quite a disparity between the applicant and the Justice Department.

MS JONES: I wouldn't have an opinion about that, Commissioner Owen. But I would suggest that maybe it would -- we could urge you to take some of their other positions with a grain of salt as well.

COMMISSIONER OWEN: I just proposed to give you an opportunity to dance around a little bit.

MS JONES: Thank you.

CHAIRPERSON MORGAN: Thank you very much. Next we will hear from Scott Stone, who is representing the Chemical Manufacturers Association. And Mr. Stone, you will have five minutes.

MR. STONE: Thank you madam Chairman. Madam Chairman, Vice Chairman Simmons and Commission Owen, I'd like to introduce Thomas e. Schick, who is Assistant General Counsel of the Chemical Manufacturers Association, and has served as inside counsel in this matter.

Members of the Board, CMA's position today is the same as that stated in its brief, filed early in June, CMA 12. And perhaps I should just sit down.
now, but I'd like to just spend two minutes outlining CMA's position and how it came to it, and answer any questions you may have.

In sum, CMA neither supports nor opposes this merger. But if the merger is granted, strongly urges the Board to adopt as condition the CMA settlement which is incorporated into the second supplemental agreement that was filed last Friday between, by UP/SP in UP/SP 266. That agreement between UP/SP and BNSF incorporated the terms of the CMA settlement, at least most of them, as well as making some additional provisions.

Now CMA originally filed comments on March 29 opposing the merger. The principal reasons were that, in our view, the merger would reduce the competition and the trackage rights agreement with BNSF would not be adequate to remedy those problems. We felt at that time that the main issue was whether BNSF would have access to sufficient traffic and would have the operational ability to compete aggressively for the traffic available to it.

Nonetheless, CMA continued to study the
issues and I should say, by the way, that a number of CMA's members, independent of CMA, filed comments and statements both supporting the merger and opposing the merger, in different cases, and they remain able to do that today.

But CMA's comments indicated that CMA might not oppose the merger if a set of eight conditions could be addressed. And those conditions, which were Attachment A to the comments, dealt principally with giving BNSF access to more traffic, with making certain operational improvements that would facilitate BNSF's ability and incentives to compete.

There then followed a series of negotiations between CMA and the applicants and BNSF. Following which a proposed settlement addressing CMA's eight points, was arrived at. And on April 16, 1996, that agreement was approved. It was then signed -- I should say that it was approved by CMA, who then signed with the applicants and BNSF on April 18 and submitted to the Board on April 19 in filing UP/SP 219.
CMA has summarized the provisions on that settlement in its brief, CMA 12 and I won’t repeat those points here.

So, at present in sum CMA does not oppose or support the merger. CMA’s settlement continued to safeguard the rights of CMA’s members to speak and advocate remedies. And several of them, in fact, are here today. And others have submitted statements.

So, if I could summarize what you need to look at, sort of the ABCs of what we are recommending. Number one, that if you do approve the merger you approve the BNSF trackage rights as amended. Second, that you look at the points that were part of the settlement between CMA and the applicants, but which were not included in the BNSF settlement, because BNSF really didn’t play a role in them. Those points are set out by the applicants in filing UP/SP 266 on page 3 in the first footnote. And UP and SP have committed to carrying through and complying with those provisions of the CMA settlement.

And the third thing that CMA would submit to the Board is that we strongly recommend five years
of scheduled annual oversight proceedings.

CHAIRPERSON MORGAN: Let me ask about that. Obviously, as I indicated earlier in one of my prior questions, there has been some concern about whether that oversight has any teeth to it. Obviously you represent shippers who would have an interest in that particular issue. How do you feel about oversight?

MR. STONE: Well, as Mr. Roach point out, CMA Agreement specifically says, and I'll quote one sentence of paragraph 14 of the CMA settlement. The Board shall have authority to impose additional remedial conditions. Now, I think the applicants feel and we feel that if the market can fully do the job, the market should do the job. If regulation is needed, we should have regulation.

We believe that oversight is an important element of this merger. You heard, and will continue to hear for most of the rest of the day, a lot of people spinning out horror stories of -- which are really not horror stories, but predictions of what they think may happen.
CMA has attempted in its settlement to put in place the necessary conditions that will enable BNSF to compete. But we can't predict whether BNSF will compete. We think they will, but can't be sure that they will. We believe that the oversight proceeding is necessary.

And if, in fact, these horror stories or predictions come to pass, I am sure that CMA members will be here before the Board, letting the Board know that the merger is not working. And I suspect, given that specter, the applicants and the BNSF will not allow that type of dissatisfaction to occur.

CHAIRPERSON MORGAN: So, I would, from what I hear you saying then, if divestiture were not ordered in this case, but seemed to be needed in the future, that the shippers, particularly your group, would intend to pursue oversight in an active way in that respect. Is that --

MR. STONE: I believe that members of CMA would participate. We have not developed any specific triggering criteria that would bring us in the doors of the Board, but I believe that if anything occurred
approaching the level of dire predictions that some of
the participants put forward, that you would see a lot
of shippers in this room.

VICE CHAIRPERSON SIMMONS: So I'm to
believe that a majority of your members with the BN
Santa Fe support a merger?

MR. STONE: I want to answer quite
precisely, Vice Chairman Simmons. CMA made its
decisions through its duly constituted committee
structures and processes. At no point did it open the
question, put to the question to a general plebiscite
of its members. It just doesn't operate that way.

But, yes, a majority of the members of the
committee with authority over this matter voted to
approve the settlement.

VICE CHAIRPERSON SIMMONS: Okay.

CHAIRPERSON MORGAN: Now, in entering the
settlement agreement, I would expect that some of your
members, at least, if not more of them, saw some
benefits to this merger. Is that accurate?

MR. STONE: I believe they did, Chairman
Morgan. But, the discussion did not depend
specifically on those benefits. Some of CMA members, I’m not speaking for them, have pointed out some of the benefits they perceive. Mr. Roach has alluded to some of those members.

And CMA, perhaps more helpfully, never submitted evidence of the benefits.

