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February 23, 1998

BY HAND DELIVERY

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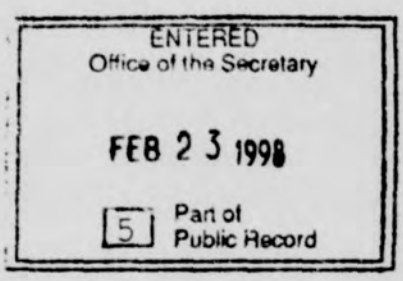
The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
Case Control Branch
ATTN: STB Finance Docket 33388
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: Finance Docket No. 33388
CSX Corporation and CSX Transportation Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company -- Control and Operating Leases/Agreements -- Conrail Inc. and Consolidated Rail Corporation

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding, please find an original and twenty-five (25) copies of the Brief of Consumers Energy Company (CE-11). In accordance with the Board's order, we have enclosed a Wordperfect 5.1 diskette containing the text of this document as well.

We have included an extra copy of the filing. Kindly indicate receipt by time-stamping this copy and returning it with our messenger.



Sincerely,

Donald G. Avery
An Attorney for Consumers Energy Company

Enclosures

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CE-11

BEFORE THE
SURFACE TRANSPORTATION BOARD

CSX CORPORATION AND CSX TRANSPORTATION, INC., NORFOLK SOUTHERN CORPORATION AND NORFOLK SOUTHERN RAILWAY COMPANY -- CONTROL AND OPERATING LEASES/ AGREEMENTS -- CONRAIL INC. AND CONSOLIDATED RAIL CORPORATION	)	Finance Docket No. 33388

BRIEF OF
CONSUMERS ENERGY COMPANY

CONSUMERS ENERGY COMPANY

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BEFORE THE
SURFACE TRANSPORTATION BOARD

CSX CORPORATION AND CSX TRANSPORTATION, INC., NORFOLK SOUTHERN CORPORATION AND NORFOLK SOUTHERN RAILWAY COMPANY -- CONTROL AND OPERATING LEASES/ AGREEMENTS -- CONRAIL INC. AND CONSOLIDATED RAIL CORPORATION	Finance Docket No. 33388

BRIEF OF CONSUMERS ENERGY COMPANY

Consumers Energy Company ("Consumers") hereby submits this, its Brief in opposition to the Application filed in this docket by CSX Corporation and CSX Transportation, Inc. (jointly, "CSX"); Norfolk Southern Corporation and Norfolk Southern Railway Company (jointly, "NS"); and Conrail, Inc. and Consolidated Rail Corporation (jointly, "Conrail") (collectively, "Applicants"). The Application seeks authorization for NS and CSX to acquire and control Conrail, and to divide up its assets between them.

For the reasons set forth in its October 21, 1997 Comments and as summarized in this Brief, Consumers urges the Surface Transportation Board ("STB" or "Board") to deny the Application. However, if the Board nonetheless decides to approve the Application, it must at a minimum impose conditions to mitigate, insofar as possible, its adverse effects on Consumers. The nature of those adverse effects, and the conditions needed to mitigate them, are discussed further below.

FACTS

As explained in its October 21 Comments ("CE Comments"), Verified Statement of William E. Garrity ("VS Garrity") at 2-8, Consumers is an electric and gas utility company serving about 1.6 million customers throughout the Lower Peninsula of Michigan, including important segments of the automobile industry. Consumers operates 12 coal-fired generating units at five plants (four sites), which collectively consume over 7 million tons of coal per year and constitute over three-quarters of Consumers' baseload generating capacity.

1. Current Coal Supply and Transportation Patterns.

One of Consumers' coal-fired plants, its three-unit Campbell plant, is served only by rail, and only by CSX. All of Consumers' other coal-fired generating plants presently have two or more coal delivery options: the Karn-Weadock complex (two plants, four units) can receive coal deliveries by CSX, by the Central Michigan Railway ("CMR"), or by lake vessel; the Cobb plant is served exclusively by lake vessel (but can choose among lake vessel operators); and the Whiting plant (three units) is served by both CSX and the Canadian National ("CN").

While Consumers enjoys competitive coal delivery options at three of its four coal-burning sites, its choices are nonetheless constrained by limitations on the kinds of coal it can burn at each plant. Specifically, as Witness Garrity explains (*Id.* at 5-8), a combination of facility design limitations, air quality control regulations, and economics have led

Consumers to follow a carefully-crafted coal blending strategy at every plant (other than Whiting, which lacks blending capabilities). As Mr. Garrity explains, Consumers cannot burn 100% eastern high-sulfur coal without violating EPA and state air quality control regulations; it cannot burn 100% western, low-Btu coal (*e.g.*, from Wyoming's Powder River Basin) and achieve full output levels with boilers and coal handling facilities designed for smaller volumes of higher-Btu fuels; and it cannot burn 100% Eastern EPA compliance coal (other than at Campbell Unit No. 3, where there is no choice), because such coals are generally too expensive. Consumers must therefore blend two or three kinds of coal together to provide an optimal fuel supply for its plants. Indeed, the confluence of these constraints has led to very precise (and differing) optimum blends for each of Consumers' twelve coal-fired units, *see* VS Garrity at 3-5 and Exhibit __ (WEG-01). Among other things, this means that Consumers cannot "play off" sources and carriers of western coal against their eastern counterparts, by altering proportions and shifting substantial coal volumes from West to East or vice versa. Rather, each type of coal and associated transportation is effectively a separate market for Consumers.

As noted above, Consumers is completely captive to CSX at its Campbell plant, and as that plant represents almost one-half of Consumers' total coal-fired generating capacity (*Id.* at 3), this gives CSX significant leverage over Consumers as a whole. Additionally, the eastern, low-sulfur coal required at

Cobb, Karn-Weadock and Whiting (and the compliance coal required at Campbell Unit No. 3) are found predominantly on CSX's lines (*Id.* at 10-11). Nevertheless, Conrail-originated coals delivered via CN (to Whiting), CN-CMR (to Karn-Weadock), or lake vessel (to Cobb) are presently a competitive substitute for at least some of the CSX-origin coals at those locations, and to that extent Conrail acts as a check on CSX's market power *vis-a-vis* Consumers.

2. Impact of Proposed Transaction on Consumers.

As Witness Garrity explained (*Id.* at 10-14), the proposed Conrail Acquisition threatens to affect Consumers adversely in two fundamental ways: (1) by substituting NS for Conrail as the alternative to CSX for eastern low-sulfur coal supplies; and (2) by raising the hurdles that Consumers must overcome to get maximum rate relief against CSX on the preponderance of Consumers' coal shipments that are, and will remain, captive to that carrier.

a. Effect on Competition. Substituting NS for Conrail as the alternative to CSX for part of Consumers' coal requirements threatens to hurt Consumers in a subtle, yet palpable, way: the success or failure of Conrail's coal marketing department has plainly rested on its ability to promote long-haul, preferably local, movements of coal to utilities in Conrail's service territory -- and especially in its heartland, the states of Michigan, Ohio, Pennsylvania, and New York. This marketing focus and attention naturally could be expected to

translate into more aggressive pricing where Conrail faced intra-modal competition, as it did at Consumers' non-captive coal plants.

NS' coal marketing personnel, by contrast, have traditionally -- and understandably -- focused their attention on NS's natural markets in the Southeast, and those markets are likely to remain NS' primary markets in terms of volume and profits, even after it acquires part of Conrail. Under these circumstances, while NS will no doubt want to inherit as much of Conrail's coal traffic as it profitably can, the success or failure of NS' coal marketers will be much less dependent on how well they do with that traffic. This reduced reliance -- or "focus" -- can be expected to translate into somewhat less aggressive pricing, making NS a less effective competitor for CSX than Conrail has been.[1] *See* CE Comments at 9; VS Garrity at 11.

b. Increased Barriers to Maximum Rate Relief. The increased barriers that threaten to block otherwise-justified rate relief for captive shippers will be a direct -- and plainly intended -- result of the Applicants' proposed inclusion of a

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[1] In this regard, Consumers is concerned about which Applicant -- NS or CSX -- will be assuming Conrail's role under an existing coal transportation contract among Consumers, Conrail, Canadian National, and Central Michigan Railway for coal deliveries to Karn-Weadock and Whiting. Section 2.2(c) of the Transaction Agreement of June 10, 1997 (CSX/NS-25, Application Vol. 8-B, at 25-29) would appear to govern, but how it would apply to this particular contract is unclear. The issue is important because if CSX rather than NS inherits Conrail's role under the coal transportation contract in question, Consumers' bargaining leverage *vis-a-vis* CSX will be still further weakened, and CSX will have assumed that much greater control over Consumers' coal traffic.

significant "acquisition premium" in their rate bases for regulatory costing purposes. NS and CSX paid approximately $3.8 billion more for Conrail's stock than it was worth on the stock markets before their bidding war began;[2] they paid at least $6.7 billion more than the book value of Conrail's stock.[3] They have admitted that if they are permitted to write up the recorded value of Conrail's assets to reflect these amounts for regulatory costing purposes, the net effect will be a rate base increase of more than $9.5 billion.[4] If this is allowed to happen, then other things being equal,[5] the effect will be to raise the 180%

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[2]Just before CSX announced its plan to acquire Conrail, Conrail's common stock was trading at about $71 per share (VS Garrity at 11); the final purchase price paid by NS and CSX, $115 per share, represents a $44 per share premium. With about 86 million Conrail shares outstanding, this translates into a premium over market of $3.784 billion.

[3]*See* CSX/NS-18, Vol. 1, Ex. 16, App. C, at 131; CSX/NS-176, Applicants' Rebuttal Volume 1, App. A, at 2 n.3.

[4]Applicants' Rebuttal, App. A, at 2 n.4.

[5]Applicants in their rebuttal quibble with the "other things being equal" assumption, asserting that CE and others challenging their addition of the acquisition premium to their rate bases ignore the revenue increases and operating cost savings that their transaction will produce. As discussed below, however, the revenue enhancements are irrelevant to the regulatory costing process (if variable costs increase, the jurisdictional threshold on captive coal traffic will also increase, no matter how wealthy the Applicants become from traffic growth elsewhere). As for the promised operating cost savings, coal movements such as those to Consumers' Campbell plant are unlikely to share in any such savings, since the operation of their unit trains will not change.

As discussed *infra*, if Applicants had truly believed that inclusion of their acquisition premium would produce no net increase in the jurisdictional threshold for captive coal movements, it would have been a simple matter for them to eliminate

(continued...)

"jurisdictional threshold" on a typical captive unit train coal movement by a full fifteen percent for CSX, and twenty-four percent for NS. CE Comments, Verified Statement of Thomas D. Crowley ("VS Crowley"), at 11-14. For any captive coal movement with a stand alone cost close to or below the jurisdictional threshold, as happened recently in the WTU case,[6] this would translate into a license to impose a corresponding rate increase, without any improvement in the service or investment in new facilities.

Because Consumers is completely captive to CSX for its Campbell coal traffic, the threat of such an erosion in the protective umbrella of STB maximum rate jurisdiction is a direct and significant adverse effect that it will suffer if the proposed Conrail Acquisition is approved.

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[5](...continued)
the issue by offering a binding commitment to that effect. Their refusal to do so speaks volumes about their true intent.

[6]Docket No. 41191, *West Texas Utilities Company v. Burlington Northern Railroad Company* (unprinted decision served May 3, 1996), *aff'd sub nom. Burlington Northern Railroad Company v. Surface Transportation Board*, 114 F.3d 206 (DC Cir. 1997) ("*WTU*"). Applicants would have the Board dismiss the *WTU* result as an aberration (Applicants' Rebuttal, App. A, at 26 n.37), but they cannot deny that in the only two unit train coal rate cases decided by this agency since its creation, stand alone costs were found to be below the jurisdictional threshold in at least some of the periods at issue. *See*, in addition to *WTU*, Docket No. 41185, *Arizona Public Service Co. v. Atchison, Topeka & Santa Fe Railway Co.* (unprinted decision served July 29, 1997).

ARGUMENT

I. INTRODUCTION.

Before focusing upon the fundamental areas of disagreement between Consumers and the Applicants, it may be useful to catalogue some important points upon which we appear to agree.

-- First, there is no dispute about the legal standards that the Board is to apply in this proceeding. Under the *ICC Termination Act*,[7] the Board's "single and essential standard of approval" in merger proceedings is that it must "find the [transaction] to be 'consistent with the public interest.'" Finance Docket No. 32760, *Union Pacific Corp., Union Pacific R.R. Co., and Missouri Pacific R.R. Co. -- Control and Merger -- Southern Pacific Rail Corp., Southern Pacific Transp. Co., St. Louis Southwestern Ry. Co., SPCSL Corp., and The Denver and Rio Grande Western R.R. Co.*, Decision No. 44, served August 12, 1996, at 98 (unprinted) ("*UP/SP*"), *citing*, *Missouri-Kansas-Texas R.R. Co. v. United States*, 632 F.2d 392, 395 (5th Cir. 1980), *cert. denied*, 451 U.S. 1017 (1981).

-- Similarly, there can be no dispute that in gauging the public interest, the essential issue facing the Board is whether the perceived public benefits, whatever they may be, are overshadowed by purely private benefits that will accrue solely to the merging carriers and at the expense of the public. *See CSX Corp. -- Control -- Chessie System, Inc. and Seaboard Coast Line*

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[7]Pub. L. 104-88, 109 Stat. 803 (December 29, 1995).

Indus., 363 I.C.C. 518, 551-52 (1980).[8] In making this determination, the Board focuses, *inter alia*, on the competitive effects of a proposed merger:

> [T]he [Board] does not favor consolidations that substantially reduce the transport alternatives available to shippers unless there are substantial and demonstrable benefits to the transaction that cannot be achieved in a less anticompetitive fashion. Our analysis of the competitive impacts of a consolidation is especially critical in light of the Congressionally mandated commitment to give railroads greater freedom to price without regulatory interference.

49 C.F.R. § 1180.1(a)(*emphasis added*).

-- Second, it is undisputed that CSX and NS paid far more for Conrail's stock than it was worth on Conrail's books, and that if permitted, they will seek to "write up" Conrail's assets by almost ten billion dollars following the acquisition, to reflect that purchase price;

-- Third, it is undisputed that such an asset write-up would be summarily rejected, at least for ratemaking purposes, in

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[8] The former Interstate Commerce Commission expounded upon this point in its *UP/CNW* decision and stated that:

> [B]enefits to the combining carriers which are the result of increased market power, such as the ability to increase rates at the same or reduced service levels, are exclusively private benefits that detract from any public benefits associated with the control transaction.

See Finance Docket No. 32133, *Union Pacific Corp., Union Pacific R.R. Co. and Missouri Pacific R.R. Co. -- Control -- Chicago and North Western Transp. Co. and Chicago and North Western Ry. Co.* (unprinted decision served February 21, 1995), at 53 ("*UP/CNW*").

industries regulated by other agencies, including the Federal Energy Regulatory Commission ("FERC"). Such agencies have reasoned that, as FERC succinctly put it, "a mere change in ownership should not result in an increase in the rate charged for a service if the basic service rendered itself remains unchanged." Docket No. OR79-1-000, *Williams Pipe Line Co.*, 21 FERC ¶61,260 (1982), at 61,635 (emphasis in original), *quoted in part in Farmers Union Cent. Exch. v. FERC*, 734 F.2d 1486, 1528 n.78 (D.C. Cir. 1984).[9]

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[9]An additional and compelling reason for rejection of acquisition premiums is the "fatal circularity" condemned by the Supreme Court in *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). As explained by Professor Kahn,

> As a matter of both economic and regulatory principle, market values simply cannot be allowed to affect regulated prices, since that would involve the fatal circularity recognized by the Supreme Court 50 years ago: if a company is allowed to earn a "reasonable" return on whatever price it pays for an asset, that will in turn determine the price it is willing to pay, up to the present discounted value of the future stream of unconstrained monopoly profits. ...
>
> As a direct consequence of this principle, whenever and wherever the net book value of a company's stock or assets serves as the basis for determining its permissible rates or return for regulatory purposes, it is axiomatic that those book values must be based on the original cost of the assets. To incorporate market-value-based write-ups in the rate base to which the allowable rate of return is applied in determining a regulated company's revenue requirements or entitlements - which in turn determine its allowable prices - is to introduce a fatal circularity into the process.

(continued...)

-- Fourth, there can be no legitimate dispute that permitting the $9.5+ billion asset write-up planned by Applicants will raise the 180% jurisdictional threshold on Consumers' captive coal traffic, and that of other similarly-situated captive shippers, by a significant amount. Applicants have quibbled with Consumers' calculations in this regard, but they have been unable to refute that fundamental fact, and it is perhaps most telling that they have studiously refrained from making a no-increase pledge as to the 180% threshold.

-- Finally, there is no dispute that the valuation of Conrail's assets following the acquisition -- that is, whether the acquisition premium write-up is allowed or rejected -- will have no effect on the revenues Applicants can earn on the overwhelming preponderance of their traffic. Indeed, Consumers agrees with Applicants that the only rates that can possibly be affected by the Board's ruling on this issue are the handful of rates on traffic that meets all of the following conditions:

(a) the traffic is not covered by a contract;

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[9](...continued)
See CE Comments, Verified Statement of Alfred E. Kahn and Frederick C. Dunbar ("VS Kahn"), at 16-17.

Applicants deny that the "fatal circularity" principle applies to railroads; we address that issue *infra*. For present purposes, however, it is worth noting that Applicants offer no explanation as to why the *Williams* principle -- that a change in ownership cannot justify a change in rates when the service itself remains unchanged -- should not apply to railroads.

(b) the traffic is qualitatively market dominant (most rail traffic, including all of the traffic Applicants claim they will wean away from trucks or other railroads, is competitive); and

(c) most importantly, the maximum reasonable rate that the Board would prescribe under the "stand alone cost" standard, but for the 180% jurisdictional threshold, is below the 180% jurisdictional threshold that would result from inclusion of Applicants' proposed asset write-ups in their rate bases. While Consumers does not share Applicants' view that such cases are aberrations, we do agree that they constitute a very small universe.

Where Consumers most definitely parts company with Applicants, is on the implications of the foregoing propositions for the Board's ultimate decision in this proceeding. We now turn to those implications.

II. THE PROPOSED CONRAIL ACQUISITION IS CONTRARY TO THE PUBLIC INTEREST UNLESS CONDITIONED ON EXCLUSION OF THE ACQUISITION PREMIUM FROM APPLICANTS' RATE BASES FOR REVENUE ADEQUACY AND REGULATORY COSTING PURPOSES.

A. Preface - The Fundamental Purpose of Railroad Regulation.

A unifying thread that runs throughout the long history of railroad regulation in the United States has been the need to protect rail-dependent shippers against abusive treatment by the

railroads that serve them. The Interstate Commerce Commission was created as an instrument to provide such protection one hundred and eleven years ago;[10] the STB survives today as its successor because Congress recognized that the need for such protection has not disappeared completely.[11]

To be sure, most rail traffic today is subject to intermodal competition to some degree, and the scope of required regulatory protection has been correspondingly scaled back. However, for that residuum of traffic that remains rail-dependent and relatively price-inelastic, such as unit train coal traffic, the need for regulation persists, and justifies the Board's continued existence.[12]

This common thread of shipper protection finds cogent expression in the National Rail Transportation Policy that Congress ordained as a fundamental guide for all of the Board's deliberations, including railroad mergers (*see UP/CNW, supra* at 53-54, *citing, Norfolk Southern Corp. - Control - Norfolk & W. Ry. Co.*, 366 I.C.C. 171, 190 (1982)). Specifically, the Rail Transportation Policy admonishes the Board *inter alia* --

> (6) to maintain reasonable rates where there is an absence of effective competition...; [and]

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[10]1 I.L. Sharfman, *The Interstate Commerce Commission*, at 14-19 (1931); S. Rep. No. 104-176, at 2 (1995).

[11]141 *Cong. Rec.* S19074-S10975 (daily ed. December 21, 1995) (statements of Sen. Hollings, Exon, and Pressler); S. Rep. No. 104-176, at 6-8 (1995); H.R. Conf. Rep. No. 104-422, at 4 (1985).

[12]S. Rep. No. 104-176, at 7, 18 (1995).

> (12) to prohibit predatory pricing and practices, to avoid undue concentrations of market power, and prohibit unlawful discrimination.

49 U.S.C. §§ 10101(6), (12) (emphasis added).

As we shall see, these shipper-protection principles are of particular relevance to the acquisition premium issue.

B. Acceptance of the Acquisition Premium Write-Up Would Sanction Unreasonable Coal Rates, In Violation of the Board's Coal Rate Guidelines.

As noted above, the Applicants' proposed write-up of Conrail's assets to reflect the acquisition premium would have one clear regulatory effect, and one effect only: it would prevent the Board from prescribing maximum rates at the level dictated by its Stand-Alone-Cost maximum coal rate standard, on a handful of captive coal movements, where the 180% jurisdictional threshold would now exceed the SAC maximum rate level. (Consumers of course fears that its Campbell plant's coal traffic on CSX would fall into that select category.)

This is important. The *National Rail Transportation Policy* includes a number of goals, in addition to rate protection for captive shippers (though all relate, directly or indirectly, to the public interest in a strong rail system for the benefit of shippers). But the acquisition premium issue, notwithstanding the Applicants' histrionics, involves none of those other goals. In particular, the acquisition premium issue does not implicate the policy that favors "allowing rail carriers to earn adequate revenues" (§ 10101(3)), because it will have no effect at all on

the Applicants' ratemaking flexibility, or marketing discretion, or any other aspect of their businesses -- except on that narrow category of rates for which the Board, through its adoption of the Coal Rate Guidelines,[13] has already determined that revenue adequacy objectives must give way to the protection of captive shippers from unreasonable rates.

In short, determinations of the public interest in major mergers typically involve the balancing of many competing public interest considerations. Not so with respect to the acquisition premium issue, however. On that issue, the only impact -- and therefore the only public interest factor to be considered -- is its impact on the maximum reasonable rates that a handful of captive shippers must pay.

The patent unfairness of allowing Applicants to raise the jurisdictional threshold for Consumers' unit train coal rates, through the simple device of writing up Conrail's assets on their books, is highlighted by the fact that Consumers will receive none of the "benefits" claimed to be the products of this transaction. As such, Consumers is being asked to help subsidize NS' and CSX's takeover of Conrail for the benefit of parties other than Consumers.

Clearly recognizing the force of Consumers' cross-subsidization complaint, Applicants go to great lengths to shore up their claim that Consumers will indeed receive benefits from

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[13] *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520 (1985), *aff'd sub nom. Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987).

the acquisition. In particular, they claim that Consumers will benefit from improved single-system transportation of coal from the former Monongahela Railway ("MGA") to Consumers' captive Campbell plant, via CSX, and competitive rail service from MGA origins to Consumers' other coal-fired stations. Consumers' witness Garrity -- the man who has been responsible for planning and optimizing Consumers' fossil fuel supplies for all of its coal-fired generating stations, and who explained clearly and unequivocally that MGA coals can play no meaningful role for Consumers due to air quality and facility design constraints -- is "in error," insists Applicants' witness Sansom, and his "testimony must be rejected." (Applicants' Rebuttal, RVS Sansom, at 37-38.)

The procedures established for this proceeding preclude Consumers' witness Garrity from responding to witness Sansom. Even without such an evidentiary response, however, it is clear that it is witness Sansom who has played fast and loose with the facts -- not Mr. Garrity.[14]

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[14]Note for example witness Sansom's bold assertion, on page 34, that "Consumers gets three benefits from the Transaction." This is, at best, disingenuous; upon closer examination it turns out that the first and second "benefits" are simply retentions of the *status quo*; they are no more "benefits from the transaction" than any other circumstance that is left unchanged. In other words, Dr. Sansom could with equal accuracy -- and irrelevance -- have claimed that "Consumers gets a fourth benefit from the Transaction: it gets to retain ownership of its generating plants."

Dr. Sansom's claimed third benefit from the transaction is CSX access to MGA coals (by which he apparently means second carrier access, since Conrail already had such access). But as

(continued...)

Perhaps the most blatant of Dr. Sansom's misstatements is his assertion, at page 37, that Consumers could indeed use substantial volumes of MGA coal at its Weadock Units 7 and 8 (and by extension, at its other blending units) without violating applicable Michigan air quality restrictions. This assertion, which is the primary basis for his claim that Consumers will benefit from the proposed two-carrier access to the MGA (and that the contrary testimony of Consumers' witness Garrity should be disregarded), rests entirely on a fundamental arithmetic error in Dr. Sansom's "blending" calculations, *to wit*, his mistaken averaging of the blended coals' respective SO_2 levels on the basis of their relative weights rather than their relative contributions to total Btu's. Had he properly weighted each coal's SO_2 output on the basis of its share of output Btu's, he would have seen that his proposed blend of 60% MGA coal and 40% PRB coal would produce 1.747 lbs. of SO_2 per million Btu's -- well above the 1.67 lb. maximum permitted under Michigan air quality controls, just as witness Garrity had said.[15]

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[14](...continued)
explained in Consumers' Comments and in the text above, that is a meaningless benefit because MGA coals cannot play a meaningful role in Consumers' fuel options. So Dr. Sansom's touted three benefits reduce to zero.

[15]If Dr. Sansom's error is not apparent on its face, it is readily shown by calculating total Btu's and total SO_2 produced from his hypothetical coal blend. Thus, assume we blend 400 lbs. of PRB coal with 600 lbs. of MGA coal to produce 1000 lbs. of "Dr. Sansom's Blend." That batch of coal will yield total Btu's and SO_2 calculated as follows:

Heating Value:

(continued...)

* * * *

Consumers respectfully submits that when the Board considers the acquisition premium issue for what it really is, and the narrow effect it really will have in the context of this transaction, the Board must conclude that the acquisition premium should be excluded from the Applicants' rate bases for regulatory costing purposes.[16]

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[15](...continued)

MGA: 600 lbs x 13,200 Btu's/lb. = 7,920,000 Btu's.

PRB: 400 lbs x 8,800 Btu's/lb. = 3,520,000 Btu's.

Total: 1,000 lbs ..... 11,440,000 Btu's.

Sulfur:

MGA: 7,920,000 Btu's x 2.14 lbs./MMBtu = 7.92 x 2.14 = 16.9488 lbs.

PRB: 3,520,000 Btu's x .863 lbs./MMBtu = 3.52 x .863 = 3.03776 lbs.

Total: 16.9488 + 3.0378 = 19.9866 lbs. of SO_2.

$\frac{19.9866 \text{ lbs.}}{11.44 \text{ MMBtu's}}$ = 1.747 lbs./MMBtu of SO_2 from Dr. Sansom's Blend, exceeding the Michigan limit of 1.67.

The same error invalidates Dr. Sansom's other blending calculations.

[16]The same conclusion holds true for revenue adequacy determinations, inasmuch as such determinations, like jurisdictional threshold determinations, can affect only that small portion of railroad traffic that remains subject to STB maximum rate jurisdiction.

C. None of the Applicants' Arguments Can Justify Inclusion of the Acquisition Premium in Their Rate Bases for Revenue Adequacy or Regulatory Costing Purposes.

The Applicants argue at great length that the Board not only may, but must let them write up Conrail's assets for regulatory purposes following the acquisition. This is required, they contend, by applicable Board accounting rules (including the Railroad Accounting Principles Board's "authoritative recommendations") (Applicants' Rebuttal, App. A, at 6-7); by ICC and STB precedents (*Id.* at 8-9); and by the need to let Applicants earn adequate revenues (*Id.* at 10-15). Contrary authority before other agencies is irrelevant, they insist, because railroads are different from other regulated industries: they operate primarily in competitive markets and are not guaranteed any particular rate of return on their assets.

As for harm to captive shippers, "not to worry", Applicants assure us: few if any rates will actually be affected by the premium, anyway. (*Id.* at 23-27.)

Finally, Applicants insist, if a "change" in "existing precedent" regarding inclusion of the acquisition premium is to be made, it should be made in a rulemaking and not in an individual case. It would be unfair, they maintain, for the Board to establish a new exclusion rule applicable only to Applicants, and to do so after they have already purchased Conrail's stock in reliance on their right to include the full price in their rate bases. (*Id.* at 17-18.)

None of these arguments can withstand analysis. Taking them in reverse order,

(1) Rulemaking vs. Adjudication. As discussed *infra*, exclusion of the Conrail asset write-up for regulatory costing purposes will not in fact constitute a change in any clearly-defined past policy, for the simple reason that there is no clearly-defined STB or ICC policy on the ultimate issue. Even if exclusion of the write-up were a change, however, there is no rule of law that requires such policy changes to be made only in rulemakings and not in individual adjudications. *See, e.g., Atchison, Topeka & Santa Fe Ry. v. Wichita B. of Trade*, 412 U.S. 800, 809 (1973). To the contrary, all that is required, in either context, is that the Board articulate a reasoned basis for its decision -- and a reasoned basis for departing from its prior positions, if that is what it is doing. (*Id.*)[17] Consumers submits that the enormous size and consequent impact of the Conrail acquisition premium, which makes this case unlike any that has come before -- coupled with the fact that the issue has been squarely and forcefully presented by the parties -- is ample

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[17]Nor, in this context, is there any merit to Applicants' implied "detrimental reliance" argument. It will be recalled that the acquisition premium issue was forcefully raised by shipper groups in the spring of 1997, before Applicants had completed their merger agreements, and well before NS and CSX elected to consummate their tender offers and purchase Conrail's stock for $115 a share. Plainly, Applicants went forward with that purchase with their eyes open, having made a calculated decision to take the risk that the Board might ultimately rule against them on the asset write-up issue.

justification for the Board's rejection of the asset write-up in this case, rather than in a separate rulemaking proceeding.

(2) Paucity of Affected Shippers. Applicants argue at some length that opponents of the asset write-up overstate the importance of the issue -- that opponents' calculations of the write-up's impact on jurisdictional threshold calculations ignore revenue improvements and cost savings from the merger, and that few if any shippers will actually see any impact in their maximum rates as a result of the write-up. Therefore, Applicants seem to be arguing, the problem is not significant enough to require Board action.

In fact the small size of the shipper group affected by the asset write-up issue is a reason for granting relief, not for withholding it. This is so because, as explained *supra*, affording this small class of shippers the protection they (we) seek will have no discernable impact on the Applicants' financial health, or on their ability to enjoy the benefits of their transaction. Stated differently, the Board can protect captive shippers' access to maximum rate protection without eroding any of the perceived public benefits of the proposed transaction. This is a rare "freebie" for the Board: for once, no balancing of competing interests is required.

However, Applicants' arguments regarding Consumers' failure to consider merger-created revenue improvements and cost savings cannot be allowed to pass without a brief rejoinder. Applicants argue that the financial underpinnings of the Corrail

acquisition are the enormous revenue increases they anticipate receiving from the diversion of truck traffic to intermodal rail service as a result of the merger, together with cost savings from consolidations and elimination of duplicate functions, etc. These fruits of the merger will cover the cost of the acquisition premium, they maintain, and obviate any need to increase rates on captive traffic. More to the point, they argue that Consumers' witness Crowley, by ignoring these revenue improvements and cost savings, has greatly overstated the acquisition premium's impact on variable costs -- and hence on the jurisdictional threshold.[18]

Consumers, like most of the shipper community, is extremely skeptical about the Applicants' chances of actually seeing the revenue increases they so blithely predict. We wish them well, of course; if their predictions are borne out it will

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[18]Applicants' rebuttal witness Whitehurst ("RVS Whitehurst") claims, without quantification, that projected revenue increases and anticipated merger-related cost savings would indeed affect Applicants' variable costs. Revenue increases (or more accurately, the traffic increases that produce them) would "affect both URCS variability percents and resulting URCS unit costs," he argues (*Id.* at 31), whereas projected reductions in operating expenses would similarly translate into reduced URCS variable costs.

Mr. Whitehurst's arguments are without merit. Volume increases will by definition be deemed to affect <u>total</u> variable costs, but not <u>unit</u> variable costs, since the URCS cost functions are linear. Similarly, the operating cost savings will apparently come primarily from a reduction in switching operations, etc., that have essentially no bearing on the variable costs of unit train coal movements. The impact of such cost savings on the traffic actually involved may be significant, but there is unlikely to be any ripple effect on the perceived variable costs of other, unaffected traffic, such as unit train operations.

-- Fourth, there can be no legitimate dispute that permitting the $9.5+ billion asset write-up planned by Applicants will raise the 180% jurisdictional threshold on Consumers' captive coal traffic, and that of other similarly-situated captive shippers, by a significant amount. Applicants have quibbled with Consumers' calculations in this regard, but they have been unable to refute that fundamental fact, and it is perhaps most telling that they have studiously refrained from making a no-increase pledge as to the 180% threshold.

-- Finally, there is no dispute that the valuation of Conrail's assets following the acquisition -- that is, whether the acquisition premium write-up is allowed or rejected -- will have no effect on the revenues Applicants can earn on the overwhelming preponderance of their traffic. Indeed, Consumers agrees with Applicants that the only rates that can possibly be affected by the Board's ruling on this issue are the handful of rates on traffic that meets all of the following conditions:

(a) the traffic is not covered by a contract;

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[9](...continued)
See CE Comments, Verified Statement of Alfred E. Kahn and Frederick C. Dunbar ("VS Kahn"), at 16-17.

Applicants deny that the "fatal circularity" principle applies to railroads; we address that issue *infra*. For present purposes, however, it is worth noting that Applicants offer no explanation as to why the *Williams* principle -- that a change in ownership cannot justify a change in rates when the service itself remains unchanged -- should not apply to railroads.

(b) the traffic is qualitatively market dominant (most rail traffic, including all of the traffic Applicants claim they will wean away from trucks or other railroads, is competitive); and

(c) most importantly, the maximum reasonable rate that the Board would prescribe under the "stand alone cost" standard, but for the 180% jurisdictional threshold, is below the 180% jurisdictional threshold that would result from inclusion of Applicants' proposed asset write-ups in their rate bases. While Consumers does not share Applicants' view that such cases are aberrations, we do agree that they constitute a very small universe.

Where Consumers most definitely parts company with Applicants, is on the implications of the foregoing propositions for the Board's ultimate decision in this proceeding. We now turn to those implications.

II. THE PROPOSED CONRAIL ACQUISITION IS CONTRARY TO THE PUBLIC INTEREST UNLESS CONDITIONED ON EXCLUSION OF THE ACQUISITION PREMIUM FROM APPLICANTS' RATE BASES FOR REVENUE ADEQUACY AND REGULATORY COSTING PURPOSES.

A. Preface - The Fundamental Purpose of Railroad Regulation.

A unifying thread that runs throughout the long history of railroad regulation in the United States has been the need to protect rail-dependent shippers against abusive treatment by the

railroads that serve them. The Interstate Commerce Commission was created as an instrument to provide such protection one hundred and eleven years ago;[10] the STB survives today as its successor because Congress recognized that the need for such protection has not disappeared completely.[11]

To be sure, most rail traffic today is subject to intermodal competition to some degree, and the scope of required regulatory protection has been correspondingly scaled back. However, for that residuum of traffic that remains rail-dependent and relatively price-inelastic, such as unit train coal traffic, the need for regulation persists, and justifies the Board's continued existence.[12]

This common thread of shipper protection finds cogent expression in the National Rail Transportation Policy that Congress ordained as a fundamental guide for all of the Board's deliberations, including railroad mergers (*see UP/CNW, supra* at 53-54, *citing, Norfolk Southern Corp. - Control - Norfolk & W. Ry. Co.*, 366 I.C.C. 171, 190 (1982)). Specifically, the Rail Transportation Policy admonishes the Board *inter alia* --

> (6) to maintain reasonable rates where there is an absence of effective competition...; [and]

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[10]1 I.L. Sharfman, *The Interstate Commerce Commission*, at 14-19 (1931); S. Rep. No. 104-176, at 2 (1995).

[11]141 *Cong. Rec.* S19074-S10975 (daily ed. December 21, 1995) (statements of Sen. Hollings, Exon, and Pressler); S. Rep. No. 104-176, at 6-8 (1995); H.R. Conf. Rep. No. 104-422, at 4 (1985).

[12]S. Rep. No. 104-176, at 7, 18 (1995).

> (12) to prohibit predatory pricing and practices, to avoid undue concentrations of market power, and prohibit unlawful discrimination.

49 U.S.C. §§ 10101(6), (12) (emphasis added).

As we shall see, these shipper-protection principles are of particular relevance to the acquisition premium issue.

B. Acceptance of the Acquisition Premium Write-Up Would Sanction Unreasonable Coal Rates, In Violation of the Board's Coal Rate Guidelines.

As noted above, the Applicants' proposed write-up of Conrail's assets to reflect the acquisition premium would have one clear regulatory effect, and one effect only: it would prevent the Board from prescribing maximum rates at the level dictated by its Stand-Alone-Cost maximum coal rate standard, on a handful of captive coal movements, where the 180% jurisdictional threshold would now exceed the SAC maximum rate level. (Consumers of course fears that its Campbell plant's coal traffic on CSX would fall into that select category.)

This is important. The *National Rail Transportation Policy* includes a number of goals, in addition to rate protection for captive shippers (though all relate, directly or indirectly, to the public interest in a strong rail system for the benefit of shippers). But the acquisition premium issue, notwithstanding the Applicants' histrionics, involves none of those other goals. In particular, the acquisition premium issue does not implicate the policy that favors "allowing rail carriers to earn adequate revenues" (§ 10101(3)), because it will have no effect at all on

the Applicants' ratemaking flexibility, or marketing discretion, or any other aspect of their businesses -- except on that narrow category of rates for which the Board, through its adoption of the Coal Rate Guidelines,[13] has already determined that revenue adequacy objectives must give way to the protection of captive shippers from unreasonable rates.

In short, determinations of the public interest in major mergers typically involve the balancing of many competing public interest considerations. Not so with respect to the acquisition premium issue, however. On that issue, the only impact -- and therefore the only public interest factor to be considered -- is its impact on the maximum reasonable rates that a handful of captive shippers must pay.

The patent unfairness of allowing Applicants to raise the jurisdictional threshold for Consumers' unit train coal rates, through the simple device of writing up Conrail's assets on their books, is highlighted by the fact that Consumers will receive none of the "benefits" claimed to be the products of this transaction. As such, Consumers is being asked to help subsidize NS' and CSX's takeover of Conrail for the benefit of parties other than Consumers.

Clearly recognizing the force of Consumers' cross-subsidization complaint, Applicants go to great lengths to shore up their claim that Consumers will indeed receive benefits from

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[13] *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520 (1985), *aff'd sub nom. Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987).

the acquisition. In particular, they claim that Consumers will benefit from improved single-system transportation of coal from the former Monongahela Railway ("MGA") to Consumers' captive Campbell plant, via CSX, and competitive rail service from MGA origins to Consumers' other coal-fired stations. Consumers' witness Garrity -- the man who has been responsible for planning and optimizing Consumers' fossil fuel supplies for all of its coal-fired generating stations, and who explained clearly and unequivocally that MGA coals can play no meaningful role for Consumers due to air quality and facility design constraints -- is "in error," insists Applicants' witness Sansom, and his "testimony must be rejected." (Applicants' Rebuttal, RVS Sansom, at 37-38.)

