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SERVICE DATE – MARCH 21, 2002

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. 96

Decided: March 19, 2002

This decision addresses a dispute concerning the mechanism for adjusting the fees that are applicable to the trackage rights that The Burlington Northern and Santa Fe Railway Company (BNSF) acquired over the lines of Union Pacific Railroad Company (UP) in connection with the 1996 UP/SP merger.

BACKGROUND

By decision served August 12, 1996,¹ we approved the merger of the “UP” 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, most prominently, the extensive BNSF trackage rights over UP/SP lines that were provided for in the BNSF Agreement.²

The initial rates applicable to the BNSF trackage rights were established in Section 9(a) of the BNSF Agreement. The initial rates were: 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 all other lines); and 3.0 mills per ton-mile (applicable to bulk traffic, which is defined for this purpose as “67 cars or more of one commodity in one car type”).

¹ Union Pacific/Southern Pacific Merger, 1 S.T.B. 233 (1996) (Merger Dec. No. 44).

² 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.

See UP/SP-386 at 36.³ Section 9(a) further provides that the initial rates “shall be escalated in accordance with the procedures described in Section 12 of this Agreement.”

Section 12 of the BNSF Agreement provides for the “adjustment” of the Section 9(a) rates: “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-386 at 47-48.

The dispute between BNSF and UP concerns two of the items that are components of the “maintenance and operating costs covered by the trackage rights fee” when using standard accounting procedures – that is, procedures consistent with the Uniform System of Accounts – in developing URCS costs. The first disputed item is the so-called “acquisition premium” — the excess of the price paid to acquire the SP rail carriers over the pre-acquisition book value of the SP rail carriers. See CSX Corp. et al.—Control—Conrail Inc. et al., 3 S.T.B. 196, 261-66 (1998); Western Coal Traffic League v. Union Pacific Railroad Company, STB Finance Docket No. 33726 (STB served May 12, 2000). The second disputed item concerns the costs of certain capacity improvements undertaken by UP on the trackage rights lines which have been allocated — by Sections 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 the BNSF Agreement otherwise generally requires that both railroads share costs based upon their respective usage of the line in question. 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.⁴

BNSF’s Position. In its BNSF-98 petition for clarification (filed December 21, 2001) and in its BNSF-99 reply (filed February 4, 2002), BNSF contends that the disputed items should be omitted (in the years in which they would otherwise be included) in the URCS calculations required to create the Section 12 adjustment factor. As to the inclusion of the disputed acquisition

³ The “UP/SP-386, BNSF-92” pleading (herein referred to as the “UP/SP-386” pleading) was filed in STB Finance Docket No. 32760 (Sub-No. 21) on July 25, 2001.

⁴ Section 9(c)(i) provides: “UP/SP shall bear the cost of all capacity improvements that are necessary to achieve the benefits of its merger as outlined in the application filed with the ICC for authority for UP to control SP. The operating plan filed by UP/SP in support of the application shall be given presumptive weight in determining what capacity improvements are necessary to achieve these benefits.” Section 9(c)(iii) provides that, “[f]or 18 months following UP’s acquisition of control of SP, BNSF shall not be required to share in the cost” of any capacity improvements not covered by Section 9(c)(i). See UP/SP-386 at 37.

premium, BNSF contends that, at the time the BNSF Agreement was negotiated, BNSF and UP were aware that UP would be paying a price in excess of book value in connection with its acquisition of control of SP; that this acquisition premium was taken into account when BNSF and UP agreed on the initial rates established in Section 9(a); and that the inclusion of the acquisition premium in the Section 12 adjustment factor would effectively require BNSF to again pay a part of that acquisition premium and amount to a kind of double-counting. As to the inclusion in the Section 12 adjustment factor of the disputed capacity improvement costs, BNSF contends that Section 9(c) of the Agreement relieves it of any obligation for those costs.

BNSF acknowledges that Section 15 of the BNSF Agreement provides that, “[e]xcept as otherwise provided by any decision of the STB or by separate agreement, unresolved disputes and controversies concerning any of the terms and provisions of this Agreement or the application of charges hereunder shall be submitted for binding arbitration under [the] Commercial Arbitration Rules of the American Arbitration Association which shall be the exclusive remedy of the parties.” UP/SP-386 at 50. BNSF insists, however, that, even though an arbitration proceeding as to the present dispute was commenced by UP prior to the filing of the BNSF-98 petition, the present dispute should be resolved in an administrative proceeding. BNSF contends that this is appropriate here because it would provide guidance to the parties and to arbitrators as to the intended scope of the conditions we imposed on the UP/SP merger and allow for the participation of other persons (principally shippers and shipper organizations) that may not be allowed to participate as parties in an arbitration proceeding.

