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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760 (Sub-No. 26)*/

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 --
HOUSTON/GULF COAST OVERSIGHT

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UP'S OPPOSITION TO CONDITION APPLICATIONS

VOLUME 1 - NARRATIVE

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September 18, 1998

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UP'S OPPOSITION TO CONDITION APPLICATIONS

The primary merger applicants, UPC, UPRR and SPR,[1] oppose all the condition applications that have been filed in this proceeding. This brief, and the accompanying volumes of verified statements and documents, explain the reasons.

INTRODUCTION

Over the past year, Union Pacific has battled a harrowing service crisis. The crisis began in the late summer of 1997 in and around Houston, where high traffic levels and a series of external stresses overwhelmed a weak SP infrastructure before the UP/SP merger had been implemented.

[1] Including related sub-dockets.

[1] Acronyms used herein are the same as those in Appendix B of Decision No. 44 in Finance Docket No. 32760. 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."

Initial efforts to address the congestion in the Houston/Gulf area proved inadequate, and caused their own operating problems across the UP system. Ultimately, the only way to solve the problem was to go forward with the key merger implementation steps -- Houston Hub labor agreements, cutover to UP's TCS computer system on SP lines and facilities in the South Central region, and directional running on major routes radiating from Houston -- in the midst of a congestion crisis. This took months, and more service difficulties, to accomplish, but it has been successful. The Houston/Gulf service crisis is over, and remaining service problems on the rest of the UP system are receding.

This crisis was a wrenching experience for all involved. Shippers suffered delays and losses. UP, long a proud and profitable company, suffered three consecutive quarters of losses; instead of catching up in the vital competitive race with the powerful new merged BNSF system, it lost 10% of its traffic while BNSF gained an equivalent amount. And the Board became a crucible for demands for action using its sweeping emergency powers.

The Board responded with measured but decisive action. It issued the first broad emergency service order directed at an economically viable carrier in the history of the railroad industry, and ultimately continued it in effect for the full 210-day period permitted by law. The Board gathered comprehensive information and crafted careful measures to alleviate the emergency. While recognizing that it could not operate railroads and that the first and best recourse was for UP to solve its own problems, the Board imposed focused remedies to provide relief to shippers and facilitate the recovery, including trackage rights for Tex Mex between Placedo and Algoa, continued use by BNSF of UP's Caldwell-Flatonia line, and expanded access by BNSF and Tex Mex to PTRA and HBT traffic in Houston.

During the crisis, some parties sought to pursue their own agendas and advantage. In particular, the Railroad Commission of Texas ("RCT") renewed arguments previously rejected by the Board in the merger case for "open access" in terminals, and proposed permanently opening up all the industry in the Houston area, with switching by PTRA. RCT also urged, in concert with KCS/Tex Mex, the sale to Tex Mex of UP lines through the middle of Houston, and of UP's Beaumont Subdivision between Houston and Beaumont. RCT contended that, notwithstanding the plain terms of 49 U.S.C. § 11123, the Board should go beyond time-limited emergency measures and permanently restructure the Houston/Gulf railroad network.

The Board again rejected these proposals, finding that they would not help alleviate the service crisis and were aimed instead at rearguing competitive issues that had been thoroughly aired and resolved in the merger case. The Board expressly found that "the service emergency was not caused by an inadequate competitive climate in the West produced by the UP/SP merger." Service Order No. 1518 & Ex Parte No. 575, Decision served Feb. 25, 1998, p. 4. The Board also found that "UP/SP did not manufacture the crisis to exploit some sort of dominant position in the market, or to obtain some sort of competitive advantage." UP's "bottom line," the Board noted, had "suffered dramatically as a result of the crisis." Service Order No. 1518, Decision served Feb. 17, 1998, p. 12.

In a decision denying a petition by RCT for reconsideration, the Board said that if RCT wished to continue pursuing its permanent restructuring proposals, the place to do so was in the merger oversight process. Id., p. 8. Subsequently, KCS/Tex Mex did petition the Board to commence a proceeding to consider imposing additional, permanent conditions on the merger, substantially similar to those that had been advanced by RCT in the service proceeding, ostensibly to address Houston/Gulf service problems.

In response, in a Decision served March 31, 1998, the Board initiated this proceeding. The March 31 decision (reissued in corrected form on May 19), and the Board's August

4 decision accepting various condition applications, clearly frame the questions to be addressed here.[2/] They are three:

- *First*, did the UP/SP merger give UP enhanced market power in the Houston/Gulf area?

- *Second*, if it did, did that increased market power cause the service problems?

- And *third*, if the answers to both of the foregoing questions are "yes," should any proposed conditions be imposed? Under longstanding merger law,[3/] this latter question in turn has three aspects: (a) whether the proposed condition is narrowly tailored to address whatever specific merger-caused harm has been identified (here, some specific problem of merger-caused market power which in turn generated service problems); (b) whether the condition is operationally feasible; and (c) whether the condition will cause harms that outweigh any benefit of imposing it.

Given the findings the Board had made in February, the challenge facing a condition applicant was clear. It

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[2/] *See* Decision No. 6, served Aug. 4, 1998, p. 6 ("whether there is any relationship between any market power gained by UP/SP through the merger and the failure of service that occurred in the region, and, if so, whether additional remedial conditions would be appropriate"); Decision No. 1, served May 19, 1998, p. 5.

[3/] *See*, *e.g.*, Finance Docket No. 33388, *CSX Corp. & CSX Transportation, Inc., Norfolk Southern Corp. & Norfolk Southern Ry. -- Control & Operating Leases/Agreements -- Conrail Inc. & Consolidated Rail Corp.*, Decision No. 89, served July 23, 1998, p. 78; *UP/SP*, Decision No. 44, served Aug. 12, 1996, p. 144.

needed to explain, through probative evidence and comprehensible reasoning rather than mere assertion, (1) how it was that, despite the Board's thorough competitive analysis in the merger case and adoption of conditions tailored to prevent any loss of competition, the merger, as conditioned, had somehow caused an increase in UP market power in the Houston/Gulf area; and (2) how it could be that, even if such a merger-caused increase in UP market power could be shown, UP would have used the market power to bring about a service crisis that cost it 10% of its business and hundreds of millions of dollars in net earnings.

None of the condition applicants has met, or even tried to meet, this challenge. None shows any error in the Board's competitive analysis in the original merger decision. None even attempts to counter the comprehensive proof that UP has presented, in two annual oversight proceedings, that the merger conditions have worked extremely well to preserve competition in the Houston/Gulf area, and indeed throughout the West. UP/SP-303 & -304, July 1, 1997; UP/SP-344 & -345, July 1, 1998. None even attempts to explain how the service crisis could have resulted from an exercise of market power -- why a supposed monopolist would have used its monopoly power not to generate monopoly profits, but to bring about calamitous and sustained losses.

Instead, the condition applicants have again pursued their own agendas and advantage. They have advanced "open access" proposals and other condition requests that are directly at odds with the Board's bedrock policy of not adding competition through merger conditions where a merger will not eliminate it. They have reargued, without offering any new evidence, theories that were considered and rejected in the merger case. And in their pursuit of self-serving advantage they have even disregarded the aim of Houston/Gulf service recovery, instead proposing many conditions that would actually undermine that recovery.

The due date for filing condition applications was July 8. Nine were filed:

- BNSF filed an application containing ten condition requests. The centerpiece is a request for trackage rights to Laredo. Giving BNSF single-line access to Laredo, which was served prior to the merger by UP on a single-line basis and by SP in joint-line service with Tex Mex, would plainly create new competition not justified by any effect of the merger. Moreover, rather than improving service, the Laredo rights that BNSF seeks would congest UP's principal line to Mexico and worsen operations at the International Bridge. Other BNSF requests would also confer benefits on BNSF unnecessary to preserve pre-merger competition. These include trackage rights between Taylor and Milano, Texas;

permanent, bidirectional trackage rights on UP's Caldwell-Flatonia-San Antonio and Caldwell-Flatonia-Placedo lines, where BNSF is now operating temporarily to help alleviate congestion; rights to operate over all of UP's lines in the Houston terminal; and trackage rights to operate directionally at any location on the UP system where BNSF has trackage rights on one UP line and UP institutes the directional operation of that and another parallel line.

- <u>KCS/Tex Mex</u> joined with RCT, SPI and CMA in what they call a "Consensus" group. Despite its name, this group did not arrive at some notable new consensus; rather, it is advancing proposals much the same as those that these same parties advanced unsuccessfully in the merger case and in the service proceeding. (For simplicity, and reflecting the real beneficiary of these proposals, we refer to this group as "KCS/Tex Mex" in this brief.) The centerpiece of this filing is a sweeping "open access" plan for the entire Houston-Galveston area. This plan would open to service by Tex Mex (and BNSF) hundreds of shipper facilities that are exclusively-served by UP, not a single one of which lost rail competition in the merger. Many other shippers now served by UP and BNSF -- located at Texas City and Galveston, and on UP's "GH&H" line between Houston and Galveston -- would also be opened to Tex Mex. Still others which Tex Mex is entitled to serve only in connection with movements to and from its

Corpus Christi/Robstown-Laredo lines -- shippers located on HBT and PTRA -- would be opened to Tex Mex for all traffic. All this would be done through the device of ordering UP to turn over most of its Houston-area infrastructure, apparently without compensation, to PTRA, which would then conduct so-called "neutral switching" of these industries.[4] Such proposals for "open access" belong in the legislative arena, not this proceeding. Clearly, "open access" should not be imposed on only one railroad, in the context of a merger that was scrupulously conditioned to prevent a single shipper from losing two-railroad competition.

KCS/Tex Mex also seek various other conditions, including a forced "swap" of UP's Beaumont Subdivision for trackage that KCS/Tex Mex propose UP be compelled to let them build on the former-SP Lafayette Subdivision; the forced sale by UP to Tex Mex of a yard in Houston; and the forced sale by UP to Tex Mex of the Wharton Branch, a partly out-of-service line between Rosenberg and Victoria, Texas.

- Three major shippers, <u>Dow</u>, <u>Formosa</u> and <u>CP&L</u>, seek "open access" for BNSF to facilities that are exclusively

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[4] By referring to it throughout their application as a plan for "neutral switching," KCS/Tex Mex try to obscure the fact that this is a sweeping "open access" proposal. The KCS web page is less coy, saying (www.kcsi.com/NW080498.html) that this proposal would give Tex Mex "permanent access to the Houston/Gulf Coast market," including "hundreds of shippers captive to UP."

served by UP and were exclusively served by one of the merging railroads before the merger.

- <u>DuPont</u> seeks access by Tex Mex to a facility in Houston that is served by UP and BNSF.

- <u>CMTA</u> reargues a request, twice rejected in the merger case, that Longhorn Railway, the operator of a line owned by CMTA in the Austin area, be allowed to interchange with BNSF at McNeil, Texas.

- Finally, <u>Houston & Gulf Coast Railroad</u> ("H&GC"), the operator of a 12-mile line between Wharton and Bay City, seeks a long list of conditions, including forced reconstruction by UP of the disused trackage between Wharton and Rosenberg; trackage rights from Bay City to Algoa; trackage rights from Rosenberg to Houston; access to Imperial Holly, a "2-to-1" shipper at Sugar Land, Texas; use of UP's Englewood and Settegast Yards in Houston, the HBT Congress Yard in Houston, and a UP locomotive repair facility in Houston; forced sales to it of the UP and SP lines between Houston and Galveston; forced interchange with it at Houston of UP Galveston-bound grain trains; and forced use by UP of its facilities for storage-in-transit of UP plastics traffic.[5]

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[5] The HGC filing, submitted in three pieces on August 3, August 27 and September 8, was late and lacks basic elements of a condition application. It is the subject of a motion to dismiss by KCS/Tex Mex, which UP believes to be well taken.

UP opposes all of these conditions (though, as we will discuss, some of them are being voluntarily implemented or negotiated). In opposing them, we do not mean to minimize the severity of the service crisis that occurred or question the appropriateness of action by the Board to address such crises through its emergency powers. UP has, indeed, joined the rest of the railroad industry in supporting the Board's initiative in Ex Parte No. 628 to codify rules for expedited relief for service emergencies. The service crisis in Houston, however, is now over, and the question presented here is the narrow one of whether the permanent conditions to the UP/SP merger that are being sought are justified by any link between merger-caused market power and that now-ended crisis. The answer to that question is plainly no: there was no increase in market power, and the crisis was not caused by any exercise of market power.

Nor should UP's opposition to these conditions be understood as indicating any unwillingness to work with our customers, and with other railroads, to find cooperative and creative ways of improving service and ensuring that there will never be another similar service crisis. UP took many extraordinary steps to assist shippers during the service crisis, including the suspension of contract requirements, the entry into new routes over short-haul junctions, and the creation of intensive problem-solving teams to find ways to keep critical traffic moving. UP established the Spring dispatching center to improve the coordinated handling of traffic in and around Houston, and made costly commercial concessions to induce BNSF to join fully as a partner in operating that center. UP has repeatedly urged Tex Mex to join the center as well. As discussed below, UP has concurred with, and is in the process of implementing, specific proposals that both BNSF and Tex Mex made in the course of this proceeding for improving the operation of the Spring center. As also discussed below, UP is negotiating in good faith with Tex Mex over the sale to it of the Wharton Branch; has made a concrete and reasonable proposal to BNSF with regard to improving operations in the Brownsville area which should moot one of BNSF's condition proposals herein; and has reached agreement with BNSF and Tex Mex on terms for the admission of Tex Mex and the Port of Houston as voting members of PTRA, which was among Tex Mex's condition proposals herein.

This brief and the accompanying verified statements address the issues framed by the Board for this proceeding:

Part I shows that the merger, as conditioned by the Board, did not cause any increase in UP market power in the Houston/Gulf area. The Board's careful and thorough analysis of competitive impacts in the merger decision stands conclusions that all "2-to-1" shippers would enjoy continued strong competition through access to BNSF; that "3-to-2" shippers would gain competitively, as both UP/SP and BNSF became much stronger and efficient railroads; that exclusively-served ("1-to-1") shippers not only would see no reduction in their competitive options, but would gain competitively from access to the larger, more efficient UP/SP system; and that source competition for Gulf Coast chemicals would be intensified, not reduced. Nor does any condition applicant cast in question -- or even so much as mention -- the mountains of evidence in two annual oversight proceedings that both BNSF and Tex Mex have competed very effectively using the trackage rights they received in the merger decision; that shippers have tangibly benefitted from this intense competition; and that rates have fallen in all categories of competitively-relevant traffic.

What little the condition applicants do say about market power is also discussed in Part I. There, for example, we address the claim of KCS/Tex Mex witnesses Grimm and Plaistow that UP controls a very high percentage of Houston rail originations, and that this percentage hardly changed at all during the service crisis. We show that these witnesses are wrong in claiming UP has a monopoly of Houston area traffic (in fact, more than two-thirds of the traffic in the Houston BEA is open to other railroads), and are wrong in claiming that UP's traffic share did not fall significantly during the service crisis (in fact, UP's share of total rail originations in the Houston BEA, on which Grimm and Plaistow focus, fell by 11 percentage points). They are also wrong, even more fundamentally, in treating a broad geographic area that mixes exclusively-served and competitive rail traffic as a single transportation market.

We also address in Part I (and in further detail in Part IV) the reckless allegations of KCS/Tex Mex and BNSF that UP has "discriminated" in dispatching their trackage rights trains. Ordered by the Administrative Law Judge presiding over discovery in this case to put up or shut up -- to provide any specifics in support of these allegations or withdraw them -- KCS/Tex Mex came up with nothing. All they could do was point again to the handful of supposed incidents already cited in its filings, each and every one of which has proven on examination to be groundless. BNSF, for its part, does not even <u>pretend</u> to have any specifics for its constantly-repeated claim of "favoritism." But if these parties thought that inflammatory claims of "discrimination" could always safely be advanced to poison the atmosphere, and never be disproved, they were wrong. As we explain in Part I, UP has been able to compile from electronic readers irrefutable, objective data proving that Tex Mex and BNSF trains receive as good --

indeed, if anything, better -- handling on UP's lines than UP's own trains.

Part II shows that the condition applicants have also utterly failed to demonstrate that any merger-generated market power caused the service problems. As Jerry Hausman, Professor of Economics at the Massachusetts Institute of Technology and a noted antitrust authority, explains in his verified statement, the financially and commercially devastating service crisis that UP has experienced bears not the remotest resemblance to the type of service reduction in which a monopolist might engage to increase its profits.

The root of the crisis lay not in any exercise of "market power," but in SP's chronic underinvestment and fragile physical plant, which was overwhelmed by external stresses. The congestion of 1997-98 was foreshadowed by a very similar service "meltdown" that SP experienced in the Gulf area in 1979-82, as discussed in the verified statements of Alan D. DeMoss and Michael D. Ongerth. That earlier crisis, which was of course entirely unrelated to any merger or any possible issue of "market power," confirms that SP has long been vulnerable to a service collapse caused by undue stress on inadequate facilities. Continued years of inadequate investment only heightened that vulnerability. The UP/SP merger, far from causing the crisis, proved to be its only real solution. Thanks to labor implementing agreements, TCS cutover, and most of all directional running -- and the dedicated efforts of 54,000 employees of UP and SP pulling together -- service has been restored in the Houston/Gulf area and across the UP system, and the efficiency benefits of the merger can now increasingly be realized.

In Part III, before turning to a review of each proposed condition, we consider generally whether the condition proposals meet the Board's test of narrow tailoring to address some harm of the merger that was not adequately addressed in the original merger decision. It is plain that they do not, but rather seek to use the merger as a vehicle for securing competitive advantages and new access at UP's expense, unrelated to any impacts of the merger.

Moreover, and crucially, these proposals would be very costly to UP at a time when further undermining UP's ability to compete against a powerful BNSF system would jeopardize the Board's fundamental objective in approving the merger. The essential fact driving this merger was that SP was in decline, and that, absent the merger, even UP, with its better finances and greater efficiency, could not hope to compete in the long term against BNSF, with its wider coverage of the West and more efficient route structure in many markets. The service crisis has been very costly for UP, and it faces tremendous challenges to regain traffic and restore the sound financial condition that will permit the huge investments needed to become a truly effective competitor to BNSF. The proposed conditions would expose hundreds of millions of dollars in UP business to loss -- in total, more than $769 million. To continue to improve the quality of its service in the Houston/Gulf area, UP needs to invest some $1.4 billion dollars over the next five years in needed Houston/Gulf infrastructure. The proposed conditions would undermine UP's ability to make these vital investments -- and other equally crucial investments all across the UP system -- and could so set back UP's service recovery and competitiveness that balanced rail competition in the West would be fatally undermined.

Finally, Part IV reviews, on a condition-by-condition basis, why each of the condition proposals fails the tests framed by the Board in this proceeding -- is not aimed at any unaddressed problem of merger-generated market power which caused or contributed to the service crisis; and in many cases would harm rail operations rather than contribute to service recovery.

* * *

An integral part of this submission is the verified statements of hundreds of shippers, railroads and governmental officials opposing the condition requests.

A cross-section of more than 175 UP customers expresses concern that UP not be saddled with costly new conditions just when it is completing its service recovery. These shippers indicate that the Board's conditions have worked well to preserve competition; that there is no proper basis for imposing further conditions to benefit UP competitors and selected shippers in Texas; and that imposing such conditions would fundamentally threaten balanced competition in the West.

Nineteen railroads, twelve of them in Texas and adjacent states and Mexico, concur. Ferromex -- the privatized Mexican railroad that serves Eagle Pass and is the competitor in Mexico for TFM, the privatized railroad that serves Laredo -- strongly opposes BNSF's request for trackage rights to Laredo, explaining that granting this request would jeopardize Ferromex's ability to compete with TFM, and thus do grave damage to competition for international freight flows between the United States and Mexico.

The condition proposals are also opposed by more than 350 public officials, including the Governors of seven states -- Arkansas, Colorado, Illinois, Iowa, Nebraska, Utah and Wisconsin -- and large contingents from the Legislatures of Texas, Louisiana, California, Nevada, New Mexico, Utah, Wyoming and other Western states. These public officials recognize that UP is recovering from its service problems; that the conditions the Board imposed in the merger decision fully preserved competition; and that the additional conditions being sought would threaten UP's ability to invest and serve the shipping public.

It is particularly striking that those opposing these conditions include many of their purported beneficiaries.

- For example, numerous shippers in the Houston terminal, where both BNSF and KCS/Tex Mex seek extensive new trackage rights and restructuring of rail operations, oppose those conditions:

Ben-Trei, which ships fertilizer from a facility on the PTRA, strongly opposes further conditions, despite the fact that it would gain unrestricted access to KCS/Tex Mex under their proposal. Ben-Trei favors "two strong competitive railroads," and believes that "any further restrictions on the UP would hamper their efforts to fully integrate and improve their services in the area."

Texas Petrochemicals, another PTRA shipper in the same posture as Ben-Trei, says that "the predicted UP monopoly has never developed; in fact, the UP has lost quite a bit of TPC business to the BNSF since the merger." Texas Petrochemicals "does not see the need to impose" KCS/Tex Mex's "neutral switching" condition, and is "satisfied with existing switching arrangements and the level of competition."

American Plant Food Corporation, located on the Clinton Branch where both BNSF and KCS/Tex Mex seek conditions, says that all of the conditions being sought in this proceeding "would go in the wrong direction, by weakening UP at a time when it has already suffered large financial and traffic losses over the last year." While BNSF and KCS/Tex Mex "may want still more opportunities," they are providing "aggressive competition against UP"; "competition is working without imposing further conditions that would weaken UP."

Occidental Chemical Corporation ("OxyChem"), with three plants in Houston, says that while, "like many shippers," it "experienced many service problems," it did not "experience a reduction in competition due to the merger." OxyChem opposes further conditions, which "will interfere with the Union Pacific's operations and could delay the future improvements in the Union Pacific service." UP needs a solid traffic base "to compete with Burlington Northern Santa Fe and to expand and improve their plant."

Exxon, with major chemical plants in the Houston terminal, states that "the crisis is over for our Texas facilities and progress continues to be made." Exxon notes that UP "has committed substantial financial resources to address the service issues and has made public a plan for making significant infrastructure investments to provide further improvement." It is doubtful these commitments would have been made "if the crisis had occurred on the former SP," and "longer term, we believe service will be better than prior to the merger." The proposed conditions "would bring competition to shipping sites where such competition did not exist prior to the merger and would provide a windfall for certain railroads."

Imperial Holly, a large sugar producer that would gain another serving railroad under one condition proposal, testifies that "service in this area has made a full recovery because of the steps taken by the Union Pacific and it would clearly be counterproductive to upset this progress." To "allow any of the proposed changes requested by competing interests would only further confuse and splinter rail service in this very busy and important terminal area."

And the *Chamber of Commerce of Galveston*, where Tex Mex's "neutral switching" scheme would introduce a third railroad, is "strongly opposed to the proposals to impose new conditions on Union Pacific's operations around Houston and the Gulf Coast area." Chamber President John Tindel indicates that the Chamber's Board of Directors verified its position "with the Port of Galveston and two major customers of Union Pacific and they are satisfied with the service provided by Union Pacific."

- Similarly, outside the Houston terminal, the Georgetown Railroad, stated beneficiary of the trackage rights that BNSF is requesting between Taylor and Milano, Texas, also opposes all further conditions. Georgetown's President, James

E. Robinson, says that "the crisis is over and Union Pacific is on the road to recovery," and that it "would be completely counterproductive to add more burdens to the merger at a time when we are seeing real progress."

- Many shippers of traffic to and from Mexico also oppose BNSF's proposed Laredo condition.

For instance, *Chrysler Corporation*, which expects to move 36,000 intermodal containers, 16,000 finished vehicles and 4,000 boxcars of auto parts across the Laredo gateway this year, strongly opposes the BNSF Laredo rights. Chrysler is "very concerned that any additional volume" on UP's San Antonio-Laredo line "will create congestion that will result in a deterioration of service for Chrysler shipments to and from Mexico." Chrysler states: "BNSF has benefitted significantly from the original conditions imposed by the STB and has demonstrated that they are a strong, vigorous competitor. Granting additional conditions to BNSF and KCS/Tex Mex will undermine UP's ability to fully restore its service and invest heavily in infrastructure in crucial lanes such as San Antonio to Laredo and the Houston/Gulf region."

Similarly, *Alimentos Balanceados Proan*, which moves large quantities of grain into Mexico via Laredo and Eagle Pass and would purportedly be a beneficiary of BNSF's proposed Laredo condition, opposes that condition and all others. It says that BNSF, KCS and Tex Mex "have been effective competitors with UP to deliver grain products to us," and that granting the requested conditions "will upset a balance among the railroads that has allowed us to obtain favorable rates and demand improved service."

Stelco McMaster, a major shipper of steel bars from Chicago to Mexico, says that none of the problems that affected the movement of traffic to Mexico "had anything to do with the ability of BNSF, KCS or Tex Mex to compete for traffic in this area"; indeed, "it seems obvious from the traffic losses UP has suffered during their difficulties and the gains made by these other carriers that there is very effective competition in these areas." Stelco concludes: "We are pleased with the efforts and dollars UP has spent to address capacity issues in the Southwest and fear that further encroachment on their traffic base will hamper their ability to continue the work that needs to be done."

And *Darling International*, a food products shipper with substantial international shipments via Laredo, testifies that it is "particularly troubled" by the BNSF Laredo proposal, which would make the congested situation at that gateway "much more difficult." Darling says that "sufficient competition for rail transportation is already in place," and opposes any additional conditions.

In all, more than 50 Houston, Texas, Gulf Coast and Mexican shippers,[6] joined by Texas Lieutenant Governor Bob Bullock and 82 Members of the Texas and Louisiana Legislatures, have submitted verified statements opposing the condition proposals.

The same sentiments are reflected in verified statements from shippers all across the West. Commonwealth Edison expresses concern "that added conditions on Houston and Gulf Coast operations will undermine UP's ability to invest in service and infrastructure throughout its system," and warns that the new conditions "could work to discourage effective competition by weakening the UP while simultaneously strengthening the BNSF." 3M emphasizes that it would be "unfair and counterproductive to grant favors to competing railroads in a localized region that will have harmful effects for competition and the overall quality of UP's service throughout the West," particularly when UP's service in the

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[6] In addition to those already mentioned, see, e.g., the verified statements of Arenas y Barros, Ash Grove Cement, Azteca, Baroid Drilling Fluids, Brokers Logistics, Capitol Cement, Chem-Rail Transport International, CMC Steel Group, Dal-Tile Mexico, Darling International, Eades Commodities, Elementis Chromium, Ferex, Ferrell North America, Fibras Quimicas, Four Way Transportation, Hampton Lumber, Hunt Forest Products, Hylsa, Leiser-Mabe, LMS International, Mervis Industries, Mitech, F.W. Myers & Co., Neste Trifinery Petroleum Services, NGL Supply, OmniSource, Osburn Sand, Pioneer Chlor Alkali, Redland Stone Products, Shintech, Slater Steels, Stroh Brewery, Tetra Technologies, Texas Gas & Oil, TexPar Energy, Transit Mix, United States Gypsum, White Sands Forest Products, Yarbrough's Material & Construction, and Zeneca Ag Products.

Houston/Gulf Coast area "has improved steadily over the past few months" and "should continue to improve." Unimin similarly urges that "it would not be appropriate to impose conditions that would in fact inhibit Union Pacific in its recovery programs." And Lipton Foods stresses that these conditions, with their adverse effects on rail service throughout the West, are entirely unjustified because "the service crisis on the Union Pacific is not the result of a reduction in competition but rather an infrastructure that was inadequate to assume the business of the merged operation." Many scores of other shippers from throughout the West make similar points.

The clear message of the hundreds of statements opposing conditions is that the service crisis and appropriate competitive conditioning of the merger are simply two different issues. No one seeks to minimize the severity of the service crisis -- many of those providing statements underscore that they suffered severely from it -- or to deny that emergency measures were needed to help address it. But the cause of the crisis did not lie in any inadequacy of the competition-preserving conditions imposed on the merger; those conditions have been effective and competition remains strong. And adding new, permanent conditions to the merger would actually retard further service improvement and the emergence of stronger competition between UP and BNSF.

ARGUMENT

I. THE MERGER DID NOT CAUSE AN INCREASE IN MARKET POWER IN THE HOUSTON/GULF AREA

The impact of the UP/SP merger on competition was very thoroughly litigated in the merger case. The Board carefully analyzed each potential competitive effect of the merger, and augmented the conditions provided for in the UP/SP-BNSF settlement agreement and the CMA agreement in order to make absolutely certain that there would be no competitive harms. We first briefly review the record and the Board's conclusions regarding each relevant category of traffic, and then address what has occurred since the merger.

A. Merger-Case Holdings

1. "2-to-1" Traffic

The first area of impact that was considered was "2-to-1" traffic -- traffic that had a choice between UP and SP before the merger, and would lose rail competition in an unconditioned merger. The applicants had entered into a settlement agreement with BNSF under which BNSF would serve all such traffic, and that settlement had been supplemented in the applicants' agreement with CMA.

The Board added still further conditions to ensure a complete remedy for any "2-to-1" effects, including: granting BNSF the right to serve new industries and transloading facilities on all lines where BNSF received trackage rights; broadening the condition under which BNSF could build in from any former SP point to any former UP point, and vice versa; and broadening a condition under which "2-to-1" shippers could immediately place up to 50% of their traffic with BNSF. The Board reserved authority to adjudicate any issues as to the full coverage of all "2-to-1" traffic, and there have been a few scattered disputes about this, which the Board has resolved.

The Board concluded that, as augmented, the BNSF trackage rights would preserve strong competition for "2-to-1" traffic. The Board found that there was ample traffic available to BNSF to support competitive operations, and that the compensation terms for the trackage rights were, if anything, lower than might be economically justified from a cost recovery standpoint.

2. "3-to-2" Traffic

The effect of the merger on "3-to-2" traffic was explored in great depth in the merger-case record, and the Board concluded that the merger would be competitively benign for this traffic. Extensive evidence showed that rail rates in two-railroad markets were lower than in three-railroad markets, and that railroads have competed intensively, and not colluded, in two-railroad markets such as the Powder River Basin and the Southeastern United States. Expert testimony explained why railroads' high fixed costs, the confidential nature of rail transportation contracts, and the heterogeneous nature of rail traffic prevent collusion. Moreover, the record clearly showed, and the Board found, that this merger, by combining a weak and declining SP with a stronger UP so that they could compete with the powerful new BNSF system, and giving BNSF major new competitive routes that would make it a much stronger competitor as well, would give rise to a much more intense two-railroad competitive environment than had existed in the pre-merger, three-railroad West.

3. Source Competition

So-called "1-to-1" traffic -- traffic that was exclusively-served by UP or SP before the merger and would remain exclusively-served by UP/SP after the merger -- of course suffered no loss of rail options, and in fact gained competitively, because after the merger it had access to a much expanded, more efficient merged-system rail network. But one possible lingering concern as to this traffic involved source competition -- the possibility that by combining UP and SP solely-served sources for the same commodity, the check that source competition imposes on rail rates and service might be lost.

The Board carefully examined this issue, particularly for Gulf Coast chemicals. Comprehensive evidence submitted by applicant witnesses Peterson, Barber, Spero and Peterman showed that, for every major rail-handled chemical produced in the Gulf Coast area, source competition would remain strong after the merger (and indeed would be intensified, because of the greater competitiveness of both UP/SP and BNSF). For chemical after chemical, the evidence proved that a large proportion of the total Gulf Coast production would remain available to other transporters -- BNSF (with expanded access to many "2-to-1" chemical plants), KCS, IC, barge, truck -- after the merger. Production outside the Gulf Coast area would also be available to check UP. On the basis of this remarkably thorough and rich record, the Board found that there would be no adverse effect on source competition, and that such competition would in fact be intensified because of the pro-competitive effects of the merger. Decision No. 44, pp. 125-26. None of the parties that had argued during the merger case that there would be an adverse impact on source competition, such as SPI, appealed.

4. Eastern Mexico Gateway Traffic

For traffic at the three Eastern Mexico gateways -- Laredo, Brownsville and Eagle Pass -- the BNSF settlement agreement provided stronger competition than existed prior to the merger. Under the settlement agreement, BNSF stepped into SP's shoes for traffic to Laredo and Brownsville -- thus replacing a weak railroad that had a more limited route structure than either UP or BNSF with a strong railroad with much wider coverage of the West -- and strengthened its pre-merger posture at Eagle Pass.

For Laredo traffic, BNSF received trackage rights to Corpus Christi/Robstown, where it could interchange with Tex Mex, just as SP had done prior to the merger. Laredo thus would go from competition between UP-direct and SP-Tex Mex routings prior to the merger, to competition between UP/SP-direct and BNSF-Tex Mex routings after the merger. Both post-merger alternatives were more competitive than their pre-merger predecessors.

For Brownsville traffic, BNSF could use, at its option, either trackage rights or haulage to compete against the merged UP/SP system. Brownsville thus went from UP versus SP before the merger, to UP/SP versus BNSF after the merger -- again, two stronger alternatives.

And for Eagle Pass traffic, BNSF haulage access was upgraded to trackage rights.[7] Eagle Pass thus went from a weak SP versus BNSF haulage, pre-merger, to a much stronger UP/SP versus BNSF trackage rights, post-merger.

Overall, therefore, competition at the Eastern Mexico gateways was stronger with the merger and the BNSF settlement agreement.

The Board generally agreed with this analysis, but decided to grant Tex Mex trackage rights to connect with KCS at Beaumont to guard against any possibility that the Tex Mex

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[7] This was a negotiated "quid pro quo" that was part of the UP/SP-BNSF settlement agreement -- not a condition that was required to prevent any merger-related loss of competition.

alternative at Laredo might suffer if BNSF favored the other gateways to which it had access. The applicants opposed this condition, and remain of the view that it was unnecessary, because BNSF's incentives to use Brownsville or Eagle Pass in lieu of Laredo were no different from SP's before the merger. The special status of Laredo as a gateway with superior facilities and customs infrastructure -- a fact the Board actually emphasized in concluding that it was important to ensure Tex Mex's continued soundness as a Laredo competitor -- would prevent BNSF from disfavoring Laredo following the merger just as it had prevented SP from doing so before the merger. But the Board disagreed and granted the Tex Mex rights, to ensure, as it saw it, a strong Tex Mex alternative at Laredo, and the applicants have accepted that condition and withdrawn their petition for judicial review of it.

B. What Has Happened Since the Merger

What has been the actual competitive outcome for these categories of traffic since the merger? Has any competitive harm, any increase in market power, emerged that the Board failed to remedy? The condition applicants point to none, and there has been none.

1. "2-to-1" Traffic

The condition applicants do not point to any "2-to-1" traffic in the Houston/Gulf area (or anywhere) that lost options and was harmed as a result of the merger, and there has been none.

UP's two annual merger oversight reports document in great detail BNSF's success in competing for "2-to-1" traffic. See UP/SP-303 & -304, July 1, 1997; UP/SP-344 & -345, July 1, 1998. BNSF's trackage rights volumes have steadily and dramatically increased, and are approaching half of the total universe of available traffic.[8] (Updated charts are attached to Mr. Peterson's verified statement.) BNSF's volumes far surpass what Mr. Crowley, the expert witness in the merger proceeding for several of the so-called "Consensus Parties" here, testified BNSF would ever handle under the rights it received in the merger. BNSF has provided fully competitive train service, operating daily or more frequent trains in every trackage rights corridor, including Houston-Memphis and Houston-New Orleans and the routes that BNSF obtained to the Eastern Mexican gateways.

The Confidential Appendices to the annual reports list hundreds of concrete traffic movements for which BNSF has competed, resulting in significant rate reductions and other shipper benefits. These include numerous examples in the Houston/Gulf area, such as a great variety of chemicals and plastics to and from Houston and other "2-to-1" points in the Houston area, rock from the Georgetown Railroad to the Houston

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[8] See UP/SP-303, p. 94; UP/SP-344, p. 80.

area, sugar from Sugar Land, Texas (near Houston), grain and grain products to Corpus Christi, and much more. UP's average rates for "2-to-1" traffic are down since the merger. Many shippers submitted verified statements in both annual reports attesting to the intensity and effectiveness of BNSF's competition for "2-to-1" traffic, and still further shippers make the same point in the present submission. See, e.g., Baroid Drilling Fluids (competition for "2-to-1" traffic "has become keener since the merger"); Exxon ("we have been satisfied with the effectiveness of conditions imposed by the [Board] to maintain competition at Exxon's sites in the Houston area"; "BNSF and Exxon entered into new contractual arrangements during 1997 which provide competitive rates and service, and Exxon estimates BNSF will move approximately 4,000 cars per year").

We could write hundreds of pages on this subject -- we have in the annual reports -- but the real point is that no condition applicant denies any of this. None addresses it at all.

BNSF itself is no exception. It ignores all the facts presented in UP's annual reports -- and indeed, its own annual reports actually confirm them, and affirmatively tout BNSF competitive successes in exercise of the merger conditions. BNSF's argument is instead that it could be even more competitive if it were given various new rights; but it nowhere shows any absence of fully-effective competitiveness, maintaining at least the level of rail competition that existed before the merger, for "2-to-1" traffic.

BNSF also makes entirely unsubstantiated assertions of UP "favoritism" in dispatching. We will shortly show that such claims of "discrimination" are false -- and any such claim by BNSF with respect to the Houston/Gulf area is utterly untenable, since BNSF has now joined UP in a joint dispatching center. But the point for present purposes is that BNSF offers not a shred of evidence that any such supposed "discrimination" has prevented it from competing with full vigor and effectiveness for "2-to-1" traffic, and the hard facts about total volumes, specific traffic movements and rates prove the opposite.

2. <u>"3-to-2" Traffic</u>

The story is the same for "3-to-2" traffic. UP's annual oversight reports document the increased vigor of competition for this traffic since the merger. The major automobile manufacturers -- the largest single source of "3-to-2" traffic -- have gained major rate and service benefits under post-merger contracts. Rates for "3-to-2" traffic are down since the merger. No condition applicant points to any "3-to-2" traffic in the Houston/Gulf area (or anywhere) that has suffered any competitive harm as a result of the merger.

Even KCS/Tex Mex, which argued in the merger case that there would be such harms, does not try to make such a showing -- perhaps reflecting the fact that their real interest here is in somehow gaining "open access" to exclusively-served traffic, not in any supposed effects of the merger on "3-to-2" traffic.

3. Source Competition

No condition applicant presents any evidence or argument as to post-merger loss of source competition. UP's annual oversight reports show that source competition has, if anything, intensified, as applicants predicted in the merger case: BNSF is carrying substantial volumes of chemical traffic to and from "2-to-1" points, and UP's rates for plastics and other chemicals, both in the Gulf and systemwide, are down since the merger.

Richard B. Peterson, UP's Senior Director-Interline Marketing, in his verified statement, updates the facts on which the Board relied in concluding that there would be no loss of source competition for Gulf Coast chemicals, and shows that the basis for this conclusion has only become stronger. Plant expansions, the access that BNSF gained to certain facilities in connection with its agreement to join in the Spring Dispatching Center, and other developments since the merger have actually increased the percentage of a number of major chemical commodities available to non-UP transporters, and UP's traffic shares have fallen.

4. <u>Eastern Mexico Gateway Traffic</u>

The effectiveness of the merger conditions in preserving strong competition for Eastern Mexico gateway traffic is clear beyond peradventure. Rates for this traffic are down since the merger, and the Confidential Appendices to UP's annual oversight reports are full of examples of the benefits shippers have realized from BNSF competition for it.

At Laredo, the BNSF-Tex Mex route is handling significantly <u>more</u> traffic than the SP-Tex Mex route handled before the merger. <u>On top of this</u>, Tex Mex is moving substantial volumes of traffic in conjunction with KCS. Tex Mex's share of total Laredo crossings in the first seven months of 1998 was 25%, compared to its share in the same months in 1996, prior to the merger, of 13%. Peterson V.S., p. 6. BNSF, searching for a pretext for direct access to Laredo, claims to be frustrated by Tex Mex's unwillingness to agree on long-term revenue divisions, but the traffic data speak for themselves: competition is more intense than it was before the merger.

BNSF has substantially replaced SP as a competitor at Brownsville. It handled 21% of total Brownsville crossings in the first seven months of 1998, an only slightly smaller percentage than SP's 25% in the same months in 1996. And

BNSF's traffic volumes at Eagle Pass are far above pre-merger levels -- its traffic has increased from 4,143 cars in the first seven months of 1996 to 15,111 cars in the first seven months of this year. Id., pp. 7-8.

