

**Before the
Surface Transportation Board
Washington, D.C.**

)	
Canadian Pacific Railway Company, et al.,)	
-- Control --)	F.D. No. 35081
Dakota, Minnesota & Eastern Railroad Corp., et al.)	
)	

**REPLY COMMENTS OF THE
UNITED STATES DEPARTMENT OF TRANSPORTATION**

Introduction

The Canadian Pacific Railway Company (“CP”) in this proceeding has applied to the Surface Transportation Board (“STB” or “Board”) for approval to acquire the Dakota, Minnesota & Eastern Railroad Corporation (“DM&E”) and its wholly-owned subsidiary, the Iowa, Chicago & Eastern Railroad Corporation (“IC&E”).¹ The United States Department of Transportation (“DOT” or “Department”) has reviewed the record compiled to date, which consists of the primary application, the Safety Integration Plan (“SIP”), and the initial comments of interested parties.² On the basis of these materials,

¹/ The CP, DM&E, and IC&E are collectively referred to herein as “Applicants.” Consistent with the Application and the STB’s usage, references to DM&E include the IC&E unless otherwise indicated.

²/ The Board has previously addressed the environmental and community impacts of this transaction. In light of very modest merger-related traffic increases, the Board determined not to conduct a general environmental review of the proposed acquisition. However, there will be a thorough consideration of the impacts of coal trains from the Powder River Basin (“PRB”) on communities along the IC&E and CP before any such traffic may be transported. Decision No. 9 (served April 4, 2008). The Chicago-area commuter passenger rail organization (“Metra”) has expressed concern about its ability to continue “essential services” as a result of merger-related traffic shifts, including PRB coal. Metra-2. Merger-related shifts of non-coal traffic are generally likely to be too small to seriously threaten Metra’s essential services. However, to the extent that CP can direct PRB coal trains over any third-party carrier as a matter of right (such as via trackage rights), as CP may be able to do over Metra, DOT submits that the condition now in place as respects this traffic on the DM&E, IC&E, and CP lines should be extended to the affected lines of such third-party carriers.

DOT believes that the SIP should be modified with respect to hazardous materials response planning and training. We also consider that the proposed transaction meets the applicable standard for approval, provided that the Board holds the Applicants to commitments they may have made to shippers with respect to traffic interchanges and gateways. There is no basis to impose other conditions.

Before turning to significant individual issues, however, 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)

The Primary Application

The Applicants have contended that this consolidation is in the public interest. Approval of the merger would expand the geographic reach of the CP rail network, allowing it access to new traffic (such as ethanol and corn) and providing extended single line service and more efficient routing options to shippers. Access to CP's financial

resources should increase DM&E's efficiency and safety, they report, and likely enhance the prospects for construction of a new rail line to the PRB. CPR-2/DME-2 at 8-10.

The Applicants also assert that this transaction is strongly pro-competitive. They emphasize that it represents an almost entirely "end-to-end" combination of systems with minimal overlap, and that within the areas served by both CP and DM&E no shipper at any rail station that currently enjoys competitive rail service options will have fewer than two such options after the merger. They also deny there will be adverse impacts on short line carriers connecting with the Applicants. *Id.*, Exhibit 12 at 7-15; Verified Statements ("VS") of Ray Foot and John H. Williams. See also CPR-7/DME-7, Supplemental VS of Williams.

The Record

A. Safety Issues

1.) – The Mayo Clinic

The Mayo Clinic identifies multiple alleged shortcomings of the SIP. Most of its attention is directed at the transport of hazardous materials, particularly anhydrous ammonia and ethanol, through the Rochester, Minnesota area. Mayo Clinic-3. The Mayo Clinic is concerned that DM&E has a substandard safety record, that its track and facilities are in need of more maintenance than can be met by the capital investment envisioned by CP (and which is in any event not focused on the proper areas), and that the SIP contains insufficient information about routing and amounts of hazardous materials, emergency response planning, etc. *Id.*, passim. The Mayo Clinic asks for conditions to limit the quantities and speed of hazardous materials shipments through Rochester, to require the installation of multiple grade-separated crossings and wayside

detectors, to institute whistle-free railroad operations, to provide advance notice of the transport of hazardous materials through Rochester, and to compel the Applicants to discuss rail safety and emergency response matters with local officials. *Id.* at 20-21.

