

STB

FD

32760

6-6-96

84084

Handwritten: E

84084

REDACTED - TO BE FILED ON THE PUBLIC RECORD

BEFORE THE
SURFACE TRANSPORTATION BOARD
FINANCE DOCKET NO. 32760



UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY
AND MISSOURI PACIFIC RAILROAD COMPANY
-- CONTROL AND MERGER --

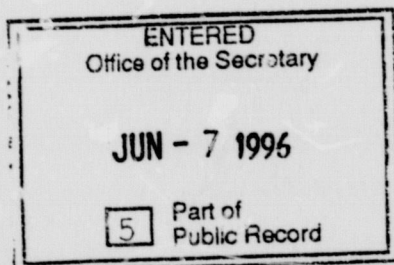
SOUTHERN PACIFIC RAIL CORPORATION, SOUTHERN PACIFIC
TRANSPORTATION COMPANY, ST. LOUIS SOUTHWESTERN RAILWAY
COMPANY, SPCSL CORP. AND THE DENVER AND
RIO GRANDE WESTERN RAILROAD COMPANY

**ERRATA TO BRIEF OF
THE SOCIETY OF THE PLASTICS INDUSTRY, INC.**

Resubmitted herewith are extracts of the Richard B. Peterson deposition relied upon by SPI in its Brief submitted June 3, 1996, SPI-21. Inadvertently incorrect deposition transcript pages were submitted in Appendix 3.

Inasmuch as the deposition extracts were included in the brief for the convenience of the staff of the Surface Transportation Board, copies of the resubmitted pages are not being served on parties of record. The undersigned certifies to serving a copy of this Errata on all parties of record, and copies of the corrected deposition extract pages will be furnished upon request.

Respectfully submitted,



Martin W. Bercovici
Martin W. Bercovici
Douglas J. Behr
Elliot Belilos
KELLER AND HECKMAN
1001 G Street, NW, Suite 500 West
Washington, DC 20001
Tel: (202) 434-4100
Fax: (202) 434-4646

Attorneys for The Society of
the Plastics Industry, Inc.

June 6, 1996

Item No. _____

Page Count 32
JUNE, 1996 #25 117

BEFORE THE

SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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

-- CONTROL 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

HIGHLY CONFIDENTIAL

Washington, D.C.

Wednesday, May 8, 1996

Deposition of RICHARD B. PETERSON, a
witness herein, called for examination by counsel
for the Parties in the above-entitled matter,
pursuant to agreement, the witness being duly
sworn by JAN A. WILLIAMS, a Notary Public in and
for the District of Columbia, taken at the
offices of Covington & Burling, 1201 Pennsylvania
Avenue, N.W., Washington, D.C., 20044, at
10:05 a.m., Wednesday, May 8, 1996, and the
proceedings being taken down by Stenotype by
JAN A. WILLIAMS, RPR, and transcribed under her
direction.

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 situations, industrial site No. 2 and industrial
2 site No. -- let's say industrial site No. 2 has
3 a hypothetical build-out to the SP line.

4 A. Okay.

5 Q. Now, I know you all have tried to
6 diligently find out those situations where that
7 existed and where it did exist you gave BN/Santa
8 Fe access; is that correct?

9 A. Yes, we searched for all those
10 locations and we've agreed to open up I believe
11 four locations.

12 Q. Four on top of the how many did you
13 open up before that, do you remember?

14 A. Well, it's two on top of -- two on top
15 of two.

16 Q. So you searched all of UP and SP's
17 system, entire systems, and you found only four
18 places that there's potential build-outs that
19 you're going to give BN/Santa Fe access to?

20 A. That's a long complicated issue here
21 and that's too simplistic. I mean we searched
22 the entire UP/SP system, we looked at each
23 build-out opportunity that we were aware of, and
24 then determined those where the shipper had
25 successfully used the threat of a build-out to

1 get -- to successfully negotiate better rates and
2 have, in fact, a physically feasible build-out.

3 And we identified -- when you said two
4 initially, I was referring to the Mont
5 Belvieu-Bayer situation, it's all in the same
6 area over east of Houston. And then subsequently
7 we have agreed that we would allow two more
8 build-outs even though the conditions that I just
9 described really in my view weren't met. But we
10 did it to put this issue to rest once and for
11 all.

12 Q. So you've got four locations where
13 you're going to give BN/Santa Fe access due to
14 build-out possibilities?

15 A. Yes.

16 Q. Okay. Now, under the CMA agreement I
17 believe is that, if a shipper felt that he is
18 losing a build-out opportunity, he can bring an
19 arbitration claim; is that correct?

20 A. I would have to go back and read the
21 CMA agreement which I'm not as intimately
22 familiar with as I should have been because of as
23 I say all our application work here in the last
24 few weeks. So I might need to refer back to
25 that. But I mean it allows for negotiations

1 as aggressively as we can because here you show
2 two sources, but, in fact, in real life there are
3 many other sources out there as well. We looked
4 for these cases where we would have only two
5 sources, one on UP, one on SP, and only two as
6 you have here and frankly couldn't find any.

7 Q. If hypothetically -- if there were
8 under my hypothetical the coal mine at UP, the
9 coal mine at SP, would the utility receive the
10 benefit of the competition between SP and UP?

11 A. Would he receive some benefit from that
12 today?

13 Q. Yes.

14 A. It's not clear, you know, what the
15 pricing is going to be. Each railroad is
16 exclusively serving its origin. It's going to
17 look first at transportation alternatives. You
18 mentioned transloading earlier, you know, can
19 that coal be trucked over, is there water
20 competition, and so on. It's going to price at a
21 level as high as it can, being constrained by the
22 competitive factors which include source
23 competition.

24 In this case, in this hypothetical, if
25 the only other source is this one other mine,

1 Q. Was the same data source used for each
2 line in this first table, the one you just
3 referred to, the traffic diversion study?

4 A. In the first column of this table?

5 Q. The applicants column, yes.

6 A. The applicants column. Yes, off-line
7 would be our two-to-one traffic diversions at
8 points in the Gulf.

9 Q. That's what, other competitive traffic?

10 A. No. That's two-to-one off-line, that
11 would be Orange, Amelia, Baytown, Corpus Christi,
12 those towns. They are two-to-one towns, they're
13 in the Houston area, and they would flow up to
14 Memphis and St. Louis over this line. Okay.
15 Mr. Crowley did not include those points. So he
16 had zero.

17 Q. Well, my question is what was the
18 source of your data? In other words, that was
19 your estimates of how much traffic from new
20 two-to-one points that BN/Santa Fe is getting
21 access to that they would route over the Houston
22 to Memphis segment?

23 A. Correct.

24 Q. How much of that traffic is moving
25 beyond St. Louis?

1 agree with you.

2 Q. Did you in making your estimates of how
3 much traffic might be rerouted by BN/Santa Fe
4 over the rights take into account cost
5 differences between the different routes?

