STB FD 32760 (Sub 21) 4-10-98 D 187090

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BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 32760 (Sub-No. 21)

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

D

[OVERSIGHT]

NOTICE OF INTENT TO PARTICIPATE IN REQUESTS FOR ADDITIONAL CONDITIONS

Pursuant to the March 31, 1998 order, United Transportation Union submits its notice of its intent to participate in this proceeding for requests for additional conditions. United Transportation Union is the largest rail labor organization on the UP/SP and has a strong presence in the Houston/Gulf Coast area. As a result, United Transportation Union has a great interest in this matter.

Respectfully submitted,

D. R. Elliott

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STB FD 32760 (Sub 21) 11-12-97 D 183856

REDACTED -- To Be Placed on Public File

183856

UP/SP-328

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760 (Sub-No. 21)

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

APPLICANTS' REPLY TO PETITION OF ENTERGY
SERVICES, INC., FOR MODIFICATION OF DECISION NO. 44
OR, IN THE ALTERNATIVE, FOR ADDITIONAL CONDITION

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November 12, 1997

UP/SP-328

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760 (Sub-No. 21)

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

APPLICANTS' REPLY TO PETITION OF ENTERGY
SERVICES, INC., FOR MODIFICATION OF DECISION NO. 44
OR, IN THE ALTERNATIVE, FOR ADDITIONAL CONDITION

Applicants UPC, UPRR, SPR and SPT[1] hereby reply to the petition of Entergy Services, Inc., to modify the conditions imposed by the Board in Decision No. 44 or, in the alternative, for the imposition of an additional condition on the UP/SP merger.

Entergy's petition does not provide a basis for imposing a new or modified condition on the merger. First, Entergy is seeking a remedy for UP's supposed breach of service commitments in a rail transportation contract, and under longstanding precedent the Board will not intervene in the resolution of private contractual disputes. Second, the Board conditions mergers only to rectify harms that the merger causes to competition or to other railroads' ability to

[1] The acronyms used here are the same as those listed in Appendix B of Decision No. 44.

provide essential services, and Entergy does not seriously suggest that the condition it now seeks satisfies those standards.

FACTUAL BACKGROUND

Entergy's White Bluff Station, on UP's line between North Little Rock and Pine Bluff, Arkansas, is served exclusively by UP, which hauls coal to White Bluff via a single-line routing from the Southern Powder River Basin. Decision No. 44, p. 55. This situation was not changed by the merger: pre-merger, Entergy did not have access to SP and was exclusively served by UP. Decision No. 57, p. 8.

In the merger proceeding, Entergy presented evidence that it could construct a 21-mile build-out from White Bluff to SP's line at Pine Bluff, and it claimed that the threat of this build-out was a competitive constraint on UP's rates and service to White Bluff. Giangrosso V.S., p. 12, ESI-12, Mar. 29, 1996.[2] As a condition on the merger, the Board imposed trackage rights permitting BNSF to substitute for SP "if a connection is ever built linking the [White Bluff] plant to a nearby SP line at Pine Bluff." Decision No. 44, p. 154.

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[2] UP/SP vigorously contested the viability of Entergy's claimed build-out option. E.g., Sansom V.S., pp. 52-55, UP/SP-231, Apr. 29, 1996. The Board has noted that there "is no indication that this build-out line has ever progressed beyond relatively preliminary planning stages." Decision No. 57, p. 8 n.34. But the Board did not undertake to resolve the viability of the Pine Bluff build-out: "the only test of feasibility is whether the line is actually constructed." Decision No. 44, p. 146.

"Entergy will thus continue to have the option of building out to an independent carrier and will continue to be able to use this option in its negotiations with applicants." Id. This condition thereby "preserve[d] the White Bluff build-out status quo," id., p. 185, by maintaining Entergy's "build-out potential," Decision No. 57, p. 8.

Entergy has entered into several contracts with UP and its predecessors that provide for the movement of coal from the Powder River Basin to Entergy's White Bluff and Independence plants. Jewell V.S., p. 3, ESI-28, Oct. 23, 1997. Entergy characterizes those contracts as "contain[ing] a service standard, under which UP has committed to transporting coal from the PRB mines to White Bluff in a quarterly average 'Elapsed Transit Time.' . . . If UP fails to meet its Quarterly Elapsed Transit Time in a particular calendar quarter, it then has a deficit, which it must make up in the following calendar quarter using its own equipment. If UP incurs a deficit and fails to make it up in the next quarter, it is obligated to pay Entergy liquidated damages equal to a specified percentage of the weighted average contract rate." Id., pp. 5-6.

On October 3, 1997, Entergy filed suit against UP in the United States District Court for the Middle District of Louisiana. Entergy Services, Inc., & Entergy Arkansas, Inc. v. Union Pacific R.R., Civil No. 97-967-B-M3; Jewell V.S., Ex. CWJ-13. The complaint claims that UP has "materially breached" its transportation contracts with Entergy, allegedly because of "its continuing failure to meet the contractual service standards." ESI-28, p. 8, Oct. 23, 1997. As remedies for UP's alleged failure to provide the service promised under its contract with Entergy, the suit seeks money damages and the right to terminate the transportation agreement. Id.; Jewell V.S., Ex. CWJ-13, pp. 13-14.

ARGUMENT

I. THIS IS A CONTRACT DISPUTE, NOT A MERGER ISSUE

The entire basis of Entergy's petition is that UP has supposedly breached service commitments in its rail transportation contract with Entergy. The injury it claims, and for which it seeks relief, is based solely on "UP's performance under its contractual service standard." Jewell V.S., pp. 6-7. Entergy's grievance is over UP's allegedly "increasingly bad cycle times" and supposed inability "to meet its contracted service commitments." ESI-28, Oct. 23, 1997, pp. 6-7. Entergy claims that UP has "materially breached its contractual obligations under the Interim Agreement." Id., p. 7.

This is a contract dispute. It arises out of claimed service commitments in UP's long-term transportation contracts with Entergy. Those contracts specifically provide for procedures that apply in the event UP does not deliver specified volumes of coal within specified time periods -- what Entergy calls UP's "service standard." Jewell V.S., p. 5. Entergy's contract rights therefore define the scope of its remedies for UP's alleged failure to deliver coal in a timely fashion under the terms of the contract. The parties clearly contemplated that UP might not make its coal deliveries within within the time periods specified in the contract, and they explicitly agreed on liquidated damages and other contractual remedies in such circumstances.[3/]

It is well-established that the Board (as the ICC before it) will not resolve or interpose itself in private contractual disputes. "[W]e have held repeatedly that we have no power to interpret or enforce contracts, and that such matters must be left to settlement by the parties or the courts." Delaware & Hudson R.R. Trackage Agreement Modification, 290 I.C.C. 103, 107 (1953). "[C]ontractual disputes between parties . . . are matters for the courts to resolve." Brotherhood of Locomotive Engineers v. Chicago & North Western Transportation Co., 366 I.C.C. 857, 858 (1983). "It would be inappropriate for this agency to interpose itself among the parties in what is essentially a private contractual dispute . . . ." Finance Docket No. 31148, Indiana Harbor

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[3/] On the facts, UP considers Entergy's claims to be without merit. But those factual issues need not be resolved to dispose of Entergy's petition for relief in the merger proceeding.

Belt R.R. -- Acquisition of Line of Chicago & Western Indiana R.R. -- Exemption from 49 U.S.C. § 11343, Decision served Sept. 22, 1988, p. 4.

The point applies with particular force where, as here, Entergy is already pursuing its contract claim against UP in federal district court. In the circumstances, there is nothing for the Board to decide: the question of Entergy's remedies for UP's claimed breach of its "contractual service commitments," Jewell V.S., p. 5, is a matter "for the courts to resolve." Brotherhood of Locomotive Engineers, 366 I.C.C. at 858.

Although Entergy claims vaguely (Petition, pp. 9, 17) that it does not intend to involve the Board in resolving a contract dispute, that is exactly what the petition seeks. It requests Board-ordered relief -- in the form of a grant of three years of trackage rights to allow BNSF to serve the White Bluff plant directly from UP's line -- as a supposed "remedy" for UP's claimed breach of contract. Aside from being grossly disproportionate to UP's alleged breach,[4] this

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[4] If, as Entergy claims (Petition, pp. 6-7), its coal supplies are threatened by UP's performance, it has an efficacious remedy: it can readily move coal by rail to the Mississippi River, and then by barge to White Bluff. Evidence in the merger case showed that rail-barge movements to White Bluff are a feasible alternative to rail-only hauls from the Powder River Basin. Sansom V.S., pp. 52-56, UP/SP-231, Apr. 29, 1996. Moreover, until the last several months UP's cycle times were lower than they had been over the past several years, and even within the past several months UP's cycle (continued...)

relief is clearly <u>in addition to</u> the monetary and other remedies that Entergy is already seeking in federal court for the same alleged contract breach. The parties agreed on the contractual remedies that would apply in the event UP did not deliver specified volumes of coal within specified time periods; and what Entergy now seeks is relief from the Board that would go <u>beyond</u> those negotiated, contractual remedies. Under longstanding precedent, the Board should not be drawn into granting such remedies for breach of contract.

II. <u>THE TRACKAGE RIGHTS ARE NOT PROPER MERGER CONDITIONS</u>

Entergy's petition seeks the imposition of new or modified conditions on the UP/SP merger. But the relief sought by Entergy is clearly outside the Board's authority to impose conditions on a merger.

A. <u>The Requested Condition Would Expand Rather than Preserve Entergy's Competitive Options</u>

The White Bluff plant was served exclusively by UP before the merger, and today it is served exclusively by UP/SP. Before the merger, it had no competitive rail alternatives except for the "build-out potential" of a 21-mile spur from White Bluff to Pine Bluff. Decision No. 57, p. 8. After the merger, that build-out option is fully preserved by

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[4] (...continued)
times are comparable to limited times in the past when cycle times have risen. Nock V.S., pp. 1-2 (attached hereto). This casts substantial doubt on Entergy's claim that its situation is "approaching critical proportions." ESI-28, p. 7, Oct. 23, 1997.

the Board's build-out condition. Decision No. 44, pp. 154, 185, 232.

Yet Entergy seeks trackage rights that would allow a second railroad to serve the plant directly -- a change that goes far beyond preserving existing competitive options for White Bluff. Unlike a build-out alternative, this immediate grant of trackage rights would give Entergy, and BNSF, the windfall of direct access to White Bluff.[5] Entergy's pre-merger competitive position would be dramatically altered by these requested trackage rights.

Such expansions or enhancements of a shipper's rail options are not a proper use of the Board's conditioning authority, which does not extend to imposing "a condition that would put its proponent in a better position than it occupied before the consolidation." Decision No. 44, p. 145.[6] "If, for example, the harm to be remedied consists of the loss of a rail option, any conditions should be confined to restoring that option rather than creating new ones." Id., p. 145 n.176. Accord, Finance Docket No. 32549, Burlington Northern

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[5] "The costs of construction, not to mention the delays that all construction necessarily entails, are such that a build-out line must be build before it can provide a competitive option that will match the competition provided by an existing line." Decision No. 57, p. 8.

[6] See also, e.g., Decision No. 44, p. 187 ("AEPCO's basic problem is that, at Cochise, it is captive to SP pre-merger and will be captive to UP/SP post-merger; but this problem is not a consequence of the merger and will not be exacerbated thereby.").

R.R. -- Control & Merger -- Santa Fe Pacific Corp., Decision served Aug. 23, 1995, p. 72 (criticizing condition that sought to "expand -- not simply preserve" -- the proponent's competitive options); Finance Docket No. 32133, Union Pacific Corp., Union Pacific R.R. & Missouri Pacific R.R. -- Control -- Chicago & North Western Transportation Co. & Chicago & North Western Ry., Decision served Mar. 7, 1995, p. 97. Entergy itself acknowledges (p. 3 n.2) that a condition requiring direct BNSF service to White Bluff "would almost certainly have been denied" in the merger case "as putting Entergy in a better position than it was in prior to the UP/SP merger." Yet that is the overbroad relief Entergy seeks here.

B. The Service Problems Claimed by Entergy Were Not Caused by the Merger

Merger conditions will not be imposed unless the harm they address is caused by the merger. Decision No. 44, pp. 144-45.[7] Entergy speaks only in the vaguest and most

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[7] Furthermore, any merger condition must be "narrowly tailored" to remedy specific adverse effects. Decision No. 44, p. 145. Here, Entergy makes an extraordinarily broad request for three years of trackage rights, as a supposed remedy for a short-term service issue that involves only three of the past four months of deliveries to White Bluff. Nock V.S., pp. 1-2 (attached hereto). Even the recent few months of higher cycle times are not significantly different from limited periods in the past when cycle times for White Bluff deliveries have risen. Id., p. 2. Furthermore, as Mr. Nock explains in his verified statement, the recent increases in cycle times to White Bluff should soon be resolved as UP/SP implements its general Service Recovery Plan. Id., p. 2. These facts cannot justify an extraordinary three-year grant of trackage rights to redress a short-term service issue.

conclusory terms (p. 16) about any causal linkage between the merger and its service complaints. It offers no explanation why the merger would have caused its service to decline when UP/SP today moves coal over the same single-line route to White Bluff that UP was operating before the merger. Nor does it explain why, if the merger "caused" the service problems, Entergy also allegedly experienced comparable service problems in the years before the merger. See Jewell V.S., p. 6 (asserting that UP's service performance was "very poor" between 1993 and 1995, and that UP "rarely met its contracted train cycle times" during 1995 and 1996).

Contrary to Entergy's conclusory allegations, UP/SP has provided specific evidence -- in the form of testimony and a verified statement of Richard Davidson, its Chairman and Chief Executive Officer -- explaining that the merger did not cause UP/SP's current service problems. Davidson V.S., pp. 3-6, 18-20, Ex Parte No. 573. As Mr. Davidson has explained, the service problems arose in an area where the merger had not yet been implemented, and were caused by "the fragility of the Southern Pacific and the extraordinary stresses that threw SP into a congestion crisis" that would have occurred with or without a merger. Id., p. 19. Mr. Davidson notes that shippers responded to "service problems on the SP lines by rerouting traffic via UP lines," which spread "congestion to such points as Dallas and Little Rock," near Entergy's White

Bluff plant. Id., p. 7. The congestion around Little Rock and White Bluff flowing from SP's problems in Texas would have occurred, merger or not, and cannot be causally attributed to the merger.

UP's history of coal movements to White Bluff over the years 1995 through 1997 further rebuts Entergy's conclusory allegations (Petition, p. 16) that the merger "clearly is a major factor" in UP's alleged service deficiencies. Entergy's petition focuses on train cycle times as a measure of the adequacy of UP's performance in delivering coal to White Bluff. Jewell V.S., pp. 6-7. Between October 1996 and June 1997, the period immediately following the merger, UP's average cycle times were lower than they had been in the two years preceding the merger. Nock V.S., pp. 1-2 (attached hereto). Even in the last few months, when congestion across the UP/SP system has caused increases in UP's cycle times for deliveries to White Bluff, those cycle times are nonetheless comparable to limited periods in the past when cycle times have risen for a variety of reasons. Id., p. 2. Moreover, Mr. Nock notes that the recent increases in cycle times to White Bluff should begin to drop in the near future as the UP/SP Service Recovery Plan takes effect. Id.

C. Conditions Cannot Be Imposed to Guarantee Levels of Service for Individual Shippers

Entergy makes no showing, nor could it, that the conditions it seeks are needed to rectify effects of the merger "harmful to the public interest (such as a significant loss of competition)." Decision No. 44, p. 144. Entergy's petition is not about competition or concerns of the public interest; rather, it is a shipper-specific complaint about the particularities of UP's service. See Petition, p. 1 (Entergy "petition[s] the Board . . . to address a critical situation that has resulted from UP's inability to provide Entergy with . . . adequate rail transportation service").

The Board imposed the oversight condition to determine if "the conditions already imposed have not effectively addressed the competitive harms caused by the merger." Decision No. 44, p. 146 (second emphasis added). Entergy makes no showing that this standard is satisfied here; it offers no evidence whatsoever of competitive harm. The Board does not act under the rubric of its merger authority simply to enhance service for individual shippers, which is what Entergy is requesting here.[8/] Even if Entergy had established some tie between its service situation and the merger -- and it has not -- the Board does not and cannot undertake to guarantee to every individual shipper that service will never temporarily worsen as a result of a merger. Such a shipper-by-shipper service guarantee could make it

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[8/] The Board does have limited powers in regard to service emergencies under 49 U.S.C. § 11123, but Entergy is not seeking to invoke those powers here.

impossible to implement merger changes that yield tremendous overall improvements in service quality and efficiency.

CONCLUSION

Entergy's petition for the imposition of new or modified conditions on the merger should be denied.

Respectfully submitted,

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Attorneys for Union Pacific Corporation, Union Pacific Railroad Company, Southern Pacific Rail Corporation and Southern PacificTransportation Company

November 12, 1997

VERIFIED STATEMENT

of

WILLIAM E. NOCK

My name is William E. Nock. I am employed by the Union Pacific Railroad Company ("UP") as General Director - Logistics in the Energy Group, which is responsible for the marketing of all UP's rail transportation of coal. In my current position, I have extensive contact with coal mines, utilities and other customers that move coal by rail. My responsibilities include, among other things, the development of marketing strategies and long-term strategic plans for UP's coal business. I have also been involved for many years with UP's transportation of coal to Entergy's White Bluff plant, located on UP's line between North Little Rock and Pine Bluff, Arkansas.

Cycle times for deliveries to the White Bluff plant are computed according to a contractual formula that measures the total number of hours involved in moving a loaded coal train from mines in the Powder River Basin to the White Bluff plant, subtracting out loading, unloading and any customer delays. Following the UP/SP merger in September 1996, and until the most recent several months, UP's cycle times to White Bluff were typically lower than they had been in the preceding two years. For instance, in the period immediately after the merger, between October 1996 and June 1997, UP's average monthly cycle time was hours, which was lower than cycle times for the comparable period of a year earlier, between October 1995 and June 1996, and was also lower on average than UP's cycle times over the prior two years.

In recent months, congestion across the UP/SP system has caused increases in our cycle times to the White Bluff plant. We believe that these congestion problems are short-term in nature and will soon be resolved as UP/SP implements its general Service Recovery Plan. Cycle times to White Bluff should therefore begin to drop in the near future.

In three of the past four months (July, September and October), cycle times for deliveries to White Bluff exceeded hours, and were thus substantially higher than they had been earlier in 1997. The cycle time for August, in contrast, was hours, only slightly above our average performance during the first half of 1997.

At times in the past, we have experienced difficulties that resulted in cycle times on deliveries to White Bluff comparable to the cycle times of the past several months. While we expect cycle times for White Bluff deliveries to decrease as the Service Recovery Plan takes hold, shippers know that cycle times vary. For this reason, many of our contracts include make-up periods and other remedies such as liquidated damages.

VERIFICATION

State of Nebraska)
) ss.
County of Douglas)

I, William E. Nock, being first duly sworn, state that I have read the foregoing statement, that I know it contents and that the contents are true as stated.

William E. Nock
William E. Nock

Subscribed and sworn to before
me this 12th day of November, 1997.

Mary R. Holewinski
Notary Public

GENERAL NOTARY-State of Nebraska
MARY R. HOLEWINSKI
My Comm. Exp. Oct. 15, 2000

My commission expires:
October 15, 2000

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that, on this 12th day of November, 1997, I caused a copy of the foregoing document to be served by first-class mail, postage prepaid, or by a more expeditious manner of delivery on all parties of record in Finance Docket No. 32760 and Finance Docket No. 32760 (Sub-No. 21), and on

Director of Operations
Antitrust Division
Suite 500
Department of Justice
Washington, D.C. 20530

Premerger Notification Office
Bureau of Competition
Room 303
Federal Trade Commission
Washington, D.C. 20580

Michael L. Rosenthal

STB FD 32760 (Sub 21) 10-21-97 D 183002

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760
(Sub-No. 21)

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

RAILCO, INC.'S SUPPLEMENTAL COMMENTS IN OVERSIGHT PROCEEDING ON EFFECTS OF MERGER ON COMPETITION

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Attorneys for Railco, Inc.

Railco, Inc. respectfully submits these supplemental comments in the Board's oversight proceeding. As described in the attached article by Daniel Machalara in the October 2, 1997 *Wall Street Journal*, the merger has been something less than the sterling success UP predicted. Instead, the merger "is fast becoming one of the industry's biggest debacles." UP's ability to serve its customers has deteriorated to the point it can no longer meet all of its commitments. The situation is having a direct impact on the Utah coal industry. Already, for reasons not within its control, Railco has lost one loading contract, for no better reason than that UP was unable to perform in a timely manner, and that Railco was not allowed to load to an alternate railroad. Railco stands to lose even more business in the future as a result of UP's present inability to meet the shipping needs of Railco's customers. Railco would not be losing this business if the right Railco had to compete with Savage, which was stripped from Railco as a result of the merger, is restored.

Ironically, UP's proposed solution to its own internal difficulties would injure Railco even more, perhaps even inflict a *coup degrace*. According to the *Wall Street Journal* article:

> Yesterday, the company [UP] hit what analysts described as rock bottom: It announced a service-recovery plan that appears to mirror parts of rescue operation outlined by its chief rival, Burlington Northern Santa Fe Co. Union Pacific said it would temporarily divert certain business, including coal, grain and automobile shipments, to other railroads throughout the Western two-thirds of the country, including Burlington Northern.

Any such unilateral diversion of coal to other railroads on the CV Spur would also "divert" (i.e., take from Railco and give to Savage) loading rights for which Railco has already contracted, or for which Railco would even now be able to compete but for UP's plan. UP has foisted a situation on Railco where UP, not Railco, has control over Railco's business. UP has made Railco totally dependent on UP's deteriorating operations for Railco's own success, while relieving Railco's next-door competitor Savage from the same control and dependency. UP's "service-recovery" plan on its face would exacerbate the situation, by intentionally diverting business away from Railco and giving it to Savage, with Railco having no say in the matter. The manifest injustice to Railco of UP's plan is readily apparent.

But for the statutory scheme vesting the Board with jurisdiction over railroads, Railco would already have obtained relief through the courts. 15 U.S.C. §1 provides, "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." The Utah Railway Agreement, to the extent it gives Savage exclusive access to the coal loading market, is a contract in restraint of trade, illegal under the Sherman Antitrust Act. The parties to that agreement are parties to an illegal combination in the form of trust and conspiracy to restrain trade.

Customers desiring to use a rail shipper other than UP are compelled also to purchase Savage's services as a coal loader, while customers desiring to use Railco are compelled also to use

UP only. This is a classic tying arrangement, and a combination in the form of trust or conspiracy to further a tying arrangement, in further violation of 15 U.S.C. §1.

15 U.S.C. §2 provides, "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony ...." The relevant part of trade or commerce includes the loading of coal via the CV Spur, and access to Railco and Savage for such loading. UP's actions constitute control over, monopolization of and a conspiracy to monopolize the market, and are a felony under the Sherman Act.

Allowing Railco to compete for the loading of coal on the CV Spur is practicable and in the public interest, without substantially impairing the ability of UP to handle its own business, and should be required pursuant to 40 U.S.C. §11102. Moreover, restoring to Railco its former right to compete for all loading traffic on the CV Spur is an accommodation that is reasonably practicable, can be made safely with no additional construction, and will furnish sufficient business to justify its maintenance. Under 49 U.S.C. §11103(a), UP should be required to allow Railco full access to the CV Spur, without discrimination in favor of Savage or against Railco.

Congress in its wisdom has given the Board the responsibility to safeguard against monopolistic and other anticompetitive effects of a railroad merger. The Board should weigh the present situation in light of the antitrust laws. In light of UP's plan to divert western coal shipments to BNSF, there is no rational reason to keep Railco and Savage from competing for loading rights to that coal. The Board's responsibility is to safeguard against anticompetitive effects of the merger. Railco respectfully submits the Board can best discharge that responsibility by restoring the competition that existed between Railco and Savage before the merger.

DATED this 15 day of October, 1997.

Mark Hansen

Attorney for Railco, Inc.

2341p.012

CERTIFICATE OF SERVICE

I certify on October 15, 1997 an original plus 26 copies of the above RAILCO, INC.'S RESPONSE TO UNION PACIFIC'S REPLY TO COMMENTS, together with a 3.5-inch diskette containing files of the same document formatted for WordPerfect 7.0 and ASCII, was served by certified mail, postage prepaid, to :

Office of the Secretary
Case Control Unit
ATTN: STB Finance Docket No. 32760 (Sub-No. 21)
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

and a copy was served by first class mail to each of the following:

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United States Senate
Washington, DC 20510

Honorable Orrin G. Hatch
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THE WALL STREET

DOWJONES VOL. CXXXVII NO. 66 WE/DE ★★ THURSDAY, OCTOBER 2, 1997

Wrong Track

A Big Railroad Merger Goes Terribly Awry In a Very Short Time

Union Pacific Is Hammered Over Service and Safety; Have Patience, It Says

Have You Seen Our Rice?

By DANIEL MACHALABA
Staff Reporter of THE WALL STREET JOURNAL

Its railroad safety record, marred by three fatal crashes in three months, is being characterized as a "fundamental breakdown" by federal regulators. Its route system has slipped into near gridlock west of the Mississippi River, with thousands of freight cars backed up for miles in the Houston area alone. Its chairman had to publicly apologize in August to its big customers.

So bad has service become that customers say Union Pacific Corp., the nation's largest railroad, can't account for millions of dollars of shipments for weeks at a time. Riviana Foods Corp., a Texas rice producer, tried to ship a freight car full of rice from Missouri to Tennessee in early August. A month later, the car was spotted on a track in Devil's Slide, Utah. The latest word is that it was somewhere in Texas. "I still don't know where it's at," says Terry Nickens, Riviana's distribution manager.

Is this any way to run a railroad?

A Major Debacle

Union Pacific's attempts to put together the biggest railroad merger in history is fast becoming one of the industry's biggest debacles. With high hopes last year, the company bought Southern Pacific Rail Corp. for $3.9 billion and promised to begin merging the systems this summer into a seamless link between the West Coast and the Midwest.

Instead, with stunning speed, the merger has unraveled in recent weeks into a series of service and safety snafus. Analysts estimate the carrier has already lost about $125 million in revenue as customers diverted shipments. Hundreds of customers have threatened to take away business, and the Federal Railroad Administration could well impose stiff fines on the company for safety violations. The company concedes that its service problems will reduce its third-quarter earnings by 10% to 15%. And the stock price has dropped 13% in the past month.

And yesterday, things got worse. The Dallas-based company said it would abandon an embarrassing plan to move goods by ship through the Panama Canal

What's News—

* * *

Business and Finance

WORLDCOM OFFERED $30 billion in stock for MCI, hoping to break up MCI's planned merger with British Telecom. If successful, the move would be the largest takeover in corporate history, turning the No. 4 long-distance carrier into a telecom titan with unmatched assets in long-distance, local and Internet services. Indeed, WorldCom could emerge with unprecedented clout and, potentially, pricing power over the Internet.

(Articles in Column 6 and Pages A3, B1 and C1)

* * *

Anheuser-Busch's sales practices are being investigated by the Justice Department amid allegations that the nation's largest brewer is abusing its dominant market position, industry lawyers and executives said.

(Article on Page A3)

* * *

Prudential Insurance is exploring a sale of its huge but unprofitable health-care business, a unit that is expected to fetch well over $1 billion, people familiar with the matter said.

(Article on Page A3)

* * *

Manufacturing activity cooled a bit in September while continuing to signal strong economic growth, a survey of purchasing managers found. Meanwhile, pricing pressures increased.

(Article on Page A2)

* * *

GM is taking longer than expected to prepare for an IPO of its giant Delphi parts making unit, likely to be one of the biggest stock sales on record.

(Article on Page B4)

* * *

Chrysler and Toyota each posted a 14% drop in U.S. sales of cars and light trucks, while Honda's rose 9.1%.

(Article on Page B4)

* * *

The Dow Jones industrials topped 8000 for the first time in six weeks, rising 70.24 to 8015.50. Bond prices surged amid weaker-than-expected economic reports and the dollar advanced.

(Article on Page C1)

* * *

Southeast Asian currencies dived as discord broke out among the region's economic leaders over Malaysian Prime Minister Mahathir's attacks on the currency markets.

World-Wide

CLINTON WARNED Congress he will use vetoes to preserve spending priorities. Budget Director Raines met with House and Senate Appropriations leaders to make clear the administration's position. At risk are at least four big spending bills. The administration fears it is losing leverage in the piecemeal approach Congress has taken this year, and would prefer an omnibus bill. Clinton may not enjoy the support he had in past budget fights, because Republicans have taken care to share the largesse with Democrats. (Article on Page A20)

The Senate voted 55-45 for a big Treasury spending bill that contains a 2.3% cost-of-living increase for lawmakers. The bill now goes to Clinton.

* * *

"Fast track" trade legislation passed the Senate Finance panel in what the White House hopes will be a boost for the troubled plan. In a compromise meant to win bipartisan support, references to labor and environmental rights would be largely advisory, and programs would continue to help those hurt by imports. (Article on Page A2)

The U.S. opened an investigation of the South Korean auto market that could lead to trade sanctions under the process known at Super-301. The move is meant to pressure Seoul into boosting imports of U.S. cars. The U.S. referred four other disputes to WTO arbitration panels. (Article on Page B4)

* * *

Attorney General Reno is almost certain to take the next step toward naming an independent counsel to investigate possible fund-raising abuses by Gore, administration officials say. She must decide by tomorrow whether to begin a formal 90-day inquiry that could lead to an appointment. Clinton's case is trickier. (Article on Page B8)

* * *

NATO troops in Bosnia seized TV transmitters to end broadcasts they said incited violence against peacekeepers. Programs by a U.S.-backed Bosnian Serb faction were then put on. Meanwhile, NATO ministers met to consider Bosnia troop cuts this year. In Serbia's Kosovo province, police broke up a march by 3,000 ethnic Albanian students.

* * *

Israel's release of a Hamas leader failed to quell Palestinian anger over his deportation to Jordan. Critics of the move also said Sheik Ahmed Yassin's release was part of a deal for Jordan to free two Israeli agents held after the attempted killing of a Hamas official last week. Meanwhile, PLO police arrested 11 Hamas activists in Nablus.