The Department shares the Mayo Clinic's concerns with the safe transport of hazardous materials, but we do not generally support the conditions sought. With one exception, DOT believes that existing rules and programs, ongoing regulatory proceedings, and the current SIP appropriately address the real risks presented.

As an initial matter, it bears repeating that the Applicants have projected only a small additional increment in traffic as a result of their consolidation, including hazardous materials, and they deny that the organic growth in ethanol traffic will flow through Rochester in any event. CPR-12/DME-12 at 10-11. The merger itself thus appears to present little new threat to the Rochester area. Moreover, DOT rules already provide local authorities with the means to establish whistle-free "quiet zones" while maintaining safe rail operations. 49 C.F.R. Part 222. We invite the Mayo Clinic to work with local authorities to avail itself of this ongoing opportunity, and we stand ready to offer any needed assistance.

Additionally, Federal regulations have for some time addressed the manner in which rail carriers are to route their hazardous materials traffic for safety and security purposes, and they have every incentive to handle these movements in the safest, most expeditious manner. 49 C.F.R. § 172.802; see also CSX Transportation, Inc. v. Williams, 406 F.3d 667 (D.C. Cir. 2005). Newly adopted rules will further enhance rail safety and

security with respect to the routing of hazardous materials.³ Special rules for the Rochester area that differ from nationally uniform rules would tend to impair rail safety and security, because no one locale can be isolated from the overall flow of hazardous materials traffic and such rules would distort the analyses on which the new rules depend.

It must also be kept in mind that railroad speed is subject to Federal regulation. In sum, train speed is a function of the standard to which a given piece of track is maintained; the higher the standard, the higher the permissible speed. 49 C.F.R. § 213.9.⁴ Moreover, moving hazardous materials through an area as quickly as possible consistent with track standards in fact reduces the likelihood and consequences of accidents. We conclude that there is no legal or policy basis to order reductions in speed in this proceeding.

Finally, although advance notification of specific hazardous materials shipments (as advocated by the Mayo Clinic) might have superficial appeal, in DOT's experience this would be a poor policy choice. The Department is responsible overall for the proper packaging, labeling, and transport of hazardous materials. See, generally, 49 U.S.C. §§ 5101 et seq.; 49 C.F.R. Parts 105, 172 -174. U.S. railroads transport more than 1.7

³/ DOT and the Transportation Security Administration proposed regulations specifically addressing, *inter alia*, the process by which railroads must make routing decisions with respect to the safe and secure transport of hazardous materials. 71 Fed.Reg. 76834 and 76852 (December 21, 2006), respectively. DOT has just adopted interim final rules under which carriers will have to take into account population centers, the frequency, amount, and type of hazardous material movements, environmental conditions, and other factors. 73 Fed.Reg. 20752 (April 16, 2008). Proper adherence to this process will result in routings with the least overall risk to safety and security.

In addition, DOT has just proposed performance-based standards for tank cars containing toxic/poisonous by inhalation materials. If made final, these would provide a quantum improvement in maintaining the integrity of these vessels and their contents (such as anhydrous ammonia) against unintended releases. 73 Fed.Reg. 17817 (April 1, 2008).

⁴/ Railroads may voluntarily reduce speed below that allowed under Federal standards, but States and localities may not require that they do so. CSX Transportation v. Easterwood, 507 U.S. 658 (1993).

million carloads of these materials annually, across thousands of local jurisdictions, overwhelmingly without incident. All major railroads already have policies to provide hazardous materials data on a yearly basis to the localities they traverse.⁵ DOT regulations in fact require train crews to maintain documents containing precise information about the materials being moved on each train for use by proper authorities in the unlikely event of an accident. 49 C.F.R. § 174.26. But transmitting this information for each shipment would be very costly, imprecise with respect to timing, apt to result in overload rather than benefit, and would pose its own security risks.

