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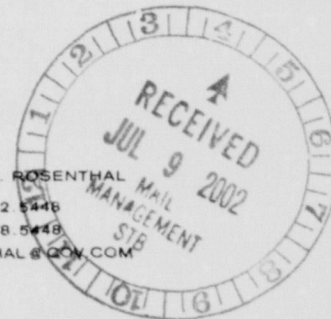
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July 9, 2002

## VIA HAND DELIVERY

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

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Office of Proceedings

JUL 10 2002

Part of  
Public Record

Re: Finance Docket No. 32760, Union Pacific Corporation, et al. –  
Control and Merger – Southern Pacific Rail Corporation, et al.

Dear Secretary Williams:

Union Pacific Railroad Company ("UP") offers the following brief comments on two replies to replies in the referenced proceeding. UP does not object to the acceptance of either CMA's "Reply to UP/SP-397" or BNSF's "Rebuttal to UP's Reply," both dated June 28, 2002, if the Board also accepts these UP comments.<sup>1</sup>

### CMA

CMA misleadingly accuses UP of "misleading" the Board. CMA-18 at 1. In substance, CMA argues that UP and BNSF amended the BNSF Settlement Agreement to embrace the method of adjusting trackage rights fees that CMA's own expert, Thomas Crowley, had proposed during the merger proceeding, but that the CMA Agreement called for a different method. We submit that CMA's new argument is not credible and must be rejected for the following reasons:

- CMA's eleventh-hour attempt to disavow the recommendation of its own expert, Mr. Crowley, contradicts CMA's sworn testimony earlier this year. In 1996, Mr. Crowley had recommended an adjustment that includes "a 1-year lag so that the 1997 adjustment would be based on the change in costs

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<sup>1</sup> We refer to the American Chemistry Council (formerly the Chemical Manufacturers Association) by the acronym used throughout these proceedings, "CMA."

Hon. Vernon A. Williams

July 9, 2002

Page 2

between 1995 and 1996." CMA-7, Crowley V.S. at 57. In a verified statement earlier this year, CMA told the Board that the CMA Agreement was "[b]ased on Mr. Crowley's recommendations." CMA-17, Schick V.S. at 3. CMA's representation earlier this year was correct, and the Board should not allow it to assert the opposite in its final reply document.

- CMA advocates an adjustment mechanism that would be impossible to apply, as CMA's Mr. Crowley recognized years ago. CMA argues that the language of the CMA Agreement requires comparisons each summer between current-year URCS costs and URCS costs for the prior year. As Mr. Crowley recognized, however, this is impossible because current-year URCS costs are not available until almost a year after the adjustment is performed. That is why BNSF and UP understood the CMA Agreement as employing Mr. Crowley's method, which compared URCS costs for two prior years. See UP/SP-266, Second Supplemental Agreement, § 9; see also UP/SP-397, Rebensdorf V.S. at 6-7.
- CMA did not object when UP, eleven days after the CMA Agreement was signed, explained how the parties understood its adjustment provision. UP/SP-231, Rebensdorf R.V.S. at 10. CMA also never objected to the language that BNSF and UP adopted to implement the CMA Agreement. The Board cannot reasonably conclude that CMA, one of the most aggressive and active parties in the UP/SP merger proceeding, suddenly lost interest and ignored both UP testimony and an amendment to the BNSF Settlement Agreement that conflicted with the hard-won CMA Agreement. Yet that is CMA's position today.
- CMA's new position conflicts with a basic purpose of the CMA Agreement – a purpose that CMA reiterated earlier this year. As a CMA witness testified earlier this year, CMA wanted to ensure that the trackage rights fees would reflect "cost savings projected by UP/SP as one of the benefits of the merger." CMA-17, Schick V.S. at 3. By advocating an adjustment mechanism based on post-merger costs, however, CMA would lose the benefit of cost reductions as two pre-merger railroads combined into one post-merger railroad. This would increase BNSF's trackage rights fees.

UP's arguments did not mislead the Board. CMA's new arguments confirm that it is attempting to rewrite a history for which it was uniquely responsible.

Hon. Vernon A. Williams  
July 9, 2002  
Page 3

BNSF

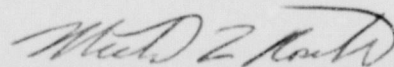
The Board invited further submissions in this proceeding in order to allow BNSF and its allies an opportunity to provide evidence for BNSF's initial, unsupported claim that the railroads agreed to deduct certain costs from URCS costs when adjusting trackage rights fees. No party provided any such evidence. Instead BNSF claimed a different agreement, arguing that the parties intended to restrict the adjustment mechanism to post-merger URCS costs. Again, however, BNSF provided not a scintilla of contemporaneous evidence to support the newly alleged agreement.

In its latest filing, BNSF steps back from both of its prior theories. BNSF now says that it does not know how the parties agreed to adjust the trackage rights fees, but that it is UP's job to find a way to depart from both URCS system average costs and the express terms of the BNSF Settlement Agreement.

BNSF's latest filing thus confirms a dispositive conclusion: there is no evidence whatsoever that UP and BNSF ever discussed, mutually considered, or agreed to adjust trackage rights fees in any way other than as they expressly agreed in the plain language of the BNSF Settlement Agreement. In this proceeding, BNSF has suggested two different and mutually inconsistent theories for departing from the plain language, but it has never adduced a single scrap of paper from the UP/SP proceeding to support either, and it now appears to recognize that neither was workable. After months of briefing, BNSF cannot tell the Board the substance or the mechanics of the parties' supposed agreement to depart from the BNSF Settlement Agreement's plain language, much less support that agreement with evidence other than post-hoc rationalizations.

UP's Reply fully addresses each of the arguments in BNSF's newest filing, so we will not belabor them here. The Board called for evidence of agreement to depart from the plain language of the BNSF Settlement Agreement, but none has come before the Board.

Sincerely, ,



Michael L. Rosenthal

cc: All Parties of Record

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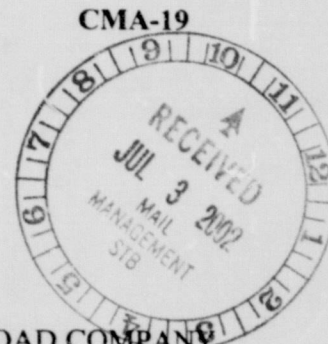
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BEFORE THE

JUL 3 - 2002 SURFACE TRANSPORTATION BOARD

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Finance Docket No. 32760



UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY

AND MISSOURI PACIFIC RAILROAD COMPANY

-- CONTROL AND MERGER --

SOUTHERN PACIFIC RAIL CORPORATION, SOUTHERN PACIFIC  
TRANSPORTATION COMPANY, ST. LOUIS SOUTHWESTERN RAILWAY

COMPANY, SPCSL CORPORATION AND THE DENVER AND

RIO GRANDE WESTERN RAILROAD COMPANY

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AMERICAN CHEMISTRY COUNCIL'S  
REPLY TO UP/SP-397

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JUL 2 - 2002

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The American Chemistry Council ("the Council")<sup>2</sup> submitted evidence to the Board on May 22, 2002 in CMA-17 showing that the Council's predecessor, CMA, had negotiated with UP and had obtained agreement to a modified escalator formula for the trackage rights fees to be

<sup>2</sup> The American Chemistry Council (formerly the Chemical Manufacturers Association, or CMA) represents the leading companies engaged in the business of chemistry. Council members apply the science of chemistry to make innovative products and services that make people's lives better, healthier and safer. The Council is committed to improved environmental, health and safety performance through Responsible Care®, common sense advocacy designed to address major public policy issues, and health and environmental research and product testing. The business of chemistry is a \$455 billion a year enterprise and a key element of the nation's economy. It is the nation's largest exporter, accounting for 10 cents out of every dollar in U.S. exports. Chemistry companies invest more in research and development than any other business sector.

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paid by the BNSF. The original escalator agreed between UP, SP and BNSF was based on 70% of year-to-year changes in the RCAF. The revised escalator adopted by UP and CMA in Paragraph 7 of the CMA Agreement provided that the trackage rights fees would "be adjusted upward or downward each year by the difference between the year in question and the preceding year in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the fee." See CMA-17, Verified Statement of Thomas E. Schick at 4.

If there is anything that can fairly be characterized as the "CMA Method," the escalator formula in Paragraph 7 of the CMA Agreement was it, because this is the only escalator formula that CMA ever agreed to. What UP labels as the "CMA Method" was an escalator formula suggested earlier by one of CMA's witnesses, Mr. Crowley, which CMA did not adopt in the CMA Agreement.

The intention and effect of the escalator formula in Paragraph 7 of the CMA Agreement was to adjust the trackage rights fees beginning in the second post-merger year. Schick V.S., id. at 4. Because the first adjustment would have been based on a comparison of costs in the second post-merger year with costs in the first post-merger year, there never would have been a comparison of post-merger costs with pre-merger costs. Id.<sup>3</sup>

CMA never agreed to, and was not involved in negotiating, the changes subsequently made by UP, in its second supplemental agreement with BNSF, which UP now refers to as the "CMA Method." As the Council has pointed out, the Second Supplemental Agreement was filed

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<sup>3</sup> Hence the Council disagrees with UP's view (UP/SP-397 at 20) that the words "the year in question" in Section 7 of the CMA Agreement must mean the previous year. If the intention had been to base the adjustment on a comparison of the two prior years' costs, that is what the CMA Agreement would have said.

on the last business day before the oral argument in the UP/SP merger, after CMA had already filed a brief withdrawing its opposition to the merger.<sup>4</sup>

UP suggests that it "agreed" to adopt the escalator formula proposed by CMA's witness Crowley. UP/SP-397 at 11. But CMA never asked UP to agree to this escalator. The CMA Agreement, as noted, did not contain this escalator. Although UP and BNSF subsequently agreed, in the Second Supplemental Agreement, to amend the agreement to incorporate the Crowley formula, CMA never agreed to this. Nor was CMA involved in the negotiations that resulted in the Second Supplemental Agreement.

In sum, it would be erroneous to infer that UP adopted the "CMA Method" in any way at the behest of, or with the agreement of CMA. As far as the Council is concerned, the so-called "CMA Method," as interpreted by UP, is invalid, both because it was adopted without consultation with CMA, and because, as now interpreted by UP, it would materially abrogate an important aspect of the CMA Agreement – that the escalator formula should be based only on a comparison of costs for post-merger years, rather than comparing pre-merger costs with post-merger costs. It would be unjust to construe the Second Supplemental Agreement as abrogating this aspect of the CMA Agreement, for two reasons. First, CMA was not involved in negotiating the Second Supplemental Agreement. Second, the Board in approving the UP/SP merger imposed the CMA Agreement (including Paragraph 7) as an additional condition separate from the UP/SP-BNSF Settlement Agreement.<sup>5</sup>

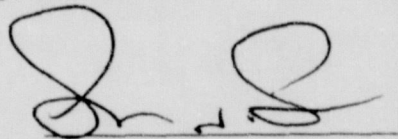
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<sup>4</sup> UP's submission of testimony from Mr. Rebensdorf on April 29, 1996 stating UP's unilateral intention or interpretation regarding the escalator formula (see quoted passage, UP/SP-397 at 12) had no effect, and could not have had any effect, in modifying the mutual agreement of UP and CMA in the CMA Agreement.

<sup>5</sup> See Decision No. 89, 1 S.T.B. 233 at 419.

The best that can be said of the escalator formula that was adopted in the Second Supplemental Agreement is that, if it were applied in such a way as not to alter the underlying intent of the CMA Agreement to compare only post-merger years, it could be harmonized with CMA's intentions. Indeed, as Mr. Schick testifies, he was advised that the change in the escalator formula made in the Second Supplemental Agreement was intended to be only a technical, non-substantive change. CMA-17, Verified Statement of Thomas E. Schick at 6. BNSF has submitted evidence and argument concerning how the formula, with the proper adjustments, could carry out the intention of the CMA Agreement and not be distorted by inclusion of merger related cost write-ups and capital investments which UP repeatedly pledged to pay for. The Council concurs with and endorses that evidence and argument.

Respectfully submitted,



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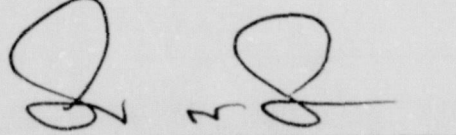
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dated: June 28, 2002

CERTIFICATE OF SERVICE

This is to certify that I have, this 28nd day of June, 2002, served copies of the foregoing filings by hand upon Washington counsel for the Burlington Northern Santa Fe and Union Pacific and by first class mail upon other parties of record.



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Scott N. Stone

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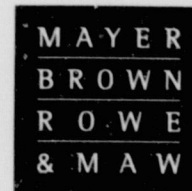
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June 28, 2002

VIA HAND DELIVERY

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

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JUL 1 2002

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Dear Secretary Williams:

Enclosed for filing in the above-captioned proceeding are the original and twenty-five (25) copies of The Burlington Northern and Santa Fe Railway Company's Rebuttal to UP's Reply to BNSF's and CMA's Responses to Order to Show Cause (BNSF-104).

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

Sincerely,

*Erika Z. Jones/als*

Erika Z. Jones

Enclosures

cc: All Parties of Record

Brussels Charlotte Chicago Cologne Frankfurt Houston London Los Angeles Manchester New York Palo Alto Paris Washington, D.C.  
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205745

BNSF-104

BEFORE THE  
SURFACE TRANSPORTATION BOARD



Finance Docket No. 32760

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

-- CONTROL AND MERGER --

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

BNSF'S REBUTTAL TO UP'S REPLY TO  
BNSF'S AND CMA'S RESPONSES TO ORDER TO SHOW CAUSE

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JUL 1 2002

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June 28, 2002

BEFORE THE  
SURFACE TRANSPORTATION BOARD



Finance Docket No. 32760

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

-- CONTROL AND MERGER --

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

BNSF'S REBUTTAL TO UP'S REPLY TO  
BNSF'S AND CMA'S RESPONSES TO ORDER TO SHOW CAUSE

The Burlington Northern and Santa Fe Railway Company ("BNSF") submits this Rebuttal to the Reply filed on June 19, 2002, by Union Pacific Railroad Company ("UP") (UP/SP-397) in response to BNSF's May 22, 2002 Response to Order to Show Cause why its Petition for Clarification of the Trackage Rights Fee Adjustment Provision (BNSF-102) ("Response") should not be dismissed. BNSF is entitled to make this Rebuttal because UP's Reply was an evidentiary submission and, unless BNSF is permitted to make this Rebuttal, it will have no opportunity to respond to the evidence submitted with UP's Reply.<sup>1</sup> In addition, UP's Reply was the first pleading in which UP

<sup>1</sup> It is the Surface Transportation Board's practice in this regard to permit parties the opportunity to respond to evidence submitted by other parties. For instance, in Illinois Central Railroad Co. - Petition for Crossing Authority - in East Baton Rouge Parish, LA, Finance Docket No. 33877 (Sub-No. 1) (served November 20, 2001), the Board set a procedural schedule which provided IC with the opportunity to submit

set forth its position on the merits of the parties' dispute, and fairness dictates that BNSF be allowed to address the evidence and argument presented for the first time by UP.

UP asserts that BNSF's Petition for Clarification should be dismissed for six principal reasons: (i) BNSF and CMA<sup>2</sup> have purportedly changed their previous positions and now are advancing an entirely new procedure for the calculation of the annual rate adjustment; (ii) the language of Section 12 of the BNSF Settlement Agreement, which provides for a one-year lag in comparing URCS costs starting July 1, 1997, follows the methodology suggested by CMA's expert witness, Thomas D. Crowley, during the UP/SP merger proceeding; (iii) the parties never agreed or intended to use only post-merger URCS costs; (iv) the language of Section 7 of the CMA Agreement, which expressly provides for the comparison of post-merger URCS costs, has been overridden by the testimony of UP's John Rebensdorf and the Second Supplemental Agreement; (v) BNSF's proposed methodology for calculating the adjustment is internally inconsistent and unworkable; and (vi) there is no competitive justification to alter the adjustment mechanism.

rebuttal to KCS's evidentiary submission. Indeed, fair hearing and due process notions require that BNSF be afforded the opportunity to respond to UP's evidentiary submission here. Moreover, BNSF has limited this rebuttal to argument in response to UP's evidence and has made no new arguments or submitted any new evidence herein. To the extent the Board determines that leave is required to file this Rebuttal, BNSF respectfully requests such leave.

<sup>2</sup> The American Chemistry Council (formerly known as the Chemical Manufacturers Association) is referred to herein as "CMA".

As shown below, each of UP's alleged grounds for dismissing BNSF's Petition is either flatly wrong or an effort to divert the Board from implementing the clear intent of the parties as expressed in Section 7 of the CMA Agreement.

### **BNSF's and CMA's Alleged Change of Positions**

Initially, in claiming that BNSF and CMA have abandoned their prior positions, UP seizes upon a distinction without a difference in its word-game about what it calls "BNSF's ever-changing stories regarding the parties' intent . . . ." UP Reply at 5. The intent at issue is, however, the same as it has been since BNSF filed its Petition on December 21, 2001: Did the parties intend to increase the GTM mill rates by a factor based on the purchase premium UP paid to acquire SP and the merger-related capital expenditures for which it was agreed that BNSF would have no responsibility in Section 9(c) of the BNSF Settlement Agreement?

Excluding or including the disputed costs makes no substantive difference in the effect on the annual GTM rate adjustment. This was specifically addressed by BNSF's witness Richard E. Weicher who participated in the negotiation of the settlement agreements. As Mr. Weicher explains:

These costs that UP has improperly included in the annual adjustment effective July 1, 1998, and in subsequent years need to be identified and removed from URCS data for those years. Alternatively, the error of basing the adjustment on use of these costs in 1997 and subsequent years could be corrected by adding those costs in the years 1995 and 1996 and any succeeding years in which such costs are not present in URCS for the preceding year.

BNSF-102, Verified Statement of Richard E. Weicher, at 11. Mr. Weicher made clear that the choice of excluding or including the costs is one that UP should make:

It is not my purpose here to propose a mechanism for correcting UP's addition to the base used for the annual

adjustments of costs that were already accounted for in September 1995. Rather, the burden should be on UP to correct the error by a procedure that prevents the costs from having any effect in the annual adjustment process.

Id.

Moreover, there is no factual basis for UP's complaint that BNSF, having signed the Second Supplemental Agreement which adopted UP's methodology, should have raised its position on the disputed costs sooner. UP Reply at 21-23. Until BNSF audited UP's adjustment methodology, it could not determine that UP was interpreting and applying the Section 12 language in a manner inconsistent with Section 7 of the CMA Agreement and with the parties' intent that post-merger URCS costs would be used.<sup>3</sup> The facts are clear that BNSF conducted that audit in late 2000 and that BNSF objected to UP about its methodology immediately thereafter.<sup>4</sup>

#### **Crowley Testimony**

UP's reliance on the testimony of Mr. Crowley as evidence of the proper adjustment methodology is misplaced for several reasons. First, Mr. Crowley's

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<sup>3</sup> It should be noted in this regard that the fact that the language of Section 12 provides for a one-year lag commencing on July 1, 1997, did not necessarily by itself indicate to BNSF that UP did not intend to adjust the rates in a manner that would adhere to the intent of Section 7 of the CMA Agreement. Rather, UP could well have adopted a methodology which provided that, if pre-merger years were to be used for purposes of the annual adjustments to the GTM mill rates, appropriate adjustments would be made to the URCS costs in such years in order to account for the fact that the SP purchase premium and the Section 9(c) implementation expenditures which UP was to fund (both of which would be included in all post-merger years) are not reflected in pre-merger years. UP did not adopt such a methodology, and thus the present dispute arose.

<sup>4</sup> The dispute between UP and BNSF concerning UP's adjustment methodology was not raised in this proceeding until BNSF's July 2, 2001 Fifth Annual Report, and thus CMA had no basis on which to express its concerns about UP's methodology before that time. Indeed, it was not until BNSF filed its Petition for Clarification in December that the specifics of the parties' dispute were made a part of the record.

testimony suggesting the use of 1995 and 1996 costs to determine the 1997 rate adjustment was incidental to Mr. Crowley's overarching position that the "proper measure for the adjustment mechanism is cost changes." CMA-7, Verified Statement of Thomas D. Crowley, at 57. All parties were aware that the adjustment mechanism would have no effect or significance until after the merger occurred. It is, therefore, not credible for UP to interpret Mr. Crowley's testimony as if it contemplated comparing pre-merger and post-merger cost changes which result in a double counting of the purchase premium. Second, Mr. Crowley's suggestion was included in CMA's March 29, 1996 Comments. Three weeks later, on April 18, 1996, CMA executed the CMA Agreement with UP/SP and BNSF, and Section 7 of the CMA Agreement provided that the URCS costs comparisons would be made between post-merger years only. Accordingly, to the extent Mr. Crowley's testimony can be read to set forth CMA's position, that position changed, and Mr. Crowley's testimony no longer reflected CMA's view of the annual adjustment process.<sup>5</sup>

#### **Parties' Intent**

UP argues that BNSF and CMA submitted no evidence to support the conclusion that the parties intended to use only post-merger URCS costs in the adjustment process. On a basic level, UP is ignoring the intent testimony of BNSF's principal negotiator, Carl R. Ice, on this subject:

The [BNSF settlement] negotiations occurred after UP's acquisition of SP had been negotiated between those parties and after the terms of that acquisition had been set. By the

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<sup>5</sup> Thus, UP's labeling of Mr. Crowley's proposal as the "CMA Method" is significantly misleading since CMA rejected his approach just three weeks later, and UP's effort to obscure the weaknesses in its proposed methodology by seeking to legitimize the methodology through Mr. Crowley is imaginative, but not credible.

same token, the negotiations under way between BNSF and UP/SP were on the terms of a possible settlement under which BNSF would not oppose the merger if it acquired sufficient conditions of value to BNSF that would address the competitive impacts of UP's merger with SP. These were rights which could only be implemented and become effective if that merger was approved and had already been consummated. Clearly, we believed that the GTM mill rates included any effects of the merger.

BNSF-102, Verified Statement of Carl R. Ice, at 4-5 (emphasis added).

Moreover, given the express contractual language, no such evidence is needed, and UP has ignored that language. First, Section 7 of the CMA Agreement clearly establishes that post-merger URCS costs should be used in making the annual adjustment calculations. There is no other way to reasonably read the language of Section 7, and no evidence of the parties' discussions or negotiations is needed. By comparing "the year in question" with "the preceding year", the language provides for a comparison of post-merger URCS costs since, given that the first adjustment to the rates would be in the second year of the merger, the "year in question" was by definition the second year of the merger. The language means what it says. Second, Section 12 of the BNSF Settlement Agreement establishes that it is the intent of the parties that the GTM mill rates should "reflect the same basic relationship to operating costs as upon execution of this Agreement". As the testimony of Christopher D. Kent in BNSF's Response shows at pages 4 to 5, UP's proposed methodology causes a greater deviation in that relationship than does the methodology proposed by BNSF and CMA.<sup>6</sup>

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<sup>6</sup> Oddly, while UP attacks almost every other aspect of Mr. Kent's testimony, it does not even address this portion of his testimony. The reason is obvious. UP has no grounds on which to counter Mr. Kent's conclusion.

### Rebensdorf Testimony and the Second Supplemental Agreement

UP contends that the language of Section 7 of the CMA Agreement is "subject to multiple interpretations". UP Reply at 12. However, there is no reasonable interpretation other than what the straightforward language provides: The trackage rights fees shall be adjusted by the difference in the relevant URCS costs "between the year in question and the preceding year", both of which, by definition, are post-merger years as discussed above. UP nonetheless argues that John Rebensdorf's April 29, 1996 rebuttal verified statement set forth how UP interpreted the language and intended to apply it and that UP and BNSF executed the Second Supplemental Agreement which incorporated language substantially identical to Mr. Rebensdorf's proposed language. UP did not, however, (nor for that matter did BNSF) have the power or authority to revise the language in Section 7 of the CMA Agreement,<sup>7</sup> and CMA has explained that UP advised it that the language change was a technical modification not intended to alter the substance of Section 7 of the CMA Agreement. CMA-17, Verified Statement of Thomas E. Schick, at 6. Accordingly, UP's reliance on Mr. Rebensdorf's testimony and the language in the Second Supplemental Agreement cannot contradict the language of Section 7 of the CMA Agreement.<sup>8</sup>

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<sup>7</sup> In fact, the CMA Agreement was imposed as a separate independent condition on the Board's approval of the UP/SP merger (Decision No. 44, 1 S.T.B. at 419), and the language of Section 7 of the Agreement must be given effect as it is written.

<sup>8</sup> In this regard, UP goes to great lengths to explain the reasons why it booked the SP purchase premium in the year after its acquisition of SP rather than in 1996, and UP makes repeated efforts to show that it did not mislead BNSF or CMA about this fact. UP Reply at 23-24. However, UP has created a straw man position for BNSF, which has not contended that it was intentionally misled or that UP's election was improper. Rather, what BNSF has contended is that, regardless of when the purchase premium was actually booked or whether UP adequately advised parties to the UP/SP merger proceeding that it might not be booked in 1996, it was the intent of the parties to the

### **BNSF's Proposed Adjustment Methodology**

UP submits several criticisms of the calculations undertaken by Mr. Kent in order to estimate the impact that UP's proposed methodology has on the GTM mill rates. In so doing, UP disingenuously criticizes Mr. Kent for making a number of assumptions which UP then proceeds to claim are unjustified. UP criticizes Mr. Kent for other alleged errors in his estimation methodology, and UP further attacks BNSF's and CMA's position for being internally inconsistent and not providing a rationale for dealing with the excluded Section 9(c) merger-related capital expenditures.

UP has, however, conveniently ignored the fact that Mr. Kent was, as reflected in his verified statement and accompanying workpapers, limited by lack of access to UP data in his ability to propose a definitive methodology to eliminate the impact of the disputed costs in the adjustment process. While UP did produce certain documents and information in response to BNSF's discovery requests, Mr. Kent's calculations were only an estimate of the impact of UP's methodology, and access to significantly more information from UP concerning exactly how the disputed costs were booked by account, as well as other relevant data, is needed to accurately determine and eliminate that impact.

Moreover, UP's criticisms are misdirected. It is UP that bears responsibility for properly implementing the intent set forth in Section 7 of the CMA Agreement that post-merger URCS costs should be used for the purpose of the rate adjustment calculations,

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BNSF Settlement Agreement that the GTM mill rates were all-inclusive and that the purchase premium should not be double counted through the adjustment process. Thus, if the fact that UP did not book the premium in 1996 would cause that to occur, an appropriate adjustment must be made.

and it is no defense to UP's failure to do so for it to assert that BNSF and CMA are unable to do so.

### **Competitive Justification**

UP argues strenuously that there is no competitive justification to alter the adjustment mechanism because BNSF has been able to compete effectively over the trackage rights lines and because the GTM mill rates that BNSF is paying are lower than they might otherwise be if different rates and/or methodologies had been adopted. UP has once again totally misconstrued (perhaps intentionally) BNSF's argument. BNSF has not asserted that the base GTM mill rates are too high or were improperly set. Rather, BNSF has argued that, once the GTM mill rates were set, changes in UP's costs should not enable UP to gain a competitive advantage. Prior to the parties' present dispute, Mr. Rebensdorf recognized that the two carriers should compete on a "level playing field" (UP/SP-22 at 301), and the parties expressly stated that the relationship between UP's costs and BNSF's rates for service over the trackage rights lines was intended by the parties to remain the same. Now, however, UP proposes a methodology that undisputedly causes a deviation in that relationship in favor of UP.

BNSF has submitted the testimony of Denis J. Smith, Vice President of Industrial Products Marketing, to establish that the deviation can and does make a difference in BNSF's ability to compete for traffic. Furthermore, UP itself buttressed this conclusion by examples it cited in the Confidential Appendices to its annual oversight reports of situations where rate differentials equivalent to the amount in question here have made a difference. Tellingly, UP has submitted no evidence from any of its marketing

personnel to counter that conclusion, and thus its argument that there is no competitive effect should not be given weight.<sup>9</sup>

Moreover, and perhaps more importantly, there is no need for BNSF and CMA to show that there is a competitive justification for correcting the adjustment mechanism, when the fundamental purpose of the trackage rights is to provide a vigorous competitor to a merged UP/SP for the long term, not a mere presence subject to degradation over time. This is in addition to the fact that the existing language of Section 7 of the CMA Agreement clearly and expressly provides that post-merger URCS costs are to be utilized in making the adjustment calculations, and the only question before the Board is whether UP should be held to the agreement that it made with BNSF and CMA.

### **Conclusion**

As established in BNSF's Response, the relationship between the GTM mill rates which BNSF pays for its use of the UP/SP trackage rights lines and UP's costs associated with those lines is critical to BNSF's ability to provide effective and efficient competitive service as a long-term replacement for SP. Section 7 of the CMA Agreement reflects the parties' clear intent that the comparison of URCS costs should be made using post-merger years only, and UP's assertion that the revised language of

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<sup>9</sup> UP contends that Mr. Kent's estimate that the impact of UP's position is approximately 0.2 mills is inaccurate because Mr. Kent did not exclude the impact on the rates caused by the disagreement between UP and BNSF over the manner in which the adjustment should be taken into account (i.e., whether the adjustment should be made based on the percentage change in the relevant URCS costs or based on the numerical change in those costs). However, Mr. Kent made his estimate as he did in order to reflect what the impact would be if UP's position was adopted with respect to both disputed issues, and there is no doubt that there is an impact caused by UP's adjustment methodology standing alone. Whether that impact is approximately 0.1 mills (as UP suggests) or some other amount is irrelevant to the issue before the Board. The issue to be decided is whether the language and intent of the parties as set forth in Section 7 of the CMA Agreement should be given effect.

Section 12 of the BNSF Settlement Agreement should be applied to allow for the comparison of pre-merger URCS costs with post-merger URCS costs is clearly contrary to the language of Section 7 and the parties' intent.

Accordingly, BNSF respectfully requests that the Board clarify that the SP purchase premium and the merger-related capital expenditures that UP was to solely fund may not be included in the Section 12 adjustment process as UP proposes because doing so would violate the express language of Section 7 of the CMA Agreement and the parties' intent that the GTM mill rates were to be comprehensive and all-inclusive.

Respectfully submitted,

*Erika Z. Jones/als*

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Erika Z. Jones  
Adrian L. Steel, Jr.  
Adam C. Sloane

Jeffrey R. Moreland  
Richard E. Weicher  
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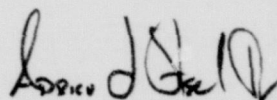
Mayer, Brown, Rowe & Maw  
1909 K Street, NW  
Washington, DC 20006  
(202) 263-3000

Attorneys for The Burlington Northern and Santa Fe Railway Company

June 28, 2002

CERTIFICATE OF SERVICE

I do hereby certify that copies of The Burlington Northern and Santa Fe Railway Company's Rebuttal to UP's Reply to BNSF'S and CMA's Responses to Order to Show Cause (BNSF-104) are being served on all parties of record.

A handwritten signature in dark ink, appearing to read "Adrian L. Steel, Jr.", written over a horizontal line.

Adrian L. Steel, Jr.

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June 20, 2002

## HAND DELIVERY

The Honorable Vernon A. Williams  
Secretary  
Surface Transportation Board  
1925 K Street, N.W.  
Room 711  
Washington, D.C. 20423-0001

Re: Finance Docket No. 32760, Union Pacific Corporation, Union Pacific Railroad Company, and Missouri Pacific Railroad Company - Control and Merger - Southern Pacific Rail Company, St. Louis Southwestern Railway Company, SPCSL Corp. and The Denver and Rio Grande Western Railway Company

Dear Mr. Williams:

I am enclosing an original and 25 copies of a new cover page to correct typographical errors in the cover of yesterday's filing in the above-referenced matter by Union Pacific Railroad Company.

Please date stamp the enclosed extra copy and return it to our waiting messenger.

Thank you for your assistance.

Sincerely,

Michael L. Rosenthal

Enclosures

cc: All Parties of Record

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JUN 20 2002

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BEFORE THE  
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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



**UP'S REPLY TO BNSF'S AND CMA'S RESPONSES TO ORDER TO SHOW CAUSE**

CARL W. VON BERNUTH  
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*Attorneys for Union Pacific Corporation,  
Union Pacific Railroad Company and  
Southern Pacific Rail Corporation*

June 19, 2002

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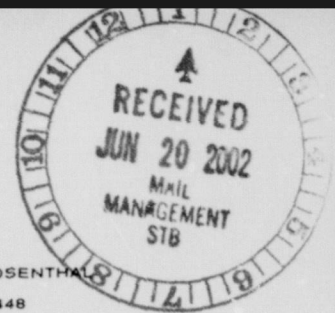
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June 20, 2002

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## HAND DELIVERY

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Michael L. Rosenthal

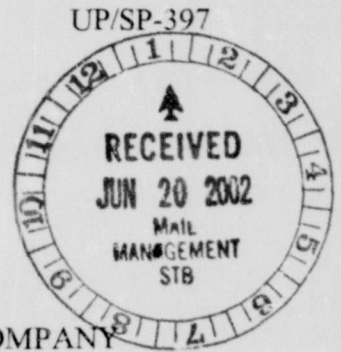
Enclosures

cc: All Parties of Record

BEFORE THE  
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY  
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-- CONTROL AND MERGER --  
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COMPANY, SPCSL CORP. AND THE DENVER AND  
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*Attorneys for Union Pacific Corporation,  
Union Pacific Railroad Company and  
Southern Pacific Rail Corporation*

June 19, 2002

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who had been involved in the September 1995 negotiations and the CMA Agreement negotiations to ensure that the Second Supplemental Agreement correctly reflected our intent.

In several of the drafts, UP and BNSF focused specifically on the CMA Agreement's provision for adjusting the trackage rights fees. We agreed to use the CMA mechanism as Mr. Crowley had described it. To the best of my knowledge, BNSF never suggested that UP's URCS should be modified to exclude the effects of purchase accounting or the costs of capacity improvements UP had agreed to pay. BNSF never suggested that the adjustment should be based only on post-merger URCS costs. BNSF never told UP that they understood the initial trackage rights fees to include the anticipated effects of purchase accounting. BNSF never mentioned purchase accounting, "merger premiums," or anything of that nature in connection with the provision for adjusting trackage rights fees. BNSF never suggested that the final form of the fee adjustment provision differed from the CMA Agreement's fee adjustment process, as BNSF now claims. If BNSF had raised any of these issues, I am certain that Mr. Conley would have informed me and the others on the UP team.<sup>3</sup>

I believe that the plain language of the Second Supplemental Agreement's provision for adjusting trackage rights fees, which was the language before the Board when it approved the UP/SP merger and which is the same language in the Restated and Amended BNSF Settlement Agreement that UP and BNSF filed in March 2002, accurately records CMA's, UP's

---

<sup>3</sup> At the same time UP and BNSF were negotiating the Second Supplemental Agreement, the parties were also negotiating the implementing agreements for each segment of the trackage rights granted under the BNSF Settlement Agreement. The implementing agreements all contained the fee adjustment provision. In the negotiations regarding the implementing agreements, as in the negotiations regarding the Second Supplemental Agreement, BNSF never raised any of the claims it is now making. As the negotiations regarding the implementing agreements were coordinated with the negotiations over the Second Supplemental Agreement, I am confident that I would have been informed had such claims been raised.

and BNSF's intent as reflected in the CMA Agreement. I believe that it also accurately records UP's and BNSF's intent in their negotiations regarding the Second Supplemental Agreement. If BNSF had any beliefs or intentions inconsistent with the plain language, no one ever shared those beliefs or intentions with UP. I am confident that BNSF would not have agreed had it believed the language was inaccurate.

#### IV. BNSF'S COMPETITION CLAIMS

I will not spend much time addressing BNSF's claims that the fee adjustment places BNSF at a competitive disadvantage. BNSF's statements to the Board throughout five years of oversight and the Board's conclusions in its five years of oversight proceedings refute BNSF's claims better than I ever could.

I do want to address, briefly, BNSF's misleading argument that it cannot compete effectively if UP has a \$25 to \$50 per car advantage in the costs measured by the trackage rights fees. BNSF's argument is completely inaccurate for several reasons, many of which the Board identified when it rejected similar arguments by parties opposed to the UP/SP merger.

First, BNSF has no basis for claiming that it cannot compete under the BNSF Settlement Agreement, because it requires UP to pay much higher rates for trackage rights designed to remedy the anticompetitive effects of the BN/Santa Fe merger. Under BN/Santa Fe's settlement agreement with SP in 1995, the initial rates were established as 3.0 mills for bulk traffic and 3.48 mills for all other traffic, and the parties agreed to an annual adjustment based on 75 percent of the RCAF(U). As of January 2000, those rates were 3.08 mills for bulk traffic and 3.57 mills for all other traffic. By comparison, the rates as of January 2000 under the BNSF Settlement Agreement were 2.9 mills for bulk traffic and 3.0 mills for all other traffic, and those rates are adjusted based on changes in UP's URCS costs.

Second, BNSF has no basis for claiming that UP has an advantage when BNSF uses the BNSF Settlement Agreement trackage rights. UP pays all of the same costs to operate its own trains over the trackage rights that BNSF pays through the trackage rights fee. BNSF complains that the trackage rights fees have increased faster than UP's costs because the fees reflect costs associated with the SP acquisition, but UP pays those acquisition costs as well. The same is true of the initial capacity costs.

Third, BNSF has no basis for claiming that UP has an advantage because the trackage rights fee represents only a portion of BNSF's total costs for any move. In many cases, BNSF utilizes a portion of its own existing routes in conjunction with the trackage rights line, and the trackage rights fee represents a fraction of BNSF's fully allocated costs. BNSF is a very efficient carrier, so its remaining costs of operating over the trackage rights segments are likely to be low in all cases, and lower than UP's costs in many cases, thus offsetting any alleged advantage UP may have based on the trackage rights fee.

Finally, BNSF has no basis for claiming that UP has an advantage because, even if BNSF's costs were higher than UP's costs for some shippers or routes, UP could never be certain of its advantage. UP knows BNSF's trackage rights fees, but it does not know whether BNSF's total costs of moving traffic on any particular route are higher or lower than UP's costs. UP thus cannot negotiate with shippers as if it can always undercut BNSF. Moreover, even if UP knew it had a slight advantage, it would be foolish to try to win away all of BNSF's business by pricing down to the level of incremental costs, because UP may then be unable to generate a satisfactory return on its investment.

The Board need only look to the past five years to see who is correct. BNSF promised during the merger proceedings that it would be an effective competitor using the

trackage rights lines. BNSF has competed. It has won business. In its final oversight report, BNSF told the Board that it had exceeded its goals. See BNSF-PR-20 at 4. When it was not trying to convince the Board that it needed lower trackage rights to compete, it told the Board that it "anticipates the continued customer growth and commercial success of its UP/SP franchise." Id. at 7. BNSF's doomsday claims are refuted by its own success and own predictions of future success.

VERIFICATION

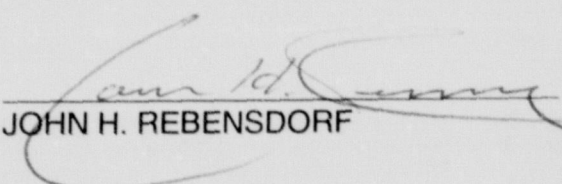
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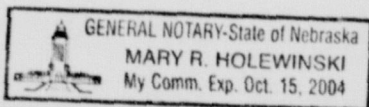
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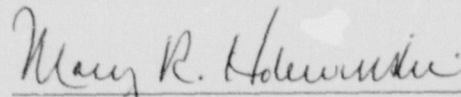
COUNTY OF DOUGLAS )

I, JOHN H. REBENS DORF, Vice President - Network & Service Planning, for Union Pacific Railroad Company, being duly sworn, depose and state that I have read the foregoing Verified Statement, that I know its contents, and that those contents are true as stated to the best of my knowledge, information and belief.

  
JOHN H. REBENS DORF

SUBSCRIBED AND SWORN TO before me this 14<sup>th</sup> day of June, 2002.



  
Notary Public

My commission expires: October 15, 2004



**VERIFIED STATEMENT**

**OF**

**JAMES V. DOLAN**

**PAUL A. CONLEY, JR.**

**AND**

**JOHN T. GRAY**

Our names are James V. Dolan, Paul A. Conley, Jr., and John T. Gray. We were all deeply involved in the negotiations of the original BNSF Settlement Agreement, the CMA Agreement, and the Second Supplemental Agreement to the BNSF Settlement Agreement. This statement addresses claims by BNSF and CMA that the parties to the BNSF Settlement Agreement and the CMA Agreement mutually agreed to adjust the BNSF Settlement Agreement's trackage rights fees in order to exclude the impact of (1) purchase accounting for the UP/SP merger and (2) costs of merger-related capacity improvements that UP agreed to fund under Section 9(c)(i) and (ii) of the BNSF Settlement Agreement.

**QUALIFICATIONS**

Dolan: I was UP's Vice President-Law when the original BNSF Settlement Agreement, the CMA Agreement, and the Second Supplemental Agreement were negotiated and drafted. I remain in that position today. I was involved in the negotiating sessions during the three days in September 1995, when UP and BNSF drafted the original BNSF Settlement Agreement. I also attended several preliminary meetings between UP and BNSF that occurred in late August and September 1995. During the negotiation of the CMA Agreement, I was in constant communication with UP's outside counsel, the late Arvid E. Roach II, who was primarily responsible for communicating with CMA's representatives. I participated in all of

UP's internal decisions regarding the content of the CMA Agreement. I reviewed the various drafts of the CMA Agreement, and I approved the final CMA Agreement. As Vice President-Law, I also participated in UP's internal discussions regarding the Second Supplemental Agreement, I reviewed the various drafts in order to insure that they reflected the agreements between and among UP, BNSF, and CMA, and I approved the final form of the Second Supplemental Agreement.

Conley: I was UP's Assistant Vice President-Law when the original BNSF Settlement Agreement, the CMA Agreement, and the Second Supplemental Agreement were negotiated and drafted. I am now retired from UP. I attended all of the negotiating sessions during the three days in September 1995, when UP and BNSF drafted the original BNSF Settlement Agreement. I personally drafted much of the BNSF Settlement Agreement's language. During the negotiation of the CMA Agreement, I was in constant contact with UP's outside counsel, the late Arvid E. Roach II, who was primarily responsible for communicating with CMA's representatives, and I participated fully in all of UP's internal decisions regarding the content of the CMA Agreement. I was also involved in drafting the language in the CMA Agreement, including the URCS adjustment provision. Finally, I was responsible on behalf of UP/SP for negotiating and drafting the Second Supplemental Agreement, and I exchanged many drafts and phone conversations with BNSF's Richard E. Weicher during the negotiating and drafting process.

Gray: I was SP's Vice President-Network and Corporate Development when original the BNSF Settlement Agreement, the CMA Agreement, and the Second Supplemental Agreement were being negotiated. Today I am UP's Executive Director-Interline. I attended all of the September 1995 meetings during which the BNSF Settlement Agreement was drafted. I

was also involved in several preliminary meetings in late August and September 1995. I signed the BNSF Settlement Agreement on behalf of SP. During the negotiation of the CMA Agreement, I regularly communicated with UP's outside counsel and the other members of the UP/SP team. I reviewed the drafts and the final CMA Agreement, and I approved the agreement on behalf of SP. I also participated in internal UP/SP discussions regarding the Second Supplemental Agreement and reviewed all of the drafts in order to insure that they reflected the agreements between and among UP, BNSF, and CMA. I signed the Second Supplemental Agreement on behalf of SP.

#### STATEMENT

The plain language of the fee adjustment provision in Section 12 of the BNSF Settlement Agreement, as amended by the Second Supplemental Agreement, reflects our intention of how the provision for adjusting trackage rights fees would apply. (The identical language is incorporated in Section 12 of the Restated and Amended BNSF Settlement Agreement, which was submitted to the Board on March 1, 2002.) The fee adjustment provision was intended to implement a procedure proposed by CMA using terms proposed by a CMA expert. It reflects our understanding of UP's, BNSF's, and CMA's agreement in the CMA Agreement. It reflects our understanding of UP's and BNSF's agreement in the Second Supplemental Agreement.

