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Mayer Brown LLP
1999 K Street, N.W.
Washington, D.C. 20006-1101

Main Tel (202) 263-3000
Main Fax (202) 263-3300
www.mayerbrown.com

Adrian L. Steel, Jr.
Direct Tel (202) 263-3237
Direct Fax (202) 263-5237
asteel@mayerbrown.com

January 9, 2014

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BY HAND-DELIVERY

The Honorable Cynthia T. Brown
Chief, Section of Administration
Surface Transportation Board
395 E Street, SW, Room #100
Washington, DC 20423-0001

Re: Finance Docket No. 32760, *Union Pacific Corporation, Union Pacific Railroad Company and Missouri Pacific Railroad Company -- Control and Merger -- Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corp. And the Denver and Rio Grande Western Railroad Company*

Dear Ms. Brown:

Enclosed for filing in the above-captioned proceeding are the original and ten (10) copies of the Petition of BNSF Railway Company and G3 Enterprises for Reconsideration of Decision No. 106.

I would appreciate it if you would date-stamp the enclosed extra copy and return it to the messenger for our files.

Please contact me if you have any questions. Thank you.

Sincerely yours,

Adrian L. Steel, Jr.

Adrian L. Steel, Jr.

Enclosures

FEE RECEIVED
January 9, 2014
Surface Transportation Board

FILED
January 9, 2014
Surface Transportation Board

BNSF-120
G3E-2

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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

**PETITION OF BNSF RAILWAY COMPANY AND G3 ENTERPRISES
FOR RECONSIDERATION OF DECISION NO. 106**

BNSF Railway Company ("BNSF") and G3 Enterprises ("G3") hereby petition for reconsideration of Decision No. 106 in the above-referenced proceeding. The decision was served December 20, 2013.

Decision No. 106 denied a request from BNSF and G3 that the Board order access to the G3 facility in Modesto, CA (UP station of Rogers), by reinstating reciprocal switching via the shortline railroad Modesto and Empire Traction Company ("MET"), which had such access when the facility was owned by Procter & Gamble ("P&G"), and which lost access when Union Pacific Railroad Company ("UP") altered a reciprocal switching tariff and failed to honor the voluntary agreement it made with MET to keep such facility open. As BNSF and G3 show below, the Board committed "material error" because its conclusion in Decision No. 106 is inconsistent with the fundamental competition-preserving principles that the Board and ICC consistently have adhered to in evaluating and conditioning rail mergers: that is, the principle mandating that facilities receiving multi-carrier service before a merger must continue to receive at least two-carrier service after the merger. That principle underlies the Board's and ICC's handling of 2-to-1 situations in merger proceedings and should be applied regardless of how many carriers served a facility pre-merger. After all, if 2-to-1 situations are not to be permitted, neither should the Board allow a merging carrier to implement a 3-to-1 situation post-merger. But that is exactly what is at issue in this proceeding.

Moreover, the transformation of the G3 facility into a location that is exclusively served by UP is contrary to UP's representations at the time of the merger that 3-to-2 facilities would enjoy enhanced competitive service as a result of the merger of UP and Southern Pacific Transportation Company ("SP"). For this reason, as well, Decision No. 106 suffers from material error.

ARGUMENT

"Under 49 U.S.C. § 722(c) and 49 C.F.R. § 1115.3(b), the Board will grant a petition for reconsideration only upon a showing that the prior action: (1) will be affected materially because of new evidence or changed circumstances; or (2) involves material error." *Allegheny Valley R.R.—Pet. for Declaratory Order*, FD 35239, slip op. at 3 (STB served July 16, 2013). This petition is premised upon material error.

BNSF and G3 predicated their request for relief in this matter upon several arguments. The principal one—and the one at issue in this petition for reconsideration—is that UP's closure of the facility "violates UP's representations in its pleadings that competition by two carriers would be preserved at all locations and would be strengthened at all 3-to-2 locations, and *more importantly* violates the Board's purpose and intent behind the conditions that it imposed on the UP/SP merger that two carrier competition be preserved." Letter from Adrian L. Steel, Jr.

(counsel to BNSF) to the Hon. Cynthia T. Brown, Chief, Section of Admin., STB, at 1 (Jan. 25, 2013) (hereinafter, "Jan. 25, 2013 Letter") (emphasis added).

This argument was made at pages 6-7 of the Amended Joint Petition of BNSF Railway Company and G3 Enterprises for Enforcement of Decision No. 44 (BNSF-117A/G3E-1A), was discussed by counsel for BNSF at the oral argument held on January 15, 2013, and was summarized in the letter from BNSF's counsel to Ms. Brown cited above. Yet, BNSF and G3 respectfully submit, the Board in Decision No. 106 did not fully consider this argument.

The Board's failure to do so was material error. As noted, BNSF highlighted the argument during the oral argument. Thus, Richard E. Weicher, representing BNSF, began his portion of the oral argument by stating, "We believe that, in the Union Pacific Southern Pacific merger, Union Pacific committed to the public and the Board, and the Board ordered, the preservation of two carrier rail competition at all locations, where otherwise a shipper facility would lose all of its pre-merger competitive options, other than the merged Union Pacific Southern Pacific Railroad. . . . Inherent in this commitment, we believe, is a commitment that UP could not take action after the merger to eliminate access by the non-Union Pacific carrier." Hr'g Tr. at 6-7 (hereinafter "Tr."). (Excerpts of the Oral Argument Hearing Transcript are attached as Ex. A).

Mr. Steel, in his portion of BNSF's argument, also stated the point, noting that "UP made a number of representations [during and after the merger proceeding] to the effect that the existing competition will be preserved, in fact, enhanced in a number of situations." *Id.* at 22. Mr. Steel emphasized that the pledge to preserve competition applied to 3-to-2 situations, noting that "if going from two to one is bad, going from three to one . . . causes the same loss of access, which we think is really the key here." *Id.* at 23.

Mr. Steel pointed out that the Board's concern in its UP/SP merger decision was to prevent shipper facilities that had pre-merger competition from becoming exclusively-served facilities. *Id.; see also id.* at 63 (noting that BNSF is not seeking a new condition on the merger because UP "can't be surprised that [the STB] would say to them, you can't take a pre-merger competitive location and turn it into a non-competitive location").[1] In addition, Mr. Steel noted that UP's Richard Peterson had stated that all three-to-two points would have stronger competition post-merger. *Id.* at 27. But that can only be the case if those facilities continue to receive at least two-carrier service. *Id.*

The failure of the Board to fully consider this argument in Decision No. 106 is clearly erroneous. It also is material, because the argument compels a different conclusion than the one reached in Decision No. 106. This is so because UP's action in closing the G3 facility is patently inconsistent both with the premises of the Board's approval of the UP/SP merger and with UP's own representations during the merger proceeding about strengthened competition at 3-to-2 points—representations upon which the public and the Board relied. Based on those representations, shippers such as P&G and shortlines such as MET had no reason to seek a merger condition affirming UP's intent to keep a facility open to two- carrier service post-merger. Both those merger representations and the specific representation made by UP to MET

[1] UP has argued that the relief requested by BNSF and G3 would require, or amount to, the imposition of a new condition to the UP/SP merger. *See, e.g.*, Letter from Michael L. Rosenthal to the Hon. Cynthia T. Brown, Chief, Section of Admin., STB, at 1 (October 11, 2012). That argument is incorrect. The relief sought by BNSF and G3 would merely require that the Board hold UP to the representations that it made during the UP/SP merger proceeding (*see* note 2, *infra*), and enforce a basic assumption of the merger proceeding—that no facility that received multi-carrier service before the merger would lose all competitive rail service post-merger.

and its shippers, which the Board has chosen to narrowly interpret, should be entitled to as much weight as a condition that MET or its shippers could have sought in the merger proceeding.[2]

I. THE CLOSING OF THE G3 FACILITY TO RECIPROCAL SWITCHING IS INCONSISTENT WITH DECISION NO. 44 AND PRIOR BOARD AND ICC PRECEDENT

As Mr. Steel stated in his January 25, 2013 letter to Ms. Brown, "the issue for Board resolution is essentially a black and white one – if a Shipper Facility (as defined in the Restated and Amended Settlement Agreement) had competitive service pre-merger, UP cannot take action post-merger to eliminate all service to the facility other than service by UP. That is a bedrock principle of Decision No. 44." Jan. 25, 2013 Letter at 1-2.

