

FD 30400 F

PAGES 1 - 57

OFFICIAL TRANSCRIPT PROCEEDINGS BEFORE

THE INTERSTATE COMMERCE COMMISSION

DKT/CASE NO. F.D. 30400

TITLE SANTA FE SOUTHERN PACIFIC CORPORATION -- CONTROL --
SOUTHERN PACIFIC TRANSPORTATION COMPANY

PLACE Washington, D. C.

DATE May 21, 1986 (REVISED COPY)

PAGES 1 thru 172

ORAL ARGUMENT

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C O N T E N T S

	<u>PAGE</u>
1	
2	
3	
4	
5	
6	
7	
8	
9	
10	
11	
12	
13	
14	
15	
16	
17	
18	
19	
20	
21	
22	
23	
24	
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ORAL ARGUMENT OF:

G. Paul Moates and

R. Eden Martin,

Santa Fe Southern Pacific Corporation

Vincent B. McKenzie,

California Public Utilities Commission

John R. Scheirman,

Kansas Department of Transportation

Donna Kopperstein,

United States Department of Justice

Samuel Freeman,

The Denver and Rio Grande Western Railroad Company

Charles A. Miller,

Union Pacific Railroad Company and

Missouri Pacific Railroad Company

(AFTERNOON SESSION P.112)

Robert Kharasch,

Missouri-Kansas-Texas Railroad Company

Charles H. White, Jr.,

The Texas Mexican Railway Company

Joseph Auerbach,

The Kansas City Southern Railway Company and

Louisiana and Arkansas Railway Company

C O N T E N T S (cont'd)

	<u>PAGE</u>
1	
2 <u>ORAL ARGUMENT OF:</u>	
3 Thomas Greene,	133
4 Office of The Attorney General of The State	
5 of California	
6 John J. Delaney,	138
7 Railway Labor Executives' Association and	
8 Brotherhood of Locomotive Engineers	
9 Deborah S. Merkel,	143
10 International Brotherhood of Teamsters	
11 Barry Roberts	148
12 Sunkist Growers, Inc.	
13 Wayne Emergy,	152
14 United States Steel Corporation	
15 David S. Ainsworth,	155
16 American President Companies, Inc.	
17 <u>REBUTTAL</u>	
18 Eden Martin	159
19 Santa Fe Southern Pacific Corporation	
20	
21	
22	
23	
24	
25	

BEFORE THE UNITED STATES
INTERSTATE COMMERCE COMMISSION

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In the Matter of: :
SANTA FE SOUTHERN PACIFIC : Finance Docket
CORPORATION -- CONTROL -- SOUTHERN : No. 30400
PACIFIC TRANSPORTATION COMPANY :
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Hearing Room A
12th & Constitution Avenue,
N.W.
Washington, D.C.
Wednesday, May 21, 1986

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

BEFORE:

- HEATHER J. GRADISON, Chairman
- JOSEPH JACOB SIMMONS, III, Vice Chairman
- FREDERIC N. ANDRE, Commissioner
- MALCOLM M.B. STERRETT, Commissioner
- PAUL H. LAMBCLEY, Commissioner

COMMISSION STAFF PRESENT:

JAMES H. BAYNE, Secretary of the Commission

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P R O C E E D I N G S

1
2 CHAIRMAN GRADISON: Good morning. This is the
3 time and the place set by the Interstate Commerce
4 Commission for oral argument in Finance Docket No.
5 30400, Santa Fe Southern Pacific Corporation --
6 Control -- Southern Pacific Transportation Company.

7 In this proceeding the Applicants seek
8 Commission approval for Santa Fe Southern Pacific
9 Corporation which currently controls the Atchison,
10 Topeka & Santa Fe Railway Company to control Southern
11 Pacific Transportation Company.

12 Under the proposal, the Southern Pacific and
13 Santa Fe Railroads would merge into SFSP after the
14 St. Louis Southwestern Railway Company merges into its
15 parent, the Southern Pacific.

16 If approved and consummated, the consolidation
17 would create a rail system of approximately 26,000 miles
18 which serves major West Coast ports in Oregon and
19 California, major Texas and Louisiana Gulf Coast ports,
20 most principal gateways to Mexico, and all principal
21 mid-continental gateways.

22 This application presents one of the most
23 difficult merger decisions the Commission has faced in
24 the last ten years. There are many parties and we have
25 an extensive record. After completion of this oral

1 argument, the Commission will consider the evidence and
2 schedule a vote on the merger application.

3 This morning we will hear first from the
4 proponents and supporters of the transaction. We will
5 also hear from California PUC which neither supports nor
6 opposes the application.

7 Upon the conclusion of these presentations, we
8 will hear from opposing railroads and other entities
9 which oppose the transaction. We will also hear from
10 representatives of labor.

11 About 11:30 or 12:00 we will take a lunch
12 break, and please also keep in mind that we are going to
13 require strict adherence to the time allotments set
14 forth in the schedule of appearances. Remember, too,
15 that time taken for questions from the Commission will
16 be included in the time allotted to each participant.

17 If you don't need all of your time, you are
18 not obliged to use it. You can help us stay on schedule
19 by adopting the remarks of prior speakers to the extent
20 that such remarks reflect your own views.

21 I will call on the individual speakers by name
22 and announce the time that each has been allotted. When
23 the green light goes on here in front of me, you will
24 have one minute left. Your time will have expired when
25 the red light goes on. When you see it, please end your

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argument.

The first presentation today will be made by Mr. Eden Martin and Mr. Paul Moates, counsel for the Applicants. You have been allotted one hour and ten minutes, and I understand Mr. Moates will go first for 30 minutes, and that he has requested that the green light go on when he has ten remaining.

Mr. Martin will then have 30 minutes. He has requested that the green light go on when he has five minutes remaining.

Counsel for the Applicants will reserve ten minutes for rebuttal.

Mr. Moates, shall we begin?

ORAL ARGUMENT BY PROPONENTS

ORAL ARGUMENT BY G. PAUL MOATES AND R. EDEN MARTIN
SANIA FE SOUTHERN PACIFIC CORPORATION

MR. MOATES: Thank you, Chairman Gradison, Commissioners. May it please the Commission, my name is Paul Moates. Mr. Martin and I from Sidley & Austin appear this morning for the Applicants.

We have handed up to you this morning several prepared counsel's exhibits which include at Tab 1 several exhibits to which we wish to address the Commission's attention this morning, and at Tab 2 we have presented you responses to the questions that were

1 included in your May 15 notice to the parties setting
2 this argument.

3 Under Section 11344 of the Interstate Commerce
4 Act, the Commission shall approve the proposed merger of
5 Santa Fe and Southern Pacific if it finds the
6 transaction to be consistent with the public interest.
7 Under this provision and under well-settled principles
8 of law, the Commission's role is to perform a balancing
9 test, weighing the potential benefits of the transaction
10 against any harms.

11 Our comments this morning will focus on the
12 factors which the Commission must analyze in performing
13 this balancing test.

14 First, after emphasizing the highly adverse
15 financial circumstances which Applicants find themselves
16 in today, I will describe the significant benefits
17 projected to result from this merger, the most
18 significant of which is, I will hasten to say right at
19 the outset, the preservation of rail service over the
20 lines of Southern Pacific and Santa Fe, and thereby the
21 enhancement of transportation in western transportation
22 service markets.

23 Second, I will discuss the economic costs
24 which Protestants claim will arise from the transaction
25 in the form of harm to competition. As the Chairman

1 indicated, I propose to do this in approximately 30
2 minutes. Mr. Martin will then show how, when these
3 factors that I am going to discuss are considered
4 together, it becomes clear that the public benefits far
5 outweigh any potential harms or costs from this merger,
6 and finally he will address the massive conditions that
7 have been requested in this proceeding, conditions which
8 we maintain are designed not to cure anticompetitive
9 problems, but to enrich our competitors. And we would
10 hope that he would do that in about 25 minutes and we
11 might have 15 for rebuttal.

12 I wish first to discuss the major benefits and
13 costs of this merger focusing, as I said, on the weak
14 and ever worsening financial condition of Southern
15 Pacific and Santa Fe and the significance of those
16 conditions for this case.

17 In the course of these remarks, I would
18 propose to respond directly to your question 6-A and B
19 that appeared in the May 15 notice.

20 The primary benefit of this merger, simply
21 stated, will be the preservation of viable rail service
22 over the lines of Southern Pacific and Santa Fe.
23 Southern Pacific Transportation Company is quite
24 literally teetering on the brink of bankruptcy today.
25 In fact, without liquidation of hundreds of millions,

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literally hundreds of millions of dollars in its real estate and the cash infusion of funds from the Santa Fe Southern Pacific Holding Company, SPT would have been forced into bankruptcy long before now.

If you will look at Tab 1 to the exhibit that I mentioned we handed up this morning and Exhibit A, the first exhibit under Tab 1, you will clearly depicted the terrible downward slide on which SPT has been for the past decade.

For example, if you will look at just the first two columns on the left, operating revenues in constant dollars have declined 30 percent over the past decade as the railroad's traffic base has eroded significantly.

A real quick look, if you will, to Exhibit C and D, and these exhibits will all be under this Tab 1 that I am referring to. A quick look at Exhibit C and D here graphically depicts the long-term inexorable decline in SPT car loadings, amounting as you can see to nearly one million loads over the period from 1974 to 1985.

Have things gotten better recently, as Protestants and others sometimes suggest they have? Absolutely not. 1985 and the first quarter of 1986 were no better at all. In fact, last month Southern Pacific

1 had 8.2 percent fewer car loadings in the same month in
2 1985, and I think this statistic is remarkable. That
3 was the 18th consecutive month in which that critical
4 statistic declined. In other words, for 18 consecutive
5 months, the Southern Pacific has had fewer car loadings
6 than in the same month of the year prior.

7 Exhibit D which is the next one, graphically
8 depicts the long-term decline in SPT's freight revenues
9 in constant 1974 dollars.

10 Now, if you would look back at Exhibit A
11 again, you will see that income from operations, which
12 is shown in the third and fourth columns, both in actual
13 and constant dollars, has also declined precipitously.
14 For the past four years, if you just look at the bottom
15 years there, operating income has been negative and the
16 railroad's operating ratio has soared well over 100.

17 MR. KHARASCH: Counsel have not been provided
18 copies of this exhibit the Commission is now looking at,
19 Madam Chairman. It is the first time in oral argument
20 this has happened.

21 I am sorry to interrupt. We cannot follow
22 because we do not have the paper in front of us.

23 CHAIRMAN GRADISON: Excuse me. There is a box
24 on the side. Mr. Moates, you may continue with your
25 presentation.

1 MR. MOATES: I certainly wouldn't want
2 Mr. Kharasch not to follow so I am glad he has the
3 volume. If you could turn back to Exhibit A, you will
4 see that the SPT's rate of return which is shown in the
5 third column from the right, has been negative since
6 1982. Its operation does not generate sufficient cash
7 to --

8 CHAIRMAN GRADISON: Mr. Moates, why don't we
9 pause and see that these are distributed? I apologize.
10 We will add the time back to your allotted time.

11 MR. MOATES: Thank you, Madam Chairman.

12 Chairman Gradison, it is clear that the
13 exhibits included here are all matters that are already
14 in the record or updates of matters that are in the
15 record.

16 (Pause.)

17 CHAIRMAN GRADISON: Mr. Secretary, will you
18 add three minutes onto the clock and with that we will
19 resume the presentation, please. Sorry for the
20 interruption.

21 MR. MOATES: Thank you very much.

22 You will recall I was still looking at Exhibit
23 A to our Tab 1 and focusing on the rate of return column
24 and pointing out that for the past four years Southern
25 Pacific's rate of return has been negative. Its

1 operations have not generated sufficient cash for the
2 railroad to cover its fixed charges, a very fundamental
3 measure of financial well-being in the industry.

4 Its margin of safety, which is the percentage
5 of the net income before federal income taxes to its
6 gross income, has shrunk from 6.24 percent in 1977 to a
7 negative 2.43 in 1985.

8 While we submit that Southern Pacific's self
9 cannibalization of its real estate and a
10 cross-subsidization from Santa Fe Southern Pacific
11 cannot go on much longer -- in fact, just as an aside,
12 the best, most salable real estate properties of
13 Southern Pacific have already been disposed of. In
14 other words, they are getting down to the less
15 attractive, less salable properties.

16 Without this merger, the end is very near for
17 SPT. The first quarter of this year, it incurred a loss
18 of \$59.7 million.

19 With this merger, approximately 20,000
20 shippers whose only rail service is via SPT can expect
21 to continue receiving viable long-term service from
22 SPSF, the merged railroad.

23 To answer directly your question 6-A, if the
24 merger is denied, SPT as that railroad exists today will
25 not long survive. Now, it is speculate, as the

1 Department of Justice has done, about other possible
2 buyers for SPT. The plain fact is that no one else has
3 expressed an interest in buying this railroad, either
4 before SFSP's acquisition or since.

5 The only party during the two years of this
6 hotly contested litigation which has even suggested the
7 possibility of acquisition is the Denver Rio Grande, but
8 it proposes only to buy a piece of the railroad, of the
9 system, and only at a completely unfair bargain basement
10 price.

11 The Department of Justice's attitude, which I
12 am afraid I can characterize as nothing short of
13 cavalier, scarcely comforts us or our customers either.
14 DOJ reassuredly told us and told you, the Commission,
15 more than six months ago, that in their view, SPT ought
16 to be able to avoid liquidation for at least a year.
17 Well, isn't that a ringing endorsement?

18 And while they blithely asserted that some
19 hypothetical white knight might come riding to SPT's
20 rescue, that just has not happened.

21 Now, depressingly, I have to report that
22 Santa Fe is not in good financial condition either and I
23 realize that this is somewhat perhaps inconsistent with
24 all of our preunderstandings of what kind of a railroad
25 the Santa Fe is. It is a well-run railroad, but it has

1 unfortunately suffered from many of the same financial
2 problems that have afflicted the Southern Pacific.

3 If I could direct your attention briefly to
4 our Exhibit F in this tab, I will not walk you through
5 each of the columns again; I would simply point out to
6 you that while the Santa Fe's statistics are clearly
7 somewhat stronger than those of the Southern Pacific and
8 it is still able, albeit barely, to cover its fixed
9 charges, it too has experienced the same long-term
10 decline in financial viability.

11 Exhibit H, attached, is a graph again that
12 will show you how the operating ratio of Santa Fe has
13 steadily increased over a long period of time, 20
14 years. Exhibit I is an interesting exhibit that shows
15 you Santa Fe's steadily worsening cash position. As far
16 as cash, I would just make one point.

17 For the past five years, Santa Fe's operating
18 income has fallen more than \$600 million short of the
19 capital expenditures made on the railroad. And yes,
20 Santa Fe has been forced to curtail capital spending.

21 As its president, Mr Schwartz, testified in
22 this case, by the end of 1984 capital projects beyond
23 those necessary to continuing rail operations were in
24 jeopardy.

25 Obviously the question we have to ask is why.

1 What has caused these declines and these losses?

2 Fundamentally, both of these railroads and especially
3 Southern Pacific Transportation Company, have serious
4 structural problems. They operate over very difficult
5 operating territory. Southern Pacific in particular has
6 an extensive branch line network in the far west, in
7 California.

8 They both have extensive operations in the
9 southern corridor, which you will hear referred to a lot
10 today. That is basically the corridor from Southern
11 California to the Texas Coast. And in that corridor
12 there is insufficient traffic to sustain profitably two
13 major rail competitors.

