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Are All Railroad Mergers In the Public Interest? An Analysis of the Union Pacific Merger with Southern Pacific

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I. Introduction

As a response to poor business performance in the late 1970s, federal regulators endorsed deregulation as a mechanism to preserve the railroad industry.[1] By 1980, a more fundamental government approach attempted to deregulate many aspects of the railroad industry, such as line abandonments, ratemaking and mergers.[2] As a result, the railroad industry has experienced several mergers and efforts to rationalize lines, substantially lowering the number of significant railroad carriers.[3] As the most recent wave of mergers continues in the industry, vast networks of trackage have become controlled by a relatively small number of carriers.[4] For the first time in U.S. history, the existence of transcontinental railroad systems are becoming a possibility.[5]

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1. *See* Richard D. Stone, *Administrative Deregulation of the Railroads: The ICC's Change in Philosophy,* 61 Transp. Prac. J. 278, 286 (1994). Stone argues that President Carter's ICC appointments precipitated deregulation. The Congressional response followed. *See also* Paul Stephen Dempsey, *The Interstate Commerce Commission: Disintegration of an American Legal Institution,* 34 Am. U. L. Rev. 1,3 (1984) [hereinafter Dempsey, *Disintegration*]. Dempsey offers similar arguments with respect to motor carrier regulation..

2. The first law to deregulate railroads was the Railroad Revitalization and Regulatory Act of 1976, Pub. L. No. 94-210, 90 Stat. 31. This legislation was somewhat limited in achieving deregulation. In 1980, Congress adopted the Staggers Act, a broader deregulation statute. *See* Staggers Rail Act of 1980, Pub. L. No. 96-448, 94 Stat. 1895. For a discussion on the two acts, *see* Frank N. Wilner *Railroads and the Marketplace,* 16 Trans. L.J. 291, 302-09 (1988) [hereinafter Wilner, *Marketplace*].

3. For example, in 1974 there were fifty-six Class I railroads. By 1986, that number dwindled to twenty-one. *See* Christopher A. Vellturo, et al., *Deregulation, Mergers, and Cost Savings in Class I Railroads, 1974-1986,* 1 J. Econ. & Management Strategy 339, 341 (1992). According to Dempsey, et al., seven major railroad systems dominated the United States in 1990. After the latest wave of mergers, that total number of competitors would decline to four. *See* Paul Stephen Dempsey, et al., *Canadian Transport Liberalization: Planes, Trains, Trucks, and Buses Rolling Across the Great White North,* 19 Trans. L.J. 113, 145 n.192 (1990) [hereinafter Dempsey, *Canadian*].

4. *See* supra note 3. Currently, CSX Transportation and Norfolk Southern have agreed to jointly acquire Conrail. Each railroad would acquire a portion of Conrail's track network. *See* Daniel Machalaba, *Conrail's Breakup Plan Is Released By Norfolk Southern,* Wall St. J., April 9, 1997, at B4. The required Surface Transportation Board approval of the transaction has not occurred to date. However, approval seems likely because the agency helped broker the current agreement to split Conrail's track network. *See id.;* Don Phillips, *Agency Eyes Even Split of Conrail,; Effect of Competition in East Is a Concern,* Wash. Post, Jan. 21, 1997, at C1; Don Phillips, *Railroads Agree To Meet To Resolve Conrail Dispute,* Wash. Post, Jan. 22, 1997, at D10. Other railroad mergers are anticipated as well. *See More Rail Deals May Be Down the Track,* Wall St. J., July 5, 1995, at A2. In addition, Illinois Central and Kansas City Southern began an aborted merger attempt that failed to muster support from analysts and shareholders. *See* James P. Miller, *Illinois Central Ends Effort To Acquire Kansas City Southern's Rail Operations,* Wall St. J., Oct. 25, 1994, at B7, B10.

5. Some railroad executives envision truly transcontinental systems. For example, Robert Krebs, President and CEO of BN-SF believes that transcontinental railroads are inevitable. *See* Gus Welty, *Redrawing the Western Map,* Railway Age , Dec. 1995, at 36, 37 [hereinafter Welty, *Redrawing*]. Further, the recent merger pact between Norfolk Southern and CSX Transporta-

The Union Pacific (UP) bid to control the Southern Pacific (SP) represents the latest consolidation that has reduced the number of Class I[6] railroad competitors that operate west of the Mississippi River from three to two. At present, two railroad corporations dominate railroad freight traffic west of the Mississippi River.[7] The UP bid to control SP represented a competitive response to the Interstate Commerce Commission's (ICC) approval of the Burlington Northern (BN) application to control the Santa Fe (SF) in 1995.[8] The new 31,000 mile BN-SF system competed directly with UP and dwarfed UP's already expansive track network. By bidding for the 11,000 mile SP, UP fortified its competitive position in the western portion of the United States, particularly in the southwest where SP had an influential market presence.

While subject to federal regulation, railroads are immune from traditional antitrust legislation such as the Sherman Act or Clayton Act.[9] Instead, the ICC and its successor, the Surface Transportation Board (STB), have applied a "public interest" standard to review the merits of a merger.[10] The ICC and STB have employed this broad standard of review to approve nearly every merger application. Thus, when the UP application to control SP came before the STB, it concluded that the merger was in the "public interest," in spite of significant concerns about the anticompetitive effects of such a union voiced by shippers, other railroad carriers, state governments, and the U.S. Department of Justice.[11]

This Article assesses the STB decision granting the UP application and explores the "public interest" standard in other railroad merger cases since 1980. In particular, this Article will focus on the failed SF applica-

tion reflected a belief that transcontinental mergers would occur. *See* CSX CORP., 1996 ANNUAL REPORT 2 (1997).

6. Class I railroads represent the major railroad networks of the United States. A Class I railroad is determined by annual operating revenue. For example, in 1991, a railroad with revenues above $250 million was a Class I carrier. 49 C.F.R. §1201.1-1 (1996).

7. *See* Dempsey, *Canadian, supra* note 3, at 145 n.192. Dempsey noted four major railroad systems operating west of the Mississippi River in 1990. Currently only two of the listed systems remain.

8. *See* Luther S. Miller, *Confident, Yes. Complacent, No,* RAILWAY AGE, Dec. 1995, at 43 [hereinafter Miller, *Confident*].

9. *See* McLean Trucking Co. v. United States, 321 U.S. 67, 87-88 (1944). The Clayton Act §7 contains an express exemption for anything governed by the ICC. *See* 15 U.S.C.A. §18 (West 1996). Also, railroad merger guidelines explicitly exempt railroads. *See* 49 U.S.C.A. §333 (West & Supp. 1996).

Further, courts have allowed a great deal of deference to ICC remedy powers to grant or deny competitive access. *See* Baltimore Gas & Electric Co. v. United States, 817 F.2d 108 (D.C. Cir. 1987); Midtech Paper Corp. v. United States, 857 F.2d 1487 (D.C. Cir. 1988); Central States Enterprises, Inc. v. ICC, 780 F.2d 664 (7th Cir. 1985).

10. 49 U.S.C.A. §333 (West 1996).

11. Union Pac. Corp. — Control and Merger — S. Pac. R. Corp., Fin. Docket No. 32760, 1996 WL 467636 (Surface Transp. Bd., Aug. 6, 1996) [hereinafter *UP-SP*].

tion to acquire SP, the only merger application rejected by the ICC and STB since 1980.[12] First, this Article summarizes the *UP-SP* proceedings. Second, this Article explores other recent merger applications as well as other evidence which demonstrates a tension with the outcome of *UP-SP*. Third, this Article examines the broader social implications of the current STB posture toward mergers. This section argues for more research on the efficiency gains from merger. This section also raises a fundamental question about whether courts should decide merger applications in lieu of a regulatory body.

II. The *UP-SP* Merger Case

This section is divided in four parts and provides a summary of the *UP-SP* decision. First, this section addresses the general circumstances that engendered the UP-SP merger. Second, this section provides the standard of review that the STB used in assessing the merger application. Third, this section emphasizes the arguments of UP-SP supporting the merger and briefly lists the objections of other parties. Fourth, this section provides the STB's analysis and reasoning used to justify its decision.

A. Background

After a lull in merger activity during the 1990s, a new wave of mergers began. Prior to 1995, four major carriers served the western two-thirds of the United States. In 1995, BN, a major western carrier from Chicago, Illinois, which served the Pacific Northwest, Denver, Colorado, and other points in Texas and Alabama, merged with SF, another major western carrier from Chicago, Illinois, which essentially served areas in California and Texas. The merged entity, BN-SF, maintained an expansive track network of approximately 35,000 miles, dwarfing all other western competitors. UP, itself a product of several mergers during the 1980s and 1990s, initially sought to thwart the merger through counter-proposals to acquire SF.[13]

When this strategy failed, on November 30, 1995, UP unveiled plans to acquire SP.[14] On that same day, it filed a merger application with the STB.[15] Immediately prior to the merger announcement, UP operated a

12. Santa Fe S. Pac. Corp. — Control — S. Pac. Transp. Co., 2 I.C.C.2d 709 (1986) [hereinafter *SF-SP I*], *reh'g denied* 3 I.C.C. 2d 926 (1987) [hereinafter *SF-SP II*].

13. *See* Daniel Machalaba & Greg Steinmetz, *Santa Fe Is Cool To Acquisition Offer of $3.25 Billion from Union Pacific,* Wall St. J., Oct. 7, 1994, at A2..

14. In the interim, UP acquired a midwestern Class I railroad, the Chicago & Northwestern (CNW) in 1995. *See* Union Pac. Corp. — Control — Chicago & Northwestern Transp. Co., Fin. Docket No. 32133 (I.C.C., Feb. 21, 1995) [hereinafter *UP-CNW*].

