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Good Morning. I am delighted for this opportunity to discuss the current law and procedures governing rail mergers, and the merger proposals in the Railroad Deregulation Act of 1979. Like the rest of the issues addressed by this bill, rail mergers are a complex and sometimes controversial subject, and careful analysis of our proposal is appropriate. As we have repeatedly stressed, the various provisions of this legislation are carefully designed to fit together to make a coherent whole. Each contributes to the achievement of the goals of the others. Thus, our merger policy re-emphasizes the primacy of competition, because our bill is premised on the ability of competition to regulate the railroads faster, more efficiently, and more fairly than a bureaucracy can today.

Specifically, we propose to remove mergers from the jurisdiction of the ICC and subject them to the scrutiny of the antitrust laws. In so doing, we are emphasizing the role of competition in assessing the merits of rail mergers, speeding up the process by which mergers are approved or rejected, and clarifying the standards by which they are judged. We are simultaneously proposing less radical, but still very important, changes in the so-called "401" process by which smaller scale restructuring is encouraged. The 401 process provides, we think, the best opportunity for the kind of limited, targeted rationalization of plant, facilities, and operations that is so vital to the rail industry. Our proposals would speed up the 401 process, and provide a balancing of interests test for approving restructuring proposals much like the test now in place for airline mergers.

I'd like to elaborate a bit on the reasons why we are proposing a major change in the way rail mergers are judged and on how and why the current regulatory scheme for mergers has failed.

First, however, I think it's extremely important to describe, at least briefly, the role of mergers in helping the railroads back to financial security, because I think the contribution that mergers can make in this effort is overstated.

It is, today, conventional wisdom that the railroads are plagued with excess plant. The most revealing statistics in this regard are that two thirds of all rail traffic moves over only one fifth of rail trackage, and, conversely, that one third of the rail route miles carry only two percent of rail traffic -- the equivalent of one train a week over those routes. Such a system cannot long survive. It is, therefore, not surprising that we are currently experiencing another of the periodic merger waves: BN and Frisco, B&O, N&W or Grand Trunk and DT&I, and Chessie and Seaboard have already been proposed. Southern, N&W and other railroads are talking. And yet, merger may not be the best solution to the rail industry's problems. In fact, as a general matter, the Department has concluded that mergers are a less promising technique to improve the rail industry than other less dramatic solutions: consolidations, joint trackage rights, market swaps, and similar smaller-scale projects that are encouraged in other provisions of this bill.

It is crucial that both mergers and smaller scale restructuring be available, but it is also crucial that each be used in the proper setting. Mergers are a broad brush, suitable when only major change will suffice and then only if any anticompetitive effects are outweighed by their benefits. This is especially true in a deregulated environment that depends so heavily on competition. 401 projects are more limited and more targeted in effect -- and yet, in m ny situations can be just as effective as mergers in reduci g costs, plant redundancy, and operating inefficiency.

Our conclusion about the limitations of mergers is s ared by others: the Task Force on Railroad Productivity s ated in 1973 that: "there [does not] appear to be any e idence that rail service has generally improved as a result o merger," and "anticipated cost savings may not be realized b cause [mergers] are based on anticipations of economies o scale or density which either do not exist or are offset b diseconomies of scale." A 1974 MIT study found: "as a form of rationalization, mergers have proven only moderately s ccessful." And in 1977, the ICC's Rail Services Planning O fice reached a similar conclusion.

One of the reasons for this result is the conflict b tween the goals of a merger and the current regulatory s heme governing rail mergers. The principal perceived b nefits of rail mergers are cost savings and new marketing o portunities. These are the classic economic incentives t at make any merger work. Any yet, the regulatory scheme o ten thwarts the achievement of these goals by superimposing c nflicting, outdated, and uneconomic goals.

Additionally, by imposing a lengthy, expensive, and b rdensome preclearance process on rail mergers, unlike t at imposed on other industries, we are discouraging mergers t at might work. Finally, since the Transportation Act o 1940, the scope and number of criteria applied by the I C and the courts in rail merger cases has multiplied to s ch an extent that no proposal could meet all of them, a d the attempt to do so renders the original economic goals o such mergers unattainable. Let me give you some examples.

Section 5(2)(c) of the Interstate Commerce Act contains t e basic "public interest" standard that any merger must m et, and then lists four criteria to be considered in determ ning the public interest: (1) "the effect of the transa tion on the adequacy of transportation to the public;"

(2) "the effect ... of including, or failing to include, other rail carriers ...," (3) "the total fixed charges that result ...;" and (4) "the interest of carrier employees."

