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August 14, 1998

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VIA HAND DELIVERY

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Office of the Secretary

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Office of the Secretary
Surface Transportation Board
Case Control Unit
1925 K Street, N.W.
Washington, DC 20423-0001

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

Dear Secretary Williams:

Enclosed for filing in the above-captioned proceeding are the original and twenty-five (25) copies of Comments of The Burlington Northern and Santa Fe Railway Company (BNSF-7). Also enclosed is a 3.5-inch disk containing the text of the filing in WordPerfect 6.1 format.

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

Sincerely,

Erika Z. Jones/als

Erika Z. Jones

Enclosures

cc: Parties of Record

BNSF-7

BEFORE THE
SURFACE TRANSPORTATION BOARD

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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

**COMMENTS OF THE BURLINGTON NORTHERN
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August 14, 1998

BEFORE THE
SURFACE TRANSPORTATION BOARD

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UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY
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— CONTROL AND MERGER —
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**COMMENTS OF THE BURLINGTON NORTHERN
AND SANTA FE RAILWAY COMPANY**

Pursuant to the Surface Transportation Board's Decision No. 10, served October 27, 1997, The Burlington Northern and Santa Fe Railway Company ("BNSF") submits the following comments regarding the Board's oversight of the Union Pacific/Southern Pacific ("UP/SP") merger and, in particular, UP's July 1, 1998 Second Annual Report on Merger and Condition Implementation ("Second Annual Report").

INTRODUCTION AND SUMMARY

In Decision No. 1 in this sub-docket, the Board instituted this proceeding to implement the oversight condition imposed as a condition of the UP/SP merger. The purpose of the oversight proceeding is to determine whether the conditions imposed by the Board have effectively addressed the competitive harms that they were intended to remedy. The Board has requested comments from interested persons on any effects of the merger on competition and the implementation of the conditions imposed to address competitive harms.

As set forth below as well as in BNSF's July 1, 1998 Quarterly Progress Report and its July 8, 1998 Application for Additional Remedial Conditions Regarding the Houston/Gulf Coast Area, BNSF's ability to provide shippers with reliable, dependable and consistent service over the UP/SP lines to which it gained access is continuing to be thwarted by certain "structural deficiencies"[1] in the rights BNSF received in the UP/SP merger proceeding as well as by certain UP operating practices which have, on numerous occasions, led to UP's trains being favored over BNSF's trains. BNSF's concerns in this regard with respect to the Houston and Gulf Coast area have been set forth in BNSF's July 1st and July 8th filings and are incorporated herein by reference.[2]

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[1] As explained in its July 8, 1998 Application (at p. 4), by use of the term "structural deficiencies" BNSF means that the trackage and other rights it received, while sound when originally conceived, have degraded substantially as a result of unanticipated service and related problems and other post-merger events and circumstances.

[2] In this regard, BNSF notes that, in UP's July 28, 1998 Reply in Opposition to the Joint Petition for Further Service Order filed in the Service Order No. 1518 proceeding, UP has addressed several of the Houston/Gulf Coast area concerns raised by BNSF. Specifically, UP has indicated its intent to continue directional operations (and the corresponding grant of trackage rights to BNSF and Tex Mex) indefinitely on its lines between Flatonia, Placedo and Algoa, TX until UP determines that capacity on those lines is clearly adequate for non-directional operations and that service would be improved by non-directional operations. Reply in Opposition at 9-10 n.5. UP has also agreed to continue BNSF's temporary bidirectional rights on the Caldwell-Flatonia-San Antonio line until such time as BNSF operations on that line are no longer necessary to facilitate the smooth operations of other UP lines (presumably including those lines over which BNSF received trackage rights under the BNSF Settlement Agreement). Id. at 10 n.5. Finally, UP has agreed to relocate its dispatchers for its lines between Spring and Palestine and Houston and Shreveport to the Spring Center. Id., Verified Statement of Dennis J. Duffy at 18-19. While these commitments by UP speak to some of BNSF's concerns in the short term, the concerns expressed by BNSF, particularly as they relate

The additional conditions BNSF seeks in the Houston/Gulf Coast oversight proceeding are necessary and vital to ensuring BNSF's ability to provide the competitive alternative envisioned by the Board's order and the shipping public. BNSF will continue to address those concerns in the Houston/Gulf Coast oversight proceeding.

In addition, BNSF's concerns with respect to its ability to compete in the Central Corridor, along the I-5 Corridor, and in California have been set forth in its July 1, 1998 Quarterly Progress Report and are also incorporated herein by reference. Accordingly, these comments will focus upon the mischaracterizations in UP's July 1 report of BNSF's competitiveness and on subsequent developments with respect to the areas of concern expressed by BNSF in its July 1 and July 8 pleadings.

I. Contrary To UP's July 1 Report To The Board, BNSF's Ability To Provide Effective Competitive Service Continues To Be Hampered

Throughout its July 1, 1998 Report, UP proclaims that the merger conditions "have worked," that BNSF and UP are now "closely matched competitors throughout the West," and that BNSF "can capture any available traffic movement at any time." In support of these claims, UP cites increased BNSF train operations and volumes. However, while BNSF is aggressively working to compete and to increase its volumes to the point where it can maintain viable long-term operations, the fact remains that, in a number of situations, including in particular, where BNSF has to rely on UP haulage and/or switching to serve "2-to-1" customers -- the customers most significantly affected by the UP/SP merger, BNSF has often been unable to compete effectively with UP. From lack

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to trackage rights in south Texas corridors, remain unsatisfactorily addressed for the long term.

of cooperation and neglect to outright discrimination and manipulation of existing agreements, UP has forced BNSF into an inferior competitive position which fails to provide "2-to-1" shippers the clearly competitive service choice they had prior to the merger when UP and SP competed.

The results are evident. While BNSF traffic moved via the trackage rights lines has continued to grow, most of the growth has come from either overhead business, business moving to and from "2-to-1" shortlines, or business where BNSF has, in order to provide some predictable level of local service, commenced its own switching operations for "2-to-1" customers.

Business handled by UP for BNSF to and from "2-to-1" customers using haulage and reciprocal switch services provided for in the BNSF Settlement Agreement has provided overall unsatisfactory results to shippers. As a consequence, BNSF's most significant success in competing for traffic with UP using UP haulage and reciprocal switch service for "2-to-1" customers occurs on moves originating on BNSF, and BNSF is also generally successful in maintaining business destined to BNSF local points. However, this represents only a fraction of the "2-to-1" business available. In any other traffic scenario, including traffic moving to or from points jointly served by BNSF and UP as well as interline connections, customers, though frequently willing to try BNSF service using UP reciprocal switch and haulage on either end, usually revert to a UP routing because the erratic nature of UP local switch and haulage service makes the overall BNSF service product unacceptable and non-competitive.

BNSF and its customers seeking to use BNSF for a service-competitive alternative option to UP at "2-to-1" points are faced with the dilemma of how to obtain BNSF service. In addition to the duplication of scarce resources -- power, crews, and infrastructure -- that providing direct BNSF local and switching service would require, many customers cannot accommodate two carriers physically switching their facilities in a 24-hour period, and BNSF is thereby precluded from starting its own local switch service to meet customer needs and compete directly with UP. Yet, UP's service for BNSF has proven erratic and unworkable when provided pursuant to the Settlement Agreement -- a remarkable occurrence because reciprocal switching has been a standard railroad service which works everywhere else, and has for most of the past century, between many carriers in many venues. BNSF has already asked the Board for neutral switching supervision to remedy this problem in several geographic areas in order to provide customers competitive service options, and it will continue to work with UP to address the problem in other areas. If those efforts fail, BNSF will seek appropriate orders from the Board to assure that "2-to-1" customers receive viable local service.[3/]

[3/] As noted, one of BNSF's responses to the service failures to customers using UP haulage and reciprocal switch service to access "2-to-1" points has been the establishment of local BNSF train service. Ironically, UP refers to this growth in BNSF local train service over trackage rights lines as a measure of BNSF's competitiveness and success in growing business for customers at these points, rather than BNSF's application of resources to gain, regain, and maintain service to customers where UP's haulage and reciprocal switch service are unreliable, inconsistent, and uncompetitive. Second Annual Report at 76.

In addition to its failure to provide viable switching service to BNSF, UP has continued to apply existing agreements in ways which hinder BNSF's ability to compete. For instance, in the critical Central Corridor, UP has a contractual obligation under Section 1(h) of the BNSF Settlement Agreement to provide, at BNSF's request, the train and engine crews necessary to handle BNSF trains moving between Salt Lake City and Oakland, CA. However, because of crew shortages, UP has been unable to provide sufficient crews to allow BNSF to operate efficiently, and the practice has been that, whenever there is a shortage of crews, UP's needs for crews are met before BNSF's needs are met. Recently, BNSF trains in the Central Corridor have often been delayed three to five days longer than scheduled, not only impacting service to customers, but severely reducing BNSF's locomotive resources. Thus, BNSF is reducing the number of trains operating in the Central Corridor. This marks the first major reduction in service and lessening of competitive options over trackage rights lines and is a result of UP's inability to crew BNSF trains on a timely basis over the western end of this route as well as UP congestion in the corridor.

While BNSF is implementing certain operational changes in an attempt to deal with UP's crew shortages[4/], and while BNSF is implementing a plan to provide its own

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[4/] Early in August, BNSF began rerouting through manifest trains off of the Central Corridor to BNSF's "Transcon" route through Arizona and Southern California. As a result of these changes, BNSF Central Corridor service will reduce to one through merchandise train/day each way, running over both the former SP and UP routes between Winnemucca, NV and Sacramento, as well as a daily merchandise train, as heretofore, between Denver and Provo, UT. The routing via the SP route through Reno/Sparks is designed to improve BNSF direct service to a new customer in Fernley, NV and to BNSF's transload facility in Sparks.

crews for its trains between Salt Lake City and Northern California,[5] UP's practice of crewing its own trains first is causing delays of several days in BNSF service. That practice is a significant impediment to competitive BNSF service. In addition, because UP failed to notify BNSF of the impending crew shortages until after they commenced, BNSF had no opportunity to plan for the shortages or to work with UP to try to minimize their impact. While BNSF is hopeful that its operational changes and crewing plan will help address the situation, BNSF is considering further possible remedies to address UP's breach of its contractual obligations under the BNSF Settlement Agreement, including whether UP should be required to allocate crews on a basis that will allow both UP and BNSF to provide equally competitive service.

Similarly, BNSF was forced to file a Petition for the Enforcement of the BNSF Settlement Agreement on August 4, 1998, because UP has refused to permit BNSF access to an existing transload that was, as of September 25, 1995, within the UP-published reciprocal switching limits at San Antonio, TX. UP has asserted that the tariff item which both South Texas Liquid Terminal, the transload involved, and BNSF have cited as defining applicable reciprocal switching limits along a given line in San Antonio is "obsolete". UP itself, however, recognized the effectiveness of the tariff item as recently as June of this year when it took steps to cancel the tariff item, which had

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[5] BNSF has commenced implementation of a plan to hire and train its own train service personnel to operate between Stockton and Provo. This plan will be implemented in stages and should be fully operational, with BNSF trains operated by BNSF crews, by early 1999. This will complete BNSF crewing its own trains across the entire Central Corridor, the last major corridor where BNSF operated over UP or SP lines using UP or SP crews.

remained published and in effect until that time. These continued manipulative efforts by UP have precluded BNSF from serving customers clearly within the scope of the Board's merger conditions.[6]

Further, as BNSF has reported to the Board in its previous Quarterly Progress Reports, UP and BNSF have agreed upon a process through which shipment specific problems are to be resolved by UP through the development and implementation of specific action plans. Contrary to UP's assertion in its Second Annual Report (at pp. 58-59) that this process has been "a great success", BNSF continues to experience significant difficulties in obtaining UP's commitment to resolve problems concerning BNSF shipments on the trackage rights lines. In reality, while participating with BNSF in recording problems exchanged between UP's National Customer Service Center in St. Louis and BNSF's UP/SP Service Assurance team involving individual BNSF shipments in UP haulage or reciprocal switch service, UP arbitrarily decides which problems to

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[6] On page 56 of its Second Annual Report, UP asserts that BNSF's list of proposed "2-to-1" facilities furnished to UP for review was based largely on information drawn from "obsolete tariffs." UP's use of the phrase "obsolete" with respect to its own tariffs, particularly when those tariffs are the documents designated in the BNSF Settlement Agreement to determine rail shippers' access to BNSF service at "2-to-1" points, is disingenuous. As the Board is aware, the critical date for determining access under the BNSF Settlement Agreement is September 25, 1995 -- the date of execution of the Agreement, and the tariffs used by BNSF to compile its list were on file, had been updated through precisely-worded supplements, and were in effect on that date. While the information contained in the tariffs may have been "obsolete" as of September 25, 1995, due to UP's failure to keep the tariffs updated, the tariffs themselves were not "obsolete". They were also, in nearly all cases, the only documents rail shippers and BNSF have had to draw on and refer to in determining shipper access to BNSF at "2-to-1" points. UP should not be able to hide behind a vague claim that a particular tariff is "obsolete" in order to evade its obligations under the BNSF Settlement Agreement and to thereby disavow its own tariffs.

focus on and closes other "problem logs", whether involving haulage or reciprocal switch traffic, regardless of BNSF's or the rail customer's specific needs. As shown in Attachments 1 and 2 hereto, UP has arbitrarily closed the problems logs referred from BNSF without addressing or resolving the shipment-specific issues raised.[7]

UP's statement in its Second Annual Report (at p. 59) that "UP assigned an employee at its National Customer Service Center to work full-time on resolving problems identified in the log" appears to be an inadequate response on UP's part to addressing these serious issues in view of the number of problems and the growth in BNSF volumes over the trackage rights lines. As a result of ongoing problems in getting UP to respond to these issues, BNSF wrote to UP in July outlining its concern that it has been unable to obtain meaningful resolutions to service problems through UP's National Customer Service Center, and BNSF has yet to receive a response from UP. (A copy of BNSF's July 10, 1998 letter to UP is attached hereto as Attachment 3.)

There are, in fact, two problem-log databases, one shared by the customer service functions to resolve shipment specific issues, and one shared between the carriers' information service ("IS") functions to resolve data-exchange issues. As indicated above, BNSF is not satisfied with the functioning of the customer service

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[7] For example, in the case of the cars in Attachment 1 at Harbor, LA, UP closed the problem log on the grounds that the problem was "not a haulage issue". However, these empty cars were in fact handled pursuant to a haulage agreement between BNSF and UP/SP dated June 1, 1996. More importantly, UP closed the log without any effort at all to try to resolve the problem and meet the shipper's needs. Arbitrarily closing problem logs by UP, as shown in these examples, drives reporting numbers and permits UP to assert that "the problem-log approach substantially improved the problem resolution process that preceded it" (Second Annual Report at 59), but does not produce results or move cars for shippers or BNSF.

processes. UP's assertion that "[m]ore than 1,000 problems have been documented in the database in the 14 months it has existed, and as of the end of June only 12 merger-related problems remained open" (Second Annual Report at p. 59), refers to the IS database, not the customer service problem-log database. Moreover, although BNSF agrees that there have been a dramatic improvement in handling IS issues and a dramatic reduction in the number of problems being addressed, the one UP employee assigned to resolve IS issues has been reassigned, and that position remains unfilled, though the former assigned employee continues to assist in resolving these issues as necessary.

Additionally, although UP has asserted that the dispatching protocol has "worked well" (Second Annual Report at p. 59), the reality is that there are far too many occasions on which UP has dispatched one of its trains over one of the trackage rights lines when the crew for that train did not have sufficient time to allow it to complete the movement. These occurrences have led to the lines being blocked while a replacement crew has been called in, and BNSF's service over the line has been adversely affected. While BNSF is continuing to discuss this issue with UP, it may be necessary for the dispatching protocol to be formally modified to require that a crew have sufficient hours of service to operate over a line or that a replacement crew be in place to relieve the original crew before a train is dispatched over the line.

UP reports produced for the month of July from the new joint service monitoring system, the first month for which such reports are available, shows BNSF trains are handled slower than their UP counterparts in a number of lanes, including Provo to

Denver; Roper (Salt Lake) to Winnemucca; and Winnemucca to Keddie, CA; and between El Pinal, CA (Stockton) and Keddie. Resolution of matters impacting train service reflected by these measurements are topics for discussion on an ongoing basis between the transportation teams of BNSF and UP. BNSF expects to follow up with UP, based on the data provided by these reports, to ensure that BNSF trains are dispatched in accordance with the dispatching protocol.

II. Developments with Respect to Competitive Concerns

A. Central Corridor

As BNSF reported on July 1, 1998, congestion along UP lines in the Central Corridor has continued to adversely impact BNSF service. UP's lines between Denver and Grand Junction are increasingly congested, and coordinated dispatching control of those lines would improve BNSF's ability to offer full competitive service to shippers. Similarly, the level of service that BNSF has been able to provide over its trackage rights line between Denver and Stockton, CA does not allow BNSF to meet its commitments to customers. Therefore, BNSF cannot be competitive with UP in this corridor on a consistent basis. While BNSF is hopeful that UP will address the congestion and other service problems along the Central Corridor, BNSF is considering pursuing possible remedies in the event that UP is either unwilling or unable to address these problems in the near future.

As reported, BNSF's service to and from shippers in Salt Lake City, using Utah Railway as its agent, has been adversely impacted by UP's practice of parking trains and blocking switching leads that are used by Utah Railway to service customers' facilities.

These problems have continued through July and into August. On July 5, UP blocked Utah Railway access to Amoco Petroleum Products' Salt Lake City refinery, which impacted directly on the delivery of high octane intermediates to the refinery for blending gasolines in a high-demand time.

As recently as August 6, Utah Railway switch crews were blocked from Salt Lake City customer plants, including Inland Container, Phillips, Conoco and Chevron due to UP trains parked on the Main Line #1 track, which is used by Utah Railway to access these "2-to-1" facilities. This requires extra crews to be called to complete the service required by customers at other than the agreed-to switching times, which is disruptive to the customers. UP trains are parked on this former SP trackage due to congestion at UP's Roper Yard, requiring the "staging of trains" on the former SP Salt Lake-Ogden route awaiting entry to the yard. This leaves the parallel UP route clear, but keeps Utah Railway from providing competitive and, indeed at times, any switching service to these customers, although UP switch service is unimpeded. BNSF and Utah Railway continue to call these instances to the attention of UP operations officers in Salt Lake and Omaha for immediate resolution. However, as long as the Central Corridor remains congested, UP trains will be backed up, consuming track facilities such as these Salt Lake lines intended for use by BNSF.

The problems experienced by BNSF in the Central Corridor have shifted from those caused by separate SP and UP data systems for Elko, NV and lines to its west to systemic mishandlings by UP of BNSF shipments in haulage service as well as congestion issues. Cars picked up by UP in haulage service are misdirected to the wrong destinations, such as BN 541677 from Baroid Drilling Fluids, Dunphy, NV, destined for Louisiana but directed by UP to California in early August. Other cars delayed and mishandled in movement, such as TLCX 35085, destined to Coastal Chemical at Rennox, NV, interchanged to UP at Elko on July 22, moved instead to Winnemucca, where it sat for the next two weeks, or GATX 37243 and GATX 38274, destined for the same receiver, interchanged at Elko on July 10, and placed to the customer's location on July 27.

Additionally, BNSF earlier this year established its own local to run between Winnemucca and Sparks, NV, initially to provide service to BNSF's Sparks transload facility and later to another new customer located at Fernley, NV. Service to the customer in Fernley was disrupted when a BNSF-delivered load on July 22 was pulled in error by UP on July 25 without informing BNSF and taken to Sparks, where the load remained until UP returned it to BNSF on August 7. The customer was forced to halt work on a project until the car was returned. No reason was given as to why UP pulled the car. Problems such as this example have been experienced both before and after the UP July 1 cutover to the TCS operating system for Elko and lines west. BNSF expects these problems to be eliminated when UP's system is fully operational. However, examples such as this illustrate the problems which persist even when BNSF commences to switch facilities directly to provide customers with required service.

When BNSF trains across the Central Corridor between Provo and Stockton are delayed by lack of UP crews, trains that are run are both significantly delayed and frequently at capacity through Nevada, thereby preventing BNSF from picking up local traffic at Winnemucca or Elko. To work around the UP's track rehabilitation work on the Tehachapis Line, BNSF worked with UP on schedules to reroute unit grain, steel, and other trains over the Central Corridor to relieve congestion in Southern California. As UP became unable to supply crews for BNSF trains operating over the UP's Feather River line between Sacramento and Winnemucca (Weso), particularly on weekends, BNSF and UP in July began rerouting BNSF trains over the former SP Donner Pass route where crew availability has been better. However, this rerouting impacts BNSF's ability to serve a customer at Herlong, CA as well as perform setouts and pickups at Winnemucca.

An extreme example of the impact of crew shortages and congestion in the Central Corridor occurred on the operation of BNSF's Train H-GALSTO1-24, a scheduled merchandise train from Galesburg, IL to Stockton, CA originating on July 24, as well as following trains. This train was delayed at Doyle, CA from August 1 to August 4 because of a lack of crews, then further delayed because locomotive problems were not properly communicated. Locomotives from a following GALSTO train were used to forward the H-GALSTO1-24 on August 5; the following train was ultimately split up and picked up by following GALSTO trains. A major BNSF customer with traffic on the H-GALSTO1-24 informed BNSF that, due to the unreliable transit time in the lane, it was rerouting its business destined to California to truck. Additionally, several of these trains were unable to pick up westbound traffic off the Winnemucca interchange track, as it was blocked by a parked UP train. Ultimately, this traffic was moved by BNSF's Winnemucca-Sparks local to another location for pickup by through trains operating over the Donner Pass route.

BNSF and UP representatives toured the Central Corridor at the end of June, completing an inspection of available facilities and discussing needs of UP and BNSF to provide local and through service to customers in Grand Junction, CO. Subsequent proposals have been made to UP by BNSF for trackage and facilities to be used by BNSF in Nevada, Utah and Colorado, and BNSF is awaiting UP's response. It is BNSF's expectation that moving forward on these proposals will permit a further separation of service between BNSF and UP in the Central Corridor, and an improvement in local and through BNSF service as well as a reduction in the kinds of operating problems reported above. As indicated previously, BNSF is also rerouting trains off the Central Corridor back to BNSF's "Transcon" route across Arizona and Southern California, which will further reduce volumes in the Central Corridor. BNSF is using BNSF crews from the I-5 Corridor to supplement UP crews operating over the Central Corridor between Keddie and Stockton, CA. Finally, BNSF is now crewing BNSF trains between Stockton and Roseville as well as Stege (Richmond) and Roseville when BNSF trains operate over the SP route, further reducing demands on UP's Central Corridor crew base.

B. I-5 Corridor/California

<u>Stockton Area.</u> During the month of July, BNSF and UP completed major track realignment and construction projects to improve the movement of trains, impacting both the Central and I-5 Corridors, between Stockton and Sacramento, CA. The new track connections were placed in service on Monday, August 3, 1998. The track connections

make it possible for BNSF trains to enter and exit the Central and I-5 Corridors at Stockton, en route to and from BNSF's Riverbank, CA yard without requiring backing or run-around movements involving UP's Stockton yard. With completion of this work, BNSF commenced Central Corridor service over the former SP Donner Pass route between Sacramento and Weso, NV through Reno/Sparks, on Monday, August 10.

The installation of these additional crossovers has not yet improved the velocity of BNSF trains in the Stockton area to the extent expected, largely due to the time consuming permit process and lack of coordination between the two UP route dispatchers controlling Stockton. Nonetheless, through much of July and into August, interchange between BNSF and UP was extremely congested and backed up in the Stockton area, impacting through operations of both railroads. UP was frequently unable to take offered interchange from BNSF at Stockton (and other points), citing "extreme yard congestion." On other occasions during July, UP was unwilling to permit BNSF to run through I-5 trains north from Stockton unless BNSF would first commit to taking interchange from UP at Stockton.

<u>**Sacramento Area**</u>. On July 1, BNSF reported to the Board on its long-running service problems using UP/SP reciprocal switch and haulage to provide Farmers Rice at West Sacramento, CA, a "2-to-1" customer, with competitive service via BNSF as replacement for SP. Since July 1, UP has still not implemented viable service between Farmers Rice and the BNSF Stockton interchange, which would both meet UP's commitment to BNSF and allow BNSF to meet its dock-to-dock service commitments to Farmers Rice or its customers. A graph of shipment dwell time on the UP between

release by Farmers Rice and interchange to BNSF is attached hereto as Attachment 4. The long term erratic nature of this service, with UP shipment dwell time once again increasing in recent weeks, has required BNSF to provide additional equipment to this customer to meet commitments in light of reduced equipment velocity per move. BNSF remains hopeful that improvement to interchange tracks in the Stockton area will improve this service. Other customers in the Sacramento area and BNSF have been likewise impacted during July and into August.

Tehachapis Line. As was reported to the Board on July 1st, the service BNSF has received over the Tehachapis Line between Kern Junction (Bakersfield) and Mojave, CA since the UP/SP merger has deteriorated significantly, and BNSF has been experiencing numerous unacceptable delays in moving its trains over the Tehachapis Line. The problems being experienced by BNSF stem from both shortages of UP crews for its trains, which result in UP trains blocking mainlines, and UP's inconsistent, unreliable and often discriminatory dispatching practices. These actions have resulted in the blocking of BNSF's access to the Tehachapis Line and the unsatisfactory handling of BNSF's priority "Z" (intermodal) trains, in particular.

While BNSF had hoped that the recently completed tie replacement program undertaken by UP would lead to the elimination of the delays that have been occurring on the Tehachapis Line, that has not been the case. It is becoming apparent that it will still be necessary to take additional steps to address this growing and serious problem, including the establishment of a joint dispatching facility to dispatch the line.

Such a joint dispatching facility would be similar to the Spring Center recently established by UP and BNSF, and it could also dispatch other jointly-used lines in Southern California. BNSF has discussed this concept with UP, including adding other jointly-used lines in Southern California such as BNSF's Cajon Pass route, BNSF's Mojave-Daggett line and, potentially, lines serving the Los Angeles-Long Beach area. However, UP so far has shown no interest in further pursuing, discussing and implementing such a proven remedy to assisting in alleviating congestion issues in major terminal areas accessed through jointly-used routes. If these discussions are not fruitful, BNSF will seek appropriate relief from the STB.

Southern California. As reported in UP's most recent service reports, there is significant congestion in Southern California and in the Los Angeles Basin. The delays caused by this congestion have affected not only UP and its shippers, but also BNSF and its shippers, and BNSF anticipates that the congestion may well become significantly worse in the near future. In particular, BNSF has been impacted by UP congestion in providing service for customers at the Ports of Long Beach and Los Angeles and in the Yermo area, and also in serving O. H. Kruse in Ontario, CA over trackage rights received in the UP/SP merger via Riverside. Interchanges at a number of key points in Central and Southern California are backed up, with UP unable to accept interchanges from BNSF due to congestion on UP. This has the potential of both congesting BNSF California facilities as shipments back up from interchange points, and depleting car supplies for shippers as congestion lengthens transit times and slows equipment velocities. While most interchange and congestion problems in July centered on the

Stockton area, congestion is now becoming a serious service issue in Southern California, particularly Barstow. Among traffic impacted is grain and military traffic interchanged in trainload lots.

CONCLUSION

In summary, UP's overly-optimistic pronouncements in its July 1, 1998 Second Annual Report do not reflect the reality of train operations and are overstated for the reasons set forth above. As it has in the past, BNSF will work with UP to resolve the continuing problems it faces in providing competitive service, particularly when BNSF is required to rely on UP haulage or switch service to serve "2-to-1" customers, but the Board may need to take additional steps to ensure competitive service if UP is unwilling or unable to correct the shortcomings BNSF and others have identified in implementing the STB's merger conditions.

Respectfully submitted,

Erika Z. Jones/dls

Erika Z. Jones
Adrian L. Steel, Jr.
Kathryn A. Kusske
Kelley E. O'Brien

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3017 Lou Menk Drive
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Ft. Worth, Texas 76161-0039
(817) 352-2353

and

1700 East Golf Road
Schaumburg, Illinois 60173
(847) 995-6887

Attorneys for The Burlington Northern and Santa Fe Railway Company

August 14, 1998

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Comments of The Burlington Northern and Santa Fe Railway Company (BNSF-7) were served on all parties of record in Finance Docket No. 32760 (Sub-No. 21).

Adrian L. Steel Jr.

ATTACHMENT 1

Burlington Northern Santa Fe
Customer Service Log
UP HAULAGE

Center Prefix:	CSS
Log#:	119131
Open Date:	1998-08-10
Opened by:	C633220
Transfer to:	C633220
Caller:	UPHAULAGE
Customer:	AGENTBNSF
Station:	LAKCHARLE LA
Telephone:	999-9999
Location Stn:	HARBOR LA
Level:	2
Division:	Gulf Coast
Problem Type:	UP Switch
Summary:	UP-20 DATA LOG 11162

Equipment affected:

Car Number	Wb Number	Wb Date
LNAC 5530	989999	08/05/98
LNAC 5825	989999	08/05/98
SRN 7354	989999	08/05/98
SRN 7368	989999	08/05/98
BN 250255	999999	12/31/99

Comments:

(LEVEL 1, 08-10-98 12:13, P AVEY, C633220):
ALL CARS RELEASED MTY AT HARBOR, LA 8-5-98 WOTH NO MOVEMENT SINCE. HAVE REQUESTED ACTION PLAN FOR MOVEMENT FROM UP HAULAGE TEAM VIA DATA LOG 11162.

(LEVEL 2, 08-12-98 08:40, P AVEY, C633220):
RAISED TO LEVEL 2 ACCOUNT NO MOVEMENT FROM HARBOR, LA. UP HAULAGE TEAM SAYS NOT HAULAGE AND CLOSED DATA LOG.
ACTION PLAN:

BNSF TRACKAGE/HAULAGE
Online Problem Log

[redacted]

Title: CAR DELAY *(Please limit your title to six words or less)*
Car #: BN250255 *(Enter one . if multiple cars add rest in problem description)*
Problem #: 11162 **Original Problem #:**

(Level 3-Highest) (Level 2-Medium) (Level 1-Low)

Current Status:
○ Level-0
● Level-1
○ Level-2
○ Level-3

Category	Reason Codes
☐ Billing	☐ CUSTOMER BILLING ERROR ☐ EDI ERROR ☐ NO BILL ☐ BNSF BILLING ERROR ☐ UP BILLING ERROR
☐ Lost Car	☐ DATA INTEGRITY ERROR-ATCS ☐ DATA INTEGRITY ERROR-NON-ATCS
☐ Equipment	☐ BAD ORDER ☐ LOAD SHIFT ☐ MECHANICAL
☐ Storage in Transit	☐ YARD PULL DELAY ☐ STORAGE RELEASE ERROR ☐ RAILROAD CONVENIENCE
☒ Yard Issues	☐ CUSTOMER CAUSE ☐ INTERCHANGE TO WRONG RR ☒ ISSUES WITH LOCAL TRAIN SERVICE ☐ MIS-BLOCKED ☐ MIS-SWITCHED ☐ PULL-SPOT ERROR ☐ TRACK-SIDING BLOCK

Root Cause C
Code ACTIVE MONITO

- [ ] Train Management

- [ ] SETOUT FAILURE
- [ ] PICKUP FAILURE
- [ ] LOCOMOTIVE ERROR
- [ ] DERAILMENT
- [ ] YARD CONJESTION
- [ ] ANNULMENTS
- [ ] CREW ISSUES
- [ ] S/0 ACCOUNT TONNAGE
- [ ] S/O ACCOUNT TRAIN LENGTH

Current Status:

Created By: Phillip E Avey/ISS/RRD/US **Date Created:** 08-10-98 11:44:57 AM
Modified By: **Date Modified:**

Problem Description

BNSF Internal PRL #:
BN 250255, LNAC 5530, 5825, SRN 7354, 7368, AND TSRD 3557 RE AT HARBOR, LA 8-5-98 WITH NO MOVEME
PLEASE SECURE ACTION PLAN FOR MOVEMENT AND DELIVERY TO BNSF. THANKS....