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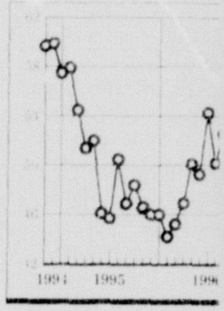
Secretary of State Albright said the U.S. hasn't yet decided how it will respond to the $2 billion natural-gas contract signed with Iran by a group led by France's Total

Purchasing Manag



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By ERNEST BE
Staff Reporter of THE WALL S

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lems will reduce its third-quarter earnings by 10% to 15%. And the stock price has dropped 13% in the past month.

And yesterday, things got worse. The Dallas-based company said it would abandon an embarrassing plan to move goods by ship through the Panama Canal—a plan that was rejected this week by its customers. Instead, in an even-more-remarkable step, it agreed to hand over some of its business to competing railroads and to "borrow" the services of dozens of former managers from Eastern railroads to help untangle the mess.

The setbacks have startled industry observers, who only a few months ago expected the merger to go smoothly, especially because Union Pacific had had a sterling reputation in railroading.

"They thought they could conquer the world," says William Withuhn, transportation curator at the Smithsonian Institution in Washington and a widely recognized expert on railroads. "They were counting on having a great success. But they just didn't plan it right. It fell apart."

Union Pacific acknowledges that it has been caught by surprise — and humbled by the experience. Richard Davidson, its chief executive, said in an interview after a recent meeting with more than 200 angry chemical-company officials and other shippers in Houston: "I never imagined in my wildest dreams that I'd be down here apologizing for our service." Yesterday, a Union Pacific spokesman said, "There's no denying we have severe service problems, but we are making headway."

Problems Acknowledged

The carrier's executives concede that they overestimated their ability to combine giant rail systems operating hundreds of thousands of freight cars. They say the company's own long record of success, unmatched through much of the late 1980s and early 1990s, may have bred overconfidence. "We are arrogant," Greg Garrison, Union Pacific's Houston superintendent, said last month. "We consider ourselves the best."

Union Pacific says it still can solve its problems, perhaps within a few months. But for now, its merger woes have raised troubling questions about how well railroads can transport goods in the nation's ever-growing consumer market. For more than a decade, the industry has been on an unprecedented merger binge that was supposed to give the remaining five powerful railroads a better chance at competing against trucks, which now deliver nearly 80% of the nation's freight revenues. That improvement, in turn, was supposed to help reduce everything from highway congestion to air pollution to fuel consumption. And consumers would gain, too, because railroads can haul goods about 20% more cheaply than trucks can, with much of the saving to be passed on to the public.

But Union Pacific's problems suggest that the railroads are a long way from fulfilling this promise and that shippers even may be discouraged from using them. Chemicals companies on the Gulf Coast have been switching to trucks whenever possible because Union Pacific's delays have cost them an estimated $100 million in plant closings and lost revenues.

In Waverly, Ohio, Mill's Pride Inc., a

Please Turn to Page A10, Column 1

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Southeast Asian currencies dived as discord broke out among the region's economic leaders over Malaysian Prime Minister Mahathir's attacks on the currency markets.

(Article on Page A12)

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A tobacco meeting with Clinton produced pledges from GOP leaders that they would try to pass legislation to cut teen smoking early next year.

(Article on Page A4)

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US Air reached a tentative accord with its pilots union that would lower the carrier's costs and move it a step closer to executing the growth strategy of chairman and CEO Wolf.

(Article on Page A4)

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Salomon dismissed John Sandelman, head of its global equity derivatives business, making him among the first casualties of Travelers' $9 billion purchase of the bond-trading firm.

(Article on Page C1)

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Small-company stock funds roared back in the three months ended Sept. 30, after lagging behind big-company funds for a long stretch.

(Article on Page C23)

* * *

Marriott International's plan to split off its food and management service businesses into a joint venture with France's Sodexho will reduce its debt burden by more than 75%.

(Article on Page B8)

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Markets—

Stocks: Volume 597,888,140 shares. Dow Jones industrials 8015.50, up 70.24; transportation 3203.59, up 23.85; utilities 240.34, up 1.97.

Bonds: Lehman Brothers Treasury index 7249.18, up 64.41.

Commodities: Oil $21.05 a barrel, off 13 cents. Dow Jones futures index 145.54, up 0.18; spot index 139.20, off 0.41.

Dollar: 120.85 yen, up 0.50; 1.7745 marks, up 0.0150.

official last week. Meanwhile, [illegible] police arrested 11 Hamas activists in Nablus.

* * *

Secretary of State Albright said the U.S. hasn't yet decided how it will respond to the $2 billion natural-gas contract signed with Iran by a group led by France's Total. Albright declined in an interview to say whether Clinton might waive sanctions as he has with a similar law involving firms doing business with Cuba. (Article on Page A2)

* * *

The quality of HMO care varies widely across the U.S. in areas ranging from prenatal to heart attack treatment, according to a report by the industry's leading accreditation organization. The group intends the report to be used by medical officials to make improvements, and by employers to select health plans. (Article on Page B5)

* * *

Congo's Kabila said he was sending troops into Congo Republic after two days of cross-border shelling that killed as many as 31 in Kinshasa. Meanwhile, the U.N. is withdrawing a team sent to Congo to investigate Rwandan refugee massacres, the second inquiry Kabila succeeded in blocking.

* * *

Louisiana Sen. Mary Landrieu was officially seated after the Senate Rules panel voted 16-0 to drop an investigation of her narrow 1996 victory over GOP challenger Woody Jenkins. The panel said it had found insufficient evidence of vote fraud, and the inquiry's pace drew Democratic protests.

* * *

Overseas farms would be inspected for possible disease-causing contaminants under a plan Clinton is set to announce today, the Associated Press said. Those failing to meet standards would be barred from exporting to the U.S. New sanitation guidelines also would be issued for U.S. farmers.

* * *

An Algerian Muslim group's truce took effect, but attacks blamed on Islamic militants continued. Three people were killed 40 miles south of Algiers, capping a week in which nearly 100 were massacred. Other groups continue to fight the government.

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An Army colonel concurred with a hearing officer's recommendation that Sergeant Major of the Army Gene McKinney be court-martialed on sexual-misconduct charges, people familiar with the case said. A final decision now rests with a general.

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TODAY'S CONTENTS

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THREE SECTIONS

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Big Railroad Merger Quickly Goes Awry

Continued From First Page

maker of prefabricated kitchens that had turned to railroads to save money, says it has dropped Union Pacific and the railroad industry entirely. "They give us excuses. They have derailments, floods, breakdowns, snow, just stuff you wouldn't think would happen," says Armando Sanchez, the distribution manager. "You would think, if a truck can get through, why can't they?"

Moreover, Union Pacific's headaches pose a threat to the next great railroad merger—the $10 billion breakup of Conrail Inc. between Norfolk Southern Corp. and CSX Corp. Once considered almost certain to be cleared by the federal government's Surface Transportation Board, the merger is now raising questions from members of Congress, labor unions and community leaders worried about a repeat performance. "This creates all sorts of problems for CSX and Norfolk Southern," says Anthony Hatch, an analyst at NatWest Securities Corp. "The future prosperity of the entire rail industry depends on Union Pacific solving its service problems — and quickly."

An Enormous Challenge

To be sure, Union Pacific faced an enormous challenge in trying to create a system with 36,000 miles of track and more than 150,000 freight cars. What's more, the company it was buying, Southern Pacific, was the weakest of the major railroads; it suffered from a lack of investment in freight yards and locomotives. Some industry executives, who jokingly called it as "the Suffering Pacific," say the railroad couldn't have survived on its own over the long haul.

Nevertheless, Union Pacific officials hoped that the merger, which become effective in September 1996, would yield huge rewards, not only through major cost savings but by increasing freight business with more-direct routes between the Midwest and West Coast. Southern Pacific's major routes stretch in a great arc from Portland, Ore., to Los Angeles, Houston, St. Louis and Chicago; Union Pacific forms a large funnel-like system, from the Midwest to Salt Lake City, with branches to Seattle, Oakland, Calif., and Los Angeles. Combining the two, Union Pacific promised, would slash delivery times as much as 20%, more than enough to win new business.

But company officials concede that they badly underestimated the number of crews and locomotives they would need; in part, they relied on their past success in acquiring other railroads. Those mergers allowed Union Pacific to lay off great numbers of employees and still keep the trains running. But instead of adding to a combined work force of 52,000, the company offered buyouts to more than 1,000 workers at a time when freight shipments were booming nationwide.

"We miscalculated," says Mr. Garrison, the Houston superintendent. "It upset a lot of customers."

The company also cut back operations at an important railyard near Houston, shifting 300 freight cars a day to a bigger but overtaxed Englewood yard in Houston 20 miles away. The result: Within a few weeks, the bigger yard was swamped, causing delays of as long as a month. "The yard is like a coffee cup that's already too filled," says Rick Carlswell, a yard manager at Englewood. "It just overflowed."

In a railroad, delays at a hub can quickly spread throughout the system—and this one did in a big way. By August, at the beginning of the peak holiday shipping season, trains were already backing up for miles along the Gulf Coast. More recently, the snarl has spread to Union Pacific's facilities in the Los Angeles/Long Beach harbor complex, where as many as 3,000 containerized shipments have been piling up for lack of locomotives.

"I've never seen it this bad," says David McLean, director of global marketing for Circle International Inc., of San Francisco, which arranges freight transportation for major companies.

Scrambling, Union Pacific is buying or leasing more than 300 locomotives, but it hasn't any quick solution to the backlog.

Through its buyouts, Union Pacific also encouraged an exodus of many Southern Pacific executives and managers, whom industry officials said were skilled at keeping the wea' er line going. "They lost a lot of institutio..al knowledge," says Ed Emmett, president of the National Industrial Transportation League, which represents about 1,200 rail and truck customers.

What's more, the exodus aggravated the clash of corporate cultures that a merger would be sure to provoke. Led by the 6-foot-4-inch Mr. Davids— who surrounded himself with equally imposing subordinates, Union Pacific runs a well-heeled and aggressive rail operation out of its Omaha, Neb., rail headquarters. Executives there, accustomed to using the latest equipment to dispatch trains and repair tracks, were skeptical about the talents of many Southern Pacific people. Former Southern Pacific executives say many of their suggestions were ignored. "You are merging two cultures, one that had no money and one that had a lot of money," says Art Schoener, until this week Union Pacific's executive vice president for operations.

Traditions Slighted

Most merging railroads, to bolster morale, have tried hard to preserve the traditions of their predecessors. But shortly after the acquisition, Union Pacific replaced the name of a famous Southern Pacific high-speed freight train, the Memphis Blue Streak, with the symbol "IMELB" (standing for Intermodal Memphis to Long Beach train). "It was an inspirational thing," says Fred Frailey, who wrote a book about the Blue Streak. "The Memphis Blue Streak was the heart and soul of the Southern Pacific. But all that was lost on the Union Pacific." In response, a Union Pacific spokesman says: "That's the least of our concerns right now."

Yesterday, the company hit what analysts described as rock bottom: It announced a service-recovery plan that appears to mirror parts of rescue operation outlined by its chief rival, Burlington Northern Santa Fe Co. Union Pacific said it would temporarily divert certain business, including coal, grain and automobile shipments, to other railroads throughout the Western two-thirds of the country, including Burlington Northern. In addition, Union Pacific plans to reroute trains around congested hubs and use less-busy freight yards to handle more of its business. It also said it would operate fewer trains and take locomotives off its faster trains and spread them around the system.

"Everyone at our company is working hard on restoring service to levels that will satisfy our customers," Mr. Davidson said in a statement yesterday.

TransCanada Plans To File Applications For Pipeline Projects

By a WALL STREET JOURNAL *Staff Reporter*

CALGARY, Alberta — **TransCanada PipeLines** Ltd. said it plans to file regulatory applications with the U.S. Federal Energy Regulatory Commission and Canada's National Energy Board for pipeline projects that are part of its plan to build a natural-gas transportation link between western Canada and the U.S. Northeast.

"All of our energies are focused on moving forward our west to east transportation link. We have made the conscious decision to respond to the needs of the marketplace and to the needs of producers," said Bob Reid, president of TransCanada's pipeline division.

The energy concern, which already operates Canada's largest natural-gas pipeline system, said it will apply by the end of October for U.S. regulatory permits to build its proposed Viking Voyageur pipeline through Minnesota, Wisconsin and northern Illinois to Chicago, and will seek regulatory approval in Canada for a new western Canadian pipeline project that would feed Viking Voyaguer. It also said it filed a preliminary regulatory submission in Canada for two smaller pipeline projects in Ontario, including one to build a natural-gas pipeline under Lake Erie.

Eventually, TransCanada hopes to build or own stakes in interconnecting pipelines forming a complete new transcontinental pipeline system stretching from Alberta to New York. However, its Viking Voyageur project, a key component of the overall plan, faces stiff competition from the rival Alliance pipeline project launched by a group of Canadian natural-gas producers. Alliance received a major boost in September, when **Westcoast Energy** Inc., a Vancouver natural-gas pipeline and distribution concern, agreed to take an equity stake in the project.

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760 (Sub-No. 21)

UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY AND MISSOURI PACIFIC RAILROAD COMPANY

— CONTROL AND MERGER —

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

REPLY COMMENTS OF CYPRUS AMAX COAL SALES CORPORATION AND TWENTYMILE COAL COMPANY

Cyprus Amax Coal Sales Corporation ("Cyprus Amax") and its affiliate Twentymile Coal Company ("Twentymile") hereby file these reply comments with the Surface Transportation Board ("Board") to correct the record in the above-captioned matter. These reply comments are necessitated by erroneous and misleading claims made by Union Pacific Corporation and Southern Pacific Rail Corporation ("UP/SP") in the fifth quarterly progress report on the implementation of merger conditions in this proceeding, filed October 1, 1997 ("October 1 report").

The bulk of the October 1 report was given over to a discussion by the UP/SP of the service crisis that it is experiencing, and various steps being taken by the UP/SP to alleviate that crisis. At page 23 of the October 1 report, the UP/SP describes steps taken to reduce certain unit train movements as follows (emphasis added):

> UP/SP has made the difficult decision that it must reduce the number of unit train operations, particularly into the congested areas of Texas and Southern California, *and has negotiated with shippers the temporary service reductions described here.*
>
> UP/SP is removing four unit coal trains from service between Colorado and Mexico via Eagle Pass, freeing twelve locomotives and reducing traffic on congested lines in Texas. . . .

The four unit coal trains removed from Colorado to Mexico service are four of six trains currently serving the Twentymile Coal Mine owned by Twentymile. Cyprus and Twentymile are suffering severe adverse impacts from the UP/SP's unilateral decision to reduce service to one-third of that needed and contracted for.

In the attached Verified Statement by Richard J. Elston, Vice-President, Logistics of Cyprus Amax, Mr. Elston describes the agreement outstanding between Twentymile and the UP/SP for transportation of coal from Twentymile's Energy, Colorado, mine to an export point at Eagle Pass, Texas, under Rail Transportation Agreement SP-C-15205. The coal produced by Twentymile is then further transported in Mexico to the Carbon II generating plant owned by Comision Federal de Electricidad ("CFE"). In order to meet its obligations to CFE, Twentymile contracted for the UP/SP[1] to move up to seven train sets in order to transport the necessary volume of coal from Colorado to the Mexican border. In practice, the UP/SP has been providing transportation service with six train sets.

Contrary to UP/SP's unverified claim to the Board that it negotiated this reduction in service, it was a unilateral decision by UP/SP to remove four of the six train sets in service to Twentymile. Notice of the service reduction came to Cyprus Amax and Twentymile by letter dated September 26, 1997. As Mr. Elston makes clear, at no time did any representative of Cyprus Amax or Twentymile negotiate with or agree with the UP/SP over the reduction in train sets. UP/SP's unverified

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1 The rail transportation contract was entered into between Twentymile and the Denver and Rio Grande Western Railroad Company and the Southern Pacific Transportation Company, and is now performed by the UP/SP following the merger.

representations to the Board in this regard are erroneous and misleading. As Mr. Elston states, Cyprus Amax and Twentymile have strenuously objected to the arbitrary and severe reduction in the service by UP/SP.

The disruption in service to the Twentymile Coal Mine is placing Cyprus Amax and Twentymile in jeopardy of losing their status as a qualified supplier to CFE. Cyprus Amax and Twentymile plan in the near future to bring a petition to the Board for restoration of this critical service. This filing, therefore, is limited solely to correcting the unverified and inaccurate claims being made by UP/SP to the Board. Cyprus Amax and Twentymile plan to participate in future Board proceedings to protect their interests and to address the restoration of the service they have contracted for.

WHEREFORE, Cyprus and Twentymile request that the Board take notice of the fact that the UP/SP reduction in service to Cyprus and Twentymile was not negotiated and is not acceptable to Cyprus and Twentymile, and that the record in the above-captioned proceeding be corrected to reflect Cyprus' and Twentymile's strenuous objection to the unilateral service reductions imposed by UP/SP in violation of Rail Transportation Contract SP-C-15205.

Respectfully submitted,

By Ted P. Gerarden

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October 20, 1997

VERIFIED STATEMENT

OF

RICHARD J. ELSTON

VERIFIED STATEMENT OF
RICHARD J. ELSTON

My name is Richard J. Elston. I am over the age of 21 years. I am employed by Cyprus Amax Coal Sales Corporation ("Cyprus Amax") and serve in the capacity of Vice President-Logistics. I am responsible for acquiring and managing all transportation services for Cyprus Amax and its coal-producing affiliates.

I have been directly responsible for negotiating and managing the rail transportation services for the transporting of coal for Twentymile Coal Company, a Cyprus Amax affiliate, from Energy, Colorado, to Comision Federal de Electricidad for its Carbon II Plant near Piedras Negras, Mexico.

The transportation services are provided pursuant to that certain Rail Transportation Agreement SP-C-15205 dated May 31, 1996, by and between Southern Pacific Transportation Company and Twentymile Coal Company. The Transportation Agreement requires that seven sets of locomotives be provided for the haulage of 159,800 short tons of coal per month in 1997, but the parties have been utilizing only six sets of locomotives.

The Union Pacific Corporation et al have filed an Applicants' Third Quarter 1997 Progress Report, Finance Docket No. 32760 (Sub-No. 21), with the Surface Transportation Board. As part of the Progress Report the Applicants set forth a Service Recovery Plan, which contained Section A. Actions to Reduce Train Movements on UP/SP, and Subsection 5. Reduce Unit Train Movement. Subsection 5 on page 23 contains the following:

"UP/SP has made the difficult decision that it must reduce the number of unit train operations, particularly into the congested areas of Texas and Southern California, and has negotiated with shippers the temporary service reductions described here. (emphasis added)

UP/SP is removing four unit coal trains from service between Colorado and Mexico via Eagle Pass, freeing twelve locomotives and reducing traffic on congested lines in Texas . . ."

I have had discussions with UP/SP representatives concerning the status of the rail services in question, but at no time did I or any other Cyprus Amax representatives ever negotiate with or agree with UP/SP representatives concerning the reduction of locomotive sets from six to two. Cyprus Amax or Twentymile Coal Company was first advised of Union Pacific's unilateral decision to make such a reduction in locomotive sets by a letter dated September 26, 1997, from Mr. Henry Arms, Vice President-Energy. Cyprus Amax on behalf of Twentymile Coal Company has strenuously objected to Union Pacific's unilateral and arbitrary reduction of locomotive sets.

VERIFICATION

I, Richard J. Elston, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this verified statement.

Executed this 17th day of October, 1997.

Richard J. Elston

CERTIFICATE OF SERVICE

I certify that I have this day served copies of the "Reply Comments of Cyprus Amax Coal Sales Corporation and Twentymile Coal Company" upon all parties of record in this proceeding, by first class mail, postage pre-paid.

Dated: October 20, 1997

STB FD-32760 (SUB 21) ID-182038 9-18-97 D

182038

D

DONELAN, CLEARY, WOOD & MASER, P.C.

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September 18, 1997

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Surface Transportation Board
Case Control Unit
1925 K. Street, NW
Washington, DC 20423

Attn: STB Finance Docket No. 32760 (Sub. No. 21)

Dear Secretary Williams:

Enclosed is the original and twenty-five (25) copies of the Response in Support of Comments of Sierra Pacific Power Company and Idaho Power Company.

In addition, the Response has been submitted on a 3.5 inch diskette which is formatted for Word Perfect 7.0. Finally, an extra copy of the Response is enclosed for stamping and return to our office.

Please do not hesitate to contact the undersigned if you have any questions.

ENTERED
Office of the Secretary
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Sincerely,

Thomas W. Wilcox

Thomas W. Wilcox
Attorney for Sierra Pacific Power Company and Idaho Power Company

ENCLOSURES
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SPP-3

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 32760 (Sub-No. 21)

UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY AND MISSOURI PACIFIC RAILROAD COMPANY

--CONTROL AND MERGER--

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

RESPONSE IN SUPPORT OF COMMENTS OF SIERRA PACIFIC POWER COMPANY AND IDAHO POWER COMPANY

On September 8, 1997, Applicants UPC, UPRR, SPT, and SSW filed a pleading styled "Supplement to Reply Comments" in this proceeding (UP/SP-319), which asked the Board to "take notice" of a trade press article, but also asserted that the article "confirms" a statement made by Applicants in their Reply Comments in this proceeding that Sierra Pacific Power Company and Idaho Power Company's ("SPP/IDPC") North Valmy Station is receiving coal from the Savage, Utah transloading facility via Utah Railway-BNSF.

SPP/IDPC are indifferent as to whether the Board takes notice of the article attached to UP/SP-319, which merely reflects, albeit imperfectly, that SPP/IDPC followed through on representations made in their August 1 Comments.[1] However, SPP/IDPC feel constrained to point out that the article provides no support for the statements in either Applicants' Reply

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[1] See Verified Statement of Jeffery W. Hill at 4, which stated that SPP/IDPCO was "strongly considering moving some coal under the higher URC-BNSF rates with the hope that this traffic perhaps will help increase the level of competition to North Valmy to pre-merger levels."

Comments or the Supplement. Indeed, the article does not even mention the Savage coal terminal. In point of fact, the North Valmy Station has received no coal from the Savage coal terminal.

Applicants' statements and use of trade press articles in this manner provides further support to the suggestions of several parties in this oversight proceeding that appropriate sub-proceedings should be instituted to take evidence as necessary to examine and remedy the issues presented by individual commenters such as SPP/IDPC.

Respectfully submitted,

Thomas W. Wilcox

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Counsel for Sierra Pacific Power Company and Idaho Power Company

Dated: September 18, 1997

CERTIFICATE OF SERVICE

I hereby certify that I have on this 18th day of September, 1997, served a copy of the foregoing RESPONSE IN SUPPORT OF COMMENTS OF SIERRA PA IFIC POWER COMPANY AND IDAHO POWER COMPANY by first-class mail or by hand-delivery, upon all parties of record.

Aimee L. DePew

Aimee L. DePew

STB FD-32760 (SUB 21) ID-181778 9-8-97 D

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D

UP/SP-319

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760 (Sub-No. 21)

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

APPLICANTS' SUPPLEMENT TO REPLY COMMENTS

Applicants UPC, UPRR, SPR, SPT and SSW ask the Board to take notice of the attached document, which confirms, as Applicants' indicated at page 65 of their August 20 submission (UP/SP-311), that SPP's North Valmy Station is receiving unit train movements from the Savage transloading facility routed Utah Railway-BNSF.

Respectfully submitted,

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September 8, 1997

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Coal

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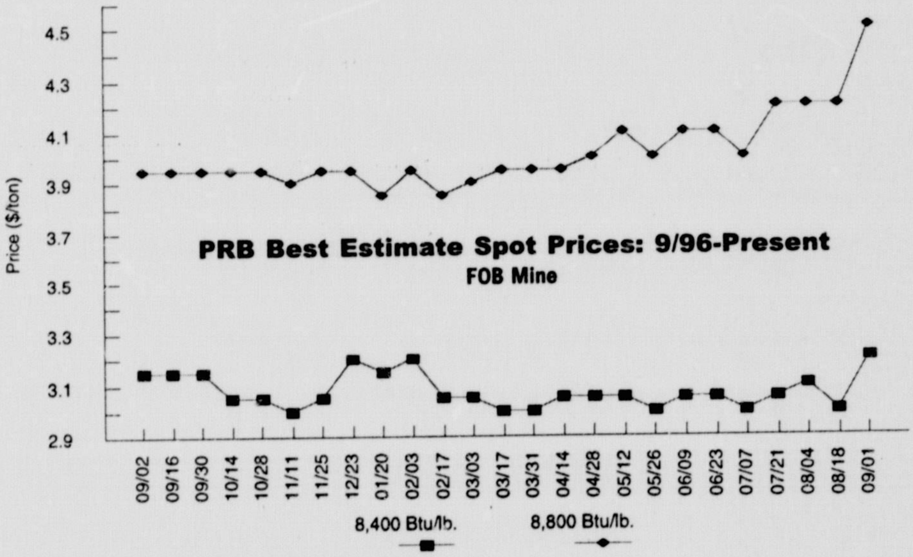
he added. "They've got those two things working against them."

"Demand is known and production is going up," agreed a power marketer. "There won't be much change." This source drew his conclusion after eyeing bids for '98 coal. "Producers are bidding like it's gonna be real flat," he said. Predicting that 8,800 Btu/lb. coal will stay near $3.90/ton and 8,450 Btu/lb. coal will sell in the $2.75-2.85/ton range, this source claimed the higher-Btu coal will do "nothing spectacular" next year while the lower-Btu product will stay "real loose."

But demand could increase for another reason, explained a second utility exec. Gas prices are sky-high, he said, which may push utilities to burn more coal. "There'll be an increase in utility consumption [of coal] if gas prices stay the same," the source said.



Market Briefs

Sierra Pacific, IP Take First BNSF Shipment

Though coal-buying took a back seat while **Sierra Pacific Power Co.** and **Idaho Power Co.** (IP) hammered out rail agreements for their jointly-owned North Valmy plant, the utilities were finally able to ink a few coal deals late last month. As this issue was going to press, the utility's first shipment of coal on the **Burlington Northern & Santa Fe Railway** (BNSF) had already been unloaded.

The utilities purchased 340,000 tons off their May solicitation for coal out of Utah's Uinta Basin (**CMB** 7/28/97, p.2; 6/30/97, p.2; 6/2/97, p.3). The coal will be sourced from four different mines, with the tonnage divided "pretty evenly" among **Commonwealth Coal Co.**'s Horizon mine, the **Co-op Mining Co.** mine and **Andalex Resources'** Genwal and Tower Complex mines, said a utility exec. The contracts also include options to purchase up to 450,000 tons.

Asked to comment on pricing, one official said bids were in-line with **CMB**'s best estimate spot price of $17.00/ton for coal out of Utah's Uinta Basin.

Coal from Genwal, the Tower Complex and Horizon will be shipped on BNSF, while coal from the Co-op mine will be shipped on **Union Pacific Railroad** (UP). Delivery of the Genwal and Tower Complex coals began last week, while deliveries of the other coals will be phased in in October.

The Humbolt County, Nev.- plant continues to take the minimum volume — 60,000 tons/month — on its long-term contract with **Canyon Fuels**' SUFCO mine via UP. That contract runs through June 2003.

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that, on this 8th day of September, 1997, I caused a copy of the foregoing document to be served by first-class mail, postage prepaid, or by a more expeditious manner of delivery on all parties of record in Finance Docket No. 32760 (Sub-No. 21), and on

Director of Operations Antitrust Division Suite 500 Department of Justice Washington, D.C. 20530	Premerg r Notification Office Bureau of Competition Room 303 Federal Trade Commission Washington, D.C. 20580

Michael L. Rosenthal

STB FD-32760 (SUB 21) ID-181692 9-3-97 D

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760
(Sub-No. 21)

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

RAILCO, INC.'S RESPONSE TO UNION PACIFIC'S REPLY TO COMMENTS

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Attorneys for Railco, Inc.

UP's "Applicant's Reply to Comments", pages 54-57, addresses Railco's comments in this oversight proceeding. UP misconstrues the purpose of this proceeding, which is not to determine whether to impose a condition in the first instance, but to review conditions the Board has already imposed, and to determine if those conditions adequately address the concerns for which they were intended, or if they need to be fine-tuned. The question is not whether the Utah Railway agreement was generally pro-competitive in intent. It is whether the specific provision in question (granting Savage Industries a new, exclusive monopoly over business for which Railco had competed before the agreement) has been shown by experience to be pro-competitive in effect.

Railco's comments did not "simply repeat the position the Board previously considered and rejected." An examination of the record shows Railco's comments address a number of proven anticompetitive effects the Board did not previously consider, not just on Railco alone, but also on Utah Railway and BNSF, producers and buyers of Utah coal, and the Utah coal market in general. Railco's comments are clearly timely.

Just as clearly, the merger condition relating to the Savage loadout has been shown by experience to be ineffective in addressing the anticompetitive concerns for which it was imposed. The condition has not assisted either Utah Railway or BNSF in competing for shipping rights to Utah coal. UP's reply does not dispute Railco's facts, and does not deny that the condition's actual impact in breaking UP's stranglehold over the Utah coal shipping market has been negligible.

UP mischaracterizes Railco's comments, by simplistically arguing Railco contends "adding competition at Savage decreases competition." While the general purpose of the Utah Railway agreement may have been to foster competition between UP and Utah Railway, the method chosen, giving Savage a monopoly over loading rights to Utah Railway shipments, had the actual effect to reduce competition between Railco and Savage, with the ultimate effect of UP taking from Utah Railway on one hand what UP was claiming to give with the other.

The past year's experience indicates that what the condition does is merely create an illusion of competition while in substance destroying competition that had previously existed. The condition has not been shown, either by experience or expectations, to actually benefit producers, consumers and competition as UP argues. There is no evidence that Savage's newly granted monopoly over part of the Utah coal transloading business has stimulated competition. The fact there has been no competition to speak of is evidence competition has not been stimulated, and that UP's claim to new competition is at best wishful thinking on its part, and is at worst a prevarication.

