

FINANCE DOCKET NO. 30400

1 - 70



## 1 APPEARANCES:

2 MARTIN FROST, CONGRESSMAN  
3 24th Congressional District  
4 of Texas

5  
6 GUS SVOLOS

7 DOUGLAS E. STEPHENSON  
8 Southern Pacific and Santa Fe

9  
10 CHARLES A. MILLER  
11 Union Pacific Railroad

12 -and-

13 Missouri Pacific Railroad

14  
15 SAMUEL R. FREEMAN  
16 Denver & Rio Grande Western Railroad

17  
18 CHARLES H. WHITE, JR.  
19 Texas Mexican Railway Company

20  
21 MARY BENNETT REED  
22 U. S. Department of Transportation

23

24

25

1 APPEARANCES: (Continued)

2

3

VINCENT V. MACKENZIE

4

California Public Utilities Commission

5

6

JOSEPH AUERBACH

7

Kansas City Southern Railway Company

8

-and-

9

Louisville and Arkansas Railway Company

10

11

DOUGLAS J. BABB

12

Burlington Northern Railroad Company

13

14

CATHERINE B. KLION

15

U. S. Department of Justice

16

17

JOHN J. DELANEY

18

Railway Labor Executives Association

19

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PROCEEDINGS

[1:30 p.m.]

THE CLERK: All rise, please.

Please be seated.

The Interstate Commerce Commission is now in session to hear oral argument in Finance Docket 30400, Santa Fe Southern Pacific Corporation Control, Southern Pacific Transportation Company.

CHAIRMAN GRADISON: Good afternoon ladies and gentlemen. This is the time and the place set by the Interstate Commerce Commission for oral argument in Finance Docket No 30400 Santa Fe Southern Pacific Corporation Control, Southern Pacific Transportation Company.

In this proceeding the Commission is considering a petition to reopen filed by the applicants; and the focus of today's argument is the question of reopening.

This afternoon, we will hear first from the proponents and the supporters of reopening. We will then hear from the opponents of reopening, and from representatives of labor.

Please keep in mind that we're going to require strict adherence to the time allotments set forth in the schedule of appearances. Remember, too, the time taken for questions from the Commission will be included in the time allotted for each participant. If you don't need all of your

1 time, you're not obliged to use it.

2 I will call on each individual speaker by name and  
3 announce the time that each has been allotted. When the green  
4 light goes on here in front of me you will have one minute  
5 left, or for those of you who have requested a three minute or  
6 a five minute signal, it will indicate that. As your time will  
7 have expired, the red light will go on. When you see it,  
8 please end your argument and be seated.

9 Before we proceed with our regularly scheduled  
10 speakers, we will hear from Congressman Martin Frost. The  
11 first presentation today will then be made by Douglas  
12 Stephenson and Gus Svolos for the Southern Pacific and the  
13 Santa Fe.

14 Mr. Frost.

15 MR. FROST: Chairman Gradison and Commissioners, I am  
16 Congressman Martin Frost and I represent the 24th Congressional  
17 District of Texas, which includes the west and southwest parts  
18 of Dallas County.

19 I am here to urge a reopening of this merger  
20 proceeding in order to allow the City of Dallas and the Dallas  
21 area rapid transit, DART, to demonstrate the substantial public  
22 benefit that would occur if Southern Pacific and Santa Fe  
23 merge.

24 DART is the Dallas areas equivalent of the Washington  
25 Metro System; designed and construction of DART's planned 93

1 mile light rail transit system is critical to meeting future  
2 transportation needs in Dallas County.

3 Under the proposal that DART has brought to the  
4 railroads, the transit system would acquire over 27 miles of  
5 rail right of way, that would be redundant trackage for  
6 combined rail carriers. Also, over 10 miles of right of way  
7 would be available for the City of Dallas to develop as linear  
8 parts.

9 In your January 30, 1987 order allowing applicant  
10 railroads 30 days to refine their petition to reopen the  
11 proceedings, you stated that changed circumstances constituted  
12 an important element in considering whether to reopen.

13 The railroads themselves are sold on this plan, and  
14 clearly it constitutes a changed circumstance. DART staff and  
15 outside consultants have carefully considered the possibility  
16 of obtaining exclusive use of the corridors absent  
17 consolidation of Santa Fe and Southern Pacific; and have  
18 determined that such an acquisition is very unlikely.

19 The Southern Pacific line in to plain old Texas is  
20 critical for Southern Pacific's existence. And trackage rights  
21 on the Santa Fe in Oak Cliff, southwest Dallas County, will not  
22 be available unless the Santa Fe has trackage rights on the  
23 Union Pacific, which is part of the settlement Union Pacific  
24 and Southern Pacific Santa Fe have agreed to.

25 However, DART negotiating with a combined Southern

7  
1 Pacific Santa Fe can make the proposal work at a price that all  
2 parties find acceptable. If Santa Fe and Southern Pacific do  
3 not consolidate, DART will have to build and operate its  
4 transit line in an existing rail freight corridor. While this  
5 is technically feasible, it would be much more expensive and  
6 dangerous. In fact, it would result in increased cost of at  
7 least \$100 million by the year 2000.

8 Also, because of the risks inherent in joint rail  
9 transit operations insurance policies necessary for coverage  
10 are prohibitively expensive, if they are available at all.

11 I am convinced that reopening this proceeding to  
12 allow the implementation of DART's plan is critical in  
13 providing the safest and most economical rail transit system  
14 for citizens in Dallas and the surrounding communities.

15 I appreciate the opportunity to appear before you  
16 today, and strongly urge the Commission to take into account  
17 the substantial public interest in granting the reopening.

18 Thank you.

19 CHAIRMAN GRADISON: Thank you, Congressman Frost.

20 We will now proceed with presentation made by Douglas  
21 E. Stephenson and Gu. Svolos for the Southern Pacific and Santa  
22 Fe. Each of you will speak for 18 minutes. And they have  
23 requested that the green light go on when there are three  
24 minutes remaining.

25 Counsel for the applicants have reserved nine minutes

1 for rebuttal.

2 Shall we begin.

3 MR. SVOLOS: Madam Chairman and members of the  
4 Commission, good afternoon, my name is Gus Svolos; I'm speaking  
5 on behalf of the applicants in this proceeding.

6 I thank you for this opportunity to explain why we  
7 believe this case should be reopened. We have also appreciated  
8 the patience and consideration that you have shown in your  
9 rulings responding to our petition.

10 In the days following the open hearing conference and  
11 your written decision of October 10, we made a basic decision  
12 which is controlling everything that we've done since then.

13 We accept the Commission's decision as the law of the  
14 case. We recognize that it was based on each Commissioner's  
15 judgment regarding the public interest. Although we believe  
16 our evidence that pervasive truck competition existed, four  
17 Commissioners just as sincerely evaluated, they were not  
18 persuaded by the evidence.

19 Therefore, as far as we're concerned that battle is  
20 over. The Commission's decision has resolved the competitive  
21 issues in this case.

22 Nevertheless, we have persevered a work hard at the  
23 job of trying to save this merger, because we believe now as we  
24 did three years ago that this merger is still where it's  
25 sitting; a continuance to offer an opportunity to strengthen

1 the rail transportation system in the western United States.

2 This case should be reopened because no evidence and  
3 changed circumstances exist in two categories.

4 First, negotiated agreements which are workable  
5 solutions to the competitive problems identified by the  
6 Commission.

7 Secondly, new evidence of the amount of public  
8 benefits which will be achieved as a result of the merger.

9 Mr. Stephenson --

10 COMMISSIONER STERRETT: Can I interrupt for a  
11 second. I want to clear away maybe another potential piece of  
12 underbrush. You accept the decision, so therefore I presume in  
13 that argument or will argue that there was material error in  
14 the decision. How about the argument of the Failing Firm  
15 Doctrine, have you been in that as well?

16 MR. SVOLOS: We believe that the financial condition,  
17 Commissioner Sterrett, of the carriers is important in the  
18 southern corridor. We're not arguing failing company; that's  
19 not part of the case anymore. But we believe that it is  
20 important in the southern corridor because of the solution they  
21 may have reached. It's going to place two companies in the  
22 southern corridor, the Union Pacific and the, if the merger is  
23 approved, the SPSF, which are much stronger companies than the  
24 two companies that are now competing in that corridor, the ATSF  
25 and the SP.

1 I don't think that they can be characterized as  
2 strong companies. The SP, certainly in the Commission's  
3 decision was characterized as a marginal carrier. The Santa Fe  
4 is not much stronger.

5 But we're not, to answer your question directly, not  
6 arguing failing company.

7 COMMISSIONER STERRETT: But they are companies that  
8 can stand alone at this point?

9 MR. SVOLOS: Yes, sir.

10 VICE CHAIRMAN LAMBOLEY: Mr. Svolos.

11 MR. SVOLOS: Yes.

12 VICE CHAIRMAN LAMBOLEY: In connection with the prior  
13 record and what you suggest are changes in circumstances, I  
14 have a question I guess really of how you assess -- how you  
15 suggest we assess the prior record in a couple of matters. One  
16 being environmental considerations, given the negotiated  
17 agreements and the relationship of public benefits you are  
18 urging.

19 Consider, if you will, the prior record, as I'm sure  
20 you're familiar with, the fact that we have had no  
21 environmental impact study, we have had an environmental  
22 assessment report.

23 I'm curious what your position would be about some  
24 substantive and procedural concerns and considerations, and  
25 what type of environmental impact investigation you would think

1 appropriate were we to reopen this case?

2 MR. SVOLOS: I think, Commissioner Lamboley, that the  
3 environmental issues have to be explored. I do not believe the  
4 environmental impact statement is necessary; this is really  
5 Mr. Stephenson's part of the argument. And I believe that's  
6 what he is going to say, and I would rather defer to him, if  
7 that's all right with you.

8 VICE CHAIRMAN LAMBOLEY: Just as long as we will pick  
9 up on what we have.

10 MR. SVOLOS: We will.

11 VICE CHAIRMAN LAMBOLEY: I have a second question, if  
12 I might, that flows now in the same concerns about the status  
13 of the record. We have now today significant restructuring in  
14 the 1986 of both companies. How would you suggest we evaluate  
15 that, if at all, and what impact as a factor do those  
16 restructuring arrangements have on the presentation on  
17 reopening?

18 MR. SVOLOS: I believe in our petition we stated that  
19 the restructuring had an impact in two areas, equipment  
20 utilization and there are some labor reductions which are  
21 planned which we have taken out of the benefits of the merger.  
22 But in calculating the benefits of the merger we have removed  
23 the reductions, cost reductions, which were taken by the two  
24 carriers on a stand alone basis. And that restructuring was  
25 performed on a stand alone basis.

1 VICE CHAIRMAN LAMBOLEY: So, I gather your position  
2 is that the 1986 restructuring for both railroads, those  
3 benefits in short have been backed out of any benefits you're  
4 proposing in support of the reopening?

5 MR. SVOLOS: That's correct.

6 VICE CHAIRMAN LAMBOLEY: Does that include the  
7 abandonment situations?

8 MR. SVOLOS: The abandonments were taken -- you're  
9 talking about the sales of abandonments where they're taken  
10 independently by both rails in a stand alone basis. I can  
11 speak for the Santa Fe, and I think I would prefer to have  
12 Mr. Stephenson speak for the Southern Pacific.

13 As far as we were concerned, I think we said 3100  
14 miles. And it was a coincidence, they said 3100 miles. But  
15 the press release said, sales or abandonments.

16 Now, the facts as far as Santa Fe are concerned and  
17 of the 3100 miles, 600 miles are yards and switching which  
18 wouldn't qualify yards and side tracks which wouldn't qualify  
19 for abandonments anyway. 250 miles of that 3100 miles is on  
20 our abandonment map. The balance of that may be sold. And the  
21 write downs were required, because our records show that in the  
22 next five years, five year period, those properties would not  
23 be earning a return. And under accounting principles, we were  
24 required to write off expense, the ledger value, plus the cost  
25 of the removing of the track for those properties based on the

1 year in which it was anticipated that they would stop producing  
2 revenue for the company.

3 But it's certainly not a fact they really intend to  
4 abandon 3100 miles on a system, right now Santa Fe is 250. And  
5 I believe our petition demonstrated that they will probably be  
6 reduced modestly if we go ahead by this merger.

7 VICE CHAIRMAN LAMBOLEY: What's the relationship  
8 between whatever has been considered as a part of the  
9 restructuring and the merger? The merger numbers that are  
10 submitted to us are quite nominal.

11 MR. SVOLOS: I would say that the restructuring,  
12 Commissioner, was done by the two companies independently on a  
13 stand alone basis, on the assumption that no merger would take  
14 place. Therefore, it would have no bearing on the benefits.  
15 Where we found some overlapping, we backed it out of the  
16 benefits.

17 COMMISSIONER STERRETT: Would a new operating plan  
18 devised to work with your new proposal indicate, following on  
19 Commissioner Lamboley's question, any differences in the  
20 abandonment numbers?

21 MR. SVOLOS: I don't believe so. I think they will  
22 probably show that they are a little less, but not much  
23 difference. I can't say that there will be a dramatic  
24 improvement.

25 COMMISSIONER STERRETT: Getting back to the changed

1 circumstances, have they changed in any way other than your  
2 willingness to accept conditions that you were unwilling to  
3 accept before, after all, everything was on the table at one  
4 point; it appears to me that it was within your control all  
5 along to change the circumstances at any time.

6 MR. SVOLOS: Well, there were -- first of all, as far  
7 as the Rio Grande is concerned, I believe what we said was,  
8 there was the deal breaker under the terms that they proposed,  
9 \$40 million for that entire line. Now, we never said that we  
10 were going to explore. But we said under those terms there's a  
11 deal breaker.

12 Secondly, as far as the Union Pacific is concerned, I  
13 think you will recognize in your decision, I believe page 94,  
14 that the primary obstacle was the compensation level. This is  
15 what caused much of the problem.

16 The serious problem arising from the fact that there  
17 was no indication, for instance, that the Union Pacific was  
18 willing to pay for improvements. And we thought that their  
19 entry on that sunset route would cause congestion which would  
20 require improvements if they didn't pay for them and we had to  
21 expand the capacity of the line, put in sidings and signaling.  
22 Of course, we would be subsidizing a competitor.

23 And we also had very serious concern about the line  
24 becoming large, you know, because of the diversion we thought  
25 that the Union Pacific would take from that line no other

1 traffic.

2 Now, that's the remedy by the trackage rights which  
3 we have patented from the Union Pacific between Dallas/Fort  
4 Worth and Sierra Blanca. We feel that those trackage rights  
5 will generate a form of traffic out to the sunset route which  
6 will more than compensate for the inefficiencies that would  
7 have been caused by Union Pacific diversions.

8 COMMISSIONER STERRETT: Excuse me a second, that  
9 leads me to two questions. One of your witnesses, Neil Owens  
10 suggested that the trackage rights, particularly in the  
11 southern corridor would be operationally unfeasible.

12 MR. SVOLOS: Yes, for the reason that I just gave.  
13 He thought that they would become marginal. He thought that,  
14 as a result of that, he would have to run shorter trains, which  
15 would be inefficient or combine trains that would decrease the  
16 quality of the service.

17 And it was based -- I believe his testimony was based  
18 primarily upon the amount of diversion that would occur. And  
19 thereby render that line marginal. And here again, the  
20 trackage rights that we've gotten back have been the critical  
21 factor in our being able to accept the UP rights. There are,  
22 of course, other changes.

23 COMMISSIONER STERRETT: He said that it would in fact  
24 obliterate the benefits of the operating plant, which you feel  
25 is made up now by your trackage rights you were getting from

1 the UP.

2 MR. SVOLOS: Yes, sir.

3 COMMISSIONER STERRETT: Why should we enclose that as  
4 a condition to the merger?

5 MR. SVOLOS: Well, Commissioner, there are other  
6 changes. First of all, the Union Pacific wanted us to block  
7 the trains --

8 COMMISSIONER STERRETT: But I'm talking about the  
9 conditions -- the trackage rights you're getting from the UP,  
10 why should we impose that if we were ultimately to grant the  
11 merger?

12 MR. SVOLOS: You don't have to; it's not necessary.

13 COMMISSIONER STERRETT: Not necessary.

14 MR. SVOLOS: We have an agreement right from the  
15 Union Pacific, and we would get those rights. Actually, it's  
16 the kind of --

17 COMMISSIONER STERRETT: Who approves that?

18 MR. SVOLOS: Pardon me?

19 COMMISSIONER STERRETT: Who approves that?

20 MR. SVOLOS: Ordinarily it's the kind of transaction  
21 which would be exempt from Commission approval under ex parte  
22 282 sub 9; there's a presumption that the award of trackage  
23 rights from one carrier to another, particularly bridge carrier  
24 rights, the kind involved in this case are pro-competitive.  
25 And that the carriers having negotiated this in the marketplace

1 have concluded that efficiencies will occur; and because of  
2 that the Commission has exempted trackage rights transactions  
3 of this kind from regulation.

4 COMMISSIONER STERRETT: It still is subject to our  
5 approval?

6 MR. SVOLOS: You could, if you wanted to, exert  
7 authority to approve it, but in the past you have exempted it.

8 COMMISSIONER STERRETT: What would happen if we did  
9 not approve it?

10 MR. SVOLOS: If you denied approval of the trackage  
11 rights between Fort Worth and Sierra Blanca, obviously it would  
12 remove the essential element for the Union Pacific  
13 transaction.

14 COMMISSIONER STERRETT: How essential?

15 MR. SVOLOS: I would say that it's vital.

16 COMMISSIONER STERRETT: Are there other areas that  
17 are vital? I mean, it appears to me we have an elaborate  
18 interdependent set of conditions that are proposed by you and  
19 your new found friends, what happens if we, looking at it from  
20 a public interest perspective, decide to change the conditions  
21 such as, direct service competition rather than rate  
22 competition of the San Joaquin Valley, the removal of trackage  
23 rights or something less for the Rio Grande, does the whole  
24 thing fall of its own weight?

25 MR. SVOLOS: No, certainly not.

1           COMMISSIONER STERRETT: You just said that one was  
2 vital, though.

3           MR. SVOLOS: Well, that part of it -- that part of it  
4 which I believe amounts to \$37 million in efficiencies is  
5 extremely important. But other changes I certainly would not  
6 be -- we would certainly take a look at it. Of course, if that  
7 was changed or replaced with something else, we would look at  
8 that.

9           VICE CHAIRMAN LAMBOLEY: If the prior record --  
10 excuse me.

11           CHAIRMAN GRADISON: Excuse me. Why don't you proceed  
12 with your question and after that I'd like to ask you to try to  
13 consolidate your presentation. You have a presentation for us,  
14 that we have so many questions that -- my question is, what's  
15 the summary of your argument?

16           MR. SVOLOS: I think I ought to do that because there  
17 are three things, and I'm going to have to depart from the  
18 script, but there are three things that we have come back with,  
19 which I think make this a very attractive proposal as far as  
20 the public is concerned. I'll mention one of them.

21           The competition will now exist between the Santa Fe  
22 and the Southern Pacific in the southern corridor, and how it  
23 can be characterized as between two strong companies. If this  
24 transaction is approved, it will be replaced with competition  
25 between the Union Pacific and the Southern Pacific and Santa

1 Fe, two much stronger companies, and those would serve that  
2 market today and the public would benefit.

3 In the central corridor for the first time in  
4 history, if this transaction was approved, you're going to have  
5 two single line systems competing head-to-head, the Rio Grande  
6 and the Union Pacific. Shippers from Oregon, California, the  
7 San Joaquin Valley will have access to competitive single line  
8 service under the central corridor for the first time in the  
9 history; and that would cure the historical problem of the  
10 Central Pacific conditions which has plagued the western  
11 railroads. And this Commission with litigation for about 80  
12 years, going back to 1905, and that controversy which is  
13 swirled around the CP conditions would finally be put to rest  
14 by the agreement relating to the central corridor.

15 And it was made possible by a concession by the Union  
16 Pacific, you wrote it in your opinion that you couldn't do it  
17 because the DRGW would have to operate over UP track between  
18 Wells and Flanagan and Aliceson or rather west on Flanagan and  
19 Aliceson west. So, the Union Pacific has agreed to permit that  
20 operation by the Rio Grande, and it's a significant concession  
21 because it permits the entry of the Rio Grande as a competitor.

22 MR. SVOLOS: In the San Joaquin Valley the situation  
23 now on the map is that you've got just two railroads, the Santa  
24 Fe and the Southern Pacific, neither one of which can provide  
25 single line service over the central corridor. That will be

1 replaced in our proposal by competition between three  
2 railroads; the Denver Rio Grande, the Union Pacific, and the  
3 Southern Pacific and Santa Fe. Those shippers will have for  
4 the first time service by three railroads which will -- and  
5 they can be served by both a single line service of those  
6 carriers going out on the central corridor and the southern  
7 corridors. And those are the three major improvements in the  
8 competitive posture that we have come back here with.

9 Now, these are not just the same deals. If we wanted  
10 to -- we haven't come back here and said, "Look, we're now  
11 willing to accept conditions. You tell us what they are." We  
12 went through intensive negotiations for six months. And it was  
13 done by experts in all three carriers, and all that hard, came  
14 up with the deals that we felt, the agreements we felt would  
15 terminate the competitive problems that you described in your  
16 decision, and we use your decision as a road map.

17 CHAIRMAN GRADISON: And you don't feel that you've  
18 divided up the market?

19 MR. SVOLOS: Certainly not. Each one of those  
20 markets now has more competition than it had before.

21 VICE CHAIRMAN LAMBOLEY: In that regard, should we be  
22 concerned about the agreements, certainly in the central  
23 corridor area, those which raise questions of termination and  
24 duration of the agreements?

25 MR. SVOLOS: Well, once a carrier commences

1 operations it has to come back to the Commission to get  
2 approval to stop operating. The carrier, once a common -- once  
3 a railroad assumes a common carrier obligation, it just can't  
4 stop servicing. It has to come back here to get permission to  
5 do that.

6 VICE CHAIRMAN LAMBOLEY: Were you concerned about the  
7 portions of the central corridor that deal with perishables and  
8 the access from the south that's allowed to the UP but not from  
9 the northern region?

10 MR. SVOLOS: The Union Pacific can go both ways from  
11 the San Joaquin Valley under their rate making authority. They  
12 can serve those shippers through the southern corridor or the  
13 central corridor.

14 CHAIRMAN GRADISON: Thank you, Mr. Svclos.

15 We will now here from Douglas E. Stephenson.  
16 Mr. Stephenson, you have 18 minutes.

17 MR. STEPHENSON: Thank you.

18 Madam Chairman, members of the commission, good  
19 afternoon.

20 I have represented Southern Pacific throughout this  
21 proceeding, and today on behalf of all the applicants, I would  
22 like to talk to you about the substantial benefits we see  
23 emerging from the successful conclusion of this case, and lest  
24 there be any question as to what Southern Pacific views as  
25 being a successful conclusion, it would be approval of this

1 transaction before the Commission.

2 I also would like to address the question that I know  
3 some of you and some of the staff must have asked yourselves  
4 recently; namely, how can a merger that's previously identified  
5 287 million in annual benefits claim an additional \$8 million  
6 after having granted substantial trackage rights and other  
7 competitive access to Rio Grande, Union Pacific and the MKT.

8 I know it must sound counterintuitive to you when you  
9 hear that claim, but I hope by the time that I've finished  
10 today, you will understand that this is not just puffery for  
11 this case, but is based on solid evidence that we are prepared  
12 to file with the commission, should the commission reopen.

13 Before getting into a detailed explanation of the  
14 merger's benefits, however, I would like to digress for a  
15 minute and answer a question that has been asked by the  
16 commission in its recent order.

17 One of the questions in that order asks what evidence  
18 the applicants felt, and the other parties felt, should be  
19 entertained by the ICC in a reopened proceeding. Mr. Svolos  
20 mentioned that most of the record in this case focused on  
21 competitive issues. From our perspective, that part of the  
22 case is over. While we may disagree with some of the  
23 commission's findings on those issues, your conclusions are now  
24 the law of the case from our perspective.

25 As a result, we don't believe that the commission

1 should require or would find relevant any issues dealing with  
2 the competitive issues that have already been addressed.

3 Mr. Svolos also mentioned that the ICC's October 10  
4 decision was used by applicants as a roadmap to resolve the  
5 competitive problems identified by the commission. A reopened  
6 proceeding ought to permit evidence on both sides of the  
7 question as to whether applicants properly read that roadmap  
8 and learned from it, and have followed it. We don't dispute  
9 that evidence on those issues is appropriate for a reopened  
10 proceeding. We do not believe, however, that other competitive  
11 evidence is warranted under the circumstances.

12 In addition, applicants suggest that the commission  
13 receive evidence by way of a modified operating plan on the  
14 impact of the merger as conditioned on rail operations.

15 We also believe that supplemental operating plan  
16 ought to contain evidence as to the merger benefits, the impact  
17 of the merger as conditioned on labor, and the impact on  
18 environmental parties in this case.

19 While I am on the subject of environmental issues, I  
20 am pleased to announce that after many months of discussions,  
21 applicants have resolved their differences with the City of  
22 Martinez and the East Bay Regional Park District as of today,  
23 and those two entities will no longer be a part of this  
24 proceeding.

25 VICE CHAIRMAN LAMBOLEY: Does that suggest, then,

1 Mr. Stephenson, that the record as it now stands is satisfied  
2 as a result of investigation and the assessment report, and  
3 does not require any EIS or anything further?

4 MR. STEPHENSON: No, sir, I don't believe that's the  
5 case. There are two factors that are involved in our  
6 settlement with the Park District and the City of Martinez.  
7 One deals with mitigation issues that they were concerned  
8 about. We have satisfied those in their mind. But there are  
9 many other impacts of this operating plan that we feel as  
10 parties to a proceeding that may go -- if it were to be  
11 approved and go up on appeal, we would feel ourselves that we  
12 would rather have an evidentiary record that supported the  
13 transaction that we are putting on, rather than the evidentiary  
14 record that was heard before.

15 So we would ask that you would entertain additional  
16 environmental evidence that assesses the impact of this  
17 transaction, the newly proposed transaction on the environment,  
18 and on labor.