Resolution Section

UPRR Internal PRL #:

Resolution Section:

Edited By: Edward K. Forest **Date & Time:** 08-10-98 01:06:43 PM

Action Plan
N

Description of Problem Resolution

Resolution Description

NOT A HAULAGE ISSUE

- [x] COMPLETED **Date Resolved:** 08-10-98 01:06 PM

[redacted] [redacted]

ATTACHMENT 2

Burlington Northern Santa Fe
Customer Service Log
UP HAULAGE

Center Prefix: CSS
Log#: 119135
Open Date: 1998-08-10
Opened by: C633220
Transfer to: C633220
Caller: UPHAULAGE
Customer: AGENTBNSF
Station: LAKCHARLE LA
Telephone: 999-9999
Location Stn: LAKCHARLE LA
Level: 2
Division: Gulf Coast
Problem Type: UP Switch
Summary: RC-20
DATA LOG 11163

Equipment affected:

Car Number	Wb Number	Wb Date
SRN 7297	989999	08/06/98
CAGY 14040	989999	08/06/98
BN 214503	989999	08/06/98
BN 249972	989999	08/06/98

Comments:

(LEVEL 1, 08-10-98 12:22, P AVEY, C633220):
ALL CARS MTY CARS ARRIVED LAKE CHARLES 8-6-98 WITH NO FURTHER MOVEMENT. HAVE REQUESTED ACTION PLAN FOR DELY TO BNSF AT LAKE CHARLES VIA DATA LOG 11163 TO UP HAULAGE TEAM.
ACTION PLAN:

(LEVEL 1, 08-12-98 08:45, P AVEY, C633220):
UP HAULAGE TEAM CLOSED DATA LOG SAYING THESE ARE NOT HAULAGE CARS. RAISED TO LEVEL 2 ACCOUNT NO MOVEMENT.

(LEVEL 2, 08-12-98 08:50, P AVEY, C633220):
UPDATED TO LEVEL 2 ACCOUNT NO MOVEMENT.
ACTION PLAN:

BNSF TRACKAGE/HAULAGE
Online Problem Log

[redacted]

Title: CAR DELAYS *Please limit your title to six words or less)*
Car #: BN 214503 *(Enter one , if multiple cars add rest in problem description)*
Problem #: 11163 **Original Problem #:**

(Level 3-Highest) (Level 2-Medium) (Level 1-Low)

Current Status:
- ○ Level-0
- ● Level-1
- ○ Level-2
- ○ Level-3

Category	Reason Codes
☐ Billing	☐ CUSTOMER BILLING ERROR ☐ EDI ERROR ☐ NO BILL ☐ BNSF BILLING ERROR ☐ UP BILLING ERROR
☐ Lost Car	☐ DATA INTEGRITY ERROR-ATCS ☐ DATA INTEGRITY ERROR-NON-ATCS
☐ Equipment	☐ BAD ORDER ☐ LOAD SHIFT ☐ MECHANICAL
☐ Storage in Transit	☐ YARD PULL DELAY ☐ STORAGE RELEASE ERROR ☐ RAILROAD CONVENIENCE
☒ Yard Issues	☐ CUSTOMER CAUSE ☐ INTERCHANGE TO WRONG RR ☒ ISSUES WITH LOCAL TRAIN SERVICE ☐ MIS-BLOCKED ☐ MIS-SWITCHED ☐ PULL-SPOT ERROR ☐ TRACK-SIDING BLOCK

Root Cause C
Code ACTIVE MONITC

- [ ] Train Management

- [ ] SETOUT FAILURE
- [ ] PICKUP FAILURE
- [ ] LOCOMOTIVE ERROR
- [ ] DERAILMENT
- [ ] YARD CONJESTION
- [ ] ANNULMENTS
- [ ] CREW ISSUES
- [ ] S/0 ACCOUNT TONNAGE
- [ ] S/O ACCOUNT TRAIN LENGTH

Current Status:

Created By: Phillip E Avey/ISS/RRD/US **Date Created:** 08-10-98 11:50:01 AM
Modified By: **Date Modified:**

Problem Description

BNSF Internal PRL #:
BN 214503, 249972, CAGY 14040, AND SRN 7297 ARRIVED LAKE CHARLES 8-6-98. NO MOVEMENT SINCE. PLEASE SECURE ACTION PLAN FOR DELIVERY TO BNSF AT LAKE CHARLES. THANKS

Resolution Section

UPRR Internal PRL #:

Resolution Section:

Edited By: Edward K. Forest **Date & Time:** 08-10-98 01:09:07 PM

Action Plan
N

Description of Problem Resolution

Resolution Description

NOT A HAULAGE ISSUE

- [x] COMPLETED **Date Resolved:** 08-10-98 01:09 PM

[redacted] [redacted]

ATTACHMENT 3

BNSF

ELIAS LYMAN, JR
VICE PRESIDENT
CUSTOMER SERVICE &
BUSINESS UNIT SUPPORT

Burlington Northern & Santa Fe Railway

2650 Lou Menk Drive, 3rd Floor
Fort Worth, TX 76131
(817) 352-2769 Office
(817) 352-7174 Fax

July 10, 1998

Jim Damman
VP - Customer Service
Union Pacific Railroad
210 North 13th Street
St. Louis, MO 63103

Dear Jim:

The purpose of my correspondence is to review some outstanding issues involving service that we have not been able to resolve along trackage rights lines and at "2 to 1" points. These items involve the service resolution process through the joint Lotus Notes database involving BNSF traffic in "trackage" status, and unresolved system interface issues.

When the joint Lotus Notes Database was created (approximately May, 1997) as a means of communicating service issues, this method of documentation was used for traffic in both trackage and haulage status. In recent months, we have been unable to obtain action plans for BNSF traffic that has incurred a service delay while in trackage status (the most recent example is referenced by Database Log number 10761). This "trackage" status was as a result of the conditions set forth by the Surface Transportation Board for the 1995 BNSF Settlement Agreement. We want to continue the initial Service Resolution process through the joint Lotus Notes Database for BNSF traffic regardless if it is in a Trackage or Haulage status. This provides the best means for documenting issues in pursuing root cause.

In addition, BNSF has identified and documented seven unresolved UP system problems. I have included an attachment that provides details on all these items. A majority of these problems surround 451 car reporting messages. These 451 problems range from lack of reporting to duplicate reportings and everything in between. Another problem we have identified is the manner empty bills are handled. However, progress is being hindered by the effort required for your July 1 cut-over. The last system problem I will mention is the electronic formats of your origin haulage waybills (417). No progress is being made on this issue.

I would be happy to arrange telephone or face-to-face discussions if that will accelerate resolution of these issues.

Sincerely,

Tay

Elias Lyman, Jr.

cc: Pete Rickershauser
Lenny Berz

Attachment

Attachment Draft

A detailed description of every problem is maintained in a Lotus Notes database which is shared by the UP and the BNSF. This database assigns a number to each problem. The problem numbers which have been identified as UP problems are problem numbers 711, 10073, 10222, 10264, 10410, 10595, and 10627.

Problem number 711 deals with the routing of cars in the TCS system to Dayton instead of the agreed operational route of Houston. This problem was identified and entered into the problem log on March 5, 1998.

Problem number 10073 deals with the format of origin haulage waybills. BNSF feels that the format of the electronic waybill received from the UP is not consistent with an agreement reached in September of 1997. This problem was identified and entered into the problem log on March 19, 1998. This problem is one that the system representatives can not agree on and are waiting for the business units to direct.

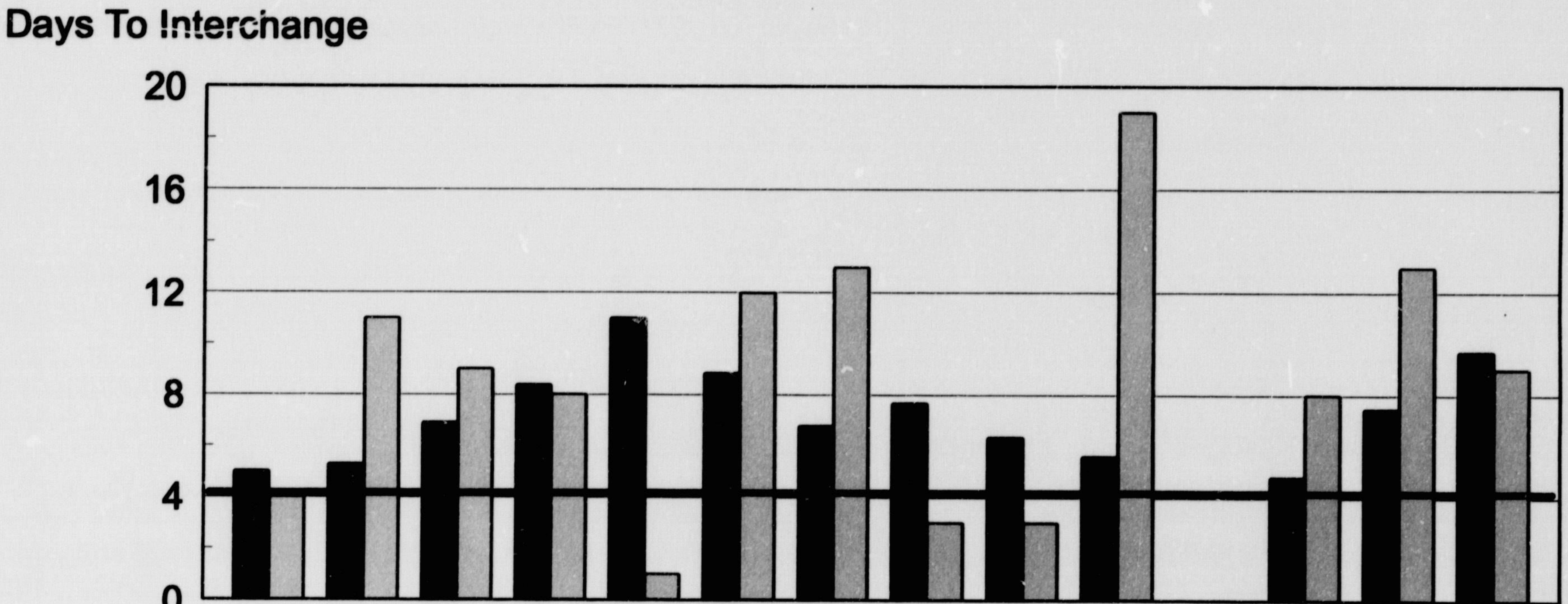
Problem numbers 10222, 10264, 10410, and 10627 all deal with the reportings known as 451s. UP is not sending the proper reportings. There is a lack of reportings from the origin, intermediate, and terminating car movements. There are also cases of duplicate reportings. These problems were all entered on April 29, 1998.

Problem number 10595 deals with empty waybills and the way TCS deals with them. TCS is not handling our empty cars correctly. This problem was entered on June 3, 1998.

ATTACHMENT 4

UP Haulage For Farmers' Rice Cooperative
West Sacramento to BNSF, Stockton

Average Days From Release Date to Interchange



Report Date	05/08/98	05/15/98	05/22/98	05/29/98	06/09/98	06/12/98	16/19/98	06/26/98	07/03/98	07/10/98	07/17/98	07/24/98	07/31/98	08/07/98
UPRR Dwell	5.00	5.27	6.89	8.37	11.00	8.83	6.77	7.67	6.33	5.58		4.80	7.46	9.67
Volume Measured	4.00	11.00	9.00	8.00	1.00	12.00	13.00	3.00	3.00	19.00	0.00	8.00	13.00	9.00

Operating Plan is Four Days, Release to Interchange

sacramento

STB FD 32760 (Sub 21) 8-14-98 D 190537

190537

ORIGINAL

D

BEFORE THE
SURFACE TRANSPORTATION BOARD

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UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY, AND MISSOURI PACIFIC RAILROAD COMPANY -- CONTROL AND MERGER -- SOUTHERN PACIFIC RAIL CORPORATION, SOUTHERN PACIFIC TRANSPORTATION COMPANY, ST. LOUIS SOUTHWESTERN RAILWAY COMPANY, SPCSL CORP., AND THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY	Finance Docket No. 32760 (Sub-No. 21)

COMMENTS OF THE
COLORADO, KANSAS & PACIFIC RAILWAY COMPANY

ENTERED
Office of the Secretary

AUG 17 1998

Part of
Public Record

JOHN D. HEFFNER
Rea, Cross & Auchincloss
1707 L Street, N.W.
Suite 570
Washington, DC 20036
(202) 785-3700

Counsel for Colorado, Kansas & Pacific Railway Company

DATED: August 14, 1998

BEFORE THE
SURFACE TRANSPORTATION BOARD

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)

COMMENTS OF THE
COLORADO, KANSAS & PACIFIC RAILWAY COMPANY

Colorado, Kansas & Pacific Railway Company ("CK&PR") submits these Comments pursuant to the Board's Decision No. 10 in this proceeding served October 27, 1997.

I. INTRODUCTION

CK&PR is a Colorado corporation established in 1997 for the purpose of acquiring and operating railroad lines. Specifically, its shareholders established CK&PR for the purpose of acquiring and operating certain rail lines owned by the Union Pacific Railroad ("UP") known as the Towner Line and the Tennessee Pass Line.[1] CK&PR offers these comments to give the

[1] The Towner Line extends between NA Jct. east of Pueblo, CO, and Towner, CO, on the Kansas/Colorado border. It is a segment of the former Missouri Pacific Railroad line between Kansas City and Pueblo which forms part of the "Central Corridor" operated by the Southern Pacific Railroad prior to its acquisition by UP. Abandonment of the Towner Line was authorized at page 204 of the Board's decision approving UP's control of the

Board a flavor of UP's commitment to preserving competitive rail service in the Central Corridor. CK&PR believes that eradication of the former Missouri Pacific-Denver & Rio Grande Western Central Corridor routes and the competitive options they offer is a top Union Pacific corporate priority even if such actions result in continued degradation of service over UP's other Central Corridor routes.

II. BACKGROUND

In Decision No. 10 issued by the Board on October 27, 1997, the Board asked parties to address the competitive concerns arising out of the UP-SP Control Case and set August 14, 1998, as the deadline for filing comments.

On October 1, 1997, CK&PR entered into negotiations with UP proposing to acquire the Towner Line as the first step towards purchasing the entire segment of the Central Corridor between the Colorado/Kansas border at Towner and the junction between the Tennessee Pass Line and the UP mainline across Colorado at Dotsero, CO (near Glenwood Springs). CK&PR advised UP that it was in the process of assembling a two part financing packaging consisting of corporate revenue bonds based upon a series of forward take or pay shipper contracts for agricultural

---

Southern Pacific Railroad (the "UP-SP Control Case"). The Tennessee Pass Line extends between Canon City, CO, west of Pueblo, and Dotsero, CO, near Glenwood Springs. It is a former Denver & Rio Grande Western rail line that was acquired and operated by the Southern Pacific Railroad. It constitutes another segment of the "Central Corridor." In the UP-SP Control Case, the Board authorized UP to discontinue operations over but not abandon the Tennessee Pass Line.

commodities and a short term bridge loan. While UP senior management professed its willingness to sell the entire Central Corridor route to CK&PR with the Towner Line being the first part of the transaction and to give CK&PR more time to assemble the financing, junior officials gave CK&PR preciously little time -- only one month -- to assemble the complicated financing arrangements required to close on the Towner Line purchase.[2] After CK&PR requested a several month extension to permit it to complete financing negotiations including those for a bridge loan and UP senior management indicated that it would favorably consider such an extension, junior management responded by granting a series of very short extensions.[3] Senior management indicated that if CK&PR would put up a nonrefundable deposit, it would entertain an extension to March 14, 1998. To show its seriousness and good faith, CK&PR responded by tendering to UP a good faith nonrefundable deposit of $100,000 for the Towner Line purchase. UP then countered by granting a very short extension of the closing deadline to December 22, 1997. After CK&PR failed to make that deadline, UP refused to grant any more extensions and kept the deposit.

Before UP could physically dismantle the line, Colorado law required it to give the State a right of first refusal to purchase the line. Colorado exercised its purchase option in

---

[2] The agreed upon purchase price was UP's net liquidated value.

[3] In each case the deadlines occurred just before a major holiday, Thanksgiving and Christmas.

July 1998. The State has indicated that it would go out for short line operator bids once it takes possession of the line.[4] However, UP has told the State that it does not want the State to select CK&PR or any affiliate thereof as an operator and wants to forbid the State from reselling the line to CK&PR or any affiliate thereof. UP has even gone so far as to attempt to persuade one of CK&PR shipper backers to refrain from supporting CK&PR in any future purchase or operating bids for the line.

Meanwhile as to the Tennessee Pass Line, UP has exercised the classic monopolist "divide and conquer" behavior by selling a small 11.75 segment of the line to a newly established passenger excursion operator known as Royal Gorge Express and its new short line freight affiliate, Rock & Rail, Inc.[5] Although UP has retained a permanent easement to provide service over this segment, it has made no long term commitments as to the continuity of the Tennessee Pass Line.

III. COMMENTS

In preparation for these comments, CK&PR has reviewed submissions in this proceeding by other affected parties. In its July 1, 1998, quarterly progress report the Burlington Northern and Santa Fe Railway noted that UP congestion on the Central

---

[4] CKPR will submit a bid in response to that request.

[5] Between Parkdale and Canon City, CO. CKPR urges the Board to ask the UP whether it required Royal Gorge Express to pay fair value for that line as it required CKPR to pay or whether it sold the line for nominal consideration as it has in some other short line transactions.

Corridor has adversely affected its operations over that line between Denver and Grand Junction, CO. See, the Burlington Northern and Santa Fe Railway Company's Quarterly Progress Report at 21. Similarly, in its comments, the Public Service Company of Colorado ("PSCo") has advised the Board that UP's service in transporting PSCo coal trains over the Moffat Tunnel line has markedly deteriorated after the time UP discontinued its use of the Tennessee Pass Line. PSCo comments at 4. Perhaps the Board should have heeded the warnings of the US Department of Agriculture which had opposed the closure of the Towner Line. See, Decision No. 10 at 6. For the Board to focus its attention on the narrow issue of the amount of local traffic moving over the Towner Line and not to view this line as part of a larger picture involving the Central Corridor illustrates a critical flaw in the Board's interpretation of the abandonment statute. In some abandonments involving the truncation of through routes, the Board, like the ICC before it, has tended to focus on the trees rather than the forest.

In its comments the PSCo properly notes its concern that UP "may be taking actions that would disrupt the continuity of the Tennessee Pass Line as well as the [Towner Line]." PSCo then goes onto note that efforts by a short line operator to purchase the portion of the Towner Line from NA Junction to Towner have been "unsuccessful." PSCo comments at 6-7. CK&PR is the very short line to which PSCo refers.

CK&PR has not given up in its efforts to preserve the

Towner Line. However, CK&PR emphasizes that UP has not gone out of its way to help this transaction come to fruition.

CONCLUSION

For all of the foregoing reasons, CK&PR respectfully urges the Board to scrutinize carefully UP's assertions regarding the Tennessee Pass Line and competition in the Central Corridor. Specifically, CK&PR urges the Board to continue the condition it previously imposed permitting UP to discontinue service over but not abandon the Tennessee Pass Line and order UP to preserve the integrity and continuity of the Tennessee Pass Line as a through route between Pueblo and Dotsero, CO, until such time as it might sell the line in one piece to another rail carrier for continued service.

Respectfully submitted,

JOHN D. HEFFNER
Rea, Cross & Auchincloss
1707 L Street, N.W.
Suite 570
Washington, DC 20036
(202) 785-3700

Counsel for Colorado,
Kansas & Pacific Railway
Company

DATED: August 14, 1998

CERTIFICATE OF SERVICE

I hereby certify that I have this 14th day of August, 1998, served the foregoing document on all parties of record by first class U.S. mail.

John D. Heffner

STB FD 32760 (Sub 21) 8-14-98 D 190524

190524

SLOVER & LOFTUS

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August 14, 1998

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D

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
Case Control Unit
1925 K Street, N.W.
Washington, D.C. 20423-0001

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

Dear Secretary Williams:

Enclosed for filing are the original and 25 copies of the Comments of Public Service Company of Colorado in the second annual UP/SP merger oversight proceeding. Also enclosed is a diskette containing the text of this pleading in WordPerfect 8.0 format, and the exhibit to the Verified Statement of David N. Lawson in both EXCEL and LOTUS format.

An extra copy of this pleading is also enclosed. Kindly confirm receipt by date-stamping and returning the extra copy to our messenger.

Respectfully submitted,

Christopher A. Mills

Christopher A. Mills
An Attorney for Public Service
Company of Colorado

Enclosures

cc: Parties of Record in F.D. 32760 (Sub 21)

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BEFORE THE
SURFACE TRANSPORTATION BOARD

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COMMENTS OF PUBLIC SERVICE COMPANY OF COLORADO IN SECOND ANNUAL OVERSIGHT PROCEEDING

PUBLIC SERVICE COMPANY OF COLORADO

By: C. Michael Loftus
Christopher A. Mills
Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036
(202) 347-7170

Its Attorneys

OF COUNSEL:

Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036

Dated: August 14, 1998

BEFORE THE
SURFACE TRANSPORTATION BOARD

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)

COMMENTS OF
PUBLIC SERVICE COMPANY OF COLORADO
IN SECOND ANNUAL OVERSIGHT PROCEEDING

Public Service Company of Colorado ("PSCo") submits the following Comments pursuant to the Board's Decision No. 10 in this proceeding served October 27, 1998.

I. INTRODUCTION

PSCo participated in the first annual proceeding to implement the oversight condition imposed by the Board when it approved the Union Pacific/Southern Pacific ("UP/SP") merger in Finance Docket No. 32760. See Decision No. 44 (served August 12, 1996) ("Decision No. 44"). In that proceeding, PSCo voiced its concern that UP's proposed abandonment of the SP's Tennessee Pass line in Colorado would adversely affect the quality of UP's service in transporting western Colorado coal to PSCo's power plants in the Denver area via the Moffat Tunnel line.[1]

PSCo's specific concern was that service problems could develop on the Moffat Tunnel line as a result of the additional traffic shifted to this line from the Tennessee Pass line (as well as additional BNSF traffic moving over the Moffat Tunnel line under its new Central Corridor trackage rights). This matter was addressed at some length in PSCo's Comments in the merger proceeding filed March 29, 1996 (PSC-3); and in its Brief filed on June 3, 1996 (PSC-4). In response to PSCo's concern, the Board imposed a condition permitting UP/SP to discontinue service on the Tennessee Pass line, but denying their request for authority to abandon it and remove the track. See Decision No. 44 at 155-156.

In its Comments in the first annual merger oversight proceeding filed on August 1, 1997 (PSC-8), PSCo advised the Board that because UP had only recently (on July 1, 1997) shifted traffic formerly routed via the Tennessee Pass line to the Moffat

---

[1] The Tennessee Pass line, which crosses the Continental Divide west of Pueblo, CO, was SP's principal route for the movement of coal originated in Colorado and Utah to Midwestern destinations. It also provided an alternative to the Moffat Tunnel line for the movement of other commodities between the Salt Lake City/Ogden/Provo area and points east/south of the Front Range cities of Denver/Colorado Springs/Pueblo.

Tunnel line, it was unable to assess whether the shift was adversely affecting UP's service on the Moffat Tunnel Line. In Decision No. 10 in this proceeding, the Board referred to PSCo's concerns, and acknowledged that it was too early to tell whether the Moffat Tunnel line is capable of handling traffic diverted from the Tennessee Pass line. Id. at 5 n.7. The clear implication was that this issue could be revisited in this second annual oversight proceeding, after a full year of experience with the discontinued rail operations on the Tennessee Pass line and the shifting of traffic to the Moffat Tunnel line.

The purpose of these Comments is to share with the Board PSCo's experience with respect to UP service on the Moffat Tunnel line, particularly during the past year. The facts concerning UP's service on this line both before and after UP's discontinuance of operations on the Tennessee Pass line are set forth in the accompanying Verified Statement of David N. Lawson, the Railcar and Coal Transportation Coordinator for PSCo and its affiliate, New Century Services, Inc.

II. ASSESSMENT OF UP SERVICE ON THE MOFFAT TUNNEL LINE

PSCo consumes approximately 2.5 million tons of western Colorado coal annually at its Denver area power plants. Historically, UP's predecessors have transported this coal from the mines to the Denver area via the Moffat Tunnel line. As Mr. Lawson indicates in his testimony, UP's service in transporting PSCo coal trains over the Moffat Tunnel line has deteriorated markedly during the period of approximately one year since UP discontinued train operations on the Tennessee Pass line and shifted traffic (especially eastbound coal traffic) that formerly used that line to the Moffat Tunnel line.

During the twelve-month period from July 1995 through June 1996, which preceded the Board's approval of the UP/SP merger, SP delivered over 98% of the trainload shipments of Colorado coal that were scheduled by PSCo for delivery to its Cherokee Station[2] -- a percentage of deliveries consistent with PSCo's historical experience with SP. (Lawson V.S. at 4.) However, during the comparable twelve-month period immediately following UP's shifting of traffic from the Tennessee Pass line to the Moffat Tunnel line (July 1997 through June 1998), UP delivered only 87% of the shipments scheduled by PSCo for movement to Cherokee Station. (Id. at 4-5.) UP's service deteriorated further during the last two months of this period (May and June of 1998), when it was able to deliver only 76% of the scheduled shipments. (Id. at 5.)

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[2] The Cherokee Station is the largest of PSCo's three Denver area power plants. It consumes approximately two million tons of western Colorado coal annually. (Lawson V.S. at 2.)

In addition, the round-trip cycle times for trains delivering coal from western Colorado mines to Cherokee Station have increased substantially over the past year and a half. The increase in cycle time ranges from 33% to 50%, depending on the specific mine origin involved. (Id.)

In a recent meeting, UP operating personnel confirmed to PSCo that traffic on the Moffat Tunnel line has increased since traffic was shifted off the Tennessee Pass line, and that UP is experiencing service problems on the Moffat Tunnel line. (Id. at 6.) However, UP's Second Annual Report on Merger and Condition Implementation filed in this proceeding on July 1, 1998 (UP/SP-344) ("Second Annual Report") is silent with respect to changes in the quality of service provided on the Moffat Tunnel line before and after the addition of the traffic that formerly moved via the Tennessee Pass line.

BNSF, on the other hand, is not so reticent. In its July 1, 1998 Quarterly Status Report (BNSF-PR-8), BNSF indicates that it is now operating daily train service over the Denver/Stockton/Richmond "Central Corridor" trackage rights line (Id. at 47), and confirms that UP is having service problems due to congestion on the Moffat Tunnel line:

> Throughout the second quarter [of 1998], congestion along UP lines in the Central Corridor has adversely impacted BNSF

> service. For example, UP is increasing its coal business in the Grand Junction, CO area, and there has been significant build up of traffic on the former SP [Moffat Tunnel] line between Denver and Grand Junction. . . .
>
> BNSF also remains increasingly concerned about its train operations between Denver and Stockton. The level of service that BNSF has been able to provide over its trackage rights line does not allow BNSF to meet its commitments to customers, and therefore, does not allow BNSF to be competitive with UP on a consistent basis.

Id. at 21.

In short, far from being able to "demonstrate that overhead traffic over the Tennessee Pass line has been successfully rerouted" (Decision No. 44 at 156), UP's service on the alternative Moffat Tunnel line has deteriorated. This is a matter of concern not only to PSCo, but also to its sister utility, Southwestern Public Service Company ("SPS").[3] SPS also consumes Colorado coal at its Harrington Station near Amarillo, TX, and it has experienced congestion and delays in receiving timely deliveries of this coal (which also moves via the Moffat Tunnel line). (Lawson V.S. at 7).

PSCo is also concerned that UP may be taking actions that would disrupt the continuity of the Tennessee Pass line, as

[3] PSCo and SPS are operating subsidiaries of New century Energies, Inc. (Lawson V.S. at 1.)

well as the former UP line extending east from Pueblo which was used by SP to transport Colorado coal to Midwestern destinations. PSCo has been given to understand that efforts by a short-line operator to purchase the portion of this line from Towner to NA Junction, CO (which has been abandoned by UP) have been unsuccessful, although the State of Colorado remains interested in acquiring this line segment so that rail operations thereon can be resumed. (See UP's Second Annual Report at 27.) With respect to the Tennessee Pass line itself, UP is in the process of selling the 11.75-mile segment of this line between Parkdale and Canon City, CO to another rail carrier for both freight and passenger service. Id. at 28.[4] Although UP apparently is retaining overhead trackage rights "so as to preserve the integrity of the Tennessee Pass through route,"[5] the Board should be vigilant in assuring that the entire line is preserved as a potential through route given the condition (imposed in Decision No. 44) prohibiting the line's full abandonment and the continuing nature of this oversight proceeding.

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[4] See, also, the Notices of Exemption served July 15, 1998, in Finance Docket No. 33608, Rock & Rail, Inc.--Lease and Operation Exemption--Royal Gorge Express, LLC and Finance Docket No. 33622, Royal Gorge Express, LLC--Acquisition and Operation Exemption--Union Pacific Railroad Company.

[5] See Finance Docket No. 33622 (served July 15, 1998) at 1 n. 1.

III. CONCLUSION

For all of the foregoing reasons, PSCo respectfully requests that the Board (1) continue in effect the condition permitting UP to discontinue service on, but not fully abandon, the Tennessee pass line in view of UP's recent service problems on the Moffat Tunnel line; (2) order UP to continue to preserve the integrity and continuity of the Tennessee Pass line as a potential through route for coal and other traffic moving between points west of Dotsero, CO and Pueblo, CO; and (3) revisit the level of service UP is providing on the Moffat Tunnel line in a third annual UP/SP merger oversight proceeding, to be conducted in mid-1999.

Respectfully submitted,

PUBLIC SERVICE COMPANY OF COLORADO

By: C. Michael Loftus
Christopher A. Mills
Slover & Loftus
1224 Seventeenth Street, N.W.
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(202) 347-7170

Its Attorneys

OF COUNSEL:

Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036

Dated: August 14, 1998

BEFORE THE
SURFACE TRANSPORTATION BOARD

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)

VERIFIED STATEMENT OF
DAVID N. LAWSON

My name is David N. Lawson. I am employed by New Century Services, Inc. as Railcar and Coal Transportation Coordinator. My business address is 550 Fifteenth Street, Suite 900, Denver, CO 80202.

New Century Services is a wholly-owned subsidiary of New Century Energies, Inc., which is a public utility holding company and the parent company of Public Service Company of Colorado ("PSCo") and Southwestern Public Service Company ("SPS"). As Railcar and Coal Transportation Coordinator for New Century Services based in Denver, my responsibilities include supervision of the scheduling of the transportation of coal to the power plants operated by PSCo, as well as the maintenance of PSCo's private railcar fleet.