UP’s Position. In its UP/SP-392 motion to dismiss (filed January 14, 2002), UP contends that the BNSF-98 petition should be dismissed not only because the present dispute has already been submitted to arbitration but also because, in UP’s view, BNSF has failed to “state a claim.” UP further contends that, in view of BNSF’s competitiveness to date on the trackage rights lines and the fact that the present dispute will not cause the trackage rights fees to rise in the future, there is no important policy question for the Board to address, and thus this dispute can appropriately be resolved in an arbitration proceeding. Further, UP asserts, BNSF has failed to submit any evidence in support of its argument that the Section 12 adjustment factor should be altered to exclude the disputed cost items.

Other Parties. Pleadings expressing support for the positions taken by BNSF have been submitted separately by The National Industrial Transportation League (NITL), the American Chemistry Council (ACC), the Western Coal Traffic League (WCTL), and TXU US Holdings Company (TXU), and jointly by Entergy Services, Inc., and Entergy Arkansas, Inc. (referred to collectively as Entergy).

DISCUSSION AND CONCLUSIONS

The Arbitration Issue. The present dispute respecting the mechanism for adjusting the fees applicable to the trackage rights that BNSF acquired in connection with the UP/SP merger appears to us at this time to involve a “general matter[] with broad implications with respect to

implementation of [the conditions we imposed on the UP/SP merger],”⁵ and, therefore, we believe is better suited to resolution in an administrative proceeding than in an arbitration proceeding. Accordingly, the UP/SP-392 motion to dismiss is denied at this time, insofar as that motion is premised on the argument that an arbitration proceeding would be preferable.

The Merits. The original version of the BNSF Agreement (dated September 25, 1995) provided that the 3.48, 3.1, and 3.0 mills per ton-mile trackage rights rates “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. The UP/SP applicants argued that

[t]he use of RCAF-U is appropriate because productivity has been driven more by initiatives in areas such as crew consist and fuel conservation than in the area of maintenance of way. To use a productivity-adjusted RCAF [i.e., the RCAF-A] would, among numerous other serious deficiencies, reflect productivity gains that would not reduce maintenance of way costs — which are the principal costs covered by the trackage rights fees. Using a percentage of RCAF-U as the adjustment mechanism is also common in long term agreements. Here, the 70% factor shares some productivity gains with BN/Santa Fe without disincenting UP/SP from making investments (such as to purchase high production maintenance of way equipment) that will improve maintenance of way efficiency — investments which must earn an adequate return.

UP/SP-22 at 308.

During the course of the UP/SP merger proceeding, however, several parties insisted that the use of 70% of the unadjusted RCAF index as the adjustment mechanism would, over time, create an advantage for UP/SP vis-à-vis BNSF. The UP/SP applicants, though they consistently argued that there would be no advantage, elected to eliminate the issue by agreeing, with BNSF and the Chemical Manufacturers Association (CMA), “to a purely actual-cost-based escalator.” UP/SP-230 (filed April 29, 1996) at 125. This resolution of the adjustment issue was memorialized in §7 of the CMA Agreement, which provides: “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

⁵ 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, Finance Docket No. 32760, Decision No. 86 (STB served July 12, 1999) (Merger Dec. No. 86), slip op. at 6.

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, Attachment at 3.

In our decision approving the UP/SP merger, we noted that CMA §7 had "improved the method by which the [trackage rights] charges are updated each year. Originally, the index was to be 70% of the RCAF, unadjusted for productivity. Certain protestants wanted to use the RCAF, adjusted for productivity. UP/SP has agreed to use actual maintenance related expenses, rather than using an index at all. This reflects costs more accurately." Merger Dec. No. 44, 1 S.T.B. at 416 n.169. Without any doubt, an URCS mechanism based on pertinent UP-specific maintenance and operating cost data reflects UP's relevant costs of providing BNSF access to its track more accurately than would an RCAF mechanism based on industry-wide data.⁶

There is no indication in the record — either in the text of §7 of the CMA Agreement, the text of Section 12 of the BNSF Agreement, or anywhere else in the record as far as we are aware — that any party ever contemplated that the URCS calculations required to create the Section 12 adjustment factor would not be performed as required. Moreover, BNSF's present assertion that it contemplated that the URCS adjustment mechanism would reflect actual costs does not advance BNSF's case. URCS costs, when calculated in the required manner, reflect actual costs; that, in fact, is what URCS is all about. While BNSF may have contemplated that the Section 12 adjustment factor would exclude costs related to the acquisition premium and to Section 9(c)(i) and (iii) capacity improvements, it has not yet provided evidence of any agreement with UP/SP to exclude such items. BNSF agreed to a formulation that references, without any mention of any such exclusion, "UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the trackage rights fee."

