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BEFORE THE
INTERSTATE COMMERCE COMMISSION

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In the Matter of: :
SANTA FE SOUTHERN PACIFIC CORPORATION : Finance Docket
-- CONTROL -- : 30400 et al.
SOUTHERN PACIFIC TRANSPORTATION :
COMPANY :
----- x

Hearing Room A
12th & Constitution, N.W.
Washington, D.C.
Monday, October 1, 1984

The hearing in the above-entitled matter was
convened, pursuant to notice, at 9:30 a.m.

BEFORE:

JAMES E. HOPKINS,
Administrative Law Judge

1 APPEARANCES:

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0040 0042

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3 On behalf of Texas Mexican Railway:

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9 On behalf of the People of the State of California,
10 the California State Public Utilities Commission,
11 and California State Department of Transportation:

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16 On behalf of the U.S. Department of Transportation:

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On behalf of Patrick W. Simmons:

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0040 0010

P R O C E E D I N G S

1
2 JUDGE HOPKINS: The hearing will come to
3 order.

4 The Interstate Commerce Commission has set for
5 hearing before Administrative Law Judge James F. Hopkins
6 Finance Docket No. 30400, Santa Fe Southern Pacific
7 Corporation, control, Southern Pacific Transportation
8 Company, merger, the Atchison, Topeka, and Santa Fe
9 Railway Company and Southern Pacific Transportation
10 Company, and related dockets.

11 We will now take the appearances. Who appears
12 for the Applicants?

13 MR. NELSON: Your Honor, my name is Milton E.
14 Nelson, Jr. I represent the Atchison, Topeka & Santa Fe
15 Railway Company, an Applicant in this proceeding. My
16 address is 80 East Jackson Boulevard, Chicago, 60604.

17 JUDGE HOPKINS: Next.

18 MR. MARTIN: My name is Eden Martin. I'm
19 appearing on behalf of the Santa Fe Southern Pacific
20 Corp. My address is One First National Plaza, Chicago.

21 MR. STEPHENSON: Your Honor, my name is
22 Douglas Stephenson. I represent Southern Pacific
23 Transportation Company. My address is One Market Plaza,
24 San Francisco, 94105.

25 JUDGE HOPKINS: Thank you.

1 Next.

2 MR. SVOLOS: Your Honor, my name is Gus
3 Svolos. I represent the Atchison, Topeka & Santa Fe
4 Railway Company. My address is 80 East Jackson
5 Boulevard, Chicago.

6 JUDGE HOPKINS: Next.

7 MR. MOATES: Your Honor, my name is Paul
8 Moates. I represent the Santa Fe Southern Pacific
9 Corporation. My address is 1722 Eye Street, Northwest,
10 Washington, D.C.

11 MR. KNOWLTON: Your Honor, my name is B.K.
12 Knowlton. I represent the Santa Fe Southern Pacific
13 Corporation. My address is 224 South Michigan Avenue,
14 Chicago, 60604.

15 MR. MILLER: My name is Thorndund A. Miller. I
16 represent the Southern Pacific Transportation Company.
17 My address is One Market Plaza, San Francisco, 74105.

18 MR. SMITH: My name is Michael Smith,
19 representing Southern Pacific Transportation Company;
20 One Market Plaza, San Francisco.

21 MR. WILSON: Your Honor, my name is Dennis W.
22 Wilson. I'm representing the Atchison, Topeka and Santa
23 Fe Railroad.

24 JUDGE HOPKINS: Who appears for the
25 Protestants?

1 MR. PRETTYMAN: E. Barrett Prettyman, Jr.,
2 representing Denver & Rio Grand Railroad, 815
3 Connecticut Avenue, Washington, D.C. 20006.

4 MR. SANFORD: Your Honor, Kendall T. Sanford
5 for the Denver & Rio Grand Western Railroad Company,
6 1515 Arapaho, Denver, Colorado 80202.

7 MR. MAYO: Your Honor, George Mayo
8 representing the Denver & Rio Grande Railroad, 815
9 Connecticut Avenue.

10 MR. LEARY: Your Honor, Tom Leary representing
11 the Rio Grande; same address.

12 MR. BAKER: Morris Baker representing the
13 Kansas City Southern Railway Company. I am with the law
14 firm of Sullivan & Worcester, One Post Office Square,
15 Boston, Massachusetts. With me this morning is Joseph
16 Auerbach, same address.

17 Oh, excuse me. And Mario Calhoun of the
18 firm's Washington office, 1025 Connecticut Avenue.

19 JUDGE HOPKINS: Thank you.

20 Next.

21 MR. KHARASCH: Robert M. Kharasch, Galland,
22 Kharasch, Morse & Garfinkle, 1054 31st Street,
23 Northwest, Washington, 20007. With me is Kathleen Mahon
24 of the same firm, same address; Michael E. Roper,
25 Missouri-Kansas-Texas Railroad Company, 701 Commerce

1 Street, Dallas, Texas, 75202.

2 JUDGE HOPKINS: Thank you.

3 Next.

4 MR. WHITE: Your Honor, my name is Charles
5 White, representing the Texas Mexican Railway; 1000
6 Potcmac Street, Washington, D.C.

7 MR. MILLER: My name is Charles Miller,
8 representing the Union Pacific Railroad Company and the
9 Missouri Pacific Railroad Company. Also I will enter an
10 appearance on behalf of Virginia Watkin and Arvid E.
11 Roach, law firm of Covington & Burling, and other
12 appearances as the case goes on.

13 MR. SIPPPEL: Your Honor, I'm William C.
14 Sippel, representing the Trustee of the Milwaukee Road.
15 With me is Ellen Kirschenbaum. Both of our addresses
16 are 888 Union Station, Chicago, Illinois 60606.

17 JUDGE HOPKINS: Next.

18 MR. HYMSON: Your Honor, Edward Hymson
19 representing Consolidated Rail Corporation, 1138 Six
20 Penn Center, Philadelphia, Pennsylvania 19103.

21 MR. EVANS: William C. Evans representing
22 Chicago & North Western Transportation Company, Suite
23 100C, 1660 L Street, Northwest, Washington, D.C. 20036.
24 I would also like to enter the appearance of James P.
25 Daley, Stuart F. Gassner of the Chicago & North Western

1 Railroad.

2 MR. CRAIG: Your Honor, Peter S. Craig,
3 representing the National Railroad Passenger
4 Corporation, otherwise known as Amtrak, 400 North
5 Capitol Street, Northwest, 20001. I would also like to
6 make an appearance for Mr. Frederick C. Ohly of the same
7 address.

8 JUDGE HOPKINS: Governmental bodies?

9 MS. CAMPBELL: Good morning. Elizabeth A.
10 Campbell representing Fig Garden New Town; Suite 1000,
11 1660 L Street, Washington, D.C. 20036. I'd also like
12 to enter an appearance for L. John Osborn.

13 MR. MacKENZIE: Vincent MacKenzie. I
14 represent the People of the State of California, the
15 State Public Utilities Commission, and the State
16 Department of Transportation. The address is State
17 Building, Civic Center, San Francisco, 94102.

18 MS REED: Your Honor, Mary Reed on behalf of
19 the U.S. Department of Transportation, 400 Seventh
20 Street, Southwest, Washington, D.C. I'd also like to
21 enter the appearance of G. Joseph King from the Federal
22 Railroad Administration of the same address.

23 MS. COOPERSTEIN: Donna M. Cooperstein with
24 the Department of Justice, 414 F Street, Northwest.
25 With me is James Ratner.

1 MR. ROBERTS: My name is Barry Roberts. I
2 represent SunKist Growers, Inc. I'm at 600 Maryland
3 Avenue, Southwest, Washington 20024.

4 MS. MADIGAN: Your Honor, my name is Kimberly
5 Madigan. I would also like to enter an appearance on
6 behalf of William Mahoney, John Clarke, William Pirney,
7 and John Delaney, who are with the law firm of Highsaw &
8 Mahoney at 1050 Seventeenth Street, Northwest,
9 Washington, 20036.

10 JUDGE HOPKINS: You didn't indicate who you
11 represent.

12 MS. MADIGAN: The Railway Labor Executives'
13 Association.

14 JUDGE HOPKINS: Thank you.

15 MR. MacDOUGALL: Gordon P. MacDougall, 1120
16 Connecticut Avenue, Northwest, Washington, D.C. 20036,
17 appearing on behalf of Patrick W. Simmons.

18 JUDGE HOPKINS: Are there any other
19 appearances?

20 (No response.)

21 JUDGE HOPKINS: Let the record note that, if
22 there are any preliminary matters, we will either
23 discuss them at the recess or at some later time in the
24 day, unless there are some preliminary matters that have
25 got to be discussed before Mr. Schmidt gets on the

1 stand.

2 Well, let's call your first witness then,
3 please.

4 MR. NELSON: Thank you, Your Honor. Mr.
5 Schmidt, would you take the stand, please.

6 Your Honor, I did have one preliminary
7 matter. I'm sorry. I don't think it will take up much
8 time, but I have a document here which I'm not asking to
9 be marked as an exhibit at this time, but it's entitled
10 "SPSF Joint Route and Rate Policy." I intended it,
11 essentially as a counsel's exhibit, to be marked at the
12 appropriate time. Mr. T.J. Fitzgerald, Santa Fe's chief
13 traffic officer, will be available to explain it in the
14 event any party has any question with respect to it.

15 I'm passing it out at this time so that it
16 doesn't come right on before Mr. Fitzgerald's testimony,
17 so that people have an opportunity to review it. I will
18 distribute it after the recess.

19 Now, Your Honor, as we discussed before the
20 hearing began, we are not going to mark Mr. Schmidt's
21 testimony as a separate exhibit. I do have separate
22 copies here for the convenience of the parties.

23 What I have here is the document that appears,
24 the same as it appears in the volume SFSP-12. And Mr.
25 Schmidt is going to need a copy. I think I will leave

1 the balance of these copies over by Ellen Goldstein's
2 desk for anyone who would like one.

3 Whereupon,

4 JOHN SCHMIDT

5 was called as a witness by counsel for Applicants and,
6 having been first duly sworn, was examined and testified
7 as follows:

8 DIRECT EXAMINATION

9 BY MR. NELSON:

10 Q Mr. Schmidt, do you have before you a document
11 entitled verified statement of John J. Schmidt?

12 A Yes, I do.

13 Q Are you aware of the fact that that verified
14 statement has been amended in some respects as a result
15 of errata which have been filed with the application?

16 A I am.

17 Q Are there any other changes you would like to
18 make in that statement?

19 A Well, just one. On page 4 in the first full
20 paragraph, the third line, that meeting referred to
21 there in January 1980 was February 1980.

22 Q With that correction, Mr. Schmidt, does this
23 statement constitute your testimony in this proceeding?

24 A It does.

25 MR. NELSON: The witness is available for

1 cross-examination, Your Honor.

2 JUDGE HOPKINS: Thank you.

3 Who will be the first one?

4 MR. PRETTYMAN: Here, Your Honor.

5 CROSS EXAMINATION

6 BY MR. PRETTYMAN:

7 Q Mr. Schmidt, I am Barry Prettyman,
8 representing the Rio Grande.

9 I see that the reporter is already having some
10 difficulty hearing us, so I'm going to suggest that both
11 you and I keep our voices up, both for her benefit and
12 also so that others in the room can hear us.?

13 A I have a chest cold, so if I sound a little
14 garbled I'll try to repeat.

15 Q All right. As I understand it, putting aside
16 the voting trust for a moment, at present Santa Fe
17 Southern Pacific Corporation controls Santa Fe
18 Industries, Inc., and also the Southern Pacific Company;
19 is that correct?

20 A Yes.

21 Q Santa Fe Industries owns Atchison, Topeka &
22 Santa Fe Company, which in turn controls several smaller
23 railroads?

24 A That's correct.

25 Q Southern Pacific Company owns Southern Pacific

1 Transportation Company, which in turn controls the St.
2 Louis Southwestern Railway Company and several motor
3 carriers.

4 A It owns it, but in trust now.

5 Q I understand if this merger is approved by the
6 Commission, Atchison, Topeka, Santa Fe Railway Company
7 will merge into a new company, Southern Pacific and
8 Santa Fe Railway Company; is that correct?

9 A That's correct.

10 Q Southwestern, St. Louis, Southwestern, and the
11 motor carriers will merge into Southern Pacific
12 Transportation Company, which in turn will merge into
13 the Southern Pacific and Santa Fe Railway Company?

14 A I don't believe the motor carriers will merge
15 into the railroad. I believe St. Louis and Southwestern
16 will merge into Southern Pacific Transportation
17 Company.

18 Q The motor carriers who will merge, how will
19 they be controlled by the parent, through what company?

20 A They will remain as separate corporations,
21 it's my understanding. And where their stock ownership
22 will be when the merger is completed, I'm not sure. It
23 will start out under the new railway company, the
24 Southern Pacific and Santa Fe.

25 Q All right. And then Southern Pacific and

1 Santa Fe Railway Company will be owned by Santa Fe
2 Southern Pacific Corporation?

3 A You said "earned by" or owned by"?

4 Q Owned by.

5 A Yes.

6 Q So the net result will be one railroad in turn
7 directly owned by the parent, Southern Pacific -- I'm
8 sorry, Santa Fe Southern Pacific Corporation?

9 A That's correct.

10 Q Will Santa Fe Industries, Inc., and Southern
11 Pacific Company maintain, remain separate companies
12 controlled by Santa Fe Southern Pacific Corporation?

13 A The need for those companies as separate
14 corporations is being researched right now, and I can't
15 tell you what the outcome will be. If they're not
16 necessary and can be dissolved, they probably will be.

17 Q So here today we don't know?

18 A We don't know.

19 Q Unless and until you are replaced, you will
20 remain the chairman and CEO of the parent, Santa Fe
21 Southern Pacific, Inc.?

22 A That's right.

23 Q Who is expected to become chairman or the
24 president or the CEO of the new company, Southern
25 Pacific and Santa Fe Railway Company?

1 A I'm expected to be the chairman. Mr. Larry
2 Cena is expected to be the next highest officer. We
3 haven't decided on a title at this time, whether it is
4 president and chief executive officer or president. No
5 specific title has been selected.

6 Q Well, assuming that he takes that position,
7 will he report directly to you?

8 A Yes, he will, as chairman, as chairman.

9 Q Yes, as chairman.

10 You say on page 3 of your statement that the
11 Commission approval of the UP-MoP-WP combination created
12 an imbalance in competition among the major western
13 railroads. Which railroads are you referring to?

14 A I'm referring to the Southern Pacific
15 Transportation Company, the Atchison, Topeka, & Santa Fe
16 Railway Company, the Burlington Northern System, and the
17 Union Pacific System, if I might call it that.

18 Q You're not referring to the Rio Grande?

19 A No, I did not refer to them as a major
20 railroad at that time.

21 Q Were they involved in that imbalance?

22 A They're involved in it now.

23 Q In what respect?

24 A In that they're normal traffic patterns I'm
25 sure have been changed or disrupted by the merger of the

1 Union Pacific with the Missouri Pacific and Western
2 Pacific.

3 Q On pages 4 and 5, you recount how on May 15th,
4 1980, SFI and SP entered into a memorandum of intent
5 contemplating a combination of the two companies, and
6 then during the summer of 1980 you say that intensive
7 studies were made, but the memorandum was cancelled in
8 September of '80 because "we were unable to find a means
9 whereby SFI could fulfil its obligation to its
10 stockholders to protect its investment in SP's non-rail
11 assets pending the outcome of regulatory proceedings and
12 whereby SP could fulfil its obligation to manage those
13 assets during that period."

14 A Was the voting trust mechanism discussed at
15 all during that period?

16 A Yes, it was.

17 Q And why was that used at that time?

18 A The parties could not agree on whether it was
19 to be invoked at that time.

20 Q You mean you couldn't agree on the terms or
21 you didn't think it was workable?

22 A No, at one time one side suggested the voting
23 trust mechanism, and I believe it was the Southern
24 Pacific that suggested it first, and our counsel's
25 advice was that it probably would create more problems

1 than it would solve and we rejected it. And later on
2 during the negotiations, when these difficulties were
3 cropping up, I believe I suggested the voting trust, and
4 at that time, for whatever reasons they had in mind, the
5 Southern Pacific Company did not want to use the voting
6 trust mechanism.

7 So we just never agreed at the same time that
8 we should do the voting trust.

9 Q Why was it unworkable from your standpoint in
10 1980, why was it not workable then but workable later?

11 A It was not unworkable from my standpoint.
12 There were legal reasons cited, which I don't recall,
13 why it might be unworkable.

14 Q The legal reasons disappeared later?

15 A I think we had some experience later. We saw
16 the Union Pacific put the Western Pacific in trust, and
17 that seemed to work very well. I think that gave us
18 some encouragement on a practical basis.

19 Q You don't know what the legal reasons were in
20 1980?

21 A I did not review. There was a lot of talk. I
22 don't believe there was a formal written opinion and I
23 really don't recall the detailed legal reasons given.
24 But it was the lawyers who kind of put the X on it, as
25 the saying goes, at Santa Fe.

1 Q The only reason from Santa Fe's standpoint
2 that it was not adopted in 1980 was purely because of
3 legal complications?

4 A Yes. I personally thought it was a highly
5 desirable mechanism for achieving this, especially after
6 getting involved in the detailed negotiations, which I
7 sort of summarized in my statement.

8 Q You refer on page 4 to intensive studies of
9 both the rail and the non-rail operations of SFI and
10 SP. Could you identify those studies and tell us who
11 conducted them? Were they the Salomon Brothers and
12 Morgan Stanley studies, or were there additional
13 studies?

14 A These studies were conducted in a team
15 format. We at Santa Fe designated a project executive
16 who was in charge under me of all of the coordination of
17 studies, exchange of information, the like. And what we
18 did is formed a team for each of the separate
19 operations, not each of the separate companies but
20 separate operations of the Southern Pacific.

21 And those that were similar or almost
22 identical to our operations, such as forest products,
23 trucking, the oil and gas, mining, pipelines, we
24 assigned company personnel, usually the president of one
25 of our operating companies, to head up a team to look at

1 their properties, "their properties" being the Southern
2 Pacific Company's properties.

3 And the Southern Pacific organized its effort
4 along the same lines. They assigned a project executive
5 and a project manager.

6 Where we did not have the expertise in-house
7 at Santa Fe to evaluate a Southern Pacific operation,
8 such as TICCR or their SPRINT operation, we asked
9 Salomon Brothers to assist us in doing that. So it was
10 a combination of teams from the operating companies and
11 teams from Salomon Brothers.

12 Also, there was a question of the staffs of
13 each company. Santa Fe Industries operated with a staff
14 up in the holding company that served the operating
15 companies in many ways, and we had to look at the tax
16 situation of the Southern Pacific Company, accounting
17 areas, and various areas, legal matters, lawsuits and so
18 forth.

19 Those studies were conducted by Santa Fe
20 Industries' staff members.

21 Q Did you have a team for the railroad?

22 A Well, we had a team for the railroad, but the
23 railroad was being handled in the same way the railroad
24 is being handled now. We were in the process of
25 preparing, doing the preliminary work to prepare an

1 application for the Interstate Commerce Commission.

2 Q Who was your project executive for the
3 railroad?

4 A Well, the project executive for the entire
5 project was Jerry Donahoe. He is now vice president,
6 law, of the holding company. The project executive in
7 charge of the railroad study was Larry Cena, under the
8 watchful eye of our commerce lawyers,, Mr. Knowlton and
9 Mr. Nelson and others.

10 Q Who was his counterpart on the SP, Mr.
11 McNear?

12 A Mr. McNear would be his counterpart, yes.

13 Q Now, did they conduct the studies you have
14 referred to in your testimony?

15 A Which "they" are you referring to now?

16 Q Your project team, and I'm now referring only
17 to the railroad.

18 A The railroad?

19 Q Yes.

20 A The study was under way in the railroad. It
21 was never completed, never reduced to an application and
22 reduced to the reports that the other operations
23 entailed.

24 Q Why was that?

25 A Well, because the merger was called off before

1 those massive studies could be completed. I think
2 you're aware of the scope of the application that has to
3 be filed in a merger case, and it had completely
4 different timing, completely different complexities than
5 the studies of the other operations.

6 Q Even though it was never completed, was it
7 reduced to writing in any form?

8 A There may have been preliminary reports with
9 the study teams which I never saw. It just never got to
10 the point where we had reduced anything that I know of
11 to a specific report on the railroad side.

12 Q You don't recall receiving anything in writing
13 from this railroad team?

14 A Just progress reports as to what they were
15 doing. They were hiring people like, I believe, Booz
16 Allen to do an operational model, and the other
17 consultants that were being retained at the time I can't
18 even recall, but there were 12, 13 or 14 of them.

19 Q Did this team to your knowledge work with
20 Salomon Brothers or Morgan Stanley?

21 A The railroad team had no reason that I know of
22 to work with Salomon Brothers or Morgan Stanley, except
23 where Salomon Brothers was doing what they call a due
24 diligence study.

25 I might add that, in addition to the specific

1 work we asked them to do on a few of the operations
2 which I mentioned, like SPRINT and TICOR -- and I might
3 add that Bankers Leasing was in there -- Salomon had the
4 obligation to review the entire corporation, both Santa
5 Fe Industries and Southern Pacific Corporation, for the
6 purpose of rendering an opinion to the shareholders on
7 the fairness of the transaction.

8 Q Mr. Schmidt, I would like to quote to you a
9 few of your statements from your testimony that I think
10 in combination, if you will listen to them, are
11 attempting to make several important points, and I want
12 you to clarify them.

13 On page 2 you say that, after the various
14 events of the period 1978 to mid-1983, you "became
15 increasingly concerned about the long-range earning
16 power and competitive position of ATSF." And again on
17 page 2, you say: "Yet, as an independent railroad,
18 ATSF's long-term competitive and financial positions are
19 far from clear."

20 At the bottom of page 3 you say that in
21 January 1980, "It was difficult to see how ATSF and SPT
22 could retain any realistic hope of remaining successful
23 independent competitors to the EN and UP systems over
24 the long term."

25 And on page 4, referring to the same time

1 period: "It seemed unlikely that either ATSF or SPT
2 standing alone could continue to be financially strong,
3 effective competitors for freight traffic."

4 MR. NELSON: Excuse me. Just for
5 clarification, when you said the same time period, I am
6 confused as to what time period.

7 MR. PRETTYMAN: The one I just quoted from.
8 That is 1978 to mid-1983.

9 MR. NELSON: Thank you.

10 BY MR. PRETTYMAN: (Resuming)

11 Q On page 5 you say that in the months that
12 followed September 1980, "a number of events made the
13 combination of SFI and SP not only more desirable than
14 it was in 1980, but imperative."

