STB FD-32760 (SUB 21) 9-19-00 D 199773

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September 19, 2000

EEI **EDISON ELECTRIC INSTITUTE**

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Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW
Washington, D.C. 20423-001

Re: STB 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 (General Oversight)*

Dear Secretary Williams:

Edison Electric Institute ("EEI") respectfully asks the Surface Transportation Board to accept this brief letter responding to the Reply Comments of Burlington Northern and Santa Fe Railway Company ("BNSF") filed in this sub-docket on September 5, 2000. The purpose of this letter is to clarify one aspect of the BNSF's reply comments. Specifically, at page 7, footnote 1 of BNSF's filing, BNSF states the following concerning Sierra Pacific Power Company ("SPP") and Idaho Power Company ("IPC"), two EEI member utilities (emphasis added):

> EEI and AECC thus seriously overstate the role the Board anticipated that BNSF would fulfill post-merger. That role was to serve as a joint line partner with Utah Railway to provide a competitive alternative to such facilities as the North Valmy, Nevada power plant owned jointly by Sierra Pacific Power and Idaho Power Company. *The only evidence of record in this sub-docket establishes that BNSF has provided such a competitive alternative and has in fact provided service to the North Valmy facility pursuant to the rights it received under the Board's conditions.*

EEI respectfully submits that the following record evidence in this sub-docket refutes BNSF's assertion in the italicized passage above:

1. Comments of Sierra Pacific Power Company and Idaho Power Company, filed August 1, 1997 at pages 2, 4. See also 5-6 ("...to date BNSF has shown either a lack of desire, or as SPP/IDPC believes, a lack of ability, to be a serious competitor with UP/SP for the transportation of coal to North Valmy."). See also *id.* at 9.

2. Verified Statement of Jeffery W. Hill, filed August 1, 1997 at 4 (BNSF-URC joint line rate offers for transportation to North Valmy were higher than UP single line rate offers by "a large differential", but SPP and IPC decided to move "some coal" under the higher BNSF-URC rates "with the hope that this traffic perhaps will help increase the level of competition to North Valmy to pre-merger levels. However, we are not optimistic that this can be accomplished without further action by the Board.")

3. EEI also notes that Decision No. 10 in this sub docket, which addressed SPP's and IPC's complaints and request for relief in the oversight proceeding, contains no language supporting a claim that the movement of coal to North Valmy was the result of competition between UP and BNSF.

Finally, EEI notes that BNSF's assertion is contradicted by the fact that in Finance Docket No. 42012, *Sierra Pacific Power Company and Idaho Power Company v. Union Pacific Railroad Company*, SPP and IPC formally alleged in a complaint filed August 1, 1997, that BNSF was not an effective competitive alternative to UP at North Valmy, to the point that UP had market dominance over this traffic under 49 U.S.C. 10707. The complaint proceeding was settled prior to a final decision on the market dominance issue. The complaint proceeding is obviously relevant to the assertions made by BNSF in this sub-docket, and the Board can and should therefore take official notice of it in this proceeding.

Respectfully submitted,

Michael F. McBride

Michael F. McBride
for Edison Electric Institute

cc: Honorable Linda Morgan
Honorable Wayne Burkes
Honorable William Clyburn
(All by hand delivery)
Parties of Record

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September 5, 2000

Via Hand Delivery

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Vernon A. Williams
Secretary
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Re: Finance Docket No. 32760 (Sub-No. 21), *Union Pacific Corp et al. - Control and Merger - Southern Pacific Rail Corp. et al. (General Oversight)*

Dear Mr. Williams:

Pursuant to the oversight condition imposed by the Board Decision No. 44 in Finance Docket No. 32760 (Sub-No. 21), *Union Pacific Corp et al. - Control and Merger - Southern Pacific Rail Corp. et al.* and the provisions of former 49 U.S.C. section 11347 (now 49 U.S.C. section 11327), The National Industrial Transportation League ("the League") urges the Board to conduct a comprehensive review of the effectiveness of the competitive conditions imposed in the Central Corridor on approval of the control of Southern Pacific by Union Pacific ("UP"). It is the League's view that the comments already filed in this year's annual oversight review raise serious doubts about the effectiveness of the Burlington Northern and Santa Fe Railway Company ("BNSF") as a competitive successor to Southern Pacific in the Central Corridor. These doubts require the Board, now that the five-year oversight period is at or near its end, to conduct a thorough, in-depth review of the competitive situation to ensure that it satisfies the Board's expectation that the conditions it imposed would create an "intense rivalry" between BNSF and UP.

The Board's approval of the merger of UP and SP was conditioned on the imposition as a condition an agreement which provided for extensive new operations, service and access to customers by BNSF. The Board's approval was based on the expectation that the competition on the trackage rights lines in the Central Corridor between the merged UP/SP and BNSF would result in lower rates and better service. Fin. Dkt. 32760, Decision 44, 1 S.T.B. 233, 413 (1996). But the Board also established a five-year oversight period, and specifically stated that:

"We retain jurisdiction to impose additional remedial conditions if, and to the extent, we determine that the conditions already imposed have *not* effectively addressed the competitive harms caused by the merger."

1 S.T.B. at 420 (emphasis in original)

The comments filed by a number of parties in response to the reports by UP and BNSF raise serious questions about whether there is true competition between BNSF and UP across the Central Corridor. In this important corridor, where SP and UP competed vigorously over their own lines, BNSF received trackage rights over the merged UP/SP system. As the comments by the California Public Utilities Commission put it, the key question is whether all of the reported "business activity is reflective of true competition between both railroads." CPUC Comments at 4. Several other commenting parties expressed similar concerns.

League members have also indicated substantial concerns about the existence of meaningful competition between BNSF and UP in the Central Corridor. For coal, in particular, UP has been able to establish higher rate levels, lower service levels and more onerous contract terms and conditions for Central Corridor coal shippers and receivers, because BNSF has not been an effective competitive force.

BNSF's quarterly report (filed on July 3) asserts that "BNSF continues to offer vigorous and effective competition to shippers located on its Central Corridor trackage rights...." BNSF-PR-16 at 4. But no supporting data is provided.

The League urges the Board to conduct a meaningful oversight process by initiating a comprehensive review of the competitive realities in the areas where BNSF was supposed to provide competition to the merged UP/SP system. As the comments submitted to the Board indicate, BNSF has not been the intense competitor that the Board expected in this area where its access to competitive points and shippers requires extensive use of trackage rights over the UP/SP system. The Board should develop relevant data on the competitive situation since the implementation of the UP/SP merger and the commencement of BNSF operations under the merger conditions, such as rate history and levels, market share, traffic volumes (including the relative proportion of overhead versus local traffic, etc.

Such a comprehensive review of the competitive circumstances in the Central Corridor is important, not only because of its relevance to the oversight condition, but because of the Board's pending consideration of the its merger policies in Ex Parte No. 582 (Sub-No. 1), *Major Rail Consolidation Procedures.* The Board there stated that "the time has come ... to consider whether we should revise our rail merger policy ... with an eye towards affirmatively enhancing ... competition." Such consideration should also govern the Board's conduct of its oversight of the UP/SP merger.

Respectfully submitted,

Frederic L. Wood

Nicholas J. DiMichael
Frederic L. Wood
Attorneys for The National Industrial Transportation League

FLW/flw

cc: All Parties of Record

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Re: Fin. Dkt. 32760 (Sub-No. 21)

Dear Secretary Williams:

Enclosed herewith are an original and ten copies of the Reply Comments of the United States Department of Transportation (DOT-5) in the above-referenced proceeding. I have also enclosed a computer diskette containing these comments in a format readable by WordPerfect 7.0. Included as well is an additional copy that I request be date-stamped and returned to the messenger delivering these documents.

Respectfully submitted,

Paul Samuel Smith

Paul Samuel Smith
Senior Trial Attorney

Enclosures

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DOT-5

BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.

Union Pacific Corp., Union Pacific Railroad Co. and Missouri Pacific Railroad Co. - - Control and Merger - - Southern Pacific Railroad Corp., Southern Pacific Transportation Co., St. Louis Southwestern Railway Co., SPCSL Corp., and the Denver & Rio Grande Western Railroad Company (OVERSIGHT)	F.D. No. 32760 (Sub-No. 21)

REPLY COMMENTS OF THE UNITED STATES DEPARTMENT OF TRANSPORTATION

Introduction

The Surface Transportation Board ("STB" or "Board") instituted this proceeding to assess the oversight conditions it imposed in Finance Docket No. 32760, the merger of the Union Pacific ("UP") and the Southern Pacific ("SP") railroads (collectively, "UP/SP"). Decision No. 1, served May 7, 1997 ("Decision"). In this proceeding the Board at least annually seeks input on the effects of the merger, on the efficacy of the conditions used to address the transaction's competitive harms, and other matters. Id. at 2. The most important condition imposed by the STB involves extensive trackage rights awarded to the Burlington Northern Santa Fe Railway Co. ("BNSF") to enable it to replace the competition previously provided by SP.

The United States Department of Transportation ("DOT" or "Department") has participated in this proceeding in each of the last three years. DOT-1 (filed August 1, 1997); DOT-2 (filed August 20, 1997); DOT-3 (filed

September 1, 1998); DOT-4 (filed August 16, 1999). The Department has now reviewed the reports of UP and BNSF and the comments they have generated. At this, the fourth of five years of scheduled oversight, the record shows that the Board's conditions have proven effective as a general matter, although questions raised concerning the Central Corridor and capacity in the Southern Corridor deserve the Board's continued attention.

Background

Approximately one year after the merger, in its first oversight decision, the STB preliminarily concluded that the merger, as conditioned, had not caused substantial competitive harm. Decision No. 10 (served October 24, 1997) at 2. The Board also expressed concern over post-merger safety and service problems. Id. at 13-14. [1]

The following year, UP/SP was suffering from what had become an unprecedented service crisis. After reviewing the record the Board concluded that "notwithstanding ... the effects of the UP service crisis, the UP/SP merger has not thus far caused any substantial competitive harm." Decision No. 13 (served December 21, 1998) at 8 (emphasis in original). The competition provided by BNSF appeared to the STB to be "at least as effective as the pre-merger UP vs. SP competition." Id. at 11. The Board also found that UP's service problems would likely "continue to improve." Id. Finally, the Board noted that DOT had found no safety problems requiring action in the context of the general oversight proceeding. Id.

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[1]/ Indeed, the Board instituted separate proceedings to address UP/SP's then-growing service crisis. E.g., Rail Service in the Western United States, STB Ex Parte No. 573 (served October 2, 1997); Joint Petition for Service Order, STB Service Order No. 1518 (served October 31, 1997).

In the third year of its oversight of this transaction, the Board determined that "the service crisis is over and ... there have been no competitive problems resulting from the merger." Decision No. 15 (served November 30, 1999) at 1.

The Board's previous orders in this docket have largely mirrored DOT's concerns. The Department's earlier submissions addressed two issues in addition to the ongoing concern with intramodal competition -- the safety of railroad operations and the adequacy of service levels. Id. The record in prior years established the existence of substantial problems in these areas that have now been essentially resolved. The Federal Railroad Administration ("FRA") last year concluded that UP had made large strides in improving the safety of its operations since the rash of incidents that followed the consummation of the merger. DOT-4 at 3-4. We also concluded that UP's service crisis had apparently passed. Id. at 5. An extended period of normal operations allowed for a relatively accurate assessment of the competitive effects of the merger and its attendant conditions. On this subject DOT believed that the original conditions had functioned as intended to maintain intramodal competition. Id. at 5-7.

DOT has now reviewed the UP and BN reports, as well as the comments of interested parties.[2] On the basis of this record, our views generally have not changed. Parties have raised questions about competition in the Central Corridor and capacity in the Southern Corridor, however, that warrant additional attention by the Board.

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[2]/ The Department is aware of submissions from the Kansas City Southern Railway Company ("KCS"), the California Public Utilities Commission ("CPUC"), the Edison Electric Institute ("EEI"), and the Arkansas Electric Cooperative Corporation ("AECC").

Competition

No party challenges the reality of vigorous competition between UP and BNSF generally. There is a shared concern, however, with respect to the adequacy of competition between these carriers in the Central Corridor.

EEI submits that the evidence supplied by UP and BNSF in quarterly and annual reports fails to establish that BNSF has replaced SP as a viable competitor to the UP for movement of Utah and Colorado coal. EEI at 2. KCS raises similar concerns about the level of competition in the Corridor. It contends that the reports' information on the number of trains operating over the Corridor is not sufficient to demonstrate that BNSF is providing effective competition to UP at 2-to-1 points created by the UP/SP merger. *See* KCS-16 at 4-7. CPUC agrees. CPUC at 4.

To resolve these concerns, EEI suggests that UP and BNSF submit evidence to show how many times BNSF has bid against UP for coal business and that they demonstrate the general direction of rates for this traffic. EEI at 3. CPUC and KCS also recommend that the Board require BNSF and UP to submit sufficient market share data and information sufficient for a rate analysis. CPUC at 4; KCS-16 at 9.

The Department in the course of the merger proceeding concluded that the BNSF was the only carrier that had the network of gathering lines sufficient to generate enough density to support and maintain operations over the Central Corridor in competition with the UP. Finance Docket No. 32760, Brief of DOT (filed June 3, 1996) at 39 and 40. Since this oversight proceeding began, UP and BNSF reports have shown that BNSF has been a competitive presence in the Central Corridor and that its presence continues today.[3]

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[3] For example, BNSF reports that it is working with a company to locate a waste transload facility west of Salt Lake City on the Central Corridor. BNSF-PR-16 at 26. BNSF also states that it developed a transportation plan and rate

Although the most recent data show that BNSF through traffic levels are flat, DOT remains of the opinion that the carrier is still maintaining an important competitive constraint on UP in the Corridor. BNSF continues to operate regularly scheduled daily merchandise trains eastbound and westbound on the Corridor between Denver and Stockton, California, and has increased the operating frequency of its eastbound merchandise train service from Riverbank, California to Denver. BNSF-PR-16 at 4. Most importantly, one would expect that rates or service reflective of a lack of vigorous competition in the Corridor would prompt affected shippers to so note. They have not done so, however. *See* CPUC at 5 (CPUC has not received complaints from shippers).

Moreover, we doubt that a study of UP and BNSF market shares at 2-to-1 points in the Corridor (or elsewhere that BNSF has trackage rights) would yield any meaningful results about the level of competition between the two carriers. [4] As the Board noted last year in this proceeding, market share "is not the decisive criterion" by which to judge the viability of intramodal competition. Decision No. 15 at 8. What is important is the effect of BNSF's presence on the rates offered by UP. Id.

The concentrated nature of the railroad industry, however, counsels caution in assessing that vital competitive presence. As DOT and many other parties stressed in Ex Parte No. 582 (Sub-No. 1), when facing a vast region served by only two major railroads, there is virtually no room for error. *See* Initial Comments of DOT (filed May 16, 2000) at 1-2, 36-37. Decisions about the present and future state of competition, service, and other factors must be based upon

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agreement with Utah Railway under which coal moved from Utah to Arizona. BNSF-PR-16 at 20.

[4]/ Due to the nature and length of contracts, one carrier could manage to obtain the entirety of a shipper's business for a number of years. A yearly market share analysis would show no participation in these moves from the unsuccessful but still competing carrier. The next round of bidding for the business could yield the same or different results.

sufficient information to ensure that the risks inherent in such a situation are reduced.

The Department therefore believes that the parties have at least raised a question regarding BNSF operations, and thus its "presence," in the Central Corridor. Rather than a market share study, however, DOT believes that BNSF should be required to report the total number of carloads that it originates and terminates by major commodity in the Corridor for each of the years that it has been operating. This information should then be compared against a benchmark of total carloads that the SP handled at 2-to-1 locations in the Corridor prior to the merger. The result would enable the Board to ascertain BNSF's participation -- its competitive presence -- with greater confidence.

Similarly, DOT agrees with EEI that the record now contains little data showing how much Utah and Colorado coal traffic BNSF has been able to secure and transport. At the very least, a BNSF report noting the number of carloads of Utah and Colorado coal it moves would answer whether or not it has successfully gained any of this important business. If it turns out that BNSF has not moved any significant amounts of this coal, the STB should undertake to consider why. There could be a number of reasons for such an outcome, including the possibility that the trackage rights fees BNSF must pay might leave it with a higher cost than UP, and therefore unable to compete.[5] Such concerns were raised by the Department and other parties during the merger proceeding. Brief of DOT at 41.

Finally, UP reports that in the Southern Corridor it is facing capacity constraints on the important "Sunset Route" segment, and notes an intent to add a second main track. UP/SP-378 at 11. *Also*, CPUC at 6. We think the same considerations of caution and concern for adequate capacity expressed in Ex

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[5] AECC also requests that the Board give consideration to the trackage rights fee structure. AECC has concerns that BNSF will not be able to compete with the UP for coal moves if AECC undertakes construction of a build-out to gain access to BNSF. AECC-1 at 3 and 4.

Parte No. 582 (Sub-No.1) apply here. DOT would ask that UP in its next informational report explain the situation in more detail, and that it outline more clearly the steps it intends to take to address the capacity problem.

Conclusion

The conditions originally imposed by the Board to preserve intramodal competition following the merger of the UP and SP appear to have served their purpose generally. The Department and others have stressed that the existence of only two major railroads in the region pose great risks for the public interest. This factor makes it particularly incumbent upon the Board to base its regulatory decisions upon an adequate record. We therefore support a requirement that BNSF supply additional information to respond to questions raised about its competitive presence in the Central Corridor. We also suggest that UP explain the nature and extent of any capacity problem in the Southern Corridor, and its plans for remedying the situation.

Respectfully submitted,

Rosalind A. Knapp

Rosalind A. Knapp
Acting General Counsel

September 5, 2000

CERTIFICATE OF SERVICE

I hereby certify that on this date I have caused a copy of the foregoing Reply Comments of the United States Department of Transportation in STB Finance Docket No. 32760 (Sub-No. 21) to be served upon all Parties of Record by first class mail, postage prepaid.

Paul Samuel Smith

Paul Samuel Smith

September 5, 2000

B. THE BOARD SHOULD REJECT KCS'S EFFORTS TO USE THIS OVERSIGHT PROCEEDING TO RELITIGATE ISSUES THAT WERE PREVIOUSLY CONSIDERED BY THE BOARD

In its comments, KCS makes requests relating to three issues that have previously been considered by the Board. First, KCS requests that the Board initiate a special study of rates and BNSF's market share for traffic to or from the Houston switching district to determine whether BNSF's presence in the Houston market has effectively constrained UP's rates for Houston shippers. Further, KCS requests that the Board reconsider its decision to allow BNSF access to Lake Charles area shippers, claiming that the Board's grant of such access was excessive and overly intrusive and that BNSF is without legal right to operate over certain tracks in the Lake Charles area. Finally, KCS requests that the Board require UP and BNSF to make public the documents consummating the Houston to Iowa Junction line swap. The Board should not allow KCS to use this oversight proceeding to relitigate the Houston, Lake Charles, or line swap issues -- all of which have been considered by the Board on other occasions -- particularly in light of the fact that KCS has presented no new evidence or support for its positions with regard to these issues.[4/]

[4/] BNSF generally agrees with KCS's assessment that, "as established through numerous post-merger approval disputes brought to the Board, UP's post-merger implementation of the Board's merger conditions demonstrate that UP has been slow to achieve agreement on conditions". KCS Comments at 2. In some instances, BNSF and UP continue to have disagreements as to implementing the terms, or defining the meanings, of specific conditions imposed on the UP/SP merger by the Board. In all cases, BNSF's ability to provide competitive service on a timely basis to customers under the terms BNSF and the customers interpret as applying in specific instances from the merger conditions are impacted. BNSF continues to either work out these issues with UP, or, as necessary, to resort to other remedies to resolve them wherever required. It should be noted that, as to the issues brought before the Board, KCS, EEI, CPUC and AECC have

1. Houston Rate Study

First, KCS submits no new evidence and makes no assertions to suggest that BNSF's presence has not constrained rates in the Houston switching district.[5] Nevertheless, KCS requests that the Board initiate a special study of rates and BNSF's market share for traffic to or from the Houston switching district to determine whether BNSF's presence in the Houston market has effectively constrained UP's rates for Houston shippers.

On a number of occasions since consummation of the UP/SP merger, the Board has been asked to review whether BNSF's presence has constrained rates for Houston switching district shippers. Less than two years ago, the Board found that:

> UP has shown . . . that it has vigorously competed with BNSF to retain the business of [Houston] shippers, and that it has done so only because it has provided them with rate reductions and other benefits in response to that competition.

Fin. Dkt. No. 32760 (Sub-No. 26), Decision No. 10 at 16. Further, in response to suggestions by KCS that BNSF's presence in Houston was not serving as a competitive restraint on UP's rates, the Board stated that "BNSF has proven itself an effective competitive presence for precisely those Houston area shippers at which the trackage

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not provided support to customers and BNSF in defense of the merger conditions or competition they now are so interested in.

[5] In fact, the only "evidence" KCS puts forward at all is a reference to the evidence it submitted in the Houston/Gulf Coast Oversight Proceeding (Fin. Dkt. No. 32760 (Sub-No. 26)) in 1998. Besides now being outdated, that evidence was rejected by the Board in that proceeding as insufficient to establish that BNSF is not competitive for Houston traffic (Fin. Dkt. No. 32760 (Sub-No. 26), Decision No. 10 at 14-17), and KCS has advanced no reason to suggest that the evidence has any more probative value now.

rights condition was directed: those that lost competitive rail service as a result of the merger." Id. at 17.

KCS has failed to allege or provide any examples of competitive harm to Houston switching district shippers, nor has KCS produced any evidence that UP and BNSF no longer competes vigorously for Houston business. Therefore, KCS's attempt to reopen an issue that has been considered -- and reconsidered -- by the Board should be denied.

2. BNSF's Access To Lake Charles Area Shippers

As discussed, KCS also asks the Board to reconsider its decision to allow BNSF access to Lake Charles area shippers and claims that BNSF is without legal right to operate over certain tracks in the Lake Charles area. KCS submitted evidence and argument relating to BNSF's access to Lake Charles shippers during the UP/SP merger proceeding and then raised the identical objections that it raises here in a Petition to Reopen/Reconsider the merger decision. *See* Fin. Dkt. No. 32760, KCS's Petition to Reopen/Reconsider (KCS-65), filed Sept. 3, 1996.

In rejecting KCS's Petition, the Board stated that:

> we continue to believe that the conditions we imposed, by building upon a privately negotiated settlement agreement, as endorsed by all relevant shippers, offer a better competitive solution than KCS has offered.

Fin. Dkt. No. 32760, Decision No. 63 at 8. The Board also noted that "KCS lacks a sufficient route structure to be competitive with UP/SP in many corridors on a single-line basis" and that, as a result, giving BNSF "rights was the most effective way to assure continued competition for Lake Charles area shippers." *Id.* at 7. KCS has submitted no evidence or argument here challenging those conclusions.

Moreover, if KCS wanted to challenge the Board's decision denying its Petition to Reopen/Reconsider, it should have pursued the proper appellate procedures.[6] Having failed to do so, KCS should not now be permitted to use this oversight proceeding as a further avenue for appeal. Additionally, because KCS has made no showing of material error, new evidence, or substantially changed circumstances, the Board should not reconsider its prior decisions relating to BNSF's access to Lake Charles area shippers.[7]

3. *Houston To New Orleans Line Swap*

KCS's assertions and requests relating to the Houston to New Orleans line swap are yet further attempts to use the oversight proceeding to have the Board reconsider a prior decision without presenting any new evidence. As background, on February 12, 1998, UP and BNSF agreed to exchange undivided half-interests in UP's line between Iowa Junction, Louisiana and Houston (Dawes), Texas, and BNSF's line between Iowa Junction and Avondale, Louisiana. The agreement also granted BNSF new access to

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[6] KCS did in fact file a petition for review with the U.S. Court of Appeals for the District of Columbia Circuit (Case No. 97-1004) challenging, *inter alia*, the Board's grant to BNSF of access to Lake Charles area shippers. However, KCS voluntarily dismissed its petition for review on October 6, 1997.

[7] As discussed, KCS once again suggests that BNSF is without legal right to operate over certain tracks in the Lake Charles area. As BNSF has previously explained, BNSF's Lake Charles service complies with all applicable agreements. *See* BNSF's Reply to KCS's Petition to Reopen/Reconsider (BN/SF-70), filed Sept. 23, 1996, at 10-12. Nevertheless, the Board has stated that the proper forum for handling disputes under those agreements in the first instance is arbitration (Decision No. 63 at 9). KCS's claims in this regard are thus not appropriately raised in this oversight proceeding.

existing and future local customers along the former-SP line between Houston and Iowa Junction, as well as former SP branches and spurs off that line. This access -- which did not require Board action -- went into effect immediately.

On July 1, 1998, UP and BNSF filed a joint petition seeking an exemption from the prior approval requirements for the acquisition of the joint ownership in the rail line. BNSF and UP submitted the February 12th term sheet agreement outlining the provisions for the line swap. In a decision served September 29, 1998, in Fin. Dkt. No. 33630, the Board exempted the exchange of ownership interests from its prior approval requirements.

In its comments, KCS suggests that the line swap could put "competitive forces in place in ways not contemplated prior to the Board's [decision] approving the UP/SP merger." KCS Comments at 14. Therefore, KCS requests that the Board require BNSF and UP to make the final line swap agreements available and allow an opportunity for comment on the documents.

Clearly, the Board considered the competitive impact of the Houston to New Orleans line swap in granting BNSF and UP's joint petition for exemption in Fin. Dkt. No. 33630. KCS had an opportunity in that proceeding to comment on the terms of the line swap. KCS -- having chosen not to participate in that proceeding -- should not now be permitted to reopen issues that have already been considered and addressed by the Board.

C. PROCEDURES FOR FINAL YEAR OF OVERSIGHT

CPUC requests that the Board require UP and BNSF to answer a number of questions during the final year of oversight. Further, CPUC requests that, during the final year of oversight, the Board survey "2-to-1" shippers, conduct an analysis of UP and BNSF traffic and waybill tapes, and develop quantifiable standards to be used to determine the actual level of competition. BNSF does not believe that the Board should change the oversight procedures or adopt the studies, analyses and standards suggested by CPUC. These proposed procedures, studies, analyses and standards would be burdensome and would not add to the Board's or parties' assessment of the effectiveness of the competitive conditions imposed by the Board on the UP/SP merger.

BNSF does not dispute CPUC's suggestion that the Board must ensure during the final year of oversight that it has the information necessary for a meaningful assessment of the effectiveness of the competitive conditions imposed on the UP/SP merger. However, BNSF believes that the data and information provided by UP and BNSF in their quarterly and annual reports, and the information contained on the 100% traffic waybill tapes which are made available to all parties, are fully sufficient for such a meaningful assessment.

The questions posed and procedures suggested by CPUC, on the other hand, would be burdensome on the parties and the Board and would not allow the Board to draw useful conclusions regarding the effectiveness of the merger conditions. For example, a number of questions posed by CPUC focus on BNSF's market shares along the trackage rights lines. First, it would be burdensome for UP and BNSF to compute such corridor-specific market shares. More importantly, as discussed earlier, market shares are not a meaningful measure of the effectiveness of the competitive conditions.

Therefore, BNSF urges the Board to adhere to the oversight procedures used in the four years since consummation of the UP/SP merger. Specifically, the Board should require UP and BNSF to file quarterly reports and a comprehensive annual report. Parties should then be given the opportunity to access UP's and BNSF's 100% waybill traffic tapes and file comments and reply comments relating to the effectiveness of the competitive conditions imposed by the Board on the UP/SP merger.

CONCLUSION

As the evidence submitted to the Board establishes, BNSF continues its efforts to offer vigorous and effective competition to shippers located along the lines to which BNSF gained access as a result of the UP/SP merger. Although BNSF may not always be successful in securing business, no evidence has been presented that BNSF is not serving as a realistic competitive alternative to UP along these lines. Further, the Board should reject efforts by KCS to use this oversight proceeding to reopen issues that have already been considered by the Board -- particularly in light of the fact that KCS has not produced any new evidence. Finally, the Board's existing oversight procedures and processes have worked well and should be continued for the fifth and final year of UP/SP oversight.

Respectfully submitted,

Erika Z. Jones /KEC

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September 5, 2000

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Reply of The Burlington Northern and Santa Fe Railway Company to Comments of The Kansas City Southern Railway Company, Edison Electric Institute, California Public Utilities Commission, and Arizona Electric Cooperative Corporation (BNSF-9) is being served on all parties of record in this proceeding.

Kelley E. Campbell

insufficient long-term investment, thereby rendering a railroad revenue inadequate." The landlord railroad would have no incentive to invest in trackage rights lines if it must bear all the fixed costs yet has no hope of recovering them from a subsidized tenant. The Board therefore rejects trackage rights compensation that does not provide "a sufficient incentive to the landlord carrier to maintain the route in first class operating condition." St. Louis Southwestern Ry. Compensation – Trackage Rights, 8 I.C.C.2d 80, 96-97 (1991).

UP's former DRGW rail lines in Utah and Colorado carry primarily coal. If coal rates are too low to cover investment costs, UP will not be able to justify reinvestment in those lines, and coal shippers will lose service. The Board is well aware of this risk and of the importance of maintaining investment incentives, which is why the Board rejected demands for subsidized trackage rights compensation in UP/SP and Conrail. Decision No. 44 at 141. Mr. Nelson's recommended trackage rights fee would destroy the economics of coal transportation for the landlord railroad.

E. AECC's Position

Significant developments last week involving the White Bluff power plant, of which AECC is a minority owner, undermine AECC's challenge to the trackage rights fees under the BNSF Settlement Agreement. Those developments are inconsistent with AECC's position here. Because of a protective order in another proceeding, we describe those developments in a Highly Confidential Appendix.

II. CPUC COMMENTS

CPUC offers a potpourri of comments, culminating in a list of proposed investigations for next year's oversight proceeding. It asks whether BNSF and UP have aggressively competed for traffic at "2-to-1" points, and whether the merger has caused competitive harm (CPUC Comments at 2), but it provides no evidence to suggest concern on either score. Indeed, it acknowledges that the merger is delivering promised benefits and reports that not one shipper registered a complaint about the merger in the last year.[6] Like other commenting parties, CPUC identifies no failure of competition attributable to the merger.

We will respond first to CPUC's renewed concerns about Central Corridor rail competition. We then consider its comments about rail investment. We conclude by reviewing its eight information requests and its call for new merger conditions.

A. Central Corridor Competition. Acknowledging that BNSF and UP are providing "new services . . . beneficial to California shippers" (id. at 3), CPUC's primary concern appears to be competition in the Central Corridor, the route between the Midwest and Northern California via Utah. CPUC raised the same concerns last year, and the Board rejected them. CPUC does not present any new arguments to support a different conclusion this year.

As in 1999, CPUC proposes to compare BNSF and UP market shares in the Central Corridor with SP and UP pre-merger market shares. CPUC Comments at 5. The

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6 As CPUC reports, it "has not received any complaints from shippers suggestive of anti-competitive behavior by UP or BNSF to date." CPUC Comments at 5. For five years, since early in the UP/SP merger proceeding, some parties have suggested that shippers remain silent in Board proceedings not because they are satisfied but because they fear retaliation. EEI engages in the same speculation now. EEI Comments at 2. The fact that many shippers and shipper organizations have been vocal in raising concerns about mergers calls this theory into serious doubt. Moreover, shippers could present complaints to any number of entities and organizations that have proved quite fearless, including CPUC, the National Industrial Traffic League, the Western Coal Traffic League, and others. The fact that no shipper contacted CPUC is telling.

Board rejected this erroneous market analysis last year. As the Board explained, BNSF's "Central Corridor traffic level can be far less than that of an independent SP." General Oversight, Decision No. 15 at 8. According to the Board, the important question is not market share, but whether BNSF's presence in the market constrains UP's rates. Id. The Board concluded that BNSF's presence achieves that goal: "All indications are that BNSF's presence in the Central Corridor has required UP to compete vigorously for BNSF-accessible traffic requiring the use of that corridor." Id.

No one should expect BNSF's Central Corridor market share to equal SP's or UP's pre-merger market share. The Central Corridor "2-to-1" shippers comprised only a small fraction of the total number of shippers that UP or SP served in that corridor before the merger. Only those "2-to-1" shippers obtained BNSF service under the Board's merger conditions. Accordingly, BNSF could not be expected to achieve either SP's or UP's pre-merger share of Central Corridor traffic.

While CPUC continues to worry that BNSF routes traffic to and from California "2-to-1" shippers via its high-speed line through Arizona and New Mexico, CPUC does not explain why shippers should care whether their shipments pass through the Humboldt Valley in Nevada or the Petrified Forest in Arizona. The Board last year agreed with UP that BNSF's choice of route has no competitive significance. Id.

Although CPUC admits that it has not received any complaints from shippers, it nevertheless asks the Board to survey shippers. CPUC Comments at 5. We see no reason for this exercise when there is no evidence of a problem. If CPUC decides to survey Central Corridor "2-to-1" shippers on its own, it should ask this question: "Would you prefer competition from BNSF, with its comprehensive route system and Southern transcontinental route, or would you prefer that another carrier be allowed to serve the Central Corridor?" We urge CPUC to consider the answer in formulating its comments next year.

B. Capital Investments. Applauding BNSF and UP for "substantial improvements to their rail infrastructure which should improve existing service levels and intensify competition" (CPUC Comments at 6), CPUC nevertheless sounds an alarm about UP's statement in its July Report that its Sunset Route between El Paso and Los Angeles is nearly full. As we reported in July, UP plans to target this line for capital investment in coming years. UP's ability to invest in this line is another advantage of the merger, as SP could never have afforded to make the investments UP is undertaking.

C. CPUC's Information Requests. CPUC asks BNSF and UP to respond to eight questions in their Oversight reports next summer, and it asks the Board to perform several analyses. CPUC Comments at 7-8. Compiling answers to many of CPUC's inquiries would require burdensome and expensive investigations by the carriers, and several would generate no useful information. We respectfully suggest that government agencies should not impose costly reporting requirements on private parties unless the need for the information is clear.

We comment on each CPUC information request below:

1. What is the current market share of UP and BNSF for shipments in the I-5, Central Corridors [sic] and at "2 to 1" shipper locations?

For reasons already described, market shares say little or nothing about the vitality of competition, and a study would not yield meaningful information. The proposed study of the I-5 Corridor would be especially pointless. The UP/SP merger enhanced competition in this corridor and did not eliminate any prior competition between UP and SP.

The merger created a new BNSF single-line route in this corridor. Any BNSF market share is a merger benefit.

> 2. What percentage of the market does each railroad expect to achieve in each corridor and "2 to 1" point?

This is also a meaningless inquiry. Both competitors surely hope to attract 100 percent of the traffic available to them.

> 3. What is the level of cost efficiences resulting from the merger and to what extent have these have been passed on to shippers in the form of rate reductions or increased investment in plant and equipment?

This would require a massive study involving numerous judgments and assumptions. Prior attempts to quantify the extent to which merger benefits were passed on to shippers have been highly contentious. See, e.g., UP/SP-231, Kauders R.V.S. (demonstrating that such a study by KCS was flawed). Changes in the economy and individual industries affect measures of benefits, rate levels, investment, and traffic volumes, making it very difficult to trace quantifiable merger benefits. It is even more difficult, and perhaps impossible, to quantify intangible benefits to shippers, such as the benefits of single-line ratemaking and reduced transit time. Accordingly, this exercise would primarily benefit consultants and lawyers.

> 4. Did the estimated impacts and traffic diversion projections resulting from the BNSF trackage right agreement included in the UP/SP merger application materialize?

BNSF answered this question. BNSF reports that its traffic on trackage rights lines meets or exceeds its expectations. BNSF told the Board in UP/SP that its goal was to "grow the traffic associated with its rights from zero to the size and scale of a new Class I railroad." BNSF-PR-14 at 2. As BNSF now reports, "we have exceeded that goal." Id.

5. What is the existing capacity of the I-5, Central Corridors [sic], Sunset Routes [sic] and other routes serving California; what proportion of this capacity is currently being used?

Respectfully, we do not understand what CPUC or the Board would do if it had this information. Low capacity utilization alleviates concern about congestion but raises questions about efficiency and, possibly, a railroad's viability. High capacity utilization may suggest the need for more investment, but it is also necessary if railroads are to recover their capital costs. Neither condition requires government intevention in private-sector decisions.

6. To what extent has [sic] the planned capital improvements presented in the UP/SP merger application actually been completed and are there any plans to downgrade any routes serving California?

UP has provided extensive information on merger-related investments in each of its annual oversight reports. It plans to update that information next year. UP has no plans to downgrade any of its mainlines serving California.

7. Is the current volume in the Central Corridor sufficient to maintain or increase existing track standards for both the former SP and UP routes and does any elements of the trackage rights agreement (e.g., level of track fees) lead to a withholding of transportation services offered to shippers?

Following post-merger upgrades of SP lines, all of UP's lines in the Central Corridor are in excellent condition, and current traffic volumes warrant that condition. BNSF's reports about its trackage rights successes are inconsistent with any concern that it might withhold transportation services.

8. What is BNSF and UP's current evaluation of their development and implementation of Positive Train Separation?

This topic has nothing to do with the UP/SP merger. Along with BNSF, UP is testing this technology in the Pacific Northwest. Another modest experiment is underway in Illinois with government funding.

D. Requests for New Conditions. In its concluding comments, CPUC recommends that the Board impose new conditions to enhance competition even though there is no evidence that the merger is causing competitive harm. Id. at 9. Such a request is beyond the scope of this proceeding as defined by the Board. In Decision No. 44, the Board imposed the oversight process "to examine whether the conditions we have imposed have effectively addressed the competitive issues they were intended to remedy." Decision No. 44 at 146. The Board retained jurisdiction to add new conditions only "if, and to the extent, we determine that the conditions already imposed have not effectively addressed the competitive harms caused by the merger." Id. See also General Oversight, Decision No. 10 served Oct. 27, 1997, p. 14. Thus, the Board could add new conditions only if the existing conditions fail.[7]

Although the Board may change its merger rules and policies in Ex Parte No. 582 (Sub-No. 1), it cannot change them retroactively and apply them to prior mergers. UP was entitled to decide whether to consummate the UP/SP merger based on the Board's approval order and the conditions (including oversight) it imposed. The Board cannot change those conditions after UP exercised its choice. Landgraf v. USI Film Products,

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[7] The Board imposed conditions that enhanced competition beyond the level of competition that existed before the merger. For example, its modifications of the BNSF Settlement Agreement to give BNSF access to every new shipper and transload facility along trackage rights lines created ever-expanding competitive service on more than 4,000 miles of UP's lines.

511 U.S. 244, 280 (1994) (holding that an agency rule is impermissibly retroactive if it "impose[s] new duties with respect to transactions already completed"); Guilford Transportation Industries, Inc. – Control – Boston & Maine Corp., 5 I.C.C.2d 202, 206 (1988).

CPUC proposes a new condition giving BNSF an improved intermodal route in the I-5 Corridor. CPUC made the same suggestion last year, and the Board rejected it. General Oversight, Decision No. 15 at 7. This proposal has nothing to do with the UP/SP merger, which did not reduce intermodal competition on the I-5 Corridor. "Rather, rail competition in the I-5 Corridor was created by the merger." Id. CPUC's vague proposal to give BNSF "proportional rates" to UP shippers is simply a call for open access. Only Congress can grant that request.

The Board should reject all of CPUC's recommendations.

III. KCS COMMENTS

KCS's comments foretell relitigation of the UP/SP merger in the final year of the oversight proceeding. KCS all but predicts that it will seek to replace BNSF as UP's competitor in the Central Corridor and that it will, for the fourth time, ask the Board to modify the conditions affecting the Houston area. Reminding us that KCS is concerned with its own parochial interests, not with abstract principles such as competition, KCS asks the Board to reverse a condition that allows BNSF to serve KCS's Lake Charles, Louisiana, customers. We assume that BNSF will respond to that request.

KCS's comments consist largely of unsupported assertions and misstatements.

▶ KCS opens its comments by asserting that "the UP/SP merger has resulted in a number of problems which are either glossed over or ignored by UP." KCS Comments at 1. KCS never identifies these "competitive problems," much less provides evidence of them. The Board reached precisely the opposite conclusion last year, when it held "that there have been no competitive problems resulting from the merger." General Oversight, Decision No. 15 at 1. DOT reached the same conclusion as the Board: "[C]ompetition between BNSF and UP/SP still seems to be vigorous," and "it is not now necessary to revisit the conditions imposed by the STB." DOT-4 at 3-7. KCS does not explain why the Board and DOT were wrong last year, nor does it identify any subsequent change in competitive conditions.

▶ KCS then asserts that UP has provided no evidence of effective competition. KCS Comments at 1. Year after year, UP prepared detailed and voluminous data, coupled with many dozens of examples, showing that (a) BNSF attracted enormous amounts of traffic using the merger conditions, (b) UP had to make commercial concessions to retain traffic, (c) UP's rates in competition with BNSF declined or remained stable, and (d) BNSF took advantage of opportunities to attract new industries and transload business. No party ever took issue with any of those showings. UP presented hard data and specifics. KCS ignores that evidence and offers nothing of substance in response.

▶ KCS next urges the Board to remember Thomas D. Crowley's warnings in UP/SP regarding BNSF's inability to compete with UP/SP using trackage rights. KCS Comments at 5. KCS apparently has forgotten how wrong Mr. Crowley's predictions in UP/SP proved to be. For example, Mr. Crowley testified that BNSF would be able to garner only 15,000 carloads per year for the trackage rights between Houston and Memphis.

SPI-11, Crowley V. S. at 57. In fact, BNSF carried more than 37,000 carloads on that route in the 12 months preceding BNSF's latest report. BNSF-PR-16, Att. 8. Mr. Crowley underestimated BNSF's success in that corridor by nearly 150 percent.

KCS also refers to Mr. Crowley's claim in 1996 that trackage rights compensation under the BNSF Settlement Agreement was too high. KCS Comments at 7. UP demonstrated that Mr. Crowley's calculations were grossly defective. UP/SP-231, Rebensdorf R.V.S., pp. 14-30. For example, Mr. Crowley purported to compare compensation under other trackage rights agreements. UP showed that many of these agreements covered movements on industry tracks, not on intercity rail lines. One of the agreements for which Mr. Crowley calculated a trackage rights fee did not even involve trackage rights; it was an agreement regarding highway signals at road crossings. Id. at 28. The Board found that Mr. Crowley's examples were comparable to the BNSF Settlement Agreement. Decision No. 44 at 142.

▶ KCS repeatedly urges the Board to develop market share studies that would be without value. Like CPUC, KCS proposes to compare BNSF's current market shares with SP's shares before the merger. KCS Comments at 7. As the Board recognizes, no one would expect BNSF to match SP's pre-merger market share. BNSF does not have access to SP or UP solely-served shippers, but only to "2-to-1" shippers. Accordingly, BNSF never expected to acquire all of SP's traffic. BNSF's declarations that it has met its trackage rights goals should silence any call for further market-share studies.

▶ KCS asks the Board to launch an expensive and burdensome rate study of Houston-area rates. KCS Comments at 7-9. It expects BNSF and UP to bear the costs and burdens of the study. Nothing in KCS's comments warrants this undertaking. KCS offers not a single fact that suggests a lack of competition in the Houston area.

KCS is engaged in a fishing expedition, and it wants BNSF and UP to pay for the trip. KCS had access this year, as in every prior year, to traffic tapes containing 100 percent of BNSF's traffic and 100 percent of UP's traffic. KCS did not even ask for the tapes, much less study them. Instead, based only on speculation and parochial interests, KCS asks the Board to launch a massive investigation, with BNSF and UP performing all the work. The Board ought not reward this opportunistic conduct by imposing a major and expensive regulatory burden on BNSF and UP when all of the evidence points to vigorous competition.[8]

KCS's comments, as well as recent press reports, indicate that KCS in next year's oversight proceeding will seek to replace BNSF in the Central Corridor. Not a single shipper in that corridor criticizes BNSF's service or rates. We believe that affected shippers in the Central Corridor are overwhelmingly likely to prefer BNSF, with its comprehensive

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[8] We endorse KCS's request for approval of its petition to acquire UP's "Wharton Line." KCS Comments at 9-10. This transaction carries out UP's offer to sell its Rosenberg-Victoria "Wharton Line" to Tex Mex at a price to be determined by an arbitrator. UP/SP-356 at 213-17; see also UP/SP Houston/Gulf Coast Oversight, Decision No. 10, served Dec. 21, 1998, p. 26. KCS criticizes UP for delaying the transaction. UP declined to proceed with negotiations until Tex Mex paid millions of dollars in overdue trackage-rights compensation. As soon as Tex Mex paid its bills, UP acted promptly.

KCS objects that BNSF and UP have not yet completed their planned exchange of ownership interests in the former SP line between Houston and New Orleans. KCS Comments at 13-14. Coincidentally, BNSF and UP signed the operating agreement and revised trackage rights agreements for this line last Friday, September 1, 2000. They will execute the property exchange agreement, bills of sale, and other conveyance documents by September 8, 2000.

route network and single-line service throughout the West, to a new entrant such as KCS that would extend only an isolated finger of rail service to Northern California. This is especially true for "2-to-1" shippers in Northern California who today enjoy BNSF's single-line service in the I-5 Corridor. They would lose both if BNSF were replaced by KCS with its limited route network and fewer resources.

IV. ROCK AND CEMENT SERVICE IN SOUTH CENTRAL TEXAS

Although no party commented on UP's service, we reported in July the UP's service to rock and cement shippers in Texas had declined during the early summer. Through May UP had been setting all-time records in rock deliveries in Texas, but service slipped in May and June. This decline resulted from a temporary shortage of locomotives. UP added substantial numbers of locomotives to rock and cement service, including a number of locomotives leased from Mexico. UP is now committing approximately 180 locomotives to this service, the highest total in memory.

Despite these efforts, UP continued to fall short of meeting the high level of customer demand during July and early August. UP concluded that it needed to perform heavy rail and tie maintenance on the Austin Subdivision, the line that serves most of the area's rock shippers. For approximately six weeks ending August 10, a rail gang and a tie gang performed major track work on a segment of single track on the Austin Subdivision north of San Marcos, Texas. This heavily used line was out of service for ten hours per day. That forced UP to operate Amtrak trains, UP's Mexico traffic, and BNSF trains on alternate routes or during the remaining 14 hours, causing severe congestion. Weeks of record-breaking heat contributed to the congestion. High temperatures cause rails to expand and create a risk of derailments. UP imposed extensive slow orders to ensure safe operations.

Effective August 10, 2000, the rail and tie gangs moved off the single track to a segment of double track south of San Marcos. This improved the situation but did not cure it. Service should return to normal when the maintenance projects are complete. UP expects these maintenance gangs to finish work by mid-September. We hope that the record heat will abate by then as well.

UP is also conducting a detailed study of how to improve rock operations. This study will focus on a range of issues, including improving locomotive utilization, moving empty trains promptly after unloading, and possible additional investment.

CONCLUSION

During this fourth year of the Board's oversight of the UP/SP merger, no party has offered any evidence to contradict the Board's conclusion last year that the merger conditions effectively protect competition. Concerns about UP's commitment to transporting Utah and Colorado coal are based on faulty assumptions that UP is uninterested in this traffic and that traffic volume is falling. The facts show that UP is investing heavily; traffic has grown; and BNSF constrains UP's rates by bidding on traffic. BNSF eagerly competes with UP using the inexpensive trackage rights fees that the Board approved four years ago. Finally, none of the calls for new and burdensome studies is based on facts showing any failure of competition.

The Board should reaffirm its decision last year that rail competition is healthy in the West.

Respectfully submitted,

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September 5, 2000

VERIFICATION

STATE OF NEBRASKA)
) ss.
COUNTY OF DOUGLAS)

I, John T. Gray, Vice President and General Manager - Business Development of Union Pacific Railroad Company, state that the information in Section I, Parts A-C, and Section IV of UP's Reply to Comments in STB Finance Docket No. 32760 (Sub-No. 21) was prepared by me or individuals under my supervision, I know its contents, and to the best of my knowledge and belief it is true as stated.

