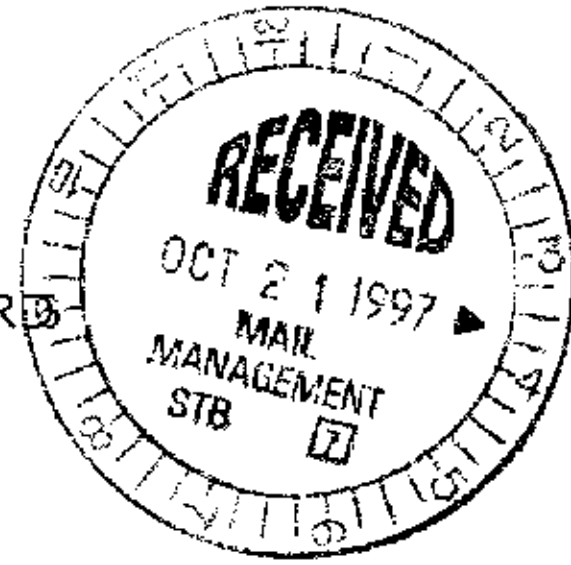


BEFORE THE  
SURFACE TRANSPORTATION BOARD



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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

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COMMENTS OF THE  
UNITED STATES DEPARTMENT OF AGRICULTURE

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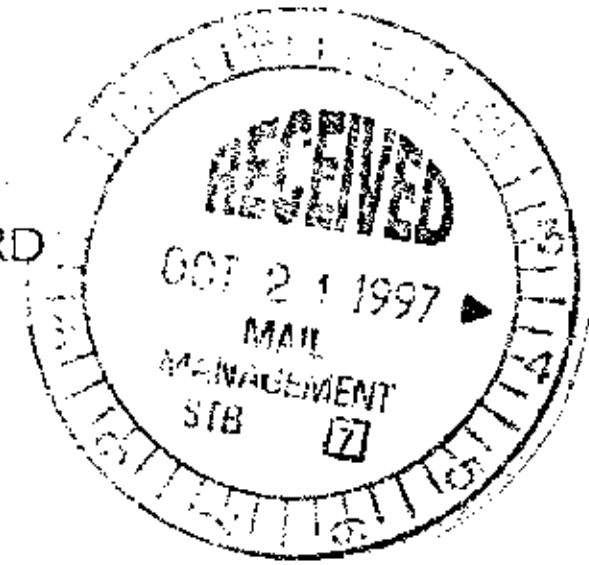
Michael V. Dunn  
Assistant Secretary

Marketing and Regulatory Programs

U. S. Department of Agriculture  
Washington, D.C. 20250

Date: October 21, 1997

BEFORE THE  
SURFACE TRANSPORTATION BOARD



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COMMENTS OF THE  
UNITED STATES DEPARTMENT OF AGRICULTURE

These comments are filed on behalf of the United States Department of Agriculture (USDA) in response to the Surface Transportation Board's (STB) decision served May 30, 1997, setting forth its procedural schedule for this merger application.

AUTHORITY AND INTEREST

Through the Agricultural Adjustment Act of 1938 (7 U.S.C. 1291) and the Agricultural Marketing Act of 1946 (7 U.S.C. 1622 (j)), Congress has directed and authorized the Secretary of Agriculture to participate in proceedings before STB to "assist in improving transportation services and facilities . . . for agricultural products and farm supplies" and to make "complaint or petition to [STB] . . . with respect to rates, charges, tariffs, practices, and services. . . ." In addition, the USDA, through the opera-

tions of the Commodity Credit Corporation and foreign commodity donation programs, is a participant in the markets for agricultural products.

Rail service is critical to the economic well-being of this Nation's agricultural and rural economies. Reliable, cost-effective transportation of agricultural products is essential for U.S. agricultural producers and shippers to maintain competitive viability in domestic and export markets. Nearly half of all grain produced in the United States moves to market by rail.<sup>1</sup> In 1995, grain, grain mill products, and other farm products accounted for nearly two million rail car loadings.<sup>2</sup> Agricultural shippers pay \$3 billion annually in freight car costs to U.S. railroads to move agricultural products from country, subterminal, and terminal elevators in grain producing areas in domestic and international markets. These figures demonstrate that an adequate and efficient rail infrastructure is essential for the marketing of U.S. agricultural products.