Overall, Mr. Peterson finds that in the two years since the merger, SP competition at the Eastern Mexican gateways has been more than replaced by BNSF and Tex Mex. Mr. Peterson analyzed competitive traffic moving through the gateways and found that, while in 1996 UP had a 71% share of that traffic, SP 21%, and Tex Mex and BNSF 9% between them, by July 1998 the UP/SP share was down to 65% and the combined Tex Mex and BNSF share was 35%. Peterson V.S., p. 10.

C. The Condition Applicants' Arguments

What do the condition applicants say about whether the merger increased UP's market power? For the most part, they simply ignore the issue. Most of them focus on describing the service crisis, and then move directly to arguing that more competition will solve it, or help solve it. In fact, as we show in subsequent Parts of this brief, the Houston/Gulf service crisis is over, and the conditions that are being proposed would in many cases worsen rather than improve service. But the key point for present purposes is that this argument by the condition applicants evades the relevant question, for if the merger did not cause an increase in market power (and an increase in market power did not cause the service crisis), there is no legal basis for imposing any new, permanent competitive conditions on it.

To the extent parties say anything about whether the merger caused an increase in market power, they tend either to assume conclusively that it did, with no explanation or evidence as to how or why, or tacitly admit that it did not, and ask the Board to be "innovative" and disregard the issue. In the first category, for example, is CMTA, which repeatedly speaks of "market power" and "market dominance" without ever once explaining how the merger, as conditioned, gave rise to any such power or dominance (e.g., CMTA-1, pp. 10, 17), and the Greater Houston Partnership, which roundly declares (Resolution, p. 4) that "deregulation and consolidation have left too many shippers captive to a single railroad," apparently in total ignorance of the extraordinary care that the Board took to prevent this from happening to a single shipper in this transaction. In the second category, for example, is Formosa Plastics, an exclusively-served shipper seeking "open access" which clearly recognizes that it cannot show the merger deprived it of any rail competition,[9] and therefore urges the Board to be "innovative" and develop "new approaches" (Application, pp. 9, 11) -- which really means,

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[9] Its only feeble effort to do so is a passing mention of the fact that, pre-merger, some of its traffic moved in joint-line UP-SP service (Application, p. 26). It is of course well established that end-to-end consolidations do not eliminate competition.

ignore the core proposition of decades of merger law that mergers that are in the public interest will not be saddled with conditions creating new competition.

Several condition applicants, and their supporters, struggle to find some element of merger-caused market power lurking in the service crisis, but to no avail. For example, CP&L, a coal receiver that was exclusively served by SP prior to the merger and is seeking "open access" by BNSF, tries to repackage the perennially-unsuccessful vertical foreclosure argument[10] as a service argument. It suggests that if UP and SP had not merged, then, when the service crisis struck, it might have secured alternative upstream service offerings from UP and BNSF; with the merger, so CP&L's theory goes, BNSF's service competition was foreclosed. Application, Heller V.S., pp. 5-8.

The problem with this admittedly speculative argument (which is presented throughout with words like "may" and "might") is that it is directly at odds with what actually happened. During the congestion crisis, UP asked BNSF to take over, on a temporary basis, as many coal sets bound to Texas receivers as possible. BNSF, with power and capacity

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[10] CP&L did not argue vertical foreclosure in the merger case. CP&L was one of the complainants in the Bottleneck rate proceeding, and it secured a settlement from the applicants in the merger case under which, if it prevailed in the Bottleneck case (which it ultimately did not), it would be treated as a "2-to-1" shipper. See Decision No. 44, p. 63.

constraints of its own, agreed to handle only a few trainsets. Handley V.S., p. 58. UP was effectively granting temporary "open access" during the emergency -- and if it had not done so, the Board had ample power to require it, where that would have assisted in alleviating the crisis. UP did not gain or exercise any "market power" to block alternative service in an emergency. CP&L's notion that every exclusively-served shipper on a merging railroad should be opened to permanent competition so that there will be alternative service in the event of an emergency is obviously absurd.

Dow would also like "open access" for BNSF (via haulage) to its exclusively-served chemical complex at Freeport, and its search for the elusive increase in market power lurking in the service crisis focuses on investment incentives. Dow's notion is that, if BNSF had access to its traffic, it would invest in its own infrastructure to handle it, and thus the merger somehow reduced investment incentives. DOW-1, pp. 4, 10-11. The NIT League articulates much the same theory. NITL-4, pp. 10-11, 15-17.

The fatal flaw in this theory is that there is no explanation of the relevance of the merger. Merger or no merger, there was only one railroad serving Dow at Freeport. If the merger had not happened, there would not have been some second railroad serving that complex, with investment incentives that have instead been suppressed because of the merger. The merger did not change the traffic demands at Dow's facility, or at any other shipper facility in the Houston/Gulf region, and it did not change the exclusively-served or competitively-served status of a single such facility. It thus cannot have had any negative impact on investment incentives.

In truth, of course, the merger applicants undertook to make billions of dollars in investments that would occur only because of the merger, and, as a result of the service crisis, the merged system has since adopted still more Gulf Coast investment plans.

Moreover, Dow does not even explain how granting BNSF the access that Dow seeks would affect total investment. BNSF might indeed invest in its own lines to handle Dow's traffic, but the loss of that traffic would undermine UP's investment capability and incentives. See Barber V.S., pp. 80-86; Peterson V.S., pp. 32-34. In short, the investment theory simply does not hold water.

The NIT League makes one other effort to suggest that merger-related market power is to be detected in the service crisis: it argues that, had there been "a truly competitive market" in Houston, UP would have lost all its traffic when the service crisis struck. NITL-4, p. 9. This argument is patently wrong on its own terms; in fact, the congestion crisis ground the entire Houston terminal to a halt, and all railroads using it were equally affected. But suppose for a moment that it is correct. How did the merger cause this lack of "true competition"? Every shipper that had rail alternatives in the Houston terminal before the merger had rail alternatives after the merger, and every shipper that was exclusively-served before the merger was exclusively-served after the merger. The lack of "true competition" that the NIT League is decrying is the fact that these exclusively-served UP shippers -- who, as Messrs. Barber and Peterson show, account for only about a third of the traffic in the Houston BEA -- could not use a second railroad during the service crisis. (This is actually not true; UP agreed to suspend contracts and hand off traffic at short-haul junctions for such shippers wherever this would help alleviate congestion; but put that element of reality aside too for the moment.) The merger simply did not give rise to the fact that exclusively-served shippers were exclusively-served. Thus, this argument, like all the others, fails to identify any respect in which the merger caused an increase in market power in the Houston/Gulf area.

In the remainder of this section, we give more extended consideration to two remaining arguments: (a) the suggestion of KCS/Tex Mex witnesses Grimm and Plaistow that merger-caused market power can be seen in the alleged facts that UP's "market share" in Houston is at virtual monopoly levels and fell hardly at all during the service crisis; and (b) contentions by KCS/Tex Mex and BNSF that UP discriminates in dispatching trackage rights trains. The first of these arguments is really just an elaboration of the fallacious "truly competitive market" argument of the NIT League that we just discussed; but because it is so replete with factual as well as conceptual errors, we give it more extended treatment. The second argument -- "discrimination" -- has repeatedly been considered and rejected by the Board as a basis for finding trackage rights an inadequate means of preserving competition. One might be tempted to dismiss these yet-again-renewed, unsupported claims of "discrimination" on the basis of the Board's prior reasoning: trackage rights have worked again and again as a method of preserving rail competition; "discrimination" has never been proven; and there are clear remedies for it, including both the Dispatching Protocols that UP/SP entered into with both BNSF and Tex Mex and simply the practical leverage that railroads with trackage rights over each others' systems have to prevent any mishandling of their trains. But there is also now direct, quantitative proof that the "discrimination" claims are false.

1. <u>Grimm/Plaistow "Houston Market Shares"</u>

KCS/Tex Mex witnesses Dr. Curtis Grimm and Joseph Plaistow assert in their verified statement that "UP's service meltdown" provides "evidence that the merger created significant UP market power in Houston." KCS-2, Grimm/Plaistow V.S., p. 2. They conducted a study which they assert shows that UP has a virtual monopoly of traffic in the Houston BEA. Using data for rail originations in 1994, 1996 and the second half of 1997, they contend that UP/SP has very high shares -- generally, 80% or more -- of traffic moving between the Houston BEA and certain destination regions, and that these shares barely changed between 1994, 1996 and the second half of 1997. Their conclusion is that UP has a virtual monopoly of rail traffic in the area, and that this is dramatically confirmed by the fact that UP's share barely changed at all during a severe service crisis.

This study, and the conclusions they draw from it, are wrong at every level.

First, the study is conceptually wrong-headed. As already discussed, the relevant question is whether the merger diminished competition for any shipper. A proper analysis of this question -- the analysis the Board followed in approving the merger -- requires careful consideration of how the merger affected competition for "1-to-1," "2-to-1," and "3-to-2" traffic, and how it affected source competition. Grimm and Plaistow do not attempt to address applicants' showing in the merger case and the subsequent oversight proceedings that competition was not harmed in any one of these categories.

Instead, they, and others who echo their assertions,[11] devise a construct called the "Houston market" by lumping all types of shippers into one pot, and thus provide no evidence of how the merger actually affected pre-existing levels of competition.

Second, the study is factually wrong. As Mr. Barber explains, the data that Grimm and Plaistow present are riddled with error and gerrymandered geographically and temporally. In fact, the UP share of total Houston-BEA originations was not stagnant, but fell 11 percentage points during the service crisis, from 80% to 69%. UP's share of terminations fell five percentage points to an even lower level -- 59%. Overall, UP's traffic share dropped seven percentage points from 70% to 63%. See Barber V.S., pp. 26-30.

One source of error is that Grimm and Plaistow purport to define three "destination geographic regions" but fail to follow their own rules in selecting traffic. As Mr. Barber explains, although Grimm and Plaistow claim to have defined destination regions by reference to state boundaries, a comparison of the data provided in discovery against actual

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[11] E.g., Greater Houston Partnership, Resolution, June 2, 1998, p. 4.

waybill data demonstrates that the study omitted traffic from many BEAs that clearly fall within their defined regions.[12]

It is not clear how Grimm and Plaistow decided which BEAs to include in their study (and they clearly used BEAs, not states as they claim), but what is clear is that by excluding significant amounts of traffic, they skewed the results. When all of the BEAs within the regions Grimm and Plaistow have defined are included, UP's traffic share is, on average, several percentage points lower that Grimm/Plaistow say.

A second source of error is that the Grimm/Plaistow study is gerrymandered geographically. Even when all the traffic moving to the regions Grimm and Plaistow defined is

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[12] For example, although Grimm and Plaistow claim that the "East-Northeast" region includes "eastern Canada," no data from Canadian BEAs appears in their study, although waybill data confirms that such traffic exists. Similarly, Grimm and Plaistow claim that the "East-Northeast" region includes "all of New England" and "New York," but their study in fact did not include, for example, the Bangor ME, Burlington VT-NY, or Albany-Schenectady-Troy NY BEAs. In all, they excluded 10 of the 17 BEAs in the region where waybill data indicated that Houston traffic had terminated.

In the "South-Southeast" region, Grimm and Plaistow claim that they included "all the states from Virginia southward to Florida," but their study did not include, for example, the Greensboro-Winston-Salem-High Point NC-VA, Wilmington NC-SC or Jacksonville FL-GA BEAs. In all, they excluded 25 of the 54 BEAs in the region. And similar problems infect the "Midwest" region. Grimm and Plaistow claim the region includes "all states east and west between Ohio and Kansas" and between "Michigan and Arkansas," but they did not include, for example, the Northern Michigan MI, Jonesboro AR-MO, Peoria-Pekin IL or Chicago-Gary-Kenosha IL-IN-WI BEAs. Barber V.S., p. 27 n.7.

included, the study still excludes a tremendous amount of UP traffic that moves to the West, to Canada and Mexico, and within Texas. Grimm and Plaistow offer no justification for excluding these important bodies of traffic. It is not surprising that they chose to exclude them, though, because UP's share of traffic moving from Houston to Western destinations is some 20 to 25 percentage points below the figures Grimm and Plaistow provide. Moreover, UP's share of Houston BEA traffic terminating in Texas has dropped more dramatically than in any other region, as one might expect given the service problems.

The final and most important error is that the Grimm/Plaistow study is gerrymandered temporally, in that it does not provide data for the most recent time period available. Although UP's service problems became serious in the late summer of 1997, there was inevitably a lag in the translation of these problems into traffic loss. The comparison period Grimm and Plaistow used -- July to December of 1997 -- is thus much less meaningful that the January through June 1998 time period. When one looks at this period, analyzes all of the UP traffic originating in Houston, and includes the destination regions that Grimm and Plaistow chose to omit, one finds the quite substantial declines described above. Moreover, these figures actually understate the amount of traffic that UP lost during the service crisis, because they do not include the traffic that UP lost because it agreed to short-haul itself on certain routes. This traffic would have been counted as UP traffic in the Grimm/Plaistow study, but UP received little of the revenue from it. See Peterson V.S., p. 21.[13]

All of this would be enough to discredit the Grimm/Plaistow conclusions, because it shows that, contrary to their claim, UP did lose a substantial percentage of its Houston BEA traffic to BNSF and Tex Mex during the service crisis. But Mr. Peterson took the analysis one step further.

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[13] Grimm and Plaistow also present a second study in which they analyze UP's share of traffic originating in subdivisions of the Houston BEA defined by four-digit SPLCs. This study is another example of pure gerrymandering. First, Grimm and Plaistow have specifically selected those SPLCs with the highest percentage of UP-exclusive shippers. Indeed, this is not surprising, because they admit that they selected the locations based on the KCS/Tex Mex access proposals, and KCS/Tex Mex are seeking to access a large volume of UP-exclusive traffic. In locations with a substantial number of non-UP-exclusive shippers (such as SPLC 6864 and SPLC 6861), even the Grimm/Plaistow data (with its other errors) show a far lower traffic share.

Second, as in their first Houston study, Grimm and Plaistow do not follow their own rules in defining destination regions, and this leads them to report figures that are several percentage points higher than if they had followed those rules.

Finally, as in their first Houston study, Grimm and Plaistow do not use the most recent data. The more recent data show that, while UP has of course retained a large share of the traffic in SPLCs populated primarily by UP-exclusive shippers, UP's share of traffic moving from even the SPLCs selected by Grimm and Plaistow to the destination regions they selected is in every case lower -- in some cases, as much as 15 to 18 percentage points lower -- than they report. Barber V.S., p. 27.

He examined the traffic that UP handled in the January-June 1998 period in the Houston BEA and broke that traffic down between traffic to and from facilities exclusively served by UP and traffic to and from facilities served by UP and one or more other railroads. The results showed that 42% of UP's Houston BEA originations in January-June 1998, 62% of its terminations, and 52% of its overall traffic was directly competitive with other railroads.

Thus the total traffic in the Houston BEA breaks down approximately into thirds. One third was handled by other railroads. Another third of the total -- half of what remains after subtracting the third that was handled by other railroads -- was handled by UP but competitive with other railroads. And only the remaining third was exclusive to UP.

As Mr. Peterson puts it: "This is clearly not the picture of a monolithic, unbudgeable monopoly that Messrs. Grimm and Plaistow try to paint. Even if the entire Houston BEA were viewed as a single rail market -- and it is not properly so viewed -- UP does not come remotely close to having a monopoly in that market."

2. "Discrimination"

A recurrent and pervasive theme of the KCS/Tex Mex parties' filings is their claim that UP and BNSF dispatchers are discriminating against their trains. E.g., KCS-2, Watts V.S., pp. 384-85; Nichols V.S., pp. 372-73. BNSF also claims dispatching discrimination and other mishandling of its traffic. E.g., Rickershauser V.S., p. 3. In an interesting twist, KCS/Tex Mex now accuse BNSF and UP of joint discrimination against Tex Mex. KCS-2, Nichols V.S., passim.

In a number of filings since 1994, UP has demonstrated that tenant railroads almost universally believe, mistakenly, that they are the victims of discrimination, or at least that their traffic is not being treated properly. They tend to present those perceptions to the Board (formerly, to the ICC) when they are pursuing other agendas. In 1994, for example, SP accused UP of dispatching discrimination as part of its attack on the UP/CNW merger. It later backed off that claim and concluded that it had been failing to manage its own trains properly.

We are submitting herewith a 1994 verified statement by Jerry R. Davis, who was then Executive Vice President and Chief Operating Officer of CSX Transportation. He summarized the pattern of misperception:

> "In my experience, railroads that operate over trackage rights are always concerned about the treatment their trains receive from the owning railroad and its dispatchers. In every trackage rights arrangement that I have had contact with, the pattern has been very consistent: the tenant always has the perception that its trains are being delayed or not given preferential treatment at particular places and times. The tenant always wonders whether these delays are the result of . . . 'discrimination.' When an operating officer looks into the details of specific decisions, though, it usually turns out that there was a good explanation."

Davis V.S., p. 4. As Mr. Davis also observed: "Dispatchers are subject to more criticism and Monday-morning quarterbacking than employees in any other railroad craft. Everyone thinks he or she would have done a better job of running the railroad." Id., p. 5.

Mr. Davis explained that in his position at CSX, he had occasion to wonder whether CSX trains were being treated fairly by UP dispatchers on a 64.4-mile joint line between Chicago and Woodland Junction, Illinois. After he investigated the situation, though, he concluded that "CSX trains were getting a fair shake." Trains of both railroads were getting delayed because of congestion, but the UP dispatchers were following "good dispatching practice." Id.

Now KCS/Tex Mex and BNSF are making "discrimination" allegations in an effort to garner commercially valuable rights from the Board. Unfortunately, the KCS/Tex Mex "discrimination" claims have a personal element. One of SP's lead "discrimination" witnesses in 1994 was Patrick W. Watts, who now is Vice President-Transportation for Tex Mex. He had been thrown out of UP's Harriman Dispatching Center after a UP employee witnessed him engaging in improper and unauthorized use of a UP computer terminal, an allegation Mr. Watts vehemently denies but surely did not forget. Even after that unhappy experience, though, Mr. Watts concluded in a written report to his SP supervisors as follows: "I highly doubt that any UP dispatcher intentionally mishandles SP trains." (A copy is in Appendix A.) That remains true today. Duffy V.S., p. 20.

We respond in detail at appropriate points below to specific allegations. We show, for example, that BNSF's claims that its unit trains to a grain exporting facility are being handled improperly on UP's Clinton Branch are untenable, because the Port of Houston's grain facility dictates which trains move to that facility on the basis of the movements of ocean vessels. We also discuss individual examples of "discrimination" that KCS/Tex Mex mention in their evidence, and show why they are grievously mistaken and do not show any "discrimination." For example, in the incident to which KCS/Tex Mex devote the most space, UP trains were in fact delayed to give a Tex Mex train preferential handling.

It is virtually impossible for landlord railroads to disprove discrimination claims, as is the case with proving most negatives. The claims invariably come to the Board long after the events, when the individuals involved are often unable to recall why they made specific, complex dispatching decisions. Mr. Davis, a former dispatcher, describes the problem:

> "I know that unless you are asked to recreate your decisions within the first few hours after you have made them, you cannot do it. On each shift you make hundreds of decisions and are flooded with communications and changing conditions. It is impossible to go back months or years after a complicated

> night of decisions and figure out why the dispatcher made particular choices. There is no way to recreate all of the factors the dispatcher had to think about, such as what each train crew was saying about how its engines were working, whether the dispatcher was having trouble reaching a train on the radio, whether there was a signal failure, and dozens of other events."

Davis V.S., pp. 5-6. To give that testimony a current context, the two dispatching positions responsible for controlling most UP and PTRA trackage in the Houston area today must deal with, by actual measurement, 2,300 communications or actions every 24 hours, or approximately one every 40 seconds. T. Slinkard V.S., pp. 2-3.[14]

In the last few weeks, however, UP has implemented on 4,000 miles of UP lines a capability that has never been available before. At great expense, BNSF and UP have installed large numbers of "AEI" scanners at numerous locations on the UP lines where BNSF and Tex Mex have trackage rights on each other. Those segments include the UP lines where Tex Mex operates. One of the reasons BNSF and UP installed this expensive equipment was to be able to provide reliable, consistent data comparing transit times of UP trains with transit times for trackage rights trains. UP is awaiting BNSF's results. Wilmoth V.S., p. 2.

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[14] UP recently completed a study of these dispatching positions and confirmed that they are overburdened. UP will reallocate the work of these two positions to three positions, which will reduce workloads and improve the efficiency of operations throughout the Houston terminal. Duffy V.S., p. 22.

UP will produce the results of these measurements covering the period from August 11 through September 10, 1998. In order to ensure that apples are compared with apples, UP gathered the data by train type, breaking down the trains among premium intermodal, intermodal, premium manifest, manifest, and unit trains (rock, coal and grain). Wilmoth V.S., p. 3. Local trains are excluded because they would have the effect of increasing UP's transit times but be less likely to increase the transit times of its tenants. In reporting the results, UP included every major segment on which BNSF and Tex Mex have trackage rights over UP. Segments were excluded only if there were very few or no comparable movements or data could not be collected. Id. Specifically, data are not available for some segments within Houston because identification of trains using available equipment is essentially impossible. Id., p. 3. UP will make the workpapers available to BNSF and KCS/Tex Mex.

As one would expect if dispatching is unbiased, one finds situations where UP trains performed better than BNSF or Tex Mex trains, and situations where BNSF and Tex Mex trains performed better than UP trains. If there is an overall pattern, though, it is actually that Tex Mex and BNSF trackage rights trains on UP tracks perform somewhat better than UP trains of the same class.

<u>Tex Mex Trains</u>. KCS/Tex Mex have been much more vociferous than BNSF in making discrimination claims, and they have made them more often and more publicly. Accordingly, we begin with a comparison of Tex Mex and UP train performance. Due to directional running, Tex Mex operates on two UP routes both east of Houston and south of Houston. Southbound Tex Mex trains operate from Beaumont to Houston on the former SP, then west from Houston to Flatonia and south to Placedo and Robstown. Northbound, following the directional running pattern, Tex Mex trains operate from Robstown to Algoa, where they transfer to BNSF trackage. They then operate through the Houston terminal and back to Beaumont on UP's Beaumont Subdivision.

UP was able to generate automated data covering most of these trackage rights, divided into four directional segments. Mr. Wilmoth's charts showing the results are reproduced in full below. On one of the segments, the UP transit times appear to be inflated by en-route stops. Nevertheless, on every segment during the 31-day period, Tex Mex trains had faster transit times than comparable UP trains. Note that from Beaumont to Dawes (Houston), Tex Mex trains achieved almost the same average transit time as UP's priority intermodal trains. The results are shown on the following table:

Segment	Train Type	Tex Mex Transit Time (in hours)	UP Transit Time (in hours)
Beaumont to Dawes (just east of Houston)	Manifest Intermodal (UP only)	3.0 N/A	3.5 3.1
Settegast to Beaumont	Premium Manifest Manifest Intermodal	N/A 3.2 N/A	4.1 5.0 3.0
Houston (Tower 26) to Rosenberg	Manifest	3.7	3.2
Rosenberg to Flatonia	Manifest	5.2	6.5
Corpus Christi/ Robstown-Algoa[15/]	Manifest	10.0	19.4[16/]

These data do not show any indication that Tex Mex trains are victims of UP (or where BNSF and UP provide joint dispatching, BNSF/UP) dispatching discrimination.

KCS recently had the opportunity to experience what it was like to be on the receiving end of complaints about train handling, although UP did not hurl charges of "discrimination" but merely complained about congestion delays. In an exchange of letters, UP identified hundreds of hours of delays to 136 UP trains at Beaumont, in each instance because the KCS operator who controls UP trains could not

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[15/] The Tex Mex time is from Robstown to Algoa, a distance of 202 miles. The UP transit time is from Corpus Christi to Algoa, a distance of 206 miles.

[16/] UP trains stop en route for crew changes and switching.

allow them passage. After two weeks of investigation, KCS responded with a detailed and lengthy reply that listed many additional delays to UP trains. Its response was designed to show that UP misunderstood the situation, that the problems were not intentional, and that most were attributable to normal operating factors. KCS/Tex Mex should learn from that experience.

BNSF. BNSF has extensive trackage rights over UP, and therefore UP has ample opportunity to compare transit times for BNSF trains of multiple types to transit times for comparable UP trains. On some occasions, UP trains moved faster than BNSF trains. More often, UP trains moved more slowly. In a few instances, there was no difference. Again, we replicate Mr. Wilmoth's chart in full.

The table below shows the comparative transit times for all significant BNSF trackage rights segments on UP between the Mississippi River and Texas. UP gathered similar data for BNSF trackage rights on UP between Denver and Northern California. Although UP will make these data available to BNSF, we are not replicating them here because they are not, in UP's judgment, meaningful. The BNSF transit times are much faster than comparable UP transit times in the Far West, because of the significant congestion UP experienced in the last month in that area. That congestion probably adversely affected some BNSF trains, but it affected UP trains far more severely.

Segment	Train Type	BNSF Transit Time (in hours)	UP Transit Time (in hours)
Memphis (Bridge Junction) to Pine Bluff	Premium Manifest	4.9	6.0
Pine Bluff to Houston (Tower 26)	Manifest	19.2	19.4
Houston (Tower 26) to North Little Rock	Manifest Premium Manifest	20.1 N/A	22.6 23.4
North Little Rock to Memphis (Bridge Junction)	Premium Manifest Manifest	5.2 6.4	5.3 5.9
Iowa Junction to Beaumont	Intermodal Manifest	3.8 4.9	4.3 5.9
Beaumont to Dawes	Intermodal Manifest	2.6 3.0	3.1 3.5
Houston to Beaumont[17]	Manifest	3.0	5.0
Beaumont to Iowa Junction	Premium manifest	6.9	14.3
Tower 26 to Rosenberg	Grain[18]	3.7	3.7
Corpus Christi to Algoa	Manifest	9.6	19.4[19]

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[17] For BNSF, Tower 26 to Beaumont. For UP, Settegast Yard to Beaumont. The BNSF segment is longer.

[18] BNSF's trackage rights over this route are restricted to unit grain trains.

[19] UP trains change crews and work en route.

Segment	Train Type	BNSF Transit Time (in hours)	UP Transit Time (in hours)
Caldwell to Flatonia	Manifest Coal	3.6 4.6	3.1 3.1
Flatonia to San Antonio	Manifest Coal	5.1 6.1	5.9 7.8
San Antonio to Eagle Pass	Manifest	6.2	6.3
Eagle Pass to San Antonio	Manifest	7.7	8.5
San Antonio to Flatonia	Manifest Coal	4.2 5.3	5.8 5.9
Flatonia to Caldwell	Coal	3.0	7.1
Ft. Worth to Sweetwater	Intermodal Manifest	6.2 13.4	6.1 16.4
Sweetwater to Ft. Worth	Intermodal Manifest	6.3 8.9	8.3 13.0[20/]

It bears repeating that these measurements are not the results of human judgment. They are measurements recorded by automated trackside equipment detectors transmitted directly to a computerized data base. These data constitute highly persuasive evidence against BNSF's and KCS/Tex Mex's unsubstantiated claims of dispatching "discrimination." They are the only quantifiable data in the record to date.

Dennis Duffy, UP's new Executive Vice President-Operations, states UP's policy clearly and unequivocally. UP does not discriminate against trackage rights tenants. Duffy

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20/ Some UP trains may perform work en route.

V.S., p. 60. Troy T. Slinkard, the joint BNSF/UP manager of the BNSF/UP Consolidated Dispatching Center in Spring, Texas, separately states that he has instructed his dispatcher to treat Tex Mex trains fairly and that they do not discriminate. In fact, he testifies that they bend over backward to help Tex Mex trains. T. Slinkard V.S., p. 3. The data UP's AEI scanners measured last month appear to establish that both of these men are correct, and that the KCS/Tex Mex hyperbole is mistaken.

II. THE SERVICE PROBLEMS DID NOT RESULT FROM ANY EXERCISE OF MARKET POWER

We have seen that the UP/SP merger did not give rise to any increase in market power in the Houston/Gulf area (or elsewhere). But even if it had, it is equally clear that the service crisis was not the product any exercise of such market power.

A. Market Power Did Not Cause the Service Crisis

Notice, first, that the question is not whether the merger was the cause of the service crisis; it is whether merger-generated market power caused it. We believe it is clear, as we shall discuss below, that the merger was not to blame for the service crisis. There were of course links between the two -- the fact that the railroads were part of a single system affected how the crisis unfolded; and the merger's efficiencies proved essential to overcoming the crisis. But the cause of the crisis lay in SP's pre-merger fragility, not in the merger. However, all that is really beside the point, for the question presented in this proceeding is a much more specific one appropriate to determining whether to impose further competition-preserving conditions on the merger. That question is: Did market power, resulting from the merger, in turn cause the service crisis?

A moment's thought shows that the very notion is ridiculous. Monopolists do sometimes allow service to deteriorate, but they do that in order to extract monopoly profits. This crisis has inflicted grievous economic harm on UP. No sane monopolist would have engineered this result through an intentional exercise of market power, and no condition applicant claims that that is what happened.

Professor Hausman reviews the issue thoroughly in his verified statement. He explains that the traffic gains of BNSF and Tex Mex contradict any notion that there has been an exercise of market power through coordinated interaction. He then explains that any unilateral exercise of market power by UP to bring about the service crisis can be conclusively ruled out. In direct contradiction to the well-accepted economic model of a monopolist's exercise of market power to gain from service diminutions, UP's costs here <u>rose</u>, rather than falling. UP's profits <u>fell</u> -- calamitously -- rather than rising. Its enterprise value, as measured in stock price, also plunged, rather than increasing. All of these facts are "inconsistent with the hypothesis that UP has exercised market power following its merger with SP."

Professor Hausman's conclusion is straightforward: "No economic data are consistent with the hypothesis of increased market power caused by the merger. Thus, I conclude that the service problems are not caused by the attempted exercise of market power by UP."

There is a further basis for reaching this conclusion. As Mr. Barber points out, if parties such as KCS/Tex Mex were right, and the service crisis was the inevitable result of UP's supposed market power, the end of the crisis would be inexplicable. On KCS/Tex Mex's account, UP's market power remained intact throughout the crisis because the Board did not fundamentally restructure the Houston-area rail system. But since the supposed monopoly remained in place, the service crisis should have remained in place as well. That is indeed what KCS/Tex Mex argued in their July 8 filing -- that the congestion was not abating, and would continue indefinitely until their proposed remedies were adopted. Twenty-two days later, the Board found that the emergency was over, and since then, as we discuss below, service has improved even more. The KCS/Tex Mex theory of market power causation is thus demonstrably disproven.

One really need say nothing more: the condition applicants entirely fail to show that merger-generated market power caused the service crisis, and it is plain that it did not. But it is also useful to consider what did cause the crisis, and how it has been overcome. Those are the topics of the next two sections.

B. <u>What Did Cause the Crisis?</u>

UP's Gulf Coast service crisis, which lasted from the late summer of last year through approximately the end of March 1998, cannot be attributed to any alteration of competitive balance or acquisition of market power. Whether, in the absence of the merger, it would have happened when and in the precise form that it did -- indeed, whether it would be continuing today had the merger not occurred -- can be debated for years but never answered with certainty. It can be said with complete confidence, though, that implementation of the UP/SP merger brought the crisis to an end. No one has even ventured any other explanation.

History provides a useful perspective. From October 1978 until October 1980, SP suffered a catastrophic and unrelieved service meltdown throughout the Gulf Coast area that SP's Vice President of Operations Alan B. DeMoss christened "World War III." DeMoss V.S., p. 12. There was no merger in 1978, and no change in competitive conditions at all. SP was managed by experienced railroaders who knew their territory and their yards intimately. Yet it collapsed under the conflict between traffic growth and inadequate infrastructure. Only massive changes in operations relying heavily on yards east of Houston, two years of aggressive hiring, an extensive facility rehabilitation program, and a fortunately-timed business slowdown ended "World War III" after two full years. Id., p. 15. Significantly, UP brought the recent service crisis to an end in a strong economy and in less than one year. It did so because it implemented the UP/SP merger.

"World War III" resembled the recent crisis in many ways. Englewood Yard melted down. Cars got lost, with no new computer system to blame. Trains were delayed and stashed in sidings all over the railroad. As train velocity declined, SP ran out of locomotives because they were stuck on trains and used ineffectively. Then it ran out of train and engine crews because the crews could not complete their runs under the Hours of Service Law. Transit time skyrocketed. By actual measurement, transit time for SP's fastest intermodal train from New Orleans to Houston increased from 16.5 hours in 1977 to 35 hours in July 1979 to over 49 hours in December 1979. Manifest service was worse, consuming 4 to 6 days between the same two points. Ongerth V.S., pp. 7-8. Other railroads, not affiliated with SP, suffered from congestion.

In some ways, "World War III" may have been worse than the recent crisis. At one point, SP pulled strings of unswitched cars out of Englewood Yard and stashed them on the Bellaire Branch west of Houston. Six weeks later, they were still there. Id., p. 8. SP was forced to store SIT cars in 19 different locations in the Houston area alone in 1979. Id. Amtrak sued SP for failing to move the Sunset Limited. The ICC imposed an emergency service order that required SP to move every car at least every 24 hours. To comply with this ill-advised prescription, SP managers moved cars back and forth between the same points. DeMoss V.S., pp. 11-12. SP borrowed locomotives from Norfolk & Western Ry. during a strike, and then refused to return them when the strike ended. Id.

No UP with comparatively deep pockets came to SP's rescue. There was no magic bullet like directional running to solve the crisis. There was no merger, allowing SP to redeploy crews and adopt an improved computer system. So "World War III" lasted two years.

SP managers recognized that SP lacked adequate infrastructure in the Gulf Coast area during the 1978-80 era, and that this shortage contributed to "World War III." DeMoss V.S., pp. 12-13; Ongerth V.S., pp. 2-6. After doing little to increase capacity during the 1970s, SP spent heavily in 1979, 1980 and into 1981, but mainly to rehabilitate existing assets, not to expand capacity. Ongerth V.S., p. 9. It built Strang Yard to serve the burgeoning petrochemical business on the Bayport Loop, and it added CTC for a distance east of Houston. Otherwise, the SP's Houston rail network changed little.

When the recession of 1982 struck with a vengeance, SP discontinued all Gulf Coast capacity expansion efforts, never returning to them. DeMoss V.S., p. 15. As SP officers have explained in many contexts, the railroad spent much of the 1980s pursuing the ill-fated Santa Fe merger. SP was in financial distress throughout that decade and into this one. During the years after "World War III," SP actually reduced its capacity in the Gulf Coast area. For example, it closed a yard in Ennis, Texas; took out most of Glidden Yard west of Houston; allowed Depot Yard in Houston to deteriorate; closed Navigation Yard in Houston; abandoned the Wharton Branch; abandoned a Houston bypass between Beaumont and Lufkin, Texas; allowed the Bellaire Branch, a second mainline for the Sunset Route, to deteriorate before selling it; and abandoned most of the Rockport Branch between San Antonio and the Gulf Coast. Ongerth V.S., pp. 11-12. At one point, an SP Chief Engineer set out to rebuild Chaney Yard in Houston, took up all the track and then, short of assets, used it elsewhere to keep the railroad running. Today, Chaney Yard is an empty field west of downtown Houston. Id., p. 12.

SP in the Gulf Coast area approached the UP/SP merger with less capacity than when it finished "World War III." Meanwhile, the region's petrochemical industries and traffic had continued to grow throughout the intervening years. Farenthold V.S., pp. 1-4; Peterson V.S., pp. 32-33 n.6. As UP's Mr. Handley, for 13 years the General Manager of the PTRA, describes it, the core of the Houston terminal in 1997 was largely unchanged from 1980, other than the loss of several smaller SP yards. Handley V.S., p. 2. It was, and remains, a heavily-used maze of tracks without a single grade-separated crossing between two mainlines. Its mainlines must carry thousands of cars per day, yet also support industry switching with few industrial leads that would take the switching off the mainlines. Id. It is as complex and difficult a terminal to operate as exists in this country. Id. The table was set for 1997.

We will recount only briefly the stresses that hit SP and UP in the Gulf Coast area during the spring and summer of 1997, which have been addressed in multiple prior submissions in the service proceeding. The derailment that tore apart the Englewood hump lead track put the yard out of commission for a lengthy period. SP suffered other derailments, and washouts. Mexico traffic backed up at the Laredo gateway before, during and after privatization. Among these stresses, none struck with a greater vengeance than

BNSF's virtual closure of the SP Sunset Line for maintenance work beginning April 1, 1997. Duffy V.S., p. 17. BNSF's managers, many of them former SP executives and Houston experts, knew how essential this line and its capacity was as a safety valve to keep Englewood healthy, but, with little BNSF traffic and a lot of SP traffic on the line, they shut it down at both ends for heavy repair work. That may have been smart and well-timed for BNSF, but it was crippling for SP. Trains could not get out of Englewood to the east, and when trains cannot get out of Englewood, it gridlocks. Duffy V.S., p. 16. Virtually all the SP relief yards that had been available in 1978, except Eagle Lake and Beaumont, were gone or sold to BNSF.

UP managers did make two acknowledged errors during that period, both of them reversed within two weeks. They tried to reduce activity at Dayton Yard. The goal was to address the growing congestion on the Sunset Route east of Houston by reducing the number of trains switching at Dayton. This shifted cars into Englewood. The other error was to reduce switching at Strang Yard in an effort to avoid double-switching of more than 150 cars per day. This shifted more cars into Englewood too, and Englewood could not handle them. Those decisions were quickly reversed.

The UP/SP merger process did not, however, result in massive dismissal of experienced SP operating officers, as many have alleged. UP and SP managers worked jointly to identify the best officers from both companies, and they kept the overwhelming majority of SP's Houston-area managers in that process. Only six managers were not offered jobs in the Houston area, five from SP and one from UP. SP's senior manager in the Houston area recommended those selections based on his personnel assessments. Duffy V.S., p. 18.

Some might say, with 20-20 hindsight, that UP and SP operating planners should have "gamed out" how losing the east end of the Sunset Route to BNSF could interact with other factors to throw SP into crisis. But no one at UP or SP had reason to expect that BNSF would move very quickly to virtually rebuild the line, and that, with the effects of this interacting with other stresses, SP would fall into a severe congestion spiral in Houston. Id., p. 16. Had UP and SP fully anticipated all those developments, they would have negotiated a different settlement agreement with BNSF.

It bears repeating that the merger was *not* in any practical way implemented when the service crisis began. Because labor implementing agreements had not been reached, UP and SP operated essentially as separate railroads throughout the Gulf Coast region until late fall. By then the service crisis was deeply entrenched.

There is no connection between any arguable concentration of market power and the SP service meltdown of

1997. This was an operational crisis, caused by operating factors, decisions and incidents. The only way in which competition played a causal role was in BNSF's actions -- the actions of a powerful and effective competitor looking out for its own best interests. That was not an <u>absence</u> of competition, but if anything an excess of it. And BNSF, not UP, won that competitive battle.

UP/SP management may have been unlucky. It may have been foolish. It may have been "arrogant," as so many claim. Or it may have done the very best anyone could under the circumstances. Most likely, it did the best it could, made some mistakes, and got a lot of things right. But none of these alternative verdicts implicates any use of market power derived from the merger. UP/SP had no opportunity to wield any market power created by the merger because it acquired none. The mere fact that it did not turn over all of its exclusively-served business to competitors is not an exercise of merger-related market power, because those shippers would have been exclusively served with or without the merger.

In late 1997 and early 1998, UP/SP began to implement the merger in the Gulf Coast area. Duffy V.S., p. 16. It did this at the worst possible time, in the midst of a crisis. While implementation did have some initial negative effects on service, it was ultimately curative. UP/SP had no choice but to move forward with merger implementation. It knew then -- and history shows it was correct -- that the only sure and reasonably swift way out of the service crisis was to obtain the benefits of the merger as quickly as possible. Id. at 19. Merger implementation explains why this crisis ended in less than a year, while "World War III" continued for two years.

Implementing the UP/SP merger in the Gulf Coast area consisted of three primary transitions, all of which were essential. First, UP/SP had to obtain labor implementing agreements with labor unions so that the two operations could be combined. Second, it had to migrate SP employees and operations to UP's TCS and other computer systems and teach them how to use them. Third, it had to implement directional running and yard specialization throughout the corridor between East St. Louis and Texas. Id.

Each of these steps themselves caused interim disruptions. That is why UP/SP service seemed to recover, then fall back again. Id. UP/SP would take one step, suffer the consequences, then begin to recover just in time to take the next essential step.

