, CP candidly acknowledges that this arrangement would allow Mr. Harrison to begin to implement the “precision railroading model” it believes NS should put into place (which CP sees as a primary benefit of a CP-NS merger, along with reductions of costs by reducing the number of employees and locomotives) immediately, instead of after the STB authorizes the merger (assuming *arguendo* that it were to do so). And all of this, of course, assumes facts not in evidence – (a) that CP and NS ever actually agree to merge (when that arrangement could well be different than what CP now envisions), (b) that they would do so while Mr. Harrison is still able to serve as a NS executive (apparently he will be 72 in 2016 and NS’s mandatory retirement age is 72), and (c) that the actions Mr. Harrison and CP proposes to take at NS (*inter alia*, reducing the number of employees and crews, and introduction of scheduled service) would actually improve NS’s operations and profitability, among other things.

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<sup>5</sup> Statements by CP indicate that this arrangement would allow it to control *both* CP and NS while their merger application is pending (*e.g.*, interview with Mr. Harrison, <http://trn.trains.com/news/news-wire/2016/02/04-hunter-pauses>, stating that “I need to be convinced that we have the players, which includes me, to run *both* organizations” (emphasis added); *see also*, CP Investor Call, Tr. at 4 (Dec. 8, 2015, statement of Paul Guthrie, Esq., Special Counsel to the CEO, describing “pre-merger” operational improvements CP sees with its proposed arrangement), but as FE sees it, that “pre-merger” control is precisely what the statute forbids.

<sup>6</sup> 49 U.S.C. §11325(a)-(b).

<sup>7</sup> CP candidly acknowledges that its proposed voting trust would be “atypical.” Petition at 8.

## Substantive Comments

### 1. The Law Imposes Strict Restrictions on CP in the Event That It Agrees to Acquire and Merge with NS.

Under 49 U.S.C. § 11323(a)(3), “[a]cquisition of control of a rail carrier by” another rail carrier “may be carried out only with the approval and authorization of the” STB.<sup>8</sup> The STB has stated that its “authority to rule on, or prevent the use of, a voting trust ... is inherent in [its] statutory authority over rail mergers” under 49 U.S.C. §11323. Major Rail Consolidation Procedures, Ex Parte No. 582 (Sub-No. 1), 2001 STB LEXIS 546, at \*62 (STB served June 11, 201) (“Merger Rules”). Accordingly, the voting-trust structure has evolved to permit one Class I railroad to acquire another and to put the acquired railroad’s stock in trust, free from the control of the acquiring railroad, until the STB has completed its proceeding to determine whether to permit the acquiring railroad to take control of the acquired railroad, and has authorized that control. In the meantime, the acquiring railroad must maintain strict separation from the acquired railroad, which can occur because of the voting-trust arrangement. 49 C.F.R. §1180.4 (“In each proceeding involving a major transaction, applicants contemplating the use of a voting trust must explain how the trust would insulate them from an unlawful control violation and why their proposed use of the trust in the context of their impending control application, would be consistent with the public interest.”).

In 2001, the STB revised its regulations regarding the use of voting trusts. In particular, the STB established a “more formal and open process for applicants in major rail consolidations, requiring them to demonstrate in a public filing that their contemplated use of a trust would not result in unlawful control and would be consistent with the public interest.” *Id.* at \*61-62; *see also* 49 C.F.R. §1180.4(b)(4)(iv). The STB has cautioned that “voting trusts should not be used routinely, but rather should be available for those rare occasions when their use would be beneficial.” Merger Rules at \*65 n.29. Thus, the STB’s revised regulations implement a heightened approval standard for the use of a voting trust in connection with a proposed major rail consolidation.

CP’s proposed voting trust would be the first voting trust considered under the STB’s revised regulations. Although many<sup>9</sup> ( according to CP, 144<sup>10</sup>) voting trusts have

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<sup>8</sup> A combination of two Class I railroads is referred to as a “major transaction” and is subject to the STB’s 2001 rail merger policy. 49 C.F.R. §§1180.1(a) and 1180.2.

<sup>9</sup> As noted above, we say “many” because, at least in the circumstances of the putative Illinois Central-Kansas City Southern merger, the lawfulness of the proposed voting-trust arrangement, which CP argues was similar to that proposed here by CP, was never resolved by the ICC, because that merger never occurred.