#### PREFATORY REMARKS

This statement has two parts. In the first part, USDA discusses the recent consolidation of the Class I railroads. We examine the criteria STB uses in its evaluation of the public interest. We suggest that certain costs are not being included in STB's calculation of the public interest and that these costs lessen the net benefits the public gains from railroad consolidations. Most importantly, USDA believes STB must place

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<sup>1</sup>Jerry D. Norton, Paul J. Bertels, and Freeman K. Buxton, *Transportation of U.S. Grain: A Modal Share Analysis*, (Washington, DC: U.S. Department of Agriculture, Agricultural Marketing Service), July 1992.

<sup>2</sup>Association of American Railroads, *Weekly Railroad Traffic: Revenue Freight Traffic Statistics of Major Railroads*, (Washington, DC: Association of American Railroads, Economics, Policy and Statistics Department), 1996.

more emphasis on maintaining effective competition in the rail industry while pursuing increased efficiency. It is not USDA's purpose to argue points that properly belong in another proceeding, but to place in context the second part of this statement which discusses the proposed acquisition of Conrail (CR) by Norfolk Southern (NS) and CSX.

In addition to this statement, USDA is also submitting a confidential filing with STB. This confidential filing summarizes the findings of a report prepared by a USDA team analyzing the agricultural impact of the proposed acquisition of CR by NS and CSX. The report is confidential because it contains information from the ICC Waybill Sample that is protected by federal regulations.

## Part I: Recent Rail Mergers and the Public Interest

### Recent Rail Mergers

The proposed joint acquisition of CR by CSX and NS will create two giant eastern railroads. It has generated concern about the impact of the consolidation on agricultural rail traffic in the eastern United States. This latest merger is part of a broader wave of consolidation activity within the rail industry that has reduced the number of major U.S. railroads from 33 in 1982 to just 7 today. If this latest merger occurs, the United States will be left with only six major railroads.

USDA has watched with mounting concern the consolidation of the Class I railroads these past three years. In the proposed merger of the Burlington Northern Railroad (BN) and The Atchison, Topeka and Santa Fe Railway (Santa Fe), we noted our suspicion "that the merger will have significant negative impacts on competition as the

number of railroads operating in the Western United States is reduced.”<sup>3</sup> USDA did not oppose that merger, but we did ask the Interstate Commerce Commission (ICC) to “make every effort to assure that an adequate level of competition is maintained in those markets and on those routes where competition will likely suffer as a result of the merger.”

USDA’s statement in the BN-Santa Fe case noted, presciently, that the merger “could stimulate interest in, and might set a precedent for, further railroad consolidation.” Soon after the Commission decided the BN-Santa Fe merger, Union Pacific (UP) announced its intention to acquire the Southern Pacific (SP). USDA opposed that consolidation. The Secretary himself highlighted the importance of competitive rail service for agricultural producers and shippers, and the entire rural economy, as well as the adverse effects of continuing consolidation and concentration in the railroad industry.<sup>4</sup>

In both of these cases, USDA believed that protective conditions crafted between selected railroads and shippers were inadequate and that additional conditions were needed to ensure effective competition. Consequently, USDA asked STB/ICC to impose additional protective conditions to mitigate the loss of competition for rural and agricul-

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<sup>3</sup>Comments of the Department of Agriculture, Burlington Northern Inc. and Burlington Northern Railroad Company -- Control and Merger -- Santa Fe Pacific Corporation and The Atchison, Topeka and Santa Fe Railway Company, Finance Docket No. 32549. May 10, 1995.

<sup>4</sup>Brief Comments of the Secretary of Agriculture, 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, Finance Docket No. 32760, June 3, 1996.

tural shippers. Unfortunately, STB chose to approve both mergers largely along the lines the applicants had proposed.

#### Statutory Authority and Decisional Standards

We recognize that STB is bound by the statutory provisions codified at 49 U.S.C. 11321-27. Specifically, in deciding a major transaction, one involving two or more Class I railroads, STB must at least consider the five factors specified in Sec. 11324(b) which are listed below,

- (1) the effect of the proposed transaction on the adequacy of transportation to the public;
- (2) the effect on the public interest of including, or failing to include, other rail carriers in the area involved in the proposed transaction;
- (3) the total fixed charges that result from the proposed transaction;
- (4) the interest of rail carrier employees affected by the proposed transaction; 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.