By overlooking the applicability of this "bedrock principle" to the issue raised by BNSF and G3 in the Amended Joint Petition, the Board has materially erred. UP's elimination of competition for facilities that previously received three-carrier service is contrary to the Board's policy of "preserving two-railroad competition" at 3-to-2 points. Decision No. 44, 1 S.T.B 233, 387 (1996). In both Decision No. 44 and the ICC's previous merger decisions, conditions to protect 3-to-2 shippers have generally not been imposed because the preservation of at least two-carrier service to those shippers has been presumed. *See id.* If that presumption can be

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[2] As BNSF and UP noted in their Amended Joint Petition (at page 6), UP is bound by the representations that it made during the UP/SP merger proceeding. In Decision No. 44, the Board stated that:

> During the course of this proceeding, applicants have made numerous representations to the effect that certain points will be covered, certain services will be provided, and so on. Some of these representations relate to the terms of the BNSF agreement; others do not. Applicants must adhere to all of their representations.

Decision No. 44, 1 S.T.B. at 246 n.14.

overturned by unilateral revisions of reciprocal switching arrangements by merging carriers, a long line of Board and ICC decisions will be undermined or will need to be reconsidered.

In light of UP's repeated representations that competition at 3-to-2 points would be stronger after the UP/SP merger than it was before (*see* Section II, below) and the Board's assumption in merger proceedings that two-carrier service would continue at 3-to-2 points post merger, BNSF, shippers and the Board would have expected that two-carrier service would continue at all 3-to-2 points. UP's conduct with regard to the G3 facility reflects a renunciation of its representations and the defeat of the reasonable expectations of shippers and the Board, alike.

II. THE CLOSING OF THE G3 FACILITY TO RECIPROCAL SWITCHING IS INCONSISTENT WITH UP'S REPRESENTATIONS THROUGHOUT THE MERGER PROCEEDING THAT COMPETITION WOULD BE STRENGTHENED AT 3-TO-2 POINTS

That two-carrier service would continue and not be diminished for all facilities that had multi-carrier service before the merger was stated explicitly by UP's Richard K. Davidson and was an implicit premise of UP's discussions of 3-to-2 points in the UP/SP proceeding. Thus, Mr. Davidson, who was then President and Chief Operating Officer of Union Pacific Corporation and Chairman of the Board of Union Pacific Railroad Company and the Missouri Pacific Railroad Company, stated, "When we concluded last August that the only course for UP was a merger with SP that would create a world-class railroad to compete against BN/Santa Fe, we made the commitment from day one that *we would not allow a single shipper to lose a choice between two railroads*." Verified Statement of Richard K. Davidson (in UP/SP-22; excerpts attached as Ex. B) ("Davidson V.S.") at 172-73 (emphasis added).

To the same effect, in its Rebuttal (UP/SP-230; excerpts attached as Ex. C), UP argued that it was not necessary to replace the loss of SP service that would be experienced by facilities at 3-to-2 points because the rail merger regulatory policy had consistently focused on "ensuring that at least two strong railroads [would] continue to serve every important market." UP/SP-230 Rebuttal at 178.

Similarly, the premise that 3-to-2 facilities would continue to receive at least two-carrier service was at the core of the arguments made by UP's witness Richard B. Peterson, then Senior Director – Interline Marketing, who was UP's principal witness on competition issues. In his Verified Statement ("Peterson V.S.") (UP/SP-23; excerpts attached as Ex. D), Mr. Peterson stated that "[t]he UP/SP merger will intensify competition for all shippers," and he specifically noted that 3-to-2 shippers will enjoy "stronger, not weaker competition" as a result of the UP/SP merger. Peterson V.S. at 170, 171 (emphasis in original); *see also id.* at 187 ("Intermodal shippers are very clear that competition between a combined UP/SP and BN/Santa Fe will be stronger than competition among BN/Santa Fe, UP and SP.") (footnote omitted; emphasis in original). Because "stronger" competition implies the existence of competitive options, these representations are inconsistent with the elimination of competition at 3-to-2 facilities by closing such facilities to reciprocal switching.

Moreover, the analytic approach to identifying 3-to-2 industries that Mr. Peterson set forth in his Verified Statement assumed that facilities that were open to reciprocal switching would remain open after the merger. As Mr. Peterson explained, in identifying 3-to-2 industries he considered whether the industries were outside reciprocal switching limits or were not open to all three carriers in an area that received three-carrier service. Peterson V.S. at 189-90. After identifying those points where industries were open to three-carrier service in part by reciprocal switching (as well as those comparatively few points where shippers were directly served by three carriers (*see id.* at 190)), Mr. Peterson discussed how the industries at such points would receive *enhanced* competition as a result of the merger. *Id.* at 191-231. Mr. Peterson's discussion of facilities at 3-to-2 points and the analytic approach underlying it are incompatible with the notion that UP would eliminate competitive options for rail facilities that were open to three carriers by closing them to reciprocal switching.[3]

Modesto was one of the 3-to-2 points discussed by Mr. Peterson. *Id.* at 211-12. Mr. Peterson noted that most of the industries at Modesto were served by MET (*id.* at 211) and that Modesto was "one of the very few locations where more than half of the rail carload traffic is competitive among UP, SP and another major Western railroad" (*id.* at 212). Indeed, the statistics on competitive traffic in Modesto that were included in the public version of Mr. Peterson's Verified Statement indicate that over *70%* of the Modesto traffic was determined by Mr. Peterson to be "competitive" (*id.* at 211) and thus within his narrow definition of 3-to-2 traffic. Nothing in Mr. Peterson's discussion of Modesto or other 3-to-2 points in his Verified Statement gave the slightest inkling that UP might unilaterally eliminate rail competition post-merger by closing facilities at those points to reciprocal switching.[4]

To like effect, in his Rebuttal Verified Statement ("Peterson R.V.S.") (UP/SP-231; excerpts attached as Ex. E), Mr. Peterson stated, "I explained in my initial testimony that this '3-to-2' traffic will also benefit competitively from the UP/SP merger. The new competitive

[3] If UP assumed that it could simply close points served by three carriers, two of which had access via reciprocal switching, there would have been no point in Mr. Peterson initially identifying 3-to-2 points by identifying facilities that were open to reciprocal switching.

[4] But that is precisely what has happened at Modesto. UP's Oral Argument Exhibits for the January 15, 2013 Oral Argument indicate that seven industries at Modesto were open to reciprocal switching in 1995. *See* Slide 3 of UP's Oral Argument Exs. (information drawn from 1995 tariff publication); *see also* Union Pacific's Reply to the Amended Joint Petition of BNSF Railway and G3 Enterprises for Enforcement of Decision No. 44 (UP/SP-409) at 4-5. Now, according to UP's own submissions, only three industries are open. *See* Slide 6 of UP's Oral Argument Exs.; *see also* UP/SP-409, Reply Verified Statement of Chris Sanford at 4-5. UP's gradual closing of industries is precisely the kind of harm that we discuss below at page 11.

environment that the merger will bring about for such traffic will be far more intense than the competitive environment that exists today." Peterson R.V.S. at 24.[5] The elimination of competitive options at 3-to-2 facilities by closing such facilities to reciprocal switching contradicts such representations.

UP also had two outside consultants, Richard J. Barber and Robert D. Willig, discuss competition issues. Mr. Barber repeatedly emphasized the stronger competition that would result from head-to-competition between a combined UP/SP and BNSF, which, of course, assumed that BNSF would continue to have access to 3-to-2 shippers.

Thus, Mr. Barber stated:

- "With *two* strong railroads pitted against one another at locations (and in lanes) where there are, as of now, three carriers (a market-leading BN/Santa Fe, a route constrained UP, and a weak SP), there can be no legitimate fear that UP/SP, post-consolidation, would have the power to raise prices to supracompetitive levels." *See, e.g.*, Verified Statement of Richard J. Barber (UP/SP-23; excerpts attached as Ex. F) at 476 (emphasis added).

- "Combining in carefully executed complementary fashion the undeveloped route potential of SP with the financial strength and proven service of UP will bring about the *two-carrier* balance of strength and market reach that Riss [Intermodal] and others see as prerequisites to vigorous rail competition." *Id.* at 475-76 (emphasis added).