UP's statement that "Railco is fully capable of competing for the loading of coal from Utah mines" is another fiction. The statement is true only if UP has the shipping contract. If Utah Railway (or BNSF) should actually succeed in obtaining a shipping contract for central Utah coal, Railco is no longer able to compete for the loading of that coal as it could have previously. UP's statement it "has every interest in encouraging area producers to truck their coal to Railco ..." amounts to an admission UP intends, not to compete, but to do everything in its power to continue its monopoly and exclude BNSF and Utah Railway from the market. That is hardly the fostering of competition. UP's position is myopic, even ironic, in light of the fact UP's own long term interest is best served by stimulating rather than strangling competition between Railco and Savage, which would lower overall loading rates for Utah coal, ultimately resulting in two stronger, healthier transloading facilities, greater competition between Utah coal and other coal markets, and a larger Utah coal shipping pie for UP to share in.

UP still has given no good faith, rational reason to keep Railco and Savage from competing for Utah Railway's loading business. One might ask why UP is so adamant in ending competition which previously existed between two transloading facilities, virtually sitting in each other's laps on the same short spur, which do not themselves compete with UP. The obvious and inevitable effect, if not the actual purpose, of UP's efforts to block competition between Railco and Savage is to cripple Utah Railway's supposed newly granted right to compete with UP, and to give the appearance of competition while denying the substance. The Board's responsibility is to safeguard against such anticompetitive effects of the merger. Railco respectfully submits the Board can best discharge that responsibility by restoring the competition that existed between Railco and Savage before the merger.

DATED this 27 day of August, 1997.

Mark Hansen
Attorney for Railco, Inc.

2341p.011

CERTIFICATE OF SERVICE

I certify on August 27, 1997 an original plus 26 copies of the above RAILCO, INC.'S RESPONSE TO UNION PACIFIC'S REPLY TO COMMENTS, together with a 3.5-inch diskette containing files of the same document formatted for WordPerfect 7.0 and ASCII, was served by certified mail, postage prepaid, to :

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ATTN: STB Finance Docket No. 32760 (Sub-No. 21)
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

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UP/SP-311

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760 (Sub-No. 21)

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

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August 20, 1997

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BEFORE THE
SURFACE TRANSPORTATION BOARD

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

APPLICANTS' REPLY TO COMMENTS

Applicants UPC, UPRR, SPR, SPT and SSW[1/] submit this reply to the comments filed on or about August 1 in this proceeding, as well as USDA's comments, filed August 15.

INTRODUCTION AND SUMMARY

The comments offer no reason for the Board to alter its conclusions that the merger, as conditioned, is pro-competitive, and that no additional competitive conditions, beyond those imposed in the merger approval decision and subsequent clarifying decisions, are warranted. While it remains early, it is not, as some commentators suggest, too early to arrive at the firm conclusion that merger implementation is going well and the conditions are working as intended.

1/ Acronyms used herein are the same as those in Appendix B of Decision No. 44. On January 1, 1997, Applicant MPRR merged into Applicant UPRR. On June 30, 1997, Applicants DRGW and SPCSL also merged into Applicant UPRR.

Applicants' showing, in their July 1 report, that competition is stronger and the competitive conditions are effective is not impeached by any of the comments. No commentator even addresses key parts of that showing. For example, no commentator denies the multiple dimensions of stronger competition that are resulting from the merger, as outlined in Applicants' July 1 report, including new single-line service, shorter routes, improved equipment supply, lower costs, and reduced switch fees.[2/] UP/SP-303, pp. 65-77, & related Confidential Appendices.[3/] No commentator questions

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[2/] The NIT League reports that in response to a survey, some shippers indicated that UP/SP had not kept its commitment to reduce switch fees. NITL-2, Survey, p. 6, Question G.1. In fact, the question asked in the NIT League's survey was misleading. Applicants' commitment -- which UP/SP strictly abided by -- was to reduce to \$150/car (\$130/car in the case of BNSF) all SP switch fees that were above that level, as well as to set switch fees charged to BNSF at "2-to-1" points at \$130/car. The NIT League question incorrectly stated that all switch fees of both UP and SP were to be reduced.

[3/] Intermountain Power Agency ("IPA") does argue that it has not benefitted competitively, but IPA's complaint is not well taken. The merger did not reduce competition for rail transportation to IPA's UP-exclusive plant. See, e.g., Decision No. 44, served Aug. 12, 1996, pp. 187-88, 191, 192. IPA concedes as much: it acknowledges (IPA-3, p. 5) that its "concerns are not directly related to the competitive questions at issue in this proceeding." In 1984, IPA entered into long-term rail contracts with DRGW and UP for the interline movement of coal to the Lynndyl plant that do not expire until well after the year 2000. There is no basis for IPA's complaint (IPA-3, p. 4) that UP/SP has not renegotiated these contracts. UP/SP cannot be faulted for standing by the agreed terms of a contract. But at the same time, even before its contracts expire, IPA will benefit from dealing with a single railroad on a single-line movement, in lieu of the pre-merger SP-UP joint-line movement. For example, before the (continued...)

the clear proof of BNSF's success, as seen in hundreds of concrete examples, in mounting competitive operations, capturing substantial business, and causing UP/SP to reduce rates and improve service compared to the pre-merger levels established by competition between UP and SP. UP/SP-303, pp. 78-107, & related Confidential Appendices. And no commentator takes issue with Applicants' showing of the clear absence of any competitive harm to the categories of traffic, such as "3-to-2" traffic, as to which the Board concluded that conditions were not warranted. UP/SP-303, pp. 113-21, & related Confidential Appendices. No one suggests the Board was wrong to approve the merger, or that the conditions the Board imposed are not fundamentally sound.

Instead, the comments for the most part deal with whether adjustments should be made to the conditions at the margin, and with how to structure the oversight process itself. We show in Part I of this reply that the specific issues raised in the comments as to the scope of the conditions either are being addressed by the parties without a need for Board intervention, or do not merit any adjustment to

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[3] (...continued)
merger, SP and UP had consistent difficulty in resolving which railroad would provide the power for trains moving to and from Lynndyl. Uncertainties over locomotive power caused delays in cycle time and the pick-up of empty cars at IPA's car repair shop in Springville, and led to disruptions in coal loading schedules. The merger will allow centralized management of locomotive power on both UP and SP lines.

the conditions that have been imposed. As regards the oversight process, we suggest that the present process has provided a sound model for continuing oversight. Applicants and BNSF should be required, on a quarterly basis, to update the various charts and aggregate data that they submitted in their July 1 reports and to advise the Board and the parties of any significant developments and material disputes. Reports thoroughly reviewing merger and condition implementation, such as were submitted on July 1, should be required annually. The Board should resolve the requests for relief that are now pending before it -- and of course, parties can always seek additional relief at any time, subject to the Board's normal rules and the rulings in the merger case -- but no cause has been shown for any further proceedings at this time.

Part II of this reply addresses in more depth the operating problems that currently face the merged system, which are the focus of many of the comments. Applicants acknowledged these problems in their July 1 report, and outlined steps that are being taken to deal with them pending the only <u>complete</u> solution -- which is full implementation of the merger. Part II provides much more detail about the steps that are being taken to achieve immediate improvements in service while the longer-term process of implementing the merger goes forward.

Finally, in Part III, Applicants respond to the comments of the UTU regarding their compliance with the New York Dock conditions and their agreements with rail labor.

I. COMPETITION ISSUES

In this Part, we reply to the portions of the comments that address competition issues. First, we reply to the few comments that address BNSF's effectiveness as a competitor utilizing the rights it received as conditions to the merger. Second, we reply to the assorted arguments that are advanced in the comments in favor of expansions in the scope of BNSF's rights. Third, we reply to three other miscellaneous arguments about conditions: Railco's renewal of its request that Utah Railway's rights be broadened; Sierra Pacific Power/Idaho Power's renewal of their request for trackage rights, for a railroad of their choice, from their power plant at Valmy, Nevada, to all SP-served coal mines in Colorado and Utah; and Tex Mex's renewal of its argument for broader access to shippers in Houston. Finally, we reply to the suggestions of various commentators as to the oversight process itself, as regards competition.

A. BNSF's Effectiveness

The central issue in this oversight proceeding is BNSF's effectiveness as a competitor using the trackage rights and other rights it received as conditions to the merger. The record on that issue is clear. Not one of the 28 parties that submitted comments took any issue with the detailed showings in the July 1 reports of both the Applicants and BNSF as to BNSF's vigorous and effective competition.

- Both the Applicants and BNSF presented extensive data about the growth in BNSF traffic volumes. Those volumes continued to grow in June and July: BNSF operated 468 through trackage rights trains in July, carrying over 21,500 cars and nearly 1.6 million gross tons of freight, as compared to 392 trains, 17,800 cars and 1.4 million gross tons in May.[4/] In August BNSF announced further major increases in Central Corridor service, as discussed below.

- Applicants also presented literally hundreds of examples of significant traffic movements that had been captured by BNSF using its new rights, or as to which UP/SP had improved rates or service in response to strong competition from BNSF. Those examples provide the clearest possible proof of BNSF's competitiveness -- they render academic all the debates during the merger case about BNSF's ability to mount effective service over the trackage rights

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[4/] Applicants stand by their BNSF volume data, which are somewhat higher than the data submitted by BNSF. The principal causes of the differences appear to be BNSF's inadvertent omission of grain trains and of one of its regular symbol trains in the Houston-New Orleans corridor. There also appear to have been smaller differences in the way that trains and cars were counted. In addition, BNSF's June figures in its July 1 report were cut off well prior to the end of the month. But whether Applicants' or BNSF's data are used, it is indisputable that BNSF's service has reached the levels necessary to be fully competitive.

routes and to compete effectively under the rental and other terms established in the settlement agreement. No commentator addressed those examples at all.

The few specific arguments about BNSF's effectiveness in the comments are readily refuted:

1. KCS' "Market Share" Test

One commentator and only one -- KCS -- argues that the test of BNSF's effectiveness should be whether it is handling the same volumes of traffic in the major corridors where it received trackage rights that SP handled prior to the merger. KCS-2, p. 11. KCS then builds on this false premise a proposal that if BNSF does not reach this level of traffic in three years, line divestitures should be compelled. Id., pp. 11-13.

KCS' premise is obviously wrong. As Applicants' demonstrated during the merger case, a large part of the traffic that SP handled on the lines where BNSF received trackage rights was not "2-to-1" traffic. See, e.g., UP/SP-230, pp. 234, 246. That traffic fell in the "1-to-1" category, the "3-to-2" category, or other non-"2-to-1" categories. The BNSF rights were never intended to give BNSF access to SP's "1-to-1" or "3-to-2" traffic, and the Board specifically rejected arguments by KCS and others that the merger would adversely affect such traffic.

KCS' "market share" test is also wrong because the purpose of the BNSF conditions -- like any competitive condition -- is to provide the recipient a fair opportunity to compete, not a guaranteed outcome. The latter smacks of market division rather than competition. As Applicants said in their July 1 report, they will fight for every competitive carload with BNSF -- and the Board would surely not want it any other way. If UP/SP gains traffic by offering better rates and service under the goad of BNSF competition, shippers benefit just as surely as if BNSF gains the traffic.

At base, KCS' "market share" standard is nothing but an effort to reargue, by indirection, the divestiture issue that it argued and lost in the merger case. Applicants showed, and the Board agreed, that divestiture was unjustified, and would have devastating effects on the benefits of the merger. UP/SP-230, pp. 230-55; Decision No. 44, pp. 157-64. KCS does not even try to offer any new reasons for a different outcome now, and its "market share" test should be rejected.[5/]

[5/] KCS also asserts, in support of its continued pursuit of divestiture, that because BNSF has elected to work with Illinois Central at Memphis rather than use its trackage rights between Memphis and St. Louis, "2-to-1" shippers on the Memphis-St. Louis segment have been deprived of competition. KCS-2, pp. 13-14. This is incorrect. The only "2-to-1" shippers on this segment are a handful at Paragould, Arkansas, and Dexter, Missouri. The "2-to-1" shippers at those points are open to BNSF via haulage to and from Pine Bluff, and BNSF has in fact moved traffic to and from Paragould via haulage.

2. Central Corridor Volumes

A few commentators suggest that BNSF volumes in the Central Corridor may not be high enough for effective competition. See CPUC Comments, pp. 3-5; NITL-2, pp. 3-4; SPP-2, pp. 7-8. Even the data that were available at the time of the July 1 reports were to the contrary. As of May, BNSF was operating near-daily train service in each direction between Denver and Salt Lake City, and 3-day-a-week service in each direction between Salt Lake City and Northern California. There were already scores of concrete examples of BNSF's effectiveness in competing for Central Corridor business, including Utah grain, metals, petroleum products and intermodal traffic, Nevada barites, Northern California food products, and much more. UP/SP-304, Conf. App. B.

But any possible issue in this regard was eliminated when, effective July 14, BNSF instituted seven-day-a-week service across the entire Central Corridor. This step coincided with BNSF's purchase of the Bieber-Keddie line and commencement of new service in the I-5 Corridor, which provides additional traffic flows for BNSF's Central Corridor rights as well.[6] It also coincided with BNSF's cut-over to a single computer system to replace the separate BN and Santa Fe

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[6] In a July 28 press release, BNSF said that I-5 volumes were exceeding its expectations.

systems, which will greatly facilitate BNSF's use of its UP/SP rights.

BNSF's Central Corridor trackage rights volumes almost doubled from 176,777 gross tons on 76 through trains in May to 320,849 gross tons on 126 through trains in July. In addition to its regular daily train service, BNSF is operating unit trains of coal, wheat and steel over its Central Corridor rights.

In the two weeks following the July 14 changes (July 15 to July 28), BNSF's new daily service resulted in 28 Central Corridor through freight trains west of Salt Lake City -- where BNSF volumes had initially been lightest -- averaging well over 4,000 gross tons per train. This compares to a total of 28 trains, averaging only 2,000 gross tons per train, in the entire month of May. BNSF's daily trains west of Salt Lake City are now averaging some 50 cars per train, which is a substantial train size in Western mountain territory.

BNSF continues to build Central Corridor volumes, handling, for example, unit trains of steel coils between Indiana and Northern California; food products shipments from Iowa to Central California; and metals, paper products and plastics between the Midwest and the San Francisco Bay Area. BNSF has also begun to move unit trains of coal from Wild Cat, Utah, to Chicago in interline service with Utah Railway, with interchange at Grand Junction, Colorado. <u>See</u> <u>Coal Outlook</u>, Aug. 11, 1997, p. 6. BNSF also has advised that it will shortly begin unit train coal movements in interline service with Utah Railway from the transloading facility at Savage, Utah, to the Sierra Pacific Power/Idaho Power North Valmy plant in Nevada, using the Central Corridor trackage rights.

Furthermore, BNSF formally notified UP/SP on August 15 that it will increase its Central Corridor trackage rights volumes by one additional train daily in each direction west of Salt Lake City, effective September 1, and it has already instituted two additional trains per week operating between Klamath Falls, Oregon, and Provo, Utah, entering the Central Corridor trackage rights at Keddie, California. And BNSF plans another step forward on September 9, when it will begin to use its own crews between Denver and Salt Lake City.

Thus, less than a year following the Board's decision approving the merger and imposing BNSF's rights, BNSF has mounted a very substantial Central Corridor operation which is fully competitive with UP/SP.[7]

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[7] CPUC also says that "BNSF appears to have made little use of its right to run intermodal trains in the Central Corridor." Comments, p. 5. In fact, BNSF quickly established intermodal service at Salt Lake City, and now handles substantial Salt Lake City intermodal volumes on a daily basis. Applicants never projected that BNSF would use its Central Corridor rights to operate any appreciable volume of intermodal traffic between points east of Denver and the Bay Area. Such transcontinental intermodal traffic is well suited to BNSF's own Chicago-California mainline. But the flexibility that BNSF gained from the Central Corridor trackage rights to route certain bulk and carload traffic over

(continued...)

3. USDA

USDA suggests that BNSF has not used its trackage rights to compete vigorously for grain traffic. Comments, p. 4. In fact, as Applicants' July 1 report laid out in detail, BNSF has been extremely effective in using the rights to compete for grain movements. BNSF has used its trackage rights to handle large volumes of grain to Mexico, California, Utah, Gulf ports, and Arkansas feeders. BNSF's vigorous competition has also caused UP/SP to reduce rates and improve service and equipment supply in these markets. UP/SP systemwide grain rates are down since the merger.[8] See UP/SP-303, p. 121; UP/SP-304, Conf. Apps. B, C, E. The competitive benefits of the merger and the competitive conditions for grain shippers were specifically attested to in

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[7] (...continued)
UP/SP's lines is enhancing its ability to provide reliable, high-speed Midwest-California intermodal service over its own lines. In its July 14 press release announcing its new daily service on the Central Corridor, BNSF said that "some merchandise flows will be rerouted to ease congestion and open slots for other traffic on the South Corridor."

[8] Ignoring the significant grain rate decreases that have been brought about by competition between BNSF, using its trackage rights, and UP/SP, USDA suggests that an increase in certain UP/SP and BNSF tariff rates effective September 1 may indicate collusion between the two railroads. Comments, p. 4. There is absolutely no collusion between these competitors in setting grain rates or otherwise. The tariffs to which USDA refers provided for temporary rate decreases, a common phenomenon in the grain transportation marketplace, in which demand for transportation varies on a cyclical basis. The fact that UP/SP matched BNSF's rate reductions in order to remain competitive does not suggest any collusion, and there was none.

the verified statements of Albert City Elevator, West Bend Elevator Company, and Zacky Farms submitted with Applicants July 1 report, and no grain shipper has submitted any contrary evidence. USDA disregards all these facts, and instead relies on vague hearsay reports of an "apparent lack of vigorous competition" between UP/SP and BNSF. Comments, p. 4. Such reports are simply not correct.

USDA also states that Tex Mex received only haulage rights as a merger condition, and suggests that trackage rights may be needed to preserve effective competition for export grain. Comments, pp. 5-6. In fact, Tex Mex received trackage rights, not haulage rights, and it has used those rights to increase its volumes of grain and other traffic moving via Laredo. UP/SP-303, pp. 108-12.

As clearly shown in Applicants' July 1 report -- and the original merger record (UP/SP-23, Peterson, pp. 113-15; UP/SP-231, Peterson, pp. 227-33) -- the UP/SP merger increased, rather than decreased, competition for grain traffic, and USDA offers no evidence to the contrary. The Board found USDA's competitive concerns "misplaced" in its decision approving the merger (Decision No. 44, p. 131), and USDA presents nothing new to alter that conclusion.

USDA also offers generalized complaints about the car ordering and multi-car loading policies of all Class I railroads, and asks that the Board "exercise its powers to require Class I railroads improve the level of service to [smaller agricultural] shippers and to the short line railroads to which they connect." Comments, p. 12. Whatever the merits of these complaints -- and they have been very extensively debated for years -- they plainly do not relate to any effect of the UP/SP merger, as USDA concedes, and thus they should not be addressed in this proceeding.

4. International Paper

International Paper ("IP") argues that BNSF has been an ineffective competitor for its "2-to-1" business.[9] While acknowledging that it has awarded substantial "2-to-1" traffic to BNSF, IP complains particularly about BNSF's alleged failure to supply as much equipment as IP desired. IP-19, pp. 7-8.

Applicants are not privy to the details of BNSF's car supply to this shipper. Nonetheless, Applicants would respectfully suggest that the arguments of this implacable opponent of the merger should be viewed skeptically.

First, it is very clear that BNSF is competing effectively for "2-to-1" business in the Houston-Memphis corridor, including large volumes of paper products originated by a major competitor to IP located on the Little Rock &

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[9] A number of the comments contain praise for BNSF's competitiveness -- for example, the shipper questionnaires attached to CMTA's filing. The arguments of the one other "2-to-1" shipper to question BNSF's competitiveness, Sierra Pacific Power/Idaho Power, are addressed below.

Western Railroad, large volumes of chemicals originating at Longview, Texas, and large volumes of grain bound to Pine Blu: ', among a variety of other traffic movements. See UP/SP-304, Conf. App. B.

Second, BNSF handles large volumes of paper and allied products nationwide (some 150,000 carloads per year, according to AAR data), and has a large fleet of boxcars suitable for this traffic, as well as access to foreign cars, Railbox cars, customer-owned cars and leased cars suitable for paper loading.

Third, BNSF is a strong competitor against UP/SP for paper products at many locations, capturing, for example, an equal or greater than equal share of the business at many paper mills where the two railroads compete, including the Inland mills at Evadale and Mulford, Texas, the Longview Fibre mill at Longview, Washington, the Potlatch mill at Lewiston, Idaho, and the Gaylord Container mill at Antioch, California. In addition, BNSF works successfully with IP to handle business to and from other IP facilities, such as traffic from IP's Texarkana and Mansfield, Louisiana, mills to destinations in California.

Whatever start-up problems BNSF may have had in serving IP's "2-to-1" facilities (and it is notable that the focus of IP's complaints is on the early period of trackage rights operations), Applicants have no doubt that BNSF, with its incentives to move IP's Arkansas traffic not only to Memphis but to Birmingham, Alabama, and other points on the BNSF system throughout the West, will be an equally formidable competitor for IP's business at the Pine Bluff and Camden mills.

B. The Scope of the BNSF Conditions

The main thrust of the comments, insofar as they address competitive issues, is to advance a variety of proposals to expand the BNSF conditions. Applicants address each of those proposals individually below, and show that none of them are justified. At the outset, Applicants wish to stress the importance of settling, to the extent reasonably possible, the scope of BNSF's conditions, so that all concerned can direct their energies to the full and efficient development and utilization of those rights within their defined parameters, rather than continually rearguing what the scope of the rights should be. Many of the proposals discussed below seek to relitigate matters fully litigated in the merger case; others seek to expand BNSF's rights in ways that are clearly unjustified under the principles of preserving competition that lay at the heart of the Board's decision approving the merger. Applicants submit that the Board should find that BNSF is successfully providing strong competition under its existing rights; that no case has been made for any fundamental change in the scope of those rights;

and that the parties' energies should now be directed toward the full exercise of the rights that BNSF has received, rather than seeking to change them.

1. Contract Reopener Condition

In its July 1 and August 1 submissions, BNSF argues that the Board should eliminate Guideline No. 9 to the contract modification condition, which allows Applicants the option to release the entire volume under contract if a "2-to-1" shipper elects to take advantage of the Board's contract modification condition. BNSF-PR-4, p. 14, & Rickershauser, pp. 20-23; BNSF-1, p. 14; see Decision No. 57, served Nov. 20, 1996, p. 12. Several commentators support this request. See CMA-2/SPI-3, pp. 6-10; FINA-1, pp. 3, 10; TM-2, pp. 6-7; NITL-2, pp. 3-4.[10]

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[10] Although the NIT League states that "some respondents" to its survey indicated that Guideline No. 9 "has been an impediment to utilization of the contract reopener condition" (NITL-2, p. 3), the survey question to which NIT League refers asks only whether the "ten guidelines adopted by the STB for implementation of the contract modification condition facilitated the process of seeking and/or obtaining modification" of "2-to-1" contracts, and the NIT League reproduces only a single remark that expresses dissatisfaction with Guideline No. 9. NITL-2, Survey, p. 5, Question D.3. The NIT League says that 25 respondents opined that the ten guidelines were not helpful; yet only 22 of the 56 shippers answering the questionnaire were even "2-to-1" shippers. Id., p. 4, Question C.1.

The NIT League also asserts (NITL-2, p. 5) that Applicants did not provide "2-to-1" shippers with sufficient notice of their right to obtain a modification of their existing contracts. This is flatly wrong, and is disproven by the survey on which the NIT League bases its assertion. The (continued...)

Neither BNSF nor any other party offers any evidence that Guideline No. 9 has had any appreciable effect on BNSF traffic volumes. As noted in our July 1 report, only a tiny handful of shippers have even inquired whether contracts would be terminated pursuant to Guideline No. 9 if business was diverted to BNSF. UP/SP-303, p. 86.

Guideline No. 9 was thoroughly briefed and considered, and no party offers a sound basis for reconsidering it. The only new argument -- CMA/SPI's suggestion that the Board lacks statutory authority to override shippers' contract rights (CMA-2/SPI-3, pp. 9-10) -- is clearly without merit. The contract modification condition gives a shipper an <u>option</u> -- one with particular terms and conditions associated with it -- to divert contractually-

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[10] (...continued)
NIT League bases its claim on the fact that, when its Rail Transportation Committee members were asked whether Applicants had provided notice that they had a right to obtain a contract modification, 22 answered "yes" and 34 answered "no." NITL-2, Survey, p. 5, Question D.1. In concluding that this answer demonstrates a "surprising lack of notice," the NIT League ignores the fact that only 22 of survey respondents were "2-to-1" shippers in the first place. What the NIT League's survey really demonstrates is that Applicants fully complied with the Board's directive (Decision No. 57, served Nov. 20, 1996, p. 13) that they inform "2-to-1" shippers of their contract modification rights. In fact, Applicants sent "2-to-1" shippers three separate letters describing their contract modification rights. <u>See</u> UP/SP-280, Shattuck V.S., pp. 1-2 (two letters sent to each shipper, the first on September 6, the second on September 19); UP/SP-290, pp. 4-5 (all affected customers provided with copy of Decision No. 57 and guidelines for asking UP/SP whether a contract would be terminated in letter of November 25).

committed traffic to BNSF. But the shipper is always free to enforce in its entirety the original contract. Thus, no infringement of shipper contract rights is involved.

Not surprisingly, BNSF does not even mention the principle that led the Board to adopt Guideline No. 9 -- the gross unfai: ess to UP/SP of holding it to expensive contractual rate and service commitments if it is deprived of the traffic volumes that economically justified those commitments. As the Board explained:

> "This contract termination option is, we think, essential to the protection of UP/SP's own interests, given the way we have structured the contract modification condition. . . . UP/SP could easily be left with a fractured loss-generating half-contract that neither UP nor SP would ever have negotiated."

Decision No. 57, p. 12. This holding is clearly correct, and neither BNSF nor any of its supporters has offered any reason for changing it.

BNSF and its supporters also ignore the main reason why more use has not been made of the contract modification condition: the vast majority of "2-to-1" contracts in existence at the time of the merger have already expired or will expire in just a few short months. As Applicants' witnesses Peterson and Gray explained, of all the "2-to-1" contracts in place at the time of the merger involving volumes of more than 100 cars/year, fully <u>94%</u> will have expired by the end of this year. UP/SP-231, Peterson, p. 194; UP/SP-231, Gray, p. 43. It is not surprising that shippers would choose not to renegotiate contracts that were about to expire -- particularly contracts they had negotiated under the competitive conditions that existed before the merger. As these contracts have come up for renewal, BNSF has been able to bid on 100% of the business, and, as Applicants have demonstrated, shippers have enjoyed the benefits of this competition. See UP/SP-304, Conf. Apps. B, C.

The Board recognized that the contract reopener condition provided shippers with a windfall. Decision No. 57, p. 6. The Board nonetheless expanded the condition to be certain that BNSF could successfully mount immediate competitive operations over its trackage rights lines. Decision No. 44, p. 146. There can be no question that BNSF has done so. All the evidence in this proceeding -- including BNSF's own evidence -- demonstrates that BNSF is providing fully competitive service over its trackage rights lines.11/ BNSF says that the contract modification condition "has

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11/ Moreover, BNSF's request that Guideline No. 9 be altered so that it can secure more traffic can only be viewed with a great deal of suspicion. In Decision No. 57, at p. 6, the Board questioned how BNSF, given its representations at the July 1996 merger-case oral argument that "traffic densities were sufficient to permit the building of trains to provide quality service," could then, after the Board further expanded the contract modification condition, "suggest that it needs to open up even more contract volumes to compete effectively." It is now clear from all of the evidence that BNSF has access to more than enough traffic to mount fully competitive operations.

generated little additional traffic for BNSF," BNSF-PR-4, p. 11, but makes no attempt to show that access to such incremental contractual business as it might gain if Guideline No. 9 were rescinded would be of even marginal significance to BNSF's competitiveness. In fact, CMA and SPI explicitly argue that the impact would be minimal. CMA-2/SPI-3, p. 9.

BNSF also argued in its July 1 report that the contract reopener condition should be extended to shippers in the Lake Charles area to which BNSF gained access as a condition of the merger. BNSF-PR-4, Rickershauser, p. 24; see also CMA-2/SPI-3, pp. 12-13; KCS-2, p. 6. Applicants have responded to this argument in their reply (UP/SP-308) to the separate petition of Montell (MONT-13). Briefly, it is clear that the contract reopener condition does not, and should not, apply to these shippers. They are not "2-to-1" shippers, and there has been no showing that BNSF needs immediate access to their contractually-committed traffic in order to mount effective competition. To the contrary, BNSF is operating multiple daily trains across southern Louisiana, and is clearly a highly effective competitor in this area, as in the Houston-Memphis corridor and the other corridors where it has trackage rights.[12/]

12/ For the same reason, the Board should reject DOT's passing suggestion that shippers at "2-to-1" points that were served prior to the merger by only one of the merging railroads should be opened to BNSF. DOT-1, p. 6. DOT (continued...)

2. <u>Definitive List of "2-to-1" Shippers</u>

BNSF complains that the parties have not arrived at a definitive list of 100% of the "2-to-1" shipper facilities that it is entitled to serve. BNSF suggests, as a remedy for this supposed problem, establishing a presumption, which UP/SP would have the burden of affirmatively disproving, that any shipper at a "2-to-1" point was served by both UP and SP before the merger, and thus is open to BNSF. BNSF-PR-4, p. 7, & Rickershauser, pp. 9-11; BNSF-1, pp. 11-13, 20.[13] Other commentators, accepting at face value BNSF's claims that this is a significant problem and has impeded BNSF's ability to compete for "2-to-1" business, support BNSF's arguments. E.g., CMA-2/SPI-3, p. 13; FINA-1, pp. 7, 11.

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[12] (...continued)
conducts no analysis of the adequacy of BNSF's present traffic volumes to support fully competitive service, but simply offers the unsupported suggestion that BNSF's lack of access to non-"2-to-1" shippers "may undermine BNSF's ability to develop the traffic base necessary to be an effective competitor." Id. (emphasis added). The actual facts, contained in the July 1 reports of Applicants and BNSF and updated here, show that BNSF has already developed that traffic base. Exclusively-served shippers at "2-to-1" points did not lose rail competition (except indirect competition in such forms as transloading, which is separately preserved through other merger conditions), and DOT presents no justification for adding to their competitive options.