In 1976, Congress adopted nine additional merger criteria, including: environmental impact, the rationalization of the rail system, impact on shippers, consumers, local communities, employment, and quality of rail service, and, finally, the effect of the transaction on retention and promotion of competition.

To add to this, the courts have required that the goals of the National Transportation Policy be considered in rail merger cases, thus bringing yet more factors into play: preservation of the inherent advantage of each mode of transportation; promotion of safe, adequate, economical, and efficient transportation; encouragement of sound economic conditions among carriers and reasonable rates for shippers, cooperation with state officials, and fair working conditions. The courts have also required that the interests of competing carriers be considered.

And, finally, just last year the ICC added seven more criteria: continuation of essential rail services; operating efficiency; elimination of redundant facilities; ability to attract new business; financial viability; maintenance of effective competition "wherever economic realities make it possible;" and environmental impact. In adopting these criteria, the ICC clouded the matter yet further by stating that no criterion has priority over any other, that they inevitably conflict, and that the weight given to each may differ from proceeding to proceeding.

In light of all these issues, and the fact that merger applications are always contested, a merger application runs to six or eight volumes, hearings go on for a year or more, and the costs are literally in the millions. More importantly, however, it is not surprising that faced with this kind of regulatory maze, by the time a merger proposal is approved, it is quite unlikely to be able to accomplish most of its original goals. The classic case is, of course, the Rock Island-Union Pacific merger. In the course of the 14 years it took the ICC to approve the merger, the Rock Island's situation deteriorated so drastically that the Union Pacific was no longer willing to take it on.

If a merger should happen to survive this regulatory process in a form that anyone still wanted, it is immediately appealed in the courts. This adds more conflicting criteria, more delay, and more cost to the merger process. In fact, we now have a significant body of case law developed by the Supreme Court on the subject of rail mergers. The considerations addressed by the Court in the past give us some indication of the concerns they are likely to raise in the future -- with one important caveat. Since rail mergers are now entrusted to the ICC, the Court accords great weight to the ICC's decision, and this factor would be removed from the Court's consideration if our proposal is enacted.

Perhaps the most important issue addressed by the Court in these rail merger cases, and one of especial importance in light of our proposed changes in the laws governing rail mergers, is the relationship of competition, and the policies of the antitrust laws, to the merger standards of the Interstate Commerce Act.

The Court has repeatedly been called on to weigh the standards contained in the Interstate Commerce Act, and employed by the ICC in judging the merits of a proposed merger, against those embodied in the antitrust laws -- primarily the preservation and enhancement of competition.

Early on, a tenuous truce between these not always consistent standards was declared. In 1944, the Court held:

> Congress...neither has made the anti-trust laws wholly inapplicable to the transportation industry nor has authorized the Commission in passing on a proposed merger to ignore their policy...
>
> [T]he Commission must estimate the scope and appraise the effects of the curtailment of competition which will result from [a] proposed consolidation and consider them along with the advantages of improved service, safer operation, lower costs, etc., to determine whether the consolidation will assist in effectuating the over-all transportation policy.[17]

This conclusion is cited in virtually every subsequent rail merger case to reach the Court.

The effect of this line of decisions is that preservation of competition has often taken a back seat to the achievement of other social goals. These decisions thus reflect the objectives and requirements of the rest of the Interstate Commerce Act -- an Act passed in the days when railroads were used to implement social policy, and could afford to do so. Today, the railroads can no longer afford to subsidize other, even worthy, goals, and yet merger decisions based on current statutory standards continue to require them to do so. Such a merger policy is no longer viable.

A merger policy for a less regulated rail system must place greater stress on the value of competition, for competition makes a deregulated system work, and protects shippers and consumers faster and better than the government can, or has. Removing ICC authority over rail mergers would result in according greater consideration to the anticompetitive effects of mergers, while paying relatively less deference to their effects on particular competitors. And we obviously think this desirable. And yet -- and this cannot be overemphasized -- we do not believe in, nor are we proposing a system in which some ivory tower definition of competition would be the only factor in rail merger cases.

We expect that under our proposal the courts would be presented with extensive argument on the effects of a proposed merger in terms of maintenance of a balanced transportation system, continuation of vital rail services, enhancement of rail safety, and protection for shippers, railroad employees, and communities affected by the mergers.

