Houston is 2,768 miles--over 70 percent longer than the present SPT route (1,625 miles) that applicants would use to handle this traffic after the merger. The UP/MP Central Corridor Los Angeles-Dallas route is 2,541 miles, as compared to ATSF's present (and SPSF's future preferred) route of 1,641 miles. The UP/MP Los Angeles-New Orleans route is 2,944 miles, while SPT's single-line route is 1,978 miles. Similar comparisons can be made from the Bay Area. For example, the UP/MP Bay Area-Houston route is over 2,900 miles, as compared to the present ATSF and SPT routes, each of which is just over 2,000 miles.45/

Traffic share data in evidence confirm the inability of the Central Corridor to handle this traffic. The analysis by UP/MP of rail shares for traffic moving between Los Angeles and San Francisco BEA's, on the one hand, and Dallas, Houston, New Orleans, and Atlanta BEA's, on the other, shows a combined ATSF/SPT share of at least 92.4 percent for each individual origin-destination pair. For several of the pairs, the combined ATSF/SPT share is 100 percent.46/ An analysis by the State of California of rail shares for traffic flows between the Los Angeles Basin and the Bay area, on the one hand, and the South Central and Southeast States, on the other, shows combined ATSF/SPT shares of at least 90 percent for almost all individual flows.47/ In UP Control, we found that the Southern Corridor was used for 65.9 and 85.8 percent of Northern California (including San Joaquin Valley) rail traffic to and from the South Southeast and South Central States, respectively. For Southern California rail traffic, the comparable percentages were 84.9 and 95.9.48/ As an example of the Southern Corridor's dominance of this traffic, UP/MP does not even bid on minilandbridge traffic moving from West Coast ports to Gulf Coast or South Atlantic ports.49/

We have defined the appropriate product market as rail transportation. Much Southern Corridor traffic, in particular, requires movement by rail rather than by other transportation modes. Distances over which Southern Corridor movements would

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45/ UP/MP-23, VS of Matney at 8; UP/MP-24, VS of Barber at 12-13.

46/ See UP/MP-24, VS of Barber, Fig. 5, and the tables shown supra. However, some of this traffic moved in SPT joint-line routings through the Central Corridor, particularly Atlanta to Bay area traffic, only 52 percent of which had Southern Corridor routings.

Similar data for the San Joaquin Valley would not be equally revealing of the relative importance of the corridors, because ATSF and SPT would hold a 100 percent share of the rail traffic regardless of the corridor it moved over. Nevertheless, it is logical that to the the extent traffic cannot be moved efficiently over the Central Corridor between the Bay area and Gulf/South Southeast points, movement between the San Joaquin Valley and those points over the Central Corridor would be even less efficient.

47/ CPUC-5, VS of Williams, Appendix A, Tables A-15, 18, 26, and 29. The Southeast includes North Carolina and Tennessee, in addition to the South Southeast. The South Central States are Texas, Louisiana, Arkansas, and Oklahoma. See Williams, p. II-13. KCS submitted similar data. See KCS-14, VS of Levin, Tables 1 and 2.

48/ UP Control, Tables 1 (at 508) and 7 (at 520).

49/ Tr. 8782, 8797.

travel are generally well over 1,000 miles, making trucks ineffective competitors for most commodities. Shippers using TOFC/COFC service, which accounts for the largest portion of Southern Corridor rail movements, have indicated why transportation economics disfavor use of motor and water transportation for the movements of trailers and containers. Chemicals, assembled automobiles, food products, iron and steel, and cotton are heavily represented in Southern Corridor movements, and shippers of those commodities have also explained why, economically, those movements must be by rail.[50] The record is replete with evidence of the inability of shippers to depend on modes other than rail for significant movements of many important commodities.

The record also demonstrates that ATSF and SPT compete with each other for substantial Southern Corridor traffic and that shippers have come to depend on that competition to maintain favorable rates and service. American President Lines states that applicants historically have been strong competitors for foreign intermodal traffic between California ports and the Gulf. This competition has provided it with rail contracts containing better rate and service packages than it might have otherwise received. Without this competition, rates for joint water-rail service could rise to the level of all-water service rates.[51] Several of Dow Chemical's rail transportation contracts were established as the direct result of ATSF-SPT competition.[52] National Piggyback Services has experienced constant incremental improvements in service by both railroads and extremely competitive pricing. Each railroad has been impelled to meet the price reductions of the other.[53] Armco's ability to compete in Arizona for the movement of grinding balls from Kansas City was the result of ATSF's efforts to devise a rail-truck movement to substitute for SPT's service.[54] Calcot details competitive moves by SPT and ATSF over a 10-year period that have kept rates at a reasonable level. The diversion of Calcot's and other shippers' traffic from ATSF to SPT forced ATSF to keep open a ramp at Bakersfield that it had intended to

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50/ For example, UP/MP-23, VS of of Hemb, Thompson; UP/MP-24, VS of Barber; UP/MP-33, VS of Bryant, Corcoran, Crouch/Green, Gilb, and Moore.

51/ UP/MP-23, VS of Orris at 4-6.

52/ UP/MP-23, VS of Thompson at 6.

53/ UP/MP-23, VS of Matney at 4-5.

54/ UP/MP-33, VS of Brewer at 7.

close.[55] Again, these are simply examples from an extensive record documenting competition between applicants for Southern Corridor traffic. They are supported by evidence showing that SPT and ATSF have comparable rail shares for almost all of the traffic flows between the San Francisco and Los Angeles BEAs and the four southern BEAs previously mentioned. For the 16 traffic flows (eight each eastbound and westbound), only in four of them did the carrier with the smaller share fail to obtain at least one-third of the rail market.[56]

Nor can there be any doubt that a substantial amount of traffic is at stake. As an example, the State of California's study includes estimates of 1982 rail traffic moving between the four South Central States and the Los Angeles Basin, South San Joaquin Valley, and the Bay Area, which traffic would logically take Southern Corridor routings. Between the Los Angeles Basin and those States, over 1.6 million tons moved eastbound and almost 3.2 million westbound. The comparable figures from and to the South San Joaquin Valley were 215,000 and 219,000 tons and from and to the Bay Area 663,000 and about 1.45 million tons.[57] According to applicants' own evidence, rail volume between Los Angeles and the Texas Coast in 1982 amounted to 1.8 million tons, divided almost equally between MLB and other traffic.[58] APL ships 12,000 containers a year between California ports and the Gulf.[59] Dow cites Federal Railroad Administration statistics indicating that 20,560 carloads containing almost 1.6 million tons of chemicals and allied products were shipped by rail from Texas and Louisiana origins to California destinations in

55/ UP/MP-33, VS of Crouch and Green at 5-6.

56/ See VS of Barber, Figures 3 and 4.

57/ See CPUC-5, VS of Williams, and Appendix A to that statement.

58/ UP/MP-26, VS of Murphy (Barber, App. E) at B-1 and 2.

59/ UP/MP-23, VS of Orris at 4.

1982.[60] NPS shipped 20,000 trailer loads over the Southern Corridor in 1983.[61]

Our citation of these figures should not be taken as reflecting an assumption that this traffic volume is static. In fact, there is reason to expect that the amount of rail tonnage across the Southern Corridor will increase. The introduction of double-stack containers, referred to at many points in the record, may accentuate rail's advantage over truck for Southern Corridor container movements. In the future, increased highway taxes and fuel costs may reduce motor carrier effectiveness for many categories of traffic. Moreover, the States most dependent on Southern Corridor routings have experienced considerable recent growth. Los Angeles County ranked first in the nation in 1983 in manufactured goods shipments (valued at $69 billion), and 10 other California, Texas, and Arizona counties ranked in the top 50. California has a gross state product of about $400 billion a year, greater than the gross national product of all but six foreign countries.[62]

For all of these reasons, we cannot accept or authorize the creation of a rail monopoly across the Southern Corridor. Applicants have attempted to show that consolidation of their systems would not be harmful to the shipping public, because other modal options are available for this traffic and applicants compete for very little of it now. As noted earlier in this decision, applicants' studies supporting these assertions are based on faulty assumptions and are seriously flawed. In fact, the evidence demonstrates that a considerable amount of traffic requires movement by rail across this corridor if it is to move economically, that there are no other Southern Corridor rail options to applicants' service, and that many shippers now rely on applicants' competition to maintain favorable rates and service. The amount of traffic requiring rail competition is substantial. Moreover, a consolidation, once approved, would continue to exist indefinitely. Its monopolistic character could only be undone with extreme difficulty if changed transportation conditions or growth in production make California and the southern tier of States even more dependent on a single Southern Corridor railroad.

We conclude that competitive rail options are necessary for transcontinental traffic requiring movement across the Southwest between the major California areas now experiencing rail competition (Bay Area, San Joaquin Valley, and Los Angeles area) and the origins and destinations of that traffic in eastern Texas and beyond. In addition, Phoenix and other California points (primarily in the San Joaquin Valley) located on applicants' Southern Corridor routes and now served exclusively by applicants must be assured of competing rail service for all interstate traffic. Even at California points not served by both ATSF and SPT, the use of TOFC ramps enables both carriers to compete for substantial amounts of traffic. Thus, that entire area must be assured of continued rail competition comparable to that now available before the consolidation could be approved.

One further Southern Corridor problem requires consideration in this section, that of Los Angeles Basin transcontinental traffic moving to or from points other than those already discussed. This traffic can move over either of applicants'

60/ UP/MP-23, VS of Thompson at 3.

61/ UP/MP-23, VS of Matney at 4.

62/ UP/MP-24, VS of Barber at 8.

Southern Corridor routes, in connection with their routes to Midwest gateways where necessary, and over UP/MP's route between Los Angeles and Salt Lake City, in connection with UP/MP's Central Corridor routes between Salt Lake City and the Midwest.

The Los Angeles Basin is an extremely important origin and destination for traffic moving to or from the Northeast, the North Central States (Nebraska, South Dakota, North Dakota, Iowa, Minnesota, and Wisconsin), and the States of Kansas and Missouri. Based on 1982 data (CPUC-5, VS Williams, Tables A-15 and A-26), the Los Angeles Basin accounted for the origination of 2.2 million tons and the termination of 7.9 million tons of the described traffic. The following data focus on the shares of this traffic held by SPT, ATSF, and UP:

Traffic Flow	Tonnage	SPT	Market Share (%) ATSF	UP	SPSF
	(000)				
From Los Angeles to:					
N. Central States	106.0	26.0	25.2	48.8	51.2
KS and MO	305.5	30.7	42.2	27.0	72.9
Northeast	1,827.6	22.7	47.4	29.9	70.1
To Los Angeles From:					
N. Central States	3,126.6	19.8	21.9	58.3	41.7
KS and MO	1,021.6	30.8	48.7	20.5	79.5
Northeast	3,711.5	39.1	44.8	16.1	83.9

The above data clearly show that, even with an SPSF merger, UP/MP would hold approximately half of the rail market for traffic moving between the Los Angeles Basin and the North Central States. However, the merger unquestionably would place SPSF in control of approximately three-fourths of the traffic moving between the Los Angeles Basin and Kansas, Missouri, and the Northeast, representing a substantial reduction of competition in a very significant market.

Moreover, in Tucumcari, we authorized sale of the Rock Island Tucumcari line to SSW in large part because, with the decline of the Rock Island, traffic between southern California and Kansas City and Chicago had been diverted to the UP and ATSF routes, and we wished to create an additional option for shippers. Tucumcari, at 343. This merger would again reduce shippers' options to two routings for that traffic.

C. The Central Corridor

Introduction

The Central Corridor embraces three of the seven competing routes for transcontinental traffic. These are the UP/MP (formerly WP-UP) single-line route, and the SPT interline route with either the DRGW or the UP/MP. The Northern Corridor contains two principal routes, one operated by the BN, the other by UP (UP's Pacific Northwest lines connect to its Central Corridor route near Green River, WY), and the Southern Corridor contains applicants' two competing routes. Because the Central Corridor has a natural advantage for certain transcontinental traffic, it has sometimes been treated as a separate market. UP Control, 366 I.C.C. at 507; Tucumcari, 363 I.C.C. at 383.

The Central Corridor has been and remains the most heavily used transcontinental rail route. In UP Control, the Commission found that the Central Corridor had the following market shares: (A) between Oregon and Northern California and the East (62 percent for both Oregon and Northern California), and mid central (77.0 and 79.3 percent respectively); (B) between Oregon and the South (57.4 percent) and south central (44.5 percent); and (C) between Northern California and north central (70.2 percent).63/ This territory generates $1.4 billion in rail revenues annually.

Central Corridor rail operations move traffic between interchange points in the East and its numerous gathering or distributing points in the West. Eastbound traffic moves first to the Ogden gateway by UP/MP or SPT, which handle the traffic in the Central Corridor's west end. The traffic then moves over the Continental Divide on UP or DRGW to the interchange points on the Great Plains or the Mississippi River. Westbound movements simply reverse this process.

The grant of trackage rights to DRGW between Pueblo, CO, and Kansas City in UP Control ensured the continuation of competitive outlets at the Central Corridor's east end. Kansas City is a major interline point served by several long-haul carriers.

SPT and the Central Pacific Conditions

SPT involvement in the Central Corridor has consistently been subjected to elevated public scrutiny since SPT first leased Central Pacific Railroad (CP) in 1885 and then purchased CP's stock in 1899. Plans to merge SPT and CP were prevented in 1922 by the Supreme Court. It held that SPT control over both a Southern Corridor route through El Paso, TX, and a portion of the Central Corridor route violated the Sherman Act. Consequently, it ordered severance of CP from SP. United States v. Southern Pac. Co., 259 U.S. 214 (1922) (Southern Pacific). Only the intervention of the Congress, while the Southern Pacific case was pending, prevented an SPT-CP breakup. During that time, Congress adopted the Transportation Act of 1920, which amended former section 5 of the Interstate Commerce Act to allow Commission approval of acquisition or control by one railroad of another and to allow such approval to supersede the antitrust laws.

The Commission approved an SPT application for control of CP, subject to conditions to assure the continued use of the Central Corridor for traffic for which it would be efficient. These conditions became known as the Central Pacific, or CP conditions. See Appendix F. Generally, the conditions precluded SPT from preferring its long haul over the Southern Corridor, by focusing on non-discrimination (or equalization) in rates, and preferential solicitation. For 43 years, the primary beneficiary of the CP conditions was the Union Pacific. CP Control, 76 I.C.C. 508 (1923).

In 1962, the Commission denied a request of the DRGW to eliminate SPT's preferential solicitation arrangement with UP for traffic moving from Central Pacific territory through Ogden.

63/ For a breakdown of market shares in transcontinental traffic moving by carrier and corridors prior to the WP/UP consolidation, see UP Control, 366 I.C.C. at 508-9. "Northern California" here includes the Bay area and the San Joaquin Valley. These statistics are cited to show only that the Central Corridor is heavily used, not that it is the only available routing for all of this traffic.

[Condition (e) of the CP Conditions.] CP Control, 317 I.C.C. 469 (1962). However, the Commission's initial treatment of this issue was set aside by the United States District Court for the District of Colorado in Denver & R. G. W. R. Co. v. ICC, 229 F. Supp. 249 (D. Colo. 1964). In accord with the court's decision, the Commission reviewed the CP conditions and granted the DRGW similar rights, recognizing that DRGW offered similar routing capacity, and that extension of CP conditions to other carriers would strengthen the Central Corridor route. CP Control, 328 I.C.C. 345 (1966).

Although the CP conditions favored UP over the DRGW, the DRGW, which was in receivership in 1923, had supported the conditions. See CP Control, 317 I.C.C. 469, 472 (1962). The conditions encouraged DRGW participation in the transcontinental freight traffic market. DRGW participation was noted in CP Control, id. at 474: "[In 1924, DRGW] bridge traffic accounted for only 9.04 percent of the total tons handled by the Rio Grande, and 16.28 percent of its total freight revenue; whereas, in 1958, the corresponding figures were 34.72 percent and 51.18 percent. DRGW's highest percent of bridge traffic was 56.58 percent during the Second World War." By comparison, in recent years its bridge traffic has fluctuated between 26 and 29 percent of its total traffic base.

In Finance Docket No. 2613 (Sub-No. 1), Control of Central Pacific by Southern Pacific, ___ I.C.C.2d ___, slip op. at 14, served June 24, 1986, (Termination--CP--Conditions), the Commission removed the CP conditions to the extent they benefited UP, but retained Condition (e) for the benefit of DRGW, pending resolution of the instant proceeding. The Commission based its decision on the earlier acquisition by UP of the WP line connecting the Bay Area and Sacramento with Salt Lake City, thus removing UP's dependence on SPT as a source of traffic at the Ogden gateway.

The removal of the CP conditions for the benefit of UP was based on two findings: that the continuation of CP conditions was (1) "detrimental to transcontinental competition" and (2) "adverse to SP's financial viability and its ability to compete." Termination--CP--Conditions, slip op. at 1.

The Commission found that:

> SP, in effect, is forced to provide service and schedules not clearly related to demand. Consequently, service is provided where there is little or no economic justification or withheld where justification exists. Thus, these conditions erode SP's financial viability because they prevent it from using the actual demand for services and schedules to maximize its revenues.
>
> The removal of the CP conditions . . . will improve SP's otherwise declining financial viability as well as its ability to provide essential services . . . . While our primary concern must be with the preservation and enhancement of competition and of the market share of the individual carriers, it nevertheless appears reasonably certain that expanding SP's competitive opportunities will enhance its financial viability without having an unacceptable adverse impact on regional competitors or essential services.

We also found that discontinuing SPT's forced solicitation of traffic for UP would improve SPT's financial viability and enhance its ability to cover fixed charges. Id. at 12.

Condition (e) was preserved as to DRGW, because the condition does not act as a per se bar to rate or service competition. Although it requires preferential solicitation of the Central Corridor route for certain traffic, it does not prevent SPT from developing competitive rate and service packages for its Southern Corridor routes. In addition, removal of Condition (e) was denied for lack of evidence on the volume of traffic likely to be affected by its removal, and for lack of evidence of its effect on DRGW and the Central Corridor route. Id. at 15.

Effect of the UP/MP/WP Merger

With approval of the UP/MP/WP merger in 1982, the picture in the Central Corridor changed substantially. UP lost its incentive to interline traffic with SPT in Utah, and MP lost its incentive to interline traffic with DRGW in Colorado. This would have resulted in the loss of a competitive alternative route to the UP for transcontinental traffic through the Central Corridor. The problem was addressed by granting the DRGW trackage rights between Pueblo, CO, and Kansas City. Access to the important Kansas City gateway ensured DRGW independent interline partners at the Central Corridor's east-end connection for transcontinental traffic. This condition, "by enhancing and stimulating competition in the Central Corridor" was found to provide "substantial public benefit." UP Control, 366 I.C.C. at 576. This condition was supported by DOJ, DOT, and the State of California, to mitigate the harm arising from the "reduction in competitive alternatives for some shippers in the Central Corridor . . . ." Id. DRGW trackage rights were designed to place DRGW "in a position to provide competitive transcontinental service through the Central Corridor, and will add a competitor for all transcontinental traffic." UP Control, 366 I.C.C. at 578.