14 And they don't -- and this is especially true
15 of Southern Pacific -- they don't enjoy the heavy
16 participation in coal and grain which many of their
17 competitors do and which affords those competitors the
18 opportunities to achieve efficiencies and line
19 densities.

20 In this regard, if you would for a moment look
21 at Exhibit E in our first tab, you will see there a
22 depiction of the amount of coal and grain hauled by
23 several major railroads, about seven as I recall, and
24 the percentage of their total traffic which these two
25 important commodities constitute and the significant

1 profitability and efficiency correlations between that
2 participation in coal and grain traffic and their
3 operating incomes and operating ratios. Look where
4 Southern Pacific is. It is about as distant -- seventh
5 -- as it could possibly be.

6 In sum, SPT today is a failing company by any
7 reasonable definition of that term. Santa Fe's
8 long-range financial outlook as a viable competitor is
9 also poor.

10 The Commission should recognize these
11 fundamental overriding facts in its consideration of our
12 application. Indeed, the extraordinarily serious and
13 adverse consequences both for the railroads themselves
14 and the shipping public which would result if this
15 merger could not be consummated and present rail
16 operations over the SPT system were discontinued, should
17 weigh very heavily, we submit, in your determination of
18 the public interest implications of this transaction.

19 Now, you asked us specifically in question
20 6-B: If denied, what would be the likely consequences
21 for rail competition in three corridors, three flows:
22 transcontinental flows across the southern and central
23 corridors; traffic moving north-south on the West Coast
24 of the United States; and traffic moving from the
25 Midwest to Gulf ports and to Mexico.

1 Again, I will point out to you that we have
2 provided you brief written responses at Tab 2, but I
3 would just like to summarize. Our answer here is
4 simple. As I said, if the merger is denied, in the
5 short run SPT is gone; in the long run, Santa Fe will be
6 gone and they are likely to withdraw as providers of
7 rail service.

8 What does this mean for the corridors? In the
9 southern corridor this could lead to the elimination of
10 significant competitive rail service. Simple enough.

11 In the central corridor, competitive rail
12 service would be diminished, leaving basically the Union
13 Pacific/Missouri Pacific system.

14 In all honesty, on the West Coast, due to the
15 pervasive nature of competition from motor and water
16 carriers in that area, although there would be
17 disruptions, painful disruptions, dislocations -- these
18 railroads employ tens of thousands of people, they have
19 tens of thousands of shippers they serve exclusively --
20 notwithstanding all that unhappiness, that pain, in the
21 long run in all honesty we believe that transportation
22 rates and service would not be harmed.

23 Similarly, with respect to traffic moving from
24 the Midwest to Gulf ports in Mexico, because of the
25 pervasive nature of intramodal/intermodal and source

1 competition after all these dislocations and disruptions
2 took place, we honestly believe that again there would
3 be little long run effect on rates and service.

4 This merger will result in other very
5 substantial public benefits as well. I have suggested,
6 I think as clearly as I think I can, that we think the
7 primary and overwhelming benefit of this merger will be
8 the salvation of Southern Pacific and the opportunity
9 afforded Santa Fe to stop its steady downward spiral
10 that we have seen in these exhibits, and for the SPSF
11 railroad to emerge as a viable and long-term rail
12 competitor in the west.

13 Just parenthetically, I would also ask the
14 Commission to recognize that these railroads serve a
15 very large number of important defense installations in
16 the west. To many of them they are the only railroad
17 serving them -- installations like Fort Ord, California
18 and Fort Hood, Texas, and a number of Air Force bases.

19 As summarized in Exhibit J of our presentation
20 under Tab 1, the financial benefits of this merger will
21 also be very substantial. It is the achievement of
22 these benefits not undermined by the imposition of
23 costly and unnecessary conditions which offer the merged
24 system the opportunity to reverse the traffic and
25 financial losses which these railroads have separately

1 incurred.

2 Let me emphasize if I may that this
3 information on Exhibit J is virtually uncontroverted
4 evidence no railroad parties took serious issue either
5 with the scope or the achievability of the savings that
6 we projected. In fact, one of the Union Pacific
7 witnesses testified that in his opinion the benefits
8 probably, if anything, had been understated.

9 What are the benefits? Two hundred and eight
10 seven million dollars in annual recurring benefits that
11 derive from motor and water carrier diversions, internal
12 rerouting of traffic via more efficient single system
13 routes, improved switching, equipment utilization, all
14 the things that you are familiar with from other merger
15 cases.

16 The point is that what you are not familiar
17 with are these numbers. These are the largest savings
18 in the history of this Commission for a rail merger. No
19 railroad has ever projected these kinds of savings.

20 In addition, we project total net avoided
21 capital expenditures of \$522.4 million, more than half a
22 billion dollars of avoided capital for two railroads,
23 one of which is on the verge of bankruptcy and the other
24 of which is headed in the same direction.

25 Savings of these magnitudes are unprecedented

1 and these railroads desperately need to achieve these
2 savings and they do not need to have those savings
3 undermined by costly conditions.

4 There will be numerous other public benefits
5 that we have detailed, of course, in our briefs. They
6 include new single system service to thousands of
7 shippers. This will be the first time, of course, that
8 the Santa Fe will reach many of the points in California
9 and the Southwest that it can reach with the Southern
10 Pacific. It will be the first time Santa Fe shippers
11 will reach such places as Memphis, St. Louis, and
12 New Orleans. It will be the first time Southern Pacific
13 shippers will have a direct single system route to
14 Chicago and to other important gateways.

15 We project and we plan to offer more frequent,
16 more reliable and more competitive train service. For
17 example, we propose 15 new TOFC and perishables trains,
18 14 new improved TOFC and perishables schedules, 36 new
19 manifest trains.

20 You have asked us a specific question, your
21 question No. 5 about service competition. You have
22 inquired to what degree the consolidation would
23 eliminate or reduce service competition and how
24 important is it?

25 Well, the merger will not eliminate service

1 competition. It will increase it. If the merger is
2 denied, it sure will reduce service competition and
3 other types of competition because the Southern Pacific
4 is going to go out of business.

5 I have noted many new service improvements. I
6 would like to note also there are no major abandonments
7 that have been proposed in association with this
8 merger.

9 The Southern Pacific/Burlington Northern
10 agency solicitation agreement about which you will hear
11 more from Mr. Martin also preserves service competition
12 for the very limited amount of traffic that arguably
13 might be adversely affected by the anticompetitive
14 effects of the transaction.

15 How important? The service competition to us
16 is very important because trucks are so fast and so
17 responsive and so reliable for shippers' needs that they
18 set the standard that we constantly strive to meet. We
19 have no choice but to be service-competitive.

20 This merger then will not reduce but will
21 instead strengthen competition in the affected markets.
22 If I may, let just summarize the thrust of the
23 Protestants' arguments as to the horizontal
24 competition.

25 They say first, for much if not most of all

1 the traffic that we carry, rail is the only practical
2 mode of transportation. It has to go by rail.

3 Second, the merger will eliminate most, if not
4 all, of this intramodal rail competition. It will all
5 be gone. Therefore, they conclude, the Commission
6 should either deny the merger or they should remedy
7 these fantastic harms that the Protestants claim will
8 exist based on this analysis by imposing their various
9 conditions with which you are familiar.

10 We submit these arguments fail for several
11 reasons. First of all, their premise that denial will
12 result in vigorous Southern Pacific Santa Fe competition
13 if the merger is turned down is demonstrably false.
14 There won't be any competition because there won't be
15 any Southern Pacific.

16 Therefore, absent this merger, there will be a
17 serious loss of competition now provided by these two
18 railroads in the west.

19 Another important defect, we believe, in their
20 argument is the focus on rail-only competition. In the
21 Union Pacific case, didn't you analyze rail-only
22 competition? Yes, you did.

23 All right. Why isn't the the appropriate
24 market for this case? I think the answer is pretty
25 straightforward. You decided that case based on a

1 record that was created in 1979. I certainly don't need
2 to tell you that in 1980 something happened to the motor
3 carrier industry with which you are very familiar; it
4 was deregulated.

5 Unlike the UP case, the record in this case is
6 replete with well-documented evidence that motor and
7 water carriers are extremely effective competitors for
8 the movement of virtually all commodities and for lengths
9 of haul of thousands of miles.

10 Since the Union Pacific case was decided,
11 motor carrier deregulation has seen trucks become much
12 more efficient, due in part to increased truck sizes and
13 weights. They have lowered their costs. You are
14 familiar with the lower fuel costs that all
15 transportation companies have benefited from in the
16 recent months and trucks benefit from that more than
17 railroads; and the overall trend towards containerized
18 freight which shippers support. It gives them better
19 inventory control, better control over their products.
20 It has been a boon to truck lines as well.

21 Exhibit K to our attachment demonstrates, just
22 as an example, the significantly increased modal shares
23 for trucks in several important corridors for this case
24 just from 1979 when the UP merger was decided to 1982,
25 four years ago. Not dragging you through the whole

1 exhibit, but if you just look, for example, at the entry
2 for Memphis, for the Pacific Northwest, the Bay Area,
3 and Southern California as an example, you will see a
4 tremendous and striking increase in motor carrier
5 penetration.

6 Now, let me hasten to add before one of my
7 esteemed colleagues points out, the geographic areas for
8 1979 and 1982 are not perfect matches. Boston is not
9 the Northeast. Memphis really isn't Memphis. One is a
10 BEA; one is a geographic area a little smaller than
11 that. But I think the point is still very obvious.
12 Without nitpicking about how the areas are put together,
13 the impact of what has happened is very apparent.

14 The next exhibit, Exhibit L, which I certainly
15 will not take you through in detail, but if you'll turn
16 the page and look at it, you will see that it depicts
17 1982 traffic flows for Southern Pacific, for Santa Fe,
18 for motor and water carriers, and for a variety of
19 important corridors to this case.

20 When you have a moment, we would ask that you
21 peruse some of these figures, but I would just say that
22 it demonstrates that even though based on a simplistic
23 glance at a map, which is one of our opponent's favorite
24 techniques, you might expect SPSF, the merged railroad,
25 to dominate a particular flow.

1 Let's take, for example, the Bay Area through
2 the Gulf Coast. Everybody knows Southern Pacific and
3 Santa Fe are major factors in that market. What do we
4 see when we look at the exhibit?
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1 We see that they have less than half of the
2 traffic in that flow, and this is 1982, and I submit
3 that over the last four years trucks have not become
4 less effective competitors.

5 This Commission has itself acknowledged on a number
6 of occasions that pre-1980 statistics substantially
7 understate the significance of motor carrier
8 competition. I won't cite you chapter and verse here,
9 but I will remind you what you said about this in your
10 boxcar deregulation decision and the decision in which
11 you approved Guilford's control of the Delaware and
12 Hudson and such merger cases as Norfolk Southern and
13 Cotton Belt's acquisition of the Tucumcari line.

14 Okay. Cutting through all this, how much
15 traffic do you really need to be concerned about? What
16 really is the problem here? Well, the Department of
17 Transportation and for that matter the Department of
18 Justice, all of its opposition notwithstanding,
19 identified only a relatively small amount of traffic
20 that would be potentially adversely affected by the
21 merger. DOT says it's 5.9 million tons; DOJ says it's
22 6.2 million tons. Even DOJ's number, which I submit is
23 demonstrably wrong in many, many respects, would be 3.5
24 percent or less of the merged railroad's traffic base.

25 Now I ask you, does it make sense to submit

1 the kind of relief that Protestants like the Union
2 Pacific and the Rio Grande are asking conditions which
3 would actually cause the merger not to be consummated to
4 deal with, at most, 3.5 percent of the traffic? Well,
5 the answer is clearly no and the answer is in addition,
6 it's not 3.5; it's a lot less than that.

7 Let me just mention a few of the ways that the
8 Department of Justice has vastly misidentified and
9 overstated traffic that is supposedly a problem. The
10 Department has told you in its brief that it has
11 identified real, direct and nonspeculative problems.
12 But what are these? Twenty-five percent of their
13 problems are grain. I think you are very familiar from
14 the Soo Milwaukee/Chicago and North Western case which
15 this Commission has concluded about the competitive
16 nature of grain markets, railroads don't control the
17 pricing of grain or rates on grain. The source
18 competition controls that.

19 They say that we are going to dominate 400,000
20 tons of corn syrup from various Midwest origins to the
21 West Coast. When you look at their flows, Santa Fe and
22 Southern Pacific don't serve a single one of the origins
23 that they say will be a problem. We are going to depend
24 on other railroads to give us the traffic.

25 They say that wine from the Bay Area to

1 Chicago, wine transportation -- a serious, direct real
2 competitive problem -- Union Pacific has a direct
3 competing single line route. Trucks carry wine in
4 refrigerated trailers.

5 And one of my favorites, frankly, they
6 identified initially petroleum coke moving from
7 Portland, Oregon to Los Angeles as a terrible problem.
8 We pointed out in our evidence, it was not controverted,
9 that the railroads have lost all that traffic. I wish
10 we had it; we lost it. It went to other railroads, it
11 went to trucks, and in one case the plant closed; we
12 don't have a ton of that today. Yet DOJ includes that
13 in their summation of real, direct and nonspeculated
14 problems.

15 I submit to you that a review of Appendix C to
16 our reply brief which addresses in detail the DOJ
17 tonnage would be revealing.

18 Much of the overlap identified by all of the
19 parties in this case is in the southern corridor. But
20 I'd like to emphasize a few things about the southern
21 corridor. The record reveals that approximately 73
22 percent of all the freight units handled by Southern
23 Pacific and Santa Fe in that corridor is deregulated
24 TOFC/CCFC traffic. When you include deregulated boxcar
25 traffic and deregulated perishables traffic, the moves

1 in refrigerator cars, the percentage of our traffic in
2 the southern corridor that is not deregulated is very,
3 very small.

4 And in addition there are a multiplicity of
5 competitive alternatives for that traffic that does
6 remain. And by the way, about 70 percent of the
7 diversions that the Union Pacific projects that it would
8 get if it got its trackage rights are TOFC/COFC.

9 Not only does our evidence show that truck and
10 water carrier alternatives for the vast preponderance of
11 this traffic are real and viable, but again the BM
12 agency solicitation agreement deals with just this
13 traffic. That's what it's all about; it deals with 4.5
14 million tons of traffic, identified by using screens
15 that the Department of Transportation introduced in this
16 case, traffic across the southern corridor.

17 I will touch briefly on the central corridor
18 and simply say that the potential adverse effects there
19 are really minimal. They are vertical in nature; they
20 are not horizontal, and the Commission has consistently
21 recognized the efficiencies of the central corridor for
22 much transcontinental traffic. I think Mr. Martin may
23 have more to say about the Rio Grande momentarily.

24 I suggest that the potential adverse effects
25 for north-south traffic in California are minimal; you

1 are going to hear from our friends from California
2 today. And I would like you to keep this in mind when
3 they are talking. Of all the traffic moving north-south
4 in California today, motor carriers have 70 percent,
5 water carriers have 20 percent, Southern Pacific has
6 5 percent, and Santa Fe has one 1 percent. Other
7 railroads have the rest. So what we are talking about
8 is putting together our 5 and our 1 to have 6 percent of
9 the market.

10 In addition, the Union Pacific and BN/UP joint
11 routings exist on the West Coast for traffic coming from
12 Washington and Oregon to Southern California.

