

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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**PETITION FOR RULEMAKING TO ADOPT REVISED
COMPETITIVE SWITCHING RULES**

**OPENING COMMENTS AND EVIDENCE
OF UNION PACIFIC RAILROAD COMPANY**

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Contains color images

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Union Pacific Railroad Company (“UP”) is filing these comments in response to the Board’s Notice inviting interested parties to submit information on the impact of a proposal by The National Industrial Transportation League (“NITL”) to modify the Board’s mandatory reciprocal switching standards. *Petition For Rulemaking To Adopt Revised Competitive Switching Rules*, EP 711 (STB served July 25, 2012) (“*EP 711 Notice*”).¹

Part I of these comments introduces the critical issues raised by NITL’s proposal and summarizes UP’s comments. Part II places NITL’s proposal in historical context. It explains that NITL’s proposal would reverse decades of competition policies that allowed and encouraged UP to respond to shipper demands for more and better rail service by designing our network and transportation plans to route traffic using the most efficient routes, with the fewest interruptions. Part III discusses the disruptive impact on UP’s network of re-introducing inefficient switching operations and the consequences for UP’s customers. Part IV addresses the remaining issues

¹ The facts and information concerning UP’s operations that are presented in these comments have been verified by Richard A. Gray, General Director, Asset Planning, in UP’s Network Planning and Operations Department, and Jeffrey S. Meyer, General Director, Measurement and Evaluation, in UP’s Network Planning and Operations Department.

raised by NITL's proposal on which the Board requested comments, including the issue of access pricing.²

I. INTRODUCTION AND SUMMARY

NITL has proposed a dramatic expansion of governmental intervention in the railroad industry in an attempt to obtain reduced rates for a subset of shippers that are served solely by a single railroad. NITL's proposal relies on the government to introduce a second railroad where market conditions have not justified the entry of a second railroad. Under NITL's proposal, the Board would use forced access to reduce the first railroad's revenues without any showing that its rates are unreasonable. Moreover, the Board's method of intervention would have collateral consequences that do not arise in rate reasonableness cases: certain shippers would be allowed to demand service that the rail network is not designed to provide, and accommodating their demands would degrade network operations and drive down service levels for all customers.

Adoption of NITL's proposal would reverse regulatory policies that encouraged UP and other railroads to rationalize their networks, eliminate inefficient routes and interchanges, and provide more shippers with the benefits of single-line service—benefits this agency repeatedly endorsed. UP has invested billions of dollars in its network since the Staggers Act. These were market-driven investments, made in response to shipper demand for more and better rail service. UP coordinated its investments and transportation plans to increase traffic density, which means it can move fewer, larger trains, with fewer work events. This allows UP to make more productive use of its tracks, yards, locomotives, cars, and crews, and to deliver better utilization for private equipment. Reducing work events also reduces safety risks and opportunities for

² UP endorses the Opening Comments and Evidence of the Association of American Railroads, including the Association of American Railroads' answers to the specific questions posed on page 9 of the Board's Notice.

delay. Our customers have enthusiastically endorsed these efforts with record-high customer satisfaction scores and by increasing the volume of traffic they ship on UP.

NITL's proposal would return the railroad industry to its balkanized past. Each shipment via forced reciprocal switching would need additional switching, and each affected car would require more time to move from origin to destination and back again for reloading. The new operations would drive down service levels and make the entire railroad network less safe and less efficient. The need for additional switching, along with the need for additional cars to compensate for the longer cycle times, would increase the demands on yard capacity, which railroads have reduced as consolidations and evolving transportation plans have allowed them to develop more efficient and reliable service by reducing the need for intermediate switching and other work events. In many cases, railroads could not reproduce the yard capacity they eliminated. Even if they could, they would have little incentive to invest in facilities that would be used to switch cars for their competitors and less ability to pay for such facilities if forced switching reduces their earnings. Yard congestion and loss of network velocity would degrade service to all shippers, not just the shippers that invoke forced switching. UP has had the unfortunate experience of demonstrating how seemingly local problems can spread rapidly across the rail network. Moreover, the loss of traffic to forced switching would disrupt the transportation plans that have allowed railroads to build longer trains with fewer stops, which would also put new demands on yard capacity and reduce service levels for all customers.

UP appreciates the Board's recognition that there is reason to be concerned about NITL's proposal and its impacts on the railroad industry, including the impacts on network operations and service to customers. *EP 711 Notice* at 2. UP is submitting these comments to help the Board understand the proposal's impacts. UP has already submitted evidence addressing the

consequences of changing the Board’s access policies in STB Ex Parte No. 705. NITL’s proposal represents the type of change that UP warned about in Ex Parte No. 705: one that would add work events and delay, unraveling efficiencies achieved over decades, and disrupt network operations by forcing traffic over facilities that were not designed to handle the business. At the same time, NITL’s proposal would cause UP to reduce capital investments by reducing our earnings and increasing the risk that we will not recover our investments. UP is therefore submitting its comments in Ex Parte No. 705 as an addendum to these comments.

UP is also submitting new comments to address more specifically the impacts of forced reciprocal switching on the railroad network and customers. We use examples drawn from UP’s operations in Houston, Kansas City, and Sioux City—locations where some reciprocal switching already occurs—to illustrate the consequences of forcing additional switching on the rail network. We also draw on UP’s experience to discuss a problem associated with reciprocal switching that can have a devastating impact on yard operations—the inability to control the flow of cars into facilities that cannot accommodate the traffic. NITL’s proposal suggests that forced switching should not occur unless it “is safe and feasible, with no adverse effect on existing service.” *EP 711 Notice* at 4. Based on our own experience, UP is convinced that any significant amount of forced switching would have a materially adverse effect on existing service.

UP can describe the impacts increased reciprocal switching on our network and our customers, but we cannot provide “rigorous empirical analyses” of the impacts of NITL’s proposal. *Id.* at 9. We have no practical way of identifying the traffic potentially affected by

NITL's proposal.³ Equally important, we do not know how shippers or other railroads would respond to the incentives created by forced switching—for example, we do not know how far rates would have to fall to elicit diversions, or whether other railroads would offer such rates.

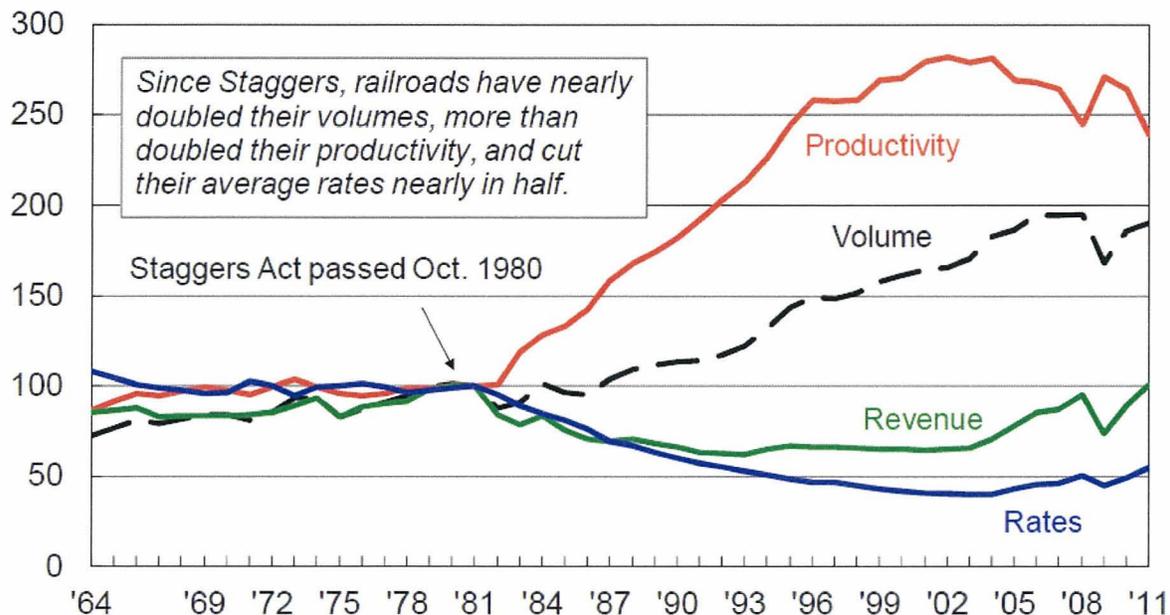
We do know, however, that shippers that use forced switching would be doing so to obtain lower rates, not improved service. Additional switching would inevitably increase car cycle times and reduce service reliability. If access prices were set so that rates were not reduced, few shippers would seek forced switching, and any shipper receiving such poor service that it would prefer forced switching should be able to obtain relief under existing law.

We also know that shippers that invoke forced switching would be imposing the costs of their decisions on other customers and on our network by reducing our ability to provide safe, reliable, and efficient service. Those shippers might be willing to turn back the clock to when railroads were losing traffic to other modes and could not afford to invest to maintain and expand their infrastructure, but there is no justification for changing federal competition policies to take the rail industry in the opposite direction from the one that has worked so well for the past three decades, as shown below in Figure 1.⁴

³ The Association of American Railroads identifies the reasons for this in its comments. We discuss some of the reasons below in Part IV.

⁴ The graph in Figure 1 is from Association of American Railroads, *An Overview of America's Freight Railroads 5* (July 2012), available at <https://www.aar.org/keyissues/Documents/Background-Papers/Overview-US-Freight-RRs.pdf>.

Figure 1: Post-Staggers Improvements



UP's submission of comments in this proceeding does not mean UP believes the Board could lawfully adopt NITL's proposal. Congress established separate mechanisms for pursuing relief for shippers that believe they are paying unreasonable rates and shippers that believe they are suffering other competitive harm. NITL's proposal is not a lawful means of regulating rates. To obtain rate relief, a shipper must establish that the railroad has market dominance over the transportation to which the rate applies *and* that the challenged rate is unreasonable. See 49 U.S.C. § 10701(d). NITL's proposal is designed to provide a back-door method of reducing rates using 49 U.S.C. § 11102—a method that does not require proof that the existing rate is unreasonable. NITL's proposal thus is not a lawful approach to regulating rates.⁵

NITL's proposal also is not a lawful application of the Board's authority to require rail carriers to enter into reciprocal switching arrangements. As the Board has recognized, "NITL's

⁵ See *Midtec Paper Corp. v. United States*, 857 F.2d 1487, 1505 (D.C. Cir. 1988) (rejecting contention "that section [11102] was intended to be an alternative means of obtaining rate relief").

proposal, if adopted, could change the competitive rail service landscape.” *EP 711 Notice* at 6. However, Congress did not intend statutory access remedies to serve as tools for restructuring the railroad industry. The Interstate Commerce Commission (“ICC”) and the Board have repeatedly interpreted their authority to order reciprocal switching and other forms of access relief as a means to address specific instances of anticompetitive conduct, not as a tool to restructure the railroad industry,⁶ and courts reviewing the agency’s decisions have repeatedly agreed.⁷ In addition, the severe operational disruptions and collateral impacts on all shippers that would accompany widespread forced switching provide additional reasons why wholesale application of mandated reciprocal switching would be contrary to the public interest and thus unlawful.⁸

⁶ See *Intramodal Rail Competition*, 1 I.C.C.2d 822 (1985) (adopting competitive access rules), *aff’d sub nom. Balt. Gas & Elec. v. United States*, 817 F.2d 108 (D.C. Cir. 1987); *Midtec Paper Corp. v. Chi. & N.W. Transp. Co.*, 3 I.C.C.2d 171, 174 (1986) (“[W]e think it correct to view the Staggers changes as directed to situations where some competitive failure occurs.”), *aff’d sub nom. Midtec Paper Corp. v. United States*, 857 F.2d 1487 (D.C. Cir. 1988); *Cent. Power & Light Co. v. S. Pac. Transp. Co.*, 1 S.T.B. 1059, 1067 (1996) (“Congress chose not to provide for the open routing that shippers seek here.”), *clarified, Cent. Power & Light Co. v. S. Pac. Transp. Co.*, 2 S.T.B. 235 (1997), *aff’d sub nom. MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8th Cir. 1999).

⁷ See *Balt. Gas & Elec.*, 817 F.2d at 115 (finding “not the slightest indication that Congress intended to mandate a radical restructuring of the railroad regulatory scheme”); *Midtec*, 857 F.2d at 1507 (“We have not found even the slightest indication that Congress intended the Commission in this way to conform the industry more closely to the model of perfect competition.”); *MidAmerican Energy*, 169 F.3d at 1105 (noting Congress’s intention that “market forces would operate in the rail industry as they do in other spheres”).

⁸ As an additional matter, NITL’s proposed 30-mile distance rule could produce cases in which shippers would not be seeking reciprocal switching, but rather would be asking a railroad to short-haul itself—a situation governed by 49 U.S.C. § 10705, not section 11102.

II. NITL'S PROPOSAL WOULD REVERSE THE "RAIL RENAISSANCE" AND REPEAL PUBLIC POLICIES THAT RESTRUCTURED THE RAIL INDUSTRY TO IMPROVE SERVICE.

In seeking pervasive changes to the Board's competitive access rules, NITL is asking the Board to repudiate—retroactively—a forceful public policy reflected in a long string of decisions that restructured America's railroad network and delivered enormous benefits to the shipping public. Today's rail network, including the UP system, is the direct result of agency decisions favoring single-line service in preference to a balkanized rail system with extensive reliance on interchanges. The ICC and the Board emphatically and correctly embraced that policy in a series of epochal decisions from 1980 through 1999 that approved rail consolidation proposals and endorsed the single-line services they promised and subsequently delivered. Railroads and their investors relied on those ICC and Board decisions, completely revamping the American rail map, eliminating widespread inefficiencies resulting from interchanges, and saving shippers billions upon billions of dollars by building today's integrated rail systems.

Reintroducing the inefficiencies that public policy and agency decisions empowered railroads to eliminate, as NITL requests, would be unwarranted and would endanger customer service, rail safety, rail efficiency, and rail investment. The railroads have invested billions of dollars and continue to invest in reliance on agency decisions that embraced consolidation and single-line service. The railroads physically reconfigured their rail systems, building new capacity to handle changed traffic flows, while eliminating rail yards and unneeded interchange facilities. In many places, that capacity could not be replaced today, because cities and towns have occupied the properties, and "NIMBY" neighbors would object.⁹ The railroads also

⁹ "Not-in-my-back-yard" residents often object to long-standing rail operations and oppose new or expanded operations. UP has had to increase the lead time for projects to allow for such (continued...)

developed and refined transportation plans to use their reconfigured infrastructure to reduce work events and to increase network velocity and reliability. As a result, railroads delivered the service and efficiency benefits that they promised and passed along most of the savings to shippers, as this agency has repeatedly found.¹⁰

The Board cannot simply change its mind and decide to re-balkanize the rail network, disregarding the restructuring that created today's efficient rail system. If some shippers want lower freight rates, the Board needs to consider the reasonableness of their rates directly, not by rejecting the agency policies that railroads followed to produce today's revitalized rail network. Had the agency attempted to condition rail mergers beginning in 1980 with the NITL proposal, railroads likely would not have undertaken the restructurings they did, and the rail renaissance would have been stillborn.¹¹ The Board should not today do the opposite of what it called for

reactions and has had to forego creating facilities at all or limit operations in response to community concerns.

¹⁰ See, e.g., *Major Rail Consolidation Procedures*, 4 S.T.B. 570, 573 n.12 (2000) ("Agency decisions issued under our existing regulations have preserved and sometimes enhanced competition, while promoting efficiency-enhancing system rationalizations whose benefits were ultimately passed along to shippers in the form of lower rates and improved service."); *Union Pacific/Southern Pacific Merger—General Oversight*, FD 32760 (Sub-No. 21), Decision No. 16, slip op. at 13 (STB served Dec. 15, 2000) ("Moreover, we have verified, through our staff study discussed above, that the western railroads have achieved significant efficiency gains over the past several years, and that they have indeed passed along many of those gains to their shippers in terms of reduced rates."); Office of Economics, Environmental Analysis, and Administration, Surface Transportation Board, *Rail Rates Continue Multi-Year Decline 2* (Dec. 2000) (Since the Staggers Act, "nearly all of the productivity gains [experienced by railroads] have been passed along to rail customers (and ultimately consumers) in the form of lower rates").

¹¹ The fate of the Chicago, Rock Island, and Pacific Railroad provides a hint of what might have occurred. After 11 years of considering the proposed UP-Rock Island merger, the ICC finally approved the acquisition in 1974, but with so many conditions that UP walked away, and the weakened Rock Island declared bankruptcy in March 1975. The Rock Island trustee liquidated the railroad by selling some pieces and abandoning the rest. Congress, fearing a similar fate for the U.S. rail system as railroad bankruptcies multiplied, passed a series of acts to allow rationalization of the railroad network through mergers, joint route cancellation and demand-based pricing.

during those decades of pivotal decisions by reinstating balkanized, interchange-dependent service across the national rail system.

A. ICC and Board Decisions Restructured the U.S. Rail Network, Including UP's Network, to Promote Single-Line Service.

The U.S. Government recognized the need to consolidate Class I railroads at least as early as 1920 because the national rail system was overbuilt, with too many railroads and too much capacity. When Congress passed the Esch-Cummins Transportation Act that year, it included provisions directing the ICC to plan for a limited number of rail systems.¹² The result was the never-implemented “Ripley Plan.” After World War II, the Government created a separate commission to devise a plan to consolidate the rail network, spearheaded by John W. Barriger. For decades, the ICC retained a large map showing how the major railroads could be combined into (coincidentally) seven Class I systems, although not the seven that exist today.

In the late 1970s, and especially after multiple railroad bankruptcies and passage of the 4R Act in 1976¹³ and the Staggers Act of 1980,¹⁴ the process of railroad consolidation finally moved ambitiously forward and with strong agency support. Today’s larger Class I systems are products of ICC and Board decisions between 1980 and 1999 that advanced the congressional objective of healthier railroads delivering more reliable and safer service. Today’s UP resulted from five consolidations in the period from 1980 to 1999:¹⁵ UP/Missouri Pacific; UP/Western Pacific; UP/Missouri-Kansas-Texas; UP/Chicago & North Western; and UP/Southern Pacific. The BNSF Railway (“BNSF”), Canadian National Railway (“CN”), Canadian Pacific Railway

¹² Pub. L. 66-152, 41 Stat. 456 (1920).

¹³ Pub. L. 94-210, 90 Stat. 31 (1976).

¹⁴ Pub. L. No. 96-448, 94 Stat. 1895 (1980).

¹⁵ To avoid repetition, we use the terms “merger” and “consolidation” interchangeably.

“CP”), CSX Transportation (“CSX”), The Kansas City Southern Railway (“KCS”), and Norfolk Southern Railway (“NS”) all are products of rail consolidation during that period.

A basic premise of each of the ICC and Board consolidation decisions, including every decision that created today’s UP, was that single-line or single-system service¹⁶ was superior to less efficient service provided via separate carriers using interchange. Indeed, expanding single-line service was a primary public benefit, extolled by the agency, of every transaction. The ICC and the Board emphasized the fact that single-line service eliminates delays at interchanges, expands commercial opportunities for shippers, makes it easier for shippers to interact with carriers, and ensures more reliable service that is more competitive with other modes of transportation.

Although many may not personally recall the inefficiencies and frustrations of dealing with a balkanized rail network, shippers in the 1980s and 1990s turned out in droves to support single-line service. The ICC cited their support repeatedly as evidence of the public benefits of eliminating interchanges. The Rail Services Planning Office, in its *Rail Merger Study, Final Report*, found that “shippers chose single over multiple railroad service more than 90 percent of the time.”¹⁷

In two of the earlier consolidation decisions during the 1980-1999 period, the ICC explained in detail why single-line service is superior to interchange service. In *CSX Corp.–Control–Chessie System, Inc., & Seaboard Coast Line Industries, Inc.*, 363 I.C.C. 521 (1980), the ICC expansively discussed why single-line service is better and why shippers preferred it:

¹⁶ Some transactions led to a consolidation of railroads into a single system but with the participants retaining their separate legal identities. Those systems later consolidated and today provide single-line service.

¹⁷ Rail Services Planning Office, Interstate Commerce Comm’n, *Rail Merger Study, Final Report* 31 (1978).

It is generally thought that single-line service has many advantages over joint-line service for both shippers and carriers. Interchange operations can be eliminated, reducing both operating and overhead costs and transit time; transaction costs are reduced; and incentives to provide less than efficient service (arising from per diem charges for railcars, rate divisions, or production externalities) are reduced. Thus, speed, reliability, and handling are enhanced. For these reasons, shippers tend to prefer single-line service over joint-line service. (*Id.* at 553.)

The ICC explained that CSX did not—at that time—plan to fully integrate the Chessie and Seaboard systems and that it would create only “single-system service,” not “single-line” service. The ICC, nevertheless, found that single-system service “will provide many of the benefits of single-line service” because of centralized priorities and management that would “enable the system to avoid many interchange costs . . . and delays.” *Id.* As the ICC concluded, “The consolidation of interchange partners should provide faster, more efficient service to a wider geographic area, to the public benefit.” *Id.* at 552.

The ICC’s decision in *Norfolk Southern Corp.–Control–Norfolk & Western Ry. & Southern Ry.*, 366 I.C.C. 173 (1982), also described “the inherent benefit of single-system service” as one of the principal public benefits of the consolidation. *Id.* at 195. The ICC explained:

Shippers, however, prefer single-system service. Single-system service offers the opportunity to improve speed and reliability of service and equipment utilization and distribution. It also focuses responsibility for an entire movement on a single carrier, improving shippers’ ability to control and trace individual shipments and to expedite shipments when necessary. Additionally, single-system responsibility facilitates prompt settlement of loss and damage claims. (*Id.* at 194-95, footnote omitted.)

Summarizing the public benefits of the transaction, the ICC stated that “[o]ne of the primary benefits of the proposed consolidation is the creation of a single railroad system,” in contrast to a rail system that “has not been adequately structured.” *Id.* at 194. The ICC flagged eliminating

terminal interchanges as a specific example. “Operation of N[orfolk & Western] and Southern local and through trains to or from a consolidated terminal will reduce terminal delays involved in present interchange arrangements.” *Id.* at 204.

Every one of the ICC and Board decisions that approved consolidations involving UP highlighted single-line service as a public benefit.

- In *Union Pacific Corp.–Control–Missouri Pacific; Western Pacific*, 366 I.C.C. 462 (1982), the ICC offered a lengthy discussion of single-system service and its benefits. As the ICC concluded, “Shippers also benefit from improved transit times and resultant reduced equipment costs made possible when single rail systems are able to minimize interchange delays by increasing the use of preblocking and run-through trains.” *Id.* at 489. The ICC added that “[s]hippers prefer single line or single system service because it improves reliability and transit times, and equipment availability.” *Id.*
- In *Union Pacific Corp.–Control–Missouri-Kansas-Texas R.R.*, 4 I.C.C.2d 409 (1988), the ICC detailed the expected single-line service improvements from the consolidation. *See id.* at 430-31. Specifically, the ICC applauded that “[c]ars currently interchanged between UP and MKT will spend less time in terminals due to the elimination of interchange delays and the establishment of new through blocks and better connections.” *Id.* at 431.
- In *Union Pacific Corp.–Control–Chicago & North Western Transportation Co.*, FD 32133, Decision No. 25 (ICC served Mar. 7, 1995),¹⁸ the ICC stated that “[t]here are

¹⁸ This decision was never published in ICC reports, despite the recitation at the beginning of the decision that it would be.

substantial efficiencies in single-line service compared to joint-line service.” *Id.*, slip op. at 66-67.

- Finally, in *Union Pacific/Southern Pacific Merger*, 1 S.T.B. 233 (1996), the Board applauded “unprecedented opportunities for improved routings and new single-line routes here.” *Id.* at 381. The Board focused directly on shippers served by only one of the merging carriers, explaining that “every shipper served by UP, but not by SP, will gain single-line service to all SP points, and vice versa. More than 350,000 cars, trailers, and containers, carrying 26 million tons of freight, will gain single-line service each year. The BNSF agreement will add single-line service for another 120,000 cars a year.” *Id.*

The benefits of single-line service, compared to interchange service, were so compelling that both the Board and NITL were concerned about the partial *loss* of single-line service when CSX and NS divided Conrail. As a result, the Board provided special protections for affected shippers. The Board concluded that the harm to those shippers was outweighed by the benefits of new single-line service to six times as many shippers, but not before it prescribed a rate preservation remedy that NITL had negotiated to protect the adversely affected shippers. *See CSX Corp. & Norfolk Southern Corp.—Control & Operating Leases/Agreements—Conrail Inc.*, 3 S.T.B. 196, 271 (1998).

B. UP Reconfigured Its Network at Great Cost and Effort to Deliver the Benefits of Single-Line Service.

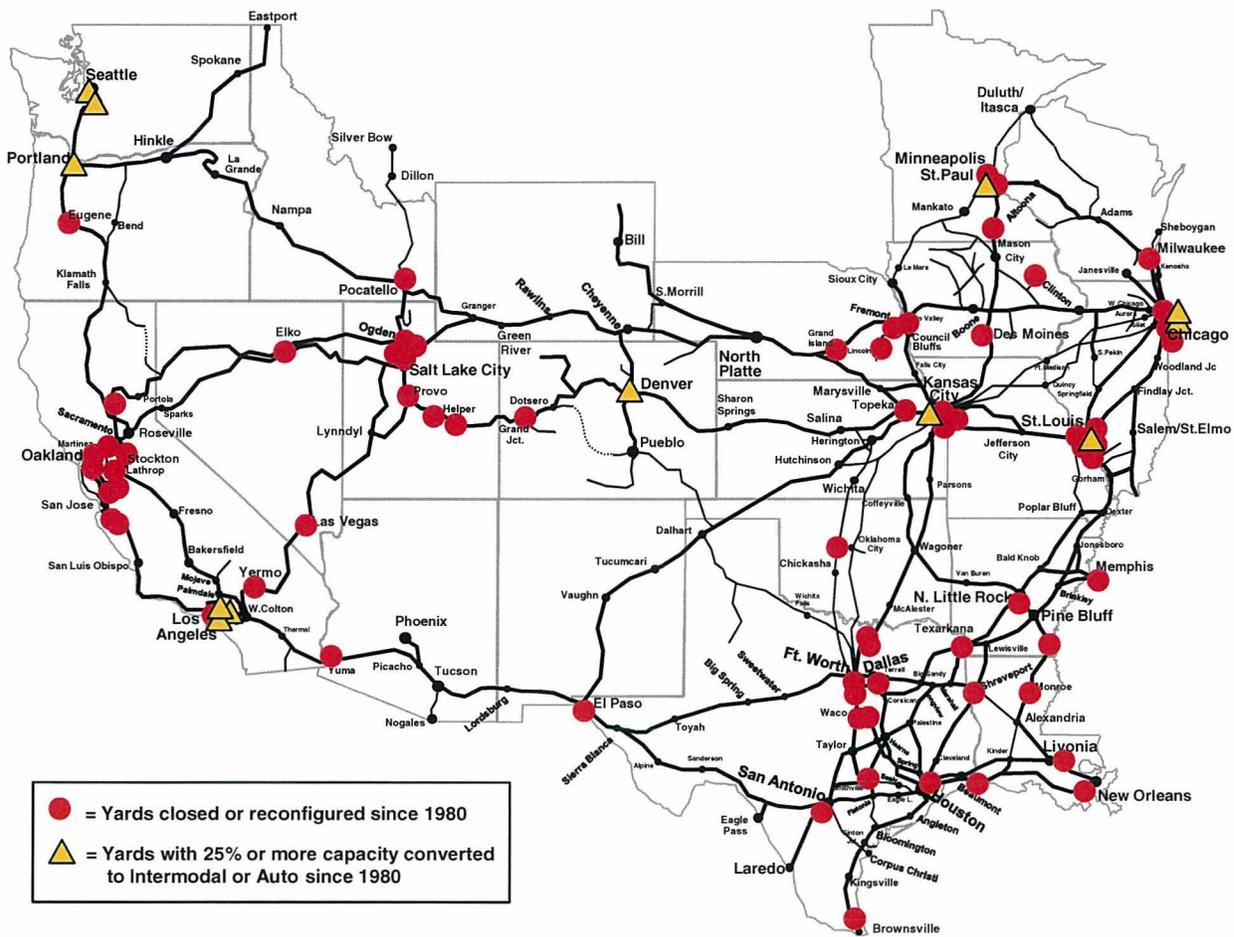
For the last three decades, American Class I rail systems have been streamlining their networks, primarily to provide the public (and private) benefits of single-line service. They removed or spun off the excess capacity that had burdened the industry for the prior six decades and more. They invested billions of dollars to provide the single-line service that was a pivotal basis for ICC and Board merger approvals. They eliminated freight yards that had provided en

route switching as they redesigned train service to carry cars further with fewer work events. They eliminated or scaled back interchange facilities that became unnecessary or inefficient.

UP reconfigured six railroads to deliver on the commitments it had made in obtaining ICC and Board authority for its consolidations. Since 1982, when UP started to implement the UP/MP/WP consolidations, UP has been building a railroad network that maximizes single-line service and expedites customer shipments. UP's merger integration efforts continued well into the last decade, requiring greater investment than UP management had expected, particularly to provide reliable single-line service involving C&NW and SP terminals and routes.

To provide the benefits of single-line service that the ICC and Board identified, UP systematically eliminated interchanges between component carriers, developed train plans and car blocking plans so traffic could bypass yards, and removed or downsized yards that were no longer needed. As shown in the map in Figure 2 on the next page, many of these yards were in terminal areas, where land could be sold or used for other purposes. UP also repurposed a number of these yards into intermodal, automotive, or transload facilities. The map shows how UP eliminated or scaled back en route yards that were no longer needed because shipments could move over longer distances without switching. At many more locations, UP, BNSF, and their predecessors have removed tracks at junctions where interchange was no longer required or no longer efficient. Since 1989, for example, BNSF and UP have eliminated approximately 53 interchange locations, and KCS and UP have eliminated at least seven.

Figure 2: UP Yards Closed or Reconfigured Since 1980



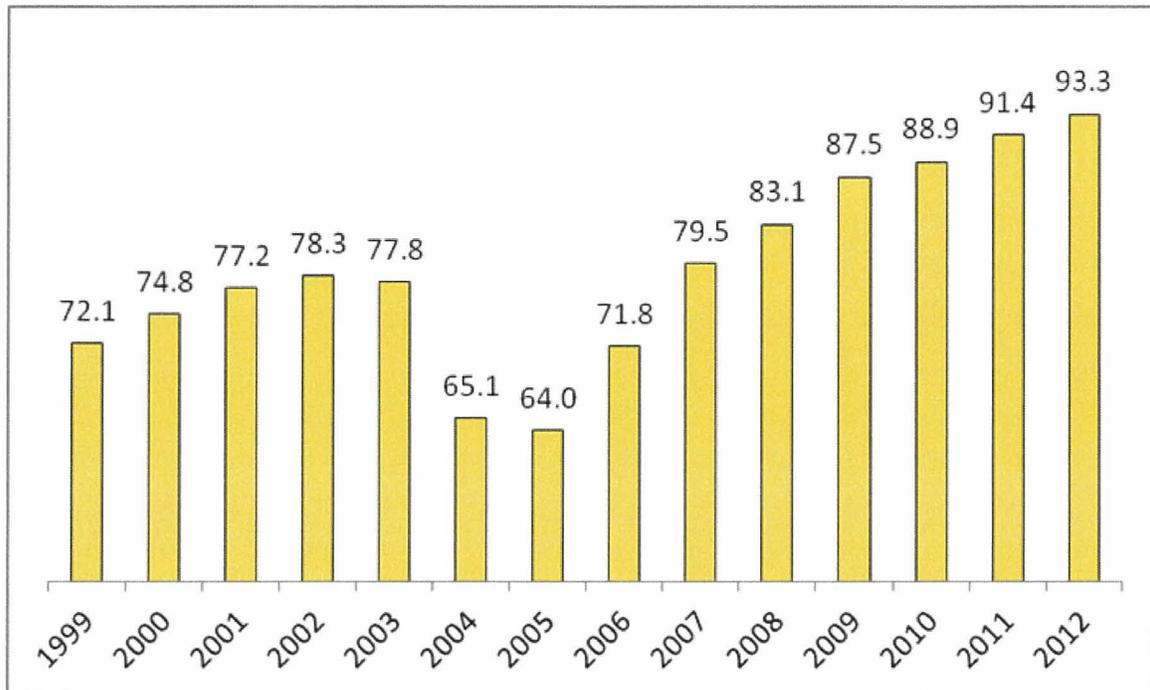
Since 1982, UP has invested tens of billions of dollars of private capital to replace, improve, reconfigure, and upgrade its network. Almost all of these investments (Positive Train Control investments are a notable exception) have advanced the goal of providing single-line service to our customers. As UP’s Executive Vice President-Operations, Lance Fritz, testified in Ex Parte No. 705:

We aligned our capital spending with our basic operating strategy of concentrating traffic where possible on higher-capacity, higher-density corridors. We invested heavily in modernizing and increasing the productivity of our rail yards and other terminal facilities. All of this minimizes variability, reduces time-consuming interchanges, and allows us to move traffic safely and efficiently from origin to destination. (Opening Verified Statement at 5.)

