1973

The Burlington Northern Merger

Minn. L. Rev. Editorial Board

Follow this and additional works at: https://scholarship.law.umn.edu/mlr

Recommended Citation

https://scholarship.law.umn.edu/mlr/3037

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review collection by an authorized administrator of the Scholarship Repository. For more information, please contact lenzx009@umn.edu.
Note: The Burlington Northern Merger

I. INTRODUCTION

A great increase in merger activity among the nation's railroads has occurred in the past several years. Unlike the mergers of expansion typical in many other industries, however, these rail mergers have been intended to scale down the now unwieldy railroad companies into manageable, efficient units. Specifically, rail mergers have been used to facilitate contraction of investment, reduction in facilities and, in many cases, decreases in service. The foremost recent example of such an attempt is the 1970 merger of several northwestern railroads into the Burlington Northern.¹ This Note will consider that merger as part of the phenomenon of recent rail merger activity and as a standard for future mergers in the industry. It also will consider the rationale of the Interstate Commerce Commission and the United States Supreme Court in approving that merger, particularly in the context of determining the role competition should play in the ultimate consideration of merger in the rail industry.

II. THE PROBLEM OF OVERINVESTMENT

The American railroad industry underwent much of its growth and development in the last half of the Nineteenth Century, a period of tremendous territorial and industrial expansion. Indeed, the development of new industrial centers and the expansion of the rail industry were each very much a cause and effect of the other.² Additionally, the railroads developed as the sole form of effective, large scale transportation. Without the rigors of competition from other modes of transportation, and aided by public subsidies in a variety of forms, the railroads engaged in a fierce competitive effort to expand their services

¹. Hereinafter referred to as the “BN.” The Northern Pacific Railway will hereinafter be referred to as the “Northern Pacific”; the Chicago, Burlington and Quincy Railroad, as the “Burlington”; the Great Northern Railway Company as the “Great Northern”; the Seattle, Portland, and Spokane Railroad as the “SP&S”; the Chicago, Milwaukee and St. Paul Railway as the “Milwaukee”; the Chicago and Northwestern Railroad as the “Northwestern.”

². See P. LOCKLIN, ECONOMICS OF TRANSPORTATION 84-114 (1966), for a general history of the growth of the railroad industry. See also R. SAMPSON & M. FARRIS, DOMESTIC TRANSPORTATION 23-28 (1966), where the correlative development of the rail industry and the economy as a whole is discussed briefly.
into as many of the new markets as possible. As the infant trucking industry began to compete with the railroads for freight business after World War I, the rails increasingly lost the revenues necessary to support what had already become a greatly overbuilt plant.

Under the pressures of a competitive market, the railroads could be expected to contract plant and eliminate unprofitable service through line abandonments, and to follow a "lowest possible price" policy in order to stimulate demand and thereby increase revenue. However, the rail industry is regulated by the Interstate Commerce Commission under a scheme which prevents effective price cutting and disallows most service reductions and plant contractions. As a result, railroads are forced

3. The overbuilding and overcapitalization arising out of the era of railroad dominance is documented in P. LOCKLIN, supra note 2, at 112-14, 308; R. SAMPSON & M. FARRIS, supra note 2 at 26-28. The effect of this overbuilding and overcapitalization is discussed in M. CONANT, RAILROAD MERGERS AND ABANDONMENTS 1-24 (1964). See also G. KOLKO, RAILROADS AND REGULATION 1-44 (1965).

4. M. CONANT, supra note 3, at 19-21, points out that there is substantial evidence of overinvestment in the rail industry. He asserts that prior to the emergence of effective intermodal competition, i.e., competition between the railroads and other transportation modes, such as trucks, overbuilt rail systems could be profitable, especially in light of a regulatory policy that guaranteed a return on all investments. Pressure from competing modes since the 1920's has increasingly cut into rail dominance; excess capacity in the rail industry, he concludes, will eventually lead to the bankruptcy of the roads.


6. The Commission was created in 1887 to regulate the monopolistic railroad industry and was empowered to establish rates, prevent personal discrimination and long haul/short haul rate variation. The Commission's authority was periodically extended. Passage of the Transportation Act of 1920, 41 Stat. 481 (1920), hereinafter the "1920 Act," added additional powers. For a detailed discussion of these, see R. SAMPSON & M. FARRIS, supra note 2, at 250-58. The basic outline of the present state of regulation of the rail industry is summarized in id. at 258-59:

Elements of Transportation Monopoly Control
Rates and Discrimination Elements
1. All rates must be just and reasonable; all unjust and unreasonable rates are illegal. The I.C.C. has power to determine reasonableness and prescribe maximum and minimum rates.
2. All shippers must be treated equally if they have similar transportation circumstances and conditions (no personal discrimination).
3. All undue preference and prejudice to any person, locality, or type of traffic is illegal (broad discrimination prohibition).
4. A carrier may not charge more for a short haul than for a long haul where the short is included in the long haul
to divert revenue from service improvements to the operation of uneconomic routes. The resulting deterioration in rail service has prompted growing numbers of shippers to turn to alternative means of transportation, thus further decreasing revenue available for the maintenance and improvement of service.

---

5. Rates must be published and available to all. No deviation from the published rate is allowed under penalty of law. Rebates and passes illegal (except for certain exceptions relative to passes).

6. The general level of rates for carriers as a group are to be so established as to allow the carrier to earn a fair rate of return on a fair value. Excessive individual carrier earnings are to be recaptured in part and made available as loans to carriers earning less than the determined fair level.

7. Rates may be suspended for a limited time while they are being investigated.

8. A carrier may not carry its own products in competition with other shippers (except lumber).

9. Commodity classification procedures may be controlled by the I.C.C.

10. Intrastate rates may be raised so as not to discriminate against interstate commerce.

---

Service Elements
1. Car service rules must be formulated, filed, and approved by the I.C.C. The Commission may control car movement in emergencies.

2. The I.C.C. may establish through routes and joint rates.

3. The Commission may order joint use of terminals.

4. All abandonments and extensions must be approved by the I.C.C.

5. All pooling or combination must be approved by the I.C.C.


Security and Financial Elements
1. All accounts must be uniform and open for inspection.

2. Periodic and detailed financial reports must be rendered.

3. The I.C.C. may divide revenues from joint rates with the needs of carriers as a standard.

4. All changes in capital structure and the issuance of securities must be approved by the Commission.

5. All reorganization and bankruptcy must be approved by the I.C.C. A special procedure is established to facilitate restoration of the carrier to sound financial health.

6. All consolidations and mergers must fit a master plan and have I.C.C. sanction (after being absolutely illegal for a period of time).

7. The railroads are forced to operate lines that fail to supply sufficient revenue to meet day-to-day operating costs of the line. Deficits must be made up from other revenues, but this depletion uses much of the money that would be available for capital improvements that would result in new technologies. M. Conant, supra note 3, at 116.

8. M. Conant, supra note 3, at 36-40, discusses the interplay of poor capital structure, regulatory constraints, low profits and lack of competitive incentive. The result is described as an industry seri-
The railroads are also burdened with substantial overinvestment in plant and equipment.\textsuperscript{9} Given this physical structure and the regulatory restraints under which they operate, the lines are turning to mergers as a method of achieving reduced costs and increased revenue, thereby leading to service improvements and hopefully resulting in the ultimate revitalization of the industry as a competitor to other modes of transportation.

\section*{III. HISTORY OF THE CONSTITUENT LINES AND THE MERGER}

The Burlington Northern was a result of the 1970 merger of the Great Northern Railway Company, the Northern Pacific Railroad and the Chicago, Burlington and Quincy Railroad. In conjunction with the merger, the new line also entered into a long-term lease agreement with the Seattle, Portland and Spokane Railroad, the stock of which was jointly owned by the Great Northern and Northern Pacific prior to merger.\textsuperscript{10} The oldest and largest of the participants was the Burlington, which traces its origins to the Aurora Branch Railroad founded in 1849. At the time of the merger, the Burlington had nearly 10,000 miles of track extending from the Great Lakes to the Rockies and from there to the Gulf of Mexico. The Great Northern, Minnesota's oldest railroad, was formed in 1862. In 1870, the line was purchased by a group headed by James J. Hill and eventually expanded to a transcontinental line. The Northern Pacific, the recipient of vast federal land grants, was founded in 1873 and was the first of the Northern Lines to reach the coast.

The Great Northern and Northern Pacific have a long history of attempted merger. After the Panic of 1873 forced the Northern Pacific into receivership, Hill attempted to purchase the line, but the acquisition was held by the Supreme Court to be in violation of a Minnesota statute prohibiting the merger or consolidation of parallel lines.\textsuperscript{11} The two lines were actually, if

\textsuperscript{9} M. Conant, supra note 3, at 17-24.

\textsuperscript{10} The map reproduced as Figure 1, printed with the permission of Burlington Northern, Inc., portrays the extent of the coverage of service after the merger. For a complete history of the constituent lines, see Burlington Northern's Predecessors (1971) (Burlington Northern Public Relations—Advertising Department Press Release).

\textsuperscript{11} Pearsall v. Great Northern Ry., 161 U.S. 646 (1896).
fleetingly, merged in 1901 when the stock of both lines was purchased by the Northern Securities company, a New Jersey holding company. Although the purchase was invalidated by the Supreme Court under the Sherman Act, dissolution of the holding company did not actually result in a return to two wholly independent railroads because the stock of the lines was redistributed such that individuals who possessed only Great Northern or Northern Pacific stock prior to the creation of the holding company received shares in both companies. Thus what was probably an oversight in the Court's decree had the effect

of creating a community of interest and a community of ownership in the two Northern Lines which was to last until the time of the recent merger. The companies recognized this community of interest and in 1903 each purchased 46.7% of the stock of the Burlington. In 1905, the lines jointly constructed the Seattle, Portland and Spokane Railroad, which is now leased by the Burlington Northern. Subsequently, merger of the two Northern Lines was contemplated by the Commission's consolidation plan developed under the Transportation Act of 1920, but was conditioned upon divestiture of ownership of the Burlington—a condition the Great Northern and Northern Pacific were unwilling to accept.