19 Otherwise, we think that we are inviting error on  
20 appeal if we don't submit that kind of record.

21 We believe also, Commissioner Lamboley, that we have  
22 addressed most, if not all, of the environmental issues that  
23 were a source of irritation to parties in the case. We have  
24 certainly addressed the issues of the City of Tracey, the  
25 cities of Brentwood, Antioch, Martinez; a whole raft of

1 municipalities that were involved in this proceeding earlier  
2 on, and who had legitimate environmental concerns.

3 We altered our operating plan to take into account  
4 their objections, and I think that that should take care of it.

5 VICE CHAIRMAN LAMBOLEY: And you would believe that,  
6 with those alterations in the operating plan, no new issues of  
7 significant import would arise as a result of any change in the  
8 operating plan?

9 MR. STEPHENSON: That is our belief.

10 VICE CHAIRMAN LAMBOLEY: You know, one of the  
11 concerns no doubt you would have, and as would we, on a  
12 consideration for reopening is environmental evaluations  
13 investigations could take a significant period of time,  
14 depending on the nature and the extent of the issues, and I  
15 assume that in any event you are hopeful for expeditious  
16 considerations.

17 MR. STEPHENSON: Yes, sir.

18 CHAIRMAN GRADISON: Well, we can promise you  
19 expeditious consideration, but it takes time to build a record,  
20 we have a new record before us, we have a new group of issues  
21 before us. You proposed a very tight schedule. The statute  
22 provides 31 months for the commission's review of a merger. I  
23 recognize this is a merger which we have already visited, but  
24 let's take a look at what would happen if a year from now the  
25 commission were to finally have a record to render a decision

1 on. It's 12 months of investors' money on the shelf, waiting  
2 for a decision. If this takes 31 months, my question is what  
3 happens to the companies in the interim? How long can the  
4 investors wait for the Interstate Commerce Commission to  
5 complete a thorough record, to build a thorough record and to  
6 complete a thorough analysis?

7 MR. STEPHENSON: We want a fair record ourselves, for  
8 the reasons that I've described. We want a record that can be  
9 defended on appeal. We think it can be done in seven or eight  
10 months. We don't mean to be dictating to the commission on  
11 this issue or any other issue. That is your decision to make.  
12 All --

13 CHAIRMAN GRADISON: I appreciate that. We don't take  
14 it as a dictation. We are trying to work together to help you  
15 resolve the issue that you have placed before us. We are  
16 looking for advice, and we will accept reasonable advice.

17 MR. STEPHENSON: As time goes on -- I can only speak  
18 for Southern Pacific -- we have had our problems over the last  
19 few years. We have had the problems that the commission is  
20 aware of. We have had the problems that occur in any merger  
21 case where people leave the company because of the merger. We  
22 have lost key people because of the uncertainties that have  
23 befallen us. We have run into problems in getting shippers to  
24 site on our property because of the uncertainty to enter into  
25 long-term contracts because of the uncertainty. But we are

1 going to be around when the commission decides the case, and I  
2 think that we can put up with whatever reasonable time period  
3 it takes to put the merger together. We feel it is important  
4 to get the merger, and all we can do is urge that we all take  
5 the most expeditious course to get there.

6 COMMISSIONER STERRETT: Even if you have no guarantee  
7 that we are going to grant the merger if we reopen. I mean  
8 that is not tantamount to reopening at all.

9 MR. STEPHENSON: Yes, sir.

10 COMMISSIONER STERRETT: I mean to granting the merger  
11 at all. So you realize that it's a substantial risk, that we  
12 may not grant it or we will grant it in a substantially  
13 different form that is not acceptable to you.

14 MR. STEPHENSON: We understand that all those things  
15 are possible.

16 VICE CHAIRMAN LAMBOLEY: How much of the existing  
17 record, prior record, may we deal with, and how much do you  
18 think needs to be supplemented, and in what specific areas?

19 MR. STEPHENSON: I think that an operating plan, a  
20 new operating plan, or certainly a modified operating plan to  
21 take into consideration that the negotiated agreements have to  
22 be done, and I think an operating plan necessarily impacts the  
23 environment and necessarily impacts the labor situation. We  
24 think that that must be covered. We think that other parties  
25 are entitled to determine, as I said, whether or not we have

1 properly read the roadmap and learned from it and followed it.  
2 And certainly parties are entitled to issue or to introduce  
3 evidence on this.

4 VICE CHAIRMAN LAMBOLEY: How about the traffic  
5 evidence?

6 MR. STEPHENSON: I don't think that the traffic  
7 evidence is that vital. The traffic evidence -- we did a new  
8 traffic diversion study based upon 1985 data to update the  
9 record. That was done because it is necessary to drive the  
10 operating plan, and it is a necessary predicate to doing an  
11 operating plan and to do the merger benefit analysis.

12 We don't think that is necessarily something that we  
13 have to introduce as part of the record in this case. We  
14 certainly are willing to do it; we are not reluctant to do it;  
15 but it's not absolutely necessary.

16 VICE CHAIRMAN LAMBOLEY: Other than those areas that  
17 are modified, and you have proposed new evidence on, or  
18 supplemental, additional evidence, you would stand then  
19 basically on the factual record previously developed?

20 MR. STEPHENSON: Yes. And the merger benefits that  
21 we have, that are now being generated out of the merger plan as  
22 modified. We think that the merger benefits are a big issue,  
23 and our evidence is going to be one thing, perhaps the other  
24 parties will have a different view of what the benefits are.  
25 But certainly that is evidence that we think ought to be

1 covered.

2 COMMISSIONER SIMMONS: Mr. Stephenson, you made  
3 extensive claims about increased public and private benefits  
4 here. In fact, you opened your presentation stating that, and  
5 even surmised why we shouldn't question it. My question to you  
6 is why you have not already submitted this evidence that you  
7 say you have already developed?

8 MR. STEPHENSON: Well, there are three basic reasons,  
9 Commissioner Simmons. The first is that 40 percent of the  
10 operating-related or operating-driven savings are generated by  
11 the trackage rights we are -- the reciprocal trackage rights  
12 that we are getting from Union Pacific. That is the  
13 substantial part that obviously we couldn't anticipate until  
14 this reopening procedure.

15 The second is -- and it's a very important factor --  
16 we had three months to consider and assess what the merger  
17 impacts were at the beginning of the case, back in early 1984,  
18 before we filed in March of '94. We have had three years for  
19 the people who have been involved in generating the studies,  
20 the merger benefit studies, to assess what the potential is for  
21 merger savings and coordinations, and they have come up with a  
22 substantial new number and increased values, in most cases. In  
23 some cases that has not been the case. That is the second  
24 reason.

25 The third reason that we have increased the savings

1 is a simple mathematical fact that the merged company will be  
2 lopping off a substantial portion of its property from Ogden  
3 and Klamath Falls to Roseville, and those will generate  
4 substantial long term labor and maintenance savings.

5 COMMISSIONER SIMMONS: You want me to believe these  
6 claims, though, don't you?

7 MR. STEPHENSON: I'm sorry?

8 COMMISSIONER SIMMONS: You want me to believe these  
9 claim, don't you?

10 MR. STEPHENSON: Absolutely.

11 COMMISSIONER SIMMONS: Well, it's hard for me to  
12 believe them if you haven't submitted work papers and evidence  
13 to me other than your claim itself.

14 MR. STEPHENSON: I understand that, Commissioner, but  
15 we are prepared to do that. We are poised and ready to do it,  
16 and --

17 COMMISSIONER SIMMONS: But you don't want to do it  
18 until after this hearing?

19 MR. STEPHENSON: We will do it now. We will turn the  
20 papers over to the commission staff.

21 CHAIRMAN GRADISON: In your brief moment left, would  
22 you address the question of are you worth more dead than alive?

23 [Laughter.]

24 MR. STEPHENSON: That's a very good question, and  
25 it's one that obviously has been asked by a number of people,

1 and certainly is one of some interest to those of us in  
2 Southern Pacific who have been portrayed as the party that may  
3 be dismembered and sold piecemeal. I think that perhaps the  
4 greatest return to the shareholders, if that is the only  
5 consideration, would be to dismember the Southern Pacific and  
6 sell it off in bits and pieces, probably worth as much or more  
7 on a dismembered basis as on a --

8 CHAIRMAN GRADISON: What about the shipping  
9 community?

10 MR. STEPHENSON: To the shipping community, an intact  
11 railroad is certainly -- a mainly intact railroad is certainly  
12 more important than dismembering. But those are issues that  
13 obviously the commission will have to address, and there will  
14 be lots of evidence going both ways. And in the event that we  
15 get divestiture, and we certainly hope that that's not the  
16 concern --

17 CHAIRMAN GRADISON: Commissioner Andre.

18 COMMISSIONER ANDRE: But you are admitting then that  
19 if you were to have your shareholders' interest at heart,  
20 breaking it up would be the answer; is that correct? Is that  
21 what --

22 MR. STEPHENSON: I haven't done any studies, and I  
23 know that nobody else, at least to my knowledge, has done any  
24 studies on that. Intuitively, seeing what has happened to the  
25 Rock Island and the Milwaukee and the ICG and the way they have

1 sold themselves off in bits and pieces, my intuitive personal  
2 feeling is that that probably would be the most economically  
3 viable situation for the shareholders. But whether that is the  
4 only interest that ought to be addressed by the commission,  
5 should they get down the road that far, is certainly  
6 problematic.

7 CHAIRMAN GRADISON: Would you qualify that by saying  
8 it's short term economically viable as opposed to long term?

9 MR. STEPHENSON: I wasn't making any distinction, and  
10 I don't think that I could make a distinction, standing here  
11 today.

12 In summary, I think that Commissioner Simmons is  
13 correct, we haven't introduced any evidence, and we want to do  
14 that. We feel that we have \$295 million of merger savings,  
15 \$272 million of which are public benefits that will be  
16 generated by the amalgamation of these two companies. We don't  
17 think that there is any other feasible choice.

18 Thank you very much.

19 CHAIRMAN GRADISON: Thank you, Mr. Stephenson.

20 We will now hear from Charles A. Miller, representing  
21 the Union Pacific Railroad Company and Missouri Pacific  
22 Railroad Company.

23 Mr. Miller.

24 Mr. Miller, you have eight minutes.

25 MR. MILLER: Madam Chairman, may it please the

1 Commission, some of the questions that have been asked from the  
2 podium today, I think underscore the importance of reopening  
3 this case, for many of the questions go to what would the  
4 evidence show if the case is reopened. Would, in fact, the  
5 evidence show that the competitive concerns raised in the  
6 Commission's decision, have they been answered by the new  
7 proposals that have been put forward.

8 I want to address myself specifically to the question  
9 set forth in your Order setting up this argument: Should the  
10 case be reopened? For you have had opponents of that  
11 proposition present two diametrically opposite responses. They  
12 say there have been no changed circumstances that would warrant  
13 reopening the record, and they also say that the changes have  
14 been so vast that you've got to start the proceeding from  
15 scratch, as if it were a new case.

16 Obviously, both of those propositions cannot be true,  
17 and, in fact, we think neither is true. Have there been  
18 changed circumstances? Unquestionably there have been changed  
19 circumstances. You have legally effective agreements entered  
20 into by the primary applicants with various of the former  
21 protesters, which purport to address each of the competitive  
22 concerns that were set forth in the Commission's decision in  
23 this case, and we believe they do address them and address them  
24 properly. But that is the subject to be dealt with, if there  
25 is a reopened hearing, and that's the significant change in

1 circumstances.

2 In addition, the Commission's decision pointed to  
3 other impediments to approval, such things as the problem of  
4 the Rio Grande's access to Union Pacific tracks in Nevada; such  
5 as the overlap of the Union Pacific and Rio Grande requested  
6 trackage rights conditions, which the Commission did not feel  
7 it should try to resolve; such as the issue of trackage rights  
8 compensation, which has not been resolved and which the  
9 Commission felt it ought not have to deal with in the context  
10 of imposing conditions.

11 Now the agreements that have been presented to the  
12 Commission and the petition to reopen have addressed each of  
13 those points. We believe they've answered each of those points  
14 satisfactorily, but again, that's the subject of the hearing.  
15 But it cannot be denied that the circumstances are changed in  
16 that those important matters, those that the Commission turned  
17 its decision on, have now been addressed by the parties.

18 VICE CHAIRMAN LAMBOLEY: Should those be weighed in  
19 relationship to the existing record?

20 MR. MILLER: Yes, Commissioner Lamboley, they should  
21 be weighed in relation to the existing record as supplemented  
22 by whatever appropriate evidence is required and necessary to  
23 shed full light on these changes.

24 VICE CHAIRMAN LAMBOLEY: What would you suggest we  
25 do, to the extent that there may be a conflict between the

1 existing record and the representations of what would be shown  
2 in the application?

3 MR. MILLER: There are bound to be conflicts between  
4 the record that was made before and the new evidence that goes  
5 in, because the new evidence is based on changed  
6 circumstances. The change in circumstances is going to  
7 produce, in some instances, different information than was the  
8 case before.

9 I think what has to be looked at by the Commission,  
10 when the new evidence is received, is: Are the changes that  
11 have been produced, based upon the evidence that's now offered,  
12 do they satisfy the concerns that the Commission raised before  
13 on the old record when it didn't have these changed  
14 circumstances before it?

15 VICE CHAIRMAN LAMBOLEY: You are suggesting, then,  
16 for the purpose of reopening, at least as to that issue, you  
17 accept the representations of the applicants that what the  
18 evidence would show is true?

19 MR. MILLER: The applicants in their petition to  
20 reopen?

21 VICE CHAIRMAN LAMBOLEY: Yes.

22 MR. MILLER: Yes. I think the Commission should  
23 accept that, because that evidence is supported by the  
24 agreements themselves and by other material in the showing that  
25 the primary applicants put forward. It wasn't a complete case,

1 but it was, I would say, as one would say in the law, a prima  
2 facie case to support the allegations. They are not just bare  
3 allegations. There is reason to believe that those allegations  
4 could be sustained, if subjected to a full hearing, and that  
5 really ought to be sufficient in these circumstances to take  
6 the look.

7 CHAIRMAN GRADISON: Yes, it ought to be sufficient to  
8 take a look. But there is a tremendous risk in reopening  
9 this. There is no promise of a grant if we reopen. It puts  
10 people at risk for a long period of time, if we do reopen it,  
11 when we cannot assure the results, and we have a responsibility  
12 to review what is placed before us if we do reopen it.

13 MR. MILLER: Yes, Madam Chairman, that is quite true,  
14 and I think it is analogous to the situation when parties  
15 present a merger proposal to you in the first instance, when  
16 they come before the Commission knowing that it could take as  
17 much as 31 months to have that decision made.

18 The Commission has been very good about getting its  
19 decisions out in less than 31 months, and I hope and presume  
20 that it wouldn't take 31 months to decide a reopened case.

21 But that's right. Any time someone brings a proposal  
22 to the Commission requiring its approval, it is implicit in  
23 that that there is going to be a waiting period and no  
24 certainty of ultimate approval, and that situation is the case  
25 here.

1           COMMISSIONER ANDRE: But isn't time running out on  
2 these two railroads? Aren't they, in fact, less well today  
3 than they were a year or two ago and certainly less well than  
4 they were six or seven years ago when they first proposed the  
5 idea?

6           MR. MILLER: I guess I'm not really the best person  
7 to speak to that, but I'm inclined to think from what we heard  
8 this morning that that's not so with Southern Pacific.

9           Mr. Stephenson, I heard him say that SP will be there  
10 when the case is over, and that's a somewhat more optimistic  
11 statement than I think was made earlier in this case. I don't  
12 think the situation is necessarily worse in the aggregate.

13           In any event, it seems to me that they are free to  
14 take that risk knowingly and have done so.

15           COMMISSIONER SIMMONS: You wouldn't enter into an  
16 agreement anyway if they weren't well, would you?

17           [Laughter.]

18           VICE CHAIRMAN LAMBOLEY: Mr. Miller, do you share the  
19 applicants' view that there isn't any --

20           COMMISSIONER SIMMONS: You didn't give him a chance  
21 to answer my question.

22           VICE CHAIRMAN LAMBOLEY: Oh, I'm sorry. I thought  
23 that was merely an observation.

24           [Laughter.]

25           MR. MILLER: Well, the answer to that, Commissioner

1 Simmons, is that I think we'll enter into any lawful agreement  
2 that is advantageous to the company to do so. And this was a  
3 close case for us.

4 COMMISSIONER SIMMONS: When I looked at the map,  
5 since you're talked about an advantage, it certainly looks like  
6 UP has a favorable situation if this happens.

7 MR. MILLER: Well, you've got to look at that central  
8 corridor, too, Commissioner Simmons, because there's a long  
9 line in that central corridor that's not our color that wasn't  
10 there before.

11 COMMISSIONER SIMMONS: Well, your color is all the  
12 way around, though.

13 MR. MILLER: Well, our color is there a lot.

14 [Laughter.]

15 MR. MILLER: But to have that new competitor from the  
16 Bay Area all the way to the Missouri River, single-line service  
17 in the central corridor, is a major new development adverse to  
18 the competitive interests of the Union Pacific, and that's what  
19 we had to weigh in this case, and as I say, it was a balance  
20 for us.

21 COMMISSIONER SIMMONS: You will have circled the  
22 wagons, though.

23 MR. MILLER: Well, I don't know. Those wagons move  
24 pretty fast. It's hard to get around them.

25 COMMISSIONER SIMMONS: Okay.

1 VICE CHAIRMAN LAMBOLEY: That must be a western  
2 expression, right.

3 Do you share the applicants' view that the MKT-UP  
4 merger proposal will have any impact on our considerations?

5 MR. MILLER: Yes, and I'll just say in one sentence,  
6 Madam Chairman, that issue was raised by your Order. It was  
7 raised in the applicants' submission. No one offered any  
8 evidence to suggest the contrary.

9 The MKT is a north-south operator that has little  
10 central or southern corridor participation

11 VICE CHAIRMAN LAMBOLEY: So the Midwest, north-south  
12 is not a corridor of concern?

13 MR. MILLER: Well, in this case, you found that there  
14 weren't anticompetitive effects in that corridor.

15 CHAIRMAN GRADISON: Thank you, Mr. Miller.

16 We will now hear from Samuel R. Freeman of the Denver  
17 & Rio Grande Western Railroad.

18 Mr. Freeman, you have eight minutes.

19 MR. FREEMAN: Thank you.

20 Let us focus on the central transcontinental  
21 corridor. As much transcontinental traffic flows through this  
22 corridor as the entire southern corridor, since the UP/MOP  
23 merger and the filing of this case, the circumstances in the  
24 central transcontinental corridor have changed. There has been  
25 a major erosion of competition in this corridor.

1           The UP merger allowed UP to take advantage of the  
2 opportunities provided by deregulation, something they had an  
3 absolute right to do. Quantifying the seriousness of the  
4 situation, Rio Grande's share of central transcontinental  
5 traffic is about 25 percent in the last few years. Unless  
6 major structural changes are made which recognize the  
7 competitive requirements of deregulation, competitive  
8 alternatives for shippers will disappear in this corridor.

9           Prior to the UP merger, the UP and Rio Grande  
10 connected with either the SP or the WP at Utah Junction. Thus,  
11 shippers had full alternative joint line routes, UP/SP, UP/WP,  
12 Rio Grande/SP, Rio Grande/WP.

13           After the UP acquired WP, which was SP's central  
14 corridor competitor, the competitive balance radically  
15 shifted. We now have a single line UP route competing with a  
16 joint SP/Rio Grande route. As we explained in this case and  
17 you accepted our view, in a deregulated environment, a joint  
18 line route simply cannot compete with a single line route,  
19 especially in this situation, where one of the joint line  
20 participants, SP, has competitive and self interest pressures  
21 to provide alternative service over its single line southern  
22 route, important blocks of West Coast traffic.

23           The only way to correct the situation is to create a  
24 new single line competitor to the UP. This requires the  
25 cooperation of four carriers, UP, Southern Pacific, Santa Fe

1 and the Rio Grande. These agreements collectively provide an  
2 historic and precedented private sector solution to the eroding  
3 competitive balance in the central corridor. It directly  
4 addresses the competitive realities of deregulation and your  
5 decision.

6 What do the agreements collectively accomplish?

7 First, they create a second single line carrier, the Rio  
8 Grande, to compete with UP and that's the only way to fix the  
9 corridor. The Rio Grande will have a 99 year lease over the  
10 Southern Pacific Ogden/Roseville line. This by itself  
11 required, in answer to an earlier question, a major concession  
12 by UP which agreed to SP's assignment to Rio Grande of SP's  
13 pair track and trackage rights arrangement with the UP system.  
14 This was something that you mentioned. It is no longer a  
15 problem.

16 Additionally, Rio Grande will have trackage rights at  
17 the major traffic points, as far north as Portland and as far  
18 south as Bakersfield. The effect of the trackage rights will  
19 convert many exclusive Southern Pacific points from California  
20 and Oregon to common points, so shippers will for the first  
21 time have competitive service at those stations.

22 I have provided you with a list of these stations for  
23 your review. It's a very extensive list. It's impressive as  
24 to both sides and the major blocks of traffic which will not be  
25 subjected to competitive alternatives.

1           To help balance the competitive options for shippers  
 2 and recognizing the somewhat limited reach of the Western  
 3 Pacific, UP's access to major traffic generating stations has  
 4 been enlarged and will cover much of the California territory  
 5 to be served by DRGW.

6           By virtue of the L.A. DCS, which we negotiated with  
 7 Santa Fe, Southern Pacific, three carrier service will be  
 8 preserved in the L.A. Basin. This is another problem that you  
 9 identified in your decision.

10           SF/SP will maintain open gateways at Portland and  
 11 Sacramento, which will allow SF/SP/UP or SF/SP/Rio Grande  
 12 routings. Shippers in the important San Joaquin Valley will  
 13 have the flexibility of Rio Grande service, which means they  
 14 will now have the availability of the transcontinental carrier  
 15 oriented towards the central corridor, not just for the  
 16 southern corridor.

17           Finally, the MODOC line in Oregon, which is Oregon's  
 18 short line to the central corridor, will be preserved by Rio  
 19 Grande as the main line. This is of extreme importance to  
 20 Oregon shippers.

21           The principal financial and operating terms are  
 22 final, something else you were concerned with in your  
 23 decision. This will enable you to thoroughly analyze the  
 24 agreements. We have provided the agreements to you.

25           Any open items, and they are minor, where any dispute

1 must be settled by the binding arbitration, you will not be  
2 burdened with periodic petitions or required to referee  
3 disputes among the carriers.

4 Everyone talks about encouraging private sector  
5 solutions to competitive problems rather than resorting the  
6 regulatory or legislatively imposed solution. In your decision  
7 and subsequent orders, you invited us to propose solutions and  
8 we have responded. The proposal has received unprecedented  
9 public and shipper support and is critically necessary to  
10 re-establish the former balance of competition in the central  
11 corridor and I underscore the central corridor is equally as  
12 important as the southern corridor.

13 In fact, as you look through the massive papers piled  
14 before you, other than the understandable desire of several  
15 public agencies to examine the details of the transaction,  
16 there is no public or private criticism of the overall solution  
17 to the central corridor problem.

18 The traffic flow results of the past four years show  
19 that maintaining the status quo, either an independent SP or  
20 acquisition of SP by another entity, railroad or otherwise,  
21 which continues the joint line arrangements, will not preserve  
22 competition in this corridor. Competition can only be saved by  
23 a carefully developed change. The proposal provides that  
24 change.

25 VICE CHAIRMAN LAMBOLEY: Since there are no

1 development of facts to support the agreements so far, how  
2 would you suggest we interpret the agreements as they relate to  
3 our assessment as to whether to re-open or not?

4 MR. FREEMAN: I think the agreements are self  
5 explanatory. We will provide traffic and operating information  
6 if you re-open.

7 VICE CHAIRMAN LAMBOLEY: Should we be concerned about  
8 any particular provisions, termination, duration, as a fraction  
9 voluntarily to choose to serve or not to serve, and how they  
10 would be compared against conditioning?

11 MR. FREEMAN: Certainly, we can be questioned on it.  
12 I think the real answer is we can't discontinue service without  
13 Commission approval. If you awarded trackage rights in a  
14 merger case, you have the same situation. In other words, you  
15 cannot as a Class I railroad operating common carrier service,  
16 eliminate service without the approval of the Commission. I  
17 see no problem in those agreements on that point.

18 CHAIRMAN GRADISON: Thank you, Mr. Freeman.

19 We will now hear from Charles H. White, Jr., of the  
20 Texas Mexican Railway Company. Mr. White, you have five  
21 minutes.

22 MR. WHITE: Thank you, Madam Chairman. May it please  
23 the Commission.

24 My name is Charles White. I have the privilege of  
25 representing Texas-Mexican Railway.

1 I am not going to reargue the merits of our position  
2 but I think it important to restate it to substantiate our  
3 conclusion that reopening is in the public interest.

4 Tex-Mex was concerned with a very important  
5 competitive aspect of the Southern Corridor throughout this  
6 proceeding, and that is that if the merger took place, SFSP  
7 would serve directly every single Mexican rail border crossing  
8 with the exception of Laredo. Laredo is the most important  
9 rail border crossing linking the United States to Mexico, and  
10 it is served only by the Union Pacific and my client, Tex-Mex.

11 Tex-Mex, however, is dependent upon its traffic  
12 moving into and out of Mexico on its connection with Union  
13 Pacific and Southern Pacific in Corpus Christi. We argue that  
14 Southern Pacific, as part of a new single-line system that had  
15 access to all the other rail border crossings, would favor  
16 those border crossings over Laredo, and therefore competition  
17 over Laredo would suffer.

18 We negotiated in good faith an agreement with SFSP  
19 which commits SFSP to keep the Tex-Mex access to Laredo open  
20 and viable and competitive with Union Pacific.

21 COMMISSIONER STERRETT: Mr. White, excuse me. You  
22 wouldn't have us impose that as a condition, though, would you?

23 MR. WHITE: No, we wouldn't have it imposed as a  
24 condition. We would have it imposed as a voluntary arrangement  
25 between the parties in the reopening, and I would suggest very

1 strongly that it in itself is a reason why the agency should  
2 reopen the case to look at the Mexican-U.S. traffic, for two  
3 reasons. One, Your Honor, is that after the case is reopened  
4 and if the merger is granted, SFSP will still have direct  
5 access to all the border crossings with the exception of  
6 Laredo, and we believe our voluntary agreement with SFSP will  
7 keep the Laredo traffic competitive and will keep the U.S. and  
8 Mexican shippers with a full panoply of competitive access  
9 routes.