The procedures established for this proceeding preclude Consumers' witness Garrity from responding to witness Sansom. Even without such an evidentiary response, however, it is clear that it is witness Sansom who has played fast and loose with the facts -- not Mr. Garrity.[14]

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[14]Note for example witness Sansom's bold assertion, on page 34, that "Consumers gets three benefits from the Transaction." This is, at best, disingenuous; upon closer examination it turns out that the first and second "benefits" are simply retentions of the *status quo*; they are no more "benefits from the transaction" than any other circumstance that is left unchanged. In other words, Dr. Sansom could with equal accuracy -- and irrelevance -- have claimed that "Consumers gets a fourth benefit from the Transaction: it gets to retain ownership of its generating plants."

Dr. Sansom's claimed third benefit from the transaction is CSX access to MGA coals (by which he apparently means second carrier access, since Conrail already had such access). But as

(continued...)

Perhaps the most blatant of Dr. Sansom's misstatements is his assertion, at page 37, that Consumers could indeed use substantial volumes of MGA coal at its Weadock Units 7 and 8 (and by extension, at its other blending units) without violating applicable Michigan air quality restrictions. This assertion, which is the primary basis for his claim that Consumers will benefit from the proposed two-carrier access to the MGA (and that the contrary testimony of Consumers' witness Garrity should be disregarded), rests entirely on a fundamental arithmetic error in Dr. Sansom's "blending" calculations, *to wit*, his mistaken averaging of the blended coals' respective SO_2 levels on the basis of their relative weights rather than their relative contributions to total Btu's. Had he properly weighted each coal's SO_2 output on the basis of its share of output Btu's, he would have seen that his proposed blend of 60% MGA coal and 40% PRB coal would produce 1.747 lbs. of SO_2 per million Btu's -- well above the 1.67 lb. maximum permitted under Michigan air quality controls, just as witness Garrity had said.[15]

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[14](...continued)
explained in Consumers' Comments and in the text above, that is a meaningless benefit because MGA coals cannot play a meaningful role in Consumers' fuel options. So Dr. Sansom's touted three benefits reduce to zero.

[15]If Dr. Sansom's error is not apparent on its face, it is readily shown by calculating total Btu's and total SO_2 produced from his hypothetical coal blend. Thus, assume we blend 400 lbs. of PRB coal with 600 lbs. of MGA coal to produce 1000 lbs. of "Dr. Sansom's Blend." That batch of coal will yield total Btu's and SO_2 calculated as follows:

Heating Value:

(continued...)

* * * *

Consumers respectfully submits that when the Board considers the acquisition premium issue for what it really is, and the narrow effect it really will have in the context of this transaction, the Board must conclude that the acquisition premium should be excluded from the Applicants' rate bases for regulatory costing purposes.[16]

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[15](...continued)

MGA: 600 lbs x 13,200 Btu's/lb. = 7,920,000 Btu's.

PRB: 400 lbs x 8,800 Btu's/lb. = 3,520,000 Btu's.

Total: 1,000 lbs ..... 11,440,000 Btu's.

Sulfur:

MGA: 7,920,000 Btu's x 2.14 lbs./MMBtu = 7.92 x 2.14 = 16.9488 lbs.

PRB: 3,520,000 Btu's x .863 lbs./MMBtu = 3.52 x .863 = 3.03776 lbs.

Total: 16.9488 + 3.0378 = 19.9866 lbs. of SO_2.

$\frac{19.9866 \text{ lbs.}}{11.44 \text{ MMBtu's}}$ = 1.747 lbs./MMBtu of SO_2 from Dr. Sansom's Blend, exceeding the Michigan limit of 1.67.

The same error invalidates Dr. Sansom's other blending calculations.

[16]The same conclusion holds true for revenue adequacy determinations, inasmuch as such determinations, like jurisdictional threshold determinations, can affect only that small portion of railroad traffic that remains subject to STB maximum rate jurisdiction.

C. None of the Applicants' Arguments Can Justify Inclusion of the Acquisition Premium in Their Rate Bases for Revenue Adequacy or Regulatory Costing Purposes.

The Applicants argue at great length that the Board not only may, but must let them write up Conrail's assets for regulatory purposes following the acquisition. This is required, they contend, by applicable Board accounting rules (including the Railroad Accounting Principles Board's "authoritative recommendations") (Applicants' Rebuttal, App. A, at 6-7); by ICC and STB precedents (*Id.* at 8-9); and by the need to let Applicants earn adequate revenues (*Id.* at 10-15). Contrary authority before other agencies is irrelevant, they insist, because railroads are different from other regulated industries: they operate primarily in competitive markets and are not guaranteed any particular rate of return on their assets.

As for harm to captive shippers, "not to worry", Applicants assure us: few if any rates will actually be affected by the premium, anyway. (*Id.* at 23-27.)

Finally, Applicants insist, if a "change" in "existing precedent" regarding inclusion of the acquisition premium is to be made, it should be made in a rulemaking and not in an individual case. It would be unfair, they maintain, for the Board to establish a new exclusion rule applicable only to Applicants, and to do so after they have already purchased Conrail's stock in reliance on their right to include the full price in their rate bases. (*Id.* at 17-18.)

None of these arguments can withstand analysis. Taking them in reverse order,

(1) Rulemaking vs. Adjudication. As discussed *infra*, exclusion of the Conrail asset write-up for regulatory costing purposes will not in fact constitute a change in any clearly-defined past policy, for the simple reason that there is no clearly-defined STB or ICC policy on the ultimate issue. Even if exclusion of the write-up were a change, however, there is no rule of law that requires such policy changes to be made only in rulemakings and not in individual adjudications. *See, e.g., Atchison, Topeka & Santa Fe Ry. v. Wichita B. of Trade*, 412 U.S. 800, 809 (1973). To the contrary, all that is required, in either context, is that the Board articulate a reasoned basis for its decision -- and a reasoned basis for departing from its prior positions, if that is what it is doing. (*Id.*)[17] Consumers submits that the enormous size and consequent impact of the Conrail acquisition premium, which makes this case unlike any that has come before -- coupled with the fact that the issue has been squarely and forcefully presented by the parties -- is ample

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acquisition are the enormous revenue increases they anticipate receiving from the diversion of truck traffic to intermodal rail service as a result of the merger, together with cost savings from consolidations and elimination of duplicate functions, etc. These fruits of the merger will cover the cost of the acquisition premium, they maintain, and obviate any need to increase rates on captive traffic. More to the point, they argue that Consumers' witness Crowley, by ignoring these revenue improvements and cost savings, has greatly overstated the acquisition premium's impact on variable costs -- and hence on the jurisdictional threshold.[18]

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Mr. Whitehurst's arguments are without merit. Volume increases will by definition be deemed to affect <u>total</u> variable costs, but not <u>unit</u> variable costs, since the URCS cost functions are linear. Similarly, the operating cost savings will apparently come primarily from a reduction in switching operations, etc., that have essentially no bearing on the variable costs of unit train coal movements. The impact of such cost savings on the traffic actually involved may be significant, but there is unlikely to be any ripple effect on the perceived variable costs of other, unaffected traffic, such as unit train operations.

indeed benefit their financial health, and reduce the pressure on them to increase captive shippers' rates. But such revenues would logically have no effect on Applicants' variable costs, and hence no effect on the jurisdictional threshold; *see* footnote 18, *supra*.

The same holds true for Applicants' projected cost savings. For the most part those savings will be limited to switching and other terminal operations affecting general merchandise and intermodal traffic, especially interline traffic. As such, they will not have any significant impact on the jurisdictional threshold for captive unit train coal movements. (*Id.*)

(3) Asserted Irrelevance of Other Agencies' Rulings. In its Comments, Consumers pointed out the long line of legal and economic authority requiring the use of predecessor costs for regulatory purposes when one utility acquires another. *See, e.g., Federal Power Comm'n v. Hope Natural Gas Co., supra* note 9; *Farmers Union, supra*, 734 F.2d at 1528 (an oil pipeline attempted to include acquisition costs in its rate base and was prohibited from doing so); *Transcontinental Gas Pipe Line Corp. v. FERC*, 652 F.2d 179, 180 (D.C. Cir. 1981). *See also Montana Power Co. v. FERC*, 599 F.2d 295, 300 (9th Cir. 1979) ("[t]he original cost method has been applied to property acquisitions by utilities to prevent utilities from artificially inflating their rate bases by acquiring properties at unrealistically high prices"). *See also* VS Kahn at 18.

Applicants' response can best be described as "circling the wagons." Use of predecessor costs may be fine and good for other regulated industries, they insist, but not for railroads. (Applicants' Rebuttal, App. A, at 16.) Reciting the time-honored mantra of revenue adequacy, Applicants and their hired experts argue fervently that railroads must be allowed to earn a competitive return on the current value of their investments, or else new investment will dry up (*Id.* at 11-13); and merging carriers must be able to do the same on whatever they pay for acquired carriers, or else mergers will be discouraged (*Id.* at 14-15).[19]

Nonsense! As Applicants themselves acknowledge elsewhere in their argument, rejection of their attempted write-up of Conrail's assets will have no effect on the rates they can and will charge on the overwhelming majority of their traffic, and hence can have no significant effect on their ability to recover "adequate revenues," however they choose to define them. In particular, it will have no effect whatsoever on their ability to

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[19]Applicants characterize the Board's use of a "depreciated historical cost" rate base for regulatory purposes as an "administrative convenience," and argue that such use should not prevent substitution of "more reliable measures of current value" when they are available. (*Id.* at 12.)

This characterization is at best a half-truth. The Railroad Accounting Principles Board did indeed opt for retention of an original (or "historical") cost rate base -- with the associated cost-of-capit l return computed on a nominal, inflation-augmented basis -- in preference to use of a "current" cost rate base with associated "real" (zero inflation) return, in part for reasons of administrative feasibility. But what Applicants are pressing for is a "mix and match" option: use of a rate base re-calibrated to include price level increases, together with continued use of a nominal cost-of-capital return, thereby double counting inflation.

obtain 100% of the additional revenues and cost savings they have projected in their Application, and which they claim will pay for the entire acquisition premium. To reiterate, rejection of the acquisition premium write-up will only affect what Applicants can charge on those few captive movements for which the Board's own maximum rate standards would, jurisdiction permitting, prescribe a maximum rate below the write-up-augmented 180% threshold. Indeed, if Applicants are to be believed, no traffic would fall into this category; if so, then rejecting the write-up as a condition on the merger would have no real-world effect at all.

It is time for the Board to take a good, hard look at the acquisition premium, and for all the reasons set forth herein, to reject it.

(4) Alleged Binding Effect of GAAP, and of RAPB and ICC/STB Precedents.

But, Applicants insist, (a) "generally accepted accounting principles" ("GAAP") require that assets acquired in a merger accounted for as a purchase rather than a pooling be recorded at acquisition cost rather than predecessor cost; (b) the Board and its predecessor the ICC are required to conform their Uniform System of Accounts for Railroads with GAAP; and (c) the RAPB, the ICC, and now the STB have already considered all the arguments on the choice of acquisition costs versus predecessor costs for railroads, and have come down squarely on the side of acquisition costs. (Applicants' Rebuttal, App. A, at 6-10.)

Again, there is considerably less to Applicants' arguments than meets the eye. GAAP is, after all, a system of

accounting rules, not regulatory policies. The RAPB recognized this distinction, and made it clear that although it generally preferred use of acquisition costs for railroad mergers as an accounting matter, the ICC retained the discretion to use "another measure, such as predecessor cost" for particular situations if it concluded that "GAAP cost does not produce meaningful regulatory results" in those situations. *Railroad Accounting Principles--Final Report*, vol. 2, at 40 (1987). In this regard it is noteworthy that the ICC had previously been criticized by the courts for ignoring the distinction between accounting methodologies and regulatory principles, *see Farmers Union Central Exchange v. United States*, 584 F.2d 408, 420 (DC Cir.), *cert. denied sub nom. Williams Pipeline Co. v. FERC*, 439 U.S. 995 (1978) ("Once again, we cannot countenance the ICC's current unexplained insistence on irrevocably hitching its ratemaking theory to its accounting rules"); *cf. Williams Pipeline, supra*, at 61,135. In short, GAAP, *per se*, does not bar the Board's rejection of the Applicants' proposed write-up of Conrail assets.

Nor do the past ICC decisions cited by Applicants, which as they admit all involved recognition of asset write-downs for revenue adequacy purposes where acquisition costs were lower than predecessor costs, constitute determinations -- reasoned or otherwise -- regarding how asset write-ups based on higher acquisition costs should be treated for purposes of the jurisdictional threshold in maximum rate cases. It was not unreasonable for the ICC to conclude in those cases that when Railroad "A"

purchased Railroad "B" for less than Railroad B's book value, it did not need to earn a return on predecessor book value amounts that it had never actually paid, in order to be earning a fair return. That was common sense. It is not common sense, and it certainly does not follow, that if Railroad A purchases Railroad B for more than Railroad B's book value, it should on that basis be able to turn to Railroad B's captive shippers and force them to help finance its purchase by increasing their rates above what Railroad B was allowed to charge them.[20] Neither the ICC nor the STB has, to Consumers' knowledge, ever so held. Yet, this is precisely what Applicants are now proposing, however much they might seek to divert the Board's attention from that fact.

III. NS TRACKAGE RIGHTS TO SERVE CONSUMERS' CAMPBELL PLANT ARE THE ONLY PRACTICABLE CONDITION THAT CAN OFFSET TO SOME DEGREE THE ACQUISITION'S ADVERSE EFFECT ON COMPETITION FOR CONSUMERS' OTHER COAL TRAFFIC.

In addition to rejection of the acquisition premium, Consumers requested in its Comments that the Board impose trackage rights over 36 miles of CSX lines from Grand Rapids to its Campbell plant, in favor of NS, as a condition on its approval of the merger.

In their Rebuttal, Applicants lambast Consumers' trackage rights condition. They note that the Campbell plant is

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[20]Recall that maximum rates under the STB's *Coal Rate Guidelines* already include a return on the current market value of required assets. Every time a rate must be set at a level higher than this level, due to the jurisdictional threshold, the affected shipper is being forced to pay more than a fair return on all of the assets required to serve him -- by definition.

captive to CSX now, and that the proposed transaction will not change that situation. Pointing out that the ICC and STB have been careful to impose only conditions that preserve what competition there already is, and not conditions designed to put a shipper in a better competitive position, they assert that Consumers' trackage rights condition request fails this test, and must therefore be rejected.

Applicants are wrong, for two (2) reasons.

First, Applicants' analysis of this issue implicitly treats Campbell as if it were Consumers' only coal-fired generating station. But it is not. As summarized *supra* at 2-5, Consumers' evidence demonstrated that as to its other coal plants, Conrail is presently a competitive alternative of some significance, and as such serves to limit CSX's dominance over Consumers' coal shipments. Consumers further showed that although NS is in theory going to step into Conrail's shoes as that competitive alternative, it cannot be expected to have the same competitive intensity that Conrail did, if only because the success of its coal marketing department will not turn on how aggressively it promotes movements of its tributary coals (including those on former Conrail lines) to Great Lakes destinations.

While the prospect of having NS rather than Conrail as the only competitive check on CSX is disquieting to Consumers, we understand that there is nothing the Board can do (short of outright rejecting the Application) to prevent that from happen-

ing; the Board plainly cannot order NS to compete more aggressively than it is prepared to do in its own interests.

What the Board can do, however, at least in Consumers' case, is mete out a rough equivalent of preserving Conrail's competitive drive: it can allow NS to have access to the Campbell plant. From Consumers' perspective, this would put it almost (but not quite) in as good a position as it is today: it would suffer an unfortunate diminution in competition for the one-half of its coal traffic that moves to Karn-Weadock, Whiting, and Cobb, but it would gain some competition for a portion of the other half of its coal traffic, which moves to Campbell.

To summarize, if it were up to Consumers it would have the Board preserve the *status quo* totally, by rejecting the Conrail Acquisition outright. The second-best alternative, from Consumers' standpoint, would be trackage rights for NS to serve Campbell, to compensate in part for the reduction of competition at its other coal-fired facilities.

Second, and more generally, granting NS the right to serve Consumers' Campbell plant would be the most direct and effective means of protecting Consumers from rail market power abuse on its Campbell coal traffic. The requested rights would ameliorate the harmful effects of the consolidation, by neutralizing Consumers' present and future captivity to CSX. The rights are operationally feasible, as no additional traffic would move over the subject lines that was not offset by a commensurate

reduction in traffic on alternative lines, and existing facilities are adequate to handle Consumers' coal trains.

Finally, the trackage rights would produce positive public benefits in the form of an enhancement of competition and adequate rail service, without an adverse impact on the purported public benefits which Applicants tout. As the Board has held previously, the ability to raise rates on captive traffic is not a public benefit cognizable in evaluating a proposed consolidation. *See UP/CNW, supra* at 53.

CONCLUSION

For the reasons set forth in Consumers' evidence and argument filed October 21, 1997, and summarized in Part II, above, if the Board decides to approve the NS/CSX takeover of Conrail, it should condition that approval on the exclusion of any write-up of Conrail assets from NS' and CSX's rate bases for revenue adequacy and regulatory costing purposes, including specifically calculations of the 180% jurisdictional threshold for maximum rate regulation on captive traffic.

For the reasons set forth in Consumers' October 21 filing and as summarized in Part III, above, the Board should condition any approval of the Application on CSX's agreement to grant NS trackage rights from Grand Rapids, MI to Consumers' Campbell generating station, a distance of about 36 miles, to compensate for the acquisition-caused loss of competition threatened at Consumers' other three plants.

Respectfully submitted,

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ORIGINAL

APL-18

PUBLIC

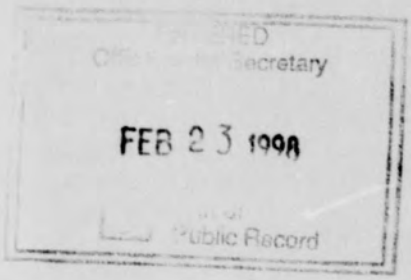
BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 33388

CSX CORPORATION AND CSX TRANSPORTATION, INC.
NORFOLK SOUTHERN CORPORATION AND
NORFOLK SOUTHERN RAILWAY COMPANY
--CONTROL AND OPERATING LEASES/AGREEMENTS--
CONRAIL INC. AND CONSOLIDATED RAIL CORPORATION

BRIEF OF APL LIMITED

VOLUME 1



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Dated: February 23, 1998

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 33388

CSX CORPORATION AND CSX TRANSPORTATION, INC.
NORFOLK SOUTHERN CORPORATION AND
NORFOLK SOUTHERN RAILWAY COMPANY
--CONTROL AND OPERATING LEASES/AGREEMENTS--
CONRAIL INC. AND CONSOLIDATED RAIL CORPORATION

BRIEF OF APL LIMITED

SUMMARY OF APL LIMITED'S POSITION AND REQUESTED RELIEF

APL Limited ("APL"), pursuant to Decision No. 12 in this proceeding and the Surface Transportation Board's (the "Board" or "STB") Railroad Consolidation Procedures at 49 C.F.R. Part 1180, hereby submits its Brief and requests that the Board hold Applicants[1] to their claims of increased competition and cooperation with shippers by: (1) disapproving Section 2.2(c) of the Transaction Agreement (referred to hereafter as "Section 2.2(c)") between Applicants[2]; and (2) disapproving Applicants' request for relief (1)c. that non-assignment clauses in Rail Transportation Contracts[3] between Conrail and its shippers be

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[1] Applicants are CSX Corporation ("CSXC"), CSX Transportation, Inc. ("CSXT") (both referred to as "CSX"), Norfolk Southern Corporation, Norfolk Southern Railway Company ("NSR") (both referred to as "NS"), Conrail Inc., Consolidated Rail Corporation, and CRR Holdings LLC (all three referred to as "Conrail"), collectively referred to as "Applicants."

[2] Railroad Control Application, Volume 8B, CSX/NS-25 (referred to as "CSX/NS-25/8B"), the Transaction Agreement, pages 25-29.

[3] APL shall define a Rail Transportation Contract as the Applicants do in section 1.1 of the Transaction Agreement as a contract between rail carrier(s) and a person or persons relating to the purchase of transportation services as specified in 49 U.S.C. § 10102(9)(A) and (B). *See* CSX/NS-25/8B, page 23.

abrogated.[4] The Board should not countenance the Applicants' attempt to breach the sanctity of Rail Transportation Contracts. There are a number of reasons that compel this result.

APL and Conrail voluntarily negotiated and entered into a Rail Transportation Contract on June 1, 1988 with a term lasting until May 31, 2004 (the "APL-Conrail Contract").[5] As a result of the proposed transaction, APL should not be placed in a worse position than it is today. Hence, the contract between APL and Conrail must establish the baseline of APL's rights and the railroads' obligations. To retain the benefit of the bargain it struck with Conrail, APL must be allowed to negotiate separately with CSX and NS prior to the division of the APL-Conrail Contract between CSX and NS to determine which of the two railroads will provide the service APL requires to "Dual" points[6] and will receive the revenues for that service. Moreover, Section 17 of the APL-Conrail Contract requires negotiation between the parties of any gross inequities resulting from a substantial change in circumstances or conditions.[7] Under Section 17, the control of one railroad (Conrail) by two railroads (CSX and NS), particularly in light of CSX's competitive position vis-à-vis APL, is a change of circumstance or condition requiring resolution through good faith negotiation between APL and CSX and APL and NS. Good faith negotiation under Section 17 cannot be accomplished unless Section 2.2(c) and the request to void the anti-assignment provision are disapproved.

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[4] Railroad Control Application, Volume 1, CSX/NS-18 (referred to as "CSX/NS-18"), pages 102-103.

[5] Applicants' Rebuttal, Volume 3D, CSX/NS-178 (referred to as "CSX/NS-178/3D"), page 205.

[6] "Dual" points are defined in the Transaction Agreement as "a station with line-haul service by both...." CSX/NS-25/8B, page 25, Section 2.2(c)(iii)(A).

[7] In discovery, APL agreed with Applicants not to produce the APL-Conrail Contract. Instead, APL provided the contract to Applicants on an informal basis and classified the entire APL-Conrail Contract as Highly Confidential. Because the Inequities Section and the Assignment Section of the contract do not contain specific commercial terms regarding the rates to be paid by APL and the service to be provided by Conrail, APL is declassifying these two sections for ease of reference by APL in this brief and for ease of reference by the Board in its decision because APL believes that these two sections represent the clearest of example of the substantial harm that will occur if the Board uses 49 U.S.C. § 11321 to preempt contracts entered under 49 U.S.C. § 10709. APL specifically preserves the Highly Confidential classification as it relates to the remainder of the APL-Conrail Contract.

Applicants have touted the competition which will be created by this transaction; like some of its competitors who may have no contract or short term contracts with Conrail, APL wants to participate in that competition, not be locked into terms negotiated under entirely different circumstances for years to come. This is especially true in APL's most important traffic lane between Chicago and nortnern New Jersey where Conrail handled over 91,000 containers under the APL-Conrail Contract for APL in 1996.[8]

By granting the relief sought by APL for traffic moving under Rail Transportation Contracts, the Board will indeed "create...competition between two Class I railroads capable of providing single-line service between the Port of New York/New Jersey and Chicago..."[9] and will "bring about a blossoming of rail competition, the likes of which the Northeast has not experienced in decades."[10]

There is another compelling reason to grant APL's request. The entire history of 49 U.S.C. §10709 ("Section 10709") points to the sanctity of contracts between railroads and shippers[11] and the Board's lack of jurisdiction over those contracts.[12] Section 2.2(c) flies in the face of Congress' avowed purpose of removing contracts from the Board's jurisdiction. "Once a contract...goes into effect..., the service provided under the contract is exempt...from all regulation and all of the requirements of the Interstate Commerce Act." H. Rept. 96-1430, 96th Cong., 2d sess. 100 (1980) (the "Staggers Act Conference Report"). Neither the Interstate Commerce Commission (the "Commission" or "ICC," the predecessor agency to the

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[8] Applicants' Rebuttal, Volume 3A, CSX/NS-178 (referred to as "CSX/NS-178/3A"), page 311.
[9] CSX/NS-18, Verified Statement of John W. Snow (referred to as "Snow VS"), page 316.
[10] CSX/NS-18, Verified Statement of David R. Goode (referred to as "Goode VS"), page 323.
[11] *See*, Interstate Commerce Commission 1983 Annual Report, page 31, where it said "Once approved, a contract removes the subject traffic from further Commission regulation.... Contracts have proven to be an easy mechanism for coordination of railroad services with shipper needs without regulatory oversight. They have been particularly effective in facilitating intermodal movements, such as ocean exports...."
[12] Unless otherwise specified, when APL refers to Section 10709, it also includes former 49 U.S.C. § 10713.

Board) nor the Board has ever attempted to modify an effective contract without the shipper's agreement.[13] The Board should not begin now.

Moreover, there is no necessity for the Board to take this road. Competitors CSXT and NSR need not meet behind locked doors to decide between themselves which railroad will handle which traffic without any shipper input. There is time -- at least the same time the two railroads have already set aside for the allocation process after the Control Date -- to talk to shippers. By negotiating with the shippers, the railroads could determine the resources needed to meet the contract requirements (which include equipment, manpower, yards, etc.) and prepare their operating plans. Perhaps most importantly from APL's perspective, negotiations would begin the process of building a cooperative relationship between CSX and APL, who up until this time have dealt with each other as competitors instead of partners.[14] Indeed, there is no reason why CSX and NS cannot negotiate now with APL under appropriate confidentiality agreements negotiated between APL and CSX and APL and NS.

Without the relief sought, APL has demonstrated in a variety of ways that Section 2.2(c) is not consistent with the public interest because APL will receive inadequate transportation under the criterion of 49 U.S.C. § 11324(b)(1). For that reason as well, the requested relief should be granted. The Board should disapprove Section 2.2(c) for one other very important reason. Section 2.2(c) is clearly anticompetitive as to all current holders of Conrail Rail Transportation Contracts because it requires two competitors to divide up markets.[15] Section 2.2(c) will therefore have an adverse effect on competition, one of the key

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[13] *See* STB Finance Docket No. 32760, *Union Pacific Corporation, Union Pacific Railroad Company, and Missouri Pacific Railroad Company--Control and Merger--Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway company, SPCSL Corp., and The Denver and Rio Grande Western Railroad Company* (not printed), served November 20, 1996, Decision No. 57, at 5. Other decisions in that proceeding will be cited as "*UP/SP Decision No. __*."

[14] APL has established a very good relationship with NS, the railroad that serves APL in the southeastern United States.

[15] The partition of Rail Transportation Contracts traffic is provided for in Section 2.2(c)(ii, iii, and iv).

factors that the Board must consider under 49 U.S.C. § 11324(b)(5). Since there is no necessity to engage in such anticompetitive behavior, it should not be allowed.

The relief sought by APL would not change the structure of the transaction proposed by Applicants. By striking Section 2.2(c) and refusing to approve the novation of the anti-assignment provision, the Board would allow the APL-Conrail Contract to remain in full force and effect, which would require CSX and NS to sit down separately with APL (and any other shipper in like circumstances) to negotiate APL's rail service needs. APL would be able to determine which railroad (or possibly both) will handle which of APL's shipments moving today between Dual points under the APL-Conrail Contract and would be able to deal with the changed circumstances. The proposed transaction would be able to move forward.

In summary, Applicants' proposals for handling contract traffic are not consistent with the public interest, are contrary to law, and are not necessary for the implementation of the proposed transaction.[16]

BACKGROUND

APL filed a notice of intent to participate in this proceeding on August 5, 1997, APL-1, and filed a Response and Request for Conditions on October 21, 1997, APL-4 (the "Response"). The Response included verified statements from Mr. Timothy J. Rhein, APL's President and Chief Executive Officer (cited as "Rhein VS"), Mr. Alan C. Courtney, Director of Customer Processes for the Stacktrain Services Group of APL Land Transport Services, Inc. ("APL Land Transport"), a subsidiary of APL (cited as "Courtney VS"), Mr. Peter K. Baumhefner, Director of Stacktrain Operations for APL Land Transport (cited as "Baumhefner VS1"), and Mr. Robert F. Sappio, Managing Director - Eastern Region North America, for APL (cited as "Sappio VS"). In addition, 12 intermodal shippers supported APL's position.[17]

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[16] APL adopts the Confidentiality Conventions used by Applicants in Applicants' Rebuttal. *See* CSX/NS-176, at xxiii.

[17] The shippers supporting APL are Australia-New Zealand Direct Line, GST Corporation, Interstate Consolidation, Keystone Terminals, Inc., Matson Intermodal System, Mitsui O.S.K. Lines (America) Inc., NOL(USA) Inc., NYK Line (North America) Inc. ("NYK Line"), Orient Overseas Container Line, Inc., Quality Intermodal Corporation, The Riss Companies, and

The Response explained that APL is an Oakland, California-based company which provides international and domestic transportation with containerships and a fleet of company-owned containers and doublestack railcars. With a continuous history of transportation innovations extending back almost 150 years, APL is one of the world's leading international and domestic transportation companies and a service leader in containerized surface transportation between points in the eastern United States and ports in Asia and the Pacific Rim. APL is one of Conrail's major customers.

APL developed the stacktrain in the United States.[18] In order to facilitate its stacktrain service APL entered the APL-Conrail Contract, and that contract has been part of the reason for the continued growth of APL's intermodal business.[19] Today, APL's stacktrain network schedules over 200 train departures each week and spans 22,000 miles in the United States, Canada, and Mexico. APL owns equipment for its stacktrain service consisting of 367 stackcars, with another 200 to be delivered early this year, and almost 20,000 containers, consisting of 2,750 53-foot containers, over 10,000 48-foot containers, and the remainder being 45-, 40-, and 20-foot containers. APL's rail freight bill for 1997 was over **$ 600,000,000** for moving over 680,000 international and domestic containers between 64 stacktrain terminals in 26 states, Canada and Mexico. Rhein VS at 11. With this volume of traffic, railroads are the most efficient and economical transportation available to APL.

The Response explains that Section 2.2(c) both deprives holders of Conrail Rail Transportation Contracts of competition between CSX and NS for the duration of the term of those contracts and that the process of division of the contracts is anticompetitive and contrary to the public interest.[20] Section 2.2(c) deprives contract holders of the benefit of the competition to

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Yangming Marine Transport Corporation. Applicants have erroneously treated NYK Line as a separate party. NYK Line has always been a supporter of APL. Its statement of support was filed with APL's Response, and in the cover letter accompanying the Response, APL stated that NYK Line's letter of support was separate only because it was received too late to be included in the bound Exhibit D to the Response.

[18] Coutney VS at 2-6.

[19] Rhein VS at 14-15.

[20] Rhein VS at 17-18.

which non-contract holders will have access. Moreover, the actual administration of the APL-Conrail Contract in particular by two railroads will be unworkable, especially for APL's most favored nation provision,[21] and market driven price adjustments at Dual points where the refusal by either CSX or NS result in rejection.[22] Another major concern raised by APL is that CSXC competes with APL, through CSXC's subsidiaries Sea-Land Service, Inc. ("Sea-Land") and CSX Intermodal, Inc. ("CSXI"). Sea-Land has been APL's main U.S. competitor in ocean services between Asia and the United States. CSXI has become APL's fiercest competitor in the stacktrain market for domestic and international containers.[23] APL is concerned that CSXT and CSXI (which acts as CSXT's intermodal arm) will not administer[24] the portion of the APL-Conrail Contract that it is assigned with the spirit of partnership which Conrail has had, but will instead continually look to improve the competitive posture of its affiliates at APL's expense.[25] APL believes that it can provide itself with sufficient protection against this result if CSX is required to negotiate with APL before providing service to APL.

Potential operational problems with the division of the APL-Conrail Contract were also addressed in detail in the Response. *See* Baumhefner VS1. Partition of the APL-Conrail Contract without input from APL will disrupt, if not destroy, the network that APL has developed with Conrail in the northeast over many years of cooperative effort. APL's main operation is between Chicago and the APL intermodal terminal at South Kearny, NJ ("APINY"). The principal route is from Chicago to Cleveland, then via the water-level route to Selkirk, NY,

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[21] In shorthand, the most favored nation provision requires Conrail to give APL the lowest rate for comparable traffic between comparable service points whether Conrail provides that rate to another shipper, or another carrier provides that rate to another shipper. CSX/NS 178/3D, at 235-237.

[22] Rhein VS at 17-19.

[23] Rhein VS at 19-22, Courtney VS at 9, and Sappio VS at 1-6.

[24] From the depositions of Mr. William M. Hart, the Response, Exhibit E, pages 266-268 (to be cited as "Hart TR at __"), Mr. John W. Orrison, the Response, Exhibit E, page 562 (to be cited as "Orrison1 TR at __"), and [[

]], it is not even clear that CSXT will administer the APL-Conrail Contract. [[

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[25] Courtney VS at 10-13.

and then south on the River Route to APINY. Baumhefner VS1 at 5. However, at times, the River Route suffers from congestion which would unduly delay APL's shipments. When congestion occurs on the River Route, Conrail has two alternate high speed routes available to reroute APL's traffic, the Old Pennsylvania Route through Pittsburgh, or the "Southern Tier" route from Buffalo and over the former Erie-Lackawanna line through Elmira to the greater New York area. *Id.* Today, Conrail can route traffic over all three of these lines to avoid congestion and provide APL with timely delivery. Once Conrail is partitioned, these three routes will not be available on either CSXT or NSR. CSXT is to be allocated the River Route,[26] while NSR is to be allocated the Old Pennsylvania Route and the Southern Tier.[27] Mr. Orrison's claim that a standard detour arrangement will[28] keep all three routes available provides no assurance to APL since the quality service APL needs is not normally available under a detour arrangement. Moreover, detour arrangements have never been used simply to maintain on-time performance; they are used when a rail line has been closed due to a derailment, washout, or other accidents, or natural disasters. However, APL can assure itself of reasonable service and deal with all other operational problems by negotiating with CSX and NS instead of allowing CSX and NS to unilaterally partition the APL-Conrail Contract.

In response to Decision No. 44, on November 24, 1997, APL filed a Response to the CSX/NS Operating Plan for the North Jersey Shared Assets Area ("NJSAA") and Supporting Statement-CSX/NS-119, APL-8 (the "North Jersey Response"). Supporting the North Jersey Response is a verified statement from Mr. Baumhefner (cited as "Baumhefner VS2"). CSX and NS did not obtain input from APL in preparing the NJSAA Operating Plan.

APL has serious concerns about the NJSAA Operating Plan. NS does not have equal access or facilities to serve APINY; there is no assurance that Applicants' proposed schedules can actually replace the Conrail schedules; Applicants did not recognize the current congestion in the NJSAA in preparing the operating plan; and Applicants have not contractually committed to

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[26] CSX/NS-25/8B at 95.
[27] CSX/NS-25/8B at 98-100.
[28] Applicants' Rebuttal, Volume 2A, CSX/NS-177 (referred to as CSX/NS-177/2A), at 645.

APL that they will live up to their proposals. Baumhefner VS2 at 1-15. More specific operational problems are that Applicants do not indicate: the specific lines they will use to reach certain yards; the routes CSXT and NSR will use to and from APINY; the specific transit times once operating within the NJSAA; the entity that will furnish crews for APL's trains; the crew change points; where NSR will store cars for APL; whether NSR will operate locomotives to pick-up individual containers that are now literally trucked next door to Conrail; and which interterminal moves will be handled by CSXT, NSR, or the Conrail Shared Asset Operator. Particularly important is the apparent denial to NS of the use of storage tracks that are now used by Conrail in its yard which is adjacent to APINY.

APL achieved its competitive leadership in the North American stacktrain market in large part due to the APL-Conrail Contract which has in essence created a partnership between APL and Conrail. This partnership has been implemented and developed in a number of ways, including through a long-term $17.5 million dollar investment by APL to develop the APINY intermodal terminal on Conrail property at South Kearny, NJ; through mutual commitments, faithfully pursued, to maintain consistent high levels of service for APL; through ongoing, responsive modifications as opportunities for new business arose to the long-term transportation contract that currently does not expire until May 31, 2004; and through a Conrail rate commitment to APL in an encompassing most favored nation provision.

APL should not be deprived of the opportunity to participate in deciding its own fate. Applicants should not be permitted to implement Section 2.2(c), nor should the Board override anti-assignment clauses in Rail Transportation Contracts. Denial of the relief sought by Applicants in these two instances is consistent with the law and the public interest.

ARGUMENT

The Board may only approve the control and partition of Conrail by CSX and NS if it finds the proposed transaction consistent with the public interest. 49 U.S.C. §11324(c). The Board cannot conclude that the Application is consistent with the public interest because it requires the Board to interfere with the Rail Transportation Contracts between Conrail and its

shippers. The Board does not have the jurisdiction to modify Rail Transportation Contracts once they take effect. 49 U.S.C. §10709(c)(1). There are sound policy reasons grounded in the Staggers Act[29] that mandate the Board continue its consistent policy of refusing to interfere in Rail Transportation Contracts. Moreover, Section 2.2(c) and overriding anti-assignment clauses are not necessary to implement the proposed transaction and would create potentially inadequate transportation. Finally, Section 2.2(c) allows Applicants to engage in horizontal market divisions even though such conduct is not necessary to implement the transaction. Therefore, for all these reasons, the Board must find that Section 2.2(c) of the Transaction Agreement and voiding anti-assignment clauses in Rail Transportation Contracts are not consistent with the public interest.

APL will first demonstrate that the preemption power of the Board under 49 U.S.C §11321(a) ("Section 11321(a)") does not reach Rail Transportation Contracts which were entered pursuant to Section 10709. Second, APL will demonstrate that the preemption of Rail Transportation Contract terms is not necessary for the Applicants to implement this transaction. Next, APL will explain how Section 2.2(c) will result in potentially inadequate transportation and will have anti-competitive effects. Finally, APL will explain how the relevant provisions of Section 2.2(c) as interpreted by CSX and NS are inconsistent with Section 17 of the APL-Conrail Contract, are a disincentive to providing adequate transportation, and conflict with the anti-assignment clause of Section 19 of the APL-Conrail Contract.