The Department *does* agree with the Mayo Clinic that emergency preparedness training should be a priority in the Rochester area, and we will work to modify the SIP in this regard. The SIP includes an “accountability matrix” that serves as a timetable for completion of the various elements in a SIP. At present it calls for CP to conduct emergency response exercises with appropriate community groups starting in early 2010 and continuing until mid 2011. There is no reason for this item to be delayed. DOT will work with CP to conduct these exercises beginning no later than sixty days following any regulatory approval of the merger.⁶

⁵/ Association of American Railroads Circular OT-55, “Recommended Railroad Reporting Practices for Transportation of Hazardous Materials.”

⁶/ We note that Rochester authorities can also benefit from an ongoing DOT program designed to enhance the planning and training of local authorities to respond to hazardous materials accidents. 49 C.F.R. Part 110. The Department administers grants whereby representatives of 1,700 State and local authorities annually receive training in emergency preparedness and response. We encourage Rochester to participate in this program.

2.) – Minnesota DOT

The Minnesota Department of Transportation (“MinnDOT”) submitted the only other comments on the subject of safety to which DOT would like to respond. MinnDOT expressed concerns about the need for additional safety measures at grade crossings due to increased train speed on DM&E lines as a result of track upgrades.⁷ It seeks conditions that would require the Applicants to implement those improvements deemed necessary by MinnDOT at grade crossings within the State. MinnDOT Comments at 2-4. The Department must oppose these conditions.

First, as already noted, FRA regulations establish the speeds appropriate to a segment of track by relation to track classification standards. 49 C.F.R. § 213.9. So long as a carrier maintains a line according to the requirements of a given class, it can operate on that line up to the permissible speed without regard to the safety measures in place at particular grade crossings.

Train speed, however, is not irrelevant to such measures. There is an extensive Federal scheme in place, administered by DOT’s Federal Highway Administration, that involves States, rail carriers, and others in a cooperative effort to reduce safety hazards at highway-railway grade crossings. 23 U.S.C. § 130; 23 C.F.R. Part 646; see also 49 U.S.C. §20134.⁸ This program provides a process by which State and local governments work with interested parties (such as railroads), to use their expertise to identify and prioritize crossing improvements within their boundaries, including the installation and

^{7/} The Mayo Clinic would also impose a condition requiring the Applicants to “install multiple grade separated crossings” in the Rochester area. Mayo Clinic-3 at 20. DOT opposes this condition for the reasons discussed in this section.

^{8/} More information is available at: <http://safety.fhwa.dot.gov/xings/index.htm>

upgrade of warning devices at crossings; train speed is one of the factors considered. See 23 C.F.R. §§ 646.204; 646.214(b)(3), (4). Under the circumstances, and particularly where, as here, the projected increase in merger-related traffic is so small, there is no basis to depart from the above approach and grant a condition giving exclusive authority to MinnDOT to prescribe grade crossing measures throughout the State.⁹

B. Competition Issues

1.) – Kansas City Southern Railroad

The Kansas City Southern Railroad Company (“KCS”) has contended that the proposed acquisition will adversely affect competition. KCS submits that the merger of the CP and DM&E will both foreclose competitive options for grain receivers that it serves and reduce competition for North American Free Trade Agreement (“NAFTA”)-related traffic. The Department disagrees.

KCS alleges specifically that shippers and receivers of corn originating on the DM&E will likely see adverse effects from the proposed merger “in the form of reduced market access for shippers and higher prices for receivers.” KCSR-2, VS of Thad Jones at 2. Today KCS transports corn from two principal regions. The first is the area around Atchison and Topeka, Kansas, Omaha, Nebraska/Council Bluffs, Iowa, and Lincoln, Nebraska.¹⁰ The majority of the corn that KCS originates from this area is destined for

⁹/ Federal funding for improvements at a crossing strictly limits the financial demands that may be made on railroads. 23 C.F.R. § 646.210; Norfolk Southern Ry. Co. v. Shanklin, 529 U.S. 344, 358-59 (2000). In the absence of Federal funding States have more leeway with respect to warning devices and financial contributions from railroads.

