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DOT-4

Before the
Surface Transportation Board
Washington, D.C.

Canadian National Railway Company, and Grand Trunk Corporation -- Control -- EJ&E West Company	)	Finance Docket No. 35087

Reply Comments of the
United States Department of Transportation

Introduction

The Surface Transportation Board ("STB" or "Board") in this proceeding is considering whether to approve the combination of the Canadian National Railway Company ("CN") and the Elgin, Joliet & Eastern Railway Company ("EJE"). See Decision No. 2, served November 26, 2007 [1] The United States Department of Transportation ("DOT" or "Department") has reviewed the record compiled to date, which consists of the primary application, related environmental and safety filings, and the initial comments of interested parties. On the basis of these materials, DOT believes that the proposed transaction meets the applicable standard for approval, provided that the Board imposes appropriate conditions to ensure that the transaction will not substantially lessen competition, to hold the Applicants to their representations and commitments made on the record, and to establish an oversight period.

[1]/ Technically, the transaction before the Board is the acquisition by Canadian National Railway Corporation ("CNR") and Grand Trunk Corporation ("GTC") (collectively, "Applicants") of EJ&E West Company, a non-carrier wholly owned by EJE There are also related notices of exemption involving an intra-corporate family transaction and the granting of trackage rights to CNR/GTC-owned rail carriers Id

Before turning to significant individual issues, the incomplete state of the record requires the Department to qualify the views expressed herein. DOT cannot take into account the simultaneously filed reply comments of other parties and the rebuttal of the Applicants. We nonetheless must acknowledge the possibility that these materials may contain countervailing information and argument sufficient to alter our judgment in some respect. If that should occur, DOT will inform the Board.

The Legal Standard

With respect to matters other than safety and the environment, the applicable legal standard requires the STB to approve this transaction unless it finds that –

> (1) as a result of the transaction, there is likely to be substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States; and
> (2) the anticompetitive effects of the transaction outweigh the public interest in meeting significant transportation needs.

49 U.S.C. § 11324(d) [2]

The Primary Application

The primary application describes in detail the proposed combination of the CN and the EJE railroads. CN-2. The Applicants have always stressed the public benefits of their transaction, such as the reduction of rail congestion in Chicago made possible by transferring CN traffic to the EJE, and the enhanced safety and operational

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[2]/ DOT has already expressed its view on the proper scope of the environmental impact statement to be prepared in this proceeding. DOT-3, filed February 15, 2008 That would encompass the proposed acquisition's effects on intercity and commuter rail passenger service as well as a runway extension project at the Gary-Chicago International Airport We expect to participate further in these aspects of this proceeding Decision served December 21, 2007, at 3 It is also relevant to report that the Applicants have prepared a draft Safety Integration Plan ("SIP") for the Federal Railroad Administration ("FRA") to review. FRA is working with the Applicants to further develop the SIP prior to its submission in the docket

efficiency brought about by significant new investment planned for the EJE and area rail facilities. Id. at 23, Operating Plan (Exhibit 15), Verified Statement ("VS") of David L. Novak. They have also emphasized that this transaction would have no anti-competitive effects because CN and EJE are complementary rather than competing carriers, that all current gateways would remain open, and that all current customers of both carriers would receive the same or better service after the merger. Id. at 23-25, VS of E. Hunter Harrison at 53-54, and, generally, VSs of Gerald P. Radloff, Christopher A. Vellturo, and Gary L. Kolbe.

With one exception, it appears to the Department that the Applicants are correct overall in their competitive assessment. Several individual shippers have also expressed significant concerns with the effects of the proposed acquisition on the level of services they now enjoy. We turn to these below.

The Merger's Effects on Competition

The Board has long recognized that the presence of a nearby rail carrier provides potential competition for the benefit of shippers served by a single railroad, for the possibility of constructing a rail line to that carrier (a "buildout") serves as leverage against the serving railroad. Union Pacific/Southern Pacific Merger, 1 S.T.B. 233, 419-20 (1996); Conrail Acquisition Case, 3 S.T.B. 196, 320 (1998). The Applicants aver that no shipper would suffer a reduction in competition due to the loss of a buildout opportunity because of their merger CN-2, VS of Radloff at 65-66 At least one shipper, however, offers contrary evidence.

American Chemical Services, Inc. ("ACS") is a producer of specialty chemicals located in Griffith, Indiana. When ACS built its present site in 1955 it was served by the

Chesapeake and Ohio Railway, which later became the CSX Transportation Company ("CSX"). CSX abandoned service to Griffith in 1981, at which time ACS purchased one mile of CSX's line in order to connect with the EJE. ACS Opposition Statement and Request for Conditions, VS of David Tarpo. EJE has provided frequent and dependable service to ACS since then. Id. at 4.