A. SECTION 11321 PREEMPTION DOES NOT APPLY TO RAIL TRANSPORTATION CONTRACTS

Applicants argue that 49 U.S.C. §11321(a) permits overriding of private contracts.[30] They rely on *Norfolk and Western Ry. Co.* v. *American Train Dispatchers' Ass'n*, 499 U.S. 117, 129-133 (1991) ("*N&W*") and *Schwabacher* v. *United States*, 334 U.S. 182, 201 (1948) ("*Schwabacher*") to support that position. Those cases are inapplicable. Applicants also seek to rely on *UP/SP Decision No. 44* and *UP/SP Decision No. 57*. However, a careful reading of these decisions and a clear understanding of the Board's conditioning power lead to the inescapable

[29] The Staggers Rail Act of 1980, Public Law 96-454 (the "Staggers Act").
[30] CSX/NS-176, at 95.

conclusion that the *UP/SP* decisions do not allow the Board to interfere with shippers' rights under their Rail Transportation Contracts.

The preemption provision of Section 11321(a) has existed since the Transportation Act of 1920. Transportation Act, 1920, 66th Cong., 41 Stat. 456, 482 (1920).[31] However, 49 U.S.C. §10709, which governs contracts, was passed as part of the Staggers Act of 1980.[32] Under commonly accepted principles of statutory construction, where two statutes conflict, the one later in time governs.[33] Section 10709 was adopted after the preemption provision and should therefore be accorded greater weight. *Posadas* v. *National City Bank*, 296 U.S. 497, 503 (1935). Moreover, the purpose and effect of Section 10709 was to remove contracts from the regulation and jurisdiction of the STB. The Board itself has said Section 10709(c) "relieves transportation provided under such contract from the regulatory provisions of new 49 U.S.C. 10101-11908 ..." STB Ex Parte No. 541, *Railroad Contracts* (not printed), served March 26, 1996, at 1.

The Staggers Act, for the first time, clearly permitted railroads and their shippers to enter into private contracts to govern their transportation arrangements. *Rates on Iron Ore, Randville to Escanaba Via Iron Mtn.*, 367 I.C.C. 506, 509 (1983). Not only could railroads and shippers agree to the terms of service, compensation, and all other related matters, but they could do so without fear of interference by the ICC. The statute is clear: "The Commission may not require a rail carrier to violate the terms of a contract that has been approved under this section...." Former 49 U.S.C. §10713(g). Further, "[a] contract that is approved by the Commission under this

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[31] In *N&W*, the Supreme Court uses the statutory term "exemption." APL will use the term "preemption" when referring to the Board's power under Section 11321(a).

[32] Section 208(a) of the Staggers Act added 49 U.S.C. § 10713, the predecessor to Section 10709. The ICC Termination Act of 1995 reenacted former section 10713(i)(1) as Section 10709(c)(1) with only one insubstantial change. The word "authorized" replaced the word "approved" since not all contracts were required to be approved under the ICCTA. Indeed, under section 10713(e)(2), although contracts were required to be approved, they were deemed automatically approved if they were not disapproved within 60 days of filing.

[33] APL does not believe that there is a conflict between Section 10709 and Section 11321(a). Under Section 10709(c)(1), once a Rail Transportation Contract takes effect it is beyond the reach of the STB. Therefore, Section 11321(a) cannot reach Rail Transportation Contracts which have been specifically removed from the STB's jurisdiction **and** Part A of Subtitle IV, which contains Section 11321(a).

section, and the transportation under such contract, **shall not be subject to this subtitle**, and may not be subsequently challenged before the Commission or in any court on the grounds that such contract violates a provision of this subtitle." Former 49 U.S.C. §10713(i)(1) (emphasis added).

The Congressional findings in the Staggers Act explain why interference by the ICC in transportation contracts was undesirable. "The Congress hereby finds that ... (4) many of the government regulations affecting railroads have become unnecessary and inefficient: ... and (9) modernization of economic regulation for the railroad industry with a greater reliance on the marketplace is essential in order to achieve maximum utilization of railroads to save energy and combat inflation." Staggers Act, Section 2.

The legislative history of Section 10709 makes it clear that Congress intended to insulate contracts from the jurisdiction of the ICC. "Once a contract...goes into effect..., the service provided under the contract is exempt...from all regulation and all of the requirements of the Interstate Commerce Act." Staggers Act Conference Report, at 100. In numerous decisions both the ICC and the courts have recognized this principle:

"The Commission has never had specific authority to enforce a contract between a shipper and a carrier." *Rates on Iron Ore, Randville to Escanaba Via Iron Mtn.*, 367 I.C.C. 506, 508 (1983). "[C]ontract rate disputes arising after October 1, 1980...are exclusively within the jurisdiction of the courts." *The Toledo Edison Co. v. Norfolk & Western Railway Co.*, 367 I.C.C. 869, 870 (1983). *See also, Cleveland Cliffs Iron Co.* v. ICC, 664 F.2d 568 (6th Cir. 1981); *Burlington Northern R. Co.* v. *ICC*, 679 F.2d 934 (D.C. Cir. 1982); and ICC Docket No. 39060, *Petition of Denver and Rio Grande Western Railroad Company and Salt Lake, Garfield and Western Railway Company for Review of a Decision of the Public Service Commission of Utah Pursuant to 49 U.S.C. 11501* (not printed), served March 2, 1983, at 2. In adopting coal rate guidelines the ICC said that "some of this traffic is under contract, and therefore not subject to Commission scrutiny." *Coal Rate Guideline*, Nationwide, 1 I.C.C. 2d 520, 522 (1985).

The ICC has specifically acknowledged that it has no jurisdiction over contracts in Section 10709: "Our granting of this exemption has no direct impact on the contract which expired on October 12, 1983. The traffic under the contract is statutorily exempt from subtitle IV title 49 by virtue of section 10713(i)(1) of the act, and our exemption authority under section 10505 extends only to matters under subtitle IV. **In short we cannot exempt under section 10505 what Congress has already removed from our jurisdiction under section 10713.**" *Consolidated Rail Corp.--Exemption Requests*--Charges, 1 I.C.C. 2d 164, 165 (1984) (emphasis added).

As the ICC itself has held, shipper-railroad contracts are a "cornerstone" to the successful implementation of the Staggers Act: "A cornerstone of the Staggers Act was the contract provisions of section 208, 49 U.S.C. 10713 [now 10709], which allows railroad carriers and the purchasers of rail service to enter into binding contracts governing transportation rates and services. These provisions were implemented to reduce regulation and to encourage carriers to operate in a new competitive environment." *Exempt.--Shipments Subject to a Contract* Rate, 1 I.C.C. 2d 966, 967 (1985). In assuring that this "cornerstone" is kept intact, the Commission has found that contracts preempt its broad jurisdiction over non-ferrous recyclable commodities "Paper waste may move under contracts, which removes it from our jurisdiction." *Investigation--Freight Rates for Recycled Commodities*, 5 I.C.C. 2d 101, 109 (1988). Where the ICC was asked to determine if certain provisions of a tariff applied to a contract, it declined to do so, saying, "The Commission has no jurisdiction... to determine the rights of the parties under these contracts." *Coal Trading Corp., et al. v. B & O Railroad Co., et al.*, 6 I.C.C. 2d 361, 365 (1990).

Although it is difficult to tell, it appears that Applicants are relying on *N&W* as the basis for arguing that the Board can exercise jurisdiction over shippers' Rail Transportation Contracts in this case. That reliance is misplaced. In *N&W*, the Supreme Court addressed "the narrow question whether the exemption in § 11341(a) from 'all other law' includes a carrier's legal obligations under a collective-bargaining agreement." *Id.* at 127. Despite broader language concerning contracts later in the Supreme Court's decision, the only issue that that Court

addressed was whether the ICC could preempt collective-bargaining agreements under former Section 11341(a). In further circumscribing its decision, the Supreme Court stated: "For purposes of this decision, we assume without deciding, that the Commission properly considered the public interest factors of § 11344(b)(1) in approving the original transaction, that its decision to override the carriers' obligations is consistent with the labor protective requirements of § 11347 which allows up to six years of pay and benefit protection, and that the override was necessary to the implementation of the transaction within the meaning of § 11341(a). *Id.* The Court then stated: "Under these assumptions, we hold that the exemption from 'all other law' in § 11341(a) includes the obligations imposed by the terms of a collective-bargaining agreement." *Id.* at 127-128.

The request by Applicants that the Board preempt Rail Transportation Contracts is vastly different from the need to preempt collective-bargaining agreements. First, although APL agrees with Applicants that requiring Applicants to comply with collective-bargaining agreements might prevent Applicants from implementing changes to effectuate the consolidation, that is not true of the Rail Transportation Contracts. Second, Rail Transportation Contracts involve the relations between Conrail and its customers, not between Conrail and its employees. Conrail's customers, including APL, have no extraneous statutory protection equivalent to the generous protection which railroad employees receive under section 11347. The only protection which Conrail's customers have is what they have negotiated in their Rail Transportation Contracts with Conrail. For APL, two of those protections are the Inequities provision of Section 17 and the Assignment provision of Section 19. However, Applicants have requested the preemption of both of these sections.

Applicants also mistakenly contend that *UP/SP Decision Nos. 44 and 57* stand for the proposition that the Board has the power to preempt Rail Transportation Contracts under Section 11321(a). In *UP/SP Decision No. 44*, the Board adopted what has become known as the "contract modification condition." Under the "contract modification condition," the Board required the Union Pacific Railroad Company and all of the merging railroads ("UP") to open up

50 percent of their Rail Transportation Contracts at 2-to-1 points, as a condition to the approval of the consolidation. *Id.* at 231. The purpose of this condition was to give the Burlington Northern and Santa Fe Railway Company ("BNSF"), the Board's designated competitor with the new UP, "immediate access to a traffic base sufficient to support effective trackage rights operations." *Id.*. at 146. The result was to give UP's customers the right -- **if they wished** -- to open up their Rail Transportation Contracts with UP to competition from BNSF. That is. shippers won the right to competition.

The condition was imposed on UP under 49 U.S.C. §11324(c). At that point, UP had the option of accepting the condition and going ahead with its consolidation or rejecting the condition and not going forward with the consolidation. The important thing is this: UP was subject to the Board's jurisdiction. *See Thurston Motor Lines, Inc.--Control and Merger*, 104 M.C.C. 1, 11-12 (1965); and *Missouri Pac. R.. Co.--Control--Chicago & E. I. R. Co.*, 327 I.C.C. 279, 310-311 and 324 (1965). UP's shippers who had Rail Transportation Contracts were not. In *UP/SP Decision No. 57,* which made five general observations, the second observation found that "The condition merely allows a 2-to-1 shipper **to put up for bidding** traffic that had previously been committed by contract to UP or to SP. The shipper need not tender any traffic to BNSF, and **is free to reject the contract modification condition in its entirety.** " *Id.* at 5 (emphasis added). The Board left it to the sole discretion of the shippers whether they wished to take advantage of the BNSF competition.

In adopting ten guidelines to be followed, without mentioning Section 10709, the Board affirmed "the shipper selection right" in guideline #4 under which the shipper party to a Rail Transportation Contract, and only the shipper, could select the portion of its contract traffic (up to 50%) to open up to BNSF. *Id.* at 10. The Board also granted the shipper the option of the timing of the opening of the contract in guideline #5. *Id.* As an alternative, guideline #8, allowed UP and a contract shipper by mutual agreement to modify any term of a contract. *Id.* at 11.

In *UP/SP Decision No. 57*, the Board recognized that it could not force shippers to involuntarily modify their Rail Transportation Contracts with UP and the Southern Pacific Transportation Company ("SP"). Even though the preemption power of Section 11321(a) was available to the Board, it did not invoke this power to require UP to give up UP contract traffic. And it was a critical condition in that proceeding because, without a designated competitor to resolve the competitive problems of the UP-SP consolidation, the Board most likely would have denied the transaction. Hence, in UP-SP, the transaction itself created the competition, while here CSX and NS are attempting to use Section 2.2(c) to circumvent that competition.

There is yet another reason for the Board to refuse Applicants' invitation to interfere in Rail Transportation Contracts. The APL-Conrail Contract is for intermodal traffic. The Commission exempted intermodal traffic from regulation in *Improvement of TOFC/COFC Regulation*, 364 I.C.C. 731 (1981). Before the Board can regulate a matter that has been deregulated, it must revoke the exemption. 49 U.S.C. § 10502(d). Applicants have not asked the Board to revoke the *TOFC/COFC Exemption*, and so the Board cannot regulate the APL-Conrail Contract in this proceeding. Hence, not only do the protections of Section 10709 apply to the APL-Conrail Contract, but so does the exemption of Section 10502. APL agrees that "[i]n short, experience has proven the wisdom of deregulating intermodal transportation. The Board should be leery of those that seek, through the back door ... to re-regulate it." CSX/NS-176 at 465. When closing that back door, the Board should be sure that the back door is equally closed on Applicants.

Using Section 11321(a) to preempt contracts entered under Section 10709 would quickly begin to erode this "cornerstone" of the Staggers Act. In this proceeding, Applicants have specifically requested the Board to preempt the non-assignment clauses of contracts entered pursuant to the authority of Section 10709. Further, as has been demonstrated above, by application of Section 2.2(c) to the APL-Conrail Contract, Applicants are also seeking a covert preemption of Section 17 (Inequities) of the APL-Conrail Contract.

But, why should the Applicants stop here? Rail Transportation Contracts contain obligations and requirements that may make it more difficult for Applicants to implement the proposed transaction. Perhaps it would be easier for Applicants to implement the transaction if these provisions were overridden. The financial requirements of some contracts may also increase the difficulty of implementing a transaction. Why not preempt those terms so the Applicants will have a greater stream of revenue to pay for improvements and reduce debt? As noted above, shippers with Rail Transportation Contracts have no extraneous protection analogous to labor protection under Section 11326; all they have are the terms of the contract they bargained for. The Board should not sanction the breach of the sea wall to erode the "cornerstone" of the Staggers Act created by Section 10709.

If the Board were to unwisely allow the use of Section 11321(a) to preempt Rail Transportation Contracts, the flood would be immediate. The Board's preemption power under Section 11321(a) is not limited to control and merger applications between Class I railroads. That power extends to exemptions under Section 10502. *See D&H Ry--Lease & Trackage Rights Exempt. Springfield Term.* 8 I.C.C. 2d 839, 847 (1992), where the ICC said "... there is no legitimate economic or regulatory policy basis for upholding a distinction between exemptions and approvals...." The same preemption applies to approval or exemption. If the STB opens the flood gates in this proceeding, APL foresees the swift final erosion of the contract "cornerstone" through the use of notices of exemption for trackage rights, 49 C.F.R. § 1180.2(d)(7) where the railroad does not like one or all of the provisions of a Rail Transportation Contract, and sees an easy way to preempt the unfavorable terms. The Board should not even start down this path, for it will destroy the good achieved under Section 10709.

The public interest in Rail Transportation Contracts requires that the Board not exercise its preemption power; both the Staggers Act Conference Report at 100 and Section 10709(c)(1) prohibit it. When the Board weighs the public interest in this proceeding, it must conclude that the sanctity of Rail Transportation Contracts outweighs the convenience of CSX and NS in

dividing the contracts as called for by Section 2.2(c) and the voiding of non-assignment provisions.

B. SECTION 2.2(c) AND THE PREEMPTION OF NON-ASSIGNMENT CLAUSE IN RAIL TRANSPORTATION CONTRACTS ARE CONTRARY TO THE PUBLIC INTEREST AND ARE NOT NECESSARY TO THE IMPLEMENTATION OF THE TRANSACTION

A railroad consolidation proposal must be judged by the Board under 49 U.S.C. §§ 11321-11327. "The Act's single and essential standard of approval is that the [Board] find the [transaction] to be 'consistent with the public interest.'" *Missouri-Kansas-Texas R. Co.* v. *United States*, 632 F.2d 392, 395 (5th Cir. 1980), *cert. denied*, 451 U.S. 1017 (1981). *UP/SP Decision No. 44*, at 98. *Accord Penn-Central Merger and N & W Inclusion Cases*, 389 U.S. 486, 498-499 (1968).

Section 11324(b) lists five factors that the Board must consider in a proceeding involving the merger or control of at least two Class I railroads. Of those five factors, two are relevant to APL's position that the Board should disapprove Section 2.2(c) and not void anti-assignment clauses: "(1) the effect of the proposed transaction on the adequacy of transportation to the public; ... and (5) whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region or in the national rail system." 49 U.S.C. § 11324(b)(1 and 5).

Typically, when analyzing the adequacy of transportation factor, the Board looks at the public benefits, which may be defined as efficiency gains. *UP/SP* at 99. Since APL and Conrail together created an ***offering*** of contract service to APL, the contract constitutes the measure of adequate transportation to APL. Applicants should provide nothing less. Yet, APL has shown in the Response that the proposed means of dividing the APL-Conrail Contract under Section 2.2(c)

has the potential to create serious efficiency problems. Since the protocol proposed by CSX and NS in Section 2.2(c) impedes efficient and adequate transportation offered under the APL-Conrail Contract, and all other similar contracts, the Board must not approve Section 2.2(c) and must not override the anti-assignment clauses.

When considering the second factor, the Board's consideration of competition is not limited to rail carriers alone, but includes an examination of the total transportation market. *UP/SP Decision No.* 44, at 99. *See Central Vermont Ry.* v. *ICC*, 711 F. 2d 331, 335-337 (D.C. Cir. 1983). In this transaction, the division of Rail Transportation Contracts between CSX and NS has blatant horizontal effects which would allow per se conduct. The two competing railroads have very simply agreed to divide the market of Rail Transportation Contracts, and even to divide up individual Rail Transportation Contracts, between them, instead of competing to serve the market. Applicants' market division is particularly egregious for contracts or portions of contracts involving service between Dual points.

To demonstrate to the Board more fully that approval of Section 2.2(c) and voiding anti-assignment clauses in Rail Transportation Contracts will not result in adequate transportation, APL will: (1) explain the operational and administrative problems it foresees with the proposals made by Applicants to serve APL after the Closing Date; and (2) explain why Section 2.2(c) and the voiding of anti-assignment clauses are not necessary for CSX and NS to efficiently provide transportation under Conrail's Rail Transportation Contracts. To demonstrate to the Board more fully the competitive problems with approval of Section 2.2(c) and the voiding of anti-assignment clauses in contracts, APL will show that Section 2.2(c) and the voiding of anti-assignment clauses result in an anticompetitive market division and process.

1. Applicants' proposal to divide Conrail's Rail Transportation Contracts under Section 2.2(c) and to void anti-assignment clauses in Rail Transportation Contracts will not result in adequate transportation service to the public.

Under Applicants' unknown plan for dividing Conrail's contract traffic, APL sees the potential for an operational melt-down far exceeding anything that has happened in the west.[34] For example, the service APL receives from Conrail under the APL-Conrail Contract is for a network in the northeastern United States between 15 city pairs.[35] Baumhefner VS1 at 2. Service is not just between point A and point B, but, for example, from Chicago to APINY via Cleveland, Buffalo, and Syracuse, where containers are added to and removed from trains. These containers are delivered locally or put on other trains for delivery to other points on APL's network. Baumhefner VS1 at 4. Conrail provides this service to all 15 cities on its system today. CSXT and NSR will provide the service after the Closing Date, but neither will serve all 15 cities. CSXT will not serve Allentown, PA, Harrisburg, PA, Morrisville, PA, Pittsburgh, PA, or Toledo, OH. NSR will not serve Syracuse, NY, Boston, Ma, Worcester, MA, or Springfield, MA. In addition, CSXT will solely serve Marysville, OH. CSXT and NSR will both serve Chicago, IL, Baltimore, MD, Cleveland, OH, Columbus, OH, APINY, and St. Louis, MO.

CSXT and NSR have not decided how they will divide the traffic under the APL-Conrail Contract moving between Dual points. Hart TR at 273. Response, Exhibit E, deposition of Mr. James W. McClellan, pages 208-209. All they have told APL is that the traffic will be divided by them under the "protocol" of Section 2.2(c), regardless of APL's desires. That this creates the potential for inadequate transportation is self evident; APL believes, in fact, that the current lack of planning could make the service problems in the west appear mild in comparison. Rhein VS at 4.

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[34] It was for this reason that APL sought an oversight condition, to be able to prevent problems in the east similar to those in the west. APL believes that the Board's oversight condition must have stronger teeth than that agreed to in the NITL Settlement. CSX/NS-176, at 771. See Rhein VS at 24-25.

[35] The cities are Chicago, Boston, Springfield, MA, Cleveland, Columbus, OH, Baltimore, Allentown, PA, Pittsburgh, Worcester, MA, Syracuse, Toledo, OH, South Kearny, NJ (APINY), Morrisville, PA, Harrisburg, PA, and St. Louis.

APL's service will suffer and be wholly inadequate without APL's input. Baumhefner VS1 at 15-16. The Conrail operation of the APL-Conrail Contract is intricate. It requires an excellent interchange in Chicago with UP. CSXT has said that its new 59th Street facility will be operational and will be able to handle the interchange. Applicants' Rebuttal, Volume 2A, CSX/NS-177 (referred to as "CSX/NS-177/2A"), Rebuttal Verified Statement of John W. Orrison, at 638-643 (to be cited as "Orrison RVS at __"). But, if Mr. Orrison is so convinced that the 59th Street intermodal yard will be up and running, why does he then state that Conrail's 63rd Street terminal is an alternative, that a routing over the IHB is an alternative, and that routing through Dolton is an alternative. *Id.* at 641-642. Although no details are given for these alternatives, the only reason for proposing them at the rebuttal phase of the case must be because there are questions about the 59th Street terminal. APL's experience is also that a new facility cannot just open and run; it must go through a shake down period. The interim period is sure to provide less than adequate transportation, unless APL can participate in the planning.

There are other significant operational problems:

(a) The operation of APINY. Conrail provides the service that APL requires today. CSXT will acquire APINY from Conrail, but access will be available to both CSXT and NSR. However, NSR has no track or other facilities available at APINY. APL does not know how NSR can serve APINY without any track or support facilities on site, where travel will be required from a NSR yard through the NJSAA. Indeed, NSR's response is that it is studying the matter. CSX/NS-177/2A, Rebuttal Verified Statement of D. Michael Mohan, at 397 (to be cited as "Mohan RVS at__"). NSR will not have parity with CSXT to serve APL at APINY. Baumhefner VS2 at 2-6. Nor is there any guarantee that the proposed CSXT and NSR train schedules will be operated (Mohan RVS at 398) or meet APL's needs. Baumhefner VS2 at 6-12. Finally, the Applicants have refused to recognize that there is congestion in the NJSAA. Baumhefner VS2 at 12-15.

(b) Elimination of three alternate routes that APL has between Cleveland and APINY. Today, when Conrail experiences congestion on the River Route between Selkirk, NY and

APINY, it can reroute an APL train over the Southern Tier, from Buffalo to APINY, or over the Old Pennsylvania Railroad route from Cleveland to APINY via Harrisburg. After Conrail is partitioned, CSXT will operate the River Route and NSR will operate the Southern Tier and Old Pennsylvania Route, limiting APL's options to avoid congestion. Baumhefner VS at 7-8. Mr. Orrison only suggests alternate routes, but does not state that they will be as timely as the current service that APL receives from the Conrail alternates. Orrison RVS at 643-647. His main alternative is a detour over the NSR lines. But a detour is usually available only in emergencies, and takes the lowest priority, not the high priority service APL needs.

To summarize: "To see Conrail carved and divided into two packages connected by enclaves of joint services, in a process from which APL has been completely excluded, is not only troubling to us, but appears to be a blueprint for disaster.... The present integrated APL network on Conrail will be dismantled by the Applicants under the partition plan which they have described to the Board. In its place, new plans, and new traffic flows are contemplated, adding new volume to lines which our experience tells us are already choke points today. Terminal services are not simply revised; they are re-invented. Existing, proven interchanges are abandoned. We see, ... a clear potential for multiple and continuing service disasters ahead, potentially culminating in gridlock and the melt-down of what had once been a sterling Conrail rail service. If this is to be avoided, APL needs to be part of the planning process for the future handling of its traffic, and the Board needs to retain jurisdiction to act further if the public interest is shown to require it." Rhein VS at 22-23.

However, Mr. Baumhefner acknowledges that these problems can be resolved through negotiations, as do Mr. Orrison (Orrison RVS at 637 and 649)[36] and Mr. Mohan (Mohan RVS at 395, 398, and 399).

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[36] Curiously, when Mr. Orrison suggests discussions with APL, he limits it to "legitimate operational concerns." Unfortunately, neither Mr. Orrison nor CSX seem to realize that the contract between APL and Conrail is a whole document that cannot be addressed on one specific issue without taking a look at all other issues.

In addition to the service problems, administration of the APL-Conrail Contract in its current form by two competitors will create serious anticompetitive concerns, rendering the level of transportation wholly inadequate. Mr. Rhein explained the problems that would arise from two railroads trying to administer a very complex contract that was established with and is currently administered by one railroad. "Applicants propose that this Transportation Agreement be administered by CSXT and NS, who are competitors to each other and one of whom is a competitor to APL. Upon examination, this result is totally unworkable and creates significant antitrust concerns. For example, APL has, in its Conrail contract, a comprehensive most-favored nation clause between Conrail service points. How can that clause be administered between two competitors, especially when both serve a point such as South Kearny which is covered by the APL-Conrail contract, and both are separately quoting rates to APL competitors to and from New York/New Jersey terminals? How is APL to monitor, in a cost-effective way, the rates extended by CSXT or CSXI for counterpart services, without gaining information about CSXI's commercial business? In order to administer the most-favored-nations clause, are CSXT and NS to meet regularly and discuss the prices they are charging to intermodal shippers at APL common points?" Rhein VS at 18.

In order to adequately administer the APL-Conrail Contract, NS and CSX would need to engage in conduct which raises serious anti-competitive concerns. They include: (1) the most favored nation provision would require inappropriate communications between NS and CSXT, who are competitors, when that provision is triggered by a rate action of one of them;[37] (2) at

[37] Mr. Rutski has suggested that the use of "competent third party neutrals ... to resolve any MFN issues on a basis that does not disclose confidential information improperly." CSX/NS-177/2B, at 384. Before this proposal would be workable, the answers to many questions would have to be resolved through negotiations, such as: (1) who will pay the third party; (2) how can APL be sure that CSX and NS share each and every rate they establish with the third party; and (3) what access does APL have to the third party?

Under the proposed transaction, Mr. Rutski's proposal would introduce the fourth third party neutral, where there is only one today. If APL and Conrail cannot agree under the most favored nation provision, an auditor is brought in. Applicants propose arbitration if they cannot agree how to divide APL's contract. Transaction Agreement, Section 11.12, CSX/NS-25/8B at 75-76. If shippers are dissatisfied with service they may seek arbitration under Section II. C. of

Dual points served by both carriers, APL would need to obtain the consent of both NSR and CSXT before any rate adjustments to the contract could be made, creating a situation where one of the railroads could reject a market driven price adjustment; (3) in the allocation process, CSXT and NSR will both review the APL-Conrail Contract, so that each will know the commercial terms of its competitor; (4) APL will lose the routing options that it has available today between Chicago and APINY; (5) new operators will serve APL without any input into those operations from APL; and (6) APL's largest competitor CSXI will administer APL's contract and obtain access to the confidential commercial provisions of that contract without APL being able to negotiate provisions to protect itself.[38] The result of this situation is that APL will not receive adequate transportation.

Mr. Rhein identifies other problems which arise because of APL's unique relationship to CSX and its concern that CSX will not provide the same level of commitment to APL's business as Conrail does now, and thus APL cannot possibly receive the same contract benefits that it now receives. These problems are: (1) existing service monitoring,[39] correction of service deficiencies, and day-to-day coordination of APL's needs by two new, untried (in these markets) service partners, one of whom actually stands to benefit from any APL service failures; (2) modifications of the APL-Conrail Contract, routinely agreed to by Conrail today to assist APL in adjusting to changing shipper requirements, will now require the approval of two providers, one a competitor of APL who may benefit each time permission is denied; (3) new rates and new

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the NITL Settlement. CSX/NS-176, at 771-772. Finally, Mr. Rutski suggests using a third party neutral to monitor implementation of the most favored nation provision. CSX/NS-177/2B, at 384. APL does not believe that a commercial relationship that relies on all of these third party intermediaries can work efficiently. Applicants should just sit down and negotiate with APL instead of relying on such an intricate house-of-cards of third parties.

[38] CSXI is CSX's intermodal subsidiary which provides stacktrain service and competes head-to-head with APL in moving international and domestic containers in the domestic stacktrain market. As a competitor of APL and without written contract modifications protecting APL, the result of allowing CSX and NS to jointly administer APL's contract with Conrail would substitute CSXI as a service provider with a disincentive to continue the partnership relation developed over many years between Conrail and APL.

[39] APL holds three conference calls with Conrail personnel every day to resolve problems. Neither CSX nor NS has proposed such in depth monitoring.

services will require disclosing target customers and business objectives to, and receiving approval from CSX and NS, who are also competitors of each other and one of whom is a competitor of APL; (4) management of APL's terminal services at APINY, and other terminals allocated to CSX, by CSXI, a competitor which has conflicting needs of its own; and (5) new train schedules must be negotiated with two new entities which have their own service requirements to meet, one of whom will benefit financially if APL's needs take second place. Rhein VS at 19.[40]

Mr. Rhein has said that APL can work with CSX. Rhein VS at 6. But, he is very concerned that APL's prime competitor may become APL's primary service provider in the Northeast without giving APL the chance to negotiate contract provisions that will protect APL in these changed circumstances. In the Pacific shipping lanes Sea-Land is APL's main competition. In the domestic stack train market it is CSXI.[41] Rhein VS at 19-20. "[S]pecial care must be taken in defining the duties and responsibilities and commitments of CSXT, if it is to substitute for Conrail." Rhein VS at 19. APL is "concerned that, without special provisions in a contract with CSXT, we will thus lose the benefit of the partnership which we have had with Conrail and will be served by a provider who may well have a disincentive to work with us when we seek to advance competitive frontiers. The result will be that competition will suffer. That is why APL must be allowed to negotiate new contracts." Rhein VS at 21-22.

All of these potential problems demonstrate powerfully that the proposed allocation of Conrail's Rail Transportation Contracts under Section 2.2(c) without APL's participation will create potentially inadequate transportation under the APL-Conrail Contract. However, the

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[40] APL notes that NS has refrained from responding to APL's competitive claims concerning CSXI. *See* CSX/NS-176, at 188.

[41] [[

]] It is also clear from the depositions of Mr. Hart, Mr. Orrison, [[ ]] that there is an excellent possibility that CSXI will administer the APL-Conrail Contract for CSXT. How can a non-railroad non-applicant in this proceeding be assigned a contract between APL and a railroad? Certainly the Applicants' attempt to void the anti-assignment clauses of the contracts should not allow the free assignment of these contracts beyond CSXT or NSR. That result would be truly bizarre.

problems raised above can be solved by negotiations and agreement between APL and CSX and APL and NS. In order for that to occur, the Board must disapprove Section 2.2(c) and not void anti-assignment clauses in contracts.

2. Section 2.2(c) and voiding anti-assignment clauses are not necessary for the transaction to go forward.

CSX and NS have erroneously claimed that the only way to divide the Conrail Rail Transportation Contracts between CSX and NS is by implementation of Section 2.2(c). CSX and NS have also erroneously claimed that it is necessary to eliminate the anti-assignment clauses of Rail Transportation Contracts for CSX and NS to obtain these assets of Conrail. They are wrong. Instead, CSX and NS must simply do what their Chairmen, Presidents, and Chief Executive Officers have said they will do -- compete. In his deposition, Mr. Prillaman acknowledges this can be done (See Volume 2A - Public Appendix, deposition of Mr. L.I. (Ike) Prillaman at 14-16 and 18 (to be cited as "Prillaman TR at __")), although Mr. Jenkins of CSXT and [[[ ]]] claim there is no other way of allocating these contracts. *See* Volume 2A - Public Appendix, deposition of Mr. Christopher P. Jenkins at 8 (to be cited as "Jenkins TR at __") and [[[ ]]].

Mr. Rutski's assurances that everything will be just fine do little to alleviate APL's concerns. In his verified statement, Mr. Rutski used the word "assure" five times and the word "ensure" two times.[42] [[[

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[42] "I want to assure APL that none of its fears are warranted." Rutski VS at 376. "... our goal is to ensure not only that APL receives at least the same level of service from CSXI as it receives from Conrail, but wherever possible to provide improved service." *Id.* at 376-377. "I can assure him CSXT and CSXI will respect APL's contract rights and continue to provide the level of service that APL deserves." *Id.* at 378. "As to APL's concern that CSXI will attempt to steal APL's TPI traffic, I can assure APL that we will not attempt to do so." *Id.* at 382. "I can assure Mr. Sappio that if CSXI made it a practice to unreasonably disadvantage other ocean carriers, those carriers would take their business elsewhere." *Id.* "We would, however, work to ensure that the contract is properly and lawfully administered and are confident in our ability to do so, with APL's full cooperation." *Id.* at 383. "I can assure APL that we will work cooperatively with it and NS to address issues that may arise." *Id.* at 384.

]]] Mr. Rutski obviously realizes that APL has a number of legitimate concerns. [[[

]]] CSXI is not a party to this proceeding; it is a subsidiary of CSXC and an affiliate of CSXT. [[[

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At the end of his response to APL Mr. Rutski finally admits that "[t]he intervention of the Board is not needed to permit a mutually beneficial relationship to develop and flourish between our companies, a goal that I very much look forward to quickly achieving." Rutski VS at 387. With this sentence, Mr. Rutski contradicts the prior thirteen pages he spent defending Section 2.2(c) and attacking APL's requested relief -- that the Board not interfere in its commercial relationship with Conrail and Conrail's successors by striking down section 2.2(c) and not voiding anti-assignment clauses.

Contrary to Applicants' position, APL does not believe that section II. C. of the Agreement Between the National Industrial Transportation League, Norfolk Southern, and CSX (the "NITL Settlement"), CSX/NS-176 at 768-774, provides a solution to the problems of Section 2.2(c). Section II. C. is very narrow. First, it only applies to contracts between Dual points where the allocated railroad has not met the shippers' service requirements within the first six months after the Closing Date. Second, it provides relief only as to service issues.

Mr. Prillaman has said that the Closing Date could be as early as October 1, 1998 (Prillaman TR at 9), but Mr. Hart said the Closing Date could be six to nine months after the Control Date (Hart TR at 278). If the Board approves the proposed transaction and issues its decision according to schedule on July 23, 1998, with a typical 30 day effective date, the Control

Date could be August 22, 1998 at the earliest. Six months after that is late February 1999, the Closing Date projected by Mr. Hart. Section II. C. cannot be used until six months after the Closing Date. Based on Mr. Prillaman's earlier Closing Date of October 1, 1998, Section II. C. would apply to Rail Transportation Contracts still in effect on April 1, 1999. Using Mr. Hart's later Closing Date of late February 1999, Section II. C. would only apply to Rail Transportation Contracts still in effect in late August 1999. The only Rail Transportation Contract of record in this proceeding that would still be effective on either of those dates involving service between Dual points and therefore eligible for relief under the NITL Settlement is the APL-Conrail Contract.[43] Based on the record, Section II. C. would only apply to APL.

But APL, which did not enter the NITL Settlement, does not believe that Section II. C. provides any real relief. Section II. C. allows a shipper dissatisfied with the service it is receiving to notify the railroad providing its service of its dissatisfaction and gives the railroad a chance to solve the problem. If the service problem cannot be solved, the matter can go to arbitration, where if there is just cause the arbitrator can only order the transfer of the service obligation to the other railroad. However, the service responsibility can be transferred **only** if the transferee does not certify that it cannot perform the service.

The arbitration cannot affect any other rights or terms under the contract (*See* CSX/NS-176 at 771-772), yet service is only one of the many potential problems that APL has with the allocation of the APL-Conrail Contract under Section 2.2(c). Since Section II. C. does not address any of APL's other problems, as explained previously, and makes it extremely difficult to transfer service, APL views this provision as no relief at all. As the only shipper with

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[43] APL attempted to find out how many Rail Transportation Contracts would be effective on April 1, 1999. See APL-12. Applicants objected, and APL's Motion to Compel, APL-16 was denied by Judge Leventhal on February 5, 1998. APL then sought to depose Mr. John Q. Anderson of CSX, a signatory to the NITL Settlement, APL-17. Judge Leventhal granted CSX's Motion to Quash, CSX/NS-200 on February 12, 1998. Applicants have blocked all of APL's efforts to discover this information and have not presented one scintilla of evidence to support Section II. C.

evidence of record that Section II. C. would apply to its contract, APL believes the Board should not impose this "do nothing" provision, upon it.

In light of all the problems with Section 2.2(c) pointed out in APL's Response and here and the lack of practical assistance from the NITL Settlement, APL believes there is a better solution. That is the solution that APL has advocated from the start: face-to-face negotiation between CSX and APL and between NS and APL, with APL selecting the right rail carrier for the right traffic lane. But this simple solution, Applicants claim, is precluded by Section 2.2(c).

When CSX and NS entered the letter agreement on April 8, 1997,[44] they could have begun the process of negotiating with shippers under contract to Conrail at that time. They could have created teams (there are already several hundred implementation teams at CSX and NS, CSX/NS-177/2A, Rebuttal Verified Statement of Ms. Nancy S. Fleischman, at 95 and Applicants' Rebuttal, Volume 2B, CSX/NS-177, Rebuttal Verified Statement of Mr. Michael J. Ward at 7) to negotiate with shippers after signing confidentiality agreements with those shippers. Instead, CSX and NS chose to establish Section 2.2(c).

There is still time, however, for CSX and NS to compete for Conrail's traffic under Rail Transportation Contracts. Both CSX and NS have said that where traffic is not moving under contract, the shipper will decide whether CSX or NS will get its traffic. Prillaman TR at 14-16, Jenkins TR at 8-9, [[ ]]. Conrail's contract shippers should not be treated differently than its common carriage shippers. APL proposes that, if the Board approves the transaction, strikes Section 2.2(c), and does not void anti-assignment clauses, on June 9, 1998, the day after the Board's scheduled public voting conference, APL will enter confidentiality agreements with CSX and NS and allow them access to the APL-Conrail Contract. By August 9, 1998 CSX and NS will submit proposals for handling APL's traffic (during the time between June 9 and August 9, APL and Conrail personnel will discuss any issues and questions that CSX or NS has). By September 9, 1998 APL will respond to the proposals so that CSX and NS can then plan for and allocate the resources necessary for operations on the Closing Date. This meets

[44] CSX/NS-25/8A, at 350-399.

Applicants' stated objective for Section 2.2(c), knowing which railroad will provide which service to which shipper on the Closing Date so that they can allocate the necessary resources. This will also be consistent with the sworn testimony of Mr. Snow and Mr. Goode advocating competition between CSX and NS. This will be a burden on APL and Applicants. APL is willing to take on the burden, and Mr. Prillaman said that it can be done. Prillaman TR at 25-27. And it will not be much more of a burden than what Applicants now face: they must go through each contract and decide which railroad will provide the service. The result of APL's proposed solution in contrast to Applicants' plan will be that the two main rail competitors in the eastern United States will not collude to divide Rail Transportation Contracts, but instead will bid for them.