Although the merger of the constituent lines of the Burlington Northern Railroad was not accomplished until March 5, 1970, active preparation for the merger began in 1957 when the Northern Pacific and Great Northern jointly commissioned the consulting firm of Wyer, Dick and Company to study the feasibility and estimated cost savings which would result from merger. As a result of that study, the firm presented a Report on the Economics of Proposed Consolidation which estimated that savings resulting from the proposed merger would run as high as $46,479,246 annually for the first five years after merger. On the basis of this report, the lines entered into ex-

13. The stock was distributed such that one who had owned one per cent of the stock in one of the railroads before the merger, and then, hypothetically, one third of one per cent of the stock of the holding company, received on dissolution not the original one per cent of the railroad he had owned, but rather one third of one per cent of the stock of each of the roads. He thus had the same actual ownership in the lines after divestiture as he had during the life of the holding company, but was deprived of the benefits of a single management. At the time of divestiture, this common ownership existed in over 90% of the Northern Pacific stock and over 75% of the Great Northern stock. At the time of the merger in 1970, over 60% of the stock of each line was still owned in common. Interview with Burlington Northern Management Representative, in St. Paul, Minn., February 10, 1972 [hereinafter cited as “BN Interview”].

14. The 1920 Act called upon the Commission to draw up a master plan for national rail consolidation which was to establish a limited number of competitive rail systems. The plan, however, was voluntary and never achieved success. Not completed until 1929, the plan was doomed to failure at the outset because it offered nothing of value to strong railroads. Moreover, the plan did not strike at the heart of the growing rail inefficiency brought about by the duplication of facilities. M. CONANT, supra note 3, at 49-50.

15. M. CONANT, supra note 3, at 51.

16. The report, hereinafter referred to as the “Wyer Report,” was issued on December 1, 1957.

tensive negotiations which resulted in a 1960 agreement to merge.

In 1961 the lines filed a merger application with the Interstate Commerce Commission pursuant to Section 5 of the Interstate Commerce Act. The Commission appointed a hearing examiner and extensive public hearings on the proposed merger were held in 1961-62. Although the examiner recommended approval of the merger, the Commission denied the application by a five to four vote in its "First Report" of March 31, 1966. According to this document, the denial was based on the Commission's belief that most of the alleged savings could be achieved without merger and that the merger would severely curtail intramodal competition. The Commission concluded, therefore, that the merger would not be "in the public interest" as required by Section 15(3) of the Interstate Commerce Act.

While a petition for rehearing was pending, the lines entered into agreements with labor unions which guaranteed lifetime employment to all employees of the constituent lines. Contemporaneously, the lines agreed to grant extensive trackage rights to the Milwaukee and the Northwestern Railroads and to grant eleven gateways to the Pacific coast to the Milwaukee. In exchange for these concessions, the unions and the railroads withdrew their opposition to the merger. During this time, a second Wyer Report was prepared considering new areas.

460, 501 (1966). The constituent lines depended heavily upon the Wyer Reports throughout the entire course of the proceedings. The Commission gave little credence to the report at the first merger hearing, but the findings of the second Wyer report were well received. See text accompanying notes 23-24 infra.

19. 328 I.C.C. 460 (1966). The effect upon intramodal competition clearly dominated the Commission's decision to deny the merger application. In the majority opinion, the loss of competition is balanced against the savings anticipated from the merger. The dissent expressed doubts that the Milwaukee could be a viable competitor and concluded that the real concern ought to be to maintain a strong rail system on the Northern Tier to compete with the growing trucking industry.
20. 331 I.C.C. 228, 277 (1968).
21. The right of one line to send its cars on the tracks of another line is a "trackage" right, an essential privilege for lines that wish to carry freight from their own area of service to points in other areas.
22. Gateways are distinguishable from trackage right in that the carrier is allowed, in return for a fee, to use the tracks of another carrier as if they were its own. In this case, the Milwaukee achieved access to the Pacific Northwest, and the entire West Coast by means of these gateways.
of savings and eliminating areas of savings that could be achieved through interline cooperation but without merger. This report also estimated that annual savings would amount to $47 million, notwithstanding the new conditions to which the lines had agreed.

On January 4, 1967, the Commission granted the application for rehearing and reopened the proceedings. Although the rehearing was nominally a reconsideration of all issues, it was in fact limited to the issue of savings to be realized from the proposed merger in the face of the adverse economic impact of the employee protection, gateway and trackage rights agreements. The lines cited the findings of the second Wyer Report that new areas of savings and inflation would offset losses from the agreements. The Justice Department, certain company stockholders, and state regulatory bodies continued to oppose the merger, but the labor unions and other rail lines no longer offered opposition. On November 30, 1967, the Commission approved the application.24

In May 1968, the Justice Department filed a complaint in United States District Court challenging the Commission order approving the merger. When the district court unanimously affirmed the Commission,25 finding that it had not abused its administrative discretion, the Justice Department and other interested parties appealed to the Supreme Court. The Supreme Court stated that it was in the first instance the function of the Commission rather than the courts to determine whether the merger was consistent with the public interest. Moreover, the Court concluded that the Commission had properly weighed the loss of competition among the constituent lines against the benefits to be gained from the merger. The Court therefore affirmed the conclusion of the district court that the Commission had not abused its administrative discretion in approving the merger.26 As a result the merger was consumated on March 5, 1970.

IV. RELEVANT MERGER STANDARDS UNDER SECTION 5 OF THE TRANSPORTATION ACT OF 1940; ROLE OF COMPETITION

The dominance of rail transportation began to wane in the nineteen twenties with the emergence and growth of trucking as

24. Id. at 228 (1967).
a more expeditious and convenient method of transportation. It soon became apparent that unless railroad mergers and abandonments were regulated, many communities that relied on the railroads for their essential transportation would be deprived of service as the lines reduced expenses and investment in order to meet the competition from the trucking industry.

Congress first responded to this situation through the Transportation Act of 1920 which, inter alia, amended the Interstate Commerce Act. This Act sought to merge weaker carriers into stronger systems and to stabilize the industry in what essentially amounted to a regulated cartel. The Act further empowered the Commission to regulate all interstate modes of transportation in order to foster the "inherent advantage" of each mode. The Commission sought to meet its responsibilities under the 1920 Act by promulgating a nationwide consolidation plan. It became apparent, however, that the Commission's plan was actually retarding rather than encouraging rail consolidations, primarily because the stronger carriers were unwilling to merge with their weaker counterparts.

Of prime importance to the recent rail merger phenomenon is the Transportation Act of 1940. Unlike the 1920 Act, this Act expressly recognized that one of the proper considerations in promoting an efficient national transportation system is the retention and intensification of intermodal as well as intramodal competition:

It is hereby declared to be the national transportation policy of Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical and faster service and foster sound economic conditions in transpor-

---

27. For a discussion of the 1920 Act, see P. Locklin, supra note 2, at 226-39. See also notes 6 and 14 supra.

28. "Inherent advantage" is the notion that an industry, or some sub-industry within an industry, is better able to provide some product or service than any competing unit because of some unique characteristic.

29. "Mode" is the term used to designate a type of transportation, such as trucking, in the larger transportation industry. The 1920 Act was the first recognition of the need to promote each type of transportation where it offered inherent advantages over other modes. Prior to that Act the effort had been directed toward restraining the rail monopoly; however, from 1920 on the realization of the demise of the rail industry began to assert itself. See generally R. Sampson & M. Farris, supra note 2, at 253-58.

30. See note 14 supra.

31. Id.

32. 54 Stat. 899 [hereinafter referred to as "1940 Act"].
tation and among the several carriers; to encourage the es-
establishment and maintenance of reasonable charges for trans-
portation services, without unjust discrimination, undue pref-
ferences and advantages, or unfair or destructive competitive
practices; to cooperate with the several states and duly au-
thorized official thereof; and to encourage fair wages and equi-
table working conditions—all to the end of developing, coor-
dinating, and preserving national transportation by water, high-
way, and rail, as well as other means, adequate to meet the
needs of commerce of the United States, of the Postal Service,
and of the national defense.\(^3\)

The competitive standard for evaluating mergers which has
evolved since the passage of the 1940 Act is largely a product of
case law, of which *McLean Trucking Co. v. United States*,\(^3\) is the
seminal decision. *McLean* involved the proposed consolidation of
eight motor carriers, all competitors with at least one of their
number, into a single company. The merged company would
have been the only trucking company with through service over
the entire Atlantic coast. Though there would then be carriers
in competition over all parts of the new route, no other single
carrier served the entire market served by the new company.
The Court found that although the merger would substantially
lessen competition, competition from other truckers would fur-
nish a sufficient incentive for providing adequate service.\(^5\)
The Court further held that mergers regulated under the Interstate
Commerce Act were exempt from antitrust considerations im-
posed upon other mergers by the Sherman and Clayton Anti-
trust Acts. Prior to *McLean* it was acknowledged that such
mergers were exempt from those laws, but it had been thought
that they were, nevertheless, governed by the same antitrust
considerations as other mergers. The Court in *McLean* recog-
nized that the situation in the transportation industry was a
unique one for which Congress had provided a unique standard
under which the activities of the nation's regulated carriers were
to be judged:

\[
[The national transportation policy] which is the Commission's
guide to the 'public interest' . . . demands that all modes of
transportation subject to the provisions of the Interstate Com-
merce Act be so regulated as to 'recognize and preserve the in-
herent advantages of each; to promote safe, adequate, economic
service and foster sound economics in transportation and among
\]

33. Id. (emphasis added).
34. 321 U.S. 67 (1944).
35. Id. at 71. It should be noted that the proposed merger did not
involve all the motor carriers serving that region, so that some carriers
would still exist at all points served by the new system. The system
would, however, have the obvious competitive advantage of being able
to offer through service that none of its competitors could duplicate.
Antitrust standards and considerations relevant in other industries were to have no independent validity under the public interest test of the 1940 Act:

The preservation of competition among carriers, although still a value, is significant chiefly as it aids in the attainment of the objectives of the national transportation policy.\(^\text{37}\)

In *Seaboard Air Line R.R. v. United States*,\(^\text{38}\) the Court affirmed per curiam a decision by the Commission approving a rail merger involving a significant reduction in rail competition. Although the emerging companies were two financially healthy, parallel railroads which prior to the merger had been in strong competition with each other, the Commission held that the putative benefits of improved service to shippers would outweigh the loss of competition. It considered as well the long term ability of the lines to maintain such competition without a merger, citing a seven year period of declining revenues and excess capacity sometimes reaching as high as 25% as indicative of a gradual deterioration in the ability of the lines to meet the growing competition from other transportation modes.\(^\text{39}\) In order to offset the effect of the merger upon intramodal competition, it ordered certain protective conditions to insure the ability of other rail lines to offer positive competition.\(^\text{40}\) However, the Commission also noted that:

> With the development of intense competition in recent years from other modes of transportation, the preservation of intramodal rail competition has lost much of its significance in the furtherance of overall national transportation policy.\(^\text{41}\)

\(^{36}\) Id. at 82.  
\(^{37}\) Id. at 87.  
\(^{38}\) 382 U.S. 154 (1965).  
\(^{39}\) Seaboard Air Line R.R., 320 I.C.C. 122, 153 (1963). The similarities between the Seaboard Lines and the Northern Lines cases is compelling. In each case, the Court demonstrated a willingness to save reasonably healthy lines from eventual deterioration; happily the merger came in each case while there was still a workable line upon which to build. In the case of the Penn Central, on the other hand, it has been suggested that the merger was doomed from the outset because of the weak condition of both the Pennsylvania and the New York Central. See generally J. Daughen & P. Binzen, The Wreck of the Penn Central (1971).  
\(^{40}\) 320 I.C.C. at 168 et seq. Here, as in the Northern Lines case, the conditions are imposed to protect less efficient competitors. There seems to be a reluctance on the part of the Commission to recognize the impotency of intrarail competition. The result has been protective conditions that remove some of the benefits of merger without a corresponding long term improvement in rail competition. See discussion accompanying notes 87-121 infra.  
\(^{41}\) 320 I.C.C. at 166.
Thus, the Commission emphasized that the proper inquiry was not only the effect of the merger upon intramodal competition, but rather the effect of the merger on transportation competition in the aggregate.42

The Commission also noted other factors relevant to a determination of the public interest, principally a potential reduction in fixed costs by the elimination of duplicative facilities and the resultant effects of scale economies.43 It also noted the forecast improvement in service, including better schedules, increased car supply, improved “on time” efficiency, decreased switching time and generally improved administration and management.44

V. APPLICATION OF THE MERGER CRITERIA TO BURLINGTON NORTHERN

A. INTERSTATE COMMERCE COMMISSION AND SUPREME COURT APPROVAL

In affirming the Burlington Northern merger, the Supreme Court considered the arguments of merger opponents that the Commission had failed to properly apply the controlling criteria set forth in McLean and Seaboard.45 The Court held that the Commission had given proper consideration to all of the relevant factors necessary for a determination of the public interest.46

1. Savings

The Commissioner and the Supreme Court accepted the railroads’ contention that the merger would result in a reduction of operating costs, thereby improving the railroads’ competitive position both with other rail lines and with other modes, and ultimately resulting in the new line’s ability to attract new freight. The first Wyer Report had estimated the savings from such contractions to be $47 million annually for the first five years of the merger.47 The Commission in its First Report had estimated

42. Id.
43. Id. at 153.
44. Id. at 160-61. It is interesting to note that these are exactly the same areas of savings that the Commission later found in the Northern Lines case.
46. The Court stated:
[V]igorous advocacy of the divergent views on this difficult problem has narrowed and sharpened the issues and aided the Court in their resolution, ensuring that no factor which ought to be considered would elude our attention.
Id. at 506.
the probable annual merger related savings to be approximately $25.5 million, including $10.5 million attributable to improving wholly internal procedures, and $15 million attributable to consolidation of duplicative facilities and services.\textsuperscript{48} Upon rehearing, and after the expensive employee protection agreements and gateway and trackage concessions, the second Wyer Report estimated savings of approximately $47 million annually\textsuperscript{49} while the Commission increased its estimate of annual savings, notwithstanding the added expenses, to $40 million dollars.\textsuperscript{50}

The principal areas of potential cost saving were consolidation of facilities, economies of scale and operational efficiencies. The Great Northern and the Northern Pacific predicted that cost saving would result from centralization of management, communications, and purchasing and planning departments. The lines argued that because the Great Northern and Northern Pacific were parallel lines and also had common switching points, the merger would make possible the elimination of such duplicative facilities as city freight yards, switching crews and equipment, maintenance facilities, abandonment of unnecessary trackage and service and finally, a phased reduction in employment through attrition.\textsuperscript{51} Railroad mergers involving parallel carriers offer the greatest opportunity for service improvements since they allow for the elimination of duplicative lines and facilities; however, end to end mergers—such as the merger of the Northern Lines with the Burlington—are also a source of saving for they permit elimination of switching points. The railroads in the instant case contended that the Burlington Northern merger would involve all of these service improvements because the lines involved were both end to end and parallel.

The railroads predicted that the merger would increase operational efficiencies and introduce economies of scale, thereby re-

\begin{itemize}
  \item \textsuperscript{48} Id. at 460.
  \item \textsuperscript{49} Id. at 504. The consolidation of management, planning, communications, soliciting and billing of freight accounted for the overhead savings. Terminals, rail switching and classification yards accounted for some of the duplicative facility savings, while the use of more efficient track grades generated most of the remaining savings in this category. The reduction of duplicate employees from such duplicative facilities was one of the greatest areas of potential savings.
  \item \textsuperscript{50} 331 I.C.C. at 236.
  \item \textsuperscript{51} Id. at 262. The cost of the employee protection plan at the time of the Commission approval was estimated to be $10.15 million annually. 331 I.C.C. at 277.

The company also asserted that it had actually made some of the suggested cooperative moves outlined in the First Wyer Report without the benefit of merger, and that these savings were not included in the new estimates.
ducing unit costs. Since the merger would have the effect of combining the freight of the constituent lines into a single pool, it was argued that the increased volume would allow the use of more long-haul and unit trains, thereby, for example, increasing the number of nonstop shipments from Seattle to Chicago. The new line would thus be able to bypass intermediate switching points, reducing both costs and delays. Another asserted benefit of the merger would be increased car supply. The new line would be better able to locate available cars due to new computerized communications and accounting made feasible by the merger, and would be freed from the reluctance of the constituent carriers to part with valuable, though vacant, cars. Finally, it was contended that the merger would enable the lines to consolidate outdated and duplicative yards, replacing them with single, computerized yards which would reduce switching time, labor costs, and intercity delay.

2. Service Benefits

The Commission and the Court also found that the merger

52. Even if freight volume were not to increase, the freight of four lines would become the freight of one line, which would permit the use of more composites of unit and long haul trains. Whereas in the past, each line might have had, for example, 30 cars of freight in Chicago bound for Minneapolis, Fargo, and Seattle, there would now be 90 cars for each destination. Prior to the merger each line would have composed one freight that would have stopped and switched in Minneapolis and Fargo before reaching Seattle. Now a single train serves each city, thus eliminating switching expenses and delays. Obviously, the lines had sufficient freight for some long haul runs before the merger, but the pooled freight increased that capability, especially with respect to freight bound for smaller terminals.

53. “Long haul” and “nonstop” are used interchangeably here, and refer to trains that can bypass intermediate points as described in note 52 supra.

54. “Unit trains” are those carrying a single commodity to or from a single user. One example of a unit train would be a train used to transport iron ore. Such trains are less expensive to assemble and switch because they are nonstop and do not involve the usual amount of work in composition. Here, as described in note 52 supra, the merger increased the number of such expense-saving hauls.

55. Notwithstanding the fact that railroads regularly lease cars to and from other lines, there is an understandable reluctance to part with temporarily unused cars as a peak season approaches. The merged company would not face that reluctance with respect to its own cars and would therefore have more cars available at any one time. Centralized car accounting and assignment also fostered much more efficient utilization of available cars. These improvements would redound to the benefit of the shippers who would be more likely to have cars available when they needed them, and would also benefit the railroad by increasing its ability to compete for the shipper's business and by reducing costs and increasing profit.
would allow the BN to improve service. Most of these improvements are mentioned above in conjunction with reduction of costs. The participants predicted that increased revenues and savings in operational expenses would provide capital for research and development of techniques to improve service.

3. Intramodal Competition

The Supreme Court accepted the Commission's finding that the merger would foster intramodal competition, a conclusion based largely on the anticipated effect of the gateway concessions granted the Milwaukee which made it a transcontinental line. Prior to the merger, the Milwaukee lacked access to the Pacific coast, chiefly because of the Northern Lines' control of the SP&S. Although the Milwaukee actually possessed superior grades and a shorter route west of the Twin Cities, it was never a "rate making" line. The Commission and the Court both attributed this weakness to lack of transcontinental gateways and poor financial condition. The Northwestern, like the Milwaukee, is a post merger competitor of the BN, having been

56. See note 52 supra.
57. It should be noted at this point that service improvements do not always or necessarily mean faster service. Railroads provide moving warehouses free of charge to shippers. Sometimes it is in the shippers' interest to have the railroad take longer to deliver the goods because of the shippers' need to provide warehouse space. Shippers interviewed in the course of preparation of this Note stated that they sometimes routed their freight by circuitous routes in order to take advantage of such free warehouse space. See note 88 infra. What was important to those shippers, however, was reliability of "on time" delivery, which the BN merger was arguably to improve.

Another related point worthy of comment, although not strictly related to the topic of this Note, is the structure of the industry which allows shippers the opportunity to use rail cars as warehouses. Besides the free space during transit, the daily demurrage charge for unreturned cars is so low that it is often to the shippers' advantage to retain cars rather than unload them into his warehouse. The tendency to depend upon this auxiliary warehouse space reduces the storage costs to the shipper and increases the capital costs to the rail industry. The merger does not specifically resolve this problem, which is illustrative of the general inefficiency into which the industry has fallen.

58. The competitive position of the Milwaukee will be discussed in detail in connection with the discussion of intramodal competition. See text accompanying notes 107-09 infra.
59. "Rate making" designates a line whose share of the market is large enough to allow it to alter prices confident that the other lines would have to follow its lead or lose business. On the Northern Tier the GN and NP were able to lower prices and force the others to follow. The Milwaukee's share of the market and capacity are too small to alter traffic patterns on the tier significantly. See notes 108-111 infra.
While the Commission granted some gateways into Duluth-Superior, Nebraska and the Dakotas, North Western operates primarily in Illinois and Wisconsin, but was only a nominal competitor of the Burlington. Substantial competition between the two lines was precluded primarily by the fact that the Burlington had access to the Gulf of Mexico and to the Pacific Northwest via the Northern Lines.