10 We think that fact alone, from the prospect of  
11 international U.S.-Mexican rail traffic, warrants an  
12 examination on a reopened docket. That is our position, simply  
13 put. We feel the facts have changed with respect to  
14 international traffic, and we feel that the Commission deserves  
15 a look at the changed circumstances that the agreement between  
16 Tex-Mex and SFSP has created.

17 VICE CHAIRMAN LAMBOLEY: And as it relates to your  
18 agreement, you would offer different traffic evidence?

19 MR. WHITE: Yes, we would.

20 There is one other point, I think, Your Honor, that  
21 is relatively important, and that is that as the application  
22 was originally drafted, for whatever reason, the applicants did  
23 not focus on international U.S.-Mexican traffic. That evidence  
24 developed on its own during the course of the hearing. If the  
25 matter is reopened, I think it would behoove the applicants and

1 Tex-Mex to put before the agency a coherent picture of what the  
2 pro-competitive aspects of international U.S.-Mexican rail  
3 traffic are inherent in our agreement.

4 Thank you, Your Honor.

5 CHAIRMAN GRADISON: Thank you, Mr. White.

6 We will now hear from Mary Bennett Reed of the United  
7 States Department of Transportation.

8 Mrs. Reed, you have six minutes.

9 MS. REED: Chairman Gradison, Vice Chairman Lamboley,  
10 members of the Commission, I appreciate this opportunity to  
11 present the views of the Department of Transportation.

12 The issue before you is whether to reopen the SF-SPS  
13 merger proceeding and to reconsider your decision to deny the  
14 merger. The decision to reopen is a matter which is entrusted  
15 to the Commission's discretion. In this case, however, the  
16 applicants have clearly established that reopening is  
17 justified, based on substantially changed circumstances.

18 Those circumstances are the settlement agreements  
19 that have been reached between the applicants and other  
20 carriers. These agreement reflect more than just a willingness  
21 of the applicants to accept conditions. They reflect the  
22 give-and-take efforts of applicants and the other carriers to  
23 reach agreement on critical elements such as price and scope of  
24 access.

25 In your October 10 decision, you concluded that

1 "uncertainty as to the consequences and acceptability of the  
2 alternatives we have considered prevent us from arrive at  
3 solutions we can impose with any meaningful confidence."  
4 Therefore, instead of approving the consolidation subject to  
5 conditions which might not be workable or effective, you denied  
6 the merger altogether.

7 I submit that the agreements that have been  
8 negotiated --

9 COMMISSIONER STERRETT: Does the Department approve  
10 of the agreements?

11 MS. REED: The Department has accepted the  
12 Commission's competitive analysis, and we are operating,  
13 assuming that that is the law of the case for purposes of  
14 determining whether or not it should be approved, subject to  
15 the settlement agreements that have been reached.

16 COMMISSIONER SIMMONS: Do you approve of all the  
17 agreements?

18 MS. REED: We believe that the settlement agreements  
19 that have been reached between the Union Pacific and the Denver  
20 Rio Grade and the KATY appear on their face to address the  
21 competitive concerns that the Commission raised in their  
22 October 10 decision, and based on what we have seen so far, we  
23 believe that the proceedings should be reopened.

24 You were concerned that the conditions that were  
25 sought by the parties would not solve all the identified

1 problems. Moreover, involuntarily imposed conditions might be  
2 operationally and legally infeasible, might erode the benefits  
3 of the merger, and might jeopardize the new system's ability to  
4 compete.

5 Those uncertainties have been eliminated.  
6 Accordingly, the premise underlying your decision to deny the  
7 merger and not impose conditions is no longer valid. In these  
8 circumstances, the courts and the Commission itself in other  
9 cases have found that reopening is warranted.

10 Specifically, as you've heard earlier today, the  
11 applicants submitted final settlement agreements with the Union  
12 Pacific, the Denver Rio Grade, and the KATY in response to your  
13 specific competitive concerns. These agreements describe in  
14 detail the geographic areas where access is granted, the type  
15 of service, the terms of access price and service and  
16 enforcement procedures.

17 The applicants have shown how the agreements are  
18 intended to ameliorate your competitive concerns. Union  
19 Pacific's rates address traffic moving in the southern and  
20 central corridor and to and from Phoenix, Arizona and Deming,  
21 New Mexico. The Denver Rio Grande's rights address traffic  
22 moving to and from California and Oregon via the central  
23 corridor. And KATY's rights would enable it to serve  
24 Midlothian, Texas, an international terminal -- excuse me -- an  
25 international terminal which is formerly Apry Industries.

1           Therefore, the geographic coverage of the agreements  
2 is the same as you have identified in your October 10 decision.

3           They also address -- the agreements also address the  
4 other concerns that you express in your October 10 decision and  
5 in your later February 3rd decision on reopening. The  
6 applicants project public benefits of \$272 million annually.  
7 Total private benefits, based on revised traffic studies,  
8 indicate the applicants will still achieve \$255 million, which  
9 will enhance their system's financial viability. The  
10 feasibility of the agreements is also discussed.

11           The second issue which we've asked the parties to  
12 address today is whether assuming reopening, should the merger  
13 be treated as a new application. One of the purposes behind  
14 reopening is to enable the Commission and the parties to rely  
15 on the evidence that's already been presented. Treating the  
16 merger as a new proposal would frustrate that purpose.

17           The parties and the Commission have spent a  
18 substantial amount of time and resources in determining the  
19 competitive effects of the primary applications and in  
20 analyzing the response of applications which form the basis of  
21 the settlement agreements, and we think that this evidence is  
22 worthwhile in determining whether or not these agreements  
23 should be approved.

24           CHAIRMAN GRADISON: Thank you, Ms. Reed.

25           And finally we will hear from Vincent V. Mackenzie of

1 the California Public Utilities Commission.

2 Mr. Mackenzie, you have eight minutes.

3 MR. MACKENZIE: Thank you, Madam Chairman and members  
4 of the Commission.

5 California supports a reopening of this proceeding  
6 and believes the public interest would be served if the  
7 Commission were to require as a condition of a reopening that  
8 the Petitioners file a sufficiently revised application, in  
9 effect, so that the parties are able to adequately assess the  
10 consequences of a revised and restructured transaction. Only  
11 then could the Commission and California be able to properly  
12 determine if the proposed revised transaction, based on  
13 agreements and reciprocal trackage rights, adequately address  
14 and mitigate the undercompetitive consequences described in the  
15 Commission's October decision.

16 VICE CHAIRMAN LAMBOLEY: Has the California Attorney  
17 General's position changed, as consistent with yours, or do you  
18 have a different view?

19 MR. MACKENZIE: I have had no contact with them for,  
20 I'd say, about six months, so I'm unsure. I assume that their  
21 position is unchanged, since they haven't made a filing.

22 VICE CHAIRMAN LAMBOLEY: Since their filing?

23 MR. MACKENZIE: Since they have not made a filing.

24 The agreements that Petitioners propose with its rail  
25 competitors present a significantly revised proposal from that

1 originally proposed, evaluated by the parties and reviewed on  
2 an evidentiary record. The agreements contain a comprehensive  
3 and complex array of trackage rights, leased track, and  
4 ratemaking authority unprecedented in rail history.

5 The economic, operational, and financial impacts and  
6 other consequences of implementing the agreements and the new  
7 trackage rights should be sufficiently clear from the  
8 Petitioners' and their contracted rail parties' initial filings  
9 to enable California and the parties to determine if the  
10 impacts resulting from the agreements' implementation are in  
11 the State's best interests. It would also enable the  
12 Commission to expeditiously weight the public benefits against  
13 the harmful effects.

14 Essential elements of an adequately revised  
15 application should reflect the transaction which is now before  
16 the Commission. It's important elements would include an  
17 updated and complete market impact analysis, a revised  
18 operating plan, and revised pro forma financial projections.

19 I could be more particular on those parts, if the  
20 Commission desires.

21 Our objective is to permit us to weigh the full  
22 consequences of implementing the proposed rail agreements and  
23 the new trackage rights and to weigh alternative dispositions.  
24 The rail carriers party to the agreements, as well as the  
25 petitioners, should provide the essential elements of the

1 revised transaction that they propose, as well as the effect  
2 upon their proposed operations and the expected market impacts  
3 on other carriers.

4 The rail carriers affected by the revised transaction  
5 should also be able to file inconsistent and responsive  
6 applications to permit the Commission to weigh alternative or  
7 mitigating proposals.

8 VICE CHAIRMAN LAMBOLEY: You see this as a new  
9 application, then?

10 MR. MACKENZIE: No, not in effect. It needs to be  
11 revised, though, sufficiently to enable us to view and to  
12 assess the consequences of these agreements upon the  
13 operations, the financial impact, the market effects, the  
14 market shares, the effects on other carriers.

15 I think those things so far have not been addressed  
16 in the filings.

17 As far as timing is concerned, there is no overriding  
18 reason to rush to judgment in determining the decision upon  
19 reopening. However, at the same time, the proceeding need not  
20 require a full 31 months to come to judgment. The Commission  
21 should be able to complete a review and render a decision on an  
22 expedited schedule perhaps by the end of the year.

23 CHAIRMAN GRADISON: If we had nothing else to do.  
24 But we do have a few other items on our docket, a few  
25 Congressional committees to testify before, a budget to put

1 together, a few other odds and ends that we're responsible for.

2 But to assure all the parties, both for and against  
3 the merger, it's one of our priorities to get this thing  
4 decided.

5 MR. MACKENZIE: Yes. And I would submit, Madam  
6 Chairman, it's in the national and the state's best interest to  
7 resolve the future of the SPT as soon as possible, and I refer  
8 the Commission to our response and comments filed on January  
9 2nd, 30th, and March 24th for a further indication.

10 I would like to address two more things that were  
11 raised earlier.

12 One, Mr. Stephenson indicated that all competitive  
13 issues had been addressed. I think that we still need in the  
14 record and in the initial filings a description of the  
15 competitive issues that are caused by and result from the  
16 agreements and the trackage rights.

17 Number two, Mr. Freeman indicated that the agreements  
18 are self-explanatory. I would suggest that they are not  
19 self-explanatory. There are a number of ambiguous or nebulous  
20 areas that need explanation and assessment as far as their  
21 effects.

22 And thirdly, if the applicants or petitioners are  
23 going to stress or rely upon private and public benefits from  
24 the reciprocal trackage rights agreements, I think they should  
25 be required also to justify the competitive and public impacts

1 from those agreements.

2 COMMISSIONER SIMMONS: Mr. Mackenzie, are you a  
3 proponent or opponent?

4 [Laughter.]

5 MR. MACKENZIE: Let's say I'm both here and there.

6 COMMISSIONER SIMMONS: Well, you've been classified  
7 as a proponent, and I'd like for you to try to be as objective  
8 as you can and answer my question. It's rather general.

9 What do you think would be most beneficial to the  
10 California rail shippers and to the public, the public in  
11 general? The merger of Santa Fe/Southern Pacific as presently  
12 proposed or two strong, independent railroads competing against  
13 one another?

14 MR. MACKENZIE: Well, Commissioner, I think that's  
15 the question.

16 COMMISSIONER SIMMONS: I'm asking you.

17 MR. MACKENZIE: That is the question that we would  
18 like to answer as well, and we think that the agreements appear  
19 to point in the direction of a transaction which is more to the  
20 benefit of California than not, than the present situation,  
21 that is. But we don't know for sure yet. We have to have more  
22 evidence and more filings to determine that first.

23 CHAIRMAN GRADISON: So you are as proponent of  
24 reopening.

25 MR. MACKENZIE: Correct.

1 CHAIRMAN GRADISON: But you're not an advocate of the  
2 merger one way or the other.

3 MR. MACKENZIE: Yes, ma'am.

4 CHAIRMAN GRADISON: But you want us to look at it.

5 MR. MACKENZIE: Correct.

6 CHAIRMAN GRADISON: Okay. That completes the  
7 presentations of the proponents with the nine minutes reserved  
8 for rebuttal from Mr. Stephenson and Mr. Svolos.

9 What I'd like to do is take a ten-minute break and  
10 reconvene at about four minutes to three. We'll be prompt, so  
11 that we can keep moving.

12 Thank you.

13 [Recess.]

14 THE CLERK: All rise. Please be seated.

15 CHAIRMAN GRADISON: Thank you, ladies and gentlemen.

16 We will now hear from the opponents to the case,  
17 first from Joseph Auerbach of the Kansas City Southern Railway  
18 Company and the Louisville and Arkansas Railway Company.

19 Mr. Auerbach, you have 30 minutes.

20 MR. AUERBACH: Madam Chairman, Mr. Vice Chairman,  
21 members of the Commission.

22 We oppose the reopening of this proceeding, and I  
23 will address in the course of my argument why we say to the  
24 Commission there are no changed circumstances here. There are  
25 charged positions, but there are no changed circumstances. We

1 will go on to the question of whether this should be treated as  
 2 a new case, and in that regard, whether you reopen or treat it  
 3 as a new case, the question of what the deficiencies are in the  
 4 record and what the record would have to contain to permit you  
 5 to make the decisions that the law requires you to consider.

6 In saying these things, and I will deal with each one  
 7 of them before I am through, we must recognize that if you  
 8 reject this petition for reopening, you have not sent them  
 9 home. They have the opportunity with their collaborators to  
 10 file a new Section 11,343. The question that is going to be  
 11 before you is whether there is such a significant difference  
 12 between those two procedures -- the reopening procedure or the  
 13 new case procedure -- that it ought to enter into your  
 14 decision.

15 Since we believe that the record in both cases would  
 16 be essentially the same and require the same effort on the part  
 17 of the Applicants and their collaborators, we think and we urge  
 18 you to find that there won't be any difference in that regard.

19  
 20 That gets me to what you ought to do, and here we are  
 21 terribly concerned. We think we have discerned today from the  
 22 Commission's questions that there is a concern at the  
 23 Commission, and that is to say, what happens during the  
 24 interim? What happens while you reopen, if you should do that  
 25 and go to the question of the merits again? What does this

1 visit upon the SPT?

2 We would call to the Commission's attention -- and  
3 this will be part of the proposals which I will make in my  
4 argument -- that you have got the problem now of whether you  
5 should not go back and revisit the voting trust agreement and  
6 your order and opinion of December 22, 1983 which approved that  
7 voting trust agreement and which, as part of that approval,  
8 recognized they should be permitted to go forward with the  
9 merger.

10 That is 3-1/2 years ago. A lot of things have  
11 happened in 3-1/2 years, and without even thinking in terms of  
12 the last seven or eight months since you decided the merits,  
13 3-1/2 years for SPT has been a very significant period. You  
14 have heard that today from counsel for the SPT, and I don't  
15 have to dwell on it but I intend to come back to that point  
16 because it is so important in your consideration.

17 But for this purpose let me say as a kind of  
18 summation of what I am going to propose to you that I think  
19 that if you reopen the case, you must condition it. You must  
20 condition the reopening on not only the normal matters of the  
21 kind of record you would want to have before you, but on a  
22 reopening of the trust agreement and a change and modification  
23 of the trust agreement to provide some parallel action which  
24 would occur while they proceed with their reopened case if you  
25 decide to do it.

1           Secondly, if you decide not to do it, then as part of  
2 my argument I am going to say to you please now on your own  
3 motion, not as a condition because there will be nothing to  
4 condition, but on your own motion reopen the voting trust  
5 agreement and start the procedures going which will assure that  
6 SPT during this interim period before anything happens, is  
7 going to be in a position where it will survive, and hopefully  
8 not just survive but increase its viability.

9           CHAIRMAN GRADISON: What is it you want us to do on  
10 our own motion?

11           MR. AUERBACH: Yes. Let me go back for a moment,  
12 Madam Chairman, to the opinion and order of December 22, 1983.  
13 You provided in your order a reservation of jurisdiction at any  
14 time to require changes in the voting trust agreement, almost  
15 in those words, with respect to the ownership and operation of  
16 SPT. That is what I am asking you to do in your own motion, go  
17 back and do that now. I will give you some ideas that we have,  
18 for any assistance they may be to the Commission, of what you  
19 think we ought to do in that respect.

20           VICE CHAIRMAN LAMBOLEY: I am not sure I follow what  
21 you have just said. Have we ever abandoned the notion of that  
22 jurisdiction?

23           MR. AUERBACH: No, sir. What I am suggesting,  
24 Mr. Vice Chairman, is that now is the time to go back and do  
25 it. No, you have never abandoned it.

1 VICE CHAIRMAN LAMBOLEY: I am just trying to  
2 anticipate your point, and I'm not getting there.

3 MR. AUERBACH: Let me go back to the December 22  
4 opinion and order. In that you said the following: "The cease  
5 and desist order entered in these proceedings on December 14th"  
6 -- that's when you told them they couldn't go ahead with the  
7 merger -- "will be lifted subject to our receipt of a full and  
8 unqualified acceptance of the Commission's authority to impose  
9 conditions upon the trust instrument" -- and you got that  
10 consent from them -- "governing the ownership and operation of  
11 SPT to include but not limited to matters discussed in the text  
12 of this decision."

13 I am asking you now to operate under that provision,  
14 either as a condition to any reopening, if you decide that, but  
15 if you don't decide to reopen and let them go ahead and they  
16 don't file a new 11,343, I think you must act anyway or SPT is  
17 in grave difficulties.

18 VICE CHAIRMAN LAMBOLEY: What you see is the role of  
19 the trustee, and certainly in relationship to a recent order  
20 that we issued regarding the independent trustee's  
21 responsibility in this regard.

22 MR. AUERBACH: Yes, Mr. Vice Chairman. The trustee  
23 is a stakeholder. The trustee doesn't represent beneficial  
24 holders in the normal stance. It is not responsible to  
25 beneficial holders. Under the trust agreement it is only

1 responsible for gross negligence. It isn't in the position of  
2 someone now operating a railroad in an atmosphere of  
3 deregulation, which we have had now since prior to this  
4 proceeding started 3-1/2 years ago.

5 We have got the problem of how does a major railroad  
6 of this country, in an atmosphere requiring dynamic management,  
7 manage a railroad? It can't abandon lines in terms of an  
8 efficient, energetic management. It can't borrow money in  
9 terms of a mortgage. It can't pay dividends. It can't issue  
10 common stock.

11 CHAIRMAN GRADISON: Things do get complicated.

12 MR. AUERBACH: And the problem is that now is the  
13 time when they have to be uncomplicated, Madam. It seems to me  
14 the Commission now has to act in this regard or, if you let the  
15 status quo remain, either by reopening and waiting or by  
16 denying reopening and doing nothing, then SPT will cease to be  
17 a competitor. It is bound to go downhill. You will find  
18 yourself in a year, two years where SPT in these districts that  
19 we are talking about today won't even exist. It won't be a  
20 competitor.

21 CHAIRMAN GRADISON: The proponents just told us they  
22 were healthy and viable, they expected to be here, that the  
23 failed firm doctrine had been abandoned in this case, and my  
24 question, I guess, is why is it that you know they are going to  
25 go under and they say they aren't, and a year ago they said

1 they were going to go under and they didn't, and what is it  
2 that you know that no one else seems to know?

3 MR. AUERBACH: What I know, Madam Chairman, is the  
4 record. What you have heard are counsel's opinions. The  
5 record said flatly in 1985 by the chief executive officer of  
6 this corporation it is now bankrupt, and they told you in all  
7 the prior proceedings you have had that it is a dead duck and  
8 we have got to do something to save it. When you came to your  
9 own opinion what you found was that it was marginal. I don't  
10 have to give you my opinion; I give you your opinion and I give  
11 you their opinion.

12 CHAIRMAN GRADISON: You are saying cut this marginal  
13 railroad off.

14 MR. AUERBACH: No, ma'am. What I am going to propose  
15 to you, having tried to lay the foundation, is a procedure  
16 whereby we can try to save the SPT in the context of your  
17 jurisdiction. What I propose is the following.

18 VICE CHAIRMAN LAMBOLEY: As it relates to reopening  
19 or not reopening. You gave us a choice, reopen or not reopen  
20 and do nothing. I don't understand.

21 MR. AUERBACH: No. I was giving that as an example  
22 in answer to a question, Mr. Vice Chairman. What I am saying  
23 to you is under these circumstances, if you decide to reopen --  
24 which I oppose but you will decide that on your own discretion  
25 -- if you decide to reopen, the procedure which I am going to

1 now outline would still be applicable and I urge you to follow  
2 it even if you reopen. If you don't reopen, you can't impose  
3 it as a condition, which you could if you reopened, so hence  
4 you can and would have to act in your own discretion under the  
5 order which I read to you. It is there. It exists. You have  
6 that discretion and jurisdiction.

7 VICE CHAIRMAN LAMBOLEY: I don't think we are  
8 fighting you on that.

9 MR. AUERBACH: Let me tell you what I propose that  
10 you do.

11 CHAIRMAN GRADISON: I can't wait.

12 MR. AUERBACH: I propose that the first thing you do  
13 is direct the voting trustees to direct the board of directors  
14 of SPT to give access to any person who wants to bid to buy the  
15 SPT.

16 CHAIRMAN GRADISON: Wait. Give access?

17 MR. AUERBACH: Access to a real inspection, books and  
18 records, cooperation of staff, everything that is needed in  
19 order to let people decide what they can pay for SPT.

20 VICE CHAIRMAN LAMBOLEY: Wouldn't that be consistent  
21 with a divestiture approach, then? Isn't that what you are  
22 saying?

23 MR. AUERBACH: The divestiture approach in the past  
24 has been to wait for a divestiture order. What I am now  
25 suggesting to you is the conditions you would put on a

1 divestiture order, and one of the questions would be to get  
2 access for people to go in and take a look at it. And I am not  
3 talking just KCS. We will be the first --

4 CHAIRMAN GRADISON: Kind of an auction preview.

5 MR. AUERBACH: You can call it that.

6 CHAIRMAN GRADISON: To go through and review what is  
7 available and test the springs and see how it works.

8 MR. AUERBACH: Or you could call it the person who  
9 has to sell a property deciding what he has to do to show the  
10 property. Now, whether it is KCS who is the bidder --

11 COMMISSIONER ANDRE: Do you visualize a possible  
12 non-rail purchaser?

13 MR. AUERBACH: Yes, sir.

14 COMMISSIONER ANDRE: Do you think that might create a  
15 disparity in the price that is being offered?

16 MR. AUERBACH: It could, Mr. Commissioner. Clearly,  
17 there could be non-rail people and there might be out in the  
18 woodwork. There may be non-rail people. If so, they don't  
19 have to worry about 11,353. We know there are rail people. We  
20 know there is --

21 COMMISSIONER ANDRE: You are proposing that it be  
22 opened to all comers, non-rail?

23 MR. AUERBACH: Oh, all persons, Commissioner.

24 CHAIRMAN GRADISON: Let me follow on an analogy or a  
25 question that I made earlier. We are talking about Southern

1 Pacific Transportation Company.

2 MR. AUERBACH: Yes, ma'am.

3 CHAIRMAN GRADISON: Is it dead or is it alive?

4 MR. AUERBACH: Alive.

5 CHAIRMAN GRADISON: And we are talking about the  
6 divestiture of the Southern Pacific from the Santa Fe holding  
7 company.

8 MR. AUERBACH: Yes, ma'am.

9 CHAIRMAN GRADISON: And we are talking about doing  
10 this next week.

11 MR. AUERBACH: No, we can't do it next week.

12 CHAIRMAN GRADISON: As soon as possible.

13 MR. AUERBACH: You could do it tomorrow if you have a  
14 non-rail purchaser because they are not subject to 353.

15 CHAIRMAN GRADISON: But you are saying let's open the  
16 door so everyone can look.

17 MR. AUERBACH: Everyone can come in, yes.

18 CHAIRMAN GRADISON: All right.

19 MR. AUERBACH: My first point was open the door. The  
20 second point is to tell the voting trustee, by fixing a period  
21 of time, that the voting trustee must come up during that  
22 period of time with a purchaser -- if there should be one, and  
23 we know we are going to bid for it and presumably many others  
24 -- to come up with a purchaser, and if it is a rail purchaser,  
25 Commissioner, to join in an 11,353 application. If it is a

1 non-rail purchaser, go ahead and make the deal.

2 VICE CHAIRMAN LAMBOLEY: Is there some suggestion  
3 here that because there is a potential purchase, we shouldn't  
4 reopen?

5 MR. AUERBACH: No, sir.

6 VICE CHAIRMAN LAMBOLEY: I am trying to figure out  
7 how this marries with the main issue, and that is whether we  
8 should or should not reopen.

9 MR. AUERBACH: It marries in this fashion. As I told  
10 you earlier, I am going to oppose reopening on the ground there  
11 are no changed circumstances and it requires a very significant  
12 record, but if you don't agree with me on this, then I ask you  
13 to condition your reopening for these other matters.

14 CHAIRMAN GRADISON: But if you go back to what  
15 Mr. Miller said, those two premises are inconsistent with one  
16 another. Either you have changed circumstances, and that would  
17 require a significant record, or you don't have changed  
18 circumstances, and therefore if the circumstances haven't  
19 changed, why would you need to build a significant record?

20 MR. AUERBACH: Madam Chairman, I wrote that down too  
21 as Mr. Miller said it because I utterly refused to accept it.  
22 It is not a question of these being inconsistent; it is a  
23 question of these are changed proposals. The circumstances  
24 have not changed. No one is inconsistent by saying there are  
25 no circumstances but there are many changed proposals, hence

1 it's a new case. This is where I disagree with Mr. Miller.

2 Here I am not saying --

3 CHAIRMAN GRADISON: So you are saying proposals do  
4 not change circumstances.

5 MR. AUERBACH: Of course, Madam.

6 CHAIRMAN GRADISON: That the tracks are still there  
7 and the tracks haven't changed.

8 MR. AUERBACH: The facts -- we have to take their  
9 tracks, not "the" tracks. The facts that existed when you  
10 decided this case in October --

11 CHAIRMAN GRADISON: The what?

12 MR. AUERBACH: The formal opinion that people could  
13 read in October, those facts have not changed. What has  
14 changed is their willingness to accept new proposals and make  
15 new proposals to you, but the facts have not changed. You have  
16 got the same railroads, the same structures. You have got  
17 other railroads coming in, but that is, again, new proposals.  
18 That is not a change in their circumstances.