As previously explained, preemption of Rail Transportation Contract rights is not necessary for Applicants to implement their partition of Conrail. Applicants have options available to them which are not contrary to the public interest or anticompetitive.

3. Applicants' Proposed Division of Contracts is Anticompetitive.

The application of Section 2.2(c) to Rail Transportation Contracts and the voiding of non-assignment clauses in those contracts not only will create the potential for inadequate transportation but will be contrary to the public interest because they will allow two competitors to divide markets.

There can be no doubt that the territorial division of traffic proposed by Section 2.2(c), especially when considered in conjunction with the Applicants' attempt to eliminate the shippers' contractual right to refuse to agree to assignment of their contracts, is a per se restraint of trade. CSXT and NSR are competitors between Dual points, yet Section 2.2(c) would allow them to sit down and divide up those horizontal markets and shippers would be required to accept that market division if their anti-assignment clauses were voided. The Department of Justice, in this proceeding has stated that it is possible that one Rail Transportation Contract can be a market. See Volume 2A - Public Appendix, Deposition of Dr. Peter A. Woodward at 44-45 (to be cited as "Woodward TR at __"). Division of even one Rail Transportation Contract that

requires service between Dual points by these two competitors is a classic case of a horizontal conduct which the Supreme Court has found to be per se illegal. *United States* v. *Topco Associates, Inc.*, 405 U.S. 596 (1972).[45]

If allowed to divide up Conrail's contracts between Dual points, depriving contract holders of the right to refuse to consent to the assignment, Applicants will have created an unreasonable constraint on competition. *See* Woodward TR at 44, where Dr. Woodward said "...from an economic point of view an agreement between the only competitors in a market on the way in which the market would be divided ought to be looked at carefully, the incentives of the competitors probably aren't in line with the incentives of the consumers who are buying..."

Not only is the result of Applicants' implementation of Section 2.2(c) and the novation of the anti-assignment clauses anticompetitive, but the very process of dividing the contracts also raises serious antitrust concerns. Applicants have explained that, after the Control Date, they will determine whether CSX or NS will operate a Rail Transportation Contract between Dual points. To reach that agreement, CSX and NS will have to review each Rail Transportation Contract between Conrail and its shippers. The result is that these two rail competitors will necessarily share rate information. Regardless of the railroad chosen to serve APL, its competitor will have had knowledge of and access to APL's rates. "Absent immunity, *** compilation and dissemination of rate information would subject [participants] to severe antitrust risks." *Central & Southern Motor Freight Tariff Ass'n* v. *United States*, 777 F.2d 722, 732 (D.C. Cir. 1985), *citing United States* v. *Container Corp.*, 393 U.S. 333 (1969), and *American Column and Lumber Co.* v. *United* States, 257 U.S. 377 (1921). "Because agreements among firms to

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[45] Even though the partition of Conrail by CSX and NS can be viewed as a joint venture, the effect of Section 2.2(c) is to allocate markets. This should not be allowed. *See Citizens Publishing Co.* v. *United States*, 394 U.S. 131, 135 (1969) where the formation of a joint venture by two competing newspapers for combined production and distribution was illegal "beyond peradventure" since it pooled profits and fixed prices. "Even if the essential business of a joint venture is lawful, collateral restraints limiting competition among the venturers or its parents may be unreasonable where participants in a joint venture are actual or potential competitors." ABA Antitrust Section, Antitrust Law Developments (2d ed. 1984) at 51. Section 2.2(c) and the voiding of anti-assignment clauses will unquestionably limit the competition between CSXT and NSR.

exchange or post price information can constitute violations of § 1 of the Sherman Act (although not on a per se basis), systems providing for such exchanges are viewed with suspicion under the antitrust laws." *See, e.g., Battipaglia* v. *N.Y. State Liquor Authority*, 745 F.2d 166, 172 (2d Cir. 1984); *Flav-O*-Rich v. *N.C. Milk Comm'n*, 593 F.Supp. 13, 15 (E.D. N.C. 1983); *Railroad Transportation Contracts*, 3 I.C.C. 2d 219, 228-229 (1986). Hence, even the process of partitioning the Conrail Rail Transportation Contracts raises serious and significant anticompetitive concerns.

The transaction as currently structured clearly creates potential anticompetitive effects. The Board has held that anticompetitive effects are contrary to the public interest. 49 C.F.R. §1180.1(c)(2); and *Santa Fe Southern Pacific Corp.--Control--SPT Co.*, 2 I.C.C. 2d 709, 726 (1986). Typically, the Board imposes conditions to ameliorate potential anticompetitive effects. 49 C.F.R. 1180.1(d)(1). To ameliorate the harm here, the Board using its authority under Section 11323, must strike down at the very least the anticompetitive portions of Section 2.2(c) dealing with the allocation of contracts between Dual points. Further, it must refuse Applicants' request to void anti-assignment clauses.[46]

C. SECTION 2.2(c) IS INCONSISTENT WITH THE APL-CONRAIL CONTRACT

Section 2.2(c) is a complex formulation developed primarily to divide the revenue generated by Conrail's Transportation Contracts between CSXT and NSR.[47] However, except for service between Dual points, Section 2.2(c) actually accomplishes nothing more than what would happen in the normal course of events because of the division of routes proposed by

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[46] "[T]he Commission can modify terms of agreements submitted to it. *"Chicago & N.W. Transp. Co.--Construction*, 363 I.C.C. 905, 918-919 (1981); *Illinois Central Gulf R.--Acquisition--G., M. & O., Et. Al.*, 338 I.C.C. 805, 844 (1971); *Great Northern Pac. & B. L.--Merger--Great Northern Ry. Co.*, 331 I.C.C. 228, 245-248 (1967); *Walker* v. *United States*, 208 F. Supp. 388, 395 (W.D. Tex. 1962)(three-judge court), *affirmed* 372 U.S. 526 (1963).

[47] It is interesting to note that in filing its rebuttal, Applicants did not provide any witnesses to defend Section 2.2(c), instead, they presented argument, CSX/NS-176, at 177-201, and a claim that the settlement with NITL (for which there is also no evidentiary support in the record) resolves all problems. APL previously addressed the NITL Settlement. APL notes that NS did not join in certain arguments made by CSX in rebuttal addressed to APL's position.

Applicants. Routes which are only served by one railroad will continue to be served by one railroad, regardless of Section 2.2(c). Simply put, where CSXT or NSR serve two points, but only one of the railroads serves the origin or destination, the revenue and the service obligation for the contract traffic is allocated to that railroad. *See* Section 2.2(c)(iii)(aa, bb, cc). Indeed, Mr. Prillaman in his deposition stated -- and it is consistent with common sense -- that even if section 2.2(c) did not exist, this traffic would still move over the railroad with single line service. Prillaman TR at 11-13. For inexplicable reasons, neither Mr. Jenkins of CSXT nor [[[ ]]] could reach this conclusion. [[[ ]]] APL agrees with Mr. Prillaman that the traffic that it moves over Conrail under contract will likely move over the railroad that can provide single line service.[48] Although only Dual points are truly affected, Section 2.2(c) creates other problems with the APL-Conrail Contract aside from the anticompetitive and operational issues raised above.

1. Section 2.2(c) Would Not Allow Contract Amendments and Does Not Acknowledge Section 17 Of The APL-Conrail Contract

First, Section 2.2(c)(i) states that contracts in effect on the Closing Date shall remain in effect through their stated term and that CSXT and NSR shall carry out the obligations thereunder.[49] CSX/NS-25/8B at 25. The provision creates a presumption that the contracts cannot be amended. This is contrary to the actual evolution of APL's relationship with Conrail under the APL-Conrail Contract, since there have been numerous contract changes and amendments over its ten year history. Under Section 2.2(c)(i) that flexibility will be eliminated.

The second major problem is that, although Section 2.2(c)(i) requires compliance with Section 17 (Inequities) of the APL-Conrail Contract, Applicants have refused to acknowledge

[48] Based on its analysis of the operating plans and schedules proposed by CSXT and NSR at this time, APL has found no joint line CSXT/NSR service that appears to be as efficient as single line service. Since APL requires the most efficient service available, it sees no alternative to using single line service.

[49] Section 2.2(c)(i) states that the "obligations thereunder shall be carried out..." CSX/NS-25/8B, page 25.

that obligation. Section 17 states: "It is the further intent of the parties that they shall mutually benefit from the terms, conditions and provisions of this Agreement, and in the event that either party shall suffer a gross inequity resulting from such terms, conditions or provisions, or from a substantial change in circumstances or conditions, the parties shall negotiate in good faith to resolve or remove such inequity. It is mutually understood and agreed, however, that nothing herein shall be construed to relieve either party of any of its obligations under this Agreement."[50]

Section 2.2(c)(i) requires NS and CSX to carry out the obligations of the Transportation Agreements. Section 17 of the APL-Conrail Contract requires negotiations if there are substantial changes in circumstances or conditions. If Section 2.2(c)(i) truly took precedence over all of the other provisions of Section 2.2(c), then Applicants would be required to negotiate with APL to resolve the inequities created by the transaction in order to meet the obligation of Section 17 of the APL-Conrail Contract.[51]

2. Section 2.2(c) creates a disincentive to handle Dual points under Rail Transportation Contracts.

Section 2.2(c)(iii) does not provide the criteria for allocating Rail Transportation Contract traffic where CSXT and NSR can both serve the origin and destination.[52] The "protocol" for CSXT and NSR to allocate traffic between Dual points is set forth in Section 2.2(c)(iv). It provides that where Dual points are covered by a Rail Transportation Contract, CSXT and NSR will "promote the use of efficient routes, high-quality service and consistency of service to customers, and in that connection there shall be a presumption against dividing a contract between a single destination and a single origin between the two carriers." The problem is that CSX and NS have not figured out how to do this. First, CSXT and NSR do not agree on which points are Dual and which are not. [[

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[50] CSX/NS-178/3D, at 237.

[51] [[[

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[52] Where CSXT and NSR serve the same point, that is defined in the transaction Agreement as a "Dual," a station with line haul service by both.

]][53] [[

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Second, the criteria for allocating traffic under Rail Transportation Contracts are not precise. Reasonable people could differ over whether CSXT or NSR has the more efficient route, high-quality service, and consistency of service to customers. Mr. Orrison, the CSXT operating witness, and Mr. Mohan, the NSR operating witness, were not willing to say, and therefore could not agree, on which railroad provided the more efficient service between Chicago and APINY. North Jersey Response, Exhibit A, Deposition of D. Michael Mohan and John W. Orrison at 170-171. This is APL's densest corridor, moving over 91,000 containers in 1996. See Applicants' Rebuttal Volume 3A, CSX/NS-178, at 310. APL can certainly not determine which railroad will serve it from the available information, and it seems that neither CSXT nor NSR know either. As Mr. Hart answered when asked "Who will provide APL's service between Chicago and South Kearny?" it is "Not settled." Hart TR at 273, lines 9-15.

The problem with this confusion is that, although substantial APL traffic between Chicago and APINY is available to CSXT or NSR[54], Section 2.2(c) actually creates a disincentive for either railroad to handle the traffic. Where service is provided between Dual points, revenue and expenses are to be allocated on the Percentage Division. Section 2.2(c)(iii)(C)(cc)(z). The term "Percentage Division" means 50% CSXT and 50% NSR. Section 2.2(c)(iii)(B). Hence, regardless of which railroad serves APL between Chicago and APINY, it will receive only 50% of the revenues and the other railroad which is not performing any service

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[53] [[

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[54] Section 2.2(c)(iv) creates a "presumption against dividing a contract between a single destination and a single origin between two carriers." There is no indication in this record that CSXT or NSR intend to challenge that presumption, even on traffic volumes the size of APL's.

for APL will also receive 50% of the revenues. Being the non-serving railroad is a deal that any corporation would find attractive! But from the customer's standpoint, the arrangement is anything but attractive. The incentive to handle the traffic is diminished because the railroad providing the service will only receive 50% of the revenue that it would normally receive, while the incentive for sitting home and receiving a check for doing nothing is greatly enhanced.[55] Mr. John W. Snow, the Chairman, President and Chief Executive Officer of CSXC, said "[w]e will share certain assets, but we will price and market independently...no one should doubt the determination of both companies to compete vigorously." Snow VS at 315. An admirable sentiment, but Section 2.2(c) does not permit any, much less vigorous, competition for Conrail's contract traffic between Dual points.

APL contracted with Conrail; now it is faced with a situation not of its own making, in which it must deal with CSX and NS where neither has great incentive to serve APL's Dual point traffic. APL should not receive less than it now has, but it **should** be made whole in light of the changed circumstances. That is the purpose of Section 17. [[[

]]] This Board should not allow Applicants to use Section 2.2(c) to deprive contract holders of their contract rights.

3. APL's Anti-Assignment Clause Is An Integral Part Of The Contract.

In entering the APL-Conrail Contract, APL (as we suspect other shippers did)[56] required a provision in its Rail Transportation Contract prohibiting assignment of the contract or delegation of duties under the contract without prior consent of the other party.[57] This provision

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[55] Mr. Prillaman of NSR was not happy with this prospect of handling all of the traffic and receiving 50% of the revenue, Prillaman TR at 28-29, [[

]].

[56] See Verified Statement of Linda L. Kelly on behalf of Eastman Kodak Company, EKC-2, at 5.

[57] The Assignment provision in Section 19 of the APL-Conrail Contract states: "No party hereto may assign this Agreement, in whole or in part, or any rights granted herein, or delegate to another party any of the duties hereunder, without the prior written consent of the other parties;

creates protection for parties in a situation just like this one; it allows a party to terminate a Rail Transportation Contract if it does not wish to work with the proposed assignee.

APL's assignment provision is not the "boilerplate" anti-assignment clause disparaged by Applicants in their Rebuttal.[58] This provision not only allows both parties to back out of the Rail Transportation Contract if they do not want to work with a proposed assignee or delegee, but it also specifically allows assignment within APL's corporate family without Conrail's prior consent. But, whether "boilerplate" or not, the Board should not void contractual provisions agreed to by the parties for their protection.

CONCLUSION

Depriving APL of the right to renegotiate its Conrail contract with CSX and NS separately deprives APL of critical contract rights. Depriving all Rail Transportation Contract holders of the right to decide their own fate is anticompetitive. Nor is it needed for the proposed transaction to work. It is inconsistent with the statements made by CSX and NS that the transaction will add competition in the affected markets. The Board should not permit this result. To that end, APL prays that the Board hold Applicants to their claims of increased competition and cooperation with shippers by: (1) disapproving section 2.2(c) of the Transaction Agreement between Applicants; and (2) disapproving Applicants' request for relief (1) c. that non-assignment clauses in Rail Transportation Contracts between Conrail and shippers be

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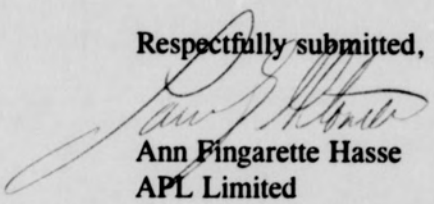
provided, however, that API or APL may assign their rights under this Agreement to another corporation under common control; and provided, further, that the obligation of API or APL shall not be assigned to such other corporation without the consent of Conrail unless its or their obligations are unconditionally guaranteed by API or APL." CSX/NS-178/3D, at 238.

[58] CSX/NS-176, at 103.

obviated. As a result of this transaction, APL should not be placed in a worse position than today. APL also asks the Board to retain jurisdiction and conduct oversight for five years so that it may take action if necessary to avoid an operational crisis in the east.

Respectfully submitted,



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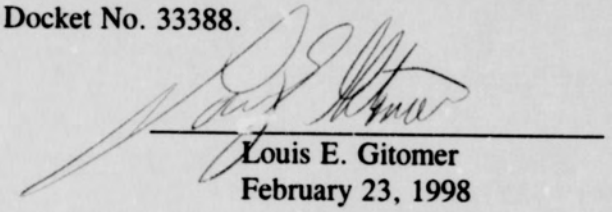
CERTIFICATE OF SERVICE

I hereby certify that I have caused the Brief of APL Limited to be served by hand on Applicants' representatives in this proceeding and by first class mail, postage pre-paid on all other parties of record in STB Finance Docket No. 33388.



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February 23, 1998

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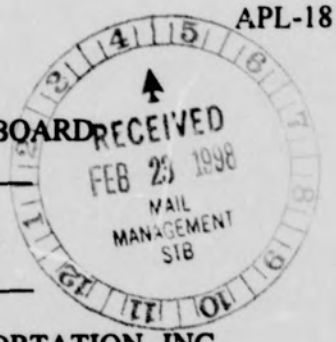


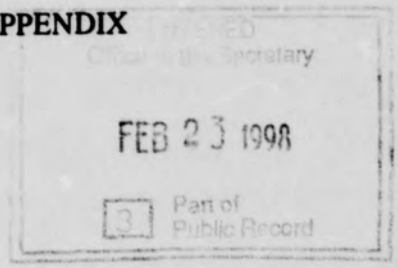
BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 33388

CSX CORPORATION AND CSX TRANSPORTATION, INC.
NORFOLK SOUTHERN CORPORATION AND
NORFOLK SOUTHERN RAILWAY COMPANY
--CONTROL AND OPERATING LEASES/AGREEMENTS--
CONRAIL INC. AND CONSOLIDATED RAIL CORPORATION

BRIEF OF APL LIMITED

VOLUME 2A - PUBLIC APPENDIX



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Dated: February 23, 1998

DEPOSITION OF DR. PETER A. WOODWARD

off peak pricing. I had a PJM monthly report, and I had some questions about it which she was able to answer. I don't remember who I talked to.

Q. In connection with preparing your statement, did you interview other members of PJM?

A. Well, I interviewed PEPCO. My answer would be the same I think to your earlier question about ECAR. I did talk to other utilities which I believe are members of PJM but I did to the talk to them specifically about the PJM network.

Q. Did you develop any conclusions as to circumstances under which its economical for PEPCO to purchase power through the PJM Interconnection Association rather than generating it itself?

A. Yes.

Q. And what were they?

A. That the PJM would not provide any – a perfect substitute for PEPCO's own generating stations, particularly PEPCO's most efficient generating stations. That PEPCO certainly buys a lot of electricity from that network, but that would not be an adequate substitute,

that's not a perfect substitute for their own generating stations.

Q. How much of PEPCO's power is purchased through the PJM Interconnection Association as compared to generated itself?

A. I say in my statement that they purchased over all about as much electricity as they generated. I don't know what share of that was from the PJM. I couldn't answer you specifically. I would assume that most of it was from the PJM utilities.

Q. What is the basis for the conclusion in your statement on page 21 that NS may have insufficient capacity at Lamberts Point to load additional coal that PEPCO would acquire?

A. That was from my PEPCO interview.

Q. Did you examine any documents that analyzed the capacity NS has at Lamberts Point?

A. No.

Q. Did you interview anybody at Norfolk Southern about Lamberts Point?

A. No.

Q. Did you interview anybody who is employed at

Lamberts Point about NS's capacity to load additional coal there?

A. No, the only information from Norfolk Southern about Lamberts Point that I recall is from the application, and I don't recall that there was anything in the application regarding Norfolk Southern's plans or interest in shipments to utilities like PEPCO from Lamberts Point via barges.

Q. How much additional coal would PEPCO require? I'm trying to understand the statement that you've made here, page 21, there was insufficient capacity – I'm trying to figure out how much additional coal you had in mind.

A. Well, it would depend on the situation. If CSX were to raise the rate, if – let me go back a second. If the merger goes through as planned and CSX were to raise the rate to Dickerson in Morgantown and Chalk Point a large amount, then to defeat that and to essentially cause CSX to pull back that increase, PEPCO would require a larger amount of coal from Norfolk Southern than it would if CSX only raised it a small amount. If PEPCO wanted to throw CSX out of Morgantown,

for example, and only use Norfolk Southern supply barges, assuming the barge operation could occur, it would need two and a half million tons a year approximately if PEPCO wanted to completely replace CSX.

Q. Do you believe that PEPCO would have to completely replace CSX in order to constrain CSX rail rates?

A. No, depending on the size of a price increase that CSX would try to impose, PEPCO would just need enough to make that price increase unprofitable, and that would depend on, as I mentioned, CSX's price increase, the margins CSX was earning on its coal, and PEPCO 's ability to shift out – electricity output from one generating station to another. That would be the most extreme response PEPCO might make.

Q. Do you know what NS's capacity at Lamberts Point to load coal is?

A. No.

Q. Do you have an understanding for PEPCO's –

the
basis for PEPCO's belief that you referred to in your statement that NS accessed two types of coal that PEPCO uses might be inferior?

Page 39

A. I'm sorry, what – could you repeat that, please?
Q. Do you have an understanding of what PEPCO's basis for the belief that NS has inferior access to the types of coals they use?
A. PEPCO, in making that point to me, PEPCO talked about things like the sulfur content of the coal and PEPCO's ability to use the different types of coal in its different generating stations. I couldn't say much beyond that.
Q. Did you do anything to independently verify PEPCO's belief?
A. No.
Q. Do you have an understanding from whom permits would be required in order to build a facility that could serve barges bringing coal to PEPCO's Morgantown plant?
A. I think there would have to be both a Coast Guard permit and – to operate the barges and a permit to construct the facility, a separate permit, and I don't know who would have to issue that.
Q. Did you interview anybody at the Coast Guard regarding this?

Page 40

A. I made one call to someone in the Coast Guard with some questions about navigation in the Potomac and he gave not much – did not provide much information to my questions.
Q. Did you review any PEPCO documents relating to the prospect for delivery of coal by barge to Morgantown?
A. I did after I prepared my statement. I did not review any documents on that where before I prepared my statement. I only had talked to PEPCO about what these studies said.
Q. When you prepared your statement, do you have any evidence that PEPCO had ever substituted – generated at one of its plants in order to constrain rail rates at another of its plants?
A. Not – no, not substitution because of past rail rates or current rail rates. The issue of substitution came up, and PEPCO talked about how they would do it based on fuel costs, but they did not say that at current rates they had done that.
Q. Do you know if PEPCO had ever threatened to substitute generation at one of its plants in order to constrain rail rates to another of its plants?

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A. No, I don't know.
Q. At this time, Dr. Woodward, I don't have any further questions. I would like to reserve the right perhaps to follow up briefly. If any of the other counsel have questions.
MS. DURHAM: I have some.
(Brief recess taken.)
EXAMINATION BY COUNSEL FOR IP&L
BY MS. DURHAM:
Q. Doctor, my name is Brenda Durham and I represent Indianapolis Power & Light in this proceeding. I just have a couple of questions for you. On page 1 of your testimony in the first footnote you state that you testified in the BNSF merger on use of competitive effects as well as trackage rights and haulage rights.
A. Yes.
Q. In that proceeding did you state that trackage rights should be based on the railroad's cost of service?
A. Yes.
Q. And as an economist, do you agree that as a competitor soliciting new or incremental business must consider its variable cost in developing its prices?

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A. Yes.
Q. That concludes my questions for you, Dr. Woodward, thank you.
(Discussion off the record.)
EXAMINATION BY COUNSEL FOR APL
BY MR. GITOMER:
Q. Good afternoon, Dr. Woodward. I'm Louis Gitomer with Ball Janik LLP. I'm on behalf of APL Limited. I have questions for this afternoon both about your statement and about some general issues in this case which weren't touched on in your statement. From your statement it seems that you reviewed the CSX/Norfolk Southern application to control and partition Conrail in some detail; is that correct?
A. That's correct.
Q. Do you recall whether you reviewed section 2.2C of the transaction agreement which is in volume 8 at pages 25 to 29 referred to on the front cover volume as CSX/NS 25?
A. No.
Q. Did you review the transaction agreement

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between CSX and Norfolk Southern?
A. Yes, I did, particularly when I was interested in particular lines or areas and try to understand exactly what – which Conrail asset was being allocated to Norfolk Southern and which asset was being allocated to CSX.
Q. Did you review the pleadings in this proceeding that were filed on October 21st?
A. Could you explain what you mean by the pleadings?
Q. On October 21st you filed your statement and all of the other parties filed statements either in opposition requesting conditions seeking responsive applications.
A. Oh, yes, I did review many of those that were filed, yes.
Q. Do you recall if you reviewed the pleading filed by APL Limited which is designated APL?
A. No, I do not.
Q. But is it possible that you did review it, you just don't remember?
A. That's possible, yes.

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Q. Let me give you a hypothetical. If there are two entities that decide to enter a market and they are the only two entities serving that market, and there are no other competitive restraints on them, would you be concerned if the two entities agreed on how they would divide the market?
A. Yes, generally.
Q. And why would that be?
A. Well, that could constitute explicit market allocation. I don't want to get into what sort of law violations that might involve, but certainly from an economic point of view an agreement between the only competitors in a market on the way in which the market would be divided ought to be looked at carefully, the incentives of the competitors probably aren't in line with the incentives of the consumers who are buying and the competitors.
Q. Thank you. Speaking of the definition of market, how narrow do you think a market could be drawn perhaps to, say, a single contract?
A. The market, a single shipper, if that's a fair answer – if by that you mean a contract to a specific

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shipper, the market could only be, for example, rail transportation to a particular shipper. It could be defined that way.
Q. That's a fine answer. How important is the ability of a buyer of a service to freely choose who will purchase that service from?
A. Could you ask – I don't quite understand that.
Q. That's fine and, again, if you don't understand any of the questions, please ask me. I'll try to make them clearer for you.
One of the utilities that your statement talks about, how important would it be for that utility to be able to choose which railroad serves it?
A. Well, I don't really know how to answer that. If the utility has two competitors currently serving it, of course it's important that the utility have the right to choose one competitor. The other that will keep competition at two and not at one. I would be concerned if the ability of the utility were – the ability of the utility to choose one competitor or the other, if that were eliminated, if that is what you're asking?
Q. Yes, that's what I'm asking. The utility has

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to have the ability to choose in order for there to be any competition at all.
Q. If the competitors by agreement between them determined that the utility would not – or let me expand it. Not just utility but another shipper would not have the opportunity to choose between the two competitors, would that cause you some concern?
A. Well, it would, but let me just clarify the kind of situation I'm thinking about when I try to answer your question. It would be important that the buyer have a choice of two existing – between two existing competitors. It would be less important if, for example, there were a single competitor serving a buyer and that competitor were being replaced by a different competitor, it might not be important whether the customer had the ability to choose which of the two competitors was going to replace the existing competitor.
I'm trying to distinguish between what I think are two very different situations which I think each could fall under the – in the situation of your question.
Q. Yes, they could.

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A. I just want to make that distinct that the buyer certainly needs to keep – it would be good if the buyer retains the right to pick between two existing competitors. I think generally it would be less of a concern if the buyer didn't have the right to choose which of two new competitors was replacing an existing competitor. If the customer was going to only end up with one customer – excuse me, if the customer were only going to end up with one competitor in the end.

Q. Now, if the customer were to end up with two competitors in the end but the competitors told the customer we will decide which one of us serves you?
A. Well, that would be – I'm not sure what you're asking. In terms of how that would be bad for competition, it would be bad if the two competitors were deciding that instead of both of them serving the customer, that only one of them would. In the situation where there were two competitors at the beginning, that the agreement between the competitors caused there to be a reduction in the number of competitors to the customer, that would be the worst situation for the customer.
Q. Okay. I'm following your answer. Let me ask

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some general questions about some background. Are you familiar with the – generally with intermodal service provided by the railroads?
A. Generally, yes.
Q. And what about double stack service, do you know what that is?
A. I know what it is. I don't know much about it beyond that.
Q. Why do you think shippers use intermodal rail service as opposed to just truck service?
A. Well, it's frequently much cheaper if it's a long haul. It's particularly in the west in the earlier railroad proceedings I looked at intermodal more than I did in this current proceeding. If it's a haul over, say, 500 miles, it's likely that the containers of trailers can be carried much more cheaply on a railroad than they can individually on trucks.
Q. And the same would apply for double stack service?
A. I would assume so. I don't know much about double stack service except there are more containers per car, I suppose. I would assume that something that was

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generally true for intermodal would be true for double stack service.
Q. How many railroads today provide service between the East Coast and the gateways on the Mississippi River?
A. Well, before, currently?
Q. Currently.
A. Three possibly. Something involving one of the Canadian railroads but that would be a circuitous route. I would say three, three is the answer.
Q. After CSX and Norfolk Southern partition Conrail?
A. Two.
Q. Do you know of any other railroads and let's exclude the Canadian right now, that can handle the intermodal traffic between Mississippi gateways and CSX, Norfolk Southern, and Conrail?
A. No.
Q. And after the partition of Conrail it would be limited to only CSX and Norfolk Southern?
A. Yes.
Q. So then there won't be any alternatives to CSX

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and Norfolk Southern in the eastern United States after the partition of Conrail, any rail alternatives?
A. No other rail alternatives, yes.
Q. Do you think there's any likelihood of a new rail entrance in the eastern United States after the partition of Conrail by CSX and Norfolk Southern?
A. I think it's unlikely for the route you're talking about, the eastern – East Coast, say, to the Mississippi gateway it seems extremely unlikely.
Q. Now, if there were open competition between CSX and Norfolk Southern for intermodal and double stack traffic in the markets where they will compete after partition of Conrail, do you see any problem?
A. Could you ask that again? I didn't understand.
Q. That's okay. After the partition of Conrail, there will be markets where CSX and Norfolk Southern compete for intermodal traffic. If there is open competition between the two, unfettered competition, do you see any problem with that?
A. Well, I don't know quite how to answer that. Do you mean problem in the fact there were two of them competing now and there were three of them on some

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particular routes? There were three of them competing before there was a reduction or generally –
Q. Generally it's not a three to two question. It's a question of if there are two competitors and they're competing, do you think there's any problem with that?
A. I still don't know what you're asking. It's better for them to be competing than if there were only one, but I don't think that's what you're asking.
Q. I'm just asking you a general question. If the two of them compete, and I think from APL's perspective we don't see a problem if the two of them are competing head to head in different markets. And all we're asking is whether you think there might be a problem if they're competing.

Let me turn the question around and ask a reverse of the question. Is there a problem if CSX and Norfolk Southern have voluntarily agreed not to compete for certain intermodal and double stack traffic after the partition of Conrail?

A. Well, any agreement between those two competitors not to compete for any kind of traffic

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including the traffic you're talking about might be bad for consumers. It's hard to answer precisely how bad, whether – and also I don't know whether they're agreeing not to compete when only one of them – when they could not compete anyway.

Q. No, this is only in this situation where they could compete. I'm not asking you about a situation where they have divided Conrail and –

A. So you're asking me is it bad, say, for consumers if CSX and Norfolk Southern agree not to compete in a market where they could compete?

Q. Yes.

A. Generally that will be bad for consumers, yes.

Q. In fact I can probably skip a couple of questions and give you a – I will phrase it as a hypothetical since I don't want to testify, but it's based on some of the facts in this proceeding. Both CSX and Norfolk Southern will be able to serve Chicago and both will, by definition, serve the North Jersey shared asset area. Let's assume for the hypothetical they both serve the Chicago area and interchange with western

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railroads there and both shared the North Jersey shared asset area. And they agree to divide the traffic between those two points between them, regardless of the wishes of any shippers, regardless of any contract provisions between Conrail and shippers, would that raise any competitive problems or red flags for you?

A. Well, it might. It would depend – whether it did, though, would depend critically on how they were – what dimension of their competition they were agreeing to eliminate. Exactly how they were agreeing not to compete. For example, if CSX and Norfolk Southern agreed on a rate to charge any shipper who was shipping from Chicago to the New Jersey shared assets area, they agreed on a rate of a thousand dollars per container, that would, I think, certainly be an agreement that was bad for consumers.

On the other hand, if CSX and Norfolk Southern were in the course of their allocating the Conrail existing Conrail lines, if they agreed that CSX would get one a certain route and Norfolk Southern would get another route and neither would contest the other one getting a certain route, that's a very different kind of

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agreement not to compete.

When I answered your earlier question about agreements where I said that agreements between competitors are certainly suspicious, I want to qualify that. That it's critical to see exactly what they're agreeing on. For example, if their agreement were something like a joint venture, there could be some – or a new product or product that had a fundamentally different quality or something like that, this could be an agreement that is beneficial. It's very hard to answer your question about whether the agreement is good or bad for consumers without knowing – without understanding exactly what dimension of their competition that they're agreeing on.

Q. What do you mean by dimension?

A. Well, okay. Are they agreeing on providing a completely new product that neither one of them has provided before? Are they agreeing on allocating lines or are they agreeing on what the price they're both going to charge for transportation between the same two points.

These are three very different kinds of agreements, all of which are agreements not to compete broadly defined.

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They're all agreements about the way in which they compete. I'm not trying to avoid your question but without knowing what kind of agreement it is, it's hard to answer.

Q. We'll get to exactly what the agreement is.

A. Okay.

Q. Dr. Woodward, do you know or believe that Conrail's transportation contracts which are defined in this transaction agreement and they are defined as on page 23 of volume 8B of the control application, and I did not provide you with that but let me just read this to you. Transportation contract means contracts between rail carriers and a person or persons relating to the purchase of rail transportation services. As specified in 49USC10102, paren, 9, paren, barge A, it's essentially a contract between Conrail and a shipper for Conrail to provide service as opposed to under a tariff.

A. Okay.

[19] *Q. Now, do you know or believe whether Conrail's*
[20] *transportation contracts are a substantial asset of*
[21] *Conrail?*
[22] **A. I would expect they would be a very valuable**

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[1] **aspect, existing contracts, yes, I would predict that.**
[2] *Q. When you looked at the division of Conrail's*
[3] *aspects of CSX and NS, did you consider Conrail's*
[4] *transportation contracts?*
[5] **A. Only indirectly. For example, when a Conrail**
[6] **contract was the result of some Conrail competition with**
[7] **CSX or Norfolk Southern, I would have been – if I quoted**
[8] **it in my statement – a rate it might have been a rate**
[9] **from a contract. But beyond that I did not specifically**
[10] **consider the Conrail contracts.**
[11] *Q. Just take a couple of minutes and read the*
[12] *section 2.2C which I provided you which begins on page*
[13] *25. And this is section 2.2C of the transaction*
[14] *agreement which is in volume 8A of the railroad control*
[15] *application. While you're reading that, please keep an*
[16] *eye out for any provisions that indicate that a shipper*
[17] *party to a transportation contract with Conrail has any*
[18] *input into the division of that contract between CSX and*
[19] *Norfolk Southern.*
[20] **A. So you want me to read C and what follows C?**
[21] *Q. Right, C through the end of the document I*
[22] *provided you.*

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[1] **A. Okay. Okay, I reviewed it quickly.**
[2] *Q. Okay, thank you. Did you see anywhere in*
[3] *section 2.2C where a shipper gets to have any say in how*
[4] *its contract with Conrail would be divided by CSX and*
[5] *Norfolk Southern?*
[6] **A. No. The allocation seems to be based on the –**
[7] **which line its originating terminating. That seems to be**
[8] **the rule.**
[9] *Q. Let me ask you some – I'm not going to ask you*
[10] *to interpret the contract. I don't expect you to*
[11] *memorize it or have a great understanding on your quick*
[12] *peruse. I appreciate that. On page 26 at the top there*
[13] *is section barge B right at the top which talks about*
[14] *percentage division, and under this agreement how is –*
[15] *what is the percentage division?*
[16] **A. 50 percent CSX, 50 percent Norfolk Southern.**
[17] *Q. Thank you. Then further down on the page there*
[18] *is section 3C which – does that tell us how the revenue*
[19] *will be allocated between CSX and Norfolk Southern?*
[20] **A. Yes.**
[21] *Q. And then on page 28 there is section down at*
[22] *the bottom of the page, section IV. Does the first*

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[1] *sentence there tell us how responsibility for the*
[2] *performance of contracts will be allocated?*
[3] **A. Yes.**
[4] *Q. And how is that to be done?*
[5] **A. It looks like it will – the responsibility**
[6] **will be the same as the allocation earlier in the**
[7] **contract. Responsibility will be allocated in the same**
[8] **way that the revenues are allocated I think as described**
[9] **earlier in the contract.**
[10] *Q. Thank you. Now, later on in that same section,*
[11] *isn't there an exception?*
[12] **A. Yes.**
[13] *Q. And I think as relevant to what I would like to*
[14] *discuss is section 2.2CIII barge C CCZ, one of those*
[15] *exceptions?*
[16] **A. Yes.**
[17] *Q. Now, do you know that after the partition of*
[18] *Conrail CSX will be able to operate between Chicago and*
[19] *the North Jersey shared asset area?*
[20] **A. Yes.**
[21] *Q. And is the same true for Norfolk Southern?*
[22] **A. Yes.**

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[1] *Q. Can you tell from the section on page 27*
[2] *section 2.2C III barge C CC which is right at the top Z,*
[3] *how CSX and NS will allocate the traffic moving between*
[4] *Chicago and the North Jersey shared asset area?*
[5] **A. Well, it looks like they'll divide the**
[6] **revenue – well, I'm sorry could you repeat the question,**
[7] **please?**
[8] *Q. Under this section CCZ which begins at the top*
[9] *of page 27 and the relevant parts of the large paragraph*
[10] *CC and the subparagraph Z.*
[11] **A. Yes.**
[12] *Q. Can you tell how CSX and NS will allocate the*
[13] *revenue for traffic moving between Chicago and the*
[14] *North Jersey shared asset area? I think your answer*
[15] *was –*
[16] **A. I think so, yes. Well, there's a rule here for**
[17] **how they'll divide the revenue. I don't understand it.**
[18] **There is a rule here.**
[19] *Q. Okay. That's fair enough. I'm not trying to*
[20] *make this more –*
[21] **A. It's just hard to follow the whole contract at**
[22] **once.**

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[1] *Q. Does it seem that the division will be on the*
[2] *percentage division basis of 50 percent to CSX and 50*
[3] *percent to Norfolk Southern?*
[4] MR. DENIS: I'm going to object to the
[5] question. The document speaks for itself. If you're not

asking him to interpret it, he's already answered your question.
BY MR. GITOMER:
Q. You can go ahead and answer.
A. It looks like the percentage division in the part you referred to but then – and earlier it looks like percentage division means 50 percent CSX and 50 percent Norfolk Southern. So it appears they're dividing things 50, 50.
Q. As far as revenue is concerned?
A. It looks that way, yes, yes.
Q. Now, from the same section, can you tell how they will allocate responsibility for traffic moving? And let me suggest –
A. No.
Q. Then let's go – that's fine, let's go back to subsection 4 on page 28 which we spoke about before and

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which contains certain exceptions as to how the responsibility for traffic will be allocated. From section 4, can you say how that traffic would move or, excuse me, who would move that traffic, whether it would be CSX or Norfolk Southern?
A. I don't know. I can't tell.
Q. That's a fair answer. Now, hypothetically let me ask you a question. After the partition of Conrail, do you see anything in section 4 on page 28 that would prohibit CSX from handling, say, 80 percent of APL's traffic between Chicago and the North Jersey shared asset area?
A. But this seems to be written in terms of existing contracts.
Q. Yes.
A. So it – I'm not sure I understand from this how the – if the existing contract had – well, okay. I don't know. Could you repeat the question, please?
Q. Is there anything that you see that would prohibit CSX from handling 80 percent of the traffic of APL's traffic that Conrail now handles between Chicago and the North Jersey shared asset area?