CHAIRPERSON MORGAN: So there’s more --

MR. STONE: It never challenged the benefits, it never submitted evidence on that. So I think you should look to other parties to --

CHAIRPERSON MORGAN: But it was more than certain issues that were important to your members. Obviously this agreement is intended to address those concerns, address those concerns --

MR. STONE: Yes, the agreement focuses on the anticompetitive concerns, and we believe adequately addresses those concerns.

COMMISSIONER OWEN: Excuse me, are most of your members, members of the Met League, also?

MR. STONE: I’m not sure. I suspect that a good portion are. I don’t know the precise percentage.
COMMISSIONER OWEN: An assumption on my part from being a businessman, that if a group such as yours would vote on something of this nature, then they expect the quality of service and the price to be commensurate with the marketplace. They must think they are getting a fairly decent deal, or else they wouldn’t be moving ahead. I just make an observation, I --

MR. STONE: We were trying to take account of the real world. That’s right.

COMMISSIONER OWEN: Thank you.

CHAIRPERSON MORGAN: Thank you very much.

MR. STONE: Thank you very much.

CHAIRPERSON MORGAN: Next we will hear from Charles White, Jr., representing Utah Railway Company.

MR. WHITE: Good afternoon Madam Chairman. My name is Charles White. I have the privilege of representing Utah Railway in this proceeding.

Utah Railway strongly supports its settlement agreement, strongly supports the Burlington Northern settlement agreement to which it is linked.
And as a corollary strongly opposes the inconsistent application filed by Montana Rail Link on the central corridor as being both unnecessary and more important deleterious to competition on that corridor.

Utah Railway is an historic bringer of competition to the Utah coal fields. It has moved over 30 percent of coal mined in Utah over its lifetime. And it is a living example of how trackage rights work.

A fact that has been overlooked by many parties in this proceeding is that Utah Railway is a co-owner with Southern, with Southern Pacific, of the very significant portions of the central corridor at issue in the inconsistent application. Moreover, it is intertwined with Southern Pacific with trackage rights agreements running through the coal fields in Utah.

As a result of that very close relationship, Utah Railway has been able to cooperate with Southern Pacific and its predecessor the Rio Grande, while it competed head on with them. And as our brief shows, in the latter years it is winning the

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competition and developing new coal moves.

The fact of the interlaced relationships between the Utah Railway and Southern Pacific has caused two important aspects that have matured in this case. One was the negotiations with the applicants. They realized early on that the Burlington Northern settlement agreement had a rather large obstacle to cross were it to work, and that is to have access to Utah Railway's trackage. And they do not have access, except with the written consent of Utah Railway.

So our negotiations with the applicants began on a technical level at this stage, but quickly moved into a very procompetitive settlement. As a result of that settlement agreement, Utah Railway will have access to Grand Junction Colorado, an extension of over 170 miles to the east, and will have access to important new high Btu, high quality coal mines.

And with that access to the east, Utah Railway is already working with Burlington Northern, I want to underline that for the Board, to develop new movements of high quality, low sulphur, high Btu Utah coal to new eastern and mid-western destinations. We
feel we are in a perfect position, with the cooperation of Burlington Northern and with the new service of an extended UP/SP system, to reach out and send the premium Utah coals on an expedited basis to utilities in the central segment of the country.

We are in a perfect position to compete with Appalachian coals of similar Btu and the sulphur content, and I can vouch for my colleagues who are in the room with me, intend to vigorously compete and to move that coal.

The second part of the aspect of our interrelationship with the ownership of the central corridor, of course, touches Montana Rail Link. Montana Rail Link, as an inconsistent applicant, neither acknowledged our ownership of their sought property, nor consulted with us during the building of the case. But that aside, that’s not at all the important aspect of what I would like to talk about. The real deleterious affect of what Montana Rail Link’s alternative to BN on the central corridor is the simple fact that they are not sufficient in terms of reach, in terms of their own market destinations.
And in fact because of that they would be a less qualified competitor for us than Southern Pacific is today, and certainly a far less competitive force than the combination of a BNSF and a UP/SP alternative.

Furthermore, their proposal would have overhead trackage rights given to the two large carriers on the corridor, and as rent payers that would only invite them to find other routes for their service, lowering the density on the corridor and leading to its ultimate demise.

I agree in closing with the Department of Transportation that Montana Rail Link's solution to the central corridor problem is no solution and there is no problem. There is more competition than ever under the settlement agreements on the corridor.

Thank you, your Honor.

CHAIRPERSON MORGAN: Now, in this record we have much concern expressed by the western coal shippers that this merger could hurt the competitiveness of Colorado Utah coal. How does your entering into this picture respond to that concern?

MR. WHITE: We have precisely the opposite
apprehension, of course, and we are acting on our apprehensions. Utah Railway, in conjunction with the two major systems, is in the process now of opening new markets towards the east for Utah coal. We feel with the reach provided by the two supersystems, if I may use that word, and the quality coal coming off of our origins, we will be highly competitive. In fact, so competitive that one of our colleagues, one of the coal companies in Colorado, Colowyo, has asked this Board for protection against the new competition they feel coming eastward from Utah.

It's quite contrary to the hypothetical fears of the coal shipper groups. We have an 80 plus year history of being a low cost, high quality coal mover, and that, in combination of the reach of the two supersystems, should provide extraordinary marketing opportunities that will be capitalized upon by Utah.

We feel it's highly competitive. The support we have from our mines, our shippers has been unanimous. And if you will allow me to just bring one example to the Board’s attention. I think this tells...
in the strongest way the feeling of competition for Utah coal shippers. And that is there is a very important new mine facility being developed at Willow Creek, which is technically not exactly on our line, but off of it by a short distance. As part of the settlement agreement, the Cypress AMAX people agreed to allow Utah Railway to have exclusive access to that new facility. And, allows us to be something like an honest broker between the two giant systems for through movements both to the east, to the new market targets, and to the Pacific Rim. Utah Rail --

VICE CHAIRPERSON SIMMONS: Is that the midwestern --

MR. WHITE: And to the midwest, of course, your Honor. And, if I can close by also saying that western movements, Utah Railway today generates the majority of coal moving to the Pacific Rim through the ports in California.