We do not recall any occasion on which BNSF or CMA ever mentioned purchase accounting, "merger premiums," or anything of that nature in connection with the fee adjustment provision. We do not recall any occasion on which BNSF or CMA ever suggested that SP's purchase costs should be excluded from the trackage rights fee adjustment. We do not recall any occasion on which BNSF or CMA ever suggested that the fee adjustment should be based only

on post-merger URCS costs. We do not recall any occasion on which BNSF or CMA ever suggested that the cost of certain merger capacity costs should be excluded from the trackage rights fee adjustment. We do not recall ever being informed by anyone that BNSF or CMA had ever raised any of these issues during the negotiations of the original BNSF Settlement Agreement, the CMA Agreement, or the Second Supplemental Agreement. And we do not recall any occasion on which BNSF or CMA ever suggested that the plain language of the BNSF Settlement Agreement did not reflect their intent.

If BNSF or CMA made any assumptions about modifying UP's URCS costs or excluding SP's purchase cost or certain merger capacity costs from the trackage rights fee adjustment provision, neither BNSF nor CMA disclosed those assumptions to UP during the negotiations or drafting of the original BNSF Settlement Agreement, the CMA Agreement, or the Second Supplemental Agreement. UP's understanding and intention was that the plain language of the BNSF Settlement Agreement, as amended by the Second Supplemental Agreement, provided the procedures for adjusting the trackage rights fees.

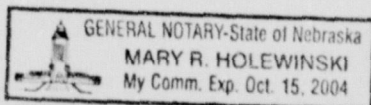
VERIFICATION

STATE OF NEBRASKA   )  
                                  )  
COUNTY OF DOUGLAS   )   SS:

I, JAMES V. DOLAN, Vice President-Law for Union Pacific Railroad Company,  
being duly sworn, depose and state that I have read the foregoing Verified Statement,  
that I know its contents, and that those contents are true as stated to the best of my  
knowledge, information and belief.

James V. Dolan  
JAMES V. DOLAN

SUBSCRIBED AND SWORN TO before me this 14<sup>th</sup> day of June, 2002.



Mary R. Holewinski  
Notary Public

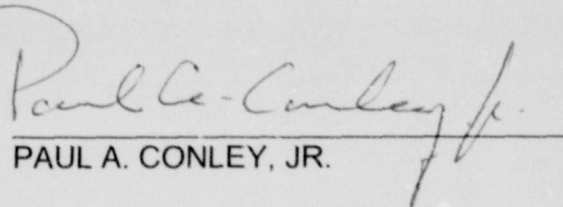
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VERIFICATION

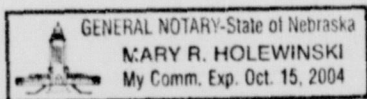
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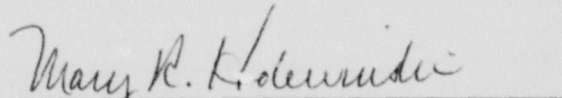
SS:

I, PAUL A. CONLEY, JR., being duly sworn, depose and state that I have read the foregoing Verified Statement, that I know its contents, and that those contents are true as stated to the best of my knowledge, information and belief.

  
PAUL A. CONLEY, JR.

SUBSCRIBED AND SWORN TO before me this 14<sup>th</sup> day of June, 2002.



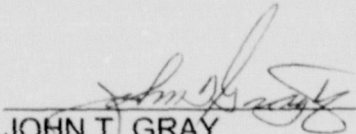
  
Notary Public

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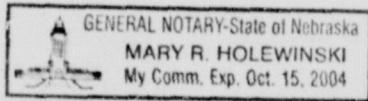
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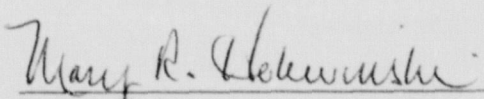
STATE OF NEBRASKA    )  
                                  )  
COUNTY OF DOUGLAS    )    SS:

I, JOHN T. GRAY, Executive Director - Interline, for Union Pacific Railroad Company, being duly sworn, depose and state that I have read the foregoing Verified Statement, that I know its contents, and that those contents are true as stated to the best of my knowledge, information and belief.

  
\_\_\_\_\_  
JOHN T. GRAY

SUBSCRIBED AND SWORN TO before me this 12<sup>th</sup> day of June, 2002.



  
\_\_\_\_\_  
Notary Public

My commission expires: October 15, 2004

**Rhoades**

**VERIFIED STATEMENT**

**OF**

**KEITH A. RHOADES**

My name is Keith A. Rhoades. I am Director-General Ledgers/Financial Research for Union Pacific Railroad Company ("UP"). I graduated from Brigham Young University in 1972 with a B.S. in Accounting. I have worked in UP's Finance Department for 29 years in a variety of positions of increasing responsibility, including Internal Auditor, Internal Auditor-Supervisor, Manager-Division Accounting Development, Manager-Ledgers and Financial Reporting, Assistant Director-Ledgers and Financial Reporting, and Manager-Financial Research. I was promoted to my present position in 1988.

As Director-General Ledgers/Financial Research, I am responsible for research and analysis concerning accounting issues, policies, principles, and procedures. I am also responsible for ensuring UP's accounting and reporting integrity. I have been personally involved in the accounting for UP's acquisitions of Missouri-Kansas-Texas Railroad Company, Chicago & North Western Transportation Company, and Southern Pacific Rail Corporation.

I previously have submitted testimony to the Surface Transportation Board in the FMC,<sup>1</sup> WCTL,<sup>2</sup> and WPL<sup>3</sup> cases with regard to UP's accounting treatment of its acquisitions. In each case, I explained UP's accounting treatment and how that treatment was required by

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<sup>1</sup> FMC Wyoming Corp. v. Union Pacific R.R., STB Docket No. 42022 (STB served May 12, 2000).

<sup>2</sup> Western Coal Traffic League v. Union Pacific R.R., STB Finance Docket No. 33726 (STB served May 12, 2000).

<sup>3</sup> Wisconsin Power & Light Co. v. Union Pacific R.R., STB Docket No. 42051 (STB served Sept. 13, 2001).

generally accepted accounting principles ("GAAP") and the Board's own railroad accounting rules, the Uniform System of Accounts ("USOA").

In this statement, I address BNSF's allegations that UP's accounting and reporting of the UP/SP merger was improper and unexpected. In particular, I address BNSF's claims regarding the purchase accounting adjustments necessary to reflect the fair value of the assets that UP acquired from SP. I show that UP properly accounted for the UP/SP merger in its Annual Report Form R-1 for 1997 and that its plans and proposed timing for its merger accounting should have been expected.

After the FMC, WCTL, and WPL cases, I am surprised that anyone would question UP's purchase accounting in connection with the UP/SP merger. In each case, the Board agreed that UP's accounting treatment of purchase accounting adjustments conformed to GAAP and the USOA. In each case, the Board agreed that UP's 1997 Annual Report R-1 properly reflected the purchase accounting entries in UP's books for the acquisition of SP. The results in those cases were not surprising, because UP had discussed its plans with the Board's accounting staff and had received the staff's approval for its reporting of the UP/SP merger.

BNSF is mistaken when it suggests that UP should have recorded the effects of purchase accounting in its 1996 R-1 report rather than in its 1997 R-1 report. GAAP did not dictate that purchase accounting should be reflected in the railroads' 1996 financial statements. UP followed GAAP and the USOA in determining the manner and timing for recording the purchase accounting adjustments associated with the UP/SP merger.

The UP/SP merger was consummated in September 1996 when Union Pacific Corporation ("UPC") acquired Southern Pacific Rail Corporation ("SPR"). As a result of the acquisition, UPC owned six different railroads, all of which were distinct corporate entities with

separate books and records – Union Pacific Railroad Company (“UP”), Missouri Pacific Railroad Company (“MP”), Southern Pacific Transportation Company (“SPT”), St. Louis Southwestern Railway Company (“SSW”), SPCSL Corp. (“SPCSL”), and The Denver & Rio Grande Western Railroad Company (“DRGW”).

UPC accounted for the transaction as a purchase at the parent-company level in 1996, and its books and SEC reports reflected the effects of purchase accounting in 1996. The railroads themselves remained separate, direct or indirect subsidiaries of UPC. Until SPR’s railroad subsidiaries were merged or consolidated with UP, the effects of purchase accounting should not have been included in UP’s R-1.

There were two important reasons why the mergers of the various railroad subsidiaries could not occur in 1996. First, UP was awaiting a ruling from the IRS to ensure that the SPR railroad subsidiary mergers would not jeopardize the tax-free status of UPC’s initial purchase of SPR. A favorable ruling was not received until 1997.<sup>4</sup> Second, UP needed to deal with minority shareholders before the SSW merger could be completed. Once these issues were resolved UP merged the SPR railroad subsidiaries into UP. As a result, UPC should not have included the purchase accounting in UP’s R-1 until 1997.<sup>5</sup>

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<sup>4</sup> Had the IRS ruling been unfavorable, UP would have considered different means of consolidating the SPR railroad subsidiaries into one merged system. See UP/SP-22 at 2 (describing the possibility that “in lieu of such mergers some or all of [the SPR subsidiaries] will be merged into, or their assets leased to, MPRR or other means used to accomplish their consolidation into the merged system”).

<sup>5</sup> The final merger of subsidiaries, in which UP merged into SPT and SPT changed its name to Union Pacific Railroad Company, took place in February 1998, but its effects were appropriately recorded in UP’s 1997 financial statements, because UPC had both the intent and ability to consummate the merger before issuing UP/SPT financial statements. See AICPA AU Section 560, Subsequent Events. UPC did not have the intent and ability with respect to SPT or the other SPR railroad subsidiaries in 1996 because of the tax and shareholder issues described above.

It was no secret that the railroad-level mergers might not occur until sometime after the Board approved the Merger Application. UP explained on the second page of the Application that its "present intent is to merge SPT, SSW, SPCSL and DRGW into UPRR, although these subsidiaries of SPR may retain their separate corporate existence for a period of time." UP/SP-22 at 2. Moreover, the accounting rules governing this type of transaction are well established; any knowledgeable person reviewing the Application should have recognized the distinct possibility that purchase accounting might not be reflected in UP's books until sometime after the application was approved and the transaction was consummated.

UP never tried to disguise its accounting methodology. UP affirmatively asked the Board's staff to approve its proposal for reflecting the UP/SP merger and the associated purchase accounting adjustments in its 1996 and 1997 R-1 reports. See Letter from UP's Robert W. Schmidt, Jr., to STB's Ward L. Guinn, Jr., dated Sept. 26, 1996 (attached as Exhibit A). The Board's staff confirmed that UP and SPT should file separate R-1 reports for 1996 reflecting each railroad's historical costs and a combined R-1 report for 1997 reflecting the revaluation of the SPR rail subsidiaries' assets as a result of purchase accounting. See Letter from STB's Ward L. Guinn, Jr., to UP's Robert W. Schmidt, Jr., dated Oct. 2, 1996 (attached hereto as Exhibit B).

I am surprised to see this issue raised at such a late date. If anyone truly thought that the effects of purchase accounting would be reflected in UP's 1996 R-1 report and relied on that accounting occurring in 1996, that report's publication should have put any such misimpressions to rest. UP's 1996 R-1 report revealed that purchase accounting had not occurred at the railroad level in 1996. The explanatory notes regarding the UP/SP merger state:

The business combination with Southern Pacific has been accounted for as a purchase, but SP's results are not currently included in UP's results.

An even more obvious indication that UP's and SPT's accounts had not been combined in 1996 was the fact that SPT filed a separate 1996 R-1 report. Finally, if anyone was still under the misimpression that the 1996 R-1 report reflected UP's purchase accounting for the UP/SP merger, they could not possibly still misunderstand the situation after publication of UP's 1997 R-1. UP's 1997 R-1 report contained an extensive discussion of purchase accounting and should have made clear to anyone precisely how and when UP's books reflected the purchase accounting adjustment associated with the UP/SP merger.

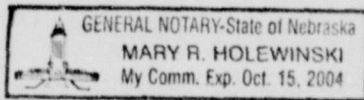
VERIFICATION

STATE OF NEBRASKA     )  
                                      )  
COUNTY OF DOUGLAS    )     ss:

I, KEITH RHOADES, Director - General Ledgers - Financial Research, for Union Pacific Railroad Company, being duly sworn, depose and state that I have read the foregoing Verified Statement, that I know its contents, and that those contents are true as stated to the best of my knowledge, information and belief.

Keith Rhoades  
KEITH RHOADES

SUBSCRIBED AND SWORN TO before me this 17<sup>th</sup> day of June, 2002.



Mary R. Holewinski  
Notary Public

My commission expires: October 15, 2004

FINANCE DEPARTMENT

## UNION PACIFIC RAILROAD COMPANY

1416 DOOGUE STREET  
OMAHA, NEBRASKA 68179

September 26, 1996

Mr. Ward L. Ginn  
Chief, Section of Costing and Financial Information  
Surface Transportation Board  
Office of Economics and Environmental Analysis  
Room 3219  
Washington, D.C. 20423

RECEIVED  
OFFICE OF ECONOMICS  
DIRECTOR'S OFFICE  
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RECEIVED  
SURFACE TRANSPORTATION  
BOARD

Dear Mr. Ginn:

In reference to my conversation with Paul Aguiar and Jeff Warren, of your staff, regarding reporting requirements of Southern Pacific Transportation Company and Union Pacific Railroad for third and fourth quarter 1996 and for 1997 -- below is our understanding of the STB requirements.

We will continue to report as separate railroads in 1996, and file consolidated reports for 1997 operations. Thus, for 1996, separate Revenue Expense and Income (RE&I), Condensed Balance Sheet (CBS), Wage Statistics (Forms A and B) and Quarterly Commodity Statistics (QCS) will be filed for each road. A separate 1996 Annual QCS, Forms A&B and Form R-1 will also be filed for each railroad on the same cost basis as has historically been submitted.

Beginning in 1997 we will file combined UP/SP reports for quarterly RE&I and CBS, quarterly and annual QCS and Forms A and B, and annual R-1. We will include the revaluation of SP assets and liabilities and all appropriate eliminations.

Please review this request and provide us confirmation of the reporting requirements for the acquisition of SP. If you have any questions, please call me at (402)271-4269

Very truly yours,

Robert W. Schmidt Jr.  
Manager, Reporting & Analysis

cc: Mr. James R. Young, Union Pacific Railroad, Omaha, NE  
Mr. Fred van Naerssen, Union Pacific Corporation, Bethlehem, PA  
Mr. Brian Kane, Southern Pacific Railroad, San Francisco, CA



Surface Transportation Board  
Washington, D.C. 20423-0001

October 2, 1996

Mr. Robert W. Schmidt, Jr.  
Manager, Reporting & Analysis  
Finance Department  
Union Pacific Railroad Company  
1416 Dodge Street  
Omaha, NE 68179

Dear Mr. Schmidt:

Thank you for your letter of September 26, 1996, regarding the post-merger reporting requirements of Southern Pacific Transportation Company and Union Pacific Railroad.

Your proposal to file separate reports for 1996 and combined reports for 1997 is approved. Also, use of the same historical cost basis for the separately filed 1996 annual QCS, Forms A&B, and Form R-1 is likewise approved.

With respect to the revaluation of SP assets and liabilities reflected in all reports filed for 1997, we would appreciate that you disclose by separate letter the accounting to be performed to reflect the necessary revaluation. It is also important that UP/SP's Schedule 250 for the year 1997 be footnoted to disclose any significant adjustments pertaining to the merger.

Your assistance in this matter is greatly appreciated. Please call me at (202) 927-6204 if you have any questions.

Sincerely,

Ward L. Ginn, Jr.  
Chief, Section of Costing & Financial Information



**VERIFIED STATEMENT**

**OF**

**RICHARD F. KAUDERS**

My name is Richard F. Kauders. When I retired in September 2001, I was Manager-Economic Research for Union Pacific Railroad Company ("UP"). I was employed by UP more than 29 years. My responsibilities included the development of cost and related testimony for use before the Surface Transportation Board ("Board") and its predecessor, the Interstate Commerce Commission ("Commission"). I hold a B.S. Degree from Cornell University and the M.B.A. degree from Northwestern University. My experience with UP consisted principally of work in the regulatory costing area, including mergers, trackage rights, rate complaints and investigations, and branch line abandonments.

I participated in cost studies and the calculation of benefits in a number of merger proceedings before the Commission and the Board, including Finance Docket 30000, Union Pacific – Control – Missouri Pacific & Western Pacific; Finance Docket 30800, Union Pacific – Control – Missouri-Kansas-Texas; Finance Docket 32133, Union Pacific – Common Control – Chicago North Western; and Finance Docket 32760, Union Pacific – Control & Merger – Southern Pacific.

One of my responsibilities as UP's Manager-Economic Research was to calculate the annual adjustment to the trackage rights fees under the BNSF Settlement Agreement. In this statement, I address the fee adjustment calculations Mr. Christopher D. Kent presents on behalf of The Burlington Northern and Santa Fe Railway Company ("BNSF"). I show that significant flaws invalidate the BNSF modifications to URCS costs for 1995 and 1996 and entirely undermine BNSF's effort to estimate the difference between UP's and BNSF's calculations.

BNSF's theory is that fee adjustments were to be based on comparisons of only post-merger URCS costs, beginning with a comparison between UP's 1996 and 1997 URCS costs. See BNSF-102 at 8. BNSF purports to "correct" for the fact that the purchase accounting for the UP/SP merger was first reflected in UP's 1997 R-1. Mr. Kent makes this "correction" not by carrying out the comparison between 1996 and 1997, but by constructing hypothetical URCS costs for 1995 and 1996.<sup>1</sup>

He substitutes the investment and depreciation data from UP's 1997 R-1 for the actual investment and depreciation data used to calculate UP's and SP's 1995 and 1996 URCS costs. Specifically, he substitutes (i) UP's 1997 beginning-of-year investment data for the actual year-end investment data used in calculating 1995 and 1996 URCS costs; (ii) UP's 1997 beginning-of-year accumulated depreciation for the actual year-end accumulated depreciation data used in calculating 1995 and 1996 URCS costs; and (iii) UP's 1997 full-year depreciation charges for depreciation charges used in calculating 1995 and 1996 URCS costs. BNSF-102, Kent V.S. at 3. His workpapers reveal that he retains UP's and SP's actual 1995 and 1996 maintenance-of-way operating expenses and gross ton-miles.

Mr. Kent then calculates hypothetical, combined UP/SP 1995 and 1996 URCS costs. BNSF claims that the results show what UP's 1995 and 1996 URCS costs would have been if the UP and SP systems had been merged and the results reflected in combined UP/SP URCS. Id. at 2. BNSF is mistaken.

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<sup>1</sup> Apparently to be consistent with BNSF's notion that the parties intended to compare post-merger URCS, Mr. Kent moves the purchase accounting back to 1995, a year before it could have happened. He presumably does this to give BNSF the benefit of substantial cost reductions on SP and UP between 1995 and 1996 for the first rate adjustment.

A. BNSF's Hypothetical URCS Costs Bear No Relationship to the Costs UP Would Have Incurred in 1995 and 1996

---

Mr. Kent substitutes UP 1997 investment and depreciation data for 1995 and 1996 data, but he uses actual SP and UP 1995 and 1996 gross ton-miles and maintenance-of-way costs to calculate URCS costs. This creates numerous apples-and-oranges comparisons that undermine any effort to provide a meaningful restatement of 1995 and 1996 URCS costs.

Mr. Kent's computations violate the principle of "causality" that underpins URCS theory. The causality principle means that operating and maintenance expenses, return on investment, and depreciation costs must all derive from the same physical plant in the same reporting period and should be allocated to relevant service units (such as gross ton-miles) reported for the same period. See Railroad Accounting Principles Board, Final Report, Vol. 1 at 29. Mr. Kent's modifications to URCS ignores this principle. His calculations do not reflect the costs of any railroad that did exist or could have existed.

A few examples help illustrate this basic flaw in Mr. Kent's methodology:

First, Mr. Kent introduces a fundamental inconsistency when he calculates URCS costs for return on investment using 1997 beginning-of-year investment levels and 1995 and 1996 gross ton-miles. This results in a calculation with no connection to the real world. UP's and SP's gross ton-miles in 1995 and 1996 reflect the railroads' physical structure, actual operations, and competitive relationships in those years. We cannot know how many gross ton-miles UP would have moved in 1995 and 1996 if the UP and SP systems had been configured as they were at the beginning of 1997 and the railroads had been merged. We do not know whether mileage savings from reroutes made possible by the merger (for example, UP rerouted SP's Central Corridor traffic to UP's Wyoming mainline after the merger) and traffic losses to BNSF from use of its trackage rights would have offset increases in traffic resulting from new business

opportunities. We do know, however, that Mr. Kent's computations have no connection to reality, because they are based on investments in a post-merger network, on the one hand, and gross ton-miles produced by two different pre-merger networks, on the other hand.

Second, Mr. Kent introduces another inconsistency into his 1995 and 1996 URCS calculations by combining 1997 depreciation data with actual 1995 and 1996 gross ton-miles to calculate the URCS unit costs for depreciation. This destroys the link between the use of an asset and its depreciation expense. UP's 1997 depreciation charges are a function of UP's use of its depreciable assets in 1997. For the track accounts at issue in this proceeding, use is measured by gross ton-miles. When Mr. Kent calculates URCS depreciation costs for 1995 and 1996, however, he uses UP's 1997 depreciation expense, which was based on UP's gross ton-miles in 1997, and he divides it by UP's gross ton-miles in 1995 and 1996. This produces a disconnect between depreciation costs and the actual usage. Mr. Kent's URCS cost calculations for depreciation in 1995 and 1996 thus have no connection to the real world.

Third, Mr. Kent further compounds his errors by mixing UP's 1997 investment and depreciation costs with SP's and UP's 1995 and 1996 maintenance-of-way expense. This procedure directly contradicts BNSF's theory that the parties agreed to use only post-merger URCS costs. Moreover, it repeats the mistake of improperly combining results based on two very different sets of circumstances. No one can guess what UP's maintenance-of-way costs would have been in 1995 or 1996 if the UP and SP systems were configured as they were at the beginning of 1997 and the railroads were in fact merged. We know, however, that Mr. Kent's computations, which are based on investment and depreciation costs for one network in one year and maintenance-of-way costs for two different, pre-merger networks in earlier years, do not reflect the costs of any railroad that did exist or could have existed.

B. BNSF's URCS Costs Artificially Mask Changes in UP's Costs

The provision for adjusting trackage rights fees is designed to adjust the fees based on changes in UP's URCS costs. Mr. Kent's calculations are flawed, because they ignore changes in UP's investment and depreciation costs resulting from increased UP and SP investment unrelated to the disputed SP purchase cost and merger capacity costs. Mr. Kent's calculations ignore two significant sources of cost changes by projecting 1997 investment and depreciation costs back into 1995 and 1996.

First, by projecting the same 1997 beginning-of-year investment level back into 1995 and 1996, Mr. Kent's calculation implicitly assumes that UP's and SP's level of investment did not increase between 1995 and 1996. Mr. Kent's calculations thus ignore changes in UP's URCS costs resulting from all of UP's and SP's capital investments in 1996, not just the disputed merger capacity costs. BNSF accepts that the undisputed investment costs should be included in UP's URCS costs, and those are the vast majority of the investments.

In 1996, UP/SP invested approximately \$850 million in capitalized maintenance on its lines, none of which involved merger-related expenditures for capacity improvements on trackage rights lines. In addition, in 1996 UP invested some \$110 million as part of its multi-year project to expand capacity on its coal corridor in Wyoming, Nebraska, Kansas, and Iowa. By projecting UP's 1997 beginning-of-year investment back into 1995 and 1996, however, Mr. Kent ignores any change in URCS costs resulting from any capital investments, including those that BNSF accepts should be counted in computing cost changes.

As a result of capital investments in 1996, UP's and SP's 1996 expenses for return on investment were higher than their 1995 expenses for return on investment. Under Mr. Kent's calculations, however, the combined UP/SP expense for return on investment in both

1995 and 1996 was based on 1997 investment data, thus ignoring the increase between 1995 and 1996. This in turn would have the effect of artificially reducing the trackage rights fees.

Second, by using the same depreciation charge in 1995, 1996, and 1997, Mr. Kent implicitly assumes that UP's depreciation expenses did not change between 1995 and 1996, or between 1996 and 1997. This is an entirely unrealistic assumption, because depreciation is a function of a railroad's investment and gross ton-miles, and both of those factors were different for UP and SP in 1995 and 1996 than they were for the merged UP in 1997. In particular, UP's and SP's investments in 1996 increased their 1996 depreciation expenses above their 1995 levels, and UP's investments in 1997 increased its 1997 depreciation expense above its 1996 level. By projecting 1997 depreciation charges back into 1995 and 1996, Mr. Kent does not simply cancel out increased depreciation resulting from the disputed items, he wipes out all increased depreciation expense resulting from all of UP's and SP's investments, including investments that BNSF agrees should be included in the fee adjustment. This in turn would have the effect of artificially reducing the trackage rights fees.

C. BNSF's Calculations Do Not Address Merger Capacity Costs

Mr. Kent never explains how the parties intended to remove the effects of disputed merger capacity costs from URCS cost calculations. As Mr. Kent recognizes, using only post-merger URCS costs does not address the disputed merger capacity costs, because those costs occurred in post-merger years. See BNSF-102, Kent V.S. at 4.

Relying on Section 9(c) of the BNSF Settlement Agreement, BNSF objects to the inclusion of merger capacity costs in the adjustment calculation. Mr. Kent claims that his adjustment provides a way to address BNSF's objection with respect to merger capacity costs incurred in 1997. As even Mr. Kent appears to acknowledge, however, shifting investment as of January 1, 1997 backwards into 1995 and 1996 addresses only those modest merger capacity

costs incurred in the last three months of 1996. It fails to address the effect in future years of merger capacity costs incurred in 1997 and later years, which are the majority of the disputed capacity costs. Moreover, as I have already explained, Mr. Kent's method of addressing BNSF's objection affects much more than the disputed costs – it also wipes any impact of all of UP's additional investment during 1996.

D. BNSF's Calculations Exaggerate the Size of the Dispute

Even setting aside the conceptual problems with his efforts to develop combined UP/SP 1995 and 1996 URCS and his inability to address the affect of the disputed merger capacity costs, Mr. Kent exaggerates the parties' dispute. He exaggerates the parties' dispute by using yet another apples-and-oranges comparison. He compares (i) the fees under UP's adjustments of the trackage rights fees each year based on the difference in the two preceding years' URCS costs, with (ii) the fees under BNSF's proposed approach of adjusting the fees based on the percentage change between the two preceding years' URCS costs.<sup>2</sup> I understand that UP and BNSF have agreed to arbitrate their dispute over these two approaches; that dispute should not have been used to exaggerate the disputed issues before the Board. In the chart below, I restate the comparison of the BNSF and UP approaches based on a consistent computational method.<sup>3</sup>

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<sup>2</sup> If Mr. Kent's calculations were consistent with BNSF's theory, they should have ignored 1995 URCS costs and based the first years' adjustment on the difference between 1996 and 1997 URCS costs. Apparently Mr. Kent wanted to take advantage of the cost decrease between 1995 and 1996, which is larger than any other cost decrease, in BNSF's calculation of the first rate adjustment.

<sup>3</sup> I have also provided for UP's brief a calculation of what the fees would have been had the RCAF(U) adjustment provision remained in place.

**Comparison of BNSF and UP Approaches to  
Adjustment of GTM Mill Rates**

Year	BNSF Approach			UP Approach			Difference Between Parties
	GTM Unit Costs	Adjustment	Fee	GTM Unit Costs	Adjustment	Fee	
1995	\$0.00178841			\$0.00166805			
1996	\$0.00169823		3.1	\$0.00161108		3.1	n/a
1997	\$0.00164835	-0.00009018	3.0	\$0.00164835	-0.00005697	3.0	0.0
1998	\$0.00164752	-0.00004988	3.0	\$0.00164752	0.00003727	3.1	0.1
1999	\$0.00157770	-0.00000083	3.0	\$0.00157770	-0.00000083	3.1	0.1
2000		-0.00006982	2.9		-0.00006982	3.0	0.1

For purposes of obtaining a consistent comparison, I incorporated BNSF's approach to calculating 1995 and 1996 URCS costs as set forth in the table in Mr. Kent's statement. See BNSF-102, Kent V.S. at 4. I did not incorporate UP's approach as set forth in Mr. Kent's table, because his computations were based on inaccurate data. Mr. Kent's table does not correspond to the basis upon which UP actually billed BNSF; instead, it appears to be derived from a letter UP sent to BNSF as part of the parties' efforts to compromise their dispute. That letter contained a typographical error, and possibly other errors.<sup>4</sup>

The upshot of my comparison between BNSF's position in this proceeding and UP's past approach to billing BNSF is that, even accepting Mr. Kent's flawed calculation of

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<sup>4</sup> In its letter, UP attempted to demonstrate what the fee adjustment would be if the parties adopted BNSF's proposal to create a combined UP/SP URCS for 1995 and 1996 rather than a weighted average of UP's and SP's 1995 and 1996 URCS costs, but not including BNSF's proposal for excluding the effects of purchase accounting. UP's calculations were only estimates. Implementing BNSF's proposal to create a combined URCS requires access to the Phase II URCS model. UP did not have access to the model, so it estimated the impact of adopting BNSF's approach. Further research suggests that the trackage rights fees would actually be higher if BNSF's approach were adopted.

1995 and 1996 URCS, the difference in trackage rights fees between the parties would be only 0.1 mills, not the 0.2 mills that Mr. Kent claims.<sup>5</sup>

It is important to stress that even the 0.1-mill difference still overstates the difference between the parties' positions. Mr. Kent's (a) inappropriate substitution of 1997 data for actual 1995 and 1996 data, (b) mixing and matching of 1995, 1996, and 1997 data, and (c) effort to ignore the effect of changes in investment and depreciation costs in 1996 and 1997, all combine to overstate UP's costs in 1995 as compared to 1996, and overstate UP's costs in 1996 as compared to 1997.

Because Mr. Kent's method is invalid, I cannot correct it. The Board can safely assume, however, that the true difference between the parties' positions would be even less than my table indicates.

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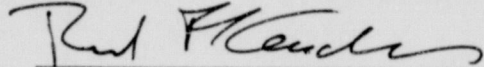
<sup>5</sup> I calculate the adjusted fees to one decimal place because that is how the fees were presented in the BNSF Settlement Agreement and that is how UP has billed BNSF, except for the fee for the Keddie-Stockton trackage rights.

VERIFICATION

STATE OF NEBRASKA   )  
                                  )  
COUNTY OF DOUGLAS   )

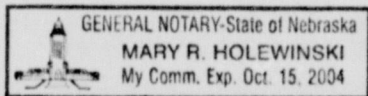
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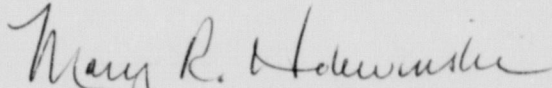
I, RICHARD F. KAUDERS, being duly sworn, depose and state that I have read the foregoing Verified Statement, that I know its contents, and that those contents are true as stated to the best of my knowledge, information and belief.



RICHARD F. KAUDERS

SUBSCRIBED AND SWORN TO before me this 14<sup>th</sup> day of June, 2002.





Notary Public

My commission expires: October 15, 2004

STB

FD-32760

6-19-02

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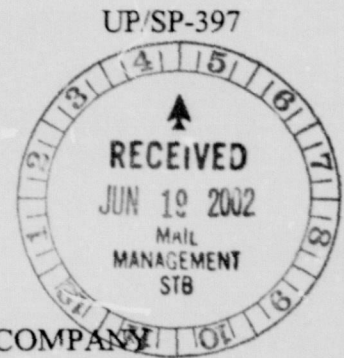
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ID-205661

205661  
BEFORE THE  
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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



**UP'S REPLY TO BNSF'S RESPONSE TO ORDER TO SHOW CAUSE**

Respectfully submitted,

CARL W. VON BERNUTH  
Union Pacific Corporation  
1416 Dodge Street, Room 1230  
Omaha, Nebraska 68179  
(402) 271-6304

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LOUISE A. RINN  
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ENTERED  
Office of the Secretary  
JUN 19 2002  
Part of  
Public Record

J. MICHAEL HEMMER  
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*Attorneys for Union Pacific Corporation,  
Union Pacific Railroad Company and  
Southern Pacific Rail Corporation*

June 19, 2002

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JOHN T. GRAY

VERIFIED STATEMENT OF KEITH A. RHOADES

VERIFIED STATEMENT OF RICHARD F. KAUDERS

BEFORE THE  
SURFACE TRANSPORTATION BOARD

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Finance Docket No. 32760

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

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**UP'S REPLY TO BNSF'S AND CMA'S RESPONSES TO ORDER TO SHOW CAUSE**

In Decision No. 96, BNSF gained a second chance to prove that UP and BNSF had mutually agreed to remove certain costs from post-merger URCS calculations when performing the BNSF Settlement Agreement's annual trackage right fee adjustment.<sup>1</sup> In its Response, BNSF abandons that claim. Adopting a new theory of the parties' intent, BNSF – joined by CMA<sup>2</sup> – now claims that UP and BNSF mutually agreed to an entirely different procedure. BNSF now claims that the true agreement was to adjust fees based only on comparisons of UP's URCS costs between post-merger years. BNSF no longer says that the disputed costs should be excluded from

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<sup>1</sup> See Union Pacific Corp. – Control & Merger – Southern Pacific Rail Corp., STB Finance Docket 32760, Decision No. 96 (STB served Mar. 21, 2002), slip op. at 6 (“[W]e will allow BNSF a further opportunity to demonstrate that the disputed items should be omitted from the URCS calculations required to create the Section 12 adjustment factor.”).

<sup>2</sup> We refer to the American Chemistry Council (formerly the Chemical Manufacturers Association) by the acronym used throughout these proceedings, “CMA.”

merger URCS. Instead, it says that the parties intended to adjust fees using post-merger URCS that should have included the disputed costs.

In adopting this new theory, BNSF again asks the Board to disregard the BNSF Settlement Agreement's plain language, which requires comparisons using pre-merger URCS. It asks the Board to find a contrary intent that is inconsistent with the Agreement, inconsistent with the evidence in the merger proceeding, inconsistent with BNSF's and CMA's behavior, internally inconsistent, and inconsistent with preserving the competitive balance between BNSF and UP.

The parties never agreed to depart from the plain language that they carefully negotiated for the BNSF Settlement Agreement. Nor is there any competitive justification for altering the agreed-upon fee adjustment process. BNSF pays trackage rights fees (a) lower than the rates it originally negotiated, and which it swore would make it competitive, (b) lower than rates the Board would have prescribed under its *SSW Compensation* methodology, and (c) much lower than rates BNSF charges UP to remedy the anticompetitive effects of the BN/Santa Fe merger.

While paying these fees, BNSF's trackage rights traffic has grown "to the size and scale of a new Class I railroad," and BNSF has "exceeded [its] goal" for the trackage rights. BNSF-PR-20 at 4. BNSF has reported, and the Board has agreed, that the trackage rights have effectively preserved rail competition in the West. See Union Pacific Corp. – Control & Merger – Southern Pacific Rail Corp., STB Finance Docket 32760 (Sub-No. 21), Decision No. 21 (STB served Dec. 20, 2001).

The Board should reject BNSF's ever-changing stories regarding the parties' intent and dismiss BNSF's Petition with prejudice.

In the following sections, we briefly summarize our arguments and review the background of the BNSF Settlement Agreement and the CMA Agreement negotiations. In Part I of our Argument, we demonstrate that BNSF and CMA offer no credible evidence that the parties intended to depart from the BNSF Settlement Agreement's plain language. In Part II we show that their new theory of intent does not rationally apply to one of the two types the costs that BNSF and CMA seek to disregard in the fee adjustment. In Part III we explain why BNSF's proposed recalculation of the fee adjustment is unworkable. Finally, in Part IV we show that the trackage rights fees allow BNSF to be a vigorous competitor using its trackage rights and allow UP and BNSF to compete fairly. This Reply is supported by verified statements from John H. Rebensdorf, Keith A. Rhoades, and Richard F. Kauders, and by a joint verified statement from James V. Dolan, Paul A. Conley, Jr., and John T. Gray.

#### SUMMARY OF ARGUMENT

BNSF and CMA ask the Board to override the plain language of the BNSF Settlement Agreement – language that adopts a CMA proposal and that BNSF agreed upon with UP after intensive negotiations. Unable to provide the evidence that the Board invited them to produce in support of BNSF's December Petition, BNSF and CMA offer an entirely new theory never voiced in the six years since UP and SP merged. They argue for the first time that the BNSF Settlement Agreement is wrongly drafted, and that the parties had a different but unarticulated intent. They walk away from their prior theory that the parties intended to remove some of UP's costs in adjusting the fees.

The plain language of the BNSF Settlement Agreement's provision for adjusting trackage rights fees requires the parties to adjust the fees every year based on the difference in pertinent UP system-average URCS costs for the prior two years. The language is clear; the

computation is straightforward; and the Agreement contemplates no exceptions or modifications. BNSF and CMA now claim that the true intent was to use the difference between the current year (at a time when URCS costs would not yet be available) and the year before.

The BNSF Settlement Agreement's plain language carries out the specifications of a CMA expert witness, Thomas D. Crowley. CMA's witness specifically urged that the first adjustment occur in 1997, based on a comparison between UP's 1995 and 1996 system-average URCS costs (hence we will call this comparison the "CMA Method"). BNSF and UP then agreed to use the CMA Method. BNSF and UP faithfully incorporated the CMA Method into the BNSF Settlement Agreement, and UP has employed it since. Even though the trackage rights fees were one of the most contentious and closely watched issues in the UP/SP merger proceeding, no party ever suggested that BNSF and UP got the language wrong – until BNSF and CMA filed their Responses last month.

The new BNSF and CMA theory is remarkable not only because it lay unexpressed for half a decade, but also because it points in the opposite direction from the theory that BNSF advocated only five months ago. In its December Petition, BNSF repeatedly asserted that the railroads intended to modify UP's URCS every year to exclude two elements of UP's costs associated with the UP/SP merger: (1) the difference between SP's book value and the higher amount that UP paid to acquire SP (the "SP purchase cost") and (2) the costs of certain post-merger capacity improvements on the trackage rights lines that UP agreed to fund in Sections 9(c)(i) and 9(c)(iii) of the BNSF Settlement Agreement (the "merger capacity costs"). BNSF-98 at 12-16.

BNSF and CMA now ignore BNSF's previous claims of intent to exclude these costs from URCS beginning in 1997. They provide none of the evidence that the Board requested

to support these claims. In their Responses, they instead claim that the parties intended to compare only post-merger URCS costs. They now argue that the parties intended to adjust fees using post-merger URCS costs that should have included the disputed items. They claim that the BNSF Settlement Agreement should have expressed that intent. See BNSF-102 at 7-9; CMA-17 at 2.

The Board should reject this new argument for a host of reasons:

- The BNSF Settlement Agreement does not restrict fee adjustments to post-merger URCS costs, but instead requires an adjustment in 1997 based on two prior years' URCS costs.
- Not a shred of evidence shows that BNSF, CMA, and UP ever discussed, much less agreed to, the alleged intent to base fee adjustments on only post-merger URCS costs.
- The BNSF Settlement Agreement accurately adopts the CMA Method recommended by CMA witness Thomas Crowley.
- BNSF and UP jointly adopted the language that implements the CMA Method.
- BNSF and CMA have never before suggested that the BNSF Settlement Agreement misstates the parties' intent, even though BNSF and CMA were intensely interested in this issue during the merger proceedings.
- BNSF's and CMA's new allegations leave them with no theory that explains how the parties could have intended to avoid reflecting merger capacity costs in the fee adjustment. The post-merger URCS they want to use reflected those cost increases as UP incurred them.
- As a BNSF witness inadvertently demonstrates, the adjustments BNSF now wants cannot be performed. They would require illegitimate distortions of URCS costs and principles.

Finally, the evidence demonstrates that BNSF has been a formidable competitor using the trackage rights it obtained in the UP/SP merger, as the Board has repeatedly found. BNSF has repeatedly bragged of competing successfully, despite paying trackage rights fees that it now claims are too high. The CMA Method has proven highly favorable to BNSF: As we will show, BNSF's trackage rights fees are 10 percent below the fees BNSF would be paying under the

RCAF(U) adjustment to which it initially agreed, 19 percent below the fees BNSF charges for trackage rights that UP received in connection with the BN/Santa Fe merger, and 28 percent below the fees the Board would have established for similar trackage rights.<sup>3</sup> There is no competitive justification for departing from the BNSF Settlement Agreement's plain language.

### BACKGROUND

BNSF and UP established the initial trackage rights fees in the original BNSF Settlement Agreement through intense, arms-length negotiations. They agreed on rates of 3.0 mills per gross ton-mile for bulk traffic, 3.1 mills per gross ton-mile for most intermodal and carload traffic, and 3.48 mills per gross ton-mile for intermodal and carload traffic moving between Keddie and Stockton, California. They initially agreed to adjust those rates from year to year to reflect seventy percent of increases or decreases in RCAF(U). Responding to concerns from other participants in the UP/SP merger proceedings, however, UP and BNSF subsequently amended the BNSF Settlement Agreement by agreeing to adjust the trackage rights fees using system-average URCS costs instead of RCAF(U). That agreement reduced the fees.

#### A. The September 1995 Negotiations

In their initial settlement negotiations in September 1995, BNSF and UP bargained over the rates that they would pay each other for the rights they exchanged. Their negotiations used as benchmarks trackage rights fees in their other recent trackage rights agreements. See *Rebensdorf V.S.* at 2. The parties negotiated the levels of the trackage rights fees, but they never discussed costs or exchanged any information about costs. Id. As all of UP's negotiators testify,

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<sup>3</sup> See also Decision No. 96 at 5 n.6 ("We note that BNSF has benefited, and competition over the trackage rights lines has been enhanced, by the change from the RCAF-based fee adjustment (initially agreed to by BNSF) to the URCS-based adjustment that we imposed, at the urging of CMA and other parties, as a condition to our approval of the UP/SP merger.").

neither UP nor BNSF ever mentioned the SP purchase cost or the accounting treatment of the purchase. Id. at 2-3; Dolan/Conley/Gray V.S. at 3-4.

If BNSF made any assumptions about whether the initial rates reflected the SP purchase cost or the timing of UP's accounting for the SP purchase, it never shared them with UP. Rebensdorf V.S. at 3. UP did not even consider these issues. Id. UP simply sought to establish rates that the parties and the Board would accept and that would cover UP's operating and maintenance costs while contributing to its investment costs. Id. The parties adopted an adjustment based on 70 percent of RCAF(U) because it is commonly used in the industry. Id. at 2. Under a flat-rate agreement with an RCAF(U) adjustment, the SP purchase cost was irrelevant. Id. at 3.

UP agreed to use flat rates with an RCAF(U) adjustment to avoid the substantial clerical work and expense associated with traditional joint facility arrangements. Id. at 4. Traditional arrangements require annually allocating the actual cost of maintenance and operation between the parties on the basis of their relative usage, adding appropriate overheads, and then adding an interest rental factor to provide a return to capital invested in the trackage rights lines. Using flat rates with an indexed adjustment eliminates the need to monitor separately the maintenance expenses and capital investments associated with the lines. It also eliminates uncertainty about what the tenant will pay. Id.

In sworn testimony, BNSF represented that it could compete effectively using the original trackage rights compensation provisions. In 1995 BNSF's Executive Vice President and Chief Operations Officer, Carl Ice, testified: "With respect to the level of compensation for trackage rights under the agreement, the terms of the agreement were the subject of intense arms-length negotiation. From BN/Santa Fe's perspective, they are at a level at which we believe we

can offer competitive pricing . . . and will not place BN/Santa Fe at a disadvantage in competing with the landlord railroad UP/SP.” BN/SF-1, Ice V.S. at 12. BNSF’s latest position in this proceeding, and Mr. Ice’s new testimony, cannot be reconciled with Mr. Ice’s sworn testimony in BN/SF-1.

B. The Revised Adjustment Mechanism

BNSF’s confidence in 1995 notwithstanding, other participants in the merger proceeding raised concerns that the RCAF(U) fee adjustment mechanism might eventually place BNSF at a competitive disadvantage. CMA, among others, argued that RCAF(U) reflected changes in prices but not changes in productivity. If UP’s productivity improved, they worried, UP’s costs associated with maintaining and operating the trackage rights lines might fall even as RCAF(U) increased, leaving BNSF at a competitive disadvantage. See, e.g., CMA-7 at 14.

