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BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

REPLY COMMENTS OF
UNION PACIFIC RAILROAD COMPANY

Union Pacific Railroad Company offers these reply comments in accordance with the Surface Transportation Board's Notice served January 11, 2011, in this proceeding.[1] Union Pacific urges readers to review the accompanying reply verified statements of John J. Koraleski, Executive Vice President - Marketing and Sales for Union Pacific Railroad Company, and Lance M. Fritz, Executive Vice President - Operations for Union Pacific Railroad Company. Union Pacific also endorses the reply comments submitted by the Association of American Railroads and Norfolk Southern Railway Company's admonition that the Board should take care to "do no harm."

An already extensive record reveals sharp divergence between the public interest – a foundation against which all Board action must be gauged – and the private interests of primarily coal and chemical shippers who, when the dust settles, want billions of dollars in rate reductions however they can get them. To serve the public interest, to meet the President's goal of doubling exports in four years, to advance the Administration's policy of shifting goods and

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

people from deteriorating roads to rails, the Board must above all protect the tremendous, post-Staggers Act rejuvenation of the national rail network.

The railroads stand alone as the one mode of freight transportation that is responsible, both financially and managerially, for its own infrastructure. That infrastructure is highly productive and expanding. In contrast, due to fiscal challenges, publicly funded infrastructure is in "crisis," putting America's economic competitiveness "at risk."[2] Union Pacific and other railroads achieved incredible productivity and infrastructure gains as a result of the Staggers Act and their control over their own networks, and those gains must not be undermined now, or the nation's economic future could be compromised.

The Board cannot ignore the broader, global economic context in which its policies reside. It should not, and cannot, regulate in a vacuum. Given the health and productivity of the railroads under the current balance of market forces and regulation, and the challenges faced by the U.S. economy, the Board's first priority must be to promote the one mode of freight transportation that can reduce demands on the road network, improve the nation's environmental footprint, and support the imperative to make America more competitive. And railroads can do it all with private dollars. Government or shipper direction of traffic movement on the national network, combined with losses of billions in rail revenue that certain shippers want for themselves, will not serve that national interest.

Part I of these comments summarizes the reasons why changing the Board's competitive access policies in the ways that certain shippers and shipper organizations have proposed in this proceeding is not in the public interest. Part II addresses various claims that

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[2] National Surface Transportation Infrastructure Finance Commission, Paying Our Way: A New Framework for Transportation Finance (Feb. 2009).

competition in the rail industry has diminished and summarizes the testimony of Mr. Koraleski, who shows that rail competition remains strong and that many specific allegations to the contrary are inaccurate. Part III addresses the impact on rail operations of proposed policy changes and summarizes the testimony of Mr. Fritz, who explains why the Board's adoption of the proposals would reduce rail productivity and service and increase costs. Part IV addresses arguments that the Board could increase rail-to-rail competition by imposing new conditions on past rail mergers.

I. INTRODUCTION

Union Pacific continues to oppose any change to the competition policies that transformed the U.S. rail industry into the world's best freight rail system. In our initial comments, we explained how the policies adopted by the Interstate Commerce Commission and the Board benefit shippers and the nation's economy as a whole. We showed that Union Pacific has never run a safer, more productive, or more service-oriented network than we do today, and that we achieved these results by investing billions of dollars in our infrastructure. We showed that we must – and expect to – continue investing if we are to meet customer expectations and contribute to the growth of our economy, especially as demand for rail service continues to rise. Finally, we described in detail the dangerous impacts on future investment, productivity, and service of adopting the forced access and forced interchange proposals that certain parties – mostly coal and chemical interests – advocate in this proceeding. We explained why adopting those proposals would require us to curtail investment in our network, would override our efficient management of our network, would put our service at risk, and would raise rail costs.

Despite their claims to the contrary, the parties urging thė Board to change its competition policies seek a massive increase in government regulation of the railroad industry solely to transfer revenues from railroads to them. Granting shippers access to additional rail carriers would constitute direct government involvement in how railroads operate. Requiring carriers that have developed efficient, single-line routes and interchanges to quote rates and route traffic to shipper-designated interchange points or to switch traffic to other carriers within terminals would also constitute a major exercise of regulatory control over the rail transportation system. Establishing the fee one carrier may charge another carrier for access to its lines or terminals would be yet another major intrusion of regulation into the rail transportation system. All of this regulatory expansion would contravene Congress' Rail Transportation Policy, *see* 49 U.S.C. § 10101, and President Obama's directive (which the Board has accepted) that agencies refrain from unnecessary or burdensome regulation, *see* Exec. Order No. 13563, 76 Fed. Reg. 3,828 (Jan. 21, 2011).

The parties urging the Board to change its competition policies fail to show why extensive new regulation and government intrusion into rail operations is necessary. They make incendiary claims that rates have increased because of failures to compete, but rail competition remains strong, as we will demonstrate. The parties complaining that rates have increased after falling for two decades ignore the well-documented economic and network factors affecting the rail marketplace, including the rising demand for transportation services, capacity constraints, rising costs, and lower productivity gains. Rail rate levels remain below 1984 levels in real terms and are the lowest in the developed world.

Union Pacific does not take any of its business for granted. We compete every day against BNSF and other railroads, other modes, and competing sources by offering our customers competitive, market-based rates. Our customers also benefit from non-price competition as we seek to attract and retain business by offering valuable service, developing new products, and investing in new capacity. As Mr. Koraleski discusses in his statement, claims that competition has diminished are unfounded.

Moreover, the parties urging the Board to change its competition policies do not seem to comprehend the impact their proposals would have on railroad investment and operations, the larger shipper community, or the economy as a whole. They focus only on their short-term goal of obtaining lower rates, without regard for the consequences. They assume railroads could continue providing the high levels of service and investment that they and other shippers desire, and that our economy needs, despite disruptions to rail operations and reductions of revenues that would result from shipper-dictated access and interchange decisions. As Mr. Fritz explains in his statement, they cannot have it both ways.

The Board cannot ignore the consequences of the proposals it is being asked to adopt, even though the proponents do. The current, highly successful rail environment reflects a careful balance between reliance on market forces and regulation. Railroads respond to market forces in setting rates and investing in their systems, while shippers can seek relief if they believe that their rates exceed a reasonable maximum or that railroads are abusing market power. This balanced approach to regulation was developed in response to ill-advised policies of the past that bear strong similarities to proposals offered here. Disturbing the balance will cause harms that far offset any benefits that a small subset of shippers might gain in the form of lower rates.

The Staggers Act, as implemented by the Interstate Commerce Commission and the Board, has been a spectacular success, creating a privately funded rail system that is the only bright star in the nation's transportation infrastructure. Union Pacific is investing private funds in rail transportation infrastructure at record levels, while the nation's non-rail transport infrastructure declines. Our investment helps move cargo from highways to rail, which is especially critical as federal and state transportation budgets face extreme financial challenges. Under the policies advocated by a vocal minority of shippers, financial markets would force us to curtail investment, the costs of rail service would rise, service quality would fall, and traffic would be pushed off the rails and back to trucks, as occurred in the pre-Staggers era.

Railroad investment is also critical for supporting passenger service. For example, Union Pacific's improving revenues allowed us to invest hundreds of millions of dollars in the tracks Amtrak uses, supporting the best Amtrak service on Union Pacific in memory and the best performing passenger corridors in America. But we cannot continue to invest at these levels if regulation cuts our revenues.

Our investments are also critical to increasing exports. Many shippers in this proceeding express a strong interest in increasing exports, and so does the Administration, which views exports as crucial to America's economic future. Railroads provide the primary export infrastructure in this country, and only railroads are building substantial capacity to increase exports of American goods. On Union Pacific, exports are growing faster than imports, and we are investing to drive additional export traffic growth. Policies that reduce rail revenue and curtail investment will limit America's ability to compete in the world market.

Over the last 30 years, Union Pacific and other railroads have made remarkable gains in safety, service, and efficiency by managing our networks in response to market forces. We have benefited from these gains, but so has the shipper community and the economy as a whole. The Board should not imperil this progress through regulatory changes that would increase federal intrusion into the rail transportation system.

II. UNION PACIFIC'S EXPERIENCE SHOWS THAT COMPETITION IN THE RAIL INDUSTRY REMAINS STRONG.

Union Pacific faces pervasive competition from other railroads and from other modes of transportation, including trucks and barges, and must respond every day to competitive pressures for every type of business. *See* Koraleski R.V.S. at 6. We will show specific examples. Moreover, in Union Pacific's experience, customers want low rates, but they also want more. They want reliability, service offerings that allow them to enter new markets, and safe and secure transportation for their products and raw materials, all of which affect their total logistics costs and their ability to compete in today's global economy. They also want to know that we are continuing to invest in both infrastructure and productivity to meet their needs. *See id.* Union Pacific competes for business across all of these dimensions because "[c]ustomers weigh the value of the services we provide against the price we offer in deciding whether to ship with us or someone else." *Id.* Unless the Board considers the full value proposition railroads offer, it would blind itself to the full breadth of competition.

Although certain parties in this proceeding claim that railroad competition ceased in 2004, Union Pacific's "results speak volumes about how hard we are competing for business, and particularly how hard we have been competing since 2004." *Id.* Union Pacific's train velocity in 2010 exceeded pre-2004 levels. Our Service Delivery Index was at a record high in 2010. Our customer safety performance set a new record in 2010. Our Customer Satisfaction Index was at record levels in 2010. We have been investing in infrastructure at record levels. *See id.* None of this would be happening if we were not competing vigorously every day.

Parties contending that rail competition has diminished ignore Union Pacific's service improvements and massive ongoing investments in infrastructure. They focus instead on changes in rail rates, which began rising in 2004 after falling for two decades. But their attempts to attribute changes in rate trends to a decline in rail competition are wrong. *See id.* at 8-9.

In Union Pacific's experience, changes in rate trends around 2004 resulted from changes in economic and network conditions that we began to recognize in 2003. These changes included a significant upward shift in demand for our services and a realization that we needed to make substantial investments in network capacity to accommodate this growing demand. *See id.* at 9-10. The changes also included rising costs, especially fuel costs, and slower productivity gains. *See id.* at 11. Union Pacific has discussed the impacts of these economic and network conditions in prior proceedings,[3] and they have been documented by Board studies that have examined these issues.[4]

The shippers complaining most vocally in this proceeding are generally those that entered into long-term contracts "under market and network conditions very different from those that exist today." Koraleski R.V.S. at 15. For many years, they benefited from our efforts to fill excess capacity to generate economies of density. Their rates made some contribution to our fixed costs, but often "were well below levels needed to generate market-level returns on our investments." *Id.* They had rate adjustment provisions that allowed them to avoid paying for the rapidly rising costs of fuel. As a result of their long-term contracts, "many enjoyed that environment long after those market conditions ended, but those rates were not sustainable." *Id.* These shippers are understandably disappointed to be facing higher rates today, "but their claims

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3 *See* Opening Submission of Union Pacific Railroad Company &Verified Statement of Thomas C. Haley, *Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1) (May 1, 2006); Comments of Union Pacific Railroad Company, *Rail Fuel Surcharges*, STB Ex Parte No. 661 (Apr. 27, 2006).

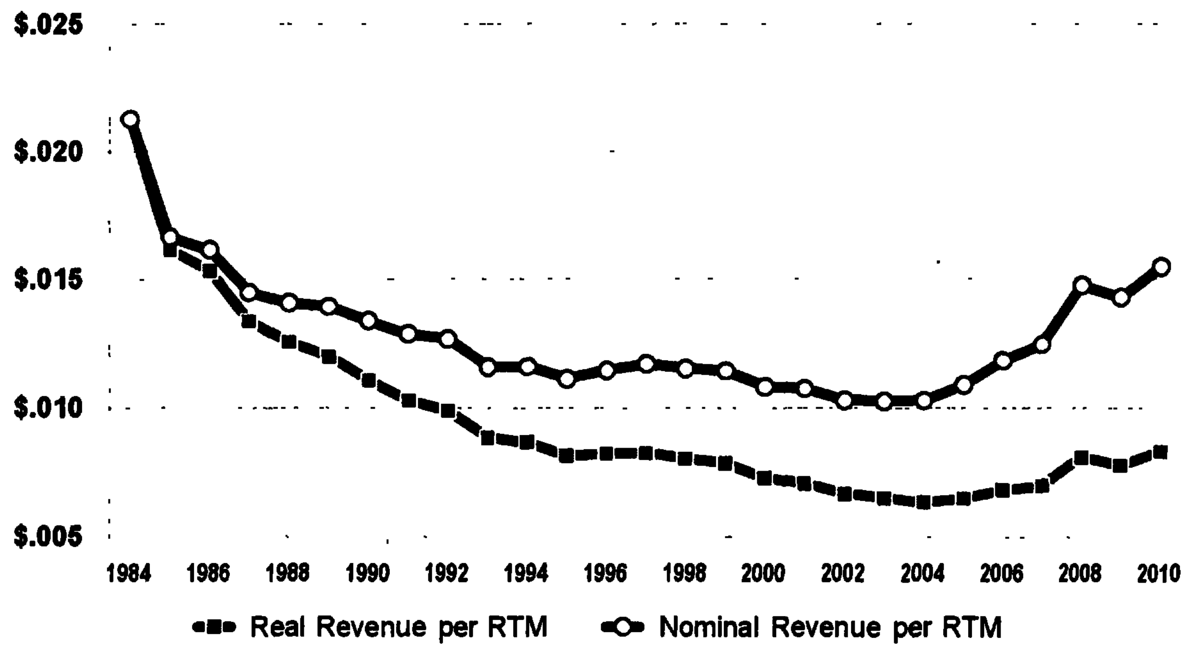
4 *See* Laurits R. Christensen Associates, Inc., An Update to the Study of Competition in the U.S. Freight Railroad Industry, Final Report, at 4-13 (Jan. 2010).

that higher rates reflect the disappearance of railroad competition are incorrect." *Id.* As discussed below, Union Pacific continues to compete vigorously for all types of business.

A. Competition for Coal Traffic Remains Strong.

Union Pacific is competing vigorously with BNSF for coal business, just as it has since a predecessor entered the Southern Powder River Basin in 1984. After falling for two decades, Union Pacific's coal rates increased after 2004 as a result of economic and network factors discussed above, but coal shippers are still getting a very good deal. Union Pacific's revenue per revenue-ton-mile for coal remains below 1984 levels in nominal and real terms. *See* Koraleski R.V.S. at 18.

Union Pacific Coal Revenue per Revenue-Ton-Mile 1984-2010



Source. Nominal· UP Fact Books and 10-K Annual Reports

Although rates no longer fell as they had in the past, coal traffic volumes continued to grow. Union Pacific's SPRB coal deliveries increased from 177 million tons in 2004, to 205 million tons in 2008, before settling to 177 million tons in 2009 as the economy stalled. Coal deliveries are climbing back, however, reaching 184 million tons in 2010. *See id.*

at 21. The Western Coal Traffic League's own data show that, despite recent rate increases, western railroad originations of coal movements as a percentage of western coal production have continued to increase in every period since 1995. *See* Comments of WCTL, Richards V.S. at 5, Chart II.

Claims that competition for coal traffic has ceased are simply incorrect. WCTL's Duane Richards wrongly asserts that, "after 2004 the incumbent carrier invariably prevailed in keeping its account." Richards V.S. at 18. But Dairyland Electric just recently awarded BNSF certain coal business that Union Pacific had handled for several years. *See* Koraleski R.V.S. at 24. Several other Midwestern utilities also shifted their traffic in recent years. *See id.* at 24-25. Other recent examples show that, even when traffic has not changed hands, Union Pacific competed vigorously for the business. *See id.* at 24-25. We are in a battle right now against BNSF for a major coal contract. We might lose, but if we win, the incumbent carrier's retention of traffic would not signify any absence of competition. *See id.* at 25

WCTL and certain shippers also claim that Union Pacific is no longer pursuing opportunities to serve coal plants through "build outs." *See* Richards V.S. at 8; Ameren Comments at 5. In fact, Union Pacific *has* competed to serve plants through build-outs when the opportunity has arisen – as we did in the case of Ameren's build-out from its Duck Creek plant in 2005. *See* Koraleski R.V.S. at 30-31. If coal shippers are not pursuing viable build-outs, it may reflect the unintended consequences of Board policies. For example, several years ago, Entergy filed a notice that it was planning to construct a build-out to BNSF from its

Independence plant in Newark, Arkansas.[5] However, rather than proceed with the build-out, Entergy fought for several years in an ultimately unsuccessful attempt to convince the Board to grant it access to BNSF over a Union Pacific-owned line that is leased to Missouri & Northern Arkansas Railroad.[6] In other words, if coal shippers are not pursuing viable build-outs, it is likely because they believe the Board will provide the benefits through regulation at a lower cost than if they follow a market-based approach and construct a new line.

Union Pacific's efforts to compete for coal business can also be seen in our investments and service performance. Between 2004 and 2010, Union Pacific invested $6.04 billion in its coal franchise, including $525 million in capacity. *See* Koraleski R.V.S. at 22-23. Thanks to these investments, as well as other focused efforts to improve safety and efficiency, Union Pacific is providing better service to coal customers than ever. In 2010, we delivered 4 percent more coal using 17 percent fewer trainsets than in 2003. *See id.* at 29. These massive investments and service improvements would not be happening if we were not competing.

Claims that Union Pacific is earning unreasonably high returns from coal are also incorrect. WCTL disputes statements that rail rate increases are being offset by increasing costs. *See* Richards V.S. at 18-19. But WCTL's own data disprove WCTL's claim. According to WCTL's data, Union Pacific's revenue-to-variable cost ratio for coal traffic fell from 2.01 in 1999 to 1.77 in 2004.[7] Then, even as Union Pacific's revenue per revenue-ton-mile began

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5 *See* Prefiling Notice, *Entergy Arkansas, Inc. & Entergy Services, Inc. – Petition for Exemption – Construction & Operation of a Line of Railroad in Independence, Jackson, & Lawrence Counties, Arkansas*, STB Finance Docket No. 35122 (Feb. 22, 2008).

6 *See Entergy Arkansas, Inc. & Entergy Services, Inc. v. Union Pacific R.R.*, STB Docket No. 42104 (served Mar. 15, 2011).

7 In response to requests from Union Pacific, WCTL produced some of the data underlying the charts in its comments. However, WCTL did not reveal how it calculated variable cost per (continued…)

increasing in 2004, Union Pacific's R/VC ratio continued to fall, reaching a low of 1.55 in 2008. Not until 2010 did Union Pacific's R/VC ratio rise above 2004 levels, and even then, it was just a sliver higher, at 1.78. Thus, when WCTL claims that railroads are enjoying dramatically higher contribution from coal, WCTL's own data show that most of the increase reflects rising coal volumes, not rising rates. These rising volumes are what shippers want, and they would not have been possible without our massive investments in our network.

WCTL and certain coal shippers also claim that Union Pacific has become less flexible in contract negotiations, but they seem mostly concerned that they can no longer obtain the favorable terms that produced two decades of declining rates. *See* Richards V.S. at 18; Comments of Omaha Public Power District *et al.* at 8, 13. Union Pacific is considerably more flexible than WCTL and others say we are with respect to most contract terms, but we are certainly not willing to enter into contracts that do not ensure a fair recovery of cost increases. *See* Koraleski R.V.S. at 27. Moreover, contrary to the claims of WCTL and others, Union Pacific continues to enter into contracts with service commitments. However, we are not willing to make commitments that would require us to favor a particular customer over the broader

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ton mile for coal transportation, a figure that also affects its calculations of contribution, other than to state that the data are "from L.E. Peabody & Associates, Inc's. estimates of coal unit train costs based on Rail Form-A and Western Region URCS for each calendar year shown in the estimates." Email from Peter Pfohl, Esq., to Michael Rosenthal, Esq., dated May 3, 2011.

Accordingly, Union Pacific does not endorse the R/VC levels calculated by WCTL or represent that they are correct. We present the data only to show that they contradict WCTL's other claims. (Union Pacific calculated the figures in the text using WCTL data regarding Union Pacific revenue and ton miles, and the variable cost per ton mile data produced by WCTL.)

In fact, Union Pacific has previously shown that coal generated 1.9 mills per revenue ton-mile of contribution in 2004, not the 4.47 mills calculated using WCTL data. *See* Opening Submission of Union Pacific Railroad Company, Verified Statement of Thomas C. Haley at 12 & Ex. TCH-6, *Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1) (May 1, 2006).

interest of all customers in operating a fluid network, as some coal shippers have demanded. *See id.* at 27-28. Instead, we offer service commitments centered on delivery of specified volumes of coal with a certain amount of equipment and that align with operating practices that maximize service. *See id.* at 28.

Finally, contrary to WCTL's claims, Union Pacific does not disclose public prices for coal. *See* Richards V.S. at 15. Union Pacific has not created new rates under the tariff known as Circular 111 for more than five years, and even when we were using Circular 111, the rates were never public. *See* Koraleski R.V.S. at 31. WCTL actually filed a lawsuit challenging Union Pacific's use of Circular 111 on the grounds that the rates were *not* made public. *See id.* Even now, WCTL's witness Richards complains that "railroads impose needless and unreasonable secrecy and confidentiality on their pricing and contracting activities." Richards V.S. at 18. WCTL's story seems to shift to suit its short-term objectives, and its claimed concern about price signaling conflicts with its demand to see prices.

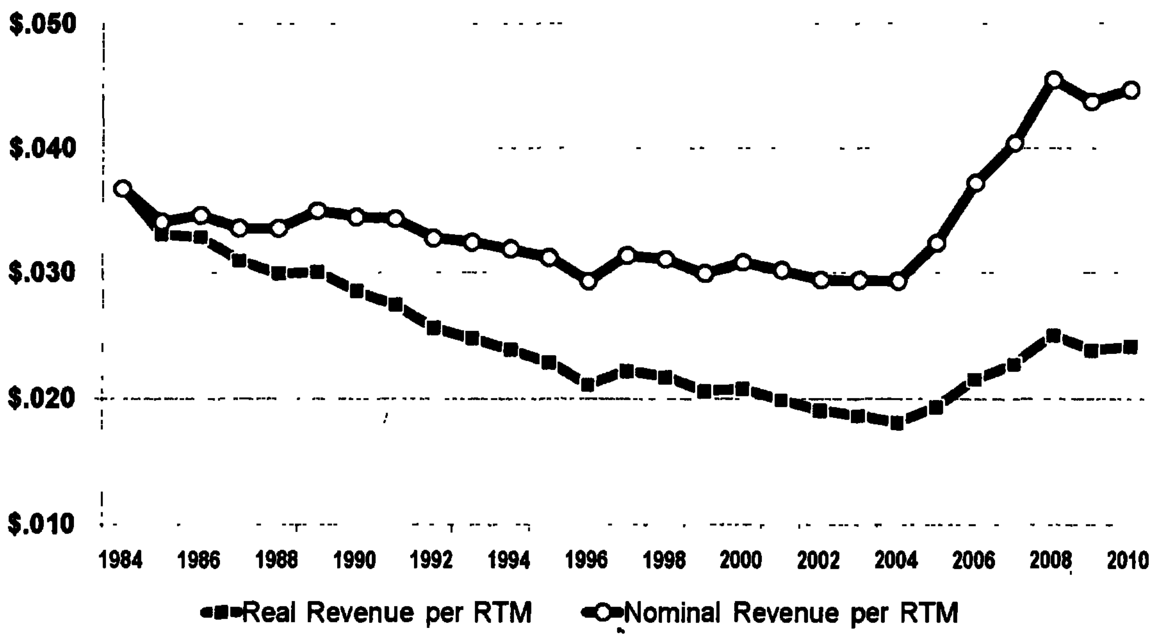
Union Pacific's coal rates increased in response to economic and network conditions, including rising demands, constrained capacity, rising costs, and slower growth in productivity. But claims that attempt to equate those rate increases with a reduction in competition for coal business are incorrect.