15. *UP-SP*, *supra* note 11, at *5.

22,000 mile track network.[16] UP operated primarily from Chicago, Illinois, to Salt Lake City, Utah. From that western point, one northern route branched to Portland, Oregon, while another traversed southward to points along California. In addition, UP maintained operations from Chicago, Illinois, to Minneapolis, Minnesota, and various points throughout Arkansas, Texas and Louisiana. In contrast, SP operated approximately 14,000 miles of track. SP operated southwesterly from Chicago, Illinois, to southern points in Texas and California with a southern line that skirted the Mexican border and served New Orleans, Louisiana. Another portion of the SP network operated from Chicago, Illinois, to Denver, Colorado, and Salt Lake City, Utah. From Salt Lake City, Utah, SP reached various points in California. A third portion of the SP network ran along the Pacific coast from southern California to Portland, Oregon.

In contrast to the BN-SF system, a substantial portion of the track network of UP and SP overlapped. In some overlap territories, the UP-SP consolidation would eliminate railroad competition. For example, the track network extending from northern California to Salt Lake City, Utah, and eastward to Denver, Colorado, would be exclusively controlled by UP-SP.[17] To alleviate these monopoly concerns, the UP-SP merger proposal also included provisions to sell 330 miles of trackage and to provide access on approximately 4,000 miles through trackage rights to its primary western rival, BN-SF.[18] The scope of assignment for trackage rights was unprecedented in relation to prior merger agreements. In one instance, UP-SP provided trackage rights roughly from Oakland, California, to Denver, Colorado, a distance of over 1,000 miles. In spite of these concessions, several parties objected to the UP-SP merger application before the STB.

B. Standard of Review

In evaluating the merger, the STB applied the statutory "public interest" standard.[19] In essence, the STB interpreted the "public interest" standard as a balancing test which weighs "the potential benefits to applicants and the public against the potential harm to the public."[20] According to the STB, the "public interest" standard consisted of five basic

16. *Id.*

17. *Id.* at *87.

18. *Id.* Trackage rights allow a railroad to operate on another railroad's network using its own equipment and crew. In exchange, the railroad that owns the track receives a fee for use.

19. Missouri-Kansas-Texas R.R. Co. v. United States, 632 F.2d 392, 395 (5th Cir. 1980), *cert. denied*, 451 U.S. 1017 (1981).

20. *UP-SP, supra* note 11, at *86; *see also* 49 C.F.R. 1180.1(c) (1996). This standard, along with the five prong test set out in the text, *infra*, has been noted in virtually all merger decisions. *E.g.*, *SF-SP I, supra* note 12, at 722-26; *UP-CNW, supra* note 14 at 53. Federal courts have also applied such standards in certain cases involving the Rule of Reason in antitrust adjudication.

factors which the agency would weigh in evaluating the merits of an application for merger of two Class I railroads. The five factors in this balancing test are: (1) the impact the merger has on the adequacy of public transportation; (2) the effect of including or excluding other railroads in the region from the transaction on the public interest; (3) the total fixed charges that result from the transaction; (4) the interest of railroad employees affected by the transaction; and (5) the adverse effect on railroad competition in the affected region.[21]

Of the five factors, the STB emphasized the first and fifth criteria. The STB interpreted the "adequacy of transportation" prong of the test to include "public benefits" from the merger.[22] In the STB decision, public benefits were broadly construed to extend to any efficiency gains a railroad may derive from the merger, including cost savings and service improvements. The STB reasoned that such benefits passed on to shippers in the form of better service or lower rates. However, the STB noted that any benefits a railroad may realize from expanded market power, such as the ability to raise rates, is a private benefit and therefore excluded from this calculus.

In contrast, the STB applied the fifth criterion, which examines adverse effects of the merger on railroad competition more narrowly. Relying on prior federal adjudication, the STB "examine[d] the total transportation market(s)" when evaluating competitive harm.[23] The STB also relied on the Staggers Act's stated policy of "reliance on competitive forces, not government regulation, to modernize railroad operations and to promote efficiency."[24] The STB reasoned that in cases where railroad competition is eliminated through the combination of the only existing competitors, then competitive alternatives, in the form of trucks, barges or pipelines, act as a constraint to competitive harm. While the STB recognized two basic types of mergers, it concluded that the central question remained the same in each case: "Will the merger result in increased rates

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Such cases seek to assess the ultimate consequences of a particular form of conduct. *E.g.*, United States v. Brown Univ., 5 F.3d 658 (3d Cir. 1993).

21. *UP-SP, supra* note 11, at *83 (citing 49 U.S.C. § 11344(b)(1)); 49 C.F.R. §1180.1).

22. The STB reasoned that "in determining whether a proposed transaction is consistent with the public interest, we must examine its effect on the adequacy of transportation to the public. This necessarily involves an examination of the public benefits that will result from the transaction." *Id.*

23. *Id.* at *84 (citing Central Vermont Ry. v. ICC, 711 F.2d 331, 335-37 (D.C. Cir. 1983)). Notably, outside the railroad context, market definition has been mixed in antitrust adjudication. An additional factor seems at work. *Compare* United States v. Aluminum Co. of America, 148 F.2d 416 (2d. Cir. 1945); United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377 (1956); United States v. Grinnell Corp., 384 U.S. 563 (1966).

24. *UP-SP, supra* note 11, at *84 (citing H.R. Rep. No. 96-1430, 96th Cong., 2d Sess. 88 (1980), *reprinted in* 1980 U.S.C.C.A.N. 4110, 4119).

or deteriorated service or both?"[25]

Taken to an extreme, the competitive harm analysis applied by the STB ignores the potential demise of another rail carrier adversely affected by a proposed merger if other competitive alternatives exist which will keep the consolidated railroad's market power in check. In its decision, the STB adopted ICC policy guidelines which noted that the agency's "concern is the preservation of essential services, not the survival of particular carriers."[26] If an adversely affected railroad provides "essential services" which will be impaired from the merger, the STB weighs this impact against the merger. An essential service is defined as "a service for which there is a sufficient public need, but for which adequate alternative transportation is not available."[27]

C. Arguments of the Parties

In justifying the merger proposal, UP-SP emphasized the economic benefits from consolidation to the new corporation and railroad shippers. The applicants claimed approximately a $750 million benefit. The claimed savings fell into three general categories: (1) cost reductions and operating efficiencies; (2) new traffic; and (3) savings in shipper logistics. Significantly, UP-SP predicated these benefits on significant capital infusions of approximately $1.3 billion in addition to the actual consolidation of the firms.[28] The most significant quantified component consisted of $583 million from cost reductions and other efficiencies. The applicants claimed that the combination of networks would consolidate parallel lines and also provide "single line" service where cooperation of two railroads was required. By providing "single line" service in a greater geographic area, UP-SP could consolidate freight destined for the same location in larger sections, reduce interchange times and develop shorter routes. The consolidation would also result in labor savings from the elimination of duplicative administrative and operations functions inherent in any merger. Reductions in labor costs represented the most significant component in these savings, amounting to $261 million.[29] As a result of bet-

25. The STB has recognized horizontal mergers which are defined as mergers of two overlapping systems and vertical mergers which are combinations of systems at their end-points thereby extending the geographic reach of the network. Many railroad mergers contain both aspects. *Id.* at *85. *See also* Milwaukee - Reorganization - Acquisition by GTC, 2 I.C.C. 2d 161, 224-25 (1984).

26. *UP-SP, supra* note 11, at *86 (citing 49 C.F.R. 1180.1).

27. *Id.* (citing 49 CFR 1180.1(c)(2)(ii)).

28. Applicant's Supporting Information for Merger, V.S. Mark J. Draper and Dale W. Salzman, vol. 1, at 364, *UP-SP*, Fin. Docket No. 32760, 1996 WL 467636 (Surface Transp. Bd., Aug. 6, 1996) ("In a UP/SP merger, however, operating efficiencies and traffic gains will depend in part on substantial capital expenditures.").

29. *Id.*, Appendix A, at 93.

ter service capabilities from "single line" service and a lower cost structure, the applicants projected a $76 million increase in new traffic. In addition, UP-SP estimated that shippers would accrue benefits of $91 million from improved service or lower freight rates.

The applicants also offered other less tangible benefits as a justification for the merger. First, according to the applicants, the UP-SP merger would support the financially troubled SP.[30] Without a capital infusion from UP, SP risked business failure in competing against the considerably larger and financially healthy UP and BN-SF systems. Integration of SP into a larger system greatly reduced the risk of business failure. Second, because UP contended that SP was a weaker competitor than BN-SF or UP, the creation of trackage rights on the UP-SP system for BN-SF would enhance competition because both railroads were more capable of effective competition than SP would be as an independent entity.[31]

A diverse group of parties rallied against the merger, including several different shippers, shipper organizations, state governments, various departments of the federal government, and other railroads.[32] However, a conspicuous opposition party was missing from the STB proceedings—BN-SF, the prime competitor of a merged UP-SP. The opponents to the merger had two basic contentions: (1) that the merger benefits were greatly exaggerated; and (2) the anticompetitive effects of the merger outweighed the benefits.[33]

D. STB Analysis and Reasoning

In weighing the "competitive harm" criterion against the "public benefits" criterion of the public interest standard, the STB ultimately concluded that "[i]n sum, the merger benefits here outweigh any competitive harms of the transaction, and the public interest requires that we approve it."[34] Essentially, the STB accepted nearly all of the $750 million in claimed benefits with the exception of $76 million in gains from diverting traffic of other railroads and $47 million in gains from the net proceeds of line sales.[35] The STB excluded these items because they were "private benefits." After deducting the line sales and traffic diversion figures, the net quantifiable "public benefit" of the merger was $627 million.