19 COMMISSIONER SIMMONS: Aren't financial conditions a  
20 circumstance?

21 MR. AUERBACH: Yes, they are. Now, the financial  
22 conditions we have seen, at least as we go to the first quarter  
23 this year, have changed somewhat, Mr. Commissioner, but not  
24 what was predicted as I sat in this very room and heard the  
25 oral argument made by them to you. They are better than they

1 were then.

2 The question of going along a parallel route,  
3 Mr. Vice Chairman, of permitting the auction procedure to go  
4 on, if you should reopen, let that go on. You can consolidate  
5 both. You can still decide that you want to approve the  
6 merger. I am not arguing the merits of the merger today.

7 VICE CHAIRMAN LAMBOLEY: I guess on that I would  
8 react just quickly to that. I am wondering how efficient and  
9 effective that would be. There is a potential of crossed-over  
10 issues very easily to be developed on that, and the primary  
11 mission is for us to decide, one, to reopen, and if it is  
12 reopened, then what to do in connection with that.

13 MR. AUERBACH: Yes, sir.

14 VICE CHAIRMAN LAMBOLEY: If you are going to track  
15 parallel, a divestiture kind of approach, it seems to me that  
16 you can blur a lot of the issues if you want to.

17 MR. AUERBACH: I hope to persuade you that the  
18 evidence is precisely the same. I hope to persuade you on  
19 that. Let me go to that point. You asked some questions about  
20 this. The question of the evidence. What do you need here for  
21 this case that they have now proposed if you grant reopening?  
22 What kind of evidence do you need?

23 There are five principal areas that you must have  
24 evidence in. Financial data, certainly. It is all brand new.  
25 Their evidence is 1982. We are talking about 1987. Certainly

1 we have got to use 1986 evidence. We have got to use a whole  
2 different period, and 1982, as you said in your own opinion,  
3 was a bad year. It was a recession year. It was an  
4 untrustworthy year for purposes of making financial  
5 projections. This is an entirely new game on financial.

6 How can you go to a 50,000 mile, and that is what  
7 this proposal is to you now, you understand, when you are  
8 bringing Union Pacific and the Rio Grande and the KATY, you now  
9 have a 50,000 mile case where you had a 25,000 mile case  
10 before. How can you not have new traffic and competition  
11 analysis? The old isn't even any good. Why isn't the old any  
12 good? You rejected the credibility of the traffic evidence in  
13 your own opinion. You weren't satisfied with that.

14 The principal case was intermodal evidence. Now, the  
15 question of whether intermodal evidence is going to have a  
16 place here at all, we don't know about, that doesn't even show  
17 in the filing they made with you. This is a brand new case on  
18 traffic and competition, and it's one of those extraordinary  
19 circumstances, but this is the kind of problem you have with  
20 the old evidence which they say they are going to rely on.

21 It's hard to believe that the 1982 traffic data does  
22 not even include the effects of the merger or the acquisition  
23 of the Union Pacific or the Missouri Pacific. The impact of  
24 that combination is not even in that data. If you listened to  
25 what I heard today, it would propose to take that data and add

1 these savings benefits to it. That's brand new stuff. It's  
2 five years old, but it's brand new stuff.

3 VICE CHAIRMAN LAMBOLEY: Is that a bar to re-opening?

4 MR. AUERBACH: No, sir. I'm addressing now the  
5 question, Mr. Vice Chairman, if you re-open, the evidence you  
6 need in order to make the record that you have to have to reach  
7 your decision.

8 VICE CHAIRMAN LAMBOLEY: Isn't that something that  
9 comes post-decision to whether to re-open or not? Maybe I'm  
10 just not following.

11 MR. AUERBACH: No, to me, it doesn't. I can separate  
12 in my mind if somebody says to you, let's re-open the case, but  
13 change the circumstances. That's what they said. That's  
14 absolutely not so. There are not changed circumstances. Then  
15 you said in your order to us, what evidence would be needed.  
16 All right, suppose you find I'm wrong, there are changed  
17 circumstances, if that is your decision, this is the evidence  
18 you have to have.

19 This is the same evidence, Mr. Vice Chairman, you  
20 have to have whether you do parallel cases I've proposed or  
21 just the re-opened case.

22 I mentioned traffic, I mentioned financial.  
23 Operating plans. Again, you have 50,000 miles with cross  
24 trackage rights. Can they seriously persuade you there is no  
25 need for new evidence on what the operating plans are going to

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1 have --

2 COMMISSIONER LAMBOLEY: That is using DOT's  
3 screens.

4 MR. MARTIN: Yes, sir. Yes, sir. Using the  
5 DOT's screens as they were amended.

6 But let's assume we've got a movement that  
7 falls within the 4-1/2 million or so tons. Let's say  
8 today it's moving at 160 percent of our variable costs.  
9 That's not even up to the level of the market dominance  
10 threshold today.

11 Let's say we have the merger and let's say  
12 we're wrong. Let's suppose that we do get market power  
13 out of this merger because the trucks aren't effective  
14 and that after the merger our temptation would be to  
15 take that rate from 160 to 200 percent. So what  
16 happens?

17 We have to tell the shipper about the rate increase  
18 and the shipper knows about the BN solicitation  
19 agreement and if we take that rate up from 160 to 200,  
20 the BN has the absolute right under this agreement to  
21 come in and make us carry it on their account at the 160  
22 percent level, assuming that's the rate level that's in  
23 place on the day the merger goes into effect.

24 The fact that that is there means that we won't be  
25 able to take the rate up in the first place.

1           Now, some of our friends have criticized this  
2 arrangement and they have said, "Well, the BN is not  
3 going to make any money out of it. How can it be  
4 effective?" Well, of course.

5           In the first place, we say that competition is  
6 going to prevent us from raising those rates in the  
7 first place; but in the second place, the BN's role here  
8 is that of the policeman, the traffic cop on the  
9 corner. They stop anybody from trying to rob the corner  
10 liquor store. We are not going to be able to take those  
11 rates up from 160 to 200 precisely because this  
12 agreement's in place.

13           And I should add that the agreement requires  
14 us to give them service which is at least as good a  
15 service as we would give ourself anyplace else in our  
16 system. And that includes all other competitive places  
17 on the system. So we believe that is an effective,  
18 competitive restraint which will prevent us from abusing  
19 any market power that we might have, even if you thought  
20 we would get some, and we won't.

21           Thank you.

22           CHAIRMAN GRADISON: Thank you, Mr. Martin.

23           We will now hear from Vincent B. McKenzie,  
24 representative for the California Public Utilities  
25 Commission.

1 Mr. McKenzie, you have ten minutes.

2 ORAL ARGUMENT OF VINCENT B. MCKENZIE  
3 CALIFORNIA PUBLIC UTILITIES COMMISSION

4 MR. MC KENZIE: Thank you, Madam Chairman.

5 Madam Chairman, Members of the Commission and  
6 distinguished guests, I am Vincent McKenzie,  
7 representing the People of California and the California  
8 Public Utilities Commission. We appreciate the  
9 opportunity to briefly address you on this important  
10 matter.

11 People in business in California have a major  
12 stake in the outcome of this proceeding. The  
13 substantial body of rail traffic to and from California  
14 moves over the central and southern rail corridors.  
15 Many of the industries and our 25 million citizens rely  
16 heavily on efficient, economic and competitive rail  
17 transportation.

18 Fifteen percent of all Class I rail revenues  
19 emanate from the State of California. Fresh market  
20 fruits and vegetables, cotton, wine, canned goods,  
21 grapes, nuts, olives, sugar beets, chemicals,  
22 automobiles and parts, lumber, petroleum products, and  
23 various minerals are only some of the major products  
24 which require viable and competitive railroads industry  
25 to provide the nation with needed products at

1 competitive prices.

2 Today California relies on three primary rail  
3 carriers to provide service. Based on the rail tonnage  
4 in 1982, SP had a market share of about 45 percent,  
5 Santa Fe 34 percent, UP about 22 percent. With the  
6 combination of the Southern Pacific and Santa Fe, their  
7 combined market share would approximate 79 percent of  
8 all tonnage originating and terminating in California.

9 Our experts weighed the impacts from this  
10 proposed merger in studies presented to the Commission.  
11 Exhibit CP C-5 in the examination of our witness John  
12 Williams presented our analysis. On the one hand our  
13 experts believe there will be benefits to be realized  
14 from the combined SPSF system. Applicants will be able  
15 to realize efficiencies through consolidation of  
16 facilities and certain service improvements. The  
17 combination will improve their financial health. The  
18 improved financial condition of the SFSP is particularly  
19 significant.

20 Decline in the financial health of the SP or  
21 Santa Fe may lead to a decline in levels of service and  
22 their ability to compete. Applicants have not  
23 demonstrated the strong financial performance compared  
24 to the Union Pacific or the Burlington Northern. A  
25 financially strong SFSP would better allow it to

1 competitively and reliably serve the public and benefit  
2 the shippers and the economy of California and the  
3 nation.

4 California also presented to the Commission  
5 evidence that the State's interest will sustain adverse  
6 or anti-competitive impacts from the merger that will be  
7 detrimental to the interests of the State. SP and  
8 Santa Fe individually control substantial blocks of  
9 traffic originating and terminating in California. The  
10 primary adverse impact will be a substantial increase in  
11 the amount of real traffic dominated by a single  
12 carrier, the combined system, and the resultant  
13 elimination of rail competition that will occur in  
14 several important subregions of the state.

15 Our expert testified that as a result of the  
16 market concentration and market power, that existing or  
17 potential rail competition will be eliminated east of  
18 the Los Angeles Basin, which includes most of Riverside  
19 County and all of Imperial County and in the South San  
20 Joaquin Valley, which includes the Counties of Kern,  
21 Tulare, Kings, Fresno, Madeira and Merced.

22 In addition, competition will be reduced in  
23 the Los Angeles Basin, the North San Joaquin Valley and  
24 the San Francisco Bay area.

25 We presented an estimate that intramodal

1 competition would be effectively eliminated for  
2 approximately 32 percent of California's rail traffic.  
3 In more particular, California is fearful that an  
4 unconditioned rail consolidation will reduce the  
5 viability of the central rail corridor in its  
6 availability to shippers between California and the  
7 Midwestern and Eastern United States over the so-called  
8 Overland Route.

9 CHAIRMAN GRADISON: Mr. McKenzie, does the  
10 California PUC have a position, in the event the two  
11 carriers were to go bankrupt?

12 MR. MC KENZIE: The position was not evidenced  
13 in our presentation of -- I do have my own personal  
14 position on it that I'd be happy to give you. We think  
15 that in the short run there is no real danger. In the  
16 long run, we can see some serious consequences of the SP  
17 or Santa Fe not merging, to the point where service  
18 could be affected.

19 If they did go bankrupt under your  
20 hypothetical, there conceivably could be purchasers,  
21 railroads and otherwise, that would be available to  
22 purchase those portions of property that were useful.

23 CHAIRMAN GRADISON: Thank you.

24 MR. MC KENZIE: Competition on the central  
25 rail corridor today exists between the Union Pacific

1 system and the SP/Rio Grande interchange route. An  
2 expected reduced usage by the SFSP on the Overland route  
3 in favor of its single-system long-haul southern routes  
4 would essentially deprive California's shipping public  
5 the benefits from the rail carriers effectively  
6 competing on that central corridor. This, we believe,  
7 would be the primary outcome of an expected diversion of  
8 central corridor traffic by the SFSP to its more favored  
9 southern routes.

10 Our witness estimate was as much as 50 to 55  
11 percent of the present traffic would be diverted to the  
12 southern routes. But even though it was only the 25  
13 percent that the Applicants estimated, it would still be  
14 serious. California is also greatly fearful of an  
15 expected loss of rail competition from the SFSP  
16 consolidation that will occur over its southern corridor  
17 between California and the southeastern and southwestern  
18 United States.

19 The further impact expected from a merger was  
20 provided by our expert witness to the Commission was an  
21 expectation of increased rates to shippers that will  
22 likely occur for various commodities shipped by rail.  
23 Our analysis of 12 representative commodities presented  
24 to the Commission showed a most likely rate increase  
25 level averaging 43 percent in a post-merger

1 environment.

2 But the primary adverse impact resulting from  
3 a merger, we emphasize, would be a diminution of rail  
4 competition over the central and southern rail  
5 corridors. Our experts do not believe that intermodal  
6 competition such as trucking would really alleviate the  
7 loss of rail competition that the merger will cause,  
8 primarily because of the distances and types of  
9 commodities involved.

10 Based on the benefits expected from the  
11 consolidation, California believes the merger should be  
12 approved, but only on condition that the present rail  
13 competition is maintained. This could best be achieved  
14 by permitting other carriers access into these important  
15 rail markets.

16 Granting the application of the Rio Grande and  
17 the Union Pacific, with minor exceptions, would provide  
18 this competition. The expected reduction in intramodal  
19 competition over the central corridor should be  
20 substantially mitigated, we believe, by affording the  
21 Rio Grande access to the California markets over that  
22 corridor. The Rio Grande has formally requested  
23 trackage or acquisition rights to serve California and  
24 Oregon shippers over the Overland route and the  
25 evidence, we believe, strongly supports your granting

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1 these rights.

2 This Commission in California has long  
3 supported the need to sustain a viable central rail  
4 corridor and the preservation of the central corridor  
5 competition was a prime objective of the Commission's  
6 decision in the UP merger case. Approval of this merger  
7 without the Rio Grande conditions would undercut that  
8 decision. Our expert believes that SFSP will no longer  
9 have the strong incentive to use the central corridor  
10 after the merger, since it will divert more and more  
11 traffic to its long-haul single-system southern corridor.

12 Now with regard to the submission by the  
13 Applicants that they desire to continue the solicitation  
14 agreement and the CP conditions, those even together we  
15 do not believe would suffice for the loss of rail  
16 competition in that they both require incentive of the  
17 Southern Pacific to turn over traffic. Nothing in  
18 either of those arrangements require that certain  
19 commodities or certain volumes be utilized so that the  
20 incentive to divert to the south would still remain in  
21 our opinion.

22 CHAIRMAN GRADISON: Mr. McKenzie, could you  
23 address the Commission's 445 -- We didn't get a green  
24 light, Mr. Secretary. It just went to red. Where are  
25 we?

1                   Okay. Could you address the Commission's 445  
2 requirements for an efficient carrier with regard to use  
3 specifically of the central corridor.

4                   MR. MC KENZIE: This is CP conditions, section  
5 E?

6                   CHAIRMAN GRADISON: Yes.

7                   MR. MC KENZIE: That, again requires the  
8 incentive of the carrier. Today it works to a modicum.  
9 In the future, there won't be, really, an incentive of  
10 the Southern Pacific to utilize that corridor despite  
11 that requirement. There is no requirement to turn over  
12 any specific volumes or types of goods, commodities, to  
13 those carriers.

14                   CHAIRMAN GRADISON: Thank you.

15                   MR. MC KENZIE: Let's see. Now what's the  
16 situation now. One more minute?

17                   CHAIRMAN GRADISON: You're within your last  
18 minute, yes, sir.

19                   MR. MC KENZIE: I better state the final  
20 position, then.

21                   The People of California and the Public  
22 Utilities Commission, therefore, supports this primary  
23 application only if those portions of the application  
24 for the Rio Grande and Union Pacific are granted. We do  
25 not support a merger without conditions being imposed

1 which mitigate the anticompetitive consequences of the  
2 merger. We greatly appreciate the Commission and the  
3 judge's and the staff's courtesies that they have  
4 granted California in this matter.

5 CHAIRMAN GRADISON: Thank you, Mr. McKenzie.

6 COMMISSIONER LAMBOLEY: Mr. McKenzie?

7 CHAIRMAN GRADISON: I'm sorry. His time has  
8 expired.

9 COMMISSIONER LAMBOLEY: He didn't mention  
10 abandonments. I would like to ask him if California had  
11 a position on the abandonments. There are about four of  
12 those out of the eight -- in California, if your staff  
13 made any studies about prospective abandonments beyond  
14 that. .

15 MR. MC KENZIE: No. But like all matters,  
16 it's conceivable that post-merger there will be  
17 abandonments. But those abandonments that had been  
18 proposed by the Applicants we are not in opposition to.

19 CHAIRMAN GRADISON: Thank you, Mr. McKenzie.

20 Our next witness will be Mary Bennett Reed  
21 from the Department of Transportation. You have 10  
22 minutes, and I remind you that all the questions must be  
23 addressed within the speaker's time allotment in order  
24 to be fair to all those making presentations to us  
25 today.

1 MS. REED: Chairman Gradison, Vice Chairman  
2 Simmons, Commissioners, I appreciate this opportunity to  
3 present the Department of Transportation's views on the  
4 proposed merger.

5 COMMISSIONER STERRETT: Ms. Reed, before you  
6 begin, I am going to ask the same question of the  
7 witness from the Department of Justice. I wonder if you  
8 would clarify for me how two branches of the same  
9 administration, looking at the same merger, exercising  
10 the same public interest considerations, can come up  
11 with such diametrically opposed conclusions. Is it  
12 methodology and, if so, how?

13 MS. REED: The Department of Justice  
14 recognized that there were three deficiencies in their  
15 analysis. First, that they did not consider the impact  
16 of the merger on TOFC service and they did not analyze  
17 it separately. That is an analysis that the Department  
18 of Transportation specifically performed. And we  
19 submitted extensive data on that subject, which shows  
20 that there will be no reduction in competition for TOFC  
21 traffic.

22 Secondly, they did not -- and they admitted  
23 that they did not consider the effect of the merger on  
24 geographic competition. We did a specific analysis  
25 which shows that there will not be a reduction in

1 geographic competition.

2 Third, they said that they did not consider  
3 the effects of the merger on potential -- for reducing  
4 potential competition; again, the Department of  
5 Transportation performed that analysis. And to the  
6 extent the potential competition will be reduced, the  
7 BN, SPSF solicitation agreement will correct any  
8 anticompetitive effects.

9 So they have said that there are three  
10 deficiencies in their analysis and, therefore, they are  
11 unsure that the 6 million tons that they have identified  
12 are the maximum amount. We are confident that we have  
13 identified all the potential reductions in competition.  
14 And, therefore, we support the merger subject to the  
15 amelioration of those anti-competitive effects.

16 It has been said that railroads often view a  
17 merger proceeding as an invitation to a buffet at which  
18 the guests first review what is on the table and then  
19 select the choicest morsels. Here the guests are the  
20 Protestants and the morsels are those parts of the SP  
21 Santa Fe system which they find most lucrative and  
22 attractive. The Protestants realize, however, that  
23 their appetites and tastes are not sufficient to get  
24 them a plateful. They have to justify each choice to  
25 the Commission.

1                   However, when you go beyond the service of  
2 their request and review their self-interested  
3 justification, you will find that the underlying  
4 analysis is not valid and should be rejected.

5                   The Commission has repeatedly held, and  
6 properly so, that conditions will not be imposed on a  
7 merger unless they are necessary to ameliorate  
8 significant anticompetitive effects and to preserve  
9 essential rail services. Protestants, however, are only  
10 concerned with protecting routes and revenues. However,  
11 to the extent that the Applicants are able to offer  
12 better service at lower cost, competition will not be  
13 reduced.

14                   Protestants have not carried the burden of  
15 showing that the conditions they seek are needed to  
16 ameliorate the anticompetitive effects. Instead a  
17 proper and thorough competitive analysis of the markets  
18 where the Applicants compete and the competitive forces  
19 in those markets shows that with the major exception of  
20 the 6 million tons of traffic which we have identified,  
21 competition will not be reduced.

22                   Nor do Protestants' requested conditions  
23 address these anticompetitive effects. Only a narrowly  
24 targeted remedy such as we have proposed and which  
25 Applicants have developed with the Burlington Northern

1 correct the competitive problems.

2 Protestants have failed to include intermodal  
3 and source competition in the relevant geographic  
4 markets, even though it is clear that these are  
5 effective, competitive forces for TOFC, boxcar  
6 perishable and grain traffic, competitive forces which  
7 the Commission has recognized in previous cases.

8 They have proposed an all-or-nothing  
9 approach. Unless intermodal competition is effective  
10 for all movements, it is ineffective. Such crude  
11 assumptions are not only improper but also violate the  
12 Commission's stated policy of imposing conditions only  
13 where needed to ameliorate anticompetitive harms.

14 Protestants have also failed to define  
15 adequately the relevant geographic markets in which the  
16 applicants compete. UP's analysis looks at BEAs or  
17 groups or BEAs which are broad enough to include an area  
18 from the Mexican-California border to Lake Tahoe.

19 While their competitive analysis looks at  
20 flows between BEAs in fashioning its remedy, UP only  
21 seeks to serve common SPSF points, a significantly  
22 smaller geographic area.

23 On the other hand, the remedies include all  
24 traffic to or from SPSF points regardless of where it  
25 moves. So their analyses are inconsistent.

1 Protestants' own evidence contradicts their  
2 use of a broad geographic area in which Applicants  
3 compete. Except for TOFC, boxcar, grain, and  
4 perishables, they have stated there is very little  
5 trucking to another rail head. Therefore, their use of  
6 a BEA or a state as a geographic area in which  
7 Applicants compete is unsupported. Instead, the narrow  
8 geographic definition we have used, a town or a  
9 municipality, is a proper area for determining where  
10 Applicants and other carriers are engaged in competition.

11 Other parties, on the other hand, would  
12 unjustifiably reduce the geographic area. Our analysis  
13 of Southwest Kansas Grain, using rail rates and trucking  
14 costs, cited by the Katy, found that shippers located at  
15 Liberal, Kansas, the end of the SP's gathering line,  
16 would be able to truck grain to the terminal at  
17 Hutchinson, Kansas without any loss in that revenue, if  
18 SPSF tried to raise their rates by 1.5 percent. The  
19 power of a merged SPSF to raise grain rates, therefore,  
20 will be significantly constrained post-merger.

21 Traffic moving to Mexico is also subject to  
22 similar broad competitive constraints which Protestants  
23 would ask you to ignore. The primary commodity moving  
24 to Mexico is grain and approximately 60 percent of that  
25 moves by barge. Yet, the Katy would ask you to ignore

1 water competition.

2 We also consider the possibility of broad  
3 reductions in geographic competition and found that they  
4 did not exist. Does this mean that we didn't find any  
5 reductions in competition? No. We identified 6 million  
6 tons where competition could be reduced. And I use the  
7 word "could," because our flow analysis is conservative,  
8 not taking into account intermodal and source  
9 competition for this traffic. It also includes flows  
10 where other rail carriers participate.

11 Traditionally, the Commission has considered  
12 trackage rights and sales to correct competitive  
13 problems. We saw two problems with this approach in  
14 this case. First, the tonnage and the competitive  
15 problem flows ranges from 631,000 tons to 8 tons.

16 Seccond, there is the issue of what is the  
17 proper level of compensation, and as you know, this is  
18 an extremely difficult issue that you are still  
19 grappling with in the DRGW's trackage rights in the  
20 UP/MOP.

21 Therefore, we tried to develop an approach  
22 whereby a more narrowly targeted and voluntary entered  
23 an agreement to cure the anticompetitive effects would  
24 be reached. We propose that the Commission first  
25 identify the competitive problems and then allow the

1 Applicants to propose a remedy. The Commission would  
2 then review the agreement to determine whether it  
3 corrected the anticompetitive problems.

4 COMMISSIONER STERRETT: Ms. Reed, another  
5 party on brief has stated that "we have had the  
6 evidentiary hearing, at great length, and it is now time  
7 for decision, not invention." I intend to agree with  
8 that. Once a merger is approved, it cannot practically  
9 be undone.

10 Do you have any solutions now that we could  
11 impose, if we were to grant the merger?

12 MS. REED: You can require and approve the  
13 EN/SPSF solicitation agreement and you will cure the  
14 anticompetitive effects. You do not need to hold  
15 another round of hearings. You have the remedy right  
16 before you now on the record to support the imposition  
17 of that condition.

18 COMMISSIONER STERRETT: And that will cure all  
19 the anticompetitive effects you have found?

20 MS. REED: We have one quibble with the  
21 Applicants regarding traffic handled, flows that were  
22 eliminated where another rail carrier is involved, to  
23 the extent that those flows are included and we have  
24 identified in the records those flows, you have within  
25 your power to impose the condition.

1 CHAIRMAN GRADISON: Thank you, Ms. Reed. Your  
2 time is expired.

3 We'll now hear from John R. Scheirman of the  
4 Kansas Department of Transportation.

5 Mr. Scheirman, you have ten minutes.

6 ORAL ARGUMENT OF JOHN R. SCHEIRMAN

7 KANSAS DEPARTMENT OF TRANSPORTATION

8 MR. SCHEIRMAN May it please the Commission, I  
9 am John Scheirman. I represent the Kansas Department of  
10 Transportation and the State of Kansas. We appreciate  
11 the opportunity to address the Commission today. Kansas  
12 is one of several States having substantial mileage of  
13 both Santa Fe and Southern Pacific lines. We feel that  
14 our concerns are representative of a greater region of  
15 the Midwest. I will make some general remarks and then  
16 turn to the Commission's questions.

17 Initially we were concerned when the proposed  
18 merger was announced. Kansas has seen a great deal of  
19 rail restructuring in recent years and has sought to  
20 preserve rail service and to maintain competition. We  
21 recognize that the proposed merger might result in  
22 diminishment of competition and in abandonment of  
23 parallel lines. Therefore, it was a matter of  
24 importance to the State of Kansas.

25 We filed as a formal party while initially

1 taking an undetermined position pending further  
2 investigation.

3 In accessing the merger's impacts, we retained  
4 a consultant who is familiar with the Kansas Rail  
5 System. From his study he formed recommendations for  
6 the State's position. The State of Kansas endorsed  
7 Mr. Mosler's findings. We concurred in his opinion that  
8 the merger would allow for orderly and favorable  
9 economic growth of the State of Kansas, that it would  
10 benefit shippers in terms of single-system service and  
11 that it could prevent the risk of elimination of the  
12 Southern Pacific system.

13 Santa Fe has also suffered declining returns  
14 in investment and needs the merger to remain a viable  
15 competitor. These last considerations are of particular  
16 importance to Kansas, due to the prolonged struggle  
17 which we experienced over the Rock Island bankruptcy and  
18 our desire to avoid a repetition of that experience.

19 Our first statement of position also endorsed  
20 some of the protective conditions requested by other  
21 railroads. This requires further explanation as it is  
22 not the position which we take today.

