

SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY, AND  
MISSOURI PACIFIC RAILROAD COMPANY—CONTROL AND MERGER—SOUTHERN  
PACIFIC RAIL CORPORATION, SOUTHERN PACIFIC TRANSPORTATION  
COMPANY, ST. LOUIS SOUTHWESTERN RAILWAY COMPANY, SPCSL CORP.,  
AND THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY

Decision No. 98

Decided: October 16, 2002

This decision resolves a dispute over the mechanism for adjusting the fees to be paid by The Burlington Northern and Santa Fe Railway Company (BNSF) for trackage rights that BNSF acquired over the lines of Union Pacific Railroad Company (UP) in connection with the 1996 UP/SP merger. We find that BNSF has not shown that certain disputed items should be omitted from the calculations used to determine annual adjustments to the trackage rights fees.

BACKGROUND

By decision served August 12, 1996,<sup>1</sup> we approved the merger of the rail carriers controlled by Union Pacific Corporation (Union Pacific Railroad Company and Missouri Pacific Railroad Company) and the “SP” rail carriers controlled by Southern Pacific Rail Corporation (Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corp., and The Denver and Rio Grande Western Railroad Company) subject to various conditions, including extensive BNSF trackage rights over UP/SP lines that were provided for in the BNSF Agreement.<sup>2</sup>

As relevant here, Section 9(a) of the BNSF Agreement established the initial charges for the BNSF trackage rights: 3.48 mills per ton-mile (applicable to intermodal and carload traffic on the Keddie-Stockton/Richmond line); 3.1 mills per ton-mile (applicable to intermodal and carload traffic on

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<sup>1</sup> Union Pacific/Southern Pacific Merger, 1 S.T.B. 233 (1996) (Decision No. 44).

<sup>2</sup> With respect to the period ending September 10, 1996, “UP” refers to the rail carriers then controlled by Union Pacific Corporation, and “SP” refers to the rail carriers then controlled by Southern Pacific Rail Corporation. With respect to the period beginning September 11, 1996 (the date of consummation of common control), “UP” refers to the combined UP/SP system.

all other lines); and 3.0 mills per ton-mile (applicable to bulk traffic). Section 9(a) provides that these initial fees “shall be escalated in accordance with the procedures described in Section 12 of this Agreement.” See UP/SP-393 at 33.<sup>3</sup> Section 12 of the Agreement, in turn, provides that:

All trackage rights charges under this Agreement shall be subject to adjustment upward or downward July 1 of each year by the difference in the two preceding years in UP/SP’s system average URCS costs for the categories of maintenance and operating costs covered by the trackage rights fee. ‘URCS costs’ shall mean costs developed using the Uniform Rail Costing System.

UP/SP-393 at 12.<sup>4</sup>

The current dispute between BNSF and UP concerns the treatment of two items in the computation of URCS maintenance and operating costs within the context of the Section 12 trackage rights fee adjustment procedure:

- 1) the “acquisition premium,” i.e., the excess of the price that UP paid to acquire the SP rail carriers over the pre-acquisition book value of the carriers; and
- 2) the costs of certain capacity improvements undertaken by UP on the trackage rights lines that were allocated by Section 9(c)(i) and 9(c)(iii) of the BNSF Agreement entirely to UP, even though such lines are used both by UP and by BNSF, and even though the BNSF Agreement generally requires that both railroads share such costs based upon their respective usage of the line in question.<sup>5</sup>

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<sup>3</sup> The “UP/SP-393, BNSF-100” pleading (herein referred to as “UP/SP-393”) was filed on March 1, 2002.

<sup>4</sup> A disagreement over the mechanics of the Section 12 calculation (one view calling for the calculation of the “difference” between 2 years of URCS costs; the other view calling for the calculation of the “percentage change” between 2 years of URCS costs) and other technical issues were submitted to arbitration. See UP/SP-397 at 32 & n.21.

<sup>5</sup> The capacity improvements governed by Section 9(c)(i) are those that are necessary to achieve the benefits of the UP/SP merger as outlined in the UP/SP merger application. The capacity improvements governed by Section 9(c)(iii) are those that were undertaken within the first 18 months following UP’s acquisition of control of SP. See UP/SP-393 at 34.