B. Competition for Chemical Traffic Remains Strong.

Competition for chemical business also remains strong. Many Union Pacific-served facilities have rail access directly or via short lines or terminal railroads to BNSF and KCS, and many have the additional option of moving traffic by water, pipeline, or truck. *See* Koraleski R.V.S. at 35. Our customers with facilities served solely by Union Pacific often have plants at other locations, so they can divert production to facilities served by other railroads if our rate and service terms are not competitive. *See id.* Because our customers have so many options for obtaining competitive rates and service terms that do not require head-to-head rail competition at each facility, they often construct new facilities or expand production at locations served by only one railroad, even when they could choose a location served by more than one railroad. *See id.* at 46-47. Our customers do not hesitate to remind us about their many competitive options when we are negotiating for new business or to retain existing business. Mr. Koraleski provides specific examples of these types of competition. *See id.* at 36-39.

Union Pacific competes for chemical business by offering competitive rates and excellent service to create value for our customers. Our rates for chemical business declined in nominal terms almost every year for the 20 years between 1984 and 2003, before beginning to trend upward as a result of factors described above. In real terms, our revenue per revenue-ton-mile remains 34 percent lower than in 1984. *See id.* at 34. And customers tell us that our superior service delivers significant savings. *See id.* at 44.

Union Pacific Chemical Revenue per Revenue-Ton-Mile 1984-2010



Source: UP Fact Books and 10-K Annual Reports

Union Pacific's experience is that service plays a critical role when chemical shippers choose among their transportation options. Union Pacific has therefore devoted considerable effort to improving service and thus the value we provide to customers. We have achieved measurable results. In 2004, we were delivering chemical traffic on time or early just 60 percent of the time. *See id.* at 45. By 2010, we raised that figure to 88 percent. *See id.* We also improved the average cycle time for private chemical cars from 16.9 days in 2004 to 13.3 days in 2010. *See id.* This not only makes us more competitive in general, but it allows our customers to maintain smaller car fleets, which saves them money. *See id.* We have taken substantial volumes of traffic from competitors because of our service. *See id.* at 44.

Claims that Union Pacific approaches negotiations for chemical business with an inflexible, take-it-or-leave-it attitude are wrong. Examples involving several customers that filed comments in this proceeding show how chemical shippers used their broad range of competitive options when negotiating with Union Pacific, and that Union Pacific approaches negotiations on a flexible basis and responds to customer concerns. *See id.* at 36-39. Although we do not always reach an agreement that allows us to handle the traffic rather than one of our competitors, "[m]ost often, our negotiations result in market rates that move traffic." *Id.* at 40. "Those rates may be higher than our customers wanted and less than we hoped for, but they move traffic and allow us to sustain and grow our network." *Id.*

Many of the comments regarding chemical traffic relate to transportation of chlorine, ammonia, and other toxic inhalation hazards ("TIH"). TIH shippers certainly experienced rate increases as their long-term contracts expired during the last decade. But their claims that rate increases reflect improper pricing behavior ignore the very significant increases in costs to move TIH by rail, which come on top of the many other factors that have affected rates for all rail traffic. Government policies have made TIH extremely expensive to transport. TIH traffic is subject to a long list of safety and security requirements. *See id.* at 34-35. Rates in the future must pay for the $1.4 billion Union Pacific expects to spend to install Positive Train Control on lines that carry TIH, plus approximately $225 million annually to keep it running. *See id.* at 35. We address the implications of shipper access proposals on safety and security of TIH in Part III. Notably, none of the shippers or shipper groups that complains about TIH rates even mentions the implications of their access proposals on rail safety or government security requirements.

While Union Pacific is spending significant sums to move TIH traffic safely and securely, this is the one segment of our chemical business in which we are not pursuing more traffic. We encourage shippers to pursue product and sourcing alternatives that will reduce the need for rail transportation. *See id.* at 42. Nonetheless, Union Pacific accepts its common carrier obligation to transport TIH. When a customer wants to move TIH, we establish rates and risk allocation terms that address fairly the costs and risks of providing this service. *See id.* The one claim that we forced a TIH customer out of business conflicts with that customer's press release and private statements. *See id.* at 43-44.[8] We urge the Board to focus more of its energy on addressing the pressing, practical issues associated with rail transportation of TIH.[9]

Finally, several shippers and shipper groups claim that Union Pacific and other railroads are charging rates that make the U.S. chemical industry non-competitive in world markets. As the American Chemical Council's website shows, this charge is untrue. "U.S. chemical manufacturers [have] become more competitive than producers in the rest of the world."[10] Union Pacific has made, and continues to make, significant efforts to promote U.S. competitiveness in world markets, as we discuss in detail in Part II.E.

U.S. chemical production depends on the costs of petroleum and natural gas, which are critical feedstocks for many chemical products. *See* Koraleski R.V.S. at 32-33. A

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8 One TIH shipper, Dyno Nobel, recently alleged in a different proceeding that Union Pacific had "doubled its anhydrous ammonia rail rates," forcing Dyno Nobel to shut down its plant in Battle Mountain, Nevada, "as the increased rates alone made the plant uneconomic." Letter from Dyno Nobel, Inc. at 2, *Union Pacific Railroad Company – Petition for a Declaratory Order*, STB Finance Docket No. 35504 (May 17, 2011). When Dyno Nobel shut down the plant, it issued a press release stating that "the Battle Mountain decision was driven by substantially reduced customer demand." *See* Koraleski R.V.S. at 44 & Ex. A. Mr. Koraleski explains in greater detail how Dyno Nobel's discussions with Union Pacific made clear that the plant closed for reasons beyond Union Pacific's control. *See id.* at 44.

Another TIH shipper, Olin Corporation, criticizes Union Pacific for failing to compete for chlorine traffic that originates at a Norfolk Southern-served facility in McIntosh, Alabama. *See* Comments of Olin Corp. at 31. But Union Pacific cannot reach the facility at McIntosh, and we already handle the traffic from an interchange with Norfolk Southern in New Orleans to a facility in Texas that is also served by BNSF. *See* Koraleski R.V.S. at 42-43.

9 *See Reporting Requirements for Positive Train Control Expenses and Investments*, STB Ex Parte No. 706 (served Feb. 10, 2011); *Class I Railroad Accounting and Financial Reporting – Transportation of Hazardous Materials*, STB Ex Parte No. 681 (served Jan. 5, 2009); Petition of Union Pacific Railroad Company for a Declaratory Order, *Union Pacific Railroad Company – Petition for Declaratory Order*, STB Finance Docket No. 35504 (Apr. 27, 2011).

10 American Chemistry Council, Economic Outlook for U.S. Chemical Industry Improving, ACC's Year-End Report Reveals, *available at* http://www.americanchemistry.com/Media/PressReleasesTranscripts/ACC-news-releases/Economic-Outlook-for-US-Chemistry-Industry-Improving-ACCs-Year-End-Report-Reveals.html.

decade ago, many producers were locating their production capacity in the Middle East because feedstocks were much cheaper. *See id.* at 33. More recently, however, U.S. natural gas prices have dropped due to vast new discoveries and new technologies, and domestic chemical production is increasing. *See id.* Indeed, several shippers that filed comments in this proceeding have recently announced plans to expand their production capacity in North America. *See id.* Union Pacific is experiencing strong growth in chemical traffic volumes in 2011, reflecting growing domestic production, and our success in competing for this business. *See id.*

C. Competition for Agricultural Traffic Remains Strong.

Union Pacific also faces strong competition for agricultural business, which includes transportation of whole grains, grain products (including ethanol), and other food and refrigerated products. Union Pacific must compete with other railroads, trucks, and barges for movements of agricultural products. In fact, agricultural products move mostly by truck or barge, not by rail. *See* Koraleski R.V.S. at 49. We also face significant source competition for this traffic. Agricultural shippers are dispersed over a wide geographic area. *See id.* at 48; *see also* Comments of U.S. Department of Agriculture at 2. This means that many shippers are served by carriers other than Union Pacific, and we have a strong interest in quoting rates to shippers we serve that will allow them to remain competitive in their markets, so they can expand the business they give to us. *See* Koraleski R.V.S. at 50.

Union Pacific competes for agricultural traffic by offering competitive, market-based rates and high-quality service. Union Pacific's rates for transporting agricultural products are subject to the same basic market forces that affect other traffic, so they have been increasing in recent years, although less than for other business groups. *See id.* at 51. Moreover, to put the issue into a broader perspective, "our rates for agricultural traffic have risen less than prices for several other significant agricultural inputs, including fertilizer, fuel, and seed." *Id.*

Union Pacific's efforts to compete for agricultural traffic are reflected in our work to improve service and develop new services to attract and retain business. As measured using our service delivery index, service quality for unit grain trains increased from 74 in 2003, to 86 in 2010. *See id.* at 52. Our service quality for agricultural manifest shipments showed even stronger improvement, increasing from 62 in 2004, to 87 in 2010. *See id.*[11] In recent years, Union Pacific has also added new origins for grain shuttle trains, developed unit train operations to serve the growing ethanol business, and developed truck-competitive premium services for shipments of perishables. *See id.*

Union Pacific has also made substantial investments to improve our competitive posture for agricultural traffic moving within the U.S. and for export traffic. We maintain the largest refrigerated boxcar fleet in the industry. *See id.* at 55. We recently expanded yards used to serve agricultural shippers in Texas and Kansas and acquired thousands of new hopper cars to carry agricultural products. *See id.* at 54-55. Car deliveries continue today. *See id.* at 55. We have also invested tens of millions of dollars in infrastructure to support the ethanol business. *See id.* at 54.

Union Pacific also recognizes that export traffic is important to many agricultural shippers. *See also* Comments of U.S. Department of Agriculture at 3. In recent years, we have made significant investments to support agricultural export traffic, as discussed below in Part II.E. Export traffic is important to the growth of our agricultural business, so our interests are closely aligned with the interest of our customers in providing efficient, competitively-priced service for this traffic. *See* Koraleski R.V.S. at 55-56.

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[11] Union Pacific did not begin to calculate a service delivery index for agricultural manifest shipments until 2004. *See id.*

D. Competition for Intermodal, Automotive, and Industrial Products Traffic Remains Strong.

Union Pacific discussed in detail the highly competitive nature of the marketplace for its intermodal, automotive, and industrial products businesses in its January 31, 2011, written testimony and accompanying verified statements in Ex Parte No. 704, *Review of Commodity, Boxcar, and TOFC/COFC Exemptions*. Union Pacific's testimony and statements showed that we face intense competition from other railroads, trucks, and water carriers for this traffic. Rather than repeat that discussion here, we refer the Board to those materials.

No intermodal or automotive shipper or shipper organization filed comments advocating changes to the Board's competition policies. Two industrial products customers filed comments that specifically mention Union Pacific. One, Roseburg Forest Products, observed that shipping patterns have changed over time, with trucks now dominating shorter distance hauls and less business moving from Oregon to Texas and the Northeast. Comments of Roseburg Forest Products at 3-4. However, the issue is not our rates, which are well below the Board's jurisdictional threshold. Rather, the issue is that, especially in this weak market for lumber products, trucks are offering rock-bottom rates for short haul lumber traffic, and Roseburg is at a cost and geographic disadvantage for many movements, given its location on a short line in Oregon the many source options for lumber products. *See* Koraleski R.V.S. at 60-61. Roseburg's situation reflects the highly competitive market for lumber products that Union Pacific described in Ex Parte No. 704.

The second shipper, Mississippi Lime, offered more pointed complaints about its commercial relationship with Union Pacific. Union Pacific has had constructive dealings with Mississippi Lime in the past and offered a proposal earlier this year that was designed to respond to Mississippi Lime's interest in expanding production at its facility in Mosher, Missouri. *See id.*

at 62. We are hopeful that this commercial relationship is not being undermined by efforts to gain a regulatory advantage. *See id.*

E. Competition for Import and Export Traffic Remains Strong.

Several shippers and shipper groups claim that Union Pacific and other railroads are harming the U.S. economy and driving U.S. jobs overseas by favoring imported traffic over exported traffic. These claims are nonsense. U.S. rail rates are not driving U.S. jobs overseas. The reasons U.S. jobs have moved, and continue to move, overseas are well-known: jobs are moving to countries with "wage rates that are a fraction of U.S. wages, scant benefits for employees, restrictions on labor organizations, limited environmental controls, and less regulation." *See* Koraleski R.V.S. at 66. More U.S. jobs moving overseas these days involve information technologies – they are not dependant on rail service. *See id.* Moreover, U.S. tax policy encourages offshoring by imposing some of the highest corporate tax rates in the world and also allows U.S. companies to shelter foreign earnings from U.S. tax rates so that they can compete overseas with foreign corporations. *See id.* "Railroad rates are not even a drop in the bucket compared with these tremendous economic forces driving decisions by U.S. companies to send jobs overseas." *Id.*

Parties complaining about imports create a false dichotomy between "us" and "them." They fail to recognize that most of the companies that are importing the goods we move by rail "are *American* companies: Ford, Wal-Mart, Kohl's Catepillar, General Motors, and many others." *Id.* The complaining parties also fail to recognize that "[t]he same rail infrastructure that carries imports into the U.S. also carries America's exports to the world." *Id.* at 67. Their proposals would make U.S. railroads less able to invest in infrastructure, which would do as much damage to our ability to transport exports as imports.

Many of the complaining parties would probably be surprised to learn that "Union Pacific carries slightly *more* exports than imports, and exports are growing faster than imports." *Id.* at 67. We are seeing this growth across the business groups discussed above, as these examples illustrate:

- Energy: Union Pacific's export coal traffic is growing, and we could be carrying even more if environmental regulation and litigation were not preventing expansion of coal export facilities. *See id.*

- Chemical: Union Pacific plays a pivotal role in the world competitiveness of soda ash, and we have recently invested in yard facilities to improve our service. *See id.* at 68. We have also been increasing exports of plastics. Between 2005 and 2010, Union Pacific's export plastics volumes have grown by 30 percent. *See id.*

- Agricultural Products. Approximately 25 percent of Union Pacific's agricultural business is exports, and we are currently building new transload facilities to accommodate rapidly growing exports of dried distillers grain, a co-product of ethanol production used for animal feeds. *See id.* at 67.

- Industrial products: Union Pacific has been increasing iron ore exports to China, though lack of port capacity restricts this opportunity. *See id.* at 68.

The outcome of this proceeding will have a major impact on whether Union Pacific will be able to make the investments necessary to grow export traffic and help keep America competitive on the world stage.

III. COMPLAINING SHIPPERS AND ORGANIZATIONS FAIL TO RECOGNIZE THE IMPACT THEIR PROPOSALS WOULD HAVE ON RAIL OEPRATIONS, SERVICE, AND COSTS.

Union Pacific's opening submission explained in detail how the proposed changes to the Board's competitive access policies would reverse the tremendous gains we have made in safety, service, and productivity over the last 30 years. None of the parties advocating changes to the Board's policies demonstrates any awareness of these consequences. The changes they propose – splitting traffic densities and increasing inefficient interchanges – would be the opposite of what railroads invested billions of dollars to achieve, generating astonishing gains in productivity that benefited shippers.

As Mr. Fritz explained in his opening statement and confirms in his reply statement, introducing shipper or regulatory routing decisions into the rail network would destroy productivity gains and herald a return to the operating inefficiencies of the pre-Staggers Act era.

From a policy perspective, this would be a dangerous error. Union Pacific's customers must compete in a global marketplace that requires efficient supply chains, which Union Pacific now supports with efficient, quality service. Introducing inherently less efficient and more costly interline service and interchanges within busy terminals will undermine the competitiveness of all customers, whether or not it brings the rate reductions that a subset of those customers seek. It would also reduce Union Pacific's ability and willingness to invest at a time when we are committed to continuing investment to meet the needs of our customers.

The complaining shippers' proposals are so ill-informed that some of them would be unworkable. For example, Occidental Chemical and The Fertilizer Institute complain that Union Pacific is selecting interchange points for self-serving purposes. They want to control routing decisions, and would have Union Pacific route more traffic to eastern carriers via New Orleans, instead of gateways further north. *See* Comments of Occidental Chemical Corp. at 4; Comments of TFI at 13. However, Occidental and TFI are apparently unaware that New Orleans is perhaps the least capable gateway for handling more traffic. "[I]t is the single worst congestion point affecting the Union Pacific system today." Fritz R.V.S. at 7. "[T]rains routinely sit for hours, and sometimes a day or more, before reaching a connecting carrier in New Orleans." *Id.* Over the years, Union Pacific has worked with connecting carriers to create gateways and design service plans to avoid congested terminals and delay whenever possible. *See id.* at 11-12. Complainants like Occidental and TFI do not understand how to operate a complex rail network or the dangers of routing more traffic through New Orleans, so it is easy to see how "shipper routing selections could wreck the rail network." *Id.* at 7.

Complaining shippers also seem unaware that expanding inter-carrier switching, especially in rail terminals, could cause severe congestion and would at least reduce productivity and service while adding costs. These parties fail to appreciate that "interchanges are inherently inefficient." *Id.* at 12. They cause delay and require railroads to use "more capacity in terms of rail cars, locomotives, crews, and track to move a given volume of traffic." *Id.* Reciprocal switching also introduces all of the conflicts that have impaired interline services for decades. For example, it blindfolds the receiving carrier about arriving traffic and causes shipments to pile up. "Union Pacific works closely with its customers to ensure that car flows are compatible with our capacity and with theirs." *Id.*. But when we do not participate in the line haul "[w]e cannot see the shipments coming." *Id.* We therefore lose the ability to ensure "that the demands we place on each yard are within its capabilities and allow it to keep shipments moving on schedule." *Id.* at 13.

Significantly, no party favoring shipper discretion in routing and switching attempts to address how such discretion could be reconciled with safety and security rules that apply to rail transportation and interchange of TIH and other "Rail Security-Sensitive Materials" ("RSSM"). These include the regulation requiring railroads to use the safest routes based on a 27-factor analysis and the requirement that railroads install Positive Train Control systems on track segments that carry more than a *de minimis* amount of TIH. Allowing shippers to select interchange points for RSSM shipments "would dash detailed plans we have developed with other carriers" to comply with positive hand-off rules for RSSM and require us to institute costly new operations at new interchange points. *Id.* at 14. A shipper could "force railroads to spend tens or hundreds of million dollars on Positive Train Control on new routes of its choosing, when better routes already have PTC." *Id.* Union Pacific is deeply concerned about "uninformed decisions on how traffic moves that damage both rail operations and economics." *Id.* at 15.

These comments and Mr. Fritz's statements set forth only examples of the many operational drawbacks to the shippers' proposals. Although the examples are many, the end results are the same: decreases in productivity, service delays, and potential congestion nightmares, as the New Orleans proposal illustrates. Rail network costs would increase, which logically would increase the costs of rail transportation and send more shipments back to the highways. This is not what rail customers need or want, especially when they need to rely on freight rail transportation more than ever.

IV. THE BOARD CANNOT INCREASE RAIL-TO-RAIL COMPETITION BY IMPOSING NEW CONDITIONS ON PAST MERGERS.

A collection of shipper associations calling itself the "Interested Parties" suggests that the Board could revamp the current regulatory regime by reopening prior railroad mergers that were approved and consummated in the 1990's and issuing orders imposing new conditions on these mergers. *See* Joint Comments of Interested Parties at 7, 68-69. The Interested Parties assert that the Board has authority to take such action under 49 U.S.C. § 11327, which provides that the Board may make "appropriate" orders that are supplemental to an order made in a proceeding under sections 11322 through 11326 of title 49 "[w]hen cause exists." Olin also discusses this argument in its comments. *See* Comments of Olin Corp. at 18-22. Both the

Interested Parties and Olin seek the same three new conditions.[12] They primarily advocate imposition of a requirement that the railroads quote rates for bottleneck segments. Their two other proposals involve prohibitions on certain railroad communications regarding rates.

Changes to the Board's competitive access policies are unwarranted and would be counterproductive, and the suggestion that three major merger proceedings should be re-opened at this late date is extremely far-fetched and should be rejected. All three mergers – BN/ATSF, UP/SP, and the Conrail transaction – were approved by the Board over twelve years ago and were consummated soon after receiving approval. The UP/SP merger was consummated almost fifteen years ago. For the UP/SP merger and the Conrail transaction, the Board established five-year oversight periods so that it could monitor implementation of the mergers and the effectiveness of the conditions it had imposed. The Board ultimately terminated these oversight proceedings, almost a decade ago in the case of the UP/SP merger.

It is certainly too late in the day for Olin and the other shippers to seek new conditions on the UP/SP merger. In its order approving the merger in 1996, the Board laid out extensive conditions[13] and imposed the oversight process "to examine whether the conditions we

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[12] The three new conditions proposed by the Interested Parties and Olin are "(1) requirements that each railroad quote, upon request, a single-line rate applicable from any origin or interchange point served by it to any destination or interchange point served by it without restricting in any way the application of such a single-line rate in combination with other rail rates; (2) prohibitions against any railroad from discussing, agreeing upon, or sharing information with respect to any single-line rate with any person, including any other railroad or railroad agency or association, other than the shipper involved in that specific single-line movement; and (3) prohibitions against any discussions between or among railroads regarding rates other than those individual rate discussions regarding joint line rates between or among participating interline partners." Joint Comments of Interested Parties at 68-69; Comments of Olin Corp. at 21.

[13] Some of these conditions were based on settlements Union Pacific had reached with associations that are now listed as "Interested Parties." In view of these settlements, it is plainly inappropriate for these associations to be seeking new merger conditions.

have imposed have effectively addressed the competitive issues they were intended to remedy." *Union Pacific/Southern Pacific Merger*, 1, S.T.B. 233, 420 (1996). The Board retained jurisdiction to add new conditions only "if, and to the extent, we determine that the conditions already imposed have *not* effectively addressed the competitive harms caused by the merger." *Id.* Union Pacific accepted the conditions the Board imposed in 1996, including the imposition of the oversight process. It then cooperated fully in the oversight process, providing extensive information to the Board.

The Board conducted five annual reviews during the oversight period, reviewing and carefully analyzing the evidence submitted by Union Pacific, BNSF, and other parties. In December 2001, at the end of the oversight period, the Board concluded that the conditions it had imposed in approving the merger had been effective, and it terminated the oversight proceeding. *See Union Pac. Corp., Union Pac. R.R., & Missouri Pac. R.R. – Control & Merger – Southern Pac. Rail Corp., Southern Pac. Transp. Co., St. Louis Sw. Ry., SPCSL Corp., & The Denver & Rio Grande W.R.R. Co. (General Oversight),* 5 S.T.B. 1173, 1173 (2001) (finding that, "overall, the evidence demonstrates that the conditions . . . imposed on the UP/SP merger have effectively remedied, as intended, any competitive harm that would otherwise have been associated with that transaction"). In its final oversight order, the Board cited Section 11327, but only for the proposition that it would have authority to enforce the conditions it had previously imposed. *See id.* at 1177-78. The Board nowhere suggested that it would be free to impose entirely new conditions years after the oversight period had ended. It certainly did not suggest that it could use Section 11327 to impose a broad requirement that Union Pacific quote rates for any bottleneck segment on its system, a significant measure not grounded in any of the merger conditions the Board had imposed previously.

Moreover, there is no basis for concluding that Section 11327 authorizes imposition of new conditions on the UP/SP merger at this stage. The Interested Parties and Olin cite no precedent for application of this provision to impose new conditions on a merger after it had been consummated, much less at a point almost 15 years after consummation. In fact, an effort to apply Section 11327 in this manner would be flatly inconsistent with Board precedent.