I have been with PSCo (and New Century Services since it was formed in 1997) for almost 35 years. I have had responsibilities similar to those described above for approximately the past ten years. I am very familiar with the transportation of coal to PSCo's plants, both before and after the 1996 merger of Union Pacific Railroad Company ("UP") and Southern Pacific Transportation Company ("SP"). I have been authorized to provide this testimony on behalf of PSCo in the UP/SP merger oversight proceeding.

As more fully described in PSCo's Comments filed in the UP/SP merger proceeding on March 29, 1996 (PSC-3), PSCo operates three coal-fired electric generation facilities in the Denver area, commonly referred to as our "Denver area plants." These plants include the Cherokee, Arapahoe and Valmont Generating Stations. The Cherokee and Valmont plants presently burn coal originated by UP at mines in western Colorado.[1] This coal moves to Denver via the "Moffat Tunnel" line, which is the former DRGW/SP (now UP) main line between Salt Lake City, Grand Junction and Denver via the Moffat Tunnel.

Prior to approximately July 1, 1997, UP (and SP before it) moved substantial quantities of coal traffic from western Colorado and northeastern Utah origins to the Midwest and Texas

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[1] PSCo consumes approximately 2.5 million tons of Colorado coal annually at its Denver area plants. Three-quarters of this total, or about two million tons per year, move to Cherokee Station which is the largest of these plants. Cherokee Station is served exclusively by UP.

via the "Tennessee Pass" line. This line extends from Dotsero, CO on the west (where it connects with the Moffat Tunnel line) to Pueblo, CO on the east. At Pueblo, coal trains could either continue eastward via the former SP line to Kansas City, or move south (to Texas) via SP's north-south line located on the east side of the Colorado "Front Range." This route was also occasionally used as a detour route for PSCo coal trains when SP experienced a severe derailment or other problems on the Moffat Tunnel line east of Dotsero.

I understand that as part of the UP/SP merger, the Surface Transportation Board ("Board") permitted UP to discontinue all train operations on the Tennessee Pass line and shift all rail traffic that formerly used that line to other routes -- primarily the Moffat Tunnel line. However, as a result of concerns expressed by PSCo and others, UP was not permitted to abandon the Tennessee Pass line or remove the track until it could show that it is able to accommodate the traffic that formerly moved over that line on the Moffat Tunnel line without disrupting service to shippers such as PSCO whose coal traffic normally moves over the Moffat Tunnel line.

The purpose of my testimony is to provide the Board with facts concerning UP's service in transporting PSCo coal trains both before and after UP shifted through trains from the Tennessee Pass line to the Moffat Tunnel line on approximately July 1, 1997.

PSCo schedules trainload shipments of Colorado coal to its Denver area plants on a monthly basis. We measure rail service performance primarily in terms of shipments scheduled and shipments received each month (and annually), and train cycle times.

Exhibit DNL-1 attached hereto shows the number of trainload shipments scheduled and received each month, and cumulatively, at our Cherokee Station (the largest of our three Denver area plants) for each of the following three twelve-month periods: July 1995-June 1996, July 1996-June 1997, and July 1997-June 1998. The first of these periods is roughly equivalent to the final year of SP independence from UP. The second period covers most of the first year following the consummation of the UP/SP merger in September of 1996. The third period covers the first full year of UP operations after it shifted rail traffic from the Tennessee Pass line to the Moffat Tunnel line.

Exhibit DNL-1 shows that during the period from July 1995 through June 1996, SP delivered more than 98% of the shipments scheduled by PSCo for the Cherokee Station (156 of 159). This is consistent with our historical experience with SP/DRGW in delivering western Colorado coal to our Denver area plants. During the period from July 1996 through June 1997, UP/SP's service declined slightly; the railroad delivered approximately 95% of the shipments scheduled for Cherokee Station (199 of 212). During the most recent twelve-month period from July 1997 through June 1998 (again, the first full year of service after UP stopped operating on the Tennessee Pass line), UP's service declined considerably; it was able to deliver only 87% of the shipments scheduled (194 of 223). UP's deliveries were also more erratic during this period, and got worse as the period progressed. In the last two months, May and June of 1998, UP delivered only 76% of the shipments scheduled.[2]

The difference between delivering 95% of the scheduled shipments (as in 1996-97) and 87% of the scheduled shipments (as in 1997-98) represents a shortfall of approximately 200,000 tons per year. This represents about 10% of the total annual volume consumed at Cherokee Station.

The round trip cycle time required for coal trains traveling between western Colorado mines and Cherokee Station has also increased considerably over the past year and a half. The cycle time for trains operating between Cyprus AMAX's Twenty Mile Mine and Cherokee has increased from approximately 36 hours in late 1996 to 48 hours at present, an increase of 33%. During the same time period, the cycle time for trains operating between Arch Mineral's West Elk Mine and Cherokee has increased from approximately 48 hours to over 72 hours -- an increase of 50%.

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[2] It will be noted that the total number of scheduled trainload shipments increased from 159 in the 1995-96 period to 212 in the 1996-97 period and 223 in the 1997-98 period. These increases were the result of additional demand for generation (and thus coal) at Cherokee Station, and efforts by PSCo to keep the Cherokee coal inventory at acceptable levels. They were made with the advance knowledge of (and without objection by) UP. The increase in scheduled shipments for the 1997-98 period is due in part to the scheduling of additional shipments later in the period to make up for UP delivery shortfalls early in the period.

Historically, PSCo was able to depend on SP for regular delivery of scheduled shipments. This has not been the case with UP, particularly since it shifted rail traffic from the Tennessee Pass line to the Moffat Tunnel line on approximately July 1, 1997. Indeed, UP has acknowledged that it is experiencing service problems on the latter line.

We conduct periodic operations meetings with UP operating personnel to discuss the operation of coal trains to and from PSCo's Denver area plants. During such a meeting this past spring, UP confirmed that the number of trains using the Moffat Tunnel line has increased substantially. This includes both UP's own trains and trains operated by the Burlington Northern and Santa Fe Railroad ("BNSF"), which obtained trackage rights over the Moffat Tunnel line between Denver and Salt Lake City/Ogden via Grand Junction as a result of the UP/SP merger.

All of this traffic must pass through the six-mile-long Moffat Tunnel. The tunnel is definitely a bottleneck. UP personnel have advised us that at least twenty minutes must elapse after one train exits the tunnel before another train is allowed to enter the tunnel, due to the need to vent locomotive exhaust fumes, and that this is becoming an increasing problem as the volume and frequency of train traffic passing through the tunnel grows.

We have also been advised by UP that BNSF has recently increased the frequency of its train operations on the Moffat Tunnel line, and that both UP and BNSF have experienced problems in scheduling locomotives and crews at Grand Junction. According to UP, these factors have also contributed to the congestion on the Moffat Tunnel line.

PSCo is greatly concerned that the congestion problems UP is experiencing on the Moffat Tunnel line may become worse in the future, with resulting adverse consequences in terms of UP's ability to deliver western Colorado coal to PSCo's Denver area plants on a timely basis. In addition, PSCo's sister company, SPS, also consumes Colorado coal at its Harrington Generating Station near Amarillo, TX. UP transports this coal eastward to Denver via the Moffat Tunnel line, and thence southward via Colorado Springs and Pueblo to Amarillo, rather than over the more direct route via the Tennessee Pass line. SPS has also experienced congestion and delays in receiving timely deliveries of Colorado coal at the Harrington Station.

For these reasons, PSCo urges the Board to preserve the Tennessee Pass line as an alternative through route for coal traffic that presently moves via the Moffat Tunnel line for at least another year. We are not as yet prepared to advocate that UP be required to actually restore through rail service over the Tennessee Pass line. However, at a minimum, UP should not be permitted to completely abandon the line, or sell portions of it in such a manner that UP's ability to resume through train operations between Dotsero and Pueblo via Tennessee Pass would be impaired. This would preserve the line's integrity as an alternative route if the Board were to conclude that UP is unable to rectify the present congestion problems on the Moffat Tunnel line, and that the public interest requires UP to resume through train operations on the Tennessee Pass line.

CHEROKEE STATION COAL SHIPMENTS - SCHEDULED VERSUS ACTUAL: JULY 1995 - JUNE 1996

MONTHLY

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
SCHEDULED	19	18	10	13	13	13	12	13	14	15	10	9
RECEIVED	16	18	8	15	13	13	12	12	15	15	9	10

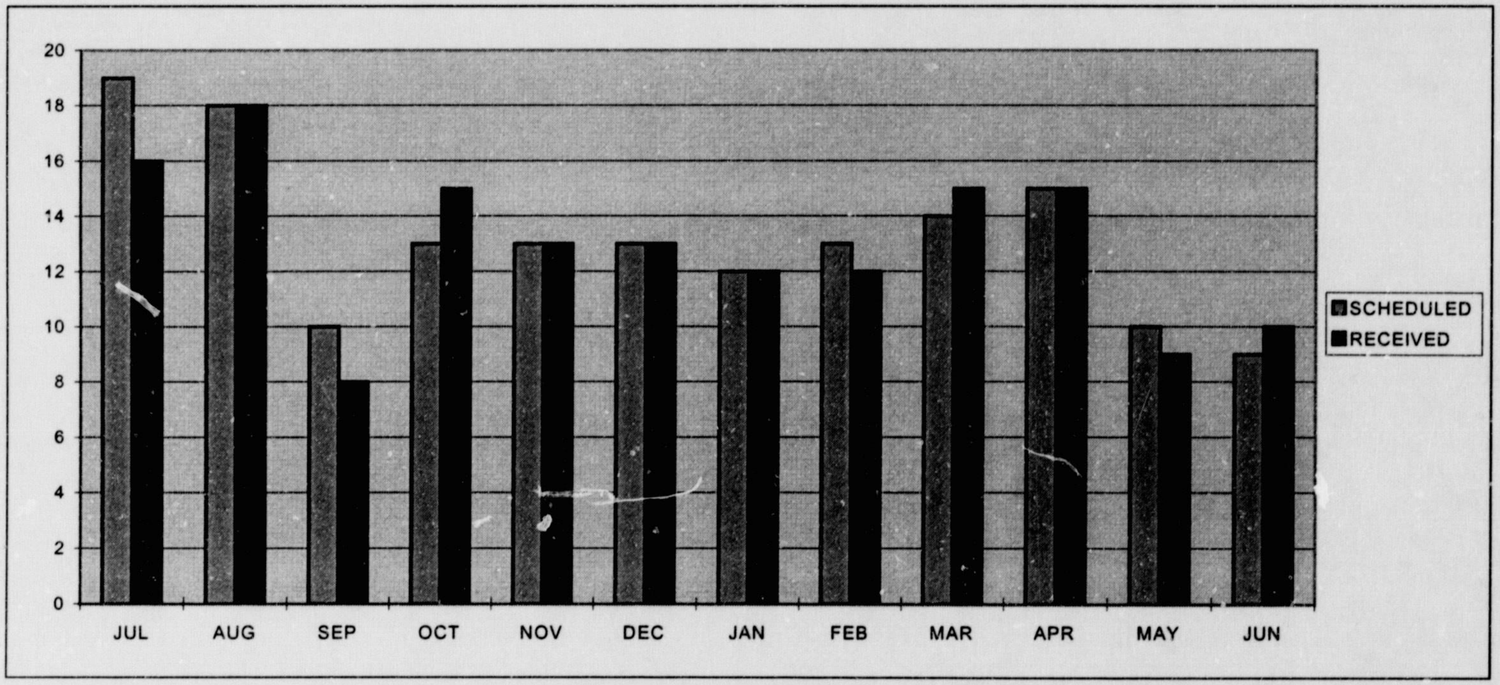

Exhibit DNL-1
Page 1 of 6

chedelm9596

CHEROKEE STATION COAL SHIPMENTS - SCHEDULED VERSUS ACTUAL: JULY 1995 - JUNE 1996

CUMULATIVE

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
SCHEDULED	19	37	47	60	73	86	98	111	125	140	150	159
RECEIVED	16	34	42	57	70	83	95	107	122	137	146	156

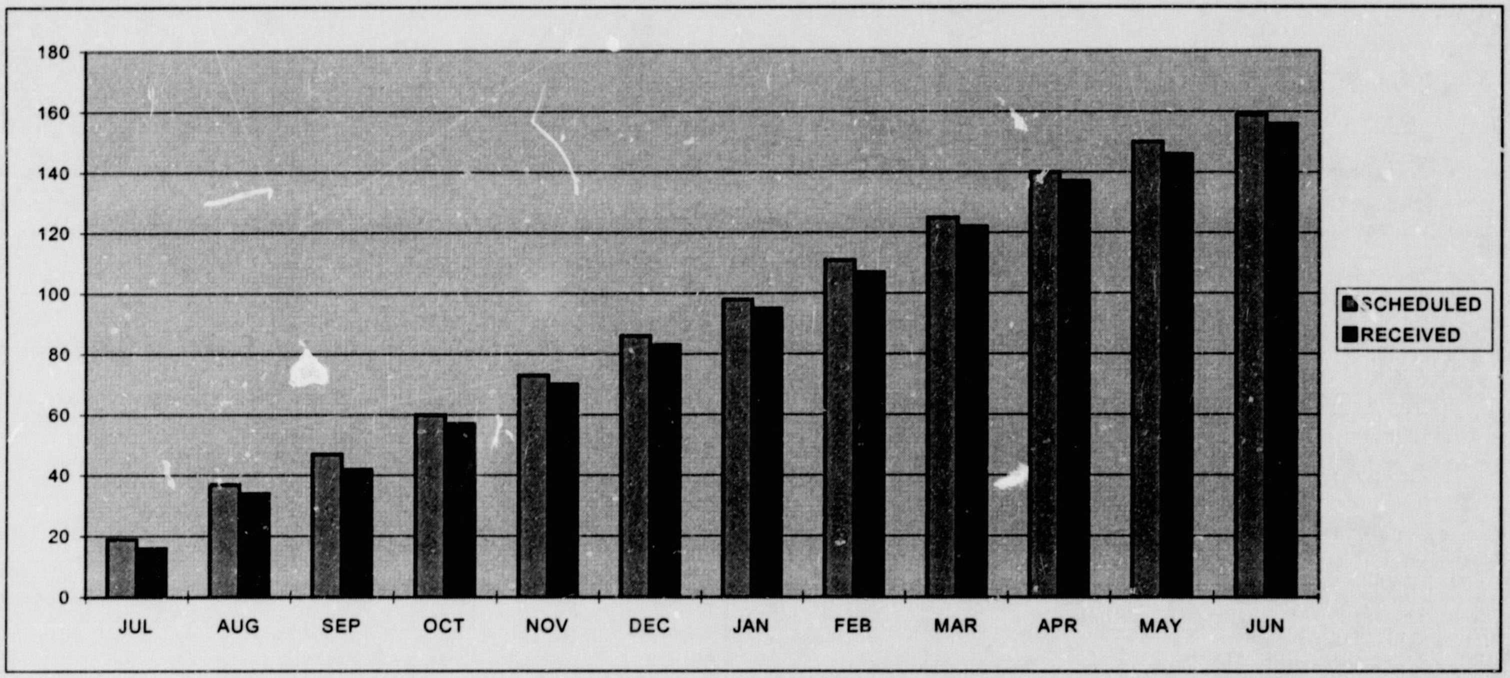

Exhibit DNL-1
Page 2 of 6

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CHEROKEE STATION COAL SHIPMENTS - SCHEDULED VERSUS ACTUAL - JULY 1996 - JUNE 1997

MONTHLY

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
SCHEDULED	10	13	16	24	21	21	20	15	15	18	18	21
RECEIVED	9	9	14	19	23	22	20	14	15	17	18	19

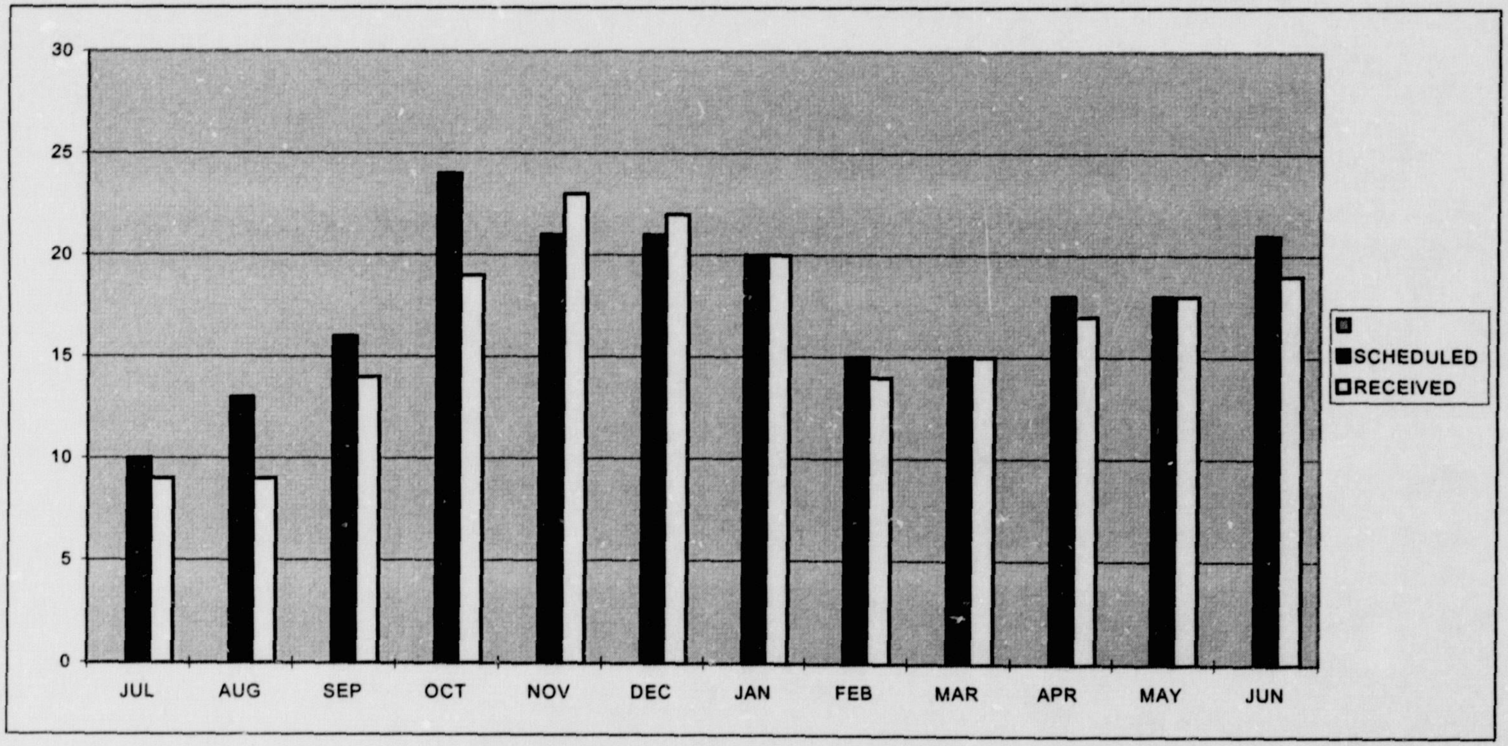


Exhibit DNL-1
Page 3 of 6

dl/cherdel

CHEROKEE STATION COAL SHIPMENTS - SCHEDULED VERSUS ACTUAL: JULY 1996 - JUNE 1997

CUMULATIVE

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
SCHEDULED	10	23	39	63	84	105	125	140	155	173	191	212
RECEIVED	9	18	32	51	74	96	116	130	145	162	180	199

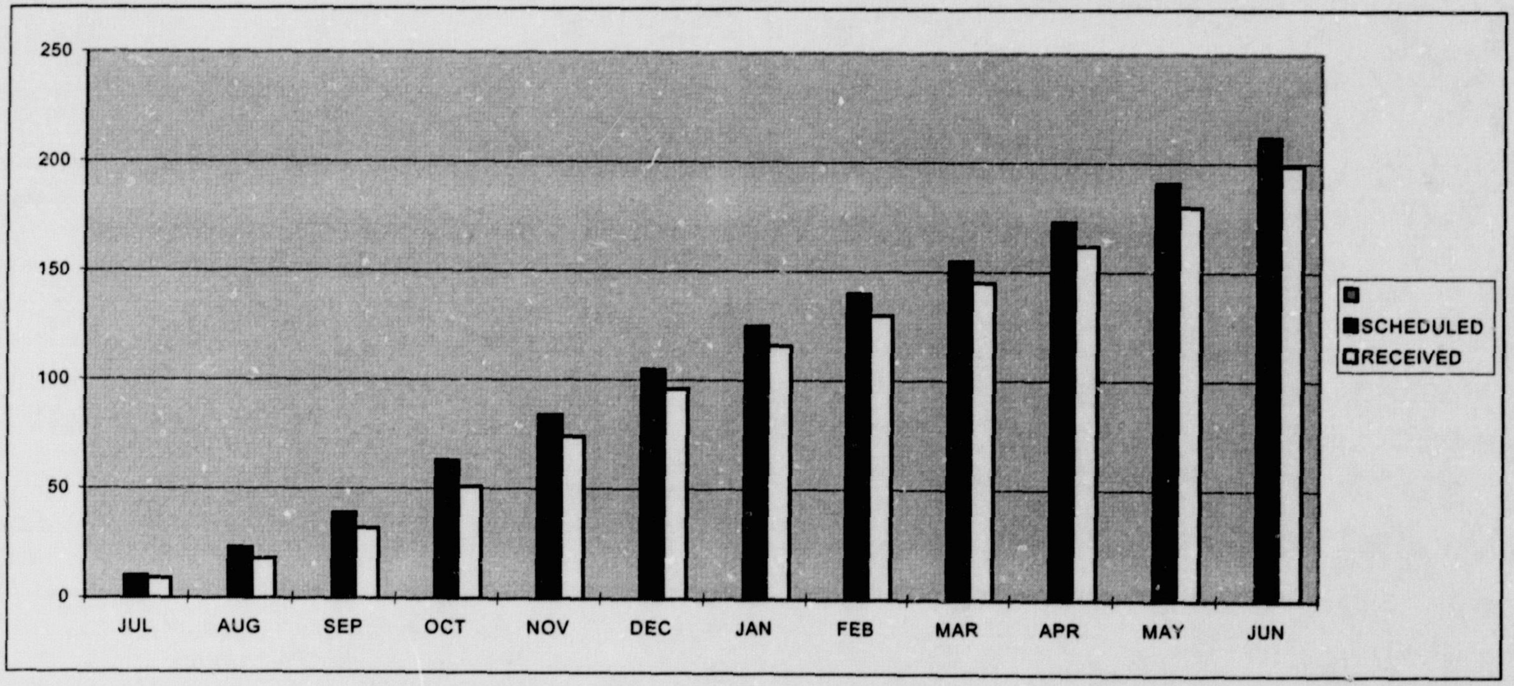


Exhibit DNL-1
Page 4 of 6

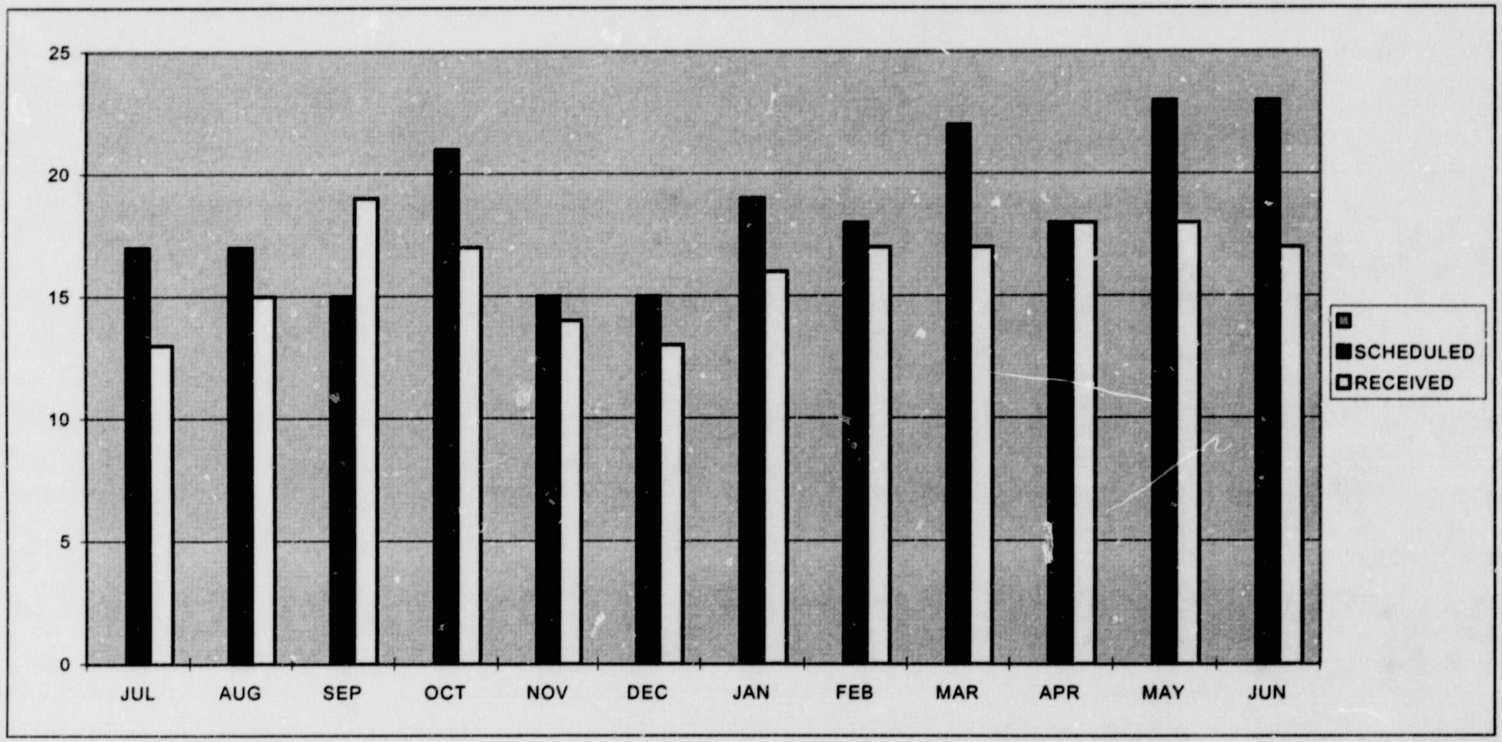
dl/cherdei

CHEROKEE STATION COAL SHIPMENTS - SCHEDULED VERSUS ACTUAL
JULY 1997 - JUNE 1998

MONTHLY

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
SCHEDULED	17	17	15	21	15	15	19	18	22	18	23	23
RECEIVED	13	15	19	17	14	13	16	17	17	18	18	17

Shipment size = 105 cars July - Jan; 108 cars Feb - June.



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CHEROKEE STATION COAL SHIPMENTS - SCHEDULED VERSUS ACTUAL
JULY 1997 - JUNE 1998

CUMULATIVE

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
SCHEDULED	17	34	49	70	85	100	119	137	159	177	200	223
RECEIVED	13	28	47	64	78	91	107	124	141	159	177	194

Shipment size = 105 cars - July - Jan; 108 cars - Feb - June.

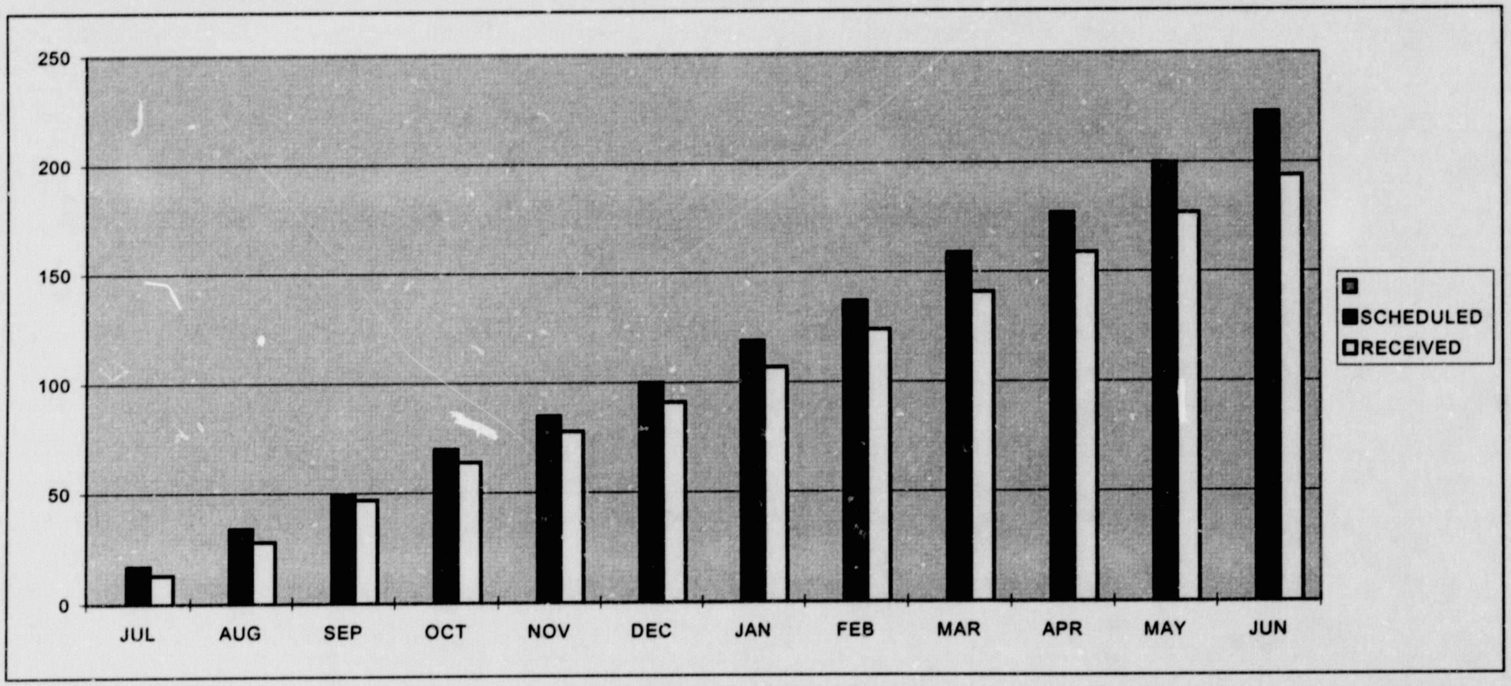

Exhibit DNL-1
Page 6 of 6

dl/cherdel

VERIFICATION

STATE OF COLORADO)
) SS:
COUNTY OF DENVER)

David N. Lawson, being duly sworn, deposes and says that he has read the foregoing Verified Statement, knows the contents thereof, and that the same are true as stated, except as to those statements made on information and belief, and as to those, that he believes them to be true.

David N. Lawson
David N. Lawson

Subscribed and sworn to before me
this 12th day of August, 1998.

Jacqueline Page
Notary Public for the State of Colorado

My commission expires 7/23/2000.

CERTIFICATE OF SERVICE

I hereby certify that on this 14th day of August, 1998, I served copies of the foregoing Comments by hand delivery on Washington counsel for UP and for BNSF, and by first-class mail, postage prepaid, on all other parties of record in Finance Docket No. 32760 (Sub-No. 21).