6 A. We assumed that the Houston-St. Louis
7 route would be a lower cost route or I should say
8 our operating plan people did, but I participated
9 in that as well, on the basis that it's 150 miles
10 shorter, it has much less grades, must less
11 curvature, and is, in fact, therefore, a lower
12 cost route. Now, the CMA settlement enhances the
13 route even more.

14 Q. Is that cost estimate that you just
15 referred to that your operating people made based
16 on the merged UP/SP's cost of operating over that
17 route?

18 A. I don't know. I believe it was in --
19 it was based on looking at the two physical
20 routes and deciding which one will produce the
21 best service, the best reliability, and the
22 lowest cost.

23 Q. You say it's a lower cost route.
24 You're comparing the Houston to St. Louis route
25 to what route?

1 A. Well, I'm first comparing BN/Santa Fe's
2 existing Houston-St. Louis route with the new
3 rights that it would receive from Houston to
4 Memphis and then using its own route from Memphis
5 to St. Louis, okay, up the west side of the
6 river.

7 That route was 100 and some miles
8 shorter than BN/Santa Fe's existing route,
9 followed the river valleys, was very low grade
10 line, was a low curvature line, and on balance
11 was felt a better line. That was our feeling,
12 that's the feeling of our operating plan people.

13 Now, with the CMA settlement, with
14 directional running, using the UP double track
15 line on the east side of the river, the line is
16 now 30 miles shorter in addition so it's 155
17 miles shorter now and is virtually a double track
18 route the whole way. So the answer is even more
19 clear-cut now than it was when we first made this
20 assumption last December.

21 Q. So the comparison was between BN/Santa
22 Fe's operations over the new trackage rights as
23 amended by the CMA settlement versus their
24 existing line?

25 A. Well, that's our most recent

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 Q. Did you make any estimate of how much
2 it would cost BN to route intermodal traffic via
3 that route, to handle I should say intermodal
4 traffic via that route?

5 A. Well, we made the following estimate.
6 We know BN has got extensive intermodal
7 facilities in St. Louis and Houston and in
8 Memphis. We connect those with a direct line
9 that is as good as our line and better than their
10 line, it's fairly easy to make the judgment that
11 they will move the traffic over the new rights.

12 Now, I'll say this, we were actually
13 somewhat conservative in that we said yes,
14 they're going to reroute some of their existing
15 Houston-St. Louis intermodal over the new route.
16 But we didn't predict an increased market share
17 for BN/Santa Fe. This gets back to this
18 discussion we had on the 15 percent and the 30
19 percent market share enhancements between Omaha
20 and Oakland, okay, because they're going to have
21 a new direct single line.

22 We didn't do that here. We know that
23 BN/Santa Fe has a certain share of the
24 St. Louis-Houston market. We think that, because
25 of the new rights, that market share is going to

1 Q. Let me ask you a further question about
2 what you said this morning which is subsequently
3 that you, applicants, reviewed the situation and
4 you agreed to protect two more build-in
5 situations or build-out situations as the case
6 may be even though they did not meet the
7 conditions or qualifications you established. Do
8 you recall that discussion this morning?

9 A. Yes.

10 Q. And one of those is the Seadrift
11 facility of Union Carbide Corporation; is that
12 correct?

13 A. Yes, Union Carbide at North Seadrift,
14 that's correct.

15 Q. In what manner did the North Seadrift
16 situation not meet the qualifications for
17 protection of build-in or build-out that you had
18 set?

19 A. Well, as I indicated this morning, and
20 I was attempting to read out of the statement but
21 didn't do it very well, when we searched for
22 feasible build-in situations, they had to be
23 physically feasible and have been used by the
24 customer to influence its rates, influence its
25 rate service package successfully by the

1 customer, used successfully by the customer to
2 influence its rates and service.

3 We talked to our people about the Union
4 [REDACTED]

5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

[REDACTED]

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO

1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

[REDACTED]

1

2

3

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

Q. What's Union Carbide's posture if the merger is approved and there is no protection of their build-out opportunity and the contract either expires or is terminated under the terms of the agreement, what options do they have at that point in terms of seeking leverage in negotiating with Union Pacific?

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 A. Well, I mean you're hypothesizing
2 something that won't exist.

3 Q. The merger going through?

4 A. No. I mean --

5 Q. Excuse me. I was being facetious.

6 A. No. My understanding is that we are
7 agreeable to allowing Union Carbide to build out
8 to the Port Lavaca branch, to a point where it
9 could connect with BN/Santa Fe. So that
10 preserves and, in fact, enhances the competitive
11 option that was available before. And, you know,
12 we've indicated that position to Union Carbide a
13 number of times over the past few weeks or
14 months.

15 But, if that were not available, then
16 as I say Union Carbide's rates have already been
17 significantly lowered. I think our studies have
18 shown that for polyethylene production there's a
19 tremendous amount of source competition. UP has
20 a lot invested as does Union Carbide at North
21 Seadrift.

22 You know, it would not be in Union
23 Pacific's interest to raise the rates for a point
24 where Union Carbide shifted production to another
25 plant or lost market share to other plants or

1 and it's clear to me the traffic to the Northeast
2 will move via St. Louis.

3 Q. Did they state that they had made a
4 decision to move it via St. Louis on the trackage
5 rights?

6 A. That was certainly my reading of their
7 filings. Neal Owen talked explicitly about a new
8 St. Louis-Houston train to operate over the
9 rights. They talked about track connections or
10 whether to build them or not to build them on the
11 west side of the river across from Memphis so
12 they could go up on their own line or, of course,
13 they could stay on our line.

14 I would be shocked if they made any
15 statements that they would try to influence
16 customers to move northeastern chemicals over
17 Memphis because it's just not something that
18 really works well service-wise for the Eastern
19 roads or the Western roads.

20 Q. If they do exercise the option to route
21 through your St. Louis or East St. Louis routing
22 trackage rights, what percentage of the route of
23 movement going from the Gulf Coast to the
24 St. Louis or East St. Louis gateway would use the
25 trackage rights as opposed to using the BN/SF's

1 own track?

2 A. Well, it depends what route they use
3 north of Memphis. I think I had one example on
4 that. I can give you the exact miles here.

5 MR. ROACH: Are you assuming an origin
6 of something? Houston?

7 MR. BERCOVICI: I'm assuming an origin
8 in the Houston area, yes. I'm assuming a
9 two-to-one point in the Houston area moving into
10 Conrail territory over St. Louis.

11 THE WITNESS: Say, for example, a
12 movement from Galveston, Texas, to Birmingham,
13 Alabama, would utilize the trackage rights for 64
14 percent of its movement, a movement from
15 Beaumont, Texas, which would cover the
16 Orange-Amelia-Beaumont area. Those new points to
17 Memphis would use 71 percent of its route of
18 movement on trackage rights.