23 The State of Kansas recommended granting  
24 certain of the trackage rights requested by the MKT. We  
25 also recommended unspecified action by the Commission to

1 ensure that the traffic in the central corridor would  
2 remain viable.

3 Subsequent events and further analysis have  
4 required that our position be modified. The briefs  
5 filed in November 1985 outline the current position of  
6 the State of Kansas in this proceeding.

7 First and foremost we argue that the merger  
8 should be approved by this Commission. The controlling  
9 standard is whether the proposed merger is in the public  
10 interest. We believe that it is. We believe that the  
11 consolidated carrier would be a financially sound  
12 competitor, able to realize operating efficiencies and  
13 increased marketing opportunities. We believe that the  
14 proposed merger passes the balancing test with  
15 substantial public benefits and only insignificant harm  
16 to competition and essential services.

17 The applicants appear to have adequately  
18 addressed any anti-competitive effects by their  
19 voluntary solicitation agreement with the Burlington  
20 Northern.

21 The Santa Fe and the Southern Pacific are  
22 important to Kansas. Currently they provide  
23 approximately 6700 jobs with a payroll of \$240 million.  
24 Last year they paid over \$6 million in Kansas property  
25 taxes. They provide service to shippers at 532 stations

1 in Kansas.

2 The proposed merger is also important to  
3 Kansas. It will provide new single-system service to  
4 locations such as St. Louis, Mexico border crossings,  
5 points in California and Oregon, Texas gulf ports, and  
6 Chicago.

7 We no longer feel that the State of Kansas can  
8 support the granting of protective conditions. The  
9 continuing financial troubles of the Southern Pacific  
10 Railroad raise serious concerns about that carrier's  
11 future. To justify taking on a money-losing enterprise,  
12 the Santa Fe must have every reasonable opportunity to  
13 make the merger work and to receive the benefits of the  
14 consolidation.

15 At a later time it may be reasonable to  
16 determine whether the merger is causing harm to  
17 competition or to essential services. However, at the  
18 outset the greatest threat to competition and essential  
19 services in the Santa Fe and Southern Pacific region  
20 lies in the prospect of a failure of the Southern  
21 Pacific lines. This cannot be permitted to occur.

22 The State of Kansas has endured the failure of  
23 the Rock Island, which affected 13 States. Although  
24 most of the Rock Island lines in Kansas were preserved,  
25 this could not have been done without Federal funding,

1 which has since been curtailed. Rock Island workers  
2 lost their jobs and entire communities were disrupted.  
3 A major Rock Island line was purchased by the St. Louis  
4 Southwestern and would become a part of the Santa Fe  
5 Southern Pacific system under the merger. We cannot  
6 afford to lose the Tucumcari line.

7 Another factor which we have considered is the  
8 announcement of purchase negotiations between the Union  
9 Pacific and the Missouri-Kansas-Texas Railroads.  
10 Although the Katy has stated in its pleadings that the  
11 assumption of such a purchase is factually wrong, the  
12 Commission can take administrative notice of a report in  
13 "Traffic World Magazine," May 12, 1986, indicating that  
14 these negotiations have resumed.

15 In any event, it is our opinion that the Katy  
16 remains a prime prospect for purchase. We would prefer  
17 to see such a private solution to any financial problems  
18 which the Katy may experience, rather than see mandatory  
19 protective conditions imposed.

20 Regarding the DRGW conditions, our original  
21 endorsement was weak, at best. We noted that the  
22 conditions requested are quite extensive. We  
23 recommended only that the Commission be diligent in  
24 taking action to assure that competition is maintained  
25 in the central corridor. We are unable to say what

1 action, if any, is needed to accomplish this goal.  
2 However, we now understand that applicants are willing  
3 to make concessions on this point. So our concerns are  
4 satisfied.

5 We have proposed two alternatives to the  
6 granting of protective conditions as sought by SFSP's  
7 competitors. First, we suggest that the Commission  
8 encouraged the parties to negotiate private solutions.  
9 An example of this is the recently negotiated joint  
10 trackage agreement in Kansas between the Santa Fe and  
11 the Katy. Although it involves lines other than those  
12 in the Katy's trackage rights proposal, it does  
13 demonstrate that Applicants, in fact, are willing to  
14 negotiate.

15 Secondly, if the Commission has serious  
16 concerns about adverse impacts of the merger, we suggest  
17 that it retain jurisdiction and impose reporting and  
18 oversight conditions as has been done in other cases.  
19 Then after the merging carriers have had a reasonable  
20 time to implement the merger and to voluntarily  
21 negotiate solutions to any adverse impacts, the  
22 Commission could, if necessary, impose specific  
23 conditions to protect the public interest. We feel that  
24 at this time the public interest can best be served by  
25 allowing the Applicants to form a strong and viable

1 system capable of providing competition and service to  
2 the public.

3 I will now respond to some of the questions  
4 posed by the Commission.

5 Number 1-A, we believe that if trackage rights  
6 were granted to the UPMP as requested, this could  
7 seriously impair the Applicants' ability to obtain  
8 merger benefits. The UP system is already a direct  
9 competitor of the Applicants. An extension into the  
10 southern corridor would increase this pressure on the  
11 Applicants and further diminish a thin traffic base. We  
12 are unable to quantify these effects, however.

13 Question 4. Loss of competition for Southwest  
14 Kansas grain traffic as a result of the merger would be  
15 limited. According to our consultant's study, there is  
16 currently insignificant evidence of competition for  
17 wheat between Santa Fe and SP in Southwest Kansas. The  
18 only market segment where the merged system could  
19 exhibit its power is in the long haul at Mile to Arizona  
20 and California. MKT's proposed Kansas trackage rights  
21 would do nothing to provide competition for these  
22 movements.

23 Question 6. If the consolidation is denied,  
24 we believe that the Southern Pacific, at least, would  
25 not continue operating for the foreseeable future. It

1 is likely that other railroads would acquire portions of  
2 the Applicants' system, but our experience with the Rock  
3 Island shows that such changes cannot occur without  
4 disruptions and dislocations and that some local  
5 business, once disrupted, cannot be regained. Moreover,  
6 a substantial outlay of public funds would be needed to  
7 offset the effects of a bankruptcy.

8 We respectfully request the Commission to give  
9 consideration to these views. Thank you for the  
10 opportunity to speak today.

11 CHAIRMAN GRADISON: Thank you, Mr. Scheirman.

12 I believe that concludes the presentations by  
13 our proponents with the reservation of time of 15  
14 minutes for rebuttal.

15 We'll now move to the opponents beginning with  
16 Donna Kooperstein of the United States Department of  
17 Justice.

18 Ms. Kooperstein, you have 10 minutes.

19 ORAL ARGUMENT BY OPPONENTS

20 ORAL ARGUMENT OF DONNA KOOPERSTEIN

21 UNITED STATES DEPARTMENT OF JUSTICE

22 MS. KOOPERSTEIN: Madam Chairman and Members  
23 of the Commission, my name is Donna Kooperstein, and I  
24 represent the United States Department of Justice. We  
25 oppose this merger and urge you to disapprove it and

1 allow deregulation of the rail industry to work.

2 COMMISSIONER STERRETT: Could you address  
3 yourself to the same question I asked the Department of  
4 Transportation?

5 MS. KOOPERSTEIN: Yes, I could. I can tell  
6 you why the Department of Justice reached the results it  
7 did. What we did was performed a straightforward  
8 application of our merger guidelines just as we do in  
9 every other merger case that we look at. We looked at  
10 the competitive effects, we looked at the efficiencies,  
11 we looked at the financial condition, and we looked at  
12 the possibility of remedies. And based on that, we  
13 reached our recommendation. The Department of  
14 Transportation, I think, took a bit more of a regulatory  
15 approach to its analysis.

16 COMMISSIONER ANDRE: But did the Department of  
17 Justice concern itself with the facts or does it just  
18 have a dogmatic bias in favor of end-to-end mergers  
19 against all parallel mergers? Do you really care about  
20 the facts?

21 MS. KOOPERSTEIN: I think we really care about  
22 the facts and we spent a lot of time looking at the  
23 facts. We didn't submit economic testimony until March  
24 and we were looking at the facts the whole time until we  
25 submitted that testimony and after we submitted that

1 testimony, we still were looking at the facts and  
2 reached our own conclusions.

3 COMMISSIONER ANDRE: Has the Department of  
4 Justice ever okayed a parallel situation?

5 MS. KOOPERSTEIN: I don't know that we have.  
6 But we do look at each one.

7 COMMISSIONER STERRETT: What about Conrail and  
8 NS?

9 (Laughter.)

10 MS. KOOPERSTEIN: I think you'll find that  
11 Conrail and NS -- that was a merger to a large degree  
12 with parallel overlap, we've recommended that a remedy  
13 be imposed.

14 We think it's a seriously anticompetitive  
15 merger. It would create a rail monopoly in one of the  
16 fastest-growing parts of the country, the southern  
17 corridor, and duopoly in other parts of the country.  
18 Applicants have provided no substantial reasons that  
19 would justify approving this merger, despite its  
20 anti-competitive effects, no satisfactory remedy or  
21 combination of remedies has been proposed.

22 As we were talking about when you look at the  
23 map, you see a parallel merger and there is no getting  
24 around that fact. We think the evidence confirms what  
25 common sense tells you, that a parallel merger leads to

1 a substantial loss of competition.

2 CHAIRMAN GRADISON: Ms. Kooperstein, if a  
3 parallel merger does lead to a substantial loss of  
4 competition, what if one of the two carriers or both of  
5 the carriers go out of the railroad business? Then what  
6 kind of competition do we have in the Southwestern  
7 United States, as our proponents have put forward before  
8 the Commission today?

9 MS. KOOPERSTEIN: Well, I think that what we  
10 have in the merger guidelines to deal with just that  
11 possibility is something called the Failing Firm  
12 Defense. If I could just take a little time to address  
13 your question, I think that will take it into account.

14 The Failing Firm Defense indicates how you  
15 ought to look at the financial condition of merging  
16 firms when evaluating whether merger would be in the  
17 public interest. Well, Applicants claim that they don't  
18 need to meet the Failing Firm Defense. We believe it  
19 sets forth the only circumstances in which any  
20 decisionmaker can safely conclude that an  
21 anticompetitive merger should be allowed. It ensures  
22 that an anticompetitive merger is not permitted as a  
23 bailout for a company in poor financial condition unless  
24 there are no less anticompetitive alternatives to  
25 keeping its assets in the market.

1           And that's the key. If we apply this defense  
2 and we go through the three prongs of it and we find  
3 there are no less anticompetitive alternatives to  
4 keeping its assets in the market, we would not oppose  
5 this merger. But we went through those prongs and we  
6 did not think that they met it. If you would like, I  
7 could talk about those prongs.

8           The Failing Firm Defense has three  
9 requirements: First, bankruptcy must be imminent. Our  
10 analysis here is that it is not and, moreover, Southern  
11 Pacific has only recently begun to take steps that could  
12 turn its financial performance around such as  
13 substantial work force and pay reductions.

14           Second, even if bankruptcy were imminent, the  
15 allegedly failing firm must be unable to reorganize  
16 under bankruptcy. Applicants have submitted no evidence  
17 showing this. We, in fact, asked if they had any  
18 reports to this effect and they said they had none.

19           Finally, the firm must have made -- and this  
20 is very important -- unsuccessful, good faith efforts to  
21 elicit reasonable offers of acquisition that would keep  
22 it in the market and it would pose a less severe danger  
23 to competition than this acquisition.

24           Here, to our knowledge, Southern Pacific made  
25 only one phone call and that was in 1983, to find

1 another offer of acquisition. It clearly does not  
2 satisfy this important requirement. It seems quite  
3 likely that other firms would purchase the Southern  
4 Pacific's rail assets in whole or in part for continued  
5 rail use. It has 20,000 exclusively served shippers, it  
6 serves the Southwest Sunbelt States, parts of which are  
7 experiencing extremely rapid growth and indeed their  
8 Sunset line is operating near capacity.

9 Now, Applicants have made much of the fact  
10 that no other offers are on the table right now, yet we  
11 would not expect to see any other offers on the table at  
12 this point. After all, by virtue of the voting trust  
13 arrangement, the stock of Southern Pacific is held by  
14 SFSP itself, which has given no indication that it is  
15 interested in selling. And since SFSP can expect to  
16 earn monopoly rents if the merger is approved, it is  
17 highly unlikely that anyone else could offer a price  
18 that SFSP would find satisfactory. The Commission only  
19 reluctantly approved the voting trust.

20 CHAIRMAN GRADISON: Wait. Let me ask another  
21 question with regard to these monopoly rents. The  
22 proponents have made a number of indications as to why  
23 they would not be able to extract monopoly rents and  
24 they have come up with the remedy with their agreement  
25 with BN. The Commission has guidelines that would help

1 prevent monopoly rents, as well.

2           Could you just develop that premise a little  
3 further as to why you think they could extract those  
4 rents?

5           MS. KOOPERSTEIN: We think they could extract  
6 those rents based on our analysis that there would be  
7 substantial competitive harm from this merger. We don't  
8 think that the BN agreement is sufficient to remedy it.  
9 Any agreement would allow them to raise rates  
10 substantially before it would be at the level that BN  
11 would have to pay SPSF to move BN's traffic.

12           CHAIRMAN GRADISON: And does this also take  
13 into consideration any other modes of competition or is  
14 this strictly limited --

15           MS. KOOPERSTEIN: Our analysis took into  
16 account other modes of competition. The tonnages and  
17 the markets that we identified were those that remained  
18 after we considered other modes and after we considered  
19 source competition. So those constraints would not be  
20 present in those markets. The only constraint then  
21 would be the Applicants could raise their rates to 160  
22 percent, perhaps, of revenue to variable costs. We  
23 don't think that those are magic numbers. We think they  
24 serve a purpose in determining when the Commission  
25 should intervene to rate regulate. We don't think it

1 should create a situation where you're going to  
2 constantly have to intervene and regulate rates.

3 CHAIRMAN GRADISON: So we would have shippers  
4 who were captive to one railroad at monopoly rents as  
5 one choice and the other choice is that, as our  
6 proponents have alleged, we would have no railroad. So  
7 either way the shippers would lose; is that your  
8 premise?

9 MS. KOOPERSTEIN: No, that's not our premise.  
10 We don't think that's likely at all. That's what -- the  
11 purpose of the Failing Firm Defense is to see if you're  
12 going to end up without that railroad there. And if we  
13 thought that railroad wouldn't be there, we'd say  
14 approve the merger. We think that railroad will be  
15 there. Either it could turn itself around by making  
16 some hard choices or other folks would buy it. We think  
17 it's highly likely that other folks would buy it.

18 Now if they cannot turn themselves around and  
19 if no one -- none of the railroads in this room or  
20 anyone else is interested in buying all or parts of it,  
21 then let it merge with the Santa Fe. But we don't have  
22 that evidence. That evidence is not here. And we  
23 believe that it is quite likely that other parties would  
24 be interested.

25 CHAIRMAN GRADISON: So you think we should

1 deny the merger, let the market respond to having the  
2 merger denied in the event there are no buyers, in the  
3 event that the two carriers do go under, then the market  
4 will again respond by other carriers purchasing those  
5 lines?

6 MS. KOOPERSTEIN: First of all, we don't think  
7 that the SF is going to go under at any time soon or  
8 perhaps any time at all and we think that if you let the  
9 market work, if they can't turn themselves around, if  
10 nobody else comes forward, then the market will provide  
11 that SF will buy.

12 COMMISSIONER ANDRE: Do you see an intervening  
13 period where we will just have another Conrail Southwest  
14 with a repetition of the captive taxpayer dilemma?

15 MS. KOOPERSTEIN: I'm not sure I'm totally  
16 familiar with that situation. But I don't see an  
17 intervening period where we would not have service  
18 provided.

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1           If these lines are profitable and if they are  
2 performing a service, somebody ought to be interested in  
3 buying them.

4           COMMISSIONER ANDRE: Without an intervening  
5 period of risk for the captive taxpayer.

6           MS. KOOPERSTEIN: Without that intervening  
7 period. Someone ought to come forward soon, or SP could  
8 turn itself around. It still has the time to do that.  
9 It may have to meet some hard cuts, but that is what we  
10 think the Staggers Act was about, in part.

11          CHAIRMAN GRADISON: Would you foresee  
12 significant abandonments in the steps that the SP would  
13 have to take in order to "turn itself around"?

14          MS. KOOPERSTEIN: We think that there may have  
15 to be some abandonments, and that is based on the  
16 evidence that is in the record. They have said that  
17 there are tracks that are unprofitable and that are a  
18 drain on their system, but we think that is far  
19 preferable than to keep these unprofitable lines going  
20 at the cost of handing Applicants market power  
21 throughout their system.

22          CHAIRMAN GRADISON: That completes your time.

23          MS. KOOPERSTEIN: I worked a long time on  
24 this. I'm sorry.

25          CHAIRMAN GRADISON: Are there any other

1 opponents who would like to grant Ms. Kooperstein part of  
2 their time? They are welcome to do so. Otherwise we  
3 will hear from our next opponent, Mr. Samuel Freeman of  
4 the Denver and Rio Grande Western Railroad Company. Mr.  
5 Freeman, you have 15 minutes.

6 ORAL ARGUMENT OF SAMUEL FREEMAN

7 THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY

8 MR. FREEMAN: Thank you. Have you been  
9 supplied with our exhibits? While they are being  
10 supplied to you and they are available for others --

11 CHAIRMAN GRADISON: Yes, let's make sure that  
12 all parties have copies of them.

13 MR. FREEMAN: They have been made available.

14 (Pause.)

15 CHAIRMAN GRADISON: Okay, if the hearing room  
16 will come to order, please. Mr. Secretary, if you will  
17 begin his time from this point, please.

18 Mr. Freeman, you may proceed.

19 MR. FREEMAN: My name is Sam Freeman, and I am  
20 General Counsel of the Denver Rio Grande Western  
21 Railroad.

22 This proposal is so radical and devastating to  
23 rail competition in the west that I welcome the  
24 opportunity to discuss it with you. I will utilize a  
25 series of maps and charts to answer the questions you

1 pose, and place this case in perspective.

2 On Map 1, you will see the result that was  
3 created when you decided the Union Pacific case. You  
4 suggested the Rio Grande, the Southern Pacific route  
5 would compete with the Union Pacific route to preserve  
6 central corridor competition. This was critically  
7 important because the central corridor carries the  
8 largest single block of transcontinental traffic. This  
9 proposal that you suggested worked because of the  
10 self-interest of the two carriers to work together, and  
11 that is the only reason it worked.

12 If we will now proceed to Map 2.

13 Map 2 shows the result of merging the Santa Fe  
14 and the Southern Pacific together. That merger would  
15 make a critical change. The reason it makes such a  
16 critical change involves the long-haul self-interest of  
17 a railroad which in reality, in real life controls the  
18 routing decisions and the policies of every railroad in  
19 the country.

20 The facts are that Santa Fe today obtains its  
21 long haul on 99 percent of its western transcontinental  
22 traffic. It is the reason today why the Southern  
23 Pacific and Santa Fe don't exchange traffic. They could  
24 cooperate. The long-haul self-interest is the  
25 overriding thing that drives a railroad's policy. In

1 the UP case we told you that long-haul self-interest of  
2 the UP after it acquired the Missouri Pacific and the  
3 Western Pacific would destroy the large interchanges  
4 which Rio Grande had with both Western Pacific and  
5 Missouri Pacific.

6 What we told you in that case is precisely  
7 what happened. We are not critical of it, but we are  
8 saying that the Union Pacific, just as the Sante Fe will  
9 do after merger, recognizes its self-interest and favors  
10 its long haul.

11 In one of your questions you asked what  
12 commodities, origins, and destinations are affected. We  
13 went back and looked at our traffic studies and we found  
14 that every commodity, every origin-destination pairs are  
15 adversely affected, and there are no major differences.

16 About the only traffic, in answer to another  
17 question, that is unaffected is Rio Grande traffic to  
18 local points.

19 Let us turn now to Map 3.

20 This map dramatically shows what happens after  
21 merger is approved without conditions, and this is what  
22 the Western Railroad map will look like. What is created  
23 is basically a monopoly in each corridor. This is a  
24 rare case in that one merger will create two monopolies,  
25 a southern corridor monopoly for the Southern Pacific

1 Santa Fe, a central corridor monopoly for the Union  
2 Pacific, and these two corridors control about 80  
3 percent of the total transcontinental traffic in the  
4 west.

5 We suggest that shippers in the public simply  
6 will not accept this type of solution for a railroad  
7 western map. In fact, 647 shippers, and these are major  
8 shippers, the Chryslers, the Fords, the Hunt Foods, the  
9 Cargills, and so forth, and I could go on, agree with  
10 our proposal and have supported our condition. The five  
11 states directly involved, Colorado, Utah, Nevada,  
12 California, and Oregon, have either directly supported  
13 our conditions or have expressed serious concerns about  
14 preservation of competition in the central corridor.

15 Finally, under the Staggers Act, if you  
16 believe in maintaining competition and allowing  
17 competition to serve the marketplace, you have to have  
18 some competitors left. Staggers will not work with a  
19 duopoly or a monopoly, nor are trucks competitive. The  
20 difference between the east and the west on trucks is  
21 the average haul in the east is about 500 miles, and the  
22 west is 1,500 miles or more.

23 Despite what was said earlier, the Applicants'  
24 witnesses themselves admitted that for heavy loading  
25 long haul traffic the rail mode is dominant and the

1 overall split between rail and truck in the west has not  
2 significantly changed in the last several years.

3 The final thing that is important to  
4 recognize, and I think Commissioner Sterrett mentioned  
5 it earlier, is that you can't fix this later. Once you  
6 have set this map, it is in concrete. The difference in  
7 our industry is that there is no freedom of entry.  
8 There is no way that the marketplace can work such as  
9 airlines or something else. There is no freedom of  
10 entry. You can't fix it later. You have to fix it  
11 now. We have a suggestion on how to fix it.

12 If you would go to the next map.

13 We have proposed a series of conditions. Our  
14 conditions will allow us to serve exactly the same  
15 market we are serving today. These are the same  
16 commodities, the same area, and you have asked, well,  
17 can something else work, can Central Pacific conditions,  
18 solicitation agreements, and things like that work in  
19 lieu of the conditions we propose?

20 The answer is no. First of all, it is  
21 unreasonable to expect any applicant to solicit against  
22 its own long haul preference and its own long haul  
23 self-interest. It does not cover these types of  
24 agreements. Critical competitive factors such as  
25 equipment, rates, service, even the service proposal --

1 even the proposal made by the Santa Fe is strictly  
2 subject to volume. The volume is controlled by them.  
3 As they divert the volume, the service declines. We  
4 don't have any service. We don't have any rate  
5 control. Basically what happens is, you would require  
6 major commission supervision of their type of proposal.

7 I have addressed in Exhibit 7 at the end,  
8 which you can read after, and specifically analyzed the  
9 differences between our proposal and these types of CP  
10 conditions and solicitations. So, in order to preserve  
11 competition, as we have shown on Map 4, you must have  
12 physical access. Nothing else works. There is no quick  
13 fix. This is the only way to do it.

14 Now, the proposal that we have made looks  
15 extensive. It really isn't. It is a problem of  
16 geography in that the markets are in California and we  
17 are at Ogden, so almost 700 miles of that proposal is  
18 basically desert. There are no stations except one,  
19 Reno, Nevada, in that entire length of track.

20 Let's talk about what the price of competition  
21 would be, of preserving competition, the price of our  
22 conditions. What is it going to cost? You have heard a  
23 lot about the value to the applicants. The Santa Fe  
24 projected or hopes to make \$900 million in profit as an  
25 objective in Year Five. DRG conditions affect their

1 profit by one-tenth of 1 percent. This is unchallenged  
2 in the record. Santa Fe projects and projected again  
3 today 287 million per year in savings. DRGW's  
4 conditions adversely affect those savings by 1.6  
5 million, or less than six-tenths of 1 percent. That is  
6 also unchallenged in the record. This is a very meager  
7 price for the applicants to pay in order to preserve  
8 competition.

9 As far as the comments concerning the price  
10 that we have proposed to pay, we followed meticulously  
11 the standards that you set in the Union Pacific case.  
12 The applicants in effect have answered by saying that  
13 you decided it wrong. If you take a look at some of the  
14 exhibits, you find the problem we had is, the applicants  
15 didn't pay much for the Southern Pacific. In fact, they  
16 had a negative net worth value on the equity after they  
17 figured the debt. So we have applied exactly the same  
18 standard that you mandated in the UP case.

19 Now, I recognize that there is a difference in  
20 price. We would propose since we have to be able to  
21 operate Day One -- if we are not out there Day One we  
22 lose the market. What I would propose is, if you want  
23 to defer this, you want further evidence, although we  
24 think the evidence is in -- basically our figures are  
25 unchallenged -- we ask that you at least award us

1 trackage rights in the interim and fix the rate or the  
2 purchase price or the traffic rights rental at a later  
3 time.

4 In summary, this is a simple case. To  
5 preserve competition in the west, which you found to be  
6 essential in the UP decision, the cost to applicants of  
7 our conditions is insignificant. It is insignificant in  
8 and of itself, and a comparison with the public benefit  
9 of preserving the present competition is an overwhelming  
10 reason to grant what we have asked.

11 Are there any questions?

12 CHAIRMAN GRADISON: Hearing none, thank you,  
13 Mr. Freeman.

14 We will continue with the opponents, and let  
15 me add that when Mr. Miller completes his presentation  
16 we will then take a break for lunch of about an hour and  
17 a half.

18 Mr. Charles A. Miller of the Union Pacific  
19 Railroad Company and the Missouri Pacific Railroad  
20 Company. You have 15 minutes.

21 ORAL ARGUMENT OF CHARLES A. MILLER  
22 UNION PACIFIC RAILROAD COMPANY AND  
23 MISSOURI PACIFIC RAILROAD COMPANY

24 MR. MILLER: Thank you, Madam Chairman, and  
25 may it please the Commission, in this case the Union

1 Pacific/Missouri Pacific stands in a middle ground  
2 position looking at two extreme positions that have been  
3 presented to the Commission this morning. On the one  
4 hand, you have the primary applicants who have said you  
5 must approve our merger without condition or one or both  
6 of us will collapse, and you just have to pay the price  
7 of the lost competition that will result from that  
8 merger.

9 The Department of Justice, on the other hand,  
10 takes the position that this merger is anticompetitive  
11 and therefore must be disapproved, and all of the  
12 benefits that could come from the accomplishment of the  
13 merger must be lost with the disapproval.