In its First Report, the Commission denied the merger application partly because:

Neither intervenor [the Milwaukee or the North Western] is a match in terms of size, earnings, financial strength and economic capability. Neither can provide the quantity and quality of service made possible by the proposed merger. In fact, if the Milwaukee and North Western were protected only by the standard routing conditions proposed by the applicants, the North Western would be materially weakened and the Milwaukee's ability to survive would be highly doubtful. Both the North Western and the Milwaukee now provide essential and efficient rail service to hundreds of communities that would not be served by the New Company. 60

The Commission also considered the contentions of the applicant lines that the crucial consideration in the merger was the impact of competition from other modes. The Commission rejected these arguments, stating rather that much of the freight carried by the Northern Lines was:

... either substantially noncompetitive or falls in a competitive 'twilight' zone and is thus available to that mode best able to exploit its inherent advantages of cost and service. In the former category are heavy loading, low-value bulk commodities and unfinished commodities in which traffic the applicants predominate. The most conspicuous example of the latter is the traffic moving in increasing quantities under various piggyback (trailer-on-flatcar) plans. Regardless of the type of traffic involved, applicants have a decided competitive advantage in many long haul movements. In this case, rail transportation must be considered as a distinctive market in its own right. 61

The Commission held that the putative service improvements and the cost savings to the railroads were outweighed by the reduction of competition and loss of jobs, and denied the merger application on that basis. 62

Upon reconsideration, 63 the Commission indicated that its

60. 328 I.C.C. at 481.
61. Id. at 511. See text accompanying notes 121-37 infra.
62. The Commission stated:
   We conclude, therefore, that the disadvantages of an appropriately conditioned merger—a drastic lessening of competition and adverse effects on carrier employees—outweigh the benefits that might be derived by applicants and the shipping public.
328 I.C.C. at 528.
63. 331 I.C.C. 228 (1967).
former emphasis upon the preservation of intramodal competition was not supported by existing law and that its earlier finding of decreased intramodal competition was no longer a correct statement of the actual result of the merger. In light of the new protection provisions favoring the Milwaukee and the North Western, the Commission expressed the view that the merger would actually preserve rail competition, since without the merger and its attendant protective conditions the Milwaukee would be "relegate[d]... to an increasingly marginal and deteriorating role." 

4. **Intermodal Competition**

The Commission and the Court agreed that except for the north-south traffic of the Burlington, the Northern Lines are not subject to meaningful competition from water or air carriers. Only the trucking industry offers any substantial challenge to the railroads in the area served by the BN. In its First Report, the Commission expressed little concern for the threat assertedly posed to rail freight by the trucking industry, for it found that rail freight transportation "must be considered as a distinctive market in its own right." In its Second Report, the Commission did not address itself to the specific impact of the trucking industry upon the merged lines, but did recognize that the merger would:

suitably conditioned, augur an era of increased railroad strength, both in intermodal and intramodal competitive aspects in the long run resulting in a benefit to, and not a burden on, communities in the northern tier states.

5. **Effect on the Public in General**

The Justice Department and nine states or state regulatory agencies opposed the merger on the grounds of reduced intramodal competition, loss of jobs in merger related cutbacks and the possible loss of service to small communities due to anticipated abandonments made possible by the merger. However, both the Commission and the Court found that the pressure of intermodal competition precluded any substantial anticompetitive effect. In approving the merger, the Commission also noted

64. Id. at 269-70.
65. Id. at 271-76.
66. Id. at 275.
68. 328 I.C.C. at 511.
69. 331 I.C.C. at 284.
that merger related abandonments, like all others, require its approval and could thus be carefully controlled should they be proposed. The question of employment reductions was effectively removed from crucial importance with the lifetime employment protection agreements negotiated by the railroads and the unions.

The Justice Department maintained its steadfast opposition to the merger throughout the entire proceedings, primarily on the grounds that a drastic reduction of intramodal competition outweighed any benefit to be obtained by the merger, and that any economies actually obtainable by merger could be realized through cooperation between the constituent lines.

B. EVALUATION

The issues underlying the positions taken by the Justice Department, the Commission and the courts include the extent to which rail mergers, and particularly the Burlington Northern merger, are necessary to and actually do achieve cost savings; the relative importance of preserving intramodal versus intermodal competition; and the extent to which the public service and employee protection considerations should preempt cost efficiencies.

1. Cost Savings

Critical to the merit of the BN merger is the assumption that it will result in significant cost savings. Perhaps the strongest criticism leveled by merger opponents was that the merger was unnecessary since the achievement of cost savings could be realized by intracompany reorganization. Savings may be achieved both by economies of scale and by elimination of duplicative facilities.

a. Economies of Scale

As a firm expands, it buys in greater quantities, separates into departments which specialize in the various aspects of production, and purchases larger equipment capable of greater production. The natural result of expansion is thus a reduction in per unit costs—“economies of scale.”

70. Brief for Appellant at 18 et seq., United States v. U.S. Interstate Commerce Comm'n, Civil No. 1132-68.

71. “The theory of economies of scale is the theory of the relationship between the scale of use of a properly chosen combination of
economies of scale are realizable by specialization of labor and management, long-haul trains, and the use of specialized equipment.\textsuperscript{72}

Realization of such economies is of course not unlimited; at some point in a firm's growth savings will begin to increase at a decreasing rate and finally will stop altogether.\textsuperscript{73} Further, there are some costs which accompany increase in size, "diseconomies of scale,"\textsuperscript{74} of which large scale management is the most frequently cited example.\textsuperscript{75} It has been asserted that real diseconomies begin to appear in the rail industry after a railroad grows to 10,000 or more employees.\textsuperscript{76} By this standard, all three of the major participants had reached the point even before the merger at which diseconomies were due to appear.

The BN merger participants countered the pessimism of those who argued that size would only lead to administrative unmanageability with evidence of substantial economies and with technological and administrative means of combatting the problems of bureaucracy. The lines argued that their unification would indeed result in more streamlined operations and consequently faster and better service to their consumers. Further, the participants pointed to technological advances such as the


\textsuperscript{73} See J. Bain, \textit{Price Theory} 112 (1961); C. Phillips, \textit{The Economics of Regulation} 26 (1965); F. Scherer, \textit{supra} note 72, at 113.

\textsuperscript{74} The point at which such diseconomies begin to manifest themselves may not be the same in all cases. For example, diseconomies might appear at almost any point beyond the minimum optimal scale or may not appear until after a substantial increase in size beyond that point. See \textit{generally} J. Bain, \textit{Industrial Organization} (1959).

\textsuperscript{75} \textit{Id.} at 113. Graphically, the appearance of managerial inefficiency born out of the attainment of unmanageable size is typified by the "U" shaped long run total cost curve; the downward part of the "U" representing the decreasing costs resulting from the large-scale economies, while the upward part of the "U" depicts the increases in cost resulting from the managerial diseconomies. F. Scherer, \textit{supra} note 72, at 75.

\textsuperscript{76} K. Healy, \textit{The Effect of Scale in the Railroad Industry} 3 (1961). At heart of this belief is concern over the potential diseconomies created by the additional vertical layers of operation which necessarily result from merger and the consequent strain placed upon management and administrative personnel. Professor Healy's choice of number of employees as a gauge for determining when diseconomies of scale begin to set in may be due to the fact that labor represents a high cost to the industry and would therefore provide a good standard for judging the effects of large scale operations.
advent of computers, more precise definitions of staff functions designed to facilitate the supply of information to the chief decision makers, and the refinement of cost accounting and other forms of budgetary control as factors which would help reduce bureaucratic inefficiency.\textsuperscript{77}

It appears that the merger participants were correct. Shippers now report that complaints and claims are more rapidly processed, that shipping time has been decreased, and that cars are more readily available.\textsuperscript{78} The BN is a better managed carrier than were the component lines prior to merger. Moreover, significant economies are apparently occurring. A new switching facility in Fridley, Minnesota, enabling substantial specialization is a principal example. However, in light of the inherent difficulty in measuring economies of scale, particularly the increase in unit and long haul traffic attributable to merger rather than market forces, it remains to be seen whether the merger will fulfill the promises of the participants.

b. Elimination of Duplicative Facilities

It was noted earlier that railroads have resorted to mergers as a means of more efficient allocation of plant facilities. Mergers facilitate the utilization of more efficient routes made available as a result of the mergers. Critics of the BN merger charged that such savings would be minimal since, although the NP and GN had parallel trackage, the lines were often more than 100 miles apart and therefore served different customers. Thus the only elimination of facilities would occur at common intersection points. Further, any economically feasible track abandonment would still be prevented by Commission control over line abandonment. Finally, opponents argued that the elimination of duplicative facilities could be achieved without a merger by the use of pooling agreements or "functional mergers."

While it is true that the merger has resulted in abandonment of relatively little trackage, and that abandonments resulting directly from the merger will probably remain at a low level,

\textsuperscript{77} Id. It may be, however, that the component lines were not as easily classified as many of the other roads in Professor Healy's study. This is because the largest of the lines were eastern roads, and transportation growth in that part of the country has not matched that in the midwest. It may be that had midwestern lines been considered alone, the results of a comparison would have shown them to be at least "not as inefficient" as their eastern counterparts.

\textsuperscript{78} See note 88 infra.
it is nonetheless clear that significant economies have resulted from elimination of duplicative facilities. Moreover, the argument in favor of "functional merger" is of little weight. While it is probably true that many of the merger related savings in the BN case could have been achieved through the use of pooling of service agreements, it was highly unlikely that the Northern Line and the Burlington would have engaged in a voluntary functional merger. Historically, pooling and trackage agreements have not been widely used by the railroads. Aside from the difficulties inherent in the negotiation of such agreements and in gaining requisite Commission approval for their operation, it may be that some sense of "company pride" has retarded the railroads' use of the functional merger as a means of attaining increased economies of operation. More importantly, since a functional merger has many of the same competitive effects as an actual merger, it seems irrational to prohibit full consolidation. Finally, it appears that savings from consolidation have to date been substantial. Merger has enabled the use of more efficient grades, reducing fuel and maintenance; the trimming of executive positions; better car accounting and availability; reduction in the number of switching facilities and attendant equipment.

c. Protective Conditions

The BN merger was accomplished only after substantial compromise with and concession to opposing parties. It is virtually impossible to measure the cost to the BN of the gateways to the west coast given to the Milwaukee. The most expensive concession exacted from the merging lines was the protective labor agreement whereby the BN agreed not to terminate the employment or force relocation of any union worker. A criticism articulated but not stressed by merger opponents is that the costs of such concessions will neutralize whatever savings the merger might have enabled. The argument has considerable force since the labor concessions will admittedly cost the BN an estimated $10.15 million annually for five years. This cost,
however, will diminish as the number of employees diminishes as a result of attrition. It is clear, however, that even the BN estimate is conservative. Inflation and the inefficiencies resulting from the retraining and geographic imbalance of employees mandated by the labor concessions have undoubtedly added material costs. The concessions prohibit the line from relocating hourly employees; thereby causing surpluses at some points and deficits at others. Thus the protective conditions are significant costs of the merger.