Mr. Fritz's Verified Statement explains UP's investment and service strategy in considerable detail and is provided in the Addendum to these comments.

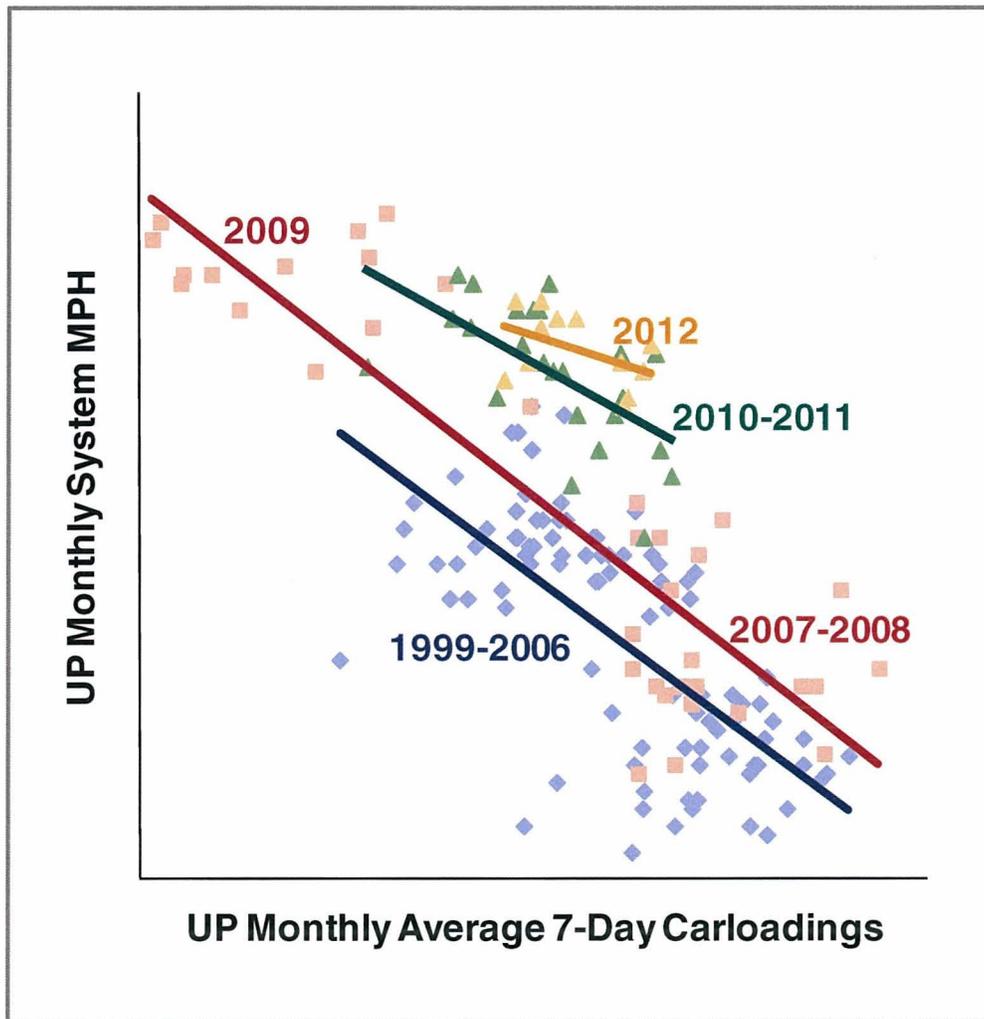
UP today delivers the single-line service that the ICC and the Board endorsed as public benefits in multiple merger decisions. Perhaps the best overall measurement of UP's benefits for shippers is our Customer Satisfaction Index ("CSI"), which is shown below in Figure 3. After we disappointed our customers in 2004-05 when we lacked sufficient employees to meet their needs when traffic surged (resulting in terminal congestion and slower velocity that spread from one region to the broader system), the CSI began a steady climb. By 2007, the CSI had returned to previous levels, but it did not stop rising. We began setting customer satisfaction records, and we continue to set them. (It is worth noting that UP's CSI includes customer satisfaction or dissatisfaction with our freight rates.) In 2011 and 2012, the CSI has been in the 90s, a higher level than the Toyota designers who helped UP create the survey system thought was possible for any railroad.

Figure 3: UP Customer Satisfaction Index



The foundation for achieving these levels of customer service is heavy investment and rigorous planning that lets us move each shipment with the fewest possible stops for switching or other work events. UP has invested in the infrastructure and developed operating plans that enable us to move more freight at better service levels than ever before. Figure 4 demonstrates how UP's continuing investments in our network and focus on managing for fluid operations allows us to improve service, even as we face new challenges, such as the current surge of growth in our Southern Region. By aligning our investments with our operating plans, we are moving the relationship between average volume and average velocity up and to the right, which means we are moving more freight, faster. That progress coincides with the improving CSI results in Figure 3.

Figure 4: Service-Volume Relationship



NITL’s proposal would undermine the foundation upon which UP has built our improved service. Every interchange required to provide reciprocal switching would delay the car to be interchanged, as well as other cars. The car to be interchanged (assuming it originates at a shipping location on UP) must be withdrawn from our normal operating plan and switched into a group of cars for interchange. Replicating this interruption, and the associated delays, thousands of times per day throughout the UP system would severely undermine the single-line service we have developed over the last several decades to fulfill the ICC’s and the Board’s expectations. We describe the operating consequences in detail below in Part III.

C. The Board Lacks a Basis for Adopting Policies That Would Reverse the Preference for Single-Line Service on Which Rail Restructuring Was Based.

NITL's proposal asks the Board to reverse the agency's conclusion in each of its major rail consolidation decisions of the 1980s and 1990s that single-line service is preferable to interchange service and should be expanded. Those decisions recognized the benefits of single-line service and expected the consolidated railroads to expand it by investing in restructured networks, finally solving a problem recognized early in the last century. NITL's proposed rules would move the national rail system in the opposite direction, turning back the clock in favor of balkanized, inefficient rail service more reliant on interchange service.

Adopting NITL's proposal would increase rail costs and reduce the quality of rail service for most shippers, including those who do not use forced switching. It would, in the end, make rail service less competitive with motor carriage and shift traffic from the rails to the roads at precisely the moment when the nation is least able to maintain its highway system. In short, adopting NITL's proposal would override railroad investment decisions of three decades, downgrade rail service, and represent a large step backward in agency policy.

Advocates for NITL's proposal may argue that the rail system has become more consolidated and therefore that creating a measure of balkanized interchange service is justified. But the ICC and Board were aware of the degree of consolidation in the rail industry when they approved past consolidations and embraced single-line service. The agency imposed conditions necessary to ensure that no shipper would lose competitive rail service as a result of those consolidations. There is no reason to believe today that the agency erred in those decisions.

Advocates for NITL's proposal may also argue that the Board should restructure the railroad industry because the industry is approaching revenue adequacy. This, of course, provides no reason for the Board to reverse course. On the contrary, it shows that the Board is

satisfying the congressional mandate to ensure railroads have the opportunity to achieve revenue adequacy. 49 U.S.C. § 10101(3). Revenue adequacy is essential to preserve and renew today's rail network and to meet tomorrow's demand.

UP would not have proceeded with the series of consolidations that created the current UP system had they been conditioned at the time by NITL's proposal. NITL's proposed rules would have so severely undermined UP's ability to realize single-line efficiencies and provide single-line service that the economics of the consolidations would not have justified going forward. Attempting to change the structure that UP built under express agency authority and at great cost by requiring interchanges at numerous locations across the railroad would therefore be fundamentally unfair and raise significant legal questions. *See Guilford Transp. Indus. Inc.—Control—Boston & Maine Corp.*, 5 I.C.C.2d 202, 206 (1988) (“The unfairness that would result from imposing a condition of which the consolidating carriers had no advance knowledge at the time of the consummation is obvious.”). In a specific application involving reciprocal switching, the Board declined to impose a reciprocal switching requirement in the New Orleans terminal area after consummation of the UP/SP consolidation. *See Union Pacific/Southern Pacific Merger*, FD 32760, Decision No. 77 (STB served Jan. 7, 1998).

UP does not question the Board's authority to prescribe reciprocal switching should the Board find competitive abuse under the longstanding competitive access rules. *See* 49 C.F.R. § 1144.2. But replacing a rule that applies such a highly intrusive remedy only when necessary to address a specific competitive abuse with an approach that is designed to produce a wholesale change in the railroad industry's competitive landscape would improperly reverse agency policy favoring single-line service on which railroads relied.

The ICC and the Board approved and enthusiastically endorsed consolidating the U.S. rail system to provide increased single-line service and eliminate interchanges, including interchanges in terminal areas. NITL's proposal asks the Board to go back in history and discard that structure in favor of broadly-available reciprocal switching that would require new patterns of operation. Having embraced and applied a public policy favoring single-line service—which America's railroads delivered to the public's benefit at enormous cost—the Board should not return to the unsuccessful and inefficient type of rail structure from the pre-1980 period by displacing single-line service with interchange service.

III. THE NEGATIVE IMPACTS OF NITL'S PROPOSAL ON RAIL NETWORK EFFICIENCY AND SERVICE TO CUSTOMERS WOULD BE SUBSTANTIAL.

NITL's proposal would not only reverse the Board's competition policies on which railroads relied in structuring their networks, it would also have the immediate and practical effect of severely disrupting UP's operations and transportation plans if shippers used forced reciprocal switching for a significant volume of traffic. In section A, we describe generally the likely impacts of increased forced switching on railroad operations. In section B, we illustrate those impacts by describing the potential impacts on UP operations in Houston, Kansas City, and Sioux City. In section C, we discuss a particular challenge associated with reciprocal switching that would become an even larger problem if NITL's proposal were adopted: the receiving railroad's inability to monitor and control inbound traffic flows to shipper facilities.

A. Forced Reciprocal Switching Would Disrupt Yard Operations and Transportation Planning.

Under NITL's proposal, every car that is subject to forced reciprocal switching would require extra yard switching, which typically means 24 to 48 hours of delay for each affected car movement between railroads. Thus, from the time the empty cars arrive in a terminal until the

loaded cars depart, even in relatively uncomplicated interchange situations, where two railroads are operating in the same terminal and delivering cars directly into each other's yards, reciprocal switching would add 48 to 96 extra hours during which the affected cars would remain in yards, increasing car inventory and consuming capacity.¹⁹ These estimates are conservative. They assume both railroads are operating under fluid conditions. Often the delays would be longer. Every car subject to reciprocal switching must traverse the terminal area twice as it moves from one railroad's yard to the other railroad's yard, once when it is empty and again after it is loaded, and these movements cannot occur until the receiving railroad has the capacity in its yard to accept the cars being transferred. Difficulties in coordinating interchange between two railroads can also lead to additional delay—delay that crops up every day on the U.S. rail system when cars are interchanged between railroads. As discussed above, eliminating those delays is one of the benefits of single-line service. NITL's proposal promises slower, less efficient service for every shipper that uses forced switching.

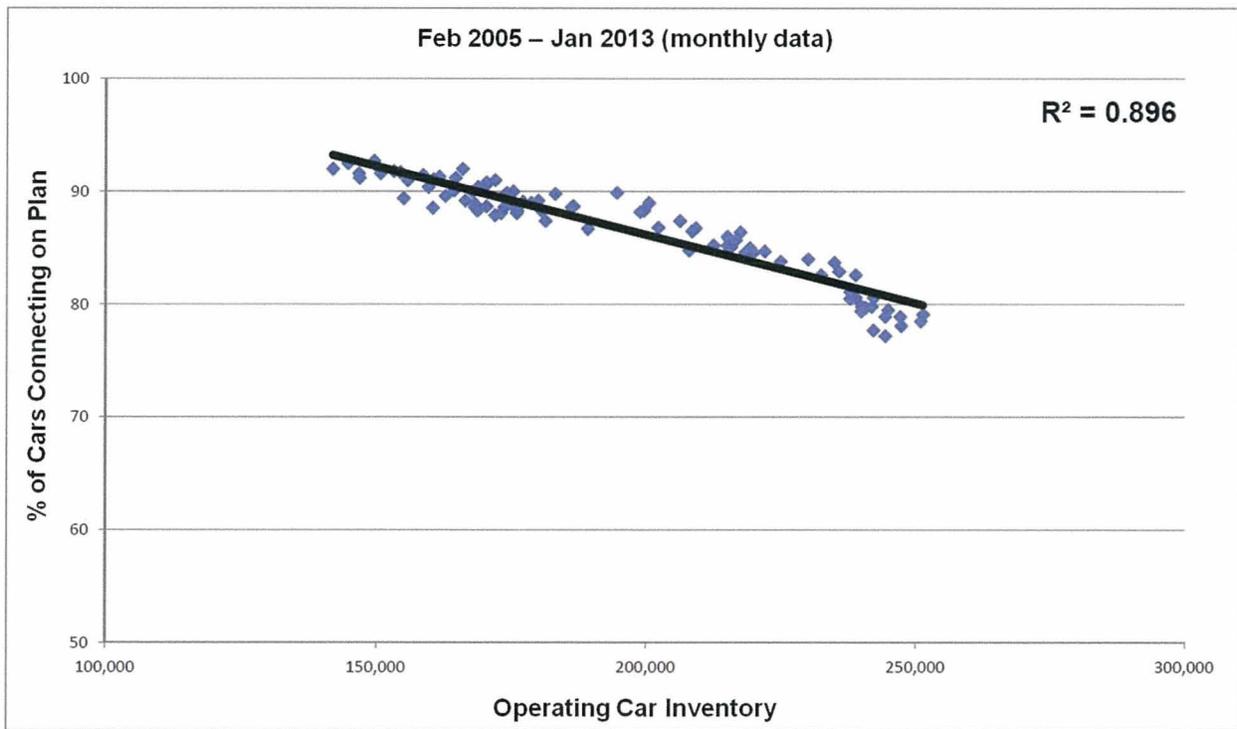
Moreover, the impact of NITL's proposal would not be confined to shippers that use forced switching. Even where two railroads already switch cars in a terminal, the extra time that the additional cars requiring switching would remain in yards would increase car inventory and consume capacity needed to serve other customers efficiently. As discussed above, as railroads have invested in their networks and developed transportation plans to eliminate intermediate switching, they reduced yard capacity that they had used for switching. In addition, because car cycle times would increase, shippers that use forced switching would need more cars to move the same volume of traffic, which would add even more cars to the network. As car inventory

¹⁹ The same would be true if the forced switching occurred at destination. UP's comments generally apply to railroads at either origin or destination.

increases, network velocity slows, degrading service to other shippers, who would also need more cars, further fueling a vicious cycle that can gridlock busy yards, disrupt the operating plan, and spread congestion across the network.

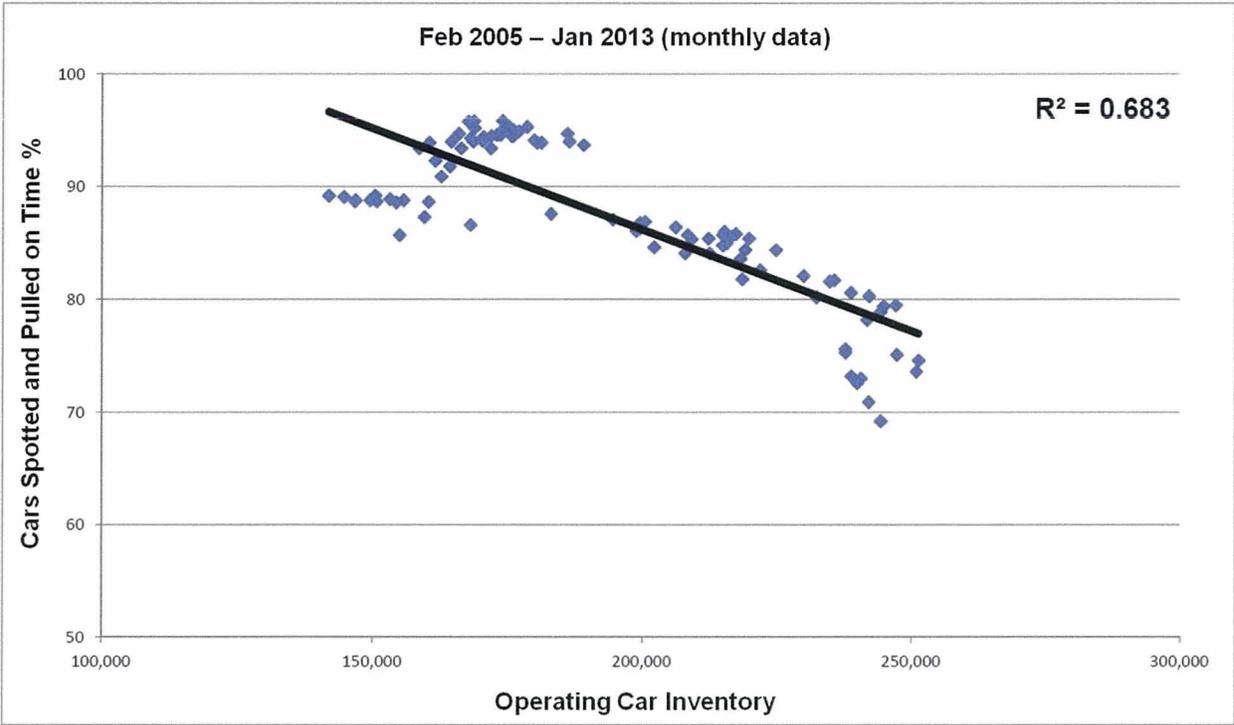
UP has studied the effects of car inventory—that is, the number of cars on its rail lines and in its yards—on operations, and the relationship is clear. As shown in the graph below, car inventory directly impacts UP’s ability to meet a car’s trip plan at terminals—that is, UP’s ability to get cars on their scheduled trains to deliver the cars to our customers. As inventory rises, on-plan performance falls, as shown in Figure 5.

Figure 5: Car Inventory Effect on Terminal Connection Performance



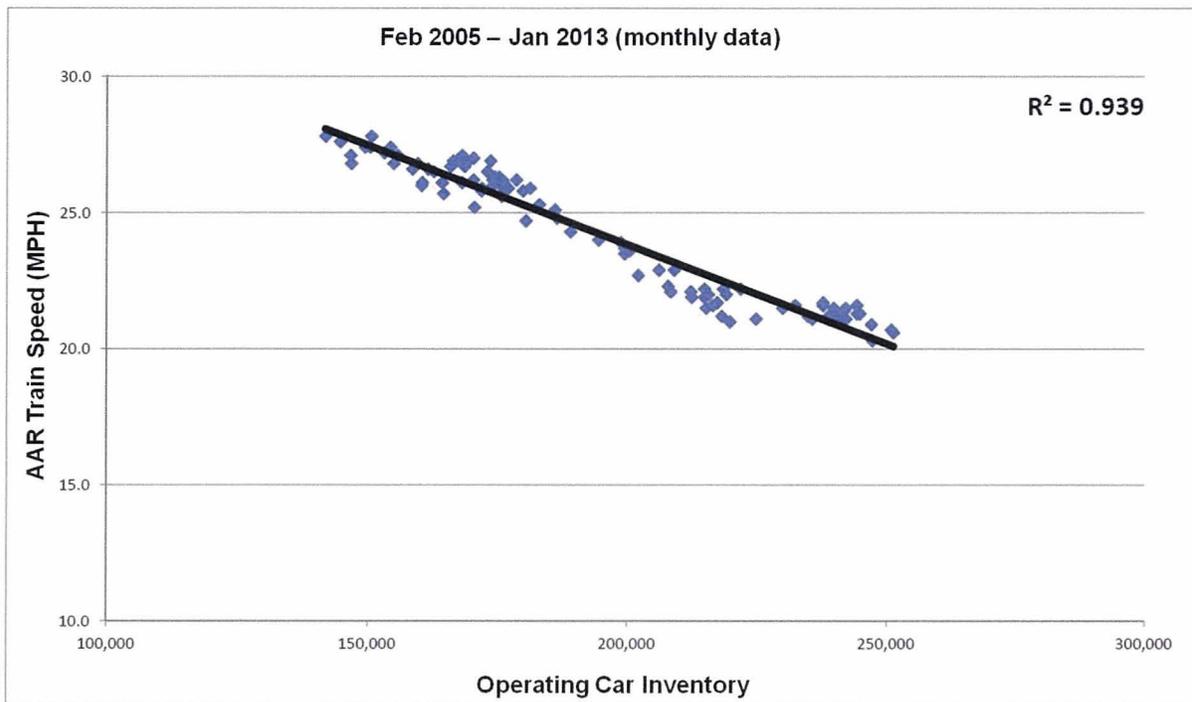
Car inventory also has a direct effect on UP’s industry spot and pull performance. UP measures an aspect of our performance that is most visible to our customers: whether we deliver and pull cars at the customers’ facilities when we say we will. Not surprisingly, as car inventory rises, industry spot and pull performance falls, as shown in Figure 6.

Figure 6: Car Inventory Effect on Service Performance at Industry



Car inventory also directly impacts train speed. As car inventory rises, train speed falls, as shown in Figure 7.

Figure 7: Car Inventory Effect on Train Speed



Decreases in train speed are extremely costly to the network and shippers that depend on rail service. UP has determined that a one mile-per-hour loss of velocity translates into the consumption of 200-250 additional locomotives, 5,000 additional freight cars, and 110-220 additional train, engine, and yard employees.

The impact of NITL's proposal on busy terminals where railroads already interchange traffic is a particular concern because forced switching could disrupt already complex operations and overwhelm existing infrastructure. As the volume of traffic that must be transferred between railroads rises, the movement of this traffic would interfere with the movements of other trains through the terminal. Cars that had moved from a shipper's facility to a yard where they were placed on a through train would instead be hauled from one railroad's yard to another railroad's yard. In fact, some cars would have to move from yard to yard on the same railroad before being

interchanged with the other railroad, creating additional, unnecessary movements through terminals and unnecessary congestion in yards that were not designed to handle those cars.

Shippers that use forced reciprocal switching would also degrade service to other shippers because they would be diverting traffic that UP uses to build through trains to more distant destinations and blocks of cars that bypass intermediate switching yards. They would fragment traffic into smaller volumes that require more switching. If shippers were to use forced switching for a significant volume of traffic, UP would need to run more trains with fewer cars and stop its trains more often for intermediate switching. This would represent an unraveling of the efficiencies that UP has worked hard to build, undermining reliable operations and creating additional delay for affected cars and additional costs for customers. UP would also need to restructure yard operations to accommodate additional intermediate switching. As discussed above, this would be difficult and costly because UP eliminated or repurposed many yard facilities as it reduced the need for intermediate switching.

Of course, if yards were to become congested and operations become gridlocked because customers invoked forced switching, UP would adjust its operations in an attempt to restore fluidity, as we have adjusted to changing traffic patterns and resulting congestion before. However, in the case of forced switching, UP would be left operating less efficiently as a result of regulation, not changes in market conditions. Moreover, UP would be continually vulnerable to network disruptions as shippers in different locations invoked regulatory intervention to gain advantage in rate negotiations. In addition, the resources that we use to respond to surges in traffic caused by changes in market conditions or to disruptions caused by weather events or incidents would be consumed in responding to changes resulting from regulatory intervention.

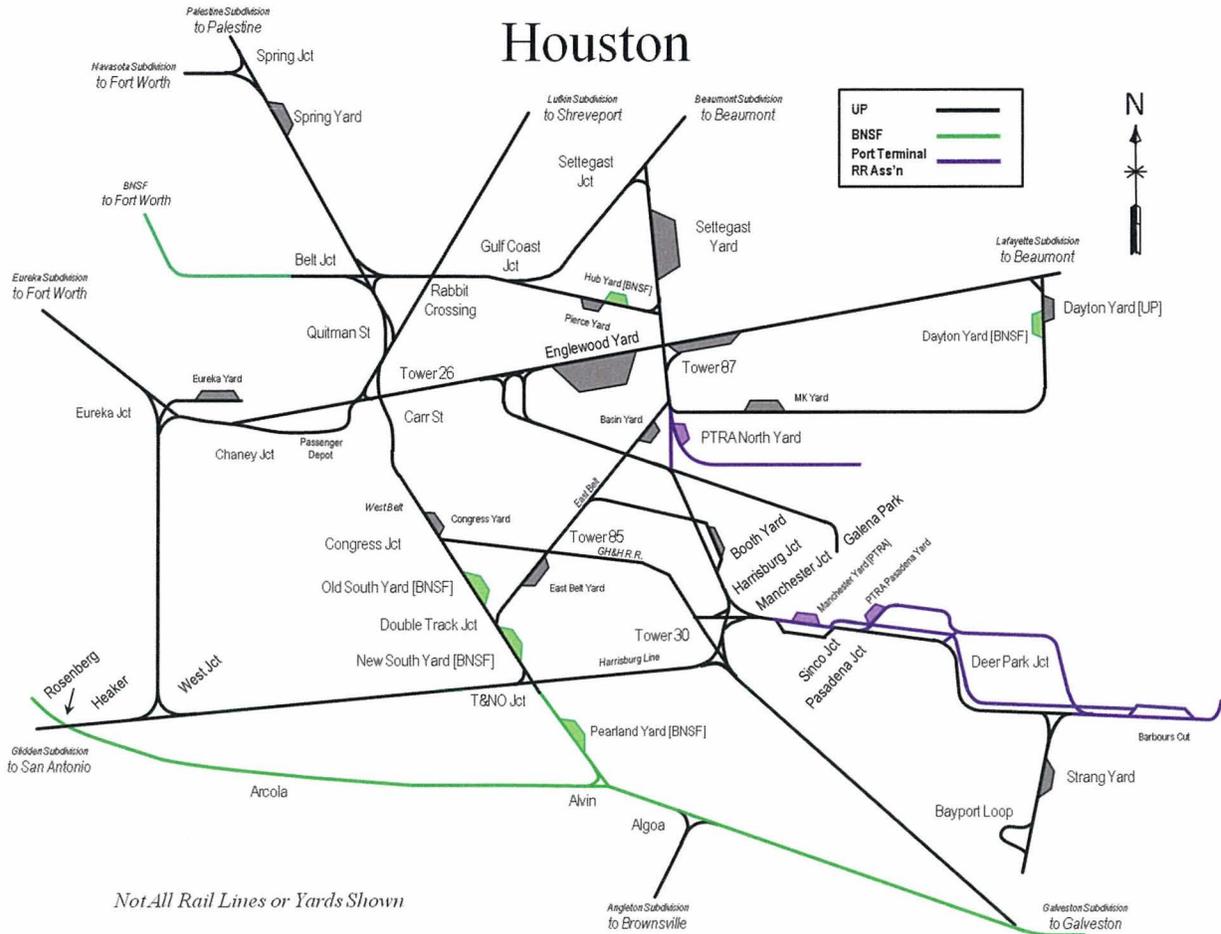
In the section below, UP's first two illustrations of the negative impacts of NITL's proposal focus on major urban areas, but our third illustration shows that similar problems would arise if shippers could use forced reciprocal switching where less switching presently occurs. In many cases, forced switching would not be "feasible, with no adverse effect on existing service." *EP 711 Notice* at 4. The fact that two railroads interchange traffic within 30 miles, or within any number of miles, of a shipper facility does not mean the railroad serving the facility has local service in place to move traffic from that facility to the interchange point. The railroad might move cars from the shipper facility in the opposite direction from the interchange to a yard and place the cars on a through train that never passes the interchange. Providing new "switching" service might require additional locomotives and crew—indeed, it might be a lengthy move from the yard used to serve the shipper facility to the interchange point. Or the interchange might not have the capacity to accommodate the volume of cars that would move using forced switching without interfering with other traffic. If existing facilities are inadequate to support interchange, the railroad losing the line-haul would have no incentive to invest, for obvious reasons, and the railroad gaining the line-haul would have a diminished incentive to invest, because it would have to account for the risk the traffic could revert to the original railroad. Moreover, the use of reciprocal switching dramatically reduces the ability of the railroad providing the switching to prevent back-ups of traffic at shipper facilities from undermining service to other customers. We illustrate these issues, which would arise unless access fees were properly computed, in the examples below.

B. Illustrations of the Impacts of Forced Reciprocal Switching on Yard Operations

1. Houston

NITL's proposal has the potential to significantly impair UP's ability to efficiently serve customers in and move traffic through the Houston area, one of the busiest terminal areas in the UP network. A map of the Houston area is provided below in Figure 8. Capacity in Houston is an extremely precious asset. Houston is densely populated and has complex industrial infrastructure, including port facilities, and there is little or no room to expand existing yards. Also, a large amount of traffic originates and terminates in Houston, which means UP cannot expand its effective local capacity in Houston by routing through traffic around Houston. UP's only practical means of addressing capacity constraints in Houston is to develop and implement transportation plans that make the most efficient use of existing facilities, and that is exactly what UP has done.

Figure 8: Houston Area



UP’s Houston-area transportation plans are designed to protect and preserve existing capacity by limiting the number of times cars are handled as they move into and out of Houston. UP has streamlined its Houston operations to run primarily out of two yards: Englewood and Settegast. Englewood, UP’s largest yard in Houston and its third busiest yard overall, operates as a network yard primarily for movements to and from the west and south of Houston. Settegast, UP’s second largest yard in the Houston area, operates as a network yard primarily for movements to and from the north and east of Houston. As network yards, Englewood and Settegast focus on receiving, building, and launching through trains to or from areas outside of Houston, rather than supporting service to local industries. Cars that flow to Englewood and

Settegast for delivery to local customers are transferred to UP's Houston-area industrial support yards for local delivery.²⁰

UP's operations in Englewood and Settegast are carefully coordinated with operations at nearby industrial support yards. UP's Houston-area industrial support yards include Strang, which serves customers to the southeast of Houston, including many large chemical shippers located on UP's Bayport Loop; Spring, which serves customers in North Houston; Congress, which serves central Houston; and Eureka, which serves northwest Houston. UP designed moves between its network and support yards based on car origins and destinations, and efforts to minimize congestion on the lines linking its yards. Maintaining a balanced, coordinated relationship among the Houston-area yards is vital to avoiding congestion and delays to traffic moving to and from Houston.

The threat posed by NITL's proposal can be illustrated by considering the potential consequences for traffic moving to and from shippers on the Bayport Loop. In general, the threat comes from two sources, which we describe in more detail below. First, UP currently is able to move cars originating on the Bayport Loop out of Houston quickly and efficiently, minimizing the time they spend in yards, which frees capacity for other traffic. Interchanging those cars with BNSF would mean more movements in Houston and less available capacity in UP yards in Houston, interfering with service to other UP customers. Second, UP's transportation plans depend on moving substantial volumes of traffic from the Bayport Loop. If UP volumes drop because of forced switching, UP would have to adopt less efficient plans for the remaining traffic, again causing a deterioration in service provided to other UP customers.

²⁰ As network yards, Englewood and Settegast lack the capacity to perform industry switching for local customers. It would likely require installation of many miles of additional tracks to allow Englewood and Settegast to perform as both network yards and industrial support yards.

a) UP's current service is highly efficient and helps avoid congestion in Houston.

UP handles a significant volume of traffic on the Bayport Loop, and it has established highly efficient service for that traffic. When a loaded car is released by the customer, UP picks up the car on a local train and delivers it to Strang. At current traffic levels, UP can build trains several days a week that run directly from Strang to UP's Livonia Yard, near Baton Rouge, Alton & Southern's Gateway Yard in East St. Louis, and UP's North Little Rock Yard in Little Rock, Arkansas, without any additional handling in Houston. On other days, UP switches cars at Strang into blocks for Livonia, East St. Louis, and North Little Rock. UP moves the Livonia block to Settegast, where it is placed on a through train, and the East St. Louis and North Little Rock blocks to Spring, where they are placed on through trains. After arriving in Livonia, East St. Louis or North Little Rock, these blocks are switched and combined with other traffic that can run deep into other railroads' systems before being broken up. For example, with current traffic levels, UP is able to build blocks for CSX's Selkirk Yard in Albany, New York, and NS's Conway Yard near Pittsburgh. This blocking reduces congestion in terminals outside Houston and provides better service for customers nationwide. Today, a car blocked in Strang for Livonia, East St. Louis, or North Little Rock can be on a train out of Houston approximately 24 hours after being released by the customer.

b) Forced interchange would be inefficient and would add unnecessary movements between yards in Houston.

Under NITL's proposal, certain shippers on the Bayport Loop might be able to force UP to switch their traffic to BNSF, which also has yards in Houston. UP currently interchanges some traffic that flows to and from Strang with BNSF, so it is easy to illustrate the potential consequences of being forced to interchange additional cars with BNSF.