SPT was granted trackage rights eastward, between Kansas City and St. Louis. This created a competitive joint-line trackage rights operation from SPT territory in California, through Pueblo, CO, to the Mississippi River. It was expected that: "SPT's operation in this corridor will enhance competition in the Central Corridor and between the Central and Southern Corridors for transcontinental traffic." UP Control, 366 I.C.C. at 580. The Commission noted that SPT exclusively served 12,800 shippers in Northern California and Southern Oregon, and thus these combined trackage rights would mitigate the loss of UP as a friendly connection for SPT in Utah. Id. at 515.

As a consequence of the UP/MP/WP merger, SPT and DRGW entered into a solicitation agreement that provides that the parties:

> . . . Shall use their best efforts to influence eastbound and westbound transcontinental traffic via SP and DRGW over the Ogden gateway from and to SP and its connections between Portland, OR on the north and Salinas, CA, Los Banos, CA and Chowchilla, CA on the south . . . .
>
> The parties also agree to use their best efforts to develop the SP-DRGW-SSW route via the St. Louis gateway.

SPT/DRGW Agreement, January 19, 1983, Section 1.

Pursuant to this agreement, SPT and DRGW have interchanged over 100,000 carloads annually. The agreement is due to expire in 1987.

In determining to impose corrective actions in UP Control, the adverse competitive effect of the UP consolidation on all alternative transcontinental routings was examined. We determined that BN's northern routes offered limited competition for California shippers, primarily between northern California and the North Central States. UP Control, supra at 518 and n. 50.

Existing Competitive Situation

There are now three Central Corridor transcontinental routings: UP single-line; SPT-DRGW; and SPT-UP. On the West Coast, UP single-line service is available primarily for the Bay Area, the Sacramento Valley and parts of northeastern California, because UP's Central Corridor lines extend only to these areas. The SPT joint-line routings, however, are available to serve an extensive area from western Oregon through the San Joaquin Valley, including the Bay Area and northern California.

Prior to the incorporation of WP into the UP system, WP and SPT competed with each other and provided friendly interchanges with both UP and DRGW. In 1982, WP interchanged 39 percent of the DRGW's overhead traffic and SPT interchanged 61 percent. After the UP/WP merger, in 1983, SPT's interchanged share with the DRGW at Ogden had risen to 86 percent of DRGW's traffic and accounted for 94 percent of DRGW's interchanged traffic at Ogden for the last 6 months of that year. During the first 5 months of 1984, SPT's interchange share of DRGW's overhead traffic was 97 percent. (DRGW-14, VS Brainard at 13). Stated in terms of carloads, in 1981, the DRGW-WP traffic amounted to nearly 49,000 carloads and trailerloads. After the UP merger, this traffic declined to less than 3,000 cars/trailers in 1984. Conversely, the SPT-DRGW interchange at Ogden markedly increased from about 88,000 carloads (all traffic, regardless of how it moved on DRGW) to nearly 107,000 carloads in 1984 (in 1982 there was a decline to 75,000 cars reflecting the recession). See DRGW-33, Vol. 11, VS A.L. Thiessen, and Exhibit SFSP-C-115. Rio Grande is now totally dependent on SPT at Ogden for the interline movement of transcontinental traffic over DRGW lines.

Characteristics of SPT's Ogden Gateway Traffic

Data submitted by CPUC details the interregional traffic flows for all traffic interchanged by SPT at Ogden (in other words, to/from both UP and DRGW).[64] The data reveal that the traffic originated by SPT moving via Ogden amounted to approximately 4.1 million net tons in 1982, while westbound, about 5.5 million net tons were received at Ogden and terminated by SPT. In the following discussion, "Bay Area" is the area comprised of San Mateo, Santa Clara, Alameda, and Contra Costa Counties. "Northern California" is comprised of four sub-state groups of counties as used in the evidence submitted by CPUC: (1) Northwestern California, (2) Northeastern California, (3) Sacramento Valley, and (4) the North San Joaquin Valley.[65]

64/ CPUC-5, VS of Williams at II-54 and II-58.

65/ CPUC's "North San Joaquin Valley" refers to the counties at the northern end of the valley served not only by applicants, but also by Union Pacific. CPUC's area designated "South San Joaquin Valley" includes Merced, Madera, Fresno, Tulare, Kings and Kern Counties. Our own references to the "San Joaquin Valley" encompass the same area as CPUC's "South San Joaquin Valley".

These four sub-state areas lie north and east of the Bay Area, and generally north of Merced, Mariposa, Mono, and Alpine Counties.

With respect to the overall traffic flows moving via SPT's Ogden gateway, approximately one-fourth of the eastbound tonnage (interchanged by SPT at Ogden) originated in Oregon (1.1 million out of 4.1 million net tons), and Northern California accounted for almost 20 percent. The Bay Area, Nevada/Utah, and the San Joaquin Valley each accounted for the origination of about 15 percent of the eastbound traffic.

In terms of the areas in which the eastbound Ogden traffic terminates, the principal areas are the Northeast (40 percent), Utah/Colorado (17 percent), and the South Central States ([illegible] percent.) The bulk of the traffic terminating in the Northeast originated in Oregon, Northern California, the Bay Area, Nevada/Utah, the San Joaquin Valley, and "Southwest California" (basically the counties served by SPT's Coast Line north from the Los Angeles Basin to Santa Clara County). Nearly all of the traffic which terminated in Utah/Colorado originated in Oregon, Northern California and the Bay Area. Traffic originated in Oregon, Nevada and Utah accounted for nearly 90 percent of the terminations in the South Central States (Texas, Louisiana, Oklahoma, and Arkansas).

Westbound, SPT's Central Corridor traffic has characteristics quite different from those of the eastbound flow. Tonnage terminated in Oregon represented only about 8 percent of the westbound flow compared to nearly one-fourth of the eastbound flow. Traffic terminated in Oregon had origins distributed generally throughout the United States, with roughly 75 percent originating in the northern one-half of the 48 contiguous States.

The predominant westbound flow (nearly 78 percent of the 5.3 million net tons received by SPT at Ogden) terminated in Northern California, the Bay Area, and the San Joaquin Valley. Approximately 90 percent of the traffic moving to the Bay Area and Northern California originated in the northern half of the United States. Nearly the same was true for traffic terminated in the San Joaquin Valley, although in the latter instance, the North Central States and the States of Utah, Colorado, Idaho, Montana, and Wyoming originated traffic comprising the 90 percent portion: The Northeast accounted for less than 3 percent of San Joaquin Valley terminations.66/

Focusing specifically on the Bay Area, we see that traffic that originated there (652,500 net tons) moved predominantly to the Northeast (371,500 net tons) and to Utah and Colorado (166,300 net tons). Significantly, very little Bay Area traffic (about 5,000 net tons) was destined to the States of Oklahoma, Texas, Arkansas, and Louisiana in the Southern Corridor. Only slightly more (6,500 net tons) moved to the Southeast. A similar situation holds true with respect to westbound Ogden gateway traffic terminated in the Bay Area by SPT.

66/ In this discussion, we refer to SPT's Ogden traffic as having been originated or terminated by SPT. This is technically correct for 95 percent of the traffic of either class. The remaining 5 percent in each instance represents originations or terminations primarily by short-line railroads, or by UP, BN or ATSF. In the case of the identified carriers, each accounted for about 1 percent or less of the traffic.

Comparable statistics exist for San Joaquin Valley traffic. Of the 559,300 net tons originated by SPT in the valley and routed via Ogden, well over half (346,700 net tons) terminated in the Northeast. Less than one percent of the 559,300 net tons terminated in the Southeast, and an insignificant amount terminated in the South Central States. Westbound, over 1.4 million net tons of freight were received by SPT at Ogden and terminated in the San Joaquin Valley. Nearly one million net tons of the westbound traffic originated in the North Central States. Traffic originated in the South Central States and the Southeast destined to the San Joaquin Valley was de minimis.67/

Substitutability of Central and Southern Corridors

For some traffic under discussion here, a Southern Corridor routing might be as economical or efficient as a Central Corridor routing.68/ There is no specific evidence of the substitutability of these two corridors for particular traffic, but the suggestion that they are substitutable is supported by the fact that ATSF competes for Bay Area and San Joaquin Valley traffic, which it moves over its Southern Corridor route.

It is clear, however, that many West Coast shippers and receivers favor Central Corridor movements. As we stated above, this Commission has consistently recognized a Central Corridor advantage for some traffic. For the Bay Area and points north, the Central Corridor offers the most favorable transit times for transcontinental traffic, and the SPT-UP-CNW route between the West Coast and Chicago is the shortest active route for this traffic. Evidence submitted in this proceeding supports the existence of a Central Corridor preference. Of particular interest is CPUC's evidence of traffic flows from the Bay Area, Northern California, and the San Joaquin Valley to the Northeast. In 1982, SPT originated approximately 527,600 net tons of such traffic in the Bay Area, at least 435,000 tons in Northern California, and 473,000 tons in the San Joaquin Valley. Slightly over 70 percent of the tonnages from the Bay Area and the San Joaquin Valley and about 62 percent of the Northern California traffic moved via Ogden to the Northeast. It is reasonable to conclude that (1) the balance of the flows moved via the Southern Corridor, and (2) the Central Corridor clearly is the preferred route for these SPT traffic flows.

It is clear from the above that a significant amount of traffic must be afforded a Central Corridor movement. We cannot approve this merger without Central Corridor routing options.

Effect of the Merger on Central Corridor Routings

DRGW emphasizes that it and SPT are partners in the joint venture to provide competitive transcontinental through service over the Central Corridor. DRGW asserts that, as a consequence of the merger, it will lose SPT as an interline partner for a substantial amount of traffic, resulting in (1) the loss of a competitive through route over the Central Corridor, (2) the creation of a monopoly position for WP/UP for Central Corridor

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67/ These statistics confirm our earlier finding that the Central Corridor is not competitive with the Southern Corridor for San Joaquin Valley and Bay Area traffic to and from the Southeast and the South Central States.

68/ We exclude from this discussion traffic that clearly prefers the Southern Corridor, which was discussed in our section on the Southern Corridor.

movements, (3) possible collusion between SPSF and UP, with an SPSF monopoly in the Southern Corridor and a UP monopoly in the Central Corridor, and (4) unrestrained SPSF market power throughout the area in which DRGW seeks trackage rights and purchase. These results would occur because SPSF through its exclusive service at West Coast points now served exclusively by SPT or by SPT and ATSF, would seek to direct over ATSF's Southern Corridor route considerable traffic that SPT is now willing to interline over the Central Corridor.

CPUC expresses similar concerns. It expects that the Central Corridor SPT route would retain most of the eastbound traffic terminating in Utah, Colorado, Idaho, Montana, and Wyoming together with much of the Oregon traffic destined to the Northeast and the North Central States. On this basis, CPUC estimates that as much as 45 percent of the eastbound Ogden gateway traffic would be retained. As for westbound movements, CPUC believes at least one-half would be shifted to the Southern Corridor. The westbound traffic which CPUC believes would retain an Ogden routing is that which originates in the Northeast and the North Central States and terminates in Oregon, as well as movements originated in Idaho, Montana, Wyoming, Utah, and Colorado, and movements terminated in Nevada or Utah. Stated differently, CPUC asserts that at least 50 to 55 percent of traffic between Northern California, the Bay Area, and the San Joaquin Valley on the west, and points in the Northeast, the South Central States, the North Central States and the Southeast is likely to be diverted to the Southern Corridor by a merged SPSF.

The validity of these concerns is underscored by reference to applicants' operating plan, which shows that the merged system would favor SPSF's long-haul route over the Southern Corridor at the expense of Central Corridor joint-line traffic. Applicants state that:

> ATSF's Barstow yard, located east of Los Angeles will be used primarily as a northern California service yard and will receive and dispatch trains to and from the San Francisco Bay Area, Roseville, Eugene and San Joaquin Valley points. Traffic bound from Northern California from the East will generally be switched at Barstow, as is currently the practice for ATSF . . . . Traffic from Northern California headed for eastern points will be switched at Barstow for movement on eastward trains.
>
> Certain traffic will bypass Barstow. Examples are most eastbound TOFC traffic and a new train which is scheduled from Eugene, Oregon, to Kansas City. In some cases eastbound trains will originate at West Colton and fill with traffic from Northern California at Barstow. An example is a new train which will operate to the Conrail interchange at Streator, Illinois, without intermediate work after leaving Barstow.

SFSP-4, Vol. 5 at 56.

Four of applicants' new service patterns concern traffic that originates in or north of the Bay Area. These include new TOFC trains between the Bay Area and Texas/New Orleans, and new manifest trains from Eugene, OR, routed through Barstow to Kansas City "to take advantage of frequent eastward schedules out of Barstow." Id. at 46.

By the end of post-merger year four, the applicants' operating plan projects a decrease of 4.6 million gross ton miles

(MGTM), or 22.7 percent, on the SPT Central Corridor line between Roseville and Weso. A similar reduction is projected on the line between Weso and Ogden. The reduction in traffic from this line is reflected in a sizeable increase in traffic over the Southern Corridor. Due to internal rerouting of other traffic, the diversion of Central Corridor traffic, for example, is illustrated best in the increase of 11.1 MGTM on the line segment between Bakersfield and Mojave.[69]

The planned reduction in traffic in the Central Corridor is further reflected in the applicants' discontinuance of through trains OGOAF (Ogden to Oakland) and RVOGY (Roseville to Ogden), and divisional train OGSKY (Ogden to Sparks). The applicants indicate that traffic that formerly moved on the above trains will be handled on new or existing trains and consolidated with other service. However, the operating plan does not provide for the institution of any new trains over the Central Corridor, while it does for the Southern Corridor. Therefore, traffic previously moved on the discontinued Central Corridor trains, which has not been rerouted over the Southern Corridor, would apparently be combined into other trains, probably resulting in some traffic delays that would not exist absent merger.

Applicants' operating plan was based on the assumption that CP conditions would be removed, including Condition (e) in favor of the DRGW. Applicants' rebuttal traffic diversion study also reflected the end of the SPT-DRGW solicitation agreement. SFSP Opening Brief at 48-9. Applicants' testimony supported the possibility that the solicitation agreement would be terminated after the merger was consummated. Tr. at 17436, 18588, 42122, 63133. These developments would enable applicants to move traffic over the Southern Corridor to a greater extent than at present.

In support of the contention that SPSF would maximize use of its long-haul route at the expense of the Central Corridor route, SFSP's Chairman reported to the SFI Board of Directors, May 16, 1983, the following:

> It is believed from past analysis of the SP that substantial savings can be realized by consolidating facilities and equipment and by utilizing shorter, more cost efficient routes. The combined railroad will have better coverage of key shipping points and more single line hauls, thereby placing the merged entity in a better position to utilize the benefits of the Staggers Act. Enhancement of potential carrythrough could be in the range of $240-500 million per year after full implementation of the consolidation.

KCS-C-1 at 8.

Referring to the benefits of the Staggers Act, the SFSP's Chairman reported that:

> The Staggers Rail Act of 1980 . . . increased rate flexibility where single-line hauls can

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69/ For the 1982 base year, SPT operated 12 daily through trains between Weso and Ogden, transporting 23.3 million gross tons annually. Two of these through trains operated between Weso and Klamath Falls, handling 4.8 million annual gross tons to and from northern California and Oregon, while 10 trains and 20.3 million annual gross tons were destined to the greater Bay Area primarily within the "Central Pacific" territory.

> be employed. In such instances railroads have increased capability to control their participation or non-participation in joint line rates. The railroads demonstrating the most attractive financial results in the future will be those having the greatest coverage of important shipping points, the largest share of single-line movements and other geographically advantaged traffic. Mergers and consolidations can result in substantial Staggers Act benefits.

KCS-C-1 at 8.

Referring to interline movements, the Chairman stated:

> . . . the majority of most railroad's (sic) traffic is involved in some sort of interconnection with another carrier. This factor is a key to understanding the consequences of major rail consolidations, as wherever possible the combining carriers can be expected to reroute traffic interchanged with unaffiliated companies to the new combination.

KCS-C-1 at 24.

We have no doubt that SPSF would attempt to route substantial amounts of traffic over its Southern Corridor lines. We generally agree with CPUC that roughly half of the traffic interchanged by SPT at Ogden is at least susceptible to rerouting via the Southern Corridor. A merged SPSF would have substantially enhanced market power over this traffic by virtue of (1) the large portions of Northern California and Oregon served exclusively by SPT, (2) the creation of a rail monopoly for applicants in the San Joaquin Valley, and (3) the creation of more efficient combined routes via the Southern Corridor and via that Corridor and the main Chicago and St. Louis routes. Applicants' proposed operations discussed in Appendix C clearly indicate their intent to increase the use of southern routings and to shift traffic from the Central Corridor.

Given our conclusion that considerable West Coast traffic favors a Central Corridor routing, and that reduction or elimination of Central Corridor routing options presently available would be an unacceptable consequence of the merger, it is necessary to evaluate the effect on this traffic of applicants' anticipated Southern Corridor rerouting. It is helpful to analyze traffic preferring a Central Corridor routing by category, as follows:

(1) Traffic originating or terminating at West Coast points now served by both SPT and UP/MP (e.g. Bay Area and parts of northern California). This traffic now has two Central Corridor routing options, UP/MP single-line and SPT-DRGW joint-line.70/ Following an unconditioned merger, SPSF rerouting of this traffic would leave it with only one Central Corridor routing, UP/MP. In this respect, the merger would completely eliminate competition over the Central Corridor. This is unacceptable.

(2) Traffic now originating or terminating at SPT exclusively-served West Coast points (e.g. western Oregon and much of northern California). Although without competition for the western portion of movements, this traffic experiences competition between UP/MP and DRGW for movement east of

70/ We assume here that UP/MP would not choose to participate in a joint-line routing with SPT where it could handle the traffic entirely on its own system.

Ogden.[71] Following an unconditioned merger, SPSF's rerouting of this traffic over the Southern Corridor would replace existing competition over part of the preferred Central Corridor routing with a single, less desirable Southern Corridor routing, in effect eliminating not only competition over the Central Corridor but even the ability to choose a Central Corridor routing at all. This is also unacceptable.

(3) Traffic originating or terminating at West Coast points now served exclusively by SPT and ATSF (e.g. San Joaquin Valley). Although this traffic now experiences competition that the merger would eliminate, its Central Corridor options are the same as those of the traffic in the preceding category, because any competition provided by ATSF is over the Southern Corridor. Therefore, this traffic would suffer the same unacceptable loss of Central Corridor routing options after the merger as traffic now exclusively served by SPT.

We find the above effects of the merger anticompetitive, and the merger cannot be approved unless conditions can be imposed to alleviate them. We acknowledge that some shippers now moving traffic over the Central Corridor would be indifferent to applicants' rerouting it over the Southern Corridor. However, our analysis and conclusions focus on the need to preserve existing Central Corridor routings for shippers that find movement over that corridor economically preferable or necessary.