[13] BNSF also complained in its July 1 report that it had not received from Applicants a list it had requested of all transloading facilities at "2-to-1" points. BNSF-PR-4, Rickershauser, pp. 11-12. Applicants supplied this list on July 10, though BNSF did not mention the fact in its August 1 filing. The process of compiling the list was costly and labor-intensive, and Applicants furnished it as soon as it could be completed.

In fact, this supposed issue is a "red herring." Most of the shipper facilities at "2-to-1" points are not "2-to-1" -- they did not have service from both UP and SP prior to the merger. UP/SP-231, Peterson, p. 37. As Applicants' witness Peterson testified at length at his deposition (e.g., Dep., Feb. 5, 1996, pp. 73-76, 78-80, & Feb. 6, 1996, pp. 215-17), beginning as soon as the merger was first agreed upon, staff of the Applicants, under Mr. Peterson's direction, spent extraordinary amounts of time and effort to identify all "2-to-1" shipper facilities. This involved the review of such sources as switching tariffs and joint facility agreements. It was complicated by the fact that both UP and SP had all but completely eliminated field offices and agents, so that primary reliance had to be placed on documentary sources.

After the merger was approved, an initial listing of "2-to-1" shipper facilities was provided to BNSF. There has been an ongoing process of minor refinements to this list. In a very few instances, BNSF has presented requests to clarify whether a particular facility, not on the list, was in fact "2-to-1" so that BNSF could handle a specific traffic movement. In those instances, UP/SP has responded with alacrity. There have been virtually no unresolvable disputes about these matters, once the facts were laid out.[14] It is

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[14] For example, on July 18, BNSF inquired as to the "2-to-1" status of two facilities in Nevada, indicating that a customer (continued...)

absolutely not true that BNSF's ability to compete for actual traffic movements has been impeded by this process.

The list to which BNSF refers of some 250 unresolved shipper facilities is a very different matter. BNSF assembled this list in large part by scouring obsolete UP and SP switching tariffs going back for decades and compiling every shipper facility in any such document. BNSF then tendered this compilation to Applicants without doing any research of its own to determine whether the facilities still existed,[15] and demanded a prompt response as to whether the listed facilities were current "2-to-1" facilities. Rather than rejecting this demand out of hand, as would have been quite reasonable, Applicants undertook the massive research task of checking every entry against such sources as UP and SP customer records, business directories, telephone books, Dun & Bradstreet, and the Internet, and following up with telephone

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[14](...continued)
had an immediate desire to ship via BNSF to those facilities. On the same day, UP/SP confirmed the "2-to-1" status of the two facilities. Similarly, in its first progress report in October 1996, BNSF questioned whether Intermod Industries at Ortega, California, had incorrectly been left off the "2-to-1" list (BNSF Progress Report & Operating Plan, Oct. 1, 1996, Brown, pp. 8-9), and a shipper to this site wrote to Applicants shortly thereafter raising the same question. Applicants immediately investigated and found that a joint facility agreement did give SP the right to serve this UP industry. Applicants wrote to the shipper and BNSF and advised that the industry was a "2-to-1" facility.

[15] The additional request to which BNSF refers (BNSF-1, p. 11 n.2) simply listed many of the same facilities again, without providing any new information.

inquiries. Applicants were able to confirm that the vast majority of the listed shipper facilities no longer existed at the time of the merger. Another several dozen had already been on Applicants' list. Fewer than 50 were added to the listing of "2-to-1" facilities -- and fewer than 20 of these have moved a single carload of rail traffic this year.

There is clearly no justification for turning this heroic effort at cooperation against the Applicants, and presuming that -- unless UP/SP can satisfy the inherently very difficult burden of proving a negative -- the many hundreds of non-"2-to-1" facilities at "2-to-1" points are "2-to-1" and open to BNSF service. The process of identifying "2-to-1" facilities has worked well, and there is no reason why the parties should not be left to continue to work it out between themselves, with genuine disputes, if any, subject to resolution by the Board. There is no justification for adopting any false presumptions or applying any artificial burdens of proof on Applicants.

For several reasons, there may never be a 100%-perfect "2-to-1" facility list, and such a perfect and comprehensive list is simply not necessary. First, such a list is a moving target -- shipper facilities are built or shut down from time to time; ownership of shipper facilities changes; shipper names change. It is thus difficult to keep any listing perfectly up-to-date. Second, among the universe of "2-to-1" facilities are all shipper facilities located on "2-to-1" shortlines and substantial stretches of UP/SP joint track where UP and SP both had the right to provide full local service before the merger, such as the "paired track" in Nevada and the El Paso-Sierra Blanca line. Preparing a definitive inventory of every shipper facility in all these areas would be extremely burdensome, and is unnecessary since all present and future shippers at these geographic locations are by definition "2-to-1." Third, since the definition of "2-to-1" includes any existing facility that had direct access at the time of the merger to both UP and SP, whether or not it had shipped via either railroad for many years or ever, it is very difficult -- and of little or no practical value -- to catalogue these facilities exhaustively with 100% perfection.

All significant "2-to-1" shipper facilities were long ago identified and agreed upon. The ongoing refinement of the listing should continue, and Applicants pledge their continued cooperation in that regard. But this is not an issue of any materiality to BNSF's competitiveness, or that calls for radical remedies.

3. Definition of "New Facility"

The merger conditions, as expanded by the Board in Decision No. 44, permit BNSF to serve any new facility (including new transloading facilities) located anywhere on the lines over which BNSF received trackage rights. (As discussed further in the next subpart, BNSF also has the right to serve existing transloading facilities at "2-to-1" points.) Applicants have been working with BNSF to arrive at a formal written protocol to facilitate the exercise of this condition. On one issue -- the definition of "new facility" -- the parties appear to have reached impasse, and this is the only issue that is holding up completion of the protocol.

In its July 1 and August 1 submissions, BNSF asks that the Board resolve this dispute. BNSF-PR-4, p. 12, & Rickershauser, p. 24; BNSF-1, pp. 13, 20. Various other commentators, while not specifically addressing BNSF's proposed definition, endorse BNSF's request that the Board clarify this matter. CMA-2/SPI-3, p. 6; DOT-1, pp. 6-7; MPI-2, pp. 3, 8. Save for a single case involving R.R. Donnelley which is the subject of a separate petition recently filed by Donnelley and BNSF,[16/] Applicants are unaware of any concrete instance in which this dispute has been of practical significance.[17/] Nonetheless, Applicants agree that it would be desirable for the issue to be resolved by the Board.[18/]

[16/] BNSF-81/RRD-1. Applicants will be replying to this petition on or before the due date of August 28.

[17/] Applicants thus sharply dispute the unsubstantiated suggestions of some commentators that this dispute has affected BNSF's ability to compete. E.g., MPI-2, p. 8.

[18/] Applicants reserve the right to insist on the arbitration of future disputes arising in connection with the BNSF settlement agreement, as provided for in the agreement. In (continued...)

BNSF argues that the Board should hold that, while "new facility" "does not include expansions of or additions to existing facilities," it "does include (1) vacant or existing rail-served facilities that undergo a change of ownership or lessee and (a) change the product shipped from or received at the facility, or (b) have not shipped or received by rail for at least 12 months prior to the resumption or proposed resumption of rail service; (2) existing facilities constructing trackage for accessing rail service for the first time; and (3) newly constructed rail-served facilities." BNSF-1, pp. 13-14 n.3.

Applicants submit that "new" means "new," and only the third item in BNSF's proposed definition is appropriate.[19] The mere fact that an "existing" facility changes its owner or lessee, and either changes the commodity shipped or received or undergoes a hiatus in using rail service, plainly does not make it a new facility. Nor is an

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[18] (...continued)
this instance, however, and especially in light of the Board's role in broadening this condition, Applicants waive any claim to arbitration, and are happy to have the Board resolve the matter.

[19] BNSF discloses in its filing that Applicants offered to compromise this matter by including the second item in BNSF's proposed definition as well as the third. Applicants made this proposal solely by way of seeking a compromise agreement. Since the parties have been unable to reach agreement, Applicants submit that only the third item in BNSF's proposed definition is justified as a matter of plain meaning and the governing competitive principles.

"existing" facility located on a rail line which commences rail service a new facility.[20] (Nor -- to respond briefly to the theory advanced in the petition recently filed by BNSF and R.R. Donnelley but not reflected in BNSF's proposed definition in BNSF-1 -- is an existing rail-served facility that shifts from a non-transloading use to a transloading use a new facility.)

There is a particular irony to BNSF's arguments, since at "2-to-1" points BNSF and its supporters have instead labored to expand the definition of existing facilities. In response to CMA's concerns, Applicants agreed, in their settlement with CMA, to expand as widely as possible the concept of an existing shipper facility at a "2-to-1" point that was open as of the time of the merger to both UP and SP. A facility would be included whether it was active or inactive; regardless of any changes of facility ownership or commodity shipped; and even if it had not used UP or SP rail service for many years, or ever, so long as it had access to both at the time of the merger. BNSF, in its arguments about the definitive "2-to-1" shipper list, is continuing to pursue

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[20] If a facility is located at a distance from a UP/SP line over which BNSF has trackage rights, and a new rail line is built to connect it to the BNSF-served line, it falls outside the new facility condition for a different reason: it is not located "on" (Decision No. 44, pp. 124, 146) the BNSF-served line at all. To treat such a situation as a "new facility" would be to expand greatly the build-in condition that the Board imposed in Decision No. 44.

these very themes -- collecting from decades-old tariffs the names of industries that might still have existed when the merger took place, and arguing that, whether or not they had shipped a carload in anyone's memory, these facilities should be on the list of existing "2-to-1" facilities open to BNSF. But if facilities of this kind -- despite long non-use of rail, long periods of inactivity, and changes in ownership and commodity shipped -- are existing facilities at "2-to-1" points, they cannot magically be transformed into new facilities elsewhere.

Moreover, the definition of "new facility" that makes sense as a matter of plain English also makes sense as a matter of policy. The new facilities provisions in the BNSF and CMA settlement agreements were intended to address concerns about the possible loss of UP-SP competition for the siting of facilities. See Decision No. 44, p. 124 ("Location of new facilities provides competitive pressure . . . ."); UP/SP-230, p. 17 (condition intended to "preserve competition for the siting of new facilities"). For a facility that already has been located at an exclusive point on a particular railroad, such competition is no longer relevant; in the jargon of economists, it can no longer benefit from ex ante competition. Allowing BNSF to serve it thus has no competitive justification. Nor, as already discussed, can it be justified by any need to provide BNSF arbitrarily with additional traffic so that it can provide adequate service. BNSF trackage rights service is already fully competitive.

4. Definition of "Transloading Facility"

BNSF also asks that the Board define "transloading facility"[21/] for purposes of the condition giving BNSF access to existing (at the time of the merger) transloading facilities at "2-to-1" points. BNSF-1, p. 13. BNSF remarks that "UP's position on BNSF access to existing transloads at '2-to-1' points is that such access is limited to 'public' transloads (i.e., ones that are for hire and open to the public in general)." Id. Apparently BNSF disagrees with this definition, though it does not say what definition it prefers.

Applicants doubt that there is a need for the Board to promulgate a detailed definition of transloading facility for purposes of the condition allowing BNSF to serve such facilities that existed at "2-to-1" points at the time of the merger. BNSF identifies no particular dispute in this regard, and points to no concrete case that turns on the issue. If a dispute does arise, there is no reason it cannot be arbitrated, as the settlement agreement provides.[22/]

[21/] BNSF actually asks that the word "transload," used as a noun, be defined. For clarity, we here use "transloading facility."

[22/] Unlike the condition allowing BNSF to serve new shipper facilities anywhere on the trackage rights lines, this condition was purely the subject of agreement between Applicants and BNSF, and thus is well suited to arbitration.

Should the Board nonetheless be inclined to address this matter, Applicants would urge that the Board confirm that a shipper-owned or leased facility being used by that shipper to handle its own traffic is not a transloading facility within the meaning of this condition. The facility should be one open to use by multiple shippers, and one in which the service being provided is transloading itself rather than value-added services such as materials processing. In addition, the Board has already held that a transloading facility is not simply a loading point, but must involve real facility and operating costs to the owner-operator. See Decision No. 61, served Nov. 20, 1996, p. 12.

These parameters ensure that covered facilities conform to the purpose of the condition as to existing transloading facilities at "2-to-1" points -- which was to preserve pre-merger competition between UP and SP for traffic via such transloading. See, e.g., UP/SP-231, Peterson, pp. 38, 76-77. Where a shipper owned its own facility and was using it to transport its own products (which would literally cover every shipper loading dock), such competition was not present; nor was it present where the central function of the facility was to provide other value-added services.

5. Shippers Open to Switching in New Orleans

BNSF argues that it should be granted access to UP- and SP-served shippers in the New Orleans switching district that are open to reciprocal switching. BNSF-PR-4, p. 12, & Rickershauser, p. 25; BNSF-1, p. 18; see also DOT-1, p. 6.[23] BNSF stated on August 1 that it intended "shortly" to file "a separate petition for relief" on this issue. BNSF-1, p. 18.

Applicants will offer a full response when and if that petition is filed. For the present, it suffices to say that this is an entirely new condition request that is (a) clearly untimely,[24] (b) contrary to BNSF's contractual agreement not to seek additional conditions,[25] and (c) wholly unjustified. The request is unjustified because the relatively few shippers in New Orleans that are served by UP/SP and open to reciprocal switching are also open to, among other railroads, KCS and IC, and thus did not lose rail competition as a result of the merger. Contrary to DOT's speculation (DOT-1, p. 6), KCS and IC are free to handle traffic of these shippers that is bound to or from points west of New Orleans. Neither BNSF nor any other party has made any showing that any such shipper lacks effective competitive options for its traffic movements. Moreover, Applicants'

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[23] Shippers in the New Orleans switching district that are served by other railroads, such as KCS, IC, CSX and NS, are not at issue. BNSF needs to negotiate with the serving railroads to obtain access to such shippers. BNSF already has access to the New Orleans Public Belt Railway, which serves the Port of New Orleans.

[24] See Decision No. 66, served Dec. 31, 1996, pp. 13-14.

[25] See BNSF Settlement Agreement § 14.

preliminary analysis indicates that a very small amount of traffic moves between these shippers and competitive facilities at points such as Lake Charles and Houston. Expanding BNSF's rights would thus have a negligible effect on its traffic base -- and, as we have already seen, there is no need to expand that base in any event, given BNSF's multiple-daily-train service in this corridor.

6. Storage in Transit

BNSF's July 1 report identified two operational issues concerning its access to the SP storage-in-transit ("SIT") facility at Dayton, Texas. BNSF-PR-4, Rickershauser, p. 26, & Hord, pp. 22-23; see also BNSF-1, pp. 16-17, 20. This in turn provoked vague comments by others to the effect that inadequate SIT capacity may be hampering BNSF's ability to compete. See CMA-2/SPI-3, pp. 11-12, 17-18; MPI-2, pp. 3, 6-8. Applicants have complied fully with the Board's condition requiring that BNSF be given access to SP SIT capacity in order to handle "2-to-1" traffic. Applicants have already resolved BNSF's concerns, and access to SIT capacity has not hampered BNSF's competitiveness.

As required by the Board, UP has committed to BNSF 50% of the total capacity at UP/SP's Dayton and Beaumont SIT facilities, for a total of 1,525 car storage spots. Most of this capacity -- 1,400 spots -- is at Dayton. Thus far, BNSF has made little use of the Dayton facility for storage, and

BNSF thus has ample capability to expand its usage of that facility.

UP/SP has also voluntarily agreed to procedures that will allow BNSF improved access to outbound line-haul movements of cars placed into storage at Dayton by UP/SP. The Dayton facility is unusual in that, by UP/SP's voluntary agreement, several of the "2-to-1" shippers on UP/SP's Baytown Branch are permitted to place their outbound traffic into storage without designating which carrier will handle the traffic beyond the SIT facility. In response to BNSF's inquiry involving one of these shippers, UP agreed in July to a procedure whereby UP/SP would credit the shipper for charges incurred in moving cars into storage and bill BNSF for the appropriate haulage and switching charges whenever BNSF was awarded the outbound line-haul, so as to eliminate any chance that the shipper would be discouraged from selecting BNSF as the outbound carrier.

More recently, the UP/SP-BNSF Joint Service Committee addressed situations where UP/SP has placed cars originating at "2-to-1" shippers on SP's Baytown Branch into storage at SIT facilities other than Dayton because UP/SP has insufficient room at Dayton. BNSF's concern was that some of these cars are subject to being designated by the shipper for movement via BNSF upon release from storage. In those circumstances, to avoid delay that might be incurred were these SIT cars returned to Dayton for delivery to BNSF, UP/SP and BNSF agreed that, when the shipper selects BNSF to handle the cars outbound from the SIT facility, UP/SP will deliver the cars to BNSF at a closer, agreed-upon, operationally feasible interchange point, rather than returning them to Dayton. This is a temporary measure pending full integration of UP and SP operations in the region. After UP/SP is able to integrate its former-UP and former-SP SIT facilities and thereby optimize utilization of available capacity, UP/SP and BNSF intend to discuss long-term arrangements for storage of cars originating at "2-to-1" shippers on the Baytown Branch, including whether those cars should receive preferential access for operational efficiency to the Dayton SIT facility.[26/]

Some shippers have complained more generally that there is inadequate SIT capacity to handle all of the Gulf plastics traffic, and have urged that Applicants be directed to report more detailed information concerning SIT capacity utilization. See MPI-2, pp. 7-8; FINA-1, pp. 3-4; CMA-2/SPI-3, pp. 17-18. There is no doubt that recent demand for SIT capacity has been forcing UP/SP to use more distant storage facilities, in addition to those located closest to Gulf production sites. However, although this situation has caused

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[26/] Applicants will be sensitive to the needs of "1-to-1" shippers such as Fina for access to this facility. See FINA-1, p. 3.

some operating difficulties, all SIT capacity is not being used -- as of August 15, UP/SP was using 78% of total available capacity -- and the current tight conditions should resolve themselves without the need for the Board to impose onerous reporting obligations.

UP/SP believes that the current SIT conditions are the result of several interrelated developments. First, plastics production and the related need for SIT storage have been very strong, with Gulf manufacturers recently undertaking an unprecedented period of plant expansion. See, e.g., FINA-1, p. 3. Second, demand for plastics tends to be highly seasonal, with slow demand during the summer months, and this year has been no exception. The result is a bulge in the movement of loaded cars into storage. Third, one manifestation of the rapid expansion in production capacity has been an extraordinarily rapid growth in plastics shippers' private car fleets, with outstanding orders for new cars that will increase the size of the total shipper fleet by more than 25%. In part as a result of this fleet expansion, UP/SP has already had to devote significant storage capacity -- including SP's East Baytown SIT facility -- to the storage of empty equipment. Fourth, UP/SP has been delayed in its efforts to achieve optimum utilization of all UP/SP SIT capacity in the Gulf region because it has not yet been able to commingle former-UP and former-SP traffic.

These tight capacity conditions are fundamentally not the result of merger implementation, and they should ease as UP/SP proceeds toward full integration of UP and SP operations in the Gulf and carries out its capital expansion plans, which combined will result in a 40-60% increase in SIT capacity by 2001. UP/SP is currently evaluating the extent to which the full integration of UP and SP operations will free up redundant yard capacity in the Gulf region that can be put to efficient use as new SIT capacity, and is simultaneously preparing plans for the construction of new capacity to supplement that made available as a result of merger integration. UP/SP is also working closely with its plastics shippers to identify ways in which their storage needs can be met more efficiently, such as by storage closer to end-users or on-site at production plants.

7. Team Tracks

In its August 1 comments, BNSF complains that Applicants have declined its requests to acquire UP/SP trackage for team tracks at Rose Park and Welby, Utah. BNSF-1, p. 18; see also BNSF-PR-4, p. 12, & Rickershauser, p. 25. BNSF suggests that Applicants' response with respect to these requests highlights a larger problem requiring the Board's attention: the need to define "principles governing when BNSF may gain access to team tracks." BNSF-1, pp. 18-19. But BNSF neglects to tell the Board why Applicants rejected the Rose

Park and Welby requests or what other arrangements Applicants have made to provide BNSF with facilities in the Salt Lake City area.

There is no need for the Board to establish procedures to ensure that Applicants respond reasonably to BNSF requests for team tracks or other terminal facilities. Contrary to the impression that BNSF apparently wishes to convey, Applicants have responded promptly and reasonably to BNSF requests. Applicants have agreed to lease to BNSF existing UP/SP trackage where it would not interfere with Applicants' current operations, and have agreed to work with BNSF to construct new trackage when BNSF has so requested.

Before describing Applicants' specific efforts to assist BNSF in establishing Salt Lake City area team tracks and other terminal facilities, it is important to correct a potential misimpression created by BNSF's filings. Those filings imply that Applicants are obligated to make available any UP/SP facilities that BNSF concludes it needs in order to establish team tracks or other terminal facilities. See BNSF-1, p. 18; BNSF-PR-4, Rickershauser, p. 25. This is clearly not the case. The BNSF settlement agreement allows BNSF to build "yards and other facilities to support trackage rights operations" at "2-to-1" locations, and provides that if BNSF leases or purchases available facilities from Applicants at Salt Lake City and other locations, Applicants will provide those facilities "at normal and customary charges." BNSF Settlement Agreement § 9g, i. But Applicants are under no obligation to impair their own service by surrendering facilities they are currently using to conduct rail operations, or by allowing BNSF to share access to those facilities. Applicants are willing to work with BNSF to make available excess UP/SP terminal facilities, including team tracks, and to facilitate BNSF's construction of its own facilities where a UP/SP facility cannot be made available.

Applicants have met their obligations regarding team tracks and other terminal facilities in the Salt Lake City area, which is the only location in which the issue has arisen. Applicants have provided BNSF with existing trackage at two Salt Lake City locations, and have agreed to assist BNSF in its construction of additional track for its use at one of these locations.

First, at BNSF's request, Applicants leased BNSF two tracks in UP/SP's Midvale, Utah, yard, where UP/SP currently has a team track. When BNSF requested more track at Midvale, Applicants responded that UP/SP was using the remaining track, but moved quickly to assist BNSF to build two additional tracks at Midvale for BNSF's use.

Second, at BNSF's request, Applicants have agreed to lease BNSF team track and other property at Murray, Utah, just outside Salt Lake City proper.

BNSF's suggestion that Applicants have inappropriately refused to provide it with team tracks at Welby and Rose Park is incorrect. Applicants did not ignore BNSF's requests or treat them lightly. Applicants' personnel spent two days in the Salt Lake City area studying both situations before determining that UP/SP could not meet BNSF's requests without seriously disrupting its own operations.

At Welby, the tracks in question were two sidings along the DRGW line to Magna, Utah, which serves Kennecott Copper. Applicants do not use the tracks as team tracks today; they are using one track to stage cars for Kennecott and the other for cleaning Kennecott's cars. Although BNSF's August 1 filing (BNSF-1, p. 18) says that BNSF wanted to use the Welby trackage as a team track, BNSF's July 1 report indicates that BNSF desired this track for "staging of traffic" (BNSF-PR-4, Hord V.S., p. 18), apparently to conduct the same type of operations Applicants are conducting there. But whatever use BNSF actually had in mind for the tracks, Applicants did not decline BNSF's request arbitrarily; they declined to lease these tracks to BNSF for the very simple reason that UP/SP is actively using them to conduct its own operations. If BNSF wishes to establish a team track near Welby, it will be able to do so using the track it acquired at Midvale, which is just 3.2 miles to the east of Welby and equally accessible for team track use.

With respect to Rose Park, when BNSF initially inquired about UP/SP's Rose Park team track, it described a 1.2-mile spur track off DRGW's mainline, along with a team track that holds ten to fifteen cars. BNSF explained that it was interested in acquiring the spur and team track, along with the surrounding land, in order to build a staging yard. Again, while BNSF's August 1 filing (BNSF-1, p. 18) describes Rose Park as raising a team track issue, its July 1 report and its other communications to Applicants indicate that BNSF had other purposes in mind for the trackage. BNSF-PR-4, Hord V.S., p. 18 (BNSF has requested Rose Park trackage to "support the North Salt Lake Chemical Complex").

The actual situation at Rose Park is very different from what BNSF indicated in its request to Applicants. The Rose Park track does not include a 1.2-mile spur; instead, the team track is a ten- to fifteen-car-length spur directly off the DRGW mainline. Applicants explained to BNSF that its impression of UP/SP's track at Rose Park was inaccurate, and even provided photographs to illustrate the point, and BNSF apparently agreed that Rose Park would not suit its needs. Moreover, Applicants explained that the track was unavailable to BNSF because it was currently being used for UP/SP's operations: the entire track, together with the surrounding property, is being leased to Pacific West, Inc., for an unloading operation. If BNSF actually desires to construct a team track in the Rose Park area, Applicants are willing to work with BNSF once a viable site has been identified.

Utah Railway raises similar issues. It claims to be experiencing "impediments to efficient service" caused by the lack of adequate yard capacity required to serve "2-to-1" customers in the Salt Lake City area. UTAH-2, p. 8. It says that its own rail yard at Provo is "fully utilized," and suggests that the only solution is for Applicants to give BNSF access to additional yard space in the Salt Lake City area. Id. However, Utah Railway neglects to mention that BNSF is "working on an agreement" with it "to construct a 75 car and a 30 car track at Utah Railway's Provo yard at BNSF expense." BNSF-PR-4, Hord, p. 17. Moreover, Utah Railway expresses concern about the "limited track space" that BNSF has secured at Midvale yard, UTAH-2, p. 9, but ignores or is unaware of Applicants' agreement to work with BNSF to construct two additional tracks for BNSF's use at Midvale.

None of this is to deny that it may be beneficial for BNSF to develop additional terminal facilities in the Salt Lake City area, but Applicants have fully complied with their obligations to assist BNSF in obtaining such facilities, and will continue to do so.

8. "Bundling"

In its August 1 comments, BNSF devotes all of two sentences to an argument that it should receive access to exclusively-served UP/SP traffic that UP/SP "bundles" with "2-to-1" traffic, if "anticompetitive effects can be shown." BNSF-1, pp. 14, 20; see also CMA-2/SPI-3, p. 11 (Board "may need to consider" some remedy in this regard in the future). Any such argument should have been made long ago if it was going to be made at all;[27] but even if it were timely, this argument would be without merit.

BNSF cites not a shred of evidence that "bundling" has been used to dampen competition.[28] The ICC rejected the identical notion that "bundling" -- there referred to as "packaging" -- was anticompetitive only two years ago in the UP/CNW case. Finance Docket No. 32133, Union Pacific Corp., Union Pacific R.R. & Missouri Pacific R.R. -- Control -- Chicago & North Western Transportation Co. & Chicago & North Western Ry., Decision No. 25, served Mar. 7, 1995, pp. 79-80. The Commission explained that economic theory and plain common sense make clear that a railroad can gain nothing by lowering the rate it would otherwise charge for exclusively-served traffic in order to subsidize its own competition for jointly-served traffic. Moreover, it is the shipper that has the ultimate control over whether its traffic will be "bundled." A shipper will abjure "bundling" and give its jointly-served

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[27] BNSF was precluded from seeking such an additional condition by the settlement agreement (§ 14).

[28] It also ignores its own ability to "bundle," which is no less than UP/SP's.

traffic to the railroad that does not serve its exclusive point (here, BNSF) whenever it stands to gain from doing so, whether or not the railroad that serves both the exclusive and the joint points (here, UP/SP) proposes some different "bundling" arrangement.

"Bundling," in short, does not allow a railroad to raise rates above the level they would otherwise have, nor does it make it rational to reduce them below that level. It is not rational for UP/SP (or any other railroad) to price exclusively-served traffic below the level that would otherwise be set, simply to secure jointly-served business -- the jointly-served business will be priced in any event at a level that reflects direct two-railroad competition, and further price concessions on the exclusively-served traffic are simply self-defeating.[29/] There is thus no basis for BNSF's sweeping proposal that it be given access to any exclusively-served UP/SP traffic that may be covered under a contract that also covers "2-to-1" traffic. Such a contract can only be in a shipper's interest, and cannot be anticompetitive.

9. Temple-San Antonio Delays

BNSF expressed concern in its July 1 report about delays on the Temple-San Antonio segment of its trackage

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[29/] Of course, if consolidation of traffic in a single contract yields genuine efficiencies that are passed on to the shipper to attract its business, the shipper benefits.

rights. BNSF-PR-4, Hord, pp. 5-6. BNSF did not mention in its August 1 comments that this issue was amicably resolved through the grant by UP/SP to BNSF of temporary rights to operate its trains over UP/SP's Caldwell-San Antonio line, effective July 22.

10. Support Tracks at Oroville

BNSF says in its August 1 comments that it would like to use UP/SP tracks at Oroville, California, "space permitting," for set-outs and pick-ups to facilitate its new operations in the I-5 Corridor, and that if "UP does not provide reasonable accommodations, BNSF will ask the Board to intervene." BNSF-1, p. 16. UP/SP needs the Oroville tracks for train passes and meets, staging of trains, and local work, and BNSF has conceded in writing that it has no right to the tracks under the settlement agreement.[30] Applicants understand that BNSF is no longer pursuing this request, because with rapid increases in its I-5 traffic volumes it is now operating solid trains from Klamath Falls, Oregon, to Provo, Utah.

11. "Neutral" Switching at "2-to-1" Points

BNSF vaguely suggests that it might at some time in the future ask the Board to require "neutral" switching at "2-to-1" points. BNSF-PR-4, Rickershauser, pp. 27-28; see also

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[30] Letter from E.L. Hord to R. Bradley King, July 11, 1997, p. 1 ("I concede this was not contemplated when the settlement agreement was made").