14 We believe we can propose a middle ground that  
15 preserves the benefits of the merger and yet remains  
16 faithful to the charge of the Commission that it  
17 preserve competition, which is the basis upon which the  
18 rail system in this country is based under the teachings  
19 of the Staggers Act.

20 The Union Pacific application is really a  
21 response to an unusual, unprecedented outpouring by  
22 shippers to the announcement of the merger of the  
23 Southern Pacific and Santa Fe Railroads, and based upon  
24 that response initially the Union Pacific decided to  
25 come forward and develop a relatively limited proposal

1 for trackage rights to deal with the concerns that had  
2 been voiced by most of these shippers, those who are  
3 presently the beneficiaries of the competition between  
4 the Southern Pacific and the Santa Fe.

5 As the case developed, that outpouring became  
6 manifest, and more than 800 shippers set forth evidence  
7 in this case, specific, detailed evidence of how they  
8 currently benefit from the competition of Southern  
9 Pacific of Santa Fe, and how they would lose the  
10 benefits of that competition if the merger were allowed  
11 to go forward without condition.

12 This wasn't just a beauty contest, a lot of  
13 me-toos' and I'm for the trackage rights. This was hard  
14 evidence. In many cases several people appeared. Many  
15 have filed briefs with the Commission. Some will appear  
16 at the argument today. Union Pacific's response to this  
17 evident concern of shippers was to tailor some trackage  
18 rights that meet precisely the most serious competitive  
19 problem presented by this transaction and no more, and  
20 so Union Pacific has proposed to you the following.

21 Bridge trackage rights -- I emphasize bridge  
22 because we do not seek the massive rights to serve  
23 shipper that SF/SP has suggested we do -- bridge  
24 trackage rights across the corridor between El Paso and  
25 Colton, and up California to the Central Valley or to

1 the areas where the Southern Pacific and Santa Fe  
2 systems are parallel. At points where both of those  
3 railroads today serve shippers, at common points where  
4 both railroads can today serve a shipper directly, we  
5 would propose to be able to serve that shipper directly  
6 so as to maintain the two carrier competition that that  
7 shipper has today. As to any shipper that today does  
8 not have two carrier rail service, we would not propose  
9 to serve that shipper, and thus we would not alter the  
10 present competitive situation with respect to that  
11 shipper. So it is bridge trackage rights with the right  
12 to serve commonly served shippers at commonly served  
13 points of Santa Fe and Southern Pacific, to which we add  
14 two very important ancillary rights which will make  
15 these rights, we believe, effective to preserve  
16 competition and make them viable for Union Pacific.

17 First is the right to establish on our own  
18 intermodal facilities that would connect to the trackage  
19 rights line so that we could today serve a shipper that  
20 is captive, for example, to the Santa Fe by truck or  
21 auto hauler or such other intermodal facility as is  
22 available and which we are able to provide, just as  
23 today the other carrier in the market, Southern Pacific,  
24 can do the same thing and thus provide a competitive  
25 restraint on the shipper or on the railroad that

1 otherwise has a captive shipper to serve.

2           Secondly, we would propose the right to site  
3 new industry, new plants of shippers along the trackage  
4 rights lines, and to serve them so that just as today if  
5 either Southern Pacific or Santa Fe is able to persuade  
6 a new shipper to locate his plant on its line rather  
7 than on the other, it will get the business, and that is  
8 the competition that the record shows exists. There is  
9 considerable evidence about this competition in the  
10 record. And that competition would be eliminated  
11 through the merger. We would replace it with our right  
12 to site new business and to serve it if we are  
13 successful in having the new business located along our  
14 trackage rights line.

15           The Commission's order of oral argument raised  
16 the question of whether the Union Pacific rights might  
17 be expanded so as to have full trackage rights, full  
18 local service rights in the California Central Valley  
19 between Colton and Lathrop. We considered that when we  
20 submitted our application. For the reasons that I have  
21 indicated, our application did not propose direct rail  
22 access to all shippers along the trackage rights line.  
23 We limited ourselves to direct rail access only to those  
24 shippers that today have direct rail access from both  
25 railroads. And we would serve the others if we could do

1 so through intermodal facilities if we were able to  
2 serve them at all.

3 A case could be made that to fully eliminate  
4 the -- fully remedy the elimination of competition, that  
5 it would be appropriate to grant Union Pacific the right  
6 to serve all shippers located along these lines, and  
7 that is because in the Central Valley area, which is  
8 largely a produce market type of business, there is a  
9 considerable degree of source competition that serves as  
10 a competitive restraint on either railroad against  
11 raising the rates to monopoly levels on its captive  
12 customers, and that source competition would be lost by  
13 the merger, and it would be our intermodal facility  
14 condition, though addressing it does not address it  
15 fully as effectively as it could be addressed if we were  
16 able to serve the shippers directly, and if you see fit  
17 to grant trackage rights with full access to those  
18 shippers, Union Pacific would serve them, but we are not  
19 seeking that, and we believe that the proposal we have  
20 put before you does deal with the anticompetitive  
21 effects that I have mentioned here, and serves to  
22 ameliorate those effects.

23 I want to stress that our conditions are  
24 directed to the worst kind of anticompetitive effect one  
25 can have in this business, and that is the elimination

1 entirely of the only rail competition that exists in the  
2 market, where we go from two railroad service to one  
3 railroad service. That is what we address, and we think  
4 that the case for granting those trackage rights is  
5 powerful.

6 CHAIRMAN GRADISON: Mr. Miller, in one of our  
7 briefing sessions consideration came up that we consider  
8 granting the SP/SF trackage rights over the UP/MP in  
9 exchange for trackage rights over the SP/SF. I  
10 recognize this is not part of the record. It would be  
11 highly unusual action, but would you mind just  
12 addressing the very concept of dual trackage rights  
13 being granted tit for tat, so to speak?

14 MR. MILLER: Well, in a sense you have already  
15 done that, because in the UP/MP/WF merger, as a  
16 condition to its approval you did grant trackage rights  
17 to the Southern Pacific between Kansas City and St.  
18 Louis, a very vital artery in the Union Pacific system,  
19 which we resisted, but the Commission did grant those  
20 trackage rights, and we did go forward with the merger  
21 notwithstanding that condition.

22 We also granted trackage rights to the Rio  
23 Grande between Pueblo and Kansas City, and also to the  
24 Katy for some north-south traffic, so some 1,300 miles  
25 of trackage rights were imposed upon the Union Pacific

1 as a condition to its merger, but perhaps one of the  
2 most critical was the ones that went to the Southern  
3 Pacific and allowed that railroad to cut 400 miles off  
4 of its transcontinental line and to gain for the first  
5 time direct access to St. Louis through the Tucumcari  
6 route.

7 So, I would say that in a sense, you  
8 anticipated that dual exchange, and now to complete the  
9 job --

10 (General laughter.)

11 MR. MILLER: -- in return for the approval of  
12 a merger which is many times more anticompetitive than  
13 the one approved in our case. You have the remedy at  
14 hand.

15 I do want to make this point. I said at the  
16 beginning you could have -- we proposed a solution that  
17 gives you preservation of competition without the loss  
18 of the merger benefits. That is a very important point,  
19 and I want to stress it. The applicants have told you  
20 that they anticipate very large benefits from this  
21 merger, operating savings in the amount of some quarter  
22 of a billion dollars per year, additional revenues net  
23 after costs, diversion of traffic which would still be  
24 substantial even after taking account of diversion that  
25 would come from our trackage rights, and savings in

1 capital investment one time only of over one-half  
2 billion dollars.

3 In our brief to the Commission, we acknowledge  
4 those benefits which, on a simple calculation, on a  
5 discount cash flow basis they have a present value of  
6 about \$3 billion, and that is rather conservative  
7 because it is based on high interest rates. The rates  
8 have come down now, which would cause the value to go up  
9 even higher, but the figure is sufficient for our  
10 purposes. This is a \$3 billion benefit transaction for  
11 the applicants, and the trackage rights -- that is after  
12 the trackage rights of the Union Pacific are granted.

13 Mr. Martin referred to the possibility of some  
14 suggestion along the lines that if trackage rights are  
15 granted, I think the Commission staff and yourselves  
16 when you look at the details of this will realize that  
17 there is not much to that, in fact, there is nothing to  
18 it. We are talking about adding one train a day each  
19 way up and down the California Central Valley and two  
20 trains a day between El Paso and Colton, and there is  
21 evidence from Mr. Davis of Union Pacific who dealt with  
22 each of the so-called operating concerns, and showed  
23 that there really was nothing at all to be concerned  
24 about, that these are modest rights in the context of  
25 the operations of Southern Pacific and Santa Fe.

1           The main point I want to make is, I want to  
2 address the proposition that has been put before you,  
3 the threat, if you will, or the warning that if Southern  
4 Pacific -- that if Union Pacific trackage rights are  
5 granted, the SF/SP merger will not go forward. Mr.  
6 Schmidt, who is here today, took that position at the  
7 hearing. He suggested that he would be inclined to  
8 recommend against it to his board, and that has been  
9 repeated again in the briefs and in the submissions that  
10 I just saw this morning.

11           I don't think that that ought to dissuade the  
12 Commission from doing the right thing here, which is to  
13 preserve the competition by granting the UP trackage  
14 rights. Mr. Schmidt in his annual report to  
15 shareholders released just the other day stressed the  
16 company's commitment to building shareholder value,  
17 which is a very fine goal, and I think it can be  
18 achieved. In this case, this merger promises increasing  
19 shareholder value of a present value of \$3 billion after  
20 including the imposition of the Union Pacific trackage  
21 rights.

22           Now, if the Santa Fe/Southern Pacific decides  
23 to reject the merger and those benefits, presumably it  
24 is going to have to decide that there is something worth  
25 more than \$3 billion to its stockholders that would

1 justify that decision. I don't think it is there. Mr.  
2 Moates this morning began the argument by saying there  
3 are no alternatives, and I do want to point out that  
4 this is not a transaction that the applicants can just  
5 walk away from.

6 SF/SP owns the Southern Pacific Transportation  
7 Company. Its stock is held in voting trust, to be sure,  
8 but it is not a merger when you turn your back on it and  
9 say to your partner, I am sorry. It owns the stock, and  
10 it will have to do something with the stock and the  
11 company if it decides not to go forward with the merger,  
12 and I suggest to them and to the Commission that in  
13 making that hardheaded business judgment, as Mr. Schmidt  
14 and his board certainly will do, they will be faced on  
15 one side of the equation with an asset that they own  
16 which can increase shareholder value by \$3 billion if  
17 they accept the Commission's terms and go forward with  
18 the merger, and if they decide to do something  
19 different, they are going to have to have something else  
20 on the other side of that equation that is at least  
21 equal to \$3 billion, because I don't think they are  
22 going to act irrationally.

23 And that is why we say that there really isn't  
24 any credible reason to doubt that this merger would go  
25 forward even if the necessary Union Pacific proposed

1 conditions are imposed to preserve the existing rail  
2 competition.

3 CHAIRMAN GRADISON: Thank you, Mr. Miller.  
4 With that, your time has expired.

5 The Commission will take a break for an hour  
6 and a half, and will resume at 1:15. Thank you.

7 (Whereupon, at 11:45 a.m. the Commission  
8 recessed, to reconvene at 1:15 p.m., this same day.)  
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## AFTERNOON SESSION

(1:30 p.m.)

1  
2  
3 CHAIRMAN GRADISON: We are now ready to  
4 continue our hearing. We will begin this portion with a  
5 ten-minute presentation by Mr. Robert Kharasch of the  
6 Missouri-Kansas-Texas Railroad Company

7 Mr. Karasch.

8 ORAL ARGUMENT OF ROBERT KHARASCH  
9 MISSOURI-KANSAS-TEXAS RAILROAD COMPANY

10 MR. KHARASCH: Thank you.

11 May it please the Commission, the MKT's basic  
12 position throughout this case is that it favors rail  
13 efficiency, it favors least interference with the  
14 competitive market, but it insists that the competitive  
15 market must be maintained as between railroads. That is  
16 the policy of the Staggers Act, it is the policy of this  
17 Commission, to preserve regional rail competition. If  
18 preserved, then daily regulation is not needed.

19 We do not favor monopoly. We do not favor the  
20 selfishness of the Applicants in urging efficiencies for  
21 their operations and not for others. We do not favor  
22 presenting great quantities of totally inconsistent  
23 testimony to the Commission, which we think is not a  
24 proper way to approach this learned body.

25 For example, from the Applicants' arguments

1 this morning about truck pervasiveness, you would not  
2 know that the testimony of their trucking witness, the  
3 famous wizard of trucks, a Mr. Forrest Baker, was  
4 explicitly that for long hauls of heavy commodities,  
5 trucks cannot compete with railroads.

6 We do not favor meaningless arithmetic, vast  
7 manipulations by computer which propose to prove  
8 ridiculous propositions such as that the Santa Fe and  
9 the Southern Pacific do not compete. These propositions  
10 are evidently false; they are treated as false in their  
11 own papers. I do recommend that Exhibit KSC-1 to the  
12 Commission's careful attention.

13 I'll give you an example from this morning.  
14 In the hundred pages of paper you were handed this  
15 morning by the Applicants there is an Exhibit L which  
16 purports to tell you something about motor and water and  
17 rail competition.

18 Four things I can say now about it, without  
19 careful analysis. First, the areas are carefully  
20 gerrymandered so as to include other railroads' traffic  
21 so that the SFSP traffic will not seem so big. Second,  
22 they are based on inconsistent principles of counting  
23 competition, and that was proved on the record. Third,  
24 the Applicants have suppressed their post-merger market  
25 shares which were prepared but never introduced into

1 testimony in the case. Fourth, the table, I believe --  
2 and this is subject to check -- uses trucking figures  
3 which are known to be wildly inflated and were corrected  
4 later in the record. Truck shares of more than the  
5 national product of tangerines and such.

6 Now, most of all, we do not favor and the  
7 Commission should not favor carefully meaningless,  
8 carefully indefinite promises about undefined  
9 efficiencies which will be preserved, such promises  
10 culminated in the so-called BN settlement which is a  
11 fiasco, because if you read the record you will see that  
12 the BN itself says, and I quote about this policeman's  
13 role: "We do not believe any substantial opportunities  
14 exist for us with respect to the policeman role of  
15 traffic."

16 The only reason the BN signed that so-called  
17 settlement is because they feared they would be cut off  
18 from access on existing joint line traffic, and that's  
19 perfectly clear in the BN papers.

20 Now, the MKT is concerned here only with  
21 preserving regional rail competition that would be  
22 destroyed by the merger. We have carefully tailored  
23 what the Applicants themselves call a relatively modest  
24 list of rights that would not interfere with SFSP  
25 operations or efficiencies. This list is not deal

1 breakers, and the Applicants say it is not a deal  
2 breaker. All this list of five rights would do is  
3 provide competition and it would provide better single  
4 line competition by the MKT with the Applicants, so that  
5 the public would get the best possible service.

6 Finally, I want to note for the benefit of Mr.  
7 Scheirman, if you look at page 27 of our reply brief in  
8 this case, he will find that the MKT has already  
9 promised to you that it is quite agreeable that any  
10 rights awarded in this case will be subject to  
11 cancellation in a later proceeding involving the MKT if  
12 the Commission should find the rights are duplicative or  
13 otherwise not needed. That is a written promise, page  
14 27 of the reply brief. I repeat it.

15 Now, to the Commission's questions. Question  
16 3-A: What is the SFSP's ability to divert Mexican  
17 traffic?

18 Answer: The ability is complete, except for  
19 origins where the UP/MP would have competing service  
20 from the origin to the same Mexican gateway. Today's  
21 competition where there are essentially three carriers  
22 to Mexico would be lost without the MKT traffic rights.

23 Question 3-B: How can the SFSP reconcile its  
24 statements that it will continue to interline to Mexico  
25 with previous SPT statements?

1           Answer: You can't reconcile these previous  
2 statements. At this moment they are arguing before the  
3 Commission in another case that the rent for trackage  
4 rights -- that's the UP/MP case -- that the rent for  
5 trackage rights should be lower and here they think it  
6 should be infinitely high.

7           The Applicants' case is a horrendous tangle of  
8 inconsistencies. You cannot reconcile it.

9           Question 3-E: What MKT traffic to Mexico is  
10 foreclosed?

11           The Commission has already discussed the MKT  
12 service to Mexico in the UP/MP case, and found that  
13 without the Southern Pacific the MKT would be left with  
14 no friendly connection, no independent access to  
15 Mexico. The record shows, to answer the Commission's  
16 question -- reference MKT-20 Gastler, page 49; MKT-27,  
17 Dimmerman, page 3 and 4 -- 77 percent of the 1983 cars  
18 to Mexico would be cut off.

19           There is no question that these cars would be  
20 cut off. There is no question of the SPSP policy of  
21 cutting off access. They don't cut off access to be  
22 efficient, but to keep all traffic on their own lines,  
23 even if it's inefficient.

24           Read Mr. McNear, transcript 484. Look at the  
25 Southern Pacific present tariffs now in force, discussed

1 in Mr. Noser's statement in MKT-21; the present tariffs  
2 foreclose any competition. They do not allow anyone to  
3 connect with the SP if the SP serves origin to  
4 destination.

5 During the hearing in June 1984, the Santa Fe  
6 published a tariff that closes all but its lines and the  
7 SP. It's effective against everybody except itself and  
8 the SP. Closes all its lines, all competitive access  
9 where they could carry the cargo, and no one else is  
10 allowed to.

11 Now, Question 3-D: What is the effect on the  
12 TexMex if MKT gets the rights to Mexico? You must  
13 understand the geography a little here. The only  
14 independent railroad that the TexMex would be allowed to  
15 connect to when it got to San Antonio, Texas is the  
16 MKT. Only three railroads serving San Antonio; the MKT  
17 is the independent one.

18 We think the MKT is the better choice for the  
19 long haul traffic operationally and we have explained  
20 why. Better as a long haul railroad able to handle the  
21 traffic, but the connection would be the same.

22 We have already agreed to work together if the  
23 MKT gets the rights. We will work together to  
24 interchange traffic. Those arrangements are made.

25 Question 4: What southwest Kansas grain

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1 competition would be lost through the merger?

2 I really do not know what evidence was  
3 referred to by DOT counsel this morning. I do not know  
4 what part of the record she was thinking about. You can  
5 truck grain around Kansas, but it costs. The measure of  
6 the monopoly achieved by having exclusive rail service  
7 in southwest Kansas, that monopoly is measured by the  
8 cost of trucking out of the monopoly area. It may be in  
9 some cases 25 or 50 cents a bushel. That's a lot to a  
10 farmer these days.

11 Discussion of this in O'Mary's testimony,  
12 MKT-38.

13 The competition between these two lines is 60  
14 or 70 percent of the SP grain traffic. The SP carries  
15 back to Hutchinson, which is a terminal point for  
16 distribution, and it carries down south. Its  
17 destinations are the Gulf and Hutchinson for 60 or 70  
18 percent of its traffic.

19 You would lose all grain competition, rail  
20 competition for grain and grain must move by rail. You  
21 would lose all the competition in southwest Kansas, plus  
22 more, because the more is the exclusive dealing  
23 contracts which these Applicants always maintain,  
24 chilling any broader competition, tying their monopoly  
25 beyond the monopoly area.

1                   That's my time. Thank you.

2                   CHAIRMAN GRADISON: Continuing, we will now  
3 hear from Charles H. White, Jr. of the Texas Mexican  
4 Railway Company. Mr. White, you have ten minutes.

5                   ORAL ARGUMENT OF CHARLES H. WHITE, JR.

6                   THE TEXAS MEXICAN RAILWAY COMPANY

7                   MR. WHITE: May it please the Commission, my  
8 name is Charles White. I have the privilege of  
9 representing TexMex in this proceeding.

10                  I will address your specific questions but I  
11 think, since Texas Mexican Railway is not a frequent  
12 participant before the Agency, it would be worth the  
13 diversion of a few minutes to talk about TexMex and its  
14 role in this case.

15                  TexMex is a 100-year-old railway providing  
16 essential services linking the Mexican railroad system  
17 to the United States rail system in Texas. It operates  
18 a single line running from Laredo on the Mexican border,  
19 to Corpus Christi on the Gulf, where it connects with  
20 both the Southern Pacific and now the Union Pacific.

21                  It is an overhead carrier. It is dependent  
22 upon its connecting U.S. carriers for the great vast  
23 bulk of its traffic. As a result of this proceeding,  
24 TexMex will lose its only neutral connection -- Southern  
25 Pacific. Southern Pacific will be subsumed into a

1 megasystem, and here I would like to differ from my  
2 friend, Mr. Martin. TexMex's concerns in this case, and  
3 I think the way we made this case, are in the nature of  
4 the horizontal competition-reducing merger along the  
5 Mexican/U.S. border.

6 As a result of this proceeding, Southern  
7 Pacific, SPSF, will reach every single rail gateway into  
8 Mexico except Laredo.

9 TexMex will be put in the awkward and  
10 untenable position of being a regional railroad with  
11 each of its U.S. connections now in a megasystem with  
12 their own single system routing imperatives. Union  
13 Pacific already has taken the lion's share of the  
14 traffic moving over Laredo, and we submit the record is  
15 replete with evidence showing that SPSF seeks to compete  
16 with Union Pacific by direct hauls to its own single  
17 system directly-served Mexican gateways.

18 Where does that leave TexMex who is dependent  
19 upon overhead traffic? It leaves TexMex in a  
20 vulnerable, critical, disastrous position. We propose a  
21 simple neutral solution to the situation that we are in  
22 TexMex wants only a neutral right to reach another  
23 railroad -- the Katy, and to reach them in San Antonio.  
24 We are asking for bridge rights over a little-used line  
25 which the Applicants' top management have admitted will

1 not be a deal stopper.

2 At the same time, the top cabinet official of  
3 Mexico with specific jurisdiction over railroads, Mr.  
4 Vasquez, and United States Secretary of Agriculture  
5 supported TexMex's modest request to maintain  
6 competition in the U.S.-Mexico rail market.

7 I want to reiterate at this point before I  
8 turn to the questions, that TexMex views the case from  
9 its perspective and its marketplace as a horizontal  
10 competition-reducing proceeding.

11 Now, turning to the ability to divert traffic,  
12 we think the record is clear that the Applicants see as  
13 their first marketing opportunity -- and indeed  
14 Mr. Edwards and Mr. Fitzgerald have testified to this  
15 effect -- the ability to reach directly the Mexico  
16 border crossings.

17 What does that mean for TexMex? It means  
18 TexMex as a joint line reacher of the border will be  
19 eliminated. How will the Applicants compete with Union  
20 Pacific in the international U.S.-Mexico rail traffic?  
21 Simply by routing the traffic over their own  
22 directly-served gateways.

23 What can we point to as evidence for this?  
24 TMC-1, which is in the record, clearly shows that the  
25 Southern Pacific views itself as the predominant rail

1 carrier into Mexico. That predominance will be enhanced  
2 by this case and it will allow the Applicants to use  
3 their preferred "rail crossings," i.e., their own single  
4 system rail crossings.

5 What means will the Applicants use to reach  
6 the marketplace in Mexico? They'll put together the  
7 Santa Fe's vast gathering opportunities for grain with  
8 Southern Pacific's preponderance of direct-served border  
9 crossings to create single system service into Mexico.  
10 And when will that happen? It will happen Conasupo, the  
11 buying agent of Mexico, has withdrawn itself from the  
12 buying role. The buying role for grain in Mexico has  
13 been privatized, it has been individualized, it has been  
14 taken out of the Mexican Government.

15 Where does that leave TexMex? It leaves  
16 TexMex vulnerable. It leaves TexMex's essential service  
17 which has been in existence for a hundred years very  
18 much in doubt.

19 What is the cumulative effect of this case on  
20 TexMex? It's disastrous. TexMex submitted a traffic  
21 study which showed cumulatively more than 50 percent of  
22 its gross revenues being lost to both the Union Pacific  
23 and the SPSF merger.

24 CHAIRMAN GRADISON: Mr. White, if this merger  
25 does not take place, where will the TexMex stand when

1 this change in the control of the selection of the grain  
2 direction takes place, or the grain shipments takes  
3 place?

4 MR. WHITE: If the merger does not take place,  
5 TexMex's -- I don't follow your question.

6 CHAIRMAN GRADISON: You said when will these  
7 problems occur, and you said when Mr. Conasupo of Mexico  
8 -- when the Mexican Government's role is no longer  
9 related to the direction of the shipments, the  
10 determination of how the grain is moved. And therefore,  
11 there would be no obligation to use TexMex whatsoever.

12 in the event that the merger were not to take  
13 place, would this not occur at any rate?

14 MR. WHITE: TexMex would be left precisely  
15 where it is today, dependent on its connections, and  
16 that is precisely why we are asking for trackage rights  
17 to make a new connection with another carrier.

18 CHAIRMAN GRADISON: This is unrelated to their  
19 merger in fact.

20 MR. WHITE: What is unrelated? The Conasupo  
21 change?

22 CHAIRMAN GRADISON: That's correct.

23 MR. WHITE: No. It is directly related to the  
24 merger in the sense that Iaredo is no longer an  
25 automatic entry point into Mexico. The Mexican grain

1 importers now can choose any gateway they want, and with  
2 Southern Pacific serving every Mexican rail gateway with  
3 the exception of Laredo, the opportunities for diverting  
4 away from TexMex are multiplied.

5 It's a matter of timing. It's a happenstance  
6 that happened along precisely when this merger is taking  
7 place, which doubles the vulnerability of TexMex.

8 TexMex must increase its interlines with  
9 Southern Pacific simply to maintain a status quo. Union  
10 Pacific has turned out to be such an effective single  
11 system competitor over the Laredo gateway, that TexMex  
12 during the pendency of this very hearing has lost a  
13 third of its traffic moving over the bridge, a third of  
14 its market share moving through Laredo.

15 TexMex must work with a connecting road,  
16 simply to maintain the status quo, and everything that  
17 we've seen in the record in terms of marketing plans,  
18 marketing objectives, and single system imperatives  
19 points out to us and, I believe in a fair reading, to  
20 the Commission that the marketing staff of the  
21 Applicants will do everything in their power to maintain  
22 single system routing into Mexico; i.e., to the  
23 detriment of TexMex.