- "Another fear—pricing through tacit collusion—is also baseless in a *two-railroad* context." *Id.* at 477 (emphasis added).

- "What is to be expected is that with UP/SP *and BN/Santa Fe both positioned to contest*, from their postures of considerable strength, competition will be increased to a degree far greater than now exists at 3-to-2 locations." *Id.* at 478 (emphasis added).

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[5] In addition, Mr. Peterson trumpeted the reduction of SP's switching charges to $150/car as a reason that many 3-to-2 shippers supported the UP/SP merger. Peterson R.V.S. at 25. In Decision No. 44, the Board expressly relied on this reduction in its discussion of unquantified merger benefits. *See* 1 S.T.B. at 381 n.116. This switching charge reduction would do little good were UP to retain the power to unilaterally eliminate the availability of reciprocal switching altogether.

Similarly, in his Verified Statement, Professor Willig discussed the economic implications of the merger for 3-to-2 points, and he also assumed the continuation of two-carrier competition:

- "[W]hether there are two or three or more rail carriers vying for a shipper's business is irrelevant to the degree of interrail competition – it is intense due to the character of rivalry, regardless of the numbers, as long as the market is *not a case of pure monopoly*." Verified Statement of Robert D. Willig (UP/SP-23; excerpts attached as Ex. G) at 562 (emphasis added).

- "[E]mpirical evidence . . . demonstrates that railroads do compete vigorously when *two railroads* serve a market." *Id.* at 641 (emphasis added).

UP's representations that the merger would strengthen competition for industries at 3-to-2 points undercut any argument that UP may now eliminate competitive service at such points by closing industries to reciprocal switching. These representations also make irrelevant the fact that UP or SP could have closed facilities to competitive service *pre-merger* by eliminating reciprocal switching to them. There is no question that UP or SP could have done so, thereby transforming such facilities into exclusively-served facilities before the UP/SP merger. But UP or SP did not do so. Thus, at the time of the merger those facilities were served by three carriers, and UP represented repeatedly in its merger filings that such facilities would benefit from the merger through stronger competition. By knowingly making these representations, upon which 3-to-2 shippers and the Board relied, and then proceeding to consummate the merger after the Board expressly stated that UP would be bound by *all* of its representations in the merger proceeding (*see* note 2, *supra*), UP tied its hands post-merger.

UP may argue that its representations regarding the strengthening of competition at 3-to-2 points applied only to *shippers* (not *facilities*) that were open to three-carrier service pre-merger. This argument would be incompatible with the Rail Transportation Policy (*e.g.*, 49 U.S.C. § 10101(1), (4), and (5)) because it would permit a long-term *erosion* of competitive rail service.

The effects of railroad mergers are long-term: Such mergers are expected to affect the competitive landscape for years to come. Thus, the Board, in assessing merger applications, evaluates the competitive effects of the merger on *markets* rather than on individual shippers, because shippers may come and go, but markets are expected to endure. *See* Decision No. 44, 1 S.T.B. at 364 ("We examine several criteria in assessing whether *markets* served by the merging parties will suffer competitive harm.") (emphasis added).

If merging railroads could eliminate competitive options every time an incumbent shipper moves and a new shipper replaces the previous one at a facility, then, over time, increasing numbers of markets and facilities would lose competitive rail options, resulting in anti-competitive Balkanization of the competitive rail environment. As noted above (note 4, *supra*), that is exactly what has been happening at Modesto, where UP's revisions of its reciprocal switching tariff since the UP/SP merger have resulted in fewer and fewer industries receiving competitive rail service. Such a result is clearly contrary to the Board's policies in assessing rail mergers.

That also is why the BNSF Settlement Agreement with UP (as restated and amended and as adopted by the Board as a condition of the merger), which has a 99-year term, focuses on the protection of competition for shipper *facilities* not just individual shippers. *See* Restated and Amended Settlement Agreement at 2 (setting forth definition of "Shipper Facilities" as first defined term in the Agreement); *see also id.* at 2-3 ("'2-to-1' Points" defined as locations "at which at least one '2-to-1' Shipper Facility is located"); *id.* at 3 (defining "'2-to-1' Shipper Facilities" and "New Shipper Facilities"; *e.g.*, *id.* at 5-7 (repeatedly referring to "facilities" in defining access rights of BNSF).

More importantly, it would be arbitrary and capricious for the Board to protect 2-to-1 shippers from the loss of all competitive rail options post-merger while failing to prevent the loss of all competitive rail service for facilities that happened to receive service from *more* than two carriers before a merger. In short, *all* facilities that received competitive rail service before a merger should continue to enjoy at least two-carrier service afterwards, and UP should be prohibited from taking any action post-merger to reduce any shipper facility to one-carrier service.

CONCLUSION

In rail merger proceedings, the Board (and ICC before it) have consistently protected multi-carrier facilities from becoming exclusively-served. Yet, that is what has happened with regard to the G3 facility as a result of the UP/SP merger and what is likely to happen to other facilities if Decision No. 106 is not reconsidered. Moreover, UP represented at the time of the merger, and the Board assumed, that two-carrier service would continue for all 3-to-2 shippers. If, during the merger proceedings, UP had indicated that competitive rail service at 3-to-2 points would be eliminated, the Board would have been compelled to impose conditions to prevent the creation of numerous exclusively-served shippers at pre-merger 3-to-2 locations. UP's unilateral elimination of reciprocal switching for the G3 facility conflicts with UP's representations and the Board's entirely reasonable assumption.

Thus, Decision No. 106 was based on material error and should be reconsidered, and the Board should issue an order requiring UP to reinstate and maintain competitive service to the G3 Facility via reciprocal switch or otherwise.

Respectfully submitted,

Andrew Johnson/als

Andrew Johnson
Associate General Counsel -- Legal
E. & J. Gallo Winery
600 Yosemite Blvd.
Modesto, CA 95354
(209) 341-5531

Counsel for G3 Enterprises, Inc.

Adrian L. Steel

Adrian L. Steel, Jr.
Robert M. Jenkins III
Adam C. Sloane
Mayer Brown LLP
1999 K Street, NW
Washington, DC 20006
(202) 263-3237

Roger P. Nober
Richard E. Weicher
David T. Rankin
BNSF Railway Company
2500 Lou Menk Drive
Fort Worth, TX 76131
(817) 352-2383

Counsel for BNSF Railway Company

Dated: January 9, 2014

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Petition for Reconsideration have been served on all parties as listed on the Board's website for the service list in Finance Docket No. 32760.

A copy of the petition has also been served on counsel for Modesto and Empire Traction Company:

Mark H. Sidman
Weiner Brodsky Kider PC
1300 Nineteenth Street NW, Suite 500
Washington, DC 20036-1609

Adrian L. Steel, Jr.

EXHIBIT A
EXCERPTS OF ORAL ARGUMENT HEARING TRANSCRIPT
JANUARY 15, 2013

UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD
+ + + + +

ORAL ARGUMENT

----------------------------------x
IN THE MATTER OF: :
UNION PACIFIC CORPORATION, :
UNION PACIFIC RAILROAD COMPANY, Finance
and MISSOURI PACIFIC RAILROAD : Docket
COMPANY No. 32760
:
- CONTROL AND MERGER -
:
SOUTHERN PACIFIC RAIL CORPORATION,
SOUTHERN PACIFIC TRANSPORTATION :
COMPANY, ST. LOUIS, SOUTHWESTERN
RAILWAY COMPANY, SPCSL CORP., :
AND THE DENVER AND RIO GRANDE
WESTERN RAILROAD COMPANY. :
----------------------------------x

Tuesday,

January 15, 2013

Surface Transportation Board
Suite 120
395 E Street, S.W.
Washington, D.C.

The above-entitled matter came on for hearing, pursuant to notice, at 9:30 a.m.

BEFORE:

DANIEL R. ELLIOTT, III Chairman
ANN D. BEGEMAN Vice Chairperson
FRANCIS P. MULVEY Commissioner

MR. WEICHER: Good morning. Thank you, Chairman Elliott, Commissioner Mulvey, and Vice Chairman Begeman. We appreciate the opportunity to appear.

We are sharing our time with G3, so I'll make a brief comment and then pass to her. We'll try to make this efficient at the podium.