15 And finally, on page 11 you conclude: "I am
16 not optimistic about the long-term prospects of ATSF and
17 particularly SPT standing alone to remain as financially
18 healthy railroads, capable of competing effectively with
19 UP, BN, and other modes of transportation. In my view,
20 only through merger can we achieve the degree of
21 efficiency and financial stability necessary to provide
22 that competition and to warrant the level of capital
23 investment required to sustain the competitive service
24 capabilities of our rail operations."

25 Now let me ask you several questions as to

1 what you meant there. You did not mean to say, did you,
2 that absent merger either ATSE or SPT would go out of
3 business?

4 A No, I mean to say that both would go out of
5 business, not either.

6 Q Both would go out of business?

7 A That's the way I saw it and that's the way I
8 see it.

9 Q How long would it take for them to go out of
10 business?

11 A Well, I'd have to be a better financial guru
12 than I am, but we cited examples in here of the
13 disproportionate relationship of capital expenditures on
14 Santa Fe, Atchison, Topeka and the operating income that
15 we have. These statements were all made in the light of
16 a longer-term trend which started in 1951 where the
17 Santa Fe Railway was earning -- had an operating ratio
18 in the high 70's, meaning its carry-through, the reverse
19 of the operating ratio, was over 20 percent, and we
20 watched that go down steadily for 30 years, with periods
21 of remission, you might call it.

22 It looked like the chart of a patient with
23 multiple sclerosis, where you have a remission during a
24 good economic cycle and then it would just go down
25 farther and farther. That's been going on for 30

1 years.

2 We went from a carry-through in the 20-plus
3 percent to carry-through in the four, five and six
4 percent. And the Southern Pacific Transportation
5 Company went from the 18 and 19 percent down to
6 negative. So that is the context in which I made the
7 statement I did.

8 Q At what precise time, Mr. Schmidt, did you
9 determine in your own mind that the Santa Fe would go
10 out of business if you do not get this merger?

11 A There is no precise day you wake up and have a
12 light turn on.

13 Q I understand. Would you tell me as close as
14 you can get?

15 A It's been a growing feeling. I have been
16 involved in forward planning for the company for many
17 years, although I have not been involved in any
18 operational sense with the railway for close to 15
19 years. But it's one of our biggest assets. It's our
20 biggest asset.

21 And I've been concerned with what's been going
22 on there. I have seen its lack of ability to improve
23 its carry-through, and I'd have to say some time in the
24 1979 to '80 period I drew the conclusion that this
25 railroad was heading for oblivion.

1 Q And what was the first board meeting that you
2 informed your board that you would be going out of
3 business absent a merger?

4 A Sir, I was only the president from 1978 to
5 1983, and I didn't inform the board of anything that the
6 chairman didn't want to inform them of.

7 Q Did you ever inform the chairman that this was
8 your view?

9 A Oh, yes. I don't think I went in and yelled,
10 the sky is falling. It's more of a business approach,
11 trying to convince a gentleman who was very steep in
12 railroading that this beautiful property -- and it's
13 still beautiful -- is not really heading in the right
14 direction.

15 Q For the record, would you identify which
16 chairman you're talking about?

17 A John Reed.

18 Q Now, did Mr. Reed agree with you?

19 A I can't say he agreed, no, wholeheartedly.

20 Q Did he disagree with you?

21 A I think he thought that the railroad could
22 last a lot longer than I thought it could last.

23 Q Did anyone in your presence ever inform the
24 board that this was your view, that you were going out
25 of business?

1 A When I became chairman I informed the board.

2 Q You did? Did you inform the stockholders?

3 A It's not the kind of thing you run and yell to
4 the press and the stockholders.

5 Q Well, did you give any indication to the
6 stockholders that there was an imminent problem of this
7 magnitude?

8 A I didn't say the problem was imminent. And we
9 informed the stockholders accurately of what our
10 financial fortunes are, what has happened, and the
11 stockholders would have to draw their own conclusion.
12 It is not the duty of the chairman of the company or the
13 president to tell the stockholders to invest or not
14 invest in that company.

15 Q Did you paint a rosy picture to the
16 stockholders and to your financial analysts over the
17 years of what your future was?

18 A We tried our darnedest to turn it around.

19 Q No, no. My question was not what you were
20 trying to do. My question was what you were informing
21 them.

22 A That was a prelude to the answer. We tried
23 our darnedest to plan, to bootstrap, and to get better
24 results, and indicated in public appearances that we
25 were going to be tougher and, as Larry Cesa says, leaner

1 and meaner, and try to run that railroad on a better,
2 more profitable basis.

3 Q Is it true, Mr. Schmidt, that other railroads,
4 and particularly in the West, were also experiencing
5 declines in their operating income and their operating
6 ratios?

7 A I think your statement is probably true at any
8 given point in the business cycle. On a comparative
9 basis, though, both Santa Fe and Southern Pacific,
10 unfortunately, seem to fare worse than most of the
11 western railroads, if not all of them.

12 Q I take it from the statement that I have read
13 to you that you consider SPT to be a strong, effective,
14 successful, healthy competitor today?

15 A I won't doubt that statement in its totality.

16 Q Well, it puzzles me, because you talk about it
17 remaining a successful independent competitor and you
18 talk about it continuing to be financially strong and
19 effective.

20 A Where is that, sir?

21 Q The first is on page 3: "It was difficult to
22 see how ATSF and SPT could retain any realistic hope of
23 remaining strong and independent." And on page 4: "It
24 seemed unlikely that they would continue to be
25 financially strong and effective." And then on page

1 11: "To remain as financially healthy railroads."

2 The implication to me is that they are today
3 and that the problem is their remaining so.

4 A That's correct. The Atchison, Topeka and
5 Santa Fe, which I might call the Santa Fe, is a very
6 well maintained railroad today. We have put a lot of
7 money into property, much more than we have earned out
8 of the property for a couple of decades. And it is a
9 viable competitor for certain types of traffic today.
10 It has good customer orientation and service.

11 And from what I know of the Southern Pacific,
12 it is still very well maintained or fairly well
13 maintained. I don't know the property in detail. And
14 it seems to attract more business than the Santa Fe.

15 But my job is not looking at short-term
16 trends. My job is looking at long-term trends, and on a
17 long-term basis I don't see these properties staying in
18 the viable position they are today.

19 Q All right. Well, you correct me if I have
20 mischaracterized your testimony, but as I understand it
21 you're saying that both railroads are strong, healthy,
22 effective competitors today, but that over some time in
23 the future that you can't define both of them are going
24 to go out of business.

25 MR. NELSON: That's been asked and answered,

1 Your Honor.

2 JUDGE HOPKINS: I will allow him to answer.
3 Go ahead. Overruled.

4 THE WITNESS: There has been a great
5 deterioration of carry-through at the Southern Pacific
6 Transportation Company since the first merger
7 discussions which we have been referring to, 1980. So I
8 would say the Southern Pacific Transportation Company is
9 less viable today than it was a few years ago, but still
10 able to run its own operations effectively and compete
11 effectively.

12 The trends don't look good to me.

13 BY MR. PRETTYMAN: (Resuming)

14 Q Mr. Schmidt, I'm not trying to put words in
15 your mouth. I'm trying to interpret your testimony, and
16 these are your words you are using here about remaining
17 remaining a successful, independent, strong, effective
18 competitor. I'm just trying to determine what you
19 mean.

20 You do mean that they are that today, both
21 railroads?

22 MR. NELSON: I object to this, Your Honor.
23 He's already asked that question.

24 BY MR. PRETTYMAN: (Resuming)

25 Q Originally when I suggested that to you you

1 suggested it was wrong.

2 JUDGE HOPKINS: Overruled. Go ahead.

3 THE WITNESS: They are effective competitors
4 today. Whether all those adjectives you are putting
5 together apply today as I sit here, I would have some
6 doubt, because there has been deterioration. I don't
7 see better competitive position vis a vis trucks and
8 other major railroads for either of them.

9 So although they are effective competitors
10 today, I repeat, I don't see them remaining in that
11 posture for very long.

12 BY MR. PRETTYMAN: (Resuming)

13 Q All right. Then would you tell me, please,
14 sir, your best estimate, based on your experience, your
15 judgment, your knowledge of the railroad, as to what
16 period of time we're talking about before these
17 railroads go out of business? Are we talking about a
18 month, a year, five years, 20 years?

19 A I couldn't give you -- I'm not that much of an
20 economist. I couldn't give you a timetable for their
21 demise.

22 Q You don't have a judgment as between one month
23 and 20 years?

24 A No, I don't have that judgment. It'll be gone
25 long before 20 years; I can tell you that. But how much

1 before, I just don't know.

2 Q Mr. Schmidt, is it not a fact that throughout
3 these years that we have been talking about,
4 particularly since '79 until the merger was announced,
5 you constantly said in speeches and talks that the
6 future was bright and that, far from being in jeopardy,
7 both Santa Fe Industries and the railroad were
8 constantly improving their competitive position?

9 A You'll have to tell me when I said what, what
10 period of time.

11 Q Well, do you want me to quote some statements
12 to you? This is in July 1981: "As I said earlier, we
13 feel we have adapted well to current conditions and
14 we're confident of the future." This is to your New
15 York security analysts.

16 MR. NELSON: Your Honor, could I interrupt?

17 JUDGE HOPKINS: Just a second.

18 MR. NELSON: Excuse me. I wonder if -- you
19 know, this conceivably is taken out of context. I think
20 Mr. Schmidt should have an opportunity to see the
21 context in which the remarks are made.

22 JUDGE HOPKINS: Do you have a copy of the
23 speech?

24 MR. PRETTYMAN: Sure.

25 JUDGE HOPKINS: Off the record.

1 (Discussion off the record.)

2 BY MR. PRETTYMAN: (Resuming)

3 Q Number one at page 18 --

4 MR. NELSON: Excuse me, Your Honor. Were
5 there copies available for counsel?

6 MR. PRETTYMAN: Oh, I'm sorry. I wasn't
7 planning to introduce this.

8 JUDGE HOPKINS: You can stand as you wish.
9 You can stand right there.

10 MR. PRETTYMAN: I apologize.

11 JUDGE HOPKINS: We're going to have a big
12 enough record. With some things, there's probably no
13 necessity of putting it in.

14 MR. NELSON: I might also so, while I wasn't
15 personally involved in the negotiation about the
16 notification of documents 24 hours in advance, it had
17 been my understanding -- and again, this is hearsay --
18 that long documents, documents that would require the
19 witness to read and consume hearing time that would
20 otherwise be unnecessary, would definitely be noticed up
21 24 hours in advance.

22 We did not have any notice of this.

23 JUDGE HOPKINS: I don't think there's any
24 agreement yet on that. In the particular matters as to
25 speeches and that, I should think you people would have

1 been ready, expecting this.

2 THE WITNESS: What is your question?

3 BY MR. PRETTYMAN: (Resuming)

4 Q Did you not say that?

5 A I believe I said it in the context of the
6 entire company, Santa Fe Industries. It's a summary
7 remark at the end of the speech.

8 Q But it also applied to the railroad, did it
9 not?

10 A Well, in varying degrees. I don't know as I
11 sit here how much that remark applied to the railroad.
12 We were getting terrific growth in oil earnings,
13 exceptional growth in mining earnings. We had a steady
14 up trend in pipeline earnings. And you could make a
15 remark like this -- I don't think I broke it down in my
16 mind as to just how much of this applied to which
17 segment.

18 Q Well, look down at number two on page 5. This
19 is also to your New York security analysts, August 11,
20 1982:

21 "As economic conditions improve, we believe
22 that overall rail profits will improve, even though we
23 will increase maintenance expense as required to
24 maintain our plant and equipment at a level related to
25 increased activity. Profitability will also be

1 enhanced, because we have in place the capability and
2 ability to provide superior intermodal service, which is
3 still difficult for others to match."

4 A little later: "We have no doubt that the
5 future for the railroad is bright as the economy
6 improves and we are ready to fully exploit the
7 opportunity."

8 A I said that and I believed it and it came
9 true. We improved our operating ratio from that period
10 from the high 90's to the low 90's, and we are strong on
11 intermodal. But lo and behold, for a couple of the last
12 three months we experienced no growth in intermodal for
13 the first time in years.

14 Q Look at number three.

15 A So it's a changing situation, sir, almost
16 daily.

17 Q I'm sure. Look at number three, page 7. This
18 is September 14th, 1982:

19 "The first half of 1981 had been an excellent
20 one for our rail operations. The first half had just
21 ended when the plan for 1982-'86 was submitted. We saw
22 business begin to tail off during the third quarter of
23 last year." That would have been 1981. "But based on
24 all the economic forecasts available to us, we were
25 anticipating that business would again pick up early in

1 1982."

2 Look at number four, page 1.

3 A Do you have a question about that?

4 Q Well, did you say it and was that accurate?

5 A Yes, I said it.

6 Q Look at number four, page 1. After referring
7 to a record second quarter of 1983, you said: "This was
8 accomplished in good part because we achieved a
9 turn-around in rail operations after the" --

10 A I can't find it. Number four?

11 Q Yes, page 1.

12 A Page 1?

13 Q Yes.

14 "This was accomplished in good part because we
15 achieved a turn-around in rail operations after the
16 first quarter." Then on page 3: "If the second quarter
17 earnings are any criteria, we have a workable formula
18 going." This, incidentally, was also to your New York
19 security analysts.

20 And then if you look at number six, page 8,
21 you told the New York financial community on February
22 21, 1984, that: "There is no reason why we should not
23 be able to aggressively compete in a free market and at
24 the same time realize profit margins that are essential
25 to maintain the physical plant and continue to provide

1 services."

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1 And then if you look at Number 7 on Page 2,
2 that is as late as five months ago, you were telling
3 your stockholders how pleased you were about the
4 "significant turnaround" in results from your rail
5 operations.

6 A Would you tell me what paragraph you are
7 referring to?

8 Q I think it is on Page 2. The quote I have is
9 this. "So both railroads," and now you are referring to
10 both the Santa Fe and the Southern Pacific, "are doing a
11 good job of holding costs in line as traffic has begun
12 to return to a more normal level following the
13 recession."

14 Do you recall those statements?

15 A I recall those statements about --

16 Q And were they accurate at the time, Mr.
17 Smith?

18 A Yes, but they are not the complete picture
19 being painted here. I was also telling the analysts
20 during this period of time that the Santa Fe Railway had
21 to do something in the merger arena. And I was telling
22 our stockholders that, and I was doing things at the
23 time on a long-term basis.

24 Sure, we have an upturn in the business cycle
25 of the country, and Santa Fe and Southern Pacific are

1 doing better now than they were in the period of the
2 recession, but they are not doing as well as they did in
3 other upswings in the business cycle.

4 Our car loadings are just not there compared
5 to what they used to be, and I don't believe the
6 Southern Pacific's are, so taking the whole picture in
7 context, yes, you have the picture of a railroad or
8 railroads fighting to do their best, and holding their
9 own on a temporary basis.

10 Q It is true, is it not, that in 1983 the
11 combined operating income of the Santa Fe and the
12 Southern Pacific Transportation was only 29 percent of
13 SFI's total operating income, and in fact you made a
14 point of this in your 1983 annual report, I believe.

15 A That is transportation. I think the railroads
16 were slightly less. I think there is a correction
17 there.

18 Q And SPT's operating income was less than 1
19 percent of SFI's operating income.

20 A Of SFP's operating income. Yes, I believe
21 that's true.

22 Q Of SFP?

23 A SFSP, Santa Fe Southern Pacific Corporation.

24 Q Incidentally, you also noted in that same
25 report that the larger railroads are better able to take

1 advantage of the substantial freedom now allowed by
2 today's laws in pricing equipment utilization and
3 contracting of service. Is that your view?

4 A Yes, it is.

5 Q Had there been any changes in the fortunes of
6 the two railroads in the first quarter this year, Mr.
7 Schmidt?

8 A The first quarter of this year?

9 Q Yes.

10 A I believe there have been improvements. These
11 have been reported in detail to the public.

12 Q In both railroads?

13 A Yes, compared to what? Compared to last year,
14 first quarter?

15 Q Yes.

16 A Yes, I believe there have been improvements.

17 Q Before moving back to the nonrail assets, let
18 me ask you this. Were you involved in the decision to
19 engage Solomon Brothers in February of 1980 to advise
20 Santa Fe in connection with a possible Santa Fe/SP
21 merger?

22 A Yes, I was.

23 Q And did you work with Mr. Roger Miller and his
24 group thereafter?

25 A Among others, I worked with Roger Miller, yes.

1 Q Were you involved in reengaging them in June
2 of 1983?

3 A Yes, I was.

4 Q And did you have a team working under you that
5 helped the Solomon Brothers team, and is that the same
6 team that you were referring to before?

7 A Help them do what?

8 Q In their work, in preparing the
9 reevaluations.

10 A We didn't prepare any evaluations in 1983.

11 Q Well, what was Solomon Brothers engaged to do
12 first back in 1980?

13 A Solomon Brothers was engaged to assist me in
14 what you might call the financial aspects of -- did you
15 say 1980?

16 Q Eighty.

17 A Eighty. Well, Solomon Brothers was engaged to
18 assist me and the chairman in the financial aspects of
19 merger negotiation. That is, what kind of transaction
20 you should negotiate, what kind of security or
21 securities you should offer or that might be acceptable
22 to the other side.

23 And sort of the pricing of those securities.
24 If you have a convertible preferred or a preferred, the
25 conditions of the preferred, and if you have debt

1 instruments, the conditions of the debt instruments,
2 they were much more expert in that than anyone in the
3 company.

4 Q And when they were reengaged in June of 1983,
5 was their job the same?

6 A It was essentially the same, plus the
7 rendering of a fairness opinion, which is required in
8 today's structure of mergers.

9 Q And did I understand you to say that they did
10 not do an evaluation? Or did you mean that your company
11 did not do an evaluation?

12 A In which period, sir?

13 Q In either period.

14 A I testified to detailed evaluations we did in
15 the 1980 period, and I also stated that in 1983 the
16 company did no detailed evaluations of the Southern
17 Pacific properties.

18 Q Well, did you have a team working under you
19 that helped the Solomon Brothers team? And I am now
20 referring to such people as Terry Booth and Donna Helmes
21 and Orville Adams and so forth.

22 A When?

23 Q In the '83 period.

24 A No, not in the sense that we did it in 1980.

25 Q Was that the team that was working with them

1 in the 1980 period?

2 A Yes, it was.

3 Q Was there a similar team working with them in
4 the '83 period?

5 A No.

6 Q Did Mr. Miller periodically report to you with
7 regard to his progress in evaluation for an exchange
8 ratio?

9 MR. NELSON: What period, counsel?

10 MR. PRETTYMAN: Any period.

11 THE WITNESS: Mr. Miller was never
12 specifically assigned the task of determining an
13 exchange ratio. At one time in the 1983 period when
14 negotiations between Mr. Biaggini and I broke down, the
15 investment bankers were asked to look at it, their
16 investment banker being Morgan Stanley and ours being
17 Solomon, were asked to determine whether they could come
18 up with, yes, an exchange ratio, but they never did.

19 BY MR. PRETTYMAN: (Resuming)

20 Q Well, my question was, did he report to you
21 periodically in regard to his work in that regard?

22 A Yes, he did.

23 Q And were the continual discussions both face
24 to face and over the phone?

25 A Yes.

1 Q Now, Solomon Brothers was not asked to analyze
2 what the effects on Santa Fe would be if the SP were not
3 acquired, were they?

4 A No.

5 Q Were you aware that Mr. Miller was using as
6 part of his data materials prepared by Mr. E. Phillip
7 Anderson, who was doing some analytical studies in the
8 executive department of SP?

9 A No, I wasn't aware. We furnished Mr. Miller
10 with certain materials which he asked for, most of which
11 are published materials, and some not generally
12 published. But I wasn't aware that he had materials
13 from Southern Pacific. They must have been given to him
14 by Morgan Stanley, because Morgan Stanley was evaluating
15 Southern Pacific and, well, vice versa. They were
16 looking at each company.

17 Q Were you aware that Mr. Miller discussed with
18 people at SP such subjects as business, finances,
19 prospects, markets, labor, capital budgeting plans, and
20 the like?

21 A Not personally familiar. No.

22 Q And that he also discussed the long-term
23 prospects of the transportation company?

24 A I don't know what he discussed with them. I
25 know through Morgan he had access to them.

1 Q So despite his repeated communications with
2 you, you were not aware that he was directly in contact
3 with the SF people?

4 A Well, I knew generally he was in contact,
5 because he was asked to evaluate their assets and our
6 assets, and Morgan Stanley was asked to evaluate their
7 assets and our assets. That is at one stage in the
8 negotiations for the purpose of negotiating an exchange
9 ratio. That is the only purpose which they were turned
10 loose on the project for.

11 Q Are you aware that in October, 1983, Solomon
12 Brothers assigned a stand-alone value to the SP Railroad
13 of a negative \$200 million?

14 A Yes, and I believe that was minus the real
15 estate of Southern Pacific.

16 Q Did you agree with that conclusion?

17 A I didn't agree or disagree with it, because
18 Morgan had assigned a value of 800 or 900 million, and
19 that shows you what we can get out of investment bankers
20 at times.

21 Q Have you ever had anyone do an analysis of the
22 liquidation value of the SP Railroad?

23 A No, I haven't.

24 Q Did you have any discussion with anyone at the
25 Santa Fe or the SP about the possibility of not merging

1 the railroad?

2 A Would you repeat that question?

3 Q Did you ever have any discussions with anyone
4 either at the Santa Fe or the SF about the possibility
5 of not acquiring the railroad, not merging the
6 railroad?

7 A Well, the only discussions I ever had with SF
8 people is about merging the railroads. That was the
9 whole purpose of dealing with Southern Pacific.

10 Q So you never discussed the possibility of not
11 acquiring the railroad?

12 A My grandmother said, never say always or
13 never. I am sure at some time we must have been
14 discussing the consequences of not being able to come to
15 an agreement on merging.

16 Q Tell us about that, Mr. Schmidt.

17 A We both had, we being Mr. Biaggini and I, both
18 had a similar dire outlook long-term on the prospects of
19 our railroads if we didn't get to merge them. We were
20 the only kids on the block at the time, so to speak, not
21 in a merged condition.

22 So aside from general conversations, you don't
23 dwell in detail on the not merging of our companies when
24 you are trying to merge them, and discussing merger with
25 the chairman of another company.

1 Q Mr. Schmidt, I want you to tell us as much as
2 you recall about your discussions with Mr. Biaggini
3 about the possibility of your not acquiring the
4 railroad.

5 A There wasn't much to tell. There isn't much.

6 Q Tell us what little bit there was.

7 A There isn't much to tell, because it was sort
8 of a prelude that you go to a chairman and you say, we
9 really should think of merging our companies because,
10 and the because is, I don't think we will last long term
11 any more than your railroad will last long term, and
12 therefore we need each other for the efficiencies
13 inherent in the combination of our railroads.