Although UP disagreed with those concerns, UP agreed to adopt the URCS adjustment mechanism proposed by its critics. Rebensdorf V.S. at 5-6. In fact, UP agreed to adopt the URCS adjustment mechanism exactly as proposed by Thomas D. Crowley, a witness for CMA. On behalf of CMA, Mr. Crowley argued that “the proper measure for the adjustment mechanism is cost changes,” and he supplied an exhibit showing which system-average URCS components should be included in the adjustment calculation. CMA-7, Crowley V.S. at 57 & Ex. (TDC\_11). Crowley also stated that the adjustment “should reflect a 1-year lag so that the 1997 adjustment would be based on the change in costs between 1995 and 1996.” Id., Crowley V.S. at 57.

BNSF and UP adopted CMA’s formula as Mr. Crowley had proposed it. UP specifically agreed that the fee adjustment would reflect a one-year lag, so that the 1997 adjustment would be based on the difference between 1995 and 1996 URCS costs, as Mr. Crowley

had recommended. *Rebensdorf V.S.* at 6. The parties recognized that the Board's URCS calculations were typically not available until several months after the end of the year in question, so the annual adjustment had to include a lag period to be workable, exactly as Mr. Crowley had suggested. *Id.* at 6-7. This is the mechanism BNSF and CMA now attack.

In its negotiations with UP, CMA never suggested that UP's URCS costs should be modified to exclude the SP purchase cost or the merger capacity costs, or that the CMA Method required the use of only post-merger URCS costs. *Id.* at 7; *Dolan/Conley/Gray V.S.* at 3-4. BNSF, also a party to the CMA Agreement, never raised these issues with UP either. *Rebensdorf V.S.* at 7; *Dolan/Conley/Gray V.S.* at 3-4. Neither CMA nor BNSF ever told UP that they understood that the initial trackage rights rates already included the anticipated effects of the SP purchase cost. *Rebensdorf V.S.* at 7; *Dolan/Conley/Gray V.S.* at 3-4.

The URCS adjustment first appeared in section 7 of the CMA Agreement, which provided that "BN/Santa Fe's trackage rights fees shall be adjusted upward or downward each year by the difference between the year in question and the preceding year in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the fee." UP/SP-219, CMA Agreement, § 7. Although this language is subject to multiple interpretations, UP promptly announced that it had agreed to the CMA Method as specified in Mr. Crowley's statement. Just eleven days after the CMA Agreement was signed, on April 29, 1996, UP's John Rebensdorf testified:

[W]e have decided to address the concerns leveled at the adjustment provision by amending Section 12 to provide that trackage rights fees shall be adjusted upward or downward July 1 of each year by the difference for the two preceding years in UP/SP's system average URCS costs for the categories of maintenance and operating costs (including depreciation and return on investment) covered by the trackage rights fee.

UP/SP-231, Rebensdorf R.V.S. at 10. Mr. Rebensdorf's testimony reinforced three points that were clear from the parties' discussions and Mr. Crowley's testimony for CMA: (i) the adjustment would be made on July 1 of each year based on the difference between the two prior years' URCS costs; (ii) the adjustment would necessarily include a lag period, so the "year in question" would be the full calendar year before each year's annual adjustment; and (iii) the relevant maintenance and operating costs included depreciation and return on investment. Id.; see also Rebensdorf V.S. at 7. Neither CMA nor BNSF ever suggested (until their May 22, 2002 Responses) that Mr. Rebensdorf's testimony incorrectly reflected the parties' agreement of a few days before.

On June 27, 1996, some two months after Mr. Rebensdorf's testimony and after extensive negotiations between BNSF and UP, the two railroads filed the Second Supplemental Agreement to the original BNSF Settlement Agreement. This filing incorporated the CMA Method. Section 9 of the Second Supplemental Agreement amended the original fee adjustment provision to reflect the CMA Agreement. It provided:

All trackage rights charges under this Agreement shall be subject to adjustment upward or downward July 1 of each year by the difference in the two preceding years in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the trackage rights fee. "URCS costs" shall mean costs developed using the Uniform Rail Costing System.

UP/SP-266, Second Supplemental Agreement, § 9. This is the language that was before the Board when it approved the UP/SP merger.<sup>4</sup> It calls for adjustments based on URCS costs for two prior years.

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<sup>4</sup> The identical language is incorporated in Section 12 of the Restated and Amended BNSF Settlement Agreement, which was submitted to the Board on March 1, 2002. See UP/SP-393; BNSF-100, Joint Submission of Restated and Amended BNSF Settlement Agreement, § 12.

UP and BNSF exchanged multiple drafts of the Second Supplemental Agreement. In several of those drafts, they focused specifically on the fee adjustment provision. *Rebensdorf V.S.* at 8-9. BNSF never suggested that UP's system-average URCS costs should be modified to exclude the SP purchase cost or the merger capacity costs (BNSF's and CMA's original theory). *Id.* at 9; *Dolan/Conley/Gray V.S.* at 3-4. Nor did BNSF ever suggest that the parties would use only post-merger URCS in the fee adjustment process or that the Second Supplemental Agreement incorrectly reflected the CMA Agreement's fee adjustment process (BNSF's and CMA's new theory). *Rebensdorf V.S.* at 9; *Dolan/Conley/Gray V.S.* at 3-4. If BNSF harbored any such beliefs or intentions, it withheld them from UP.

BNSF considered the URCS adjustment provision an improvement to already acceptable trackage rights fees. BNSF's Carl Ice told the Board: "I testified in my first Verified Statement that the trackage rights compensation levels included in the Original Agreement were established at a level at which BN/Santa Fe believes it can offer competitive pricing. . . . To the extent that shippers have expressed concern about the effect of the negotiated compensation level on BN/Santa Fe's ability to compete, the CMA Agreement's favorable revision of the rate escalator clause should alleviate much of that concern." *BN/SF-54, Ice V.S.* at 7-8.

C. The Effect of Adopting CMA's URCS Adjustment Mechanism

BNSF implies that the trackage rights fees exceed the amount it was willing to pay if the URCS adjustment includes the SP purchase cost and the merger capacity costs. *See BNSF-102* at 4; *id.*, *Ice V.S.* at 10. As the Board has already recognized, however, this impression is false. The URCS adjustment using the CMA Method reduced the fees that BNSF said would let it compete. *See Decision No. 96* at 5 n.6. BNSF now seeks further advantage.

In order to appreciate how much BNSF has already benefited, one need only compare the changes in trackage rights fees that would have occurred using the original RCAF(U) adjustment with the changes using the CMA Method. Chart 1 provides this comparison using the 3.1 mills per gross ton-mile fee for intermodal and carload traffic. As Chart 1 shows, the rates BNSF pays have never increased above their initial levels, and they are now below the original rates. In contrast, under the RCAF(U) adjustment, the rates would have increased above their original levels beginning with the very first adjustment, and they would have climbed even higher in recent years.<sup>5</sup>

The benefits BNSF has obtained from the CMA Method are also apparent from the higher fees that BNSF charges UP. Chart 2 compares the fees that BNSF pays under the CMA Method with the fees that UP pays to BNSF for rights over BNSF between Pueblo and Ft. Worth. BNSF granted SP rights between Pueblo and Ft. Worth in order to remedy competitive losses caused by the BN/Santa Fe merger. As Chart 2 shows, the rates BNSF pays UP under the BNSF Settlement Agreement are far below the rates that UP pays BNSF for its rights between Pueblo and Ft. Worth. Moreover, the rates BNSF pays under the BNSF Settlement Agreement actually decreased between 1996 and 2000, while the rates UP pays to use BNSF's lines between Pueblo and Ft. Worth increased by 3 percent between 1996 and 2000. If the UP/SP trackage rights fees compromise BNSF's ability to compete, UP is at an even greater disadvantage.

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<sup>5</sup> The UP data do not reflect the parties' recent agreement to calculate 1995 and 1996 URCS by creating combined UP/SP URCS rather than weighting each railroad's separate 1995 and 1996 URCS. See *Kauders V.S.* at 8. BNSF had argued that the parties should use a combined URCS, and UP agreed as part of a compromise of several other outstanding issues. Ironically, UP's preliminary calculations suggest that BNSF's proposal will actually result in higher fees in certain years. If that turns out to be the case, UP remains willing to use the weighted average URCS methodology it originally proposed.

As a final means of placing BNSF's claims in perspective, we note the Board's conclusion that under its *SSW Compensation* capitalized earnings methodology, the trackage rights fees would have been at least 3.84 mills per gross ton-mile – much higher than the rates BNSF pays. See Union Pacific Corp. – Control & Merger – Southern Pacific Rail Corp., 1 S.T.B. 233, 415 (1996). The Board concluded that “because the agreed levels are lower than [the Board] would set under *SSW Compensation*, they are reasonable.” Id. at 414. BNSF's rates six years later remain far below the levels that would be reasonable under the Board's *SSW Compensation* methodology. We provide this comparison in Chart 3.

### ARGUMENT

I. BNSF AND CMA OFFER NO CREDIBLE EVIDENCE THAT THE PARTIES INTENDED TO DEPART FROM THE BNSF SETTLEMENT AGREEMENT'S PLAIN LANGUAGE

The BNSF Settlement Agreement's plain language requires an annual fee adjustment based on the difference in the two preceding years in UP's system-average costs developed using the Board's URCS. In this proceeding, however, BNSF has offered two different, inconsistent theories for calculating the fee adjustment using a modified URCS. BNSF initially claimed that the parties intended to calculate the fee adjustment by deducting costs from URCS. BNSF and CMA now claim that the parties intended to calculate the fee adjustment using post-merger URCS costs only and assume that all the disputed costs were included in URCS costs before 1997.

Without providing any contemporary evidence to support their new theory, BNSF and CMA try to explain how this supposed intent was defeated. BNSF and CMA argue that (i) UP misled BNSF and CMA by altering the CMA Agreement's language in the BNSF Settlement Agreement, see BNSF-102 at 9; CMA-17 at 2-3; and (ii) in “a development that was not and could

not have been anticipated," UP's recorded the SP purchase cost in 1997 rather than 1996, see BNSF-102 at 8. Both claims are demonstrably wrong.

BNSF never explains its sudden shift in its position. Neither BNSF nor CMA credibly accounts for its failure to mention its new theory for more than half a decade. Neither BNSF or CMA provides any evidence that the parties mutually intended to do anything other than adjust the trackage rights fees based on system-average URCS costs for two prior years as specified by BNSF Settlement Agreement's plain language. Neither BNSF nor CMA provides any evidence that UP's accounting for the SP purchase cost was incorrect or unexpected.

A. BNSF Altered Its Claims About the Parties' Intent

In its December Petition, BNSF claimed that UP and BNSF had agreed to deduct the SP purchase cost and merger capacity costs from URCS when calculating the BNSF Settlement Agreement's annual trackage rights fee adjustment. BNSF-98 at 16.<sup>6</sup> CMA filed a statement supporting BNSF. CMA-15 at 2-3. The Board was not persuaded, but it gave BNSF and others who supported its December Petition a second chance "to demonstrate that the disputed items should be omitted from the URCS calculations." Decision No. 96 at 6.

BNSF failed to do what the Board authorized. It presented no evidence of any intent to exclude costs from URCS. Instead, its Response offers a new, inconsistent version of the parties' intent, adopted by CMA as well. Rather than argue that the parties intended to exclude the disputed items from post-merger URCS, it now argues that the parties intended to adjust the fees

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<sup>6</sup> In its December Petition, BNSF asked the Board to clarify that "(i) in the application of the adjustment methodology, the combined UP/SP 1997 URCS costs must exclude any amounts attributable to the purchase premium paid by UP for SP; and (ii) the separate 1996 UP and SP URCS costs as well as the combined UP/SP URCS costs for 1997, 1998, and any applicable subsequent years must exclude any merger-related capital expenditures relating to the trackage rights lines for which UP has sole responsibility under Section 9c of the BNSF Settlement Agreement." BNSF-98 at 16.

based on post-merger URCS costs only, using 1996 and 1997 URCS costs that included the disputed items.<sup>7</sup> BNSF never even acknowledges this abrupt reversal in position.

B. The Parties Never Agreed to Use Only Post-Merger URCS Costs

BNSF and CMA provide absolutely no evidence that the parties to the CMA Agreement or the BNSF Settlement Agreement ever discussed using – much less agreed to use – only post-merger URCS costs to calculate trackage rights fee adjustments.

1. CMA Proposed Adjustments Based on Comparing Pre-Merger and Post-Merger URCS Costs

As we explained above, the URCS adjustment provision incorporates CMA's demand in the merger proceedings. CMA's witness, Mr. Crowley, called for an URCS adjustment provision that would include "a 1-year lag so that the 1997 adjustment would be based on the change in costs between 1995 and 1996." CMA-7, Crowley V.S. at 57. In March 1996, when CMA made its submission, it surely understood that the SP purchase cost could not be reflected in UP's pre-merger 1995 URCS. BNSF and UP then agreed on language for the BNSF Settlement Agreement that closely tracks Mr. Crowley's language. See pp. 13-14, above.

Neither CMA nor BNSF provides any evidence that, despite Mr. Crowley's recommendations and the carriers' adoption of the CMA Method, the parties to the CMA Agreement mutually agreed to adjust the trackage rights fees based only on post-merger URCS costs. CMA admits that its negotiations were "[b]ased on Mr. Crowley's recommendations." See

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<sup>7</sup> See BNSF-102 at 8 ("the CMA Agreement provided for an annual adjustment mechanism in which URCS costs from one post-merger year would be compared with URCS costs from another post-merger year"); id. at 9 n.6 ("it was BNSF's expectation and understanding that the language [of the Second Supplemental Agreement] would be interpreted and applied in such a manner that all comparisons of URCS costs would be between post-merger years"); id. at 9 ("Accordingly, if pre-merger years are to be used . . . appropriate adjustments must be made to the URCS costs in such years . . .").

CMA-17, Schick V.S. at 3. None of CMA's or BNSF's witnesses claims to have discussed the alleged intent with UP. UP's witnesses did not discuss the issue with CMA or BNSF. Rebensdorf V.S. at 7; Dolan/Conley/Gray V.S. at 3-4. Neither CMA nor BNSF produced a single document reflecting the parties' discussion of or supposed intention to use only post-merger URCS costs, and UP's documents lack any such evidence.

The CMA Method is consistent not only with Mr. Crowley's specific testimony, but also with the thrust of CMA's concerns. CMA was concerned that the original mechanism for adjusting the trackage rights fees would "not include the cost savings projected by UP/SP as one of the benefits of the merger." CMA-17, Schick V.S. at 3.<sup>8</sup> An adjustment provision that begins by comparing pre-merger and post-merger URCS is consistent with CMA's effort to capture cost savings resulting from the merger; an adjustment that takes only post-merger years into account would violate CMA's intent by failing to reflect any initial cost savings.<sup>9</sup> An adjustment provision that begins by comparing 1995 costs to 1996 costs is also consistent with the adjustment mechanism in the original BNSF Settlement Agreement, which used 1995 as the base year for the RCAF(U) adjustment.<sup>10</sup>

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<sup>8</sup> BNSF had the same concern. See BNSF-102, Ice V.S. at 2 ("UP/SP had projected substantial improvements in efficiency, and it was important to BNSF that reductions in the costs of the merged entity should be passed on to BNSF in the form of lower rates for trackage rights.").

<sup>9</sup> UP and SP costs declined substantially from 1995 to 1996, thereby reducing the trackage rights fee under the CMA Method. If UP had based the adjustment on post-merger years only, one suspects that BNSF and CMA might be before the Board pointing to Mr. Crowley's testimony and the BNSF Settlement Agreement's plain language and arguing that UP was violating the parties' clearly expressed intent.

<sup>10</sup> The original adjustment mechanism provided: "All trackage rights charges . . . shall be subject to adjustment annually beginning as of the effective date of this Agreement . . ." UP/SP-22 at 337, BNSF Settlement Agreement, § 12 (emphasis added). The Agreement was made "effective upon execution," in September 1995. *Id.* at 336, BNSF Settlement Agreement, § 11.

The CMA Agreement's fee adjustment language provides that the fees shall be adjusted upward or downward "each year by the difference between the year in question and the preceding year in UP/SP's system average URCS costs." The CMA Agreement does not state that the "year in question" and the "preceding year" are the two years preceding the yearly adjustment, but that is the only reasonable reading. Moreover, CMA's witness specifically proposed that the two preceding years be compared, and that was certainly UP's intent. See CMA-7, Crowley V.S. at 57; Rebensdorf V.S. at 6-7. UP accepted a one-year lag because it was unavoidable: Based on past practice, everyone recognized that the Board could not publish the 1997 URCS costs until 1998. If there was to be an annual adjustment during 1997, it would have to be made using a comparison of 1996 (the "year in question") and 1995 (the "preceding year"). Rebensdorf V.S. at 7.

If there were ever any doubt about the CMA Agreement's meaning, UP resolved it just eleven days after the CMA Agreement was signed. On April 29 1996, John Rebensdorf testified that "that trackage rights fees shall be adjusted upward or downward July 1 of each year by the difference for the two preceding years in UP/SP's system average URCS costs for the categories of maintenance and operating costs (including depreciation and return on investment) covered by the trackage rights fee." UP/SP-231, Rebensdorf R.V.S. at 10. Neither BNSF nor CMA suggested at that time, or at any time before their May 22, 2002 filings, that Mr. Rebensdorf's statements misrepresented the intent of the parties to the CMA Agreement.<sup>11</sup>

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<sup>11</sup> CMA misleadingly suggests that it did not have time to catch to the alleged misstatement of the CMA Agreement in the BNSF Settlement Agreement, because the Second Supplemental Agreement was filed on the last business day before oral argument in the UP/SP merger proceeding. CMA-17 at 2. Mr. Rebensdorf's testimony, which tracks the language of the fee adjustment provision contained in the Second Supplement Agreement, was served on CMA more than one month before CMA filed its Brief in the UP/SP merger proceedings on June 3, 1996, see (continued...)

2. BNSF Agreed to Adjustments Comparing Pre-Merger and Post-Merger URCS Costs

Less than two months after Mr. Rebensdorf's testimony, and after meticulous negotiations, BNSF and UP adopted the CMA Method in the Second Supplemental Agreement to the original BNSF Settlement Agreement. Section 9 of the Second Supplemental Agreement provided for an adjustment upward or downward "each year by the difference in the two preceding years in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the trackage rights fee." UP/SP-266, Second Supplemental Agreement, § 9. That language, still in effect, reflects both Mr. Crowley's method and Mr. Rebensdorf's endorsement of that method of adjusting fees. BNSF never even hinted at a concern that the Second Supplemental Agreement had altered the CMA Agreement's terms, as BNSF and CMA now claim. Rebensdorf V.S. at 9; Dolan/Conley/Gray V.S. at 3-4.<sup>12</sup>

3. BNSF's and CMA's Past Actions and Inaction Belie Their Current Claims

Both BNSF and CMA now claim that they believed in 1996 that the language of the BNSF Settlement Agreement – which BNSF jointly proposed with UP – departed from the intent of the CMA Agreement. These assertions are inconceivable and should not be credited.

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(footnote cont'd)

CMA-12, and almost two months before the Second Supplemental Agreement was filed with the Board on June 28, 1996.

<sup>12</sup> Moreover, while UP and BNSF were negotiating the Second Supplemental Agreement, they were also negotiating individual implementing agreements for each segment of trackage rights granted under the BNSF Settlement Agreement. Each of the implementing agreements contained the fee adjustment provision. The implementing agreements provide that the first fee adjustment would take place in July 1997, based on "the difference in the two (2) preceding years in UP/SP's system average URCS costs," thus confirming that a comparison between pre-merger and post-merger URCS would be required. See, e.g., UP/SP-266, Denver, CO to Stockton and San Jose, CA Trackage Rights Agreement, § 3(c); id., Houston, TX to Valley Junction, IL Trackage Rights Agreement, § 3(c). Again, no one suggested that this language was incorrect. Rebensdorf V.S. at 9 n.3.

CMA admits that it never mentioned the alleged misinterpretation to UP or the Board. CMA says that it understood the perceived difference between the CMA Agreement and the BNSF Settlement Agreement to be a "technical amendment" that would have no practical effect. CMA-17, Schick V.S. at 6.<sup>13</sup> Yet CMA protected its interests in the UP/SP merger proceeding with fervent intensity, raising serious questions about whether it would have accepted any "technical amendment." In any event, CMA provides no proof whatsoever of any agreement with UP to depart from the BNSF Settlement Agreement's plain language, which tracks the testimony of CMA's own witness.

BNSF itself negotiated and adopted the revised language of the BNSF Settlement Agreement. BNSF considered the initial fee and the fee adjustment provisions to be among the most important aspects of the September 1995 negotiations. See BNSF-102, Ice V.S. at 2. The new fee adjustment provision was one of the most significant changes in the Second Supplemental Agreement. The language BNSF and UP negotiated faithfully implemented the recommendation of CMA's expert. The Board can only conclude that the Second Supplemental Agreement and implementing agreements accurately reflected the intent of the parties to the CMA Agreement.

Until its Response, BNSF never raised the claim that the BNSF Settlement Agreement failed to carry out the CMA Agreement. BNSF did not raise this claim in its final progress report to the Board. See BNSF-PR-20. BNSF did not raise this claim in the recently concluded proceeding to develop a final version of the BNSF Settlement Agreement, which BNSF and UP worked on for months. See UP/SP-393; BNSF-100. BNSF did not raise any claims at all

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<sup>13</sup> Mr. Schick correctly describes the reasons for the one-year lag, but incorrectly suggests that UP and not CMA's own witness was the source of the one-year lag in the fee adjustment provision. See id.

about the fee adjustment provision until 2000. When it then brought its claims to the Board, it made a different argument. See BNSF-98 at 16. BNSF's newest argument about the parties' intent in 1996 is imaginative, but it is not credible.

C. The Purchase Accounting Was Properly Reported in 1997 and Its Timing Was No Secret

Even if the BNSF Settlement Agreement's fee adjustment provision had departed from the CMA Agreement's language, BNSF and CMA could not prevail. BNSF and CMA argue that they expected to compare 1996 URCS costs with 1997 URCS costs. Even under that theory, though, the first annual fee adjustment would still have involved a comparison between pre-merger (1996) and post-merger (1997) URCS costs.

BNSF dances around this problem by asserting that UP caught BNSF off guard. BNSF mistakenly asserts that UP's purchase accounting in 1997 "could not have been anticipated," and that the parties understood that 1996 and 1997 would both be post-merger years. BNSF-102 at 8. The second page of the UP/SP Merger Application proves that BNSF is mistaken.

UP had explained on the second page of the Merger Application that its "present intent [was] to merge SPT, SSW, SPCSL and DRGW into UPRR, although these subsidiaries of SPR may retain their separate corporate existence for a period of time." UP/SP-22 at 2 (emphasis added). Due to the uncertainties regarding the IRS rulings and SSW shareholder issues, UP did not know when the legal mergers at the railroad level would occur. Rhoades V.S. at 3-4.<sup>14</sup> UP

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<sup>14</sup> Union Pacific Corporation ("UPC") acquired Southern Pacific Rail Corporation ("SPR") on September 12, 1996, following STB approval of the UP/SP merger. The railroads themselves remained separate direct and indirect subsidiaries of UPC. The railroad-level mergers did not begin until 1997. Before the railroad-level mergers could occur, UP needed to obtain certain tax rulings from the IRS, and it needed to deal with minority shareholders of SSW. Id. at 3-4. The (continued...)

never told BNSF or CMA that the railroad mergers and the consequent purchase accounting would occur in 1996 as opposed to 1997. *Rebensdorf V.S.* at 7, 9. Neither BNSF nor CMA ever asked when the mergers would occur. *Id.* at 7, 9. BNSF and CMA cannot claim to have been misled, as the Application put them on notice that the railroad-level mergers might not occur until some time after the UP/SP merger was approved.

UP's accounting for the SP merger was dictated by tax and shareholder considerations and by STB accounting rules, not ulterior motives. *Rhoades V.S.* at 2-3. UP did not "elect" to make the purchase cost adjustment in 1997 rather than 1996, as BNSF claims. *See BNSF-102* at 3. It followed well-established accounting rules. Its accounting was reviewed and approved by the STB staff. UP's accounting was proper and public. *Rhoades V.S.* at 4-5.

Moreover, BNSF recognized in subsequent years that the purchase accounting for the UP/SP merger had occurred in 1997 yet said nothing. UP's accounting for the SP merger in its 1997 R-1 was the subject of a hard-fought Board proceeding brought by Western Coal Traffic League. This challenge was common knowledge. AAR participated as an amicus, and BNSF's witness Weicher appeared on the pleadings in support of UP's purchase accounting. If BNSF or CMA had been surprised that the purchase accounting occurred in 1997 rather than 1996 – and if the timing mattered to them – one would have expected them to object years ago.

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BNSF and CMA provide no evidence to support their claims that the BNSF Settlement Agreement's plain language fails to reflect the parties' intent when they agreed upon

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(footnote cont'd)

timing of UP's purchase accounting followed from the timing of the railroad-level mergers. *Id.* at 3. Until the railroad subsidiaries themselves could be merged or consolidated, UPC could not allocate the SPR purchase accounting to UP's property accounts. *Id.*

the URCS adjustment provision. Nor do they provide any support for their complicated explanation of how UP defeated the parties' supposed intent by altering the CMA Agreement's language and engaging in undisclosed accounting tricks.

II. BNSF'S AND CMA'S NEW VERSION OF THE PARTIES' INTENT CONTRADICTS THEIR POSITION ON MERGER CAPACITY COSTS

BNSF's and CMA's new claim that the parties intended to compare only post-merger URCS costs creates a logical inconsistency in their position. UP's post-merger URCS cost reflected UP's increasing merger capacity costs as UP incurred them. If trackage rights fees are to be adjusted based on changes in post-merger URCS costs, as BNSF and CMA now claim, the adjusted fees would increase to reflect the merger capacity costs, as UP invested the money in 1996, 1997, into 1998, and beyond. BNSF and CMA cannot have it both ways: they cannot claim an intent to use post-merger URCS costs but deny that UP's post-merger URCS costs increased over time as UP incurred merger capacity costs.

BNSF and CMA have no theory whatsoever to explain how the parties intended to use post-merger URCS costs but disregard the merger capacity costs in performing the fee adjustment. BNSF and CMA offer no explanation of how the BNSF Settlement Agreement language can be reconciled with any intent to modify UP's post-merger URCS costs. They know well that the parties never agreed to disregard the merger capacity costs in the annual fee adjustment.

In the BNSF Settlement Agreement, the parties agreed that BNSF would not have to pay its own funds for capacity improvements on the trackage rights lines that were necessary to achieve the benefits of the merger. BNSF Settlement Agreement, § 9(c)(i). In order to minimize disputes about which capacity improvements were necessary to achieve the merger's benefits, UP agreed that it would fund any capacity improvements on the trackage rights lines for 18 months

following the merger. Id., § 9(c)(iii). After the 18-month period, the parties would determine on a case-by-case basis whether a particular capacity improvement on a trackage rights line was necessary to achieve the merger's benefits or whether BNSF would fund the improvements in accordance with its relative usage. Id., § 9(c)(ii). UP and BNSF agreed that BNSF would not be required to pay the initial merger capacity costs, but they never agreed to try to modify the impact of those costs on the fee adjustment when they adopted the CMA Method. *Rebensdorf V.S.* at 5.

BNSF and CMA are unable to supply either a theory or a shred of evidence for the assertion that the parties mutually agreed to disregard these merger capacity costs in the annual fee adjustment. Under BNSF's and CMA's own theory that the fee adjustment should be based on post-merger URCS costs, merger capacity costs would be reflected in the fee adjustment. BNSF's argument reveals an explicit but erroneous assumption. BNSF assumes that every UP URCS beginning in 1996 would have included the merger capacity costs. BNSF-102 at 9.<sup>15</sup> This assumption is demonstrably wrong. By definition, the merger capacity costs could only be incurred over time after the merger.<sup>16</sup> As UP incurred merger capacity costs in post-merger years, UP's URCS costs for those years would increase to reflect the new investment, and the trackage rights fee would rise.

UP could not have included all the merger capacity costs in its early post-merger URCS even if it had wanted to. UP had made few of the investments by 1997 when the first fee

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<sup>15</sup> BNSF incorrectly assumed that both the SP purchase cost and the merger capacity costs "would be included in all post-merger years." Id.

<sup>16</sup> BNSF and CMA were on notice that merger capacity costs would be incurred over a four-year period. UP said so in the *Application*, where it anticipated that merger investments would occur over four years. See UP/SP-24 at 114.

adjustment occurred. The amount and timing of the future investments was then unknowable. The Board cannot conclude that the parties agreed to perform an impossible adjustment.

This glaring defect alone destroys the new BNSF and CMA argument, because it demonstrates that BNSF and CMA cannot offer a consistent theory to support the result they seek.

### III. BNSF'S PROPOSED METHOD OF PERFORMING THE FEE ADJUSTMENT VIOLATES URCS PRINCIPLES AND IS UNWORKABLE

BNSF presents Christopher D. Kent's testimony to quantify the difference between the CMA Method and BNSF's approach to the fee adjustment and to suggest how the fees could be recalculated in accordance with BNSF's theory of the parties' intent. He does so using a method that departs from the newly alleged intent of the parties to use post-merger URCS.<sup>17</sup> A review of Mr. Kent's calculations demonstrates that there is no practicable way to recalculate the fees. Mr. Kent's efforts suffer from three major conceptual flaws. They also exaggerate the amount in dispute.

First, Mr. Kent's URCS costs bear no relationship to the actual costs UP and SP would have incurred in 1995 and 1996 had the railroads been merged. In order to calculate fee adjustments under BNSF's theory, Mr. Kent purports to "correct" for the fact UP's purchase accounting occurred in 1997 by shifting UP's 1997 investment and depreciation data into UP's and SP's actual 1995 and 1996 data, and then calculating hypothetical, combined UP/SP 1995 and 1996 URCS costs. BNSF claims that the results show what UP's 1995 and 1996 URCS costs

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<sup>17</sup> BNSF argues that the first annual fee adjustment was supposed to be based on a comparison of 1996 and 1997 URCS costs. See BNSF-102 at 8. Mr. Kent compared 1995 and 1996 URCS costs. See id., Kent V.S. at 4. Mr. Kent apparently generated a modified 1995 URCS because UP's costs decreased sharply between 1995 and 1996. He therefore departed from BNSF's theory and based the first annual fee adjustment on a comparison of 1995 and 1996 URCS costs. Kauders V.S. at 7 n.2.

would have been if the UP and SP systems had combined and the results reflected in a combined UP/SP URCS. BNSF-102, Kent V.S. at 2-3. BNSF is mistaken.

While Mr. Kent substitutes UP 1997 investment and depreciation data for 1995 and 1996 data, he still uses actual UP and SP 1995 and 1996 gross ton-miles and maintenance-of-way costs to calculate URCS costs. He thus creates several apples-and-oranges comparisons that undermine any effort to provide a meaningful restatement of 1995 and 1996 URCS costs.

For example, when Mr. Kent calculates URCS costs for return-on-investment using 1997 beginning-of-year investment levels and 1995 and 1996 gross ton-miles, he disconnects the physical network from the ton-miles it produced. UP's and SP's gross ton-miles in 1995 and 1996 reflect the railroads' physical structure, actual operations, and competitive relationships in those years. We cannot know how many gross ton-miles UP would have moved in 1995 and 1996 if the UP and SP systems had been configured as they were at the beginning of 1997 and the railroads had been merged. We do not know whether mileage savings from reroutes made possible by the merger (for example, UP rerouted SP's Central Corridor traffic to UP's Wyoming mainline after the merger) and traffic losses to BNSF from its use of its trackage rights would have offset increases in traffic resulting from new business opportunities. We do know, however, that Mr. Kent's computations have no connection to reality, because they are based on investment in a post-merger network and gross ton-miles produced by two different, pre-merger networks. Kauders V.S. at 3-4.

Mr. Kent creates a similar inconsistency by combining UP's 1997 investment and depreciation costs with SP's and UP's maintenance-of-way costs for 1995 and 1996.<sup>18</sup> Once

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<sup>18</sup> This procedure directly contradicts BNSF's theory that the parties agreed to use only post-merger URCS costs.

again, no one can guess what UP's maintenance-of way costs would have been in 1995 and 1996 had the UP and SP systems been configured as they were at the beginning of 1997 and had the railroads been merged. We know, however, that Mr. Kent's computations are based on investment and depreciation costs for one network in one year and maintenance-of-way costs for two different, pre-merger networks in different years. Id. at 4.

Mr. Kent creates yet another inconsistency by combining 1997 depreciation data with actual 1995 and 1996 gross ton-miles to calculate the URCS unit costs for return on investment and depreciation. UP's 1997 depreciation expense is a function of UP's gross ton-miles in 1997, which are used to measure use of the track assets in question. When Mr. Kent calculates URCS depreciation costs for 1995 and 1996, however, he uses UP's 1997 depreciation expense and divides it by UP's and SP's gross ton miles in 1995 and 1996. This produces a disconnect between depreciation costs and the assets used. Id.

Mr. Kent's computations violate the principle of "causality" that underpins URCS theory. The causality principle means that operating and maintenance expenses, return on investment, and depreciation costs must all derive from the same physical plant in the same reporting period. See Railroad Accounting Principles Board, Final Report, Vol. 1 at 29. Mr. Kent's modifications to URCS ignore this principle. His railroad and its costs are developed using data from various different periods. Kauders V.S. at 3-4. Mr. Kent's calculations cannot be used to provide a meaningful comparison of costs.

Second, Mr. Kent's calculations artificially mask changes in UP's costs. The provision for adjusting the trackage rights fees is designed to adjust the fees based on changes in UP's URCS costs. Mr. Kent's calculations are flawed because they ignore changes in UP's

investment and depreciation costs resulting from increased UP and SP investment unrelated to the disputed SP purchase cost and merger capacity costs.

By projecting the same 1997 beginning-of year investment level back into 1995 and 1996, Mr. Kent's calculation implicitly assumes that UP's and SP's level of investment did not increase between 1995 and 1996. Mr. Kent's calculations thus ignore changes in UP's URCS costs resulting from all of UP's and SP's capital investments in 1996, not just the disputed merger capacity costs. Id. at 5.<sup>19</sup> In 1996, UP invested hundreds of millions of dollars in capital projects, such as the triple mainline between Gibbon and North Platte, Nebraska. As a result of capital investments in 1996, UP's and SP's 1996 expenses for return on investment were higher than their 1995 expenses for return on investment. Under Mr. Kent's calculations, however, the combined UP/SP expense for return on investment in both 1995 and 1996 was based on 1997 investment data, thus eliminating the increase between 1995 and 1996. This in turn has the effect of artificially reducing the trackage rights fees. Id. at 5-6.

Similarly, by using the same depreciation charge in 1995, 1996, and 1997, Mr. Kent implicitly assumes that UP's depreciation expense did not change between 1995 and 1996, or between 1996 and 1997. This is a false assumption, because depreciation is a function of a railroad's investment and gross ton-miles, and both of those factors were different for UP and SP in 1995 and 1996 than they were for UP in 1997. In particular, UP's and SP's investments in 1996 increased their 1996 depreciation expenses above their 1995 levels, and UP's investments in 1997 increased its 1997 depreciation expenses above its 1996 levels. By projecting 1997 depreciation

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<sup>19</sup> BNSF claims that capital expenditures for capacity improvements on trackage rights lines necessary to achieve the merger's benefits should be excluded from URCS cost calculations, but it accepts that UP's other capital expenditures should be included in URCS costs.

charges back into 1995 and 1996, Mr. Kent wipes out all increased depreciation resulting from all of UP's and SP's investments, including investments that BNSF agrees should be included in the fee adjustment. This in turn has the effect of artificially reducing the trackage rights fees. Id. at 6.

Third, Mr. Kent did not even try to address merger capacity costs. As Mr. Kent recognizes, BNSF theory that the parties intended to use post-merger URCS costs does not address the merger capacity costs issue, because those costs occurred in post-merger years.<sup>20</sup> Mr. Kent claims that his calculations provide a way to address BNSF's claims with respect to merger capacity costs incurred in 1997. BNSF-102, Kent V.S. at 4 n.4. As even Mr. Kent appears to acknowledge, however, shifting 1997 beginning-of-year investment back into 1995 and 1996 addresses only those modest merger capacity costs that were incurred in the last four months of 1996. It fails to address merger capacity costs incurred in 1997 and later years. Moreover, it also wipes out any impact of all of UP's additional investments in 1996, even though BNSF has accepted that such investments should be considered in performing the fee adjustment. Kauders V.S. at 6-7.

Finally, Mr. Kent's calculations exaggerate and distort the amount in dispute by using an unrelated dispute between the parties to accentuate the apparent magnitude of the issues before the Board. BNSF and UP disagree about whether one calculates the fee adjustment by calculating the difference or computing a percentage change between two years of URCS costs. The financial impact is significant. UP and BNSF agreed to arbitrate their disagreement between

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<sup>20</sup> As Mr. Kent recognizes, trying to untangle the accounting for each of the merger capacity projects in order to exclude those costs from URCS calculations, which was BNSF's original theory, would be exceedingly difficult. BNSF-102, Kent V.S. at 4. BNSF requested and received discovery from UP on this issue, and it sought and received thirty additional thirty days from the Board to analyze the material UP provided, but it apparently concluded that it could not make significant inroads on this problem. See Union Pacific Corp. – Control & Merger – Southern Pacific Rail Corp., STB Finance Docket 32760, Decision No. 97 (STB served Apr. 16, 2002).

the "difference" and "percentage change" approaches. BNSF specifically disclaimed any intent to submit this issue to the Board. See BNSF-98 at 2 n.3.

Mr. Kent compares (i) the fees under UP's adjustments each year based on the difference in the two preceding years' URCS costs with (ii) the fees under BNSF's proposed approach of adjusting the fees each year based on the percentage change between the two preceding years' URCS costs. However one views the merits of the parties' dispute between the "difference" and "percentage change" approaches, Mr. Kent's use of two different computational methods is misleading.<sup>21</sup> If Mr. Kent's calculations are corrected to use a consistent method, the apparent difference between the parties' position on URCS costs is cut in half, to 0.1 mills per gross ton-mile. See Kauders V.S. at 7-9.<sup>22</sup>

#### IV. THE ADJUSTED FEES HAVE FOSTERED VIGOROUS COMPETITION

BNSF devotes a substantial portion of its Response to arguing that the CMA Method places BNSF at a competitive disadvantage. The short answer to BNSF's complaints is the one the Board already identified: BNSF pays lower fees under the URCS adjustment than it would have paid under the RCAF(U) adjustment, which it initially told the Board would allow it to compete successfully. See Decision No. 96 at 5 n.6. BNSF also pays lower fees under the BNSF Settlement Agreement than UP pays for trackage rights between Pueblo and Ft. Worth, even though both sets of rights were designed to preserve pre-merger competition. See p. 15, above.

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<sup>21</sup> This issue is not before the Board for resolution because it is being arbitrated. UP expects to introduce extensive evidence on this issue, and we expect BNSF to do the same.

<sup>22</sup> UP calculates the adjusted fees to one decimal place. The fees were presented in the BNSF Settlement Agreement using one decimal place, and UP has billed BNSF using fees calculated to one decimal place, except for the fee for the Keddie-Stockton trackage rights, which was initially presented using two decimal places. Id. at 9 n.5.

BNSF tries to show that a 0.2-mill difference in its fee provides UP with a \$25-to-\$50-per-car advantage, and that this advantage could meaningfully effect competition. See BNSF-102, Smith V.S. at 4. Even ignoring the many flaws in Mr. Kent's calculations, the actual difference is only 0.1 mill. More importantly, BNSF's arguments are based on several false claims regarding BNSF's ability to compete with UP.

A. UP Has No Cost Advantage over BNSF

UP has no cost advantage over BNSF, because it pays all of the disputed costs. UP's costs encompass the same operating and maintenance costs that BNSF pays through the trackage rights fee. UP thus pays the SP purchase cost and the merger capacity costs. BNSF pays a fixed fee while UP's actual costs vary based on the specific lines involved, but neither railroad is systematically advantaged or disadvantaged.

BNSF and CMA claim that the CMA Method tilts the competitive playing field in UP's favor. They claim that the CMA Method creates a double count and thus deprives BNSF of a level playing field on which to compete. BNSF's and CMA's new approach, however, is the one that would tilt the playing field, but in BNSF's favor. The CMA Method does not create a double count, and unless the fee adjustment mechanism reflects UP's increased costs as a result of the SP purchase cost and the merger capacity costs, BNSF will gain an unfair competitive advantage over UP.

BNSF and CMA incorrectly claim that including SP purchase costs in the fee adjustment produces a double count. BNSF-102 at 3; CMA-17 at 3. There is no double count because the initial trackage rights fee could not have included the purchase costs. Evidence presented during the merger proceeding demonstrates that the initial rates did not reflect purchase costs, and the Board agreed. During the merger proceeding, the Board found that including the purchase costs would have increased the initial trackage rights compensation to at least 3.84 mills

per gross-ton mile. See Union Pacific Corp. – Control & Merger – Southern Pacific Rail Corp., 1 S.T.B. at 415. The initial trackage rights rates of 3.0, 3.1, and 3.48 mills per gross-ton mile were thus 28 percent, 24 percent, and 10 percent, respectively, lower than they would have been had the fees been derived based on UP's full costs, including the cost of acquiring SP. The rates remain far below the 3.84 rate today.<sup>23</sup>

Because the initial trackage rights fees did not reflect the SP purchase cost, the annual fee adjustment must be calculated using pre-merger and post-merger URCS in order to preserve a level playing field between UP and BNSF. BNSF repeatedly asserts that comparing pre-merger and post-merger URCS is inconsistent with the parties' statement in Section 12 of the BNSF Settlement Agreement that "[i]t is the intention of the parties that the rates and charges for trackage rights and services under this Agreement reflect the same basic relationship to operating costs as upon execution of this Agreement." See, e.g., BNSF-102 at 6-7, id., Ice V.S. at 5; id., Weicher V.S. at 3, 8 & 10. BNSF's approach, however, is the one that would distort the parties' intentions, because it would disregard real changes in UP's URCS costs after the September 1995 execution of the BNSF Settlement Agreement that resulted from the SP purchase cost. The BNSF

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<sup>23</sup> BNSF and CMA argue that the SP purchase cost was included in the original fee because UP described the trackage rights fee as "comprehensive." See BNSF-102 at 5; id., Ice V.S. at 4; CMA-17, Schick V.S. at 6 n.3. As Mr. Rebensdorf explained at the time, the rates were "comprehensive" in the sense that BNSF would not have to pay additional fees to conduct routine trackage rights operations – there were no separate fees for maintenance and operations, overheads, or return to capital. See UP/SP-22, Rebensdorf V.S. at 308; see also Rebensdorf V.S. at 4. An annual adjustment calculated using UP's actual system average costs is not an additional type of fee. Rebensdorf V.S. at 4.

BNSF also argues that an adjustment based on RCAF(U) would not have included the SP purchase cost, so the URCS adjustment should not include the purchase price adjustment either. See BNSF-102, Weicher V.S. at 9. This argument is a red herring. The two adjustment provisions rely on entirely different approaches to approximating changes in UP's costs, and thus they rely on different underlying data. If BNSF would prefer to return to the RCAF(U) adjustment and pay UP millions of dollars in higher fees to avoid the supposed double count introduced by the URCS adjustment, UP will agree.

Settlement Agreement as written therefore preserves the basic relationship of the fees to UP's operating costs, as the Agreement specifies. BNSF suggests that the SP purchase cost does not represent actual costs, see BNSF-102, Weicher V.S. at 6, but the Board has already rejected that argument: "URCS costs, when calculated in the required manner, reflect actual costs; that, in fact, is what URCS is all about." Decision No. 96 at 5.

B. BNSF Does Not Have to Match UP's Costs to Provide Meaningful Competition

Even if UP had a slight cost advantage, it would be irrelevant. BNSF does not have to match UP's costs to provide the competition the Board expected it to provide. The Board did not expect BNSF to replicate UP's costs. The Board expected BNSF to step into SP's shoes and thus to match or better SP's costs. See Union Pacific Corp. - Control & Merger - Southern Pacific Rail Corp., 1 S.T.B. at 423. BNSF once recognized this. It understood that the BNSF Settlement Agreement was designed to allow it to replace the competition SP provided, not to match UP's costs. In its December Petition, BNSF noted that "the purpose of the trackage rights conditions was, in effect to put BNSF in the 'shoes of SP' as a competitor so that BNSF could replace the competitive service that would otherwise have been lost when SP was absorbed into UP." BNSF-98 at 6-7.