VICE CHAIRPERSON SIMMONS: And that's because of your Btu content?

MR. WHITE: That's because of the high quality coal we have, yes, your Honor. And this is
the most procompetitive development in the central
corridor that I can imagine. We have access to the
new quality coal and access to the two preeminent
systems with reach throughout the United States. And
this can be nothing but procompetitive for everybody
cconcerned.

COMMISSIONER OWEN: Now you will be
competitive with the east coast coal also out of
Appalachia and --

MR. WHITE: Absolutely, your Honor, and
that's precisely the target we are looking at because
of the similarities of the coal and the new reach that
we can get going eastward. We will go head on head
with the Appalachian coal for the utilities in the mid
section of the country.

VICE CHAIRPERSON SIMMONS: That's a long
haul.

MR. WHITE: It's a long haul, but we can
do it. There is no reason why we can't do it. We are
going to do it.

COMMISSIONER OWEN: Even with the
additional mileage there, you are going to be
competitive with Appalachia?

MR. WHITE: We are intending to be competitive with Appalachian coal in that mid section of the country.

COMMISSIONER OWEN: What rail line service is Appalachia for their --

MR. WHITE: It would be CSX, but I'm talking about the utilities in the Mississippi River Basin. So --

COMMISSIONER OWEN: I was just trying to bring up the competitive nature of the rail lines, that we are still able to move at that distance and still really do a good job of it.

MR. WHITE: It would be CSX and it would be Norfolk Southern, of course. But the utilities that we are targeting in the, really, the mid section of the country. So that the rail rates won't be completely prohibitive, they will be adjustable and contestable and competitive.

In sum, we feel that we have a very competitive settlement agreement and we respectfully ask for your approval of that agreement should the
merger be approved.

CHAIRPERSON MORGAN: Thank you very much.

What I would like to do now is to recognize the Honorable Ann Bingaman who has joined us. I understand that she has a tight schedule. So, if you could come up and make your presentation now, then we will go back to the regular schedule and we will hear from DOT and then we will go back and hear from the Justice Department again, if that would be all right.

MS BINGAMAN: Chairman Morgan, that is very generous of you and I appreciate it very much. I did not seek it, but I accept it. Thank you very much.

I heard someone say a minute ago that they took our position with a grain of salt, and I guess I would say to you, I am the salt. And the Department is the salt.

CHAIRPERSON MORGAN: We've been the salt, too.

MS BINGAMAN: We take this with extreme seriousness. I have personally devoted many hours to this as have the top deputies in the antitrust
division and the staff has devoted enormous time for many months. We do not take the positions we take lightly. We take them with the greatest seriousness and the greatest sternness, and with some regret we wish we could be before you in a happier mode.

I would say simply that this merger is of enormous importance. It is of enormous importance to the country and to competition in this most fundamental of industries, rail transportation.

The merger is unlike any other merger, I think, that this Board or its predecessor has ever considered. It is larger. It involves more parallel lines. And it would affect competition in many more markets. It is also a merger which has a remedy of unprecedented scope, the trackage rights which you have under consideration.

It is the Department’s considered view that the applicants here are asking this Board to do something that is in fact extremely radical, allow the most anticompetitive rail merger in our history. And a merger which would harm prices for consumers nationwide.

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I would say the Board should take into account the fact that there will not be other railroads built in the west, or elsewhere. There is no argument about the proper product market here, which is rail transportation, and we believe, in fact, there really is not much argument because of the extensive trackage rights proposed to solve the problem. That approval of this merger would result in a monopoly in many markets, and rail monopoly throughout the west forever.

The trackage rights agreement which is proposed to solve these immense competitive problems is itself unique, extreme. It is a trackage rights agreement which would cover thousands of miles of the UP/SP system. This arrangement in its scope and magnitude, and length of the trackage rights proposed to try to solve the tremendous monopolies created here is an arrangement without precedent in the industry. Because of that the effectiveness of the immense trackage rights proposal is highly uncertain, and even then it does not cover all the competitive problems.

Finally, the applicants have asked this
Board to adopt a novel rule of law, that this anticompetitive transaction can be justified by the financial condition of SP, a company that is admittedly not failing, whose assets will not leave the industry absent the merger, and this also is a unique aspect of what is sought here in remedy.

The Department has taken an active role in these proceedings because of the fundamental importance of rail transportation and costs in so many segments of the economy, the ripple effect we believe this merger would have.

After reviewing all of the evidence and after months and months of work, we have concluded that the public interest dictates in our view that the application be denied. We believe denial of the application would restore competition immediately and allow SP to get on with the business of strengthening itself or coming up with an alternative transaction that does not raise these immense competitive concerns that are present on this application.

If the Board does decide to approve this merger, we believe it should be conditioned on
divestiture of the lines we have identified, and that these divestitures must be to a party other than BNSF. Nothing less could possibly protect competition.

We believe, however, that because of the complexity of the issues here and the scope of this merger, by far the better course is simply to deny the application outright and let the parties come up with a better proposal.

I repeat, we have not come to this lightly. We have devoted months and months of work to it. I would say to the Board that of the many rail mergers we have participated in in the last 20 years, the Department has opposed only two of them outright, as we do here. Both of which were disapproved by the ICC.

We are forced to conclude that the applicants have not met their public interest burden and that the merger should be disapproved. Roger Fones, the Chief of of the Transportation, Energy and Agriculture Section will make the major presentation. I'd be glad to answer any questions.

VICE CHAIRPERSON SIMMONS: Before you
leave, it seems to be the basic premise of the
Department of Justice that the prices become higher as
the competitors decrease, is that your feeling?

MS BINGAMAN: yes.

VICE CHAIRPERSON SIMMONS: Well, how do
you explain that in the Powder River Basin you only
have two railroads, the Burlington North and the Union
Pacific, and in the east you only have two, you have
Norfolk Southern and CSX, and the prices are going
down, in both cases?