19 A movement from Houston itself to East
20 St. Louis would be the one move that would have a
21 majority of its move on trackage rights and it
22 could be 100 percent of the movement.

23 BY MR. BERCOVICI:

24 Q. You talk in your rebuttal statement --
25 did you have something further to add?

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 A. No.

2 Q. -- about contracts and contract
3 expirations on page 194. You talk about the
4 number of contracts that expire the year 1996
5 through the year 2000. Are there any two-to-one
6 contracts which expire past the year 2000?

7 A. Well, if I can check a work paper
8 quickly, I think I can answer that.

9 Q. Please.

10 A. I see a contract, is it okay to mention
11 the detail here or are these confidential?

12 MR. ROACH: The transcript is highly
13 confidential until it's declassified.

14 THE WITNESS: Okay. And I can refer

15 [REDACTED]

16

17

18

19

20

21

22

23

24

25

[REDACTED]

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

1 [REDACTED]

2 MR. ROACH: You need to look at the
3 right of termination as well in this analysis.

4 MR. BERCOVICI: The right of
5 termination of --

6 MR. ROACH: On the part of the
7 shipper.

8 BY MR. BERCOVICI:

9 Q. Did you review the contracts from the
10 perspective of whether any of these contracts
11 you've referred to have a right of last refusal
12 on the part of UP?

13 A. Not to my knowledge. We did, however,
14 determine whether or not, you know, the contract
15 bound the shipper to volume, whether it was a
16 letter quote which is more of a unilateral
17 offering on our part to offer service at a price,
18 you know, as opposed to a contract that actually
19 committed a customer to a certain volume in
20 exchange for a certain price. That was an
21 important distinction we made. But I don't
22 recall us doing anything with regard to a last
23 right of refusal.

24 Q. You didn't look at whether the
25 contracts had such a term?

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 A. Not to my knowledge.

2 Q. These numbers, of course, you have in
3 your testimony, and I'm looking at page 194, do
4 not include any SP contracts, do they?

5 A. No.

6 Q. With regard to storage in transit,
7 there is a provision paragraph 5 of the
8 settlement agreement with CMA that deals with
9 storage in transit. Maybe I received the answer,
10 but I'll ask it again, is there any written
11 agreement or elaboration on the provision with
12 regard to allowing BN/SF into the Dayton yard
13 beyond what's stated in the agreement between
14 applicants and CMA?

15 A. I'm not aware of any.

16 Q. Are you aware of any Southern Pacific
17 commitments to customers assuring the customers
18 that they will have car spots reserved at Dayton
19 yard?

20 A. No.

21 Q. Could SP have such contracts with
22 customers?

23 A. Well, these would be contracts or
24 assurances or written contracts?

25 Q. Well, let's start with contracts.

1 Could they have contractual agreements with
2 customers?

3 A. I don't know.

4 Q. You don't know whether they have them
5 or you don't know whether they could have them?

6 A. I don't know whether they have them.

7 Q. But they could have them, it's
8 possible?

9 A. Well, I mean, you know, Dayton is
10 operated by a third party, it's owned and
11 operated by a third party. SP has commitments to
12 utilize the facility with a third party.. And so
13 SP could very well be going out to customers, and
14 I'm sure they are, marketing the facility.

15 Now, the duration of their contracts,
16 the nature of the assurances they're giving the
17 customers about availability and service and so
18 on, I don't know and I'm not probably allowed to
19 know that kind of thing about SP's day-to-day
20 marketing activities.

21 Q. Do you know if that was evaluated
22 before the commitment was made in the C.T.
23 agreement to open up the Dayton yard to equal
24 access by the BN/SF?

25 A. I know that the Dayton yard is a big

1 yard, I know it's a busy yard, I know that
2 there's flat land all around it, it can be
3 expanded very easily. And there's no doubt in my
4 mind that whatever capacity is needed by BN/Santa
5 Fe will be in place there. Louisiana & Delta can
6 easily put that in place, if additional capacity
7 is needed, and would be delighted to do so if
8 more business can be brought their way.

9 Q. Is Louisiana & Delta the operator of
10 the Dayton yard?

11 A. Right.

12 Q. Is the commitment under the CMA
13 agreement to extend to the current trackage
14 that's at Dayton or does it contemplate building
15 out additional capacity at the Dayton location?

16 A. Well, that's a good question, that's
17 kind of fine point, it's a good question. I know
18 we've had discussions about that. And, after
19 saying all that, I can't answer your question. I
20 know that capacity is going to be there for
21 BN/Santa Fe. How much of it's going to come from
22 existing tracks and how much might have to come
23 from some additional tracks I don't know. In
24 fact, probably no one can predict, it depends on
25 the ebb and flow of business and so on.

1 So perhaps one of the other witnesses
2 can help you or I can go try to get an answer to
3 your question. I can't answer it this minute.

4 Q. Do you know if BN/SF has agreed to take
5 any specified capacity at Dayton yard?

6 A. Well, they have certainly testified
7 that they fully expect to have Dayton yard
8 available to them. They have testified that that
9 yard will more than meet their needs for the
10 Baytown branch shippers. And so they've got
11 every expectation and every confidence that
12 they're going to get what they need at Dayton.

13 Exactly how that's going to be
14 implemented is probably one of the many subjects
15 that our implementing teams are going through
16 right now. And, when you've got a third party
17 involved, then that complicates it even further.
18 But literally that's the extent of my knowledge.

19 Q. You are unaware as to whether or not or
20 whether they have made any financial commitment
21 with regard to Dayton yard at this point in time;
22 is that correct?

23 A. Well, that's right. And I don't really
24 expect that they're going to need to make any
25 financial commitment to Dayton yard to have what

1 Q. In your testimony, Mr. Peterson, you
2 suggest that BN/SF, and I'm looking at page 159
3 to 160, BN/SF finds itself with a significant
4 number of potential new SIT locations throughout
5 the Southwest, and you name a number of
6 locations?

7 A. Yes.

8 Q. Have you discussed those locations with
9 BN/SF as possible storage facilities?

10 A. Well, I haven't personally, but I
11 talked to our operating plan people. And, as you
12 know, there is a lot of interaction now between
13 us and BN/Santa Fe people on implementation. And
14 I talk to our operating plan people, our people
15 that work closely with the Santa Fe down there,
16 and our people that are most knowledgeable with
17 regard to the SIT yards on our system.

18 And these are facilities that they
19 mentioned. They gave me specific numbers of
20 tracks, 22 tracks in this yard, 12 here, so on,
21 you know. They may have talked to BN/Santa Fe
22 directly or indirectly, but I did not. That's
23 the way I derived this information plus based on
24 my personal knowledge of the yards and of the
25 area and the role the yards play and the role

1 that they used to play.

2 Q. You say they may have talked to
3 BN/Santa Fe directly. You don't know whether or
4 not they have discussed this with BN/Santa Fe,
5 correct?