<sup>10</sup> See CP press release: <http://www.cpr.ca/en/investors/canadian-pacific-petitions-us-surface-transportation-board-for-declaratory-order>.

been requested of, and approved by, the STB or ICC since enactment of the Staggers Rail Act of 1980, all of these trusts either predated the 2001 revision of the STB's regulations or were not used in connection with a major rail consolidation.<sup>11</sup> The fact that those voting trusts were approved in the past is, therefore, not relevant, because no such proposed voting-trust proposal has been reviewed or approved since the STB's new rail merger policy was approved. It is notable that CP touts the ICC's and STB's prior approval of those many voting trusts on its website, but not in its Petition; that suggests it knows the point is not relevant under the new merger policy.

Under the STB's revised regulations, the proposed use of a voting trust in connection with a major rail consolidation must (1) prevent an unlawful control violation, and (2) be in the public interest.

A. Control. "Control" is defined to include "actual control, legal control, and the power to exercise control, through or by (A) common directors, officers, stockholders, a voting trust, or a holding or investment company, or (B) by any other means." 49 U.S.C. §10102(3). The power to exercise control includes the power to select the management team for a rail carrier. E.g., Louisville & Jeffersonville Bridge & R.R. Merger, etc., 295 I.C.C. 11, 16 (1955), aff'd sub nom. Alleghany Corp. v. Breswick & Co., 353 U.S. 151, 163 (1957)(noting that the power to "organize and elect" officers of a rail carrier "constitutes control"); see also John Colletti – Control – Comet Freight Lines, 38 M.C.C. 95, 97 (1942)(noting that control is the "power or authority to *manage*, direct, superintend, restrict, regulate, govern, administer, or oversee"(emphasis in original).

Therefore, whether the acquiring carrier can control or select the management of the target carrier during the pendency of the voting trust is a key factor in determining whether a proposed voting trust prevents an unlawful control violation.

The STB's obligation is to preserve the independent management of the target carrier during the pendency of the voting trust, regardless of which carrier is placed in trust. The STB has approved voting trust arrangements involving management swaps where management has moved *from the target carrier to the acquiring carrier*.<sup>12</sup> In CN-IC, Mr. Harrison was hired away from the target carrier, IC to join the management team of the acquiring carrier, CN. However, the STB has *never* approved voting trust

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<sup>11</sup> STB response to House Judiciary Committee, Major Rail Mergers and Consolidations Correspondence at 2 (Jan. 7, 2016)(noting that the STB has not approved CP's particular proposed voting trust "arrangement in the contest of a proposed merger between two Class I railroads" and stating that the STB will "take a much more cautious approach" with regard to voting trusts in major mergers)(available on STB's website).

<sup>12</sup> E.g., Canadian National Ry. Co. – Control – Illinois Central Corp., FD No. 33556 (served Aug. 14, 1998)("CN-IC").

structures involving management swaps where management has moved *from the acquiring carrier to the target carrier*.<sup>13</sup> Under IC-KCS, shared business philosophies and plans between management teams of the acquiring carrier and the target carrier, even if one carrier is held in trust, can create an unlawful control violation.

Based on the foregoing, CP's proposed use of a voting trust would not prevent an unlawful control violation, because CP proposes to select the management teams for *both carriers* during the pendency of the voting trust, and to move its CEO, Mr. Harrison, *from the acquiring carrier to the target carrier*.<sup>14</sup> Mr. Harrison would control and manage NS; the remaining CP management (headed by Mr. Creel) would continue to manage CP. This is clearly an effort by CP to take control of NS before the STB could decide whether to approve the proposed merger; that premature control is precisely what the statute forbids.

B. Public Interest. Clearly, the STB must consider how placing a carrier in trust would affect service for shippers, competition between carriers, investments in rail infrastructure and network capacity, and rail labor interests.<sup>15</sup> Under STB precedent, the "public interest is concerned ... also with the maintenance of respect for and observance of the law."<sup>16</sup> In IC-KCS, the ICC expressed concerns with the proposed voting trust structure because it would circumvent the ICC's authority to review and approve the proposed merger. The ICC noted that, because the proposed voting trust structure would effect immediate changes to KCS's management and operation on approval of the trust, "when the [ICC] finally addresses the [proposed merger], the agency will be presented with a *fait accompli*."<sup>17</sup> Such a *fait accompli* would effectively usurp the STB's jurisdiction to review and authorize mergers. In Procedures, the STB expresses a particular interest in preserving its jurisdiction, noting that "we must take a more cautious approach to future voting trusts in order to preserve our ability to carry out our statutory responsibilities."<sup>18</sup>

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<sup>13</sup> STB response to House Judiciary Committee (Jan. 7, 2016), *supra*, at 2; *see, e.g.*, Illinois Central Corp. – Common Control -- Illinois Central R.R. Co. and The Kansas City Southern Ry. Co., FD 32556 (served Oct. 19, 1994) ("IC-KCS").