MS BINGAMAN: We think the scope of this
merger is unprecedented. We think the Powder River
Basin precedent is too small, and too narrow, and too
recent to be applied to the facts of this case. I am
actually not familiar with the prices in the east, but
Mr. Fones can address it if you want to.

VICE CHAIRPERSON SIMMONS: Okay.

COMMISSIONER OWEN: The Department of
Justice predicts that if this merger is approved there
will be a collusive behavior between the applicants
and their principal competitor, BNSF. For the past
quarter century, there have been dozens of rail
mergers and many have resulted in duo-opoloies in the various markets. Where duo-opoloies have occurred in the past, can you provide any evidence at all of collusive behavior?

MS BINGAMAN: We have evidence of collusive behavior in many industries, in many circumstances where there are duo-opoloies, and that’s the Department’s concern. I don’t know if there is a railroad case specifically, but it is a fundamental tenet of merger law that collusion, where there are only two parties, is much more possible. And we’ve seen it in many cases. It’s part of the merger guidelines, and it’s part of the Department’s experience.

COMMISSIONER OWEN: We haven’t had anything presented to us, I don’t believe, in the history of this Agency here in the rail industry as such, but it may occur in others. But, do you agree with that in the indication of railroads, the Surface Transportation Board serves the role of an alert policemen and has the powers to guard against future collusive behavior? Such as this five year agreement
that we have working on this now?

MS BINGAMAN: I would say to you with respect Commissioner that it is a fundamental tenet of the antitrust laws, that the way to stop collusion is to keep the market structure from being put in place that would allow it, or encourage it or set the stage for it. That's a fundamental premise of our merger laws.

Frankly, Commissioner, in our, in the job I've had, many parties come to you and say, let us merge. We understand there are competitive problems. Let us put an agreement in place to either control prices. I see it quite a bit to tell you the truth. Parties come forward because they understand there are potential problems.

We have rejected that out of hand. We prefer a structural approach. It is the Department's long standing view, embodied in the merger guidelines put in in 1982 in the Reagan Administration and continued in force in several iterations and enforced by us, that the best protection for competition is a market structure that allows for competition and not
agreements that enforcement agencies essentially have to police and chase and chase the parties.

So that’s our fundamental concern in many other industries.

COMMISSIONER OWEN: But in the case of consumers throughout our nation, and the transportation industry is the lifeblood of our nation as a whole, the prices have gone down since 1980 after the Staggers Act and a number of mergers have taken place and benefitted considerably from those mergers and such.

MS BINGAMAN: I don’t think you can point to the past necessarily as a predictor of the future. I think it is a fact that this merger is unprecedented in its scope, it’s unprecedented in its effects on the West, the very trackage rights that are proposed to solve the problem are unprecedented, and I think are a recognition by the parties of the scale of the problem that they have. And I think honestly that to point to other precedents in this, and I really do think it’s unique, situation is maybe misleading. That’s our view.
CHAIRPERSON MORGAN: If I could just ask
you a little bit broader question related to the whole
area of mergers. In May of this year, as you know,
the Federal Trade Commission came out with a report
that was entitled Competition Policy in the New High
Tech Global Marketplace. And this report suggests
that with the increase in global competition that U.S.
businesses face, the FTC in evaluating the mergers
within its direct purview, should focus more attention
on the extent to which transactions are likely to
achieve efficiencies.

And, recently, FTC Chairman Petovsky was
quoted as saying it’s important for antitrust laws not
to put needless barriers in the way of companies
looking to get more efficient.

Now as you know our statute directs us
specifically to look at transportation benefits. And,
an important part of transportation benefits is
efficiencies that are realized in the transportation
arena. Now, I know we all in the Administration and
elsewhere are concerned about global competitiveness,
and I think that’s impacts railroads as well as other
industries. I just would like to get your thoughts on how, given this increased global competition, should we be attentive to efficiencies that transactions realize?

MS BINGAMAN: We are working right now, we are appointing three people to work with the FTC to examine the efficiencies section of the merger guidelines. I think I would caution that that statement not be taken for more than it might be.

Number one, the staff today of both the FTC and the divisions, looks carefully at efficiencies when they are presented to us. We are not unmindful of them. But it is also a fact that experience has taught us, and this is experience going back many, many years, decades, that once an anticompetitive structure is in place, it is very difficult to control prospective price increases. When that, the whole, the fundamental premise of the antitrust laws, 106 years old now, is that you want to protect the market structure. And, if you have a structure in place that permits either collusion or increased prices because of insufficient competition, merger to monopoly or
otherwise duo-opoly, you have a potential problem.
That is the basis for our entire merger jurisprudence.

And so, while efficiencies are important
and we look at them carefully, we also look at market
structure carefully. And its been our conclusion in
this case, based on this structure and an examination
of the entire industry, the, we believe the
infeasibility of the trackage rights solution to the
monopoly problems, that we have come to the conclusion
we have.

CHAIRPERSON MORGAN: But I guess at the
same time we need to be mindful of not discouraging
transactions that might assist business as well.

MS BINGAMAN: Chairman, I would say it is
all a matter of judgement. Judgement is paramount.

Here where you have our judgement on this
record, and we respectfully submit it to you, our
judgement is where you have a merger to monopoly that
is unprecedented in scale, no chance of new entry,
trackage rights is the only possible solution. Many
users of these railroads, shippers greatly concerned
over the problems. Many other agencies concerned, and
a structure set in place for decades and decades going forward. We actually think, when you talk about the global economy and the U.S. price, this could be harmful to U.S. participation in the global economy. Because to the extent our shipping costs are increased, getting out to coast, to ship to foreign markets through rail transportation which is often crucial and the essential way shipping has to be done, it could actually harm our ability to compete in global markets by increasing prices.

So that's our concern, that's part of the concern. That is the --

CHAIRPERSON MORGAN: Well the other recommendation that I noted in that report was one that related to efficiencies not being excluded because they could be attained some other way. And I think the specific quote from the report was that it was not for antitrust enforcers to require some imagined alternative business arrangement.