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A. It seems like it would be 50/50, if I'm reading this correctly, but I don't know. I can't answer that.
Q. That 50/50 is based on a decision between which parties?
A. CSX and Norfolk Southern.
Q. Do you see anywhere that APL has had any input into this decision?
A. No.
Q. Do you agree that section 2.2C, again based on your review today, prevents a shipper with a transportation contract with Conrail from negotiating with CSX or NS for the provision of service after the partition of Conrail?
A. No, it appears that the shipper is not making the decision of what the allocation will be. The allocation is going to be based on what particular Conrail assets of the traffic is moving on right now.
Q. Now, if the Conrail assets that the traffic is moving on right now can be used by both CSX and Norfolk Southern after the partition, do you think that this provision may limit a shipper's competitive options?
A. Well, yes, if this contract is specifying fixed

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allocation of revenue and presumably traffic between CSX and Norfolk Southern, then I suppose the shipper necessarily follows – if the shipper has a current Conrail contract that is the subject of this agreement, that the shipper will not have an ability to increase the revenue to CSX from him and decrease it to Norfolk Southern. It seems that that contract prohibits that for the existing – under an existing contract.
Q. Do you think CSX and Norfolk Southern should be able to limit a shipper's competitive options?
A. Well, this, though, could be the kind of situation you're talking about. The shipper might want to do that and essentially get two railroads where he's now got one. If he's going to say the New Jersey area right now on Conrail from Chicago and let's suppose Conrail is the only railroad that can carry the traffic the whole way that seems correct, the shipper under this agreement it looks like the shipper is restricted in how much additional competition he can get for that same haul by getting Norfolk Southern to compete with CSX. But I don't know what the correct standard should be. This agreement because Conrail was the only

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competitor to begin with, this agreement is perhaps putting constraints on how much CSX and Norfolk Southern can compete as in a new duopoly, but I don't know what the appropriate standard is. That is it right for the shipper to get an unconstrained Norfolk Southern and CSX to compete for the remainder of the Conrail contract? So while I would say certainly the competition being restricted, it looks like the competition between Norfolk Southern and CSX is being restricted by this agreement. I don't know whether that is necessarily a

bad
thing because we're not talking about the – as I see this, we're not talking about the competitive situation that I address in my statement which is areas of likely reduction varies in competition from the current situation.
This seems to be a situation of an increase in competition from the current situation, and I don't know what the correct standard would be for that. So it's hard to answer your question.
Q. That's fine. Based on what we're doing today I don't know that there are any cut and dried answers that you could give us, but if Conrail were replaced

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completely by one of the railroads in an area where both could serve, based on this provision do you think that – would that improperly have limited the shipper's competitive options?
MR. HUTCHINS: I'm going to object to that. I'm not sure what you mean by improperly. What's your standard? Are you talking about a legal standard or something else?
MR. GITOMER: I think improperly within the testimony that Dr. Woodward has provided to the surface transportation board.
MR. DENIS: He hasn't provided any.
MR. HUTCHINS: I'm still not sure what you mean by improper.
MR. GITOMER: Dr. Woodward has provided some general principles in his testimony, and I think under those general principles that is what I'm talking about as far as improperly.
THE WITNESS: I'll try to answer it this way: If the baseline here is two independent railroad competitors, then this agreement between those two competitors certainly seems to restrict how they can

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compete.
On the other hand, if the baseline is a single railroad, and that will be replaced with two railroads competing under these provisions, it seems to be an increase in competition, although I would have to think carefully about what would be the implications of this revenue allocation rule and what kind of incentive that would create for, say, CSX to cut price to a shipper. I would have to think it through. I don't want to say something – this is a little complicated.
Whether this is an increase ~~and~~ or decrease in competition it depends on what the baseline is. This is what I would call restricted competition under this contract would seem to fall between a situation of no competition and monopoly, to completely independent competitors. I'm not sure where – it certainly falls in the middle somewhere. Whether it's closer to two independent competitors or monopolies, I don't know. I would have to think about the incentives that CSX would have in its agreement.
MR. GITOMER: Dr. Woodward, thank you very much. That concludes my questioning.

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(Whereupon, at 3:15 P.M., the deposition was concluded.)

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CERTIFICATE OF DEPONENT
I hereby certify that I have read the foregoing pages of my deposition testimony in this proceeding, and with the exception of changes and/or corrections, if any, find them to be a true and correct transcription thereof.

Deponent

Date

NOTARY PUBLIC
Subscribed and sworn to before me this day of , 19 .

Notary Public

Date

[22]

[1] CERTIFICATE OF REPORTER
[2] UNITED STATES OF AMERICA
[3] DISTRICT OF COLUMBIA
[4] I, Katie B. Stewart, the reporter before whom
[5] the foregoing deposition was taken, do hereby certify
[6] that the witness whose testimony appears in the foregoing
[7] deposition was sworn by me; that the testimony of said
[8] witness was taken by me in machine shorthand and
[9] thereafter reduced to typewriting under my direction;
[10] that said deposition is a true record of the testimony
[11] given by said witness; that I am neither counsel for,
[12] related to, nor employed by any of the parties to the
[13] action in which this deposition was taken; and further
[14] that I am not a relative or employee of any attorney or
[15] counsel employed by the parties hereto, or financially or
[16] otherwise interested in the outcome of this action.
[17]
[18]
[19] Katie B. Stewart
[20] Notary Public in and for the
[21] District of Columbia
[22] My commission expires 11/14/2001

DEPOSITION OF L. I. (IKE) PRILLAMAN

BEFORE THE
SURFACE TRANSPORTATION BOARD
----------x
:
CSX CORPORATION AND CSX TRANSPORTATION :
:
INC., NORFOLK SOUTHERN CORPORATION AND : STB
: Finance
NORFOLK SOUTHERN RAILWAY COMPANY – : Docket
:
CONTROL AND OPERATING LEASES/AGREEMENTS: No. 33388
:
– CONRAIL INC. AND CONSOLIDATED RAIL :
:
CORPORATION :
----------x

DEPOSITION OF L. I. (IKE) PRILLAMAN
CONFIDENTIAL
Washington, D.C.
Tuesday, January 13, 1998

Deposition of L.I. (IKE) PRILLAMAN, called for examination pursuant to notice of deposition, on Tuesday, January 13, 1998, in Washington, D.C., at the law offices of Zuckert, Scoutt & Rasenberger, 888 17th Street, N.W., Suite 600, at 1:10 p.m., before JOE W. STRICKLAND, RPR, a Notary Public within and for the District of Columbia, when were present on behalf of the respective parties:

LOUIS E. GITOMER, ESQ.
Ball Janik, LLP
1455 F Street, N.W., Suite 225
Washington, D.C. 20005
(202) 638-3307
On behalf of APL, Limited

– continued –

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- and -
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On behalf of CSX Corporation and CSX Transportation

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ALSO PRESENT:
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Norfolk, Virginia 23510-2191
(804) 629-2752

PROCEEDINGS

Whereupon,
L.I. (IKE) PRILLAMAN,
a witness, was called for examination by counsel for APL, Limited and, having been first duly sworn, was examined and testified as follows:

MR. GITOMER: My name is Louis Gitomer. I'm appearing on behalf of the APL, Limited today. I have executed the Confidential and the Highly Confidential undertakings in this proceeding.

MR. ALLEN: I'm Richard A. Allen representing Norfolk Southern Corporation and Norfolk Southern Railroad in this proceeding, and I have executed the Highly Confidential and the Confidential undertaking.

MR. LYONS: And I'm Dennis Lyons representing CSX Corporation and CSX Transportation, Inc. I have signed both the Highly Confidential and the Confidential undertakings.

MR. COBURN: I am David Coburn with

Steptoe
& Johnson for CSX Corporation and CSX Transportation as well, and I have signed both of

CONFIDENTIAL MATERIAL Page 6

the undertakings as well.
MR. HOWE: James L. Howe – H-o-w-e – the Third, with Norfolk Southern Corporation. We have executed the Confidential agreement. "We," being me.
MR. SUMMY: And I Greg Summy on behalf of NS as well, and I have executed the Confidential agreement.
EXAMINATION BY COUNSEL FOR APL, LTD.
BY MR. GITOMER:
Q. Mr. Prillaman, good afternoon. I'm glad you could be available to answer just a couple of questions that I've got for you concerning your rebuttal statement. I am here on behalf of APL, Limited, who is very interested in the partition of Conrail by CSX and Norfolk Southern. APL agrees with you that detailed planning will be necessary to provide service to Conrail's contract shippers. How long do you think it will take to plan for a contract movement that is between a local NS origin and a local NS destination once you have obtained and reviewed the

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contract?
A. As you probably know, we will not have access to any contract or agreement until the control date.
Q. Well, let us assume that you have them on the control date and go from there forward.
A. Okay. Okay. In that instance, to work it into the network as of closing date, I would say that we would certainly feel like that the local-to-local we would be in position to make that service available.
Q. Okay. You mentioned closing date. In your statement you've referred to control date, closing date, and a transition period. Let's assume that the Surface Transportation Board approves the application on July 23rd, 1998, and that approval becomes effective on August 22nd, 1998, which means that you could then go ahead with the transaction. Could you put some dates or time periods on the control date, the closing date, and the transition period based on those dates that I just gave you?

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A. Those dates have not been determined and will depend on some varying things such as getting the necessary labor agreements together, having information technology in place, and also the operating plan to our best and fullest knowledge ready to go. And at that time, we believe that it would be the appropriate time to begin with the closing date.
Q. How about the control date? Will that require the implementing agreements and the information systems?
A. No, that's legislative. I mean, that – I'm sorry? Control date occurs automatically. That's August 23rd or August 22nd.
Q. August 22nd. And some time after August 22nd would be the closing date?
A. Yes.
Q. Do you have a feel for that in days, weeks, months?
A. We – we have for discussion purposes continued to talk about September 1. More realistically, it will be beyond September 1, but

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we certainly hope not too far beyond that. And that's –
Q. So you're talking about nine days to get the implementing agreements?
A. Well, that is why I say it's obvious that September 1 is more of a theoretical date. We still – we, Norfolk Southern, are still hoping for an October 1 implementation date. But all of that depends, again, on the variables that I previously mentioned.
Q. Okay. How about the transition period which you've talked about in your statement. Do you have any idea about when that would begin; how long that would last?
A. Transition – by my definition, transition starts on closing date.
Q. Okay.
A. And closing date – closing date could be a month, could be six months or on out.
Q. I understand. I understand. And the transition period would last how long?
A. Again, personally, the transition date I do

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not think should exceed, you know, with any luck at all to get the operation smoothly working, I do not see it exceeding a year. Hopefully, no more than six months.
Q. In your rebuttal statement, are you saying that section 2.2(c) of the transaction agreement between CSX and NS is for the purpose of both allocating revenue and traffic that is generated by Conrail's transportation contracts?
A. Yes, that's correct.
Q. Now, which is the primary concern of section 2.2(c), revenue or traffic allocation?
A. I – my personal opinion, the overall purpose of 2.C is, as I indicated in my statement, to ensure – to ensure an effective transition period so that service can be performed as contracted. Now, we have in the agreement with CSX, we have agreed to honor the contracts.
Q. Then the structure of section 2.2(c) seems a little strange if honoring the contracts is the major point, because the first three pages talk

about revenue allocation, and then there's one page

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that talks about performance responsibility. If it was performance responsibility, wouldn't you think more verbiage would have been put into that instead of allocating revenue?

A. Probably represents the result of negotiation between Norfolk Southern and CSX. I think there needed to be very little discussion on service because that is a given. That's what's needed. The financial aspects between CSX and Norfolk Southern had to be more definitive. That's my – I would think that's the reason.

Q Let's move on to some relatively basic questions under section 2.2(c). If there are Conrail transportation contracts for traffic that move between two points that NS will serve exclusively, will NS be carrying that traffic according to your understanding of section 2.2(c)?

A. That's correct, yes.

Q Do you think that the resulting carrier carrying the traffic would change if there were no section 2.2(c)? Again, two local points to NS.

A. Probably not, no. Well, obviously, no.

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Q. Okay. And would you think the same would be true for CSX local origin and destination points? That CSX would carry the traffic?

A. Yes, yes, yes.

Q. Now, if there were traffic between – again between two points where Norfolk Southern serves one point and the other point is dual, as defined in the transaction agreement, would CSX or Norfolk Southern handle that traffic?

A. That has yet to be agreed upon, how that will actually occur, because we do not know the volume of traffic involved with the various contracts.

Q. Okay. This is where Norfolk Southern serves one point exclusively and then there's service at the other point by both carriers.

A. Oh, I'm sorry. That would be Norfolk Southern. I'm sorry.

Q. Okay. And do you think that would be the same result if there were no section 2.2(c)?

A. That's correct. Yes.

Q. Okay. Now, then for traffic that would

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move between – for Norfolk Southern between a local origin and a local destination, or between a local origin and a dual destination, or a dual origin and a local destination – all the local points are Norfolk Southern.

A. Okay.

Q. It seems the only purpose of section 2.2(c) is to allocate revenue between CSX and Norfolk Southern.

MR. ALLEN: Is that a question?

BY MR. GITOMER:

Q. Yes, does it seem to you that that is?

A. In those instances, it would not be allocated. I mean, it is allocated solely in your example, to Norfolk Southern. Or that service would obviously be performed by Norfolk Southern.

Q. The service is performed, but are the revenues –

A. And the revenues are –

Q. Are 100 percent Norfolk Southern?

A. Yes, 100 percent.

Q. Now, you've mentioned at the bottom of page

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1 and the top of page 2 of your statement, which is page 109 and 110 in the volume, that there will be a protocol for allocating traffic between Norfolk Southern and CSX where the origin and destination are dual.

A. (Witness nods.)

Q. There is a, I guess, protocol established in section 2.2(c) subsection IV. Is that the protocol you were referring to or something else?

A. That's the protocol I was –

Q. So that's essentially –

A. – describing.

Q. – efficiency of service?

A. Yes.

Q. Now, have you worked out how noncontract traffic between dual points is going to be allocated between CSX and Norfolk Southern?

A. Between – I'm sorry? Non –

Q. Where Conrail serves between Chicago and the North Jersey shared asset area?

MR. ALLEN: Not under contracts. This is competitive.

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MR. GITOMER: The traffic doesn't move under contracts.

MR. ALLEN: Competitive traffic.

MR. GITOMER: Yes.

THE WITNESS: To the extent that information is available, that has been part of our transition planning – transition plan to develop a network that would handle that traffic. Now, my understanding that there is a – a run being made from a consultant – by a consultant, sorry, that will give us more definitive understandings of these point-to-point moves. But until that is done, until that information or knowledge is gained, we cannot make a definitive or develop a definitive operating plan or protocol on how to handle local business.

MR. ALLEN: Just so I hope to make sure the record is clear, I believe Mr. Gitomer's question was whether you've worked out with CSX how that traffic is going to be divided.

THE WITNESS: From a joint –

MR. ALLEN: The competitive traffic. Is

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that your question?

MR. HOWE: Noncontract.
THE WITNESS: Noncontract from a shared area?
MR. GITOMER: Yes.
MR. ALLEN: Competitive traffic.
THE WITNESS: No, we haven't. No, we have not.
BY MR. GITOMER:
Q. You haven't –
A. I went way too far with an answer.
Q. So you and CSX have not agreed to allocate traffic that is not contract traffic?
A. That's correct.
Q. How do you know which traffic you will handle that is not contract traffic where it's competitive with CSX?
A. Well, obviously, we do not.
Q. When do you think you will know?
A. In the terms that you described it, the customer will dictate it.
Q. Now, why wouldn't that work for contract

traffic?
MR. ALLEN: Why wouldn't what work?
BY MR. GITOMER:
Q. Why couldn't the customer who has a contract with Conrail dictate the allocation of traffic between CSX and Norfolk Southern if the customer without a contract could dictate the allocation?
A. The best way I can explain is what was worked out with the NITLIG, [phonetic] that the customer will participate. But – that has been discussed. But otherwise, it's part of the agreement between Norfolk Southern and CSX.
Q. Okay. So but for section 2.2(c), the allocation may be based on the customer's preference?
MR. ALLEN: if you didn't have section 2.2(c)?
BY MR. GITOMER:
Q. If you did not have section 2.2(c)?
A. If we did not have section 2.2(c), personally that's what I would do.

MR. ALLEN: Let me just make sure this is clear. Are you asking if there was no section 2.2(c), could the customer with a contract decide which railroad was going to handle his business? Was that your question?
MR. GITOMER: That's, I guess, a shortcut of the question. The real question is if the STB struck down the revenue and traffic allocation provisions of section 2.2(c) only with respect to dual origins and destinations –
A. Uh-huh.
Q. – how would you go allocating the traffic? Or would you just compete with CSX for the traffic?
A. That's the only thing you could do, that you would be allowed to do, is compete for the traffic.
Q. And would you see anything wrong with CSX and Norfolk Southern competing for that traffic?
A. No.
Q. Again, assuming the absence of section 2.2(c)?

A. No.
Q. Okay. You've said that – well, confirm for me that you've said it's very important to know exactly what traffic is going to be carried when you're planning railroad operations?
A. Yes, yes.
Q. Then could you tell me how credible a plan of operation would be if it's not based on the exact traffic to be carried?
MR. ALLEN: How credible?
MR. GITOMER: Yes.
MR. ALLEN: I don t understand that.
THE WITNESS: I guess the credibility would vary with the volume of omissions. I mean, it's how good your knowledge is.
BY MR. GITOMER: ?
Q. How good do you think your knowledge is of Conrail's traffic?
A. Not very good.
Q. Okay. Do you have any idea of how much Conrail's traffic moves under transportation contracts?

A. No.
Q. Neither volume, revenue, or units?
A. There has been something in total units, but that doesn't necessarily – if it doesn't have volume requirements, it's not necessarily a contract in a respect of going forward.
Q. But you expect to obtain all of this information or to be able to obtain this information on the control date?
A. That's correct.
Q. And then will you prioritize your review of the contracts or just start at number one and go to number whatever, or start alphabetically, or will you perhaps prioritize based on traffic volume or some other factor?
A. I'm not sure that we have a priority definition yet, but we certainly would take the total volumes and determine as the agreement suggests, that we would presume that we would not split the traffic with a particular customer – for a particular customer, of a particular customer – but would divide it as equally as possible.

Q You would divide the traffic or the revenues?
A. The traffic to fit the revenue – to be related to revenues.

Q. On page 2 you've explained why Conrail's contracts can't be opened on the closing date because of the operational problems it would cause. I've asked you this already to project the closing date and you've said perhaps October 1 is your best estimate now, assuming everything else falls into place. What if you had the contracts earlier than August 22nd? Would you then be able to move the closing date up?

A. Yes. It would certainly lend to that.

Q. Now, does the closing date also depend on having all the contracts allocated? Will you go forward with the closing date if they're not all allocated?

A. Yes. Yes, you could do that.

Q. Okay. Who would provide the service to the shippers where the contracts are aren't allocated?

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A. That certainly would have to be decided. That the service – service decisions would have to be decided, but allocation as far as revenues and that sort of thing could be subsequently trued up between Norfolk Southern and CSX.

Q. Doesn't – I think section 2.2(c) provides for an annual resolution of the revenue matter?

A. That's correct.

Q. But the service matter would have to be resolved before you could go to the closing date?

A. That's correct.

Q. If Norfolk Southern and CSX can't agree on an allocation of traffic of the service, what happens?

A. On the service – well –

Q. If Norfolk Southern and CSX just for some reason on some traffic can't agree that it will be allocated to one or the other –

A. I have to defer to counsel, but I believe there is a mediation provision in there somewhere.

MR. HOWE: I think there is an arbitration clause in the transaction agreement to cover that.

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THE WITNESS: Arbitration, yes. And then otherwise beyond that, it would be the issue of involving the true-up financially between the two, again.

BY MR. GITOMER:

Q. The money we can always work out. I think the service is the important issue.

A. Right. Right.

Q. So if CSX and Norfolk Southern couldn't agree on a certain traffic then that would have to be arbitrated and an arbitrator would decide which one of the two railroads handles the traffic?

A. That is to my recollection, that is correct.

Q. And then the closing date would be held until that arbitration is concluded?

A. I certainly would hope that the two of us would never allow something to get that far, that we have service being held up for arbitration. I believe we could work though that if, again, financially it's all going to be trued up anyway. I do not – hopefully, we would not ever allow

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that. Theoretically, yes, I mean, we could not have Day One of operations if someone was in question of not receiving service; you're correct.

MR. GITOMER: All right. Let me ask counsel, I have a hypothetical question which is somewhat complex and I would like to give your client a copy of it. I'll read it into the record, then he can read it so that he can answer it from that. Is that all right with you? I don't want to make it an exhibit.

MR. ALLEN: That's fine.

MR. GITOMER: I didn't expect quite this many.

(Document proffered.)

MR. LYONS: We will share.

MR. HOWE: We will share.

BY MR. GITOMER:

Q. Let me read it so that it's in the record then you can think about your answer. If a shipper provided its contract to Norfolk Southern and CSX on July 23rd, 1998, assuming the Surface Transportation Board approved

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the transaction on that date, and the shipper requested service proposals from CSX and Norfolk Southern for its traffic between dual points within 20 days, and during that 20-day period the shipper would be available to answer questions and discuss its needs, and the shipper committed to decide which railroad's service to use between the dual points within 10 days of that 20-day period, would you still have enough time to plan for your operations by the closing date? Do have you any problems with that process? And if so, what problems do you have and are there any ways to avoid or lessen those problems?

A. I'll answer this I would say from a personal standpoint.

MR. ALLEN: One question at a time.

THE WITNESS: Okay. Do I have any problem with such a process? I guess depending on the volume. Up to a point, no. If – if – if its a very complex and large volume, it could possibly take more than 10 days. But – but it should be

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settled within a short period of time. We do that today, as described.

BY MR. GITOMER:

Q. Okay. So would you have any problem with such a process, assuming you could get it done within the time frame or some other time frame?

A. Literally, we have this problem every day.

It's sometimes a good problem to have.
Q. This is how you run the railroad and how contracts are negotiated every day by Norfolk Southern?
A. That's correct.
Q. Now, again on page 2 of your statement, you explain why you believe that Conrail's transportation contracts can't be opened on the closing date. Why couldn't Conrail's transportation contracts be opened on the control date?
A. They will – oh, why can't they be opened? They could be. They could be opened. I mean, but that – that's not our agreement.
Q. But do you think you would have enough time

if they were opened on the control date to be ready to operate by the closing date?
A. Yes.
Q. I asked you about your knowledge of the Conrail transportation contracts before, and I just want to verify that your answer would be the same if I asked you how many transportation contracts Conrail has. Your answer would be that you don't know?
A. That's correct.
Q. And that would be the same answer as far as how many would expire by August 22nd, and then how many would expire by the closing date, and how many would expire within six months of the closing date?
MR. ALLEN: What's your question?
BY MR. GITOMER:
Q. My question is is your answer still that you don't know those numbers of the Conrail contracts?
A. That's correct.
Q. Okay. Does anybody at Norfolk Southern

have this information?
A. Not to my knowledge, no.
Q. And do you know whether anyone at CSX would have this information?
A. Not to my knowledge.
Q. Now, if NS were allocated 100 percent of APL's traffic, would you still be required to allocate revenues and expenses with CSX on that traffic on a 50/50 basis?
A. If it were from the shared area?
Q. From the shared areas.
A. That is correct, yes. That is correct.
Q. What do you think about that? Does that give you an incentive to handle that traffic? A disincentive?
A. Well, I think that would be a contract allocation.
MR. ALLEN: Well, let's break your question down. You said, "What do you think about it?"
Well, specifically, you want to ask him?
BY MR. GITOMER:
Q. Okay. You're doing 100 percent the work,

you're getting 50 percent of the revenue and paying 50 percent of the expenses. What do you think about that?
A. The way it's described, it's – it's not the preferable way. The ideal way, contracts would be traded to the point that each were allocated. But in your instance, in essence you would be doing as you described.
Q. And that's an accurate reflection of what the transaction agreement between CSX and Norfolk Southern requires?
A. On the broad basis. Not on a contract-by-contract basis, but on an overall basis, yes. Yes.
Q. Yes. Okay, Mr. Prillaman, I thank you very much for the time and that's all the questions I have for you.
A. Thank you.
EXAMINATION BY COUNSEL FOR CSX CORPORATION
BY MR. LYONS:
Q. I think I only have one question, and I'll ask the witness to look at the sheet of paper that

Mr. Gitomer provided to him. And I note that the statement in the question is in the singular: If "a shipper" provided "its" contract. Would the problems of allocation increase if there were a great many shippers who provided their contracts or tried to go through that exercise in the same time frame with a great many shippers with their contracts? Would the problems increase in that situation and over the situation where there was simply a single one?
A. Yes, it would vary with the volume of requests.
Q. Thank you very much. I have no further questions.
FURTHER EXAMINATION BY COUNSEL FOR APL LIMITED
BY MR. GITOMER:
Q. Let me add one follow-up to that. That seems to be the situation that's going to arise on the control date where you will have however many Conrail contracts to review. And you've indicated you think that if the control date is August 22nd, that you can review them and be ready to go by

October 1st, which is just a little more than the 30 days that are in this hypothetical; is that correct? A correct review of your prior testimony?
A. I'm sorry; would you repeat the first part of it? I may have missed it.
Q. Okay. Okay. On the control date, will

Norfolk South ern and CSX obtain all of the Conrail contracts for allocation purposes?

A. Yes.

Q. Okay. Now, we've assumed that the control date will be August 22nd, and didn't you say in resporse to that that Norfolk Southern could be ready to begin operations, have the closing date on October 1st?

A. It is our intention to do that, yes.

Q. And then that would mean that you would have reviewed all of the contracts and put an operating plan into effect in that time period?

A. That's correct.

Q. Okay. Thank you.

MR. LYONS: I have nothing more.

(Whereupon, at 1:41 p.m., the deposition was concluded.)

CERTIFICATE OF REPORTER

UNITED STATES OF AMERICA)

DISTRICT OF COLUMBIA)

I, Joe W. Strickland, RPR, the reporter before whom the foregoing deposition was taken, do hereby certify that the witness whose testimony appears in the foregoing deposition was sworn by me; that the testimony of said witness was taken by me in machine shorthand and thereafter reduced to typewriting under my direction; that said deposition is a true record of the testimony given by said witness; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this deposition was taken; and, further that I am not a relative or employee of any attorney or counsel employed by the parties hereto, or financially or otherwise interested in the outcome of this action.

Joe W. Strickland

Notary Public in and for

The District of Columbia

My Commission expires November 14, 2001.

DEPOSITION OF CHRISTOPHER P. JENKINS

with the law firm of Donelan, Cleary, Wood & Maser, representing Erie/Niagara Rail Steering Committee. And I have also executed both forms of the undertaking under the protective order.

EXAMINATION BY COUNSEL
FOR APL LIMITED

BY MR. GITOMER:

Q. Good morning, Mr. Jenkins.

A. Good morning.

Q. Thank you for being here, we appreciate your time. I just have a couple questions for you about the portion of your rebuttal testimony dealing with Conrail's transportation contracts.

Are you involved in the negotiation of transportation contracts between CSXT and shippers?

A. Yes.

Q. Could you describe that process?

A. Well, the process involves working with a customer to make a commitment on both parties to move traffic usually for a designated period of time in a designated volume over a given origin/destination pair.

Q. Okay. And is there a general time period that these negotiations entail, would it

be a week, a month, a year, does it vary?

A. It varies tremendously.

Q. Could you estimate how long it might take to negotiate a contract that might have 15 or 20 origin and destination pairs and perhaps 160,000 carloads per year?

A. It could take years, I mean in many cases we have a very long sales cycle.

Q. And what about on the shorter side, if both parties were committed to negotiating to reach agreement, how short do you think it would be?

A. Well, it's difficult to say. But, in dealing with large volumes and multiple O/D pairs, you know, I would guess a minimum time of several months would be involved.

Q. Okay. Thank you. Where CSX and Norfolk Southern can provide transportation for a shipper today, do CSX and NS jointly decide which of the two railroads will handle the shipper's contract business?

A. No.

Q. Does the shipper decide?

A. The shipper decides, yes.

Q. Now, in your rebuttal verified

statement, do you discuss the allocation of Conrail's contract movements between CSXT and Norfolk Southern when the traffic moves between what will become the shared asset areas? And I would refer you to pages 1 and 2 of your statement, in the volume they're pages 209 to 210, at the bottom and then the top of the page.

A. Yes, that is, yes.

Q. Now, on page 1 you refer to the applicants' proposal for effecting a smooth commercial transition for contract movements currently performed by Conrail. And, if that was turned down by the Surface Transportation Board, could you think of another way to allocate Conrail's contracts between CSX and Norfolk Southern that would foster a smooth transition?

A. Not offhand, no.

Q. With regard to the noncontract traffic that Conrail handles today, do you know how CSX and Norfolk Southern are going to allocate that traffic?

A. I don't believe there's an issue of allocation because there's no commitment on the part of either Conrail or the shipper.

Q. Then how will CSX determine which

traffic it will handle that is noncontract traffic?

A. The customer will decide that. We're talking about tariff business I believe.

Q. Yes.

A. The customer will decide.

Q. Now, on the fourth line of page 2 of your statement, you've used the word outset. By outset do you have some specific date in mind?

A. No.

Q. Could outset be the closing date that has been referred to throughout the applicants' rebuttal case?

MR. SIPE: If you're going to use what you think is a defined term, why don't you state your understanding of it just to make sure we're all using the same term.

MR. GITOMER: That's fine.

BY MR. GITOMER:

Q. As I understand the term closing date, and please correct me if I'm wrong, that will be a date sometime after CSX and Norfolk Southern obtain control of Conrail and allocate the Conrail assets and begin operating over those assets?

A. Synonymous with split date?

Q. I would assume that could be the same date, yes.

A. Okay.

Q. Do you have an idea of what, using your term, the split date would be?

A. No.

Q. Now, you've said that section 2.2 C of the transaction agreement is the only feasible way to allocate Conrail's contract movements without -- or you've said that's the only way to do it. Is your main concern with the allocation of the contract traffic the possible shift of those movements back and forth between Norfolk Southern and CSX as you've said in your statement?

A. The concern is that, in order to have a smoothly operating railroad, we need to have a degree of volume predictability. And that could be impaired by having uncertainty as to what's going to occur with some of the traffic.

Q. And you would like to have that certainty on the split date?

A. If not sooner.

Q. Okay. How much sooner than the split

date would you like the certainty?

A. Well, we're in the process right now of resource planning, designing our operating plan, trying to understand what our locomotive and manpower needs would be. And, the sooner we have certainty, the better.

Q. And when will you have access to the Conrail transportation contracts?

A. I don't know.

Q. Now, essentially you've said that CSX and Norfolk Southern will step into Conrail's shoes to guarantee that Conrail's customers will not lose the benefit of the bargains they made.

A. Uh-huh.

Q. And that's on page 2, paragraph 2, essentially lines 3 to 6, I just attempted to summarize that.

A. Uh-huh.

Q. For those contract movements allocated to CSXT, will CSXT also retain the benefit of the bargain that Conrail made for the benefit of Conrail?

A. Yes.

Q. Okay. So the contracts are two-way streets?

A. They're a two-way street.
Q. Do you know if any customers of Conrail have made capital investments in Conrail rail facilities based on their contracts with Conrail?
A. I don't have specific knowledge of those investments.
Q. Okay. Do you have a general knowledge that there may have been some investments?
A. I am aware that on our railroad investments are made on that basis.
Q. The investments are made by the shippers?
A. Yes.
Q. Do you know how many transportation contracts with shippers Conrail has?
A. Only in a rough sense, and it --
MR. SIPE: Can I interrupt. Do you mean currently?
BY MR. GITOMER:
Q. At the present time.
A. Yeah, in a rough sense, a few thousand.
Q. Okay. Do you have any idea how many will expire by August 22, 1998?
A. No.
Q. So you wouldn't have any idea of the

expiration dates of the contracts?

A. The only thing that I have understood to be the case is that there is some decay curve on those contracts. So that, by the end of the year, 1998, there are still several hundred contracts that would be in force.

Q. Those are contracts that are in force today?

A. Yes.

MR. GITOMER: All right. Mr. Jenkins, thank you very much.

THE WITNESS: You're welcome.

MR. SIPE: Thanks, Lou.

MR. GITOMER: Sam, thank you. Paul.

(Discussion off the record.)

EXAMINATION BY COUNSEL FOR ERIE/NIAGARA RAIL STEERING COMMITTEE

BY MR. WOOD:

Q. Good morning, Mr. Jenkins.

A. Good morning.

Q. I know you've been deposed before today, but I don't think we participated in that deposition. Let me ask you first, when did you receive your assignment to prepare your rebuttal verified statement?

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185883

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APL-19

February 23, 1998

BY HAND

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
Suite 700
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: STB Finance Docket No. 33388, CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company--Control and Operating Leases/Agreements--Conrail Inc. and Consolidated Rail Corporation

Dear Secretary Williams:

APL Limited hereby files the original and 25 copies of this errata to APL-4. In the Verifeid Statement of Robert F. Sappio, on page 2, fourth line from the bottom, "7 days" should be "1 day".

Please time and date stamp the extra copy of this letter. Thank you for your assistance. If you have any questions, please call me.

Sincerely yours,

Louis E. Gitomer
Attorney for APL Limited

BALL JANIK LLP

CERTIFICATE OF SERVICE

I hereby certify that I have caused APL Limited's Errata, APL-19 to be served by hand on Applicants' representatives in this proceeding and by first clas mail, postage pre-paid on all other parties of record in STB Finance Docket No. 33388.

Louis E. Gitomer
February 23, 1998

185882

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CHARLES A. SPITULNIK
(202) 835-8196

February 23, 1998

Office of the Secretary
Case Control Branch
ATTN: STB Finance Docket No. 33388
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: *CSX Corporation and CSX Transportation Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company -- Control and Operating Leases/Agreements -- Conrail Inc. and Consolidated Rail Corporation*, Finance Docket No. 33388

Dear Secretary Williams:

Enclosed are an original and twenty-five (25) copies of the Public Version of the Brief of the Philadelphia Belt Line Railroad Company (PBL-19) for filing in the above-referenced proceeding. An additional copy is enclosed for file stamp and return with our messenger. Please note that a copy of this filing is also enclosed on a 3.5-inch diskette in WordPerfect 5.1 format.

Sincerely,

Charles A. Spitulnik

Enclosure

cc: The Honorable Jacob Leventhal
All Parties of Record

185882

PUBLIC VERSION

Before The
SURFACE TRANSPORTATION BOARD
Washington, D.C.

Finance Docket No. 33388

CSX Corporation and CSX Transportation Inc.,
Norfolk Southern Corporation and
Norfolk Southern Railway Company
-- Control and Operating Leases/Agreements --
Conrail Inc. and Consolidated Rail Corporation

Brief of the Philadelphia Belt Line Railroad Company

Dated: February 23, 1998

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PUBLIC VERSION

PBL-19

Before The
SURFACE TRANSPORTATION BOARD
Washington, D.C.

Finance Docket No. 33388

CSX Corporation and CSX Transportation Inc.,
Norfolk Southern Corporation and
Norfolk Southern Railway Company
-- Control and Operating Leases/Agreements --
Conrail Inc. and Consolidated Rail Corporation

Brief of the Philadelphia Belt Line Railroad Company

The Philadelphia Belt Line Railroad Company ("PBL"), by its undersigned counsel and pursuant to the Board's Decision No. 12 in this proceeding, hereby submits its Brief in support of the condition it requested in PBL-10, filed with this Board on October 21, 1997 ("Request for Conditions"), which mandates the continued compliance with the Belt Line Principle, even after consummation of the transaction proposed in this proceeding.[1] PBL respectfully submits that the joint application of CSX Corporation, CSX Transportation, Inc., Norfolk Southern Corporation, Norfolk Southern

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[1] PBL initially sought two conditions. The second of those was in response to and support of Canadian Pacific Railway Company's ("CP") expressed intention to request imposition of reciprocal switching rights in the South Jersey/Philadelphia Shared Assets Area in CP's favor. *See* Canadian Pacific Parties' Description of Anticipated Responsive Application (CP-10) at 2-3. Because CP subsequently withdrew its opposition to this transaction (*see* October 22, 1997 letter to The Hon. Vernon A. Williams from counsel for CP), PBL no longer seeks the second condition.

Railway Company, Conrail Inc., and Consolidated Rail Corporation should not be approved absent the condition that PBL has requested.[2]

I. CONDITION REQUESTED

In the Request for Conditions, PBL requested that the Board exercise its discretion under 49 U.S.C. § 11324(c) and impose the following condition upon an approval of Applicants' proposed transaction:

> (1) Assurance of equal access to PBL's Belt Line North lines by all carriers in Philadelphia in accordance with PBL's Belt Line Principle. Specifically, PBL requests that the Board issue a directive requiring that all carriers that now or will in the future have access to any points in Philadelphia be provided equal, non-discriminatory access to PBL's Belt Line North lines through equitable reciprocal switch rates. Such access is necessary for PBL to fulfill its mandate under its charter and its public interest Belt Line Principle, described further below.

This requested condition will not place a new obligation upon the Applicants. Rather, PBL merely seeks an affirmative declaration from this Board that the presently-existing Belt Line Principle shall remain in effect following implementation of the transaction, including creation and operation of the South Jersey/Philadelphia Shared Assets Area.

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[2] CSX Corporation, CSX Transportation, Inc., and their wholly owned subsidiaries are referred to collectively in this Brief as CSX. Norfolk Southern Corporation, Norfolk Southern Railway Company, and their wholly owned subsidiaries are referred to collectively in this Brief as NS. Conrail Inc., Consolidated Rail Corporation, and their wholly owned subsidiaries are referred to collectively in this Brief as Conrail. CSX and NS are referred to collectively in this Brief as the Applicants.