The Board and its predecessor have always recognized that mergers must be the product of voluntary agreement. Although the Board may impose conditions on its approval of such transactions, the parties retain the right to walk away from a transaction if they deem the conditions too burdensome. Thus, the Board cannot compel the parties to go through with a transaction on which conditions have been imposed. The Board's "grants of authority . . . for the conveyance of rail property . . . are permissive." *Western Fuels Serv. Corp. v. Burlington N. & Santa Fe Ry.*, Docket No. 41987 (STB served July 28, 1997), at 10 (citing *St. Joe Paper Co. v. Atlantic Coast Line R.R.*, 347 U.S. 298, 306 (1954)). "Thus, should a rail carrier find that any conditions that [the Board] impose[s] upon granting . . . authority are unacceptable to it, it can forgo" the transaction. *Id.*; *see also Canadian Nat'l Ry., Grand Trunk Corp., & Grand Trunk W.R.R. – Control – Illinois Cent. Corp., Illinois Cent. R.R., Chicago, Cent. & Pac. R.R., & Cedar River R.R.*, 6 S.T.B. 492, 496 (2002) (an applicant always "has the right to walk away from a transaction if it deems the conditions too burdensome"); *Guilford Transp. Indus., Inc. – Control – Boston & Maine Corp.*, 5 I.C.C.2d 202, 206 (1988) ("If the carriers do not accept the conditions imposed by the Commission, they need not consummate the transaction.").

Moreover, the Board has long recognized that "principles of administrative finality and commercial certainty" generally preclude the agency from reopening consummated transactions to impose new conditions on prior grants of authority. *Western Fuels* at 10. While

Section 11327 provides authority to make supplemental orders for transactions, the Board has pointed out the "obvious" unfairness associated with imposing additional conditions "long after the control transactions were consummated and consolidated operations were effected." *Guilford*, 5 I.C.C.2d at 206. "[O]nce the period for administrative reconsideration has passed, carriers that have decided to move forward with their transaction are entitled to rely on the assumption that the basic terms and conditions of administratively final decisions are not likely to be altered." *Canadian National*, 6 S.T.B. at 496. Thus, the Board has stated that, "absent some failure of a condition that we imposed or some specific reservation of jurisdiction through oversight or otherwise, it would generally not be appropriate for us to impose new conditions on our approval of a transaction that has already been consummated." *Major Rail Consolidation Procedures*, 5 S.T.B. 539, 583 (2001); *see also id.* at 583 n.53 (authority to issue supplemental orders in rail merger cases "must necessarily be used very cautiously and sparingly once the parties to an approved merger no longer have the opportunity to elect not to proceed if they are unwilling to accept all of the conditions that we have placed on our approval of their proposal").

Here, the unfairness to Union Pacific of a "supplemental" order imposing new conditions on the 1996 merger with SP is "obvious." *Guilford*, 5 I.C.C. 2d at 206. At the time the Board approved the merger, Union Pacific carefully evaluated the effect of the conditions the Board had imposed before deciding to proceed with the transaction. If Union Pacific had known then that fifteen years later the Board might issue significant new conditions – particularly conditions (such as a broad requirement to quote bottleneck rates) that would deny the railroad the opportunity to earn market-based revenues for a substantial amount of traffic and that could impose serious operational disabilities on the rail network – it might well have chosen not to consummate the merger.

In view of the Board precedent discussed above, Section 11327 should not be read to authorize the imposition of entirely new merger conditions. In light of the obvious unfairness of imposing burdensome new conditions on Union Pacific years after consummation of the merger, such action could not be regarded as an "appropriate" order or as supported by "cause" within the meaning of the statute. Moreover, if the Board were to impose new merger conditions long after consummation, with no prior warning that it was reserving the right to do so, this would raise significant due process issues. *See Landgraf v. USI Film Prods.*, 511 U.S. 244, 280 (1994) (noting that an agency rule is impermissibly retroactive if it "impose[s] new duties with respect to transactions already completed").

Even if the Board had authority to impose new conditions on the UP/SP merger in some set of circumstances, exercising that authority would be inappropriate here. There is no claim that Union Pacific withheld relevant information or made misrepresentations during either the merger proceedings or the oversight proceedings. The Board carefully considered allegations that the merger would reduce competition, and it imposed numerous conditions designed to avoid any anticompetitive effect (but no requirement that Union Pacific quote rates for bottleneck segments). There is no suggestion that the Board failed to perform a thorough analysis in developing the conditions or in monitoring merger performance and compliance with the conditions during the oversight period.

Moreover, the three new conditions proposed by the Interested Parties and Olin do not bear any meaningful relationship to the UP/SP merger. The request that the railroads be required to quote bottleneck rates based on shipper-designated interchange points would apply to portions of the Union Pacific system that were untouched by the UP/SP merger. The second and third proposed conditions, involving communication among rail carriers about rates, also have no tie to the specific effects of the UP/SP merger. Moreover, the requests are not well thought out. For example, the second proposed condition on its face appears to prohibit railroads from publishing common carrier rates for single-line routes. Furthermore, neither the Interested Parties nor Olin explains why existing antitrust laws are not sufficient to address any valid concerns about communications among rail carriers.

In sum, the changes to the current regulatory scheme the Interested Parties and Olin seek may not be imposed as new conditions to past mergers. The argument based on Section 11327 must be rejected.

V. CONCLUSION

The Board's competition policies benefit shippers, railroads, and the national interest. Competition remains strong. Changing the Board's competition policies to increase government intervention in rail operations would produce harmful impacts on railroad safety, service, and investment that the parties advocating for such changes do not even attempt to address. The Board should terminate this proceeding without taking any further action.

Respectfully submitted,

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May 27, 2011

KORALESKI

REDACTED – TO BE PLACED ON PUBLIC FILE

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

REPLY VERIFIED STATEMENT

OF

JOHN J. KORALESKI

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REPLY VERIFIED STATEMENT

OF

JOHN J. KORALESKI

My name is John J. Koraleski. I am Executive Vice President - Marketing and Sales for Union Pacific Railroad Company. I have been with the railroad since 1972 and have held my current position since 1999. I have also served as Executive Vice President - Finance and as Chief Financial Officer of Union Pacific, and as Controller of Union Pacific Corporation. I hold a bachelor's and a master's degree in business administration from the University of Nebraska at Omaha.

In my current position, I am responsible for Union Pacific's six major business units: Agricultural, Automotive, Chemicals, Energy, Industrial Products, and Intermodal. I deal with a wide range of customers from all across our network. One of the most important parts of my job involves ensuring that Union Pacific offers customers strong value: quality service that drives traffic growth, while producing revenues sufficient to support reinvestment in our network and provide competitive returns to our shareholders.

I understand that the Surface Transportation Board is considering changes to its competition policies, and that certain shippers have argued that changes are needed to remedy a supposed lack of competition in the railroad industry. I have reviewed the comments claiming that rail competition disappeared in 2004, and attributing subsequent rate increases to alleged anticompetitive effects of past mergers or pricing practices among railroads. I have also reviewed comments claiming that railroads are harming the nation's economy by favoring traffic that originates overseas. These claims are not consistent with the facts.

Union Pacific faces pervasive competition from other railroads and from other modes of transportation, including trucks and barges. Every day I discuss with my team how to respond to competitive pressures for every type of business. I found it ironic to read the Western Coal Traffic League's complaints about lack of competition between Union Pacific and BNSF when, just a month earlier, Dairyland Electric told us that it had awarded its coal traffic, which we had been handling, to BNSF. Dairyland has been one of the most vocal parties on Capitol Hill in complaining about the supposed lack of rail competition.

Rail regulation tends to ignore factors that affect transportation value other than rates. The vast majority of shippers want more than low rates – they want timely, reliable rail service that helps them reduce their own costs; they want service offerings that allow them to enter new markets or give them an advantage over competitors using other carriers; they want safe and secure transportation for their products and raw materials; they want excellent customer service and responsiveness; and they want to know that we are continuing to invest in meeting their needs. Customers weigh the value of the services we provide against the price we offer in deciding whether to ship with us or someone else.

Our results speak volumes about how hard we are competing for business, and particularly how hard we have been competing since 2004. Our train velocity in 2010 exceeded pre-2004 levels. Our Service Delivery Index was at a record high in 2010, well above pre-2004 levels. Our customer safety results have improved steadily since 2004, and we set a new record in 2010. And, as a result of our efforts to improve service and safety, including the billions of dollars we have invested in our network since 2004, our Customer Satisfaction Index was at record levels in 2010, far above the levels achieved prior to 2004.

Our efforts to create value for our customers provide tremendous benefits to the U.S. economy. Import traffic has been growing through U.S. ports because U.S. businesses and U.S. consumers are demanding the service in response to market conditions (not because we are trying to influence the choice as some parties here suggest). Many businesses rely on imported parts and materials to manufacture products here in the United States. Many consumers want to buy imported goods. Our strong service helps these businesses and consumers meet their needs. But, contrary to claims of some parties, Union Pacific's export traffic is greater than our import traffic and is growing faster than our import traffic. And, if U.S. businesses are going to survive in a growing world marketplace, they will need a strong domestic rail infrastructure to support exports. Only railroads can meet that need. Increased regulation of railroads that drives down rail revenue or increases rail costs would reduce our ability to invest and interfere with our efforts to provide the high-value services that U.S. businesses need to compete on a world stage.

In the sections below, I will elaborate on these topics. *First*, I will discuss the various factors that have played a role in reversing the decades-long downward trend in railroad pricing. I will show that shippers are wrong to claim that recent rate increases reflect reduced rail competition, rather than the operation of market forces. *Second*, I will describe the competitive environment facing each Union Pacific business group. I will show that competition remains strong for all types of traffic and that any claims that we are not working to win new business and improve the value we provide our customers are misguided. *Third*, I will discuss claims that Union Pacific is favoring imported traffic and explain how our transportation of imports, exports, and domestic traffic benefits this nation's businesses and consumers.

Union Pacific values its relationships with its customers and we appreciate their business. We also respect their right to express their views before the Board, and trust that they likewise respect our right to do so. Although this statement disagrees with specific claims that some of our customers make, our intent is to present the Board with a more complete record as it considers the important issues at stake in this proceeding. Even if we do not agree on these issues, that in no way diminishes our respect for, and appreciation of, our customers.

I. CHANGES IN UNION PACIFIC RATES REFLECT THE OPERATION OF MARKET FORCES.

The shipper groups and shippers claiming that rail rates have increased as a result of reduced rail competition observe that there was a turning point in 2004. There is widespread agreement that overall rail rates declined substantially from 1985 through 2004. What changed in 2004? Several parties offer competing theories, none of which are correct.

Shippers wrongly attribute rising rates to mergers or non-competitive pricing. According to certain shippers, as well as the group of shipper associations calling themselves the "Interested Parties," the blame for rising rates falls on so-called "mega-mergers" that created eastern and western "duopolies." But their theory does not explain the change. The last major western merger was Union Pacific's acquisition of Southern Pacific in 1996. The last major eastern transaction was CSX's and Norfolk Southern's division of Conrail in 1998. Moreover, Union Pacific's experience is that mergers dramatically *increased* competition and provided other significant benefits to shippers. For example, the "NAFTA Railway" (Kansas City Southern and Kansas City Southern de Mexico) exists solely because of a condition on the UP/SP merger that connected those railroads, creating a potent competitor to and from Mexico. The BN/ATSF and UP/SP mergers created new comprehensive networks offering competition throughout the West, especially in the "I-5 Corridor," where SP previously provided the only significant service. Moreover, at least the SP, the Missouri-Kansas-Texas, and probably the

CNW would have failed by now without the last generation of mergers, because they could not afford to reinvest in infrastructure.

The Western Coal Traffic League and certain individual coal shippers offer a different theory. They claim that Union Pacific and BNSF engaged in non-competitive pricing in 2004 when they adopted public tariffs for coal, as reflected in Union Pacific's adoption of Circular 111. But that theory does not explain why the Interested Parties and other shippers are complaining – it applies only to coal, and only to coal moved by Union Pacific and BNSF. Even as to coal, Union Pacific stopped offering Circular 111 rates years ago, and our use of Circular 111 never had anything to do with eliminating competition. It was just one part of our effort to respond to broad changes in the economy and transportation markets that became apparent in late 2003. These changes affected not only our coal business, but also our more general approach to pricing all rail traffic.

Union Pacific faced a significant turning point in 2003. In 2003, it became clear to us that the era of surplus capacity that characterized much of the nation's rail network in the latter part of the 20th century had ended. Shippers had enjoyed bargain rates, sometimes rates that unfortunately produced no return on our assets, as market pressures forced us to harvest excess capacity and pass the savings along. After two years of lackluster performance, the U.S. economy staged an unexpectedly strong recovery in the third quarter of 2003. Record volumes of traffic began pouring onto our network. Starting in the summer of 2003, Union Pacific was setting all-time carloading records in every month. By the fall of 2003, Union Pacific's system-wide carloadings had pushed above the 180,000 carloads-per-week level, which was then regarded as the top end of the range of our system fluid capacity. We were also experiencing a shortage of locomotives and crews. Our network showed the strain. System velocity fell dramatically, and other performance measures also declined. The 2003-2005 period was a tough period for Union Pacific operations.

As Union Pacific looked at the market in the fall of 2003, we understood that we were at the beginning of a significant shift in demand for our services. We saw important trends and structural economic changes suggesting that the demand increase would continue over a significant period of time. These trends and changes included regional growth in the West and Southwest, higher fuel prices affecting demand for coal, the exponential growth in the Chinese economy, and rising imports. We also saw increased demand resulting from constraints in other sectors of the shipping industry, including ports and trucking. We recognized that we would need to make substantial additional investment in our network to restore our service levels and accommodate traffic growth.

In response to the rising demand for rail service, we launched significant spending to improve our service and increase network capacity. In late 2003, we embarked on a massive hiring program, nearly tripling our hiring levels in 2004, and we continued at that high level of hiring through 2006. We acquired more than 1,500 new locomotives between 2004 and 2008. We increased our capital spending on track and terminal capacity expansion from the $300 million per year range to more than $500 million in 2005, and more than $750 million in 2008.

In a further effort to improve service, Union Pacific took temporary steps on the demand side to limit the growth in new traffic seeking to use our constrained network. At times, we used a pricing strategy that effectively encouraged shippers to use other shipping options, or to channel that demand in ways that would reduce stress on congested parts of the system. Despite these efforts, traffic volumes continued to set records. It was only by adding capacity that we were eventually able to restore our service levels, and then improve our performance, even as traffic volume continued climbing to new record levels. In this environment, we reasonably sought to ensure that all of our business groups were charging rates that would support reinvestment in the railroad. Failing to do so would have been economically irrational for any business.

Union Pacific faced another significant issue after 2003 that affected our rates: our costs were rising rapidly, especially our fuel costs. This was a particular problem because we had large amounts of traffic tied up in long-term contracts with terms that did not allow us to fully recover our cost increases. In addition, our opportunities to make the types of leaps in productivity that would help offset those rising costs had disappeared. The "low-hanging fruit" had been picked. While we continue to pursue productivity gains through investments in technology and process improvements, the rate of productivity growth is slower.

In short, there is no mystery as to why Union Pacific rates began increasing. The events were public. Shippers lived through them. We even discussed them in the Board's *Major Issues in Rail Rate Cases* proceeding in mid-2006.

<u>Union Pacific continues to face challenges that require us to have the freedom and flexibility to respond to market forces</u>. I submitted a statement in the *Major Issues* proceeding explaining why the Board should not interfere with demand-based pricing.[1] My concerns are just as applicable today.

We set rates based on market conditions, which take into account, among other things, the shipper's demand for service, and our ability to supply the service. Rates and rate structures are key to how railroads and shippers interact. The rate a customer is willing to pay

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1 Union Pacific also described the problem of rising fuel costs in public testimony submitted in the Board's *Rail Fuel Surcharges* proceeding in mid-2006.

reveals how much the customer values our service and whether we should be investing to provide even more service. Anything that distorts market-based rates and rate structures will disrupt the flow of important information between railroads and customers and distort important decisions about where railroads should direct resources to meet customer demand.

Some parties in this proceeding wrongly suggest that only lack of competition could explain why rates did not fall during the recent economic downturn, as traffic volumes fell. But for Union Pacific, the reason some rates did not fall – and some did fall – is straightforward. My team embarked on a course to pursue opportunities to move rates upward. We recognized that the economic downturn would not last forever. We concluded, as have others, that the United States would need more rail transportation in the future to remain competitive in a global market.[2] We predicted that traffic would return to the railroad, and we did not want to be caught in the same situation in which we found ourselves in 2003 – with a network full of traffic moving at non-reinvestable prices.[3]

As Mr. Fritz explained in his opening statement, Union Pacific also has been careful in other respects not to repeat what happened in 2003-2005. Through the economic downturn, we have continued to invest in infrastructure, technology, process improvement, and training. And, as Mr. Fritz showed, this strategy has worked for the railroad and for our

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2 *See, e.g.*, Federal Railroad Administration, U.S. Department of Transportation, National Rail Plan: Moving Forward (Sept. 2010); Press Release, U.S. Department of Transportation, DOT Releases New Freight Transportation Data (Nov. 3, 2010).

3 I would be remiss if I did not mention one other factor that is raised in discussions about whether to reduce rates to pursue business in times of excess capacity: the impact of Board regulation. Specifically, under the Board's Three-Benchmark methodology, short-term rate reductions can potentially have long-term impacts on the rates we can charge, because the low rates might be used to establish a low benchmark level for cases filed years in the future, when market conditions are very different. The Board's policies therefore interfere with the market and drive regulation-dictated behavior.

customers. We have been able to sustain and improve our service performance as traffic rebounded from the recessionary levels of 2009. Although volumes today remain below our prior record levels, Union Pacific is sufficiently confident in our growth opportunities that the Board of Directors earlier this month approved an additional $100 million in growth capital spending in 2011, increasing our full-year capital investment plan to a record $3.3 billion.

Shippers also complain about two rate-related changes they say occurred in 2004: Union Pacific's use of shorter-term contracts, and our use of fuel surcharges. I discuss contract length in more detail below, where I address more specific claims by coal and chemical shippers. As a general matter, however, Union Pacific did become reluctant to use longer-term contracts after 2003. When demand for our services exploded, we recognized that substantial volumes of business, and thus substantial network capacity, was tied up in long-term "legacy" contracts at what had become below-market prices. Especially in that period of rapidly changing economic conditions, we were understandably cautious about repeating the same mistake. However, as I discuss in more detail with respect to our Energy and Chemicals businesses, we do not refuse to enter into longer-term agreements. We continue to enter into such agreements when they provide sufficient returns and contain sufficient protections against rising costs to offset the risks of committing our resources to handling the traffic.

Many shippers also complain that their rates increased after 2004 because of fuel surcharges and that Union Pacific has insisted that new contracts provide for fuel surcharges. We did not begin our fuel surcharge programs in 2004, as some shippers have suggested; we began them years earlier.[4] Since then, Union Pacific increased its focus on ensuring that

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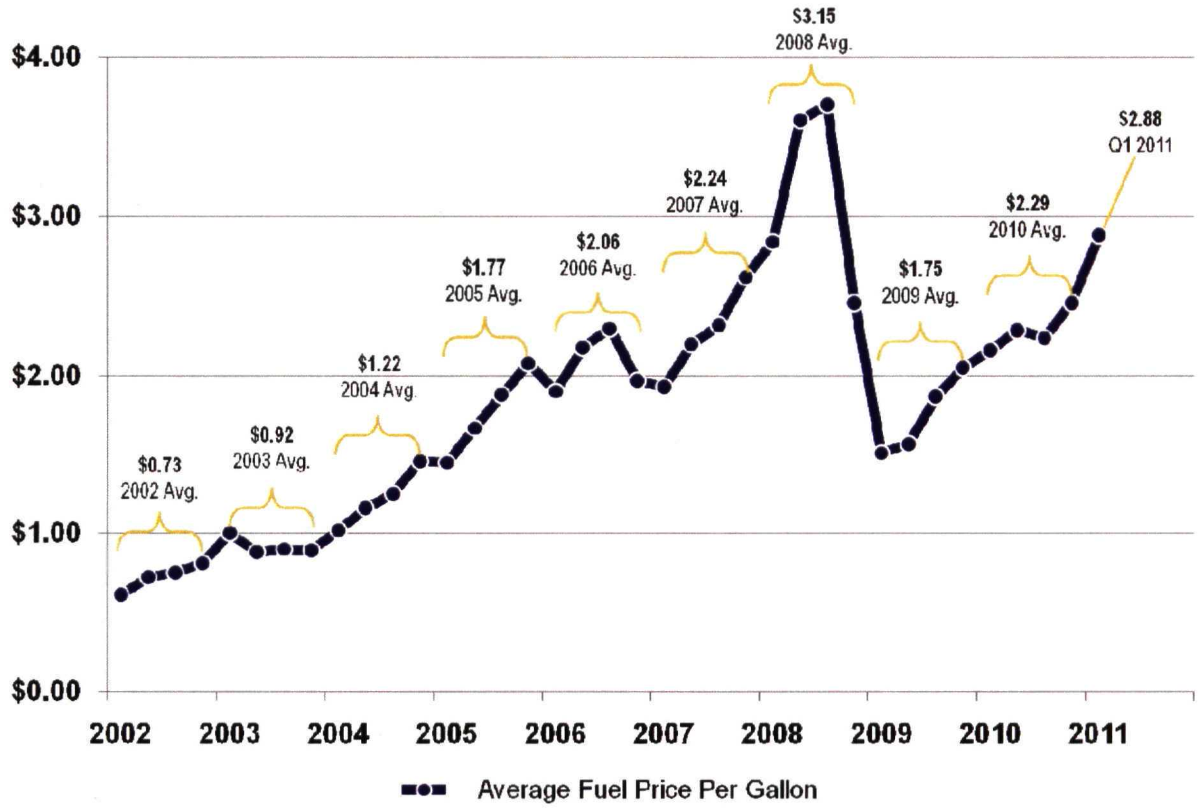
[4] We instituted a fuel surcharge program for intermodal traffic in 2000 and a standard fuel surcharge for carload traffic in December 2002. Our coal business moved under a variety of (continued...)

customers seeking new contracts agree to various fuel surcharge provisions. The reasons are obvious and include the fact that our fuel costs were skyrocketing, as the following chart shows:

Figure 1: Union Pacific Average Fuel Price per Gallon Consumed



Source: 10-K Annual Reports and 1st Quarter 2011 Earnings Release

When Union Pacific established its carload fuel surcharge program in 2002, we viewed the "normal" cost of fuel to be $0.75 per gallon. By 2004, our diesel fuel cost had risen to $1.22 per gallon. The cost continued to rise. It was $1.77 per gallon in 2005; $2.06 per gallon in 2006; $2.24 per gallon in 2007, and $3.15 per gallon in 2008. Diesel prices in the first quarter of 2011 averaged $2.88 per gallon, which is our third highest quarterly fuel price on record. It is

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escalation provisions, and as part of our attempt to simplify administration of our coal business rates and terms, we established a standardized fuel surcharge in November 2004.

no mystery why Union Pacific sought to extend fuel surcharge coverage and no surprise that all-in rates increased as our fuel costs increased.

II. UNION PACIFIC FACES STRONG COMPETITION FOR ALL TYPES OF TRAFFIC.

Raising rates toward reinvestable levels in a market that is characterized by rising demand and rising costs does not indicate a lack of competition. Our record of investment in infrastructure and improvements to service and safety demonstrates a responsiveness to customer needs that belies any claim that we are not actively competing to attract and retain business. We compete vigorously with other railroads and other modes of transportation to offer customers the best overall value proposition – that is, the best rail service and the best customer service at a competitive price.