Putting the labor implementing agreements into effect had short-term consequences. In the midst of severe congestion, train crews and engineers had to learn new territories and routes. The crew management system had to be modified to accommodate all the necessary changes.

TCS implementation in December was a painful process. UP/SP mounted an enormous training effort, but as with any major change in computer software, one does not learn it until he or she uses it. Even with a great deal of help after the cutover, that took time.

Then came the biggest and most disruptive change of all, the move to directional operations across a thousand miles of railroad. No railroad had ever attempted an operating change like this before. Id. It may well have been the most extensive change in rail operations in American rail history.

For two months, UP/SP worked to get directional running right. Every blocking assignment had to be changed. Yard functions changed. The entire transportation plan changed. Train crews again had to learn new routes on a railroad most had never seen before. And UP/SP did all of this under heavy traffic, in the midst of severe congestion. Id.

But it worked, spectacularly. UP is still working to perfect directional running. It is still finding opportunities to trim transit times, identifying locations where capacity should be added, and tailoring blocking assignments and train operations to new traffic patterns. But undeniably directional running gelled this March and early April, and UP began accelerating its way out of the worst crisis in its history. Trains are moving like cars on a divided highway, almost never waiting for or even seeing a train coming the other way. Duplicate blocks and trains have been eliminated at Pine Bluff and North Little Rock, and both yards are making trains and blocks for new destinations, bypassing en route switching. These are the exact benefits of directional running that we described in detail in the UP/SP Operating Plan before this merger was approved.

UP and SP knew that directional running would provide great benefits. They did not know that it would rescue the railroad's operations in the Gulf Coast region.

In Houston, critically, Englewood Yard finally has a role it can play reliably and consistently. Englewood was built long ago, in an era when trains were not as long as they are today. It is not a good yard for building a long train. All the departure tracks are split in half by a cross-cutting access track (the "puzzle" track), so combining the two pieces of a long train blocks access to other departure tracks and makes it hard to build a second or third train. Englewood builds very few trains now. Instead, it switches inbound trains into smaller groups of cars for delivery to industry and other railroads in Houston. It makes only three road trains per day. Duffy V.S., p. 16. That is why it works so well now.

The service crisis is over in the Gulf Coast area because UP implemented the SP merger. No other factor can explain the end of the crisis, and no one has even hinted at an alternative explanation. Traffic levels are still high. Houston's track network still looks much as it did in 1980, although UP is building new infrastructure that SP could never have afforded and upgrading tracks in ways SP never experienced. Management has not changed appreciably. The difference is the merger, and especially directional operation of UP and SP tracks and yards.

UP is now poised to return to the task it set for itself when the merger was approved: to exploit the service and efficiency opportunities inherent in the merger. Operations in the Gulf Coast area have been stable for several months. Service quality and deliveries to customers are accelerating. For example, UP is exceeding Coleto Creek's coal requirements this month for the first time since the merger, and it moved more Cemex rock cars last month than in any month in at least 3½ years. Those are only examples. As UP completes a summer of record-breaking capital investment in the Central Corridor, equivalent to almost four years of capital work, it will achieve more and more of the real benefits of this merger.

This service crisis has been a dark period in UP's history. Like its customers, UP has paid dearly. But the crisis is over, and the merger deserves the credit for this good news.

C. UP's Solid Service Recovery in the Houston/Gulf Area

On July 31, 1998, the Board declared the service emergency in Houston over and declined to permit the continued diversion of UP traffic to BNSF and Tex Mex under its emergency service order. The Houston area remains fluid and UP service has continued to improve. All indicators of service reflect vast improvement since the height of the service crisis. The majority of these indicators have returned to pre-crisis levels, and many are outperforming even that baseline.

UP's stable and even improved service in the Gulf Coast area over the last two weeks is particularly noteworthy. UP recognizes that shippers have every reason to remain nervous about whether the improvements they have seen will continue. This month, however, UP has weathered the types of incidents that would have caused SP service through Houston to deteriorate for a lengthy period of time. Ongerth V.S., pp. 13-14. As the newspapers have reported, the long Texas drought ended with torrential rains that washed out the SP Sunset Route for miles around Del Rio, Texas, and shut down the Laredo gateway. Then another more recent tropical storm last weekend flooded Englewood Yard, Galveston and several petrochemical plants. Instead of providing reasons for serious congestion, however, these incidents passed with only brief delays.

Mr. Duffy's verified statement provides details support these conclusions:

- Transit times from the Houston/Gulf Coast area to the midcontinent gateways have improved by at least 35% in most corridors, and in some cases by 50% or more. Transit times generally match or are better than pre-crisis levels for every individual shipper that has requested conditions in this proceeding, which includes Dow, DuPont, Formosa, Shell and Central Power and Light. Id., pp. 4-9.

Transit times to and from California have been adversely affected by congestion in the West since late June, attributable largely to the learning curve following the TCS cutover on SP in the West, but UP has weathered that problem as well. On the Sunset Route to California, train speeds have more than doubled and trains held have declined from dozens to none, one or two per day. UP has held no trains on this line for the last three days. Transit times will improve quickly as a result. Id., p. 3.

- Switching of individual Gulf Coast customers remains consistent and as timely as before the crisis. Since the first week in June, the large group of customers that UP tracks has received requested switches more than 96% of the time, and UP has been switching within the required period of time at the same level of consistency. Id., pp. 9-10.

- As of one week ago, UP car inventory in Texas and Louisiana was 95,301, some 15,000 cars fewer than the high reached last September. This figure is below UP's internal target for "normal" conditions. It includes some 2,000 surplus tank cars that Gulf Coast chemical customers are storing on UP lines, and up to 6,700 loaded SIT cars. Id., pp. 10-11.

- All mainlines in the Houston and Gulf Coast area are fluid, with only 17 sidings blocked on all lines south of Kansas City on Tuesday. This is down from 136 during the worst point of the service crisis, and it is again below UP's internal target for "normal." Id., p. 11.

- The total number of trains held south of Kansas City has declined 87% as of Tuesday. The number of trains held for power is down 70% and trains held for crews are down by 80% systemwide. (Regional measurements of train held are not available.) Id., p. 12.

- Average train speeds are up by at least 65% on every major corridor emanating from Houston. Directionally-operated lines have registered increases in speed of well over 100%, including the former SSW line between Dexter Junction, Missouri and Memphis on the north and Pine Bluff on the south, on which average train speed has increased by more than 250%

since February 1. Velocity on bidirectional lines has also increased by impressive percentages. On the line between Houston and Laredo via San Antonio and Smithville that includes most of the rock- and cement-producing territory, train speed is up by 145% since March. Id., pp. 12-13.

- Houston and Gulf Coast yards are fluid. Dwell time at every major yard except Settegast is down by at least 30%, and there are now generally fewer than a total of 10 trains held for all of these yards on any given day. For two days in August no trains were held at any of the yards. Id., pp. 13-14.

- UP's systemwide safety statistics reflect enormous improvement over last year, which was UP's safest by every measure except the tragic fatalities that received so much attention. FRA reportable injuries are down 17% for the first eight months of this year from the comparable period last year. For the Southern Region, reportable injuries are down by 27.6% in January through August 1998 compared to the same period in 1997; lost-day cases are down 27%, and grade crossing accidents and injuries are down by 33%. Highway-rail grade-crossing incidents are down 19%, and the number of lost work days is down 20%. UP has a more extensive hazardous materials training program than any other railroad, and during the first six months of this year, UP trained nearly 14,000 employees and over 4,000 non-employees on how to deal with hazardous materials. Id., p. 14.

- Thus far in 1998, UP has hired, or is in the process of hiring 209 new employees in its Transportation Department the Houston area. Throughout all of Texas and Louisiana, UP has hired or is in the process of hiring over 820 new Transportation Department employees, and over 270 new mechanical and engineering employees. Id., pp. 15-16.

III. THE PROPOSED CONDITIONS ARE NOT TAILORED TO ADDRESS ANY HARM CAUSED BY THE MERGER

Before turning to a separate discussion of each condition, we pause to consider in general terms whether these condition proposals meet the time-honored test of narrow tailoring to address specific harms caused by a merger.

It is clear that these proposed conditions are not aimed at undoing any discrete creation of additional market power that was overlooked in the merger decision and led to a service crisis. Rather, they further parochial agendas and opportunistic goals that have nothing to do with any harm caused by the merger, or even with addressing service problems.

BNSF demands a long list of new and better routes, including a single-line route to Laredo. The Laredo proposal plainly has nothing to do with correcting any merger-caused loss of competition: there was one single-line and one joint-line alternative at Laredo before the merger, and the same is true post-merger (though the Board elected to give Tex Mex not only a BNSF connection but a KCS connection as well).

BNSF's other proposals are largely requests for better routes than what BNSF negotiated in its settlement agreement and swore during the merger case was fully sufficient to preserve pre-merger competition. BNSF's suggested test for the so-called "structural" changes is whether they would increase its competitiveness. But this test would justify <u>any</u> additional rights at UP's expense: BNSF can always be made even more competitive by granting it more use of UP's assets. What BNSF consistently fails to ask is whether any of these rights are necessary to preserve the <u>pre-merger</u> level of competition. As we show in Part IV, they are not; each would <u>add to</u>, not preserve, pre-merger competition.

BNSF expressly maintains that if congestion negatively affected its trackage rights operations, it should receive additional "structural" rights to offset such impacts, <u>even if UP's operations were equally affected</u>. Rickershauser V.S., p. 4; Kalt V.S., pp. 8-9. In other words, BNSF should be placed at a greater relative advantage to UP. This is clearly incorrect. It goes beyond preserving pre-merger competition between two carriers, and instead places the focus on preserving and enhancing BNSF's absolute level of competitiveness at all costs. All of these requests are now moot in light of the conclusion of the service emergency, but even if there were still congestion in Texas BNSF's theory would be invalid.

BNSF also strays away from even the aim of improving service in Houston. It is quite mistaken in its suggestions that its proposed conditions would take traffic out of the Houston terminal. Application, p. 4 ("In BNSF's view, the Board should act to allow permanent reroutes of Western traffic to avoid Houston, where possible to do so"), 7, 12, 13, 26; Rickershauser V.S., pp. 7, 12, 37 (BNSF proposals "designed to divert traffic away from Houston"); Hord V.S., p. 2. The BNSF conditions would in fact do nothing to advance this laudable goal. UP's Executive Vice President Operations, Dennis Duffy, explains that those conditions, if granted, would not affect the number of cars moving through the Houston terminal. Duffy V.S., p. 22. His testimony is summarized in the following table:

Condition	**Impact on Houston Terminal**
San Antonio-Laredo rights	None. Diverts traffic from UP and Tex Mex to BNSF through Central Texas; might reduce a few cars on Algoa Line.
Caldwell-Flatonia-San Antonio rights	None. Affects routes between Temple and San Antonio only.
Caldwell-Flatonia-Placedo rights	None. Would reduce traffic on Algoa Line.
Harlingen-Brownsville rights	None. Hundreds of miles south of Houston.

Condition	Impact on Houston Terminal
"Neutral switching supervision"	None. Would not affect traffic flows.
Taylor-Milano rights	None. 100 miles northwest of Houston; Houston traffic would use same route to Houston whether or not granted.
PTRA operation of Clinton Branch	None. Would not affect traffic flows.
Directional rights on UP lines	None. Houston routes already directional.
Transfer UP dispatching to Spring	None. Would not affect traffic flows.
Rights to use all routes in Houston	None. May affect routes through Houston, but not traffic volume through Houston.

The heart of the KCS/Tex Mex plan is "open access" in virtually the entire Houston terminal. KCS/Tex Mex openly admit that this goes far beyond maintaining pre-merger competition. Based on the huge revenues that they would reap from this new access, they then add proposals to further expand the KCS/Tex Mex system through forced sales of UP lines and yards.

This scheme for "open access" and the establishment of KCS/Tex Mex as a third major rail competitor across the Gulf Coast represents a renewal, under only the thinnest veneer of any connection to the Houston service problems, of the proposals of RCT, KCS/Tex Mex, SPI and -- when it originally entered the merger case, before it settled with the applicants -- CMA. These proposals were rejected in the merger case as plainly not tailored to any anticompetitive effect of the merger, and they should be rejected for the same reason here. The identical analysis applies to the "open access" proposals of Dow, Formosa and CP&L.

The reason that such overreaching proposals are rejected in merger proceedings is especially and acutely relevant here: they sap the benefits of the merger without any proper ground in protecting the public interest. Here, the very real consequence of granting such proposals would be to undermine the central public interest objective that led the Board to approve the merger: to rescue a weak and declining SP and create a worthy and evenly-matched competitor for a powerful BNSF system.

As Mr. Peterson explains in his verified statement, UP has suffered net losses totalling $230 million (railroad level) in the last three quarters, while BNSF was reaping $759 million of net income. In 1997 and the first half of 1998, UP incurred some $1.1 billion in additional costs related to the service crisis. UP's systemwide traffic has declined by almost 10%, while BNSF's has increased by a similar amount. UP's operating ratio has been above 100, while BNSF's has been dropping into the low 70s. This cannot continue if there is to be balanced, strong railroad competition in the Western

United States. To impose conditions that would exacerbate this imbalance would be precisely the wrong step, and could fundamentally undermine the core rationale for the merger.

Mr. Peterson explains that the conditions that have been proposed in this proceeding would expose, in total, more than $769 million per year of UP revenue to new or additional rail competition. BNSF's Laredo proposal alone would expose some $350 million in UP Laredo business to a second single-line route that did not exist before the merger. The KCS/Tex Mex, Dow, Formosa and CP&L access proposals would create new or additional rail competition for $419 million per year in UP traffic.

UP did not attempt to determine precisely what percentage of this traffic would be lost if the proposed conditions were granted, but the losses clearly would be substantial. Losses of this magnitude, at a time when UP is struggling to return to profitability (and also faces a CN-IC-KCS Alliance and merger plan that its proponents project as costing UP another $165 million per year), would do grave damage to UP's ability to invest in needed infrastructure in the Gulf Coast area and to continue its service recovery and improvement efforts systemwide.

This is a central reason why hundreds of shippers, railroads and public officials oppose the proposed conditions. For example, APL, UP's largest customer, "considers these proposed new conditions to be a major threat to UP's ability to make the necessary investments in its service and infrastructure throughout the Western United States." APL testifies that depleting "the core financial and traffic resources of UP is a bad idea that would strike particularly hard at intermodal shippers," which are "highly dependent on railroads' ability to make heavy, ongoing investments in the quality of their rail service." Similarly, Zeneca Ag Products states that if the "requested conditions are imposed, UP will not earn the revenues it needs to improve its infrastructure." Many other UP customers, both in the Houston/Gulf area and all across the West, express similar concerns.

IV. REVIEW OF EACH PROPOSED CONDITION

In the following pages, we review each proposed condition. We supplement the points made above with a discussion of the specific arguments made in favor of the particular condition by its proponents, and in many cases we highlight additional negative impacts that the particular condition would have.

A. BNSF

1. San Antonio-Laredo Rights

BNSF's request for trackage rights over UP's line between San Antonio and Laredo lacks any competitive justification. In the merger case, BNSF received access to the Laredo gateway via a new connection with Tex Mex at

Robstown/Corpus Christi in order to replace the competition that SP had provided at Laredo via a similar connection. BNSF vigorously defended the adequacy of those rights as amply preserving competition at Laredo.

BNSF's connection with Tex Mex has achieved the Board's objective of preserving Tex Mex as a strong competitive alternative to UP at Laredo. New BNSF-Tex Mex interline traffic has more than offset Tex Mex's loss of SP traffic as a result of the merger. With Tex Mex's further gains of substantial volumes of KCS interline traffic as a result of Tex Mex's trackage rights to Beaumont, competition at Laredo has not only been preserved but strengthened.

BNSF argues that unforeseen developments have prevented it from exploiting as fully as it would like its access via Tex Mex to Laredo. In advancing this argument, BNSF posits a standard that would support the award of new conditions whenever an applicant could show that its own competitiveness could be enhanced. Whether maximum competitiveness of other railroads has been achieved, however, is not the test for adding burdensome conditions to a rail merger. This would quickly lead to the destruction of the benefits that propel public interest mergers. Rather, the test is whether pre-merger levels of competition have been preserved, and it is clear that none of the developments BNSF speaks of has caused to any diminution in competition relative to the pre-merger period. There is no basis for BNSF's overreaching request for a direct access to Laredo that SP never had.

BNSF first points to the Board's grant of trackage rights to Tex Mex, coupled with Tex Mex's subservience to its 49% owner KCS, as having diluted Tex Mex's incentives to work with BNSF as cooperatively as BNSF would like, thereby assertedly undermining BNSF's ability to compete for Laredo traffic. Application, Rickershauser V.S., pp. 31-33. BNSF may well be correct that Tex Mex's own trackage rights, and the link with KCS that those rights established, have diverted the focus of Tex Mex's competitive efforts toward KCS and away from BNSF. But the irrefutable fact remains that BNSF's connection with Tex Mex at Corpus Christi/Robstown, whether or not supplemented with Tex Mex's KCS traffic, has fully preserved pre-merger levels of competition at Laredo, even if it has not enriched BNSF as much as it might prefer.

To the extent the Board may be concerned that the KCS-Tex Mex relationship has encouraged unproductive disputes between BNSF and Tex Mex over divisions and unnecessarily interfered with the closeness of Tex Mex's cooperation with BNSF, BNSF's proposed remedy is vast overkill, and entirely unnecessary. The Board has ample authority to bring about a resolution of disputes between BNSF and Tex Mex by modifying the merger conditions that the two railroads received, just as it has resolved disputes between BNSF and UP over the scope of particular conditions. (The matter might also be addressed through conditions in a KCS-Tex Mex common control proceeding. It is remarkable that KCS and Tex Mex have not applied for Board approval of their intimate relationship, which appears to bear far more indicia of common control than led UP and CNW to seek common control authority in 1993.) The Board could require that BNSF and Tex Mex resolve their divisions dispute through "baseball" arbitration, or by requiring disputed issues to be presented for resolution by the Board itself following a period of Board-mandated further negotiations. Barber V.S., pp. 76-77. Indeed, BNSF itself proposes that the Board impose such a requirement instead of its obviously overreaching grant of San Antonio-Laredo trackage rights. Application, p. 15.

Alternatively, eliminating Tex Mex's unnecessary Beaumont trackage rights would address the issue in a much more narrowly tailored fashion than a grant of direct access to Laredo for BNSF.

BNSF's other purported justifications for its rights are equally insubstantial. Contrary to BNSF's assertions (Application, p. 15), accessing its connection with Tex Mex at Corpus Christi/Robstown does not require BNSF to route its trains through the Houston terminal. BNSF's primary route bypasses Houston via BNSF's Caldwell-Sealy-Algoa line. And

BNSF's route has been proven not to be an impediment to its ability to more than replace SP as Tex Mex's partner in competition with UP for traffic moving via Laredo.

Nor has the service crisis -- much less any supposed UP "favoritism" to its own trains -- had any adverse impact on BNSF's ability to compete for traffic moving via Laredo. Again, the results of BNSF's competition speak for themselves.

BNSF makes no effort to connect its assertions to any market power supposedly created by the merger. And it even fails to establish any coherent relationship between its "service" concerns and the relief it requests. If BNSF's request for direct access to Laredo were granted, BNSF's trains would not avoid the need to operate over UP lines. Instead, BNSF trains would become more "dependent" on trackage rights over UP.

Nor do BNSF's assertions about an unforeseen "lack of direct competition in the privatized Mexican rail system" (Application, p. 15, Rickershauser V.S., pp. 33-34, & Kalt V.S., pp. 18-20) have anything to do with the competitive effects of the merger. BNSF contends that competition within Mexico between Ferromex (which serves the Eagle Pass gateway) and TFM (which serves Laredo) -- both created after the UP/SP merger out of the government-owned railroad monopoly -- has not turned out to be as robust as expected.

But the pro-competitive effects of the UP/SP merger did not rest on increases in competition between Mexican gateways such as were expected from Mexican privatization. The merger strengthened competition within the United States at all of the Eastern Mexico gateways. Peterson V.S., pp. 5-12. Absent the UP/SP merger, SP would have served Eagle Pass and Brownsville directly and Laredo indirectly via its connection with Tex Mex, just as BNSF does today. By substituting BNSF for SP for Brownsville and Laredo traffic, and enhancing BNSF's rights at Eagle Pass, the merger unambiguously strengthened competition within the United States, whatever the degree of competition south of the border.

The relevance of inter-gateway competition is quite the opposite of what BNSF claims. The real significance of this issue lies in the anticompetitive impact that BNSF's proposed condition would have.

Ferromex testifies that, far from fostering inter-gateway competition between Ferromex and TFM within Mexico, BNSF's proposed rights would damage that competition. The shift of BNSF Eagle Pass traffic to Laredo which BNSF acknowledges would occur would impede Ferromex's efforts to develop into a strong competitive alternative to TFM within Mexico for rail traffic between central Mexico and the eastern and central United States. Ferromex's early efforts to compete against TFM were hampered by its late start-up of operations relative to TFM and labor difficulties that required it to shut down operations for a brief period. Ferromex, p. 3. Nevertheless, Ferromex has been gaining momentum and is increasingly able to provide meaningful competition against TFM of the sort that would have been impossible under the previous state-owned FNM monopoly. Id.

Ferromex has been working closely with UP and BNSF to add infrastructure at Eagle Pass and improve the efficiency of border crossing processes there. It has also been investing heavily to improve the condition of its line to Eagle Pass. Ferromex has taken these steps in order to improve its ability to compete against TFM for international traffic, and so fulfill one of the principal objectives of its creation by the Mexican government. Ferromex, pp. 3-5; Norman V.S., pp. 22-23.[21]

This blossoming competition within Mexico is valuable to shippers throughout North America, and should not be undermined by improvident Board action. BNSF's proposal for direct access to Laredo would have exactly that effect.

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[21] BNSF is not unfairly disadvantaged by a cap on its train volumes at Eagle Pass. See Application, Rickershauser V.S., p. 31 n.6. Earlier this year, when Eagle Pass was experiencing congestion due to inadequate infrastructure, the three railroads serving Eagle Pass mutually agreed to establish volume limits to avoid the gridlock that plagued Laredo. Now that the service problems are over, the volume limits are no longer in place. Norman V.S., p. 22 n.7.

BNSF says that it would strip Ferromex of all of the grain traffic it handles via Eagle Pass. Application, Hord V.S., p. 24. Ferromex fears that these diversions would be just the beginning, and would extend to BNSF's other Eagle Pass traffic. Ferromex, p. 5. BNSF would have a reduced incentive to work with Ferromex to improve the efficiency of the infrastructure and gateway processes at Eagle Pass. Ferromex's focus -- and investment spending -- would be redirected away from Eagle Pass and toward other traffic opportunities within Mexico. Ferromex, pp. 5-6.[22/]

BNSF's proposed trackage rights operations between San Antonio and Laredo would also have adverse operating consequences. BNSF's use of its rights would add train movements to lines that lack sufficient capacity to handle them. BNSF trains would create congestion from north of San Antonio all the way to the Mexican border, and beyond into Mexico. BNSF's plan would produce a further concentration of international traffic at Laredo, where facilities there are already straining under the weight of existing traffic volumes. There is a real risk that BNSF's proposed operations could trigger a repetition of the severe congestion that was

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[22/] Diversions of traffic from Ferromex are likely to be even more damaging in light of the recent formation of the CN/IC/KCS "Alliance," which will further strengthen the KCS-Tex Mex-TFM "NAFTA Railway" via Laredo. Ferromex, p. 6.

experienced at Laredo this spring and led UP to impose a partial embargo on UP traffic destined for Laredo.

As Mr. Norman explains, BNSF's proposed operations would increase the number of train movements on already-crowded lines between San Antonio and Laredo in several ways:

- BNSF would shift its grain -- and possibly other -- traffic from the Eagle Pass gateway, thereby adding, on BNSF's own estimate, one additional train every other day in each direction to UP's San Antonio-Laredo line and the Laredo border crossing. Application, Hord V.S., p. 24; see also Norman V.S., pp. 8-9; Ferromex, p. 5.

- BNSF would shift, again on its own estimate, 90% of the Laredo traffic it now interlines with Tex Mex at Corpus Christi/Robstown to its new direct route. This would add two to four trains per day to the UP route between San Antonio and Laredo. Shifting this traffic from Tex Mex's line would also increase the number of train movements at the border crossing. TFM and Tex Mex would no longer be able to combine BNSF-Tex Mex traffic with other Tex Mex traffic for handling at Laredo. The result would be to multiply the number of separate blocks that had to traverse the bridge. Norman V.S., pp. 9-10.

- BNSF plans to market new intermodal and automotive services via a direct UP route to Laredo. E.g., Application, Brown V.S., pp. 4-6. To be commercially viable, such operations would require dedicated train service, in addition to BNSF's planned grain and general merchandise trains. UP would not cede the market to BNSF, and would continue its own intermodal and automotive trains on the line as well.[23] BNSF's new train services would thus be in addition to existing UP operations. Norman V.S., p. 9.

BNSF would contribute to congestion and operating inefficiencies in additional ways, quite apart from adding train movements to the UP line. At Laredo, taking full advantage of the limited crossing capacity of the International Bridge requires close coordination among the railroads on both sides of the border. The need to coordinate the operations of two U.S. carriers -- UP and Tex Mex -- already makes it very difficult to achieve the number of border crossings during each six-hour directional operating window that is essential to accommodate existing traffic volumes. Adding a third carrier north of the border would multiply the communications interfaces and further complicate Laredo border-crossing operations, effectively reducing the gateway's throughput capacity at a time when more, not less, capacity is sorely needed. Similarly, the addition of a second carrier sharing UP's San Antonio-Laredo line would complicate UP's efforts to squeeze maximum capacity out its

[23] BNSF agrees that it would not garner all of this business. _See_ Application, Brown V.S., pp. 4-5.

existing infrastructure on this busy single-track line, which already lacks sufficient capacity to sustain existing traffic volumes without delays. Norman V.S., pp. 8, 20.

As a result of these effects, BNSF operations between San Antonio and Laredo would significantly increase congestion on lines that are already in need of capacity expansion just to handle current traffic, and will have to be expanded further to cope with expected future growth in rail traffic between the United States and Mexico. As Mr. Norman explains:

- North of San Antonio, the lines BNSF would use to access its new San Antonio-Laredo single-track route are heavily-used and lack sufficient capacity to handle additional BNSF movements without adding significantly to existing levels of train delay. Additional BNSF trains on UP's Austin Subdivision -- which is already overburdened by UP's freight operations, especially with growing Mexican traffic and rock trains -- would have severe consequences for the fluidity of mainline operations. Norman V.S., pp. 10-13; Handley V.S., p. 45. And using the Flatonia route for six more trains per day would exceed its capacity.

- At the San Antonio terminal (through which Amtrak operates two trains each way, the Sunset and Texas Eagle), BNSF's new trains would similarly cause interference with existing operations. BNSF trains would add to congestion at several operating bottlenecks in San Antonio, delaying other trains and blocking the sidings needed to maintain fluid operations. If BNSF trains used UP's Austin Subdivision route north of San Antonio, they would have to operate through UP's SoSan yard, robbing UP of capacity needed to stage traffic awaiting movement to Laredo and interfering with UP's ability to conduct efficient yard operations. Norman V.S., pp. 10-13.

- Between San Antonio and Laredo, there is no room for additional trains on UP's 156-mile, single-track mainline. That line is only partially signalled and has only five widely-spaced sidings, which are often pressed into use to stage trains destined for Mexico because of the vagaries of the border crossing process. Even under ideal operating conditions, this line cannot handle existing levels of traffic without delay. UP is adding CTC to this line and investing in a new siding at Moore, Texas, but the additional capacity created by those improvements will not suffice even to catch up with recent traffic growth, much less create room for BNSF's proposed new trains. Norman V.S., pp. 6-7, 15-17; see also Ex Parte No. 573, UP Report on Houston and Gulf Coast Infrastructure, May 1, 1998, pp. 44-45 ("Infrastructure Report"). The addition of BNSF's trains would be a major, unnecessary step backward, causing significant degradation in service on this line. Norman V.S., p. 14.

- At Laredo, the inherent inefficiencies associated with international border crossing processes and interchange with TFM place intensive demands on UP's existing infrastructure. Track capacity is needed to stage trains waiting to cross the border, to accept northbound deliveries from TFM, to classify northbound traffic, and to hold locomotive power for use on northbound trains. UP also operates an intermodal facility at Laredo. UP's existing facilities at Laredo are already at capacity, and UP is scrambling to find room to build additional staging tracks to accommodate its own southbound traffic. BNSF's operations would require similarly intensive use of facilities for these purposes, but there is no room for such facilities. UP's overtaxed facilities could not accommodate BNSF's new trains, and should not be required to. And there are few if any locations where BNSF could construct additional facilities of its own near enough to the border to permit efficient operations. BNSF's trains would thus create gridlock in an already-overburdened terminal. Norman V.S., pp. 6-7, 15-17.

- BNSF's operations would also impose new burdens at the Laredo bridge itself, where optimum use of the scarce available capacity is already essential in order to handle the flow of existing cross-border traffic. The bridge is a single-track bottleneck whose capacity is tightly constrained by the unique demands of the border crossing process. With the need for time-consuming government inspections, difficulties in coordinating operations among several railroads, and the inefficient layout and capacity limitations of rail facilities at the border, it is not uncommon for trains to require two hours or more to cross the bridge. This limits the number of movements that can be made across the border during each six-hour directional operating window. By adding to the number of trains and at the same time degrading the efficiency of the border crossing process, BNSF's operations would cause a significant deterioration in the ability of the gateway to handle existing traffic volumes. Norman V.S., pp. 6-7, 17-21.

- BNSF's suggestion that an operating window be set aside for its use and carved out of the UP and Tex Mex windows (Application, pp. 20-21) betrays a lack of understanding of Laredo operations. The establishment of more and shorter operating windows would mean more missed windows and fewer total trains crossed, and losses of capacity that could never be made up. Norman V.S., pp. 19, 21.

Recent experience provides a solemn reminder that the equilibrium of reasonably fluid operations that exists at the Laredo gateway is a fragile one. Because the capacity of the Laredo border crossing and the lines serving it is so tight, any disruption can quickly cause traffic to back up, leading to a spiral of further capacity reductions and further service deterioration, from which there is inadequate free capacity to recover without resorting to extreme measures. The circumstances that gave rise to UP's decision to impose a partial embargo of traffic moving via Laredo in March demonstrate why it is so important that unnecessary burdens not be placed on the infrastructure on this route. Norman V.S., pp. 21-22.

The three railroads that serve the border crossing at Laredo (UP, Tex Mex and TFM) have not been sitting on their hands in the face of the capacity limitations described above. To the contrary, each of them has been engaged in careful study and analysis of steps that could be taken to address capacity and operating conditions at this gateway. That process has led them to take, both individually and jointly, a number of actions to improve the ability of the gateway to handle existing levels of traffic efficiently, and begin to accommodate projected continuing growth in cross-border traffic.

As noted, UP is adding capacity on its lines at San Antonio and between San Antonio and Laredo. TFM is adding yard capacity in Nuevo Laredo. And Tex Mex is building a large new yard at Laredo. Norman V.S., pp. 4, 14, 16. In addition, these railroads are continuing to cooperate to improve the logistics of the border crossing process, for example by working with government agencies to reduce the delays incurred as a result of customs and agricultural inspections. Norman V.S., pp. 21-22.

But experience and careful analysis have shown that these improvements will not, as BNSF naively suggests (Application, Hord V.S., p. 25), be enough to accommodate the significantly increased burdens that BNSF's proposed operations would place on the Laredo gateway. The parties' efforts are designed to catch up with recent traffic growth that has left Laredo dangerously short of capacity. They will not result in any excess capacity that would permit BNSF's proposed new operations to be added without causing significant operating problems. Norman V.S., pp. 4-5, 22. Even with these planned improvements, more progress will be necessary to permit Laredo to handle the growing volumes of NAFTA trade.

BNSF may contend that it would not choose to operate over these rights if its operations would cause these problems, because its trains would suffer from congestion too. But BNSF would have strong incentives to do just that. It would achieve extraordinary commercial advantages by using the UP route to achieve direct access to Laredo. Such operations would save miles (and thus operating expense) and provide the opportunity to divert at least $100 million in revenues from UP. Application, Brown V.S., p. 4. These windfalls would impel BNSF to exercise its rights notwithstanding the likelihood that this would cause significant problems for the other railroads at the gateway, and for international trade. Norman V.S., pp. 5-6.

Finally, the adverse financial impact of BNSF's proposed trackage rights is another important reason why this condition request should be rejected. As its traffic witness points out, BNSF's direct access to Laredo would divert to BNSF substantial volumes of traffic currently handled by UP. BNSF witness Brown estimates that BNSF's new rights would divert to BNSF 77,473 carloads that would otherwise be handled by UP, for a revenue loss to UP of over $100 million. Application, Brown V.S., p. 4. The figure could well be much higher, since UP's total traffic at Laredo amounts to $350 million per year. UP should not be required to suffer such a very large financial impact, especially at a time when it needs to increase its revenues so that it can make further investments in capacity and service improvements and provide a real competitive check to BNSF. Peterson V.S., pp. 31-34.

2. Permanent, Bidirectional <u>Caldwell-Flatonia-San Antonio Rights</u>

For several months, UP has allowed BNSF to operate its trains between Temple, Texas, and San Antonio via Caldwell (where a BNSF line crosses the former SP transcontinental route) and Flatonia, Texas. <u>See</u> Handley Map. UP provided this accommodation because UP had not fully implemented directional running on its lines in Central Texas, resulting in heavy traffic on UP's former MKT line from Taylor through Smithville to San Marcos over which BNSF has trackage rights under the UP/BNSF settlement agreement. UP also provided these rights because BNSF's settlement agreement trackage rights use the Austin Subdivision between San Marcos and San Antonio, which UP has described as its most capacity-constrained segment. The Caldwell-Flatonia-San Antonio route avoided these lines.

UP is now in the process of moving to directional running in Central Texas, and has already begun rerouting some trains, increasing southbound traffic on the Flatonia route. Handley V.S., p. 45. It is also expanding capacity on the route BNSF negotiated in the settlement agreement. Late next month, it will reinstate service over 17 miles of second main track on the Austin Subdivision south of San Marcos. Between Smithville and San Marcos, UP will build a new siding at Rosanky, facilitating BNSF's rights. And it is constructing staging tracks at Laredo, which will handle much of the staging for Laredo crossing windows that takes place now between San Marcos and San Antonio. Id. As a result, the factors that caused UP to offer this voluntary accommodation to BNSF will be diminished.

There is no basis for a government-imposed condition allowing BNSF to continue to run trains via Flatonia. BNSF negotiated, and the Board reviewed and approved, trackage rights to San Antonio via Taylor, Smithville and San Marcos. BNSF was then and is now a sophisticated entity. It was not acting under compulsion. As Mr. Rebensdorf -- UP's principal negotiator -- explains, to obtain additional concessions such as trackage rights on UP's mainline via Flatonia, BNSF would have had to give UP something of value in return. Rebensdorf V.S., pp. 5-6.

BNSF can compete using the rights it received, as it said under oath to the Board. Id., p. 5. The negotiated route fully and completely preserved SP's pre-merger competition in Central Texas. BNSF should not now be allowed to renegotiate those rights under the self-serving pretense of addressing operating conditions in Houston, or on the basis of the tautological argument that an even better route would allow it to be an even more powerful competitor.

BNSF complains that UP's route via San Marcos is congested, and it is. Hord V.S., p. 4. This complaint is irrelevant, because UP is rerouting its trains in Central Texas to implement directional running, including moving more trains to the Caldwell-Flatonia-San Antonio route, and it will soon add capacity on BNSF's negotiated trackage rights route. UP will not move BNSF to that route until there is enough capacity. Handley V.S., p. 46. However, if BNSF remains dissatisfied with capacity and train speeds on that route, it is free under the settlement agreement to invest in more capacity, just as it would on its own trackage throughout the West. If, as is likely, UP were to make use of that additional investment, UP would share its cost.

BNSF also complains that the route it negotiated for itself has a weight limit of 268,000 pounds per car. Hord V.S., p. 4. It therefore wants access to UP routes with higher weight limits. Again, however, BNSF knew this when it agreed to rights via Smithville, and submitted them to the Board for approval. If it wants to upgrade that line to handle heavier loads, it is free to do so. UP estimates that the necessary improvements would cost about $7 million. Handley V.S., p. 46. That is a pittance compared to the revenue that BNSF gained from UP this year.

UP will voluntarily continue to provide BNSF temporary trackage rights via Flatonia as long as it believes that this is mutually desirable in light of capacity and operations on the track network in Central Texas. Id. But UP made this concession to advance operations by both railroads. When the concession is no longer mutually beneficial, UP should not be compelled to continue it. Id. There is no theory under which this condition is necessary to preserve pre-merger competition. UP is not, and should not be, in the business of making valuable unilateral concessions to its principal competitor. BNSF makes none to UP.[24]

The fact that this condition would indeed make BNSF somewhat more competitive is no reason to grant it. UP has a long list of operating rights that BNSF could give it, each of which would make UP more competitive. For example, UP would be more competitive with BNSF if it could use BNSF tracks between Denver and Sterling, Colorado, which would allow it to use a direct and relatively flat route between Denver and North Platte instead of the longer route via Cheyenne. But there is no more reason for the Board to grant that UP wish than there is for it to grant this BNSF one. Both may be in the public interest, but arrangements such as these should be

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[24] For example, BNSF has asserted a very restrictive interpretation of the trackage rights imposed in UP's favor between Superior, Nebraska, and Abilene, Kansas, as a condition to approval of the BN/Santa Fe merger. Finance Docket No. 32549, Burlington Northern, Inc., & Burlington Northern R.R. -- Control & Merger -- Atchison, Topeka & Santa Fe Ry., Decision No. 38, served Aug. 23, 1995, p. 84. The southern terminus of these rights is at a point about 1,000 feet north of the connection with UP's route heading south from Abilene. Notwithstanding the fact that UP has been operating north-south moves through Abilene for traffic moving to and from Superior since the BN/Santa Fe merger was approved, BNSF recently asserted that it will no longer allow this move and gave UP one year to construct a connection between the Superior trackage rights and UP's east-west Kansas Pacific line. While BNSF is technically correct that the trackage rights were described as ending just north of Abilene proper, this was clearly an oversight. BNSF's reading of the condition would completely undermine the utility of the rights and prevent competitive harm at a "2-to-1" point from being remedied -- notwithstanding that BNSF's witnesses in its own merger case told the Board the rights would remedy the problem.

negotiated. That is not, we should add, a hopeless dream. UP and BNSF are considering an agenda of concessions each might make to the other. Rebensdorf V.S., p. 7.

3. Permanent, Bidirectional Caldwell-Flatonia-Placedo Rights

BNSF's request to make permanent its temporary rights between Caldwell and Placedo via Flatonia (see Handley Map 6) is fundamentally indistinguishable from its request for Caldwell-Flatonia-San Antonio rights. During the BNSF-UP settlement negotiations, BNSF made the decision to reach Placedo -- a UP junction point en route to Corpus Christi, the Tex Mex interchange at Robstown and the Brownsville gateway to Mexico -- using its own Algoa Line and UP's Brownsville Subdivision. Handley V.S., p. 46. The route over which it now seeks trackage rights is more direct than the route it negotiated. To obtain rights over that route during the negotiations, BNSF would have had to give more to UP in exchange, but it did not. Rebensdorf V.S., p. 6. The Board should not improve only BNSF's side of this carefully negotiated settlement which was thoroughly scrutinized and approved in the merger case.

UP allows BNSF to use this route today because UP instituted directional running between Houston and Placedo in order to reduce congestion on the UP Brownsville Subdivision, which is the direct route between Houston and Placedo and the route over which BNSF negotiated trackage rights. UP has pledged to the Board that it will continue, voluntarily, to allow BNSF to use this route as long as UP employs directional running in this area. In the long run, however, UP plans to discontinue this directional operation, which is very expensive for UP and places undesirable constraints on UP service. It requires UP to operate southbound trains 70 extra miles between Houston and Placedo by way of Flatonia. It also prevents UP from running northbound trains directly from Placedo toward Ft. Worth and Little Rock, bypassing Houston. In order to discontinue the directional operation, UP plans to add an additional siding near Angleton, Texas, which will eliminate a bottleneck and give the Brownsville Subdivision sufficient capacity to handle trains in both directions. Handley V.S., p. 46.