John T. Gray
JOHN T. GRAY

Subscribed and sworn to before
me this 1st day of September, 2000

Doris J Van Bibber
Notary Public

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

VERIFICATION

STATE OF NEBRASKA)
) ss:
COUNTY OF DOUGLAS)

I, John H. Rebensdorf, Vice President - Network and Service Planning of Union Pacific Railroad Company, state that the information in Section I, Part D, of UP's Reply to Comments in STB Finance Docket No. 32760 (Sub-No. 21) was prepared by me or individuals under my supervision, I know its contents, and to the best of my knowledge and belief it is true as stated.

JOHN H. REBENSDORF

Subscribed and sworn to before
me this 1st day of September, 2000.

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 HERBY CERTIFY that on this 5th day September of, 2000, a copy of the foregoing UP'S Reply to Comments was mailed, postage prepaid, to all parties of record.

J. Michael Hemmer

J. Michael Hemmer

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August 21, 2000

Vernon A. Williams
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Surface Transportation Board
1925 K Street, N.W.
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Washington, DC 20423

Re: UP/SP Merger, STB Finance Docket No. 32760(Sub-No. 21), General Oversight; Request for Acceptance of Late Filed Comments

Dear Mr. Williams:

On behalf of Arkansas Electric Cooperative Corporation we are submitting herewith an original and ten copies of comments in the UP/SP merger General Oversight proceeding.

These comments were due to be filed on August 18, 2000. We were unable to complete the filing in time to arrive at the Board before the closing of the Secretary's office. Accordingly, we respectfully request that the Board accept this filing tendered one business day late. Copies are being hand served upon counsel for UP and BNSF; and accordingly, they will not experience any prejudice from the late receipt of these comments. We have conferred with counsel for both carries, and they advise they will interpose no objection.

As set forth in footnote 1 to the Comments, the issues raised by AECC also is relevant to the Board in conjunction with the Major Rail Consolidations Rulemaking, Ex Parte No. 582 (Sub-No. 1). Accordingly, as set forth in footnote 1, AECC respectfully submits that the comments be accepted and considered in conjunction with that proceeding, as well.

A copy of these comments is associated herewith in a floppy disk in WordPerfect 7.0 format.

Respectfully submitted,

Martin W. Bercovici

Enclosures

cc: J. Michael Hemmer – Counsel for UP/SP
Erica Z. Jones – Counsel for BNSF

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ORIGINAL

AECC-1

BEFORE THE

SURFACE TRANSPORTATION BOARD
Washington, DC 20423

In the Matter of:	
Public Views on Major Rail Consolidations	**STB Ex Parte ~~No. 582 (Sub-No. 1)~~**
Union Pacific Corporation, Union Pacific Railroad Company, and Missouri Pacific 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	**STB Finance Docket No. 32760 (Sub-No. 21)** **General Oversight**

COMMENTS OF
ARKANSAS ELECTRIC COOPERATIVE CORPORATION

Arkansas Electric Cooperative Corporation ("AECC") respectfully submits its comments to the Surface Transportation Board addressing the competitive implications of trackage rights arrangements in merger proceedings, specifically as those arrangements have functioned in the UP/SP merger proceeding, and also generically, as the Board considers its policies with regard to future major railroad consolidations.[1]

[1] AECC recognizes that the comment date in the initial phase of the Ex Parte No. 582 (Sub-No. 1) proceeding has passed, and the Commission is in the process of developing a notice of proposed rulemaking to be issued in the Fall. Inasmuch as the comments being submitted in the UP/SP merger oversight are relevant to the general issues being addressed by the Board in the Ex Parte No. 582 (Sub-No. 1) rulemaking, AECC submits these comments in the rulemaking proceeding as well, and respectfully requests the Board to consider these comments in the development of its Notice of Proposed Rulemaking.

I. STATEMENT OF INTEREST

AECC is a membership-based generation and transmission cooperative that provides wholesale electric power to electric cooperatives, which in turn serve approximately 400,000 customers located in each of the 75 counties in Arkansas. In order to serve its member distribution cooperatives, AECC has entered into arrangements with other utilities within the state to share generation and transmission facilities. The largest of AECC's generation assets are its ownership interests in the White Bluff and Independence coal-fired steam generation plants. AECC has a 35 percent interest in each of these plants. Entergy Arkansas, Inc., is the majority owner and also the operator of these plants.

In discharge of its fiduciary duty to its members with regard to its ownership interest in the White Bluff, Independence and other power plants, and to assure efficiency in the supply of fuel to those plants, AECC monitors the terms of fuel supply and coal transportation. Through the review of data filed with the Federal Energy Regulatory Commission and other sources, AECC seeks to assure that the cost of electric power generation at the plants in which it has an interest is competitive with the cost incurred by other utilities. This is of growing importance as the electric utility industry is becoming open to competition.

With specific reference to the White Bluff plant at Pine Bluff, Arkansas, the Surface Transportation Board protected the opportunity for competitive rail service through a build-in/build-out condition imposed in the UP/SP merger proceeding.[2] Entergy has moved forward to implement the build-in/build-out condition, through

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[2] *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 Railroad Company, SPCSL Corporation, and The Denver and Rio Grande Western Railroad Company*, Finance Docket No. 32760 (hereinafter *UP/SP*), Decision No. 44 at 185 (served Aug. 12, 1996); Decision No. 88 (served Mar. 21, 2000).

seeking exemption from the Board for the line construction.[3] AECC sought, and was granted, leave to intervene in the White Bluff exemption.[4] This build-out, if constructed, will provide the physical capability for BNSF to directly compete with Union Pacific for coal movements to the White Bluff plant. In rendering service to White Bluff, BNSF would need to operate over approximately 145 miles of UP lines on trackage rights it obtained in the UP/SP merger (from Jonesboro to Pine Bluff, Arkansas).

II. COMMENTS

In today's coal transportation marketplace, head-to-head rail competition frequently produces rates in the range of 8 mills per net ton-mile for volume movements of Powder River Basin (PRB) coal, moving in shipper-owned cars. While the margins on such movements on a ton-mile basis are relatively low, these movements are quite profitable to the railroads due to the extremely high tonnage and distances involved. In the associated verified statement, AECC's consultant Michael Nelson establishes that under the trackage rights compensation terms approved in the UP/SP merger BNSF is constrained to pay UP a return, net of variable cost, of approximately 2.5 mills per net ton-mile for use of the trackage rights. As further established in the Nelson Verified Statement, the burden imposed on BNSF due to the trackage rights compensation terms effectively undermines BNSF's ability to fully compete with UP in coal transportation, and thereby to replicate the pre-merger UP/SP competition.[5] This is particularly demonstrated by Nelson in evaluation of Colorado/Utah coal movements, where BNSF -- unlike in the PRB -- does not have an independent presence absent the trackage rights over the UP lines.

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[3] *Entergy Arkansas and Entergy Rail-Construction and Operation Exemption-White Bluff to Pine Bluff, AR*, STB Finance Docket No. 33782 (served May 4, 2000).

[4] *Id.*, Served June 30, 2000.

[5] AECC notes that in its July 3, 2000 quarterly progress report, BNSF describes its Central Corridor operations solely in terms of merchandise trains. BNSF-PR-16 at 410-11. *See also* Attachment 1 to BNSF-PR-16, reflecting BNSF operations on Central Corridor trackage rights, which reflects no unit coal train service.

The burden of the trackage rights compensation arrangements apply equally to BNSF whether the trackage rights are utilized for the origin portion of the movement – as for Colorado Utah coal, or whether the trackage rights are utilized at destination – as would occur in serving the White Bluff plant. AECC is concerned, therefore, whether BNSF will, in fact, be fully competitive with UP when the build-out from the White Bluff plant is competed.

III. RELIEF REQUESTED

The Board established the UP/SP merger oversight process to facilitate the identification and remediation of competitive problems occurring as result of the merger. While AECC recognizes that the Board addressed trackage rights compensation in the UP/SP merger, nonetheless as detailed in the Nelson Verified Statement, certain of the assumptions made by the Board have not been realized. Accordingly, AECC respectfully requests the Surface Transportation Board to evaluate whether the terms of trackage rights compensation approved by the Board fully enable BNSF to replicate pre-merger UP/SP competition for movement of western coal, and to revise the compensation terms to a level appropriate to assure the preservation of pre-merger competition.

AECC further respectfully requests the Surface Transportation Board, in the Ex Parte No. 582 (Sub-No. 1) rulemaking addressing railroad merger policy, to provide that for trackage rights granted in any future merger compensation will be set at a level which assures maintenance of pre-merger competition, based upon an evaluation of marketplace economics rather than solely based upon formulas as historically practiced by the Board and its predecessor.

Respectfully submitted,

Martin W. Bercovici
Keller and Heckman
1001 G Street, N.W.
Suite 500 West
Washington, DC 20001
(202) 434-4144
Attorney for Arkansas Electric Cooperative Corporation

August 18, 2000

CERTIFICATE OF SERVICE

I, Jean M. Bethea, hereby certify that a copy of the foregoing COMMENTS is being served by hand upon the following parties to the UP/SP Oversight Proceedings:

J. Michael Hemmer
Covington & Burling
1201 Pennsylvania Avenue, N.W.
Washington, DC 20004-2401
Attorney for Union Pacific Corporation,
Union Pacific Railroad Company and
Southern Pacific Rail Corporation;

and

Erica Z. Jones
Mayer, Brown & Platt
1909 K Street, N.W.
Washington, DC 20006
Attorney for The Burlington Northern and Santa Fe
Railway Company;

and by first class mail, postage prepaid on all parties of record in STB Docket Ex Parte No. 582 (Sub-No. 1).

Jean Bethea
Jean M. Bethea

Dated: August 21, 2000

VERIFIED STATEMENT
OF
MICHAEL A. NELSON

1. Qualifications

My name is Michael A. Nelson. I am an independent transportation systems analyst with over 18 years experience advising clients on rail transportation issues. My office is in North Adams, Massachusetts. Prior to February 1984, I was a Senior Research Associate at Charles River Associates, an economic consulting firm in Boston, Massachusetts.

I have directed or participated in numerous consulting assignments and research projects in the general field of transportation. My work typically involves developing and applying methodologies based on operations research, microeconomics, statistics and/or econometrics to solve specialized analytical problems. For example:

- I recently submitted a statement to this Board on behalf of the Committee to Improve American Coal Transportation (IMPACT) in Ex Parte 582 (Sub-No. 1), addressing a wide range of issues related to rail merger policy.

- I provided testimony before this Board regarding my analysis of the proposal of the Dakota, Minnesota & Eastern Railroad (DM&E) to construct a third rail access to the Powder River Basin (Finance Docket No. 33407).

- I also provided testimony before this Board regarding the appropriate definition of Amtrak's "express" service (Finance Docket No. 33469).

- I assisted Canadian Pacific in assessing the diversion impacts, competitive issues and potential remedial conditions associated with the proposed division of Conrail between NS and CSX (Finance Docket No. 33388).

- I advised the Moffat Tunnel Commission (Colorado) regarding factors affecting future rail use of that tunnel.

- I provided testimony regarding competitive and/or statistical issues in six railroad merger proceedings before the Interstate Commerce Commission, including control of C&NW by Union Pacific (Finance Docket No. 32133), the acquisition by Rio Grande Industries of portions of the CM&W and Soo Line railroads (Finance Docket Nos. 31522 and 31505, respectively), the consolidation of Southern Pacific with DRGW (Finance Docket No. 32000), the acquisition of MKT by Union Pacific (Finance Docket No. 30800), and extensive testimony regarding the anticompetitive effects of the proposed merger of Southern Pacific and Santa Fe (Finance Docket No. 30400).

I have also provided extensive testimony regarding methods for analyzing the cost structure of the U.S. Postal Service in five dockets before the Postal Rate Commission. In addition, I have assisted in the preparation of numerous other verified statements presented before various regulatory and legal bodies, and authored many technical reports and articles in transportation journals.

I received my bachelor's degree from the Massachusetts Institute of Technology in 1977. In 1978, I received two master's degrees from MIT, one in Civil Engineering (Transportation Systems) and one from the Alfred P. Sloan School of Management, with concentrations in economics, operations research, transportation systems analysis and public sector management. My curriculum vitae is attached as Exhibit A.

2. <u>Subjects Covered in This Statement</u>

I have been asked by Arkansas Electric Cooperative Corporation to analyze various issues related to the compensation terms established for operation over the trackage rights granted by this Board in its approval of the UP/SP merger. In this statement I specifically discuss the following:

- At least in the context of western coal transportation, the trackage rights lines have not functioned in the manner that was envisioned at the time of their creation;

- For western coal, the terms of trackage rights compensation in UP/SP are inconsistent with railroad competitive practices, market realities, and the stated purpose of the trackage rights; and,

- The adverse impact of excessive trackage rights fees extends beyond western bituminous coal, and in some circumstances inhibits competition between BNSF and UP in the supply of PRB coal.

Each of these is discussed below.

3. At least in the context of western coal transportation, the trackage rights lines have not functioned in the manner that was envisioned at the time of their creation.

Subsequent to the SP/DRGW merger in the late 1980's, SP aggressively marketed low-sulfur bituminous coal from former DRGW-served mines in Colorado and Utah. For the period from that merger to the UP/SP merger (1988-1996), the growth rate for Colorado and Utah coal production in the aggregate (5.4% annually) was only slightly lower than the explosive growth of Wyoming coal production during the same period (6.6%).

Even these production figures understate the significance of SP's initiatives. In particular, competition by SP fueled a major increase in the flow of Colorado and Utah coal to power plants spread over a large area east of Colorado, ranging from Wisconsin in the upper midwest to Texas in the south. As shown in Table 1, this volume had more than tripled in the 4-year period preceding the UP/SP merger, and far exceeded the corresponding growth rate for PRB coal.

Table 1 - Colorado/Utah Utility Steam Coal Movements to Plants East of Colorado

Origin	1992	1996
Colorado	4039	9612
Utah	339	3937
Total	4378	13549

Source: FERC Form 423.

In its decision approving the merger, the Board relied explicitly on the premise that the newly-created Utah Railway-BNSF route would prevent competitive harm for western bituminous coal flows. Indeed, the Board projected that this new route - which relies on approximately 450 miles of trackage rights over the former DRGW to connect Utah Railway with BNSF at Denver via Grand Junction, CO - would "intensify competitive options for Uinta Basin coal shippers" and enable Utah producers to "gain important new rail access to midwestern and eastern markets".

Unfortunately, the Utah-BNSF route has not provided a viable competitive option, and the market influence provided by SP has largely vanished. After the consummation of the UP/SP merger, Colorado/Utah coal movements to the east were immediately de-emphasized, and had declined by over 8% by 1998. Many plants that previously were substantial and growing users of Colorado/Utah coal have been converted in part or entirely to PRB coal.[1] Aggregate Colorado/Utah coal production is now at approximately the level it was at in 1996, but is declining at an accelerating rate. In the meantime, Wyoming production has increased more than 20%.

Data presented in these oversight proceedings have consistently shown that there are essentially no coal movements that utilize the Utah-BNSF route. This absence of traffic reflects the inability of eastern utilities and power producers to secure competitive transportation terms for movements from preferred sources served via the Utah-BNSF route. In short, the Utah-BNSF route, which relies

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[1] Such conversions appear to violate the assumptions made by the STB regarding the substitutability of western bituminous and PRB coals, and the incentives of UP and BNSF absent the preservation of SP's competitive influence.

heavily on trackage rights established in UP/SP, has not been effective in protecting competition in the supply of western bituminous coal.

4. **For western coal, the terms of trackage rights compensation in UP/SP are inconsistent with railroad competitive practices, market realities, and the purpose of the trackage rights.**

Western coal is highly rail-dependent, and typically moves in trainload quantities of 10,500-14,000 or more tons over long distances (often 1,000 miles or more). Annual movements to individual plants frequently exceed 1 million tons, and 1 billion ton-miles. For shippers, the cost of transportation may exceed the mine-mouth price of the coal, often by a wide margin. As a result, even small changes in rates on a per ton-mile basis may have major impacts on shippers, and be instrumental in defining the effective market area for different types of western coal.

For the railroads, the immense quantity of ton-miles associated with western coal movements make it possible for substantial contribution to be earned at relatively low mark-ups over variable cost. In circumstances where head-to-head rail competition occurs, rail rates in the range of 8 mills per *net* ton-mile or less can be observed, at least for high-volume contract unit train movements in shipper-owned cars.[2]

The trackage rights compensation terms adopted in the UP/SP merger decision implicitly require a contribution (i.e., return element net of variable costs) of approximately 1.6 mills per *gross* ton-mile. For a 125-car train loaded at 120 tons/car, this equates to approximately 2.5 mills per *net* ton-mile. In other words, the trackage rights compensation terms would require that a 1200 mile move to a plant consuming 6 million tons of coal annually generate a return element of $18 million annually.

Of course, there would appear to be few if any circumstances under which a railroad could earn a return of

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[2] Such rates demonstrate that selected western coal movements constitute a major exception to the Board's stated belief (at page 143 of the UP/SP decision) that most traffic moving on rates close to variable costs is protected by intermodal competition.

2.5 mills per ton-mile on rates of 8 mills or less. The 8 mill (and lower) rates result from the fact that a rational competing railroad operating an independent parallel system is often willing to bid on a volume coal movement at a rate that provides a return element of less than 2.5 mills in order to secure the business. For example, even with a return element of 1.25 mills, the movement described above would still generate a return of $9 million annually.

Even in a duopolistic supply environment for PRB coal, shippers at competitive points are often able to obtain rates that provide a lower return than that embodied in the trackage rights compensation. However, if one of the two competitors knows that the other is constrained to earn a return element of $18 million, it will have no reason to bid rates that - all else equal - provide a return element of much under $18 million. Under the trackage rights compensation formula, the shipper pays rates that annually may be millions of dollars higher than the competitive level.

More generally, current trackage rights compensation constrains the tenant to price at a level that may be significantly higher than the price that would be quoted by a rational independent competitor for the same traffic. In this context, it is important to remember that the trackage rights generally are providing access only for shippers and points that enjoyed pre-merger head-to-head rail competition. Traffic associated with such points is precisely the traffic that tends to move at the lowest margins over variable cost. When the tenant is not allowed to serve traffic at exclusive points, the primary function of the trackage rights is to enable the tenant to replicate the pre-merger conduct of an independent competitor <u>at competitive points</u>. Forcing the tenant to earn a supra-competitive return on such traffic provides a <u>de facto</u> rate increase for the landlord railroad, and deprives the shipper of a portion of the competitive pressure that would be present if not for the merger.

5. **<u>The adverse impact of excessive trackage rights fees extends beyond western bituminous coal, and in some circumstances inhibits competition between BNSF and UP in the supply of PRB coal</u>.**

In the context of western coal supply, trackage rights compensation issues affect the ability of BNSF to compete for PRB coal movements, as well as bituminous coal from the Central Corridor. For example, this Board (in Finance Docket No. 33782) recently approved Entergy's proposed build-out from the White Bluff plant, which is owned by Entergy, AECC and others. The build-out prospectively will introduce head-to-head rail competition at this plant. However, to reach the buildout, BNSF must traverse approximately 145 miles of trackage rights over the former SP line from Jonesboro to Pine Bluff, AR. With an annual burn of approximately 6.1 million tons at this plant, Entergy and its co-owners pay over $2.2 million annually due solely to the return element of the trackage rights compensation formula, even though the buildout would create a competitive environment that should be conducive to a lower return element. As a result, White Bluff will be unlikely to realize the full benefits of the competition BNSF would be able to supply if it were not constrained by the return element of the trackage rights compensation formula.

6. Recommendation

In establishing trackage rights compensation terms, the Board should account for the degree to which traffic moving over such rights (which by definition is subject to competition) makes a contribution to overhead and profit that is different from other traffic. In those circumstances, trackage rights compensation needs to replicate the costs considered by a carrier in making rates for its most competitive traffic, and not the entirety of traffic that may make use of a given line. Forcing an arbitrarily high contribution through trackage rights compensation nullifies the ability of the trackage rights tenant to replicate the low mark-ups over variable cost that are characteristic of the competitive traffic for which trackage rights are imposed.

Exhibit A

CURRICULUM VITAE

OF

MICHAEL A. NELSON

MICHAEL A. NELSON

130 Franklin Street
North Adams, MA 01247

EDUCATION

M.S. Civil Engineering, Massachusetts Institute of Technology

M.S. Management, Alfred P. Sloan School of Management, Massachusetts Institute of Technology

B.S. Management, Massachusetts Institute of Technology

Concentrations in transportation systems, economics and operations research.

EXPERIENCE

Mr. Nelson is an independent transportation systems analyst. He provides management and economic consulting and litigation support. His work typically involves developing and applying methodologies based on operations research, microeconomics, statistics and/or econometrics to solve specialized analytical problems, as illustrated by the following examples of his experience:

A. Railroad

On behalf of the Committee to Improve American Coal Transportation (IMPACT), Mr. Nelson submitted a statement to the Surface Transportation Board (STB) in Ex Parte 582 (Sub-No. 1). This statement addressed a wide range of issues related to rail merger policy.

For a major Class 1 railroad, Mr. Nelson assisted senior management staff in the design and evaluation of a potential construction project.

For the Mid-States Coalition for Progress (a group of landowners), Mr. Nelson analyzed the proposal by the Dakota, Minnesota and Eastern Railroad (DM&E) to construct an extension of its line into the Powder River Basin coal fields of Wyoming. Mr. Nelson developed estimates of DM&E's volumes and unit revenue levels on the basis of a plant-by-plant analysis, taking into account likely future market conditions and the competitive capabilities of the Burlington Northern Santa Fe (BNSF) and Union Pacific (UP) systems. Mr. Nelson's analysis was filed at the STB (Finance Docket No. 33407).

For the National Railroad Passenger Corporation (AMTRAK), Mr. Nelson investigated issues related to the definition of "express" traffic that AMTRAK is permitted to carry (STB Finance Docket No. 33469). Mr. Nelson analyzed relevant data from the STB Rail Waybill Sample and the Census of Transportation, and investigated the factors affecting use of Amtrak by the U.S. Postal Service. The definition of "express" eventually adopted by the STB was consistent with Mr. Nelson's findings.

For the Moffat Tunnel Commission (Colorado), Mr. Nelson analyzed the factors affecting future railroad use of that tunnel, which traverses the Continental Divide and serves the principal Colorado coal fields on the UP line that formerly was the Denver and Rio Grande Western Railroad (DRGW) main line west of Denver. The tunnel had historically been owned by the Commission (and leased to the railroad), but under sunset legislation was being offered for public sale. Mr. Nelson's analysis included study of the utilization of Colorado/Utah vs. PRB coals in the context of the central corridor conditions imposed by the STB in the merger of UP with Southern Pacific (SP).

For Canadian Pacific Railway (CP), Mr. Nelson performed detailed studies of competitive and traffic issues associated with the acquisition and break-up of Conrail by Norfolk Southern and CSX (Finance Docket No. 33388). These studies included analyses of competitive issues in the area served by the former Delaware and Hudson (now a CP subsidiary) and in the midwest, competitive issues involving coal traffic throughout the Conrail service area, and traffic impacts associated with potential remedial conditions. CP relied upon the results of Mr. Nelson's studies in reaching its settlements with Applicants in that case.

For SP, Mr. Nelson provided expert testimony before the Interstate Commerce Commission (ICC) in Finance Docket No. 32133 (the proposed control of C&NW by UP). This testimony was based primarily on Mr. Nelson's analyses of data from the Rail Waybill Sample, which identified substantial numbers of specific flows for which the proposed transaction created different types of potential competitive problems (including losses of point-to-point competition, source competition, competition in grain originations, and shipper leverage). In addition, Mr. Nelson's testimony utilized Rail Waybill Sample data to demonstrate the occurrence of merger-related foreclosure from previous UP acquisitions, and provided statistical support for SP's traffic study. Mr. Nelson also conducted a detailed investigation of the impact of the merger on source competition for western coal.

For Rio Grande Industries (RGI), Mr. Nelson provided expert testimony before the ICC in Finance Docket No.'s 31505 (the proposed acquisition by RGI of Soo's Kansas City - Chicago line) and 31522 (the proposed acquisition by RGI of the Chicago, Missouri and Western line between St. Louis and Chicago) based on his analysis of Rail Waybill Sample data. This testimony involved analysis of potential cumulative anti-competitive effects from the proposed transactions, development of time-series estimates of rail traffic volumes and carrier shares in different flows, and assessment of the statistical reliability of the portions of the testimony of other RGI witnesses that were based on Rail Waybill Sample data.

Also for RGI, Mr. Nelson provided expert testimony before the ICC in Finance Docket No. 32000, the consolidation of SP and DRGW. This testimony involved analysis of Rail Waybill Sample data to determine rail traffic volumes in different flows, the statistical reliability of studies conducted by other RGI witnesses, and potential competitive problem flows associated with a consolidation of SP and KCS.

For DRGW, Mr. Nelson provided expert testimony before the ICC in Finance Docket No. 30800 (the acquisition of MKT by UP) based on his analysis of Rail Waybill Sample data. This testimony involved examination of intramodal competition in the central corridor, development of traffic flow databases utilized by other witnesses, assessment of the statistical reliability of other witnesses' studies, and analysis of issues related to use of market share data from waybill samples to evaluate the competitive impact of the proposed merger.

Also for DRGW, Mr. Nelson provided extensive expert testimony before the ICC regarding a number of issues raised by the proposed merger of SP with ATSF (Finance Docket No. 30400):

* Mr. Nelson provided a detailed comparison of the economic and operating characteristics of the intercity trucking and railroad industries, with a particular focus on long-haul markets. Mr. Nelson's analysis of the trucking industry utilized the National Motor Transport Data Base (NMTDB). For this study, Mr. Nelson developed and implemented analytical techniques that compensate for the non-random sampling procedures employed in the gathering of the NMTDB, making it possible to use this source to reliably conduct studies at the industry and corridor level. The Commission adopted the results of Mr. Nelson's study verbatim in its analysis of the anti-competitive consequences of the proposed merger.

* Using the NMTDB and the Rail Waybill Sample, Mr. Nelson analyzed the extent to which rail pricing and services on selected traffic are determined by competing intercity trucking alternatives available to shippers. This analysis was conducted at a highly detailed level, and included explicit accounting for the handling characteristics of each rail commodity and the operating economics of the corresponding truck equipment needed.

* Mr. Nelson analyzed the tests applied by various economists in the proceedings, including those of the U.S. Departments of Justice and Transportation, to identify rail traffic that would most likely be subject to anti-competitive effects in the wake of the proposed merger. Mr. Nelson identified circumstances under which these tests systematically yield invalid results, and provided guidelines for their proper application.

* Mr. Nelson identified improvements needed in the merger applicants' initial methodology for estimating the rail traffic diversions that likely would result from the proposed merger.

* In addition to this expert testimony, Mr. Nelson served as principal investigator for several studies underlying testimony offered by other witnesses, addressing issues related to intramodal (rail) competition, product

and source competition, shipper benefits and leverage and trackage rights compensation. Mr. Nelson also conducted a number of special studies on request for other witnesses and counsel.

For a private client, Mr. Nelson participated in a study of the purchase and utilization of jumbo covered hopper cars by shippers and railroads. This study involved extensive analysis of the Rail Waybill Sample and other data sources, and included a detailed examination of historical car shortages in light of economic and traffic conditions, and other related factors. The results of Mr. Nelson's work were incorporated in testimony before the ICC.

As a subcontractor to consulting firms, Mr. Nelson has participated in a number of other rail-related studies. These include (1) analysis of Rail Waybill Sample data to address issues stemming from traffic protective conditions at the Jacksonville (FL) gateway between FEC and CSX, and (2) analysis of CN's Port Huron-Sarnia tunnel project and the alternative of a tunnel at Detroit-Windsor.

B. Postal Service

For Magazine Publishers of America (MPA), Mr. Nelson analyzed several issues related to the transportation costs incurred by the Postal Service in its movement of periodicals. This included identification of feasible cost reductions and efficiency improvements, as well as development of needed refinements in the methods used by the Postal Service to analyze transportation costs. The results of this work were presented to the Postal Rate Commission (PRC) in the R2000-1 omnibus rate case.

Mr. Nelson identified and developed opportunities for a major publisher to create more efficient and desirable price/service options by avoiding selected costs in its mailings of periodicals. This work included consideration of transportation, delivery and unfunded retirement liability costs.

For Foster Associates (under contract to the Postal Service), Mr. Nelson worked in the following areas:

* Delivery costing - Mr. Nelson developed a series of refinements in delivery cost analysis procedures. These refinements included analysis of driving time on motorized

letter routes, collection costing and extensive revision of costing for special purpose routes and special delivery messengers. In support of the new methodologies, Mr. Nelson developed data collection plans and assisted in the development of survey instruments and innovative procedures to gather new field data from carrier and messenger operations. He conducted extensive analysis of the new data, including development of data cleaning and weighting procedures, analysis program logic, and specifications for new econometric models. He also identified an overlap in costing systems that produced a "double-count" of delivery activity performed by personnel other than special delivery messengers but charged to LDC 24 (Cost Segment 9). He developed spreadsheet modifications needed to incorporate the costing refinements and new data, and eliminate the "double-count" problem. The results of Mr. Nelson's delivery costing work were presented before the PRC in the R97-1 omnibus rate case. The PRC adopted 9 out of 10 of Mr. Nelson's recommended methodological changes, 2 with commendations.

* New products - Mr. Nelson identified the cost basis for a number of potential new product offerings involving Express Mail and Priority Mail, and developed the analytical framework and information needed to support their implementation. This included design and analysis of a new field study of relevant Express Mail piece characteristics, which was also presented by Mr. Nelson in the R97-1 rate case.

* Litigation support - In Docket No. R94-1, Mr. Nelson reviewed intervenor testimony regarding city delivery carrier and transportation issues, and developed discovery and cross-examination topics for Postal Service counsel.

* IOCS - Mr. Nelson developed refinements in IOCS data gathering procedures to improve the validity and precision of available information regarding Express Mail activities. Mr. Nelson then interpreted the initial results from the new data and provided suggestions for improvements in Express Mail costing procedures.

* Postal AMR - Mr. Nelson developed a plan for analyzing the street time costs associated with a proposal to have postal vehicles perform automated meter reading for utility companies.

* Eagle Network - Mr. Nelson developed a potential methodology for attributing the costs of dedicated air transportation services procured by the Postal Service.

For United Parcel Service (UPS), Mr. Nelson provided extensive expert testimony before the PRC in Docket No. R90-1. This testimony presented Mr. Nelson's studies of cost causality and/or elasticity within the city delivery carrier, special delivery messenger, vehicle service driver, purchased highway transportation and expedited air network operations of the Postal Service. These studies, which involved application of operations research techniques and development of econometric models and other statistical analyses based on postal data, were referenced and relied upon extensively by the PRC in its Opinion and Recommended Decision. To a considerable degree, these studies represented extensions and refinements of Mr. Nelson's previous studies, which were presented before the PRC in Mr. Nelson's testimony in Docket No. R87-1, and in Docket No. RM86-2B, a rulemaking proceeding established in part to explore issues raised in testimony before the PRC in Docket No. R84-1 for which Mr. Nelson served as principal investigator.

C. Other

Mr. Nelson participated in an airport master planning study for Sydney, Australia. For this study, he developed a comprehensive set of site selection criteria and evaluation measures.

Until February 1984, Mr. Nelson was a Senior Research Associate at Charles River Associates (CRA), an economic research and consulting firm, where his work experience included the following:

Freight Transportation

Mr. Nelson served as Manager of Consulting Services for the National Motor Transport Data Base (described above), which at the time was sponsored by CRA. In this position, he was responsible for handling client requests for information from the database, including problem definition, sampling issues, conduct of analyses and reporting of results. He conducted specific analyses for a number of public and private clients.

Mr. Nelson served as principal investigator for a study of motor carrier safety and traffic characteristics. This study involved extensive analysis of a number of databases, including the FHWA "Loadometer" Study, the 1977 Census of Transportation, the ICC "Empty/Loaded" Survey, and the NMTDB. The results of his work were incorporated in testimony before the U.S. District Court on behalf of a private client engaged in litigation with a state over the use of twin trailers.

Mr. Nelson participated in several other projects providing support for motor carriers involved in litigation cases. For these clients he performed detailed financial analyses of motor carrier operations and traffic in different settings, and assisted in the preparation of testimony and briefs. Mr. Nelson also served as an internal consultant on a number of CRA's other motor carrier, railroad, and freight transportation studies.

For the U.S. Department of Transportation (DOT), Mr. Nelson was principal investigator of a study to develop a conceptual framework and data collection strategy for analyzing the impacts of the motor carrier regulatory reforms implemented under the Motor Carrier Act of 1980. For this project, Mr. Nelson was responsible for identifying and selecting specific research issues, data requirements, data sources and analytical techniques.

In a study for the Office of the Secretary of Transportation, Mr. Nelson made extensive use of probabilistic modeling techniques to develop quantitative estimates of potential fuel conservation resulting from selected aspects of proposed motor carrier regulatory reforms.

For DOT, Mr. Nelson was principal investigator for a study of the merits of alternative approaches that could be utilized by the ICC to implement the inflation-based index for allowable rate adjustments by railroads mandated by the by the Staggers Rail Act of 1980. For this study he analyzed the ICC's proposed approach and developed specific conclusions and recommendation in a number of issue areas, including selection of the basic index, productivity adjustments, treatment of profit and non-recurring expenses, frequency of index adjustment, rate averaging, regional differences, collective ratemaking and fuel surcharges. The results of this study were used by DOT in formulating its response to the ICC's proposed approach.

For a private client, Mr. Nelson analyzed the logistical considerations involved in siting a plant to process imported high-value mineral ores. This study, which was part of a larger study to assess the overall economic feasibility of plant construction and operation, involved comparisons of costs and other attributes of a variety of modes and modal combinations, including rail, inland waterway, motor carrier and TOFC.

In a study of urban freight consolidation alternatives conducted for the U.S. Department of Energy (DOE), Mr. Nelson utilized principles of network analysis, simulation and queuing theory to evaluate and critique the merits of previous studies, and recommend research approaches for analysis of route and terminal consolidation strategies.

Also for DOE, Mr. Nelson was a major contributor to a study of potential fuel-use changes that could occur in response to dramatic fuel price increases. Mr. Nelson's work focused on the freight and intercity passenger transportation sectors and included analyses of opportunities for improvements in fuel efficiency by each mode under different fuel price increase scenarios, as well as modal shifts and net traffic reductions caused by resulting cost (and rate) increases.

Passenger Transportation

Mr. Nelson served as principal investigator for a series of Service and Management Demonstration Evaluations conducted for DOT. For three parallel assessments of the feasibility of user-side subsidies, and one demonstration of taxicab regulatory reforms and paratransit service innovations, he developed instruments for and implemented several surveys, conducted data analysis and prepared Final Evaluation Reports. For an assessment of alternative transit transfer policies, he developed research issues and data requirements, selected and supervised interviews of over 40 transit properties, and wrote or was responsible for all major deliverables. He assisted DOT in the development of research issues to be addressed in demonstrations of innovative checkpoint paratransit services and in the review of a proposed paratransit policy.

Also for DOT, Mr. Nelson was principal investigator of a study of methods to improve transit productivity and cost-effectiveness. This study involved the identification and documentation of 146 distinct productivity-enhancement measures that have been implemented at U.S. transit properties, assessment of the transferability of each measure to different settings, and development of impact magnitude estimates. Prior to this project, Mr. Nelson developed over two dozen ideas for possible innovations to improve transit productivity and cost effectiveness.

Mr. Nelson participated in a financing study of the New York Metropolitan Transportation Authority's proposed multi-billion dollar capital improvement program. Mr. Nelson's responsibilities in this project involved econometric analysis of operating costs, with a particular emphasis on identifying the variability of different cost components with alternative future levels of rapid rail, bus, and commuter rail activity. The results of his work were incorporated in the MTA's Official Statement for the successful initial offering of $250 million in transit revenue bonds.

For DOT, Mr. Nelson participated in a study to develop technical guidelines for use by local planners to satisfy alternatives analysis requirements. For this study he developed a matrix-based method for determining data requirements in different scenarios, and played a major role in the development of a method for generating locally responsive alternatives to high-capital transit investments using multicriteria decision techniques.

For the Massachusetts Port Authority, Mr. Nelson participated in a study to forecast future levels of passenger and air cargo activity at Logan International Airport. For this study, Mr. Nelson supervised data collection efforts, developed methods for synthesizing data from diverse sources (FAA, CAB, Port Authority records, etc.) to yield relevant market segment size estimates, and analyzed seasonality and short-term peaking phenomena.

Mr. Nelson also participated in a quantitative assessment of the market penetration potential and associated impacts of electric vehicles for the Electric Power Research Institute (EPRI).

Thesis

In his graduate thesis at M.I.T., which fulfilled the thesis requirements for two Master's degrees, Mr. Nelson developed a comprehensive review of the theoretical and practical shortcomings encountered in the use of linear programming in a real time multiple vehicle routing and scheduling system (dial-a- ride). Based on network analysis techniques, he then developed a set of heuristic algorithms that avoided the shortcomings inherent in the linear programming (LP) approach. The performance of these algorithms was simulated by computer and found to meet or exceed the LP's performance in a variety of scenarios drawn from actual operating data.

TESTIMONY

Postal Rate Commission, Docket No. R2000-1

- Direct Testimony, MPA-T-3, 5-22-00

Surface Transportation Board, Ex Parte 582 (Sub-No. 1)

- Statement, 5-16-00

Surface Transportation Board, Finance Docket No. 33407

- Verified Statement, 8-31-98

- Supplemental Verified Statement, 10-28-98

Surface Transportation Board, Finance Docket No. 33469

- Verified Statement, 11-10-97

- Reply Verified Statement, 11-25-97

Postal Rate Commission, Docket No. R97-1

- Direct Testimony, USPS-T-19, 7-10-97

Interstate Commerce Commission, Finance Docket No. 32133

- Verified Statement, SP-20 (Volume 2), 11-29-93

- Rebuttal Verified Statement, SP-41 (Volume 2), 7-28-94

Postal Rate Commission, Docket No. R90-1

- Direct Testimony, UPS-T-1, 7-16-90

- Rebuttal Testimony, UPS-RT-1, 10-1-90

Interstate Commerce Commission, Finance Docket No. 31505

- Verified Statement, RGI-14/SOO-14 (Volume 2), 9-15-89

- Rebuttal Verified Statement, RGI-55/SOO-55, 2-15-90

Interstate Commerce Commission, Finance Docket No. 31522

- Verified Statement, RGI-7/CMW-7 (Volume 2), 8-25-89

Interstate Commerce Commission, Finance Docket No. 32000

- Verified Statement, RGII-10, 2-22-88

- Verified Opposition and Rebuttal Statement, RGII-59, 6-1-88

Postal Rate Commission, Docket No. R87-1

- Direct Testimony Concerning Special Delivery Messenger and City Delivery Carrier Street Time Costs, UPS-T-1, 9-14-87

- Rebuttal Testimony, UPS-RT-5, 11-23-87

- Statement Regarding SDWAFS Analyses, 12-1-87

Interstate Commerce Commission, Finance Docket No. 30800

- Verified Statement, DRGW-13, 4-7-87

- Verified Statement, DRGW-24, 7-13-87

Postal Rate Commission, Docket No. RM86-2B

- Direct Testimony Concerning City Delivery Carrier Street Time Costs, UPS-T-1, 12-1-86

Interstate Commerce Commission, Finance Docket No. 30400

- Verified Opposition Statement, DRGW-20, 11-21-84

- Verified Opposition Statement, DRGW-23, 12-10-84 (with Paul H. Banner)

- Verified Rebuttal Statement, DRGW-33, 5-29-85

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VERIFICATION

I, Michael A. Nelson, declare under penalty of perjury that the foregoing Statement is true and correct to the best of my knowledge and belief. Further, I certify that I am qualified and authorized to file this Statement. Executed on August 18, 2000.

Michael A. Nelson

STB FD-32760 (SUB 21) 8-18-00 D 199545

199545

KCS-16

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

COMMENTS OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY ON THE APPLICANTS' FOURTH ANNUAL REPORT ON MERGER AND CONDITION IMPLEMENTATION

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ATTORNEYS FOR THE KANSAS CITY SOUTHERN RAILWAY COMPANY

August 18, 2000

KCS-16

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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

**COMMENTS OF
THE KANSAS CITY SOUTHERN RAILWAY COMPANY
ON THE APPLICANTS' FOURTH ANNUAL REPORT
ON MERGER AND CONDITION IMPLEMENTATION**

The Kansas City Southern Railway Company ("KCS"), by its counsel, hereby provides the following comments in response to the "Applicants' Fourth Annual Report On Merger And Condition Implementation" filed by Union Pacific Corporation, Union Pacific Railroad Company, and Southern Pacific Rail Corporation ("SP") (collectively "UP"), UP/SP-378, dated July 3, 2000 (the "Report"). In its Report, UP provides selective statistics and commentary to argue that its 1996 merger with SP has provided all of the single-line, competition-enhancing benefits touted throughout the merger approval process.

Despite the Report's glowing outlook, the UP/SP merger has resulted in a number of competitive problems which are either glossed over or ignored by UP. The Report is barren of any real analysis of the competitive impact resulting from the amalgamation of UP with its only real system-wide competitor. Further, comments by both UP and BNSF regarding BNSF's operations over its haulage and trackage rights on UP indicate merely that BNSF has used those rights. Neither party includes market share data, traffic tape analysis, or rate comparison data to establish that BNSF is providing vigorous competition at 2 to 1 locations as contemplated by the Surface Transportation Board's ("STB," or the "Board") original merger decision. *Union Pac. Corp. et al – Control and Merger – Southern Pac. Rail Corp. et al.*, F.D. No. 32760, Decision No. 44 (STB served Aug. 12, 1996) ("Decision No. 44"). Indeed, as established through numerous post-merger approval disputes brought to the Board, UP's post-merger implementation of the Board's merger conditions demonstrate that UP has been slow to achieve agreement on conditions which might present UP with any added measure of competition. In other instances, conditions have failed to achieve any legitimate regulatory purpose and should be reexamined.

Overview Comments

After four years of oversight on this merger, it should be clear to the Board that it must carefully weigh any evidence or argument presented by UP in its annual merger reports before accepting it as fact. Indeed, the appropriate measure of caution was made clear from the very first annual merger progress report filed by UP on July 1, 1997, in which UP proclaimed that its merger with SP had generated "no repetition of the merger-related disruptions that UP encountered in absorbing [Chicago & North Western]." *Applicants' Report on Merger and Condition Implementation*, UP/SP-303, p. 5. Barely three months after this verified statement was made, the Board instituted its investigation of rail service in the West, based upon both formal and informal complaints received by the Board over UP's integration of SP (*Rail Service In The Western United States*, STB Ex Parte No. 573 (STB served October 2, 1997)), and less than a month after that, the Board declared a "service emergency" in the West. *Joint Petition for Service Order*, STB Service Order No. 1518 (STB served October 31, 1997).

Even when UP's merger Report provides seemingly objective numbers, those numbers do not necessarily provide an accurate measure of UP's claims. For example, many of the charts and graphs provided in UP's Report allegedly reflect the competitive strength of BNSF's operations on its trackage rights over UP. These rights were granted to BNSF to replace the competitive impact that SP provided in those markets and corridors. However, the numbers presented by UP are primarily for BNSF "through trains," presumably meaning trains that operate through the corridor and do not provide any direct service to on-line shippers. As such, these gross measurements of the number of through trains utilizing the trackage rights do nothing to indicate that BNSF has been, and is, an effective replacement for the previous competition that had been provided by SP for those on-line shippers.

One effective measure of BNSF's ability to replace SP's competitive effect would be a comparison of the pre-merger market share held by SP in certain origin/destination corridors and for each so-called 2 to 1 shipper with the post-merger market share held by BNSF in those same corridors and for those same shippers. Another effective measurement would be a rate study determining whether BNSF's presence in the market, through its trackage rights and its access to 2 to 1 shippers, has restrained UP's ability to raise rates above the pre-merger levels, adjusted for market conditions. Of course, one would look long and hard to find any such studies in either the BNSF or UP's annual oversight reports.

Instead, the information UP presents to the Board provides no real measure of BNSF's competitive impact because it provides no yardstick by which to measure BNSF's progress. For example, the fact that BNSF's car counts have in some instances gone up in the past year (although some have seemingly remained flat or decreased) says nothing of BNSF as a replacement for SP without information as to the available universe of traffic BNSF could be moving, or the amount of traffic UP is originating and terminating on those same lines. Likewise, the reported car counts potentially include traffic which has always been BNSF traffic that has simply been rerouted from other BNSF lines onto the trackage rights lines because the trackage rights lines are less circuitous than the previous routes utilized by BNSF. Such inclusions are possible because UP is simply monitoring the number of cars, trains and tonnage moved by BNSF over its lines. No effort has been made to break down these car counts to determine how many are simple reroutes of existing BNSF trackage or how many are former SP traffic which BNSF has been able to obtain due to the trackage and other condition imposed by the Board. In short, the figures and charts provided by UP and BNSF in their reports indicate virtually nothing about BNSF's role as a replacement for SP in the relevant markets.

In addition to these general comments about the effectiveness of the reports provided by UP and BNSF, there are five specific areas of concern that bear mentioning. KCS believes each area is important and deserves careful consideration by the Board.

<u>Central Corridor Issues</u>

Perhaps nowhere is the reality of BNSF's competitive ability to replace SP any more murky than in the Central Corridor, between Denver and Northern California. Prior to the UP/SP merger, SP provided significant competition to UP over the Central Corridor for large quantities of trans-continental traffic. See *Union Pac. Corp. et al. – Control – Chicago & North Western Trans. Co. et al.*, Finance Docket No. 32133, Decision No. 25 (ICC served March 7, 1995) (SP argued that it places "competitive constraints on UP traffic, especially…over the Central Corridor, where SP is UP's only transcontinental competition."). This route was also used by SP to provide alternative sources of coal in competition with coal originated by UP and BNSF from the Powder River Basin. Decision No. 44, at 154-55. Now, in a post-merger environment, the predictions that UP and BNSF would not use this corridor and that shippers and receivers would lose the competitive presence that had been provided by SP seem to be coming true. See, e.g., Verified Statement of Thomas D. Crowley in *Comments, Evidence and Requests for Conditions Submitted on Behalf of The National Industrial Transportation League,* NITL-9, filed March 29, 1996 ("*Crowley V.S.*"), pp. 58-70. UP's own numbers indicate that the train count for May 2000 was approximately one-third lower than it had been the previous year. UP qualifies those numbers by asserting that the decline is entirely attributable to an unspecified "change in methodology and data source." Report, at 34. Even assuming the accuracy of that statement, UP is essentially conceding that BNSF's performance on the Central Corridor has become flat, which hardly provides a ringing endorsement of BNSF's competitive impact in that corridor.

Interestingly, although UP undoubtedly possesses car counts for the Central Corridor, it has not provided them in the Report, instead relying upon the average number of trains and tons moved per month. While such aggregated numbers may seem impressive ("In the Central Corridor…average monthly tons…declined slightly to 362,394 in the most recent period." Report, at 36.), they lose their luster when broken down to more manageable numbers. Fortunately, from other numbers contained in the Report, the number of cars and loads per train for BNSF's Central Corridor operations can be estimated. For example, page 33 of the Report sets forth the average number of trains, tons and cars[1] moved by BNSF per month over all of its UP trackage rights. Those numbers reveal that the average BNSF trackage rights car carries about 79 tons. Thus, the 362,394 tons referenced above indicates that BNSF averaged about 4,587 cars (loaded and empty) per month over the Central Corridor, or (using UP's count of 93 BNSF trains in May 2000 from that same paragraph) about 49 loaded and empty cars per train for each of its three daily "through" trains operating in the Central Corridor. Estimating that the average train consist contains about 52.5% loads (Report, p. 32), we can estimate that on an average day, BNSF moves three through trains over the Central Corridor, with each train carrying 25 loads. By these calculations, BNSF is carrying the equivalent of less than one unit train per day over the Central Corridor. Moreover, the fact that BNSF's traffic levels have been flat (at UP's own estimate) indicates that BNSF has not been able to increase its virtually irrelevant 5% market share of traffic moving from Northern California to Utah and points East. *Union Pac. Corp. et al. – Control – Southern Pac. Rail Corp. et al.*, Finance Docket No. 32760 (Sub-No. 21), Decision No. 15 (STB served November 30, 1999). It is hard to imagine that such numbers demonstrate significant competitive pressure on UP.