¹⁰/ KCS obtained the right to access this area as the result of a condition imposed by the Interstate Commerce Commission on the merger of the Union Pacific (“UP”) and Missouri-Kansas-Texas railroads,

export to Mexico. KCSR-2, VS of Michael R. Bilovesky at 4. The second source of corn is in Minnesota and Iowa on the lines of the IC&E, which KCS carries to receivers in the south-central States of Kansas, Oklahoma, Arkansas, and Mississippi. KCS gained access to this region via an agreement (the “grain agreement”) with IC&E’s predecessor, the I&M Rail Link (“IMRL”), that allows KCS to publish tariff rates or write contracts for movements where the routing included either KCS or IMRL. Id. at 3.¹¹ Over time, KCS developed this market with the DM&E to the point that it now represents the single largest source of grain for domestic feed mills in the south-central States served by KCS. Id. at 4.

KCS also has another agreement whereby DM&E provides it with haulage service between Kansas City and Chicago (the “Chicago agreement”). KCSR-2, VS of George C. Woodward at 23-24. Although never used to move traffic according to its terms, KCS claims that this arrangement offers a competitive alternative to UP single-line service between Chicago and Laredo, Texas, serving NAFTA-related traffic. KCSR-2 at 34; VS of Curtis M. Grimm at 8.

KCS is concerned that it may lose access to these markets following the proposed consolidation. It believes that CP will limit the destinations available to grain shippers on these DM&E lines by closing or impeding service to existing gateways or routings, and by encouraging diversion to different markets either over its own long-haul routes to the

in order to preserve competition for grain moves from these locations to the Gulf Coast, Mexico, and the south-central States. KCSR-2 at 7.

^{11/} In 1997 KCS entered into an agreement with the IMRL that provided KCS with ratemaking authority over IMRL’s lines. KCSR-2 at 11. The agreement, renewable annually, gave KCS the ability to publish tariff rates or write contracts for moves over IMRL onto KCS’s lines. Id., VS of Bilovesky at 3. In 2002 KCS expanded the scope of the agreement (to include transit time objectives) and its duration (to 2017). Id. at 4.

Pacific Northwest or via UP to Mexico. KCSR-2 at 26-28; VS of Woodward at 22.¹² KCS does not object to the proposed transaction *per se*, but requests that the Board impose conditions to preserve the competitive routings represented by the above two agreements. Those conditions would make the two agreements permanent and prevent CP from degrading transit times over the existing DM&E/KCS routings. KCSR-2 at 6; VS of Woodward at 23-24; VS of Jones at 18-19.

The Department opposes these conditions. The record reflects that the proposed merger holds the potential to open new markets for grain shippers currently served by the DM&E, while at the same time offering efficient single-line service options to those same shippers where none existed previously. CPR-2/DME-2, Vol. 1, Exhibit 12 at 2. There will be no significant loss of rail competition because there is minimal overlap between CP and DM&E, and where the two carriers connect there will remain at least two rail options. CPR-7/DME-7, Supplemental VS of Williams at 1.

The flow of corn that concerns KCS represents the lowest price option for KCS's receivers. KCSR-2, VS of Bilovesky at 63. Following the merger, this corn will continue to be grown, and receivers on the KCS will continue to have as many options for transporting it as they have now. The increase in routes and access to new markets that the corn growers may enjoy after the merger could increase the price they receive for their grain. This may in turn raise the costs to others (including the KCS receivers) who seek to purchase this corn, or lower the revenue KCS obtains for its transport. But

^{12/} KCS alleges, in fact, that CP has already intervened in KCS-DM&E negotiations to extend and modify their existing agreements. *Id.* at 22-26.

neither of these outcomes amounts to a merger-related loss of competition requiring remedial conditions.