UTAH-2, pp. 9-10. The Board can hardly be expected to act on a request that BNSF is not making, and Applicants will respond to any such request if it is in fact made. For the present, we simply note that BNSF negotiated a very generous set of options, under which it can decide unilaterally whether to serve any "2-to-1" shipper via reciprocal switching or directly, and can also, with Applicants' consent, switch particular "2-to-1" shippers through a third-party agent. This represents more competitive options than either UP or SP had before the merger at "2-to-1" points, and manifestly increases competition. Applicants consented to third-party switching by Utah Railway in the Utah Valley, and will consider any future such requests on a good faith basis. There is clearly no basis for mandating third-party switching of all competitive traffic at "2-to-1" points -- which did not exist prior to the merger and has the potential, in particular instances, to add costs and complicate UP/SP and BNSF operations.[31/]

12. <u>Yard on Corpus Christi-Brownsville Line</u>

In its August 1 comments, BNSF says that it "is trying to obtain access from UP to a redundant UP facility that would give each carrier its own yard facility" in

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[31/] It would also be a breach of BNSF's contractual obligations for it to demand such an additional condition, on top of the ones it negotiated and agreed to support. <u>See</u> BNSF Settlement Agreement § 14.

Harlingen, Texas, along the Corpus Christi-Brownsville segment where BNSF has trackage rights and the contractual option of using haulage. BNSF-1, p. 2; see also BNSF-PR-4, Hord V.S., p. 11. This remark carries the implication that Applicants are somehow unreasonably impeding BNSF's conversion of its Corpus Christi-Brownsville operations from haulage to trackage rights. The opposite is true.

Applicants undertook as part of their settlement agreement with CMA to amend Section 4b of the BNSF settlement agreement to give BNSF "the right to purchase for fair market value a yard at Brownsville" to support Corpus Christi-Brownsville trackage rights operations. BNSF has not exercised this right. Instead, it raised at a June 4 meeting of the parties' Joint Service Committee the possibility of leasing SP's Harlingen yard. Although BNSF is thus seeking to obtain a more favorable arrangement than the one expressly provided for in the merger conditions, Applicants responded that they would consider this further accommodation, but could not do so until relevant labor implementing agreements were completed and the Harlingen yard operations of UP and SP were consolidated. Until that time, SP's Harlingen yard is not redundant as BNSF suggests: UP/SP must continue to operate separate yards in order to comply with its labor obligations.

BNSF's Mr. Hord, in his July 1 verified statement, appeared to recognize that Applicants have been responsive to

BNSF's request for access to SP's Harlingen yard. See BNSF-PR-4, Hord V.S., p. 11 ("UP agreed in an executive meeting on June 4 in Omaha to consider leasing the prior SP yard at Harlingen to BNSF as soon as UP/SP operations are consolidated."). BNSF's August 1 comments thus suggest an issue where none exists.

13. Cyprus Amax

Cyprus Amax argues that BNSF's rights in regard to the movement of coal from Utah to Los Angeles for export should be expanded, either by granting BNSF new trackage rights over UP's line via Las Vegas, or by reducing BNSF's costs on its present route, or in some other manner. CYP-2, p. 7. This argument does not withstand analysis.

Before the merger, westbound Utah coal destined to Los Angeles for export could move on SP-UP or Utah Railway-UP interline routes via Las Vegas, or, alternatively, via the significantly-longer SP single-system route through Sacramento. That competitive situation has not changed following the merger: BNSF, which can originate Utah coal in conjunction with Utah Railway as well as directly via its own transloading operations, can compete over the longer route via its trackage rights to Stockton and its own lines to the Los Angeles Basin against the single-line UP/SP routing via Las Vegas. BNSF acknowledges that it has competed for export movements via its "round the horn" routing: it "was very interested in serving Cyprus Amax and priced its services accordingly." BNSF-PR-4, Rickershauser, p. 13. Contrary to Cyprus Amax's suggestion, the fact that UP/SP secured the business with a lower rate does not mean that competition is not working; no one would suppose that competition means that BNSF must always prevail or that UP/SP always must price equivalently to BNSF.

SP competed for export coal business with its longer route, and Cyprus Amax presents no evidence that BNSF cannot at least match SP's competitiveness. As evidence in the merger case showed, BNSF's operating costs are <u>lower</u> than were SP's, reinforcing the conclusion that BNSF has every opportunity to be at least as fully effective as SP -- if not <u>more</u> effective -- in competing for export coal. UP/SP-231, Whitehurst, pp. 3-13. While BNSF suggests that backhaul arrangements could be important to its ability to compete aggressively for export coal movements (BNSF-PR-4, Rickershauser, pp. 13-14), BNSF has every opportunity and incentive to establish such backhauls with shippers in the Utah Valley. A new transload for solid waste movements from the Los Angeles Basin to Utah is only one example of a backhaul that BNSF could establish in conjunction with export coal business.

Moreover, SP's export coal business was breaking down badly just before the merger due to shortages of locomotive power and other operating problems. Given SP's weak financial condition, there is substantial doubt that SP could have continued to be an effective competitor for export coal with its "round the horn" route. SP had been losing money on the business.

Cyprus Amax itself notes (CYP-2, p. 3) that the market for export coal is "intensely competitive, with lower cost Australian coal the leading contender in end-markets" and U.S. export movements "highly sensitive to transportation cost." As noted in Applicants' July 1 report, UP/SP reduced rates for export coal movements by 4-5% in the past year. UP/SP-303, pp. 116-17.[32/] Absent the merger, the financially-strapped, high-cost SP would not have been able to offer any comparable reduction in rail rates. And these reductions are particularly noteworthy because Utah coal has been in especially heavy demand over the past year; even with this strong demand and limited supplies of Utah coal, rail rates declined sharply.[33/]

[32/] UP/SP also invested in the new Los Angeles coal export facility, which was commissioned on August 4, and in new high-capacity cars for export coal. UP/SP-303, pp. 40-41.

[33/] Cyprus Amax complains that UP/SP prefers for rail-owned equipment to be used in contract service for Utah export coal. CYP-2, p. 5. There is good reason for this preference. Export coal has invariably moved in rail-owned equipment. In contrast to the situation applicable to coal movements to electric utility plants, where movements tend to be steady and the utilities generally have space to store their own cars as necessary, export coal movements tend to be less steady and (continued...)

In short, competition is as strong or stronger for Utah export coal, including Cyprus Amax's traffic, and there is no basis to impose the further conditions that Cyprus Amax requests.[34]

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[33] (...continued)
the Utah and Colorado mines do not have appreciable car storage space. Use of rail-owned equipment provides the railroad with the flexibility to shift train sets between mines, in case any given mine experiences production problems or is otherwise not ready to load coal. For instance, over the past year Cyprus Amax's Plateau mine experienced a number of production disruptions that caused loading patterns to change. Many Utah and Colorado mines sell coal into export markets, and UP/SP would have been unable to serve these mines as effectively and flexibly if the available equipment had been shipper-owned and dedicated to particular mines. And if only a few mines will use rail-owned equipment, it becomes more difficult for the railroad to justify such investment.

Cyprus Amax makes the further claims (CYP-2, pp. 5, 6) that UP/SP has adopted a new export-coal "pricing policy" or has announced that it will not adjust rates downward next year. There is no such new policy, and no decision has been made on next year's pricing. UP/SP must respond to world market forces, as well as to BNSF competition, if it is to be an effective competitor for export coal movements.

[34] Cyprus Amax is vague about what relief it seeks, but the two possible remedies it specifically mentions (CYP-2, p. 7) clearly fail the fundamental legal test that conditions must <u>preserve</u>, rather than <u>enhance</u>, competition. Giving BNSF trackage rights over the UP line via Las Vegas would result in <u>two</u> short export routes, when only one existed prior to the merger. Taking unspecified "steps to reduce BNSF's cost structure" would arbitrarily improve BNSF's position still further vis-à-vis SP's pre-merger position. Cyprus Amax offers no explanation for failing to seek these conditions during the merger case or to request reopening within the allotted time.

Cyprus Amax also expresses concern that UP/SP might retaliate for its comments in this proceeding. UP/SP most certainly would not engage in any such conduct. <u>See</u> UP/SP-231, Gray/Shattuck, p. 10 (refuting earlier speculation of this nature).

14. Longhorn Railway

Longhorn's comments "reiterate that the BNSF interchange would be better with allowance by this Board for such, in addition to Elgin, at both McNeil and Giddings, Texas." Comments, p. 1. It is not clear whether this is a renewed request for this previously-denied relief, but if it is it should be rejected. Longhorn acknowledges that it is "actively and successfully interchanging" with BNSF at Elgin, which is the interchange point selected by CMTA after careful consideration of the Giddings alternative. Id. Longhorn's suggestion that it also be allowed to interchange with BNSF at McNeil is without merit, given that (a) the Board has twice found that shippers on the Giddings-Llano line never had the option of interchanging with a railroad other than UP at McNeil,[35/] and (b) Longhorn itself regards the geography of the McNeil interchange to be deficient in several respects (Comments, p. 4).

15. North American Logistic Services

North American Logistic Services ("NALS") renews the request it made in the merger proceeding for direct BNSF trackage rights access to its pet food plant at Wunotoo, Nevada, 30 miles east of Reno, which was exclusively served prior to the merger by SP. The Board rejected that request,

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[35/] Decision No. 44, p. 182; Decision No. 69, served Mar. 10, 1997, pp. 4-5.

finding that the merger did not deprive NALS of rail competition at its Wunotoo plant. Decision No. 44, p. 192. NALS says the Board's decision "was wrong then, and it is wrong now." NALS-1, p. 2. But NALS did not appeal the decision it claims was wrong, nor did it seek reconsideration within the allotted time on the ground of material error. And it offers no new ground for granting the relief it seeks. NALS complains about the quality of UP/SP service to the plant since the merger, but it does not answer the dispositive competitive point -- that BNSF, with its ability to handle NALS' traffic via truck-rail transloading at Reno, is in precisely the same position to provide a competitive alternative as UP was before the merger.[36] NALS' request should again be denied.

C. Other Conditions

1. Railco

During the pendency of the merger proceeding, Applicants entered into a settlement with Utah Railway to resolve a dispute over whether Applicants could grant trackage rights to BNSF over a segment of joint DRGW/Utah Railway track. Applicants resolved this contract dispute by, among other things, granting Utah Railway access to the Savage

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[36] Indeed, the Board's expanded transloading condition, which Applicants are contesting on appeal, would improve NALS' competitive position by allowing BNSF to serve a new transloading facility closer to the Wunotoo plant than Reno.

transloading facility on the CV Spur, which Utah Railway had not previously served. This arrangement was not intended to address any competitive issues raised by the UP/SP merger; it was a business agreement to avoid a contract dispute by giving Utah Railway access that it did not previously have to Savage.[37]

Though not addressed to competitive concerns, the Utah Railway agreement was unquestionably pro-competitive. It broadened Utah Railway's capability to serve Utah mines, and thus enhanced competition for coal producers and consumers by expanding their rail options. A witness for Kennecott Energy, a major Colorado coal producer, stressed the pro-competitive benefits of Utah Railway's access to Savage: "I can't think of any mine that couldn't truck to the Utah Railway and have two-for-one access." McFarlen Dep., Apr. 10, 1996, at 80. The Utah Railway agreement thus stimulates competition by expanding alternative rail access for Utah mines. See Decision No. 44, p. 129 ("competition among high-BTU coals will be stimulated by applicants' settlement" with Utah Railway).

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[37] Railco speculates that UP/SP "apparently" incorporated this provision in the Utah Railway agreement to resolve a competitive objection to the merger by Coastal Corporation. Comments, p. 5. That is simply incorrect. When Applicants submitted the Utah Railway agreement to the Board, they explained that the purpose was to resolve a dispute with Utah Railway, and not to resolve any competitive issues raised by the merger. See UP/SP-74, pp. 1-2.

But Railco complains about this arrangement because Utah Railway was given access only to Savage on the CV Spur, and did not also receive the right to serve Railco. The Board has already rejected, in Decision No. 66, served Dec. 31, 1996, this precise argument by Railco. First, the Board found that Railco had not made the argument in a timely manner. Id., pp. 13-14. Railco's comments simply repeat the same argument, without even a pretense of claiming it is timely. Second, the Board went on to reject Railco's argument on the merits: "We realize that the [Utah Railway] agreement, by providing an increased rail option for one shipper but not for another, may disadvantage the one for whom the increased option has not been provided. That, however, is not the kind of harm that should be rectified under the 49 U.S.C. 11344(c) conditioning power, which was not used by the ICC and will not be used by us to equalize rates and service among competing shippers." Id., p. 14. Railco provides no basis for reconsideration of this ruling; it simply repeats the position the Board previously considered and rejected.

Railco's claims (Comments, pp. 1-2, 5) that adding competition at Savage decreases competition make no more sense now than they did before. Before the merger, only one railroad served Savage; post-merger, a second railroad can originate coal there, to the benefit of producers, consumers and competition.

Moreover, Railco is fully capable of competing for the loading of coal from Utah mines. UP/SP serves Railco and has every incentive to expand Railco's volume in competition against Utah Railway origination from the adjacent Savage facility and other sources. UP/SP moves a substantial volume of coal westbound from the Railco facility, including to Nevada Power and Intermountain Power, and has every interest in encouraging area producers to truck their coal to Railco for UP/SP origination rather than to Savage or other points for Utah Railway (or BNSF) origination.[38]

2. Sierra Pacific Power

Sierra Pacific Power Company and Idaho Power Company (collectively, "SPP") argue that following the merger there has not been meaningful competition between UP/SP and BNSF for transportation of coal to SPP's North Valmy Station, a "2-to-1" facility in Nevada. SPP took the position in the merger proceeding that BNSF would not be an adequate substitute for SP's service to the North Valmy plant and asserted that SPP should have the opportunity to choose another carrier to serve its plant at a reduced trackage rights fee from all coal mines

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[38] Railco dwells (Comments, pp. 5-6) on a supposed misstatement of fact by Dr. Blaydon, a witness for Utah Railway, as to whether Savage is a "public" transloading facility. This is a non-issue. The Board has already found that the supposed "misrepresentation" was "not material to the matters at issue in this proceeding" and did not influence the Board's approval of the Utah Railway settlement. Decision No. 66, served Dec. 31, 1996, p. 15.

in Utah and Colorado served by SP. The Board rejected SPP's arguments and denied its extremely broad request for relief, concluding that interline Utah Railway-BNSF routings would provide SPP with an effective competitive alternative to UP/SP service. Decision No. 44, p. 187. In its comments, SPP renews the arguments it made during the merger proceeding and seeks the same relief the Board previously denied.

The record does not support SPP's arguments or its renewed request for relief. SPP argues that the range of its potential coal sources has decreased, that a bidding process it instituted several months ago has demonstrated that BNSF cannot or will not be an effective competitor for the North Valmy business, and that BNSF has had a minimal presence on the Central Corridor since the merger.[39]

SPP's claim that the merger has resulted in a decrease in its potential coal sources is plainly wrong. In fact, as Applicants explained during the merger proceedings, SPP has enjoyed an <u>increase</u> in its coal sourcing options since the merger. <u>See</u> UP/SP-230, pp. 264-65; UP/SP-231, Sansom, pp. 46-47; UP/SP-231, pp. 50-51. Before the merger, Valmy could obtain Utah or Colorado coal via SP single-line routings

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[39] The latter argument is refuted at length above. It is also irrelevant to BNSF's ability to handle SPP's unit coal train movements competitively; those movements do not depend on the existence of regular daily manifest train service that can be important to shippers of small volumes of carload business.

from mines served by SP; via UP-direct routings from truck transloading facilities at Sharp, Utah, or elsewhere; and via interline Utah Railway-UP or Utah Railway-SP hauls from mines served by Utah Railway. Valmy continues to have the option of single-line routings via UP/SP from mines that were formerly served by SP, as well as UP/SP service from the truck transloading facility at Sharp. It also continues to have the option of interline Utah Railway-UP/SP hauls from mines served by Utah Railway. In addition, it now has various options involving BNSF, including interline Utah Railway-BNSF hauls from mines served by Utah Railway and interline Utah Railway-BNSF routings from the transloading facility at Savage, Utah, to which Utah Railway gained access in connection with the merger. Furthermore, Valmy has the option of direct BNSF service from new truck transloading facilities at Provo, Utah, or elsewhere.[40]

In addition to these expanded routing options for obtaining Utah and Colorado coal, SPP enjoys, as a result of

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[40] Under the conditions imposed by the Board, BNSF can serve any newly-established transloading facilities along the trackage rights lines. This option would allow SPP to eliminate the Utah Railway-BNSF interchange, which SPP contends is a competitive impediment. (In fact, the Board properly noted in Decision No. 44, p. 187, that for unit coal train movements, interchange is <u>not</u> a significant obstacle to efficient and competitive service.) Assuming <u>arguendo</u> that single-line service is needed for effective competition, a truck transload at Provo, for example, would allow BNSF to serve Valmy through a single-line movement 55 miles shorter than UP/SP's Sharp-Valmy movement.

the merger, much-improved options for obtaining Powder River Basin ("PRB") coal. As the Board has noted, PRB coal is lower-cost, lower-BTU coal that "invariably offers a lower delivered cost than Colorado/Utah coal." Decision No. 44, p. 127. With a relatively minor modification of its facility involving only modest investment, SPP could take full advantage of these benefits of PRB coal, including the benefit of head-to-head single-line competition from mine to power plant between UP/SP and BNSF. UP/SP-231, Nock, p. 50; UP/SP-231, Sansom, pp. 46-47.[41]

In fact, there is direct, effective competition today for the North Valmy traffic. The principal source of coal for Valmy at present is the SUFCO mine, which is served only by truck. Today, SUFCO coal moves by truck to the Sharp transloading facility on UP, 81 miles from the minehead. A substantial volume of SUFCO coal -- 1 million tons in 1996 -- moves by truck to the Savage transloading facility, 94 miles from the minehead, and Savage is used for some 0.4 million tons per year of westbound Utah export coal movements. Utah

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[41] The Board did note that, prior to the merger, SPP had a single-line UP option for coal movements from the Black Butte mine in the Hanna Basin in Southern Wyoming, as well as single-line SP options involving Utah and Colorado coal. See Decision No. 44, p. 187. However, SPP's comments acknowledge that it is taking steps to reduce or eliminate its burn of Black Butte coal for reasons unrelated to the merger. SPP-2, p. 5 n.8. And the Board held that Hanna Basin coal is not a meaningful alternative to Utah coal for new contracts. Decision No. 44, pp. 127, 129.

Railway, which now has access to Savage, is fully capable today of originating movements of SUFCO coal at Savage for interline shipment via BNSF to the North Valmy station. The Sharp and Savage facilities are roughly equidistant from Valmy: 460 and 491 miles, respectively. Furthermore, Savage has a loop track, while Sharp does not, making Savage a lower-cost loading operation better suited to efficient origination of unit coal trains. The alternative of trucking from SUFCO to Savage provides a level of competition for the SUFCO coal essentially equal to what SP offered prior to the merger.

Contrary to SPP's assertions, the recent bidding for North Valmy traffic does not suggest that competition between UP/SP and BNSF is lacking. To the contrary, it confirms the vigor of that competition. The rates UP/SP offered to SPP during the bidding process -- both on SUFCO coal originated at Sharp and on coal from other Utah origins -- were significantly lower than the rates SPP previously enjoyed, i.e., the rates that had resulted from what SPP itself characterized as vigorous competition between UP and SP. SPP-10, Mar. 29, 1996, pp. 8-9; SPP-2, Aug. 1, 1997, p. 1. It appears that SPP was more interested in "setting up" a failure to agree with UP/SP on rates to support its renewed request for massive trackage rights across Nevada, Utah and Colorado than in obtaining a competitive transportation contract. Rather than negotiating seriously with UP/SP, SPP terminated

STB FD-32760 (SUB 21) ID-181298 8-20-97 D 2/3 contract negotiations, requested a tariff rate from UP/SP, and filed a rate complaint against UP/SP.

UP/SP, anticipating the expiration of the North Valmy transportation contract at the end of June 1997, approached SPP in April of this year with a rate offer covering substantially all coal shipments to the plant. SPP rejected the UP/SP offer and issued bid solicitations to UP, Utah Railway and BNSF. On May 30, UP/SP responded by offering single-line rates from Sharp, Savage and other points, and joint-line rates with Utah Railway from a number of points. Taking advantage of higher loading weights and longer trains to make the movements more efficient, as well as an improved ability to make resource allocation decisions based on a long-term volume commitment, UP/SP was able to offer rates, for both the SUFCO and other Utah originations, lower than those under the expiring contract. Upon learning that SPP was not satisfied with this new bid, UP/SP offered still another bid, with even lower rates. SPP then made a counterproposal. On August 1, UP/SP reiterated its prior offer, and also provided SPP with tariff rates that SPP had previously requested in the event an agreement could not be reached by August 1. That same day, SPP served UP/SP with a rate complaint and filed its renewed demand in this proceeding for trackage rights.

Contrary to SPP's suggestion, UP/SP did not take an inflexible approach during the negotiations. UP/SP agreed to extend the expiring contract to July 31 to give the parties more time to negotiate, and would have been receptive to further extensions if negotiations had been progressing well. Contrary to SPP's assertions, UP/SP never insisted that it would bid only on a contract that covered all of North Valmy's requirements. UP/SP sought to offer the lowest possible rates, taking account of the real efficiency benefits of long-term volume commitments, and it was prepared to offer rates without such commitments. Indeed, on August 12, at SPP's request, UP/SP offered contract rates for spot tonnage from a number of points, which were somewhat higher than the rate UP/SP quoted for a contract covering substantially all SPP coal tonnage, and on August 18 SPP accepted UP/SP's offer.

In any event, SPP clearly enjoyed the benefit of strong competition between UP/SP and BNSF in this bidding process. During the negotiations, Canyon Fuels, owner of the SUFCO mine, advised UP/SP that it was determined to ensure that Valmy would continue to take as much coal from the mine as possible, and that SPP was considering trucking SUFCO coal to Savage. UP/SP was extremely concerned about losing the Valmy movement to a Utah Railway-BNSF interline movement originating at Savage. UP/SP's assessment was that Utah Railway and BNSF would bid aggressively for the Valmy business and that UP/SP faced a real threat of losing the traffic to Utah Railway-BNSF, originating at Savage.

UP/SP also recognized that other Utah mines, closer to Savage, were credible threats to provide tonnage above the SUFCO base contract volume, and that Utah Railway-BNSF was a formidable competitor for this business. This incremental volume amounted to approximately 500,000 tons, or nearly half of the 1.2 million tons used annually at Valmy.[42]

The rate reductions UP/SP offered were directly driven by these well-grounded concerns about Utah Railway-BNSF competition for the business.

Despite the competitive pressures inherent in this bidding process, SPP argues that the rate offers it received were noncompetitive. It alleges (a) that Utah Railway-BNSF bids it received for part of the coal tonnage to North Valmy were higher than UP/SP's bids for substantially all of the tonnage, and (b) that an unnamed SPP consultant has opined that the UP/SP bid was higher than what the consultant would have expected from "head-to-head rail competition in a competitive market." Hill V.S., p. 3.

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[42] Coal procurement is directly influenced by minehead prices as well as rail rates, and many other Utah mines are directly competitive against SUFCO for the SPP business. UP/SP-231, Sansom, pp. 21-24. The potentially competing mines included the Andalex mine, which produces coal that had been successfully tested at Valmy. A mine such as Andalex, with its own loading facility (which would further reduce trucking and handling expense), posed a potent threat that UP/SP would lose the incremental tonnage above the SUFCO baseline amounts to a Utah Railway-BNSF movement originating at Savage.

Of course, strong competition does not necessarily result in identical bids, particularly when each bidder is uncertain of the level of other bids. And a bid on larger tonnages, with the attendant efficiencies, can be expected to be lower than a bid on smaller tonnages. Moreover, SPP's assertions that BNSF's bids were non-competitive are highly doubtful in light of SPP's admission that it expects to contract with BNSF to move coal to the plant. SPP-2, Hill, p. 4; see also Letter to Secretary, Aug. 18, 1997, p. 2 (desire to continue to receive bids from BNSF in the future). Indeed, as this reply is being filed, BNSF operating officials have advised UP/SP that BNSF and SPP have signed a contract for part of SPP's coal tonnage and unit train movements from the Savage transloading facility to North Valmy, routed Utah Railway-BNSF, will commence as early as next week.

But SPP's arguments should be rejected out of hand at the threshold because of SPP's flat refusal to disclose its purported basis for them. SPP has withheld all Utah Railway-BNSF bid data from the Board, and has refused Applicants' request for this data.[43/] The Board cannot give any weight,

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[43/] SPP claimed that it was withholding the information because of a duty of confidentiality to BNSF and Utah Railway. But information subject to contractual confidentiality undertakings to third parties has been routinely produced in this and other merger cases subject to the "Highly Confidential" designation which restricts it to outside counsel and consultants. When Applicants' counsel asked SPP's counsel if they would stipulate to the entry of such an order, (continued...)

consistent with basic due process, to a claim that a bid was uncompetitive when the claimant refuses to reveal to either its adversary or the Board itself the basis for the claim.

The Board should also disregard the opinion of SPP's mystery consultant. SPP's submission does not name either the consultant or the allegedly competitive rate level the consultant had in mind, and does not explain whether that supposed rate level has any relevance to the circumstances of the Utah-Valmy movements at issue here. SPP has rebuffed Applicants' requests for any further explanation, saying only that there is "no document" in which the unnamed consultant's opinion is to be found, that the opinion was expressed "over the phone," and that there is "no specific rate level" that the consultant had in mind. It is obviously impossible to understand or dispute such a hearsay opinion, and it would be grossly unfair for the Board to consider it.

[43/](...continued) they refused. They also refused a proposal that disclosure be even more tightly limited to the Board and outside counsel and consultants to the Applicants. They also refused even to say whether there was any written confidentiality agreement with BNSF and Utah Railway, or whether any such agreement, if it existed at all, allowed for production in response to a Board order. Thus, SPP's claim, in a letter to the Board dated August 18, that, as to the bid data (the letter is silent about its refusal to provide any information about its unnamed "consultant" and that consultant's purported opinion), it was put in this "difficult position" by BNSF's refusal to consent to release of the information should be rejected. SPP's "difficult position" is of its own contrivance, and results from its attempt to advance assertions it refuses to substantiate.

In any event, the fact that the UP/SP rate offer was significantly below the rate under the expiring contract -- which SPP admits was the result of vigorous competition between UP and SP -- plainly indicates that the merger did not reduce competition. SPP cannot simultaneously claim that the old, pre-merger rate reflected vigorous head-to-head competition, and then claim that a lower rate fails some secret standard that an unnamed consultant has set for "head-to-head competitive rates."

Finally, even if SPP's competitive arguments were not fatally flawed, the relief it seeks is grossly overbroad, and would have to be rejected on that basis alone. See, e.g., Decision No. 44, p. 188; BNSF, Decision No. 38, served Aug. 23, 1995, pp. 72-73, aff'd sub nom. Western Resources, Inc. v. STB, 109 F.3d 782 (D.C. Cir. 1997). Though it did not have two single-line rail alternatives to any Colorado or Utah mine before the merger,[44] SPP now wants two single-line options to dozens of Colorado and Utah mines; and it demands service by a railroad of its choosing at a subsidized trackage rights fee far below the BNSF rate which the Board upheld as

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[44] It is simply not true that, prior to the merger, SPP had "head-to-head, single-line rail competition between UP and SP from numerous coal mines in Colorado and Utah." SPP-2, p. 1. UP did not serve any coal mines in those states; it served only the Sharp, Utah, truck transloading facility. This was fully explained in the merger proceeding (e.g., UP/SP-230, pp. 264-65; UP/SP-231, Nock, pp. 50-51; UP/SP-231, Sansom, pp. 46-47), and SPP offers no basis for the mistaken assertions it makes here.

reasonable. SPP-2, pp. 2, 9.[45] Such relief would place SPP at a great advantage over its pre-merger circumstances, and would surely provoke complaints from other coal receivers demanding similar new competition and special subsidies. There is no more basis now for granting SPP's request than there was at the time of the Board's decision approving the merger.

3. Tex Mex

Tex Mex, in its August 1 comments, renews its contention that it faces difficulties competing for Mexican traffic originating in Houston because it may not use its Houston trackage rights to handle traffic to and from points other than Mexico or Tex Mex's own lines. TM-2, p. 11, & Haley, Turner. This claim offers no basis for the Board to reconsider the limitations placed on Tex Mex's trackage rights.

The appropriateness of limiting Tex Mex's trackage rights to traffic having a prior or subsequent movement on Tex Mex's Laredo-Corpus Christi/Robstown line has already been litigated twice. *See* Decision No. 44, pp. 149-50; Decision No. 62, served Nov. 27, 1996. Tex Mex's traffic to and from Laredo has significantly increased since the merger, as shown in Applicants July 1 report (UP/SP-303, pp. 108-12). These

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[45] SPP also requests, apparently in the alternative, some vague, unspecified augmentation of BNSF's competitiveness for its business alone. SPP-2, p. 2.

increases, which Tex Mex concedes,[46] show that Tex Mex's limited rights are serving the purposes for which the Board granted them.

Moreover, Tex Mex's suggestion that those limitations weaken its competitiveness for shipments originating at Houston is simply not credible. Tex Mex's supporting testimony consists entirely of vague anecdotal assertions rather than hard evidence. If Tex Mex truly serves an important competitive role for Mexican traffic originating at Houston -- a point Applicants dispute, given that every one of the Houston shippers served by Tex Mex is also served by BNSF -- Tex Mex's position requires the illogical assumption that shippers will be irrational in choosing to ignore an available competitive alternative in order to "package" their Mexican traffic with traffic for other destinations. As we have already discussed, the ICC has decisively rejected such irrational "packaging" theories.

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[46] See also KCS Press Release, July 7, 1997, announcing that Larry Fields, who had been serving as Vice President-Transportation of KCS, was being shifted back from KCS to Tex Mex to act as full-time CEO of Tex Mex: "The Tex Mex is a vital link between KCS and TFM. To provide service between these two properties, the Tex Mex operates over trackage rights granted by the Surface Transportation Board over the Union Pacific between Beaumont and Corpus Christi (Robstown) via Flatonia. With significant increases in its business levels and the challenges of operating on these trackage rights, it is imperative that the Tex Mex have someone full time with the experience and stature of Larry Fields." (Emphasis added.)

The Board also should not lose sight of the extreme overbreadth of the remedy Tex Mex appears to be suggesting. The Mexico-bound traffic about which Tex Mex complains is a tiny fraction of all Houston originations -- for UP/SP, traffic to and from Mexico is less than 5% of total Houston traffic. Marginal improvements, at best, in Tex Mex's ability to attract Mexican traffic cannot remotely justify the windfall that would be created by granting Tex Mex -- and its partner KCS -- unrestricted access to the other 95% of Houston traffic.