At least four conclusions could be suggested as the cause of BNSF's poor showing in the Central Corridor. Two conclusions should be ruled out easily. First, the fact that BNSF has operated over the Central Corridor for four years, and had access to 50% of the volume of on-line shippers from the commencement of its rights, should discount any notion that BNSF is still undergoing a significant "ramping up" phase, the

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[1] UP's car counts include both loaded and empty cars.

excuse previously used by UP and BNSF to explain BNSF's minimal use of the Central Corridor. UP's concession that BNSF's Central Corridor results are flat also discounts this theory. Similarly, while one might conclude that UP is simply a far more efficient operator or effective marketer, and thus legitimately has beaten BNSF for Central Corridor traffic, such a conclusion is not consistent with the competition between the two Western giants elsewhere.

The other two potential conclusions that might be drawn from this analysis are even more ominous because both would indicate a structural problem in the Central Corridor. First, it could be that the terms of BNSF's trackage rights are too onerous and give BNSF a higher cost structure than UP's. See, e.g., *Crowley V.S.* at 58-70. Just as likely, however, is that BNSF may have no interest in operating the Central Corridor trackage rights, but is simply making a token effort in order to prevent the rights from being assigned to any other carrier.

Before the Board concludes that BNSF has effectively replaced SP in the Central Corridor, it should do more than simply accept UP's and BNSF's claims. Real evidence of competition in the Central Corridor is lacking, and until that gap has been filled, the competitive situation in the Central Corridor will remain murky.

<u>Houston Comments</u>

UP's report contains very little information or analysis about competition in Houston, an issue that has been of great interest to KCS since the UP/SP merger was announced. As the Board is aware, UP and SP handled the vast majority of rail traffic originating or terminating at Houston before their merger. Although BNSF's share of Houston traffic was very small, the Board concluded that the consolidation of Houston's two primary rail carriers did not require any remedial conditions.[2] The wisdom of that decision, of course, can only be measured by hindsight. However, even shortly after the merger, more than enough warning signs were present to suggest that a "do nothing" approach was not justified.

In its rebuttal evidence submitted in the Houston/Gulf Coast Oversight Proceeding (*Union Pac. Corp. et al. – Control and Merger – Southern Pac. Rail Corp. et al. (Houston/Gulf Coast Oversight Proceeding)*, F.D. No. 32760 (Sub-No. 26)), KCS conclusively demonstrated that BNSF had failed to become an effective competitor in the Houston market. *See* KCS' "Rebuttal Evidence and Argument in Support of the Consensus Plan," KCS-11, Vol. 1, dated October 16, 1998 ("Rebuttal"). For example, during the second year of the UP/SP merger, despite the fact that UP was mired in its service emergency, its share of traffic moving between Houston and the Northeast remained between 80-81%. Rebuttal, at 26. Similarly, UP handled 78-84% of traffic between Houston and the Southeast, and 72-77% of traffic moving between Houston and the Midwest. *Id.* Such numbers do not reflect the balance expected between two evenly matched competitors. Rather, they demonstrate that the combined UP/SP still dominates, even in times when its service is deplorable.

Surprisingly, despite the high profile which Houston competition has maintained in post-merger analysis, UP devotes no particular importance to this subject in its Report. Neither UP nor BNSF provide any studies to determine whether BNSF's presence in the Houston market has effectively constrained UP's rates for Houston shippers nor do they

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[2] Although in Decision No. 44 The Texas Mexican Railway Company ("Tex Mex") was given rights to move Houston traffic, such rights cannot be used for traffic moving North of Houston, because such traffic must have a prior or subsequent movement over Tex Mex's tracks between Laredo and Corpus Christi/Robstown.

provide any guidance as to whether UP's dominance over BNSF has abated in the intervening two years since the service crisis.

Because of the absence of any data or comment regarding competition in Houston, KCS respectfully requests the Board to initiate a special study of rates and BNSF's market share for traffic to or from the Houston switching district similar to that commenced by the Board with regard to Buffalo. See *CSX Corp. and Norfolk Southern Corp. et al. – Control and Operating Leases/Agreements – Consolidated Rail Corp. et al. (Buffalo Rate Study)*, STB Finance Docket No. 33388 (Sub-No. 90). As with Buffalo, structural forces and historical circumstance have combined to raise serious questions about the existing ability of BNSF to compete successfully with UP in Houston. An in-depth study of the role played by BNSF in Houston, and the competitive options available to Houston shippers, is needed before any conclusions can be reached about the impact of the UP/SP merger on Houston.

<u>Sale of Victoria to Rosenberg Line</u>

One element of the Consensus Plan proposed over two years ago to alleviate UP's service problems was the transfer of UP's little-used Victoria to Rosenberg, Texas line. Sale of the line, proposed by a consortium of shippers, governmental agencies, and railroads, was suggested to reduce the amount of UP trackage used by KCS' 49%-owned affiliate, Tex Mex, in exercising its trackage rights between Corpus Christi and Beaumont, Texas. Specifically, sale of the line to Tex Mex would eliminate over 150 miles of trackage rights operation for Tex Mex, and would reduce operating conflicts between UP and Tex Mex.

Although UP agreed in principle to the transfer of the Victoria to Rosenberg line during the emergency service crisis proceedings, negotiations over the sale progressed very slowly.[3] The matter of the purchase price had to be submitted to a time consuming arbitration process, which only recently was completed. Almost four years since UP first committed to this Board to sell the line to Tex Mex, the petition seeking Board authority for the purchase was filed only last week.

The Board should act expeditiously in approving Tex Mex's petition. Given the fact that the majority of the line has not seen rail service in a number of years, the transfer clearly is of limited scope and will not present any issues of competitive harm. The reintroduction of train service to shippers on the Victoria to Rosenberg line, and the efficiency added to Tex Mex's operations between Corpus Christi and Beaumont will benefit a variety of parties, including UP. Because Tex Mex's agreement to purchase the Victoria to Rosenberg line from UP expires by its own terms in November of 2001, it is important that the Board act promptly on Tex Mex's petition.

BNSF's Access To Lake Charles Area Shippers

In its approval of the UP/SP merger, the Board granted to BNSF the right to serve shippers in the Lake Charles, Louisiana area.[4]. Decision No. 44, Slip op. at 2-13, 153-154. In its Report, UP mentions these rights at several points. Specifically, UP references the construction of a new "storage-in-transit" yard for Lake Charles area plastics shippers, the relocation of UP's main line through Lake Charles to eliminate

[3] Indeed, there is irony in the fact that the Board's approval of the UP/SP merger was accomplished in a shorter time span than it took UP to agree to sell this peripheral track to Tex Mex.

[4] The "Lake Charles, Louisiana area" includes Lake Charles, West Lake Charles, and Westlake, Louisiana.

conflicts with switching operations, and the construction of a new Lake Charles area connection at Mallard Junction. Report, at 14-15. Further into its Report, UP mentions that BNSF continues to use haulage rights over UP to access shippers in the Lake Charles area. Report, at 34.

Now that the UP/SP merger is over four years old, it is time for the Board to reassess its decision to allow BNSF to have access to Lake Charles area shippers. This grant of rights remains unique among the conditions imposed by the STB on mergers in that it is the only example of the Board imposing conditions to eliminate an alleged harm to competition that did not exist. BNSF's unfettered access to Lake Charles area shippers provided more access than even the most aggressive opponent of the UP/SP merger argued was necessary to preserve competition. Moreover, BNSF's access is accomplished in part over track the use of which is governed by agreements that do not allow admission of a third party. In the absence of a terminal trackage rights application (which has never been filed), BNSF's access to Lake Charles area shippers remains in violation of established law.

As is related in greater detail in Decision No. 44, BNSF historically had no access to the Lake Charles area. Because of concern about the potential elimination of a joint KCS-UP movement to compete with a single-line SP movement, the UP-BNSF agreement, as modified by the "CMA Agreement," gave BNSF access to Lake Charles area shippers for traffic moving between the Lake Charles area and New Orleans and Mexico. In Decision No. 44, the Board removed these routing restrictions, apparently in order to address concerns about routings between the Lake Charles area and St. Louis, Houston and New Orleans. However, the effect of the Board's grant of access to BNSF was to *increase*, rather than *preserve*, the competitive options for shippers in West Lake Charles, who previously were served by KCS and SP, but now have access to KCS, UP, and BNSF. Such enhanced access violates the Board's stated policy of narrowly tailoring conditions so as not to put any shippers in a better situation than they were before a merger. Other shippers in Westlake and Lake Charles retained their direct access to three originating and/or terminating carriers, a result unprecedented in STB merger decisions. Particularly given the fact that numerous other options existed to restore competition for Lake Charles area shippers (including allowing KCS to interchange traffic with BNSF in the Lake Charles area for movement to New Orleans, and Houston-bound traffic with BNSF at Beaumont), the Board's grant to BNSF of direct access to Lake Charles area shippers was excessive and overly intrusive.

Moreover, BNSF has no legal right to operate over certain tracks in the Lake Charles area. As KCS established in its "Petition of The Kansas City Southern Railway Company To Reopen/Reconsider," KCS-65, filed September 3, 1996, at 13-19, the underlying agreements under which railroads historically have shared track in the Lake Charles area do not allow for the admission of third parties. Because KCS has never consented to BNSF's use of this track, BNSF can legally gain access to the track only through approval of a terminal trackage rights application filed pursuant to 49 U.S.C. Section 11102. See *CSX Corp. et al. -- Control and Operating Leases/Agreements – Conrail Inc. et al.*, F.D. 33388, Decision No. 89, Slip op. at 17 n.28 and 100 (STB served July 23, 1998) (denying CSX's assumption of certain Conrail trackage rights agreements in the St. Louis area). No such application has ever been filed, and thus BNSF's access to Lake Charles area shippers is without legal support.

In light of these problems, the Board should reassess its decision to admit BNSF to the Lake Charles area. This unprecedented access expanded the competitive options of certain shippers, and was without legal justification.

<u>Houston to New Orleans Line Swap</u>

On of the more unique aspects of the UP/SP merger was the sale of a portion of UP's line between Houston and New Orleans to BNSF. Originally structured as the sale of the Eastern half of the line, with trackage rights for UP over BNSF's Eastern portion and rights for BNSF over UP's Western portion, the agreement was subsequently changed to provide each party with an undivided one-half interest in the entirety of the line, and joint operations for both parties.

Somewhat incredibly, UP's Report indicates that the "final definitive" agreements governing sale of the line to BNSF have not yet been executed, despite the fact that the exchange of ownership interests was approved in 1998. See *Burlington Northern and Santa Fe Ry. & Union Pac. R. -- Acquisition Exemption -- Lines Between Dawes, TX and Avondale, LA*, Finance Docket No. 33630 (STB served Sept. 29, 1998). UP provides no explanation for the delay in executing these agreements with BNSF.

At the time when UP and BNSF do eventually complete their line swap agreements, the Board should require that the agreements be filed with the Board in this docket. In addition, third parties should be given access to the agreements under appropriate confidentiality arrangements, and a period for review and comment should be provided for all interested parties. Without doubt, the line swap agreements are a bi-product of the UP/SP merger, and should therefore be reviewed within the context of this docket. Moreover, the agreement to share both ownership and operations on the Houston to New Orleans line changes the competitive forces in place on the line in ways not contemplated prior to the Board's Decision No. 44 approving the UP/SP merger. In light of these considerations, and in the interests of full public disclosure, the Board should make the "final definitive" agreements available to all parties.

Conclusion

In summary, a number of significant competitive issues remain unresolved from the UP/SP merger. UP's Report provides very little basis for parties to make any definitive determinations as to whether the merger has been beneficial to shippers, and whether the conditions placed on the merger by the STB have achieved their desired effect. Certainly, UP's provision of BNSF's operating results provides only a portion of the picture. Without information comparing SP's pre-merger performance with BNSF's post-merger performance, the impact of BNSF's operations has no context. Indeed, from the skimpy information relative to the Central Corridor, it appears that BNSF is failing as a competitive force. Because even less information is provided about competition in the Houston market, the Board should initiate a special rate study to judge BNSF's impact in that market. The Board should act promptly to authorize Tex Mex's acquisition of the Rosenberg to Victoria, Texas rail line from UP, before the underlying contract expires. The Board should also reconsider the scope of BNSF's access to Lake Charles area shippers, as such access violates both existing precedent and established contracts. Finally, the Board should require UP and BNSF to make public their Houston to New Orleans line swap documents.

Respectfully submitted,

Tom Healey

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CERTIFICATE OF SERVICE

I hereby certify that complete copies of the foregoing Comments Of The Kansas City Southern Railway Company On The Applicants' Fourth Annual Report On Merger And Condition Implementation were served this 18th day of August, 2000, by first class mail, postage prepaid or hand delivery, on all parties of record before the Surface Transportation Board in STB Finance Docket No. 32760 (Sub-No. 21).

Tom Healey

Thomas J. Healey

STB FD-32760 (SUB 21) 8-18-00 D 199540

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August 18, 2000

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW
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Re: STB 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 (General Oversight)*

Dear Secretary Williams:

Edison Electric Institute ("EEI") hereby submits the following comments in response to the Board's decision in this docket served on November 30, 1999.[1] These comments address one aspect of the Board's oversight of the implementation of this merger: the lack of record evidence establishing that BNSF has replaced Southern Pacific Lines ("SP") as a viable competitor to UP for the transportation of Colorado and Utah coal in the Central Corridor.

More specifically, a review of the latest annual reports filed by UP (UP/SP -378) and by BNSF (BNSF-PR-16), as well as a review of prior annual and quarterly reports and STB decisions in this oversight proceeding, reveal an alarming lack of any concrete evidence that the UP/SP merger conditions have resulted in establishing BNSF as a viable replacement of Southern Pacific lines as a competitor to UP for transportation of coal from Utah and Colorado mines in the Central Corridor. Neither BNSF nor UP have asserted specific facts demonstrating that BNSF can or has competed with UP for this particular transportation.

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[1] EEI is not a formal Party of Record in this proceeding, although several of its members are Parties of Record. To the extent EEI requires permission to participate in this proceeding, EEI hereby so requests, and submits that good cause exists to grant the request, as these comments are being submitted on behalf of all of EEI's member companies.

For its part, UP has apparently not placed in the record any examples or evidence of (1) Utah or Colorado coal business that was captured by BNSF after the merger; or (2) examples of rate reductions UP was forced to make to its existing customers to keep Utah or Colorado coal transportation business after the merger. *See, e.g.*, UP/SP-367, Confidential Appendices B and C. Likewise, BNSF has never asserted any specific facts demonstrating that it is a viable competitor to UP for Colorado and Utah coal. In fact, BNSF's latest report contradicts itself, stating on the one hand that "BNSF continues to offer vigorous and effective competition to shippers located on its Central Corridor trackage rights between Denver, CO and Stockton, CA," (BNSF-PR-16 at 4), while at the same time showing graphically that BNSF service in the Central Corridor has generally declined since 1998. *See, id*, Attachment 3, BNSF's "Loaded Units on UP/SP Trackage Rights" – Central Corridor.

In Decision No. 15 in this oversight proceeding,[2] the STB stated that "the most important indicator of the impact of BNSF's Central Corridor trackage rights is the effect that BNSF's presence in the market has on the rates offered by UP." Decision No. 15 at 7. However, the record in this oversight proceeding is devoid of any such information regarding the effect on UP's rates for transporting Utah or Colorado Coal. In fact, the present record could lead one to the conclusion that the trackage rights conditions have utterly failed to establish BNSF as a viable replacement for SP for this segment of the market. The fact that coal shippers have to date, for the most part, not publicly complained that BNSF is uncompetitive with UP for Colorado and Utah coal transportation should not be dispositive, as many such shippers have well-founded fears of retaliation from UP for such actions.

The establishment of BNSF as a viable competitor to UP for the transportation of coal from mines in Colorado and Utah was a key purpose of the conditions imposed on the Board's approval of the merger of UP and SP. The merger and trackage rights conditions are now nearly four years old, with one more year of STB oversight scheduled. EEI respectfully submits that, under the circumstances, the merger applicants and the BNSF should be required by the Board to submit specific evidence in the record of this proceeding that provides verifiable proof of the railroads' broad statements that the goals of the condition have been reached.

Specific areas of inquiry suggested by EEI are as follows:

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[2] STB 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 (General Oversight)*, served November 30, 1999 ("Decision No. 15").

1. In how many instances since 1996 have rates charged by UP for the transportation of Utah and Colorado coal to a particular customer been <u>reduced</u> due primarily to the presence of BNSF, or BNSF and Utah Railway Company ("URC"), as a transportation alternative?

2. In how many instances since 1996 have coal transportation rates charged by UP to a shipper of Colorado and Utah coal been <u>increased</u>, despite the presence of BNSF, or BNSF/URC as a transportation alternative?

3. Since October, 1996, how many times has BNSF been requested to supply a bid for transportation of Utah or Colorado coal over the UP trackage rights lines in competition with UP? In how many instances did BNSF engage in a competitive bidding process as a result of such a request, and what was the outcome of such competitive bidding process? Where BNSF was not successful, what were the reasons for failing to get the business?

4. What specific evidence is there to demonstrate that BNSF's statement that "Central Corridor shippers . . . have consistently indicated that they in fact consider BNSF to be a realistic alternative to UP and a competitive restraint on the marketplace," applies to shippers of Colorado and Utah coal that would use BNSF over the UP trackage rights lines? *See*, BNSF-8 at 8.

5. What specific evidence is there to demonstrate that BNSF has met the STB's requirement that "BNSF must have sufficient Central Corridor traffic to sustain service levels that will allow it to be a realistic choice for shippers . . ." as this statement is applied to shippers of Colorado and Utah coal. Decision No. 15 at 7.

6. What are the levels of BNSF train crews, locomotives and railcar equipment that have been utilized, or available for, coal transportation service in the Central Corridor since October, 1996?

7. Since October, 1996, how many tons of coal from Colorado and Utah mines have been transported annually by BNSF utilizing the trackage rights granted to BNSF over UP's lines? Since January 1, 1995 how many tons of Colorado and Utah coal have been shipped each year by UP and SP?

8. If "BNSF continues to offer vigorous and effective competition to shippers located on its Central Corridor trackage rights between Denver, CO and Stockton, CA," (BNSF-PR-16 at 4), then why have BNSF's "Loaded Units on UP/SP Trackage Rights" – Central Corridor (*id.*, Attachment 3) generally declined since 1998?

EEI respectfully submits that the information sought by the above questions is crucial to a determination of whether the merger conditions, as applied to the transportation of Colorado and Utah coal, have accomplished their objectives. The current record of this oversight proceeding does not support such a conclusion, and indeed leads one to infer that the opposite is true. The merger applicants and the BNSF should be required to supplement their June 3, 2000 filings with detailed responses to the above inquiries for the purpose of backing up their claims that the merger conditions, as applied to the movement of Utah and Colorado coal, are indeed working and should not be modified.

Respectfully submitted,

Michael F. McBride

Michael F. McBride
Attorney for Edison Electric Institute

Cc: Parties of Record

STB FD-32760 (SUB 21) 8-18-00 D 199539

199539

STATE OF CALIFORNIA

GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE

SAN FRANCISCO, CA 94102-3298

August 17, 2000

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Office of the Secretary
Case Control Unit
Attn: STB Finance Docket No. 32760 (Sub-No. 21)
1925 K Street, N.W.
Washington, DC 20423-0001

D

Dear Secretary:

Re: STB Finance Docket No. 32760 (Sub-No. 21)
Union Pacific, et. al -- Control and Merger – Southern Pacific Rail Corporation et. al. [General Oversight]

Enclosed for filing is an original and 26 copies of a document titled "Comments of the California Public Utilities Commission." Please file-stamp the extra copy and return it to the undersigned in the enclosed stamped, self-addressed envelope. Also enclosed is an electronic copy of the filing in WordPerfect format on a 3.5-inch IBM compatible floppy diskette.

Thank you for your cooperation in this matter.

Sincerely,

Kenneth Koss

Kenneth L. Koss, Director
Rail Safety and Carriers Division

Enclosures (27 paper, plus 1 diskette)

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB 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

[General Oversight]

Comments of the California Public Utilities Commission

The California Public Utilities Commission (Commission) hereby submits its comments in year four of the Surface Transportation Board's (Board) Union Pacific/Southern Pacific (UP/SP) merger oversight proceeding. We offer our comments to assist the Board in fulfilling the stated purpose of the five-year oversight period: ". . . to examine whether the conditions we have imposed have effectively addressed the competitive issues they were intended to remedy."[1]

Introduction:

The UP/SP merger dramatically altered the competitive landscape for rail service in California and much of the West. Prior to the merger, Southern Pacific was the state's largest railroad and competed head-to-head with Union Pacific and/or Burlington Northern Santa Fe (BNSF) in most of the state's rail corridors. The merger reduced the number of major railroads serving the state from three to two and, without conditions imposed by the Board to promote competition, communities formerly served by only UP and SP, would have lost competitive rail service.

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[1] Surface Transportation Board FD 32760, Decision No. 44, (Aug. 6, 1996), at p. 107.

To mitigate any anti-competitive effects stemming from the merger, the Board conditioned its approval with a trackage rights agreement negotiated between BNSF and UP. The agreement allowed BNSF access to several key routes that would fall under the control and ownership of UP. Additionally, shippers previously served only by UP and SP, so-called "2 to 1" points, would now receive service by BNSF. These conditions were designed to have BNSF provide the competition formerly provided by SP. Most significantly, BNSF obtained the rights to operate trains over two vit California rail routes: 1) the "I-5 Corridor", a route between the Pacific Northwest and California, and, 2) the "Central Corridor," a route between the Midwest to Northern California through the Sierra Nevada range.

The potential effectiveness of the trackage rights agreement was the subject of much debate during the merger application proceeding. Some parties argued that a number of pro-competitive benefits would flow from the arrangement and UP was credited with claiming that ". . . the merger , as conditioned by the BNSF agreement, will greatly intensify rail competition in the West . . .".[2] On the other hand, it was alleged by some that BNSF would not make extensive use of the trackage rights because of supposed high fees they would pay UP for track use or that UP might control train dispatching to its own advantage. Weighing these points, the Board determined that the trackage rights agreement was in the public interest and sanctioned its use as a condition of the merger.

Given this backdrop, the primary issue to be addressed during the oversight period is to assess whether BNSF and UP have aggressively competed for traffic at the "2 to 1" points and, further, to determine if the merger has resulted in any competitive harm. To perform such an analysis, the Board directed UP and BNSF to regularly file reports highlighting their progress implementing the merger. To address any harmful effects uncovered, the Board retained authority to impose additional

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[2] *Id.*, at p. 16.

remedial conditions, including the power to order divestiture of routes to other rail carriers during the oversight period.[3]

Review of UP and BNSF Progress Reports and Competition:

From our examination of the most recent reports dated July 3, 2000, we are encouraged to see that new services are being provided by both railroads beneficial to California shippers and that the severe implementation problems immediately following the merger have waned. For example, UP described its new "Express Lane" train originating in the Central Valley helping to move the state's produce to Eastern markets. Additionally, UP stated faster intermodal trains are being deployed to speed time-sensitive shipments to Midwestern destinations. BNSF reports similar enhancements and expanded train frequency. These are the types of service improvements the public expected from the merger; we expect to see many similar improvements well into the future.

Turning to the issue of competition, results based on traffic volume growth and train acti[illegible] in the I-5 and Central Corridors are mixed. In the I-5 Corridor, BNSF reported that the number of loaded units handled has generally increased in year 2000 through May with a corresponding increase in average monthly trains. Performance in the Central Corridor has not shown the same improvement during the period as loaded units are below 1999 and 1998 levels. Also, average monthly trains have declined to 93 in the most recent period, down from 122.[4] Additionally, loaded units handled by BNSF in the I-5 Corridor exceeds its Central Corridor volume by approximately 39%[5] for year 2000 through May raising the question of whether the

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[3] *Id.*, at p. 105.

[4] Union Pacific's Fourth Annual Report on Merger and Condition Implementation, p. 36.

[5] BNSF's Quarterly Progress Report of July 3, 2000, Attachments 3 and 10. It should be noted that subsequent to the merger, BNSF purchased a key segment of the I-5 corridor from UP thereby reducing trackage right payments and giving BNSF control to make capital improvements.

Central Corridor trackage rights are being exercised to their fullest extent given the probable relative size of each market. One explanation given for BNSF's apparent drop-off in the Central Corridor is a change in data collection methodology.[6] Another factor influencing traffic levels in the Central Corridor may be that BNSF chooses to route its trains via its own route from the Bay Area through Southern California, Arizona and beyond. Additionally, we note that BNSF reports shipments at "2 to 1" points in the Bay Area have generally increased although at Southern California points the volume has lagged for 2000.

A key question remaining to be answered is whether this business activity is reflective of true competition between both railroads. Based upon data furnished in the latest progress reports, we cannot conclude with certainty that the degree of competition in each corridor and "2 to 1" points has reached a sustainable level. A meaningful analysis must include data showing the market share each carrier has captured and examination of rate levels offered to shippers. The information supplied in the current progress reports do not permit such a study. While both carriers provided a description of BNSF train frequencies and traffic volumes over the I-5 and Central Corridors and other routes for the time period, UP did not make a similar showing of their activity for comparison purposes.

An important issue in evaluating the competitive effects of the merger is deciding which standards to use to gauge the health of competition between UP and BNSF. One benchmark is the historical measure of pre-merger market shares that existed when UP and SP were rivals. A comparison of the amount of traffic BNSF captures under the trackage rights agreement with this historical figure would provide an objective basis to measure whether competition has increased or decreased following the merger in addition to providing an indication of the amount of capacity used in a corridor.

[6] Union Pacific's Fourth Annual Report on Merger and Condition Implementation, p. 34.

One source of information in developing such a benchmark is traffic density data filed by UP in its merger application.[7] This data provides an indication of the degree of rail competition in various corridors prior to acquiring SP. Using the Central Corridor between the Sacramento area and Salt Lake Valley as an illustration, UP had approximately 55% of the volume whereas SP held a 45% share using base year 1994 actual ton-mile figures (see Exhibit 1). Additionally, UP ran approximately 17 freight trains per day and SP 14 during 1994 for a total of 31 freight trains per day in the corridor (see Exhibit 2). In contrast, it was reported BNSF ran 103 through trains in the Central Corridor during the month of May,[8] just over 3 trains per day on average. Other approaches that could serve as a barometer to gauge post-merger competition would include evaluating the degree to which BNSF is investing in operational improvements, as well as a comparison of rate levels offered by both railroads to attract traffic.

Furthermore, we wish to report to the Board that the Commission has not received any complaints from shippers suggestive of anti-competitive behavior by UP or BNSF to date. Shippers' comments provide an important source of information in ascertaining the actual extent the railroads are actively competing for traffic. The Board should consider approaching "2 to 1" shippers and others to seek their point of view on the merger's implementation and level of competition .

Capacity Concerns and Investment in Rail Infrastructure Post-Merger:

The Board proclaimed in a recent proceeding on rail mergers that, "Looking forward, the key problem faced by railroads – how to improve profitability through enhancing the service provided to their customers – is linked to adding to insufficient infrastructure, not to eliminating excess capacity."[9]

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[7] UP/SP merger application, FD 32760, exhibits to Vol. 3.

[8] Union Pacific's Fourth Annual Report on Merger and Condition Implementation, p. 34.

[9] Surface Transportation Board Ex Parte No. 582 (sub-No.1), p.3.

We concur with the Board's assessment and believe that the future health of the nation's railroads lies in targeting investment to alleviate bottlenecks on routes experiencing severe capacity constraints and in adding to the existing inventory of rolling stock to accommodate future traffic growth. Additionally, railroads can increase their productivity through the better use of existing facilities and equipment, steps which are particularly important during times when capital is scarce.

Reviewing the level of investment following the merger, we are pleased to note that both BNSF and UP have made substantial improvements to their rail infrastructure which should improve existing service levels and intensify competition. A variety of projects have been reported as completed in prior progress reports. Most notably, UP accomplished the $140 million makeover of Roseville yard which will serve as the hub of its Northern California operations consolidating the switching activities which were conducted at other, less efficient yards. Additionally, BNSF upgraded the track it purchased from UP in the I-5 Corridor allowing the railroad to run heavier trains at greater speeds in competition with UP trains.

However, it is apparent that additional investments must be made. A particular concern is the so-called "Sunset Route" between Los Angeles and the East. This line is vitally important for international trade moving through Southern California ports as well as myriad other industrial and agricultural products. UP stated in its latest report that, "This line is nearing capacity between El Paso and West Colton. This situation can cause congestion and delays when even minor incidents, such as an air hose separation, affect the flow of traffic. UP plans to add second main track…"[10]

UP should be held to their plan to increase capacity on the Sunset Route between El Paso and Los Angeles.[11] Furthermore, UP should be held to its commitments made during the merger proceeding to upgrade former SP routes which suffered under deferred maintenance and lack of investment. One such project is

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[10] Union Pacific's Fourth Annual Report on Merger and Condition Implementation, p. 11.

[11] UP/SP merger application, FD No. 32760, Vol. 3, p. 218. "The total cost of the projects in this corridor is $221.4 million."

increasing the clearances of Donner Pass to accommodate high-cube, doublestack containers.[12] These trains must either be routed via the congested line through the Tehachapi Mountains or the less direct Feather River Canyon. Looking into the future, technological innovations such as Positive Train Separation to increase capacity and improve service over existing routes should continue to be explored.[13]

Recommendations:

Our recommendations are directed at UP and BNSF as well as the Board with the objective of obtaining more information to help the Board determine by the end of the oversight period whether there is meaningful long-term competition between the two railroads or if remedial actions must be taken.

For the railroads, we request that BNSF and UP respond to these questions in their upcoming reports for the fifth and final year of the oversight proceeding:

1) What is the current market share of UP and BNSF for shipments in the I-5, Central Corridors and at "2 to 1" shipper locations?

2) What percentage of the market does each railroad expect to achieve in each corridor and "2 to 1" point?

3) What is the level of cost efficiencies resulting from the merger and to what extent have these have been passed on to shippers in the form of rate reductions or increased investment in plant and equipment?

4) Did the estimated impacts and traffic diversion projections resulting from the BNSF trackage right agreement included in the UP/SP merger application[14] materialize?

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[12] *Id.*, pp. 224-5.

[13] *Id.*, p. 65.

[14] *Id.*, p. 215.

5) What is the existing capacity of the I- 5, Central Corridors, Sunset Routes and other routes serving California; what proportion of this capacity is currently being used?

6) To what extent has the planned capital improvements presented in the UP/SP merger application actually been completed and are there any plans to downgrade any routes serving California?

7) Is the current volume in the Central Corridor sufficient to maintain or increase existing track standards for both the former SP and UP routes and does any elements of the trackage rights agreement (e.g. level of track fees) lead to a withholding of transportation services offered to shippers?

8) What is BNSF and UP's current evaluation of their development and implementation of Positive Train Separation?

For the Board, we recommend the following steps to enable a more comprehensive oversight review.

1) Survey "2 to 1" shippers to assess their views on the level of competition.

2) Conduct an analysis of UP and BNSF traffic data and waybill tapes to determine the relevant market shares and level of competitive pricing of each railroad.

3) Develop quantifiable standards to be used to determine the actual level of competition between UP and BNSF and to determine if any routes are being underutilized.

Finally, we note that the Board recently adopted Ex Parte 582 (Sub-No. 1) to craft new rules to evaluate mergers and is considering whether its merger policy should place a greater emphasis on affirmatively **enhancing**, rather than simply preserving, competition (emphasis added).[15] Among items under consideration are expanded switching rights to promote further competition at terminal areas or allowing shippers more options to route their shipments through additional gateways.

We suggest that, in light of this apparent new posture toward mergers, the Board determine if there are elements of the UP/SP merger that can be further modified to enhance competition. The Board, while retaining authority to make adjustments to the merger, could consider, for example, expanding the trackage rights agreement to allow BNSF to operate over UP's more direct route to the Pacific Northwest for intermodal traffic or impose a proportional rate adjustment to allow BNSF to quote rates on traffic at UP points routed over the Central Corridor via the Stockton, CA gateway (similar to that provided to UP on BNSF points in the Pacific Northwest under the trackage rights agreement).

DATED: August 17, 2000

Kenneth Koss

KENNETH L. KOSS

Director, Rail Safety & Carriers Division,
California Public Utilities Commission

505 Van Ness Avenue
San Francisco, CA 94102
(415) 703-1090

[15] Surface Transportation Board Ex Parte No. 582 (Sub-No. 1), p. 4.

Exhibit 1

CPUC comments in STB Finance Docket No. 32760 (Sub-No.21)
General Oversight – Year 4

Central Corridor (Sacramento area – Salt Lake City/Ogden)

Traffic Density Pre-merger

Base year 1994.
Eastbound and westbound tonnage in millions.

UNION PACIFIC (see Note):

Track segment:		Ton-miles in millions:
Sacramento – Keddie		24.93
Keddie – Hawley		22.38
Hawley – Reno Jct.		25.50
Reno Jct. – Flannigan		25.45
Weso – Alazon		42.22
Alazon – Smelter		31.71
Smelter – Salt Lake City		22.10

	Total:	194.29
	Ave:	27.76

SOUTHERN PACIFIC:

Track segment:		Ton-miles in millions:
Roseville – Sparks		20.924
Sparks – Weso		23.258
Weso – Carlin		23.854
Carlin – Alazon		23.854
Alazon – Ogden		23.854

	Total:	115.74
	Ave:	23.15

Proportion of ton-miles for each railroad in corridor:
UP = 55%
SP = 45%

Note: UP Weso – Flannigan segment not used due to missing data. Smelter – Lynndyl traffic removed from analysis.
Source: Tonnage Charts for Year 1994 contained in UP/SP Railroad Merger Application, Volume 3, Exhibit 14.

Exhibit 2

CPUC comments in STB Finance Docket No. 32760 (Sub-No.21)
General Oversight – Year 4

Central Corridor (Sacramento area – Salt Lake City/Ogden)

Average Trains per Day (freight) Pre-merger

Base year 1994.

<u>UNION PACIFIC:</u>

Track segment:	Average trains per day :
Sacramento – Marysville:	18
Keddie – Marysville:	18
Flannigan – Keddie:	16
Winnemucca – Flannigan:	16
Winnemucca – Alazon (UP-SP joint):	18
Winnemucca – Alazon (UP-SP joint):	13
Alazon – Salt Lake City:	19

Total:	118
Ave:	17

SOUTHERN PACIFIC

Track segment:	Average trains per day:
Roseville – Sparks:	13
Sparks – Winnemucca:	13
Winnemucca – Alazon (UP-SP joint):	13
Winnemucca – Alazon (UP-SP joint):	18
Alazon – Ogden:	13

Total:	70
Ave:	14

Average number of daily freight trains in corridor: 14 + 17 = 31

Source: Train frequency for Year 1994 contained in UP/SP Railroad Merger Application, Volume 3, Exhibit 13-5.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document entitled COMMENTS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION upon all known parties of record in this proceeding and served by first-class mail a copy thereof properly addressed to each party.

Dated at San Francisco, California this 17th day of August, 2000.

Charlene Lundy

Charlene D. Lundy

199172

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July 3, 2000

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Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423-0001

Re: Finance Docket No. 32760 (Sub-No. 21), Union Pacific Corp., et al. -- Control & Merger -- Southern Pacific Rail Corp., et al. -- Oversight

Dear Secretary Williams:

Enclosed for filing in the above-reference docket are an original and twenty-five copies of the Applicants' Fourth Annual Report on Merger and Condition Implementation. We have also enclosed a 3.5-inch diskette containing the pleading in a format suitable for conversion into WordPerfect.

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

Sincerely,

Michael L. Rosenthal

Enclosures

cc: Parties of Record

UP/SP-378 199172

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' FOURTH ANNUAL REPORT ON MERGER AND CONDITION IMPLEMENTATION

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Southern Pacific Rail Corporation

July 3, 2000

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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 -- OVERSIGHT

APPLICANTS' FOURTH ANNUAL REPORT
ON MERGER AND CONDITION IMPLEMENTATION

Applicants UPC, UPRR and SPR[1] hereby submit their fourth annual report on their progress in implementing the UP/SP merger, and on the implementation and effectiveness of the competition-preserving conditions imposed by the Board in its decision approving the merger. This report is being submitted in compliance with Decision No. 15 in this oversight sub-docket, served November 30, 1999.

PRELIMINARY STATEMENT

In the last annual oversight proceeding, the Board found that "the merger is producing benefits for the shipping public (i.e., better service and lower rates)" and that there "is

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[1] Acronyms used herein are the same as those in Appendix B of Decision No. 44. The following original applicants have been merged with UPRR: MPRR (on January 1, 1997); DRGW and SPCSL (on June 30, 1997); SSW (on September 30, 1997); and SPT (on February 1, 1998). For simplicity, and in light of the fact that SPT has merged with UPRR and no longer has any separate existence, we generally refer to the combined UP/SP rail system as "UP."

no evidence that the merger has produced any competitive problems." Decision No. 15, p. 5. The Board also found that UP has "recovered fully" from the service problems experienced following the merger and that service "continues to improve." Id. This year's annual report describes UP's successful efforts to maintain and extend this record of merger and condition implementation.

Part I provides an update on UP's service today and UP's progress on merger implementation. We present a number of performance measurements that confirm that UP service has in recent months reached its highest levels in the modern era. We also review merger-related service enhancements, including UP's new "Express Lane" service and new premium intermodal services. In addition, we review the progress in installing TCS and other support systems; in integrating workforces; in merger-related capital investments (including a report on investment in the Houston-Gulf Coast region); in consolidating and improving terminals and yards, and in enhancing the safety of the merged system's operations. Finally, we review the status of merger-related abandonments and, in an attachment, environmental compliance.

Part II addresses competition. It begins by reviewing how the merger is continuing to produce competitive benefits and then shows that, for a fourth straight year, the competition-preserving conditions imposed by the Board have demonstrated their effectiveness. In light of the Board's conclusions in each of the past three annual oversight proceedings that there has been no evidence of harm to competition resulting from the merger, this part is more abbreviated than it has been in past years. UP has not undertaken the expensive and time-consuming process of compiling the confidential appendices that it has presented in past proceedings. UP is confident, however, based on its day-to-day dealings with customers, that if the process were undertaken, the results would parallel those of the past three years: one could find hundreds of examples of shippers who are benefitting from the merger and the competition-preserving conditions.

In keeping with the Board's preference for a focused proceeding, we are submitting this report in verified form rather than presenting lengthy verified statements.

I. MERGER BENEFITS AND IMPLEMENTATION

A. UP's Service Recovery

With the service crisis now more than two years in the past, UP service in 2000 improved to record-setting levels. By several measures, UP provided better service during the spring than at any time in recent memory. UP's performance in moving western coal has been especially noteworthy.

During 1997 and 1998, UP reported a number of service measurements to the Board each week. These measurements of UP performance in 2000 reflect UP's full recovery and the quality of its transportation services. (Note that UP provides measurements to the AAR that it calculates differently from the following measurements; the two sets of data are not comparable.)

- UP's systemwide average train speed, which fell as low as 12 m.p.h. during the service crisis, stood at 18.7 m.p.h. when we filed our annual oversight report last July. During April and May of this year, UP's average train speed reached 20.0 m.p.h., the fastest average speed since September 1996.

- UP's locomotive productivity, measured in gross ton-miles per horsepower-day, had climbed from 93.7 to 127.7 last year. In March, locomotive productivity reached a record level of 133.5.

- Freight car dwell time at UP yards -- the amount of time freight cars spend in a defined geographic terminal area -- approached a record low in April at only 26.2 hours. Dwell time stood at 31.3 hours last July 1 from a high of 43.9 hours during the service crisis.

- Early in 1998, UP used a second crew on 20 to 25 percent of its trains. Last year we reported that this "recrew rate" had fallen to about ten percent. This year UP's recrew rate has dropped below five percent.

- In May, trains were held for power for an average of only 418 hours per day, and UP held trains for crews only 79 hours per day.

Other performance measures underscore UP's focus on service. UP's origin train performance, which reflects the percentage of trains departing on time, reached 82 percent in May, a record. Locomotive terminal dwell time dropped to 13.5 hours. And there are no car shortages on UP. In fact, UP has over 6,500 grain cars in storage due to weak demand for grain transportation.

UP has made its greatest progress in handling western coal. During March and April, UP delivered virtually every coal train within service parameters. Through May UP moved an average of ten to eleven coal trains per day from Colorado and Utah mines. This volume should increase significantly as the West Elk mine in Colorado resumes production.

Several UP shippers formally recognized UP for its outstanding performance last year. Toyota named UP "Best Rail Carrier of the Year" in 1999. General Electric honored UP as "Intermodal Carrier of the Year." UP was Air Product's "Vendor of the Year" for 1999. Daimler Chrysler gave UP its Corporation Commodity Award in the Logistics category. And ExxonMobil recently provided a steak dinner for UP employees at Baytown, Texas, near Houston, after UP crews switched three ExxonMobil plants 1,837 consecutive times without a single failure.

UP's service slipped in June. As in prior years, the railroad shut down its coal lines serving Wyoming's Powder River Basin for a maintenance and upgrading "blitz," a shutdown that lasted from June 12 to 21. Floods closed UP's St. Louis- Kansas City mainline for a week in May. UP also has suffered several disruptive derailments since Memorial Day, including a widely-publicized incident in Eunice, Louisiana, that blocked UP's mainline to Livonia Yard for a week. And UP is engaged in very extensive projects to upgrade its tracks this summer, with more than a dozen tie gangs and three welded rail gangs at work. All of these factors affected performance and caused locomotive imbalances across the system.

UP also encountered difficulties during the last two months serving the burgeoning aggregates and cement business in Texas. (Some producers report that their sales exceed their own production capabilities, as well as UP's transportation commitments.) During May UP experienced 13 major service interruptions on important mainlines serving Texas and Louisiana, including the Eunice derailment. As a result, UP found itself short of locomotives for rock service.

Service to rock shippers has improved over the last two weeks. UP recently leased 47 more locomotives, now arriving, all of which will go to Texas for rock and chemical service. UP also expects to receive an extraordinary number of high-horsepower locomotives over the next month. This influx of 90 4,000- to 6,000-horsepower units will satisfy UP's demands for locomotives across the railroad.

B. Additional Service Improvements <u>Resulting From the UP/SP Merger</u>

1. <u>"Express Lane" Service</u>

UP, CSX, and four Northern California shortline railroads are cooperating to offer a new joint service from California to Chicago, New York City, and Boston that is returning carloads of perishable shipments to the railroads. Decades ago, SP and UP hauled multiple trainloads of fresh produce from California's Central Valley to eastern markets every day, but the railroads lost that business to trucks. Since April 4, 2000, inter-railroad cooperation and excellent service have been attracting carload perishable shipments back to the railroads. Five railroads gather perishable shipments in California. UP gathers perishables along its line from Bakersfield to Roseville. San Joaquin Valley Railroad gathers additional shipments from the Central Valley. Stockton Terminal & Eastern collects shipments from the Stockton area. California Northern, a shortline operating north of San Francisco Bay, gathers wine and other produce. And the Yolo Port railroad originates shipments in Sacramento.

UP's Express Lane train operates from Fresno via Roseville to North Platte on a combination of SP and UP routes in 51 hours. At North Platte, shipments make a positive connection to a train assembled for CSX to run through to Selkirk Yard near Albany, New York. Shipments are transferred there to trains serving the New York and Boston markets. UP adds Oregon and Idaho potatoes to the CSX-bound train at North Platte. Other shipments make connection there to Chicago and St. Louis.

The railroads offer service to New York City in eight days and to Boston in nine days. For a slightly higher rate, customers may obtain guaranteed service. Most customers do not take that option, however, because the service has often been a day faster than advertised. As a result, UP and its partners are carrying potatoes, citrus fruits, carrots, and wine. Some of these commodities have not moved by rail for many years.

2. Premium Intermodal Service

UP is now providing the fastest intermodal service it has ever offered between Chicago and Northern California. Before the service crisis, UP implemented expedited Chicago-Northern California intermodal service over a combined UP/SP route. This service matched BNSF's premium intermodal service in the corridor, but UP then slowed the trains to conserve locomotives. UP not only has reinstated the fast schedules for the original trains but also added a second westbound premium intermodal train on an even faster schedule. The westbound train operates from Chicago to Oakland in less than 52 hours, serving Reno and Lathrop (in the Central Valley) en route. These trains are attracting significant new intermodal business.

UP is instituting similar improvements in Memphis-Southern California intermodal service. UP introduced premium intermodal trains between Memphis and Lathrop via Los Angeles, shortly before the service crisis, but cancelled the trains in order to conserve capacity and locomotives. UP reinstated that premium service approximately a year ago. On July 12th, UP will accelerate the schedules for a pair of standard intermodal trains in this corridor to provide a second premium schedule between Memphis and Southern California. One of the eastbound trains will connect to NS at Memphis to provide the first-ever fifth-day intermodal service from Southern California to Jacksonville, Florida. All four trains operate over the parallel UP and SP routes in Arkansas and northeastern Texas with the flow of directional running, over UP's former Texas & Pacific ("T&P") line from Dallas to El Paso, and over the SP Sunset Route between El Paso and Los Angeles.

In the I-5 Corridor, UP continues to provide excellent intermodal service between Seattle and Southern California using a combined UP-SP route.

3. <u>Other New and Improved Interline Manifest Services</u>

UP has completed the process of improving SP's interline service for manifest traffic. Before the UP/SP merger, SP delivered unblocked trains to interchange partners at most gateways, requiring the connecting carrier to switch the train and causing delays. Now shipments from former SP points move in pre-blocked run-through trains that bypass interchange points and intermediate switching.

UP and its connecting carriers have implemented numerous additional improvements in interline service, with others under development. These services benefit shippers at former SP locations, and several take advantage of merger synergies. The improvements include:

- UP and CP have created run-through service that is attracting significant new traffic via the Eastport/Kingsgate gateway on the Idaho-British Columbia border by using a combination CP-UP-SP route between Western Canada and California. Both railroads increased capacity on their lines leading to this gateway, and both are obtaining locomotives especially equipped for international service. CP and UP are also cooperating over the Minneapolis gateway, with CP blocking traffic at a North Dakota yard for UP's Centennial Yard in Fort Worth. This saves more than a day of transit time for each shipment.

- TFM, UP, and NS are working together to provide expedited service from automotive plants in Mexico to the northern half of the NS system. TFM prepares a through block of traffic for the TRRA yard in St. Louis. UP incorporates that block in a new through train at Laredo that uses directionally operated UP and SP lines to pick up traffic from other auto plants in Texas and Louisiana. UP delivers the train to TRRA, which distributes the shipments among NS trains to destinations beyond. UP is cooperating with NS and CSX regarding other St. Louis, Salem, and Sidney gateway traffic as the eastern carriers adjust their transportation plans.

- UP interline service with eastern carriers via Chicago has stabilized following the Conrail division. For CSX, UP's North Platte Yard prepares a Selkirk (Albany, New York) run-through train that handles traffic from UP and former SP points throughout the West. The train picks up additional cars at Proviso Yard in Chicago. Proviso Yard builds a second train for Cumberland, Maryland, on CSX, carrying a block of cars from North Platte. UP and NS employ a similar operating plan. North Platte sends a train to Elkhart Yard in Indiana, and Proviso launches a run-through train to Pittsburgh. UP also blocks cars at North Platte for CN; Proviso adds cars to create a run-through train for Battle Creek, Michigan. The eastern carriers provide reciprocal run-through trains for UP.