Christopher A. Mills

Christopher A. Mills

STB FD 32760 (Sub 21) 8-4-98 D 190383

190383

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Office of the Secretary

AUG - 5 1998

Part of
Public Record

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

ATTORNEYS AND COUNSELORS AT LAW
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August 4, 1998

AFPA-1

BY HAND DELIVERY
Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K St. N.W.
Washington, D.C 20423

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

Dear Secretary Williams:

This letter is to notify the Board that the American Forest & Paper Association ("AFPA") intends to participate in this proceeding as a party of record. Please include the following on the service list as representatives of AFPA:

John K. Maser III
Karyn A. Booth
Donelan, Cleary, Wood & Maser, P.C.
Suite 750 West
1100 New York Avenue, NW
Washington, DC 20005-3934
202/371-9500

In accordance with 49 C.F.R. § 1180.4(a)(2), AFPA selects the acronym "AFPA-x" for identifying all documents and pleadings it submits in this proceeding.

Enclosed with this letter are 25 copies. Copies of this letter are also being served on all persons presently on the Board's service list for Finance Docket No. 32760, Sub-No. 21.

Sincerely,

John K. Maser
KAB

JOHN K. MASER III
KARYN A. BOOTH

ENCLOSURE
0014-740
cc: All parties of record

STB FD 32760 (Sub 21) 7-20-98 D 189982

199982

BEFORE THE
SURFACE TRANSPORTATION BOARD

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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

ENTERED
Office of the Secretary
JUL 20 1998
Part of
Public Record

OVERSIGHT PROCEEDING

[redacted]

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JUL 20 1998
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REPLY IN OPPOSITION TO
KANSAS CITY SOUTHERN'S
MOTION TO STRIKE

The Arkansas Louisiana & Mississippi Railroad Company ("AL&M") respectfully opposes the motion to strike filed by the Kansas City Southern ("KCS") on July 16, 1998 ("KCS Motion").

The essence of the KCS Motion is that the supplement filed by the AL&M was a reply to a reply by which the AL&M was attempting to have the "last word." KCS Motion at 4. To the contrary, as the AL&M made very clear in the footnote on the first page of its supplement, the UP and the KCS, as well as other interested parties, are entitled to reply to the supplement. The UP has already filed its response to the supplement (UP/SP-347, filed July 16, 1998), and if the KCS wishes, it can have the last word.[1]

---

[1] The AL&M does not object to KCS's being granted 20 days following the decision of the Board on the KCS Motion to file their response to the supplement.

The AL&M did not attempt to disguise the fact that its supplement addressed points raised by the UP and KCS. It addressed those points in the interest of supplying the most complete record and focusing the issues for the Board. Many of the points raised by the UP in its reply to the AL&M's petition dealt with claims of alleged product and geographic competition, and the AL&M submits that it would be inconsistent with the spirit of the Board's recent decisions to bar the AL&M from addressing those issues after the railroad party has first identified what it considers to be relevant product and geographic competition.

The AL&M submits that its brief supplement, the reply to the supplement filed by the UP, and any reply that KCS may file, do not burden the record but rather serve to better frame the issues for the Board's decision. It therefore respectfully opposes the KCS Motion, and invites the KCS to submit any appropriate evidence or argument it may have taking issue with the contents of AL&M's supplement.

Respectfully submitted,

John L. Oberdorfer
Scott N. Stone
Patton Boggs, L.L.P.
2550 M Street, NW
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Phone: 202-457-6335
Fax: 202-457-6315
E-mail: joberdorfer@pattonboggs.com
sstone@pattonboggs.com

Attorneys for The Arkansas Louisiana and Mississippi Railroad Company

dated: July 20, 1998

CERTIFICATE OF SERVICE

This is to certify that I have, on this 20th day of July, 1998, served the foregoing Reply in Opposition to Kansas City Southern's Motion to Strike on all parties of record in the oversight proceeding by first class mail, and upon outside counsel for the Union Pacific and Kansas City Southern by hand.

Scott N. Stone

STB FD 32760 (Sub 21) 7-16-98 D 189894

189894

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DIRECT TELEFAX NUMBER
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JUL 16 1998
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July 16, 1998

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JUL 17 1998

Part of
Public Record

BY HAND

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
Room 711
1925 K Street, N.W.
Washington, D.C. 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-captioned docket are the original and twenty-five copies of Union Pacific's Reply to ALM's "Supplement" to Petition (UP/SP-347). Also enclosed is a 3.5-inch disk containing the text of this pleading in WordPerfect 5.1 format.

Please note that Union Pacific's Reply has two versions: one is redacted for the public file, and the other contains "Highly Confidential" information. The "Highly Confidential" version is clearly marked and is being separately filed with the Board under seal. The Board is being provided with 25 copies of both versions. The computer disk contains only the Highly Confidential version and is being filed under seal. We will provide the "Highly Confidential" version on request to parties that have indicated that they will adhere to the restrictions of the protective order entered in the UP/SP merger proceeding.

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

Sincerely,

Michael L. Rosenthal

Enclosures

cc: Parties of Record

189894

REDACTED -- TO BE PLACED ON PUBLIC FILE

UP/SP-347

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

UNION PACIFIC'S REPLY TO ALM'S "SUPPLEMENT" TO PETITION

Union Pacific Railroad Company ("UP") hereby responds to the "Supplement to Petition of the Arkansas, Louisiana and Mississippi Railroad Company for an Additional Remedial Condition" ("Supplement") dated June 26, 1998. ALM's Supplement is an impermissible reply to a reply,[1] which ALM has not sought leave to file. Should the Board elect to receive it, UP respectfully requests that this reply be considered as well.

ALM's claims of large UP rate increases and abuse of market power were fundamentally incorrect when first asserted in ALM's May 12 Petition, and ALM's "Supplement" provides no additional support for them. To the contrary, the data presented in ALM's Supplement demonstrate that UP did not gain market power over ALM traffic as a result of the UP/SP merger. Moreover, ALM's claims in its Supplement of continued poor service are

[1] See 49 C.F.R. § 1104.13(c).

directly at odds with the facts and with reports that ALM's own witness, Larry Ahlers, has been providing to UP.

I. THE UP/SP MERGER DID NOT PROVIDE UP WITH MARKET POWER TO RAISE GEORGIA-PACIFIC'S RATES

ALM's latest paper fails to rebut UP's showing that the results of recent contract negotiations between UP and Georgia-Pacific in fact demonstrate that UP did not gain any market power as a result of the UP/SP merger.

First, the Supplement attempts to dismiss as irrelevant UP's evidence that the overall impact of UP's ongoing process of rate simplification with respect to Georgia-Pacific was designed to be revenue neutral and has in fact resulted in huge rate reductions on many Georgia-Pacific routes. ALM does not contest UP's evidence that Georgia-Pacific will realize substantial savings and gain access to new markets as a result of UP's actions. ALM instead rests on the legalistic argument that UP "has not offered evidence sufficient to support a finding that the relevant market . . . is anything other than ALM traffic" (Supplement, p. 5), and suggests that the Board must focus exclusively on ALM traffic.

As UP explained in its initial Reply, UP's current rates for Georgia-Pacific traffic reflect a collaborative process designed to simplify Georgia-Pacific's rate structure and provide Georgia-Pacific with competitive, comprehensive market coverage. In this process, UP did not treat "3-to-2" traffic differently from other traffic, as Brian McDonald, UP's Vice-President and

Business Director-Lumber and Panel Products testified under oath in his statement accompanying UP's initial Reply. McDonald V.S., p. 4. Moreover, the process has in fact resulted in dramatic rate reductions for Georgia-Pacific, the benefits of which will only increase as Georgia-Pacific takes advantage of the new opportunities that have been created. Mr. McDonald testified about the tremendously positive benefits to Georgia-Pacific of this rate simplification process. <u>See</u> McDonald V.S., pp. 1-3.

Moreover, ALM's legalistic argument that the Board should ignore the full picture should be rejected as procedurally and substantively flawed. As a procedural matter, it is the responsibility of the <u>petitioner</u> to establish the relevant market. <u>See</u>, <u>e.g.</u>, <u>Clorox Co.</u> v. <u>Sterling Winthrop, Inc.</u>, 117 F.3d 50, 56 (2d Cir. 1997); <u>R.C. Dick Geothermal Corp.</u> v. <u>Thermogenics, Inc.</u>, 890 F.2d 139, 143 (9th Cir. 1989). ALM has not presented any evidence to show that a market consisting solely of Georgia-Pacific plywood originating on the ALM makes economic sense.

In fact, the Supplement itself demonstrates that the "market" is much broader than ALM suggests. As Exhibit A to Mr. Ahlers' supplemental verified statement shows, shipments from Georgia-Pacific's Arkansas facilities move to points throughout the West. More traffic moves to destinations in than to any other state, and substantial amounts of traffic move to . In addition, Mr.

McDonald testified in UP's initial Reply that Georgia-Pacific's Arkansas plywood competes with Canadian oriented strand board in Western markets. McDonald V.S., pp. 3-4 (noting that UP reduced rates to California to "keep Georgia-Pacific competitive" in relation to Canadian oriented strand board). ALM's Supplement provides no reason to ignore the evidence that Georgia-Pacific has in fact benefitted from UP efforts, aided by merger synergies, to make Georgia-Pacific more competitive in the lumber and panel products throughout the Western marketplace.

Second, even focusing on just the Georgia-Pacific traffic handled by ALM, the Supplement fails to substantiate, and in fact contradicts, ALM's claims of large UP rate increases. The data contained in Exhibit A to Mr. Ahlers' supplemental verified statement show that for the top ten destinations to which Georgia-Pacific originating on the ALM moves, accounting for of all the traffic ALM considers to be at issue, the total impact of UP's rate changes was a <u>decrease</u> of in Georgia-Pacific's freight costs.[2] The evidence in the Supplement that UP reduced rates demonstrates conclusively that UP is not exercising any market power gained as a result of the UP/SP merger. Moreover, despite ALM's repeated and deceptive citation, both in its Petition and its Supplement, of isolated

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[2] This calculation excludes traffic moving to As explained in UP's initial reply, the rate for traffic to increased solely because the previously-existing UP letter quote had mistakenly failed to include the costs for the shortline railroad at the destination.

instances involving high percentage rates of increase on very-small-volume flows, the overall impact of UP's rate changes, again according to ALM's own data, was only [3/] Clearly, these are not the actions of a railroad that is abusing market power.

Third, despite availing itself of the opportunity to file a reply to UP's reply, ALM did not even attempt to address UP's evidence that, in the few instances in which Georgia-Pacific's rates increased, the increases reflected the fact that existing rates had been in place for several years and were below market levels. See McDonald V.S., p. 5. ALM's Supplement fails to address this sworn explanation for UP's rate increases, choosing instead simply to re-submit data from its Petition indicating that UP increased rates over

[4/] Nor does ALM attempt to respond to UP's evidence that Georgia-Pacific's rates to the two gateways remain

Id.

Fourth, ALM's Supplement completely ignores the fact that in several instances ALM took rate increases on Georgia-Pacific traffic. In fact, ALM took rate increases on traffic

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[3/] This calculation also excludes traffic moving to See note 2, supra. Even including traffic, the overall impact of UP's rate changes was only

[4/] ALM deceptively phrases those statements in terms of UP revenues in order to boost the percentages, but the data that ALM presents in Mr. Ahlers' supplemental verified statement make clear that the increases were not as dramatic as ALM would have the Board believe.

moving to

. ALM also took an increase on traffic to , despite criticizing UP for taking an increase on this same traffic. Once again, ALM's decision to increase rates on certain traffic, including traffic with respect to which UP reduced its rates, suggests that UP is not abusing market power. If UP were abusing some newly-acquired market power, it would not have "left money on the table" that allowed for ALM increases, and it certainly would not have reduced rates just to have them offset by ALM.

Finally, ALM's Supplement repeats claims in the Petition that UP has plans to increase SP rates because SP rates are "too low," but it ignores the overwhelming record evidence that UP has reduced SP rates. ALM has no response to UP's evidence that rates from Georgia-Pacific's SP-served lumber mills in the Pacific Northwest have fallen dramatically since the merger. See McDonald V.S., pp. 2, 6-7. Moreover, ALM ignores its own evidence in the Supplement showing that UP reduced or held constant all former SP rates on traffic moving to

. ALM tries to argue that "off-the-record statements" attributed to UP personnel are more reliable than formal filings with the Board (Supplement, p. 6), but there is in reality no dispute as to the fact of UP's reductions in SP rates.

II. UP FACES EFFECTIVE COMPETITION FOR ALM TRAFFIC

In the face of clear and strong evidence that KCS provides effective competition to UP for the movement of ALM traffic, ALM responds that UP's ability to increase rates demonstrates that there is no effective competition. ALM's analysis is simplistic, and its conclusion is incorrect.

In support of its conclusion, ALM points once again to UP rate increases for traffic moving over

. However, ALM ignores the basic fact that the relevant issue in determining whether KCS is an effective competitor is not UP's rate level,[5] but KCS' rates and how much traffic KCS has moved. ALM is conspicuously silent on both points. Despite ALM's claims that KCS was not able to handle all of the traffic that Georgia-Pacific wished to provide, ALM provides no specific examples of traffic that KCS could not handle. ALM relies on assertions about "the limited scope of KCS' system and resources" (Supplement, p. 10), rather than evidence. By contrast, KCS' sworn evidence shows that it handled some cars of traffic originating on the ALM in the first quarter of 1998 alone, which on an annualized basis far exceeds

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[5] ALM ignores UP's evidence that UP's rates were (and remain) below market levels. See p. 5, supra. ALM also ignores its own evidence of UP rate decreases.

the cars of Georgia-Pacific plywood traffic that ALM discusses in its Supplement.[6]

Moreover, despite ALM's claims that KCS is not competitive because it must interchange its traffic with other railroads, almost the ALM traffic that KCS moved in the first quarter of 1998 was destined to states that KCS does not serve directly. KCS' traffic data, which ALM ignores, supports UP's evidence that KCS provides effective competition from ALM points with efficient routes to both Eastern gateways and Western destinations.

As UP demonstrated in its initial Reply, a KCS-IC route from Monroe to Memphis is only 47 miles longer than UP's route, and KCS-IC route to Chicago is only 66 miles longer. KCS can offer to route traffic over its Meridian gateway to Southeast points as an alternative to Memphis. In addition, KCS-BNSF routes to many points in the West are actually shorter than UP routes. For example, the KCS-BNSF route to Stockton is 133 miles shorter that UP's route; the KCS-BNSF route to Denver is 130 miles shorter than UP's route; and the KCS-BNSF route to the Los Angeles basin is a mere 8 miles longer than the UP route. See

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[6] Significantly, in his letter to the Board dated May 28, 1998, Norman Langberg, Director of Logistics, Paper of Georgia-Pacific, does not mention KCS' inability to provide adequate equipment as a reason that KCS is not an alternative to UP -- he mentions only KCS' "geographic limitations" and the fact that KCS "does not serve directly" many of Georgia-Pacific's destinations. As discussed below, however, KCS' evidence demonstrates that it has moved traffic from the ALM to a wide variety of destinations using joint-line routes.

McDonald V.S., p. 8. Moreover, BNSF has a strong incentive to work with KCS to capture this traffic, and as Mr. McDonald has testified, BNSF has done exactly that by taking advantage of backhaul opportunities. Id.

III. UP SERVICE HAS IMPROVED

ALM claims in the Supplement that, contrary to UP's claims, service has not improved. ALM's own witness, however, has been telling a different story.

For the past several months, ALM's witness, Larry Ahlers, in his capacity as Georgia-Pacific's President for G.P. Railroads, has been providing UP with weekly facsimiles reporting on UP's train performance in interchanges with ALM. The most recent reports are attached as Exhibit A to this pleading, and they demonstrate that, contrary to the statements contained in the Supplement, UP's performance with respect to ALM has improved substantially.

For example, in the report for the week ending June 20, 1998, Mr. Ahlers noted that

ALM asks in the Supplement whether, in the absence of ALM's request for BNSF service, UP would have taken the steps it has taken to improve service. The clear answer was provided by UP's initial Reply, in which Mark Franklin, Superintendent of UP's East Texas Service Unit, explained under oath the many approaches UP has pursued in its efforts to provide ALM's shippers with reliable service. Mr. Franklin's uncontradicted testimony shows that UP's efforts began long before ALM filed its Petition for BNSF service. <u>See</u> Franklin V.S., pp. 1-5.

Finally, ALM offers no real response to UP's evidence that adding an interchange between BNSF and ALM at Fordyce will cause added congestion and train delays on UP's line. <u>See</u> Franklin V.S., pp. 5-6. ALM's "best answer" is that "where there's a will, there's a way" (Supplement, p. 14). But the simple fact is that even if ALM might benefit from adding an interchange with BNSF, other shippers using the line would suffer.

Respectfully submitted,

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July 16, 1998

EXHIBIT A

[Redacted]

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that, on this 16th day of July, 1998, I caused a copy of the public version of Union Pacific's Reply to ALM's "Supplement" to Petition 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

Copies of the Highly Confidential version of Union Pacific's Reply have been served by hand upon outside counsel for the Arkansas, Louisiana and Mississippi Railroad Company and will be provided to other outside counsel who so request and who have signed the appropriate confidentiality undertakings.

Michael L. Rosenthal

STB FD-32760(SUB21) 7-1-98 D ID-189185 1 OF 5

189185

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BY HAND

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 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-referenced docket are an original and twenty-five copies of the Applicants' Second Annual Report on Merger and Condition Implementation. We have enclosed is a 3.5-inch diskette containing the pleading in WordPerfect 5.1 format.

Also enclosed are an original and twenty-five copies of the Confidential Appendices to Applicants' Second Annual Report on Merger and Condition Implementation, clearly marked "Highly Confidential," along with a diskette containing the confidential appendices, to be filed under seal.

Applicants have served the Report on all parties of record. Applicants have also served the "Highly Confidential" Appendices on parties' outside counsel that indicated, in the merger proceeding, that they will adhere to the restrictions of the Protective Order granted in UP/SP, Decision No. 2, served Sept. 1, 1995.

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

Sincerely,

Arvid E. Roach II

Enclosures

cc: Parties of Record

189185

UP/SP-344

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' SECOND ANNUAL REPORT ON MERGER AND CONDITION IMPLEMENTATION

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July 1, 1998

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City of Pine Bluff, Arkansas

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Louisiana State Senator John Siracusa

San Joaquin Regional Rail Commission

Texas A&M University

Tri-Met

Village of Towanda, Illinois

Railroads

Acadiana Railway

Arkansas-Oklahoma Railroad

AT&L Railroad

California Northern Railroad

Rio Valley Switching Company

Sabine River & Northern Railroad

Salt Lake, Garfield & Western Railway

Tulsa-Sapulpa Union Railway

Utah Railway

CONFIDENTIAL APPENDICES (separately bound and filed under seal)

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' SECOND ANNUAL REPORT
ON MERGER AND CONDITION IMPLEMENTATION

Applicants UPC, UPRR and SPR[1] hereby submit their second 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. 10 in this oversight sub-docket, served Oct. 27, 1997.

PRELIMINARY STATEMENT

For much of the past year, attention has understandably been focused on UP's serious service problems, which began in and were focused on the Gulf Coast area but

[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 herein as "UP."

affected systemwide operations. UP has explained in a number of prior submissions to the Board what it believes caused those problems -- and, in specific, its firm conviction that the UP/SP merger was not their cause, and in fact has proven to be essential to their solution.

The Board has commenced a separate oversight proceeding, in Finance Docket No. 32760 (Sub-No. 26), to examine the service problems as they relate to the merger. Specifically, the Board has indicated that it will consider in that proceeding whether the service problems were caused by any market power that UP gained from the merger, and, if so, whether any conditions that parties apply for are justified.

UP intends, in its September 18 submission in Finance Docket No. 32760 (Sub-No. 26), to address these issues in depth. Here, we focus, as the Board directed in Decision No. 10, on the further actions taken by UP during the past year to implement the merger, and on the evidence from the past year as to the competitive impact of the merger and the effectiveness of the competition-preserving conditions that were imposed by the Board.

Part I provides an update on merger implementation. We review the progress during the past year in installing TCS and other support systems; in integrating workforces and hiring additional employees; in merger-related capital investments; in consolidating and improving terminals and shops; in customer service; in merger-related supply savings; and in enhancing the safety of the merged system's operations. We also review the status of merger-related service enhancements, abandonments, passenger service and environmental compliance.

Part II addresses competition. It begins by reviewing how the merger is continuing to produce competitive benefits in the form of expanded single-line service and shorter routes, improved equipment supply, and reduced switch charges. It then shows that, for a second year, the competition-preserving conditions have clearly demonstrated their effectiveness. BNSF and Tex Mex trackage rights volumes have continued to grow. "2-to-1" shippers have continued to benefit both from access to the comprehensive and expanded BNSF system and from rate and service initiatives UP is taking in response to BNSF competition. Also, as the Board found would be the case, there has been no competitive harm to "3-to-2" shippers, or to shippers of Utah and Colorado coal, Gulf Coast chemicals, or grain. To the contrary, these shippers continue to enjoy better service, lower rates, and the benefits of the creation of two much more competitive, comprehensive rail systems in the West.

In keeping with the Board's preference for a focused proceeding, we again have not presented lengthy verified statements of UP officers or asked numerous shippers and other affected parties to submit statements. Instead, as we did last year, we are submitting this report in verified form, and we have asked a small number of representative shippers, public bodies and shortline railroads to prepare brief verified statements setting forth their views of the implementation of the merger and the competitive conditions to date. Those statements are attached hereto, and their contents are noted at appropriate places in the report.

I. CONTINUED PROGRESS IN MERGER IMPLEMENTATION

The past year saw continued progress in implementing the merger on a variety of fronts. We review that progress in this Part of the report.

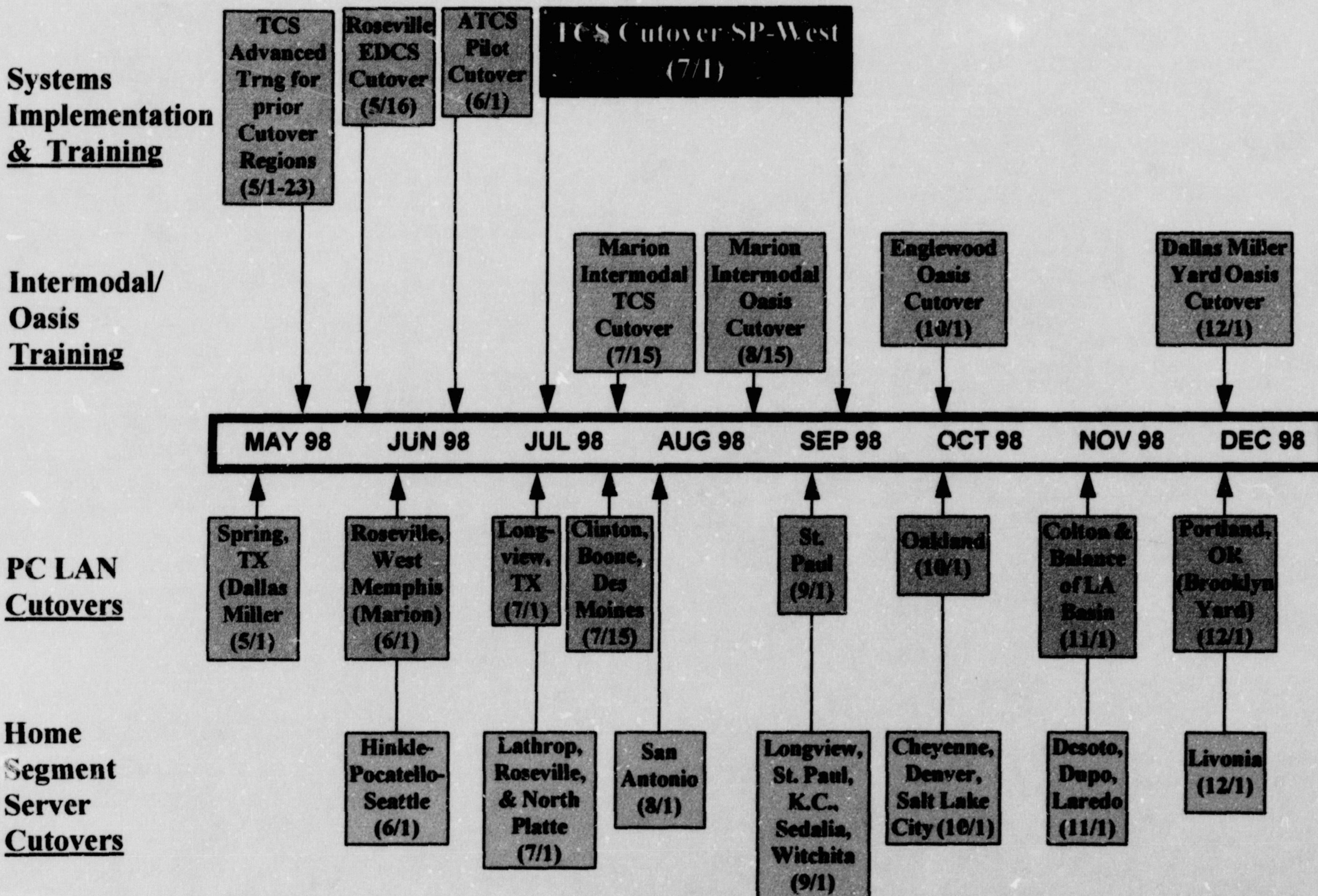
A. Technology and Support Systems

During the past year, the conversion of SP lines and facilities to UP's principal information systems has continued. Chart #1 is the current timeline for upgrading operating information systems.

The most critical of these systems is UP's Transportation Control System ("TCS"), which is the recognized industry leader in railroad management systems. It is the glue that holds the railroad together and allows it to function as an efficient, integrated system. TCS and associated systems provide all the information needed for day-to-day operations, including train and shipment scheduling, shipment monitoring, freight car accounting, car ordering,

Chart #1

Operating Services & Training Timeline



billing of customers, and financial reporting. Orderly conversion of SP to TCS is critical to efficient, integrated operation of the entire combined system and full achievement of merger benefits.

Conceptually, TCS is based on car movements. When shipment instructions are loaded into TCS, as they are for every shipment, the system creates a trip plan for the shipment, which is then used to assign the shipment to blocks, trains and routes. Similarly, when a shipper needs an empty car, TCS finds it, assigns it to the shipper, and schedules its movement to the loading facility. TCS keeps track of cars in yards and helps yardmasters build trains. It helps assign locomotives and crews to trains, provides timekeeping information, and maintains payrolls for train and engine crews. TCS drives the accounting systems related to all car movements, including collecting revenue and paying car hire to car owners. It generates data for financial accounting systems, including the general ledger and accounts payable.

The full benefits of the merger can be achieved only when the entire merged system uses common operating and financial support systems for all operations and shipments. Installation of TCS on SP is therefore critical. TCS implementation is also important from a shipper's perspective, because, along with the formal consolidation of the separate railroads, it allows the shipper to specify only "UP" on a bill of lading instead of a detailed routing between the separate railroads that comprised the UP and SP systems.

The merger plan called for a series of TCS cutovers on a region-by-region basis. As reported last year, the initial cutover was carried out where the task would be least complex -- on DRGW territory. DRGW lines and facilities were converted to TCS on May 1, 1997, and this conversion was extended west to Elko, Nevada, on June 17, 1997.

The next phase of TCS installation covered the SSW and SPCSL corridors between Chicago and Texas and between Chicago and Santa Rosa, New Mexico. This cutover was completed on August 1, 1997.

The next TCS cutover was on all remaining SP lines and facilities east of the Arizona-New Mexico border. This cutover occurred on December 1, 1997. It was accelerated by two months to help in addressing the service crisis, and although, like each TCS cutover phase, it produced some temporary dislocations, it has been an indispensable element in the substantial elimination of congestion that has been achieved in the Gulf Coast area.

The final TCS cutover is starting today, July 1, 1998, on all SP lines and facilities west of Elko and the Arizona-New Mexico border. In contrast to the third phase, which was accelerated to help address the service crisis, this phase was deferred two months from the date originally planned, so that systems expertise could continue to be focused on complete implementation of TCS in the Texas/Gulf area.

The various phases of TCS cutover are summarized on Map #1.

Overall, these conversions have involved training more than 16,000 employees in 54 cities at a cost of some $40 million -- but they have been well worth the price. With TCS installed on the entire combined system, major improvements in routing, billing and resource utilization can now be achieved.

A variety of other system cutovers have also now been completed. We reported on July 1, 1997 that the merged system had already consolidated office support systems, extended UP's Locomotive Management System to SP, and extended UP management systems to SP locomotive and car repair shops. At that time, extension of UP's Crew Management System ("CMS") had begun with a cutover on the DRGW. Since then, CMS has been extended to the entire SP, as depicted on Map #2. As a result, the merged system is now able to keep timekeeping records and call crews through a unified system. CMS also gives former SP employees access to UP's Automated Voice Response System, which provides updated line-up information.

As shown in Chart #1, UP will implement TCS at the new Marion, Arkansas, intermodal facility, across the Mississippi River from Memphis, when that facility opens on

July 15, 1998. UP is continuing to expand its "OASIS" system to SP intermodal yards. This Windows-based system allows operators to keep track of every container and trailer in a terminal and helps automate the very complicated process of matching 20-, 40-, 45-, 48-, 53- and 57-foot intermodal units to freight cars that also have multiple dimensions and carrying capacities. UP will install OASIS at the Englewood (Houston) ramp in October and the Miller (Dallas) ramp in December.