Similarly, there is no dispute that competition for NAFTA-related traffic is important and must be maintained, but the record does not establish that the combination of the CP and DM&E will reduce competitive options for these movements. KCS asserts that CP will cancel the KCS “Chicago agreement” or re-route NAFTA traffic from KCS onto UP, which already dominates rail freight to and from Mexico. KCSR-2 at 31-35. There are several flaws in this scenario. The first is that the KCS-DM&E Chicago agreement is “not currently used.” KCSR-32 at note 47. It is therefore difficult to accept that this agreement somehow represents a truly effective alternative to UP for NAFTA traffic.

DOT agrees with KCS that a DM&E/KCS routing for Chicago NAFTA traffic is a potential option to UP single-line service, and that it poses a “competitive counterbalance” thereto. *Id.*¹³ We cannot agree, however, that CP will refuse to consider arrangements to maintain this option “on mutually beneficial terms.” *Id.* at 34. CP may or may not use DM&E/IC&E lines to lengthen its haul for this traffic from Chicago to Kansas City (rather than hand traffic off at Chicago as in the past), *id.* at 34-35, but doing so would hardly be anticompetitive. And there is no reason for CP to refuse to interchange with KCS at Kansas City “on mutually beneficial terms” when that is its most efficient option. One would have to assume that CP would be willing to act irrationally or against its own self-interest. KCS points to a UP-CP “Can-Am Alliance”

^{13/} See Union Pacific/Southern Pacific Merger, 1 S.T.B. 233, 265 (1996) (“Where most or all of the firms in a market have sufficient capacity to serve a significant amount of the total market without any significant disadvantage, the analysis considers the number of competitors rather than their market shares.”)

as the reason for such conduct, but there is no evidence that this agreement would have that effect.¹⁴

Indeed, CP has promoted the proposed merger as a means for restoring its direct access to Kansas City. See CPR-2/DME-2, Exhibit 12 at 2. The Department would expect that CP, as DM&E does today, will interchange traffic with KCS and other carriers at this gateway on commercially reasonable terms, for that would be in CP's self-interest. To the extent the Applicants have expressly committed to keeping gateways open on such terms, the STB should hold them to that representation.¹⁵

Under the circumstances DOT opposes a condition to make permanent either of the agreements in place between KCS and DM&E/IC&E. These commercial arrangements resolve no competitive problems, but are designed to promote effective marketing between the parties. CP as successor in interest to DM&E will have to fulfill the terms of the agreements to the same extent as that carrier must now. The merger may change the incentives of the parties, but in this case that will result in no cognizable loss of competition.

^{14/} CP itself recently made much the same contention that KCS does here, alleging that a merged DM&E and IC&E would discriminate against DM&E/CP routings via a particular gateway and reduce shipper choices. The Board declined to grant the condition sought by CP to keep that gateway open. Dakota, Minnesota & Eastern et al., - Control - Iowa, Chicago & Eastern, 6 S.T.B. 511 at 527 (2003) ("DM&E/IC&E"):

The condition would disadvantage the combined DM&E/IC&E from routing traffic via the Owatonna gateway even if doing so were more efficient than a combined DM&E-CPR routing via Minnesota City. The shipping public will benefit if the combined DM&E/IC&E has the flexibility to operate via its most efficient routings. We do not share CPR's apparent concern that a combined DM&E/IC&E will tend to favor a 'long-haul' DM&E-IC&E routing that is less efficient than a 'short-haul' DME&E-CPR routing.

^{15/} AG Processing, Inc. (at 2-3) and the Southern Minnesota and Northern Iowa Shippers Association (at 3) report that CP has made such a commitment to them and they support the merger on this basis.