- UP and CSX are operating a second run-through train several days per week via the Memphis gateway. CSX delivers trains for the former SP Pine Bluff yard carrying traffic for Texas, Louisiana and the Southwest. CSX trains to North Little Rock Yard carry shipments for other points throughout the UP system. UP reciprocates with pre-blocked trains for Nashville, Tennessee.

- UP, NS, and CSX are restructuring run-through operations via the New Orleans gateway. As traffic continues to grow, run-through blocks can operate deeper into the NS and CSX systems throughout the South.

4. Mexico Service

Cooperative arrangements among UP, Tex Mex, TFM, and the U.S. and Mexican governments are allowing traffic through the Laredo Gateway to grow. UP's northbound traffic is running approximately 30 percent above volumes during the comparable period of 1999. Southbound volumes have increased by approximately 15-20 percent.

UP is working with U.S. Customs to develop improved pre-clearance procedures for export traffic. The first test will take place on the Canadian border at Eastport, Idaho. Once these processes are tested, they will be applied at gateways to Mexico to reduce staging of shipments for customs clearance.

C. Progress in Merger Implementation

1. Safety

UP continues to achieve significant improvements in safety, continuing a consistent trend since the merger. UP's rate of reportable injuries in 2000 improved by 24.9 percent from the same period in 1999. The rate of injuries involving lost work days declined by 25.6 percent compared to 1999. The number of grade crossing accidents declined by approximately 8 percent. Particularly in light of the major derailment at Eunice, Louisiana, however, UP is working with FRA on derailment prevention.

2. Technology and Support Systems

As we reported last year, UP has completed the transition to common information systems and support technologies as outlined in the UP/SP operating plan. With a few exceptions, UP continues to use the SP Digicon system to dispatch trains on former SP lines. Rather than convert those dispatching territories to UP's CAD II system, UP will convert the entire railroad to CAD III when it is ready.

3. Work Force Integration

With only three exceptions, UP and its labor organizations have completed merger implementing agreements covering all crafts and territories. UP and the UTU and BLE are still negotiating the second phase of the Portland consolidation; UP and the BMWE and SMWIA are still negotiating consolidation of work and territories; and UP and the IBEW are still negotiating the consolidation of seniority in the Engineering Services Department.

4. Merger-Related Capital Investments

Based on current projections, UP will have spent approximately one and one-quarter billion dollars to implement the UP/SP merger by the end of this year. This huge investment includes over $400 million in capacity expansion, almost $500 million in rail line upgrades, over $100 million in information technology, and almost $45 million to upgrade SP locomotives. UP has spent $143.5 million on merger projects this year (through May 31) and expects to spend a total of over $260 million by December 31.

Corridor Upgrades. UP's investments since the merger include more than $300 million toward the ongoing improvement of the Kansas Pacific line between Kansas City and Denver. Although UP projected capital expenditures of only $86.6 million on this line in the UP/SP operating plan, the line required much more extensive upgrading than originally estimated, and UP decided to add extra capacity to handle expected growth. UP continues to upgrade rail and will add sidings through next year so that this line can carry the ever-increasing volumes of Colorado coal that flow through Kansas City and St. Louis. This line has been closed for up to twelve hours each work day to complete track upgrades. When UP regains full use of the line in September, its coal handling capacity will greatly expand.

During the next few years, UP will invest heavily in additional capacity for its lines linking Kansas City and Ft. Worth to Los Angeles via El Paso. UP continues to add capacity on the Golden State Route, UP's primary route for expedited automotive and intermodal traffic from Chicago and Kansas City to Southern California. UP is adding several sidings and expanding Centralized Traffic Control ("CTC") this year. UP is also adding capacity on the T&P line between Ft. Worth and El Paso, a route that carries increasing volumes of traffic between Memphis and Southern California. The Golden State Route and the T&P line feed traffic at El Paso to the Sunset Route en route to Los Angeles. This line is nearing capacity between El Paso and West Colton. This situation can cause congestion and delays when even minor incidents, such as an air hose separation, affect the flow of traffic. UP plans to add second main track to the Sunset Route's El Paso-West Colton segment, especially on Beaumont Hill in Southern California.

<u>Terminal Facilities</u>. In last year's report we highlighted UP's new $143 million Davis Yard in Roseville, California, the hub of UP's routes in Northern California. After approximately six to eight months of operating and facility adjustments, Davis Yard is functioning well and as designed, providing the benefits we forecast last year. Using this yard's capabilities and cooperating with two Oregon shortlines, UP has improved service for Oregon and Washington forest products shippers who ship to California and Arizona markets. The Central Oregon & Pacific and Willamette Pacific railroads gather shipments in Oregon and pre-block trains for Roseville and West Colton. At Roseville, UP classifies shipments into trains serving yards throughout Northern and Southern California. West Colton switches the cars for Phoenix, Tucson, and other Arizona points.

In East St. Louis UP will transform the former SP Valley Yard and surrounding land into an automotive loading center for Daimler Chrysler. In Chicago, neighborhood opposition frustrated UP's plans to build a new intermodal terminal. UP is reviewing a number of options that would allow it to expand its intermodal capacity.

UP built four new tracks at the former SP Armourdale Yard in Kansas City to facilitate movement of unit coal trains and other through trains. These tracks greatly reduce congestion in the terminal area. In one of two major developments, UP and other railroads recently began using the "Sheffield Flyover." This long, double-tracked bridge carries the KCT mainline -- used by BNSF as its transcontinental line and by Amtrak, UP, GWWR, and NS, over a river and three mainline railroads. The flyover should allow all the railroads serving Kansas City to provide better service. In the second major development, BNSF, UP, and KCT will open a joint dispatching center for the Kansas City area by September.

At two Texas terminals, UP has implemented operating plans from two mergers, UP/SP and UP/MKT, to speed shipments to Mexico. As predicted in the UP/SP operating plan, UP's SoSan Yard in San Antonio is now used to stage cars destined to Mexico that have not pre-cleared customs. As this yard is much closer to the Mexican border than the former storage facility at Ft. Worth, it allows faster service when cars are released. Meanwhile, UP uses Ney Yard in Ft. Worth to clean and repair empty grain cars and assemble them into unit trains for movement to loading facilities, as originally planned in the UP/MKT merger operating plan. (Traffic to Mexico grew faster than expected, delaying this step.) Using Ney Yard to assemble grain trains allows UP to move those trains over the most efficient route north of Ft. Worth to Midwestern loading points.

In Los Angeles, UP is expanding the former SP's Intermodal Container Transfer Facility so that it can respond more effectively to traffic peaks. UP is also expanding its East Los Angeles intermodal terminal by converting part of the former carload switching yard into intermodal tracks and parking for containers and trailers. In Oakland, UP's new consolidated intermodal terminal is in service. UP released the former WP yard to the Port of Oakland for port development.

UP has solved operating difficulties that had adversely affected its Denver terminal operations, described in last year's report. UP continues to use both the former SP North Yard and the UP 36th Street Yard, each of which prepares a daily manifest train for North Platte. North Yard also builds a train for Salt Lake City. The dwell times at these yards are now among the best on the UP system. UP is developing plans for a bridge over the BNSF line in Denver, which would improve handling of coal trains.

Houston/Gulf Coast Infrastructure. UP continues to improve and expand its facilities in Texas and Louisiana where the service crisis arose in 1997. During 2000, UP expects to invest $192.7 million to upgrade rail lines and $72.9 million to expand capacity in this region. For the three-year period between 1998 and 2000, UP expects to have spent a total of $607.8 million, and additional projects are planned for 2001 and beyond.

The following projects are among those that have been completed since our last report or are underway this year:

In Houston, UP is upgrading Englewood Yard. Projects include a new hump computer and scale. UP completed CTC on the Sunset Route between Tower 26 in central Houston and West Junction. On Houston's south side, UP and BNSF are adding a critical segment of second main track between Double Track Junction and T&NO Junction. With this track in place, BNSF can switch its South Yard without blocking through trains on the HBT West Belt line. UP upgraded its Harrisburg Line and installed CTC from West Junction through T&NO Junction to Tower 30. UP is completing the interlocking and a new connection at Tower 30 and installed power switches at Pierce Junction on the Harrisburg Line.

North of Houston, UP's expanded Spring Storage-In-Transit yard will enter service this month. This expansion allows UP to store more plastics shipments awaiting sale by chemical customers to their receivers. UP has noticed a significant increase in plastics shipments going into storage in recent weeks.

Northeast of Houston, UP completed construction of additional yard tracks at Dayton Yard and, with BNSF participation, relocated the Sunset Route mainline to eliminate conflicts between through trains and switching. South of Dayton on the Baytown Branch that serves many chemical shippers, UP is seeking permits to build a new storage yard and it is investing $9.1 million this year (with BNSF help) in additional double track on the Branch. At Mont Belvieu on the Branch, UP is extending yard tracks.

Southeast of Houston, UP contributed to the cost of adding a second mainline to the former SP route between Strang and the Port of Houston's Barbours Cut container facility. This year the Port and UP are extending double track from Strang westward to Deer Park and adding CTC. UP completed new receiving and departure tracks at Strang Yard, which serves chemical customers on the Bayport Loop. UP plans to expand the classification yard at Strang in 2000, after a lease of property needed for the expansion expires.

Further east, UP completed design work for and is now constructing a new SIT yard in the vicinity of Lake Charles which will enter service next year. It also relocated the mainline through Lake Charles to eliminate conflicts between switching and through trains and expanded Lake Charles Yard. A new connection is under construction at Mallard Junction near Lake Charles. UP is upgrading the retarders at Beaumont Yard and has relocated control of Tower 74 to the joint dispatching center at Spring.

South of Houston on the line to Brownsville, UP extended yard tracks at Bloomington. It completed the important new siding at Angleton, Texas, allowing trains on the Brownsville line to operate through that busy terminal without interrupting switching. UP is rebuilding Brownsville Yard in cooperation with local agencies.

West of Houston, UP added industry support tracks at Jama, Texas, to support rock shipments. It also completed run-through tracks at SoSan Yard in San Antonio. It is upgrading the service track and fueling facilities at Kirby Yard in San Antonio, as well as expanding the Kirby automotive facility. It completed CTC between Eagle Lake and Flatonia on the Sunset Route

Several projects that UP had originally proposed will not be required due to changes in operations. For example, joint dispatching of the Houston terminal has been so successful that it has effectively generated capacity. As a result, UP no longer needs several projects, such as adding powered switches and signals on the GH&H line. The decision to adopt directional running between Houston and Beaumont eliminated the need to build additional capacity on the BNSF/UP joint line east of Houston and on UP's parallel line further north. UP had planned to add a siding at Taft, Louisiana, but instead constructed a major line relocation in the area.

UP continues to evaluate the need for capacity in Houston and throughout the Gulf Coast region and to identify ways of improving operations to serve its customers.

D. Abandonments

UP has carried out the following merger-related abandonments and discontinuances in whole or in part:

- Whittier Junction-Colima Junction, California (Docket No. AB 33 (Sub. No. 93X)).
- Magnolia Tower-Melrose, California (Docket No. AB-33 (Sub-No. 94X)).
- Hope-Bridgeport, Kansas (Docket No. AB-3 (Sub-No. 131)).
- Towner-NA Junction, Colorado (Docket No. AB-3 (Sub-No. 130)).[2]
- Little Mountain Junction-Little Mountain, Utah (Docket No. AB-33 (Sub-No. 99X)).
- Sage-Leadville, Colorado (Docket Nos. AB-8 (Sub-No. 36X) and AB-12 (Sub-No. 188)).
- Malta-Canon City, Colorado (Docket Nos. AB-8 (Sub-No. 39) and AB-12 (Sub-No. 188)).
- Gurdon-Camden, Arkansas (Docket No. AB-3 (Sub-No. 129X)).
- DeCamp-Edwardsville, Illinois (Docket No. AB-33 (Sub-No. 97X)).
- Edwardsville-Madison, Illinois (Docket No. AB-33 (Sub No. 98X)).
- Barr-Girard, Illinois (Docket No. AB-33 (Sub-No. 96)).
- Iowa Junction-Manchester, Louisiana (Docket No. AB-3 (Sub-No. 133X)).

UP has determined that the Sage-Malta-Parkdale segment of its Tennessee Pass line will be retained in place while Central Corridor capacity requirements are monitored. UP

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[2] The abandoned portion of the line was sold intact to the state of Colorado, which then leased it to an operator for revival of rail service and possible purchase, see Finance Docket No. 33857, Colorado, Kansas & Pacific Company -- Lease, Operation, and Future Purchase Exemption -- Colorado Department of Transportation, served April 7, 2000.

sold the Canon City-Parkdale portion of its Malta-Canon City, Colorado, line to another carrier, retaining overhead freight rights.

As reported earlier, UP also decided not to abandon that portion of the Edwardsville-Madison, Illinois, segment between MP 145.2 and 148.78, and not to carry out the Suman-Bryan, Texas, abandonment (Docket No. AB-12 (Sub-No. 185X)). UP has also decided not to carry out the Troup-Whitehouse, Texas, abandonment (Docket No. AB-3 (Sub-No. 134X)).

II. COMPETITION

As the merger moves toward the four-year mark, the merger and the competitive conditions imposed by the Board are promoting rail competition in the West.

First, the UP system continues to provide shippers with single-line and shorter routings that were not available prior to the merger, as well as improved equipment supply and reduced switching fees. As UP's service has improved to record levels, shippers have been increasingly enjoying these benefits.

Second, the competitive conditions -- particularly the extensive trackage and haulage rights granted to BNSF -- continue to demonstrate their effectiveness. Shippers are benefitting from BNSF's strong competition, as reflected in both the large volumes of traffic they are awarding to BNSF and the rate and service initiatives that UP has taken to meet BNSF competition. BNSF's extensive presentation in this docket on January 18, 2000, confirms this conclusion and shows that BNSF agrees.

A. Competitive Benefits of the Merger

As merger implementation moves forward for a fourth year, the merger continues to generate stronger competition.

1. Single-Line Service and Shorter Routes

One of the principal reasons that the Board approved the UP/SP merger was the synergies of the two railroads' networks -- the ability, by combining those networks, to produce much-expanded single-line service and shorter routes in many important corridors. With the installation of TCS across the former SP, further progress during the past year in completing labor implementing agreements, and continuing merger-related capital investments, the merged system has made ever-increasing progress in offering these synergies to the shipping public.

For several years now, the availability of single-line service and shorter routes has attracted new business to the merged system. New opportunities continue to arise. Shippers are enjoying improved service, and, in many cases, significant rate reductions.

In many instances, these enhancements of rail competitiveness have allowed customers to penetrate markets where they previously could not compete. For examples, shippers that continue to take advantage of major new single-line opportunities include: UP grain producers moving their grain to SP destinations such as the Imperial Valley and Nogales gateway; SP Pacific Northwest and California lumber producers reaching new markets at UP points and via UP junctions; UP-served South Central lumber producers reaching SP destinations; UP-served and SP-served Gulf Coast chemical manufacturers shipping their products to destinations and junctions on the other merging railroad; and SP aggregate producers reaching new destinations served by UP in the Houston area. New shorter routes continue to bring benefits to, among others: UP-served shippers using SP's Sunset Route across the Southern Corridor; SP-served Utah coal producers that cut 300 miles off their routes to export facilities and industrial coal users in Southern California; SP-served rock shippers in Texas; SP-served Louisiana shippers moving goods to Memphis and beyond; and intermodal shippers moving traffic between Memphis and Los Angeles that cut 200 miles off their route.

Over the past three years, UP has presented hundreds of specific examples of customers' taking advantage of new single-line service and shorter routes. See, e.g., UP/SP-367, Confidential Appendix A; UP/SP-345, Confidential Appendix A; UP/SP-304, Confidential Appendix A.

2. Equipment

Since October 1996, UP and SP equipment has been managed as a single fleet. As a result, UP and its shippers have enjoyed the benefits of improved car utilization that the merger application predicted. Over the past three years, UP has presented numerous concrete examples of shippers' benefitting from combining UP and SP fleets as a single source of car supply, and from the merged system's ability to acquire additional cars to satisfy shipper needs. Some of the most noteworthy examples continue to be: the use of UP's mechanical reefer fleet by SP shippers in California (see the description of UP's "Express Lane" service at p. 5 above); the acquisition of centerbeam flatcars for Pacific Northwest and California lumber shippers; and the repositioning of intermodal equipment between UP and SP facilities on the West Coast and elsewhere.

3. Switch Fees

As previously reported, the elimination and reduction of switch fees has been another important dimension of enhanced competition made possible by the UP/SP merger. As soon as the merger was consummated, switch fees between UP and SP were eliminated. These fees, frequently $495 per car, were a major obstacle to the use of the most efficient routes and to competition for shorter-haul movements against truck and alternate product sources. Switch fees between UP and SP amounted to more than $16 million, for over 50,000 cars, in the year prior to the merger.

Pursuant to the BNSF settlement agreement, as augmented by the CMA agreement, fees charged by the merged system to BNSF at "2-to-1" points were set at $130 per car ($60 per car for grain), and fees charged by SP at all other points to all railroads were reduced so that no charge was more than $150 per car. The applicants and BNSF reached further agreement that charges between BNSF and SP at all locations would be reduced to no more than $130 per car. These reductions went into effect promptly upon consummation of the merger. In the first full year following the merger, the BNSF-SP reductions alone amounted to more than $11 million on over 65,000 cars. This level of impact has continued in subsequent years.

In total, UP estimates that the elimination and reduction of reciprocal switching charges as a result of the merger and settlement agreements will exceed $100 million during the first four years following the merger. In addition to this monetary impact, these reductions have prompted new and increased traffic flows.

In addition, in February of 1998, UP and BNSF entered into a new systemwide reciprocal switch fee agreement that produced further overall reductions in switch fees (including in particular CNW's high switch fees) and greatly simplified switch fee administration on both railroads. The agreement superseded seven earlier agreements involving former constituent railroads of UP and BNSF, most involving higher charges. Reciprocal switch fees involving the entire UP and BNSF systems were standardized at $75 per car for whole grains and $130 per car for nearly all other traffic. This agreement was attributable in significant part to the merger, because the merger permitted negotiations on a basis of broad equality in switching volumes between these two railroads. UP has recently reached similar systemwide agreements with CP and CSX.

B. Effectiveness of Competition-Preserving Conditions

As conditions to its approval of the merger, the Board imposed the settlement agreements entered into between the primary applicants and BNSF and CMA and augmented them in a number of ways. The Board also granted in part Tex Mex's trackage rights application and imposed as a condition the applicants' settlement agreement with Utah Railway. All of these conditions have continued to work well during the past year.

1. Compliance With the Conditions

UP continued to devote substantial resources during the past year to complying with all merger conditions. UP's compliance with the competition-preserving conditions is described below.

a. BNSF and CMA Agreements

UP has fully complied with the BNSF and CMA agreements.

Clarifying Decisions. In the four years since the merger was approved, the Board has resolved a number of disputes regarding the scope of BNSF's rights. During the past year, the Board has resolved three disputes between BSNF and UP regarding the scope of merger conditions.

In Decision No. 86, served July 12, 1999, the Board addressed a request by BNSF for a determination whether it was entitled to access Four Star Sugar in El Paso, Texas, by providing additional clarification regarding the scope of its new facilities condition but leaving the parties to arbitrate their specific dispute. UP subsequently reached an agreement with BNSF regarding access to Four Star Sugar.

In Decision No. 88, served March 21, 2000, the Board found that Entergy is entitled to pursue a proposed build-out, ruling that Entergy had demonstrated that it could have pursued identical plans for a build-out to SP prior to the merger.

In Decision No. 89, served June 1, 2000, the Board found that AmerenUE's Labadie, Missouri, power plant is a "2-to-1" shipper entitled to BNSF service under the BNSF agreement's omnibus clause, but that the contract modification condition does not apply to AmerenUE's contract with UP.[3] UP has offered BNSF interim haulage between St. Louis and Labadie and also agreed to allow shortline Missouri Central Railroad to carry coal to Labadie. UP and BNSF are negotiating a permanent trackage rights agreement betv een Pacific, Missouri, and the Labidie plant.

"2-to-1" Protocol. UP continued to abide by the provisions of the protocol established by UP and BNSF to govern the listing of "2-to-1" facilities. No disputes are pending before the Board.

Further Voluntary Agreements. As previously reported, in order to facilitate BNSF's operations pursuant to the merger conditions, UP voluntarily entered into a number of haulage agreements with BNSF that were not required by the terms of the parties' settlement agreement. The agreements that had already been entered into at the time of the first annual oversight report cover El Paso-Sierra Blanca; Beaumont-Orange; Odem-Corpus Christi; Pine Bluff-Camden; Shreveport-Tenaha; Texarkana-Shreveport; and service to Nevada Paired Track customers, to Turlock, Fullerton and South Gate, California, and in the Baytown, San Jose, Stockton, Salt Lake City and Lake Charles areas. As previously reported, UP and BNSF

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[3] AmerenUE is seeking reconsideration of this portion of the decision.

developed an additional haulage agreement for traffic between Pine Bluff, Arkansas, and the "2-to-1" points of Paragould, Arkansas, and Dexter, Missouri. As also previously reported, a number of these agreements, including the Odem-Corpus Christi and Shreveport-Tenaha haulage, are no longer in use because BNSF is instead operating trackage rights trains at those locations. More recently, UP and BNSF have entered into additional new haulage agreements that cover Warm Springs-San Jose and Sacramento-Polk, and they have formalized a haulage arrangement for Midvale-Salt Lake City traffic.

Also, Utah Railway has continued during the past year to serve as BNSF's designated agent for switching customers in the Utah Valley. UP consented to this pursuant to its right of consent under the BNSF agreement to third-party feeder service arrangements.

Implementation Steps. Operating and data systems were put in place for immediate commencement of BNSF service upon consummation of the merger, and UP and BNSF have worked together since the merger to refine those systems. UP and BNSF now have in place automated systems that allow the railroads to exchange accurate and up-to-date information regarding each railroad's trackage rights trains. UP and BNSF had been conducting weekly conference calls to address data exchange issues, but they agreed last year that resolution of data issues had progressed to the point where it was no longer necessary to continue these calls.

As previously reported, in March 1997, UP and BNSF developed a formal process to record, monitor and resolve day-to-day operational issues that arise out of the trackage rights, haulage and reciprocal switching arrangements between the railroads. A special problem-log database was created that allows employees of both UP and BNSF to add and update problems. Due to a significant decrease in both call volume and problem logs from BNSF, the use of the separate database was discontinued as of August 1, 1999, and calls from BNSF are now directed to UP's National Customer Service Commodity Teams for resolution. Since this change was implemented, UP has responded to BNSF problem logs within four hours 93 percent of the time, and between January 1, 2000 and June 16, 2000, there have been only 189 problem log entries, as compared to 651 over the same period last year. The sharp decline in log entries and UP's rapid responses reflect UP's efforts to ensure that BNSF receives the full benefit of the merger conditions. UP also continues to maintain the position of Manager Interline Service Resolution in the National Customer Service Center's Service Quality Team to resolve issues that require escalation.

Dispatching Protocol. The BNSF-UP dispatching protocol has continued to work well. Both parties have exercised their rights to monitor the dispatching of their trains by the other, and issues that have arisen regarding dispatching on trackage rights lines have been resolved quickly and cooperatively. BNSF has a full-time manager at the Harriman Dispatching Center, and UP has maintained a full-time manager at BNSF's Fort Worth Dispatching center to facilitate the movement of BNSF trackage rights traffic.[4]

In the past, BNSF claimed that UP engaged in discriminatory dispatching of its trains over UP trackage rights segments. UP and BNSF developed, at substantial expense, an automated measuring system to evaluate this claim, and it demonstrated conclusively that the claim was meritless. In fact, comparisons of transit times for comparable BNSF and UP trains

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[4] In addition, UP and BNSF continue to participate successfully in the Houston-area regional dispatching center in Spring, Texas, and they implemented consolidated dispatching in Southern California and the Powder River Basin, as well. UP and BNSF are planning to begin operations in a consolidated dispatching center that will control operations throughout the Kansas City terminal area in early September.

on trackage rights segments showed that BNSF trains generally experienced faster transit times. BNSF's claims of discriminatory dispatching have been replaced by an ongoing, cooperative effort by both railroads to monitor trackage rights operations over all segments on which one railroad operates over the other.

Line Sales. The BNSF settlement agreement provided for the sale to BNSF of three line segments: Dallas-Waxahachie (completed Sept. 20, 1996); Iowa Junction-Avondale (completed Dec. 15, 1996); and Keddie-Bieber (completed July 15, 1997).[5]

Connections. UP work on connections to facilitate BNSF trackage rights operations has been completed at all locations. On June 16, 2000, UP proposed to BNSF that it construct a short connection from BNSF to UP at Pacific, Missouri, to give BNSF a direct route to the AmerenUE plant at Labidie. BNSF is considering that proposal.

Capital Reserve Fund. Section 9c of the BNSF agreement established a $25 million capital reserve fund to finance projects on the trackage rights lines required to accommodate the operations of BNSF and UP on those lines. The fund has now been exhausted. The major projects that have been financed from the fund include:

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[5] As previously reported, as part of an overall agreement under which BNSF joined in the Spring regional dispatching center, UP and BNSF agreed on February 18, 1998 to exchange undivided half-interests in UP's line between Iowa Junction, Louisiana, and Houston (Dawes), Texas, and BNSF's line between Iowa Junction and Avondale, Louisiana. The agreement also gave UP trackage rights over BNSF's line between Beaumont and Navasota, Texas, allowing trains to bypass Houston, and further clarified limitations on UP's liability for expenditures that have been and may in the future be made to upgrade the Iowa Junction-Avondale line. In addition, the agreement allowed BNSF new access to customers along the former-SP line between Houston and Iowa Junction. The access, which did not require Board action, went into effect immediately. The Board exempted the exchange of ownership interests in Finance Docket No. 33630, Burlington Northern & Santa Fe Ry. & Union Pacific R.R. — Acquisition Exemption — Lines Between Dawes, TX, & Avondale, LA, served Sept. 29, 1998. UP expects the final definitive agreements to be signed shortly.

Project	UP Cost Estimate
Avondale Connections	6.1 million
Iowa Jct. Siding	5.5 million
CTC, Echo TX to Iowa Jct.	3.4 million
El Pinal Crossing	3.7 million
Stockton Connection	4.0 million
AEI Readers	0.5 million

Storage-in-Transit Capacity. As required by the CMA agreement and the Board's merger approval decision, UP has continued to make storage-in-transit ("SIT") capacity available to BNSF at Dayton Yard, near Houston, and at Beaumont, Texas. Most of this capacity is at Dayton, where BNSF and the facility operator have constructed receiving and departure tracks to facilitate BNSF's use of the facility.

New Facilities. In Decision No. 75, served October 27, 1997, the Board held that it was necessary to determine on a case-by-case basis whether a particular shipper facility qualified as a "new facility" for purposes of the condition giving BNSF the right to serve such facilities on lines where BNSF has trackage rights. The Board further addressed the new facilities condition in Decision No. 86, served July 12, 1999, by clarifying when a new facility will be deemed to be "on" a trackage rights line. UP has promptly responded to BNSF requests for confirmation of its ability to access new facilities. Since Decision No. 86, there have been no disputes on this subject.

Joint Service Committee. The Joint Service Committee provided for in the parties' dispatching protocol has met four times since the last annual report, in August, December, March, and June. Numerous other informal communications have occurred to follow up on issues addressed at those sessions. Among the merger-related issues addressed were: train performance in trackage rights corridors; development of additional train performance measurements; BNSF's use of former SP Gulf Coast SIT facilities; and the status of various capital projects funded out of the $25 million joint capital reserve fund.

Segregated Funds. In Section 6 of the CMA agreement, the applicants agreed to place trackage rights fees received under the BNSF settlement agreement into two dedicated funds, one with respect to trackage rights lines in Texas, Louisiana, Arkansas, Missouri and Illinois, and one with respect to the trackage rights lines in the Central Corridor and California. Applicants agreed that the money in those funds would be spent on (a) maintenance on those lines, (b) offsetting depreciation of those lines, (c) capital improvements on those lines, and (d) costs for accounting necessary to administer the two funds. As UP has shown in prior quarterly reports, expenditures on the trackage rights lines are greatly exceeding the trackage rights revenues. The following table provides information regarding the two funds through the quarter ending March 31, 2000, the latest date for which the data has thus far been compiled. (In light of the great excess of outlays over fees, we have not compiled data on capital expenditures on the lines, which have been substantial.)

	Texas, Louisiana, Arkansas, Missouri and Illinois	California and Central Corridor
REVENUE		
Trackage Rights Fees	$64,335,109	$61,886,492
Capacity Improvement Fees	0	0
Total	$64,335,109	$61,886,492
EXPENSES		
Maintenance	$124,843,490	$86,342,087
Depreciation	119,606,578	90,633,536
Capital Expenditures	not calculated	not calculated
Accounting Expenses	77,298	77,298
Total	$244,527,366	$177,052,921

Contract Reopener Process. The CMA agreement, as further augmented by the Board, provided that UP must allow all "2-to-1" shippers to divert to BNSF up to 50% of contracted-for volumes under contracts in effect when the merger was consummated. In Decision No. 89, served June 1, 2000, the Board ruled that the this condition no longer applied to a contract between UP and AmerenUE that had been significantly amended after the time the merger was consummated. Ameren UE sought reconsideration of that decision on June 21.

As explained in our July 1, 1997 report, most affected contracts were of one-year duration and thus have now expired, and most shippers with affected contracts elected to take no action in response to the notices they were sent setting forth their rights under this provision. However, a substantial number of shippers did elect, in lieu of exercising the formal 50%

reopener option, to negotiate new contracts with UP to supersede the pre-merger contracts prior to their expiration.

I-5 Corridor. As previously reported, the I-5 proportional rate agreement went into effect on July 15, 1997, simultaneously with the Keddie-Bieber line sale. UP's trackage rights over BNSF's Bend-Chemult segment also went into effect on that date. In past reports, UP has provided many examples of traffic moving under the proportional rate agreement and BNSF traffic moving over the Bieber line.

UP Trackage Rights on BNSF. UP has exercised the following trackage rights that it received over BNSF lines as part of the BNSF settlement agreement: rights at Superior, Wisconsin, to facilitate access to the MERC Dock coal facility; rights between Mojave and Barstow, California, which have been used to bypass the Los Angeles Basin for such movements as industrial sand and Utah coal bound to facilities in Central California; overhead and local service rights on the Dallas-Waxahachie and Iowa Junction-Avondale lines that were sold to BNSF.

b. Tex Mex Trackage Rights

As with the BNSF rights, UP had operating and data systems in place to support Tex Mex trackage rights operations when those operations commenced on October 8, 1996. As previously reported, as a result of UP's institution of directional operations between Beaumont and Houston, UP agreed to provide Tex Mex with additional trackage rights over the former-SP line between those points so that Tex Mex could operate with the flow in each direction.

As previously reported, several construction projects facilitated the movement of Tex Mex trains. New connections were constructed at Flatonia and Robstown. New sidings were constructed south of Flatonia at Adel, Texas, and at Robstown.

In 1998 Tex Mex and its affiliate KCS proposed to acquire and rehabilitate UP's line between Rosenberg, Texas, and Victoria, Texas, in order to shorten Tex Mex's route between Laredo and Houston. After lengthy negotiations, the parties have now reached agreement for Tex Mex to acquire the portion of this line between Mileposts 2.5 and 87.8, and to receive overhead trackage rights over the remaining segments of the line (near Rosenberg and Victoria) permitting Tex Mex to connect to the UP lines over which Tex Mex already has trackage rights. Consummation of the sale and trackage rights grant is contingent on the Board's authorization or exemption. UP expects Tex Mex to submit a petition seeking such an exemption in the near future. Tex Mex will be able to use its new trackage rights both for traffic having a prior or subsequent movement on Tex Mex's original Laredo-Robstown-Corpus Christi line as well as traffic originating or terminating at shipper facilities located on the portion of the Rosenberg Line that Tex Mex will acquire. UP has also agreed, upon completion of the sale of the Rosenberg Line, to modify the terms of Tex Mex's existing trackage rights to permit Tex Mex to handle traffic to/from Rosenberg Line shipper facilities.[6] When Tex Mex begins freight operations over the Rosenberg Line, it will relinquish its existing trackage rights over UP's other lines between these points.

c. Utah Railway Trackage Rights

The Utah Railway trackage rights remained fully operational during the past year, with all necessary support systems in place.

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[6] Tex Mex has agreed that it will not be permitted to use its new or existing rights to handle traffic originating or terminating at locations on lines connecting to the Rosenberg Line or to/from transload facilities on the line.

2. The Conditions Are Working Well

Each of the competitive conditions continues to work to provide effective competition.

a. BNSF

BNSF continues to provide vigorous and effective competition using the rights it received as a condition to the merger.

BNSF Service. As we have previously reported, BNSF rapidly made the transition from interim haulage, which had gone into effect immediately following the merger at all points that BNSF had the right to serve, to full trackage rights operations in all major corridors.

BNSF is operating trackage rights trains over virtually all the lines where it has the right to do so. The sole exception is that BNSF has not used its rights to St. Louis, except for occasional movements, because it has preferred to work with IC to move traffic between Memphis and connections with Eastern carriers.

UP continues to handle BNSF traffic in haulage service between Houston and Brownsville, as provided for in the settlement agreement, as well as at several other locations mentioned above. UP also continues to provide haulage for traffic moved by BNSF to and from "omnibus" points -- i.e., "2-to-1" points not located on BNSF trackage rights corridors -- pursuant to UP's June 1997 offer to provide service to and from all such points via haulage pending any request by BNSF for an alternative form of access. Significant BNSF haulage movements were handled to or from the following "omnibus" points during the past year:

- Livermore CA (haulage to/from Warm Springs, CA)
- Trevarno, CA (haulage to/from Warm Springs, CA)

- Dickinson, TX (on the former Galveston, Houston and Henderson Railroad) (haulage to/from Houston, TX)

- Great Southwest, TX (haulage to/from Ft. Worth, TX)

BNSF Trackage Rights Volumes. The volume of traffic handled by BNSF pursuant to its trackage rights continued to increase this year. For the past three years, after reviewing BNSF's substantial trackage rights volumes and the competitive service BNSF was offering in all major corridors, the Board found that the merger conditions had effectively preserved competition.

Through May of 2000, BNSF had operated a total of 26,943 through freight trains over the trackage rights lines since the commencement of operations in October 1996. This is shown in Exhibits #1, #2 and #3, depicting, by month, the numbers of BNSF through trackage rights freight trains and the number of cars and tons on those trains.

As the exhibits show, the monthly number of BNSF trackage rights trains had grown to 875 in May 2000 -- greater than the 751 trackage rights trains that BNSF operated a year earlier, in May 1999, and greater than the 703 trackage rights trains that BNSF operated in May 1998. BNSF tonnages have also increased, reaching 4.8 million gross tons in May 2000, compared with 3.8 million gross tons in May 1999, and 3.3 million gross tons in May 1998. And cars moving in through trackage rights trains have also increased, reaching 59,777 (30,330 loads and 29,447 empties) in May 2000, compared with 47,176 (25,401 loads and 21,775 empties) in May 1999, and 40,802 (21,889 loads and 18,913 empties) in May 1998. Not only has the number of trains increased, but the tonnage and number of cars carried on each train have increased as well. Gross tons per train were 5,539 in May 2000, compared with 5,000 in May 1999, and 4,630 in May 1998. Cars per train were 68 in May 2000, compared with 63 in May 1999, and 58 in May 1998.

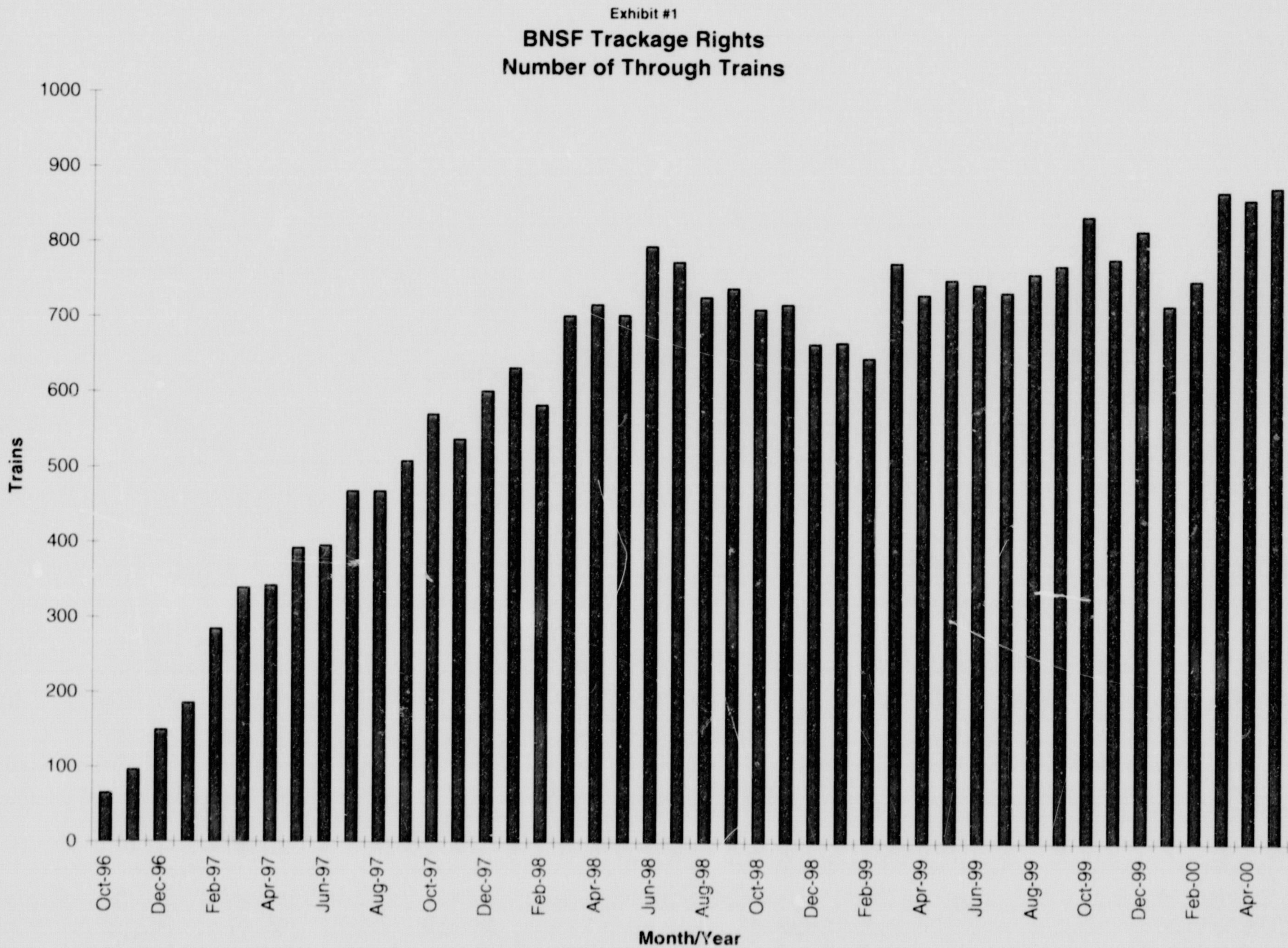


Exhibit #1
BNSF Trackage Rights
Number of Through Trains
Trains
0
100
200
300
400
500
600
700
800
900
1000
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Oct-99
Dec-99
Feb-00
Apr-00
Month/Year

Exhibit #2

BNSF Trackage Rights
Number of Cars (Through Trains)

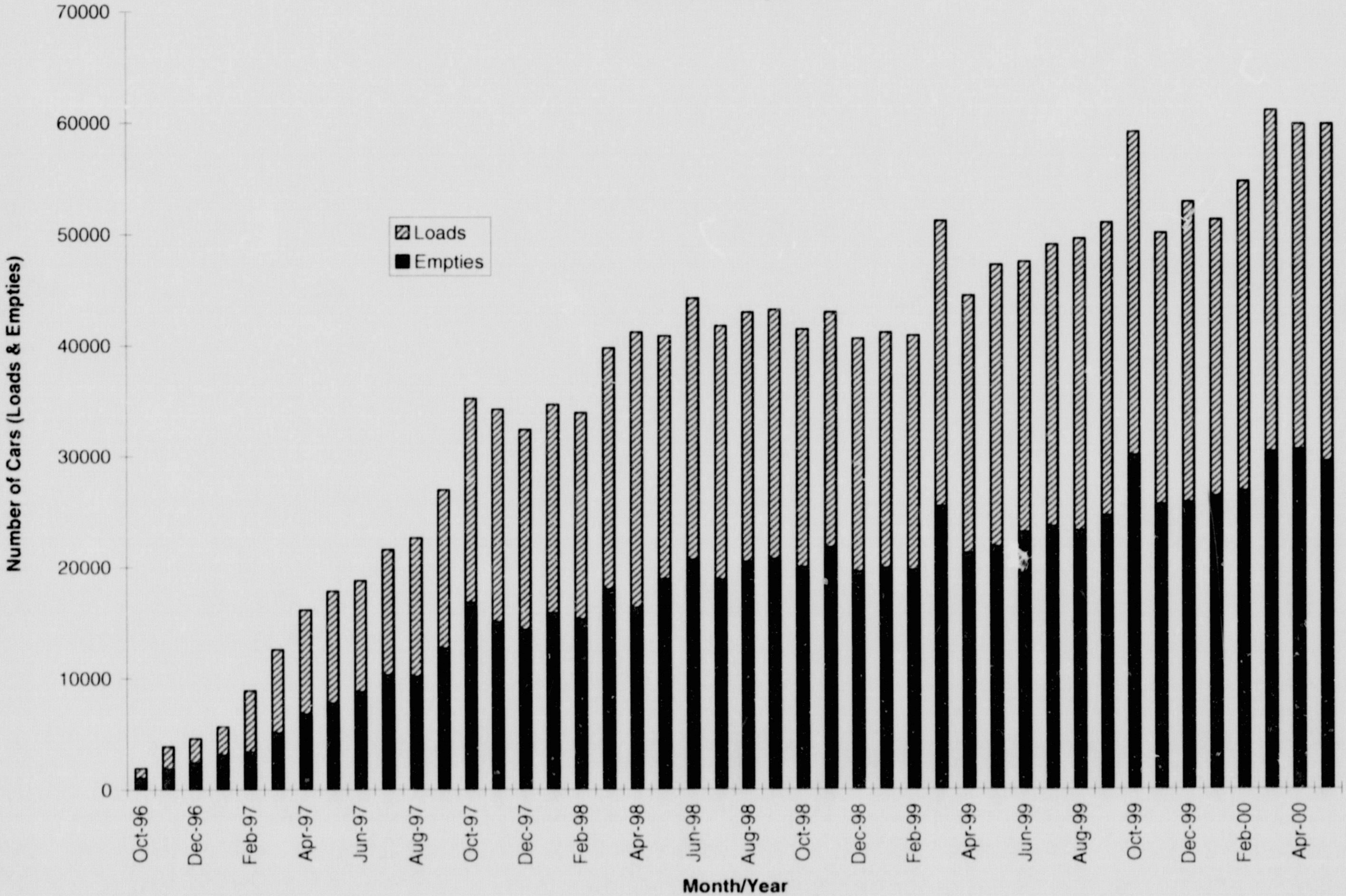
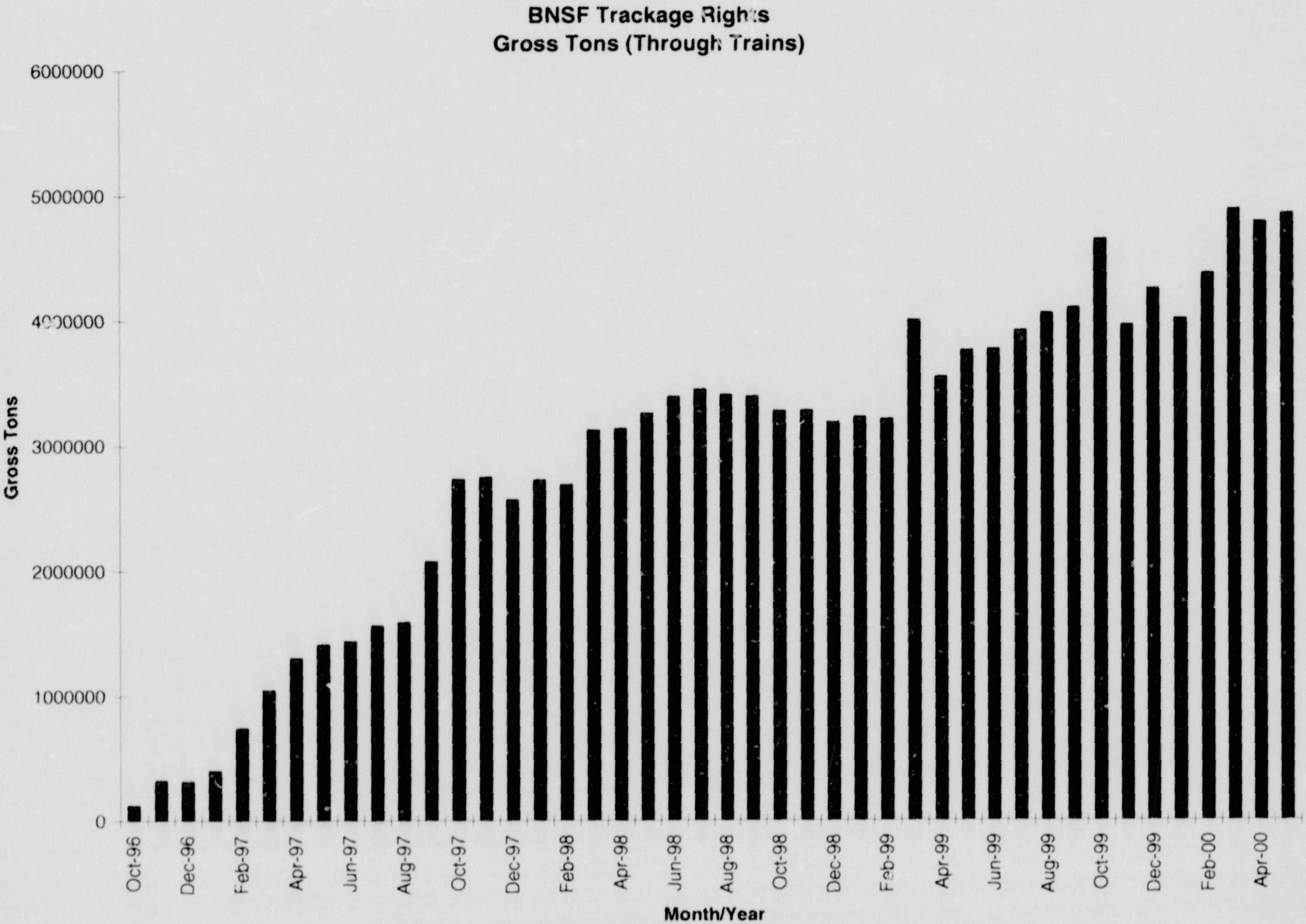


Exhibit #3



BNSF Trackage Rights
Gross Tons (Through Trains)
6000000
5000000
4000000
3000000
2000000
1000000
0
Gross Tons
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Oct-99
Dec-99
Feb-00
Apr-00
Month/Year

Another way of measuring the continued growth of BNSF's traffic volumes on trackage rights through trains is to examine average monthly data from the four periods UP has used to submit traffic data in the Board's oversight proceedings. The four periods are October 1996-May 1997; June 1997-May 1998; June 1998-May 1999; and June 1999-May 2000. In those four periods, average monthly trains have grown from 232 in the first period, to 574 in the second, to 725 in the third, to 793 in the most recent period. Average monthly tons have grown from 703,822 in the first period, to 2,467,520 in the second, to 3,423,944 in the third, to 4,295,705 in the most recent period. Average monthly cars have grown from 8,940 in the first period, to 31,828 in the second, to 43,459 in the third, to 53,768 in the most recent period. These data also show that tonnage and number of cars per train is increasing faster than the number of trains. Average monthly tons per train have grown from 3,034 in the first period, to 4,299 in the second, to 4,723 in the third, to 5,420 in the most recent period. Average monthly cars per train have grown from 38 in the first period, to 55 in the second, to 60 in the third, to 68 in the most recent period.