Interestingly, the STB rejected all other arguments which favored reducing the claimed level of quantifiable benefits. In particular, the STB

30. *UP-SP, supra* note 11, at *6.
31. *Id.* at *6-7.
32. *Id.* at *3.
33. *Id.* at *93-95 and *99-102.
34. *Id.* at *92.
35. *Id.*

emphasized that one economic critic of the application "lacked credibility" because of a prior contention that the BN-SF merger would generate few economic benefits.[36] The STB noted that according to the BN-SF, the estimated benefits of the merger were actually understated.[37]

The STB rejected two types of arguments that sought to decrease the estimated benefits of the merger. First, arguments that voluntary coordination could reduce the amount of the claimed benefit were rejected because the STB hypothesized that if such opportunities existed, the railroads would have done so independently.[38] The STB reasoned that widespread coordination required the "stimulus" of a merger as well as antitrust protection. Second, the STB rejected claims that many asserted benefits of the merger were the product of deregulation and not merger activity. One critic attempted to show that railroad productivity improved during years where no merger activity occurred, i.e., 1989-1994. The STB reasoned that while no formal mergers were approved for the period 1989-1994, implementation of two mergers occurred during that period.[39] Further, the STB contended that other mergers which occurred much earlier were continuing to accrue benefits from consolidation. The STB reasoned that while a railroad merger may have occurred in 1976, efficiency gains were still accumulating to the consolidated system in 1989.[40]

The STB also recognized certain "unquantifiable benefits" to the merger. First, the STB concluded that "[a] combined UP/SP system will provide shippers with shorter, more efficient routes throughout the

36. *Id.* at *93.

37. *Id.* n.108. According to counsel for BN-SF present during oral arguments, the benefits of that merger exceeded $1 billion, compared to the projected savings of $560 million in the application. The decision also quotes the following source:

> BN-SF president and CEO Robert Krebs told analysts in New York last Tuesday that the company had identified $400 million to $500 million in annual savings. . .on top of the $560 million in annual savings projected in their 1994 merger application. That disclosure, plus the banner earnings, helped push BN-SF stock up $5.875 for the day to close at $82.75 in heavy trading. That price, a 52-week high, represents a $20 per share gain since July 1.

Traffic World, Oct. 30, 1995, at 37. This robust financial position has subsequently weakened. Net earnings for the first quarter of 1997 fell twenty percent below earnings a year earlier. The stock price for BN-SF shares has also leveled off considerably. Moreover, service has become erratic and slow for some shippers. *See* Daniel Machalaba, *Burlington Northern Struggles To Get Merger On Track*, WALL ST. J., April 22, 1997, at B4 [hereinafter Machalaba, *Burlington Northern Struggles*].

38. *UP-SP, supra* note 11, at *94.

39. *Id.* While UP acquired the Missouri-Kansas-Texas Railway in 1988, the merger was not implemented until 1989. Similarly, the Denver & Rio Grande Western acquired SP in 1988, but did not effectuate the merger until 1989.

40. *Id.* at *94. The STB concludes that Conrail's consolidation, which occurred in 1976, still reaped economic gains in the period 1989 - 1994.

West."[41] Second, "[m]ore than 350,000 cars, trailers, and containers, carrying 26 million tons of freight, will gain single line service each year" from the UP-SP consolidation.[42] The STB observed that the BN-SF trackage rights agreement would add another 120,000 cars annually to this estimate. Third, the STB noted that the UP-SP merger would reduce switching charges to exchange cars to other railroads.[43] The original SP charges were criticized by many shippers as reducing competitive options to choose carriers. Fourth, the STB noted the proposed capital improvements from the merger as generally pro-competitive.[44] Fifth, the STB concluded that SP was a financially troubled entity that could no longer compete as an independent entity. The STB noted the disparity in capital expenditures between BN-SF and UP on one hand and SP on the other.[45] In this regard, the STB concluded that SP faced difficulty in raising capital to improve its facilities and provided inferior service relative to its western competitors, BN-SF and UP.

While the STB found substantial public benefits to the merger, it also concluded that few anticompetitive costs resulted from the transaction. The STB set the tone of this conclusion by noting:

> Rail rates have decreased markedly since 1980, despite the fact that most shippers are served by a single carrier, and few are served by three. Because of the several major mergers since that time, and due to the formation of Conrail as the single Class I carrier in the Northeast, large regions of the country are now served by a single major carrier or by two such carriers. Even with this structure, rail competition has thrived and shippers have continued to enjoy increasingly lowered rates.[46]

The STB reasoned that the anticompetitive harm from such concentrated railroad control was insignificant. First, the UP-SP proposal coupled with additional STB conditions granted trackage rights to BN-SF and other carriers in areas where the merger eliminated competing railroad firms. This remedy ameliorated the possibility of a monopoly by a single carrier and ensured rivalry.

Second, the STB rejected the notion of a "duopoly" situation where two firms collude to control prices. Relying on the existing market structure of railroads in many regions of the East, the STB observed that two

41. *Id.* at *96.
42. *Id.*
43. *Id.*
44. *Id.*
45. *Id.* at *97.
46. *Id.* at *88. Interestingly, financial analysts believe that Conrail has "monopoly" power. Indeed, some analysts fear that the pact to divide Conrail and create two competing track networks owned by CSX Transportation and Norfolk Southern in the Northeast would wipe out that power and reduce the value of Conrail's franchise. *See* Daniel Machalaba, *Conrail's Breakup Plan Is Released By Norfolk Southern, CSX Corp.*, WALL ST. J., April 9, 1997, at B4.

carriers provided ample competitive pressure to avoid collusion.[47] Moreover, a similar market structure existed in the Wyoming Powder River Basin, where two western railroads competed to deliver coal from mines in the region.[48] Significantly, opponents to the merger failed to show any empirical evidence of tacit collusion.

Basic structural considerations in the railroad industry also led the STB to conclude that tacit collusion was difficult, if not impossible, for railroad firms. The market for transportation services is heterogeneous and composed of many variables, including freight schedules, types and numbers of cars to be supplied, terminal services, and car repositioning for customers.[49] Also, the secrecy of contracts with shippers precludes railroads from easily establishing the rates of competitors. Many such contracts contain explicit secrecy clauses which prevent disclosure of the terms of the agreement.[50] Further, the STB reasoned that railroads have significant "economies of density." Economies of density, according to the STB, act as disincentives for collusion. The economies of density rationale is based on the theory that railroads have high fixed costs because of the need for substantial investment in capital to maintain a track network. Once the network is created, marginal costs are comparatively insignificant and each marginal addition of traffic on the network reduces the total average cost thereby allowing a railroad to either reduce rates to attract more traffic or reap greater profits.[51]

In accepting the use of trackage rights to ameliorate competitive concerns from monopoly, the STB rejected arguments that such agreements were ineffective substitutes for independent ownership of a competing network.[52] Recognizing the potential for abuse by the landlord railroad, the STB imposed a monitoring requirement to ensure that operations by the tenant railroad were commenced.[53] Monitoring the progress of trackage rights implementation with the power to modify those rights offered a less intrusive remedy than demanding divestiture of certain lines and an ultimate transfer to other railroads. Further, the monitoring option permits the STB to examine the progress of competition in markets and prevent any abuse by UP-SP.

Without modification, the STB found that the compensation provision of the trackage rights agreement was adequate. Notably, the STB reviewed the contract to determine whether the provisions were "unrea-

47. *UP-SP, supra* note 11, at *99.
48. *Id.*
49. *Id.* at *217 n.304.
50. *Id.* at *217.
51. *Id.* at *218.
52. *Id.* at *112.
53. *Id.* at *113.

sonable."[54] The STB continued to uphold its three prong test for trackage rights fees which considers: (1) variable costs to the landlord from tenant use; (2) proportional maintenance and operating costs as a result of tenant use; and (3) a return element on the value of the landlord's property based on use.[55] The STB evaluated the trackage rights fees against prior decisions and found that the assessed cost was lower than its established ceiling.[56]

Further, the STB rejected arguments that the structure of payment from tenant to landlord was inherently disadvantageous. The assessed fees on the trackage rights agreement were entirely variable, dependent on the level of traffic operating on the track network. The Department of Justice contended that this variable cost structure would advantage a landlord in competitive situations when pricing hovered around variable costs because the landlord's costs would always be lower than the tenant.[57]

The STB also rejected the possibility of tacit collusion in a duopoly arrangement in the trackage rights context. Unlike other competitive circumstances, under trackage rights, the landlord railroad has at least some basic understanding of the tenant's cost structure because the fees the tenant pays for use of the track go directly to the landlord.[58] Yet, this

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54. *Id.* at *119.

55. *Id.* Beyond the U.S. Department of Justice criticisms of trackage rights fees, some dispute exists in the academic literature on proper pricing. *See e.g.,* Charles N. Marshall & Cheryl A. Cook, *Issues of Cost Recovery in the Debate Over Competitive Access,* 15 TRANS. L.J. 9 (1986).

56. *UP-SP, supra* note 11, at *119.