This condition would do nothing to avoid congestion in Houston. When BNSF stops running trains through Flatonia to Placedo, it will route them over its own Algoa line via Rosenberg and Algoa. That line is more than a dozen miles southwest of the Houston terminal area, and it has never been viewed as a cause of the service problems. Duffy V.S., p. 22.

Nor is the BNSF condition needed to address any competitive effect of the UP/SP merger. BNSF told the Board in sworn testimony during the UP/SP merger that it could provide effective competition using the Algoa Line and its negotiated trackage rights. There is no reason to doubt the accuracy of that testimony.

This condition would make BNSF even more competitive, as BNSF claims. But, again, UP could also be more competitive if BNSF would grant UP additional rights. For example, UP would like trackage rights over BNSF's Algoa Line from Caldwell to Virginia Point (near Galveston), which really would take traffic out of Houston in favor of a bypass route. Id., p. 23. But all such rights should be negotiated privately, not federally imposed. There is no reason to give BNSF this additional competitive advantage when it has a fully competitive alternative that it negotiated at arms length.

4. Harlingen-Brownsville

BNSF requests two interrelated conditions that it says are intended to facilitate its implementation of trackage rights operations between Harlingen and Brownsville, Texas, in place of its existing service to Brownsville via UP-provided haulage. (The Board-approved settlement agreement expressly provided for haulage to Brownsville as an alternative to trackage rights. The only other location where this was provided was between Little Rock and Pine Bluff, Arkansas.) BNSF asks for (1) trackage rights between Harlingen and Brownsville via the former SP line between these points, in addition to the UP line where BNSF now has rights, on a temporary basis pending completion of a line relocation project, and (2) the permanent right to appoint BRGI as BNSF's agent to carry out its trackage rights operations between Harlingen and Brownsville. Application, p. 13. As a supposed predicate for this request, BNSF contends that UP's haulage services have been "erratic" and "often substantially delayed." Id.

BNSF makes no effort to connect these requests to any anticompetitive effect of the UP/SP merger, and there is no such relationship. As Mr. Peterson demonstrates, competition in Brownsville is as strong as it was before the merger. Peterson V.S., pp. 6-8.

Nor is there any merit to BNSF's contention that the rights are needed to overcome problems associated with "erratic" or "excessively delayed" haulage services provided by UP. As Mr. Norman explains, UP has provided BNSF with haulage services of the same quality as the service provided for UP's own traffic -- BNSF's cars are handled in the same trains, through the same local operations, as shipments in UP's own account. Norman V.S., p. 24. Moreover, although both railroads' service was equally affected by Gulf Coast congestion, operations are now back to normal in Brownsville, as they are elsewhere. Id.

UP does not dispute BNSF's right to commence its own trackage rights operations between Harlingen and Brownsville if it wishes. However, additional conditions are not necessary to permit such operations. BNSF argues that its ability to carry out trackage rights operations using its existing righ s is hampered by the fact that an ongoing rail bypass project has not yet been completed, making it "impossible" to serve both shippers at Brownsville and the Mexican gateway using only the UP route over which BNSF has trackage rights. Application, Rickershauser V.S., pp. 15-16. This assertion is meritless. UP trains handle both Brownsville and Mexican traffic using the same UP line on which BNSF has rights. Norman V.S., p. 24. Accordingly, there are no grounds for Board intervention.

Nevertheless, UP shares BNSF's interest in having BNSF's trackage rights operations performed efficiently and without causing undue interference with UP's own operations. Based on these considerations, UP has made a proposal to BNSF pursuant to which it would, on a voluntary, commercial basis, grant to BNSF most of the rights BNSF seeks from the Board. See Norman V.S., pp. 24-26, & Att.

Specifically, UP has proposed to grant BNSF trackage rights over the former-SP line on a temporary basis pending completion of the bypass connection between the UP line and the SP line, as BNSF has requested. Id. During this interim period, UP is also prepared to have BNSF operate its grain trains bound for Mexico directly to the TFM interchange at Brownsville via BNSF's existing trackage rights on the UP line, so long as BNSF takes reasonable steps to minimize the interference its trains might cause as a result of border-crossing delays. All other BNSF traffic would move over the SP line, again as BNSF has requested. Id. Finally, UP is willing to let BNSF appoint BRGI as its agent in the Brownsville terminal for the limited purposes of serving the Port, switching other local industry at Brownsville, and making interchange with UP in downtown Brownsville via the Port Lead. UP would transfer BNSF traffic between BRGI and TFM, in the same manner as BRGI-TFM traffic is handled today. See Norman V.S., p. 26.

Under UP's proposal, BNSF would cease operating over the SP line when the bypass connection is complete, so that UP could abandon a portion of the SP line that has no local industry, and BNSF would shift all of its trains to the UP line. This too is consistent with BNSF's proposal. BNSF acknowledges that it would be able to serve both Brownsville (via a connection with BRGI using the new bypass connection) and the Mexican border crossing efficiently via the UP route after the bypass has been completed. Application, Hord V.S., p. 11.

UP's proposal is a reasonable, and extraordinarily generous, accommodation of BNSF's concerns, and we urge BNSF to accept it. The only aspect of this BNSF condition request to which UP has declined to accede is the right of BNSF to appoint BRGI as its agent on a permanent basis between Harlingen and Brownsville. UP is willing to allow BNSF to appoint BRGI as its agent on a temporary basis to facilitate the handling of all of BNSF's non-unit-train traffic on the SP line, by allowing BRGI to move BNSF's cars over the Port Lead between BRGI's yard at the Port and downtown Brownsville. Norman V.S., pp. 25-26. Further agency operations would not serve any legitimate purpose. BNSF makes no attempt to justify this request, and it should be rejected on that basis alone.[25] BNSF's request plainly has no relationship to any effect of the UP/SP merger. SP would not have been able to use BRGI as its agent between Harlingen and Brownsville absent the merger, nor could UP do so consistent with its labor agreements. Norman V.S., p. 27.

The extensive agency relationship that BNSF proposes would entail potential operating problems. Allowing BRGI to carry out the interchange of some of BNSF's traffic with TFM would add a third carrier to the Brownsville & Matamoros Bridge, complicating border-crossing operations that already create a troublesome operational bottleneck. Norman V.S., pp. 26-27. Allowing BRGI to operate between Brownsville and Harlingen would also add a third carrier at Harlingen, complicating operations there. Id., p. 27.

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[25] Its witnesses simply assert BNSF's desire to have this right. Application, Rickershauser V.S., p. 17, & Hord V.S., p. 12.

5. "Neutral Switching Supervision"

BNSF asks for what it calls "neutral switching supervision" to control operations on the SP Baytown Branch east of Houston and on the Chaison and Sabine Branches south of Beaumont, Texas. BNSF claims that UP's handling of BNSF shipments on the Baytown Branch in haulage service "has been unacceptable," and that shipments "moving via haulage on the UP are often delayed." Hord V.S., p. 14. BNSF provides no data or concrete evidence to support these assertions. BNSF has not yet served any shippers on the Chaison or Sabine Branches, so it has no possible basis for complaints about UP performance on those routes.

BNSF's petition for a condition relating to the Chaison and Sabine Branches should be summarily dismissed. BNSF cannot assert any plausible claim that pre-merger competition has been inadequately preserved, because there was no competition on these branches before the merger. SP served them exclusively, and BNSF obtained access only as a result of the private agreement that UP entered into with it to induce it to join in the Spring dispatching center. _Any_ competition that BNSF provides on these branches is unrelated to the merger, and an expansion beyond pre-merger competition. The Board has no basis for acting on this request.

BNSF also fails to show any failure to preserve the extent of pre-merger competition on the Baytown Branch. That competition was very limited. BNSF was entitled to serve a few "2-to-1" shippers at Baytown, and it gained access to four chemical shippers at Eldon and Mont Belvieu that did not have competitive service but that were the targets of a planned UP build-in. To ensure competition, UP agreed to have these four facilities treated as "2-to-1" facilities.

The settlement agreement gave BNSF three options to serve any covered "2-to-1" shipper: direct service, reciprocal switching and an agency arrangement with a third party. Wilmoth V.S., p. 7. The haulage service that BNSF complains about was not one of those options; it was a UP accommodation to BNSF to help BNSF launch competitive service quickly. Id. BNSF has no right under the settlement agreement to haulage at all, let alone to a condition requiring that haulage be supervised in a particular way. This is more than looking a gift horse in the mouth; BNSF is shooting the horse. BNSF has not shown, or even attempted to show, that its unexercised rights under the settlement agreement do not more than preserve the pre-merger competitive situation.

UP has had considerable difficulty understanding the reasons for BNSF's Baytown Branch complaints or the nature or efficacy of the condition it seeks. UP data show that BNSF's haulage movements from the Baytown Branch experience transit times on UP that are comparable with those of UP shipments.

Wilmoth V.S., p. 8. It could hardly be otherwise, for the BNSF haulage shipments are handled in the <u>same trains</u> as the UP shipments. The BNSF shipments <u>cannot</u> receive inferior handling. Handley V.S., p. 48.

Mr. Handley's explanation of how this branch is operated demonstrates that BNSF shipments inevitably receive equal handling. The pattern of operation on this branch, as at most petrochemical facilities, is that the railroads bring in empty cars and pull out loaded shipments. As BNSF states, UP operates this branch on a directional basis, and all UP trains that pick up loaded shipments operate north on the branch, picking up traffic as they go. <u>Id.</u> The shippers on the branch mix the loaded cars for BNSF with those for UP, so the UP trains pick up cars for both railroads at the same time and without differentiation. <u>Id.</u> Many of the cars these trains pick up, whether for BNSF or UP road movement, are SIT cars that are going into the Sjolander SIT yard at Dayton.

When a UP train reaches the north end of the Baytown Branch at Dayton, the BNSF yard is on one side of the track and the Dayton SIT yard is on the other. <u>See</u> Handley Map. The UP train switches the BNSF cars into the BNSF yard and the SIT cars into the Dayton SIT yard at the same time. Then it takes the remaining cars, which are all UP cars, to UP's Dayton Yard, which is a short distance ahead. Handley V.S., p. 48. As this description shows, BNSF and UP cars are being handled together. In fact, the BNSF cars reach the BNSF yard a few minutes or longer (depending on traffic through Dayton) before the UP cars reach the UP yard. Both railroads run trains out of their yards to various destinations. UP is baffled at BNSF's complaints about physical operations that a "switching supervisor" could not affect. Id.

UP maintains data on transit times for BNSF cars in haulage service on this branch and transit times for UP cars on the branch. BNSF's cars achieve comparable or better transit times than UP's. For example, during the month of July, BNSF cars handled in haulage on the Baytown Branch to Dayton had an average transit time half a day faster than UP cars to Sjolander. Wilmoth V.S., p. 8. In August the transit time advantage was reversed. Id. BNSF complains that its service on this branch is not "competitive" (Hord V.S., p. 16), but it is clearly competitive with UP service.

It may be that BNSF's complaint is not about differential treatment of BNSF and UP shipments (BNSF does use the word "discrimination"), but instead about delays resulting from congestion and slow train movements on the branch. This is indeed a problem. Traffic has grown rapidly on this line, and SP did not have the funds to expand capacity. UP's 1999 capital investment budget includes installation of second main track on this line. Handley V.S., p. 48. Until that work is done, no railroad will be able to provide the quality of service that is really needed on the Baytown Branch. Id.

BNSF contributes significantly to the capacity problems on the branch. Id. BNSF's yard at the north end of the branch has only two tracks. BNSF is attempting to build three trains per day on these two tracks, which is not feasible. UP understands, and is pleased to learn, that BNSF intends to expand this yard by adding three more tracks. Even with those additional tracks, however, BNSF will continue to cause significant delays on the branch, because BNSF's yard does not have a yard lead on which BNSF can switch its traffic. As a result, BNSF's switching at Dayton blocks the Baytown Branch, causing major delays to UP trains. (The Sjolander facility across the tracks has a yard lead, preventing such interference.) Every delayed UP train, of course, is carrying BNSF traffic, so BNSF's switching is causing delays to BNSF's own shipments. One of the reasons BNSF's service is slow is that BNSF is blocking the only available track several times every day. Id., p. 49. BNSF needs to construct a yard lead, so that it can switch its yard without blocking the Baytown Branch, and the space is available to do that. Id.

UP is aware of two other problems with service on the Baytown Branch, but neither would be affected by "neutral switching supervision." On weekends, some shippers continue to release cars without billing instructions, giving UP no way of knowing whether the car is a BNSF car or a UP car. As most of the cars are UP cars and UP does not want to delay them by holding them, it takes them to Houston for distribution around the UP system. When the shipper later decides the car is a BNSF car, it may be delayed. Wilmoth V.S., pp. 8-9. The other problem, which affects UP and BNSF alike, is that UP generates incomplete computer records of car movements on this branch before the cars reach the BNSF or UP yard. UP is working to solve this problem. Id.

BNSF does not define what it means by "neutral switching supervision," and we are aware of no precedents for such an arrangement. BNSF does not explain what a neutral supervisor could possibly do to provide more efficient use of the line (although UP would certainly ask the supervisor to tell BNSF switch engines to stay off the mainline as much as possible). The result would simply be an additional layer of management and cost, with no apparent benefit. If BNSF believes that the branch can be operated more efficiently, it should tell UP how. In fact, UP has invited BNSF to explain to UP how BNSF thinks the line could be operated more efficiently.

6. Taylor-Milano Rights

BNSF's request for Taylor-Milano trackage rights is a blatant effort to improve its own operations at UP's expense, where BNSF's existing rights fully preserve pre-merger competition. As shown on Handley Map 7, this line segment is more than 100 miles from Houston. The requested trackage rights have nothing to do with any alleged UP "market power" in or around Houston or with improving service in the Houston area. BNSF merely wants to improve the trackage rights it negotiated in the settlement agreement with UP in order to handle traffic from the Georgetown Railroad at Kerr, Texas. Significantly, the Georgetown Railroad, which recognizes this condition as the grab that it is, opposes BNSF's request in a verified statement that is being filed with this submission.

From a competitive perspective, the condition is utterly unwarranted. The objective of the BNSF-UP settlement agreement was to replace competition that otherwise would have been lost because SP disappeared as a competitor. The route BNSF obtained in the settlement agreement did that. Peterson V.S., p. 23. Now, BNSF wants a second route to Houston and a much shorter route to end markets in the Silsbee-Beaumont area, where SP did not compete before the merger. Id.

BNSF is again attempting to renegotiate its settlement agreement, in direct contravention of its contractual undertaking not to do so. Rebensdorf V.S., pp. 2-3. This improved route would make BNSF a more effective competitor for Georgetown Railroad shipments. Similarly, though, UP would be a more effective competitor if BNSF granted UP rights over its line from Milano to Caldwell, Navasota and Rosenberg. Such exchanges should be negotiated, not compelled by the Board on a one-way basis.

These trackage rights would also place additional trains on the Taylor-Milano segment. While, at 34.3 miles, this is not a long track segment, it is near capacity. The BNSF trackage rights trains, which would be bidirectional, would add conflicting movements against UP's primarily directional flow of intermodal, automotive and manifest trains toward the northeast, creating unnecessary train delays and congestions. Handley V.S., p. 47. BNSF should stay on the routes it negotiated.

7. PTRA Operation of the Clinton Branch

Although BNSF does not endorse the wholesale expansion of PTRA proposed by KCS/Tex Mex (see Part IV.B.1, below), it supports PTRA switching on one segment of UP trackage, the Clinton Branch. See Handley Map 3. This branch runs about 6 miles from Galena Junction on SP's Galveston Line to Galena Park, with a spur to the Galena Park automobile unloading facility, where UP unloads Ford automobiles.

BNSF claims it wants PTRA to serve this branch because UP "discriminates" against BNSF grain trains to the Houston Public Elevator. UP moves BNSF's trains the length of the branch, accepting them at Gate 8, near the branch's west end. Handley V.S., p. 50. BNSF provides no data or evidence of this "discrimination," only bare assertions. In fact, BNSF does not even divulge what it is that UP is supposedly doing wrong.

BNSF's claim of "discrimination" in favor of UP grain trains and against BNSF grain trains does not withstand scrutiny. Every afternoon at 2:00 p.m., the Houston Public Elevator conducts a conference call with UP and BNSF operating personnel. During that call, the Elevator tells the railroads which trains it wants. Id. (The Port of Houston, which owns the Elevator, gave BNSF a letter in support of BNSF's condition, but the letter does not mention this arrangement.) It selects the trains it needs in order to load the next vessel calling at the Elevator. Id. If a UP (or a BNSF) train goes first, it is because the Port's elevator ordered the trains in that way. BNSF does not explain how PTRA switching would affect service.

There is an operating problem on this branch, but UP does not cause it. After a BNSF train is unloaded at the Elevator, UP moves the empty train back to Gate 8. BNSF is obligated to pick up that train and move it off of UP's tracks. BNSF frequently does not do this on a timely basis, blocking UP's limited track space for extended periods. Id., p. 50. The branch has little capacity, so little that UP plans to add trackage as part of its infrastructure plan for the Gulf Coast area. Infrastructure Report, p. 21. In addition, BNSF is supposed to leave its locomotives on its unit grain trains, but it sometimes does not do so, forcing UP to use its own locomotives to move the BNSF train to Gate 8. Id. If BNSF wants to improve service to the Elevator, it should devote the resources necessary to move its own trains.

UP is frankly concerned that BNSF's objective may be less to change service to the Houston Public Elevator than to take a first step toward possible "open access" to UP's Ford unloading center. Within the last year, UP successfully persuaded Ford Motor Company to allow it to deliver Ford autos to UP's exclusively-served Galena Park auto ramp, replacing BNSF service to Pearland, Texas. Handley V.S., p. 49. UP spent some $4 million to upgrade the former SP facility at Galena Park. We suggest that it is inevitable that if PTRA switched the Clinton Branch, without any immediate change in shipper access arrangements, BNSF would in due course seek access to this valuable body of exclusively-served UP traffic.

8. Directional Running Wherever UP Adopts Directional Running and BNSF Has Trackage Rights

BNSF seeks a condition requiring UP to grant BNSF expanded trackage rights wherever BNSF has trackage rights over a UP line that UP decides to use for directional operations. It appears that this condition would be unrestricted and apply systemwide, even though there is certainly no conceivable merger-related competitive justification for a condition on lines where BNSF has trackage rights not granted in the UP/SP merger.

There is no basis for imposing this condition by government action. UP has voluntarily provided BNSF with trackage rights for directional operations where they are mutually beneficial, which will often be the case. For example, UP voluntarily gave BNSF rights to run trains eastbound on UP's Beaumont Subdivision from Houston to Beaumont. It granted BNSF temporary rights to run southbound via Flatonia and Placedo while UP uses directional running between Houston and Placedo. And of course, UP agreed to give BNSF rights to operate northbound from Houston all the way to Memphis on a UP line where BNSF had not negotiated trackage rights in the original settlement agreement.

Further directional running rights should not be imposed by government fiat, though. They should be negotiated like any other trackage rights arrangement, because the circumstances of each situation are unique. Wilmoth V.S., pp. 9-10. Each directional operation should be addressed on its special merits by the parties involved. Government-imposed trackage rights for one party would eliminate the incentive to negotiate, and destroy the opportunity for the other carrier to cooperate in developing efficiency-enhancing benefits. Indeed, for reasons we will explain, if the Board grants

BNSF's proposed condition, UP may be forced to forgo the efficiency benefits of directional operations.

In some circumstances, it would very definitely be inequitable for one railroad to be forced to grant additional trackage rights to a competitor without obtaining compensating benefits from its competitor. BNSF chose an excellent example to illustrate this point. BNSF says that it should be given access over UP's busy, double-track mainline between Ft. Worth and Dallas if UP institutes directional operations between Waxahachie, Texas, and Ft. Worth. Hord V.S., p. 19. See Handley Map. It would be unjust for BNSF to receive these rights without extraordinary compensation to UP.

As BNSF's own map shows, BNSF had a mainline of its own between Ft. Worth and Dallas. It elected to sell that line to DART, the Dallas-area transit organization, for a substantial sum. BNSF retained trackage rights over the line, but accepted restrictions on its operations to facilitate commuter service. Now, having received that financial benefit and having agreed voluntarily to accept those restrictions, BNSF would like to appropriate UP's capacity between Ft. Worth and Dallas. BNSF should stay on its own line; or if it wants to use UP's line, it should negotiate with UP an arrangement that compensates UP fairly in light of BNSF's profit on the sale of its line and the additional burdens BNSF would place on UP's service and operations. Wilmoth V.S., p. 10.

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UP has incentives to allow BNSF to participate in directional operations. UP trains will face fewer oncoming BNSF trains and experience less delay if BNSF participates. Id., p. 9. But the weighing of offsetting costs and benefits should be done voluntarily in the private sector, not by government fiat. The Board cannot reasonably expect to weigh all the operational, capacity and other factors that should be considered in reaching a balanced solution. In this particular instance, granting rights to BNSF without extraordinary compensation to UP would be grossly inequitable. If the Board grants BNSF directional operating rights on UP between Ft. Worth and Dallas, UP will not use directional operations.

BNSF has other alternatives if it does not want to use its own route. If it concludes that its trains are suffering delay on the Ft. Worth-Waxahachie segment, BNSF can invest in additional capacity. In all likelihood, UP would help pay for that capacity, because it would use it. BNSF also has an entirely separate route from Ft. Worth to Houston via Temple, Texas, the former Santa Fe line, which it can use. Id.

In the last two years, trackage rights have acquired an additional element of risk for the landlord that should be recognized in any proposal to expand a tenant's rights. The landlord runs an increased risk that the tenant will seek, directly or indirectly, access to industries along the trackage rights line.

BNSF can benefit from "open access" opportunities without ever initiating requests for such access itself. Instead, a pattern of step-by-step movement toward "open access" is already well-established. We have seen it in operation repeatedly, and we are seeing it in this proceeding. First, BNSF obtains overhead operating rights. Then, a shipper located on the line asks for BNSF service, relying in part on the fact that "BNSF already has the authority to run trains on the UP line." See, e.g., Ex Parte No. 573, Petition for Reconsideration Submitted by Cemex USA Management, Inc., Aug. 20, 1998, p. 12 ("The only operating issue, therefore, is BNSF stopping for local service."); Ex Parte No. 573, Second Supplemental Statement and Additional Request for Emergency Relief of Entergy Services, Inc., & Entergy Arkansas, Inc., May 18, 1998, p. 11 ("accessing White Bluff would require only the right to use these existing trackage rights to reach Entergy's private White Bluff spur").

Finally, we learn that BNSF is providing behind-the-scenes support, including assuring the shipper that it is willing to provide the service and has developed an operating plan. For example, the Board was advised that "Cemex USA has worked out a detailed plan with BNSF to provide service to its Dittlinger facility." Cemex, supra, p. 12. See also Entergy, supra, pp. 10-11 ("In recent weeks, BNSF has re-confirmed its willingness to deliver coal to White Bluff . . . and can now implement this service with greater ease and speed than ever."); AL&M, supra, p. 13 ("In discussions with the BNSF, AL&M has been assured by the BNSF that interchange service at Fordyce would be operationally feasible . . . ."). Similarly, in the present proceeding, BNSF has provided encouragement to parties that have no basis for a complaint about diminished competition but nevertheless are seeking "open access." See DOW-1, Hord V.S.; Formosa Application, p. 25; CP&L Application, Argument, p. 3, & Mills V.S., pp. 12-13. The Board should recognize this unjustified proposed condition, and several others discussed below, as a BNSF stalking horse for "open access."

One of BNSF's unstated objectives in seeking this directional running condition may also be to position itself for potential access opportunities, should they arise. UP's mainline between Ft. Worth and Dallas, for example, serves a major automotive facility that BNSF would be thrilled to serve, along with many other industries. Wilmoth V.S., p. 10. UP also believes that BNSF would never agree to reciprocal application of this condition because it knows that UP might someday be positioned to gain access to numerous BNSF-served industries. Id.

UP has to be concerned about these possibilities. It has to be concerned about potential federal "access" legislation to which it might be more vulnerable if another carrier has trackage rights.

Even if this condition were reciprocal (which BNSF evidently does not contemplate), and even if parties were barred from using the rights as a predicate for seeking new access to industry (which BNSF also does not suggest), and even if the condition excluded rights to serve new industry or locate transloading facilities on the affected lines (another matter on which BNSF is silent), and even if the condition were limited to lines where BNSF's rights were obtained under the settlement agreement (another limitation that BNSF omits), this proposed condition would be competitively unjustified, and would create a strong disincentive to creating any more efficiency-enhancing directional operations.

9. Add Houston-Longview and Houston-Shreveport Lines to Spring Dispatching Center

As UP reported to the Board on July 28, 1998, it agrees with this request and plans to implement it. The only question is timing. Ten days from today, on September 28, UP expects to transfer dispatching responsibility for three routes serving Houston to its Spring dispatching center near Houston. Duffy V.S., p. 21. It will relocate dispatching for the SP "Rabbit Line" between Shreveport and Houston, which is the primary southbound route for BNSF and UP trains from East

St. Louis and Memphis to Houston. It also will give Spring dispatching control over the former SP Hearne Subdivision between Hearne, Texas, and Houston, and the former UP Ft. Worth Subdivision between Spring and Valley Junction, Texas. Id. UP will relocate dispatching of additional territories from Omaha to Houston on January 30, 1999, including the Sunset Route between Houston and San Antonio and the Austin Subdivision between Laredo and Central Texas. Id.

UP decided to give highest priority to the three segments described above because those are lines on which trains move toward Houston. With respect to the Houston-Longview segment that BNSF wants moved [illegible] the Spring center, the Houston-Spring portion of that segment, about 20 miles long, is already in the center. The line from Spring to Longview, Texas, is a northbound directional route on which all trains operate away from Houston. It is much more important for Houston-area dispatchers to know when trains are coming toward Houston than to know which trains just left. UP expects eventually to move dispatching of the Spring-Longview segment to Spring, but it has not determined when to make that move. Id.

10. BNSF Right to Use Any Clear Route Through Houston

BNSF proposes that the Board award it the unrestricted right to use any route through Houston. BNSF already has the right to use virtually every route through

Houston, but a few of those rights are restricted as a result of bilateral arms-length negotiations with SP. Handley V.S., p. 51. BNSF wants to remove the restrictions it accepted in negotiations without giving up anything in return.

Once again, the proposed condition lacks any competitive justification. Like many efficiency-enhancing conditions that railroads might negotiate, it may be beneficial. But BNSF makes no attempt to show that the restrictions that BNSF negotiated on trackage rights over SP line segments in Houston somehow prevent it from providing effective competition. During the UP/SP merger proceedings, neither BNSF nor any other party even hinted that these negotiated restrictions on trackage rights which had nothing to do with the merger raised any competitive concerns. BNSF has plenty of unrestricted routes through Houston without getting something for nothing on the remaining routes. <u>See</u> Handley Map 11.

At first blush, this condition may look like a good idea. But in fact it is no different from BNSF's proposals to embellish its trackage rights over UP tracks outside Houston. It is a request for government intervention to improve BNSF's ability to compete against UP and improve its service, while imposing its operations on UP trackage and reducing the quality of UP's service by putting more BNSF trains on UP's Houston tracks. If BNSF wants such rights, it should negotiate for them and offer something in return. For example, UP could greatly improve its service to and from the Port of Tacoma if BNSF would allow UP to operate over a very short segment of BNSF trackage in Tacoma, and UP could improve its service through Denver substantially with a few miles of BNSF trackage rights. Both of those proposals are good ideas. But they are rights that should be negotiated, not imposed unilaterally by the Board.

The parallels between the BNSF's opportunistic proposals throughout Central Texas and this condition are more extensive than might appear. BNSF has negotiated, restricted trackage rights over several UP track segments in Houston. As shown on Map 11, BNSF negotiated with UP to obtain extensive trackage rights over SP line segments in Houston. BNSF gained the right to operate over SP's entire mainline from West Junction to Englewood Yard and down to the Clinton Branch, limited to grain traffic. BNSF also gained trackage between T&NO Junction and PTRA, limited to trains moving via Rosenberg, Texas. Handley V.S., p. 51, & Map 11. Now, BNSF wants the Board to renegotiate those agreements on behalf of one side only -- BNSF. Mutually agreeable trackage rights agreements traditionally are very finely calibrated and balanced. If BNSF wants restrictions removed, it should negotiate with UP and confer offsetting efficiency benefits on UP in exchange. UP is ready and willing to discuss such an exchange. Rebensdorf V.S., p. 7. Meanwhile, if BNSF believes that the lines on which it operates in Houston have inadequate capacity, it should invest in new capacity, and UP will share the costs.

BNSF's proposed condition may contain another hidden "open access" opportunity for BNSF. BNSF does not define the "Houston Terminal Area" where it wants additional trackage rights, but its Map 9 of the Houston area extends from Eagle Lake, 70.6 route miles west of Houston on SP's Sunset Route, to Galveston, 49 miles south of Houston on UP's GH&H line, to well beyond Dayton Yard, 34.2 miles east of Houston on the SP, or roughly a 5,000-square-mile region. The map includes the entire 28-mile <u>UP</u> Baytown Branch (as distinct from the SP Baytown Branch which BNSF already serves), over which BNSF covets but does not have trackage rights. If this condition were granted, UP would expect BNSF to demand to operate over the UP Baytown Branch (and then to encourage shipper requests for BNSF access on that line, as it is doing elsewhere).

B. <u>KCS/Tex Mex</u>

This section addresses each of the conditions proposed by KCS/Tex Mex. Before addressing the individual conditions, however, we first pause to consider an argument for those conditions that is woven through the KCS/Tex Mex filing and does not involve a claim about any competitive effect of the merger. This is the claim that the conditions should be granted because Tex Mex is in financially precarious condition.

There is No Basis for Concern
<u>About Tex Mex's Financial Soundness</u>

Tex Mex's robust traffic growth, seen in its growing Laredo gateway volumes and its role as a vital link for BNSF and for KCS's "NAFTA Railway" system (recently expanded through the KCS/CN/IC Alliance), establishes that there is no basis for any further concern that the merger might pose a threat to Tex Mex's ability to provide strong competition for Mexican rail traffic at the Laredo gateway and continue to serve its on-line shippers. By every measure, Tex Mex is far better off as a result of the conditions already granted to BNSF and Tex Mex than it would have been absent the merger.

This conclusion is demanded by KCS/Tex Mex's own analysis of the overall effect of the merger, as conditioned by the Board, on Tex Mex's traffic levels and financial condition. The Board need look no farther than the testimony of KCS/Tex Mex's expert witness Plaistow in this proceeding. KCS-2, Plaistow V.S., p. 250; TM-7/KCS-7, Plaistow V.S., p. 120. Mr. Plaistow's expert analysis was submitted to the Board to establish the financial effect of KCS/Tex Mex's proposed conditions, in compliance with 49 C.F.R. § 1180.9,[26] and to support KCS/Tex Mex's contention that the

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[26] <u>See</u> KCS-2, pp. 88-89.

new investments that KCS/Tex Mex propose to make -- to construct additional trackage between Houston and Beaumont and rebuild the Wharton Branch -- would be economically justified only if the new conditions KCS/Tex Mex seek were granted.[27] In the course of arriving at these conclusions, Mr. Plaistow developed a "base case" that reflects the effects of the merger and "the implementation of the conditions the STB imposed on its approval and the other known changes since the close of 1996 absent the [emergency service order] conditions." TM-7/KCS-7, Plaistow V.S., p. 127; see also KCS-2, Plaistow V.S., pp. 254-55 (same).

Mr. Plaistow found that the merger as conditioned by the Board has achieved dramatic increases in Tex Mex's traffic, revenue and profit levels, as shown in the following table:

KCS/TEX MEX ANALYSIS OF MERGER EFFECTS

	Carloads	Car Miles	Ton Miles	Expenses	Revenues	Net Operating Income
Pre-Merger (1996)	36,660	5,333,272	400,738,197	$18,800,000	$19,800,000	$972,000
Post-Merger "Base Case"	45,134	7,034,272	457,886,197	$23,189,000	$28,573,000	$5,356,000
Incremental Gain	8,474	1,701,000	57,148,000	$4,389,000	$8,773,000	$4,384,000
% Increase	23.1%	31.9%	14.3%	23.4%	44.3%	451.0%

Source: KCS-2, Plaistow V.S., p. 257, Table 1.

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[27] KCS-2, p. 26.

On the basis of this analysis, Mr. Plaistow concluded that "Tex Mex incremental revenue from additional intermodal traffic, automotive traffic, BNSF interchange traffic and extended hauls more than offsets the revenue reduction from lost carloads of SP interchanged traffic resulting from SP's merger with UP." Id., p. 258 (emphasis added). Importantly, according to Mr. Plaistow, the Board's replacement of SP with BNSF -- all by itself, even without Tex Mex's additional trackage rights to reach a connection with KCS -- yielded a net gain of 6,155 carloads, with 14,397 BNSF carloads much more than offsetting a loss of 8,242 carloads of former SP traffic. Id., p. 257.

Tex Mex's actual experience has, in all significant respects, outstripped even these very positive projections of Mr. Plaistow's. We have already reviewed the data establishing that Tex Mex's traffic levels at the Laredo gateway (and shares of such traffic) have increased significantly since the pre-merger period. See Peterson V.S., pp. 6-8. The same strong traffic growth is reflected in Tex Mex's own 100% traffic data. As Mr. Barber explains, based on highly confidential traffic data supplied by Tex Mex in discovery, the increase in Tex Mex traffic volumes since the merger has greatly exceeded Mr. Plaistow's "Base Case" estimate. Barber V.S., pp. 55-60.[28] Indeed, Tex Mex's monthly traffic levels in the first half of 1998 were more than double pre-merger 1996 levels. Id., pp. 58-59. KCSI's recent presentations to financial analysts confirmed that Tex Mex's revenues had more than doubled between the first quarter 1997 and the same period in 1998.[29] And KCS's 1998 business plan indicates that KCS-Tex Mex Mexican traffic levels exceeded projections. Barber V.S., p. 52.[30]

Tex Mex's actual post-merger experience has also confirmed that the interline traffic generated by its new connection with BNSF at Corpus Christi/Robstown has more than replaced the SP traffic lost as a result of the merger, without regard to the large and growing volumes of interline traffic handled via Beaumont in conjunction with KCS. In

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[28] The same trend is reflected in Tex Mex trackage rights volumes, which UP reported most recently in its July 1, 1998 Progress Report filed in the annual oversight proceeding (UP/SP-344, pp. 99-104), but these data provide incomplete information because they do not directly reflect the substantial Tex Mex-BNSF interline traffic that is handled via Corpus Christi/Robstown using Tex Mex's original line and BNSF's trackage rights.

[29] KCSI First Quarter 1998 Analysts Presentation, Apr. 23, 1998, Slide 16 (copy in Appendix A hereto).

[30] A small portion of Tex Mex's gains may have occurred due to UP's service problems and partial embargo in March of this year of traffic destined for the Laredo gateway. If that is so, however, such gains undercut claims by KCS/Tex Mex and others that shippers lack competitive alternatives to UP. In any event, Tex Mex traffic levels had already increased significantly by early 1997, before UP's service crisis. See Barber V.S., pp. 57-58.

fact, as Mr. Barber explains, Tex Mex's gains in BNSF interline traffic were more than double its losses of UP/SP traffic, and with the inclusion of KCS interline traffic (and its modest Houston-Laredo traffic) Tex Mex's gains have been more than three-and-one-half times greater than its losses. Barber V.S., pp. 58-60.[31] Tex Mex's long-range analysis of potential traffic growth opportunities anticipates still more significant future growth in Mexican traffic, of which KCS and Tex Mex will garner a significant share.[32]

The UP/SP merger as conditioned by the Board has turned out to be far more beneficial to Tex Mex than Tex Mex predicted would be the case even if the Board had granted it the full unrestricted trackage rights it sought in the merger proceeding. In its Responsive Application, Tex Mex projected that the grant of its unrestricted trackage rights (including Houston-north rights) would leave Tex Mex with fewer carloads, would produce revenue gains on the order of $12 million (by extending Tex Mex's hauls), and would yield no increase in Tex

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[31] See also BNSF July 1, 1997 Quarterly Progress Report, p. 5, & Chart 1 (during first 5 months of 1997, BNSF providing traffic to Tex Mex at a rate of 31,000 units per year -- a 15% increase over the 26,500 carloads that Tex Mex claims to have interlined with SP in the 1994 base year); Western Coal Traffic League v. STB, No. 96-1373, Brief for Petitioner BNSF, Feb. 17, 1998, p. 10 n.5 (D.C. Cir.) (same).

[32] Barber V.S., p. 52. Similarly, BNSF's expert witness predicts that Laredo cross-border rail traffic will grow at a 14% annual pace. Application, Brown V.S., p. 3.

Mex's base level of net income (of approximately $500,000). See TM-23, Krick V.S., pp. 185-92. As shown above, Tex Mex's gains have greatly outstripped these predictions, even without Houston-north rights.

All indications are that this strong traffic growth will continue.[33] KCS/Tex Mex's strong confidence in the future of Tex Mex's Mexican traffic is reflected in their decision to invest heavily in new facilities to serve this traffic, without having received any additional conditions from this Board. Tex Mex has already decided to invest in a new $9.5 million new intermodal facility and yard near Laredo and $2.8 million in other capital projects on its line between Laredo and Robstown to serve increasing volumes of cross-border traffic. It has begun construction on these projects without waiting for the Board to grant further conditions. TM-7/KCS-7, Watts V.S., pp. 86-87; KCS-2, Plaistow V.S., p.256. KCS has already spent in excess of $70 million on infrastructure improvements "aimed specifically at traffic that flows into and out of Mexico," expenditures that were "in addition to Tex Mex and KCS's normal capital spending programs." TM-7/KCS-7, Rees V.S., p. 92.

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[33] Such would not necessarily be the case, however, if Tex Mex's traffic were sapped by the grant of BNSF's request for direct access to Laredo, or by conduct on the part of KCS/Tex Mex that drove BNSF away from Tex Mex and toward the Eagle Pass gateway. Such effects, however would not be the result of the UP/SP merger.

KCS/Tex Mex half-heartedly suggest that the UP/SP merger has recently caused Tex Mex to sustain small net operating losses, despite the fact that traffic and freight revenue are up dramatically. KCS/Tex Mex attribute these losses to unexpected cost increases caused by congestion on Tex Mex's trackage rights lines and inefficient Tex Mex train operations. KCS-2, p. 89, & Plaistow V.S., p. 9. In late July, for example, KCS's President and CEO, Michael Haverty, emphasized that Tex Mex's weak "bottom line numbers" were entirely the result of "congestion at this point."[34]

This phenomenon, however, affected all carriers serving Texas and are purely transitory. Mr. Plaistow's use of normalized costs as a basis for his financial analysis confirms that KCS/Tex Mex understand that Tex Mex's escalated cost levels are temporary.[35] The correctness of that judgment has been borne out by events. UP's service crisis is over, and Tex Mex trains are no longer experiencing delays that had hampered their performance, and increased crew and other costs, during late 1997. As Mr. Wilmoth explains, Tex

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[34] KCSI, Second Quarter 1998 Analysts Presentation, July 29, 1998 (remarks of Michael Haverty); see also id. ("the real cost is trying to get over the UP between Corpus Christi and Beaumont in a reasonable fashion and where the expenses are reasonable").

[35] The Board certainly cannot assume that KCS/Tex Mex would have presented a financial analysis in support of their condition requests that they believed to be inaccurate because it understated Tex Mex's costs.

Mex's transit times are extremely good, in most cases faster than UP's operations over the same track segments (and these are segments where UP's average speeds have soared). Wilmoth V.S., p. 5; Duffy V.S., p. 2.[36]

Moreover, to the extent some of Tex Mex's operations have been less efficient and more costly than they had to be, KCS/Tex Mex have themselves to blame. As we have shown, new BNSF interline traffic replaced more than twofold the reductions in SP interline traffic as a result of the merger, and these traffic gains would have boosted Tex Mex's bottom line regardless of any service problems on UP. KCS/Tex Mex's strategic desire to establish trackage rights operations in order to forge a connection with its parent KCS, even at some expense, cannot be made the basis for imposing further conditions on UP.