13 What is the conclusion? The Applicants and
14 the shipping public desperately need this merger. We
15 need the merger and the important benefits that it will
16 generate in order to survive -- just to survive -- and
17 to continue offering viable, competitive rail service
18 over the lines of Southern Pacific and Santa Fe.

19 The shipping public, I submit, needs this
20 merger for the same reason: preservation of viable,
21 competitive rail service in many areas of the West. The
22 benefits of the merger will be extensive. They include,
23 in addition to the critical salvation of the Applicants
24 themselves, hundreds of millions of dollars in savings
25 which, if not undermined by costly and unnecessary

1 conditions, will provide a tremendous assist to the
2 Southern Pacific Santa Fe Railroad -- the new
3 railroad -- in its struggle to offer efficient,
4 competitive rail service.

5 The possible anti-competitive effects are
6 truly minimal; they have been vastly overstated by our
7 competitors who seek to capitalize on this transaction
8 by asking the Commission to impose extensive conditions
9 at subsidized prices for their benefit. And the
10 Applicants having entered into the BN agency
11 solicitation agreement as well as our joint route and
12 rate policy where we have committed to maintain
13 efficient joint routes and rates with other carriers
14 ensures that any minimal potential adverse effects will
15 be dealt with fairly and effectively.

16 Mr. Martin will now address the balancing of
17 these transactions, costs and benefits and the request
18 for conditions. And I would ask that the remainder of
19 my time be saved for his rebuttal.

20 COMMISSIONER STERRETT: Excuse me, Mr.
21 Moates. Before you sit down, let me ask you a question
22 or two. Let me get back to your "overriding" fact that
23 the SP will fail if this merger is not approved.

24 Was it your opinion, at the time you filed the
25 merger application, that the SP was a failing company?

1 MR. MOATES: It was our opponent's opinion at
2 the time that the holding companies had put together
3 that the SP might be a failing company, and they argued
4 that you shouldn't allow the holding companies to go
5 together for that reason.

6 We demonstrated and our executive officers
7 testified that the Southern Pacific had enough resources
8 chiefly in the nature of the land that I have mentioned
9 to survive for the period of the voting trust. It's
10 done that, but just barely. In all honesty, it's been a
11 lot worse than we expected. This is not the case that
12 we thought we had when we filed it in 1984. Both of
13 these railroads have deteriorated much more rapidly than
14 we ever projected.

15 I know Mr. Schmidt, the Chairman of the
16 Santa Fe Southern Pacific, is terribly concerned about
17 this. And so for that reason, among others, we need
18 this merger and we need it soon because if we have to
19 wait many more months for the Commission to make a
20 decision and drag through the courts, we are all very
21 concerned about whether Southern Pacific's going to be --

22 COMMISSIONER STERRETT: Is it possible the SP
23 needs another merger and not this particular one?

24 MR. MOATES: No, sir. With all respect, I
25 submit it does not. I submit it needs this very merger

1 because it is only this merger that will give it the
2 kinds of benefits and permit the restructuring that I
3 talked about that is absolutely necessary; it goes with
4 the fundamental structure or weaknesses of the Southern
5 Pacific system.

6 Putting it together with somebody else --
7 first of all, there isn't somebody else; I've mentioned
8 that. It's been no secret in this industry that the
9 Southern Pacific has been for sale for a long time.
10 Nobody wanted to bite. Mr. Biaggini, the former
11 Chairman, talked to the Burlington about it long before
12 this merger was ever agreed to; they weren't
13 interested. Others have known that the Southern Pacific
14 has been in trust and that it's been in trouble for some
15 time. They haven't approached Mr. Schmidt, the only
16 exception being the Rio Grande, in the very narrow way
17 that I mentioned.

18 No. I submit that they need this merger and
19 they need it now.

20 COMMISSIONER STERRETT: In the event the
21 Commission does not approve this merger, what are your
22 plans for divestiture?

23 MR. MOATES: I don't have any personal plans.
24 But I think the Chairman has indicated that in the event
25 the merger is denied, you will have to quickly make a

1 determination of whether to dispose of the Santa Fe, the
2 Southern Pacific, or both. There is an exhibit in this
3 case the Protestants have made much of which was a
4 report to the Santa Fe Industries Board of Directors at
5 the time they were considering whether to approve the
6 merger with the Southern Pacific Company, and they have
7 had a little fun with a few phrases here and there taken
8 out of context.

9 But I would refer you to in that Exhibit 4 is
10 that it was a searching analysis at that time of whether
11 Santa Fe ought to be remain in the railroad business,
12 not whether it ought to do that merger, but should we
13 get out. Are we getting the return on our capital that
14 justifies continued investment to our stockholders? It
15 was a real close call.

16 Now if this merger is denied and they can't
17 achieve the kind of benefits that we project, I am not
18 sure what he'll do. I'm not sure Mr. Schmidt knows. I
19 think that if the merger is approved with the minimal
20 kinds of conditions that we've agreed to, he will
21 recommend it to his board. I am confident we will go
22 forward. If you disapprove it, probably the Southern
23 Pacific will go into bankruptcy, probably there will be
24 massive disruptions I talked about, probably major
25 portions of it will be liquidated, lots of shippers will

1 lose service.

2 Will an economist say ten years from now that
3 that was all for the better? Maybe. I don't know. I
4 don't know about you. I'm not willing to take that
5 chance. I think the Commission doesn't have to take
6 that chance; the Commission's responsibility, among
7 other things, is to see that there is an efficient
8 viable rail network maintained in this country. And I
9 think this merger will lead to that.

10 COMMISSIONER STERRETT: So you have no plans
11 for divestiture at this point?

12 MR. MOATES: I cannot tell you for a fact that
13 he does.

14 VICE CHAIRMAN SIMMONS: Before you leave, you
15 painted a kind of bleak picture for the Scuthern Pacific
16 and not too rosy picture for the Santa Fe. I mean, are
17 two weak sisters going to be able to survive together?

18 MR. MOATES: Commissioner Simmons, that's a
19 very good question. I've asked that question myself.
20 I'll tell you very honestly there are no guarantees.
21 This isn't Penn Central; we know that.

22 VICE CHAIRMAN SIMMONS: Are you getting cold
23 feet, too?

24 MR. MOATES: No, sir. No. What I want to
25 emphasize is that even with these unprecedented savings,

1 there are no guarantees. We are going to be definitely
2 the third railroad in the West; the Burlington and the
3 Union Pacific are far ahead in every category you can
4 think of, in terms of profitability, in terms of the
5 markets they serve. I think we will be viable; I think
6 we can make it, but it's going to be a real tough row to
7 hoe.

8 VICE CHAIRMAN SIMMONS: I am a little
9 concerned about the internal reroutes here that you are
10 going to save \$57 million on. I am more concerned about
11 the nonoperating and miscellaneous, where you're going
12 to save \$67 million. Could you enlarge upon that a
13 little?

14 CHAIRMAN GRADISON: Excuse me, Mr. Simmons.
15 Mr. Moates' time has expired. If you'd like to address
16 this question during Mr. Martin's time, you are welcome
17 to -- or Mr. Martin, if you would like to address the
18 question during your time.

19 MR. MOATES: I'll try in 30 seconds, as best I
20 can. The internal reroutes and the savings that you
21 referred to that are of a nonoperating nature are
22 exactly the kinds of savings you can get out of a
23 parallel merger but you couldn't get out of some other
24 kind of conceivable, but not before this Commission or
25 us, end-to-end merger. They include such things,

1 Commissioner Simmons, simply as eliminating duplicative
2 tie treatment plants, duplicative rail -- welded rail
3 plants, duplicative locomotive shops. The internal
4 reroutes are possible for a lot of the reasons that our
5 competitors say we have a problem. We have lots of
6 lines that intersect and parallel in some areas and
7 there are many more efficient ways to route the traffic
8 over those lines.

9 VICE CHAIRMAN SIMMONS: I hope that doesn't
10 indicate more abandonments.

11 MR. MOATES: No, sir, it doesn't. As I
12 suggested, there are minimal abandonments.

13 CHAIRMAN GRADISON: Thank you, Mr. Moates.

14 Mr. Martin, you have 25 minutes.

15 MR. MARTIN: Thank you, and with that, I will
16 be holding 15, with your Honor's permission.

17 I would just like to start out by briefly
18 addressing two of the questions that were asked of Mr.
19 Moates which he already answered. But I want to point
20 up the significance of his answer.

21 First, with respect to what our witnesses said
22 during the holding company merger. Our witnesses said
23 that the Southern Pacific will be able to make it
24 through the period of the voting trust; they were
25 right. But they never said that they would make it

1 indefinitely into the future. And we have barely made
2 it through the voting trust period.

3 And the real question that is before this
4 Commission is what happens afterwards, what happens in
5 the future. We've made it up to here and the question
6 is what happens now.

7 With respect to another merger as a possible
8 cure here, I think that is an important question that
9 the Commission must be considering. And the essential
10 answer is that there is no other merger on the horizon;
11 nobody has come forward. There is no alternative that's
12 been presented that would solve the systematic problem
13 with respect to the SPT. The only merger that offers a
14 possibility and the probability of savings in the
15 magnitude that would make this railroad an efficient,
16 viable, long-run competitor is this merger. No other
17 merger that you can think about -- no other possible
18 end-to-end merger offers the opportunity for the
19 economies and the efficiencies that this one does. I
20 think that's critical.

21 COMMISSIONER ANDRE: Let me interrupt on that
22 point. Wasn't some of the rationale underpinning the
23 Staggers Act the idea that the nation would eventually
24 end up with transcontinental railroads? What is
25 happening to that whole idea? We're not hearing

1 anything about it.

2 MR. MARTIN: That's not presented in this
3 case. This case certainly doesn't foreclose the
4 likelihood that in the future there will be future
5 mergers. I think what this case does, if the Commission
6 approves this merger, is assure, insofar as anybody can
7 assure, that there will be a live, viable, healthy
8 competitive railroad in the southern corridor that will
9 be available for a future transcontinental merger. But
10 this case doesn't raise or foreclose questions about how
11 those fits might work out.

12 CHAIRMAN GRADISON: Why can't these two
13 carriers realize the projected benefits by cooperation
14 without a merger?

15 MR. MARTIN: That's a question that's been
16 raised in virtually every railroad merger including the
17 last one that I was up before your Honor on, CSX/ACL,
18 and that the uniform testimony of economists and
19 railroad witnesses is that while theoretically some of
20 the efficiency gains might be achieved through contracts
21 as a practical matter, the variety of relationships when
22 you have independent parties is so enormous that to try
23 to govern those through a contract which would then have
24 to be implemented and policed would simply be
25 impossible.

1 The only way as a practical matter to get
2 these efficiencies is to have unified administration and
3 unified management. The Commission has held that in
4 numerous merger cases, most recently CSX/ACL, and
5 they're right.

6 I would like to do this with my argument
7 time. Mr. Moates has talked about the principal
8 benefits of the merger and he's talked about the costs
9 in the form of asserted injuries to competition. What I
10 would like to do, in the first part of my argument, is
11 address the question of how the Commission ought to
12 weigh these benefits and costs in assessing the
13 principal application; that is, the principal merger of
14 SP and Santa Fe.

15 In second part I would like to address the
16 question of whether conditions, such as trackage rights,
17 are necessary or appropriate to mitigate any adverse
18 competitive effects, assuming you think there are some.
19 In the course of this, I will compare the conditions
20 that have been sought by responsive applicants with the
21 Agency Solicitation Agreement, the BN and the Santa Fe
22 and SP have worked out and ask you to consider which of
23 those best meets the conditions that this Commission has
24 established in considering proposed conditions and
25 trackage rights.

1 In doing that, I will touch on several of the
2 questions that you identified in your May 15 order. I
3 would like to start, with respect to the cost/benefit
4 analysis, by a point of historical perspective. The
5 Commission's general policy statement on mergers, which
6 you came out with in 1981, sets forth the Commission's
7 policy which is, "to encourage private industry
8 initiatives that lead to rationalization of the nation's
9 rail facilities and reduction of its excess capacity."

10 And my point is that this is not a new
11 policy. Congress recognized over 60 years ago that
12 consolidation of the private railroads in this country
13 is essential to bring efficiency, long-term viability of
14 the rail system. In the Transportation Act of 1920,
15 Congress directed the Commission to develop an
16 affirmative nationwide plan for consolidation of railway
17 properties into a limited number of systems in order to
18 accomplish efficiency.

19 The Transportation Act of 1940 relieved the
20 Commission of the duty to promulgate a national plan,
21 but the principal purpose of the 1940 act was to,
22 "facilitate merger and consolidation in the national
23 transportation system." And that goal was continued in
24 the 4-R Act of 1976 when Congress expedited the
25 procedures to encourage efforts to restructure the

1 railroad system, and it was preserved in the 1980 Act.

2 This policy of encouraging restructuring of
3 the rail system to encourage greater efficiency has been
4 applied in recent years, as you know, in both the East
5 and the West. In the West, it's led to the creation of
6 two great efficient systems: one in the northern
7 corridor, the merger of the two principal northern lines
8 in the Burlington Northern; and in the central corridor,
9 with the merger of UP, MoPac, and Western Pacific.

10 COMMISSIONER ANDRE: But despite what you're
11 saying, isn't it true that in '79 or '80 the ICC's Rail
12 Service's Planning Office, when feelers were out as to
13 the possibility of a parallel merger such as this, that
14 you were informed by them to forget it and go back home?

15 MR. MARTIN: I remember your dissent in which
16 you criticized him for it and thought that that was
17 wrong. And you were right. You were raising the
18 question, as I recall, of whether or not there was an
19 improper prejudice in that report against parallel
20 mergers in relationship to end-to-end mergers.

21 I think you were raising the question of
22 whether or not there would not be efficiencies also to
23 be gained in parallel mergers. And that's exactly the
24 point of this case. And that's the central thrust of
25 our argument.

1 This case presents an opportunity to achieve
2 the same goals of system rationalization and promotion
3 of efficiency in the southern corridor that have already
4 been achieved in the northern and central corridor.

5 When applying this cost benefit analysis,
6 which is the way you've traditionally come at it, in
7 this case you have to be clear on what is a public
8 benefit; what is a public cost. That's critical.

9 On the benefits side, Mr. Moates has pointed
10 out that the Applicants estimate that they will receive
11 \$287 million in annual benefits from the savings; on top
12 of that, over \$500 million in avoided capital costs.

13 Some of the Protestants argue that all of
14 these are not, "public benefits;" some of them are
15 private benefits. The evidence makes clear that at
16 least \$244 million of these annual benefits will be
17 public benefits; this is all laid out in Mr. Champion's
18 testimony, and there is no essential controversy of that
19 \$244 million number as a public benefit. We can argue
20 that the whole thing is a public benefit. But at least
21 that much is a public benefit.

22 The principal result of these savings
23 Mr. Moates has described, the main one is saving the
24 service over the SPT; but there's lots of others:
25 efficient, single system service, speed and reliability,

1 equipment supply, pricing. These efficiencies will be
2 felt in a variety of ways and they are clearly of public
3 benefit.

4 What about the cost side? There have been two
5 different kinds of costs asserted: One, where the
6 railroads are parallel, the allegation is that there
7 will be adverse effects on competition; essentially the
8 argument is if you get rid of one competitor, you
9 increase the likelihood of some sort of collusive
10 pricing, greater market power, higher prices for
11 service. That's the argument with respect to the
12 parallel.