BNSF does not have to match UP's costs to step into SP's shoes. As BNSF has told the Board, comparisons between BNSF and UP costs "are misguided, because they focus on UP - rather than SP, the less efficient carrier." BN/SF-54 at 7. BNSF's experts, including Mr. Kent, testified during the merger proceeding that the relevant issue was whether BNSF's costs would be lower than SP's costs, not whether they would be lower than UP's costs. See BN/SF-55,

Klick & Kent V.S. at 43-44.<sup>24</sup> In fact, Messrs. Klick and Kent presented data showing that BNSF expected its variable costs for traffic moving over the trackage rights lines to be far more than \$25 to \$50 above UP's costs. See id. at 50 (Table 6).<sup>25</sup> Yet BNSF argued that it would be highly competitive using the trackage rights, and the Board agreed. See Union Pacific Corp. – Control & Merger – Southern Pacific Rail Corp., 1 S.T.B. at 417.

C. BNSF Has Proven It Can Compete Vigorously

The evidence shows that the Board and BNSF were correct in their belief that BNSF would be a vigorous competitor. BNSF is highly competitive using the trackage rights lines. The trackage rights fees have allowed BNSF to compete vigorously for the traffic opened up to it by the merger, as the Board has found in five consecutive oversight decisions.<sup>26</sup> In its final annual oversight decision, the Board concluded that "BNSF has competed vigorously for the traffic opened up to it by the BNSF Agreement and has become an effective competitive replacement for the competition that would otherwise have been lost or reduced when UP and SP

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<sup>24</sup> See also BN/SF-55, Kalt V.S. at 42 ("A proper analytic framework asks whether BN/Santa Fe can come to the post-merger marketplace with at least as much competitive vigor as SP would possess in the non-merger environment.").

<sup>25</sup> For example, BNSF's witness Smith claims that the 0.2-mill rate puts BNSF at a \$46.26 disadvantage for traffic moving between Denver and Stockton. See BNSF-102, Smith V.S. at 4. Messrs. Klick and Kent showed that BNSF expected its variable costs between Denver and Sacramento, which is near Stockton, to be \$135 higher than UP's variable costs. See BN/SF-55, Klick & Kent V.S. at 50 (Table 6). A few other examples further illustrate the basic point: between Houston and Chicago, BNSF expected its variable costs to be \$92 higher than UP's; between Chicago and Salt Lake City, the difference was \$137; between Chicago and Oakland, the difference was \$225. See id. BNSF thus appears to be much better off than it expected.

<sup>26</sup> See Union Pacific Corp. – Control & Merger – Southern Pacific Rail Corp., STB Finance Docket 32760 (Sub-No. 21), Decision No. 16 (STB served Dec. 15, 2000); Union Pacific Corp. – Control & Merger – Southern Pacific Rail Corp., STB Finance Docket 32760 (Sub-No. 21), Decision No. 15 (STB served Nov. 30, 1999); Union Pacific Corp. – Control & Merger – Southern Pacific Rail Corp., 3 S.T.B. 987 (1998); Union Pacific Corp. – Control & Merger – Southern Pacific Rail Corp., 2 S.T.B. 703 (1997).

merged.” Union Pacific Corp. – Control & Merger – Southern Pacific Rail Corp., STB Finance Docket 32760 (Sub-No. 21), Decision No. 21 (STB served Dec. 20, 2001), slip op. at 4.

The Board’s conclusion endorsed BNSF’s own pride in its competitive success. In its final oversight report, BNSF told the Board that it “has been and continues to be an aggressive and effective competitor utilizing the rights it obtained pursuant to the BNSF Settlement Agreement and the conditions imposed by the Board.” See, e.g., BNSF-PR-20 at 2. Before the merger, BNSF told the Board “that it would grow the traffic associated with its rights . . . to the size and scale of a new Class I railroad.” Id. at 4. Five years later, BNSF reported that it had met that commitment and, in fact, “has exceeded that goal.” Id. Even though it had already exceeded its goal, BNSF said that it “anticipates the continued customer growth and commercial success of its UP/SP franchise.” Id. at 7.

Nonetheless, BNSF warns that it may not be competitive in the future. Its concerns are not credible. BNSF claims that UP will take away all of BNSF’s traffic because UP will always be able to underbid BNSF by \$25.00 to \$50.00 per car. BNSF-102, Smith V.S. at 3. If BNSF’s theory were accurate, UP would already handle all of the competitive business over the trackage rights lines, because UP has had this cost advantage for years. Yet BNSF has captured substantial amounts of competitive business using its trackage rights. See UP/SP-384, Confidential App. B. BNSF has “exceeded” its own ambitious goals. BNSF-PR-20 at 4.

BNSF must disavow five years of its own oversight reports in order to argue that the fees are too high to permit it to compete or that BNSF will be unable to compete in the future. The Board would have to ignore five years of oversight decisions in order to agree. The fees BNSF has paid in the past have not hindered its ability to compete, and there is no prospect that

BNSF's position will worsen in the future. Public policy concerns do not justify Government assistance to promote BNSF's interests.

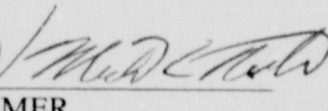
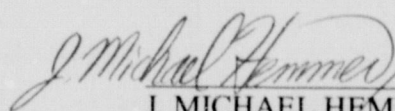
CONCLUSION

BNSF has had two opportunities to show that UP and BNSF mutually agreed in some way to depart from the BNSF Settlement Agreement's plain language. BNSF has failed both times. The Board should dismiss BNSF's petition with prejudice.

Respectfully submitted,

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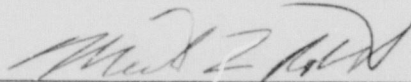
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*Attorneys for Union Pacific Corporation,  
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June 19, 2002

CERTIFICATE OF SERVICE

I hereby certify that on this 19th day of June, 2002, I caused a copy of the foregoing "UP's Reply to BNSF's and CMA's Responses to Order to Show Cause" to be served by first-class mail, postage prepaid, or by a more expeditious manner of delivery on all parties of record in Finance Docket No. 32760 (Sub-No. 21).

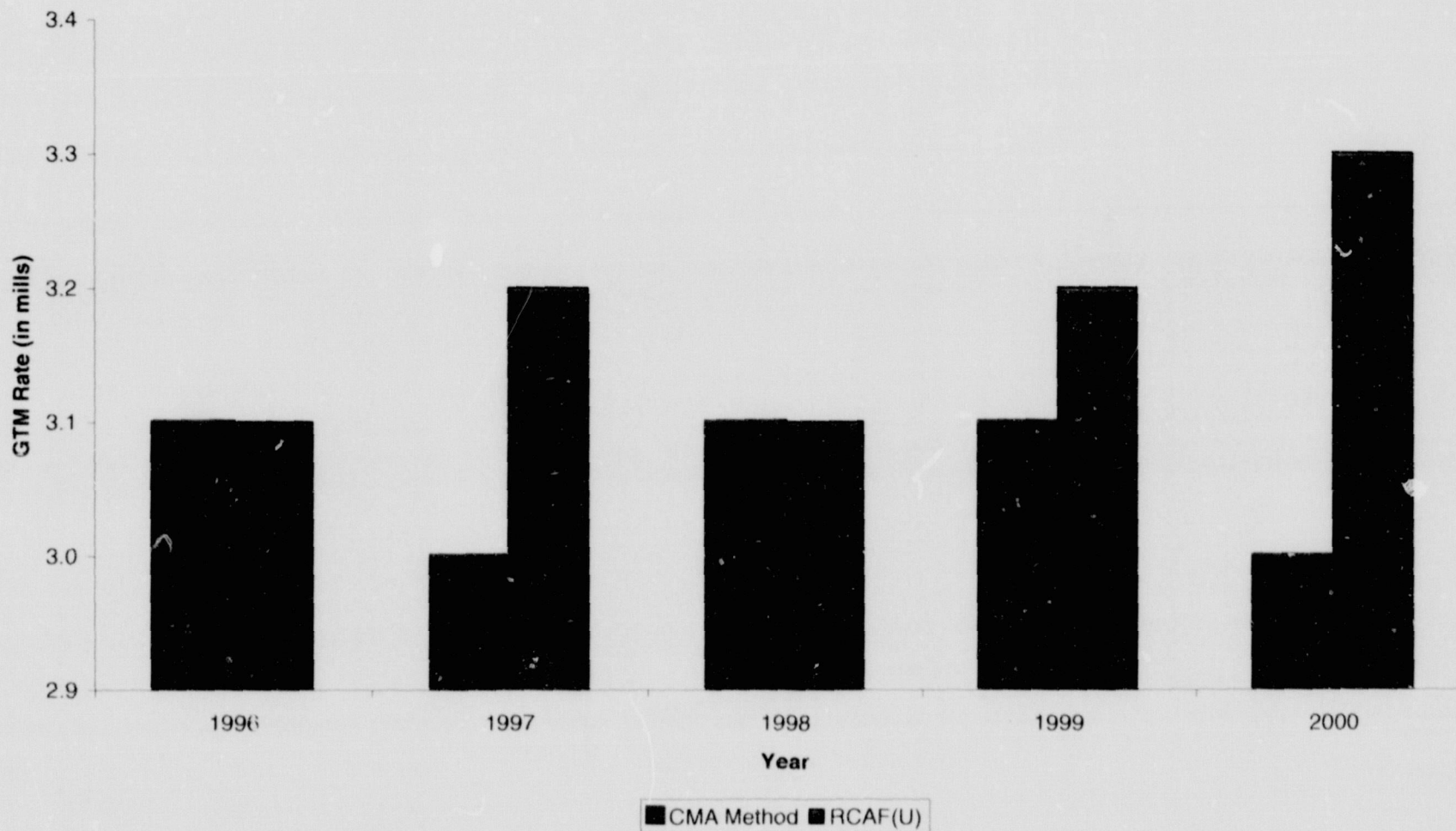


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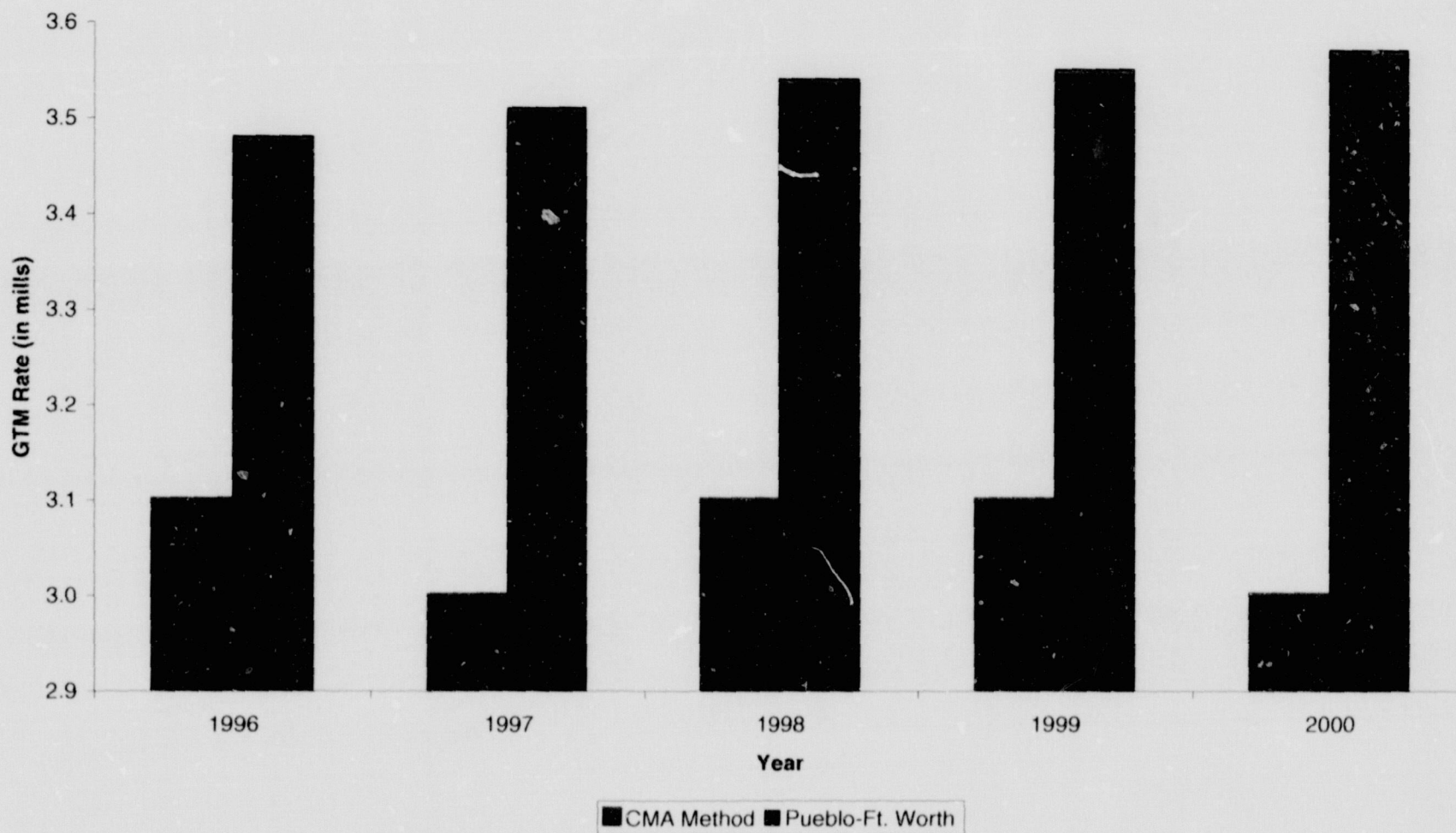
Michael L. Rosenthal

## Charts

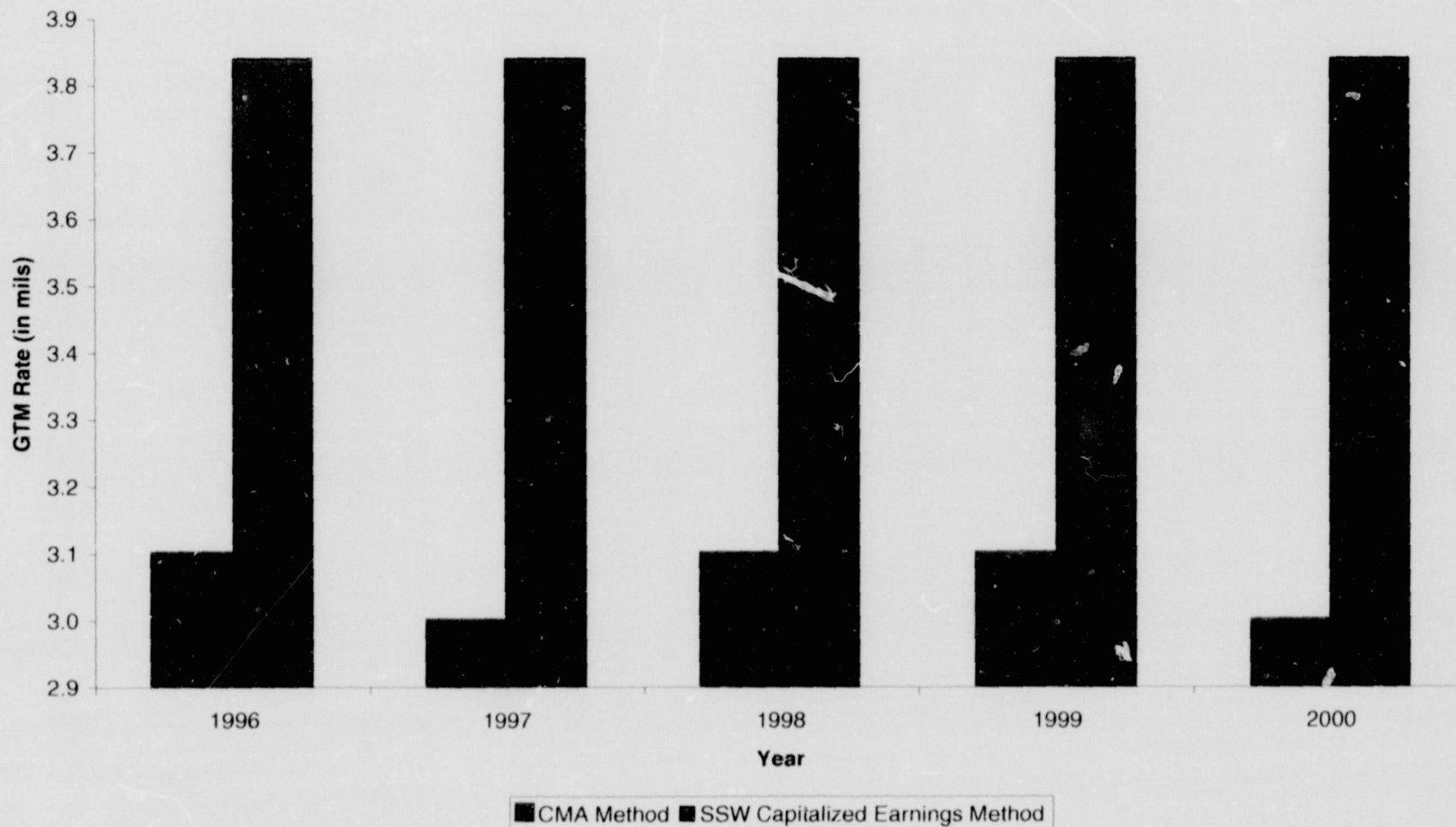
**Chart 1**  
**Adjustments in 3.1 Mill Rate Using CMA Method**  
**Compared with Adjustments in 3.1 Mill Rate Using 70 Percent of RCAF(U)**



**Chart 2**  
**Adjustments in 3.1 Mill Rate Using CMA Method**  
**Compared With Adjustments in Pueblo-Ft. Worth Rate Using 75 Percent of RCAF(U)**



**Chart 3**  
**Adjustments in 3.1 Mill Rate Using CMA Method**  
**Compared With Trackage Rights Rate Calculated Using SSW Capitalized Earnings Method**



**Rebendorf**

**VERIFIED STATEMENT**  
**OF**  
**JOHN H. REBENS DORF**

My name is John H. Rebensdorf. I am Vice President-Network and Service Planning for Union Pacific Railroad Company. I hold a Bachelor's Degree in Civil Engineering from the University of Nebraska and a Master's Degree in Business Administration from Harvard University. Before coming to UP, I was employed as a management consultant by Temple, Barker and Sloane. I have worked in the Mechanical Department of the Chicago, Burlington & Quincy Railroad and in the Operating and Engineering Departments of the Chicago, Rock Island and Pacific Railroad. I joined UP in 1971 as Manager of Budget Research. I became Assistant Controller in 1976, Assistant Vice President-Planning and Analysis in 1980, Assistant Vice President-Finance in 1984, and Vice President-Strategic Planning in 1987, and I was appointed to my present position in 1998.

I. THE ORIGINAL BNSF SETTLEMENT AGREEMENT

When UP and SP decided to merge, UP charged me with responsibility for negotiating an agreement that would preserve rail competition for all of our customers who had been served by UP and SP and no other railroad ("2-to-1" customers). I described this assignment and the resulting agreement with BNSF in the UP/SP Merger Application. See UP/SP-22, Rebensdorf V.S. at 292-316. I was involved in every meeting in which the original BNSF Settlement Agreement was negotiated and drafted. I presented the BNSF Settlement Agreement as an attachment to my verified statement in UP/SP-22.

In order to preserve competition for "2-to-1" customers, UP negotiated trackage rights and line sales with BNSF that would provide service to most of those customers. We also negotiated the fees that BNSF would pay for its trackage rights.

The fee negotiations between UP and BNSF focused on other recent trackage rights agreements between the parties. In particular, we considered BNSF's agreement with SP that addressed competitive concerns arising from the BN/Santa Fe merger, which the Interstate Commerce Commission had approved just three months earlier. The rates under that agreement were initially 3.0 mills per gross ton-mile for bulk traffic and 3.48 mills per gross ton-mile for all other traffic. These rates were subject to an annual adjustment mechanism based on 75 percent of the RCAF(U).

After extensive, arms-length negotiations, we agreed on rates of 3.0 mills per gross ton-mile for bulk traffic and 3.1 mills per gross ton-mile for most carload and intermodal traffic. We also agreed to adjust the rates annually by applying 70 percent of the RCAF(U) to the rates. We agreed to use an RCAF(U) adjustment because it was used in the BN/Santa Fe merger, it is commonly used in the industry, and it provides a simple, straightforward method for adjusting the rates.

The parties negotiated the rate levels for the trackage rights. We never discussed assumptions about the parties' costs, and we never exchanged information about costs.<sup>1</sup> We never discussed purchase accounting or whether the rates reflected the SP purchase price. We never discussed the timing of UP's accounting for the UP/SP merger. Almost all of BNSF's

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<sup>1</sup> Our only discussions about costs involved (i) our agreement that the trackage rights fee included capitalized track maintenance costs (costs for replacing rails, ties, and other track material), so UP would not charge BNSF separately for program track maintenance on the trackage rights lines, and (ii) our agreement to use a mechanism in addition to the RCAF(U) adjustment designed to ensure that costs do not get out of line with the trackage rights charges.

arguments – all of its claims about double counts and manipulations – assume that the initial fees reflected purchase accounting costs, but the parties did not negotiate or agree about costs or cost-based fees: our goal was to agree upon trackage rights fees that we and the Board could accept.

I have reviewed Carl Ice's and Richard Weicher's verified statements describing the September 1995 negotiations. Messrs. Ice and Weicher discuss their views and assumptions about how the initial fees related to BNSF's costs and whether the rates covered UP's costs. As Mr. Ice admits, however, the parties never exchanged any cost data. See BNSF-102, Ice V.S. at 6. During the negotiations, BNSF never shared any views or assumptions about costs. If they had, we could have corrected any misimpressions and resolved any differences.

Messrs. Ice and Weicher also make assertions about their own intent and their assumptions regarding UP's intent with respect to purchase accounting for the UP/SP merger. During the negotiations, however, they never described their intent or asked about UP's intent. They never mentioned purchase accounting, "merger premiums," or anything of that nature in connection with the trackage rights fees. If BNSF made any assumptions about whether the initial rate reflected purchase accounting or the timing of UP's accounting for the UP/SP merger, they never shared them with UP. UP did not consider these issues, and I would be surprised if BNSF actually considered them, since under a flat-rate agreement with an RCA(U) adjustment, purchase accounting was irrelevant.

UP had no secret intent. UP sought simply to establish rates that the parties and the Board would accept and that would cover operating and maintenance costs while contributing to investment and other fixed costs. UP intended to agree to the initial rates and the adjustment mechanism as set forth in the BNSF Settlement Agreement's plain language.

Messrs. Ice and Weicher misleadingly argue that the BNSF Settlement Agreement reflects the parties' mutual intent to include purchase accounting in the initial rates. They point to the provision allowing the parties to revisit the adjustment mechanism every five years to insure that the rates and costs retain the "same basic relationship as upon execution of the Agreement." This "truing" provision reflects the parties' understanding that the RCAF(U) adjustment might not accurately track changes in operating costs. It does not say that the initial rate included or excluded purchase accounting.

Messrs. Ice and Weicher also make misleading references to my earlier statements that the trackage rights fees are "comprehensive." I described the flat rates as comprehensive because they combine into one fee the several elements included in traditional joint facility arrangements. Unlike traditional joint facility arrangements, the parties are not required to calculate and pay separate charges for operations, maintenance, and rent. We agreed with BNSF to use flat rates to eliminate the substantial clerical work and expense associated with traditional joint facility arrangements. Including in the rates the effects of an annual fee adjustment, whether based on RCAF(U) or based on URCS, does not make the fee any less comprehensive: BNSF still only pays one fee to engage in routine trackage rights operations.<sup>2</sup> Since the parties never discussed purchase accounting, I did not intend to include it within the term "comprehensive."

Messrs. Ice and Weicher also discuss UP's agreement to pay for capacity improvements on trackage rights that were necessary to achieve the benefits of the UP/SP

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<sup>2</sup> I refer to "routine" trackage rights operations because the BNSF Settlement Agreement contains separate provisions regarding funding for capital improvements other than track programs, employee protection benefits, and liability for loss and damage – elements that are not included in the flat fee. See BNSF Settlement Agreement § 9(c), (e) & (f).

merger. UP and BNSF agreed in the September 1995 negotiations that BNSF would not have to pay for such improvements. BNSF was required, however, to pay its share of capital expenditures on trackage rights lines other than those related to capacity improvements necessary to achieve the merger's benefits. The costs of these capital expenditures were not included in the trackage rights fee. In order to minimize disputes about which capital expenditures were capacity improvements necessary to achieve the merger's benefits, we agreed to a simple procedure under which UP would pay for any capacity improvements on trackage rights lines for 18 months following the merger. We had no reason in September 1995 to engage in detailed discussions about whether these costs would affect the fee adjustment, because they would have no impact under the RCAF(U) adjustment provision. The parties' intent was to determine how to handle expenditures required for the capacity improvements; we did not intend to address future affects on UP's system-average costs associated with the improvements. In the Merger Application, I described these provisions as providing "relief from capital expenditures at the inception of trackage rights operations." See UP/SP-22, Rebensdorf V.S. at 309. We never discussed the effects on URCS, because the BNSF Settlement Agreement did not include an URCS adjustment provision at the time.

## II. THE CMA AGREEMENT

In response to several concerns about the BNSF Settlement Agreement, UP further expanded the rights granted to BNSF. Many of these enhancements were embodied in an agreement with the Chemical Manufacturers Association ("CMA"). BNSF was also a party to this agreement. I was part of the team that developed UP's position in the negotiations with CMA, and I described the changes and clarifications to the BNSF Settlement Agreement and other matters that we agreed on with CMA and BNSF in my rebuttal verified statement in the merger proceedings. See UP/SP-231, Rebensdorf R.V.S. at 5-11. Although most of the face-to-

face negotiations between UP and CMA were handled by the late Arvid E. Roach II, UP's outside counsel, Mr. Roach was in constant communication with the rest of the UP team and apprised us of all developments.

One concern the CMA Agreement addressed involved the method for adjusting the trackage rights fees. CMA and others argued that the RCAF(U) method would, over time, result in BNSF's paying fees that were greater than UP's actual costs of maintaining and operating the trackage rights lines. I did not agree, because the "truing" provision described above was designed to ensure that costs do not get out of line with the trackage rights fees, and because BNSF had already concluded that it could compete under the BNSF Settlement Agreement's terms. Also, UP must pay BNSF a higher fee that is also escalated at a higher percentage of the RCAF(U) for the trackage rights granted to SP to solve the competitive problems of the BN/Santa Fe merger. Nonetheless, in order to eliminate the issue, UP agreed to adopt the fee adjustment provision proposed by CMA.

The URCS adjustment mechanism was CMA's idea. CMA's expert witness in the merger proceedings, Thomas D. Crowley, argued for an adjustment mechanism based on changes in UP's URCS costs. He described which URCS cost categories should be included. He also explained how the procedure would work, using a one-year lag "so that the 1997 adjustment would be based on the change in costs between 1995 and 1996." CMA-7, Crowley V.S. at 57 & Ex. (TDC-11).

UP agreed to adopt Mr. Crowley's proposal and his procedure. We agreed to use the URCS components that Mr. Crowley had identified. We also agreed that the adjustment should reflect a one-year lag so that the 1997 adjustment would be based on the difference in UP's 1995 and 1996 system average URCS costs. We recognized that the one-year lag made

sense, because the Board's URCS calculations were typically not available until several months after the end of the year in question. By using a one-year lag, we could adjust the rate and apply it immediately. This provided certainty to the tenant and avoided the extra work that retroactive adjustments would have required. It was also important to us that, like the RCAF(U) adjustment, the URCS adjustment would be a straightforward process that relied on a neutral source of data and that avoided complex computations and adjustments.

To the best of my knowledge, in the negotiations regarding the CMA Agreement, neither CMA nor BNSF ever suggested that UP's URCS should be modified to exclude the effects of purchase accounting or the costs of capacity improvements UP had agreed to pay. Neither CMA nor BNSF ever suggested that the adjustment should be based only on post-merger URCS. Neither CMA nor BNSF ever told UP that they understood the initial trackage rights fees already included the anticipated effects of purchase accounting. Neither CMA nor BNSF ever mentioned purchase accounting, "merger premiums," or anything of that nature in connection with the provision for adjusting trackage rights fees. If CMA or BNSF had raised any of these issues, I am certain that Mr. Roach would have informed me and the rest of the UP team.

I described UP's understanding of the fee adjustment provision in my rebuttal testimony in the merger proceeding on April 29, 1996, less than two weeks after the parties had signed the CMA Agreement. My testimony reinforced three points that were clear from the parties' discussions and Mr. Crowley's testimony: (i) the adjustment would be made on July 1 of each year; (ii) the adjustment would include a lag period, so the comparison each year would involve the two preceding years; and (iii) the URCS costs used to calculate the adjustment would include depreciation and return on investment.

I believe I accurately reflected the parties' intent in the CMA Agreement. Once again, UP had no secret intent. We intended to replace the original RCAF(U) adjustment with a new but equally simple means of calculating an annual adjustment to the already agreed-upon rates. We intended to do this by adopting CMA's proposal as reflected in Mr. Crowley's statement. Until BNSF began this latest proceeding, no one ever suggested to me that my statement of the parties' agreement was inaccurate in any respect. I am certain that BNSF and CMA would have objected in 1996 had I erred in any way.

### III. THE SECOND SUPPLEMENTAL AGREEMENT TO THE BNSF SETTLEMENT AGREEMENT

UP and BNSF signed the Second Supplemental Agreement to the BNSF Settlement Agreement on June 27, 1996. The Second Supplemental Agreement was designed to place into one document the additions and revisions to the original BNSF Settlement Agreement necessary to implement the CMA Agreement, as well as additional changes unilaterally offered by UP to address concerns of shippers and clarifications negotiated between UP and BNSF to address issues that had arisen in developing detailed implementing agreements for the trackage rights.

The negotiations regarding the Second Supplemental Agreement occurred largely through the exchange of drafts and telephone calls between Paul A. Conley, Jr., UP's Assistant Vice President-Law, and Richard E. Weicher, one of BNSF's in-house lawyers. Throughout the negotiating process, Mr. Conley was in contact with me and the rest of the UP team, and he apprised us of all developments. I reviewed every draft UP provided to BNSF or vice versa, and Mr. Conley relayed any comments from his BNSF counterpart to me and the rest of the UP team. The parties' negotiations were detail-oriented and intense, and Mr. Conley called on the people

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May 22, 2002

VIA HAND DELIVERY

The Honorable Vernon A. Williams  
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Re: Finance Docket No. 32760, Union Pacific Corporation, et al. -- Control and Merger -- Southern Pacific Rail Corporation, et al.

Dear Secretary Williams:

Enclosed for filing in the above-captioned proceeding are the original and twenty-five (25) copies of The Burlington Northern and Santa Fe Railway Company's Response to Order to Show Cause Why BNSF-98 Petition for Clarification Should Not Be Dismissed (BNSF-102) and the Highly Confidential Appendix to BNSF-102. Also enclosed is a disk with the text of the pleading in Word Perfect 9 format.

BNSF has served copies of the cover pleading of BNSF-102 and supporting verified statements on all parties of record in Finance Docket No. 32760. Any counsel or consultants who would like a copy of the Highly Confidential Appendix and who have signed a highly confidential undertaking in Finance Docket No. 32760 should contact Adrian Steel at 202-263-3237.

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

Sincerely,

*Erika Z. Jones/als*

Erika Z. Jones

ENTERED  
Office of the Secretary  
MAY 23 2002  
Part of  
Public Record

Enclosures

cc: All Parties of Record

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Brussels Charlotte Chicago Cologne Frankfurt Houston London Los Angeles Manchester New York Palo Alto Paris Washington D.C.  
Independent Mexico City Correspondent: Jauregui, Navarrete, Nader y Rojas, S.C.

Mayer, Brown, Rowe & Maw is a U.S. General Partnership. We operate in combination with our associated English partnership in the offices listed above.

BEFORE THE  
SURFACE TRANSPORTATION BOARD

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Finance Docket No. 32760

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

-- CONTROL AND MERGER --

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

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BNSF'S RESPONSE TO ORDER TO SHOW  
CAUSE WHY BNSF-98 PETITION FOR CLARIFICATION  
SHOULD NOT BE DISMISSED

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Jeffrey R. Moreland  
Richard E. Weicher  
Sidney L. Strickland, Jr.  
Michael E. Roper

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Attorneys for The Burlington Northern and Santa Fe Railway Company

May 22, 2002



BEFORE THE  
SURFACE TRANSPORTATION BOARD

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BNSF-102

Finance Docket No. 32760

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

-- CONTROL AND MERGER --

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

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BNSF'S RESPONSE TO ORDER TO SHOW  
CAUSE WHY BNSF-98 PETITION FOR CLARIFICATION  
SHOULD NOT BE DISMISSED

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The Burlington Northern and Santa Fe Railway Company ("BNSF") submits this Response to the Surface Transportation Board's directive in Decision No. 96 in this proceeding that BNSF show cause why its Petition for Clarification of the Trackage Rights Fee Adjustment Provision (BNSF-98) should not be dismissed. In its Petition, BNSF sought a clarification as to whether, as part of the process of the annual adjustment of the trackage rights fees under Section 12 of the BNSF Settlement Agreement, BNSF (and derivatively its customers on the UP/SP trackage rights lines) should be required to pay trackage rights fees that are inflated to reflect the purchase premium that UP paid when it acquired SP and/or to reflect certain merger-related capital expenditures that were to be solely funded by UP under Section 9(c) of the

Settlement Agreement. UP filed a Motion to Dismiss the Petition for failure to state a claim (UP/SP-392).

In its decision, the Board concluded that BNSF had not submitted evidence that the two disputed items should be excluded from the Section 12 adjustment process. However, because the Board recognized that "it is important that the trackage rights fee adjustment mechanism work as intended, so that any increases or decreases in UP's costs are properly-reflected in the agreed-upon adjustments to the trackage rights fee",<sup>1</sup> the Board afforded BNSF the opportunity to demonstrate that the disputed items should not be reflected in the Section 12 adjustment factor. Decision No. 96 at 6.

Accordingly, in this response to the Board's directive and in the attached Verified Statements of Carl R. Ice and Richard E. Weicher who negotiated the BNSF Settlement Agreement on BNSF's behalf, BNSF shows that the parties to the Settlement Agreement intended the trackage rights rates to be comprehensive and all-inclusive reflections of UP's costs, including the SP purchase premium and the merger-related capital expenditures which UP was to fund. Because these costs were fully accounted for within the gross ton-mile ("GTM") mill rates set forth in the Settlement Agreement, subsequent adjustments of those rates were **not** to be based on those items.

Further, the CMA Agreement established a mechanism for adjusting the GTM mill rates in accordance with changes in UP's actual maintenance and operating costs associated with the trackage rights lines. All parties to the CMA Agreement indicated

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<sup>1</sup> Union Pacific Corporation, Union Pacific Railroad Company, and Missouri Pacific Railroad Company—Control and Merger—Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corp., and The Denver and Rio Grande Western Railroad Company [General Oversight], STB Finance Docket No. 32760 (Sub-No. 21), Decision No. 21 (STB served Dec. 20, 2001) (General Oversight Dec. No. 21), slip op. at 6.

their concurrence that **post**-merger years were to be compared when calculating the annual changes in UP's URCS costs. It is because UP elected to book the purchase premium in 1997, rather than 1996 when the acquisition occurred, that this cost is counted twice in the GTM mill rates.

As shown in the attached Verified Statement of Christopher D. Kent, UP's proposed methodology for calculating the Section 12 adjustment factor results in the comparison of URCS costs from a **pre**-merger year with URCS costs from a **post**-merger year, thereby causing a one-time artificial increase in the GTM mill rates of approximately 0.2 mills. This comparison of pre-merger costs with post-merger costs constitutes an impermissible double-counting of the SP purchase premium and the merger-related capital expenditures, contrary to the terms and intent of both the BNSF Settlement Agreement and the CMA Agreement. Finally, as described in the attached Verified Statement of Denis J. Smith, BNSF's Vice President, Industrial Products Marketing, this differential between BNSF's and UP's adjustment methodologies can affect BNSF's competitive presence on the trackage rights lines not only in the near-term but also over the 99-year term of the BNSF Settlement Agreement.

**I. THE BNSF SETTLEMENT AGREEMENT: THE PARTIES' INTENT TO ADOPT COMPREHENSIVE GTM MILL RATES THAT ACCOUNT FOR ALL OF UP'S KNOWN OR ANTICIPATED COSTS, INCLUDING THE SP MERGER PREMIUM AND THE MERGER-RELATED IMPLEMENTATION COSTS**

The terms for the trackage rights compensation under the BNSF Settlement Agreement were a critical part of the negotiations between UP/SP and BNSF which took place in September of 1995. Verified Statement of Carl R. Ice (hereinafter "Ice V.S.") at 2. The purpose of those negotiations was to address and seek to resolve BNSF's opposition to the UP/SP merger and to reach agreement on the terms under which

BNSF would provide service to preserve the pre-merger competition between UP and SP that would otherwise be lost as a result of their merger. Ice V.S. at 1-2; Verified Statement of Richard E. Weicher (hereinafter "Weicher V.S.") at 1.

It was important to BNSF in the negotiations that BNSF be able, after the UP/SP merger, to offer competitive pricing and that the rates of compensation for BNSF operations on trackage rights lines would not place BNSF at a competitive disadvantage with UP/SP as the landlord railroad. Ice V.S. at 2; Weicher V.S. at 2. In turn, it was important to UP that the trackage rights fees should reimburse it for all costs associated with BNSF's trackage rights operations, plus a factor for a reasonable rate of return on the capital in the trackage rights lines that BNSF would be using. Ice V.S. at 2. And, it was also important to both parties that, once rates had been agreed upon that would allow BNSF to provide competitive service and UP to cover its costs associated with BNSF's operations, their respective interests would continue to be protected over the term of the Settlement Agreement. Ice V.S. at 2-3.<sup>2</sup>

As Mr. Ice states, the rates agreed to were very close to the upper limit of what BNSF could accept and still offer competitive service. Ice V.S. at 2. Thus, BNSF was concerned that changes in UP/SP's costs would not enable UP/SP to gain a competitive advantage and make BNSF noncompetitive for particular movements – i.e., the reductions in costs which UP/SP projected as a result of the merger should be passed

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<sup>2</sup> In this regard, John H. Rebensdorf, one of UP's principal negotiators in the settlement discussions, stated in his Verified Statement submitted with the UP/SP Application, that it was "the intent that the trackage rights rate place both carriers on a level playing field with neither subsidizing the other." UP/SP-22 at 301. (Copies of excerpts from pleadings cited herein are attached.)

on to BNSF in the form of lower GTM mill rates.<sup>3</sup> Ice V.S. at 2. UP was concerned that it should be able to adjust the rates to account for increases in its costs. Ice V.S. at 2-3.

After extensive negotiation, UP/SP and BNSF agreed on GTM mill rates comparable to other then-current trackage rights agreements. Ice V.S. at 3.<sup>4</sup> Both UP/SP and BNSF intended that the GTM mill rates would be comprehensive and all-inclusive. Thus, as Mr. Ice explains, "It was my understanding of both sides' intent that the GTM mill rates that had been agreed to were comprehensive, and that BNSF would not be expected to pay increased rates based on costs that were already known and taken into account in the negotiations." Ice V.S. at 4.<sup>5</sup> Mr. Ice goes on to explain that

[w]hen BNSF entered negotiations with UP/SP concerning the GTM mill rates, BNSF was aware that UP had agreed to pay a substantial premium above book value to purchase SP, and we knew that the premium would be an expense that UP would bear to effect the merger. \* \* \* Nothing in the negotiations indicated that either party contemplated that the GTM mill rates would not take account of the purchase premium. To the contrary, it was my fundamental belief that negotiators for both BNSF and UP/SP always intended that the rates agreed to in the September 1995 negotiations were inclusive of all of UP's costs and return on investment in the

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<sup>3</sup> In this regard, it was BNSF's position that changes in UP/SP's costs should not enable UP/SP to gain a competitive rate advantage. UP/SP had projected substantial improvements in efficiency, and it was important to BNSF that reductions in costs of the merged entity should be passed on to BNSF in the form of lower rates for trackage rights. Ice V.S. at 2; Weicher V.S. at 4.

<sup>4</sup> The parties agreed that the rate for most carload and intermodal traffic would be 3.1 mills per GTM and that the rate for bulk traffic would be 3.0 mills per GTM. The parties also agreed that the rates would be based on ton-miles rather than car-miles because it was their belief that this would more accurately reflect the actual use made of the trackage rights lines and thus the resulting expense to UP/SP. This conclusion was based on the great variation in size and types of cars and their capacity and BNSF's belief that ton-miles is a more meaningful measure of use. Ice V.S. at 3-4.

<sup>5</sup> This intent also was expressed by UP's own Mr. Rebensdorf who stated in his Verified Statement that the "rate is comprehensive." UP/SP-22 at 308.

merged UP/SP, including UP's purchase price for acquiring SP, and those mill rates would **not** be subject to adjustment in a subsequent year to take account of these costs.

Ice V.S. at 4-5 (emphasis added). See also Ice V.S. at 6 (stating that "UP/SP shared our understanding that UP would be compensated in the GTM mill rates for all of its costs of any nature").

Mr. Weicher's Verified Statement also sheds light on the parties' intent with respect to the "comprehensive" nature of the GTM mill rates:

We viewed the GTM mill rates as covering all UP/SP's merger-related costs, including merger-related capital expenditures. I believed that the parties agreed that the GTM mill rates covered all merger-related costs. In other words, it was intended by BNSF and UP/SP that the GTM mill rates were comprehensive and were intended to be inclusive of all the costs of UP/SP associated with the trackage rights operations and the UP/SP merger for which BNSF had any responsibility. There was no basis for adding an element to reflect additional compensation to UP for the SP purchase premium or any merger implementation costs.

Weicher V.S. at 2-3.

Thus, BNSF was not to be required to pay any additional amounts nor were the GTM mill rates to be increased as a result of either the purchase premium or UP/SP's merger-related expenditures. See Ice V.S. at 7 ("It was BNSF's position during our negotiations that UP/SP should bear the full responsibility for these anticipated capital expenditures and that the GTM mill rates should not be increased as a result of those expenditures.").

When the parties agreed to the comprehensive GTM mill rates, they specifically agreed that the initial relationship between GTM mill rates and UP's costs related to the trackage rights be maintained throughout the term of the Settlement Agreement:

It is the intention of the parties that rates and charges for trackage rights and services under this Agreement reflect the same basic relationship to operating costs as upon execution of this Agreement.

Section 12 of the Settlement Agreement.

The parties also recognized that the initial GTM mill rates would need to be subject to adjustment to reflect changes in UP/SP's costs. It was agreed to use 70% of RCAF-U to enable BNSF to share in UP/SP productivity gains. Ice V.S. at 9; Weicher V.S. at 4. The parties also recognized the possibility that unforeseen developments could cause the adjustment mechanism to be ineffective in achieving the intent of the parties, and language was included in the Settlement Agreement which provided either party with the right to request a review and renegotiation of the adjustment mechanism every five years. Ice V.S. at 9; Weicher V.S. at 4.

**II. THE CMA AGREEMENT: THE PARTIES' INTENT TO BASE THE ADJUSTMENT OF THE RATES ON COMPARISONS OF POST-MERGER COSTS**

In response to criticism from the Chemical Manufacturers Association (now, the American Chemistry Council) and others concerning the level of the GTM mill rates as well as the use of 70% of RCAF-U as the basis for the annual adjustments to those rates, UP/SP, CMA and BNSF negotiated and executed the CMA Agreement in April of 1996. Weicher V.S. at 5. The annual adjustment mechanism was revised by Section 7 of the CMA Agreement which provides:

Section 12 of the BN/Santa Fe Settlement Agreement shall be amended to provide that BN/Santa Fe's trackage rights fees shall be adjusted upward or downward each year by the difference between the year in question and the preceding year in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the fee. CMA or its designee shall have the right to audit the escalation calculations. (Emphasis added.)