In addition, some of Tex Mex's costs are attributable to marginal operations occasioned by Tex Mex's eagerness, in conjunction with KCS, to serve Houston-north traffic under the emergency service order. In February 1998, KCS/Tex Mex established separate Houston-Beaumont and Beaumont-Houston trains solely to handle Houston-north traffic. These trains were otherwise unnecessary, and they

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[36] KCS President and CEO Haverty has also pointed out that Tex Mex's new yard at Laredo "is going to help us cut some expenses" on Tex Mex. KCSI Second Quarter 1998 Analysts Presentation, July 29, 1998 (Appendix A).

typically handled very few loaded cars.[37] KCS/Tex Mex acknowledge that these short "special trains" caused Tex Mex to incur substantial additional costs. See KCS-2, Ritter V.S., p. 292; id., Broussard V.S., p. 418; see also TM-9/KCS-4, Aug. 14, 1998, Response to Request No. 12, pp. 11-12. These additional costs should not be attributed to the UP/SP merger, and in any event they will disappear now that the emergency service order has expired and KCS/Tex Mex is no longer operating these trains.

Tex Mex's own strong performance since the UP/SP merger should eliminate any doubt about the merger's effect on Tex Mex's viability and its ability to continue providing strong competition at the Laredo gateway. Even if Tex Mex's own financial performance had faltered, however, there would still be no basis for concern about the robustness of competition at Laredo or the preservation of rail operations on Tex Mex's original Corpus Christi-Laredo line.

Tex Mex's Laredo-Corpus Christi line has undeniable strategic value, both to BNSF and KCS. Tex Mex, of course, provides BNSF with its only access to the Laredo gateway in competition with UP. BNSF's new quest for trackage rights of its own between San Antonio and Laredo confirms that BNSF regards Laredo as the preeminent eastern Texas gateway. As a

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[37] UP's Opposition to KCS/Tex Mex's Emergency Joint Petition for Additional Trackage Rights Conditions, June 2, 1998, Barkley V.S.

result, although Tex Mex's relationship with KCS has apparently complicated BNSF's efforts to develop a close working relationship with Tex Mex (see, e.g., Application, Rickershauser V.S., pp. 31-33),[38] there is no risk -- apart perhaps from a grant by the Board of BNSF's request for San Antonio-Laredo trackage rights -- that Tex Mex would lose BNSF's large volumes of Laredo interline traffic, or that BNSF would allow Tex Mex's Laredo line to go out of service.[39]

An even more compelling assurance of Tex Mex's continuing vitality is its role as a critical link in the integrated North American rail system that KCS calls the "NAFTA Railway." KCS's parent KCSI holds a 49% ownership interest in Tex Mex, and a similar stake in TFM, the privatized Mexican railroad serving the Laredo gateway. (In both cases, the other owner is TMM.) Without Tex Mex as the link between KCS and TFM, there would be no "NAFTA Railway," and as a result KCS has moved aggressively to integrate Tex Mex into its system. KCS presents Tex Mex to the outside

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[38] On the other hand, it is also possible that BNSF's objective of securing San Antonio-Laredo trackage rights from the Board may have led it to prefer that negotiations with Tex Mex not be fruitful, so that BNSF could point to those developments in support of its (unjustified and overreaching) condition request.

[39] See Western Coal Traffic League v. STB, No. 96-1373, Brief for Petitioner BNSF, Feb. 17, 1998, p. 19 ("no reason to doubt that if Tex Mex ceased operations, its assets would be purchased and its services continued . . . by BNSF itself, which could then offer a single-line '31,000-mile funnel' through the dominant gateway of Mexico").

world as part of <u>KCS's</u> system. Maps of the KCS system show Tex Mex as a seamless part of the NAFTA Railway. At KCSI's quarterly presentations to financial analysts, Tex Mex is treated as one integral component of the KCS NAFTA Railway system, and Tex Mex's financial performance is presented no differently from that of every other unit of KCSI's Transportation Division (which consists principally of KCS, Gateway Western, Tex Mex and TFM).[40]

From the standpoint of day-to-day management and strategic decision making, KCS and Tex Mex are tightly intertwined. High-level KCS officers hold key positions in Tex Mex's organizational structure. Michael Haverty, KCS's President and CEO, is the President of Mexrail, Tex Mex's 100% parent through which KCSI holds its 49% interest in Tex Mex. Ab Rees, KCS's Senior Vice President of Operations, is also on Tex Mex's Board and is one of three members of Tex Mex's Executive Committee. These KCS representatives are involved in every significant decision concerning Tex Mex's operations and corporate decisionmaking.[41]

As KCS's President and CEO, Michael Haverty, told analysts in July of this year, Tex Mex has become an integral

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[40] <u>See</u> KCSI First Quarter 1998 Analysts Presentation, Apr. 23, 1998, Slides 10-19 (Appendix A).

[41] KCS's role in Tex Mex's negotiations with BNSF over a rate and divisions agreement, discussed below and in Appendix B to this submission, is illustrative.

part of a large, international railroad with a strong focus on the Mexican traffic for which Tex Mex is the indispensable "funnel":

> "[W]e [at KCS] did have a strategy, and if you will look at the next slide this is the system that we have put together. And I think the point to make here is that this is not a small regional U.S. railroad. This is an international railroad. It has over six thousand route miles. The total revenues of all the properties you see here will exceed a billion dollars this year, and the revenues are growing. So we are no longer a small railroad that runs from Kansas City to New Orleans and Beaumont. We now run from the heartland of the United States to the heartland of Mexico. And we also connect with every North American carrier. So we can become a feeder system into our network with virtually every railroad."[42]

At the same presentation, KCSI's Chairman, Landon Rowland, reported that "KCSR's ability to expand its business, together with the potential synergies of our affiliates that comprise the NAFTA Railroad, begins to crystallize our positive vision for the future of the Transportation franchise." Id.

Tex Mex's strategic role in KCS's NAFTA Railway system ensures that its Laredo-Corpus Christ line will not be allowed to wither. At the same time, it is also clear that Tex Mex's role in KCS's system is subservient to the interests of its owners. KCS and TMM plainly regard Tex Mex as a feeder operation whose role is to furnish traffic to its owners' systems in the United States (KCS) and Mexico (TFM), even if that traffic may be only marginally profitable from Tex Mex's

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[42] Id., Slide 23 (Appendix A).

narrow perspective. KCS and TMM can afford for Tex Mex to incur assertedly excessive costs, and have Tex Mex forgo traffic opportunities with other connections that would boost its own revenue, in order to conduct trackage rights operations that forge a link between TFM and KCS and deliver to KCS the strategic value of its investment in Tex Mex.

Tex Mex's subservient role is manifested most clearly in the formal joint venture agreement between KCS and TMM entered in December 1995 in connection with KCSI's investment in Tex Mex. That agreement provides that each of Tex Mex's owners will be contractually bound to use their best efforts to obtain rail freight in the United States and Mexico to be transported <u>via Tex Mex</u> to its partner on the other side of the border (as opposed to other carriers) to the extent economically practicable. The document expressly states that the KCSI-TMM "joint venture shall be the exclusive agency of both parties in the creation, development and enhancement of such rail traffic between the United States and Mexico."[43]

Armed with its ownership stake in Tex Mex, its active and influential role in the management of Tex Mex's day-to-day affairs, and the formal commitments set forth in the KCSI-TMM Joint Venture Agreement, KCS has acted to protect

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[43] TMM-KCSI Joint Venture Agreement, Dec. 1, 1996, §§ 1.1(iii), 1.1(v), 4.1(a). Excerpts from the KCSI-TMM Joint Venture Agreement are part of Attachment 3 to BNSF's Application herein.

its own interest in the Mexican traffic handled by Tex Mex by intervening in Tex Mex's negotiations with BNSF over a rate and division agreement. See Appendix B; see also BNSF Application, Atts. 1-4, & Rickershauser V.S., pp. 31-33. KCS's counsel has written the Board to suggest that "BNSF should spend time developing the Eagle Pass and Brownsville gateway" -- where its traffic would not be handled by Tex Mex -- "rather than constantly complaining about the lack of cooperation by Tex Mex." Letter from W. Mullins to Chairman Morgan, Mar. 16, 1998, p. 2. Tex Mex's financial condition cannot be viewed in isolation from its role as an integral, strategically valuable link in KCS' NAFTA railway system: that is clear from KCS's willingness to have Tex Mex spurn revenues and profits it might otherwise have earned in order to ensure that KCS rather than BNSF reaps the broader benefits of bridge traffic carried by Tex Mex.[44/]

Tex Mex's vital role as a link in the NAFTA Railway is strongly enhanced by the "Alliance" reached among KCS, CN and IC on April 15, 1998, which is not dependent on approval of the CN/IC merger and is already being implemented.[45/] The

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[44/] Taken together, the facts of which UP is aware provide a substantial basis for concluding that KCS is under common control with Tex Mex, further underscoring the inappropriateness of viewing Tex Mex's financial condition in isolation.

[45/] The Alliance will remain in effect without regard to the outcome of the CN/IC merger proceeding. CN/IC-7, p. 144.

Alliance establishes a 15-year marketing partnership that is already aggressively pursuing "NAFTA" traffic. Alliance members have been meeting to develop coordinated operating and marketing plans, and have already won a significant movement of automotive traffic from Mexico to CN points in Canada via Tex Mex.[46/]

Traffic projections submitted to the Board in support of the CN/IC merger application by the same witnesses who support KCS/Tex Mex's position in this proceeding explain that implementation of the Alliance is expected to lead to significant traffic gains for Tex Mex via the Laredo gateway. Those projections encompass the impact of the proposed CN/IC transaction "with the combined traffic synergy of the [already-implemented] CN/IC/KCS Alliance."[47/] Tex Mex is expected to benefit from very significant diversions of traffic, with total revenue gains of $15.9 million spread among general merchandise, intermodal and automotive traffic categories.[48/] These projections should be treated as the equivalent of an admission by KCS/Tex Mex here, because it is

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[46/] KCS News, July 14, 1998, Aug. 18, 1998, & Aug. 26, 1998.

[47/] See Finance Docket No. 33556, CN/IC-7, Woodward & Rogers V.S., p. 4 (Appendix A).

[48/] Id., p. 11.

apparent that KCS cooperated with the preparation of this study as an Alliance member.[49]

Finally, a further significant development and important source of future traffic growth for Tex Mex is the voluntary cooperation agreement reached among KCS, Tex Mex and NS in December 1997. That relationship established closer cooperation with NS for movements, inter alia, of Mexican traffic over the Meridian, Mississippi, gateway.[50]

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We now turn to a seriatim review of the proposed KCS/Tex Mex conditions.

1. PTRA Switching of Exclusively-Served Houston-Galveston Shippers and Use of UP Yards

a. Taking of Property

This proposal is fatally defective. KCS/Tex Mex propose nothing less than a massive government confiscation of UP's private property. They purport to be proposing trackage rights (KCS-2, p. 40), but that term does not apply to their plans. As a practical matter, what they propose is to give PTRA the exclusive right to operate over most of UP's affected

[49] For example, the witnesses were given access to 100% KCS waybill data for use in their study. Id., p. 4. Moreover, as noted, Messrs. Woodward and Rogers are the same witnesses who are supporting KCS/Tex Mex's request for additional conditions in this proceeding. See KCS-2, Woodward V.S., p. 218, & Rogers V.S. p. 236.

[50] See TM-9/KCS-4, Aug. 14, 1998, Response to Request No. 20, p. 15; KCS News, Aug. 26, 1998.

tracks, removing any reason for UP to use them. They would take UP's yards, its industry trackage, its staging tracks, and its automotive facility for PTRA's exclusive use. They would deprive UP of every economic benefit of those facilities and every indicium of ownership, leaving only the obligation to pay property taxes and the costs of maintaining the assets. Simply stated, this is a "taking," a "permanent physical occupation" of UP's property. Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1015 (1992).

When the government requires a private entity to turn over a portion of its property to another, it must pay compensation. The Fifth Amendment of the United States Constitution provides: "[N]or shall private property be taken for public use, without just compensation." U.S. Const. amend. V. As the Supreme Court outlined in Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1015 (1992), "regulations that compel a property owner to suffer a physical 'invasion' of his property" result in a taking per se, without any further inquiry. In other words, such regulations result in a taking "no matter how minute the intrusion, and no matter how weighty the public purpose behind it." 505 U.S. at 1015; see also Bell Atlantic Telephone Cos. v. FCC, 24 F.3d 1441, 1446 (D.C. Cir. 1994).

In Kaiser Aetna v. United States, 444 U.S. 164 (1979), private owners created a marina at their own expense by dredging a channel from a pond to a bay and elevating a bridge so that boats could pass underneath. Id. at 167. After construction, the government sought to open the marina to the general public. Id. at 168-69. The Court held that the government could require that the general public be permitted to access the marina but the Court also held that this open access constituted a taking in the form of a physical invasion because access would deprive the private owners of the right to exclude others, "one of the most essential sticks in the bundle of rights that are commonly characterized as property." Id. at 174, 176; see also id. at 179-80 ("the 'right to exclude,' so universally held to be a fundamental element of the property right, falls within this category of interests that the Government cannot take without compensation"). Consequently, the private owners were entitled to just compensation.

The KCS/Tex Mex proposal is no different. UP paid for and built the trackage, yards, and staging tracks for its own purposes. The KCS/T x Mex proposal that the Board mandate access by PTRA to UP trackage and yards would constitute a taking in the form of a physical invasion. Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 432-33 n.9 (1982) (holding that invasion authorized by law "is a taking without regard to whether the [government], or instead a party authorized by the [government], is the occupant"); see also

Lucas, 505 U.S. at 1014 (observing that physical invasions include functional equivalent of "practical ouster of [the owner's] possession.") (quoting Transportation Co. v. Chicago, 99 U.S. 635, 642 (1879)).

Under the United States Constitution, UP would be entitled to compensation for this taking. The value likely would be in the billions of dollars. Yet no proponent even mentions this cost. KCS/Tex Mex make no attempt to explain who will pay for this unprecedented confiscation of private property. For that reason alone, the Board cannot grant this condition.

b. "Open Access"

Setting aside this fatal defect, the KCS/Tex Mex parties are proposing a sweeping program of "open access." They want to open virtually every UP exclusively-served industry in the greater Houston area to BNSF and Tex Mex by allowing PTRA to switch them. KCS/Tex Mex never acknowledge that their objective is "open access," describing this condition solely in terms of its alleged service benefits and to eliminate "discrimination." KCS-2, pp. 40-42. But there are no service benefits, and they present no evidence of "discrimination" on the tracks they want to appropriate. As we will demonstrate conclusively, the KCS/Tex Mex operating plan for the north and south sides of the Houston Ship Channel, where virtually all of the affected industries are located, would cause an immediate and devastating Houston rail service meltdown.

In any event, service is no longer the issue. UP service in Houston has been vastly improved for months, and it survived recent washouts and floods with hardly a hiccup. Ongerth V.S., pp. 13-14.

Under this proposal, as KCS/Tex Mex describe it, BNSF and Tex Mex would gain access to all UP-served industries in three areas of Houston. First, and most significantly, PTRA would be given the area known as the Strang/Bayport Loop, which can be described as huge a petrochemical industrial park, served exclusively by UP through Strang Yard. SP developed the Loop over the last 30 years. Handley V.S., p. 2. UP also serves many other industries in this area, including several exclusively-served industries on the "HL&P Lead" and others in the "Sinco" area. <u>See</u> Handley Map 3. Second, the Tex Mex parties want to give PTRA access to the Clinton Branch, opening to BNSF and Tex Mex a large Ford automobile unloading facility and giving Tex Mex new access to American Plant Food Corp. (which opposes the condition), Amoco Chemical, Cardolite, Chevron Chemical, Huntsman Polymers, Merichem, North Texas Cement, Shell Chemical, and many other industries. Finally, the proposal would open to BNSF and Tex Mex the industries on UP's Galveston, Houston & Henderson ("GH&H") line southeast of Houston, which are already open to

BNSF, and give Tex Mex access to the industries on the Texas City Terminal Railway, which are also already open to BNSF. In all, this proposal would create "open access" to exclusively-served UP industries that generated $133 million in revenues for UP in 1997. In addition, Tex Mex would gain access to $42 million in UP annual revenues that are already open to competition from BNSF. Peterson V.S., p. 28.

KCS/Tex Mex also propose to appropriate for PTRA UP's Harrisburg Line between T&NO Junction and Harrisburg Junction, UP's "Bell Main" and Galveston Subdivision between Englewood Yard and Harrisburg Junction, and UP's Beaumont Subdivision between Gulf Coast Junction and Settegast Junction. KCS-2, p. 318. Nowhere in their filing do they discuss any justification for taking these lines or explain how they would be operated. KCS-2 is silent with respect to these lines. In the absence of any attempt to justify these takeovers, UP has nothing to respond to, and the requests must be summarily denied.

With one inapposite exception,[51] KCS/Tex Mex make no attempt to show the extent to which UP's service to the Strang/Bayport Loop area, the Clinton Branch or the GH&H industries has ever been inadequate, even during the service

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[51] UP does not dispute DuPont's complaints about the quality of reciprocal switching for Tex Mex at DuPont's facility at LaPorte. As discussed in Part IV.F below, Tex Mex is not entitled to that service and UP does not have an operating pattern to provide it.

crisis. More importantly, they make no attempt to show that service has been inadequate since April, when Houston-area operations had substantially recovered. Instead, their theory is that UP "discriminates" in switching BNSF and Tex Mex cars to and from these industries. They offer no evidence to support these claims, and their handful of allegations of mishandling all arise from other areas of Houston and from last fall or early this year, when UP concedes that its problems delayed everyone's traffic. Moreover, the discrimination argument could not apply to the bulk of this traffic, which is exclusively-served.

KCS/Tex Mex's other theory is that "neutral switching" is needed to give shippers a "safety valve" in case UP service declines again. KCS-2, p. 34. Under this theory, of course, every exclusively-served industry in America, including every coal-fired utility on KCS, must be opened to alternative service to guard against any risk of service failure. KCS/Tex Mex offer no evidence that this condition is needed to provide a "safety valve" today, and the Board stands ready to provide emergency relief should it again prove necessary on an emergency basis. The rules under consideration in Ex Parte No. 628 will streamline that process.

KCS/Tex Mex could not show that UP service to shippers in the Bayport Loop/Strang, GH&H and Clinton Branch areas is inadequate, because UP is providing vastly improved service. UP has reduced transit times from the greater Houston area by 50% or more, and its switching service is now consistent.[52/]

c. Unworkable Operating Plan

Although these parties make no showing of service deficiencies on these lines -- whether or not attributable to any alleged merger-caused "market power" increase -- they offer a PTRA operating plan with effects on Houston shippers ranging from undesirable to disastrous. This plan is presented in testimony of KCS and Tex Mex operating officers. W. Slinkard/Watts V.S., pp. 315-75; see generally KCS-2, pp. 332-38.

[52/] Related to the problem of compensation is the right of UP to the least drastic remedy, which KCS/Tex Mex and the other parties advocating "open access" schemes ignore. Even assuming that these parties had made a case that it would help counter congestion to give parts of UP's infrastructure to other railroads -- and they patently have not -- UP would be entitled to select the least drastic means of accomplishing that end. See, e.g., Union Pacific Corp., Union Pacific R.R. & Missouri Pacific R.R. -- Control -- Missouri-Kansas-Texas R.R., 4 I.C.C.2d 409, 456-58 (1988). That least drastic means would clearly not involve admitting multiple new rail competitors to the property. Rather, it would likely be a sale of the franchise, intact, to the highest bidder. That this would not promote these parties' "open access" agenda does not change the fact that UP would clearly have to be given the opportunity to select the least drastic and costly remedy. Furthermore, if a massive "open access" condition were granted, UP must be entitled to look at whether undoing the merger, or any portion of the merger to which the merger the Board had attributed that condition, would be less harmful to UP's shareholders, employees and customers than going forward subject to the condition.

There is no possibility that the proposed PTRA operating plan will generate service improvements for any shipper, and in pivotal respects it is doomed to fail.

Bayport Loop/Strang/Sinco Area. The operating plan proposes a fundamental realignment of service across a broad region south of the Houston Ship Channel, an area that generates a large portion of the petrochemical traffic in the Houston area. As shown on Handley Map 3, PTRA and UP share an interwoven network of tracks along an east-west axis extending from Manchester Junction on the west, parallelling the Houston Ship Channel, to the Port of Houston's Barbours Cut port area on the east. PTRA serves a majority of the numerous industries in this area. UP operates trains through the area and serves shippers at Sinco on the west end and most industries on the east end, where UP serves the HL&P Lead and Barbours Cut. PTRA operates two yards in the area, Manchester and Pasadena.

As Handley Map 3 also shows, UP operates an extensive track network extending south from that east-west axis. Strang Yard anchors the north end of this track network, which runs south to the Bayport Loop and several industries beyond and includes a track called the Navigation Lead. This is the former SP Galveston Subdivision, but the track does not reach Galveston because two bridges are missing at Seabrook and Kemah, Texas. Handley V.S., p. 10.

Under KCS/Tex Mex's proposed operating plan, PTRA and UP rail operations throughout this entire district would be consolidated and integrated, with PTRA providing all industry switching service and yard switching. The plan proposes to use Pasadena Yard as the inbound yard for the entire area, supported as necessary by Manchester Yard. Strang Yard would serve as the outbound yard for the entire area. KCS-2, pp. 325-26.

UP's Eddy Handley, General Manager of the PTRA for 13 years and the man who led PTRA from weakness to excellence, evaluated this plan. Mr. Handley not only studied the plan but also toured the entire PTRA and SP trackage and spoke to operating officers of both carriers. His conclusion is simple: The KCS/Tex Mex plan would fail immediately and produce a meltdown of rail service in Houston. Handley V.S., p. 9. If the Board were to adopt the KCS/Tex Mex condition and authorize the attempted execution of this operating plan, it would destroy rail service for all shippers south of the Houston Ship Channel and throughout Houston. Id.

Mr. Handley explains that the basic problem with the proposed plan is that the inbound/outbound scheme will not work in a number of respects.

The principal PTRA yards, North Yard and Pasadena Yard, cannot handle all inbound traffic. These yards are already overflowing with traffic several days per week. Id., pp. 9-10. On a regular basis, PTRA forces UP and BNSF to hold cars and trains off the PTRA because its yards are full. Pasadena is particularly jammed. If anything goes wrong there, the entire south-side operation of PTRA comes to a halt. Manchester is also heavily used, and it is not a good switching yard in any event. It supports service to numerous shippers, including PTRA's second biggest customer in terms of cars handled, PakTank, which takes 70 to 100 cars per day. Manchester's utility is also constrained because several tracks are stub-ended and a Houston city street, Central Avenue, cuts through the yard. PTRA cannot block this street, which would make it impossible to use Manchester as a major classification yard. Id., p. 11.

PTRA is already studying ways to expand Pasadena Yard, because it is operating at capacity. This is proving to be difficult. The Port of Houston owns insufficient land in the Pasadena area, and the land is very expensive because of its value for petrochemical manufacturing. The utility of the available land is undermined by the maze of chemical and petroleum pipelines that criss-cross the area. Id., p. 12.

Pasadena Yard devotes most of its capacity to switching cars for industries. It processes some 400 or more inbound cars on an average day. PTRA switches those cars into numerous blocks of cars for delivery to the huge industrial complexes in the area. Pasadena launches 10 or more industry jobs per day to serve giant industrial complexes operated by companies such as Mobil, Phillips, Ethyl, Occidental Chemical, Solvay and many others, most of which operate late in the day or at night. Since Pasadena has only 14 tracks, it is pressed to its limits to handle the traffic volume on these jobs. Pasadena is so busy that it does not have room to do much switching for outbound cars from this area. As a result, PTRA is forced to perform switching for outbound trains outside the yard. PTRA industry jobs "field block" cars for UP and BNSF on industry and mainline tracks so that Pasadena will not have to devote much track space to switching outbound traffic and can continue to switch for industries. Id., pp. 12-13.

The KCS/Tex Mex operating plan would move to Pasadena 400 or 500 additional UP inbound cars and all of the classification work that the 13-track Strang Yard performs today for 72 SP customers. That is a physical impossibility. There is no room to more than double the number of industry cars switched at Pasadena Yard. Nor is there any possibility that Pasadena could build the ten or more industry jobs that it builds today, plus support 25 additional industry jobs that Strang supports today. Making matters worse, UP's customers prefer to be switched at the same times as the PTRA customers. Id., p. 15-16.

Pasadena would have to switch as many cars to industries as its total standing track capacity. That cannot be done. Congested today, Pasadena does not have the physical capacity to accommodate the additional 400 to 500 inbound cars from Strang. Id.

The proposed Strang Yard operation would fail for similar reasons. Today, Strang is exclusively an outbound yard for 12 hours each day. It fills up on most days during its outbound phase, handling 400 to 500 outbound cars and blocking them into several trains. The KCS/Tex Mex plan would push 400 or more additional outbound cars every day into Strang. There would be no room for those cars, even if Strang operates in outbound mode 24 hours per day. The only way to handle more than twice as many cars each day would be to run trains at least twice per day to every destination in order to clear the yard for more outbound cars. The proposed operating plan does not call for that (it contemplates one train per day per destination), and doing so would be terribly inefficient for the line-haul carriers and would greatly increase the number of trains operating through Houston. Id., pp. 14-15.

To take the simplest example, the KCS/Tex Mex operating plan calls for one Tex Mex manifest train per day to Beaumont. KCS-2, p. 335. To keep Strang clear, though, Tex Mex would have to run to Beaumont two times per day. Those trains would not be long enough to be efficient. And the extra trains would increase congestion on tracks throughout the Houston area. The same thing would happen for BNSF trains to Tulsa, BNSF trains to Memphis, UP trains to Livonia, UP trains to North Little Rock, and so forth.

Service quality for UP shippers would be sharply reduced because Strang could not make the outbound blocks it makes today, forcing UP to switch more cars at other yards, including Settegast Yard. On its train from Strang to North Little Rock, UP carries not only cars for North Little Rock but also for Spring (where UP has a major SIT yard) and for the Alton & Southern ("A&S") at East St. Louis. The train sets out the Spring cars at Spring, and the A&S cars move to North Little Rock, where they are placed on a solid A&S train without switching. Similarly, Strang Yard builds a train for Livonia with a Livonia block and a CSX block, which runs through Livonia to CSX without switching. Strang builds a Settegast train that carries not only cars for Settegast to switch, but also a West Colton block that goes through to the Los Angeles Basin without switching en route. And Strang builds a train for Englewood that contains a number of local shipments to other industries in the Houston area as well as cars for points south of Houston. In addition, Strang builds extra trains of plastic SIT cars and rock trains.

If Strang had to use its 13 tracks to build trains for three railroads instead of one, it would not be able to build many of these blocks for UP destinations (even though it would depart more cars to UP destinations, because of the PTRA cars). Under its rules, PTRA is obligated to make the same number of blocks for all member roads. As a result, it would reduce the number of UP blocks at Strang by two-thirds. UP would be forced to perform more switching at other yards, adding switching burdens in Houston and beyond. Id., p. 16. Its transit times on cars to West Colton, the A&S, Spring and CSX points would decline because an extra en route switch would be necessary.

Those are only the first of the insurmountable problems with this plan. The track capacity of the PTRA and UP tracks in this area is limited and delays occur every day. The KCS/Tex Mex operating plan would dramatically increase the number of operations over these tracks, and many of those operations would be extremely awkward. Under the KCS/Tex Mex Plan, all inbound traffic would come into Pasadena Yard. There, Pasadena would switch the traffic (an impossible assignment for reasons already noted) for all industries in the area. The several hundred industry cars per day that now go directly to Strang for industries on UP south of Strang would go instead through Pasadena. But, as Handley Map 3 shows, there is no physical way to move from Pasadena Yard to Strang Yard without a reverse movement. There are two alternatives, each of which requires a backup move on busy trackage and interferes with yard switching at one of the two yards. A train moving from Pasadena to Strang has the following options:

<u>Route A</u>: Shove backward out of Pasadena Yard through Pasadena Junction and onto the joint PTRA/UP line to Strang. This would halt switching at the east end of Pasadena Yard (blockage of this switching operating by arriving and departing movements is already a problem for the yard and reduces its productivity) and would block both mainline tracks through the area. A backup move is also an undesirable operating practice, to be avoided if possible. The train could then move directly to Strang.

<u>Route B</u>: Move directly east out of Pasadena Yard on the PTRA mainline through Deer Park Junction to the end of PTRA trackage and onto UP trackage on the HL&P Lead (which would have to be rebuilt to handle the extra traffic). This route is PTRA's busy main industrial service route, and the substantial additional traffic would interfere with PTRA industry work. This route has no direct entrance to Strang Yard, so the train would have to pull past the entrance to Strang. At that point (or elsewhere) the engine would have to run around the train to the opposite end, because it is facing the wrong direction to reach Bayport. Either way, the train would then have to move south over the main switching lead and the hump at Strang, which would both shut down switching at Strang and, in addition, prevent the use of one of the 13 bowl tracks, further curtailing Strang's switching capability.

Neither of these movements is acceptable. But the KCS/Tex Mex operating plan calls for one or the other to happen many times per day. In addition, numerous engines must move from one yard to the other after dropping off trains, adding another group of movements to this line. <u>Id.</u>, pp. 20-21.

There are still more problems with the plan. After the 10 or 11 daily PTRA industry jobs finished their work in the Pasadena area, they would have to follow Route A or B to Strang Yard to deliver outbound cars, adding almost a dozen more movements to the busy trackage between Pasadena and Strang. Most of them would be working somewhere along Route B, so it makes sense for them to use Route B, causing severe disruption at Strang Yard. Then, each of the engines would have to return to Pasadena Yard, again using route A or B and adding more movements. Id.

Every car on every one of these trains would incur a wholly avoidable, delay-causing and congestion-causing round trip away from its direct route. Id., p. 21. In this area, all outbound cars must move westbound through Manchester Junction to reach the rest of the railroad world. See Handley Map 3. But under the KCS/Tex Mex plan, all the cars gathered at PTRA-served industries must travel miles in the wrong direction over congested tracks to Strang. Then, after switching, they must turn around and cover the same trackage to go back to Manchester Junction. This would delay all traffic in the area and cause unnecessary congestion.

With its current configuration, the track network depicted on Handley Map 3 has great difficulty handling the number of movements it must absorb today. It could not possibly handle all of the plan's additional movements, most of which would include a time- and capacity-consuming backup maneuver or runaround (moving engines from front to rear of a train). Id., pp. 20-21.

The Port of Houston plans to add double track to some segments of this track network over the next several years. Id. Additional trackage is needed today, but the Port's objective is to support a major increase in high-priority intermodal traffic to and from Barbours Cut -- which the Port hopes to make into one of the nation's leading container facilities -- and another new Port facility. UP has already concluded that it should spend additional funds for CTC on these tracks in order to allow it to handle current business and the planned traffic increases. Infrastructure Report, p. 30. In Mr. Handley's opinion, the double track, which is not yet under construction and unlikely to be completed until late in 2000, would be unable to handle the numerous additional movements required by the KCS/Tex Mex plan. Id., p. 20.

In sum, the KCS/Tex Mex operating plan for the Bayport Loop/Strang would be a failure, not only for UP shippers but also for the dozens of PTRA shippers on PTRA's south side. The entire area would be gridlocked on the first day. Even if the entire design were workable, service quality would decline. The KCS/Tex Mex plan is a prescription for disaster.

Service Through North Yard. The KCS/Tex Mex operating plan for PTRA service to shippers on HBT, UP's Clinton Branch and the GH&H line between Houston and Galveston is equally impractical, for one primary reason. KCS/Tex Mex call on all linehaul railroads serving Houston to bring all inbound traffic for these destinations to North Yard, the primary PTRA facility on the north side of the Houston Ship Channel. W. Slinkard/Watts V.S., p. 325.[53] This plan would fail, just as surely as the Pasadena/Strang plan would fail. As Mr. Handley knows from managing North Yard for more than a decade, it is jammed several days per week. Handley V.S., p. 17. It cannot accept thousands of additional cars per year.

PTRA often is unable to accept interchange from UP because North Yard has no room. Id. KCS/Tex Mex itself has complained about PTRA's inability to handle its business at North Yard, and in fact it mounted an expensive Pasadena-Beaumont extra train for several months in order to avoid relying on North Yard. KCS/Tex Mex's Emergency Joint Petition for Additional Trackage Rights Conditions, May 14, 1998, p. 3. Yet the same operating officers who made that decision now propose to push thousands of additional cars per year into this facility. As Mr. Handley puts it, "That dog won't hunt." Id., p. 10.

Even if North Yard had space to spare, service quality would decline for one important reason. Today, UP provides service directly from Englewood Yard to industries on

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[53] The plan does not clearly state that GH&H traffic moves into this yard, but PTRA's GH&H train will leave from that yard or an adjacent yard. W. Slinkard/Watts V.S., p. 13.

HBT, the Clinton Branch and the GH&H. If the KCS/Tex Mex plan were employed, UP would have to interchange those cars to PTRA at North Yard. While traffic on through UP trains to North Yard would suffer little delay, the majority of the cars, which pass through Englewood Yard, would be delayed by a day for an additional interchange to PTRA at North Yard (assuming PTRA could solve the problem of insufficient yard space).

Mr. Slinkard and Mr. Watts confidently assert that PTRA would deliver traffic to customers within 24 hours, "a significant reduction in UP's 41 hour dwell time." W. Slinkard/Watts V.S., p. 325. This is an apples-and-oranges comparison. PTRA endeavors to deliver all cars within 24 hours from arrival at its yards. But that 24 hours does not include switching at UP's or BNSF's switching yards in Houston or interchange to PTRA, which would be necessary for most of the cars. The UP 41-hour dwell time, by contrast, is total terminal time for outbound cars from release by the shipper to departure from the Houston terminal. If all terminal time is counted, the proposed PTRA service would be slower than UP's existing service. Handley V.S., pp. 18-19.

KCS/Tex Mex offer one further justification for the Clinton Branch takeover. They say that consolidating PTRA and UP operations in the Clinton Branch area would eliminate the conflicting PTRA and UP movements on and near the branch.

KCS-2, p. 327. The two carriers share trackage for about 100 feet and Mr. Handley knows of no conflicts. Id., p. 19.

d. PTRA Often Causes Congestion

KCS/Tex Mex extol the many virtues of the PTRA. UP agrees in most respects. PTRA is a solid operating organization with a good physical plant and fine safety record. As General Manager of the PTRA from 1981 through 1994, UP official Eddy Handley directed PTRA's transformation from an undermaintained property with the worst safety record among the 24 terminal switching companies in the United States to the well-maintained and safe operation that it is today, controlled and managed by BNSF and UP. Id., p. 5.

One of the reasons PTRA is able to keep congestion in check on an inadequate physical plant, however, is that it exports its congestion to BNSF and UP. PTRA refuses to accept additional traffic when it gets too busy. BNSF and UP agree with and support that practice. There is no reason to overwhelm the PTRA with traffic it cannot handle efficiently. Id., p. 6.

When PTRA exports its problems to BNSF and UP, they must hold trains and cars for PTRA. This is significant in three respects. First, PTRA's own good service quality results from this policy, under which BNSF and UP have accepted the adverse consequences of PTRA congestion. Second, PTRA exports congestion to UP-controlled tracks throughout the

Houston terminal (BNSF operates fewer lines of its own in Houston and therefore does not suffer as many consequences of PTRA congestion, although PTRA sometimes forces BNSF to hold cars in BNSF's Houston yards). Third, as noted above, the KCS/Tex Mex Plan calls for a huge increase in deliveries to PTRA, with no expansion of the affected facilities, which would cause massive congestion not only on PTRA but also on BNSF and UP as PTRA collapsed.

A significant component of the congestion that KCS/Tex Mex blame on UP throughout their filing -- and cite as a reason to expand PTRA -- results from the fact that PTRA transfers its congestion to UP trackage and yards. During some periods, PTRA accepts all traffic without difficulty. Throughout this spring, though, PTRA often failed to pick up cars from Englewood that it was supposed to retrieve, rejected approaching trains and refused to accept deliveries from UP. PTRA's current General Manager has claimed publicly that the fault lies with UP because it allegedly fails to pick up outbound cars from PTRA, but since April UP has almost never failed to pick up or accept a PTRA interchange. Id., pp. 6-10.

The examples of PTRA's refusals to accept inbound traffic are numerous, and their effects extensive. To cite a particularly harmful example, on July 28, 1998, PTRA agreed to take BNSF train M-AMAPTR1-26 from Amarillo to the PTRA in a

6:30 p.m. time slot. (All deliveries to PTRA must fit into a slot and be approved in advance by PTRA.) The BNSF train was on time, arriving at Basin Yard for interchange to PTRA at 6:30 p.m. With the train occupying an HBT East Belt mainline, one of the busiest lines in Houston, PTRA refused to accept it. The BNSF crew ran out of time under the Hours of Service Law at 7:15 p.m., stranding the train on the East Belt. Id., pp. 7-8.

At 11:00 p.m., BNSF placed a switch engine crew from its South Yard on the train. That crew sat on the train for four hours, awaiting PTRA permission to proceed, then it too ran out of service time. Throughout this delay, the East Belt -- used heavily by Tex Mex and BNSF, as well as UP -- was blocked. BNSF called a third crew for this train at 7:00 a.m. The crew arrived at 7:30 a.m. At 9:15 a.m., almost 15 hours after PTRA had originally slotted the train for acceptance, PTRA cleared the train onto its tracks. For almost 15 hours, an essential mainline in Houston, dispatched jointly by UP and BNSF, was blocked.

BNSF certainly made every effort -- and they were expensive efforts -- to move this train. But this is an example of how PTRA exports its congestion problems onto UP-controlled trackage. If a Tex Mex train was caught behind that BNSF train, Tex Mex no doubt blamed UP for its delay, and ascribed it to UP mismanagement and "discrimination." Yet this was not UP's fault. Id.

The point is not that any other railroad erred. The point is that PTRA looks good in part because it always makes UP look bad. The Board should weigh KCS/Tex Mex's allegations of UP delay, congestion and "discrimination" in Houston with these facts in mind. The KCS/Tex Mex parties want to expand PTRA to avoid UP congestion, but PTRA is itself one of the causes of Houston congestion. If PTRA's geographic reach expands, it will have even greater ability to reject traffic at its discretion, and greater ability to force UP (and BNSF) to accommodate it.

e. Reduced Investment

The Board should consider yet another important consequence of expanding PTRA and opening additional industries to competitive access. UP's former SP facilities in Houston need upgrading and additional capacity. UP is performing that work now, and it plans to do more. It has constructed two new connections at Tower 87, a pivotal junction connecting Englewood Yard with Settegast Yard. It has made numerous physical improvements at Englewood Yard and constructed new trackage on the south side of the yard. It has installed thousands of new ties on its line between Englewood Yard and the Clinton Branch and beyond all the way to Strang. Handley V.S., p. 3.

UP plans many more investments, including investments in the facilities that KCS/Tex Mex would like to appropriate for PTRA. As UP indicated in its Infrastructure Report (p. 29), it has immediate plans to expand Strang Yard. UP has budgeted over $11 million for Strang capacity in 1998 and 1999. Handley V.S., p. 26. As Mr. Handley states, opening up the Strang area to competitive access would halt those investments.

Similarly, UP plans to construct a major SIT yard in the Strang area. Infrastructure Report, p. 29. UP already owns the property for that yard. That yard, although needed badly, likely will never be built if this condition is granted. UP also plans to spend $4.6 million to add CTC on its tracks between Strang Yard and Manchester Junction. Id., p. 30.[54] This will not happen if PTRA takes over those lines. And UP proposes to build four 2,000-foot tracks on the Clinton Branch. Id., p. 21. UP cannot reasonably proceed with those expenditures while threatened by appropriation of the assets, and it will not make those investments if the branch is opened to PTRA service. Handley V.S., p. 26. No other party is proposing to make such investments.

This is a vivid, concrete and immediate example of the proposition, advanced by the Association of American

[54] UP stated in a letter dated June 1, 1998 that its May 1 report had misstated the costs it would incur in connection with this CTC project.

Railroads in recent dialogues on rail competition, that "open access" will kill investment. UP is not being petulant; it is behaving rationally, just as it and other Houston railroads have behaved for years. UP must earn an adequate return on investments. It does not expect to do so if this condition is granted.