In this particular case the Justice Department has indicated that the benefits asserted here could be attained some other way and that that
further supports your position that the merger should not be approved. How would you square that position with the, this latest report?

MS BINGAMAN: Well, again, Chairman Morgan, I think I would say, for better or worse, and I think it is overwhelmingly for the better, for over 100 years now our jurisprudence has put antitrust enforcement in the center of business transactions. That is often not at all to the liking of the parties involved. In fact, I can testify personally it’s often to the dislike of the parties involved. But the outcome for the public interest and in keeping the economy competitive, has been, has made this economy the most competitive in the world. I think that’s true. I think our antitrust enforcement has protected the dynamism and the openness of this market to all comers, U.S. and otherwise.

So, I think I would say when people say you can’t be second guessing. We are not second guessing the business arrangement. We are second guessing, or we are judging, as the law requires us to do, we are exercising our function as you have to
exercise yours. We are judgement as best we humanly
can the competitive impacts of this transaction.

We are not telling the parties what other
transaction to engage in. We are simply saying, this
transaction, we believe, is anticompetitive and will
increase prices. And the solution you propose, these
trackage rights, are so vast in scope, so untested, so
untried, we don’t have confidence remotely that they
will work. And we think disapproval outright is the
proper course. If not that, broad divestitures to
protect competition. Thank you.

CHAIRPERSON MORGAN: Thank you very much.

MS BINGAMAN: I appreciate your
consideration, I appreciate it.

CHAIRPERSON MORGAN: Now, if we could
return to the schedule. We now will hear from Paul
Samuel Smith, representing the Department of
Transportation.

MR. SMITH: Madam Chairman and members of
the Board, good afternoon. With me today is Mr. Frank
Krusee, the Assistant Secretary of Transportation
Policy of the Department.
CHAIRPERSON MORGAN: If you could get just a little closer to that mike.

MR. SMITH: Okay.

CHAIRPERSON MORGAN: Thank you.

MR. SMITH: This is a merger between two largely parallel railroads, that would result in substantial competitive harm, even as modified by the various trackage rights agreements before you. The results would remain seriously anticompetitive. For that reason, the United States Department of Transportation opposes the merger as proposed.

However, we also believe the merger’s competitive problems can be solved. Because the merger promises significant public benefits, we think those problems should be solved. This can be done by means of substantial conditions to remedy the competitive harms that the merger brings.

After this merger, only two Class I railroads will provide service between the west coast and midwestern gateways. While the Department considers the two railroads can provide vigorous intermodal competition, the existence of two railroads...
is a necessary, but not sufficient condition, for that outcome. Providing assurance that the only two remaining rail carriers will compete vigorously must be the basis for conditions imposed by this Board.

The paradigm of intermodal competition is found in railroads that are ready, willing and able to compete on a roughly equal basis throughout their service areas. Historically, trackage rights have sufficed to maintain competition loss through consolidations.

But the circumstances of this case are unprecedented. Trackage rights have never been used to remedy competitive problems of the extensive scope presented by this transaction. The volumes of freight and the distances involved in this case magnify the inherent shortcomings facing the railroad in such a relationship.

The control of dispatching, various incentives arising from traditional compensation structures, limited, if any, access to new customers, and such similar factors exacerbate the differing postures of railroads so as to handicap the BN Santa
Fe or any other railroad that must compete as tenant with emerged UP/SP.

The ability of one of the only two remaining Class 1 carriers across the western two thirds of this country, to constrain in some measure the competitive threat posed by the other, but necessarily diminish post merger competition in the west.

Our proposed remedies in this case are designed to remove or reduce this disparity and to introduce a basic comparability between the two remaining railroads in order to assure aggressive competition between them. In short, the Department seeks to add to the necessary condition of two railroads the sufficient conditions required to assure continued vigorous competition in the West.

The Board can assure that rail competition in what we call the Texas corridors will be vigorous by making sure the competitors are on the same operational clime. As landlords or owner railroads in command of their own destinies. That can only be fully accomplished by requiring full divestiture of
the affected lines. The number and proximity of other
Class 1 rail networks to the affected areas, including
the Burlington Northern, and the volume and
attractiveness of the traffic in this area, gives the
Department confidence in the degree of post merger,
post divestiture competition one could expect.

The merger also presents substantial
competitive problems in the central corridor. The
central corridor, however, does not as readily lend
itself to duplicating the competitive ideal. First,
although the distances are long and the traffic
substantial, as in Texas, the problem areas in the
central corridor are significantly removed from the
lines of any other Class 1 railroad, save from the
Burlington Northern.

Second, other than the applicants, only
the BN Santa Fe has the gathering lines that can
supply the volume of overhead traffic necessary to
maintain competition throughout the central corridor
between the west coast and the midwestern gateways.
A consideration that was always important to the ICC.

Third, much of the merger's public
benefits arise in the central corridor. Divestiture here would likely eliminate those benefits.

These factors therefore raise questions about the ability of other railroads than the Burlington Northern to effectively restore competition lost by the merger in this area. To satisfy traditional criteria for imposing merger related conditions, and to retain the merger’s benefits, in the circumstances of the central corridor, therefore, the best solution in the Department’s view is trackage rights that were tailored to approximate competition conditions between two landlords or owner railroads.

The conditions we urge on the Board would do this by modifying the original trackage rights agreements between the BN Santa Fe and the applicants in two major respects. First, the Board should incorporate the essential elements of the CMA Agreement, such as the dispatching protocols, the opening of existing, excuse me, contracts.

Second, it should include the additional modifications contained in the Department’s brief, such as the two tier compensation structure, unlimited
build in and build out transloading options, and so forth. These modifications aim to place these two railroads in roughly comparable competitive positions. Only then would each of them have the capability and incentive to compete as aggressively as the public interest demands in return for approval of this transaction.

Anything less invites a range of scenarios from huddled competition to a comfortable duo-opoly. And the risk of any of those is unacceptable.