6 A. Correct, I don't know that with
7 certainty.

8 Q. Looking at your listing of yards here,
9 you identify Bellville, Summerville, Temple,
10 Clayburn, Fort Worth, Tulsa, Springfield.

11 A. Yes.

12 Q. Aren't they all on BN's line running
13 north and west of Houston through Fort Worth and
14 Oklahoma City towards St. Louis?

15 A. Some of these yards are on BN's line,
16 some are on Santa Fe's line.

17 Q. But isn't it the line that goes out of
18 Houston north toward Fort Worth and then cuts --

19 A. No, not entirely. Some points are.
20 But, if we start -- we talk about the Santa Fe --
21 BN/Santa Fe facilities as you say on the bottom
22 of page 159. The first are former Santa Fe
23 yards, Silsbee is over just north of Beaumont.
24 It's very well situated to serve Orange, Amelia
25 which is, in effect, in Beaumont, on the west

1 side of Beaumont, and other chemical traffic in
2 the Beaumont -- petrochemical traffic in the
3 Beaumont area. Silsbee is Santa Fe's main crew
4 change point and terminal over there, that's 70
5 miles east of Houston.

6 Summerville, Bellville, Temple, and
7 Clayburn are on Santa Fe's Houston-Fort Worth
8 line, that is correct. The facilities in the
9 Houston area on the old Burlington Northern main
10 line exist in the north side of Houston. There
11 are two or three SIT facilities on the north side
12 of Houston on the old BN line, both BN and Santa
13 Fe both have main lines going north.

14 Then, yes, you go up to Fort Worth,
15 Tulsa, and Springfield. Those are points that BN
16 is already using for SIT capacity because that's
17 its current route. However, even with that
18 route, BN has two important plastics contracts
19 out of Houston going over the Memphis gateway to
20 a great degree, the Solvay business and they've
21 had the Phillips business as well. And those
22 they've used Springfield, Tulsa as storage in
23 transit for those.

24 Q. These points that you identified other
25 than Silsbee, isn't it true that all of them are

1 out of route from the standpoint of the trackage
2 rights authority that BN/SF would get if the
3 merger is approved?

4 A. Well, it depends which trackage
5 authority we're talking about. I mean, if you're
6 going to New Orleans, then BN is going to own an
7 entire railroad to New Orleans including the SP
8 yards of Lafayette, Louisiana, and Avondale.
9 Going to Memphis, not only the Silsbee yard but
10 the BN facilities just north of Houston would be
11 in a good position. And the other facilities,
12 however, on up through Fort Worth would need to
13 be more geared for traffic moving north and
14 west.

15 Mr. Rose is BN's chief marketing --
16 chemical marketing officer. And he indicated
17 that they have I believe it was ten to \$12
18 million allocated for SIT yard expansion. That
19 would be presumably at locations other than these
20 that I mention, but I'm not sure of the exact
21 locations.

22 Q. To the extent that BN/SF would rely
23 upon the locations that you've identified here
24 other than Silsbee for storage of plastics
25 traffic, isn't it likely that they would not use

1 the trackage rights but rather would use their
2 existing routes in terms of moving traffic to the
3 Eastern gateways?

4 A. Well, again it depends on how much
5 Eastern traffic you would use these facilities
6 for. As I say these facilities might play more
7 of a role on north and westbound and West Coast
8 business. I mean we have facilities all up and
9 down our railroad, up in St. Louis, up in
10 Arkansas that are SIT yards. So, you know, yes,
11 there is some out of route movement.

12 But those facilities often play a role
13 that makes sense for the location that they're
14 in. But clearly these that I have mentioned are
15 not on the new Houston-Memphis trackage rights.
16 I don't say all of them. Some of these
17 facilities are not obviously on the
18 Memphis-Houston trackage rights. And so you
19 might elect to move traffic from them to certain
20 destinations on routes other than via the
21 Houston-Memphis trackage rights.

22 Q. You stated I believe that the
23 facilities outside of the production area as I
24 will characterize it, talking about those going
25 toward St. Louis and so forth and some of those,

1 the St. Louis storage in transit, or is that
2 railroad convenience?

3 A. No, that's -- I mean those tracks are
4 committed to just certain customers. We have
5 three customers in St. Louis that use those
6 tracks.

7 Q. With regard to the potential that BN/SF
8 may route or may utilize some of these facilities
9 you've identified on page 159 and 160, the
10 storage yards, did you take those into account in
11 your trackage rights flow calculations which
12 appear on the color chart between pages 171 and
13 172 of your testimony?

14 A. No.

15 Q. Let's talk about Lake Charles for a few
16 minutes.

17 A. Okay.

18 Q. There are as I understand it three
19 railroad stations in the area generally known as
20 Lake Charles. Please confirm or correct me if
21 I'm wrong, there's Lake Charles, West Lake, and
22 West Lake Charles; is that accurate?

23 A. That's correct. There's also a place
24 called Harbor.

25 Q. And they're all in the same general

1 shorter mileage?

2 A. It sounds like it, right.

3 Q. But still you have the circuitry?

4 A. Yes. Next time I'll take the time to
5 think that through more carefully.

6 Q. With regard to the CMA settlement and
7 the option given to the Lake Charles and West
8 Lake shippers of using BN/SF service to reach the
9 Mexican border points including Brownsville, does
10 that traffic go through Houston?

11 A. Yes.

12 Q. Why don't we come back to the question
13 you mentioned about the KCS route over Meridian
14 which you speak to on page 33 of your testimony.
15 Is that a viable route today?

16 A. Yes.

17 Q. Are there tariff rates for plastics
18 going KCS over the Meridian route connecting
19 either with Norfolk Southern or with CSX going
20 into the eastern district?

21 A. Are there tariff rates?

22 Q. Yes.

23 A. I don't know. I don't know KCS'
24 rates.

25 Q. So you don't know whether or not

1 about a customer's requirements and things like
2 that. So yes, we participate. It's not -- you
3 know, given the incredibly short time frames and
4 the amount of work to be done, each person pretty
5 much has to concentrate on his own assignment.
6 But we coordinate to the extent we can.

7 Q. Have there been meetings with regard to
8 the operating plan because of or since the CMA
9 agreement has been entered into?

10 A. I have not attended -- well, I seldom
11 attend meetings involving the operating plan.
12 The involvement I have would be a phone call or
13 something of that nature to answer a question or
14 to do something of that nature.

15 With regard to the CMA agreement, I'm
16 not aware of any meetings that have been held to
17 restructure the operating department or --
18 restructure the operating plan or change the plan
19 in any major way or anything like that.

20 Q. Will the CMA agreement result in a
21 change to your proposed operating plan?

22 A. Well, I can't answer that with
23 certainty. But I would doubt it mainly because
24 we don't anticipate any sizable changes in
25 traffic diversions or traffic flows because of

1 the CMA agreement.