Under NITL's proposal, the cars from shippers on the Bayport Loop would endure a longer, less efficient, more circuitous move through Houston that would consume additional capacity on both UP and BNSF. For example, if a Bayport Loop shipper wanted to send a car to Albany, New York, with BNSF as the line-haul railroad rather than UP, UP would pick up the car and deliver it to Strang. After switching at Strang, instead of placing that car in an East St. Louis Block for through movement, UP would classify it for a short distance transfer movement. Absent reaching a different arrangement with BNSF, UP would classify the car into an Englewood block for movement to Englewood. At Englewood, UP would switch the block again, this time to an interchange track, where it would wait for a BNSF crew to arrive and take the cars to BNSF's New South Yard. For UP, the reciprocal switching process, from the time the customer releases the car to the car's departure from Englewood would likely take at least 60 hours. In other words, cars UP is forced to switch to BNSF would likely spend at least 36 extra hours consuming UP's capacity in Houston than if they had moved in single-line service, without even having left Houston.²¹

Moreover, the 36 or more extra hours that the cars would spend on UP are only half the problem for UP (without even beginning to address the additional capacity consumed on BNSF). For every loaded outbound car affected by NITL's proposal, BNSF must move an empty car into Houston for UP to deliver to the customer. On the return trip, this car would cause the same inefficiencies, experiencing the same delays and consuming the same additional capacity on UP.

²¹ At New South Yard, BNSF would presumably switch the car again and block it for movement out of Houston. Thus, all in all, the reciprocal switching process, from the time the customer releases a car on the Bayport Loop to the car's departure on a BNSF train from New South Yard would likely take at least three days, as compared to one day for a car placed on a train to East St. Louis at Strang.

This delay is intrinsic in NITL’s proposal. Every car that is subject to forced switching under NITL’s proposal would inevitably spend more time in Houston, consuming more capacity on both UP and BNSF. Moreover, the two-day delay assumes optimal operating conditions—that is, no additional, unforeseen delays that would add to the time cars would spend in Houston, increasing congestion, reducing capacity, and slowing service for all customers. But UP commonly experiences delay when interchanging traffic with BNSF in Houston. BNSF’s New South Yard is subject to volume swings and capacity constraints, and UP is affected when BNSF has to space traffic into the New South Yard. UP must hold onto cars longer than planned, consuming capacity at Englewood, until BNSF has resources and space available to pull the cars from our yard. With or without additional delays, loss of capacity poses a very real threat to UP’s ability to provide safe, efficient, reliable service to all Houston-area customers.

In addition, every additional car that UP must switch for BNSF would add to the length of the trains used to interchange traffic between the railroads; indeed, new interchange movements may be required. Each longer—or additional—train would consume additional track capacity as it moves between UP and BNSF in Houston, blocking rail-to-rail crossings and reducing train speed throughout Houston. If longer trains are used, they may require more movements to fit into yards, which may block access to yard tracks and cause delays for other trains waiting to enter the yard.²²

The prospect of adding more interchange traffic to Englewood is especially concerning. Englewood is one of the primary network yards on UP’s system. Congestion at Englewood has

²² Additional interchanges between UP and BNSF would also interfere with automobile traffic in the Houston area. The usual train route between Englewood and New South Yard traverses more than a dozen at-grade road crossings. Every additional car that is interchanged means additional blocked crossings, additional traffic delays, and additional risk at every grade crossing.

the potential to cascade through our network, and UP's transportation plans are designed to avoid switching cars in Englewood whenever possible. The additional switching at Englewood that could occur under NITL's proposal has the potential to throw the entire Houston area, and perhaps our entire network, into disarray by shifting traffic volumes in ways that were not planned and would not be predictable.

c) Forced interchange would degrade service by disrupting efficient transportation plans for traffic in Houston.

Not only would cars diverted to BNSF require additional switching and consume capacity at Englewood, but the loss of significant volume would also result in additional switching for cars remaining on UP. If UP does not have sufficient volume at Strang to build trains or blocks of cars for destinations outside of Houston, UP would have to perform additional switching within Houston. For example, if there is not sufficient volume at Strang to build a North Little Rock block, cars that previously departed Houston from Strang would likely move first to Settegast to be blocked with other cars destined for North Little Rock. It is likely that these cars would stop again at an intermediate yard between Houston and North Little Rock for additional switching. This would require additional movements between Strang and Settegast and additional handling at Settegast. The loss of block volume would also create congestion at intermediate yards outside Houston.

Moreover, it is important to recognize that UP's opportunities to gain traffic volume would not offset the losses it could suffer under NITL's proposal, even if UP would choose to pursue that traffic. UP solely serves many more customers in the Houston area than BNSF. And, even if the volumes subject to forced access were balanced in the overall Houston area, UP's ability to build blocks at Strang would still be disrupted because UP and BNSF would

likely interchange traffic subject to forced switching at Englewood, where they interchange traffic today, not at Strang.

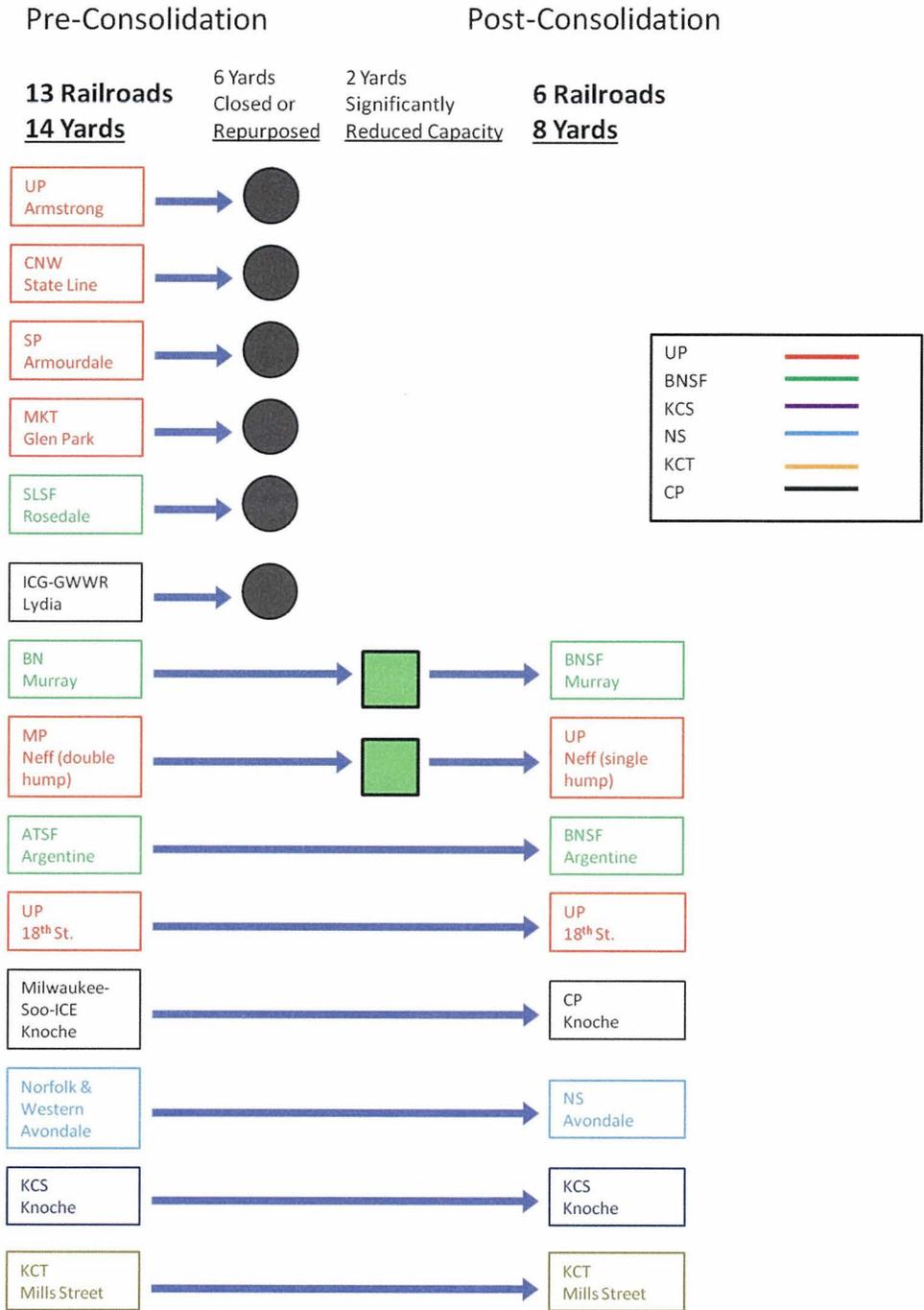
2. Kansas City

NITL's proposal also has the potential to disrupt UP's ability to use its Kansas City facilities in support of optimized network traffic flows. Kansas City is a prime example of a terminal in which consolidations have allowed UP to reconfigure its operations to increase efficiency and reliability by eliminating unnecessary interchanges and eliminating or repurposing the yards used to support those interchanges. Kansas City is also a prime example of the enormous benefits that inure to shippers, the transportation industry, and the public when railroads are allowed to plan for, invest in, and manage their business to improve service and reliability. Forcing UP to perform more reciprocal switching in Kansas City could overwhelm the infrastructure that continues to support UP's operations in Kansas City and would disrupt UP's ability to use its Kansas City facilities to support operations at other locations on its network.

In the 1970s, thirteen railroads operated a total of fourteen interchange yards in the Kansas City area, creating a terminal area that was inefficient and congested on the best of days. Customers located in and around Kansas City were commonly served directly by a single railroad, and that railroad might have to interchange traffic with any of the other railroads operating in the terminal to provide the customer with a through route. The congestion resulting from the need to interchange traffic originating or terminating in Kansas City was compounded by the fact that, in this period of balkanized rail networks, most of these railroads also needed to use Kansas City to interchange traffic originating and terminating beyond Kansas City. Capacity in all fourteen yards was devoted to interchange.

Railroad consolidations ultimately reduced the number of railroads operating in Kansas City to six. The resulting expansion of single-line service greatly simplified terminal operations, diminished the need for interchanges, and reduced the need for yard facilities. Figure 9 below shows the thirteen railroads and their yards in Kansas City as of the early 1970s, as well as the changes that have taken place since the 1970s.

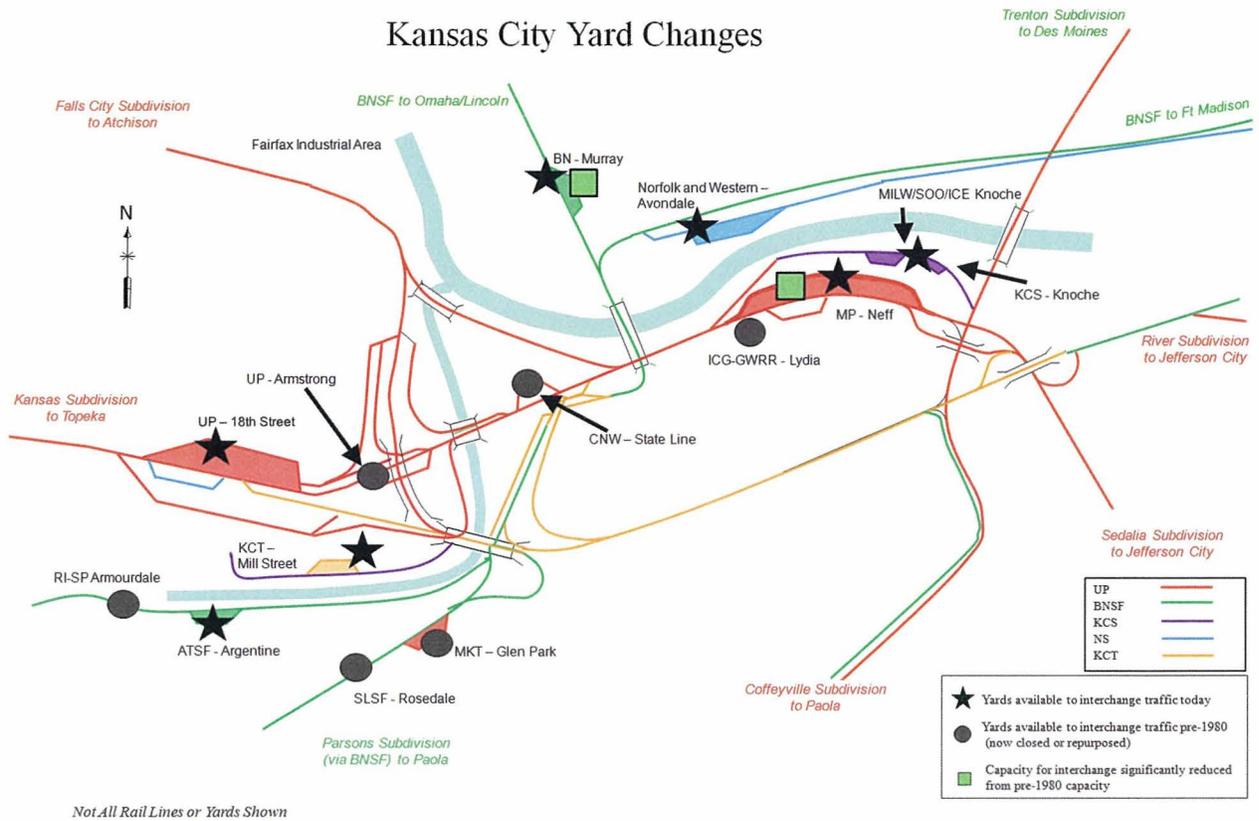
Figure 9: Kansas City Consolidation



a) Elimination of interchanges for traffic to and from Kansas City reduced the need for yard capacity.

UP now uses only three of the six yards in Kansas City that were owned by its predecessors. Other railroads serving Kansas City also have closed yards as they consolidated, as shown in Figure 10. On UP, only two of our remaining three yards are still used to interchange manifest traffic with other railroads serving Kansas City: 18th Street and Neff. With the reduced need to interchange traffic in Kansas City, UP closed Glen Park, State Line, and Armstrong yards. UP also removed one of the classification humps from Neff, and it has repurposed the former SP's Armourdale Yard to be used exclusively for auto multilevel and through traffic. UP's transportation plans have been redrawn to support significantly less car handling in Kansas City, and UP invested significantly in redesigning its remaining facilities to handle significantly more run through traffic.

Figure 10: Kansas City Yard Changes



As a result of these changes, UP is providing more efficient and more reliable service than ever before to customers in Kansas City and to the larger pool of customers whose traffic moves through the terminal and no longer requires interchange in Kansas City. For example, before UP’s consolidation with MKT, if an MKT-served customer in Texas wanted to move traffic to a UP-served customer in Kansas City’s Fairfax Industrial Area, the traffic would arrive at MKT’s Glen Park Yard, where it was classified, and MKT would then take it from its Glen Park Yard to UP’s Armstrong Yard, where it would be classified again, then moved to the Fairfax Industrial Area. As a result of UP’s consolidation with MKT, the need for an interchange was eliminated. Traffic from former MKT-served points now arrives at 18th Street or Neff, where it can be classified for delivery directly to the Fairfax Industrial Area, saving days in transit for the customer and reducing switching costs for the railroad.

b) New single-line service patterns allowed traffic to avoid Kansas City and reduced the need for yard capacity.

Another benefit flowing from UP's consolidations and the expansion of single-line service is that there is less need to use Kansas City to interchange traffic originating and terminating outside of Kansas City. In the 1970s, UP traffic coming from North Platte with ultimate destinations in St. Louis and Ft. Worth had to be interchanged in Kansas City. The UP traffic was delivered to Armstrong Yard, where the cars were classified. MKT interchanged cars from the UP yard and delivered them to MKT's Glen Park Yard for additional classification. MKT then moved the traffic heading south over trackage rights it possessed on the former Frisco line with ultimate destinations in Texas, including Ft. Worth. Traffic destined for St. Louis had to take a very inefficient route, traveling from Kansas City straight south toward Parsons, Kansas, and, eventually, taking almost the opposite direction back again traveling northeasterly to St. Louis, for eastern connections. Those cars spent relatively more time in yards waiting to be handed off. The frequent interchanges also increased the odds of a car missing its train and being delayed.

Under current transportation plans, and given current densities, however, UP can classify cars into blocks at locations wholly outside the Kansas City terminal and put them on trains that avoid Kansas City entirely. For example, UP creates blocks of 25 or more cars in North Platte, and trains that carry those blocks completely bypass Kansas City to get to their destinations, for example in St. Louis and Ft. Worth. This run-through traffic, in turn, opens up capacity within the Kansas City terminal, which allows UP to use the remaining capacity to support operations that can be handled most efficiently in Kansas City. The MKT-Fairfax example is only one example of a situation that could be illustrated for other components of the UP system.

NITL's proposal threatens to disrupt these efficient operations. If customers divert a significant number of cars from blocks on trains that now bypass Kansas City, UP might be forced again to stop trains in Kansas City to pick up additional cars to fill a train, for example to St. Louis and Ft. Worth. This means more trains in Kansas City, with more switching in Kansas City, with more car inventory, and decreases in velocity and customer service. The additional switching would also increase UP's operating costs.

c) NITL's proposal would disrupt UP's efficient use of yard capacity in Kansas City.

UP's ability to plan for new traffic and the agility that allows us to react to market changes are well illustrated by UP's current operations in Kansas City that address the demand for freight transportation of frac sand used to support natural gas drilling. UP uses its yard capacity in Kansas City to prepare large blocks of empty cars used for frac sand that move on a train that delivers the blocks directly to several industrial sites in Minnesota. According to the current plan, empty sand cars primarily from Texas are accumulated in Kansas City at Neff Yard. At Neff, deep blocks of empty sand cars, generally no fewer than 25 cars to a block and up to 40 cars, are prepared and move on a single train north through the Falls City Subdivision and are run around Council Bluffs to multiple industries located in northern Minnesota. The blocks are passed to local serving jobs with minimal handling—minimizing the need for classification or yard storage space in our major Minnesota yard in South St. Paul. Indeed, there is no need for classification upon the cars' arrival in Minnesota. The efficient car handling is continued as the loaded cars travel south. When the empties are loaded, the loaded blocks are prepared, and a train collects the blocks from the several industries and travels south to Mason City. Significant yard capacity in Mason City is dedicated to these loaded blocks which are classified for destinations in Texas and the Gulf Coast.

If more yard capacity in Kansas City were required for forced reciprocal switching, then the capacity needed to prepare the blocks of empty cars that are part of this efficient operation would be eliminated or greatly reduced. That would, in turn, impair UP's ability to build deep blocks of cars in its Kansas City yards, and would re-introduce the practice of creating smaller blocks of cars that would have to be collected from multiple yards in geographically diverse locations (for example, they might be collected in Council Bluffs and South St. Paul), resulting in less efficient operations. UP's ability to build deep blocks at Neff that can be delivered directly to the sand industrial sites in the north frees up the yards in South St. Paul and Council Bluffs to handle other traffic.

In addition, UP has designed Kansas City's yard capacity in such a way that the reciprocal switching that currently occurs between the BNSF and UP in Kansas City occurs between BNSF's Argentine and UP's 18th Street yards. As Figure 10 shows, the two yards are located in close proximity, and the disruption such reciprocal switching causes on the UP mainline in that location is relatively tolerable. Although the existing level of reciprocal switching does not currently exceed the capacity of 18th Street, if the volume of reciprocal switching increased materially, then UP would likely also have to employ Neff to facilitate reciprocal switching. As Figure 10 also shows, while 18th Street is just over the river from Argentine, Neff is not only across the river, but it is on the far side of the Kansas City terminal. Movements from Neff to Argentine would be required to traverse the extremely busy lines that slice through the middle of the terminal and over which all six railroads remaining in Kansas City run.

Considering for a moment only UP traffic, UP originates 17 through trains from the Kansas City area on a daily basis. Generally, ten trains depart from Neff, two from 18th Street,

four from Armourdale, and one from a customer at the Fairfax Industrial Area. In addition, there are two daily locals, one leaving from Neff to Trenton, Missouri, and another leaving 18th Street to Topeka, Kansas. In addition, UP currently interchanges traffic on a daily or regular basis:

1) from Neff, with NS at Avondale Yard, BNSF at Murray Yard, and with KCS at Knoche Yard (daily); 2) from 18th Street, with NS at Avondale and with BNSF at Argentine (daily); 3) autos from Armourdale, with the KCT (daily) and with NS at Avondale (six days per week). When one considers the activity that occurs among all of the other railroads that interchange in Kansas City, and then considers the additional traffic that might be interchanged under a regime of forced switching, Kansas City would have increased interchange on up to 25 pairs of connections. All of those movements would compete for capacity on the four routes through the terminal. Kansas City remains the second busiest terminal in the country, and increasing traffic on the busy lines in the Kansas City terminal could create extreme congestion and delay traffic moving to and from many parts of the U.S. rail network.

As UP has rationalized its network to satisfy market demand and customer service needs, we have significantly reduced the number of yards and reduced existing yard capacity in Kansas City and across our system, and redesigned transportation plans in a way that makes the highest use of the yard capacity that we retained to expedite movement of cars from our shippers to our receivers. To force UP to use that capacity in ways that reintroduce inefficiency and delay, like performing significantly more reciprocal switching, makes no sense for the customers, railroads, or the public.

3. Sioux City

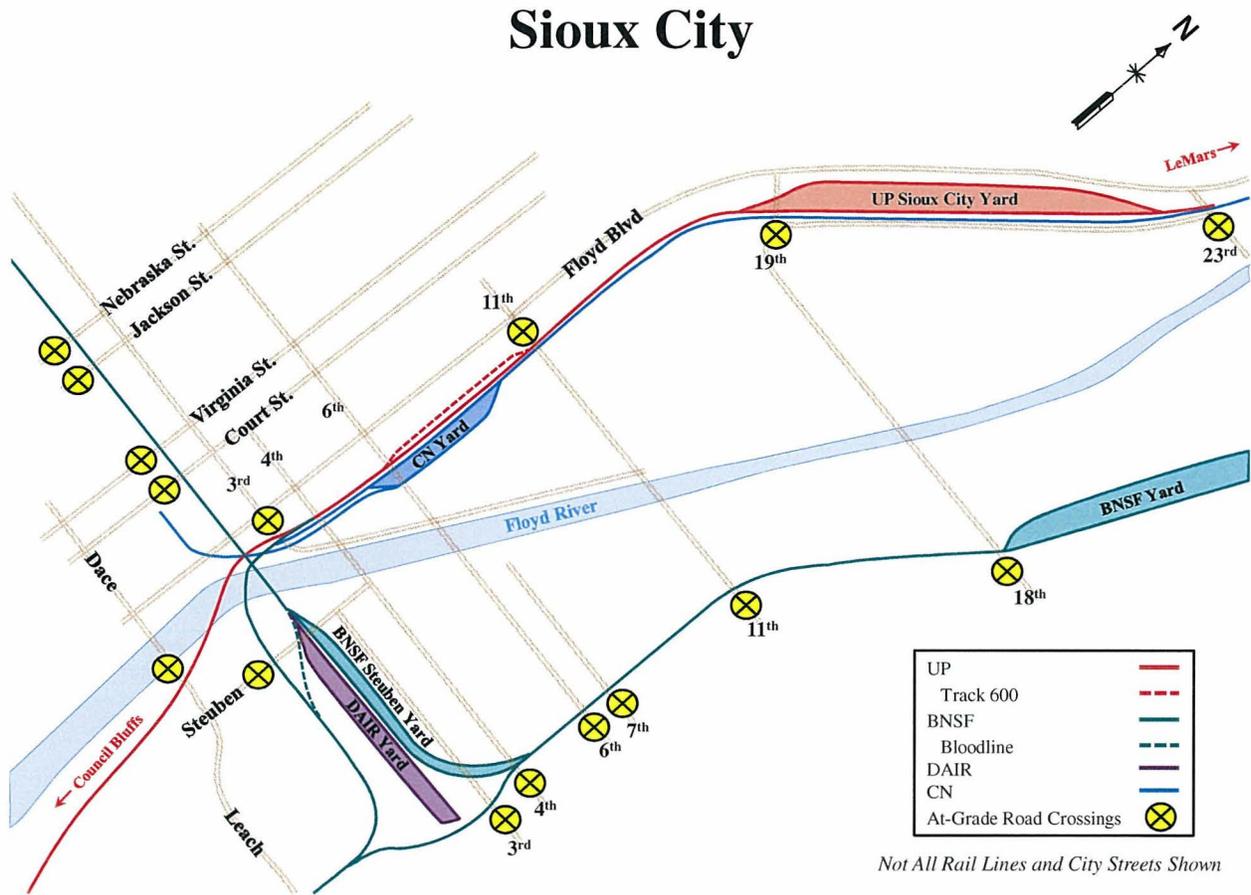
Even outside of major urban areas like Houston and Kansas City, NITL's proposal could disrupt service to customers and impose significant costs on railroads that are forced to provide reciprocal switching where they interchange some traffic today, but the existing infrastructure

does not permit an efficient interchange. Interchanges were built and have been maintained to accommodate historic traffic patterns. Consequently, the infrastructure at existing interchanges may lack capacity to handle additional traffic or certain types of traffic the railroads have not interchanged historically without interfering with other operations, incurring additional costs, and adversely affecting the public. UP's operations in Sioux City, Iowa, illustrate these issues.

Four railroads operate in Sioux City: UP, BNSF, CN, and Dakota and Iowa Railroad ("DAIR").²³ Currently, these railroads interchange traffic by using each other's mainline and yard infrastructure, which is located in a concentrated area surrounded by industrial, business, and residential districts in downtown Sioux City.

²³ BNSF, CN, and DAIR are collectively referred to as "foreign railroads" in this section.

Figure 11: Railroads Operating in Sioux City, Iowa



UP’s Sioux City operations are based out of UP’s Sioux City Yard and consist of, among other things, one yard transfer job (YSX50) and two local jobs. At UP’s Sioux City Yard, UP switches and blocks cars released by customers and picked-up by the local jobs for either outbound UP trains or for interchange with the foreign railroads on the YSX50. Cars moving in UP single-line service typically leave on an outbound UP train within 12 hours of arriving in UP’s Sioux City Yard. Cars destined for the foreign railroads, on the other hand, typically remain at UP’s Sioux City Yard for 24 hours before YSX50 moves those cars. This means cars moving in interchange service remain at UP’s Sioux City Yard for 12 more hours—at a minimum—than cars moving in UP single-line service. Furthermore, these 12 additional hours

at UP's Sioux City Yard do not account for the transfer time during the complex interchange operations described below or for the delays at a foreign railroad's yard. Depending on the foreign railroad's operations, cars moving in interchange service could remain in Sioux City for another day, if not more, while being switched at the foreign railroad's yard and launched on an outbound train.

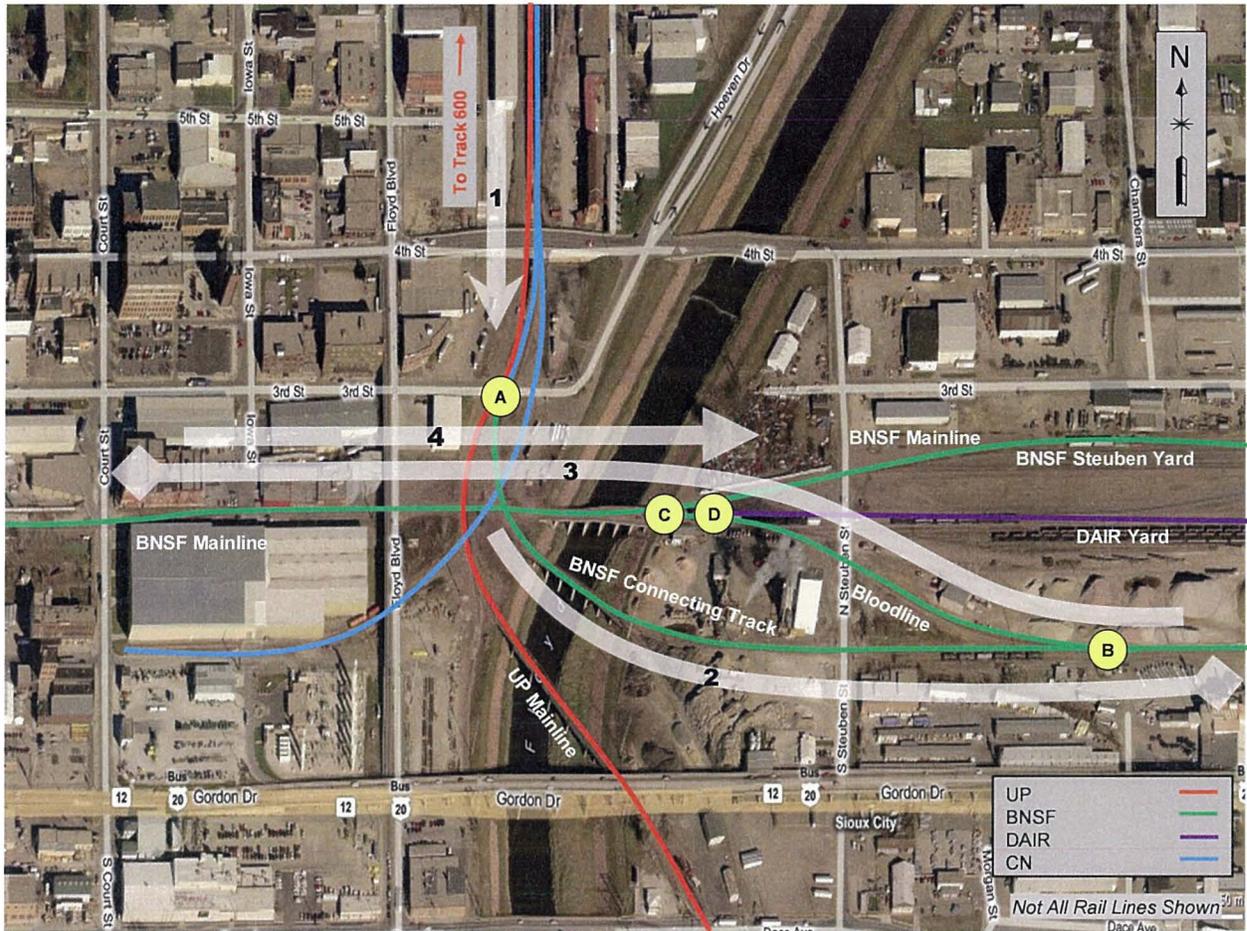
a) Sioux City's "see-saw" interchanges are inefficient.

A portion of the delay associated with interchanging carload traffic between UP and the foreign railroads in Sioux City is attributable to the existing interchange infrastructure. UP and the foreign railroads receive cars in interchange at different locations in Sioux City: UP receives cars at UP's Track 600, and the foreign railroads receive cars at their respective yards. To access each other's existing interchange infrastructure, the railroads must complete "see-saw" movements.²⁴ See-saw movements involve a series of steps by which the crew pulls the train forward and shoves the train back after throwing multiple switches so that the train can move onto different track.²⁵ YSX50 interchanges approximately 30 cars per day, six days a week with the foreign railroads in this manner.

²⁴ UP and CN can access each other's interchange infrastructure without completing a see-saw movement, but CN must complete a see-saw movement to interchange with BNSF or DAIR.

²⁵ See-saw movements are common when railroads cannot pull directly into each other's yards or other interchange infrastructure because of the configuration of their tracks and connections to each other.

Figure 12: See-Saw Move Between UP and Foreign Railroads



To interchange carload traffic with the foreign railroads, YSX50 departs UP’s Sioux City Yard shoving the train south on UP’s mainline until reaching CN’s Yard near 11th Street. YSX50 shoves into CN’s Yard, drops off the CN block of cars, and pulls back onto UP’s mainline. After dropping off the CN block of cars, YSX50 begins the see-saw movement by shoving south on UP’s mainline, stopping before 3rd Street. The conductor throws the 3rd Street switch (Point A on the map) onto the BNSF Connecting Track, and YSX50 shoves east until the head locomotive on the train clears the switch to the Bloodline (Point B on the map). After throwing the switch onto the Bloodline, YSX50 pulls forward onto the Bloodline and stops before reaching the western end of the Bloodline, waiting to obtain authority from the BNSF

dispatcher to operate over BNSF's mainline. Once the BNSF dispatcher authorizes the movement, the conductor throws the switch onto BNSF's mainline (Point C on the map), and YSX50 pulls forward until approximately Court Street. The conductor then re-aligns the switch from the Bloodline to BNSF's mainline (Point C on the map) and proceeds to align multiple switches into BNSF's Steuben Street Yard or DAIR's Yard (Point D on the map). YSX50 shoves into BNSF's Steuben Street Yard and then DAIR's Yard (or vice versa) and drops off blocks of cars to BNSF and DAIR.

YSX50 then reverses the see-saw movement to return to UP's Sioux City Yard, including obtaining authority from BNSF's dispatcher to go back onto BNSF's mainline. On the return movement, YSX50 stops at Track 600 to pick up cars that the foreign railroads have forwarded in interchange to UP.²⁶ After picking up the cars UP received in interchange at Track 600, YSX50 returns to UP's Sioux City Yard where those cars are switched onto local or outbound trains.