Accepting that SPSF would continue to route a certain amount of West Coast traffic over the Central Corridor, we have reason to be concerned about the preservation of Central Corridor competition even for this traffic. The diversion of substantial traffic to the Southern Corridor would significantly reduce the Central Corridor's traffic density. It is doubtful that the remaining traffic would be sufficient to sustain the SPT-DRGW transcontinental routing. UP/MP is a far larger and more powerful railroad than DRGW. With a more extensive system in the Midwest, UP/MP could be expected to exert greater leverage in connection with SPSF for the remaining Central Corridor traffic, especially westbound. A further substantial and unacceptable reduction in the density of the SPSF-DRGW interline route would be likely.

SPSF's increased incentive to maximize use of its Southern Corridor route would be accentuated by cessation of the SPT-DRGW solicitation agreement and removal of the CP conditions. The likely consequence of the merger would be the loss of SPT-DRGW Central Corridor traffic substantial enough to reduce the efficiency of the route. DRGW would no longer be an effective competitor for UP in the Central Corridor for shippers that depend upon the Central Corridor as the most efficient, direct, and natural route for transcontinental traffic.

In addition, DRGW's ability to provide effective <u>intra</u>-corridor service would be diminished along with reductions in transcontinental service. For example, DRGW anticipates a significant reduction in train schedules due to the loss of traffic density. The States of Colorado and Utah recognize this likely outcome, and DRGW estimates the following reductions in service as a result of merger:

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[71] The existence of this competition is illustrated by the fact that in 1983, SPT interchanged 108,741 carloads at Ogden with DRGW and 77,239 carloads with UP/MP. Exhibit SE-1, Table A.

PROJECTED TRAIN SERVICE OVER DRGW LINES - 1984 and POST-MERGER

Line Segment	1984 Actual	Post Merger	Percent Reduced
(Eastbound)			
Denver-Grand Jct.	1,125	602	46.5
Kansas City-Pueblo	1,061	354	66.7
Pueblo-Grand Jct.	1,136	354	66.7
Salt Lake-Ogden	1,593	354	77.8
(Westbound)			
Ogden-Salt Lake	1,714	354	79.3
Salt Lake-Grand Jct.	2,456	1,198	51.2
Grand Jct.-Denver	1,318	602	54.3
Grand Jct.-Pueblo	1,300	602	53.7
Pueblo-Kansas City	1,155	354	69.4

DRGW-33, VS Nance at 11.

It was to assure the existence of a competitive alternative in the Central Corridor that we imposed trackage rights for DRGW and SPT in UP Control, and we cannot ignore the reason for that decision here. While it may be true that with a more efficient SPSF Southern Corridor route some West Coast shippers that preferred the Central Corridor in the past could take advantage of inter-corridor competition,72/ those shippers who must rely upon the Central Corridor would suffer the consequences of a loss of effective SPT-DRGW competition if this merger were approved with no assurance that Central Corridor competition would be maintained. Applicants' proposal fails to address this problem in any meaningful way and thus can only be found to be highly anticompetitive.

We would be faced with a very complex set of interacting market forces if we were to grant the merger as proposed. On the one hand, approval would undoubtedly enhance applicants' ability to achieve more efficient operations over their combined southern routes by, in part, shifting as much traffic as possible from the Central Corridor to the Southern Corridor. On the other hand, in allowing this shift to take place, we would seriously jeopardize DRGW's competitive strength through the Central Corridor as a participant in transcontinental traffic and would reduce Central Corridor options for shippers requiring them. Ultimately, as DRGW argues, the result would be an unacceptable opportunity for creation of a rail monopoly over such traffic in each corridor, i.e, UP/MP/WP in the Central Corridor, and SPSF in the Southern Corridor. Loss of DRGW as an effective competitor would, in effect, allow one continuous, connected line of railroad through the Central Corridor to lie fallow. This would not promote efficient use of rail resources, given the directness of the route between the central Pacific Coast and the Midwest.

D. Midwest North-South Corridor

Parties allege that the merger would create anticompetitive effects in a variety of areas in the Midwest, principally as to

72/ DOJ and DRGW argue and we recognize that a reduction of competitors from 3 to 2 can result in significant anticompetitive behavior, such as collusion and mutual forbearance, so the duration of true inter-corridor competition is questonable. In 1982, there were 9,632,000 net tons of SPT traffic originating/terminating throughout California, Oregon, Nevada and Utah using the Central Corridor that might be subjected to this uncertainty. (VS of Williams and Schulte, Tables 16, 18.)

north-south rather than transcontinental traffic. Although each area presents unique contentions and must be evaluated individually, the anticompetitive effects are alleged to result primarily from vertical foreclosure, reduction in the number of competitors serving a market, and creation of a rail monopoly.

Vertical foreclosure can occur when the merged system is in a position to divert traffic from a competitor and foreclose it from continuing to compete. Reduction in the number of competitors from two to one, where the merging carriers have been the only competitors, creates the obvious problem of a monopoly. However, the mere reduction rather than elimination of competitors, e.g., from three to two, may create serious anticompetitive problems as well.73/

Southwest Kansas: ATSF has a network of lines in southwest Kansas. The SSW's Tucumcari line also runs southwest across Kansas from Topeka to the Oklahoma border near Liberal, and beyond. No other railroads have lines in this area. MKT alleges that the consolidation would create a rail monopoly in southwest Kansas, primarily for grain transportation. However, the State of Kansas finds no problems sufficient to justify conditions or denial.

Initially, it is worth noting that south and west of Hutchinson, ATSF and SSW serve no common points. However, the SSW line is roughly parallel to and never very far from an ATSF line. Thus, any present competition in this area would result from the ability of shippers to move grain to either railroad by truck. Analysis of the extent of this competition would have to consider both actual competition for the same grain traffic and the potential for either railroad to constrain the rate and service behavior of the other simply by virtue of its proximity.

There is little evidence of actual ATSF-SPT competition in the area. The two primary commodities shipped from Southwest Kansas are milo (grain sorghum) and wheat.74/ The 14-county Southwest Kansas Crop Reporting District produced over 1.4 million tons of milo in 1982. About 18 percent of milo shipments move to Arizona and California. However, because of the distances involved, this traffic is not truck competitive. The State of Kansas' analysis of waybill data indicates that SSW and ATSF hold approximately 53 and 45 percent of the rail share for milo traffic from Southwest Kansas moving over 500 miles. Nearly all of this is Arizona and California traffic. Thus, it appears that ATSF and SSW dominate these milo movements with fairly equivalent shares. It is still not clear from this, however, whether the railroads actually compete for this traffic. Much of it may have moved to exclusively served SPT or ATSF points. As to all other milo shipments, as well as wheat shipments generally, there is no evidence of ATSF-SSW competition for substantial traffic.75/ Shippers supporting MKT trackage rights did not furnish examples of Southwest Kansas traffic for which the two railroads have been

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73/ See, for example, MKT-25, VS of Tye at 49; UP Control at 526, 531.

74/ We rely on the State of Kansas' presentation in KANS-8 for much of the following discussion.

75/ There is some evidence of competition between the applicants for grain movements to the Gulf. See Tr. 11,288-11,296. However, the amount of involved traffic seems to have been small (one or two thousand carloads) and to have moved from Hutchinson, a point also on the UP/MP system, not directly from the area of Southwest Kansas in which applicants are the exclusive rail carriers.

competing, and which would be subject to a rail monopoly after the merger.

Similarly, except for general statements about the need to maintain intramodal competition in Southwest Kansas, MKT shippers did not submit evidence showing the presence of either railroad acting as a constraint on the rates and services of the other. In fact, several argued that it was not possible to truck grain even for short distances. These contentions, if true, undermine the position that the proximity of SSW and ATSF lines creates a competitive option for area farmers and shippers that can truck to either railroad.

The anticompetitive effects of the proposed consolidation on Southwest Kansas grain traffic appear to be limited. Of the over 1.4 million tons of milo produced in Southwest Kansas in 1982, 59.2 percent went to destinations (Kansas, Oklahoma, and Texas feedlots) less than 250 miles from the production area. Trucks are generally regarded as effective competitors for grain movements for distances of 250 miles or less, while movements of 500 miles or more are clearly rail dominant. In 1982, trucks transported 68 percent of southwest Kansas milo and railroads 32 percent.76/ This underscores the fact that the Southwest Kansas milo market is to a large extent a local market serving feedlots located within 250 miles. The State of Kansas estimates that applicants handled only 21.3 percent of the 1982 milo tonnage that moved less than 250-miles. The traffic for which the consolidation would remove all transportation options therefore seems limited to the small portion of shipments moving over 500 miles, primarily to Arizona and California as previously indicated. As an additional constraint, corn is a substitute for milo, and all corn shipments from Southwest Kansas in 1982 moved by truck.

For wheat, ATSF dominated the interstate rail market in southwestern Kansas in 1982, originating about 82.3 percent of interstate movements, including 93.5 percent of movements greater than 100 miles; SPT (SSW) handled almost all the remaining shipments. These figures seem to connote a lack of significant competition between applicants for these movements. Moreover, most Southwest Kansas wheat moves over distances of less than 250 miles to terminals, where it moves in larger volumes to Gulf destinations. Several major Kansas grain terminals, served by other railroads, are within 250 miles of most of Southwest Kansas.77/ Trucks are effective competitors for wheat within these distances. According to Kansas, trucks carried 40 percent of the wheat from Southwest Kansas in 1983, much more than SSW carried.

It is apparent that most Southwest Kansas grain is susceptible to truck diversion or at least may be protected by the constraint on railroad behavior resulting from the feasibility of truck movement. MKT's arguments that trucks are not feasible for long-distance grain movements such as to the Gulf are somewhat beside the point, because most grain from this area does not initially move these distances.

76/ KANS-8, VS of Moser, Appendix C.

77/ For example, Enid (MKT and BN) and Amarillo (BN) are within 201 highway miles of Liberal. SFSP-44, VS of Anderson at 73. Hutchinson, Salina, and Wichita, all served by UP/MP and the latter two by MKT, are within 250 highway miles of Liberal, according to the Rand McNally Road Atlas.

MKT alleges that the consolidation would be inconsistent with our decision in Tucumcari, which granted the Tucumcari line to SPT in part to provide additional competition. However, the competition addressed there was for long-distance traffic moving between Los Angeles and Kansas City, St. Louis, and Chicago. The relevance of that decision to the present Southwest Kansas issue is limited to its emphasis on the provision of reliable service to local shippers, many of which had no other rail service available. We were concerned not with restoring competition but with ensuring continuing rail service.78/ However, several parties supporting MKT's responsive application are concerned that the merger would threaten that local service, specifically through SPSF's downgrading or eliminating local service on the Tucumcari line in favor of long-haul through traffic, thus forcing local shippers to truck grain and other commodities to ATSF lines. Although applicants' operating plan calls for a reallocation of long-distance TOFC/COFC and manifest traffic between Los Angeles and the Midwest, we are not persuaded, based on the record, that local service would suffer. None of the changes in local freight service contained in applicants' operating plan pertain to Southwest Kansas, and we decline to speculate about the likelihood of changes beyond those indicated.79/

MKT also argues that it could be foreclosed from handling traffic originating on the SSW in Southwest Kansas and now subject to ATSF-MKT competition for further movement. We cannot rule out the possibility that such foreclosure could occur. However, the record does not reveal the amount of traffic that presently makes use of these competitive options. Considering the relatively small amount of traffic originated by SSW in Southwest Kansas and the destinations to which grain traffic from that area tends to move, this traffic does not appear significant. Moreover, in 1981, MKT handled only 2,264 carloads of grain from or to the Liberal-Topeka line. In 1983, the total carloads of all commodities had dropped to 450.80/

We acknowledge the possible loss of competitive options for shippers dependent on the Texas North Western Railway Company (TNWR), which operates a 120-mile line between Liberal, where it connects with SSW, and Etter, TX, where it connects with ATSF. TNWR fears SPSF abuse of market power due to the absence of any other connections. TNWR serves 12 grain elevators, 21 feed lots, and 5 other shippers. In 1983 it handled 2,834 carloads. Considering the small amount of traffic involved, we do not believe the anticompetitive effects of the consolidation on this area would be substantial.

Mexican and Corpus Christi traffic: Both MKT and TM raise the issue of anticompetitive harm to traffic moving across the Mexican border, primarily grain to Mexico. Their arguments mainly concern reduction of the number of competitors at Mexican border crossings and possibilities of vertical foreclosure of traffic moving to the border crossings at Laredo and Eagle Pass, and to Corpus Christi.

78/ See Tucumcari at 326.

79/ See SFSP-4, v.5 at 42-44; 91-94.

80/ See MKT-20, VS of Gastler at 67.

The following table shows the rail carriers presently serving Mexican border crossings.[81]

PRE-MERGER U.S. CONNECTING CARRIERS FOR RAIL GATEWAYS TO MEXICO

Mexican Border Points			
Calexico, CA	SP		
National City, CA		SF/SDAE*	
Douglas, AZ	SP		
Naco, AZ	SP		
Nogales, AZ	SP		
Ashley, TX	SP		
Brownsville, TX	SP		UP/MP
Del Rio, TX	SP		
Eagle Pass, TX	SP		
El Paso, TX	SP/SSW	SF	UP/MP
Hidalgo, TX			UP/MP
Laredo, TX	SP via TM		UP/MP
Presidio, TX		SF	
Rio Grande City, TX			UP/MP

Code:
SP: Southern Pacific Transportation Company.
SP/SSW: St. Louis Southwestern Railway Company.
SF: Atchison, Topeka and Santa Fe.
UP/MP: Union Pacific System.
TM: Texas Mexican Railway Company.
SDAE: San Diego and Arizona Eastern

SOURCE: Official Railway Guide.

* SDAE connects physically today only with SF. Because of its dependence on the SF for traffic, it is included with the SF.

Traffic is not distributed equally among these crossings. Laredo has been the gateway favored by Conasupo, the Mexican government grain purchasing agency, which has chosen the routing for all grain traffic moving into Mexico until recently, when much of this responsibility was turned over to private Mexican grain purchasers. According to TM, the Laredo crossing acccounts for about 70 percent of rail shipments to Mexico, which were divided roughly equally between it and MP, the only railroads serving that gateway directly. This ratio has now changed in favor of MP.[82]

Following a consolidation, SPSF would serve all Mexican border crossings except Laredo, and SPSF and UP/MP would be the only major railroads serving Mexican border crossings. TM operates a single line, between the Laredo gateway and Corpus Christi, where it can connect with both SPT and UP/MP. It is primarily a bridge carrier for Mexican traffic; approximately 80 percent of its traffic is dependent on UP/MP or SPT originations.[83] Since the UP/MP merger, that system has tendered very little traffic to TM, leaving it dependent on SPT. TM is concerned that the proposed merger would cut TM off from its last friendly connection, and that SPSF would attempt to

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81/ From MKT-25, VS of Tye at 48. The crossings at Ashley, Del Rio, Hidalgo, Rio Grande City, National City, and Naco may not be operating. See MKT Opening Brief at 129.

82/ TM-7, VS of Ramos at 11, 2.

83/ TM-7, VS of Ramos at 2.

redirect traffic to single-system routings over its own gateways. Viewed from a competition standpoint, the shipping public would be left with only SPSF and UP/MP serving Mexican gateways.

We are not convinced that the proposed consolidation would seriously reduce the number of competitive rail options at Mexican border crossings. Although the number of major railroads serving these crossings would be reduced from three to two, the crossings do not appear to compete substantially with one another for traffic, but rather each handles traffic that the grain purchaser has chosen to move over it. Viewing each gateway individually, many are exclusively served now by either SPT or ATSF and would not experience a reduction in rail competitors due to the merger. No gateway is presently served by both SPT and ATSF, exclusively. Moreover, Laredo, by far the most important crossing, would continue to be served by both MP and TM.

Whether Conasupo or private shippers route the traffic, Laredo has numerous operational advantages that point to its remaining the preferred gateway for rail traffic.84/ It seems logical that SPSF would continue to interline with TM rather than forego participation in this traffic. There is some indication in the record that TM anticipates its connection with the merged system would actually strengthen its competitive position.85/ If, on the other hand, circumstances were to change so that other gateways were more extensively used (whether through SPSF influence or simply shipper preference), and SPSF were able to direct traffic to gateways it served directly, the routing would have changed, but, arguably, competitive rail options to Mexico would not have been reduced, only shifted. That is, the existing SPT-TM and UP/MP alternatives for traffic now moving through Laredo would have changed to SPSF (non-Laredo) and UP/MP alternatives. Moreover, if the ability to influence shifts in traffic exists, that option is as available to SPT today as it would be to SPSF after a consolidation; TM itself states that SPT already has "vast influences" in Mexico.86/ Changes in other circumstances, such as operational ones, favoring the use of other gateways in preference to Laredo likewise would not be a result of the consolidation.87/

There is also concern regarding foreclosure of competition by elimination of carriers participating in earlier portions of movements handled ultimately by SPT and TM. Other carriers participate in traffic moving from the Midwest with a final destination in Mexico. To use TM's service from Corpus Christi to Laredo, they must first interline with SPT, the only carrier with a connection to TM that does not also have its own route to

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84/ See the summary of TM's diversion study in Appendix E; also SFSP-43, VS of Bosanko & Reyff at 92.

85/ SFSP-43, VS of Bosanko and Reyff at 94.

86/ The record contains references by applicant witnesses to applicants' desire to route traffic over their own gateways; it also reveals that SPT contemplated diverting traffic from TM even before this consolidation was proposed. Cross-examination of Edwards, Tr. 1283; TM-7, Exhibit II.

87/ In addition, the fact that the UP/MP merger may have resulted in loss of TM traffic to that system, does not guarantee that the proposed merger, although also one between two large railroads, would create similar diversion. The UP/MP system, unlike SPSF, has its own direct access to the Laredo gateway and is not dependent on TM, as SPSF would be, to reach Laredo.

Laredo.88/ Following the proposed consolidation, SPSF could favor its own single-system routing for traffic that formerly experienced competition between ATSF and other carriers for this earlier portion of the movement. This concern further applies to traffic moving to Corpus Christi itself, as well as traffic moving to the Mexican border crossing at Eagle Pass, now served exclusively by SPT. This argument is advanced by MKT and the evidence of foreclosure possibilities relates almost exclusively to MKT.

In the UP decision, MKT sought trackage rights comparable to those it seeks here, to address similar problems of foreclosure from participation in grain traffic to Mexico. We denied its request, commenting that despite the loss of MP as a friendly connection to Laredo, MKT could still interchange with SPT for further movement over TM. MKT argues that this language dictates a grant of trackage rights in this proceeding. We disagree that such a result necessarily follows. In UP Control, the Commission did not actually find that anticompetitive effects would occur if MKT had no friendly connection to TM or Laredo. Rather, we declined to make any finding on this issue in light of the continued availability of such a connection and the extension to MKT of "north end" trackage rights in grain gathering areas. In fact, we also stated that, because 80 percent of MKT's grain traffic to the Gulf terminated at Houston or Galveston (which it served directly) it did not need trackage rights to Laredo or Corpus Christi to offer competitive service on grain traffic.89/ Our discussion in that proceeding, then, while relevant to the present proceeding, is not dispositive of the issue of anticompetitive effects that might result from an ATSF-SPT merger.