2 MR. MOLM: No further questions.

3 (Thereupon, at 8:15 p.m., the taking of
4 the instant deposition ceased.)
5
6

7 -----
8 Signature of the Witness

9 SUBSCRIBED AND SWORN to before me this -----
10 day of

11 -----, 19__.
12
13

14 -----
15 NOTARY PUBLIC

16 My Commission Expires
17
18
19
20
21
22
23
24
25

STB FD

32760

6-3-96

E

84040

[PUBLIC VERSION]

Before the
SURFACE TRANSPORTATION BOARD



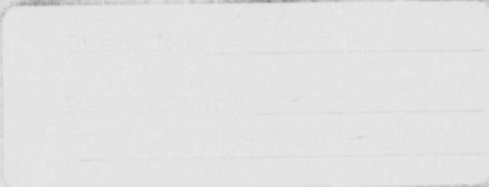
Finance Docket No. 32760

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

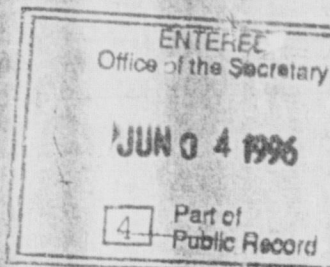
-- CONTROL AND MERGER --

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

BRIEF OF THE RAILROAD COMMISSION OF TEXAS
ON BEHALF OF THE STATE OF TEXAS



RICHARD H. STREETER
BARNES & THORNBURG
1401 EYE STREET, N.W.
SUITE 500
WASHINGTON, D.C. 20005
(202) 408-6033



COUNSEL FOR THE
RAILROAD COMMISSION OF TEXAS

CAROLE KETTON RYLANDER, CHAIRMAN
BARRY WILLIAMSON, COMMISSIONER
CHARLES R. MATTHEWS, COMMISSIONER

DATED: JUNE 3, 1996

TABLE OF CONTENTS

INTRODUCTION	1
ARGUMENT AND STATEMENT OF CONTINUING INTEREST OF THE RAILROAD COMMISSION OF TEXAS	7
I. The Elimination Of The SP Is An Essential Ingredient In The Creation Of Both Western And Nationwide Duopolies	10
II. The Only Interest Of The Texas Railroad Commission In This Merger Is The Preservation Of The Free Market	14
III. The Proposed Divestiture And Other Conditions Will Preserve Existing Competitive Conditions In The Rail Industry Witihout Threatening Any Public Benefits Which May Be Legitimately Attributed To The Merger	18
IV. TexMex's Trackage Rights Request Should Be Granted To Preserve Competition and Essential Rail Services	22
V. The Creation Of Neutral Terminal Railroads Would Effectively Preserve Competition And Prevent UP From Exacting Monopoly Profits	27
A. UP's inflammatory mischaracterization of the neutral terminal railroad condition is deliberately misleading	28
B. UP's unsubstantiated objections to the neutral terminal proposal are rebutted by BN/SF's testimony	33
C. Neutral terminal railroads are an integral component of the Mexican government's privatization plan	35
VI. The CMA Agreement Does Not Rectify The Massive Competitive Problems Which Would Result From The Merger	37

VII. The Need For Special Abandonment Conditions Arises From And Is Related To The Need To Counter The Monopoly Power Which Will Flow From This Merger	43
VIII. The SP Does Not Need To Be Saved By The UP In Order Either To Survive Or To Provide Efficient, Competitive Rail Service	44
CONCLUSION	47

APPENDIX (HIGHLY CONFIDENTIAL VERSION ONLY)

Deposition Testimony Frank D. Clifton

Deposition Testimony Robert D. Krebs

Deposition Testimony Richard B. Peterson

Deposition Testimony Matthew K. Rose

Deposition Testimony George R. Speight, Jr.

Before the
SURFACE TRANSPORTATION BOARD

RCT-7

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

BRIEF OF THE RAILROAD COMMISSION OF TEXAS
ON BEHALF OF THE STATE OF TEXAS

INTRODUCTION

By Comments filed March 29, 1996, the Railroad Commission of Texas ("Railroad Commission") gave notice that, after examining the potential impacts of the proposed merger on Texas businesses and citizens, it was opposed to the merger of the Union Pacific Corporation, *et al.* (collectively "UP"), with Southern Pacific Rail Corporation, *et al.* (collectively "SP") (hereinafter the "Merger"). As the Railroad Commission explained, based on the extensive information which it had developed, the Merger should be disapproved because it is anticompetitive and would be harmful to Texas and to the significant international trade which moves through the State as a result of the North American Free Trade Agreement. The Railroad Commission further concluded that the Agreement entered into on September 25, 1995 by the UP and the Burlington Northern Railroad Company and the Atchison, Topeka and Santa Fe Railway Company (hereinafter

collectively the "BN/SF"), as supplemented November 18, 1995 (the "Agreement"), failed to alleviate the anticompetitive effects of the Merger. Therefore, the Railroad Commission recommended that authorization for the Merger, as proposed, must be denied.

Recognizing that the Merger may produce limited public benefits if properly conditioned, the Railroad Commission proposed four conditions which would preserve and advance the goals of the free market by providing shippers with a measure of protection from reduced levels of rail service and from monopoly gouging. One condition would be to grant the Texas Mexican Railway Company's ("TexMex") request for trackage rights between Beaumont and Corpus Christi as set forth in TM-23. A second condition would require the divestiture of several SP lines and their sale to a Class I railroad. The Railroad Commission's only criterion is that the sale of the lines cure the potential anticompetitive impact of the duopoly which would result from this Merger. Furthermore, any such sale must assure the Port of Corpus Christi competitive access to its markets. A third condition is the creation of neutral terminal railroads in all major industrial markets which would otherwise be dominated by UP. The fourth condition would require UP and BN/SF, if they propose to abandon tracks in Texas following the Merger, to include all trackage necessary to ensure that a purchasing carrier, rural rail district or other acquiring entity, have unfettered access to rail junction points. In short, any line abandonments filed by merger applicants must be junction to junction, or industry to junction in the case of abandoning an industrial lead.

In addition to the economic conditions, the Railroad Commission voiced its concern that the anticipated increase in rail traffic in certain areas, especially in West Texas, may

potentially impact public safety. In order to ensure the safety of motorists, the Railroad Commission requested imposition of a condition that would require the merged railroad to agree (1) to confer with law enforcement officials, traffic engineers, and public officials in cities and counties on the merged railroad's routes where there will be a substantial increase in the number of daily trains attributable to implementation of the merged railroad's operating plan, and (2) to install flashers, bells and gates at all grade crossings where authorized maximum train speed is great enough to present a hazard to motorists and there is a sufficient number of automobiles per day at the crossing to warrant installation of electronic warning devices.