The shippers complaining most vocally in this proceeding – coal shippers and some chemical shippers – generally entered into long-term contracts some years back, under market and network conditions very different from those that exist today. For a long time, those shippers benefited from our efforts to fill excess capacity to generate economies of density. Their rates made some contribution to our fixed costs, but often were well below levels needed to generate market-level returns on our investments. They also avoided paying for the rapidly rising costs of fuel. Thanks to long-term contracts, many enjoyed that environment long after those market conditions ended, but those rates were not sustainable.

These shippers are understandably disappointed by higher rates today, but their claims that higher rates reflect the disappearance of railroad competition are incorrect. Competition in the rail industry remains strong. In the sections below, I describe the competitive environment facing each Union Pacific business group and respond more specifically to claims that we are not actively competing.

A. Energy

Union Pacific's Energy business involves the movement of coal and coke to utilities and industrial facilities throughout the U.S., and the movement of export coal through West Coast ports to Asia and through Mississippi River terminals to Europe. Coal originating in the Southern Powder River Basin ("SPRB") of Wyoming is the largest segment of our energy business, comprising 75 percent of carloads in 2010.

In the sections below, I first show that changing economic and network conditions explain trends in Union Pacific's coal transportation rates from 1984 through 2010. I then show that Union Pacific continues to compete vigorously for coal business. Finally, I address several specific allegations by the Western Coal Traffic League ("WCTL") and certain coal shippers about supposed changes in our approach to contract negotiations and build-out opportunities after 2003 and show that none of the claims demonstrates a lack of competition.

1. Trends in Union Pacific's Coal Transportation Rates From 1984 Through 2010 Reflect Changing Economic and Network Conditions.

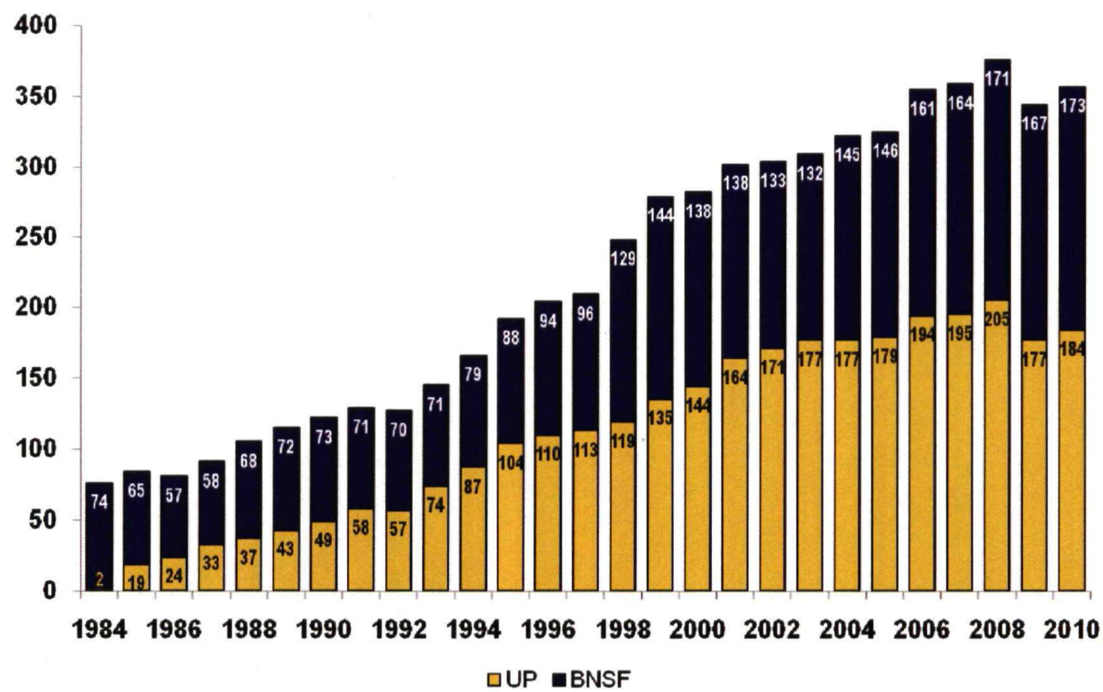
As I noted above, WCTL and several SPRB coal shippers filed comments suggesting that railroad competition to transport coal in the West ended in 2004. In particular, WCTL's President, Duane Richards, claims that when business came up for bid after 2004 "the incumbent carrier invariably prevailed in keeping its account." Comments of WCTL, Richards V.S. at 18. WCTL and others are wrong. Union Pacific continues to compete for coal traffic. Union Pacific's recent loss of Dairyland's business to BNSF is but one rebuttal to Mr. Richards' claim.

WCTL and others are correct in one respect: we did change our overall approach to the coal business in 2004. In light of the economic and network conditions I described above

– that is, rising demand, constrained capacity, increasing costs, and slowing productivity growth – it became clear that our prior SPRB coal strategy was unsustainable.

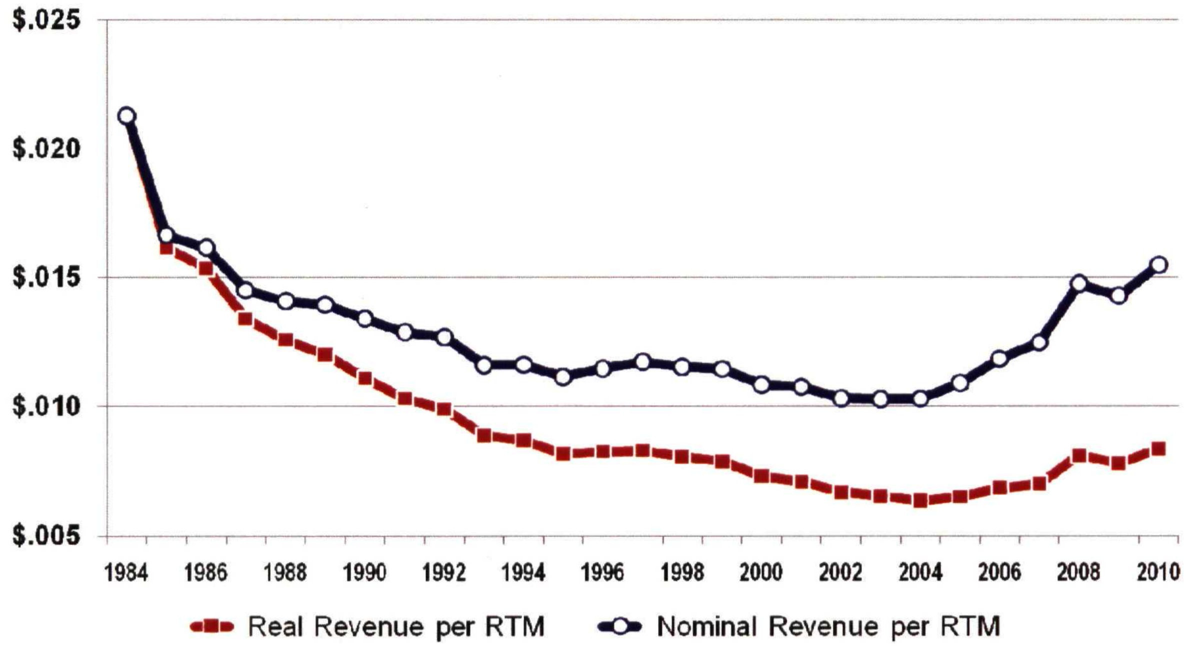
Union Pacific was the second railroad entrant into the SPRB in 1984. We had invested a great deal of money to enter this market, and we pursued long-term contracts with coal shippers to support that investment and build economies of density. From 1984 through 2003, Union Pacific's SPRB coal deliveries increased from 2 million tons to 177 million tons. Some of this growth represented traffic we captured from BNSF, but most of it reflected the conversion of existing plants from eastern coal, oil, and natural gas to SPRB coal and the construction of new plants. BNSF had moved 74 million tons of coal over the SPRB Joint Line in 1984. By 2003, Union Pacific and BNSF moved a combined 309 million tons of coal over the Joint Line.

Figure 2: SPRB Joint Line Tonnage 1984-2010



In this same period, Union Pacific's rates for transporting coal fell substantially. In nominal terms, Union Pacific's revenue per revenue-ton-mile for coal traffic fell from 21.3 mills per revenue-ton-mile in 1984, to 10.3 mills per revenue-ton-mile in 2003, a reduction of 52 percent.[5] In real terms, revenue per revenue-ton-mile fell by 69 percent.

Figure 3: Union Pacific Coal Revenue per Revenue-Ton-Mile 1984-2010



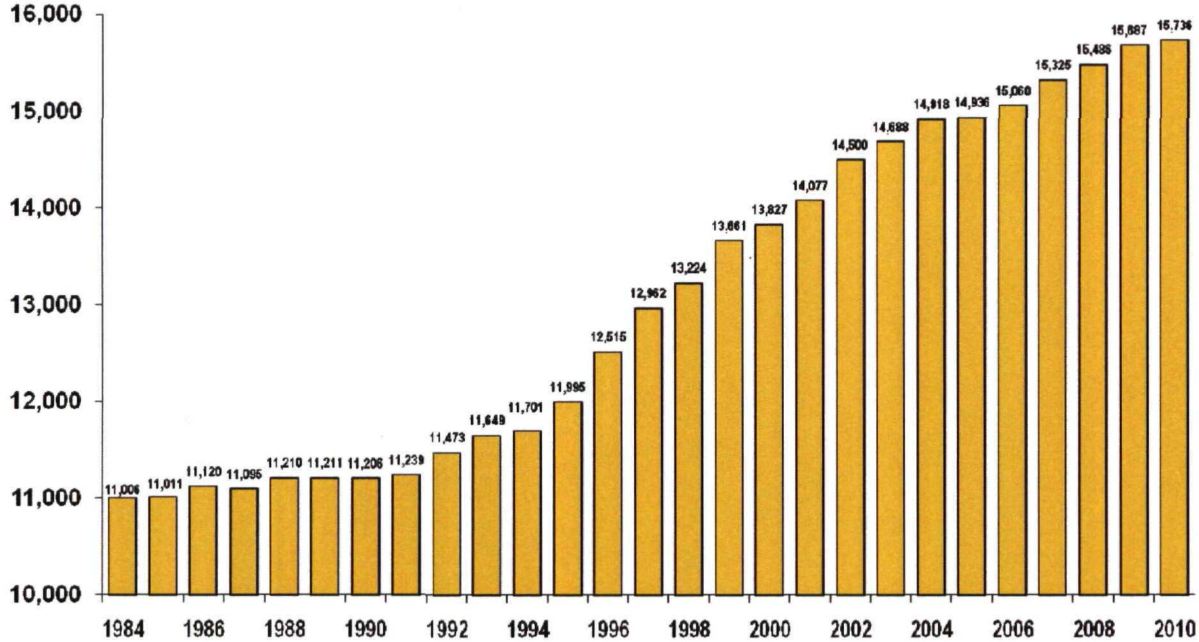
Source: Nominal: UP Fact Books and 10-K Annual Reports

During this period, Union Pacific was making substantial productivity gains. Due in large part to the introduction of aluminum cars and distributed power, Union Pacific increased the average number of tons of coal moved per train at a rate of 2.6 percent per year between 1995 and 2003. By comparison, the growth rate slowed to 0.9 percent per year between 2004 and 2010. Of course, none of these productivity gains came without costs. Union Pacific has spent significant sums to refine distributed power technology, acquire more expensive AC locomotives equipped with distributed power, and train engineers to use distributed power. We also had to

5 A "mill" is one-thousandth of a dollar, or one-tenth of a penny.

lengthen sidings to accommodate the longer trains that distributed power allowed us to run. We also offered reduced rates to give shippers incentives to switch from steel cars to higher-capacity aluminum cars.

Figure 4: Union Pacific Productivity – SPRB Tons per Train 1984-2010



In the early years of SPRB coal transportation, Union Pacific was also experiencing significant productivity gains in other respects. We were implementing the UP/MP, UP/M-K-T, and UP/CNW mergers, thus creating more efficient, high density, single-line routes for coal and other traffic; spinning-off lighter-density lines to short lines; shifting to two-person crews; expanding mechanization of maintenance-of-way technologies; replacing cabooses with end-of-train devices; and adopting other technologies that greatly simplified billing and other administrative tasks. Costs were falling, and we were sharing the savings with shippers. By 2003, rates were at rock-bottom levels.

WCTL's Mr. Richards says that life was good for coal shippers in 2003. *See* Richards V.S. at 9. But the pattern of growing volumes and declining rates was not sustainable.

The point was driven home sharply when new traffic began flooding our system in late 2003. Our SPRB coal traffic was generating returns significantly below other commodities and well below the level needed to maintain existing capacity, let alone add capacity. In prior years, we had assumed that we could make up for bargain prices through leaps in productivity, but that strategy failed to pan out, as we exhausted the biggest opportunities. We recognized that we either had to change our paradigm or stop investing in our coal network.

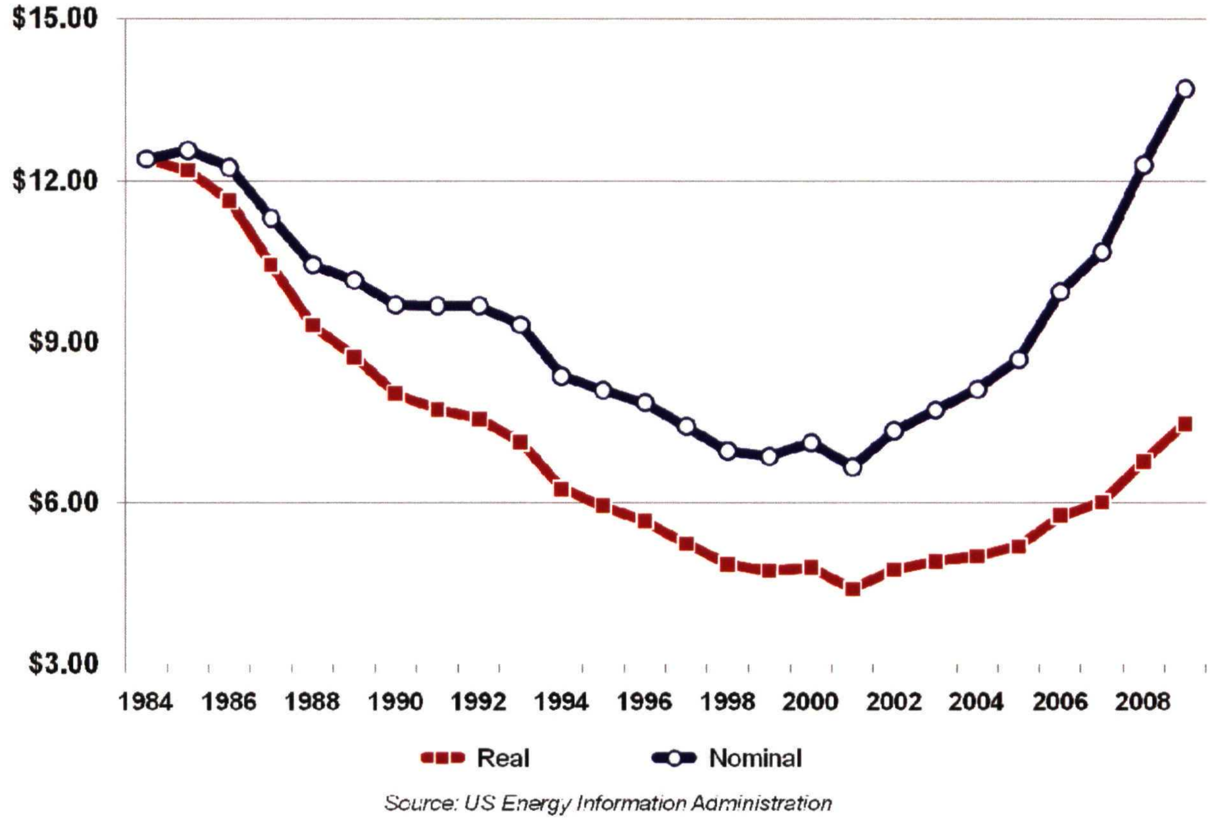
As a result, coal shippers that had enjoyed the benefits of long-term contracts faced a different market and network environment when they sought to negotiate new contracts with Union Pacific after 2003. Those shippers had negotiated low rates at a time when we had excess capacity. In that era of declining costs, many had also negotiated very favorable rate adjustment provisions (provisions generally more favorable to the customers than the railroad), including some that had "capped" our recovery of cost increases. When those contracts expired after 2003, demand for rail transportation services had increased, and network capacity was tight. Our costs had also increased, especially our costs for fuel, which showed every sign of continuing to rise rapidly, and we were discovering that heavy-haul coal was wearing out rail faster than expected. Productivity gains were becoming harder to achieve. We were faced with the need to make substantial investments in new capacity to accommodate growth in traffic of all types. As a result, we sought better protection against inflation and higher steel costs, as well as higher fuel expenses.

In the old environment, shippers got what they wanted: low rates. The railroad got volume. However, when demand for rail services increased and capacity tightened, the railroad was in a position to set new prices at reinvestable levels.

In this environment, rates increased, and Union Pacific explained to shippers that fuel surcharge provisions needed to be added when legacy contracts expired. But the impact was not nearly as dramatic as WCTL and certain coal shippers claim. Despite rate increases, demand continued to grow. Union Pacific's SPRB coal deliveries continued to increase until the economic downturn, from 177 million tons in 2004, to 205 million tons in 2008, as shown above in Figure 2. Moreover, as shown above in Figure 3, Union Pacific's revenue per ton mile for coal traffic remains below 1984 levels in both real and nominal terms.

Another way to put Union Pacific's post-2003 rate changes in perspective is to recognize that other prices associated with SPRB coal also changed significantly after 2003. According to the U.S. Energy Information Administration, the price per ton for subbituminous coal, which mostly comes from the Powder River Basin, increased from $8.12 to $13.71, or 69 percent in nominal terms, and 49 percent in real terms between 2004 and 2009, excluding transportation costs – that is, more than twice as fast in real terms as Union Pacific's rates.

Figure 5: Subbituminous Coal Prices 1984-2008



In short, Union Pacific's rate increases do not reflect a lack of competition – they reflected a changed market environment.

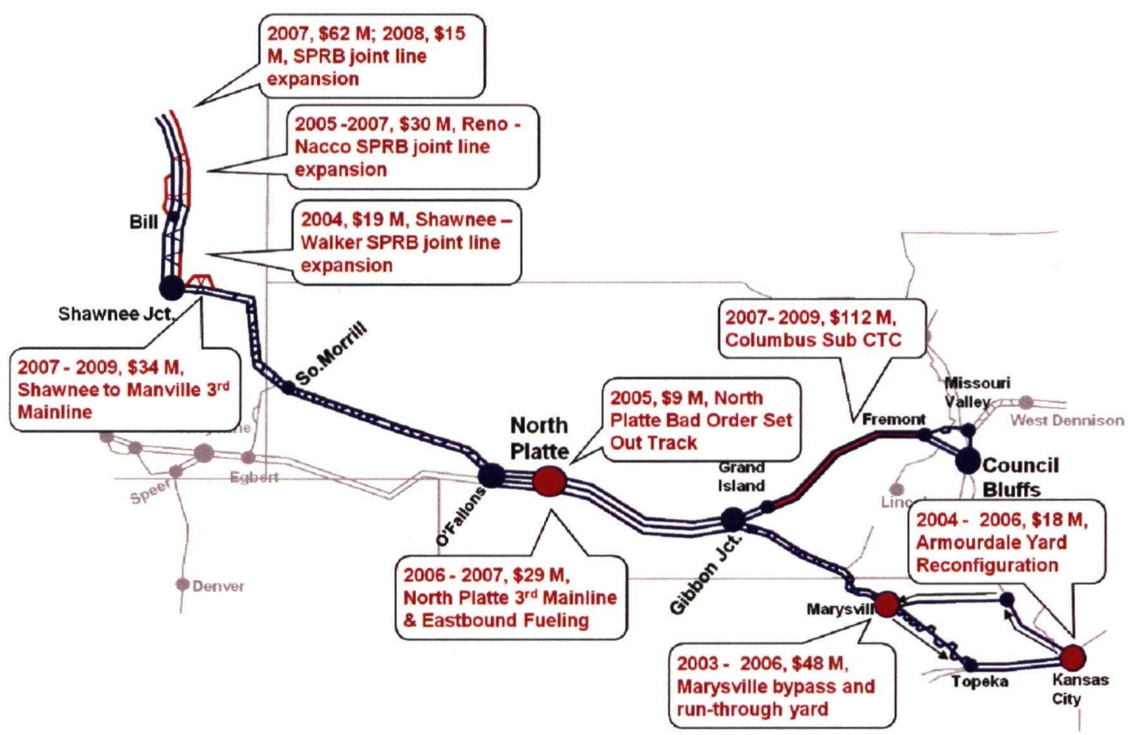
2. Union Pacific Continues to Compete for Coal Business.

Union Pacific continues to compete vigorously for coal business. We compete to retain traffic and attract new traffic by offering competitive rates, investing in our network, and providing reliable service to our coal customers. We do not take our coal business for granted.

Contrary to claims of WCTL and certain coal shippers that Union Pacific stopped competing for coal business after 2003, we have devoted substantial resources to our efforts to provide reliable service to coal shippers. Between 2004 and 2010, we invested $6.04 billion in our coal franchise. This includes $525 million in capacity – most of it directed to SRPB coal corridors. During the period that WCTL and others allege we were no longer interested in competing for SPRB coal, capacity projects that we undertook included:

- completing the Marysville bypass and run-through yard in 2006;
- triple-tracking the northern half of the Joint Line from Reno to Caballo between 2005 and 2007;
- constructing a third run-through track in North Platte in 2006 and 2007;
- building 21 miles of fourth main-line near our yard in Bill in 2007 and 2008;
- adding a third main-line between Shawnee and Manville on Union Pacific's Powder River Basin subdivision in 2008; and
- installing Centralized Traffic Control on the Columbus subdivision in eastern Nebraska between 2007 and 2009.

Figure 6: Recent Coal Capacity Projects



Union Pacific also competes for coal business by offering competitive rates when traffic is put out for bid. WCTL and several coal shippers claim that, since 2003, Union Pacific has not actively competed with BNSF for coal traffic in situations where both carriers could handle the traffic and that the incumbent carrier always retains the business. I can tell you from my own experience that those claims are not true.

As I described above, Dairyland just recently awarded coal business to BNSF that we have been handling for years. Union Pacific bid on the business, and we thought we would win. {

}[6] We regarded this as an aggressive offer and thought we would win the business. BNSF presumably offered a better deal and captured the business.

Even more recently Wisconsin Electric Power Company entered into a multi-year contract under which BNSF will move coal from Signal Peak mine to a dock in Chicago, from which it would move by barge to Wisconsin Electric's Valley plant. This BNSF movement will displace Colorado coal that had been moving to the Valley plant via Union Pacific.

Another recent example involves AES Corporation's Shady Point plant. In its comments, AES claims that when they recently sought bids on a new contract for traffic to their Shady Point plant, which had been moving via BNSF and Kansas City Southern, "UP did not submit a competitive proposal." Comments of Omaha Public Power District *et al.* at 10. I found that claim very surprising. Union Pacific submitted what we viewed as an extremely competitive offer. {

6 In this statement, text contained within brackets has been designated as Highly Confidential and is redacted from the public version of this document.

{ } AES apparently used our offer to extract an even better deal from BNSF.

As a final example, { }

WCTL and certain coal shippers argue that Union Pacific and BNSF are not actively competing for coal business because contracts are not shifting between carriers as frequently as they once did. However, the examples provided above refute that claim. They also highlight two important points about rail competition. First, the incumbent carrier can and does retain business even when there is meaningful competition. Second, many factors in addition to rates may make it undesirable for a coal customer to change rail providers, and once the traffic shifts, it can be difficult to win it back. There are benefits to continuity, and costs associated with change. As AES told us, { }

Moreover, where one rail carrier rather than another handles competitive business, it is often because the incumbent carrier has operating advantages that allow it to provide service at lower costs. In such cases, once transportation patterns are relatively established, one would not expect to see business regularly switching back and forth between carriers. For example, Union Pacific has significant advantages over BNSF in moving coal traffic to the St. Louis area.