I am Richard Weicher, from BNSF. Jolene Yee is with us, from G3, Adrian Steel for Mayer Brown. I'll give a basic overview of our position and we will still reserve three minutes between us for rebuttal.

We believe that, in the Union Pacific Southern Pacific merger, Union Pacific committed to the public and the Board, and the Board ordered, the preservation of two carrier rail competition at all locations, where otherwise a shipper facility would lose all of its pre-merger competitive options, other than the merged Union Pacific Southern Pacific Railroad.

This is embodied in a variety of specific conditions for existing and future facilities throughout the West in the Board's decisions.

Inherent in this commitment, we believe, is a commitment that UP could not take action after the merger to eliminate access by the non-Union Pacific carrier. Jolene Yee will describe the specific situation we're dealing with in Modesto, California.

MS. YEE: Good morning. My name is Jolene Yee, I am Counsel for G3 Enterprises. I am joined here today by G3 CEO, Mr. Robert Lubeck, and its VP and General Manager of Logistics Division, Ms. Patty Reeder.

We are here today to ask the STB to enforce STB Decision 44, and related actions to preserve competitive access, and to restore reciprocal switching to the Rogers facility.

On Page 91 of STB Decision 44, the Department of Labor had cautioned that preserving competition in an already concentrated rail industry is vital to businesses and communities.

And it urged the STB to carefully

the representations, with however of our blended time we have left, and, of course, I'll be here for questions.

MR. STEEL: Thank you, Mr. Weicher. I will just focus on a few points, since we're running near our time. At the time, though, of the post-merger, and the announcement of the merger, and throughout the proceeding, UP made a number of representations to the effect that the existing competition will be preserved, in fact, enhanced in a number of situations.

Mr. Davidson, then the Chairman of UP, made that statement in his verified statements and rebuttal verified statements, that no shipper facilities would lose competition.

If you'll look at the Slide 7, these are two, the next two slides are a couple of those representations. The applicants emphasized their intent to ensure that a second strong railroad would compete at every location where UP and SP provide the only rail competition.

That's our two to one situation. We

understand that. But, our point here is, that it also applies to a three to one situation, actually it wasn't needed in most cases for three to two situations.

But if going from two to one is bad, going from three to one to even, I won't say worse, but it causes the same loss of access, which we think is really the key here.

Were the merger conditions designed to preserve the competition that, at least, that existed at the time of the merger?

Modesto, the shippers that you've talked about, Chairman, there were four or five, seven of those, maybe, they were protected by the MET's access. You take away MET's access, and they all go to single service after the merger. If you look at the next slide.

COMMISSIONER MULVEY: And MET wrote a letter to UP, it said, expressing its concern over the loss of competitive access, and UP responded.

And they said in their response, that

they would not reduce competition at the Modesto facility. But then, they were very, very careful in the way they wrote it.

And they said, specifically, that they would keep competitive access, as referenced in Items 1233 of the switching tower, which names their specific customers who are served.

And in the tower, you can see, that it lists Proctor & Gamble and exists some specific industries, which is not G3, G3 wasn't there then.

So wasn't UP careful in the way it constructed its response to MET, and saying that look, we are not going to reduce competition for existing customers, but new customers, like G3, that could be another matter?

MR. STEEL: That's correct. But we view the representations as sort of, it's called alternative theory of why the joint petition should be crafted.

And we have a time problem, I don't think we used 17 minutes from where we were, so if you don't mind, if we go on a little bit?

CHAIRMAN ELLIOTT: No problem.

MR. STEEL: The representations, you can read them, we think they should be read more broadly than UP thinks they should be read.

And our view is, read them how we want to read them. If it doesn't support relief on that basis, then that's so be it, but that's an alternative.

What we think the concern here is, that UP's action, post-merger action, is that it took a facility, and if you'll look in the settlement agreement, you'll see that shipper, shippers we're talking about, are defined as facilities, not shipper customers.

It's, shipper facilities shall mean all existing or new shipper or receiver facilities, not shippers, shipper facilities. And a two to one shipper facility should mean all shipper facilities, which we just defined, as the facilities.

So the facility we're talking about

that had competition, in 1995 before the merger, was the Rogers physical plant. That physical plant is entitled to competition in perpetuity.

Up's action here cuts that off. The other ones, actually, at Modesto are probably also, but we're not arguing about those today.

If you look in the Board's Decision 44, as to, was the Board really worried about this kind of thing I'm talking about, dropping the competition of a facility down, Page 103, and you probably don't have it, but I'll read it to you, 103 footnote 97, when it talks about the items it examined.

It examined whether all shippers, whose direct access to rail service has gone from two railroads to one. So, their looking at, to make sure no shipper facility goes to one exclusively served rail carrier. That's UP, of course, here.

And this thing lasted for 99 years, and beyond that. The agreement went so far and focused on two to ones, because that was the big issue.

The three to twos were actually there, UP averred, Richard Peterson, Vice President over marketing, I think, indicated that applicants had carefully analyzed each one of the 26 cities and towns, where three to two traffic originates, Modesto was one of those, and found that in every case, combining UP and SP, would yield much stronger competition. Well, that statement's only true if the third carrier stays present.

So even by their own, those representations, not necessarily the letters, the letters have their pluses and minuses, and you can interpret those as you want, and, I think, you're actually right, Commissioner, that they did carefully craft that. With intent, I don't know, but it was pretty carefully crafted.

But we say fine, they live up to the representations, fine. That's not the issue. The issue here is access to this facility in perpetuity. And I think I made all my main times when our friends at UP raised that issue, and the Board said, we'll address the general principles, and if you all need to debate how it applies to a particular location, go arbitrate that, but what we'll do is address the general principles.

VICE CHAIR BEGEMAN: And we're not talking about a location?

MR. STEEL: Wait, excuse me?

VICE CHAIR BEGEMAN: But we are talking about a location.

MR. STEEL: We are talking about a location here, but we have our friend the shipper, who isn't bound by the arbitration clause.

A couple of things, and I'll try and limit them. First, on the shipping letters that they complain about, that's standard practice here, at the Board.

And people don't write in and go for the protective orders. If they want to respond to shippers letters, we have just as much right to respond to the response to shippers letters.

I don't think we need the last word about the shippers letters, but if they respond, we may well respond to what they have to say. But I think the shipper letter, everybody gets shipper letters and shippers come in, I don't see why we need that.

Second, a key point here is that if G3, or if Proctor & Gamble had come the Board back at the time of the merger, and said we've got this concern that MET's access, making this a three to two shipper, is conditioned on UP not closing a reciprocal switch, I think the Board would have been receptive to that.

Because what could UP have said, no, we want to be able to close it and turn it into a two to one point, where we can end up with only UP/SP combined service. So that really can't have been what happens.

The other thing is, if we don't adhere to sort of the intent of the letters, and what Mr. Beer was really trying to get across, then a party who voluntarily settles an agreement is going to end up here, as you say, Vice Chairman, with no competition after this action.

Mr. Rosenthal spent a lot of time on the letters and reciprocal switching and all that, and as you heard me say before, that's fine. We agree that there's a dispute there. We don't think that we have to win that dispute to get relief here.

As I mentioned earlier, the Board in its Decision 44, clearly, indicated it was focusing on the reduction of competition for all shippers who receive pre-merger competition. Two to ones were just sort of the big kahuna, is what had to be addressed.

The three to twos we looked at, everything they could do, as you know, Vice Chairman, to preserve existing competition, they did. The Board's new rules on mergers, not only preserve all competitions, they require the enhancement of competition.

So it makes no sense to us to say

that what we'll walk out of here today, as you say, when we walk out of here today, and if they prevail, a shipper facility, and note, that Mr. Rosenthal said nothing about the provisions in the agreement, that you said they signed, we signed, they agreed, that the analysis was of shipper facilities. It says that.

He's talking about one single named corporate entity. We know P&G's gone. But for 99 years, did we think that they were going to stay at this one facility?

It's about facilities. It's about jobs. It's about economic growth. Why should we have made G3 go build a new facility and spend all the money, implicate all the environmental issues when there's a facility that's capable of being used that had competition before the merger, and now UP just cuts that off.