2. The Role of Competition: Intramodal

a. Introduction

The foremost challenge to the BN merger was based on the claim that it would impair competition between the merged lines. In the context of unregulated industries, mergers of two major competitors would ordinarily be regarded as presumptively, if not per se, unlawful. Even in the context of regulated industries, where government regulation has partly supplanted competition, such a merger calls for close scrutiny. However, under the conditions facing the railroad industry today, the concern for competition must be informed by a realistic appraisal of the limited and special character of competition in interstate transportation. Such an appraisal casts considerable doubt on the effectiveness of competition between railroads and on the wisdom of using preservation of intramodal competition as a criterion in judging the merits of rail mergers.

It is not possible here to examine the general role of competition in the economy. Although the economic welfare consequences of competition are not unambiguous, it is assumed here that competition does promote efficiency in the production and allocation of resources, and that, efficiency aside, competition promotes desirable social objectives. The classic economic rationale of competition rests on its tendency toward efficient output and allocation of resources: goods are produced to the point of equality of marginal cost and demand price. In a perfectly competitive system, resources will be allocated among productive uses in accordance with marginal value. For a rather elaborate theoretical exigesis, see W. Baumol, Welfare Economics and the Theory of the State 64-134 (2d ed. 1965). A second rationale, somewhat less abstractly theoretical, is that competition promotes productive and
discussion here is not to challenge these widely held assumptions, but simply to question whether any of them identify gains to be achieved by intramodal competition, and particularly, by forbidding mergers which ostensibly reduce it. On the contrary, to the extent that such mergers strengthen the railroads as intermodal competitors in the larger market of interstate transportation, they will promote the interests of competitive efficiency far more than retard them.

b. The Rail Industry

Competition in the railroad industry has not yielded the normal benefits of the competitive market nor has it conformed to the competitive norm. Rail lines do not engage in effective intramodal competition. Many rail lines operate in receivership and still others flounder on the brink of a similar fate, yet they continue to operate against the very best rail lines. Rail managerial efficiency quite apart from the allocative effects of ideal output. See Leibenstein, Allocative Efficiency vs. “X-Efficiency”, 56 Am. Econ. Rev. 392 (1966). Among the several social benefits attributed to competition, “distributional equity” is said to be promoted by the elimination of monopoly “rents”—in effect shifting income from capital to consumers. See F. Scherer, supra note 72, at 19, 410. It is also commonly said that competition promotes the decentralization of economic and social power. See, e.g., C. Kaysen & D. Turner, Antitrust Policy 14-18 (1959).

All these defenses of competition have their weaknesses, both theoretical and practical. The efficiency of competition is subject to extensive theoretical qualifications in reference to the works of Baumol and Scherer, supra. Even on the assumption that universal competition would be ideal, it has been demonstrated that, short of achieving it, attempting to increase competitive conditions in parts of the economy may actually lead to greater misallocation in resources among competitive and noncompetitive industries. See, e.g., Lipsey & Lancaster, The General Theory of the Second Best, 24 Rev. Econ. Studies 11 (1956). Moreover, competition may or may not promote greater technological innovation and progress, F. Scherer, supra note 72, at 363-78. Here too the benefits are ambiguous; the redistributive effect does not necessarily favor poor over rich even in relative terms (the “tax” on the monopoly capital will often fall on investors who are earning no more than an ordinary return on their investment, the monopoly rents having long since been capitalized). Moreover, even where the burden of redistribution falls on the creator of monopoly power, it is not clear that “equity” always favors eliminating monopoly profit—that depends on how it was gained. Id. at 19, 409.

86. For a complete discussion of the lack of rail competition, see M. Conant, supra note 3, 23-41.

87. Id. at 37. See also P. Locklin, supra note 2, at 388-494. Locklin points out that under the present system weak roads are maintained by artificially high prices which bear no relation to the cost of transporting goods. While these high rates obviously do not benefit the consumer, they do not benefit the rail industry either, because they re-
service is highly variable; some lines provide fast and relatively damage free service, while others provide slipshod and irregular service. Yet carriers of both genres exist side by side, frequently serving the same markets.\(^8\) Artificially high prices established by the regulatory Commission do not reward efficient operation nor penalize inefficiency.

Two reasons have been advanced for the present lack of intramodal competition and for the assertion that ineffective competition between rail lines is inevitable. First, the rail industry is a natural monopoly in which competition is inefficient and ultimately unsuccessful. Second, both the structure of the industry and the character of its regulation preclude all but the most pro forma attempts of the lines to compete with each other.

Even the most ardent supporters of free market competition have quite generally acknowledged that an industrial structure that creates scale economies renders competition imperfect, while very large scale economies can make it inefficient and ultimately impossible. In the latter case, the scale economies are such that a single firm can supply the market at a cost significantly below the costs of multiple, competitive firms. It is thus said to be a “natural monopoly.”\(^9\) Under such circumstances, particularly in local utility industries,\(^9\) it has been widely supposed that economic regulation is necessary; competition is wasteful because it generates excess capacity and inefficient production. If a single firm can produce the output required by the market at a cost significantly lower than competitive firms, it should do so. Moreover, in such industries competition is not merely wasteful and inefficient, it is ultimately not viable. On the one hand, an existing firm may be able to expand output, cut prices commensurate with diminishing marginal costs, and ultimately drive competition from the market. On the other hand, two or more firms may strive in this same manner until

---

\(^8\) One of the shippers interviewed in the preparation of this Note indicated that of the four rail lines available to him, there was as much as a 50% difference in “on time” records, with similar disparities in claims service and damage. Interviews with major Twin Cities Shippers, in Minneapolis, Minn., February 12-20, 1972.

\(^9\) Indeed there are few true examples of natural monopolies found outside local utility services, which suggests that it is the restricted size of the market that generally makes the requisite scale economies possible. See J. Bonsright, Principles of Public Utility Rates 12-13 (1961).
they ultimately destroy each other by cutting prices down to
short term marginal costs, even though their pricing policy did
not recoup the full capital costs necessary to sustain the business
over the long term. The inefficiency and the ultimate frustra-
tion of competition under conditions of natural monopoly have
provided a traditional justification for regulation.91

The central issue is whether intramodal rail transport bears
the natural monopoly characteristics that make extensive intra-
modal competition inefficient. At least given the traditional
structure of the industry, which dictates that each competitor
own and maintain separate tracks and other fixed investment,
a strong case can be made that competition requires wasteful
duplication of facilities.92 This is particularly so where the ben-
etits of competition can be assured through maintenance of
healthy intermodal competition, which itself may be strength-
ened by limiting intramodal competition.

It is also argued that intramodal competition is precluded
in the case of the rail industry, because of the physical structure
of the industry and because of regulatory constraints imposed
by the Interstate Commission. First, a carrier's need to rely on
other carriers to cooperate in the transportation of goods pre-
ccludes competitive service improvements.93 Because of the lack
of coast to coast and other long haul trackage even in the case
of the largest carriers,94 a single rail line is seldom able to
transport goods from a point of origin to a relatively distant
destination. It has been asserted, for example, that some trans-
continental shipments involve twenty different carriers.95 Thus
the most efficient carrier may often have to transfer goods to a
very inefficient line. Further, because these switching transfers

91. Whether the justification is fully persuasive is subject to
some doubt; certainly the substitution of regulation for competition is
not without costs and inefficiencies which themselves may be greater
than the adverse effects of monopoly. See Posner, Natural Monopoly
and Its Regulation, 21 STAN. L. REV. 548 (1969). That problem is, how-
ever, beyond the scope of this Note. It is necessary only to point out
that the case for regulation is tenuous where the monopoly power is
limited by competition from other industries. The case of the rail-
roads is apposite. Whether or not regulation of the railroads was
initially justified by their natural monopoly characteristics (it has been
suggested that this was never the actual motive), the growth of com-
petition from other transport modes has undermined that rationale.
92. See M. CONANT, supra note 3, at 25-41.
93. For a thorough discussion of the barriers to intramodal com-
petition, see M. CONANT, supra note 3, at 25-41.
94. Conant points out that the industry is severely fragmented.
Id. at 33.
95. Id. at 26.
typically occur on twelve or twenty four hour intervals, a carrier desiring to outdo its competitor might have to deliver goods to a connecting carrier as much as twenty four hours ahead of a competing line. Given the short distances generally involved in one segment of the conveyance, a twenty four hour “jump” is frequently not possible. Moreover, should one carrier become noticeably competitive, connecting lines could easily sabotage its efforts by slowing switching or transit. The “competitive” line is often not in a position to choose an alternative connecting carrier. Such competition-frustrating conduct is not unlikely since one carrier may fear that another is establishing a competitive standard it cannot meet for its own customers.96

Second, fixed roadbed and rights of way inhibit intramodal competition since shippers are tied to the rail lines in their area, just as carriers are wedded to the markets they serve. Unlike the “start-up” requirements in many other industries, the cost of constructing competing lines is prohibitive97 even if the right of way can be obtained.98 New construction can be undertaken only after a certificate of public convenience and necessity documenting the need for additional service has been secured from the often recalcitrant Commission.99

Finally and most significantly, the Commission’s regulatory policies prevent price competition by establishing, in effect, one rate for all lines.100

96. The railroads remember the severe rate wars of the industry’s early years. Even at that time, when no other source of transportation was available for many shippers, lines went bankrupt with regularity. See generally G. Kolko, supra note 3, at 7-29 for a description of the state of the industry at that time. The industry is not anxious to repeat that situation, and it is doubtful that the lines would engage in competition even if it were feasible. In any case, the lack of willingness to compete is merely one of many factors that make the notion of intrarail competition a “myth.”