BNSF contends that the costs associated with those items were an integral part of the original trackage rights fees that it negotiated with UP, and that including them in any Section 12 adjustment would improperly double-count those items. Thus, BNSF asserts that:

[t]hese costs that UP has improperly included in the annual adjustment effective July 1, 1998, and in subsequent years need to be identified and removed from URCS data for those years. Alternatively, the error of basing the adjustment on use of these costs in 1997 and subsequent years could be corrected by adding those costs in the years 1995 and 1996 and any succeeding years in which such costs are not present in URCS for the preceding year.

BNSF-102, V.S. Weicher, at 11. BNSF takes no position as to which correction procedure to use, so long as the procedure prevents the disputed items from having any effect in the annual adjustment process. BNSF-104, at 3-4; see also BNSF-102, V.S. Weicher, at 11.

UP, on the other hand, asserts that the disputed items have been properly included in the Section 12 adjustment as they have been incorporated into UP's URCS costs. Thus, for example, UP claims that it properly incorporated the acquisition premium that it paid for the SP carriers into its 1997 URCS costs (the year the actual corporate mergers of the various UP/SP rail subsidiaries began), rather than in its 1996 URCS costs (the year common control was consummated).

In Decision No. 96 (served March 21, 2002), we addressed BNSF's initial argument and evidence, contained in its petition for clarification (BNSF-98) filed December 21, 2001. We were not persuaded that the disputed items should be excluded in the years in which they would otherwise be part of the URCS calculations required to create the Section 12 adjustment factor. However, to ensure that the trackage rights fee adjustment mechanism works as intended, we provided BNSF and other interested parties a further opportunity to demonstrate that the disputed items should be omitted from the URCS calculations. Decision No. 96, slip op at 7.

Several pleadings were filed in response to Decision No. 96: BNSF-102/103, filed May 22, 2002, by BNSF; CMA-17, filed May 22, 2002, by the American Chemistry Council (ACC), formerly the Chemical Manufacturers Association (CMA); UP/SP-397, filed June 19, 2002, by UP; CMA-19, filed June 28, 2002, by ACC;<sup>6</sup> BNSF-104, filed June 28, 2002, by BNSF;<sup>7</sup> and an undesignated letter, filed July 9, 2002, by UP.

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<sup>6</sup> ACC's CMA-18 request (also filed June 28, 2002) for leave to file CMA-19 is granted, and CMA-19 is accepted for filing and made part of the record.

<sup>7</sup> BNSF's request, see BNSF-104 at 1 n.1, for leave to file BNSF-104 is granted, and BNSF-104 is accepted for filing and made part of the record.

## DISCUSSION AND CONCLUSIONS

After further consideration, we remain unpersuaded by the arguments that the disputed items should be omitted from the calculations used to determine annual adjustments to the fees paid by BNSF to UP for the trackage rights received by BNSF in the UP/SP merger proceeding. BNSF and ACC continue to assert that the initial fees were meant to incorporate and fully account for both the SP acquisition premium and the anticipated costs of the Section 9(c)(i) and (iii) merger-related capital improvements that UP was to fund, and that their consideration in the fee adjustment process now would result in double counting. However, other than their current statements concerning their assumptions at the time, BNSF and ACC have not pointed to any evidence during the 1995-1996 period during which the trackage rights fees and annual adjustment mechanism were negotiated that would support or confirm that contention, or any evidence that the Section 9(a) initial trackage rights fees were intended to specifically embrace or exclude any costs. In fact, BNSF's witness admits that the carriers did not exchange cost information, and, according to UP, BNSF never shared any views or assumptions about costs. UP/SP-397, V.S. Rebensdorf, at 2-3, citing BNSF-102, V.S. Ice, at 2.

The evolution of the fee adjustment mechanism contained in Section 12 likewise does not support BNSF and ACC's position. The original version of the BNSF Agreement (dated September 25, 1995) provided that the initial trackage rights fees to be paid by BNSF "shall be subject to adjustment annually beginning as of the effective date of this Agreement to reflect seventy percent (70%) of increases or decreases in [the] Rail Cost Adjustment Factor, not adjusted for changes in productivity ('RCAF-U') published by the ICC or successor agency or other organizations." UP/SP-22 (filed November 30, 1995), at 318, 337. While BNSF had agreed to this adjustment mechanism, CMA and other shippers expressed concern that this mechanism would not fully incorporate UP's projected post-merger efficiencies. Those concerns led to the replacement of the original fee adjustment mechanism with Section 7 of the CMA Agreement (CMA §7):

Section 12 of the BN/Santa Fe Settlement Agreement shall be amended to provide that BN/Santa Fe's trackage rights fees shall be adjusted upward or downward each year by the difference between the year in question and the preceding year in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the fee.