These five factors are subject to some interpretation. Fortunately, Congress has given additional instruction to STB in the form of the rail transportation policy. Added by the Staggers Act, the rail transportation policy (49 U.S.C. 10101) articulates 15 policy goals by which STB is guided. These goals stress the importance of efficiency, effective competition, and limited federal regulatory oversight. USDA believes that the five factors listed in Sec. 11324(b) must be evaluated in light of these 15 policy goals.

Admittedly, the 15 policy goals are somewhat ambiguous if not contradictory. In its attempt to discern the public interest, STB must implicitly assign "weights" to each of

these goals. Examining the goals set out in the rail transportation policy, USDA believes that STB has placed too much weight on the achievement of efficiency and too little weight on effective competition.

Of course efficiency is an important policy objective: efficiency is associated with the cost-minimizing organization of economic activity. USDA simply notes that effective competition also has many concrete, salutary benefits. It promotes reasonable rates, minimizes the need for regulatory control, and encourages honest and efficient management of railroads. By contrast, efficiency benefits (including *potential* cost savings) are inherently more speculative. Not only might the proposed benefits of a merger never be realized, but, because of market power, whatever benefits do accrue may not be passed through to shippers in the form of lower prices.

To USDA, effective competition "to meet the needs of the public" must include effective *intra*-modal competition — the kind of competition that minimizes the number of captive shippers and the need for regulatory control over rates and service. As the number of rail carriers diminishes to just a handful, USDA questions whether the benefits achieved by increasing concentration offset the competitive harms resulting from less effective competition. That is why USDA does not believe that a single, national monopoly serves the public interest as well as effective competition among, say, six to eight major carriers.

By approving mergers that reduce effective competition, STB is forced to assume ever greater responsibility to "maintain reasonable rates." While we have no doubt that the STB is willing to assume this responsibility, it is by no means clear that the present system of oversight is effective in addressing the needs of shippers. Challenging the

reasonableness of railroad rates is expensive both in terms of time and money. It is hoped that STB's new procedures will prevent a group like McCarty Farms from languishing for the better part of two decades in a regulatory/legal process.

#### Calculation of Public Benefit and Competitive Harm

In determining whether a proposed transaction is consistent with the public interest, STB examines the efficiency gains that would result (and which need not be shared with the public). The railroads point to rate reductions that have occurred since deregulation, but a major reason rates have fallen is that all shippers, and grain shippers in particular, are shouldering greater responsibility for car supply and other functions railroads formerly provided. These offsetting costs should not be ignored by the STB when considering the public benefits resulting from a merger. For example, shippers often must make significant capital investments to obtain cost-effective rail service. In the wheat country of the western great plains, for instance, both BNSF and UP are offering multi-car discounts only to those shippers that can deliver 108 car, "unit trains." This is effectively forcing elevators to make expensive investments in sidings, inventory, storage capacity, and loading facilities. USDA believes this is a manifestation of the lack of competitive alternatives for most grain shippers and the resulting market power of railroads, and it again demonstrates the need to maintain effective competition among rail carriers.



## Use of Protective Conditions

In general, STB has been reluctant to attach conditions to mergers. This reflects STB's view that conditions generally tend to reduce the benefits of a consolidation, and should only be imposed when strict criteria are met. On the one hand, USDA believes that this reluctance reflects favorably on the STB and is in accordance with the rail transportation policy's call for minimal federal regulatory control over the industry. On the other hand, we believe that STB is again placing too great a weight on potential cost savings, and too little on effective competition. It is also STB policy not to grant protective conditions to "ameliorate long-standing problems that were not created by a merger." However, USDA believes that when a merger is likely to exacerbate long-standing problems, STB can and should impose conditions that promote effective competition.

USDA does believe that any such protective conditions should be operationally feasible and narrowly tailored to address adverse effects of the transaction. No doubt this is STB's position as well, but we believe STB erred in granting BNSF such wide-ranging trackage rights during the UPSP merger. Even now USDA is not convinced that such a broad grant of trackage rights is operationally feasible and we further believe that the protective conditions imposed by STB has restructured the competitive balance among the western roads with unpredictable effects.<sup>5</sup> USDA would prefer in the future that trackage rights granted be limited and spread among multiple railroads. We believe this promotes competition more effectively than reinforcing a duopoly.

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<sup>5</sup>In Santa Fe Southern Pacific Corp — Control — SPT Co., 2 ICC 2<sup>nd</sup> 709, 827 (1986), ICC stated its disinclination to grant conditions under these circumstances.