I'd like to make clear at this point, the Department has no doubts about the capability and the incentive of an unconstrained BN Santa Fe to compete vigorously. We consider the BN one of several suitable purchases for the Texas corridor lines, and under the competitive conditions urged in our brief, as an operator of the appropriately modified trackage rights in the central corridor.

In conclusion, the Board now faces a rail industry populated with ever fewer Class 1 carriers. As each railroad comprises a larger portion of the industry as a whole, its actions have consequences for
more shippers and for more of the nation's economy. So too, then, must the decisions of this Board that affect those carriers. As it contemplates a further concentration in the industry, it is therefore critical that the Board be mindful of the true reach and the true risks of its decisions in this case.

The Department of Transportation urges the Board to reject this merger unless it is prepared to reduce those risks by imposing conditions that ensure truly vigorous competition along the thousands of miles and for the billions of dollars of traffic that are at issue. Independent railroads can provide this. Constrained ones cannot. That concludes my prepared remarks and I'll be happy to answer any questions that you have.

CHAIRPERSON MORGAN: Obviously one of the issues that we have been discussing this morning relates to benefits from this merger. And as the Department of Transportation, you, like us, watch what has occurred since the passage of the Staggers Rail Act in terms of benefits that have been derived from deregulation in rail restructuring.
I presume that in looking at this particular transaction you have kept in mind what has occurred since the Staggers Act. Do you agree with what has occurred since 1980?

MR. SMITH: We certainly have. Our brief, in fact, recites a study of the ICC's last year; we indicated in view of the Staggers Act with increasing rail concentration, nonetheless railways have declined substantially in real terms over that period of time. So long as the competition between those carriers is maintained, the precise number, of course, not less than two, is less important.

VICE CHAIRPERSON SIMMONS: Are you for or against trackage rights as a competitive remedy?

MR. SMITH: In the circumstances of this case --

VICE CHAIRPERSON SIMMONS: In this case you are?

MR. SMITH: We are against traditional trackage rights.

VICE CHAIRPERSON SIMMONS: Were you ever for trackage rights?
MR. SMITH: In prior merger cases the
Department of Transportation has found trackage rights
to be an acceptable recommendation to the ICC where we
have found a competitive problem.

VICE CHAIRPERSON SIMMONS: What is it
that’s bothering you? Is it the length of the
trackage right, or the whole scope of it or --

MR. SMITH: Well, the length is one aspect
of it, the volume of traffic that is involved. The
fact that with only two railroads left, the risks of
being less than confident about the more, rather than
less competitive outcome, those give us great problems
both in the central corridor and in Texas.

The fact that in Texas you have several
large rail networks immediately adjacent to the area.
You have the type of traffic that will track them,
gives us reason to believe that divestiture not only
is theoretically the best means of solving that
problem, but as a practical matter would certainly
work there.

In the central corridors, I mentioned
there are particular problems that we think would make
highly augmented form of trackage rights the initial
best bet the fix the problem. But even then we do
request that there be some oversight to make sure that
indeed we are not wrong.

CHAIRPERSON MORGAN: Now under the CMA
Agreement, there is a provision for build outs, build
ins and build outs. Now, in reading your brief, it
appeared to me that the CMA Agreement, on that
particular issue, was not quite enough as you saw it
in terms of the, of the competitive changes that would
take place if this merger were approved. Is that
correct?

MR. SMITH: That's right. It's time
limited, it's subject to the discretion of a third
party arbitrator. And a landlord or an owner railroad
doesn't face anybody else's judgement or anybody
else's time constraints on when or whether it will
build in or build out. And we don't think the two
railroads that will exist here, that one should have
even that kind of indirect control placed over its
commercial decisions. It's just impossible to tell in
the future whether something that's wholly not viable
now wouldn't be viable five or ten years from now.

CHAIRPERSON MORGAN: So how could the CMA Agreement be altered to respond specifically to that concern?

MR. SMITH: Well, if I didn't think -- if I were going to apply that to the central corridor, I would take, as we have, parts of it. We do like a more refined dispatching protocol. Someone is always going to have to control the dispatching on a track, where you don't have two independent railroads.

They have gone farther than ever in the past as far as we can tell to reduce the potential for problems there. We would also like very much the idea of opening up the contracts of a large volume of the business along a line that long.

But again, and the central corridor, that provides you a basis. But even so, there isn't any -- the compensation structure remains the same between the BN Santa Fe and the applicants under the CMA Agreement. Well we think that not having a separate fixed cost component doesn't allow a tenant the same kind of incentives and flexibility as the landlord
has. And that’s very important to us. We think that
you need to have your competitive decisions not driven
by a variable cost based, or usage fee that allows you
kind of the option where to compete or how much to
compete for given traffic. We don’t want there to be
that kind of option.

A landlord has an investment of fixed
costs in the ground, so to speak, to get any of that
back out, it’s got to be very vigorously -- and that’s
what we want to have happen for the two carriers in
the central corridor.

CHAIRPERSON MORGAN: Well, given your
position on that, how do trackage rights that are in
place today work as a competitive fix? Clearly there
are, there is a lot of trackage rights --

MR. SMITH: Clearly there are, and
collectively or in the aggregate, I’m sure there are
many, many miles of them. But, the only case in which
I am aware in which there were extraordinary lengths
of trackage rights given in the merger context was
with Burlington Northern Santa Fe. And as all the
parties and as the ICC then saw, that was far in
excess of anything necessary to fix the real
competitive problems caused by that merger.

It never went beyond, it was necessary it
was simply commercial calculations made the SP and the
BN and Santa Fe in that case. In this case we don’t
think that the 4,000, roughly 4,000 miles is far in
excess of anything. We think that that’s precisely
tailored to the competitive problems posed by the
merger and is not generous in any respect.

VICE CHAIRPERSON SIMMONS: So it’s the
length of the trackage rights that’s bothering you.

MR. SMITH: That’s a huge part of it.
It’s also the billions of dollars of traffic there at
issue. And again the fact that you’ve only got two
left. You can’t, the risk of being wrong would be
horrendous. You’ve got to do everything you can to
eliminate or narrow that risk.