The see-saw interchange in Sioux City is particularly time consuming because the crew performing the see-saw movement must shove the train for the majority of the movement—that is, the engineer on the head-end locomotive must shove the train backward as opposed to pulling the train forward for the majority of the see-saw movement. Shoving the train adds additional time to any movement because shoving movements operate at slower speeds for safety. Federal regulation also requires that an employee protect the movement for the engineer who is operating

²⁶ YSX50 does not pick up cars at the foreign railroads' yards. Instead, UP receives cars in interchange from the foreign railroads at Track 600. In order to access Track 600 and to forward cars to UP, the foreign railroads (except CN) must complete a see-saw movement similar to the see-saw movement described above with YSX50.

the locomotive at the opposite end of the train.²⁷ Basically, an employee—usually the conductor—must be the eyes and ears for the engineer by walking with the rear end of the train as it is shoved backward at a slower speed. If the UP and BNSF mainlines are clear, YSX50 can complete the complicated see-saw interchange described above in two hours. If, however, the mainlines become occupied after YSX50 departs from the Sioux City Yard, YSX50 must wait for the mainlines to clear. For example, YSX50 often waits—typically for an hour—on the BNSF Connecting Track (or the Bloodline) for the BNSF mainline to clear and for the BNSF dispatcher to authorize the movement.

b) Sioux City has limited capacity for interchanges.

Although UP and the foreign railroads interchange traffic in Sioux City, the Sioux City interchange has limited capacity. As mentioned above, UP receives cars in interchange from the foreign railroads at Track 600, including cars that UP would be forced to reciprocally switch for the foreign railroads under NITL's proposal. Track 600, however, has capacity for no more than 25 cars. If the interchange traffic volume increases due to forced reciprocal switch and Track 600 does not have available capacity, the foreign railroads would likely hold the additional cars at their yards until Track 600 has available capacity or the railroads would likely increase the frequency in which they interchange. Either option would unnecessarily consume resources and create unnecessary congestion. If the foreign railroads hold the cars, the additional cars would consume yard capacity and create yard congestion for the foreign railroads. If the railroads interchange traffic more frequently, the additional see-saw interchange would consume UP's and BNSF's mainline capacity during the time-consuming movement, impeding traffic flowing to,

²⁷ See 49 C.F.R. § 218.99.

from, or through Sioux City. Furthermore, UP would have little incentive to expand Track 600 for reciprocal switch traffic because UP would not receive the line-haul revenue to justify the expansion. Indeed, if Track 600 lacks capacity because some shippers forced UP to reciprocally switch traffic, other shippers relying on interchange service in Sioux City would be affected. Sioux City shippers who may be open to reciprocal switch now or shippers who use multiple carriers that interchange in Sioux City would experience additional delays if their cars were held until Track 600 had available capacity. In short, forced reciprocal switching in Sioux City under NITL's proposal would result in more resources being used to move the same amount of traffic in a less efficient manner while disrupting service to other railroad customers.

The impact on UP's operations in Sioux City would be even more severe if UP were forced to reciprocally switch unit trains for its customers within 30 miles of Sioux City. If UP were forced to provide reciprocal switching for unit trains, the interchange would consume mainline capacity for significant periods of time because UP does not have capacity in Sioux City to hold unit trains off of its mainline.²⁸ Once again, Track 600 has capacity for no more than 25 cars, and UP's Sioux City Yard does not have capacity to hold unit trains without fouling UP's mainline. Likewise, the BNSF Connecting Track and the Bloodline do not have enough capacity to hold unit trains without fouling BNSF's mainline. Therefore, regardless of the location where the unit train is interchanged in Sioux City, a unit train would consume mainline capacity and create congestion, affecting traffic flowing to or from Sioux City, as well as traffic passing through Sioux City on other trains. Depending on the size of the unit train, the train

²⁸ UP's concern about being forced to reciprocally switch unit trains in Sioux City under NITL's proposal is not hypothetical. UP has multiple customers near Sioux City that ship unit trains of approximately 80 to 140 cars per train, and those customers could potentially force UP to reciprocally switch their unit trains under NITL's proposal.

could also block multiple road crossings for significant periods of time. For example, if BNSF pulls or shoves a 135-car unit train onto UP's mainline through the BNSF Connecting Track, the train would block 11th Street and 19th Street (and possibly 3rd Street) while crews remove and add locomotives (or reconfigure distributed power locomotives) and perform necessary inspections. During this time, the unit train would sit idly on UP's mainline and block a minimum of two road crossings for 30 minutes to over an hour. As Figure 11 above illustrates, Sioux City drivers depend on the many at-grade road crossings to enter or leave the industrial, business, and residential districts surrounding the railroads' infrastructure, and blocking these road crossings for extended periods of time would significantly delay and create additional safety risks for those drivers.

Moreover, UP's ability to build additional capacity in Sioux City to accommodate unit trains is restricted by the industrial, business, and residential districts surrounding the area, not to mention other railroad's infrastructure. Again, UP would have little incentive to invest in a track to hold a unit train that would move via line-haul on another railroad, but even if UP could build additional capacity in Sioux City to hold unit trains, UP could not avoid at-grade road crossings for building such capacity. Therefore, if UP could build such capacity, the idle trains would nonetheless block multiple at-grade road crossings, disrupting Sioux City drivers who utilize those at-grade road crossings. UP interchanges cars with other railroads in Sioux City, but the existing facilities in Sioux City could not readily accommodate additional interchange activity that might result from adoption of NITL's proposal, including interchanges of unit trains. The result would be added costs and delay, disrupting railroad operations in and through Sioux City, and imposing burdens on the residents of Sioux City.

C. Forced Reciprocal Switching Would Limit UP's Ability to Monitor and Control the Flow of Inbound Traffic to Prevent Congestion.

In both large and small terminals, adopting NITL's proposal would have a significant impact on UP's ability to monitor and control the flow of inbound traffic to prevent congestion. As discussed above, a yard's effective capacity is reduced as car dwell time increases—that is, as rail cars spend more time in a yard. When cars spend extra time in a yard, they occupy track space needed to handle other cars. If the cars also need additional switching, they consume even more resources, which further interferes with the handling of other cars, increases the time those other cars spend in the yard, and reduces overall network velocity and service. UP has made great strides in reducing a significant source of increased car dwell times: mismatches between the number of cars moving to a customer's location and the customer's track capacity at that location. UP addressed this issue by developing car management technology that allows it to match the flow of cars to and from customer locations and with the track capacity at those locations.²⁹ However, UP cannot monitor and control the flow of loaded and empty rail cars coming to it for reciprocal switching. This has been a chronic problem in the rail industry—one that would become worse if railroads were forced to perform more reciprocal switching.

The costs of holding cars for customers. If a rail car arrives in a yard but cannot be delivered because the customer's track is full, the car will consume extra yard resources. If the

²⁹ Demurrage charges are one tool that railroads use to discourage shippers from using railroad yards to hold their cars when their locations are full, but active management is far more effective than demurrage. The party that directs a car to a location may not be, or may claim not to be, the party legally responsible for demurrage. This either renders demurrage uncollectable or leads to litigation about demurrage charges. Even more important, as discussed in the text, problems caused by a lack of holding track capacity at just a few locations can multiply and spread, and demurrage charges are not structured to compensate a railroad for addressing the costs of congestion.

railroad knows the customer's track is full, then rather than switch the car to a local train for delivery, the railroad will need to find yard space for the car and switch the car to the holding track. Otherwise, the car will make a wasted round-trip, and upon its return must be switched off the local train and held for later delivery. If this occurs infrequently, it is an inconvenience that adds expense. If this occurs with multiple customers or with many cars, yard operations can rapidly deteriorate and costs can quickly multiply.

Most yards are not sized to store cars for customers or to support the switching needed to move cars off holding tracks as customer track becomes available. Switching cars from a track holding dozens of other cars requires multiple movements and space to perform those movements because a particular customer's cars will be mixed in with other cars on the holding track—it is not like reaching into a closet to grab a particular shirt. As a result, even when a space opens up at on customer's track, UP might be unable to get a car onto the next local train without delaying every other car on that train. Thus, as congestion increases, overall throughput decreases: the railroad can no longer handle other traffic efficiently even for customers that always have track space available. When congestion becomes particularly bad within the yard, railroads may need to hold trains outside the yard, occupying mainline sidings or capacity in other yards. This spreads congestion and its effects beyond the original source to other locations on the network. Experience has confirmed that it is very difficult to reverse such a downward spiral. That is why we are vigilant about preventing loss of fluidity in yards.

Matching inbound traffic to customer capacity. UP began using its car management technology, the Customer Inventory Management System ("CIMS"), in the Phoenix area in 2005. At the time, UP's yards had become congested as traffic flooded into the region faster than some shippers were unloading their cars and faster than we could spot and pull cars. The

congestion at Phoenix delayed deliveries to customers, obstructed building of outbound trains, and backed up trains on UP mainlines. Before CIMS, UP had no systematic way of monitoring whether its customers had sufficient track capacity at their locations to accept inbound cars. To implement CIMS, UP undertook a detailed survey of track capacity at customer locations. As customers submit waybill data prior to the initial movement of a loaded car, UP develops a detailed transportation plan for each car that determines how the car will move—train-by-train, day-by-day—from origin to destination. UP then uses that plan, together with data regarding prior and ongoing movements to and from the customer location and the customer's track capacity, to determine whether there will be sufficient track capacity at the destination when the car is scheduled to arrive. If a customer is planning to ship more cars to a location than the track there can accommodate when the cars will arrive, UP can address the situation with the customer before the new cars enter our network. In most cases, the process is informal: UP will bring the situation to the customer's attention and encourage the customer to unload cars faster or to make more space available by moving empty cars to a different location. But, in some cases, where the customer cannot or will not cooperate, UP has imposed embargos on consignees to keep or limit traffic from moving to locations with insufficient track space until inbound traffic matches outbound traffic.

However, when UP receives traffic for reciprocal switching at the destination, we lack the ability to monitor and control the flow of traffic provided by CIMS. For traffic that requires reciprocal switching at destination, UP receives an electronic message that a car will move to the destination, but we do not receive information about when the car is scheduled to arrive—the

next message UP gets is when the car is ready for interchange—so we cannot know in advance whether the location will have track capacity available to receive the car.³⁰

Even if UP received scheduling information for traffic that requires reciprocal switching at destination and knew that the track at destination would be full when a new car was scheduled to arrive, we could do little to prevent a problem. The information UP receives typically does not include the shipper's name, and, in any event, UP cannot prevent the shipper from sending the car or the line-haul railroad from starting the car on its way to UP. Moreover, even if UP embargoes the consignee, that does not stop the line-haul railroad from moving a car to an interchange with UP. And, as a practical matter, UP will have to accept the car.³¹ On occasion, when a problem has been severe and persistent, UP has convinced the line-haul railroad to cooperate in stemming the flow of traffic, but the railroad originating traffic generally lacks strong incentives to address congestion in another railroad's yards, especially when that means it would have to find space for those cars in its own yards. And UP prefers to resolve problems before they reach a stage that would justify an embargo.

CIMS has been a great success, and it plays an important ongoing role in helping to keep UP's network fluid. In July 2006, UP reported to the Board that in locations where CIMS had been implemented, which then covered about 60 percent of the movements to and from industry, dwell time had improved by 20 to 25 percent and switching reliability had improved by 35 to 50

³⁰ When UP handles traffic in interline service, we receive the same type of information as when we handle cars in local service because we have a relationship with the customer and also develop a transportation plan for the cars.

³¹ If the line-haul railroad has placed the car to the embargoed consignee in a consist with other cars to be interchanged, then it is not practicable for UP to attempt to cull out the car to the embargoed consignee from the other cars.

percent.³² By 2007, UP had implemented CIMS across its network. As of 2012, UP's overall average dwell time remains low, and our switching reliability was a record-high 95.2 percent. CIMS is currently playing an important role in helping UP manage the flow of traffic into its Southern Region, where demand for rail service has rapidly increased due to increases in the production of crude oil and natural gas. UP is responding to the growing demand by directing additional resources into the region, and customers have been cooperating with our requests that they control the flow of traffic into the region. UP is continuing to address the operating challenges to meet demand in the Southern Region, and CIMS is one of the tools we depend on to keep operations fluid.³³

Today, UP provides reciprocal switching at some destinations and thus cannot always make full use of CIMS. However, NITL's proposal would likely increase the amount of traffic that flows into UP's yards that UP cannot monitor and control using CIMS. NITL's proposal would thus reduce UP's ability to maintain fluid operations in its yards.

IV. OTHER IMPACTS OF NITL'S PROPOSAL ON THE RAIL NETWORK AND CUSTOMERS.

In its Notice, the Board invited parties to address the issue of pricing for forced reciprocal switching and the use of the 4-year average RSAM benchmark, rather than $R/VC_{\geq 240}$, as the basis for making a conclusive presumption of market dominance, and it also asked parties to quantify

³² See Letter from Jim Young, President & Chief Exec. Officer-UP to Hon. W. Douglas Buttrey, STB Chairman (July 17, 2006), *available at* [http://www.stb.dot.gov/PeakLetters1.nsf/99defb088828bb038525719c0061c528/5b272d6d0d881e9e852571b1004483e0/\\$FILE/UP%20-%20Fall%20Peak%20Planning%202006.pdf](http://www.stb.dot.gov/PeakLetters1.nsf/99defb088828bb038525719c0061c528/5b272d6d0d881e9e852571b1004483e0/$FILE/UP%20-%20Fall%20Peak%20Planning%202006.pdf).

³³ UP's current efforts to address the increased demand for railroad transportation in the Southern Region also illustrates one of the dangers associated with increased reciprocal switching that we describe on page 27: the danger that "surge capacity" resources UP uses to adjust to changes in market conditions or operating incidents would be consumed in addressing changes in transportation patterns brought about by regulatory intervention on behalf of a subset of shippers.

the impacts of NITL’s proposals on shipper rates and railroad revenues. *EP 711 Notice* at 2, 9, 10. We address these issues in the sections below in qualitative terms, after briefly explaining why we cannot answer the Board’s specific questions using “rigorous empirical analyses.” *Id.* at 9. We conclude this Part by addressing the impact of NITL’s proposal on the railroad industry—specifically, the impact on railroads’ ability and incentives to invest in their networks to accommodate the anticipated growth in demand for rail transportation.

A. Ambiguities in NITL’s Proposal, Limitations in the Available Data, and the Impossibility of Predicting Individual Reactions Preclude Quantification of the Impacts of NITL’s Proposal.

UP appreciates the Board’s interest in obtaining quantitative analysis of the impacts of NITL’s proposal. NITL’s proposal has a great potential to do tremendous harm to the railroad industry and customers that rely on rail service, and the Board should not start down a path of major change to regulatory policy without knowing where that path will lead. We believe an accurate analysis of the impacts of NITL’s proposal would show this substantial potential for harm, and we wish there were some way to quantify our concerns with precision. At this point, however, NITL’s proposal is too ill-defined to allow for a quantitative analysis of its impacts.

One significant problem with NITL’s proposal is that NITL’s proposed “conclusive presumptions” cannot be used to identify the scope of potentially affected shippers and traffic. For example, NITL’s presumptions require identification of shipper facilities within “terminals,” but this agency has said that existence and scope of a terminal is ultimately a legal question that requires a fact-specific analysis of each location.³⁴ UP sometimes refers to certain locations as

³⁴ *See, e.g., Midtec*, 3 I.C.C.2d at 179 (“The questions of what is a terminal area and what is switching are factual ones requiring consideration of all the circumstances surrounding a particular case.”).

terminals, but it has never systematically attempted to identify all of the locations on its network that might fit the legal definition of a terminal, much less to define the geographic boundaries of terminals, or to identify the shippers located within those boundaries.

As another example, NITL's presumptions also require identification of situations where the railroad handled 75% of origin-to-destination traffic, but UP cannot practically determine for each potentially affected customer whether customers are using non-rail modes to transport a portion of their traffic.

As a final example, NITL's proposal would not require a railroad to provide forced switching unless "switching is safe and feasible, with no adverse effect on existing service," *EP 711 Notice* at 4, but the consequences of forced switching would vary depending on the location and volume of traffic involved, and the answer would be different at different points in time. For example, if an interchange does have some capacity and one shipper invokes forced switching, the second or third shipper with a similar request may find that there is no more capacity at that location. UP also suspects that NITL and railroads have different views of what qualifies as "feasible" or when additional switching would have "no adverse effect on existing service." Indeed, we suspect these issues would be vigorously litigated by parties in most cases.³⁵

The Board's questions about the potential impacts of NITL's proposal on rail rates and revenues require other information that UP does not have and cannot develop given the current uncertainties regarding NITL's proposal. The impact of NITL's proposal on rates and revenues would depend on access prices. As discussed below, UP believes that access prices should reflect the serving railroad's cost of providing switching, plus its lost contribution to fixed costs.

³⁵ The Association of American Railroads' Opening Comments and Evidence describes a variety of other issues relating to the nature of NITL's proposals and limitations on available data that preclude efforts to quantify with any precision the impact of NITL's proposal.

But even assuming UP's view prevails, both components of the access prices would vary depending on the specific traffic involved and the characteristics of the specific location where the switching takes place, which prevents us from making systemic estimates. Moreover, a shipper's use of forced switching would depend on its willingness to trade slower, less reliable service for lower rates, but we cannot say what trade-offs individual shippers would be willing to make. In fact, even if we knew the access pricing formula, we still could not say how far or even whether rates would fall. The rates that shippers pay would depend not only on the access price, but also on the rates charged by the new line-haul railroads, which would depend on the railroads' assessments of the impact of the new traffic on their networks and other marketing considerations. UP does not have enough information about other railroads to predict the outcome of those assessments.³⁶ In addition, we cannot assess on a systemic basis how much revenue UP would lose to trucks and other modes as a result of deterioration in the level of service we are able to provide shippers that do not use reciprocal switching.

As a result of these issues, UP cannot quantify the impacts of NITL's proposals in the ways the Board has requested. However, we have provided in Part III.A empirical data about factors driving service reliability. And, in the sections below, we discuss in qualitative terms the principles that should apply to access pricing, the impacts of NITL's proposal on rates and service for shippers that cannot invoke forced switching, and the overall impacts of NITL's proposal on railroads' ability and incentives to invest in their networks.

³⁶ Given the many differences among Class I railroads, including differences in their network structures, cost structures, and mix of traffic, we expect that forced switching would not have uniform impacts on railroads, and railroads would not respond to the prospect of additional line-haul traffic in a uniform manner. *Cf. Simplified Standards For Rail Rate Cases*, EP 646 (Sub-No. 1), slip op. at 82-83 (STB served Sept. 5, 2007) (explaining reasons for excluding non-defendant traffic from comparison groups in the Three-Benchmark test).

B. Access Prices Should Encourage Shippers to Invoke Forced Reciprocal Switching Only When More Efficient Service Would Result.

The Board may not simply impose an access price or pricing formula. Rather, the Board must afford the affected railroads the opportunity to agree on “the conditions and compensation applicable” to any forced reciprocal switching arrangement. 49 U.S.C. § 11102(c)(1). This is a critical feature of the statutory framework governing forced access because it potentially allows the railroads to avoid what would likely be a complex proceeding to determine the actual costs associated with forced switching.

If the Board elects to offer guidance regarding the compensation terms it would set if the railroads cannot agree, the guidance should reflect the principle that forced reciprocal switching should be a means of addressing anticompetitive conduct that is reflected in the service provided to a shipper, not a means of reducing railroad rates or restructuring the railroad industry. The appropriate access price for forced switching follows from that principle: the access price should compensate the railroad serving the shipper for (i) the railroad’s loss of contribution to its fixed costs from the shipper’s traffic, and (ii) the railroad’s cost of providing the switching service, including the cost of any new investment needed to provide the service or offset the impacts on other customers.³⁷ If a shipper would prefer alternate service after covering those costs, then it is reasonable to conclude that the market is not performing competitively.

Stated another way, if a shipper could receive a more preferable rate/service combination from an alternate line-haul railroad, while leaving the serving railroad and its other customers no worse off, then a competitive market should produce a voluntary switching arrangement. If the

³⁷ In addition, if a railroad is unable to offset the impacts, it should be compensated for any loss of contribution to its fixed costs from any resulting loss of traffic to competing modes.

market has failed to produce such an arrangement, regulatory intervention may be justified, and the Board's current access rules provide a means for shippers to pursue relief. But if a shipper is simply seeking to impose the costs of its preferences on the serving railroad and that railroad's customers—for example, if it would accept slower, less reliable service in exchange for lower rates, but such service would impair the service provided to other customers—the serving railroad is not acting anti-competitively by refusing to change its operations.

Moreover, if the access price were set at any amount less than the serving railroad's lost contribution plus its cost of providing the switching service, shippers could use forced switching to obtain reduced rates without ever proving that their rates were unreasonable. The agency has long recognized that “in order to recover the substantial joint and common costs of its network, a railroad must be able and permitted to charge different customers different prices based on their different levels of demand for transportation service”—that is, a railroad must be able to engage in “demand-based differential pricing.” *EP 711 Notice* at 7. NITL's proposal to create artificial competition for service to certain shippers that are currently served by only one railroad would alter those shippers' demand for service from the serving carrier, thus undermining the serving railroad's ability to recover the joint and common costs of its network—unless the access price neutralizes the impact of the change in demand. Therefore, the access price must cover the serving railroad's actual cost of providing the switching service, so the serving railroad is not subsidizing the new line-haul railroad, as well as the serving railroad's lost contribution, so the serving railroad's ability to recover its joint and common costs is not impaired. Shippers may

still see rates fall from forced switching, but only when the new line-haul service is actually more efficient than the transportation that was provided by the serving railroad.³⁸

Because access prices should encourage shippers to invoke forced reciprocal switching only when more efficient service would result, access prices must reflect the actual cost of new switching at the location in question, not an estimated or system-average cost. A railroad's cost to provide forced switching, including the cost of offsetting the impact on other customers, would vary depending on local conditions. In some situations, the cost may be no more than that of providing an incremental switch (though the costs of that switching might be higher depending on the actual operations required to interchange traffic between railroads). However, in other situations, the cost may include the cost of new train operations and new construction. As applied to NITL's proposal, the use of system-average cost would not average out over time or across movements: the shippers that use forced switching would be those for whom the system-average cost understates the actual cost—that is, those shippers that are not being required to bear the full cost of their decisions. If forced switching is subsidized, shippers would use it even when the overall costs outweigh the overall benefits.

Subsidized forced switching would drive average costs up for all customers. In addition, by reducing the cash available for capital expenditures and decreasing returns on investment, it would drive down railroads' abilities and incentives to invest in their networks.

³⁸ Of course, the new line-haul railroad would have to set rates for the new service that reflect the incremental costs imposed by the new traffic on its own network, as well as its own business considerations. Thus, we cannot predict ultimate the outcome from the shipper's perspective.

C. The Board Should Not Use the 4-Year Average RSAM Benchmark as the Basis for Market Dominance Presumptions.

UP believes it would be arbitrary and thus unlawful for the Board to adopt a conclusive presumption that a railroad has market dominance over transportation if the railroad's rate for that transportation produces an R/VC ratio that equals or exceeds 240%. The Association of American Railroads addresses in detail the reasons why use of an R/VC threshold would be arbitrary in its comments, and UP recently addressed a similar issue in its comments in *M&G Polymers USA LLC v. CSX Transportation, Inc.*, NOR 42123 (filed Nov. 28, 2012).

Use of the 4-year average RSAM benchmark would make even less sense. There is no rational basis for presuming that effective competition does not exist whenever a rate produces an R/VC ratio that falls above a railroad's RSAM number. A railroad's RSAM number is not a dividing line between traffic that is subject to effective competition and traffic that is not. A railroad's RSAM number results from a mechanical calculation of the system-wide average markup the railroad would need to charge on all of its traffic priced at or above the 180% R/VC level (which the Board correctly calls "*potentially* captive traffic," rather than "captive traffic") in order to achieve revenue adequacy. See *Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1), slip op. at 20 (STB served Sept. 5, 2007). That a railroad charges a rate above or below its RSAM number for a particular movement reveals nothing about the presence or absence of effective competition for that movement.

In fact, a railroad's RSAM number can and will change without any change in competitive circumstances for any particular movement or movements. All else remaining equal, a railroad's RSAM number will:

- fall (or rise) if the rail industry cost of capital falls (or rises);

- fall (or rise) if the amount of traffic the carrier transports with R/VC ratios below 180% increases (or decreases); or
- fall (or rise) if the carrier's operating costs are reduced (or increased).

In short, the drivers of RSAM numbers are system-wide changes in costs, revenue, and traffic mix, and not the competitive circumstances of millions of individual movements.³⁹

In addition, use of RSAM numbers would mean that NITL's proposal would have an unequal impact on different Class I railroads simply because of their differing RSAM numbers, and not because of the competitive circumstances of the movements at issue. For example, UP would be exposed to forced access whenever its rates produce an R/VC ratio of at least 241%, while other railroads would not face the prospect of forced access unless their rates produced R/VC ratios of at least 257% (for BNSF), or 275% (for NS), or 284% (for CSX), or 317% (for KCS), or 320% (for CN), or 343% (CP). *See Simplified Standards for Rail Rate Cases—2011 RSAM and R/VC_{>180} Calculations*, EP 689 (Sub-No. 4), at Table 1 (STB served Feb. 11, 2013). That is an absurd outcome, and it undermines any reliance on RSAM as a measure of market power: there is no reason why the existence of market dominance would turn on the system-wide average markup a particular carrier would need to charge on all its traffic priced at or above the 180% R/VC level in order to achieve revenue adequacy.⁴⁰

³⁹ Moreover, in most cases, the Board will not even have a RSAM figure that reflects the current market environment. The Board cannot publish RSAM numbers for a particular year until well after the year has ended. For example, the Board did not publish the 2011 RSAM numbers until February 21, 2013. Thus, if a shipper were to file a complaint seeking forced access in January 2014, the Board would have to use a RSAM number from 2011 (which would itself be based on an average of RSAM data from 2008 through 2012) to assess the market environment in 2014.

⁴⁰ In addition, use of the 4-year average RSAM benchmark may become even more problematic if the Board adopts some or all of the changes to the Uniform Railroad Costing System proposed in *Review of the General Purpose Costing System*, EP 431 (Sub-No. 4) (STB served Feb. 4, 2013). Although we have not been able to analyze fully the potential impacts of the Board's proposals, it seems possible that they would result in changes that would make new RSAM (continued...)

D. Shippers that Cannot Use Forced Reciprocal Switching Would Experience Service Deterioration.

The Board's Notice identified a potential consequence of NITL's proposal: customers with rates that are constrained by the prospect of regulation under the Board's stand-alone cost constraint but that cannot use forced switching might see higher rates if other shippers use forced switching. *See EP 711 Notice at 7 n.11.* UP believes widespread rate increases would be unlikely, and rate increases would not make up for the contribution that railroads would lose if access prices were set artificially low (*i.e.*, below the levels that would cover lost contribution and the full range of costs railroads would incur to provide the forced switching). UP already has every incentive to price traffic to maximize contribution. In most cases, if UP tried to increase rates, shippers who have alternatives to our rail service, such as trucks or barges or different sources or products, would turn to those alternatives. Other shippers would likely respond to rate increases by reducing their shipments.

But if there are situations in which UP were able to raise rates on some shippers to offset the loss of contribution, there remains the question of what, if any, recourse those shippers might have. NITL's proposal might have other impacts on rate cases. If railroad operating costs rise because of congestion or other inefficiencies caused by forced switching, URCS variable costs would increase. This would raise the jurisdictional threshold, so some movements would no longer qualify for a rate challenge. As another example, if rates fall or traffic shifts to alternate line-haul railroads as a result of NITL's proposal, railroads would be further from revenue adequacy, resulting in a relatively higher ratio of RSAM to $R/VC_{>180}$, and thus a relatively larger upward adjustment to the R/VC_{COMP} ratio for shippers invoking the Three-Benchmark test. The

calculations incompatible with prior calculations, which could preclude use of a 4-year average calculation.

law of unintended consequences would ensure that the outcomes of potential rate complaints for at least some shippers would change.

Ultimately, the most significant impacts of NITL's proposal on shippers that cannot use forced switching would likely be the impacts on their rail service and on competition in markets for the goods they ship or receive. If access prices are set artificially low, shippers that cannot use forced switching or choose not to use forced switching would experience the service-related harms we described above. They would feel the effects of increased network congestion and disruption of existing, efficient transportation plans. Their rail service would be slower and less reliable, and thus their car supply costs and inventory carrying costs would increase. They may be forced to switch to non-rail transportation to meet their own customers' needs. If they compete against shippers whose rates reflect artificially low access prices, they would be left with a competitive disadvantage, and they may need to seek out different markets for their products or exit the industry altogether. In short, the most widely felt impacts of NITL's proposal on shippers that cannot use forced switching would likely be the disruptions to their businesses and the markets for their products.

E. Adoption of NITL's Proposal Would Reduce the Ability and Incentives of Railroads to Make Capital Investments in Their Networks.

The most predictable consequence of adopting NITL's proposal would be the reduction of capital investment in the railroad industry. UP's comments in Ex Parte No. 705 explained how forced access at artificially low rates would reduce the amount of revenue available for investment through a combination of rate compression and higher operating costs, how UP's shareholders would react to the prospect of diminished returns by insisting on reductions in capital expenditures, and how uncertainty about returns on individual projects would also discourage investment. All of these concerns apply to NITL's proposal.

NITL's proposal is especially troubling because its adoption would increase the need for capital spending while eliminating means for making, and the incentives that usually drive, capital investment. In other words, unless access prices cover the costs of any necessary investments, including generating an appropriate return, NITL's proposal would place railroads in a position where they were being asked to invest in yards and other facilities to support switching of traffic to their competitors at prices that would not justify the investment.⁴¹ UP would have little or no incentive to invest in these circumstances. It would be expending capital while losing line-haul revenue. From a public policy perspective, such construction would also be a monumental waste of resources—even more so because the alternate service would be less efficient than UP's single-line service.⁴² Similar issues would arise everywhere a requirement to perform forced switching would consume railroad capacity. Also, unless access prices are set correctly, UP would be investing less overall, not more, because it would be earning less revenue, and ultimately less return, overall.

Moreover, the prospect that shippers could invoke forced switching would discourage investment in new capacity by increasing uncertainty about whether investments would generate adequate returns. UP might be willing to invest to support projected traffic growth if it knows it would handle the line-haul, but not if there is a chance that it would be forced to switch the traffic to a competitor. All investments that are made in expectation of projected traffic growth come with a risk that the expectation may not be fulfilled, but the prospect that shippers could

⁴¹ Moreover, the cost of any incremental investment would have to be paid by the other railroad or the shipper before the investment was made. Otherwise, if the traffic never moves, or never moves in the anticipated volumes, the railroad making the investment would never recover its investment.

⁴² UP believes that serious constitutional issues would arise if the Board tried to order a railroad to invest in facilities to provide forced switching at artificially low prices.

invoke forced switching would be a significant new type of risk. That is, NITL's proposal adds to the usual market-related risk that projected growth may not materialize. It creates the risk that growth occurs as expected, but the traffic moves over a different haul carrier. Even worse, it creates the risk that the railroad that invests to handle the traffic might be forced to use those investments to subsidize service provided by a competitor.

The Board's Notice touches on an important aspect of the capital investment issue when it suggests that rate reductions resulting from NITL's proposal might generate increased traffic volumes that would offset revenue losses. *EP 711 Notice* at 9. In reality, UP expects that adoption of NITL's proposal would result in traffic losses that exceed the amount of traffic lost directly to forced switching. As discussed above, forced switching would degrade service to all customers, and customers that are currently satisfied with their rates and service would seek alternatives to rail as their service becomes slower and less reliable. Thus, any hypothetical traffic gains would have to offset the loss of traffic to other modes before they could begin to make a dent in the revenue losses caused more directly by forced switching. That prospect is unlikely because any traffic gains presumably would come from traffic moving at low rates reflecting artificial competition. Therefore, any traffic "gains" would not reverse the loss of contribution and resulting reduction of earnings.