We have a better route and fewer crew-change districts. It is therefore no surprise that we generally have been able to retain coal traffic moving to St. Louis-area utilities. Likewise, BNSF has certain advantages over us {

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3. Union Pacific's Post-2004 Contracting Process and Responses to Build-Out Opportunities Reflect Continued Competition for Coal Business.

WCTL and certain coal shippers claim that Union Pacific's post-2004 contracting process and responses to build-out opportunities demonstrate a lack of competition for coal business. I have already shown that competition for coal business remains strong, but I will respond to some of the more specific claims about contracting practices and build-outs so that the Board has an accurate understanding of the current competitive environment.

a. Length of Contract Term.

WCTL witness Richards asserts that coal shippers are unable to negotiate longer-term (five to ten year) contracts with railroads. *See* Richards V.S. at 18.[7] This claim is not correct. After 2003, Union Pacific was reluctant to enter into very long-term agreements of the type that had been appealing when we first began serving the SPRB. We were much more cognizant of the risks associated with rapid changes in market conditions. However, Union Pacific remained willing to enter into longer-term arrangements, provided they contained appropriate protections against cost increases.

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7 Many coal customers have their own reasons for preferring terms of less than five years, and we receive many requests for proposals for one or three years.

b. Rate Adjustment Provisions and Fuel Surcharges

WCTL witness Richards and certain coal shippers also complain that Union Pacific became less flexible in its negotiations about rate adjustment mechanisms and the use of fuel surcharges. *See* Richards V.S. at 18; Comments of Omaha Public Power District *et al.* at 17. Our changes in practices have nothing to do with reductions in competition. As I explained above, Union Pacific found that the rate adjustment provisions we had negotiated for certain coal shippers in legacy contracts were not allowing us to keep pace with rising costs, especially rising fuel costs. We believe that the rate adjustment mechanisms we are currently negotiating provide for a fair recovery of cost increases. However, the implication that we have been inflexible on rate adjustments is false. We still have many different forms of rate adjustment mechanisms. At some customers' requests, we have instituted {

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c. Service Commitments

WCTL witness Richards and certain coal shippers also complain that Union Pacific will no longer negotiate service commitments. *See* Richards V.S. at 18; Comments of Omaha Public Power District *et al.* at 8. That is incorrect. We continue to offer service commitments that have real teeth in the event that we fall short of our service obligations.

Union Pacific's legacy coal contracts contained a wide variety of complex, individualized service standards that proved difficult to apply and administer in practice. In addition, on several occasions, these contract terms led to expensive, protracted litigation with customers who claimed that their particular contract terms required us to favor them over other customers, even if it meant reduced velocity and decreased throughput.

The service commitments we offer now have terms that are more clearly aligned with the operating requirements for running a fluid network and delivering high quality service to all of our customers. In addition, the standards are easier to monitor and administer. For customers that provide their own equipment and move coal under a contract, we offer a service commitment that {

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We believe that this type of service commitment is much easier for both parties to administer. It also has the benefit of directing both parties' attention to keeping the trains moving and on solving problems, rather than on keeping score and arguing about whether the clock is running against customer time or railroad time on every movement.

Another important benefit is that our current service terms allow our operating department to control the number of trainsets in service to optimize total tonnage moved for all shippers. In other words, we can avoid or reduce congestion and thereby increase velocity and decrease cycle time. Under the prior cycle-time commitment contracts, customers would often insist that they had the contractual right to force Union Pacific to take on additional trainsets to move their coal and make up deficits, even when adding trainsets would worsen congestion, increasing cycle times and reducing throughput for everyone.

In short, our customers continue to receive the same protection under our new service standards that they had under our older, more complicated standards. Union Pacific either transports the agreed-upon volume of coal at the rates that would apply for shipper-supplied cars, or we pay liquidated damages. What is different now is the ease of application and the elimination of arguments about who controls operating decisions during times of service difficulties. In fact, service is now better than it was when we had complex cycle-time standards. Union Pacific is delivering essentially all the NCTA target demand that the mines can load and its customers are unloading and using far fewer trainsets.[8] In 2010, Union Pacific delivered 184 million tons of SPRB coal with an average 207.9 trainsets in service. This amounted to 4 percent more coal using 17 percent fewer trainsets than in 2003.

d. Rail Car Maintenance Standards

WCTL Witness Richards and certain coal shippers also complain that Union Pacific is now imposing higher rail car maintenance standards on coal shippers. *See* Richards V.S. at 18; Comments of Omaha Public Power District *et al.* at 15. I presume these complaints involve certain inspection and repair standards related to wheels, axles, and hot bearings that we now require. As Union Pacific explained in the Board's recent "Coal Dust" proceeding,[9] in 2002, we conducted a comprehensive mechanical evaluation of heavy-haul cars in response to a significant number of broken wheel and axle derailments. As a result, we adopted several

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[8] NCTA target refers to the process sponsored by the National Coal Transportation Association for using customer demand to assign train slots for loading between rail carriers on the Joint Line.

[9] *Arkansas Electric Coop. – Petition for Declaratory Order*, STB Docket No. 35306.

improvements that we first applied to our system coal cars that operate in heavy-haul traffic. Based on our experience with our own cars, in April 2005, we reached out to our customers and asked that they voluntarily adopt certain inspection and repair standards on their cars. The following year, we incorporated the new railcar standards as recommendations for our then-current contracts and determined that they would be used in all new commercial agreements with Union Pacific, effective November 1, 2006. We then published the standards as requirements effective January 1, 2008. As a result of these initiatives, derailments attributable to coal car wheel sets moving along Union Pacific lines decreased significantly. We are committed to these efforts to prevent costly derailments, which would affect not only the railroad, but also our customers and the public at large.

e. Build-outs

WCTL and certain coal shippers also claim that railroads are no longer pursuing build-out opportunities. *See* Richards V.S. at 8; Comments of Ameren at 5; Comments of Omaha Public Power District *et al.* at 16. While there have not been as many build-outs since 2003 as there were before 2003, I think the explanation is simple: most viable build-outs and similar opportunities for shippers to create multiple-carrier service to their plants were completed before 2003. By 2003, Union Pacific had been serving the SPRB for nearly twenty years. During those twenty years, many shippers constructed build-outs or made other successful efforts – such as acquiring lines or trackage rights – to obtain competitive service from Union Pacific.

When opportunities to serve shippers through build-outs have arisen since 2003, Union Pacific has competed for the business. Although some parties imply that there have been no build-outs since 2003, they are wrong. *See* Comments of Omaha Public Power District *et al.* at 16. In 2005, Ameren constructed a build-out from its Duck Creek plant in Illinois to the

Keokuk Junction Railway ("KJRY"). BNSF serves the Duck Creek plant directly, and Ameren constructed a line to obtain access to Union Pacific through a connection with KJRY. When Ameren sought bids for SPRB traffic in 2009, we competed aggressively for the business. However, Ameren ultimately awarded the business to BNSF, presumably because BNSF had undercut our bid or offered other benefits that we could not match.

f. Circular 111

Finally, WCTL witness Richards claims that Circular 111 was a form of marketplace price-signaling and that Union Pacific "continue[s] to hold out . . . public prices." Richards V.S. at 15. Both statements are demonstrably incorrect. As I explained above, Circular 111 has no relevance in today's coal marketplace. We have not created Circular 111 rates in five years, and coal shipments continue to move under confidential contracts. Even when we were using Circular 111, we never made the rates public. Circular 111 rates were made available only to the shippers that were eligible to ship traffic under those rates. WCTL knows this. When WCTL filed a federal lawsuit challenging our adoption of Circular 111, it specifically complained that we had *not* made the rates public.[10] Union Pacific adopted Circular 111 in response to the changing marketplace conditions described above as part of a necessary transition of our coal business practices that we concluded was needed to sustain and grow that service.

B. Chemicals

Union Pacific's Chemicals business is fragmented compared to our Energy business. Our Chemicals business comprises five different product segments. In 2010, no

[10] *See* Complaint of Western Coal Traffic League at 12, *Western Coal Traffic League v. BNSF Ry. & Union Pac. R.R.*, Civil Action No. 3:05CV-889-N (N.D. Tex. May 3, 2005).

segment accounted for more than one-fourth of our chemical volume. The customers we deal with are very diverse. We negotiate rates with producers who ship to themselves and who sell to others. We also negotiate rates with receivers who turn the inbound chemicals that we deliver into outbound rail freight, and those who ship outbound freight by pipeline, barge or truck. For some commodities, both shippers and receivers hold the contracts. For others, the freight may be paid predominantly by the shippers or predominantly by the receivers.

1. Trends in Union Pacific's Chemical Rates From 1984 Through 2010 Reflect Changing Economic and Network Conditions.

In contrast to our Energy business, nearly half of our Chemicals business is exposed to global market forces, which presents both risks and opportunities. We see export opportunities for soda ash, fertilizers, and plastics (and, as I describe below, we are investing and preparing to be ready as those markets expand). Whether plastics or industrial chemicals[11] are imported or exported depends on many factors beyond our control, including the cost of the feedstock needed to produce petrochemicals, the relative strength of the dollar, and how fast overseas demand grows relative to overseas capacity. Our experience is that for most plastics and industrial chemicals, transportation costs are in the neighborhood of 5 percent or less of the delivered price; for most fertilizer products, it is below 15 percent. Only for caustic soda and soda ash do transportation costs grow towards 30 percent of the delivered price. Overall, rail transportation cost of chemical products is a negligible factor.

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[11] Industrial chemicals comprises dozens of basic, intermediate, and specialty chemicals. They include, for example, adipic acid, caustic soda, chlorine, ethylene glycol, ethylene oxide, polypropylene glycol, potassium oxide, vinyl chloride monomer, and many other chemicals.

In the 1990s and early in the last decade, many producers located production capacity in the Middle East – where feedstocks were the cheapest in the world.[12] During the boom years of 2004 through 2007, U.S. capacity grew and export growth continued until the recession hit. Thanks to recent shale discoveries and improved recovery technology, domestic natural gas supply has increased and prices have decreased. North American feedstock – and therefore production – costs are now lower than European and Asian feedstock costs and higher only than Middle Eastern costs. As a result, many producers have recently announced plans to increase chemical production in the United States. This includes Dow Chemical and Westlake Chemical, both of whom have complained in this proceeding about the effect of rail rates on their competitiveness, but whose comments are silent on the greater role played by feedstock costs. Chemical shipments on Union Pacific are near record levels in 2011, reflecting stronger domestic production, and affirming the value that customers associate with Union Pacific's transportation product. This is not the picture of an industry about to be driven offshore by the railroads.

Union Pacific does not control whether the chemicals are imported or exported. Our role is to provide a network that can meet our customers' demand for transportation, whether it is outbound or inbound. That is why we price our services to generate the returns required for investments in terminals, line capacity, and equipment, and why we need the freedom to manage our operations to maximize efficiency and productivity.

Despite these differences between our Energy and Chemicals businesses, the same market forces that I described earlier (*i.e.*, rising demand, lack of surplus capacity,

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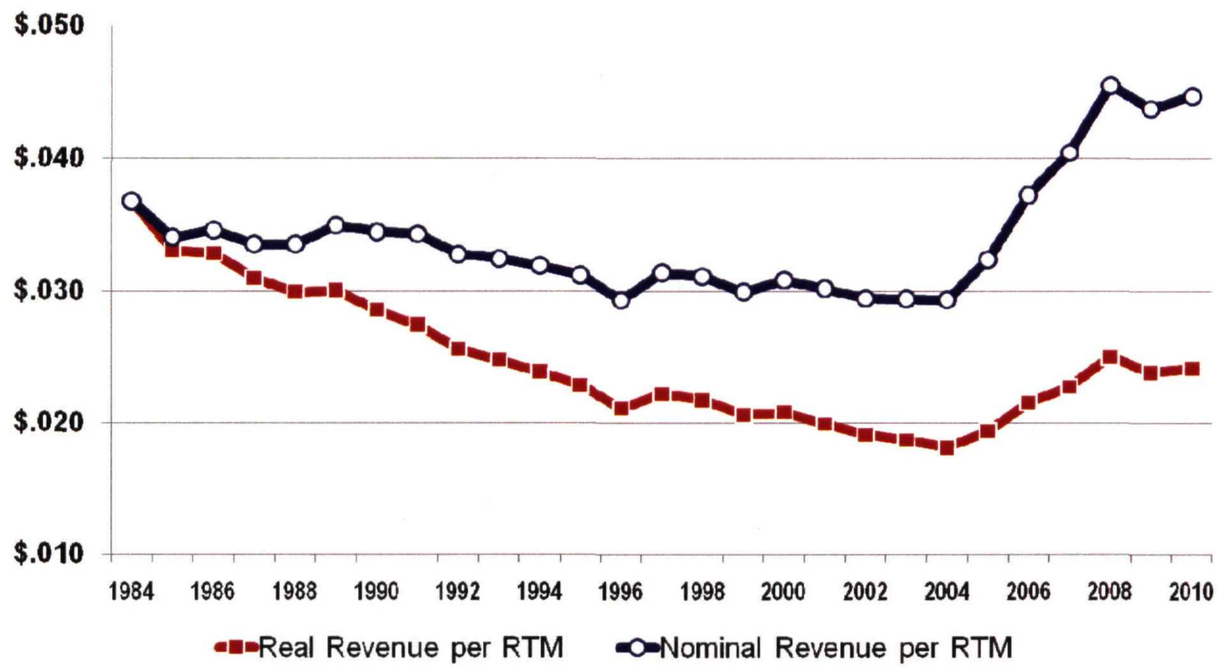
12 Natural gas or oil is used to make feedstocks, which are then converted into building blocks for petrochemicals.

increasing fuel and other costs, slower productivity growth) also drove the need to get our chemical rates to reinvestable levels. Union Pacific chemical rates, like its coal rates, declined in nominal terms virtually every year for 20 straight years between 1984 and 2003. Nominal rates were 20 percent lower before beginning to increase in 2004. Measured in real revenue per revenue-ton-mile, our chemical rates are still 34 percent lower than in 1984.

Figure 7: Union Pacific Chemical Revenue per Revenue-Ton-Mile 1984-2010



Source: UP Fact Books and 10-K Annual Reports

Because less of our chemical traffic was covered by legacy contracts, chemical rates were able to respond more quickly to the surge in demand for rail transportation than coal rates were. Even so, higher costs still accounted for most of the increase in rates.

Besides the factors that were driving all Union Pacific business groups to improve contribution to reinvestable levels, our Chemicals business has also faced the challenge of recovering the costs associated with increased safety regulation for some commodities. Extensive new requirements have been enacted since 9/11 and include: routing, interchange and dwell limitations; positive hand-off policies and practices; and security controls. Looking forward, our rates will have to recover the estimated $1.4 billion that Union Pacific will have to invest to comply with the Congressional mandate to install Positive Train Control ("PTC") on lines that carry commodities classified as toxic inhalation hazards ("TIH"), as well as the approximately $225 million annual cost to maintain those PTC systems. We invested $84 million in PTC in 2010, and we anticipate spending $250 million more during 2011. Despite the number of TIH customers that filed comments complaining about the increase in rates they have seen recently, they are silent on these extra costs we are incurring or will incur due to the safety and security requirements associated with their freight.

2. Union Pacific Faces Vigorous Competition for Chemical Traffic.

Contrary to the general assertions made by some chemical shippers, Union Pacific's Chemicals business is subject to strong competitive pressures. This section will review the transportation alternatives and then describe how our customers use such alternatives as leverage in negotiations.

A sizable portion of the chemical facilities that we serve are also served by at least one other railroad. BNSF and Kansas City Southern directly serve many of the same chemical facilities that we do. In addition, the Port Terminal Railroad Association serves numerous chemical customers in the greater Houston terminal area, where so much chemical production is concentrated. Trucks are also an option for some chemical customers, particularly when shippers can take advantage of transloads. A number of our chemical customers have the option of moving their products by vessel, barge, and/or pipeline. Many chemical shippers have multiple facilities located around the country and multiple choices for sourcing raw materials and distributing their products. If our customers are dissatisfied with Union Pacific's rates and terms, they can divert production or distribution to facilities that we do not serve. (Several shippers assert that rail mergers have limited their ability to negotiate lower rates using threats to shift production to facilities served by other railroads. That has not been our experience. Also, those shippers neglect to mention that chemical producers also consolidated their operations, which in certain circumstances gives them more leverage when they threaten to shift production facilities.) Chemical customers also leverage volume at competitively served facilities when negotiating for transportation at local facilities.

The following examples, which involve shippers that filed comments in this proceeding complaining about the lack of competition, are illustrative of the variety of competition we face and how we respond to that competition.

CF Industries acknowledged in their Comments that pipelines serve their Midwest terminals and that their large nitrogen complex at Donaldsonville, Louisiana, can ship by barge or vessel. *See* Comments of CF Industries at 3. CF's website proclaims that this complex ships products "by pipeline, barge, rail, and truck" and has the advantage of "access to low-cost river and other transportation modes."[13] In addition, as CF acknowledges, most of the company's distribution facilities are "in key Corn Belt markets, served by multiple modes of inbound and outbound transportation."[14] CF uses these alternatives not just to attract customers but also to obtain concessions from carriers.

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[13] *See* http://www.cfindustries.com/plants_donaldsonville-la.html.

[14] *See* http://www.cfindustries.com/ distribution_overview.html.

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Given this recent negotiating history, we were surprised to see CF complain that railroads adopt a "take it or leave it" stance in contract negotiations. *See* Comments of CF Industries at 3. We engaged in substantial bargaining over several conference calls, and we made a number of concessions before reaching a mutually acceptable agreement with CF.[15]

Westlake Chemical states in their Comments that seven of their manufacturing sites are "captive to one railroad" and eight are not. Comments of Westlake Chemicals at 2.

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[15] Similarly, DuPont complained that railroads will not negotiate until the existing contract is about to expire and refuse to negotiate contracts with terms of more than one to three years. *See* Comments of E.I. du Pont de Nemours & Co. at 9-11. That has not been our experience. {

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Westlake later alleges that they lack competition even at the eight sites served by more than one railroad because "in recent years the two railroads do not compete," but they supply no details to support their claim. *See id.* at 8. Union Pacific serves Westlake's Longview and Lake Charles facilities. Longview is also served by BNSF and Lake Charles is also served by KCS and BNSF. Taking into account how many of the destinations have rail competition, nearly three-fourths of our Westlake traffic is open to rail competition at both ends. And our experience demonstrates that Westlake benefits from robust competition.

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We did not present Westlake with "take it or leave it" terms. We took the BNSF and KCS competition seriously. We worked to accommodate Westlake's requests and looked for ways to offer value beyond the rates. {

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TOTAL Petrochemical alleges that when it asked a railroad to reduce its rate for plastic pellets to a TOTAL customer in California to prevent the plant from closing, the railroad declined and the plant closed and the customer moved to China. *See* Comments of TOTAL Petrochemicals at 3-4. I cannot address the specific allegations because I do not believe that we were involved, but I can share a recent example of how we responded to competition from BNSF and imported plastics in order to increase our volume of polyethylene terephthalate ("PET"), a plastic resin used for bottles and food packaging.

Beginning in 2008, we recognized that we were losing PET traffic moving to California to BNSF, which was developing transloads in California to serve our local destinations, and to Asian PET imports, which were arriving in containers at West Coast ports and being trucked to final destination. Union Pacific took a close look at our PET business and developed a strategy to capture a larger share of the PET traffic moving to California. We worked with UPDS, our logistics affiliate, and with transloaders in the West, to revamp a transload operation for PET use. PET producers are located primarily in the southeastern U.S., on lines of eastern carriers, so we also worked with the eastern railroads to develop a new set of through rail rates that would help the southeastern PET producers be more competitive for California business. Since 2009, we have achieved 22 percent growth in PET carloads. We also strengthened our relationships with the PET producers, who are now more competitive in the global marketplace, and who expressed appreciation for the proactive manner in which Union Pacific assisted them in regaining market share. We would have done none of this if we were immune to competition.

While I have no doubt that market forces, and not a loss of competition, explain why we have seen improved margins and achieved better returns over the last several years, pricing is more art than science. Occasionally we may misjudge the prices the market will support. When that happens, however, the competition that we face causes us to correct and adjust. At other times, the customer insists on rates that are below reinvestable levels. We regret losing the business in such instances, but if someone else finds the business attractive at what the customer is willing to pay, then the traffic should shift. Most often, our negotiations result in market rates that move the traffic. Those rates may be higher than our customer wanted and less than we hoped for, but they move traffic and allow us to invest to sustain and grow our network.

3. Union Pacific Faces Special Challenges in Handling TIH Traffic.

Several shippers have raised complaints about Union Pacific's approach to TIH traffic. One chlorine customer goes so far as to criticize us for not trying to serve its plant in a state in which Union Pacific does not even operate, and an ammonia customer wrongly accuses Union Pacific of forcing a plant to close. I will address Union Pacific's position on transporting TIH before addressing the two specific allegations against Union Pacific.

a. Responsible Transportation of TIH Commodities

At least one party claims that Union Pacific is trying to avoid its common carrier responsibility to transport TIH by imposing high rates and unreasonable terms. *See* Comments of PPG Industries at 3. That mischaracterizes both Union Pacific's attitude and actions. Union Pacific recognizes that rail is the safest surface mode of transportation for TIH and accepts its common carrier obligation to transport TIH. But the reality remains that TIH, unlike other commodities we transport, poses significant, inherent risks to our employees, the communities in which we operate, our customers, and our property, despite all we do to move it safely. To reduce these risks, Union Pacific has two strategies: first, take all precautions to carry these loaded and empty cars without safety incidents, and second, promote efforts to reduce the volume of TIH traffic that must be transported by identifying and developing safer alternatives and safer tank cars.

Union Pacific cannot achieve either objective without the active involvement of its customers who ship and receive TIH. Shippers and their consignees bear responsibility for several activities necessary to safely transport TIH. Shippers, not Union Pacific, own or lease, and maintain the tank cars that TIH moves in. They load the cars and secure the valves and seals for the loaded move. Consignees unload the cars and secure the valves and seals for the empty return of the car. Both shippers and consignees have the obligation to tender the cars, whether loaded or empty, so that they are safe to move. Shippers must correctly describe the nature of the lading. Failure in any of these activities can lead to serious injury or damage. It is in the public interest, as well for the benefit of our employees, that TIH customers should be induced to take every precaution to ensure that they perform these responsibilities correctly and thoroughly. Just as Union Pacific must bear responsibility for its negligence, so must the TIH customer.

Accordingly, we propose risk allocation terms and conditions so that all parties have a clear understanding of their respective responsibilities and the consequences if they fail.