13 With respect to the end-to-end where the
14 railroads do not today compete, the claim is that SPSF
15 would close the efficient routes -- cancel the routes,
16 cancel the rates, promote its own less efficient service
17 over a less efficient route simply because it's longer.
18 That's the essential argument where it's vertical. I
19 would like to take the first one first.

20 Mr. Moates has described the horizontal claims,
21 and they are predicated on the notion, basically, the
22 trucks are not in the same transport market with
23 railroads. I am not going to repeat the arguments as to
24 why that's wrong, but I do think it's essential for the
25 Commission to keep in mind two points:

1 First, even if DOJ -- even if DOJ and other
2 adversaries were correct about the definition of the
3 market, they have only identified a relatively small
4 amount of potentially affected traffic; we say it's
5 maybe 1 to 2.2 percent of our total. DOT says it's
6 maybe 2.7 percent of the total. DOJ identified 3.3
7 percent of the total. Even if DOJ were right about
8 that, it identified less than 3-1/2 percent of our total
9 traffic. And if you concluded that DOJ were right, that
10 rate increases on that traffic represented cost to the
11 public, if you concluded that, then you still get a
12 benefit to cost ratio in favor of this merger in the
13 range of 30 to 1 -- 30 to 1; that's all laid out. And
14 that's even if we're wrong about the trucks and we're
15 wrong about the market definition.

16 Now, second, this comparison vastly overstates
17 the public costs of this merger, in part because it
18 extends to tonnage that won't, in fact, be adversely
19 affected and also because it assumes that any rate
20 increase is a bad thing. It's a public cost and, thus,
21 anticompetitive. That's the assumption that it's
22 predicated on. And that simply isn't so.

23 This Commission knows better than anybody
24 about the basic facts of economic life in the railroad
25 business. It knows that because of economies of scope,

1 scale and density, marginal costs are below average
2 costs; it knows that if you priced all your traffic at
3 or near marginal cost, you'd go broke. It knows you
4 have to differentially price; it knows better than
5 anybody that you cannot be a long-term, viable
6 competitor unless you recover all of your costs,
7 including your capital costs in differential pricing.
8 That's an essential basic economic fact of life in the
9 railroad business.

10 Now that is not to say that the railroads
11 might not charge too much. It is conceivable that
12 railroads would charge too much, that they would recover
13 more than their costs. It is also conceivable that they
14 would charge too little and not recover their costs and
15 not be viable long-term competitors.

16 My point -- and this is the essential point --
17 is that cost recovery is the standard of what's
18 competitive. The particular rate increase may be bad if
19 it results in your recovering more than your cost. But a
20 rate increase may be good if it enables you to recover
21 all your costs, attract capital, stay in business and be
22 a viable, long term competitor.

23 In the latter case, rate increases would
24 promote competition, not be anticompetitive. And the
25 irony is that every railroad in this room agrees with

1 these principles. They not only agree; they argue them
2 in their own rate cases. And some of them even use the
3 same economist, Professor Baumel, that we used in this
4 case.

5 Now what they do say here is they don't
6 disagree with the principles. They say, this is a
7 different case; this is a merger case, not a rate case,
8 and those principles only apply where a railroad is
9 market dominant. That's that's essential argument.

10 But the point that they overlook -- and I
11 think this is crucial -- is that these economic
12 principles embody the competitive model; they are
13 principles of contestability. They are principles which
14 this Commission has decided to apply in rate cases in
15 order to achieve a competitive result, in order to
16 emulate the competitive process. They are
17 procompetitive principles. That is the key point.

18 CHAIRMAN GRADISON: Mr. Martin, in your
19 initial brief on page 97, you argued that prompt
20 approval of the merger was critical to the maintenance
21 of effective service transportation competition in the
22 Western United States.

23 The reason I bring this up at this time is
24 it's related to competition, not pricing, but the actual
25 existence of competition. You also said that almost all

1 the traffic that the applicants transport need not have
2 rail competition because trucks or water are adequate
3 substitutes.

4 Can you provide a consistency to that for me?

5 MR. MARTIN: Yes. Our justification for this
6 merger is not that our rates are going to go up. We
7 don't believe they will. We believe that the essential
8 justification for this merger is efficiencies, cost
9 reductions, making us more viable competitors because of
10 better service and because of lower costs that come with
11 the efficiencies and the savings. That's the essential
12 justification. We don't believe that there is going to
13 be enhanced market power; we don't believe that there
14 are going to be rate increases.

15 My only point in answering in the prior
16 discussion is that if there were some rates which went
17 up to some degree, that wouldn't necessarily be a bad
18 thing. And that's a point which our opponents simply
19 assume. They assume it would be a bad thing when, in
20 fact, it wouldn't be. But that's not the justification
21 for the merger. The justification is efficiencies in
22 cost savings.

23 My only point is that if some rates were to go
24 up to some degree -- and this is wholly apart from the
25 BN solicitation agreement which will assure that they

1 won't go up to an undue degree -- but if they were to go
2 up, it wouldn't be a bad thing; it wouldn't be a cost.

3 Now I'd like to move to the second main topic,
4 which is whether conditions are necessary to mitigate
5 any adverse competitive impacts and, if so, what kind of
6 conditions.

7 This Commission has made it clear in the past
8 that it only prescribes conditions in a merger case,
9 where there would be anticompetitive consequences
10 without them, where they are operationally feasible,
11 where the conditions mitigate harm caused by the merger,
12 not some circumstances extraneous to the merger; and
13 where the conditions would result in a greater benefit
14 than the costs to the public. I think it is important
15 to keep in mind in this case that in applying these
16 standards, the Commission here has a choice.

17 The Applicants were aware that the Commission
18 in the past has preferred the parties themselves to come
19 forward with voluntary solutions to problems --
20 potential problems; in this case they did that.

21 They came forth with solutions in two forms:
22 first, with respect to the vertical problem, the
23 vertical foreclosure problem, the problem that the DERC
24 and the MKT raised.

25 There we put in the record our joint route and

1 rate policy, which is a commitment to maintain efficient
2 through routes and service by existing gateways; a
3 commitment to our shippers, to the public, and to this
4 Commission. It was supplemented by a rail service
5 condition, to provide interline rail service equal to
6 that by SPSF on its single line routes of equal traffic
7 volume.

8 These commitments fully deal with any vertical
9 concerns of railroads in an end-to-end relationship
10 with SPSF, and this would include not only D&RG and Katy
11 but TexMex.

12 With respect to the market power claims, the
13 horizontal claims, we also came forward with a voluntary
14 solution which we hope you will approve. As you know,
15 we recently entered into an agency solicitation
16 agreement with Burlington Northern which deals with
17 horizontal problems. It creates a new competitive
18 constraint on SPSF pricing. It would apply to the 4-1/2
19 tons, approximately, that have been identified using the
20 DOT methodology, slightly revised.

21 Under that agreement SPSF will haul freight
22 from BN at the higher of existing rates on the date of
23 the merger for 150 percent of our variable cost. Under
24 this agreement, SPSF could not take any undue advantage
25 of any market power that it might gain through this

1 merger -- could not. If a rate increased to a level
2 over 150 percent of variable costs, we would immediately
3 face competition with respect to this issue, traffic
4 from the Burlington Northern.

5 The condition is precisely tailored to
6 mitigate the specific problem that's alleged to have
7 been caused and it would not operationally interfere
8 with SPSF achieving the operating efficiencies of the
9 merger.

10 Now what are the alternatives? Let's take the
11 D&RG first because that is a vertical situation, an
12 example of an end-to-end relationship. They are worried
13 about us closing routes, encouraging our traffic to move
14 via our long haul. They are not really raising
15 horizontal effects of the merger.

16 It is worth noting on that point that the
17 Santa Fe doesn't even operate in the areas of Northern
18 California and Oregon where D&RG is seeking trackage
19 rights. To the extent that the D&RG is concerned
20 because SPSF's southern corridor will become more
21 efficient because of this merger and it will, to the
22 extent that they fear that because of that greater
23 efficiency, some traffic that used to move over the
24 central corridor will now move over the southern
25 corridor, then what it is really complaining about is a

1 procompetitive consequence of this merger.

2 Now to the extent that it fears that we would close
3 or discourage use of the central corridor where that
4 corridor is the more efficient, there isn't any basis
5 for its concern at all. Our incentives are to use the
6 more efficient central corridor which our witnesses have
7 explained in detail, both from an economic theory
8 standpoint and from a company policy standpoint. The
9 key point here, I think, is that there is already an
10 SP/D&ERG solicitation agreement.

11 If SP had an incentive to haul traffic all the way
12 around the southern corridor where it's inefficient to
13 do so, why do they have a solicitation agreement today
14 with the SP/D&ERG that assures that traffic today is
15 handled efficiently over the central route, in fact
16 moves that way.

17 There just aren't any incentives of the kind
18 that they predicate their case on.

19 At this point, I might say that in answer to your
20 question 2-E which deals with this solicitation
21 agreement, that SPSF would be willing to maintain that
22 agreement -- this is the existing SP/D&ERG solicitation
23 agreement -- with adjustments to reflect changes caused
24 by the merger. We believe that those could easily be
25 negotiated within 90 days or so if the Commission

1 decides to approve it.

2 So the principles of that solicitation
3 agreement may be maintained into the future you just
4 give us 90 days to work out the details that would have
5 to be worked out.

6 I might also add that if SPSF were to depart
7 from what we believe are its natural incentives to use
8 the more efficient route, if we were to somehow engage
9 in anticompetitive route or rate cancellations, this
10 Commission knows how to deal with that problem. You put
11 out your Ex Parte 445 guidelines -- rules -- I am sure
12 you intend to apply them, and if anybody thinks that we
13 or anybody else is acting in an anticompetitive way that
14 would violate those rules, you know how to deal with
15 this.

16 This Commission has recognized that railroads
17 have every incentive to use the more efficient interline
18 routes in Guilford, in CSX/ACL, in the rulemaking to
19 eliminate the DTI conditions. You have also recognized
20 that the central corridor has certain natural advantages
21 that will cause the traffic to move that way. The rest
22 of your question 2-A through D is dealt with in our
23 answers.

24 Briefly, we are not going to divert any
25 traffic from that corridor -- not certainly where it's

1 the efficient way for the traffic to move. And we'll
2 continue to interline all commodities; the key is
3 efficiency. And basically we think that it's traffic
4 south of San Francisco-Stockton where the efficiencies
5 may, in fact, depending on where the Eastern or
6 Midwestern point on the other end is, cause the traffic
7 to move by the southern corridor.

8 But that will be an efficiency consequence, not a
9 consequence of any distortion of our incentives.

10 Let me move briefly to UP's proposal, which is
11 covered by the Commission's question 1. The claim here
12 is not vertical foreclosure but enhanced market power.
13 Again, I am not going to reargue the points Mr. Moates
14 made about the lack of any real competitive problem. My
15 first point here is that if there were a problem, the
16 UP's trackage rights condition is vastly overbroad. It
17 would apply not just to the 2 to 3 percent of the
18 traffic that may be competitively impacted, but to
19 massive amounts of traffic moving through the heart of
20 the system, the southern corridor and the central valley
21 of California. It is massively overbroad.

22 This includes vast amounts of traffic -- and Mr.
23 Moates mentioned some of them -- that no one has even
24 alleged would be competitively impacted by this merger.

25 Now the UP says this overbreadth is

1 necessary. You have to have it, they say, in order to
2 have trackage rights, to make them viable. But contrast
3 that proposal with the proposed BN traffic solicitation
4 agreement, where it applies and is workable only with
5 respect to the precise traffic at issue.

6 The real question here is if you think you've
7 got a problem, do you solve it with a laser beam
8 solution or do you solve it with a saved-off shotgun?

9 Now, there has been a lot of debate about
10 interference with our operations. The question is, how
11 much interference? They said it wouldn't interfere
12 much. We said it would interfere a lot. And the
13 question is how much? There really isn't any serious
14 doubt they would interfere.

15 It would be applicable -- this is the UP, now -- to
16 1455 miles over the heart of our system, which is an
17 unprecedented amount of mileage; it would interfere
18 particularly where we now have single-line track. And
19 that's where they are seeking the trackage rights. For
20 example, El Paso to Colton, Fresno to Stockton, and over
21 the Tehachapi; that's single-line track. That would
22 essentially double the number of train meets on those
23 single-line tracks; doubling those train meets would
24 increase our running time, add to our fuel and labor
25 cost and add to our expenses in a variety of other

1 ways.

2 The EN agreement does not have any operating
3 interference; it solves the competitive problem if you
4 regard it as a problem, with zero operating
5 interference.

6 So in dealing with your Question Number 1, it
7 had two subparts: Would the UP trackage rights
8 interfere with the merger benefits? The answer is it
9 sure would. Because of the overbreadth, it would
10 interfere with our operations. The details are laid out
11 in Neil Owen's testimony. It would reduce our traffic
12 densities. It would, in other words, deprive us of
13 economies of density.

14 The traffic loss is aggravated by the fact
15 that we would have an immensely powerful and subsidized
16 competitor operating in the heart of our system. The
17 degree of reduction of the merger benefits -- and I use
18 the word "reduction" in quotes because that's the word
19 you use in your question -- can't be calculated because
20 the degree of interference can only be estimated and the
21 amount of the subsidy is not now known. We believe that
22 the burdens imposed would outweigh the benefits.

23 Now as to subpart E, where the suggestion is
24 that you might limit the trackage rights, the
25 limitations really would make a very minor difference.

1 The limitation is essentially excluding local service in
2 places like Deming, New Mexico, where there isn't any
3 local service to speak of. It would exclude Sacramento
4 to Oakland; it would exclude Escalon to Oakdale.
5 Basically it would leave, even with those limits, SPSF
6 with a heavily subsidized powerful competitor right in
7 the heart of our system.

8 Now with respect to the Katy and TexMex
9 proposals, both of these are concerned with possible
10 closings of routes on grain to Mexico. Again, this is a
11 vertical-type claim. This falls in the same category as
12 the D&RG claims. And for the same reasons, we would
13 have no incentive to close efficient central corridor
14 routes with the D&RG. For the same reason we wouldn't
15 have any incentive to close those, we wouldn't have any
16 incentive to close these.

17 COMMISSIONER ANDRE: Did I hear correctly that
18 the TexMex and the Katy trackage rights conditions would
19 not constitute deal killers and that the rest would?
20 Did I hear that correctly?

21 MR. MARTIN: Yes. I should say this. There
22 are really two questions. Whether you should put the
23 conditions on and whether if you did put the conditions
24 on, they are deal killers. On the first point, you
25 shouldn't put them on. There is no competitive injury.

1 These are vertical claims -- not real horizontal
2 competitive claims.

3 The UP is the dominant rail carrier down there
4 today. This is from the central part of the country
5 going down to Mexico. They've got 47 percent of the
6 rail service and they serve, by single system, the most
7 favored gateway which is Iaredo.

8 COMMISSIONER ANDRE: But this is where you
9 draw the line on the deal killers?

10 MR. MARTIN: Yes. If you now talking about
11 the question not what you should do, but what we would
12 do if you did it, the answer is yes. You stated it
13 correctly.

14 But I should emphasize we would have no
15 ability or incentive to divert export grain away from an
16 efficient route with the Katy or with Tex-Mex.

17 In conclusion, let me just say this. We do
18 not believe any conditions are necessary. This merger,
19 if it's approved, will be procompetitive, not
20 anticompetitive. But if you disagree with us, then we
21 urge you to compare carefully the BN solicitation
22 agreement with the trackage rights proposals that have
23 come in from the other lines -- D&RG, UP, Katy -- we
24 think that you will find that the BN agreement is far
25 preferable on at least four grounds.