57. *Id.* at *120. The STB dismissed this claimed disadvantage on the tenant railroad for two reasons. First, the STB cited the earlier ICC rationale that "potential tenants may have difficulty in making such capital contributions, and a one hundred percent variable rental charge reduces risks for the tenant railroad, which may not have experience participating in that market." *Id.* at *120 (citing Burlington N. Inc. — Control and Merger — Santa Fe Pac. Corp., Fin. Docket No. 32549 at 90-91 (I.C.C., Aug. 16, 1995) [hereinafter *BN-SF*]). Second, the STB rejected the notion that railroad pricing was reduced to variable costs in competitive situations with other railroads:

> The only markets in which railroads tend to price their services down to their total variable costs are those where motor carriage is extremely competitive. Those markets are not of concern in the rail merger context because rail competition is relatively unimportant in such markets in comparison to the overall competitive picture. And because railroads need to return their joint and common costs to replace their road bed and track structure as these items deteriorate, they cannot long continue to provide service in such markets. The issue of how fees are structured is ultimately a red herring because railroads generally must price significantly above their variable costs in order to return their joint and common costs and continue to compete.

UP-SP, supra note 11, at *121. The STB reasoned that variable cost pricing was a result of non-railroad competition where cost structures were lower. In this competitive environment, railroads are forced to lower prices in order to sustain market share. However, in the long run this behavior is untenable. Pricing at variable cost only is ultimately unsustainable by any railroad because of the need for capital expenditure to maintain the track network.

58. *Id.* at *218.

knowledge did not cross the threshold of accurate information to collusively set prices because the STB reasoned that "tenants and landlords do keep secret many aspects of service from each other in bidding for traffic."[59] The STB held that partial information a landlord acquires about a tenant's cost structure was insufficient to promote collusive arrangements.

III. The *UP-SP* Decision: Tension with Precedent?

In many respects, a tension exists with the *UP-SP* decision and other prior ICC decisions. This section explores five aspects of the *UP-SP* decision with prior merger decisions. First, the section compares the outcome of the SF-SP merger application with the result in the UP-SP application. Second, this section compares the standard of scrutiny applied in prior parallel merger proceedings with the standard applied in the UP-SP application. Third, this section explores the failing firm doctrine as it has been applied to SP since 1986. Fourth, this section investigates the sufficiency of trackage rights as a viable alternative to ensure competition. This section uncovers an apparent paradox in finding trackage rights as a viable competitive tool when merger eliminates all other competing track networks, and at the same time finding that voluntary agreements are inadequate to fully reap the benefits that a merger provides. Fifth, this section compares the ICC and STB treatment of vertical foreclosure with voluntary trackage rights arrangements.

A. Tension with the Result of the SF-SP Merger Application

In 1983, SF merged with SP.[60] The merged SF-SP stock was placed in a voting trust until the ICC decided the application. Both railroad networks overlapped substantially since each served the southwestern portion of the United States. Particularly in California, SF-SP would essentially control the entire railroad network. The initial application provided no trackage rights access to ameliorate these "two-to-one" situations and was ultimately rejected by the ICC.[61] The applicants characterized any trackage rights agreements to ameliorate anticompetitive effects as "deal breakers."[62] In an effort to resuscitate the merger, SF-SP changed its position and proposed substantial trackage rights agreements to the other western rivals.

In rejecting the amended SF-SP application, the ICC emphasized the dilatory tactics of the applicants, noted the inadequacy of the trackage

59. *Id.*
60. *SF-SP I, supra* note 12, at 709.
61. *Id.*.
62. *SF-SP II, supra* note 12, at 928.

rights agreements to resolve all anticompetitive concerns and expressed reservations about the use of significant grants of trackage rights to ameliorate anticompetitive effects.[63] With respect to this last factor, the ICC observed:

> Even overlooking these gaps between our evaluation of the anticompetitive effects and applicants' present attempts to address them, we are confronted with a complex set of agreements that promise to alter significantly the relationships between major western railroads. In our initial decision, we emphasized our reluctance to engage in major railroad restructuring to rearrange traffic patterns in ways that might have unforeseen consequences. . . . While we encourage cooperative efforts between railroads, we are dealing here with a complicated set of arrangements made by several western railroads now in competition with each other across two rail corridors. We are disinclined to risk the possibility of collusion and market splitting that might result from such an artificial, settlement induced rationalization of the western rail system.[64]

While *UP-SP* implicated the same concern because of the extent of parallel trackage involved in the merger and the extent of trackage rights, the STB rejected this reasoning.

Instead, the STB noted that railroad markets involving two carriers provided robust competition. The STB relied on sections of the eastern U.S. and on the Powder River Basin in Wyoming, where only two firms compete in many regions, to demonstrate that rail rates have continued to decline.[65] Relying on the notion that trackage rights access is equivalent to competing ownership of two track networks, the STB concluded that "the fact that applicants and BN-SF have granted access to each other's markets is not a splitting of markets, but a pro-competitive action that promotes the public interest."[66] With the benefit of additional "experience," the STB decided to overrule this final factor.

However, the rationale supporting the new STB position seems somewhat misleading. First, the additional "experience" retained from the years following the SF-SP application shows that two firm rivalry exists *over competing networks*. The two examples which the STB cites do not involve substantial amounts of trackage rights to facilitate competition. Indeed, the only recent instance of substantial trackage rights agreements arose from the BN-SF merger in 1995.[67] Thus, the STB conclusion rests on the assumption that having "access" through trackage

63. *Id.* at 933-36.

64. *Id.* at 935.

65. *UP-SP, supra* note 11, at *99-100.

66. *Id.* at *99.

67. *BN-SF, supra* note 57 at 121. Eight railroads were involved in a series of trackage rights agreements designed to ameliorate competitive concerns.

rights is equivalent to the competition generated by two separate networks.

Second, the example of two firm rivalry in the east cited by the STB, involved firms that had been competing for at least five years when the second SF-SP application had been decided. Norfolk Southern, which was created by merger in 1982, competed with CSX Transportation, which was formed by merger in 1980.[68] When the ICC framed its decision in 1987 against the SF-SP merger, it had five years of experience available, but rejected the issue of two firm rivalry in the trackage rights setting.

B. Tension with the Standard of Review

While the SF-SP merger decision applied the same public interest standard set forth in federal statutes,[69] the ICC utilized a higher standard of scrutiny because of the existence of a railroad monopoly in the southwest section of the United States.[70] The ICC observed that the states affected by this railroad monopoly experienced tremendous population growth.[71] Because of the significance of these states, the ICC concluded that the SF-SP application would be reviewed with "extreme caution."[72] Thus, the STB's approach seems inconsistent with the apparently higher standard of scrutiny the ICC had applied to mergers which involved parallel trackage in the Southwest.[73]

A subsequent merger proceeding also supports the existence of a higher standard of scrutiny for parallel mergers. In the UP bid to control the Missouri-Kansas-Texas Railway (MKT), the ICC stated:

> The proposed consolidation is largely a parallel one . . . . Because parallel mergers generally present more serious competitive problems than end-to-end ones, we must examine carefully the competitive options that would remain in these corridors.[74]

In order to assess the merger's effects on competition, the ICC undertook two forms of investigation: (1) an examination of products and market

68. *See* CSX Corp. — Control — Chessie System Inc., and Seaboard Coast Line Indus., 363 I.C.C. 518 (1980); Norfolk S. Corp. — Control — Norfolk & W. Ry. Co. and S. Ry. Co., 366 I.C.C. 171 (1982).

69. *See supra* notes 20-21 and accompanying text.

70. *SF-SP I, supra* note 11, at 760-62.

71. *Id.* at 761-62.

72. *Id.* at 762.

73. Compare the language of the *UP-SP* decision at *supra* note 25 and accompanying text. A parallel merger represents one of two general aspects of a railroad merger. For a brief discussion of both types see *supra* note 25.

74. Union Pac. R.R. Co. and Mo. Pac. R.R. Co. — Control — Mo.-Kan.-Tex. R.R. Co., 4 I.C.C.2d 409, 436 (1988) [hereinafter *UP-MKT*].

shares routed over each parallel segment;[75] and (2) an examination of existing competitors in each affected area.[76]

In approving the UP-MKT merger, the ICC found that only crushed stone shipments faced competitive harm. However, trucking provided a substitute to railroad transportation since the commodity had a low profit margin and traffic was largely localized.[77] More significantly, the ICC noted that:

> Post-merger, four railroads will continue to compete with the merged carrier. The particular array of competitors varies to a certain extent, corridor to corridor, but one basic fact remains constant: in each of the corridors in which MKT operates today, there will be effective post-merger rail competition.[78]

While a reduction in competitors occurred because of the parallel effects of the merger, at least one other competing track network existed in each affected area to mitigate the impact. Also, competing modes of transportation existed to set a ceiling on railroad prices.[79] In *UP-SP*, the STB disregarded this higher standard of review and instead emphasized the existence of railroad monopolies in certain regions of the nation. Moreover, while the ICC sought to evaluate the existence of competing networks for traffic moving over long distances,[80] the STB found that trackage rights provide a remedy to ameliorate competitive harms.

C. SP: Failing Firm or Not?

Analogous to antitrust law, the ICC has recognized that preventing a failing firm from ending business may, in itself, become a justification that a merger falls within the ambit of the public interest.[81] In *SF-SP I*, the applicants alleged that SP was a failing firm. The ICC noted that the key test to establish the failing firm doctrine was the existence of a clear

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75. *Id.* at 440.

76. *Id.* at 449.

77. *Id.* at 464.

78. *Id.* at 449.

79. *Id.* at 449-50.

80. Notably, the *UP-MKT* decision considered trucking as an alternative mode of transportation. The distinguishing feature of the *UP-MKT* decision from *SF-SP I* was the shorter length of haul of much of the MKT network. The ICC further held that for traffic moving distances less than 1,000 miles, trucking was generally considered a substitute. *See id.* at 434-35. Notably, the UP-SP application generally involved traffic moving beyond 1,000 miles. Thus, trucking failed to appear prominently in the decision.