That just doesn't make good public policy sense to us. I don't think it would to anybody else. G3, they may have had their faults in their due diligence, but the bottom line was, this was a competitively served facility that's not. And so, I guess, the thought that I just wanted to leave you with, it's not a new condition, they can't be surprised that you would say to them, you can't take a pre-merger competitive location and turn it into a non-competitive location. That can't be a condition that they're talking about is a new condition. If they're surprised about that, then they didn't understand what the Board was doing in 1996. But, I guess, I'll close with, and we'll answer any questions, of course, but I'll close with, as you leave today, I would part with Vice Chairman's question, this facility, the relevant facility is losing competition. He didn't say otherwise. He can't say otherwise. It's gone from three carrier service to two carrier service, and now they make it one, and that's a simple fact. It's about access. It's about preserving competition, and what they've done doesn't do that. Thank you, and we appreciate your time.

EXHIBIT B
EXCERPTS OF VERIFIED STATEMENT OF RICHARD K. DAVIDSON (UP/SP-22) IN UP/SP MERGER PROCEEDING

VERIFIED STATEMENT

OF

RICHARD K. DAVIDSON

My name is Richard K. Davidson. I am the President and Chief Operating Officer of UPC and the Chairman of the Board of UP. I began my railroad career as a brakeman/conductor with MPRR in 1960. Thereafter, I rose through the ranks in the MPRR Operating Department, becoming Vice President-Operations in 1976. In 1986, four years after the UP/MP/WP consolidation, I was promoted to Vice President-Operation of UP, and in 1989 I became Executive Vice President-Operation of UP. In 1991 I became Chairman and Chief Executive Officer of UP and in 1994 I assumed additional responsibilities as President of UPC. Earlier this month, I became Chief Operating Officer of UPC and relinquished the position of Chief Executive Officer of UP.

The merger of UP and SP will greatly strengthen rail competition in the West and produce tremendous benefits for shippers. It is clearly in the public interest, and should be expeditiously approved.

Time is of the essence because BN/Santa Fe, by its merger, has achieved a level of competitiveness that neither UP nor SP can match. Without the UP/SP merger, BN/Santa Fe will open a wider and wider lead over UP and SP, and our customers will be denied the routing and efficiency benefits that BN/Santa Fe can offer its customers. SP in particular, which has been carriage for large volumes of freight in this rapidly growing market. We will build a new "Inland Empire" intermodal terminal in the eastern Los Angeles Basin to compete with BN/Santa Fe for premium intermodal traffic. We will institute the first-ever California-Laredo intermodal service, the first-ever Pacific Northwest-Texas-New Orleans through intermodal service, improved Twin Cities-Texas intermodal service, new dedicated automobile trains, and many new through trains and blocks with Eastern carriers that bypass congested terminals. We will upgrade UP's "OKT" line in Kansas and Oklahoma so that it can be used in conjunction with SP line segments to run heavy coal and grain trains around the congested Kansas City terminal. Equipment supply will be significantly improved. The list goes on and on.

The bottom line is that we will offer customers a comprehensive, efficient rail network that is the equal of BN/Santa Fe. Competition will be greatly enhanced, as discussed in detail in the verified statements of Mr. Peterson, Mr. Barber, Professor Willig, Mr. Sharp and Mr. Spero. And as a result, shippers will hugely benefit.

The Commission is rightly concerned not only about the competitive and other benefits of mergers, but about ensuring that mergers do not cause any harmful reductions in competition. When we concluded last August that the only course for UP was a merger with SP that would create a world-class railroad to compete against BN/Santa Fe, we made the commitment from day one that we would not allow a single shipper to lose a choice between two railroads. We announced that we would negotiate conditions that would introduce a second strong railroad competitor at every location where UP and SP provided the only rail service.

In talking with customers, I heard that they wanted a financially strong carrier with broad geographic coverage -- not a combination of regional competitors. And while BN/Santa Fe might not have been my first choice at the outset, it became increasingly clear that only BN/Santa Fe would satisfy the concerns of our customers. On September 25, we kept our commitment to preserve competition and signed an agreement with BN/Santa Fe -- an agreement that will not only preserve competition, but greatly enhance it.

Under our agreement with BN/Santa Fe, as more fully described by Mr. Rebensdorf and Mr. Peterson, every shipper that has service only from UP and SP today will have much stronger competition, as they will be able to reach <u>both</u> all UP and SP points <u>and</u> all BN/Santa Fe points on a single-line basis. Moreover, the agreement adds <u>new</u> competition where none exists now. Under the agreement, there will be a second competitive single-line rail route -- in addition to the one that the merger itself will create -- from Western Canada all the way down the West Coast to Arizona, Texas and the gateways to Western Mexico. Similarly, BN/Santa Fe will gain access to New Orleans -- the only midcontinent gateway it does not reach -- and for the first time ever there will be two direct single-line rail alternatives between New Orleans and Los Angeles. And BN/Santa Fe will have a

EXHIBIT C
EXCEPTS OF APPLICANTS' REBUTTAL VOLUME 1 (UP/SP-230)
IN UP/SP MERGER PROCEEDING

Before the
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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

RAILROAD MERGER APPLICATION

APPLICANTS' REBUTTAL

VOLUME 1 - NARRATIVE

CANNON Y. HARVEY
LOUIS P. WARCHOT
CAROL A. HARRIS
Southern Pacific Transportation Company
One Market Plaza
San Francisco, California 94105
(415) 541-1000

PAUL A. CUNNINGHAM
RICHARD B. HERZOG
JAMES M. GUINIVAN
Harkins Cunningham
1300 Nineteenth Street, N.W.
Washington, D.C. 20036
(202) 973-7600

Attorneys for Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corp. and The Denver and Rio Grande Western Railroad Company

CARL W. VON BERNUTH
RICHARD J. RESSLER
Union Pacific Corporation
Martin Tower
Eighth and Eaton Avenues
Bethlehem, Pennsylvania 18018
(610) 861-3290

JAMES V. DOLAN
PAUL A. CONLEY, JR.
LOUISE A. RINN
Union Pacific Railroad Company
Missouri Pacific Railroad Company
1416 Dodge Street
Omaha, Nebraska 68179
(402) 271-5000

ARVID E. ROACH II
J. MICHAEL HEMMER
MICHAEL L. ROSENTHAL
Covington & Burling
1201 Pennsylvania Avenue, N.W.
P.O. Box 7566
Washington, D.C. 20044-7566
(202) 662-5388

Attorneys for Union Pacific Corporation, Union Pacific Railroad Company and Missouri Pacific Railroad Company

April 29, 1996

efficiencies is through mergers.[69] The ICC, in approving numerous mergers since the enactment of the Staggers Act, has taken pains to preserve intramodal competition while allowing merger efficiencies to be achieved. It has done this by ensuring that at least two strong railroads continue to serve every important market. The Shepherd approach would prohibit a reduction in the number of railroads in any real-world rail market. This view is incompatible with applying the public interest standard mandated by Congress.

Advocates of strict antitrust doctrines like Professors Shepherd, Grimm and White simply fail to take account of any of the facts of real pertinence. They ignore SP's competitive weakness, BN/Santa Fe's dominance, the quantum improvements in UP/SP's efficiency and service that the merger will bring about, and the further enhancement of BN/Santa Fe's competitiveness that will result from the settlement. Even their sponsors clearly do not adhere to

[69] Similarly, Professor Shepherd's urging of HHI calculations (pp. 29-30) (which he does not conduct) embodies the same error. No major rail merger could have occurred if HHI calculations were the governing test, and, contrary to WCTL (WCTL-11, pp. 11-12), the ICC has not relied on HHI calculations in such cases. An expert testifying for CCP, for example, found pervasive HHI "violations" in the UP/CNW merger, and his arguments were rejected by the Commission. UP/CNW, Slip Op., pp. 84-87. Mr. Crowley's HHI calculations for SPI (SPI-11, Crowley, pp. 21-28) illustrate the same point: they indicate that the "market" for transporting plastics is already grossly overconcentrated, whereas SPI argues in the rest of its submission (e.g., SPI-11, pp. 49-51) that competition among the railroads that serve different producers is very effective in placing a cap on rail rates.