UP/SP-230 (filed April 29, 1996), Attachment at 3.

Shortly thereafter, UP and BNSF agreed to modify the Section 12 mechanism to its current form to calculate any change in the fees in a given adjustment year based on the difference between UP's URCS maintenance and operating costs for the 2 prior calendar years, rather than, as with CMA §7, on the difference between URCS data for the year in question—data that, as a practical matter, would not have been available until several months after the year had ended—and data for the

past year.<sup>8</sup> Thus, in the first fee adjustment required by Section 12 in 1997,<sup>9</sup> the difference would have been that the Section 12 adjustment for 1997 would have been based on the difference between UP's 1996/1995 URCS data, while the CMA §7 adjustment for 1997 would have been based on the difference between UP's 1997/1996 URCS data.<sup>10</sup>

Indeed, in its initial submission in this proceeding (CMA-15, at 2), ACC agreed that "the literal language of Section 7 of the CMA Agreement . . . could be read as justifying what UP has done" here as to the disputed items. However, ACC now states (CMA-17, V.S. Schick, at 4):

Because the base trackage rights fee (unadjusted) would be paid in post-merger year 1, the first time the fee would be adjusted would be in year 2, and the adjustment would be based on the difference between post-merger year 2 [1997] costs and post-merger year 1 [1996] costs. There was no provision for adjustments based on comparing pre-merger years with post-merger years.

ACC's current position cannot be squared with its predecessor's original rationale for proposing to alter the original adjustment mechanism (RCAF-U) agreed to by BNSF and UP. Indeed, revising the fee adjustment mechanism to incorporate UP's projected post-merger efficiencies in the

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<sup>8</sup> While CMA did not negotiate or formally agree to this technical clarification, UP indicates that this adjustment was based in large part upon the testimony of CMA's Witness Crowley, who stated that the adjustment "should reflect a 1-year lag so that the 1997 adjustment would be based on the change in costs between 1995 and 1996." UP/SP-397, at 18-19, citing CMA-7, V.S. Crowley, at 57.

<sup>9</sup> Sixteen of the 19 separate trackage rights agreements required by the BNSF Agreement, which were submitted into the record as Exhibit B to the UP/SP-266 pleading (filed June 28, 1996), clearly indicate that UP and BNSF intended that the first adjustment would be made on July 1, 1997. (In each of the 16 indicated agreements, Section 3(c) provides that "[t]he GTM Rates set forth in Section 3(a) of this Agreement shall be subject to adjustment annually, commencing as of July 1, 1997.") And, although the other three trackage rights agreements do not clearly indicate that UP and BNSF intended that the first adjustment would be made on July 1, 1997, nothing in those three agreements is at odds with that date.

<sup>10</sup> This modification should have been anticipated by CMA. As UP has explained (UP/SP-397 at 12-13), the parties were put on notice on April 29, 1996, by UP's Witness Rebensdorf – 11 days after the CMA Agreement was signed (April 18, 1996) and almost 2 months before BNSF and UP filed the Second Supplemental Agreement to the original BNSF Settlement Agreement (June 27, 1996) containing the current Section 12 – that UP had agreed to a fee adjustment process as outlined in CMA's Witness Crowley's statement (see footnote 8).

trackage rights fees would necessarily mean an adjustment mechanism that would use UP's pre-merger, not post-merger, costs as a base. Moreover, ACC's position would also revive the unworkability concerns with CMA §7 that led UP and BNSF to modify the Section 12 mechanism in the first place: that the required July 1, 1997 adjustment could not be made because the 1997 URCS costs required for that adjustment would not be available until well into 1998.