1 First, it is a voluntary market-oriented
2 transaction. Second, it is tailored to fit the problems
3 of traffic. It is not overbroad. Third, it does not
4 involve any operating interference and it does not
5 impose any efficiencies on the merged carrier due to
6 reduced densities. And finally, it does not involve any
7 mandatory subsidy, the way their proposals would.

8 Any vertical problems in this merger -- and we
9 believe there are none -- but any that you might think
10 would be there are fully dealt with by our joint route
11 and rate policy under which we would keep open these
12 gateways and pursuant to your ability and Ex Parte
13 number 445, to make sure we don't engage in any
14 anticompetitive route closing. Any horizontal problems
15 are fully dealt with by the EN agreement.

16 CHAIRMAN GRADISON: Thank you, Mr. Martin.

17 COMMISSIONER LANBOLEY: Mr. Martin, before you
18 sit down, I'd like you to perhaps expand a bit on the
19 last comment you made; why you believe the EN agreement
20 provides effective intramodal competition. Rather than
21 some of the general characteristics, can you be a little
22 more specific on that?

23 MR. MARTIN: Sure. Let's take a case today
24 where you have problem tonnage that's been identified
25 pursuant to the DOT methodology. Let's suppose we

FINANCE DOCKET NO. 30400

71 - 122

1 he with these trackage rights?

2 A question was raised concerning a statement made
3 with respect to the operating plans by Mr. Owens. I pulled a
4 quote on that statement. This is quoting Mr. Owens, testimony
5 in the case. "Thus, it is frustrating as a career operating
6 man to see a rail system that offers as much promise as that of
7 the SP/SF system in terms of potential operating benefit, being
8 measured and sized for trackage rights that would inevitably
9 result in poor service, schedule times and reliability and
10 higher rates over the long term." In our brief, there is a
11 reference to it.

12 What I am saying to you is, new evidence must be put
13 in on the operating plans, by their own witnesses' testimony.

14 Then we come to public benefits. We are told now,
15 and let's leave out credibility, just look at what they tell
16 you. They tell you now this is a better deal than the last
17 one, they are going to get more savings than before. That's
18 the one area where they say, yes, you will need some more
19 evidence.

20 I suggest to the Commission you need a lot of new
21 evidence because the methodology changes. The methodology
22 changes when you change the trackage rights, when you go from a
23 25,000 mile case to a 50,000 mile case.

24 Finally, energy and environmental matters, which you
25 raised, Mr. Vice Chairman. You will recall in the October

1 opinion where you said flatly. we, the Commission, have not
2 considered environmental matters. You have to consider it. At
3 this point, the record, and I disagree very respectfully with
4 the applicants, the record does not contain a full
5 environmental record that I think you can look upon.

6 Let me go back if I may, to the point which I think
7 is most important in terms of what you must do under the
8 present circumstance if you decide to re-open or if you decide
9 not to re-open. You have to take care of the problem of time
10 running out on SPT. Time is running out. You heard
11 Mr. Stephenson say it. Key people have left, he said. You
12 can't get industries to site on the line. You know there is
13 only a stakeholder trustee and a caretaker board. A caretaker
14 board can't do long range strategic plans for this railroad,
15 they don't have the power to do it. Indeed, they can't raise
16 the money to do it.

17 The only thing that is open conceivably financially
18 to the SPT is equipment trust certificates for somebody to
19 carry the paper. Nothing else.

20 VICE CHAIRMAN LAMBOLEY: We have before us, and I'm
21 not sure how your argument gets to the issue that we have to
22 grapple with, because it is going to take time, we are
23 obviously sensitive to that, but if the applicants have merit
24 to their case and indeed it may take some time to get an
25 evidentiary record developed so that all parties have an

1 opportunity to review and evaluate that, that is obviously
2 going to take some time.

3 MR. AUERBACH: You used a phrase which disturbed me,
4 you said "merit to their case." I didn't think that was before
5 us.

6 VICE CHAIRMAN LAMBOLEY: Let me finish. I said if
7 they have merit, and it is going to take time to develop a
8 record, and we decide to re-open. I'm not sure the fact that it
9 is going to take time mitigates -- I guess it cuts both ways --
10 how does it deny or bar the re-opening?

11 MR. AUERBACH: Mr. Vice Chairman, I think I've said
12 before and I'll repeat, as much as I believe they have not
13 demonstrated the changed circumstances required for re-opening,
14 it doesn't bar the re-opening. It can live with re-opening, if
15 you decide to re-open. I hope you won't do that. If you
16 should do that, I can live with it. I can live with it if you
17 do the other thing, which is to make sure that SPT and its
18 trustee go down the road of seeing whether there is a purchaser
19 and at what price and in parallel, if it is a rail purchaser,
20 filing a --

21 CHAIRMAN GRADISON: Wait a minute. You just blew
22 your case.

23 MR. AUERBACH: Did I?

24 CHAIRMAN GRADISON: Were you trying to explain to us
25 either we should re-open it or we should not re-open it?

1 MR. AUERBACH: I said you should not.

2 CHAIRMAN GRADISON: What I am looking for from you
3 and what I believe the Vice Chairman is looking for, is reasons
4 why we should not re-open. You said you can live with it
5 either way and here's what we ought to do if we don't re-open
6 and here's what we ought to do if we do re-open it. Why should
7 we not re-open this case?

8 MR. AUERBACH: There is only one basis that they have
9 given you for re-opening the case. The question by
10 Commissioner Sterrett this morning, whether there was any
11 reason other than changed circumstances and the answer was that
12 was the reason. I say to you there are no changed
13 circumstances. I've said it now several times, Madame
14 Chairman. There are no changed circumstances. There are
15 changed proposals, but nothing has changed with these carriers.

16 The only suggestion, being the one from Commissioner
17 Simmons, their financials have changed. Nothing else has
18 changed. That's not a change in circumstances. A change in
19 circumstances is a matter of law. You have cases that you have
20 decided on changed circumstances and cases that are parallel to
21 this in their approach. Changed circumstances mean something
22 has happened to the facts. One of the railroads has had
23 something happen to it in the meantime since you last
24 considered it.

25 This is not what has happened here. They are now

1 willing and what they are seeking is to be rewarded for their
2 willingness to go along with what you said was wrong with their
3 proposal. This is not, it seems to me, a change in
4 circumstances.

5 I've tried to say that again and again. When you
6 suggest I've blown my case, what I said was I can live with
7 your re-opening if you condition it in this other fashion. I
8 urge you not to re-open it under any circumstances, but I can
9 live with it if you condition it. If you condition it that
10 way, you ought to also condition it if you don't re-open it.

11 VICE CHAIRMAN LAMBOLEY: In your opinion, we should
12 not re-open, it is not a new circumstance situation, it has not
13 been made out, so we should deny the re-opening and we should
14 issue an appropriate order with conditions as you propose to
15 move forward basically in the nature of a divestiture
16 consideration?

17 MR. AUERBACH: Yes.

18 VICE CHAIRMAN LAMBOLEY: If they choose to re-file or
19 to file again a new application, that is another matter?

20 MR. AUERBACH: I don't object to their re-filing. I
21 think they have that right as a matter of law. Let them
22 re-file if they want to.

23 COMMISSIONER ANDRE: If there are these other
24 prospective buyers, why haven't they come forward in a serious
25 way since October?

1 MR. AUERBACH: I can only reason it one way,
2 Commissioner Andre. There are two railroads here. No
3 non-railroad buyer can come forth and buy two railroads, by
4 buying the parent holding company. That is the only stock you
5 can buy, the parent holding company. Insofar as buying one of
6 the two railroads, they have said they intend seriously to push
7 forward with their merger, they are not willing to sell one of
8 the two railroads.

9 There is no buyer except as it happens, KCS, and we
10 have been saying for a year, we will buy the Southern Pacific
11 but we can't get in the door to do our physical inspection.

12 The answer to your question is, if I were a non-rail
13 buyer, I wouldn't buy their problems, their 31 month problems.
14 I would want them to get rid of one of the railroads and indeed
15 if they get rid of one of the railroads, then you may find an
16 entirely different story about other purchasers on the
17 remaining railroad.

18 COMMISSIONER SIMMONS: If I am correct, you said that
19 Kansas City Southern has an interest in buying if we deny the
20 re-opening?

21 MR. AUERBACH: We have an interest in buying even if
22 you grant the re-opening.

23 CHAIRMAN GRADISON: Even though you haven't had a
24 chance to review the books?

25 MR. AUERBACH: That's why we have asked them to let

1 us in.

2 COMMISSIONER SIMMONS: Suppose you don't get a chance
3 to review the books?

4 MR. AUERBACH: We will be forced then hopefully to do
5 what Mr. MacKenzie said, get you to accept an application and
6 put in a proposal to buy as part of an inconsistent
7 application. That raises the issue you raised, Mr. Vice
8 Chairman, whether that is possible under the circumstances and
9 I don't know the legal answer to that.

10 VICE CHAIRMAN LAMBOLEY: It would be helpful if you
11 did.

12 MR. AUERBACH: I don't know the answer but I know
13 this; we would file and attempt to file an inconsistent
14 application. We would do everything we could to get in and
15 become a buyer.

16 In my last minute or two, let me propose to you
17 something that has not been discussed before. If you open this
18 up for buying and if we are the person who is able to make the
19 negotiated arrangements with the trustee and file the 353,
20 concurrently with that, we will file a Section 10505 seeking
21 temporary authority to manage and operate the Southern Pacific
22 while you are considering our 353, their 353, re-open, or
23 whatever, that you consider it altogether.

24 We will keep our operations separate from SPT so
25 there is no question of scrambling the eggs. They will not be

1 scrambled. We will keep them separate under your
2 jurisdiction. At least we will put in a railroad management
3 interested in the long range strategic planning for SPT.

4 CHAIRMAN GRADISON: What you want to avoid beyond
5 scrambled eggs is eggs that are fried.

6 MR. AUERBACH: Let me conclude, since I have just a
7 minute or so. We urge you to exercise your jurisdiction. You
8 retained it, you retained it very broadly. We think public
9 interest demands that you do this. We ask you to do that now,
10 to repeat, so I'm quite clearly understood, if you re-open,
11 which is against what we think the law is, there are no changed
12 conditions, then do condition it along the lines I have
13 suggested to you.

14 If you don't re-open it, then you must exercise your
15 jurisdiction or you are going to have an interim period in
16 which SPT is in a complete management limbo and that's
17 something which the Commission in the public interest should
18 not permit.

19 We have had three and a half years of this
20 situation. I think at this time the Commission ought to face
21 any solution within its power and you have these within your
22 power to prevent its continuation.

23 CHAIRMAN GRADISON: Thank you, Mr. Auerbach.

24 We will now hear from Douglas J. Babb of the
25 Burlington Northern Railroad Company. Mr. Babb, you have 25

1 minutes.

2 COMMISSIONER STERRETT: Mr. Babb, before you begin,
3 I'd like to ask one question. I'm sort of puzzled why the BN
4 has decided to become an active participant at this stage.
5 After all, it is essentially the same case that was on the
6 table before, and I don't see from your pleading that your
7 interest has changed.

8 MR. BABB: Commissioner Sterrett, the original merger
9 proposed by Santa Fe/Southern Pacific is either now being
10 requested to be reopened without any new evidence or changed
11 circumstances, or it is being proposed as a brand new plan of
12 merger that will totally restructure the western rail system in
13 the United States, is being proposed.

14 When we participated in the case early, we filed
15 comments, and we specifically reserved the right to come back
16 into the case in the event the primary applicants reached
17 agreements with opponents. That is what has now been done.

18 The reason that we feel, Commissioner Sterrett, that
19 we have to be actively involved in this case is that this case,
20 if it is reopened with all of the new evidence and with all of
21 the new competitive implications, it is going to dramatically
22 alter the traffic flows and the competitive balances in the
23 Western United States for years to come.

24 So that when we saw that the Union Pacific in
25 December had reached an agreement with the primary applicants,

1 in which the applicants conceded the major market extension
2 which Santa Fe/Southern Pacific said would undermine the entire
3 merger, we decided that we had to evaluate the competitive
4 implications.

5 And what we found out, Commissioner Sterrett, is that
6 the potential diversions in the southern corridor, based on our
7 analysis, which was preliminary and to decide our position in
8 the case, UP would divert three times as much traffic as it
9 predicted during this proceeding. This made us very concerned,
10 and we felt that if we did not participate, the Commission
11 might be asked by the primary applicants to restructure the
12 entire western railroad system, altering the transcontinental
13 flows in the northern, the central, and the southern corridor,
14 in which the UP is a very dominant or strong force, without our
15 interests being protected.

16 Also, we feel that there are new competitive
17 ramifications in this case, that the public, given an
18 opportunity to review -- and our shippers, given an opportunity
19 to evaluate with a new application -- would conclude that this
20 is such a different merger that there would be, in fact,
21 additional opposition.

22 COMMISSIONER STERRETT: But the competitive harm you
23 see now, you could have suffered at the hands of the conditions
24 in the original application; is that correct?

25 MR. BABB: When we viewed the original proposal,

1 Commissioner Sterrett, we realized that the Santa Fe/Southern
2 Pacific was a very different merger from the mergers which have
3 been proposed for the last ten years. We recognized it as
4 wholly parallel, particularly in the southern corridor.

5 When the Union Pacific, contrary to all of its
6 positions in its other merger cases, came forward and proposed
7 1455 miles of a major market extension in the southern
8 corridor, we viewed that as having really no opportunity for
9 Commission approval. When we saw the D&RGW and the Union
10 Pacific fighting each other vigorously for their central and
11 southern corridor conditions, saw the applicants fighting and
12 resisting the conditions to the extent that former Chairman
13 Schmidt said that the merger would be abandoned if those
14 conditions were granted, we didn't feel that there was any
15 realistic chance that we'd suffer any competitive harm.

16 COMMISSIONER STERRETT: In other words, former
17 Chairman Schmidt asked for a straight-up, with no conditions or
18 else a flat denial.

19 MR. BABB: That is correct. That was the request
20 that was made. We viewed the merger as one that would have
21 such anticompetitive problems that it was very unlikely that it
22 would be approved. If it was going to be approved, Burlington
23 Northern was very mindful --

24 CHAIRMAN GRADISON: Are you sure that's not Monday
25 morning quarterbacking?

1 [Laughter.]

2 MR. BABB: Chairman Gradison, we actually went
3 through an analysis when the merger was filed. We recognized
4 there would be some revenue lost to Burlington Northern. But
5 we decided that with a \$46 million revenue transfer -- that's
6 what the applicants projected -- that that was not a reason for
7 us to dedicate a lot of time, a lot of resources, a lot of
8 complications in the case that were already being protected by
9 other parties, when the Commission itself has said it's not
10 going to impose conditions for the benefit of health carriers,
11 unless they can show an anticompetitive problem.

12 In fact, from our perspective, the idea that Union
13 Pacific would get a 1500-mile market extension with its already
14 dominant position in the central corridor was really
15 unthinkable. We didn't think there was any chance it would
16 happen.

17 We were not surprised by the Commission's decision.
18 In fact, what we think is, today the Commission has a very
19 straightforward and simple question before it. It's not as
20 complicated as it has been made seem to be by earlier
21 participants.

22 It's one of two things. Either the Commission has
23 before it the same plan of merger with the same anticompetitive
24 impacts, with the same conditions now packaged in the form of
25 agreements, in which case there is nothing new, or it has a new

1 plan of merger.