While UP has responded to the final condition with the comment that "SEA has already considered these issues, and UP/SP will work with local authorities to address legitimate safety concerns," UP/SP-230 at 282, it then states that the "proposals about signalling . . . are unwarranted." Although UP cites to King RVS p. 17-25 as its "authority" for the proposition that signals are unwarranted, that testimony has nothing to do with the safety measures which the Railroad Commission has proposed. This equivocation leaves the Railroad Commission with no alternative but to demand a specific condition that can be easily enforced. Otherwise, it appears that UP will arrogantly refuse to take any affirmative action to address the legitimate safety issues which are posed by the lack of road-crossing signals.

The Applicants and BN/SF have objected to the Railroad Commission's proposed conditions with varying amounts of invective. For example, in order to avoid having to admit that the Railroad Commission's divestiture proposals are driven by the public interest,

and not by any economic self-interest, both UP and BN/SF have avoided any direct attacks on the Railroad Commission's divestiture proposals by claiming that it "discusses issues that are raised by other parties and already addressed." BN/SF-54. By taking this approach, UP and BN/SF seek to make it appear that the divestitures are driven solely by the Kansas City Southern Railroad ("KCS") and Conrail which applicants brand as "shameless opportunists." However, when considering the divestiture conditions, the Board is urged to remember that the Railroad Commission is not seeking to promote its own self-interest. Rather, its request for divestiture is motivated solely by the unquestioned need to preserve rail competition on behalf of Texas shippers and receivers. Moreover, similar divestiture proposals have been advanced by a number of shippers which stand to be victimized by the merger and which recognize that if the lines are not divested, rail competition will be non-existent.

The applicants follow a similar course with regard to the requests involving rail service in South Texas and the need to ensure the continued existence of the TexMex. Once again the Surface Transportation Board ("Board") must remember that the Railroad Commission's concerns are based on the public interest and not on any self-interest. As shall be demonstrated, the demise of the TexMex would have a disastrous impact on South Texas as it would leave UP in the position of having a complete monopoly over rail service at Laredo.

Also, while BN/SF accuses the Railroad Commission of advancing assertions that are not backed by any evidence, see BN/SF-54, statements attached to the TexMex's Responsive Application confirm the advice that "UP and SP have repeatedly refused to accept traffic moving from South Texas over the Laredo gateway into Mexico." RCT-4 at 4. See, e.g.,

Letter to Vernon A. Williams from Corpus Christi Grain Co.; Letter to Vernon Williams from Global Grain Co. ("Union Pacific and Southern Pacific are not willing to serve because they consider such short haul service unprofitable.") While BN/SF may now seek to protest this testimony, these companies appeared at the Railroad Commission hearings in Corpus Christi and offered the identical testimony without being challenged by UP, SP or BN/SF.

The Railroad Commission's neutral terminal railroad condition is vehemently attacked. See UP/SP-230 at 279-281. As will be demonstrated, many of the UP's arguments with regard to the neutral terminal railroads deliberately mischaracterize the Railroad Commission's proposal. Putting UP's rhetoric aside, the Commission's proposal is plainly a simple solution to a significant problem. As such, the neutral terminal railroads represent a true check and balance against the use of monopoly power.

The Railroad Commission submits that its original conclusions have been validated by the separate testimony and requests for conditions submitted by individual shippers -- Dow Chemical Company ("Dow"), Montell USA, Inc. ("Montell"), Arizona Chemical, Inc. ("Arizona Chemical"), Union Carbide Corporation ("Carbide"), Quantum Chemical Corporation ("Quantum"), Formosa Plastics Corporation, U.S.A. ("Formosa"), the Geon Company ("Geon"), International Paper ("IP"), PPG Industries, Inc. ("PPG"), Phillips Petroleum Company ("Phillips"), Texas Utilities Electric Company ("Texas Utilities") and Redstone Stone Products Company ("Redstone") -- by major shipper organizations and groups -- National Industrial Transportation League ("NITL"), Society of the Plastics Industry, Inc. ("SPI"), the Western Shippers' Coalition ("WSC"), Chemical Manufacturers

Association ("CMA"),¹ and the Coalition for Competitive Rail Transportation ("CCRT") -- by governmental agencies -- the United States Department of Justice ("DOJ"), the United States Department of Agriculture ("DCA"), the Attorney General of Texas, and the Verified Statements of Representatives Junnell, Cook and Saunders of the Texas Legislature -- and by competing railroads -- Conrail, TexMex and KCS -- as well as the rebuttal testimony submitted by Applicants and the CMA Settlement Agreement. Because the Applicants have not been able to devise any truly effective means of curing the Merger's unquestioned anticompetitive impacts, which impacts would be extremely harmful to the economic interests of Texas and ultimately the entire nation, the Railroad Commission adheres to the positions which it announced in its Comments of March 29, 1996.

The situation herein cannot be distinguished from that described by the former Interstate Commerce Commission ("ICC") in Santa Fe Southern Pacific Corp.-Control-SPT Co., 2 I.C.C.2d 709 (1986). While the Applicants here have attempted a preemptive strike in the form of the UP/BN/SF Agreement, that Agreement does not negate the unquestioned fact that "the merged carrier would be a monopolist in many markets and a duopolist in many others." Id. at 736. Moreover, the Agreement is woefully inadequate to remedy the anticompetitive problems of the merger in that it creates an environment in which anticompetitive collusion would flourish. In sum, because the Applicants have utterly failed to meet the "heavy" burden of demonstrating that the merger is in the public interest,

¹ The Comments initially filed by the CMA have been adopted by Arizona Chemical Company in the wake of CMA's Settlement Agreement with UP/SP. Despite the Settlement, George R. Speight, Jr., Staff Executive to CMA's Distribution Committee, has subsequently admitted that "CMA does not support the merger." Tr. Speight at 32.

all doubts should be resolved in favor of neutral parties, such as DOJ and the Railroad Commission, which are representing the public interest in this proceeding and which oppose unconditional approval of the Merger.

ARGUMENT AND STATEMENT OF CONTINUING INTEREST OF THE RAILROAD COMMISSION OF TEXAS

In their rebuttal comments, the applicants accuse their opponents of offering a long list of requested conditions which would only serve to fragment and balkanize the nation's rail systems in order to bring about "government-planned ownership and operation."² Nothing could be further from the truth. Upon taking the opportunity to step back and carefully consider the full implications of the applicants' transparent effort to divide the railroad market in the Western two-thirds of the nation between themselves, the Board will quickly realize that the conditions proposed by the Railroad Commission and other significant Merger opponents, including the major shippers and trade associations listed above, are essential for preservation of rail competition.

Furthermore, the Board will discover that the various Agreements which UP has reached with BN/SF and others do not ensure vigorous competition. Instead, the Agreements, especially those which have been reached with the BN/SF, openly invite future anticompetitive collusion.