81. *See e.g.*, United States v. General Dynamics Corp., 415 U.S. 486, 507 (1974) (cited in *SF-SP I, supra* note 12, at 828); Citizen Publishing Co. v. United States, 394 U.S. 131(1969) (cited in *SF-SP I, supra* note 12, at 828). Federal courts have recognized the ICC's ability to consider the health of a firm as a factor in accepting a merger. *See* Kansas City Southern Industries, Inc. v. I.C.C., 902 F.2d 423 (5th Cir. 1990).

probability of business failure.[82] While the ICC recognized that SP was a "marginal railroad," it concluded that the failing firm test was not met.[83] The ICC apparently relied on previous claims from SP officers which indicated that the firm was financially healthy.[84]

In 1988, the Denver & Rio Grande Western (DRGW) sought to gain control of SP.[85] Each track network possessed fairly minor overlap and was characterized as an end-to-end merger.[86] While the applicants did not invoke the failing firm doctrine, the ICC used SP's weak financial condition as a factor favoring merger:

> SPT [SP] is a marginal carrier. Its traffic base, not the most desirable to begin with, has declined over the years due to vigorous competition from strong railroads in the Southern and Central corridors, particularly from the latter, and from trucks. In recent years it has been forced to supplement operating revenues with proceeds from the sale of real estate. We are convinced that a SPT/DRGW combination will result in a stronger entity than the two carriers separately, and that SPT will have a better chance for long-term stability under RGI [the new holding company] control than as a stand-alone railroad. The combined system will have a more diverse traffic base than either railroad now has, providing the new carrier with some added insulation from economic fluctuations.[87]

The ICC considered SP's poor financial status as a factor favoring merger. However, by 1994, the trade press heralded an SP financial turnaround.[88] In a subsequent merger application in 1995, the ICC rejected SP's contention that the proposed merger between UP and the Chicago & Northwestern (CNW) weakened it.[89]

Similar to the analysis in *DRGW-SP*, the STB in *UP-SP* considered SP a financially weak firm that needed to be integrated into a larger system.[90] The STB cast SP as a weaker firm which would grow relatively weaker compared to UP and BN-SF.[91] The STB summed up SP's competitive state:

> Based on our examination of the record, and SP's Annual Reports, we con-

82. *SF-SP I, supra* note 12, at 829.
83. *Id.* at 833.
84. *Id.* at 829-30. Those statements, made over two years earlier, were used in conjunction with reported financial data to compare changes in SP's condition.
85. Rio Grande Industries, Inc. — Control — S. Pac. Transp. Co., 4 I.C.C.2d 834 (1988) [hereinafter *DRGW-SP*].
86. *Id.* at 844.
87. *Id.* at 942.
88. *See* Gus Welty, *SP Battles Back To Respectability,* RAILWAY AGE, Nov. 1994, at 22 [hereinafter Welty, *SP*].
89. Union Pac. Corp. — Control — Chicago & Northwestern Transp. Co., Fin. Docket No. 32133 at 80 (I.C.C., Feb. 21, 1995) [hereinafter *UP-CNW*].
90. *UP-SP, supra* note 11, at *97.
91. *Id.* at *98.

> clude that SP is, and will continue to be, weaker than its principal competitors in the West (BN-SF and UP). Although SP could remain in operation as an independent carrier for some time absent the merger, its inability to generate adequate cash flow from operations, and limitations on its ability to borrow or sell stock, will preclude it from being a strong competitor to UP or BN-SF. The level of service now offered by SP is below that offered by its competitors, and declining; it is essentially a single-track, low-density, high-cost railroad.[92]

Interestingly, the STB's succinct, critical examination of SP would have been equally true in 1986, when the ICC rejected the failing firm doctrine. The STB appears to give greater weight to the argument in 1995.

Further, any competitive exacerbation would have been the result of past ICC mergers of western railroads. The ICC contributed to the SP's weakened position by granting the BN-SF and UP-CNW merger applications. Notably, when reviewing merger applications, the ICC and STB fail to consider "the survival of particular carriers."[93] This approach probably defeated SP's weakened competitor argument in *UP-CNW.*

While the ICC has reasoned that a "weakened competitor" argument against a merger application would invariably lead to the rejection of all such applications, adopting the same argument as a justification for merger would invariably lead to accepting all merger applications. Each merger relatively weakens the other unaffected carriers. Therefore, the weakened carriers are justified in merging with other carriers to become larger systems. A summary of recent western railroad mergers provides an illustration of this phenomenon. UP merged with two western carriers, Western Pacific and Missouri Pacific. As a competitive response, DRGW acquired SP a few years later. UP later acquired other midwestern railroads. Then, BN acquired SF. As another competitive response, UP sought to acquire SP.

D. Trackage Rights: A Weak Substitute?

The departure from *SF-SP I* and *SF-SP II* runs contrary to the notion that trackage rights may be a poor substitute to outright ownership of a competing track network, especially when a rival controls the track network. Indeed, anecdotal evidence from the UP-SP merger application suggests the inferiority of trackage rights. In an interview with *Forbes*, Gerald Grinstein, the former CEO of BN-SF, noted that operating on trackage rights provides "service with some disability."[94] However, Grinstein chose to enter into a trackage rights agreement with UP-SP

92. *Id.* at *97.

93. *See supra* notes 26-27 and accompanying text.

94. *See* Christopher Palmeri & Ann Marsh, *Can Drew Lewis Drive the Golden Nail?*, Forbes, Dec. 18, 1995, at 60.

because of the possibility that the STB would approve the merger.[95] This prediction is highly justified since the only merger application rejected by the ICC and STB since 1980 was the SF-SP proposal.[96] Entering into a "voluntary" trackage rights agreement when induced by a merger proposal more accurately reflects an attempt to minimize competitive losses.

Merging parties themselves have contended that trackage rights were inadequate to reap the benefits of an end-to-end merger.[97] The general position of merger applicants is that such arrangements require a level of coordination between the two railroads that may either be prohibitively costly or result in a *de facto* merger. In the UP bid to acquire the CNW railroad network, the ICC adopted this approach and concluded:

> To achieve the efficiency gains and improve service, applicants need to be able to develop and implement a coordination plan based on common management objectives. The ad hoc coordinating approaches suggested by SP are no substitute for such a plan because they may not permit full realization of the public benefits or, if they do, they would likely involve crossing the control line.[98]

Similarly, several other ICC decisions have emphasized the importance of "single line" service to shippers.[99] Significantly, the ICC conceded this position in the SF-SP application even though it ultimately denied the merger.[100]

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95. *Id.* at 64.

96. Since 1980, the ICC and STB have approved the following Class I mergers: (1) BN acquisition of Frisco; (2) formation of CSX Transportation; (3) formation of Norfolk Southern; (4) Soo Line acquisition of the Milwaukee Road; (5) DRGW acquisition of SP; (6) UP acquisition of Missouri Pacific and Western Pacific; (7) UP acquisition of MKT; (8) UP acquisition of CNW; (9) BN acquisition of SF; and (10) UP acquisition of SP. Other smaller Class I acquisitions also occurred with Guilford Transportation and Grand Trunk Western. *See* Vellturo, et al, supra note 3, at 342-43. Amidst these mergers, only one application was rejected, the formation of SF-SP.

Clearly, the trend toward expectations of further mergers continues. *See Class I Mergers: Equipment Impact Analysis*, RAILWAY AGE, Dec. 1995, at DB15 ("With today's mergers, it has become commonplace to assure quick ICC approval by entering into broad, all encompassing trackage rights agreements with competitors, to blunt competitors objections and to assure competitive service to shippers.").

97. Notably, the issue of trackage rights access appears most prominently in the end-to-end context. In end-to-end mergers, the potential to rationalize use of parallel lines cannot be realized through trackage rights agreements. *See also supra* notes 73 and 25 and accompanying text.

98. *UP-CNW, supra* note 89, at 63.

99. *DRGW-SP, supra* note 85, at 894; Burlington N. Inc. — Control and Merger — Santa Fe Pac. Corp., Fin. Docket No. 32549 at 64-65 (I.C.C., Aug. 16, 1995) [hereinafter *BN-SF*]; Union Pac. Corp. — Control — Missouri Pac. Corp., 366 I.C.C. 459, 489 (1982); *SF-SP I, supra* note 12 at 872.

100. In *SF-SP I*, the ICC concluded that:

> Applicants sought to neutralize the assertion that many of the claimed merger benefits could be achieved by SPT [SP] and ATSF [SF] by cooperative efforts short of merger.

In the BN-SF merger application, the merging parties claimed substantial post-merger savings from internal re-routes over the combined network.[101] Theoretically, such savings could be recouped by trackage rights or a joint marketing arrangement between the parties. However, the ICC found such an arrangement implausible even though BN and SF had engaged in voluntary haulage agreements[102] which were not precipitated by a merger.[103] In fact, the BN-SF haulage arrangement continued until the submission of the merger application in 1995. Since the early 1990s, several voluntary arrangements have been implemented in the absence of a merger.[104]

> Applicants explored in detail the non-merger mechanisms suggested by DOJ in a manner that convinces us that there are practical, legal and competitive problems which would substantially lessen the effectiveness of such arrangements. It seems clear to us that without the unified management resulting from the merger, few if any of the operating economies projected under the Operating Plan are attainable.

SF-SP I, *supra* note 12, at 872 (also cited in *UP-SP*, *supra* note 11, at *94).

101. *BN-SF*, *supra* note 99, at 65.

102. A haulage agreement obligates a railroad to transport freight over its network for another railroad at a specified fee.