2 Mr. Svolos has said that 40 percent of the new
3 benefits included in the supplement are derived from 1000 miles
4 of reciprocal trackage rights granted by the Union Pacific.
5 That's not in the old record. That's brand new evidence.
6 That's 40 percent of new benefits.

7 If we look carefully at what this is, it's either the
8 same thing with one change, or it's a brand new merger
9 proposal. If it's the same thing, what is it the applicants
10 have said they're going to do? They're going to update some
11 studies within 30 days, ask for public comment within 45 days,
12 and then ask the Commission to act as quickly as possible.

13 What is the new circumstance which causes the
14 Commission to consider this today? It's one thing --
15 agreements reached with five former opponents.

16 Are they different agreements? Not really. The
17 supplement says that the conditions reached are operationally
18 and commercially the same or similar to the agreements proposed
19 in the merger case.

20 Mr. Svolos has said -- and I agree with him 100
21 percent -- the Commission's October 10 decision is the law of
22 the case. The law of the case is, this merger is
23 anticompetitive. The law of the case is, the conditions
24 proposed by Union Pacific and the D&RGW are not satisfactory
25 solutions to this merger.

1 Now the same conditions are in the form of an
2 agreement. There's nothing different. One of the main reasons
3 the Commission had a concern with the UP agreement was that it
4 would have an element of subsidy. Mr. Svolos said again today,
5 the Union Pacific agreement would have an element of subsidy.

6 Unless I misunderstand the agreement, for the first
7 five years, there is interest-free rental. The rental is going
8 to be reciprocal. Santa Fe/Southern Pacific gets 1000 miles of
9 trackage rights, and on the other hand, the major market
10 extension is granted with no interest amount.

11 To me, that's subsidized trackage rights. It seems
12 to Burlington Northern that the Commission has a clear choice
13 today, and the Santa Fe/Southern Pacific has been dealt its
14 fair measure of due process. It has options. It can appeal
15 the Commission's decision. It doesn't have to come up with new
16 evidence. It can take what it has and go to court. Or it can
17 file a new application.

18 If Santa Fe/Southern Pacific can produce \$83 million
19 of new public benefits, \$7 million of additional private
20 benefits, through this new merger arrangement, if it can solve
21 all the competitive problems that before were such that they
22 would abandon the merger, operationally a nightmare, then it
23 ought to file a new application. We ought to look at it. We
24 ought to have an opportunity, and so should the public and the
25 Commission, to see new traffic studies, new operating plans,

1 new competitive impacts in the southern corridor and the
2 central corridor, a new opportunity for comments, protests,
3 inconsistent applications, traffic studies that use 1985 data
4 that reflect everything that's happened the last five years
5 instead of old data.

6 COMMISSIONER ANDRE: What about Mr. Auerbach's
7 proposal to allow new purchase applicants?

8 MR. BABB: I think that the inconsistent procedure,
9 the inconsistent application procedure, in the Commission's
10 regulations and under 11-345, would be the appropriate vehicle
11 for that.

12 I'm not sure what Mr. Auerbach specifically was
13 proposing with respect to the special procedure, but I do
14 believe the Commission's normal procedures for major
15 consolidation cases would be an adequate vehicle for
16 inconsistent applications, trackage rights, but only if they
17 are designed to address specific competitive impacts.1

18 VICE CHAIRMAN LAMBOLEY: Your position is, then, very
19 similar to Mr. Auerbach's, thought, that you believe there is
20 no changed circumstances which would justify reopening?

21 MR. BABB: Correct.

22 VICE CHAIRMAN LAMBOLEY: To the extent that you talk
23 about need for other evidence, that would address the question
24 post-decision to reopen.

25 MR. BABB: That is correct.

1 VICE CHAIRMAN LAMBOLEY: What would be your view if
2 the Commission were to decide to reopen, what would be your
3 view about entertaining inconsistent applications?

4 MR. BABB: I think that would be entirely
5 appropriate. I think that the Commission, if it can believe
6 that there are really new studies that haven't been
7 demonstrated, if there really is testimony that can reconcile
8 all of the past testimony of the applicants, if the Commission
9 were to reopen, inconsistent applications ought to be filed
10 within 90 days after the new application is filed, pursuant to
11 the normal Commission procedure.

12 I should also say that although I think it's very
13 important that if the Commission reopens this case, that it
14 have a normal 11-345 procedure with comments, inconsistent
15 applications, and the normal due process rights. It could
16 accelerate the decision-making process, but that's within the
17 Commission's discretion.

18 We certainly do not advocate a reopening under any
19 circumstances.

20 VICE CHAIRMAN LAMBOLEY: That brings you back around,
21 then, to exactly that point.

22 MR. BABB: That's correct.

23 VICE CHAIRMAN LAMBOLEY: This is not a new
24 circumstance case within the framework of a request to reopen.

25 MR. BABB: The Commission and the courts have

1 developed a good deal of law concerning the concept of changed
2 circumstances. I have found no case in that body of law that
3 stands for the proposition that a party to a proceeding, by its
4 unilateral action, can change circumstances.

5 It comes up in the context of matters that are
6 external to the present proceeding.

7 VICE CHAIRMAN LAMBOLEY: Does scope have anything to
8 do with that?

9 MR. BABB: I think that the scope of a change is
10 important. I think as a legal matter that you have to look at
11 what is the nature of the change and not just the scope.

12 In this case, this new merger proposal is indeed of
13 tremendous scope. It may be one of the largest merger cases
14 ever proposed to this Commission. It has all sorts of
15 competitive implications nationally, not just in the West, but
16 for transcontinental traffic throughout the United States.

17 So it clearly is very, very broad in its
18 implications. But that has really nothing to do with the
19 question of whether there are changed circumstances. That
20 question is a legal doctrine, and it deals with the question of
21 whether or not there is something which has occurred which is
22 different, external to the transaction, and does not result in
23 an act of one of the parties.

24 If the argument of Santa Fe/Southern Pacific were
25 taken to its extreme, the parties could reopen final agency

1 actions any time it took unilateral action to change what had
2 happened before.

3 Also the Commission must recognize that in the
4 three-pronged test of reopening, the Santa Fe/Southern Pacific
5 does not take issue with the Commission's decision. It really
6 is the law of the case.

7 It also does not produce new evidence within the
8 concept of new evidence which could have been produced earlier
9 in the proceeding, but which was not, because of bona fide
10 reasons. If something had occurred with respect to the Santa
11 Fe/Southern Pacific operations in the last three months, and
12 the Commission felt that was of major significance, that might
13 be new evidence. That might be a reason to alter the public or
14 private benefits.

15 But for the Santa Fe/Southern Pacific, knowing the
16 types of implications that these conditions would have, to go
17 back and to undertake new operating studies or revised
18 marketing studies or find forced reductions in the Accounting
19 Department, new people that could be surplussed that couldn't
20 be surplussed six or eight months ago, that's not new
21 evidence. That's restated evidence.

22 COMMISSIONER STERRETT: Mr. Babb, most of what you
23 ask, we could do in a reopening in terms of looking at the
24 evidence. The one thing I think we cannot do is accept
25 inconsistent applications, which I suspect is the reason why

1 you want to treat this as a new application.

2 MR. BABB: The reason, Commissioner Sterrett, that we
3 think this should be a new application --

4 COMMISSIONER STERRETT: Well, let me ask you this:
5 Can we accept inconsistent applications at this juncture?

6 MR. BABB: I think that the Commission has broad
7 authority under its statute concerning reopened proceedings.
8 Whether that authority could be interpreted broadly enough to
9 include an inconsistent application, I can't make a
10 representation. I can't cite a specific case which would
11 assist the Commission in that regard.

12 I will say, Commissioner Sterrett that from
13 Burlington Northern's perspective, we don't need to reach that
14 issue. There is an inherent danger, if the Commission did
15 reopen -- and it should not -- and allow the Santa Fe/Southern
16 Pacific to update its entire discredited evidence, that it
17 would merely update those portions which it felt it could
18 explain. It would not be a full, new presentation as it should
19 be.

20 So I think it is very important that it is a full,
21 new application. One of the key things that the Santa
22 Fe/Southern Pacific has not addressed in its supplement or in
23 the argument today is the fact that its position is completely
24 the opposite now as it was before.

25 What is really different here? The conditions are

1 substantially the same in terms of the operation and commercial
2 impacts. They say that in their supplement, and yet that is
3 represented as something which no longer poses competitive
4 problems and creates new public benefits. The Commission, if
5 it were to reopen -- and again, it should not -- would have to
6 have a new application because the whole, entire record, the
7 positions of the Southern Pacific Santa Fe witnesses, the
8 credibility of the testimony has been impeached.

9 There is no way that, if this is essentially the same
10 merger, with agreements now in place of the conditions, that
11 the Santa Fe Southern Pacific can tell the Commission that
12 there is not a need for new competitive and operating studies
13 because before it said that those conditions would wholly
14 undermine the merger. Before it said that those conditions
15 would create operating problems in the Southern Corridor.

16 COMMISSIONER ANDRE: And the conditions you are
17 referring to are all but the Tex-Mex and KD conditions; right?

18 MR. BABB: That is correct. We have reviewed the
19 agreements. We have reviewed the agreements carefully. To us,
20 although there are differences and there are matters which
21 could be cited as distinguishing the prior conditions, they are
22 really the same thing. Look at the Union Pacific conditions as
23 an example.

24 UP wanted rights between El Paso, Los Angeles,
25 through the San Joaquin Valley up to the San Francisco Bay area

1 so that it could connect with its Western Pacific lines in the
2 Bay area and in Los Angeles. What it wanted was trackage
3 rights. What it has today in the agreement is trackage rights,
4 except for the rate-making authority in central California,
5 which, incidentally, it vigorously opposed when it was in the
6 form of the BN-Santa Fe joint solicitation agreement as
7 providing ineffective service competition.

8 It seems to us that what we really have here is
9 operationally commercially the same condition. There is
10 nothing that would occur to us as being any different. When
11 Mr. Svolos said that Mr. Jwen had taken the position that the
12 operating problems in the Southern Corridor would result
13 because of the diversions that the Union Pacific would have
14 over that corridor, I was very surprised because our analysis
15 would indicate that the UP would actually divert three times as
16 much traffic over that corridor.

17 If the former condition was operationally infeasible,
18 the new condition, if our evidence would be determined to be
19 the most accurate evidence, would show that the operating
20 problems would be three times as bad. So we don't see any way
21 of reconciling these prior positions.

22 VICE CHAIRMAN LAMBOLEY: Mr. Babb, earlier in the day
23 the Applicants indicated that they would be willing to stand on
24 the factual record developed, but for the showing that is made
25 in support of the reopening. I take it you likewise would

1 stand on the factual record previously established.

2 I have a follow-up to that, and that is if you accept
3 that, then what do you say about what ought to have been shown
4 or what is shown by the evidence, and how should we treat that
5 evidence in the issue of whether to reopen?

6 MR. BABB: If I understand your question correctly,
7 if Santa Fe Southern Pacific stands by its current evidence,
8 there is nothing for the Commission to do except enforce the
9 law of the case and deny reopening because that does not
10 support this proposition.

11 COMMISSIONER SIMMONS: You are saying the agreements
12 reached don't constitute new evidence.

13 MR. BABB: Commissioner Simmons, I am saying that the
14 new agreements represent one thing: they represent agreements
15 which have been reached by Santa Fe Southern Pacific conceding
16 essentially the same conditions that before they said would
17 undermine all the benefits of the merger. So there is nothing
18 new except their new willingness to take these conditions that
19 before would harm the merger.

20 COMMISSIONER SIMMONS: The agreements themselves do
21 not constitute a changed circumstance, then.

22 MR. BABB: That is correct. Any party would be able
23 to enter into an agreement, and you couldn't say that an
24 agreement in and of itself granting a condition that has been
25 thoroughly analyzed by the Commission and rejected is a new

1 circumstance. It is really the same circumstance.

2 CHAIRMAN GRADISON: What is to prevent the parties
3 from pursuing these agreements absent a merger proposal?

4 MR. BABB: I think nothing, Chairman Gradison.
5 Burlington Northern has been an advocate of deregulation, free
6 market enterprise solutions, independent arrangements for
7 years. We view that the appropriate solution here is a private
8 marketplace solution. The case shouldn't be reopened. The
9 case is clear. There is nothing new. It should be denied.
10 There should be no reopening, and then the private marketplace
11 should dictate what happens.

12 VICE CHAIRMAN LAMBOLEY: What would you do if they
13 implemented all the agreements? What would your position be
14 and where would you go for relief?

15 MR. BABB: Are you saying what would Burlington
16 Northern's position be if the Commission reopened and adopted
17 the --

18 CHAIRMAN GRADISON: No.

19 VICE CHAIRMAN LAMBOLEY: No. They are in the
20 marketplace, they implemented all the arrangements they have
21 reached and negotiated, presumably, and where would you go?
22 What would be your position and where would you go for relief?

23 MR. BABB: Where we would go for relief would be the
24 marketplace. I am sure that if we believed there was any basis
25 for the Santa Fe Southern Pacific to reach the types of

1 agreements in this case in a non-regulatory posture, we would
2 be in there ourselves. We would work out independent
3 arrangements with those carriers. Maybe they would work a
4 consolidation or an operating arrangement, and then we would
5 try to find some quid pro quo with that new entity that would
6 work to our benefit.

7 The key point here is this, that if it were not for
8 the Commission's October 10 denial, we probably would not be
9 here today. These agreements probably would not have been
10 negotiated. In fact, let me just quote something. The Union
11 Pacific at one point, as I recall, in one of their reply briefs
12 said, and this is not a direct quote, that had there been an
13 opportunity for agreements, conditioned agreements, they would
14 have come forward earlier, and I think that is true.
15 Essentially, the Commission would have long ago had those
16 agreements before it, if those were real free marketplace-type
17 agreements that were not necessary in order to effect merger in
18 a regulatory context.

19 I would like to make a couple of brief remarks in
20 closing. The Commission said, in its decision in the MOPAP
21 case and in its policy regarding mergers, that it would not use
22 rail merger consolidations for major rail restructuring.
23 Burlington Northern believes in that policy. We believe in
24 that policy as a competitor.

25 What the Commission has before it today is contrary

1 to that policy. This would be a regulatory solution, proposed,
2 undoubtedly, by private interests to suit their private
3 interests, but it would require regulatory intervention in some
4 agency for years to come.

5 The agreements at some point will have compensation
6 terms that either come into a dispute between competitors or it
7 is possible that some of the services may be proposed for
8 discontinuance or abandonment. It may be that a compensation
9 issue arises. The Commission has to be mindful of the inherent
10 problems of competitive solutions involving two competitors.

11 The Missouri Pacific and the D&RGW in the Pueblo to
12 Kansas City trackage rights imposed as a condition in the MOPAP
13 have been vigorous litigants against each other for a long
14 time, and it's because they have contrary competing interests.
15 The same thing could easily occur if the Commission were to
16 reopen this case.

17 I thank you.

18 CHAIRMAN GRADISON: Thank you very much.

19 At this time we will hear from Catherine B. Klion of
20 the United States Department of Justice. You have 15 minutes.

21 MS. KLION: Thank you. Madame Chairman and members,
22 of the Commission, my name is Catherine Klion and I represent
23 the United States Department of Justice.