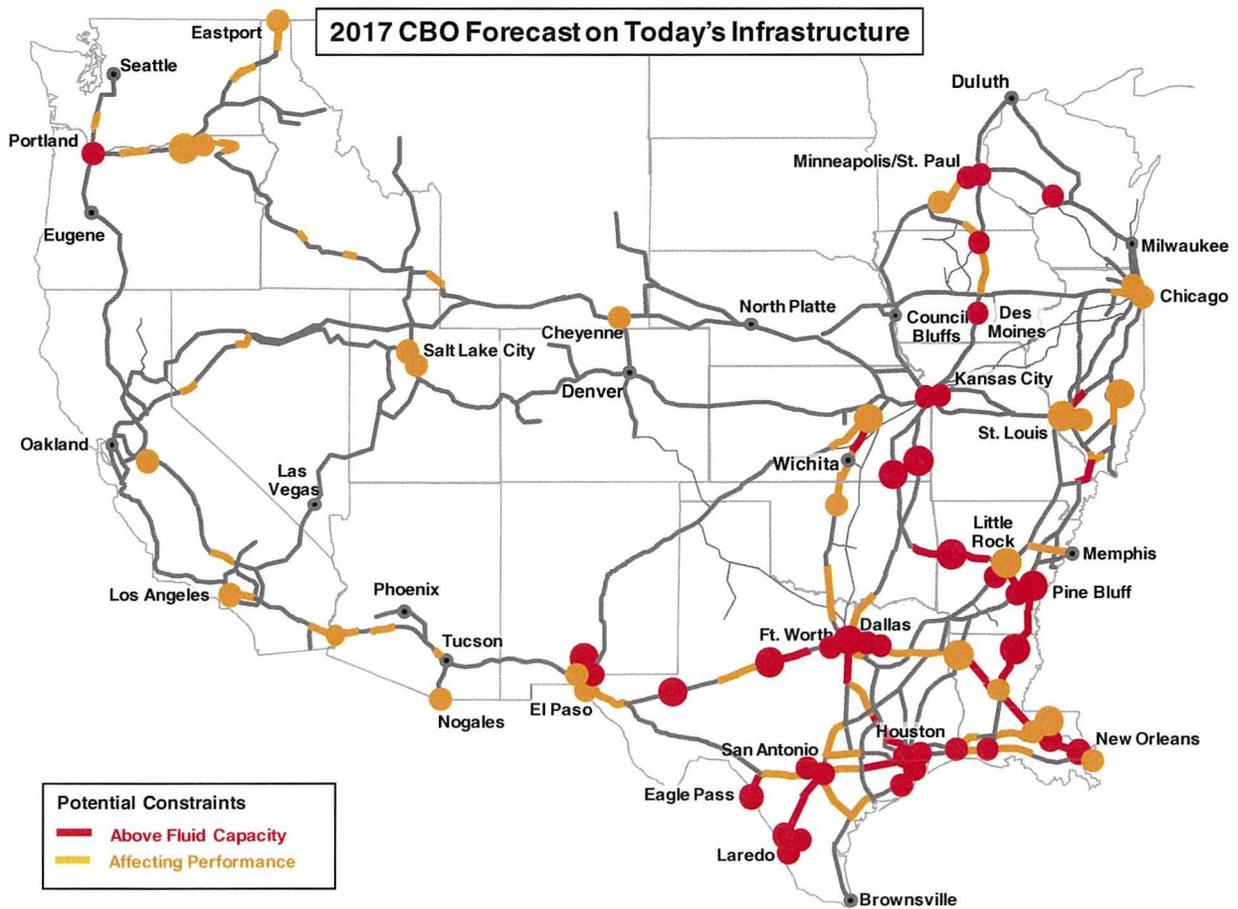
Because forced switching would increase congestion in rail yards, additional capacity would likely be required to accommodate increases in rail traffic. UP, however, would have little incentive to invest in new facilities to attract such traffic for the reasons discussed above: the new traffic would be moving at low rates reflecting artificial competition, and it would presumably be subject to forced switching, creating the risk that UP's investment might be wasted. Moreover, if the new traffic is moving at artificially low rates, UP would have less

incentive to invest in new facilities, and it would have less cash available to make those investments.

The prospect that NITL's proposals would increase congestion in UP's rail yards while depriving UP of revenue it would need to add capacity is particularly troubling in light of UP's potential capacity needs, particularly in terminals, as rail traffic continues to grow over the next five years. UP regularly engages in planning exercises to understand the areas of its network that will experience capacity constraints given potential traffic growth. The map in Figure 13 shows UP's capacity outlook for 2017—that is, the impact of potential 2017 volumes on UP's network given today's infrastructure, assuming traffic grows at rates generally consistent with projections for the U.S. economy recently released by the Congressional Budget Office.⁴³ The map shows that many terminals in UP's North-South Corridor would be above the upper limit of their fluid capacity range, and that other terminals, primarily along UP's Sunset Route, but also on its Central Corridor, would see performance suffer.

⁴³ See Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2013 to 2023* (Feb. 2013), available at <http://www.cbo.gov/sites/default/files/cbofiles/attachments/43907-BudgetOutlook.pdf>.

Figure 13: Potential Capacity Constraints



UP will need to continue to invest in the network to keep its performance strong as traffic volumes grow. But NITL’s proposal would increase the amount of capacity UP needs to handle existing traffic levels while depriving it of the revenue needed to accommodate market-based growth in demand for rail transportation.

In sum, the reduction in railroad revenue and the increase in uncertainty that would accompany NITL’s proposal would undermine the ability and incentives of railroads to invest in their networks. Any investments that would be needed to accommodate forced switching, including investments to restore excess capacity that railroads eliminated as they merged and developed more efficient transportation plans, would be subsidizing inefficient operations. No railroad would make such investments voluntarily, especially when they face a real need to

expand capacity to accommodate market-driven growth. As we explained in Ex Parte No. 705, our shareholders will require us to reduce capital spending if we are required by new regulations to incur more costs while earning less revenue. Capital flows to returns, and if railroads' returns are constrained by regulatory restructuring, capital will flow away from railroads to other firms that offer market returns.

V. CONCLUSION

UP appreciates the Board's desire to understand the potential consequences of NITL's proposal. UP cannot quantify the consequences with precision, but UP believes they are clear: the direct result could be widespread, severe service problems that would affect not just those shippers that choose to use forced switching, but all users of the rail network. Moreover, forcing railroads to increase the amount of reciprocal switching they provide would undermine our past accomplishments at making rail service more safe, efficient, and reliable, as well as our ability to invest to meet the growing demand for rail transportation. NITL's proposal is not in the public interest, and it does not merit further consideration by the Board.

Respectfully submitted,

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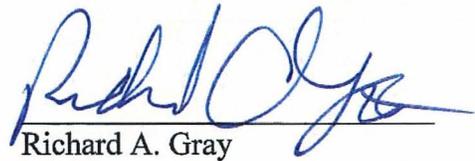
March 1, 2013

VERIFICATIONS

VERIFICATION

I, Richard A. Gray, General Director, Asset Planning for Union Pacific Railroad Company's Network Planning and Operations Department, declare under penalty of perjury that I have read the foregoing Opening Comments and Evidence of Union Pacific Railroad Company and that the facts and information relating to Union Pacific's operations that are set forth in Figures 2 and 4 in Part II, Part III, and Figure 13 in Part IV are true and correct, to the best of my knowledge, information, and belief. Further, I certify that I am qualified and authorized to file this Verification.

Executed on March 1, 2013.


Richard A. Gray

VERIFICATION

I, Jeffrey S. Meyer, General Director, Measurement and Evaluation for Union Pacific Railroad Company's Network Planning and Operations Department, declare under penalty of perjury that I have read the foregoing Opening Comments and Evidence of Union Pacific Railroad Company and that the facts and information relating to Union Pacific's performance metrics that are set forth in Figure 3 in Part II, Figures 5, 6, and 7 in Part III, and the loss of velocity metrics in Part III are true and correct. Further, I certify that I am qualified and authorized to file this Verification.

Executed on March 1, 2013.



Jeffrey S. Meyer

ADDENDUM

BEFORE THE
SURFACE TRANSPORTATION BOARD



Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

COMMENTS OF UNION PACIFIC RAILROAD COMPANY

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April 12, 2011

Contains Color Images

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

COMMENTS OF UNION PACIFIC RAILROAD COMPANY

Union Pacific Railroad Company offers these comments in response to the Surface Transportation Board's Notice served January 11, 2011, in this proceeding.¹ Union Pacific urges readers to review the accompanying verified statements of James R. Young, Chairman, President, and Chief Executive Officer of Union Pacific Corporation and Union Pacific Railroad Company, and Lance M. Fritz, Executive Vice President - Operations for Union Pacific Railroad Company. Union Pacific also endorses the comments submitted by the Association of American Railroads.

Part I of these comments introduces the critical issues raised by the prospect of regulatory change that would give shippers control over access to Union Pacific's assets and the ability to override Union Pacific's transportation plans. Part II summarizes the testimony of Union Pacific's witnesses, who describe (a) how the Staggers Act and the regulatory policies that followed produced increased investment and higher levels of service for shippers, and (b) how changing the Board's competition policies would undermine those accomplishments, reducing

¹ In a decision served February 4, 2011, the Board extended the procedural schedule established by the Notice.

investment and driving down service levels. Part III addresses whether consolidation of the rail industry provides any reason to change the Board's competition policies.

I. INTRODUCTION

Union Pacific opposes any change to the competition policies that have made possible the railroad industry's remarkable recovery and resurgence since Congress enacted the Staggers Act in 1980. The policies adopted by the Interstate Commerce Commission and the Board have benefited shippers, railroads, and the public. Following Congress's direction, the ICC and the Board freed railroads to respond to market forces and become stronger, more agile competitors while protecting shippers against abuse of market power. Importantly, the agencies permitted railroads to discontinue inefficient routes and interchanges, allowing them to increase traffic density, which in turn drives efficiency, service, and investment. The resulting transformation of the U.S. railroad industry proves the wisdom of that approach.

Union Pacific has never run a safer or more efficient network than it does today. In 2010, our reportable personal injury and rail equipment incident rates were at record low levels, and our Service Delivery Index and Customer Satisfaction Index were at record high levels.

Union Pacific achieved these results by investing billions of dollars in our network since the Staggers Act, including almost \$30 billion since 1999. These were market-driven investments, made in response to shipper demands for more and better rail service. We built our network and designed our transportation plans to route traffic via the most efficient routes, with the fewest interruptions. We were able to invest in such a network because our shareholders and capital markets believed that we would be allowed the opportunity to earn market-based returns. As we invested, our performance improved, our revenues increased, and we were able to invest even more in our network.

Our work is not done. We must continue investing if we are to meet customer expectations as traffic volumes rise. Our 2011 capital budget of \$3.2 billion is the largest in our history. Union Pacific has publicly told investors to expect us to expand capital investment to keep pace with revenues in coming years, unless the rules governing our industry change.

If the Board were to adopt rules imposing reciprocal switching or trackage rights arrangements on railroads (“forced access”) or rules requiring railroads to interchange traffic at points designated by shippers (“forced interchange”), we would curtail investments in our network. We would have less revenue to invest, and our shareholders would demand that we cut our capital budgets. Moreover, forced access and forced interchange are not just regulatory theories; they would change how rail cars move and wreck efficient networks. If shippers could require us to use inefficient routes and interchange points, our past investments would become less productive, and service would be disrupted, with the potential for serious service meltdowns. While regulatory changes favored by a small group of shippers might produce lower rates for those shippers, the ultimate effect would be to harm all rail shippers. As Mr. Young explains, the Board “has little margin for error here.” Young V.S. at 4.

II. UNION PACIFIC’S EXPERIENCE SHOWS THAT THE STAGGERS ACT IS A PUBLIC POLICY SUCCESS, BUT REGULATORY CHANGE COULD DISMANTLE OUR ACHIEVEMENTS.

Union Pacific is proving that the Staggers Act is a public policy success, despite service difficulties we experienced at earlier points. The statements of Messrs. Young and Fritz explain how the Staggers Act and the Board’s current access policies have been essential foundations for the best-ever levels of safety and service we are now providing, and how changing those policies would put safety and service at risk. We summarize their testimony below.

A. The Impact of Access Policies on Union Pacific's Financial Condition and Capital Investments (Mr. Young's Verified Statement)

The Staggers Act granted railroads the freedom and flexibility to rationalize their networks and improve their economic condition. As Mr. Young explains, Union Pacific was able to invest to improve service “because our shareholders and the capital markets believed we would have the opportunity to earn market-based returns.” *Young V.S.* at 8.

As Union Pacific's earnings increased after the Staggers Act, the company invested more in its network, and it ramped up investments in recent years. Between 1999 and 2010, the railroad devoted approximately \$30 billion to capital expenditures, with investment levels generally tracking freight revenue trends. *See id.* Union Pacific plans to invest a record \$3.2 billion in 2011 to renew current assets, improve service, and accommodate growth. *See id.* at 9. It also plans to invest in coming years at 17 to 18 percent of revenues, “the economy and regulation permitting.” *Id.* at 10.

However, if the Board “changes the regulatory landscape in a way that curtails Union Pacific's opportunity to earn market-based rates of return on investment, we will reduce our capital investments.” *Id.* at 4. As Mr. Young explains, proposals to change the Board's access policies are designed to reduce rail revenues. This will roil investors: “If the Board signals that it is no longer committed to allowing railroads to operate under market conditions, our shareholders will demand that we curtail capital investment.” *Id.* at 3. If investors do not see the prospect of market-based returns from rail investments, they will take their investment dollars elsewhere. “Investors withdrew private investment in the past, due to ill-advised regulation, and they will again.” *Id.* at 4.

Moreover, routing uncertainty would undermine our ability to invest. Forced access and forced interchange would make it “increasingly difficult to predict which lines, yards,

and interchanges will be used in the future and therefore should be investment priorities.” *Id.* at 15. “[I]f shippers can decide to move traffic to less efficient routes that they may use only briefly or for which they will pay only artificially low access fees, we cannot justify investing.” *Id.* at 14. We would also have “little or no incentive to invest in an asset that a competitor can use at a regulated, bargain price.” *Id.*

B. The Impact of Access Policies on Union Pacific’s Safety and Service (Mr. Fritz’s Verified Statement)

The limited access policies put in place to carry out the Staggers Act allowed Union Pacific to tailor its capital investments and transportation plans to develop better, more efficient, and safer services. Mr. Fritz describes how Union Pacific achieved our best-ever safety and service results by aligning “our capital spending with our basic operating strategy of concentrating traffic where possible on higher-capacity, higher-density corridors.” Fritz V.S. at 5. He explains that the Board’s existing access rules played a critical role by allowing us to “coordinat[e] our investment and transportation plans,” which “improved the efficiency and predictability of our network.” *Id.* at 4. This allowed us to maximize efficiency and minimize transit times and to take advantage of “single-line service benefits,” benefits the Board has repeatedly recognized. *Id.*² Mr. Fritz also provides examples of the extensive capital investments we have made to improve service and safety, and the additional investments we plan to make if the regulatory environment does not change in a way that reduces investment incentives and threatens our ability to provide efficient service. *See id.*, Appendices A & B.

The regulatory changes some shippers interests have proposed present such a threat. Mr. Fritz states that “[f]orced access and forced interchange are fundamentally

² See the cases cited below on page 9.

incompatible with reliable service and improving safety on our network.” *Id.* at 17. As he explains:

“Shipper-dictated access and interchange decisions would disrupt operations on our lines and in terminals. They would force traffic over facilities that were not designed to handle the business and reduce the productivity of the ones in which we have invested. The immediate result could be a service meltdown in major terminals.” *Id.* at 17-18. As we learned during the service crisis following the Southern Pacific merger, and “as we saw again in the traffic surge in the middle of the last decade, problems on one part of the railroad network quickly spread to the rest of the network.” *Id.* at 18.

Even if we avoid short-term service collapse, “forced access and forced interchange would make our entire network less efficient because traffic would be diverted from the most efficient routes, reducing densities on those routes and thus unraveling the efficiencies that Union Pacific has built over decades.” *Id.* at 24. Such measures “would also undermine our past and future capital investments.” *Id.* at 26. They “would require us to spend more to provide the same level of service, would strand investments that we previously made based on expectations that traffic flows would follow efficiency principles, not regulatory principles, and would make future investments more risky, and therefore less likely.” *Id.*

III. CONSOLIDATION IN THE CLASS I RAILROAD SECTOR DOES NOT PROVIDE A REASON TO CHANGE THE BOARD’S ACCESS POLICIES.

Union Pacific strongly disagrees with the suggestion in the Board’s Notice that changes to access policies might be justified because of “increased consolidation in the Class I railroad sector.” Notice at 3. In fact, rail mergers have increased competition. They provide no reason to explore “possible policy alternatives to facilitate more competition.” *Id.* at 1.

Those who lament the decline in the number of Class I railroads since 1980 wrongly equate the number of railroads with the strength of competition.³ The ICC made the same mistake in the pre-Staggers Act era. As a result, the rail industry was highly balkanized in that period. Multiple railroads were often needed to move traffic from origin to destination, with each interchange adding costs and delay. When railroads were allowed to consolidate, neither they nor shippers could benefit from most efficiencies associated with single-line service because the ICC imposed conditions on mergers that prohibited the new carrier from offering reduced rates or improved service that would result in the “commercial closing” of interline routes or gateways. *See Traffic Protective Conditions*, 366 I.C.C. 112, 112-13 (1982). The ICC was concerned that if shippers flocked to the more attractive service offerings, “competition would be reduced.” *Id.* at 113. As a result, railroads declined and went bankrupt.

Post-Staggers Act rail mergers helped transform a balkanized industry into efficient rail systems that compete vigorously against other modes and against each other. Thousands of shippers enthusiastically supported these mergers, recognizing that they would enhance competition by creating more single-line service, shorter routes, shorter transit times, lower costs, and many other efficiencies.⁴ The ICC and the Board repeatedly acknowledged these pro-competitive features of rail mergers in their decisions approving the transactions. *See,*

³ As the Association of American Railroads observes in its Comments, those who play this numbers game typically ignore the actual number of pre-Staggers Act solvent, independent railroads with revenues that are comparable to today’s Class I railroads. Many of the Class I railroads in 1980 were subsidiaries of others. *See AAR Comments* at 19 n.20.

⁴ Some mergers even created entirely new rail-to-rail competition, as well as enhancing the ability of the merged carriers to compete against others. For example, Union Pacific’s merger with Southern Pacific created new rail-to-rail competition in the Seattle-Los Angeles “I-5 Corridor” through a settlement that gave BNSF Railway a single-line route that it could use to compete with the new Union Pacific. *See Union Pacific/Southern Pacific Merger*, 1 S.T.B. 233, 564-65 (1996).

e.g., *CSX Corp. et al. – Control – Conrail Inc. et al.*, 3 S.T.B. 196, 333-38 (1998); *Union Pacific/Southern Pacific Merger*, 1 S.T.B. 233, 375-84, 564-69 (1996); *Burlington Northern et al. – Merger – Santa Fe Pacific et al.*, 10 I.C.C.2d 661, 733-38, 740-42 (1995). In fact, in every merger involving Union Pacific since 1980, the ICC or Board emphasized the benefits of single-line service and expected us to achieve them. *See Union Pacific – Control – Missouri Pacific; Western Pacific*, 366 I.C.C. 459, 489-93 (1982); *Union Pacific Corp. et al. – Control – MO-KS-TX R. Co. et al.*, 4 I.C.C.2d 409, 430-31 (1988); *Union Pacific Corp., Union Pacific R.R. & Missouri Pacific R.R. – Control – Chicago & North Western Transp. Co. and Chicago & North Western Ry.*, Finance Docket No. 32133, Decision No. 25 (ICC served Mar. 7, 1995) at 66-68; *Union Pacific/Southern Pacific Merger*, 1 S.T.B. at 381, 564-65. For three decades, Union Pacific has invested its capital to achieve the single-line-service benefits that the ICC and this Board (and a wide range of shippers) sought; forced access and forced interchange are the enemies of single-line service and represent an entirely different and very damaging public policy.

The ICC and the Board carefully reviewed each merger and, where necessary, imposed conditions to ensure that no shipper would lose the benefit of rail-to-rail competition. *See Central Power & Light Co. v. S. Pac. Transp. Co.*, 1 S.T.B. 1059, 1071 n.18 (1986). Also, the Board has engaged in active oversight of recent Class I rail mergers and has acknowledged the pro-competitive outcomes of those mergers in its oversight decisions. *See, e.g., Union Pacific/Southern Pacific Merger*, Finance Docket No. 32760 (Sub-No. 21), Decision No. 21

(STB served Dec. 20, 2001) at 3-5.⁵ Rail mergers present no reason for the Board to reconsider its access policies.

IV. CONCLUSION

The Board's competition policies have allowed Union Pacific to invest the billions of dollars needed to provide safe and efficient rail service. Changing those policies would undermine our past accomplishments and future ability to invest, placing safety and service at risk.

Respectfully submitted,

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⁵ Independent studies have validated these pro-competitive benefits. *See, e.g.,* Denis A. Breen, *The Union Pacific/Southern Pacific Rail Merger: A Retrospective on Merger Benefits*, Review of Network Economics, Sept. 2004, at 283.

YOUNG

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

VERIFIED STATEMENT
OF
JAMES R. YOUNG

VERIFIED STATEMENT

OF

JAMES R. YOUNG

My name is Jim Young. I am Chairman, President, and Chief Executive Officer of Union Pacific Corporation and Union Pacific Railroad Company. I started my railroad career with Union Pacific in 1978. Before assuming my present positions, I held a variety of management positions, including Vice President – Re-engineering and Design and Vice President – Customer Service Planning and Quality of Union Pacific Railroad, and Chief Financial Officer of Union Pacific Corporation.

I witnessed first-hand how the regulatory reforms of the Staggers Rail Act freed Union Pacific and other railroads to respond to the marketplace as other companies do and provided incentives for railroads to invest in their networks. Union Pacific is using those freedoms well to serve our customers and to enhance the nation’s transport infrastructure. With improving revenues, Union Pacific has invested nearly \$30 billion in its rail network since 1999, helping us provide value to our customers in recent years with the best service in memory. If the Surface Transportation Board turns back the clock by layering new regulation on the rail industry, our investments and our accomplishments for customers will be in jeopardy. The “access” measures now under consideration would reduce rail investment and cripple the efficiency, service, and safety gains that regulatory reform delivered.

OVERVIEW

This proceeding raises the question whether regulatory reform should be reversed because it is succeeding. Railroads are emerging as the vigorous competitors Congress hoped

for when it passed the Staggers Act 30 years ago, and rail competition is stronger than ever. Union Pacific is a prime example. Lance Fritz, Union Pacific's Executive Vice President – Operations, explains in his statement that in the post-Staggers Act period Union Pacific greatly improved its network and today provides record levels of customer service and safety. In the past two years alone, we invested approximately \$5 billion — despite the worst recession in 80 years — to improve and expand our network and service. This year we intend to invest well over \$3 billion — a record — to further improve safety, productivity, and customer service, as well as to expand our network for traffic growth.

In the current regulatory environment, the rail industry has blossomed, moving from the depths of the pre-Staggers Act era to provide vibrant competition and a critical contribution to our nation's economic growth today. Board regulations provide effective remedies for shippers that believe their rates are too high or that a railroad is engaging in competitive abuses. This regulatory regime has been a tremendous success for shippers, railroad employees, and the public. We should not forget that most rail rates remain well below inflation-adjusted rates from 1980.

Apparently some believe, however, that instead of celebrating this public policy success, regulators should dismantle the achievement. The Board is now considering whether to change the rules to permit solely-served shippers to insist that a second railroad access their facilities (“forced access”) or to dictate interchange of their traffic where they choose (“forced interchange”). The goal of those who advocate forced access and interchange is to reduce rates and transfer revenue from railroads to certain shippers.

If the Board signals that it is no longer committed to allowing railroads to operate under market conditions, our shareholders will demand that we curtail capital investment. As

Union Pacific has explained many times, while the Board has regulatory powers over railroads, it has no ability to govern the behavior of the financial markets. The financial markets will withdraw capital from the railroad industry if the government decides to artificially suppress rail revenues. The markets would also increase our cost of capital in terms of both higher borrowing costs and higher required equity returns.

We understand why shippers, reasonably enough, prefer lower prices (although many choose better service over lower rates). Most shippers may not understand, however, that these potential regulatory changes could devastate the rail network by imposing inefficient operations on rail carriers and degrading service to all shippers. The proposals would reduce our ability to invest and would make many investments uneconomic.

The Board has little margin for error here. If it changes the regulatory landscape in a way that curtails Union Pacific's opportunity to earn market-based rates of return on investment, we will reduce our capital investments. We are prepared to curtail investment this year, depending on the outcome of this proceeding. I do not say that to be belligerent or provocative. We will have no choice. Investors withdrew private investment in the past, due to ill-advised regulation, and they will again. That is the central message of the pre-Staggers Act era, and it remains true today.

Union Pacific is equally concerned about the effects of access regulation on network efficiency and customer service. Like other railroads, Union Pacific spent tens of billions to create a rail network out of its component railroads, a network designed to maximize efficient rail operations and customer service. If regulators or shippers can decide that traffic should move over different routes and interchanges, without regard to network efficiency or where we invested, rail service could be crippled. Shifting traffic to routes and facilities where

we have not invested could overwhelm infrastructure that was never designed for those volumes and strand investments we made to provide better service.

At Union Pacific, we know from hard experience what happens when traffic volume outstrips infrastructure, creating service meltdowns. The types of new access regulation the Board is now contemplating would splinter traffic densities that are essential foundations for high levels of customer service and could cause meltdowns in major terminals like Houston. Mr. Fritz describes these dangers in his statement.

As implemented by the Interstate Commerce Commission and the Board over the past 30 years, the Staggers Act has been a great success, providing a regulatory framework that allowed railroads to transform themselves into efficient, robust competitors. Now more than ever, as our country gradually emerges from a severe recession, we need strong, efficient railroads to keep economic recovery going. The Federal Railroad Administration recently concluded that freight railroad performance contributes importantly to U.S. competitiveness in a global economy.¹ It makes no sense to impose new regulation that will reduce incentives for rail investment. The Board must avoid adopting measures that would take us in the opposite direction from the one that has worked spectacularly well for three decades.

In the remainder of this statement, I will discuss the remarkable success of the Staggers Act and how proposals for forced access and forced interchange would reduce rail investment and hurt customer service. I will also explain why there is no justification for the Board to change course and open the railroad to new access.

¹ U.S. Dept. of Transportation, Federal Railroad Administration, National Rail Plan: Moving Forward 14 (Sept. 2010) (“National Rail Plan”).

I. THE POST-STAGGERS ACT REGULATORY REGIME IS A SUCCESS

A. Staggers Act Reforms Transformed Railroading and Gave Us the Opportunity to Grow Revenues and Investments

The Board must not lose sight of history's teachings. When I entered the railroad business in 1978, the rail industry was stagnant and mired in oppressive regulation. Railroads had little ability to respond to market conditions. Restrictive rules and misguided policies forced railroads to keep all routes open, with little ability to rationalize operations and consolidate traffic on more efficient routes. The result was a balkanized rail network, with the government propping up inefficient operations on marginal routes and over unnecessary interchanges — an outcome some propose to reinstate here.

Railroads could not earn adequate returns, and they therefore had little ability or incentive to invest in their networks. They deferred spending on infrastructure, causing even important rail lines to deteriorate. For example, Union Pacific's primary connection to Chicago, the Chicago & North Western, fell into disrepair, with one of the two tracks to Chicago under slow orders and the other surviving only on federal money. Union Pacific's Board of Directors saw little promise for the railroad business, given inadequate earnings and too much regulation. The Board of Directors also feared that the government might take over Union Pacific, just as it would soon assume responsibility for passenger service and most northeastern freight railroads. Reflecting that pessimism, Union Pacific's management created a holding company in 1969 so that it could invest in profitable non-railroad businesses, such as natural resources, without fear of nationalization. Even at Union Pacific, America's healthiest railroad at the time, money flowed out of railroading and into more promising ventures.

The Staggers Act and the regulatory regime that followed transformed the industry. Importantly, railroads gained the ability to rationalize their networks by abandoning

under-used track, eliminating inefficient routes, extending single-line movements, and consolidating traffic to produce higher densities and more efficient service. Railroads also gained rate flexibility, so they could price to meet competition. Contract rates took the place of general rate increase proceedings and rates set through rate bureaus. The regulatory environment under the Staggers Act recognized that railroads must price their services on the basis of demand if they are to make the expensive, private investments that railroading needed.

Our own experience echoed the industry's. Union Pacific rationalized its network, eliminated inefficient routes and interchanges, improved its infrastructure, and added capacity, allowing us to provide more valuable and efficient service. Lance Fritz's verified statement discusses some of these investments and improvements. Many of our investments and enhancements implemented the consolidations that the ICC and the Board approved and provided the predicted public benefits of those consolidations.² Beginning in 1982, we:

- integrated Union Pacific with Missouri Pacific and rebuilt the deteriorating Western Pacific;
- bankrolled CNW's build-in to the Southern Powder River Basin;
- rebuilt much of the Missouri-Kansas-Texas, which otherwise would have failed;
- acquired CNW and rebuilt its line to Chicago, as well as Iowa grain lines that CNW might have abandoned;

² The rhetoric in Washington about mergers reducing competition ignores the enormous benefits of the consolidations for shippers. Without mergers, for example, Southern Pacific, M-K-T, and probably CNW would have gone bankrupt and could not have afforded to rebuild their systems. No shipper lost competitive service as a result of the Union Pacific mergers, and the merged system is more competitive against trucks and BNSF. Mergers created new competition in the I-5 Corridor on the West Coast and for new shippers on over 4,000 miles of UP rail lines. The resulting Union Pacific provides better service, safer operations, and more technology than its components could have.

- added vast amounts of capacity to Union Pacific lines across Nebraska and Kansas, installing a 108-mile triple-track on the world's busiest freight corridor; and
- integrated our system with the Southern Pacific, upgrading its infrastructure and offering shippers more efficient single-line routes and other service improvements.

We were able to make these investments because our shareholders and the capital markets believed we would have the opportunity to earn market-based returns.

As our service improved, we attracted more business. Once Union Pacific's parent company began to see a good prospect of earning a competitive return from rail operations, it gradually spun off the non-transportation businesses it had turned to in the pre-Staggers Act period and refocused its attention on the railroad.

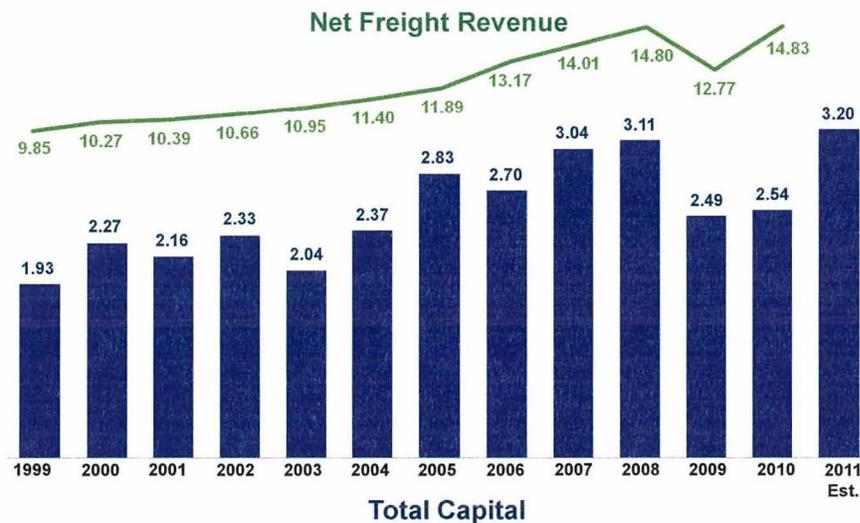
B. Our Improved Financial Condition Allows Us to Increase Capital Expenditures

Union Pacific's financial situation has improved gradually, but even now it is still not where it needs to be. The Board's measure of revenue adequacy is based on book value, and fails to account for the high replacement costs we must pay every day. Even using the Board's measure, however, Union Pacific's return on investment reached the cost of capital in only one year, 1995. Nevertheless, as our earnings increased in the post-Staggers Act period, we invested more in our system. We have continued to make large capital investments in our network, spending not only to restore and replace our system, but also to add new capacity (both track and equipment) to improve service and accommodate traffic growth.

As shown in the chart below, between 1999 and 2010 Union Pacific devoted approximately \$30 billion to capital expenditures, with investment levels generally tracking freight revenue. This figure included nearly \$10.3 billion in expansion capital (capital investments that increase Union Pacific's line or terminal capacity). Our total capital

expenditures for this period consumed 18 percent of our revenue (or 21 percent of revenue net of fuel surcharges). By comparison, the average U.S. manufacturer devoted about 3 percent of revenue to capital spending.

**UP Capital Commitments vs. Net Freight Revenue
(Includes Long-Term Leases and PTC Investments)
In Billions**



From 1999 to 2008, our capital expenditures grew by 63 percent, reaching a high of \$3.1 billion in 2008. When the recession pummeled carloadings and our earnings fell, we pulled back on investment. It was prudent to preserve liquidity when there was widespread concern about the possibility of a double-dip recession. There was also no need to spend as much when, at the bottom of the recession, Union Pacific had as many as 2,100 locomotives and 71,000 freight cars in storage and enough line and terminal capacity to accommodate at least 50,000 more carloadings per week. Our capital spending remained robust, though, at around \$2.5 billion annually during 2009 and 2010. As carloadings return and revenues grow, we plan to invest a record \$3.2 billion in 2011. We have publicly told the investment community that we expect to continue to spend 17 to 18 percent of our growing revenues on capital investments for

the next several years, the economy and regulation permitting. In other words, we expect capital spending to keep pace with revenues.

Mr. Fritz's statement describes many of the capital projects we undertook in recent years to increase efficiency and improve service for our customers — projects we could fund because of growing revenues. We continue to identify new capital projects that will increase productivity, allow us to provide quality service for our customers, and expand our offerings. In addition, as Mr. Fritz's statement describes, we developed transportation plans and implemented new management processes to maximize productive use of our resources, reduce interruptions to shipments, and otherwise improve the value we bring to our customers.