14 Q So, you discuss not merging in that context,
15 and once you agree that you should merge, you don't
16 discuss not merging any more. So that is about the
17 extent of it.

18 Q You may misunderstand what I am talking
19 about. I am talking about a merger that excludes the
20 railroad, or that involves selling the railroad to
21 somebody else.

22 A We didn't discuss that, because the whole
23 purpose of the merger was to merge the railroads. I
24 doubt that we would have gotten together to merge our
25 non-rail properties without feeling the necessity of

1 merging the railroads.

2 Q You have told us everything you remember about
3 conversations to that effect?

4 A Your question is very difficult. I am trying
5 to give you a complete answer. It is very difficult in
6 the sense that the specter of not merging is there all
7 the time. It is implicit in conversations, and you
8 don't just sit there and talk to each other about what
9 will happen if we don't merge these railroads once you
10 have had the kind of conversation I indicated that we
11 had.

12 Q If you are telling me you never had the
13 conversation, that is fine.

14 A No. I am telling you at the beginning that is
15 how I approached Mr. Biaggini about the consequences of
16 not merging the railroads and what would happen to our
17 railroads if we didn't merge.

18 Q But you never thereafter had any discussions
19 about the possibility of a merger that would exclude the
20 railroad in any way, that is, by leaving it out or by
21 selling it to somebody else or by some other fashion?

22 A We never had a conversation about merging our
23 holding companies and intentionally keeping a merger of
24 the railroads from not happening. We want the railroads
25 to merge.

1 Q Oh. Well, maybe there is a misunderstanding
2 here. Did you ever talk about the possibility that
3 regardless of whether you wanted it or not, you might be
4 forced by circumstances not to acquire the railroad?

5 A Well, if the Interstate Commerce Commission
6 won't let us merge, yes, we recognize that as a
7 possibility.

8 Q Did you have conversations along that line
9 about what would happen if the Commission did not
10 approve this merger?

11 A Yes.

12 Q What was the purport of those conversations?

13 A The purport was, what would we do? We would
14 be in trouble.

15 Q What would you do?

16 A We would have to look at what our situation is
17 at that time. And we would have to divest of at least
18 one of the railroads, it is my understanding, and we
19 might decide to divest of both of them. And that is the
20 purport of the conversation.

21 Q Did you do any study or evaluation of any
22 segments of the railroad?

23 A I did no study.

24 Q Did anybody on behalf of Santa Fe?

25 A We did not segmentize the railroad. I looked

1 upon my mission as merging with -- a going business with
2 a going business to form a more viable new going
3 business.

4 Q Mr. Schmidt, I am not sure you answered my
5 question. My question is, did anyone on behalf of the
6 Santa Fe do any study or evaluation of any segments of
7 the railroad?

8 A Not to my knowledge. We were not trying to
9 evaluate segments. We were looking at the railroad as
10 an overall business and what its prospects were, would
11 be if merged with our railroad.

12 Q And that answer would cover a study of the
13 relative importance of the segments of the railroad?

14 MR. NELSON: Could I hear the question again?

15 JUDGE HOPKINS: Do you want to repeat it, Mr.
16 Prettyman?

17 MR. PRETTYMAN: I will clarify.

18 BY MR. PRETTYMAN: (Resuming)

19 Q Did anyone on behalf of the Santa Fe, and I am
20 now including your bankers or an internal group, did
21 anyone study the relative importance of the various
22 segments of the railroad?

23 A I would have to answer generally that the
24 experts that were retained by counsel to prepare this
25 case had to look at the relative importance of segments,

1 because there are traffic studies submitted here. There
2 are studies about traffic density, where traffic will
3 flow, so in a general sense they had to look at the
4 segments of the railroad for their specific purposes of
5 preparing testimony.

6 Maybe our tax people looked at segments of the
7 railroad from the tax point of view. I don't know. I
8 didn't ask them to do that.

9 Q Did you ever consider the liquidation value of
10 the railroad in whole or in part?

11 A Which railroad?

12 Q Southern Pacific.

13 A No.

14 Q Did Santa Fe ever do any internal valuation of
15 the Southern Pacific? And I am excluding the bankers
16 now.

17 A Valuation from what point of view, sir?

18 Q Any point of view. Did you do a valuation of
19 the railroad internally?

20 A We made some judgments, therefore a valuation
21 of the potential earning power of the Southern Pacific
22 Transportation Company in a merged situation. So, yes,
23 we did an evaluation which had to include the Southern
24 Pacific Transportation Company.

25 Q Was that reduced to writing?

1 A At what time?

2 Q At any time.

3 MR. NELSON: Could I ask a question for
4 clarification? I think we might be on a different wave
5 length.

6 Mr. Prettyman, are you talking about a
7 valuation that was made in order to determine the
8 exchange ratio for the transaction, or are you talking
9 about valuation subsequent to let's say the October
10 agreement as to the transaction?

11 MR. PRETTYMAN: I am talking about any
12 valuation.

13 THE WITNESS: I am having difficulty because
14 of all of the paper that has flowed over the last four
15 years. I don't recall any specific valuation that was
16 reduced to writing in the form of a pro forma income
17 statement projecting out into the future.

18 What I do recall is the judgments that I made
19 as to the potential for the combined railroad earnings
20 in the future, and I tend to think of it in terms of
21 what could the carrythrough be if we ran the railroads
22 efficiently and got the savings that we prophesied, and
23 I think it is in my statement here that I see between
24 \$240 and \$500 million, I believe.

25 BY MR. PRETTYMAN: (Resuming)

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1 Q Is that the conclusion that you reached, that
2 you just referred to?

3 A Yes.

4 Q You are aware that Solomon Brothers and Morgan
5 Starley disagreed about the valuation of the railroad?

6 A They disagreed about the valuation of
7 everything.

8 Q You are aware that they met in July of '80 or
9 '83 to try to reach an agreement, and then they could
10 not agree?

11 A That's right. I think it was July. We asked
12 them, as I said, when Mr. Biaggini and I could not
13 agree, to see if the bankers could do it, and they
14 couldn't do it.

15 Q Did Mr. Miller and Mr. William Strong appear
16 before your board to discuss their valuation?

17 MR. NELSON: What board meeting?

18 MR. PRETTYMAN: Any board meeting.

19 THE WITNESS: The only time they would have
20 appeared before the board is after Mr. Biaggini and I
21 independently arrived at an exchange ratio, and they
22 would have come in, and I believe they did come in to
23 give support to the overall exchange ratio, tell them it
24 was fair, but did not dwell on any particular valuation
25 of any particular property.

1 BY MR. PRETTYMAN: (Resuming)

2 Q What board meeting was that?

3 A That would have been -- I just have to refer
4 to a list of board meetings I had, because I can't
5 remember all the dates. That probably would have been
6 our September -- or August board meeting. I guess it
7 was a special board meeting. Probably August of '83.

8 Q And Mr. Miller made a presentation?

9 A Mr. Miller made a general presentation
10 supportive of the exchange ratio we had worked out.

11 Q Did he present his valuation of the railroad?

12 A No, I don't believe he presented the valuation
13 of any individual company, and whether it was in any
14 papers he had is one thing, but we were concerned about
15 the overall exchange ratio and the board having a degree
16 of confidence that it was a proper exchange ratio.

17 So, that was the purpose of Mr. Miller's
18 appearance.

19 Q How long was this presentation. Do you
20 recall?

21 A I don't remember. It wasn't very long. It is
22 strange that these very important things happened very
23 quickly.

24 Q If he said it was two hours, would you say it
25 was wrong?

1 A I won't say he is wrong, but I don't recall it
2 being anywhere near two hours.

3 Q Well, recall for us as best you can what he
4 said and what your board members said about this
5 valuation.

6 MR. NELSON: Which valuation?

7 MR. PRETTYMAN: Minus \$200 million for the
8 railroad.

9 THE WITNESS: He can talk about the minus \$200
10 million to my knowledge.

11 BY MR. PRETTYMAN: (Resuming)

12 Q It never came up?

13 A I don't believe so. We were there to get the
14 board to approve of an exchange ratio which I worked out
15 with Mr. Biagini, not which anyone from Solomon
16 Brothers worked out, because they couldn't work it out.

17 Q Did your board ever at any time consider the
18 possibility of getting out of the railroad business?

19 A They must have, because they directed me when
20 I became chairman to present a study to first and
21 foremost answer the question, should we stay in the
22 railroad business. So that was my direction. And if
23 so, on which basis. So, I can't tell you what was in
24 the mind of every board member, but I would say the
25 consensus was, they questioned whether we should stay in

1 the business, and wanted us to --

2 Q Did you conduct such a study?

3 A Yes, I did.

4 Q Was that reduced to writing?

5 A Yes, it was.

6 MR. PRETTYMAN: Do we have that?

7 MR. NELSON: You don't have it. It has been
8 supplied to KCS under a confidentiality agreement in
9 response to a specific request in discovery.

10 BY MR. PRETTYMAN: (Resuming)

11 Q What conclusion did you reach?

12 A I concluded that there would be sufficient
13 growth in traffic, in the territory served by the Santa
14 Fe Railway over the next decade to warrant staying in
15 the railroad business if we could compete with other
16 megarailroads and the trucking industry and other forms
17 of transportation, and that our best chance of putting
18 ourselves in that competitive posture would be through a
19 merger with the Southern Pacific Transportation
20 Company.

21 Q Did you condition your conclusion on your
22 acquiring the SP?

23 A Acquiring the SP? What part of the SP?

24 Q Any part.

25 A That report concluded that we should merge

1 with the SP Railroad and Atchison Railroad. Now, when
2 you say SP, there is SPC, SP Company, and --

3 Q Did you have any discussion with Solomon
4 Brothers about the possibility of the Rio Grande
5 acquiring all or any part of the SP Railroad?

6 A I don't recall conversations with Solomon
7 Brothers about that specific subject.

8 Q Does that mean you didn't, or you just don't
9 remember what they were?

10 A I may have talked to them about it after the
11 Rio Grande in this case indicated that it wanted to buy
12 some of the lines of Southern Pacific Transportation
13 Company, but it didn't occur to me before that that they
14 would even be interested in such a purchase.

15 Q Mr. Schmidt, you -- the Santa Fe has
16 substantial nonrail assets, does it not?

17 A Yes.

18 Q And of course Southern Pacific did, too?

19 A Yes.

20 Q You have some 5,700 miles of pipelines in 13
21 states. Would that be accurate?

22 A I think so.

23 Q And you are the fifth largest independent
24 company in the United States in terms of oil production,
25 are you not?

1 A That's right.

2 Q You produced crude oil and natural gas in 14
3 states, the Gulf of Mexico, and offshore California?

4 A Right.

5 Q And you have an interest in about 6,500
6 producing wells. Is that figure up to date?

7 A I am very bad with the numbers in this vast
8 company, but it sounds about right.

9 Q In terms of hard minerals, you are exploring
10 some nine million acres of mineral rights. Is that
11 right?

12 A Not all at once. I mean, we are exploring.
13 We have more people exploring our property than we have
14 our own people doing it. We farm some of it out. It is
15 a vast territory, but we are active in that area, yes.

16 Q Have you begun making deliveries from your own
17 operating coal mine yet?

18 A No. We hope to within the month, I believe.

19 Q You manage more than 1.2 million acres of feed
20 timberlands, do you not?

21 A Yes.

22 Q And in real estate you own more than 160,000
23 acres of prime farmland in the San Joaquin Valley in
24 California as well as land in 15 other states in the
25 west and southwest, and some of this is prime commercial

1 and industrial property?

2 A Correct.

3 Q And you have numerous other activities, too,
4 don't you, such as services with construction and
5 trucking companies and so forth?

6 A Yes. Well, we don't have a trucking company
7 any more. The Southern Pacific Transportation Company
8 does. We could not make a go of that business, and sold
9 our trucking company a couple of months ago.

10 Q Your timber, coal, and petroleum interests
11 produce products that must be transported?

12 A Must be transported? To get to the user, I
13 would say yes.

14 Q And do you have control over the
15 transportation of these products? In other words, are
16 those captive businesses in the transportation sense?

17 A No, those companies operate totally
18 independently. If they want to transport by truck, they
19 transport by truck. If they want to transport on the
20 Santa Fe or the Southern Pacific, they do that. Or if
21 they want to route it over the Burlington, they do that.

22 We have no control and exercise no control
23 over how they route the traffic. We ask them to operate
24 as independent businesses and get the best
25 transportation deal they can.

1 Q In an interview you gave to CNN, which was
2 printed in the December, 1983, issue of the Santa Fe
3 Magazine, you were asked --

4 A CNN?

5 Q CNN. Yes. Network. Look at Number 5 there.
6 I am going to have to read this with you, Mr. Schmidt.
7 Page 8. "Question: John, let's turn away from your own
8 merger. Looking ahead to the end of this decade, how
9 many major railroads would you expect that would be
10 operating in this country?"

11 And your answer, "Mike, there is some
12 speculation, but I would say that the absolute minimum
13 is three major transcontinental systems coast to coast.
14 I rather expect there will be six or seven, three
15 regional railroads on each side of what we call the
16 river crossings, possibly a strong railroad down the
17 center of the country north-south. I think we are
18 heading in that direction."

19 Is that still your view?

20 A I think so. You get awful smart on
21 television. They ask you a question and you have to
22 answer it. Yes, basically that's my view.

23 Q Which transcontinental systems were you
24 referring to?

25 A I don't know, because I don't know what would

1 happen. If our merger is approved, we will have three
2 large systems in the west, three large systems in the
3 east, assuming that ConRail stays as an independent
4 large system, and how those three would line up, you
5 know, the world's greatest guessing game is what happens
6 next in railroading, and who is going to get together,
7 and who knows.

8 Q Well, which regional railroads did you have in
9 mind?

10 A You mean the seventh large system?

11 Q What you are referring to right there.

12 A We were on Page 8, weren't we?

13 Q Yes.

14 A The regional railroads ahead of mine were
15 ConRail, CSX, NS, BN, HACKBAIL, and hopefully the
16 Southern Pacific and Santa Fe Railway Company.

17 Q And which north-south railway company did you
18 have in mind?

19 A I talked about the possibility of an
20 amalgamation of existing smaller railroads. In what
21 configuration, I have no way of really guessing. I
22 would suppose some of them could fit into a system like
23 that, and some of them could fit into some of the larger
24 systems that either have formed or as in our case are
25 trying to form.

1 Q You didn't have in mind a single north-south
2 makeup?

3 A I am aware of several companies. I am aware
4 of Canadian companies trying to buy various midwestern
5 railroads. It seems like they are reaching toward the
6 Gulf, and I was just prophesying that some of these
7 railroads could get together, either become part of the
8 three big systems, or part of another system which I
9 tried to describe as north-south who will remain
10 independently viable, as they seem to be doing right
11 now.

12 Q A number of Santa Fe people over the years
13 have extolled the virtues of single line service. In
14 fact, I think you named this as one of the chief
15 benefits of the merger, the year 1983 annual report, did
16 you not?

17 A Yes.

18 Q Let's just look at some of the benefits that
19 have been put forth by others and see if you agree with
20 them. This is the benefits from the single line service
21 now.

22 A Put forth by others?

23 Q Yes. Improved transit time.

24 A There is a potential for that.

25 Q More frequent train service.

1 A There is potential for that.

2 Q More frequent train service.

3 A There is potential for that.

4 Q Improved equipment supply.

5 A Yes.

6 Q Penefits relating to the new pricing freedom
7 under the Staggers Act, such as new opportunities for
8 shippers to negotiate contracts between more city pairs
9 on a single line basis.

10 A There is potential for that.

11 Q An ability to respond to changing needs of
12 shippers in price on service areas since you eliminate
13 the time-consuming process of securing agreements from
14 connecting carriers.

15 A Yes.

16 Q You have said on several occasions that your
17 policy is to maximize profits. Is that correct?

18 A That's right.

19 Q And of course profits are maximized by
20 shipping over your long haul wherever possible.

21 A Not always, but mostly, mainly.

22 Q That being true, tell us what in your view
23 will happen after this merger to traffic moving, let's
24 say, between St. Louis and Oakland?

25 A I am not an expert in routing, and I couldn't

1 tell you with any degree of certainty. We retained Booz
2 Allen and perhaps others to advise the railroad on the
3 best routing of that type of traffic, and any type of
4 traffic, and I am afraid I am not familiar enough with
5 the studies to tell you.

6 Q You have no view at all?

7 A I think we will have more direct routing, but
8 which route and what will happen specifically, I have no
9 view at all. I don't know all the gateways or the
10 potential gateways, the combination of Southern Pacific
11 and Santa Fe track that could be used. I am sorry, but
12 that is not my end of the business.

13 Q Your diversion study assumed that the Central
14 Pacific condition would no longer be in effect. Is that
15 correct?

16 A I believe that is correct.

17 Q And in fact, SPT has petitioned the Commission
18 to terminate those conditions.

19 A To my knowledge, they have.

20 Q Are you aware of that?

21 A Yes.

22 Q But your diversion study also assumed that the
23 SP Rio Grande solicitation agreement would still be in
24 effect after the merger. Is that correct?

25 MR. STEPHENSON: After the merger, counsel?

1 MR. PRETTYMAN: Yes.

2 THE WITNESS: I don't believe so. But I don't
3 want to assume anything.

4 BY MR. PRETTYMAN: (Resuming)

5 Q That is what I wanted to clarify. Tell us
6 about that. How long will it remain in effect?

7 A That is their agreement. Southern Pacific
8 Transportation Company and D&RG. I don't even know if
9 they have a right to cancel it tomorrow. How long it
10 remains in effect, I have no way of prophesying.

11 Q After the merger, who will make the decision
12 as to whether that agreement remains in effect?

13 A I don't know whether it will be in effect when
14 we have the merger, so I haven't thought about that
15 agreement per se.

16 Q You haven't discussed it with anybody?

17 A I discussed it just from the point of view of
18 trying to understand generally what it was about.

19 Q Who did you discuss it with?

20 A Our counsel in meetings, and when we had a
21 meeting with counsel to discuss the future, I wanted to
22 find out what that is about.

23 Q Did you ever discuss it with Mr. Cena or Mr.
24 McNear?

25 A I think I have had Mr. McNear just confirm

1 what I thought the agreement was about, and naturally
2 Mr. Cena would know what it is about, and I no doubt
3 have talked to him about it, but neither he nor I know
4 the details of it. And I never really asked Mr. McNear
5 the details of it.

6 Q What I am trying to determine is if the
7 Commission approves this merger, and SPT is merged into
8 the Southern Pacific and Santa Fe Railway Company, who
9 is going to make the decision? Who can the Commission
10 look to to determine who will make the decision as to
11 whether that agreement remains in effect?

12 A Well, I am having difficulty with your
13 question, because you are talking about an area that is
14 just totally hands off, knowledge of details on Southern
15 Pacific. So I don't know what the agreement really says
16 in detail. It has to do with traffic, and I stay away
17 from that subject except to know about it generally.

18 If you are asking who will determine the
19 policy of whether that agreement is in effect, the
20 policy will be determined by me after consultation with
21 Mr. Cena, who will be the first chief operating officer
22 of that railroad.

23 Q But at least to date you have not concerned
24 yourself with it?

25 A No, because I don't know whether it will be in

1 effect when we merge or not, what the conditions would
2 be, and therefore I really haven't thought about that in
3 detail.

4 Q You don't know when that agreement runs out?

5 A Not as I sit here, no. I don't know if it's a
6 year or terminable in 30 days or what.

7 Q Do you know whether it is a voluntary
8 agreement in the sense that it doesn't have to be
9 approved by the Commission?

10 A My knowledge is that it is voluntary, yes.

11 Q So you have no present view as to the future
12 of that agreement one way or the other?

13 A No, I have a view that I would like to work
14 with the D&RG, because I would like to see them be a
15 viable railroad.

16 Q So we can assume that agreement will stay in
17 effect?

18 A We can't assume that agreement will stay in
19 effect. We can assume, you know, the greatest
20 cooperation with the merged company.

21 JUDGE HOPKINS: Off the record a minute.

22 (Whereupon, a discussion was held off the
23 record.)

24 JUDGE HOPKINS: We will be in recess for half
25 an hour, and then we will have some procedural matters

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that need to be discussed.

(Whereupon, a brief recess was taken.)

1 JUDGE HOPKINS: Let's get back on the record
2 here.

3 Before we start on the cross-examination of
4 Mr. Schmidt, let's have a little discussion. We had a
5 discussion off the record as to certain procedural
6 matters.

7 Mr. Moates.

8 MR. MOATES: Thank you, Your Honor.

9 For the record, the parties have generally
10 agreed that for the remainder of this proceeding, all
11 phases, there will be a rule adopted that will require
12 parties intending to cross-examine witnesses to give the
13 counsel sponsoring the witness at least 24-hour prior
14 notification if counsel intends to use particular types
15 of documents in the cross-examination of the witness.

16 The witness will be presumed to be familiar
17 with his work papers. The documents in the nature of
18 prior testimony, speeches, briefs, that the party's
19 client may have filed in prior proceedings, any sort of
20 long documents that the witness would have to
21 familiarize himself with on the stand are to be noticed
22 up at least 24 hours in advance.

23 And, as I say, this rule will apply to the
24 Applicants as well when they are conducting
25 cross-examination of the Protestant's witnesses.

1 JUDGE HOPKINS: Mr. Kharasch.

2 MR. PRETTYMAN: Your Honor, the Rio Grande
3 does not join in that agreement. We will, of course,
4 abide by your instruction.

5 JUDGE HOPKINS: Yes. I'd like you to abide by
6 it. Thank you.

7 MR. PRETTYMAN: We, of course will. But we do
8 object to it and we take exception to your ruling with
9 great respect.

10 JUDGE HOPKINS: Mr. Kharasch.

11 MR. KHARASCH: Your Honor, I think we should
12 understand that this rule of reason has to be applied as
13 a rule of reason, and that on occasion there will be
14 documents that have to be produced overnight; because of
15 something the witness said in the morning, he will have
16 to produce it in the afternoon.

17 And we also ought to understand that -- it is
18 my understanding that this applies to voluminous
19 documents where it would really hold up the hearing to
20 have the witness sit and read the document on the
21 stand.

22 JUDGE HOPKINS: We understand. That's
23 generally the agreement. When we get into the
24 definition of "voluminous," that's something that as a
25 rule of reason we can work out. If we're going to move

1 this proceeding along, we can work things like these
2 out.

3 And I am inclined to think all the parties
4 will be willing to do that, even Mr. Prettyman.

5 MR. KHARASCH: Could I have a moment on a
6 couple of other things?

7 JUDGE HOPKINS: All right, Mr. Kharasch.

8 MR. KHARASCH: Your Honor, Kathleen Mahon has
9 circulated before, in accordance with your instructions
10 to all parties, a list of people requesting
11 cross-examination. She has supplemented that list and I
12 think given you the list as supplemented by other late
13 filed requests for cross-examination.