The intent of this revision was to reflect changes in UP/SP's own maintenance and operating costs more accurately than was possible using RCAF-U rail industry data. *Weicher V.S.* at 5-6. It was **not** the parties' intent that, by using URCS data, UP would be able to increase the trackage rights rates based on costs that had already been taken into account in agreeing on the level of rates, such as the premium that UP was paying to acquire SP and the merger-related costs covered in the BNSF Settlement Agreement, Sections 9(c)(i) and 9(c)(iii). See *Weicher V.S.* at 6.

To this end, as the language set forth above reflects, Section 7 of the CMA Agreement provided for an annual adjustment mechanism in which URCS costs from one **post**-merger year would be compared with URCS costs from another **post**-merger year. However, the methodology which UP uses results in the comparison of URCS costs from what UP has, in effect, booked as a **pre**-merger year (1996) with URCS costs from a **post**-merger year (1997). See Verified Statement of Christopher D. Kent (hereinafter "*Kent V.S.*") at 2; see also *Weicher V.S.* at 10-11.

UP's flawed annual adjustment approach results from at least two different factors. First, UP apparently did not book the purchase premium in its 1996 URCS costs even though UP acquired control of SP in 1996. This effectively made 1996 a pre-merger year for purposes of the comparison of URCS costs – a development that was not and could not have been anticipated by BNSF and is contrary to the parties' clear intent in Section 7 of the CMA Agreement. See *Weicher V.S.* at 6. Second, UP modified the language of the Section 7 revision of the adjustment mechanism in the Second Supplemental Agreement to alter the practical application of the revised mechanism. UP's language provided that the GTM mill rates would be adjusted on July

1 of each year by the difference in the relevant URCS costs for the preceding two years. While BNSF agreed to this change, there was no reason for BNSF to anticipate that UP would disregard the clear intent and concurrence of the parties that the GTM mill rates already included the effects of the purchase premium and merger-related costs for which UP took sole responsibility in Section 9(c).<sup>6</sup>

Accordingly, if pre-merger years are to be used for purposes of the annual adjustments to the GTM mill rates, appropriate adjustments must be made to the URCS costs in such years in order to account for the fact that the SP purchase premium and the Section 9(c) implementation expenditures which UP was to fund (both of which would be included in all post-merger years) are not reflected in pre-merger years.

### **III. IMPACT OF DISPUTED ITEMS ON GTM MILL RATES**

In order to determine the impact of the disputed items on the GTM mill rates, BNSF requested Christopher D. Kent of FTI Consulting, Inc. (i) to identify the differences between the BNSF-proposed approach to adjusting the GTM mill rates and the approach proposed by UP, and (ii) to quantify the impact of UP's proposal to include the premium above book value which UP paid for SP in its adjustment of the trackage

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<sup>6</sup> It should be noted in this regard that, while BNSF executed the Second Supplemental Agreement and has agreed to the continued inclusion of UP's language in the Restated and Amended BNSF Settlement Agreement, it was BNSF's expectation and understanding that the language would be interpreted and applied in such a manner that all comparisons of URCS costs would be between post-merger years. See Weicher V.S. at 6-7. This understanding was based on the express language in Section 7 of the CMA Agreement and on the fact that BNSF reasonably understood that UP would book the purchase premium in 1996, thus making it a post-merger year. Indeed, it was not until BNSF audited UP's annual rate adjustment calculations in late 2000 that BNSF first had any indication that UP was interpreting the language in a manner inconsistent with Section 7 of the CMA Agreement. Throughout the parties' negotiations concerning the GTM rate adjustment, BNSF has consistently expressed its understanding that only URCS costs from post-merger years should be used to make the annual rate adjustment calculations.

rights rates effective July 1, 1998. BNSF also requested Mr. Kent to determine whether UP's approach affects the "basic relationship" between the trackage rates and UP's costs.

As shown in his Verified Statement, Mr. Kent estimates that including the SP purchase premium in the adjustment calculation, in the manner UP proposes, would increase the GTM mill rates by approximately 0.2 mills. Kent V.S. at 3-4. Further, Mr. Kent has concluded that the UP approach to adjusting the GTM mill rates results in a greater deviation from the "basic relationship" between the trackage rights rates and UP's operating costs that existed in September 1995 at the time of the execution of the BNSF Settlement Agreement than does the use of BNSF's approach. Id. at 5.

#### **IV. IMPACT OF DISPUTED ITEMS ON BNSF'S COMPETITIVENESS**

In Decision No. 96, the Board questioned whether the amount in dispute here has any significant impact on BNSF's ability to maintain its success in establishing a competitive presence over the trackage rights lines. Specifically, the Board noted that the disputed costs amount to approximately 5.7 to 6.7 percent of the GTM mill rates and that, while such increases were not by themselves insignificant, they were misleading in assessing BNSF's competitiveness with UP since BNSF's trackage rights fees are only a small part of its overall total costs. Decision No. 96 at 6. However, as set forth in the attached Verified Statement of Denis J. Smith, BNSF's Vice President, Industrial Products Marketing (hereinafter "Smith V.S."), the amounts represented by the disputed items can readily affect BNSF's competitive presence. As Mr. Smith explains, much of the traffic over the trackage rights lines is highly sensitive to price and, therefore, even though many factors ultimately influence competition on the trackage rights lines, pricing is the most critical in the end. Smith V.S. at 2-3. "Over the long-run, an unfavorable

cost structure (resulting, for instance, from inflated trackage rights fees) can (and likely will) erode BNSF's ability to compete." Id. at 3.

Thus, as Mr. Smith explains, the rate differential caused by the disputed items can indeed be determinative in BNSF's efforts to compete for traffic. The likelihood that the disputed rates will affect BNSF's competitiveness has increased with UP's ability to predict the rates that BNSF can offer over the trackage rights lines. At the beginning of BNSF's operations over the trackage rights lines, there was a fairly wide range between the rates offered by BNSF and UP as each carrier was feeling out the market and adjusting its price, service and routing offerings to compete with the other carrier. Smith V.S. at 3. Now, however, UP is able to determine the rates which BNSF can offer over the trackage rights lines with some accuracy because it knows the GTM mill rates which BNSF will be required to pay. Accordingly, the range of competitive rate offerings has narrowed to \$25.00 to \$50.00 per car. Ibid. This knowledge allows UP to exploit the cost advantage that it has obtained from the artificially inflated trackage rights rates. As Mr. Smith explains, "UP essentially knows how low BNSF can take the price it offers for a movement over the trackage rights lines, and it can then simply underbid that price by \$25.00 to \$50.00." Ibid.

Moreover, as Mr. Smith further explains, the rate differential caused by the amount in dispute (approximately 0.2 mills or 5 to 6 percent of the rates) can cause rate quotation differentials in the \$25.00 to \$50.00 per car range where the parties currently compete and can be expected to compete in the long run. Smith V.S. at 3-4. For instance, a move over the Central Corridor between Stockton, CA and Denver, CO

would result in a reduction of about \$46.00 per car.<sup>7</sup> Similarly, for a move from Houston, TX to East St. Louis, IL, the disputed amount would result in a reduction of about \$30.00 per car. On moves from Denver, CO to Fernley, NV and Ogden, UT, the disputed amount would result in reductions of approximately \$38.00 and \$21.00, respectively. Id. at 4.

UP has itself recognized in the Confidential Appendices attached to its July 2, 2001 Fifth Annual Report in the general oversight proceeding (UP/SP-384) that rate differentials in the range of \$25.00 to \$50.00 per car can in fact be determinative. For instance, in Appendices B and C to its Report, UP has identified numerous movements where either BNSF or UP reduced its rates by amounts in the range of \$25.00 to \$75.00 to secure or retain traffic which the other carrier was competing to carry. Similarly, UP cited other instances where it was forced to freeze its rates in order to prevent BNSF from successfully gaining the traffic. In those situations, any rate differential can be determinative of which carrier will win the business. Copies of UP's Confidential Appendices B and C from its July 2, 2001 Fifth Annual Report are included in the Confidential Appendix filed herewith.

Thus, the rate differential at issue here can have a significant effect on BNSF's competitiveness.

## **V. CONCLUSION**

As established above and in the Verified Statements of Messrs. Ice and Weicher, the relationship between the GTM mill rates which BNSF pays for its use of the UP/SP

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<sup>7</sup> The rates cited in the text include both the movement of a loaded 286,000 pound car as well as the empty return move. In this regard, for most carload commodities, the trend is to larger and heavier shipments

trackage rights lines and UP's costs associated with those lines is critical to BNSF's ability to provide effective and efficient competitive service as a replacement for SP. The GTM mill rates were intended by both UP and BNSF to be comprehensive and all-inclusive, and the parties set forth their intent that the relationship between the rates and UP's costs was to be maintained. While the mechanism for the adjustment of the rates was revised to better track UP's costs associated with the trackage rights in response to criticism from CMA and others, the adoption of an adjustment mechanism based on the comparison of UP URCS maintenance and operating costs was not intended to enable UP to incorporate the purchase premium it paid for SP and the Section 9(c) merger-related capital expenditures it was to solely fund into the adjustment process in such a manner that there would be a double-counting of those costs. Indeed, the parties clearly intended that the comparison of URCS costs would be made using post-merger years only, and, to the extent UP reads the revised language of Section 12 of the BNSF Settlement Agreement to allow for the comparison of pre-merger URCS costs with post-merger URCS costs, such a reading is clearly contrary to the language of Section 7 of the CMA Agreement and the parties' intent.

The resolution of the issue presented by BNSF's Petition for Clarification is important to BNSF's competitive presence on the trackage rights lines. The differential between BNSF's and UP's adjustment methodologies is significant in terms of the current competition between the two carriers on the trackage rights lines as it has developed, and it will be significant over the 99-year term of the BNSF Settlement Agreement as well.

Accordingly, BNSF respectfully requests that the Board clarify that the SP purchase premium and the merger-related capital expenditures that UP was to solely fund may not be included in the Section 12 adjustment process as UP proposes because doing so would violate the express language of Section 7 of the CMA Agreement and the parties' intent that the GTM mill rates were to be comprehensive and all-inclusive.

Respectfully submitted,

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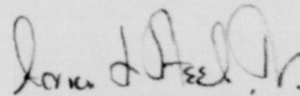
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CERTIFICATE OF SERVICE

I do hereby certify that copies of The Burlington Northern and Santa Fe Railway Company's Response to Order to Show Cause Why BNSF-98 Petition for Clarification Should Not Be Dismissed (BNSF-102) are being served on all parties of record.

A handwritten signature in dark ink, appearing to read "Adrian L. Steel, Jr.", written over a horizontal line.

Adrian L. Steel, Jr.

**EXCERPTS FROM CITED PLEADINGS**

Before the  
INTERSTATE COMMERCE COMMISSION

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Finance Docket No. 32760

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

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**RAILROAD MERGER APPLICATION**

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**VOLUME 1**

SUPPORTING INFORMATION, SUMMARY OF BENEFITS,  
EXHIBITS 1, 8, 10-12 AND 16-19, STATEMENTS OF APPLICANTS' PRINCIPAL OFFICERS,  
AND OTHER SUPPORTING STATEMENTS

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## **VERIFIED STATEMENT**

### **OF**

## **JOHN H. REBENS DORF**

My name is John H. Rebensdorf. I am Vice President-Strategic Planning for Union Pacific Railroad Company. I hold a Bachelor's Degree in Civil Engineering from the University of Nebraska and a Master's Degree in Business Administration from Harvard University. Before coming to Union Pacific, I was employed as a management consultant by Temple, Barker and Sloane. I have worked in the Mechanical Department of the Chicago, Burlington & Quincy Railroad and in the Operating and Engineering Department of the Chicago, Rock Island and Pacific Railroad. I joined Union Pacific in 1971 as Manager of Budget Research. I became Assistant Controller in 1976, Assistant Vice President-Planning & Analysis in 1980, Assistant Vice President-Finance in 1984 and was appointed to my present position in 1987.

The purpose of my statement is to describe the settlement agreement that was reached between UP and SP, on the one hand, and BN/Santa Fe, on the other hand, on September 25, 1995. I will review the background of the settlement agreement and the underlying negotiations and describe the key provisions of the agreement, including the rights granted and the compensation terms.

overhead trackage rights on BN/Santa Fe's line between West Memphis and Presley Junction in Arkansas.

Finally, some provisions of the Agreement resolved outstanding issues of concern that have no connection with the merger -- also adding to competition in the process. These included operating rights in Northern Wisconsin for UP/SP to resolve access to the MERC dock at Superior as well as direct access to the DWP and DMIR at Pokegama, Wisconsin. BN/Santa Fe, on the other hand, was granted the right to purchase UP's line between Dallas and Waxahachie, Texas, in order to consolidate maintenance and operating responsibility on this track which is part of BN/Santa Fe's main line between Houston and Dallas.

### **III. Compensation Terms**

My objective in negotiating the trackage rights compensation terms was to ensure that Union Pacific would be fairly reimbursed for the maintenance and operating expense associated with BN/Santa Fe's trackage rights operations, and would receive a reasonable return on the capital tied up in the lines whose capacity BN/Santa Fe would be partially using. It was my intent that the trackage rights rate place both carriers on a level playing field with neither subsidizing the other. I am confident these goals were reached.

The rates ultimately agreed to were the result of arm's-length negotiation with a considerable give and take between the parties. There were several possible starting points for the rate negotiation.

One starting point, which until recently has been traditional in joint facility arrangements, would have been to allocate the actual cost of maintenance and operation between the parties on the basis of their relative usage together with an appropriate "interest rental" factor to provide a return to capital. The Commission has found that, to cover full economic costs, the interest rental factor must be based on the replacement cost of the property times the current cost of capital.

Another starting point was to establish a flat rate. Clerical work and expense associated with traditional joint facility arrangements are substantial, and railroads are increasingly moving to flat rate compensation for these facilities. We and EN/Santa Fe were in agreement that a flat rate was the best alternative.

I began my consideration of an appropriate flat rate by reviewing flat rates in other agreements that the parties had recently negotiated. The most recent flat rates, and ones that were before the Commission when it approved the BN/Santa Fe merger, were the rates included in the settlement agreement reached between SP and BN/Santa Fe in connection with the BN/Santa Fe merger. In fact, the rates we ultimately negotiated were, for intermodal and carload business, lower than the rates in the SP-BN/Santa Fe agreements.

The most important consideration from our standpoint was to recover UP/SP's cost of maintaining and operating the joint UP/SP-BN/Santa Fe track. I believe that the rates negotiated with BN/Santa Fe will cover the relevant costs. However, UP/SP is still exposed to significant risk. The risk results from the fact that the rates apply systemwide and reflect systemwide average costs. In some instances, the cost of

maintaining a particular line segment will be greater than systemwide costs, and in other cases it may be lower. However, several of the line segments in question involve some of the highest-maintenance portions of UP's and SP's systems. These include the UP and SP lines along the Gulf Coast, SP's line through the Rocky Mountains between Denver and Salt Lake City, SP's line through the Sierra Nevada Mountains over Donner Pass, and the former WP line through the Feather River Canyon in California.

The Gulf Coast lines are prone to flooding from hurricanes and other tropical storms. The terrain they cover is low lying and wet, requiring numerous bridges and shortening the life of wooden cross ties. In the Rockies and Sierra Nevadas, the grades and curvature inherent to mountain railroading increase wear and tear on the track structure. Tunnels, snowsheds, cuts and fills must also be maintained. Weather also leads to higher costs. For example, 24-hour-a-day snow removal is occasionally a necessity on Donner Pass. The Feather River Canyon is also subject to floods and slides. In fact, at certain times hi-rail vehicles must precede all trains in the Feather River Canyon to check for rock slides.

The settlement agreement does not restrict the traffic BN/Santa Fe can handle over these rights. BN/Santa Fe can - and likely will - choose to route quite a bit of east-west traffic over the Central Corridor rights. For example, the rights will shorten BN/Santa Fe's mileages in numerous corridors as described in Mr. Peterson's statement. These mileage savings (e.g., 387 miles between Oakland and Denver; 664 miles between Oakland and the Twin Cities) will likely lead to the rerouting over these lines of substantial

traffic that is unrelated to the "2-to-1" situations at which the rights were principally focused.

The rates in the settlement agreement are shown in Table 1 below.

**Table 1**  
**Trackage Rights Compensation**  
**(mills per ton-mile)**

	<u>Keddie-Stockton/Richmond</u>	<u>All Other Lines</u>
Intermodal and Carload	3.48	3.1
Bulk (67 cars or more of one commodity in one car type)	3.0	3.0

I want to address three likely questions about these rates before discussing them in more detail. First, why is the rate different for intermodal and carload traffic as compared to bulk traffic? Second, why is the intermodal and carload rate higher for the Keddie-Stockton/Richmond segment than for other lines? Third, why is the rate based on ton-miles rather than car-miles?

1. The rate is different for intermodal and carload traffic as compared to bulk traffic. Certain expenses of maintenance and operation such as dispatching and signal operation are traditionally costed on a train mile basis. Spreading these expenses over all traffic on the basis of gross ton-miles will lead to bulk commodities bearing a disproportionately high share of these expenses. The extra one-tenth of a mill charged to intermodal and carload business more properly allocates expenses between the two categories of traffic.

2. The intermodal and carload rate is higher for the Keddie-Stockton/Richmond segment than for other lines. The rate for the rights between Keddie-Stockton/Richmond were set at 3.48 mills per ton-mile because this line segment is unquestionably a very high maintenance area and will handle BN/Santa Fe's north-south traffic in the so-called "I-5 Corridor" as well as some transcontinental business of both railroads. Accordingly, in this one instance, we negotiated a higher rate for a territory we felt would clearly incur high levels of traffic requiring correspondingly high levels of maintenance and expense.

3. The rate is based on ton-miles rather than car-miles. We used gross ton-miles as the basis for assessing the charges because it most accurately reflects the actual use made of the facility, and therefore the resulting expense.

Turning back to the rates themselves, they are not only cost-based, but reflect rates recently negotiated between SP and BN/Santa Fe as well as rates found in other recently negotiated joint facility agreements between UP and parties other than BN/Santa Fe.

Table 2 lists recent flat rate agreements involving UP, SP and BN/Santa Fe. Included in italics in Table 2 is the 3.0-3.1 mill per ton-mile rate applicable to the settlement agreement, which has been converted to a car-mile rate for ease of comparison.<sup>2</sup> Also converted to a car-mile rate is the mill-per-gross-ton-mile charge from

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<sup>2</sup> The conversion was based on a 100-ton load and 100% empty return. The actual rate will depend on the lading weight and the empty return associated with a given move. The 3.48 mill per ton-mile rate applicable to the Keddie-Stockton/Richmond line segment produces a higher car-mile rate, in the \$0.28 range. It applies to only a small percentage of the overall trackage rights. Even this rate is not out of line with the recent agreements.

the 1995 agreement between BN/Santa Fe and SP.

**Table 2**  
**Rates in Other Recent Trackage Rights Agreements**

<b>Date</b>	<b>Landlord</b>	<b>Tenant</b>	<b>Location</b>	<b>Miles</b>	<b>1994 Rate Per Car Mile</b>
1990	IC	SP	IL	48	\$0.45
1990	UP	CP	MN	25	\$0.36
1986	UP	DME	IA	48	0.34
1990	BN	SP	KC-Chi	465	0.28
1990	NS	SP	MO	25	0.27
1990	UP	SP	TX	96	0.27
1992	SP	SO	TX	10	0.27
1986	UP	CP	MN	10	0.24
1995	BN/Santa Fe	SP	Various	2,108	0.24-0.28
1995	UP/SP	BN/Santa Fe	Various	3,968	0.24-0.25
1995	BN/Santa Fe	UP	KS	139	0.20

As can be seen, the rates of \$0.22 to \$0.25 per car mile applicable to the settlement agreement are at the low end of rates found in other recent joint facility agreements.

The rates can also be viewed in comparison to costs developed using the Uniform Rail Costing System ("URCS"). A weighted average of UP and SP costs was used because 56 percent of the BN/Santa Fe trackage rights mileage will be over SP lines and 44 percent will be over UP lines. On a weighted average basis, the rates will cover between 143% (at the 3.0 mill rate) and 148% (at the 3.1 mill rate)<sup>3</sup> of what URCS defines as the system average variable cost of the so-called "M&O" (maintenance and operations) functions that a trackage rights landlord must perform (e.g., track maintenance/dispatching).

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<sup>3</sup> At the 3.48 mill per ton-mile rate the coverage of variable cost is 166%.

URCS variable cost includes only a percentage of all the costs associated with maintaining and operating the track. The balance of these costs is treated by URCS as fixed in the short term. However, given the permanent nature of these rights, I believe the coverage of full costs is important because over the long-run, as will be the case with these rights, all costs become variable. UP/SP must recover these costs to avoid subsidizing BN/Santa Fe's operations. Moreover, the URCS variable cost computation includes only 50% of the book value of the assets involved, and reflects no return on the other half of the book value, or on the difference between the book value and the current value of the assets. An economic return on the current value of assets must ultimately be earned if a railroad is to continue replacing its plant and stay in business and even URCS fully allocated cost includes only return to capital on the basis of 100% of the book value of the assets, not replacement cost. Looking at these rates on the basis of URCS fully allocated costs, again on a weighted average basis, the ratio of the trackage rights fee to our expense drops to 75% (at the 3.0 mill rate) and 77% (at the 3.1 mill rate).<sup>4</sup> I believe these rates will be sufficient, but only marginally so, for UP/SP to receive a sufficient return from BN/Santa Fe's trackage rights fees to ensure that UP/SP is not investing its capital to subsidize BN/Santa Fe's operations.

The rates are also subject to adjustment, upward or downward. The adjustment will be undertaken annually by applying 70% of the Unadjusted Rail Cost Adjustment Factor (RCAF-U) to the rates. RCAF-U is the most commonly utilized index for measuring railroad inflation. The RCAF-U Index is developed by the Association of

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<sup>4</sup> At the 3.48 mill per ton-mile rate the coverage of fully allocated costs is 87%.

American Railroads from audited data that is supplied by the Class I railroads, and is approved by the Commission. The use of RCAF-U is appropriate because productivity has been driven more by initiatives in areas such as crew consist and fuel conservation than in the area of maintenance of way. To use a productivity-adjusted RCAF would, among numerous other serious deficiencies, reflect productivity gains that would not reduce maintenance of way costs -- which are the principal costs covered by the trackage rights fees. Using a percentage of RCAF-U as the adjustment mechanism is also common in long term agreements. Here, the 70% factor shares some productivity gains with BN/Santa Fe without disincenting UP/SP from making investments (such as to purchase high production maintenance of way equipment) that will improve maintenance of way efficiency -- investments which must earn an adequate return.

In looking at the relationship between this fee and the cost structures of the two carriers, one must also bear in mind three points. First, the fee is comprehensive. Second, the fee represents only one component of total operating expense, the balance being equipment, fuel, labor, switching and related overheads. Third, because very few moves will involve solely the trackage rights lines, the fee will be further diminished as a fraction of BN/Santa Fe's total cost.

1. The rate is comprehensive. It includes all day-to-day maintenance of the right-of-way, track, ties, bridges, turnouts, subgrade, signals, and communication systems. Replacement of the existing plant including rail relays, tie replacements and bridge replacements is also included. All dispatching expense and the overhead associated with maintenance and operation is also included.

BN/Santa Fe's responsibility for capacity-related improvements is also quite limited. However, there is no limitation on BN/Santa Fe's right to use capacity-related improvements for which it bears no financial responsibility. Specifically, BN/Santa Fe has no responsibility for capacity improvements related to the merger, or for any capacity improvement, whether merger-related or not, made during the first 18 months of operation. Finally, BN/Santa Fe will have no responsibility for the first \$25 million worth of capital expenditures for which it would otherwise have shared responsibility. The settlement agreement calls for establishing a capacity-related capital reserve fund to be drawn down to cover those first \$25 million of capacity-related capital expenditures. Accordingly, it will not be until 18 months after BN/Santa Fe has begun trackage rights operations that it will begin to fund any capacity-related improvements and even the first \$25 million of those will be funded out of a capital reserve fund. This total relief from capital expenditures at the inception of trackage rights operations will be a real advantage to BN/Santa Fe in building its trackage rights traffic base.

The sorts of capital projects that BN/Santa Fe ultimately will be responsible for will include its usage share of projects such as upgrading a signal system from automatic block signals to centralized traffic control; adding CTC and universal crossovers to double track; constructing new sidings; and lengthening existing sidings. However, as I have stated above, BN/Santa Fe will only be responsible for these expenses if they (a) are not merger-related, (b) take place more than 18 months after implementation of trackage rights operations and (c) exceed the \$25 million capital reserve fund.

2. The trackage rights fee is only one element of cost, but a cost both carriers must incur in competing. The balance of operating costs are up to each individual carrier. These costs include locomotives, equipment, crews, fuel and terminal support services.

3. Finally, the trackage rights fee is important, but from BN/Santa Fe's perspective, it will only represent a small portion of total costs for most moves. Few moves will involve a haul solely over the trackage rights lines. In most cases, BN/Santa Fe will utilize its own existing routes -- often for the great majority of the overall haul -- in conjunction with the trackage rights lines. A good example is the Keddle-Stockton segment, which will give BN/Santa Fe single-line routes in the I-5 Corridor. Between Spokane and Los Angeles, this segment, at 183 miles, will be only 12.4% of BN/Santa Fe's total mileage (1,478 miles). On this move, only 4.2% of BN/Santa Fe's URCS variable cost would be attributable to the trackage rights fee. The trackage rights fee as a percentage of total variable and fully allocated cost is shown in Table 3 for Spokane-Los Angeles and several other representative moves:

**Table 3**  
**Trackage Rights Fee as a**  
**Percentage of Total Cost**

<b>Move</b>	<b>Total Miles</b>	<b>Trackage Rights Miles</b>	<b>Trackage Rights Fees as a % of Total Variable/ Fully Allocated Costs</b>
Spokane-LA	1,478	183	4.2/3.1
Chicago-Eagle Pass	1,487	357	7.1/5.5
Denver-Oakland	1,383	1,383	33.5/27.2
PRB-LCRA*	1,468	115	4.0/3.0

\* Powder River Basin to Lower Colorado River Authority Power Plant at Halsted, TX.

In conclusion, the trackage rights charges are fair. They are cost-based and also reflective of rates in similar agreements. They will ensure that UP/SP can cover the costs attributable to BN/Santa Fe's operations and will not result in either carrier's subsidizing the other.

#### **IV. Line Sale Purchase Prices**

The Settlement Agreement calls for three line sales. They are: (1) UP's line between Keddie and Bieber, California; (2) UP's line between Dallas and Waxahachie, Texas; and (3) SP's line between Iowa Junction and Avondale, Louisiana, including terminal facilities in the New Orleans area. The purchase prices for these segments are \$30 million, \$20 million, and \$100 million, respectively. As with the trackage rights compensation, these purchase prices were the subject of arm's-length negotiation. They simply reflect what a willing buyer, BN/Santa Fe, would pay a willing seller, UP/SP, for these properties.

In the case of the Dallas-Waxahachie and Avondale-Iowa Junction sales, UP/SP retained trackage rights over those lines. The trackage rights will be subject to the same terms as applied to BN/Santa Fe operations over the rights it was granted by UP/SP. BN/Santa Fe can also elect not to purchase these lines and operate instead via trackage rights. In the case of the Avondale-Iowa Junction and Dallas-Waxahachie segments, trackage rights would be covered by the compensation terms applicable to other trackage rights line segments. The Keddie-Bieber trackage rights charges would, however, be allocated "on a typical joint facility basis." Since BN/Santa Fe will become the sole user of this line should it choose not to purchase the line, we felt it reasonable that BN/Santa

## **VERIFIED STATEMENT OF CARL R. ICE**

### **I. BACKGROUND**

I am Executive Vice President and Chief Operations Officer for The Burlington Northern and Santa Fe Railway Company ("BNSF"). I was appointed to this position in December 2000.

I began my career in the railroad industry with The Atchison, Topeka and Santa Fe Railway Company ("Santa Fe") in the industrial engineering department in 1979. I later held positions in operations, finance and information systems. In 1992, I was named Vice President – Administration. I became Vice President – Carload Business Unit in January 1994 and was named Vice President – Executive in July of the same year. In January 1996 after the merger of Burlington Northern and Santa Fe, I was appointed Vice President and Chief Mechanical Officer of BNSF. I became Vice President Operations North in January 1999 and was promoted to Senior Vice President Operations in June 1999.

I received a Bachelor of Science degree in industrial engineering from Kansas State University. I am a member of the Institute of Industrial Engineers.

### **II. THE BNSF SETTLEMENT AGREEMENT**

I was BNSF's principal negotiator, assisted by Richard E. Weicher, in negotiations for the settlement agreement executed between BNSF and Union Pacific on September 25, 1995 ("BNSF Settlement Agreement"), in connection with the proposed merger of UP and SP. The purpose of the negotiations, which took place over several weeks in September 1995, was to attempt to resolve BNSF's opposition to the UP/SP merger and to reach agreement with UP on the role BNSF would play if the parties were to agree that BNSF would be the carrier to address the competitive issues

raised by the merger. This would include the terms by which BNSF would provide service to preserve the pre-merger competition between UP and SP that would otherwise be lost as a result of their merger.

**A. The Gross Ton Mile Mill Rates**

The terms of compensation for the trackage rights under the BNSF Settlement Agreement were a critical part of those negotiations and were the subject of intense arms-length discussions. UP/SP's position was that the trackage rights fee should reimburse UP/SP for all the costs associated with BNSF's trackage rights operations, not just direct out-of-pocket costs for operation and maintenance of the trackage rights lines that BNSF would be using. BNSF's position was that the rates should be at levels that would enable BNSF to offer competitive pricing, taking into account all of our costs, and would be comparable to other then-current trackage rights agreements. We emphasized that the rates of compensation should not place BNSF at a disadvantage in competing with UP/SP as the landlord railroad.

In addition to the rates of compensation, the parties also agreed that their respective interests should continue to be protected over the term of the Settlement Agreement. As with any negotiation, we had to find a rate that would work for both parties. In my view, the agreed upon GTM mill rates were very close to the upper limit that BNSF could accept and still offer competitive service. Consequently, any increases later could make us noncompetitive for particular moves. UP/SP had projected substantial improvements in efficiency, and it was important to BNSF that reductions in costs of the merged entity should be passed on to BNSF in the form of lower rates for trackage rights. UP/SP took the position that, once it had agreed on rates to cover

costs associated with BNSF's operations, it should be able to adjust the rates to account for increases in its costs. At the time, it was apparent that BNSF's primary concern was that the trackage rights rates should, over time, reflect reductions in UP/SP's costs, and UP/SP was more concerned that the rates should take account of increases in its costs.

Although our specific interests differed, we were able to agree in principle on all major issues in the negotiations. In this regard, I agree with the statement made in the Verified Statement of John H. Rebensdorf, one of UP's principal negotiators in our settlement discussions, which was submitted with the UP/SP Application, when he said that it was "the intent that the trackage rights rate place both carriers on a level playing field with neither subsidizing the other." UP/SP-22 at 301.

With respect to the form of compensation for trackage rights use, it was agreed between UP/SP and BNSF that a defined, flat rate would be used. This is distinguished from compensation based on periodic sharing of expenses, as is common in some joint facilities and other methods. To determine the appropriate flat rate, we reviewed flat rates in other recent trackage rights agreements that the parties had entered. These included the flat rates in the then-recent settlement agreement reached between SP and BN/Santa Fe in connection with the BN/Santa Fe merger. After significant discussion and negotiation, the parties agreed that the rate, expressed in mills per gross ton-mile ("GTM"), for most carload and intermodal traffic would be 3.1 mills per GTM and that the rate for bulk traffic would be 3.0 mills per GTM.

The parties also agreed that the rates would be based on ton-miles rather than car-miles because it was our belief that this would more accurately reflect the actual use

made of the trackage rights lines and thus the resulting expense to UP/SP. This conclusion was based on the great variation in size and types of cars and their capacity and our belief that ton-miles is a more meaningful measure of use.

It was my understanding of both sides' intent that the GTM mill rates that had been agreed to were comprehensive, and that BNSF would not be expected to pay increased rates based on costs that were already known and taken into account in the negotiations. UP's intent in this regard is reflected in Mr. Rebensdorf's Verified Statement where he stated that the "rate is comprehensive." UP/SP-22 at 308.

BNSF agreed with this because, through the GTM mill rates, it was paying for its use of UP's capital in the trackage rights lines. It was my conviction and understanding that these GTM mill rates specifically included all of UP's costs – both short-term as well as long-term costs – that had anything to do with capital maintenance, near-term capacity improvements, or consummation and implementation of its merger – i.e., all costs of any kind whatsoever.

#### **B. The Parties' Intent**

When BNSF entered negotiations with UP/SP concerning the GTM mill rates, BNSF was aware that UP had agreed to pay a substantial premium above book value to purchase SP, and we knew that the premium would be an expense that UP would bear to effect the merger. UP's August 3, 1995 press release announcing the merger had valued the transaction at \$5.4 billion, and SP's 1994 Annual Report reflected a book value of approximately \$4.15 billion.

The negotiations occurred after UP's acquisition of SP had been negotiated between those parties and after the terms of that acquisition had been set. By the same

token, the negotiations under way between BNSF and UP/SP were on the terms of a possible settlement under which BNSF would not oppose the merger if it acquired sufficient conditions of value to BNSF that would address the competitive impacts of UP's merger with SP. These were rights which could only be implemented and become effective if that merger was approved and had already been consummated. Clearly, we believed that the GTM mill rates included any effect of the merger.

Nothing in the negotiations indicated that either party contemplated that the GTM mill rates would not take account of the purchase premium. To the contrary, it was my fundamental belief that negotiators for both BNSF and UP/SP always intended that the rates agreed to in the September 1995 negotiations were inclusive of all of UP's costs and return on investment in the merged UP/SP, including UP's purchase price for acquiring SP, and those mill rates would not be subject to adjustment in a subsequent year to take account of these costs.

This intent is reflected in our agreement that the GTM mill rates would stay in the "same basic relationship" to "operating costs" throughout the life of the BNSF Settlement Agreement. Section 12 of the Agreement states: "It is the intention of the parties that the rates and charges for trackage rights and service under this Agreement shall reflect the same basic relationship to operating costs as upon execution of this Agreement." This provision was in the very first draft of the Settlement Agreement, which was prepared by BNSF on September 19, 1995, and provided to UP. The provision identifies a relationship between the GTM mill rates and UP's operating costs, and provides that it is the parties' intent that the relationship should remain the same throughout the term as it was at execution.

During the negotiations, both sides had cost experts available and were considering their costs in relation to the levels of GTM mill rates. BNSF made an evaluation of the impact of the GTM mill rates on our cost structure and whether BNSF could be competitive at those rates. It is my belief that UP/SP's representatives were making comparable analyses of their costs, although we did not share the results with each other.

We knew the 3.1 mill rate per GTM was higher than UP/SP's direct operating costs because it covered all their costs of every nature. It thus clearly was BNSF's intent and belief that the GTM rate included more than UP's operating costs and covered items such as return on investment, capital maintenance and merger implementation. Since we did not exchange the cost data used in these comparisons with UP/SP, I do not know UP/SP's precise internal calculus for understanding that relationship, but I am confident from the course of negotiation and the language agreed upon in the final sentence of Section 12, quoted above, that UP/SP shared our understanding that UP would be compensated in the GTM mill rates for all of its costs of any nature.

It is my understanding that UP now takes the position that the premium above book value that it paid to acquire SP should be taken into account in the annual adjustment to the trackage rights rates, effective July 1, 1998. I believe that both sides intended in September 1995 that the return and depreciation on all UP/SP assets including this purchase premium were fully taken into account when we negotiated and agreed on the rates. Inclusion of the purchase premium in UP's URCS costs used in the annual adjustment mechanism would disrupt the basic relationship between the

GTM mill rates and operating costs because, at the time of execution of the Settlement Agreement, the purchase premium was already encompassed in the amount of the GTM mill rates. In other words, UP's adjustment of the GTM mill rates, effective July 1998, would result in a form of double-counting of the purchase premium paid for SP since the premium has been in the GTM mill rates since the execution of the BNSF Settlement Agreement. The inevitable result of such an adjustment of the GTM mill rates is to disrupt their relationship to the "operating costs", and defeat the guiding principle of the adjustment process that the "same basic relationship" be maintained.

We also knew in September 1995 that UP/ SP planned to undertake numerous capital expenditures necessary to implement the proposed merger. It was BNSF's position during our negotiations that UP/SP should bear the full responsibility for these anticipated capital expenditures and that the GTM mill rates should not be increased as a result of those expenditures. Accordingly, BNSF negotiated for and received a commitment from UP/SP that UP/SP would bear the cost of all capacity improvements necessary to implement the merger as outlined in the Operating Plan submitted with the Application. BNSF Settlement Agreement, § 9(c)(i).

In addition, while the Settlement Agreement provided in Section 9(c)(ii) that any capacity improvements to the trackage rights lines other than those covered by Section 9(c)(i) would be shared by the parties based on their respective usage of the trackage rights line in question, the Agreement provided in Section 9(c)(iii) that BNSF would not be required to share in the cost of any capital improvements for 18 months following UP's acquisition of control of SP.

In addition, UP/SP agreed in Section 9(c)(iv) of the Settlement Agreement to set up a capital reserve fund which was to be used to pay for the first \$25 million worth of capital expenditures for which BNSF would otherwise have had shared responsibility.

At the time the BNSF Settlement Agreement was negotiated and executed, we knew that UP/SP contemplated and would spell out their capital improvements related to the merger, and it was very important to me that BNSF not pay for those expenses beyond the agreed level of GTM mill rates. We could not have any additional responsibility for expenses to facilitate the merger and, at the same time, step into the shoes of SP as an effective competitor to a merged UP/SP.

These provisions which decreed that BNSF was not to be required to contribute to merger implementation costs and that adjustments to the GTM mill rates were not to disrupt the relationship of those rates to operating costs were crucial to us. Both parties wanted something to make it clear that this relationship was to be maintained, but this was probably even more fundamental to BNSF. For UP, it was a matter of dollars. For BNSF, it was a matter of maintaining our competitive capabilities. In the end, we knew that we had to have trackage rights rates that worked to keep us an effective competitor. Without such rates, the trackage rights were meaningless to us. The overarching concept was that we needed to stay competitive, and by its nature this was more important to us than to UP. We took the obligation to be an effective competitor very seriously. We knew we were near the upper limit of what would be an acceptable trackage rights fee, and we had to make it clear that we could not be charged for other elements and that there should be enough capacity on these lines, at UP's expense, for BNSF to operate effectively.

### **C. The Adjustment Mechanism**

The parties recognized that the initial GTM mill rates should be subject to adjustment, upward or downward, for changes in UP's costs that were not known or contemplated at the time of the negotiations. We negotiated at length over the proper adjustment of the GTM rates. Initially, we discussed the various types of indices used in the industry for measuring railroad inflation. We agreed upon annually applying 70% of the Unadjusted Rail Cost Adjustment Factor ("RCAF-U"). By using 70% of the RCAF-U (rather than the fully productivity-adjusted RCAF ("RCAF-A")), the parties agreed to share some of any productivity gains UP achieved.

As discussed above, both UP/SP and BNSF had determined, after internal review and analysis, that the agreed-upon GTM mill rates would enable UP/SP to recover its costs, including a return on its capital or contribution to fixed costs, and would enable BNSF to compete effectively. Nevertheless, we recognized the possibility that unforeseen developments could cause the adjustment mechanism, as written, to be ineffective in achieving the intent of the parties. Thus, we agreed to include language in the Settlement Agreement which provided either party with the right, which could be exercised every fifth year, to request a joint review of the operation of the adjustment mechanism and to renegotiate its application. The purpose of this review and renegotiation process was not to overlap or interfere with the annual adjustment process but, rather, to provide an agreed mechanism for renegotiating the terms of the Settlement Agreement. As Mr. Rebensdorf stated in his Rebuttal Verified Statement, this "truing mechanism" was "designed to ensure that costs do not get out of line with

the trackage rights charges." UP/SP-231, Vol. 2, Part C at 9-10. Again, protecting this relationship was fundamental to protecting our ability to compete.

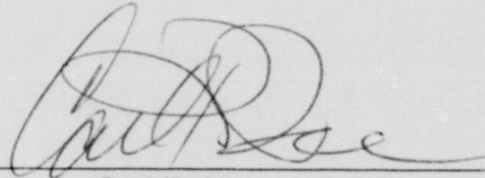
Thus, in my view, the above language in Section 12 providing for periodic review of the adjustment mechanism, the provisions of Section 9(c) dealing with capital improvements, and the whole basis of negotiation of the GTM mill rates themselves all demonstrate the clear intention of the parties that the GTM mill rates were to reflect all costs of any kind of associated with the trackage rights operations and the UP system, including UP's acquisition of and merger with SP.

In summary, the GTM mill rates were intended to be comprehensive. They were at the maximum of what we could afford to pay and still be competitive. The clauses that reflect the importance of the adjustment mechanism maintaining the same relationship of the GTM mill rates to operating costs and that specifically exclude any contribution by BNSF to capital improvements to implement the UP/SP merger were to keep us from becoming less competitive. Philosophically, it was important that this relationship not be denigrated. It would be a distortion of that entire intent to use an adjustment mechanism that would make BNSF any less competitive by reflecting any form of the costs of UP's merger implementation, whether to reflect a purchase accounting premium, specific capital investments to implement the UP/ SP merger or otherwise.

**VERIFICATION**

I, Carl R. Ice, verify under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on May 21, 2002.

A handwritten signature in dark ink, appearing to read 'Carl R. Ice', is written over a horizontal line.

Carl R. Ice

## VERIFIED STATEMENT OF RICHARD E. WEICHER

### **I. BACKGROUND**

I am Vice President and Senior Regulatory Counsel for The Burlington Northern and Santa Fe Railway Company ("BNSF"), and have held this position since June 1999. I joined the Law Department of The Atchison, Topeka and Santa Fe Railway Company ("Santa Fe") in 1974 and was named General Counsel for Santa Fe in 1989. I subsequently became Vice President and General Counsel of BNSF in October 1995.

I have worked in the areas of regulatory practice, administrative litigation and transactions in the railroad business throughout my career, including the merger of Burlington Northern and Santa Fe in 1995, and BNSF's participation in the settlement agreements between BNSF and Union Pacific imposed as conditions to the merger of Union Pacific and Southern Pacific in 1996.

I received a bachelor of arts degree from Holy Cross College in 1971, a J.D. *cum laude* from Loyola University of Chicago School of Law in 1974, and an M.B.A. from the University of Chicago in 1986.

### **II. THE BNSF SETTLEMENT AGREEMENT**

I was a negotiator for BNSF with respect to the settlement agreement executed between BNSF and UP on September 25, 1995 ("BNSF Settlement Agreement") as well as the CMA Settlement Agreement, dated April 16, 1996. I worked with Carl R. Ice on the BNSF Settlement Agreement. Throughout the negotiations, I also served as legal counsel. Mr. Ice's and my purpose was to seek a settlement with UP/SP with respect to BNSF's concerns about the proposed merger between UP and SP and to negotiate the terms under which BNSF would provide service to preserve the pre-merger competition between UP and SP that would otherwise be lost as a result of the merger. As Mr. Ice

describes in further detail in his Verified Statement, the terms for the nature and level of compensation for the trackage rights under the BNSF Settlement Agreement were the subject of extended and substantial, arms-length negotiations.

From the earliest point at which BNSF considered the opportunity to provide this competitive service, we intended that the rates charged for rights over UP/SP trackage must be at levels that encouraged competition, and there must be contractual assurances that the rates would decline in line with UP's anticipated merger-related efficiencies. Mr. Ice and I emphasized these objectives to UP/SP's representatives throughout the negotiations, and we further affirmed the importance to BNSF by bringing to the first negotiating session draft language that would accomplish our intentions. UP/SP's representatives advised that they understood the importance we attached to the role of trackage rights fees in providing competitive service and were receptive to our draft contractual language.

The BNSF Settlement Agreement that was executed on September 25, 1995, contained virtually all of the contractual provisions in broad structural terms that we deemed essential to offering competitive pricing.