ACS also reports that another track (the "Chessie-Grand Trunk Interchange Track") at one time connected its track with a CN line, but it was removed some time after 1981. Id. at 2. ACS and CN tracks are now separated by 150 feet at their closest point, and otherwise by no more than 800 feet. Id. ACS claims that over the past 27 years it has consistently relied on the threat of a buildout to reach CN as a competitive restraint in rate and service negotiations with the EJE. Id. The combination of CN and EJE will extinguish that leverage, however, and ACS fears it may also introduce a larger carrier unlikely to find ACS's traffic attractive enough to warrant continuing current service levels. Id. at 2, 4.[3]

To maintain the competitive status quo, ACS requests that the Board require CN to grant trackage rights on EJE both to ACS (or a carrier created by ACS) and to the nearby Norfolk Southern Railway Company ("NS") so that NS can serve the shipper.[4] Alternatively, ACS requests that the Board impose a condition requiring CN to continue to serve the ACS plant as EJE now does (five days a week), and to abide by all provisions

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[3]/ ACS accounted for 167 railcars in 2007

[4]/ NS lines are located within three or four miles from Griffith (at Hartsdale and Van Loon, Indiana, respectively), an active EJE/NS interchange exists at the farther point Id at 3

of the existing EJE-ACS transportation contract for a period of five years from the date of consummation of the merger, and indefinitely thereafter. Id. at 2-3, 6-7.

The details of the actual and potential competition situation at ACS are a little uncertain to DOT However, the record clearly establishes the existence of a second rail carrier in very close proximity to the ACS plant. The proposed transaction will combine that railroad (CN) with the one now serving ACS (EJE), thereby eliminating this source of potential intramodal competition. [5] The Department accordingly urges the Board to impose a condition to preserve the competitive status quo.

STB precedent in these circumstances would ordinarily call for a third-party carrier to be accorded trackage rights on the CN to the point of the buildout. Conrail Acquisition Case, 3 S.T.B. at 320. If the standard response is operationally infeasible or apt to prove ineffective for other reasons, the Board has gone further and granted trackage rights to a third-party railroad to reach adversely affected shippers. Id. at 319-20. It might wish to consider such a step here. Indeed, the particulars of ASC's situation may make even this option ineffective to replicate the shipper's current competitive conditions. [6] In that case, the STB may entertain ASC's suggested condition that it (or a

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5/ CN denies a loss of competition where its tracks are close to EJE's because it is unaware of any efforts (1) by shippers served by one railroad trying to reach the other or (2) by either railroad trying to reach shippers served by the other CN-2, VS of Radloff at 70-71 But these scenarios are neither surprising nor relevant They are not surprising because ACS may offer too little traffic to be attractive to a major carrier like CN, and note 6 below explains the traffic may have been of marginal interest even to a small railroad like EJE. They are not relevant because "the ultimate test of feasibility of a build-out is whether the line is built." 3 S T B at 319, note 179 Since the option does not just rest with railroads but with shippers as well, the condition of third-party carrier access is triggered if the connecting line is constructed regardless of who builds it In this case, the traffic volume is small, but the distance is short

6/ ACS faced a loss of rail service when CSX abandoned its line to Griffith The shipper apparently was only able to maintain service by purchasing CSX track, deeding part of that track to EJE, and agreeing to maintain the rest by itself ACS Opposition Statement and Request for Conditions, VS of Tarpo at 1 If the low volume or other circumstances of its traffic were such that a regional railroad would transport it only carrier it forms) receive trackage rights on the EJE to reach NS or another third-party railroad. DOT will address the service concerns of ACS and other shippers below.

<u>The Merger's Effects on Service</u>

A number of shippers served by CN or EJE have expressed concerns that post-merger service levels will decline, with the consequence that their transportation needs will not be met Two such parties are sited at the same rail location, rely upon EJE as a neutral connecting carrier to reach Class I railroads, and depend upon EJE for specialized storage services. They ultimately adopted a common position on the transaction. [7] DOT thus addresses those parties together

Aux Sable Liquid Products and Equistar Chemicals

Aux Sable Liquid Products, LP ("Aux Sable") operates one of the largest natural gas liquid extraction and fractionation plants in North America at Channahon, Illinois, where it produces propane and butane. Opposition Statement and Request for Conditions, VS of Michael Van Winkle at 11. [8] The Channahon plant is located at the rail station known as East Morris, Illinois, on a section of track jointly owned by EJE and the trustee of the former Rock Island Railroad (the "Joint Lead Track"). [9] Although it is served by

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after ACS had undertaken these steps, it may well be that a substantially larger rail carrier would demand at least as much in order to provide service

[7]/ Notice of Adoption of Evidence and Argument and of Common Position, filed February 29, 2008 ("Common Position")

[8]/ Aux Sable accounts for approximately 4,000 carloads per year over the EJE, although it anticipates shipping an additional 500 carloads this summer. <u>Id</u>. at 12.