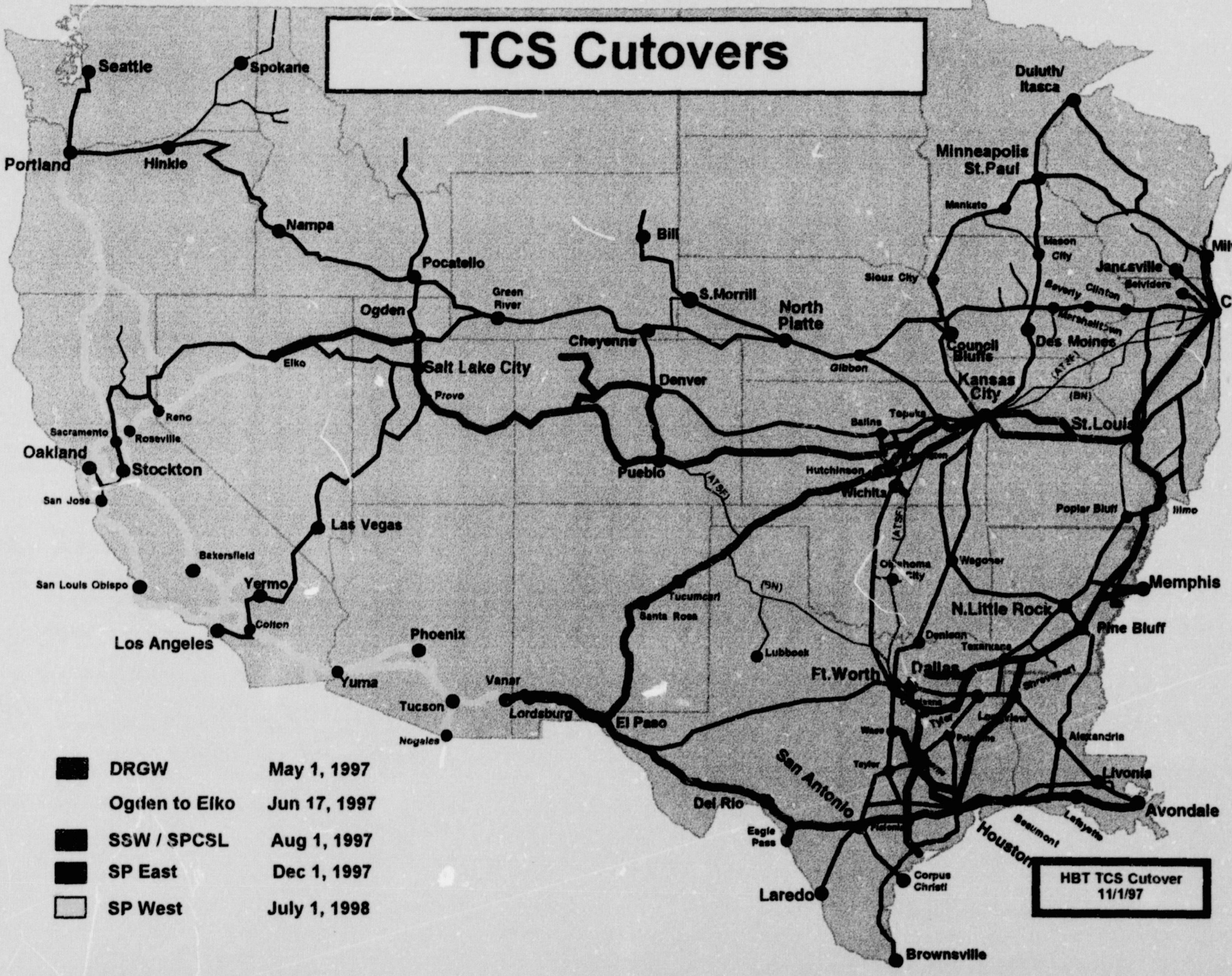
B. Workforce Integration and Hiring

UP continues to move forward to reach implementing agreements with labor unions under New York Dock procedures. UP has worked to resolve these matters to the maximum possible extent on an amicable basis through voluntary agreements.

UP now has implementing agreements with the BLE and the UTU for the following hubs: Denver, Salt Lake City, Salina (Phase I), Roseville, Houston, Longview and North Little Rock/Pine Bluff. Negotiations are in progress for the Los Angeles hub and will start in the near future for the Salina (Phase II), San Antonio, Dallas/Ft. Worth, El Paso and Dalhart hubs. UP anticipates that all hub agreements should be in place by the second quarter of next year.

UP has essentially completed the implementing agreement process with respect to all non-operating crafts except the signalmen, maintenance-of-way employees and

Map #1


TCS Cutovers
Seattle
Spokane
Portland
Hinkle
Nampa
Pocatello
Ogden
Green River
Elko
Salt Lake City
Provo
Reno
Sacramento
Roseville
Oakland
Stockton
San Jose
Las Vegas
Bakersfield
San Louis Obispo
Yermo
Colton
Los Angeles
Phoenix
Yuma
Tucson
Nogales
Vanar
Lordsburg
El Paso
Bill
S.Morrill
North Platte
Cheyenne
Denver
Pueblo
Gibbon
Tucumcari
Santa Rosa
Lubbock
Duluth/ Itasca
Minneapolis St.Paul
Mankato
Mason City
Sioux City
Janesville
Belvidere
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Topeka
Salina
Hutchinson
Wichita
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Illmo
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N.Little Rock
Pine Bluff
Denison
Texarkana
Ft.Worth
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Taylor
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Livonia
San Antonio
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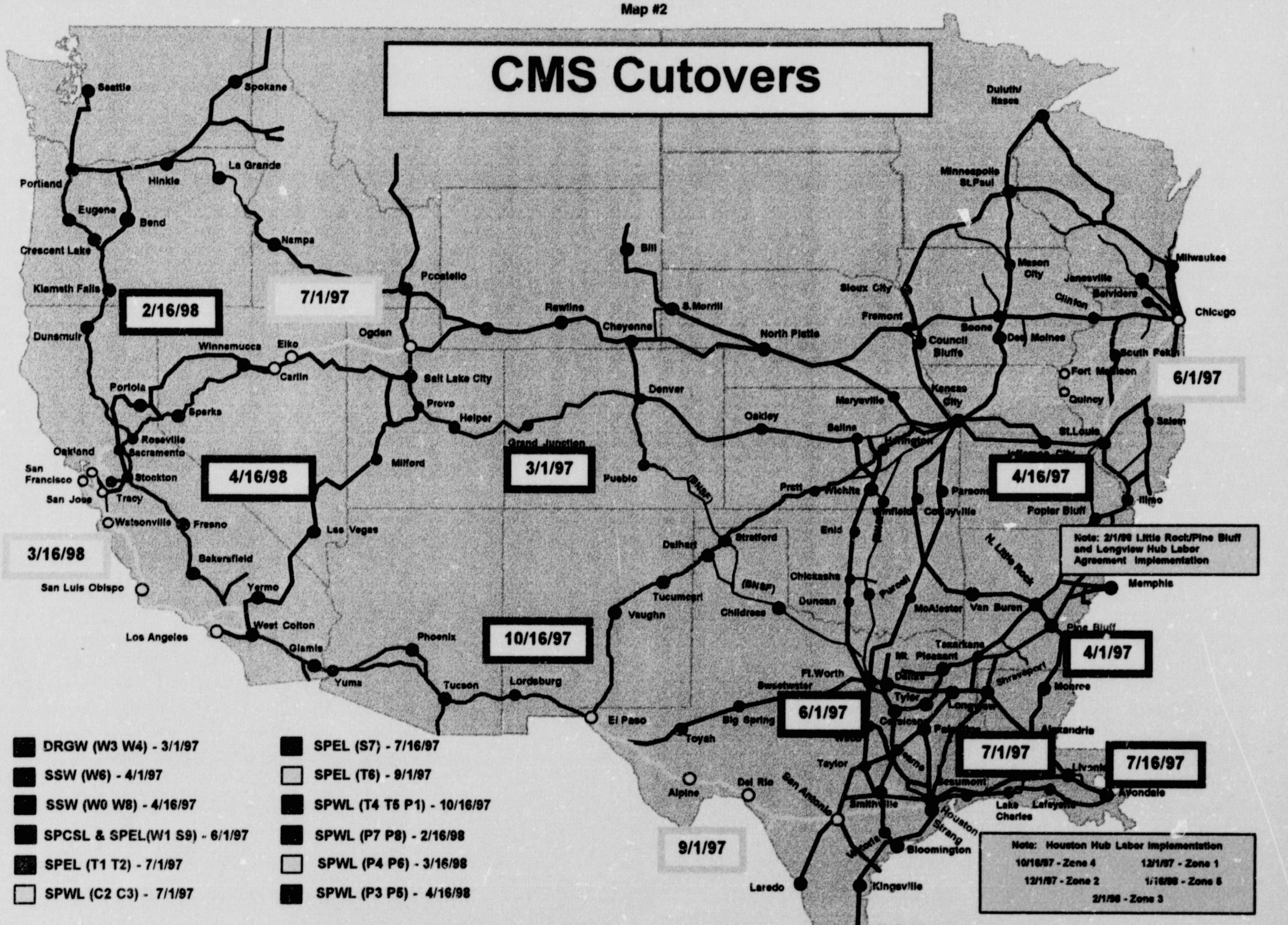
Eagle Pass
Laredo
Corpus Christi
Brownsville
Houston
Beaumont
Lafayette
Avondale
DRGW May 1, 1997
Ogden to Elko Jun 17, 1997
SSW / SPCSL Aug 1, 1997
SP East Dec 1, 1997
SP West July 1, 1998
HBT TCS Cutover 11/1/97

Map #2



Yard cutovers are indicated by colored town name.

yardmasters. Negotiations with the signalmen and maintenance-of-way employees are nearing conclusion. Negotiations with yardmasters will need to progress on a terminal-by-terminal basis.

As previously reported, the orderly integration of the UP and SP non-agreement workforces was completed during 1997. Positions with the combined company were awarded on the basis of merit, and all employees received "a good job or a good severance." UP has closed SP's offices in San Francisco and Denver, allowing resources to be consolidated in Omaha and St. Louis.

UP has reported from time to time in its service-related filings on its unprecedented hiring efforts, the most extensive in decades. Railroad industry employment fell steadily after World War II,[2] as other forms of transportation captured passengers and merchandise traffic and railroads eliminated excess capacity. Railroad employment may be curving upward now, and it certainly is on UP. UP is hiring at a record clip to address its service problems and to make up for inadequate hiring, especially on SP, before the merger.

UP's 1998 hiring far exceeds its projections at the start of the year. UP's Human Resources Department projected new hires to total approximately 2,200 for the year. This

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[2] AAR, Railroad Facts, 1997 Edition, p. 55.

year's hiring has already exceeded that number, with 2,284 new hires and 957 offers outstanding as of June 18. UP has hired 1,301 new employees for train and engine and yard service, while 549 additional candidates have received job offers but have not yet passed the mandatory physicals and drug tests. The Engineering Department had hired 725 new agreement employees by June 4, 1998, with another 312 offers pending. The Locomotive Department has hired 150 new agreement employees for locomotive servicing and has 51 prospective employees pending, and the Car Department has hired 52, with 29 pending. Over 50 agreement employees have been hired to work in other departments throughout the railroad, with 16 more offers pending.

The most recent hiring figures project 4,700 new agreement employees for the year in all departments, more than double the projection at the beginning of 1998. The Transportation Department expects to hire a total of 2,400 employees during 1998, the Engineering Department 1,400, the Locomotive Department 400, and the Car Department 200. Some 300 employees will be hired to work in various other departments.

UP is also hiring non-agreement employees at a faster rate than expected. At the start of the year, UP projected that it would hire 300 non-agreement employees during 1998. UP is on pace to surpass this projection. As of

June 26, 1998, UP had hired 165 non-agreement employees, with 41 additional offers outstanding. The largest number of additional non-agreement employees are in the Operating Department. UP has hired 72 new non-agreement Operating employees and has offers outstanding to 25 more. UP also has hired 59 employees in the information technology area and has offers outstanding to 8 potential employees.

C. Merger-Related Capital Investments

UP continues to invest heavily in capital projects to implement the merger and improve SP infrastructure, which required more rehabilitation than UP had anticipated. Also, on May 1, UP described new plans to invest over $600 million in capacity expansion projects in the Gulf Coast area over the next five years.

UP expects to spend a total of some $400 million on merger-related capital projects in 1998, an amount limited only by the preliminary engineering work necessary to prepare for more projects. No one questions that SP could never have mounted capital investments on this scale.

The two largest merger-related projects for 1998 are the reconstruction of Roseville Yard and the completion of a new intermodal facility for the Memphis area, at Marion, Arkansas. UP originally had planned to upgrade parts of Roseville Yard for $38.2 million, but it is now completely rebuilding the yard, which will be the most modern on the UP system when it opens next summer. UP expects to spend $65 million at Roseville this year alone.

The Marion intermodal facility, a $69.5 million project, will open on July 11, making it possible for UP to move out of jammed facilities in Memphis. The Marion ramp will have the capacity to perform 375,000 lifts annually on four tracks, with eight additional tracks for storage and for arriving and departing trains. This new facility will also reduce rail traffic in the busy Memphis terminal. Much of the intermodal traffic loads and unloads locally and will no longer move through the multiple rail crossings in downtown Memphis.

In connection with implementing the merger, UP is adding capacity to a number of critical mainlines this year. UP expects to spend $58.2 million by the end of this year to upgrade the Kansas Pacific mainline between Topeka and Denver in order to handle coal trains to and from Colorado and Utah. The fact that UP has made this line one of its highest merger-related capacity priorities should be a complete response to those who feared UP would deemphasize those coal sources. UP is opening approximately one new siding per month on this line.

On the former SP Tucumcari Line between Topeka and El Paso, UP expects to spend some $48 million in 1998 to upgrade rail, ties and signals, add powered switches at several sidings, construct and extend sidings and perform the engineering studies for future capacity expansions. The work on this corridor is essential for UP to eliminate congestion and compete effectively with BNSF for intermodal traffic between the Midwest and Southern California.

By the end of 1998, UP expects to spend $58.5 million on upgrading the former Texas and Pacific line between Ft. Worth and El Paso. UP is spending $24 million this year on rail and ties and is adding one siding to the line.

By the end of the year, UP also will have added three sidings on the Iowa Junction-Avondale route via Kinder, Louisiana, where UP is spending $19 million on new rail and ties. UP expects to spend some $24 million this year on that line segment, in addition to the $13 million it spent last year. This work allows UP to reroute manifest trains from the former SP line, now owned by BNSF but to be owned jointly by BNSF and UP, to UP's line through the classification yard at Livonia.

UP is working on double track to ease two important bottlenecks. In southwest Missouri, UP is beginning to work on second mainline in the Dexter terminal area and between Ardeola and Messler. At least as important is UP's work to reopen the former MKT mainline in the New Braunfels area on what may be the most congested segment of the UP system. Once reopened, this line will provide 17.9 miles of essential double track.

UP is working on a number of merger-related connections, including several identified after the Operating Plan was prepared. It recently opened the important connection between Settegast and Englewood Yards in the northwest quadrant of Tower 87 in Houston. UP is beginning work on a second connection, in the northeast quadrant at that location, which will further improve operations in this area and reduce conflicts between UP trains and BNSF and Tex Mex trains on the HBT East Belt line. That connection should open in August.

UP plans to construct new connections this year in the Hearne, Texas, area, where several UP and SP mainlines intersect. It is working on the new connection at Kinder, Louisiana, and has constructed an important universal cross-over in the San Antonio terminal. It is also working this year on connections linking UP and SP trackage in Topeka, and on reconstruction of a wye track in Denver.

In California, UP is urging the City of Colton to issue permits for an essential connection between SP's Sunset Route and UP's Riverside Line, which would allow trains to and from El Paso to use the UP line between Colton and Los Angeles and the ports at Los Angeles and Long Beach. UP has placed in service two new connections at Montclair and Pomona, which will allow UP to use the UP and SP lines as paired track. UP is doing engineering work on a new connection near the top of Cajon Pass to permit trains to move between BNSF's line, over which UP has trackage rights, and the former SP line, avoiding a 3% grade on BNSF. UP also plans to realign trackage at Haggin, where the SP Donner Pass line crosses the former WP line in Sacramento.

As UP has reported to the Board in its weekly letters in Ex Parte No. 573, it is conducting a massive track maintenance and capacity expansion project on its Central Corridor between Chicago and Utah. This work, though not strictly merger-related, will allow UP to provide improved service for former SP shippers whose traffic was rerouted to this line from the DRGW route. This six-month, $400 million project includes 66 miles of second and third main track between North Platte and Topeka, as well as 33 miles of second main track on CNW segments between Fremont, Nebraska, and Dennison, Iowa. This latter project will eliminate a single-track bottleneck resulting from a CNW capacity reduction project many years ago. UP's maintenance work will include 350 miles of new continuous welded rail, 685,000 wood ties and 178,000 contrete ties, all of which will reduce slow orders and ensure that trains can operate at maximum speed. As UP installs track or performs maintenance on multiple-track lines, it is separating the tracks by seven extra feet, so that future maintenance projects on one track will not affect traffic on the other.

In addition to the corridor investments described earlier, UP is continuing to upgrade other SP line segments. For example, two UP tie gangs are installing tens of thousands of new ties on the Lafayette Subdivision between Houston and Beaumont to remove slow orders and increase speeds. And in Southern California, UP's P-811 automated tie gang is replacing wood ties with concrete ties on the jointly-used BNSF-UP line over Tehachapi Pass, which has been called the busiest single-track mountain railroad in the world.

UP is also expecting to spend millions of dollars to upgrade SP locomotives and freight cars. UP will spend over $10 million this year on SP locomotive rehabilitation that it had not anticipated during merger planning. This is a small investment in an area where UP is making huge investments -- expanding its locomotive fleet. UP has already taken delivery this year of 148 high-horsepower, AC-traction locomotives, with 122 more on order for delivery this year. Each costs about $2.3 million. Most of these units will go into coal service, reducing the number of units needed to move a coal train out of the Powder River Basin from four to three and releasing locomotives for other duties.

UP is investing an additional $1.5 million in the Laredo area to speed the flow of merged system traffic between the U.S. and Mexico. At its Port Laredo facility about 12 miles north of Laredo, UP will add two tracks to stage trains for Mexico, a building to house U.S. Customs and Border Patrol officers as well as UP police, and additional security infrastructure. The expanded facility, to be completed by October, will allow shipment and drug inspections to take place north of the border instead of on the International Bridge, where they cause significant train delays. This is another benefit of the merger for SP international shippers, who already gained access to UP's Despacho Previo system, which pre-clears shipments for the border crossing.

Finally, UP continues to invest heavily in information technology. UP has budgeted over $18 million for development of new systems, such as the CAD III dispatching system, which will greatly improve dispatching efficiency.

D. Terminal Improvements and Consolidations

In addition to opening the new Memphis-area intermodal ramp, UP is pursuing other intermodal projects. UP is expanding its Mesquite ramp, which serves the Dallas area, in a project to be completed on August 1. UP had closed the SP intermodal ramp at North Yard in Denver, but reopened it to accommodate the volume of business.

West of Chicago, UP is planning a major new intermodal facility, to be called Global III, to complement its Global I facility near downtown Chicago and Global II facility near Proviso Yard. Completing this facility will be an integral step in rationalizing UP's multiple Chicago-area intermodal facilities.

UP closed its Shreveport, Louisiana, and Marshall, Texas, intermodal facilities on September 1 last year. UP had planned to construct a new facility at Texarkana, but intermodal business in the area does not presently warrant a new intermodal ramp. On July 15, UP will close SP's cramped Valley Junction intermodal yard in East St. Louis, moving its activities to Dupo Yard.

In addition to the major yard project at Roseville, described above, UP is investing in other freight yards. It plans to add trackage at Strang Yard in Houston this year. It is already adding trackage at Coady Yard on the UP Baytown Branch. It expects to spend almost $7 million this year to add capacity at West Colton Yard, plus $1.7 million to upgrade the hump computer at that facility. A new switching lead at Ney Yard in Ft. Worth will reduce conflicts between switching and through trains in that busy terminal.

E. <u>Equipment Repair Facilities</u>

With an additional expenditure of approximately $14 million in 1998, UP is completing a major new locomotive servicing facility at Hinkle Yard in Oregon. Once this facility opens, UP will close its older locomotive shop at Salt Lake City. UP is also spending several million dollars to upgrade locomotive repair facilities at Houston, North Little Rock, Kansas City and Salt Lake City's Roper Yard. Finally, UP is transferring responsibility for rebuilding General Electric locomotives from Denver's Burnham Shop to the Jenks Shop at North Little Rock.

UP has deferred, during its service recovery, plans to consolidate car repair facilities at several locations. For example, UP has not yet closed SP's "one-spot" car repair facility at Armourdale Yard in Kansas City as projected in the Operating Plan. After relocating SP's wheel shop repair activities function from Sacramento to Pocatello last year, UP expects to relocate the UPFE car shop in Pocatello this year and to move heavy car repair work to DeSoto, Missouri, and Palestine, Texas.

F. Customer Service

UP's National Customer Service Center ("NCSC") handles all day-to-day customer contacts, including car orders, releases of loads, shipment tracing, and problem resolution. NCSC has the ability to transmit work orders directly to train crews. The NCSC is organized by commodity group -- allowing customer service representatives to gain expertise about the needs of each customer industry -- instead of geographically as was SP's customer service center.

As SP lines and facilities have been converted to TCS, UP has consolidated the two railroads' customer service functions at UP's NCSC facility in St. Louis. (Mexican business continues to be handled out of the International Customer Service Center in Laredo.) The final step in this consolidation process will take place in conjunction with the July 1 TCS cutover, when UP will transfer all remaining SP customer service functions to St. Louis and close the former SP customer service center in Denver.

Training for SP employees for certification as UP customer service representatives has been completed, and the NCSC has further augmented its staff by hiring 75 new employees over the past year.

G. Supply Savings

As predicted in the UP/SP Operating Plan, the consolidation of purchases by the merged system has led to substantial savings, as shown in the following table:

SUPPLY SAVINGS AS A RESULT OF THE MERGER

($ millions)

		1997 Actual	1998 Est.
Materials -	expense	8.6	12.0
	capital	10.4	13.0
Contracts -	expense	9.5	16.0
	capital	13.2	9.0
Locomotive Acquisitions		6.6	-0-
Fuel		11.0	16.0

Volume procurement of fuel and locomotives is an important source of these savings, as is the efficient purchasing of such supplies as rail, spikes, rail anchors, concrete ties, signal equipment and bridge components. Although largely attributable to economies of scale, these savings have also been facilitated by the conversion of SP materials centers to UP's Materials Management System ("MMS") and related systems, which are more sophisticated than the systems used by SP.

UP is also in the process of consolidating and expanding its warehouse functions, yielding greater operational and economic efficiency. In California, UP has completed a project to remodel the Roseville supply facility and close the Sacramento warehouse. UP has consolidated in Sedalia, Missouri, the distribution of signal maintenance materials formerly fragmented among warehouses in Pocatello, Denver and North Little Rock.

A project is underway to consolidate UP's general material distribution operations, now located in Pocatello and North Little Rock, at the newly acquired Osage Street Facility in Denver. This project also includes the consolidation of UP's freight car parts distribution operations from Pocatello and North Little Rock into the North Yard facility in Denver. UP is planning and undertaking additional warehouse consolidation projects in Houston, Los Angeles and Hinkle, Oregon.

H. Service Enhancements

UP has been focusing its energy and resources on returning service to normal levels, rehabilitating the SP system, and adding capacity in congested areas. To maintain this focus, it is deferring many of the new services identified in the merger Operating Plan. In fact, to conserve locomotives and crews, UP has reduced the scope and speed of some of the new services it initiated after the merger. For example, UP temporarily slowed the schedule of its new Chicago-Oakland intermodal train because of track work in the Central Corridor.

In a recent exception, UP on June 1 re-established its run-through intermodal train with NS between Columbus, Ohio, and Los Angeles. Although initially operating on a slower schedule than expected, the train is already capturing new business. For example, Hanjin will be a major user of this train, routing containers from the Los Angeles docks to North Bergen, New Jersey. The train saves shippers as much as two days transit time as compared to service via Chicago.

UP continues to operate through intermodal service between Seattle and Los Angeles, a service made possible by the merger. UP's Eugene-Chicago manifest train continues to provide greater reliability and faster transit times for

Oregon shippers than SP was able to provide. This service has attracted substantial new traffic and opened up new markets for Oregon forest products shippers.

In a number of corridors, UP traffic is moving over routes that are more direct than those used before the merger. Texas-California traffic that UP routed via Nebraska now flows via El Paso, saving up to 1,000 miles. Traffic that once used the circuitous SP-DRGW route through Colorado now runs directly between Midwestern gateways and Northern California via North Platte and Ogden on the original Overland Route. SP traffic that before merger passed through Sacramento between Southern California and the Rocky Mountain area now flows over UP's direct line through Las Vegas. And a Memphis-Los Angeles intermodal train uses the T&P route through West Texas, saving over 200 miles compared to the former SP route.

Despite the recent service problems in the Central Corridor, UP has moved more coal this year, both from the Powder River Basin and from Utah and Colorado, than in the same period of 1997, before service problems had spread beyond the Gulf Coast area.

The most significant merger-related service enhancement to date, however, is directional running from Missouri through Arkansas and Louisiana to Texas and vice versa. This massive operational change, which simultaneously improves service and expands capacity, is directly responsible for the great improvement that has occurred in UP service along the Texas and Louisiana Gulf Coast.

Between Memphis and Dexter Junction (in southeast Missouri) on the north and Houston and San Antonio on the south, the former SSW lines and connecting SP lines are almost exclusively a southbound railroad for both UP and BNSF trains. Dozens and dozens of daily train meets, each of which caused ten minutes' to an hour's delay to one or both of the trains involved, disappeared. Similarly, the former MP tracks from Texas to Memphis and Missouri are now used primarily for northbound service. By eliminating delays associated with train meets, UP effectively has more capacity and can run more total trains on both lines with less delay. As a result, average train speeds are higher than before directional running was implemented.

Even more importantly, UP is able to use its major freight yards in North Little Rock, Pine Bluff, Houston and San Antonio more efficiently, sharply reducing train congestion. Before UP adopted directional operation, the SSW Pine Bluff Yard was frequently jammed. Today, Pine Bluff is rarely backed up and is one of the most fluid yards on the UP system. Before UP adopted directional operation, North Little Rock Yard was overrun with traffic three or four days per week on a regular basis. Today, although delays still occur, North Little Rock is generally fluid. The two yards in combination are able to make far more blocks than before merger, because each is blocking primarily for one direction and much duplication is eliminated. Merely as an example, Pine Bluff now runs a through train directly to the Baytown Branch at Coady Yard, avoiding switching at Englewood.

In Houston, Settegast and Englewood Yards were severely congested from last summer until this spring. Since March, however, with directional service, both yards have been fluid most of the time. UP plans to add capacity to both yards over time, but they have the capacity today to handle existing workloads thanks to directional running and specialized yard functions. Englewood handles inbound traffic, launches industrial jobs serving most local industries and builds only three trains per day, all for points south of Houston, while Settegast receives outbound traffic from industries and connections and builds eastbound, westbound and northbound road trains.

UP has recently implemented a separation of former UP and SP yard functions in San Antonio, with similar positive results. By specializing yard functions in San Antonio and making one of those yards (SoSan) a staging yard for traffic to Mexico, UP will shorten the route for many Mexico-bound cars by 200 miles.

As a result of directional running, transit times have improved markedly for Houston area shippers, as detailed in UP's weekly letter in Ex Parte No. 573 this Monday. Shippers and connecting railroads have seen the results, as the attached verified statements attest. For example, Fibras Quimicas, a Mexican shipper of polyester chips in the Laredo-Memphis corridor, states:

> "Before the merger, Fibras Quimicas moved its U.S. traffic over Eagle Pass, for movement via SP to Memphis and then NS to eastern points. SP's transit time for loaded cars was typically 7 to 8 days, and 9 to 10 days for empty returns. In contrast, now that UP has implemented directional running the transit time for our traffic is presently 5 days, for both loaded and empty cars. This is a huge improvement in transit times that we could not have achieved without the merger."

3M indicates that directional running in the Houston-Memphis corridor "was a good decision," and that it expects to "continue to see additional benefits as the merger is more fully implemented." And the Sabine River & Northern Railroad reports:

> "As a result of the UP and SP merger, our operation has become much more efficient. . . . [T]he directional running of trains by the UP has resulted in much less congestion at the UP interchange."

Because of the efficiencies inherent in directional operation, UP (along with Tex Mex and BNSF) is using the concept between Houston and Beaumont, where most trains run eastward over the former MP line and westward over the former SP route. Directional operation is also in place for most trains between Ft. Worth and Houston, and between Houston and Placedo in the Houston-Brownsville corridor (where the benefit in terms of capacity is offset by additional mileage for southbound moves). A shortline railroad operating in the Rio Grande Valley, Rio Valley Switching Company, reports that its carloadings are up dramatically from its 1997 volumes, and "UP has been able to maintain the flow of cars to our line to facilitate this growth."

I. Abandonments

UP reported a year ago that it had carried out only two of the abandonments authorized in connection with the merger, abandoning 1.3 miles of the former WP mainline between Melrose and Magnolia Tower in Oakland and five miles of the UP Anaheim Branch between Whittier Junction and Colima Junction in the Los Angeles area. UP consummated three additional abandonments during the past year and discontinued service on two more segments. As it has worked to improve service and increase capacity, it also has identified several instances in which its abandonment plans as detailed in the merger application may be modified.

UP carried out the following merger-related abandonments and discontinuances during the past year:

- Hope-Bridgeport, Kansas (Docket No. AB-3 (Sub-No. 131)) -- Abandoned on November 1, 1997.

- Towner-NA Junction, Colorado (Docket No. AB-3 (Sub-No. 130)) -- Abandoned on December 22, 1997. The sale of this line to the State of Colorado for continued rail operation is pending.

- Little Mountain Junction-Little Mountain, Utah (AB-33 (Sub-No. 99X)) -- Abandoned on December 1, 1997.

- Sage-Leadville, Colorado (Docket Nos. AB-8 (Sub-No. 36X) and AB-12 (Sub-No. 188)) -- UP discontinued operations on December 18, 1997, leaving the rail in place between Sage and Malta as required by Decision No. 44.

- Malta-Canon City, Colorado (Docket Nos. AB-8 (Sub-No. 39) and AB-12 (Sub-No. 188)) -- On April 27, 1998, UP exercised its authority to discontinue service to intermediate stations between Malta and Parkdale, Colorado, although UP continues to provide local service for the shipper at Malta and between Parkdale and Canon City. UP plans to sell the 11-mile segment between Parkdale and Canon City to another carrier for passenger and freight service through the Royal Gorge, retaining overhead freight rights.

In last year's report, UP stated that it had decided not to abandon that portion of the Edwardsville-Madison, Illinois, segment (Docket No. AB-33 (Sub-No. 98X)) between MP 145.2 and MP 148.78. On May 14, 1998, UP notified the Board that it had elected not to carry out the Suman-Bryan, Texas, abandonment (Docket No. AB-12 (Sub-No. 185X)), as the capacity provided by this 12.53-mile former SP line will be needed for freight service.

UP has also decided to defer exercising its authority to abandon a number of additional line segments, pending further analysis of whether their capacity is needed. A decision will be made in the future regarding the following abandonment projects, and UP will notify the Board of its decisions promptly:

- Gurdon-Camden, Arkansas (Docket No. AB-3 (Sub-No. 129X))
- Whitewater-Newton, Kansas (Docket No. AB-3 (Sub-No. 132))
- Iowa Junction-Manchester, Louisiana (Docket No. AB-3 (Sub-No. 133X))
- Troup-Whitehouse, Texas (Docket No. AB-3 (Sub-No. 134X))
- Wendel-Alturas, California (Docket No. AB-12 (Sub-No. 184X))
- Seabrook-San Leon, Texas (Docket No. AB-12 (Sub-No. 187X))
- DeCamp-Edwardsville, Illinois (Docket No. AB-33 (Sub-No. 97X))

UP has not yet consummated the Barr-Girard, Illinois, abandonment (Docket No. AB-33 (Sub-No. 96)). UP has negotiated trackage rights over a segment of the Illinois & Midland Railroad to facilitate the abandonment and is improving a connection at Barr.[3]

J. Safety

During the past year, UP has continued to adhere to its strict policy that neither the pressure to reduce costs and move freight expeditiously nor the importance of implementing the merger will take higher priority than continuing to improve the company's safety record.

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[3] See Finance Docket No. 33454, Union Pacific R.R. -- Trackage Rights Exemption -- Illinois & Midland R.R., Decision served Sept. 17, 1997.

As the Board knows, there were several distressing accidents on lines of the combined system in the months following the merger. UP has worked very closely with the FRA and rail labor to intensify attention to safety throughout the railroad, and to address such critical matters as: fatigue; dispatcher hiring, training and workload; improved crew management; testing and inspection of equipment and signals; and issues of organizational culture. All involved have agreed that the results have been positive.