EXHIBIT D
EXCERPTS OF VERIFIED STATEMENT OF RICHARD B. PETERSON (UP/SP-23) IN UP/SP MERGER PROCEEDING

VERIFIED STATEMENT

OF

RICHARD B. PETERSON

My name is Richard B. Peterson. I am Senior Director-Interline Marketing of UP. I received a Bachelor of Science degree in Civil Engineering from the University of Minnesota in 1968. In 1970, I was graduated from Northwestern University with a Master of Science degree in Transportation. My undergraduate and graduate studies concentrated on transportation and my thesis topic at Northwestern presented a mathematical programming approach to railroad freight train scheduling.

During my college and graduate years, I held various summer and part-time jobs with the Milwaukee Road's Engineering and Operating Departments and with the Operating Department of the Chicago, Burlington and Quincy, which subsequently became part of BN. In 1970, I was employed by UPRR as a Research Analyst in the Traffic Department. In 1974, I was appointed Assistant Manager-Service Planning, and I received a series of promotions thereafter, assuming my current position in 1988.

My responsibilities as Senior Director-Interline Marketing include strategic planning in the marketing and sales area, involvement in merger cases, routing and divisions issues, switching issues, managing UP's shortline program, abandonment matters and commuter rail issues. In carrying out these responsibilities, I work closely with marketing, sales and

K. Shippers Now Served By Three or More <u>Railroads Will Enjoy Stronger Competition</u>

The UP/SP merger will intensify competition for <u>all</u> shippers. Shippers in the "2-to-1" category will, as we have just seen, gain stronger competition. Exclusively-served shippers on both UP and SP lines will as well, for reasons I have already discussed at length. Still other shippers, such as BN/Santa Fe shippers who are covered by the proportional rate arrangement and shippers on the Southern Louisiana line that will be sold to BN/Santa Fe, will go from a single rail option today to two rail options after the merger and the settlement, clearly increasing competition.

Here, I focus on why competition will also be increased for shippers who are served by more than two railroads today, and will have the number of railroads serving them reduced by one. In many cases, this reduction will be to a number greater than two -- <u>i.e.</u>, from 4 to 3, 5 to 4, etc. Shippers between competitive points in Chicago and St. Louis, for example, go from 7 to 6 (UP/SP, BN/Santa Fe, IC, NS, CSX, Conrail and Gateway Western), and shippers between common points in Chicago and Kansas City go from 6 to 5 (UP/SP, BN/Santa Fe, CP, NS and Gateway Western). I shall focus here, however, on shippers who go from three serving railroads to two, because that is the situation that has been highlighted by certain opponents of the merger, and because once it is established that these shippers will enjoy stronger competition, it will follow even more clearly that the remaining shippers will.

Opponents of the UP/SP merger have claimed that the merger will produce a "duopoly," weakening rail competition. One of those opponents, KCS, has claimed that the traffic falling in the "3-to-2" category accounts for nearly $4 billion in annual revenues.[83] I want to make two points in response.

First, and most fundamentally, the shippers who do go from three rail options to two as a result of the UP/SP merger will have stronger, not weaker competition. SP is a weak competitor that faces the prospect of becoming relatively less and less competitive in the wake of the BN/Santa Fe merger. UP is also at a competitive disadvantage compared with BN/Santa Fe. For all the many reasons I have discussed -- shorter routes, faster service, lower costs, more single-line service, and so on -- the merged system will offer a true competitive alternative to BN/Santa Fe as neither SP nor UP individually can. Moreover, with the settlement, BN/Santa Fe will be strengthened as well, and much further competition will be introduced throughout the West. Nor, as I explain further below, can there be any doubt that these two systems will compete to the full extent of their potential. For the reality is that where two strong railroads

[83] KCS-3, Grimm V.S., p. 4 ("There are another $3.93 billion in revenues in BEA origin-destinations that would fall from 3-2 independent alternatives if merger is approved.").

In total, the breakdown of the "3-to-2" traffic in 1994 was .

This traffic moves to and from 26 locations in the West, ranging from large cities to small hamlets, which I shall discuss individually. The intermodal and automotive traffic is limited to five major points -- Portland, Oakland, Los Angeles/Long Beach, Denver and Houston -- which I address first. At the other 21 points, which I then address, there are not three competing intermodal or automotive facilities. For these points, intermodal and auto traffic is largely handled via the five major points.

A review of the actual circumstances with respect to this traffic will reveal that large parts of it are not competitive among three railroads in any meaningful sense. The great majority of the traffic is intermodal and automotive, and as I have already shown SP is a weak competitor or a non-competitor for much of this traffic. SP cannot compete at all for high-end transcontinental intermodal traffic, yet we have included that traffic in the total that we have treated as three-railroad competitive. Intermodal shippers are very clear that competition between a combined UP/SP and BN/Santa Fe will be stronger than competition among BN/Santa Fe, UP and SP.[94] Also,

[94] See, for example, the statements of Riss Intermodal, p. 7 ("The combination of Union Pacific and Southern Pacific offers shippers, IMCs and capacity providers the best means of getting to sustainable, intense competition."); Fort Pitt Consolidators, p. 2 ("We believe that the merger of UP and SP will enhance (continued...)

auto traffic potentially subject to three-railroad competition was included.) We first identified all locations that are currently served (either directly or through a shortline) by UP, SP and a third Class I railroad (generally this was BN/Santa Fe, but sometimes it was KCS). This yielded the 26 points I shall discuss.[95] Using the same comprehensive rail traffic data base that I discussed in connection with the regional flows above, we selected 1994 traffic that moved to or from any 6-digit SPLC in these 26 areas that we determined could be within the switching limits of each terminal. We also included all connecting shortline traffic. We did this in a painstaking way by studying detailed maps of each area.

Our next step was to eliminate that carload traffic at each terminal that could not be handled by UP, SP and another Western line-haul carrier. This could be because the industry

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[95] We also identified Carrollton, Texas, as a possibility, but upon investigation we found that there was no "3-to-2" traffic there. UP only provides reciprocal switching at Carrollton in instances where it cannot receive a line haul. This is a situation that UP inherited from MKT.

One other point worthy of mention is Cape Girardeau, Missouri. This point, located in Southeast Missouri, could theoretically receive competitive rail service from UP, SP and BN/Santa Fe. Cape Girardeau is on BN/Santa Fe's St. Louis-Memphis mainline, and UP's branch line was recently sold to the Southeast Missouri Port Authority, which could potentially connect to both UP and SP. Cape Girardeau also benefits from extensive barge service, as it lies along the Mississippi River. There are no current industries located at the Southeast Missouri Port Authority that handle rail traffic. The data for 1994 showed no competitive rail traffic at Cape Girardeau. QC Chemical Company, which is located near Cape Girardeau and is exclusively served by BN/Santa Fe, is the major customer in the area and is a supporter of the UP/SP merger.

was outside of the reciprocal switching limits or because, even though within the limits, it was not open to all three carriers. (We included those few industries that are directly served by three railroads, rather than served through reciprocal switching; sometimes this was through a joint facility agreement.) We performed this elimination by identifying for large numbers of UP and SP customers in each terminal whether the customer was open or closed. We initially matched the traffic data by computer with the UP and SP reciprocal switching data bases. These data bases (commonly known as customer masters) indicate the open or closed status of the customer. We also manually reviewed a substantial number of larger-volume movements that could not be matched by computer. We were able to determine open or closed status for some 75% of the UP and SP movement records in this manner. (Open/closed status could not be determined for any of the Waybill Sample records, because they lack customer name.) On a location-by-location basis, we applied the open/closed ratio that we determined in this fashion to the remaining records to obtain an estimate of open traffic.

For the open traffic, we then turned to the other end of the movement. We found that for 36% of the movements, the origin or destination point at the other end was served only by one major Western railroad. For this traffic, there is only one rail option available today. As to another 17% of the movements, we found that the other end was served by only two major Western railroads. Here the customer has two options today and will continue to have two options following the merger: if the other end is served by UP and SP, the settlement agreement provides for BN/Santa Fe service, and if the other end is served by either UP or SP and another Class I railroad, then the merger will only strengthen competition. Finally, we classified movements as non-competitive where the route of one of the three carriers was 150% or more circuitous. This represented only 3% of the total carloads.