The level of charges for our trackage rights was expressed in mills per gross ton-mile ("GTM") and, as discussed in Mr. Ice's Verified Statement, the rates were at levels that BNSF considered at the high end of what we could accept and still competitively price our proposed services. We viewed the GTM mill rates as covering all UP/SP's merger-related costs, including merger-related capital expenditures. I believe that the parties agreed that the GTM mill rates covered all merger-related costs. In other words, it was intended by BNSF and UP/SP that the GTM mill rates were comprehensive and

were intended to be inclusive of all the costs of UP/SP associated with the trackage rights operations and the UP/SP merger for which BNSF had any responsibility. There was no basis for adding an element to reflect additional compensation to UP for the SP purchase premium or any merger implementation costs.

The guiding principle for any changes to the level of the GTM mill rates was expressed in the final sentence of Section 12 of the BNSF Settlement Agreement. The sentence states, "It is the intention of the parties that the rates and charges for trackage rights and service under this Agreement shall reflect the same basic relationship to operating costs as upon execution of this Agreement."

We had agreed on the amount of "the rates and charges for trackage rights and service" as expressed in the GTM mill rates. In the course of negotiations, each side had consulted its cost experts, and both BNSF and UP/SP had understandings of the level of "operating costs" based on their own definitions of the term. The guiding principle would be achieved by comparing the relationship of the GTM mill rates to "operating costs" at the time of execution to whatever relationship existed at a later time by comparing the GTM mill rates and the amount of "operating costs" under the same definition. In other words, the "same basic relationship" could be compared so long as the definitions of "the rates and charges for trackage rights" and for "operating costs" were consistent from one period to the next.

BNSF also negotiated for and obtained provisions that were intended to assure that it would not be responsible for any of UP/SP's costs necessary to achieve the benefits anticipated from the merger, as provided in Section 9(c) of the BNSF Settlement Agreement.

The parties recognized that UP's costs associated with the trackage rights lines could change and, indeed, it was expected by BNSF that these costs would decline as the merged entity achieved the substantial improvements in productivity and efficiencies that were expected from the merger. In line with the guiding principle cited above, BNSF and UP/SP agreed to a mechanism in Section 12 that we intended to serve as an indication of the merged company's costs, based on 70% of annual increases or decreases in the RCAF-U. This mechanism would serve as a surrogate for changes in the merged entity's costs to reflect productivity improvements. The GTM mill rate would be adjusted accordingly, in relation to changes in 70% of the RCAF-U.

The parties further recognized the possibility that the adjustment provisions we had agreed to might not achieve our intentions. Therefore, we included a provision in Section 12 of the BNSF Settlement Agreement that, on each fifth anniversary of the effective date of the Agreement, the parties would review the operation of the adjustment mechanism and renegotiate its terms, subject to arbitration if necessary. The guiding principle of maintaining the "same basic relationship" of GTM mill rates to costs, quoted above, applied to all of these provisions in Section 12.

There were numerous additional negotiations and resulting amendments to the BNSF Settlement Agreement, but none of the provisions discussed above was changed, with the exception of the basis used in the annual adjustment process. The provisions of the guiding principle of maintaining the basic relationship of rates to costs, the terms of Section 9(c) defining UP's sole responsibility for merger-related implementation costs, and the five year review process all remained intact, reflecting the same intentions as when they were agreed to in the September 1995 negotiations.

### III. THE CMA AGREEMENT

After the Application was filed, a number of shippers and other parties to the merger proceeding questioned the level of the GTM mill rates and the use of 70% of RCAF-U as the basis for the annual adjustments to the rates, as well as other issues concerning competitive service and access. As to all of these matters, their concerns centered around the need for effective competition to the merged UP/SP entity.

As to RCAF-U and the annual adjustments to the GTM mill rates, these shippers and their representatives were concerned that the differential in the rates BNSF would have to pay would, compared to UP/SP's costs, increase substantially over time because the BNSF rates would not be fully adjusted for the substantial productivity gains that UP/SP was likely to achieve and because any adjustment would be based on industry data rather than UP/SP's own costs. According to these parties, this increased differential would adversely affect BNSF's competitiveness. These parties also objected to the use of 70% of RCAF-U as the adjustment factor because the proper adjustment measure should be based on costs, not prices.

As a result of these concerns, UP/SP, BNSF and the Chemical Manufacturers Association (now, American Chemistry Council) entered into negotiations to revise the Section 12 adjustment mechanism. On April 18, 1996, all three parties executed the CMA Agreement which provided, in Section 7, that the trackage rights fees would be adjusted annually by the difference "between the year in question and the preceding year in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the fee." (Emphasis added.)

A key purpose of these negotiations was to address shippers' concerns and amend the mechanism to better reflect changes in UP/SP's maintenance and operating

costs associated with the trackage rights lines so that the relative relationship between UP's costs and BNSF's costs over the trackage rights lines would be more accurately measured than was possible using industry-based RCAF-U data. The focus of negotiations leading to the CMA Agreement was to protect BNSF's ability to compete with UP from year to year during the life of the trackage rights. The mutual decision to rely on UP's URCS costs was based on the parties' agreement, confirmed by their statements in negotiations, that a more reliable indicator of UP's operating costs, including the achievement of improved efficiencies, would be achieved by relying on "the categories of [UP/SP system average] maintenance and operating costs covered by the [trackage rights] fee," rather than RCAF-U data.

In light of the unanimous intent of the parties in agreeing to these changes, as well as the language that they used in the CMA Agreement, it was never intended or contemplated that the purchase premium UP paid to acquire SP would be used to increase the costs that would be used to adjust the GTM mill rates. All parties understood that BNSF's trackage rights, and related GTM mill rates, would not become effective until after the UP/SP merger was effected. In such a transaction, the purchase premium would be paid at the time the merger was approved and consummated and not in a subsequent year. Nor would the purchase premium be an actual maintenance and operating cost. Therefore, it was not foreseeable that the purchase premium could be used by UP in the annual adjustment mechanism to increase the GTM mill rates.

I submit that this intent is so clear that it should not require contractual language to be self-evident. But the language used in the CMA Agreement further affirms this intent. By comparing "the year in question" with the "preceding year", there was no

opportunity for UP to base the annual adjustment mechanism on a year that did not include the purchase premium since the first year was by definition the year in which the merger occurred.

UP's election to book the premium in 1997 rather than the year of the merger contradicted the foreseeable payment of the purchase premium at the time of acquisition. The parties' intent in the CMA Agreement was so clear that it never seemed plausible that UP would use this change in language as a reason to double count the purchase premium.

#### **IV. THE PURPOSE OF THE RATE ADJUSTMENT PROVISIONS**

Since BNSF and UP/SP had agreed in September 1995 on the terms they considered necessary to preserve rail competition as it existed between UP and SP prior to the merger, our main concern in negotiating and executing the CMA Agreement was to protect the essence of our existing agreement and satisfy the concerns of CMA (including its allied interests). Mr. Ice has described in his Verified Statement the issues that concerned BNSF and UP/SP in negotiating the level of trackage rights fees and related provisions that concerned adjustments to those fees and preserving the same basic relationship between rates and costs. The CMA negotiations and resulting Agreement did not result in changes to those provisions, except as to the basis for annual adjustments.

I believe all parties intended that the use of UP URCS data in the annual adjustment mechanism, in lieu of RCAF-U data, was to achieve more reliable measures of UP's actual operating and maintenance costs associated with the trackage rights operations and, thereby, link the level of GTM mill rates more directly to the expected declines in UP's costs. There was no intent, expressed by any party, that this use of

URCS data would enable UP to offset these declining costs by double counting the purchase premium and ignoring the provisions of Section 9(c).

The bases of this belief are, first, the self-evident advantages that CMA saw in using URCS costs, which were based on UP's own experience, versus the RCAF-U index, which is based on industry prices. My second reason is the inconsistency between the intent of the CMA negotiations and CMA Agreement, on the one hand, and the result of UP's efforts to base the annual adjustment on a double counting of the purchase premium and merger-related capital expenditures it had agreed were not BNSF's responsibility. Finally, I base this belief on the intent of the parties as manifested in our negotiations and the language of the agreements that we executed, including the portions of Section 12 that remained unchanged following the CMA Agreement and are in effect today. I will discuss each of these in sequence.

#### **A. UP's Costs Versus Industry Prices**

In support of their merger application, UP/SP relied heavily on operating efficiencies that they claimed would result in greater productivity and reduced operating costs. CMA, as well as BNSF, accepted UP/SP's basic premise that the merger would produce efficiencies. That acceptance is at the heart of our negotiations with UP/SP in the settlement process. CMA wanted the preservation of competing rail service after the UP/SP merger, and it was willing to rely on BNSF's proposed service, with certain conditions, including annual adjustment of the trackage rights rates that would give full effect to UP's improved productivity. BNSF also knew that its competition over UP/SP lines could not be effective over the long term unless its rates reflected reductions in UP's costs.

In the September 1995 negotiations, BNSF had been satisfied that the annual application of RCAF-U, reduced to 70 percent, was an adequate surrogate for the anticipated improvements in UP's productivity. UP also agreed to these provisions and accepted the methodology as a satisfactory way to adjust the GTM mill rates. CMA, however, insisted that a much more reliable measure was UP's costs, rather than a modified industry price index, and insisted on the use of UP's annual URCS costs. UP and BNSF were agreeable to this change. Therefore, the driving force behind the decision to rely on URCS costs was that they would reflect declining expenses due to increased efficiencies.

It should be noted that there was no way that the RCAF-U mechanism which is based on industry data would have enabled UP to adjust the GTM mill rates for the SP purchase premium or merger-related capital improvements, further demonstrating that the adjustment was not to be affected by those factors. There was no intention in the CMA Agreement negotiations to adopt an adjustment mechanism that allowed UP to apply costs that were already agreed to be embraced in the GTM mill rates.

**B. UP's Result Is Inconsistent With The CMA Negotiations and Agreement**

When UP booked the purchase premium in 1997 rather than 1996 when the acquisition occurred, it effectively made the purchase premium a factor in the July 1, 1998 annual adjustment. CMA or BNSF could hardly have anticipated this. We could not know what was in the corporate mind of UP/SP, but UP/SP never suggested that it was thinking of adding the purchase premium in some year after the first year used the annual adjustment comparisons.

Throughout the negotiation of the CMA Agreement, I am not aware that any party ever contemplated that the use of URCS would provide UP with an argument for basing the annual adjustment on the SP purchase premium and merger-related costs that were its responsibility under Section 9(c) of the Settlement Agreement. This result is wholly counter to the purpose of the amendment proposed by CMA and accepted by BNSF and UP/SP. Instead of providing a more accurate measure of UP's operating and maintenance costs that reflected improved efficiency and productivity, UP's application of URCS has the incredibly perverse result of offsetting cost reductions and double counting the substantial costs that had already been taken into account in setting the trackage rights fees.

**C. The Parties' Intent Is Confirmed by the Contractual Language**

The final sentence of Section 12 of the BNSF Settlement Agreement, unchanged by the CMA Agreement, sets forth the fundamental intent of the parties that "the rates and charges for trackage rights and services under this Agreement reflect the same basic relationship to operating costs as upon execution of this Agreement." The meaning of this guiding principle was well understood by BNSF and UP/SP in our negotiations, and there was no suggestion that it required further definition.

I understand that UP's adjustment of the GTM mill rates effective July 1, 1998, was based on including merger-related costs in its 1997 URCS costs that the parties intended to be included in the GTM mill rates agreed to in 1995. This has distorted the relationship of rates to costs and disregards the intent expressed in Section 12.

The effect of including these costs in 1997 and subsequent years is that the annual adjustments effective on July 1, 1998, and thereafter, are distorted by higher

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costs and are not comparable to costs used in 1996. There is no justification for including these costs in 1997 URCS costs, or in any subsequent year, because UP agreed that the GTM mill rates set in September 1995 took full account of all costs, which would include any purchase premium and the Section 9(c) implementation costs.

These costs that UP has improperly included in the annual adjustment effective July 1, 1998, and in subsequent years need to be identified and removed from URCS data for those years. Alternatively, the error of basing the adjustment on use of these costs in 1997 and subsequent years could be corrected by adding those costs in the years 1995 and 1996 and any succeeding years in which such costs are not present in URCS for the preceding year.

It is not my purpose here to propose a mechanism for correcting UP's addition to the base used for the annual adjustments of costs that were already accounted for in September 1995. Rather, the burden should be on UP to correct the error by a procedure that prevents the costs from having any effect in the annual adjustment process.

I believe UP's construction of the adjustment mechanism contradicts the intent of the parties that the GTM mill rates were comprehensive rates covering all costs as well as their intent to preserve the "same basic relationship" between rates and costs over the life of the Settlement Agreement.

**VERIFICATION**

I, Richard E. Weicher, verify under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on May 21, 2002.

Richard E. Weicher

Richard E. Weicher

## **VERIFIED STATEMENT OF CHRISTOPHER D. KENT**

### **I. BACKGROUND AND QUALIFICATIONS**

My name is Christopher D. Kent. I am Senior Managing Director of FTI Consulting, Inc. My office is located at 1201 Eye Street, N.W., Washington, D.C. 20005. For the past 30 years, I have been continuously involved in economic, financial, and cost studies of network industries, including railroads, telecommunications companies and electric power companies. I have testified on behalf of The Burlington Northern and Santa Fe Railway Company ("BNSF") and other Class I and II railroads numerous times before this Board and its predecessor, the Interstate Commerce Commission. A summary of my qualifications and previous testimony is included as Attachment 1.

### **II. INTRODUCTION**

In this Verified Statement, I estimate the impact of several issues that have arisen in connection with the dispute between BNSF and Union Pacific Railroad ("UP") concerning the proper adjustment of the trackage rights rates negotiated under the BNSF Settlement Agreement.<sup>1</sup> First, I compare the impact of UP's adjustment methodology on the gross ton-mile ("GTM") mill rates with the BNSF-proposed approach to adjusting the trackage rights rates. Specifically, I estimate the impact on the GTM mill rates of including the premium above historic book value that UP paid to acquire SP, and of including the merger-related capital expenditures which UP agreed to pay in Sections 9(c)(i) and (iii) of the Settlement Agreement. As set forth below, I

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<sup>1</sup> I am informed by counsel that there were originally three additional issues in dispute between BNSF and UP concerning the proper adjustment methodology. I am further informed that those three issues have been preliminarily resolved by the parties, and the various calculations I have undertaken in preparing this Verified Statement reflect the parties' resolution of those issues.

estimated that UP's proposed adjustment methodology results in GTM mill rates approximately 0.2 mills higher than they would be if BNSF's proposed adjustment methodology were used.

Second, I compared the UP methodology for adjusting the GTM mill rates with the BNSF methodology in order to determine the effect of the different approaches on the "basic relationship" between rates and UP's "operating costs" established in Section 12 of the BNSF Settlement Agreement. I determined that the BNSF methodology is much closer to maintaining the same relationship.

### **III. IMPACT OF UP'S POSITION ON GTM MILL RATES**

In order to determine the impact of including the SP purchase premium and the merger-related capital expenditures on the trackage rights rates, it was necessary to make certain adjustments to the 1995 and 1996 combined UP/SP URCS. These adjustments were required because the UP adjustment methodology compares the pre-merger UP/SP 1996 URCS costs with post-merger UP 1997 URCS costs. The 1997 UP costs include the SP purchase premium as well as post-merger 1996 and 1997 merger-related capital expenditures.<sup>2</sup> As set forth in the Verified Statements of Carl R. Ice and Richard E. Weicher, such a comparison is directly contrary to the language of Section 7 of the CMA Agreement.

The starting point I used for the process to include the SP purchase premium and merger-related capital expenditures in the 1995 and 1996 combined UP/SP URCS was the STB URCS Master File (the "UMF") that contains five years of selected data culled from carriers' annual R-1 Reports. Under the Board's URCS methodology, the UMF consolidates all data for predecessor roads, i.e., the UP data includes the former C&NW

<sup>2</sup> UP did not "book" the merger until its 1997 R-1 Report.

and SP. I obtained updated UMF files for UP and SP from the STB for each year 1995 through 1999, inclusive. I then made the following modifications to the 1995 and 1996 UP and SP data in the various UMF files in order to calculate the unit costs shown in URCS Phase II worktable E in my workpapers:<sup>3</sup>

- Substituted 1997 depreciation charges reported in the Revised R-1 Schedules 410, 412 and 415 for the data in the 1995 and 1996 UP and SP UMF files;
- Substituted the Revised 1997 Schedule 330 "Balance at the Beginning of Year" investment data for the 1995 and 1996 beginning and end-of-year data included in the UP and SP UMF files; and
- Substituted the Revised 1997 Schedule 335 Accumulated Depreciation as of the beginning of 1997 for the 1995 and 1996 beginning and end-of-year accumulated depreciation in the 1995 and 1996 UP and SP UMF files.

It was necessary to use 1997 data for 1995 and 1996 because the Board did not generate a combined UP/SP system URCS for 1995 and 1996.

After including the 1995 and 1996 combined UP/SP URCS, I calculated what the difference was in the GTM mill rate using BNSF's approach and UP's approach. In developing the BNSF figures in the Table, I applied a rate of change (or percentage change) rather than UP's approach of applying the absolute dollar difference. As the table below indicates, the difference is, over the five year period from 1996 to 2000, approximately 0.2 mills.

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<sup>3</sup> Copies of my workpapers are contained in the Confidential Appendix submitted with BNSF-102.

<b>Comparison of BNSF and UP Approaches to Adjustment of GTM Mill Rates</b>						
BNSF Approach (Adjusted URCS for 1995 and 1996)				UP Approach (Unadjusted URCS for 1995 and 1996)		
Year	GTM Unit Costs*	Annual Rate of Change (lagged 1 year)	Mills per GTM Adjusted Trackage Fee	GTM Unit Costs*	Absolute Change (lagged 1 year)	Mills per GTM Adjusted Trackage Fee
1995	\$0.00178841			\$0.00156806		
1996	\$0.00169823		3.100	\$0.00150524		3.100
1997	\$0.00164835	-5.042%	2.944	\$0.00164885	-0.00006282	3.037
1998	\$0.00164752	-2.937%	2.857	\$0.00164752	0.000014361	3.051
1999	\$0.00157770	-0.051%	2.856	\$0.00157770	-0.00000133	3.050
2000		-4.237%	2.735		-0.00006982	2.980
* Includes maintenance, operations, depreciation and return.						

It was not possible for me to quantify the impact of the dollar impact of UP inclusion of the Section 9(c) merger-related capital expenditures it agreed to fund in the URCS costs used for the adjustment. This is because, although the total dollars UP expended by project may be known, the specific accounts to which these dollars were assigned by UP are not known. In any event, the amount of these merger-related capital expenditures is significant, and inclusion of the expenditures in the URCS costs used to adjustment the trackage right mill rates would increase the resultant rate.<sup>4</sup>

#### IV. IMPACT OF UP'S POSITION ON THE "BASIC RELATIONSHIP"

BNSF also requested that I determine whether UP's position causes the "basic relationship" between the GTM mill rates and UP's operating costs to deviate from the

<sup>4</sup> I note in this regard that the substitution of the 1997 investment and depreciation costs for the data in the 1995 and 1996 combined UP/SP URCS, as I described above, accounts for the Section 9(c) merger-related capital expenditures booked by UP in 1997 which UP was to solely fund.

ratio between those two figures at the time of the execution of the Settlement Agreement.

I believe that the meaningful comparison for the basic relationship relates to the adjustments effective July 1, 1997 and July 1, 1998, because those adjustment periods were when the impact of the SP purchase premium is evident. Therefore, for the July 1, 1997 adjustment, I compared the change between the 1995 and 1996 URCS costs on a consistently applied basis and the resultant GTM mill rates for the UP approach with the BNSF approach. The UP approach shows a 4 percent decrease in URCS costs and a 2 percent decrease in the GTM mill rate. In contrast, the BNSF approach shows a 5.6 percent decrease in URCS costs and a 5.0 percent decrease in the GTM mill rates. For the July 1, 1998 adjustment, the same results occur. The UP URCS costs increase by 9.5 percent and the GTM mill rate increases by 0.5 percent. The BNSF approach results in URCS cost decreases of 3.1 percent, and the GTM mill rate decreases by 3.0 percent. Clearly, for the 1997 and 1998 adjustments, the BNSF approach is closer to maintaining the same basic relationship. Finally, a comparison of the overall change between 1995 and 2000 shows that under the UP method costs decrease by 0.6 percent while the rate declines by 3.8 percent. Under the BNSF approach, the costs decrease by 11.7 percent, while the rate declines 11.8 percent. The BNSF approach more closely maintains the same basic relationship of costs and rates.

**STATEMENT OF QUALIFICATIONS**  
**OF**  
**CHRISTOPHER D. KENT**

My name is Christopher D. Kent. I am Senior Managing Director of FTI Consulting, Inc. My office is located at 1201 Eye Street, NW, Washington, DC 20005.

I hold a Bachelor of Arts degree from the University of Virginia. In 1970 I joined Western Electric, Inc. as a Management Trainee in its "High Risk-High Reward" program. During the next six years I was promoted through various levels in the production, production scheduling and costs and forecasting departments.

Since 1977, I have been involved in various aspects of transportation including traffic analyses, economic studies including costs and revenue analyses, railroad valuations, and the development of railroad operating plans, railroad facility plans and rolling stock requirements.

In 1977, I joined Conrail as Project Manager and worked primarily in assisting the Operating Department in optimizing fleet availability.

In 1978, I was employed by the United States Railway Association as the Manager of Equipment and Facilities. I was subsequently appointed Chief, Equipment and Facilities, Rail Asset Valuation, in the Office of General Counsel. In this capacity, I supervised a staff of in-house professionals and outside consultants in developing the equipment, maintenance of way and operating evidence submitted by the U.S. government in the valuation proceedings before the Special Court created under Section 303(c) and 306 of the Regional Rail Reorganization Act.

In 1980, I formed Kent Associates, a consulting firm dealing with operating, transportation and marketing issues for various clients. Kent Associates was affiliated with the Washington Management Group and I served as Vice President of that firm.

In 1984, I joined the economic consulting firm of Snavely, King & Associates, Inc. as a Senior Consultant. While with that firm I participated in numerous studies related to Section 229 proceedings and anti-trust litigation.

In 1987, I founded Klick, Kent & Allen, Inc., an economic and financial consulting firm. I was a Principal of KK&A until its acquisition by FTI Consulting, Inc. in June 1998.

I have presented testimony in the valuation proceedings before the Special Court, the House of Courts of Justice Committee of the Virginia General Assembly, various state courts and federal courts and the Interstate Commerce Commission and Surface Transportation Board. Specific transportation-related testimony I have filed is listed below.

#### **TESTIMONY**

January, 1980	In the Matter of the Valuation Proceedings Under Sections 303(c) and 306 of the Regional Rail Reorganization Act. Special Court Misc. No. 76-1
October, 1981	In the Matter of the Valuation Proceedings Under Sections 303(c) and 306 of the Regional Rail Reorganization Act. Special Court Misc. No. 76-1
January, 1986	Oral testimony before the House of Delegates, Commonwealth of Virginia, Courts of Justice Committee
May 15, 1987	I.C.C. Docket No. 38301S - Coal Trading Corporation et al. v. The Baltimore and Ohio Railroad Company et al.

December, 1987	I.C.C. Docket No. 38301S (Sub-No. 1) - Westmoreland Coal Sales Company v. The Denver & Rio Grande Western Railroad Company, et al.
December, 1987	I.C.C. Docket No. 37038 Bituminous Coal -- Hiawatha, Utah to Moapa, Nevada and consolidated proceedings
January 14, 1988	I.C.C. Docket No. 38301S - Coal Trading Corporation et al. v. The Baltimore and Ohio Railroad Company et al.
June 20, 1988	I.C.C. Docket No. 37038 Bituminous Coal -- Hiawatha, Utah to Moapa, Nevada and consolidated proceedings
July, 1989	Oral testimony before the Superior Court of Rhode Island in the matter: National Railroad Passenger Corporation v. DOT, Providence & Worcester Railroad Co. v. RI
July 30, 1990	I.C.C. Docket No. 37038 Bituminous Coal -- Hiawatha, Utah to Moapa, Nevada and consolidated proceedings
October 10, 1990	I.C.C. Docket No. 37063, 38025S - The Dayton Power and Light Company v. Louisville and Nashville Railroad Company
December 14, 1990	I.C.C. Docket No. 37063, 38025S - The Dayton Power and Light Company v. Louisville and Nashville Railroad Company
January 25, 1991	I.C.C. Docket No. 37063, 38025S - The Dayton Power and Light Company v. Louisville and Nashville Railroad Company
July 15, 1991	I.C.C. Docket No. 37038 Bituminous Coal -- Hiawatha, Utah to Moapa, Nevada and consolidated proceedings
April 24, 1992	I.C.C. Finance Docket No. 31951 Southern California Regional Rail Authority For an Order Requiring Joint Use of Terminal Facilities of The Atchison, Topeka and Santa Fe Railway Company
May 7, 1993	I.C.C. Finance Docket No. 21215 (Sub-No. 5) Seaboard Air Line Railroad Company -- Merger -- Atlantic Coast Line Railroad Company -- Petition to Remove Traffic Protective Conditions
June 10, 1994	I.C.C. Finance Docket No. 21215 (Sub-No. 5) Seaboard Air Line Railroad Company -- Merger -- Atlantic Coast Line Railroad Company -- Petition to Remove Traffic Protective Conditions

October 11, 1994	I.C.C. Finance Docket No. 32549 Burlington Northern, Inc. And Burlington Northern Railroad Company -- Control and Merger -- Santa Fe Pacific Corporation and the Atchison, Topeka and Santa Fe Railway Company
March 29, 1995	I.C.C. Docket No. 37809, 37809 (Sub-No. 1) McCarty Farms, Inc., et al., and consolidated proceedings
May 30, 1995	I.C.C. Docket No. 41191 West Texas Utilities Company v. Burlington Northern Railroad Company
October 30, 1995	I.C.C. Docket No. 41185 Arizona Public Service Company and PacifiCorp v. The Atchison, Topeka and Santa Fe Railway Company
April 29, 1996	Finance Docket No. 32760. Union Pacific Corporation, Union Pacific Railroad Company and Missouri Pacific Railroad Company -- Control and Merger -- Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSI Corp., and The Denver & Rio Grande Western Railroad Company.
May 23, 1996	Docket No. 41191. West Texas Utilities Company v. Burlington Northern Railroad Company -- Petition of Burlington Northern Railroad Company to Reopen Proceeding.
October 15, 1996	Docket No. 41242. Central Power & Light Company v. Southern Pacific Transportation Company; Docket No. 41295 Pennsylvania Power & Light Company v. Consolidated Rail Corporation; Docket No. 41626 MidAmerican Energy Company v. Union Pacific Railroad Company and Chicago & North Western Railway Company.
October 25, 1996	Docket No. 41242. Central Power & Light Company v. Southern Pacific Transportation Company; Docket No. 41295 Pennsylvania Power & Light Company v. Consolidated Rail Corporation; Docket No. 41626 MidAmerican Energy Company v. Union Pacific Railroad Company and Chicago & North Western Railway Company.
July 11, 1997	Docket No. 41989. Potomac Electric Power Company v. CSX Transportation, Inc. Reply Statement and Evidence of Defendant CSX Transportation, Inc.
May 1998	Docket No. 42012, Sierra Pacific Power Company and Iowa Power Company v. Union Pacific Railroad Company

July 1998	Finance Docket No. 33556, Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated -- Control -- Illinois Central Corporation, Illinois Central Railroad Company, and Cedar River Railroad Company.
September 1998	Docket No. 42022, FMC Corporation and FMC Wyoming Corporation v. Union Pacific Railroad Company.
December 1998	Finance Docket No. 33556, Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated -- Control -- Illinois Central Corporation, Illinois Central Railroad Company, and Cedar River Railroad Company.
January 15, 1999	Docket No. 42022. FMC Corporation and FMC Wyoming Corporation, v. Union Pacific Railroad Company. Opening Verified Statement of Christopher D. Kent and Benton V. Fisher.
March 31, 1999	Docket No. 42022. FMC Corporation and FMC Wyoming Corporation, v. Union Pacific Railroad Company. Reply Verified Statement of Christopher D. Kent and Benton V. Fisher. Reply Verified Statement of Christopher D. Kent and John C. Klick.
April 30, 1999	Docket No. 42022. FMC Corporation and FMC Wyoming Corporation, v. Union Pacific Railroad Company. Rebuttal Verified Statement of Christopher D. Kent and Benton V. Fisher.
July 15, 1999	Docket No. 42038. Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Railway Company. Opening Verified Statement of Christopher D. Kent and Benton V. Fisher.
August 30, 1999	Docket No. 42038. Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Railway Company. Reply Verified Statement of Christopher D. Kent and Benton V. Fisher.
September 28, 1999	Docket No. 42038. Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Railway Company. Rebuttal Verified Statement of Christopher D. Kent and Benton V. Fisher.
April 15, 2000	Expert Report. IFL Group, Inc., and Contract Air Cargo, Inc. v. Lincoln General Insurance Company.
June 15, 2000	Docket No. 42051. Wisconsin Power and Light Company v. Union Pacific Railroad Company. Opening Verified Statement of Christopher D. Kent and Benton V. Fisher.

August 14, 2000     Docket No. 42051. Wisconsin Power and Light Company v. Union Pacific Railroad Company. Reply Verified Statement of Christopher D. Kent and Benton V. Fisher.

August 14, 2000     Docket No. 42051. Wisconsin Power and Light Company v. Union Pacific Railroad Company. Reply Verified Statement of Christopher D. Kent and Michael R. Baranowski.

September 28, 2000     Docket No. 42051. Wisconsin Power and Light Company v. Union Pacific Railroad Company. Rebuttal Verified Statement of Christopher D. Kent and Benton V. Fisher.

December 14, 2000     Docket No. 42054. PPL Montana, LLC v. The Burlington Northern Santa Fe Railway Company, Opening Verified Statement of Christopher D. Kent and Benton. V. Fisher.

March 13, 2001     Docket No. 42054. PPL Montana, LLC v. The Burlington Northern Santa Fe Railway Company, Reply Verified Statement of Christopher D. Kent and Benton. V. Fisher.

March 13, 2001     Docket No. 42054. PPL Montana, LLC v. The Burlington Northern Santa Fe Railway Company, Reply Verified Statement of Christopher D. Kent and John C. Klick.

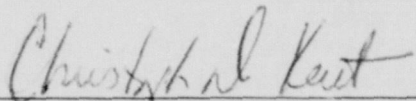
May 7, 2001     Docket No. 42054. PPL Montana, LLC v. The Burlington Northern Santa Fe Railway Company, Rebuttal Verified Statement of Christopher D. Kent and Benton.V. Fisher.

January 15, 2002     Docket No. 42057. Texas Municipal Power Agency v. The Burlington Northern Santa Fe Railway Company, Reply Verified Statement of Christopher D. Kent and John C. Klick.

**VERIFICATION**

I, Christopher D. Kent, verify under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on May 20, 2002.

  
\_\_\_\_\_  
Christopher D. Kent

## **VERIFIED STATEMENT OF DENIS J. SMITH**

### **I. BACKGROUND AND QUALIFICATIONS**

My name is Denis J. Smith, and I am Vice President, Industrial Products Marketing for The Burlington Northern and Santa Fe Railway Company (BNSF), a position I have held since March of 2001. My business address is 2650 Lou Menk Dr., Fort Worth, TX 76131-2830. I have responsibilities of price, markets, capacity, and program direction for BNSF's Industrial Products Business Unit. I began my career as market manager in BNSF's agricultural business unit in 1993 and have held various positions in the Marketing Department since that time.

Before joining BNSF, I was a trading member of the Minneapolis Grain Exchange and was employed by Continental Grain Company in various positions for 13 years. I received a Bachelors of Business Administration (Marketing) from Kent State University in 1976 and a Masters of Agricultural Science from California Polytechnic, San Luis Obispo in 1980.

### **II. PURPOSE OF VERIFIED STATEMENT**

The purpose of my Verified Statement is to describe the competition between BNSF and UP over the trackage rights which BNSF received as a condition to the approval by the Surface Transportation Board of the merger between Union Pacific Railroad Company ("UP") and Southern Pacific Transportation Company ("SP") in 1996. Specifically, I will provide a summary of BNSF's competitive presence on the UP/SP trackage rights lines and will then describe how, even though we believe that we are currently providing competitive service over those lines as a replacement for SP, it is important to BNSF's long-term ability to provide such service (i) that the rates which BNSF pays to UP for its use of the trackage rights lines remain in the same relative

relationship to UP's costs as when the BNSF Settlement Agreement was executed in September of 1995, and (ii) that UP not gain a competitive advantage over BNSF when UP's costs decline.

### **III. BNSF COMPETITION OVER THE TRACKAGE RIGHTS LINES**

Initially, as set forth in BNSF's quarterly and annual oversight reports filed in the UP/SP proceeding, BNSF has provided effective and efficient competitive service over the trackage rights lines. We have done so by aggressively marketing our services to shippers and by then providing them with reliable, timely service. We have established a number of innovative marketing programs and have introduced several initiatives designed to improve our service offerings. The fact of BNSF's successful competitive presence has been recognized by the Board, and it is a fact of which we at BNSF are quite proud.

We have, however, been able to achieve this success in large part because, when the BNSF Settlement Agreement was negotiated, the GTM mill rates were set at levels which, when compared to UP/SP's costs over the trackage rights lines, allowed us to provide competitive service. Indeed, Section 12 of the Settlement Agreement expressly acknowledged this basic relationship and provided that it was the parties' intent that this relationship be maintained throughout the 99-year term of the Settlement Agreement.

There are a number of factors and variables that determine whether BNSF is able to compete effectively over the trackage rights lines. These factors and variables include primarily factors such as the rate which BNSF offers to shippers, BNSF's schedules and transit times, equipment availability and track access among others. Of these, the rate offered to shippers is often the most critical factor, and the GTM mill

rates which BNSF pays under the Settlement Agreement are a significant element of the rate which BNSF can offer to shippers.

Much of the traffic over the trackage rights lines is highly sensitive to price and, even though many factors influence competition on the trackage rights lines, pricing is ultimately the most critical. In this regard, BNSF's short-term ability to compete by offering particular shippers the combination of price, service and route structure they demand is not determinative. Over the long-run, an unfavorable cost structure (resulting, for instance, from inflated trackage rights fees) can (and likely will) erode BNSF's ability to compete.

#### **IV. IMPACT OF GTM MILL RATE DISPUTE**

In the first few years of competition between BNSF and UP over the trackage rights lines, there was often a fairly wide range between the rates offered by the two carriers as each carrier was learning about the new competitive market and adjusting its price, service and routing offerings to compete with the other. Now, UP is able to determine with some accuracy the rates which BNSF can offer for service over the trackage rights lines. Because UP knows the GTM mill rates which BNSF will be required to pay on any given movement, the range of competitive rate offerings has narrowed to a range of \$25.00 to \$50.00 per car. In other words, UP essentially knows how low BNSF can take the price it offers for a movement over the trackage rights lines, and it can then simply underbid that price by \$25.00 to \$50.00.

As the Board has recognized, the approximate amount in dispute between UP and BNSF with respect to the GTM mill rates (0.2 mills) is in the range of five to six percent of the GTM mill rates. When such a percentage is applied to moves over the trackage rights lines, the amount represented by the dispute can often equate to the

\$25.00 to \$50.00 per car range in which, as discussed above, the parties currently compete and can be expected to compete over the long run

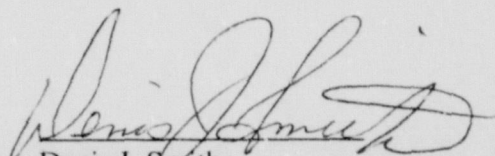
Here are examples of what the impact of the amount in dispute (0.2 mills) is on the rates per car (loaded to 286,000 pounds) for sample round trip moves on the trackage rights lines:

Houston to East St Louis	\$29.51
Denver to Stockton	\$46.26
Denver to Fernley, NV	\$38.34
Denver to Ogden, UT	\$20.97

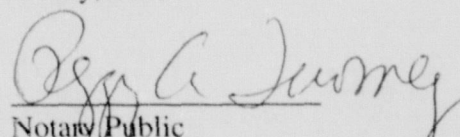
Accordingly, if the productivity improvements which UP has achieved since the merger with SP are not properly reflected in the adjusted GTM mill rates, UP will have gained a competitive advantage over BNSF that will potentially endure for the term of the Settlement Agreement.

## VERIFICATION

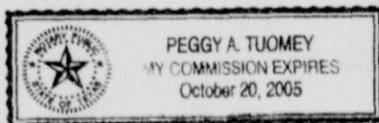
Denis J. Smith, being duly sworn, deposes and says that he has read the foregoing statement and that the contents thereof are true and correct to the best of my knowledge and belief.

  
Denis J. Smith

Subscribed and sworn to before me on this 17<sup>th</sup> day of May, 2002.

  
Notary Public

My Commission expires:



STB

FD-32760

5-22-02

D

205459

Title This Jacket

STB FD-32760 5-22-02 D

ID-205459

205459

2550 M Street, NW  
Washington, DC 20037-1350  
202-457-6000

Facsimile 202-457-6315  
www.pattonboggs.com

Scott N. Stone  
202-457-6335  
sstone@pattonboggs.com

April 9, 2002

The Honorable Vernon A. Williams, Secretary  
Surface Transportation Board  
1925 K Street, NW Suite 700  
Washington, DC 20423-0001



Re: Fin. Docket No. 32760, Union Pacific Corporation, Union Pacific Railroad Company, and Missouri Pacific Railroad Company – Control and Merger – Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corp., and the Denver and Rio Grande Western Railroad Company

Dear Secretary Williams:

Enclosed are an original and 25 copies of CMA-17, the Evidentiary Submission of the American Chemistry Council Regarding Trackage Rights Fee Escalator. Included in the submission is the Verified Statement of Thomas E. Schick.

Please stamp the additional copy with the date of receipt and return with our messenger.

Sincerely,

A handwritten signature in black ink, appearing to be "Scott N. Stone", written over a horizontal line.

Scott N. Stone

Counsel for the American  
Chemistry Council

**ENTERED**  
**Office of the Secretary**  
**MAY 23 2002**  
**Part of**  
**Public Record**

205 459

CMA-17

BEFORE THE  
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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

-- CONTROL AND MERGER --

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

EVIDENTIARY SUBMISSION OF THE  
AMERICAN CHEMISTRY COUNCIL  
REGARDING TRACKAGE RIGHTS  
FEE ESCALATOR

ENTERED  
Office of the Secretary  
MAY 23 2002  
Part of  
Public Record

The American Chemistry Council ("the Council")<sup>1</sup> respectfully submits the attached  
verified statement of Thomas E. Schick in response to the show cause order served by the  
Surface Transportation Board ("the Board") on March 21, 2002. Mr. Schick is counsel to the

<sup>1</sup> The American Chemistry Council (formerly the Chemical Manufacturers Association, or CMA) represents the leading companies engaged in the business of chemistry. Council members apply the science of chemistry to make innovative products and services that make people's lives better, healthier and safer. The Council is committed to improved environmental, health and safety performance through Responsible Care<sup>®</sup>, common sense advocacy designed to address major public policy issues, and health and environmental research and product testing. The business of chemistry is a \$455 billion a year enterprise and a key element of the nation's economy. It is the nation's largest exporter, accounting for 10 cents out of every dollar in U.S. exports. Chemistry companies invest more in research and development than any other business sector.

Council's Distribution Team and was counsel to CMA's Distribution Committee during CMA's negotiations with the UP in 1996 over what has become known as the "CMA Agreement." Mr. Schick's verified statement explains the background and intent of the relevant provisions of the CMA Agreement.

As Mr. Schick explains, paragraph 7 of the CMA Agreement, as submitted to the Board on April 19, 1996 (UP/SP-219) modified section 12 of the UP/SP-BNSF Settlement Agreement to change the escalator for the trackage rights fees to be paid by BNSF. Paragraph 7 provided that the trackage rights fees would "be adjusted upward or downward each year by the difference between the year in question and the preceding year in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the fee." (Emphasis added.) The most significant aspect of this provision in light of the issues now before the Board is that it would have adjusted URCS costs based upon a comparison of costs for post-merger years only. Because the first adjustment would have been based on a comparison of costs in the second post-merger year with costs in the first post-merger year, there never would have been a comparison of post-merger costs with pre-merger costs. UP/SP-219 clearly reflects this intention.

After CMA management reviewed and approved the CMA Agreement, the Agreement was filed with the Board (UP/SP-219, filed April 18, 1996), and CMA submitted a brief advising the Board that it had withdrawn its opposition to the merger (CMA-12, filed June 3, 1996). However, after CMA filed its brief, the escalation methodology was further amended as part of the "Second Supplemental Agreement" negotiated between UP and BNSF, which was submitted to the Board on June 28, 1996, the last business day before oral argument in the UP/SP merger case. CMA was not a signatory to that supplemental agreement, and indeed was not involved in these last-minute negotiations, except that CMA was aware of a clarification, contained in the

same set of amendments, relating to BNSF access to shippers in the Lake Charles, LA area. Schick V.S. at 5. Mr. Schick testifies that when he later learned of the change to the escalation formula, he understood that the amendment was intended to be technical in nature only. Schick V.S. at 5-6.

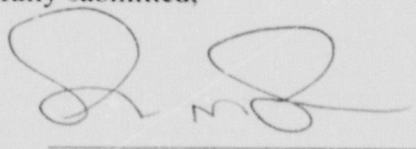
As amended in that Second Supplemental Agreement, the escalator was to be applied on July 1 of each year and was based upon a comparison of the relevant URCS costs in the two preceding years, rather than in the current and preceding year. This technical change arose from the difficulty of making adjustments based upon costs which might normally only be compiled some time after the end of a given year. As interpreted and applied by the UP, however, this amendment to the escalator would not be technical, but rather substantive, because it would base the escalation upon a comparison of URCS costs for the first post-merger year versus the last pre-merger year.

Hence, as interpreted by the UP, the effect of this amendment would permit UP to build into the trackage rights fee, through the escalator, the merger-related write-up of its track assets, reflecting both the purchase price paid for the track in the merger and certain post-merger capital investments that UP had elsewhere prominently pledged to pay for itself. Yet as Mr. Schick testifies, CMA understood that the trackage rights fee already reflected the merger as a fully accomplished transaction. Schick V.S. at 3. It was not and could not have been CMA's intention that a technical amendment, which it did not even negotiate or sign on to, should increase the trackage rights fee further to capture again the price of assets in the merger. In addition, CMA was well aware of, and relied upon, the representations of UP on the record that the trackage rights fee was intended to be

comprehensive, and that UP was itself going to pay for certain merger-related improvements, rather than passing these costs along to BNSF. Id. at 6-7.

In sum, it would be contrary to CMA's intent, and grossly unfair, to permit a last-minute technical amendment which CMA had no involvement in, to overcome both the representations of UP and the intention of CMA regarding the trackage rights escalator. If the escalator formula is to be applied as revised in the Second Supplemental Agreement, such that pre- and post-merger years are compared, then the only fair way to preserve the intention of the parties, in particular the intention of CMA, is to exclude or adjust the items reflecting the merger-related write up of assets and the capital improvements which UP promised to pay for. Hence, the Council fully supports the adjustments requested by BNSF in this proceeding, as reflecting the intention of the Council and its predecessor CMA.

Respectfully submitted,



Scott N. Stone  
John L. Oberdorfer  
Patton Boggs, LLP  
2550 M Street, N.W.  
Washington, D.C. 20037

Counsel for the American  
Chemistry Council

dated and due: May 22, 2002

BEFORE THE  
SURFACE TRANSPORTATION BOARD

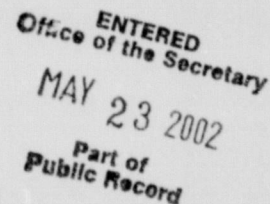


Finance Docket No. 32760

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

-- CONTROL AND MERGER --

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



VERIFIED STATEMENT OF THOMAS E. SCHICK

My name is Thomas E. Schick. I am Counsel for the Distribution Team at the American Chemistry Council ("the Council").<sup>1</sup> I provide this verified statement to explain the Council's intentions at the time it entered into what has become known as the "CMA Agreement" with

<sup>1</sup> The American Chemistry Council (formerly the Chemical Manufacturers Association, or CMA) represents the leading companies engaged in the business of chemistry. Council members apply the science of chemistry to make innovative products and services that make people's lives better, healthier and safer. The Council is committed to improved environmental, health and safety performance through Responsible Care<sup>®</sup>, common sense advocacy designed to address major public policy issues, and health and environmental research and product testing. The business of chemistry is a \$455 billion a year enterprise and a key element of the nation's economy. It is the nation's largest exporter, accounting for 10 cents out of every dollar in U.S. exports. Chemistry companies invest more in research and development than any other business sector.