Overall, rates of reportable injuries on the combined system have declined since the merger took effect. Between 1996 and 1997, the number of reportable injuries per employee-hour dropped by 20%. The rate on the merged system for the first five months of 1998 was 22% lower than for the same period in 1997.

The merged system has also seen a decrease in grade crossing accidents. The number of such accidents fell from 990 in 1996 to 785 in 1997, a 21% decline. The figure for the first five months of 1998 -- 258 -- is 22% below the figure for the same period a year earlier (330). An example of the high priority that the merged system gives to grade crossing safety is provided by the attached verified statement of the Village of Towanda, Illinois.

The merged system has also successfully reduced the severity and frequency of derailments, especially on SP. SP's derailment costs per million gross ton miles of freight were more than 50% higher than UP's in 1996. As UP's track investment, maintenance and inspection standards have been applied to SP lines, results for the combined system have approached the UP experience. UP deploys hot-box detectors to prevent derailments more extensively than any other railroad, and the merged system is expanding the number of such detectors on SP lines. UP has upgraded switches at SP yards in Houston and Pine Bluff, which had the highest incidence of derailments.

The merger brought UP's award-winning hazardous materials safety programs to SP lines. UP's Chemical Transportation Safety program is the industry leader, and it is being applied across the merged system. UP's unique program of risk assessment along key chemical routes has been expanded to SP. UP is also expanding to SP lines its program of preparing detailed emergency response plans and its program of conducting emergency response drills. SP routes are benefitting from UP's industry-leading efforts to reduce the incidence of non-accident releases of hazardous materials. And UP has extended to SP territory other safety-enhancing programs that SP could not afford, such as the UP supplemental tank car inspection program, use of head-hardened rail in mountain areas, and a more disciplined program for track inspections.

K. Passenger Service

UP continues to cooperate with state and local authorities to accommodate commuter operations. As SP was often less able to be cooperative, the merger has provided new opportunities for commuter services. For example, the verified statement of the San Joaquin Regional Rail Commission describes how UP has cooperated with that agency to launch the Altamont Commuter Express between Stockton and San Jose, California, this fall:

> "UP has shown in this project a dedication to making rail service work effectively. We see UP's merger with SP as an important opportunity to ensure that SP's valuable rail franchise is put to its best use."

UP is also cooperating with Portland Tri-Met on sharing corridors for light rail development, and their verified statement indicates that the merger "has resulted in improved responsiveness from the railroad." The City of Phoenix offers similar testimony as to UP's support for transit initiatives using former-SP lines. In Colorado, plans to develop rail passenger service to the new airport are progressing, aided by potential access to UP's right of way and relocation of a UP intermodal facility.

UP's service under contract for METRA, the Chicago commuter service, continues to be within contractual commitments. UP continues to operate all three METRA corridors above the contract threshold of 95% on-time performance. UP's performance level is down modestly from last year at this time, due in part to increased freight train interference on the east-west "Geneva Line."

In Southern California, Metrolink commuter service over UP lines has recovered this month from weather-related disruptions in April and May.

UP calculates its performance for Amtrak on the same basis that the parties use to determine UP's compensation. To oversimplify substantially, this calculation of on-time performance uses a segment-by-segment analysis. Last year, we reported performance on SP segments as ranging from 82% to 91% on a systemwide basis. On those segments in 1998, Amtrak trains operated 87.6% on time in April, 84.6% on time in May and 85.7% on time during the first half of June. Amtrak performance on UP segments ranged from 76% to 81% over that period.

Most Amtrak trains have higher levels of on-time performance than these numbers suggest, but the overall levels are dragged down by the weaker performance of two train pairs on lines where UP has significant capacity constraints and frequently suffers from congestion. Trains 1 and 2, the Sunset Limited, have performed especially poorly during the last month, due primarily to congestion between El Paso and Los Angeles, which simply has too many trains for the available track capacity. Trains 21 and 22, the Texas Eagle, also encounter significant congestion between San Antonio and Temple, Texas, which may be UP's most constrained corridor. UP is adding 17.9 miles of second main track in the New Braunfels area to improve this situation.

In California, UP is working with the state's Department of Transportation ("Caltrans") to establish new service on the former-SP line between Stockton and Sacramento. While improvements are being done on this line, one train per day will operate on the UP line between these cities. This could not have taken place prior to the merger. Also, at Caltrans' request, UP has agreed to make improvements to the former-SP Coast Line and Mococo Line in order to allow higher speeds and ensure reliability for Amtrak operations on those lines. For these reasons, Caltrans indicates in its verified statement that the merger has produced benefits "for intercity rail passenger service in California."

Finally, the Illinois Department of Transportation describes UP's assistance on a demonstration project to test Positive Train Separation on portions of its Chicago-St. Louis passenger route.

L. <u>Compliance With Environmental Conditions</u>

Exhibit A details UP's continuing compliance with the 108 Environmental Mitigating Conditions prescribed in Appendix G to Decision No. 44. UP has now fully complied with most of the "Systemwide" mitigation conditions and has procedures in place to comply with the more specific conditions. For example, UP has established a toll-free telephone number in appropriate areas so that citizens may register concerns about noise associated with operating changes (Condition No. 16). UP has established strict procedures to ensure that environmental conditions are satisfied as UP effects abandonments (Conditions No. 26-61) and performs construction projects (Conditions No. 62-108).

UP continues to work with local communities and government agencies to develop and implement Memoranda of Understanding that address merger-related operating changes. Six days ago, UP, the City of Wichita and Sedgwick County, Kansas, filed with the Board a comprehensive Memorandum of Understanding ("MOU") under which -- subject to Board approval -- the parties will cooperate to reduce conflicts between rail operations and urban development. Among other changes, UP will remove trains from a former MP line that passes through the center of downtown Wichita and convey the property to the City for redevelopment. It will contribute over a period of years to new grade separations at Pawnee Street and elsewhere in Wichita. It will fund grade crossing improvements and improved crossing protection at a number of crossings. And the MOU provides the City and County with considerable flexibility in deciding which improvements to pursue. This is a good example of the progress that railroads and local communities can make when they cooperate in a constructive manner.

UP continues to communicate with City of Reno representatives regarding Reno's desire for a depressed trainway through the center of that community. Currently discussions are focusing on the substitution of property for cash, since it is not realistic to expect UP to borrow to contribute to the project. Each side has a specific study to undertake before returning to the table. It is anticipated that further discussions will continue through the summer. Meanwhile, Washoe County voters will be asked to vote on a sales tax that is an integral element of the funding for the project.

M. Good Corporate Citizenship

Good corporate citizenship involves, in addition to attention to safety and environmental concerns, constructive participation in the community in other ways. UP believes strongly in good corporate citizenship. The ability of the former SP to make positive contributions to the local communities where it had facilities was limited by its chronically straitened financial circumstances. UP is trying to do more, as exemplified by the attached statements from Texas A&M University and the City of Pine Bluff, Arkansas.

II. COMPETITION

As the merger moves toward the two-year mark, it becomes ever more clear that both the merger and the competitive conditions are strengthening transport competition in the West.

First, the UP system continues to enhance its competitiveness by providing new single-line and shorter routings, better equipment supply, and reduced switch fees. As already discussed, new train services have also been introduced, though the congestion problems have forced the merged system to move deliberately in this area.

Second, the competitive conditions -- and particularly the extensive trackage and haulage rights granted to BNSF -- continue to demonstrate their clear effectiveness. Shippers continue to benefit from BNSF's strong competition, as reflected in both the large volumes of traffic they are awarding to BNSF and the price reductions and service improvements UP has had to provide to meet BNSF competition. And for a second year events continue to prove that the Board was correct in its rejection of claims that the merger would have adverse competitive effects on "3-to-2" traffic or on Utah and Colorado coal, Gulf Coast chemicals, or grain.

A. Competitive Benefits of the Merger

As merger implementation has moved forward for a second year, the merger has continued to generate stronger competition in important ways.

1. New 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 continued progress during the past year in completing labor implementing agreements, installing TCS across the former SP, and moving forward with merger-related capital investments, the merged system has been able to make increasing progress in exploiting these synergies, to the distinct benefit of the shipping public.

In numerous instances, the availability of single-line service and shorter routes is yielding extended hauls on existing UP and SP business and attracting new business to the merged system. As a result, shippers are enjoying improved service and, in many cases, significant rate reductions. Confidential Appendix A contains more than 130 concrete examples of how, in the year since our last in-depth report, new single-line service and shorter routings made possible by the merger have brought shippers lower rates and better service.

In many instances, these enhancements of rail competitiveness have allowed customers to penetrate new markets where they previously could not compete. For example, the merger continues to open up major new single-line marketing opportunities for UP grain producers to move their grain to SP destinations such as the Imperial Valley and the Nogales gateway; for SP Pacific Northwest and California lumber producers to reach new markets at UP points and via UP routes and junctions; for UP-served South Central lumber producers to reach SP destinations; for UP-served and SP-served Gulf Coast chemical manufacturers to ship their products to destinations and junctions on the other merging railroad; and for SP aggregates producers to reach new destinations served by UP in the Houston area. New shorter routes are bringing benefits to, among others, UP-served shippers using SP's Sunset Route across the Southern Corridor; SP-served Utah coal producers that can cut 300 miles off their routes to export facilities and industrial coal users in Southern California; SP-served rock shippers in Texas; and SP-served Louisiana shippers moving goods to Memphis and beyond.

The attached verified statements provide a variety of specific examples:

- Seneca Foods, which manufactures Green Giant, Libby and other well-known brands of food products, reports substantial improvements in routings and rates from "the Upper Midwest to Texas and the other destinations in the Southwest":

> "For example, traffic from our Janesville plant often required routings over three or four different railroads to reach distribution points in Houston and other major markets. The merger creates much more direct and efficient routings from our plants. We have seen reductions of several days' transit time in movements from Janesville to Houston, as an example, and we have eliminated two or three railroads from the movement. Similarly, we now have a more direct service from the Upper Midwest to the Phoenix market, with a shorter rail route and fewer carriers. These routing efficiencies have reduced our rail costs and will make us more efficient in our end-markets. For instance, our Phoenix freight rates have been adjusted downward to reflect the efficiencies of the more direct route created by the merger. For the first time, we now enjoy equalized freight charges for movements to the entire Houston area, whereas before the merger our rates were higher for suburban destinations because of the need to involve an additional railroad in the movement. These important benefits from route consolidation and greater routing efficiencies would not have occurred without the UP/SP merger."

- Agripac, a large Oregon grower cooperative that ships frozen vegetables through the major Midwest gateways to distribution centers in the East, reaffirms its testimony last year[4] that, thanks to better routes as well as improved equipment supply and lower rates, it is "able to meet customers' demands more effectively today than we could prior

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4/ See UP/SP-303, pp. 70-74, for a detailed discussion of the benefits of the merger for Pacific Northwest frozen foods, perishables and lumber shippers.

to the UP/SP merger." Agripac stresses that without the merger, it "would have lost most of the East Coast market because of SP's deteriorating equipment and inefficient routes."

- Ag Partners, a major Iowa grain marketer, reports that with new single-line routes to SP destinations in California, "we achieved substantial freight savings."

- AT&L Railroad, a UP-served shortline in Oklahoma, states that the merger "has opened many new markets for wheat to flour mills in many additional destinations at competitive rates."

- Fairmount Minerals, a major industrial sand producer with a transload origin on UP in Illinois, explains that the merger created competitive new single-line routes to SP destinations in Arizona and California, and to SP-served Mexican gateways. The result has been "enhanced competition between UP and BNSF," because "UP combined with SP is much stronger than UP and SP separately."

- California Northern Railroad, the largest shortline railroad in California, which connected exclusively to the former SP, states:

> "The merger has allowed us to access geographical areas that the SP did not previously serve, such as grain producing points in Idaho, Montana and the Midwest. For example, Idaho grain moving inbound to the General Mills flour mill at Vallejo can now be handled in a two-line UP-California Northern haul. The Anheuser Busch brewery in Fairfield has benefited with the elimination of a switch between

> the UP and SP at its distribution center in Portland. Napa Pipe Company has benefited from new single-line service for some of its long-distance pipe moves, and local lumber customers sourced by certain Pacific Northwest mills have also been aided by new UP routes."

- Riviana Foods, a rice producer located on the line of the former SP in Southern Louisiana, advises that the merger opens up single-line destinations all across the UP system, giving Riviana "substantial opportunities to expand our penetration into different areas of the country, and to improve the efficiency and competitiveness of our distribution system for finished products."

- Laredo Moving and Storage, which operates transloads on UP and Tex Mex in Laredo, indicates that the merger provided "better single-line alternatives to previously served destinations and entirely new opportunities, such as the westbound movement of steel coils."

- And the President and Chief Executive Officer of the Arkansas-Oklahoma Railroad ("A-OK"), an Oklahoma shortline, says:

> "Put simply, the UP/SP merger has been great for our business. The main benefit has been that the UP rail system has much more efficient routings than the old SP network. In situations where there used to be multiple carriers involved with one rail movement, we now have single-line UP hauls available. I can't exaggerate the difference these new single-line routes have made. Instead of fragmented routes where every carrier demanded its own piece of the pie, a shipper now has one smooth transition from us to UP, at considerably lower freight rates. When rates drop for shippers, traffic increases. That is good news for A-OK.

> Increased traffic hasn't been the only merger-related benefit, either. With UP's tracing system, a capability that the old SP never had, I can track cars headed toward my short-line from points anywhere on the UP network. In the old days I was riding blind, never knowing just when an SP train would show up. My customers really appreciated that.
>
> Things are good right now for A-OK, and I expect that as the merger gets further implemented, they will become even better. UP's marketing people have really stepped up to the plate in this regard, asking me to estimate rates for rail traffic to several markets we don't currently serve. Shipping wood to the West Coast is one example. UP has been very aggressive in trying to drum up new business for the A-OK, and as far as I am concerned, if they can get us the customers, we can handle the traffic."

2. Equipment

Another important dimension of strengthened competition is equipment supply and utilization. For a second year, the merger of the UP and SP equipment fleets, and the consolidation of the car management functions, has allowed UP to bring many competitive benefits to shippers. All across the merged system, UP shippers are benefitting from access to SP equipment, and vice versa. Consolidation of the two railroads is also opening up numerous opportunities for backhauls, triangulation, and more efficient equipment repositioning, which in turn allow more competitive rates and service to be provided to customers.

Since October 1996, UP and SP equipment has been managed as a single fleet of some 150,000 freight cars. As a result, UP and its shippers have enjoyed the benefits of improved car utilization that the merger application predicted.

UP has maintained conservative measures of the accelerating equipment utilization savings already achieved at this stage in merger implementation. Through the first 20 months of merged operations (October 1996 through May 1998), UP calculates that it saved at least $10.5 million in costs attributable to reduced car-days and car-miles. In addition, UP estimates that it avoided lease payments that would total more than $10.1 million on an annual basis. These savings are attributable to specific, identifiable equipment flows, and we know that there are additional savings that are more difficult to quantify. As UP continues to invest capital and implement merger-related operating changes and terminal consolidations, equipment savings will only increase.

Exploiting backhaul and triangulation opportunities made possible by the merger has yielded significant improvements in loaded-to-empty mileage ratios for many equipment types. Among the more notable improvements: between the first quarter of 1997 and the first quarter of 1998, for example, there was a 22% improvement in the loaded-to-empty ratio for coil gondolas, 21% for tall tri-levels, and 16% for airslide covered hoppers.

As was the case last year, numerous concrete examples can be cited of shippers' benefitting during the past year 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:

- Customers of the merged system now benefit from the largest mechanical reefer fleet in the United States -- 5,268 cars. The UP reefer fleet has provided a new competitive option for SP shippers in California. Since the merger, UP has made major repairs to SP's reefer cars, reducing damage claims and providing more reliable transportation for former SP shippers. Because of its financial constraints, SP had not made repairs to its refrigerated cars for more than a decade. The merged system will have rebuilt or leased more than 600 mechanical reefer cars in the two years following the merger.

- In addition, UP is developing, in cooperation with Trinity Industries and DuPont Composites, a new reefer car made from a composite material. This is the first new refrigerated car developed in the industry in 26 years, and it promises to provide benefits to all customers of the combined system. Fifty of these cars will be introduced this year.

- SP lacked the financial resources to acquire centerbeam flatcars for Pacific Northwest and California lumber shippers. The merger made UP's fleet of centerbeams available to such shippers, and the merged system has continued to acquire more of these cars, which are highly valued by shippers. Since the merger, UP has purchased or leased 675 of these cars, and it is now in the process of acquiring 200 more. The merged system has also worked with shippers and shortlines to support their expansion of their centerbeam fleets. In recent months, as Far East lumber markets have declined, the availability of these cars, together with the merged system's new through train service to Chicago and simplified, lower rates, has allowed Pacific Northwest producers to ship much more of their output into Eastern U.S. markets.

- To handle steel pipe from Napa Pipe on the California Northern Railroad, a shortline that connected only to SP, the merged system has acquired 500 new 89-foot flatcars, nearly trebling UP's fleet of these cars. SP was unable to afford such acquisitions. With these cars and the merged system's new single-line routes, Napa Pipe has penetrated major new markets.

- In Mexico, shippers on lines south of Eagle Pass, who suffered from SP car shortages before the merger, now receive UP boxcars and hopper cars via repositioning in Mexico. UP and SP equipment made empty in Mexico can now return to the U.S. via any of the multiple border crossings that were served by either UP or SP. The availability of UP equipment also allows new traffic to move from areas of Mexico served via SP gateways, such as Nogales and Eagle Pass. And the merged system's ability to use all of its Mexican gateways interchangeably has greatly facilitated the movement of empty multilevel cars to Mexico for the automobile manufacturers.

- When Idaho potato shipments slow down in July and August, the UP reefer fleet is available to SP-served potato growers in California's San Joaquin Valley and SP-served tomato paste producers in Northern California.

- UP doublestack cars made empty in Northern California continue to be moved over SP's direct route to Southern California, where they are used for eastbound moves at the Intermodal Container Transfer Facility, remedying a persistent SP car shortage. These cars had previously been repositioned to Southern California over UP's extremely circuitous route via Utah, or returned empty to Chicago.

- The merger has eliminated wasteful cross-hauls by the two railroads of empty doublestack cars between the Pacific Northwest and Northern California. Before the merger, SP had moved a full train of such cars south from Portland twice a month, while UP paid SP to relocate even more UP empties to Portland from Northern California. Now these cars are reloaded where they become empty.

- UP intermodal flatcars that previously would have returned empty to Chicago are now satisfying SP equipment needs in Texas.

- At Portland, Oakland and Los Angeles, UP continues to provide conventional intermodal cars to handle former-SP traffic. Before the merger, those cars had routinely moved empty to Chicago.

- UP shippers now benefit from the former SP's surplus of trailers at Salt Lake City. UP had been routing empty trailers from other locations to Utah to handle those loads. Similarly, surplus UP trailers fill the former-SP trailer deficit at Oakland.

- UP and former-SP intermodal facilities at common points routinely supply trailers to each other to remedy temporary shortages.

- As a result of the merger, SP empty centerbeams and boxcars are being reloaded at UP points in Texas, Louisiana and Arkansas for backhauls to SP points in Arizona and California.

- Use of SP boxcars for paper loading in Arkansas is allowing UP to reduce the use of foreign cars.

- On their shipments to the Midwest and the East, SP-served California food products shippers continue to benefit from access to the merged system's larger combined fleet of 50-foot and 60-foot boxcars.

- UP continues to provide from 30 to 125 high-cube 50-foot boxcars per month to SP-served shippers for paper moves from Oregon to Southern California. In addition, UP is providing as many as 125 60-foot boxcars per month to SP-served shippers for lumber loading in the Pacific Northwest.

- UP has acquired hundreds of gondola cars and flatcars to handle Geneva Steel shipments.

- UP acquired 315 new coal cars to handle increased volumes of export coal through the new LAXT terminal in Los Angeles.

- The merged system has acquired hundreds of bulkhead flatcars for lumber and steel traffic, hundreds of hopper cars to handle aggregates, and hundreds of coil gondolas to handle steel.

- This year, UP is rebuilding 232 open hoppers for use in handling copper concentrates.

- The merged system has acquired or reconditioned hundreds of boxcars to move forest products and metals.

- UP provides up to 40 60-foot boxcars per month to SP-served Arkansas plywood shippers.

- SP double-door boxcars which UP used to return to SP empty at Ogden are now made available to UP-served customers in the Denver area. UP and SP cars are similarly being cross-utilized in the Omaha and Kansas City areas.

- Gondolas terminating on UP in Los Angeles that returned empty to Utah before the merger are now being reloaded by SP-served shippers for scrap movements to Utah. Similarly, by using available UP gondolas, an SP-served

STB FD-32760(SUB21) 7-1-98 D ID-189185 2 OF 5 shipper in Northern California can ship scrap to Utah. The cars are then cleaned and loaded again with steel products for Los Angeles.

- Access to UP cars continues to alleviate the chronic car shortages that SP-served steel shippers in Illinois, Colorado and Oregon used to face. Steel shippers continue to benefit from broader access to UP and SP plain 52-foot and 65-foot gondolas. The combined plain gondola fleet is the largest in the industry. And because UP coil cars can move traffic to SP-served destinations in Texas, UP is attracting traffic from truck at significantly lower rates.

- SP 50-foot plain boxcars available at Ogden are being repositioned for loading by UP-served customers in Utah instead of moving empty to the west.

- Copper shippers in El Paso and Arizona continue to benefit from the merged system's combined boxcar fleet.

- SP empty boxcars have been used to load cottonseed at UP points in the Arkansas-Louisiana delta area and cotton at UP points in Texas.

- UP continues to use empty SP RBL cars for beer and canned goods loading at Laredo.

- The merged system continues to have a greater ability to supply appropriate boxcars for moving tinplate from Eastern points to SP-served canners in California.

● UP open-top hoppers continue to supplement SP equipment supplies to transport petroleum coke originating in central Kansas.

● UP open-top hoppers terminating in Arizona had been returning empty before the merger, but are now being used for copper concentrate loading at SP points. Similarly, SP open-top hoppers made empty in California are being used by UP shippers in Nevada.

● Salt shippers in Kansas continue to benefit from the merged system's new policy of supplying SP plastic-lined large covered hoppers for their business. This policy has allowed shippers to use private equipment elsewhere.

● Processors of sugar beets benefit from the merged system's ability to use the combined UP/SP open top hopper fleet during the September-to-February season in Idaho and the May-to-August season in California. The hoppers are used to ship sugar beets as well as lime rock to support the processing operations.

● SP-served sugar shippers are benefitting from UP's larger fleet of airslide covered hopper cars, and UP is purchasing 100 "next generation" sugar cars this year. These cars have improved gate mechanisms that allow efficiencies in unloading and require less maintenance.

● Use of the merged system's combined fleet of lined food-grade covered hoppers is generating efficiencies in the shipment of rice. SP cars that previously moved empty back to California are being loaded at UP points in Arkansas and Texas.

3. Switch Fees

As we reported last year, yet another important dimension of enhanced competition has been the elimination and reduction of switch fees. 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 use of most efficient routes, and to competition for shorter-haul movements against truck and alternative 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.

SP had imposed these high reciprocal switching charges on all major railroads, and those railroads had reciprocated. 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/car ($60/car for grain), and fees charged by SP at all other points to all railroads were reduced to no 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/car. These reductions went into effect promptly upon consummation of the merger. Actual experience in the full year following the merger showed that the BNSF-SP reductions alone amounted to more than $11 million per year on over 65,000 cars. This level of impact has continued during the second post-merger year.

In total, UP estimates that the eliminations and reductions of switch charges that were produced by the merger and the settlement agreements will amount to some $56 million during the first two years following the merger. In addition to this monetary impact, these reductions have promoted new and increased traffic flows, as rail rates have become more competitive.

In addition, in February of this year, UP and BNSF entered into a new systemwide reciprocal switch fee agreement that produced further overall reductions in 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/car for whole grains and $130/car for nearly all other traffic. Reductions in former-CNW fees were particularly significant -- on the order of 50%. This agreement was attributable in significant part to the merger, because the merger permitted negotiations on a basis of broad equality in switching volumes and brought about a commitment by the entire merged system to promoting traffic development through reducing switch fees.

B. Effectiveness of Competition-Preserving Conditions

The Board imposed, as conditions to its approval of the merger, the settlement agreements entered into between the primary applicants and BNSF and CMA, and augmented those settlements 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 the Utah Railway. These conditions have continued to work well during the past year.

1. Compliance With the Conditions

UP continued to devote very substantial resources during the past year to complying strictly 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.

Definitive Contracts. As the Board knows, even before the merger had been approved, Applicants had completed and filed 30 definitive trackage rights agreements and a master haulage agreement with BNSF. Following approval of the merger, a series of disputes as to the scope of BNSF's rights, including those involving CPSB, CMTA and TUE, were resolved, and in last year's report, in compliance with Decision No. 72, served May 23, 1997, p. 10, we submitted, as Exhibit B, an amended and restated BNSF settlement agreement reflecting those decisions. With very few exceptions, the language of that amended and restated agreement was agreed upon between UP and BNSF.

During the past year, the following decisions further clarified the scope of BNSF's rights:[5]

- Decision No. 73, served Aug. 14, 1997 (right to move traffic not committed by contract to UP to Lower Colorado River Authority plant at Halsted, Texas)
- Decision No. 74, served Aug. 29, 1997 (whether facilities that BNSF is entitled to serve in Lake Charles area are "2-to-1" facilities for purposes of contract reopener condition)
- Decision No. 75, served Oct. 27, 1997 (right to serve R.R. Donnelley facility at Sparks, Nevada)
- Decision No. 77, served Jan. 7, 1998 (access to facilities in New Orleans)
- Finance Docket No. 32760 (Sub-No. 21), Decision No. 11, served Jan. 23, 1998 ("2-to-1" facilities protocol)

On September 15, 1997, as directed in Decision No. 4[illegible], served Aug. 26, 1996, pp. 2-3, a notice of class exemption was filed in Finance Docket No. 32760 (Sub-No. 24) with respect to the additional rights granted to BNSF to handle CPSB traffic.

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[5] Except as indicated, the decisions were issued in Finance Docket No. 32760.

"2-to-1" Protocol. As noted, the Board resolved issues as to a definitive protocol to govern the listing of "2-to-1" facilities in Decision No. 11 in Finance Docket No. 32760 (Sub-No. 21), served Jan. 23, 1998.[6] Since the Board's decision in October 1997 regarding an R.R. Donnelley facility in Sparks, Nevada, there have been no disputes that have required arbitration or resolution by the Board. The lengthy list of possible "2-to-1" facilities that BNSF had submitted to UP, largely culled from obsolete tariffs, has been addressed.

Voluntary Further Agreements. As reported last year, in order to facilitate BNSF's operations pursuant to the merger conditions, UP has 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 last year's 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. During the past year, an additional haulage agreement was entered into for the movement of traffic

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[6] The parties have executed the final protocol. See Exhibit B hereto.

between Pine Bluff, Arkansas, and the "2-to-1" points of Paragould, Arkansas, and Dexter, Missouri. As previously reported, some of these agreements, such as the Odem-Corpus Christi and Shreveport-Tenaha haulage, are no longer in use because BNSF is instead running trackage rights trains at those locations.

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 UP-BNSF settlement agreement to third-party switching arrangements.

Implementation Steps. Although data systems were in place to allow immediate commencement of BNSF service upon consummation of the merger, considerable manual effort was required to support trackage rights because there was not enough time in advance of the merger date to automate the process fully. This manual work primarily involved the maintenance of BNSF trackage rights train schedules in UP's computer systems and the schedules for UP trackage rights trains in BNSF's systems. In addition, the railroads would often change train symbols and schedules on short notice before corresponding updates could be made to the other railroad's computer systems, which resulted in breakdowns in the data exchange process and a need for additional manual data exchange. Collection of data to support performance measurements for trackage rights was also primarily a manual effort.

Last fall, a joint UP-BNSF team was organized to study data exchange problems and design improved systems in order to correct problems and implement greater automation. UP completed and implemented its portion of this project on April 14, 1998. Under the new system, information regarding each railroad's trackage rights trains will automatically create train sheets in the other railroad's system. These train sheets are then updated by computer as the train moves along its route. As a result, both BNSF and UP are able to receive more accurate and up-to-date information on BNSF trackage rights trains. There has been a major reduction in the need for manual data entry by train dispatchers and supervisors, and data integrity has improved. BNSF is expected to complete its portion of this project, which will provide more accurate information about UP trackage rights trains moving over BNSF lines, later this summer.

In March 1997, UP and BNSF developed a formal process to record, monitor and resolve problems that arose out of the trackage rights, haulage and reciprocal switching arrangements between the railroads. A problem-log database was created that allowed employees of both UP and BNSF to add and update problems, and the railroads agreed to hold weekly calls to review progress on existing problems and discuss new ones. UP assigned an employee at its National Customer Service Center to work full-time on resolving problems identified in the log.

By improving communications and avoiding duplication of effort, the problem-log approach substantially improved the problem resolution process that preceded it. More than 1,000 problems have been documented in the database in the 14 months it has existed, and as of the end of June only 12 merger-related problems remained open. This process, created to address problems relating to implementation of the merger conditions, has proven such a great success that it has also been used to solve issues between UP and BNSF that are not merger-related.

The BNSF-UP dispatching protocol has also worked well.[7] Both parties have exercised their rights to monitor the dispatching of their trains by the other, and any issues that have arisen have been resolved quickly and cooperatively. BNSF has placed 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. Advisories have been sent to remind dispatchers of the importance of scrupulous fairness in dispatching tenants' trains in

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[7] BNSF has confirmed this in its periodic reports. See, e.g., BNSF-PR-2, p. 6; BNSF-PR-4, Hord, pp. 12-13; BNSF-PR-5, p. 15.

accordance with their proper priorities. In addition, as previously reported, UP and BNSF have now stationed dispatching personnel at a Houston-area regional dispatching center in Spring, Texas.

Finally, on January 12, 1998, UP and BNSF entered into a general agreement covering UP's provision of terminal services to BNSF in connection with BNSF's exercise of its trackage and haulage rights.

Line Sales. The BNSF settlement agreement provided for the sale to BNSF of three line segments: Dallas-Waxahachie, Iowa Junction-Avondale and Keddie-Bieber. As we reported last year, the first two sales were completed on September 20 and December 15, 1996. The Keddie-Bieber sale closed on July 15, 1997, simultaneously with the commencement of the I-5 proportional rate arrangement.

On February 18, 1998, UP and BNSF executed a final settlement of their dispute concerning whether the Iowa Junction-Avondale line's physical condition met the contractual requirement on the sale date.

As previously reported (UP/SP-335, pp. 4-5), as part of an overall agreement under which BNSF joined in a regional dispatching center critical to improving service in the Houston/Gulf Coast area, UP and BNSF agreed on February 18, 1998 to exchange undivided half-interests in UP's line between Iowa Junction, Louisiana, and 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. This access, which did not require Board action, went into effect immediately. UP is today filing a petition for exemption of the ownership exchange.