CHAIRPERSON MORGAN: You mentioned in the
central corridor that there are indeed benefits that
you wanted to make sure that we do not undermine in
some way if we were to approve this merger and impose
some sort of conditions. Now, the central corridor
benefits, why are they unique as compared to the benefits that might occur in the Gulf Coast area?

MR. SMITH: Well, I don't know that they are unique. I think that -- although there is the directional flow traffic plan in the Texas corridor that doesn't exist in the central corridor. I don't know that they are unique, other than that there are quantitatively more of the public benefits promised by the merger taking place outside the Texas corridors.

Even if they weren't, that isn't absolutely critical to us. We share the view that the Antitrust Division has and that the ICC has had for years, which is that you fix it first. If there is a problem, try to get what benefits you can from the merger, but always fixing the problem comes first.

We think, in this merger where there are certainly some benefits in the Texas corridor where the problem can be readily, structurally once and for all resolved without doing harm to the other traditional merger condition criteria, which always go, essentially against overreaching on one way, shape, or form, that they should be honored.
And here in the central corridor, we think that honoring those conditions requires first resort to a high leverage form of trackage rights to the carrier that’s best now in position to fix the problems and not do more than that. And we think that’s the BN Santa Fe.

CHAIRPERSON MORGAN: Now with respect to divestiture, if the Board were to approve the merge and impose some sort of divestiture requirement, how would you envision that that process would work?

MR. SMITH: I think the broad outlines would flow from the model in the SP/SF case where the Commission ordered, disapproved the merger and ordered the holding company that owned both the SP and the SF to divest itself of one of them. Thereafter, when that was accomplished there was a subsequent proceeding whereby the Commission and interested parties could review the proposed divestiture to ensure that in fact it carried out the intent of the Commission in the first place. And that’s what I would envision here.

You would have to have some kind of

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opportunity to review whatever might be proposed to make sure that it did what it was proposed to do in the first place.

VICE CHAIRPERSON SIMMONS: Well, I was here then, a particular case that you recall, and here we are back here today worrying about the health of the SP. What do you have to say about that? The Southern Pacific?

MR. SMITH: It was soldiered on --

VICE CHAIRPERSON SIMMONS: That was a divestiture.

MR. SMITH: That was a divestiture and it was soldiered on since then and they are, I suppose financially, less well off than the other two carriers in the west. But this is such a totally different merger with problems in different areas of the country that, again, this is a commercial decision that BC has anticompetitive ramifications that the Board can in short, fix.

COMMISSIONER OWEN: Excuse me. You have been talking an awful lot but somehow I haven’t figured out what your problem is with the central
corridor there and the divestiture. I'm trying to be
a little more specific about it. Is it shippers in
the central corridor you are concerned about, or what?

MR. SMITH: Well, we are concerned, of the
shippers in the central corridor, we are concerned
about those --

COMMISSIONER OWEN: How many shippers are
there in the central corridor then?

MR. SMITH: I don't --

COMMISSIONER OWEN: That's a pretty
interesting question when you take a look at that.
Most of the shippers come from the west coast.

MR. SMITH: Right, for the --

COMMISSIONER OWEN: That's through traffic
there, pretty much so --

MR. SMITH: That's right and I think --

COMMISSIONER OWEN: More shippers in Texas
probably and the Gulf Coast and the Gulf states than
there are in that central corridor.

MR. SMITH: And one of our concerns is
that if you don't fix the central corridor problem
correctly then the shippers of that overhead traffic
going to the midwest won't have what the ICC has striven over the to provide them with which is independent competitive routes all the way through. There is a large segment of that corridor around the Nevada and east -- should be western Utah that doesn't generate a lot of its own traffic. And we are concerned very much about the possible atrophy of that.

COMMISSIONER OWEN: But it seems pretty obvious to me anyway that if you start fragmenting the line that all of a sudden you are going to give interchanges and so forth. So really your shipping cost goes up rather than down. And the more you wrap the line for some of those areas, the better your shipping cost is for the consumers and for the shippers.

MR. SMITH: We wouldn't propose to parcel out that line at all. We would propose that as augmented, the Burlington Northern Santa Fe operate the rights and have a single line service along the central corridor.

CHAIRPERSON NEAL GROSS: The Vice Chairman
raised a question about the SP and its financial health. In thinking about this merger, if we were to disapprove this merger, what do you think would happen to SP?

MR. SMITH: I have seen published reports that indicate some doubt as to whether the current owners of the Southern Pacific would continue in the railroad business, at least as that railroad is presently constituted.

VICE CHAIRPERSON SIMMONS: The Department of Justice said they were doing fine.

MR. SMITH: In some respects they have done fine. But as an operational matter they have generally been kept afloat only by resources from other components of the SP corporate structure.

VICE CHAIRPERSON SIMMONS: You are talking about real estate?

MR. SMITH: I beg your pardon?

VICE CHAIRPERSON SIMMONS: Are you talking about real estate?

MR. SMITH: Primarily, yes, I am. At some point that runs out. Again, it doesn't necessarily
have to have any views that whatever could happen to SP would necessarily be a bad thing. I mean, I -- we don't know about that --

VICE CHAIRPERSON SIMMONS: So them going out of business is not necessarily a bad thing?

MR. SMITH: It would almost entirely depend upon what transactions were presented to you. There are certainly some scenarios that could be very bad from any number of perspectives, from labor to competitive. And some that might not be at all.

CHAIRPERSON MORGAN: But, as we both are responsible for transportation, looking at the SP situation now, is there cause for some concern about what will happen to it in the future? Whether we, whether it's going to go bankrupt sooner or later, or whether it's just going to peter along some minimal level?

MR. SMITH: I guess I'd say perhaps some greater concern over the UP ought to begin, but not to the level or degree that would cause me to think that this was their last best hope of continuing as a rail entity or a viable competitor.
CHAIRPERSON MORGAN: Now, in your brief you talk about the three to two markets and the two to one markets. And, obviously there is a lot on the record about competitive harm in those markets. Do I understand the conclusion of the Department to be that with respect to three to two that the evidence is, would not lead us to conclude that there is harm there that we must address if we were to approve this merger?