[9] According to Aux Sable, the Joint Lead Track and adjacent main track were leased to CSX for fifty years <u>Id</u>. at 11 All shippers on the Joint Lead Track are served by both CSX and EJE, although Aux Sable reports that virtually all of the traffic from five major shippers on the Joint Lead Track (including Equistar) is handled by EJE <u>Id</u> at 12. The track connects with EJE's Illinois River Line, a twenty mile branch line

both CSX and EJE, Aux Sable principally relies on EJE because its service has been more reliable and responsive than that offered by CSX, and because EJE provides storage capacity for empty tank cars. Id., at 4-5; VS of Van Winkle at 12-13.

Aux Sable seeks conditions that would require CN (1) to provide for ten years the same level of service now provided by EJE; (2) to keep intact for five years the shipper's contract with EJE for storage space; and (3) to maintain nondiscriminatory access to other railroads. Id. at 13-14.

Equistar Chemicals, LP ("Equistar") owns and operates a polymers plant situated on the Joint Lead Track at East Morris, Illinois. Like Aux Sable, Equistar is served by both EJE and CSX, but it also relies on the EJE because of superior service and because only that carrier has sufficient track capacity to meet Equistar's need for storage-in-transit. Petition to Deny, Or in the Alternative, Request for Imposition of Conditions, at 2-3. Equistar asks the Board either to deny the application or to impose conditions that ensure the continuation of service, storage-in-transit capacity, and neutral connection to other rail carriers that it receives today. Id. at 4.

Both Equistar and Aux Sable are concerned that as a result of the transaction they will lose their relatively high quality of service, their neutral connecting carrier to Class I railroads, and the availability of storage-in-transit capacity. They consider major carriers generally to be less responsive than smaller railroads, and point to their own experience with CSX and that of other shippers on the Wisconsin Central adversely affected by that

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that extends from EJE's main track at Walker, Illinois For CSX, the track connects with its Bureau-Joliet, Illinois rail line carrier's merger with CN. *Opposition Statement and Request for Conditions* at 3-4, VS of Sandra J. Dearden; Common Position at 4.

These shippers have identified credible service-related concerns arising from the proposed transaction. Nonetheless, the Department does not support the precise conditions they seek. Reliance upon existing obligations and upon standard merger conditions should appropriately safeguard the legitimate interests at issue. First, there is no doubt that the plastics and chemical industries share a fundamental need for storage-in-transit. Union Pacific/Southern Pacific Merger, 1 S.T.B. at 426-27. Railroads that serve such plants but that cannot provide this service are less able to compete for these industries' business than those that can, as apparently demonstrated by CSX in this instance.

To protect against untoward risk, the Department would first expect that CN as the successor-in-interest would have to comply with the terms of EJE's contracts, including any in place with Aux Sable and Equistar that pertain to storage-in-transit or other services. [10] More importantly for regulatory purposes, in support of their transaction the Applicants have voluntarily promised to maintain or improve service to all current customers of CN and EJE -- presumably including Aux Sable, Equistar, and ACS -- and to keep open current rail gateways to other carriers. CN-2 at 24, VS of Harrison at 53, VS of Radloff at 75, VS of Vellturo at 130. It is standard practice in rail consolidation proceedings to hold merging railroads to such commitments Canadian

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[10]/ The Board holds authority to override contractual terms when necessary to give effect to an approved transaction, but the Applicants have not even invoked this power, much less offered any compelling reasons for its exercise 49 U.S.C § 11321(a). see 3 S.T.B at 272-74

National/Illinois Central Merger, 4 S.T B. 122, 187 (1999); Conrail Acquisition Case, 3 S.T B. at 288, 366, 387. The STB should follow this policy here. [11]