The following tables show the number of carloads MKT handled moving to and from Laredo, Eagle Pass, and Corpus Christi, and a breakdown of the traffic moving to those points by origination State and by grain/non-grain movements. Among other things, the tables show that MKT's access to these points is highly dependent

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88/ As an indication of the extent to which SPT in connection with TM provides a bridge service for Mexican traffic, 17,000 of the 22,000 carloads SPT interchanged with TM at Corpus Christi in 1983 moved as bridge movements over SPT. Of these carloads, 16,000 were delivered to TM and the remainder received from TM. Exhibit SE-1.

89/ UP Control at 570.

on SPT and that grain is the principal commodity transported.[90]

M-K-T SYSTEM TRAFFIC TO AND FROM LAREDO, TX, EAGLE PASS, TX, CORPUS CHRISTI, TX
1983 (Carloads)

	Via SP Access (Carloads)	Via MP Access (Carloads)	Total Carloads M-K-T Traffic
TO			
LAREDO, TX			
- Grain	2551	- 0 -	2551
- All other	1310	249	1559
- Total	3861	249	4110
EAGLE PASS, TX			
- Grain	1150	- 0 -	1150
- All other	103	- 0 -	103
- Total	1253	- 0 -	1253
CORPUS CHRISTI, TX			
- Grain	559	- 0 -	559
- All other	26	26	52
- Total	585	26	611
FROM			
LAREDO, TX	105	881	986
EAGLE PASS, TX*	1110	- 0 -	1110
CORPUS CHRISTI, TX	- 0 -	46	46
TOTALS TO AND FROM	6914	1202	8116

Source: M-K-T Traffic records, 1983; MKT-20, VS of Gastler, page 49.

*Includes stone moving from a point on SPT's San Antonio - Eagle Pass line.

90/ MKT's diversion studies, based on sampling rather than 100 percent traffic records, produce somewhat different figures. MKT-27, VS of Anderson.

M-K-T TRAFFIC, 1983, TO LAREDO, TX; CORPUS CHRISTI, TX: EAGLE PASS, TX
(CARLOADS)

	Grain (Carloads)	Non-Grain (Carloads)
I. TO: LAREDO, TX		
Total cars Principal origins:	2551	1559
FROM: IA	1372	24
KS	348	4
MO	349	-0-
ND	287	4
NE	195	15
TX	-0-	654
WY	-0-	461
II. TO: EAGLE PASS, TX		
Total Cars Principal Origins:	1150	103
FROM: IA	367	-0-
KS	308	1
MO	89	-0-
NE	374	2
OK	-0-	25
III. TO: CORPUS CHRISTI, TX		
Total Cars Principal Origins:	559	52
FROM:		
KS	61	-0-
OK	493	-0-

Source: M-K-T Traffic Records; MKT-20, VS of Dimmerman at 9.

Despite SFSP's promises to continue interchanging traffic with MKT where the MKT joint-line route is more efficient than SPSF's single-line route, we believe that the merged system would attempt to divert practically all of the traffic now moving in MKT/SPT interline service to and from Laredo, Corpus Christi, and Eagle Pass. MKT specifies a number of points served exclusively by it and ATSF.[91] The proposed SPSF and present MKT/SPT routes between these exclusive MKT points and the three Texas points are comparable, and there would be no advantage to SPSF in allowing MKT to participate in the traffic to and from those points. However, the record does not reveal how much traffic is involved. Given that the total amount of traffic MKT handles to and from Laredo, Corpus Christi, and Eagle Pass was only 8,116 carloads in 1983, and that the largest portion of that traffic

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91/ MKT-25, VS of Tye at 59-60. The points are Bartlesville and Shawnee, OK, Temple and Sealey, TX, and Wellington, Chanute, Peabody, and Marion, KS. In addition, Enid and Oklahoma City are served by these two carriers and BN, which, lacking direct access to Mexico, could also expect to be foreclosed from participation with SPSF for traffic between these points and the three points in question. In contrast, MKT states that it serves relatively few points not served also by ATSF.

appears to have moved from large grain consolidation points such as Kansas City and Enid, OK, the amount of traffic attributable to MKT/ATSF exclusively served common points could not be great.92/ Moreover, it would seem possible for MKT to participate in joint-line service with UP/MP to move this traffic to Laredo and Corpus Christi (though not to Eagle Pass, exclusively an SPT gateway), because UP/MP could not provide single-line service from these origins. We cannot conclude that these points would lose all competitive rail options.

The more significant traffic at issue moves from large grain shipping points and includes traffic that originates at points beyond the proposed SPSF system. Shippers supporting MKT trackage rights include large grain enterprises that are particularly concerned about traffic moving from various Midwest points to Kansas City, where ATSF and MKT now both offer competitive options for further movement to Mexican border crossings and Corpus Christi. These shippers are also concerned about loss of competition from such points as Omaha/Council Bluffs NE/IA, Lincoln, NE, and Wichita, Atchison, Herrington, and Salina, KS, all of which are served by MKT, and many of which are served by ATSF.

Although the MKT/SPT and MKT/SPT/TM routing options could disappear for traffic moving from these points, this would result only in a reduction, not an elimination of competition. UP/MP also serves all of the points mentioned above and can provide single-system service to Laredo and Corpus Christi. Therefore, at least two routings, via UP/MP and SPSF, would be available for this traffic. From points served by a third carrier, such as MKT or BN, and by either UP/MP or SPSF (but not both), the carrier not serving the point would seem to have an incentive to interline with the third carrier to participate in traffic moving from that point to Laredo or Corpus Christi. For example, MKT or BN could originate traffic at Enid for further movement over UP/MP; MKT could originate traffic at Lincoln and Omaha-Council Bluffs (not served by ATSF) for further movement over SPSF. In some of these situations, such as the latter, MKT could lose its present long-haul (Kansas City-Denison, for example) to the proposed system. But a change in the carrier enjoying the long-haul does not necessarily represent a reduction in the competitive options available to shippers.

We conclude that the proposed merger might result in a reduction in competition for traffic moving from and to Laredo and Corpus Christi, although little if any traffic should completely lose rail competition. The significance of this reduction must be measured by the amount of traffic in which MKT participates with SPT in joint-line service, as reflected on the tables printed above. In 1983, this traffic amounted to slightly fewer than 4,000 carloads from and to Laredo and 585 carloads from and to Corpus Christi. Eagle Pass traffic, in contrast, would be more likely to lose all competition for originating or intermediate portions of movements, but MKT participated in even less of this traffic (2,363 carloads in both directions).

Bayport, TX: SPT owns a line between Houston and Texas City, passing through Bayport. Numerous chemical shippers, producing a significant portion of the nation's petrochemicals, are located on the line. While these shippers are now subject to a monopoly on traffic moving to or from other SPT exclusively-served points, they enjoy competition between other carriers for portions of movements beyond SPT's lines. To the extent that ATSF competes for those hauls, the merger may result in vertical foreclosure of the competing carriers from those markets.

92/ For example, 81 percent of MKT carloads to Corpus Christi in 1983 consisted of grain from Enid. MKT-20, VS of Gastler at 54.

The evidence contains several examples of traffic that shippers state now experiences competition after initial movement by SPT. These include movements over SPT (1) to Dallas, then over UP/MP or ATSF to points in the Midwest and in California served by those carriers but not SPT, (2) to East St. Louis, then via different carriers to Chicago, (3) to unspecified junctions, then via competing bridge carriers, with ultimate movement by Grand Trunk Western, and (4) to unspecified junctions, then via competing carriers to the Rocky Mountain area, particularly specific points in Colorado and Utah. For each of these movements, SPSF could capture a much longer haul than SPT now enjoys and foreclose competition for portions of the movement where it is now available.93/ However, although the size and productive capacity of these petrochemical shippers is substantial, there is little evidence identifying the amount of traffic for which ATSF has been in a position to compete with other rail carriers, and it is this traffic alone that would be subject to competitive harm from the consolidation. MKT, the party seeking to remedy the anticompetitive effects in this area, handled only 714 carloads, or 1 percent of Bayport line traffic in joint-line service with SPT during 1983, according to applicants.94/ MKT's own evidence for that year shows that it handled only 1,312 carloads moving to the line and 526 moving from it,95/ and not all of that traffic would necessarily be subject to ATSF competition. Bayport line shippers also do not provide much information on the volumes of traffic subject to loss of competition. Therefore, while we have no doubt that possibilities exist for the foreclosure of competition in favor of SPSF's long-hauls, we cannot evaluate the extent of this foreclosure or determine that the anticompetitive consequences are significant.

Beaumont: Beaumont is now served by four railroads, ATSF, SPT, UP/MP and KCS. The proposed consolidation would reduce the number of competitors from four to three. MKT emphasizes that the remaining two carriers do not serve all the areas SPSF would serve but fails to identify these areas, other than southwest Kansas, or specify the amount of traffic that would suffer from this reduction in competition. In fact, UP/MP has an extensive network of lines in major grain-producing areas served by SPSF, and both UP/MP and KCS serve the major market of Kansas City and can interline with other carriers to and from points beyond their systems. Shipper support for MKT trackage rights to Beaumont and nearby Chaison rarely mentions reduction in competitive options resulting from consolidation but stresses instead the improved service, greater flexibility, and expansion of markets the MKT proposal promises. MKT itself admits that its joint-line traffic

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93/ On the other hand, shippers are also concerned about some movements that the consolidation would not appear to affect. Despite their concern about competition to Kansas City, SPT has recently been capturing the long-haul on many of these movements even given the circuity of its existing routes, so the consolidation would not be expected to exacerbate that situation. Concern about the loss of SPT-ATSF competition to California seems curious, because SPT could foreclose ATSF participation at any time, and in fact the evidence indicates tht it has done so in recent years. Also, many shippers are interested simply in having competition at their facilities where none has existed and in obtaining an improvement over the service of the monopoly origin carrier.

94/ SPSP-43, VS of Bosanko and Reyff at 116-117.

95/ MKT-20, VS of Gastler at 76.

to Beaumont would not be foreclosed after the merger. We do not anticipate serious anticompetitive consequences in the Beaumont area.

Midlothian/Ward Spur: SPT and ATSF lines cross at Midlothian, TX, south of Dallas. Shippers located in the area fear the loss of competitive options if applicants merge. Mazda Motors of America (Central), Inc., states that it located there expressly to ensure availability of service by both railroads and control by neither. Its facility is located on SPT, but direct rail service by ATSF would be possible through construction of a spur track. It expects to use over 2,500 railcars a year in the transportation of motor vehicles, primarily between Midlothian and California. We acknowledge that Mazda would lose the potential competition that formed the basis for its considerable investment in this area. We also accept that the economics of motor vehicle shipment over long distances make rail the only feasible transportation option. Texas Industries, Inc., ships or receives over 5,000 carloads a year of coal, cement, anhydrite, gypsum, and other commodities at its facility on the ATSF line at Ward Spur. It is not clear that it relies on SPT's proximity as a constraint on ATSF rates and services, nor has any other shipper presented such evidence, so Mazda's situation is apparently unique. Some alleviation of the anticompetitive effect on Mazda would be warranted if the application were granted.

Houston (AGRI): American Grain and Related Industries (AGRI) operates an export facility at Houston, from which it receives grain from several midwestern States. The facility is served only by SPT, but several other railroads participate in the origination of the grain, and MKT and SPT now maintain arrangements to ensure MKT both direct access to the facility and access through SPT switching. ATSF, BN, MKT, and MP hold substantial market shares of milo and wheat, and those four carriers plus SPT hold substantial shares of soybeans and corn moving to the facility. AGRI is concerned that after consolidation, SPSF may favor former ATSF routes over those of other carriers and, through cancellation of joint routes or increased switch charges, eliminate the rail competition that AGRI is convinced has been responsible for holding down grain rates. The facility receives several thousand cars a year handled by MKT (3,373 cars according to MKT diversion study).96/ It has a capacity of 6.5 million bushels and can handle over 21 million bushels a month during peak periods. We conclude that, in the absence of some form of protection (such as the maintenance of existing access agreements), there would be an unacceptable potential for reduction of competition for this traffic following consolidation.

Kansas City-Fort Worth and Kansas City-Houston: KCS argues that the proposed consolidation would reduce competition between Kansas City, on the one hand, and Fort Worth and Houston/Galveston, on the other. KCS, which serves Kansas City, now interchanges with SPT at Shreveport, LA, to serve Houston/Galveston, and at Texarkana, AR/TX, to serve Fort Worth. KCS contends this transportation option would be eliminated after the merger because ATSF could offer single-line service between Kansas City and these points.

We agree that SPSF could seek to divert former KCS-SPT joint-line traffic to its own single-system routing. However, the effect on the public of losing this routing option is not clear. BN, UP/MP, SPSF, and MKT would provide single-line service between Kansas City and both Fort Worth and the

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96/ MKT-27, VS of Dimmerman & Sheridan at 4.

Houston/Galveston area. Thus, the public would continue to have several rail options available for this traffic. KCS has failed to show that a significant amount of traffic now uses the KCS-SPT routing.97/ Shippers supporting KCS conditions do not provide specific information about traffic moving between these points or exhibit particular concern about the loss of this routing option. It has not been demonstrated that the elimination of KCS competitive options in these corridors would have serious anticompetitive effects.

In summary, we conclude that the merger would create serious anticompetitive problems. Competition would be eliminated across the Southern Corridor between California and the Gulf and Southeast. Phoenix and the San Joaquin Valley would be left without rail competition. In the Central Corridor, traffic now experiencing competition would be likely to lose competitive routing options across that corridor following the merger. DRGW's participation as a competitor for transcontinental traffic would be jeopardized by loss of traffic density. SPSF would face no competition for traffic moving between Los Angeles and Oregon and Washington in the Pacific Coast Corridor. Specific shippers in Texas that have demonstrated their reliance on existing competition, namely AGRI at Houston and Mazda at Midlothian, would be disadvantaged by the merged system's increased market power.

Moreover, although not essential to our decision, we note that our conclusion that the merger would have serious anticompetitive effects is consistent with documentary evidence obtained from SFSP indicating that one purpose of the merger was to achieve monopoly power. In a revealing document entitled "A Strategic Assessment of Santa Fe's Position in the Railroad Industry," SFSP's Chairman, then chairman of SFI, recommended to his Board of Directors that they acquire SPT to eliminate the competition Santa Fe faced from SPT. SFSP has attempted to protect that study from public disclosure.98/

The "Strategic Assessment" study (entered into evidence and referred to here as Exhibit "KCS-C-1") was prepared not for the purpose of litigation but for corporate business planning. It

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97/ For example, KCS' Loss Study predicts a loss of about $360,000 due to a closure of the Kansas City-Houston routing, but this fact neither reveals the amount of traffic that has used the routing nor clarifies the seriousness of closing the route to the shippers of that traffic. KCS-12, VS of Ploth at 20.

98/ The "Strategic Assessment" study was discovered by KCS in the course of this proceeding. SFSP argued that the document contains confidential and proprietary information and thus demanded that it not be made public. It was therefore entered into the record under seal.

However, this does not mean the Commission is proscribed from referring to that evidence in this decision. The Administrative Law Judge who presided over the hearings in this case never ruled on the issue of whether the study did indeed contain confidential and proprietary information. Moreover, Mr. Schmidt submitted to public cross examination, without objection, on the contents of the document, and SFSP did not request that the transcript of that cross examination be placed under seal.

Upon review of the document, we find that some of the econometric forecasting data contained in it may be considered proprietary information. We will not refer to those data, but will limit our discussion to those portions of the document upon which Mr. Schmidt testified. The latter do not contain information which may be legitimately withheld from public scrutiny in the context of this proceeding, although we can understand why SFSP would want them to remain secret. In any event, by not objecting to public cross examination on that material, SFSP has effectively waived any claim of privilege to which it otherwise might have been entitled.

was conducted under the direction of the Chairman in response to a request from SFI's Board of Directors that he evaluate whether the company should remain in the railroad business. Tr. at 176, 225, 228. It was presented by the Chairman to the Board in May 1983. Tr. at 223. Thus, unlike expert testimony and legal argument prepared in anticipation of litigation, KCS-C-1 appears to be a candid appraisal by SFSP's chief executive officer of a "matter of paramount importance" on which his Board of Directors was intended to rely in determining the company's future course. KCS-C-1 at 1.

Document KCS-C-1 is not subtle in its language. Pervading the study is management's perception that Santa Fe's goal must be to raise revenues by reducing intramodal competition. The "strategic option" recommended in the report was to "[s]eek an affiliation with a major western carrier so as to gain significant market power and potential Staggers Act benefits." Id. at 40. The suggested merger candidate was the SPT. Id. at 43-44.

The study cited two significant benefits that would result from a merger with SPT. First, the Chairman and his study team identified the opportunity to achieve a benefit variously referred to as "pricing flexibility" or "pricing freedom," by virtue of a merger that would increase the number of exclusively served origin or destination points. Id. at 33. In context, the study used the terms "pricing flexibility" and "pricing freedom" to refer to an ability to command price, not merely the ability to adjust prices to meet competition. See id. at 8, 18-20, 32, 43. Second, the merger would eliminate costly competition from SPT which was seen as having a "strong . . . presence" in intermodal traffic, and was identified as having "significantly undercut" existing rates. Id. at 31, 43.

The study illustrated the adverse effect of competition on Santa Fe's profits by comparing Santa Fe's "carrythrough" -- the percentage of gross revenues from railroad operations brought down to net -- with that of UP for the period 1951 to 1982. Id. at 15-21. During that period, Santa Fe's carrythrough had deteriorated, while UP's had improved. Id. at 15. The Chairman observed that UP's superior performance was due not to lower costs, but primarily to its ability to comand greater revenue per ton-mile than Santa Fe. Id. at 18. The Chairman concluded that Santa Fe's "lesser pricing flexibility" had led to its slower growth in revenue per ton-mile during the study period, and that competition was responsible for the discrepancy in UP's and Santa Fe's respective revenues per ton-mile. Id. at 18-20. In describing the basis for UP's "greater pricing freedom," the Chairman pointed out, among other things, that UP enjoys a "lesser degree of rail competition in much of its service territory." Id. at 20.

However, that situation could be rectified. The study found that Santa Fe's revenues would increase if Santa Fe and another carrier were to merge to become the only carrier serving more origin or termination points. Id. at 32. Specifically, "pricing freedom" would result if a merger gave the new combination the following traffic characteristics: (1) a potential to improve revenues derived from single-line movements; (2) an increase in the number of origin or destination points served exclusively by the merged carriers; and (3) creation of the most efficient, shortest route corridors between key city pairs. Id. at 33.

While the first and third characteristics are not necessarily anticompetitive, the second is. Santa Fe's merger with SPT was seen as a means of achieving what is described in the second characteristic: a rail monopoly at points in California and throughout the Southwest, by greatly increasing the number of exclusively served points.