Due both to the inherent risk in moving TIH and the potential consequences of an incident, this is not business that we actively pursue. We encourage our customers to pursue alternatives that reduce or eliminate the need for rail transportation of TIH. Union Pacific is aware of and endorses actions that some producers are taking to substitute products, reduce inefficient cross-hauling (thereby reducing TIH car-miles), advance on-site generation and consumption, and improve TIH tank cars. For example, Union Pacific has played a central role, working with a shipper and a car manufacturer, to develop a new chlorine tank car that will achieve a significant reduction in risk. The design is awaiting Department of Transportation approval. As another example, thirty percent of the chlorine that Union Pacific shipped in 2010 went into water treatment. Bleach is an alternative to moving chlorine, and we are working collaboratively with chlorine producers to develop networks of bleach movement. But when a customer wants to move TIH, we establish rates and risk allocation terms that address fairly the costs and risks of providing this service.

b. Olin/SunBelt Chlorine from Alabama

Olin, now the sole owner of SunBelt Chlor Alkali (collectively Olin), operates a chlorine production facility in McIntosh, Alabama, which is solely served by Norfolk Southern. Olin ships 250,000 tons of chlorine to a customer in LaPorte, Texas. The LaPorte receiver is open to both BNSF and Union Pacific. Olin complains about the state of rail competition generally, but it specifically complains that Union Pacific has not "attempted to gain access to the SunBelt plant." Comments of Olin at 31. Yet, as Olin's own map shows, Union Pacific's system ends at New Orleans, which is several states, and several hundreds of miles, away from the SunBelt plant. *See id.* at 29. Accordingly, it is not clear what Olin expects Union Pacific could do, even if the Board adopted some of the access proposals in this proceeding, since McIntosh, Alabama, is far beyond the reach of reciprocal switching or terminal trackage rights based in New Orleans (and Union Pacific has no crews in either Mississippi or Alabama that could operate trains over any such trackage rights).

For the service that Union Pacific can provide west of New Orleans, we already face competition from BNSF. Nearly the entire route from New Orleans to LaPorte is comprised of joint facility arrangements created as a result of the UP/SP merger. Accordingly, it is hard to see how Union Pacific, which does compete west of New Orleans, can be charged with lack of competitive spirit for not offering service hundreds of miles east of New Orleans.

c. Dyno Nobel Ammonia to Battle Mountain

Dyno Nobel has lodged a more serious, and false, accusation against Union Pacific by blaming us for its decision to close its Battle Mountain plant near Rennox, Nevada.[16] This plant is open to both BNSF and Union Pacific, since it is a 2-to-1 point subject to UP/SP merger conditions. Dyno Nobel claims that "UP doubled its anhydrous ammonia rail rates from the Gulf Coast to DNI's Battle Mountain manufacturing facility in Utah [sic]," and that, "[u]ltimately, DNI was forced to shut down its Battle Mountain plant, as the increased rail rates *alone* made the plant uneconomic."[17] This claim is false in several respects.[18]

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16 Dyno Nobel made this accusation in its opposition to Union Pacific's Petition for a Declaratory Order asking the Board to find our TIH risk allocation tariff to be reasonable in STB Finance Docket No. 35504.

17 *See* Letter of Dyno Nobel, Inc. at 2, *Union Pacific Railroad Company – Petition for Declaratory Order*, STB Finance Docket No. 35504 (May 17, 2011) (emphasis added).

18 As a minor matter, Dyno Nobel's Battle Mountain plant is located near Rennox, Nevada, not in Utah. And, as it happens, most of the ammonia that Union Pacific was delivering when the plant closed {

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Dyno Nobel announced in a press release that "the Battle Mountain decision was driven by substantially reduced customer demand." *See* Exhibit A hereto. In a meeting, Dyno Nobel told us that the Battle Mountain plant was {

} *See* Exhibit B hereto. Clearly the plant closed for reasons beyond Union Pacific's control.

4. Union Pacific Competes for Chemical Traffic by Providing High-Quality and Responsive Service.

a. Timely, Reliable Service Delivers Value to Customers.

Union Pacific is committed to excellent service and has seen record improvements in recent years. Better service improves our customers' competitiveness and enhances our ability to retain and capture traffic. Customers tell us that our service delivers significant savings. In recent years, our service performance has become a key competitive advantage for Union Pacific in retaining existing chemical business and winning new business. We have taken substantial volumes of traffic from competitors because of our service.

Our chemical customers value reliable service. They seek to utilize their cars as efficiently as possible and they want us to deliver those carloads as planned. We therefore measure performance for chemical traffic based on planned delivery time and car cycle time and strive to improve our performance. In 2004, we delivered on time or early 60 percent of the time. We have made substantial improvements since then, delivering cars on time or early 88 percent of the time in 2010. We have worked hard to reduce car cycle time, which improves effective utilization of customer equipment. Between 2004 and 2010, average cycle time for private chemical cars improved by 3.6 days, from 16.9 days to 13.3 days. Customers would not see these improvements if we were not competing for their business.[19]

In one case, we were able to improve a customer's car utilization so much that it reduced its fleet by 10 percent. Our efforts began when an explosion damaged a refinery's pipelines, and, as a result, our customer had to nearly double its outbound rail shipments to keep the refinery running. This jump in volume congested our local yard, which was not prepared to hold an average of 200 cars per day, and disrupted operations. We worked with the customer and UPDS to develop a comprehensive fleet management program. After the program was implemented in September 2009, we were able to restore fluidity to the yard and eliminate missed switches due to congestion. Demurrage charges fell more than 95 percent (which both Union Pacific and the customer consider a victory).

Some parties complain that railroads are no longer willing to include service commitments in their contracts. This has not been an issue in our negotiations with chemical shippers. In fact, in our experience, specific service commitments have never been a common

[19] DuPont claims that transit time on certain lanes of traffic did not decrease between 1992 and 2007. *See* Comments of DuPont at 6. While we are uncertain which traffic DuPont is discussing, we have not received complaints from Du Pont regarding transit time in the last several years. Increasing system velocity and reducing terminal dwell time have improved cycle time generally, but if DuPont or another customer is experiencing problems, we want to spend the time and effort to figure out why and what can be done about it.

feature for contracts covering carload shipments of chemicals. Chemical traffic is typically shipped one carload at a time. The mix of origin-destination pairs can change frequently. Accordingly, it would be difficult to establish a practical service metric. In any event, as discussed above, our reliability and car utilization are at record highs. Most customers seem confident in our performance. They are not asking for contractual service commitments.

b. Customers Choose to Locate on Union Pacific.

A good test of the competitive options available to shippers comes when they choose to invest in new or expanded facilities. Customers carefully analyze their options before making such major investments, and they generally have the opportunity to choose between locations served by one railroad and locations served by two or more railroads. Since 2007, sixteen different customers who ship or receive a wide variety of chemicals (*e.g.*, fertilizers, plastics, caustic soda, acrylic acid) have built or are in the process of building new or expanded facilities at locations that are or will be served only by Union Pacific. We anticipate that those new plants will generate more than 25,000 carloads in incremental traffic on Union Pacific.

I will discuss three examples where the customer had choice of locations served by another railroad or two railroads.

Shintech is one of world's largest producers of PVC. It built its first North American PVC plant in 1976 in Freeport, Texas. That location is local to Union Pacific. When Shintech built its second PVC plant at Addis, Louisiana, in 2000, it chose a location that only Union Pacific served. In 2007, Shintech began to build its third North American facility at Allemania, Louisiana, and again chose a site served only by Union Pacific. The third facility is an integrated plastics and chemical plant. The first phase was completed in 2009, and the remainder is expected to be completed this year.

Western Emulsion produces and distributes asphalt. When it decided to build an asphalt production facility in the Phoenix area, it considered multiple sites, including sites from which it could have received service by both BNSF and Union Pacific. It finally chose a location that was local to Union Pacific because the inbound and outbound transportation services and logistical support we offered were superior to the alternatives. Western Emulsion's experience with Union Pacific rates and service for its Tucson facility apparently made it willing to choose Union Pacific. The Phoenix facility opened in January 2010.

Georgia Gulf is a PVC producer that operates one plant that is local to Union Pacific in Allemania, Louisiana, and another that is jointly served by BNSF and KCS in Aberdeen, Mississippi. When it decided in 2007 to increase its production capacity, it chose to expand its Union Pacific-served facility in Allemania.

Chemical manufacturers consider a number of factors besides rail service when deciding where to build or expand a chemical plant. However, it is significant that in each of these cases, the customer had experience with being "captive" to Union Pacific, yet chose to repeat the experience. Their experience must have convinced them that the rates and service that we could provide them were competitive and would allow their new plants to succeed.

c. Union Pacific Uses Accessorial Charges to Promote Network Efficiency, Not as a Source of Revenue.

Some parties complain that railroads are imposing numerous "accessorial" charges, shifting costs to customers for actions such as retaining railroad-owned cars for an extended period. For Union Pacific, these charges are not designed to generate revenue, but rather to encourage shippers to refrain from behavior that will compromise safety, upset the balance of equipment on our system, block service to other shippers, or otherwise interfere with efficient operations. In general, these charges accomplish their purpose. Union Pacific collects a relatively small amount of money from these charges, and we would be satisfied if we never had to impose the charges on any customer. While the charges may be an annoyance for some customers, they play an important role in keeping Union Pacific's system operating safely and efficiently for all shippers.

C. Agricultural

The Department of Agriculture and various agricultural producer and shipper organizations assert that agricultural shippers do not enjoy robust rail competition and that existing Board access remedies should be enhanced. Union Pacific's perspective is very different. Farmers have numerous transportation options, and Union Pacific works hard to win and retain their business. The same is true for food processors and other agricultural receivers, which generally have many options for sourcing their shipments. Moreover, we believe that changing the Board's access rules in the ways certain parties have suggested would interfere with our efforts to provide the transportation services agricultural shippers seek.

Union Pacific's Agricultural business includes transportation of whole grains, grain products (including ethanol), and other food and refrigerated products. In this part of my statement, I will discuss how we compete for agricultural traffic against railroads and other modes of transportation by offering competitive rates, high quality services, and innovative products, and by investing in rail infrastructure to support the growth of domestic and export traffic.

1. Robust Competition Exists for Transportation of Grain and Other Agricultural Products.

Agricultural shippers have considerable flexibility when considering transportation alternatives. Farm operations are spread out across a wide area, and many are not located on a rail line. Thus, agricultural shippers often use truck transportation for at least the first leg of a movement, and in some cases for the entire movement. A farmer may truck his corn to a feed lot, an ethanol plant, or one of several grain elevators (which may be served by different railroads). Trucking grain or other products to a barge loading point on a river may also be an option.

A group of twelve agricultural associations that filed comments in this proceeding (the "Agricultural Associations") acknowledged the availability of these other modes: "Rail shipping comprises about 35% of the physical volume in agricultural shipping markets; trucks hold about a 50% market share; and the balance is served by the barge industry." Comments of Agricultural Associations at 2. The shipment of perishables in particular is a highly truck-competitive business, since customers require fast, reliable transit times. Perishables also move in intermodal service, which is intensely truck-competitive.

Our experience with Produce Railexpress ("Railex"), which initiated a premium service in the fall of 2006, illustrates the competition that exists for agricultural business. Railex wanted to develop a high speed service to move produce from the West Coast to New York State. When it was deciding where to locate its West Coast facilities for this service, we worked hard to design unit train service that would be as attractive as using trucks. In addition, we were aware that BNSF wanted this type of business and that the Port of Wallula, Washington, was offering a location open to both Union Pacific and BNSF. Railex could have chosen to use trucks rather than rail, and could have located anywhere, so this was a very competitive situation. Union Pacific and CSX ultimately won the business, and Railex chose Union Pacific closed locations in Washington and California for its West Coast origin facilities. {

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2. Union Pacific Charges Competitive Rates for Agricultural Traffic.

Union Pacific charges market-based, reinvestable rates, to remain competitive for agricultural business. In developing the rates and terms for agricultural traffic, Union Pacific takes into account the many alternatives agricultural shippers enjoy and seeks to keep competitive with other modes. We have a strong incentive to offer reasonable rates and terms to agricultural shippers. We want to be sure that grain elevators and other gathering facilities and agricultural products producers located on Union Pacific lines are competitive and attract substantial volumes of business.[20] Yet we must balance that consideration with the need to earn enough contribution to be able to re-invest in the track, yards, cars, and locomotives required to serve these customers.

The Agricultural Associations assert that between 2006 and 2010 Union Pacific's rate increases for agricultural shipments increased by 27 percent, compared to 21 percent for all rail cars and 20 percent for intermodal traffic. *See* Comments of Agricultural Associations at 4. However, average revenue per carload is not an appropriate measure for such comparison purposes, because it does not account for differences in traffic mix by distance. That is a significant shortcoming, particularly for agricultural traffic. As the Agricultural Associations recognize, shifts in production, shifts in export demand, and the recent boom in ethanol production can alter traffic flows on short notice.

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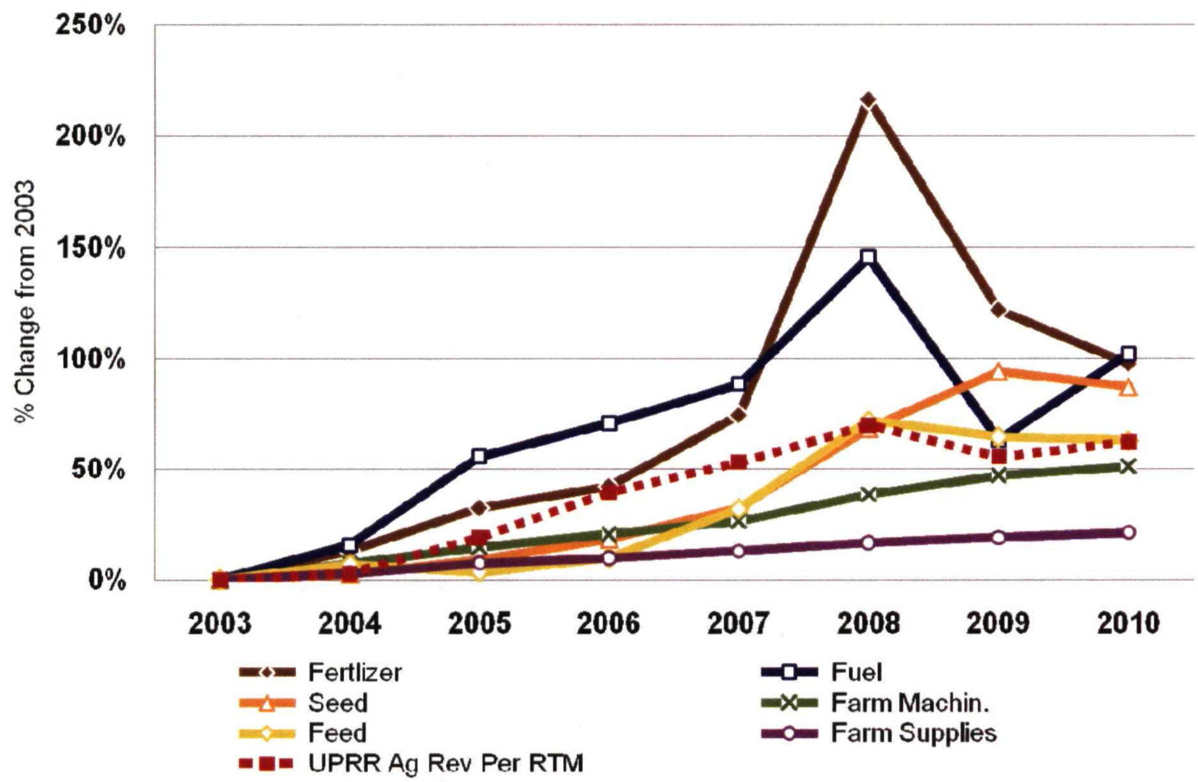
[20] Transportation of agricultural products generally occurs under public tariffs rather than contracts. Most grain customers prefer the transparency of tariffs to confidential contracts. This tariff pricing allows customers to see what their competitors will pay to reach the same markets. It also allows producers and elevators to choose the markets for their grain, and provides information that can influence what crops will be planted. Given the dynamic nature of grain markets, tariff rates provide more flexibility and more information for our grain customers and their suppliers and receivers.

A better measure of how agricultural rates have changed over time in relation to rates for commodities is a comparison of revenue per revenue ton mile, a measure that accounts for differences in the distance the traffic moves (and thus also more accurately reflects the impact of fuel surcharges). A comparison of revenue per revenue ton mile shows that Union Pacific's agricultural rates increased only 16.3 percent between 2006 and 2010, as compared with an increase of 17.9 percent for all traffic.

As another way to put rate changes in perspective, it is worth noting that our rates for agricultural traffic have risen less than the prices of several other significant agricultural inputs, including fertilizer, fuel, and seed, as shown below.

Figure 8: Farm Input Costs Relative to Union Pacific Rail Rates



Source: USDA National Agricultural Statistics Service and UP Fact Books

3. Union Pacific Competes for Agricultural Traffic by Offering High-Quality Service and Innovative Products.

Union Pacific has worked hard to enhance our competitiveness by improving the service we provide agricultural customers, and we have made significant strides. Although some parties say that railroads are not competing as they did prior to 2004, in our experience, agricultural shippers are enjoying better service because of the strong competition that drives us to improve. In the past few years, we have improved our service significantly in response to this competition. In 2004, our service delivery index ("SDI") for agricultural manifest shipments (reflecting the percentage of time such shipments arrive at destination within 26 hours of the original trip plan) was 62;[21] in 2010, the SDI was up to 87. For unit grain trains, our 2003 SDI was 74; by 2010 our SDI had increased to 86, well above the previous record of 78 in 2001. Thus, our data show that agricultural shippers are enjoying better service from Union Pacific now than they received seven or eight years ago.

We have also worked to improve service by continuing to add new origins and destinations for grain shuttle trains and to push to improve loading, unloading, and transit times for these trains. We have also developed unit train operations to serve the ethanol business, for carriage of both ethanol and a by-product used in animal feed, dried distillers grains ("DDG"). Greater use of unit trains for high volume agricultural operations has allowed us to reduce transit times and improve equipment utilization for this traffic. These improvements benefit our agricultural customers by allowing them to reduce their own costs.

We have also helped shippers develop premium services for the shipment of perishables. As discussed above, we worked with Produce Railexpress to develop a unit train

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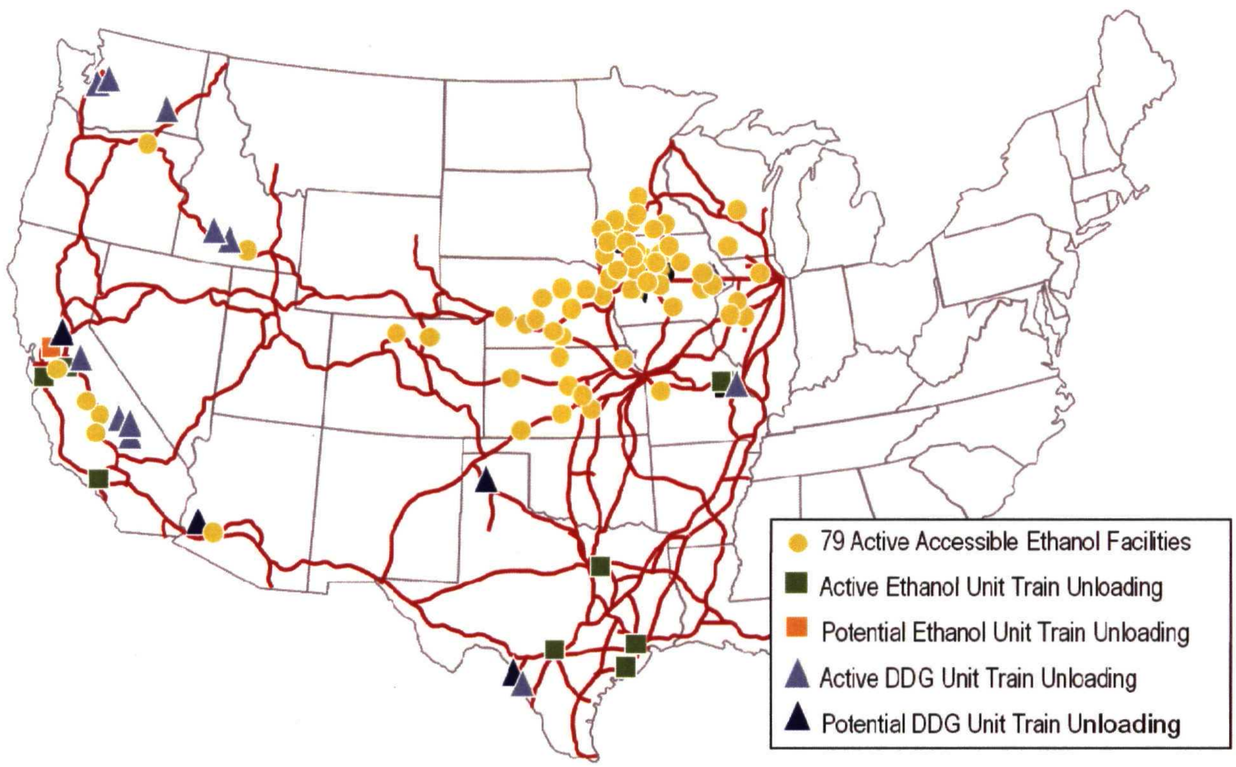
21 2004 is the earliest year for which Union Pacific has this metric.

operation that provides truck-like service for fresh produce moving from the West Coast to New York. We also introduced Express Lane, which moves a variety of food products (including dairy products, canned goods, wine, frozen foods, and fresh produce) from the West Coast to destinations in the East and Southeast. While we stress service delivery improvement for established products, we also strive to understand our customers' evolving needs to reach new markets. As in the perishables market, we develop new or improved products to meet those evolving needs.

Markets do not stand still, and if Union Pacific tried to stand still we would lose opportunities for profitable growth to our competitors. The ethanol business is a prime example. Following enactment of legislation promoting biofuels, we moved quickly to work with terminal developers and operators to identify optimal locations and create high volume, efficient ethanol terminal facilities. We worked to consolidate manifest volumes into unit trains dedicated to ethanol traffic. Today we have 79 active ethanol facilities and a growing number of unit train unloading locations for ethanol and DDG.

Figure 9: Union Pacific Ethanol and DDG Network



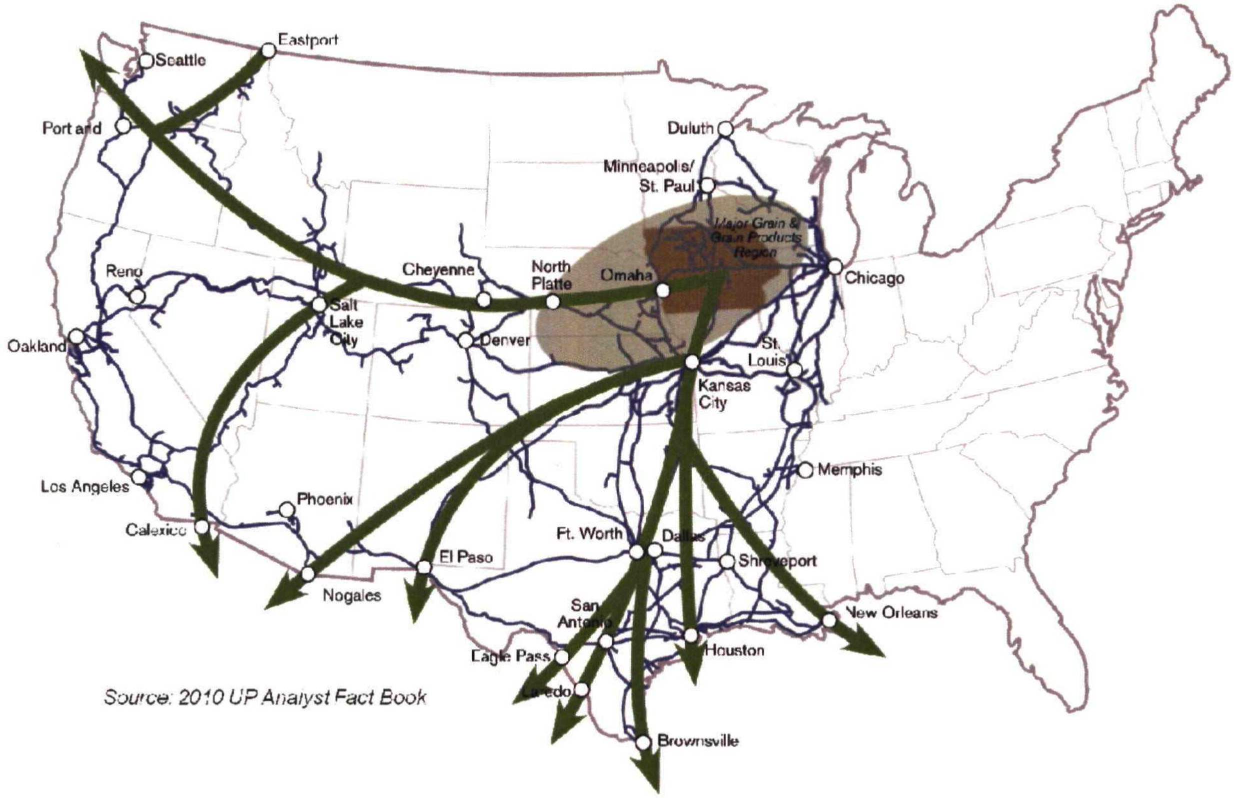
4. Union Pacific Competes for Agricultural Traffic by Investing in Infrastructure and Equipment.