97. One 1.91 mile extension of a rail line cost $231,000. See M. Conant, supra note 3, at 30.

98. Since today cities stand where empty prairie stood at the time the present rail system was built, rights of way are not available in any area where a railroad might wish to build a competing line. 99. 49 U.S.C. § 1(18) (1970). Such certificates are granted only after the applicant has demonstrated a clear need for such additional service. Such need has not frequently been shown in recent years. M. Conant, supra note 3, at 28-30.

100. The Commission has adopted a rate structure which sets minimum rates for all cargo. This floor on rates prevents competition on a rate basis between the various railroads since they all must charge the same rate for the same service. While a line is legally permitted to charge more for its service, in practice the Commission minimum has also become the ceiling. Given the rate structure alone, the lines
Because of the necessity for interline carriage, rates must be set cooperatively by the various lines. This is accomplished by rate bureaus made up of the various carriers who pool information as to cost and revenues.\textsuperscript{101} Any line seeking a rate increase is subject to the scrutiny of the other bureau members. Although the applicant line can appeal an adverse determination of the rate bureau to the Commission, this is seldom done both because the Commission gives great weight to the bureau's determination and because compromise is more expedient. This unofficial form of rate making is complemented by the Commission's policy of setting minimum rates at a level sufficiently high to allow the least efficient carrier to remain in operation. The net result of these two factors is an industry with very strong pressure toward cooperation rather than competition in rate making. The Commission also impairs service competition by restricting entry and disallowing critical abandonments\textsuperscript{102} which would reduce costs and arguably yield revenues for service improvements.

Since the physical structure and constraints of the railroad industry are not susceptible to change and restrictive regulation of price and service is likely to continue, substantial competition among railroads is a virtual impossibility.

c. The Northern Tier

The \textit{Northern Lines} case illustrates some of the practical impediments to intramodal competition. Prior to the merger the Northern Tier states were served by the Great Northern, the

\textsuperscript{101} Rate bureaus are composed of rail carriers which fix rates jointly for carriage involving two or more lines. Although the determinations of these bureaus have no legal effect, they are typically accepted by the Commission when it approves or disapproves proposed rates. As important as Commission acquiescence in this rate fixing practice is the cooperation between the lines. Because each railroad must share financial data regarding costs of operations, general financial condition, and proposed profits or losses, the ability to compete is substantially reduced. The level of cooperation established by the continuing relationship of the lines in the bureaus fortifies the system of collusion prevalent in the industry. \textit{See generally} M. \textsc{Conant}, \textsuperscript{supra} note 3, at 27, 30-31.

\textsuperscript{102} Barriers to entry are discussed in note 98 \textit{supra}, and extensively in M. \textsc{Conant}, \textit{supra} note 3, at 28-30. The importance of new entrants in a competitive system is discussed in note 85 \textit{supra}. Restriction against abandonment of unprofitable rail lines and services has the effect of drawing off much of the revenue needed to improve profitable lines and services. \textit{See} note 6 \textit{supra}. 
Northern Pacific, and the Milwaukee Railroads. The Chicago and North Western served the eastern states of the Northern Tier.

Initially, the facts demonstrate that the Milwaukee and North Western prior to merger provided no real competition to the Burlington, the Great Northern or the Northern Pacific. The North Western was a regional railroad, serving only the states of Illinois, Iowa, Wisconsin, and Minnesota in common with the other lines. Because it carried mostly short haul freight, the other lines possessed a clear advantage in their ability to offer both long and short haul service.

The Milwaukee, too, was at a disadvantage because it had no direct connection with the Southern Pacific, the Western Pacific, or the Union Pacific Railroads, and because it could not use alternate transcontinental through routes west of the Twin Cities. It was therefore unable to participate in north-south traffic along the West Coast. Routing restrictions greatly impaired its ability to transport eastern originating freight to points in the Dakotas and westward. Because the Milwaukee had no gateways to Portland, Oregon, the traffic from the Milwaukee’s points in Montana, Idaho, and Washington required three or four separate hauls to points in Oregon, California, and British Columbia, thereby frequently making it impossible for the Milwaukee to compete with the Northern Lines for westward traffic from that region. This disadvantage was reflected in poor volume. Traffic density on the Milwaukee lines west of the Twin Cities was one half that of the Northern Lines, notwithstanding the fact that the Milwaukee actually possessed better track grades. According to the Commission’s First Report:

In the six states in which the Great Northern, Northern Pacific, and Milwaukee each operated, in 1960 the Milwaukee handled a smaller percentage of total ton miles for the state than its percentage of total miles of road in that state. On the other hand, the GN and NP both handled a greater percentage of ton miles than their percentages of total miles of roads in those states.

103. “Regional” here refers to lack of access to the west coast from the midwest.
104. Discussion of the Northwestern is omitted because it was not as significant a competitor as the Northern Lines.
105. A complete discussion of the Milwaukee’s shortcomings can be found in 328 I.C.C. at 490-93. The restrictions also had secondary adverse effects, most notably dual switching charges and delays for freight not already excluded from the line because of its routing limitations.
106. Id. at 490-91.
The Milwaukee was also in a much weaker financial position than the constituent lines. In the period 1951-1960, the Burlington lost fifteen million dollars in traffic revenues, the Great Northern lost two million dollars, and the Northern Pacific actually gained one million dollars. During that same period, the smaller Milwaukee lost thirty million dollars on traffic revenues, twice that of the Burlington, and fifteen times that of the Great Northern.\textsuperscript{107} In 1965, for example, the Milwaukee had net income of $7.3 million; the combined Northern Lines-Burlington income for that year was $82 million.\textsuperscript{108} The Milwaukee has been plagued by financial difficulty since 1925. It was driven into receivership that year, subsequently experienced deficit operations in all but two years from 1926-1940, and has suffered declining income from 1942 to the present.\textsuperscript{109}

d. The Merger Participants

Although the impotence and continued presence of the Milwaukee and North Western attested a lack of effective intra-modal competition, the more important question is whether effective competition existed between the merger participants. It is readily apparent that if any two American railroads could have engaged in meaningful competition, they were the Great Northern and Northern Pacific. The physical structure of the lines was somewhat conducive to bidding for customers in terms of both services and prices. Although their tracks were sometimes as much as 100 miles apart, they were parallel at key points.\textsuperscript{110} The financial structure of the lines would also have facilitated service and price competition. Both were financially solvent:

In 1966, the Great Northern had railway operating revenue of $281.1 million and net income of $36.5 million; the Northern Pacific, $210.2 million in railway operating revenue and net income of $23.8 million (331 I.C.C. at 249-250). Each has long

\textsuperscript{107} Id. at 489.
\textsuperscript{108} Id. at 490-91.
\textsuperscript{109} Brief for Appellant, supra note 70, at 11.
\textsuperscript{110} The Commission found in its First Report that the lines were competitive at points for approximately 43\% of their gross revenues, and 34\% of their total tonnages. 328 I.C.C. at 515. Upon rehearing, the Commission found that the merger would not have any effect upon 88.28\% of the applicants' stations, accounting for 60.73\%, 66.59\%, and 56.13\% of cars, 66.59\% of tonnage and 56.13\% of revenues on the Northern Tier. Systemwide, the Commission found that there would be no competitive effect at 91.38\% of the applicants' stations accounting for 74.91\% of its cars, 78.64\% of total tonnage, and 68.59\% of total revenues. 331 I.C.C. at 272.
enjoyed profitable operation. ‘Burlington has not experienced nor missed a dividend in 35 years. Great Northern has had only 3 years (1932-34 inclusive) of deficit operations, and Northern Pacific only 2 (1932 and 1939) since 1926 . . . . Beginning in 1942, applicants have been able to pay increasingly larger amounts in dividends . . . ’ 328 ICC at 489.111

Moreover, both lines were efficient and well managed, thus precluding ruination by the other in the event of competition. Since the two lines owned equal interests in the connecting carriers at both ends of their parallel lines (the Burlington in the east, the SP&S in the west), they could have competed on their long main lines with the assurance that the connecting carriers would not sabotage their efforts.112

Despite these conditions which were seemingly conducive to vigorous competition, the Northern Lines were not strong competitors.113 In fact, the lines generally emphasized the carriage of different products; the Great Northern concentrating on grain and agricultural products while the Northern Pacific carried proportionately more lumber and ore. Shippers asserted that there was often no difference in service between points served by both roads and those points served by only one road, as there presumably would have been had the lines been in active competition with each other at those common points.114

The most plausible explanation for the lack of competition was, of course, the strong community of interest between the lines.115 The Great Northern and Northern Pacific had been pursuing a common goal for many years and had always been desirous of merger. The result of the Northern Securities di-

111. Brief for Appellant, supra note 70, at 5.
112. The unusually long hauls used across the Northern Tier would have facilitated competition between the two lines because either could have completed a midwest to west coast shipment solely on facilities it owned or controlled.
113. Although the lines did share common points at which competition was possible, neither line actively sought sustained competition. Executives of the BN admitted that the management of both lines realized that vigorous competition was not in their best interests. Repeated merger attempts and a community of ownership were the principal reasons for this generally benign attitude. See text accompanying notes 11-12 supra.
114. 331 I.C.C. at 274. Had there been substantial competition at the common points, with resultant better service, violent objection to the merger from shippers who stood to lose this competitive bargaining tool could have been expected. As a matter of fact, shippers generally supported the merger even before the protective conditions to the Milwaukee were granted. It is reasonable to assume that shippers expected to gain more from the merger than from continued separate operation.
115. See notes 11-12 supra.
vesture arrangement was to award ownership of the stock of each railroad to the owners of Northern Securities stock regardless of which stock any individual stockholder had originally contributed. As a result the same stockholders owned an interest in each railroad. Subsequently the lines jointly purchased the SP&S and the Burlington. Thus neither line had any incentive to harm the other. In any case, the pricing system of the Commission precluded price competition.