24 I'd like to turn briefly to the question of  
25 whether TexMex or MKT should be awarded the trackage

1 rights. Mr. Kharasch was right; we both have agreed to  
2 work together, no matter who gets them, but we submit  
3 that TexMex in its unique historic role as a regional  
4 carrier serving a critical border crossing probably is  
5 the best carrier to extend its routes up into  
6 San Antonio to preserve its viability for the future.

7 I would like to close my argument by simply  
8 saying that TexMex for a hundred years has provided  
9 essential service, linking the rail systems of the  
10 United States and Mexico. It asks for nondisruptive  
11 neutral relief and it need not be jeopardized by having  
12 its two connections with megasystems the only  
13 connections that it has.

14 We humbly and urgently ask for the simple  
15 non-deal-stopping relief of making a connection in  
16 San Antonio with Katy.

17 Thank you, Your Honor.

18 CHAIRMAN GRADISON: Thank you, Mr. White.

19 Our next witness is Joseph Auerbach of the  
20 Kansas City Southern Railway Company and Louisiana and  
21 Arkansas Railway Company.

22 Mr. Auerbach, you have ten minutes.

23 CRAL ARGUMENT OF JOSEPH AUEREACH  
24 THE KANSAS CITY SOUTHERN RAILWAY COMPANY AND  
25 LOUISIANA AND ARKANSAS RAILWAY COMPANY

1 MR. AUERBACH: Madam Chairman, members of the  
2 Commission, rail transportation is, of course, unique in  
3 antitrust law. This stems from the impossibility of  
4 acquiring effective intramodal rail access to  
5 competitive markets.

6 No matter how necessary or appropriate in the  
7 public interest, building a competitive parallel rail  
8 system is a casualty of history.

9 That brings on three regulatory corollaries  
10 corollaries. First, you should not destroy parallel  
11 rail systems when the public interest requires  
12 competition unless there is an overwhelming other set of  
13 circumstances and that, of course, is what you are told  
14 exists here today with respect to the Southern Pacific.

15 I intend to address that principally in my  
16 argument.

17 Secondly, if these circumstances do exist, you  
18 must still be sure to install an effective rail  
19 substitute.

20 And, third, when you design the substitute,  
21 you must be sure to create effective competitive rail  
22 access to the monopoly which has otherwise been  
23 created.

24 Traditionally the substitute has been achieved  
25 by requiring trackage rights. You have rights over the

1 monopolist line; hence, you are a competitor. That  
2 solution, however, as you have heard today may entail  
3 operating interference and it may affect adversely the  
4 public and private benefits anticipated by the merger.

5 In this proceeding, KCS has proposed an  
6 innovative, more effective substitute than a blanket  
7 grant of trackage rights. For operations east of  
8 Houston where KCS now operates effectively, it seeks  
9 trackage rights which would make it an effective  
10 competitor for the combined system which it now cannot  
11 do.

12 It proposes west of Houston, where the merger  
13 produces its savings -- the merger savings aren't  
14 produced east of Houston -- it proposes a system which  
15 would be wholly consonant with the Applicants'  
16 operations involving simply the right of KCS to make its  
17 own competitive rates to shippers which the Applicants  
18 would be required to serve.

19 If imitation is the sincerest form of  
20 flattery, KCS ought to be flattered because the BN  
21 cooperation agreement produces that very same result in  
22 concept, but not in practice. In practice you have this  
23 situation: KCS, with exactly the same principle  
24 approach, would be an effective competitor. BN, we  
25 must submit, would not.

1           You heard in response to a question asked this  
2 morning how it would work, and you were told, assume 160  
3 percent of variable cost, and the Applicants raise the  
4 rates above it; BN would then be able to step in as a  
5 policeman. But the significant thing is that the system  
6 average on the Santa Fe today is 140 percent of variable  
7 cost, so you've got a spread between 140 and whatever  
8 this impinges under the BN agreement. That would not be  
9 true under KCS's proposal.

10           KCS proposes to pay for the service and if it  
11 can't reach agreement with the Applicants, whatever the  
12 Commission says is the proper payment is what KCS would  
13 do.

14           I said that I would address principally the  
15 question of the Southern Pacific viability and the whole  
16 question of whether there are circumstances here which  
17 would cause you to approve this merger.

18           CHAIRMAN GRADISON: As you do that, I'd like  
19 to ask, isn't your independent ratemaking authority  
20 request more extensive than the Commission has ever  
21 imposed? And why should a merger proceeding be the  
22 vehicle for such a massive market extension?

23           MR. AUERBACH: Yes, indeed, Madam Chairman.  
24 It is certainly is much more extensive and let me  
25 explain why. Let me explain the difference with BN in

1 that regard.

2 How much traffic is subject to this kind of a  
3 system of independent ratemaking? The BN takes a very  
4 tiny segment and that's all that will apply, but that  
5 doesn't an effective competitor. An effective  
6 competitor has got to be able to offer its services over  
7 an entire range to a shipper.

8 The shipper who is told we can take commodity  
9 A but not commodity B under the agreement is not going  
10 to use the competitor at all. That is the BN provision  
11 in their competitive agreement. Not so in KCS. KCS  
12 wants the right to serve all commodities at common  
13 points. Is that more than you've ever done before?  
14 Yes, I think it is.

15 Is it adaptive to this kind of a merger? Yes,  
16 it is. Why? It does not compete operationally. And so  
17 long as they don't go above this area of fair profit,  
18 you are not going to be able to compete. It's when they  
19 do get into that area that we can create competitive  
20 rates.

21 Why is that so? Because we do have to pay for  
22 the service. We will have to pay for the service on  
23 the basis that you think is fair. Obviously, variable  
24 cost -- and we've said a fair rate of return. And so  
25 when you determine that, then we are in the business of

1 being able to compete across the whole gamut of traffic.

2 Now, if you're not, it does not work.

3 Frankly, it doesn't work. We have got to have enough  
4 traffic to make it work. And to be able to do that, we  
5 have got to have a system that will work across the  
6 board.

7 Southern Pacific viability. You've heard one  
8 approach to it this morning and some of my colleagues  
9 who are opponents have given you some facts. There is  
10 another view from the bridge, the bridge on which I  
11 stand. Southern Pacific has not shown any signs of the  
12 bankruptcy that has been alleged to you today. Indeed,  
13 in 1985 in the summer at the tail end of the hearings,  
14 the CEO of the holding company, when asked about  
15 viability, said Southern Pacific is bankrupt right now.  
16 That was the summer of '85.

17 Now, if that were true, certainly it's  
18 material. It is alleged here to be material. If it  
19 were material, why didn't they file an 8(k) report with  
20 the SEC? Why doesn't it show up in their 10(k) reports  
21 of the SEC? Why doesn't it show up in their reports  
22 with you? You won't find it anywhere.

23 You've heard today that at the time of the  
24 court proceeding on whether the holding company should  
25 be permitted to acquire SPT, they were only thinking of

1 a relatively short term. The fact remains, the  
2 testimony they gave then in court, if you will bear with  
3 me for just a moment, was as follows: "SPT with its  
4 stock in trust will be as it is today, a significant and  
5 financially viable business." And they didn't limit  
6 it. "SPT on its own has an asset base and the financial  
7 capacity to not merely survive, but to vigorously  
8 compete with other large western railroads and motor  
9 carriers." That was their testimony.

10 Now, they added to that Morgan Stanley's  
11 testimony. Morgan Stanley said, "SPT can be expected to  
12 be financially viable over the next several years."  
13 Now, maybe that's what they have reference to. Well,  
14 what's happened in the next several years?

15 Take a look at the exhibit that was handed up  
16 to you this morning by them, Exhibit B. Now, Exhibit B  
17 is depreciation accounting, which is what applies here.  
18 Exhibit A is RRB accounting which doesn't apply. And  
19 under depreciation accounting, in 1983 SPT covered its  
20 fixed charges 1.33 times.

21 Incidentally, it has very high ratings on its  
22 debt. In 1984, 2.52 times; 1985, its had year, 2.40  
23 times. This is the railroad which they say is ready for  
24 bankruptcy.

25 If you will look at the 10(k)s which they did

1 file with the SEC in March of 1986 for the year 1985,  
2 you will see the following: In 1985, SPT had operating  
3 revenues of \$2.5 billion versus \$2.5 billion in '83. It  
4 had income before taxes of \$104 million, or four times  
5 that of 1983. It had net income of \$118 million versus  
6 \$32 million in 1983.

7 CHAIRMAN GRADISON: As we step into the last  
8 moment here, I'd like to ask how would you come out if  
9 this merger were disapproved? Would you be better off?  
10 Judging from the conditions which you have requested,  
11 you might actually come out better if the merger is  
12 granted.

13 MR. AUERBACH: Madam Chairman, fair question.  
14 Right now we are a friendly connection with Santa Fe on  
15 east-west traffic. Right now we are a friendly  
16 connection with Southern Pacific on north-south  
17 traffic. This is what we lose in that sense.

18 And we think that where the public interest is  
19 so involved and where we play that kind of prominent  
20 role, we should not be put in the position of having  
21 nothing come out of this except a single line.

22 CHAIRMAN GRADISON: Which is your preference,  
23 the granting or the denial?

24 MR. AUERBACH: Our preference is for you to  
25 observe the Department of Justice abjuration here and

1 deny the merger. That is our preference.

2 Now, in terms of what you asked

3 Ms. Kooperstein this morning, let me say Denver and Rio  
4 Grande Western has authorized me to say to you they  
5 would be interested in the northern segment of those  
6 lines, of SPT's lines. And I am authorized to say to  
7 you the KCS would be interested in the southern segments.

8 CHAIRMAN GRADISON: Okay. Well, time has  
9 expired. I've been tight with everybody else. I am  
10 going to have to be tight on my own questions.

11 MR. AUERBACH: I thought you were going to  
12 permit me to buy the railroad.

13 CHAIRMAN GRADISON: Our next witness will be  
14 Thomas Greene of the Office of the Attorney General of  
15 the State of California.

16 ORAL ARGUMENT OF THOMAS GREENE

17 OFFICE OF THE ATTORNEY GENERAL OF THE STATE OF CALIFORNIA

18 MR. GREENE: Thank you.

19 May it please the Commission, Thomas Greene  
20 with the Antitrust Section of the California Department  
21 of Justice on behalf of California's Attorney General,  
22 John Vandekamp.

23 The position of the Attorney General of  
24 California is that this merger represents a serious  
25 threat to California, absent the imposition by this

1 Commission of the Union Pacific conditions and the DRC  
2 conditions.

3 We think it is crucial for the Commission to  
4 realize the nature of the prize that Santa Fe and SP  
5 seek today. In our own state, 100 percent of the  
6 southern traffic in the southern San Joaquin Valley, 100  
7 percent of the traffic east of Los Angeles which  
8 includes the crucial Imperial and Cotella Valleys.  
9 Together these areas represent in agricultural products  
10 alone, something in the range of \$6 billion in  
11 production, most of it exported out of California every  
12 year, much of it moving over rail transit.

13 In general in California, this merger would  
14 represent 100 percent market share for approximately  
15 one-third of California's traffic and approximately 80  
16 percent of the rest. It also represents the creation of  
17 monopoly power in our sister states, or virtually  
18 monopoly power in our sister states of Arizona and  
19 New Mexico.

20 The effect of that on our own state, as  
21 indicated this morning in the testimony of the CPUC  
22 representative citing the Williams study, is an  
23 approximate 40 percent increase in prices in 12  
24 different commodities, the commodities closely studied.

25 This is generally consistent with the findings

1 in the Levin and Pittman studies which were submitted by  
2 other parties.

3 For our own state, key commodities which will  
4 be affected include oranges, cotton, wine, chemicals and  
5 petrochemical products.

6 In short, what is being created here may not  
7 be the octopus of ages past that dominated traffic in  
8 California, but you are being asked to grant  
9 extraordinary market power to this new megasystem.

10 We believe and we join with the California  
11 Public Utilities Commission in requesting you to grant  
12 the UP and DRG conditions. We think that, consistent  
13 with the testimony given this morning, that you can  
14 create competition, you can allow competitive forces to  
15 restrain price increases and the market power which  
16 would be created by this merger sufficiently so that the  
17 merger could go through and you could allow what is  
18 clearly a weak sister in the railroad industry to  
19 continue and in fact thrive.

20 But it is essential that competitive forces  
21 consistent with the mandate of the Staggers Act and the  
22 4-Rs Act be allowed to push prices down. Otherwise we  
23 will be left with a situation in which rail prices will  
24 be allowed to rise to the approximate average long run  
25 prices of trucking, which will mean significant

1 increases all across the board for all of the traffic  
2 coming out dynamic Sunbelt states of California,  
3 Arizona, and New Mexico.

4 With specific reference to the questions posed  
5 by the Commission, with respect to 2-A, consolidation in  
6 the central corridor, we join with others this morning  
7 who have indicated that Applicants have said diversion  
8 will represent approximately 20 percent. The Williams  
9 study indicates that it will be something in the nature  
10 of 50 percent.

11 Whether you choose to believe the high end or  
12 the low end, they are both very significant numbers. If  
13 there is a significant reduction in traffic across the  
14 central corridor, what that means is that the fixed  
15 costs will have to be allocated over fewer and fewer  
16 units of traffic which will increase those prices,  
17 making that corridor less and less competitive, which  
18 means that California shippers will have less  
19 opportunity to choose a competitive option across the  
20 central corridor.

21 With respect to 2-D and E, the so-called  
22 Central Pacific conditions and the solicitation  
23 agreement, we believe that these are marginally useful.  
24 They don't substitute, however, for the necessity to  
25 increase traffic across the central corridor and

1 maintain traffic across the central corridor.

2 Specifically with respect to the EN  
3 conditions, we agree with the Levin study that was  
4 supplied in the KCS-14 exhibit, which suggests that the  
5 conditions could yield a dramatic and relatively quick  
6 increase in prices all across the range of commodities  
7 being covered.

8 With respect to No. 5, service competition,  
9 you will hear from California shippers later in the day  
10 on the importance of service competition. We believe  
11 that service competition has been one of the most  
12 significant aspects of increased competition in  
13 California. We are now shipping traffic by rail that  
14 would not have been conceived of being shipped two to  
15 three years ago.

16 We believe that we are now reaching a point in  
17 which rail service, because of the intense competition  
18 between SP and Santa Fe, in which they are becoming very  
19 viable competitors in new areas in which trucks have  
20 traditionally taken the lead role. We believe that this  
21 this kind of competition should be continued.

22 The only option available at this point to the  
23 Commission in order to maintain that level of  
24 competition would be to approve the UP and ERG conditions.

25 In conclusion and perhaps in specific

1 reference to question 6 which appears to be the key  
2 question here -- what happens if you don't approve the  
3 merger -- I think that's an example of Aristotle's  
4 fallacy of the excluded middle. You can approve the  
5 merger with the conditions that have been offered to you  
6 today and still maintain competition, while increasing  
7 the strength and the financial effectiveness of the  
8 combined system.

9 And with those comments we would close, unless  
10 there are questions.

11 CHAIRMAN GRADISON: Thank you, Mr. Greene.

12 We will now hear from John Delaney and Deborah  
13 S. Merkel. Mr. Delaney represents the Railway Labor  
14 Executives' Association and I believe will also be  
15 speaking for the Brotherhood of Locomotive Engineers; is  
16 that correct?

17 MR. DELANEY: That is correct.

18 ORAL ARGUMENT OF JOHN J. DELANEY  
19 RAILWAY LABOR EXECUTIVES' ASSOCIATION AND  
20 BROTHERHOOD OF LOCOMOTIVE ENGINEERS

21 MR. DELANEY: Good afternoon. May it please  
22 the Commission, my name is John Delaney and I am with  
23 the law firm of Highsaw & Mahoney. We represent the  
24 Railway Labor Executives' Association in this proceeding.

25 Mr. Krashauer from the Brotherhood of

1 Locomotive Engineers is here today, and he has  
2 graciously allocated to me his time. Whatever time I do  
3 not use, the Teamsters will use

4 I would just like to address two topics today,  
5 briefly. First, the level of employee protective  
6 conditions to be imposed in this transaction; and  
7 second, any purported conflict between certain rights  
8 under the Railway Labor Act and collective bargaining  
9 agreements and the Applicants' ability to implement this  
10 transaction under the Interstate Commerce Act.

11 First, the proper level of employee protective  
12 conditions. Now, in the past, the Interstate Commerce  
13 Commission has found that the New York Dock conditions  
14 satisfy Section 11347 of the Interstate Commerce Act. I  
15 would refer the Commission to RLEA's submissions in this  
16 proceeding and ask the Commission to consider those  
17 changes that RLEA has proposed.

18 I would suggest a change be made to increase  
19 protection from the level of protection in New York Dock  
20 to take into consideration the very great ramifications  
21 that will be spawned as a result of this proposed  
22 merger.

23 On that basis, I would suggest that the  
24 conditions proposed by the Railway Labor Executives'  
25 Association take into account those harmful effects and

1 will more adequately protect the employees under Section  
2 11347.

3           Secnd, an issue has arisen in this case  
4 concerning the Railway Labor Act. Applicants, both  
5 primary and responsive, propose to implement their  
6 proposals without any recognition to the Railway Labor  
7 Act. I would submit two things on that topic.

8           First, it's not within the jurisdiction of the  
9 Interstate Commerce Commission to even address this  
10 issue. Second, even if the Commission so holds that it  
11 is, I would suggest that it is not necessary in this  
12 proceeding to even address the issue. The Applicants  
13 simply have not proven their case.

14           First, why doesn't the Commission have  
15 jurisdiction to consider the Railway Labor Act  
16 question? Congress created two separate acts, the  
17 Interstate Commerce Act and the Railway Labor Act.

18           The point I would like to make here today is  
19 that transactions, mergers, abandonments, what have you,  
20 have been going on for years. These transactions have  
21 been implemented coextensively with the Railway Labor  
22 Act negotiation and mediation procedures. There has  
23 been no problem.

24           Similarly today, we have no problem with this  
25 proposed merger in recognition of Railway Act rights.

1 Now, Applicants tell us that Section 11341(a) gives the  
2 Commission plenary power to do just about whatever the  
3 primary Applicants want done, to be implemented. And  
4 that is just not the case.

5 For years, the parties have gone to the  
6 bargaining table and we have had bilateral negotiations  
7 and we have worked out our differences. It is in Rail  
8 Labor's and the railroads' best interest to implement  
9 proposals that will effect a strong railroad at the end  
10 of the transaction.

11 CHAIRMAN GRADISON: Do you want trackage  
12 rights?

13 MR. DELANEY: What? No. We are not even  
14 going to get close to that.

15 COMMISSIONER ANDRE: In Britain, I understand  
16 the policy there is when something reverts back to state  
17 ownership, that the most effective way to restore it to  
18 the private sector is to sell it at cut rate to the  
19 complaining employees.

20 Is that a good idea here?

21 MR. DELANEY: I would like to tender you a  
22 check today, but I'm not in a position to do that. That  
23 has come up in different cases, but we are not making  
24 such a proposal today.

25 COMMISSIONER ANDRE: That has nothing to do

1 with your opposition to the merger, then?

2 MR. DELANEY: No. Basically our opposition to  
3 the merger stems solely from the Applicants' proposals  
4 to disregard the Railway Labor Act.

5 Now, I would just like to emphasize that the  
6 Railway Labor Act in recognition of the employees's  
7 rights thereunder, will not prevent consummation of this  
8 transaction. We have heard throughout today and this  
9 entire proceeding that there are many obstacles to this  
10 transaction.

11 I would submit to you that the Railway Labor  
12 Act is not one of those; just as in the past we can  
13 recognize the Railway Labor Act and also implement this  
14 transaction if the Commission desires.

15 I would like to emphasize that there has been  
16 no showing by the Applicants that Railway Labor rights  
17 should be abrogated, just as the D.C. Court of Appeals  
18 found in that transaction that the carriers did not  
19 submit any evidence to support their conclusions that  
20 rights should be abrogated, the same situation is  
21 presented today.

22 On that basis, I would submit the Commission  
23 could dispose of these issues.

24 Finally, I don't want to beat a dead dog, but  
25 I am going to. I am asking you to leave here today with

1 the point that the ICC has never before abrogated  
2 employees' acts under the Railway Labor At. And I would  
3 submit to you that it should not do so in this case.

4 Thank you very much.

5 CHAIRMAN GRADISON: Thank you very much,  
6 Mr. Delaney.

7 MR. DELANEY: Any time that I didn't use, I  
8 would defer to the Teamsters.

9 CHAIRMAN GRADISON: Ms. Merkel.

10 This is Deborah Merkel of the International  
11 Brotherhood of Teamsters. I don't know what the  
12 remaining time is, but you are welcome to use it.

13 ORAL ARGUMENT OF DEBORAH S. MERKEL

14 INTERNATIONAL BROTHERHOOD OF TEAMSTERS

15 MS. MERKEL: Madam Chairman, member of the  
16 Commission, my name is Deborah Merkel. I represent the  
17 International Brotherhood of Teamsters. We appreciate  
18 the opportunity to address you today.

19 The IBT intervened in this proceeding to  
20 request labor protective conditions for employees of two  
21 subsidiaries and one former subsidiary of the  
22 Applicants. These subsidiaries are Pacific Motor  
23 Trucking Company, Santa Fe Trail Transportation Company,  
24 and Santa Fe Terminal Services.

25

1           The IBT's argument for the most part is in  
2 accordance with the Eight Circuit's opinion in the case  
3 of Cosby v. ICC. Rather than rearguing the issues that  
4 were addressed in Cosby, we are going to rely on our  
5 briefs and urge the Commission to apply the Cosby  
6 rationale and holding in this case.

7           I'd like to emphasize that there were  
8 alternate holdings in Cosby. As Applicants have  
9 observed in their brief, the Court found that the  
10 employees of FTC, which was a motor carrier subsidiary,  
11 were entitled to protective conditions because of  
12 certain misrepresentations that had been made to them by  
13 the parent rail carrier.

14           The Court also found, however, that there were  
15 employees affected by the merger within the meaning of  
16 Section 11347 of the Interstate Commerce Act and it is  
17 that holding which the IBT believes should apply in this  
18 case.

19           Cosby does not apply only to carriers with  
20 auxiliary to rail operating authority such as FTC. The  
21 Court discussed FTC's limited authority but in the  
22 context of a discussion contrasting  
23 transportation-oriented subsidiaries like FTC with  
24 non-transportation-oriented subsidiaries such as mining  
25 companies. This is the key distinction.

1                   Since the three subsidiaries with which the  
2 IBT is concerned are transportation subsidiaries, then  
3 their employees are railroad employees under the  
4 definiton of "employed" in Ccsby.

5                   COMMISSIONER ANDRE: Question. Are you really  
6 an opponent of the merger or just merely requesting what  
7 the conditions would be if it were approved?

8                   MS. MERKEL: We are asking for conditions in  
9 the event it is approved. We are not necessarily  
10 opposing it, no.

11                   COMMISSIONER ANDRE: Oh, you are not? Nor the  
12 speaker before you.

13                   MS. MERKEL: I do not know about the speaker  
14 before me.

15                   COMMISSIONER ANDRE: Thank you.

16                   MS. MERKEL: With the rest of my time I am  
17 going to address myself to issues pertaining to each of  
18 two subsidiaries specifically.

19                   The first is Santa Fe Terminal Services.  
20 Santa Fe Terminal Service is not a motor carrier. It  
21 holds no operating authority from this Commission. It  
22 is not described in Applicants' annual reports and other  
23 financial materials as a trucking subsidiary.

24                   Rather, Santa Fe Terminal Services is a  
25 subsidiary of ATSF, engaged solely in terminal services

1 operations for ATSF. Its employees in most, if not all,  
2 respects are treated as railroad employees. They are  
3 covered by the Railway Labor Act, the Railroad  
4 Retirement Tax Act, the Railroad Unemployment Insurance  
5 Act.

6 More important for purposes of this  
7 proceeding, the Commission has historically exercised  
8 jurisdiction over terminal services as part of its  
9 jurisdiction over transportation by rail, and the Act  
10 itself gives the Commission jurisdiction over terminal  
11 services as part of its jurisdiction under Part I of the  
12 Interstate Commerce Act rather than Part II.

13 So under all of these circumstances, it seems  
14 clear that the employees of Santa Fe Terminal Services  
15 are clearly railroad employees, and even if the  
16 Commission declines to adopt the more expansive  
17 definition of railroad employee used in Costy, these  
18 employees should still be entitled to protective  
19 conditions.

20 Lastly, I want to clarify the IET's position  
21 with respect to Santa Fe Trail Transportation Company.  
22 Trail was sold approximately three or four months after  
23 the application was filed in this proceeding. In  
24 response to a petition filed by Teamsters Local 315, the  
25 Commission ruled that it had no jurisdiction over the

1 sale because Trail was sold to a non-carrier.

2 We are not now trying to attack that  
3 decision. It is the IBT's contention, based on the  
4 facts and especially the timing of the sale, it appears  
5 that Trail was sold because of and in anticipation of  
6 this merger. If that is the case, then these employees  
7 were affected by the merger, and at least under the  
8 Cosby rationale, they would be entitled to protective  
9 conditions.

10 The Applicants refused to respond to our  
11 discovery requests concerning Trail and the  
12 Administrative Law Judge did not direct them to  
13 respond. Also, the IBT was not allowed to introduce any  
14 evidence concerning Trail. We believe this was error  
15 because we were seeking to discover whether or not the  
16 company was sold because of the merger, in anticipation  
17 of the merger, and if so the employees would be  
18 affected.

19 For this reason, if the Commission declines to  
20 impose conditions for the employees of Santa Fe Trail,  
21 we request the opportunity for the record to be reopened  
22 and the opportunity to engage in discovery and introduce  
23 evidence as it relates to this issue.

24 That is all, unless there are any questions.

25 CHAIRMAN GRADISON: Thank you, Ms. Merkel.

1                   Next we will hear from Barry Roberts of  
2 Sunkist Growers, Wayne Emery of the United States Steel  
3 Corporation and David S. Ainsworth of the American  
4 President Companies, Inc.

5                   The three of you have 15 minutes.

6                   Mr. Robert.

7                   ORAL ARGUMENT OF BARRY ROBERTS

8                   SUNKIST GROWERS, INC.

9                   MR. ROBERTS: Thank you, Madam Chairman. I  
10 will take five minutes. My name is Barry Roberts. I  
11 represent Sunkist Growers, Inc.