14 In general, that list is supposed to be the
15 general order of cross-examination, subject to
16 rearrangement as necessary.

17 With respect to the question of counsel's
18 exhibits, I'm informed by Ellen Goldstein that the
19 Commission Staff would like two copies of each counsel's
20 exhibit. Your Honor will, of course, get one and the
21 record will get one. And I have said that for my part,
22 I would give the Applicants two if they would give me
23 two.

24 JUDGE HOPKINS: Thank you.

25 MR. KHARASCH: And we'll have others in the

1 room for the active parties.

2 JUDGE HOPKINS: One other point before I
3 forget it. As we were discussing again off the record,
4 we have a problem that Columbus Day is celebrated by the
5 government on October 8th. That's next Monday. So I'm
6 afraid we will be in recess on October 8th.

7 MR. KHARASCH: Your Honor, one other thing.
8 I'm sure this will happen repeatedly during the
9 hearing. On the morning of Wednesday, I have a Court of
10 Appeals. I hope -- it may interrupt the examination of
11 Mr. McNeer. I hope not, and that we can arrange
12 something by Tuesday on that.

13 It is unavoidable, especially since I'm
14 defending Your Honor's decision.

15 JUDGE HOPKINS: A great decision, too, wasn't
16 it?

17 MR. KHARASCH: It was.

18 JUDGE HOPKINS: There will be problems during
19 the hearing. If a party intends to cross-examine, I
20 believe they should be here for all of cross-examination
21 of the witness.

22 If there are any reasons to be excused, please
23 inform me, and I would like it on the record as a matter
24 of fact, generally.

25 Let's get back on the record. Mr. Prettyman.

1 MR. PRETTYMAN: Thank you, Your Honor.

2 BY MR. PRETTYMAN: (Resuming)

3 Q Mr. Schmidt, one of the reasons you give for
4 thinking that this merger is necessary is because of the
5 UP-MoP/WF merger. Is that correct?

6 A That's one of the reasons, but the real reason
7 is the efficiencies that come from the merger. The
8 merger of the other companies is sort of the efficient
9 cause of our merger.

10 Q Let me see if I understand that. The real
11 precipitating cause is --

12 A Is the competition that we are facing in this
13 new environment of larger megarailroads, plus the
14 continued viability and increased viability of the
15 trucking companies and other modes. And the real reason
16 for the merger is to gain efficiencies and to reduce
17 costs in operating this merged system.

18 Q But if I understood the statements you have
19 made, including your testimony, the UP merger is one of
20 the reasons why, as you have testified today, you think
21 you are going to go out of business if you don't merge.

22 A Yes, that is one of the reasons.

23 Q And I take it, then, that -- I assume you
24 think both railroads were justified in objecting to the
25 UP merger and believing that they would be harmed by the

1 diversions that they thought they would suffer as a
2 result of that merger.

3 A I believe so, but I was not involved in the
4 matter. Well, naturally, not on the part of Scuthern
5 Pacific, and I wasn't directly involved for Santa Fe at
6 the time.

7 Q But you were clearly aware of the objections
8 that they made and, in a general way, the diversions
9 they thought they would suffer?

10 A Generally, yes.

11 Q Let me ask you this. If the Santa Fe Railway
12 began having a loss on the order of \$100 to \$105 million
13 a year diverted to another railroad, would that be a
14 matter of concern to you?

15 A Diverted to another railroad?

16 Q Another set of railroads. You lose that
17 business.

18 A Are you talking about operating income or
19 revenues? I'm not sure.

20 Q Operating income.

21 A That would be disastrous to lose \$105 million
22 of operating income. I probably wouldn't be around very
23 long.

24 Q It would, I take it, affect your essential
25 services?

1 A I think that was more than we made a couple of
2 years ago on the railroad.

3 Q \$105 million a year is less than 6 percent of
4 Santa Fe's operating income, is it not?

5 A No, that's not correct. \$105 million of
6 operating income, as compared to -- what operating
7 income for the whole company, and what year, I'm not
8 sure that I know --

9 Q Let's take '83, and let's say that the \$105 is
10 in revenue.

11 A Well, that's a different story.

12 Q Now, would that have any effect on your --
13 would you be concerned about that at all?

14 A Oh, yes, I'd be concerned about that.

15 Q Do you think it might have an impact on your
16 essential services?

17 A That, in and of itself, I can't answer whether
18 it would have an impact on our essential services. I
19 would have to know the patterns of loss of traffic and
20 so forth, and whether it's a short-term or a long-term
21 thing, whether it's related to general economic
22 conditions or strictly to the -- I presume the merged
23 company you're talking about that took it away from us.

24 Q Let's assume that it's every year for the
25 long-term as a result of diversions to other railroads.

1 That wouldn't be of concern to you?

2 A Yes, it would be of concern to me.

3 Q Would it be of serious concern to you?

4 A Oh, I don't know what you mean by serious
5 versus just plain concern. I would be concerned.

6 Q Well, do you think it would have any impact on
7 your essential services?

8 A I guess it would depend on how long it lasted.

9 Q I just told you it would last indefinitely.

10 A Well, it would also depend on whether we had
11 the ability to take other measures such as we are doing
12 in this case, merging, trying to become more efficient.
13 It would depend on whether we have run out of avenues to
14 increase our efficiency.

15 Q Are you aware, Mr. Schmidt, in the UP case the
16 SP objecting to an alleged diversion of \$105,216,000,
17 which was less than 6 percent of its operating income?

18 A I'm not aware of the details of the numbers
19 but I will take your word for it.

20 Q What kind of double standard do you use here
21 when you say that --

22 MR. NELSON: I object to the characterization,
23 Your Honor.

24 JUDGE HOPKINS: I'll sustain the objection.

25 BY MR. PRETTYMAN: (Resuming)

1 Q What standard do you apply in terms of the Rio
2 Grande where you say that we're not going to have any
3 adverse effect on our essential services when we lose
4 about 6 percent of our gross revenue which, in our case,
5 is comparable to our operating income; whereas, SF was
6 justified in complaining about less than 6 percent loss
7 of its operating income?

8 A I didn't say SF was justified or not
9 justified. I took your figure as to what they
10 complained about and what percentage it was. I have
11 nothing to do with SFT and what it says or does at thi
12 time, and I had nothing to do with what they said or did
13 at that time.

14 So I make no value judgments on what they did
15 in that case.

16 Q Well, let's take Santa Fe then. You said you
17 would be concerned about diversion of \$105 million a
18 year in revenues from the Santa Fe. That would be less
19 than 6 percent of your operating income, would it not?

20 A It would be much more than 6 percent of our
21 operating income.

22 Q Well, your income was 1 billion,
23 757 thousand --

24 A I wish it were, sir.

25 Q All right. Let's say it right here.

1 Translate for me your page 7. Do you have your annual
2 report?

3 A No, I don't.

4 Q This is your operating income in millions. Is
5 that what it says?

6 A That's \$175 million, not a billicn. There's a
7 point there, I believe, unless my glasses are failing
8 me.

9 Q Well, my glasses are not too good either.
10 \$175 million; right?

11 A Yes.

12 Q Suppose you were to lose 6 percent of that
13 \$175 million. Would that be of any concern to you?

14 A I would be concerned, depending on the reason
15 I lost it.

16 Q I've assumed you've lost it because of
17 diversion to other railroads.

18 A I'd be concerned and I'd try to do something
19 to gain the income through whatever means I had at my
20 disposal.

21 Q Well, that isn't what you said about us.

22 A What statement are you referring to?

23 Q You say that there could be no doubt that the
24 Union Pacific and Burlington Northern can absorb these
25 diversions without any adverse effect on their essential

1 services.

2 The same is true with regard to other affected
3 railroads. For example, Kansas City Southern is
4 projected to lose about 5 percent of its current gross
5 revenue. Denver and Rio Grande would lose about 6
6 percent of its gross revenue; unquote.

7 A You are mixing an apple and an orange, if you
8 will pardon my observation, and I'm having difficulty
9 answering the question because you're slipping from
10 operating income to revenue and using the same
11 percentages, and they don't necessarily apply.

12 Q But, Mr. Schmidt, in our case gross revenue is
13 operating income. We have practically no additional
14 income other than railroading.

15 A That means you have no expenses and you're
16 running a wonderful railroad. I wish we could operate
17 that way, sir. You have a better operating ratio than
18 we do and a better return on investment. But I didn't
19 think it was that good.

20 MR. PRETTYMAN: Can I have one second, Your
21 Honor?

22 JUDGE HOPKINS: Sure.

23 (Pause.)

24 BY MR. PRETTYMAN: (Resuming)

25 Q Mr. Schmidt, let me step back.

1 If the Santa Fe were to lose 6 percent of its
2 gross revenue, would that be a matter of concern to
3 you?

4 A Yes, it would be a matter of concern.

5 Q And my question is, why is it not a matter of
6 concern to the Rio Grande when it's going to lose
7 6 percent of its gross revenue?

8 A I didn't say in my statement that it shouldn't
9 be a matter of concern to the Rio Grande. I just said I
10 didn't think it would affect their essential services.
11 They're two different things.

12 Q Well, does that mean that the Rio Grande, for
13 example, is not going to go out of business but, on the
14 other hand, is not going to be able to compete as
15 effectively as it does today?

16 A I can't answer that question because I don't
17 know enough about the Rio Grande to answer that
18 question.

19 Q Yes. Well, you have made a judgment here that
20 we can absorb these diversions without any adverse
21 effect on our essential services. How did you reach
22 that conclusion?

23 A I reached that conclusion based on my general
24 knowledge, general knowledge of the efficiency of the
25 Rio Grande. They operate with generally a much better

1 operating ratio than the Santa Fe Railway, and they get
2 a much better return on investment.

3 They have a very good traffic base in coal,
4 and they have some good bridge traffic. And I think
5 it's, all in all, a very well run and very good
6 railroad.

7 MR. PRETTYMAN: Thank you. That's all I
8 have.

9 JUDGE HOPKINS: Mr. Baker, are you going to be
10 next?

11 MR. BAKER: Yes, Your Honor.

12 Your Honor, before I begin the
13 cross-examination, as I think was referred to earlier,
14 we have received a document which we received under a
15 protective order.

16 I have advised counsel to the Applicants that
17 I plan to cross-examine based on that document. I also
18 expect to mark it and offer it. Perhaps I should let
19 counsel for the Applicants respond.

20 I just want to make it perfectly clear on the
21 record that I am in compliance with the protective
22 order.

23 MR. NELSON: Yes. I will accept that, Mr.
24 Baker. We would like, as you may know, Your Honor --
25 I'll inform you now that this document was delivered up

1 to the Kansas City Southern substitute, the
2 confidentiality agreement and the protective order.

3 We have no objection to it being marked as an
4 exhibit. We would like it to be an exhibit under seal.
5 We have no objection to Mr. Baker asking questions about
6 it, and I'm sure his cross-examination will not tread
7 upon the confidential portion.

8 It doesn't mean I won't be objecting from time
9 to time.

10 JUDGE HOPKINS: Go right ahead, then. You are
11 going to mark it as a confidential --

12 MR. BAKER: Yes. Perhaps I ought to do that
13 right now. I have a number of copies, and maybe you're
14 not going to want me to mark them all.

15 Also, Your Honor, I wasn't sure how you wished
16 these to be marked. Should they be KCS-H for hearing
17 one, or how would you --

18 JUDGE HOPKINS: I think we put counsel's with
19 whatever your --

20 MR. BAKER: That would be KCS.

21 JUDGE HOPKINS: Well, wait a minute. We're
22 talking about, we would start with whatever your acronym
23 is first, and then counsel, and then one -- as I
24 remember.

25 (The document referred to

1 was marked Exhibit KSC-C-1
2 for identification.)

3 MR. KHARASCH: Your Honor, this is a strange
4 procedure. I know of having a confidential hearing.
5 You excuse people and you have a confidential record.
6 We're going to have an open hearing on this with a
7 confidential record of this case?

8 I have a number of documents from the
9 confidential production which I'm offering as exhibits
10 in the open record and I've notified the Applicants of
11 it.

12 JUDGE HOPKINS: What does the Applicant want
13 to do in those circumstances? This has been a problem
14 that I figured was going to come up with all of these
15 protective orders that we have here.

16 MR. KHARASCH: It seems to me you are either
17 slave or free on it.

18 JUDGE HOPKINS: I know, because I am very
19 reluctant to put people out of the room or anything on
20 that, too. That's one of the problems that I find with
21 this.

22 MR. NELSON: I realize that. This is one of
23 the reasons why we are not suggesting that we close the
24 hearing.

25 JUDGE HOPKINS: You're just suggesting the

1 document itself be protected?

2 MR. NELSON: And copies thereof to be kept
3 under seal. And subsequent use by Mr. Baker, we can
4 discuss that. But I also think that it would be
5 disruptive to try to exclude -- to close people out of
6 the room, which is why --

7 JUDGE HOPKINS: Now, there have been cases
8 where confidential documents have been accepted, and
9 they are in a confidential docket.

10 One of the problems, I really don't like
11 confidential dockets. I don't like that system. But
12 with these protective orders that have been worked out,
13 it seems to me that we're going to have to have a
14 confidential docket in these instances.

15 MR. NELSON: I think there already have been
16 some documents.

17 JUDGE HOPKINS: There have.

18 MR. NELSON: As a matter of fact, the Sic
19 Grande has offered up some exhibits, I believe, which
20 are exhibits under seal.

21 JUDGE HOPKINS: Those are the ones that were
22 shipped in the other day that I saw Friday afternoon, I
23 believe.

24 MR. KHARASCH: Your Honor, it seems to me
25 there are two different aspects. First, the production

1 was made so the production could go on in discovery
2 under a confidentiality agreement. That constituted no
3 ruling as to whether they were properly confidential or
4 not.

5 We have under those agreements the obligation
6 to provide notice in adequate time for the people
7 producing to make a request for confidential treatment
8 at the hearing.

9 Now, I hope that we could have most documents,
10 that most documents should have been sterilized and
11 should be in. The fact that they were produced under
12 confidential order doesn't make them confidential. Your
13 Honor would have to rule each time.

14 Second, the other parties are entitled to
15 copies of these.

16 JUDGE HOPKINS: You see, that's the problem.
17 Usually we can sterilize these, and that is the best
18 procedure. If you could work it out, I would much
19 prefer that procedure if we can sterilize the documents,
20 and then we wouldn't be faced with this.

21 MR. KHARASCH: But we must have copies of them
22 if it's to be a record in which we are supposed to
23 participate.

24 MR. RAKER: Your Honor, as to this document, I
25 don't know how to sterilize it. I can't identify,

1 myself, anything in it that ought to be subject to an
2 order of confidentiality. But I leave that to the
3 Applicants.

4 MR. NELSON: Your Honor, in that regard, we
5 regard the entire document as confidential. It's
6 constituted material prepared for the board of
7 directors. It's the sort of thing that, were these
8 kinds of documents freely available in proceedings of
9 this kind, I think it would have a chilling effect on
10 management's ability to communicate with its board of
11 directors.

12 I'm sure there is material in that document
13 that might even qualify as of a public nature in and of
14 itself, but we feel very strongly that documents of that
15 nature should not be spread around the public domain.
16 We're perfectly prepared to have Mr. Schmidt answer
17 questions about it for Mr. Raker.

18 JUDGE HOPKINS: What about the other parties
19 in the case?

20 MR. NELSON: The other parties in the case
21 have not asked for this document, did not ask for access
22 to it, to the best of my knowledge, in any of their
23 discovery requests. And I think, as a matter of fact, it
24 would probably not be a good idea if multiple people
25 would be asking questions about individual documents

1 anyway.

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1 MR. KHARASCH: Your Honor, the one principle
2 we should be firm on is that nothing can go in the
3 docket and be part of the decisional basis for this case
4 without the parties having access to it.

5 The fact that we didn't ask for it is not
6 relevant at this point. It is going into the record as
7 an exhibit. I insist, and I should think all counsel
8 would insist on a copy of that exhibit or else it can't
9 go in.

10 MR. NELSON: Well, Your Honor, the whole
11 purpose of the protective order would be totally
12 frustrated under an approach like that.

13 MR. KHARASCH: I hate to disagree with
14 counsel, where the proper procedure is that he asks you
15 for a ruling as to treatment, and then if I receive it
16 or any other counsel receives it, we receive it under
17 your instructions to not publicize it.

18 If we have to write a brief about it, then we
19 have to write a brief quoting it in a confidential
20 appendix, which we all have done.

21 JUDGE HOPKINS: Is there any reason, Mr.
22 Nelson -- you know, one of the problems I find, that
23 copies can be given to other parties in the case that
24 this would be, if it is received, that it could be
25 received in a confidential docket, but with the parties

1 having the right to comment on that.

2 MR. NELSON: In other words, having the other
3 parties to the proceeding enter into the same sort of
4 protective order?

5 MR. KHARASCH: It's not the entering the
6 order. It is the judge's instruction.

7 JUDGE HOPKINS: If I instructed that it be put
8 in a confidential docket, but with the parties having
9 copies of this, so that if they want to comment in their
10 briefs they have a right to comment, as a matter of
11 fact.

12 MR. NELSON: That would be satisfactory.

13 MR. KHARASCH: Whatever ruling Your Honor
14 makes on this or any other document, we will obey. But
15 please, may we have a copy of it?

16 JUDGE HOPKINS: I think you have a right to a
17 copy on it, with the understanding that this would -- I
18 don't like it, but the Commission has done it before.
19 They have put them in confidential dockets, and I will
20 allow this to be part of a confidential document.

21 But the parties, of course, should have a
22 right to receive a copy of this.

23 MR. NELSON: The lawyers?

24 JUDGE HOPKINS: The lawyers. I'm talking
25 about the lawyers in the case.

1 MR. MARTIN: Judge, just one point. I think
2 it's implicit, but I want to make it clear. I think you
3 mean that if lawyers get a copy of the document, they
4 would be subject --

5 JUDGE HOPKINS: They would be subject to the
6 order, in my opinion, that we made in the beginning
7 between the original two parties. They should be
8 subject to the same thing.

9 Is that understandable to everybody?

10 BY MR. BAKER:

11 Q Now, Mr. Schmidt, I can say good afternoon. I
12 am Morris Baker, representing Kansas City Southern.

13 You have been quoted in various publications
14 as being concerned about the scope and substance of
15 certain of the conditions being sought in this case by
16 the response of Applicants.

17 Is it fair to conclude that therefore you are
18 familiar with the conditions that are being sought?

19 A I am generally familiar with the conditions.
20 I'm not familiar in detail. I have not had the time to
21 go over the details of each request that is in the
22 process, and I understand that the Council is preparing
23 a response to that set of submissions asking for
24 conditions.

25 Q In your testimony at page 14, you use the term

1 "onerous conditions." Is it your position that every
2 one of the conditions being sought in this case is
3 onerous?

4 A I don't know if every one of them is onerous,
5 but collectively they are more than onerous.

6 Q And are some of them individually onerous?

7 A There are a couple that stand out that I would
8 have to say are individually onerous as I sit here,
9 without having had a chance to really go into total
10 detail.

11 Q I'd like to know what your principal concern
12 is with the conditions being sought. Is it that they
13 would detract from the operating efficiencies that you
14 expect that the merged company would otherwise have?

15 MR. NELSON: Your Honor, I think I would like
16 to object to this. I think we could go into the
17 conditions being sought ad nauseum with the witness here
18 whose testimony is on a direct case.

19 We have separate dockets to deal with the
20 individual conditions that are being sought. I'm just
21 seeking to limit the cross-examination on two conditions
22 in this particular proceeding.

23 JUDGE HOPKINS: Mr. Baker.

24 MR. BAKER: This cross-examination is based
25 directly on the statements in Mr. Schmidt's testimony on

1 page 14.

2 MR. NELSON: On that score, on page 14 Mr.
3 Schmidt says: "I believe there is no need for the
4 Commission to impose any onerous conditions."

5 He said that long before any specific
6 conditions were offered up in this case. So he is
7 speaking in a generality there, as opposed to having
8 addressed himself in March of 1983 to conditions as to
9 which evidence was not submitted until September of
10 1983.

11 JUDGE HOPKINS: Are you talking about specific
12 onerous conditions now, specific condition?

13 MR. RAKER: Yes. I do wish to ask Mr. Schmidt
14 about specific conditions. Your Honor, may I ask a
15 question for foundation?

16 JUDGE HOPKINS: Go ahead.

17 BY MR. RAKER: (Resuming)

18 Q Mr. Schmidt, have you corresponded with any
19 shippers concerning conditions being sought?

20 A Yes, I have.

21 Q And have you indicated to shippers that some
22 or all of the conditions being sought are so onerous
23 that Santa Fe/Southern Pacific may conclude that it
24 cannot go forward with the merger if the merger is so
25 conditioned?

1 A I believe the only indication I made to these
2 shippers and to the press is that if all of the
3 conditions are granted, it would surely be too onerous
4 for us to go ahead.

5 MR. RAKER: This, Your Honor, was the subject
6 of discussion off the record concerning KCS attempting
7 to secure a copy of this correspondence. I still do not
8 have a copy of it furnished to me by the Applicants.

9 So may I ask, do the Applicants have a copy
10 available at this time?

11 MR. NELSON: Efforts are being made at this
12 very moment to locate a copy of this generalized letter
13 which went out. We will supply it to Mr. Raker.

14 JUDGE HOPKINS: Mr. Raker particularly wanted
15 to get it before Mr. Schmidt was off the stand.

16 MR. NELSON: I understand that, and that's
17 what we're trying to do.

18 JUDGE HOPKINS: Go ahead.

19 BY MR. RAKER: (Resuming)

20 Q I'd like to get back to the question on which
21 the objection was made, and that is what is your
22 principal concern with the conditions? Is it that they
23 would detract from operating efficiencies?

24 MR. NELSON: Your Honor, that's the reason --
25 excuse me, Mr. Raker. You're saying "the conditions."

1 He means the specific conditions which have been sought
2 subsequent to Mr. Schmidt's testimony at this point in
3 time. As a matter of fact, the shipper letter that Mr.
4 Baker refers to, as well as Mr. Schmidt's comments to
5 the press, were made with respect to those specific
6 conditions.

7 Those specific conditions are going to be
8 addressed in detail in the subdockets involving the
9 petition. Mr. Schmidt has nothing to do with this
10 petition. It's just a general reference to saying
11 prospectively, he doesn't think there is need for any
12 conditions.

13 I don't believe that's a proper springboard
14 for asking Mr. Schmidt, for example, do we have
15 operational problems with the Kansas City between points
16 A and B, or do you have traffic problems?

17 It seems to me that subject in its entirety should
18 be addressed in those subdocket proceedings.

19 MR. BAKER: Your Honor, there's a sentence in
20 the carryover paragraph on page 14 of Mr. Schmidt's
21 testimony. He says: "As a result, I believe that there
22 is no need for the Commission to impose any onerous
23 conditions upon approval of this application which would
24 frustrate our objectives and detract from the operating
25 efficiencies and other benefits we foresee."