Mr. Handley explains that PTRA's owners made the same decision while he was managing PTRA. Although they were willing to maintain a consistent level of operating funding for PTRA, which Mr. Handley used to maintain the property, they were never willing to make major investments in new capacity on PTRA, leaving it short of capacity today. Id., pp. 26-27. They did not want to spend their scarce capital dollars on investments that would benefit competitors, and on property owned by the Port of Houston, which has the power to dissolve the PTRA whenever it chooses. If PTRA becomes the operator of the Bayport Loop/Strang/Sinco and Clinton Branch trackage, much-needed capacity expansions will not take place.

f. Obstacles to Implementation

PTRA simply is not equipped to serve the entire Houston industrial complex. The KCS/Tex Mex plan severely underestimates both the difficulty of the transition and the costs of transforming the PTRA into a much larger railroad. It devotes less than two pages to this complex subject. KCS-

2, pp. 5-6. Here are the challenges to PTRA that KCS/Tex Mex does not adequately confront:

Locomotives. KCS/Tex Mex assume that BNSF and UP will give PTRA all the locomotives it needs until PTRA can purchase 37 of its own locomotives at a rate of two per month, a period of 19 months. BNSF and UP have no obligation to do that, and (unless its overall traffic levels fall) UP would deploy its locomotives to higher priority uses before giving locomotives to PTRA to help UP competitors take UP traffic. Handley V.S., p. 24-25.

Crews. KCS/Tex Mex also assume that they would have no difficulty filling 70 switchmen and 40 engineer positions. If they are assuming they would simply take the existing UP personnel for their new service, they are mistaken. UP has been hiring at a record pace and needs all of those employees. Id., p. 25. PTRA would have to hire 110 new employees off the street, just as UP has been doing, and it would have to train them from scratch. This would be no easy task. The petrochemical plants in the Houston area are very complex to switch, and it is even harder to learn those jobs without the help of an experienced employee. Id. Yet KCS/Tex Mex propose to use inexperienced new hires to switch these complex plants and move some of the nation's most dangerous shipments. That is of doubtful wisdom.

Dispatching. KCS/Tex Mex also assume that PTRA would open a new dispatching office with nine dispatchers, four corridor managers, and entirely new equipment. KCS-2, pp. 337, 362. PTRA has no dispatchers and no dispatching equipment. It operates its lines with yardmasters. Again, KCS/Tex Mex may be assuming that PTRA would simply appropriate the UP employees who perform that work today, but they are again mistaken. UP has been hiring and training dispatchers (a six-month task) as fast as possible, and the FRA determined that UP needs more. Handley V.S., pp. 25-26. UP would keep all of its dispatchers and corridor managers.

PTRA would be starting from scratch to acquire dispatching equipment and software, a cost ignored in the KCS/Tex Mex plan, and would be training its entire dispatching force from scratch. It is generally agreed in the industry that it takes two to five years of experience to make a dispatcher a good dispatcher. Id. Novice dispatchers delay trains. Id.

Other Personnel. The KCS/Tex Mex plan ignores many of the personnel requirements for running a greatly expanded railroad, as well as the associated costs. See KCS-2, pp. 328, 337. It does not include any maintenance-of-way employees at all to maintain the miles and miles of UP track that PTRA would take over. There are no signal maintainers to keep the grade crossing signals operating and the rail signal system working. There are no clerical personnel to enter data into PTRA's computer system on the thousands upon thousands of carloads it would handle. There is no one to repair the hundreds of additional cars on the PTRA every day.

This plan is presented by two experienced railroad operating men, but they appear to have focused only on what is generally considered the "transportation" function on a railroad, ignoring clerical support, mechanical activities, maintenance of way, communications and signals. Again, they may be assuming that UP, as track owner, would perform some of these tasks, but UP would have little incentive to do that. Handley V.S., p. 24. PTRA would need to staff all those functions, on a vastly expanded scale. The costs and difficulty of setting up this operation are overlooked.

2. PTRA Switching of HBT Industries and Use of Certain HBT Yards

KCS/Tex Mex want PTRA to take over switching of HBT industries and appropriate the HBT yards now used by UP, other than Pierce Yard. Like KCS/Tex Mex's proposal to appropriate other yards and tracks for use by a public entity that the Port of Houston has the power to dissolve, this proposal would be a taking of private property owned by HBT, and thus indirectly by BNSF and UP. UP and BNSF would be left with rights to operate through trains over HBT trackage in Houston, but all the HBT yards now operated by UP and all HBT industry trackage switched by UP would be taken for PTRA's exclusive use. HBT and its owners would be deprived of all incidents of ownership of these assets, except the duty to pay taxes. KCS/Tex Mex's proposal fails to provide for payment for this unconstitutional taking of private property.

The proposal also would not work. The KCS/Tex Mex plan to force all cars, some 8,000 loads and 8,000 empties per year, into already-full North Yard was mentioned earlier. In addition, while KCS/Tex Mex want PTRA to take over switching of the entire HBT, they do not propose to give PTRA any of the HBT yards used by BNSF, even though those yards are necessary to support HBT industry switching. Handley V.S., pp. 17-18, & Map 4. In other words, the KCS/Tex Mex parties want to transfer all of the switching activities of HBT to PTRA, but to take only the facilities that UP uses, not the ones BNSF uses. PTRA would not have the ability to provide the service BNSF now provides.

KCS/Tex Mex offer this proposal because, they say, service quality to HBT customers declined after UP and BNSF took over responsibility for HBT switching last November.[55]

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[55] As UP has shown in response to complaints filed by KCS/Tex Mex, those parties are wrong in their repeated contentions that UP and BNSF have dissolved HBT. The two railroads have entered into a trackage rights agreement to provide better service for HBT shippers, lower the switch fees, improve operations of through trains in the Houston Terminal, and bring about substantial operating cost savings. HBT remains in existence, and continues to have the underlying common carrier obligation to its shippers if UP or BNSF should ever fail to perform their contracted-for services.

KCS-2, p. 32. UP acknowledges that service to those shippers declined sharply late last year and during the first three months of this year. HBT trackage in Houston was congested, which would have impaired service no matter what entity tried to provide it. UP also was short of crew members, hundreds of whom have been hired in the last year, so it did not always provide reliable service. UP made the transition to TCS on SP and moved HBT dispatching to Spring at the same time in November. Those service problems affected not only UP traffic, but also shipments interchanged from BNSF and Tex Mex. UP corrected all those problems months ago.

KCS/Tex Mex rail at length against UP's alleged mishandling of Tex Mex interchange traffic, which they label "discrimination." E.g., id. As examples, they cite UP's misrouting or mishandling of several shipments and empty cars many months ago. Those events probably happened. Similarly, such events regrettably happened to hundreds of UP shipments during the service crisis, especially during the first 60 to 90 days after UP's TCS cutover in November.

UP was responsible for poor service and for information systems cutover problems, but there is no basis for any claim of "discrimination," then or now. Handley V.S., p. 23. UP receives Tex Mex cars for HBT industries at Basin Yard. It puts those cars into groups of cars to be moved directly to shippers or to other industry support yards for marshalling. The employees who handle the cars do not know which cars come from Tex Mex. They treat them all the same. No supervisor at UP has time to investigate car movement records to see which cars came from Tex Mex and to try to single them out for different treatment. The KCS/Tex Mex claims of "discriminatory" industry switching are misplaced.

Railroads switch each others' traffic in interchange and reciprocal switching service in virtually every terminal in America. UP provides switching service in virtually every large city it serves. UP is not aware of any complaints about "discrimination" in switching in any of those locations (including from KCS in many locations). Nor is UP asserting "discrimination" claims against any other carrier that it relies on for such switching. Only in this proceeding do these claims arise. Wilmoth V.S., pp. 7-8.

UP switching service on the HBT in recent months has improved to pre-merger levels if not better. UP has increased the frequency of service to HBT customers on the part of the HBT that it is operating. It uses eleven industry jobs where HBT used only nine. Handley V.S., p. 23. Throughout late spring and summer, UP switching service to industries throughout Houston has also been extremely reliable. Duffy

V.S., pp. 9-10. KCS/Tex Mex's service case for PTRA operation on HBT has simply evaporated.[56]

KCS/Tex Mex also argue, at considerable length, that PTRA should switch the HBT in order to restore the efficiency benefits of having a "neutral switcher." KCS-2, pp. 35-36, & Ritter V.S. This argument is inconsistent with the evolution of the railroad industry in this country. UP asked James E. Martin -- who, unlike KCS/Tex Mex witness Ritter, is not employed by a party to this proceeding -- to review Mr. Ritter's statement. Mr. Martin's credentials to address this issue are unmatched: in his 51 years in the railroad industry, he has served as President of the Belt Railway Company of Chicago; a board member of the Terminal Railroad Association of St. Louis, the Kansas City Terminal Railway, and the Peoria & Pekin Union Railroad; and project director in the recent establishment of a terminal railroad in Mexico City, among other positions. As he explains, terminal carriers owned by multiple railroads were created to avoid duplicate investment and the inefficiencies and conflicts that could be caused by having multiple carriers operating in close quarters in major terminals. Martin V.S., pp. 2-3.

Mr. Martin notes that terminal railroads promote efficiency when the terminal is served by a large number of

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[56] UP is aware of switching problems for one HBT customer, because of the extreme difficulty of reaching this customer on a very busy HBT track. Handley V.S., p. 23.

linehaul railroads, such as the 18 that serve Chicago. Id., pp. 2-3. Houston once had large numbers of carriers, giving rise to the HBT. According to Mr. Martin, though, where the number of linehaul carriers is small, using a terminal carrier becomes inefficient and increases costs. As a result, the Nation's railroads have been disbanding terminal railroads to reduce costs and provide more efficient service. Id., pp. 5-7. That is precisely the reason BNSF and UP agreed to assume direct responsibility for service on HBT trackage last fall. HBT's per-car costs had exploded to $200 to $300 by 1997. KCS/Tex Mex therefore want to take an unnecessary and inefficient step backward. PTRA would have to absorb higher costs, increasing delays to linehaul carriers and, ultimately, shippers.

KCS/Tex Mex do not make any attempt to explain how PTRA would serve HBT shippers that BNSF serves today, much less serve them better. As noted earlier, they would not confiscate BNSF-operated yards, as they would UP-operated yards, but they do not provide any facilities to replace the activities of those yards in supporting local industry switching. Perhaps their unstated assumption is that BNSF would continue to switch cars, which would then be delivered by PTRA crews. If so, one wonders why they bother, since BNSF could still inflict whatever "discrimination" it wished in preparing the traffic for movement. Or perhaps their theory is that UP has some unique propensity to discriminate.

3. Houston-North Rights

KCS/Tex Mex renew their request that the Board remove the limitation it placed on Tex Mex's trackage rights between Corpus Christi/Robstown and Beaumont. That limitation requires that traffic handled using those rights have a prior or subsequent movement on Tex Mex's original Laredo-Corpus Christi line. The Board has on three separate occasions held that unrestricted trackage rights, which would principally open to Tex Mex traffic moving between HBT and PTRA industries in Houston and points north in conjunction with KCS (so-called "Houston-north" traffic),[57] are unjustified. This proposed condition would expose $118 million in UP revenue per year to loss. Peterson V.S., p. 28.

In Decision No. 44, at pp. 149-50, the Board made clear that unrestricted rights were not justified by any competitive or essential services rationale. Tex Mex petitioned to reopen, arguing that unrestricted rights were needed to remedy "3-to-2" competitive effects in Houston and that Tex Mex's inability to handle Houston-north traffic would

[57] Unrestricted rights would also allow Tex Mex to handle "2-to-1" traffic between other points on its trackage rights lines such as Amelia, Texas, and points north. KCS/Tex Mex have never made any effort to justify these rights, which are equally meritless, and would simply expand the windfall they would receive.

"seriously impair Tex Mex's ability to compete effectively for the traffic it is permitted to carry." Decision No. 62, served Nov. 27, 1996, p. 3. The latter is exactly the argument Tex Mex now repeats here. The Board expressly rejected both contentions. Id., pp. 5-9. Then, in the first annual merger oversight proceeding, the Board again rejected requests for the removal of Tex Mex's prior/subsequent haul restriction, finding no basis in the record "to revisit the extent of the access granted to Tex Mex." Finance Docket No. 32760 (Sub-No. 21), Decision No. 10, served Oct. 24, 1997, p. 6.

For the reasons discussed above, there is still no competitive justification for adding a third carrier -- Tex Mex -- for the 3-to-2 traffic moving between Houston (or other Tex Mex-served 2-to-1 points) and points north. And it is clearer than ever that Tex Mex and its affiliate KCS have no need for the windfall of Houston-north traffic to preserve essential services on Tex Mex's original Laredo-Corpus Christi/Robstown line. That line provides BNSF's only access to the important Laredo gateway, is an integral part of the KCS-Tex Mex-TFM "NAFTA Railway," and is a salient component of the newly-formed CN/IC/KCS Alliance.[58]

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[58] Nor does this windfall have anything to do with KCS/Tex Mex's plan to acquire and rehabilitate the Wharton Branch. Although they say they need the revenues from Houston-north traffic to support the Wharton Branch investment, this is (continued...)

KCS/Tex Mex have again attempted to justify their request for Houston-north rights by arguing that such rights are important to Tex Mex's ability to provide effective competition for Mexican traffic, including Mexican traffic originating and terminating at Houston as well as intermodal and automotive traffic moving via Houston. KCS-2, pp. 14-16. These same arguments have already been rejected by the Board, and KCS/Tex Mex offer no new evidence -- other than vague and conclusory assertions (see Woodward V.S., pp. 220-22; Turner V.S., pp. 230-31) -- to support their contention that the Board's prior decision was wrong. The facts in this record establish even more clearly that Tex Mex's assertions are baseless.

First, the robust success Tex Mex has enjoyed in competing for traffic moving between the United States and Mexico via Laredo, discussed above, flatly contradicts any theory about the need for Houston-north rights to compete

[58] (...continued) manifestly not the case. The investment would not serve Houston-north traffic, and thus could not rationally be justified on the basis of its proceeds. Instead, the economic viability of the Wharton Branch investment would depend on the returns that KCS/Tex Mex expected to earn on Tex Mex Mexican traffic, which would use the Branch. Also, as discussed below, there is no relationship between Tex Mex's ability to compete for Mexican traffic and its demand for Houston-north rights.

effectively for Mexican traffic.[59] This general observation applies with equal force for Mexican traffic to and from Houston. As Mr. Barber explains, the level of traffic Tex Mex has handled between Mexico and Houston was not affected by Tex Mex's lack of Houston-north rights. By late 1997, Tex Mex had increased its Houston-Mexico trackage rights volumes manyfold as compared to the early months of its trackage rights operations, primarily as a result of winning a significant volume of southbound business from a single HBT shipper. Tex Mex's temporary Houston-north service order rights were granted after this new traffic was won, and did not lead to any further traffic gains. Barber V.S., pp. 66-69.

Second, through its interline partner BNSF, Tex Mex already enjoys, in competing for Mexican traffic, the interline equivalent of the Houston-north rights that KCS/Tex Mex now seek for themselves. Before the UP/SP merger, the only ability Tex Mex had to serve "Houston-north" traffic as a way of bolstering its competition for Mexican traffic was via its interline relationship with SP. By replacing SP with BNSF, the Board has given Tex Mex a partner that has a far more comprehensive network -- including the ability to

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[59] As discussed above, the first two years of post-merger experience have shown that BNSF alone has more than replaced SP as a source of Tex Mex interline traffic, demonstrating that Tex Mex's role as a competitor for Laredo traffic would have been more than amply preserved even without any grant of trackage rights to Tex Mex, much less unrestricted Houston-north rights.

originate traffic at Houston for all points of the compass -- than SP had, or than KCS/Tex Mex could hope to achieve by expanding Tex Mex's own Houston-north rights. Thus, even if KCS/Tex Mex were correct -- and they are not -- that access to Houston-north traffic is necessary to compete effectively for Mexican traffic, Tex Mex already has the benefit of its new, robust interline connection with BNSF to preserve and strengthen its capabilities relative to pre-merger conditions.

Third, the statements of KCS/Tex Mex's witnesses about the need for Houston-north rights in order to compete for "packaged" traffic offer no support for KCS/Tex Mex's position. Such "packaging" is not an obstacle to Tex Mex's competition for Houston-Mexico traffic using its Board granted trackage rights. Peterson V.S., p. 24-25 n.4. The Board has consistently rejected the notion that a railroad capable of providing efficient service for a subset of a shipper's traffic is foreclosed from competing for that traffic unless it can also bid on a broad "package" of the shipper's other traffic. See UP/CNW, Slip Op., p. 80. The contrary statements of KCS/Tex Mex's witnesses are entirely conclusory and do not even attempt to make a concrete showing that Tex Mex has been deprived of any competitive opportunities as a result of its inability to package Houston-north traffic (via

KCS) with Mexican traffic. See Woodward V.S., pp. 220-22; Turner V.S., pp. 230-31.[60]

In the specific context of Houston traffic, moreover, KCS/Tex Mex's "packaging" theory also founders on the fact that there is very little nexus between traffic originating in Houston and destined for points in the United States north and east of Houston, on the one hand, and traffic destined for Mexico, on the other hand. Tex Mex's experience during the period under the emergency service order, when it was permitted to handle Houston-north traffic, confirms this conclusion.

Of all the traffic originating in Houston that Tex Mex handled during this period, only a single shipper had any traffic moving both north and south. Barber V.S., pp. 68-69. That shipper's northbound shipments, however, involved different commodities than the one commodity it shipped to Mexico. The northbound and southbound commodities have traditionally moved under separate contracts, as evidenced by the fact that this shipper had been using Tex Mex to handle southbound shipments for some time before Tex Mex became authorized to handle Houston-north traffic on a temporary

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[60] When asked in discovery for an identification of any traffic opportunities missed because Tex Mex lacked Houston-north rights, KCS/Tex Mex merely referred UP nonsensically to its 100% traffic tapes -- to show traffic it did not carry. See TM-4/KCS-4, May 28, 1998, Response to Request No. 3, pp. 4-5.

basis. Under these circumstances, there is no possibility that "packaging" could have played any role in these movements. Id. Indeed, for this shipper, the expansion in Tex Mex's rights under the emergency service order was actually accompanied by a reduction in the volume of its Mexican traffic. Id. This experience contradicts the theory advanced by KCS/Tex Mex that the "package bidding" made possible by Houston-north rights is indispensable in order to permit Tex Mex to compete effectively for Mexican traffic using its trackage rights.

Fourth, KCS/Tex Mex's witnesses suggest that Houston-north rights are necessary to enable Tex Mex to compete for intermodal and automotive traffic moving via the Laredo gateway, suggesting that Tex Mex needs to be able to "hub" this traffic at Houston to be competitive. Woodward V.S., pp. 5-6. Again, however, these statements are purely conclusory and fail even to hint at concrete examples of actual traffic opportunities that Tex Mex has been -- or will be -- unable to compete without Houston-north rights.

Moreover, KCS/Tex Mex again overlook the fact that Tex Mex is already in a better position to compete for such traffic than it was before the merger. The only ability Tex Mex had to build intermodal volumes and "hub" traffic at Houston before the merger was through SP's ability to do so, and BNSF is more capable than SP was of competing effectively for such traffic in conjunction with Tex Mex.[61]

Even more important, it is clear that KCS/Tex Mex have no need for Houston-north rights to compete for this traffic. Tex Mex is making a $9.5 million investment in a new classification yard and intermodal facility near Laredo, which, according to KCS/Tex Mex, "enables Tex Mex to handle intermodal and automotive traffic for the first time, breaking Union Pacific's Laredo monopoly over these commodities."[62] Mr. Plaistow included both categories of traffic in his "Base Case" analysis of the effect of the UP/SP merger on Tex Mex, which assumes no expansion in Tex Mex's limited trackage rights.[63] Tex Mex would not have made this substantial investment unless it expected to be able to compete successfully for such traffic, and it certainly could not have been gambling that the Board would remove the restriction on Tex Mex's rights as a precondition for this investment to be viable.

These competitive capabilities are clearly being rewarded in the marketplace. KCS/Tex Mex, in conjunction with

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[61] It should not be forgotten that Tex Mex was not handling any automotive or intermodal traffic with SP at the time of the UP/SP merger. KCS-2, Plaistow V.S., pp. 256-57.

[62] KCS-2, Plaistow V.S., pp. 256-57; TM-7/KCS-7, Fields V.S., p. 86.

[63] KCS-2, Plaistow V.S. p. 258.

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"Alliance" partners CN/IC and voluntary cooperation agreement partner Norfolk Southern, have recently won significant movements of finished Volkswagen automobiles between Mexico and distribution facilities in Canada and the Southeastern United States, and KCS is investing heavily in new auto-rack equipment to handle this traffic.[64] According to KCS:

> "Because of its unique relationship with CN/IC and NS, KCS' NAFTA Railway is positioned for dramatic growth in this market, affirms Vaughn Short, Vice President of the Intermodal business unit. He assures that the new auto racks are just the first step. Stay tuned."[65]

KCS/Tex Mex's ability to compete for automotive and intermodal traffic thus has nothing to do with whether Tex Mex can serve Houston-north traffic.

As already discussed, confirmation of Tex Mex's ability to compete effectively for intermodal and automotive traffic without Houston-north rights is to be found in the traffic projections submitted to the Board, by the same witnesses who support KCS/Tex Mex's position in this proceeding, in support of the CN/IC merger. Those projections rested on the explicit assumption that Tex Mex would continue not to have Houston-north rights,[66] and nonetheless forecast

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[64] Test shipments reportedly began in July 1998, and KCS began receiving 100 newly-leased auto-racks painted in "NAFTA Railway lettering" in August. KCS News, Aug. 26, 1998, p. 1.

[65] Id.

[66] Finance Docket No. 33556, CN/IC-7, Woodward/Rogers V.S., p. 22 (Appendix A).

substantial diversions of intermodal and automotive traffic to KCS/Tex Mex between Shreveport and Laredo.[67]

Fifth, KCS/Tex Mex repeat their assertion about the need for Houston-north rights in order to be able to compete for Houston-originating plastics traffic that some shippers place in SIT storage at Houston before making a determination as to the final destination. Woodward V.S., p. 222. This conclusory statement should be rejected for the same reason that the Board rejected precisely the same argument in 1996. See Decision No. 62, p. 8. The Board specifically found that UP had "effectively rebutted Tex Mex's contention that the requirement of some plastic shippers that they be able to use storage-in-transit facilities will unduly limit Tex Mex's ability to compete for Houston traffic moving into Mexico," because plastics comprised only a tiny fraction of the traffic moving to Mexico from Houston and none of this traffic requires storage in-transit." Id.; see also UP/SP-283, Peterson V.S., pp. 11-12. KCS/Tex Mex's position is all the more defective now, given that, despite a substantial period of operation under Tex Mex's limited trackage rights, they are still unable to present even one concrete example of plastics traffic Tex Mex was unable to compete for -- whether using its

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[67] Id., pp. 11-24. Tex Mex is shown as gaining $3 million in new intermodal revenues, $8 million in new finished vehicles revenue, and $0.8 million in new auto parts traffic, not including KCS's much greater revenue gains for its portion of these movements.

own trackage rights or in conjunction with BNSF -- because of its lack of Houston-north rights.[68]

Finally, it cannot be overlooked that KCS/Tex Mex's request for Houston-north rights as a way of (supposedly) allowing Tex Mex to compete more effectively for unspecified amounts of additional Mexican traffic is vastly overreaching. KCS/Tex Mex are desperately trying to use the tail to wag the dog in order to achieve a tremendous windfall of Houston-north traffic. Although KCS/Tex Mex have not prepared traffic projections on a condition-by-condition basis, it is clear that the great preponderance of the additional traffic that Tex Mex would handle if given new Houston-north rights would _be_ Houston-north traffic, not Mexican traffic for which Tex Mex claims a desire to compete more effectively.[69]

Apart from being wholly unnecessary and unjustified, the expansion of Tex Mex's trackage rights to permit the handling of Houston-north traffic would also cause significant adverse operating consequences in Houston and elsewhere in Texas. As Mr. Handley explains, Tex Mex's Houston-north

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[68] Again, when asked to identify any such lost opportunities, KCS/Tex Mex merely referred UP to Tex Mex's 100% traffic data.

[69] _See_ KCS-2, Rogers V.S., p. 242 (Ex. 3). Moreover, it is apparent that much, if not all, of Tex Mex's projected traffic gains to and from Mexico are attributable to other conditions, especially Tex Mex's shorter route via the Wharton Branch and the opening of large numbers of exclusively-served UP shippers in the Houston area under the guise of expanding PTRA. _Id._., pp. 236-37.

operations (with or without KCS/Tex Mex's other condition requests) would unnecessarily impose on Houston's rail infrastructure inefficient and operationally-burdensome new train operations:

- Experience under the emergency service order has shown that Tex Mex's Houston-north operations, by splintering traffic among three railroads rather than two, would result in a net increase in the number of trains operating in Houston. Tex Mex's additional trains would cause an increase in delays and congestion on the lines in Houston that have the least capacity to absorb additional train movements -- the East Belt and, if Tex Mex's request for access to Booth Yard were granted, the Booth Yard/Bridge 5-A route. See Handley V.S., pp. 27-31, & Map 5.[70] There is no need for these additional train movements, because the traffic Tex Mex would handle is already being handled more efficiently by UP and BNSF.

- The additional Tex Mex trains would have to operate through UP's Settegast Yard, where there is no bypass track and Tex Mex trains already cause significant disruption to yard activities. Handley V.S., p. 30.

- Tex Mex's Houston-north operations would also result in its existing trains between Mexico and Beaumont

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[70] Importantly, Tex Mex's use of Booth Yard would not avoid the need for the trains to traverse most of the East Belt and UP's Settegast Yard. Id., pp. 41-42.

performing additional work at Houston in order to pick up and/or set out Houston-north traffic in addition to the "Houston-south" traffic that Tex Mex already handles. Handley V.S., pp. 28-30.

- Dividing Houston-north traffic among three carriers rather than two would also require the preparation of additional blocks by the carriers serving Houston -- especially PTRA. This additional work, and the additional transfer moves needed to handle the movement of Tex Mex's Houston-north traffic within the terminal, would put additional strain on track and yards that are already at or close to capacity. Handley V.S., p. 31.

- KCS/Tex Mex's demand for access to UP's Booth Yard confirms the adverse operating effects of an expansion of Tex Mex's trackage rights. As discussed below, Tex Mex's use of Booth would displace important UP operations that have been very useful in relieving congestion at Englewood and Strang Yards, advancing UP's service recovery efforts, and improving service to shippers in the Sinco area. See Handley V.S., pp. 39-40. Yet, as Mr. Handley explains, KCS/Tex Mex's perceived need for additional infrastructure in the form of Booth Yard only arises because of their request to expand the scope of Tex Mex's existing, limited Houston operations to encompass the handling of Houston-north traffic.[71] Declining to grant the unnecessary and unjustified expansion of Tex Mex's trackage rights would thus not only avoid the operating problems described above but also eliminate any basis for KCS/Tex Mex's request for access to Booth Yard and the further operating problems caused by displacing UP's use of Booth. Id., pp. 35-36.

4. Permanent Placedo-Algoa Rights

In the merger case, Tex Mex fought in the trenches and on the beaches to operate over the SP Placedo-Flatonia-Houston route. It defended that choice vigorously against criticisms from other parties. And it won. Then it resisted operating on UP's Placedo-Algoa line when UP adopted directional operation, with this segment operated primarily as a northbound track. Only under pressure from UP and the Board did Tex Mex agree to use it. Now, like a bad house guest, it wants to stay forever.

UP believes that this condition is beyond the Board's power, because the Board would have to grant trackage rights over BNSF between Algoa and T&NO Junction, and we know of no legal ground for doing so, unless BNSF consents. We leave that issue to BNSF.

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[71] KCS/Tex Mex demanded access to Booth to support the handling of Houston-north traffic even before they made their request for the expansion of PTRA to gain access to hundreds of solely-served UP shippers in the Houston-Bayport-Galveston area. TM-7/KCS-7, p. 4.

This condition is in any case unnecessary, and it would impair UP and BNSF operations. The condition is unnecessary because, as long as UP is operating directionally, UP will -- as it has pledged to the Board -- allow Tex Mex to continue to operate northbound over this segment. The condition is also moot, because, as discussed below, UP has agreed to sell the Wharton Branch to Tex Mex, giving Tex Mex its own route closely parallel to this segment. With its own line, Tex Mex does not need to use UP's line.[72]

This condition is unreasonable because Tex Mex vociferously insisted on obtaining trackage rights between Houston and Placedo via Flatonia, not via Algoa. In the UP/SP merger proceeding, Tex Mex asked for this route knowing that it was much longer than the Algoa route. It presented and defended a "jam capacity" analysis by Alan Haley, now a Tex Mex operating officer, showing that the Algoa route was too congested to accept Tex Mex trains. TM-23, Haley V.S. It argued that its choice would be fully competitive with the BNSF route via Algoa. TM-34, Haley V.S., p. 7 ("The Tex Mex route does not, therefore, suffer by comparison to the BNSF route when they are examined in full"). It acted on that preference by investing in a new siding south of Flatonia,

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[72] Tex Mex offers to allow UP and BNSF to preserve directional operations by using the Tex Mex line southbound and the UP line northbound. However, UP wants to reinstate bidirectional service on this line. Handley V.S., p. 32.

Texas, and by helping to fund the upgrading of a connection at Flatonia. Tex Mex made this choice and it should live with it.

The Tex Mex condition would degrade service because UP plans, after it adds additional capacity near Angleton, Texas, to return to bidirectional operations on this line. Handley V.S., p. 32. UP prefers to operate bidirectionally because it has numerous customers on line that it can best serve that way, and because operating over its alternative route via Flatonia is 70 miles longer and more expensive. When it returns to bidirectional operation, BNSF also will operate bidirectionally on the line. Even with the new Angleton siding, the line will then be close to capacity without Tex Mex trains. Id. UP, BNSF and their customers should not have to suffer the additional delays resulting from Tex Mex operations, merely because Tex Mex has changed its mind.

5. "Neutral Dispatching" by PTRA

UP's response to this specific condition request is relatively simple. However, we will also take this opportunity to respond in more detail to KCS/Tex Mex's repeated claims that UP -- and, more recently, BNSF and UP acting in concert -- have "discriminated" against Tex Mex trains.

If PTRA were providing the service on, and ousting UP from, the Strang/Bayport Loop/Sinco area, the Clinton Branch, and the GH&H -- which we have shown is <u>utterly</u> unjustified -- it would then make sense for PTRA to dispatch all of the trackage south and east of Tower 30 in Houston, all the way to Galveston, and the Clinton Branch. We have already noted the manifold costs and difficulties PTRA would face in developing such a dispatching capability, but it would make no sense for UP or BNSF to dispatch trackage which they would use very little or not at all (and which the KCS/Tex Mex plan would render unmanageable in any event).

It would under <u>no</u> circumstances make sense for PTRA to dispatch any other segment of UP or HBT trackage in the Houston area, even if it had the right to switch the shippers on those lines. Specifically, UP opposes PTRA dispatching of the following lines under any circumstances:

- Harrisburg Line, Tower 81 to Harrisburg Jct., including Katy Neck
- UP Houston Subdivision between North GH&J Jct. and Tower 30, including Tower 30
- HBT West Belt Subdivision
- HBT East Belt Subdivision
- HBT Booth Yard Lead
- UP Houston Terminal Subdivision from Bell Yard Wye to the Galveston Line and the Galveston line through Tower 86 to Harrisburg Junction.

All of these lines carry UP mainline trains.

The KCS/Tex Mex proposal to turn these lines over to PTRA dispatchers would destroy one of the most significant improvements to Houston operations accomplished since the service crisis -- the consolidation of Houston-area dispatching at the Consolidated Dispatching Center in Spring, Texas, with UP and BNSF dispatching of other tracks in the region from the same facility. Notwithstanding incessant KCS/Tex Mex sniping and refusals to cooperate, UP and BNSF have created a coordinated dispatching center with dispatchers from both railroads sitting side by side, able to control the entire region. BNSF and UP agree that it works beyond their expectations.

At the Spring center, dispatchers with adjoining territories can talk directly to each other, regardless of employer, without having to use often busy telephones. They can look at computer screens to see approaching trains, so they can plan for them. They can work together in the interest of avoiding delay and conflicts.

The KCS/Tex Mex proposal would wreck this success by creating a black hole in the middle of Houston. They want to move the Houston terminal complex dispatchers out of the Spring center to a facility in downtown Houston. They want to destroy the ability of one dispatcher to talk directly to another, and the ability of supervisors to confer with each other. They want to return to the old days, when a train passing through Houston on many routes had to talk to one dispatching office to get into Houston, another to get through it and yet another to get out. And every one of those dispatchers was oblivious about what trains are approaching his or her territory and what effects his or her actions would have on the next dispatcher. They want to return to the days when dispatching territory boundaries were almost automatic delay points for trains.

Applied to Houston terminal mainlines, this condition is unwise and improvident.

The KCS/Tex Mex "Discrimination" Claims

In KCS-2, KCS/Tex Mex continue their longstanding campaign of resistance to cooperation with BNSF and UP, choosing instead to complain to the Board about "discrimination" in the hope that the Board will give them commercially valuable UP rights. Originally, KCS/Tex Mex contended that UP was discriminating against other railroads. When BNSF and UP joined forces to create the BNSF/UP Consolidated Dispatching Center in Spring, Texas, KCS/Tex Mex had to change their theory and blame BNSF and UP for jointly discriminating against them. Now they devote more than 10 full pages of KCS-2 to excuses for their persistent refusal to cooperate with BNSF and UP in coordinated dispatching. KCS-2, pp. 50-53, 54-46, 379-85.

The data presented in Part I.C.2 above, showing that Tex Mex trains enjoy better transit times than comparable UP trains on all segments, powerfully refute KCS/Tex Mex's claims of "discrimination" by UP and BNSF dispatchers. There are many other reasons to reject those claims as a basis for Board action.

KCS/Tex Mex say that discrimination occurs constantly, day in and day out. Their lawyers, resisting discovery, asserted in writing that they could not document these discriminatory events because there were too many of them. According to KCS counsel, KCS/Tex Mex could not identify the incidents of "discriminatory or preferential treatment involving Tex Mex trains" because there have been "innumerable incidents that have taken place over a period of years" and reconstructing them would "require several months' work of high level Tex Mex personnel" doing nothing else. TM-9/KCS-4, Responses to UP's Third Set of Discovery Requests, Response to Request No. 1. They said this even though Tex Mex usually operates only two, or at most four, trains per day on UP lines and Tex Mex had been operating those trains for less than two years.

The Administrative Law Judge appointed by the Board refused to accept these transparently exaggerated claims. He rejected the assertions that routine crew records that show on-duty and off-duty times reflect incidents of discrimination. He gave KCS/Tex Mex two weeks to describe and document alleged instances of discrimination upon which they proposed to rely in support of their extravagant "discrimination" claims. Hearing Transcript, Aug. 27, 1998, pp. 28-35.

Two weeks later, KCS/Tex Mex returned without a single new description or document evidencing "discrimination." Under the ALJ's ruling, KCS/Tex Mex are thus limited to the specific allegations they have advanced in specific pleadings. In KCS-2, KCS-Tex Mex witness Watts identifies only three such allegations from the month of May, and witness Nichols adds four from the month of June. KCS-2, Watts V.S., pp. 384-85; Nichols V.S., pp. 372-73. The modest showing by Mr. Watts, a former train dispatcher for SP, is significant in light of the fact that he spent four days in Omaha reviewing tapes of UP and BNSF/UP dispatching decisions recorded on tape for an eleven-day period. Watts V.S., p. 384. This allowed him to re-create the dispatching decisions made by UP and BNSF/UP dispatchers with respect to every one of the 30 or more Tex Mex trains that ran over UP during that period.

KCS/Tex Mex also contended that they had made so many attempts to complain to UP officials about "discrimination" that they could not begin to list them. They said there were "countless daily complaints that have been made," and that listing them would, again, consume all the time of Tex Mex's high level personnel. TM-9/KCS-4, Response to Request No. 3.

KCS/Tex Mex had never described or documented a single such complaint in this proceeding, so the ALJ ordered them to provide evidence of their "innumerable," continuous efforts to have "discrimination" addressed, or to forfeit their claims. Hearing Transcript, Aug. 27, 1998, p. 45. They failed to produce a single document reflecting such efforts, and they described not a single complaint. Under the ALJ's ruling, KCS/Tex Mex must be deemed to have failed to substantiate their claims that they made such continuous efforts.

When asked about these allegations in recent months, UP has encouraged government agencies and interested parties to go to the Spring Center and talk to the human beings who are alleged to be the discriminators. Duffy V.S., p. 20. The BNSF/UP manager of the Spring joint dispatching center joins in this open invitation. T. Slinkard V.S., p. 1. The dispatchers in Spring are not a large, faceless corporation. They are individual professionals trying to do a good job in moving all trains through the Houston terminal. And they bristle at Tex Mex's reckless, self-serving assertions. Id., p. 1.

Troy Slinkard, the brother of KCS's witness and Superintendent-Gulf Region, Bill Slinkard, is the joint BNSF-UP manager at Spring. He testifies that Spring Center dispatchers are told to treat all trains equally and that they do not discriminate. If anything, they favor Tex Mex trains because they know their treatment of those trains is under a microscope. Id., p. 3. The measurements we present today support that.

Mr. Slinkard testifies as well that Tex Mex officials almost never raise questions about the dispatching of their trains. In fact, except shortly before important STB filings or hearings, they would only rarely appear at the Spring Center. Thus, while KCS/Tex Mex counsel are claiming "countless daily complaints," Tex Mex officials are not even putting in a daily appearance at the dispatching center. They usually do not make contact until a daily 11 a.m. conference call among all Houston railroads. They usually discuss only Tex Mex's plans for the day. Id., p. 8.

According to Mr. Slinkard, when Tex Mex officials raise questions, they tend to do so long after the event rather than at the time when he could look into the situation. He observes that Tex Mex "seems to prefer to watch what happens and question it later." Id., p. 9.

Over the course of seven months, KCS/Tex Mex have submitted three pleadings and associated materials that they assert contain evidence of "discrimination." Letter from S. Zimmerman to D. Meyer, Sept. 9, 1998. Under the ALJ's order, they are foreclosed from relying on any other evidence, because they were unable to adduce any.

One of those pleadings contained evidence, alleged to reflect "discrimination," that UP management refused to allow Tex Mex to operate over Houston routes where it does not have trackage rights. Emergency Joint Petition of Tex Mex and KCS for Additional Trackage Rights Conditions to Emergency Service Order No. 1518, May 14, 1998, Watts V.S., passim. That is not "discrimination," and UP stands by its conduct and the terms of this Board's Decision No. 44. The Board granted Tex Mex's request for specific trackage rights through the Houston terminal and no others. As UP explained in response to that petition, the trains Tex Mex wanted to route through the terminal without regard to its trackage rights were unnecessary operations carrying very few cars that caused more congestion in Houston than they resolved. UP's Opposition to KCS/Tex Mex's Emergency Joint Petition for Additional Trackage Rights Conditions, June 2, 1998, pp. 8-11.

The second pleading contains allegations of severe delay to Tex Mex trains in November 1997 through February 1998. KCS-7, filed in Finance Docket No. 32760 (Sub-No. 21), Watts V.S., pp. 164-65. UP does not deny these delays; similar delays afflicted UP trains during that period. These unfortunate incidents reflected significant service problems in Houston, oft-acknowledged by UP, but no "discrimination." The examples list delays, but not claims that UP trains were given preferred handling.

That leaves only the three incidents claimed by Mr. Watts after four days of reviewing dispatching tapes in Omaha, and the four more mentioned by Mr. Nichols, all in KCS-2.

Mr. Watts devotes the most attention to an incident on May 28, when UP allegedly discriminated by allowing two UP trains to operate against the flow of traffic on the directionally-operated line from Houston to Beaumont. Watts V.S., p. 9. UP has already responded to this claim. Letter from A. Roach to W. Mullins and R. Allen, June 10, 1998. As UP explained then, the Tex Mex train was not delayed at all by the two UP trains. The two-hour delay happened much earlier, caused in part by another Tex Mex train.

The Tex Mex train, MMXSH-27, was never delayed by the two UP trains. The first of those UP trains, MALMX-27, incurred all the delay when it met the Tex Mex train, which did not stop at their meeting point of Dyersdale. The second UP train, MAVHO-26, waited for the Tex Mex train for <u>four hours</u> and again took all the delay. Those UP trains had been allowed to make the unusual contra-flow trip because there was no reasonable option on leaving Beaumont, but UP paid dearly for that decision as the Tex Mex train received preferred handling. There was no discrimination, and Tex Mex sailed by the offending trains.

Mr. Watt's second example, a 50-minute, allegedly "inexplicable" delay to Tex Mex train 1MMXSHJ-30 (Watts V.S., p. 384), was not inexplicable to BNSF/UP dispatching manager Troy Slinkard. He observed the events of that day. The Tex Mex train suffered this short delay on the busy HBT East Belt because the UP train had a clear route and the Tex Mex train did not. T. Slinkard V.S., pp. 5-6. He notes that, on that same day, a Tex Mex train waiting for a relief crew occupied a strategic siding on the same line for over 4 hours. The same train then occupied an equally important HBT main track for several hours because the train had been blocked improperly by KCS, and the crew reported after almost 8 hours that it was still switching in the heart of the Houston terminal complex. Id.