In the end, however, we must keep returning to competition, because it is our fundamental belief -- a belief that underlies this entire bill -- that competition is the best protector of these interests. Thus, a merger policy that preserves and enhances competition -- in light of the realities of the affected marketplace -- is one that directly, effectively and efficiently protects shippers, transportation competitors, employees, and communities.

In this context, it might be illuminating to review briefly a few of the Supreme Court's decisions in rail merger cases and to note the types of concerns it addressed and how it weighed them.

In Seaboard Air Line RR et al v. United States et al, 382 U.S. 154 (1965), the Court upheld the Commission's approval of a merger between the Atlantic Coast Line Railroad Co. and the Seaboard Air Line Railroad Co.

During the administrative proceedings before the Commission, the applicant railroads argued that the merger would yield significant transportation benefits: lower operating costs, improved service, and reduced duplication of facilities. Other carriers argued it would have adverse competitive effects, an argument supported by the Department of Justice. The Commission rejected these concerns, stating:

> [W]e conclude and specifically find that (1) the reduction of rail competition caused by the proposed merger will not be substantial; (2) ample competitive rail service will remain after the merger throughout most of the affected area, and (3) such reduction in competition as will result from

> the merger will have no appreciably injurious effect upon shippers and communities... (320 I.C.C. 122, 167).

It is particularly interesting to note the type and amount of competition that the Commission deemed satisfactory in this case:

> There is no question that there will be a significant reduction in rail competition in Florida. However, the overall reduction in rail competition in the Southeastern states viewed as a whole will be relatively moderate when considered in light of the alternative rail service that will be provided by competitors of the merged company at practically all of the major industrial centers throughout the affected area. The impact of this reduction in competition becomes even less significant when we consider the increasingly strong competition that the merged company will encounter from other modes of transportation. The competitive effect of the merger will be further minimized by the fact that it will result in the elimination of rail competition, for the most part, only at a number of smaller cities and counties and will not affect the overall competitive picture in the Southeastern region (382 U.S. 154, 166).

The Supreme Court upheld the ICC, noting approvingly the Commission's conditions regarding preservation of existing routing and gateways and the Commission's discussion of the importance of intermodal competition.

Three years after it decided the Seaboard case, the Supreme Court was faced with an unusually complex rail merger proposal -- the Penn-Central Merger and N&W Inclusion Cases, 389 U.S. 486 (1968). The facts of the case are sufficiently recent and familiar as to need no repetition here. Suffice it to say that the merger, particularly with all of the approved inclusions, constituted a significant diminution of competition.

In affirming the Commission's approval of the merger, the Supreme Court relied heavily on the Commission's findings that motor and water carriers, as well as nonmerged railroads serving the affected area, would offer adequate competition to the new road, and that the merger would yield significant transportation benefits, stating:

> With respect to the lessening of competition where it now exists between the roads to be merged, the Commission pointed out that it will retain continuing power over reductions in service and facilities... It also noted that the rail service by the merged company will remain subject to vigorous competition from other roads...and from motor, water, and air carriers... (*Id.* at 502).

Finally, as in the merger decisions discussed above, the Court discussed the general question of the relationship between antitrust and transportation policies.

> It is, of course, true that the policy of Congress, set forth in the Transportation Act [of 1940], to consolidate the railroads of the Nation into a 'limited number of systems' is a variation from our traditional national policy, reflected in the antitrust laws, of insisting upon the primacy of competition as the touchstone of economic regulation. Competition is merely one consideration here... This departure from the general and familiar standard of industrial regulation emphasizes the need for insistence that, *before a rail merger is approved, there must be convincing evidence that it will serve the national interest and that terms are prescribed so that the congressional objective of a rail system serving the public more effectively and efficiently will be carried out*. Obviously, not every merger or consolidation that may be agreed upon by private interests can pass the statutory tests.
>
> Examination of the record of the findings in the present case, however, satisfies us that the Commission has properly and lawfully discharged its duties with respect to the merits of the merger. As the Commission concluded, the evidence before it, with negligible exceptions, attested to the probability of significant benefit from the merger, not only to the railroads and their investors, but also to shippers and the general public. (*Id.* at 499-500; citations omitted; emphasis supplied.)

This case thus serves as an important and recent reminder that while preservation of competitors is not the sole question to be addressed in a rail merger proceeding, the preservation of competition -- sufficient to assure needed transportation service and overall efficiency of the transportation system -- is crucial. This would be true under our proposal just as it is today.