These investments and improvements have paid off in important ways for our customers, our employees, and our investors. Mr. Fritz's statement describes the many ways in which the railroad's performance has improved in recent years, resulting in better service for our customers and higher levels of safety for our employees. In 2009 and 2010, we achieved all-time highs in our service delivery index (which measures the overall quality of our service), as well as record velocity levels, record reliability, reduced slow orders, and other service "bests." Our work force also set records for employee safety in 2009 and again in 2010.

I see the results of our capital investments and our other efforts to improve service in the high levels of customer satisfaction ratings we received in recent years. Our ratings on customer satisfaction surveys have risen to the highest level we have seen since we began conducting the surveys 20 years ago. In addition, when I speak with our customers one-on-one, they tell me how pleased they are with our performance and that our service levels have persuaded them to give us more business. Many focus on the additional value we provide because our service reduces their logistics costs or allows them to reach new markets or

suppliers. For me, this is the best evidence of how far we have come under the post-Staggers Act regulatory framework. But we cannot let our customers down again.

II. FORCED ACCESS AND FORCED INTERCHANGE WOULD REDUCE INVESTMENT AND SERVICE

Shipper groups calling for changes to the regulatory framework likely do not understand the consequences. Granting solely-served shippers the right to require a railroad to provide reciprocal switching and terminal trackage rights or to dictate interchange points would move the industry backward, both by artificially reducing rail revenues and by damaging efficient service. The Staggers Act allowed railroads to stop behaving inefficiently, but some want to turn the clock back to an era of poor service and poor performance.

A. Reduced Revenues Will Reduce Capital Investment

When I visit our customers, they applaud our capital investments and urge us to make sure that we will have capacity for their shipments in the future. To do this, we must first invest huge amounts of capital just to replace our existing assets. We constantly replace and upgrade rail, ties, bridges, and yard facilities and acquire or overhaul locomotives and cars. As Mr. Fritz's statement describes, we also have ambitious plans to handle anticipated traffic growth and provide additional value to customers. If the Board were to adopt broad forced access and forced interchange measures of the sort some shippers want, though, Union Pacific would reduce investment and would have much less incentive to invest in the future.

1. Expanded Regulation Would Reduce Rail Revenues

Advocates of forced access and interchange want the Board to change the rules so that Union Pacific and other railroads earn less. The result would be to leave us with less to invest in rail infrastructure. The purpose behind any forced access or forced interchange proposal is for solely-served shippers to pay less to move goods. Shippers advocating those

changes hope to reduce their rates, either by negotiating lower rates due to government-imposed “competition” or by bringing rate cases against “bottleneck” rates and obtaining rate prescriptions more favorable than they could obtain by challenging through rates. Another crucial ingredient of government-created “competition” is access fees set at artificially low levels, further depleting rail revenues. Without below-market access pricing, the artificial competition would not generate a large enough revenue transfer to satisfy proponents.

Meanwhile, railroad costs would increase, further depleting revenues. As Mr. Fritz explains in his statement, shippers are likely to make routing and access decisions favorable for them individually, but not for the rail network as a whole. Our unit costs would rise as we move backward toward pre-Staggers Act inefficiencies.

Rate compression and higher costs can result only in driving down revenues — a forced economic transfer by regulation. Proponents may claim that any lost revenue from the traffic Union Pacific loses could be made up by revenue on traffic diverted to us from other railroads. But shippers would not divert traffic to Union Pacific unless they would pay less in total, partly by avoiding payment of the market price for use of another railroad’s assets. If the access option were truly more efficient, the two railroads would have offered a joint route or agreed to some type of joint facility already. The bottom line is that the proposals for forced access and forced interchange are aimed at having shippers pay less for transportation, in the face of added costs of hand-offs from one railroad to the other and of less efficient networks.

Rate increases for those shippers who have more options are not a solution. Shippers who do not wish to pay higher rates and who have alternatives, such as trucks or barges or a different source or product, will turn to those alternatives. We already have every incentive to price their traffic to maximize revenue without losing too much traffic. So we would have no

alternative but to reduce investment, and our rail franchise would shrink. We would serve fewer shippers and provide less service at the same time that the marketplace and government transportation authorities are telling us they want more freight on rail, not less.

2. Lower Returns on Investment and Less Cash Would Lead to Less Rail Investment

For both shareholders and lenders, it comes down to cash and returns. Our shareholders, and our lenders, want to know how much cash we are generating today, and, more importantly from their perspective, how much cash can they expect us to generate in the future. Our lenders want to know how likely we are to meet our future debt obligations on the money we borrow today. Our shareholders want to know if we will generate enough cash in the future to make us a good investment today. When they invest in our stock, they are taking an ownership position in our company. They expect us to generate enough cash going forward to increase the value of that ownership. We do this by spending wisely on growth capital opportunities that will improve our business and earn more in the future, and by running the company well enough to have some cash left over to return directly to them, *i.e.*, a cash return.

Investors have the choice of investing in any public company or industry, and they assess the returns they can expect across their various investment alternatives in making that choice. Railroads already have a high cash hurdle because so much of the cash we generate must go back into capital expenditures. After including the other costs of running a business, such as labor and other operating costs, taxes, and pension contributions, the cash remaining for our shareholders is already relatively small. One measure investors consider is the excess cash generated as a percentage of a company's total assets. Cash returns on assets for other representative large industrial companies averaged about 6 percent in 2010, compared to 4.7 percent for Union Pacific. In recent years, our returns have been improving, which gives

investors hope that they can expect stronger returns in the future. Even with recent success in improving returns, however, our earnings do not generate enough cash to generate an adequate return for our owners when the high cost of replacing our assets is considered.

Investors watch closely for any changes that would reduce our future cash returns. Expanded regulation would directly impact our cash generation by driving down the revenue we earn, while at the same time increasing our operating costs through forced inefficiencies. With less cash available, our shareholders will insist that we reduce capital expenditures.

This is not idle speculation. Already, Wall Street analysts and our major shareholders are keeping a close eye on this proceeding. Analysts regularly discuss regulatory proposals and their likely effects on rail earnings. They ask us about regulatory developments during our quarterly conference calls and presentations. Our major shareholders tell us they are very concerned about any regulatory changes that will reduce our prospects for returns in the future.

3. Uncertainty About Returns on Individual Replacement and Capacity Projects Would Discourage Investment

Forced access and forced interchange options would increase the uncertainty that Union Pacific and other railroads face in considering each investment. This includes uncertainty about how much and where to invest in line capacity and terminals and how much to spend on replacing assets. We would have little or no incentive to invest in an asset that a competitor can use at a regulated, bargain price. And if shippers can decide to move traffic to less efficient routes that they may use only briefly or for which they will pay only artificially low access fees, we cannot justify investing.

In addition, we would face uncertainty about whether we would achieve projected cost savings from investments. Many capital projects are justified primarily because we expect

they will produce lower costs. Other projects pass muster only because the combination of anticipated revenue and cost savings allows them to exceed our hurdle rate. If shippers gain the ability to overrule our decisions on how to operate trains and to design service, our ability to estimate cost savings from investments will diminish.

If we cannot count on market-driven traffic flows or rates, we could not make rational decisions about where to invest in new capacity. We would find it increasingly difficult to predict which lines, yards, and interchanges will be used in the future and therefore should be investment priorities. Likewise, it would be more difficult to determine where to place more train crews to provide service for new reciprocal switches or interchange operations. Unless access prices were set at economically efficient levels (which advocates of more regulation oppose), forced access and interchange are investment killers.

4. The Public Interest Favors More Railroad Investment, Not Less

Adopting measures that would discourage rail investment would be poor public policy. Just a few years ago, a national commission reported on the urgent need for massive infrastructure investment in the United States, including investment to improve freight rail capacity.³ The Federal Railroad Administration also stresses the need for more rail capacity.⁴ Recently, the President emphasized the importance of new infrastructure investment in his State of the Union address. Infrastructure needs, including new construction to expand freight transportation capacity, are a national priority.

³ National Surface Transportation Policy and Revenue Study Commission, *Transportation for Tomorrow*, Vol. II, at 4-13 to 4-19 (Dec. 2007).

⁴ National Rail Plan, at 6, 8-9.

As the Federal Railroad Administration reminds us, investment in freight railroads serves many vital interests.⁵ Healthy freight railroads are important to the economic health of our nation and to the global competitiveness of U.S. companies. Putting more freight on the rails helps reduce highway congestion. Moreover, rail is a particularly fuel efficient form of transportation, so moving more freight by rail diminishes U.S. dependence on foreign oil. Rail also helps cut highway emissions, producing health benefits and reducing greenhouse gases.

The ongoing budget battles in Washington underscore the importance of encouraging private investment in rail infrastructure. A government that is borrowing 40 cents of every new dollar it spends will not increase, or even maintain, funding for subsidized trucks, barges, or air transport. Reducing rail investment would damage American competitiveness on the world stage and damage the U.S. economic recovery. Board actions that reduce investment incentives would hurt the nation for years, if not decades.

For all these reasons, the Board must avoid discouraging investment in railroads. The access measures under consideration here would push more traffic onto the highways, increasing congestion and placing more strain on our already burdened and under-funded highway infrastructure. The nation's dependence on foreign oil would increase, and there would be more emissions. Clearly, the Board should be looking for ways to encourage investment in rail capacity, not taking steps that are likely to discourage it.

B. Expanded Regulation Will Endanger Service and Efficiency

Mr. Fritz's statement explains how forced access and forced interchange requirements would create serious problems for Union Pacific's rail operations (as well as those

⁵ See *id.* at 5-8, 18 and 25.

of other railroads). We operate a highly complex network, and we have invested billions of dollars in tailoring it to provide better, more efficient service. We also have devoted great effort to managing the network in a way that reduces costs and improves service. As Mr. Fritz describes, we structure our operations carefully and invest capital selectively, all with the goal of producing maximum value for our customers and maximum efficiency for our operations.

Giving shippers the ability to force access by other railroads or to force the use of specified interchanges would cripple the valuable services we provide to our customers. Instead of advancing efficient operations to reduce costs and enhance service, as we have done with our transportation planning and nearly \$30 billion in investments since 1999 alone, we would lose control of transportation planning and service delivery. Our operations would become more complex, and traffic flows would be fractured and less efficient. Those changes would increase costs and diminish service over the entire system, affecting all shippers. Shipments would move more slowly. Shipper-owned cars would be used less efficiently. Reliability would decline. We know this because, under pre-Staggers Act government restraints, railroads operated that way.

Moreover, our reduced ability and incentive to invest in infrastructure would affect our operations and customer service. We learned this lesson from painful service failures. Most notably, major causes of the post-merger service crisis in 1997 and 1998 included an under-maintained Southern Pacific network; shippers shifting traffic from Southern Pacific to Union Pacific routes in search of better service; a simultaneous traffic surge; and lengthy repair curfews to rebuild Southern Pacific's route west of New Orleans. Service at our Houston facilities melted down because the infrastructure was inadequate, and service problems cascaded throughout our system and beyond to connecting railroads, resulting in a national rail service crisis. Our 2003-05 service problems, when we did not have enough crews to handle traffic

growth in our western region, gave us another sobering lesson in the importance of adequate investment and careful network planning. Congestion can develop quickly in a complex, interconnected rail network. Allowing shippers to override our service design plans and reroute cars without regard to infrastructure and resource constraints would leave the rail system vulnerable to systemic weakness and failures. Service crises would be more likely.

Forced access and forced interchanges have the potential to return the rail industry to the balkanized routing patterns of the pre-Staggers Act era and otherwise interfere with quality service. To avoid responsibility for causing such harms, the Board should decline to impose regulation that presents so many risks for railroads and their customers.

III. THERE IS NO NEED FOR NEW REGULATION

The Board should not risk the consequences I have described, because there is no need for forced access and forced interchange. With rates below 1980 levels, adjusted for inflation, and rate regulation that already is painful for railroads, additional regulation serves no desirable purpose.

Moreover, Union Pacific faces robust and pervasive competition today. Most Union Pacific customers have access to more than one railroad, either directly or through a transload or intermodal option. (Our Union Pacific Distribution Services subsidiary is extending transloading and logistics services to a wide variety of customers, many of whom are served by other railroads, and intermodal service is drawing some carload shipments into trucks and containers.) Most of our customers have trucking and other options. As Eric Butler, who leads our Industrial Products group, testified in the exemption hearing in February, we must replace 10 percent or more of our Industrial Products business each year because of competition from other railroads and motor carriers. Some shippers who claim that they have no options, including

aggregates shippers, not only tell us about their truck options but also sometimes prove the point by moving product by truck.

Where a shipper is served only by Union Pacific, it is not because we have taken steps to shut out other railroads. Rather, it is because demand is insufficient to induce private capital to fund multiple railroad service. Many of these shippers have access to some form of competing service, via truck or water, and can use alternative sources or production facilities. Even solely-served shippers without good alternatives have bargaining leverage in negotiations. We are always sensitive to the need to keep our customer competitive — an important constraint on our rates.

I meet with many of our customers, often at the level of the President or Chief Executive Officer. At that level, most of our customers understand that we must increase revenues in order to invest more, and they are not concerned with forced access and forced interchange. Their greater concern is whether Union Pacific will continue to invest in their future, so that they can count on reliable service that allows them to be competitive and to expand their businesses. Preserving a regulatory framework that serves those interests, by encouraging rail investment and operational efficiency, should be the Board's top priority.

CONCLUSION

As I mentioned at the outset, the Board has very little room to get things wrong in this proceeding. It must avoid actions that are likely to discourage investment in the rail network and to take the industry backward to a time of government-compelled inefficiency.

Understandably, some shippers with limited rail options want changes to the regulatory scheme to improve their own economics. But the changes they propose would hurt all shippers, including them. Railroads need differential pricing and the freedom to choose efficient routes in

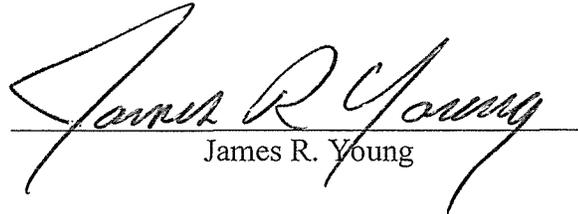
order to maintain a robust rail system with a high level of customer service. Adopting measures that will artificially depress rates or force less efficient, balkanized routes will threaten the important progress Union Pacific and other railroads have made since the Staggers Act.

If Union Pacific cannot look forward to earning market-based returns on its investments, but instead is limited to artificially constrained returns, we will have no choice but to reduce investment, to the detriment of all shippers and the public interest. Important capital projects will go unfinished, and traffic will move to other modes (increasing highway congestion and emissions), as investors move their funds to other, more promising options. Imposing regulation that interferes with natural market forces will lead to retrenchment, removing our ability to accommodate traffic growth and significantly reducing efficiency and customer service levels. In the long run, new regulation of the sort the Board is considering would return railroads to the pre-Staggers Act days of disinvestment, poor service, and stagnation — a result wholly contrary to the public interest.

VERIFICATION

I, James R. Young, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on April 11, 2011.


James R. Young

FRITZ

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

VERIFIED STATEMENT

OF

LANCE M. FRITZ

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VERIFIED STATEMENT

OF

LANCE M. FRITZ

My name is Lance M. Fritz. I am Executive Vice President - Operations for Union Pacific Railroad Company. I have overall responsibility for Union Pacific's rail operations throughout our 23-state rail network. I am in charge of all transportation services, including management and maintenance of locomotives, rail cars, tracks, train dispatching, and crew calling.

I began my career with Union Pacific in Marketing and Sales in 2000 as Vice President and General Manager - Energy. In 2005, I moved to the Operating Department as Regional Vice President - Northern Region, where I was responsible for the day-to-day safe operations of trains in Colorado, Iowa, Illinois, Kansas, Minnesota, Missouri, Nebraska, Wisconsin, and Wyoming. In 2006, I became Regional Vice President - Southern Region, which includes Arkansas, Kansas, Louisiana, Oklahoma, and Texas. In 2008, I was named Vice President - Labor Relations, responsible for negotiation and administration of all collective bargaining agreements with Union Pacific's more than 40,000 unionized employees. In January 2010, I was named Vice President - Operations. I was promoted to my present position in September 2010.

I understand that the Surface Transportation Board is considering changes to its rules about when a railroad must give access to a competing railroad. The changes could force railroads to interchange traffic that they could otherwise handle in single-line service, that is, without interchanging with another railroad ("forced interchange"). They could also force railroads to enter into terminal switching or trackage rights arrangements that would give a

second railroad access to solely-served shippers (“forced access”). Those proposals would threaten safety, degrade service, and destroy efficiency.

I. OVERVIEW

Union Pacific is operating at record high levels of safety and service, providing greater value to its customers than ever before. In large part, these accomplishments are a result of regulatory policies that allowed us to earn revenues needed to invest in our network and to plan the flow of traffic over our network. By coordinating our investment and transportation plans, we have improved the efficiency and predictability of our network, which in turn produces better safety and service. We invested for and are providing the single-line service benefits that the Interstate Commerce Commission and the Board sought in every major rail consolidation since 1980. This progress would be reversed if shippers could force us to provide access to other carriers without any regard for the impact on network operations or on other shippers that depend on our service.

Safety is a foundation of our business and our service to customers. We view safety and service as co-dependent goals: improvements in safety produce improvements in service, and improvements in service produce improvements in safety. By routing traffic to concentrate density on preferred routes, we have been able to systematically rebuild and replace old infrastructure, using new and better components and technology that enhance safety as well as service. We have also been able to standardize operations. As operations become more predictable, consistent, and repeatable, they become safer and more productive. Union Pacific and its employees have reduced reportable personal injury and reportable rail equipment incident rates to record-low levels.

We are driven to provide customer value, and our service levels are as high as they have been since Congress enacted Staggers in 1980, improving steadily since 2005. Our customers

recognize the value of our service, awarding us a best-ever average score on our Customer Service Index in 2010.

Union Pacific has spent the past several decades building and restructuring our network and improving transportation plans to match our resources with customer needs. Since 1980, we have consolidated six railroads into an efficient system, removing bottlenecks and inefficient operations, including unnecessary interchanges, and increasing single-line service. Although we stumbled in getting here, Union Pacific today is more effective than the sum of the individual merged railroads. We have been able to provide safer, better, and expanded service because of our ability to leverage the economics of consolidation.

Since 1999, we have invested almost \$30 billion of capital. We aligned our capital spending with our basic operating strategy of concentrating traffic where possible on higher-capacity, higher-density corridors. We invested heavily in modernizing and increasing the productivity of our rail yards and other terminal facilities. All of this minimizes variability, reduces time-consuming interchanges, and allows us to move traffic safely and efficiently from origin to destination.

We also devote tremendous effort and technology to make a complex network serve many types of customers with integrated, quality service. Union Pacific's transportation planning process furthers our basic network goals of producing fewer, larger trains, and fewer work events.¹ This allows us to move more rail cars further without stopping en route. It also makes the most productive use of our locomotives and crews, reduces car cycle time, and increases the total amount of freight we can move. By reducing stops en route and terminal switching, we reduce safety risks, costs, and delay.

¹ Work events include stopping to set out or pick up cars on a rail line or in a rail yard.

Union Pacific must plan its capital investments and its operations carefully. The investments we make to expand and enhance our network are very expensive, require a long lead time, and last for decades. Most track and terminal expansions require at least three years from concept to operation. We must design the project, gain community support, secure property for the project, obtain permits, relocate roads and utilities, and then construct.

Forced access and forced interchange would reroute traffic from the routes and facilities where we have invested billions, scattering them to less efficient routes and interchanges that are not suited for more traffic. The negative impacts could be devastating, particularly in terminal areas like Chicago and Houston, where big increases in interchange volume could cripple operations. The rail industry would move backward several decades to a time when most routes were open and all provided inferior service. The operations would also be less safe because traffic would be diverted away from “hardened” (upgraded with stronger and better components) infrastructure and established service patterns.

Forced access and interchange would also diminish our ability to plan future operations and make capital commitments. If we cannot control the routes over which traffic would flow on our network, the economic attractiveness of most investments would decline. We could not predict whether any particular investment would generate a reasonable rate of return, especially if we must allow competitors to use the investment at below-market prices. We would also have less revenue to invest, because our operating costs would rise, and revenues would fall.

My most immediate concern is that shipper-driven access and interchange decisions would bottleneck service and could melt down the network. Disregarding our network structure and transportation plans by shifting traffic to new interchange points or overcrowding terminals creates a risk of cascading failures. Yards that have been efficiently designed to place cars going to certain destinations on certain trains could become swamped if network destinations suddenly

change as individual customers demand new interchanges. A train that needs no intermediate switching today might require switching so certain cars can move to various shipper-selected interchanges. Forcing new access and changing interchange points would add work events to busy rail lines with heavy through train density, thus slowing down the overall network, and reducing throughput capacity. We know from experience in 1997-98 how quickly a network can break down when it becomes congested with traffic, and Union Pacific will not voluntarily repeat that experience. The Board, however, might cause the next service crisis if its prudent access policy is reversed.

In this statement, I will describe Union Pacific's record-high levels of safety and service. I will also explain why forced access and forced interchange would undermine our investments and operations, to the detriment of shippers, our employees, and the public. In Appendix A, I will describe some of our most significant investments and explain how these investments have allowed us to realize record safety and service. Finally, in Appendix B, I will describe the planned investments that we hope to make to maintain these high levels of safety and service as demand continues to increase.

II. BECAUSE OF A STABLE REGULATORY ENVIRONMENT AND YEARS OF INVESTMENT AND WORK, UNION PACIFIC HAS EMERGED IN RECENT YEARS AS A SAFER, MORE RELIABLE RAIL CARRIER.

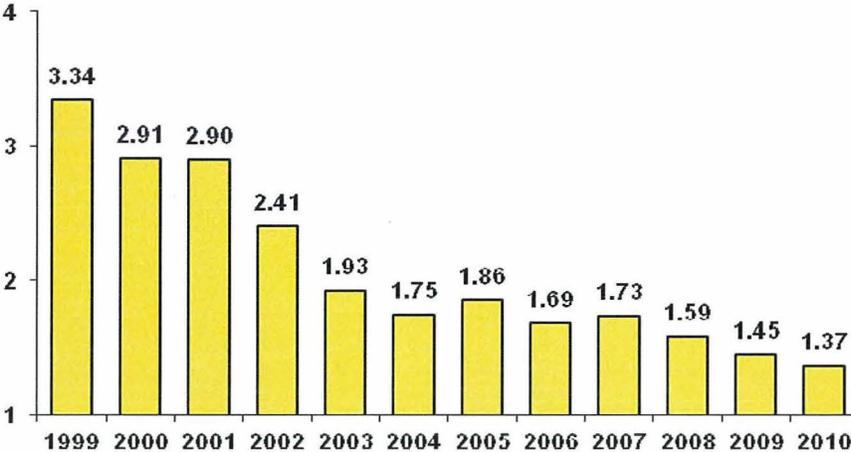
Our improving financial results are enabling Union Pacific to invest more heavily and to achieve major gains in safety and service.

A. Safety

With the support and engagement of our employees, Union Pacific's focus on safety allowed us to achieve our best-ever employee safety results in 2010. Our personal injury FRA reportable rate was 1.37 per 200,000 man hours in 2010, a 59 percent improvement over our

FRA reportable rate in 1999,² and a 6 percent improvement compared with our prior record in 2009.

Personal Injury FRA Reportable Rate (Figure 1)

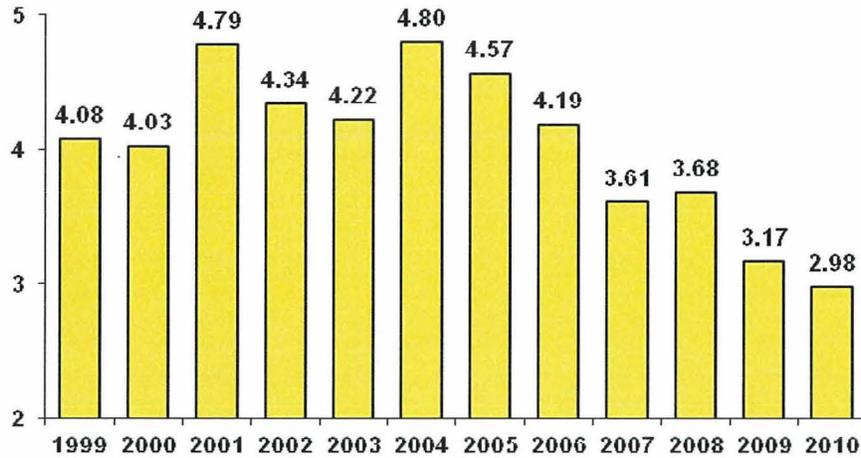


Our focus on safety also allowed us to achieve record results in what we call customer safety in 2010. Our rail equipment incident FRA reportable rate (a comprehensive definition that includes derailments and other incidents that interfere with reliable service) was 2.98 incidents

² We show various measures that compare to 1999, the first full year after Union Pacific had recovered from the service crisis that occurred after we acquired Southern Pacific.

per million train miles in 2010, a 27 percent improvement over our FRA reportable rate in 1999, and a 6 percent improvement over our prior record in 2009.

Rail Equipment Incident FRA Reportable Rate (Figure 2)



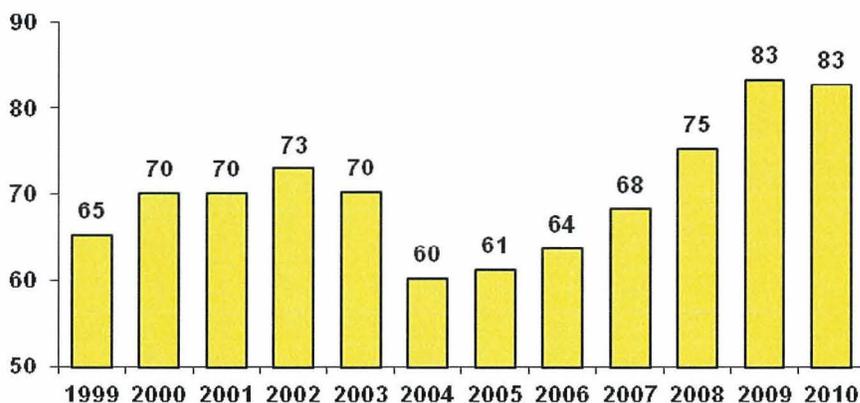
To increase safety, we have removed risks and created a safer environment through investments in infrastructure, technology, process improvement, and training. Our employees take personal responsibility for keeping each other safe. Our goal is continuous improvement toward eliminating safety incidents, which also yields better customer service.

B. Service

We are dedicated to providing valuable service to shippers and to never repeating our service failures of 1997-98 and 2003-05. In 2009, Union Pacific produced record service results, according to almost every metric that we track. Our challenge in 2010 was to move growing volumes of traffic while maintaining and further improving our performance. We achieved that goal. As traffic volume increased by 13 percent, from a recessionary low of 151,758 carloadings per week in 2009 to 171,764 carloadings per week in 2010, our key measures of service reliability and efficiency either essentially remained at record levels or improved. I illustrate this point below, showing various measures that compare 1999 to 2010. I also reference 2009 to demonstrate our ability to sustain and improve performance with increasing traffic that we handled from 2009's recessionary levels to the 2010 rebound in traffic.

Union Pacific's Service Delivery Index measures overall quality of service by whether cars arrive at their destination within established transit standards and schedules. (The higher the index, the better the service.) In 1999, the index stood at 65.³ In 2010, the index was at 83, an increase of 18 points, or 28 percent. (If we include cars delivered early, the index was 90 percent.) This tied our record of 83 from 2009, when traffic volumes were lower.

Service Delivery Index (Figure 3)

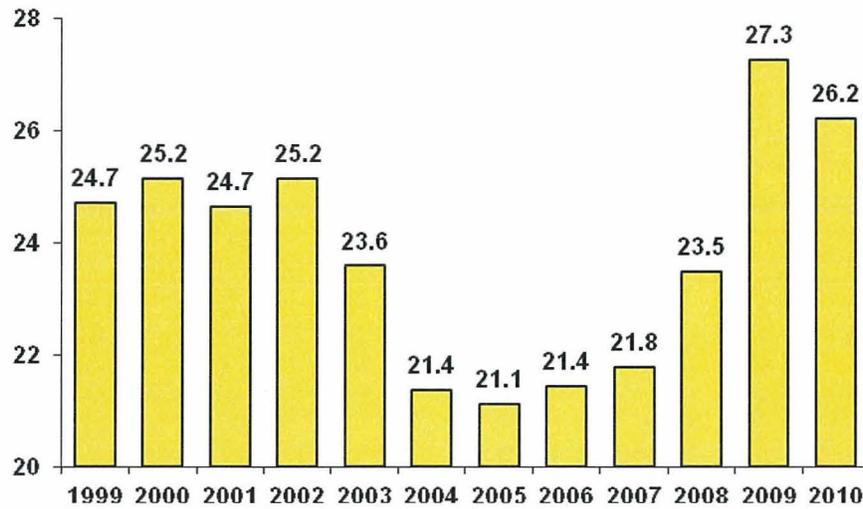


Union Pacific's average train velocity was 24.7 miles per hour in 1999. In 2010, our average train velocity was 26.2 miles per hour, an increase of 1.5 miles per hour, or 6 percent.

³ In 1999, Union Pacific averaged 167,104 carloadings per week, about 3% lower than our 2010 carloadings, which should address any concern that the service and safety improvements are simply the result of much lower traffic volumes on our network.

This put us only slightly below our record of 27.3 miles per hour in 2009.

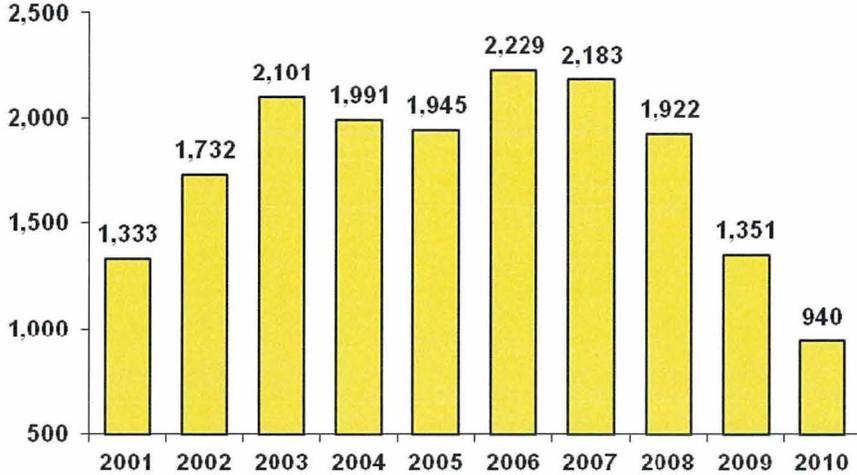
Velocity (Figure 4)



One reason our velocity remained high as traffic volumes increased is that we carefully planned to have all of the resources we would need to handle growth. We made sure that we had enough capacity, enough crews, enough locomotives, and enough cars in the right places and at the right time. We also made sure that our infrastructure had capacity and was ready. For

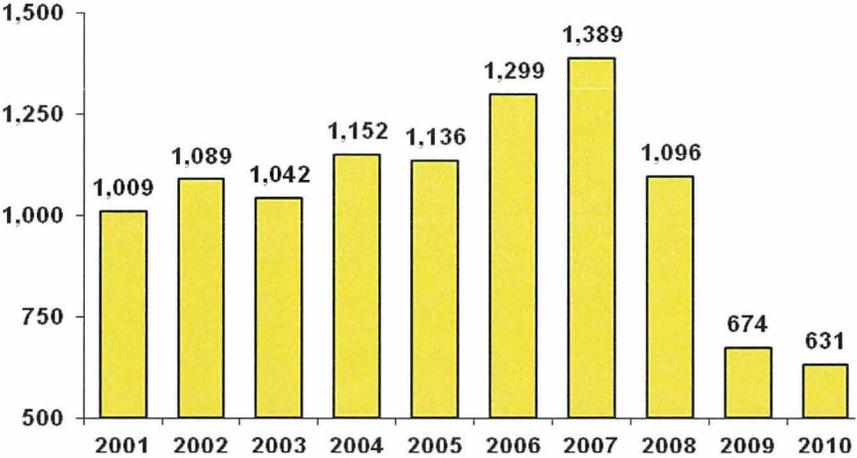
example, we had invested heavily to reduce slow orders. By the end of 2010, we had reduced slow orders⁴ to a record-low daily average of 940 miles of track.

Miles of Form A Slow Orders (Figure 5)



As a result, delays from slow orders dropped to a record-low 631 hours per day.