D. <u>Oversight Process</u>

1. <u>Discovery</u>

KCS and Tex Mex, alone among the commenting parties, argue that there is a need for more discovery before this first annual oversight proceeding can be concluded. KCS-2, pp. 9-10 & Ex. C; TM-2, pp. 3, 6-8. KCS and Tex Mex point to no tangible need for more information before the fundamental issues presented here -- the effectiveness to date of the competitive conditions, and whether there is any cause for altering them -- can be resolved.

KCS and Tex Mex made no serious effort to pursue any additional discovery. Together with other parties, they served extensive requests on Applicants in June, which Applicants, without conceding a right to formal discovery in this proceeding, responded to with extensive information, including their full traffic tapes, within 15 days. Neither KCS nor Tex Mex made any further requests, nor did they file any motions to compel as to the limited items to which Applicants objected.

The failure of KCS and Tex Mex to make any serious effort to pursue discovery or use the material they did obtain shows that they have no genuine interest in pursuing relevant information, but only seek to delay and complicate the proceeding. The Board has ample information before it on which to base its first-year oversight determinations, and a delay for more discovery is not merited.

2. Reporting

Several commentators make proposals as to future reporting by the Applicants and BNSF of information the Board could use in its future oversight in the area of competition. CMA and SPI, for example, urge that the Board should mandate reporting of unspecified competitive "metrics," using a "baseline" of the second or third quarter of 1995. CMA-2/SPI-3, p. 15.[47/] KCS urges that the Applicants be required to report corridor-specific "market share" data. KCS-2, pp. 3, 7-10. Tex Mex and Fina suggest that a breakdown of BNSF traffic volumes -- apparently among reroutes, "2-to-1"

47/ Applicants will be happy to comply in the future with CMA/SPI's one specific request -- for more detailed data about the segregated funds that have been established for BNSF trackage rights fees. CMA-2/SPI-3, p. 12.

traffic, and new marketing opportunities -- should be mandated. TM-2, p. 7; FINA-1, pp. 6, 11.

Applicants do not take issue with the need for future reporting of information that will allow a meaningful assessment of ongoing progress with the merger and the effectiveness of the competitive conditions. Applicants believe, however, that the extensive quantitative data and other information contained in their July 1 report constituted the kind of information best suited to that assessment. Clearly, BNSF (and Tex Mex) traffic volumes are of basic importance. The sort of detailed, shipper-specific information that was contained in the Confidential Appendices in UP/SP-304 is equally valuable in gauging whether strong competition is occurring. So are the rate comparisons that were contained in those appendices. As for a "baseline," Applicants believe that the one they used -- comparing identical periods following and preceding the merger -- is more informative than the ones suggested by CMA and SPI.

Applicants submit that corridor- or point-specific "market shares" cannot be computed without inordinate burden, and would not be meaningful if they were computed. Without involving outside consultants and conducting massive discovery, Applicants are in no position to break down BNSF traffic into reroutes and other categories, or to measure the ever-changing universe of traffic at former "2-to-1" facilities and in former "2-to-1" corridors for the purpose of trying to compute "market shares." Any such reporting would be hugely burdensome, and would not provide information from which the Board could draw useful conclusions, or on the basis of which it should make decisions about the effectiveness of the conditions or the need for any further conditions. Applicants did report on BNSF's "market share" at the level at which such a concept can be meaningfully assessed -- in the aggregate.[48]

The proper test of BNSF's competitiveness is not what percentage of the traffic at some particular "2-to-1" point it handles, but rather whether it is mounting competitive service, attracting substantial business, gaining a substantial share of its overall potential traffic base, and having an impact on rates and service. All of that is clear from the data that are available and have been submitted -- and it is such data that should continue to be submitted in the future.

Applicants suggest that future in-depth oversight inquiries continue to be held annually, with detailed

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[48] See UP/SP-303, pp. 94-95. BNSF volumes have risen very substantially since, in April, it indicated publicly that trackage rights revenues were running at a level of nearly $150 million per year. Obviously, the security analyst's report described by CMA and SPI (CMI-2/SPI-3, p. 7) as indicating that BNSF expects no positive revenues from the trackage rights either is in error or is mischaracterized by CMA and SPI.

reporting by Applicants and BNSF along the lines of the July 1 report. Quarterly reports would update the data from the annual reports, and be less technical and "legalistic" -- but should nct be required to contain the sort of comprehensive analysis contained in the annual reports. Applicants devoted many hundreds of hours of key managers to preparing their July 1 report, and if such reports had to be submitted quarterly there would be little time left for key personnel to run the railroad and continue to attain the merger benefits that this process is all about.

3. Oversight Period

Millennium argues that the oversight process should be extended by one year because the first year has involved a phase-in of the competitive conditions. MPI-2, p. 4. But the Board was of course well aware that this would be the case when it adopted a five-year oversight period. The period can be adjusted, either to lengthen or shorten it, as experience with the merger and the conditions continues to accumulate.

II. MERGER IMPLEMENTATION: BENEFITS AND SERVICE PROBLEMS

UP/SP continues to implement the merger essentially as predicted in Applicants' July 1 report, acting to introduce new services, invest heavily in physical plant, and realize operating efficiencies. At the same time, operating problems in the Gulf Coast area, acknowledged in the July 1 report, are proving to be more severe than originally anticipated, and

UP/SP is also experiencing service deficiencies in other regions. UP/SP recognizes that these service failures are creating significant problems for customers, and its highest corporate priority is to resolve them as promptly as safety and prudence permit.

The most severe service difficulties are not the result of the merger or merger implementation, as demonstrated by the fact that they are concentrated on the Gulf Coast Corridor where labor agreements still forbid operational consummation of the merger. Instead, UP/SP believes that the difficulties vexing the railroad and its shippers result from the long-term effects of years of SP financial weakness and underinvestment in track, locomotives and operating personnel, combined with a string of disruptive events and conditions during the spring and summer. Service on SP in the Gulf Coast Corridor suffered a breakdown akin to earlier service breakdowns that had plagued SP for years. This in turn had ripple effects throughout the UP/SP system. The principal disruptive factors appear to have been heavy upgrading work on the Sunset Route in Texas and Louisiana; several unfortunate derailments and weather-related service interruptions; a temporary period of debilitating delays to traffic to and from Mexico as a result of the privatization of part of the Mexican railway system; a surge in the volumes of plastics shipments requiring storage; and -- most recently -- flooding, trackwork and derailments on CSX east of New Orleans. Combined, these problems have resulted in severe crew and locomotive shortages that would not otherwise have occurred or at least would have been more easily remedied.

UP/SP urgently wants to remedy these service problems. We know they are expensive for shippers, as well as the railroad. They increase operating costs and drive customers to competitors, such as BNSF, which is highlighting UP/SP's problems in marketing its services, and is enjoying growth in its overall Western traffic share. As a result, UP/SP is pouring management, physical, financial and personnel resources into the effort to restore service quality. The railroad is hiring more aggressively than at any time in memory; new and leased locomotives are arriving on the property; facilities are under construction; and management forces have been deployed to problem areas. A few commenting shippers attest that UP/SP is working hard to resolve their problems.

Unfortunately, it takes much longer for a railroad to extricate itself from operating difficulties than to incur them, and there is no quick and easy fix. The brightest hope for major improvement lies in implementing the UP/SP merger and taking advantage of the benefits of integrated operations. UP/SP will continue to provide meaningful reports to the Board and its shippers as it works to correct these problems.

A. Merger Implementation Update

1. Essential Building Blocks

As UP/SP explained in its July 1 report, the three key building blocks for implementation of this merger are information systems consolidation, human resource integration, and UP/SP's $1.5 billion capital investment program. The recent service disappointments make it even more important to proceed apace with these critical processes.

a. TCS Installation on SP

Over the August 1-3 weekend, UP/SP completed the second phase of Transportation Control System ("TCS") implementation on the SP system. This second phase, much larger than the first on DRGW lines,[49] delivered TCS to former SSW and SPCSL lines between St. Louis and Santa Rosa, New Mexico, and between Chicago and points in North Texas and Louisiana. This TCS expansion appears to have been successful and to have caused few disruptions, although the full effects of programming changes on car routings may not appear until later. In addition to giving personnel on SSW and SPCSL lines more sophisticated management tools, this expansion provides UP/SP managers on the Gulf Coast with more reliable and integrated information about traffic flows into that area, improving their ability to plan operations and reduce

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[49] A small supplemental expansion covered SP's line between Ogden, Utah, and Elko, Nevada.

unnecessary movements. UP/SP is currently revising the next phase of TCS expansion so that TCS can be implemented throughout the Texas area as soon as possible.

b. Workforce In.egration

After the Board dissolved its stay, UP/SP on July 1 consolidated UP and SP train operations in the Central Corridor between Herington, Kansas, and Elko, Nevada. This allowed UP/SP to act as a single carrier in this region, and to combine UP and SP traffic for the first time anywhere. UP/SP is gradually shifting manifest freight trains from SP's Tennessee Pass route to UP's much faster and more efficient line through Wyoming, and it is moving coal trains to the Moffat Tunnel line. UP/SP is now operating through trains and blocks linking SP yards in Stockton, Oakland and Eugene with UP's North Platte, Nebraska, classification yard. With only one classification between the West Coast and terminals in Chicago, St. Louis and Kansas City, on the Conrail system, and at other locations throughout the Midwest, all the shipments on these trains receive faster service across the Central Corridor than SP provided.

As predicted in the July 1 report, UP/SP was able to reduce the inefficient, delay-causing operating pattern in the Salt Lake Valley, which had prevailed for over a decade, in which SP and UP trains bound to the same destinations moved in opposite directions between Ogden and Salt Lake City. UP/SP removed some twenty through train movements per day from this busy line. Utah Railway's service as agent for BNSF should benefit from this reduction in through train operations, as it also uses this line.

UP and SP consolidated their Central Corridor yard operations at Denver and Salt Lake City. These consolidations eliminated some interchanges between the two railroads and allowed UP/SP to specialize yard functions at both locations. In Denver, UP/SP intermodal service is now consolidated at UP's facility, and most automotive traffic is handled at UP's Rolla facility. In Salt Lake City, SP's Roper Yard becomes the major carload facility, eliminating duplicative activities in UP and SP yards. UP/SP is developing plans to close the SP intermodal facility in favor of UP's North Salt Lake ramp.

On September 16, UP/SP will be able to combine UP and SP workforces and operations throughout the Gulf Coast area, where service has been inadequate. As described later, this will allow UP/SP to make a large number of operating changes to improve service and eliminate inefficient operations throughout this territory. UP/SP expects to begin directional operations between Ft. Worth and Houston in September. Directional operations will eliminate most of the delays caused by train meets, reduce congestion in this crucial corridor, and allow train crews to be used more efficiently. Labor implementing agreements with train and engine crews are expected in the St. Louis-Texas Corridor by the end of the year, leading to directional operations in this corridor.

Except for ongoing negotiations with UTU and BLE, UP/SP has reached merger implementing agreements with all unions except signal, maintenance of way, and yardmaster employees. The process of combining UP and SP headquarters functions is also essentially complete. The railroad has made all management personnel selections, and most employees have relocated. SP dispatchers are beginning to move to UP's Harriman Dispatch Center in Omaha.

2. New and Improved Train Services

UP/SP continues to introduce new and improved services made possible by the merger. By late July, UP/SP had removed enough trains from the Tennessee Pass line to free up yard space in Herington, Kansas. This in turn allowed UP/SP to restructure SP intermodal service between the Midwest and California as forecast in the July 1 report. Operating like an airline hub, Herington receives three trains each day, one each from Chicago, St. Louis and Kansas City, and converts them to three outbound dedicated trains, one for Oakland and one each for the UP and SP intermodal facilities in Southern California. These trains avoid switching en route and provide more reliable and faster service. The same procedure speeds shipments moving eastbound. All the trains between Herington and the West Coast operate over the Tucumcari Line, where the first steps of a $125 million upgrade are already allowing the line to operate more smoothly than it has in many years.

UP/SP's new intermodal trains are operating successfully and promoting competition. Trains ZMELT and ZLTME between Memphis and California are carrying growing amounts of traffic. Congestion on the Southern Corridor has held performance below desired levels, but the trains generally arrive within the windows that satisfy customer requirements. They already have pushed BNSF to improve its service. On July 28, BNSF announced that it would double its premium intermodal service between Dallas/Ft.Worth and both Los Angeles and Stockton, California, giving it two daily departures in that corridor. It also advertises twice-daily service between Memphis and the two California terminals. BNSF reduced transit times of these trains by one to four hours, a clear response to UP/SP's new train.

UP/SP's Oakland-Chicago premium service continues to set the service standard in this traffic lane long dominated by Santa Fe. On-time performance declined somewhat during the summer maintenance period on the Central Corridor but still exceeded 85%. The trains continue to be heavily patronized. The traffic volume on the new UP/SP-NS intermodal service between Columbus, Ohio, and Los Angeles is growing steadily. It now averages about 55 units per day, with a high thus far of 80 units. In the I-5 Corridor, UP/SP's Seattle-Los Angeles intermodal service continues to attract new traffic. In June, it carried a total of 247 units to and from Seattle; in July, it carried 755, a threefold increase. The latest data show that on-time performance steadily improved through the first ten days of August.

B. Safety First

DOT's comments raise questions about whether UP/SP is rushing to implement its merger at the expense of safety. Let there be no doubt about UP/SP's policy. As Art Shoener, Executive Vice President-Operations, recently told company employees: "Safety is always No. 1." Even a project as important as combining two railroads does not override the focus on safe operations. "In our railroad," said Shoener, "safety comes before productivity." He also urged the company to guard against distraction from safety as a result of the merger. In the wake of three recent accidents, UP/SP is rededicating itself to its safety-first philosophy.

DOT presents no evidence that merger implementation has resulted in any decline in safety, and it offers no comparison of pre-merger and post-merger safety levels, save one: it acknowledges that UP/SP has accomplished a "significant achievement" in reducing injury rates, especially on SP lines, since the merger. DOT-1, p. 3. DOT also acknowledges that "UP management has cooperated forthrightly with FRA on its Safety Assurance and Compliance Program on addressing every safety issue brought to its attention." Id. In light of this record, it is unclear why DOT thinks the Board should become more involved in safety enforcement.

The three recent accidents had nothing to do with the merger or its implementation. Most UP and SP rail operations have not yet been merged. The accident at Devine, Texas, appears to have resulted from a dispatching error at the Harriman Dispatch Center. UP/SP had not implemented any merger-related changes to dispatching at the Harriman Center at the time of the accident. Contrary to DOT's comment (DOT-1, p.3), the incident at Delia, Kansas, which occurred on a CTC-controlled line where no merger-related service changes had taken place, did not involve dispatcher error. Train crew error appears to have been the cause. The most recent incident in Western Nebraska apparently resulted from an equipment malfunction on a freight car.

UP/SP has cooperated fully with FRA's intensive inquiries into its operating practices, as DOT acknowledges. FRA has conducted two thorough audits of UP/SP dispatching since the Devine accident. UP/SP developed a comprehensive safety improvement action plan to address FRA concerns, a plan that extends well beyond FRA requirements. FRA has reviewed this plan with UP/SP managers on several occasions, and UP/SP officials understand that FRA is satisfied with it. DOT's filing mentions concerns about dispatcher workloads, an industry issue FRA highlighted in a recent report to Congress, but FRA did not indicate concern about this issue after reviewing this subject with UP/SP.

Readers may be alarmed by DOT's statement that, when it monitored communications at the Harriman Center, "almost 80% of the orders monitored contained one or more errors." DOT-1, p. 3. Assuming this figure is correct, the types of errors referred to are of a highly technical sort that did not compromise safe operations, such as a dispatcher identifying himself or herself as "Dispatcher 27" instead of the required "UP Dispatcher 27." UP/SP takes these errors seriously, and it conducts daily audits of dispatching audio tapes so that it can retrain any dispatcher whose communications are not complete in every respect. Similar steps are being taken to ensure that train crews communicate properly.

UP/SP also has adopted a policy of subjecting its dispatching practices to review by an independent body three times per year. Well before DOT submitted its filing, UP/SP had invited FRA to conduct a reinspection of UP/SP dispatching early next year. We welcome FRA's scrutiny and are confident that FRA will not identify any significant dispatching issue where safety is compromised.

As regards safe operations in "dark" territory where there are no trackside signals, the Harriman Center action plan reviewed by DOT includes several new rules governing communication of track authority that make miscommunications such as those that appear to have played a role in the Devine accident essentially impossible. DOT also expresses an undefined concern about recordkeeping that could make it difficult to monitor compliance with the Hours of Service laws. DOT may have been concerned that UP/SP would adopt UP's system for recording crew time electronically, when FRA preferred the SP system. UP/SP has already told FRA that it will use the SP system.

DOT does not provide enough information about alleged problems in connection with hazardous materials placarding and documentation to permit us to respond. DOT-1, p. 4. UP/SP just completed a round of claim settlement conferences with FRA in June and July, but the number of FRA citations discussed in those conferences was no greater than normal. Nevertheless, UP/SP employs a compliance audit process to address the principal problem with hazardous materials labeling and documentation: intermodal shippers sometimes fail to provide the railroad with proper disclosure of shipment contents.

Twice during the last several months, FRA has sponsored meetings (in Phoenix and Kansas City) at which labor union legislative representatives alleged violations by UP/SP and other railroads of the types described by DOT in its filing. FRA did not present any findings or evidence of such violations during these meetings. Nevertheless, UP/SP is participating actively in task forces established during those meetings to address the labor concerns.

In an effort to enhance rail safety, UP/SP and the UTU -- which represents 60% of UP/SP's operating employees -- recently announced a new joint safety program administered by an executive-level oversight team. This partnership will focus on derailment and injury prevention, grade crossing safety and employee quality of life, with specific attention to fatigue management. UTU President Charles Little said that this program is directed toward a common goal shared by UTU and the railroad: "the safety of our members."

C. Service Problems and Corrective Measures

One of UP/SP's principal objectives during the period of merger implementation was to avoid any deterioration in service. SP's history of financial weakness and underinvestment, combined with a number of unanticipated circumstances, kept that goal from being achieved. No one is more disappointed than UP/SP management. UP/SP is committed to overcoming these service problems as promptly as safety and prudence permit in order to regain the full confidence of its customers.

UP/SP service in the Gulf area is well below UP/SP's expectations and standards. Elsewhere on the UP/SP system, service problems are more modest but nevertheless appreciable. Although we do not agree with every assertion or complaint in the shipper statements filed with the Board, in general we will not contradict our customers' views.

Unfortunately, there are no quick and easy solutions. New trainmen are being hired at a record rate, but they must be trained. Trainmen are being promoted to engineers, but they too must receive lengthy training. UP/SP is hiring as many train dispatchers as it can find, but training a dispatcher can take up to six months. As we explain below, the largest improvements should come from the process of merger implementation itself, as UP/SP garners the efficiencies of combining the two railroads. UP/SP will realize these improvements as it continues to obtain labor implementing agreements, which the law requires it to obtain before it can consolidate train and yard operations.

1. <u>Causes of Service Problems</u>

Service problems of the kind UP/SP now faces are complex and the result of numerous interrelated factors. We offer here the best judgment of UP/SP's senior operating officials about the explanation for UP/SP's unanticipated service problems.

On September 11, 1996, UP merged with an SP system in fragile condition after years of financial weakness. The Houston terminal area in particular had long been an operational headache. For example, a 1993 article described SP's Houston terminal as "stockpiling trains like cordwood."[50] During its final years of independent operation, SP had to deploy its investment dollars with great care and it could not afford to invest in track and capacity to the extent of other railroads. As Oregon DOT reports, the I-5 Corridor "is being all but rebuilt," and "the rebuilding of SP's old mainline was a necessity."[51] SP's supply of locomotives was inadequate, and many were aging or in poor condition. It also avoided hiring train crew employees for almost a decade.

When the merger was implemented, SP operations had little margin for disruption or error. As we stated in the July 1 report, UP immediately transferred large numbers of locomotives to SP to get trains moving. This allowed SP to remove backlogs, such as pent-up demand for coal transportation from Colorado and Utah mines, and to improve its on-time performance. But the SP system was still stretched. Although UP/SP was taking delivery of large numbers of new locomotives, power remained tight. Train and engine crews in the Gulf Coast area and many other parts of the SP system were working long hours.

50/ Trains, Sept. 1993, pp. 48, 62.

51/ Comments, p. 2.

It is important to keep in mind that, although the merger was consummated at the corporate level on September 11, 1996, it cannot be implemented at the train-service level until labor implementing agreements are in place. Until then, most UP and SP traffic must be handled as though the railroads are separate entities, yards cannot be combined or coordinated, and separate UP and SP trains must continue to operate, even between the same points. As noted earlier, the first operational consolidation took effect on July 1 in the Central Corridor.

UP/SP expected to be able to maintain service quality until labor implementing agreements allowed major gains in equipment and employee utilization. Unfortunately, a series of events and conditions conspired to batter UP/SP operations in the Gulf Coast Corridor during the spring and summer:

a. <u>Upgrading of the SP Mainline</u>

UP/SP and BNSF simultaneously engaged in major upgrading projects on SP's Sunset Route between New Orleans and Houston. On December 16, 1996, BNSF purchased the easternmost 200 miles of SP's Houston-New Orleans mainline. BNSF immediately slowed all freight trains to 40 mph.

On approximately April 1, BNSF sent a tie gang to work on the east end of the line and imposed curfews that blocked train operations for parts of each day. BNSF then put a bridge gang to work on the other end of the line, imposing another curfew at that end. As UP/SP operated most of the trains on the line, this had a disproportionate effect on UP/SP operations. We do not suggest here that BNSF acted with intent to degrade UP/SP service. But UP/SP service suffered from the curfews and lower speeds. BNSF agreed in June to modify its work schedule to reduce the impact on UP/SP.

Further west, on the segment of the SP line east of Houston, retained by UP/SP, UP/SP deployed its own tie gang to install 100,000 new ties. Tie conditions on this section were far worse than on the portion BNSF bought, and the repairs were essential to correct slow orders. This work, which will continue until the end of September, created additional windows when trains could not run.

With curfews and slow orders between New Orleans and Houston, SP's service on the line began to unravel and traffic began to back up into the already congested Houston terminal. As operations between New Orleans and Houston and in the Houston area congealed, they consumed more and more assets and resources. Locomotive utilization plummeted as locomotives were stuck on line, leaving the Houston terminal with inadequate power and full of cars that could not move. Car utilization declined because car cycles lengthened.

And the demand for scarce SP train crews increased. Crews were unable to finish their runs within twelve hours, requiring second crews to move trains to the next terminal. This left fewer crews available to move other trains. It also forced train crews to work "on their rest" -- to go back on duty after the minimum rest time required by federal law. Some SP crews took time off, further depleting UP/SP's ability to run trains. BNSF hired a number of SP train crew members to staff its new trains, exacerbating the shortage.

The delays due to upgrading and maintenance were not confined to the area east of Houston. UP/SP rushed a tie gang to work on the worst section of the SP Sunset Route mainline, between Houston and San Antonio. That work is now complete. Further west, near Lordsburg in Arizona, UP/SP still has a gang at work replacing rail. All these activities cause traffic congestion and delays, consuming locomotives, cars and crews.

b. <u>Service Interruptions</u>

During the spring, UP/SP service was adversely affected by a series of incidents that impacted operations, especially on SP in the Gulf Coast area. SP suffered a derailment at Rison, Arkansas, that temporarily halted service north of Houston. The Sunset Route was blocked by flash floods at Hondo, Texas, west of San Antonio. Two derailments blocked switching at Englewood Yard in Houston. Then UP suffered its accident at Devine, Texas, south of San Antonio, which interrupted traffic to and from Mexico.

c. Disruption of the Laredo Border Crossing

In the weeks surrounding the transfer of Mexico's Northeast rail concession to private ownership, and especially in the two weeks prior to the transfer, the all-important Laredo gateway became congested. Laredo is UP/SP's principal route to Mexico, and it handles more than 80% of all rail traffic between the U.S. and Mexico. UP/SP needs to send some 400 or more cars southbound each day across the border at Laredo to keep up with demand. During the two weeks before the transfer, the Mexican railway often accepted fewer than 300, and on June 23 -- the transfer date -- accepted only 63 UP/SP cars for movement into Mexico. This disruption was apparently due in part to reduced availability of crews and locomotives on the line in Mexico just before privatization on June 23. At the same time, northbound trains were backed up in Mexico because of congestion on UP/SP.

As border crossings declined, UP/SP had as many as eleven trains stuck in sidings along its mainline, preventing other trains from using the sidings and tying up locomotives. Additional trains filled yard tracks at San Antonio, Ft. Worth, and further north. UP had as many as 4,500 cars en route to Mexico at one time, compared to an average of 3,000.

This problem may now be fixed. Over the last 45 days, UP/SP and the Mexican operator, KCS affiliate TFM, have worked cooperatively to solve it. The backlog of cars on

UP/SP bound for Mexico has declined, and the number of cars crossing the border is up to pre-transfer levels. TFM recently agreed to increase the number of cars it takes each day to 550. Assuming that happens, this cause of congestion should be over.

d. <u>Increased Plastics Traffic and SIT Volume</u>

A number of plastics shippers note with dissatisfaction that UP/SP is storing some SIT cars far from their origins in Texas. FINA-1, p. 4; CMA-2/SPI-3, p. 17. As discussed above, a number of factors have created especially heavy demand for capacity in UP/SP's SIT facilities, both in the Houston area and at more distant locations. These conditions have added to the strain on UP/SP's Gulf operations by adding to the number of train movements and causing some of UP/SP's yards to operate at reduced efficiency because many tracks are devoted to temporary storage. On one day, for example, UP/SP had to run five full trains of SIT cars out of Houston.

e. <u>Hurricane and Other Disruptions on CSX</u>

Nature dealt the most recent blow to UP/SP service in the Gulf Coast Corridor. Hurricane Danny did not directly affect UP/SP's service area, but it lingered for days over the CSX mainline northeast of New Orleans, dropping more than thirty inches of rain in some areas. Miles of the CSX line were under water. As a result, traffic that usually runs via

New Orleans had to be rerouted via Memphis, consuming increasing numbers of the already-meager supply of locomotives and crews. In addition, CSX recently had a 250-person rail gang on its New Orleans line, and it has experienced two derailments on the same line. UP/SP has no complaints about CSX's efforts. CSX has been supportive of UP/SP's attempts to alleviate congestion on the Gulf Coast Corridor, and has worked with UP/SP to offset the effects of these disruptions. But its problems became UP/SP problems.

* * *

All these factors combined to slow the overall velocity of train and shipment movements throughout the Gulf Coast Corridor. That slowdown, in turn, is having ripple effects throughout the merged system, especially on SP.

As locomotives and cars became tied up in Texas congestion, service on the remainder of the UP/SP system suffered because locomotives and car supplies were depleted. In addition, UP/SP judged the situation in the Houston area to be sufficiently critical to justify diverting locomotives from other merged system terminals. As a result, more trains are being held for power on other parts of the merged system and fewer locomotives are being assigned to some trains, resulting in longer transit times. UP/SP will address these situations by acquiring and leasing more locomotives, as described in detail below.

UP/SP service for Powder River Basin coal traffic has been adversely affected by several factors, but appears to be returning to normal except for trains to and from Texas utilities which are affected by the Gulf Coast situation. In late May, the nation's largest coal mine, located in the Basin, shut down due to flooding, and it continued to be adversely affected for some time. Although some empty trains were diverted to other mines, empty trains backed up throughout the coal corridors east of the Basin, causing congestion and delays. Weather problems returned with a vengeance in July, when one mine was disabled by lightning and several were closed by heavy rain, completely disrupting UP/SP's coal operations and causing congestion throughout the Midwest. Coal loadings in the Basin returned to normal in early August and should remain at near normal levels, although the operation continues to be affected by tight crew and power availability.

UP/SP coal service was also disrupted by unexpected crew shortages in the Colorado and Utah coal mining region. UP/SP gives priority to staffing BNSF trains in the Central Corridor. BNSF, which is about to begin supplying crews for its own increasing Central Corridor trackage rights operations, has been hiring aggressively in this area. A number of UP/SP personnel, uncertain of how the UP/SP merger might affect them or wishing to avoid relocation, transferred to BNSF. The merged system is working aggressively to stabilize the situation and return operations to normal levels.

Finally, service on former SP lines in Phoenix and in the Southern California area has been adversely affected. In Phoenix, UP/SP recently revised its operating plan to improve service to shippers on the SP line. In Southern California, the problem arises primarily from congestion at SP's West Colton yard. Implementation of TCS in the Central Corridor shifted some interchanges between UP and SP to Colton, increasing the switching burden and causing congestion delays. UP/SP recently made programming changes in TCS to reverse that pattern. SP is also short on crews in the area, so UP/SP is hiring approximately 100 new employees in Southern California.

2. UP/SP Initiatives to Restore Service Quality

UP/SP management at the very highest levels and down through the ranks is mobilized to identify and implement effective solutions to these service problems. UP/SP's personnel from the Executive Vice President-Operations on down have canceled vacations, spent extended time on-site in the Gulf area, and worked unrelentingly to find answers to the service difficulties.[52]

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[52] UP/SP notes with concern the statements by one shipper that UP/SP ignored its service complaints. NALS-1, DeVoe, pp. (continued...)

Unfortunately, it is much easier for a railroad to slip into a service decline than to reverse it, and it takes extra resources to return the service to normal. When a railroad is operating normally and reasonably efficiently, train crews generally reach their destination terminals within the time period permitted by federal law, and locomotives on their train are available to take another train out of the terminal. When a railroad becomes congested, however, train crews are more likely to run out of time short of their destination terminal and must be replaced, requiring extra crews. Locomotives are not available as expected, requiring extra locomotives to keep trains running. Thus, it takes more than the normal level of locomotives and crews to overcome a service disability.