Connections. UP work on connections to facilitate BNSF trackage rights operations has now been completed at Sealy, Texas; Bridge Junction, Arkansas; Avondale, Louisiana; Westwego, Louisiana; and Longview, Texas. Construction of the connection at Stockton, California, is complete save for the installation of a grade crossing, which will be done as soon as a required permit is received. In March of this year, BNSF completed a connection at Basta, California, that will allow BNSF to operate its trackage rights trains to Fullerton and La Habra, California. And last November BNSF and the Utah Railway completed the installation of tracks and a crossover at Provo to facilitate BNSF's Utah operations (see BNSF-PR-6, p. 9).

Capital Reserve Fund. Section 9c of the UP-BNSF settlement 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 parties have concurred on the following projects:

Project	UP Cost Estimate
Avondale Connections	$6.1 million
Iowa Jct. Siding	5.5 million
CTC, Echo TX to Iowa Jct.	3.4 million
Crossing Near Stockton	3.7 million
Stockton Connection	4.0 million
AEI Scanners	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 (1,400 out of 1,525 storage spots) is at Dayton, where BNSF and the facility operator have constructed receiving and departure tracks to facilitate BNSF's use of the facility. UP has also continued to adhere to the special, favorable billing arrangements, and to the special interchange arrangements with regard to handling of cars stored outside the immediate Gulf Coast area that Gulf Coast "2-to-1" shippers elect to tender to BNSF, which we described in UP/SP-311, pp. 35-36. SIT capacity is tight throughout the Gulf Coast area, and UP is pursuing capital investment and other initiatives to add to storage space.

New Facilities. In Decision No. 75, served Oct. 27, 1997, the Board held that it would 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.[8] In light of this decision, the parties have not pursued their efforts to arrive at a formal written protocol regarding procedures for initiating such service. However, since Decision No. 75, which resolved BNSF's right to serve a facility in Sparks, Nevada, there have been no further disputes on this subject.

Joint Service Committee. The Joint Service Committee provided for in the parties' dispatching protocol has met four times since our last annual report: in September, December, January and June. Numerous other informal communications have occurred to follow up on issues addressed at these sessions. Among the issues addressed were: improving billing and data systems; establishing the Spring, Texas, dispatching center; defining common criteria for measuring numbers of blocked sidings; establishing standardized train performance measures; instituting directional running on various lines; completing needed connections and other capital projects; improving interchange;

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[8] In October 1997, the Applicants withdrew their petition for judicial review of the "new facilities" condition.

detouring trains to facilitate maintenance activities; completing agreed-upon line sales; increasing weight limits; and miscellaneous operating issues. There have been no dispatching issues that have required dispute resolution through arbitration or recourse to the Board.

Segregated Funds. In Section 6 of the CMA agreement, Applicants agreed to place trackage rights fees received under the BNSF settlement agreement into two dedicated funds, one with respect to the 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, 1998, the latest date for which the data has thus far been compiled. (In light of the great excess of outlays over fees, capital expenditures on the lines, which have been substantial, have not been calculated.)

	Texas, Louisiana, Arkansas, Missouri and Illinois	California and Central Corridor
REVENUE		
Trackage Rights Fees	$16,465,335	$19,824,947
Capacity Improvement Fees	0	0
Total	$16,465,335	$19,824,947
EXPENSES		
Maintenance	$50,108,661	$35,935,839
Depreciation	51,259,962	38,842,944
Capital Expenditures	not calculated	not calculated
Accounting Expenses	29,730	29,730
Total	$101,398,353	$74,808,513

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. Questions concerning the details of this condition were resolved in Decision No. 57, served Nov. 20, 1996. As explained in our July 1, 1997 report, most affected contracts were of one year in 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 contract prior to its expiration. The rate and service benefits that those shippers received during the past year are reflected in the discussions below and in the examples set forth in the Confidential Appendices, particularly Confidential Appendix C.

As of the time of last year's report, only six shippers had written to UP pursuant to Guideline No. 10 in the Board's decision to ask whether UP would terminate contracts if the shipper diverted contractually-committed volumes to BNSF. Since last year's report, UP has received only one further letter pursuant to Guideline No. 10, and that matter was resolved by an agreement to terminate several contracts and reduce the volume commitment in another.

We reported on July 1, 1997 that in a number of other instances shippers had diverted volumes under pending contracts to BNSF without formally inquiring whether UP would terminate the contract, and UP had not elected to terminate the contracts. This has continued to occur during the past year. Examples involving traffic that moved during the past year are contained in Confidential Appendix B.

I-5 Corridor. As noted, 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.

UP Trackage Rights on BNSF. UP has exercised the following trackage rights that it received over BNSF lines as part of the UP-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; and overhead and local service rights on the Dallas-Waxahachie and Iowa Junction-Avondale lines that were sold to BNSF. All of these rights have strengthened competition and added to UP's efficiency. With the completion of TCS implementation and labor implementing agreements in the Far West, UP expects soon to make use of the final such segment -- rights between Bend and Chemult, Oregon, which will provide a much shorter route for traffic moving between inland points in Washington and Oregon and points to the south.

b. Tex Mex Trackage Rights

In last year's report, we noted that final trackage rights terms had been established for Tex Mex's trackage rights over UP's lines between Beaumont and Corpus Christi/Robstown, and for Tex Mex's terminal trackage rights over HB&T in Houston. We also noted that UP had put necessary operating and data systems in place to support Tex Mex trackage rights operations when those operations commenced on October 8, 1996. As a result of UP's institution of directional operations between Beaumont and Houston in February of this year, 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 of traffic in each direction. Also, Tex Mex has expressed an interest in becoming a member of the Port Terminal Railroad Association in Houston, and discussions of this matter are currently underway.

We also noted in last year's report a number of steps to support Tex Mex operations, including establishment of an operating liaison for Tex Mex within UP's Harriman Dispatching Center. Those efforts continued during the past year.

UP has made other efforts to facilitate Tex Mex's operations of which Tex Mex has not taken full advantage. For example, to accommodate Tex Mex's change from SP's computer system to the KCS system, which took place during August 1997, UP worked with Tex Mex to develop and implement new protocols to effect electronic data interchange concerning train crew and consist information. Although those protocols are in place and Tex Mex briefly used them, Tex Mex has not been providing information to UP electronically, which has caused operating problems and additional administrative expense.

UP's trackage rights agreement with Tex Mex also established a Joint Service Committee mechanism, identical to that set forth in the UP-BNSF trackage rights agreements, but Tex Mex has not availed itself of that process. In addition, UP has repeatedly urged Tex Mex and its parent KCS to participate in the Houston-area dispatching center opened at Spring, Texas, by UP and BNSF this February, but thus far they have not agreed to do so. Tex Mex has also failed to exercise its rights under the Tex Mex-UP dispatching protocol, the terms of which are modelled on the successful BNSF-UP dispatching protocol.

As previously reported, UP constructed a new connection at Flatonia to facilitate the movement of Tex Mex trains. Construction of a new connection at Robstown to handle Tex Mex trains was completed in June, and the construction of an associated siding is presently scheduled to be completed on July 15. Design work is complete for a new siding south of Flatonia, and construction will begin as soon as the necessary permits are received.

Finally, it should be noted that as a result of the Board's Service Order No. 1518, Tex Mex received additional temporary trackage rights designed to address the Houston/Gulf Coast service emergency. The Board temporarily suspended the restriction in Tex Mex's trackage rights that limited those rights to traffic having a prior or subsequent movement on Tex

Mex's Laredo-Corpus Christi line. The Board also authorized Tex Mex to operate over UP's line between Algoa and Placedo. When UP instituted directional operations on that line and its Houston-Flatonia-Placedo line in cooperation with BNSF, the Board ordered Tex Mex to participate in directional running. Supplemental Order No. 1 to Service Order No. 1518, served Dec. 4, 1997, p. 5. UP subsequently agreed to grant Tex Mex trackage rights on its Algoa-Placedo line that would not expire at the conclusion of the Board's service order, so that Tex Mex will be able to operate directionally between Houston and Placedo as long as UP continues such operations.

c. Utah Railway Trackage Rights

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

2. The Conditions Are Working Well

Each of the competitive conditions is working to provide effective competition.

a. BNSF

BNSF is providing ever more vigorous and effective competition using the rights that it received as a condition to the merger.

BNSF Service. As we reported last year, 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. As of July 1, 1997, BNSF had taken the following key steps to institute trackage rights services:

10/8/96	Denver-Salt Lake City
	Salt Lake City-Stockton
	Houston-Corpus Christi
	Kerr-Temple (aggregates trains from Georgetown Railroad to Houston area)
10/26/96	Riverside-Ontario CA
12/16/96	Houston-New Orleans
	Pine Bluff-Memphis
	Houston-Cleveland TX
	Richmond-Warm Springs CA
1/13/97	Houston-New Orleans intermodal service
1/16/97	Houston-Pine Bluff-Memphis
	Houston-Dayton TX
3/10/97	Temple-Waco TX
	Temple-Elgin TX (with Longhorn Ry. interchange)
3/12/97	Temple-San Antonio
3/23/97	Beaumont-Amelia TX
4/1/97	Direct service to Utah Valley "2-to-1" customers by Utah Railway as BNSF's agent
	San Antonio-Eagle Pass
4/21/97	Longview-Memphis train via Tenaha TX

During the past year, BNSF has continued to expand its service and complete the full transition to trackage rights. Here are some of the significant milestones:

- July 14, 1997: daily Denver-Stockton service instituted.

- July 15, 1997: in connection with Keddie-Bieber sale, BNSF I-5 Corridor trains began using Keddie-Stockton portion of Central Corridor rights.

- On September 1, 1997, BNSF began using its own crews on its Central Corridor trains between Denver and Salt Lake City.

- In November, UP and BNSF agreed on directional operations between Houston and Placedo. BNSF was granted southbound rights between Caldwell and Placedo via Flatonia, to remain in place so long as UP operates directionally in this corridor.

- On January 16, 1998, BNSF initiated trackage rights operations between Pine Bluff and Little Rock. BNSF is serving some of its Little Rock-area customers directly and others via reciprocal switching provided by UP and the Little Rock Port Authority.

- On January 20, 1998, BNSF began running various trains over the UP line between Sacramento and Richmond, California.

- On January 27, 1998, BNSF initiated local train operations between Winnemucca and Sparks, Nevada, to serve a new facility at Sparks that BNSF was authorized to serve in Decision No. 75, served Oct. 27, 1997.

- On February 1, 1998, when UP implemented directional running in the Houston-Memphis and Houston-Beaumont corridors, BNSF was included in the more efficient directional routings.

- On April 15 of this year, following the completion of a connection between UP and BNSF at Longview, Texas, BNSF's Longview-Memphis train began operating directionally on UP's Houston-Memphis line.

- On May 6, 1998, BNSF began operating a local train to and from Baytown, Texas. UP continues to provide haulage to BNSF for some customers on the Baytown branch.

- Also in May, BNSF instituted local service to new facilities established by Total Petroleum and Conoco at Durham, Colorado.

- Also in May, BNSF began using its Sealy-Smithville-San Antonio trackage rights to move coal trains from New Orleans to Eagle Pass.

- Finally, last month BNSF instituted regular service over its Taylor-Smithville-Sealy trackage rights for rock trains originating on the Georgetown Railroad.

In sum, 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 Illinois Central to move traffic between Memphis and St. Louis-area connections to 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 the locations discussed above. As already mentioned, the connection that BNSF has constructed at Basta, California, will allow it to serve "2-to-1" customers at Fullerton and La Habra, California, via trackage rights, in lieu of the present haulage arrangement.

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 from Warm Springs CA)
- Trevarno CA (haulage from Warm Springs CA)
- Sugar Land TX (haulage from Houston)
- Dickinson TX (on the former Galveston, Houston and Henderson Railroad) (haulage from Houston)
- South Gate CA (haulage from Colton and Barstow CA)
- Turlock CA (haulage from Stockton)
- Grand Prairie TX (on the former Great Southwest Railroad) (haulage from Ft. Worth)

BNSF Traffic Volumes. The volume of traffic handled by BNSF pursuant to its rights continued to increase dramatically this year. Last year, after reviewing BNSF's substantial trackage rights volumes and the competitive service that BNSF was offering in all major corridors, the Board found that the merger conditions had effectively preserved competition. This year, BNSF's volumes reached twice last year's levels.

Through May of 1998, BNSF had operated a total of 8,736 through freight trains over the trackage rights lines since the commencement of operations in October 1996. This is shown in Charts #2, #3 and #4, depicting, by month, the numbers of BNSF through trackage rights freight trains and the numbers of cars and tons on those trains.

As the charts show, the number of BNSF trackage rights trains had grown to 703 in May 1998 -- 1.8 times the 392 trackage rights trains that BNSF operated a year earlier, in May 1997. Over the past year, train lengths have also continued to grow. BNSF tonnages have therefore increased even more sharply than the number of trains, reaching 3.3 million gross tons in May 1998 -- 2.3 times the 1.4 million figure in May 1997. And cars moving in through trackage rights trains reached 40,589 (21,676 loads and 18,913 empties) in May -- 2.3 times the 17,834 cars (10,077 loads and 7,757 empties) in May 1997.

Another way of measuring the continued growth of BNSF's traffic volumes on trackage rights through trains is to divide the 20 months of available data into two 10-month periods. The 6,021 through trackage rights freight trains in the second 10-month period were well over twice the 2,715 through trains in the first 10-month period. The 341,387 cars on those trains in the second 10-month period were more than three times the 111,868 cars in the first 10-month period.

And the 26,618,601 gross tons on those trains in the second 10-month period were also more than three times the 8,625,465 gross tons in the first 10-month 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 to through trackage rights trains -- and thus represents still further traffic secured by BNSF because of the rights. Through May 1998, BNSF had operated a total of 340 locals between Houston and Dayton, Texas; 330 locals between Temple and Waco or Elgin, Texas; and 322 locals between Richmond and Warm Springs or Oakland, California. These trains handled 19,070 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 1,500 local trains, carrying a total of some 35,000 loaded and empty cars.[9]

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 1998, loaded and empty haulage cars totalled nearly 2,000. More than half of these moved to and from Brownsville, with the remainder spread

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[9] Data on Utah Valley locals for April and May 1998 had to be estimated because of a reporting error by BNSF.

Chart #2
BNSF Trackage Rights
Number of Through Trains

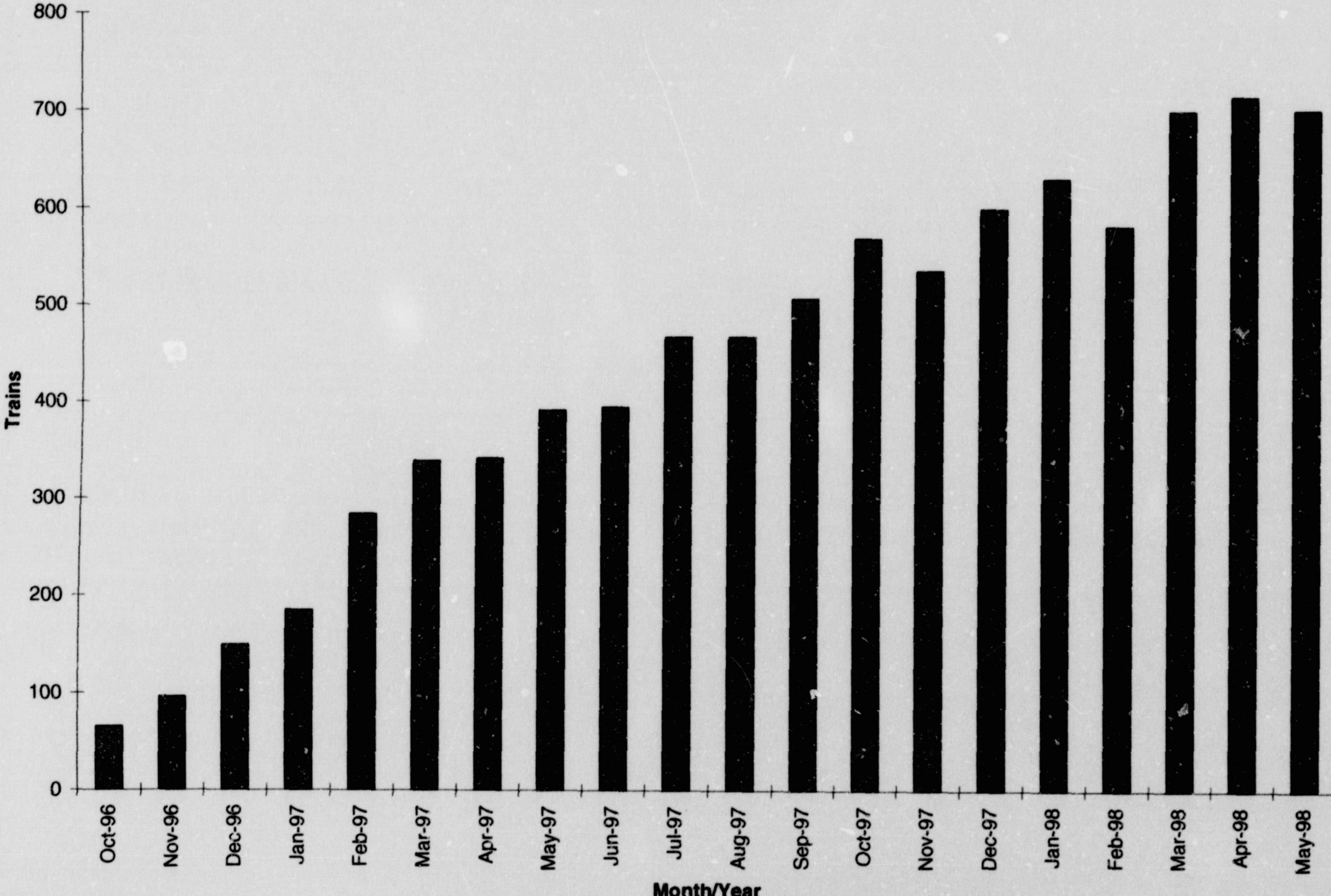
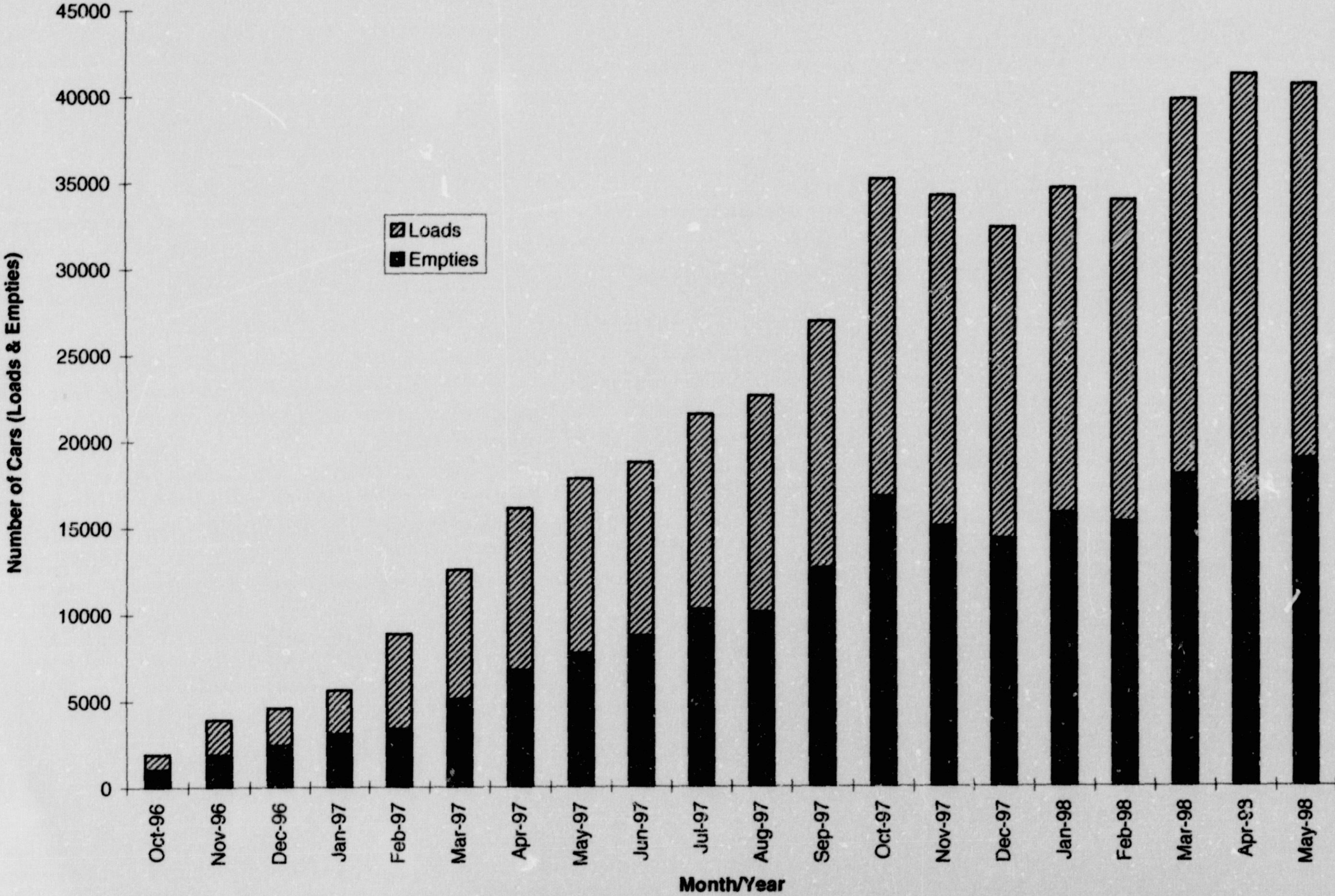


Chart #3

BNSF Trackage Rights
Number of Cars (Through Trains)



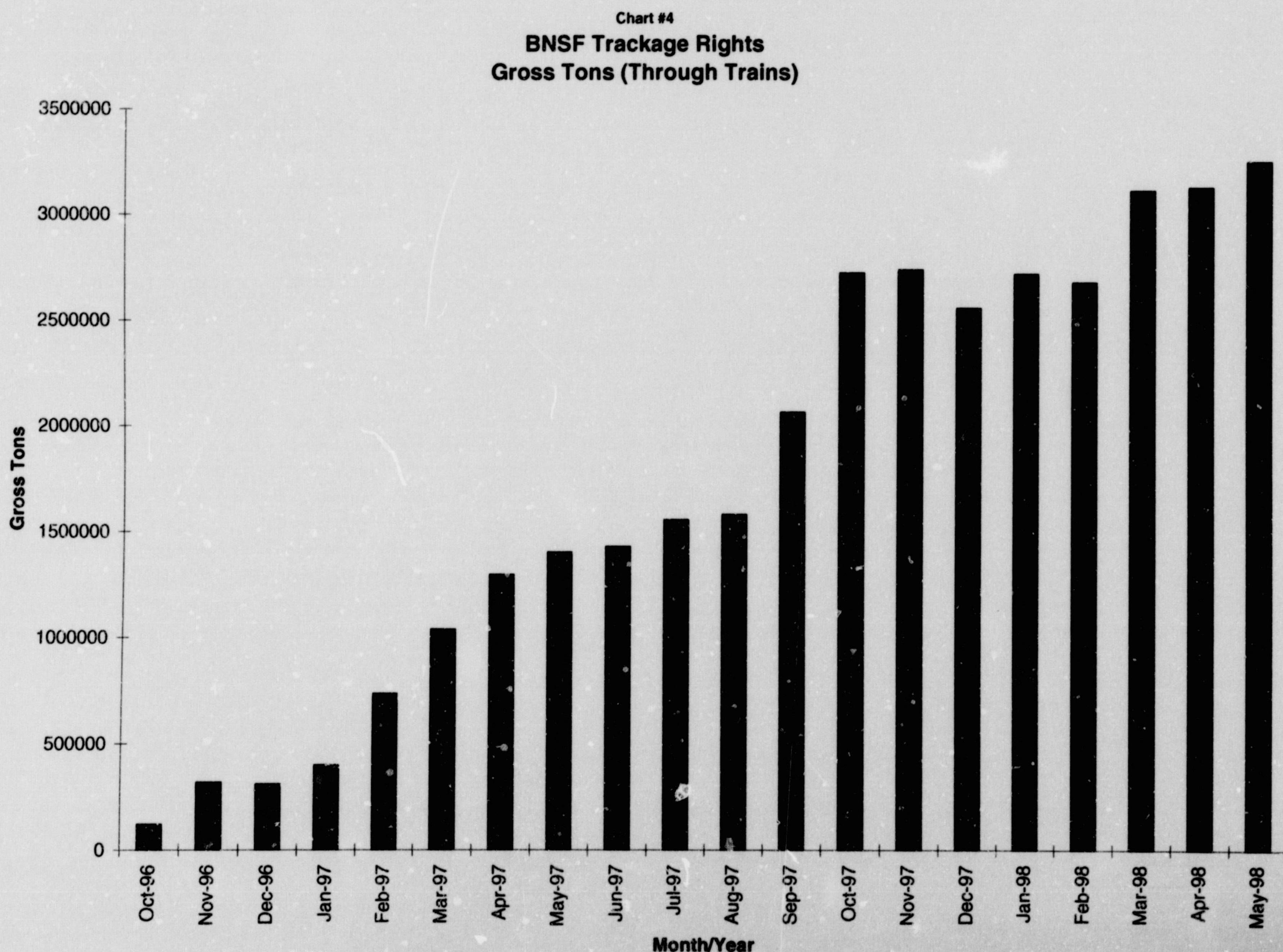


Chart #4
BNSF Trackage Rights
Gross Tons (Through Trains)
3500000
3000000
2500000
2000000
1500000
1000000
500000
0
Gross Tons
Oct-96
Nov-96
Dec-96
Jan-97
Feb-97
Mar-97
Apr-97
May-97
Jun-97
Jul-97
Aug-97
Sep-97
Oct-97
Nov-97
Dec-97
Jan-98
Feb-98
Mar-98
Apr-98
May-98
Month/Year

among such locations as Fullerton, California; Lake Charles, Louisiana; Orange, Texas; the Dayton Branch; the Northern California area; and the "paired track" in Nevada.

BNSF's through train frequencies in major corridors underscore its competitiveness. Even last year, those frequencies -- daily or more frequent at most locations -- clearly supported highly competitive service. Now, those frequencies are much higher -- generally two or even three trains per day in each direction -- and there can be no conceivable question as to BNSF's ability to compete very effectively:

- In the <u>Central Corridor</u>, BNSF operated 168 through trains in May 1998, carrying 497,557 gross tons. By comparison, the totals in May 1997, which we cited in last year's report, were 76 through trains and 176,777 gross tons. BNSF service in the Central Corridor is now at the level of two trains per day in each direction between Denver and Salt Lake City, and one train per day in each direction between Salt Lake City and Stockton.

- In the <u>Houston-Memphis corridor</u>, BNSF operated 116 through trains in May 1998, carrying 609,058 gross tons. The totals in May 1997 were 104 through trains and 391,743 gross tons. BNSF is running two trains per day in each direction in this corridor.[10]

- In the last of the three major BNSF corridors -- <u>Houston-New Orleans</u> -- BNSF operated 164 through trains in May, carrying 812,718 gross tons. The totals in May 1997 were 120 through trains and 384,942 gross tons. BNSF service in this corridor is now at a level of nearly three trains per day -- one of them an intermodal train -- in each direction.

Not only is the increase in the numbers of trains in each of these major corridors striking -- more than 2.2 times last year's level in the Central Corridor, for example -- but <u>tonnage</u> has grown even faster in each corridor, meaning that BNSF trackage rights trains are longer, more efficient, and more cost-effective. Total tons in May 1998 were 281% of the year-earlier total in the Central Corridor, 155% of the year-earlier total in the Houston-Memphis corridor, and 211% of the year-earlier total in the Houston-New Orleans corridor. Tons per train were 127%, 139% and 154%, respectively, of the year-earlier level in the three corridors.

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[10] Even International Paper, which strongly opposed the BNSF rights during the merger proceeding, now concedes that BNSF is replacing the competition that SP had provided in this corridor. <u>See</u> IP-21, June 1, 1998, McHugh, p. 7 ("BNSF made substantive efforts to increase its presence on the Houston-Memphis corridor, has agreed to provide local switching crews at Camden and Pine Bluff, has agreed to make other infrastructure investment and is in the process of becoming the replacement along this corridor for the lost SP competition that was envisioned and promised").

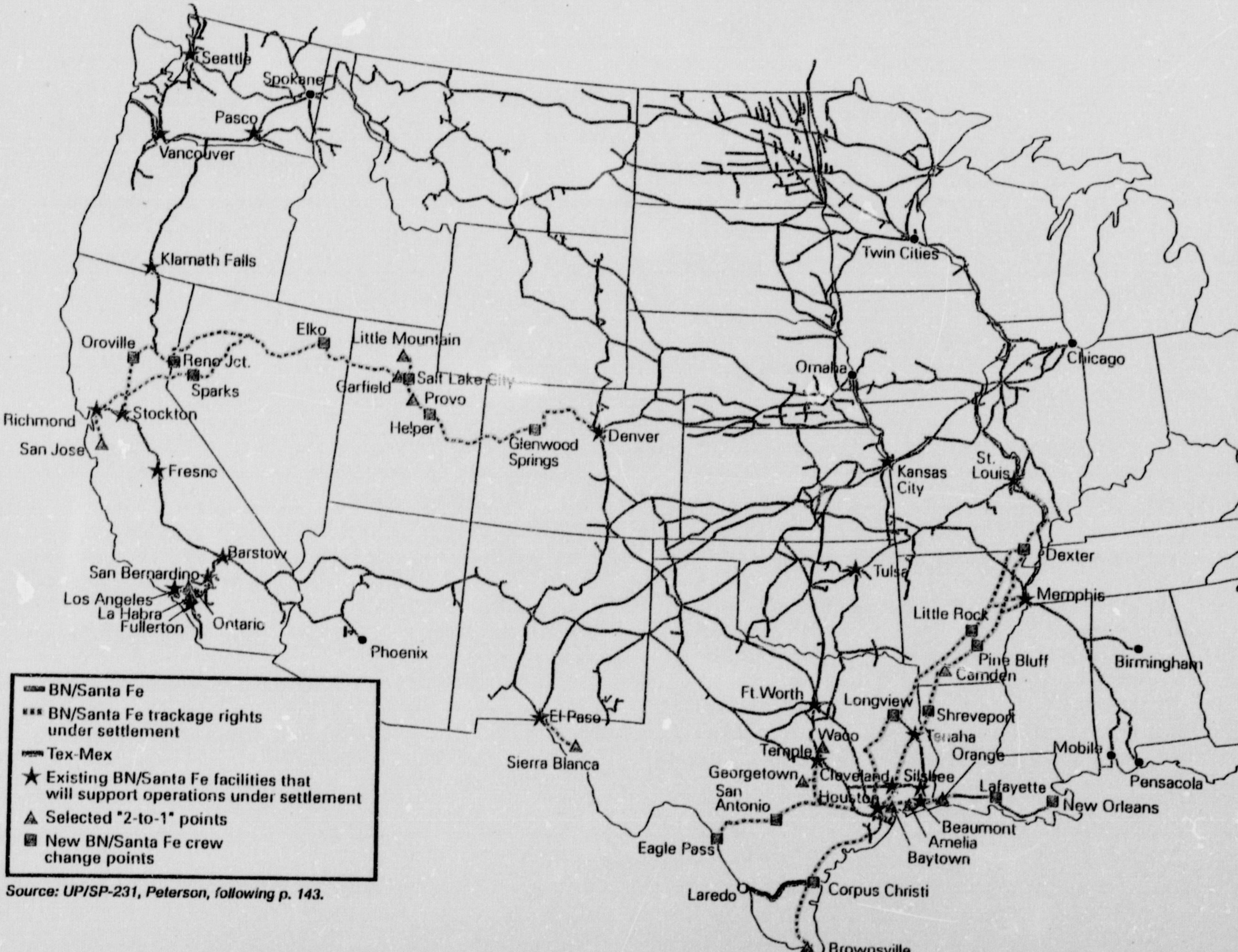
As was true of the figures presented last year, the foregoing corridor figures do not include many other trackage rights trains, including I-5 Corridor trains that use trackage rights over UP between Keddie and Stockton, California (78 trains in May); trains between Houston and Corpus Christi (76 trains in May); trains between Temple and Eagle Pass via San Antonio (50 trains in May); rock trains interchanged with the Georgetown Railroad (26 trains in May); coal trains to Halsted and Elmendorf, Texas; grain trains to Ontario, California; and a variety of locals.