Slow Order Delay Hrs/Day (Figure 6)

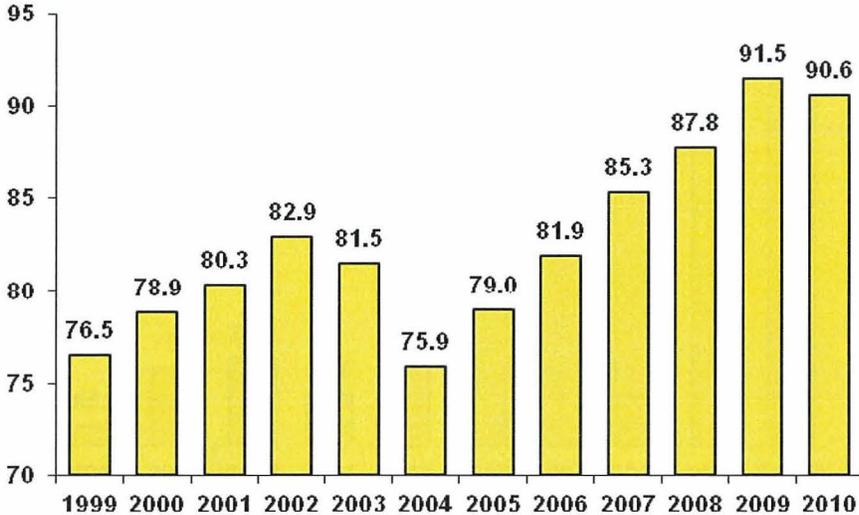


Union Pacific also continued to execute its transportation plan consistently, despite growing volumes. Our connection performance index, which measures whether cars meet the car scheduling plan at terminals, was at 76.5 in 1999. By 2010, we had improved connection

⁴ “Slow orders” are imposed when track conditions require us to reduce speed limits under FRA or Union Pacific standards. The slow order is lifted and track speed limits are increased after we perform maintenance to address the conditions triggering the slow order.

performance to 90.6, an increase of 14 points, or 18 percent. This put us just below our record of 91.5 in 2009, and well above the prior best-ever result of 87.8 in 2008.

Connection Performance (Figure 7)



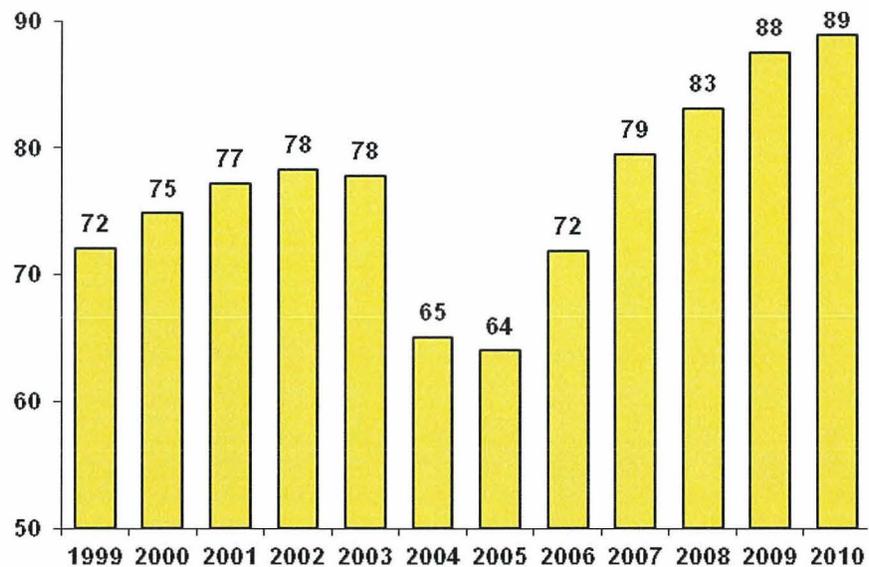
Another important measure of consistent execution is our industry-spot-and-pull average. This measures an aspect of our performance that is one of the most visible to our customers: whether we arrive at their facilities and switch cars when we say we will. Our 2010 industry spot-and-pull average was a best-ever 93.0 percent, above our prior record of 88.5 percent in

This improvement has been especially valuable for our chemical and plastics customers, who have been able to reduce their fleets of tank cars and covered hoppers.

C. Customer Value

Union Pacific's customers have recognized our efforts to improve service and safety and the results we have achieved thus far. One of the best indicators of how customers view our service and its value to them is our overall Customer Satisfaction Index. That index averaged a record 89 in 2010.⁵ The 2010 result reflects a 17-point gain over the score of 72 that we received in 1999, and a one-point gain over our prior best-ever result in 2009.

Customer Satisfaction Index (Figure 10)

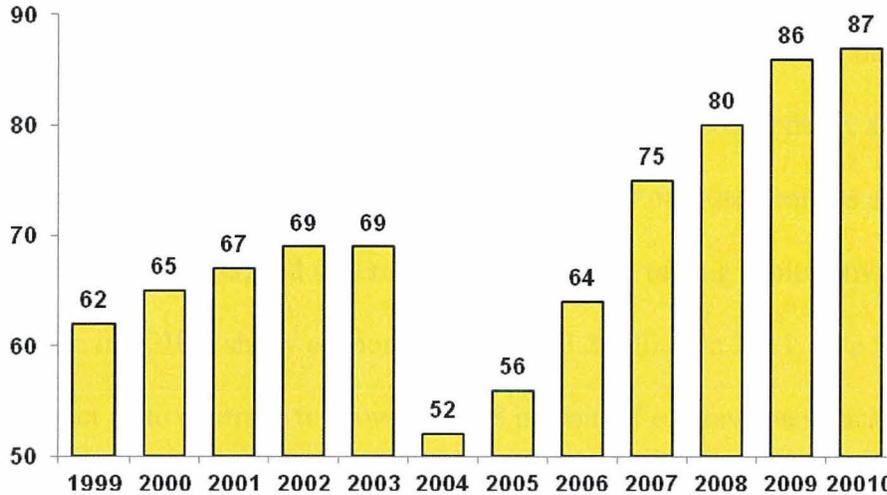


Union Pacific also specifically tracks and analyzes customer satisfaction with transportation service, though a series of questions regarding transit time and consistency, service with connecting lines, and adequacy of corrective action. The Transportation

⁵ A perfect 100 score would indicate that all customers participating in the survey were “Overall Very Satisfied.”

Satisfaction Index averaged a record 87 in 2010, which reflects a 25-point gain over the rating of 62 that we received in 1999, and a one-point gain over our prior best-ever result in 2009.

Transportation Satisfaction Index (Figure 11)



Another important indicator of how customers view the service and value we provide comes in the form of recognition by our customers. For example:

- We became the first railroad to earn the Eastman Chemical Company Supplier Excellence Award for overall company performance in 2009, and we earned the award again in 2010.
- General Motors honored us with its 2010 Supplier of the Year Award.
- Toyota Logistics Service recognized us as the top railroad in on-time performance and customer service in 2009, and we earned the customer service award again in 2010.
- Owens Corning named us as a Global Logistics Carrier Excellence award recipient for our service in 2009.
- Lowe’s Home Improvement named us Rail Carrier of the Year for our service in 2009.

We are committed to continuing to provide high levels of service and value even as traffic volumes rise.

Some forced interchanges would hurt service because our physical interchange facilities with other railroads, and the tracks leading to those interchange points, were not built to accommodate operations that shippers might demand in a forced access or forced interchange regime. For example, a shipper might decide to force Union Pacific and BNSF to interchange many more shipments at Tulsa, Oklahoma. Tulsa lies at the end of a Union Pacific branch line that begins near Muskogee, Oklahoma. The line from Muskogee to Tulsa is not suitable, in its current condition, for large volumes or for heavy traffic, such as unit coal trains, with bridges limited to 20 miles per hour. In Tulsa, we have only two tracks in the median of a major highway. Interchanges would require additional switching by BNSF at its Tulsa yard and by Union Pacific at Muskogee, causing congestion and delay. If BNSF and Union Pacific were forced to interchange coal traffic at Tulsa, Union Pacific would be expected to divert capital from more worthy projects to upgrade the Tulsa branch.

D. Increased Variability

Another issue is that customers could frequently switch access and interchange decisions, so that efficiency could not be achieved. We would not know with certainty where cars will move or be interchanged, in stark contrast to our current planning process, in which we change course gradually and deliberately with changes in markets. Predictability and consistency are critical to driving safety, service, and efficiency.

E. Forced Access and Forced Interchange Would Add Costs and Create Delay Across Union Pacific's Entire Network

On a broader scale, forced access and forced interchange would make our entire network less efficient because traffic would be diverted from the most efficient routes, reducing densities on those routes and thus unraveling the efficiencies that Union Pacific has built over decades. Cars would require additional handling, and thus we would need more terminal capacity, as well as more locomotives and crews to handle traffic in yards and on local trains that would be

needed to move the traffic to additional interchange locations. And even if the shippers that demand the new or different interchanges gain some short-term rate advantage for themselves, they will have done so at a steep cost to the many other shippers that benefit from our existing service, and ultimately to the very rail network that serves them.

Moreover, I believe it is unlikely that any shipper with single-line service that forced Union Pacific to interchange at new locations would obtain any service benefit. From an operating standpoint, there is no doubt that single-line service, where one railroad has the ability to manage service over its own routes, is almost always superior to interline service. Movements requiring an interchange between railroads are always subject to inefficiencies because they require the railroads to coordinate their operations. Even under the best of circumstances, when railroads have strong incentives to cooperate to provide service, the coordination challenges can be difficult or impossible to overcome because the railroads ultimately have different overall priorities for their systems.

At a more basic level, the physical process of interchanging cars between railroads creates delay and inefficiencies. Unless there is enough traffic going to the right place to justify run-through trains, one railroad must switch cars for the other and then deliver them. The other railroad then must switch them again. Transit time and equipment utilization suffer. Except where the railroads have enough volume to use run-through trains, one of the carriers must use its locomotives and crews to make the delivery, and both must typically switch the cars to take them to and from the interchange. In addition, recent rules have imposed costly additional requirements for interchanges of hazardous materials, including human handoff between carriers at interchange. All of these inefficiencies are avoided by single-line service.

Forcing railroads to grant trackage rights to shipper facilities would be particularly pernicious. It would raise operating costs by requiring two railroads to operate at facilities that

were never constructed for use by multiple carriers. This potentially doubles the use of limited infrastructure in the most constrained parts of our network. It may also result in additional switching, which could greatly reduce our ability to sort cars for our own network. Both railroads would incur added costs in attempting to coordinate their services, and, even with those efforts, interference and conflict are almost inevitable. Moreover, operational conflicts would likely affect not only the shipper that created the situation, but also any other shippers within the terminal area. Shippers usually do not like to interrupt their activities twice per day for dual service.

F. Forced Access and Forced Interchange Would Sacrifice Capital Investment Efficiencies

Forced access and forced interchange would also undermine our past and future capital investments. Forced access and forced interchange would require us to spend more to provide the same level of service, would strand investments that we previously made based on expectations that traffic flows would follow efficiency principles, not regulatory principles, and would make future investments more risky, and therefore less likely.

Forced access and forced interchange will result in inefficient service and higher costs. They could also leave Union Pacific with stranded or underutilized investments in rail lines and yard facilities. For example, as I note in Appendix A, Union Pacific invested \$145 million to transform Davis Yard in Roseville, California, into the premier switching facility (classification yard) on the West Coast and allow us to consolidate traffic previously handled by many smaller yards. Under a forced access or forced interchange regime, shippers could decide to interchange cars between Union Pacific and BNSF or shortlines throughout California, such as at Stockton, Sacramento, Fresno, Oakland, Warm Springs, and Bakersfield, which would undermine our investment in Davis Yard and increase the need for expensive switching and local train operations at other points.

As another example of the potential for stranded investment and worse service, Union Pacific has continually refined its service to soda ash shippers in southwestern Wyoming, site of the world's largest deposit of soda ash. We just opened a new \$23.9 million yard at Westvaco, Wyoming, to support this service. We assemble through trains that operate without delay or switching to Bailey Yard (North Platte, Nebraska), where the cars are distributed to our network of trains destined to points throughout the Midwest, South, and East. Shipper-directed interchange could destroy this efficient operation and impose new costs on Union Pacific. Shippers might decide to divert some of their shipments to interchanges with BNSF at Cheyenne, Denver, or Salt Lake City. This would break up the volume that allows us to operate the North Platte through-trains. It would require us to develop a less efficient, more expensive service to Salt Lake City, or Denver, or Cheyenne, where the interchanges are cumbersome and not suited to large volumes. The new service would be much slower, reducing utilization of shipper-owned and rail-owned equipment. For the entire service, this would be a leap backward and reduce use of our investments.

Finally, a regime that included forced access or forced interchange would make it even more difficult than it is today to engage in capacity planning or to fund capacity projects. We would have no assurance that, if we made an investment on any route, shippers would keep their traffic there. We cannot shift our investments as quickly as shippers could demand a new interchange. We cannot invest without some assurance of a reasonable return. Once our capital dollars are spent, most of them cannot be removed from the ground. We would also find it more difficult to determine whether to hire and train additional crews for particular locations. Even if shippers invoked forced access or forced interchange only rarely, the lack of predictability increases our risk and thus reduces our ability to invest.

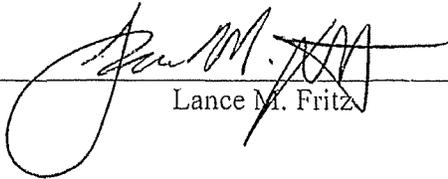
V. CONCLUSION

Union Pacific is providing safe, reliable, efficient service and value to customers, and we are investing to meet growing demand. Forced access and forced interchange would undermine the progress we have made by counteracting our efforts to maximize density and uninterrupted movement. At the same time, forced access and forced interchange would result in wasted spending and reduce our ability to make investments that will benefit the rail network. The Board should reject any proposals to implement such a counterproductive regime.

VERIFICATION

I, Lance M. Fritz, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on April 11, 2011.


Lance M. Fritz

APPENDIX A

APPENDIX A: CAPITAL INVESTMENT AND IMPROVEMENT

UNION PACIFIC'S ACHIEVEMENTS HAVE BEEN MADE POSSIBLE BY MASSIVE INVESTMENT IN OUR NETWORK.

Union Pacific's high levels of service and safety rest on a foundation of massive investments to expand and enhance our operations over the past 30 years. Through a series of transactions that culminated in our acquisition of Southern Pacific, Union Pacific has grown from a carrier operating 9,315 miles of railroad in 13 states to a complex network that operates more than 32,000 miles of railroad in 23 states. By combining traffic flows on the most efficient routes, and investing in those routes, the consolidated Union Pacific provides safer and better service than any of our individual railroads could have. Union Pacific spent billions of dollars to acquire other carriers, upgrade their facilities and equipment, and integrate their operations to create today's railroad.

Union Pacific has spent additional billions of dollars to remove bottlenecks from the network we created, to remove interruptions and variability from our service, and to harden our infrastructure. Today our network provides tremendous benefits to shippers by expanding our ability to provide single-line service, creating shorter routes, eliminating service-killing inefficiencies, and increasing capacity.

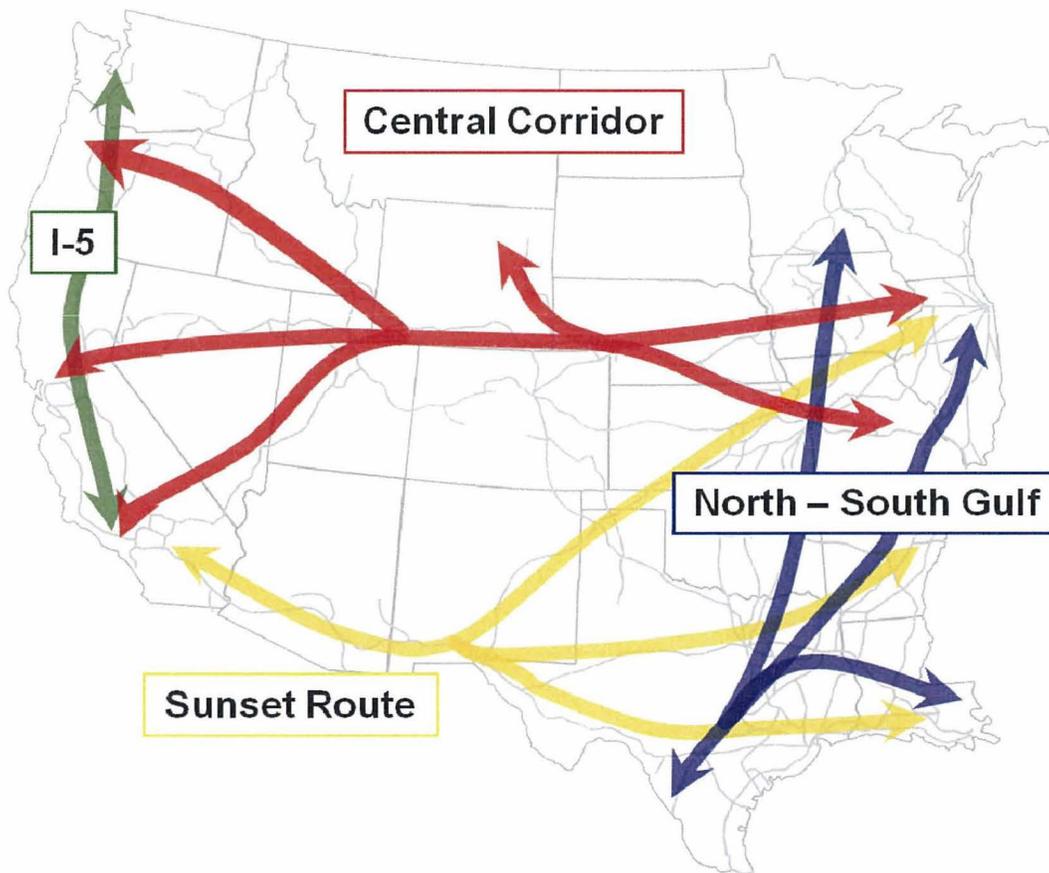
In the sections below, I provide examples of the investments we have made to improve safety, capacity and service. Our ability to maintain the gains we have achieved and to continue investing to address shipper demand for expanded and enhanced service is, however, threatened by the potential revenue and operational impacts of a regulatory regime that would include forced access and forced interchange.

A. Investments in New Track and Facilities

Particularly as our revenues have improved, we have been investing more in new track and terminal facilities. These investments are designed to promote the efficiency and reliability of our service to customers. They improve performance by keeping our mainlines and yards fluid as volumes increase, often by removing bottlenecks that cause delay and constrain growth.

We think about our investments by corridor. Although we shift trains between corridors for flexibility, we invest to ensure that our major corridors serve customers well. I will summarize some of our most significant investment in recent years in our four major corridors.

(Figure 1)

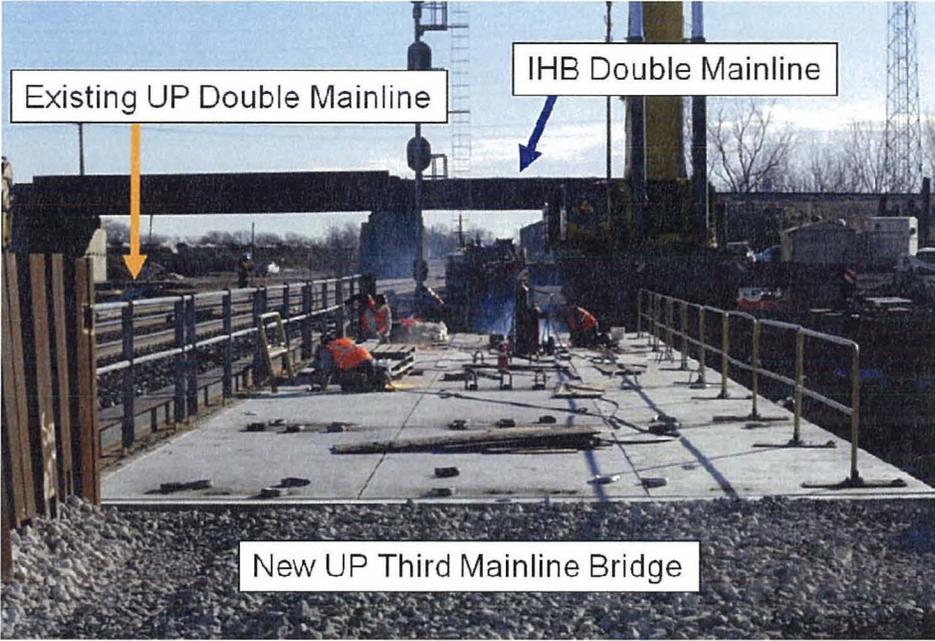


Central Corridor. Union Pacific's Central Corridor, which includes the original transcontinental railroad from Council Bluffs, Iowa, to Sacramento, California, extends from Chicago to Northern California, with extensions to the Los Angeles Basin and the Pacific Northwest.

In the Chicago area, Union Pacific has invested substantially, along with others, in the CREATE projects. CREATE involves most of the railroads serving Chicago, as well as regional, state, and federal agencies, in an ongoing series of projects that will improve passenger, freight, and vehicular movement through the congested Chicago area. We have already constructed a new rail line eastward from our major rail yard in Chicago, Proviso Yard. This important route allows trains to leave our Proviso Yard for eastern connections without conflicting with Metra commuter trains. Also, as part of CREATE, Union Pacific is constructing a new connection between our Proviso Yard and the Indiana Harbor Belt Railroad, which carries freight to and from other railroads in the Chicago area. That \$82 million project will allow more fluid interchange of large volumes of traffic through Chicago. The picture showing progress as

of the end of March is provided below and help show why these big projects require years of planning and preparation.

(Figure 2)



A major capacity enhancement in recent years added more than 290 miles of Centralized Traffic Control and universal crossovers between tracks at numerous locations on the double-tracked, former Chicago & North Western line across Iowa. (I will refer to the automated switches, signals and new crossovers as “CTC”.) CTC allows dispatchers in our train-control center to operate switches remotely, eliminating the need for employees to stop their trains, throw switches, and walk the length of the train after it passes. By adding CTC from Denison, Iowa, all the way to the Mississippi River at Clinton, Iowa, we gained the ability to allow faster trains to pass slower trains, increased the reliability of all trains on the route, and avoided significant delays when interruptions occur.

We also added a 2,550-foot, double-track bridge 190 feet above the Des Moines River. This \$48 million bridge allows two trains to cross the river at full speed, replacing the historic

Kate Shelley Bridge, which required trains to slow to 25 miles per hour and handled only one train at a time, causing significant delays. The picture below shows the old bridge on the left and the new concrete bridge on the right.

Kate Shelley Bridge – Boone, Iowa (Figure 3)



The largest capacity project on the Union Pacific system in recent years was a multi-year initiative to expand our coal-handling capability out of the Powder River Basin, costing almost a billion dollars over a decade. It included completing construction of 108 miles of third main line track between North Platte and Gibbon, Nebraska, in 1999; 106 miles of second main line track between Gibbon, Nebraska, and Marysville, Kansas, in 2000; 47 miles of second mainline track between South Morrill, Nebraska, and Shawnee Junction, Wyoming, and 66 miles of second mainline track between South Morrill and North Platte, Nebraska, in 2003. It also included purchasing and rebuilding a shortline railroad in northeast Kansas to create directional operations between Kansas City and Marysville. These investments allowed us to increase coal service

reliability, even as our volumes increased, and also provided capacity for grain, carload, intermodal, and automotive traffic that shares this high-density corridor.

Powder River Basin, Wyoming (Figure 4)



On the parallel “Kansas Pacific” route between Denver and Topeka, Kansas, Union Pacific invested over \$350 million to entirely rebuild the railroad and add segments of CTC. We also invested \$30 million in Denver to build a by-pass track and avoid having to back up trains in the busy Denver terminal. We use this route to move coal trains between Colorado mines and customers in the East, Midwest, and South. Some shipper groups argued when we acquired SP that Union Pacific would never invest to serve Colorado coal shippers, who are “captive.” They were wrong, as over one-third of a billion dollars proves.

We have continuously upgraded the world’s largest freight yard, our Bailey Yard at North Platte, Nebraska, so that it can now process more than 150 trains per day. These investments made sense because our control over routing decisions allows us to consolidate traffic in Bailey Yard and use the yard’s capacity to build trains that can move long distances

without the need for additional switching. We also recently added a third main line through the yard at a cost of over \$8 million, allowing trains running through North Platte to move through the terminal without interfering with other operations.

North Platte, Nebraska (Figure 5)



In western Wyoming, we recently completed a new rail yard to originate and terminate trains carrying soda ash. This helps our customers reach their markets efficiently and use their private equipment more effectively, reducing costs for both the customers and Union Pacific. We built this yard even though these customers, too, are “captive.”

In Salt Lake City, Union Pacific constructed and opened a \$90 million intermodal facility west of the city. We also participated in a public-private partnership to modify a notorious bottleneck in Salt Lake City at Grant Tower, increasing train speeds through Salt Lake City from 10 miles per hour to 40 miles per hour. On our line from Salt Lake City toward Los Angeles, we

lengthened several sidings so that we can operate longer trains, as we are doing on our line to the Pacific Northwest.

In northern California, we recently improved clearances in tunnels on our Donner Pass line to allow full-size double-stack intermodal trains to operate on this most direct transcontinental line. This project allowed us to reroute numerous trains per day from a 70-mile-longer route through the Feather River Canyon. The Feather River Route deserves additional mention. Twenty or thirty years ago, Union Pacific would not have been able to afford to maintain this second rail route through the Sierra Nevada, as it recently has handled only about two trains per day each way. With higher revenues, we not only retained the Feather River Route, but also invested millions of dollars last year to upgrade it and remove slow orders. When the heaviest snows in 120 years hit Donner Summit last month – 15 feet in 10 days –

Union Pacific was able to reroute almost 20 trains per day via the Feather River Route, avoiding significant delays for large numbers of shippers. That is the service value of investment.

Donner Pass (Figure 6)



At the western end of the Central Corridor, Union Pacific in 1999 opened the J.R. Davis Yard in Roseville, California, after a \$145 million reconstruction project that transformed the yard into the premier classification yard on the West Coast. The new yard greatly increased efficiency by allowing us to consolidate traffic previously handled by many smaller yards and

build longer, dedicated trains that can move more directly to final destination or interchange with fewer time-consuming intermediate stops.

Davis Yard – Roseville, California (Figure 7)



South of Stockton, California, we constructed the Lathrop intermodal facility, serving domestic shippers throughout the region.

Sunset Corridor. Union Pacific's Sunset Route connects the Los Angeles area with El Paso. The Sunset Route has the lowest, flattest crossing of the Continental Divide in the United States. This is the most direct route to major Gulf and Southeast markets, which are projected to continue growing. We include in this corridor not only the former SP line from El Paso east to San Antonio, Houston, and New Orleans, but also the former Texas & Pacific line from El Paso

to Dallas/Ft. Worth and Memphis, and the Shreveport Gateway, as well as the former SP-Rock Island line from El Paso to Kansas City and Chicago.

Sunset Route (Figure 8)



Union Pacific's progress in double-tracking the Sunset Route provides another major example of investment to expand capacity and improve efficiency. When Union Pacific acquired Southern Pacific, the line from Los Angeles to El Paso was mostly a single-track line that had difficulty accommodating Southern Pacific's volumes. Lacking revenue to invest, Southern Pacific cannibalized its Central Corridor route by shifting rail from Nevada to the Sunset Route. With growing revenue, Union Pacific added a second track from Tucson to El Paso and on mountain grades east of Los Angeles. As of the end of 2010, approximately 61 percent of the line is double-tracked. The added capacity has been essential to our ability to improve service for the vast quantity of intermodal, automotive, agricultural, and carload shipments that use the line, which now carries about 20 percent of all Union Pacific traffic. At the west end of the

corridor, Union Pacific rebuilt Southern Pacific's major West Colton terminal, which serves carload customers throughout Southern California. We also added through tracks on our mainline, bypassing the yard, as well as more tracks in the yard, and a modern diesel locomotive shop.

On the eastern extensions of the Sunset Corridor, Union Pacific has invested in new intermodal terminals. The \$100 million San Antonio facility not only serves customers in that area, but also traffic to and from Mexico. In Dallas, Union Pacific created the Dallas Intermodal Terminal, investing another \$100 million and sparking rapid industrial development southeast of Dallas. Near Memphis, we constructed a new intermodal terminal at Marion, Arkansas. In the Chicago area, we recently opened the \$370 million Joliet Intermodal Terminal, which is already a major terminal for shipments to and from the West Coast. This important facility allows us to

meet customer demand for service from the Los Angeles-area ports to the highest concentration of distribution centers in the Midwest.

Joliet Intermodal Terminal (Figure 9)



Union Pacific also invested heavily in the former Texas & Pacific mainline between El Paso and Ft. Worth. This line carried as few as two trains per day on its West end two decades ago. It now carries 18-23 trains daily. Union Pacific rebuilt the railroad from the foundation up, increasing train speeds, and we built a number of new sidings and extended others to increase the number and length of trains the route can handle.

We have invested in many improvements in terminals and along mainlines in Texas and Louisiana. We improved Houston freight yards that struggled after Union Pacific acquired Southern Pacific. We installed connections and additional tracks to smooth the flow of traffic through that busy terminal. We added passing tracks and extended sidings to remove bottlenecks throughout Texas and beyond.

North-South Corridor. Union Pacific groups several routes into its North-South or Heartland Corridor. Moving from south to north, Union Pacific in recent years has had the funds to rebuild the “OKT” line from Ft. Worth to Wichita and beyond, using new rail and ties. We also added or extended sidings and double-track at numerous locations between Ft. Worth and Kansas City on other north-south routes.

Kansas City is the spoke of the wheel for Union Pacific lines in all directions, as well as a major interchange point. To handle over 100 trains per day, growing toward 150, we invested heavily to increase network efficiency. For example, we rebuilt Southern Pacific’s Armourdale Yard into an efficient facility for automobile, coal and other run-through trains. We participated, as a member of the Kansas City Terminal Railway, in a public-private partnership to lift the KCT mainline over busy Rock Creek Junction in northeast Kansas City, and we streamlined the tracks through Rock Creek. We also shared in funding an expensive third main track along the BNSF mainline for about nine miles east of Rock Creek to give Union Pacific a clear route to our River Subdivision toward St. Louis that branches off of the BNSF line.

On our north-south corridor from Texas through Arkansas to St. Louis and Chicago, directional operation between Texas and Southern Missouri and Memphis gives us a substantial amount of capacity, although high-priority Amtrak trains moving against the directional flow are a daily challenge. We virtually rebuilt the former Southern Pacific (St. Louis Southwestern)

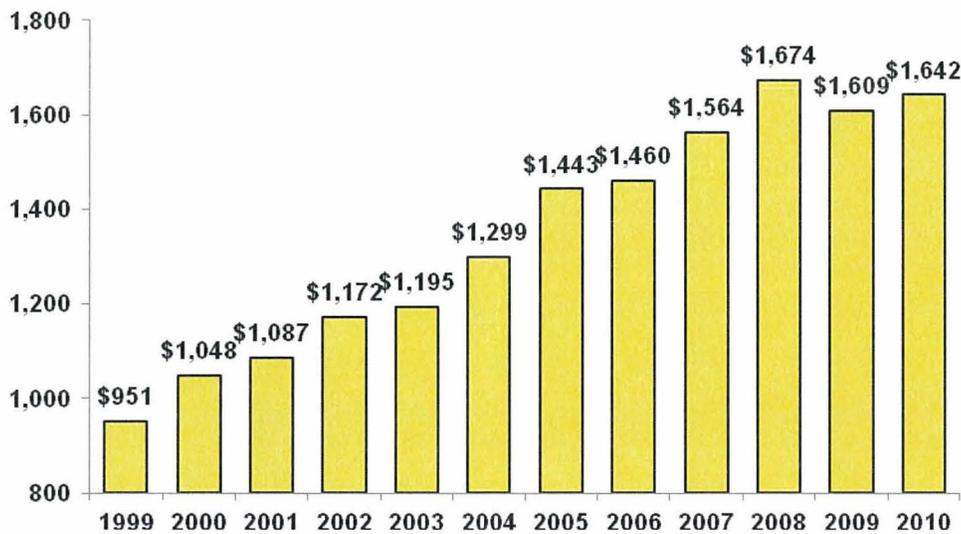
segments that carry Illinois coal or that connect our former Chicago & Eastern Illinois line from Chicago with our routes to Texas.

Growing revenues made all of these investments possible, and all are contributing to network service improvement and capacity growth.

B. Investment to Renew and Replace Existing Track and Facilities

As much as Union Pacific has invested to increase capacity and improve service by adding new track and facilities, we have invested even more to enhance service by improving and hardening our track and roadbed infrastructure. Since 1999, our annual investments have grown as we have replaced millions of ties and hundreds of track miles of rail across our network every year. We maintained this high level of investment even during the recession.

Replacement Capital Investment (millions) (Figure 11)



Our consistently high level of spending on replacement capital has been critical to our ability to provide fluid and safe operations and increase network efficiency in several respects.