## General Comments

The first part of this statement has reviewed the consolidation of Class I railroads these past three years. Admittedly, this trend is not new, but is the continuation of a long-standing public policy aimed at supporting railroad consolidation in order to achieve more efficient provision of transportation services to the public. This policy has been highly successful and is, in large measure, responsible for the improved fortunes of railroads in the post-Staggers period.

But as the number of rail carriers diminishes to just a handful, USDA questions whether the benefits achieved by increasing concentration offset the competitive harms resulting from less effective competition. Therefore, USDA believes that in approving additional mega-mergers, STB must be extraordinarily sensitive to the possibility of competitive harm to shippers of all types, and to agricultural and bulk shippers in particular. STB should use its broad conditioning power to advance the public's interest in competition, and not content itself with imposing the particular conditions a favored few have managed to obtain from the applicants beforehand.

Additionally, USDA believes that a five-year oversight period should be a condition of any major transaction approved by STB. It is surely the case that some examples of competitive harm, causally related to the merger, will only become apparent over time. This is particular true when the competitive harm manifests itself in deteriorating service quality.

## Part II: An Assessment of the Proposed Conrail Merger on Agriculture

### Background

Conrail (CR), CSX, and Norfolk Southern (NS) compete in ten States for agricultural shipments. For feed grains and grain mill products, competition focuses on movements from the eastern Cornbelt to the feed deficit areas of the East, Mid-Atlantic, and Southeast. For wheat, competition is for shipments to the Northeast milling market, and for export grain from the eastern Cornbelt to Atlantic ports facilities. The three railroads are also the dominant mode of transport for agricultural fertilizers shipped into the eastern Cornbelt.

Of the five Class I railroads operating east of the Mississippi River, CR, CSX, and NS are the dominant carriers. CR, CSX, and NS together account for three-fourths of all eastern rail shipments. The other two Class I railroads are the Grand Trunk Western -- a subsidiary of the Canadian National -- and the Illinois Central.

Food and agriculture, and agriculture-related commodities are an important part of the traffic on eastern Class I railroads. Grain, the major agricultural commodity moved by rail, ranks seventh among the 20 major classes of rail freight hauled by the eastern carriers. Over one-fourth of all U.S. rail grain originations are carried by the five eastern Class I railroads, and rail remains the dominant mode of transport for eastern U.S. grain.

## Potential Costs to Agriculture from Consolidation

The CSX-NS agreement to acquire CR jointly would create a small number of duopoly rail markets that previously were served by three railroads.<sup>6</sup> (In no case did an entire Crop Reporting District (CRD) go from having two competitors to just one.) To estimate the potential costs to agricultural shippers and receivers, USDA conducted an analysis of all shipments to and from these markets that involve distances greater than 300 miles. USDA assumed that shipments under 300 miles faced effective truck competition. Competition from the navigable waterways was ignored as the east-to-west and west-to-east nature of the affected shipments limits the competitiveness of water transportation in the affected markets.

MacDonald (1987) showed that corn market CRDs without effective intermodal competition have rail rates that are 15.2 percent higher when the number of competing railroads drops from three to two.<sup>7</sup> Using this estimate of potential rate increases, and accounting for those shipments being double-counted as both origins and terminations in the affected CRDs, USDA estimates:

- The CR breakup, as proposed by CSX and NS, could lead to increased rates on 2.7 million tons of agricultural commodities and inputs. Under the proposed CR breakup plan, grain and oilseed shipments account for 62 percent of the impacted agricultural traffic with corn more than 70 percent of this grain and

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<sup>6</sup>The affected markets are as follows: in Indiana, CRDs 1830, 1860; in Maryland, CRD 2420; in Ohio, CRDs 3960, 3990; in West Virginia, CRDs 5420, 5440.

<sup>7</sup>MacDonald, J.M., [1987], "Competition and Rail Rates for the Shipment of Corn, Soybeans, and Wheat," Rand Journal of Economics, Vol. 18, 151-163.

oilseed traffic. Affected grain and oilseed shipments could total 1.7 million tons. Grain mill and feed products would total 289,624 tons and fertilizer shipments 673,484 tons. Food and kindred products could total 249,420 tons and forest and lumber products 328,140 tons.

- The affected shipments of agricultural products and inputs could be expected to experience rate and transportation cost increases totaling \$8.2 million per year, using MacDonald's findings. Affected shipments of food and kindred products could experience rate increases totaling nearly \$2 million annually. Forest and timber product shipments in the impacted markets could experience rate increases totaling \$1.8 million annually. These increases in transportation costs would ultimately be borne by both producers and consumers of these products.