Union Pacific ("UP"), Southern Pacific ("SP") and Burlington Northern Santa Fe ("BNSF") on April 18, 1996. The CMA Agreement was filed with the Board on April 19, 1996 (UP/SP-219).

As background, I will set out briefly the chronology of the Council's deliberations with respect its position on the UP/SP merger. I served as counsel to the CMA Distribution Committee (predecessor to the Council's Distribution Team) through the period discussed below.

On March 5, 1996, CMA's Executive Committee adopted a policy on railroad mergers in general and the UP/SP merger in particular. The Executive Committee directed that CMA file comments with the Surface Transportation Board ("the Board") expressing eight listed concerns with the UP/SP merger as then proposed, and directed CMA representatives to negotiate with the applicants to seek voluntary agreement to ameliorate the eight concerns. Of the eight concerns, the one of relevance here was number 2C, which stated the following objective:

2C. Renegotiate (lower) the trackage rights fees or establish a trust fund to provide for shared maintenance costs rather than subsidize the host railroad's operations.

On March 27, 1996, CMA's Distribution Committee met and considered whether certain concessions offered by UP prior to that date were adequate to address the eight listed concerns. The Committee determined that those concessions were inadequate and that CMA should file comments opposing the merger. On March 29, 1996, CMA filed comments with the Board opposing the UP/SP merger (CMA-7), and appended (as Attachment 1) the list of eight concerns adopted by the Executive Committee.

As part of its March 29, 1996 comments, CMA also submitted a Verified Statement by Thomas D. Crowley of L.E. Peabody & Associates (Attachment 2 to CMA-7). Mr. Crowley

testified, among his other points, that the trackage rights fees set out in the UP/SP-BNSF Settlement Agreement were above UP/SP costs including a return on capital. Crowley V.S. at 51. Mr. Crowley stated that the trackage rights fee levels reflected the monopoly rents that UP and SP could charge as a merged entity. Id. In other words, the fees reflected the merger as a fully implemented transaction, except that Mr. Crowley stated that even if these fees were lowered to the proper level (the combined UP/SP URCS costs for 1994 indexed to fourth quarter 1995 wage and price levels), the fees calculated in this way would still be too high because they "do not include the cost savings projected by UP/SP as one of the benefits of the merger." Id. at 51-52. Mr. Crowley also commented on the escalator then proposed – 70% of the Rail Cost Adjustment Factor unadjusted for productivity ("RCAF(U)"). Mr. Crowley showed that this escalator would allow the trackage rights fee to rise over time relative to inflation, whereas using a productivity-adjusted escalation factor would cause the trackage rights fee to rise at a rate commensurate with UP's actual costs. Id. at 56.

Based on Mr. Crowley's recommendations, and the Executive Committee's eight points, CMA sought to negotiate a reduction of the trackage rights fees stated in the UP/SP BNSF Settlement Agreement and/or the establishment of a fund into which the trackage rights fees could be paid to ensure that they were not used to subsidize the maintenance of UP lines other than the trackage rights lines. In addition, CMA sought to change the escalator so that the fees would track the long-term trend of decreasing railroad costs reflecting increased productivity.

Between March 29 and April 16, 1996, I and other CMA representatives met with representatives of Union Pacific for further negotiations. Among the new provisions offered during this period by UP were (1) to place trackage rights fees in two dedicated regional accounts so that these fees would not be used to subsidize improvements elsewhere on UP's

merged system and (2) to escalate the trackage rights fees not on the basis of 70% of RCAF(U), but rather in accordance with year-to-year changes in UP/SP actual system average costs.

These negotiations resulted in what has come to be referred to as the CMA Agreement. The provisions of the CMA Agreement regarding the escalator formula are worthy of particular note. Paragraph 7 of the CMA Agreement provided as follows:

7. Section 12 of the BN/Santa Fe Settlement Agreement shall be amended to provide that BN/Santa Fe's trackage rights fees shall be adjusted upward or downward each year by the difference between the year in question and the preceding year in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the fee. CMA or its designee shall have the right to audit the escalation calculations.<sup>2</sup>

I would like to point out the phrase that I have underlined. The escalator formula in the CMA Agreement provided for adjustment of the trackage rights fee based on the difference between the current and previous year. Because the base trackage rights fee (unadjusted) would be paid in post-merger year 1, the first time the fee would be adjusted would be in year 2, and the adjustment would be based upon the difference between post-merger year 2 costs and post-merger year 1 costs. There was no provision for adjustments based on comparing pre-merger years with post-merger years.

On April 16, 1996 CMA's Distribution Committee reviewed the final draft of the CMA Agreement and decided that it adequately addressed the eight stated concerns. On April 18, the CMA Agreement was signed, and on April 19 it was filed with the Board (UP/SP-219).

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<sup>2</sup> UP/SP-219 at 3.

After approving the CMA Agreement, the Distribution Committee directed CMA's counsel to advise the Board that CMA had withdrawn its opposition to the merger. CMA did so in its June 3, 1996 brief to the Board (CMA-12). CMA's brief, in summarizing the terms of the CMA Agreement, commented as follows regarding the effect of the CMA Agreement on the trackage rights fee to be paid by BNSF (the italicized emphasis was in the original):

- Places 100% of the trackage rights fees in a segregated fund to be used exclusively for maintenance, improvements and depreciation on the trackage rights lines, with one fund for the South Central region and one fund for the Central Corridor/California. *This ensures that trackage rights fees are used for the trackage rights lines rather than subsidizing other lines.*
- Changes trackage rights fee escalator from 70% of RCAF(U) to year-to-year changes in UP/SP actual system average cost for the maintenance and operating cost elements covered by the fee. CMA will have the right to audit. *This will correct the tendency of the fee to rise above actual costs over time because of the use of an escalator that did not incorporate productivity gains.*

Following the filing of CMA's brief, UP and BNSF continued negotiating between themselves a series of modifications to the UP/SP-BNSF Settlement Agreement. These were incorporated into a "Second Supplemental Agreement" that was submitted to the Board on June 28, 1996, the last business day before the July 1 oral argument on the UP/SP merger. CMA was not a signatory to that agreement and was not involved in negotiating it, except that it was consulted regarding a provision clarifying BNSF's access to certain points in the Lake Charles, LA area.

One of the provisions of the Second Supplemental Agreement, which again CMA had no involvement in negotiating, modified the escalator formula established by the CMA Agreement. The modification provided that the escalator would be applied on July 1 of each year, and would be based on the difference in costs for the prior two years. To the best of my recollection, I was

not aware of this provision when it was negotiated and submitted to the Board. Although I later learned of the provision, I believe it was portrayed as simply a technical amendment which arose from the difficulty of adjusting fees in the current year based on comparing current year costs to previous year costs, because current year costs (and even the prior year's costs) could not be calculated until some time after the end of the year.

As interpreted and applied by UP, the practical effect of this "technical" modification would be to escalate fees for the second post-merger year based on a comparison of the first post-merger year with the last pre-merger year. This would have the effect of escalating the fee based on the write-up of UP/SP assets resulting from the merger and UP track-related investments made in the first post-merger year. This would certainly be contrary to CMA's intent, because the escalator provision in the CMA Agreement compared costs only for post-merger years, and never compared pre-merger costs with post-merger costs. It would be unjust if CMA's clear intent could be defeated by a technical amendment in a last-minute agreement to which CMA was not a party.

As noted, CMA had presented evidence, through Mr. Crowley, that the trackage rights fee set out in the original UP/SP-BNSF Agreement was already too high and already reflected the merger as an accomplished fact. For these additional reasons it would be directly contrary to CMA's express intent to modify the escalator formula so as to permit UP/SP to further increase the trackage fee as a result of its merger-related write-up of assets.<sup>3</sup>

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<sup>3</sup> This write-up would also be inconsistent with the testimony of UP witness Rebensdorf that the trackage rights fee was intended to be "comprehensive." UP/SP Merger Application, Vol. 1, V.S. of John Rebensdorf at 308.

The intent of the CMA Agreement with respect to the trackage rights fee, apart from establishing segregated accounts for the fees and thus avoiding cross-subsidization, was to ensure that, following the merger, the escalation formula would reflect UP's productivity gains and allow BNSF to compete more effectively with UP. It was not CMA's intention that the new escalation formula – URCS system average costs – would be a means of allowing UP to capture for a second time a merger premium which in CMA's understanding was already reflected in the base trackage rights fee.

In conclusion, the current potential inequity (UP's effort to increase the trackage rights fee to reflect its merger-related write-up of assets), is based on UP's interpretation of an agreement (the Second Supplemental Agreement) to which CMA was not even a party. It would be illogical and unfair for this last-minute technical amendment to override the clear intention of CMA that the trackage rights fees not be further written up.

A related point at issue here is whether the trackage rights escalator should include or exclude the effect of certain capital expenditures that UP expressly committed to pay for. Those commitments were incorporated into section 9c of the original UP/SP-BNSF Settlement Agreement. Although CMA did not participate in the negotiation of those provisions, CMA was well aware of them, and relied on them to facilitate BNSF's becoming an effective competitive counterweight to UP. It would be contrary to CMA's intentions and expectations for BNSF to be required to pay for those investments through the back door of the trackage rights fee escalator. Again, the technical fine points should not be interpreted in such a way as to undermine the main points of the agreements that enabled the UP/SP merger to occur.

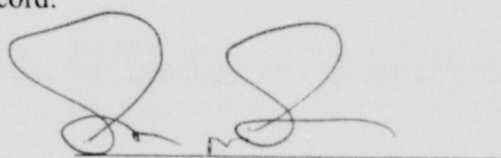
I, Thomas E. Schick, swear under penalty of perjury under the laws of the United States,  
that the foregoing verified statement is true and correct to the best of my knowledge and belief.

Thomas E. Schick

Thomas E. Schick

# CERTIFICATE OF SERVICE

This is to certify that I have, this 22nd day of May, 2002, served copies of the foregoing filing by hand upon Washington counsel for the Burlington Northern Santa Fe and Union Pacific and by first class mail upon other parties of record.



Scott N. Stone

STB

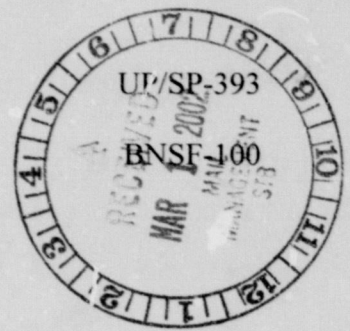
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204871

1 of 3



BEFORE THE  
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760      **204871**

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

— CONTROL AND MERGER —

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

Finance Docket No. 32760 (Sub-No. 21)      **204872**

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

**JOINT SUBMISSION OF RESTATED AND AMENDED  
BNSF SETTLEMENT AGREEMENT**

ENTERED  
Office of the Secretary

MAR 04 2002

Part of  
Public Record

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March 1, 2002

BEFORE THE  
SURFACE TRANSPORTATION BOARD

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Finance Docket No. 32760

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

– CONTROL AND MERGER –

SOUTHERN PACIFIC RAIL CORPORATION, SOUTHERN PACIFIC  
TRANSPORTATION COMPANY, ST. LOUIS SOUTHWESTERN RAILWAY  
COMPANY, SPCSL CORP. AND THE DENVER AND  
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Finance Docket No. 32760 (Sub-No. 21)

UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY  
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– CONTROL AND MERGER –

SOUTHERN PACIFIC RAIL CORPORATION, SOUTHERN PACIFIC  
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COMPANY, SPCSL CORP. AND THE DENVER AND  
RIO GRANDE WESTERN RAILROAD COMPANY – OVERSIGHT

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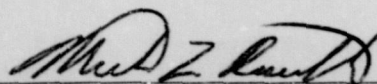
**JOINT SUBMISSION OF RESTATED AND AMENDED  
BNSF SETTLEMENT AGREEMENT**

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The Burlington Northern and Santa Fe Railway Company (“BNSF”) and Union Pacific Railroad Company (“UP”) submit the attached Restated and Amended BNSF Settlement Agreement pursuant to the Board’s order in General Oversight Decision No. 21, served December 20, 2001. Also attached is a red-lined version of the Restated and Amended BNSF

Settlement Agreement that identifies the changes from the version of the Restated and Amended BNSF Settlement Agreement submitted by the parties on July 25, 2001.

Respectfully submitted,

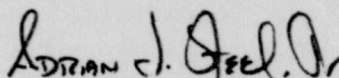


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*Attorneys for The Burlington Northern  
and Santa Fe Railway Company*

March 1, 2002

03/01/02

## RESTATED AND AMENDED AGREEMENT

This Restated and Amended Agreement ("Agreement") is entered into this \_\_\_\_ day of March, 2002, between UNION PACIFIC RAILROAD COMPANY ("UP"), a Delaware corporation, and THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY ("BNSF"), a Delaware corporation.

### WITNESSETH:

WHEREAS, UP and BNSF entered into an agreement dated September 25, 1995, as amended by supplemental agreements dated November 18, 1995, and June 27, 1996 (collectively, the "1995 Agreement"), in connection with UP's acquisition of Southern Pacific Rail Corporation and its affiliates ("SP") in Finance Docket No. 32760, Union Pacific Corporation, Union Pacific Railroad Company, and Missouri Pacific Railroad Company -- Control and Merger -- Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corp., and The Denver and Rio Grande Western Railroad Company;

WHEREAS, the Surface Transportation Board ("STB") approved the common control and merger of UP and SP in Decision No. 44 in Finance Docket No. 32760 (served August 12, 1996) and in so doing imposed certain conditions on UP and SP, including, as modified by the STB, the April 18, 1996 settlement agreement among UP, BNSF and the Chemical Manufacturers Association (the "CMA Agreement");

WHEREAS, as a part of its oversight of the UP/SP merger in Finance Docket Nos. 32760, 32760 (Sub-No. 21), and 32760 (Sub-No. 26), the STB has modified and clarified certain of the conditions it imposed in Decision No. 44;

WHEREAS, UP and BNSF entered into a Term Sheet Agreement dated February 12, 1998 (the "Term Sheet Agreement"), pursuant to which UP and BNSF agreed to the joint ownership of the line of railroad between Dawes, TX and Avondale, LA, which joint ownership was effected by separate agreement dated September 1, 2000 (the "TX-LA Line Sale Agreement");

WHEREAS, UP and BNSF have reached agreement with respect to the implementation of the conditions imposed by the STB on the UP/SP merger, as modified and clarified, and certain other matters relating to their rights and obligations under the 1995 Agreement, the CMA Agreement, the Term Sheet Agreement and the TX-LA Line Sale Agreement; and

WHEREAS, UP and BNSF now wish to amend and restate the 1995 Agreement to incorporate the conditions imposed by the STB on the UP/SP merger (including the CMA Agreement, as modified by the STB) and the agreements they have reached relating to those conditions and other related matters.

NOW, THEREFORE, the parties agree to amend and restate the 1995 Agreement as follows:

#### DEFINITIONS

For purposes of this Agreement, the following definitions and terms shall apply:

Shipper Facilities shall mean all existing or new shipper or receiver facilities, including transload facilities as well as rail car storage and car service and repair facilities not owned, leased or operated by UP.

"2-to-1" Points shall mean all geographic locations at which at least one "2-to-1" Shipper Facility is located. Such points include, without limitation, the points listed in Section 8(i) of and on Exhibit A to this Agreement. The boundaries for such "2-to-1" Points shall be deemed to

include all areas within the switching limits of the locations as described in Section 9(g) of this Agreement.

"2-to-1" Shipper Facilities shall mean all Shipper Facilities that were open to both UP and SP, whether via direct service or via reciprocal switching, joint facility or other arrangements, and no other railroad when the 1995 Agreement was executed, regardless of how long ago the shipper or receiver at that facility may have shipped or received, or whether the shipper or receiver at that facility ever shipped or received, any traffic via either UP or SP. The "2-to-1 Point Identification Protocol" between the parties attached hereto as Exhibit E shall govern the process for identifying "2-to-1" Shipper Facilities open to BNSF as a result of the conditions imposed on the UP/SP merger.

New Shipper Facilities shall mean: (i) existing Shipper Facilities constructing trackage for accessing rail service for the first time; and (ii) newly constructed rail-served Shipper Facilities. New Shipper Facilities shall also mean previously-served Shipper Facilities that begin to ship by rail again where (i) there has been a change of owner or lessee, and (ii) the use of the facility is actually different in nature and purpose from the facility's prior use (e.g., there has been a change in the type of products shipped from or received at the facility). New Shipper Facilities shall not include expansion of or additions to an existing rail-served Shipper Facility, but do include (1) Shipper Facilities which, on September 25, 1995, were being developed or for which land had been acquired for that purpose in contemplation of receiving rail service by both UP and SP, and (2) Transload Facilities located after September 11, 1996, including those owned or operated by BNSF.

Trackage Rights Lines shall mean the lines over which BNSF has been granted trackage rights pursuant to this Agreement, but shall not include any other lines over which UP/SP grants

BNSF trackage rights ("Overhead Trackage Rights") solely (i) to facilitate the parties' operation over Trackage Rights Lines, (ii) to permit BNSF's operation between a mutually-agreed upon BNSF junction point and points listed or described in Section 8(i) of this Agreement, or (iii) to permit BNSF's operation between a mutually-agreed upon BNSF junction point and a build-in/build-out line pursuant to Sections 4(a), 6(c) and 8(l) of this Agreement. The mutually-agreed upon junction point will be selected with the objective of minimizing the operating inconvenience to UP, consistent with ensuring that BNSF can provide competitive service. BNSF acknowledges that it shall not have the right to serve any existing or New Shipper Facility on a line over which BNSF has been granted Overhead Trackage Rights unless such right is specified in this Agreement or in any agreement implementing the Overhead Trackage Rights or unless BNSF has the right to serve a build-in/build-out line on such Overhead Trackage Rights line pursuant to the CMA Agreement or the conditions imposed on the UP/SP merger. All Overhead Trackage Rights Lines, as of the date of the execution hereof, are listed in Exhibit F to this Agreement, which exhibit may be amended and replaced from time to time by a new exhibit signed and dated by the parties. New Shipper Facilities shall be deemed to be "on" a Trackage Rights Line if the facility is either (1) adjacent to a Trackage Rights Line or (2) adjacent to a spur, an industrial track, or a yard that is itself served by such Trackage Rights Line. New Shipper Facilities are not "on" a Trackage Rights Line if they can be accessed only via a 49 U.S.C. 10901 "line of railroad" which is not a Trackage Rights Line.

Transload Facilities shall mean Shipper Facilities other than automotive or intermodal facilities or team tracks where freight is transferred from one railcar to another or from one mode to another (short term incidental storage may also occur) as defined by the STB in its decisions

in Finance Docket No. 32760. An "Existing Transload Facility" is a Transload Facility which was in existence on September 25, 1995.

1. **Western Trackage Rights**

(a) UP/SP shall grant to BNSF trackage rights on the following lines:

- SP's line between Denver, CO and Salt Lake City, UT;
- UP's line between Salt Lake City and Ogden, UT;
- SP's line between Ogden and Little Mountain, UT;
- UP's line between Salt Lake City and Alazon, NV;
- UP's and SP's lines between Alazon and Weso, NV;
- SP's line between Weso, and Oakland, CA via SP's line between Sacramento, CA and Oakland referred to as the "Cal-P" (subject to traffic restrictions as set forth in Section 1(g));
- Overhead Trackage Rights on SP's line between Binney Junction, CA and Roseville, CA in the vicinity of SP MP 106.6;
- SP's line between Elvas (Elvas Interlocking) and Stockton, CA (subject to traffic restrictions as set forth in Section 1(g) and also excluding any trains moving over the line between Bieber and Keddie, CA purchased by BNSF pursuant to Section 2(a) of this Agreement);
- UP's line between Weso and Stockton, CA; and
- SP's line between Oakland and San Jose, CA.

(b) The trackage rights granted under this section shall be bridge rights for the movement of overhead traffic only, except for the local access specified herein. BNSF shall receive access on such lines only to (i) "2-to-1" Shipper Facilities and Existing Transload

Facilities at points listed on Exhibit A to this Agreement, (ii) any New Shipper Facilities located subsequent to UP's acquisition of control of SP at points listed on Exhibit A to this Agreement, and (iii) any New Shipper Facilities located subsequent to UP's acquisition of control of SP on the Trackage Rights Lines. BNSF shall also have the right to establish and exclusively serve intermodal and auto facilities at points listed on Exhibit A to this Agreement and at points identified or described in Section 8(i) of this Agreement. BNSF shall also receive the right to interchange with: the BHP Nevada Railroad Company at Shafter, NV; the Utah Railway Company at Utah Railway Junction, UT; Grand Junction, CO; and Provo, UT; the Utah Central Railway Company at Ogden; the Salt Lake, Garfield and Western at Salt Lake City; and the Salt Lake City Southern Railroad Company at Salt Lake City. BNSF shall also receive the right to utilize in common with UP/SP, for normal and customary charges, SP's soda ash Transload Facilities in Ogden and Salt Lake City. BNSF shall also have the right to access any shipper-owned soda ash Transload Facilities in Ogden and Salt Lake City and to establish its own soda ash Transload Facilities along the Trackage Rights Lines. BNSF shall have the same access as UP to all "2-to-1" Shipper Facilities and "2-to-1" Points between Salt Lake City, UT, and SP MP 755.1 north of Woods Cross, UT.

(c) Access to Shipper Facilities at points listed on Exhibit A to this Agreement open to BNSF shall be direct or through reciprocal switch, or, with UP/SP's prior agreement, through a third party contractor. Access to New Shipper Facilities open to BNSF on the Trackage Rights Lines shall be (i) direct; (ii) with UP/SP's prior agreement, through haulage for the shortest period of time necessary to allow BNSF to establish its own direct operating access after initiating service to a New Shipper Facility, but not to exceed the later to occur of 90 days or the date upon which UP completes the construction of and accepts for service any connections,

sidings or other support facilities to be paid for by BNSF that UP is then obligated to construct pursuant to this Agreement or the trackage rights agreements executed pursuant to Section 9(f) of this Agreement; (iii) with UP/SP's prior agreement, reciprocal switching where, at the time BNSF service is to commence, UP/SP already provides reciprocal switching on the portion of the Trackage Rights Line upon which the turnout to the facility is to be located; or (iv) with UP/SP's prior agreement, the use of a third party contractor; PROVIDED, HOWEVER, that it shall be UP/SP's sole decision whether BNSF's service will be provided by either haulage or reciprocal switching; and PROVIDED, FURTHER, that in no case shall UP/SP be required to initiate any new local service or increase its level of service to accommodate the level of service proposed by BNSF. New Shipper Facilities open to BNSF under this Agreement shall be open to both UP/SP and BNSF, subject to the terms of Section 9(c)(v) of this Agreement. The geographic limits within which (x) New Shipper Facilities shall be open to BNSF service at points listed on Exhibit A to this Agreement and (y) BNSF shall have the right to establish and exclusively serve intermodal and auto facilities at points listed in Section 8(i) of and on Exhibit A to this Agreement shall generally correspond to the territory within which, prior to the merger of UP and SP, a new shipper or receiver could have constructed a facility that would have been open to service by both UP and SP either directly or through reciprocal switch. Where switching districts have been established, such districts (as described in Section 9(g)) shall be presumed to establish these geographic limitations.

(d) At least forty-five (45) days before initiating service to (i) a Shipper Facility open to BNSF at a point listed or described on Exhibit A to or in Section 8(i) of this Agreement, or (ii) any New Shipper Facility on a Trackage Rights Line, BNSF shall notify UP of its election, subject to Section 1(c) above, of the manner by which it proposes such service be provided and

the specifics of its operating plan over UP/SP trackage. Within thirty (30) days of its receipt of BNSF's proposed operating plan, UP shall notify BNSF of its approval or disapproval of BNSF's plan. UP's approval of such plan shall not be unreasonably withheld. In the event UP disapproves of BNSF's proposed plan, UP shall provide an explanation in writing to BNSF of its reasons for disapproval, and UP shall propose an alternative operating plan that would be acceptable to UP and also be no more onerous than the operating plan that UP would establish for service provided by UP. If UP approves BNSF's plan but establishes conditions on that approval, those conditions shall be set forth in writing and shall be no more onerous than UP would establish for service provided by UP. BNSF shall have the right, upon one hundred eighty (180) days' prior written notice to UP/SP, to change its election; PROVIDED, HOWEVER, that BNSF shall not change any such election more often than once every five (5) years. BNSF shall reimburse UP/SP for any costs incurred by UP/SP in connection with any changed election.

(e) For Reno area intermodal traffic, BNSF may use SP's intermodal ramp at Sparks, NV with UP/SP providing intermodal terminal services to BNSF for normal and customary charges. If expansion of SP's Sparks intermodal facility is required to accommodate the combined needs of UP/SP and BNSF, then the parties shall share in the cost of such expansion on a pro rata basis allocated on the basis of the relative number of lifts for each party in the 12-month period preceding the date construction begins. If for any reason UP/SP vacates its Sparks intermodal facility, BNSF (i) may vacate the facility and independently establish one of its own, or (ii) shall be permitted by UP/SP to continue to occupy the Sparks facility upon entry into an agreement with UP/SP containing normal and customary terms and conditions (including, without limitation, rental) for the use of similar facilities. If UP elects to offer the Sparks intermodal ramp property for sale to a third party and/or receives an offer UP is willing to accept,

UP will offer to sell the property to BNSF on the same terms and conditions as are applicable to the third party. BNSF shall have thirty (30) days in which to advise UP whether or not it will buy the property on those terms. In the event BNSF declines to buy the property on those terms or fails to advise UP of its intentions within thirty (30) days, BNSF's right of first refusal will be extinguished, and UP may sell the property to the third party. BNSF will then be required to vacate the property within six (6) months, and UP's obligation to furnish BNSF with intermodal terminal services and access to a UP intermodal facility in the Sparks/Reno area will be extinguished.

(f) Except as otherwise herein provided, the trackage rights and access rights granted pursuant to this section shall be for rail traffic of all kinds, carload and intermodal, for all commodities.

(g) BNSF may operate only the following trains on SP's "Cal-P" line between Sacramento and Oakland: (i) intermodal and automotive trains composed of over ninety percent (90%) multi-level automobile equipment and/or flat cars carrying trailers and containers in single or double stack configuration and (ii) one overhead through manifest train of carload business per day in each direction. These BNSF manifest trains may be either I-5 Corridor or Central Corridor trains. On the Donner Pass line between Sacramento and Weso, BNSF may operate only intermodal and automotive trains as described in clause (i) and one overhead through manifest train of carload business per day in each direction. The manifest trains must be equipped with adequate motive power to achieve the same horsepower per trailing ton as comparable UP/SP manifest trains. BNSF may use helpers on these trains only if comparable UP/SP manifest trains use helpers; BNSF must provide the helper service. The restrictions set forth in this section do not apply to local trains serving Shipper Facilities to which BNSF has

access on the identified lines, and such trains shall not be considered in determining whether BNSF is in compliance with such restrictions. If UP grants its prior concurrence, BNSF's overhead through manifest trains shall be allowed to set out and pick up traffic to or from intermediate points on the identified lines.

(h) At BNSF's request, UP/SP shall provide train and engine crews and required support personnel and services in accordance with UP/SP's operating practices necessary to handle BNSF trains moving between Salt Lake City and Oakland. UP/SP shall be reimbursed for providing such employees on a cost plus reasonable additives basis and for any incremental cost associated with providing employees such as lodging or crew transportation expense. BNSF must also give UP/SP reasonable advance notice of its need for employees in order to allow UP/SP time to have adequate trained crews available. All UP/SP employees engaged in or connected with the operation of BNSF's trains shall, solely for purposes of standard joint facility liability, be deemed to be "sole employees" of BNSF. If UP/SP adds to its labor force to comply with a request or requests from BNSF to provide employees, then BNSF shall be responsible for any labor protection, guarantees or reserve board payments for such incremental employees resulting from any change in BNSF operations or traffic levels.

(i) UP/SP agree that their affiliate Central California Traction Company shall be managed and operated so as to provide BNSF non-discriminatory access to industries on its line on the same and no less favorable basis as provided UP and SP.

(j) If BNSF desires to operate domestic high cube double stacks over Donner Pass, then BNSF shall be responsible to pay for the cost of achieving required clearances. UP/SP shall pay BNSF one-half of the original cost of any such work funded by BNSF (including per annum interest thereon calculated in accordance with section 9(c)(v) of this Agreement) if UP/SP

subsequently decides to begin moving domestic high cube double stacks over this route. If UP/SP initiates and funds the clearance program, then BNSF shall pay one half of the original cost (including per annum interest thereon calculated in accordance with section 9(c)(v) of this Agreement) at such time as BNSF begins to use the line for domestic high cube double stacks.

(k) BNSF agrees to waive its right under Section 9 of the Agreement dated April 13, 1995, and agreements implementing that agreement to renegotiate certain compensation terms of such agreement in the event of a merger, consolidation or common control of SP by UP. BNSF also agrees to waive any restrictions on assignment in the 1990 BN-SP agreement covering trackage rights between Kansas City and Chicago.

2. **I-5 Corridor**

(a) UP/SP shall sell to BNSF UP's line between Bieber and Keddie, CA. UP/SP shall retain the right to use the portion of this line between MP 0 and MP 2 for the purpose of turning equipment. UP/SP shall pay BNSF a normal and customary trackage rights charge for this right.

(b) BNSF shall grant UP/SP overhead trackage rights on BN's line between Chemult and Bend, OR for rail traffic of all kinds, carload and intermodal, for all commodities.

(c) The parties will, under the procedures established in Section 9(f) of this Agreement, establish a proportional rate agreement incorporating the terms of the "Term Sheet for UP/SP-BNSF Proportional Rate Agreement Covering I-5 Corridor" attached hereto as Exhibit B.

3. **Southern California Access**

(a) UP/SP shall grant access to BNSF to serve all "2-to-1" Shipper Facilities in Southern California at the points listed on Exhibit A to this Agreement.

(b) UP/SP shall grant to BNSF trackage rights on the following lines:

- UP's line between Riverside and Ontario, CA; and

- UP's line between Basta, CA and Fullerton and La Habra, CA.

(c) The trackage rights granted under this section shall be bridge rights for the movement of overhead traffic only, except for the local access specified herein. BNSF shall receive access on such lines only to (i) "2-to-1" Shipper Facilities and Existing Transload Facilities at points listed on Exhibit A to this Agreement, (ii) any New Shipper Facility located subsequent to UP's acquisition of control of SP at points listed on Exhibit A to this Agreement, and (iii) any New Shipper Facility located subsequent to UP's acquisition of control of SP on the Trackage Rights Lines. BNSF shall also have the right to establish and exclusively serve intermodal and auto facilities at points listed on Exhibit A to this Agreement and at points identified or described in Section 8(i) of this Agreement.

(d) Access to Shipper Facilities at points listed on Exhibit A to this Agreement open to BNSF shall be direct or through reciprocal switch, or, with UP/SP's prior agreement, through a third party contractor. Access to New Shipper Facilities open to BNSF on the Trackage Rights Lines shall be (i) direct; (ii) with UP/SP's prior agreement, through haulage for the shortest period of time necessary to allow BNSF to establish its own direct operating access after initiating service to a New Shipper Facility, but not to exceed the later to occur of 90 days or the date upon which UP completes the construction of and accepts for service any connections, sidings or other support facilities to be paid for by BNSF that UP is then obligated to construct pursuant to this Agreement or the trackage rights agreements executed pursuant to Section 9(f) of this Agreement; (iii) with UP/SP's prior agreement, reciprocal switching where, at the time BNSF service is to commence, UP/SP already provides reciprocal switching on the portion of the Trackage Rights Line upon which the turnout to the facility is to be located; or (iv) with UP/SP's prior agreement the use of a third party contractor; PROVIDED, HOWEVER, that it shall be

UP/SP's sole decision whether BNSF's service will be provided by either haulage or reciprocal switching; and PROVIDED, FURTHER, that in no case shall UP/SP be required to initiate any new local service or increase its level of service to accommodate the level of service proposed by BNSF. New Shipper Facilities open to BNSF under this Agreement shall be open to both UP/SP and BNSF, subject to the terms of Section 9(c)(v) of this Agreement. The geographic limits within which (x) New Shipper Facilities shall be open to BNSF service at points listed on Exhibit A to this Agreement and (y) BNSF shall have the right to establish and exclusively serve intermodal and auto facilities at points listed in Section 8(i) of and on Exhibit A to this Agreement shall generally correspond to the territory within which, prior to the merger of UP and SP, a new shipper or receiver could have constructed a facility that would have been open to service by both UP and SP either directly or through reciprocal switch. Where switching districts have been established, such districts (as described in Section 9(g)) shall be presumed to establish these geographic limitations.

(e) BNSF shall grant UP/SP overhead trackage rights on Santa Fe's line between Barstow (including both legs of the wye) and Mojave, CA.

(f) Except as otherwise provided herein, the trackage rights and access rights granted pursuant to this section shall be for rail traffic of all kinds, carload and intermodal, for all commodities.

(g) UP/SP shall work with BNSF to facilitate access by BNSF to the Ports of Los Angeles and Long Beach, CA. Other than as legally precluded. UP/SP shall (a) extend the term of the present agreement dated November 21, 1981, to continue until completion of Alameda Corridor, (b) amend that agreement to apply to all carload and intermodal traffic, and (c) grant BNSF the right to invoke such agreement to provide loop service utilizing UP's and Santa Fe's

lines to the Ports at BNSF's option to allow for additional operating capacity. UP/SP's commitment is subject to available capacity. Any incremental capacity related projects necessary to accommodate BNSF traffic shall be the sole responsibility of BNSF.

(h) At least forty-five (45) days before initiating service to (i) a Shipper Facility open to BNSF at a point listed or described on Exhibit A to or in Section 8(i) of this Agreement, or (ii) any New Shipper Facility on a Trackage Rights Line, BNSF shall notify UP of its election, subject to Section 3(d) above, of the manner by which it proposes such service be provided and the specifics of its operating plan over UP/SP trackage. Within thirty (30) days of its receipt of BNSF's proposed operating plan, UP shall notify BNSF of its approval or disapproval of BNSF's plan. UP's approval of such plan shall not be unreasonably withheld. In the event UP disapproves of BNSF's proposed plan, UP shall provide an explanation in writing to BNSF of its reasons for disapproval, and UP shall propose an alternative operating plan that would be acceptable to UP and also be no more onerous than the operating plan that UP would establish for service provided by UP. If UP approves BNSF's plan but establishes conditions on that approval, those conditions shall be set forth in writing and shall be no more onerous than UP would establish for service provided by UP. BNSF shall have the right, upon one hundred eighty (180) days' prior written notice to UP/SP, to change its election; PROVIDED, HOWEVER, that BNSF shall not change any such election more often than once every five (5) years. BNSF shall reimburse UP/SP for any costs incurred by UP/SP in connection with any changed election.

4. **South Texas Trackage Rights and Purchase**

- (a) UP/SP shall grant to BNSF trackage rights on the following lines:
- UP's line between Ajax and San Antonio, TX;

- UP's line between Houston (Algoa) and Brownsville, TX (with parity and equal access to the Mexican border crossing at Brownsville);
- UP's line between Odem and Corpus Christi, TX;
- UP's line between Ajax and Sealy, TX;
- SP's line between San Antonio and Eagle Pass, TX (with parity and equal access to the Mexican border crossing at Eagle Pass);
- UP's line between Craig Junction and SP Junction, TX (Tower 112) via Track No. 2 through Fratt, TX;
- SP's line between SP Junction (Tower 112) and Elmendorf, TX;
- SP's line in San Antonio between SP Tower 105 and SP Junction (Tower 112);
- Overhead Trackage Rights on SP's Port Lavaca Branch, between Placedo and Port Lavaca, TX, for the purpose of reaching a point of build-in/build-out to/from Union Carbide Corporation's ("UCC") facility at North Seadrift, TX. UP/SP shall permit BN/Santa Fe or UCC to construct and connect to the Port Lavaca Branch, at their expense, a build-in/build-out line. BN/Santa Fe or UCC shall have the right to purchase for net liquidation value all or any part of the Port Lavaca Branch that UP/SP may abandon;
- UP's line between Kerr (connection to Georgetown RR) and Taylor, TX;
- Overhead Trackage Rights on UP's line between Round Rock and McNeil, TX for the purpose of interchanging with the Capital Metro Transit Authority, its successors or agent;

- UP's line between Temple and Waco, TX;
- UP's line between Temple and Taylor, TX;
- UP's line between Taylor and Smithville, TX; and
- SP's line between El Paso and Sierra Blanca, TX.

(b) The trackage rights granted under this section shall be bridge rights for the movement of overhead traffic only, except for the local access specified herein. BNSF shall receive access on such lines only to (i) "2-to-1" Shipper Facilities and Existing Transload Facilities at points listed on Exhibit A to this Agreement and City Public Service Board of San Antonio, Texas Elmendorf facilities listed on Exhibit A to this Agreement, (ii) any New Shipper Facility located subsequent to UP's acquisition of control of SP at points listed on Exhibit A to this Agreement, and (iii) any New Shipper Facility located subsequent to UP's acquisition of control of SP on the Trackage Rights Lines. BNSF shall also have the right to establish and exclusively serve intermodal and auto facilities at points listed on Exhibit A to this Agreement and at points identified or described in Section 8(i) of this Agreement. BNSF shall also have the right to interchange with: the Texas Mexican Railway Company at Corpus Christi and Robstown, TX; the Georgetown Railroad at Kerr; Transportacion Ferroviaria Mexicana ("TFM") at Brownsville (Matamoros, Mexico); Ferrocarril Mexicano ("FXE") at Eagle Pass; and the operator of SP's former line between Giddings and Llano at McNeil, TX. BNSF's access and interchange rights at Corpus Christi and Brownsville shall be at least as favorable as SP had on September 25, 1995. BNSF shall have direct access to the Port of Brownsville, the Brownsville and Rio Grande International Railroad, and the TFM. UP will designate a yard in Brownsville for sale to BNSF at such time as BNSF establishes its own trackage rights operations into Brownsville and at such time as the connection between UP and SP as a part of the Brownsville

relocation project is completed. In the event UP/SP determines to cease operations in the SP East Yard at San Antonio, TX, UP/SP will give first consideration to BNSF for taking over operation of the East Yard pursuant to a mutually-agreeable arrangement.

(c) Access to Shipper Facilities at points listed on Exhibit A to this Agreement open to BNSF shall be direct or through reciprocal switch, or, with UP/SP's prior agreement, through a third party contractor. Access to New Shipper Facilities open to BNSF on the Trackage Rights Lines shall be (i) direct; (ii) with UP/SP's prior agreement, through haulage for the shortest period of time necessary to allow BNSF to establish its own direct operating access after initiating service to a New Shipper Facility, but not to exceed the later to occur of 90 days or the date upon which UP completes the construction of and accepts for service any connections, sidings or other support facilities to be paid for by BNSF that UP is then obligated to construct pursuant to this Agreement or the trackage rights agreements executed pursuant to Section 9(f) of this Agreement; (iii) with UP/SP's prior agreement, reciprocal switching where, at the time BNSF service is to commence, UP/SP already provides reciprocal switching on the portion of the Trackage Rights Line upon which the turnout to the facility is to be located; or (iv) with UP/SP's prior agreement, the use of a third party contractor; PROVIDED, HOWEVER, that it shall be UP/SP's sole decision whether BNSF's service will be provided by either haulage or reciprocal switching; and PROVIDED, FURTHER, that in no case shall UP/SP be required to initiate any new local service or increase its level of service to accommodate the level of service proposed by BNSF. New Shipper Facilities open to BNSF under this Agreement shall be open to both UP/SP and BNSF, subject to Section 9(c)(v) of this Agreement. The geographic limits within which (x) New Shipper Facilities shall be open to BNSF service at points listed on Exhibit A to this Agreement and (y) BNSF shall have the right to establish and exclusively serve intermodal and

auto facilities at points listed in Section 8(i) of and on Exhibit A to this Agreement shall generally correspond to the territory within which, prior to the merger of UP and SP, a new shipper or receiver could have constructed a facility that would have been open to service by both UP and SP either directly or through reciprocal switch. Where switching districts have been established, such districts (as described in Section 9(g)) shall be presumed to establish these geographic limitations.

(d) At least forty-five (45) days before initiating service to (i) a Shipper Facility open to BNSF at a point listed or described on Exhibit A to or in Section 8(i) of this Agreement, or (ii) any New Shipper Facility on a Trackage Rights Line, BNSF shall notify UP of its election, subject to Section 4(c) above, of the manner by which it proposes such service be provided and the specifics of its operating plan over UP/SP trackage. Within thirty (30) days of its receipt of BNSF's proposed operating plan, UP shall notify BNSF of its approval or disapproval of BNSF's plan. UP's approval of such plan shall not be unreasonably withheld. In the event UP disapproves of BNSF's proposed plan, UP shall provide an explanation in writing to BNSF of its reasons for disapproval, and UP shall propose an alternative operating plan that would be acceptable to UP and also be no more onerous than the operating plan that UP would establish for service provided by UP. If UP approves BNSF's plan but establishes conditions on that approval, those conditions shall be set forth in writing and shall be no more onerous than UP would establish for service provided by UP. BNSF shall have the right, upon one hundred eighty (180) days' prior written notice to UP/SP, to change its election; PROVIDED, HOWEVER, that BNSF shall not change any such election more often than once every five (5) years. BNSF shall reimburse UP/SP for any costs incurred by UP/SP in connection with any changed election.

(e) Except as otherwise provided herein, the trackage rights and access rights granted pursuant to this section shall be for rail traffic of all kinds, carload and intermodal, for all commodities.

(f) In lieu of BNSF's conducting actual trackage rights operations between Houston, Corpus Christi, Harlingen and Brownsville, TX (including TFM interchange), UP/SP agrees, upon request by BNSF, to handle BNSF's business on a haulage basis for the fee called for by Section 8(m) of this Agreement. UP/SP shall accept, handle, switch and deliver traffic moving under haulage without any discrimination in promptness, quality of service, or efficiency in favor of comparable traffic moving in UP/SP's account.

(g) UP/SP shall sell to BNSF UP's line between Dallas and Waxahachie, TX with UP retaining trackage rights to exclusively serve local industries on the Dallas-Waxahachie line.

(h) Upon the effectiveness of the trackage rights to Eagle Pass under this section, BNSF's right to obtain haulage services from UP/SP to and from Eagle Pass pursuant to the agreement between BNSF and SP dated April 13, 1995 and subsequent haulage agreement between those parties shall no longer apply, provided BNSF shall continue to have the right to use trackage at or near Eagle Pass as specified in that agreement for use in connection with trackage rights under this Agreement.

5. **Eastern Texas - Louisiana Trackage Rights and Purchase**

(a) UP/SP shall grant to BNSF trackage rights on the following lines:

- SP's line between Houston and Iowa Junction in Louisiana, which trackage rights have been amended by the Term Sheet Agreement and the TX-LA Line Sale Agreement implementing UP's and BNSF's joint ownership of SP's line between Dawes, TX and Avondale, LA;

- SP's line between Beaumont and Port Arthur, TX;
- SP's line between Dayton and Baytown and East Baytown, TX;
- SP's Channelview Spur which connects to the SP's line between Houston and Iowa Junction near Sheldon, TX for the purpose, inter alia, of reaching a point of build-in/build-out to/from the facilities of Lyondell Petrochemical Company and Arco Chemical Company at Channelview, TX. UP/SP shall permit BN/Santa Fe or one or both shippers to construct and connect to SP's Channelview Spur, at their expense, a build-in/build-out line. BN/Santa Fe or the shippers shall have the right to purchase for net liquidation value all or any part of the Channelview Spur that UP/SP may abandon;
- SP's line between Mallard Junction and Harbor, LA;
- SP's line near Avondale (SP MP 14.94 and West Bridge Junction (SP MP 9.97);
- UP's Main Line No. 1 from UP MP 14.29 to MP 14.11 including crossover to SP's main line and UP's MP 10.38 to MP 10.2; and
- UP's line between West Bridge Junction (UP MP 10.2) and UP's Westwego, LA intermodal facility (approximately UP MP 9.2).