<sup>14</sup> On March 9, 2016, the U.S. Department of Justice ("DOJ") testified before the Antitrust Subcommittee of the U.S. Senate Committee on the Judiciary that such an arrangement would risk creating an improper "fait accompli." <http://www.wsj.com/articles/u-s-raises-competition-concerns-about-railways-proposed-voting-trust-1457563534>. FE agrees. DOJ said it would file comments in this proceeding; FE looks forward to those comments.

<sup>15</sup> 49 U.S.C. §10101.

<sup>16</sup> Central of Georgia Ry. Control, 307 I.C.C. 39, 43 (1958).

<sup>17</sup> IC-KCS, FD No. 32556 at 4.

<sup>18</sup> 2001 STB LEXIS 546 at \*63.

Based on the foregoing, CP's proposed use of a voting trust, especially with CP, not NS, being placed in trust, could not be shown to satisfy the public interest standard at this point. CP has not shown the harms to the public interest would be relatively small.<sup>19</sup> Moreover, it is quite obvious that one of the STB's primary concerns in adopting its current rail merger policy was that it would trigger a "domino effect," resulting eventually in only two Class I North American railroads. That outcome could have a significant adverse effect on the public interest unless the proposed transaction were pro-competitive (in reality, not just in form, which will require a careful consideration of the details of CP's "pro-competitive" proposals), would not result in a diminution of rail service, and would not cause a reduction in rail safety (all of which are among those considerations the STB is required to consider).<sup>20</sup> Those showings cannot be made now, but will depend on what CP and NS propose in their application to merge, *if* they ever agree to merge and file such an application with the STB.

## 2. FE's Interests Could Be Harmed by a CP-NS Combination.

FE has an interest in the structure and use of the voting trust that CP may propose should it reach agreement to merge with NS. The reason is that FE is aware that that CP has stated, as stated above and in its Petition filed herein, that approval of its voting-trust approach, in substantially the form proposed, is essential to its ability to enter into an agreement to merge with NS, and to realize the "benefits" (to *it*, that is) that it believes are necessary to justify the price (including a significant premium) it would be prepared to pay for NS's outstanding stock. FE, on the other hand, as a customer of NS, is rightly concerned that CP's stated plans for NS involve reducing the number of employees and locomotives, among other things, to save money, and therefore to increase the profitability of NS. CP apparently believes that by inserting its CEO, Mr. Harrison, in a

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<sup>19</sup> Indeed, CP candidly admits (Petition at 21) that there could be competitive harms created by Mr. Harrison moving to NS from CP, and so CP proposes that a condition would be adopted when approving the voting trust CP and NS would hypothetically propose if they were to agree to merger, to prevent those harms.

<sup>20</sup> E.g., Senate Hearing No. 107-112, Railroad Shipper Concerns, Hearing Before the Subcommittee on Surface Transportation and Merchant Marine of the Committee on Commerce, Science and Transportation, United States Senate, 107<sup>th</sup> Cong., 2<sup>nd</sup> Session (July 31, 2002) (testimony of Linda Morgan, then-Chairman of the STB, noting that "[f]uture merger proposals would likely result in a North American transportation system composed of as few as two transcontinental railroads.... Given that the next round of mergers would put in place the rail network of the future, applicants under the new [major merger] rules bear a substantially heavier burden in demonstrating that a merger proposal is in the public interest"), *available at* <https://bulk.resource.org/gpo.gov/hearings/107s/92235.txt>. The public record to date does not suggest that there are significant public interest benefits associated with CP's proposed use of a voting trust.

similar position at NS, he can achieve operating efficiencies that more than offset the effects of reducing the number of employees and locomotives. Mr. Harrison and CP believe this because, they say, they have achieved such savings by creating scheduled service on CP (as Mr. Harrison supposedly did on the IC before its merger with CN, and on a combined CN-IC after their merger was approved by the STB).