PUBLIC VERSION

II. FACTUAL SUMMARY

A. History

PBL is a Class III rail carrier operating in Philadelphia, Pennsylvania ("City" or "Philadelphia"). Verified Statement of Charles E. Mather III in Support of the Philadelphia Belt Line Railroad Company's Comments and Request for Conditions ("Mather V.S."), attached as Appendix I to the Request for Conditions (PBL-10), at 1. PBL had its genesis in the 1880's, when City leaders, recognizing that rail access to the Port of Philadelphia was essential to the successful economic development of the City and surrounding region, developed what is known as the "Belt Line Principle." *Id.* at 1-2. The primary driving force behind this principle was the concern that a single railroad, at that time, the Pennsylvania Railroad Company, could gain monopolistic control over rail access to and from the industries and wharves located along the Philadelphia waterfront, and use this control for its own benefit rather than for the benefit of the region. *Id.* at 2. To counter this feared rail monopoly and protect the public interest, the concept of a "belt line" of railroad was developed. *Id.* This belt line was intended to run along the City's waterfront and act as a terminal and switching company, the facilities and services of which would be available on an equal access basis to all railroads then and in the future serving the City. *Id.*

The task of implementing the Belt Line Principle fell to PBL, which was chartered for that purpose in 1889, under the Pennsylvania Act of June 8, 1874. *Id.* PBL's charter, in conjunction with a City ordinance of December 26, 1890, authorizes PBL to construct, operate, and maintain its lines through the City. *Id.* These lines, the ordinance directs, "shall be open to the use of all railroad companies which shall

execute a satisfactory agreement to comply with all reasonable rules and regulations, which rules and regulations shall apply to all without discrimination." *Id.*, Exh. B at 7. The PBL lines are thus to remain accessible, on an equal and nondiscriminatory basis, to any railroad company serving the City. *Id.* at 2.

In 1914, the City further affirmed and memorialized the Belt Line Principle by passing an ordinance authorizing execution of a contract known as the South Philadelphia Agreement. *Id.* The South Philadelphia Agreement, signed by the City, PBL, and several other railroads -- among them corporate predecessors of Conrail and CSX, including the Pennsylvania Railroad Company, the Lehigh Valley Railroad Company, and the Baltimore & Ohio Railroad Company -- revised the PBL route through the southern portion of Philadelphia.[3] *Id.* at 2-3. The agreement also declares:

> The City deems it necessary that all railroad companies now or hereafter entering the City should have free access on equal terms to all public and private wharves on the Delaware river [sic] and desirable that what is popularly known as the "Belt Line" principle should be of the most general public application, and recognizes that [PBL] . . . is in fact a corporation created and existing in the public interest.

Id. at Exh. C, ¶ Sixteenth. The South Philadelphia Agreement continues to govern all rail traffic to port facilities located in South Philadelphia. *Id.* at 3; *see* Joint Comments of the City of Philadelphia and the Philadelphia Industrial Development Corporation in Support of Approval of the Proposed Control Application (dated 10/20/97), at 2 (stating

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PIDC's subsidiary, Philadelphia Food Distribution Center, "owns an extensive network of tracks that are served, according to the Philadelphia Belt Line Principle . . .").

B. The Belt Line North

At present, PBL owns about 16.3 miles of railroad track, right-of-way, and trackage rights along the Philadelphia waterfront. *Id* PBL's line is now bisected unequally by obstructions erected by the City as part of waterfront redevelopment projects. *Id.*; Response of PBL to Applicants' First Set of Interrogatories and Requests for Production of Documents (PBL-14) ("PBL's First Response"), at Interrog. Resp. Nos. 1, 2, 7. As a result, the "Belt Line" is now composed of two line segments -- a roughly three-mile-long "Belt Line North" and a "Belt Line South" of roughly thirteen miles -- that cannot be reached directly from one to the other.[4] *See* Mather V.S. at 3. Nonetheless, both lines are available for access by all freight railroads serving Philadelphia, subject to payment of compensation and adherence to the Belt Line Principle. *Id.*

Conrail has leased the Belt Line North from PBL since March 1, 1987. *Id.* at 4, n. 2

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[4] PBL recognizes that its common carrier obligation to provide service along its lines remains despite these obstructions and continues to reserve the right to seek enforcement of its ability to fulfill that obligation from the Board. PBL has set out the route it may seek from the Board, should enforcement be necessary, in previous submissions. *See* Mather V.S. at 3, n. 1; Response of PBL to CSX's Second Set of Interrogatories and Requests for Production of Documents (PBL-15) ("PBL's Second Response"), at Interrog. Resp. No. 1.

The Belt Line North services ten shippers,[5] who together generate between roughly 1,500 and 3,000 revenue car loads annually.[6] Mather V.S. at 4. Predominant commodities moving on the Belt Line North include chemicals, intermodal containers, and various import and export goods. *Id.*

The Lease Agreement ("Lease"), duly executed between PBL and Conrail,

Because the obstructions erected by the City prevent PBL from utilizing the full extent of its right-of-way, Conrail presently controls direct rail access to and

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[5] These shippers include GATX Terminals and customers served through GATX, Rohm & Haas, Tioga Marine Terminal, Franklin Smelting, Lumber Millwork, and the City of Philadelphia. Mather V.S. at 4.

[6] PBL has received conflicting estimates from Conrail and GATX as to actual traffic volume on the Belt Line North. *See id.* at 4, n.2; PBL's Second Response (PBL-15), at Interrog. Resp. No. 2.

from the Belt Line North via Conrail's Port Richmond Yard. Mather V.S. at 4; Rebuttal Verified Statement of Christopher P. Jenkins ("Jenkins R.V.S.") at 18. Thus, shippers desiring to reach a rail carrier other than Conrail from the Belt Line North must rely upon Conrail's switching service for access to those other carriers. Mather V.S. at 4. Conrail, however, discourages Belt Line North shippers from choosing to interchange with other rail carriers by charging these shippers rates for intra-terminal switching that are significantly higher than rates Conrail charges other Philadelphia-area shippers for interchange services. *Id.*; PBL's First Response (PBL-14), at Interrog. Resp. No. 5. Some Belt Line North shippers have chosen in the past to avoid the excessive Conrail charges by trucking their shipments to points where other rail carriers may be accessed. Mather V.S. at 4-5; PBL's First Response (PBL-14), at Interrog. Resp. No. 3. However, the clear and unfortunate result of Conrail's discriminatory rates is to force Belt Line North shippers to utilize Conrail's own long haul route. *Id.* This practice by Conrail is a violation of the Belt Line Principle's clear mandate that Belt Line traffic not be subjected to unequal or discriminatory treatment.[7]

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[7] As it must do to comply with its obligations under the various Belt Line Principle agreements, PBL has sought, and if necessary will continue to seek, resolution of this matter through negotiations and/or other avenues. *See, e.g., Philadelphia Belt Line R.R. Co. v. Consolidated Rail Corp., CP Rail System, and CSX Transp., Inc.*, Finance Docket No. 32802 (served July 2, 1996) (seeking trackage rights over Conrail terminal trackage under 49 U.S.C. 11103(a) [now recodified as 49 U.S.C. 11102(a)] as means of giving shippers the ability to escape Conrail's discriminatory switching charges).

C. Effect of the Shared Assets Area Operating Agreement for South Jersey/Philadelphia.

The Shared Assets Area Operating Agreement for South Jersey/Philadelphia ("SAAOA"), executed by and among the Applicants, purports to govern the allocation and operation of former Conrail assets in the Philadelphia area. *See* Railroad Control Application, Vol. 8C at 106-36 (Exh. H). Expressly included among the Shared Assets is the Belt Line North. *See id.*, Vol. 8B at 102 (Sched. 1, Attach. I). Of course, the Belt Line North's inclusion is based solely upon Conrail's rights as lessee under the Lease (*see id.*, Vol. 8C at 111, ¶ (ss)); Conrail, or its successors, cannot become "owner" of the Belt Line North by virtue of the SAAOA provisions. Thus, should a third party (other than Conrail or the Applicants) become the lessees, the Belt Line North would no longer be a Shared Asset. Access to the Belt Line North, however, would continue to be controlled by the Applicants through their shared ownership of the Port Richmond Yard, which yard offers the only rail connection to the Belt Line North. *See* Request for Conditions, App. I, Exh. D.

The SAAOA makes clear the Applicants' plans for the Belt Line North's future. Among the recitals included in the SAAOA is the declaration that the Applicants "desire that the Shared Assets shall be owned, operated and maintained by CRC [Conrail] and used by or for the exclusive benefit of CSXT and NSR . . . ." Railroad Control Application, Vol. 8C at 106. While the SAAOA thus makes Conrail the nominal owner of the Shared Assets, for purposes of that agreement, it forbids Conrail from taking part in any freight traffic rate activities within the Shared Assets Area, and forbids it from entering into transportation contracts "for freight transportation services

to, from and within the Shared Assets Area" with anyone other than CSX or NS. *Id.*, Vol. 8C at 117, ¶ (f). The SAAOA further directs that none of the parties to it "may permit any Person (other than a party hereto) to have access to, operate over or use any Shared Asset without the prior approval of all parties, which approval may be given or refused in the sole discretion of each party." *Id.*, Vol. 8C at 119, ¶ (o). The SAAOA's restrictions will remain in effect for at least twenty-five years. *Id.*, Vol. 8C at 132, § 14.

III. ARGUMENT

A. Without Imposition of the Condition PBL Seeks, Applicants May Attempt to Ignore the Belt Line Principle's Public Interest Protections.

The documents initially submitted by the Applicants in support of their transaction ignore the mandates of the Belt Line Principle. The Applicants apparently believed that ignoring the Belt Line Principle would make this wrinkle in their designs for dividing the Philadelphia market go away. Should the Board decline PBL's request, the Applicants may argue that they are exempted from the Belt Line Principle's public interest requirements upon approval of their transaction, through operation of 49 USC § 11321's preemption provision.

At present, PBL could counter an express disavowal of the Belt Line Principle by Conrail through enforcement of the ordinance as PBL must do to comply with its charter. If this Board approves the subject transaction without imposing the condition requested by PBL, however, the Applicants can claim they are exempted from adherence to the Belt Line Principle by operation of 49 U.S.C. § 11321(a). That section reads, in pertinent part:

> The authority of the Board under this subchapter. . . is exclusive. A rail carrier or corporation participating in or resulting from a transaction approved by or exempted by the Board under this subchapter. . . may carry out the transaction, own and operate property, and exercise control or franchises acquired through the transaction without the approval of a State authority. A rail carrier, corporation, or person participating in that approved or exempted transaction is exempt from the antitrust laws and from all other law, including State and municipal law, as necessary to let that rail carrier, corporation, or person carry out the transaction, hold, maintain, and operate property, and exercise control or franchises acquired through the transaction.

The U.S. Supreme Court, upon interpreting the language of § 11321's predecessor (former 49 U.S.C. § 11341), ruled that the exemption applies "when necessary to carry out an approved transaction." *Norfolk & Western R.R. Co. v. American Train Dispatchers' Assoc.*, 499 U.S. 117, 127 (1991).[8] The Court has also held that when triggered, the exemption extends to "any obstacle imposed by law." *Id.* at 133. This reach includes "laws that govern the obligations imposed by contract." *Id.* at 129.

Thus, if this Board should decide not to affirmatively condition approval of the transaction on approval of PBL's requested condition, PBL could find itself faced with an argument from Applicants that they need no longer abide by the ordinance

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[8] In a somewhat broader interpretation of this statute, Justice Stevens has written in a concurring opinion that Section 11341 does not condition exemptions on the ICC's announcing that a particular exemption is necessary to an approved transaction. "Rather, § 11341 [now recodified as § 11321] automatically exempts a person from 'other laws' whenever an exemption is 'necessary to let that person carry out the transaction, hold, maintain, and operate property, and exercise control or franchises acquired through the transaction.'" *ICC v. Brotherhood of Locomotive Eng'rs*, 482 U.S. 270, 298 (1987) (Stevens, J., concurring).

allowing them to discriminate against other carriers at will. In effect, the Board will be acquiescing in the complete nullification of the Belt Line Principle's public interest protections and the creation of a competition-free enclave for the benefit of the Applicants. This Board does not grant conditions that will "merely rectify pre-existing problems." *Burlington N., Inc. - Control and Merger - Santa Fe Pac. Corp.*, Docket No. 32549, Dec. No. 38 (August 16, 1995). However, PBL's predicament does not meet that description. Refusal to grant PBL's condition could immunize the Applicants from pre-existing obligations -- obligations that will have no adverse impact on the transaction if they are allowed by the Board to continue in effect.

The provisions of the SAAOA, and the Applicants' actions, make it clear that the Applicants' plan is to contravene the Belt Line Principle's public interest protections. While the Belt Line Principle calls for equal access to the Belt Line for all carriers in Philadelphia,[9] the Applicants claim the opposite -- that the Belt Line North is to be for their "exclusive benefit' and that they may, collectively or individually, prohibit third-party access to it. Further, the Applicants pointedly refuse to allow

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[9] Applicants challenge PBL's interpretation of the governing principle, Applicants' Rebuttal (CSX/NS-176), Vol. 1 at P-152, and suggest erroneously that PBL's arguments here are a "rehash of an earlier complaint dismissed by the Board." *Id.* at 153. Applicants misunderstand the clear difference between the two circumstances. In the earlier case, the PBL sought trackage rights over Conrail to begin its own operations between the two disconnected segments of the Belt Line, as a way of rectifying the anti-competitive conduct in which Conrail was engaging by its imposition of discriminatory switch charges. Here, PBL seeks confirmation that the proposed transaction does not disturb the continuing viability of the Belt Line Principle. The main similarity between the earlier case and this one is that PBL is initiating the attempt here, as it did earlier, to protect its ability to fulfill its obligations.

competing carriers even the unintrusive, equitable treatment that PBL seeks through its condition. Applicants' Rebuttal (CSX/NS-176), Vol. 1 at P-152.

There can be little doubt that the Applicants intend, or at least seek the ability, to avoid the requirements of the Belt Line Principle. Approval of their transaction without imposition of PBL's condition may facilitate this avoidance by bestowing immunity upon the Applicants to engage in their planned anticompetitive behavior, then stripping away the legal power of PBL, "a corporation created and existing in the public interest," to enforce this Principle.

The Applicants contend that the Board should take a "wait and see" approach to the question of Philadelphia carrier competition. They argue that, should other carriers come to serve Philadelphia in the future, those carriers' access to Belt Line commerce "can be examined in an appropriate forum at that time." Applicants' Rebuttal, Vol. 1 at P-152. There is no reason to wait. The Board should decide the issue now, in favor of open competition, rather than allowing the Applicants to argue that they have received an exemption, or passing the question on to another day.

The Applicants' "wait and see" argument is also untenable for other reasons. First, contrary to the Applicants' assertion, this proceeding is the appropriate forum to determine whether conditions intended to benefit the public interest or to

ameliorate the anticompetitive aspects of a rail consolidation should be imposed as part of the approval of a transaction. *See* 49 U.S.C. §§ 11321(a), 11324; 49 C.F.R. § 1180.1.[10] Further, the mere existence of the CSX-NS duopoly may act as a barrier to any prospective entrant into the Belt Line shipping market and effectively prevent any growth in carrier competition for at least twenty-five years. Thus, the "time" for examination that the Applicants hypothesize, may never come to pass. In resolving the question now, by affirming the continued viability of the Belt Line Principle, the Board can remove at least this barrier to prospective carriers and thereby greatly increase the potential for true competition in the Philadelphia area.

B. PBL's Condition is Consistent with the Public Interest Because It Requires Applicants to Preserve Competitive Options That Should be Available to Belt Line North Shippers.

PBL's condition assures that commerce to and from the Belt Line North will be accessible on an equal and nondiscriminatory basis to all present and future carriers serving the Philadelphia area. The least intrusive way to achieve this objective is by affirming the Belt Line Principle and requiring equitable switching rates. PBL's condition does not force Applicants to allow other carriers physical access to the Belt Line North, nor does it confer any new rights upon other carriers. The result of imposing the condition PBL seeks will be to insure the availability of full competition to the shipping public, while detracting nothing from the benefits of the transaction.

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[10] While it is certainly true that the Board is not bound "to accede to the policies of the anti-trust laws" when reviewing a transaction such as the present one, it is also true that the Board should consider those policies in making its determination of whether the transaction is "consistent with the public interest." *United States v. ICC*, 396 U.S. 491, 512-13 (1970) ("Northern Lines Merger Cases").

PUBLIC VERSION

1. Standards for Granting Conditions

The Board "has 'extraordinarily broad discretion' in deciding whether to impose protective conditions in the context of railroad consolidations." *Grainbelt Corp. v. Surface Transp. Bd.*, 109 F.3d 794, 798 (D.C. Cir. 1997) (quoting *Southern Pacific Transp. Co. v. ICC*, 736 F.2d 708, 721 (D.C. Cir. 1984)). Included among applicable conditions are "those that might be useful in ameliorating potential anticompetitive effects of a consolidation." 49 C.F.R. § 1180.1(d)(1).

The Board may impose conditions that will protect or further the public interest. *Union Pacific - Control - Missouri Pacific; Western Pacific*, 355 I.C.C. 459 (1982), *aff'd sub nom. Southern Pac. Transp. Co. v. ICC*, 736 F.2d 708 (D.C. Cir. 1984). Public interest conditions will be imposed upon a railroad consolidation where: (1) the consolidation may produce effects harmful to the public interest (such as a significant reduction of competition in an affected market); (2) the conditions sought will ameliorate or eliminate the harmful effects; (3) the conditions will be operationally feasible; and (4) the conditions will produce public benefits (through reduction or elimination of the possible harm) outweighing their harm to the merger. *Id.*

2. PBL's Condition Satisfies the Public Interest Criteria.

PBL's condition meets the criteria for imposition of conditions in the public interest. It is designed to counteract directly the Applicants' stated anticompetitive scheme to use the Belt Line North for their own "exclusive benefit," in violation of the expressed public interest of the City of Philadelphia, by ensuring all carriers serving the City now or in the future will have equal access to the Belt Line. Conversely, the discriminatory provisions of the Applicants' SAAOA, at least insofar as they relate to

the Belt Line, add nothing to the public interest benefits to be realized from this transaction.

a. In the absence of PBL's condition, the Applicants' transaction is harmful to the public interest.

The first of the public interest criteria looks to whether the transaction produces effects harmful to the public interest, such as anticompetitive consequences. Here, the answer to that question is "yes". Conrail is presently required

to allow other carriers equal and nondiscriminatory access to the Belt Line North; thus, the potential currently exists for other rail carriers to compete independently against Conrail for Belt Line North shipping business.[11] In contrast, Applicants openly intend to use the Belt Line North for their "exclusive benefit," excluding all third party rail carriers from access in contravention of the public interest Belt Line Principle.

As a result, competition from other carriers will be prevented. The SAAOA eliminates any such potential competition for at least twenty-five years, in order that the plans NS and CSX have mutually agreed upon for the Belt Line North's future can be implemented.

The Applicants contend that the transaction here "enhances competitive alternatives for Belt Line shippers and is clearly in the public interest. . . ." Applicants' Rebuttal, Vol. 1 at P-152. The Applicants are wrong. It is true that at present Conrail

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[11] Conrail's persistent refusal to honor its obligations under the Belt Line Principle does not suggest that its conduct should be condoned or permitted to continue following the implementation of the proposed transaction.

alone controls direct rail service to and from Belt Line North shippers. It also appears to be true that, post-merger, two carriers will assume Conrail's role and thus provide shippers with two, at least nominal, competitors. The transaction, then, at least on its face, does seem to enhance the competitive alternatives now available for Belt Line North shippers. However, Applicants ignore the fact that preservation of the Belt Line Principle will enhance competitive alternatives to a much greater degree now and in the future by opening up the Belt Line North long haul traffic to true competition. Requiring nondiscriminatory rates ensures that carriers without direct access to the Belt Line North will not remain economically impractical alternatives for shippers. Simply put, without the Belt Line Principle the universe of carriers servicing the Belt Line North is effectively limited to CSX and NS; with the Belt Line Principle the universe of carriers with direct commercial access to shippers on the Belt Line North continues to include CSX and NS, and also includes any carrier entering the Philadelphia market now or in the future. Affirmance of the Belt Line Principle takes nothing from the supposed CSX-NS competition, while adding much to the shippers' competitive alternatives.

Moreover, there exists no guarantee that true CSX-NS competition will exist for Belt Line North traffic. While the future of operating and commercial relationships in Philadelphia remains unknowable at this time, it is certainly true that the Board will impose conditions on consolidations where to do so could ameliorate the "*potential* anticompetitive effects" of the transaction. 49 C.F.R. § 1180.1(d)(1). In fact, this is the essential goal of the process for granting conditions. Conditioning approval of this transaction upon CSX and NS providing the access contemplated by the Belt

Line Principle ensures Belt Line North shippers will have at least some measure of competitive alternatives in the form of third party carriers. The condition eliminates the *potential* for anticompetitive behavior evident in the Applicants' proposed plans.

An additional point involving competitive alternatives for Belt Line North commerce requires clarification. The Applicants contend that competition will be further enhanced by CP's "commercial access to the Philadelphia Belt Line shippers under its Settlement Agreement with CSX." Applicants' Rebuttal, Vol. 1 at P-152.

The agreement thus has no impact on Belt Line North competition and no relevance to the question of access to Belt Line North shippers who wish to have traffic switched to other carriers.

This transaction, then, creates anticompetitive consequences by isolating the entire Belt Line North from direct and indirect access by carriers other than CSX and NS. It does this contrary to the public interest as expressed by the City, and upon the unilateral machinations of the Applicants.

b. PBL's condition ameliorates the transaction's intended anticompetitive effects.

The second public interest criterion requires that the requested condition ameliorate or eliminate the transaction's harmful effect. PBL's requested condition is narrowly tailored to achieve this end with no burden upon the Applicants. Its sole purpose is to preserve an existing mandate. PBL's condition will prevent the Applicants from charging discriminatory rates for carriers other than CSX and NS to

reach Belt Line North shippers. Belt Line North shippers will have reasonably cost-effective alternatives, confronting CSX and NS with true competition for Belt Line North commerce. PBL's condition will eliminate the transaction's harmful effect by eliminating the CSX-NS duopoly, at least with respect to the Belt Line North.

The Applicants assert that this amelioration would require the "imposition of further rights" for other carriers. Applicants' Rebuttal, Vol. 1 at P-152. The Applicants are wrong. PBL does not seek imposition of "*further* rights" for other rail carriers. The Belt Line Principle presently confers on all carriers that reach Philadelphia an equal and nondiscriminatory right of access to PBL lines. The principle has existed for over one hundred years.

The Applicants attempt to paint PBL's condition as an award of new rights for other carriers; in fact, however, the condition simply asks the Board to affirm that the *now-existing* obligations of the Belt Line Principle will continue in force after consummation of this transaction. PBL does not seek the expansion of rights but the preservation of status quo.

c. PBL's condition will not affect the Applicants' operations.

The third public interest criterion requires that the condition be operationally feasible. PBL's condition will have no impact on operations. *See Union Pacific Corp. and Union Pacific R.R. Co. - Control - Missouri Pacific Corp. and Missouri Pacific R.R. Co.*, Finance Docket No. 30000, 1985 ICC Lexis 457 (April 16, 1985)

(conditions relating only to rate-setting do not present operational problems). It does not force the Applicants to alter their projected routes or schedules, to admit another carrier to the Shared Assets Area, to give trackage rights, or to do anything else of an operational nature. Conrail already provides switching services for Belt Line North traffic and the Applicants have stated that they anticipate no changes relevant to the handling of that traffic. *See* Applicants' Response to PBL's First Set of Interrogatories (CSX/NS-98), at Resp. No. 11. PBL's condition simply prohibits the Applicants from charging unequal and discriminatory switch rates for Belt Line North shipments coming to or from other carriers. It does not affect Applicants' operations.

d. PBL's condition provides the public benefit of competition while causing no harm to the Applicants' transaction.

The final public interest criterion requires that the proposed condition produce public benefits that outweigh the condition's harm to the merger. PBL's condition provides an open and competitive market for carrier services in Philadelphia. Competition will decrease costs to shippers and ultimately to the general public. It will also decrease truck traffic, and its associated harms, on City streets as shippers no longer find it necessary to truck shipments to competing carriers in order to avoid discriminatory switch rates. *See* Mather V.S. at 4-5. The condition ensures that all carriers are treated equally when servicing Belt Line shippers, promoting open competition among carriers, and thereby providing shippers with a competitive market from which to draw. The Applicants' alternative leaves Belt Line North shippers at the whim of the plan devised cooperatively by Applicants, which totally ignores the necessity of equality in an efficiently functioning marketplace.

The condition causes no harm to the merger. The Applicants have offered no reasoning to the contrary, nor, for that matter, have they offered any rationale whatsoever to explain why the Belt Line Principle must be pushed aside in order for their plans to be consummated. *See* Applicants' Rebuttal, Vol. 1 at P-151-53. This lack of rationale for their need to exclude competition from the Belt Line North for at least twenty-five years, standing alone, may call for the imposition of PBL's condition; for, the Board "does not favor consolidations that substantially reduce the transport alternatives available to shippers unless there are substantial and demonstrable benefits to the transaction that cannot be achieved in a less anticompetitive fashion." 49 C.F.R. § 1180.1(a). The Applicants' plan for Philadelphia reduces shippers' transport alternatives without providing any benefit to the transaction; PBL's condition will avoid this disfavored outcome.

C. Applicants' SAAOA Not Only Insulates CSX and NS from Competition, but Also Creates a Virtual Monopoly Over Access to the Belt Line North in Favor of the "Shared Assets Operator."

A plain reading of the SAAOA, an agreement expressly created for the "*exclusive benefit*" of CSX and NS, reveals that its designers intend to include the Belt Line North within their systems while effectively blocking any and all other potential rail carriers from accessing, operating over, or using its facilities. Even should the Lease be assumed by a third party, the Applicants could continue their control of the Belt Line North by denying reciprocal switching rates over or equal access through the Shared Assets Area. CSX and NS thus intend to replace the monopoly now forced upon the Belt Line North shippers by Conrail with a duopoly of their own making. They seek

actively and cooperatively to divide the spoils of the merger transaction between themselves, and thereby minimize or totally eliminate competition -- an act that not only directly violates the expression of public interest embodied by the obligations of the Belt Line Principle but that also smacks clearly of anticompetitive behavior regardless of those pre-existing obligations.

Further, the SAAOA results in the creation of a virtual monopoly for CRC in the Lease. No other rail carrier could rationally have an interest in entering into a lease for the Belt Line North when the only access to it is over track expressly and exclusively for the use of CSX and NS. Indeed, it would appear that not even CSX and NS could enter into a bidding war for the Lease, since it is among the assets to be shared by them under the SAAOA.

The anticompetitive aspects of the Applicants' plans not only isolate the Belt Line North from access by third party carriers, but also ensure the continued control of the Belt Line North lease by the "Shared Assets Operator."

PUBLIC VERSION

IV. CONCLUSION

The Board should grant the condition set out in PBL's Request for Conditions if the transaction is approved. PBL's condition will counteract the Applicants' plans to control Belt Line North commerce by ensuring that carriers competing from outside the Shared Assets Area will receive equitable treatment from the Applicants; this in turn will provide adequate service for shippers by allowing market forces, rather than CSX and NS, to decide which carrier will service individual Belt Line North shippers. Further, the condition is merely an affirmance of carrier obligations already existing in the Philadelphia area, and will have no adverse impact upon the public benefits anticipated from this consolidation. Absent imposition of this condition, the Applicants will have an arguable basis for disregarding the Belt Line Principle. Approval of the requested condition will serve the public interest by preserving the open access to Belt Line facilities envisioned by the City of Philadelphia's leaders over one hundred years ago.

Dated: February 23, 1998

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on February 23, 1998 a copy of the foregoing Public Version of the Brief of Philadelphia Belt Line Railroad Company (PBL-19) was served by hand delivery upon the following:

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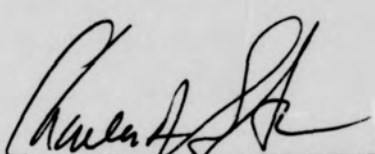
and by first class mail, postage pre-paid upon all other Parties of Record in this Proceeding.



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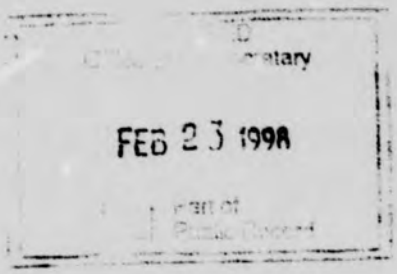

Office of the Secretary
Case Control Branch
ATTN: STB Finance Docket No. 33388
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: *CSX Corporation and CSX Transportation Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company -- Control and Operating Leases/Agreements -- Conrail Inc. and Consolidated Rail Corporation*, Finance Docket No. 33388

Dear Secretary Williams:

Enclosed are an original and twenty-five (25) copies of the **Highly Confidential Version** of the Brief of the Philadelphia Belt Line Railroad Company (PBL-18). An additional copy is enclosed for file stamp and return with our messenger. Please note that a copy of this filing is also enclosed on a 3.5-inch diskette in WordPerfect 5.1 format. Because of the confidential nature of this filing, copies are not being served on parties other than Judge Leventhal and Applicants' counsel; however, the Philadelphia Belt Line Railroad Company will be happy to provide any party on the Restricted Service List with a copy upon request.

Sincerely,

Charles A. Spitulnik

Enclosure

cc: Honorable Jacob Leventhal
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February 23, 1998

Via Hand Delivery

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Re: CSX Corporation and CSX Transportation Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company -- Control and Operating Leases/Agreements -- Conrail, Inc. and Consolidated Rail Corporation, Finance Docket No. 33388

Dear Secretary Williams:

I submit an original and twenty-five copies of each of the highly confidential and public versions of NS-62, Brief of Applicants Norfolk Southern Corporation and Norfolk Southern Railway Company. Also enclosed is a 3 1/2" computer disk containing the pleading in Wordperfect 5.1 format, which is capable of being read by Wordperfect 7.0.

Should you have any questions regarding this, please call.

Sincerely,

Richard A. Allen

Counsel for Norfolk Southern Corporation and Norfolk Southern Railway Company

Enclosures

cc: The Honorable Jacob Leventhal
All Parties of Record

185866

REDACTED
FILED FOR THE PUBLIC RECORD

NS-62

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 33388

CSX CORPORATION AND CSX TRANSPORTATION, INC.,
NORFOLK SOUTHERN CORPORATION AND
NORFOLK SOUTHERN RAILWAY COMPANY
--CONTROL AND OPERATING LEASES/AGREEMENTS--
CONRAIL INC. AND CONSOLIDATED RAIL CORPORATION

BRIEF OF APPLICANTS NORFOLK SOUTHERN CORPORATION AND NORFOLK SOUTHERN RAILWAY COMPANY

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Statutes:

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TABLE OF ABBREVIATIONS

AA	Ann Arbor Railway Company
ACE	Atlantic City Electric Company
ACE, et al.	Atlantic City Electric Company and Indianapolis Power & Light
AEP	American Electric Power Service Corporation
Amtrak	National Railroad Passenger Corporation
APL	APL Limited
Applicants	CSX Corporation, CSX Transportation, Inc., Norfolk Southern Corporation, Norfolk Southern Railway Company, Conrail, Inc. and Consolidated Rail Corporation
Applicants' Rebuttal	CSX/NS-176 through 178, filed December 15, 1997
Application	the Railroad Control Application (CSX/NS-18 through 25) filed on June 23, 1997
ARU	the Allied Rail Unions
BLE	Bessemer & Lake Erie Railroad
Board	Surface Transportation Board
Closing Date	the date on which operation of Consolidated Rail Corporation's lines will be divided between CSX and NS
CMA	Chemical Manufacturers Association
CN	Canadian National Railway
Commission	Interstate Commerce Commission
Conrail	Conrail Inc., Consolidated Rail Corporation and their subsidiaries
CP	Canadian Pacific Railway Company
CRC	Consolidated Rail Corporation

CRR	Conrail Inc.
CSX	CSX Corporation and CSX Transportation, Inc.
CSXC	CSX Corporation
CSXT	CSX Transportation, Inc.
D&H	Delaware and Hudson Railway Company, Inc.
DEIS	Draft Environmental Impact Statement
Delmarva Power	Delmarva Power and Light Company
DOJ	U.S. Department of Justice
DOT	U.S. Department of Transportation
EFM	Eighty Four Mining Company
EIS	Environmental Impact Statement
EJE	Elgin, Joliet and Eastern Railway Company
FRA	Federal Railroad Administration
IC	Illinois Central Railroad Company
ICC	Interstate Commerce Commission
ICCTA	ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803
IORY	Indiana & Ohio Railway
IP&L	Indianapolis Power & Light Company
ISRR	Indiana Southern Railroad
Labor Impact Exhibit	the Labor Impact Exhibit attached to CSX/NS-26
LAL	Livonia, Avon & Lakeville Railroad Corporation
LD&RT	Lakefront Dock and Railroad Terminal Company

MMM	Martin Marrietta Materials
NEC	Northeast Corridor
NECR	New England Central Railroad, Inc.
NITL	National Industrial Transportation League
NITL Settlement	the agreement reached between Applicants and the National Industrial Transportation League, signed on December 12, 1997
NMB	National Mediation Board
NS	Norfolk Southern Corporation and Norfolk Southern Railway Company
NSC	Norfolk Southern Corporation
NSR	Norfolk Southern Railway Company
NW	Norfolk and Western Railway Company
NYSEG	New York State Electric and Gas Company
NYC	New York Central Lines LLC
P&W	Providence and Worchester Railroad Company
PRR	Pennsylvania Lines LLC
RCAF-U	Rail Cost Adjustment Factor - Unadjusted
RJCW	R.J. Corman Railroad Company/Western Ohio Line
RLA	Railway Labor Act
SAAs	Shared Assets Areas
SEA	the Surface Transportation Board's Section on Environmental Analysis
SIPs	the Safety Integration Plans
SMSAs	Standard Metropolitan Statistical Areas

TCU	Transportation Communications International Union
Transaction	the transaction proposed by Applicants in the Application
UP/SP merger	the merger contemplated by the primary application filed in Finance Docket No. 32760 and approved by the Surface Transportation Board in Decision No. 44 in that docket
UTU	the United Transportation Union
W&LE	Wheeling & Lake Erie Railway Company
WCL	Wisconsin Central Ltd.
WJPA	Washington Job Protection Agreement

TABLE OF SHORT CITATION FORMS

BG&E	Baltimore Gas and Electric Co. v. Natural Resources Defense Council, 462 U.S. 87, 97 (1983)
Bell Aerospace	NLRB v. Bell Aerospace Co., 416 U.S. 267 (1974)
BN/Frisco	Burlington Northern, Inc. -- Control & Merger -- St. Louis-San Francisco Railway Company, 360 I.C.C. 784 (1980), aff'd sub nom. Missouri-Kansas-Texas R.R. v. United States, 632 F.2d 392 (5th Cir.) cert. denied, 451 U.S. 1017 (1981)
BN/SF	Finance Docket No. 32549, Burlington Northern Inc. and Burlington Northern Railroad Company -- Control and Merger -- Santa Fe Pacific Corporation and the Atchison, Topeka and Santa Fe Railway Company, Decision served Aug. 23, 1995, aff'd sub nom., Western Resources, Inc. v. STB, 109 F.3d 782 (D.C. Cir. 1997)
Central Vermont	Central Vermont Ry. v. ICC, 711 F.2d 331 (D.C. Cir. 1983)
CSX Control	CSX Corp. -- Control -- Chessie System, Inc. and Seaboard Coast Line Industries, Inc., 363 I.C.C. 521 (1980)
Dispatchers	Norfolk and Western Ry. Co. v. American Train Dispatchers' Ass'n., 499 U.S. 117 (1991)
Hughes River	Hughes River Watershed Conservancy v. Glickman, 81 F.3d 437 (4th Cir. 1996)
Marin County	County of Marin v. United States, 356 U.S. 412 (1958)
New York Dock	New York Dock Ry. -- Control -- Brooklyn Eastern District Terminal, 360 I.C.C. 60, aff'd sub mon. New York Dock Ry. v. United States, 609 F.2d 83 (2d Cir. 1979)
NS Control	Norfolk Southern Corp. -- Control -- Norfolk & Western Ry. and Southern Ry., 366 I.C.C. 173 (1982)
Railroad Consolidation	Railroad Consolidation Procedures, 363 I.C.C. 784 (1981)
Railroad Revenue Adequ.	Railroad Revenue Adequacy -- 1988 Determination, 6 I.C.C.2d 933 (1990), aff'd sub nom. Association of American Railroads v. ICC, 978 F.2d 737 (D.C. Cir. 1992)

Rio Grande Control	Rio Grande Industries, et al. -- Control -- Southern Pacific Transportation Co., 4 I.C.C.2d 834 (1988)
Robertson	Robertson v. Methow Valley Citizens Council, 490 U.S. 332 (1989)
Schwabacher	Schwabacher v. United States, 334 U.S. 182 (1948)
Soo Line	Soo Line R.R. -- Petition for Declaratory Order, Finance Docket No. 33350, served February 4, 1998
Southern Control	Southern Ry. -- Control -- Central of Georgia Ry., 331 I.C.C. 151 (1967)
UP/CNW	Finance Docket No. 32133, Union Pacific Corp. et al. -- Control -- Chicago & North Western Transportation Co., et al., served March 7, 1995
UP/MKT	Union Pacific Corp., Union Pacific R.R. & Missouri Pacific R.R. -- Control -- Missouri-Kansas-Texas R.R., 4 I.C.C.2d 409 (1988) petition for review dismissed sub nom. RLEA v. ICC, 883 F.2d 1079 (D.C. Cir. 1989)
UP/MP/WP	Union Pacific Corp., Pacific Rail System, Inc., and Union Pacific R.R. -- Control -- Missouri Pacific Corp. and Missouri Pacific R.R., 366 I.C.C. 459 (1982), aff'd in part & remanded in part sub nom. Southern Pacific Transportation Co. v. ICC, 736 F.2d 708 (D.C. Cir. 1984), cert. denied, 469 U.S. 1208 (1985)
UP/SP	Finance Docket No. 32760, Union Pacific Corp., Union Pacific R.R., and Missouri Pacific R.R. -- Control and Merger -- Southern Pacific Rail Corp., Southern Pacific Transportation Co., St. Louis Southwestern Railway Co., SPCSL Corp., and The Denver and Rio Grand Western Co., Decision No. 44, served Aug. 12, 1996, appeal pending sub nom. Western Coal Traffic League v. Surface Transportation Board, No. 96-1373 (U.S. Court of Appeals for the District of Columbia Circuit)

UP/SP, Dec. No. 66	Finance Docket No. 32760, Union Pacific Corp., Union Pacific R.R., and Missouri Pacific R.R. -- Control and Merger -- Southern Pacific Rail Corp., Southern Pacific Transportation Co., St. Louis Southwestern Railway Co., SPCSL Corp., and The Denver and Rio Grand Western Co., Decision No. 66, served Dec. 31, 1996
UTU	United Transportation Union v. STB, 108 F.3d 1426 (D.C. Cir. 1997)
Western Resources	Western Resources, Inc. v. STB, 109 F.3d 782 (D.C. Cir. 1997)

TABLE OF CONVENTIONS

CONFIDENTIALITY CONVENTIONS

This document contains two classifications of material: highly confidential and public. All highly confidential material appears between sets of three brackets in the highly confidential version. In the public versions, highly confidential material has been redacted, but the three brackets remain to identify the existence of this material.