Our improvements in service for agricultural shippers result at least in part from the substantial amounts we have invested in recent years to create infrastructure that specifically benefits agricultural traffic. As discussed above, we have worked particularly hard to provide infrastructure needed to develop the ethanol business, which has experienced dramatic growth. A growing number of ethanol facilities are located on Union Pacific lines. Between 2005 and 2008, our total expenditures on ethanol-related infrastructure approached $80 million.

Other investments have benefited a broad range of agricultural shippers. Since 2008, we have invested over $15 million in expansion of several yards that serve agricultural shippers, including our yards at Clarks Park, Texas, and Wichita, Kansas. Our installation of centralized traffic control across Iowa and into Chicago has benefited a variety of customers, including our perishables customers. In addition, in recent years we have invested heavily in acquiring hopper cars and other specialized equipment for agricultural shippers. Since 2005, we have acquired over 4,000 new hoppers for Agricultural products through purchase or lease, and we are continuing to take delivery of new cars. We have the largest refrigerated boxcar fleet in the industry, and we work to maintain a competitive advantage in shipment of perishables. Our improved network performance – the result of continuing investment in many parts of our system – has given us opportunities to capture some of this business from trucks.

A number of the investments we are making benefit our agricultural export traffic. Exports are a significant part of our agricultural business, approximately 25 percent in 2010. In recent years, export demand for grain and soybeans has been particularly strong. We participate in the movement of over 10 percent of all U.S. grain exports. Export grain traffic flows in multiple directions on our network.

Figure 10: Union Pacific Export Grain Traffic Flows



As an example of our investment to serve export traffic, we expect to open a new transloading facility at Yermo, California, to handle the transfer of product from covered hopper unit trains directly to marine containers. This new "plant-to-port" service will include double-stack intermodal train service "on dock" to the ports of Los Angeles and Long Beach. Initially this program will serve DDG customers, but it is designed to handle bulk grain and processed grain products as well. Our capacity investments in the Wyoming-Pacific Northwest corridor and near New Orleans will facilitate export shipments to various destinations, and our investments north of Dallas/Fort Worth will help expedite shipments to Mexico.

We have had to be agile in responding to shifting economic conditions, which can make export destinations attractive to shippers on short notice. For example, last year we shifted crews to the Pacific Northwest because it appeared that there would be strong export demand at those ports. However, conditions changed, and instead there was stronger export demand via Gulf Coast ports. We had to act quickly to shift crews to accommodate the new surge of export traffic from the Midwest to the Gulf Coast ports. We are committed to continuing to support our customers with resources as they see export opportunities develop.

D. Industrial Products

Only a few shippers of industrial products filed individual comments in this proceeding. This section provides an overview of the competitive environment for industrial products traffic and then responds to specific comments from two customers that we serve: Roseburg Forest Products and Mississippi Lime.

Union Pacific's industrial products business involves shipments of hundreds of commodities between thousands of origins and destinations in North America. Our industrial products traffic includes commercial and highway construction products, metals and minerals moving to industrial manufacturing plants, paper and consumer goods, lumber for use in new home construction and repair and remodeling, and other miscellaneous products.

Union Pacific described the highly competitive marketplace for this traffic in the recent testimony of Eric Butler, Union Pacific's Vice President and General Manger - Industrial Products, in Ex Parte No. 704, *Review of Commodity, Boxcar, and TOFC/COFC Exemptions.* Mr. Butler provided an overview of the largest segments of our industrial products business and described the intense competition we face for that traffic from other railroads and other modes, especially from trucks. He also explained how product and geographic competition constrains the rates that we can charge because receivers can often turn to sources that are served by carriers other than Union Pacific.

For example, as Mr. Butler explained, trucks dominate markets for movements of lumber and wood products, and are competitive with rail over long distances. Rail competition is also strong. Shippers with facilities served exclusively by Union Pacific can readily transload their products to obtain service from BNSF. Geographic competition is also a significant factor because products from the Pacific Northwest and Western Canada must compete with products from the Southeast United States and from Eastern Canada. As another example, trucks move the vast majority of the crushed stone, sand, and gravel (or "aggregates") used to make concrete for road construction projects. Aggregates are mined from quarries located all across the United States, so there is usually a source within trucking distance, and they require a truck haul to the construction site. When we have an opportunity to compete for aggregates business – usually when a quarry we serve is trying to penetrate a distant market – we are typically competing against aggregates trucked from a closer quarry, aggregates moving from a different quarry served by another railroad, and even aggregates shipped from Mexico in bulk cargo vessels.

Mr. Butler also described our efforts to compete for industrial products business by offering innovative products and delivering quality service at rates that provide value to our customers while achieving fair returns on our investments. As he explained, we have invested to improve our terminal performance through yard renewal and expansion projects, as well as process improvement. We have also sought to capture new business by increasing access to transload facilities and building new distribution centers. We face continuing, intense pressure to innovate and invest in creating value for our customers to win or retain their business. And that in turn, compels us to price so that we can reinvest. Yet, as Mr. Butler testified at the Board's February hearing in Ex Parte No. 704, we must replace ten percent or more of our industrial products business each year because of market changes, geographic source competition, and competition from other railroads and motor carriers that can reach our customers' facilities directly or by transloading or that serve competing sources.

In fact, for many of our industrial products customers, rail provides a critical competitive option to truck service, which relies on the nation's overloaded and deteriorating highway system. The views of many of these shippers are well represented by the comments filed by Rosboro, LLC, a manufacturer and distributor of lumber and other products located in Springfield, Oregon. They understand that "the strength of the nation's economy and the jobs encompassed by the national economy varies directly with transportation capacity." Comments of Rosboro at 2-3. They recognize that railroads have reinvested profits "into capacity-related expansion," which "has benefited their customers during the economic recession and will further benefit their customers as economic activity increases during the ongoing recovery." *Id.* at 3. They believe there is a place for Board regulation, but they do not want the Board to adopt new regulatory schemes that would provide some limited number of shippers with an economic advantage "at the expense of the general shipping public and the productivity of the nation's transportation system." They recognize that the "nation's shipping public and the national economy need the railroads to continue earning an adequate return to attract capital that will be applied toward further capacity expansion, thus supporting economic growth for all industries, railroads and their customers alike." *Id.* Many regional economic development organizations filed comments in this proceeding to make the same points: railroad investment of private dollars in infrastructure is critical to this nation's ability to meet the existing and growing demand for transportation and ensure that our products remain competitive in world markets.

Two Union Pacific customers that ship industrial products filed comments addressing specific concerns.

<u>Roseburg Forest Products</u>. Union Pacific has a long and highly valued relationship with Roseburg Forest Products, and we appreciate its business. We also appreciate

Roseburg's balanced viewpoint and agree with virtually all of its comments, which include recognizing the improvements we have made to our physical plant and car supply. Like Roseburg, we wish all of those modern, centerbeam flatcars were carrying freight, rather than occupying storage tracks. When the housing market recovers (America is constructing fewer new residences today than it loses), we hope to see more lumber, plywood, particleboard, and other wood products move by rail from Oregon.

Union Pacific has been investing heavily, banking on the recovery of customers like Roseburg. For example, we essentially rebuilt the entire Southern Pacific rail route from Portland, Oregon, to Northern California. We completed much of that work during the recent period when the housing market has been depressed and rail traffic has slowed on our I-5 Corridor. East from Portland, we continue to spend tens of millions of dollars annually to expand capacity and improve the railroad. For example, in 2011, we are creating or expanding seven sidings between Portland and western Wyoming, and we are installing new terminal trackage to handle through trains at locations such as Pocatello and Nampa, Idaho. We might not be making these investments if we were not optimistic that the lumber markets will someday recover, and we need to be ready.

Our rates, however, are not excessive. Based on our calculations, none of the rates we offer for Roseburg's products would come close to the Board's jurisdictional thresholds for a rate case. Part of the problem that Roseburg faces is geographic. It is located in southern Oregon, and all of its traffic must move north a substantial distance before it can move eastward toward the Midwest, East or South. In addition, Roseburg is located on a short line railroad, which must maintain itself in order to remain in service. Its rates must cover those extra miles.

In the very weak market for Roseburg's products, we also have suffered. Union Pacific has had on average 1,235 centerbeams in storage this year that are not earning a penny of return on investment. We also have seen our traffic decline precipitously. As I discussed above, there is intense competition for movements of lumber products, including modal and geographic competition. In the north-south markets on the West Coast, trucks dropped their rates to rock-bottom levels, and trucks dominate what little business is left. Especially in difficult economic times for the U.S. lumber industry, other changes in market structure are hurting Union Pacific traffic volumes. Roseburg faces increasing competition in Midwest, Northeast, Texas, and Southeast markets from production in the Southeastern states. We assume that is why Roseburg acquired a number of Georgia Pacific facilities in the Southeast, so that it could reach those other markets more efficiently. Union Pacific cannot establish rates that are low enough to compete against those sources from origins in Oregon and still maintain our rail network.

Mississippi Lime. Union Pacific has been pleased to provide excellent service to Mississippi Lime and is disappointed by its counsel's one-sided characterizations of our relationship. As its statement recounts, Union Pacific normally moves traffic from Mississippi Lime's facility at Mosher, Missouri, to a Union Pacific rail yard at St. Genevieve, Missouri, and then via trackage rights over BNSF's line adjacent to the Mississippi River to Crystal City, Missouri, where the traffic returns to a Union Pacific line for movement to a classification yard in St. Louis. Union Pacific, with supporting contribution from the customer, also keeps in service an emergency route westward from Mosher for about 30 miles to connect to the remainder of the Union Pacific system. In addition to this line-haul service, Union Pacific provides extensive switching service within Mississippi Lime's operating complex and between the plant and St. Genevieve.

Based on Union Pacific's detailed operating records for the last decade, Union Pacific reduced its trackage rights frequency to and from St. Louis over BNSF from six days per week (not seven, as Mississippi Lime states) to five days per week. In 2009, however, in a change not mentioned by Mississippi Lime, Union Pacific increased local switching service exclusively for Mississippi Lime from 10 shifts per week to 15 shifts per week, so that we provide coverage for about 75 percent of the time when we could possibly switch the facility.

Mississippi Lime suggests that it would add trackage and increase shipments if it obtained access to another carrier. {

} Union Pacific's constructive response demonstrates that it is eager to work with this valued customer. We hope that this will not be yet another instance in which a commercial relationship will be undermined and distorted by regulatory objectives. The market provides sufficient incentive for Union Pacific to serve this customer well.

The Board and the customer should consider one additional perspective. Union Pacific has kept in service the 30-mile emergency route because the customer and its traffic are important to us. If the traffic had been substantially diverted to another carrier, Union Pacific's incentive to maintain the emergency route would have evaporated. We would have sought to abandon the backdoor route to Mosher. Either Mississippi Lime would have been forced to buy it for liquidation value, or the track would have been removed. In recent weeks, the Mississippi River flooded BNSF's river route, cutting off service on both railroads to St. Louis. Union Pacific made preparations in advance of the flood and spruced up the emergency route and initiated service to Mississippi Lime using that route. Had that option not been preserved, Mississippi Lime would have been entirely without rail service due to the record floods on the Mississippi. The Board should be thoughtful about the incentive structures it establishes for railroads.

E. Automotive

Union Pacific operates or accesses 43 automotive distribution centers. We serve vehicle assembly plants directly, and we connect to West Coast ports and the Port of Houston to accommodate both import and export traffic. We also provide expedited handling of automotive parts in both boxcars and intermodal containers destined for Mexico, the U.S., and Canada.

Union Pacific described the highly competitive marketplace for automotive traffic in our testimony in Ex Parte No. 704, *Review of Commodity, Boxcar, and TOFC/COFC Exemptions*. We described the vigorous competition we face for shipments of finished vehicles and parts from other railroads and from other modes. Union Pacific and BNSF compete vigorously for movements of finished vehicles from ports and manufacturing facilities to destinations in the western United States. Over short distances, railroads cannot match the combination of service and rates offered by trucks, and we also compete with trucks in several relatively long-distance lanes. We also compete intensely with BNSF and Kansas City Southern to move auto parts, although trucks carry most auto parts traffic in the current marketplace.

Union Pacific also described how we have responded to this competition by investing in new facilities and developing new processes and technologies to improve service quality and make us even more competitive. Union Pacific has invested approximately $350 million since 2005 to improve service to the automotive industry. We have reduced transit times for finished vehicles from an average of 5.1 days to an average of 4.4 days, resulting in millions of dollars in savings for our customers each year. We have improved on-time delivery, and we are providing 99.7 percent damage-free delivery. We have developed products that provide value to our customers, including our VINformation™ system, which allows customers to track their finished vehicles moving by rail; our LogicNet software, which allows customers to analyze and improve their overall vehicle distribution networks; and our co-loading process, which permits customers to use rail rather than truck for destinations that otherwise would not have sufficient volume to make rail a competitive option.

I do not see how anyone could look at our investment of time and money and claim we are not competing for automotive business. Although several auto manufacturers filed comments in Ex Parte No. 704 asking the Board to consider further whether their traffic should continue to be exempted from regulation, they have not appeared in this proceeding to seek changes to the Board's competition policies.

F. Intermodal

Union Pacific's intermodal business involves the movement of international freight for import or export in containers designed for ocean transit and domestic freight in containers or truck trailers. Intermodal traffic is the most competitive category of traffic that moves by rail, as we explained in Ex Parte No. 704, *Review of Commodity, Boxcar, and TOFC/COFC Exemptions.*

As far as I can tell, no party in this proceeding has suggested that the intermodal business is not competitive. To the contrary, several parties in this proceeding complain that we and other railroads devote too many of our resources to serving imported traffic that moves in intermodal service. However, as I discuss in more detail below, those complaints reflect an extremely misguided view of the role that imports play in our economy and the benefits of investments in our network. Imported goods that we move in intermodal service are going to American businesses that rely on parts and materials from overseas, and American consumers that chose to buy imported products. We do not view it as our role to use rail rates to dictate international trade policy. Moreover, our rail lines work both ways. We move a tremendous amount of export business from the interior of our nation to our ports. There is no industry that is investing more to support the infrastructure necessary to encourage U.S. export traffic than railroads.

III. UNION PACIFIC'S TRANSPORTATION OF IMPORT AND EXPORT TRAFFIC BENEFITS THIS NATION'S BUSINESSES AND CONSUMERS

In an astonishingly cynical and political gambit, several parties assert that U.S. railroads are driving U.S. jobs overseas by preventing U.S. companies from competing with foreign companies and favoring imported traffic over exported traffic. Claims that increasing rail regulation and reducing rail revenues would somehow make American companies more competitive in world markets are wrong and dangerous. The policy changes being proposed would drive up rail costs, destroy productivity and service, and curtail investment in the infrastructure that U.S. companies need to export American goods and keep our country competitive on the world stage.

U.S. railroads create U.S. jobs. U.S. railroads provide this country with an extraordinary competitive advantage in world markets. We carry more freight, more efficiently, and charge shippers less than any other major railroad system in the world. The suggestion that U.S. railroads are driving jobs overseas is nonsense. Many factors affect the decision of U.S. companies to send jobs overseas, but rail prices are not even on the radar screen. We commissioned a major search of economic literature on offshoring American jobs and found no mention of U.S. rail rates as a factor.

Every American knows the major reasons jobs move overseas. Many are summed up in the phrase "the China price" – wage rates that are a fraction of U.S. wages, scant benefits for employees, restrictions on labor organizations, limited environmental controls, and less regulation. In fact, according to published reports, the wave of jobs moving overseas today is dominated by companies specializing in information technologies and semiconductor or software – companies not dependant on rail services. President Obama has observed that we have "a tax code that says you should pay lower taxes if you create a job in Bangalore, India, than if you create one in Buffalo, New York, and that "reward[s] our companies for moving jobs off our shores or transferring profits to overseas tax havens."[22] Railroad rates are not even a drop in the bucket compared with these tremendous economic forces driving decisions by U.S. companies to send jobs overseas.

Railroad investment in infrastructure is not a choice between "us" and "them." Parties complaining about imported traffic moving by rail ignore two crucial facts. First, most of the companies using U.S. railroads to move goods from overseas to points in the U.S. are *American* companies: Ford, Wal-Mart, Kohl's, Caterpillar, General Motors, and many others. They are using imported products and materials to create U.S. jobs and provide goods to U.S. consumers. Presumably, none of the complaining parties is suggesting that railroads should ignore their common-carrier duties on behalf of those American companies that choose to import goods.

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22 *See* Remarks by the President on International Tax Policy Reform (May 4, 2009).

Second, parties complaining about imports miss a point that is pivotal to America's future. The same rail infrastructure that carries imports into the U.S. also carries America's exports to the world. The President wants to double U.S. exports within the next four years. Only the railroad industry's infrastructure can carry the export grain, metals, iron ore, coal, and other American-produced goods that are essential for sustaining the American economy in a globally competitive landscape. Self-interested proposals that would make American railroads less productive, more costly to operate, less able to provide service, and less able to invest would stick a dagger in the future of American exports.

<u>Union Pacific is highly focused on serving export traffic</u>. This will probably surprise many parties complaining that railroads favor imports, but Union Pacific carries slightly *more* exports than imports, and exports are growing faster than imports. We estimate that our import volumes will grow from 2010 to 2011 by less than six percent, while exports are expected to grow by almost ten percent. Over the 2007 to 2013 (estimated) period, we expect imports to grow at under two percent annually, while exports should grow at over four percent. The weak U.S. dollar should support this trend.

Union Pacific's export growth should dispel any claim that Union Pacific is doing anything to impair onshore production or unduly favoring import traffic. Our experience with several specific commodities confirms our commitment to export business:

- Union Pacific moves a tremendous amount of agricultural traffic to ports for export, as discussed above. We export large quantities of grain, soybeans, soybean meal, soybean oil, and DDG. Exports accounted for approximately 25 percent of our agricultural business in 2010. To place that amount in perspective, Union Pacific participated in the movement of over 10 percent of all U.S. grain exports.

- Union Pacific is actively pursuing opportunities to increase shipments of export coal. Union Pacific's coal exports through bulk export facilities at West Coast ports are up by over 100 percent year over year. West Coast ports are at capacity, but the issue is not the railroads. Port expansion is being constrained by environmental regulation and legislation. For example, the Port of Tacoma planned a large coal export facility, but risk of environmental litigation killed the project. More recently, an Australian company proposed a major coal export facility at Longview, Washington, but that project is on hold due to environmental litigation. Union Pacific continues to seek export coal opportunities and recently obtained new export coal business to Chile moving from a Mississippi River dock.

- U.S. soda ash production costs are the lowest production costs for this product in the world. Union Pacific plays a pivotal role in the world competitiveness of U.S. soda ash, and U.S. exports are growing. In 2010, rail exports of soda ash exceeded domestic movements of U.S. soda ash for the first time in history, and we expect this trend to continue. Over the five year period through 2014, Union Pacific expects soda ash exports to grow to 5.7 million tons (over 10 percent of world consumption), destined to consuming nations throughout the world. Union Pacific invested in a new rail yard in Wyoming to handle this growth, and our customers are opening new facilities and adding capacity. We have also been increasing exports of plastics. Between 2005 and 2010, Union Pacific's export plastics volumes have grown by 30 percent.

- Iron ore exports, especially to China, are growing rapidly on Union Pacific. For 30 years or more, Union Pacific did not move any iron ore for export; in fact, we can recall no movements in our history. With growing steel production in China, demand for iron ore increased over the last two years. Australia, Brazil, and India are the world's leading exporters, with huge reserves, but Utah contains magnetite iron ore, which is especially valuable. About a year ago, Union Pacific began handling two export trains per week to the Port of Richmond in northern California. We recently increased service to four trains per week, with a fifth about to begin, by moving additional traffic through the Port of Stockton in California, where we upgraded tracks to provide staging capacity for this traffic. If port capacity were not constrained, we could be moving even more of this traffic.

The outcome of this proceeding will have a major impact on whether America fails or succeeds in international markets. America's road network is already declining and faces severe cutbacks. It cannot hope to keep America competitive by handling export demand. Only railroads can meet that challenge. As the most efficient freight rail system anywhere, America's railroads will be the highway for competition with other nations. The nation's economic future depends on avoiding short-sighted decisions in this proceeding.

VERIFICATION

I, John J. Koraleski, 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 May 23, 2011.

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John J. Koraleski

EXHIBIT A

Marty Huff/UPC

11/19/2009 08:54 AM

To Diane K. Duren/UPC@UP, Lee E. Grimes/UPC@UP

cc Steven W. Anders/UPC@UP, Jim L. Bishop/UPC@UP, John Ahrens III/UPC@UP

Subject Dyno Nobel announces plans to cease production at Battle Mountain, NV (aka Rennox, NV)

The attached was released in Green Markets this morning. Rennox will cease Ammonium Nitrate production but will remain open as a transload facility. Production will end at the end of January 2010. This will eliminate a large volume lane of ammonia moving inbound to Rennox from . We will continue to monitor the inbound ammonium nitrate shipments that will undoubtedly begin next year. This facility is open to BNSF so we will be competing for the inbound nitrate business. More to come.

Dyno Nobel to close two AN plants -- November 19, 2009 —

Dyno Nobel North America, Salt Lake City, plans to close ammonium nitrate production at Battle Mountain, Nev., and Maitland, Ont., early next year. Both sites will continue as transloading operations, and Maitland will continue to produce nitric acid. The company said the development of transloading operations will ensure no disruption to customer supply and service.

Dyno said the Battle Mountain decision was driven by substantially reduced customer demand. The change is effective from the end of January 2010. The transloading operation will employ about a third of the current workforce of 31 people.

Dyno Nobel Vice President, North American Nitrogen Plant Operations Phil Morrow said the decision followed an extensive review of the continued viability of the site. "The review examined the best way to meet customer requirements for quality and service balanced with the economics of supplying a market where demand has reduced substantially."

Dyno said the Maitland decision was driven by the closure of an Invista facility, a major customer, and the general softening in customer demand. The Invista facility, at one point, consumed some 40 percent of the plant's nitric acid production.

The change to the Maitland operation is effective from the end of January 2010. It is expected that the continuing operation will employ about a third of the current workforce of 60 people.

"Manufacturing at the site has been under pressure since Invista ceased operations about six months ago," said Morrow. "In July, we reduced production from three nitric acid plants and two AN plants to one acid and one AN plant resulting in a workforce reduction from 101 people to 60 people."

At both locations, Morrow said the company would call for expressions of interest from employees seeking a voluntary separation. "To transition employees through this difficult time, we will be developing appropriate separation packages including career change and financial counseling."

"Safety is the highest priority," he said. "We recognize that this will be a difficult time for our employees and we must all be even more vigilant regarding safety. It is important that we watch out for each other to maintain a safe workplace."