More significantly, we see no basis for ACC's claim that the current Section 12 adjustment process results in far less favorable trackage rights fees to shippers using BNSF's service than the procedure provided in CMA §7. There is virtually no difference (0.1 mills per ton-mile) in the total trackage rights fee adjustments using either method, and reverting to ACC's current interpretation of CMA §7 would have led to slightly *higher*, not lower, trackage rights fees in 1997 and beyond. That is because the 1997 trackage rights fee adjustment under that interpretation could not have included the reductions in UP's relevant URCS costs from 1995 to 1996 that, pursuant to the plain language of Section 12, could and were reflected in the 1997 adjustment that UP actually put in place. Instead, under ACC's current interpretation of CMA §7, UP could have incorporated only the increases in those costs that were reflected in UP's 1998 adjustment.<sup>11</sup>

In the end, absent any compelling evidence to the contrary, the URCS costs used in the Section 12 adjustments must be developed in accord with our Uniform System of Accounts (USOA) and our standard costing procedures. Neither the BNSF Agreement itself nor any other document or evidence presented during the course of the UP/SP merger proceeding contains any indication that either BNSF or UP, or any other party to the UP/SP merger proceeding, ever contemplated that the URCS calculations required by Section 12 would not be performed in that manner. This necessarily means that, in performing the calculations required by the plain language of Section 12, the disputed cost items must be incorporated into URCS costs in the year(s) as provided by our standard procedures and may not be removed from URCS in any year in which removal is not justified by those procedures. Here, the acquisition premium was properly incorporated by UP into its URCS costs in 1997, the year that

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<sup>11</sup> See UP/SP-397, Chart 1. The "CMA Method" referred to in the chart is actually the current Section 12 adjustment method that has been applied by UP since the merger, which UP apparently chose to characterize as the "CMA Method" only because it was originally suggested by CMA witness Crowley.

UP accounted for the acquisition premium on its books,<sup>12</sup> and the vast majority of the costs associated with the Section 9(c)(i) and (iii) capacity improvements in 1997 and later years as UP incurred them.

Finally, contrary to BNSF's continuing arguments, there is no competitive justification for adjusting the fees that have been in place. As we have found in our UP/SP oversight decisions, BNSF has continued to effectively replace the competition that otherwise would have been lost when SP was absorbed into UP. The initial trackage rights fees, as annually modified through the Section 12 trackage rights fee adjustment process, have proven highly favorable to BNSF and to the competitive process. As UP points out, the initial fees here were considerably less, and the fee adjustment process more favorable to BNSF, than the fees and adjustment process governing competition-preserving trackage rights received by SP in the BN/Santa Fe merger proceeding. See UP/SP-397, at 15 & Chart 2. Moreover, BNSF's trackage rights fees under the Section 12 fee adjustment process are almost 10% below the fees that BNSF would now be paying under the "70% of the RCAF-U" adjustment to which it initially agreed.<sup>13</sup> Decision No. 96, slip op. at 5 n.6. They are also considerably below the trackage rights fees we would have set under our governing compensation methodology had the parties not agreed to lower charges. See UP/SP-397, at 16, citing Decision No. 44, 1 S.T.B. at 414-415 (1996).

Thus, the history behind the current trackage rights fee agreement between UP and BNSF does not lead us to the conclusion that an additional fee adjustment is appropriate. Nor is there any other evidence presented that would dictate a different outcome.

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<sup>12</sup> BNSF and CMA argue that the excess of the price paid by UP to acquire the SP rail carriers over the pre-acquisition book value of those carriers should have been incorporated into UP's URCS costs in 1996, rather than 1997, because common control was consummated in 1996. However, UP has explained that, because the corporate mergers of the various UP/SP railroad subsidiaries did not begin until 1997, it acted properly in incorporating this item into its URCS costs in 1997. It further explains that its purchase accounting, which was dictated by tax and shareholder considerations and by our accounting rules, was properly recorded in 1997, and the parties to the original proceeding were aware of the timing of the purchase accounting. See UP/SP-397 at 23-24.