PAGE REFERENCES

In all cases, when reference is made to a particular page in a document that has been submitted to the Board under seal, reference is made to the highly confidential version of that document.

BRIEF OF NORFOLK SOUTHERN

Norfolk Southern Corporation and Norfolk Southern Railway Company (collectively, "NS") submit this brief in support of the Railroad Control Application (CSX/NS-18 through 25) filed on June 23, 1997 (the "Application").[1/] This brief will focus on issues and aspects of the transaction proposed by Applicants (the "Transaction") that are of principal relevance or concern to NS; the brief being filed by CSX Corporation and CSX Transportation, Inc. (collectively, "CSX") will address matters of principal relevance or concern to CSX.

INTRODUCTION AND SUMMARY

The Applicants seek the Board's approval for a Transaction the public benefits of which are manifest, widely recognized and largely undisputed. The improvements in rail service, the planned capital improvements to the rail systems and the tremendous increase in rail competition will spur economic development and enhance the ability of shippers throughout the Eastern United States to compete in the global marketplace.

Applicants submit that the case for speedy approval and implementation of the Transaction is compelling. Thousands of parties that are urging approval of the Transaction agree. These include the National Industrial Transportation League ("NITL"), the United Transportation Union ("UTU"), the Brotherhood of Locomotive Engineers ("BLE"), more than 100 railroads, the governors or transportation agencies of 10 states, and over 2200 shippers and groups representing shippers.

The remaining protestants claiming competitive or economic injury do not present substantial or difficult issues in this case. To the extent shippers and other parties have

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1/ Tables of Abbreviations and short case citation forms follow the Table of Authorities. Applicants' proposed findings and order are set forth in Appendix A. Deposition excerpts cited in this brief are set forth in Appendix B.

raised legitimate competitive and economic concerns, those have been reasonably addressed in the settlements Applicants have made with NITL and other parties.

The more substantial concerns that have been raised in this case relate to the manner in which Applicants will implement the Transaction and to the environmental effects of the Transaction on particular communities. NS and CSX take these concerns very seriously.

Concerns about implementation, which are largely service and safety related, have been reasonably addressed in the NITL Settlement and in the Safety Integration Plans (SIPs) that NS and CSX developed in consultation with the Department of Transportation ("DOT") and Federal Railroad Administration ("FRA"). In the NITL Settlement, NS and CSX have made extraordinary commitments relating to implementation of the Transaction, far beyond those made in any previous case. And, as DOT recently stated, the SIPs, which have also not been required in previous cases, fully and satisfactorily deal with the safety implementation issues that have been raised in this case.

Environmental issues are being addressed primarily in an environmental impact statement. Accordingly, unlike previous mergers, which only performed environmental assessments, the Board is not required to ensure that the Transaction will have no significant environmental effects. On an overall, systemwide basis, the Transaction will provide very substantial environmental benefits. In some communities, there will be decreases in train movements and in others there will be increases. The latter have prompted demands for mitigating conditions, including various operating restrictions and other conditions that would shift burdens to others and would substantially reduce, if not eliminate, the public benefits (including environmental benefits) of the Transaction. While NS and CSX are making every

effort to reach agreements with the affected communities that will reasonably resolve their concerns, it is unlikely that every demand for mitigation will be met. To the extent demands remain unmet, Applicants submit that it would not be reasonable to impose proposed environmental conditions on Applicants in light of the significant overall environmental benefits of the Transaction, the impacts to be mitigated, the other public benefits of the Transaction and the extent to which conditions sought would undermine those benefits and burden the rail system as a whole.

In sum, the Transaction is very much in the public interest, economically, competitively and environmentally, and should be approved without conditions except those set forth in the NITL Settlement and standard employee protective conditions.

BACKGROUND

A. The Transaction: A Unique Opportunity

Under the proposed Transaction, NS and CSX will divide between them the use and operation of most of the 10,500 miles of rail lines and other assets of Consolidated Rail Corporation ("CRC"), and each will integrate the operation of lines and assets allocated to it into its existing system. In addition, both NS and CSX will use and serve shippers on some 700 miles of lines to be retained by CRC in three Shared Assets Areas ("SAAs") -- North Jersey, South Jersey/Philadelphia and Detroit -- and CSX will have access to shippers on some 190 miles of lines to be allocated to NS in the coal fields served by the former Monongahela Railroad. The Transaction divides or shares CRC's principal routes in a way that will enable both NS and CSX to offer efficient and competing single-line service to

communities in the Northeast most of which, for more than 20 years, have had rail service from only one Class I railroad, CRC. In addition, the Transaction will result in two strong, far-reaching and very competitively balanced rail networks in the Eastern United States. After the Transaction, NS will operate 21,400 route miles and CSX will operate 23,100. CSX/NS-18 at 523.

Today, of the four main rail routes between the Northeast and the Midwest, CRC has three and CSX has one. After the Transaction, NS and CSX will each have two. CSX/NS-18 at 330. In addition, the Transaction divides CRC's east-west routes between CSX and NS in a way that ensures that neither carrier will be precluded from competing with the other in the major markets because of excessive circuity, and it also ensures that each will have adequate line and terminal capacity. Id. at 520-521.

Other enormous benefits of the Transaction include greatly expanded single line routes, increased competitiveness with trucks that will divert substantial traffic from highways to rail lines, associated environmental and safety benefits, and hundreds of millions of dollars of budgeted capital improvements. These largely undisputed benefits are detailed in the Application and discussed further in Part I of the Argument.

It could well have been otherwise. Conrail was created by Congress in 1976 out of the remains of the Penn Central and seven other bankrupt Northeast railroads. Despite their desires and best efforts, Congress, the Department of Transportation and the United States Railway Association were unable to devise multiple rail systems to replace Penn Central and the others that would be both competitive and financially viable. To ensure financial viability, they created a single railroad to serve most of the Northeast, CRC, leaving

additional competitive systems for another day if at all. CSX/NS-18 at 506-508. There was no particular reason, however, to believe that such systems would develop.

As the Board knows, the Transaction represents the culmination of a vigorous contest between NS and CSX for control of Conrail that lasted from mid-October 1996 to early March 1997. Though it cannot speak for CSX, NS believes that the outcome of that contest owes a great deal to the existing statutory and regulatory framework governing railroad consolidations. While that framework recognizes the parties' basic freedom to structure the transaction and battle out the terms in the open market, the statute's strong emphasis on competition, and the Board's known commitment to it, led to a result far more beneficial to the public than anyone could have hoped for at the outset.

In short, a fortunate confluence of circumstances presents the Board with by far the most pro-competitive railroad restructuring in history and a unique opportunity to do what Congress, DOT and others were unable to do after the collapse of Northeast railroads in the 1960s and 70s: to restore to the Northeast competitive rail service that will at the same time be efficient and financially viable.

B. Support for the Transaction: NITL and Other Settlements

Support for the Transaction is truly unprecedented. Almost every affected constituency supports it. That support says more about the merits of the Transaction than Applicants ever could. Over 2,700 letters of support were included with the Application, including letters from more than 2,200 shippers, 350 public officials and 80 railroads. CSX/NS-21, Volumes 4A through 4G. Since then, more than 300 additional parties, most notably NITL, UTU, BLE, NYSEG and 22 additional railroads, have filed statements of support.

Among those supporting the transaction are 10 states.[2] These include Pennsylvania (the home of Conrail), New Jersey and Maryland, which are among the states most directly affected by the Transaction.

In addition, opposition to the Transaction is extremely limited. Most notably, neither the Department of Justice nor the Department of Transportation opposes the Transaction. Although DOJ has expressed concerns about three isolated situations, it has acknowledged the new rail competition that the Transaction would create. DOJ-1 at 3. DOT's initial comments, filed on October 21, 1997, expressed concerns only about safety and implementation. More recently, DOT's very favorable comments on Applicants' SIPs and other steps to address safety, indicate that DOT's concerns in that regard are largely satisfied. The comments of DOJ and DOT in this case are in marked contrast to those they expressed in UP/SP.

The support for and lack of opposition to the Transaction reflect not only its merits but also Applicants' efforts to reach agreements with public agencies, shippers and other railroads to address their concerns. The Board, like the ICC have emphasized many times their preference for privately negotiated resolutions of disputes between railroads and the shippers and communities they serve over agency-imposed dictates.[3] Applicants have

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[2] The states whose Governor or Department of Transportation have issued statements supporting the transaction are: Alabama, Kentucky, Maryland, Michigan, Mississippi, New Jersey (press release), Pennsylvania, South Carolina, Virginia and West Virginia. In addition, letters of support have been received from other officials, agencies and legislatures of the following states: Alabama, Georgia, Indiana, Kentucky, Maryland, Michigan, Mississippi, Ohio, South Carolina, Tennessee and Virginia.

[3] See, e.g., BN/Santa Fe, Decision No. 40, 1995 ICC LEXIS 242, served Sept. 21, (continued...)

heeded that admonition and have reached agreements with numerous parties. These include agreements with 16 railroads, listed at CSX/NS-176 at 19. As a result of these agreements or other considerations, a number of parties that filed oppositions to the Transaction and/or requests for conditions filed by the following parties on October 21, 1997 have since withdrawn them. These include NITL, NYSEG, ACE, Delmarva Power and Light, UTU, BLE, Toledo-Lucas County Port Authority, Toledo Metropolitan Council of Governments, and the City of East Cleveland.

The number and scope of the settlement agreements bear witness to Applicants' efforts to satisfy legitimate concerns. In cases where settlements have not been reached, it is not for lack of trying but for lack of any proportionality between the protestants' settlement demands and the Transaction's impact and protestants' apparent hope to use the regulatory process to extract unrelated private benefits from Applicants. That strategy should not be rewarded.

The most noteworthy of these settlements is the agreement NS and CSX have reached with the nation's largest shipper trade association, NITL, on December 12, 1997. That agreement, which is set forth in full at CSX/NS-176 at 768-774, addresses the principal concerns raised by shippers and their representatives in this proceeding and resolves them in a reasonable way. The NITL Settlement includes the following provisions:

- Establishment of a Conrail Transaction Council to function as an ongoing forum for constructive dialogue among NS, CSX and shipper representatives regarding implementation planning and the implementation process.

[3/](...continued)
1995, at *15-*16; BN/Santa Fe, Decision No. 38, served Aug. 23, 1995, slip op. at 88; UP/MKT, 4 I.C.C.2d at 468; UP/MP/WP, 366 I.C.C. at 589.

- Commitments by NS and CSX to obtain all necessary labor implementing agreements and to have in place management information systems to manage operations on CRC lines in the SAAs, to manage interchanges between NS and CSX and having necessary car tracking capabilities before the date on which operation of CRC's lines will be divided between CSX and NS ("Closing Date").

- Conrail transportation contracts will be honored by NS and CSX and allocated between them pursuant to the Transaction Agreement; shippers that are not local to NS or CSX who are dissatisfied with service after six months may seek to change carriers through expedited arbitration.

- For shippers of more than 50 carloads a year on routes on which CRC now provides single-line service which will become interline NS/CSX routes post-Transaction, NS and CSX will, at the shipper's option, maintain existing CRC rates for three years (subject to RCAF-U adjustments).

- At all points where CRC now provides reciprocal switching, NS and CSX will keep those points open for at least 10 years and will cap their switching charges at such points for five years to no more that $250 per car (subject to RCAF-U adjustments), which in many cases is substantially less than CRC's current charge.

- The parties will jointly recommend that the Board require oversight of the implementation of the Transaction for a three-year period, with quarterly reports that will use objective, measurable standards to be developed and recommended by the Council.

These provisions go well beyond the traditional conditions that the Board and the ICC have imposed in previous consolidations. Applicants' agreement to undergo three years of Board oversight is all the more remarkable, inasmuch as the concerns raised about implementation have been largely generated by Western service problems following the UP/SP merger, yet these circumstances have no parallel in this Transaction. See CSX/NS-176 at 724-25 and pp. 47-48, infra. The fact that NITL opposed the UP/SP merger but (along with most other affected parties) supports this Transaction reflects the general recognition of the basic differences between the two transactions.

C. The Statutory Standards and Their Application to this Proceeding.

The statute governing the Board's decision in his case, 49 U.S.C. § 11324(c), provides:

> The Board shall approve and authorize a transaction under this section when it finds the transaction is consistent with the public interest.

This statute reflects a long-standing national policy favoring railroad consolidations. That policy has its roots in the Transportation Act of 1920 (see Schwabacher v. United States, 334 U.S. at 191-92), and was reinforced in the Transportation Act of 1940, which was enacted "to facilitate merger and consolidation in the national transportation system." Marin County, 356 U.S. at 416. It was reaffirmed again in the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210 ("4R Act"), which was "intended to encourage mergers, consolidations, and joint use of facilities that tend to rationalize and improve the Nation's Rail system." S. Rep. No. 94-499, 94th Cong., 1st Sess. 20 (1975).

In determining whether a transaction is consistent with the public interest the Board is required by 49 U.S.C. § 11324(b) to consider five factors: (1) adequacy of transportation; (2) inclusion of other carriers; (3) total fixed charges; (4) rail carrier employees' interests; and (5) competition. In addition, the Board and ICC have held that the effects of the transaction on the environment will also be considered as part of the public interest determination. UP/SP at 218; BN/SF at 54.

In this case, the second and third factors are not at issue. No other railroad has requested inclusion and no party has disputed the ability of CSX and NS to cover their fixed

charges.[4] The only disputes concern the effects of the Transaction on the adequacy of transportation, railroad employees, rail competition and the environment. While a number of parties are still requesting conditions based in some fashion on those factors, in reality the disputes between Applicants and those parties are quite limited.

As to factor one, no party has seriously disputed the transportation efficiencies and improvements, the increased rail competition and the other public benefits that the Application shows the Transaction will bring about.[5] The asserted adverse effects on the adequacy of transportation to alleged adverse effects on other specific carriers. The Board and ICC, however, have long recognized that the public interest in competition and transportation efficiency is generally disserved by imposing restrictions or conditions on rail consolidations carriers. BN/Frisco, 360 I.C.C. at 951 (conditions are not warranted to protect competing railroads; such conditions generally harm shippers and competition.)

With respect to the effect on employees (factor four), UTU and BLE now support the Transaction. Furthermore, Applicants agree that the Board must impose New York Dock and other standard conditions to protect adversely affected employees, and the principal dispute with the remaining unions is whether the Board should find that this is an extraordinary transaction warranting more than those standard protections.

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[4] Although the responsive application filed by W&LE asks the Board "to reserve jurisdiction to entertain an inclusion petition shou.d financial considerations make that necessary as an alternative to bankruptcy liquidation during the oversight period" (WLE-4 at 9), it has not filed an inclusion application, as the Board recognized in Decision No. 54.

[5] Some parties, such as CMA, have claimed that the benefits are not as great as Applicants say they will be, but even those parties do not deny that the Transaction will have a substantial positive effect on the adequacy of transportation throughout the region affected.

While some shipper interests argue that the Transaction will have adverse effects on rail competition (factor five) -- based mainly on arguments about vertical foreclosure that have been repeatedly rejected by the Board, the ICC and the courts, see pp. 22-23, infra -- virtually no railroads have made that claim. The two railroads whose requests for trackage rights and other conditions are of principal concern to NS -- the Wheeling and Lake Erie ("W&LE") and Ann Arbor ("AA") -- have not based those claims on an asserted need to preserve rail competition. Their claims are based instead on an asserted adverse impact on those railroads' revenues, and thus on a claimed -- but wholly unsupported (see pp. 29-35, infra) -- threat to essential transportation services.

Similarly, while a number of parties have complained about potential environmental effects of the Transaction at discrete locations (including alleged impacts on safety) and have requested conditions to mitigate them, no party has disputed the showing made in the Application, and acknowledged in the Draft Environmental Impact Statement (DEIS at ES-2), that, on a systemwide basis, the Transaction will have a positive environmental effect. In fact, Applicants have shown that the net overall environmental effects of the Transaction will be extremely positive, mainly (but by no means exclusively) as a result of the projected diversion of almost one million truckloads of traffic each year from the highways to the rails. CSX/NS-23 at 18-19. Those diversions will reduce fuel consumption, air pollution and highway congestion, as well as deaths and injuries by a highly predictable amount. CSX/NS-18 at 16; DEIS at B-14. Those diversions, as well as rerouting of traffic to achieve operating efficiencies, will necessarily result in increases in rail traffic on some line segments (and reductions on others), but even those areas with rail increases on line segments will

share in the beneficial effect of reduced highway traffic. In considering requests for conditions to mitigate specific local impacts, however, the Board must also consider the associated costs of such conditions, particularly the loss of the environmental, economic and other public benefits that led to those impacts. See pp. 43-46, infra.

D. The Standards For Imposing Conditions

49 U.S.C. § 11324(c), authorizes the Board to impose conditions. The Board's policy with respect to conditions has been well established and consistently applied for at least 20 years. That policy embodies the following principles and conclusions:

1. "[C]onditions generally tend to reduce the benefits of a consolidation." BN/SF at 55.

2. Conditions will therefore be imposed only on a clear showing that they are needed to remedy harms that are both transaction-related and significant. "To be granted, a condition must first address an effect of the transaction. We will not impose conditions 'to ameliorate longstanding problems which were not created by the merger,' nor will we impose conditions that 'are in no way related either directly or indirectly to the involved merger.'" Id. at 55-56.

3. Conditions "must also be narrowly tailored to remedy [the merger-related harm]." Accordingly, conditions will not be imposed "that would put its proponent in a better position than it occupied before the consolidation." Id. at 56.

4. "[C]onditions are not warranted to offset revenue losses by competitors." Id.

5. Conditions must be "operationally feasible" and must "produce public benefits (through reduction or elimination of the possible harm) outweighing any reduction of the public benefits produced by the merger." Id.

6. Conditions should not be imposed "that would broadly restructure the competitive balance among railroads with unpredictable effects." Id.

7. The fact that a consolidation results in competitive or other transportation benefits to some shippers but not to others is not a transaction-related harm to the latter for which conditions are warranted. UP/SP at 130 ("We will not

> impose a condition just because one group of shippers obtains pro-competitive merger benefits that other shippers do not enjoy.")

See also UP/SP at 144; UP/CNW at 97; UP/MKT at 437; UP/MP/WP at 562-565.

In addition, in considering requests for conditions, it is essential that the Board keep in mind the basic and paramount purpose for which Congress entrusted the Board and its predecessor with exclusive authority to review and approve railroad consolidations: to protect and promote the national interest in commerce and in a strong transportation system, often against the clamorous imprecations of competing local interests. That was the basic purpose for which the Transportation Act of 1920 first granted exclusive authority over rail consolidations to the ICC.[9] As Justice Jackson explained in Schwabacher, 334 U.S. at 191:

> [T]he stress and strain of World War I brought home to us that the railroads of the country did not function as a really national system of transportation. That crisis also made plain the confusions, inefficiencies, inadequacies and dangers to our national defense and economy flowing from the patchwork railroad pattern that local interests under local law had created.
>
> The demand for an integrated, efficient and coordinated system of rail transport, equal to the needs of our national economy and defense resulted in the Transportation Act of 1920 . . . [That Act conferred on the ICC] the power and duty . . . regardless of state law to control rate and capital structures, physical make-up and relations between carriers, in light of the public interest in an efficient national transportation system.

See also, State of Colorado v. United States, 271 U.S. 153, 164 (1926) (ICC's duty is to "prevent unjust preference to particular intrastate shippers or localities at the demonstrated expense of interstate commerce.") The fundamental duty of the Board to protect "the public interest in an efficient national transportation system" was reinforced in the ICCTA, which

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[9] See "National vs. State Regulation" in Gabriel Kolko, Railroads and Regulation (Princeton University Press, 1965, Norton ed. 1970), pp. 217-30 (Transportation Act of 1920 outgrowth in part of 1742 different state rail regulatory laws passed between 1902 and 1915).

specifically added to the factors the Board must consider in rail merger cases the effect on competition among rail carriers in "the national rail system." 49 U.S.C. § 11324(b)(5). This duty is pertinent to all of the requests for conditions in this case and particularly to the demands, often conflicting, of different localities in this case to reroute trains or impose operating restrictions or other exceedingly costly conditions to reduce the effect of Applicants' projected operations on those localities.

ARGUMENT

I. THE TRANSACTION WILL PRODUCE UNPRECEDENTED PUBLIC BENEFITS

There can be no question that the Transaction is consistent with the public interest and thus should be approved. The public benefits are enormous. The projected quantified public benefits, based on 1995 data, are almost $1 billion annually. CSX/NS-18 at 16. No party has disputed these projections. The quantified public benefits do not include the even greater non-quantified public benefits that will result from increased rail competition, diversion of traffic from the highways, increased economic development and global competitiveness, and hundreds of millions of additional dollars that NS and CSX plan to expend to improve the rail system in the Eastern United States. The quantified and unquantified public benefits include the following:

First, the Transaction will bring about an unprecedented increase in rail-to-rail competition without any reduction in competition elsewhere. Shippers in the SAAs, in the Monongahela coal fields and many other locations currently served by only one Class I

carrier will be gaining direct rail service by a second one.[7] Dr. Barry Harris, has estimated that more than $700 million in annual freight movements that are now rail-served solely by Conrail at origin or destination will have two independent and competitive routings after the Transaction. CSX/NS-19, Vol. 2B at 14-17.[8]

The Transaction will also bring about a tremendous increase in competition between railroads and other modes. NS and CSX have estimated that the expansion of direct single-line intermodal service throughout the new NS and CSX systems will divert million tons of freight annually from truck to rail, resulting in almost a million fewer truck trips per year. CSX/NS-19, Vol. 2A at 255; CSX/NS-19, Vol. 2B at 156; CSX/NS-23, Vol. 6A at 71.

The expansion of the NS and CSX systems will enable them to provide shippers far more extensive single-line service, more direct routes, more reliable service and improved equipment utilization. All of this will improve operating efficiency, reduce costs, cut transit times and terminal delays, and provide logistics savings to shippers associated with single-line service and the shift of traffic from highways to rail lines. The operating cost savings, logistics savings and other quantifiable public benefits will amount to nearly $1 billion for

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[7] These include shippers like ACE, which, presumably recognizing the competitive benefits it will obtain, has withdrawn the comments and request for conditions it filed in October.

[8] This estimate, of course, greatly understates the amount of traffic that will benefit competitively from the Transaction, since it does not include traffic that will continue to have direct service by only one Class I carrier after the Transaction (e.g., to or from a shipper in Boston, MA) but will still gain important competitive alternatives through improved joint line service by the other Class I carrier and smaller carriers, possible truck movements to nearby transload points on the other Class I carrier, and possible shifts of production to facilities served by the other Class I carrier. This estimate also does not reflect the qualitative enhancement of competition that will result from competition between two far-reaching and competitively balanced rail networks.

NS and CSX each year. CSX/NS-18 at 16, 592; CSX/NS-19 at 52. These transportation benefits will bring new economic development opportunities to the East and help industries served by the new systems to be more competitive in the global marketplace. CSX/NS-19, Vol. 2B at 248-56.

The operating efficiency gains and diversion of traffic from highways to rail lines will also yield substantial environmental benefits, as recognized in the DEIS. Because trucks on average require at least three times the amount of fuel as trains to move the same amount of freight the same distance, by the most conservative estimate the shift of traffic to the rails will cut diesel fuel consumption by 80 million gallons per year (DEIS at 3-1), improve overall air quality (id. at 4-70), and reduce the potential for accidental release of ozone-depleting materials (id. at 4-62).

The Transaction will yield similar safety benefits. NS is a recognized leader in safety in the railroad industry, having recently earned, for the eighth straight year, the prestigious E.H. Harriman Gold Award for employee safety. As the DEIS noted (DEIS at B8-1), NS and CSX had the lowest accident rates of all Class I railroads for the period 1994-1996. Applying either NS's or CSX's low accident rate to the new lines would reduce rail accidents by approximately 50 per year. CSX/NS-23, Vol. 6A at 75. Each year, the diversion of traffic from trucks to rails will prevent approximately 1600 highway accidents and 133 related personal injuries and save 31 lives. DEIS at B-14. Also, because trucks have ten times more hazardous materials incidents per ton mile of freight moved than do railroads (NS Comments on DEIS at 3-2), any diversion of hazardous materials from truck to rail will provide significant environmental and safety benefits. The total commitment of NS and CSX

to safety is reflected in their exemplary safety records and in the SIPs they developed in close consultation with FRA and submitted to the Board in December. DOT has said that "the Department is satisfied that the SIPs address and satisfactorily mitigate every safety concern raised in the environmental review portion of this proceeding." DOT-5 at 4.

The competitive benefits, operating efficiency gains and environmental and safety benefits will be achieved with no significant adverse competitive effects. The existing NS and CSX systems are largely end-to-end with the portions of Conrail that each will operate. In those few areas where customers would have gone from two to one, the Transaction Agreement preserves two-carrier service, through trackage rights or other arrangements. CSX/NS-19, Vol. 2A at 19; CSX/NS-19, Vol. 2B at 8.

The benefits will also be achieved with minimal line abandonments. NS anticipates only 29 miles of lines will be abandoned, and they will be lines that have little or no local traffic and where overhead traffic can be routed more efficiently over other lines. CSX/NS-20, Vol. 3B at 174-177; NS-28.[9/]

All of these benefits are largely undisputed. While a number of parties have claimed that the Transaction will have various adverse effects on them, none have challenged Applicants' projections of the public benefits or have seriously questioned the overall

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[9/] As stated in NS-28, NS has withdrawn the petition for exemption in Docket AB-290 (Sub-No. 195X) to abandon a 21-mile line between Dillon and Michigan City, IN. Also, NS has agreed with the Toledo-Lucus County Port Authority and Toledo Metropolitan Council of Governments to change the notice of exemption in Docket No. AB-290 (Sub-No. 197X) to abandon the Toledo Pivot Bridge to a notice of discontinuance.

competitive, environmental and safety benefits.[10] On the contrary, these are widely acknowledged. See CSX/NS-176 at 20-24. Indeed, impressive confirmation of the transportation and economic benefits of the Transaction is reflected in the recent decision of one of Applicants' principal Class I competitors, Canadian Pacific Railway ("CP"), to retain its St. Lawrence & Hudson Railway unit, which CP had indicated earlier last year it might sell. CP has now decided to retain a line that was apparently slated for oblivion, citing "new opportunities in the wake of the Conrail Inc. breakup."[11]

II. THE BOARD SHOULD NOT PERMIT CONTRACTUAL PROVISIONS TO THWART IMPLEMENTATION OF THE TRANSACTION.

The essence of the Transaction is that NS and CSX will divide (and in the case of SAAs, share) the operation and use of Conrail's entire system and all the rights and assets comprising it. Those assets include Conrail's rights and obligations under transportation contracts with shippers, as well as trackage rights over other carriers' lines, such as rights over New Jersey Transit lines between Suffern, NY and Hoboken, NJ, rights over the IHB in the Chicago area and rights over various Amtrak lines, including the Northeast Corridor ("NEC"), which Conrail has retained and used ever since it transferred those lines to Amtrak in 1976. CSX/NS-18 at 93-94, 217-224.

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[10] As we will discuss below, a number of parties have disputed the degree of the competitive benefits claimed by Applicants on the basis of arguments that, as to those parties, the transaction will reduce competition for various reasons, by, for example, not extending to them benefits extended to others; converting some movements from single-line to joint-line service; causing alleged vertical foreclosure of competitive options; and leading to shifts in gateways that will be less efficient and more costly. None of these parties, however, dispute the obvious pro-competitive effects of the overall Transaction.

[11] Wall Street Journal, December 8, 1997 at B4.

Because the Transaction could not be carried out otherwise, the Application asks the Board to declare that its approval of the Transaction "will permit CSXT and NSR to conduct operations over the routes of Conrail covered by Trackage Agreements . . . as fully and to the same extent as CRC could, notwithstanding any provisions in such Trackage Agreements purporting to limit or prohibit Conrail's unilateral assignment of its operating rights to another person." CSX/NS-18 at 102. The Application also requests a similar declaration with respect to other assets, including Conrail's transportation contracts. Id. at 102-103.

Several parties have contended that the Board cannot or should not permit NS and CSX to acquire Conrail's contractual rights, including trackage rights, without those parties' consent.[12/] These contentions are incorrect. As the Board made clear in UP/SP, the Board's approval of a transaction under 49 U.S.C. § 11323 and 11324 overrides private contractual provisions, including those requiring consent to the assignment of trackage rights, where such overrides are necessary to permit the parties to carry out the approved transaction. UP/SP at 170 and n. 217; UP/SP, Dec. No. 66, 1996 STB LEXIS 356 at *21-22 (STB, Dec. 31, 1996). Because the Transaction simply could not be implemented unless all such consent requirements are overridden and because it is essential that there be no uncertainty about the scope of Applicants' operating rights post-Transaction, it is of the utmost importance that the Board's decision expressly reject these parties' contentions and grant the declaratory relief requested.

12/ These parties include Amtrak (NRPC-7), CMA (CMA-10), APL (APL-4), the City of Indianapolis (CI-5), Eastman Kodak Company (EKC-2), the Gateway Western and Gateway Eastern Railways (GWWR-3), P&W (undesignated) and Redland Ohio, Inc. (Redland-2).

The Rebuttal refutes the arguments of each of these parties. CSX/NS-176 at 94-105. NS adds here only the following points regarding Amtrak's arguments concerning the assignment of CRC's rights on the NEC.

First, as Amtrak notes in its comments (NRPC-7 at 2), Amtrak and Applicants have been in discussions regarding Applicants' post-Transaction operations on Amtrak lines, and Amtrak expressly acknowledges that it "is anxious to maximize the efficient utilization of the Northeast Corridor by freight traffic that is compatible with Amtrak and commuter freight operations." Id. at 11.

Second, the Transaction will not adversely affect Amtrak's passenger operations. Amtrak will continue to control dispatching on the NEC, and Applicants' operations will continue to be subject to the operating agreement between Amtrak and Conrail, which, among other things, makes any requested changes in freight service subject to the "physical limitations of the NEC, to Amtrak's speed, weight, and similar operating restrictions and rules or safety standards, and to the needs of, and in particular to the adequacy, safety and efficiency of, Amtrak passenger train operations and commuter service."[13/] Indeed, Amtrak recently stated that it "agrees with SEA that Amtrak's ownership and control of the NEC is an important safeguard in ensuring that neither Amtrak nor commuter train service on the NEC will be harmed by the Acquisition." NRPC-11 at 4.

Third, although Amtrak asserts in a footnote that the Board lacks the authority to grant the override relief requested, it cites no authority and offers no reasons in support of

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13/ Second Amended and Restated Northeast Corridor Freight Operating Agreement, Dated October 1, 1986, Sections 2.3(b) and (c).

that claim. The claim, moreover, is squarely in conflict with the Supreme Court's decision in Norfolk and Western Ry. Co. v. American Train Dispatchers' Ass'n., 499 U.S. 117, 129-33 (1991), and with the Board's decision in UP/SP, which specifically held that § 11321(a) would override a consent requirement in a trackage rights agreement that would otherwise prevent the track user from assigning operating rights to another carrier as contemplated by the approved transaction. The Board ruled that earlier decisions to the contrary "did not survive the Supreme Court's 1991 Dispatchers decision, which made clear that the immunity provision may override contractual obligations." UP/SP at 170, n.217. Furthermore, there can be no question that such overrides are absolutely necessary to enable Applicants to carry out the Transaction; without them, not only the NEC but many other lines on which Conrail now operates could be unavailable to NS and CSX.

III. THE BOARD SHOULD DENY ALL REQUESTS FOR CONDITIONS OTHER THAN THOSE CONTAINED IN THE NITL SETTLEMENT.

Applicants' Rebuttal (CSX/NS-176 through 178) addresses in detail all of the requests for conditions and shows why all of them other than those contained in the NITL Settlement should be denied. Space does not permit them all to be discussed here. This brief will address those requests that are of principal concern to NS.

A. Conditions Based on Claims That Rail Competition Will Be Reduced.

Various parties have challenged the proposition that the Transaction will have no adverse effects on rail competition in two ways: First, some argue, contrary to well-settled economic principles and Board precedents, that shippers currently served at origin or destination by only one carrier will suffer reduced competition as a result of the vertical integration of that carrier with one of its joint-line connections. Second, several parties

claim that some shippers currently served by two carriers will lose effective service by one of them.[14/]

Vertical Integration Claims. The argument that competition will be reduced through vertical integration has been refuted fully in the Rebuttal (CSX/NS-176 at 80-93; CSX/NS-177, Vol. 2A at 248-284) and need not detain the Board long. Significantly, one of the principal proponents of this argument, ACE, has since withdrawn its comments and request for conditions.[15/]

The argument rests on contentions that repeatedly have been rejected by the Board, the ICC and the courts. The Board and the ICC consistently have recognized and applied the common-sense presumption that a railroad which is the sole carrier serving an origin or destination will seek to maximize its economic advantage in the rates that it charges, with the result that its combination with another railroad with which it interlines will not result in less competition or higher rates to the shipper. See, e.g., UP/SP at 119-20; BN/Santa Fe at 70-78, aff'd sub nom., Western Resources, Inc. v. STB, 109 F.3d 782, 787 (D.C. Cir. 1997); UP/MKT, 4 I.C.C. at 476; UP/MP/WP, 366 I.C.C. at 538. The Board, the ICC and the courts have made clear that this is a presumption that a shipper may overcome if it can

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[14/] No party has made a claim that competition will be significantly reduced by the reduction of the number of carriers in a market from three to two. NS believes there would be no basis for any such claim in the facts of this case or in the Board's previous analyses of such claims. See, e.g., UP/SP at 119-20.

[15/] The only parties that explicitly advanced this argument in their comments were ACE, Indianapolis Power & Light Company ("IP&L") and Orange and Rockland Utilities, Inc. See ACE et al.-18; ORU-3. Other parties suggested the same claim, but made no effort to support it with evidence or arguments. See, e.g., NECR-4 at 7; CMA-10 at 26-27; IC-5, Skelton VS at 6-7.

supply evidence clearly showing "that, prior to the merger, the benefits of origin competition flowed through to the [shipper] and were not captured by the destination monopoly . . . [and] that such a competitive flow through will be significantly curtailed by the merger." UP/MKT, 4 I.C.C.2d at 476.

As discussed in the Rebuttal, no party making this argument even attempts to supply the kind of evidence needed to overcome the presumption. Instead, IP&L and their consultants have attempted to refute the validity of the presumption itself. They have attempted to do so on the basis of arguments that have been specifically rejected by the Board and the ICC and on the basis of a patently fallacious analysis that compares Conrail rates for different coal movements between 1991 and 1995. CSX/NS-176 at 88-91; CSX/NS-177, Vol. 2A at 269-281 (Kalt RVS).[16/] As the Board aptly observed in Decision No. 17 in this case, affirming the denial of a discovery request based on these arguments:

> [ACE et al.] are attempting to undermine more than the one-lump theory here. They are challenging a basic principle of economics, that firms will generally attempt to maximize their profits. This is the basic premise the ICC and Board have long applied, with court approval, when viewing competitive issues in assessing mergers: if carriers have additional market power, they will use it. Petitioners have not suggested a plausible rival economic theory to replace this one.

Decision No. 17 at 3.[17/]

[16/] As Professor Kalt points out in his rebuttal verified statement, among the numerous errors in the analysis of Conrail coal rates is the fact that there is no "before" in the purported "before and after" analysis. Throughout the entire period examined, Conrail controlled both the origins and destinations involved. CSX/NS-177, Vol. 2A at 269-270.

[17/] The court of appeals made much the same observation when it affirmed the ICC's views on the effects of vertical integration in the BN/SF case, stating: "It may not take a theory to beat a theory, but it helps." Western Resources, Inc. v. ICC, 109 F.3d at 790.

Two-to-one Claims. The only specific claims that the Transaction will have unremedied 2-to-1 effects with NS as the only remaining carrier are made by DOJ (Gibson Plant), AEP (Cardinal plant), and Ann Arbor Railway. None of these claims is correct.

With respect to the Gibson plant in Carol, Indiana, the plant's owner, PSI, has not complained or sought conditions, and DOJ's claim is based on an incorrect factual premise: that the plant has two-railroad access today. As shown in the Rebuttal, only NS has access to that plant. Conrail formerly provided service to that plant from one coal mine under a contract with PSI and via trackage rights over a four-mile segment of NS lines unconnected with any other Conrail lines, but Conrail's contract with PSI and its trackage rights on NS terminated contractually in 1996. Moreover, despite Conrail's limited service before 1996, there has been no meaningful competitive two-carrier access to the plant since at least 1981. CSX/NS-176 at 77-79; CSX/NS-177, Vol. 2A at 453-455.

AEP's 2-to-1 claim regarding its Cardinal plant on the Ohio River at Brilliant, Ohio, is equally groundless. In 1995, over 93% of the coal delivered to the plant was by river barge, and the rest was delivered by W&LE and by truck. AEP's professed concern is that W&LE "may not survive as a result of the proposed transaction" (AEP-5 at 2), and that if it does not, the plant will be reduced from two railroads to one. The first difficulty with this claim is that there is no basis for AEP's speculation that W&LE will not survive the Transaction (see pp. 32-33, infra). Second, Conrail has never served this plant, [[[

]]] Finally, any loss of rail service options would

have no significant competitive impact on the plant in any event, because more than 90% of its coal supply has been [[[ ]]] delivered by barge and truck. Id.

AA's 2-to-1 claims are also without merit and will be addressed at pp. 35, below. CSX will address in its brief the 2-to-1 claims asserting that CSX will be the only remaining carrier.

B. Conditions Seeking Changes to Existing Rules Governing Railroad Accounting and Maximum Rate Regulation.

Several shippers and shipper groups seek conditions that would reverse or alter, for NS and CSX alone, established rules governing railroad accounting and maximum rate regulation. These conditions would (1) preclude Applicants from including the full acquisition cost of Conrail in their accounts for purposes of revenue adequacy and jurisdictional threshold determinations, (2) modify existing rules governing market dominance and rate reasonableness determinations, and (3) impose an absolute rate cap for certain movements.