In terms of specific traffic, the study made clear that TOFC/COFC traffic would play an important role in Santa Fe's future. TOFC/COFC traffic, which the Chairman refers to as "merchandise" traffic, has been Santa Fe's single largest revenue generator and is projected to be the fastest growing of all rail traffic types in the 1981-1992 period. Tr. at 239; KCS-C-1 at 33, 37. Santa Fe's Board was advised that the principal threat to the profitability of its TOFC/COFC business would come from SPT. For example, the Chairman complained that, concurrent with SPT's acquisition of a direct route into Kansas City via the Tucumcari line, it had "published TOFC rates west to California and Arizona that significantly undercut then existing rates," and had "adversely affected" Santa Fe's Chicago to California rates. Id. at 31. Thus, the Chairman observed that Santa Fe "appears well advised . . . to limit its exposure to the predatory pricing potential inherent in this traffic" and, further, that acquisition of SPT would be "especially attractive in terms of its recent strong [TOFC] traffic presence . . . ." Id. at 38, 43. Thus, Santa Fe could both expand its TOFC/COFC business and reduce competition by acquiring SPT.

In summary, SFSP's own analysis showed the merger would be anticompetitive. In the words of Santa Fe's senior management, merger with SPT offers "[s]ubstantial Staggers Act flexibilities and potential benefits . . . suggesting that substantial additional profits may be achieved over and above any cost savings." Id. at 43-44. While SFSP may seek to maximize private benefits, our responsibility is to the public interest.

THE PROPOSED CONDITIONS WOULD NOT REMEDY THE ANTICOMPETITIVE EFFECTS

Under 49 U.S.C. 11344(c), we have broad authority to impose conditions governing railroad consolidations. In deciding whether to impose conditions, our overriding concern is the public interest. BN-Frisco, 360 I.C.C. at 950. In the BN-Frisco decision the Commission reexamined its policy regarding merger conditions. 360 I.C.C. at 950-952. We concluded that conditions generally tend to reduce the benefits to be derived from a consolidation and that conditions should not be imposed unless they will produce benefits outweighing their harm to the transaction. In UP Control, we stated that we would deny merger proposals that were substantially adverse to the public interest, rather than use our conditioning power "to restructure a transaction beyond the scope proposed by applicants." 366 I.C.C. at 565. In making this finding, we noted that rail consolidations are not the proper vehicle for rail system restructuring. 366 I.C.C. at 564. We stated that: ". . . our role in merger proceedings is to evaluate carrier-originated proposals to determine whether they are consistent with the public interest." Id. In addition, if appropriate public interest conditions cannot be formulated, then the transaction should either be approved without conditions, if it offers benefits that outweigh the threatened harm, or be denied, if the harm outweighs the benefits. In BN-Frisco, we set forth criteria for the imposition of conditions. 360 I.C.C. at 951-952. These criteria, with slight modifications, have been incorporated into our regulations. 49 CFR 1180.1(d).

In Railroad Consolidation Procedures, 363 I.C.C. 784 (1981), at 789, we recognized that these criteria applied to conditions being proposed to protect a particular carrier, where essential services would be affected, but that the Commission would also consider imposing conditions that might be useful in ameliorating potentially anticompetitive effects of a consolidation. Conditions designed to protect the public from anticompetitive consequences were not to be limited by the essential services criteria.

The codified essential services criteria state that the Commission will not normally impose conditions to protect a carrier unless essential services are affected and the condition: (1) is shown to be related to the impact of the consolidation; (2) is designed to enable shippers to receive adequate service; (3) would not pose unreasonable operating or other problems for the consolidated carrier; and (4) would not frustrate the ability of the consolidated carrier to obtain the anticipated public benefits. Criteria for imposing conditions to remedy anticompetitive effects remain uncodified but were set out in UP-Control. There we stated that we will not impose public interest conditions on a railroad consolidation unless we find that the consolidation may produce effects harmful to the public interest (such as a significant reduction of competition in an affected market), that the conditions to be imposed will ameliorate or eliminate the harmful effects, that the conditions will be operationally feasible, and that the conditions will produce public benefits (through reduction or elimination of the possible harm) outweighing their harm to the merger.

In either situation, the issue of whether conditions should be imposed in a consolidation goes essentially to whether the transaction will result in a lessening of the adequacy of transportation to the public. In the absence of public benefit considerations, carriers are not entitled to protection from traffic diversion or from the risk of competition.

We conclude that the adverse effects of the proposed consolidation outweigh the expected benefits and cannot effectively be mitigated by the conditions proposed by the parties.

Various railroads have proposed conditions purporting to alleviate anticompetitive problems. These conditions, primarily in the form of trackage rights, independent ratemaking authority, and offers to purchase lines, would permit participation by these railroads in the full range of traffic handled by the primary applicants, within specified geographic areas. By contrast, the primary applicants themselves have offered certain more limited conditions, and DOT has recommended its own approach to the method of granting conditions.

Applicants' Proposed Conditions Would be Ineffective

Early in the proceeding, applicants made a commitment to maintain efficient through routes and service via existing gateways following the consolidation. Subsequently, in their rebuttal statements, applicants expressed a willingness to be bound by a rail service condition obligating SPSF to provide interline rail service through all connections in a manner that does not discriminate in quality among rail routes and connections having nearly equal volumes of traffic. At the same time, applicants proposed a pricing constraint condition, under which SPSF would be limited to rate increases on specified traffic of no more than 5 percent a year plus inflation, as measured by the Commission's Rail Cost Adjustment Factor (RCAF). However, rates below 150 percent of variable cost on the date of the merger could be raised to that level in equal increments over a 3-year period. The conditions would apply to both common carrier tariff and contract rates, and to both divisions of joint rates and any proportional rates that might replace such joint rates. The traffic to which the pricing constraint would apply consists of specific traffic flows involving separate 5-digit Standard Transportation Commodity Codes (STCC) commodities moving from individual origin to individual destination stations. These flows were identified as traffic potentially subject to anticompetitive harm by a study largely applying the competitive analysis principles employed in the DOT study.

Near the close of the proceedings, applicants offered as a condition to the consolidation an agency-solicitation agreement reached with Burlington Northern Railroad Company (BN). This agreement was intended to supplement the conditions offered previously, but applicants indicated willingness to substitute it for the pricing constraint condition. Applicants offered the agreement as the solution to all adverse anticompetitive consequences of the merger. The agreement would apply to approximately 4.5 million tons of freight identified by DOT as subject to potential adverse competitive impacts as a result of the consolidation, with an adjustment to exclude traffic flows where one or more other railroads would remain a significant competitor for traffic after the consolidation. The traffic subject to competition from BN under the agreement would be all traffic moving between the regions identified in the agreement's 665 bi-directional flows between Specified Point Locator Code No. 4 (SPLC-4) group regions, excluding TOFC, COFC, perishables, grain, and boxcar traffic, and traffic moving to or from an SPLC-6 point served by only one railroad.

BN would have the right to quote rates independently of SPSF for all of the freight traffic covered by the arrangement. SPSF would carry the freight over SPSF's lines as BN's agent, charging BN the higher of (1) the lower of SPT's or ATSF's rates on the date of the merger, plus inflationary increases as measured by the RCAF, or (2) 150 percent of SPSF's Rail Form A variable costs on the date of the merger, as described in the agreement. Rate increases in excess of inflation would not be prevented by the agreement for traffic earning below 150 percent of SPSF's variable costs, until rate levels reached 150 percent of SPSF's variable costs. If at any time SPSF decided to increase rates on covered traffic to the point where SPSF's rates to shippers exceed SPSF's charges to BN, the agreement would require SPSF to notify all affected shippers so that they could seek a competitive offer from BN, and also would require SPSF to inform BN of the identity of the traffic involved.

We do not think the agreement with BN would alleviate the anticompetitive consequences of the proposed consolidation. First, it is likely that BN would be an ineffective competitor. The charges BN would have to pay, equalling at least 150 percent of SPSF's variable costs, may alone make BN noncompetitive, considering that the applicants' system-average rates are now significantly below this level. Moreover, the real cost to BN of transporting the covered traffic would be greater than this because the costs to BN of soliciting the traffic, handling and auditing revenues, recordkeeping and other overhead, plus the minimum profit BN would accept, must be factored in. Also since the compensation level is based on 1982 variable costs, BN would be at a competitive disadvantage, because SPSF's actual variable costs in transporting the competitive traffic should be reduced by the anticipated merger efficiencies. Faced with these disadvantages, BN would probably be discouraged from transporting much traffic. And SPSF would be able to raise rates to the level at which BN became interested in the traffic before facing any competitive constraint. There is no reason to assume that 150 percent of 1982 variable costs--or whatever actual rate level BN would have to set to compensate it for handling the traffic--represents the rate level that would apply to this traffic in an unrestrained competitive market. We have already rejected the argument that rates below the threshold level for establishing a railroad's market dominance should be viewed as *per se* competitive.

We must be particularly concerned with preserving service competition, and the BN solicitation agreement is deficient in this area. Because BN would use SPSF trains to carry the traffic BN attracted, its service could never be better than or competitive with SPSF's.99/ There would be no competition in equipment supply, scheduling, transit time, accessorial services, new or improved intermodal facilities, or service to new shipper facilities, areas in which ATSF and SPT compete strongly at present. SPSF would have no incentive to reduce its costs and introduce innovations to promote efficiency, because BN, limited by the quality of SPSF operations, could not threaten to divert traffic through its own increased efficiency.

The piecemeal nature of the traffic BN would be authorized to solicit would also greatly reduce its competitiveness with the full commodity and territorial service SPSF could provide. BN would be unable to offer a shipper service for the full range of commodities the shipper might be shipping to or receiving from a variety of points, and therefore could not compete with SPSF in offering the shipper an attractive rate package. SPSF could offer a shipper lower rates on traffic not covered by the agreement in exchange for charging higher rates on competitive traffic, and thus could capture all of the shipper's covered traffic despite its rates being higher than BN's. Similarly, BN would not be an effective competitor for traffic moving under rail contracts, because its lack of flexibility to handle all commodities and serve all origins and destinations reachable by the merged system would frustrate its efforts to put together an attractive contract package tailored to the requirements of an individual shipper.

The BN solicitation agreement would also require the sharing of SPSF's confidential information on traffic covered by contracts. This information would provide BN with an informational advantage in its own contract negotiations, perhaps even with the same shippers, and for its marketing strategies. By depriving shippers of the right to confidential contracts under 49 U.S.C. 10713, it could place some shippers in a less favorable negotiating position, thereby reducing the competition for their traffic.

These obstacles aside, we are not convinced of the extent to which BN is even interested in the covered traffic. BN's interest appears to be in the diversion of that rather small portion of the covered traffic now transported by BN and either ATSF or SPT in interline service, with a secondary interest in traffic which is subject to such interlining but is not now interlined. BN foresees its greatest traffic opportunities in connection with its low-density lines between Chicago and Denver, and those south of Kansas City.100/

99/ Applicants argue that the commingling of BN and SPSF traffic would insure that SPSF would not discriminate against BN's traffic as to service. But this does not address the question of whether BN's presence would preserve service competition.

100/ BN-3 at 8.

Unfortunately, these are not areas subject to significant anticompetitive harm due to the proposed consolidation. On the other hand, in areas in which we expect a serious reduction in competition, such as within and between California, Arizona, and Texas, BN does not expect any substantial opportunities to handle traffic.101/ BN itself seems far from certain as to which anticompetitive consequences of the consolidation its presence would alleviate, admitting that it is not "totally predictable" as to the specific competitive implications of the agreement on any particular movement.102/

Even if we were to find that BN would be an effective competitor for the traffic covered by the agreement, the agreement would not solve all, or even most, of the anticompetitive problems of the consolidation, contrary to SFSP's assertions. The agreement fails to include substantial traffic that would be subject to serious loss of competitive options. TOFC, COFC, perishables, and boxcar traffic, which the Commission has exempted from regulation, have been excluded. We have explained why the exemption of a category of traffic from regulation cannot be construed to connote Commission indifference to the preservation of intramodal rail competition.103/ In this proceeding, moreover, there is a substantial body of evidence submitted by numerous shippers demonstrating that they need rail transportation for particular movements of this traffic, and that it is not economically feasible to use trucks or other modes of transportation for these movements.104/ The screening procedures by which the covered traffic was isolated and identified were invalid for several other reasons.105/ They narrowed the traffic that applicants were willing to protect from anticompetitive impacts to only approximately 2.5 percent of the total traffic carried by ATSF and SPT, and much of this traffic does not even move in the corridors that would suffer the most severe consequences from loss of rail competition. Movements of traffic for which applicants compete are excluded or included in a manner which applicants may view as consistent with their screening procedures but which appear in fact to be capricious and at odds with any logical evaluation of the areas in which ATSF-SPT competition exists.

101/ Applicants and BN argue that this admission regarding what BN refers to as "Policeman Role" traffic only reflects BN's recognition that this traffic is already subject to competitive restraints, making it unlikely that SPSF would ever raise rates to the point at which BN would solicit traffic. SFSP-71 at 36-37. But this traffic is covered by the agreement because other competitive constraints have been conceded to be absent. Even if we accepted applicants' characterization of BN's statement, the statement nevertheless reveals that BN does not think its presence will have any pro-competitive effect on this traffic, which removes any justification for approving the agreement to protect that traffic from anticompetitive harm.

102/ BN-3 at 5-13.

103/ See Competition Section, _supra_.

104/ _Id_.

105/ _Id_.

Applicants' entire approach of selecting highly specific traffic flows for protection is inconsistent with the basic need for conditioning a consolidation. Because consolidation is irrevocable, it is necessary for us to define traffic or corridors that would lose competitive options not only at present but for the foreseeable future. Traffic patterns change from year to year as innovation alters transportation options and product sources, and new economic and technological conditions may render captive to a railroad traffic that is currently intermodally or source competitive, or perhaps that does not yet exist. For example, the introduction of double-stack containers may cause certain traffic to be transportable economically only by rail, where previously trucks were the primary transportation mode. The record reveals that technological or economic developments have altered the transportation patterns for such commodities as soda ash, cotton, and packaging containers. Also, the market area served by the Southern Corridor is expected to grow considerably, creating the potential for a merged SPSF to monopolize substantially increased future traffic. Protective measures that respond only to conditions existing at present cannot be relied on to remain equally effective for the indefinite future.

In contrast, the temporal narrowness of applicants' identification of threatened traffic is illustrated by the fact that applicants' studies treat particular traffic movements differently according to the year in which the data supporting the study was analyzed. The study identifying traffic to be covered by the BN agreement, based on 1984 traffic data, treats many flows as warranting protection that were excluded from protection by the study (based on 1982 data) identifying the traffic to be covered by the rate constraint proposal. The reverse is also true. Moreover, the failure of one of the applicants to participate in a given year's traffic may indicate not that competition between the applicants is absent but that one carrier has effectively, but perhaps temporarily, foreclosed the other's participation through competitive efforts, such as offering the shipper an advantageous exclusive service contract.

Therefore, we must reject any approach such as the BN agreement that would restrict us to protecting individual point-to-point flows of highly specific commodities, identified by analysis of a static sampling of traffic patterns and competitive conditions. Protecting only limited flows that survive a flawed screening process is no substitute for the permanent presence of rail carriers competing in an open market for any traffic that is available.

The applicants' rate constraint proposal is unacceptable for many of the same reasons. It too applies only to a very limited amount of traffic (about 1.2 percent of applicants' total tonnage) identified by SFSP as vulnerable to post-merger lack of competition. SFSP used a screening procedure that improperly excluded exempted traffic, many movements of which have been shown to require rail transportation. The inclusion or exclusion of traffic again depends on the particular movements that happen to be analyzed during the year studied, and does not provide for changing economic circumstances. The changing nature of traffic patterns and market conditions is not taken into consideration. The proposal would not preserve service competition or create any incentive for service innovations or rate reductions. At the same time, SPSF would have considerable freedom to raise rates (as much as 28 percent, excluding inflation, during the 5-year period for rates already over 150 percent of variable costs), and there is no reason to assume these levels would approximate those that would prevail with true market competition. After five years, even the small amount of identified traffic would be unprotected. Moreover, in determining whether to approve a consolidation and how to condition it, we seek to preserve competition or to restore the competition that would be lost. By contrast, this rate constraint proposal would have us replace existing competition with rate regulation, and the potential would exist for disputes over access to SPSF cost data, proper computation of revenue-to-variable cost ratios, and other issues. Such a result would be contrary to the rail transportation policy of 49 U.S.C. 10101a, which admonishes us to allow competition and the demand for services to establish reasonable rail rates.

Applicants' announced "policy" of maintaining efficient through routes and the subsequent proposed condition obligating SPSF to provide nondiscriminatory interline rail service would not solve the anticompetitive problems the proposed consolidation poses. It is difficult to evaluate how much a promise to maintain efficient routes adds to the existing constraints on carriers, who must be prepared to prove that cancellations of joint rates and through routes are consistent with the public interest if the Commission suspends them under 49 U.S.C. 10705(e). The policy cannot be enforced to a greater extent than the statute already provides, and the potential for disagreement over whether a route is efficient makes the policy a poor substitute for actual competition. The service condition also lacks a specific enforcement mechanism, although arbitration to resolve disputes apparently is contemplated. We could expect disputes regarding whether joint line services have in fact been downgraded, and if so, whether for improper reasons; whether different SPSF system connections had or continued to maintain "nearly equal" volumes of traffic; and whether different connections actually receive equally good service in all respects, among other issues. Furthermore, to the extent a joint rate becomes higher than a single-line rate for particular traffic, the joint-line route could expect to obtain lower volume than that obtained by the single-line route, and consequently to lose the protection of the condition. Under both the policy and the service condition, we would have no assurance that competition would be maintained without recourse to some dispute-resolving forum.[106/] But perhaps the greatest flaw in both proposals is that they do not clearly address the most serious anticompetitive problems that we have identified.

DOT's Approach to Conditions is Unacceptable

DOT recommends a three-step approach to imposing conditions on the consolidation: approval of the merger along with Commission identification of the competitive problems, negotiation by applicants with potential competitors to handle the identified problem traffic, and Commission review of the negotiated agreements. In essence, DOT would allow SPSF to choose its competitor or competitors, as well as the form the competition would take, subject to Commission review. DOT reasons that the Commission is best suited to identify competitive problems and to evaluate the effectiveness of

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106/ For similar reasons we reject applicants' insistence that the competitive access rules promulgated in Ex Parte No. 445 (Sub-No. 1) be considered sufficient to address any vertical foreclosure problems. We seek in this consolidation proceeding to create a situation in which the market itself will maintain competition, not one in which the Commission may be inundated with disputes to resolve.

proposed solutions to preserve competition, but that applicants are best suited to determine the most efficient solutions. It envisions applicants being given the freedom to approach a number of buyers, including not only other railroads but third party agents such as shipper associations and freight forwarders, and negotiating the sale of access rights to the problem traffic. Applicants would be permitted to consummate the merger before any agreement is reached or approved, but they would not be permitted to raise rates on problem traffic until agreements were approved by the Commission and implemented.

This approach is unacceptable for several reasons. The present proceeding has been continuing since applicants filed a notice of intent to file, and did file an application in March 1984. DOT would have us ignore the evidence presented in this proceeding concerning proposed conditions in favor of another proceeding conducted to review conditions that, apparently, no party has seen fit to present before. In effect, DOT is asking us to adopt a whole new procedure to evaluate conditions as a substitute for the procedures already established. Not only would this approach encourage procedural redundancy, it would also undermine the legitimacy of the existing procedures as the means by which conditions are proposed and evaluated.