<sup>13</sup> In explaining the withdrawal of its opposition to the merger, CMA acknowledged during the merger proceeding that the change in the trackage rights fee escalator from 70% of RCAF(U) to year-to-year changes in UP/SP's actual system average cost for the maintenance and operating cost elements covered by the fee would "*correct the tendency of the fee to rise above actual costs over time because of the use of an escalator that did not incorporate productivity gains.*" (emphasis in original) CMA-17, V.S. Schick, at 5 (citation omitted). While ACC suggests that the Section 12 adjustment has failed to accomplish this, the change in the fee adjustment process brought about by CMA's intervention during the original merger proceeding directly led to trackage rights fees in place today that have been reduced from their initial level and are almost 10% lower than the RCAF-U adjusted fees that would be in place absent CMA's intervention.

While we have resolved in this decision the specific dispute brought before us by BNSF, the record has also presented evidence of numerous other disputed areas involving the trackage rights fee adjustment process. These other areas of dispute have been either submitted to arbitration or have been resolved in negotiations between BNSF and UP. Based on our review of the record, it appears that these other areas of dispute include, but may not be limited to: (i) how to combine or create 1995 and 1996 UP and SP URCS costs; (ii) the categories of maintenance and operation costs that are used to calculate the fee adjustment; (iii) the source of dispatching expenses that are used to calculate the fee adjustment; (iv) whether the adjustment should reflect the difference in URCS costs in the two preceding years or the percentage change in URCS costs in the two preceding years; and (v) whether UP has correctly reflected in the adjustment of the mill rates the charges in the gross ton mile costs associated with its declining URCS unit costs involved in trackage rights operations.

These issues, and any other issues that concern the trackage rights fee adjustment process governed by Section 12 of the BNSF Agreement that may have been resolved by UP and BNSF, appear to us to have the potential to be general matters that could have broad implications with respect to BNSF's trackage rights, which are the linchpin of the competition-preserving conditions we imposed on the UP/SP merger. Since these issues have been resolved via arbitration or negotiations, however, the Board and the public have not been privy to the resolution of these disputes. For example, it is not known whether the agreed-upon method used to create combined UP/SP URCS data for 1995 and 1996 complies with our procedures. See Uniform Railroad Costing System, 5 I.C.C.2d 894 (1989). Consequently, the potential impact to the escalation of the trackage rights charges is unknown. Moreover, it is apparent that the language of Section 12 should be revised to incorporate the resolution of these disputes in order to avoid future disputes.

Therefore, we will require UP and BNSF to submit a report to the Board, either independently or jointly, which includes a full and complete description of any and all matters pertaining to the implementation of Section 12 that have either been resolved through negotiation or arbitration or remain outstanding. This report should include an analysis of the impact of these changes to the escalation of the trackage rights charges. Proposed revised Section 12 language that fully incorporates the resolution of these matters should also be included for Board approval. Interested parties will have the opportunity to comment on the resolution of these matters and the proposed revision to Section 12.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. The BNSF-98 clarification petition is denied.
2. Within 30 days of the service date of this decision, UP and BNSF shall submit an original and 10 copies of a report which includes: a full and complete description of any and all matters

pertaining to the implementation of Section 12 of the BNSF Agreement that have either been resolved through negotiation or arbitration or remain outstanding; an analysis of the impact of these changes to the escalation of the trackage rights charges; and proposed revised Section 12 language that fully incorporates the resolution of these matters.

3. Interested parties may comment on the resolution of these matters and the proposed revision to Section 12 within 20 days thereafter.

4. This decision is effective on the date of service.

By the Board, Chairman Morgan and Vice Chairman Burkes. Chairman Morgan commented with a separate expression.

Vernon A. Williams  
Secretary

Chairman Morgan, commenting:

In addition to resolving the dispute before us, this decision requires UP and BNSF to submit certain information pertaining to the implementation of Section 12 of the BNSF Agreement, and then establishes a new formal approval process for that provision. While I do not see the need to institute a formal governmental process to approve privately resolved matters involving clarification of the Section 12 language where no party has questioned those matters, I do support the portion of this decision that resolves the actual dispute brought by the parties before us here. Without the formal approval process called for in this decision, parties would continue to have the right, as appropriate, to seek Board clarification of matters related to the implementation of Section 12, and the American Chemical Council would continue to have its audit rights specifically applicable to that provision, which rights were part of the CMA Agreement and imposed by the Board as a condition of its UP/SP merger approval. Nevertheless, to bring final resolution to the long-standing dispute actually before us now, I have voted to approve this decision.