103. *See Santa Fe, BN Launch Haulage Agreement*, RAILWAY AGE, July 1993, at 18; *Santa Fe, J.B. Hunt Start Tulsa Service*, RAILWAY AGE, July 1993, at 20. Both articles describe a joint haulage agreement for intermodal traffic. The traffic flowed from the Southwest (originating in California) to the Southeast. SF was allowed to operate over BN trackage from Avard, Oklahoma to Birmingham, Alabama.

104. *See supra* note 103; *see also e.g., RGI Scuttles Soo Deal, Looks To BN Trackage Rights*, RAILWAY AGE, Sept. 1990, at 22 (Denver & Rio Grande Western decided to negotiate trackage rights over a line extending from Kansas City, Missouri to Chicago, Illinois rather than buying it outright from Soo Line); *BN Teams Up with South Orient*, RAILWAY AGE, Sept. 1992, at 22 (BN gains access to Mexico by acquiring the South Orient, a shortline which negotiated a haulage agreement from southern Texas to Fort Worth, Texas to connect with BN); *IC, KCS Agree on Joint-Line Service*, RAILWAY AGE, March 1993, at 13 (Illinois Central and Kansas City Southern agreed to market joint-line service); *First, KCS-Midsouth, Now . . . ?*, RAILWAY AGE, June 1994, at 64 (Kansas City Southern and BN enter into a haulage agreement to move intermodal freight from Texas to the Pacific Northwest); *BNSF, IC Forge Intermodal Agreement*, RAILWAY AGE, Sept. 1996, at 24 (Illinois Central and BN-SF have established a joint marketing agreement for movement of intermodal traffic between Memphis, Tennessee and Mobile, Alabama); Mark W. Hemphill, *Taconite West, Coal East: How Wisconsin Central and Southern Pacific Snared the Big Geneva Steel Ore Haul*, TRAINS, Mar. 1995, at 36-47 (Wisconsin Central and Southern Pacific through joint marketing agreements obtained a lucrative contract, surpassing "single line" service from UP-CNW); *Conrail and Guilford Launch 'Press Runner,'* RAILWAY AGE, Mar. 1995, at 22 (joint marketing effort to ship paper from mills in Maine to Chicago within four days); *Conrail, NS Join in New Intermodal Service*, RAILWAY AGE, June 1995, at 23 (Conrail and Norfolk Southern introduced a new intermodal service which connected Atlanta, Georgia with Kearney, New Jersey); *North-South Route Focus of SP/IC Partnership*, RAILWAY AGE, July 1994, at 4 (Illinois Central and SP entered into an agreement to interchange in Memphis over Illinois Central trackage to shorten SP transit times); *NS, Conrail Explore Intermodal Venture, Triple Crown To Market Services*, RAILWAY AGE, Dec. 1992, at 13 (Norfolk Southern and Conrail began exploring a joint venture to market intermodal services); *CN, BN Haulage Agreement Speeds Canada To U.S. Traffic Movement*, RAILWAY AGE, Dec. 1992, at 13 (BN and Canadian National implemented a haulage agreement which "vastly simplified" movement into the U.S. according to Canadian National CEO Paul M. Tellier); Arthur J. McGinnis, *Welcome To the*

In addition, railroads have criticized the inadequacy of trackage rights access. Perhaps the most ironic instance of criticism occurred in the UP-CNW merger proceedings when SP claimed UP violated the terms of previous trackage rights arrangements imposed by the ICC.[105] Some SP complaints included inadequate capitalization of tracks over which SP operated[106] and unequal treatment of trains.[107]

The problems stemming from trackage rights conflicts occur because of the differing interests of parties. In spite of the existence of trackage rights agreements, both parties often have diverging economic interests. The landlord railroad may have a diverging interest in the level of maintenance to provide, the priority of the train, or potential competitive concerns. BN argued that such diverging interests existed in its haulage agreement with SF as a justification for merger.[108]

Currently, railroads are providing a similar strand of arguments against involuntary competitive access, a concept which essentially mandates trackage rights access for a regulated cost on any track network.[109] Moreover, some railroads have contended that open access would erode economies of density and discourage capital investment.[110] Since competitors could access the network, the owner of the network risks losing business to the tenant. The owner would, according to some railroad officials, lose the incentives to develop the franchise. Significantly, these arguments apply equally to *all* trackage rights arrangements.

Under the ICC and STB rationale, voluntary trackage or haulage arrangements are inadequate to reap the same benefits as unified control provides over the same two track networks. Further, some railroads have conceded that being a tenant on another railroad provides a competitive disadvantage to the owner of the network.[111] Given these perspectives,

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World of NAFTA, RAILWAY AGE, April 1994, at 1 (UP pre-blocking agreement with the Mexican National Railways to speed traffic movement); *More SP Track Available for Lease*, RAILWAY AGE, Feb. 1993, at 16 (SP offers leases to short line and regional carriers over certain segments of track which it believes it cannot adequately service).

105. *UP-CNW, supra* note 89, at 19 ("SP is adamant that it has had an unsatisfactory experience with UP's administration of trackage rights . . .").

106. *Id.* at 21 ("SP alleges that UP has no incentive to maintain and operate efficiently the line between Pueblo and Herington, because SP provides 95% of the line's traffic.").

107. SP sought to have UP dispatchers "informed" by their superiors that SP trains should be given equal treatment as UP trains. Further, SP sought performance monitoring and a restructuring of UP dispatcher incentive. *See id.* at 20.

108. Applicants Supporting Information, V.S. Joseph Kalt, vol. 1, at 496, Burlington N. Inc. — Control — Santa Fe Pac. Corp., Fin. Docket No. 32549 (I.C.C., Aug. 16, 1995). Currently, some conflict also exists in the administration of BN-SF trackage rights pursuant to *UP-SP*. *See BNSF Implementing Rights Granted Under UP-SP*, RAILWAY AGE, Dec. 1996, at 6.

109. *See* Gus Welty, *The Case Against Open Access*, RAILWAY AGE, Dec. 1996, at 35 [hereinafter Welty, *Case*].

110. *Id.* at 38.

111. *See supra* notes 94-95 and 105-07 and accompanying text.

trackage rights to ensure competition in an otherwise monopolistic railroad market seems unrealistic. While BN-SF and UP-SP have become interdependent for trackage rights access, non-cooperation by either party encourages a reciprocity of non-compliance that amounts to a division of railroad markets to the extent that other competing modes of transportation permit.[112]

E. The Vertical Foreclosure Paradox

While the STB has noted that some voluntary trackage rights are unobtainable because of barriers such as conflicts of interest, the ICC has rejected the same arguments regarding vertical foreclosure. Vertical foreclosure occurs in the railroad context when a consolidation precludes another competitor from providing service.[113] In a hypothetical, one railroad has a monopoly over either the destination or origin. Multiple railroads connect with the monopoly railroad at an intermediate point and either provide the destination or origin of the shipment. When one of those multiple lines merges with the monopoly carrier, it is possible that the other railroads will be "foreclosed" from providing service for that particular shipment. Some economists have contended that such vertical foreclosure will occur even if the foreclosed railroad is the more efficient carrier.[114]

The ICC has soundly rejected any ill effects from this type of vertical foreclosure, reasoning that whoever owns the monopolist railroad will extract the highest price both before and after a merger. Thus, if the price is the same, a shipper would not have any incentives to route over one railroad or the other.[115] Further, from a rational economic perspective, a merged railroad which can extract a near perfect price squeeze from the other bridge carriers would choose a bridge carrier if its own costs were somewhat higher. In *BN-SF*, various utilities contended that vertical foreclosure would occur in coal shipments. The ICC rejected this argument reasoning:

> The utilities also depend heavily on the companion argument that they will be harmed by the merger because a vertically integrated BN/Santa Fe will

112. This non-cooperation issue is further addressed in *infra* note 118 and accompanying text.

113. *See* Curtis M. Grimm & Robert G. Harris, *A Qualitative Choice Analysis of Rail Routings: Implications for Vertical Foreclosure and Competition Policy,* 24 Logistics & Trans. Rev. 49-51 (1987) [hereinafter Grimm & Harris, *Qualitative Choice*]; Henry McFarland, *The Economics of Vertical Restraints and Relationships Between Connecting Railroads,* 23 Logistics and Trans. Rev. 207 (1986) [hereinafter McFarland, *Economics*].

114. *See* Curtis M. Grimm & Robert G. Harris, *Foreclosure of Railroad Markets: A Test of Chicago Leverage Theory,* 35 J.L. & Econ. 295 (1992); see also Grimm & Harris, *Qualitative Choice, supra* note 112.

115. *E.g., UP-CNW, supra* note 89, at 74.

> always act to foreclose unaffiliated origin or bridge carriers from participating in efficient through routes. Again, both experience and logic are to the contrary. Simply put, there is no reason for a carrier to foreclose an efficient connecting carrier just to achieve a long haul. If a connecting carrier can provide service at a lower cost than can BN/Santa Fe, it is in the interest of all the carriers to reach an agreement for a joint service.[116]

When efficiency gains are plausible, railroads can negotiate voluntarily to assure the most efficient routing.

According to the ICC, other factors mitigate the potential effects of vertical foreclosure. The ICC observed that vertical foreclosure is less likely when the cost structures of the two routes are very different or when one route suffers from lower service quality.[117] Shippers will act as a force to choose one routing over another when service quality is at stake. The ICC also has reasoned that the interdependence of railroads, with each in a position as a destination monopolist in certain circumstances, curtails abusive practices.[118]

In addition, a merged firm may have some incentive to pass routing savings to shippers even if it has a monopoly to avoid substitution away to other commodities or other modes of transportation.[119] For example, a utility with different types of electric producing plants may, in the short term, decide to substitute oil for coal at the margin when it decides how much capacity to allocate to each type of plant. In the long run, such a utility may also plan to build a new generating facility elsewhere.[120] These factors would act as an incentive for the monopolist railroad to pass on some cost savings to the shipper. If another carrier provides a lower cost route structure, the monopolist has every incentive to use that carrier and pass the savings on to the shipper.