2.) – Muscatine Power and Water

Muscatine Power and Water (“Muscatine”) is a power utility headquartered in Muscatine, Iowa. It operates three coal-fired generating facilities in Muscatine that burn 1.1 million tons of PRB coal annually. Currently, this coal originates on the Burlington Northern and Santa Fe Railway (“BNSF”) and is interchanged with the IC&E at Ottumwa, Iowa for delivery to the generating station at Muscatine. IC&E is the sole (“bottleneck”) railroad serving that facility. This rail transportation is provided through two proportional rate contracts, one with each rail carrier, that expire in 2012. Comments and Request for Conditions of Muscatine Power and Water (“Muscatine Comments”) at 3-4.

Muscatine reports that it has been able to choose either UP or BNSF for PRB coal originations since IC&E historically has been a neutral delivery carrier. It also notes that IC&E can interchange traffic with UP or BNSF at four interchange points: Kansas City, Missouri with both BNSF and UP; Ottumwa, Iowa with BNSF; Clinton, Iowa with UP and Owatonna, Minnesota with UP. *Id.* at 3.

During the pendency of the DM&E/IC&E merger, Muscatine expressed concern about the possible loss of these interchange points, but withdrew its opposition following execution of a settlement agreement with the DM&E. *Id.* at Exhibit 1; also 6 S.T.B. at 543. Muscatine believed that this agreement both maintained those interchange points and provided it with the protection offered by the “contract exception” to the Board’s “bottleneck” decision.¹⁶ Apparently CP interprets the settlement agreement differently

^{16/} In sum, that decision protects the discretion of bottleneck carriers with respect to route and rate options, and generally prevents shippers from challenging the reasonableness of the rate attributable only to the segment of transportation provided by a bottleneck railroad. The “contract exception” allows for such

than Muscatine (and perhaps DM&E), for the shipper now again seeks to preserve the continuing availability of these interchange points and the “contract exception” by means of a condition on the merger. Id. at 4-7.

The Department does not support such a condition. For the reasons discussed above and in the Board’s “bottleneck” decision, railroads properly enjoy a significant prerogative in their decisions about the particular routing and rating of traffic. Consistent with that prerogative, the STB allows merging carriers flexibility in determining the most efficient routes to use. Regulatory conditions to preserve specific interchange points or gateways are disfavored because they ultimately tend to be detrimental to both railroads and shippers. Canadian National. et al., - Control - Wisconsin Central Transportation Corp. et al., 5 S.T.B. 890, 904 (2001)(“[W]e prefer to allow a merged entity the flexibility to determine what routes are most efficient given the newly restructured system because shippers would benefit from this process.”); also 6 S.T.B. at 527.

In this case there is no reason to depart from that policy. There was no cognizable competitive harm posed to Muscatine in the DM&E/IC&E merger, and thus there was and is no regulatory reason for the STB to impose the condition sought. Muscatine at this point appears to have an inchoate dispute with CP as the successor-in-interest to DM&E about the meaning of a settlement agreement. Should that dispute still exist in 2012, when Muscatine’s existing coal transportation contracts expire, it will be a matter for the parties to resolve; by negotiation if possible, by litigation if not. But there is no basis for the Board to act in any event.

challenges where shippers contract with the originating carrier to transport freight to a particular interchange point on the bottleneck railroad’s system. Central Power & Light v. Southern Pacific Transportation Co. et al., 1 S.T.B. 1059 (1996), clarified in 2 S.T.B. 235 (1997).

Conclusion

The proposed consolidation of the CP and DM&E meets the statutory standard for approval. The Department will work with the Applicants to accelerate emergency response exercises with Rochester officials, but all other safety-related concerns are already properly addressed by existing or proposed Federal programs and regulations. The instant merger will not substantially reduce competition, and thus there is no reason to impose conditions on this basis. CP should of course be held to any commitments it has made regarding traffic interchanges and gateways.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D.J. GRIBBIN", with a stylized flourish at the end.

D.J. GRIBBIN
General Counsel

April 18, 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. 35081 to be served by first class mail, postage prepaid, upon all Parties of Record in this proceeding.


Paul Samuel Smith

April 18, 2008