Before the merger, then, there was little effective competition on the Northern Tier, and in light of the firmly established community of interest, and price and service restrictions imposed by the Commission, realistically none was likely.

e. Merger

While the merger has not eliminated any meaningful intramodal competition, neither has it facilitated such competition as some proponents thought it would. The gateway concessions granted the Milwaukee, making it a transcontinental line, were predicted to increase intramodal competition on the Northern Tier, since the tier would be served by two "antagonistic" lines. This argument fails principally because it identifies a lack of gateways as the sole factor in the premerger weakness of the Milwaukee. The poor financial condition of the Milwaukee had also hindered its ability to render service improvements and new technologies, a factor which the gateways do not directly affect. Moreover, the theory fails to recognize the reality of the situation of the new "competitors." The BN will presumably be stronger after the merger than the constituents were together before it. Economies of scale and operational efficiencies ought to yield better service and greater profit. Reports from shippers indicate that the BN has already achieved much more reliable deliveries, vastly improved claim service, and better car availability. Such benefits are expected to con-

116. The Commission and the courts at least ostensibly expected an improved Milwaukee to result from the merger and to intensify competition as a result.
117. Concrete examples of the expected efficiencies were cited by the Commission. 331 I.C.C. at 265. Fruit from the Yakima Valley will reach Chicago 12 hours and Kansas City a full 24 hours sooner than it would have before the merger. High volume, high powered freights were expected to make the Chicago to Seattle trip in 82.5 hours after the merger, while the same service required 94.5 hours prior to the merger.
118. Shippers already report a line much improved in these respects.
tinue to improve as the merger potential is increasingly realized. Against this stronger line, the Milwaukee has only new gateways.

In its First Report, the Commission itself found that the BN would offer service which the Milwaukee could not meet:

[Milwaukee cannot] provide the . . . quality of service made possible by the proposed merger.

Finally, even if the Milwaukee were able to vie for freight with the Burlington Northern, competition in the Northern Tier would still be handicapped by the presence of uniform regulated prices.119 Hence it is apparent that the merger is not likely to materially increase competition or measurably improve the position of the Milwaukee vis a vis the new company. Indeed, the Milwaukee's position has deteriorated to the point that it now seeks entry into the BN.120

It is nonetheless apparent that the Milwaukee gateway provisions have resulted in a loss of some freight to the Burlington Northern. This would have been relatively high profit freight since it could easily be accommodated in underutilized cars without significant additional cost. As such the gateway provisions granted the Milwaukee only defeat some of the real efficiency made possible by the merger.

3. The Role of Competition: Intermodal

With respect to intermodal competition two questions are important. First, does the trucking industry impose a competitive burden on the rail industry? Second, are railroads effectively competing with the trucks? The first question is important in determining whether the Commission in considering a merger should involve itself with intramodal competition. If the trucking industry constitutes a significant threat to rail carriage, there will be sufficient pressures on the lines to provide cheap and efficient service, thus rendering intramodal competition unnecessary.121 The second question involves comparative advantage.122 Railroads theoretically have some cost or

119. See note 127 infra.
120. Permission for inclusion was requested on March 9, 1973. Interview with Milwaukee employee on May 4, 1973.
121. This is correct at least insofar as there is competition for the same freight. Trucks do not constitute a significant threat for bulk commodities such as iron ore.
122. "Advantage" is the ability of one subindustry to produce some good or service at a lower cost than any other subindustry. Here the lower cost producer will always be able to provide the good or service at a lower price than other producers, and this is so because that
service advantages that give them an edge in competition for some goods. If the present system inhibits the exercise of that preference, the reasons for, and the extent of, that inhibition are important to the question of whether merger can help railroads more effectively compete with the trucking industry.

The Commission's First Report argued that in this case the trucking and rail industries had very little competitive relationship because of the very distinct type of goods carried by each.\textsuperscript{123} Railroads in the Northern Tier generally make predominately long hauls of heavy loading, low value bulk commodities while trucks generally carry higher value goods.

There are, however, several indications that the Commission's initial conclusions are simply not correct. First, and most important, is the profit level of the Great Northern and Northern Pacific prior to merger. If the railroad industry faced no competition from the trucking industry, one would expect relatively high prices and profits among the rail lines, since demand for transport was high on the Northern Tier and there was no competition among the railroads. Independent of the trucking industry, railroads were apparently in a position to be anti-competitive and exploitative of monopoly conditions. However, the profits of the two lines, although reasonable in each of the 16 years preceding merger, were clearly not exorbitant.\textsuperscript{124} The competitive pressure of the trucking industry is at least one of a number of likely explanations for the low level of profits of the rail lines. Second, the assertion that the railroads and trucks are two distinct industries because they transport different goods ignores the fact that the basis for the goods differentiation is to a large extent due to the Commission inspired "value-of-service" pricing.\textsuperscript{125}

\begin{itemize}
\item producer has some unique ability that the others cannot duplicate. Within that subindustry, the normal competitive pressures would apply, so that only the most efficient producers would remain, but even the less efficient would enjoy some advantage over those producers in other subindustries. A good example of this situation exists in the transportation industry. Railroads have so much more capacity than trucks that they can carry goods at a much lower cost than trucks; this is their "comparative advantage." Since trucks, on the other hand, are not tied to fixed rails, they can deliver freight door to door, while rails can offer such service only in those few cases where rails and siding happen to go from the shipper to the consignee. Flexibility is the trucks' comparative advantage. This concept will be developed in detail, \textit{infra}. See P. \textsc{Samuelson}, \textit{Economics} 605 (6th ed. 1964). See also J. \textsc{Bain}, \textit{Price Theory} 164-69 (1961).
\item 123. 328 I.C.C. at 510-11.
\item 124. See text accompanying note 109 supra.
\item 125. Value of service is that mode of pricing wherein the price
Because that pricing system is not related to the cost of providing service but rather to the value of the goods shipped, it inevitably is disadvantageous to railroads vis-a-vis trucks. The inherent flexibility of trucks allows them to compete successfully for the carriage of the most profitable goods, leaving railroads to carry much less profitable cargo. Under a cost based rate system, the railroad's inherent cost advantage in long haul shipments would substantially outweigh the service advantages possessed by trucks, and the railroads would capture much more of the high value freight. It is apparent that the Commission's imposition of "value-of-service" pricing, which results in higher than cost pricing for high value goods, significantly contributes to the artificial cargo differentiation which presently exists.

Third, the Commission argued that rails and trucks are separate industries because of the long haul cost advantage of railroads. However, this argument ignores the fact that trucks have to a significant degree minimized this advantage through the ability to offer more rapid and flexible service.

Finally, the argument for the separability of the two industries founded on carriage of different types of goods for different hauls also fails to consider the fact that no clear dichotomy exists. There is a significant market of middle-value, middle-haul freight for which trucks and railroads could actively compete. Moreover, the evidence reveals that trucks are continuing to compete successfully for such freight. Thus, contrary to the position of the Commission, most economists agree that the charged for transporting a good from one point to another is based upon the demand for that good rather than the cost of transporting it. Thus, goods with a relatively inelastic demand are "high value" freight, whereas goods with a relatively elastic demand are "low value" freight. A proportionally higher part of the price paid for a high value item by the consumer will be attributable to transportation cost because the consumer is willing to pay such an additional amount as evidenced by the relatively inelastic demand for the good. This system of pricing has enabled the trucking industry to compete selectively with the railroads. Since by definition the highest price at which a good will move from one point to another is the value of service, the trucks have been able to compete for the high value freight by offering faster service and thereby leaving the railroads with predominately low value freight such as grain. Hence, the situation now exists in which trucks, with their relatively low fixed costs, have captured most of the high priced freight, while the railroads, with very high costs of operation, have been left with low value freight. See generally P. Locklin, supra note 2, at 144-46. The Commission, in making or adjusting rates, is charged to consider "the general and comparative levels in market value of the various classes and kinds of commodities" shipped by the carrier. 49 U.S.C. § 55 (1970) (emphasis added). See also 49 U.S.C. § 1 (1970).
trucking industry does impose competitive pressure upon the rail industry.\textsuperscript{126}

On the other hand, that pressure has not spurred the service improvements and efficiencies that would normally be expected to flow from competition. One plausible explanation is that reduced profits and revenues resulting from the Commission's policy of forcing the railroads to maintain unproductive lines to small communities results in low revenue for research and development and replacement of worn equipment and facilities with technologically advanced plant. Regardless of the cause of the failure to eliminate inefficiency, it is apparent that trucks do pose a competitive threat, and that as a result promoting competition among railroads is less important than it otherwise would be.

With respect to the second question, it is apparent that the railroads are being outmaneuvered by the trucks even in those areas where they have a clear comparative advantage. Theoretically, each transport mode possesses some unique advantages that enable it to perform a particular service more efficiently or at a lower cost than the other—a "comparative advantage." Market forces would eventually cause the more efficient mode to predominate over the less efficient mode in that service. It is generally agreed that trucks possess a clear comparative advantage over railroads in shipments of less than one hundred miles, and that the rails have a clear, and growing, advantage for shipments in excess of two hundred miles.\textsuperscript{127} The advantages are ascribed to differences in the costs necessary to "start up" a shipment.\textsuperscript{128} Since trucks have lower fixed costs than railroads, they reach a point where revenues equal fixed costs much sooner than railroads.\textsuperscript{129} Railroads, however, have fewer

\textsuperscript{126} See J. Meyer, et al., Competition in The Transportation Industry 134-86 (1964). See also A. Friedlaender, The Dilemma of Freight Transport Regulation 144-48 (1966). The same competitive pressure that normally exists in the market would force the rail industry to abandon service where it could not effectively compete against the trucks; such pressure would force the rails to improve efficiency or lose more and more of the profitable freight.

\textsuperscript{127} J. Meyer et al., supra note 126, at 194-95.

\textsuperscript{128} "Start up" costs include the original capital investment in equipment, a pro rata portion of terminals, administration expenses, and the actual labor necessary to put the carrier in motion.

\textsuperscript{129} Trucks have very low fixed capital costs. The vehicle itself and terminal buildings are the major expenses. However, the railroads have enormous capital costs in slowly depreciating equipment, roadbed and yards. Trucking labor costs are high once the truck is loaded because the driver is paid by the mile. Once a train is composed, much more freight is hauled per man hour of work than by truck.
variable costs because of their larger hauling capacities. Thus once the break even point is reached at approximately the 200 mile figure, the railroads have a clear comparative advantage which grows as distance increases.