1 Now, I would like to know what are the
2 problems, what are the main problems? Are the main
3 problems one of detracting from operating efficiencies?
4 Is the main problem something else?

5 JUDGE HOPKINS: Are you talking about specific
6 conditions or just overall conditions? Any conditions?
7 If you're referring to any conditions, then I would ask
8 him that specific question.

9 MR. BAKER: I can certainly start with any.

10 BY MR. BAKER: (Resuming)

11 Q Mr. Schmidt, in terms of your statement on
12 page 14, what would be your principal objection to
13 conditions? In other words, what would make a condition
14 onerous?

15 A A condition which would frustrate in a
16 material way the purpose of our proposed merger, which
17 is to become more efficient, reduce our cost to the
18 point where given the competitive pressures we are
19 under, we can carry traffic at a reasonable profit.

20 There are corridors we operate in that we
21 can't make a profit right now. And if, for instance,
22 someone was allowed to operate in that corridor, another
23 railroad, that would just be doomsday as far as I'm
24 concerned.

25 Q Do you have an opinion as to whether the

1 independent remaking authority being sought by Kansas
2 City Southern would detract from those operating
3 efficiencies?

4 MR. NELSON: Objection, Your Honor. That is
5 precisely the sort of thing I'm objecting to. That is,
6 the specific --

7 MR. BAKER: Just a question as to whether he
8 has an opinion, Your Honor.

9 JUDGE HOPKINS: There's no reason why he can't
10 give an opinion. And then the next question will be
11 what is your opinion. I will allow it.

12 THE WITNESS: I have a general opinion based
13 on the summary analysis. I did not read in detail all
14 of the railroad's requests for conditions. I had
15 summaries that I relied on up until this point.

16 Q And what is that opinion?

17 A My opinion is it would be devastating, because
18 it represents a request to exercise authority over our
19 operations extensively, with no responsibility, no
20 understanding of what our problems and our costs are,
21 and no ability to respond on our part to shipper
22 pressures and competitive pressures.

23 And I think your request would be just
24 devastating, if granted.

25 Q Would you explain how these problems would

1 occur? What is your understanding of the ratemaking --

2 MR. NELSON: I object. This is where this is
3 leading. We are going to go through specific conditions
4 with every party in this room who has asked for
5 cross-examination, and there's a whole other case,
6 there's a whole docket.

7 JUDGE HOPKINS: There aren't very many other
8 parties who have asked for cross-examination of this
9 witness. I will allow him. Go ahead.

10 THE WITNESS: What was your question, sir?

11 BY MR. RAKER: (Resuming)

12 Q What is your understanding as to how the
13 independent ratemaking authority would work?

14 A My understanding is your client would be able
15 at any jointly served point, served jointly by Santa Fe
16 Railway and Southern Pacific Railway, to --

17 MR. CHARLES MILLER: Your Honor, I'm having a
18 very hard time hearing Mr. Schmidt. He looks that way,
19 his voice is falling, and we're missing most of it.

20 I'm sorry to interrupt, Mr. Schmidt.

21 JUDGE HOPKINS: And he has a bad cold, too.
22 Speak up if you could.

23 THE WITNESS: My understanding is that your
24 client is asking for authority to set rates at all
25 jointly served points, that is, served jointly by the

1 present Santa Fe and Southern Pacific Railroads, and to
2 do so at their whim and to have Santa Fe haul their
3 traffic, Santa Fe/Southern Pacific haul their traffic,
4 in our cars, with our people, over our lines and pay you
5 some undefined -- that is, receive some undefined
6 stipend for being your agent as I see it.

7 BY MR. RAKER: (Resuming)

8 Q Now, if the traffic moving under this
9 independent ratemaking authority moves in your trains,
10 the same trains that it would move in if it were your
11 traffic, how does that undermine your efficiency?

12 A I don't know what I'm going to get for hauling
13 that traffic, number one. I don't know how you could
14 know what it would cost us to haul that traffic and what
15 our problems are with the shippers.

16 You might as well be on our board of directors
17 and take full responsibility for what's going on with
18 the profits of the company.

19 Q I'm not talking about profits at this point.
20 I'm talking about efficiency. How would this interfere
21 with the proposed operating efficiencies of the
22 railroad?

23 A We wouldn't know when your traffic is coming
24 or how much is coming. We wouldn't be able to plan for
25 it. We wouldn't be able to plan for our own traffic.

1 I think it would have -- it would wreak havoc
2 on the efficiency of operating the railroad. The
3 efficiency of producing a reasonable profit from that
4 traffic is another problem that would be twice as bad.

5 Q In terms of not knowing when the traffic is
6 coming, Mr. Schmidt, if it's the same amount of traffic
7 that would move under your waybills, but instead it
8 moves in part under KCS waybills and in part under
9 Southern Pacific/Santa Fe waybills, how does that
10 interfere with your ability to plan?

11 A I just told you. I'm not an operating person,
12 but I could just see havoc wreaked on our railroad just
13 from that point of view, let alone the financial damage
14 you would inflict on two railroads that aren't making it
15 right now.

16 Your plant also has a better operating ratio
17 on a general basis and a better return on investment
18 than either of the railroads I'm trying to get merged.

19 Q What is your understanding of the proposal as
20 to what KCS would pay for you to haul the traffic?

21 A I don't understand that the made any concrete
22 proposal that I could understand, at least from what I
23 have looked at.

24 Q You have not been advised that KCS proposes to
25 pay you an amount that would cover all of your expenses

1 plus a return on investment?

2 A What return on investment? More or less than
3 we are making now?

4 Q My question, Mr. Schmidt, is have you been
5 advised that KSC has proposed to pay you an amount which
6 would cover all of your expenses, plus a fair return on
7 investment?

8 A Well, I don't know what a fair return on
9 investment is. If you define it and if you said it was
10 our cost of capital, it might be worth listening to and
11 looking at. But fair return on investment, I don't think
12 the industry is making a fair return on investment, and
13 we are making less than the industry average generally.
14 So I don't know what you mean by fair.

15 What's fair to one person is totally unfair to
16 another.

17 Q Mr. Schmidt, did you furnish to the directors
18 of Santa Fe industries a document entitled "A Strategic
19 Assessment of Santa Fe's Position in the Railroad
20 Industry"?

21 A Do you have a date on the document?

22 Q Mr. Schmidt, I am giving you a document which
23 contains a one-page covering letter and then attached to
24 it is a lengthy document. All together, there appear to
25 be 92 pages.

1 And, Your Honor, I'd like this to be marked
2 KCS counsel 1 for identification.

3 JUDGE HOPKINS: C-1. Is this a confidential
4 matter?

5 MR. RAKER: Yes. This is a confidential
6 matter.

7 MR. PRETTYMAN: May those of us who have
8 signed the confidentiality agreement now get copies of
9 that?

10 MR. KHARASCH: On the contrary, we all get it
11 under the judge's rule.

12 JUDGE HOPKINS: You're all getting it under
13 the general protective order. The same rule applies.
14 That's what we talked about a few minutes ago, counsel.

15 MR. RAKER: Your Honor, I was not aware they
16 were going to be distributed so freely. I will see that
17 more copies are made available this afternoon.

18 MR. PRETTYMAN: For the future, Your Honor,
19 may I ask how many copies you would like made of
20 exhibits that we intend to introduce?

21 JUDGE HOPKINS: Well, we had talked before
22 about having two for the Commission and one for myself
23 and then, of course, for the parties. And you'd have to
24 work that out.

25 You know, I get into the situation, I don't

1 know how many individual parties are involved in this.
2 You would have to -- it's rather difficult for me to set
3 a specific number. All I can do is set it for
4 ourselves.

5 MR. PRETTYMAN: Thank you.

6 BY MR. RAKER: (Resuming)

7 Q Mr. Schmidt, is KSC-C-1 for identification a
8 document which you delivered to the directors of Santa
9 Fe Industries?

10 A Yes, I mailed it to them and, in some cases,
11 delivered it because a few of them are in the building.

12 Q And the document was furnished to provide
13 background reading in conjunction with a matter to be
14 considered at the board meeting to be held on May 24,
15 1983; is that correct?

16 A That's correct.

17 Q And the matter to be considered at that board
18 meeting, or at least one of the matters to be
19 considered, was the competitive posture of the Santa Fe
20 Railway and the strategic options open to it in the rail
21 industry.

22 A More specifically, what was to be considered
23 was whether we would stay in the railroa industry and,
24 if so, under what conditions.

25 Q And, in fact, in that connection you advised

1 the directors in this document, didn't you, that it
2 would not be prudent or would not be a prudent course of
3 action to sell the Santa Fe Railway; isn't that
4 correct?

5 A Not without a further statement.

6 Q Well, you said that it would not be prudent,
7 and among the reasons given were the basic strength of
8 the Santa Fe Railway and projected rail growth in the
9 region; isn't that correct?

10 A I wish you'd direct me to specific portion.

11 Q The numbers that I'm going to refer to are the
12 numbers that are stamped at the bottom of each page
13 preceded by four zeros. Page 39.

14 A And your question, sir?

15 Q The question is, didn't you advise the
16 directors that it would not be a prudent course of
17 action to sell off the Santa Fe Railway? That's the
18 first question.

19 Q Putting this in context, I did not write this
20 report, and so this may or may not have been my advice.
21 The summary and conclusion I'm more directly responsible
22 for, and the cover letter. But this portion of the
23 report which is, as you point out, 39 pages into it, has
24 many predicates to it before coming to this conclusion.

25 In view of what was said before, it does not

1 appear a prudent course of action to sell the Atchison.
2 Unquote.

3 Q Mr. Schmidt, didn't you respond earlier to Mr.
4 Prettyman that shortly after becoming chairman, you were
5 directed by the directors to respond to the question of
6 whether or not the Santa Fe Railway should be sold?

7 A Yes.

8 Q And didn't you indicate that this document,
9 KCS-C-1 for identification, was your response to that
10 question?

11 A That's right.

12 Q But you say that the conclusion here that it
13 is not a prudent course of action was not your opinion;
14 it was someone else's.

15 A I'm just saying in the context of that page,
16 that is someone else's. My advice, this report advises
17 the board of directors that traffic which is susceptible
18 of railroad movement in the territory that Santa Fe
19 operates in will experience real growth over the next
20 ten years in the range of 2-plus percent and that if we
21 were in a viable, competitive position we should stay
22 in railroading because we would have a fighting chance
23 to grow.

24 X
25 And the conclusion was that to stay in a
viable competitive position and get the efficiencies

1 that we need, we should merge with the Southern Pacific
2 Transportation Company. We should merge our railroad
3 with the Southern Pacific.

4 Q Now, this document contains various data that
5 were furnished the directors; isn't that the case?

6 A Yes.

7 Q And you consider that the data furnished were
8 the best available?

9 A Yes.

10 Q You took adequate precautions, didn't you, to
11 avoid including any data that might be inaccurate?

12 A My adequate precautions along those lines,
13 sir, were to delegate the data handling to some of the
14 best people in our company.

15 Q People who you certainly rely on?

16 A Yes.

17 Q And the same would be true, that you took
18 precautions to make sure that none of the data were
19 misleading?

20 A Data, in and of itself, is not misleading. It
21 is, you know, the way you present it and the conclusions
22 you draw which could be misleading.

23 We try to take precautions along those lines.

24 Q And also precautions to make sure that no
25 irrelevant data was presented to the directors; isn't

1 that correct?

2 A I don't think I thought of irrelevancy per
3 se. I tried to get data more on the issue that they
4 wanted me to address.

5 Q All right.

6 But the data that is included, in your
7 opinion, was relevant to the issue that you were asking
8 the directors to address themselves to.

9 A Yes. But you have to understand, sir, that
10 this was a study that we purchased from Data Resources,
11 I believe, Inc. And it was -- it started with a model
12 of the entire United States and where the economy was
13 going, and as to the study there certainly had to be a
14 lot of irrelevant data in our file, because we have the
15 entire data base.

16 Q Okay.

17 When you're talking about a particular study,
18 Mr. Schmidt, I just want the record to be clear --
19 there, you are talking about one aspect of KCS-C-1 for
20 identification, which is a projection performed by Data
21 Resources, Inc. of rail traffic growth through 199 --

22 A 2, I believe.

23 Q Thank you.

24 But that is the case. You are talking about
25 that one aspect; is that correct?

1 A Yes. And none of that data is in this
2 exhibit. The conclusions and summaries from that data
3 are.

4 Q Who are the principal authors of KCS-C-1 for
5 identification?

6 A The principal author is Terry Booth and, I'm
7 not sure to what extent, Robert Keyes. Terry Booth had
8 the principal job of putting this report together.

9 Q And what role did you have in its
10 formulation?

11 A I directed the study in an overall sense, sort
12 of sitting down and saying how we should approach the
13 study which the directors asked for, the general
14 categories of data we should cover, the sources of data,
15 and the general organization of the report.

16 Q And as chairman, you officiated at the board
17 meeting in May '84?

18 A Yes, I did.

19 Q And in particular, you presided over the
20 board's discussion and consideration of the issues
21 raised in this document?

22 A That was one of the matters on the docket.

23 Q You presented the matter to the board and you
24 recommended a course of action; is that correct?

25 A Yes.

1 Q And you agree with all of the conclusions
2 contained in the document, don't you?

3 A I don't know if I agree with every one. The
4 conclusions I came to are generally -- they are stated
5 in my cover letter. And the highlights and conclusions
6 are sort of the way I saw this data lining up, this
7 report lining up, and the way I saw the picture.

8 Q Well, you agree with all of the
9 recommendations that are contained in it in an event;
10 isn't that correct?

11 A There were two recommendations that I made;
12 that we would stay in the railroad business if we can
13 merge with the Southern Pacific.

14 Q And it is these recommendations which were
15 adopted by the board, is that correct, or at least you
16 were authorized to go forward to attempt to accomplish
17 that merger?

18 A That's right.

19 Q What was your corporate position before
20 becoming President of Santa Fe Industries?

21 A I was Executive Vice President.

22 Q And what responsibilities did you have in that
23 position?

24 A I had some of what we call our operating
25 companies reporting to me, and I was in charge of what

1 generally might be called corporate development,
2 basically in the non-rail areas.

3 Q Now, isn't it the case that the analysis that
4 you furnished to the directors, that is, the analysis
5 that is encompassed in KCS-C-1 for identification,
6 compares Santa Fe's operating results going back to the
7 1950s with the operating results of certain other
8 railroads?

9 A That's correct.

10 Q And one of those other railroads to which
11 comparison was drawn is the Union Pacific?

12 A That's right.

13 Q And another one is the Souther Pacific?

14 A Right.

15 Q The analysis uses the term "carrythrough." I
16 think you used that same term a little bit earlier.

17 I wonder if you could explain what is meant by
18 that term.

19 A Well, the carrythrough is the reverse of the
20 operating ratio. It is the amount of revenue carried
21 through to the line generally designated net income from
22 railway operations, as distinguished from income from
23 real estate or if you sell oranges because you have an
24 orange grove, and that kind of thing.

25 Q And the carrythrough percentage which is used

1 in this document is that NROI as a percent of rail
2 revenues; is that correct?

3 A Yes.

4 Q So it's a percentage of gross rail revenues
5 that you bring down to net railway operating income?

6 A Right.

7 Q Your analysis shows, doesn't it, that during
8 the period 1951 through 1982, Santa Fe's carrythrough
9 percentage has deteriorated.

10 A Yes, considerably.

11 Q And Southern Pacific's has as well.

12 A Even more. Yes.

13 Q Yet, in contrast, UP's carrythrough percentage
14 has actually increased during that period, hasn't it?

15 A That's right.

16 Q And one of the predicates to the
17 recommendations that are contained in this document is
18 an analysis that you carried out to identify the reasons
19 as to why Santa Fe's carrythrough percentage went down,
20 while at the same time it's competitor, UP's, went up;
21 isn't that right?

22 A Yes. I might add that ours went down
23 precipitously and theirs went up from about an average
24 of 15 percent, something, to 16 or 17 percent.

25 Q No, you concluded, didn't you, that the

1 problem appears not to be with the level of expenses at
2 Santa Fe; isn't that correct? In other words, that
3 Santa Fe has done reasonably well in terms of its
4 expenses per ton mile.

5 A The statement you've made is not totally
6 correct because in the body of the report is the finding
7 that about a third of the difference in ability to carry
8 revenue through to operating income was due to higher
9 expenses on the Santa Fe than the Union Pacific, and
10 about two-thirds of that inability to carry revenue
11 through to operating income was due to the inability of
12 Santa Fe to get rates that covered its cost and gave it
13 a profit as compared to the Union Pacific.

14 Q But you're just talking about now that
15 one-third to two-third ratio that relates to the 30-year
16 period of -- was it 1951 to 1981, approximately?

17 A Generally we try to relate it to --

18 Q But it's also the case, isn't it that --

19 A May I just correct that? At one time, we
20 obviously had both expenses and rates in line and
21 produced in excess of 20 percent. And along the line
22 somewhere, there was a gradual deterioration.

23 So what we just talked about doesn't apply
24 uniformly throughout the years. It's that in the fix we
25 found ourselves in, we explained at that time that

1 one-third was due to containment of costs and
2 two-thirds, inability to get the right rates.

3 Q What you're talking about is displayed in a
4 table at page 19. Isn't that the case?

5 A Yes, I believe that's the case.

6 Q Now, you have also come to the conclusion
7 though, haven't you, that even though historically
8 during this 13-year period there had been a slight
9 erosion in Santa Fe's expenses in the sense that they
10 had gotten too large, that you brought those back into
11 line already, haven't you?

12 A I don't know that we have brought those back
13 into line in the total sense that you're talking about.

14 Q Why don't you look at page 21? It says:
15 "Although its expense levels at times have appeared to
16 be increasing at a more rapid rate than at least one of
17 its competitors, actions within the last year indicate
18 that expense levels are now back in line."

19 A Yes. I --

20 Q Thank you.

21 JUDGE HOPKINS: Go ahead. He hadn't finished.

22 THE WITNESS: You don't, you know, determine
23 the ballgame in one year in railroading. We have taken
24 some very strenuous efforts, Mr. Cena and I, in reducing
25 costs, and only time will tell whether we can maintain

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1 the kind of tight screw we have on costs, and given
2 various economic conditions.

3 JUDGE HOPKINS: Off the record.

4 (Discussion off the record.)

5 (Recess.)

6 (Whereupon, at 12:30 o'clock p.m. the hearing
7 was recessed, to reconvene at 1:30 o'clock p.m., this
8 same day.)

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AFTERNOON SESSION

(1:30 p.m.)

JUDGE HOPKINS: Back on the record.

Mr. Baker.

Whereupon,

JOHN SCHMIDT

the witness on the stand at the time of the recess,
resumed the stand and, having been previously duly
sworn, was further examined and testified as follows:

CROSS EXAMINATION - RESUMED

BY MR. BAKER: (Resuming)

Q Good afternoon, sir. Before we broke, Mr.
Schmidt, we were discussing KCS-C-1 for identification,
and I would like to get back to it.

The analysis that was undertaken by you and
your staff showed that between 1957 and 1980, Union
Pacific enjoyed a significantly larger increase than
either Santa Fe or SP in freight revenue per revenue ton
mile. Isn't that the case?

A I believe so. You will have to direct me.

Q Page 18, Mr. Schmidt. Again, I am talking
about the stamped numbers in the lower righthand corner
of the pages.

Do you see it? It's at the very top of the
page.

1 A Yes.

2 Q Is that a yes to both do you see it and to my
3 question?

4 A I see it, and that's what the statement says,
5 the exhibit says.

6 Q But on the other hand, your analysis of
7 changes over that period in the mix of traffic carried
8 by Santa Fe and Union Pacific indicated that actually
9 the opposite result should have come about.

10 In other words, as Santa Fe's revenue --
11 freight revenue per revenue ton mile should have
12 increased at a faster rate than UP's.

13 MR. MARTIN: Is that a statement or a
14 question?

15 BY MR. RAKER: (Resuming)

16 Q That's a conclusion that is at the bottom of
17 that paragraph, and it is also -- that conclusion is
18 taken from --

19 A The author to that conclusion, and I don't
20 have any argument with it. I was not the author of this
21 document.

22 Q Did you spell that out to the board as to who
23 was the author of this document?

24 A Yes. The author was there.

25 Q And did the board understand that there were

1 any differences between you and the author as to
2 conclusions and recommendations to be drawn from those
3 conclusions?

4 A I said I didn't draw this conclusion, but I
5 agree with it.

6 Q Thank you.

7 Now, there's another conclusion to be drawn,
8 isn't there, and that is that Santa Fe's slower growth
9 has largely been attributable to what is referred to in
10 the document as lesser pricing flexibility.

11 A That's right. We are subject, we felt, to
12 more competition and therefore unable to increase our
13 prices to get the return that we feel is reasonable.

14 Q In other words, Santa Fe has more intense
15 competition in the geographic territory that it serves
16 than UP appears to have in the territory that it
17 serves.

18 A That was our conclusion from trucks and --

19 Q And from Southern Pacific?

20 A Yes, and from the Union Pacific and from
21 Missouri Pacific, and from all the other railroads and
22 ocean-going vessels. A lot of competition.

23 Q And you're saying that this is greater
24 competition than the UP has?

25 A That was our conclusion, yes.

1 Q Now then, you used Union Pacific as the
2 standard, so to speak, to determine what Santa Fe's
3 revenues -- income would have been over the period 1951
4 to '81 if Santa Fe had had freight revenue per revenue
5 ton mile -- excuse me -- if Santa Fe's freight revenue
6 per revenue ton mile had grown at the same pace as UP's
7 and if Santa Fe's expenses had grown at the same pace as
8 UP's.

9 And that is essentially the figures that you
10 referred to before, aren't they, and those are the
11 figures at page 19?

12 A Yes. It wasn't done from the point of view, I
13 guess, as much as what would happen if we had grown as
14 UP, but why didn't we grow as much as UP. It's just a
15 point of reference.

16 Q All right. But you used this analysis, didn't
17 you, to determine how much of the better performance
18 that UP had was attributable to lower expenses and how
19 much of it was attributable to higher revenue per
20 revenue ton mile; isn't that correct?

21 A Essentially, yes.

22 Q And you concluded, didn't you, that UP's
23 better performance is much more due to pricing and
24 marketing factors than to expense and productivity
25 factors?

1 A Yes.

2 Q Now, merchandise traffic is extremely
3 important to Santa Fe, isn't it?

4 A Yes.

5 Q And -- well, when you use the term
6 "merchandise traffic," are you speaking essentially
7 about piggyback traffic?

8 A Piggyback traffic, yes.

9 Q And your projections of traffic growth for
10 1991 -- and when I say "yours," I mean the ones done by
11 the Econometric firm that you hired -- in that, it is
12 projected, isn't it, that merchandise traffic will have
13 by far the greatest percentage growth of any commodity?