The UP/BN/SF Agreements must be viewed with extreme skepticism. If it is true that the UP/SP merger is driven by the need to "compete effectively with the powerful,

² BN/SF-54 at 18. See also UP/SP-230 at 280-281. As shall be demonstrated, such contentions are based on a deliberate misstatement of the Railroad Commission's position on neutral terminal railroads, as set forth in its Comments filed March 29, 1996.

dominant BN/Santa Fe system" (UP-SP-230 at 3), why is it that UP would be so solicitous of BN/SF as to gratuitously enter into an agreement which would enhance BN/SF's competitive prowess by allegedly handing over \$450 million in new revenue? UP/SP-231, RVS Peterson at 160. Certainly, this is not the normal behavior associated with vigorous competition.

Furthermore, why would UP, apparently without even consulting with BN/SF, unilaterally propose changes to the Agreements if those Agreements had been the product of vigorous negotiations, and if BN/SF would not have experienced any significant operational difficulties? As BN/SF acknowledged in a letter to the CMA dated April 15, 1996, "[t]he operational and other improvements UP has advised will be made in these and other areas would significantly improve our service capability and transit time between Texas and the East St. Louis gateway." See SPI-16, Ex. 3 at 3. Still to be answered is why BN/SF voluntarily would have agreed in the first place to operational proposals which contained such obvious problems?

In addition, what would prompt UP to agree "to work with BN/Santa Fe to locate additional SIT facilities on the trackage rights lines as necessary"? UP/SP-231, RVS Peterson at 160. Certainly, if BN/SF is UP's "biggest, meanest, toughest competitor" as Mr. Rebensdorf has claimed (Tr. at 150), it would seem that BN would be capable of locating its own SIT facilities and would not need UP's assistance. Of course, by providing such assistance, UP would gain invaluable competitive information about its "competitor's" capacity.

Finally, given the tremendous expertise and resources which UP and BN/SF have at their disposal, why was it necessary to wait until after March 29, 1996 to admit that the original Agreements were not workable? As Conrail has observed, "the 'CMA Settlement Agreement' is the seventh attempt by Applicants to remedy the anticompetitive harms that they acknowledge would be produced by the proposed merger." CR-37 at 4 (emphasis added).

Or as SPI has observed with respect to the CMA Settlement:

The first question posed by the BN's new position is what the Board is to believe of BNSF's assertions with regard to its competitive posture under the trackage rights agreement? On the one hand, the trackage rights provisions as initially agreed were asserted as fully adequate to enable BNSF to be an effective competitor; now, the changes conceded by UP to win CMA support are a condition precedent to its competitive posture. Was BN correct previously? Was it mistaken and its comments erroneous? Or was it merely obfuscating and covering for the UP and SP in good market sharing fashion? Secondly, why is BNSF so complacent toward and defensive of the UP/SP merger? Is it because the merger rids the railroad industry of the aggressive competition of the SP? Is it because of a tacit understanding, whether stated or unstated, see KCS-33 at 73-82, between the UP and BN to jointly dominate the western railroad market through absorption of their smaller and more aggressive independent rivals? Or is it because acceptance of the trackage rights agreement is designed to foreclose divestiture of the parallel route system in the petrochemical belt, thereby precluding real competition in the Gulf Coast market from an owning railroad with real incentive to vigorously compete for all available traffic?

SPI-16 at 14. The Railroad Commission agrees with SPI's observation (*id.*) that "[a]ny and all of these answers are logical." However, the Railroad Commission must add one further scenario. While Mr. Davidson has recently publicly denied any ambitions with respect to the Eastern portion of the United States, a view which obviously is not shared by Mr. Krebs,

see NIT League spurns UP overtures on SP merger, sticks with call for divestiture, Traffic World, May 27, 1996 at 24,³ all of the questions posed above may be answered by noting that with the elimination of SP, both UP and BN/SF are in a position to expand the Western duopoly from coast to coast without any fear that a third transcontinental system could evolve.

I. The Elimination Of The SP Is An Essential Ingredient In The Creation Of Both Western And Nationwide Duopolies.

The UP/SP merger is but the latest in a string of rail mergers that has inexorably lessened rail competition in the Western two-thirds of the country. As the Board is aware, the wave of railroad mergers which have occurred over the past twenty-five years has resulted in the creation of several enormous rail systems, with three systems in the West and three in the East. The instant merger, however, threatens the present and future competitive balance by eliminating one of the major systems in the West. By eliminating SP from the picture, both BN/SF and UP benefit by avoiding the continuing irritation of having to contend with a competitor which, while weak, is still capable of carving out its own niche.⁴ Indeed, following the merger, "two-thirds of total UP and SP traffic" will consist of shippers who are exclusively served by UP. UP/SP-230 at 89.

³ As Krebs is quoted in the same article (*id.* at 24-25):

There will be transcontinentals. I'm not saying when or with whom, but the commercial and financial benefits are too great to ignore. We need to go everywhere the Interstate Highway System goes.

⁴ As will also be demonstrated, the Merger and the Agreements are also likely to seal the fate of much smaller railroads, such as the TexMex.

UP seeks to gloss over the implications of this astounding figure by claiming that "[a]ll '1-to-1 shippers -- those now exclusively served by UP or SP . . . will enjoy much more competitive service than UP or SP can offer them now." Id. 89 and at 10-11. That claim is highly misleading. By definition, a shipper which is "exclusively served" by UP cannot be served by BN/SF. Therefore, because the two carriers do not compete, it is irrelevant if the service a shipper receives from UP is equal to that which BN/SF may theoretically provide to some other, unidentified shipper. Second, it is a gross generalization to claim that all captive shippers will enjoy more competitive service. For some, the only difference will be that they are paying far higher rates than they currently pay without enjoying any measurable improvement in service. As Geon, one of the leading manufactures of vinyl compounds in North America, has testified based on its past experiences with multiple rail mergers at its facilities along the Texas Gulf Coast:

Invariably, merger proposals are accompanied by ringing promises of improved service resulting from better coordination and increased capital investment. It has been Geon's experience that those promises are not fulfilled.

It is Geon's experience that competition for available traffic spurs improved service in the same way that it spurs lower rates. Carrier coordination often results not from a single carrier controlling a movement, but from a carrier seeking to increase its market share by offering coordinated service or run-through trains with a second carrier also interested in increasing its market share.

For example, Geon enjoys a run-through train movement via the Union Pacific from LaPorte [Texas] to beyond St. Louis where the power and train crew operate as Conrail's. Conrail then moves the cars to Geon's Pedricktown plant, which is served only by Conrail. This run through service is the result of the desire of the Union Pacific to increase its market share in competition with the Southern Pacific and the BN/Santa Fe.

The service will not improve if the proposed merger is consummated. In fact, one of the reasons for the expedited service, the competition of the Southern Pacific, will disappear.

Comments of Geon Company at 7.