24 Last July, you disapproved the merger of the Santa Fe
25 and Southern Pacific because it would result in serious

1 competitive problems throughout the merged system. Now we urge
2 you to stick by your decision. There are no changed
3 circumstances or new evidence that materially affect your prior
4 action.

5 You should not re-open this proceeding. Instead, you
6 should order divestiture. If you do that, you will preserve
7 rail competition in the West and you will let the railroads get
8 on with their business.

9 The alternative is to spend another year looking at a
10 complicated patchwork of regulatory solutions.

11 COMMISSIONER ANDRE: If we did what you are
12 suggesting, and you said divestiture, how soon after that could
13 the marketplace take over in terms of possible other
14 purchasers?

15 MS. KLION: Well, Kansas City Southern has stated its
16 intention to offer to purchase Southern Pacific.

17 COMMISSIONER ANDRE: I'm not talking about concrete
18 proposals. I'm just saying as far as the statute is concerned,
19 how soon could the marketplace resume its activity here?

20 MS. KLION: If there were another railroad purchaser,
21 there would have to be another proceeding before the
22 Commission. That could hopefully be done on an expedited
23 basis. This is the worse, from a competitive standpoint, the
24 worse acquisition for Southern Pacific.

25 COMMISSIONER ANDRE: Because it is dragging things

1 out?

2 MS. KLION: Because the railroads are parallel.
3 Perhaps another railroad purchaser would not be as problematic
4 an acquisition.

5 COMMISSIONER ANDRE: If we did the divestiture you
6 are suggesting, would it be 30, 60, 90 days before other rail
7 carriers or non-rail carriers could make offers?

8 MS. KLION: I believe under your divestiture order,
9 SF/SP has two years to divest either of the railroads. We
10 would urge it be done much more quickly than that.

11 COMMISSIONER ANDRE: Thank you.

12 MS. KLION: It is obvious today that these solutions
13 can't work and they would require you to keep regulating
14 indefinitely. Instead of deregulation, these remedies would
15 require re-regulation. Keeping this proceeding open serves no
16 purpose and risks harming Southern Pacific's viability as a
17 competitor. At the same time, it locks out other purchasers
18 for Southern Pacific.

19 Virtually the same conditions as those contained in
20 the agreements have been fully litigated in this proceeding.
21 The record showed there would not be effective remedies. No
22 amount of evidence in an re-opened proceeding would change the
23 agreements' fundamental flaws. The only thing that has changed
24 is applicants' mind. Now they accept conditions that last year
25 they rejected. If that is enough to re-open the proceeding, it

1 would set a dangerous precedent for the future. It would
2 provide every incentive for a railroad seeking merger to resist
3 resolving any competitive problem because it would know that if
4 it lost, it could always have a second bite at the apple, by
5 agreeing to conditions, re-opening, and having essentially a
6 second hearing.

7 This would totally defeat Congress' mandate that rail
8 merger proceedings be completed in a reasonable time period and
9 there be some finality. In every proceeding, there can always
10 be more evidence, new shipper statements, or a new way to
11 re-hash the arguments.

12 At some point, the decision maker has to decide. In
13 this proceeding, that point has been reached.

14 The agreements on their face would not be an
15 effective remedy. Why not? Because they are a complicated
16 patchwork of regulatory solutions. The scope of this patchwork
17 is unprecedented. It stitches together too many agreements,
18 too many railroads, too many parts of the country.

19 It covers almost the entire merged system, and that
20 just underscores the fact that this is a thoroughly
21 anti-competitive merger.

22 You wouldn't have to try to patch the whole merger if
23 the whole merger wasn't a problem. While it might make sense
24 to remedy a small part of a basically pro-competitive merger,
25 it makes no sense here.

1 These agreements in no way create independent
2 competitors. Instead, they create competitors dependent in
3 many ways on SP/SF. Their ability to discipline SP/SF's
4 pricing is dependent on rate regulation.

5 As you have recognized, compensation is the key to
6 whether these types of agreements would provide adequate
7 competition. If the price is too high, there might not be any
8 competition at all. If the price is too low, SP/SF might not
9 have the ability to maintain the track. You cannot depend upon
10 the parties to negotiate access prices that would ensure that
11 competitive rates would be charged.

12 The only way to protect the public interest is for
13 you to review the access prices.

14 CHAIRMAN GRADISON: If as our studies have shown,
15 less than 20 percent of rail traffic is captive, would the
16 market not regulate the prices charged by the carriers for
17 "competitive traffic," traffic that is in competition with
18 motor carriers?

19 MS. KLION: The record showed that for the problem
20 commodities in this proceeding, trucks were not competitive.
21 Where SP/SF has a monopoly as in the southern corridor, it
22 could charge a monopoly price for access and the tenant
23 railroad would be willing to agree to this price as long as it
24 could earn a competitive rate of return.

25 The parties would have an agreed upon price but the

1 shippers would not have competitive rates.

2 The UP agreement deprives you even of the opportunity
3 to review the interest rental by postponing that issue for five
4 years, but even where you have the opportunity to review the
5 access prices, it is very difficult to determine competitive
6 rate levels, as we all know. These are dynamic situations. A
7 price that is appropriate today might be too high or too low
8 next year. There would be a perpetual SP/SF rate case on your
9 docket, exactly the kind of regulatory activity that Congress
10 was trying to limit as much as possible when it passed the
11 Staggers Act.

12 It is always difficult to get the right access price
13 for these kind of remedies but the risk of getting the wrong
14 price is especially high when the remedies are as extensive as
15 they are here and particularly where they provide the only
16 competitive alternative for a monopoly such as in the southern
17 corridor.

18 CHAIRMAN GRADISON: Ms. Klion, does the Justice
19 Department see any public benefit in the Commission's
20 re-opening this proceeding?

21 MS. KLION: The Justice Department thinks that the
22 legal standard has not been met, that re-opening would serve no
23 purpose because it's obvious the solutions can't work and that
24 re-opening would risk harming Southern Pacific's viability as a
25 competitor, so the answer is no, the Department sees no public

1 benefit to re-opening.

2 You don't have to consider this regulatory result.
3 You can choose instead to let competition work by ordering
4 divestiture.

5 Another fundamental problem with the agreements is
6 they would substantially increase interdependence between SP/SF
7 and Union Pacific. This would make it more likely that the
8 public would lose the benefits of vigorous competition. Again,
9 this is always a potential problem with trackage rights and
10 pricing agreements, but again the risk is greatest where the
11 remedies are so expensive and where they provide the only
12 competitive alternative to a monopoly.

13 Another problem with the agreements is that
14 competition for significant traffic flows, including movements
15 from Los Angeles to the Gulf and Southeast and movements from
16 the San Joaquin Valley to the Midwest and Northeast, is
17 dependent on pricing agreements very similar to Kansas City
18 Southern's proposed independent rate making authority and the
19 proposed SP/SF solicitation agreements, yet you squarely
20 rejected those agreements and the ERMA because they would not
21 provide adequate competition.

22 This is by no means an exhaustive list of the
23 agreements' fundamental problems. It is enough to decide now
24 that the agreements could never provide the competition that
25 currently exists between Southern Pacific and Santa Fe or that

1 would exist if they were operating under independent ownership.

2 We urge you not to re-open, not only because it would
3 serve no purpose, because you can decide now that the
4 agreements won't work, but also because re-opening would risk
5 hurting Southern Pacific's viability as a competitor. There
6 are risks to re-opening.

7 As you are well aware, Southern Pacific has been in a
8 voting trust for three and a half years. The voting trust
9 arrangement has left Southern Pacific's management without the
10 usual incentives to compete as effectively as possible. How
11 can Southern Pacific plan for its future if it doesn't know
12 whether it will be part of SP/SF or bought by KCS or someone
13 else, or operating independently or even when it will be out of
14 this limbo?

15 If the proceeding is re-opened, it is certain to be
16 many months before it is resolved, particularly given the
17 expanded scope of issues in the proceeding and the need to use
18 updated traffic data.

19 COMMISSIONER ANDRE: If it is not re-opened, again,
20 how quickly will it be resolved? How quickly will the market
21 be able to re-open to other prospective buyers?

22 MS. KLION: We think there seems to be a lot of
23 interest in Southern Pacific or Santa Fe. Our concern is these
24 purchasers are locked out as long as the proceeding continues.

25 COMMISSIONER ANDRE: How quickly can we get them no

1 longer locked out?

2 MS. KLION: Well, much more quickly than if the
3 proceeding was re-opened and you had a long proceeding and then
4 divestiture were ordered.

5 COMMISSIONER ANDRE: Obviously, but I mean how
6 quickly, if we do not re-open, how soon can other buyers make
7 their offers? Do you know?

8 MS. KLION: You gave applicants 90 days to come up
9 with a plan. I would assume that after that, it could happen
10 within a matter of months.

11 COMMISSIONER ANDRE: Thank you.

12 MS. KLION: As I say, as long as this proceeding
13 continues, these purchasers are locked out. You cannot be
14 assured their interest would continue throughout the pendency
15 of a long proceeding.

16 Why leave Southern Pacific out on a limb for another
17 year, risking serious harm to its viability when you can decide
18 now that the agreements could never restore the competition
19 lost through the merger?

20 The Department of Justice urges you to deny the
21 re-opening and order divestiture so the railroads can get on
22 with their business.

23 Thank you.

24 CHAIRMAN GRADISON: Thank you, Ms. Klion.

25 We will now hear from John J. Delaney, representing

1 the Railway Labor Executives' Association. Mr. Delaney, you
2 have 10 minutes.

3 MR. DELANEY: Madam Chairman and members of the
4 Commission, good afternoon. It has been a long afternoon. My
5 comments will be brief especially in light of what's already
6 been said and the questions that you have asked of the
7 speakers.

8 RLEA's position is that your job right now is very
9 simple, and it's very limited. Quite simply, we have new
10 evidence or changed circumstances. What does that entail?
11 Changed circumstances. We had a proposal that was submitted
12 and rejected, okay. It sits over here. We have a new
13 proposal. What is changed and what is new.

14 Well, changed circumstance is over here. Point to me
15 and hear something that has changed and presented over here.
16 Point to me that's missed something that's missing over here
17 and present it to me over here. It's a question of law.

18 Our position is, that limited question has not been
19 answered; it has not been satisfied. The only thing that we
20 are presented with is voluntarily negotiated agreements. That
21 could have been long ago and wasn't, and that's a decision that
22 the primary applicants will have to live with.

23 The best argument that I've heard all afternoon for
24 reopening this proceeding was proposed by Mr. Miller of UP, and
25 that is that, the opponents of reopening seem to have

1 inconsistent positions.

2 First of all, that's not good enough. It's a
3 wonderful tactic on argument, but the proponents of reopening
4 have an obligation to prove an affirmative case. The burden of
5 proof rests there and they have not done it. Even Mr. Miller
6 has said that, the main basis of reopening are these
7 voluntarily negotiated agreements.

8 Just because the positions of the opponents seem to
9 be inconsistent should not justify reopening this proceeding.
10 I'm not going to pretend that I understand what that
11 inconsistency is. Our position is very simple. Have
12 circumstances changed or has new evidence been presented? No.
13 We are told that there will be additional --

14 CHAIRMAN GRADISON: It seems to me in the case that
15 we had before us last year, all these parties had not agreed to
16 all these agreements.

17 MR. DELANEY: That's right, Madam Chairman.

18 CHAIRMAN GRADISON: It seems to me that today the
19 parties have come to us and said, "We have these agreements and
20 we would like you to look at them."

21 So before, we were looking at people wishful
22 thinking, opportunities to participate in one another's market,
23 and the Commission had the opportunity at that time to impose
24 those kinds of agreements on the parties. And we said, "We
25 don't want to tell the parties what they may or may not do."

1 And we gave them an opportunity to come up with some
2 agreements, and to come back to us if they happen to come up
3 with some agreements. So now they have come up with some
4 agreements and you're saying, nothing has changed. We didn't
5 have agreed upon agreements before, and today we do. And
6 you're saying that's no different?

7 MR. DELANEY: That's correct, Madam Chairwoman. Take
8 a look at what's in that new pile.

9 CHAIRMAN GRADISON: That's like being married and not
10 being married; you either agree you're going to do it or you
11 agree -- maybe we're talking about being engaged here.

12 [Laughter.]

13 MR. DELANEY: I can't begin to address that one.

14 [Laughter.]

15 CHAIRMAN GRADISON: But I find -- what I'm really
16 trying to understand is, it seems to me that there is a
17 difference here. It seems to me that we do have a difference.

18 MR. DELANEY: There is a difference, and it doesn't
19 matter. It just doesn't matter. If -- now the applicants are
20 willing to accept these applications. They made a decision in
21 1983 that any responsive applications would destroy this
22 transaction. It would destroy it. That was their position
23 there.

24 And now we're presented with the same proposals that
25 were presented back then in response. Take a look at them,

1 they're talking about trackage rights over the same area. The
2 same area. It's all the same. The only thing that's changed
3 is, the position of the primary applicants. And the position
4 of the responsive applicants. It's in their financial interest
5 not to agree, because if they don't everything is down the
6 tubes.

7 But that's not the question here. The question is,
8 have the standards for reopening been satisfied? And they
9 haven't; it's the same thing.

10 Now, the primary applicants could have agreed to
11 voluntarily enter into these agreements way back when. And
12 they made a business decision not to do it. And now we're
13 told, "These trackage right agreements won't destroy the
14 transaction. Hey, it's going to make it better."

15 COMMISSIONER ANDRE: Do you think they really care
16 whether it does go all down the tubes?

17 MR. DELANEY: Do they care?

18 COMMISSIONER ANDRE: Yes.

19 MR. DELANEY: Oh, sure. Obviously, they have
20 financial interests at stake. I think the question for us
21 today --

22 COMMISSIONER ANDRE: No, but they can probably sell
23 it off at a better price to prospective buyers, couldn't they?

24 COMMISSIONER ANDRE: If that were so, perhaps they
25 wouldn't be asking for reopening. In fact, today we're told

1 that the two railroads are very strong railroads. And that
2 just doesn't matter today. We have a very limited issue before
3 us today.

4 What is changed and what is new? And it's just the
5 same.

6 Let me sum it up this way. Let's take a look at two
7 parties here who will not be affected financially by your
8 decision; that's the Department of Transportation and the
9 Department of Justice. All that the Department of
10 Transportation has told you is that, the change, is that these
11 agreements have now been entered into between the parties.
12 But, hey, everything that's in both proposals is the same.

13 We submit, that's not a valid position. The more
14 valid position has been presented to you by the Department of
15 Justice. Let's look at the substance of what's happened here.
16 Nothing. It's all the same.

17 In summation I would state the obvious, the
18 conditions for reopening have not been satisfied. You should
19 order divestiture and let's get on with it. Let's not let
20 things sit around and degenerate to the point where we will all
21 be sorry.

22 I thank you for your time.

23 CHAIRMAN GRADISON: Thank you.

24 COMMISSIONER SIMMONS: Before you leave. The Railway
25 Labor Executive Association, who makes up this group?

1 MR. DELANEY: It's an association, every labor union
2 in the railroad industry has a chief executive or president.
3 That president becomes part of an association. In effect, it
4 pulls the resources of the various railroad unions, and they
5 create this association. It's an independent body, but in
6 effect it gives them a chance to try and stand up to some of
7 these powerful railroads.