14 A That was our conclusion from the data.

15 Q And this is the case nationally as well as for
16 the Santa Fe, isn't that correct?

17 A I'm not sure if it really would apply
18 nationally because the Burlington Northern and, to an
19 extent, UP territory, grain and coal is so important and
20 such a big factor. I don't recall now what piggyback
21 looked like in that area as compared to those
22 commodities.

23 Q I'd just like you to look at page 83, Mr.
24 Schmidt, and you see there's a reference there in one
25 column to average annual growth rate.

1 If you look down that column, merchandise is
2 at 4.5 percent and -- well, the next highest one is 3.6
3 percent for transportation equipment. Do you see that?

4 A Yes, I do.

5 Q Do you understand that this table is
6 national?

7 A Yes, it is national. And my answer to your
8 previous question was I don't know if it applied in that
9 same proportion to the territory I just mentioned.

10 Q Well, in fact, you concluded, didn't you, that
11 if anything, these figures for merchandise traffic may
12 be understated because they don't adequately take into
13 account the reduction in use of boxcars and the
14 movement, for example, of the traffic from boxcar to
15 piggyback. Isn't that correct?

16 MR. NELSON: Could I, just for purposes of
17 continuing this and following it, I would appreciate it
18 you would identify pages from your conclusions because
19 you seem to be jumping from one to the other.

20 I don't think you're trying to confuse the
21 witness or his counsel.

22 MR. BAKER: I couldn't if I tried.

23 THE WITNESS: I do recall a statement in her
24 that the merchandise traffic growth may be understated
25 because it does not account for the shift from boxcars

1 to piggyback. If it does shift, it's kind of a Pyrrhic
2 victory for the railroads, taking it out of one category
3 and putting it into another.

4 BY MR. BAKER: (Resuming)

5 Q On the other hand, though, it is significant
6 that merchandise traffic is expected to grow at such a
7 clip. And let me suggest to you one reason why this
8 ought to be taken into account. And that is something
9 that is mentioned at page 34, to the effect that what is
10 referred to there as piggyback flexibility greatly
11 increases the geographic area within which all carriers
12 are able to originate and terminate traffic on a
13 competitive basis.

14 Did you follow that?

15 A I follow it. I'm not sure where you're
16 going.

17 Q Oh, excuse me. What I want is confirmation
18 that you agree with that concept.

19 A The latter concept that it increases your
20 flexibility in reaching out for the traffic? Yes.

21 Q That's right. Increases the geographic area
22 in which a carrier can compete.

23 A Yes. It sort of permits you to invade another
24 carrier's territory, as they call it.

25 Q So in other words, as an example, if you have

1 railroad A that exclusively serves point A, if what you
2 have at point A is a coal mine, let's say, one can say
3 that that coal traffic is essentially captive to
4 railroad A. But if what is being originated at point A
5 is piggyback traffic, there might be competition from
6 railroad B that perhaps gets only 50 miles, let's say,
7 not closer than 50 miles to point A. Isn't that
8 correct?

9 A That's correct but there is the ever-present
10 pervasive competition from the motor carrier who can and
11 does and wants to take it all away. There is your real
12 cap.

13 Q But when you made this projection of DRI, the
14 Econometric firm made this projection that you
15 considered ought to go to your board, that merchandise
16 traffic was going to increase at this rate, we're not
17 talking about merchandise traffic being carried by all
18 modes, are we? We're talking about merchandise traffic
19 that's going to be carried by railroads; isn't that
20 correct?

21 A No. We're talking about merchandise traffic
22 that's subject to pervasive trucking competition.
23 Throughout this report, we talk about the trucking
24 competition, trucking competition almost ad nauseum.
25 There is the basic competition.

1 Q I'm not questioning whether trucks are there,
2 Mr. Schmidt. What I want to make certain of is that the
3 forecast of a 4-1/2 percent, approximately, annual growth
4 in merchandise traffic, that is a forecast that pertains
5 to rail movement of merchandise traffic.

6 A Oh, no. That pertains to the national
7 increase in merchandise traffic, whether it goes on
8 rubber or rail.

9 Q So let's go back, then, to the table on page
10 83. Are you saying that the increase in growth of the
11 movement of commodities, each of those commodities that
12 is listed there, that that is the total intercity
13 movement, rather than the rail movement growth?

14 A It's my understanding that, although the
15 report is couched in terms of what can be and does move
16 by rail, that the projected growth figures are national
17 figures and that's traffic the rails can participate in
18 if they can be competitive.

19 The report may be awkwardly worded along those
20 lines, but that's my understanding of what those figures
21 are.

22 Q If you look at -- on page 83, Mr. Schmidt, you
23 see at the bottom there is the word "total" in the
24 lefthand column, and then if you look over to the right,
25 you see it says "average annual growth rate."

1 A Yes.

2 Q And 2.1 percent.

3 A Yes, for all commodities.

4 Q For all commodities, yes.

5 Now, I would like you to look at page 77. The
6 paragraph begins in the middle of the page. Notice the
7 first sentence. It says: "Overall rail ton miles are
8 anticipated to grow at a 2.1 percent average annual rate
9 between 1981 and 1992."

10 Doesn't that lead you to believe that you may
11 be mistaken as to whether the figures on page 83 relate
12 to rail growth?

13 A I may be mistaken. But I think we applied the
14 percentage figure based on overall growth in the economy
15 of absolute ton miles, and so the railroads could get
16 their share of that.

17 I would have to really read through this
18 report to get the full context to see if I'm totally
19 accurate on that one.

20 Q Let's assume for the moment that you are
21 right, Mr. Schmidt. Let's assume that you're right.
22 That means that at the very least, the assumption is
23 that rail growth will not fall off, that rail growth --
24 in other words, that rail will hold its own; that if the
25 total growth in the movements are 2.1 percent per year

1 and if the rail growth is going to be at the same rate,
2 that means that rail is not losing share; isn't that
3 correct?

4 A That would be the assumption here under the
5 scenario I put forth.

6 Q All right. We will leave the question open
7 for the moment at least as to whether these projections
8 are rail or for the total economy.

9 But getting back to my question before about
10 the expended competition to which piggyback traffic is
11 subject, let me ask you; the Southern Pacific is also an
12 important carrier of merchandise traffic, isn't it?

13 A It's recently gaining in importance, yes.

14 Q So to the extent that one can say that there
15 is an added vulnerability, territorial vulnerability to
16 a railroad that carries merchandise traffic as
17 distinguished from bulk traffic, let's say, both the
18 Santa Fe and the Southern Pacific would be subject to
19 that added vulnerability; is that correct?

20 A Added vulnerability by what? Through what?

21 Q Well, let's take an example. Let's take an
22 example of a location, a point in California, let's say,
23 a point that is exclusively served by Santa Fe, but
24 there is a Southern Pacific line 40 miles away, let's
25 say.

1 Now, at that exclusively served point by the
2 Santa Fe where you have shippers of merchandise traffic,
3 there is the possibility and perhaps even the likelihood
4 that Southern Pacific is going to be able to compete for
5 that traffic at that point; isn't that correct?

6 A Yes, sir. Union Pacific or any one of those
7 or an over-the-road trucker.

8 Q And the same thing is true, is it not, in
9 reverse? In other words, Southern Pacific has an
10 exclusively served point 40 or 50 miles away from a
11 Santa Fe point. Santa Fe is going to try to get that
12 merchandise traffic away from the SF, isn't it?

13 A I presume if it demands a rate that you could
14 make a profit at, and there are other factors, as you
15 know, that determine whether you can get that traffic.

16 Q Oh, of course. Of course. But it means,
17 doesn't it, that if you are going to do a competitive
18 analysis of this proposed merger, you've got to take
19 into account that the two railroads compete for traffic
20 even at stations that they don't serve in common; isn't
21 that correct?

22 A As is the case, yes, with all of the
23 railroads. And again, I repeat, the real competitor is
24 the trucker himself.

25 Q When you say all other railroads, Santa Fe is

1 really the premiere merchandise carrier in the United
2 States today, isn't it?

3 A It carries more than other railroads.

4 Q And a very high percentage of merchandise
5 traffic either originates or terminates -- when I say
6 percentage, I mean a high percentage in terms of the
7 national scene of all merchandise traffic carried by
8 rail -- either originates or terminates in the Santa Fe
9 Southern Pacific territory; isn't that right?

10 A Yes.

11 Q Are you familiar at all with the competitive
12 analysis that was performed by Temple, Parker & Sclar on
13 behalf of the Applicants?

14 A Just generally. They get pretty over my head
15 pretty quick.

16 Q I found it confusing, too, Mr. Schmidt.

17 A Well, I didn't find it confusing. But having
18 a zoology degree, I don't relate too much to some of the
19 things they do.

20 Q Now, in connection with the analysis furnished
21 to your directors, we previously determined, didn't we,
22 that Santa Fe had engaged Data Resources. My question
23 is, were the projections of Data Resources furnished to
24 Temple, Parker & Sloan?

25 A Data Resources was engaged to help us answer

1 the questions that the board asked. Temple, Barker &
2 Sloan has a much more pinpointed job to do. I don't
3 know if Temple, Barker & Sloan has the access to the
4 data or not.

5 I did not direct the studies in the ICC case
6 myself.

7 Q Well, it would be relevant, wouldn't it, to an
8 analysis of the potential competitive consequences of
9 the merger to know what the competitive environment is
10 going to be like after the merger?

11 A I'm not sure, you know, the methodology of
12 Temple, Barker & Sloan so I can't answer the question as
13 to whether that would be relevant to their methodology
14 or not.

15 Q Well, if you were going to analyze the
16 anticompetitive consequences of the merger, wouldn't you
17 want to do that in the context of the competitive
18 environment?

19 MR. NELSON: I would object, Your Honor. This
20 is going pretty far afield from Mr. Schmidt's verified
21 statement.

22 JUDGE HOPKINS: It is, Mr. Baker.

23 MR. BAKER: I don't think it is, Your Honor.

24 JUDGE HOPKINS: You don't, I do.

25 MR. BAKER: Let me just suggest to Your Honor

1 that Mr. Schmidt did verify the application, and the
2 application is supported by the testimony, the verified
3 statements of Temple, Barker & Sloan and I am trying to
4 determine what Mr. Schmidt -- and in addition to that,
5 there are statements in Mr. Schmidt's verified statement
6 as to the pro-competitive nature of the transactions.

7 JUDGE HOPKINS: I sustain the objection.

8 BY MR. RAKER: (Resuming)

9 Q For purposes of the analysis by your board,
10 Mr. Schmidt, you considered, didn't you, that to provide
11 an analysis which took into account the competitive
12 environment between the present and 1992 directed the
13 directors towards a relevant time frame?

14 A I really don't understand your question.

15 Q I don't blame you. I confused it. Excuse
16 me.

17 What I am wondering about, Mr. Schmidt, is
18 when you decided to present to your directors an
19 analysis of the future rail traffic during the period
20 between the present or the then-present and 1992, did
21 you consider that the time frame involved was relevant
22 to their consideration?

23 A They didn't tell me anything about a time
24 frame. I chose the time frame because that's the time
25 frame for which fairly reliable data was available. I

1 was limited by data that were available.

2 Q I'm not asking you as to whether or not it is
3 too short, but clearly it isn't too long, is it? It's a
4 relevant period to consider; isn't that right?

5 A Yes. It's not too long in the history of this
6 industry and where it's going and how long I hope it
7 will be around.

8 Q All right. I will change the subject then.
9 The analysis that you presented to the
10 directors included an analysis of the consequences of
11 the Staggers Act and the effect that it could have on a
12 railroad's profitability in the future, didn't it?

13 A Yes.

14 Q And one of these effects or one of the
15 consequences of deregulation brought about by the
16 Staggers Act that you brought to the attention of the
17 directors is what you referred to in the document as
18 enhanced flexibility in setting single line rates; isn't
19 that correct?

20 A That's right.

21 Q And you pointed out that this flexibility is
22 dependent on being the only carrier serving the origin
23 or the destination; isn't that right?

24 MR. NELSON: Could you point out where that
25 is, Mr. Baker?

1 MR. BAKER: Oh, of course. That's at page
2 32.

3 BY MR. BAKER: (Resuming)

4 Q In the paragraph numbered one, Mr. Schmidt.

5 A I said only carriers serving either or both
6 the origin or destination or termination.

7 Q When you talk about carrier there, you really
8 mean only railroad, don't you?

9 A This paragraph, I think, was in terms of
10 railroads.

11 Q Because motor carriers are essentially
12 ubiquitous. This is the problem with them. They can be
13 anywhere.

14 A Yes, they are everywhere.

15 Q Now, this means, doesn't it, that a merger can
16 be especially attractive from a future profitability
17 standpoint if it increases the number of exclusively
18 served origins and destinations; isn't that right?

19 A Only if they can be served efficiently and at
20 a cost that gets to traffic from the trucker. In this
21 case -- or the barge line, or the steamship company.

22 Q Now, with regard to piggyback traffic, where
23 we talked about that before and we agreed that there
24 were points where even though you serve a point
25 exclusively, there may be competition from another

1 railroad on that piggyback traffic.

2 Now, there it can be quite significant, can't
3 it, that not only do the Santa Fe and the Southern
4 Pacific serve many of the same stations, and they're the
5 only two railroads at those particular stations, but in
6 fact that they are the only two railroads in certain
7 transportation corridors for hundreds of miles around.

8 A That's a pretty broad general statement.

9 Q Would you like me to confine it
10 geographically?

11 A You know, you could look at the BN and the UP,
12 and they're the only transportation corridor for
13 hundreds of miles around, and we all serve exclusively
14 thousands of customers, each of the railroads. I'm not
15 sure about the point you're making.

16 There would be a few more customers,
17 relatively, and I don't mean to minimize the numbers.
18 But there would be more customers as a result of this
19 merger that are on a single line. But that is the
20 prevailing situation pervasively throughout the United
21 States.

22 Q I'm not talking about what might have existed
23 historically. I mean what is going to actually happen
24 in terms of this merger. And my question to you is to
25 ask you to expand a bit upon the notion that it's

1 attractive to put two railroads together to create a
2 situation where you have more exclusively served origins
3 and/or destinations.

4 And I'm saying to you that when you look at
5 the Santa Fe and the SF which carry a lot of merchandise
6 traffic, it's also particularly significant from the
7 same standpoint to see that in the corridor, for
8 example, between California and Arizona or into Texas,
9 they are the only two railroads for hundreds of miles
10 around, so that there's no other railroad that's going
11 to be able to compete for that piggyback traffic, is
12 there?

13 A There is that situation across Arizona and New
14 Mexico, but we have pervasive competition, and you're
15 talking about exempt traffic which was declared to be
16 exempt because of this ever-present competition from
17 either railroads, trucks, or other forms of
18 transportation.

19 Q Now, getting to the strategic options that you
20 advised the board existed, you said there were four of
21 them, didn't you? And the reference here is page 39,
22 Mr. Schmidt.

23 A Yes.

24 Q And there you suggested that one of those
25 options is to seek an affiliation with a major western

1 carrier and that the major western carrier of choice,
2 naturally enough, is the Southern Pacific. Isn't that
3 correct?

4 A Yes.

5 Q And it's your belief, isn't it, that the
6 proposed merger offers a meaningful opportunity to
7 achieve substantial additional profits over and above
8 those that would come from cost savings.

9 A No. The biggest increment of profits is from
10 cost savings. We detail those as well as we can. And
11 the other increment of profits we hope is from
12 attraction of additional business because our rates can
13 either be lowered or kept in line.

14 And it's from that additional business that
15 another increment of profit, I hope, would come.

16 Q Ah, well let me explore that with you. Didn't
17 you furnish to the directors an estimate of the
18 additional earnings which the merged company would
19 achieve if it could simply achieve the same carrythrough
20 percentages as the Union Pacific?

21 A I believe I did.

22 Q It's on page 44. There is reference to it at
23 least. And you advised them, didn't you, that based on
24 1981 revenues, the additional earnings in that year
25 alone, were you able to achieve the same carrythrough as

1 UP, would have been almost \$500 million; correct?

2 A That wasn't my report. That was the report of
3 Mr. Boeth. I believe I indicated either in my statement
4 or the report itself, in a summary, that I thought we
5 could achieve operating income of somewhere between \$240
6 million and I think \$500 million.

7 Q Well, that's halfway. It says, "If we can cut
8 the spread in half it will be 240, and if we can go all
9 the way, it will be 500." Correct?

10 A Right.

11 Q Now, that analysis is not based on any new
12 traffic, is it?

13 A You will have to understand this report you're
14 referring to and cross-examining me about was made
15 before we did any of this work for the ICC case. I had
16 no knowledge of it.

17 Q No knowledge of what?

18 A I had no knowledge of what the conclusions
19 were going to be of our various expert witnesses and
20 employee witnesses. And this was prophesying, just
21 based on potential improvement in carrythrough, what the
22 profits could be.

23 Q What this report made available to your expert
24 witnesses and inside witnesses when they prepared their
25 testimony in this proceeding?

1 A Until you received a copy of it, no one but
2 the preparers and the board of directors and a couple of
3 selected officers have ever seen this report.

4 Q You didn't feel that they ought to have an
5 opportunity to see it, to let them know what the board
6 of directors had been advised?

7 A No.

8 MR. NELSON: That is argumentative, Your
9 Honor.

10 JUDGE HOPKINS: He said no.

11 THE WITNESS: I didn't have any input in it.
12 I wasn't asked, and I didn't intrude on the process of
13 having the experts prepare testimony for this case.

14 BY MR. RAKER: (Resuming)

15 Q Have you gone back to the board and advised
16 them that the projections here might have been
17 overstated?

18 A I haven't gone back and I don't think I would
19 advise them that the projections are overstated within
20 the range that they are here.

21 Q And in addition, isn't it the case that when
22 you compared what Santa Fe/Southern Pacific, the merged
23 company, might be able to achieve, when you compared
24 that based on UP's carrythrough in 1981, you're
25 comparing that to the UP before a merger, aren't you?

1 A Necessarily so.

2 Q So therefore, the cost savings that the UP has
3 achieved and will achieve by virtue of its merger aren't
4 reflected in that 1982 carrythrough, are they?

5 A No. I expect the UP will probably do better
6 than it has in the past.

7 Q And, in fact, you ought to do better than this
8 also, shouldn't you?

9 A I don't know. I'd be satisfied with doing
10 this well, because I want to stay alive and healthy in
11 this industry.

12 Q Now, the Data Resources information that you
13 furnished to the directors -- obviously, since this
14 document was furnished to the directors, the information
15 contained in here regarding the Data Resources project
16 including the exhibit -- I think it's Appendix D -- that
17 was also furnished to the directors; correct?

18 A Yes. This entire exhibit was furnished.

19 Q And based on that forecast of Data Resources,
20 you advised the directors, didn't you, that the
21 territory served by Santa Fe will account for an
22 extremely important share of rail traffic growth between
23 1981 and 1992.

24 A What page was that?

25 Q That's on page 78, sir. Right up at the top

1 of the page in the run-over paragraph.

2 A That's what the author of this report stated,
3 and I furnished this report to the directors and
4 embraced --

5 Q And you in no way indicated to the directors
6 that you disagreed with it.

7 A I said that I embraced that conclusion.

8 Q And the same would be true, would it not, of
9 the territory served by the Southern Pacific. I just
10 raise that because the Southern Pacific essentially
11 serves the same geographic territory as the Santa Fe,
12 doesn't it?

13 A I'd have to hesitate a little bit because they
14 serve areas that we don't serve. They serve the
15 chemical complex around Texas and Louisiana. And we
16 don't serve it.

17 Q That might make it better, though, rather than
18 worse, right?

19 A I would hope so. I mean the merged company, I
20 would hope, would make it stronger.

21 Q Now, with regard to coal traffic, it is
22 projected that the territory served by Santa Fe -- and
23 this is on page 79 -- will account for over half the
24 total absolute increase in ton miles between 1981 and
25 1992. Do you see that?

1 A Well, no. I would like to see that. '79?

2 Q Yes, sir.

3 A What statement are you referring to?

4 Q At the top of the page, run-over.

5 (Pause.)

6 A The statement is there. It says what it
7 purports to say. It doesn't say who is going to carry
8 that coal, because Santa Fe states that are served by
9 the definition of this study, are served by Union
10 Pacific, Burlington Northern, and they're the great coal
11 carriers.

12 We have coal, but nothing compared to those
13 two.

14 Q Yes, but the indication that the reason for
15 the growth in the Santa Fe states is not so much coal
16 originations, is it? It's coal terminations. Isn't
17 that what the study shows?

18 A Basically, coal terminations in the Santa Fe
19 states.

20 Q So in other words, Santa Fe which does
21 originate a substantial amount of coal, but even
22 Southern Pacific which I'll assume originates none,
23 still has the potential to participate in that coal
24 traffic growth, don't they?

25 A Yes. But I'd like to correct your statement

1 that Santa Fe originates a substantial amount of coal.
2 Compared to what? Not compared to UP, BN, or even
3 D&RG.

4 Q Well, this document indicates, doesn't it,
5 that if anything, the originations in the Santa Fe
6 states may be understated because you're hoping to bring
7 new coal production on line very soon, and I think you
8 indicated earlier this morning that that might be
9 imminent; isn't that correct?

10 A That's correct.

11 Q All right.

12 Returning to the projections regarding the
13 growth in merchandise traffic, I think previously it was
14 indicated that it has the greatest annual growth rate
15 projected. But in addition to that, if you will note on
16 page 83, isn't it also the case that its growth in
17 absolute terms, its growth in ton miles, will be second
18 only to the projected growth in coal traffic?

19 A Yes. I think that exhibits states that 30
20 million -- I mean 30 billion ton versus versus 80.8
21 billion for coal.

22 Q Yes, yes. But on the other hand, the
23 desirability of this traffic which you see, as I
24 understand it, as the large growth commodity in your
25 territory, the desirability of this traffic from the

1 standpoint of profitability is dependent on two things,
2 as I understand it. And this is at page 81

3 And one of those is containing costs, isn't
4 that right?

5 A Yes.

6 Q And the other, in the words of this document
7 that was furnished to the directors, the other is to
8 avoid cut-throat pricing tactics; isn't that correct?

9 A Well, that's why I emphasize I'm not the
10 author of this report. I really don't like the term. I
11 didn't use it myself, and I can't edit everything that
12 comes before me because I get hundreds, sometimes
13 thousands of pages in a month.

14 Q Hundreds of thousands of pages a month?

15 A I said hundreds, sometimes thousands. I
16 didn't say hundreds of thousands.

17 Q You see hundreds or thousands of pages a month
18 that are to be presented to your board of directors?

19 A Not presented to the board of directors.

20 Q So this is a more important document than
21 many, isn't it?

22 A Yes.

23 Q Perhaps than most.

24 So I take it that if you had disagreed with
25 this strongly, you certainly would have amended it,

1 wouldn't you?