These figures do not include the many local trackage rights trains that BNSF has also operated. Much of the business on these local trains connects directly with BNSF's through trains at BNSF's own terminals, rather than connecting through trackage rights trains -- and thus represents still further traffic secured by BNSF because of the merger conditions. Through May 2000, BNSF had operated a total of 970 locals between Houston and Iowa Junction, 693 locals between Temple and Waco or Elgin, Texas; and 632 locals between Richmond and Warm

Springs or Oakland, California.[7] These trains handled 123,191 loaded and empty cars. In addition, since commencing service as BNSF's agent for local train operations in the Utah Valley on April 1, 1997, the Utah Railway has operated some 3,337 loc[illegible] trains, carrying a total of some 80,600 loaded and empty cars.

BNSF also continues to move appreciable volumes via haulage, though more and more of BNSF's operations have shifted to trackage rights over time. In May 2000, loaded and empty haulage cars totaled nearly 3,100. Almost half of these moved to and from Brownsville, with the remainder spread among such other locations as Lake Charles, Louisiana; Orange, Texas; the Northern California area; and the "Paired Track" in Nevada.

BNSF's through train frequencies in major corridors continue to underscore BNSF's competitiveness. Those frequencies -- generally two or even three trains per day in each direction -- clearly support highly competitive service:

- In the Central Corridor, BNSF operated 103 through trains in May 2000, carrying 440,836 gross tons. By comparison, the totals in May 1999 were 153 through trains and 500,234 gross tons. The totals in May 1998 were 168 through trains and 497,557 gross tons. The decline between May 1999 and May 2000 resulted from a change in the methodology and data source that UP uses to count Central Corridor trackage rights trains, not any actual change in BNSF operations or volumes. If the old methodology were applied to the recent data, BNSF volumes would have remained approximately the same. BNSF's service in the Central Corridor consists of approximately two trains per day westbound from Denver to Stockton via Salt Lake

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[7] BNSF has cancelled its Houston-Dayton local. In an effort to keep cars out of its yard in Houston, BNSF began running a Silsbee-Dayton manifest train in each direction, bypassing Houston. Between Houston and Iowa Junction, BNSF operates a Beaumont-Korf local, a Lafayette (Iowa Jct)-Lake Charles local, and a Dayton-Sheldon local.

City, one train per day eastbound from Stockton to Denver via Salt Lake City, and one train per day eastbound from Salt Lake City to Denver.

• In the Houston-Memphis Corridor, BNSF operated 185 through trains in May 2000, carrying 916,131 gross tons. The totals in May 1999 were 115 through trains and 692,946 gross tons. The totals in May 1998 were 116 through trains and 609,058 gross tons. BNSF is running at least two trains per day in each direction in this corridor.

• In the last of the three major BNSF corridors -- Houston-New Orleans -- BNSF operated 239 through trains in May 2000 carrying 1,372,779 gross tons. The totals in May 1999 were 166 through trains carrying 781,727 gross tons. The totals in May 1998 were 164 through trains carrying 812,718 gross tons. A portion of the increase from May 1999 to May 2000 is attributable to traffic moving in manifest trains that had previously moved in local trains.[8] BNSF service in this corridor remains at a level of approximately three trains per day -- on of them an intermodal train -- in each direction.

Another way of measuring the continued, and indeed increasing, strength of BNSF competition is to consider average monthly data from the four periods UP has used to submit data in these oversight proceedings. In those four periods, in the Houston-New Orleans Corridor, average monthly trains have grown from 67 in the first period, to 132 in the second, to 167 in the third, to 201 in the most recent period; and average monthly tons have grown from 164,116 in the first period, to 551,343 in the second, to 772,231 in the third, to 1,116,474 in the most recent period.

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[8] See note 7, supra.

In the Houston-Memphis Corridor, average monthly trains have grown from 47 in the first period, to 112 in the second, to 120 in the third, to 140 in the most recent period; and average monthly tons have grown from 154,475 in the first period, to 493,446 in the second, to 674,911 in the third, to 721,355 in the most recent period.

In the Central Corridor, average monthly trains have grown from 62 in the first period, to 138 in the second, declined slightly to 122 in the third, and then declined to 93 in the most recent period; and average monthly tons have grown from 92,656 in the first period, to 412,999 in the second, declined slightly to 373,370 in the third, and then declined slightly to 362,394 in the most recent period. As discussed above, the difference between this year's report and last year's report relates to a change in data collection methodology.

These data show BNSF's continued strength in all three major corridors.

The foregoing corridor figures do not include many other trackage rights trains, including I-5 Corridor trains that use trackage rights over UP between Keddie and Stockton California (166 trains in May 2000, versus 106 in May 1999, 78 in May 1998, and none in May 1997); trains between Houston and Corpus Christi (66 trains in May 2000, versus 84 in May 1999, 76 in May 1998, and 42 in May 1997); trains between Temple and Eagle Pass via San Antonio (53 trains in May 2000, versus 60 trains in May 1999, 50 in May 1998, and 19 in May 1998); rock trains interchanged with the Georgetown Railroad (26 trains in May 2000, versus 22 trains in May 1999, 26 in May 1998, and 21 in May 1997); coal trains to Halsted and Elmendorf Texas (29 trains in May 2000, versus 27 trains in May 1999, 12 in May 1998, and none in May 1997); grain trains to Ontario, California (8 trains in May 2000, versus 18 trains in May 1999, 13 in May 1998, and 9 in May 1997); and a variety of locals.

The continued strength of BNSF's Mexico volumes is also notable. In May 2000, BNSF operated 66 trackage rights trains to and from Corpus Christi and Robstown, principally for interchange with Tex Mex of Mexico traffic (the trains also included some Corpus Christi business and perhaps some business interchanged for Tex Mex local points). Those trains handled 6,035 loaded and empty cars and 484,948 gross tons. In May 1999, the figures were 84 trains with 6,914 cars and 538,758 tons. In May 1998, the figures were 76 trains with 6,688 cars and 436,543 tons. And in May 1997, the figures were 43 trains, with 3,332 cars and 278,836 gross tons. Eagle Pass trains also remain strong: 53 trains, carrying 4,495 cars and 350,504 tons in May 2000, compared with 60 trains, carrying 4,962 cars and 395,479 tons in May 1999, and compared with 50 trains, carrying 2,877 cars and 333,024 tons, in May 1998, and 19 trains, carrying 703 cars and 60,599 tons, in May 1997.

We noted in the first annual oversight report that, based on its own public statements, BNSF was already earning revenues from traffic moving pursuant to its merger rights at a rate representing some 20% of BNSF's estimate during the merger proceeding of a $1 billion total universe of available traffic. Today, BNSF volumes are now several times greater. It is now clearer than ever that BNSF, with its extensive Western network and infrastructure of terminals and other support facilities, was uniquely situated to mount fully competitive service over the new rights, and that there is no reason why BNSF cannot compete effectively for the entire universe of available traffic.

BNSF Competitive Successes. BNSF has continued to compete aggressively for "2-to-1" business, quoting very competitive rates and bidding on all major contracts. It continues to call on many shippers and receivers that had not been actively solicited, and to make repeated proposals in order to capture some or all of a customer's business.

In its most recent quarterly report, BNSF stated that it has already exceeded the goals it established when it was granted the merger conditions, that it is offering increasingly competitive, efficient and reliable service to shippers, and that it plans to grow more in the future. See BNSF-PR-14, pp. 2-3.

In light of the overwhelming proof of BNSF's competitiveness in the last three oversight proceedings, and the evidence in this proceeding that BNSF has continued to move growing amounts of trackage rights traffic, UP has not undertaken the expensive and time consuming process of compiling confidential exhibits listing specific examples. It is clear from UP's day-to-day experience in the marketplace that BNSF continues to compete for and capture the same types of "2-to-1" traffic that it has been capturing for the past three years, and that it continues to be a much stronger competitor that SP ever was.

Benefits for "2-to-1" Shippers Using UP. Just as important as BNSF's successes in capturing traffic, shippers at "2-to-1" points and in "2-to-1" corridors continued this year to benefit where UP retained traffic in the face of strong competition from BNSF. Again, UP has not undertaken the process of compiling lists of specific examples, as it has done for the past three years, but it is clear from UP's day-to-day experience in the market that the same types of shippers are receiving the same types of benefits as described in years past.

"2-to-1" Rates. UP has not undertaken the resource intensive process of compiling information on rates for "2-to-1" traffic as it has in past years. In its annual oversight reports for the past three years, UP has shown that in the years following the BNSF merger rates for the "2-to-1" traffic it has handled have remained steady or declined.

Build-In Condition. The CMA agreement, as augmented by the Board's merger approval decision, preserved shippers' pre-merger opportunities to build in from SP points to UP points, and vice versa, and thereby obtain rail competition. Though no build-ins have yet occurred in connection with the BNSF rights, this condition has had a competitive impact, as UP has described in past annual oversight reports. See, e.g., UP/SP-367, Confidential Appendix F.

Transload Condition. The BNSF settlement agreement permitted BNSF to serve existing and new transloading facilities at "2-to-1" points. The Board's merger approval decision also gave BNSF the right to serve new transload facilities on all BNSF trackage rights lines. This condition has proven effective, as UP has described in past oversight reports. See, e.g., UP/SP-366, p. 76; UP/SP-367, Confidential Appendix G.

New Industries Condition. The BNSF settlement agreement permitted BNSF to serve new industries at "2-to-1" points. The CMA agreement extended this right to SP-owned BNSF trackage rights lines, and the Board's merger approval decision expanded it to all BNSF trackage rights lines. Again, experience continues to show that this condition is effective. BNSF continues to serve new facilities of Total Petroleum and Conoco at Durham, Colorado, on the overhead portion of its trackage rights across the DRGW east-west mainline. BNSF is also serving a new Pilgrim's Pride feed mill near Tenaha, Texas, on the Houston-Memphis trackage rights line, and Quebecor's printing press in Fernley, Nevada, on trackage rights over the former SP line. See also UP/SP-367, Confidential Appendix H. More recently, BNSF commenced service to a new Southdown cement facility at Polk, California.

"1-to-2" Shippers. Additional competitive benefits have been realized by shippers on the Iowa Junction-Avondale line that was sold to BNSF. As a negotiated "quid pro quo" in the settlement agreement, shippers on this line that had formerly been exclusively served by SP gained service from both BNSF and UP. The shippers along that line have continued to benefit from this new competition. See also UP/SP-367, Confidential Appendix I.

__Pro-Competitive Benefits in the I-5 Corridor__. Finally, a further extremely significant pro-competitive "quid pro quo" aspect of the BNSF settlement agreement was the sale to BNSF of the Keddie-Bieber line, which, together with BNSF's trackage rights from Keddie to Stockton, links up the BNSF system on the West Coast and creates a second single-line rail alternative up and down the I-5 Corridor between the Pacific Northwest and the Pacific Southwest. The establishment of two new single-line alternatives in the I-5 Corridor, together with the proportional rate agreement that allows UP to compete for the business of shippers at BNSF local points and junctions by offering competitive service and rates via a BNSF-Portland-UP route, has brought to this region an enhancement of competition that was without precedent in any previous rail merger.

With the merger and its accompanying conditions, UP and BNSF now offer competing single-line alternatives from western Canadian gateways and jointly-served points in Washington and Oregon to jointly-served points in California and Arizona and western Mexican gateways. Prior to the merger, there was __no__ single-line rail service in this huge transportation market. Shippers of lumber and panel products, for example, have taken extensive advantage of the new competition. BNSF has increased its lumber shipments in the I-5 Corridor by moving traffic from the Pacific Northwest to California points on its new single-line routes, by greatly expanding the volumes at its reload facilities in the Los Angeles Basin, and by developing new reload facilities in Arizona. BNSF's expanded use of origin reloads in Eugene, Salem and Portland, Oregon, is a further sign of its growing penetration of the lumber and panel products marketplace. BNSF has also used its new single-line ability to increase its share of petroleum shipments moving from California points to the Pacific Northwest. BNSF is operating approximately six trains per day in each direction in the I-5 Corridor.

UP customers are also benefitting from new single-line routes in the I-5 Corridor. UP-served shippers now have single-line access to the many SP-served destinations in California, as well as to Phoenix and Tucson. SP-served shippers in California and Oregon now have single-line access to important UP-served destinations for lumber and panel products such as Las Vegas. And Canadian producers in British Columbia and Alberta are taking advantage of single-line service to move increasing quantities of panel products via barge to Seattle for onward single-line movement via the UP system.

Customers are also seeing benefits from the I-5 proportional rate arrangement. Shippers have used I-5 proportional rates to move lumber, petroleum products, edible oils and other traffic between BNSF-served points in Washington and BNSF-served Canadian gateways, on the one hand, and points on the UP system, on the other hand, via the Portland routing.

Over the past three years, UP has provided dozens of examples of shippers who have benefited from new competition in the I-5 Corridor. See, e.g., UP/SP-267, Confidential Appendix J.

b. Tex Mex

Since the inception of its rights, Tex Mex has operated a total of 2,280 through freight trains through May 2000. In the period from June 1999 through May 2000, Tex Mex has averaged 63 trains per month. Exhibits #4, #5 and #6 depict, by month, Tex Mex's through trackage rights trains, and the number of cars and tons on those trains. Exhibits #7, #8, and #9

Exhibit #4

Tex Mex Trackage Rights
Number of Through Trains
(All Traffic Included)

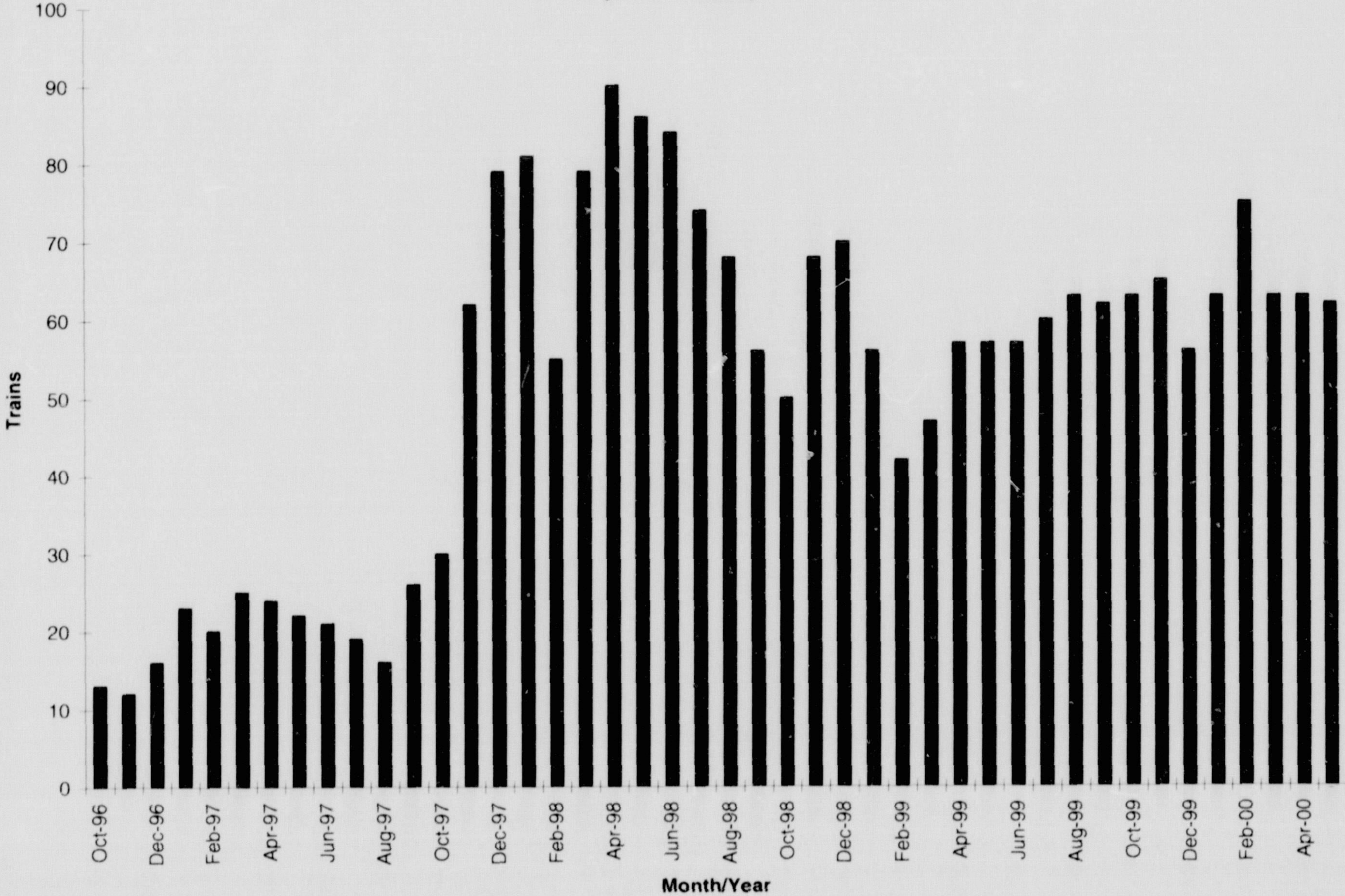


Exhibit #5

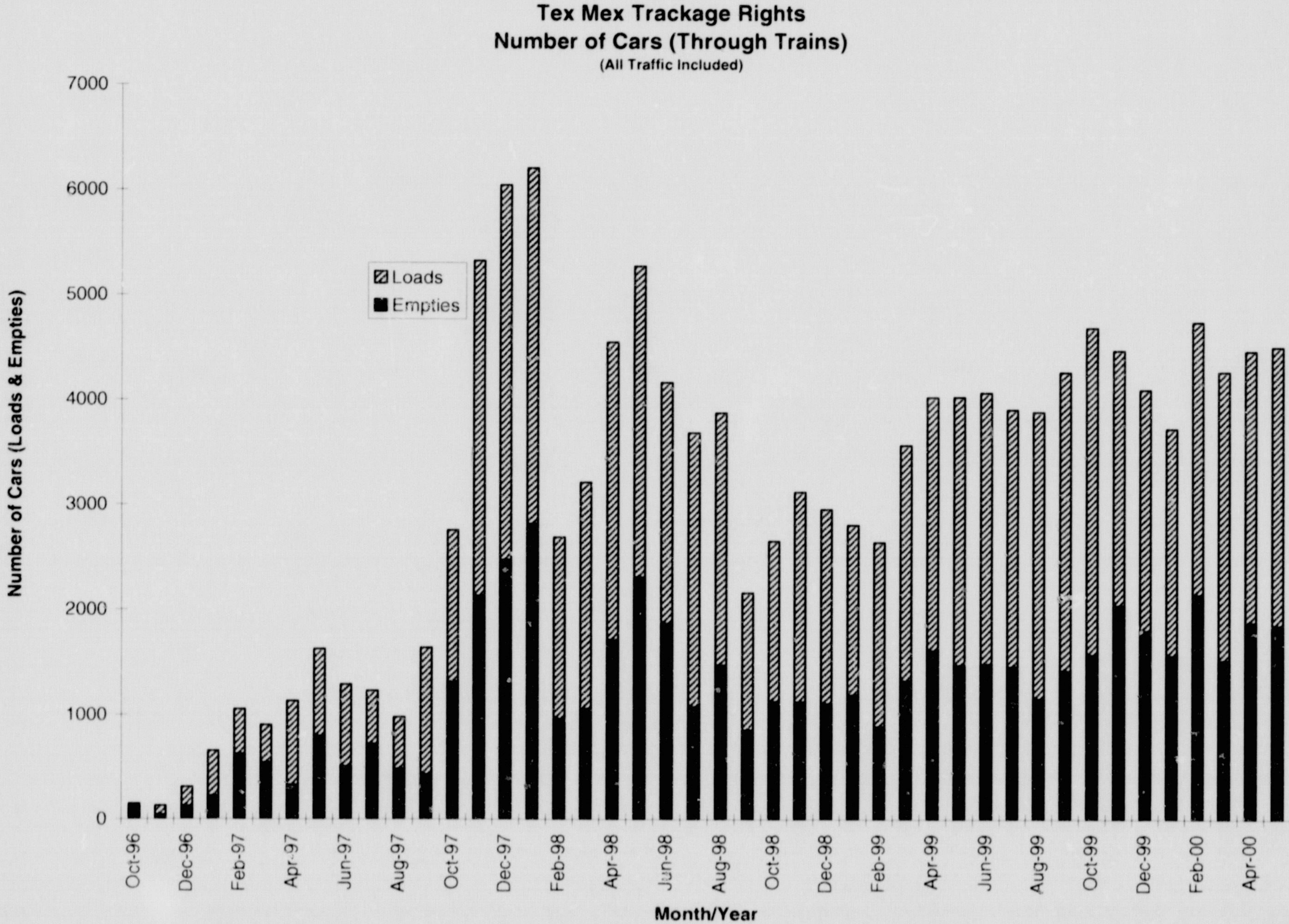

Tex Mex Trackage Rights
Number of Cars (Through Trains)
(All Traffic Included)
Number of Cars (Loads & Empties)
7000
6000
5000
4000
3000
2000
1000
0
Loads
Empties
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Oct-99
Dec-99
Feb-00
Apr-00
Month/Year

Exhibit #6

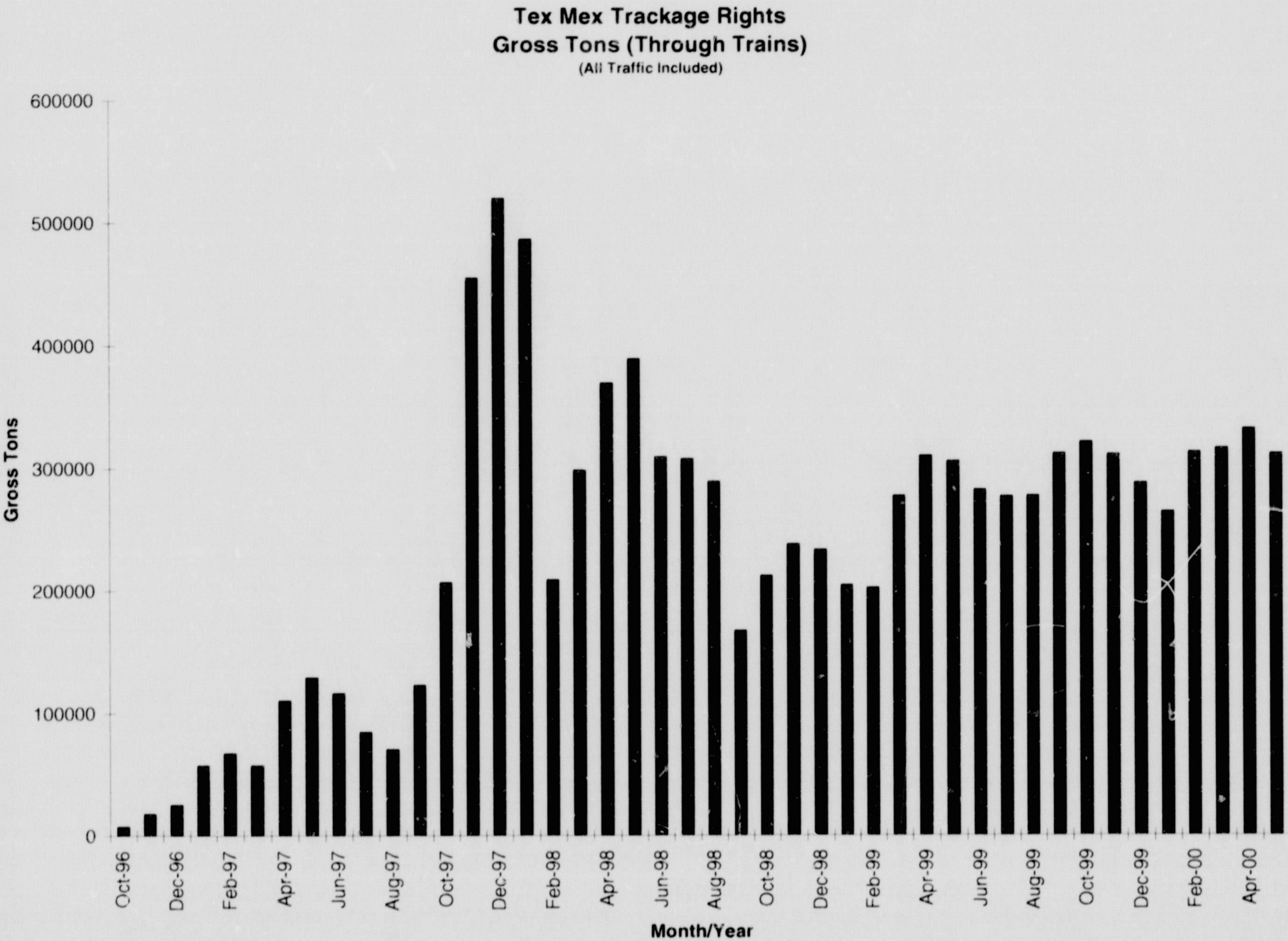
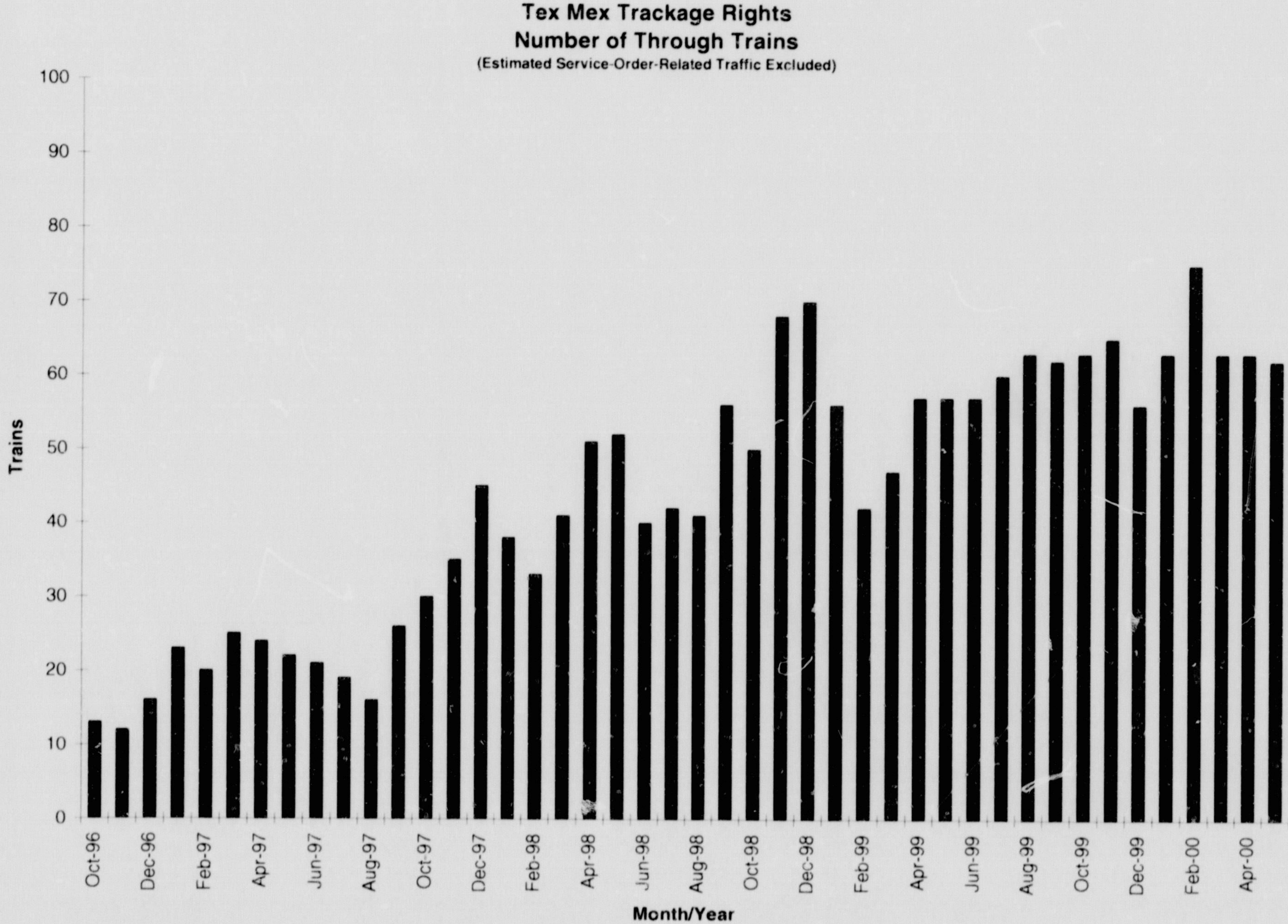

Tex Mex Trackage Rights
Gross Tons (Through Trains)
(All Traffic Included)
600000
500000
400000
300000
200000
100000
0
Gross Tons
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Oct-99
Dec-99
Feb-00
Apr-00
Month/Year

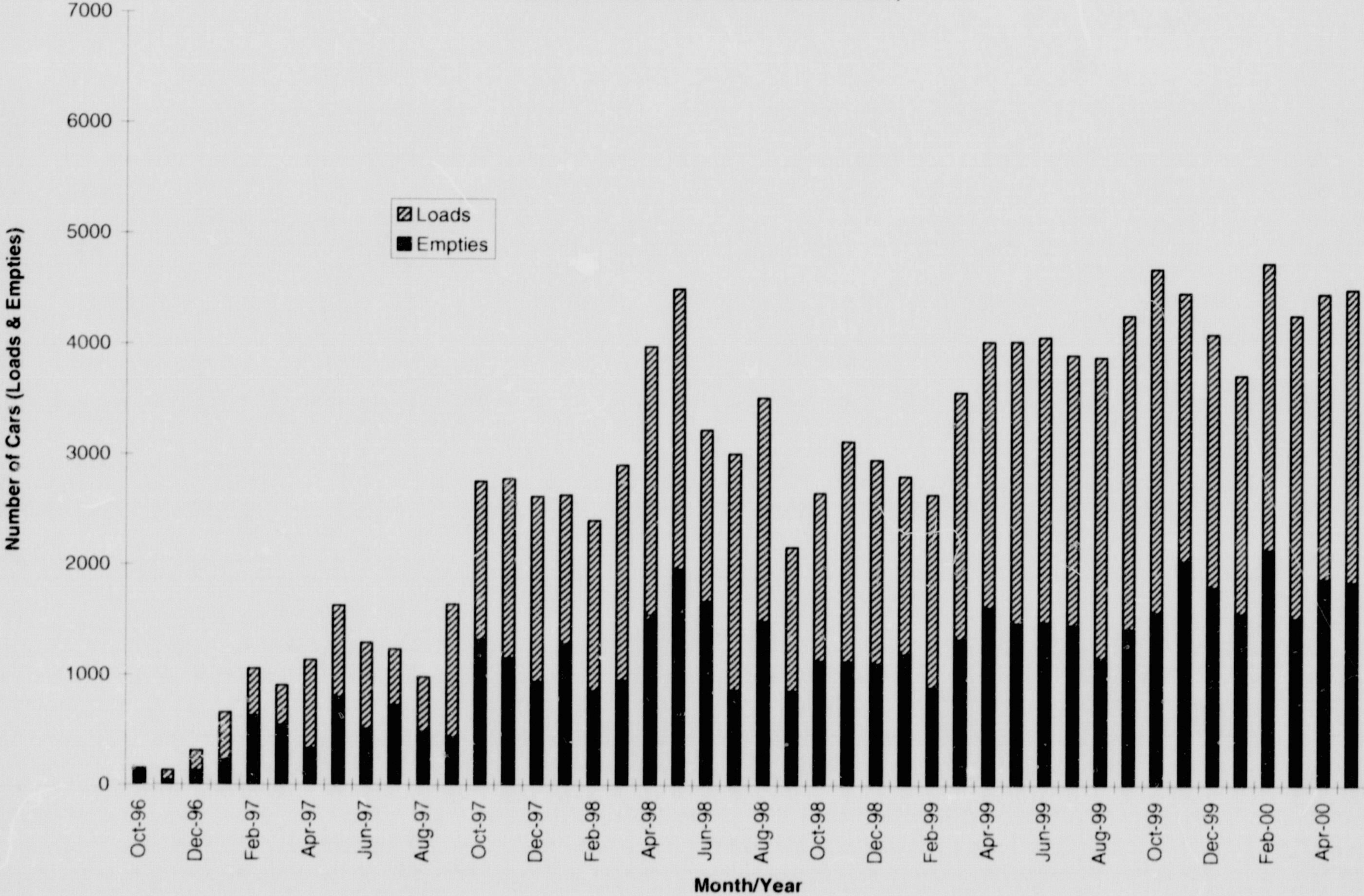
Exhibit #7



Tex Mex Trackage Rights
Number of Through Trains
(Estimated Service-Order-Related Traffic Excluded)
Trains
Month/Year
0
10
20
30
40
50
60
70
80
90
100
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Oct-99
Dec-99
Feb-00
Apr-00

Exhibit #8

Tex Mex Trackage Rights
Number of Cars (Through Trains)
(Estimated Service-Order-Related Traffic Excluded)



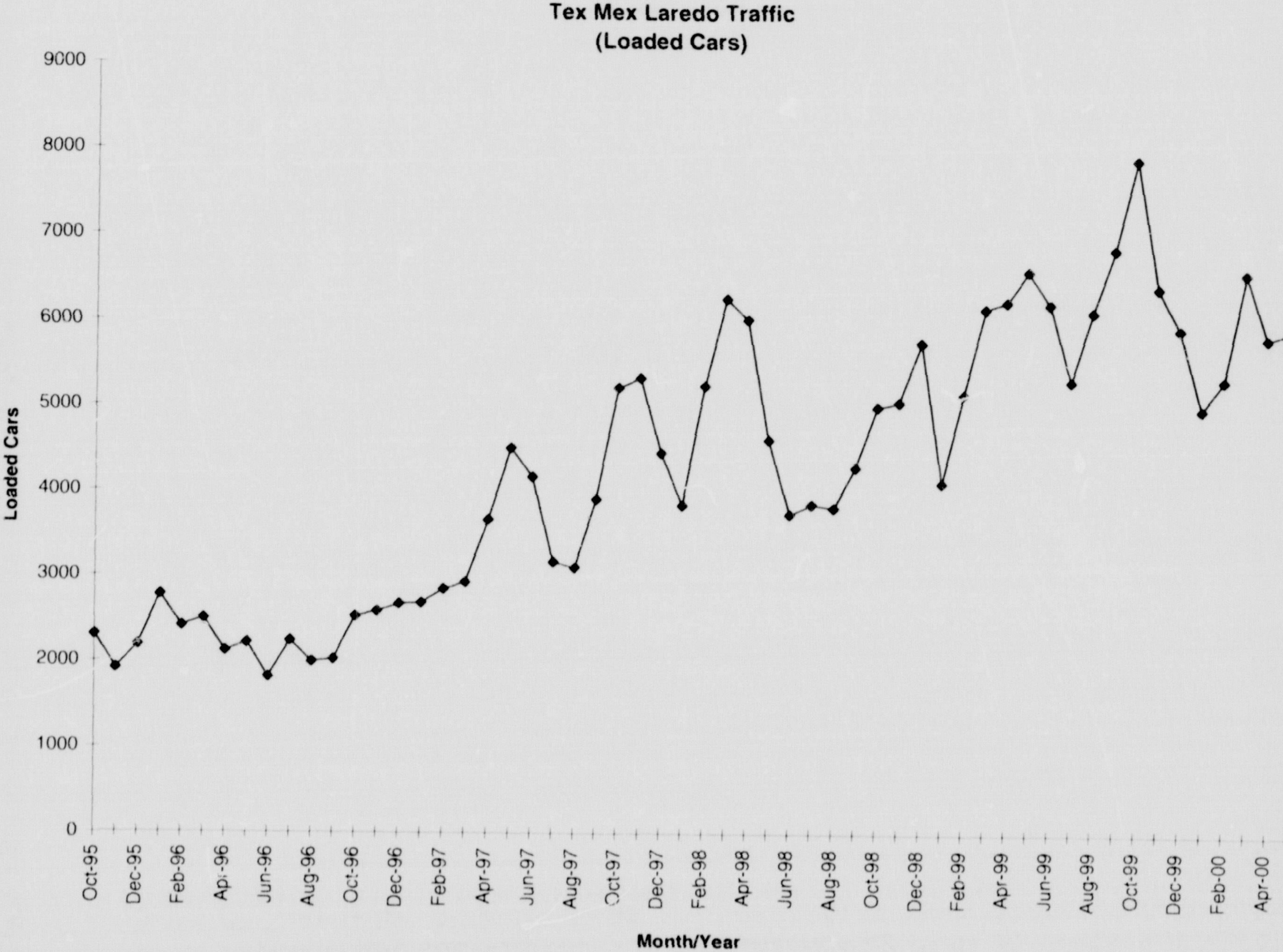
STB FD-32760 (SUB 21) 7-3-00 D 199172 2 of 2 present the same data, adjusted to exclude the temporary effects of the Board's Service Order No. 1518.[9]

The Board's purpose in partially granting the trackage rights conditions sought by Tex Mex in the UP/SP merger proceeding was to "address the possible loss of competition at the Laredo gateway into Mexico and to protect the essential services provided by Tex Mex to its shippers." Decision No. 62, p. 6. There is no question that competition has remained strong at Laredo and Tex Mex has remained viable subsequent to the implementation of the merger. The volume of traffic handled by Tex Mex to and from Laredo has more than doubled since the UP/SP merger. Exhibit #10 depicts the dramatic increase in Tex Mex's Laredo traffic. Tex Mex's <u>southbound</u> traffic over Laredo -- which has traditionally made up virtually all of its Laredo business -- was 59,976 carloads in the June 1999-May 2000 period compared with 24,953 carloads in the same period prior to the merger (June 1995-May 1996). Tex Mex's much smaller northbound volumes have increased even more dramatically, from 492 carloads in the June 1995-May 1996 period to 13,511 carloads in the June 1999-May 2000 period.

---

9 Tex Mex's trackage rights operations were affected in two significant ways by the Board's Service Order No. 1518. First, between November 10, 1997 and January 29, 1998, BNSF and Tex Mex interchanged considerable volumes of traffic, mostly grain, at Flatonia instead of at Corpus Christi or Robstown pursuant to the Board's emergency order authorizing interchange at that location. As a result, this BNSF-Tex Mex traffic was temporarily included in Tex Mex's trackage rights volumes rather than in BNSF's trackage rights volumes. Second, in February 1998, Tex Mex commenced the operation of new trains between Houston and Tex Mex's interchange with KCS at Beaumont that carry traffic moving between Houston and points north, as permitted by the Board's emergency service order. Exhibits #7, #8 and #9 depict, by month, Tex Mex's through trackage rights trains, and the numbers of cars and tons on those trains, excluding estimates of (a) traffic interchanged with BNSF at Flatonia, (b) traffic on BNSF trains that Tex Mex handled for three months between Corpus Christi and Algoa as BNSF's agent, and (c) traffic carried in Tex Mex's Houston-Shreveport trains.

Exhibit #10


Tex Mex Laredo Traffic
(Loaded Cars)
9000
8000
7000
6000
5000
4000
3000
2000
1000
0
Loaded Cars
Oct-95
Dec-95
Feb-96
Apr-96
Jun-96
Aug-96
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Oct-99
Dec-99
Feb-00
Apr-00
Month/Year

This post-merger growth in Tex Mex's volumes and shares of Laredo traffic has occurred because the growth in the volume of traffic that Tex Mex interchanges with BNSF at Corpus Christi/Robstown and handles itself using its new trackage rights between Beaumont and Corpus Christi/Robstown has greatly outstripped the decline in the volume of traffic that Tex Mex interchanged with UP and SP. This is most readily seen by focusing on southbound volumes. Exhibit #11 overlays BNSF and Tex Mex trackage rights volumes with SP and UP Tex Mex interchange traffic and graphically demonstrates why Tex Mex's Laredo gateway volumes have increased so significantly.

Tex Mex's volumes and shares can be expected to grow even further. In December 1998, Tex Mex and BNSF reached agreement on a five-year interline divisions arrangement for traffic moving between those two carriers via Robstown to and from Mexico via Laredo.[10] In April 1999, Tex Mex, KCS and TFM announced the introduction of a new intermodal service that takes advantage of Tex Mex's new intermodal facility located in Laredo.[11] More recently, in April 2000, BNSF announced that it was "team[ing] with Tex Mex" in a "significant expansion of its North American intermodal network" by establishing new intermodal service between U.S. points and the Mexican cities of Monterrey, Queretaro and Mexico city via the Laredo gateway. BNSF Press Release, Apr. 11, 2000. In the same month, Triple Crown Services announced new five-day-a-week RoadRailer intermodal service between the United States and Mexico City, via Tex Mex and the Laredo gateway. Norfolk Southern Press Release, Apr. 25, 2000.

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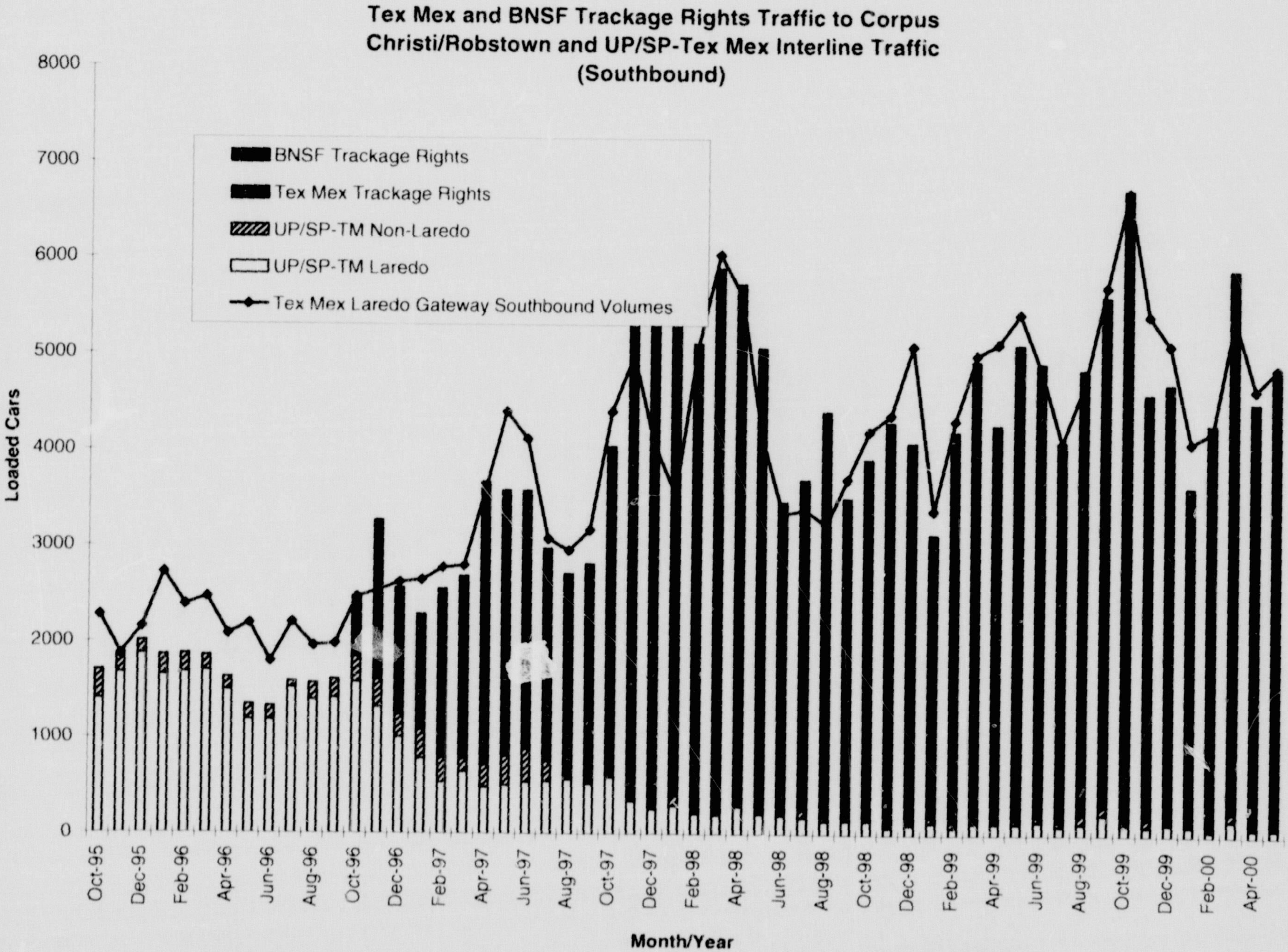
[10] See BNSF-PR-10, p. 7.

[11] See http://notes.kcsi.com/WebApps/kcspress.nsf.

Exhibit # 11



Tex Mex and BNSF Trackage Rights Traffic to Corpus Christi/Robstown and UP/SP-Tex Mex Interline Traffic (Southbound)
BNSF Trackage Rights
Tex Mex Trackage Rights
UP/SP-TM Non-Laredo
UP/SP-TM Laredo
Tex Mex Laredo Gateway Southbound Volumes
Loaded Cars
0
1000
2000
3000
4000
5000
6000
7000
8000
Oct-95
Dec-95
Feb-96
Apr-96
Jun-96
Aug-96
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Oct-99
Dec-99
Feb-00
Apr-00
Month/Year

c. Utah Railway

Utah Railway, a "2-to-1" shortline, obtained the right to interchange with BNSF as a condition to the merger, thereby preserving competitive options for its on-line shippers. In addition, in consideration for settling issues regarding the use of joint UTAH-DRGW track, UTAH received access to the Savage coal transloading facility and the Willow Creek mine, and trackage rights to Grand Junction, Colorado, where it can interchange with both BNSF and UP. UTAH has maintained a high level of activity working as BNSF's agent operating local trains in the Utah Valley, and its trackage rights continue to act as a competitive check on UP.

C. "3-to-2" Traffic and Source Competition

Experience continues to confirm that the Board was correct in determining that the merger would have no adverse competitive effect on "3-to-2" traffic, or on source competition for such commodities as Utah and Colorado coal, Gulf Coast chemicals, and grain. In fact, competition has been strengthened for all these categories of traffic.

1. "3-to-2" Traffic

Autos. We have previously explained that the competitive benefits of the merger and the BNSF settlement for "3-to-2" traffic had been dramatically illustrated by the results of head-to-head bidding between UP and BNSF for Western automotive traffic, a large portion of total "3-to-2" traffic. In that bidding, each of the Big Three auto makers secured large savings, clearly demonstrating that competition between the new UP and BNSF networks was stronger than the three-railroad competition that preceded it. See UP/SP-367, Confidential Appendix K.

Intermodal Traffic. Competition has remained strong for intermodal traffic, the largest single category of "3-to-2" traffic. BNSF's access to New Orleans has strengthened competition for east-west international doublestack container traffic to and from the West Coast ports. UP's Los Angeles-Memphis intermodal service, by combining UP and SP routes, is winning business from BNSF because it is able to offer the shortest and fastest single-line route between Memphis and Los Angeles.

Carload Traffic. Competition for "3-to-2" carload traffic also remains strong. For example, although the merger reduced the number of railroads able to originate lumber in the Pacific Northwest from three to two, competition for this traffic has intensified, as UP has simplified rate structures, improved SP transit times and improved equipment supply. Other "3-to-2" shippers are seeing similar benefits.

2. Utah and Colorado Coal

Those who speculated that the merger would disadvantage Utah and Colorado coal continue to be proven wrong. UP has been pursuing this business with the same aggressiveness that SP had employed. Utah and Colorado coal shippers continue to benefit from UP's investment in a new export terminal in Los Angeles, which has led to significant reductions in cycle time, and from UP's investment in the Kansas Pacific line to improve the handling of eastbound Utah and Colorado coal movements.