12                   Sunkist ships in excess of 18 million cartons  
13 a year of fresh citrus by rail from points in California  
14 to destinations in the United States.

15                   Today the two Applicants, the Southern Pacific  
16 and the Santa Fe, vigorously compete with one another  
17 for every one of those cartons of fresh citrus. They  
18 compete in terms of price, they compete in terms of  
19 service. And, interestingly, the competition between  
20 them and the rail share of Sunkist shipments went up  
21 following deregulation.

22                   Sunkist is here because we fear that the  
23 benefits of competition will be lost. Sunkist, its  
24 growers, its customers, and the consuming public  
25 benefits from that competition.

1           The question has come up, what about truck  
2 competition? Over 60 percent of that volume moving by  
3 rail goes to points in the far northeastern part of the  
4 United States, approximately a 3,000-mile haul, and into  
5 northeastern Canada.

6           That is and has been a traditional rail  
7 market. The rail share of that market is going up, the  
8 truck share is going down, despite the fact that one  
9 would think just the opposite, given lower fuel costs.  
10 In fact, truck share continues to decline .

11           If we cannot have the competition between the  
12 Applicants that we have enjoyed through these years --  
13 and Sunkist believes that the merger should be opposed  
14 and should be denied because of the elimination of that  
15 competition -- we would request that you grant the  
16 trackage rights to the Union Pacific.

17           Sunkist has looked very carefully at the  
18 different Applicants for trackage rights. We believe  
19 that the Union Pacific's combination of experience in  
20 handling of fresh produce, the fact that they have a  
21 very substantial fleet of both refrigerated piggyback  
22 cars and refrigerated boxcars, speaks well in their  
23 favor.

24           Another point I would like to mention on  
25 behalf of Sunkist, the question came up about

1        abandonments. The Applicants have proposed to abandon  
2        as part of this merger a portion of lines near Visalia,  
3        California that serves a Sunkist plant. The evidence in  
4        the record is that this plant will ship approximately  
5        100 rail carloads per year. They have indicated there  
6        are no significant abandonments. This is very  
7        significant.

8                        This is an important packing house. The rail  
9        movement from this packing house goes to the long haul  
10       points. Although they have made some rather vague  
11       allegations about alternative service there is nothing  
12       to guarantee us that service and they should not be  
13       allowed to slip this abandonment into a merger  
14       proceeding.

15                      Essentially Sunkist opposes the service  
16       because of the loss of competition that we have really  
17       experienced and that we have really seen a benefit from,  
18       and we hope that the Commission will, one way or  
19       another, see that we continue to have competitive rail  
20       service in the citrus growing region, particularly in  
21       the San Joaquin Valley.

22                      COMMISSIONER LAMBOLEY: Mr. Roberts, do you  
23       see in the future any other abandonments as they affect  
24       your company?

25                      MR. ROBERTS: Yes. We've been notified by the

1 Southern Pacific that they are considering some  
2 abandonments along what is known as the Santa Paula  
3 line.

4 There have been indications of other  
5 abandonments. The Visalia abandonment was specifically  
6 proposed as a part of this merger and we don't think  
7 that the merger ought to be an excuse to abandon a line  
8 where we are actively shipping 100 carloads a year.

9 COMMISSIONER LAMBOLEY: With the merger, do  
10 you see any other potential areas of abandonments that  
11 would affect you?

12 MR. ROBERTS: We believe that to some extent  
13 all of our packing houses are susceptible to a loss of  
14 some service. A good deal of the increased rail service  
15 has been TOFC, but because of the shipping  
16 characteristics of fresh citrus fruit, we are a very  
17 substantial user of rail refrigerated boxcars, again  
18 principally to points in the northeast and eastern  
19 Canada. And we are fearful that abandonments will  
20 deprive us of this service.

21 For the most part, the Santa Fe has been  
22 pushing TOFC service. We've still been getting the  
23 competitive boxcar service from the Southern Pacific.  
24 We believe if the Santa Fe emerges as the dominant  
25 carrier, that is going to increase the likelihood that

1 we will lose our refrigerated boxcar traffic.

2 The Union Pacific has that equipment and has  
3 represented we will have it. Thank you.

4 CHAIRMAN GRADISON: Thank you, Mr. Roberts.

5 We will hear next from Mr. Wayne Emery of the  
6 United States Steel Corporation.

7 Mr. Emery.

8 ORAL ARGUMENT OF WAYNE EMERY

9 UNITED STATES STEEL CORPORATION

10 MR. EMERY: May it please the Commission, my  
11 name is Wayne Emery. I represent United States Steel  
12 Corporation. In the very limited time available to us,  
13 and I would take no more than five minutes, I would like  
14 to emphasize what we consider to be the central and  
15 perhaps critical issue in the proposed merger and its  
16 impact on United States Steel Corporation as a major  
17 consumer of the services provided by these carriers.

18 We consider this case to be a landmark case,  
19 in that the precedents that will be established here  
20 will formulate the guidelines of regulatory and/or  
21 legislative activity for some time to come.

22 We are dealing with a situation in which two  
23 directly aggressive and intensely competitive railroads  
24 are seeking permission to merge and are asking at the  
25 same time that all competition-retaining conditions

1 sought by other railroads and by the consuming public be  
2 summarily rejected.

3 U.S. Steel's interest in this case is  
4 substantial and is focused primarily on the  
5 anticompetitive effects that would result from an  
6 unconditioned merger in an area comprehended by the  
7 States of Texas, New Mexico, Arizona, and California.

8 In this corridor, United States Steel  
9 Corporation alone has facilities for the production and  
10 shipment of metals and chemicals with aggregate annual  
11 capacities of approximately 4 million tons.

12 We have detailed in testimony and on brief  
13 that a significant part of this production is  
14 distributed in this four-state area. And because of the  
15 physical characteristics of the products involved and  
16 the transport economics of their distribution, this  
17 traffic is largely immune to truck or water carrier  
18 competition and is in fact and as a matter of law,  
19 captive to rail movement.

20 Because of the direct and intense competition  
21 between the Santa Fe and the Southern Pacific, the  
22 service available and the rates assessed on this  
23 railroad captive traffic have historically been adequate  
24 to meet our distribution requirements.

25 However, we are deeply concerned that the

1 elimination of this intramodal competition will render  
2 us totally captive not to a single mode of  
3 transportation, but rather to a single carrier within  
4 that mode.

5 As we have shown in our testimony, it has been  
6 our experience throughout the nation that wherever two  
7 rail carriers are competing for our traffic, our rates  
8 are more than 20 percent lower than when traffic is  
9 captive to a single railroad. We expect a similar  
10 increase would result from an unconditioned merger of  
11 the Santa Fe and the Southern Pacific.

12 I should add and I would hasten to add that  
13 these comments are not intended to reflect any  
14 derogatory perception of the Santa Fe or the SP  
15 management. To the contrary, our traffic executives are  
16 personally acquainted with the executives of both  
17 systems and consider them to be dedicated, competent and  
18 ethical professionals.

19 They are, however, subject to the same  
20 economic imperatives applicable to all private  
21 enterprise: maximize the return on investment. When  
22 competition is eliminated, economic necessity dictates  
23 that return can be optimized by reducing service and  
24 increasing price.

25 I see that I am running quickly out of time

1 and I would like to perhaps get to the part of this that  
2 is unique to United States Steel Corporation, and that  
3 is that we are not opposing the merger, but we are  
4 requesting urgently that conditions be attached.

5 We endorse the trackage requirements of the  
6 Rio Grande and the Union Pacific, but we also request as  
7 regards the Union Pacific, the carrier be granted direct  
8 physical access to all industries currently served by  
9 the Santa Fe, the Southern Pacific, the former SDAE, and  
10 Pacific Electric Railroads, California, and Arizona. We  
11 detail that in our briefs.

12 CHAIRMAN GRADISON: Thank you, Mr. Emery.

13 We will now hear from David S. Ainsworth,  
14 American President Companies, Inc. Mr. Ainsworth, you  
15 have five minutes.

16 ORAL ARGUMENT OF DAVID S. AINSWORTH

17 AMERICAN PRESIDENT COMPANIES, INC.

18 MR. AINSWORTH: Good afternoon.

19 Although our stock trains and TCFC traffic  
20 normally rides somewhere up near the head of the train,  
21 I feel like I'm on the caboose today.

22 My name is David Ainsworth. I represent  
23 American President Companies. American President  
24 Companies has two transportation subsidiaries which are  
25 vitally affected by this merger, American President

1 Lines and National Piggyback Services.

2 I am here to address the merger's impact on  
3 central valley and southern corridor minilandbridge and  
4 TOFC service. Two-railroad competition has been a  
5 crucial factor in keeping the quality of service in the  
6 central valley and the southern corridor high and the  
7 rates low. There will simply be no constraint on the  
8 Santa Fe SP's power to raise rates and curtail service  
9 in the central valley and the southern corridor if the  
10 merger is allowed without granting the trackage rights  
11 requested by the Union Pacific.

12 MLB traffic via the southern corridor has  
13 grown exponentially in the past decade to become the  
14 dominant service in the Asia Gulf Coast. Against the  
15 shorter minilandbridge transit times and cost advantage  
16 of stack trains, all-water service is now virtually  
17 obsolete. It is not a competitive alternative to MLB  
18 service.

19 In fact, the sole remaining direct all-water  
20 carrier for this trade, Yang Ming, supports UP's  
21 conditions. Alternative rail routings of Asia Gulf  
22 Coast cargo via the central corridor, utilizing San  
23 Francisco Bay Area or Pacific Northwest ports are also  
24 not a competitive alternative.

25 The rail rates are 60 to 75 percent higher and

1 the inland transit times are as long or longer. Very  
2 little MLB cargo moves between Asia and Gulf Coast ports  
3 via the central corridor.

4 Nor can motor carriers provide a competitive  
5 alternative to southern corridor rail service for MLB  
6 traffic. Motor carrier rates are significantly higher  
7 than rail rates wherever rail competition exists.  
8 Moreover, the logistical problems with trans-shipment of  
9 hundreds of trucks for each vessel arrival, if trucks in  
10 such numbers could be found, would be nightmarish.

11 From the standpoint of National Piggyback  
12 Services, TOFC service competition between Southern  
13 Pacific and Santa Fe in the southern corridor has  
14 required each to meet the price of the other. Both have  
15 bid aggressively to secure contracts for National  
16 Piggyback's 2000 loads per year and growing TOFC  
17 business in that corridor.

18 As with MLB traffic, central corridor routes  
19 cannot compete with southern corridor routes for TOFC  
20 shipments moving between California and Houston, Dallas,  
21 or New Orleans. The distance is 800 to 1,000 miles  
22 longer. TOFC service depends upon fast transit at low  
23 cost.

24 Truck service also cannot provide a substitute  
25 for TOFC service through the southern corridor.

1 Counting local drayage costs, rail rates average 95  
2 cents per mile wherever rail competition exists. Motor  
3 carrier rates start at \$1 per mile and often range as  
4 high as \$1.50 per mile.

5 Indeed National Piggyback receives TOFC  
6 business from motor carriers who use our services  
7 precisely because rail is more cost-effective.  
8 Moreover, trucks are often just not available for our  
9 very large volumes, especially during harvest seasons.  
10 If competition between railroads in the southern  
11 corridor is eliminated, TOFC rates will tend to rise to  
12 the level of motor carrier rates and perhaps command a  
13 service premium.

14 Neither the proposed agency agreement between  
15 BN and the Santa Fe SP nor the Kansas City Southern/IRMA  
16 proposal offer a remedy for the loss of such competition  
17 as far as American President Lines and National  
18 Piggyback services are concerned.

19 The proposed BN plan would not cover  
20 inland bridge or TOFC service. The IRMA proposal does  
21 not provide for service competition and does not apply  
22 to new traffic.

23 Although our focus has been on the southern  
24 corridor, we also believe competition should be  
25 preserved in the central corridor. For this reason, we

1 also support DRGW's application for trackage rights and  
2 rail line acquisition conditions.

3 In closing, I wish to stress that we are not  
4 here to do Union Pacific or DRGW a favor. We are here  
5 because our customers and our shareholders depend on the  
6 benefits of two-railroad competition in the southern and  
7 central corridors.

8 Thank you.

9 CHAIRMAN GRADISON: Thank you, Mr. Ainsworth.

10 Now we have 15 minutes reserved for Messrs.  
11 Martin and Moates for rebuttal.

12 Mr. Martin

13 ORAL ARGUMENT -- REBUTTAL

14 BY R. EDEN MARTIN

15 SANTA FE SOUTHERN PACIFIC CORPORATION

16 MR. MARTIN: Thank you. I will take the  
17 time.

18 It would be tempting to try to chase through  
19 some of the details of what has been said by  
20 Mr. Kharasch about the record, by some of the labor  
21 executives, and their point basically comes down to  
22 whether labor ought to have a veto over this transaction  
23 or whether matters ought to be subject to the  
24 Commission's protection and arbitration and appeal  
25 procedures as they have been in the past.

1           To take on some of the other things that have  
2           been said -- but I am going to try and resist and hold  
3           my discussion to the BN agreement, to the UP proposal,  
4           and to the D&EG proposal, although I would be glad to  
5           take questions.

6           I cannot resist, however, making one point.  
7           The first quarter 10(k) report for the SFSP was referred  
8           to by one of our colleagues on the other side as if that  
9           somehow helped their case. I think it is important to  
10          point out that on the first page of the report to  
11          stockholders -- this is the most recent quarterly report  
12          -- it discloses that SPT had an operating loss of \$59.7  
13          million in the first quarter of 1986; that its car  
14          loadings declined 8 percent; and its revenue per carload  
15          was down 3 percent.

16          I do not see how anybody opposing this merger  
17          can take any comfort from this report.

18          With respect to the BN agreement, this is an  
19          alternative solution that the carrier should propose.  
20          It is a voluntary negotiated agreement. It is not  
21          overly broad and it doesn't involve any operating  
22          interference.

23          There have been some questions with respect to  
24          it. One question is whether it is a present solution,  
25          whether it is available now. If the Commission were to

1 approve the merger subject to the BN agreement, does it  
2 clank into gear immediately; is it effective  
3 immediately? And the answer is yes.

4 The agreement is in the record. There is  
5 evidence with respect to it in the record. The parties  
6 have had an opportunity to comment on it. It has been  
7 briefed. So it is submitted to the Commission along  
8 with the other proposals. It is available for the  
9 Commission to use as a condition if you decide to do  
10 it.

11 Mr. Kharasch made the point that the BN will  
12 not make much money out of it. He referred to an  
13 internal statement to that effect. He is right.  
14 Because of present competition which holds down our  
15 rates and would hold down our rates after the merger and  
16 particularly because of the availability of BN as a  
17 competitor, as a potential competitor with respect to  
18 this covered traffic, it is clear they are not going to  
19 make much money. They may make a little. If the rates  
20 go up they will have an opportunity to make some, but  
21 that opportunity and their availability as a competitor  
22 is what will provide the solution and keep the rates  
23 down.

24 COMMISSIONER LAMBOLEY: There has been some  
25 comment regarding the traffic base that's included in

1 that agreement. Could you perhaps make some comment  
2 regarding that?

3 MR. MARTIN: Yes. DOT counsel this morning  
4 made the point that the way DOT does the analysis,  
5 instead of 4-1/2 million tons of covered traffic, which  
6 is the way we have proposed it, they would add another  
7 million or a million and a half tons because of a  
8 technical disagreement about the way the analysis ought  
9 to be properly done.

10 We think that we were right about it. But I  
11 must say that that is not a deal breaker. That is a  
12 detail. If the Commission is troubled by that one and  
13 believes that the scope of the coverage ought to be  
14 expanded from the 4-1/2 million tons that we say, up to  
15 the million or so tons that they would add, while we do  
16 not think it is necessary and we would not agree --

17 COMMISSIONER LAMBOLEY: Are you talking about  
18 tonnage or commodity?

19 MR. MARTIN: This is tonnage. This is  
20 tonnage, and it would involve some other commodities and  
21 some other movements. That is a detail. It is not a  
22 deal breaker. And there are some other details with  
23 respect to the agreement which we think, while they are  
24 important, they also are not deal breakers.

25 The main thing is that here is a concept which

1 has another major rail carrier available as a competitor  
2 or potential competitor with respect to precisely  
3 defined tonnage which has been determined to be problem  
4 tonnage and which involves no operating interference and  
5 no mandatory subsidy.

6 Now, by contrast, the UP proposal as they have  
7 made it, is a deal breaker. There was a question about  
8 that this morning and I do not want to leave any doubt  
9 in the record on that one. Their proposal is for  
10 trackage rights of 1450 miles. They say it is surgical,  
11 and it is in the sense that it cuts the heart out of our  
12 system.

13 The basic economics are against it. It is  
14 going to involve operating interference. Now, Mr.  
15 Miller said it might involve one or two trains a day as  
16 they have planned it. It might. It might involve  
17 five. There is no reason why it would be held at two.  
18 They have not committed to hold it to two. They have a  
19 plan, but there is nothing to say that they couldn't  
20 increase it to five or ten trains.

21 It involves loss of density for SPSF through  
22 the heart of our system and it is aggravated by the fact  
23 that as they propose it, they would be a subsidized  
24 competitor.

25 Now, Mr. Miller compared these injuries to us

1 with a \$3 billion gain. I just want this Commission to  
2 understand that that is a lawyer's number. He  
3 calculated that number. We don't believe it is a real  
4 number. It's not in the record in the sense that it is  
5 supported by a witness. Mr. Miller calculated it.

6 Whatever the right number is, Mr. Miller  
7 ignores the basic facts that SPT is in desperate  
8 financial condition today and that we need every dollar  
9 of savings that we can get out of this merger in order  
10 to make the combined company a viable long-term  
11 competitor. Every dollar is essential.

12 Now, Mr. Miller also invites this Commission  
13 to ignore the testimony of Mr. John Schmidt who is the  
14 CEO of Santa Fe Southern Pacific. I invite the  
15 Commission to look at his testimony. It is at SFSP-48,  
16 pages 6, page 23, and in the transcript at 15539. And  
17 in that testimony Mr. Schmidt said that if the UP  
18 proposal as proposed, or the D&RG proposal as proposed,  
19 or the KCS/IRMA were established as conditions to this  
20 merger, then he would recommend to the board of  
21 directors of the company that they not consummate. That  
22 is his testimony. He is the CEO.

23 He has a way of saying exactly what he means  
24 and I believe that if you read the testimony, you will  
25 not think that there is any question about what he means

1 or what he intends.

2 VICE CHAIRMAN SIMMONS: Mr. Martin, pardon  
3 me. I am still concerned about abandonments. You filed  
4 concurrent requests for immediate abandonments,  
5 discontinuances in over 150 miles of track. If we  
6 approve the merger, what are your estimates of future  
7 abandonments of service in the medium and long-range  
8 term?

9 MR. MARTIN: I can't give any detail on that.

10 VICE CHAIRMAN SIMMONS: I hope you will.

11 MR. MARTIN: I can't give it to you here. I  
12 will be glad to supply the references. The amount of  
13 abandonments in relationship to the significance of the  
14 merger, compared to other merger cases, is relatively  
15 minor and many of the abandonments that have been  
16 proposed in the past, some of which were referred to,  
17 would occur whether the merger happened or not.

18 Of course, the biggest abandonment of all that  
19 we got in this case is what is going to happen to the  
20 SPT if the merger does not go forward. But with respect  
21 to the location of the miles and the segments, I just  
22 can't give that to you today. I'm sorry. I will have  
23 to supply you with the record references.

24 VICE CHAIRMAN SIMMONS: The number of miles  
25 that you did submit seem abnormally small to me.

1 MR. MARTIN: Well, I think it is. Mr.  
2 Roberts, for example, referred to supposed abandonment  
3 of service to his packing plant, but the answer is we  
4 are not going to abandon it. We are going to supply it  
5 from another line.

6 I think when you examine the number of miles  
7 that are proposed to be abandoned, it is very, very tiny  
8 in relation to the overall size of this case.

9 VICE CHAIRMAN SIMMONS: I want you to know I  
10 will be looking very closely at it.

11 MR. MARTIN: I know you will, Mr. Commissioner.

12 I want to get back to the so-called deal  
13 breaker or show stopper problem. I have pointed out or  
14 summarized what the basic economics are with respect to  
15 the economic impact of the D&RG/UP or the IRMA  
16 proposals, particularly the UP, and I have referred you  
17 to Mr. Schmidt's testimony, what he said and where he  
18 said it, because I hope that you'll look at that. I  
19 think it is very important.

20 I think a key point here is what happened in  
21 the Union Pacific merger case, because there you have a  
22 parallel situation. In that case, the Southern Pacific  
23 sought trackage rights over the heart of the Union  
24 Pacific system. They sought trackage rights on the UP  
25 line to Council Bluffs.

1                   And what happened? The Union Pacific said no  
2 way. They said if you do that, if the Commission poses  
3 that as a condition, this merger is off.

4                   Mr. Miller stood here before the Commission  
5 and he said that kind of trackage right condition  
6 granted to a competitor like the SP over our main line  
7 would create operational problems.

8                   To be honest with you, we do not spend a great  
9 deal of time developing a large record because there has  
10 never been any doubt about this matter from the  
11 beginning, that this is an unacceptable situation for  
12 the Union Pacific and it would break the merger. That  
13 is what they said would happen if you put a major  
14 competitor on their main line in the heart of their  
15 system.

16                   VICE CHAIRMAN SIMMONS: Now what are you  
17 telling us?

18                   MR. MARTIN: We are saying exactly the same  
19 thing. It didn't make sense to put a major competitor  
20 in the heart of their system there and it doesn't  
21 today.

22                   I think it's important what the Commission  
23 did. The Commission dealt with this in the UP decision  
24 at page 584. The Commission agreed with the UP there  
25 not to put a major competitor in the heart of the

1 system. They said it would disrupt the UP's  
2 operations. It would reduce operating efficiency over  
3 the UP's main line, downgrade service.

4 Then the said, referring to what Mr. Miller  
5 said to this Commission, counsel for Applicants, UP,  
6 stated that if SP's main line trackage rights were  
7 granted, Applicants would not consummate the  
8 transaction.

9 What does the Commission say? That "Such a  
10 consequence would be contrary to our general policy  
11 statement which requires that conditions not frustrate  
12 the ability of Applicants to obtain the anticipated  
13 public benefits of consolidation."

14 So you didn't do it. You didn't put the major  
15 competitor in the heart of their system there and you  
16 shouldn't do it here, and there is more reason not to do  
17 it here. The principal one is the condition of the SPT.

18 I am not going to repeat the summary of their  
19 financial condition. You have heard it all morning, but  
20 I will just point out that that condition is far, far  
21 more serious than was the condition of the UP's merger  
22 partner, which was the MoPac. It was in a reasonably  
23 healthy condition -- was then, is now.

24 There was reference to the SP getting trackage  
25 rights in that case, and it's true. They got them from

1 Kansas City to St. Louis. They already had service from  
2 Kansas City to St. Louis, so it was really not putting  
3 them in a new market. It was simply giving them a  
4 better operating route.

5 It is also true that the D&RG got trackage  
6 rights from Pueblo to Kansas City in that case. But  
7 that was not the heart of the system. That was not the  
8 heart of their system. And today it is my understanding  
9 that the UP only operates local service on that route.

10 Their main line is the line to Omaha and that  
11 is the line that you did not let them, did not make them  
12 absorb a major competitor on the heart of their system.

13 The UP is asking this Commission to take a  
14 tremendous gamble with the public interest based on  
15 their speculation that Mr. Schmidt did not mean exactly  
16 what he said. And we urge you not to take that gamble.  
17 I might just note that Mr. McKenzie, while he represents  
18 the California PUC, Cal-Trans also told this Commission,  
19 don't take the chance; if you think it's going to  
20 threaten the merger, don't do it.

21 Now, as far as the D&RG is concerned, it was  
22 sort of interesting to look at their map. This is the  
23 map that they say represents the Western United States  
24 after the merger. You've all got copies of it. A lot  
25 of red lines down here in the southern part of the map.

1 This is what the west would look like, with a couple of  
2 exceptions which they didn't mention to you.

3 One is that it leaves out the Burlington  
4 Northern. The second is that it leaves out the MoPac.  
5 A third is that it leaves out the Katy. And a fourth is  
6 that it leaves out the KCS. This isn't quite a map of  
7 the west, what it would look like after the merger.

8 DRG proposes to buy 1400 miles of our line for  
9 \$43 million and that \$43 million they say would cover  
10 not only the line but the equipment. Now, you compare  
11 that with what you know about the offers in the  
12 Milwaukee case.

13 Their proposal, if it were granted, would  
14 trigger repayment of debt by SPSF of \$200 million. One  
15 thing that I am not sure came clear this morning is that  
16 they have to buy this line. They have to buy it because  
17 trackage rights themselves won't work. It's a joint  
18 line operated in one direction by the Union Pacific, in  
19 another direction by the Southern Pacific, and Union  
20 Pacific has a veto over trackage rights grant.

21 So the only way they can get what they want is  
22 to buy the line and if they buy the line we are out of  
23 business. We can't serve Ogden. So what they are  
24 really talking about is not adding a competitor, but  
25 replacing us as a competitor with themselves.

1           We said that we would extend the DERC  
2 solicitation agreement. I won't add any more on that  
3 point.

4           Thank you very much.

5           CHAIRMAN GRADISON: Thank you, Mr. Martin.

6           Before we wrap up, I am told that Mr. Moates  
7 and Mr. Kharasch have reached an agreement or that they  
8 are in agreement on one issue and that they would like  
9 to make a brief statement before the Commission.

10          MR. KHARASCH: Thank you.

11          Our statement is that we are grateful, as the  
12 coordinators during the trial proceeding, for the  
13 services of Judge Hopkins and we think this record ought  
14 to reflect his services in the highest tradition of the  
15 Commission.

16          Things went well, smoothly, and you now have a  
17 nice, compact 20,000-page record.

18          (Laughter.)

19          MR. MOATES: Applicants endorse that.

20          CHAIRMAN GRADISON: Thank you very much.

21          On behalf of the Commission, I want to thank  
22 all the participants for their arguments presented here  
23 today. We also appreciate your cooperation in helping  
24 us finish on schedule. This oral argument is now  
25 adjourned and the matter will stand submitted.

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Thank you.

(Whereupon, at 2:50 p.m. the Commission  
adjourned.)