That is not to say that regulatory conditions should freeze current rate and service levels to shippers indefinitely. Such levels, whatever they are, have certainly changed over time and can be expected to do so again if and when circumstances change in the future -- and this need not be detrimental to shippers. [12] On the other hand, standard policy would also require the Applicants to make substantial good faith efforts to meet the continuing needs of shippers on the CN and EJE. The carriers would bear the burden of establishing whatever factors might support significant departures from their commitments. See STB F.D. No. 33388, (Conrail Acquisition Case), Decision No. 198, served September 19, 2001. [13]

Finally, oversight of a merger by the Board has proven valuable in the past to administer this and other conditions. The STB has tailored the timeframe and characteristics of its oversight to the circumstances of each merger. Sometimes the oversight has had a particular geographic focus, sometimes the merging carriers have had to submit reports detailing their activities, and sometimes the time period has remained

[11]/ Naturally, the Applicants and other parties remain free to resolve these points and other differences by mutual agreement.

[12]/ Aux Sable recounts, for example, that EJE worked with it over the years to increase both parties' business with the other Aux Sable Opposition Statement and Request for Conditions at 4

[13]/ In that decision the STB allowed the NS to depart from a commitment made in the course of its acquisition of part of Conrail on the basis of the railroad's demonstrated good faith efforts and materially different circumstances The Board also imposed additional measures on NS for the benefit of those adversely affected

flexible.[14] In every case, however, the Board has made itself available to consider complaints from those who believe either that merging carriers have violated regulatory conditions or that the conditions imposed have proven ineffective. UP/SP Merger, 1 S.T.B at 248; CN/IC Merger, 4 S.T.B. at 161; Canadian National/Wisconsin Central Merger, 5 S.T.B. at 919. The Department endorses just such a condition in this case for the same purpose.

Wisconsin Public Service Corporation

Wisconsin Public Service Corporation ("WPSC") is a major electric service provider in Wisconsin that relies on coal from the Powder River Basin (PRB) in Wyoming to fuel its power plants at two locations: the Weston Generating Station near Wausau, Wisconsin, and the Pulliam Plant in Green Bay, Wisconsin. WPS-4, VS of David J. Wanner at 2-3. WPSC has expressed concerned that the unreliable service it now receives for unit train coal moving on EJE track will deteriorate further after the merger due to projected increased traffic levels on that carrier.

Currently, unit coal trains to the Pulliam Plant originate on the Burlington Northern Santa Fe Railway ("BNSF"), which operates on the EJE line via trackage rights (from Eola to Leithton, Illinois) and then hands off the traffic to CN for final delivery. Id., VS of Wanner at 3. Coal traffic to the Weston Generating Station has proceeded from the PRB via two different routings. It also originates on the BNSF, but can be interchanged at Minneapolis-St. Paul with the Canadian Pacific Railway ("CP") or at Chicago, again using trackage rights on the EJE and handing off to CN for final delivery.

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[14]/ See STB F D No 32760 (Sub-No 26) UP/SP Merger – Houston/Gulf Coast Oversight, Decision served May 19, 1998, Canadian National/Wisconsin Central Merger, 5 S.T B. 890, 909 (2001), and CN/IC Merger, 4 S.T B at 161, respectively

Id. at 4. WPSC reports that when it adds another coal-fired unit later this year at Weston, well over half of this traffic, too, will move through the Chicago (EJE/CN) routing Id.

WPSC points out that the portion of the EJE used for its unit trains is single-line track, which it claims has been responsible for slow transit times and erratic service levels. Id. at 5-6. The shipper is concerned that, following the merger, service levels will deteriorate even further as CN dramatically increases traffic on the same EJE line. Moreover, the infrastructure improvements planned by CN for EJE will benefit this line only very modestly Id. at 6-8.

Under the circumstances, WPSC questions the import of the Applicants' repeated representations to maintain or improve service for existing customers. Id. at 9-10. WPSC requests that the Board impose conditions to mitigate any deterioration in the service it receives. These include oversight for three years (during which the Applicants would file detailed reports), and holding the Applicants to their service commitments, including one that allegedly prohibits additional traffic being rerouted on the EJE until CN has completed the necessary capacity and operating improvements at the end of the merger implementation period.

The conditions supported by the Department above are also appropriate to address WPSC's concerns. CN should, of course, honor the terms of all existing agreements, and the Applicants should be held to the commitments made in support of their transaction. [15] We also agree that the Board should condition the merger by imposing an oversight

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[15]/ It is unclear to DOT whether the Applicants have in fact committed not to shift large volumes of CN traffic unto the EJE until all capital investments have been made See CN-2, VS of Novak at 203 and Operating Plan at 215-216 If they have, that would satisfy WPSC's request The Applicants should clarify this point

condition for at least the three years during which the merger would be implemented. During that time the STB would assess complaints regarding the Applicants' compliance with conditions and the efficacy of those conditions.