#### Potential Gains from Consolidation

Mergers and consolidations naturally generate concerns regarding the potential for declines in service and increases in rates. Mergers, however, can also generate savings and benefits for shippers through improved operating efficiencies, passed along in the form of lower rates, and improved marketing opportunities through broader market access.

Under the present proposal to divide CR between CSX and NS, each railroad will gain its own and shared routes into New York City, providing both with single-line service opportunities from Florida to the New York City market. This alone, however,

seems unlikely to reduce substantially the domination of trucks over rail for Florida produce shipments. The strength of trucking in this market is tied largely to service-related factors that railroads find difficult to improve. These include timeliness of delivery, size of shipment, and direct door-to-door service.

The CR acquisition could also improve market access for agricultural shippers moving eastern Cornbelt grain and feed products into the southeastern feeding markets. Grain and feed ingredient shipments now originated by CR at elevators and processing plants in Indiana, Michigan, and Ohio must be interchanged with NS or CSX to reach the livestock markets of Alabama, Georgia, North and South Carolina, and Tennessee. The CSX-NS plan would create single-line service to a number of markets particularly in the Southeast and lower Mid-Atlantic that now must be reached through interchange. Single-line service could increase operating efficiencies for the carriers and improve service levels for shippers. The extent to which the gains in operating efficiencies are passed on to shippers as lower rates depends upon the levels of competition in both the origin and destination markets following the merger.

### Conclusions

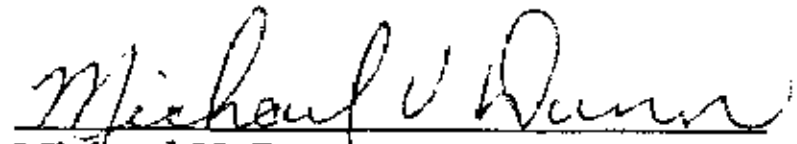
The CSX and NS application to acquire and control CR is the latest in a wave of consolidation activity within the railroad industry. The three railroads compete for agricultural shipment in 10 states including feed grains and grain mill products moving from the eastern Cornbelt to the feed deficit areas of the East, Mid-Atlantic, and Southeast; wheat shipments moving to the Northeast milling market; export grain traffic

moving from the eastern Cornbelt to the port facilities along the Atlantic seaboard, and agricultural fertilizers shipped into the eastern Cornbelt.

USDA believes that in evaluating any merger, STB should give at least as much weight to safeguarding effective competition as it does to reducing costs in the U.S. rail network. Evaluated in this light, USDA does not oppose the acquisition of CR by NS and CSX. Our analysis of the proposed merger indicates that the anticompetitive effects were neither large nor widespread. In fact, USDA believes that by breaking up CR's "monopoly" in the Northeast, this merger promotes the kind of effective competition Congress refers to in the rail transportation policy. We hasten to add, however, that while USDA does not oppose the merger, neither do we endorse it. USDA believes that STB should carefully examine the protective conditions requested by protesting parties and impose those conditions that promote effective competition.

Finally, USDA notes that service problems have attended all the recent mergers of Class I railroads. These problems have been particularly severe in the UPSP case. If anything, they strengthen USDA's point that the proposed cost savings from mergers are often elusive, if not illusory. USDA strongly urges that, should STB approve the acquisition of CR by CSX and NS, a "go-slow" approach to implementing the acquisition should be adopted. We would request that STB carefully condition its approval so that service problems are unlikely to manifest themselves. While such conditions may lessen the efficiency and public benefits the applicants hope to gain, these losses seem minimal in light of the disruption shippers are currently experiencing in the UPSP service crisis.

Respectfully submitted,

A handwritten signature in cursive script that reads "Michael V. Dunn".

Michael V. Dunn  
Assistant Secretary

Marketing and Regulatory Programs

U.S. Department of Agriculture  
Washington, DC 20250



CERTIFICATE OF SERVICE

The undersigned hereby certifies that on October 21, 1997, he caused a copy of the Department of Agriculture's comments to be served by first-class mail, postage prepaid, on all parties of record in STB Finance Docket No. 33388.

A handwritten signature in cursive script, appearing to read "Keith A. Klindworth", is written over a horizontal line.

Keith A. Klindworth  
Program Manager  
Marketing and Transportation Analysis  
Agricultural Marketing Service