In addition, DOT would limit the scope of Commission review to an evaluation of the new entrant's ability to compete, and would limit comments by interested parties to this issue. This limited review would not protect the public interest. The Commission would not have the opportunity to analyze the possible harm the proposed conditions might cause, including their effect on the operation of, and traffic diversion from, other railroads. The Commission would also be precluded from evaluating the proposed conditions' effects on the consolidation's public benefits. DOT does not view this as a problem because it considers the applicants the persons "best suited to determine the most efficient (least social cost) solutions to identified problems." This perspective ignores the distinction between public and private benefits. In a conflict between the two, we cannot presume that applicants would favor preserving the former at the expense of the latter.

In fact, applicants might be inclined to propose conditions that would create the least effective competition.[107/] DOT assumes that the temporary rate cap and the prospect of Commission rejection of a proposal offering ineffective competition would inspire applicants to come up with the most socially beneficial proposals immediately to avoid delay in consummation. But applicants might instead find it worthwhile to offer a proposal that addresses some but not all of the anticompetitive problems, in the hope that the Commission would be satisfied. The new proceeding suggested by DOT might then have to be repeated several times as applicants proposed conditions and the Commission analyzed them, until conditions were fashioned that both applicants and the Commission would be

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107/ DOT recognizes that applicants have no incentive to create meaningful new competition unless forced to do so by the Commission. DOT-8 at 42-43; DOT-3 at 31.

willing to accept.108/ Applicants might be willing to tolerate the rate cap during this period in the belief that the benefits of consolidation would ultimately compensate them for any temporary inability to increase rates, especially if conditions offering minimal competition were approved.

Prolonging this proceeding, even if acceptable conditions were proposed on the first attempt, is contrary to Congress' intention, in adopting section 11345(b), "to remedy the chronic problem of extended and unnecessary delay" in the Commission's processing of rail consolidation applications.109/ That section requires issuance of a final decision 180 days after conclusion of evidentiary proceedings. We could not regard as final a decision in which the conditions needed to render the transaction consistent with the public interest were as yet unproposed, not to mention unapproved. Denver & R.G.W.R. Co. v. United States, 387 U.S. 485, 500-01, 506-07 (1967). Moreover, the statutory requirement that we approve a consolidation only upon a finding of consistency with the public interest conflicts with the immediate consummation DOT urges, when, as here, we cannot find a consolidation consistent with the public interest in its unconditioned state. We are not authorized to approve a consolidation based on the prospect of its being made consistent with the public interest at some time in the future. Baltimore and Ohio R.R. Co. v. United States, 386 U.S. 372 (1967).

Other Conditions Were Not Shown To Be Effective

Consolidation of applicants' Southern Corridor routes into a single system would be consistent with the public interest only if a competitive alternative in that corridor could be found. Some parties have suggested that anticompetitive problems in this corridor might be solved by authorizing additional rail competition only for certain types of movements or commodities. This would threaten to deprive the competing carrier of the traffic density needed to maintain effective competition, prevent it from offering a full service to customers that ship or receive a variety of commodities, and restrict it from serving other potential customers altogether. It could also create unwarranted uncertainty and disputes for shippers, the carriers, and this agency concerning which movements were "covered" and which were not. As we have said in discussing the BN agreement, the carrier would also have to be able to provide both rate and service competition. A rail consolidation proceeding does not involve merely an evaluation of rate constraints. Our concern is not limited to the ability of the merged carriers to raise rates substantially for a continuing period of time. We also must ensure that the carrier will not be in a position to reduce the quality of its service with impunity or to be indifferent to the

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108/ Applicants' tender of the BN agreement, and the degree to which the agreement fails to address serious anticompetitive problems, only confirm our belief that this could occur. Moreover, rather than approaching a number of buyers in the market place, as DOT envisions, applicants have singled out a solitary carrier that, until now, obviously exhibited less interest in competing with applicants than the protestants have.

109/ S. Rep. No. 94-595, reprinted in 1976 U.S. Code Cong. & Ad. News 148, 151-52.

possibilities of improving its service. The record clearly reveals that shippers have benefited from ATSF-SPT competition not only by lower rates but also by improved or at least satisfactory service. This service competition must be maintained. Hence, we must now evaluate whether conditions have been proposed that could alleviate the anticompetitive consequences that the proposed merger would have in the Southern Corridor. The inefficacy of such conditions would necessitate a denial of the application.

At the outset, it is clear that we must reject the KCS independent ratemaking authority (IRMA) proposal. In combination with certain requested trackage rights, it is intended to provide competition to SPSF along the Southern Corridor between the Bay Area and New Orleans, with connections with other railroads to and from points further east.110/ However, for the greater portion of this route, between the Bay Area and Houston, traffic would move in SPSF trains, with KCS simply having the authority to publish rates and solicit traffic for its own account at ATSF-SPT common points. While this might offer some rate competition for this traffic, depending on how the mechanics of the proposal operated in practice, service competition would be wholly absent. Because KCS would not run its own trains through the corridor, it would be unable to compete in terms of car supply, transit times, frequency of service, efficiency of operations, or in other respects. Its transit time could not be shorter, nor its service more frequent than that of SPSF, in whose trains KCS' traffic would move. Sharing the market with KCS under this arrangement would provide no incentive for SPSF to improve its service, or even to refrain from downgrading it, because KCS would never be able to improve on whatever service SPSF chose to offer. While other objections to the IRMA have been raised, we see no need to evaluate them, the lack of service competition being sufficient to fatally undermine the entire proposal.111/

The only other conditions proposed that address Southern Corridor traffic problems are those requested by UP/MP. These are trackage rights extending roughly from the Bay Area through the Central Valley of California to the Los Angeles area, then eastward to connect with UP/MP's existing line at El Paso, TX. These trackage rights cover the territory about which we are concerned in this corridor. UP has existing lines in the Bay Area and Los Angeles. They would connect with the trackage rights to afford those areas a Southern Corridor routing. The trackage rights include a request to serve points now served in common only by ATSF and SPT, which would permit service at Phoenix and at the exclusively served California points. UP/MP's request to establish intermodal facilities could ensure continued competition for other points in the San Joaquin Valley now enjoying ATSF-SPT competition through the use of TOFC ramps. Because UP/MP's line terminating at El Paso extends eastward to a

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110/ A fuller description of the IRMA operations is found in Appendix F.

111/ However, we also question the degree of commitment KCS would maintain to this operation over time. Having no physical presence in the corridor, and having made no substantial capital investment, KCS might find it irresistibly easy to withdraw the operation if it failed to meet KCS' expectations, leaving much of the shipping public locked into a monopoly.

network of lines throughout eastern Texas and Louisiana, including most major Gulf ports as far as New Orleans, and joint-line service could be provided to and from the Southeast. UP/MP's proposed conditions would appear to address the major anticompetitive problems the consolidation would create for the Southern Corridor. As a major transcontinental carrier, UP/MP could be expected to compete aggressively on rates and services among all shippers.

On the other hand, a grant of these conditions would insert SPSF's strongest competitor into the heart of its system. UP/MP estimates it would divert approximately $97 million (gross) of traffic a year from the merged carrier.112/ The conditions would enable it to connect the western termini of three lines (at the Bay Area, Los Angeles, and El Paso). As the only carrier conducting single-system service through the Central Corridor, UP/MP would then have access to San Joaquin Valley traffic. This result could very possibly negate the effect of trackage rights awarded DRGW in UP Control. The effect of these changes is extremely unclear from the evidence, however, and we are not prepared to impose solutions to competitive problems in this corridor without some confidence in their consequences and practicality.

We have explored possible alternatives to UP/MP single-system competition for the entire range of Southern Corridor traffic. Unfortunately, the remaining responsive applications provide few options, none of which is satisfactory. The only other carrier seeking conditions to serve the West Coast is DRGW, which requests trackage rights extending from the Central Corridor to the Bay Area and Bakersfield (effectively encompassing the San Joaquin Valley). We have given consideration to attempting to solve the Southern Corridor problems by a combination of DRGW and UP/MP conditions, with the two carriers connecting at Bakersfield or Colton. However, there are numerous problems with such a solution. The principal drawback with a Colton connection is that DRGW has not sought trackage rights south of Bakersfield, and we cannot assume it would wish to accept them, especially as they would involve difficult operations through the Tehachapi Mountains merely to obtain a shorthaul. The carriers involved have not proposed a joint connection, and we have no evidence showing either their interest in it, its operational feasibility, or its effectiveness as a competitive option to SPSF's single-line service. In particular, because DRGW's interest appears limited to Central Corridor movements, there is doubt about its motivation to cooperate with UP/MP for a short haul on Southern Corridor movements. Finally, the legal and operational problems pertaining to DRGW's sought conditions, as elaborated on in our Central Corridor discussion, would interfere equally with the operations we contemplate here. In light of these problems and uncertainties, we are unable to impose such a solution on the basis of the evidence in this proceeding.

Regarding UP's trackage rights request, we recognize applicants' reluctance to place a full service rail carrier over a significant portion of their main line, and although UP would certainly pay its fair share for any improvements necessitated by its presence, we are unprepared to impose conditions that modify

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112/ However, this would be more than offset by the $165.6 million in gross revenue represented by traffic SPSF would divert from UP/MP. See the analysis of diversion studies in Appendix E.

applicants' proposal so substantially. Applicants have said throughout this proceeding that they would refuse to consummate this transaction if the UP conditions were imposed, and have based much of their opposition on the assumption that UP's compensation would be set at an inequitable level.113/ We recognize the inherent dispute between landlord and tenant in unique situations such as this, where compensation must be set at a level that enables landlord and tenant to compete against one another.

Applicants would continue to realize subtantial annual benefits from consolidation even with UP conditions, including over $65 million in traffic diversion revenues from UP alone, over $180 million in efficiency savings, trackage rights rental revenues from UP, and traffic diversion revenues from other carriers. However, the Southern Corridor is not the only market necessitating conditions to address anticompetitive effects of the merger, and we recognize the substantial burdens on applicants of absorbing both Central and Southern Corridor conditions, and retaining significant benefits.

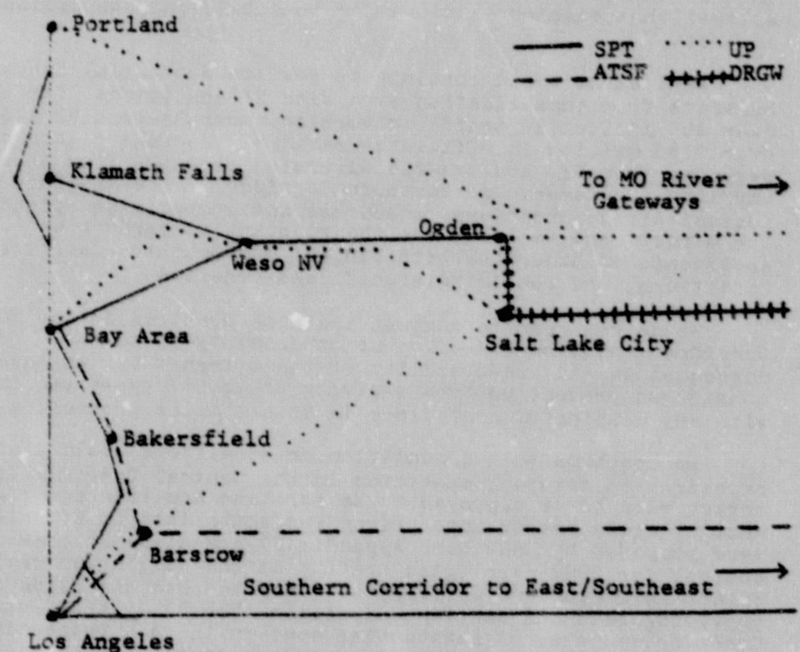
We do not mean to suggest that the problems in the Southern Corridor cannot be solved. But uncertainty as to the consequences and acceptability of the alternatives we have considered prevent us from arriving at solutions we can impose with any meaningful confidence in this complex proceeding.

We conclude that a condition or conditions would also be necessary to assure competition in the Central Corridor if this merger were to be approved. The purchase and trackage rights west of Ogden, north into Oregon and south into California that were proposed by DRGW (see Appendix F) are aimed at creating control for DRGW over Ogden traffic at the origin and destination points in Oregon and California. They address the issue of providing rate and service competition for UP in the Central Corridor, an area of substantial concern in this proceeding, by enabling DRGW to obtain traffic without significantly relying on SPSF's cooperation, thus maintaining sufficient density to keep the route viable. However, there are consequences arising from imposition of DRGW's proposed conditions that, especially in conjunction with Southern Corridor problems, make approval of this merger impossible at this time.

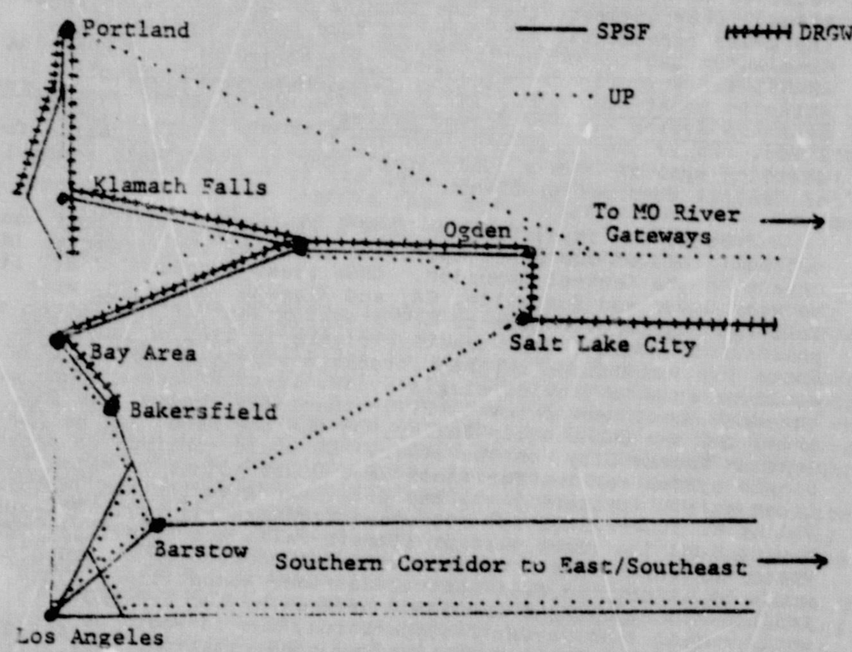
The following schematics illustrate the issues discussed.

113/ SFSP-48, VS Schmidt at 23; SFSP Reply Br. at 260.

EXISTING ROUTES OF SPT, ATSF, UP AND DRGW
WEST OF OGDEN AND NORTH OF LOS ANGELES



POST MERGER ROUTES OF SPSF WITH UP AND DRGW TRACKAGE RIGHTS
WEST OF OGDEN AND NORTH OF LOS ANGELES



First, we recognize the existence of legal problems concerning portions of the lines at issue. SPT and WP are parties to a trackage rights agreement whereby SPT operates over WP (UP) lines between Flanigan and Weso, NV. Thus, the only SPT connection between its lines from northern California to Ogden and its line to Klamath Falls and Lakeview, OR, is via trackage rights over WP/UP. Furthermore, under a "paired track" agreement between SPT and WP/UP, between Weso and Alazon, NV, SPT and UP eastbound trains operate on the WP/UP line, and westbound trains operate over the SPT line. Under the existing trackage rights and paired track agreements, UP's permission would possibly be required to enable DRGW to operate over the WP/UP lines at issue. DRGW suggests that the Commission can set aside or modify the prior agreements, but there is some doubt whether the Commission has the authority to do so, particularly concerning DRGW's trackage rights request. See St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 305-06 (1954). But see Seaboard System R.R. v. United States, ___ F.2d ___ (7th Cir. 1986). While the legal problems are not the primary reason for deciding against DRGW's conditions, they do complicate resolution of Central Corridor problems.

Second, the imposition of DRGW's requested conditions would not solve all of the anticompetitive problems the merger would create in the Central Corridor. DRGW seeks purchase of SPT lines between Ogden and Roseville, CA, and Klamath Falls, OR, with trackage rights over much of SPT's system west of the latter two points. It would accept trackage rights in lieu of purchase Under the combination purchase/trackage rights proposal, DRGW would be able to provide single-system service between much of the West Coast served now by SPT, especially Oregon, the Bay area, and the San Joaquin Valley, on the one hand, and as far east as Kansas City, on the other. UP would continue to provide single-system service for those West Coast points to which its lines extend (primarily the Bay Area, but also the San Joaquin Valley if it received its requested trackage rights). However, having lost its lines east of Klamath Falls and Roseville, SPSF would no longer have a transcontinental connection at Ogden and would be eliminated from Central Corridor competition. Thus, traffic now enjoying competition between UP and SPT-DRGW routings would retain that level of competition, but it would be provided by UP and DRGW (single-system) after consolidation. But traffic from and to points served by SPT but not by UP would lose the competition it now enjoys east of Ogden between DRGW and UP. DRGW, as the Central Corridor "replacement" competitor for SPT, would not be inclined to interline at Ogden with UP for traffic it could move entirely on its own system. And any connection between SPSF and UP other than at Ogden (e.g., in California) would so short-haul SPSF that it could not be expected to retain interest in participating in Central Corridor movements. We have already stated that the existing level of competition east of Ogden must be maintained.

If DRGW were granted all trackage rights, rather than a combination of purchase and trackage rights, the situation would not be substantially different. Central Corridor traffic to or from UP and SPT common points for which they now compete would have UP and DRGW options post-merger. Although SPSF, retaining ownership of its lines east of Roseville and Klamath Falls, would still be able to connect physically at Ogden with UP or DRGW, neither UP nor DRGW would wish to interline traffic at that point because each could now handle this traffic completely on its own system. For Central Corridor traffic in California and Oregon, which is not available to UP for origination or termination, SPSF would be in competition with DRGW, which would be a tenant over SPSF's lines from Ogden to the Bay Area, the San Joaquin Valley as far south as Bakersfield, and Oregon as far north as Portland. Clearly, SPSF would not have a friendly connection with DRGW for traffic moving east of Ogden. Given the amount of traffic DRGW could be expected to divert from SPSF on these lines, with the resulting lower traffic density for SPSF, and given applicants' preference for using their Southern Corridor routes whenever possible, SPSF would have even less incentive to route this traffic over the Central Corridor than it would if the merger were approved with no conditions. It is reasonable to conclude that SPSF would have no interest in maintaining its Ogden connection with UP, and that its interest in the Ogden line would be relegated to that of a local carrier for traffic originated or terminated between Sacramento and Ogden. Rio Grande, on the other hand, would handle Oregon and Northern California transcontinental traffic in single-line service between those areas and Kansas City and, if such traffic increased, Rio Grande's portion of the upkeep of its landlord's lines would proportionately increase. Further, UP's traffic base would diminish due to its loss of SPT interlined traffic. SPT exclusively-served traffic that now enjoys competition between UP and DRGW east of Ogden would be subject to a DRGW Central Corridor monopoly. This would be an unacceptable loss of competition.