The most recent major rail merger case considered by the Supreme Court, and one of especial interest to you, is the so-called "Northern Lines" case, United States v. Interstate Commerce Commission et al, 396 U.S. 491 (1970). This case dealt with the creation of the Burlington Northern Railroad through the merger of the Great Northern Ry. Co., the Northern Pacific Ry. Co., the Pacific Coast RR Co., the Chicago, Burlington & Quincy RR Co. and the Spokane, Portland & Seattle Ry. Co. The Commission approved the merger, notwithstanding the fact that the Northern Pacific and the Great Northern were direct competitors whose numerous previous attempts to merge had been denied as anticompetitive. The final success of the merger proposal (at the Commission level) was predicated primarily on the protective conditions agreed on with respect to the Milwaukee and C&NW Railroads.

The case was appealed to the Supreme Court by the Department of Justice, which argued:

> ...under the statute when a proposed merger will result in a substantial diminution of competition between two financially healthy, competing roads, its anticompetitive effects should preclude the approval of the merger absent a clear showing that a serious transportation need will be met or important public benefits will be provided beyond the savings and efficiencies that normally flow from a merger... (Id. at 506).

The Court was thus forced to address the questions of whether Congress intended to permit parallel mergers and of Congress' general policy toward rail mergers. The Court based its approval of the merger primarily on deference to the administrative expertise of the ICC -- and the philosophy of the Interstate Commerce Act that protective conditions, gateway, preservation, and similar regulatory requirements could effectively substitute for the reduction in the number of competitors.

The Court then outlined some of the legislative history of rail merger legislation, suggesting that the Congressional goal of encouraging mergers effectively required the ICC and the courts to weigh merger proposals in a very untraditional way: that is, with a clear bias toward "corporate simplification," even at the cost of a more competitive transportation system.

One other issue noted in the Court's opinion merits quotation here, and that is its analysis of the advantages of the merger, since that analysis indicates the kind of benefits to the transportation system and protective conditions for other railroads the Court believes must exist if a merger -- particularly a parallel merger -- is to be approved:

> Shippers will benefit from improved car supply, wider routing, better loading and unloading privileges, and improved tracing and claims service. New Company will be able to use the shortest and most efficient routes while eliminating yard interchange delays, thus providing shippers with faster service. The Commission found that the economies New Company will realize as a result of consolidating yards, repair facilities, and management, eliminating duplicate train services and pooling of cars and trains will result in lower rates to shippers and receivers.

In this context, I suggest to you that if a rail merger proposal arose under the antitrust laws, and presented these kinds of benefits, it would still be approved. The difference is only that the bias in favor of mergers would be eliminated -- leaving merger proposals to be weighed on their own merits.

The points I want to emphasize from this brief tour through rail merger cases are basically two: first, that antitrust analysis does require examination of a broad range of factors of which the number of competitors is only one; but, second, that the multitude of social criteria imposed on mergers by the Interstate Commerce Act, and the discretion afforded the ICC under that Act, tend to overshadow competition.

We believe that our proposal will, first, speed up the review process for rail mergers, so that the economic and marketing conditions that prompted the merger talks will still exist when the merger is consummated. Second, it will treat rail mergers like others, removing the special, onerous, expensive, and counterproductive burdens that are now imposed on the railroads. Third, by emphasizing the primacy of competition, our proposal will more effectively protect shippers, communities, and other carriers than does the current law. Fourth, antitrust analysis will assure continued scrutiny of shipper, community, employee and overall transportation needs and the importance of a balanced, efficient transportation network. Fifth, our plans to modify the 401 process will make lesser restructuring proposals more attractive, limited, and viable than the sometimes overly broad merger conceptions. Sixth, and there isn't time to develop this fully, but our deregulation proposals generally will remove some of the pressure to merge, by allowing the price and service flexibility railroads need to compete effectively. And, finally, our proposals will bring rationality and coherence to a regulatory area too long beset by conflicting statutory goals, and confusing administrative regulations.

I'd be very pleased to answer your questions. Thank you again for the opportunity to be here today.

FOOTNOTES

1/ McLean Trucking Co. v. United States, 321 U.S. 67, 87-8 (1944). Although this is a trucking case, the Court stated that: "Nothing in [the Interstate Commerce Act] indicates an intention to create one authority for rail consolidations and another for motor mergers. Identical provisions govern both..." (Id. at 78-9).