Interestingly, the reasoning of the ICC's conclusion that vertical foreclosure is unlikely should also apply equally to voluntary trackage rights and other similar agreements *if they are efficient.* Where market forces work to avoid the inefficient routing in the vertical foreclosure context, they should also work to seek out efficient voluntary agreements that reap benefits even if far short of a merger. As the ICC stated succinctly: "[r]ailroads, like other firms, normally have no incentive to foreclose efficient alternatives to in-house production."[121] For example, a railroad that could reap gains through a shorter re-routing by diverting the traffic to a competitor would negotiate with that competitor to divert

116. *BN-SF, supra* note 99, at 74.
117. *UP-CNW, supra* note 89, at 74.
118. *BN-SF, supra* note 99, at 74-75.
119. *Id.* at 75.
120. *Id.* at 74 n.95. The ICC referred to this type of decision as the "make or buy" paradigm.
121. *Id.*

the inefficient portion of the move off its own network. Further, the pressure from other modes of transportation, particularly trucks, would act as a strong incentive for a railroad to enter such an agreement, even if it loses a portion of the length of haul, because it risks losing the business entirely if rates remain the same or increase.

Numerous examples of voluntary arrangements exist.[122] For example, through its traffic movements from the Southwest, which are routed through Memphis, Tennessee, before reaching their Chicago, Illinois destination, Illinois Central had a more efficient route than SP. As a result of this routing disadvantage, SP negotiated a haulage agreement with Illinois Central to gain access to the less circuitous route.[123] Another joint venture example demonstrates how two railroads can effectively defeat a "single line" service carrier. Wisconsin Central (WC) and SP gained a contract with Geneva Steel to haul 2.6 million tons of taconite pellets per year from Minnesota to Geneva, Utah.[124] The SP-WC route, which was substantially longer and more inefficient, remained competitive with the single-line UP-CNW bid because of a coal backhauling arrangement. Cooperation between the two railroads was the essential ingredient to winning the contract.[125] Moreover, in contrast to the STB's dismal picture of an SP unable to provide adequate service,[126] this shipper had substantial confidence that SP could meet deadlines.[127]

In *UP-SP*, the STB dismissed this troubling paradox by suggesting that "if UP and SP have not yet been able to coordinate the core operations of their competing systems outside of the merger context, it is not realistic to suppose they could easily do so."[128] Of course, coordination of "core operations" are not necessary for many proposed gains from "single line" service. As the examples above illustrate, improved service quality through better routing and joint marketing are possible without merger. In stark contrast to the STB's interpretation, the record clearly demonstrates that the UP-SP merger proposal was a competitive response to the creation of BN-SF. The timing and general context of the merger provide evidence to support this conclusion.[129] Moreover, the

122. *See supra* notes 103-04 for a listing of examples.

123. *See North-South Route Focus of SP/IC Partnership, supra* note 104, at 4

124. *See* Hemphill, *supra* note 104, at 36; *see also SP, WC Will Test Two-Way Open-Top Service*, RAILWAY AGE, March 1994, at 22.

125. *See* Hemphill, *supra* note 104, at 42.

126. *See supra* notes 90-92 and accompanying text.

127. *See* Hemphill, *supra* note 104, at 42 (Geneva Steel President and Chief Operating Officer, Robert J. Grow, was "confident that SP will provide the level of service necessary to live up to the requirements of such a relationship.").

128. *UP-SP, supra* note 11, at *94.

129. The trade press seems to compare the *BN-SF* application with *UP-SP. See* Welty, *Redrawing, supra* note 5, at 36; *UP Prepares To Move To the Top of the Class I's*, RAILWAY AGE,

record itself does not support the STB's conclusions. UP *never* considered means short of a merger to achieve at least some efficiency gains.[130]

IV. Are All Mergers in the "Public Interest"?

As the concentration of railroad firms and the scope of railroad networks grow, the seriousness of anticompetitive impacts also increase. Yet, in the post-Staggers Act era, the STB and ICC have become more accommodating toward mergers. Indeed, the holding of the only failed merger application has been eviscerated by the UP-SP decision. Under the STB rationale, *all* railroad mergers are in the public interest. Of course, with this rubber stamp of approval, the pace of new consolidations continues.[131]

The continual approval of railroad mergers may lead to the ills that deregulation sought to avoid— excessive regulatory intervention.[132] When the Staggers Act was adopted, forty Class I railroads existed; now only nine remain.[133] As industry concentration increases, the potential for collusive behavior also increases. A growing class of shippers may file petitions seeking regulatory relief. The STB itself has set up this form of monitoring through oversight of UP-SP trackage rights agreements.[134] Ultimately, such oversight may be less desirable and more costly than simply preventing mergers.

More significantly, some question remains about the real efficiency

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Aug. 1996, at 33. A bidding war was fought by BN and UP to acquire SF. *See* Steven Lipin & Daniel Machalaba, *Union Pacific Quits Battle for Santa* Fe, WALL ST. J., Feb. 1, 1995, at A3. Once UP failed in this bidding war, it sought SP. Former President and CEO of UP, Ronald Burns indicated:

> The Burlington Northern Santa Fe combination propelled us directly into our agreement with Southern Pacific. The goal: To forge a new rail system in the West capable of competing with the BN-SF giant.

Miller, *Confident*, *supra* note 8, at 43.

130. *See* Dep., John H. Rebensdorf, Jan. 22, 1996, at 55, *UP-SP, supra* note 11 (UP never considered alternative methods to obtain the competitive gains from coordination; it merely considered acquiring SF or SP); Dep., Dale W. Salzman, Feb. 22, 1996, at 126-27, *UP-SP, supra* note 11 (UP never considered acquiring use of SP assets that were essential to the Operating Plan by means other than merger); Dep., John T. Gray, Feb. 26, 1996, at 143, *UP-SP, supra* note 11 (SP never examined the economics of selling SP trackage to UP and retaining trackage rights)..

131. *E.g.*, the current merger proposal to split Conrail. *See supra* note 4.

132. *See* Luther S. Miller, *Tougher Rail Merger Guidelines?*, RAILWAY AGE, Dec. 1995, at 18 [hereinafter Miller, *Tougher*] (covering speech by Ed Emmet, president of National Industrial Transportation League); *see also* Henry McFarland, *The Effects of United States Railroad Deregulation on Shippers, Labor and Capital*, 1 J. REG. ECON. 259, 267 (1989) [hereinafter McFarland, *Effects*] (concluding that re-regulation of the railroad industry would, on balance, harm shippers).

133. *See* Miller, *Tougher*, *supra* note 132 at 18; *see also supra* note 3.

134. *See supra* note 53 and accompanying text. The STB clearly anticipates holding proceedings on the level of competition in areas where trackage rights exist. *See UP-SP, supra* note 11, at *123.

gains stemming from mergers. A great deal of difficulty exists in establishing the gains from mergers because the Staggers Act deregulated freight pricing, allowed greater flexibility for track abandonments, reduced reporting requirements, and facilitated mergers.[135] Clearly, after the Staggers Act the railroad industry's general economic condition has improved.[136] However, the link between improved financial performance and mergers remains unclear. Before the Staggers Act, at least one major merger became a well publicized financial disaster, ultimately bankrupting many eastern railroads.[137] More recently, UP encountered severe difficulty in absorbing CNW in 1995. In an open letter to customers dated November 6, 1995, Ronald Burns, former CEO of UP, conceded that "[s]ervice has deteriorated to levels never before seen on UP" and that "many customers are experiencing unprecedented problems with service."[138] Of course, other mergers have been considered successful.[139]

At least one recent economic study which attempted to separate gains from merger and gains from other regulatory reforms concluded that the efficiency gains from mergers were negligible in contrast to gains from other Staggers Act provisions.[140] This study examined the period 1974-1986. A subsequent study of the same data quantified the industry-wide efficiency gains from mergers and other forms of deregulation, and concluded that deregulation accounted for over ninety percent of cost reductions while merger activity accounted for about nine percent.[141]

Notably, the STB has rejected productivity studies during "quiet" years where no merger activity occurred, reasoning that firms who exper-

135. *See* Wilner, *Marketplace, supra* note 2, at 307-08 and 311-16.

136. *See e.g.,* Wilner, *Marketplace, supra* note 2; Frank N. Wilner, *The Railroads' Productivity Challenge,* 59 TRANSP. PRAC. J. 15, 27-33 (1991) [hereinafter Wilner, *Productivity Challenge*]; Stephen R. Klein, *Railroads Second Golden Era May Be Dawning,* STANDARD & POORS INDUSTRY SURVEYS, Nov. 4, 1993, at R29; McFarland, *Effects, supra* note 132, at 259.

137. The merger of the Pennsylvania Railroad and New York Central was perhaps the first large combination of major networks. Effectuated in 1968, the merger proved a failure and led to the bankruptcy of several other eastern carriers. Conrail was ultimately created from the ashes of these failed carriers. *See* JOSEPH R. DAUGHEN & PETER BINZEN, THE WRECK OF THE PENN CENTRAL (1971)..

138. *See For Union Pacific, "Unprecedented Problems with Service,* RAILWAY AGE, Dec. 1995, at 20; Palmeri & Marsh, *supra* note 94, at 58; Daniel Machalaba, *Union Pacific Struggles To Clear Up Delayed Shipments,* WALL ST. J., Nov. 30, 1995, at B4. See also *supra* note 37 which discusses the present service difficulties at BN-SF.