(b) The trackage rights granted under this section shall be bridge rights for the movement of overhead traffic only, except for the local access specified herein. BNSF shall receive access on such lines only to (i) "2-to-1" Shipper Facilities and Existing Transload Facilities at points listed on Exhibit A to this Agreement, (ii) any New Shipper Facility located subsequent to UP's acquisition of control of SP at points listed on Exhibit A to this Agreement,

and (iii) any New Shipper Facility located subsequent to UP's acquisition of control of SP on the Trackage Rights Lines. BNSF shall also have the right to establish and exclusively serve intermodal and auto facilities at points listed on Exhibit A to this Agreement and at points identified or described in Section 8(i) of this Agreement. BNSF shall also have the right to handle traffic of shippers open to all of UP, SP and KCS at Lake Charles, Rose Bluff and West Lake, LA, and traffic of shippers open to SP and KCS at West Lake Charles. BNSF shall also have the right to interchange with: the Acadiana Railway Company at Crowley, LA; and the Louisiana & Delta Railroad, Inc. at Lafayette, Raceland and Schreiver, LA. BNSF shall also have the right to interchange with and have access over the New Orleans Public Belt Railroad at West Bridge Junction, LA.

(c) Access to Shipper Facilities at points listed on Exhibit A to this Agreement open to BNSF shall be direct or through reciprocal switch, or, with UP/SP's prior agreement, through a third party contractor. Access to New Shipper Facilities open to BNSF on the Trackage Rights Lines shall be (i) direct; (ii) with UP/SP's prior agreement, through haulage for the shortest period of time necessary to allow BNSF to establish its own direct operating access after initiating service to a New Shipper Facility, but not to exceed the later to occur of 90 days or the date upon which UP completes the construction of and accepts for service any connections, sidings or other support facilities to be paid for by BNSF that UP is then obligated to construct pursuant to this Agreement or the trackage rights agreements executed pursuant to Section 9(f) of this Agreement; (iii) with UP/SP's prior agreement reciprocal switching where, at the time BNSF service is to commence, UP/SP already provides reciprocal switching on the portion of the Trackage Rights Line upon which the turnout to the facility is to be located; or (iv) with UP/SP's prior agreement, the use of a third party contractor; PROVIDED, HOWEVER, that it shall be

UP/SP's sole decision whether BNSF's service will be provided by either haulage or reciprocal switching; and PROVIDED, FURTHER, that in no case shall UP/SP be required to initiate any new local service or increase its level of service to accommodate the level of service proposed by BNSF. New Shipper Facilities open to BNSF under this Agreement shall be open to both UP/SP and BNSF, subject to the terms of Section 9(c)(v) of this Agreement. The geographic limits within which (x) New Shipper Facilities shall be open to BNSF service at points listed on Exhibit A to this Agreement and (y) BNSF shall have the right to establish and exclusively serve intermodal and auto facilities at points listed in Section 8(i) of and on Exhibit A to this Agreement shall generally correspond to the territory within which, prior to the merger of UP and SP, a new shipper or receiver could have constructed a facility that would have been open to service by both UP and SP either directly or through reciprocal switch. Where switching districts have been established, such districts (as described in Section 9(g)) shall be presumed to establish these geographic limitations.

(d) At least forty-five (45) days before initiating service to (i) a Shipper Facility open to BNSF at a point listed or described on Exhibit A to or in Section 8(i) of this Agreement, or (ii) any New Shipper Facility on a Trackage Rights Line, BNSF shall notify UP of its election, subject to Section 5(c) above, of the manner by which it proposes such service be provided and the specifics of its operating plan over UP/SP trackage. Within thirty (30) days of its receipt of BNSF's proposed operating plan, UP shall notify BNSF of its approval or disapproval of BNSF's plan. UP's approval of such plan shall not be unreasonably withheld. In the event UP disapproves of BNSF's proposed plan, UP shall provide an explanation in writing to BNSF of its reasons for disapproval, and UP shall propose an alternative operating plan that would be acceptable to UP and also be no more onerous than the operating plan that UP would establish

for service provided by UP. If UP approves BNSF's plan but establishes conditions on that approval, those conditions shall be set forth in writing and shall be no more onerous than UP would establish for service provided by UP. BNSF shall have the right, upon one hundred eighty (180) days' prior written notice to UP/SP, to change its election; PROVIDED, HOWEVER, that BNSF shall not change any such election more often than once every five (5) years. BNSF shall reimburse UP/SP for any costs incurred by UP/SP in connection with any changed election.

(e) UP/SP shall grant BNSF the right to use SP's Bridge 5A at Houston, Texas.

(f) Except as otherwise provided herein, trackage rights and access rights granted pursuant to this section shall be for rail traffic of all kinds, carload and intermodal, for all commodities.

(g) UP/SP shall sell to BNSF UP's Main Line No. 1 between MP 14.11 and 10.38, UP's Westwego intermodal terminal, SP's old Avondale Yard (together with the fueling and mechanical facilities located thereon) as shown on Exhibit C; and SP's Lafayette Yard.

6. **Houston, TX-Valley Junction, IL Trackage Rights**

(a) UP/SP shall grant to BNSF trackage rights on the following lines:

- SP's line between Houston, TX and Fair Oaks, AR via Cleveland and Pine Bluff, AR;
- UP's line between Fair Oaks and Bridge Junction, AR;
- SP's line between Brinkley and Briark, AR;
- UP's line between Pine Bluff and North Little Rock, AR
- UP's line between Houston and Valley Junction, IL via Palestine, TX;
- SP's line between Fair Oaks and Illmo, MO via Jonesboro, AR and Dexter Junction, MO; and

- UP's line between Fair Oaks and Bald Knob, AR.

(b) In lieu of conducting actual operations between Pine Bluff and North Little Rock, AR, UP/SP agrees, upon request of BNSF, to handle BNSF's business on a haulage basis for the fee called for by Section 8(m) of this Agreement.

(c) BNSF shall have the right to transport unit coal trains (i) over the Trackage Rights Lines to and from a point of build-in/build-out to and from Entergy Services, Inc.'s plant at White Bluff, AR if and when such a build-in/build-out line is constructed by an entity other than UP/SP to connect such plant with an SP line, and (ii) to and from Entergy Services, Inc.'s plant at White Bluff (1) by entering and exiting the Trackage Rights Lines at Jonesboro and Hoxie, AR, respectively, and/or (2) by utilization of BNSF's line via Memphis, TN.

(d) The trackage rights granted under this section shall be bridge rights for the movement of overhead traffic only, except for the local access specified herein. BNSF shall receive access on such lines only to (i) "2-to-1" Shipper Facilities and Existing Transload Facilities at points listed on Exhibit A to this Agreement, (ii) any New Shipper Facility located subsequent to UP's acquisition of control of SP at points listed on Exhibit A to this Agreement, and (iii) any New Shipper Facility located subsequent to UP's acquisition of control of SP on the Trackage Rights Lines. BNSF shall also have the right to establish and exclusively serve intermodal and auto facilities at points listed on Exhibit A to this Agreement and at points identified or described in Section 8(i) of this Agreement. In addition to the other restrictions and limitations set forth herein, as to UP's and SP's lines between Memphis and Valley Junction, IL: (1) BNSF shall not have the right to enter or exit at intermediate points north of Bald Knob and Fair Oaks, AR; and (2) BNSF traffic is limited to traffic that moves through, originates in, or terminates in Texas or Louisiana. These two restrictions do not apply to traffic moving to or

from shipper Facilities in the Houston-Memphis-St. Louis Corridor to which BNSF has access pursuant to this Section 6(d) or Section 8(i) below. The two restrictions also do not apply to the traffic that BNSF is permitted to handle pursuant to the remaining provisions of this Section 6(d), which remains subject to all other conditions and restrictions. BNSF shall also have the right to handle traffic of shippers open to all of UP, SP and KCS at Texarkana, TX/AR, and Shreveport, LA, to and from the Memphis BEA (BEA 73), but not including proportional, combination or Rule 11 rates via Memphis or other points in the Memphis BEA. In the Houston-Memphis-St. Louis corridor, BNSF shall have the right to move some or all of its traffic via trackage rights over either the UP line or the SP line, at its discretion, for operating convenience. BNSF shall also have the right to interchange: with the Little Rock and Western Railway at Little Rock, AR; the Little Rock Port Authority at Little Rock, AR; KCS at Shreveport, LA and Texarkana, TX/AR, for movements of traffic originated by KCS at or delivered by KCS to shippers or receivers at Lake Charles, West Lake, or West Lake Charles, LA; with KCS (y) at Shreveport, LA for movements of loaded and empty coal trains moving to and from Texas Utilities Electric Company's Martin Lake generating station, and (z) at Texarkana, TX/AR for movements of empty coal trains returning from Texas Utilities Electric Company's Martin Lake generating station; and with the Texas Northeastern Railroad at Texarkana, TX for the sole purpose of moving BNSF traffic to and from Shipper Facilities at Defense, TX.

(e) Access to Shipper Facilities at points listed on Exhibit A to this Agreement open to BNSF shall be direct or through reciprocal switch, or, with UP/SP's prior agreement, through a third party contractor. Access to New Shipper Facilities open to BNSF on the Trackage Rights Lines shall be (i) direct; (ii) with UP/SP's prior agreement, through haulage for the shortest period of time necessary to allow BNSF to establish its own direct operating access after

initiating service to a New Shipper Facility, but not to exceed the later to occur of 90 days or the date upon which UP completes the construction of and accepts for service any connections, sidings or other support facilities to be paid for by BNSF that UP is then obligated to construct pursuant to this Agreement or the trackage rights agreements executed pursuant to Section 9(f) of this Agreement; (iii) with UP/SP's prior agreement, reciprocal switching where, at the time BNSF service is to commence, UP/SP already provides reciprocal switching on the portion of the Trackage Rights Line upon which the turnout to the facility is to be located; or (iv) with UP/SP's prior agreement, the use of a third party contractor; PROVIDED, HOWEVER, that it shall be UP/SP's sole decision whether BNSF's service will be provided by either haulage or reciprocal switching; and PROVIDED, FURTHER, that in no case shall UP/SP be required to initiate any new local service or increase its level of service to accommodate the level of service proposed by BNSF. New Shipper Facilities open to BNSF under this Agreement shall be open to both UP/SP and BNSF, subject to the terms of Section 9(c)(v) of this Agreement. The geographic limits within which (x) New Shipper Facilities shall be open to BNSF service at points listed on Exhibit A to this Agreement and (y) BNSF shall have the right to establish and exclusively serve intermodal and auto facilities at points listed in Section 8(i) of and on Exhibit A to this Agreement shall generally correspond to the territory within which, prior to the merger of UP and SP, a new shipper or receiver could have constructed a facility that would have been open to service by both UP and SP either directly or through reciprocal switch. Where switching districts have been established, such districts (as described in Section 9(g)) shall be presumed to establish these geographic limitations.

(f) At least forty-five (45) days before initiating service to (i) a Shipper Facility open to BNSF at a point listed or described on Exhibit A to or in Section 8(i) of this Agreement, or (ii)

any New Shipper Facility on a Trackage Rights Line, BNSF shall notify UP of its election, subject to Section 6(e) above, of the manner by which it proposes such service be provided and the specifics of its operating plan over UP/SP trackage. Within thirty (30) days of its receipt of BNSF's proposed operating plan, UP shall notify BNSF of its approval or disapproval of BNSF's plan. UP's approval of such plan shall not be unreasonably withheld. In the event UP disapproves of BNSF's proposed plan, UP shall provide an explanation in writing to BNSF of its reasons for disapproval, and UP shall propose an alternative operating plan that would be acceptable to UP and also be no more onerous than the operating plan that UP would establish for service provided by UP. If UP approves BNSF's plan but establishes conditions on that approval, those conditions shall be set forth in writing and shall be no more onerous than UP would establish for service provided by UP. BNSF shall have the right, upon one hundred eighty (180) days' prior written notice to UP/SP, to change its election; PROVIDED, HOWEVER, that BNSF shall not change any such election more often than once every five (5) years. BNSF shall reimburse UP/SP for any costs incurred by UP/SP in connection with any changed election.

(g) Except as otherwise provided herein, the trackage rights and access rights granted pursuant to this section shall be for rail traffic of all kinds, carload and intermodal, for all commodities.

(h) BNSF shall grant to UP/SP overhead trackage rights on BN's line between West Memphis and Presley Junction, AK. UP/SP shall be responsible for upgrading this line as necessary for its use. If BNSF uses this line for overhead purposes to connect its line to the trackage rights lines, BNSF shall share in one-half of the upgrading cost.

7. **St. Louis Area Coordinations**

(a) UP/SP agree to cooperate with BNSF to facilitate efficient access by BNSF to other carriers at and through St. Louis via The Alton & Southern Railway Company ("A&S"). If

BNSF requests, UP/SP agree to construct or cause to be constructed for the use of both BNSF and UP/SP a faster connection between the BN and UP lines at Grand Avenue in St. Louis, MO and a third track from Grand Avenue to near Gratiot Street Tower at the sole cost and expense of BNSF. Upon completion of such construction, UP/SP shall grant to BNSF overhead trackage rights on UP's line between Grand Avenue and Gratiot Street.

(b) UP wishes to secure dispatching authority for the MacArthur Bridge across the Mississippi River at St. Louis. Dispatching is currently controlled by the Terminal Railroad Association of St. Louis ("TRRA"). BNSF agrees that it will cause its interest on the TRRA Board or any shares it owns in the TRRA to be voted in favor of transferring dispatching control of the MacArthur Bridge to UP if such matter is presented to the TRRA Board or its shareholders for action. Such dispatching shall be performed in a manner to ensure that all users are treated equally.

(c) If BNSF desires to use the A&S Gateway Yard, upon transfer of MacArthur Bridge dispatching to UP, UP/SP shall assure that charges assessed by the A&S to BNSF for use of Gateway Yard are equivalent to those assessed other non-owners of A&S.

(d) UP/SP and BNSF agree to provide each other reciprocal detour rights between Bridge Junction-West Memphis and St. Louis in the event of flooding, subject to the availability of sufficient capacity to accommodate the detour.

(e) UP/SP shall provide BNSF Overhead Trackage Rights over UP/SP's Jefferson City Subdivision between MP 34.8 near Pacific, MO and MP 43.8 near Labadie, MO for the purpose of accessing Ameren UE's facility at Labadie. BNSF shall have the right to serve all "2-to-1" Shipper Facilities, New Shipper Facilities and Existing Transload Facilities at Labadie.

8. **Additional Rights**

(a) UP/SP shall grant BNSF overhead trackage rights on SP's line between Richmond and Oakland, CA for rail traffic of all kinds, carload and intermodal, for all commodities to enable BNSF to connect via SP's line with the Oakland Terminal Railroad ("OTR") and to access the Oakland Joint Intermodal Terminal ("JIT"), or similar public intermodal facility, at such time as the JIT is built. BNSF shall pay 50% of the cost (up to \$2,000,000 maximum) for upgrading to mainline standards and reverse signaling of SP's No. 1 track between Emeryville (MP 8) and Stege, CA (MP 13.1). Compensation for these trackage rights shall be at the rate of 3.48 mills per ton mile for business moving in the "I-5 Corridor," 3.1 mills per ton mile on all other carload and intermodal business, and 3.0 mills per ton mile for bulk business (as defined in Section 9(a) of this Agreement) escalated in accordance with the provisions of Section 12 of this Agreement. UP/SP shall assess no additional charges against BNSF for access to the JIT and the OTR.

(b) BNSF shall waive any payment by UP/SP of the Seattle Terminal 5 access charge.

(c) BNSF shall grant to UP overhead trackage rights on BN's line between Saunders, WI and access to the MERC dock in Superior, WI.

(d) BNSF shall grant UP the right to use the Pokegama connection at Saunders, WI (i.e., the southwest quadrant connection at Saunders including the track between BN MP 10.43 and MP 11.14).

(e) BNSF shall waive SP's requirement to pay any portion of the Tehachapi tunnels clearance improvements pursuant to the 1993 Agreement between Santa Fe and SP.

(f) BNSF shall allow UP to exercise its rights to use the Hyundai lead at Portland Terminal 6 without any contribution to the cost of constructing such lead.

(g) BNSF shall allow UP/SP to enter or exit SP's Chicago-Kansas City-Hutchinson trackage rights at Buda, Earlville, and west of Edelstein, IL. UP/SP shall be responsible for the cost of any connections required.

(h) BNSF will amend the agreement dated April 13, 1995, between BNSF and SP to allow UP/SP to enter and exit Santa Fe's line solely for the purposes of permitting UP/SP or its agent to pick up and set out interchange business, including reciprocal switch business at Newton, KS, and switching UP industries at that point.

(i) It is the intent of the parties that this Agreement result in the preservation of competition by two rail carriers for (a) all "2-to-1" Shipper Facilities at points listed on Exhibit A to this Agreement and (b) all other shippers who had direct competition or competition by means of siting, transload or build-in/build-out from only UP and SP pre-merger.

The parties recognize that some "2-to-1" Shipper Facilities, Existing Transload Facilities, and New Shipper Facilities at "2-to-1" Points will not be able to avail themselves of BNSF service by virtue of the trackage rights and line sales contemplated by this Agreement. For example, "2-to-1" Shipper Facilities, Existing Transload Facilities, and New Shipper Facilities located at points between Niles Junction and the end of the joint track near Midway (including Livermore, CA, Pleasanton, CA, Radum, CA, and Trevarno, CA), Lyoth, CA, Lathrop, CA, Turlock, CA, South Gate, CA, Tyler, TX, Defense, TX, College Station, TX, Great Southwest, TX, Victoria, TX, Sugar Land, TX, points on the former Galveston, Houston & Henderson Railroad served only by UP and SP, Opelousas, LA and Herington, KS are not accessible under the trackage rights and line sales covered by this Agreement. Accordingly, UP/SP and BNSF agree to enter into arrangements under which, through trackage rights, haulage, ratemaking authority or other mutually acceptable means, BNSF will be able to provide competitive service

to "2-to-1" Shipper Facilities, Existing Transload Facilities, and New Shipper Facilities at the foregoing points and at other "2-to-1" Points not along a Trackage Rights Line.

(j) BNSF shall have the right to interchange with any short-line railroad which, prior to the Effective Date of this Agreement, could interchange with both UP and SP and no other railroad.

(k) BNSF shall also have the right to interchange with any short-line railroad that constructs a new line to and establishes an interchange on a Trackage Rights Line subsequent to UP's acquisition of control of SP; PROVIDED, HOWEVER, that the short-line railroad must be a Class II or Class III railroad neither owned nor operated by BNSF or any BNSF affiliate. In addition, the new rail line must be either (i) an extension of an existing Class II or Class III carrier that does not connect with UP or (ii) a new Class II or Class III carrier. BNSF shall not be entitled to interchange traffic with a Class II or Class III carrier at such a new interchange on a Trackage Rights Line if the traffic originates or terminates at a Shipper Facility that is now served solely by UP unless the Shipper Facility qualifies as a New Shipper Facility or unless the new line qualifies as a build-in or build-out under this Agreement.

(l) In addition to the right to serve build-in/build-out lines specified in Sections 4(a), 5(a) and 6(c) of this Agreement, BNSF shall have the right to serve a new build-in/build-out line constructed to reach a facility that was, prior to September 11, 1996, solely served by either UP or SP and would be open to two railroad service upon construction of the build-in/build-out line (i) to a point on lines owned by SP on September 11, 1996, in the case of facilities solely served by UP, or (ii) to a point on lines owned by UP on September 11, 1996, in the case of facilities solely served by SP. UP shall grant BNSF Overhead Trackage Rights necessary for BNSF to reach the build-in/build-out line. The routing of such trackage rights shall seek to minimize the

operating inconvenience to UP, consistent with ensuring that BNSF can provide competitive service.

(m) Where this Agreement authorizes BNSF to utilize haulage to provide service, the fee for such haulage shall be \$.50 per car mile plus a handling charge to cover handling at the haulage junction with BNSF and to or from a connecting railroad or third party contract switcher. The handling charge shall be \$50 per loaded or empty car for intermodal and carload and \$25 per loaded or empty car for unit trains with unit train defined as 67 cars or more of one commodity in one car type moving to a single destination and consignee. UP/SP shall bill BNSF the \$50 per car handling charge for all cars and, upon receipt of appropriate documentation from BNSF demonstrating that business assessed the \$50 per car handling fee was a unit train, adjust prior billings by \$25 per car for each car BNSF demonstrates to have been eligible for the \$25 per car handling charge for unit trains. Where UP/SP is providing reciprocal switching services to BNSF at "2-to-1" Shipper Facilities as provided for in Section 9(i) of this Agreement, the per car handling charge shall not be assessed at the point where such reciprocal switch charge is assessed. The haulage fee and handling charge set forth above as of September 25, 1995, shall be adjusted upwards or downwards in accordance with Section 12 of this Agreement.

(n) In the event, for any reason, any of the trackage rights granted under this Agreement cannot be implemented because of the lack of sufficient legal authority to carry out such grant, then UP/SP shall be obligated to provide an alternative route or routes, or means of access of commercially equivalent utility at the same level of cost to BNSF as would have been provided by the originally contemplated rights.

(o) In the event UP determines to terminate or not renew a lease to an Existing Transload Facility to which BNSF gained access as a result of this Agreement or the conditions

imposed on the UP/SP merger and BNSF has previously entered into a contract to provide transportation services to the Existing Transload Facility, UP shall extend the lease for the remaining period of such transportation contract or for a period not to exceed 24 months, whichever period is shorter.

9. **Trackage Rights - General Provisions**

(a) The compensation for operations under this Agreement shall be set at the levels shown in the following table as subsequently indexed under the 1995 Agreement:

**Table I**  
**Trackage Rights Compensation**  
**(mills per ton-mile)**

	Keddie-Stockton/Richmond	All Other Lines
Intermodal and Carload	3.48	3.1
Bulk (67 cars or more of one commodity in one car type)	3.0	3.0

These rates shall apply to all equipment moving in a train consist including locomotives. The rates shall be escalated in accordance with the procedures described in Section 12 of this Agreement. The owning line shall be responsible for maintenance of its line in the ordinary course including rail relay and tie replacement. The compensation for such maintenance shall be included in the mills per ton mile rates received by such owning line under this Agreement.

(b) BNSF and UP/SP will conduct a joint inspection to determine necessary connections and sidings or siding extensions associated with connections, necessary to implement the trackage rights granted under this Agreement. The cost of such facilities shall be borne by the party receiving the trackage rights which such facilities are required to implement. Either party shall have the right to cause the other party to construct such facilities. If the owning carrier decides to utilize such facilities constructed by it for the other party, it shall have

the right to do so upon payment to the other party of one-half (1/2) the original cost of constructing such facilities.

(c) Capital expenditures on the Trackage Rights Lines and on lines over which BNSF is granted Overhead Trackage Rights will be handled as follows:

- (i) UP/SP shall bear the cost of all capacity improvements that are necessary to achieve the benefits of its merger as outlined in the application filed with the ICC for authority for UP to control SP. The operating plan filed by UP/SP in support of the application shall be given presumptive weight in determining what capacity improvements are necessary to achieve these benefits.
- (ii) Any capacity improvements other than those covered by subparagraph (i) above shall be shared by the parties based upon their respective usage of the line in question, except as otherwise provided in subparagraph (iii) below. That respective usage shall be determined by the 12 month period prior to the making of the improvement on a gross ton mile basis.
- (iii) For 18 months following UP's acquisition of control of SP, BNSF shall not be required to share in the cost of any capital improvements under the provision of subparagraph (ii) above.
- (iv) BNSF and UP/SP agree that a capital reserve fund of \$25 million, funded out of the purchase price listed in Section 10 of this Agreement, shall be established. This capital reserve fund shall, with BNSF's prior consent which will not unreasonably be withheld, be drawn down to pay for capital projects on the Trackage Rights Lines that are required to

accommodate the operations of both UP/SP and BNSF on those lines, but in any event shall not be used for expenditures covered by subparagraph (i) above. Any disputes over whether a project is required to accommodate the operation of both parties shall be referred to binding arbitration under Section 15 of this Agreement.

- (v) If both UP/SP and BNSF intend to serve New Shipper Facilities located subsequent to UP's acquisition of control of SP as authorized by Sections 1(b), 3(c), 4(b), 5(b), 6(d), and 8(i) of this Agreement, they shall share equally in any capital investment in such connections and sidings and siding extensions or other support facilities required by both UP and BNSF to provide rail service to such New Shipper Facility. If only one railroad initially provides such service, the other railroad may elect to provide service at a later date, but only after paying to the railroad initially providing such service 50% of any capital investment (including per annum interest thereon) made by the railroad initially providing rail service to the New Shipper Facility. Per annum interest shall be at a rate equal to the average paid on 90-day Treasury Bills of the United States Government as of the date of completion until the date of use by the other railroad commences. Per annum interest shall be adjusted annually on the first day of the twelfth (12th) month following the date of completion and every year thereafter on such date, based on the percentage increase or decrease, in the average yield of 30-year U.S. Treasury Notes for the prior year compared to their average yield in first year of completion of the

access to such industry or industries. Each annual adjustment shall be subject, however, to a "cap" (up or down) of two percentage points more or less than the prior year's interest rate.

(d) Subject to the terms of the Dispatching Protocols attached hereto as Exhibit D and incorporated herein, the management and operation of the lines over which the parties have granted trackage rights to each other pursuant to this Agreement ("Joint Trackage") shall be under the exclusive direction and control of the owning carrier, and the owning carrier shall have the otherwise unrestricted power to change the management and operations on and over Joint Trackage as in its judgment may be necessary, expedient or proper for the operations thereof intended. Trains of the parties utilizing Joint Trackage shall be given equal dispatch without any discrimination in promptness, quality of service, or efficiency in favor of comparable traffic of the owning carrier. Trains operating in the Houston terminal shall be routed over the most efficient routes as necessary to avoid delays and congestion, even routes over trackage over which the operating carrier has no operating rights.

The owning carrier shall keep and maintain the Joint Trackage at no less than the track standard designated in the current timetable for the applicable lines subject to the separate trackage rights agreement. The parties agree to establish a joint service committee to regularly review operations over the Joint Trackage lines.

In the event the owning carrier determines to sell or remove from service a Joint Trackage line and/or any associated facilities, the owning carrier shall provide the other carrier with reasonable written notice of such determination. Any such sale to a third party shall be expressly made subject to the terms and conditions of this Agreement, and the owning carrier

shall remain responsible as to the obligations imposed on it herein in the event the third party purchaser does not fulfill those obligations.

(e) Each party shall be responsible for any and all costs relating to providing employee protection benefits, if any, to its employees prescribed by law, governmental authority or employee protective agreements where such costs and expenses are attributable to or arise by reason of that party's operation of trains over Joint Trackage. To the extent that it does not violate existing agreements, for a period of three years following acquisition of control of SP by UP, BNSF and UP/SP shall give preference to each other's employees when hiring employees needed to carry out trackage rights operations or operate lines being purchased. The parties shall provide each other with lists of available employees by craft or class to whom such preference shall be granted. Nothing in this Section 9(e) is intended to create an obligation to hire any specific employee.

(f) The trackage rights grants described in this Agreement and the purchase and sale of line segments shall be included in separate trackage rights and line sale agreement documents respectively of the kind and containing such provisions as are normally and customarily utilized by the parties, including exhibits depicting specific rail line segments, and other provisions dealing with maintenance, improvements, and liability, subject to more specific provisions described for each grant and sale contained in this Agreement and the general provisions described in this section. BNSF and UP/SP shall elect which of their constituent railroads shall be a party to each such trackage rights agreement and line sale and shall have the right to assign the agreement among their constituent railroads. The parties shall use their best efforts to complete such agreements by June 1, 1996. If agreement is not reached by June 1, 1996 either party may request that any outstanding matters be resolved by binding arbitration with the

arbitration proceeding to be completed within sixty (60) days of its institution. In the event such agreements are not completed by the date the grants of such trackage rights are to be effective, it is intended that operations under such grants shall be commenced and governed by this Agreement.

(g) All locations referenced herein shall be deemed to include all areas within the switching limits of the location designated by tariff, clarified to the extent necessary by publicly-available information, in effect as of September 25, 1995, and access to such locations shall include the right to locate and serve new auto and intermodal facilities at such locations.

(h) The tenant carrier on the Joint Trackage shall have the right to construct, or have constructed for it, for its sole use exclusively owned or leased facilities, including, without limitation, automobile and intermodal facilities, storage in transit facilities, team tracks and yards along the Joint Trackage pursuant to the following terms and conditions:

- (i) The party wishing to construct such exclusively owned facilities for its sole use shall submit its plans to the other party for its review and approval, which approval shall not be unreasonably withheld or delayed;
- (ii) In the case of the construction of team tracks and ancillary facilities, including loading facilities and necessary track connections, the parties shall work cooperatively with each other to enable such construction;
- (iii) Such exclusively owned or leased and used facilities shall not (i) impair the other party's use of the Joint Trackage, (ii) prevent or unduly hinder the other party's access to existing or future customers or facilities served from the Joint Trackage, or (iii) impair access to other exclusively owned facilities then in existence; and

(iv) If jointly owned or leased and used property is to be used for the construction of such exclusively owned or leased and used facilities, the party so constructing such exclusively owned or leased and used facilities shall reimburse the other party for its ownership of the jointly owned property so utilized at 50% of its then current fair market value. If the tenant carrier uses property of the owning carrier for the construction of exclusively owned or leased and used facilities, the tenant carrier shall reimburse the owning carrier for its ownership of the property at 100% of its then current fair market value.

(i) Where UP/SP provides reciprocal switching services to BNSF under this Agreement, UP/SP will do so at a rate of no more than \$130 per car as of September 25, 1995, adjusted pursuant to Section 12 of this Agreement, and all such reciprocal switching services shall be provided on an impartial basis. In the event BNSF's access to a Shipper Facility pursuant to this Agreement is effected by means of a third party contractor, (i) any associated third party switch fee shall be paid by UP/SP, (ii) BNSF shall pay to UP/SP the applicable reciprocal switch fee established between the parties to this Agreement, and (iii) BNSF shall neither be entitled to become an assignee of UP/SP nor become eligible to enter into a separate agreement with the shipper so served.

(j) It is the intent of the parties that BNSF shall, where sufficient volume exists, be able to utilize its own terminal facilities for traffic handled by BNSF under the terms of this Agreement. These locations include Salt Lake City, Ogden, Brownsville and San Antonio, and other locations where such volume develops. Facilities or portions thereof presently utilized by UP or SP at such locations shall be acquired from UP/SP by lease or purchase at normal and

customary charges. Upon request of BNSF and subject to availability and capacity, UP/SP shall provide BNSF with terminal support services including fueling, running repairs and switching. UP/SP shall also provide intermodal terminal services at Salt Lake City, Reno, and San Antonio. UP/SP shall be reimbursed for such services at UP's normal and customary charges. Where terminal support services are not required, BNSF shall not be assessed additional charges for train movements through a terminal. BNSF shall also have equal access, along with UP/SP, to all SP Gulf Coast storage in transit facilities ("SIT") (i.e., those SP facilities at Dayton, East Baytown, and Beaumont, TX), on economic terms no less favorable than the terms of UP/SP's access, for storage in transit of traffic handled by BNSF under the terms of this Agreement, including, but not limited to, traffic to or from Shipper Facilities to which BNSF gained access under the terms of this Agreement. UP/SP agree to work with BNSF to locate additional SIT facilities on the Trackage Rights Lines and on lines over which BNSF is granted Overhead Trackage Rights to serve a build-in/build-out line as necessary.

(k) BNSF may, subject to UP/SP's consent, use agents for limited feeder service on the Trackage Rights Lines and on lines over which BNSF is granted Overhead Trackage Rights to serve a build-in/build-out line.

(l) BNSF shall have the right to inspect the UP and SP lines over which it obtains trackage rights under this Agreement and require UP/SP to make such improvements under this section as BNSF deems necessary to facilitate its operations at BNSF's sole expense. Any such inspection must be completed and improvements identified to UP/SP within one year of the effectiveness of the trackage rights.

(m) BNSF shall have the right to connect, for movement in all directions, with its present lines (including existing trackage rights) at points where its present lines (including

existing trackage rights) intersect with Trackage Rights Lines or lines it will purchase pursuant to this Agreement. UP/SP shall have the right to connect, for movement in all directions, with its present lines (including existing trackage rights) at points where its present lines (including existing trackage rights) intersect with lines over which it will receive trackage rights pursuant to this Agreement. BNSF shall also have the right, at the option of the City Public Service Board of San Antonio, TX, to connect for movement to and from Elmendorf, TX, where BNSF's trackage rights granted pursuant to this Agreement intersect at SP Junction (Tower 112) with the existing trackage rights SP has granted to City Public Service Board of San Antonio, TX.

(n) In the event UP/SP institute directional operations over any Trackage Rights Line or on lines over which BNSF is granted Overhead Trackage Rights, (i) UP/SP shall provide BNSF with reasonable notice of the planned institution of such operations and shall adjust, as appropriate, the trackage rights granted to BNSF pursuant to this Agreement so as to avoid impairing BNSF's ability to provide competitive service on a Trackage Rights Line, and (ii) BNSF shall operate in accordance with the flow of traffic established by such directional operation; PROVIDED, HOWEVER, that any rights granted to BNSF as a result of UP/SP's institution of directional operations shall be Overhead Trackage Rights only, and PROVIDED FURTHER that BNSF shall have the right, on any Trackage Rights Line over which directional operations have been instituted (including lines on which BNSF received Overhead Trackage Rights to serve a point listed or described in Section S(i) of this Agreement or a build-in/build-out line), to operate against the flow of traffic if it is reasonably necessary to do so for BNSF to provide competitive service to shippers on the line which are accessible to BNSF (including service to New Shipper Facilities and build-in/build-out lines) over such line including but not

limited to circumstances where UP operates against the flow of traffic with trains of the same or similar type for the same shipper(s) or for shipper(s) in the same general area.

10. **Compensation for Sale of Line Segments**

(a) BNSF shall pay UP/SP the following amounts for the lines it is purchasing pursuant to this Agreement:

<u>Line Segment</u>	<u>Purchase Price</u>
Keddie-Bieber	\$ 30 million
Dallas-Waxahachie	20 million
Iowa Jct.-Avondale MP 16.9 (includes UP's Westwego intermodal yard; SP's old Avondale yard; and SP's Lafayette yard)	100 million

(b) The purchase shall be subject to the following terms:

- (i) the condition of the lines at closing shall be at least as good as their current conditions as reflected in the current timetable and slow orders (slow orders to be measured by total mileage at each level of speed restrictions).
- (ii) includes track and associated structures together with right-of-way and facilities needed for operations.
- (iii) indemnity for environmental liabilities attributable to UP/SP's prior operations.
- (iv) standard provisions for sales of this nature involving title, liens, encumbrances other than those specifically reserved or provided for by this Agreement.

- (v) assignment of associated operating agreements (road crossings, crossings for wire and pipelines, etc.). Non-operating agreements shall not be assigned.
- (vi) removal by UP/SP, from a conveyance, within 60 days of the closing of any sale, of any non-operating real property without any reduction in the agreed upon purchase price.
- (vii) the purchase will be subject to easements or other agreements involving telecommunications, fiber optics or pipeline rights or operations in effect at the time of sale.

BNSF shall have the right to inspect the line segments and associated property to be sold and records associated therewith for a period of ninety days from the Effective Date of this Agreement to determine the condition and title of such property. At the end of such period, BNSF shall have the right to decline to purchase any specific line segment or segments. In such event, UP/SP shall grant BNSF overhead trackage rights on any such segment with compensation to be paid, in the case of Avondale-Iowa Junction on the basis of the charges set forth in Section 9(a) of this Agreement, and in the case of Keddie-Bieber on a typical joint facility basis with maintenance and operating costs to be shared on a usage basis (gross ton miles used to allocate usage) and annual interest rental equal to the depreciated book value times the then current cost of capital as determined by the ICC times a usage basis (gross ton miles). In the case of Dallas-Waxahachie, operations would continue under the existing trackage rights agreement.

(c) Prior to closing the sale of SP's Iowa Jct.-Avondale line (the "IJA Line"), representatives of UP/SP and BNSF shall conduct a joint inspection of the IJA Line to consider

whether its condition at closing meets the standard established in Section 10(b)(i) of this Agreement. If the representatives of the parties are unable to agree that the condition of the IJA Line meets this standard, then BNSF shall place \$10.5 million of the purchase price in escrow with a mutually agreed upon escrow agent, and closing shall take place. After closing the parties shall mutually select an independent third party experienced in railroad engineering matters (the "Arbitrator") who shall arbitrate the dispute between the parties as to whether the condition of the IJA Line is in compliance with Section 10(b)(i) of this Agreement. Arbitration shall be conducted pursuant to Section 15 subject to the foregoing qualification that the Arbitrator be experienced in railroad engineering matters. If the Arbitrator finds the IJA Line is below the standard, the Arbitrator shall determine the amount (which shall not exceed \$10.5 million) required to bring it in compliance with the standard and authorize the payment of such amount out of the escrow fund to BNSF with the balance, if any, paid to UP/SP. Any amount so paid to BNSF out of the escrow fund to bring the IJA Line into compliance with the standard shall be used by BNSF exclusively to that end (or to reimburse BNSF for funds previously expended to that end) and UP/SP shall not, as a tenant on the IJA Line be billed for any work undertaken by BNSF pursuant to the provisions of this Section 10(c).

11. **Term**

This Agreement shall be effective upon execution (which occurred on September 25, 1995) (the "Effective Date") for a term of ninety-nine years, PROVIDED, HOWEVER, that the grants of rights under Section 1 through 8 shall be effective only upon UP's acquisition of control of SP, and provided further that BNSF may terminate this Agreement by notice to UP/SP given before the close of business on September 26, 1995, in which case this Agreement shall have no further force or effect. This Agreement and all agreements entered into pursuant or in relation hereto shall terminate, and all rights conferred pursuant thereto shall be canceled and

deemed void ab initio, if, in a Final Order, the application for authority for UP to control SP has been denied or has been approved on terms unacceptable to the applicants, PROVIDED, HOWEVER, that if this Agreement becomes effective and is later terminated, any liabilities arising from the exercise of rights under Sections 1 through 8 during the period of its effectiveness shall survive such termination. For purposes of this Section 11, "Final Order" shall mean an order of the STB, any successor agency, or a court with lawful jurisdiction over the matter which is no longer subject to any further direct judicial review (including a petition for writ of certiorari) and has not been stayed or enjoined.

12. **Adjustment of Charges**

All trackage rights charges under this Agreement shall be subject to adjustment upward or downward July 1 of each year by the difference in the two preceding years in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the trackage rights fee. "URCS costs" shall mean costs developed using the Uniform Rail Costing System.

The rates for reciprocal switching services established in Section 9(i) and for haulage service established in Section 8(m) shall be adjusted upward or downward each July 1 of each year to reflect fifty percent (50%) of increases or decreases in Rail Cost Adjustment Factor, not adjusted for changes in productivity ("RCAF-U") published by the Surface Transportation Board or successor agency or other organizations. In the event the RCAF-U is no longer maintained, the parties shall select a substantially similar index and, failing to agree on such an index, the matter shall be referred to binding arbitration under Section 15 of this Agreement.

The parties will agree on appropriate adjustment factors if not covered herein for switching, haulage and other charges.

Upon every fifth anniversary of the effective date of this Agreement, either party may request on ninety (90) days notice that the parties jointly review the operation of the adjustment mechanism and renegotiate its application. If the parties do not agree on the need for or extent of adjustment to be made upon such renegotiation, either party may request binding arbitration under Section 15 of this Agreement. It is the intention of the parties that rates and charges for trackage rights and services under this Agreement reflect the same basic relationship to operating costs as upon execution of this Agreement (September 25, 1995).

13. **Assignability**

This Agreement and any rights granted hereunder may not be assigned in whole or in part without the prior consent of the other parties except as provided in this section. No party may permit or admit any third party to the use of all or any of the trackage to which it has obtained rights under this Agreement, nor under the guise of doing its own business, contract or make any arrangement to handle as its own trains, locomotives, cabooses or cars of any such third party which in the normal course of business would not be considered the trains, locomotives, cabooses or cars of that party. In the event of an authorized assignment, this Agreement and the operating rights hereunder shall be binding upon the successors and assigns of the parties. This Agreement may be assigned by either party without the consent of the other only as a result of a merger, corporate reorganization, consolidation, change of control or sale of substantially all of its assets.

14. **Government Approvals**

The parties agree to cooperate with each other and make whatever filings or applications, if any, are necessary to implement the provisions of this Agreement or of any separate agreements made pursuant to Section 9(f) and whatever filings or applications may be necessary to obtain any approval that may be required by applicable law for the provisions of such

agreements. BNSF agrees not to oppose the primary application or any related applications in Finance Docket No. 32760 (collectively the "control case"), and not to seek any conditions in the control case, not to support any requests for conditions filed by others, and not to assist others in pursuing their requests. BNSF shall remain a party in the control case, but shall not participate further in the control case other than to support this Agreement, to protect the commercial value of the rights granted to BNSF by this Agreement, and to oppose requests for conditions by other parties which adversely affect BNSF; PROVIDED, HOWEVER, that BNSF agrees to reasonably cooperate with UP/SP in providing testimony to the ICC necessary to demonstrate that this Agreement and the operations to be conducted thereunder shall provide effective competition at the locations covered by the Agreement. UP/SP agree to support this Agreement and its implementation and warrant that it has not entered into agreements with other parties granting rights to other parties granted to BNSF under this Agreement. UP/SP agree to ask the ICC to impose this Agreement as a condition to approval of the control case. During the pendency of the control case, UP and SP shall not, without BNSF's written consent, enter into agreements with other parties which would grant rights to other parties granted to BNSF or inconsistent with those granted to BNSF under this Agreement which would substantially impair the overall economic value of rights to BNSF under this Agreement.

15. **Arbitration**

Except as otherwise provided by any decision of the STB or by separate agreement, unresolved disputes and controversies concerning any of the terms and provisions of this Agreement or the application of charges hereunder shall be submitted for binding arbitration under Commercial Arbitration Rules of the American Arbitration Association which shall be the exclusive remedy of the parties.

16. **Further Assurances**

The parties agree to execute such other and further documents and to undertake such acts as shall be reasonable and necessary to carry out the intent and purposes of this Agreement.

17. **No Third Party Beneficiaries**

This Agreement is intended for the sole benefit of the signatories to this Agreement. Nothing in this Agreement is intended or may be construed to give any person, firm, corporation or other entity, other than the signatories hereto, their permitted successors and permitted assigns, and their affiliates any legal or equitable right, remedy or claim under this Agreement.

UNION PACIFIC RAILROAD COMPANY

By: \_\_\_\_\_

Title: \_\_\_\_\_

THE BURLINGTON NORTHERN AND  
SANTA FE RAILWAY COMPANY

By: \_\_\_\_\_

Title: \_\_\_\_\_

**Exhibits to Restated and Amended BNSF Settlement Agreement**

Exhibit A -- List of "2-to-1" Points

Exhibit B -- Term Sheet for UP/SP-BNSF Proportional Rate Agreement Covering I-5 Corridor

Exhibit C -- Schematic drawing of UP's Main Line No. 1 between MP 14.11 and 10.38, UP's Westwego intermodal terminal, and SP's old Avondale Yard (together with the fueling and mechanical facilities located thereon)

Exhibit D -- Dispatching Protocols

Exhibit E -- "2-to-1 Point Identification Protocol"

Exhibit F -- Overhead Trackage Rights Lines

## EXHIBIT A

### LIST OF "2-TO-1" POINTS

#### Points Referred to in Section 1(b)

Provo UT  
Salt Lake City UT  
Ogden UT  
Ironton UT  
Gatex UT  
Pioneer UT  
Garfield/Smelter/Magna UT (access to Kennecott private railway)  
Geneva UT  
Clearfield UT  
Woods Cross UT  
Relico UT  
Evona UT  
Little Mountain UT  
Weber Industrial Park UT  
North Salt Lake City UT  
American Fork UT  
Orem UT  
Points on paired track from Weso NV to Alazon NV  
Reno NV (only intermodal, automotive [BNSF must establish its own  
automotive facility], transloading, and new shipper facilities)  
Herlong CA  
Johnson Industrial Park at Sacramento CA  
West Sacramento CA (Farmers Rice)  
Port of Sacramento CA  
Points between Oakland CA and San Jose CA (including Warm Springs CA,  
Freemont CA, Elmhurst CA, Shinn CA, Kohler CA, and Melrose CA)  
San Jose CA

#### Points Referred to in Section 3(a)

Ontario CA  
La Habra CA  
Fullerton CA