FE generally regards NS as an efficient and reasonably well-run railroad, even if it is going through changes now (consolidating operations and reducing crews) that may impact on service in the near term, which are the sorts of things CP has advocated be done at NS. For that reason, FE is skeptical that Mr. Harrison, despite his industry experience and prior success, can achieve additional substantial, near-term operational efficiencies at NS; to achieve those supposed “benefits” CP apparently needs to justify the premium CP intends to pay to purchase NS’s stock. This is especially true because many of the Class I railroad mergers approved in the 1990s resulted in *worse* service, not better service. That history cannot be denied or overlooked.

FE is greatly concerned that, if Mr. Harrison were to take over NS immediately after the voting trust were approved, and he were to reduce the number of employees and locomotives at NS in the near-term, as he says he would, at the same time he would be attempting to improve NS’s operational performance, all while Mr. Harrison simultaneously is learning about NS’s system, the region in which it operates, and its customers, while first becoming familiar with NS’s employees and management, the greater likelihood would be of service problems than service improvements. The prospect that Mr. Harrison could take a reasonably well-run railroad and make such improvements in the near term, while cutting costs substantially, is unproven and dangerous because of the potential adverse impact on service and the customers served by NS. Therefore, FE believes that the atypical voting-trust proposal of CP is not in the public interest.

FE respectfully believes that the STB should not allow Class I railroads to impose on their customers acquisition premiums that the railroads pay for another railroad, without any say by their customers, and then recover those premiums through higher rates. Other regulatory agencies (such as the Federal Energy Regulatory Commission) allow acquisition premiums, if any, to be recovered only if there are net benefits to customers – generally, lower rates due to cost savings from the merger – as a result of the merger.<sup>21</sup> The sole purpose for CP’s unusual voting-trust proposal is to begin to recover

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<sup>21</sup> E.g., Missouri Public Service Comm’n v. FERC, 783 F.3d 310 (D.C. Cir. 2015); Seaway Crude Pipeline Co. LLC, 154 FERC ¶61,070 at P 92 (2016)(“... the pipeline must show clear and convincing evidence that its acquisition of the facilities will provide substantial, quantifiable benefits to ratepayers even if the full purchase price, including the portion above depreciated original cost is included in rate base”).

immediately the acquisition premium that CP seeks to pay for the stock of NS. Given past precedents of the STB allowing such acquisition premiums to be recovered from captive customers, FE is not interested in facilitating such an approach through an unusual voting-trust arrangement.

If CP and NS eventually agree to merge, FE believes that the STB should evaluate the proposed arrangement at that time, not beforehand, just as FE would do. FE believes that the voting-trust arrangement that should be allowed under such circumstances, if any, is the conventional approach that has nearly always been taken in the past. That is, FE believes that the STB should make clear that it will only permit a voting trust that puts the *acquired* railroad (NS) in trust, free of control by the *acquiring* railroad (CP), including by its current management personnel, until and unless the STB approves of the merger and authorizes CP to take control of NS.

### Conclusion

For the foregoing reasons, FE urges the STB to decline to institute the declaratory proceeding requested by CP, because it is not in the public interest at this time to encourage any Class I railroad mergers because of the likely adverse impact on rail-to-rail competition. If the STB nevertheless decides to institute such a proceeding, it should decline to issue a declaratory order in the form requested by CP, because that declaratory order might permit CP and NS to merge. FE opposes such a merger not only because of its impact on rail-to-rail competition but also because of its likely adverse impact on service on the NS due to Mr. Harrison's stated determination to reduce the number of crews and locomotives at NS.

Denial of the CP Petition could be without prejudice to CP and NS filing a revised voting trust request, if but only if they first agree to merge, so that the STB and the interested parties will know the details of the proposed merger agreement entered into by CP and NS, and so that CP does not seek or obtain premature control of NS. In order to avoid premature control, the STB may wish to state that the voting-trust arrangement proposed at that time by CP should be such that NS stock, not CP stock, would be put into voting trust, and that CP management would not be allowed to take premature control of NS as is (in effect) proposed by CP in its Petition, as discussed above.

Respectfully submitted,



Rick C. Giannantonio

cc: All Persons on Service List

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the forgoing letter has been served this 8<sup>th</sup> day of April, 2016, via first-class mail upon the following:

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