First, our replacement capital spending has allowed us to reduce substantially the number of slow order miles across our system. As I observed earlier, by the end of 2010, we had reduced Form A slow orders on our network to a record-low daily average of 940 miles. This translates into a reduction in the hours of delay caused by track defects, which were also at a record-low of just 631 hours per day in 2010. Reductions in slow order delay protect velocity and consistency, which in turn means better service and improved asset utilization.

Second, replacement capital spending substantially reduced the number and impact of service disruptions caused by track and signal failures.

Third, when we replace aging assets, we often replace them with higher quality assets. These efforts to “harden” the railroad play an important role in furthering our goal of increasing reliability and safety. On all heavy-traffic corridors, we now install head-hardened, premium rail. With more premium rail and other actions, we have extended rail life from 2 to 3 billion gross tons. That means fewer interruptions to replace rail. In addition, when we replace ties, we are often installing concrete ties, which are more durable, and therefore require less frequent

replacement, than wooden ties. The before and after pictures below illustrate use of stronger rail and concrete ties to hold proper gage on this curved route.

Moffat Tunnel Subdivision (Figure 12)

(Before)

(After)



Similarly, when we replace aging bridges on our system, we typically use materials that are more durable than those used in the original construction. We replace timber with steel and concrete. We also build the new bridges to accommodate expected growth in freight volumes. Union Pacific has over 400 miles of bridges, so bridge replacements are an expensive proposition, but they are the type of major investment in infrastructure we can now make so that we provide more reliable, efficient service.

Concrete Bridge – Sacramento, California (Figure 13)



As a result of these investments in replacement capital, Union Pacific is a much more robust railroad than its components were at the time of the Union Pacific-Chicago & North Western and Union Pacific-Southern Pacific mergers. That lets us provide better service.

C. Investment in Locomotives and Freight Cars

Union Pacific has also used improved revenues to acquire new locomotives and freight cars. Since 1999, we have invested more than \$6.7 billion to replace older equipment at the end of its useful life and position the company to handle growing customer volumes. For example, we have acquired, on average, 279 new road locomotives for our fleet each year since 1999. Our new locomotives are more fuel efficient and produce fewer emissions than older locomotive units. Over 75% percent of our locomotives are certified under existing EPA emission standards.

D. Investment in Technology

As our revenues have grown, investments in technology have played a critical role in improving our service and increasing our effective capacity. In our quest to improve service, Union Pacific is investing in technology that reduces interruptions to the flow of trains and, as a result, makes our service faster and more reliable.

Harriman Dispatch Center (HDC) (Figure 14)



Many of the actions we are taking deal with problems that have affected the industry for more than a century, but were treated as unavoidable aspects of operating a railroad. Union Pacific risks unplanned interruptions – a locomotive failure, a train splitting apart, a false reading on a wayside defect detector, and many other events. Every one of these interruptions potentially stops one or more freight trains, usually delays other trains, causes crews to be on the road longer than planned, and disrupts the reliability of our customer service. Here are several examples of what we are doing about this situation.

Locomotive health diagnostics. Modern diesel locomotives contain sophisticated, computerized monitoring systems that transmit numerous reports on non-standard operating conditions. Union Pacific has developed a unique system that accumulates and analyzes the reports on each locomotive as it operates throughout the system. When the locomotive reaches a repair or servicing facility, our system tells mechanical forces exactly what needs to be looked at and precisely how to repair it, saving time in the shop. As a result of this system, we improved the mean time between locomotive failures on our premium trains by 20 percent in one year.

Reducing derailments caused by defects. Over the last decade, Union Pacific has installed a battery of technological innovations to catch defects before they become derailments. In 2002, we and other railroads began installing “WILD” wheel-impact detectors. These detectors identify individual wheels that have imperfections and produce unusual impacts on the rail. The WILD detectors are linked by communications and computer systems, so that we can

monitor the evolution of each individual wheel. As a wheel approaches a point where it could cause a derailment or damage rail, we proactively fix it.

Wheel Impact Load Detector (WILD) (Figure 15)



In 2004, we also installed acoustic sensing devices that “hear” signs of a wheel bearing failure before it can cause a derailment.

At North Platte, we created a one-of-a-kind, automated facility to perform ultrasonic testing of individual wheels to look for defects that visual inspection cannot find. Using this system, we have located 93 defective wheels, each of which would likely have derailed a train. An entire train can operate through the testing system at 5 miles per hour and then proceed toward its destination. We have “scrubbed” the coal-train fleet on Union Pacific and are now moving on to other types of unit trains. Union Pacific has not suffered a shattered wheel-caused coal train derailment in two years, a major improvement. This is an example of our ability to

innovate because of the size and strength of the railroad. It is unlikely that one of our smaller predecessor railroads could have dedicated resources to this kind of innovation.

Ultrasonic Wheel Defect Detector (Figure 16)



Reducing derailments caused by equipment is only part of our campaign. We also have deployed state-of-the-art technology to identify defects in rail that can cause derailments or delays due to broken rails. Our suppliers perform tests on all new rail, but defects can nevertheless slip by, and they are not visible. Union Pacific has deployed sophisticated rail detector cars that use ultrasonic and induction technology to look inside rails for hidden defects. These cars can operate at speeds from 10-15 miles per hour.

depending on the technology used, so we can inspect big segments of the railroad quickly and repeatedly.

EC-5 Track Evaluation Car (Figure 17)



A related area in which investment in technology is helping to maintain network fluidity is our investment in the most modern, efficient track maintenance equipment. For example, our TRT 909 track renewal train installs new rails and concrete ties in one pass, and can install up to 6,000 ties plus new rail in a ten-hour day. Moreover, by using this equipment we can

undertake the extensive renewal projects that are necessary to maintain and upgrade our service while minimizing disruption to traffic that must continue to move over our network.

Track Renewal Train (Figure 18)



Another area in which technology has played a critical role in improving service has been the development of advanced information systems, such as our Customer Inventory Management System, or “CIMS.” We developed CIMS to help proactively manage terminal inventory, in order to maintain terminal fluidity and increase asset utilization. CIMS monitors customer railcar inventory and storage capacity, freight cars en route on Union Pacific, and freight cars awaiting final delivery to customers. It allows us to help customers manage traffic flows and avoid delays. It therefore helps reduce terminal inventory and dwell time and improve switching performance. If cars arrive using reciprocal switching or terminal trackage rights, we would lose the ability to adjust the flow into terminals to protect fluidity.

Still another significant example of technology investment is expanding the number of locomotives that are equipped to operate using distributed power. Use of distributed power – placing additional locomotives at intermediate points in, or on the end of, a train and controlling them from the lead locomotive – lets us operate fewer, longer trains to deliver the same amount

of freight. In addition, distributed power reduces failure rates because distributing the motive power throughout the train reduces forces that can cause damage to draw bars and shipments. We also save fuel and improve rail life because distributing the motive power reduces friction between wheels and rail on curves. We used distributed power to move 62 percent of our gross ton miles in 2010, up from 26 percent of gross ton miles in 2007. If shippers could dictate the interchanges that we use, thus fracturing our traffic across a wide variety of routings, we would need to operate more, smaller trains, and the efficiencies we have gained by using distributed power to create longer carload trains would be lost.

E. Transportation Planning

Union Pacific's transportation plan, which is our "playbook" for train operations is called the "Unified Plan," and it is a living playbook. The Unified Plan reflects an ongoing effort that we began in the second half of 2004, when we took a "clean sheet" approach to designing plans for all types of train service. Using this process, we have since 2005 removed 39 percent of work events and reduced the number of switch events by 21 percent. Because capital planning requires starting three years before an investment is needed, we cannot respond to frequent and unplanned shifts in routing. Our planning process will be far less effective and produce poorer service if shippers can introduce work events and switch cars to less efficient routes and interchanges.

APPENDIX B

APPENDIX B: PLANNED INVESTMENT IN A STABLE REGULATORY AND ECONOMIC ENVIRONMENT

Union Pacific has publicly told investors that they can expect us to bump up capital investment in coming years if demand for the service grows and regulatory rules remain stable. In the following pages, I will summarize some of the important investment that we want to make.

A. Rail Infrastructure Renewal Needs Capital

As I discussed previously, Union Pacific spends heavily every year to replace the track infrastructure over which we operate. We plan to continue reinvesting capital in our existing infrastructure at a rate of approximately \$1.6 billion to \$1.7 billion annually. Especially since the Union Pacific-Southern Pacific merger, we have focused heavily on tie replacement to bring the railroad into a regular cycle for ties. With more than 90 percent of our core mainline routes now in tie cycle, we are focusing more of our capital on renewing mainline rail, bridge replacement, and upgrading yards and industry lead tracks. The history of Southern Pacific's deteriorated service due to lack of resources to maintain track, and the years and billions of dollars required to restore that infrastructure, underscore the importance of our commitment to capital maintenance.

In 2011, we expect to replace approximately 4.2 million ties and relay about 1,000 miles of rail, including yard and industry lead tracks. We will continue a robust bridge-replacement program, spending about \$127 million. Our replacement programs will be especially extensive this year on the railroad's Southern Region. Our aggressive work plan has had a modest impact on service in that region during early 2011, which will continue through the summer.

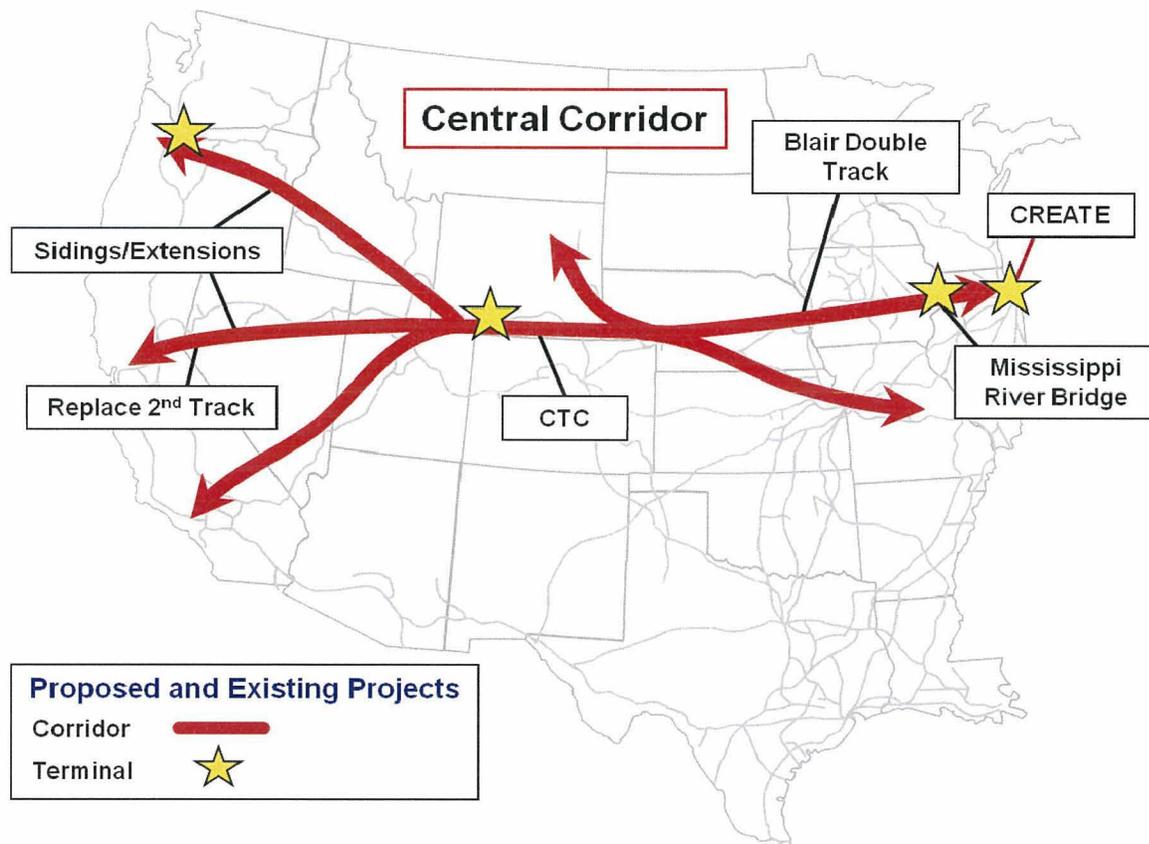
B. Capacity Expansion Projects

Union Pacific wants to increase our investments in new capacity. In 2011, we expect our capacity investments, broadly defined to include all investments except PTC and replacements of assets, to increase by about 72 percent above 2010 levels, to over a billion dollars. We expect

that higher amount to continue to grow modestly over the next few years. I will provide an overview of how we now foresee investing capacity dollars in the coming years, if legal or regulatory directives do not undermine our plans, and how those investments would help us improve service to our customers. Loss of revenue and loss of control over routing decisions would put these projects in jeopardy.

Central Corridor. The following map shows our major capacity projects in this corridor, which I will describe in more detail below.

Central Corridor Capacity Projects (Figure 1)

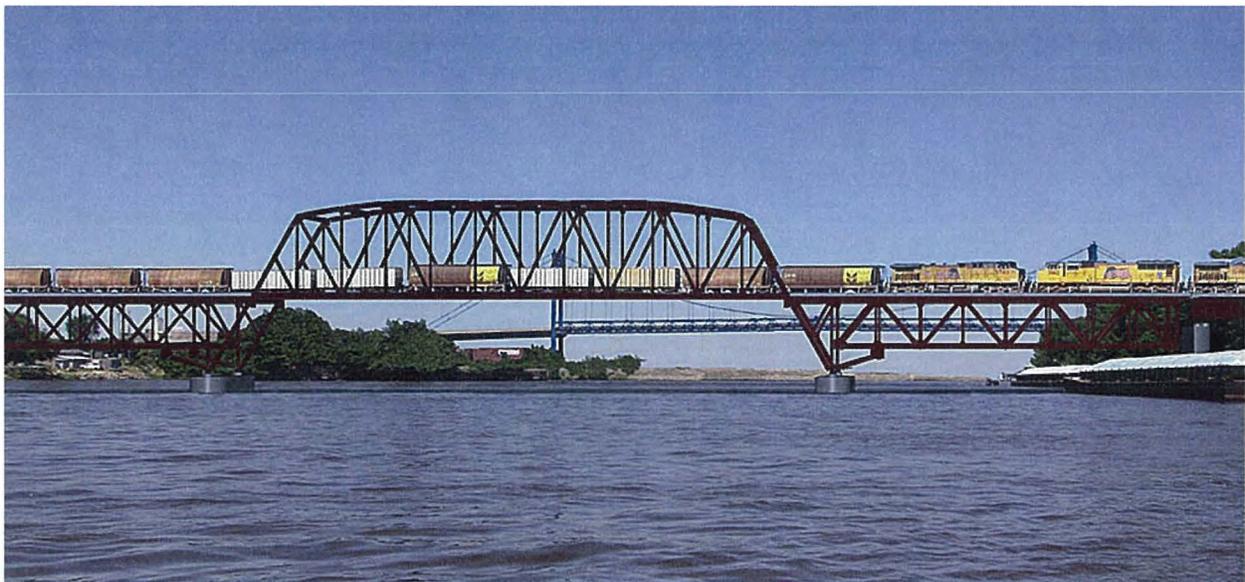


In the Chicago area, in addition to the CREATE projects that I described earlier, we are working in a public-private partnership with METRA to ensure passenger safety while improving METRA train and freight train reliability. We share our Geneva Subdivision from Chicago west beyond Geneva, Illinois, with METRA commuter trains. We are collaborating

with METRA on a major project, costing well over \$100 million that includes adding new protections for METRA passengers at stations along the route, new crossovers between tracks, and new sections of third main track. As segments are completed, Union Pacific will be able to operate freight trains during rush hours under specified conditions, eliminating multi-hour morning and evening windows when freight trains have to wait outside the corridor. These windows have been a major thorn in the side of freight service reliability, because even a slight delay to a freight train anywhere in the West can cause the train be held outside Chicago for the METRA curfew and delay shipments for several hours.

Further west, Union Pacific will be launching a project costing almost \$400 million to build a new Mississippi River bridge at Clinton, Iowa. An artist's rendering of the proposed bridge is shown below.

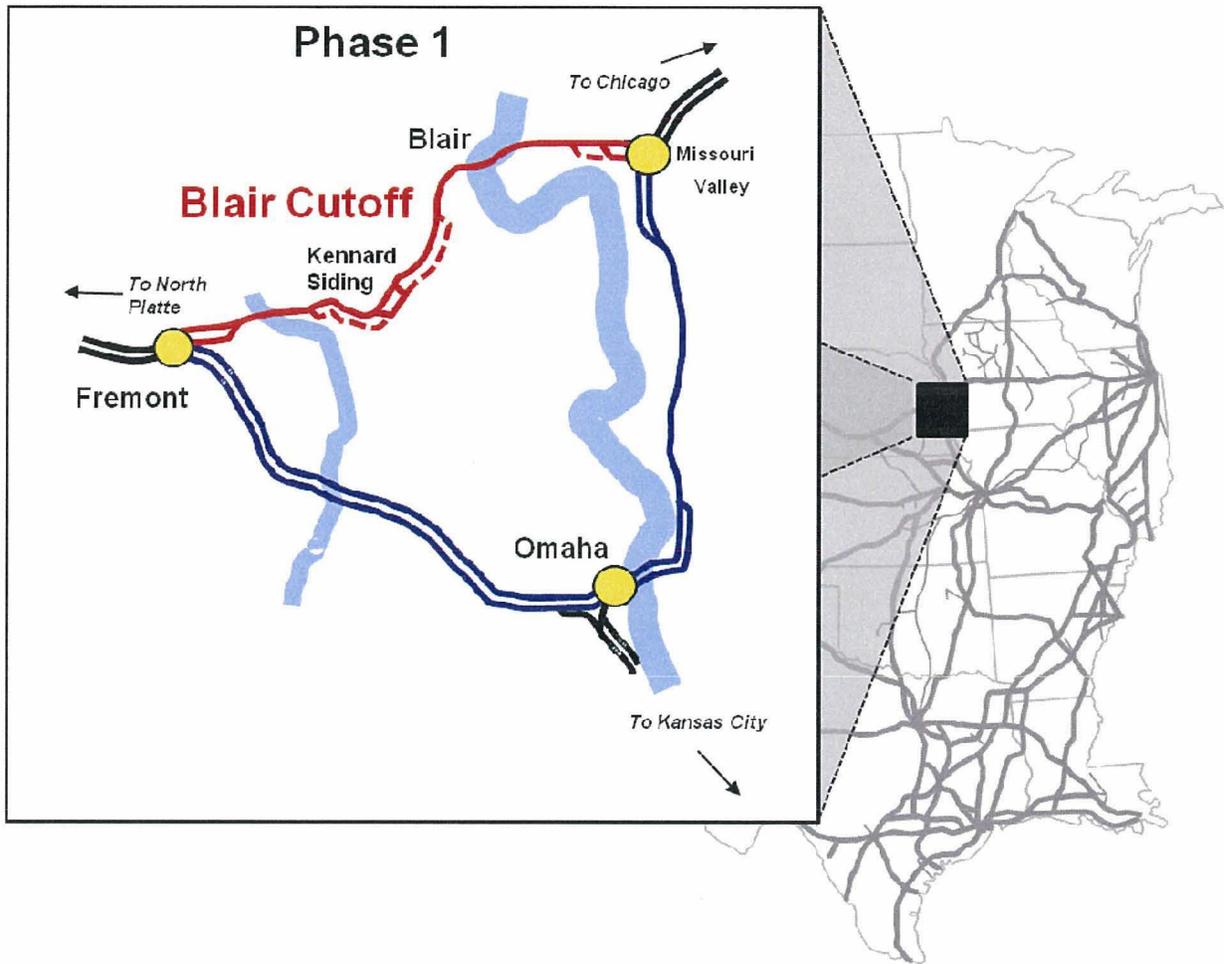
(Figure 2)



Unlike today's bridge, which includes a swing span that must be opened for passing barges and pleasure craft for hours per day in season, the new bridge will be high enough to allow river traffic to pass unimpeded.

Continuing west, we reach a major capacity expansion that is under construction today. As shown on the following map, Union Pacific tracks form a triangle in eastern Nebraska and western Iowa.

Blair Cut-Off (Figure 3)



The shorter, more direct route of the former Chicago & North Western between Missouri Valley, Iowa, and Fremont, Nebraska, is primarily single-track, so we do not have enough capacity to handle 70 or more Central Corridor trains per day on the shorter route. We run most westbound trains over the direct route and most eastbound trains via the longer route through Omaha.

We are now constructing a second main track between Fremont and Blair, Nebraska, double-tracking most of the shorter route. This \$260 million project will allow us to save 25 miles for dozens of trains daily. More importantly, because of congestion and track

configurations in the Omaha/Council Bluffs area, the project will save each of those trains two to four hours, reducing transit times and making transportation more predictable.

Moving further west, we will continue to add CTC to the original transcontinental mainline in southern Wyoming, ultimately extending CTC's reach all the way from Chicago into western Wyoming. In northern Nevada, where we have the two routes (Donner and Feather River, discussed earlier), the Donner route will get a new siding and longer sidings to permit us to run longer trains all the way between Chicago and northern California.

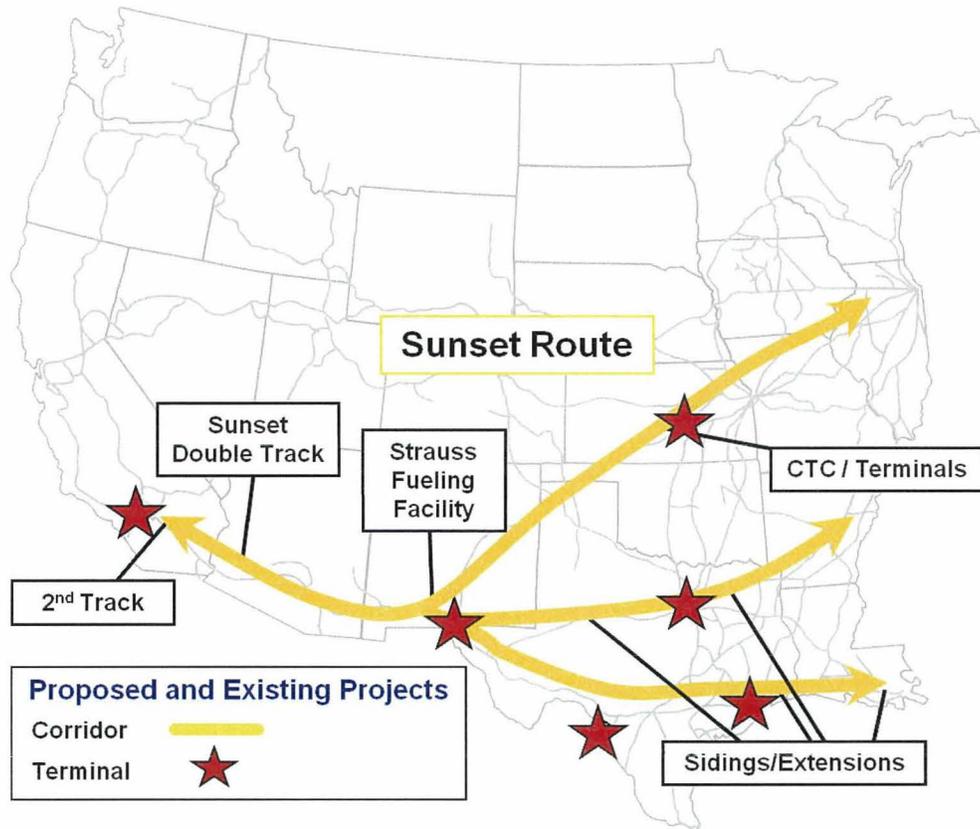
At the top of Donner Pass, where the cash-strapped Southern Pacific removed a portion of its second track over the Sierra Nevada Mountains, Union Pacific plans to replace that track to increase capacity on this more direct route. Also in California, our Lathrop intermodal facility, south of Stockton in the Central Valley, has been very attractive to domestic shippers. We are expanding it this year, and we will need to expand it further, a project costing almost \$90 million.

Branching northwest from the Central Corridor in western Wyoming, Union Pacific's route to Portland and Seattle is a major trade route, with ocean-going containers moving east, and grain, coal, and soda ash moving west. It also carries a large volume of carload traffic, and will carry even more when the housing market recovers and forest product traffic returns.

Union Pacific is presently extending sidings and adding terminal tracks along this route to increase reliability and allow us to operate longer trains. We will continue to do both. We will also expand our intermodal terminal in Portland. We plan to add an expensive connection in central Portland to allow trains to move directly between our east-west routes and our North-South I-5 Corridor along the West Coast.

Sunset Corridor. The following map shows the many projects we have planned for this corridor, which I will describe below.

Sunset Corridor Capacity Projects (Figure 4)



Beginning at the California terminus of this corridor, Union Pacific plans to add capacity at its domestic intermodal facilities at Los Angeles Transportation Center and East Los Angeles, at a cost of over \$100 million. Near the Ports of Los Angeles and Long Beach, we have been pursuing environmental clearance for years to upgrade our Intermodal Container Transfer Facility – an upgrade that, if permitted, will significantly reduce emissions. The first phase would be to add a new gate complex that would substantially reduce waiting time for trucks entering the facility.

Between Pomona, California, and West Colton, California, we plan to install double-track in segments, completing the project by 2014. This will reduce conflicts between Union

Pacific and Metrolink and BNSF trains on our other route through the Los Angeles Basin, improving reliability for all of us. A major project, which Union Pacific will help fund, will begin construction soon at Colton, where BNSF's Transcon Route crosses Union Pacific's Sunset Route at the busiest rail crossing in the West. This public-private-partnership project will elevate Union Pacific's double-track over the BNSF, eliminating significant freight train delay, improving freight movement to and from the ports, and protecting the reliability of Metrolink and Amtrak passenger service.

Our largest Sunset Route project continues, as we adds more second main track across the corridor between Southern California and Tucson. We expect to add 53 miles this year, bringing the route to 68 percent double track. We want to pace expansion ahead of anticipated demand for our services.

We accomplish little if we hustle trains across the Sunset Route but cannot get them through El Paso, the major bottleneck on this route. We have substantially improved train processing through this congested terminal, but there is no room to add more tracks. As a result, this month we authorized construction of a \$400 million terminal west of El Paso, which we call Strauss but most people call Santa Teresa. This terminal will include refueling facilities (supported by a new pipeline from El Paso), a rail yard where trains to and from West Coast ports can be sorted for destinations throughout the corridor, and a new intermodal facility serving the El Paso area.

On the most southerly route, east from El Paso to New Orleans, Union Pacific and BNSF serve a rapidly growing gateway to Mexico (Mexican rail traffic has fully recovered from the recession) at Eagle Pass, Texas. We need to improve the connection on the Sunset Route at Spofford, Texas, add sidings en route to the border, and expand switching capacity near Eagle Pass, a project already underway.

We plan to improve capacity and fluidity in the San Antonio corridor, adding second main track and additional crossovers between tracks. Our single-track Glidden Subdivision connecting San Antonio to Houston is at capacity today. We will add second track and extend sidings to improve fluidity and reduce delays. A second main track is especially important at the east end, between Rosenberg, Texas, and Houston, where we share tracks not only with Amtrak's New Orleans-Los Angeles trains, but also with Kansas City Southern and BNSF. And we plan further improvements to our Houston terminal trackage to reduce delays and increase capacity.

At the eastern end of this corridor in Louisiana, our line between our yard at Livonia (near Baton Rouge) and New Orleans is at capacity and must be expanded. Traffic to and from this heavily industrialized corridor continues to grow, with crude oil now arriving from North Dakota, more export grain, and increasing chemical shipments. We plan to construct support tracks to take our local trains off the mainline while they serve customers and second main track for through trains to and from the New Orleans gateway.

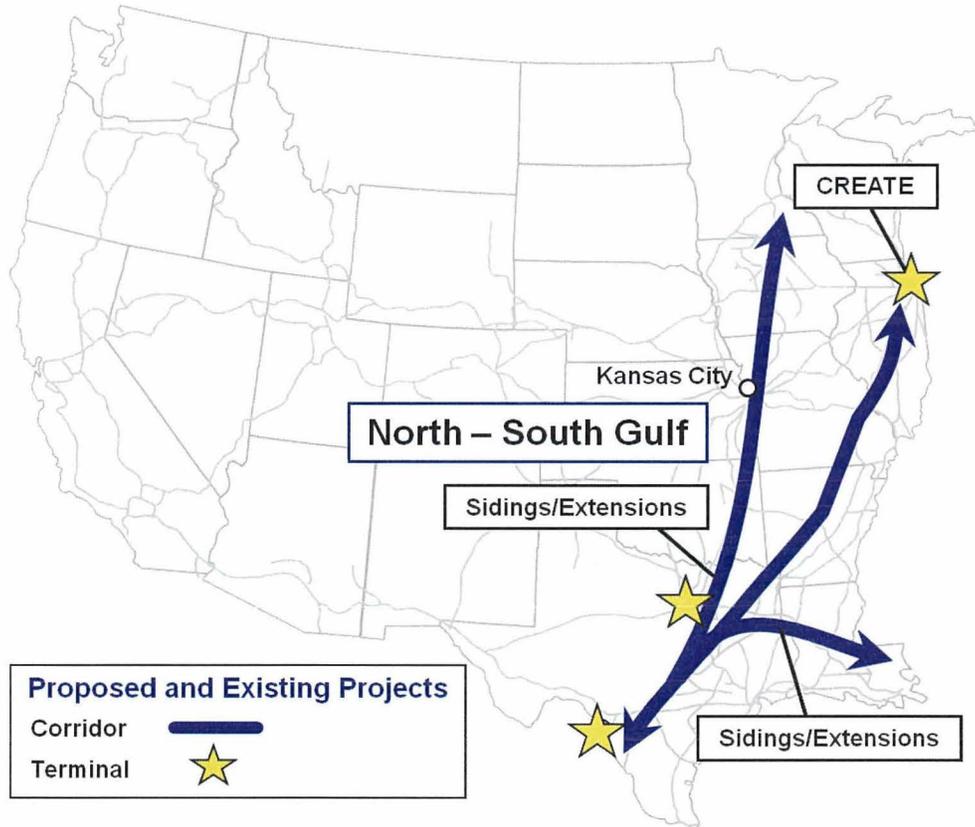
The former Texas & Pacific route from El Paso to Ft. Worth, now handling 18-23 trains per day, should handle more in the future if traffic patterns are not disrupted. Each year, we plan to extend three or four sidings along the route. Each time we do, we will be able to add an additional pair of longer, more efficient trains. At Ft. Worth, we are reconfiguring our major rail yard, Davidson Yard, in a public-private partnership that will add two main tracks between the yard and the busiest rail crossing in Texas, at Tower 55. A public-private partnership to expand capacity at Tower 55 has been funded and is awaiting approval.

Our line from El Paso to Kansas City includes a segment of single-track without CTC between Pratt and Herington, Kansas. When trains meet, employees must detrain to move hand-thrown switches, and dispatchers must use less efficient systems for train control. We plan to

add CTC across this segment. We will also add terminal capacity for through trains at crew-change points such as Dalhart, Texas, and Herington.

North-South Corridor. Union Pacific also has plans for capital spending in its North-South Corridor, as the following map illustrates.

North-South Corridor Capacity Projects (Figure 5)



We plan to add capacity at a number of points in this corridor in coming years. We will add track north of Ft. Worth and in the Denison, Texas, area to improve fluidity. We will begin installing CTC on what we call our Van Buren Subdivision, which carries trains between Little Rock and eastern Oklahoma.

On the Trenton Subdivision, which connects Kansas City and Des Moines, significant traffic growth – especially in ethanol, crude oil, and agricultural products – has outstripped capacity. As a result, we operate some northbound trains hundreds of miles out of route via

Omaha to make room for southbound trains on this route. As we add capacity on the Trenton Subdivision, we can turn those trains back to the most direct route.

Locomotives and Rail Cars

Although our locomotive fleet is the youngest in history, we will need to replace 100 - 200 road locomotives per year just to maintain quality. At over \$2,000,000 per copy, that investment will require more than \$400 million annually. We will need to invest even more to rebuild or replace local and switching locomotives.

In addition, we routinely have about 250,000 freight cars on our system, not including cars in storage. Of course, shippers own many of those cars, especially to transport coal, and TTX owns the majority of the intermodal cars on our railroad. To maintain the current carrying capacity of those rail cars, many of which are approaching the end of their lives, requires the renewal of several thousand cars per year. Union Pacific will continue to invest in freight cars, especially covered hopper cars for agricultural and other bulk commodities, and auto-carrying cars, and intermodal containers and chassis. We are evaluating replacements for other car fleets, but those investments – like all investments – will depend on the expected return on capital from each investment.

Positive Train Control

Our capital spending on PTC is ramping up this year, when we expect to invest roughly \$250 million in system development and pilot programs. We expect to continue to invest at that level or higher in coming years. We have no choice but to make these investments, although we have made it clear to government officials that we already have made, and will continue to make, greater improvements in safety for far less cost. PTC diverts capital from capacity, freight cars, and locomotives. It adds costs to rail service, both by consuming capacity and by substantially increasing operating costs as far into the future as we can see.