This analysis revealed that of the 977,772 carloads at the 26 points, only 291,693 were <u>theoretically</u> competitive among three railroads. (It is this traffic I mean when I speak of "competitive" traffic in the discussions of each "3-to-2" location below.) Still to be considered was whether the three-way competition for this traffic was in fact substantial. This number is a liberal estimate of "3-to-2" carload traffic, because in fact many of the industries located at the other ends of these movements are not open, but we were unable in the time available to conduct the sort of detailed open/closed analysis at the other ends of these movements that we conducted for the 26 points.

a. <u>Major "3-to-2" Points</u>

<u>Portland</u>. Portland is one of the primary metropolitan areas in the Pacific Northwest, and is an important port and center for forest products traffic. Portland dramatically illustrates how a major city directly served by SP, UP and BN/Santa Fe can in fact have very little competitive traffic.

in from outlying points. As a location of a major UP terminal, it is a location where UP can switch cars directly into trains destined to the east. As a result,

. As is the case throughout California, BN/Santa Fe's aggressive intermodal programs are its primary weapon to secure canned goods and other food products traffic. BN/Santa Fe handles sizeable volumes of canned goods traffic via its intermodal terminals at Stockton, Richmond, Modesto and Fresno.

A UP/SP merger will dramatically improve carload service from Stockton to the Midwest. BN/Santa Fe will be a much stronger competitor through its merger and its settlement with UP/SP, which will give it new single-line routes to the Pacific Northwest and Western Canada, via the Central Corridor, and to New Orleans.

Modesto. Modesto is located in Central California on the SP and BN/Santa Fe Bay Area-Southern California mainlines. UP reaches Modesto via a branch line south from Stockton. Most industry in Modesto is on a shortline, the Modesto and Empire Traction Company ("MET"), which connects with BN/Santa Fe, UP and SP. Gallo generates large volumes of outbound wine and other traffic, and there are several other important customers on the MET as well.

There were 17,550 carloads at Modesto in 1994. Our process identified 12,408 as competitive. The heavy volumes shipped to the major population centers in the Northeast and Southeast are competitive, and result in Modesto's being one of the very few locations where more than half of the rail carload traffic is competitive among UP, SP and another major Western railroad.

BN/Santa Fe handled . BN/Santa Fe provides top-notch service and equipment to Gallo and other Modesto customers via its high-speed mainline. UP handled and SP, as is often the case, handled a very low percentage, here only competitive traffic.

A UP/SP merger, including the settlement with BN/Santa Fe, will be highly beneficial to Modesto customers, for the same reasons referred to in regard to Stockton.

Fullerton. Fullerton, California, is located 26 miles east of Los Angeles on BN/Santa Fe's mainline. UP and SP each serve Fullerton via a branch line. Only one shipper at Fullerton is served by three railroads -- Hunt-Wesson, a subsidiary of ConAgra, which supports the merger. BN/Santa Fe accesses the Hunt-Wesson facility directly, while a UP/SP joint facility agreement covers UP and SP access. There were 3,628 carloads at the Hunt-Wesson facility in 1994. After eliminating movements to and from locations served by one or two railroads or involving undue circuity, there were 1,979 competitive carloads. Due to its advantageous mainline service, Santa Fe handled . Clearly, a UP/SP merger will be pro-competitive -- which is the customer's

EXHIBIT E
EXCERPTS OF REBUTTAL VERIFIED STATEMENT OF RICHARD B. PETERSON
(UP/SP-231)
IN UP/SP MERGER PROCEEDING

REBUTTAL VERIFIED STATEMENT

OF

RICHARD B. PETERSON

My name is Richard B. Peterson. My background and experience are described in the verified statement that I submitted as part of the application. In that statement, I explained why the UP/SP merger, as conditioned by the BN/Santa Fe settlement agreement, will intensify competition throughout the West, and I described the Traffic Study that we conducted to estimate the traffic impacts of the merger and settlement.

In this rebuttal statement, I respond to various arguments that have been presented by parties opposing the merger or seeking the imposition of conditions.

In Part I, I address a number of arguments about the effect of the merger and settlement on competition. These include arguments about the competitive benefits of mergers generally, about the amounts of traffic falling into the "2-to-1" and "3-to-2" categories and the effect of the merger and settlement on those categories of traffic, and about Mexican traffic. My discussion of Mexican traffic also addresses Tex Mex's request for trackage rights conditions.

In Part II, I address the effectiveness of the BN/Santa Fe settlement agreement in preserving and enhancing competition. I show that, contrary to the claims of certain opponents of the merger, trackage rights are a widely-used, chart following this page shows, that it accounts in total for $2.1 billion in revenues, or only a tenth of the total rail traffic in the West. This includes <u>all</u> traffic in "3-to-2" markets -- both that handled by UP and SP and that handled by BN/Santa Fe (and in a few cases by KCS). Of the total, as the chart shows, almost <u>half</u>, or $987 million, is handled by BN/Santa Fe. SP handles only $428 million -- or barely 20% -- reflecting its weakness as a competitor in the West.

I explained in my initial testimony that this "3-to-2" traffic will also benefit competitively from the UP/SP merger. The new competitive environment that the merger will bring about for such traffic will be far more intense than the competitive environment that exists today.

At present, "3-to-2" shippers have a choice among the powerful BN/Santa Fe system, which is rapidly pulling away as the dominant Western railroad; UP, which cannot match BN/Santa Fe's overall route structure or financial capabilities; and SP. SP is a distinctly weak third alternative. As the chart shows, it has only 17% of "3-to-2" automotive traffic, because its poor service and inability to invest in costly autorack equipment have caused its position to erode. In the intermodal sector, SP has 20%, almost entirely in the low-service end of the business -- and, as I described in my opening testimony, it faces a grave threat of losing much of even this low-service segment of the business to BN/Santa Fe. In the carload sector, SP's share is a bit higher -- 24% -- reflecting the fact that it has hung on to carload traffic by adopting high reciprocal switch charges. (I treated all the traffic that SP switches for $495 per car as "3-to-2," even though a strong argument can be made that this traffic is virtually exclusively-served.)

The UP/SP merger will bring genuine competition to the two-thirds of a billion dollars in BN/Santa Fe "3-to-2" <u>intermodal traffic</u> shown on my chart, for which neither UP nor SP can rival BN/Santa Fe today. That is why intermodal shippers and ports overwhelmingly support the merger. The merger will greatly strengthen competition for the "3-to-2" <u>auto traffic</u> by creating two full-scale, highly-efficient Western rail networks that can reach the entire range of major destinations the automakers need to reach, and that can afford the investments in service quality and equipment that the automakers demand. That is why General Motors and many other auto shippers support the merger. And the merger will intensify competition for "3-to-2" <u>carload traffic</u> in countless ways, not least by eliminating all switch charges between UP and SP and dropping SP charges vis-a-vis other railroads to $150 per car. That is why hundreds of "3-to-2" carload shippers, such as California perishables shippers and canners, steel mills, and forest products shippers, support the merger.

EXHIBIT F
EXCERPTS OF VERIFIED STATEMENT OF RICHARD J. BARBER (UP/SP-23) IN UP/SP MERGER PROCEEDING

VERIFIED STATEMENT

OF

RICHARD J. BARBER

TABLE OF CONTENTS

strong competitors is better than the UP and SP competing separately with the BN/SF." (Totalogistics Management Co.)

The Port of Oakland, the fifth-largest container port in the country, is now served by UP, BN/Santa Fe, and SP. After assessment, it concluded that it was in its best interest to support the consolidation. One of its reasons is that 3-road competition—rather than being of benefit—has actually "resulted in carload shippers being left without access to competitive routes and destination or origin points due to the charges on industrial switching." It concluded:

> "The convergence of terminal capacity issues, route structures, access issues, and the financial difficulties that have been experienced by SPL has more than offset the competitive advantages of having three rail carriers serve the Port.... [Consolidation of UP/SP] will give ocean carriers and other receivers and shippers of goods direct access to two effective competing railroads and open new markets to shippers using the Port.... The merger of Union Pacific and Southern Pacific offers an unprecedented opportunity to increase competitive rail services to our customers, increase the Port's competitive position among west coast ports and bring about much needed expansion of Port facilities." (Port of Oakland.)[123]

In the words of an intermodal shipper, with approval of the consolidation, and the settlement in place, "we will have the strongest and most competitive railroads as alternatives for shipments in the western United States."[124]

Combining in carefully executed complementary fashion the undeveloped route potential of SP with the financial strength and proven service competence of UP will bring about the two-carrier balance of strength and market reach that Riss and others see as prerequisites to vigorous rail

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[123] The Kansas City Board of Trade, which historically has not taken a position in rail consolidation proceedings because of the diverse views of its many members, also has filed a statement in support of the UP/SP application. It does so out of a desire to maintain a competitive position as a result of the BN/Santa Fe merger. The Kyle Railroad, whose 750 miles of lines in northeastern Kansas connect with BN/Santa Fe and UP, supports the application because its approval will ensure "two strong rail competitors in the West." See also FMC Corp. and B&B Transportation Services.