UP/SP is moving aggressively to add the core resources that will be necessary to return the railroad to normal operation. The list of steps UP/SP is pursuing is lengthy:

52/ (...continued)
3-4. In fact, the UP/SP representative who handles the NALS account, Maureen Horrigan, is in contact with Mr. DeVoe virtually every day, and often more than once a day, regarding service issues. It is certainly likely that some complaints have received inadequate attention, because UP/SP marketing, customer service and operating personnel have been swamped with customer inquires and requests for assistance. They are attempting to be as responsive as possible. UP/SP is attempting to act immediately on the most exigent circumstances, such as attempting to prevent plant shutdowns and losses of business, and to make the improvements that will bring the most benefit to the most shippers.

a. Train Crews

UP/SP is hiring over 500 new train service employees, approximately half of them in the Gulf Coast area. This is the most ambitious hiring campaign by these railroads in decades, and it represents the first substantial SP recruitment of employees for these crafts since the 1980s. It takes about 60 days to train new switchmen and trainmen. Thus far, almost 80 new employees have completed training programs and are now in service in Texas. Fifty additional employees are training in the Gulf Coast region. Additional new employees have been hired and are in training in Chicago (30 employees), Council Bluffs (12), North Platte (24), and St. Louis (12). More hiring programs are underway or about to begin not only in these areas, but also in many Texas cities, the Twin Cities, Boone (Iowa), Denver, Cheyenne, Rawlins (Wyoming), Pine Bluff, Tucson, Phoenix, Portland, Salt Lake City, and the Los Angeles Basin.

As UP/SP increases the pool of switchmen and trainmen, more senior trainmen become eligible for training and promotion to positions as locomotive engineers. New engineers are already entering service in several areas. A total of 285 new locomotive engineers should be on UP/SP locomotives or in training by the end of the fall.

UP/SP also has temporarily moved more than 100 train and engine service employees to the Gulf Coast Corridor from areas where there were surplus crews. And it will be offering permanent transfer opportunities in several areas where crews are scarce.

b. Locomotives

UP/SP is making sure that these new and transferred employees will have locomotives to operate. It already has taken delivery of 227 high-horsepower locomotives this year, with 45 more on their way. It is accelerating delivery of 21 additional units from its 1998 locomotive order. The railroad has contracted to lease 135 additional units, 29 of which arrived on the property this month. UP/SP is repairing and placing in service 42 locomotives that had been stored or were awaiting retirement. And productivity improvements should release more than 100 additional locomotives for service in areas with deficits. In total, UP/SP will have well over 300 more locomotives available this fall than it did on August 1. This will replenish locomotive supply in the Midwest, which diverted about 100 locomotives to the Houston area, and provide dozens of additional locomotives to improve service in the Gulf Coast Corridor and throughout the system.

c. Management Redeployment

UP/SP has taken a number of steps to provide greater management focus on the Gulf Coast Corridor. On August 1, it created a new service unit in Texas to ensure that managers can concentrate on this corridor. UP/SP also established a new Houston Terminal Control Center, which provides 24-hour coordination of train and switching operations among UP/SP's numerous yards and in conjunction with local terminal railroad companies in Houston. An Industrial Switch Team monitors customer switching commitments. A team of chemical marketing specialists is addressing the needs of chemicals and plastics shippers. A new Tactical Corridor Team of six full-time managers schedules trains in the Houston-Ft. Worth-San Antonio triangle 24 hours per day. This team also is charged with improving crew calling accuracy to ensure that train crews are used efficiently, and with improving blocking plans so that cars are handled more efficiently.

d. Operating Patterns and Facilities

UP/SP (along with BNSF and Tex Mex) has already established directional running between Houston and Beaumont. It is expediting the construction of a key track connection in Houston to make this operating pattern more effective. UP/SP is preparing to begin directional operation between Ft. Worth and Houston, to take effect in September once a connection is ready at Hearne, Texas. This will eliminate most of the delays associated with train meets in this important corridor, improve locomotive utilization and ensure that crews reach their destinations within the Hours of Service law.

UP/SP reduced some of the switching burden at the Houston yards by making greater use of other terminals such as

Alexandria and Shreveport, Louisiana, and Waco, Texas. For example, Pine Bluff now makes a block for SP's Strang Yard to expedite these cars and avoid switching at Englewood. Strang is building trains for the east to eliminate switching delays at Englewood. UP's Settegast Yard is making Strang and Beaumont blocks that are moved to destination without switching.

During August and September, UP/SP is implementing UP's Rail Yard Management system at Houston rail yards. This system improves the operating efficiency of terminals, a major problem at SP's Englewood and Strang yards. UP/SP also rebuilt the Englewood hump and expanded switching capacity so that the yard can classify cars more efficiently. SIT cars that had been occupying switching tracks at Englewood and Strang were relocated. And UP/SP plans to expand track capacity at Strang and Coady Yards early next year.

East of Houston, UP/SP either has completed or is working on connections at Kinder and Iowa Junction, Louisiana, so that some SP traffic can move off the BNSF line next month. It is constructing sidings at Edna and Elton, Louisiana, to support these new operations.

e. <u>September 16 Consolidation</u>

Without question the most important immediate steps UP/SP can take to improve service in the Gulf Coast Corridor will begin on September 16, when new labor implementing agreements take effect throughout the corridor from Brownsville to New Orleans and from Houston to Shreveport and into Central Texas. This will allow UP and SP, for the first time, to combine their Gulf Coast operations, eliminating today's parallel and duplicate functions. Effective that day, train and engine employees can be used in the most efficient manner. This will result in a number of important changes:

- Most SP manifest traffic will be removed from the BNSF Avondale-Iowa Junction line and consolidated with UP traffic routed via the efficient freight yard at Livonia, Louisiana, where a $15.5 million expansion is nearing completion. This will allow hundreds of shipments each day to avoid the delays on the BNSF route and will reduce congestion for the remaining UP/SP trains, as well as BNSF and Amtrak trains, on that route.

- Use of Livonia Yard will allow UP/SP to improve transit times. With increased traffic density, UP/SP will implement extensive new blocking plans and through train operations in conjunction with connecting carriers at New Orleans. New through trains will connect Livonia with the IC terminal in New Orleans. New trains will also move pre-blocked traffic to and from CSX and NS yards at Knoxville, Chattanooga, Macon, Atlanta, Hamlet (North Carolina) and Baldwin (Georgia). Livonia Yard also will begin constructing trains blocked for San Antonio which will bypass Houston entirely. CSX and NS will send trains directly to Englewood Yard, avoiding switching in New Orleans.

- UP/SP will begin operating trains linking chemical coast yards at Dayton, Beaumont, Orange, and Lake Charles with Livonia, North Little Rock and Pine Bluff, using a combination of UP and SP tracks. These trains will save most shipments a day or more in transit and again reduce switching in the Houston terminal.

- In Houston, UP/SP will also discontinue a typical but inefficient operating pattern in which a UP crew brings cars to Englewood and then an SP crew takes them to their destination (or vice versa). One crew can take the cars directly to their destination. And UP/SP will begin to specialize the functions of all its Houston yards, with Englewood assuming primary responsibility for service to PTRA and HBT shippers.

- Southwest of Houston toward Brownsville, UP and SP train service will be consolidated on the shorter UP route. This will eliminate the current inefficient operation of both UP and SP trains between the same points. Between Bloomington, Texas, and Brownsville, a distance of over 200 miles, these UP and SP trains share the same track and get in each other's way. They also create unnecessary conflicts with BNSF and Tex Mex trains over portions of their routes. By consolidating UP and SP operations, UP/SP will reduce congestion and improve service for all three carriers. In addition, one pair of trains on this route will originate and terminate at Englewood Yard, eliminating interchange movements and reducing transit time.

The September 16 consolidation will not solve all the Gulf Coast Corridor issues overnight. Implementation will take time, and there are sure to be some dislocations as operations change. But it should make a substantial dent in the problem. Then, later this year, UP/SP expects to reach implementing agreements for the Texas-St. Louis Corridor, which will bring additional important changes. Most significantly, UP/SP will combine UP and SP traffic and begin to implement directional running, which will allow UP/SP to combine all UP and SP traffic to and from the Gulf Coast into trains to and from the yards that best serve its customers.

D. <u>Responses to Specific Comments</u>

1. <u>Coal Shippers</u>

Five coal shippers, some of whom are seeking modification of merger conditions, complain about service quality. Three of these -- Cyprus Amax, Intermountain Power, and Colorado Public Service -- originate coal in the Colorado/Utah area where UP/SP encountered recent crew shortages. These crew problems, which UP/SP hopes it has resolved, adversely affected UP/SP's performance for these shippers in recent months.

Two utilities that receive coal from the Powder River Basin also complain about service. As explained above, several factors, largely not within UP/SP's control, recently affected service from the Basin, but service appears to be returning to normal. Empire District Electric suggests that it has been the victim of some form of discrimination, but the recent problems affected all shippers who receive PRB coal. The contractual cycle time for shipments to Empire's Asbury, Missouri, plant is ambitious, and Empire is correct in its statement that UP/SP and KCS "have had great difficulty" meeting it. EDEC-3, p. 2. While we do not want to disclose the confidential terms of the Empire contract, it provides a remedy for failure to meet an agreed cycle time, and UP/SP has complied with that contract remedy.

LCRA also complains about deteriorating service over the last three months. UP/SP service to LCRA did decline in June and July. UP/SP's computations of cycle time do not agree with those supplied by LCRA, because UP/SP is not responsible for some of the delays,[53] but service during those two months was severely impacted by Texas congestion. LCRA's contract with UP/SP also contains remedies which LCRA is entitled to invoke.

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[53] For example, LCRA reports the July cycle time for its trains as 333 hours. LCRA-10 at 5. UP/SP data show that the railroad component of the cycle time was 262.7 hours, a slight improvement over June, but still much longer than the contract standard.

Empire and LCRA object to UP/SP's decision earlier this year not to go forward with the "Kansas City Bypass" route via Wichita. This decision resulted in part from environmental objections raised by the City of Wichita and Sedgwick County against operation of coal trains through Wichita. Those objections seemed likely to raise the cost of the bypass route substantially. In addition, UP/SP determined that it could invest its funds on its existing routes via Kansas City and provide similar service benefits with greater operational flexibility. UP/SP is already moving forward with capacity expansion projects on those routes, including installation of Centralized Traffic Control between Kansas City and Topeka. This decision should not adversely affect coal shippers.[54/]

2. BNSF

BNSF complains that UP/SP is responsible for "repetitive service failures" in haulage and reciprocal switch service on BNSF traffic that UP/SP handles. BNSF-1, p. 15.

BNSF's haulage and reciprocal switching movements have been adversely affected by UP/SP's service problems, as have UP/SP shipments. But any notion that UP/SP has failed to do its utmost to facilitate BNSF operations and support BNSF

[54/] It should be noted that UP/SP had not intended to upgrade the Kansas City Bypass route for coal trains until 1998 or 1999, so that route would not have been available to limit the effects of current service problems.

service is absolutely incorrect. Our July 1 report detailed UP/SP's extraordinary efforts and commitments of resources to supporting BNSF competition, often outstripping BNSF's own efforts. Those efforts continue. UP/SP has assigned even more management personnel to the task of responding to BNSF inquiries and concerns. UP/SP staff responsible for ensuring the quality of customer service are in regular contact with their BNSF counterparts. UP/SP prepares reports for BNSF daily. UP/SP provides BNSF dedicated toll-free numbers to inquire into service issues. The frequency of problem-solving conference calls was recently doubled.

UP/SP service to BNSF was until recently impaired by the fact that both carriers had dual information systems. As a result, BNSF frequently sent haulage bills to UP when SP had the car and vice versa. Haulage instructions were often improperly coded. BNSF's July 4 cutover to a single information system improved this situation substantially. UP/SP's TCS implementation on August 1 resulted in further improvement, but errors continue to appear.

UP/SP encountered a particular problem with BNSF traffic interchanged from shortline carrier Little Rock and Western, which frequently turned interchanged cars to UP/SP before it issued billing instructions to BNSF. When that happened, the cars went to hold tracks or to the wrong destination. UP/SP affiliate UP Technology supplied a partial solution to this problem, routing the instructions to both UP/SP and BNSF upon issuance.

UP/SP and BNSF representatives continue to refine solutions to problems that affect BNSF haulage and reciprocal switching service. They continue to make real progress, and they will make more as both companies implement their respective mergers. There is no reason for the Board to intervene in this area.

3. Tex Mex

Tex Mex says it has suffered "severe delays to its trackage rights operations over the Flatonia Route." TM-2, p. 9. During the principal proceeding, Applicants warned that Tex Mex sought trackage rights over a route containing segments with limited capacity and slow speeds. UP/SP-232, Ongerth, pp. 63-68. Nevertheless, UP/SP did not expect Tex Mex to encounter problems of the magnitude it has experienced recently. Tex Mex is incorrect, however, in suggesting that these problems and the resulting costs place it at a competitive disadvantage in relation to UP/SP. TM-2, pp. 10-11. UP/SP is suffering comparable delays and incurring similar costs.

The steps UP/SP is taking to improve its own service in the Gulf Coast Corridor will benefit Tex Mex as well. For example, as UP/SP hires additional crew members and adds locomotives to improve the velocity of its trains, congestion in the Houston terminal and on the lines where Tex Mex has trackage rights should ease. The September 16 consolidation of UP and SP operations in the Houston area should be of special benefit to Tex Mex. One of the first steps UP/SP will take is to consolidate operations in the corridors where Tex Mex has trackage rights. SP train service between Houston and Corpus Christi and Brownsville over the Flatonia Route will be consolidated into UP's existing schedule, reducing the number of trains Tex Mex trains must meet.

Tex Mex accuses UP/SP of "gross impropriety" for allegedly blaming TFM for congestion in the Houston area in a conversation with a shipper. TM-2, p. 9, & Letter from Larry D. Fields to A.L. Shoener. UP/SP's response to Mr. Fields, attached hereto as Exhibit A, was written before TM-2 was filed. As Mr. Shoener explained to Mr. Fields, the UP/SP official readily acknowledged to the shipper that UP/SP was experiencing problems in the Houston area. But Tex Mex cannot deny that the number of UP/SP cars crossing the border at Laredo, particularly before privatization, declined. This was a contributing factor to the Texas congestion. As noted, this problem has eased through cooperation between UP/SP and TFM, which we expect to continue.

4. <u>Utah Railway</u>

Utah Railway states that "overall congestion in the Salt Lake Valley" is an impediment to its competitiveness.

UTAH-2, p. 9. UP/SP's recent actions to implement the merger in the Salt Lake region should reduce that congestion substantially. As noted earlier, UP/SP has eliminated 20 through train movements per day between Ogden and Salt Lake City. South of Salt Lake City on the line to Provo, UP/SP has eliminated as many as ten manifest train movements each day by shifting that traffic to UP/SP's Wyoming mainline. Except for coal, taconite and local movements, there is very little UP/SP rail traffic left on that line, which Utah Railway shares with BNSF and Amtrak.

5. Longhorn Railway

Longhorn Railway says that UP/SP service deprived it of expected revenues, that UP/SP failed to return Longhorn's dedicated cars, and that UP/SP has not honored duties to supply additional equipment for car pools serving Longhorn. It expresses great frustration about its efforts to get these problems resolved.

UP/SP has every incentive to help Longhorn develop business that will use UP/SP service. In fact, UP/SP has taken several steps to address Longhorn's problems. For example, when service failures prevented the delivery of empty cars, UP/SP ran a dedicated train from Houston to McNeil with 20 hoppers, and stopped an intermodal train to pick up and set out another 20 hoppers. It increased the size of the primary open-top hopper pool available to Longhorn from 60 cars in

April to 119 cars in July. In addition, it created another 40-car open-top hopper pool for use by Delta Materials, a Longhorn shipper.

On August 6, 1997, six UP/SP representatives met with Longhorn's president, Donald Cheatham. At the meeting, UP/SP agreed, among other things:

- To notify Longhorn six hours in advance if the Longhorn interchange will not be switched.
- To try to revise the handling of empties in the Taylor-Austin-San Antonio corridors to provide a more consistent daily car supply.
- To have UP Engineering personnel evaluate the interlocking plant at McNeil.
- To seek equipment to accommodate a new Longhorn shipper.
- To arrange for communications between Longhorn and UP/SP train crews.
- To provide a single contact at UP/SP (and two backups) to resolve problems. This person is responsible for handling all Longhorn concerns with various UP/SP departments.

UP/SP did not knowingly divert Longhorn's freight cars to others. Four cars erroneously were diverted to other shippers. At the recent meeting, UP/SP told Longhorn how to change the instructions in the Uniform Machine Language

Equipment Register so that its cars will be listed properly and automatically directed back to Longhorn. Also, UP/SP neither committed to supply a specific quantity of cars to pools serving Longhorn, nor knowingly diverted the cars it had placed in those pools to other shippers. If Longhorn works with UP/SP to manage cycle time on available cars, it should be able to load over 500 cars per month.

Many of the conditions about which Longhorn complains, particularly those of car supply, are part and parcel of the prevailing situation in Texas described above, and should improve as conditions in Texas improve. Meanwhile, UP/SP has taken steps to address Longhorn's unique problems immediately and to establish a communications structure to ensure that future problems do not fester.

6. CPUC

CPUC raises two service-related concerns. First, it says that a state-owned railroad, the Northwestern Pacific Railroad ("NWP"), has not received enough empty freight cars to support its loadings. Comments, p. 8. NWP, like UP/SP, is experiencing shortages of flatcars due in part to unusually high demand and in part to congestion. In addition, however, NWP is in perilous financial condition and has not paid car hire to UP/SP on a current basis. As part of a 1995 settlement that created NWP, SP wrote off approximately $1.0 million in car hire owed by NWP's predecessor and during the first five months of 1997 NWP failed to pay $400,000 in car hire charges. UP/SP is concerned about ever-growing liabilities from an entity that apparently cannot pay its bills. UP/SP and NWP recently agreed that UP/SP can deduct car hire from revenue due NWP.

Nevertheless, NWP has received empty equipment supplies in proportion to other lumber shippers on UP/SP. During May, UP/SP provided 70 empty cars and sent 90 additional loaded cars to NWP, authorizing NWP to reload them. (Unfortunately, loaded cars tend to disappear on the NWP for long periods and are not reloaded promptly.) In June, UP/SP delivered 95 empty flatcars, and in July, 156. In June, UP/SP also provided NWP with a pool of 20 cars for its sole and exclusive use at a below-market car hire rate. It should be apparent that UP/SP is attempting to work with NWP in difficult circumstances.

CPUC also is concerned that UP/SP may be standing in the way of BNSF access to the Port of Oakland and to development of the Joint Intermodal Terminal contemplated in the BNSF Settlement Agreement. Comments, pp. 9-10. Although UP/SP has determined that its existing facilities are sufficient for its needs, the Port of Oakland is proceeding with a Joint Intermodal Terminal that will serve BNSF. The Port is providing a letter to the Board confirming this fact, and confirming UP/SP's cooperativeness in this effort. This development will allow BNSF to originate at dockside in Oakland some of the trains that it now originates in Richmond, California. Those doublestack trains use BNSF's Southern Corridor route and will continue to use that route, so tunnel restrictions on BNSF's Central Corridor route should not adversely affect its ability to compete.

7. SCRRA

SCRRA's complaint about service quality on the UP/SP line between Los Angeles and Riverside, California, is unwarranted. Under its contract with SCRRA, UP/SP is required to provide on time service for not less than 95% of the Metrolink trains on this line. UP/SP has satisfied that standard every month save one since January 1996. During the first seven months of 1997, UP/SP's performance exceeded the standard consistently:

January	96.6%
February	95.4%
March	95.6%
April	96.6%
May	97.6%
June	96.1%
July	97.4%

Thus, UP/SP is doing what it contracted to do. But there is more.

SCRRA's complaint reflects a problem that railroads frequently encounter when operating passenger trains for passenger agencies: many agencies are unwilling to adjust their schedule demands to reflect changes in operating conditions. In the wake of a catastrophic head-on collision between a Maryland MARC train and an Amtrak train in Silver Spring, Maryland, over a year ago, FRA established a new safety rule requiring trains to operate at restricted speed if they stop after passing a signal.[55] This rule, which UP/SP is required by law to follow, increases the westbound running time for commuter trains from Riverside to Los Angeles by three minutes and the eastbound running time by two minutes. Those increases reduce the schedule cushion to which SCRRA originally agreed, making it harder for UP/SP to operate Metrolink trains on time. SCRRA has been unwilling to lengthen the schedules to reflect this new safety rule. As a result, although UP/SP's apparent schedule compliance is not perfect, UP/SP is doing as good a job as ever under greater operating constraints. The solution is more realistic schedules.

8. Amtrak

Amtrak reports that it has not seen the improvement in performance on SP lines that it expected as a result of the merger and that the Applicants said they would provide. It fears that growing freight traffic on some of the lines it uses will lead to poorer service. It asks the Board to require UP/SP to provide several additional reports.

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[55] Emergency Order No. 20, 61 Fed. Reg. 6876 (1996), modified, 61 Fed. Reg. 8703 (1996).

As Amtrak agrees (Comments, p. 10), it is too early to form a judgment about the effects of the UP/SP merger on Amtrak train performance. At the operating level, UP/SP began integrating operations and changing service only last month. The changes UP/SP made in the last seven weeks in the Central Corridor should work to Amtrak's benefit: UP/SP removed up to ten manifest trains per day from the route of the California Zephyr between Dotsero, Colorado, and Salt Lake City, Utah, a distance of almost 400 miles. UP/SP is also transferring trains from the 215-mile former WP route between Salt Lake City and Alazon, Nevada, which is used by the Zephyr, to SP's route further north. Both segments are mostly single-track railroad, so the reduced freight traffic should lower the possibility of train conflicts and delays.

The changes UP/SP will make in the Gulf Coast area beginning September 16 also should benefit Amtrak. UP/SP will remove many of its trains from a 200-mile segment of the former SP Sunset Route between New Orleans and Iowa Junction used by Amtrak's Sunset Limited. (BNSF will get credit for any performance improvement resulting from this UP/SP change, because it now owns the track.) UP/SP also expects to reduce congestion in the Houston area as a result of this and other changes in the Gulf Coast Corridor. Like other railroads and many shippers, Amtrak has at times been adversely affected by this congestion, especially during the last two months.

Some of the essential and constructive changes resulting from the UP/SP merger will adversely affect Amtrak performance in the short run but will aid it in the long run. UP/SP is investing heavily in maintenance and upgrading of the SP mainlines that Amtrak uses. When a railroad performs major rail or tie work, as UP/SP is pursuing on the Sunset Route and elsewhere, it must place slow orders on its track. Oregon DOT observes that UP/SP is practically rebuilding the I-5 Corridor, used by Amtrak's Coast Starlight. Amtrak trains will be delayed by this type of work as UP/SP brings SP mainlines up to UP standards. Once the work is complete, Amtrak trains will be able to operate more reliably.

The Board should understand that when major trackwork is underway and delays are inevitable, Amtrak often does not adjust its current schedules.[56/] Thus, even though Amtrak knows before its Sunset Limited departs New Orleans three times a week that it will encounter delays due to BNSF and UP/SP trackwork, it holds itself out to the public as operating a schedule it cannot keep. Under its compensation formulas, Amtrak penalizes the host railroad for delaying its trains in order to perform the trackwork necessary to keep Amtrak and other trains running.

[56/] Amtrak sometimes provides schedule relief to the railroad for maintenance work, but it also reduces incentive payments, and the relief is often insufficient.

Contrary to Amtrak's apparent assumption, Amtrak trains do not have performance problems on SP because of any practice of improperly preferring freight trains. To illustrate, we discuss the July 9-11 run of Amtrak's train no. 1, the Sunset Limited, on SP's Sunset Route from Iowa Junction to Los Angeles, which Amtrak describes. Comments, pp. 7-8. We base our discussion on taped replays from SP's Digicon dispatching system of the actual movement of this train and UP/SP trains over the Sunset Route on July 9-11. These replays show exactly what happened and when it happened to the second. They provide an opportunity to review actual events.

This Amtrak train had a terrible trip. It arrived in Los Angeles eight hours late. Slightly over five hours of this delay were attributable to interactions with freight trains. Two hours were attributable to slow orders, presumably some on BNSF, certainly some on UP/SP. As a result of these delays, UP/SP lost all performance payments for handling this train, comprising more than half of the total compensation UP/SP could hope to receive for handling the train under SP's current operating agreement with Amtrak. This late train also made it much more difficult for UP/SP to earn any performance payments for the entire month, even if most of the other Amtrak trains operated on time.

But it is not true, as Amtrak asserts, that UP/SP dispatchers committed "several incidents of egregious violations of the statutory priority to which Amtrak is entitled under the Rail Passenger Service Act." Comments, p. 7. Even on this difficult trip, UP/SP dispatchers did the opposite. Their efforts were dashed by unexpected or unavoidable events on a congested railroad that needs more capacity for the traffic it carries. When those events occurred, the dispatchers did their best to give preference to Amtrak's train and its passengers.

On this run, as is typically the case for the Sunset Limited, train no. 1 was given priority over more than 60 UP/SP freight trains, each of which was held at a siding to let no. 1 go by. These freight trains were delayed by more than 30 hours in total. The delayed trains included the highest-priority intermodal trains on the railroad. Two UP/SP intermodal trains were delayed almost an hour to favor Amtrak. Several other trains were delayed even longer.

Here is how train no. 1 was delayed:

- As Amtrak correctly points out, the longest delay suffered by this train was 1 hour and 32 minutes at Lasca, in West Texas, because a freight train ahead stalled and had to be split apart to get over a hill. Comments, pp. 7-8. That UP/SP train, a routine manifest train, failed at 5:20 p.m. straddling a switch, blocking entry to the siding. At that point, Amtrak train no. 1 was at Alpine, Texas, 139 miles away, so the dispatcher obviously had not planned the delay to favor the freight train. The dispatcher put two UP/SP intermodal trains that were ahead of the Amtrak train into sidings to allow Amtrak to be the lead train behind the stalled train. Amtrak was the first train out once the stalled train was able to clear the area. This was an unfortunate incident that delayed UP/SP trains more than Amtrak trains, but not an "egregious violation of statutory priority."

- Amtrak says that its train was forced to follow a slower freight between Maricopa and Yuma, Arizona. That happened because a switch failed unexpectedly. The dispatcher had arranged a meet between two freight trains at Enid, Arizona. After one of the trains entered the siding, the dispatcher could not get the switch behind it to return to its normal position so that the other train, which was occupying the mainline, could depart. Thus, both tracks were blocked. At that point, the Amtrak train was 28 miles away. It took about 20 minutes to fix the switch and release the train on the mainline. It proceeded ahead of the Amtrak train to the next siding and got out of the way as quickly as possible. Once again, this freight train was not a priority train. Again, this was an unexpected event, not favoritism to freight trains.

- Amtrak says that the Sunset Limited was delayed for 22 minutes at Frink, California, to let two freight trains pass. Comments, p. 8. Playback of the dispatching tapes shows this did not happen. Amtrak met only one train at Frink. The dispatcher arranged a reasonably good meet at Frink with that UP/SP train, delaying the Amtrak train by approximately 7 minutes and 30 seconds. The dispatcher could not reasonably have held the UP/SP train further back because the next five sidings behind it held trains or cars.

- Amtrak asserts that UP/SP held train no. 1 for 40 minutes at Uvalde, Texas, to "await the passage of <u>three</u> freight trains." Comments, pp. 7-8. This delay occurred because a local freight became disabled on the mainline, blocking it, and the two sidings beyond were blocked. At the very time the three freight trains were moving east toward the Amtrak train, a railroad official conducted surprise, random tests of the train crews, as required by FRA, delaying each of the three trains in turn. This may not have been a good time to conduct tests, but there is no reason to believe that the dispatcher expected these surprise tests. The dispatcher's only alternative to letting the three trains go first was to hold them, as well as a fourth behind them, for horrendous delays much further west, where there was yet another train in the way.

- Amtrak states that train no. 1 was delayed for nine minutes at Lanark, New Mexico. The dispatching tapes indicate that this was a reasonably good meet, with both trains arriving at the siding at about the same time. The freight train was delayed longer.

- Amtrak claims 67 minutes of delay between Houston and San Antonio, an area of severe congestion on UP/SP now. The dispatcher confronted the situation of two priority Amtrak trains heading towards each other and sandwiching five UP/SP freights, one of which was stuck in a siding without a crew. The dispatcher put train no. 1 in a siding to meet one of the UP/SP trains in a manner that would cause the least delay to Amtrak. He held another UP/SP train for an hour, another for 30 minutes and yet another for 46 minutes, all to let train no. 1 pass. With a second Amtrak train coming, the dispatcher had no alternative but to put no. 1 in a second siding to let the oncoming traffic, including the second Amtrak train, go by. This was an awkward and difficult situation involving extreme congestion, but the Amtrak trains received the highest priority.

- Amtrak claims train no. 1 was delayed in California "for the passage of two helper engines." Comments, p. 8. The dispatching replays do not substantiate this claim. At one location (Fingal, California), the Amtrak train was delayed by five minutes because a UP/SP freight train was slow getting out of the way after putting helpers in its train.

- Amtrak correctly states that its train was delayed by trains ahead of it between Lake Charles and

Beaumont. Comments, p. 7. In fact, there were six trains in front of Amtrak's train and only two sidings. The dispatcher delayed two UP/SP freight trains by a total of 3 hours and 55 minutes by squeezing them both into a single siding in order to let Amtrak train no. 1 get by. With four more trains ahead and only a single siding, the dispatcher's decision to let all the trains keep running caused the least delay possible to no. 1.

- Amtrak's train was not accorded the "indignity" of running through a freight yard at West Colton. It used the "Colton Drill" track, which is the second main track in that location.

This Amtrak train was delayed. The delays are the responsibility of UP/SP, as the owner and operator of the track. Most Amtrak trains have much better outings than this. But Amtrak's assertion of unlawful behavior (Comments, p. 8) is not warranted by the facts. The dispatching tapes do <u>not</u> show a pattern of favoritism to freight trains over this Amtrak train.