The continued growth of BNSF's Mexico volumes is particularly notable. In May 1998, BNSF operated 76 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). These trains handled 6,688 loaded and empty cars, and 436,543 gross tons. A year earlier, in May 1997, the figures were 43 trains, with 3,332 cars and 278,836 gross tons. Eagle Pass trains are up even more sharply: 50 trains, carrying 2,877 cars and 333,024 tons, in May 1998, compared with 19 trains, carrying 730 cars and 60,599 tons, in May 1997. Underscoring the strength of BNSF's Mexico competition, BNSF has announced that it is purchasing 1,100 bi-level and 600 tri-level cars to handle additional automobile traffic, particularly traffic from Mexico.

We noted a year ago 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. A year later, BNSF volumes are twice as high. It is now even more clear that BNSF, with its extensive Western network and infrastructure of terminals and other support facilities (see Map #3), was uniquely situated to mount fully competitive service over the new rights, and that, as we said last year, there is no reason why BNSF cannot reach 50%, or even more, of the entire available universe of traffic -- though UP will continue to fight for every carload.

It may be that some part of this year's growth in BNSF volumes reflects the congestion problems on the UP system -- though we believe that element is likely to be modest, given that BNSF's trackage rights operations were often affected by the congestion just as UP's own operations were. As we indicated last year, though, the real point continues to be that BNSF is there for the long term with fully competitive service. It can capture any available traffic movement at any time. Its trackage rights and haulage service is supported by its existing, comprehensive Western rail network, and its

BNSF NETWORK, INCLUDING TRACKAGE AND HAULAGE RIGHTS



Source: UP/SP-231, Peterson, following p. 143.

costs for moving trackage rights and haulage traffic are incremental.

BNSF Competitive Successes. BNSF has continued to compete aggressively for the "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.

BNSF continues to capture numerous traffic movements across the full range of "2-to-1" points and corridors. The breadth of its successes has only expanded since last year. Confidential Appendix B contains some 150 specific examples -- twice as many as last year, reflecting the doubling in BNSF volumes since that time. As those examples demonstrate, shippers have continued to benefit from lower rates, improved routings, and new single-line access to BNSF points. The many rate reductions described in the appendix continue to underscore that BNSF is providing stronger competition than SP did in these markets.

Examples of BNSF traffic include:

- Large volumes of corn, soybeans and milo moving to Mexico via Corpus Christi and the Tex Mex, and via Brownsville and Eagle Pass.
- Unit trains of corn syrup from Iowa to Mexico.

- Cotton, soda ash, flue dust, tallow, steel, auto parts and chemicals movements to and from Mexico.

- Large volumes of auto parts from the Midwest to the NUMMI plant at Fremont, California, as well as outbound finished vehicles from the plant.

- Three major east-west doublestack container contracts -- OOCL's 55,000-unit contract, K Line's 17,000-unit contract, and Maersk's 10,000-unit contract -- which BNSF was able to capture because of its new access to New Orleans.

- Traffic movements from virtually all the "2-to-1" chemical plants on the Gulf Coast.

- Traffic from major chemical manufacturers in Longview, Texas, to Houston and points in the Midwest and East, for which the Houston-Memphis trackage rights gave BNSF new direct single-line routes.

- Unit-train coal movements to Sierra Pacific Power at Valmy, Nevada, the Lower Colorado River Authority at Halsted, Texas, and City Public Service of San Antonio at Elmendorf, Texas.

- Large volumes of aggregates from Texas Crushed Stone at Feld, Texas, to the Houston area. BNSF had run 310 Texas Crushed Stone rock trains on its trackage rights through May 1998.

- Traffic of major "2-to-1" shippers in Arkansas such as 3M, Green Bay Packaging and International Paper.

- Traffic of major Utah shippers such as Great Salt Lake Minerals, Kennecott, Cargill, Amoco, Chevron, Pennzoil, Consolidated Oil and Nucor-Yamato Steel.
- Numerous unit-train movements of grain to O.H. Kruse Grain in the Los Angeles Basin.
- Edible oil movements to Fullerton, California.
- Corn from Midwest origins to Tyson Foods in Pine Bluff, Arkansas.
- Wheat and flour from Kansas to Corpus Christi, Texas, for export.
- Rice from Farmers' Rice in West Sacramento, California.
- Barites from the UP-SP paired track in Nevada.
- Intermodal traffic to Salt Lake City.
- Other traffic to and from a wide constellation of "2-to-1" points, including Paragould, Arkansas; Herlong, Livermore, San Jose, South Gate, Warm Springs and West Sacramento, California; Harbor and Opelousas, Louisiana; and Baytown, Brownsville, Great Southwest, Harlingen, Orange, San Antonio, Sierra Blanca, Sugar Land and Waco, Texas, and "2-to-1" shortlines including the Longhorn Railway, the Little Rock and Western Railway, the Little Rock Port Authority, and the Salt Lake, Garfield and Western Railway.

● A wide array of other movements that traversed BNSF's new Central Corridor, Houston-Memphis and Houston-New Orleans routes.

As was the case last year, much of this traffic formerly moved in single-line UP or SP service -- belying the contention by witness Crowley, on behalf of a various parties, that BNSF would be unable to compete for such traffic.[11]

The attached verified statements confirm BNSF's success in competing for "2-to-1" traffic:

● 3M, one of the largest "2-to-1" shippers, with a major roofing granule plant at Little Rock, Arkansas, says: "The merger has established a competitive situation between UP and BNSF at our Little Rock, AR granule plant. This was not the case when SP was the competition. SP always seemed to be teetering on the edge financially and operationally. SP really needed UP's resources to rescue a very bad situation."

● Chevron reports: "The head-to-head competition between UP and BNSF for our business in the Salt Lake area has been strong." As a specific example, Chevron notes that a "contract for waxy crude transportation from Salt Lake to Richmond [California] was awarded to an aggressive BNSF."

● Deacero, a Mexican steel manufacturer, says that, thanks to the merger, it "can take advantage of strong

[11] See, e.g., NITL-9, Crowley, pp. 24, 43-44; SPI-11, Crowley, pp. 36, 55-56; see also UP/SP-231, Peterson, pp. 163-67 (refuting Crowley contentions).

competing single-line alternatives via UP or BNSF for movements from Eagle Pass or Laredo to California." This "head to head competition," Deacero advises, "promises numerous benefits for us, as each railroad fights to take the other's traffic and offers us favorable freight rates."

- Exxon, a major "2-to-1" shipper in the Houston area, states that it is "satisfied with the effectiveness of conditions imposed" to maintain competition at these locations. "BNSF and Exxon entered into new contractual agreements during 1997 which provide competitive rates and service, and Exxon estimates BNSF will move approximately 4000 cars per year (≈20% of total business) from our Mont Belvieu Plastics Plant, our Baytown Chemical Plant and our Baytown Refinery."

- Coors sees the "most important benefit" of the UP/SP merger as "improved competition." For example, Coors has benefitted from BNSF access to "2-to-1" rice sources in California: "Most of our inbound rice comes from the Sacramento area of California and we can use BNSF direct for this move, greatly improving our service and transportation costs."

- Farmers' Rice, the major "2-to-1" rice producer at West Sacramento, California, that supplies Coors, advises: "We now rely on the BNSF as a competitive lever to keep UP's rates in line, and it has proven to be an effective, vigorous competitor for our business. BNSF has taken away traffic from UP moving from our West Sacramento mill to the Pacific Northwest. And we recently selected BNSF for our long-haul movements to a number of destinations in the Midwest because it provided a more competitive rate than UP."

- Ag Partners, which markets Iowa grain in California and other end markets, states: "By expanding UP's single-line route network, and creating a directly competitive BNSF single-line alternative via the Central Corridor to California destinations, the merger significantly expanded the rail options for our business."

- The President of the Salt Lake, Garfield and Western Railway, a "2-to-1" shortline, reports: "BNSF is a much stronger competitor than SP. It has a much broader route structure than SP and offers our customers efficient single-line services to many more points than SP served. UP's single-line network is also greatly expanded due to the merger, with net results that our customers have much better single-line options from two carriers than what they had before." He adds: "BNSF has already competed aggressively for new business. It has recently persuaded two customers to relocate their facilities from another shortline to SLGW, so that they can move their product via SLGW-BNSF routings."

- And the Acadiana Railway, another "2-to-1" shortline in Louisiana, says: "We now connect with two extensive single-line networks, with much broader reaches than either UP or SP could offer before the merger. This creates long-term opportunities for our customer base. Post-merger, UP and BNSF offer them more efficient and cheaper connections with the Acadiana."

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 gain rate, service and equipment benefits where UP retained traffic in the face of this powerful competition from BNSF. Confidential Appendix C contains some 75 specific examples from the past year. Again, these many instances of rate, service and equipment improvements versus the pre-merger status quo are proof that UP-BNSF competition is actually stronger than the UP-SP competition that preceded it.

The prime example remains Geneva Steel in Geneva, Utah, by far the largest single "2-to-1" shipper. As reported last year, after intense competition involving many rounds of bidding, UP secured a 15-year contract for 99% of Geneva's business to and from UP points and competitive junctions.[12]

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[12] Geneva Steel's volumes are so large that the Geneva traffic remaining available to BNSF is substantial. In its statement submitted last year, Geneva estimated those volumes at 13,000 cars per year, and indicated that it planned "to offer to the BNSF as much competitive traffic as is available." Still more traffic is available to BNSF if UP does not meet the stringent service requirements in the contract.

The contract brought Geneva major rate savings and other benefits. As previously reported, Geneva in fact did significantly <u>better</u> than the so-called "lowball" SP rates that it had expressed concern during the merger case that it might lose. This year, pursuant to the contract, UP has acquired many hundreds of cars to handle Geneva's business, has set several monthly records in moving outbound Geneva steel shipments, and has taken extraordinary measures to keep vital taconite supplies moving into Geneva during periods of Central Corridor congestion. Details are set forth in Confidential Appendix D.

In its accompanying verified statement, Geneva Steel confirms that it secured "significantly lower rates" as "a direct benefit of the head-to-head competition between UP and BNSF created by the merger"; that its "car supplies are as good as they have ever been"; and that UP "has invested resources as necessary to protect our sources of raw materials." It indicates that UP "has taken steps to help Geneva penetrate new markets in the east," and that because of "enhancements in our rail service we are competitive in more long-distance eastern markets than was true before the merger." The result is that "Geneva is shipping more steel by rail than it has ever shipped before."

Other examples of rate and service benefits that UP "2-to-1" shippers received this year as a result of strong

BNSF competition, as detailed in Appendix C, include new contracts on improved terms, or broad rate reductions, for:

- Gulf Coast "2-to-1" chemicals traffic.
- Autos and auto parts from NUMMI's Fremont, California, plant.
- Grain and grain products to Mexico, the Gulf, California and other markets.
- Nevada barites.
- Utah petrochemicals, intermodal and metals traffic.
- Arkansas building supplies.
- Manifest and intermodal traffic moving via New Orleans.
- Steel products moving in the Central Corridor.
- Chemicals moving from the Gulf Coast to the East.
- Louisiana carbon black.
- Traffic to and from Mexico.
- Texas aggregates.
- A wide range of other commodities to and from such "2-to-1" points as Little Rock, Paragould and Pine Bluff, Arkansas; Warm Springs, California; Beowawe and Carlin, Nevada; Opelousas, Louisiana; and San Antonio and Waco, Texas.
- Many other movements that the merger conditions allowed BNSF to compete to handle via the Central Corridor,

the Houston-Memphis corridor and the Houston-New Orleans corridor.

Shipper verified statements confirm these competitive benefits:

- Celanese, with a major chemical plant at South Bay City, Texas, says:

> "Before the merger, the Bay City plant was served by both UP and BNSF, but BNSF could not offer the route structure that effectively matched our needs. As a result, BNSF was not a significant competitor for most of the cars that originated out of Bay City.
>
> All of that changed with the UP/SP merger. The rights that BNSF got as a result of the merger approval process have greatly strengthened its ability to compete for Bay City business. BNSF gained access to SP's Houston-New Orleans route, which was critical to our traffic flows. BNSF also gained trackage rights to move traffic from Bay City to the Memphis and St. Louis gateways, which again were critical to its ability to originate traffic from Bay City.
>
> These structural changes in BNSF's route system, as a result of the UP/SP merger, have made BNSF much more competitive for the Celanese business at Bay City. We recently put most of our Bay City volume out for competitive bids between the UP and the BNSF. BNSF was far more aggressive than it had ever been before in the bidding process for this business. UP ultimately retained most of the traffic, but at significantly reduced rates. This is a direct result of the enhanced competition created by the UP/SP merger."

- Similarly, Chevron reports that "UP retained our petroleum coke business" at Salt Lake City "after a spirited competitive bid process" against BNSF.

- Dal-Tile is a Mexican receiver of natural stone dust from a "2-to-1" origin in North Little Rock, Arkansas.

BNSF now has access to this origin, at a much lower switch fee than applied between UP and SP before the merger. Dal-Tile reports: "BNSF has been very aggressive in attempting to get our North Little Rock traffic. Recently BNSF made a very attractive offer for the movement of that traffic. Although we decided to stay with UP, BNSF's aggressive competition forced UP to respond with its own favorable rates. The result was that Dal-Tile received much more favorable contract terms for this North Little Rock traffic. Dal-Tile would not have realized the benefits of this head-to-head competition without the merger."

- And Laredo Moving & Storage International, which operates rail transload centers on both UP and Tex Mex in Laredo, offers these comments on the strong competition offered by BNSF, in conjunction with Tex Mex, for Laredo business:

> "LMS is benefiting from aggressive competition between UP/SP and Tex Mex/BNSF, as each strives to take the other's traffic with offers of better rates and improved service. Although LMS sends 100-120 cars a month to and from the UP transload and only 20-30 from the Tex Mex, this is not an indication of BNSF's weakness as a competitor. To the contrary, BNSF has been very aggressive in trying to draw our business away from UP, and on several occasions they have talked about expanding the Tex Mex shipments. LMS may not yet have shifted the bulk of our traffic over to Tex Mex/BNSF, but I am certain that BNSF's aggressive competitive presence has kept UP's feet to the fire and resulted in improved service and rail rates. LMS would not have received the benefits of this increased competition without the merger.

> The aggressive competition between UP/SP and Tex Mex/BNSF looks particularly good for LMS when compared with the competition that Tex Mex/SP provided against UP before the merger. At the time of the merger, I had hoped that SP would be replaced by a more effective competitor, and this has indeed happened. SP had such severe financial and service problems that LMS was forced to build a new transload on the UP line just so that we could have decent rail service. Now LMS can choose between two strong, service-oriented railroad options, each with a more extensive route network and better operating efficiencies than SP alone could offer. Clearly our rail alternatives have improved dramatically."

"2-to-1" Rates. Still further proof of the effectiveness of BNSF competition for "2-to-1" traffic can be seen in the fact that average UP rates[13] for "2-to-1" traffic declined in the October 1997-March 1998 period compared to the same period a year earlier. See Confidential Appendix E. This is the second straight year that "2-to-1" rates have declined.

Note, too, that this analysis reflects only the "2-to-1" traffic that UP handled. Rates for the entire universe of "2-to-1" traffic, including the traffic handled by BNSF, undoubtedly fell even more, given the many movements that BNSF captured by rate decreases.

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

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[13] All average rate figures herein are computed as total revenue (net of allowances) divided by total ton-miles for the particular periods and commodities at issue.

points, and vice versa, and thereby obtain rail competition. Though no such build-ins have yet occurred in connection with the BNSF rights, this condition has already had a competitive impact, as described in 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, too, has proven effective. In Decision No. 75, served Oct. 27, 1997, the Board held that a facility of R.R. Donnelley at Sparks, Nevada, qualified as a new transload facility for purposes of this condition, and BNSF has been running local trains to serve this facility. BNSF also continues to handle soda ash from the UP-exclusive Green River area via transloading facilities that SP had operated in Salt Lake City. And BNSF is handling steel and radioactive waste to new transloads in Salt Lake City and food products from a new transload in Ogden, and has competed for a variety of other traffic movements with transloading proposals. Details are in 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 is serving significant new facilities of Total Petroleum and Conoco at Durham, Colorado, on the overhead portion of its trackage rights across the DRGW east-west mainline. It will also soon serve a major new Pilgrim's Pride feed mill near Tenaha, Texas, on the Houston-Memphis trackage rights line, and has successfully bid for large volumes of traffic from a soon-to-be-constructed iron carbide facility in Corpus Christi. Details are in Confidential Appendix H.

"1-to-2" Shippers. Special, 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, shippers on this line that had formerly been exclusively served by SP gained service from both BNSF and UP. Substantial rate reductions have resulted, as detailed in Confidential Appendix I. The benefits of this provision are described in the accompanying verified statements of Riviana Foods and Louisiana State Senator John Siracusa.[14/]

[14/] Also, the February 1998 agreement between UP and BNSF to "swap" 50% ownership interests in the Iowa Junction-Avondale line and UP's Houston-Iowa Junction line gave BNSF access to all shippers on the latter line and associated branches. This, however, was not pursuant to a merger condition, but rather was agreed to by UP in order to secure BNSF's agreement (continued...)

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 on July 15, 1997 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 all up and down the I-5 Corridor between the Pacific Northwest and the Pacific Southwest. The establishment of two new single-line rail alternatives in the I-5 Corridor, together with the proportional rate arrangement, which also became effective on July 15, 1997, has brought this region an enhancement of competition entirely without precedent in any rail merger.

As demonstrated more fully in the Confidential Appendix material accompanying this report, numerous customers are enjoying benefits from the enhanced competition and new marketing opportunities that have resulted from the creation of two new single-line rail systems along the entire I-5 Corridor from Canada to Mexico, and from the further augmentation of competition produced by the proportional rate arrangement, which allows UP to compete for the business of shippers at BNSF local points and junctions by offering

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[14] (...continued)
to join in the joint dispatching center at Spring, Texas, which has been crucial to addressing congestion problems in the Houston area.

competitive service and rates via a BNSF-Portland-UP route. Confidential Appendix A contains numerous examples of specific traffic movements that have benefitted from new UP-SP single-line routes in the I-5 Corridor made possible by the merger. Confidential Appendix J adds more than 40 examples of traffic movements that have benefitted from new BNSF single-line service in this corridor, and from use of the proportional rate arrangement.

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 <u>no</u> single-line rail service in this huge transportation market. Shippers of lumber and panel products, for example, have already taken extensive advantage of the new competition. BNSF has increased its lumber shipments in the I-5 Corridor by moving more 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. In addition, BNSF is increasing its presence in Las Vegas through a reload facility in Kingman, 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 two trains per day in each direction in the I-5 Corridor (BNSF-PR-6, pp. 9-10).

UP customers are also benefitting from new single-line routes in the I-5 Corridor. UP-served shippers in Washington 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 and edible oils 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 efficient Portland routing. In addition, customers are benefitting from enhanced competition between CN and CP, as the proportional rate agreement creates CN-BNSF-UP routings to compete with the UP-

CP link at Eastport, Idaho. And the availability of the proportional rate option has also caused BNSF to leave competitive joint rates with UP via Portland in effect.

The attached verified statements illustrate the benefits of new competition in the I-5 Corridor. California Northern Railroad cites "BNSF's aggressive competition for UP traffic" in this corridor. Chevron states:

> "For our West Coast traffic to the Pacific Northwest and Western Canada, the I-5 agreement between UP and BNSF has created two single-line options for movements of product from our Richmond refinery. Before the merger we had only multi-carrier routes. This represents a major change in our ability to obtain competitive rates for this business. Just recently, for instance, Chevron put out for bid a large movement of anhydrous ammonia from Richmond to Hedges (a/k/a Finley), Washington. Before the merger, this traffic moved via SP-Klamath Falls-BNSF, and now we were able to secure competing single-line bids from UP and BNSF. BNSF competed vigorously for the business and won it. As a result of the merger, we have a lower rate for this movement via single-line BNSF service.
>
> We have also seen benefits from the proportional rate agreement between UP/SP and BNSF, which allows UP to secure competitive proportional rates from BNSF for movements to BNSF-served destinations in the Pacific Northwest and Western Canada. As an example, last year the UP was able to provide Chevron with a favorable through rate for movements of petroleum wax from Richmond to a large customer in New Westminster, British Columbia. This year the BNSF won our competitive bid for this business. In addition, competition between BNSF and UP has resulted in lower rates to several of our customers in the Pacific Northwest."

Similarly, Canadian Enterprise Gas Products states that the proportional rate arrangement "allows UP/SP to secure a competitive proportional rate from BNSF for traffic moving between New Westminster, British Columbia, and UP/SP at Portland" --

> "The merger therefore created a new opportunity for movements into the United States via Canadian National over New Westminster, and allows CN-BNSF or CN-BNSF-UP routings from Edmonton as a competitive alternative to the CP-UP routing over Eastport. Competition between these alternative rail routes has led to intense price competition that has dropped our rates for LPG movements into the United States.
>
> The UP/SP merger has therefore stimulated competition in an important way. It has created competitive options where none previously existed, and forced the railroads to lower their prices to retain business. We expect that, in turn, the increased flexibility and lower prices flowing from this rail competition will make us more competitive in our end-markets."

b. Tex Mex

Since the inception of its rights, Tex Mex has operated a total of 799 through freight trains through May 1998. Since the beginning of 1997, Tex Mex has averaged 45 trains per month. Charts #5, #6 and #7 depict, by month, Tex Mex's through trackage rights trains, and the numbers of cars and tons on those trains.

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.

We have attempted to present data on Tex Mex's trackage rights operations that exclude the impact of these temporary phenomena. Charts #8, #9 and #10 depict, by month, Tex Mex's through trackage rights trains, and the numbers of cars and tons on those trains, excluding (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. It is plain that even with these exclusions, Tex Mex's trackage rights volumes have continued to grow.

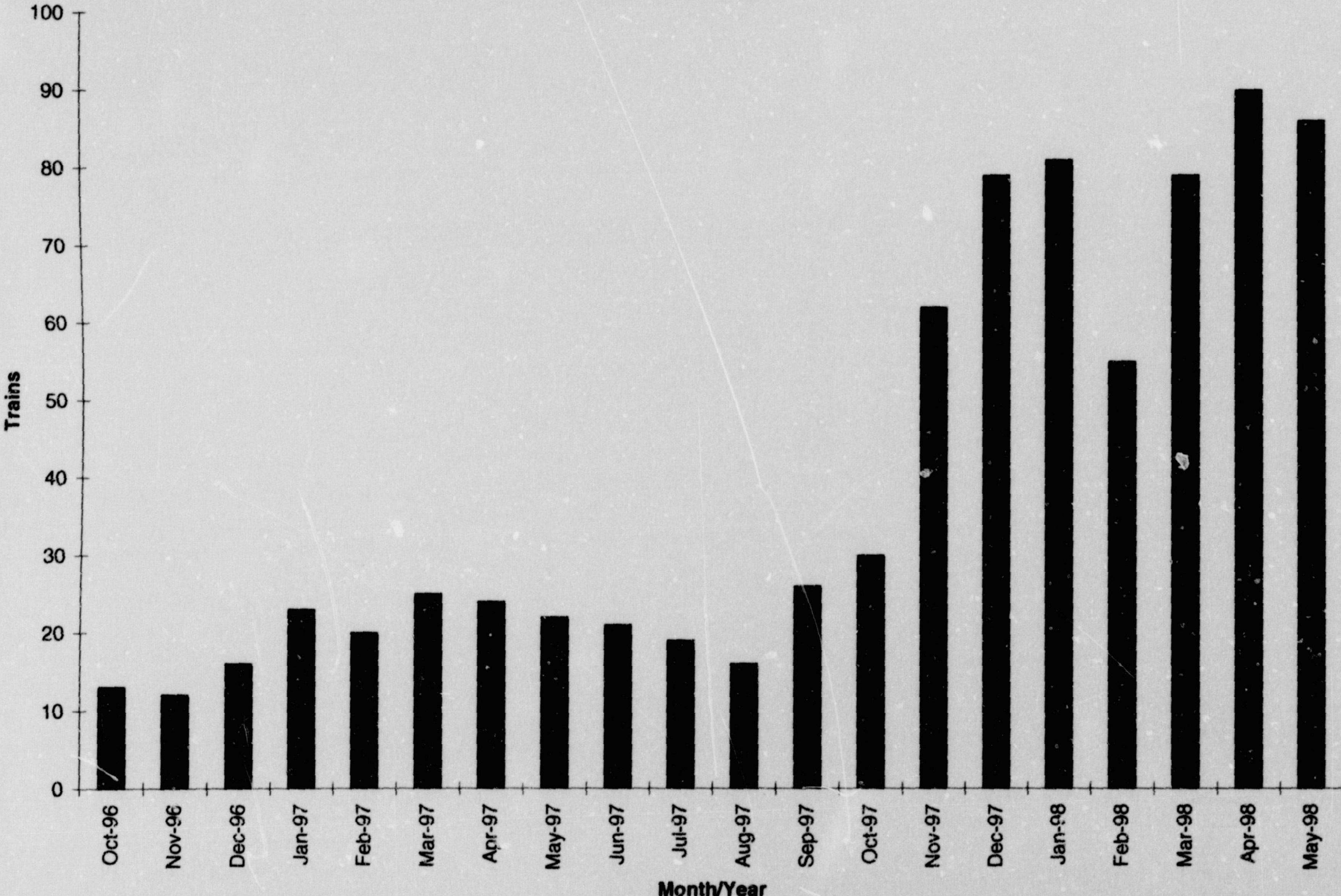
The Board's purpose in partially granting the trackage rights conditions sought by Tex Mex in the UP/SP merger proceeding was to "address the possible loss of competition at the Laredo gateway into Mexico and to protect the essential services provided by Tex Mex to its shippers." Decision No. 62, p. 6. There is no question that competition <u>has</u> remained strong at Laredo and Tex Mex <u>has</u> remained viable

Chart #5

Tex Mex Trackage Rights

Number of Through Trains

(All Traffic Included)



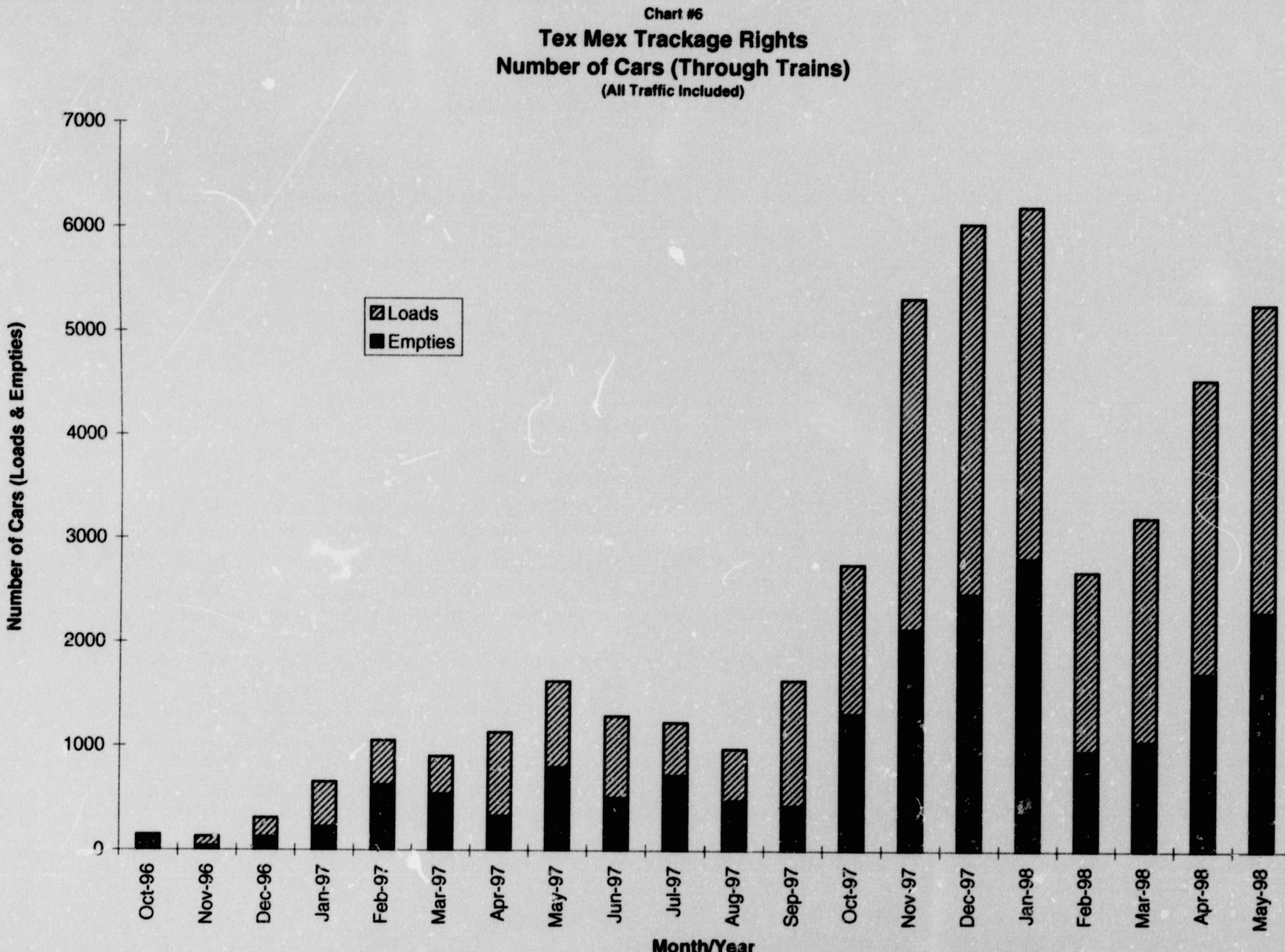


Chart #6
Tex Mex Trackage Rights
Number of Cars (Through Trains)
(All Traffic Included)
Loads
Empties
Number of Cars (Loads & Empties)
0
1000
2000
3000
4000
5000
6000
7000
Oct-96
Nov-96
Dec-96
Jan-97
Feb-97
Mar-97
Apr-97
May-97
Jun-97
Jul-97
Aug-97
Sep-97
Oct-97
Nov-97
Dec-97
Jan-98
Feb-98
Mar-98
Apr-98
May-98
Month/Year

Chart #7

Tex Mex Trackage Rights
Gross Tons (Through Trains)
(All Traffic Included)