The merged system continues to market Utah and Colorado coal aggressively. UP recently obtained new contracts for Colorado coal movements to Arizona Electric Power, Empire district Authority, Alliant Energy, Nebraska Public Power District, and Dairyland.

3. Gulf Coast Chemicals

Competition for Gulf Coast plastics and other chemicals traffic also continues to be strong. Gulf Coast chemical shippers have continued to benefit from new single-line service, shorter routes, and vigorous rate and service competition from BNSF.

4. Grain

Concerns of USDA and others that source competition for grain would be harmed continue to prove unfounded. UP grain producers continue to benefit from access to SP markets. BNSF continues to use its trackage and haulage rights to move large volumes of grain to Mexico, Arkansas, California and Utah.

Respectfully submitted,

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

July 3, 2000

<u>**VERIFICATION**</u>

STATE OF NEBRASKA)
) ss.
COUNTY OF DOUGLAS)

I, Woodruff F. Sutton, Vice President-Manifest Products, of Union Pacific Railroad Company, state that the information in Part I (except those subsections relating to capital investments) of the Applicants' Fourth Annual Report on Merger and Condition Implementation, 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.

Woodruff F. Sutton
WOODRUFF F. SUTTON

Subscribed and sworn to before
me by Woodruff F. Sutton this
29th day of June, 2000

Beverly A. Meeks
Notary Public

GENERAL NOTARY-State of Nebraska
BEVERLY A. MEEKS
My Comm. Exp. Sept. 2, 2003

VERIFICATION

STATE OF NEBRASKA)
) ss.
COUNTY OF DOUGLAS)

I, David Wheeler, Director-Capacity Planning & Analysis, of Union Pacific Railroad Company, state that the information concerning merger-related capital investments and the Houston/Gulf Coast Region infrastructure investments in Part I of the Applicants' Fourth Annual Report on Merger and Condition Implementation 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.

DBWheeler
DAVID WHEELER

Subscribed and sworn to before me by David Wheeler this 29th day of June, 2000

Beverly A. Meeks
Notary Public

GENERAL NOTARY-State of Nebraska
BEVERLY A. MEEKS
My Comm. Exp. Sept. 2, 2003

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 II of the Applicants' Fourth Annual Report on Merger and Condition Implementation 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 B. Peterson

RICHARD B. PETERSON

SUBSCRIBED and sworn to before me by Richard B. Peterson this 29th day of June 2000.

Beverly A. Meeks

Notary Public

GENERAL NOTARY-State of Nebraska
BEVERLY A. MEEKS
My Comm. Exp. Sept. 2, 2003

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that, on this 3rd day of July, 2000, 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 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

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

Michael L. Rosenthal

ATTACHMENT

ENVIRONMENTAL MITIGATION CONDITIONS

The following is a report on steps taken, and plans for future steps, in regard to the environmental mitigation conditions, which are addressed in the order they are listed in Appendix G to Decision No. 11:

D. System-wide Mitigation

1-9. These conditions have been satisfied as previously reported.

10. Security Forces. As previously reported, UP has extended to SP territory its policy of zero tolerance of vagrancy and trespassing on railroad property. UP is participating in a new nation-wide initiative by Operation Lifesaver to reduce trespassing on railroad property. UP met with the Reno Police Department regarding a zero tolerance program in late June of 1997; these discussions are on hold pending a City of Reno legal determination.

11-13. These conditions have been satisfied as previously reported.

E. Corridor Mitigation

14. EPA Emissions Standards. EPA's national locomotive emissions rule was published in the Federal Register on April 16, 1998. Since no appeals were filed by the June 15, 1998 deadline, the rule is now final. UP is working with locomotive industry suppliers to develop its compliance plan.

15. Consultations With Air Quality Officials. UP has held detailed discussions with environmental officials in the states of Arizona, Colorado, Illinois, Nevada, Oregon, Texas, Washington and Wyoming. Dialogue between UP and California officials continues to address ongoing improvement in UP/California air quality issues.

16. Noise Impacts. UP implemented a noise comment hotline and re-notified each affected county and requested comments in the first part of 1999. UP monitors the noise

hotline and will compile and analyze data to determine if a noise abatement plan is required. Through June 26, 2000 there were no calls to the noise monitoring hot line in the second quarter.

17. Use of Two-Way-End-of-Train Devices. This condition has been satisfied, as previously reported.

F. <u>Rail Line Segment Mitigation</u>

18. Priority List for Upgrading Grade Crossing Signals. UP provides train density information to states on a regular basis, which they use to prioritize their grade crossing improvements. UP provides the states of Arizona, California, Kansas, Nevada, Oregon, Texas and Colorado with train density data for approximately 500 individual crossing improvements annually.

19. East Bay Regional Park District MOU. The MOU is being implemented in accordance with its specifications. UP is reviewing the Crockett Trail Feasibility Study and is awaiting property descriptions from the District for all trails.

20. Town of Truckee MOU. The MOU is being implemented in accordance with its specifications. UP has completed construction of its portion of the bridge at the I-80 Central Truckee off ramp and is working with the city on roadway approaches. The railroad continues to work with local and federal agencies in the development of a Truckee River hazardous material spill response plan.

21. Placer County MOU. The MOU is being implemented in accordance with its specifications. UP continues to meet and work with the City of Roseville. UP has installed train control mechanisms to facilitate passenger operations. Several improvement projects specified in the MOU have been completed while others have been deferred or canceled at the request of the county and/or city involved. UP has conveyed, and is in the process of conveying or leasing other properties as specified in the MOU.

22. City of Reno. The MOU between UP and Reno is being implemented in accordance with its terms.

23. City of Wichita/Sedg vick County. The MOU between UP and City of Wichita/Sedgwick County is being implemented in accordance with its terms.

G. Rail Yards and Intermodal Facilities

24. Noise Abatement Plans for Rail Yards. Before UP undertakes any rail yard construction at the specified locations, UP will contact appropriate state and local officials and will report to SEA on the results of those consultations. No construction is planned for these facilities at this time.

25. Intermodal Facilities. Before any changes are made at the specified intermodal facilities, UP will contact appropriate state and local air quality officials in the states of California and Illinois and will report to SEA on the results of those consultations. A permit application for East LA is in progress. No construction or operating changes are planned for the Chicago facilities at this time.

H. Abandonments

26-61. As abandonments are carried out, UP will comply with all conditions. UP has developed a process to ensure that contractors and railroad personnel comply with all general conditions. Progress on specific abandonment conditions is reported below.

40. This work still being enacted. Contractor currently operating on property.

41. This condition has been satisfied, as previously reported.

42. This work still being enacted. Contractor currently operating on property.

43. This condition has been satisfied, as previously reported.

44. This condition has been satisfied, as previously reported.

47. This condition has been satisfied, as previously reported.

48. This condition has been satisfied, as previously reported.

49. This condition has been satisfied, as previously reported.

50. This condition has been satisfied. There is no bridge at this location. The line has been sold to Norfolk Southern.

51. New connection in place at Girard. NHPA work will follow.

52. This condition has been satisfied, as previously reported.

55. This condition has been satisfied, as previously reported.

57. This condition has been satisfied, as previously reported.

58. Suman-Benchley, TX UP has decided to retain this line. The Board vacated the abandonment exemption for the line on June 12, 1998. This condition is no longer applicable.

59. This condition has been satisfied, as previously reported.

60. This condition has been satisfied, as previously reported.

61. This condition has been satisfied, as previously reported.

I. Construction Protects

62-108. As construction projects are carried out, UP will comply with all listed conditions. UP has developed a process to ensure that contractors and railroad personnel comply with all general conditions. Progress on specific construction provisions is reported below.

70. This condition has been satisfied, as previously reported.

78. This condition has been satisfied, as previously reported.

79. This condition has been satisfied, as previously reported.

80. This condition has been satisfied, as previously reported.

81. This condition has been satisfied, as previously reported.

83. This condition has been satisfied, as previously reported.

84. This condition has been satisfied, as previously reported.

88. This condition has been satisfied, as previously reported.

89. This condition has been satisfied, as previously reported.

92. This condition has been satisfied, as previously reported.

97. This condition has been satisfied, as previously reported.

98. This condition has been satisfied, as previously reported.

99. This condition has been satisfied, as previously reported.

100. This condition has been satisfied, as previously reported.

101. This condition has been satisfied, as previously reported.

107. This condition has been satisfied, as previously reported.

108. This condition has been satisfied, as previously reported.

STB FD-32760 (SUB 21) 7-3-00 D 199172

199172

UP/SP-378

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Office of the Secretary

JUL 05 2000

Part of
Public Record

BEFORE THE
SURFACE TRANSPORTATION BOARD

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MANAGEMENT
STB

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

D

APPLICANTS' FOURTH ANNUAL REPORT ON MERGER AND CONDITION IMPLEMENTATION

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Union Pacific Railroad Company and
Southern Pacific Rail Corporation

July 3, 2000

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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 -- OVERSIGHT

APPLICANTS' FOURTH ANNUAL REPORT ON MERGER AND CONDITION IMPLEMENTATION

Applicants UPC, UPRR and SPR[1] hereby submit their fourth annual report on their progress in implementing the UP/SP merger, and on the implementation and effectiveness of the competition-preserving conditions imposed by the Board in its decision approving the merger. This report is being submitted in compliance with Decision No. 15 in this oversight sub-docket, served November 30, 1999.

PRELIMINARY STATEMENT

In the last annual oversight proceeding, the Board found that "the merger is producing benefits for the shipping public (i.e., better service and lower rates)" and that there "is

[1] Acronyms used herein are the same as those in Appendix B of Decision No. 44. The following original applicants have been merged with UPRR: MPRR (on January 1, 1997); DRGW and SPCSL (on June 30, 1997); SSW (on September 30, 1997); and SPT (on February 1, 1998). For simplicity, and in light of the fact that SPT has merged with UPRR and no longer has any separate existence, we generally refer to the combined UP/SP rail system as "UP."

no evidence that the merger has produced any competitive problems." Decision No. 15, p. 5. The Board also found that UP has "recovered fully" from the service problems experienced following the merger and that service "continues to improve." Id. This year's annual report describes UP's successful efforts to maintain and extend this record of merger and condition implementation.

Part I provides an update on UP's service today and UP's progress on merger implementation. We present a number of performance measurements that confirm that UP service has in recent months reached its highest levels in the modern era. We also review merger-related service enhancements, including UP's new "Express Lane" service and new premium intermodal services. In addition, we review the progress in installing TCS and other support systems; in integrating workforces; in merger-related capital investments (including a report on investment in the Houston-Gulf Coast region); in consolidating and improving terminals and yards, and in enhancing the safety of the merged system's operations. Finally, we review the status of merger-related abandonments and, in an attachment, environmental compliance.

Part II addresses competition. It begins by reviewing how the merger is continuing to produce competitive benefits and then shows that, for a fourth straight year, the competition-preserving conditions imposed by the Board have demonstrated their effectiveness. In light of the Board's conclusions in each of the past three annual oversight proceedings that there has been no evidence of harm to competition resulting from the merger, this part is more abbreviated than it has been in past years. UP has not undertaken the expensive and time-consuming process of compiling the confidential appendices that it has presented in past proceedings. UP is confident, however, based on its day-to-day dealings with customers, that if the process were undertaken, the results would parallel those of the past three years: one could find hundreds of examples of shippers who are benefitting from the merger and the competition-preserving conditions.

In keeping with the Board's preference for a focused proceeding, we are submitting this report in verified form rather than presenting lengthy verified statements.

I. <u>MERGER BENEFITS AND IMPLEMENTATION</u>

A. <u>UP's Service Recovery</u>

With the service crisis now more than two years in the past, UP service in 2000 improved to record-setting levels. By several measures, UP provided better service during the spring than at any time in recent memory. UP's performance in moving western coal has been especially noteworthy.

During 1997 and 1998, UP reported a number of service measurements to the Board each week. These measurements of UP performance in 2000 reflect UP's full recovery and the quality of its transportation services. (Note that UP provides measurements to the AAR that it calculates differently from the following measurements; the two sets of data are not comparable.)

- UP's systemwide average train speed, which fell as low as 12 m.p.h. during the service crisis, stood at 18.7 m.p.h. when we filed our annual oversight report last July. During April and May of this year, UP's average train speed reached 20.0 m.p.h., the fastest average speed since September 1996.
- UP's locomotive productivity, measured in gross ton-miles per horsepower-day, had climbed from 93.7 to 127.7 last year. In March, locomotive productivity reached a record level of 133.5.
- Freight car dwell time at UP yards -- the amount of time freight cars spend in a defined geographic terminal area -- approached a record low in April at only 26.2 hours. Dwell time stood at 31.3 hours last July 1 from a high of 43.9 hours during the service crisis.

- Early in 1998, UP used a second crew on 20 to 25 percent of its trains. Last year we reported that this "recrew rate" had fallen to about ten percent. This year UP's recrew rate has dropped below five percent.
- In May, trains were held for power for an average of only 418 hours per day, and UP held trains for crews only 79 hours per day.

Other performance measures underscore UP's focus on service. UP's origin train performance, which reflects the percentage of trains departing on time, reached 82 percent in May, a record. Locomotive terminal dwell time dropped to 13.5 hours. And there are no car shortages on UP. In fact, UP has over 6,500 grain cars in storage due to weak demand for grain transportation.

UP has made its greatest progress in handling western coal. During March and April, UP delivered virtually every coal train within service parameters. Through May UP moved an average of ten to eleven coal trains per day from Colorado and Utah mines. This volume should increase significantly as the West Elk mine in Colorado resumes production.

Several UP shippers formally recognized UP for its outstanding performance last year. Toyota named UP "Best Rail Carrier of the Year" in 1999. General Electric honored UP as "Intermodal Carrier of the Year." UP was Air Product's "Vendor of the Year" for 1999. Daimler Chrysler gave UP its Corporation Commodity Award in the Logistics category. And ExxonMobil recently provided a steak dinner for UP employees at Baytown, Texas, near Houston, after UP crews switched three ExxonMobil plants 1,837 consecutive times without a single failure.

UP's service slipped in June. As in prior years, the railroad shut down its coal lines serving Wyoming's Powder River Basin for a maintenance and upgrading "blitz," a shutdown that lasted from June 12 to 21. Floods closed UP's St. Louis- Kansas City mainline for a week in May. UP also has suffered several disruptive derailments since Memorial Day, including a widely-publicized incident in Eunice, Louisiana, that blocked UP's mainline to Livonia Yard for a week. And UP is engaged in very extensive projects to upgrade its tracks this summer, with more than a dozen tie gangs and three welded rail gangs at work. All of these factors affected performance and caused locomotive imbalances across the system.

UP also encountered difficulties during the last two months serving the burgeoning aggregates and cement business in Texas. (Some producers report that their sales exceed their own production capabilities, as well as UP's transportation commitments.) During May UP experienced 13 major service interruptions on important mainlines serving Texas and Louisiana, including the Eunice derailment. As a result, UP found itself short of locomotives for rock service.

Service to rock shippers has improved over the last two weeks. UP recently leased 47 more locomotives, now arriving, all of which will go to Texas for rock and chemical service. UP also expects to receive an extraordinary number of high-horsepower locomotives over the next month. This influx of 90 4,000- to 6,000-horsepower units will satisfy UP's demands for locomotives across the railroad.

B. Additional Service Improvements <u>Resulting From the UP/SP Merger</u>

1. <u>"Express Lane" Service</u>

UP, CSX, and four Northern California shortline railroads are cooperating to offer a new joint service from California to Chicago, New York City, and Boston that is returning carloads of perishable shipments to the railroads. Decades ago, SP and UP hauled multiple trainloads of fresh produce from California's Central Valley to eastern markets every day, but the railroads lost that business to trucks. Since April 4, 2000, inter-railroad cooperation and excellent service have been attracting carload perishable shipments back to the railroads. Five railroads gather perishable shipments in California. UP gathers perishables along its line from Bakersfield to Roseville. San Joaquin Valley Railroad gathers additional shipments from the Central Valley. Stockton Terminal & Eastern collects shipments from the Stockton area. California Northern, a shortline operating north of San Francisco Bay, gathers wine and other produce. And the Yolo Port railroad originates shipments in Sacramento.

UP's Express Lane train operates from Fresno via Roseville to North Platte on a combination of SP and UP routes in 51 hours. At North Platte, shipments make a positive connection to a train assembled for CSX to run through to Selkirk Yard near Albany, New York. Shipments are transferred there to trains serving the New York and Boston markets. UP adds Oregon and Idaho potatoes to the CSX-bound train at North Platte. Other shipments make connection there to Chicago and St. Louis.

The railroads offer service to New York City in eight days and to Boston in nine days. For a slightly higher rate, customers may obtain guaranteed service. Most customers do not take that option, however, because the service has often been a day faster than advertised. As a result, UP and its partners are carrying potatoes, citrus fruits, carrots, and wine. Some of these commodities have not moved by rail for many years.

2. <u>Premium Intermodal Service</u>

UP is now providing the fastest intermodal service it has ever offered between Chicago and Northern California. Before the service crisis, UP implemented expedited Chicago-Northern California intermodal service over a combined UP/SP route. This service matched BNSF's premium intermodal service in the corridor, but UP then slowed the trains to conserve locomotives. UP not only has reinstated the fast schedules for the original trains but also added a second westbound premium intermodal train on an even faster schedule. The westbound train operates from Chicago to Oakland in less than 52 hours, serving Reno and Lathrop (in the Central Valley) en route. These trains are attracting significant new intermodal business.

UP is instituting similar improvements in Memphis-Southern California intermodal service. UP introduced premium intermodal trains between Memphis and Lathrop via Los Angeles, shortly before the service crisis, but cancelled the trains in order to conserve capacity and locomotives. UP reinstated that premium service approximately a year ago. On July 12th, UP will accelerate the schedules for a pair of standard intermodal trains in this corridor to provide a second premium schedule between Memphis and Southern California. One of the eastbound trains will connect to NS at Memphis to provide the first-ever fifth-day intermodal service from Southern California to Jacksonville, Florida. All four trains operate over the parallel UP and SP routes in Arkansas and northeastern Texas with the flow of directional running, over UP's former Texas & Pacific ("T&P") line from Dallas to El Paso, and over the SP Sunset Route between El Paso and Los Angeles.

In the I-5 Corridor, UP continues to provide excellent intermodal service between Seattle and Southern California using a combined UP-SP route.

3. <u>Other New and Improved Interline Manifest Services</u>

UP has completed the process of improving SP's interline service for manifest traffic. Before the UP/SP merger, SP delivered unblocked trains to interchange partners at most gateways, requiring the connecting carrier to switch the train and causing delays. Now shipments from former SP points move in pre-blocked run-through trains that bypass interchange points and intermediate switching.

UP and its connecting carriers have implemented numerous additional improvements in interline service, with others under development. These services benefit shippers at former SP locations, and several take advantage of merger synergies. The improvements include:

- UP and CP have created run-through service that is attracting significant new traffic via the Eastport/Kingsgate gateway on the Idaho-British Columbia border by using a combination CP-UP-SP route between Western Canada and California. Both railroads increased capacity on their lines leading to this gateway, and both are obtaining locomotives especially equipped for international service. CP and UP are also cooperating over the Minneapolis gateway, with CP blocking traffic at a North Dakota yard for UP's Centennial Yard in Fort Worth. This saves more than a day of transit time for each shipment.

- TFM, UP, and NS are working together to provide expedited service from automotive plants in Mexico to the northern half of the NS system. TFM prepares a through block of traffic for the TRRA yard in St. Louis. UP incorporates that block in a new through train at Laredo that uses directionally operated UP and SP lines to pick up traffic from other auto plants in Texas and Louisiana. UP delivers the train to TRRA, which distributes the shipments among NS trains to destinations beyond. UP is cooperating with NS and CSX regarding other St. Louis, Salem, and Sidney gateway traffic as the eastern carriers adjust their transportation plans.

- UP interline service with eastern carriers via Chicago has stabilized following the Conrail division. For CSX, UP's North Platte Yard prepares a Selkirk (Albany, New York) run-through train that handles traffic from UP and former SP points throughout the West. The train picks up additional cars at Proviso Yard in Chicago. Proviso Yard builds a second train for Cumberland, Maryland, on CSX, carrying a block of cars from North Platte. UP and NS employ a similar operating plan. North Platte sends a train to Elkhart Yard in Indiana, and Proviso launches a run-through train to Pittsburgh. UP also blocks cars at North Platte for CN; Proviso adds cars to create a run-through train for Battle Creek, Michigan. The eastern carriers provide reciprocal run-through trains for UP.

- UP and CSX are operating a second run-through train several days per week via the Memphis gateway. CSX delivers trains for the former SP Pine Bluff yard carrying traffic for Texas, Louisiana and the Southwest. CSX trains to North Little Rock Yard carry shipments for other points throughout the UP system. UP reciprocates with pre-blocked trains for Nashville, Tennessee.

- UP, NS, and CSX are restructuring run-through operations via the New Orleans gateway. As traffic continues to grow, run-through blocks can operate deeper into the NS and CSX systems throughout the South.

4. Mexico Service

Cooperative arrangements among UP, Tex Mex, TFM, and the U.S. and Mexican governments are allowing traffic through the Laredo Gateway to grow. UP's northbound traffic is running approximately 30 percent above volumes during the comparable period of 1999. Southbound volumes have increased by approximately 15-20 percent.

UP is working with U.S. Customs to develop improved pre-clearance procedures for export traffic. The first test will take place on the Canadian border at Eastport, Idaho. Once these processes are tested, they will be applied at gateways to Mexico to reduce staging of shipments for customs clearance.

C. Progress in Merger Implementation

1. Safety

UP continues to achieve significant improvements in safety, continuing a consistent trend since the merger. UP's rate of reportable injuries in 2000 improved by 24.9 percent from the same period in 1999. The rate of injuries involving lost work days declined by 25.6 percent compared to 1999. The number of grade crossing accidents declined by approximately 8 percent. Particularly in light of the major derailment at Eunice, Louisiana, however, UP is working with FRA on derailment prevention.

2. Technology and Support Systems

As we reported last year, UP has completed the transition to common information systems and support technologies as outlined in the UP/SP operating plan. With a few exceptions, UP continues to use the SP Digicon system to dispatch trains on former SP lines. Rather than convert those dispatching territories to UP's CAD II system, UP will convert the entire railroad to CAD III when it is ready.

3. Work Force Integration

With only three exceptions, UP and its labor organizations have completed merger implementing agreements covering all crafts and territories. UP and the UTU and BLE are still negotiating the second phase of the Portland consolidation; UP and the BMWE and SMWIA are still negotiating consolidation of work and territories; and UP and the IBEW are still negotiating the consolidation of seniority in the Engineering Services Department.

4. Merger-Related Capital Investments

Based on current projections, UP will have spent approximately one and one-quarter billion dollars to implement the UP/SP merger by the end of this year. This huge investment includes over $400 million in capacity expansion, almost $500 million in rail line upgrades, over $100 million in information technology, and almost $45 million to upgrade SP locomotives. UP has spent $143.5 million on merger projects this year (through May 31) and expects to spend a total of over $260 million by December 31.

Corridor Upgrades. UP's investments since the merger include more than $300 million toward the ongoing improvement of the Kansas Pacific line between Kansas City and Denver. Although UP projected capital expenditures of only $86.6 million on this line in the UP/SP operating plan, the line required much more extensive upgrading than originally estimated, and UP decided to add extra capacity to handle expected growth. UP continues to upgrade rail and will add sidings through next year so that this line can carry the ever-increasing volumes of Colorado coal that flow through Kansas City and St. Louis. This line has been closed for up to twelve hours each work day to complete track upgrades. When UP regains full use of the line in September, its coal handling capacity will greatly expand.

During the next few years, UP will invest heavily in additional capacity for its lines linking Kansas City and Ft. Worth to Los Angeles via El Paso. UP continues to add capacity on the Golden State Route, UP's primary route for expedited automotive and intermodal traffic from Chicago and Kansas City to Southern California. UP is adding several sidings and expanding Centralized Traffic Control ("CTC") this year. UP is also adding capacity on the T&P line between Ft. Worth and El Paso, a route that carries increasing volumes of traffic between Memphis and Southern California. The Golden State Route and the T&P line feed traffic at El Paso to the Sunset Route en route to Los Angeles. This line is nearing capacity between El Paso and West Colton. This situation can cause congestion and delays when even minor incidents, such as an air hose separation, affect the flow of traffic. UP plans to add second main track to the Sunset Route's El Paso-West Colton segment, especially on Beaumont Hill in Southern California.

<u>Terminal Facilities</u>. In last year's report we highlighted UP's new $143 million Davis Yard in Roseville, California, the hub of UP's routes in Northern California. After approximately six to eight months of operating and facility adjustments, Davis Yard is functioning well and as designed, providing the benefits we forecast last year. Using this yard's capabilities and cooperating with two Oregon shortlines, UP has improved service for Oregon and Washington forest products shippers who ship to California and Arizona markets. The Central Oregon & Pacific and Willamette Pacific railroads gather shipments in Oregon and pre-block trains for Roseville and West Colton. At Roseville, UP classifies shipments into trains serving yards throughout Northern and Southern California. West Colton switches the cars for Phoenix, Tucson, and other Arizona points.

In East St. Louis UP will transform the former SP Valley Yard and surrounding land into an automotive loading center for DaimlerChrysler. In Chicago, neighborhood opposition frustrated UP's plans to build a new intermodal terminal. UP is reviewing a number of options that would allow it to expand its intermodal capacity.

UP built four new tracks at the former SP Armourdale Yard in Kansas City to facilitate movement of unit coal trains and other through trains. These tracks greatly reduce congestion in the terminal area. In one of two major developments, UP and other railroads recently began using the "Sheffield Flyover." This long, double-tracked bridge carries the KCT mainline -- used by BNSF as its transcontinental line and by Amtrak, UP, GWWR, and NS, over a river and three mainline railroads. The flyover should allow all the railroads serving Kansas City to provide better service. In the second major development, BNSF, UP, and KCT will open a joint dispatching center for the Kansas City area by September.

At two Texas terminals, UP has implemented operating plans from two mergers, UP/SP and UP/MKT, to speed shipments to Mexico. As predicted in the UP/SP operating plan, UP's SoSan Yard in San Antonio is now used to stage cars destined to Mexico that have not pre-cleared customs. As this yard is much closer to the Mexican border than the former storage facility at Ft. Worth, it allows faster service when cars are released. Meanwhile, UP uses Ney Yard in Ft. Worth to clean and repair empty grain cars and assemble them into unit trains for movement to loading facilities, as originally planned in the UP/MKT merger operating plan. (Traffic to Mexico grew faster than expected, delaying this step.) Using Ney Yard to assemble grain trains allows UP to move those trains over the most efficient route north of Ft. Worth to Midwestern loading points.

In Los Angeles, UP is expanding the former SP's Intermodal Container Transfer Facility so that it can respond more effectively to traffic peaks. UP is also expanding its East Los Angeles intermodal terminal by converting part of the former carload switching yard into intermodal tracks and parking for containers and trailers. In Oakland, UP's new consolidated intermodal terminal is in service. UP released the former WP yard to the Port of Oakland for port development.

UP has solved operating difficulties that had adversely affected its Denver terminal operations, described in last year's report. UP continues to use both the former SP North Yard and the UP 36th Street Yard, each of which prepares a daily manifest train for North Platte. North Yard also builds a train for Salt Lake City. The dwell times at these yards are now among the best on the UP system. UP is developing plans for a bridge over the BNSF line in Denver, which would improve handling of coal trains.

Houston/Gulf Coast Infrastructure. UP continues to improve and expand its facilities in Texas and Louisiana where the service crisis arose in 1997. During 2000, UP expects to invest \$192.7 million to upgrade rail lines and \$72.9 million to expand capacity in this region. For the three-year period between 1998 and 2000, UP expects to have spent a total of \$607.8 million, and additional projects are planned for 2001 and beyond.

The following projects are among those that have been completed since our last report or are underway this year:

In Houston, UP is upgrading Englewood Yard. Projects include a new hump computer and scale. UP completed CTC on the Sunset Route between Tower 26 in central Houston and West Junction. On Houston's south side, UP and BNSF are adding a critical segment of second main track between Double Track Junction and T&NO Junction. With this track in place, BNSF can switch its South Yard without blocking through trains on the HBT West Belt line. UP upgraded its Harrisburg Line and installed CTC from West Junction through T&NO Junction to Tower 30. UP is completing the interlocking and a new connection at Tower 30 and installed power switches at Pierce Junction on the Harrisburg Line.

North of Houston, UP's expanded Spring Storage-In-Transit yard will enter service this month. This expansion allows UP to store more plastics shipments awaiting sale by chemical customers to their receivers. UP has noticed a significant increase in plastics shipments going into storage in recent weeks.

Northeast of Houston, UP completed construction of additional yard tracks at Dayton Yard and, with BNSF participation, relocated the Sunset Route mainline to eliminate conflicts between through trains and switching. South of Dayton on the Baytown Branch that serves many chemical shippers, UP is seeking permits to build a new storage yard and it is investing $9.1 million this year (with BNSF help) in additional double track on the Branch. At Mont Belvieu on the Branch, UP is extending yard tracks.

Southeast of Houston, UP contributed to the cost of adding a second mainline to the former SP route between Strang and the Port of Houston's Barbours Cut container facility. This year the Port and UP are extending double track from Strang westward to Deer Park and adding CTC. UP completed new receiving and departure tracks at Strang Yard, which serves chemical customers on the Bayport Loop. UP plans to expand the classification yard at Strang in 2000, after a lease of property needed for the expansion expires.

Further east, UP completed design work for and is now constructing a new SIT yard in the vicinity of Lake Charles which will enter service next year. It also relocated the mainline through Lake Charles to eliminate conflicts between switching and through trains and expanded Lake Charles Yard. A new connection is under construction at Mallard Junction near Lake Charles. UP is upgrading the retarders at Beaumont Yard and has relocated control of Tower 74 to the joint dispatching center at Spring.

South of Houston on the line to Brownsville, UP extended yard tracks at Bloomington. It completed the important new siding at Angleton, Texas, allowing trains on the Brownsville line to operate through that busy terminal without interrupting switching. UP is rebuilding Brownsville Yard in cooperation with local agencies.

West of Houston, UP added industry support tracks at Jama, Texas, to support rock shipments. It also completed run-through tracks at SoSan Yard in San Antonio. It is upgrading the service track and fueling facilities at Kirby Yard in San Antonio, as well as expanding the Kirby automotive facility. It completed CTC between Eagle Lake and Flatonia on the Sunset Route

Several projects that UP had originally proposed will not be required due to changes in operations. For example, joint dispatching of the Houston terminal has been so successful that it has effectively generated capacity. As a result, UP no longer needs several projects, such as adding powered switches and signals on the GH&H line. The decision to adopt directional running between Houston and Beaumont eliminated the need to build additional capacity on the BNSF/UP joint line east of Houston and on UP's parallel line further north. UP had planned to add a siding at Taft, Louisiana, but instead constructed a major line relocation in the area.

UP continues to evaluate the need for capacity in Houston and throughout the Gulf Coast region and to identify ways of improving operations to serve its customers.

D. Abandonments

UP has carried out the following merger-related abandonments and discontinuances in whole or in part:

- Whittier Junction-Colima Junction, California (Docket No. AB 33 (Sub. No. 93X)).
- Magnolia Tower-Melrose, California (Docket No. AB-33 (Sub-No. 94X)).
- Hope-Bridgeport, Kansas (Docket No. AB-3 (Sub-No. 131)).
- Towner-NA Junction, Colorado (Docket No. AB-3 (Sub-No. 130)).[2]
- Little Mountain Junction-Little Mountain, Utah (Docket No. AB-33 (Sub-No. 99X)).
- Sage-Leadville, Colorado (Docket Nos. AB-8 (Sub-No. 36X) and AB-12 (Sub-No. 188)).
- Malta-Canon City, Colorado (Docket Nos. AB-8 (Sub-No. 39) and AB-12 (Sub-No. 188)).
- Gurdon-Camden, Arkansas (Docket No. AB-3 (Sub-No. 129X)).
- DeCamp-Edwardsville, Illinois (Docket No. AB-33 (Sub-No. 97X)).
- Edwardsville-Madison, Illinois (Docket No. AB-33 (Sub No. 98X)).
- Barr-Girard, Illinois (Docket No. AB-33 (Sub-No. 96)).
- Iowa Junction-Manchester, Louisiana (Docket No. AB-3 (Sub-No. 133X)).

UP has determined that the Sage-Malta-Parkdale segment of its Tennessee Pass line will be retained in place while Central Corridor capacity requirements are monitored. UP

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[2] The abandoned portion of the line was sold intact to the state of Colorado, which then leased it to an operator for revival of rail service and possible purchase, see Finance Docket No. 33857, Colorado, Kansas & Pacific Company -- Lease, Operation, and Future Purchase Exemption -- Colorado Department of Transportation, served April 7, 2000.

sold the Canon City-Parkdale portion of its Malta-Canon City, Colorado, line to another carrier, retaining overhead freight rights.

As reported earlier, UP also decided not to abandon that portion of the Edwardsville-Madison, Illinois, segment between MP 145.2 and 148.78, and not to carry out the Suman-Bryan, Texas, abandonment (Docket No. AB-12 (Sub-No. 185X)). UP has also decided not to carry out the Troup-Whitehouse, Texas, abandonment (Docket No. AB-3 (Sub-No. 134X)).

II. COMPETITION

As the merger moves toward the four-year mark, the merger and the competitive conditions imposed by the Board are promoting rail competition in the West.

First, the UP system continues to provide shippers with single-line and shorter routings that were not available prior to the merger, as well as improved equipment supply and reduced switching fees. As UP's service has improved to record levels, shippers have been increasingly enjoying these benefits.

Second, the competitive conditions -- particularly the extensive trackage and haulage rights granted to BNSF -- continue to demonstrate their effectiveness. Shippers are benefitting from BNSF's strong competition, as reflected in both the large volumes of traffic they are awarding to BNSF and the rate and service initiatives that UP has taken to meet BNSF competition. BNSF's extensive presentation in this docket on January 18, 2000, confirms this conclusion and shows that BNSF agrees.

A. Competitive Benefits of the Merger

As merger implementation moves forward for a fourth year, the merger continues to generate stronger competition.

1. <u>Single-Line Service and Shorter Routes</u>

One of the principal reasons that the Board approved the UP/SP merger was the synergies of the two railroads' networks -- the ability, by combining those networks, to produce much-expanded single-line service and shorter routes in many important corridors. With the installation of TCS across the former SP, further progress during the past year in completing labor implementing agreements, and continuing merger-related capital investments, the merged system has made ever-increasing progress in offering these synergies to the shipping public.

For several years now, the availability of single-line service and shorter routes has attracted new business to the merged system. New opportunities continue to arise. Shippers are enjoying improved service, and, in many cases, significant rate reductions.

In many instances, these enhancements of rail competitiveness have allowed customers to penetrate markets where they previously could not compete. For examples, shippers that continue to take advantage of major new single-line opportunities include: UP grain producers moving their grain to SP destinations such as the Imperial Valley and Nogales gateway; SP Pacific Northwest and California lumber producers reaching new markets at UP points and via UP junctions; UP-served South Central lumber producers reaching SP destinations; UP-served and SP-served Gulf Coast chemical manufacturers shipping their products to destinations and junctions on the other merging railroad; and SP aggregate producers reaching new destinations served by UP in the Houston area. New shorter routes continue to bring benefits to, among others: UP-served shippers using SP's Sunset Route across the Southern Corridor; SP-served Utah coal producers that cut 300 miles off their routes to export facilities and industrial coal users in Southern California; SP-served rock shippers in Texas; SP-served Louisiana shippers moving goods to Memphis and beyond; and intermodal shippers moving traffic between Memphis and Los Angeles that cut 200 miles off their route.

Over the past three years, UP has presented hundreds of specific examples of customers' taking advantage of new single-line service and shorter routes. See, e.g., UP/SP-367, Confidential Appendix A; UP/SP-345, Confidential Appendix A; UP/SP-304, Confidential Appendix A.

2. Equipment

Since October 1996, UP and SP equipment has been managed as a single fleet. As a result, UP and its shippers have enjoyed the benefits of improved car utilization that the merger application predicted. Over the past three years, UP has presented numerous concrete examples of shippers' benefitting from combining UP and SP fleets as a single source of car supply, and from the merged system's ability to acquire additional cars to satisfy shipper needs. Some of the most noteworthy examples continue to be: the use of UP's mechanical reefer fleet by SP shippers in California (see the description of UP's "Express Lane" service at p. 5 above), the acquisition of centerbeam flatcars for Pacific Northwest and California lumber shippers; and the repositioning of intermodal equipment between UP and SP facilities on the West Coast and elsewhere.

3. Switch Fees

As previously reported, the elimination and reduction of switch fees has been another important dimension of enhanced competition made possible by the UP/SP merger. As soon as the merger was consummated, switch fees between UP and SP were eliminated. These fees, frequently $495 per car, were a major obstacle to the use of the most efficient routes and to competition for shorter-haul movements against truck and alternate product sources. Switch fees between UP and SP amounted to more than $16 million, for over 50,000 cars, in the year prior to the merger.

Pursuant to the BNSF settlement agreement, as augmented by the CMA agreement, fees charged by the merged system to BNSF at "2-to-1" points were set at $130 per car ($60 per car for grain), and fees charged by SP at all other points to all railroads were reduced so that no charge was more than $150 per car. The applicants and BNSF reached further agreement that charges between BNSF and SP at all locations would be reduced to no more than $130 per car. These reductions went into effect promptly upon consummation of the merger. In the first full year following the merger, the BNSF-SP reductions alone amounted to more than $11 million on over 65,000 cars. This level of impact has continued in subsequent years.

In total, UP estimates that the elimination and reduction of reciprocal switching charges as a result of the merger and settlement agreements will exceed $100 million during the first four years following the merger. In addition to this monetary impact, these reductions have prompted new and increased traffic flows.

In addition, in February of 1998, UP and BNSF entered into a new systemwide reciprocal switch fee agreement that produced further overall reductions in switch fees (including in particular CNW's high switch fees) and greatly simplified switch fee administration on both railroads. The agreement superseded seven earlier agreements involving former constituent railroads of UP and BNSF, most involving higher charges. Reciprocal switch fees involving the entire UP and BNSF systems were standardized at $75 per car for whole grains and $130 per car for nearly all other traffic. This agreement was attributable in significant part to the merger, because the merger permitted negotiations on a basis of broad equality in switching volumes between these two railroads. UP has recently reached similar systemwide agreements with CP and CSX.

B. Effectiveness of Competition-Preserving Conditions

As conditions to its approval of the merger, the Board imposed the settlement agreements entered into between the primary applicants and BNSF and CMA and augmented them in a number of ways. The Board also granted in part Tex Mex's trackage rights application and imposed as a condition the applicants' settlement agreement with Utah Railway. All of these conditions have continued to work well during the past year.

1. Compliance With the Conditions

UP continued to devote substantial resources during the past year to complying with all merger conditions. UP's compliance with the competition-preserving conditions is described below.

a. BNSF and CMA Agreements

UP has fully complied with the BNSF and CMA agreements.

Clarifying Decisions. In the four years since the merger was approved, the Board has resolved a number of disputes regarding the scope of BNSF's rights. During the past year, the Board has resolved three disputes between BSNF and UP regarding the scope of merger conditions.

In Decision No. 86, served July 12, 1999, the Board addressed a request by BNSF for a determination whether it was entitled to access Four Star Sugar in El Paso, Texas, by providing additional clarification regarding the scope of its new facilities condition but leaving the parties to arbitrate their specific dispute. UP subsequently reached an agreement with BNSF regarding access to Four Star Sugar.

In Decision No. 88, served March 21, 2000, the Board found that Entergy is entitled to pursue a proposed build-out, ruling that Entergy had demonstrated that it could have pursued identical plans for a build-out to SP prior to the merger.

In Decision No. 89, served June 1, 2000, the Board found that AmerenUE's Labadie, Missouri, power plant is a "2-to-1" shipper entitled to BNSF service under the BNSF agreement's omnibus clause, but that the contract modification condition does not apply to AmerenUE's contract with UP.[3] UP has offered BNSF interim haulage between St. Louis and Labadie and also agreed to allow shortline Missouri Central Railroad to carry coal to Labadie. UP and BNSF are negotiating a permanent trackage rights agreement between Pacific, Missouri, and the Labidie plant.

"2-to-1" Protocol. UP continued to abide by the provisions of the protocol established by UP and BNSF to govern the listing of "2-to-1" facilities. No disputes are pending before the Board.

Further Voluntary Agreements. As previously reported, in order to facilitate BNSF's operations pursuant to the merger conditions, UP voluntarily entered into a number of haulage agreements with BNSF that were not required by the terms of the parties' settlement agreement. The agreements that had already been entered into at the time of the first annual oversight report cover El Paso-Sierra Blanca; Beaumont-Orange; Odem-Corpus Christi; Pine Bluff-Camden; Shreveport-Tenaha; Texarkana-Shreveport; and service to Nevada Paired Track customers, to Turlock, Fullerton and South Gate, California, and in the Baytown, San Jose, Stockton, Salt Lake City and Lake Charles areas. As previously reported, UP and BNSF

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[3] AmerenUE is seeking reconsideration of this portion of the decision.

developed an additional haulage agreement for traffic between Pine Bluff, Arkansas, and the "2-to-1" points of Paragould, Arkansas, and Dexter, Missouri. As also previously reported, a number of these agreements, including the Odem-Corpus Christi and Shreveport-Tenaha haulage, are no longer in use because BNSF is instead operating trackage rights trains at those locations. More recently, UP and BNSF have entered into additional new haulage agreements that cover Warm Springs-San Jose and Sacramento-Polk, and they have formalized a haulage arrangement for Midvale-Salt Lake City traffic.

Also, Utah Railway has continued during the past year to serve as BNSF's designated agent for switching customers in the Utah Valley. UP consented to this pursuant to its right of consent under the BNSF agreement to third-party feeder service arrangements.

Implementation Steps. Operating and data systems were put in place for immediate commencement of BNSF service upon consummation of the merger, and UP and BNSF have worked together since the merger to refine those systems. UP and BNSF now have in place automated systems that allow the railroads to exchange accurate and up-to-date information regarding each railroad's trackage rights trains. UP and BNSF had been conducting weekly conference calls to address data exchange issues, but they agreed last year that resolution of data issues had progressed to the point where it was no longer necessary to continue these calls.

As previously reported, in March 1997, UP and BNSF developed a formal process to record, monitor and resolve day-to-day operational issues that arise out of the trackage rights, haulage and reciprocal switching arrangements between the railroads. A special problem-log database was created that allows employees of both UP and BNSF to add and update problems. Due to a significant decrease in both call volume and problem logs from BNSF, the use of the separate database was discontinued as of August 1, 1999, and calls from BNSF are now directed to UP's National Customer Service Commodity Teams for resolution. Since this change was implemented, UP has responded to BNSF problem logs within four hours 93 percent of the time, and between January 1, 2000 and June 16, 2000, there have been only 189 problem log entries, as compared to 651 over the same period last year. The sharp decline in log entries and UP's rapid responses reflect UP's efforts to ensure that BNSF receives the full benefit of the merger conditions. UP also continues to maintain the position of Manager Interline Service Resolution in the National Customer Service Center's Service Quality Team to resolve issues that require escalation.

Dispatching Protocol. The BNSF-UP dispatching protocol has continued to work well. Both parties have exercised their rights to monitor the dispatching of their trains by the other, and issues that have arisen regarding dispatching on trackage rights lines have been resolved quickly and cooperatively. BNSF has a full-time manager at the Harriman Dispatching Center, and UP has maintained a full-time manager at BNSF's Fort Worth Dispatching center to facilitate the movement of BNSF trackage rights traffic.[4]

In the past, BNSF claimed that UP engaged in discriminatory dispatching of its trains over UP trackage rights segments. UP and BNSF developed, at substantial expense, an automated measuring system to evaluate this claim, and it demonstrated conclusively that the claim was meritless. In fact, comparisons of transit times for comparable BNSF and UP trains

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[4] In addition, UP and BNSF continue to participate successfully in the Houston-area regional dispatching center in Spring, Texas, and they implemented consolidated dispatching in Southern California and the Powder River Basin, as well. UP and BNSF are planning to begin operations in a consolidated dispatching center that will control operations throughout the Kansas City terminal area in early September.

on trackage rights segments showed that BNSF trains generally experienced faster transit times. BNSF's claims of discriminatory dispatching have been replaced by an ongoing, cooperative effort by both railroads to monitor trackage rights operations over all segments on which one railroad operates over the other.

Line Sales. The BNSF settlement agreement provided for the sale to BNSF of three line segments: Dallas-Waxahachie (completed Sept. 20, 1996); Iowa Junction-Avondale (completed Dec. 15, 1996); and Keddie-Bieber (completed July 15, 1997).[5]

Connections. UP work on connections to facilitate BNSF trackage rights operations has been completed at all locations. On June 16, 2000, UP proposed to BNSF that it construct a short connection from BNSF to UP at Pacific, Missouri, to give BNSF a direct route to the AmerenUE plant at Labidie. BNSF is considering that proposal.

Capital Reserve Fund. Section 9c of the BNSF agreement established a $25 million capital reserve fund to finance projects on the trackage rights lines required to accommodate the operations of BNSF and UP on those lines. The fund has now been exhausted. The major projects that have been financed from the fund include:

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[5] As previously reported, as part of an overall agreement under which BNSF joined in the Spring regional dispatching center, UP and BNSF agreed on February 18, 1998 to exchange undivided half-interests in UP's line between Iowa Junction, Louisiana, and Houston (Dawes), Texas, and BNSF's line between Iowa Junction and Avondale, Louisiana. The agreement also gave UP trackage rights over BNSF's line between Beaumont and Navasota, Texas, allowing trains to bypass Houston, and further clarified limitations on UP's liability for expenditures that have been and may in the future be made to upgrade the Iowa Junction-Avondale line. In addition, the agreement allowed BNSF new access to customers along the former-SP line between Houston and Iowa Junction. The access, which did not require Board action, went into effect immediately. The Board exempted the exchange of ownership interests in Finance Docket No. 33630, Burlington Northern & Santa Fe Ry. & Union Pacific R.R. — Acquisition Exemption — Lines Between Dawes, TX, & Avondale, LA, served Sept. 29, 1998. UP expects the final definitive agreements to be signed shortly.

Project	UP Cost Estimate
Avondale Connections	6.1 million
Iowa Jct. Siding	5.5 million
CTC, Echo TX to Iowa Jct.	3.4 million
El Pinal Crossing	3.7 million
Stockton Connection	4.0 million
AEI Readers	0.5 million

Storage-in-Transit Capacity. As required by the CMA agreement and the Board's merger approval decision, UP has continued to make storage-in-transit ("SIT") capacity available to BNSF at Dayton Yard, near Houston, and at Beaumont, Texas. Most of this capacity is at Dayton, where BNSF and the facility operator have constructed receiving and departure tracks to facilitate BNSF's use of the facility.

New Facilities. In Decision No. 75, served October 27, 1997, the Board held that it was necessary to determine on a case-by-case basis whether a particular shipper facility qualified as a "new facility" for purposes of the condition giving BNSF the right to serve such facilities on lines where BNSF has trackage rights. The Board further addressed the new facilities condition in Decision No. 86, served July 12, 1999, by clarifying when a new facility will be deemed to be "on" a trackage rights line. UP has promptly responded to BNSF requests for confirmation of its ability to access new facilities. Since Decision No. 86, there have been no disputes on this subject.

Joint Service Committee. The Joint Service Committee provided for in the parties' dispatching protocol has met four times since the last annual report, in August, December, March, and June. Numerous other informal communications have occurred to follow up on issues addressed at those sessions. Among the merger-related issues addressed were: train performance in trackage rights corridors; development of additional train performance measurements; BNSF's use of former SP Gulf Coast SIT facilities; and the status of various capital projects funded out of the $25 million joint capital reserve fund.