Beyond the problems inherent in DRGW's proposed conditions, there are complications that would arise if we granted both DRGW's and UP's conditions to address the Central and Southern Corridor problems, respectively. DRGW's trackage rights would extend south through the San Joaquin Valley to Bakersfield, while UP's would extend northward through the Valley to the Bay area. San Joaquin Valley shippers would have the option of using three rail carriers as opposed to the two presently serving the region. Rio Grande's participation clearly would be restricted to traffic moving over the Central Corridor, and SPSF clearly would concentrate on Southern Corridor service. UP could take traffic over either corridor. While on its face this would appear to be a pro-competitive situation, there are no facts of record indicating that rail traffic originating or terminating in the San Joaquin Valley is of sufficient volume economically to sustain the operations of three virtually side-by-side competitors operating physically throughout the length of the Valley.

In addition, we are reluctant to impose both sets of conditions in light of the economic burden that together they might place on the newly-created system. It is not in the public interest simultaneously to create a consolidated railroad and to place it under such pressures that its chances for success are seriously compromised. Throughout this proceeding, applicants have characterized each of these sets of conditions individually, not to mention in combination, as "deal-breakers", at least if the existing compensation formula and the purchase price offered by DRGW were to apply. We cannot determine that SPSF would be unable to compete with UP/MP and DRGW if these conditions were imposed, but in the absence of an indication by applicants that they view their competitive prospects favorably, we cannot responsibly force SPSF into this competitive situation.

Applicants stated at oral argument that they would agree to continuation of SPT's solicitation agreement with DRGW as a condition of merger. This would require both parties to use their best efforts to solicit certain traffic for the Ogden Gateway, and has been presumably successful, considering the recent 100,000-plus annual carload interchange history. However, arrangements between carriers in joint routes, and similarly in solicitation agreements, require incentive by both parties to assure the success of the arrangement. We have serious doubts whether SPSF would have sufficient incentive to do its necessary part in soliciting traffic for Ogden. And without such incentive, the service it would provide might discourage the use of the route, as might its less than enthusiastic solicitation. Further, such an agreement would have to be structured to avoid the anti-competitive problems that would occur if DRGW received purchase and/or trackage rights approval.

We are thus faced with a combination of difficult interrelated situations. First, we are confronted with the severe anti-competitive results of the proposed merger in the Central Corridor, the San Joaquin Valley, and the Southern Corridor.[114] Second, we have before us proposed conditions which, when viewed narrowly, appear to alleviate some of the anti-competitive problems, while continuing or creating others, and rearranging traffic patterns in ways that may have unforeseen consequences. Third, in attempting to apply the conditions, we risk diluting the traffic base for all the competitors and jeopardizing the success of the merged system. We have refused to indulge in this sort of restructuring in the past,[115] and we affirm that position here. We are compelled to deny this merger proposal in the absence of a solution that would both resolve the identified anticompetitive problems and furnish us with a basis to expect that the merged carrier would become and remain a strong and effective competitor.

The Midwest North-South Corridor

While we have found that the merger would have some anticompetitive effects in this corridor, either they are limited or their extent cannot be determined from the record. We do not favor unnecessary conditions, and, were the application to be granted, we would refrain from requiring applicants to accept conditions here except where the anti-competitive consequences seem clear and specific, and where conditions have been proposed that are not out of proportion to the degree of harm found to exist. MKT's Midlothian/Ward Spur trackage rights would prevent the elimination of rail competition for a shipper that chose its location to benefit from such competition, and the conditions would be no more than a minor burden on the merged system. Similarly, requiring applicants to maintain existing access agreements for AGRI is not an unreasonable burden. Approval of the consolidation would have to be subject to applicant's acceptance of these, or similarly effective, conditions.[116] Imposing these conditions presents no complications.

114/ Unacceptability of these conditions obviously also makes the anti-competitive problem in the Pacific Coast Corridor (loss of the BN-UP-ATSF competitive route) impossible to remedy on the present record.

115/ See 366 I.C.C. at 564-5.

116/ We note that to the extent the previously discussed milo shipments between Southwest Kansas and the Southwest United States would experience loss of competition, no conditions have been proposed that would address this problem.

THE APPLICANTS' FINANCIAL CONDITION IS NOT AN OVERRIDING FACTOR

The applicants claim that SPT's financial condition is so desperate that the Commission should approve the merger despite its anticompetitive consequences, and without corrective conditions.117/ SFSP Opening Brief at 97-110, 324. SFSP invokes the "failing firm" doctrine, a weakened competitor defense, and the applicants' lack of revenue adequacy, to justify that proposition. The thrust of this argument is that the Commission should subordinate the public interest standard by which rail mergers are ordinarily measured to the goal of avoiding a reorganization of SPT.

We conclude that SPT's financial condition is not desperate, that SPT has not been shown to be failing, and that applicants' "weakened competitor" and revenue adequacy arguments are without merit.

The Failing Firm Doctrine

The applicants argue that the Commission should approve the merger, regardless of its anticompetitive effects, lest the public soon be saddled with a bankrupt SPT. They urge the Commission to consider the "failing firm" doctrine as a legal basis for granting approval. Simply stated, the doctrine provides that a merging company's imminent failure may serve as a basis for approving an otherwise anticompetitive merger. This theory "presupposes that the effect on competition and the 'loss to [the company's] stockholders and injury to the communities where its plants were operated' will be less if a company continues to exist even as a party to a merger than if it disappears entirely from the market." United States v. General Dynamics Corp., 415 U.S. 486, 507 (1974), quoting Int'l Shoe Co. v. FTC, 280 U.S. 291, 302 (1930). Although the failing firm doctrine has apparently never been used by the Commission to approve a merger, it is a complete defense to an acquisition otherwise illegal under Section 7 of the Clayton Act, that the merging firm meets the requirements of the doctrine at the time of the challenged transaction. See id. The requirements of the doctrine were set forth by the United States Supreme Court in Citizen Publishing Co. v. United States, 394 U.S. 131 (1969). In that case the court held that the defense was not available unless the party asserting it could show that: (1) the resources of the acquired company were so depleted and the prospect of the firm's rehabilitation so remote that it faced the distinct likelihood of insolvency from which it could not be viably reconstituted; (2) the acquiring company was the only available purchaser; and (3) the acquired firm had made bona fide efforts to seek alternative purchasers. Id. at 137-8. If less

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117/ SFSP also argues that Santa Fe is in deteriorating financial condition and will cease to be viable as an independent railroad in 5-10 years. Tr. at 15,247 (Schmidt). An unexplained anomaly in these circumstances is that SFSP has initiated a program to repurchase 50 million of its shares. Tr. at 15,451-52 (Schmidt). The total cost is estimated to be nearly $1.5 billion, and the repurchase is being funded in part by railroad dividends. Tr. at 15,658-60 (Swartz). There is no evidence that the shareholders have been informed of an impending Santa Fe bankruptcy, and we will not assume that the investing public not selling its shares has been misled. Thus, we conclude that the bankruptcy of an independent Santa Fe is not seriously anticipated by SFSP. See also Appendix G.

anticompetitive purchasers can be found, the defense is not available. See Pillsbury Co., 93 F.T.C. 966, 1032 (1979) ("there must have been a good faith effort to determine whether there were other purchasers available whose acquisition of the company would have resulted in less anticompetitive effects").

The primary test of the failing firm doctrine is whether in fact the company faces a clear probability of business failure. Seeking approval of their merger on these grounds, the applicants have forecast impending doom for an independent SPT. Indeed, SFSP's Chairman testified in July 1985, that SPT "is in bankruptcy right now." Tr. at 15,425. In an effort to demonstrate how serious the situation is, the applicants offered the testimony of: (1) the former president of SPT, now the president of SFSP (Krebs), that extensive capital and operational improvements by SPT have been without financial benefit; (2) the former president of SFI, then vice chairman of SFSP (Swartz), and a senior SPT executive (McPhee), that SPT will soon run out of cash; and (3) an investment banker (Starmann), that absent merger SPT will be forced into bankruptcy.

However, this evidence appears to be directly contrary to their own statements only 18 months earlier. Testimony by SPT's Vice President and Treasurer filed in the United States District Court for the District of Columbia on December 8, 1983, when the applicants were seeking merger of their holding companies, states:

> SPT, with its stock in trust, will be as it is today, a significant and financially viable business. SPT, on its own, has an asset base and the financial capacity to not merely survive, but to vigorously compete with other large western railroads and motor carriers.
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>
> When its stock is placed into the Voting Trust, SPT will be in the strongest working capital and debt position it has been in during the last four years . . . . Based on SPT's current financial condition and the prospects for improved operating results, the contention that SPT, with its stock in a Voting Trust, will be unable to maintain its operations at a competitive level is wholly unfounded.

Affidavit of David A. Smith at 3, 14 (D.D.C. Civ. Action No. 83-3631).

In the same proceeding, SPT's Chairman and Chief Executive Officer testified that

> SPT is in good financial health. Even if SPT were ultimately to emerge [from the voting trust] as an independent railroad, SPT's financial position is sufficiently strong that it could continue indefinitely as an independent competitor.

Affidavit of Denman K. McNear at 16.

Finally, Morgan Stanley & Co., SPT's financial advisor in the merger, stated that "SPT can be expected to be financially viable over the next several years." Affidavit of Joseph G. Fogg, III at 10.

Now the applicants want SPT to be viewed as a failing firm. The obvious question is: What happened to SPT to convert its prospects as an independent railroad from financial viability to imminent bankruptcy in the 18 months between the time that the applicants submitted their testimony in Federal court and the time that they submitted their testimony in this proceeding?

Our financial analysis does not show substantial overall change in SPT's condition over the last 2-1/2 years. See Appendix G. This conclusion is confirmed by applicants' reports to the Securities and Exchange Commission, outside the context of this case. Having given public assurances as to SPT's financial viability as an independent railroad in December 1983, the applicants arguably incurred a correlative obligation. At the point thereafter that they seriously anticipated bankruptcy by SPT absent merger, SPT and SFSP were required to make a public statement to that effect, if not in an 8-K Report, then in a 10-Q or 10-K Report filed with the SEC.118/ Instead, SFSP's and SPT's filings with the SEC do not mention any deterioration in SPT's ability to compete effectively for rail traffic, nor the allegation that SPT may soon become unable to pay its obligations as they come due.

Moreover, there is evidence in the record that steps have been taken to upgrade SPT's performance. In the past several years SPT's management has invested heavily and devoted substantial attention to improving SPT's plant and operations. According to SPT's former president (Krebs), during the period 1979 to 1983, SPT improved maintenance of both track and equipment, expanded its locomotive fleet, upgraded its track structure, reduced slow orders by 70 percent, increased train speed, reduced terminal time by 20 percent, doubled the miles of track surfaced, increased by 60 percent the miles of track relaid with new rail, and increased the installation of cross-ties by 40 percent, among other things. Tr. at 15,619-20. Productivity also improved according to important measures, including ratio of net ton-miles to gross ton-miles, reduced expense for crew wages per thousand trailing gross miles, and improved trailing tons per gallon of fuel. Tr. at 15,623-24. These accomplishments continued into 1984 "in almost every area of operations and efficiency and productivity." Tr. at 15,624-5. Indeed, Mr. Krebs concluded his cross-examination by stating:

> What I am the witness on is whether or not in the last four or five years the performance of the Southern Pacific measured against itself improved, and to that I can give you a clear yes.

Tr. at 15,640. And, SPT's Chairman and Chief Executive Officer testified that he anticipated these improvements would produce long-term benefits to the company. Tr. at 603.

In sum, we simply cannot reasonably conclude that SPT is a "failing firm" as that doctrine has been applied by the courts. Indeed, the failing firm doctrine has not saved the merger of companies demonstrated to be in far worse shape than SPT.119/

118/ See generally Form 8-K, Item 5 (requiring reporting of events "of importance to security holders"), and SEC Regulation S-K, Item 303, applicable to Forms 10-K and 10-Q (management must discuss "any material changes in financial condition").

119/ See, e.g., United States v. Greater Buffalo Press, Inc., 402 U.S. 486 (1971); Citizen Publishing Co. v. United States, 394 U.S. 131 (1969); United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964).

Although the applicants cite several cases where the doctrine saved the merger, the companies involved had far greater financial difficulties than SPT. In United States v. M.P.M., Inc., 397 F. Supp. 78 (D. Colo. 1975), the failing company was expressly found to be "faced with inevitable business failure." Id. at 101. The company was accumulating losses "at an alarming rate and magnitude;" the ratio of its net worth to total debt was precipitously low and declining; its only commercial lender was threatening both a cut-off of credit and foreclosure; certain principals of the business were forced to incur personal liability on corporate debts; and operating expenses could be met only by improper manipulation of company accounts. Id.

In Granader v. Public Bank, 281 F. Supp. 120 (E.D. Mich. 1967), aff'd, 417 F.2d 75 (6th Cir. 1969), the failing company was found to be "on the brink of bankruptcy with no chance of rehabilitation." 281 F. Supp. at 123. And in United States v. Maryland and Virginia Milk Producers Ass'n, 167 F. Supp. 799 (D.D.C. 1958), aff'd in part and rev'd in part, 362 U.S. 458 (1960), the court found that the two acquired companies "were hopelessly insolvent and were deeply in debt." 167 F. Supp. at 808. None of these cases describes the financial condition of SPT.

Moreover, the applicants have not shown that the doctrine is applicable under the other tests outlined in Citizens Publishing, supra. The applicants have not asserted that there was a good-faith effort made by SPT to find a less anticompetitive merger partner or purchaser, nor was any evidence presented that SPT would have no prospect of successful reorganization should it become insolvent.

The Weakened Competitor Defense

The applicants also argue that market-share evidence should be given little weight in assessing the anticompetitive effect of their merger because SPT is financially weak. Their argument is based on the claim that another "principle of antitrust law is that the poor financial health of a company may significantly diminish the reliability of its present market share as a measure of its market power." SFSP Opening Brief at 48. Under this theory, as articulated by the applicants, the financial weakness of a merging firm may prevent a threshold determination that a merger will reduce competition. However, the decisions cited by SFSP do not support their case.

In United States v. General Dynamics Corp., 415 U.S. 486 (1974), the purported genesis of this doctrine, the Supreme Court held that available coal reserves -- rather than past production, as reflected in market share -- were a better indicator of future competitiveness in the coal market. The Court affirmed that the acquisition of a company whose entire reserves of coal had been previously committed to certain purchasers, had no adverse effect on competition. Id. at 502. That holding had nothing to do with financial weakness; the acquired firm in General Dynamics was "highly profitable." Id. at 503. The Court explicitly stated that the District Court's holding was not "identical with or even analogous to a finding that the acquired firm was a failing company . . . ." Id. at 507-08.

Following General Dynamics, in United States v. Int'l Harvester Co., 564 F.2d 769 (7th Cir. 1977), the Seventh Circuit appeared to create a "financial weakness" defense, but subsequently rejected any such interpretation:

> It should be emphasized that International Harvester does not rely solely on the acquired firm's weak financial condition as a defense to §7. The case instead considers the firm's weak condition as one relevant economic factor among many. It is therefore a mischaracterization to view International Harvester as adopting a weakened company doctrine as a per se defense to §7 liability.

Kaiser Aluminum & Chem. Corp. v. FTC, 652 F.2d 1324, 1339 (7th Cir. 1981).

Neither these nor the other cases cited by applicants support their assertion that "many courts have relied on General Dynamics to hold that the weak financial condition of one or both of the merging companies rebuts the inference, based on market share data, that the merger will be anticompetitive." SFSP Opening Brief at 50-51. Rather, the cases stand for the proposition that future competitive significance may depend on future ability to obtain needed competitive tools and for the proposition that financial weakness may make a merger of less competitive concern when the market is already competitive and moving away from concentration.120/ Neither of these propositions is applicable to the facts of this case.

Revenue Adequacy

Finally, the applicants argue that because SPT and Santa Fe are revenue inadequate, they must obtain the ability to increase more of their rates above long-run marginal costs.121/

It is true that the Commission has found SPT and Santa Fe, like all other major railroads, to be revenue inadequate. But that in no way provides a justification for approving the merger. To accept SFSP's argument would turn the Staggers Act on its head. That Act reflects Congress' well-founded conclusion that earlier regulation had systematically deprived rail carriers of adequate revenues and that the rail industry should be governed instead by market forces to the maximum extent feasible. Congress thus limited the Commission's ability to regulate rates, believing that in the long run, competition would allow carriers to earn an adequate rate of return. The Staggers Act is thus premised on the encouragement of competition. It is not an excuse for the elimination of competition.122/

Conclusion

In summary, we cannot justify overriding the confessed anticompetitive effects of this merger in the absence of demonstrably effective mitigating conditions, by concluding that SPT is a "failing firm." At the same time, we have no illusions

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120/ See, e.g., United States v. Tracinda Investment Corp., 477 F. Supp. 1093, 1110 (C.D. Cal. 1979) (citing International Harvester for proposition that acquisition did not violate Section 7 of Clayton Act when acquired firm was financially weak, industry was vigorously competitive, and industry was moving away from concentration).

121/ SFSP Opening Brief at 94.

122/ This conclusion is supported by the fact that the only Staggers Act amendment to the rail merger provisions of the Interstate Commerce Act added the requirement that the Commission consider the effect of a proposed merger on competition among rail carriers. See 49 U.S.C. §11344(b)(1)(E).

that SPT is a marginal railroad, and has been for some years. While a merger might assist SPT, this merger, as proposed, is inconsistent with the public interest.

We are not, however, shutting the door on the possibility of an eventual Southern Pacific and Santa Fe merger. But, as the Commission warned over five years ago in its Merger Policy Statement, parallel mergers are not favored where there are no other competing railroads. See *Merger Policy Statement*, 363 I.C.C. 784, 791 (1981). The burden of demonstrating that such a merger is in the public interest is a heavy one, and must be borne on the shoulders of substantial evidence, not *in terrorem* legal argument.

DIVESTITURE

The stock of SPT is currently held in a voting trust. This arrangement, approved by us prior to the filing of the merger application, was designed to insulate SPT from control by SFSP while the merger proceeding was pending.[123] However, the voting trust mechanism is a temporary one. As we observed in *Water Transport Assn.--Petition For Declaratory Order*, 367 I.C.C. 559, 568 (1983),[124]

> an independent voting trust of the type entered into here is merely a temporary device designed to avoid a technical violation of the law in the context of a corporate acquisition. It is not, and cannot, be a device for holding stock on a permanent basis.

With our denial of the SFSP application to acquire SPT, steps must be taken to ensure the orderly divestiture of either SPT or ATSF so that the control provisions of the Interstate Commerce Act are not violated.

The Voting Trust Agreement, ¶7(c), stipulates that upon denial of the merger, SFSP "shall use its best efforts to sell or direct in writing the Trustee to sell the Trust Stock to one or more eligible purchasers or otherwise dispose of the Trust Stock during a period of two years after such order becomes final."[125] The terms of the voting trust, however, do not override our jurisdiction to oversee the orderly divestiture of SPT by SFSP. As the Supreme Court has held, such powers are inherently within our authority to approve consolidations and acquisitions of control. See *Gilbertville Trucking Co. v. United States*, 371 U.S. 115, 129-130 (1962); *Pan American World Airways v. United States*, 371 U.S. 296, 312 (1963). Moreover, in approving the voting trust, we specifically reserved jurisdiction over the terms of the trust to ensure its compliance with the statute and to protect the public interest.