2 A Sir, when you are working under the pressures
3 I do and was working under here, getting a report of
4 this substance together in a very short period of time,
5 you don't get to be a school teacher about it.

6 I have to rely on people, and did rely on
7 these people. I think you will find that in the
8 highlights and conclusions which I did edit much more
9 carefully because it represented my distilled thinking
10 of this report, I don't talk about cut-throat
11 competition. I don't believe it is in there.

12 MR. BAKER: That's all the questions I have,
13 Your Honor. I would like to offer exhibit KCS-C-1.

14 MR. NELSON: We have no objections. I
15 understand it is part of the confidential docket.

16 JUDGE HOPKINS: It will be put in the
17 confidential docket and it will be received.

18 (The document referred to,
19 previously marked Exhibit
20 KCS-C-1 for identification,
21 was received in evidence.)

22 JUDGE HOPKINS: Who is next?

23 MR. CHARLES MILLER: Your Honor, I guess I
24 will have to make my way to the table.

25 BY MR. CHARLES MILLER:

1 Q Good afternoon, Mr. Schmidt. I'm Charles
2 Miller, representing UP. I just have a few questions.
3 It won't take long.

4 I'd like first to inquire about the voting
5 trust arrangement that was entered into between Southern
6 Pacific and SFSP in advance of your consummation of the
7 holding company merger.

8 At that time that the voting trust arrangement
9 was developed, there was a capital contribution made of
10 \$150 million from Southern Pacific Company to the
11 Southern Pacific Transportation Company. Are you aware
12 of that fact?

13 A I'm aware, but I would like to correct
14 something you said. There was no voting trust
15 arrangement entered into between Santa Fe and Southern
16 Pacific Transportation Company. It was with the
17 trustee. I talked to Mr. Biaggini about the concept.
18 The Commission approved the voting trust, and the trust
19 is between the trustee and Southern Pacific
20 Transportation.

21 Q I understand that, and I appreciate the
22 correction. The trust was entered into between the
23 Southern Pacific Holding Company and the trustee prior
24 to the actual consummation of the merger?

25 A That's right. They put the trust in -- the

1 stock in trust.

2 Q Were you involved at all in the deliberations
3 or consideration of the making of \$150 million capital
4 contribution from Southern Pacific Holding Company to
5 Southern Pacific Transportation Company?

6 A Sir, I was advised by Mr. Biaggini, the
7 then-chairman of Southern Pacific Company, that he felt
8 it prudent to do this based on his projection of giving
9 the Southern Pacific Transportation Company a good cash
10 cushion to work with during the pendency of the trust,
11 and I had no superior knowledge to his of what the
12 cushion might be that was needed or that would keep them
13 viable and competitive.

14 And I relied on his judgment and the judgment
15 of the Southern Pacific Company board in assenting to
16 that.

17 Q All right. But I think you have answered my
18 question as to the purpose of it, and you used the term
19 "to give the transportation company a cushion during the
20 interim voting trust period."

21 A Give them first enough working capital and
22 cash to work with and a cushion so they wouldn't be
23 strapped.

24 Q In the -- there were some legal proceedings
25 initiated by Union Pacific before the courts and the

1 ICC, just prior to your actual consummation of the
2 merger, and I think you know what I'm referring to.

3 A Yes.

4 Q During that time, during those brief but
5 fast-paced proceedings, you on behalf of the SFSP
6 Corporation made a commitment to the continued financial
7 viability of Southern Pacific Transportation Company
8 during the course of the voting trust period; is that
9 correct?

10 A Yes, and that commitment was reduced to
11 writing and accepted by the Commission.

12 Q That's correct. It was, I believe, set forth
13 in a verified statement that you supplied to the
14 Commission.

15 A Either that or it was called an affidavit; I'm
16 not sure.

17 Q It was referred to in the Commission's
18 decision as ground upon which the Commission lifted a
19 stay and permitted the merger to go forward.

20 A That's correct.

21 Q You understand that commitment to be that --
22 an assurance that SPT would be maintained in a
23 financially viable position as long as this proceeding
24 is underway? I'm not trying to hold you to it
25 precisely, but that's the general idea.

1 A There are a couple more elements that should
2 be brought out, I think. One is that if the Commission
3 reasonably finds that capital or cash is needed to keep
4 the SPT in a viable and its present competitive mode,
5 then I agreed to put up the money.

6 But it was keeping it in its viable mode in
7 the competitive posture it was in at the time of the
8 trust.

9 Q And have you had occasion since the merger was
10 consummated to make any further capital contributions to
11 SPT?

12 A No. None have been requested and none have
13 been ordered.

14 Q And is it your belief, to the best of your
15 knowledge, that SPT at the present time remains
16 competitive viable and not in need of a further
17 financial contribution to maintain its competitive
18 effectiveness?

19 A Not at this time.

20 Q I suppose I should ask you one more question
21 along that line, and that is have there been any studies
22 that contemplate an additional financial contribution
23 for that purpose to SPT during the voting trust period?

24 A There are no studies done in contemplation of
25 such a --

1 Q Do you have any reason to think at this time
2 that such a further contribution would be necessary?

3 A Under guidance of the Commission's staff and
4 the trustee, I receive cash reports and financial
5 reports of the Southern Pacific Transportation Company,
6 because I'm required to report them on a consolidated
7 basis. And their cash position is slipping during the
8 year, and it gives some pause to me; they are using up
9 cash at a faster pace than they had planned.

10 So there is sort of a caution light on in my
11 mind.

12 Q I want to ask you one more thing about the
13 undertaking that was made at the time the merger was
14 consummated. If, for any reason, the railroad
15 combination is not consummated, either because it's not
16 approved or because you decide not to accept the
17 conditions if they're imposed, or for any other reason
18 you decide not to do it, do you understand that the SFSP
19 undertaking was to leave SPT at that point in a
20 financially viable condition?

21 In other words, I understand that you haven't
22 agreed, I don't think you've agreed to underwrite that
23 company for the indefinite future.

24 A No. As I understood the commitment, it was to
25 keep them in their competitive posture during the period

1 of the trust.

2 Q That's right. Let's say to the end of this
3 case or to the end of the trust. If at that point, if
4 for any reason the transaction, the railroad merger was
5 not consummated, then it would be correct that the
6 obligation is to ensure that at that time SPT, if it's
7 going to be set free or divested, is in reasonably
8 financially viable condition?

9 A It is in our best interest as the owner of the
10 equity in the company, if not the legal title, to have
11 it in viable condition; yes.

12 Q I agree to that. It's in the best interests,
13 and I just wanted to emphasize or stress or make it
14 express that that is the undertaking that was made by
15 SFSP.

16 A I don't know if you equate keeping them in a
17 competitive -- their current competitive environment,
18 that is, the competitive posture they were in at the
19 time of the trust, with keeping them financially
20 viable. Something could happen, I don't know, that they
21 really, despite our efforts, do not become financially
22 viable.

23 Our effort, or commitment was to respond to
24 the Commission if it reasonably found that they needed
25 an infusion of capital to be kept in their competitive

1 posture. You could be competing very viciously and
2 still not end up in very good financial condition.

3 So I don't know if I equate the two. I'm not
4 trying to play word games with you, but to put it in the
5 vernacular, they could go down the tube while we are
6 still giving them money, and the promise is not to keep
7 them financially viable, but to give them money to try
8 to keep them competitive.

9 Whether they succeed or not is another
10 question.

11 Q All right.

12 Maybe I should not stress so much the
13 financial viability as the competitive effectiveness, if
14 that's the commitment. So that if for any reason, the
15 railroad combination doesn't go forward at that point in
16 time, they will be competitive effective. Whether they
17 stay there thereafter depends.

18 A Right.

19 Q A different point. I wanted to ask you just in
20 conclusory terms whether you agree that the southwestern
21 area of the country, by which I mean the area between
22 Texas and California, is an area of substantial growth
23 and anticipated further growth in the future.

24 That's a rather broad question. I really have
25 a copy of a statement that I think you made to Chicago

1 analysts some time ago, in which I think you said you
2 projected that a very large percentage of your increased
3 piggyback traffic would come from originations or
4 terminations in the southwestern area.

5 Do you recall something along that line?

6 A You asked a very complex compound question,
7 but I think we have demonstrated that the area you
8 generally refer to will be -- will have growth,
9 experience growth above the national average.

10 As you probably know, a couple of the major
11 states in that area, California and Texas, have gone
12 through some shock waves they have never experienced,
13 called local recessions; housing starts down, business
14 starts down, a lot of problems.

15 But our projections show it would be a
16 better-than-average territory.

17 Q Over the long term, which is what we're trying
18 to focus on today at least, you see those as being areas
19 of substantial growth, do you not?

20 A Yes, providing the country stays as a country
21 with substantial growth.

22 Q Just one final area of questions that I have
23 for you. I want to ask you one question about a
24 statement you make on your verified statement at page
25 8. Near the top of the page on page 8, the last

1 sentence of the carryover paragraph, you state there
2 that: "If the Commission either denies approval of the
3 merger or imposes materially adverse conditions upon it,
4 SFSP would be required to dispose of either SPT or
5 ATSF."

6 My focus there is really on the word
7 "required." And I'm asking the question with reference
8 to your voting trust arrangement where I believe you
9 find this restriction. Your voting trust agreement uses
10 the terms "materially adverse conditions," and states
11 that if the Commission imposes materially adverse
12 conditions, there will be a disposition of one of the
13 other railroads.

14 A I don't believe the voting trust contains
15 those terms, sir. I'm not sure. I haven't looked at it
16 for so long a period of time.

17 Q I didn't mark this as an exhibit, but I had in
18 mind section -- I think it's section 7-C, Voting Trust
19 Agreement. I'll paraphrase it and I'll show it to Mr.
20 Nelson.

21 It says in the event the ICC should deny the
22 application or various other things, or impose
23 conditions which would have a material adverse effect on
24 the business or properties of SFSP or others, then the
25 trustee will sell the stock. And I am paraphrasing

1 that.

2 A Southern Pacific Company before the merger
3 entered into that agreement. And I take it that is the
4 language used. I saw it after it was agreed to, but I
5 did not recall that.

6 Q I wasn't trying to hang you upon on detail.
7 All I wanted to ask you was a process question. And
8 that is, who decides if conditions imposed by the ICC
9 were materially adverse such that you would not go
10 forward with the transaction?

11 A I would get advice from various sources within
12 the company, both legal and railroad and financial, make
13 a decision myself as to whether I believe the conditions
14 to be adverse enough to warrant making a recommendation
15 to the board of directors for the disposition of one or
16 the other or both of those major properties.

17 And that's the way the process would go.

18 Q Just to be specific, when you say board of
19 directors, you mean of SFSP?

20 A SFSP, yes. The holding company.

21 Q This would be a judgment made based upon all
22 the relevant factors at the time, including options
23 available to you and so forth?

24 A Yes.

25 Q There is nothing automatic that's been decided

1 in advance as to what is or is not a materially adverse
2 condition?

3 A No. Except for the one statement I made to
4 the press that if they were all granted, I know what my
5 recommendation would be.

6 Q That is, everything that's been sought by all
7 the parties?

8 A That's right.

9 Q Among the things that you have to take into
10 account at that time, if you confronted with this
11 unfortunate eventuality from your point of view, would
12 be whether you were then obliged to make any further
13 contribution to SPT along the line I discussed earlier.

14 You would take that factor into account as
15 well?

16 A That would be one of many factors that would
17 be taken into account at that point. We would be faced
18 with a very important set of decisions and
19 alternatives.

20 Q The only thing I want to ask you is this.
21 Have you yet made any decision as to whether or not you
22 would go forward with the railroad consolidation if the
23 Commission were to adopt, as a condition to that, that
24 the Union Pacific requested conditions be granted?

25 A That set of conditions, aside from the KCS's,

1 is a very formidable set of conditions. And I would
2 have to say at this time, it is probable that I would
3 recommend not going ahead if those were granted.

4 Q You mentioned both. Did you mean just the
5 UP's?

6 A Yes.

7 Q Did you mean in your answer to that, that if
8 any of UP's conditions were granted or if all of them?

9 A I understood your question to be if all of
10 them were granted.

11 Q And I would ask you the same question. If the
12 Commission were to grant that condition which seeks
13 trackage rights from Texas to California, from El Paso
14 to Colton, if that alone would cause you to have the
15 same conclusion.

16 A That's the most serious of the requests in its
17 potential impact on the combined system. But I have not
18 gotten around to breaking down any single company's
19 request.

20 As counsel pointed out, we're in the process
21 of answering -- I don't know technically what it is --
22 requests for conditions, and we haven't gotten around to
23 just looking at that in detail.

24 MR. CHARLES MILLER: That's all I wanted to
25 ask. Thank you.

1 MR. SIPPEI: Your Honor, William Sippel for
2 the Milwaukee Trustee. In light of the questions which
3 have already been asked of the witness and the witness's
4 answers to those questions, I think we're prepared to
5 waive cross-examination of this witness at this time.

6 JUDGE HOPKINS: Thank you.

7 MR. KHARASCH: Your Honor, if you permit,
8 though we do not wish to cross-examine Mr. Schmidt,
9 though we would have enjoyed it, I'd like to ask some
10 technical questions about KCS-C-1 for about five
11 minutes.

12 MR. NELSON: I'd like to object, Your Honor.

13 MR. KHARASCH: They were occasioned by the
14 introduction of the exhibit, and they are as to the
15 exhibit.

16 JUDGE HOPKINS: Mr. Kharasch, how long would
17 this -- I don't want to open up the door so that we get
18 a lot of questions from everybody on every instance now
19 when a situation might occur. But I can see the
20 problem.

21 MR. NELSON: I stand on my objection, even if
22 it's only five minutes because this sort of thing can
23 proliferate.

24 MR. KHARASCH: It's not a question of time.
25 It's a question that the question -- we put an exhibit

1 in the record, and I want to know who wrote which
2 parts. That was not clear. And who were the people who
3 were available and have seen it before?

4 JUDGE HOPKINS: I will allow a few questions
5 in that regard. Go ahead.

6 BY MR. KHARASCH:

7 Q Would you state, just precisely for the
8 record, Mr. Schmidt, who wrote which parts of KCS-C-1?

9 A I wrote the cover page, which is a one-page
10 letter to the directors. Page one again referring to
11 counsel's numbering of pages. I was presented with a
12 draft of the outline, the forward, and the highlights
13 and conclusions, and I believe the draft was prepared by
14 Mr. Terry Booth. I worked with him on restructuring the
15 four-page portion, pages 5 through 8, and the rest of
16 the report which I believe was prepared by Terry Booth.
17 It all came together for writing under his jurisdiction,
18 I think actually by him.

19 I just worked with him on organization of the
20 data. And what I do not know, sir, is whether Mr.
21 Robert Keyes had inputs into the actual writing of the
22 remainder of this document or not.

23 Mr. Booth, no doubt -- he had two or three
24 other analysts under him who were manipulating and
25 handling the data. They no doubt prepared some of the

1 tabular pages which present the data in number form, and
2 I can't say certainly which of them actually prepared
3 which page.

4 Q What are the names of the people on the small
5 team of Santa Fe people who contributed to the study?

6 A I have to admit I don't know. They were
7 people either in our market research or cost analysis
8 department who were experts in handling computer
9 programs and so forth.

10 And I know one. I catch a train with him
11 every morning; that is, the same train. And I can't
12 remember his name.

13 Q Mr. Fitzgerald, did he know of this?

14 A Mr. Fitzgerald is not involved in this.

15 Q Did he see it?

16 A Not to my knowledge.

17 MR. KHARASCH: Thank you.

18 JUDGE HOPKINS: Are there any other
19 questions? Is that all who asked for
20 cross-examination?

21 MS. MADIGAN: RLEA has questions for Mr.
22 Schmidt.

23 BY MS. MADIGAN:

24 Q Mr. Schmidt, good afternoon. My name is
25 Kimberly Madigan. I represent the Railway Labor

1 Executive Association. I believe that this morning, in
2 response to a question by Mr. Prettyman, you testified
3 that you -- and by using the term "you," I mean the
4 Santa Fe/Southern Pacific Corporation was unsure at this
5 point whether, following the merger, the Cotton Belt,
6 the Santa Fe, and the Southern Pacific would be operated
7 as a single carrier or as independent, whether the Santa
8 Fe and the Southern Pacific would be operated
9 independently.

10 Is that accurate?

11 A No, I did not say that. If I did, I didn't
12 intend. It's my knowledge that the plan is to merge the
13 Cotton Belt into the Southern Pacific Transportation
14 Company and then merge the Atchison and the merged
15 Southern Pacific Transportation Company into a new
16 railroad, the Southern Pacific and Santa Fe.

17 Q And that would be operated as a single
18 carrier?

19 A As a single carrier.

20 Q Following that merger, what entity will set
21 the labor policy for the carrier?

22 A The Southern Pacific and Santa Fe.

23 Q The railway, not the holding company?

24 A Well, there is an ill-defined border of
25 magnitude of consequence of policymaking that I can't

1 really define as to when the holding company steps in
2 and makes policy.

3 Ordinarily, in our mode of doing business at
4 Santa Fe, which is the only thing I can testify to now,
5 the policy with respect to labor is made by the people
6 running the railroad. The management is by exception.
7 If we don't like what's going on, the holding company
8 people feel we have an obligation to step in and discuss
9 it and maybe change it.

10 Q Following the merger, do you have an opinion
11 as to what the combination or what effect the
12 combination will have on the carrier's present
13 collective bargaining agreements?

14 A That is an area I have never gotten into, and
15 so it's complex, from what I understand of it, that I
16 can't safely say that I have an opinion.

17 Q Will anyone else be produced at the hearing
18 who will have an opinion on that subject?

19 A I am sure there will be. The Chief Executive
20 Officer of Santa Fe Railway and the proposed head of
21 Santa Fe/Southern Pacific -- Southern Pacific & Santa Fe
22 Railway -- will be testifying, and I believe we will
23 have a labor officer here, too.

24 Q Thank you. So then you would not know what
25 labor organizations were going to be recognized on the

1 combined carrier? That would be a question I should
2 reserve for one of these individuals?

3 A Yes. I would be very happy if you would.

4 Q Now, it's my understanding from the
5 application that the merged carrier is going to use one
6 set of reporting marks; is that correct?

7 A That's right.

8 Q Now, for purposes of ease, I will use the
9 Houston Belt as an example. Can you tell me what will
10 happen to the rail and motor carrier subsidiaries of the
11 Applicant carriers in terms of using reporting marks?

12 Will the Houston Belt use the merged
13 carriers' reporting marks?

14 A I can't answer that question. I don't know if
15 we own the Houston Belt and terminal. I think we are
16 part owners, aren't we? I'm not into that detail of the
17 Southern Pacific at this time.

18 Q Well, do you know whether these rail and motor
19 carrier subsidiaries are going to be operated
20 independently from the merged carrier?

21 A Would you tell me which rail subsidiaries you
22 are referring to?

23 Q What's the difference? Can you tell me --

24 A We both own companies that are railroads in
25 name, and in name only. They are lesser companies, as

1 as call them, where we leased the track. And for
2 historic and tax and other reasons, they are maintained
3 as separate corporate entities.

4 But you don't even know they exist because
5 they don't do anything. I mean they are just book
6 corporations.

7 Now, if you're referring to those, you know,
8 the just don't exist in my mind, the Cimarron Valley and
9 Santa Fe, and a few names like that. They're not
10 operating entities.

11 Q Well, in terms of the operating entities, can
12 you tell me which ones are the operating entities?

13 A Well, there's going to be one major operating
14 entity, and it's going to be the Southern Pacific &
15 Santa Fe Railway Company.

16 Q Well, will the operating subsidiaries, the
17 operating rail and motor carrier subsidiaries be
18 eventually subsumed or integrated into this merged
19 carrier?

20 A I don't think there will be an operating
21 wholly-owned subsidiaries of that company, the Southern
22 Pacific & Santa Fe Railway Company on the rail side.

23 The trucking side, we will have FMT and I
24 believe they have a couple of other corporations. I'm
25 not sure what will happen to those. I'm presuming they

1 will stay under the corporate ownership of the railroad,
2 but I'm not certain. I haven't looked into that yet.

3 Q I don't mean to be repetitive, but I want to
4 make sure I understand this. Let's take the Houston
5 Belt as an example. Will the Houston Belt remain a
6 separate entity from the merged carrier?

7 A I don't know if Southern Pacific owns the
8 Houston Belt.

9 Q So I should reserve that question for Mr.
10 McNeer?

11 A That's right. They may have some ownership in
12 it, but I don't know if they are sole owner.

13 Q Mr. Schmidt, I was informed late Friday
14 afternoon that the Southern Pacific has announced
15 approximately 1,000 furloughs to be effective today.

16 From my information, I've learned that there
17 will be about 910 maintenance of way employees
18 furloughed, 48 carmen furloughed, and 11 machinists
19 furloughed.

20 Can you confirm those furloughs for me
21 today?

22 A No, I can't. I have nothing to do with
23 running the Southern Pacific Transportation Company and
24 I cannot do a thing about it or confirm anything to
25 you.

1 Q No one has informed you of these furlough
2 then?

3 A I was told in response to a question about the
4 cash, that they were planning some cuts. And that's all
5 I was told by Mr. McNeer. I don't get into the details
6 of the way he runs the business.

7 Q Do you know who made the decision to furlough
8 these employees?

9 A No. I just have to presume it's the top man.
10 But Mr. McNeer will be here.

11 Q Do you know whether or not the holding company
12 or the Southern Pacific is offering these employees any
13 protective conditions?

14 A Not the ones you're referring to, because I
15 don't know any of the details about them.

16 Q Mr. Schmidt, it's my understanding that the
17 purpose of this merger is to combine these two carriers
18 to create efficient, cost-effective rail entity. Is
19 that correct?

20 A That's a proper way of stating, I guess, from
21 one view. Yes.

22 Q Am I also correct in stating that there is a
23 substantial number of parallel lines in the
24 Santa Fe/Southern Pacific System?

25 A Well, substantial. There are a number of

1 parallel lines. I don't know what you mean by
2 substantial. The vast majority of the mileage is not
3 parallel. There are parallel lines, though.

4 Q Do you have any idea how much in terms of
5 mileage is parallel?

6 A Not as I sit here. And it depends on what you
7 call parallel. They could be 200 miles apart and
8 parallel. Does that fit your definition? I'm just not
9 sure.

10 Q It would not be, though, cost-efficient to
11 continue to maintain, repair and operate duplicative
12 track, would it?

13 A As a general proposition. But the question of
14 whether you maintain the track as you describe is really
15 one for detailed study by people who operate the
16 railroad, and it depends on capacity of the track, the
17 purpose for which the trains run on that track, and the
18 kind of traffic -- things beyond my scope to sit here
19 and give you concrete answers to today.