In spite of this, it has been estimated that over 91% of all trucking shipments involve distances of over two hundred miles—a service in which the rails have the natural advantage. The direct cost to society in ignoring these inherent advantages has been estimated to be as high as five hundred million dollars annually.130

Of course, this theoretical cost advantage in long haul carriage is dissipated to a great degree by the inefficiencies inherent in the regulatory system. Commission policy forces costs to an artificially high level by restricting the elimination of excess labor and little used and duplicative routes. Start up costs are thus driven higher for all rail operations, and the break even point is increased. The long haul comparative advantage is further reduced by the indirect cost subsidy given by the government to the trucking industry. Although the trucking companies pay substantial user fees for highway use, they are not required to make capital investments to build the highways, nor are they required to pay property taxes on them.131

All the reasons for the railroads’ failure to assert whatever long haul cost advantages which remain are readily apparent. First, even though railroads may have a long haul cost advantage, they do not have long haul service parity with trucks. Shipments from Chicago to Seattle generally take approximately five days by rail but only two to three days by truck.132 The truck shipment is also door to door, while the rail figure merely reflects terminal to terminal time, so that still more time must be added to the rail figure if the shipper or receiver of the goods do not have spur tracks. While many shippers prefer the free storage provided in the rail cars by these delays, most shippers of high value, high profit freight prefer the faster service.133

Second, the Commission’s “value-of-service” pricing134 is based not upon cost but upon the price the consumer is willing

130. A. FRIEDLAENDER, supra note 126, at 66. While there is some question as to the actual figure, the losses are apparent.
131. A. Friedlaender concludes that there is considerable evidence that the trucks do not pay the full cost of their use. Id. at 105-06. There can be no doubt that they are spared the tax burden of widening the roads.
132. Truckers can generally make the cross country trip over Interstate Highway 94 and average 40-50 miles per hour.
133. See note 55 supra.
134. See note 125 supra.
to pay for the commodity transported. Value-of-service pricing bears no relation to cost and may result in a price higher than actual cost. Thus, where a railroad had costs of $2 for a long-haul shipment and a truck $5, the railroad should capture the freight because the $3 difference in price should outweigh the value to a consumer of the service advantages provided by truckers. Where price is not set by cost, the railroad's price may reach $3.50. In such case the consumer may well be willing to pay an additional $1.50 for the faster and more reliable service provided by a trucker.\textsuperscript{135}

Transportation on the Northern Tier attests to the inferior position occupied by the railroads. Although the Tier is an ideal long haul market which should be well suited to railroad dominance, the trucking industry has succeeded in capturing the more lucrative freight. Most rail traffic on the Tier flows from west to east and is largely comprised of low value and low rated goods such as unfinished lumber and agricultural products, as well as ores and minerals.\textsuperscript{136} Most high value, high rated freight moves from manufacturing centers in the east and midwest to the west. The trucking industry competes vigorously with the rails for this westward business, generally capturing the lucrative high value imported goods from West Coast seaports for the return trip.\textsuperscript{137}

But for the rate structure and artificially high costs which seriously impair the ability of the rails to compete, they would be able to offer much lower prices for such lucrative freight and capture a significant portion of it, notwithstanding the inherent service advantages offered by the trucks.

The Northern Lines merger will arguably improve the opportunity for intermodal competition by fostering service improvements and by allowing the realization of substantial capital and operational savings. It was argued that the merger would result in immediate service improvements because of the ability of the new line to pool freight and thus operate more nonstop, long haul, through, and unit train service, all of which would decrease time and cost of shipment. It was also expected that the merger would result in improved car availability, especially in peak seasons, due to centralized car accounting and assignment.

The merger was expected to result in annual savings of between thirty-six and forty-six million dollars, to be achieved by

\textsuperscript{135} See note 122 supra.

\textsuperscript{136} Loving, \textit{A Railroad Merger that Worked}, \textit{Fortune}, August 1972, at 128, 130-31.

\textsuperscript{137} Id.
the immediate consolidation of terminals, switching facilities, rolling stock, and management, and by the gradual elimination of unnecessary employees. These savings would greatly strengthen the financial position of the new line and, it was argued, make available new sources of capital for modernization, innovation, and service improvements. These in turn would generate new customers and increased business from existing customers, all at the expense of the trucking industry.

The Burlington Northern asserts that the above service improvements and cost savings have come to pass. The average time for cross country shipments has been cut from 92.5 hours to 87 hours. The line has announced a future service improvements program including a one hundred million dollar, five-year plan of constructing computerized yards.\textsuperscript{138} In 1972 alone, the company expected to acquire railroad equipment and make improvements to roadbed, structures and other items at an aggregate cost of one hundred sixty million dollars.\textsuperscript{139} The confidence of the financial community in the new line was demonstrated by the successful distribution of the first railroad equity security offered since the 1950's a sixty-five million dollar, 5.25\% convertible debenture offered by BN.

Each service and efficiency improvement will advance the railroad's position vis à vis the trucks. As the railroad provides more reliable service, it is better able to vie for the higher value freight; each operational efficiency or savings that results in higher earnings increases the financial ability of the BN to invest in service improving innovations—which in turn increase competitive ability.

In spite of these developments, the merger has resulted in additional costs for the company. The labor concessions will preclude immediate employee reductions that might have taken place even without the merger. The gateway conditions granted to the Milwaukee and the North Western divert freight previously awarded to the participants. Further, contemporaneously with the merger, the long-haul capability of the trucks has been greatly advanced by the construction of Interstate Highway 94 across the Northern Tier.

More importantly, the merger will not alleviate the more basic problems underlying the Northern Lines' inability to cope

\begin{footnotesize}
\end{footnotesize}
with intermodal competition. The trucking industry retains the advantages of convenient door to door service, while fixed rates preclude price competition. Moreover, the railroads are saddled with artificially high costs due to the restrictions against abandonment, which may be all the more difficult to procure in light of an improved profit picture.

VI. CONCLUSION

This Note was intended to identify the proper factors to be considered in analyzing a railroad merger, particularly with regard to the emphasis to be placed upon competition. It was also intended to discuss whether mergers can solve the rail industry's ills. Several key problems in the present plight of the rail industry have been identified. Foremost among these is the past and, to a lesser extent, present emphasis by the Commission upon intramodal competition among railroads as a method of achieving low cost, efficient service. This emphasis is costly in that it results in substantial duplication of effort which is unnecessary in view of the competitive pressure of the trucking industry. Moreover, it is practically unworkable since the present Commission price policy and the physical structure of railroads precludes effective rail competition.

A second significant problem is the poor service record the railroads have established as compared to the trucking industry. One plausible explanation is that the lines do not have sufficient revenues to upgrade their service capabilities. Whatever the reason, the central fact is that the service problem exists. Finally there is the Commission rate making scheme and general policy of prohibiting line abandonments. With a pricing system based on costs rather than value of service, railroads would undoubtedly be better able to exploit their inherent advantages in long-haul service. Moreover, the excessive costs of maintaining unprofitable lines limit expenditures for service improvements.

Prospective mergers should be tested in light of and as potential solutions to these problems. First, little weight should be given to the preservation of intramodal competition. Rather, the focus should be whether there is sufficient pressure from other transportation modes to force merged lines to be efficient carriers, and, if so, whether the merger will enable the participants to more effectively compete with other transport modes.

Two additional considerations of substantial importance are the extent to which the merger will achieve cost savings and in-
creased revenues, and whether those savings will result in investment for service improvement. It is not at all clear, as evidenced by the case of the Penn Central, that merger necessarily results in savings and operational efficiencies. It may well be that a merged railroad may be content to accept whatever profits are available from the carriage of low value bulk goods, without actively seeking freight in higher value goods presently carried by trucks. The answer to the latter question may necessarily depend on a case by case evaluation of the dynamics of the companies involved.

It is somewhat futile to evaluate a merger in terms of whether it may relieve the problems associated with Commission policy, since the impact in any case will not be significant. A pricing system not tied to costs puts the railroads at a competitive disadvantage with trucks, a disadvantage which the cost savings and service improvements of a merger can only partially alleviate. Moreover, the Commission's abandonment restrictions will continue to impose significant artificial costs. In determining a policy of rail abandonment, society may have to choose between efficiency and availability of rail service to all citizens and segments of the country. To the extent the latter course is chosen, the railroads will never be fully competitive and may even require subsidization. Mergers will arguably yield cost savings, but they may represent a mere holding action.

On the basis of the above model, the approval of the BN merger by the Commission and the Supreme Court appears to be substantially correct. First, as to intermodal competition, the evidence indicated that the trucking industry did represent a competitive threat, that the railroads were at a distinct service disadvantage, and that the merger would yield savings, efficiencies, and new technologies that would improve the line's position with the trucks. The Commission and the Court were therefore correct in concluding that the merger was desirable in this regard.

However, the plan of merger was incorrect insofar as it emphasized intramodal competition and required gateways for the Milwaukee. Effective rail competition is precluded after merger as well as before because of uniform pricing policies and because of the physical composition of railroads. To emphasize intramodal competition as a method of serving the consumer is nonproductive. Further, even if it is sensible to foster intramodal competition, it is apparent from the historical financial weakness of the Milwaukee, coupled with the superior serv-
ice potential of the BN, that the Milwaukee was precluded at the outset of the merger from providing meaningful competition. The protective provisions only reduce the savings the merger may have yielded.

The merger was, of course, desirable in terms of the cost savings and new technologies facilitated thereby. With the benefit of hindsight, it is apparent that merger was the key to substantial cost savings and programs of technology and service improvement, and that the management of the new company was committed to competitive improvement.

On another level, approval was not only consistent with the above model, but also with past precedent in McLean and Seaboard. The decision reinforces Seaboard in that it emphasizes intermodal rather than intramodal competition, not so much in the written opinion itself as in the facts of the case. Two financially healthy, if not wealthy, lines which could have competed to a significant degree were allowed to merge. In spite of the fact that the lines carried substantial amounts of bulk goods which no other transport mode could have captured, the trucking industry was recognized as a sufficient competitive threat to compel the merged lines to press for efficiency. To the extent that Northern Lines moves the case law towards merger approval criteria which measure first, whether the merged line will face intermodal competition and second, whether the merger will facilitate more effective intermodal competition, it represents progress in attuning the law to economic realities. On the other hand, insofar as the case emphasizes intramodal competition as a factor in the decision whether merger is in the public interest, it widens the chasm between economic reality and the law.

Although the BN merger is a moderately good example of how mergers can alleviate some of the economic ills of the railroads, its uniqueness cannot be underestimated, particularly in light of the Penn Central experience. The constituent lines of the BN shared a community of interest well before the merger which helped immensely in the smooth transition into one large firm. The Northern Lines were also healthy before the merger and enjoyed a significant market of raw materials in which they enjoyed a huge comparative advantage over the trucking industry. Finally, the lines had much less unnecessary trackage than most railroad lines. Thus, although the BN merger is indicative of some of the potential benefits of merger in the railroad industry, the particularly advantageous situations of the Northern lines prior to merger should not be overlooked.