Segregated Funds. In Section 6 of the CMA agreement, the applicants agreed to place trackage rights fees received under the BNSF settlement agreement into two dedicated funds, one with respect to trackage rights lines in Texas, Louisiana, Arkansas, Missouri and Illinois, and one with respect to the trackage rights lines in the Central Corridor and California. Applicants agreed that the money in those funds would be spent on (a) maintenance on those lines, (b) offsetting depreciation of those lines, (c) capital improvements on those lines, and (d) costs for accounting necessary to administer the two funds. As UP has shown in prior quarterly reports, expenditures on the trackage rights lines are greatly exceeding the trackage rights revenues. The following table provides information regarding the two funds through the quarter ending March 31, 2000, the latest date for which the data has thus far been compiled. (In light of the great excess of outlays over fees, we have not compiled data on capital expenditures on the lines, which have been substantial.)

	Texas, Louisiana, Arkansas, Missouri and Illinois	California and Central Corridor
REVENUE		
Trackage Rights Fees	$64,335,109	$61,886,492
Capacity Improvement Fees	0	0
Total	$64,335,109	$61,886,492
EXPENSES		
Maintenance	$124,843,490	$86,342,087
Depreciation	119,606,578	90,633,536
Capital Expenditures	not calculated	not calculated
Accounting Expenses	77,298	77,298
Total	$244,527,366	$177,052,921

Contract Reopener Process. The CMA agreement, as further augmented by the Board, provided that UP must allow all "2-to-1" shippers to divert to BNSF up to 50% of contracted-for volumes under contracts in effect when the merger was consummated. In Decision No. 89, served June 1, 2000, the Board ruled that the this condition no longer applied to a contract between UP and AmerenUE that had been significantly amended after the time the merger was consummated. Ameren UE sought reconsideration of that decision on June 21.

As explained in our July 1, 1997 report, most affected contracts were of one-year duration and thus have now expired, and most shippers with affected contracts elected to take no action in response to the notices they were sent setting forth their rights under this provision. However, a substantial number of shippers did elect, in lieu of exercising the formal 50%

reopener option, to negotiate new contracts with UP to supersede the pre-merger contracts prior to their expiration.

I-5 Corridor. As previously reported, the I-5 proportional rate agreement went into effect on July 15, 1997, simultaneously with the Keddie-Bieber line sale. UP's trackage rights over BNSF's Bend-Chemult segment also went into effect on that date. In past reports, UP has provided many examples of traffic moving under the proportional rate agreement and BNSF traffic moving over the Bieber line.

UP Trackage Rights on BNSF. UP has exercised the following trackage rights that it received over BNSF lines as part of the BNSF settlement agreement: rights at Superior, Wisconsin, to facilitate access to the MERC Dock coal facility; rights between Mojave and Barstow, California, which have been used to bypass the Los Angeles Basin for such movements as industrial sand and Utah coal bound to facilities in Central California; overhead and local service rights on the Dallas-Waxahachie and Iowa Junction-Avondale lines that were sold to BNSF.

b. Tex Mex Trackage Rights

As with the BNSF rights, UP had operating and data systems in place to support Tex Mex trackage rights operations when those operations commenced on October 8, 1996. As previously reported, as a result of UP's institution of directional operations between Beaumont and Houston, UP agreed to provide Tex Mex with additional trackage rights over the former-SP line between those points so that Tex Mex could operate with the flow in each direction.

As previously reported, several construction projects facilitated the movement of Tex Mex trains. New connections were constructed at Flatonia and Robstown. New sidings were constructed south of Flatonia at Adel, Texas, and at Robstown.

In 1998 Tex Mex and its affiliate KCS proposed to acquire and rehabilitate UP's line between Rosenberg, Texas, and Victoria, Texas, in order to shorten Tex Mex's route between Laredo and Houston. After lengthy negotiations, the parties have now reached agreement for Tex Mex to acquire the portion of this line between Mileposts 2.5 and 87.8, and to receive overhead trackage rights over the remaining segments of the line (near Rosenberg and Victoria) permitting Tex Mex to connect to the UP lines over which Tex Mex already has trackage rights. Consummation of the sale and trackage rights grant is contingent on the Board's authorization or exemption. UP expects Tex Mex to submit a petition seeking such an exemption in the near future. Tex Mex will be able to use its new trackage rights both for traffic having a prior or subsequent movement on Tex Mex's original Laredo-Robstown-Corpus Christi line as well as traffic originating or terminating at shipper facilities located on the portion of the Rosenberg Line that Tex Mex will acquire. UP has also agreed, upon completion of the sale of the Rosenberg Line, to modify the terms of Tex Mex's existing trackage rights to permit Tex Mex to handle traffic to/from Rosenberg Line shipper facilities.[6] When Tex Mex begins freight operations over the Rosenberg Line, it will relinquish its existing trackage rights over UP's other lines between these points.

c. Utah Railway Trackage Rights

The Utah Railway trackage rights remained fully operational during the past year, with all necessary support systems in place.

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6 Tex Mex has agreed that it will not be permitted to use its new or existing rights to handle traffic originating or terminating at locations on lines connecting to the Rosenberg Line or to/from transload facilities on the line.

2. The Conditions Are Working Well

Each of the competitive conditions continues to work to provide effective competition.

a. BNSF

BNSF continues to provide vigorous and effective competition using the rights it received as a condition to the merger.

BNSF Service. As we have previously reported, BNSF rapidly made the transition from interim haulage, which had gone into effect immediately following the merger at all points that BNSF had the right to serve, to full trackage rights operations in all major corridors.

BNSF is operating trackage rights trains over virtually all the lines where it has the right to do so. The sole exception is that BNSF has not used its rights to St. Louis, except for occasional movements, because it has preferred to work with IC to move traffic between Memphis and connections with Eastern carriers.

UP continues to handle BNSF traffic in haulage service between Houston and Brownsville, as provided for in the settlement agreement, as well as at several other locations mentioned above. UP also continues to provide haulage for traffic moved by BNSF to and from "omnibus" points -- i.e., "2-to-1" points not located on BNSF trackage rights corridors -- pursuant to UP's June 1997 offer to provide service to and from all such points via haulage pending any request by BNSF for an alternative form of access. Significant BNSF haulage movements were handled to or from the following "omnibus" points during the past year:

- Livermore CA (haulage to/from Warm Springs, CA)
- Trevarno, CA (haulage to/from Warm Springs, CA)

- Dickinson, TX (on the former Galveston, Houston and Henderson Railroad) (haulage to/from Houston, TX)
- Great Southwest, TX (haulage to/from Ft. Worth, TX)

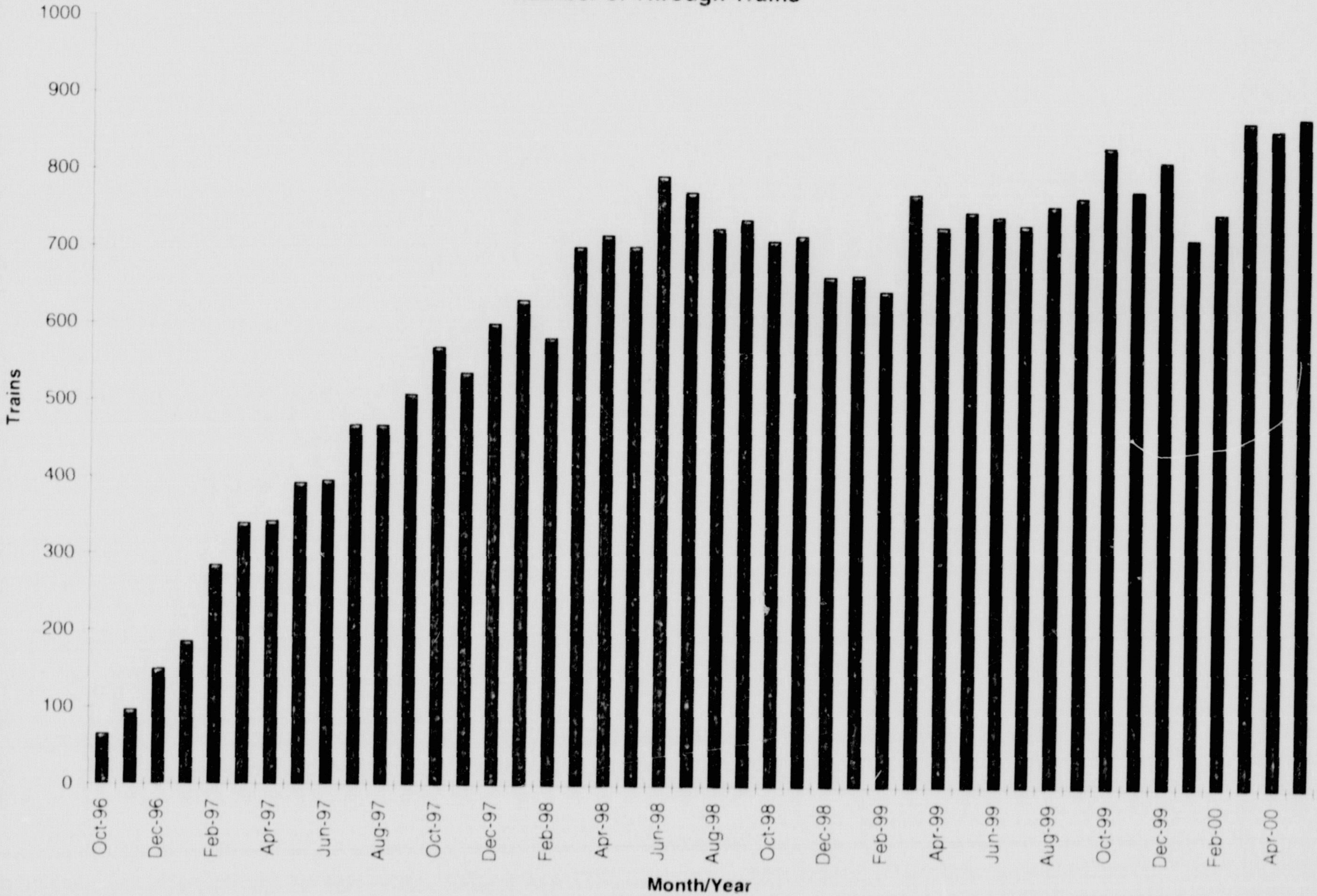
BNSF Trackage Rights Volumes. The volume of traffic handled by BNSF pursuant to its trackage rights continued to increase this year. For the past three years, after reviewing BNSF's substantial trackage rights volumes and the competitive service BNSF was offering in all major corridors, the Board found that the merger conditions had effectively preserved competition.

Through May of 2000, BNSF had operated a total of 26,943 through freight trains over the trackage rights lines since the commencement of operations in October 1996. This is shown in Exhibits #1, #2 and #3, depicting, by month, the numbers of BNSF through trackage rights freight trains and the number of cars and tons on those trains.

As the exhibits show, the monthly number of BNSF trackage rights trains had grown to 875 in May 2000 -- greater than the 751 trackage rights trains that BNSF operated a year earlier, in May 1999, and greater than the 703 trackage rights trains that BNSF operated in May 1998. BNSF tonnages have also increased, reaching 4.8 million gross tons in May 2000, compared with 3.8 million gross tons in May 1999, and 3.3 million gross tons in May 1998. And cars moving in through trackage rights trains have also increased, reaching 59,777 (30,330 loads and 29,447 empties) in May 2000, compared with 47,176 (25,401 loads and 21,775 empties) in May 1999, and 40,802 (21,889 loads and 18,913 empties) in May 1998. Not only has the number of trains increased, but the tonnage and number of cars carried on each train have increased as well. Gross tons per train were 5,539 in May 2000, compared with 5,000 in May 1999, and 4,630 in May 1998. Cars per train were 68 in May 2000, compared with 63 in May 1999, and 58 in May 1998.

Exhibit #1

BNSF Trackage Rights
Number of Through Trains



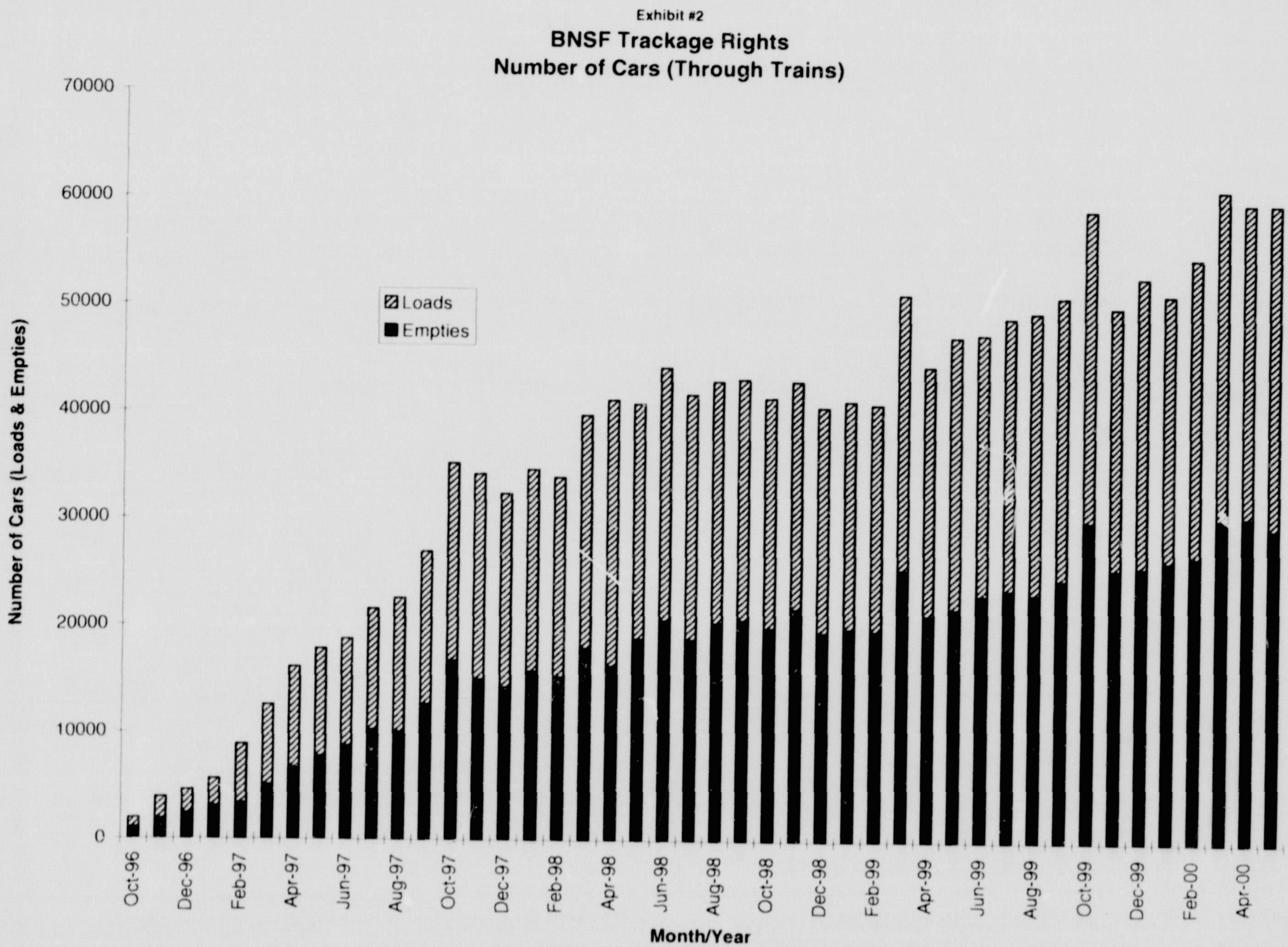


Exhibit #2
BNSF Trackage Rights
Number of Cars (Through Trains)
Number of Cars (Loads & Empties)
70000
60000
50000
40000
30000
20000
10000
0
Loads
Empties
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Oct-99
Dec-99
Feb-00
Apr-00
Month/Year

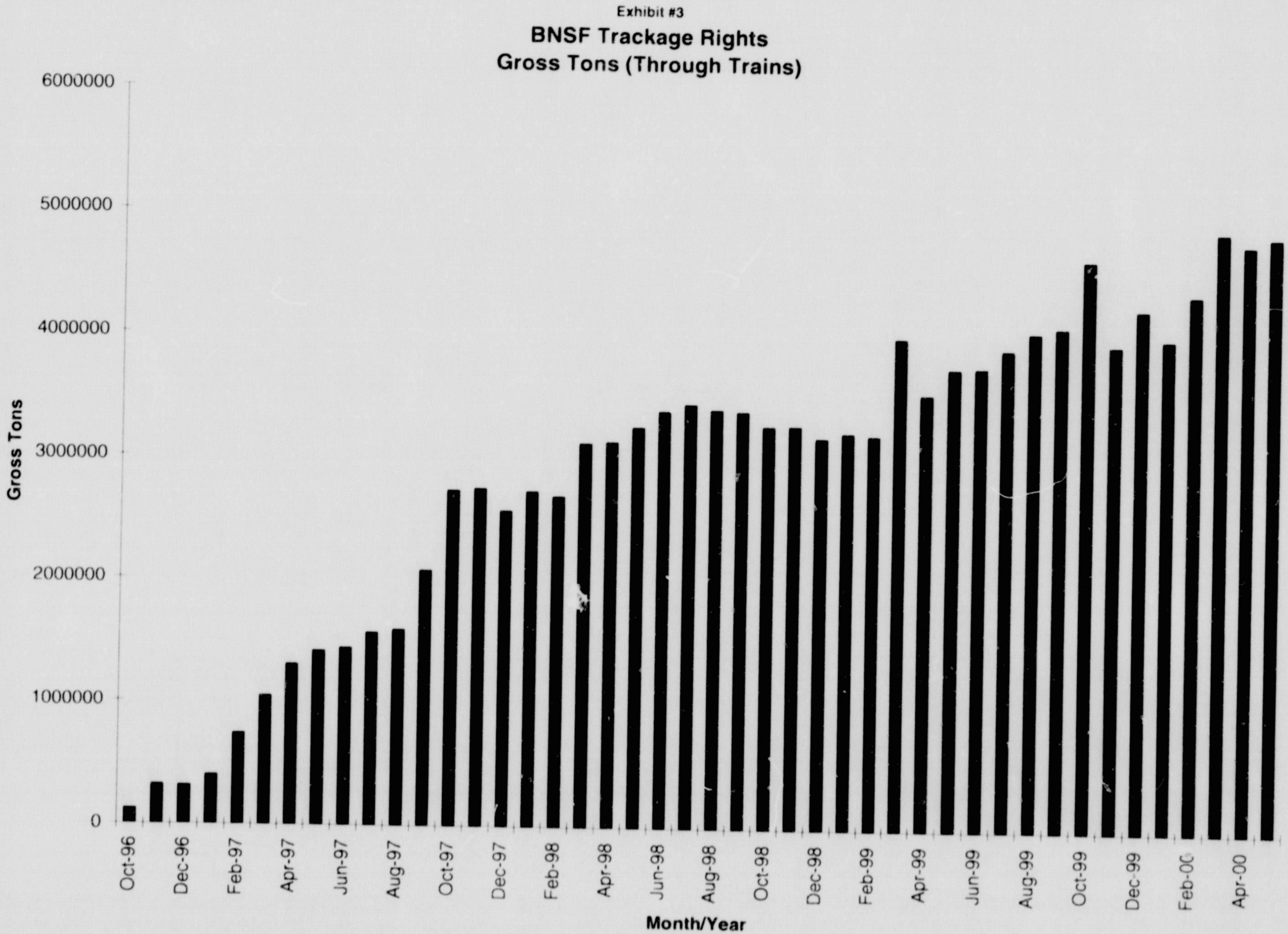


Exhibit #3
BNSF Trackage Rights
Gross Tons (Through Trains)
Gross Tons
6000000
5000000
4000000
3000000
2000000
1000000
0
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Oct-99
Dec-99
Feb-00
Apr-00
Month/Year

Another way of measuring the continued growth of BNSF's traffic volumes on trackage rights through trains is to examine average monthly data from the four periods UP has used to submit traffic data in the Board's oversight proceedings. The four periods are October 1996-May 1997; June 1997-May 1998; June 1998-May 1999; and June 1999-May 2000. In those four periods, average monthly trains have grown from 232 in the first period, to 574 in the second, to 725 in the third, to 793 in the most recent period. Average monthly tons have grown from 703,822 in the first period, to 2,467,520 in the second, to 3,423,944 in the third, to 4,295,705 in the most recent period. Average monthly cars have grown from 8,940 in the first period, to 31,828 in the second, to 43,459 in the third, to 53,768 in the most recent period. These data also show that tonnage and number of cars per train is increasing faster than the number of trains. Average monthly tons per train have grown from 3,034 in the first period, to 4,299 in the second, to 4,723 in the third, to 5,420 in the most recent period. Average monthly cars per train have grown from 38 in the first period, to 55 in the second, to 60 in the third, to 68 in the most recent period.

These figures do not include the many local trackage rights trains that BNSF has also operated. Much of the business on these local trains connects directly with BNSF's through trains at BNSF's own terminals, rather than connecting through trackage rights trains -- and thus represents still further traffic secured by BNSF because of the merger conditions. Through May 2000, BNSF had operated a total of 970 locals between Houston and Iowa Junction, 693 locals between Temple and Waco or Elgin, Texas; and 632 locals between Richmond and Warm

Springs or Oakland, California.[7] These trains handled 123,191 loaded and empty cars. In addition, since commencing service as BNSF's agent for local train operations in the Utah Valley on April 1, 1997, the Utah Railway has operated some 3,337 local trains, carrying a total of some 80,600 loaded and empty cars.

BNSF also continues to move appreciable volumes via haulage, though more and more of BNSF's operations have shifted to trackage rights over time. In May 2000, loaded and empty haulage cars totaled nearly 3,100. Almost half of these moved to and from Brownsville, with the remainder spread among such other locations as Lake Charles, Louisiana; Orange, Texas; the Northern California area; and the "Paired Track" in Nevada.

BNSF's through train frequencies in major corridors continue to underscore BNSF's competitiveness. Those frequencies -- generally two or even three trains per day in each direction -- clearly support highly competitive service:

- In the Central Corridor, BNSF operated 103 through trains in May 2000, carrying 440,836 gross tons. By comparison, the totals in May 1999 were 153 through trains and 500,234 gross tons. The totals in May 1998 were 168 through trains and 497,557 gross tons. The decline between May 1999 and May 2000 resulted from a change in the methodology and data source that UP uses to count Central Corridor trackage rights trains, not any actual change in BNSF operations or volumes. If the old methodology were applied to the recent data, BNSF volumes would have remained approximately the same. BNSF's service in the Central Corridor consists of approximately two trains per day westbound from Denver to Stockton via Salt Lake

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7 BNSF has cancelled its Houston-Dayton local. In an effort to keep cars out of its yard in Houston, BNSF began running a Silsbee-Dayton manifest train in each direction, bypassing Houston. Between Houston and Iowa Junction, BNSF operates a Beaumont-Korf local, a Lafayette (Iowa Jct)-Lake Charles local, and a Dayton-Sheldon local.

City, one train per day eastbound from Stockton to Denver via Salt Lake City, and one train per day eastbound from Salt Lake City to Denver.

- In the Houston-Memphis Corridor, BNSF operated 185 through trains in May 2000, carrying 916,131 gross tons. The totals in May 1999 were 115 through trains and 692,946 gross tons. The totals in May 1998 were 116 through trains and 609,058 gross tons. BNSF is running at least two trains per day in each direction in this corridor.

- In the last of the three major BNSF corridors -- Houston-New Orleans -- BNSF operated 239 through trains in May 2000 carrying 1,372,779 gross tons. The totals in May 1999 were 166 through trains carrying 781,727 gross tons. The totals in May 1998 were 164 through trains carrying 812,718 gross tons. A portion of the increase from May 1999 to May 2000 is attributable to traffic moving in manifest trains that had previously moved in local trains.[8] BNSF service in this corridor remains at a level of approximately three trains per day -- on of them an intermodal train -- in each direction.

Another way of measuring the continued, and indeed increasing, strength of BNSF competition is to consider average monthly data from the four periods UP has used to submit data in these oversight proceedings. In those four periods, in the Houston-New Orleans Corridor, average monthly trains have grown from 67 in the first period, to 132 in the second, to 167 in the third, to 201 in the most recent period; and average monthly tons have grown from 164,116 in the first period, to 551,343 in the second, to 772,231 in the third, to 1,116,474 in the most recent period.

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[8] See note 7, supra.

In the Houston-Memphis Corridor, average monthly trains have grown from 47 in the first period, to 112 in the second, to 120 in the third, to 140 in the most recent period; and average monthly tons have grown from 154,475 in the first period, to 493,446 in the second, to 674,911 in the third, to 721,355 in the most recent period.

In the Central Corridor, average monthly trains have grown from 62 in the first period, to 138 in the second, declined slightly to 122 in the third, and then declined to 93 in the most recent period; and average monthly tons have grown from 92,656 in the first period, to 412,999 in the second, declined slightly to 373,370 in the third, and then declined slightly to 362,394 in the most recent period. As discussed above, the difference between this year's report and last year's report relates to a change in data collection methodology.

These data show BNSF's continued strength in all three major corridors.

The foregoing corridor figures do not include many other trackage rights trains, including I-5 Corridor trains that use trackage rights over UP between Keddie and Stockton California (166 trains in May 2000, versus 106 in May 1999, 78 in May 1998, and none in May 1997); trains between Houston and Corpus Christi (66 trains in May 2000, versus 84 in May 1999, 76 in May 1998, and 42 in May 1997); trains between Temple and Eagle Pass via San Antonio (53 trains in May 2000, versus 60 trains in May 1999, 50 in May 1998, and 19 in May 1998); rock trains interchanged with the Georgetown Railroad (26 trains in May 2000, versus 22 trains in May 1999, 26 in May 1998, and 21 in May 1997); coal trains to Halsted and Elmendorf Texas (29 trains in May 2000, versus 27 trains in May 1999, 12 in May 1998, and none in May 1997); grain trains to Ontario, California (8 trains in May 2000, versus 18 trains in May 1999, 13 in May 1998, and 9 in May 1997); and a variety of locals.

The continued strength of BNSF's Mexico volumes is also notable. In May 2000, BNSF operated 66 trackage rights trains to and from Corpus Christi and Robstown, principally for interchange with Tex Mex of Mexico traffic (the trains also included some Corpus Christi business and perhaps some business interchanged for Tex Mex local points). Those trains handled 6,035 loaded and empty cars and 484,948 gross tons. In May 1999, the figures were 84 trains with 6,914 cars and 538,758 tons. In May 1998, the figures were 76 trains with 6,688 cars and 436,543 tons. And in May 1997, the figures were 43 trains, with 3,332 cars and 278,836 gross tons. Eagle Pass trains also remain strong: 53 trains, carrying 4,495 cars and 350,504 tons in May 2000, compared with 60 trains, carrying 4,962 cars and 395,479 tons in May 1999, and compared with 50 trains, carrying 2,877 cars and 333,024 tons, in May 1998, and 19 trains, carrying 703 cars and 60,599 tons, in May 1997.

We noted in the first annual oversight report that, based on its own public statements, BNSF was already earning revenues from traffic moving pursuant to its merger rights at a rate representing some 20% of BNSF's estimate during the merger proceeding of a $1 billion total universe of available traffic. Today, BNSF volumes are now several times greater. It is now clearer than ever that BNSF, with its extensive Western network and infrastructure of terminals and other support facilities, was uniquely situated to mount fully competitive service over the new rights, and that there is no reason why BNSF cannot compete effectively for the entire universe of available traffic.

BNSF Competitive Successes. BNSF has continued to compete aggressively for "2-to-1" business, quoting very competitive rates and bidding on all major contracts. It continues to call on many shippers and receivers that had not been actively solicited, and to make repeated proposals in order to capture some or all of a customer's business.

In its most recent quarterly report, BNSF stated that it has already exceeded the goals it established when it was granted the merger conditions, that it is offering increasingly competitive, efficient and reliable service to shippers, and that it plans to grow more in the future. See BNSF-PR-14, pp. 2-3.

In light of the overwhelming proof of BNSF's competitiveness in the last three oversight proceedings, and the evidence in this proceeding that BNSF has continued to move growing amounts of trackage rights traffic, UP has not undertaken the expensive and time consuming process of compiling confidential exhibits listing specific examples. It is clear from UP's day-to-day experience in the marketplace that BNSF continues to compete for and capture the same types of "2-to-1" traffic that it has been capturing for the past three years, and that it continues to be a much stronger competitor that SP ever was.

Benefits for "2-to-1" Shippers Using UP. Just as important as BNSF's successes in capturing traffic, shippers at "2-to-1" points and in "2-to-1" corridors continued this year to benefit where UP retained traffic in the face of strong competition from BNSF. Again, UP has not undertaken the process of compiling lists of specific examples, as it has done for the past three years, but it is clear from UP's day-to-day experience in the market that the same types of shippers are receiving the same types of benefits as described in years past.

"2-to-1" Rates. UP has not undertaken the resource intensive process of compiling information on rates for "2-to-1" traffic as it has in past years. In its annual oversight reports for the past three years, UP has shown that in the years following the BNSF merger rates for the "2-to-1" traffic it has handled have remained steady or declined.

Build-In Condition. The CMA agreement, as augmented by the Board's merger approval decision, preserved shippers' pre-merger opportunities to build in from SP points to UP points, and vice versa, and thereby obtain rail competition. Though no build-ins have yet occurred in connection with the BNSF rights, this condition has had a competitive impact, as UP has described in past annual oversight reports. See, e.g., UP/SP-367, Confidential Appendix F.

Transload Condition. The BNSF settlement agreement permitted BNSF to serve existing and new transloading facilities at "2-to-1" points. The Board's merger approval decision also gave BNSF the right to serve new transload facilities on all BNSF trackage rights lines. This condition has proven effective, as UP has described in past oversight reports. See, e.g., UP/SP-366, p. 76; UP/SP-367, Confidential Appendix G.

New Industries Condition. The BNSF settlement agreement permitted BNSF to serve new industries at "2-to-1" points. The CMA agreement extended this right to SP-owned BNSF trackage rights lines, and the Board's merger approval decision expanded it to all BNSF trackage rights lines. Again, experience continues to show that this condition is effective. BNSF continues to serve new facilities of Total Petroleum and Conoco at Durham, Colorado, on the overhead portion of its trackage rights across the DRGW east-west mainline. BNSF is also serving a new Pilgrim's Pride feed mill near Tenaha, Texas, on the Houston-Memphis trackage rights line, and Quebecor's printing press in Fernley, Nevada, on trackage rights over the former SP line. See also UP/SP-367, Confidential Appendix H. More recently, BNSF commenced service to a new Southdown cement facility at Polk, California.

"1-to-2" Shippers. Additional competitive benefits have been realized by shippers on the Iowa Junction-Avondale line that was sold to BNSF. As a negotiated "quid pro quo" in the settlement agreement, shippers on this line that had formerly been exclusively served by SP gained service from both BNSF and UP. The shippers along that line have continued to benefit from this new competition. See also UP/SP-367, Confidential Appendix I.

Pro-Competitive Benefits in the I-5 Corridor. Finally, a further extremely significant pro-competitive "quid pro quo" aspect of the BNSF settlement agreement was the sale to BNSF of the Keddie-Bieber line, which, together with BNSF's trackage rights from Keddie to Stockton, links up the BNSF system on the West Coast and creates a second single-line rail alternative up and down the I-5 Corridor between the Pacific Northwest and the Pacific Southwest. The establishment of two new single-line alternatives in the I-5 Corridor, together with the proportional rate agreement that allows UP to compete for the business of shippers at BNSF local points and junctions by offering competitive service and rates via a BNSF-Portland-UP route, has brought to this region an enhancement of competition that was without precedent in any previous rail merger.

With the merger and its accompanying conditions, UP and BNSF now offer competing single-line alternatives from western Canadian gateways and jointly-served points in Washington and Oregon to jointly-served points in California and Arizona and western Mexican gateways. Prior to the merger, there was no single-line rail service in this huge transportation market. Shippers of lumber and panel products, for example, have taken extensive advantage of the new competition. BNSF has increased its lumber shipments in the I-5 Corridor by moving traffic from the Pacific Northwest to California points on its new single-line routes, by greatly expanding the volumes at its reload facilities in the Los Angeles Basin, and by developing new reload facilities in Arizona. BNSF's expanded use of origin reloads in Eugene, Salem and Portland, Oregon, is a further sign of its growing penetration of the lumber and panel products marketplace. BNSF has also used its new single-line ability to increase its share of petroleum shipments moving from California points to the Pacific Northwest. BNSF is operating approximately six trains per day in each direction in the I-5 Corridor.

UP customers are also benefitting from new single-line routes in the I-5 Corridor. UP-served shippers now have single-line access to the many SP-served destinations in California, as well as to Phoenix and Tucson. SP-served shippers in California and Oregon now have single-line access to important UP-served destinations for lumber and panel products such as Las Vegas. And Canadian producers in British Columbia and Alberta are taking advantage of single-line service to move increasing quantities of panel products via barge to Seattle for onward single-line movement via the UP system.

Customers are also seeing benefits from the I-5 proportional rate arrangement. Shippers have used I-5 proportional rates to move lumber, petroleum products, edible oils and other traffic between BNSF-served points in Washington and BNSF-served Canadian gateways, on the one hand, and points on the UP system, on the other hand, via the Portland routing.

Over the past three years, UP has provided dozens of examples of shippers who have benefited from new competition in the I-5 Corridor. See, e.g., UP/SP-267, Confidential Appendix J.

b. Tex Mex

Since the inception of its rights, Tex Mex has operated a total of 2,280 through freight trains through May 2000. In the period from June 1999 through May 2000, Tex Mex has averaged 63 trains per month. Exhibits #4, #5 and #6 depict, by month, Tex Mex's through trackage rights trains, and the number of cars and tons on those trains. Exhibits #7, #8, and #9

Exhibit #4

Tex Mex Trackage Rights
Number of Through Trains
(All Traffic Included)

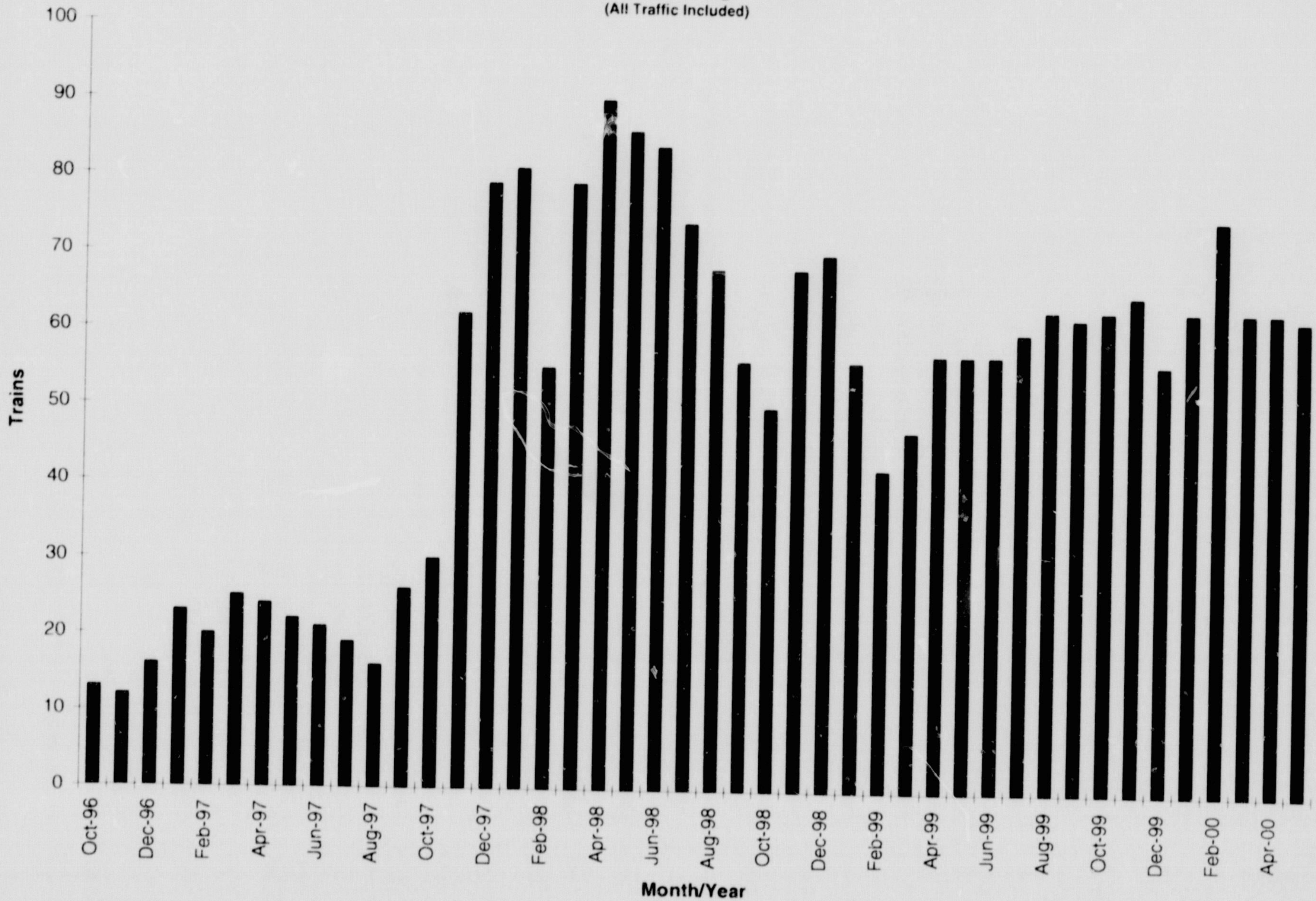


Exhibit #5

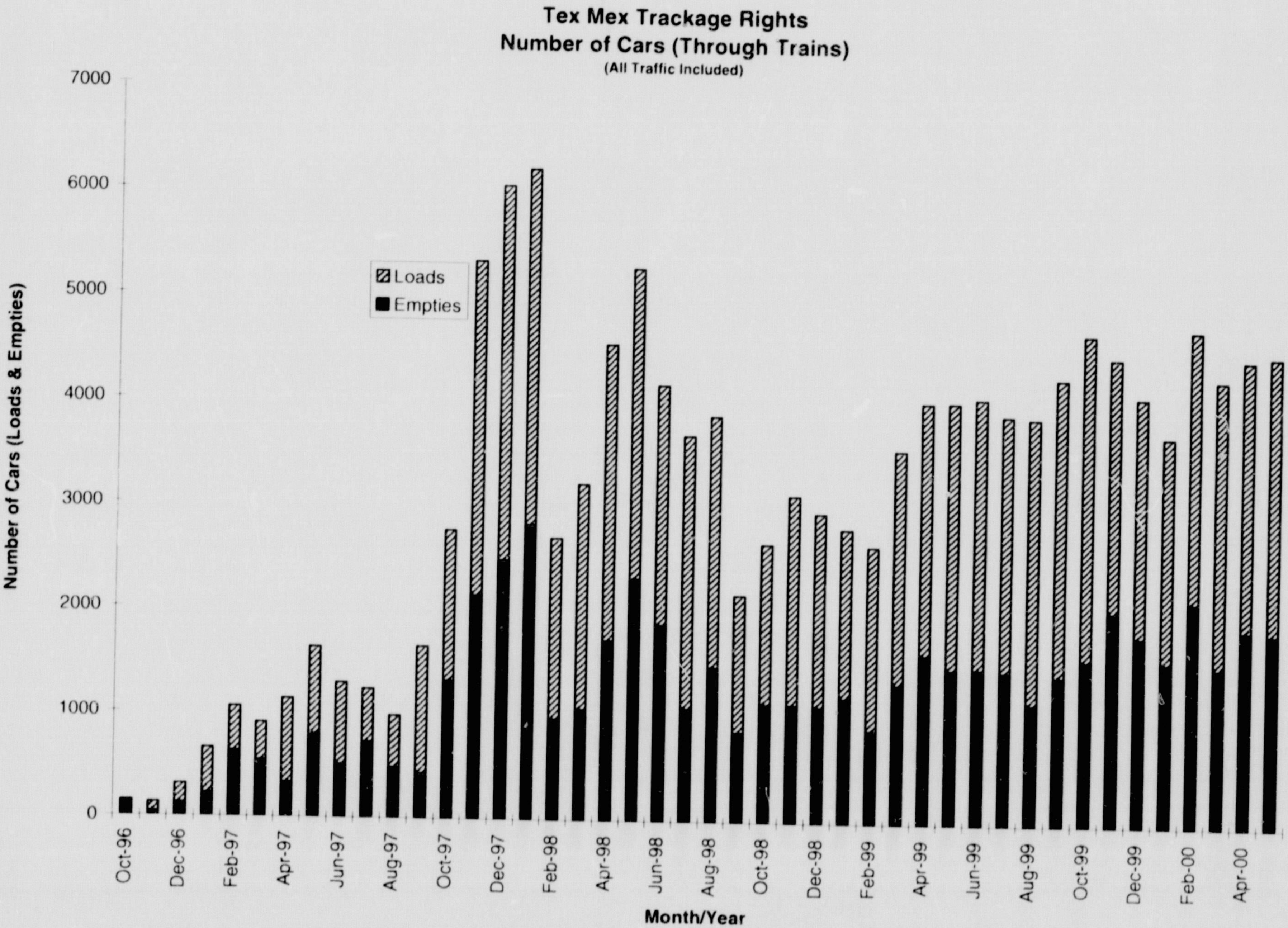

Tex Mex Trackage Rights
Number of Cars (Through Trains)
(All Traffic Included)
7000
6000
5000
4000
3000
2000
1000
0
Number of Cars (Loads & Empties)
Loads
Empties
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Oct-99
Dec-99
Feb-00
Apr-00
Month/Year

Exhibit #6

Tex Mex Trackage Rights
Gross Tons (Through Trains)
(All Traffic Included)

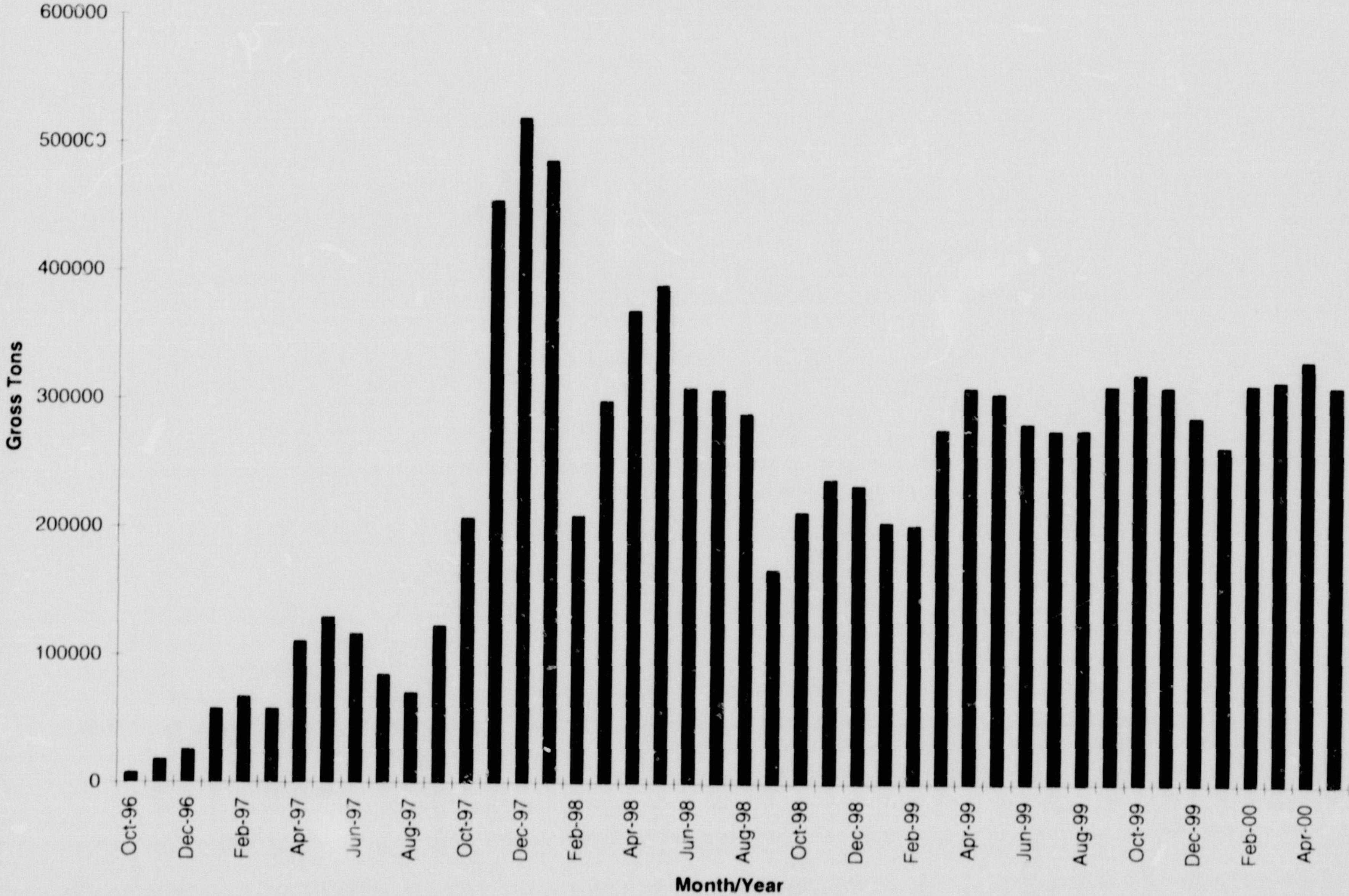


Exhibit #7

Tex Mex Trackage Rights
Number of Through Trains
(Estimated Service-Order-Related Traffic Excluded)