In his final example, Mr. Watts refers to a "needless" 80-minute delay to Tex Mex train 1MHOSH-11 at T&NO Junction. Watts V.S., p. 384. Here, Mr. Slinkard agrees with Mr. Watts that the delay was needless. Mr. Slinkard noted the same incident when it occurred, as a busy dispatcher failed to recognize that she was getting into a gridlock situation. He personally intervened to help her solve the problem and release the Tex Mex train -- not in response to a Tex Mex complaint, but on his own volition to help Tex Mex and the terminal. T. Slinkard V.S., p. 6.

Mr. Slinkard also reviewed the four incidents described by Mr. Nichols and found no reason to suspect "discrimination." Id., p. 7. For example, Mr. Nichols complains that Tex Mex train 1MSHHOJ-04 was "inexplicably" delayed at Fauna, Texas, to allow 3 comparable UP trains to pass. Nichols V.S., p. 373. As Mr. Slinkard explains, Fauna is a location where several routes intersect, and it is common for trains in one direction to be held while trains going in another with a clear track proceed. T. Slinkard V.S., p. 7. In fact, he testifies that holding the trains with a clear track ahead would be considered poor dispatching and contrary to the interests of the terminal. Id.

UP and BNSF could mount identical claims of discrimination in favor of Tex Mex trains if they wished:

- On May 13, the joint BNSF/UP dispatcher allowed Tex Mex train 1MSHCPJ-13 to pass two UP manifest trains of the same class, which the dispatcher held at Fauna. Should UP claim "discrimination?" Tex Mex would if the tables had been turned.

- On May 16, BNSF could have asserted a "discrimination" claim against its own joint dispatcher for allowing an 11,000-ton Tex Mex 1MSHCPJ-16 to pass a BNSF intermodal train, IAVHOJ-16, again at Fauna. A claim of discrimination against yourself would of course make no sense, but the facts are indistinguishable from those Mr. Nichols relies on for his June 5 "discrimination" claim and Mr. Watts relies on for his May 1 "discrimination" claim.

- UP again arguably suffered discrimination at its own hands on May 1, 1998, when the BNSF/UP dispatcher allowed Tex Mex train MSHHOJ-01 to pass UP train MLIFP-29 at Hatchery, Texas, in an action as "inexplicable" as the KCS/Tex Mex examples.

- A day later, on May 2, the joint line dispatcher held UP train MBTHO-02 at China, Texas, to allow train 1MSHHOJ-02 to pass it. This too was not discrimination.

For months, UP has been urging KCS/Tex Mex to follow BNSF's lead and participate in joint dispatching at the CDC. UP wants KCS/Tex Mex to bring to Spring Tex Mex dispatchers who control the entire Tex Mex between Corpus Christi and Laredo, and the KCS operator who controls the Beaumont-DeQuincy line, along with their KCS and Tex Mex supervisors. The space is reserved for them and available now. T. Slinkard V.S., p. 9.

We believe that the only reason this has not happened is that KCS/Tex Mex believe they still have a chance of wresting commercially valuable conditions from the Board. If the Board would tell KCS/Tex Mex to stop complaining and start cooperating, this saga would end. The Spring Center could then exercise coordinated and totally unbiased dispatching of every mainline railroad between New Orleans and San Antonio and south to the Mexican Border, as well as lines north of Houston.

None of KCS/Tex Mex's excuses for refusing to join the Center bear up to illumination:

<u>Excuse No. 1</u>. KCS/Tex Mex complain at length that merely playing an "observer" role at the Spring center is not enough. But UP does not want Tex Mex to be only an observer, showing up only infrequently at the center. UP wants KCS/Tex Mex to participate in the management of the CDC with respect to every line where Tex Mex operates. Tex Mex's Mr. Watts claims that this participation would be insufficient "without an attempt by UP to address the concerns of KCS/Tex Mex." KCS-2, Watts V.S., p. 380. We do not know what that means. In the very next paragraph, he admits that BNSF and UP were able to negotiate an arrangement to ensure coordinated supervision of dispatching on lines where BNSF has trackage rights. UP invites KCS/Tex Mex to do the same, but it refuses even to discuss the matter.

<u>Excuse No. 2</u>. Mr. Watts makes every argument imaginable against using the Tex Mex/UP contractual Dispatching Protocols, which guarantee neutral dispatching and provide remedies for any failure. KCS-2, Watts V.S., pp. 381-83. These are the same Dispatching Protocols that BNSF and UP

use, and that, in the days immediately following the merger decision, Tex Mex insisted be extended to the trackage rights that the Board had awarded it. KCS/Tex Mex have never tried to apply these Protocols and should not be heard to complain. The Protocols call for establishment of a Joint Service Committee, which UP has volunteered to initiate, but that KCS/Tex Mex has never acted. UP can only conclude that KCS/Tex Mex is dead set against letting the Dispatching Protocols to work.

Excuse No. 3. Mr. Watts and Mr. Nichols complain that they are allowed to raise complaints only after the incidents occur. Watts V.S., p. 382. Mr. Slinkard testifies, however, that Mr. Watts and Mr. Nichols choose to behave in this ineffective manner and he wishes they would speak up promptly if they have any questions or complaints. T. Slinkard V.S., pp. 8-9.

Mr. Nichols claims that he was denied the opportunity to participate in a joint meeting at Spring. Nichols V.S., p. 370. As Mr. Slinkard testifies, though, Mr. Nichols had told him before the meeting that he was not a Tex Mex employee, which is why he was not invited. T. Slinkard V.S., p. 9. Otherwise, he would have been. Id.

UP cannot force KCS/Tex Mex to take advantage of opportunities. It strongly objects, though, to defamatory, unsupported and self-serving allegations about "discrimination" when KCS/Tex Mex is doing everything it possibly can to frustrate cooperation in Houston-area dispatching.

6. Voting Membership in PTRA for Tex Mex and the Port of Houston

KCS/Tex Mex ask the Board to adopt a condition requiring that Tex Mex and the Port of Houston be admitted as voting members of PTRA's Board of Managers. This request is partly, if not entirely, moot. UP, BNSF and Tex Mex have reached agreement regarding the terms of which Tex Mex will become a full-fledged member of PTRA's Board. BNSF and UP have also extended an offer to the Port of Houston for conditional membership on the PTRA Board. Handley V.S., p. 6.

There is no reason for this Board to impose as a condition the KCS/Tex Mex request for Port of Houston membership. Those parties do not allege any connection between Port membership and any purported UP market power resulting from the UP/SP merger. KCS-2, p. 60. They merely "feel strongly" about the subject. Id.

As PTRA's Manager for 13 years, Mr. Handley is very familiar with the complex issue of Port control of PTRA. He explains why UP is concerned about unrestricted Port membership on the PTRA Board. For those reasons, BNSF and UP have proposed to admit the Port to PTRA's Board, but to restrict it from voting on capital expenditures and rates. Handley V.S., p. 6.

Many years ago, the Port had to fund and approve all capital investments on PTRA. When Mr. Handley took over as General Manager in 1981, he found a poorly maintained property with the worst safety record in its class. Id., pp. 4-5. BNSF and UP predecessors shortly afterward negotiated with the Port to take over funding responsibility for PTRA. That is how PTRA became the high-quality property it is today. Id., p. 5.

The Port may also have a conflict of interest as a member of the PTRA Board. It is a PTRA customer, operating the facilities at Barbours Cut. The Port has incentives to vote in favor of rate reductions for its traffic, even if that might not be in the interest of PTRA. Id. Accordingly, this Board should not grant the KCS/Tex Mex request for unrestricted voting rights for the Port of Houston.

7. Sale of Wharton Branch

KCS/Tex Mex ask the Board to require UP to sell Tex Mex the former SP's Wharton Branch between Rosenberg and Victoria, Texas. There is no basis for imposing this sale as a merger condition because Tex Mex is able to compete effectively under the rights granted to it in the merger case without this purchase. Moreover, there is no reason for the Board to impose this sale as a merger condition because, as Mr. Rebensdorf explains in his verified statement, UP has agreed to sell the Wharton Branch to Tex Mex, and the parties have reached agreement in principle on an arbitration process to determine the sale price. Rebensdorf V.S., p. 9.

As Mr. Rebensdorf explains, UP and KCS/Tex Mex are still attempting to reach an agreement on the precise boundaries of the sale and on several additional matters, but UP is pursuing the negotiations in good faith, and there is no need for the Board to interfere. Id., p. 11. As the negotiations presently stand, KCS/Tex Mex are seeking to purchase the Wharton Branch between Milepost 0.0 at Rosenberg and Milepost 86.8 at Victoria, and they have asked for trackage rights between Milepost 86.8 to a connection with Tex Mex's trackage rights over UP's Flatonia Subdivision, which would be at Milepost 90.8. UP is willing to sell the line between Milepost 2.5 and Milepost 87.0. UP is also willing to grant Tex Mex overhead trackage rights to operate on the remaining portions of the line.

UP is unwilling to sell its line between Mileposts 0.0 and 2.5 and between Mileposts 87.0 and 90.8 because sale of these segments would create inefficient and unnecessary additional dispatching interfaces between UP and KCS/Tex Mex. Tex Mex overhead trackage rights over these short segments will allow KCS/Tex Mex to provide the service they wish to provide without imposing operational complications on UP. Id., p. 10.[73]

KCS/Tex Mex have articulated a vague request for access to "sufficient terminal track" of UP at Rosenberg to support Tex Mex's proposed Wharton Branch operations. TM-7/KCS-7, p. 4. They never describe precisely what access they seek, but a careful reading of the exhibits to Tex Mex's operating plan discloses that Tex Mex proposes to make up a Rosenberg-Laredo through train and base a local turn at Rosenberg. See KCS-2, p. 353, 355.[74] There is, of course, no competitive justification for such operations, and thus no basis for Board action here. Tex Mex's proposed operations could not be accommodated without disrupting UP's operations and adversely affecting UP's ability to serve shippers in and around Rosenberg. As Mr. Handley explains, UP makes intense use of all available facilities at Rosenberg to conduct interchange with BNSF, support a local train and industry switching, and stage cars for nearby rock shippers. There is no room for Tex Mex's proposed operations. Handley V.S., pp.

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[73] KCS/Tex Mex are also seeking the right to construct a track around UP's Victoria Yard using a right of way that UP uses for an access road. As Mr. Rebensdorf explains, this proposal is unacceptable, but UP believes that there are other ways that KCS/Tex Mex's needs can be accommodated.

[74] UP served discovery request aimed at eliciting this information. Although KCS/Tex Mex answered that responsive information would be produced, it never was. TM-9/KCS-4, Aug. 14, 1998, Response to Request No. 11.

32-35. Nor is there any reason why Tex Mex needs such access. Tex Mex should instead be required to construct whatever facilities it might want to facilitate its proposed operations over the Wharton Branch along its own right of way.[75]

KCS/Tex Mex have also indicated a desire to conduct interchange with BNSF at Rosenberg. Rebensdorf V.S., p. 11. Again, there is no competitive justification for such rights, as Tex Mex already is able to interchange effectively with BNSF at Corpus Christi; Robstown, Houston and other points. Nevertheless, UP is willing to permit Tex Mex to interchange full trains with BNSF at Rosenberg in connection with, and conditioned upon, its acquisition of the Wharton Branch. However, UP is not willing to permit the exchange of blocks of cars there. Id. Such interchange simply could not be accommodated without interfering with UP's use of its own facilities at Rosenberg. Handley V.S., pp. 32-35.

UP believes that KCS/Tex Mex's needs can be accommodated, and it is continuing to negotiate in good faith with KCS/Tex Mex on the precise boundaries of a Wharton Branch sale, as well as ancillary operating matters. Thus, while the

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[75] Indeed, Tex Mex says that it intends to build a SIT yard along the Wharton Branch as a repository for the UP operations at Booth Yard that KCS/Tex Mex propose to displace. KCS-2, p. 76. The suggestion that such a facility would be useful to UP as a replacement for Booth Yard is absurd, for the reasons set forth below. But KCS/Tex Mex's suggestion indicates that KCS/Tex Mex are capable of building such a yard, which should be used by Tex Mex in lieu of usurping UP's Rosenberg facilities.

Board should decline KCS/Tex Mex's request because Tex Mex is able to compete effectively without these rights and because the precise rights it is seeking are unworkable, the Board should also decline to inject itself into the parties' ongoing negotiations.

8. Yard in Houston

The Board should also reject KCS/Tex Mex's request for access to UP's Booth Yard. See KCS-2, pp. 69-78; id., Broussard V.S., p. 411.

Tex Mex has no need for a yard in Houston to facilitate its exercise of the limited trackage rights granted by the Board. As limited by the Board, the core of Tex Mex's trackage rights operations consists of bridging traffic between Laredo/Corpus Christi and Tex Mex's connection with KCS at Beaumont. To handle this traffic, Tex Mex already has ample yard facilities -- Tex Mex's own yards at Laredo and Corpus Christi, including a large new yard at Laredo that it is building to handle increasing traffic volumes (see TM-7/KCS-7, Fields V.S., p. 86), and KCS's Chaison Yard in Beaumont.

In Houston, Tex Mex only needs to be able to pick up or deliver traffic moving between PTRA and HBT shippers and points on Tex Mex's original Laredo-Corpus Christi line, principally Laredo.[76] Tex Mex is able to carry out these functions without the need for any yard of its own at Houston.

Tex Mex interchanges its Mexican (and other Corpus Christi-Laredo) traffic with PTRA (and with UP and BNSF for the HBT shippers they switch) at UP's Basin Yard and PTRA's North Yard, which are physically-linked facilities conveniently located adjacent to the East Belt route used by almost all Tex Mex trains. In addition to interchanging with PTRA at Basin/North Yard, Tex Mex also is entitled to originate and terminate Houston-Mexico trains via an interchange with PTRA at Manchester Yard (via Katy Neck), although Tex Mex has thus far not used these rights except to handle Houston-north traffic under the emergency service order. These facilities are adequate for Tex Mex's needs.

So long as Tex Mex's operations at Basin/North Yard are limited to picking up <u>or</u> setting out cars -- and not attempting to do both, as would be required if Tex Mex were also handling Houston-north traffic -- interchange at this location works reasonably well. Although some delays are inevitable, only causes minor delays, these delays can be tolerated when operations are executed properly.[77] Handley

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[76] Thus far, Tex Mex's volume of such traffic has been quite small. <u>See</u> Handley V.S., p. 36.

[77] In particular, there is no merit to the contention of KCS/Tex Mex witness Broussard (KCS-2, pp. 419-20; <u>see also id.</u>, pp. 71-73) that Tex Mex must engage in costly "double-
(continued...)

V.S., pp. 29, 36.[78] Tex Mex does not need its own yard to be able to perform classification (or blocking) because the carriers with which Tex Mex interchanges -- PTRA, UP and BNSF -- are already performing these functions for Tex Mex traffic at their own yard facilities. Handley V.S., pp. 31, 37, 42.[79]

As a result, only if Tex Mex were granted access to Houston-north traffic, or to the numerous Houston industries it seeks to serve under the guise of a PTRA expansion -- neither of which is justified -- would there be any

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[77] (...continued) reverse handling" in order to pick up southbound traffic at Booth Yard. There is no obstacle to Tex Mex's picking up southbound cars at Basin/North Yard without engaging in this practice. See Handley V.S., pp. 36-38. As Mr. Handley explains, KCS/Tex Mex are complaining about a feature of their Houston-north operations. In fact, Tex Mex's identification of the occasions on which Tex Mex asserts it engaged in "double-reverse" handling (produced in response to UP's discovery request) indicates that, contrary to KCS/Tex Mex's assertions, Tex Mex rarely if ever handled southbound traffic in this manner. Instead, virtually every alleged incident involved Houston-north traffic that Tex Mex was allowed to handle during the pendency of the emergency service order. See TM-8-HC-02082 to -95; see also Handley V.S., p. 37.

[78] On the other hand, Tex Mex should be required to consolidate all of its work at this one location, rather than picking up and/or setting out at multiple yards along the East Belt, as Tex Mex has sometimes tried to do. Such operations cause unnecessary additional delay, as KCS/Tex Mex acknowledge. See KCS-2, Broussard V.S., p. 9.

[79] PTRA already performs the necessary switching and blocking of traffic to and from Tex Mex using its North Yard. Similarly, UP or BNSF already switch HBT industries for Tex Mex for interchange via Basin Yard, and Tex Mex does not propose to perform this work itself whether or not it secured access to Booth Yard. Handley V.S., p. 36.

conceivable need for Tex Mex to have its own yard at Houston, much less one as large as Booth Yard. Handley V.S., pp. 35-36.

If Tex Mex nevertheless has a sincere interest in acquiring yard space of its own to handle the Houston traffic to which it has access, it could obtain that space without displacing UP's operations at Booth Yard (or elsewhere). As noted, Tex Mex already has the right to make use of PTRA's North and Manchester yards, including the right to originate and terminate trains there (as it has done for Houston-north traffic under the service order), and Tex Mex's ability to take advantage of those rights stands to be reinforced by its new membership in the PTRA. Handley V.S., pp. 36, 42.

In addition, in the merger case Tex Mex asked for, and the Board granted, access to the former-SP Glidden Yard, located west of Houston on the Sunset Route mainline Tex Mex uses to reach Laredo.[80/] Tex Mex told the Board it wanted that access "for field blocking traffic received in interchange at Houston or which operated from KCS's Chaison Yard in Beaumont." TM-23, p. 31.[81/] Tex Mex has made no

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[80/] See Tex Mex-UP Trackage Rights Terms, ¶ 2(e).

[81/] This description of Tex Mex's proposed use of Glidden Yard is telling in that, given Glidden's location, it shows that Tex Mex clearly contemplated trackage rights for purposes of serving traffic moving between Houston and Beaumont, on the one hand, and points south, on the other hand, and not Houston-north traffic.

effort to use Glidden Yard for any purpose, despite its right to do so. Handley V.S., p. 42.

Tex Mex should also explore whether underutilized BNSF yards would serve its needs. BNSF witness Hord acknowledges that BNSF has a significant amount of excess capacity at the Houston yards it operates. See DOW-1, Hord V.S., p. 3 (explaining that BNSF Old South facility has room for 15,000 cars per year of new traffic). One BNSF facility that might be of use to Tex Mex is the East Belt Yard, an little used facility with three long tracks located on Tex Mex's East Belt route. Handley V.S., p. 42.

Finally, Tex Mex has the contractual right to construct additional facilities that it concludes it needs to facilitate its exercise of its trackage rights.[82/] This includes the right, when feasible, to construct new yard trackage in the Houston area adjacent to the routes over which Tex Mex operates. It does not appear that KCS/Tex Mex have made any effort to pursue this alternative, preferring instead to take one of UP's existing yards. One possible location at which KCS/Tex Mex might build a new yard for Tex Mex's use is at the site of SP's former Chaney Yard, located just west of downtown Houston on Tex Mex's alternative trackage rights route via Eureka. Id., p. 43. UP would be willing to convey,

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82/ Tex Mex-UP Trackage Rights Terms, Ex. B, § 2.2; Tex Mex-HBT Trackage Rights Terms, Ex. B, § 2.2.

for fair market value, its interest in the property at this location to permit Tex Mex's construction of a yard there.[83/]

Tex Mex's proposed conveyance of Booth Yard should also be rejected because it would cause significant harm to the efficiency of Houston operations and degrade the level of service UP is able to provide shippers. KCS/Tex Mex mischaracterize -- or do not understand -- the nature of UP's use of Booth Yard. UP uses this yard to build several local trains (for Sinco and the Columbia Tap line) and transfer moves (for Basin and Englewood), to stage cars -- primarily specialized, privately-owned tank cars -- awaiting receipt (and sometime waybill after delivery) for chemicals shippers in the Sinco area, and to support the switching of local industry, not to store cars as KCS/Tex Mex suggests (at KCS-2, Broussard V.S., p. 427). Booth Yard is far and away the facility best positioned to support these local operations and meet the needs of Sinco shippers for the prompt delivery of their staged equipment when they are ready to load it. Handley V.S., pp. 39-40.[84/]

[83/] In addition, of course, Tex Mex would also have the right to construct a yard along the Wharton Branch, if it acquires that line. KCS/Tex Mex in fact plan such a yard (KCS-2, pp. 75-76) and argue that UP could efficiently use such a yard to replace Booth Yard -- a point UP strongly disputes below. But if KCS/Tex Mex are right then there is no reason that Tex Mex should not use this facility itself.

[84/] UP is not underutilizing this yard as KCS/Tex Mex suggest (Broussard V.S., pp. 424-29). KCS/Tex Mex's reference to

(continued...)

KCS/Tex Mex seem to have confused UP's use of Booth Yard with the yard's use under the previous operators -- PTRA and HBT. Until the early 1990s, the yard was operated by HBT, which made little use of it. HBT -- not UP, as KCS/Tex Mex suggest -- stub-ended several of the yard tracks. PTRA then leased the yard from HBT and used it primarily to store cars for its customers. Handley V.S., p. 39. When UP assumed control of Booth Yard from HBT in the fall of 1997 as a result of the UP-BNSF restructuring of HBT, UP quickly moved to make more effective use of this well-located facility by converting the yard to its present functions.[85/] UP's ability to use Booth for these purposes played a very significant role in UP's successful service recovery efforts, by relieving Englewood and Strang yards of these functions and at the same time significantly improving service to Sinco shippers. Id.

Were UP displaced from Booth Yard as KCS/Tex Mex propose, UP would have no choice but to attempt to reassign Booth's current functions to Englewood or Strang (or both). This would reduce the fluidity of operations at these facilities. A shift of Booth's functions to Englewood and

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[84/] (...continued)
standing car counts at specific times (id., p. 15) represent snapshots that do not reflect the intensity of the yard's use. Handley V.S., p. 40.

[85/] Like KCS/Tex Mex, UP plans to reconnect the tracks that were severed by HBT. However, UP would not attempt to switch the yard from the south end. See Infrastructure Report, p. 31.

Strang would also degrade service to Sinco shippers by putting their needed equipment farther away from their plants. Handley V.S., p. 40.

In addition, Tex Mex operations at Booth Yard would themselves create new sources of congestion. Tex Mex's plan to switch the yard from the south (KCS-2, p. 74, & Broussard V.S., p. 425) would not be workable, and would block the heavily-trafficked mainline adjacent to Booth. And Tex Mex's use of Booth would appear to foreclose the use of yard trackage to reach the Booth Yard Lead as an escape valve for trains that encounter significant delays on the heavily congested Harrisburg Junction-Bridge 5-A route or which Booth is located. Handley V.S., p. 41.

Nor would Tex Mex's use of Booth achieve any offsetting advantages in terms of reduced congestion on other lines or at other facilities in Houston. Although KCS/Tex Mex suggest that use of Booth would remove trains from a congested part of the East Belt (KCS-2, Broussard V.S., pp. 8-9), a routing via Booth Yard would shift those trains onto trackage that is no less congested, and would in any event not avoid the need for Tex Mex's trains to traverse most of the East Belt as well as UP's Settegast Yard, where Tex Mex's operations disrupt UP's yard operations on an ongoing basis. Handley V.S., p. 41, & Map 5. Of even more serious concern is KCS/Tex Mex's related request (made in the March 30 filing in a section heading on page 42 of KCS-2) for trackage rights over PTRA from Booth Yard to the East Belt via Bridge 5-A and PTRA's North Yard. Use of these rights would require Tex Mex trains to traverse several critical bottlenecks -- especially Bridge 5-A itself and Galena Junction -- and the heart of North Yard itself, which would require PTRA to shut down switching operations while Tex Mex trains were in the yard. Handley V.S., pp. 41-42.

KCS/Tex Mex's notion that UP's use of Booth Yard could be replaced with access to a new yard on the Wharton Branch (KCS-2, pp. 75-76) is ridiculous, and betrays a glaring lack of understanding of current Houston operations. Such a yard would be much too far from the Sinco and Columbia Tap shippers now served from Booth. The beginning of the Wharton Branch at Rosenberg is more than 35 miles west of Sinco, whereas Booth Yard is within three miles of these shippers. Having to use such a yard would drastically degrade the service UP provides to these shippers and significantly increase UP's costs of serving them. Nor would the availability of a yard along the Wharton Branch for storage of cars be of any value to UP's Houston operations. Booth is not used for storing cars, and it would not be efficient to shift the storage performed by UP at other Houston-area facilities to the Wharton Branch. Handley V.S., p. 40.

9. Houston-Beaumont Construction and "Swap"

KCS/Tex Mex propose an arrangement under which they would build second main track on segments of UP's Lafayette Subdivision (the former SP line) between Houston and Beaumont at their expense, then exchange this track for UP's Beaumont Subdivision between the same two points. They say this would be done so that Tex Mex could control its own route, but then discard the asserted importance of such control by agreeing to maintain directional operations, and thus to remain subject to BNSF/UP joint dispatching of all westbound Tex Mex trains.[86] Because it will continue to use directional running, KCS/Tex Mex's computation that it would reduce its use of trackage rights by 64% (KCS-2, p. 80) is inaccurate.

It is important to understand at the outset that this is a much less even trade than it appears. KCS/Tex Mex is not really proposing to build a second main track on the Lafayette Subdivision, because it does not want to build the expensive parts of the second track. It would skip the 12 miles of that line that consist of bridges and trestles. In effect, KCS/Tex Mex proposes to lengthen and connect existing sidings, leaving multiple single-track segments, and to "swap"

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[86] Some might think that KCS/Tex Mex want to control the own route on which BNSF and UP trains operate in order to have the power to counteract "discrimination" by BNSF and UP. But KCS/Tex Mex do not need the Beaumont Subdivision to gain this power, because a KCS operator has control over every UP, BNSF and Amtrak train between Houston and New Orleans at Beaumont, Texas.

that investment for a fully functional UP mainline with several sidings -- and with all its bridges.

The investment and forced "swap" have no competitive rationale. The BNSF settlement agreement fully preserved competition in the Houston-Beaumont corridor. After that, BNSF and UP reached agreement on full joint ownership of the Lafayette Subdivision, giving BNSF access to all exclusively-served industries and branch lines. That transaction expanded competition well beyond what existed before the merger. KCS/Tex Mex are seeking to "open access" to 13 exclusively-served industries on the Beaumont Line (without even mentioning that effect), and are also seeking access to a large "2-to-1" shipper at Amelia. Peterson V.S., pp. 27, 29. Again, the KCS/Tex Mex parties do not even mention this new KCS/Tex Mex access, which is not justified by any competitive impact of the merger.

The proposed condition is splashy, but upon analysis makes no sense. The Beaumont-Houston corridor is entirely the wrong place to invest a precious $58 million in scarce railroad capital. With directional running, this corridor has ample capacity, except immediately east of Houston and at Dayton, where UP already proposes to add trackage. Amtrak's operation of a tri-weekly passenger train against the flow of traffic on the Lafayette Subdivision causes some disruption, but otherwise trains generally get over the lines with little delay, and should do better now that KCS has agreed to operate its line beyond Beaumont in a way that will not delay trains west of Beaumont.[87] The transit time information presented above shows that Tex Mex trains move over these lines rapidly and without "discrimination." If KCS/Tex Mex think capacity on these lines is inadequate, they have the right under the trackage rights agreements to add it.

If KCS/Tex Mex has $58 million to spend to improve Tex Mex service, there are very important investments to be made that will make much more difference than pouring the money into long running tracks on the Lafayette Subdivision. UP's Mr. Handley (V.S., p. 44) offers a number of suggestions:

- Double-track the Neches River Bridge in Beaumont, a major bottleneck for Amtrak, BNSF, KCS and UP.
- Add capacity on KCS between Beaumont and DeQuincy.
- Help fund a third main track at New South Yard on the HBT East Belt, one of the major congestion points in Houston. Estimated cost is $5.0 million.
- Help fund a second main track across Bridge 16, another major congestion point on the Houston East Belt. Estimated cost is $12.7 million.
- Build a bypass route around Settegast Yard so that Tex Mex trains will not have to operate through Settegast

[87] Letter from J. Hemmer to M. Clemens, Sept. 14, 1998.

Yard and interrupt UP switching. (This could be accomplished relatively cheaply by building a connection at Gulf Coast Junction. See Handley Map 5.)

- Help fund CTC and upgrading on the Sunset Route between Tower 26 and West Junction, allowing Tex Mex, BNSF grain, Amtrak and UP trains to run faster on increased capacity.

The proposed exchange would be financially unfair to UP. Rebensdorf V.S., pp. 7-8. This condition therefore could not be imposed without payment of constitutionally adequate compensation to UP. The track capacity that Tex Mex would build (using land that will be, when the Board exempts the UP/BNSF exchange for 50% ownership in their Houston-Iowa Junction and Iowa Junction-Avondale lines, jointly owned by UP and BNSF) might cost $58 million, but it would have much less value to UP added to a line that already has adequate capacity, especially since part of the arrangement would be that UP would have to share the track with three other carriers, including Tex Mex. Even if valued at $58 million, however, that track is not nearly as valuable as the high-quality Beaumont Subdivision that KCS/Tex Mex wants in return.

KCS/Tex Mex say they would build 63 miles of intermittent second main track. KCS-2, p. 80. In return, they want a complete 78-mile railroad with CTC and five long sidings. The difference in value is obvious. KCS/Tex Mex say they would leave UP with the Beaumont Subdivision right-of-way, but that is of little value if Tex Mex owns the track, which will be used into the indefinite future. In addition, Tex Mex would gain access to some $11 million in UP business on the Beaumont Subdivision. Peterson V.S., p. 29. In exchange for its flashy but wasteful $58 million investment, KCS/Tex Mex are demanding a railroad and industry access with far greater value. Rebensdorf V.S., pp. 7-8.

C. <u>CP&L</u>

CP&L seeks a condition allowing BNSF to provide service to its Coleto Creek plant 16 miles south of Victoria, Texas. This is yet another request for "open access." SP served CP&L's Coleto Creek plant exclusively before the UP/SP merger, and there is no competitive rationale for granting BNSF access to Coleto Creek today.

UP's service to Coleto Creek has improved enormously, and UP is now delivering coal to Coleto Creek at a rate that exceeds CP&L's level of demand. Handley V.S., p. 57-58. In July, UP not only met 100% of Coleto Creek's demand for Colorado coal, but exceeded it by 14%. UP also delivered 78% of Coleto Creek's requirements for Powder River Basin coal. In August, UP delivered 126% of Coleto Creek's requirements for Colorado coal, and 88% of its requirements for Powder River Basin coal. During the first ten days of September, UP has delivered coal at a pace equal to 144% of

Coleto Creek's requirements for Colorado coal and 113% of its requirements for Powder River Basin coal. Id. With UP now exceeding Coleto Creek's demand level, and there is no basis for adding BNSF service.

UP's round-trip transit time for coal trains from the Southern Powder River Basin to Coleto Creek and back has declined from 312 hours earlier this year to approximately 221 hours in August. Duffy V.S., p. 9.

UP's experience with BNSF service at LCRA's Halstead plant and at City Public Service of San Antonio's Elmendorf power plant shows that BNSF service could interfere with UP's service to Coleto Creek. UP has had numerous problems with BNSF being unable to move empty coal trains out of the Halstead and Elmendorf plants. Id. At both facilities, UP often must use its own crews to move empty BNSF trains out of the plant, so that UP can bring in its own trains. This is not only expensive for UP but delays unit trains to the customer.

CP&L proposes that BNSF be granted trackage rights over 16 miles of track between Victoria and Coleto Creek. But BNSF does not have permanent trackage rights through Victoria. Accordingly, in order to grant this condition, BNSF would have to be granted much more extensive trackage rights than those CP&L propose.

Under the BNSF/UP settlement agreement, BNSF has trackage rights through Placedo, Texas, which is approximately 14 miles from Victoria. Running unit coal trains over this route, however, would be highly undesirable. Handley V.S., p. 58. If BNSF were to operate southbound on the Brownsville Subdivision to Placedo and west to Victoria, its train would be facing the wrong direction for entry to the Coleto Creek line. BNSF would have to take the train to the siding at Thomaston, 14 miles further west, run around its train, and bring it back. This is a time-consuming and congestion-causing maneuver. BNSF would have to follow the same procedure to move an empty coal train back to Placedo. UP and Tex Mex, which operate over the line through Victoria, should not suffer the resulting congestion and delays.

D. <u>Dow</u>

Like CP&L, Dow Chemical wants "open access." It proposes BNSF haulage for allegedly temporary access, and a new build-out condition for "permanent" competition. But Dow offers no competitive justification for these conditions. Dow Chemical's facility has been served by UP, and its predecessor, MP, throughout its existence. There is no reason to add a new railroad now.

With one exception, Dow shipments in over 20 strategic corridors arrived either on time or early more than 90% of the time since the end of June 1998, and arrived on-time or early 97.2% of the time during the first week of September, the latest date for which this data is available. Transit times on Dow shipments in high-volume lanes compare favorably to pre-crisis transit times. For much of August, transit times on Dow shipments between Freeport and Chicago were affected by a temporary change in the transportation plan that occurred while some of the traffic was in transit, resulting in the need to switch those cars twice rather than once. The transportation plan has been fixed and the average transit time in that corridor during the first week of September exceeded the pre-crisis April 1997 average by less than three hours.

The average transit time on Dow shipments from Plaquemine to Griffith for interchange with Canadian National Railroad has generally outperformed the average achieved during pre-crisis April 1997 since at least the end of May. The only exceptions to this strong performance were one week in May and one week in August, during which transit times exceeded the April 1997 average by less than five hours. The average transit time in this corridor was better than the April 1997 average by more than a full day for five consecutive weeks beginning the week of June 25, and again during the first week of September. Since at least the end of May, the average transit time on Dow shipments between Plaquemine and the New Orleans gateway for interchange with

Norfolk Southern has remained within one day or below the pre-crisis April 1997 average transit time, with the exception of one week in June. Since June 11, average transit time between Plaquemine and Freeport has been equal to or within three hours of the average transit time for April 1997.

Dow suggests that its second condition -- the right to build out directly eastward to the UP mainline and connect with BNSF between Chocolate Bayou and Angleton -- might provide permanent relief, while BNSF haulage could be granted to provide interim relief. In fact, the requested haulage would effectively render Dow jointly-served, and neither Dow nor BNSF would then have any reason to pursue a costly build-out. But even if the build-out proposal is viewed separately, it, like the haulage proposal, has no competitive justification. The Board carefully analyzed Dow's build-out situation in the merger case, and again in response to a Dow petition for reconsideration. The Board concluded that the condition it imposed -- allowing Dow to build out to (or BNSF to build in from) the closest SP point -- precisely replicated the competition that Dow enjoyed prior to the merger. Decision No. 44, p. 188; Decision No. 58, pp. 3-4.[88/] Permitting Dow, which was exclusively served by UP before the

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[88/] Dow's argument that BNSF has less traffic incentive to build in that SP had (DOW-1, p. 16) was previously presented, refuted (UP/SP-231, Spero V.S., pp. 15-16), and rejected by the Board.

merger, to build to a much closer UP point, creates an enhanced form of competition that did not exist prior to the merger, and thus is unjustified under the Board's long-established principles for merger conditions.

E. Formosa

Formosa is still another industry seeking "open access" from BNSF. Its situation is virtually indistinguishable from Dow's. There is no competitive rationale for additional access to a plant that has been solely served by UP and its predecessor MP since it opened.

UP's service to Formosa has improved dramatically, and can no longer be thought to provide any rationale -- however uncoupled from long-established merger law -- for imposing the condition Formosa seeks. See Duffy V.S., pp. 5-6.

F. DuPont

In its July 8 Request for New Remedial Conditions, DuPont says it was unfairly deprived of a Tex Mex reciprocal switching option when UP cancelled the SP tariff that had governed DuPont's switching and replaced it with a UP tariff provision stating that DuPont's LaPorte facility is open to reciprocal switching for BNSF only. UP did not unfairly deprive DuPont of a Tex Mex option. DuPont was not granted access to Tex Mex in the Board's decision approving the UP/SP merger, and UP's tariff modification simply reflects UP's ongoing systemwide efforts to clarify its switching tariffs so that they provide for reciprocal switching only with those carriers with which UP has a switching arrangement.

The Merger Decision. DuPont's LaPorte facility is a former SP local point. At the time of the merger, DuPont was a "3-to-2" shipper -- it was served directly by SP and open to UP and BNSF via reciprocal switching. In Decision No. 47, served Sept. 10, 1996, the Board clearly explained that by granting in part Tex Mex's condition request in the UP/SP merger proceeding, it was not granting Tex Mex access to shippers such as DuPont's LaPorte facility:

> "As UP/SP notes, the formulation proposed by Tex Mex might be interpreted as allowing Tex Mex access to shippers currently open to three carriers (UP, SP, and a third carrier). We wish to clarify that, except for shippers located on HB&T and PTRA (to which Tex Mex will have access via HB&T and PTRA, respectively), the only shippers on the trackage rights lines open to Tex Mex will be 2-to-1 shippers."

Decision No. 47, p. 16 n.30.[89/] UP's modification of tariff language applicable to DuPont to exclude a Tex Mex reciprocal switch option is thus entirely consistent with, not contrary to, the Board's decision approving the UP/SP merger.

[89/] DuPont notes (pp. 3-4) that other nearby shippers are served by PTRA, and that PTRA operates over a line that passes by DuPont's LaPorte facility. But DuPont cannot dispute that its LaPorte facility was SP-served, and that the PTRA gained the right to operate over the line that passes by DuPont's facility as part of an agreement that explicitly maintained DuPont's status as SP-served.

<u>Tariff Claim</u>. As UP has previously explained (<u>see</u> Applicants' Reply to BNSF's Petition for Clarification (UP/SP-330), Dec. 4, 1997. p. 6), its switching tariffs reflect mutual agreements among railroads to open certain shipper facilities to reciprocal switching. By cancelling the former SP tariff and providing in a UP tariff that DuPont is open to BNSF reciprocal switching only, UP was simply making its reciprocal switching agreements explicit.

Prior to the UP/SP merger, under Freight Tariff SP-9500-D, DuPont's LaPorte facility was open via reciprocal switching to the two other rail carriers serving Houston -- UP and BNSF. DuPont's LaPorte facility was not open to reciprocal switching by Tex Mex. After the merger, had UP not altered this tariff, a literal interpretation of the SP tariff language could have obligated UP to provide Tex Mex reciprocal switching to serve DuPont (and several other SP-served shippers), because the Board granted Tex Mex rights to serve Houston in approving the UP/SP merger. Thus, when UP cancelled the SP tariff and incorporated its provisions into a UP tariff, UP also altered the SP tariff language to preserve the pre-merger status quo by explicitly stating that UP would provide reciprocal switching for DuPont only for BNSF -- the carrier with which it had previously had a switching relationship.

The Board has previously recognized that similar UP efforts to clarify its switching tariffs to address a shipper's status in regard to new access created by the Board's conditions on the UP/SP merger are entirely appropriate. See Finance Docket No. 32760, Decision No. 77, served Jan. 2, 1998 (rejecting BNSF's argument that UP's altering its New Orleans-area tariff unfairly deprived it of reciprocal switching access to New Orleans-area shippers). As the Board has explained, if "a reciprocal switching arrangement would be beneficial to its operations, [a party] should negotiate with UP/SP and seek to obtain one in exchange for granting UP considerations." Id. p. 7.[90]

Finally, there is no competitive justification for granting DuPont access to Tex Mex. The Board thoroughly considered the question of "3-to-2" traffic, and found that it would not suffer any competitive harm as a result of the merger. The Board granted Tex Mex access to only certain Houston-area "3-to-2" shippers -- those served by PTRA and HBT -- in response to Tex Mex's "essential services" argument, not to remedy any merger-related reduction in competition. Decision No. 44, pp. 148-49. Moreover, while DuPont complains

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[90] DuPont also asks the Board to remove a restriction in UP's switching tariff that prohibits reciprocal switching for intrastate traffic. This restriction, like other similar restrictions found elsewhere in UP tariffs, reflects a bargained-for arrangement. It existed before the merger, and thus does not raise any merger-caused competitive issue.

about the service it received during UP's recent service crisis,[91] it never complains that it has been competitively harmed as a result of the reduction from three to two in the number of carriers serving Houston.