8 COMMISSIONER SIMMONS: So, as a collective body the
9 railroad --

10 MR. DELANEY: United we live, divided we die.

11 CHAIRMAN GRADISON: Thank you, Mr. Delaney.

12 COMMISSIONER STERRETT: I have two quick questions
13 for you. I don't want to cut into your time too much, but the
14 question has arisen of whether an inconsistent application
15 could be filed at this juncture. Do you have a legal opinion
16 on that?

17 MR. SVOLOS: It's too late for them to come into our
18 case. The date for responsive applications was in October of
19 1984.

20 CHAIRMAN GRADISON: I'm sorry, what did you say?

21 MR. SVOLOS: I said it's too late for them to come
22 into our case. The date for responsive applications was in
23 October of 1984. That's when the Union Pacific filed its
24 responsive application. Mr. Babb said one of the reasons they
25 didn't come in was John Schmidt's deal-breaker statement. That

1 wasn't made until July the following year. I want to clarify
2 the record on that.

3 COMMISSIONER STERRETT: The second question is have
4 you made any plans for divestiture?

5 MR. SVOLOS: No, we have not. We have considered it
6 in the abstract, but nothing specific.

7 All right. Now Mr. Babb is obviously much younger
8 than I am, and maybe he wasn't with the Burlington Northern law
9 department in 1967, but there was a significant merger that
10 occurred that year which has now made the Burlington Northern
11 the biggest railroad in the United States. I'm talking about
12 the merger of the Northern Lines and the Great Northern,
13 Chicago, Burlington and Quincy, and there were some interesting
14 things about that merger that I think I should bring to your
15 attention because Mr. Babb said, and I quote, he found no case
16 where a party by unilateral action came back and claimed
17 changed circumstances and asked the Interstate Commerce
18 Commission to revise its decision. And he chastised us for
19 taking a position which is completely opposite, and this is
20 what really hurt, he said our credibility was impeached.

21 Now, I direct Mr. Babb's attention, and I'm sure it's
22 in the law department of the Burlington Northern, to 318 ICC
23 481, which is also known as Northern Lines 1, and I want to
24 quote a dilemma that the commission experienced in that case
25 when they decided they had to turn down the merger. They said,

1 "If all the conditions set up by the Northwestern and Milwaukee
2 were imposed, the benefits derived by the applicants of the
3 proposed merger would be minimal."

4 In fact, applicants indicate in their pleading that
5 imposition of all the conditions might preclude consummation.
6 Indeed, applicants argued and the commission assumed in its
7 condition the imposition of these conditions might so dilute
8 the benefits of the proposed transaction as to preclude
9 consummation, and the commission turned it down and they said
10 sorry, your merger is anticompetitive, you said you couldn't
11 live with the conditions. That's it.

12 Now, six months later Burlington Northern came back
13 and they said they wanted the commission to reconsider its
14 initial decision, and one of the reasons was that they had
15 concluded agreements with the Northwestern Milwaukee Railroad
16 pursuant to which applicants agreed to accept all the
17 conditions found necessary in Northern Lines 1 and that the
18 annual benefits of the merger were substantially greater than
19 estimated by the commission in its initial decision.

20 VICE CHAIRMAN LAMBOLEY: I assume that is for our
21 benefit as well as Mr. Babb's.

22 MR. SVOLOS: Pardon me?

23 VICE CHAIRMAN LAMBOLEY: I assume that recitation is
24 for our benefit as well as Mr. Babb's.

25 MR. SVOLOS: Yes. Yes. I guess what I should be

1 saying is that if the commission did not do for the Burlington
2 Northern in 1967 what they are asking you not to do for us here
3 today, the Burlington Northern would not exist as it does
4 today, the biggest railroad in the United States. They came
5 back, they asked for a limited hearing, and the hearing,
6 according to the reported case, took four days. Three days for
7 evidence, one day for response. The case was reopened on March
8 4, 1967 and it was decided eight months later. The only issue
9 considered by the commission in that case is whether the
10 benefits had survived the agreements that they had entered into
11 and whether changes that had occurred after the record was
12 closed affected the competitive issues.

13 CHAIRMAN GRADISON: Would you suggest we use that
14 manner of reopening as somewhat of a map to follow in the event
15 we reopen this one?

16 MR. SVOLOS: Madam Chairman, this is a lesson of
17 history. This has happened in the past. The commission did
18 it, and they did it not because they looked at the applicant
19 and they said, well, wait a minute, you said that you wouldn't
20 accept these conditions and now you're coming back here and
21 you're accepting them, so we're going to punish you; you should
22 have done this the first time.

23 The commission reopened the Burlington Northern
24 because it was in the public interest for them to do that, and
25 they didn't give the BN a second chance, they gave the public

1 interest a second chance. And that's what you would be doing
2 in our case if you granted reopening. The public interest
3 deserves a second chance, and we deserve to have the changes
4 that we brought to your attention examined further.

5 COMMISSIONER ANDRE: What about Mr. Auerbach's
6 proposal, that on the contingency that we do reopen, we make it
7 possible for new purchasers?

8 MR. SVOLOS: Well, as I understand it, he would
9 delegate to the trustee the power to sell the property out from
10 under us. If that happened while the application was pending,
11 of course, it would have a serious impact on the application.
12 But aside from that, I think that there are some serious legal
13 problems with it.

14 Now I hadn't planned to respond to that, because I
15 really don't believe that Mr. Auerbach's argument was
16 responding to what you asked us to address here today, which
17 was whether or not this case should be reopened, and I think he
18 went beyond that. I hadn't planned to respond to that.

19 Now the statement was also made that I said 40
20 percent of the benefits, Mr. Babb said I said 40 percent of the
21 benefits would come from the trackage rights that we got back
22 from the UP. I didn't say that. I said \$40 million, which is
23 probably more like 15 percent.

24 CHAIRMAN GRADISON: Help me with the implementation
25 of these agreements. The Department of Justice suggests that

1 the continuation of the agreements would be extremely
2 cumbersome, and that they might ultimately be noncompetitive or
3 actually extract anti-extreme revenues from captive shippers.

4 MR. SVOLOS: Yes, those are all matters that they
5 could explore if they wanted to in a reopened proceeding. In a
6 petition for reopening, we are not required to prove that the
7 merger should be approved.

8 As a matter of fact, you asked us to restrict
9 ourselves to the question of whether the case should be
10 reopened, not whether the merger should be approved, because
11 you recognized the standards are different.

12 Now the question is have the competitive problems
13 been solved? We think they have. And then is there a basis,
14 have we provided you with a basis to believe that the benefits
15 that will survive now outweigh the competitive harms of the
16 merger? And if the answer to those two is yes, then you should
17 grant reopening.

18 Now I would also like to say that we are committed to
19 going ahead with this merger. Other options, such as
20 dismantling the carrier, have not been explored, and are not
21 attractive to us. We have significant benefits exceeding \$294
22 million. We believe that we have put together a solid package
23 which advances the public interest, and none of the speakers
24 addressed the three main points which are furthered by our
25 proposal.

1 As I said, we are going to have two stronger carriers
2 competing in the southern corridor. We are going to have, for
3 the first time in history, two single line systems over the
4 length of the central corridor, and we are going to have for
5 the first time in history San Joaquin shippers who will have
6 access to three railroads and the availability of single line
7 service over both the southern and the central corridors.
8 Nobody addressed those points.

9 CHAIRMAN GRADISON: What about the three points that
10 were laid out, they said you had three additional choices? One
11 was to appeal to the ICC the denial of the merger. The other
12 was to take the denial of the merger to court, and the third is
13 to file for a new merger plan. My question is, why are you
14 filing reopening application as opposed to an appeal which
15 would not necessarily require extensive new record-building?

16 MR. SVOLOS: Well, we think that this is the most
17 expeditious way to realize the benefits of the merger. We had
18 to make an appraisal, obviously, after your decision came down,
19 and we felt that this was the quickest way to realize the
20 benefit.

21 COMMISSIONER SIMMONS: Mr. Svolos, again, you have
22 based your whole argument on the agreements that have been
23 agreed to, plus the increased benefits to the public, both
24 public and private. Why is it you didn't submit your work
25 papers and your evidence at this point? Am I supposed to just

1 trust you?

2 MR. SVOLOS: Well, Commissioner Simmons, we didn't
3 introduce the evidence and the work papers because we were
4 afraid that somebody would have thought we were being
5 presumptuous if we had done that. And the reason for that is
6 this --

7 COMMISSIONER SIMMONS: Well, you drew a map here with
8 SP-SF, you know.

9 MR. SVOLOS: That's not evidence. That's something
10 that I'm using in argument.

11 COMMISSIONER SIMMONS: Oh, I see.

12 MR. SVOLOS: What we are asking for permission here
13 to do is we are asking you for permission to let us introduce
14 those work papers and that evidence, and if you reopen --

15 COMMISSIONER SIMMONS: But I'm supposed to trust you;
16 is that what you're saying?

17 MR. SVOLOS: Well, I think right now, Commissioner,
18 you know, we filed a petition --

19 COMMISSIONER SIMMONS: And believe it.

20 MR. SVOLOS: -- we filed a petition which contains 40
21 pages which discussed how we saw the competitive issues,
22 another 30 or 40 pages which described the benefits, and we did
23 that in detail. We gave you a detailed description of what the
24 evidence is, but the rules don't permit us, as I read them, to
25 give you that evidence until --

1 COMMISSIONER SIMMONS: I don't know anything in the
2 rules that would have prevented you from doing so.

3 MR. SVOLOS: Well, I think that the opposition would
4 have objected, and on a sound basis, if we introduced evidence
5 before the case was reopened. I don't think the rules permit
6 us to do that.

7 COMMISSIONER SIMMONS: I think it might have been
8 more believable.

9 VICE CHAIRMAN LAMBOLEY: The gentleman from
10 California seemed to indicate, as did others, like your
11 observation, after having heard those, that rather extensive
12 development of the record might be necessary. And you
13 generally talked about that at the outset of your presentation,
14 but --

15 MR. SVOLOS: You know, we have run an analysis of the
16 commercial impact of these transactions on our traffic, and
17 that was done on the basis primarily of 1985 data. And we are
18 going to present a revised operating plan. And we think
19 certainly that we should introduce evidence on the labor impact
20 and the environmental issues.

21 VICE CHAIRMAN LAMBOLEY: Well, there was talk by
22 Mr. White about the Mexican border traffic and a variety of
23 other things that were suggested more than that.

24 MR. SVOLOS: I do not believe, Vice Chairman, that it
25 is necessary to revisit the competitive issue. Those have been

1 put to rest. We accept your findings, and it would be a waste
2 of time and three years effort -- 80 percent of the effort in
3 this case over the past three years went into the competitive
4 issues. Now you made your findings and we say we accept that.
5 That's the law of the case. It would be a waste of three years
6 time to go back and revisit those issues. Just as in the
7 Burlington Northern case, they didn't revisit.

8 CHAIRMAN GRADISON: Thank you, Mr. Svolos.

9 I have one point of confusion. Mr. Stephenson, did
10 you in addition reserve nine minutes?

11 MR. STEPHENSON: I did not. I had only one argument
12 to make or point to make, and that was basically handled by
13 Mr. Svolos, but I would like to make a comment if I might.

14 The Kansas City Southern throughout the proceeding
15 has made the contention that Southern Pacific was not in poor
16 financial health, that they were going great guns and that
17 there were no problems. This was all throughout this hearing.
18 Now that there seems to be a light at the end of the tunnel or
19 things seem to be improving for Southern Pacific, all of a
20 sudden the Kansas City Southern is very solicitously seeking to
21 manage the Southern Pacific, and I can tell you categorically
22 that the management of Southern Pacific does not need the
23 management of Kansas City Southern to direct our activities
24 over the next year that this merger is pending.

25 Lest my comments earlier be misinterpreted, I was

1 never suggesting that SP be dismantled, nor does SP's
2 management feel that way. We want this merger. We feel that
3 this is our destiny and we want to see it happen.

4 CHAIRMAN GRADISON: Thank you very much.

5 VICE CHAIRMAN LAMBOLEY: As long as you are in
6 town --

7 [Laughter.]

8 CHAIRMAN GRADISON: Mr. Vice Chairman.

9 VICE CHAIRMAN LAMBOLEY: I just thought I would ask
10 if you would comment about your view of those who have urged a
11 rather extensive development of the record. Do you share that
12 view, and if not, why not?

13 MR. STEPHENSON: Basically I said earlier that I felt
14 that we do have to have an updating of the record in the
15 operating, in the merger benefits area, in the environmental
16 and labor areas. I do not agree, for the same reasons that
17 Mr. Svolos articulated. I think that we have accepted the
18 Commission's decision on the issue of competitive impacts.

19 VICE CHAIRMAN LAMBOLEY: The record will stand on
20 those issues.

21 MR. STEPHENSON: That is correct. And to correct
22 another misapprehension, Mr. Auerbach was hitting at straw men
23 when he was saying that this 1982 data is just unacceptable.
24 All of the data that we intend and that we have submitted and
25 that we have commented on in our March 5 filing is 1985 data,

1 operating data, traffic data.

2 CHAIRMAN GRADISON: Commissioner Andre.

3 COMMISSIONER ANDRE: In the event of the divestiture
4 of the Southern Pacific, what percentage of the non-rail
5 Southern Pacific properties would also be divested?

6 MR. STEPHENSON: I can't speak to that. As the
7 Commission is aware, we have still rather ample real estate
8 assets that are still part of the Southern Pacific
9 Transportation Company, and whether those would be made part of
10 any sale of the Southern Pacific Transportation -- and again, I
11 am assuming, along with your question, that we have gone past
12 the merger and are in a divestiture setting. I would assume
13 that the decision would have to be made by the trustee, by this
14 Commission or by the Santa Fe Southern Pacific management as to
15 what happens to the real property of the Southern Pacific.

16 CHAIRMAN GRADISON: And finally, Commissioner
17 Simmons.

18 COMMISSIONER SIMMONS: yes. The Department of
19 Defense did not support nor oppose reopening. At least they
20 didn't issue a statement to that effect. But they did express
21 their apprehension about post-merger sales and abandonments.
22 They did request also that the Commission consider the economic
23 and national defense concerns prior to making a decision on the
24 question to reopen the proceeding. Do you have any comments to
25 make on that?

1 MR. STEPHENSON: Commissioner Simmons, I was under
2 the impression that the Department of Defense had given limited
3 support for reopening although they indicated that they felt
4 there were some questions that had to be determined following
5 reopening on the evidentiary record. We have no quarrel with
6 that. We would work with them and attempt to address their
7 concerns.

8 CHAIRMAN GRADISON: Thank you, Mr. Stephenson.

9 MR. SVOLOS: May I just add something? We have had a
10 communication with the Department of the Army.

11 COMMISSIONER SIMMONS: That is where I got my
12 information.

13 MR. SVOLOS: Yes. And we did make a commitment to in
14 general not make any abandonments or sales which would affect
15 an essential defense facility.

16 COMMISSIONER SIMMONS: Thank you.

17 VICE CHAIRMAN LAMBOLEY: They talk, do they not,
18 about facilities, that there is going to be a loss in two and a
19 gain in seven? They accepted the arrangements that you
20 proposed?

21 MR. SVOLOS: I am not familiar with that.

22 VICE CHAIRMAN LAMBOLEY: There is a separate letter
23 on that.

24 CHAIRMAN GRADISON: With that, this concludes the
25 Commission's oral argument. We will take the matter under

1 advisement and render a decision on the reopening as soon as we
2 possibly can.

3 With that, the hearing is now adjourned.

4 Thank you.

5 [Whereupon, at 4:29 p.m. the hearing was
6 concluded.]

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