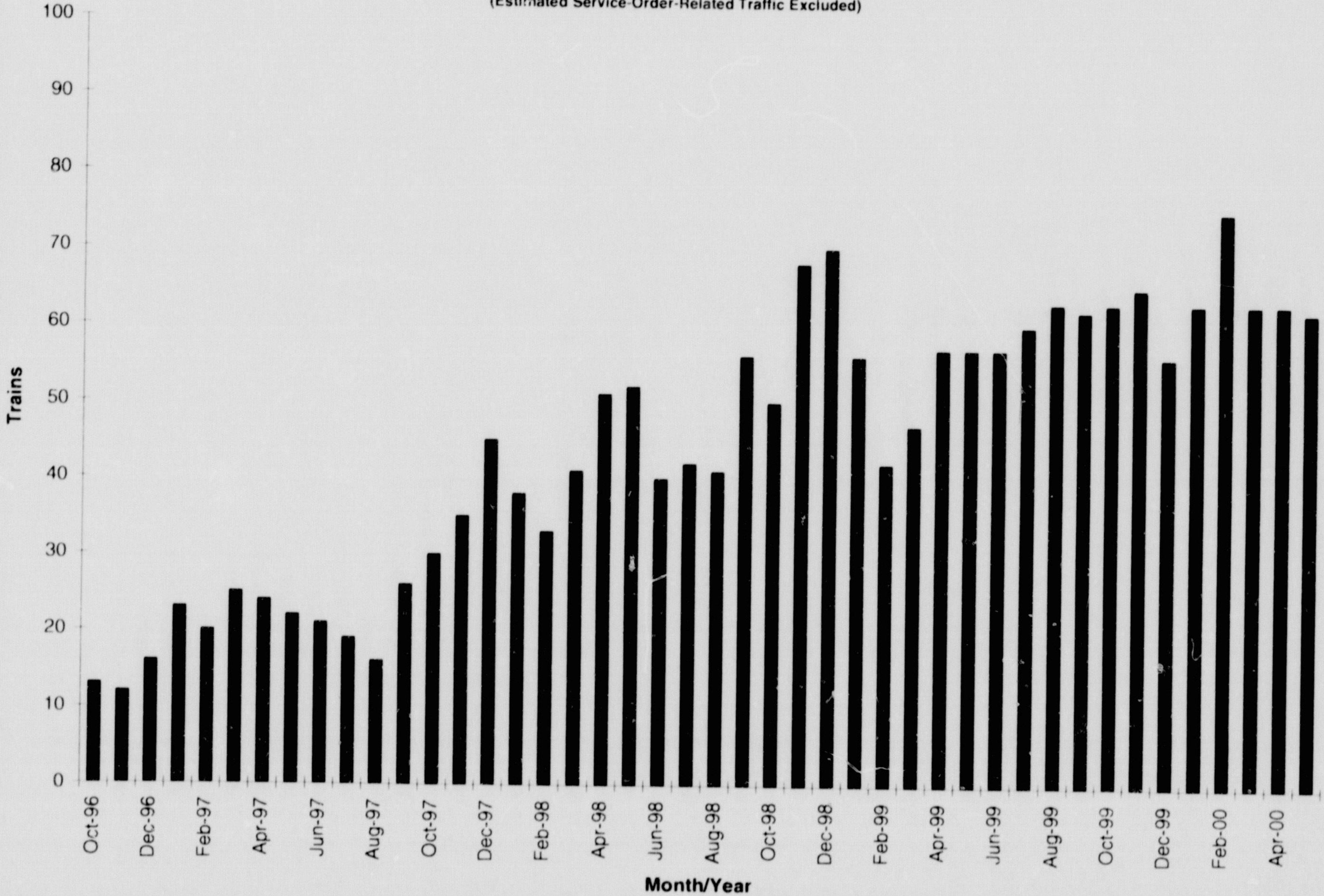
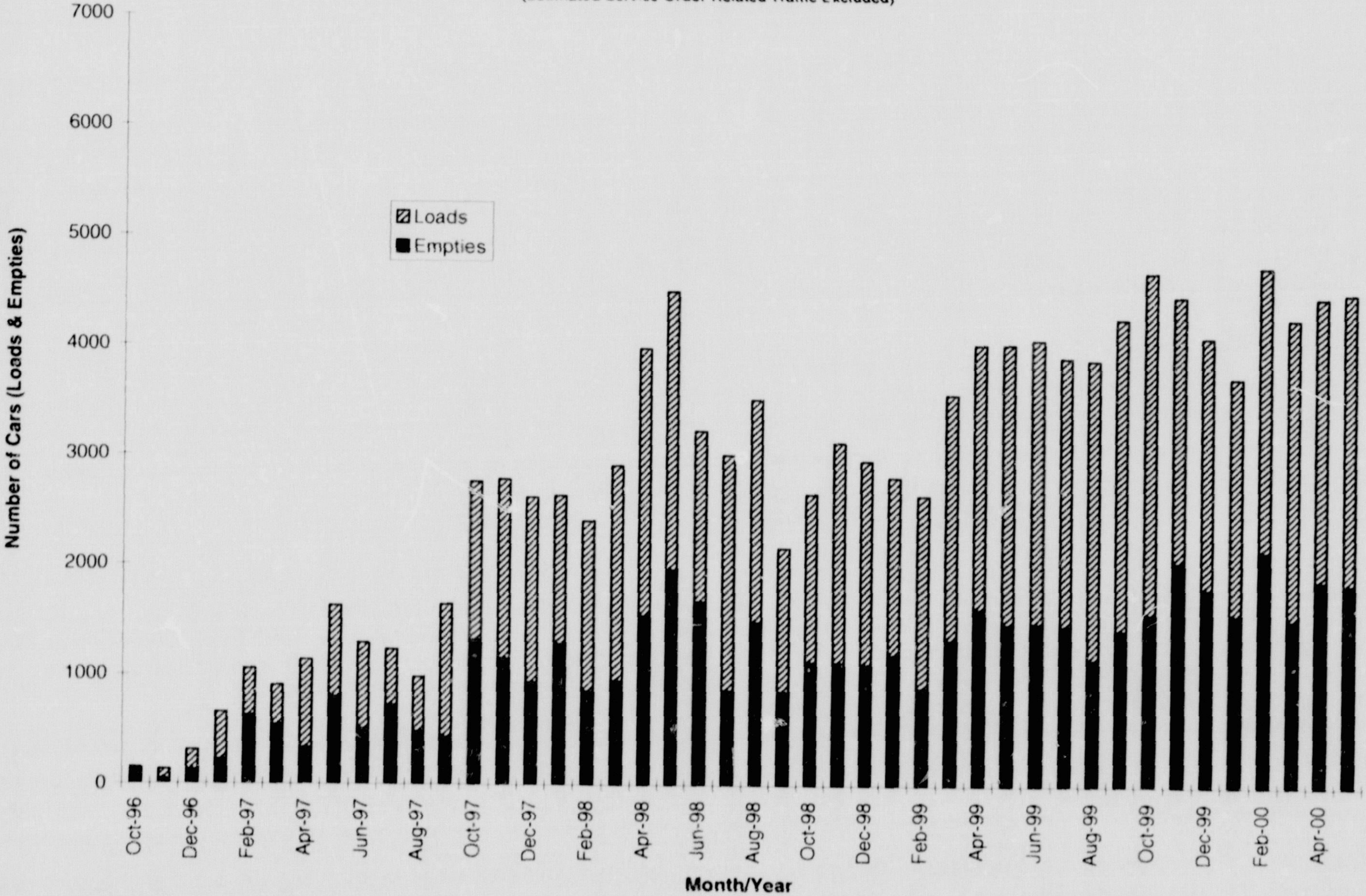


Exhibit #8

Tex Mex Trackage Rights
Number of Cars (Through Trains)

(Estimated Service-Order-Related Traffic Excluded)



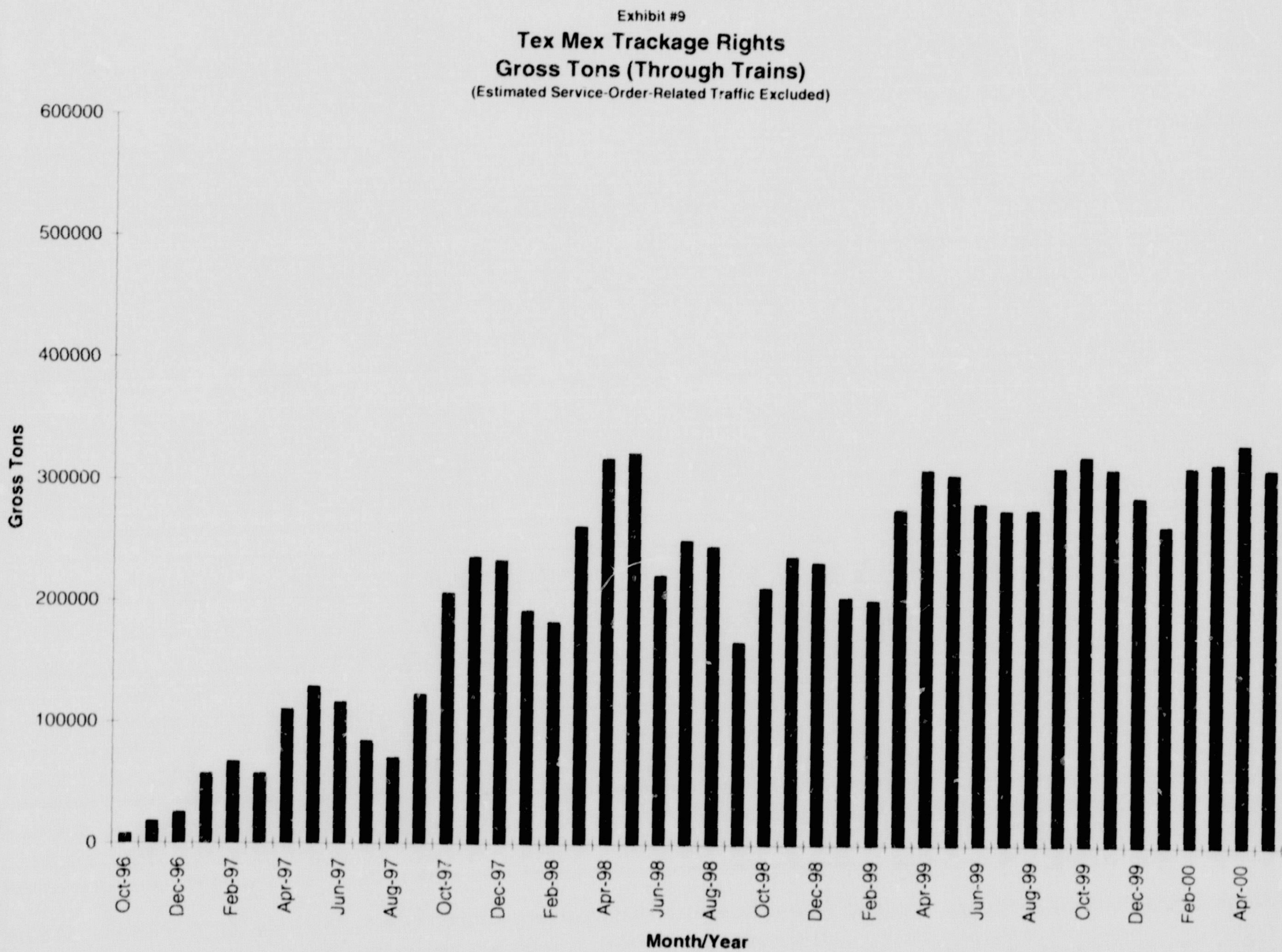


Exhibit #9
Tex Mex Trackage Rights
Gross Tons (Through Trains)
(Estimated Service-Order-Related Traffic Excluded)
600000
500000
400000
300000
200000
100000
0
Gross Tons
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Oct-99
Dec-99
Feb-00
Apr-00
Month/Year

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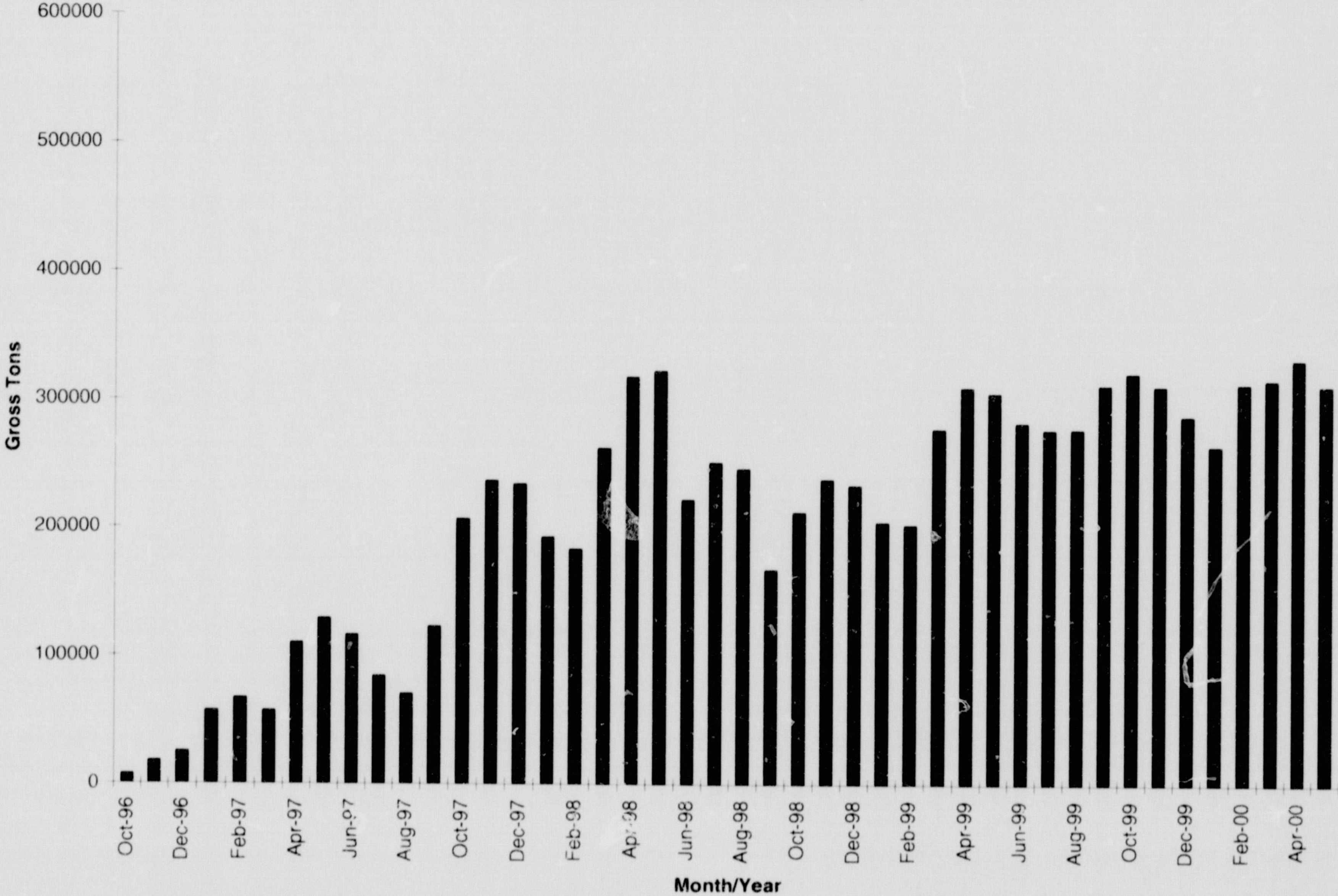
Exhibit #9

Tex Mex Trackage Rights
Gross Tons (Through Trains)

(Estimated Service-Order-Related Traffic Excluded)



present the same data, adjusted to exclude the temporary effects of the Board's Service Order No. 1518.[9]

The Board's purpose in partially granting the trackage rights conditions sought by Tex Mex in the UP/SP merger proceeding was to "address the possible loss of competition at the Laredo gateway into Mexico and to protect the essential services provided by Tex Mex to its shippers." Decision No. 62, p. 6. There is no question that competition has remained strong at Laredo and Tex Mex has remained viable subsequent to the implementation of the merger. The volume of traffic handled by Tex Mex to and from Laredo has more than doubled since the UP/SP merger. Exhibit #10 depicts the dramatic increase in Tex Mex's Laredo traffic. Tex Mex's southbound traffic over Laredo -- which has traditionally made up virtually all of its Laredo business -- was 59,976 carloads in the June 1999-May 2000 period compared with 24,953 carloads in the same period prior to the merger (June 1995-May 1996). Tex Mex's much smaller northbound volumes have increased even more dramatically, from 492 carloads in the June 1995-May 1996 period to 13,511 carloads in the June 1999-May 2000 period.

---

[9] Tex Mex's trackage rights operations were affected in two significant ways by the Board's Service Order No. 1518. First, between November 10, 1997 and January 29, 1998, BNSF and Tex Mex interchanged considerable volumes of traffic, mostly grain, at Flatonia instead of at Corpus Christi or Robstown pursuant to the Board's emergency order authorizing interchange at that location. As a result, this BNSF-Tex Mex traffic was temporarily included in Tex Mex's trackage rights volumes rather than in BNSF's trackage rights volumes. Second, in February 1998, Tex Mex commenced the operation of new trains between Houston and Tex Mex's interchange with KCS at Beaumont that carry traffic moving between Houston and points north, as permitted by the Board's emergency service order. Exhibits #7, #8 and #9 depict, by month, Tex Mex's through trackage rights trains, and the numbers of cars and tons on those trains, excluding estimates of (a) traffic interchanged with BNSF at Flatonia, (b) traffic on BNSF trains that Tex Mex handled for three months between Corpus Christi and Algoa as BNSF's agent, and (c) traffic carried in Tex Mex's Houston-Shreveport trains.

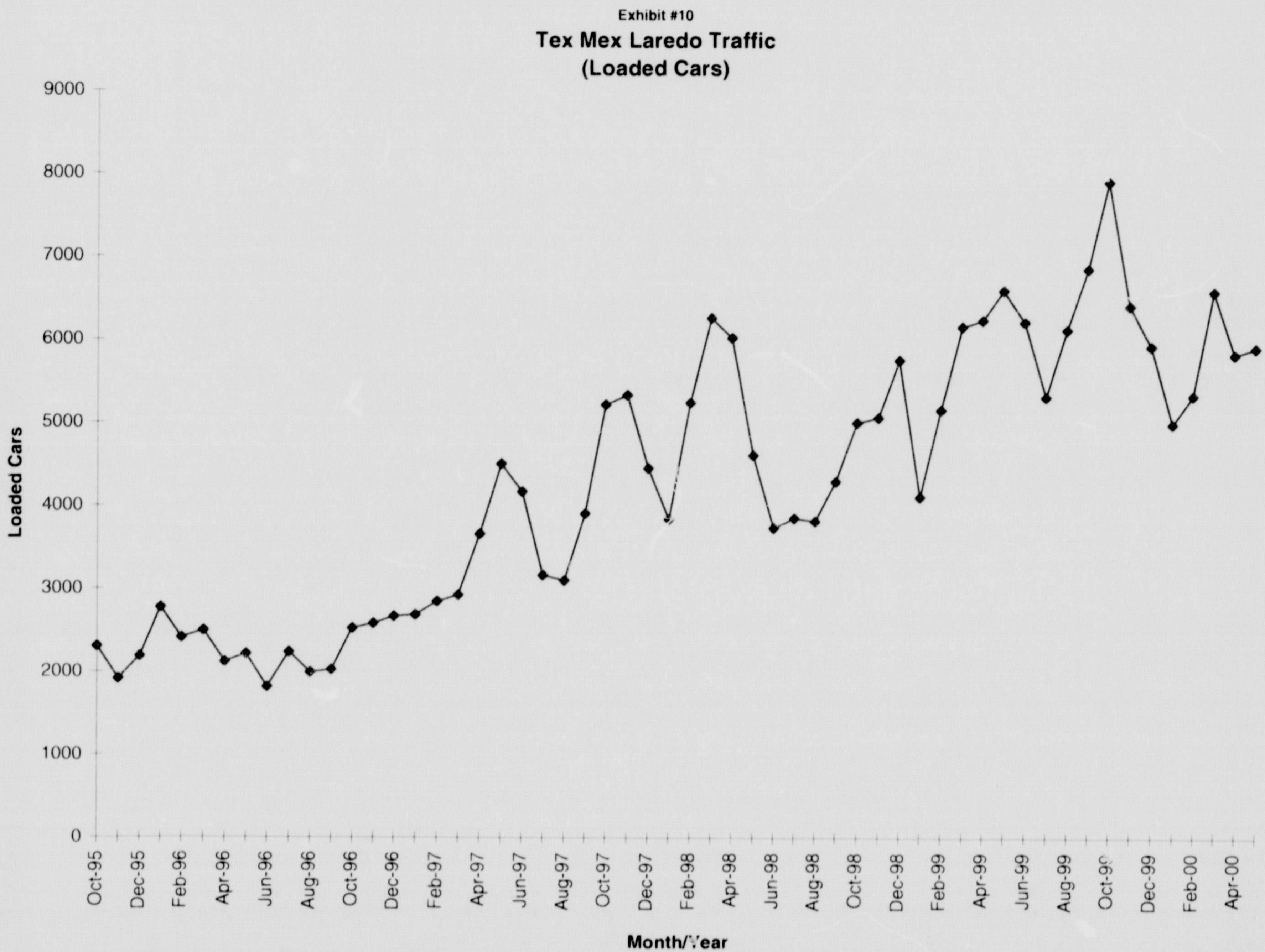


Exhibit #10
Tex Mex Laredo Traffic
(Loaded Cars)
9000
8000
7000
6000
5000
4000
3000
2000
1000
0
Loaded Cars
Oct-95
Dec-95
Feb-96
Apr-96
Jun-96
Aug-96
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Jun-99
Aug-99
Dec-99
Feb-00
Apr-00

This post-merger growth in Tex Mex's volumes and shares of Laredo traffic has occurred because the growth in the volume of traffic that Tex Mex interchanges with BNSF at Corpus Christi/Robstown and handles itself using its new trackage rights between Beaumont and Corpus Christi/Robstown has greatly outstripped the decline in the volume of traffic that Tex Mex interchanged with UP and SP. This is most readily seen by focusing on southbound volumes. Exhibit #11 overlays BNSF and Tex Mex trackage rights volumes with SP and UP Tex Mex interchange traffic and graphically demonstrates why Tex Mex's Laredo gateway volumes have increased so significantly.

Tex Mex's volumes and shares can be expected to grow even further. In December 1998, Tex Mex and BNSF reached agreement on a five-year interline divisions arrangement for traffic moving between those two carriers via Robstown to and from Mexico via Laredo.[10] In April 1999, Tex Mex, KCS and TFM announced the introduction of a new intermodal service that takes advantage of Tex Mex's new intermodal facility located in Laredo.[11] More recently, in April 2000, BNSF announced that it was "team[ing] with Tex Mex" in a "significant expansion of its North American intermodal network" by establishing new intermodal service between U.S. points and the Mexican cities of Monterrey, Queretaro and Mexico city via the Laredo gateway. BNSF Press Release, Apr. 11, 2000. In the same month, Triple Crown Services announced new five-day-a-week RoadRailer intermodal service between the United States and Mexico City, via Tex Mex and the Laredo gateway. Norfolk Southern Press Release, Apr. 25, 2000.

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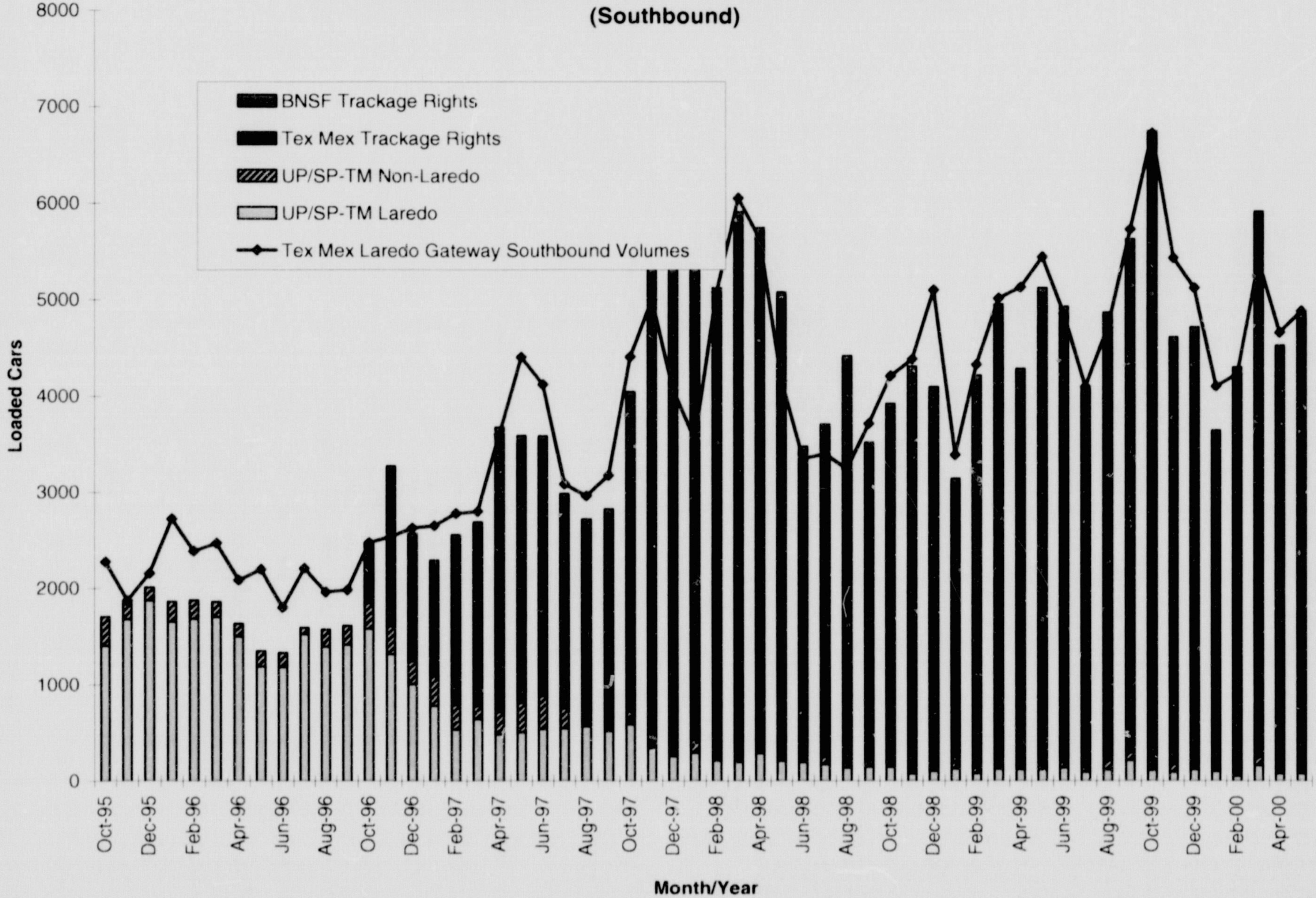
[10] See BNSF-PR-10, p. 7.

[11] See http://notes.kcsi.com/WebApps/kcspress.nsf.

Exhibit # 11

Tex Mex and BNSF Trackage Rights Traffic to Corpus Christi/Robstown and UP/SP-Tex Mex Interline Traffic (Southbound)



c. Utah Railway

Utah Railway, a "2-to-1" shortline, obtained the right to interchange with BNSF as a condition to the merger, thereby preserving competitive options for its on-line shippers. In addition, in consideration for settling issues regarding the use of joint UTAH-DRGW track, UTAH received access to the Savage coal transloading facility and the Willow Creek mine, and trackage rights to Grand Junction, Colorado, where it can interchange with both BNSF and UP. UTAH has maintained a high level of activity working as BNSF's agent operating local trains in the Utah Valley, and its trackage rights continue to act as a competitive check on UP.

C. "3-to-2" Traffic and Source Competition

Experience continues to confirm that the Board was correct in determining that the merger would have no adverse competitive effect on "3-to-2" traffic, or on source competition for such commodities as Utah and Colorado coal, Gulf Coast chemicals, and grain. In fact, competition has been strengthened for all these categories of traffic.

1. "3-to-2" Traffic

Autos. We have previously explained that the competitive benefits of the merger and the BNSF settlement for "3-to-2" traffic had been dramatically illustrated by the results of head-to-head bidding between UP and BNSF for Western automotive traffic, a large portion of total "3-to-2" traffic. In that bidding, each of the Big Three auto makers secured large savings, clearly demonstrating that competition between the new UP and BNSF networks was stronger than the three-railroad competition that preceded it. See UP/SP-367, Confidential Appendix K.

Intermodal Traffic. Competition has remained strong for intermodal traffic, the largest single category of "3-to-2" traffic. BNSF's access to New Orleans has strengthened competition for east-west international doublestack container traffic to and from the West Coast ports. UP's Los Angeles-Memphis intermodal service, by combining UP and SP routes, is winning business from BNSF because it is able to offer the shortest and fastest single-line route between Memphis and Los Angeles.

Carload Traffic. Competition for "3-to-2" carload traffic also remains strong. For example, although the merger reduced the number of railroads able to originate lumber in the Pacific Northwest from three to two, competition for this traffic has intensified, as UP has simplified rate structures, improved SP transit times and improved equipment supply. Other "3-to-2" shippers are seeing similar benefits.

2. Utah and Colorado Coal

Those who speculated that the merger would disadvantage Utah and Colorado coal continue to be proven wrong. UP has been pursuing this business with the same aggressiveness that SP had employed. Utah and Colorado coal shippers continue to benefit from UP's investment in a new export terminal in Los Angeles, which has led to significant reductions in cycle time, and from UP's investment in the Kansas Pacific line to improve the handling of eastbound Utah and Colorado coal movements.

The merged system continues to market Utah and Colorado coal aggressively. UP recently obtained new contracts for Colorado coal movements to Arizona Electric Power, Empire district Authority, Alliant Energy, Nebraska Public Power District, and Dairyland.

3. Gulf Coast Chemicals

Competition for Gulf Coast plastics and other chemicals traffic also continues to be strong. Gulf Coast chemical shippers have continued to benefit from new single-line service, shorter routes, and vigorous rate and service competition from BNSF.

4. Grain

Concerns of USDA and others that source competition for grain would be harmed continue to prove unfounded. UP grain producers continue to benefit from access to SP markets. BNSF continues to use its trackage and haulage rights to move large volumes of grain to Mexico, Arkansas, California and Utah.

Respectfully submitted,

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LAWRENCE E. WZOREK
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(202) 662-5578

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

July 3, 2000

VERIFICATION

STATE OF NEBRASKA)
) ss.
COUNTY OF DOUGLAS)

I, Woodruff F. Sutton, Vice President-Manifest Products, of Union Pacific Railroad Company, state that the information in Part I (except those subsections relating to capital investments) of the Applicants' Fourth Annual Report on Merger and Condition Implementation, 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.

Woodruff F. Sutton

WOODRUFF F. SUTTON

Subscribed and sworn to before
me by Woodruff F. Sutton this
29th day of June, 2000

Beverly A. Meeks

Notary Public

GENERAL NOTARY-State of Nebraska
BEVERLY A. MEEKS
My Comm. Exp. Sept. 2, 2003

VERIFICATION

STATE OF NEBRASKA)
) ss.
COUNTY OF DOUGLAS)

I, David Wheeler, Director-Capacity Planning & Analysis, of Union Pacific Railroad Company, state that the information concerning merger-related capital investments and the Houston/Gulf Coast Region infrastructure investments in Part I of the Applicants' Fourth Annual Report on Merger and Condition Implementation 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.

DWheeler

DAVID WHEELER

Subscribed and sworn to before
me by David Wheeler this
29th day of June, 2000

Beverly A. Meeks

Notary Public

GENERAL NOTARY-State of Nebraska
BEVERLY A. MEEKS
My Comm. Exp. Sept. 2, 2003

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 II of the Applicants' Fourth Annual Report on Merger and Condition Implementation 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 B. Peterson

RICHARD B. PETERSON

SUBSCRIBED and sworn to before me by
Richard B. Peterson this 29th day of
June 2000.

Beverly A. Meeks

Notary Public

GENERAL NOTARY-State of Nebraska
BEVERLY A. MEEKS
My Comm. Exp. Sept. 2, 2003

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that, on this 3rd day of July, 2000, 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 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

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

Michael L. Rosenthal

ATTACHMENT

ENVIRONMENTAL MITIGATION CONDITIONS

The following is a report on steps taken, and plans for future steps, in regard to the environmental mitigation conditions, which are addressed in the order they are listed in Appendix G to Decision No. 11:

D. System-wide Mitigation

1-9. These conditions have been satisfied as previously reported.

10. Security Forces. As previously reported, UP has extended to SP territory its policy of zero tolerance of vagrancy and trespassing on railroad property. UP is participating in a new nation-wide initiative by Operation Lifesaver to reduce trespassing on railroad property. UP met with the Reno Police Department regarding a zero tolerance program in late June of 1997; these discussions are on hold pending a City of Reno legal determination.

11-13. These conditions have been satisfied as previously reported.

E. Corridor Mitigation

14. EPA Emissions Standards. EPA's national locomotive emissions rule was published in the Federal Register on April 16, 1998. Since no appeals were filed by the June 15, 1998 deadline, the rule is now final. UP is working with locomotive industry suppliers to develop its compliance plan.

15. Consultations With Air Quality Officials. UP has held detailed discussions with environmental officials in the states of Arizona, Colorado, Illinois, Nevada, Oregon, Texas, Washington and Wyoming. Dialogue between UP and California officials continues to address ongoing improvement in UP/California air quality issues.

16. Noise Impacts. UP implemented a noise comment hotline and re-notified each affected county and requested comments in the first part of 1999. UP monitors the noise

hotline and will compile and analyze data to determine if a noise abatement plan is required. Through June 26, 2000 there were no calls to the noise monitoring hot line in the second quarter.

17. Use of Two-Way-End-of-Train Devices. This condition has been satisfied, as previously reported.

F. Rail Line Segment Mitigation

18. Priority List for Upgrading Grade Crossing Signals. UP provides train density information to states on a regular basis, which they use to prioritize their grade crossing improvements. UP provides the states of Arizona, California, Kansas, Nevada, Oregon, Texas and Colorado with train density data for approximately 500 individual crossing improvements annually.

19. East Bay Regional Park District MOU. The MOU is being implemented in accordance with its specifications. UP is reviewing the Crockett Trail Feasibility Study and is awaiting property descriptions from the District for all trails.

20. Town of Truckee MOU. The MOU is being implemented in accordance with its specifications. UP has completed construction of its portion of the bridge at the I-80 Central Truckee off ramp and is working with the city on roadway approaches. The railroad continues to work with local and federal agencies in the development of a Truckee River hazardous material spill response plan.

21. Placer County MOU. The MOU is being implemented in accordance with its specifications. UP continues to meet and work with the City of Roseville. UP has installed train control mechanisms to facilitate passenger operations. Several improvement projects specified in the MOU have been completed while others have been deferred or canceled at the request of the county and/or city involved. UP has conveyed, and is in the process of conveying or leasing other properties as specified in the MOU.

22. City of Reno. The MOU between UP and Reno is being implemented in accordance with its terms.

23. City of Wichita/Sedgwick County. The MOU between UP and City of Wichita/Sedgwick County is being implemented in accordance with its terms.

G. Rail Yards and Intermodal Facilities

24. Noise Abatement Plans for Rail Yards. Before UP undertakes any rail yard construction at the specified locations, UP will contact appropriate state and local officials and will report to SEA on the results of those consultations. No construction is planned for these facilities at this time.

25. Intermodal Facilities. Before any changes are made at the specified intermodal facilities, UP will contact appropriate state and local air quality officials in the states of California and Illinois and will report to SEA on the results of those consultations. A permit application for East LA is in progress. No construction or operating changes are planned for the Chicago facilities at this time.

H. Abandonments

26-61. As abandonments are carried out, UP will comply with all conditions. UP has developed a process to ensure that contractors and railroad personnel comply with all general conditions. Progress on specific abandonment conditions is reported below.

40. This work still being enacted. Contractor currently operating on property.

41. This condition has been satisfied, as previously reported.

42. This work still being enacted. Contractor currently operating on property.

43. This condition has been satisfied, as previously reported.

44. This condition has been satisfied, as previously reported.

47. This condition has been satisfied, as previously reported.

48. This condition has been satisfied, as previously reported.

49. This condition has been satisfied, as previously reported.

50. This condition has been satisfied. There is no bridge at this location. The line has been sold to Norfolk Southern.

51. New connection in place at Girard. NHPA work will follow.

52. This condition has been satisfied, as previously reported.

55. This condition has been satisfied, as previously reported.

57. This condition has been satisfied, as previously reported.

58. Suman-Benchley, TX UP has decided to retain this line. The Board vacated the abandonment exemption for the line on June 12, 1998. This condition is no longer applicable.

59. This condition has been satisfied, as previously reported.

60. This condition has been satisfied, as previously reported.

61. This condition has been satisfied, as previously reported.

I. <u>Construction Protects</u>

62-108. As construction projects are carried out, UP will comply with all listed conditions. UP has developed a process to ensure that contractors and railroad personnel comply with all general conditions. Progress on specific construction provisions is reported below.

70. This condition has been satisfied, as previously reported.

78. This condition has been satisfied, as previously reported.

79. This condition has been satisfied, as previously reported.

80. This condition has been satisfied, as previously reported.

81. This condition has been satisfied, as previously reported.

83. This condition has been satisfied, as previously reported.

84. This condition has been satisfied, as previously reported.

88. This condition has been satisfied, as previously reported.

89. This condition has been satisfied, as previously reported.

92. This condition has been satisfied, as previously reported.

97. This condition has been satisfied, as previously reported.

98. This condition has been satisfied, as previously reported.

99. This condition has been satisfied, as previously reported.

100. This condition has been satisfied, as previously reported.

101. This condition has been satisfied, as previously reported.

107. This condition has been satisfied, as previously reported.

108. This condition has been satisfied, as previously reported.

STB FD-32760(SUB21) 5-22-00 D 198738

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May 22, 2000

The Hon. Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

198737

Re: Finance Docket No. 32760, *Union Pacific Corporation, et al. – Control & Merger -- Southern Pacific Rail Corporation, et al.* Finance Docket No. 32760 (Sub-No. 21), *Union Pacific Corporation, et al. – Control & Merger -- Southern Pacific Rail Corporation, et al.* (Oversight)

198738

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are an original and twenty-five (25) copies of the Reply of AmerenUE In Support Of BNSF's Petition For Enforcement Of Merger and Oversight Conditions. In accordance with the Board's regulations, we have also enclosed a 3.5-inch diskette containing the pleading in WordPerfect format.

An additional copy of each version of the filing is enclosed. Please date and time stamp these copies and return them to the messenger for our files.

Sincerely,

John R. Molm

John R. Molm

Enclosures

cc: Parties of Record

RECEIVED
MAY 22 2000
MAIL MANAGEMENT
STB

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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

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)

REPLY OF AMERENUE IN SUPPORT OF BNSF'S PETITION FOR ENFORCEMENT OF MERGER AND OVERSIGHT CONDITIONS

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Attorneys for AmerenUE

May 22, 2000

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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

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)

REPLY OF AMERENUE IN SUPPORT OF BNSF'S PETITION FOR ENFORCEMENT OF MERGER AND OVERSIGHT CONDITIONS

On May 2, 2000, The Burlington Northern and Santa Fe Railway Company ("BNSF") filed a Petition For Enforcement of Merger and Oversight Conditions, BNSF-91, ("BN Petition"). BNSF seeks the Surface Transportation Board's ("STB" or "Board") quick resolution of a dispute between BNSF and Union Pacific Railroad Company ("UP") regarding the AmerenUE ("UE") Labadie Plant's applicability under the "2-To-1 Point Identification Protocol" ("2-to-1 Protocol") established by the Board in Decision Nos. 10 and 11 in Finance Docket No.

32760 (Sub-No. 21).[1] UE files this reply in support of the BN Petition and respectfully requests the Board to expeditiously resolve the issues in the BN Petition which are intertwined with the UE Petition for Clarification and Enforcement of Merger Conditions filed January 19, 2000 ("UE Petition") and related filings.[2] Specifically, UE requests the Board to declare that BNSF is entitled to access UE's Labadie Plant under the "omnibus" clause of the BNSF Agreement[3] and the 2-to-1 Protocol.

1. UE's Labadie Plant Is A "2-To-1" Shipper

It is undisputed that UE's Labadie Plant was a "2-to-1" shipper at the time of the UP/SP merger. *See* BNSF-91 at 3; UP/SP-374 at 4; and UE Petition at 5-6. Labadie is a shipper that was served directly by UP and SP, and no other rail carrier, prior to the merger. *See* UE Petition at 5-6. The Labadie facility was not directly accessible to BNSF via the trackage rights BNSF obtained under the BNSF Agreement. Therefore, Labadie falls under the section 8(i) "omnibus" provision of the BNSF Agreement for "2-to-1" shippers.

2. UE's Labadie Plant Never Lost Its "2-to-1" Status

UE has never given up any of its rights as a "2-to-1" shipper. UE did not and would not have agreed to waive any conditions imposed by the Board in the UP/SP merger. *See* UE Petition, Verified Statement of Udo A. Heinze ("V.S. Heinze") at 2-3. The "Conceptual Framework" signed

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[1] *Union Pac. Corp. et al—Control and Merger—Southern Pac. Rail Corp., et al.*, F.D. 32760 (Sub-No.21)("UP/SP Oversight"), Decision No. 10, Slip op. (STB served Oct. 27, 1997)("Decision No. 10"); UP/SP Oversight, Decision No. 11, Slip op. (STB served Jan. 23, 1998).

[2] BNSF filed a reply in support of the UE Petition (BNSF-90), UP filed a response in opposition to UE's Petition (UP/SP-374). UE filed a reply on February 23, 2000 ("UE Reply") and UP filed a reply (UP/SP-375) to the UP Petition.

[3] UE refers to the BNSF Agreement as defined by the STB in *Union Pac. Corp. et al.—Control and Merger—Southern Pac. Rail Corp. et. al.*, F.D. 32760, Decision No. 44, Slip op. at 12 n.15 (STB served Aug. 12, 1996) ("Decision No. 44").

by UP and UE was not formed as a "settlement," is not enforceable under Missouri law[4] and most importantly, has not resulted in any benefit to UE.[5] Most significantly, the "Conceptual Framework," which was premised on UP's misleading UE to believe that Labadie was not entitled to direct BNSF access, has not preserved any means of rail replacement for SP's service that UE had prior to the merger. UE's lack of an alternative carrier service was most evident during the UP/SP service meltdown in 1998 when UP refused to move any BNSF trains to Labadie. *See* UE Petition at 13.

Furthermore, UP has stated that UP and BNSF agreed to prevent Labadie's access to BNSF under the "2-to-1" shipper rights granted through the omnibus clause by treating UE "uniquely,"[6] however, BNSF has stated that BNSF only agreed to allow UP to sell the former Rock Island line to another carrier to replicate SP's lost service to Labadie. Whichever is correct, the fact remains that Labadie has lost its two carrier service that it had prior to the UP/SP merger. UE's lack of rail service replicating SP's service to UE prior to the merger is in direct contradiction to the Board's strong policy of protecting UE as a "2-to-1" shipper.

3. The Board Should Uphold Its Strong Public Policy Of Protecting All "2-to-1" Shippers

In conditioning the UP/SP merger, the Board relied upon UP's assertions that every "2-to-1" shipper would be protected by the BNSF Agreement. *See* UE Petition at 19 (selected quotes from UP's Brief, UP/SP-260), BNSF-91 at 10-11, and Decision No. 44 at 16. Yet, UP has admitted that it misled UE to believe that it was not entitled to the benefits of the BNSF Agreement. *See* UE Reply at 3-4 and UP/SP-374, Verified Statement of John H. Rebensdorf ("V.S. Rebensdorf") at 3.

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[4] *See* UE Reply at 8-9.

[5] *See* UE Reply at 5-8.

[6] UE finds it extremely disturbing to believe that UP and BNSF collectively pre-determined the fate of a shipper to effectively cut that shipper out of the benefits of "2-to-1" status that every other "2-to-1" shipper enjoyed. *See* UE Petition at 7-15 and UE Reply at 3-4. The Board should not condone such carrier action.

Notwithstanding UP's assertions to the Board that all "2-to-1" shippers were protected by the BNSF Agreement, which the Board relied upon in approving the UP/SP merger, UP has denied UE rail service to replicate the lost service of SP that resulted from the merger.

The Board should not allow UE to fall through the crack, created by UP, which will give UP sole access to Labadie after the UP/SP merger, something which UP did not have prior to the merger. UP has stated that UE was treated "uniquely" because BNSF "refused" to purchase the former Rock Island (SP) line. *See* UE Reply at 3, UP/SP-374 at 2, 6; Verified Statement of Jerry P. Klym at 2 and V.S. of Rebensdorf at 1-4. BNSF's decision to not purchase the former Rock Island line which SP used to serve Labadie, cannot negate UE's rights under the BNSF Agreement. *See* BNSF-91 at 4. In any event, the former Rock Island line cannot be used to provide the second carrier access it once did because of restrictions placed in the sale agreement by UP. *See* UE Petition at 15-17. As a result, the Board should declare that BNSF has the right to access Labadie from either St. Louis or Kansas City to replicate SP's service prior to the merger. The Board should assure that BNSF's access is sufficient for BNSF to compete effectively with UP as a replacement for SP. *See* BNSF Agreement Section 8(i) and BNSF-91 at 6.

Granting BNSF's right to serve Labadie will not create a windfall to UE or to BNSF. Granting UE's and BNSF's petitions will only place UE in the same position as every other "2-to-1" shipper and thereby uphold the Board's strong public policy of protecting "2-to-1" shippers. Furthermore, granting the petitions will enable BNSF to fulfill its rights and obligations that it independently obtained under the BNSF Agreement. *See* BNSF-91 at 10 and Verified Statement of Richard E. Weicher at 3. Finally, the Board should particularly be concerned with upholding its policy of protecting "2-to-1" shippers during the ongoing oversight proceeding which was intended to oversee and ensure that the protective conditions imposed in the merger are being uniformly applied.[7]

4. UP has Wrongfully Denied BNSF Access to Labadie Under the 2-to-1 Protocol

The "2-To-1 Point Identification Protocol" was established by the Board's direction because the Board was concerned about the "possibility that BNSF may be unable to obtain a prompt determination of whether BNSF is entitled to serve a particular shipper." Decision No. 10 at 7. The 2-to-1 Protocol states that "UP shall approve all such requests where, on the basis of all available information, UP concludes that a particular facility was open to service by both UP and SP, and no other carrier, as of September 25, 1995." *See* BNSF-91 Attachment D at Section 6. Since there is no dispute that UE's Labadie plant was open to UP and SP service and no other carrier as of September 25, 1995, UP should be estopped from denying BNSF's access to Labadie under the 2-to-1 Protocol. UE agrees with BNSF that UP's reliance on the "Conceptual Framework" is an insufficient explanation to deny BNSF access to the UE Labadie plant. *See* UP Petition, UE Reply and BNSF-91 at 6. UE also fully supports BNSF's right to a prompt resolution by the Board of UP's denial of BNSF's access under the 2-to-1 Protocol. *See* BNSF-91 at 6-8.

CONCLUSION

WHEREFORE, UE respectfully requests that the Board grant BNSF's Petition for Enforcement of Merger and Oversight Conditions (BNSF-91) and declare that BNSF is entitled to access UE's Labadie Plant under the "omnibus" clause of the BNSF Agreement and the 2-to-1 Protocol.

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[7] The STB stated in Decision No. 44 that it would retain jurisdiction over the UP/SP merger in order to implement the conditions imposed as part of the merger and to impose new conditions as necessary. Decision No. 44 at 231. UE is not seeking new conditions but is only seeking the enforcement of the same protections given to every other "2-to-1" shipper.

Respectfully submitted,

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Attorneys for AmerenUE

May 22, 2000

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the "REPLY OF AMERENUE IN SUPPORT OF BNSF'S PETITION FOR ENFORCEMENT OF MERGER AND OVERSIGHT CONDITIONS" was served this 22nd day of May, 2000, by hand delivery to counsel for Union Pacific Railroad Company, counsel for Burlington Northern and Santa Fe Railway Company and by first class mail upon all other parties of record in this proceeding.

Sandra L. Brown

Sandra L. Brown
Attorney for AmerenUE

STB FD 32760 (Sub 21) 2-26-98 D 186036

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D

Mr. Vernon C. Williams
Secretary
Surface Transportation Board
12th & Constitution Avenue, N.W.
Washington, D.C. 2007

Re: Finance Docket No. 32760 (Sub-No. 21): Union Pacific Corp. et al. Control and Merger - Southern Pacific Rail Corp. et al.

Dear Mr. Williams:

Enclosed for filing please find an original and ten (10) copies of the Notice of Intention to Participate filed on behalf of Utah Railway Company

Will you kindly stamp and return the enclosed copy of this service letter when the Notice is filed.

Very truly yours,

Theodore A. McConnell

Theodore A. McConnell

TAMc/jam
Enclosures

cc: Parties of Record

186036

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UNITED STATES OF AMERICA

BEFORE THE

SURFACE TRANSPORTATION BOARD

DEPARTMENT OF TRANSPORTATION

F.D. No. 32760 (Sub-No. 21)

**Union Pacific Corporation, et al. –
Control and Merger – Southern Pacific Corporation, et al.**

**Notice of Intention to Participate
as Party of Record – Utah Railway Company**

Utah Railway Company ("URC"), pursuant to Oversight Notice served May 7, 1997, submits this Notice of Intention to Participate in oversight proceedings as a party of record ("POR"), and requests that it be appropriately placed on the Service List as such.

URC previously participated as a party of record in F.D. 32760.

URC requests placement on the POR Service List through its counsel as follows and that such representative be served with all notices and orders issued by the Board.

Utah Railway Company:

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Dated: February 25, 1998

Theodore A. McConnell

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Counsel for Utah Railway Company

CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of the foregoing NOTICE OF INTENTION TO PARTICIPATE to be served by first class mail, postage prepaid on all parties of record in Finance Docket No. 32760 (Sub-No. 21) this 25th day of February 1998.

Theodore A. McConnell

Theodore A. McConnell

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