Marty Huff
Sr. Business Director - Fertilizer
Union Pacific Railroad
(402) 544-5466
martyhuff@up.com

EXHIBIT B

REDACTED

HIGHLY CONFIDENTIAL MATERIAL OMITTED

FRITZ

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

REPLY VERIFIED STATEMENT

OF

LANCE M. FRITZ

REPLY VERIFIED STATEMENT

OF

LANCE M. FRITZ

My name is Lance M. Fritz. I am Executive Vice President - Operations for Union Pacific Railroad Company. I am responsible for Union Pacific's rail operations throughout our 23-state network. On April 12, 2011, I provided a verified statement accompanying Union Pacific's initial comments in this proceeding.

I. INTRODUCTION

Of the several changes that rescued the American railroad industry from excessive government regulation and numerous bankruptcies before the Staggers Act, two stand out. For the first time in decades, railroads were allowed to set prices based on market conditions, rather than being required to offer the same price between any two points regardless of route costs and efficiencies. From my perspective, though, the more important change was that railroads became free to pursue productivity and network efficiency. Prior to Staggers, railroads were forced to transport shipments over virtually every possible route and interchange point – a regulatory requirement that made railroad service costly, unproductive, unresponsive to the market, and unable to compete with motor carriers and other forms of transportation that were using government-funded infrastructure. In short, Congress decided to turn over management of rail networks to rail managers, allowing railroads to become productive in order to survive.

Railroads used their new freedom to achieve amazing gains in productivity. Most of those gains were given to shippers in lower rail rates. In real-dollar terms, rail rates remain far below 1980 levels, and America enjoys the lowest rail transportation costs on the planet. As the Executive Summary of the Final Christensen Report for this Board concludes:

> "In the years following the passage of The Staggers Act, the railroad industry experienced dramatic reductions in costs and increased productivity, which yielded higher returns for carriers and lower inflation-adjusted rates for shippers."

This proceeding exists because some rail shippers are unhappy that rail rates did not remain at bargain-basement, non-viable levels and began to turn upward during the last six or seven years.

Many commenting parties would have the Board destroy the productivity that provides the foundation for all of the benefits of a healthy rail system. They ask the Board to impose more, or even unlimited, interchanges and split traffic across more routes, broadly reducing efficiency, delaying shipments, and increasing transportation costs. Union Pacific cannot provide productive, cost-effective, reliable service to our customers if we cannot plan for, manage, and control car movements on our network using the most efficient routes.

In my initial statement, I explained the enormous capital investments that Union Pacific has made in our rail network to provide efficient services; the steps we have taken to improve safety; the ways we have enhanced service and reliability; and the impressive results that our hard work and investments have provided to customers. Although we do not like every aspect of the current regulatory environment, at least it has enabled Union Pacific and other railroads to act like businesses and make rational decisions about how to curtail costs and unnecessary movements, including inefficient interchanges between railroads. As a result, Union Pacific is producing and sustaining record service and safety results.

I also explained how proposed changes to the Board's competitive access rules would reverse these trends. Expanding "access" by increasing the number of interchanges, whether in terminals or on lines of road, would undermine the decades of planning, investment, and improvements that have allowed Union Pacific to build a highly integrated, efficient network. Forced access and forced interchanges are exactly what the Staggers Act tossed aside. They are fundamentally incompatible with reliable service and with continuing safety gains.

For all the reasons I described in my initial statement, the proposed changes could easily cause service meltdowns in major terminals, as regulators force railroads to exchange freight cars where capacity is insufficient. They would degrade over-the-road freight service as the traffic volumes essential for uninterrupted movement get divided by government action. Interchanges mean higher costs, more delays, reduced equipment utilization, inefficient use of employees and locomotives, and greater risks of delays and injuries. The interests of individual shippers would be placed, by government, ahead of the interests of all other customers collectively. The proposals would also sacrifice capital investment efficiency, requiring more investment to accomplish what we can accomplish today at lower cost. Ultimately our investors will take their money elsewhere, and capital investment will shrink.

The Board needs to face squarely one obvious (to an operating man) and unavoidable fact: it cannot grant the wishes of the complaining shippers for more access without simultaneously reducing productivity, service, reliability, and safety on the nation's rail system. The Board therefore must choose: do we go back to pre-Staggers Act governmental interference in rail operations, which was a documented public-policy disaster, or move forward toward an ever-improving national rail network? Neither the complaining shippers nor the Board can have it both ways. Even the best-intended government interference in complex networks involving millions of shipments with specialized needs would likely fail, and the already crumbling national transportation infrastructure would lose its one bright star.

In this statement, I will note that not one submission in the voluminous complaining comments reflects any awareness whatsoever of the profound conflict between today's productive rail networks and proposed regulatory disruption of those networks. At best, one or two comments urge the Board not to worry about it. I will give extra attention to the expressed desire of some parties to route more traffic via New Orleans, because that gateway – the most congested on the entire Union Pacific network – provides a startling example of how the complaining shippers' wishes can produce real-world service failures. I will also discuss the unique impact of the access proposals on the railroads' ability to comply with safety, security, and environmental regulations concerning hazardous chemicals.

II. COMMENTS ON THE IMPACTS OF PROPOSED REGULATION CHANGES ON RAIL OPERATIONS ARE UNINFORMED

I find no evidence in the comments that anyone outside the rail industry has given adequate consideration to the major impacts that proposed changes in regulation would have on the nation's rail network and service. In my initial statement, I explained that the changes to the Board's access rules being proposed by many parties would undermine decades of planning and capital investment that have allowed us to develop an integrated network that moves millions of carloads of traffic each year safely, reliably, and productively under unified control. As I explained, one of the primary drivers of improved railroad safety, service, and productivity was eliminating the system of "open routing" that regulators had forced on the rail industry. The Staggers Act allowed railroads to consolidate traffic on fewer routes and discontinue inefficient interchanges, which allowed us to use our train crews and locomotive and track assets more productively and reduce delays and decrease injuries and damage to freight associated with switching. Our customers benefited from improved service as well as productivity gains, which we generally passed along in the form of lower rates. Yet today, many commenters ask the Board to go right back to the policies that undermined rail service and economics for decades. If those commenters could see into the future what they advocate, they would shudder at the deteriorating service and the exploding costs that they and other shippers would experience.

I explained, with examples, how opening little-used interchanges and rerouting traffic would wreck efficient through-train operations, squander investments that Union Pacific has made in today's routes, and impose new capital and operating costs that would reduce our ability to make the investments that would truly benefit the rail network and our customers. I focused in particular on how increasing interchanges within terminals, which a number of people seem to think is not worth worrying about, would cause congestion and operations conflicts that could melt down some of the nation's largest terminals, such as Houston. Interchanges within terminals are costly and slow. They require capacity that does not exist.

The Board should ignore "don't worry about it" comments from those who have not thought about the impact of all the new interchange movements, delays, and costs that their proposals would create. At Union Pacific, we learned that lesson in 1997-1998. One factor that caused Houston and the entire Union Pacific network to experience a service crisis was that both shippers and Union Pacific decided to shift large volumes of traffic from SP routes to Union Pacific routes before we could make the two systems operate as one (with crew agreements, information technologies support, and directional operations).

A. Interline Routing Protocols

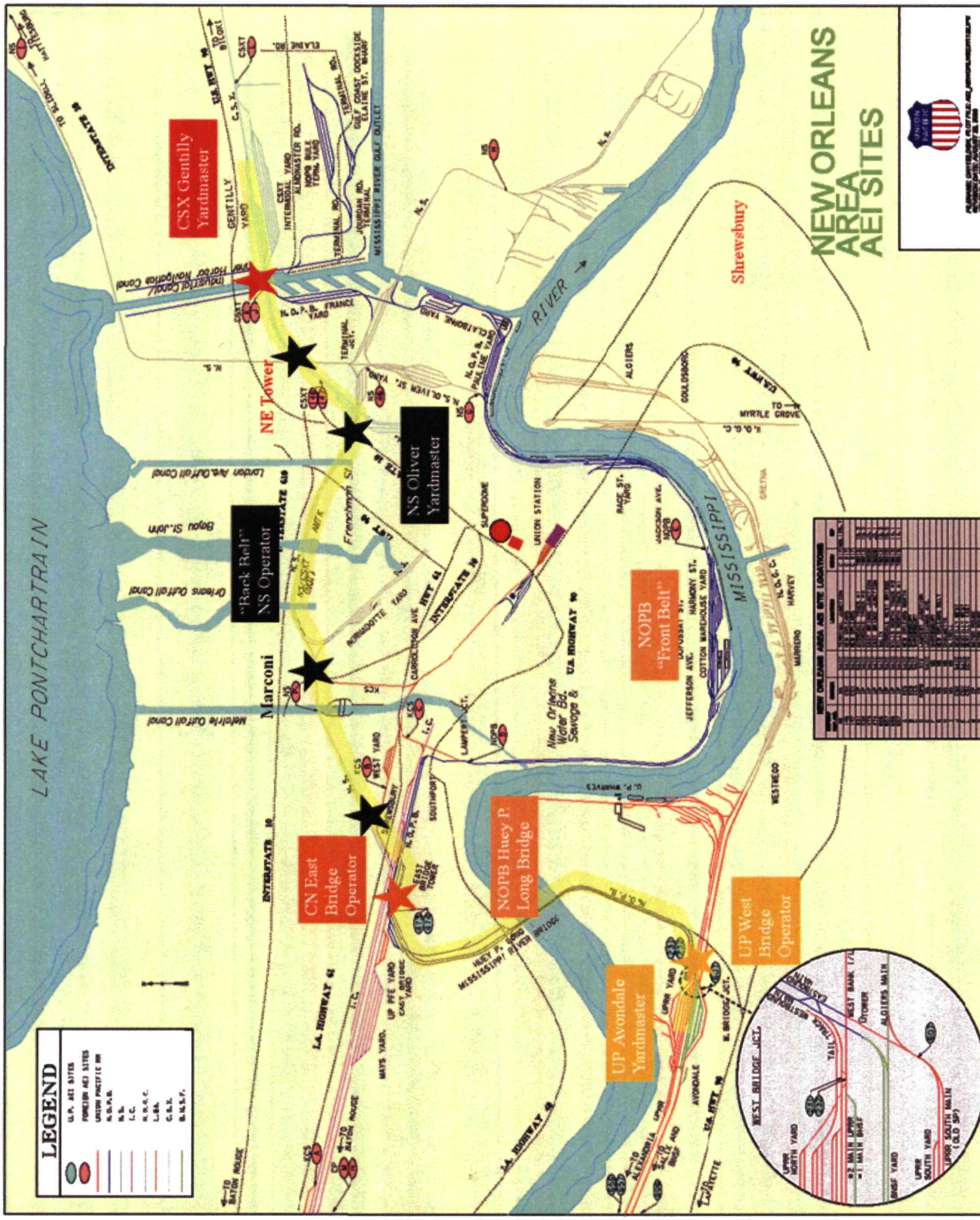
A few shippers highlight their disregard of railroad operations and efficiencies by attacking our use of interline routing protocols. They say that railroads use routing protocols to "extend" bottlenecks or employ inefficient routes for self-serving purposes. These complaints are inaccurate. As I previously explained, railroads use interline routing protocols to concentrate traffic on selected routes to improve efficiency, taking into account capacity, track conditions, geography, congestion, service capabilities, and other factors. The concept of "extending" bottlenecks makes no sense, because neither railroad will allow the other to obtain an unreasonable economic advantage by extending its routes – and thereby expanding its revenues – at the other railroad's overall expense. The suggestion that eastern and western railroads use routing protocols to increase fuel-surcharge revenues is also mistaken, because the East-West protocols preceded development of fuel surcharges by various railroads. Union Pacific-Norfolk Southern and Union Pacific-CSX routing protocols were developed at the time of the Conrail breakup in the late 1990s, when we had to decide how to adjust our operations to the new eastern rail systems.

Imposing customer selection of interchange points would do severe damage to rail service. For example, Occidental Chemical and The Fertilizer Institute argue that more shipments should be routed via New Orleans, instead of gateways further north. New Orleans should be the poster child for why shipper routing selections could wreck the rail network. New Orleans cannot handle more trains, and many New Orleans interests are fighting to curtail current use of this gateway. If a number of shippers were able to reroute their traffic via New Orleans, rail service on the southern tier of the American rail system would break down in a matter of days.

New Orleans has been a major congestion point for decades, and it is the single worst congestion point affecting the Union Pacific system today. Because of extreme delays and capacity constraints, trains routinely sit for hours, and sometimes a day or more, before reaching a connecting carrier in New Orleans. For example, during April 2011, the highest priority eastbound train from Union Pacific to CSX, the ZLCAT from Los Angeles to Atlanta, averaged

14.2 hours – more than a crew shift – <u>within</u> New Orleans after leaving Union Pacific control. And that is our fastest train on the route.

The following map illustrates the rail complexity in New Orleans, highlighting the primary "Back Belt" route in yellow.

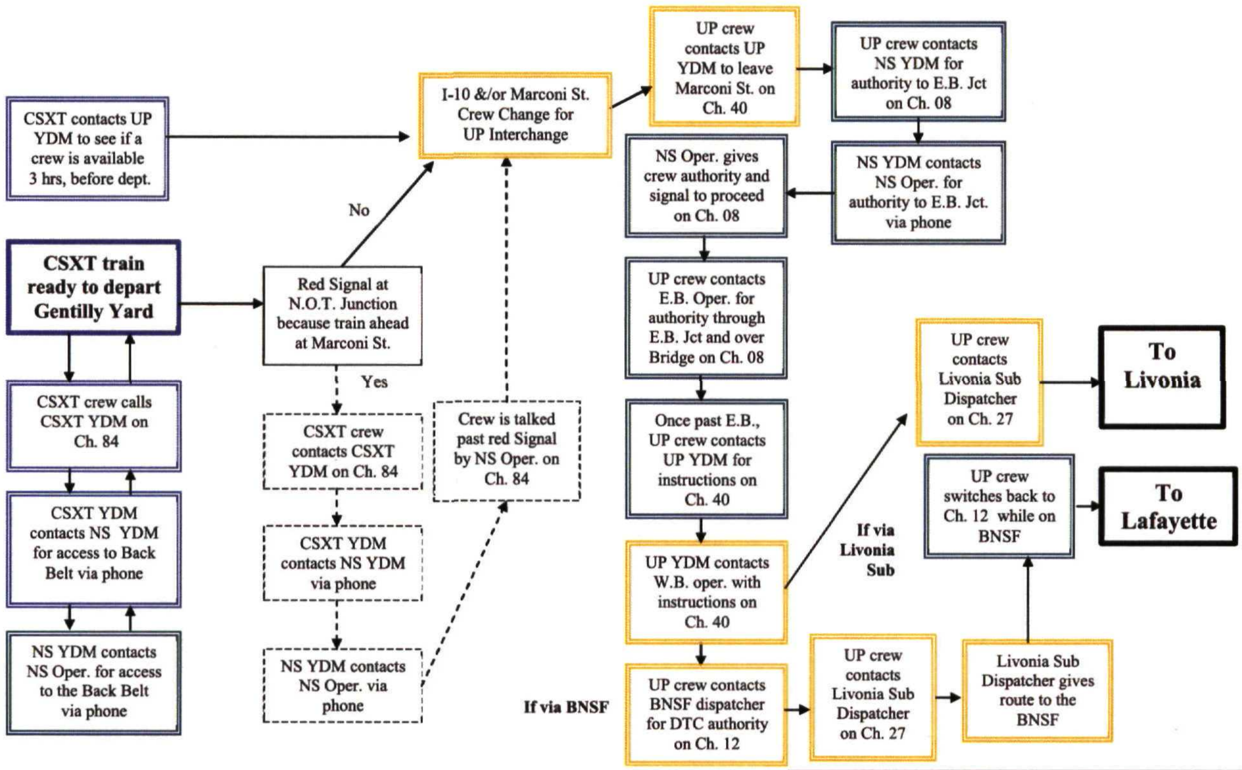

NEW ORLEANS
AREA
AEI SITES
LAKE PONTCHARTRAIN
LEGEND
CSX Gentilly
Yardmaster
NE Tower
NS Oliver
Yardmaster
"Back Belt"
NS Operator
Marconi
CN East
Bridge
Operator
NOPB Huey P
Long Bridge
UP West
Bridge
Operator
UP Avondale
Yardmaster
NOPB
"Front Belt"
Shrewsbury
MISSISSIPPI
RIVER

Starting from the west, the massive Huey P. Long Bridge over the Mississippi River provides the only route connecting Union Pacific and BNSF on the west side of the river with NS, CSX, KCS, and CN on the east. The bridge is owned by a city-owned entity called the New Orleans Public Belt (NOPB), which often finds itself caught between the demands of five competing carriers for use of the bridge and related trackage. In addition, the independent NOPB has its own ideas about how to run the bridge. For example, NOPB recently proposed shutting down one of the two tracks over the bridge for a few hours in the evening to operate a dinner train to the top of the bridge for passengers to enjoy the view – a proposal that would force freight railroads to divert traffic to other gateways.

The double-track bridge feeds into a railroad called "the Back Belt," the primary interline route through New Orleans, a portion of which is single track. Trains exiting the bridge must immediately cross busy CN and KCS tracks serving New Orleans. Once beyond that hurdle, trains must get clearance to use the Back Belt. Moreover, NS and CSX sometimes cannot accept Union Pacific trains, causing added delay. The alternative route on NOPB, the Front Belt, is hopelessly circuitous and delay-prone, and traverses the most popular tourist attractions in New Orleans, next to the French Quarter.

Moving a train across New Orleans also confronts many barriers. As the following chart shows, to move a train from CSX to Union Pacific via the Back Belt requires calling ten or eleven contacts to obtain movement authority and involves 13 to 16 communications steps, every one of which can be a source of delay.

CSXT to UP Interchange *via Back Belt* – Communication Process



Note: There are 8:00am, 15:00 and 22:00 conference calls between UP, CSXT, NS and BNSF to discuss daily interchange plans. NS Operator is in Birmingham, AL *(E.B. = East Bridge Jct., W.B. = West Bridge Jct.)*

		(via Livonia)	(via Lafayette)
Number of people involved	-	10	11
Number of communication steps	-	13	16

Meanwhile, public officials (including some in Washington) and several citizen groups oppose any additional train operations on the Back Belt. At the same time, there is strong opposition, including from more than a dozen shippers and the New Orleans Board of Trade, to any use of the Front Belt for through-train movements. Even without changing the competition rules, the Board and the nation already face a major challenge in maintaining, much less expanding, this gateway of national significance for rail traffic. The Board should consider New Orleans a warning flag for this proceeding, although it is only one example.

In contrast, in recent years the Class 1 railroads have developed interchanges for interline through trains in locations like Memphis or Salem, Illinois, which involve little delay and save hours or even days of transit time. Union Pacific and its connecting carriers created the rural Illinois gateways at great cost over many years and designed their service plans to avoid more congested terminals. Union Pacific and other railroads need to retain the right to determine interchange points to maintain fluid operations that benefit all shippers.

B. Expanded Terminal Access Would Reduce Productivity and Service

A number of commenting parties appear to believe that increasing inter-carrier switching, especially in rail terminals, is innocent or minimally intrusive. This is a mistake that can cause severe damage to the national rail network. Mr. Manion of Norfolk Southern and I have already explained that interchanges are inherently inefficient. They delay rail cars and require railroads to use more capacity in terms of rail cars, locomotives, crews, and track to move a given volume of traffic. They require additional work, and all of this increases cost. As the New Orleans example shows, forced interchanges may add switching demands where there is no rail capacity, crippling service. If shippers can decide whether, where and when a railroad must hand-off cars to another, the national rail network will become unmanageable.

Reciprocal switching has less visible impacts as well. Union Pacific works closely with its customers to ensure that car flows are compatible with our capacity and with theirs. For example, it does no one any good to jam 30 shipments into a busy terminal when the customer can unload only four cars per day. We must control car flows to keep the customer supplied, without delaying its goods or congesting our facilities. When reciprocal switching is imposed, the railroad serving the customer no longer participates in the line haul and loses both visibility of shipments and the ability to control how many cars are coming via the connecting carrier. The serving carrier is forced to become the "buffer," whether or not it has any buffering capacity. We cannot see the shipments coming, and have no ability to plan for them. This is an especially serious problem if empty cars pile up for shippers, and the shippers – contrary to OT-5 and Board decisions – don't have space to store them. This has been a major problem for Union Pacific in the past.

Union Pacific also avoids overloading its freight yards by using our Unified Plan to manage traffic flows across the system and through yards en route. We make sure that the demands we place on each yard are within its capabilities and allow it to keep shipments moving on schedule. Increased reciprocal switching disrupts system planning and can create traffic surges that affect yard performance. When the ICC and the Board (and many shippers) endorsed the benefits of single-system service many years ago, they were correct. Going backward on reciprocal switching and other forms of routing will reduce rail reliability and our ability to serve our customers

C. "Access" and Toxic Inhalant Hazards

Comments favoring shipper discretion in routing and switching do not address how their discretion could be reconciled with extensive and detailed safety regulation of Toxic Inhalant Hazards (TIH). Proposals to allow shippers to designate routes and interchanges conflict with regulations governing transportation of certain hazardous commodities. Regulatory agencies responsible for safety and security (PHMSA, FRA, and TSA) have promulgated rules for "Rail Security-Sensitive Materials" (RSSM), which include TIH, such as anhydrous ammonia and chlorine. Regulations require railroads to route RSSM on only "the safest and most secure practicable" route, as determined by a 27-factor regression analysis. 49 C.F.R. § 172.820. Additionally, Congress directed railroads to install Positive Train Control Systems on track segments that carry more than a *de minimis* amount of TIH.

TSA also imposes requirements on how rail carriers interchange RSSM. In most instances. each freight railroad carrier must "ensure that the rail car is not left unattended at any time during the physical transfer of custody." 49 C.F.R. § 1580.107. The receiving freight railroad carrier must inspect the rail car, and both the transferring and the receiving railroads must document the transfer of custody, identifying the individuals who attend the transfer in person. *Id.* Furthermore, PHMSA regulations impose security requirements on shipments that are stored or delayed enroute.

Any changes in competitive access rules to allow shippers to select interchange points for RSSM shipments would make it impossible for rail carriers to comply without much higher costs and inefficient use of capacity. Measures that require railroads to change operations at interchanges not currently designated for RSSM, and particularly for TIH shipments in order to comply with PHMSA routing schedules, Positive Train Control mandates, TSA human hand-off rules, and FRA hours of service regulations would be extremely inefficient and costly, if they would be legal at all. They would dash detailed plans we have developed with other carriers to ensure positive hand-offs. A shipper could also casually force railroads to spend tens or hundreds of millions of dollars on Positive Train Control on new routes of its choosing, when better routes already have PTC.

From an operational standpoint, there are hundreds of interchange points where the transferring carrier delivers non-RSSM cars before the receiving railroad is ready to move the train, resulting in interchange delay. At these numerous interchanges, the transferring carrier "delivers blind" (leaving the train before the receiving railroad's train crew is present). If RSSM shipments could be and were rerouted to those interchanges by shipper fiat, all affected interchanges would become more expensive and difficult.

III. CONCLUSION

From an Operating Department perspective, we consider ourselves in intense competition for every customer's business every day, competing against trucks, other railroads, barges, changes in logistics, evolving business models, and other shipper choices. That is why the first and second imperatives of the Union Pacific Operating Department are Safety and Service. What we fear is uninformed decisions on how traffic moves that damage both rail operations and economics and that will impair network productivity, rail service, and investment in infrastructure. Expanding inefficient rail interchanges in the name of competition cannot be viewed as in the national interest at a time when transportation infrastructure is in crisis. We need to support rail service and investment, not revert to the mistakes of the past.

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 Reply Verified Statement.

Executed on May 23, 2011.

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Lance M. Fritz