The UP/SP and Amtrak filings reflect disagreement, and perhaps miscommunication, about how well or poorly SP has performed in handling Amtrak trains. Amtrak disputes UP/SP's assertion in the July 1 report that "SP has ranked as high as first among all the railroads with substantial Amtrak operations" when measured on the ICC basis. That statement was based on data supplied by Amtrak for November 1996, which showed the following:

SP	79.6%
Conrail	79.4%
UP	78.8%
BNSF	73.9%
CP-D&H	69.0%
CSX	65.3%
NS	48.5%

The greatest challenge in handling Amtrak trains on time is long-distance operations over several corridors, such as are conducted by the carriers listed above.[57/]

One reason SP's performance is not better is that SP has not had access to the hundreds of millions of dollars necessary to upgrade and expand capacity sufficiently on some of the routes Amtrak uses, such as the Sunset Route. In recent years, as SP freight traffic grew on some routes, it became harder and harder for SP dispatchers to avoid the types of situations listed above and to avoid delays to Amtrak

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[57/] Amtrak presents a different measure of performance, which is the amount SP earns from Amtrak in incentive earnings. Comments, pp. 4-5. Amtrak's compensation formula for performance payments is extremely complex, and not suitable for treatment in this report. To illustrate its complexity -- and to highlight a major reason why SP earns so little -- if the westbound Sunset Limited is delayed by slow orders, track work and congestion east of Houston on SP, SP is at great risk of losing not only its performance payment for that segment, but also its performance payment for the remaining three segments, even if Amtrak operates on time over those segments. If the same amount of delay incurs near the end of the trip in California, however, SP would earn most of its performance payment under Amtrak's formula. So incentive or performance payments are a weak surrogate for on-time performance. Under this formula, UP/SP has been severely penalized not only for congestion in Texas but also for upgrading the SP.

trains. As the merger capital program is carried out, Amtrak will benefit.

9. USDA

USDA expresses concern about the disposition of the "Central Corridor line from Salina, Kansas to Pueblo, Colorado." Comments, p. 6. Presumably, USDA intended to refer to UP/SP's line between Pueblo and Herington, Kansas, which does not serve Salina. USDA says the line is important to wheat growers in southeastern Colorado.

USDA is rearguing the merits of the Board's decision to authorize abandonment of the line segment between NA Junction and Towner, Colorado. That decision was based on a complete record, which established the very low volumes of rail traffic on the segment and the fact that wheat shipments were moving through loading facilities on other railroad lines. USDA offers no new evidence justifying reconsideration of the abandonment decision, or of the Board's decision not to require divestiture of this and other lines.[58]

E. New Service Reporting Requirements Are Not Necessary

A number of commenting parties ask the Board to require UP/SP to provide new types of reports on UP/SP service quality in future quarterly filings. Amtrak Comments, p. 10; CMA-2/SPI-3, pp. 16-18; SNA-2, pp. 7-8; FINA-1, pp. 8, 11.

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[58] The NA Junction-Towner segment will of course qualify for the Act's offer of financial assistance provisions.

UP/SP urges the Board to avoid or limit the imposition of particularized service reporting requirements, which have never before been imposed on any merger. Applicants recognize their obligation to keep the Board and the parties informed about the progress of merger implementation, and, as this record shows, interested parties also have every incentive to provide their own input about service levels. But burdensome, particularized reporting requirements are not called for, and could do more harm than good by consuming resources and creating unnecessary disputes.

Preparation of the July 1 report and of this reply consumed substantial time of the senior UP/SP managers who are directly responsible for developing and overseeing service improvement initiatives. Additional reporting requirements would consume more.[59/] They also would give rise to more disputes about what "metrics" to measure and to further filings debating the implication of the reports. The Board and its staff would be forced to devote time and resources to studying the reports and comments on the reports, and resolving disputes.

59/ Sasol Alpha Olefin proposes that UP/SP report to the Board on every complaint from a shipper, UP/SP's response, and the ultimate results. SNA-2, p. 7. This condition would require enormous effort to convert daily communications into formal, written Board filings, and would severely undermine the railroad's ability to respond to the concerns in the first place.

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Particular "metrics" of the type suggested are not sufficient to provide an accurate picture of a railroad's service. Evaluating operations requires an understanding of what the railroad is seeking to accomplish, and experience with the railroad in order to interpret the data. Interaction with local operating officials is essential, as are on-site visits in many instances.

One of the most reasonable-sounding proposals, made by CMA and SPI, would have the Board require reports on the percentage of cars tendered in the Houston area that make the next scheduled train. CMA-2/SPI-3, p. 16. This number will vary enormously, however, depending on the operating and blocking plans in effect at the time, without providing any useful information about overall quality of service. For example, if UP/SP decides to run all Conrail traffic from Strang to Little Rock for switching, cars may leave the Houston area quickly, while a decision to block Conrail traffic in Houston could cause cars to miss the "next" train from Houston but reduce switching time in Little Rock. Similarly, the CMA/SPI request for data on average transit times into storage and from storage to the main route of movement (id.) would be very burdensome to satisfy, and the results would say as much about shippers' decisions (to acquire cars, to store large numbers of shipments) and the state of their markets) as it would about railroad performance.

The suggested reporting requirements fail to pass a cost-benefit analysis for another reason. With all respect, there is little the Board could, or wisely should, do with particular numbers about performance. The Board, like the ICC before it, does not attempt to control railroad operations absent a finding of an unlawful practice. 49 U.S.C. § 10704. It would be unwise for it to do so. Directives to improve service in specific ways -- such as an order to put all shipments on the next train out of Houston or move SIT cars from St. Louis to Lake Charles -- could have counterproductive effects, harming more shippers than they benefit and degrading overall efficiency and service quality.

The more stringent requirements suggested by some parties would be unwise. For example, Fina demands reports showing not only that computer systems are being integrated (which we have provided and will provide) but also that doing so does not delay any shipments. FINA-1, p. 8. That would be impossible for two reasons. First, in a network environment like a railroad, dozens of factors can interact to cause delay, and it is very difficult to determine whether the ultimate cause of a delay is an information system or something else. Second, it is inevitable that some shipments will be affected by a massive computer integration affected tens or even hundreds of thousands of cars.

The CMA/SPI request that the Applicants set schedules for all merger implementation activities, such as labor agreements and track upgrades, is undesirable and unrealistic. UP/SP does not have unilateral control over labor negotiations or the arbitrations that may be necessary to resolve disagreements. And UP/SP is continuously evaluating which projects to perform in what order in response to operating conditions and traffic levels. Any attempt to fix a rigid schedule would fail, as it should. The exceptions would become the rule. Applicants will continue to provide reports on merger implementation status and plans.

Amtrak also asks for new reports from UP/SP, primarily on SP lines. It asks for "detailed information on changes in freight traffic levels" on three routes. Comments, p. 10. On SP routes where TCS has not been implemented, which is the case on most of these routes, counting trains is a burdensome manual task. UP/SP is already required to do this every month in order to provide reports to SEA on trains through Reno, Nevada. It takes substantial time each month. Because the number of freight trains differs between each pair of terminals, complying with Amtrak's request would be many, many times more burdensome.

Amtrak's request for information on the "impact those changes have had on the on-time performance of Amtrak trains" would entail even more burden and lead to endless disputes. It would take a massive research study and numerous judgment calls even to begin to attribute delays to the addition of particular trains.[60] For example, if Amtrak's Coast Starlight leaves Portland 20 minutes late due to loading mail, causing it to be delayed five minutes at the next siding south of Portland by a meet with UP/SP's intermodal train to Seattle, is that delay caused by Amtrak or the UP/SP train? Every judgment could and would be contested. Amtrak already maintains statistics on freight train delay by route, and can make whatever arguments it wishes from those data.

Amtrak also wants a report on steps UP/SP is taking to improve Amtrak performance. UP/SP reminds dispatchers of Amtrak's priority rights. The dispatchers do their very best to honor that priority. For example, in connection with the diversion of coal traffic from the Tennessee Pass line to the Moffat Tunnel line used by Amtrak, UP/SP has issued special written instructions to dispatchers reminding them of the need to give the California Zephyr priority handling. Over the long term, steps to implement the UP/SP merger, such as those reported above and in the July 1 report, should also improve Amtrak performance.[61]

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[60] The evaluation of delays to <u>one</u> Amtrak train, presented above, took many hours of work.

[61] Amtrak alludes to the possibility that it should be allowed to penalize poor performance not only by reducing incentive payments but also by dipping into the base

(continued...)

III. LABOR ISSUES

The only comments the Board has received from labor are those filed by the UTU. These comments contain a number of allegations that particular UP/SP actions have constituted improper premature implementation of the merger. On a closer look, however, it is clear that the UTU has failed to demonstrate any evidence of intentional premature merger implementation. While UP/SP has moved forward with merger implementation as quickly as possible, it has done so with due regard for the rights of labor. Indeed, UP/SP has had to move more slowly than it would like in addressing some of the service problems discussed in the preceding section because the necessary labor implementing agreements have not yet been completed.

UP/SP has moved aggressively to negotiate implementing agreements with its employee unions, as required under the Board's New York Dock condition. UP/SP initiated this process in September 1996, shortly after the merger was consummated. As Applicants' July 1 report indicates (UP/SP-303, pp. 17-20), UP/SP has been successful in completing many

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[61] (...continued)
compensation it pays railroads. This oversight proceeding is plainly not the appropriate forum for litigating Amtrak compensation terms. However, Amtrak's suggestion that it might be appropriate for it to pay UP/SP less than incremental costs for its use of UP/SP facilities is flatly inconsistent with the Rail Passenger Service Act and would violate the constitutional prohibition against governmental takings of private property without just compensation.

implementing agreements with most of the affected unions, covering a number of geographical areas in the UP/SP system. UP/SP has had greater difficulty reaching agreements with the UTU, and it was necessary to go through both arbitration and Board review with respect to an implementing agreement covering a substantial portion of the merged system. However, the Board resolved that matter on June 26, with most issues decided in UP/SP's favor. UP/SP has reached agreement with the UTU on merger implementation in several other geographical areas, including the Houston and Salina hubs. UP/SP is moving ahead promptly in an effort to complete remaining agreements with the UTU and other unions.[62]

Thus, far from avoiding its obligation to negotiate implementing agreements prior to merger implementation, UP/SP has taken that duty very seriously. Moreover, UP/SP has been particularly solicitous of the interests of its agreement employees in connection with the merger implementation process. UP/SP has entered into special agreements with both the UTU and the BLE under which members of those unions have received interim protection pending completion of long-term

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[62] UP/SP is certainly not attempting to avoid its New York Dock obligations, as suggested at page 6 of the UTU filing. The incident discussed there involved a disagreement which UTU acknowledges was "defused." At page 2 of its comments, the union acknowledges that UP/SP and UTU have negotiated an implementing agreement covering the Houston area, which had been sent to union members for ratification as of the time the UTU comments were filed, and has in fact since been ratified.

implementation agreements for the Avondale to Houston line and the entire SSW territory.

The UTU nevertheless insists that UP/SP has engaged in premature merger implementation. The account offered by the UTU does not include, and indeed barely acknowledges, numerous written and oral responses that UP/SP has made to the union's allegations. Copies of several letters setting out UP/SP's responses to the UTU allegations or documenting its prior oral explanations are attached hereto as Exhibit B. The filing also disregards the fact that UP/SP has made conscientious efforts to inform its officers about the need to avoid any merger-related changes that would adversely affect labor prior to the completion of implementing agreements. In addition, the UTU fails to acknowledge that on the few occasions when the union raised legitimate issues as to inadvertent merger-related changes, UP/SP took prompt corrective action.

Of the various complaints described in the UTU filing and the attachments thereto, only a handful involve legitimate issues. Most do not involve merger implementation at all, but rather involve misperceptions by the union of the reasons for certain operational steps, or garden-variety labor relations matters unrelated to the merger.

For example, UP/SP's diversion of certain traffic that had moved over DRGW, described at page 4 of the UTU filing, was due not to the merger but to massive flooding in the West. Like other Western railroads, UP/SP was forced to divert trains to routes that were still passable; this would have occurred without the merger. See Letter from Brenda J. Council to Clinton J. Miller III, Feb. 20, 1997 (Exhibit B).

The rerouting of iron ore trains, also referred to at page 4 of the UTU filing, was likewise unrelated to the merger. As UP/SP has explained to the UTU, that rerouting was due to, among other things, the Western flooding and a shortage of raw materials that threatened Geneva Steel with a plant shutdown. See Letter from Brenda J. Council to Clinton J. Miller III, Aug. 7, 1997, p. 3 (Exhibit B).

The upgrade of the computerized payroll system for SPCSL employees, discussed at page 5 of the UTU filing, could have occurred in the absence of the merger, and in any event did not adversely affect the working conditions of employees and thus was not subject to New York Dock. See Letter from Brenda J. Council to Clinton J. Miller III, June 2, 1997 (Exhibit B).[63]

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[63] As UP/SP's written responses indicate, many of the "numerous complaints" referred to at the top of page 5 of UTU's filing were likewise unrelated to merger implementation. In some instances, it appears that union personnel may not have understood that an operating change did not constitute implementation of the merger but rather involved the use of operating agreements under which UP or SP had the right to move traffic over the other's lines. The standard procedure in such instances is for the original crew to stay on the train and for a pilot from the second railroad to travel with (continued...)

There have been a small handful of occasions on which, despite UP/SP's best efforts, UP/SP personnel appear to have taken a step that amounted to implementation of the merger prior to completion of the relevant implementing agreement.[64] Where UP/SP has been able to confirm that such an error has been made, it has corrected the situation immediately and committed to avoid the error in the future.[65] For example, after the UTU called attention to the El Paso interchange practice cited in Exhibit 6 to the UTU filing, UP/SP eliminated the practice.

In the overall scheme of UP/SP's operations, the actual instances of inadvertent merger-related changes identified by UTU have been insignificant. For example, the complaint cited at the bottom of page 4 of the UTU filing involved the handing of one train out of the many hundreds running on the UP/SP system on a single day in February.

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[63] (...continued) the crew of the first railroad. No union member is disadvantaged by such operations. In addition, occasionally UP/SP has encountered situations in which the UP and SP UTU General Chairmen in an area have disagreed about how an operating situation should be handled. Several of the most vehement complaints contained in the UTU correspondence arose out of such differences of opinion between two union officials.

[64] Such instances have been inadvertent. For example, an error may occur because an employee has difficulty distinguishing between trains carrying pre-existing traffic and trains carrying new traffic.

[65] In some cases, UTU has failed to provide enough specifics to permit UP/SP to investigate an allegation.

In sum, instances of premature merger-related changes adverse to labor have been few and inadvertent, and have been corrected when they were called to UP/SP's attention. The New York Dock conditions are working as they should, and there is no need for the Board to fashion any further remedies in connection with labor issues.[66]

CONCLUSION

The UP/SP merger is proving to be pro-competitive and in the public interest as the Board anticipated. The competitive conditions are working well, and no party has made a case for jettisoning or changing them. While the merged system is confronting interim service problems, that is not surprising in light of SP's deep pre-merger capital and operating inadequacies, and everything possible is being done to ameliorate those problems. The ultimate route to far better service for all UP/SP shippers is full implementation of the merger. Applicants have complied with their obligations to rail labor. This round of oversight proceedings provides a good model for future ones, and imposing burdensome additional reporting requirements would not contribute to the process.

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[66] Of course, as UP/SP and its unions reach additional implementing agreements, there will necessarily be less scope for potential disputes. UP/SP expects that all merger implementation agreements will be completed by the end of 1998.

Respectfully submitted,

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August 20, 1997

VERIFICATION

STATE OF NEBRASKA)
)   ss.
COUNTY OF DOUGLAS)

I, Richard B. Peterson, Senior Director-Interline Marketing of Union Pacific Railroad Company, state that the information in Part I of the Applicants' Reply to August 1 Comments (UP/SP-311) in STB Finance Docket No. 32760 (Sub-No. 21) was complied by me or individuals under my supervision, that I know its contents, and that to the best of my knowledge and belief those contents are true as stated.

Richard B. Peterson

RICHARD B. PETERSON

SUBSCRIBED and sworn to before me by Richard B. Peterson this 18th day of August 1997.

Elaine H. Myers

Notary Public

GENERAL NOTARY-State of Nebraska
ELAINE H. MYERS
My Comm. Exp. May 31, 1998

VERIFICATION

STATE OF NEBRASKA)
) ss.
COUNTY OF DOUGLAS)

I, R. Bradley King, Vice President-Transportation of Union Pacific Railroad Company, state that the information in Part II of the Applicants' Reply to August 1 Comments (UP/SP-311) in STB Finance Docket No. 32760 (Sub-No. 21) was complied by me or individuals under my supervision, that I know its contents, and that to the best of my knowledge and belief those contents are true as stated.

R Bradley King

R. BRADLEY KING

SUBSCRIBED and sworn to before me by R. Bradley King this 18th day of August 1997.

Beverly J Sommer

Notary Public

GENERAL NOTARY-State of Nebraska
BEVERLY J SOMMER
My Comm. Exp. Nov. 9, 1999

VERIFICATION

STATE OF NEBRASKA)
)   ss.
COUNTY OF DOUGLAS)

I, Richard D. Meredith, Assistant Vice President-Employee Relations Planning of Union Pacific Railroad Company, state that the information in Part III of the Applicants' Reply to August 1 Comments (UP/SP-311) in STB Finance Docket No. 32760 (Sub-No. 21) was compiled by me or individuals under my supervision, that I know its contents, and that to the best of my knowledge and belief those contents are true as stated.

Richard D. Meredith

RICHARD D. MEREDITH

SUBSCRIBED and sworn to before me by Richard D. Meredith this 18th day of August 1997.

Doris J Van Bibber

Notary Public

GENERAL NOTARY-State of Nebraska
DORIS J. VAN BIBBER
My Comm. Exp. Nov. 30, 2000

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that, on this 20th day of August, 1997, I caused a copy of the foregoing document to be served by first-class mail, postage prepaid, or by a more expeditious manner of delivery on all parties of record in Finance Docket No. 32760 (Sub-No. 21), and on

Director of Operations
Antitrust Division
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Premerger Notification Office
Bureau of Competition
Room 303
Federal Trade Commission
Washington, D.C. 20580

Michael L. Rosenthal

EXHIBIT A

UNION PACIFIC RAILROAD COMPANY

A. L. SHOENER
EXECUTIVE VICE PRESIDENT-
OPERATION

ROOM [illegible]
1416 DODGE STREET
OMAHA, NEBRASKA 68179-1214

July 29, 1997

Mr. Larry D. Fields
President & Chief Executive Officer
The Texas Mexican Railway Company
P.O. Box 419
Laredo, TX 78042-0419

Dear Mr. Fields:

Reference your letter of July 10 regarding train delays between Beaumont and Robstown, Texas. As cited in your letter, we have been experiencing congestion in our Southern Region. Consequently, we have recently authorized the hiring and training of over 160 train crew employees in Texas, and feel confident an early resolution is forthcoming.

I asked Jim Damman, our Vice President-National Customer Service Center to check into allegations of liability regarding statements made about TFM. Jim stated that he was personally involved in the situation referred to in your letter. He advises Bayer had telephoned Union Pacific requesting assistance in a shutdown situation. We assisted Bayer, even though their contact should have been with TexMex. Jim readily admitted to Bayer and the Tex Mex that Union Pacific had problems on the Brownsville Subdivision and in Houston, and made the statement that one continuity factor to our congestion in Texas was the large volume of cars awaiting interchange with the TFM. It is not Union Pacific's policy or practice to "shift responsibility" to other carriers for our problems. This is not a practice with regard to the Tex Mex or TFM.

Thank you for surfacing this issue, and I assure you we will work together and cooperate with one another in the future.

Sincerely,

cc: Dennis Duffy - Room 1200
[redacted] 1206
Jim Damman - St. Louis

EXHIBIT B

BRENDA J. COUNCIL
SENIOR COUNSEL

UNION PACIFIC RAILROAD COMPANY

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February 20, 1997

Clinton J. Miller, III
General Counsel
United Transportation Union
14600 Detroit Ave.
Cleveland, Ohio 44107-4250

RE: Shifts in Traffic from the DRGW

Dear Clint:

This responds to your letter of February 18, 1997, and your claim that the shift of certain traffic from the DRGW constitutes implementation of the UP/SP merger without an implementing agreement. I discussed the changes in traffic outlined in your letter with Mr. Hinckley. You are correct in your assumption that there is no agreement similar to the agreement that surfaced in connection with the change in switching operations at Avondale. However, unlike the situation at Avondale, the changes in traffic outlined in your letter did not occur as result of the UP/SP merger. Rather, those changes were the result of a combination of non-merger related conditions; not the least of which was the loss of approximately 100 miles of traffic due to the widely-publicized flooding in the Feather River Canyon.

Attached is a copy of Mr. Hinckley's letter to Mr. Pollard of February 14, 1997, setting forth the reasons for the changes in traffic listed in Mr. Pollard's letter dated February 5, 1997. If, after reviewing Mr. Hinckley's response, you are still of the opinion that we were precluded from making those traffic changes without the benefit of a merger implementing agreement, please give me a call.

Very truly yours,

Brenda J. Council

Brenda J. Council

UNION PACIFIC RAILROAD COMPANY

1416 DODGE STREET
OMAHA NEBRASKA 68179

February 14, 1997

Mr. J.G. Pollard
UTU General Chairman
1675 Carr, Suite 200N
Lakewood, CO 80215-3139

Dear Sir:

This responds to your concerns listed in your letter dated February 5, 1997, regarding shifts in traffic from the DRGW.

The UTLBC/LBUTC trains were shifted to alternate routes due to new contract negotiations with Customers resulting from renewal of expired contracts and reopener of contracts resulting from BNSF trackage rights competition in this territory in accordance with STB directives. The UTWCC/WCUTC is interchanged with the Utah Railway and waybilled at the Customer's direction to be routed UP at Provo for interchange with the BNSF at Barstow. The MNGVC/GVMNC taconite trains for Geneva Steel experienced transit delays due to the severe weather in the Midwest. As a result, product supply decreased to critically low levels and Geneva Steel requested expedited routing to avoid a shutdown of their furnaces. Geneva advised a shutdown would cost one million dollars per day. The Carrier anticipates a return to normal routing when the shipper emergency is over.

The remaining train symbols listed in your letter involved traffic that was diverted due to the flooding in the Feather River Canyon which also resulted in traffic congestion over the Sierra Nevada route necessitating alternate routing on an emergency basis. I have been advised that these trains have returned to their normal routes. As information, the SNWCC/WCSNC symbols are no longer active and these trains are now included under the symbols SKTAC/TASKC, SNWCC/WCSNC.

The reduction of yard engines was due to movement of some work from Grand Junction to Roper and reductions in business, which includes a seasonal decrease in coal traffic, as well as the flood situation and normal shifts in business generated by customers. There have been reductions in business elsewhere on the system which has triggered job reductions similar to reductions on the DRGW.

Finally, due to the planned cessation of business over the Tennessee Pass capital improvements in the track will not be made. However, until there is a complete cessation of business over this line, maintenance will be scheduled as necessary.

In summary, the changes in traffic are a function of emergency conditions caused by the weather, reductions in business or new customer activity. If you have any further concerns, please bring them to my attention by contacting me or Catherine Andrews at 271-5948 and we will investigate.

Yours truly,

W S Hinckley

W.S. Hinckley
General Director Labor Relations

cc: Mr. Lankford
Mr. Thompson
Mr. Futhey

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June 2, 1997

Clinton J. Miller, III
General Counsel
United Transportation Union
14600 Detroit Ave.
Cleveland, Ohio 44107-4250

Dear Clint:

This refers to your letter of May 5, 1997, concerning the following two items: A complaint that employees have been told it is UP's policy not to issue vouchers when employees are short on their paychecks; and A complaint concerning UP's implementation of a computerized timekeeping system on the SPCSL.

First, it is not UP's policy to refuse to issue vouchers when an employee is short on his/her paycheck. To the contrary, Tony Zabawa, Director of Timekeeping, advised that the policy is to issue vouchers for pay shortages. The fact that General Chairman Downey received a voucher is confirmation of the policy.

Second, UP is implementing a computerized timekeeping system on the SPCSL as it has done across the railroad. The new system is designed to make timekeeping more accurate, thereby greatly reducing payroll problems such as those experienced by General Chairman Downey. The training on the new system provided to the SPCSL employees is the same program that has been successful elsewhere on the railroad.

I hope that this reply satisfactorily addresses the issues raised in your May 5 letter. I am in the process of finalizing my response to your letter of April 17, 1997, and will be forwarding it to you shortly.

Very truly yours,

Brenda J. Council

Brenda J. Council

UNION PACIFIC RAILROAD COMPANY

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August 6, 1997

Clinton J. Miller, III
General Counsel
United Transportation Union
14600 Detroit Ave.
Cleveland, Ohio 44107-4250

Re: Alleged diversion of traffic from the SPCSL

Dear Clint:

This refers to our telephone conversation on Monday, August 4, 1997, concerning additional complaints you received from General Chairman C.W. Downey. Mr. Downey alleges that (1) system wide application of our UPGRADE discipline policy constitutes a unilateral change of SPCSL's Rule 39 and (2) we have diverted the HOCH train from the SPCSL to UP.

First, SPCSL's Rule 39 is not affected by UPGRADE. Rule 39 is procedural while UPGRADE is substantive. As you conceded during our conversation, the carrier has the unfettered right to change the substance of its discipline policy.

Second, the HOCH train operates on SP's line out of Englewood up through Pine Bluff to the A&S. The train comes off the A&S onto the SPCSL and moves through Bloomington into Chicago. Our investigation revealed that there has been no diversion of this train from the SPCSL.

Please advise if you have other questions or concerns.

Very truly yours,

Brenda J. Council

Brenda J. Council

UNION PACIFIC RAILROAD COMPANY

BRENDA J. COUNCIL
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August 7,1997

Clinton J. Miller, III
General Counsel
United Transportation Union
14600 Detroit Ave.
Cleveland, Ohio 44107-4250

Dear Clint:

This has reference to our exchange of correspondence and my extensive oral replies to you in the course of numerous telephone conversations regarding the UTU's allegations of premature implementation of the UP/SP merger. As you have acknowledged, we have responded to the complaints you have presented. In most cases, our responses were in writing. With respect to the matters raised in your letter of April 17, 1997, I advised you during one of our telephone conversations that our preliminary investigation revealed that there was no merit to the claims of premature implementation. The following outline of the results of our investigation of each of those claims will confirm my advice to you:

1. Beaumont Yard - SP has trackage rights on UP between Houston and Beaumont. As a result of congestion on SP's line between Houston and Beaumont, selected SP trains, manned by SP crews, have operated on UP's line under the trackage rights. The trains return to SP's line for the remainder of the movement to Echo/Lafayette. The pick-up location in Beaumont has been changed to accommodate the operations on UP's line; however, the same SP block is being made by SP crews. This change in the pick-up point in connection with the exercise of the trackage rights would occur even in the absence of the merger. Moreover, there has been no adverse impact on labor.

2. San Antonio Yard - This blocking of trains is not due to merger-related consolidations, but is simply the result of complying with the competitive conditions imposed by the Surface Transportation Board. The Board provided BNSF with rights in San Antonio, and what the SP crews are doing is nothing more than an example of pre-blocking by one railroad for another. In addition, San Fernando Yard is a joint UP/SP yard.

3. <u>Lake Charles, Louisiana</u> - This situation is also unrelated to merger implementation. As a result of congestion in Lake Charles, SP cars are now being stored at UP's yard in Lake Charles. This has not resulted in any adverse impact on SP yard crews at Lake Charles. In fact, the storage of cars at UP's yard began before the switching at West Lake Yard reverted to SP from the KCS. The chemical cars moving from Lake Charles to Beaumont are SP cars, and are being moved to Beaumont because of the Lake Charles congestion. Such a move could have occurred pre-merger, under existing operating agreements.

4. <u>Houston</u> - The movements between Hardy Street and Settegast are nothing more than movements between two UP facilities, and thus do not relate to merger implementation. You have not provided enough information for me to determine what has occurred with respect to the alleged Englewood to Settegast move. If you can provide details, I will investigate further.

5. <u>Kansas City to East St. Louis (SSW)</u> - This issue is being handled by the UTU local chairman and carrier officers responsible for coal movements. If no agreement is reached and it is determined that there has been premature merger implementation, UP will take steps to correct the situation.

6. <u>M. D. Somers</u> - This is strictly a disciplinary matter. Any objection Mr. Somers may have to the contents of the notice of investigation may be resolved through minor dispute process. There is no indication that this situation is related to the merger.

7. <u>C.P. Piland</u> - A UP train destined for Mexico via Brownsville did operate on SP's line to Bloomington because of congestion on UP's line. This train contained empty auto racks that had to get over the border into Mexico in its scheduled time slot. This diversion could have occurred in the absence of the merger. Further, it is to be noted that the train was operated by UP crews with a SP pilot while on SP's line. While it appears, based on your description, that the carrier's records may have been in error, we don't believe this one example is sufficient to warrant a charge challenging the correctness of the carrier's records.

8. <u>Brownsville</u> - Yes, a job was taken off; however, it was not because of the UP/SP merger. Instead, the job was eliminated because of a decline in business.

9. <u>SP Houston - New Orleans trains on UP</u> - This situation is the result of BNSF speed restrictions on the Avondale - Iowa Junction trackage, which BNSF purchased. Some SP trains have to be operated on UP's line to prevent congestion and to meet customer requirements. These SP trains are manned by SP crews with UP pilots. The UP pilots should not take

over the operation of the trains when SP crews reach their limit under the Hours of Service Act, and instructions have been issued to stop that practice.

10. Train symbol changes - Such changes are permissible and have no evil motive.

11. Beckman - Los Fresnos - The change in operations you report has taken place, but it was in response to a customer, Redland Stone, not the merger. The change was made due to the risk of losing the entire movement to truck. In fact, the former move had a truck component, while the new move is all rail.

12. Iron ore trains - As I have previously advised, we have had to operate some of these trains on UP's line for a number of reasons that are not related to the merger: there was an emergency situation in which the customer was faced with the threat of a shutdown due to ore shortages; transit delays due to severe weather in the Midwest; and problems with the Wisconsin Central connection. Even without the merger, SP and UP could have negotiated an agreement for SP's use of UP's shorter route in the circumstances. In any event, SP crews were not impacted because steps were taken to ensure proper SP train starts on the SSW/SPCSL route.

I trust that the foregoing completes your files on the concerns that were directed to me. Please let me know if you require additional information.

Very truly yours,

Brenda J. Council

Brenda J.Council