G. CMTA

CMTA, which owns the Giddings-Llano rail line that is operated by the Longhorn Railroad, seeks a reversal of the Board's two decisions holding that there was no justification for a condition requiring that UP permit Longhorn to interchange with BNSF at McNeil instead of Elgin. Establishing a McNeil interchange would require that BNSF be granted additional trackage rights on UP's Austin Subdivision between Kerr/Round Rock and McNeil.

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[91] DuPont indicates that it obtained access to new and expanded Tex Mex routing options as a result of the Board's emergency service order. UP granted Tex Mex access to DuPont during the service crisis as an accommodation to DuPont, not as a result of the Board's order. The emergency service order allowed Tex Mex to accept traffic routed to it by Houston shippers that are switched by HBT and PTRA without regard to whether that traffic would have a subsequent movement over Tex Mex's Corpus Christi/Robstown-Laredo line. DuPont was not switched by HBT or PTRA, and thus the service order had no impact.

UP acknowledges that the reciprocal switching service it did provide as an accommodation resulted in slow service. Handley V.S., p. 9. This is an awkward, multiple-segment movement for UP in Houston that UP has no reason to make in the normal course of business. Each shipment must move from DuPont to Strang, where it is switched; from Strang to Englewood, where it is switched; and from Englewood to Basin Yard, where it is switched and where it must then await a Tex Mex train. Id. As a result, transit times were lengthy. UP provides much better service over its own lines. Id.

In Decision No. 44, the Board rejected CMTA's request for a connection with BNSF at McNeil, holding: "Because Longhorn does not have, and because its predecessors never had, two-carrier competition at the McNeil interchange, the merger will have no impact on the present or future competitive options available to Longhorn or to Giddings-Llano shippers." Decision No. 44, p. 182; see also Decision No. 69, p. 5 ("McNeil, however attractive it might be, was not an option that CMTA could have chosen"). Instead, the Board permitted CMTA to choose between a new interchange with BNSF at Giddings, which was the historical connection between the Giddings-Llano railroad and SP, or at Elgin. CMTA chose Elgin, and the Board upheld that choice over the objection of Longhorn. Decision No. 69, pp. 5-7.

CMTA now renews, with Longhorn's support, its original proposal that the interchange with BNSF be shifted from Elgin to McNeil and that BNSF be granted trackage rights over UP's Austin Subdivision in order to reach McNeil. This request is not justified in any respect. CMTA points to two reasons why an interchange at McNeil supposedly should be mandated: (1) UP's service difficulties, especially Longhorn's difficulties in obtaining adequate empty equipment from UP, and (2) Longhorn's supposed difficulties interchanging with BNSF at Elgin. Neither bears up under scrutiny.

<u>First</u>, the service difficulties of which CMTA complains are not the product of any merger-caused increase in market power. To the contrary, UP manifestly faces more competition for Longhorn's traffic than existed before the merger, when Longhorn's only connection with SP was at Giddings, at the end of a 30-mile, out-of-service line. Longhorn's active interchange with BNSF at Elgin thus provides substantially more competition than SP could have provided absent the merger. The line to Giddings is still out of service (CMTA-1, p. 20 & n.10), whereas Longhorn acknowledges that BNSF has interchanged significant volumes of traffic with BNSF at Elgin. <u>See</u> CMTA-1, Cheatham V.S., pp. 9, 16; <u>see also</u> <u>id</u>., Confidential Attachment to Ex. 5(h).

<u>Second</u>, as Mr. Handley explains, the service difficulties UP had experienced have been overcome. In particular, UP has been able to supply CMTA with all the empty equipment it wants, and has on several occasions had to take back unused equipment for which Longhorn did not have space. Handley V.S., p. 57.

<u>Third</u>, there is no merit to CMTA's (and Longhorn's) contention that Elgin is inadequate as a point of interchange with BNSF. CMTA's first complaint about Elgin is that BNSF has not yet instituted the through-train operations there that

it had originally planned,[92] but has instead served Elgin with a dedicated local based in Temple, Texas. CMTA-1, pp. 11-12. This criticism, however, is an obvious makeweight. If Longhorn's interchange with BNSF were shifted to McNeil, BNSF would also serve that point with a local train, since BNSF would have no through-train operations at McNeil, and no trackage rights south of McNeil. Handley V.S., pp. 52-53.

In any event, BNSF service at Elgin via a local turn is perfectly satisfactory.[93] Longhorn acknowledges that BNSF has interchanged traffic with Longhorn effectively using its local train, including long 25-40 car cuts of rock traffic, and has provided Longhorn with "turn around time" superior to that provided by UP via McNeil. CMTA-1, p. 7; id., CMTA-1, Cheatham V.S., p. 16. BNSF's local in fact provides Longhorn with better service and reliability than would through train operations, especially for the rock traffic Longhorn wants to develop with BNSF. As Mr. Handley explains, handling long cuts of rock traffic would require a dedicated local to be performed efficiently, and thus would not be facilitated by BNSF's institution of through-train service via Elgin. Handley V.S., p. 52. For the same reason,

[92] BNSF's Temple-San Antonio-Eagle Pass trains have been operating via temporary rights via Caldwell and Flatonia, rather than via Elgin and Smithville.

[93] The allegation that UP has restricted the number of trains BNSF can operate to and from Elgin (Cheatham V.S., p. 9) is simply untrue. Handley V.S., p. 52.

the service UP provides to Longhorn at McNeil is via a dedicated local rather than UP's through trains. Id.

CMTA and Longhorn also complain that the physical facilities at Elgin are not conducive to the interchange of long cuts of rock cars without blocking Longhorn's trackage. CMTA-1, p. 17; id., Cheatham V.S., pp. 9, 16.[94] But the Board has already rejected this precise argument. In Decision No. 69, in discussing CMTA's choice of Elgin over Giddings as the point of interchange with BNSF, the Board said that CMTA was not entitled to an "idealized" version of an Elgin interchange point, but instead had to make, and did make, the judgment that Elgin was the "better overall alternative," given Giddings' significant disadvantages. Decision No. 69, p. 7. The Board expressly found that there was no obstacle to the construction by BNSF or Longhorn of "any new facilities (including connections and sidings)" that they might determine were needed to "facilitate an Elgin interchange." The Board specifically concluded that Longhorn could build a "lengthy new siding adjacent to the Giddings-Llano line" east of the UP crossing, which could "accommodate cuts of almost a mile in length without blocking any grade crossings." Id.; see also UP/SP-298, Searle V.S. Neither CMTA nor Longhorn attempt to dispute that conclusion, and such a siding would plainly be

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[94] As noted, Longhorn in fact has been successfully interchanging this traffic with BNSF at Elgin. Id.

adequate to handle as much traffic with BNSF as Longhorn might generate. Handley V.S., p. 53. Longhorn apparently would prefer to shift the costs of adequate BNSF interchange facilities to UP.

It is apparent that the real motivation for CMTA's and Longhorn's renewed request for a McNeil interchange has nothing to do with the UP/SP merger, and everything to do with their own business objectives. Longhorn would like to escape having to maintain its line between McNeil and Elgin, which is in poor condition. CMTA-1, Cheatham V.S., p. 15. CMTA would like to remove Longhorn's freight traffic from the segment of the Giddings-Llano line between McNeil and Elgin so that it can pursue its long-held goal of establishing passenger operations without the fear of freight train interference. _See_ Decision No. 44, pp. 34-35. But there is simply no nexus between these goals and any effects of the merger, and thus no basis for granting the condition that CMTA seeks. As the Board explained in rejecting CMTA's request the first time, the need for Longhorn to operate between McNeil and Elgin (or Giddings) in order to reach a competitive interchange point was _not_ the result of the UP/SP merger. To the contrary, such operations would have been required by any effort to re-establish the out-of-service SP interchange at Giddings. As the Board found, any "disruption to CMTA's future passenger operations will be caused by the revival at Giddings (or at

Elgin) of the additional Class I connection formerly provided by SP." Decision No. 44, p. 182. The same is true with respect to Longhorn's newfound desire not to operate trains on its poorly-maintained trackage between McNeil and Elgin.

In addition to the complete lack of justification for CMTA's proposed condition, interchange between Longhorn and BNSF at McNeil would cause significant operating problems. As Mr. Handley explains, an interchange at McNeil would require BNSF to institute new local train service between Temple and McNeil on UP's Austin Subdivision, which is one of the most congested pieces of railroad on UP's system. UP recently rescheduled its own Taylor-McNeil local to operate at night in order to avoid unacceptable delays on this line and provide reliable service to Longhorn. That train still requires almost a full 12 hours to complete its 44-mile round trip because of heavy freight traffic. Handley V.S., p. 55. BNSF's McNeil local would have to operate during the same time period, but there is insufficient capacity on this line for two locals without causing unacceptable interference with other train operations, including Amtrak's Texas Eagle, which operates over this line six times per week. Id.

Interchange between BNSF and Longhorn would cause equally serious operational interference at McNeil, where there is not adequate infrastructure to support interchange between Longhorn and two carriers. UP has devoted a former mainline siding at McNeil to use as an interchange track. Longhorn could not use that track for its BNSF interchange without causing gridlock and depriving UP of the use of its siding, which, if UP did not need it for Longhorn interchange, would be used to facilitate fluid mainline operations on the busy Austin Subdivision. Id., p. 56. Nor could Longhorn use its own mainline for BNSF interchange without blocking that line, interfering with UP's ability to interchange with Longhorn, and requiring BNSF's trains to spend more time blocking the mainline at McNeil while carrying out interchange. The only feasible alternative would be for Longhorn to construct new interchange trackage at McNeil -- the same investment it does not want to make at Elgin. Such trackage, however, would still not avoid the excessive train delay caused by the introduction of new BNSF operations on UP's Austin Subdivision between Taylor and McNeil. Id., pp. 56-57.

H. H&GC

H&GC is a shortline that operates 12 miles of track between Wharton, Texas, and a connection with BNSF at Bay City, Texas, more than 60 miles from Houston. BNSF is H&GC's only connection. H&GC complains that, as early as 1996 (before the UP/SP merger), BNSF "was experiencing severe difficulties serving their customers south of Bay City, as well as providing cars for the H&GC." H&GC Proposal, p. 3.

Ostensibly to remedy these problems, H&GC now seeks an extensive web of conditions throughout the Houston area, including trackage rights on several routes between Wharton/Bay City and Houston and divestiture of UP's Houston-Galveston lines.

H&GC makes absolutely no effort to connect any of these proposals to any market power effect of the merger, or even to establish any link between them and any UP service problem.[95] H&GC acknowledges that the problems it has experienced with BNSF service pre-date the UP/SP merger; and UP does not even have a physical connection with H&GC's Bay City-Wharton line. As far as the greater Houston area is concerned, H&GC merely mouths the rhetoric of KCS/Tex Mex and others about UP's alleged monopoly, which we have already fully addressed.

Even if H&GC's extensive conditions were somehow justified -- and they plainly are not -- H&GC makes no showing that it is capable of carrying out any of the operations it proposes. No evidence is offered of H&GC's financial capabilities, operating experience, or safety record, yet it

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[95] Also remarkable is the extraordinarily offensive rhetoric included in H&GC's various submissions, including (in a previous letter) scurrilous and untrue charges of "anti-competitive racist management" on the part of UP and (in this proceeding) accusations about UP's "arrogance, superiority, and utter barbarism." UP's letter to the Board responding to H&GC's irresponsible charges of racism is attached. See Letter from D. Young to Chairman Morgan, June 25, 1998 (Appendix A).

nevertheless asks the Board to grant it a sweeping license to operate trains throughout the Houston terminal. There can be no serious doubt that H&GC's proposals would wreak havoc in the Houston terminal, by disrupting existing operating patterns (especially between Houston and Galveston) and introducing a new railroad and new train movements on heavily-used trackage and yard facilities.

The genesis of H&GC's requests appears to have been its failed effort to have some role as a provider of storage-in-transit services when UP's capacity was strained by severe congestion in and around Houston. UP did not accept H&GC's invitation to store cars on the H&GC line because storage there, at a location remote from Houston and unconnected to any active UP rail line, would have been operationally untenable and would have provided no benefit to UP's operations or the shippers UP serves. H&GC also failed to establish that it owned the property on which the SIT facilities would have been built.[96]

H&GC's new proposal to construct additional SIT facilities if the Board grants its condition requests is without merit. The UP/SP merger did not reduce competition for SIT facilities, see Decision No. 44, pp. 151-52 (granting BNSF access to Dayton and other SP Gulf Coast SIT facilities),

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[96] See Letter from D. Young to Chairman Morgan, June 25, 1998, p. 2, & Ex. H (Appendix A).

and UP has plans to add significant SIT capacity in the near future to accommodate continuing growth in shipper demand for in-transit storage of their cars. There is no basis for compelling the grant of significant new trackage rights, and forced divestiture of important rail lines, in order to support H&GC's scheme to go into business as a SIT provider, especially where the facilities H&GC proposes would have little utility. H&GC is of course free to establish a SIT facility at any available location, on its own lines or elsewhere, and seek to market the services of such a facility. Were such a facility efficiently located and operated fairly and economically, railroads serving Houston would have every incentive to use it. H&GC's proposal to build this business on the basis of compelled merger conditions, however, should be firmly rejected.

CONCLUSION

All of the condition applications should be denied.

Respectfully submitted,

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

September 18, 1998

CERTIFICATE OF SERVICE

Copies of UP's Opposition to Condition Applications containing "Highly Confidential" material have been served this 18th day of September, 1998, by first-class mail, postage prepaid, or by a more expeditious manner of delivery on counsel for parties designated by the Board as parties of record in Finance Docket No. 32760 (Sub-No. 26) who have indicated to us that they are entitled to review "Highly Confidential" material.

Copies of UP's Opposition as redacted for the public docket have today been served by first-class mail, postage prepaid, or by a more expeditious manner of delivery on all other persons designated by the Board as parties of record in Finance Docket No. 32760 (Sub-No. 26).

Copies of UP's Opposition have been served in both its "Highly Confidential" and public form by first-class mail, postage prepaid on:

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

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

Michael L. Rosenthal

STB FD 32760 (Sub 26) 3-2-98 B 186113

186113

UP/SP-333

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 PROCEEDING

B

APPLICANTS' OPPOSITION TO KCS/TEX MEX PETITION FOR IMPOSITION OF ADDITIONAL CONDITIONS

Applicants UPC, UPRR and SPR[1/] respectfully submit this opposition to the "Joint Petition of the Texas Mexican Railway Company and the Kansas City Southern Railway Company for Imposition of Additional Remedial Conditions Pursuant to the Board's Retained Oversight Jurisdiction" (TM-5/KCS-5), filed herein on February 12, 1998.

The Joint Petition is a very odd paper. While it purports, in its title and in some of its language, to be a current submission in support of the imposition of additional conditions on the UP/SP merger, it in fact simply proposes a procedural schedule to govern some future submission. No evidence at all -- not even any lawyers' argument, beyond the

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[1/] Acronyms used herein are the same as those in Appendix B of Decision No. 44 in Finance Docket No. 32760, served Aug. 12, 1996. 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).

purely conclusory -- is offered in support of the proposed conditions, or to link those proposed conditions to the merger in any way, much less to show that the appropriate legal standards for imposing additional merger conditions are satisfied.

Most of the KCS/Tex Mex paper is devoted to arguing an uncontroversial proposition: that the Board retained oversight jurisdiction over the merger, and has authority, under that retained jurisdiction and other provisions of law, to impose additional merger conditions if cause is shown for doing so. Since the legal rubrics under which the Board could take action in connection with the merger are clear, and since KCS/Tex Mex offer no case for Board action under any of those rubrics, we will not here contest all the nuances of KCS/Tex Mex's characterizations of the applicable law.

The dispositive point is that KCS/Tex Mex have given the Board no basis whatsoever for taking any action in the oversight proceeding. All they have done is to list conditions they would like to have imposed, and to suggest a schedule under which they would like to litigate some future submission requesting those conditions. The answer, for the present, is simple: if KCS/Tex Mex believe they have any evidence or arguments to support their proposed conditions, and to justify their imposition as conditions to the merger, they should present that evidence and argument. Then, the

Applicants can respond, and, if the KCS/Tex Mex submission does not fail a threshold challenge, the Board can address, as necessary, any scheduling issues that may be presented. It makes no sense to adopt a schedule now for a proceeding that KCS/Tex Mex have offered no basis for commencing.

KCS/Tex Mex's complete failure to offer any evidence or arguments in support of their condition proposals, or to justify attaching them to the merger, is hardly surprising. For despite repeated efforts, neither KCS/Tex Mex nor their supporter the Railroad Commission of Texas have shown that those proposals would have any public benefits or offered any basis for expanding, as a permanent condition imposed on the merger, the rights that Tex Mex received as conditions to the merger's approval.

- As the Board knows, Applicants have presented sworn evidence in the service proceedings regarding the counterproductive nature of the proposals advanced by KCS/Tex Mex, and explaining the fundamental causes of the service problems that have afflicted the Houston area and the essential place of the merger in overcoming those problems.[2]

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[2] E.g., Ex Parte No. 573 & Service Order No. 1518, Union Pacific's Report on Service Recovery, Dec. 1, 1997, pp. 93-108, & UP/SP Response to RCT Letter-Petition for Reconsideration, Jan. 6, 1998. Applicants have also responded through sworn testimony and extensive legal analysis to the allegations of KCS/Tex Mex in Finance Docket Nos. 33461, 33462, 33463 and 33507 concerning the restructuring of the HBT. See Finance Docket Nos. 33461, 33462 & 33463, UP's Reply (continued...)

Only recently the Board decisively rejected the Texas Railroad Commission's arguments for proposals identical or closely similar to those advanced by KCS/Tex Mex here. The Board found that those proposals were unworkable and would complicate rather than simplify Houston-area operations; that the merger had not been the cause of the Houston-area service problems; and that the efficiencies and capital investments that the merger will bring about are in fact essential to overcoming the service problems, and provide the only concrete and effective solution that anyone has proposed.[3/]

- Issues as to the competitive impact of the merger in Houston have also been thoroughly and repeatedly litigated -- as has, in specific, Tex Mex's desire for a permanent expansion of its merger-related trackage rights. The competitive contentions of KCS/Tex Mex and RCT were rejected in the primary merger proceeding,[4/] and again on petitions to reopen the merger decision.[5/] Neither KCS/Tex

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[2/] (...continued) in Opposition to KCS/Tex Mex Petition for Consolidation, to Declare Exemptions Void _Ab Initio_, and to Revoke Exemptions, Feb. 23, 1998. There is no basis for incorporating those matters into this docket, as KCS/Tex Mex suggest (Joint Petition, p. 11 n.6).

[3/] Service Order No. 1518, Decision served Feb. 17, 1998.

[4/] Finance Docket No. 32760, Decision No. 44, served Aug. 12, 1996, pp. 116-26, 132-38, 140-44, 147-52, 156-60, 179, 194.

[5/] Finance Docket No. 32760, Decision No. 47, served Sept. 10, 1996; Decision No. 62, served Nov. 27, 1996.

Mex nor RCT appealed those decisions. Those contentions were rejected yet again in the first annual oversight proceeding.[6] Applicants' quarterly reports have shown that Tex Mex has proven an effective competitor using its merger trackage rights, and that its traffic has continued to grow in the face of the service problems.[7]

In short, bare reassertion by KCS/Tex Mex, in a petition unsupported by any evidence, of propositions that have repeatedly been proven false through sworn evidence and rejected by the Board cannot form the basis for commencing a new proceeding.

While the Joint Petition thus must clearly be rejected, Applicants wish to stress that they are eager to work with KCS/Tex Mex to address Houston/Gulf service issues. Applicants are continuing to pursue all possible measures to overcome the service problems in Houston and the surrounding area. As the Board knows, Applicants recently reached agreement with BNSF to establish a joint dispatching center for Houston-area and Houston-New Orleans trackage. KCS and Tex Mex have been invited to participate in that joint dispatching center, and a meeting will be held shortly to discuss that matter further. See correspondence attached

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[6] Finance Docket No. 32760 (Sub-No. 21), Decision No. 10, served Oct. 27, 1997, pp. 14-15.

[7] E.g., UP/SP-303, pp. 108-12 & Charts #4-#10; UP/SP-323, pp. 6-7 & Charts #4-#8; UP/SP-331, pp. 7-8 & Charts #4-#8.

hereto as Exhibit A. Applicants are also interested in working with KCS/Tex Mex on a voluntary basis as to certain other aspects of their proposals, such as the idea of KCS/Tex Mex's investing in the restoration of a separate line between a point west of Houston and Victoria, Texas, which would alleviate congestion on parallel UP/SP lines. Id.

CONCLUSION

The Joint Petition should be denied.

Respectfully submitted,

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March 2, 1998

EXHIBIT A

THE KANSAS CITY SOUTHERN RAILWAY COMPANY

114 WEST ELEVENTH STREET
KANSAS CITY, MISSOURI 64105-1804

February 20, 1998

VIA FAX 214-743-5656 and 402-271-4048

Mr. Richard K. Davidson, Chairman
Union Pacific Corporation
1717 Main Street, Suite 5900
Dallas, TX 75201-4605

Dear Dick:

This letter is in response to the joint Union Pacific and Burlington Northern Santa Fe press release of February 13 about the proposed deal you and Rob made between Houston and New Orleans. While the press release contained the first invitation that Tex Mex and KCS received to participate, please understand that Tex-Mex and Kansas City Southern want to be included in any plans that improves operations around, in and through Houston for two critical reasons:

1. Tex-Mex cannot compete as intended by the Surface Transportation Board's grant of trackage rights between Beaumont and Corpus Christi/Robstown, Texas in the UP/SP merger case under present conditions. Tex-Mex is not competitive from a cost or service standpoint and cannot effectively operate the vital link between Kansas City Southern and Transportación Ferroviaria Mexicana (TFM), a network that handles NAFTA rail traffic in competition with UP and BNSF. It gives us great concern to find out that UP and BNSF struck a deal that would allow UP and BNSF to jointly control Tex-Mex operations in the Houston area when top officials of both companies stated in public forums in Houston last week that Houston only needed two railroads, UP and BNSF, and Tex-Mex was not needed as a competitor. BNSF continues to seek elimination of Tex Mex's trackage rights in its appeal of the STB decision in the UP/SP Merger case. We do not believe these positions coincide with the direction taken by of the Surface Transportation Board in establishing Tex-Mex, linked with KCS, as a competitor, or with the wishes of the customers in Houston, or with the position of the Port of Houston.

2. Tex-Mex and Kansas City Southern have a critical interest in dispatching and operations in the Houston area. Nonetheless, Tex Mex and KCS were not included in any planning or development of dispatching and operations criteria underlying the UP/BNSF deal. On February 4, at a meeting in Houston convened by the Railroad Commission of Texas to address operating problems and solutions in the Houston area and only nine days before UP and BNSF announced their deal, Mr. Jeff Moreland, Chief of Staff and General Counsel for BNSF, unveiled some concepts of a joint dispatching arrangement, apparently developed through months of meetings between UP and BNSF. When Ab Rees, Sr. Vice President - Operations, KCSR, asked Moreland why Tex-Mex and Kansas City Southern were not included in any planning meetings, Moreland aggressively responded in the presence of the entire group that Union Pacific would never have agreed to meet had Tex-Mex and KCS been included. The next day, February 5, Mike Haverty advised STB Vice-Chairman Gus Owen,

following the National Grain Car Council meeting in Chicago, that UP and BNSF had excluded Tex-Mex and KCSR from operations planning and dispatching protocol in the Houston area, even though Vice Chariman Owen had urged the railroads in the December 3 Emergency Service Order review hearing in Washington, D.C., to work together to solve problems. Both of us are on record in that meeting supporting that view, which view was also expressed by STB Chairman Linda Morgan, who requested that Tex Mex and KCS be a part of any dispatching solutions.

With the above background, we will address the UP/BNSF deal. We do not have a problem with UP and BNSF exchanging pieces of the former Southern Pacific main line between Houston and New Orleans to provide for joint ownership and expanded access by BNSF to customers formerly served by only Union Pacific. As Rob said in his quote, "The key here is greater coordination between railroads along the Gulf Coast to improve operations and reduce congestion. This will improve service options into and out of the Houston area, and increase competitive alternatives for rail customers . . ." We support these concepts and that is what our plan to the STB is all about. Given the significant damage suffered by shippers and the railroads as a result of "the worst rail crisis in the Twentieth Century", I believe that we have a serious, mutual obligation to address this crisis, remedy the harms, and provide efficient, competitive rail service to the shippers in the Gulf Coast region.

We would like to recap our plan and our reasoning but let you know that we are willing to discuss alternatives if they accomplish the same objective:

- **Greater Houston Switching Entity** -- This is not an "open access" plan as some in your organization have tried to characterize it. We are not asking for access to new customers on the Bayport Loop, in Baytown, or in Galveston. We are only asking that customers already served by HB&T and PTRA, which are covered by the STB order granting Tex-Mex access to Houston, be served by a neutral switching carrier. As you know, this is not a new idea. When you were at Missouri Pacific, and later at Union Pacific and on the boards of HB&T and PTRA, for years you personally were the driving force pushing for a merger of HB&T and PTRA. SP always moved to block the consolidation because it was not part of the HBT. Once UP and SP merged, however, and Tex-Mex was granted access to Houston as part of the merger, you were no longer interested in the consolidation of HB&T and PTRA, UP and BNSF agreed to dismantle HB&T and split it up between your two companies. We think a single switching carrier serving Houston, managed under the direction of the interested parties (UP, BNSF, Tex-Mex and the Port of Houston) would improve operations, reduce congestion, improve service options and increase competitive alternatives, all stated objectives of the deal UP and BNSF agreed to, consolidating the line between Houston and New Orleans.

- **Greater Houston Dispatching Center** -- For years Houston had a dispatching center under the direction of the HB&T that covered the greater Houston area including PTRA trackage; that is, until, right in the middle of the rail crisis and right after the STB issued its Emergency Order 1518 on October 31, 1997, (which gave Tex-Mex expanded competitive rights in

Houston) UP and BNSF agreed to dismantle the HB&T's RTC center and move it to UP"s office at Spring, Texas. This action exacerbated the chaos and confusion that already existed in Houston. Tex Mex and KCS are asking that the neutral dispatching function be moved back to a neutral point, PTRA offices, performed by a neutral operator, PTRA employees, which would report to all the operating railroads in Houston. This is really a re-establishment of what had previously existed and is intended to accomplish some of the same objectives as the neutral switching entity; improved operations, improved service options and increased competition. The funding of both the neutral switching and neutral dispatching functions can be provided for on a user basis as is done with most other similar arrangements throughout the country in major metropolitan areas. The transfer of the dispatching function to PTRA comes at an optimal time, as PTRA is moving to new, expanded facilities and its preparations for assuming the dispatching of the terminal can be done in concert with its setting up of its new office facility.

- **Houston Switching Yard** -- Tex-Mex cannot effectively compete with UP and BNSF in Houston without its own switching facility. Tex Mex must backhaul many cars which increases costs, adversely effects service, and puts additional train movements across an already congested rail network in Houston. Both UP and BNSF have been reluctant to grant Tex-Mex yard facilities in Houston. Thus, we have sought to buy or lease your Booth Yard from you. UP removed part of the yard so it is obviously not essential to UP for its operations but it gives Tex-Mex an essential facility for it to be competitive.

- **Rosenberg to Victoria Line** -- Southern Pacific has abandoned most of this line. Since Union Pacific continually alludes to the congestion on its Sunset route between Houston and El Paso, Tex Mex's and KCS's acquisition, rehabilitation, and renewal of operations of the Victoria/Rosenberg line affords a great opportunity to reduce Tex-Mex train operations on the Sunset route. Rebuilding this line not only benefits the public but it also adds back capacity which Southern Pacific's abandonment eliminated and alleviates congestion for UP, BNSF and Tex-Mex. We would be willing to buy or lease the right-of-way and trackage at each end of abandoned right-of-way. We would dispatch the line with a Tex-Mex dispatcher located at the neutral PTRA dispatching center. In fact, all Tex-Mex dispatching would be relocated to this neutral Houston site.

- **Beaumont to Houston line** -- Again, rather than seeking required divestiture of this line, we would be willing to purchase or lease it. We would grant trackage rights back to UP and BNSF on this line. A Tex-Mex dispatcher located at the PTRA neutral site would dispatch the line. Therefore, UP and BNSF could operate and dispatch their own joint line between Houston and New Orleans, serving customers on that line, and have rights on the old Missouri Pacific line which we would own or lease. Proceeds from a sale of the line to Tex Mex and KCS could be used by UP to increase the capacity of your joint line with BNSF or other lines you may want to upgrade.

The Tex Mex/KCS proposal would require some adjustment to your concept of directional running. However, any conflict would be minimal and, further, we believe that the directional running concept is ill conceived. We believe you may have let your lawyers or strategic planners, who are so opposed to divestiture that they must try and show how essential both lines are, overrule common sense operating practices. We all have been around long enough to know that railroads install centralized traffic control (CTC) to improve utilization and capacity on a single track main line by allowing trains to move expeditiously in both directions. Illinois Central ripped up one of its double-tracked main lines, installed CTC on the other and handled as much or more than both main lines combined. You have CTC on both of the main lines between Beaumont and Houston. By not running on each line in both directions, you are actually giving up capacity and not fully utilizing these lines. You argue that capacity is at a premium in Houston so here is an opportunity to improve capacity.

Speaking of capacity, we do not understand the arguments that Houston is out of capacity. Two and one-half years ago four railroads operated in and out of Houston better than three do today. Shippers are now trucking products. Grain movements into Houston elevators are not as prevalent as they have been in the recent past. We simply do not see the traffic numbers that support the your capacity constraint argument. At any rate, our plan and improved operating practices will relieve congestion and create capacity at Houston.

Incidentally, we are pleased that UP and BNSF recently recognized Tex-Mex's right to a voting seat on both the PTRA board and operating committee. As you know we have been arguing that PTRA by-laws gave Tex Mex this right and we are glad to see that the two of you are no longer attempting to block Tex-Mex's participation. We are also pleased that the Port of Houston is being granted a voting seat on and made a voting member of the board.

In conclusion, we must continue all possible efforts to allow Tex-Mex to compete effectively, as intended by the STB in its award of trackage rights to Tex Mex in the UP/SP merger case. We will be glad to meet with you independently, or you and Rob jointly, or with your designated representatives, to discuss our plan or alternatives. It is essential, however, that whatever we arrive at must address what we have outlined in order to improve service, reduce congestion and provide rail shippers competitive alternatives. Please let us know promptly when you would like to meet.

Sincerely,

Mike Haverty

Michael R. Haverty
President & CEO
Kansas City Southern Railway

Sincerely,

Larry D Fields

Larry D. Fields
President & CEO
Texas-Mexican Railway Company

cc: Rob Krebs (817-352-7100)

UNION PACIFIC CORPORATION

DICK DAVIDSON
CHAIRMAN

February 27, 1998

Mr. Michael R. Haverty
President & CEO
Kansas City Southern Railway
114 West Eleventh Street
Kansas City, MO 64105-1804

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

Dear Mike and Larry:

I am writing to address the concerns you expressed in your letter of February 20, 1998, and to give you our reactions to your proposals. I wholeheartedly agree that we have a "mutual obligation" to address the crisis in the Gulf Coast region, and I cannot overemphasize how seriously we view that commitment. I write in that spirit.

Competition

Your statements that KCS and Tex Mex are unable to compete due to Houston congestion is unsupported by the facts. KCS/Tex Mex business continues to grow. Tex Mex recently announced the construction of a new $7.5 million freight yard in Laredo to deal with the increase in traffic. News reports suggest that Tex Mex traffic may triple due to a potential agreement with BNSF. We agree that congestion in the Houston area has adversely affected Tex Mex's service quality and costs, just as it has affected all the railroads that compete with Tex Mex, notably Union Pacific. But the service crisis has not put Tex Mex at a competitive disadvantage.

Joint Dispatching

We never had any intention of excluding Tex Mex and KCS from our joint dispatching center with BNSF. We welcome you and encourage you to participate. We have even set aside physical space for your dispatchers at our Spring, Texas, dispatching center.

Your recollection that "the press release contained the first invitation that Tex Mex and KCS received to participate" is in error. We did, in fact, contact you immediately after our third meeting with BNSF, as soon as it appeared to us that our preliminary discussions might actually turn into something concrete. On February 4th and 5th, 1998, Steve Barkley spoke to both Ab Rees and Pat Watts directly to invite KCS/Tex Mex participation. Even though Union Pacific was excluded from the February 4, 1998 meeting in Houston to which your letter refers and which you helped sponsor, we had no intention of excluding KCS/Tex Mex from joint dispatching. We initially met alone with BNSF because BNSF offered us trackage rights and promising ideas for improving Houston-New Orleans operations. Your participation in those bilateral negotiations would not have been appropriate, just as our participation in your discussions with BNSF would not be appropriate now, but we welcome your participation in joint dispatching.

Of course, I cannot agree with your rhetoric about the new Spring dispatching center causing "chaos and confusion." I invite both of you to come to Spring and watch it in action. We created the center in Spring to facilitate communication between the HB&T dispatcher and the Southern Pacific's Tower 68 operator who controls operations on SP trackage in Houston, and to give them the ability to "see" lines outside of Houston. Because these dispatchers control intersecting territories, they have always needed to communicate regularly. Before moving to Spring, they were at distant locations, one at the HB&T facility in downtown Houston, and the other at the tower at Englewood Yard. They now sit an arm's length apart. These dispatchers engage in constant face-to-face communication, allowing them to usher trains through their territories as smoothly as possible.

The joint dispatching center with BNSF (and with your railroads, if you will join) will extend this successful integration. Locating employees of all of the railroads who own lines in the Gulf Coast region side-by-side at the same facility will allow for a degree of coordination that has never been attainable. Easing communication and eliminating handoffs between distant dispatchers will minimize delay and misunderstandings, while allowing dispatchers to solve problems cooperatively as they arise. This will reduce congestion and bring more consistent service to all Gulf Coast shippers.

Joint dispatching is scheduled to begin on March 15, 1998 on the HB&T lines and the joint BNSF-UP line between Houston and New Orleans. We will phase in the rest of the dispatching territories as we complete remodeling, signaling changes and installing communications systems. We expect to be operational across 100% of the affected lines no later than May 11, 1998.

Your proposal for a "Greater Houston Dispatching Center" is far more limited, would be much less effective and would take much longer to implement. Your proposed dispatching center would cover only the immediate Houston terminal area. From our center at Spring, Texas, however, joint dispatching will control operations not only for all of the greater Houston area, but for the entire former Southern Pacific from

Houston to New Orleans, the UP and BNSF lines linking Houston and Brownsville, BNSF lines to Teague and Temple, and the Union Pacific lines linking Houston with Flatonia and Victoria. Your participation would bring the KCS line from Beaumont to DeQuincy and the Tex Mex line from Corpus Christi to Laredo into the joint facility, establishing full coordination among all area railroads.

Your proposal for a Houston dispatching center, by contrast, could not be implemented for months and would not be truly effective for years. The PTRA may, as you say, be moving to a new office, but it does not perform <u>any</u> train dispatching today nor does it operate any computerized dispatching systems. It has no relevant experience. Even after hiring and installing the necessary systems, the PTRA center would struggle. In our experience, it takes approximately two years for a dispatcher to reach full efficiency. That would be two years of "chaos and confusion."

You say you want "neutral" dispatching, but all dispatching in our joint dispatching center is required by contract among the railroads to be "neutral." In addition, all of the carriers would supervise the center to ensure neutrality. Our proposal, therefore, secures the objective your proposal seeks, while also retaining highly trained expert dispatchers. The joint regional dispatching center will be a more effective operation than the PTRA far sooner, and with equal if not greater assurance of "neutrality." It would be foolhardy to forgo the advantages of this arrangement in favor of delays and confusion in the hands of a third party with no experience.

Neutral Switching

You suggest appointing a "neutral switch carrier" to serve customers on the HB&T lines in Houston. I have never understood why you want this change. No one claims that there is anything wrong with the switching service currently provided on HBT lines in Houston, other than the general congestion that will affect any switching operation, and there is no reason to believe that switching service would change under PTRA control. UP, BNSF and Tex Mex are all entitled to, and are all getting, "neutral" switching service on HBT lines today under existing agreements.

Booth Yard

You say that Booth Yard is "obviously not essential" to Union Pacific, but you know better. Union Pacific has <u>10,000</u> more private rail cars on its lines today than a year ago, consuming 100 extra miles of track, many of them in the Houston region. As you know, we are using every available track in the Houston area. Booth Yard provides us with badly-needed SIT and overflow capacity. At one time, Englewood Yard stored cars for customers in the Sinclair Oil Company ("Sinco") area, such as Texas Petrochemical, Bayer, Goodyear and Mobil. Texas Petrochemical alone regularly stored up to 100 cars at any given time. When these cars began to impede operations at Englewood, we unsuccessfully attempted to store them at Strang Yard. Today, Booth Yard handles those cars. We currently run a train of between 75 and

100 Sinco cars from Englewood to Booth Yard every day. Without Booth Yard we would be desperate for storage space, and I do not know where we would turn.

In addition, your plan to use Booth Yard as a switching facility in Houston would be disruptive. The busy mainline from Englewood to Strang passes by Booth Yard, with only one siding along that stretch. Any extensive yard switching at Booth Yard, whether conducted by Union Pacific, Tex Mex or any other railroad, would add interference to an already congested area.

Rosenberg-to-Victoria Line

We see considerable merit to your proposal to add new capacity by rehabilitating the former SP line south of Houston. This would help address the capacity shortfall described by the STB in yesterday's decision. We are willing to negotiate with you concerning your acquisition of the Rosenberg-to-Victoria line. I suggest you contact Steve Barkley to discuss the matter.

Houston-to-Beaumont Line

Your request to buy our Houston-to-Beaumont line is not new, and we remain firmly opposed to it. We instituted directional running between Houston and New Orleans, using the Houston-to-Beaumont line as the eastbound leg of a circuit completed by operating westbound over the parallel SP line. On February 17, 1998, the STB issued a decision rejecting the Railroad Commission of Texas' request that we be ordered to transfer control of the Houston-to-Beaumont line to you. I cannot improve upon the STB's discussion:

> The directional running program is one of UP/SP's more important planned improvements for the merged system, and one that the carrier is using to improve the flow of traffic to and from Houston. Handing one of the lines over to Tex Mex would defeat directional running, and would reduce operational flexibility, adversely affecting the operation of the remaining line and the movement of BNSF, UP/SP, and even Amtrak trains.

It would be counterproductive to transfer this critical line to you, destroying directional running without gaining any operational benefits. In addition, the need to obtain Tex Mex approval for every move at the north end of Settegast Yard would cripple our yard.

It seems clear from Texas Railroad Commission statements to the STB that the main purpose of this proposal is to give priority to Tex Mex trains over UP trains, harming all the Texas shippers whose shipments are on our trains. Bringing the Beaumont-DeQuincy KCS line into the joint dispatching center will generate benefits for all shippers, so we urge you to pursue that course instead.

Directional Running

Our commitment to directional running remains steadfast. Your speculation that anyone but operating personnel conceived of this program is insulting and wrong. This plan was developed solely by the 200 operating personnel who developed the merger operating plan. The SP line is essential, not because of legal considerations, but for operating capacity.

We have listened to you criticize directional running since you described it as "lunacy" during the merger proceedings. You are as mistaken now as you were then. We do not base our confidence in directional running on faith. Directional running is functioning beautifully on the three other UP corridors where it has been used for years: Weso to Alazon, Nevada; Paola, Kansas to Wagoner, Oklahoma; and Kansas City to Jefferson City, Missouri.

Your letter reflects your continued misunderstanding of directional running. You claim that we are acting hypocritically by not running bi-directionally on CTC-equipped lines, while we complain about the lack of line capacity. You are overlooking the value and time savings of eliminating hundreds of train meets every day, which frees capacity and reduces delay. In addition, the key value of directional running is improved use of terminals. By specializing terminals to handle single-direction traffic, directional running will reduce congestion in major yards and allow them to build more blocks and reduce downstream switching.

You already enjoy the benefits of directional running on the lines south of Houston. Directional running had an immediate positive impact in clearing congestion and improving operations on that corridor. While the Brownsville Subdivision was once in worse shape than any other on the railroad, directional running has cured it of these problems. The fact that the Brownsville Subdivision continues to operate smoothly while the lines around it struggle confirms that directional running works.

Sincerely,

Dick

CERTIFICATE OF SERVICE

I, Arvid E. Roach II, certify that, on this 2nd day of March 1998, I caused the foregoing document to be served by first-class mail on all parties of record.

Arvid E. Roach II