123/ *See* n.3, *supra*.

124/ *Aff'd sub nom. Water Transport Ass'n v. ICC*, 715 F.2d 581 (D.C. Cir. 1983), *cert. denied*, ___ U.S. ___ (1984). *See also Central of Georgia Ry. Co. Control*, 312 I.C.C. 125, 132 (1960), *modified*, 312 I.C.C. 539 (1961).

125/ The Voting Trust, ¶7(c), defines "eligible purchaser" as a person or entity that is not affiliated with SPCO, SFSP, or Santa Fe and which has such regulatory authority as may be required to purchase the Trust Stock.

We are concerned that the divestiture of SPT should be accomplished with the least possible disruption of the market and in a manner wholly consistent with the public interest. To this end, we will not require precipitous disposal of the SPT stock,[126] or the filing of reports with us that would publicize otherwise confidential sale negotiations. Consistent with the terms of the voting trust, and our authority under the Interstate Commerce Act, we therefore order SFSP to file an initial report with us three months from the date of service of this decision, followed by quarterly reports thereafter, describing the manner in which it proposes to approach the divestiture of SPT stock and assets. SFSP should include a description of all assets to be divested, and a report on the financial and operating condition of SPT, including the details of any proposed transfer of assets from SPT and its subsidiaries to other entities owned directly or indirectly by SFSP, and of any such transfers which may have taken place since December 23, 1983. Finally, until divestiture is accomplished, SFSP, SPT, and ATSF shall furnish us with copies of all such reports (including Forms 8-K, 10K, and 10-Q) as they may file with the Securities and Exchange Commission.

We believe it is imperative that SPT's financial condition at the time of divestiture be at least as sound as it was prior to its being placed in trust. In December 1983, when the voting trust was proposed, it was feared that SPT would cease to be an aggressive competitor and would deteriorate while held in trust. As we acknowledged then, those were legitimate concerns, and contributed to our reluctance to permit establishment of the voting trust. Thus, as a condition to lifting the cease and desist order we had issued earlier and allowing the voting trust, we sought and obtained a written commitment from SFSP's Chairman that, during the existence of the trust, SFSP would provide such financial assistance as might be necessary to maintain SPT as a "vigorous competitor and financially viable enterprise." This guarantee should protect the public interest now and until a sound divestiture can be accomplished.

To provide additional assurance of successful divestiture, we are expressly subjecting SFSP to the reporting and accounting provisions of subchapter III of chapter 111 of Subtitle 49 of the United States Code. See Louisville & Jeffersonville Bridge & R.R. Co. Merger, 290 I.C.C. 725 and 295 I.C.C. 11 (1955), aff'd on other grounds sub nom. Allegheny Corp. v. Breswick & Co., 353 U.S. 151 (1957); Illinois Central Gulf R.R. Co.--Acq.--Gulf, M. & O. R.R. Co., 338 I.C.C. 805, 856 (1971), aff'd sub nom. Missouri Pacific R.R. Co. v. United States, 346 F. Supp. 1193 (E.D. Mo. 1972). See also F.D. 30400, Decision No. 2 at 16-17. We take this action for the limited purpose of ensuring that divestiture is conducted in an orderly manner and consistent with the public interest.

SFSP should exert its best efforts to effect a prompt and prudent divestiture. However, its offer to sell SPT within two years (as stated in the Voting Trust Agreement) does not override the public interest. SFSP may of course sell the ATSF instead, or it may take longer than two years to sell SPT, if it becomes necessary. While it would be preferable that divestiture be

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126/ The provision of ¶7(c) of the Voting Trust Agreement, committing SFSP to sell SPT, was not imposed by the Commission, but was volunteered by SFSP. For this reason our discussion of divestiture primarily mentions SPT. However, the divestiture requirement may be satisfied by sale of ATSF instead. Therefore, all provisions of this order shall be deemed to apply to ATSF as well.

accomplished sooner rather than later, SFSP's guarantee of SPT's financial and competitive vigor should protect the public interest in the meantime.

ENVIRONMENT, LABOR, AND ESSENTIAL SERVICES

Several parties to this proceeding have alleged that the proposed consolidation would have adverse environmental impacts. Accordingly, they requested specific conditions to ameliorate the alleged negative impacts. Similarly, several labor unions, including the BLE, RLEA, and IBT have requested specific conditions to protect their members from alleged negative labor impacts. Because we have decided to deny the merger, those requests are moot.

We are also obligated to consider whether the proposed consoldation would harm "essential services." 49 CFR 1180.1(c)(2)(ii). A service is essential if there is sufficient public need for it and adequate alternative transportation is not available. UP Control at 546. None of the responsive applicants have explicitly argued that essential services would be harmed, most of their arguments focusing on the reduction or elimination of competition. Our denial of this merger on competitive grounds makes further discussion of this issue unnecessary.

FINDINGS

We find that the control of Southern Pacific Transportation Company by Santa Fe Southern Pacific Corporation and the proposed merger of Southern Pacific Transportation Company and the Atchison, Topeka and Santa Fe Railway Company have not been shown to be consistent with the public interest under 49 U.S.C. 11343.

We further find that the orderly divestiture of SPT or ATSF by SFSP requires our continuing jurisdiction, that the divestiture should be accomplished with the least possible disruption of the market and in a manner consistent with the voting trust, and that SFSP must provide sufficient financial resources to SPT so that at the moment of divestiture SPT is in a financial condition equal to its financial condition prior to the formation of SFSP and the placement of SPT's stock in the voting trust. SFSP, SPT and the Trustee should pursue the divestiture in a diligent and orderly manner. And finally, we find that SFSP must be subject to the reporting requirements of Subchapter III, of Chapter 111, of Title 49 of the United States Code until such time as divestiture is accomplished to ensure successful divestiture.

It is ordered:

1. The primary, all related applications, and all responsive applications are denied.

2. Applicants are immediately to pursue the orderly divestiture of SPT or ATSF from SFSP.

3. Applicants shall file, within 90 days from the service date of this decision, a plan of divestiture that includes the proposed approach to divestiture, a description of all assets to be divested, and a report on the financial and operating condition of the SPT, including details of any proposed transfer of assets from SPT and its subsidiaries to other entities owned directly or indirectly by SFSP and of any such transfers which may have taken place since December 23, 1983. They shall also furnish us with all such reports as they may file with the Securities and Exchange Commission.

4. After the filing of the initial report, applicants shall file quarterly reports on the progress of divestiture.

5. Interested parties may file comments to the initial and quarterly reports within 20 days from the date of filing of the reports with the Commission.

6. SFSP shall be considered a carrier subject to the provisions of SubChapter III, of Chapter 111, of Title 49 of the United States Code.

7. Jurisdiction is retained to make such further order or orders as may be necessary or appropriate.

8. This order shall be effective 30 days from the date of service.

By the Commission, Chairman Gradison, Vice Chairman Simmons, Commissioners Sterrett, Andre and Lamboley. Commissioner Lamboley commented with a separate expression. Chairman Gradison dissented with a separate expression.

Noreta R. McGee
Secretary

(Seal)

COMMISSIONER LAMBOLEY, commenting:

Because of our denial of the proposed merger we have found it unnecessary to review environmental issues. However, our treatment of such issues should not be read to suggest that procedural and substantive questions were not present in this proceeding.

CHAIRMAN GRADISON, dissenting:

The Commission should have approved the application to merge the Santa Fe and Southern Pacific rail operations. As proposed, the merger would have provided substantial public benefits, savings for the applicants and improved service to shippers. The feared adverse consequences have been exaggerated.

The proposed merger was and is one of great possibilities. The Commission is faced with the opportunity to permit a large scale private sector solution to the problems presented by the existence of a large western railroad in financial difficulty. A combination of the Sante Fe and Southern Pacific is projected to provide a half billion dollar one-time savings in capital expenditures and approximately $200 million in savings annually. These savings are anticipated through efficiency gains provided by traffic rerouting and operational coordinations, not through abandonment of any substantial amount of rail trackage. Savings on this scale should not be viewed lightly, especially when cost savings are so important to a railroad's ability to provide good, reliable service to its shippers, to earn a profit, and to remain in business. Moreover, the anticipated savings do not project either a reduction in service to shippers or an increase in the rates charged to shippers. Through the cost savings and improved service made possible though combined, coordinated operations, the Santa Fe Southern Pacific would better be able to compete with the highly competitive motor carrier industry and with the generally strong other western railroads.

When weighed against the real and significant savings and benefits of the merger, the potential disadvantages are slight. The most significant perceived negative consequences focus on the concern for competition. The majority, while recognizing the benefits of the merger, would nonetheless conclude that the anticompetitive aspects outweigh those benefits. The evidence, however, does not support this conclusion. In fact, there is relatively little traffic that would be competitively harmed as a result of the merger. Whatever the specific calculation in terms of traffic, I find it incredible that concern for this possible harm was of such magnitude that it will prohibit the realization of the very real benefits of the merger. I cannot help but conclude that even if competitive harm were perceived, it could have been resolved through imposition of appropriate, specific conditions designed to remedy the problems but to permit the realization of the merger benefits to the carriers, the shippers and the public.

There are a number of areas where I believe the majority went wrong. For one, I believe that effective truck competition was too quickly written off. While it may be true that the vast majority of truck movements are less than 1000 miles in length, as shown in Appendix D, Table I, I am confident that the same could be shown for rail movements, a fact which does not show rail competition to be ineffective for distances in excess of 1000 miles. In any event, motor carrier competition (which is clearly not a factor for every movement of every commodity) should not have been completely excluded from the product market definition.

A second area concerns specific adverse impacts. What are the serious adverse competitive effects that have convinced a majority of the Commission to conclude that the proposed merger should be denied? You have to hunt to find them.

The Department of Justice predicted the most serious adverse competitive effects, stating: "At a minimum, 6.2 million tons of freight, which translate roughly to 240 million dollars in revenues, would be adversely affected." DOJ-12 at 4. This is approximately <u>three percent</u> of applicants' total traffic base for the study year. The majority states: "The proposed merger is being denied because, as presently structured, the transaction's anticompetitive effects outweigh its potential public benefits." It is difficult to understand what anticipated harms, whether through rate increases or anything else, might be inflicted on such limited traffic to outweigh the benefits in excess of a billion dollars which would accrue within the first three years of the proposed merger.

In analyzing the reduction in competition, the majority has not identified how many new shippers would be subject to loss of competition. Further, the majority does not find any additional harm in having SPSF supplant existing single carrier service by either SPT or ATSF. The majority has identified two points in New Mexico, 10 points in Texas, one point, Phoenix, in Arizona, and 19 points in California, where the number of rail competitors will be reduced to one, thereby creating a new "monopoly" as a result of the proposed merger. But the majority does not identify individual shippers or receivers to quantify the effect a reduction in competition would have. By contrast, 330 shippers, throughout the affected regions, filed individual verified statements in support of the merger. Hundreds of additional shippers supporting responsive applications also supported the merger subject to conditions.

What adverse effect on the public interest is caused by a reduction in the number of carriers at these points? Because almost half of a merged system's traffic base would be TOFC/COFC traffic and because this traffic most affects small or infrequent users of the rail system, what practical harm can be identified for TOFC/COFC traffic at these points?

The two points in New Mexico are limited interchange points between applicants. Vaughn has a population of approximately 870 people and Deming has a population of 8343. Vaughn is approximately 225 highway miles and Deming is approximately 100 miles by the interstate highway system from UP's El Paso TOFC facility. While Vaughn is just over 105 miles from ATSF's TOFC facility at Belen, SPT's closest TOFC facility is at El Paso. Because El Paso will continue to have two competing TOFC facilities, there is no reduction in TOFC competition in New Mexico.

The ten points in Texas range in population from approximately 940 at Newgulf to over 36,000 (1979 est.) at Wharton. Wharton is approximately 55 miles from UP's TOFC facility at Houston. Alpine (population approximately 6000) is about 200 miles from El Paso, the closest TOFC facilities, where no reduction in competition will occur. None of these points appears to suffer a reduction in the number of available and usable TOFC facilities.

Phoenix does experience a direct loss in available competitive TOFC options because both SPT and ATSF have facilities there. However, Phoenix would not be left without competitive TOFC service which would remain available through UP gathering operations. Phoenix is approximately 286 miles from UP's TOFC facility at Las Vegas and 400 miles from UP's TOFC facility at El Paso. These are distances that are still within even the majority's findings of effective motor competition. While this is the most isolated point of any of the areas affected, the transportation needs of the city of Phoenix could be substantially met by TOFC service, or motor carrier service.

The Arizona State Legislature requested by letter that the merger be approved. They found that Arizona would be better served by one financially strong carrier than by the preservation for an indefinite period of two competing systems. Compensating for any reduction of rail competition, applicants will be able to offer improved service through single-line service to all points connected by rail, both intra- and interstate.

Finally, California has the most points and the greatest population affected by the reduction in competitors. The major impact is in the San Joaquin Valley. However, the most isolated of these points, Bakersfield, is approximately 115 and 226 miles from UP's TOFC facilities at Los Angeles and Stockton, respectively. SPT and ATSF compete in TOFC service in this area from Bakersfield and Fresno, respectively. Some increase in the distance required for gathering operations would be required as a result of the merger. However, the record demonstrates (a) that there is virtually no competition between SPT and ATSF for California intrastate traffic with SPT handling over 99 percent of all intrastate movements and (b) that 70 percent of all California traffic moves by motor carrier. Again, the impact is limited.

Assuming the worst possible corporate post-merger behavior, the impact of any reduction in TOFC competition is limited. It is presumably with large shippers, shippers of heavy commodities, or shippers that ship over the length of the affected corridors, that the majority has found reason to deny the merger.

The majority does not identify how many new captive shippers would be created or how much new captive traffic would evolve as a result of the consolidation. Without this information, no meaningful reconstruction of the harm the majority finds can be made. If the new captive shippers are confined to the 32 named points, the percentage increase cannot be great. Only a handful of specific shippers are cited as cause for concern. Additionally, several carriers which use the TOFC/COFC service are mentioned. Considering the large areas involved, reaching from Indiana in the East to San Diego in the Southwest, this appears to be a relatively small number of shippers.

Where the majority has rested its case is in corridor flows, primarily the Pacific and Southern Corridors. Considering that 70 percent of California's traffic moves by motor carrier, that over 99 percent of California's intrastate rail traffic moves by SPT, and post merger competition from UP from Oregon and Seattle, (although circuitous) would continue, the Pacific Corridor does not seem that great a problem.

The Southern Corridor has attracted more attention. The majority notes that from 23 to 66 percent of the Southern Corridor's traffic moves by rail. See Appendix D, Table 2. Then it looks only at the rail share and finds that applicants move up to 100 percent of the traffic. [It is by defining the relevant market as rail transportation, instead of surface transportation, a definition with which I do not agree, that the majority finds anticompetitive harm.] Therefore, it is found that service will deteriorate and monopoly pricing will result. To reach this result, the majority also must (1) ignore shippers' leverage and administrative recourse, (2) discount potential intra- and intermodal diversions and (3) find there is inadequate evidence to determine the elasticities of demand for inter-corridor competition, especially between the Central and Southern Corridors.

A primary concern expressed throughout this proceeding has been the potential effect the combination would have on COFC traffic moving over the Southern Corridor. Because COFC traffic is exempt, COFC shippers have less readily available regulatory recourse to resolve specific carrier-shipper differences, a problem that captive shippers do not share. Further, in exempting COFC traffic from regulation, the Commission specifically relied on intramodal rail competition.

The reduction in Southern Corridor competition, particularly for COFC traffic may be one of the strongest arguments in favor of a denial, but is it valid? The majority finds American President Lines' arguments "convincing" and has adopted them. An examination of the verbal statement of Richardson at KCS-14, shows several important facets in APL's operations. APL, as do most ocean carriers with COFC traffic to the Gulf, uses the longer ocean route from the Far East to the West Coast to call at Los Angeles first. This ocean route is generally one to two days longer than to Seattle or the Bay Area. The reason APL and other shipping companies call on Los Angeles first is that Los Angeles and Southern California is the largest West Coast consumer market. Approximately half of APL's Los Angeles traffic stops at Southern California destinations. It is because the ocean vessel is already at Los Angeles that the Southern Corridor has such a competitive advantage over other corridor routings. Indeed, at least one shipping company, Westwood Line, offers faster service from Korea/Japan through Seattle, 19 days average, to APL's 20 day average. By the same token, those vessels that make additional stops at West Coast Ports that are loaded with export containers offer slower transit times to the Orient than export originations at Seattle or the Bay Area. According to KCS-14, Exhibit 22, the cost difference of routing Far East COFC traffic through Los

Angeles, on the one hand and Seattle and the Bay Area, on the other, is less than 25 percent greater.

These statistics indicated that while the Southern Corridor has advantages for Far East-Gulf traffic, exclusive control of the corridor does not accord a monopoly position for the Gulf's COFC traffic even absent inter- or intramodal competition over the corridor. If applicants manifest their worst possible behavior, significant diversions to the other corridor routes would occur, presumably lowering the other corridors' unit costs, and decreasing transit times through more frequent train service. To the extent that applicants' projected abuse of market power might adversely affect Los Angeles' port status, an unlikely occurrence, the Commission specifically rejected continuing regulation for the protection of ports for TOFC/COFC traffic, finding that shippers may properly rely on inter-port competition to replace regulation, in Improvement of TOFC/COFC Regulation, Slip op. at 7-8, served February 19, 1981. This leads me to conclude that inter-corridor price and service competition would remain.

However, leaving aside the competitive positions of other ports and corridors for COFC traffic, the majority's concerns still seem misplaced. The majority states that the lack of service competition would decrease the service levels shippers receive. However, it is obvious that SPT, the financially weaker carrier with the larger share of this traffic, cannot significantly improve its service competition over its primarily single-line sunset route track. By the same token, ATSF's interline route with KCS appears to be operating at an efficient level. Service competition between these two carriers can only maintain these present levels. However, the merger's ability to produce more efficient use of lines, eliminate interchanges, and expand singleline service would improve service in the Southern Corridor, a result not contrary to the public interest.

It would appear then that any harm that occurs would result from the ability of SPSF to raise its divisions with the ocean carriers to some point less than 25 percent. Considering the financial situation of the applicants, particularly SPT, this would appear to provide assurance that essential services would be continued, a primary benefit, under 49 CFR 1180.1(c). In any event, the majority does not find that <u>shippers</u> would be harmed. Their concern is with the ocean carriers, who like the rail carrier participants have not made an essential service argument. The majority states: "There is general agreement among the parties that the rates charged shippers by ocean carriers have little relationship to the rate or division charged the ocean carriers by the railroads."

The majority finds that because of the new efficiencies of double stacked COFC operations, motor carriers will be even less competitive for this traffic. But rather than award the rail carriers that introduced this new service with much needed additional revenues, the majority would continue to pass these savings on to the ocean carriers through forced head-to-head competition. Only by ignoring SPT's declining traffic base, which is discussed