20 Q But it's my understanding that in your
21 application you have not proposed any major line
22 abandonments; is that correct?

23 A No major line abandonments. I believe we have
24 proposed a few relatively minor line abandonments.

25 Q Do you know when you are going to make a

1 decision as to whether you are going to abandon any
2 major line trackage?

3 A I think, as I recall Mr. Cena's statement, he
4 said something to the effect that he would prefer to see
5 how the merged system operates before proposing any
6 substantial line abandonments, if they are to be
7 proposed.

8 And I think that's a good philosophy. You
9 could theorize about how to run a combined railroad, and
10 it may not work out in practice. But that's the state
11 of my knowledge right now.

12 Q So we can't expect that decision until after
13 the merger?

14 A Until after the merger and after some
15 experiences under our belt.

16 Q Who makes the decision to abandon the
17 trackage?

18 A Again, those decisions are generally what I
19 call bottoms-up decisions in our style of management.
20 We don't try to make them from the holding company. We
21 try to ask the railroad to have a set of policies to
22 keep itself efficient and to be self-policing on the
23 utilization of assets and the return on its assets.

24 And when they have assets that just aren't
25 viable, aren't paid for by the public, the officers in

1 direct charge of those assets will make
2 recommendations.

3 I believe they have an ongoing program in the
4 railroad to look at the viability of branch lines and
5 the like, and those recommendations come up through
6 railroad and ultimately they will get to me, unless they
7 are very pedestrian kinds of abandonments.

8 Q You referred to Mr. Cena's statement, and he
9 does indicate in his statement that there will be no
10 major line abandonments, at least for a while.

11 Can you tell me what a major line abandonment
12 -- what is the definition of a major line abandonment?

13 A I could dream up one here, but I can't tell
14 you. I guess it's in relationship to all the other
15 lines you have and how shippers are served. That's what
16 they're for, is to serve shippers. We certainly aren't
17 going to abandon lines to viable shippers if we can make
18 money off them.

19 I think major is like significant and terms
20 like that. It means different things to different
21 people.

22 Q So it's not measured in terms of trackage or
23 miles? Is it determined by the industries served on a
24 particular line?

25 A I think most people use it in terms of

1 mileage, how much in the way of mileage are you
2 abandoning? But you could have a significant one-mile
3 abandonment that is, you know, devastating.

4 Q So your definition may differ from Mr.
5 Cena's?

6 A Yes, it may.

7 Q Do you know whether Mr. Cena was referring
8 just to abandonments, major line abandonments on the
9 Santa Fe lines?

10 A Oh, no. In his statement I believe he was
11 referring to the proposed merged railroad.

12 Q Do you know whether there will be major line
13 abandonments on either the Santa Fe or the Southern
14 Pacific?

15 A Not beyond those that are recounted in the
16 application or those that are pending now independently
17 by each of the railroads.

18 I think we both have some abandonment
19 applications pending, but nothing beyond that. It's
20 just good for your business, though, to keep looking at
21 the utilization of your assets. If they're not utilized
22 and are causing a drain on the entire system, you have
23 to abandon them.

24 Q In the labor impact study which accompanied
25 the application, it indicated that no operating jobs

1 would be abolished in the first three years.

2 Will you commit today that that will be, in
3 fact the case, that no operating job will be abolished?

4 A No. No, I will not.

5 Q I have calculated that there will be
6 approximately 1,429 positions abolished. Has anyone
7 told you how many employees are going to be furloughed
8 due to those job abolishments?

9 A No. That's one of the most complex areas,
10 especially when you get into the union agreements. And
11 it's beyond the scope of my knowledge at this time.

12 Q All right. Then the application also says
13 that there is going to be a great deal of transferring
14 of employees and some temporary furloughs.

15 Do you know what the application was referring
16 to in terms of great deal of transferring and temporary
17 furloughs?

18 A I don't recall the term "a great deal" but if
19 it said that, I would imagine it would result from
20 consolidation of facilities, and I don't know if they
21 have plans to change the districts and so forth.

22 As I recall, there were going to be fewer
23 divisions over which the combined railroad would run.
24 And so I think generally it refers to the fewer
25 divisions and the displacements that would cause and the

1 combination of facilities, maybe the reduction of
2 facilities.

3 Q I'm interested in knowing, of course, precise
4 numbers. But you don't know those?

5 A You have the wrong fellow for precise
6 numbers.

7 Q Thank you.

8 Do you know if any employees are going to be
9 furloughed following the three-year period which was
10 used in the labor impact study?

11 A I just don't know.

12 Q Have you told anyone to do a study on that
13 subject?

14 A I haven't directed the individual studies
15 which were done to prepare for this case. So I haven't
16 asked anyone specific.

17 Q Do you know if such a study has been done?

18 A No, I don't.

19 Q Now, in your primary and related applications,
20 are the carriers asking the Commission to grant them any
21 exemption from their current Railway Labor Act
22 obligations?

23 A Not that I know of.

24 MR. NELSON: I object to that line of
25 questioning.

1 JUDGE HOPKINS: He answered, I believe.

2 MR. NELSON: Further questions along those
3 lines.

4 JUDGE HOPKINS: We don't have any questions
5 yet.

6 BY MS. MADIGAN: (Resuming)

7 Q With respect to the primary and related
8 applications, are the carriers asking for any exemptions
9 from the provisions of their current collective
10 bargaining agreements?

11 A I don't know. I haven't retained the detail
12 in this area.

13 Q Again, is it because you haven't asked anyone
14 to do such a study, or will there be someone produced
15 during the course of the hearing that can answer
16 questions along these lines?

17 A I believe there will be someone produced.
18 Counsel, tell me if I'm wrong.

19 MR. NELSON: Let me address that. We will
20 have operating officers from the company, naturally. We
21 will also have our personal officers who deal directly
22 with labor matters and presumably will be able to answer
23 that question.

24 I think it's pretty clear that Mr. Schmidt is
25 not an expert in this field.

1 MS. MADIGAN: These are policy questions, Your
2 Honor, and I want to make sure that a labor relations
3 person can answer policy questions.

4 MR. NELSON: John Frestel and Ken Peifer will
5 be produced as witnesses who, I think, will be the
6 principal labor negotiators and labor officers for SPT.

7 MS. MADIGAN: They're going to address all
8 labor policy questions?

9 JUDGE HOPKINS: What are we talking about,
10 labor policy? It appears that Mr. Schmidt cannot
11 answer these particular questions. That's clear. So I
12 think you will have to wait until these other witnesses
13 come to see whether they can answer the specific
14 policy.

15 If not, then I think you have a right to try
16 to get a witness that can. I think the parties probably
17 will have somebody available.

18 MR. NELSON: We don't intend to try to play a
19 shell game here. I am just blanching because I am not
20 sure what "policy" means.

21 JUDGE HOPKINS: That's the point. I think
22 we'll have to wait until you question these witnesses
23 and see what they can answer, or whether you consider
24 that they have answered the questions you're seeking the
25 answers to.

1 MS. MADIGAN: Thank you.

2 BY MS. MADIGAN: (Resuming)

3 Q Mr. Schmidt, in the application there is a
4 proposal to change crew districts. Do you have an
5 opinion as to whether these changes would be a change in
6 the employees' working conditions?

7 A No, I don't have an opinion on that.

8 Q Do you know whether, since the filing of the
9 application, there have been any negotiations concerning
10 implementing agreements?

11 A No, I don't.

12 Q In response to our interrogatories, you have
13 submitted an answer along the lines of whether the
14 holding company and the carriers will accept the New
15 York Dock conditions. But I'd like to ask for some
16 clarification on that area.

17 Will you accept, or will the carriers accept
18 the imposition of the New York Dock conditions for all
19 affected Santa Fe/Southern Pacific employees, including
20 employees of subsidiaries of the primary applicants?

21 A I have made -- that is, the company has made
22 the statement to the Commission that if no other
23 conditions but New York Dock are imposed on the merger,
24 that we would accept that and go forward.

25 Now, when it comes to N subsidiary companies,

1 I am very unclear about where I am in that area because
2 I'm not aware of operating subsidiary companies of the
3 proposed merged railroad that would be in existence, so
4 I have a difficult time answering that question.

5 Q Is that an I don't know, or is that an I
6 should ask the labor people?

7 A I think you should ask the labor people.

8 Q All right.

9 Now, my question is not restricted solely to
10 the conditions, but the question is also to which
11 employee groups these conditions should be extended to.

12 So I'm talking now in terms of all affected
13 Santa Fe employees who are affected by the primary
14 application, by the related applications.

15 A I think the extent of coverage of New York
16 Dock conditions is a legal question primarily. And I
17 don't know about its total and full application.

18 So you won't get much of a set of answers out
19 of me, asking me if it applies to this group and group
20 and so forth.

21 Q So again I should reserve these questions for
22 the labor people?

23 A The labor people, or the lawyers if they are
24 legal. I'm just not sure. But the labor people, I
25 would say yes.

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1 Q Then I should also reserve them -- RLEA has
2 asked for conditions --

3 A Who has asked?

4 Q RLEA has asked not only for the New York Dock
5 conditions, but for supplemental conditions. In terms
6 of whether the carriers would accept those supplementatl
7 conditions, can you give me an answer today as to
8 whether the carriers will accept those?

9 A My answer is that we cannot accept any more
10 conditions than have been imposed on competitors and be
11 competitively viable.

12 Q So I'm not sure we can be competitively viable
13 with New York Dock conditions either. So I can't agree
14 to go beyond, but the Commission is the one to determine
15 this in the first instance.

16 Q Has the holding company or the carriers
17 analyzed the impact of the supplemental conditions on
18 the carriers' operations?

19 A I'm not sure what you mean by supplemental
20 conditions.

21 Q The conditions that RLEA has asked for in
22 addition to the New York Dock conditions.

23 A I can say I am reasonably certain they have
24 analyzed them, but I am not acquainted with what place
25 they are in their analysis and that is my answer.

1 Q All right.

2 I'm going to bring you back to page 8 of your
3 verified statement where you discuss material adverse
4 conditions. Are you referring to any specific type or
5 level of employee protective conditions in this
6 statement?

7 A I wasn't referring to any particular set of
8 conditions at that time.

9 Q Are there any employee protective conditions
10 which you consider to be so materially adverse that you
11 would not consummate or go ahead with this transaction?

12 A We're now trying to visualize every possible
13 set of conditions. I could see conditions that would be
14 so adverse that, yes, I would not go ahead.

15 Q Well, are RLEA supplemental conditions in that
16 category?

17 A I'm not sure what your supplemental conditions
18 request entailed.

19 Q I will reserve that. Thank you very much.

20 JUDGE HOPKINS: Before we take a break, who
21 else is questioning this witness?

22 Mr. Roberts, are you the last one? How much
23 time are each of you going to take, do you expect?

24 MR. MC KENZIE: Ten minutes.

25 MR. ROBERTS: About the same.

1 JUDGE HOPKINS: We'll take a 15-minute recess
2 at this time.

3 (Recess.)

4 JUDGE HOPKINS: Let's get back on the record.
5 Is Mr. Roberts going to --

6 MR. ROBERTS: Thank you, Your Honor.

7 BY MR. ROBERTS:

8 Q Mr. Schmidt, my name is Barry Roberts and I
9 represent Sunkist Growers. I just have a couple of
10 questions.

11 Turning to page 11 of your verified statement,
12 you refer to competition with the UP and the BN. Do
13 either of those carriers provide competition to the
14 Santa Fe or the Southern Pacific today in the middle and
15 lower San Joaquin Valley in the agricultural areas?

16 A I'm not totally knowledgeable on that subject,
17 but I think they do in the middle, possibly the lower
18 through the piggybacking concept that I was
19 cross-examined about earlier.

20 And I forget just how far down in northern
21 California the UP line is -- the WP line. The geography
22 isn't clear in my mind.

23 Q Would you be familiar with where the UP, WP,
24 BN have their TOFC ramps, or would that be another
25 witness?

1 A No, sir; I would not be familiar.

2 Q On page 12 of your statement, you talk about
3 certain capital expenditures. On the one hand you talk
4 about savings, and on the other hand you talk about "a
5 sum that would have to be spent to put the companies
6 together" is the phrase you use.

7 Can you tell me what capital expenditures
8 would either be saved, or which capital expenditures you
9 would make that would impact shippers of perishable
10 commodities?

11 A I cannot detail it down to shippers of
12 perishable commodities. I'm not that familiar. I know
13 the money we spent is basically building connections
14 pursuant to the operating plan, and the savings go
15 anywhere from equipment to rail to other facilities.

16 I think we will have, I know we will have
17 other witnesses who can answer those questions in
18 detail.

19 Q So, for example, if I were to ask you about
20 proposed capital expenditures for refrigerated
21 equipment, either boxcars or TCEC, would you be able to
22 answer those questions?

23 A No, not in the context of the dollar amounts
24 we have put into the testimony.

25 Q In response to a question by the attorney for

1 the Kansas City Southern, I believe you said that you
2 believe that the Santa Fe had more competition in its
3 territory than the UP does in its. Is that right?

4 A As a general statement, I did say that; yes.

5 Q And that you felt that the additional
6 competition in the Santa Fe territory has kept a lid on
7 the prices that you could charge.

8 A Yes. Again, the study seemed to indicate
9 that, and I am embraced the conclusions of the study I
10 was questioned about.

11 Q Now, does that additional competition in your
12 territory include the competition from the Southern
13 Pacific?

14 A Yes. It includes the competition of the
15 Southern Pacific, mainly of trucks and also of other
16 railroads.

17 Q Now, turning to California origin territory,
18 particularly central and southern territory, what other
19 railroads are there besides Southern Pacific?

20 A The competition there, again the geography of
21 were the UP/WP stops, is not clear in my mind. But the
22 basic competition is truck and also water
23 transportation, depending on the commodity you're
24 talking about.

25 Q But surely, the UP in its territory would have

1 truck competition.

2 A Some truck competition, yes. I am not saying
3 they have no truck competition. It's all over.

4 Q Now, in what way do you expect the merger will
5 affect this lid you believe is on your ability to --
6 this cap on your pricing ability?

7 A Very minimally, sir. The basic goodness, if
8 you will, of the merger is in cost-savings through
9 efficiency. There are very few, if any, places that we
10 would gain a ratemaking freedom because we have the
11 trucks there and other forms of transportation,
12 including rails.

13 Q So that when, in response to the question by
14 the attorney for the KCS, you said you needed the merger
15 so that you had the same sort of freedom to price in
16 your territory as the UP now does in its, I don't quite
17 understand then what you mean when you now tell me that
18 the continued truck competition will --

19 A I didn't say --

20 MR. NELSON: I object. I think that
21 mischaracterized Mr. Schmidt's prior testimony, although
22 I think he might have been about to point that out.

23 JUDGE HOPKINS: Why don't we let him point it
24 out himself and we'll get it clear.

25 Mr. Schmidt.

1 THE WITNESS: I didn't testify that we would
2 get upward pricing flexibility through this merger,
3 although I pointed out that it appears the Union Pacific
4 has more than we do.

5 My testimony on the record are replete with
6 statements that what we will gain from this merger is
7 cost efficiencies and be able to improve our margins
8 basically through cost efficiencies and not through
9 raising rates, although rates will raise as costs raise
10 on a general basis.

11 Q Are you suggesting that in those areas where
12 your principal rail competitor is the SP, the existence
13 of the SP, of that competition, does not now place some
14 restraint on your pricing ability even on exempt
15 traffic?

16 A I can't say it places no restraint. The
17 degree to which it places a restraint I really cannot
18 quantify. But the basic restraint is trucking
19 competition, other rail competition since the formation
20 of the very large BN and UP systems and the ever-present
21 water competition in certain areas.

22 Q And so conversely, if the merger were to be
23 consummated of the two rail operating companies,
24 assuming we were in an area in, say, southern California
25 or Arizona that was not effectively served by some other

1 railroad, to the extent that the existence of the SF
2 placed a restraint on your pricing ability, that
3 restraint would be gone.

4 A Yes. That restraint would be gone.

5 Q Now, on page 12 of your statement, you state
6 that -- and I'll quote: "Reduced costs will give us
7 increased ratemaking flexibility to assist shippers in
8 making or improving their own competitive positions."

9 Can you explain that a little further?

10 A Well, the transportation game, if you will,
11 especially in railroading with deregulation, has changed
12 from that of a regulated rate where carriers compete
13 with service or compete with furnishing equipment,
14 whether it is excessively furnished or not, to a game
15 where it's a low cost ballgame.

16 The carriers must be low cost. And we would
17 assist the shippers by lowering our costs and passing on
18 those lower costs to the shippers. We are in a
19 commodity business where transportation is a commodity
20 and low cost production is the rule now, rather than the
21 exception.

22 Q Can you point to any situations where the
23 Santa Fe has done for that deregulated traffic since
24 deregulation?

25 A I don't handle these shippers directly, and

1 I'm sure there are many, but we have a witness, Tom
2 Fitzgerald, the Vice President of Traffic, who is coming
3 on and I am sure he can answer that question.

4 Q Now, on page 14 of your statement, you state
5 that your "ability to provide capital resources
6 necessary for effective competition with motor carriers
7 and other modes will be greatly improved."

8 Again, what are you referring to there?

9 A Can you direct me to that?

10 Q It is almost in the middle of the only
11 complete paragraph on page 14.

12 A I see it now.

13 Well, we have huge capital requirements, and
14 my earlier testimony in that statement shows how over
15 the last decade our capital expenditures have exceeded
16 our operating income. We need to get more capital, and
17 the best way to get it, before we get very unhealthy, is
18 through earnings.

19 So by carrying down more to the operating
20 income line, we would have more capital resources
21 without resorting to borrowing on a constant basis.

22 Q Now, Mr. Schmidt, you testified earlier about
23 what you might consider to be major line abandonments.
24 Are you familiar with the proposed Santa Fe
25 abandonment? Actually, there are two abandonments, both

1 north and south of Visalia, California.

2 A No, I am not, sir. I am generally aware that
3 we are abandoning track in that area, but I'm not aware
4 of the details.

5 Q Now, if a witness from Sunkist were to testify
6 that we have a packing house located along the line of
7 the Santa Fe and the proposed abandonment of the Santa
8 Fe would leave that packing house without rail service,
9 would you consider that a major abandonment?

10 A I know your client would, but I don't know how
11 I would classify that without knowing more detail about
12 it. It might be a track that is costing us an awful lot
13 of money. I don't know.

14 MR. ROBERTS: I have no further questions.
15 Thank you.

16 JUDGE HOPKINS: Thank you.

17 Next.

18 BY MR. MC KENZIE:

19 Q Good afternoon, Mr. Schmidt. I am Vince
20 McKenzie, representing the State of California.

21 Have you determined as a matter of policy what
22 portion of the savings and costs that will result from
23 the transaction being approved will be passed on to
24 consumers, as you state on page 12 of your testimony?

25 A No. I think that comes about on a

1 case-by-case basis. We're responding basically to
2 competition. And by reducing our costs, we hope to have
3 more profit and also hope to either lower rates to gain
4 more traffic or keep the rate of increase of rates
5 down.

6 Q Do you feel, as a matter of policy, you are
7 committed to that ideal or that objective to lower costs
8 to shippers and to flow some of the benefits, as it
9 will, to consumers and shippers?

10 A We don't flow them directly to consumers, but
11 through the shipping costs, yes, I think we do. I think
12 this whole country has to be committed to that
13 concept.

14 Q There's no other method that you will help
15 pass on the benefits from the merger to consumers other
16 than in the form of either lower rates or not seeking to
17 increase rates that you otherwise would raise?

18 A That's a difficult question to answer in the
19 context of a large railroad. I suppose you would be
20 helping consumers by just better service. And you'd be
21 helping consumers, long range, by having a viable
22 railroad system, a viable competitor to other modes, to
23 keep costs down on other modes or keep rates down on
24 other modes.

25 So there are different ways of assisting the

1 consumer. But it's hard to visualize direct
2 interaction with consumers.

3 Q If the Commission either denies your
4 application or imposes conditions that you believe are
5 too onerous for you to go through with the
6 transaction, as a matter of policy, have you decided or
7 do you have a feeling for which of the two railroads
8 would be disposed of?

9 A Not at this point. It's a very complex
10 question and I will have to look at the environment at
11 the time that I have to face it. It might be both,
12 though, sir, because I can hardly see having one sick
13 railroad in lieu of just two sick railroads.

14 They may fit somewhere else with someone else
15 better than they fit with us.

16 Q Do you have an opinion on what is the outlook
17 for the continued viability of either the Southern
18 Pacific or Santa Fe rail companies if either is sold, or
19 both?

20 A I'd have to say your question is too general
21 for me to answer, because it would depend on the
22 viability or -- increased or decreased viability of the
23 Santa Fe would depend on who the SPN was sold to and
24 vice versa.

25 So it's just a question I can't answer at this

1 point.

2 Q If a policy decision were made by the
3 Applicants, SP Santa Fe, to dispose of Southern Pacific
4 to one of the eastern carriers such as CSX, do you have
5 an opinion on what would be the future for that rail
6 transaction?

7 A You say either of the railroads?

8 Q If you sold Southern Pacific to CSX, for
9 instance,

10 A I don't know in detail. I never studied
11 that. I think Mr. Biaggini studied that a lot closer
12 than I did a few years ago. They seem to have interest
13 in each other.

14 No, I haven't gone that far at this point.

15 Q On page 11, you talk about certain
16 efficiencies, operating efficiencies that the approved
17 transaction will enable you to carry out.

18 Let me ask you, in relation to passenger
19 service, if you know whether or not, as a matter of
20 policy, the company has identified any operating
21 efficiencies or savings that relate to Amtrak service
22 within California or that would affect the present
23 Southern Pacific peninsula service.

24 A The latter being the commuter service?

25 Q Yes, sir.

1 would be wise for each witness to move, even though it
2 is in the application. The application is part of the
3 record. I'll accept your moving it into the record.

4 Any objections at this time? None.

5 It will be received in evidence.

6 Mr. Nelson, did you have something else?

7 MR. NELSON: Yes. Your Honor, I think we made
8 good progress today, a lot better progress, I must say,
9 than I had anticipated.

10 As far as the Applicants are concerned, we are
11 prepared to resume tomorrow morning with Mr. Cena when
12 everyone is fresh, unless there are any objections.

13 JUDGE HOPKINS: We are finishing a little
14 earlier than I expected, but if you want to wait until
15 tomorrow morning to present the witness, that's all
16 right.

17 We have had a busy day and we have moved
18 along. It is cold in this room, I will add.

19 We will be in recess until 9:30 tomorrow
20 morning.

21 (Whereupon, at 3:37 o'clock p.m. the hearing
22 recessed, to reconvene at 9:30 o'clock a.m., the
23 following morning, Tuesday, October 2, 1984.)
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