BNSF argues that it will not be able to maintain its success in establishing a competitive presence over the trackage rights lines if costs related to the acquisition premium and to Section 9(c)(i) and (iii) capacity improvements continue to be incorporated in the trackage rights fee. BNSF indicates that its preliminary estimates are that inclusion of the disputed costs have increased its trackage rights fees "in the range of approximately 0.2 mills" per ton-mile, BNSF-99 at 13 n.11, which amounts (by our calculations) to 6.7% of the 3.0 mills rate, 6.5% of the 3.1 mills rate, and 5.7% of the 3.48 mills rate. While these increases, by themselves, are not insignificant,

⁶ We note that BNSF has benefitted, and competition over the trackage rights lines has been enhanced, by the change from the RCAF-based fee adjustment (initially agreed to by BNSF) to the URCS-based adjustment that we imposed, at the urging of CMA and other parties, as a condition to our approval of the UP/SP merger. We calculate that an adjustment based on 70% of the unadjusted RCAF would have resulted in about an 8.5% increase in the trackage rights fee to date. In contrast, even including the disputed items that BNSF now says should be omitted from the adjustment formula, UP states that "the trackage rights fees have not increased above their original levels, with one minor exception. BNSF's complaint is that the fees have not fallen as much as they should have." UP/SP-392 at 7 n.8.

they are misleading in terms of assessing BNSF's competitiveness with UP. BNSF fails to account for the fact that, for any particular BNSF movement conducted on the UP/SP trackage rights lines, BNSF's *trackage rights fees* are only a small part of its *total costs*.⁷ Thus, even if BNSF is correct as to the 0.2 mills calculation, the increase in BNSF's total costs will necessarily be substantially less than the 6.7% or 6.5% or 5.7% increases in trackage rights fees suggested by that calculation.⁸

We do not believe that BNSF has shown on this record that the disputed items (i.e., costs related to the acquisition premium and costs related to Section 9(c)(i) and (iii) capacity improvements) should be excluded (in the years in which they would otherwise be included) from the URCS calculations required to create the Section 12 adjustment factor. Nevertheless, we will not now dismiss the BNSF-98 clarification petition for failure to "state a claim." Rather, we will allow BNSF a further opportunity to demonstrate that the disputed items should be omitted from the URCS calculations required to create the Section 12 adjustment factor. We are giving BNSF this additional opportunity because, as we recently noted in our decision concluding the formal oversight process for the UP/SP merger, "it is important that the trackage rights fee adjustment mechanism work as intended, so that any increases or decreases in UP's costs are properly reflected in the agreed-upon adjustments to the trackage rights fee."⁹

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

⁷ For any BNSF movement conducted on the UP/SP trackage rights lines, BNSF's *total costs* necessarily include: the trackage rights fees for the portion of the movement that is conducted on the UP/SP trackage rights lines; various other "above-the-wheel" costs (e.g., the cost of labor, equipment, and fuel) for the portion of the movement that is conducted on the UP/SP trackage rights lines; and all the costs of the portion of the movement that is conducted on BNSF's own lines.

⁸ The same logic applies to the dollar figures cited by BNSF. See BNSF-99 at 13 n.11 (BNSF estimates that the disputed costs amount to \$2.7 million a year, which, BNSF notes, works out to more than \$250 million over the 99-year life of the BNSF Agreement). What BNSF has not mentioned, however, is how those figures relate to its total costs on an annual basis or on a 99-year basis.

⁹ 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 [General Oversight], STB Finance Docket No. 32760 (Sub-No. 21), Decision No. 21 (STB served Dec. 20, 2001) (General Oversight Dec. No. 21), slip op. at 6.

It is ordered:

1. BNSF must show cause, by pleading filed by April 22, 2002, why the Board should not dismiss the BNSF-98 clarification petition for failure to state a claim.
2. NITL, ACC, WCTL, TXU, and Entergy may, if any or all of them so choose, show cause, by pleading(s) filed by April 22, 2002, why the Board should not dismiss the BNSF-98 clarification petition for failure to state a claim.
3. UP may file, by May 20, 2002, a reply to any pleading(s) filed by BNSF, NITL, ACC, WCTL, TXU, or Entergy.
4. The UP/SP-392 dismissal motion is denied at this time, insofar as that motion is premised on the argument that an arbitration proceeding would be preferable.
5. The UP/SP-392 dismissal motion will be held in abeyance, pending the submission of the pleadings referenced in paragraphs 1 and 2 and the reply referenced in paragraph 3, insofar as that motion is premised on the argument that BNSF has failed to state a claim.
6. This decision is effective on the date of service.

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

Vernon A. Williams
Secretary

Vice Chairman Burkes, Commenting:

I agree that BNSF should show more clearly why the disputed items should be treated differently or excluded from the actual-cost-based escalator. However, I believe that it is inappropriate to presume, as we do here, that these items should not be excluded before BNSF and the other interested parties have had a further opportunity to demonstrate that the disputed items should be omitted.