MR. SMITH: I think that's right. We have seen a great deal of effort expended on the record on that point. But, from our point of view it is conflicting from both sides. Economic literature indicates there can be a wide range of outcomes when you have two participants in the marketplace. The study that I mentioned some time ago indicates that industry concentration has not led to increased rail rates at all. Your own precedent in the BN Santa Fe and UP/KD indicate your belief that two independent, unconstrained railroads can and do supply vigorous competition.

And with all that we concluded that that
is indeed the case. Two independent competent railroads can do it, and there should be enough in our view, whether they are in the Texas corridor or in the central corridor.

VICE CHAIRPERSON SIMMONS: With regard to trackage rights, you have, DOT argues about the disadvantages of the tenant versus the landlord. What specific cases are you making reference to when you talk about the tenant and the landlord in the railroad business?

MR. SMITH: I am not making a specific reference to a merger case, if that’s what you are referring to. I’m making reference to --

VICE CHAIRPERSON SIMMONS: With regard to trackage rights. That’s what you say the tenant is always at a disadvantage. I mean are there specific cases that you are making reference to?

MR. SMITH: Well, just the traditional elements of it with the control of dispatching, a compensation structure which is overwhelmingly on a usage basis, inability to access new shippers. Those are all constraints facing the tenant, not facing the
landlord.

VICE CHAIRPERSON SIMMONS: But you have no particular cases on which you are basing your particular concern?

MR. SMITH: We haven't done any kind of a systematic study to indicate to what degree those features of trackage rights --

VICE CHAIRPERSON SIMMONS: That's okay.

MR. SMITH: -- quantify the problem.

VICE CHAIRPERSON SIMMONS: Okay.

CHAIRPERSON MORGAN: The Justice Department suggests that perhaps an agreement related to this merger might include some sort of penalties provision as a way of monitoring how UP and others behave in the context of any post merger activity. Obviously, the Department has some experience given that the Amtrak freight railroad agreements do have incentives or penalty provisions that allow for certain relief if certain goals are not met.

If we were to consider some sort of penalty provision, how do you think that could work?

MR. SMITH: Well, of course, from our
institutional provision, if you have divestiture there
wouldn't be any follow-on penalties appropriate.

CHAIRPERSON MORGAN: Under you position,
you would have trackage rights in the central
corridor?

MR. SMITH: That's correct.

MR. SMITH: In other words, you
divestiture is only going to the Gulf Coast area, but
under your position, we would have trackage rights.
And there is some, obviously, concern on the record
that that needs to be beefed up and a penalty
provision has been discussed in that context.

MR. SMITH: I don't think that a penalty
provision would be appropriate, how one would arrive
at either a financial or an operational consequence
following some triggering condition, event, or series
of events, is not something that we have considered.
We think that the oversight should be, that we have
proposed for the central corridor, should be designed
to determine whether the trackage rights have worked,
whether a little bit more fine tuning is necessary, or
whether it's simply notwithstanding the best efforts
of those involved inadequate and therefore require divestiture.

CHAIRPERSON MORGAN: And then one final question, following up on the three to two discussion that we had earlier. Then you conclusion is that you do not agree with the Justice Department and other parties with respect to conclusions about three to two harm?

MR. SMITH: That's correct.

CHAIRPERSON MORGAN: Anything else?

COMMISSIONER OWEN: If I could just make an observation, it seems like there is sufficient penalty on it if we have the oversight and be able to call them back in here. The attorney fees alone will kill them.

CHAIRPERSON MORGAN: He's not an attorney so --

COMMISSIONER OWEN: Well, well --

CHAIRPERSON MORGAN: It's always non-attorneys that --

MR. SMITH: To make one final point. I think someone once said, perhaps it was in the BN
Santa Fe merger which was in other exhibits, compare
with the benefits of the merger both private and
public what it costs to throw a cordon of lawyers in
Washington at the ICC or the Board is nothing. It
wouldn’t cost them anything. Thank you.

CHAIRPERSON MORGAN: Thank you very much.

COMMISSIONER OWEN: I’d like to thank you
for your presentation because you can see that there
are ways of putting on all these aspects of the case.

Thank you.

CHAIRPERSON MORGAN: I think what I’d like
to do since it is 1:00, I would like to take a 45
minute break for lunch and reconvene at 1:45. We will
then take Roger Fones, representing the Department of
Justice and then proceed along with the rest of our
schedule.

(Whereupon, the foregoing matter went off
the record at 1:02 p.m.)
A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

(1:55 p.m.)

CHAIRPERSON MORGAN: Okay, I hope everybody got a little bite to eat or a little rest. But anyway, before I turn to you, Mr. Finest, if I could just continue what I did this morning, which is as I get congressional statements, I insert them into the record. And I have gotten two additional statements, one from Senator Hatch. And again, I will just read the first paragraph of that.

"I appreciate the opportunity to express my views to the Board regarding the proposed merger of the Union Pacific and the Southern Pacific Railroads. My home state of Utah has a proud heritage in railroading. The golden spike, joining two great railroads and joining a continent, was driven a Promontory, Utah in 1869. Railroads played a critical role in opening the American West."

The rest of that will be included in the record.

(Laughter.)

I have to read the first paragraph. I
didn’t write it. I’m just reading it.

(Laughter.)

The next statement is from Senator Burns, and the first paragraph of that reads as follows.

"Madame Chairwoman and Board members, I appreciate this opportunity to provide a statement regarding the Union Pacific and the Southern Pacific rail merger proposal pending before the Surface Transportation Board. I urge the Board to seriously consider every aspect of this proposed merger, including the effects on competition, the national rail system, and the future of the rail industry."

The rest of that statement will be included in the record. Thank you. Now we will proceed with you, Mr. Finest, representing the Department of Justice.

MR. FINEST: Thank you, Madame Chairman, Vice Chairman Simmons, Commissioner Owen. I want to start with the duopoly issue. The map that Representative Doggett brought this morning, I think, was quite dramatic. It showed the area affected by the three to two problem in this case. And it’s