139. For example, BN was initially formed by a union of three major western railroads in 1970. BN has been considered a financial success story. *See* Great Northern Pacific & Burlington Lines, Inc. - Merger - Great Northern Ry., 331 I.C.C. 228 (1967); United States v. I.C.C., 396 U.S. 491 (1970); *also noted in* DAUGHEN & BINZEN, supra note 137, at 124 n.

140. *See* Vellturo, et al., *supra* note 3, at 367-68.

141. *See* Ernst R. Berndt, et al., *Cost Effects of Mergers and Deregulation in the U.S. Rail Industry,* 4 J. PRODUCTIVITY ANALYSIS 127-44 (1993).

ienced a merger earlier still accrue benefits in later years.[142] Such an analysis would make studying the railroad industry in "quiet years" virtually impossible since every Class I railroad has evolved through merger both before and after the Staggers Act.[143] The STB implicitly argues that mergers constitute a continuing and significant component of productivity gains.[144] However, the STB analysis fails to address studies which attempt to "factor out" the effects of mergers. Adopting the logic of the STB, if productivity gains in the railroad industry are attributable in large part to mergers, the industry should continue to consolidate until only one firm remains.

Other anecdotal evidence supports the notion that efficiency gains in the railroad industry are attributable to factors other than merger. For example, Illinois Central, the first Class I railroad to achieve the goal of "revenue adequacy," substantially rationalized its route network and sold several thousand miles of trackage.[145] In the absence of mergers,[146] Illinois Central continues to earn the highest return on investment of any of the Class I railroads.[147] The success of Illinois Central at least dispels the argument that mergers are the only vehicle to obtain greater efficiency gains in the railroad industry.

Further, another railroad, Florida East Coast (FEC), has successfully attained productivity gains through flexible labor relations.[148] Over the period 1978-88, FEC gross revenues increased over one hundred percent while other Class I railroads, including firms that merged, experienced growth in gross revenues of only thirty-one percent over the same period.[149] Similarly, traffic growth on FEC outstripped the industry average for the same period. FEC was hailed as a model for other Class I rail-

142. *UP-SP, supra* note 11, at *94; *see also supra* notes 37-38 and accompanying text.

143. *UP-SP, supra* note 11, at *94. For example, consider the history of mergers within BN-SF. With a history of approximately 147 years, the corporation has acquired 330 separate railroad entities. *See* Machalaba, *Burlington Northern Struggles*, *supra* note 37, at B4.

144. *UP-SP, supra* note 11, at *94.

145. Notably, Illinois Central severely rationalized its line structure fifteen years after a merger in 1971. *See* Michael W. Blaszak, *Illinois Central: A Railroad for the Nineties,* TRAINS, Aug. 1992, at 32; Illinois Central Gulf Railroad Co. - Acquisition - Gulf, Mobile & Ohio Co., 338 I.C.C. 805 (1971).

146. Illinois Central finally did acquire a regional railroad in January 1996, the Chicago Central & Pacific for a reported $139 million. *See Chicago Central Sold,* PACIFIC RAIL NEWS, Feb. 1996, at 11.

147. In 1995, Illinois Central managed nearly a seventeen percent return on investment, surpassing the next best railroad by over three percent. Similarly, in 1994 Illinois Central accrued nearly a fifteen percent return on investment, nearly five percent better than its nearest rival. *See* Miller, *Confident, supra* note 8, at 46. Illinois Central has maintained this high return throughout the 1990s. *See* Klein, *supra* note 136, at R29.

148. *See* Wilner, *Productivity Challenge, supra* note 136, at 35-38.

149. *Id.* at 36.

roads to follow.[150]

Finally, in the age of deregulation, some question exists regarding the uniqueness of the railroad industry from other private enterprises. Perhaps such antitrust issues are best left to the court system. The STB approach to evaluating mergers seems best suited for politically neutral courts. The attitude that the STB and ICC adopted toward embracing mergers and deregulation followed a political agenda.[151] Further, intense lobbying by railroads occurred during the formation of the STB to assure a more favorable standard of review for merger applications.[152] Federal courts may maintain a better level of balance in evaluating merger proposals without adopting a specific legislative or executive agenda.[153] Further, the courts have weighed and balanced broad policies in the antitrust context when "unique" issues are at stake.[154] Given the level of deregulation, it seems unclear that the STB retains specialized knowledge that federal courts cannot easily acquire. Federal courts have evaluated nearly all other antitrust cases. Further, the early cases interpreting the antitrust laws involved railroads.[155]

V. Conclusion

Since 1980, the ICC and STB combined have only denied one merger application out of eleven major cases, the SF-SP petition.[156] However, *UP-SP* further eroded the grounds for denial in *SF-SP I* and *SF-SP II*, opening the door to more mergers. Beyond remaining in conflict with the *SF-SP* decisions, the STB approach to mergers in *UP-SP* lowered the standard of review for mergers involving parallel lines. The STB and ICC propensity toward granting mergers has also fueled an interesting application of the failing firm doctrine. While ignoring the weakened condition of non-merging parties in applications, the STB and ICC have considered a railroad's competitive position as a justification for merger. Thus, each merger spawns competitive winners and losers, offering a justification for the weakened firms to regroup and plan yet another merger.

Within the STB and ICC approaches to merger policy, an uneasy equilibrium exists. While trackage rights and other forms of voluntary

150. *Id.*

151. *See* Stone, *supra* note 1.

152. *See* Bryan Gruley, *Clout of Union Pacific Corp. Chairman Is Seen Behind Bill That May Expedite Railroad Merger,* Wall St. J., Nov. 27, 1995, at A20.

153. *See* Neil K. Komesar, Imperfect Alternatives: Choosing Institutions in Law, Economics, and Public Policy 123-50 (1994).

154. *See* United States v. Brown Univ., 5 F.3d 658 (3d Cir. 1993).

155. United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897); United States v. Joint- Traffic Ass'n, 171 U.S. 505 (1898).

156. *See supra* note 96.

arrangements short of merger provide an inadequate vehicle to reap efficiency gains, trackage rights are acceptable to alleviate competitive concerns. Ironically, the railroads themselves recognize trackage rights as "service with some disability."[157] While the STB appears to have confidence in the power of trackage rights to alleviate anticompetitive harms, the effectiveness of expansive trackage rights to alleviate such harms remains speculative. The first series of expansive trackage rights grants to alleviate competitive harm occurred in the 1995 *BN-SF* decision.[158] The *UP-SP* trackage rights agreement is even more expansive and involves more serious competitive problems. Further, many railroads are critical of analogous open access provisions, arguing that such laws would hobble competitiveness.[159]

In addition, the ICC and STB position regarding vertical foreclosure suggests that a railroad in a monopoly position will voluntarily cede traffic to more efficient carriers when it can recoup at least a portion of the savings. Yet, the ICC and STB have rejected the same arguments when applied to the possibility of voluntary agreements alleviating the need for merger even though numerous examples of such arrangements exist. For voluntary agreements, the STB has concluded that an artificial "stimulus" is a prerequisite before realizing any gains.[160] Significantly, the merging parties of *UP-SP* failed to consider any such agreements short of mergers. Taken in context, the UP-SP merger proposal represented a competitive response to the BN-SF merger application.

The continual approval of mergers has led to a domino effect of additional merger applications with no end in sight until the industry is left with one or two transcontinental systems. The most recent merger application involving Norfolk Southern, CSX Transportation and Conrail clearly represents this effect. While the UP-SP and BN-SF mergers left only two railroads west of the Mississippi River, three major Class I systems operate east of the Mississippi River. As a result, Norfolk Southern and CSX Transportation, two eastern networks, sought to acquire Conrail, the third railroad in the east. John W. Snow, the CEO of CSX Transportation conceded that: "[n]aturally, each of the Eastern carriers was concerned it might be left without a partner should transcontinental mergers occur."[161]

As the level of industry concentration increases, the risk of anticompetitive behavior increases. Moreover, while the STB and ICC approach has embraced mergers, it remains uncertain whether mergers have con-

157. *See supra* note 94 and accompanying text.
158. *BN-SF, supra* note 99, at 121.
159. *See* Welty, *supra* note 109.
160. *See UP-SP, supra* note 11, and accompanying text to note 38.
161. *See* CSX Corp., supra note 5, at 2. .

tributed a significant portion of the efficiency gains realized by the railroad industry since 1980. Continued increases in industry concentration may pave the way for anticompetitive abuses that invite more regulation, defeating the ultimate goals of the Staggers Act. When the Staggers Act sought to facilitate consolidations, the industry was financially unsound and forty Class I railroads dotted the U.S. railroad map.

In addition to the debate regarding the adjudication of railroad merger applications, the question of which institution may better decide these cases exists. The recent precedent of the ICC and STB in merger proceedings suggest that federal courts may better adjudicate the merits of such claims.[162] Unfortunately, STB and ICC review seems tainted with a political agenda to support merger applications in virtually all circumstances. The STB and ICC have effectively ignored evidence critical of this agenda. In a more balanced environment, courts may better evaluate the economic merits of mergers as well as other broader social policy goals.[163] In sum, a fundamental re-examination of railroad merger policy is necessary.

162. *See* Gruley, *supra* note 152 at A20.

163. *See* Daniel Machalaba & Anna Wilde Mathews, *Rail Mergers Take Toll on Small Towns*, Wall St. J., Nov. 29, 1996, at A2. BN-SF anticipated few abandonments or line sales after its merger. However, it now plans to eliminate approximately 4,000 miles of track. Such rationalizations have hampered small community access to reliable railroad freight service.