ArcelorMittal

Another EJE shipper that has expressed concerns about future service is ArcelorMittal USA Inc. and its affiliates ("Arcelor"), the largest steel producer in North America. Arcelor relies on the EJE in addition to other carriers to meet shipping needs at its Chicago-area facilities. Those facilities are located in East Chicago and Gary, Indiana. The former include the twin steel plants of Indiana Harbor East and Indiana Harbor West and also a significant galvanizing facility near the latter plant. The Gary facility consists of a steel plate mill (Gary Plate mill) located in the U.S. Steel Gary Works complex. ARCM-2 at 4-5, VS of Leslie K. Moll at 1-2.

The Indiana Harbor East Plant is served by EJE and the Indiana Harbor Belt Railroad ("IHB"). The Indiana Harbor West Plant is served by the EJE, IHB, and the Chicago & Indiana Harbor Railroad ("SCIH") – an Arcelor subsidiary. The galvanizing facility is served by EJE and IHB. Finally, the Gary Plate mill is now served by EJE, and following the transaction will be served by the Gary Railway, which is that portion of the EJE that U.S. Steel will retain. Id.

Arcelor recounts its dependence on the EJE and the other carriers for their efficient services, which have been specifically tailored to meet the needs and circumstances at each facility through contracts, tariffs, and other arrangements. ARCM-2 at 4, VS of Moll at 2. Arcelor believes that unconditioned approval of the proposed transaction will lead to serious deterioration of these services for three reasons. First, the

Applicants' Operating Plan contains no relevant, detailed information about post-merger operations at Arcelor's Chicago-area facilities Second, CN's basic purpose to use the EJE to ease its trunk operations through Chicago will tend to divert the Class I's attention and resources from EJE's local operations, in effect leaving Arcelor's facilities with service from one fewer railroad. Third, the new Gary Railway will serve far fewer shippers than the EJE, which will lead it to focus far more on its owner than on unaffiliated customers. ARCM-2 at 4-5,VS of Moll at 2-3.

Arcelor requests that the Board address these issues through merger conditions providing trackage rights on the EJE as follows: (1) to a third-party carrier to serve the Gary Plate mill; (2) to Arcelor's railroad subsidiary (SCIH) to serve Indiana Harbor East; and (3) to SCIH to serve the galvanizing facility. Arcelor would also have the STB preserve the status quo on all rates and services at its above facilities for a period of five years, regardless of whether they are represented in contractual obligations. Id. at 7-8. [16]

Arcelor has not established that intramodal competitive harm will arise from the proposed transaction. The merger will simply not affect the number of rail options the shipper now has, the distance to any third-party carrier, or any other recognized indicia of actual or potential rail competition. Arcelor's concerns with respect to deteriorating service, however, echo those of other parties. DOT's response to these concerns likewise echoes its reply to those parties.

That is, contractual obligations remain in place and must be honored where, as here, no showing has been made that they will in any sense interfere with the

[16]/ Arcelor allows that additional information from CN may make narrower conditions appropriate Comments at 7, note 6

implementation of the merger. Moreover, the Applicants' commitment to maintain or improve the services now enjoyed by CN and EJE shippers did not embrace only those contained in contracts. Subject to demonstrable changes in pertinent circumstances, the Applicants should be held to those commitments. An oversight period would enable Arcelor to document any merger-related service problems. DOT sees no present basis for other conditions.

Conclusion

The proposed merger of the CN and EJE promises to ease rail congestion in the country's largest rail hub. Although the environmentally-related aspects of the transaction will be fully explored elsewhere, the record to date shows both that the consolidation is overwhelmingly of an end-to-end nature, and that the relatively minor competitive and service issues it raises are properly resolved through traditional, narrowly tailored conditions. Oversight of the merger's implementation will ensure the effectiveness of the conditions, vetting of complaints, and consideration of any unexpected developments The Department supports approval of the Application, subject to the conditions noted and to the mitigation measures adopted at the conclusion of the environmental process in this proceeding.

Respectfully submitted,

D.J. GRIBBIN
General Counsel

March 13, 2008

CERTIFICATE OF SERVICE

I hereby certify that on this date I have caused a copy of the Reply Comments of the United States Department of Transportation in Finance Docket No. 35087 to be served by first class mail, postage prepaid, upon all Parties of Record in this proceeding.

Paul Samuel Smith

March 13, 2008