As discussed in detail in the Rebuttal, no justification whatever has been made for any of these conditions, which, if imposed, would amount to a significant reregulation of one part of the railroad industry -- NS and CSX -- contrary to consistent congressional policy since 1976. See CSX/NS-176 at 106-112, 736-767; CSX/NS-177, Vol.2A at 284-304, Vol. 2B at 648-724.

First, the arguments concerning acquisition costs proceed from the false premise that NS and CSX paid an excessive amount for Conrail, including some "premium" above its fair value. No party has submitted any evidence supporting such a claim, and it is ludicrous on its face to suppose that NS and CSX, through competitive bidding in the marketplace, paid

any more for Conrail than they believed it was worth. Accepting that premise, moreover, would require the Board to second-guess the marketplace. It would also fly in the face of any "fairness" finding which the Board is required to make in approving the Transaction.

Second, the requested condition that would preclude Applicants from including the full acquisition cost of Conrail in their accounts would conflict directly with long-standing accounting rules of the Board and with Generally Accepted Accounting Principles, which 49 U.S.C. § 11161 requires the Board to follow. It would also conflict with a decision of the ICC in 1990, which was supported by NITL and other shipper groups and upheld on judicial review, requiring railroads to use acquisition cost rather than pre-Transaction book value for purposes of revenue adequacy determinations.[18] Those rules and precedents are based on sound public policy. Furthermore, even if there were some reason to reconsider them, it is plainly inappropriate to do so here, in a proceeding that applies to only two railroads.

Third, the parties seeking conditions that would change the standards for determining market dominance for NS and CSX and that would impose permanent rate caps on various categories of traffic have simply made no plausible claim or showing that the requested conditions have any connection to any competitive harm caused by the transaction.

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[18] Railroad Revenue Adequacy -- 1988 Determination, 6 I.C.C.2d 933, 935-42 (1990), aff'd sub nom. Association of American Railroads v. ICC, 978 F.2d 737 (D.C. Cir. 1992). Although the ICC's decision addressed the use of acquisition cost for revenue adequacy purposes, its reasoning is fully applicable to jurisdictional threshold determinations as well, because both regulatory functions are based on the same financial accounting data prepared and submitted in accordance with the Uniform System of Accounts.

C. Conditions Seeking Enlargement of Joint Service Areas.

One aspect of this Transaction that makes it uniquely pro-competitive and will produce some of the chief public benefits is the agreement of CSX and NS to share the use of lines in three SAAs (North Jersey, South Jersey/Philadelphia and Detroit), give CSX access to lines in the Monongahela coal region in southwestern Pennsylvania and adjacent West Virginia, and provide capacity to CSX at Conrail's Lake Erie dock facility at Ashtabula, Ohio. Many shippers or their representatives outside those areas argue that the failure to include them causes competitive harm to them even though they will experience no reduction in the number of carriers serving them (and in most cases will gain significant new market opportunities through the expanded single-line service NS and CSX will be providing them). They have requested conditions that would effectively expand these areas to include them, such as trackage rights conditions or other conditions that would give them direct access to an additional carrier.

There is no merit to any of these requests, which are addressed in detail in the Rebuttal. See CSX/NS-176 at 113-176, 454-458. For very good reasons, the Board and the ICC have consistently held that the failure of a transaction to benefit all shippers equally is not a harm warranting imposition of conditions to mandate such universal equality. If it were, no consolidation having competitive, efficiency and other public benefits would ever occur, contrary to longstanding national policy. As the Board said in UP/SP at 130: "We will not impose a condition just because one group of shippers obtains pro-competitive merger benefits that other shippers do not enjoy." See also UP/SP at 183, 190; BN/SF at 38-39, 98-100; UP/MKT, 4 I.C.C. at 469.

D. Conditions Seeking Prescription of Switching Charges.

Several parties seek conditions that would prescribe or otherwise restrict post-Transaction switching charges. These are listed and discussed in the Rebuttal at CSX/NS-176 at 208-219. The requests share these features in common: first, none explains what Transaction-related harm the request is intended to redress (because, in fact, there is none); and second, none provides any evidence that would support the prescription of any specific charge or a uniform charge throughout the post-Transaction NS and CSX systems.[19] In short, there is no basis for these requested conditions. Furthermore, shippers' concerns with post-Transaction switching charges have been reasonably addressed in the NITL Settlement, in which NS and CSX have agreed for 10 years to keep open to reciprocal switching all points where Conrail now provides reciprocal switching and to cap switching charges at such points for five years at $250 (subject to annual RCAF-U adjustment), which is substantially below Conrail's current charge at many points.

E. Conditions Sought By Passenger Entities.

A number of passenger agencies and other parties with an interest in passenger agencies have requested a variety of conditions. These are addressed in detail in the Rebuttal, which shows them to be unrelated to any Transaction-related harm and unwarranted

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[19] There is no basis whatever for the reliance by several parties on the UP/SP decision in support of their requested $130 switching fee cap. The Board did not prescribe a $130 switch fee in that case; it merely accepted a charge that the applicants in that case negotiated with CMA in a private, arms-length negotiation. What applicants were willing to agree to in that case with its unique facts (including overlapping rail lines) in an agreement containing many other provisions obviously has no bearing on what the appropriate or legally required switch charges might be at hundreds of other locations in a different part of the country two years later.

for other reasons as well. We will not repeat that discussion here, except to note that Applicants are still striving to reach a settlement with Amtrak, and have reached agreement with NJ/DOT and Chicago Metra.

F. Conditions Requested By Railroads.

As noted earlier, over 100 freight railroads have filed statements supporting the Transaction. Several others have requested conditions. Two of particular concern to NS are discussed here: the requests of the Wheeling and Lake Erie Railroad ("W&LE") and of the Ann Arbor Railway Company ("AA").

1. The Wheeling and Lake Erie. Based on its claim that the Transaction will cause it to lose $12.7 million in annual gross revenue, W&LE seeks an extensive list of trackage and haulage rights and other conditions.[20] The contentions supporting these requests are refuted in detail in Applicants' Rebuttal. The following points warrant emphasis here.

First, while Applicants have shown that W&LE's claims regarding the Transaction's impact on W&LE's traffic and revenues are greatly overstated, there is a more fundamental deficiency in W&LE's request for conditions. The request is based entirely on an asserted threat to essential transportation services, yet W&LE has made no showing whatever that essential services are likely to be lost even if it were to go out of business.

The Board's railroad merger policy and many decisions applying it make clear that the Board will impose trackage rights or other conditions only where they are shown to be

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[20] If the Board does not grant W&LE's other conditions, W&LE asks the Board to retain jurisdiction to consider inclusion in the case of a W&LE bankruptcy. WLE-7, Parsons RVS at 5.

necessary to prevent a reduction of competition or harm to essential services, not just to protect competitors. 49 C.F.R. § 1180.1(c)(2); UP/MP/WP at 562; UP/MKT at 460. In the absence of such a showing, imposing conditions to protect the traffic and revenues of other railroads is not only unwarranted, it is likely to be positively harmful to competition and service to shippers. As the ICC stated in BN/Frisco:

> [R]ailroads do not have a proprietary right in the future to the traffic they have carried in the past. Therefore, we need not protect railroads from the possible loss of traffic through diversion to a merged railroad. On the contrary, protecting competing railroads tends to limit a shipper's ability to obtain the best service from the merged company and dampens the incentives for competitive response to the merged company from existing railroads. While a shift in traffic from one line to another may eliminate the need for service over the original line, this simply demonstrates that the earlier service is no longer essential. The consignor or consignee has the ability to determine, and in most instances does determine, which railroad will receive which traffic over specific routes.

BN/Frisco at 951 (emphasis supplied). In this case, Applicants have specifically demonstrated that imposition of the W&LE conditions would result in serious operational harms. CSX/NS-176 at 405-06; CSX/NS-177, Vol 2A at 127-63; CSX/NS-177, Vol. 2A at 529-40.

W&LE does not contend that any of the conditions it seeks are needed to remedy any claimed loss of rail competition resulting from the Transaction. When asked in discovery to identify the competitive harm to which each of its conditions related, W&LE stated that a special study would be needed to do so and that its requested conditions "are addressed to the cumulative impact of the expected diversions from W&LE which would render it incapable of providing competitive service to its shippers."[21/] If the requested conditions are not

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21/ Interrogatory Response, W&LE-6 at 5. Although Mr. Parsons stated in his initial (continued...)

sought to remedy any identified competitive harm, they can be justified only if shown to be necessary to prevent the loss of essential services.

W&LE, however, has failed completely to satisfy the showing required by the Board's policy and precedents to establish a likely loss of essential services. The Board's rail merger policy provides:

> In assessing the probable impacts [of consolidations], the Board's concern is the preservation of essential services, not the survival of particular carriers. A service is essential if there is a sufficient public need for the service and adequate alternative transportation is not available.

49 C.F.R. § 1180.1(c)(2)(ii) (emphasis supplied). See also, UP/MKT at 431. Neither W&LE nor any of its supporting shippers contends, or even suggests, that adequate alternative transportation would be unavailable to them if W&LE went out of business. Most of W&LE's major customers are also served by other rail carriers, and all of W&LE's primary load centers are near other railroads. CSX/NS-176 at 402-403. Indeed, W&LE has conceded that rail service can be expected to continue on its system even if it were to go into bankruptcy.[22] Nor have any shippers suggested that service by trucks or other modes

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[21] (...continued)
verified statement that Reserve Iron & Metal was a "2-to-1" shipper which W&LE was seeking trackage rights to serve, no such request was included in the list of requested conditions set forth in Mr. Wait's statement and no operating plan was presented with respect to it. Applicants' Rebuttal also shows that Reserve Iron and Metal is not a 2-to-1 shipper (CSX/NS-177, Vol 2B at 495), and W&LE's rebuttal does not dispute this showing.

[22] "W&LE does not argue that all rail service would close if it entered bankruptcy. Service under directed service order, or by NS if inclusion is ordered, would have different characteristics than that now provided by W&LE which has been endorsed by its supporting shippers in W&LE-4." WLE-6 at 5. See also, WLE-7 at 9 (asserting that Applicants want W&LE to fail so Applicants can serve W&LE shippers) and the analysis of the Ohio Rail Development Commission, included in WLE-7, which discusses the rail options W&LE shippers would have in the event of a W&LE bankruptcy.

would not be an adequate available alternative to them. See Central Vermont Ry. v. ICC, 711 F.2d 331 (D.C. Cir. 1983) (affirming ICC's conclusion that railroad had not shown its services were essential because it had not shown that its traffic could not be adequately served by other routes or by truck). See also UP/MKT, 4 I.C.C. at 474.[23]

In view of W&LE's complete failure to make the showing necessary to establish a loss of essential services, the Board need not ponder at length W&LE's greatly overstated claims about the Transaction's impact on it. The traffic diversion studies in the Application, performed by highly experienced outside consultants and based on calendar year 1995 revenue data (as required in this proceeding), showed a net annual revenue loss to W&LE of $1.4 million. W&LE's diversion study, performed by its Vice President Marketing and Sales and based on 1996 fiscal year data, claimed to show a revenue loss to W&LE of $12.7 million. NS's traffic witness, John Williams, shows that W&LE's claims were dramatically overstated and that even under the 1996 data used by W&LE, the diversions to NS would only be $2.0 million per year. CSX/NS-177, Vol 2B at 770-788. The Rebuttal also shows that W&LE's claims regarding W&LE's history and NS's post-Transaction market dominance are erroneous and that any financial difficulties W&LE may be having are the result of long-standing structural problems entirely unrelated to the Transaction. CSX/NS-

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[23] W&LE's discussion of "essential services" plainly misunderstands the term as used in the Board's policy and precedents. In arguing that its services are "essential," W&LE points repeatedly to statements from supporting shippers lauding the W&LE's quality of service and favorably contrasting W&LE's level of interest in their business to that of one or more of the Class I carriers. See, e.g., W&LE-7 at 25-26. Testimonials by shippers to the quality of a carrier's services do not establish that adequate transportation alternatives are not available to the shippers.

176 at 395-401. W&LE's Reply (WLE-7) provides new evidence or convincing arguments to refute this.[24/]

2. Ann Arbor Railway. AA, which operates a 46-mile line between Ann Arbor, MI, and Toledo, OH, seeks trackage rights between Toledo and Chicago. It advances two arguments in support of this request: First, AA claims that the Transaction will cause it to lose approximately $3.35 million in annual gross revenue, compelling it to reduce services and forcing some of AA's shippers to turn to other transportation modes, which AA contends amounts to a loss of essential services. AA-5 at 8. Second, AA claims that the Toledo to Chicago rail corridor is a "2-to-1 corridor," and that trackage rights to AA would preserve two-carrier competition. Both Applicants' Rebuttal and AA's own testimony clearly demonstrate that these two claims are groundless.[25/]

First, like W&LE, AA has failed completely to show that the Transaction's impact on AA will result in the loss of any essential transportation services. Although AA says that there are 10 active shippers on its line, it makes no claim that any of them would lose

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[24/] For example, $3.6 million of W&LE's claimed traffic diversions relate to an NS/W&LE intermodal train that ran for a few weeks in early 1997. Mr. Williams cited evidence that the train was canceled by NS for reasons unrelated to the Transaction; namely, seriously inadequate on-time performance by W&LE. CSX/NS-177, Vol. 2B at 393. In its reply, W&LE blames NS for the delays, but offers no evidence that the cancellation of the train had anything to do with the Transaction. WLE-7 at 29-30. Another $1.8 million of W&LE's claimed diversions relate to the expiration of a short-term lease of NS's portion of Huron Dock. Although W&LE agrees with Mr. Williams that non-renewal of the lease is reasonable, it argues without evidence that it is Transaction-related. Id. at 30.

[25/] In addition to its trackage rights request, AA also asked the Board to let it interchange with CN in Ann Arbor, Michigan to "recoup its projected revenue losses." AA-5 at 7. In Rebuttal, Applicants demonstrated this to be unworkable given the nature of CN's rights in Ann Arbor. CSX/NS-176 at 341. On reply, AA seems to have abandoned this requested condition by failing to submit any evidence to the contrary. AA-7.

essential transportation services if AA went out of business, and none of those shippers have submitted any statement making that claim.[26/]

Second, although AA claims gross revenue losses, it has submitted no evidence regarding the effect of the purported diversions on net revenues, and thus on the ability of AA to continue service.[27/]

Third, AA's claims regarding the impact of the Transaction on its gross revenues are greatly overstated, as Applicants show in the Rebuttal.[28/] Furthermore, since the Rebuttal was filed, AA has conceded that Chrysler Corporation will move a second automobile assembly plant next to AA's Ottawa Yard in Toledo, [[[

[26/] AA president Evert Erickson makes the conclusory allegation that several of those shippers "would be adversely impacted by the reduction or elimination of rail service," AA-5, Erickson VS at 7 (emphasis added), but he does not show that AA's demise would leave those shippers without adequate alternative rail or motor carrier service. Indeed, AA's argument that an increase in its costs would cause its customers to "switch to other transportation modes" (AA-5 at 8) clearly suggests that alternative transportation is available to them. As the court held in Central Vermont Ry. v. ICC, 711 F.2d at 338, this agency has properly put the burden on the party seeking conditions to demonstrate that the loss of its service will leave shippers without adequate transportation alternatives. AA has failed to meet that burden.

[27/] While AA does claim that "[t]he estimated revenue losses would force AA to cover its fixed costs from a declining traffic base thereby increasing its per unit cost which would have to be passed on to its remaining customers," AA submits no evidence on the level of fixed costs nor financial pro formas showing the effects of the loss on AA's balance sheets. AA-5 at 8; see also, AA-5, Erickson VS at 6-7 (same).

[28/] CSX-NS-176 at 339-341; CSX/NS-177, Vol. 2A at 355-364; CSX/NS-177, Vol. 2B at 792-799.

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AA's claim that the corridor between Toledo and Chicago will become a "2-to-1 corridor" served only by NS is demonstrably false. CSX's high-speed route between Toledo and Chicago provides a competitive alternative to the route NS will operate post-Transaction. CSX/NS-176 at 341; CSX/NS-177, Vol 2A at 356-57. AA claims that the "use of [this] CSX routing would add additional circuity to any AA traffic moving between Toledo and Chicago," implying that the circuity eliminates that route as a viable Toledo-to-Chicago option. AA-5 at 12. AA fails to inform the Board, and only admitted upon cross-examination in deposition, that the CSX high-speed route is only "between 15 and 25" miles longer than the NS route -- less than 10 percent of the NS rail miles between Toledo and Chicago. Erickson Tr. at 6-7.

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[29] Mr. Erickson's recent deposition testimony about [[[ ]]] and other matters contradicts his rebuttal verified statement in a number of significant respects. For example, Erickson admitted that [[[

]]], Erickson Tr. at 17, but in his rebuttal verified statement he argued that NS' witness "Mr. Williams ignores the fact that there are two Chrysler plants in Toledo and only one is adjacent to AA's Ottawa Yard," and further argued that because "the drayage distance to CSXT's Walbridge Yard is about 13 miles . . . AA enjoys no competitive advantage from being located closer to one of Chrysler's plants as Mr. Williams suggests." AA-7, Erickson RVS at 8. Erickson also admitted that the CSX high-speed route from Toledo to Chicago is only 15 to 25 miles longer than the CRC route NS will operate after implying in his rebuttal verified statement that NS' witnesses statements to the same effect were incorrect. AA-7, Erickson RVS at 8, Erickson Tr. at 6-7. Other examples include Erickson RVS at 6 (switching charges); Erickson Tr. at 4-5 (same); AA-7, Erickson RVS at 7 (effect of the new Chrysler contract); Erickson Tr. at 17 (same).

G. Conditions Requested By Coal Shippers.

The Transaction will provide very significant benefits to shippers and receivers of coal by virtue of expanded single-line service, new market opportunities, shorter and more efficient routes, and new competition between CSX and NS for service to shippers in SAAs and in the Monongahela coal region.[30] These benefits are recognized by a number of utilities and coal producers that support the Transaction,[31] or have withdrawn their requests for condition, such as ACE. Several utilities and other producers, however, continue to request conditions based on the same types of arguments as those already discussed. Those that will be served by NS after the Transaction are AEP (whose contentions regarding its Cardinal plant were discussed earlier), Eighty Four Mining Company ("EFM") and Detroit Edison.

EFM claims that it will be harmed because its competitors in the Monongahela region will gain access to a second carrier and it will not. As noted, however, it is well settled that this is not a harm for which conditions will be imposed. Furthermore, EFM will not in fact be harmed by the Transaction but will be significantly benefitted. CSX/NS-176 at 456-458; CSX/NS-177, Vol. 2A at 119-123.[32]

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[30] CSX/NS-19, Vol.2A at 313-349 (Sansom VS), 347-379 (Sharp VS); Vol. 2B at 261-282 (Fox VS).

[31] These include Pennsylvania Power and Light, Delmarva Power and Light, Ohio Valley Coal Company and NYSEG.

[32] A.T. Massey Coal Company expresses the same concern as EFM about competitive harms, but says only that it may be harmed at some point in the future and asks the Board to retain jurisdiction to impose conditions if its concerns materialize. ATCM-2 at 4-5. There is likewise plainly no basis for this request.

Detroit Edison seeks trackage rights for CN to gain access to Detroit Edison's Trenton Channel plant. The plant is now served only by Conrail, and after the Transaction both NS and CSX will be able to serve it. Detroit Edison's argument that the Board should require Applicants to give a third carrier access to the plant is patently groundless.

H. Conditions Requested By Parties That Will Receive Joint Line Service.

The division of Conrail's operations between NS and CSX, which will greatly increase both rail service and rail competition throughout the Northeast, will also necessarily create some situations where current single-line service will become joint-line service. The magnitude of these is relatively small. Applicants have shown that more than six times as many current joint-line movements will become single-line as the number of current single-line movements that will become joint-line. CSX/NS-18 at 550; CSX/NS-19, Vol 2B at 68. Many shippers in these circumstances will also be gaining access to more, much larger, single-line markets. These include shippers of aggregates like Martin Marrietta Materials (MMM), National Lime and Stone Company and Wyandot Dolomite, Inc., all of whom seek conditions based on their loss of single-line service for some of their current moves. CSX/NS-176 at 500-510.

While there is no question that single-line service is generally more efficient and superior to joint-line service, the division of a single-line route between two railroads to create a joint-line route causes no reduction in competition or loss of essential services and therefore does not warrant protective conditions. As noted, many of the shippers who will lose single-line routes will gain other single-line routes and market opportunities they did not previously have. Also, contrary to the claim of MMM, competitive joint-line movement of

aggregates are feasible and are now being provided. Id. at 502; CSX-NS-177, Vol. 2B at 495-496.

Although this circumstance does not warrant mandated conditions, NITL has nevertheless negotiated significant benefits for these shippers in the NITL Settlement. NS and CSX have agreed with NITL to maintain existing Conrail rates for three years for shippers of more than 50 carloads a year on all routes that will become interline NS/CSX routes post-Transaction. This provides a reasonable transition period for shippers to adjust to the changes in the Eastern rail infrastructure and take advantage of the new marketing opportunities created by the Transaction.

I. Employee Protective Conditions.

Approval of the Application, subject to the Board's standard employee protective conditions, is consistent with the public interest and the Board's mandate under the ICA. UTU and BLE, which represent all of the carriers' train and engine service employees (a total of 38 and 44 percent of the agreement employees on Conrail and NS, respectively), support the Transaction.[33] Other labor unions have filed opposing comments, but none has shown a reason for the Board to depart from the settled principles governing employee protection in railroad consolidations.

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[33] UTU's notice of its support for the Transaction (UTU-6) explained that the carriers and UTU have agreed to certain terms for application of New York Dock benefits and procedures. The carriers have committed to those terms; there is no need for the Board to impose them as conditions. UP/SP, at 171 n.218. By letter dated February 18, 1998, BLE advised the Board that it has withdrawn its opposition to the Application and furnished a copy of a separate letter agreement of the same date similarly addressing terms for application of the New York Dock conditions and expressing BLE's support for the Transaction.

For its size and scope, the Transaction will have a relatively modest impact on employees. Across the applicants' three systems, the Transaction is expected to produce a short term net loss of 1,981 agreement and nonagreement jobs (Labor Impact Exhibit (1996-97 Head Count) at 13 (attached to CSX/NS-26)), far fewer than the numbers of job losses projected for other recent railroad consolidations found to be in the public interest.[34/] More to the point, all of the projected employee impacts are the result of workforce changes that will "lead to increased efficiency" of railroad operations, a "goal to be encouraged," UP/MKT, 4 I.C.C.2d at 511. The carriers anticipate that the improved operations will permit them to increase their traffic, and that most of the agreement employees who will be furloughed from their current positions will be offered employment within three years. CSX/NS-177 at 2. In the meantime, those employees will receive monetary benefits in accordance with mandatory employee protective conditions.

The Board's standard employee protective conditions, including the New York Dock conditions, are appropriate to the Transaction. The New York Dock conditions afford extraordinarily generous monetary benefits, including up to six years' wage protection, to employees who are adversely affected as a result of the implementation of the transaction. The New York Dock benefits may be without parallel in any other industry. The ICC and the Board have consistently imposed the New York Dock conditions, without modification, in

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[34/] UP/SP, at 171-72 (projected net loss of 3,387 jobs; "Mergers of necessity involve employee dislocations and the labor protective conditions that we impose are to mitigate these dislocations."); BN/SF, at 46 n.69 (projected net loss of 2,761 jobs).

all the major railroad consolidations approved in the last two decades.[35] No "unusual circumstances" exist within the meaning of Railroad Consolidation Procedures, 363 I.C.C. 784, 793 (1981), that would require even greater levels of protection here.

Nearly all of the rail labor commentors in this proceeding acknowledge that the Board's standard employee protective conditions are appropriate to the Transaction. Only the Transportation Communications International Union ("TCU") asks the Board to enhance the New York Dock benefits. TCU-6 at 7. We addressed TCU's requests at length in our Rebuttal (CSX/NS-176 at 591-600). As we showed (id. at 594-600), TCU's contention that Conrail's current employees deserve lifetime ("attrition") protection based on asserted past sacrifices of rail labor has no basis in fact, logic, or policy. TCU's other requested enhancements -- protection against relocation and increased severance benefits -- also would contravene Board policy by substantially impairing the carriers' ability efficiently to implement the proposed transaction. The ICC and the Board consistently have rejected requests for such enhanced benefits,[36] and the Board should do the same here.[37]

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[35] UP/SP, at 172; UP/CNW, at 95; BN/SF, at 80; Rio Grande/SP, 4 I.C.C.2d at 953-54; NW/ Southern, 366 I.C.C. at 230; UP/MP, 366 I.C.C. at 620; CSX Control, 363 I.C.C. at 589.

[36] E.g., BN/SF at 80 ("Attrition-type conditions are calculated to preserve unnecessary jobs, and unduly restrict a carrier's ability to establish economical operations."); UP/CNW, at 96 (same); UP/MKT, 4 I.C.C.2d at 510-11 (rejecting various requested modifications, including changes in formula for calculation of monetary benefits); Rio Grande/SP, 4 I.C.C.2d at 953-54 (rejecting enhancements on ground, inter alia, that requested modifications would impede efficient operational implementation); NW/Southern, 366 I.C.C. at 230-31 (denying unions' requests for protections against relocation, additional relocation benefits, and extended protective period).

[37] UTU "has reserved its right to maintain its position" that employee protective conditions should be extended to employees of Delaware and Hudson Railway Company, Inc. (continued...)

The New York Dock conditions also provide the appropriate mechanism for implementing the Transaction and for invoking the Board's settled authority to modify labor agreements as necessary to implement authorized transactions. E.g., UTU v. STB, 108 F.3d 1425 (D.C. Cir. 1997). New York Dock's mandatory and assured arbitration mechanism enables carriers to implement the "operational aspects of the transaction" "without the need to apply to . . . labor unions" for "authority to do so." UP/MKT, 4 I C.C.2d at 514.[38]

The need for an expeditious implementation mechanism is particularly compelling in this case by reason of the unique structure of the Transaction, which will allocate the operations of a single carrier into three parts. It would not be possible for NS to operate its allocated Conrail properties under Conrail's existing labor agreements, which provide for the operation of a single integrated railroad by employees of a single carrier. For example, the properties that NS will operate include fragments of a number of Conrail maintenance of way and signal seniority territories. If NS were required to "preserve" the scope and seniority rights in Conrail's current labor agreements, line maintenance, signal, and production work

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[37](...continued)
("D&H"), a nonapplicant. UTU-6 at 1 n.1. As we showed previously (CSX/NS-176 at 600-02), nothing in the circumstances faced by the D&H employees justifies departing from the longstanding rule that the protective conditions do not extend to employees of nonapplicant carriers.

[38] Congress has ratified this interpretation of the ICA. In the ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803, Congress eliminated the Board's authority to modify labor agreements in certain smaller transactions, but reenacted without substantive change the statutory provision governing imposition of employee protective conditions in major railroad transactions (§ 11326(a)). See, e.g., NLRB v. Bell Aerospace Co., 416 U.S. 267, 275 (1974) (when Congress, aware of the "longstanding interpretation placed on a statute by an agency charged with its administration," reenacts the statute "without pertinent change," it is "persuasive evidence that the [agency's] interpretation is the one intended by Congress.").

forces and their equipment would be confined to those fragmented territories, creating tremendous operating inefficiencies directly at odds with the purposes of the Transaction.[39]

NS proposes to achieve the transportation benefits described in its Operating Plan by operating NS' allocated Conrail properties as part of an integrated NS system under labor agreements currently in effect on NS properties. NS has set forth its proposals in Appendix A, and it has elaborated on the necessity for its proposals in its Rebuttal and supporting testimony. In accordance with the New York Dock procedures, NS will attempt to reach voluntary implementing agreements with the representatives of affected employees and, if necessary, will seek appropriate agreements in Article I, § 4 arbitration.

The unions remaining in the ARU attack the established ICA framework by asking the Board to declare that NS' implementing proposals cannot be achieved under New York Dock, but only through the protracted procedures of Railway Labor Act collective bargaining.[40] The ARU position is a denial of settled law, based on a long discredited view that the ICA and the New York Dock conditions (Article I, § 2) require the preservation of all "rates of pay, rules, and working conditions" in addition to "rights, privileges, and benefits." ARU-23 at 8, 85-95. As we showed previously (CSX/NS-176 at 639-51), the interpretation urged by the ARU has been definitively rejected in a line of cases

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[39] TCU incorrectly contends (TCU-6 at 19-21) that NS is proposing to deny former Conrail employees benefits under Conrail's Supplemental Unemployment Benefits ("SUB") Plan. NS recognizes that Conrail employees will have the right to elect coverage under the SUB Plan in accordance with Article I, § 3 of New York Dock. CSX/NS-176 at 603.

[40] BLE, one of the two largest ARU organizations, has withdrawn its opposition to the Transaction and has agreed to follow the New York Dock process on an expedited basis.

confirming the Board's authority to modify labor agreements, including rates of pay, rules, and working conditions.

The ARU contention that the carriers should be required to implement "staffing changes" under the RLA-based Washington Job Protection Agreement ("WJPA") (ARU-23 at 101-02) is equally misguided. The ICC held long ago that implementation of authorized transactions occurs exclusively through the protective conditions imposed under the ICA, not through WJPA. Southern Ry.--Control--Central of Georgia Ry., 331 I.C.C. 151 (1967); see also CSX/NS-176, § XVIII(D). The WJPA, unlike New York Dock, does not provide an expeditious mechanism for obtaining implementing agreements. See CSX/NS-176 at 625-26.[41]

J. Environmental Conditions.

The Board's Section of Environmental Analysis ("SEA") has undertaken an exhaustive environmental review of the Transaction and the Board will, for the first time, issue an Environmental Impact Statement ("EIS") with respect to a railroad consolidation proceeding. The December 12, 1997 Draft EIS ("DEIS") concludes, correctly, that the Transaction will produce substantial systemwide environmental benefits in several respects and will not create any systemwide significant adverse environmental impacts. Nevertheless, the DEIS suggests that a variety of conditions may be imposed on Applicants in order to mitigate certain

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[41] Contrary to the United Railway Supervisors Association's contentions (URSA-3 at 5), the Board's approval of the Application will not dictate representational determinations or otherwise interfere with the jurisdiction of the National Mediation Board ("NMB"). As the Board recently confirmed (Soo Line R.R.--Petition for Declaratory Order, Finance Docket No. 33350, served February 4, 1998, slip op. at 11 n.14), the effect of a Board-approved transaction on employee representation is a question exclusively for the NMB. See CSX/NS-176 at 681-83.

localized adverse effects, and a number of parties have filed comments in this proceeding and in response to the DEIS requesting the imposition of mitigating conditions. NS addressed the issue of mitigating conditions at length in its February 2, 1997 Comments on the DEIS. The following points bear emphasis here:

In deciding whether to impose any conditions, including environmental mitigation conditions, the Board must weigh and balance all considerations relevant to its ultimate public interest determination. These include not only specific adverse environmental effects, but also the positive environmental effects and the positive economic, transportation and other public benefits of the Transaction. The fundamental command of the National Environmental Policy Act, 42 U.S.C. § 4321, is that federal agencies must take a "hard look" at potential environmental impacts associated with the exercise of federal regulatory functions, but there is no corresponding mandate to mitigate such impacts. Robertson v. Methow Valley Citizens Council, 490 U.S. 332, 349, 352-53 (1989). In choosing a course of action, the agency must weigh positive environmental effects against adverse environmental effects and must balance environmental factors against other relevant legal or policy considerations bearing on the propriety of the proposed action. Id. at 350. Indeed, the basic purpose of NEPA is to require a federal agency to "balance a project's economic benefits against its adverse environmental impacts," Hughes River Watershed Conservancy v. Glickman, 81 F.3d 437, 446 (4th Cir. 1996). The intent of NEPA is not to "elevate

environmental concerns over other appropriate considerations" before the agency. Baltimore Gas and Electric Co. v. Natural Resources Defense Council, 462 U.S. 87, 97 (1983).[42/]

In light of these principles, proposals made in the DEIS or by other parties for operating and service restrictions are particularly inappropriate. The significant economic and environmental benefits that will result from the Transaction can be fully realized only if Applicants are permitted to implement the operating plans on which such benefits are predicated. As discussed more fully in NS' Comments on the DEIS (at Section 2.5), restrictions on the number of trains that may be operated over a particular section of track or other routing or operating restrictions would (a) create operational bottlenecks or clogs that will inhibit service and infect the network with congestion and delay, (b) preclude realization of transportation benefits of the Transaction, (c) reduce the environmental benefits of the Transaction, and (d) impose long-term rigidity on railroad operating decisions. Proponents of restrictions have simply not analyzed the offsetting environmental costs of the restrictions, much less balanced the overall environmental benefits of the transaction.

[42/] In prior rail consolidations the agency's environmental review has taken the form of an Environmental Assessment ("EA"), not an EIS. Since the purpose of an EA is to assess whether the proposed action would have significant environmental effects warranting the preparation of an EIS, once the Board and or the ICC identified any significant adverse environmental impacts associated with such prior consolidations, the agency was faced with the choice of either requiring that all such impacts be mitigated as a condition to the consolidation or performing a complete EIS. See, e.g., 46 Fed. Reg. 18026, 18037 (1981) (agencies can include enforceable mitigation measures to conclude that an action does not require preparation of an EIS). In this proceeding, by contrast, since a detailed EIS is being prepared in the first instance, there is no requirement that all identified adverse impacts be mitigated; instead, there is only the essentially procedural requirement that all environmental impacts be taken into consideration by the agency. Given the broad scope of the EIS in this case and the significant systemwide public benefits to be derived from the Transaction, it is not at all unlikely that some localized environmental impacts identified in the EIS will appropriately remain unmitigated.

The Board's paramount concern and responsibility is the national rail transportation system. Thus, any conditions proposed to remedy a localized impact of the Transaction must not only be reasonably related in nature and degree to the particular impact, but must also not impose an unreasonable burden on the rail systems being created by the Transaction. With respect to asserted environmental impacts of the Transaction, much attention is being focused on Northern Ohio and, in particular, on Cleveland and its environs. Faced with the challenge of allocating routes and assets in that area so as to provide both competitive balance and operational integrity, NS and CSX developed a plan that they firmly believe will achieve those goals safely, efficiently and effectively.

As Applicants have shown in their Rebuttal and in their Comments on the DEIS, the rail lines and facilities in Cleveland and Northern Ohio play a critical role in the rail transportation network in the Eastern U.S. that will result from this Transaction, just as they have historically played such a critical role. It bears noting that, overall, the Cleveland area will not experience a significant increase in rail traffic as a result of the Transaction, and some of the most contentious lines have handled equal or greater traffic in the past. NS Comments on DEIS at 2-12. Over time, traffic patterns will change for reasons unrelated to the Transaction, and while shifts in traffic patterns projected from the Transaction will result in more traffic for some portions of the Cleveland Area, other portions of the area will experience less traffic. Consequently, regulatory reshuffling of the traffic at the expense of efficient operations of the network is unjustified.

The mitigation proposals advanced by Cleveland and other Ohio interests would, in many cases, shift the burdens and impacts from one city to another or one community to

another. Among other things, the City of Cleveland has proposed material changes in the allocation between NS and CSX of lines and facilities in Cleveland. This proposal would disrupt the competitive balance and operating efficiencies of the Transaction, clog the traffic at the heart of the system, and spread that congestion along the arteries leading west to Chicago and east to Pittsburgh and New York. The record contains no evidence whatsoever to respond to the operating and efficiency concerns raised by Applicants. The proposal would also require the construction of a very large, extremely expensive and environmentally questionable railroad "fly-over" in an adjoining city, Berea. While for their part the Applicants are endeavoring to reach reasonable accommodations with Cleveland and other Northern Ohio communities, the Board should not adopt proposals that would seriously undermine the salutary goals of this Transaction.[43/]

K. Conditions Regarding Implementation and Oversight.

Based on concerns about whether the Transaction will be implemented smoothly and safely, several parties ask the Board to impose various conditions before the Transaction can be implemented and also post-implementation oversight conditions. These concerns have been heightened by service problems that have arisen on the UP/SP system.

No party in this proceeding has a greater concern or a greater stake than NS and CSX in the safe and smooth implementation of the Transaction. That concern is reflected in the

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[43/] Preserving the benefits of the Transaction does not only mean preserving the operating plans designed by CSX and NS. It also means preserving the economic benefits of Transaction. In this regard, proposals that would require the Applicants to spend extraordinary sums of money that are out of proportion to the adverse impacts that would be remedied must also be rejected. Those are costs that would be imposed not just on CSX and NS but on their railroad systems and all who use them. State of Colorado v. United States, 271 U.S. 153, 162-63 (1926).

extraordinary implementation planning activities both railroads have been performing since well before the Application was filed[44] and in the SIPS, which, as noted, DOT states "address and satisfactorily mitigate every safety concern raised in the environmental review portion of this proceeding." DOT-5 at 4. It is also reflected in the NITL Settlement, in which NS and CSX have made commitments to the shipping community regarding implementation that exceed by far anything agreed to in previous cases. These include promises to obtain necessary labor implementing agreements and to have in place certain management information systems before operation of CRC lines will be divided between NS and CSX. They also include an agreement to recommend a three-year oversight proceeding for the Board to monitor implementation of the Transaction.

Any requested pre-implementation and oversight conditions that go beyond these actions and commitments, however, would be unwarranted and should be denied. As explained in the Rebuttal, pre-implementation conditions that would require further submissions and Board proceedings before the Transaction could be implemented would not contribute positively to its smooth or safe implementation. On the contrary, they would seriously harm shippers and Applicants by imposing substantial delays and by reducing critically needed operating flexibility. CSX/NS-176 at 719-724. They are also based on a view very much at odds with the Board's own recognition, recently stated in the UP/SP

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[44] These are described in CSX/NS-176 at 708-712; CSX/NS-177, Vol. 2A at 88-115, Vol. 2B at 597-629.

oversight proceeding, that "government cannot operate private businesses as well as private businesses themselves."[45/]

NS believes that NITL, DOT and many other parties recognize that the circumstances of the UP/SP merger and of the current service problems have little bearing on this Transaction and do not warrant more by way of government-mandated conditions in this case than what NS and CSX have done and agreed to. The Board's recent analysis of the circumstances leading to the UP/SP service problems strongly reinforces that conclusion. After the reviewing the circumstances, the Board stated:

> [T]he evidence does not lead to the conclusion that approval of the merger was the cause of the service problems, and there is no reason to believe that rail mergers, in and of themselves, result in systemic service problems.[46/]

L. Other Condition Requests.

The conditions requested by other parties are fully addressed in the Rebuttal and will not be discussed further here.

[45/] STB Service Order No. 1518, Joint Petition for Service Order, unpublished decision served February 17, 1998 at 2.

[46/] Id. at 6.