[124] Sunac America.

competition. Post-consolidation, UP/SP and BN/Santa Fe will both be able to offer comprehensive single-line service in the West, and both would be of comparable financial strength. That will lay the groundwork for the same intensity of competition that now exists between two railroads in the Southeast and the Pacific Northwest.

(iv) Two-Carrier Competition Will Constrain Supra-Competitive Rail Pricing

With two strong railroads pitted against one another at locations (and in lanes) where there are, as of now, three carriers (a market-leading BN/Santa Fe, a route constrained UP, and a weak SP), there can be no legitimate fear that UP/SP, post-consolidation, would have the power to raise prices to supracompetitive levels.

Consider an example. Suppose that UP/SP has been moving 100 units of traffic at a price of $10.00 per unit. Hypothesize that UP/SP increases the price by five percent in the mistaken expectation that it would realize a profit increment of $50 (at $10 its revenue was $1,000 for the 100 units, at $10.50 its revenue would be $1,050). What would happen? UP/SP would face considerable risk of losing the business.[125] BN/Santa Fe serves the same points that UP/SP does and connects with other railroads at all major gateways. Drawing on its excess capacity (all major railroads have significant unused resources), BN/Santa Fe would have the incentive and ability to capture this traffic.[126] Very little traffic would have to be diverted from it in order for UP/SP's action to be

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[125] And it could be harmed even after its price increase has been blunted since buyers might in the interim commit to longer-term arrangements with other transporters or suppliers having other transport options.

[126] If, as an illustration, UP/SP were to have moved 60 percent of supply in a given year and were to post a five percent increase in price, others—other transporters, other sellers—would have to increase their sales by only 7.5 percent (3/40) to divert enough traffic to deny UP/SP any

(continued...)

unrewarding. Diversion of something slightly over[127] five units of the traffic would leave UP/SP worse off in revenue at its new $10.50 price, for example, than it was at a competitive $10 price (with a loss of six units, UP/SP's revenue, $10.50 x 94, would be $987). The illustration need not be extended.[128] Iteratively the UP/SP price would be brought back down to the $10 price, for the suppositional increased price is simply not sustainable.[129] Market forces—source and direct transport competition among two railroads and from others (trucks, intermodal vendors of different types, etc.)—constrain a price increase of the sort hypothesized.

Another fear—pricing through tacit collusion—is also baseless in a two-railroad context. The reasons are two-fold. First, tacit collusion is impractical where the product (here rail service) is not fungible. Rail freight transportation services are heterogeneous, differing in a great many respects

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[126](...continued)
increase in revenue. Even at higher supply shares, the risk of diversion is a substantial constraint on pricing, as the soda ash experience discussed later demonstrates.

[127] I say "something slightly over" to allow for the tiny cost savings that would be realized by having to move, in this example, fewer units. The cost saving would be barely calculable since the railroad's fixed costs would be unchanged in the short run, and it would not be able to reduce train-starts (hence labor costs would be unaffected). Only a bit less fuel would be needed, but fuel costs are not proportional to train trailing weight (as with an automobile, most fuel is used to carry the locomotive or car itself). For UP, "fuel and power" makes up just 7.1 percent of its aggregate operating expenses and fixed charges. AAR 1994 Analysis of Class I Railroads, lines 28, 41, 253.

[128] This sort of example is quite academic. Firms understand the competition they face and typically refrain from raising prices which they know will not be viable and will trigger competitive response (and possible long-term losses of business through impaired customer relations). Even if a price increase is made, the response is nearly instantaneous.

[129] In railroading the loss of a railroad's capacity through consolidation "can be offset by increases in the output of the remaining railroads in the market (and not by building new ones). These economic conditions foster price competition even in markets where there are few railroads. As long as there is excess capacity, railroads have the economic incentive to reduce rates, expand output, and increase profits." UP/CNW at 86.

(car types and supply, schedules, terminal support, car repositioning for customers, etc.). Not only does this make it impractical to compare prices, even if they are known, as among services but it also frustrates enforcement of imagined tacit prices (by altering the mix of services a carrier can undercut the supposed price).[130]

Second, for there to be tacit collusion, the purported participants must know what prices they are all charging.[131] In some industries current prices may be public, but this is not the case in rail transportation where most traffic moves under contracts, whose terms are confidential (49 U.S.C. 10713). Moreover, contracts can have many unique terms that make "price-guessing" fruitless (ex post refunds based on achieved volume, special allowances for rapid car unloading and return, and penalties or rewards for schedule reliability are among the variables that can be reflected in customer agreements and affect the actual price). Only through an overt, systematic exchange of confidential information might price coordination be accomplished, but this could readily run afoul of the antitrust laws.[132] Tacit collusion is all specter in this context, not substance.

What is to be expected is that with UP/SP and BN/Santa Fe both positioned to contest, from their postures of considerable strength, competition will be increased to a degree far greater than now exists at 3-to-2 locations.

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[130] "The less standardized (more customized) a product is . . . the more difficult it will be for the sellers to the product to collude collectively." Posner, Antitrust Law: An Economic Perspective (1976) at 59.

[131] "The most important step is the exchange of information as to what prices each is charging, or charged in the recent past, or intends to charge in the future." Id. at 135.

[132] See, e.g., United States v. Container Corp. of America, 393 U.S. 333 (1969).

EXHIBIT G
EXCERPTS OF VERIFIED STATEMENT OF ROBERT D. WILLIG (UP/SP-23) IN UP/SP MERGER PROCEEDING

VERIFIED STATEMENT

OF

ROBERT D. WILLIG

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competition is indeed important to industry outcomes, as Levin asserts. But whether there are two or three or more rail carriers vying for a shipper's business is irrelevant to the degree of interrail competition -- it is intense due to the character of rivalry, regardless of the numbers, as long as the market is not a case of pure monopoly.

It is important to emphasize two lessons of this discussion. First, the Levin paper does not prove, either empirically _or_ theoretically, that mergers consolidating three into two rail carriers lead to price increases. Second, Levin's paper does show that the impacts of the number of rival rail carriers, and the impacts of changes in that number (perhaps through merger), depend entirely on the way that the carriers interact with each other; _i.e._, on the nature of their rivalry. This lesson is of course not unique to Levin's paper -- it is a standard principle of the academic field of Industrial Organization, and an important leg of standard antitrust analysis. Nevertheless, it is critical to keep it in mind when evaluating the significance of the cited empirical papers. And, of course, it is most important to recognize that meaningful assessments of the impacts of the UP/SP combination must not rest on comparisons of numbers of carriers alone, without the consideration of the character of railroad's rivalrous conduct that is needed to determine whether the merger will significantly diminish competition.

E. Competitive Experience And The Views Of Shippers Confirm That UP/SP And BN/Santa Fe Will Compete Vigorously

My analysis has shown that the merger of UP/SP will significantly expand the capacity and competitive potential of UP/SP, that those efficiency benefits will redound directly to the benefit of the railroads' customers (and others who do not currently use them for their transportation needs), and that the characteristics of the transportation markets in which these firms compete make highly unlikely any express or tacit collusion involving UP/SP and BN/Santa Fe after the merger. These conclusions are confirmed by the available empirical evidence that demonstrates that railroads do compete vigorously when two railroads serve a market, and by the views of shippers that competition between UP/SP and BN/Santa Fe will be more, not less, effective than three-railroad competition involving BN/Santa Fe, UP and SP.

There are today a number of transportation corridors that are served by two railroads. Indeed, among these corridors are several that have been put in this category by previous railroad mergers. Each of these situations provides a laboratory in which to test the proposition that two railroads will compete vigorously for the available traffic. Mr. Peterson reviews several significant putative markets -- such as Powder River Basin coal originations, the Seattle/Tacoma-Chicago corridor, and the Los Angeles-Texas corridor -- where only two railroads compete today, and his testimony effectively demonstrates the