Equally important, the elimination of the SP not only results in the creation of a duopoly, but it paves the way for UP/BN/SF, after taking full advantage of the lack of real competition in the West, to expand the reach of the duopoly. As Geon has noted, "the lack of effective competition places rail carriers in the position of extracting prices based on 'what the traffic will bear' rather than on a fair rate of return for the carriers." *Id.* at 5. In this instance, the UP will be able to exact monopoly profits from its captive shippers in Texas and elsewhere to be used to extend the reach of the Western duopoly to the entire nation. Such a result cannot be in the public interest.

While Mr. Davidson may now claim that the Merger is "not a step toward a transcontinental merger,"⁵ the blue prints for the next stage has already been printed. As described in *Man With a One-Track Mind*, Washington Post, May 3, 1996, at B1, col. 1:

The president of the newly merged Burlington Northern-Santa Fe Corp., now the country's largest railroad, has made no secret of his desire to create the country's first transcontinental railroad by linking up with a major eastern line.

While there is nothing inherently repugnant about the idea of a transcontinental railroad system, the article vividly highlights the problem of allowing BN/SF and UP to eliminate SP:

⁵ NIT League spurns UP overtures on SP merger, sticks with call for divestiture, *supra*, at 24.

If Krebs should go for Norfolk Southern and succeed, Union Pacific and CSX likely would be forced to form a transcontinental link in defense. Analysts question whether Conrail could then hold out as a much smaller regional railroad, and say its lines likely would be divided between the two giants.

Id. (emphasis added). As this demonstrates, it is not surprising that BN/SF would eagerly cooperate with UP in dividing up the SP -- much more is at stake than securing the duopoly in the West. What is ultimately at stake is the establishment of a nationwide duopoly from coast to coast -- a goal which can only be achieved if the SP is eliminated. As will be shown, the duopoly can only be thwarted by the divestiture of the eastern portion of the SP and the central corridor.

Although Mr. Davidson, in attempting to lure the NITL into dropping its opposition to the merger, has disclaimed any transcontinental ambitions, it is respectfully submitted that the extreme hostility which UP has exhibited to the pro-competitive conditions which have been offered by the Railroad Commission and several other parties must be attributed to UP's acute awareness that the proposed conditions would impede any long-term objective to extend the Western duopoly. Because imposition of the proposed conditions would preserve the possibility that three nationwide rail systems would remain following the UP/SP merger, the UP/BN/SF duopoly would no longer be in a position to dictate the future course of transcontinental rail mergers.

Simply stated, the immediate elimination of SP is an essential ingredient in the realization of two transcontinental mega-systems. As Mr. Krebs candidly agreed during the course of his May 9 deposition, if the SP is merged into the UP without the proposed

conditions, there is no possible way, based on the status quo, that three transcontinental railroads could evolve in the future. Krebs, Dep. at 67.

With this in mind, and with the hope that free market forces will ultimately prevail, the Railroad Commission urges the Board not to abandon its responsibility to enforce the spirit of the antitrust laws in this proceeding. Moreover, the Board must vigorously protect shippers and communities from the dangers posed both by the UP/SP merger and by the BN/SF Agreements.

II. The Only Interest Of The Texas Railroad Commission In This Merger Is The Preservation Of The Free Market

In a blatant attempt to distort the Railroad Commission's position in this proceeding, UP has accused the Commission of "re-engineer[ing] freight and commuter operations according to the Commission's preferred regulatory blueprint" and of "trying to impose its own regulatory regime." UP/SP-230 at 280. Had UP bothered to check the record of the current Railroad Commission at any time during the protracted period when it was lobbying the Railroad Commission for its support, it would have discovered that all three members have been critical of excessive government regulation, not only of the transportation industry, but of the oil and gas industry as well. Instead of clinging to the past policies of excessive governmental regulation, they have vigorously championed deregulation measures so that the free market could prevail and competition could flourish. Nonetheless, while championing deregulation, the Commissioners recognize that monopoly power is the antithesis of a free market and will, if permitted, destroy the fruits that would otherwise be gained by virtue of competition. Given the Applicants' concession that the Merger would be *per se* anticompetitive if not for the Agreements which they have trotted

out seriatim, rigged up, the Railroad Commission obviously had reason to conclude that counter measures may be in order.

There is no evidence whatsoever that the Railroad Commission is seeking to impose any regulatory blueprint or that it had any "predetermined biases" as UP has repeatedly charged those who have opposed the merger. See UP/SP-230 at 66, 77, 96 and 194. The Board can rest assured that the Railroad Commissioners, both individually and jointly, approached the task of evaluating the impact of the merger on Texas with a sense of total neutrality. Not only did they repeatedly meet with the applicants and give them a full opportunity to discuss the merger's merits, but they also carefully considered and weighed the opposing views before reaching their conclusions.

In addition to meeting with the applicants, the Commissioners encouraged the general public to make its views known. In order to facilitate full public participation, hearings were held in different geographical locations: Fort Worth, Corpus Christi and Houston. The hearings attracted a wide spectrum of interests, including UP, SP and BN/SF, which appeared at the hearings and presented multiple statements to support their positions. In addition, shippers and other concerned citizens from throughout the State appeared to voice their support, concerns and outright opposition.

The public hearings, which were conducted in mid-January of this year, unleashed a torrent of shipper opposition to the merger. In addition, the public hearings highlighted the ominous threat to competition which is posed both by the UP/SP Merger and by the cosmetic, superficial remedies which UP has concocted to brush aside the anticompetitive

concerns which UP correctly anticipated would surface as shippers and governmental agencies focused on the big picture.

However, the Commission did not rush to judgment. Instead the investigation was broadened by requesting the Center for Economic Development and Research at the University of North Texas ("the Center") to conduct an independent economic analysis. See RCT-4, Exhibit 1. In hiring the Center, the Commissioners did not set any guidelines which would have signaled any predisposition on their part, nor did they request the study to reach any particular conclusion.

The Center's draft study was released in the middle of March. This was the first time that the Commissioners became aware that the economists recommended divestiture of the SP lines in parts of Texas (RCT-4 at 13-2 through 13-6); the granting of trackage rights to the Texas Mexican Railway Company ("TexMex") (*id.* at 13-8, n.2); the establishment of neutral terminal railroads (*id.* at 13-6 through 13-8); and the need to condition the abandonments which will inevitably follow the granting of the UP/SP merger (*id.* at 13-2).

After the study was received, the Commissioners continued to consider the merger and the UP/BN Agreements, both in open public meetings at which the Center's Draft Report was discussed and in individual conversations with the Applicants' top management. As Mr. Krebs has testified, in an attempt to influence the outcome, Mr. Davidson continued to meet in person with individual members of the Railroad Commission until the afternoon before the Commission voted. See Krebs, Deposition (May 9, 1996) at 92. In addition, Mr. Krebs telephoned to reinforce Mr. Davidson's comments on that same afternoon. *Id.* In fact, in a last ditch attempt to persuade the Railroad Commission to favor the merger, Mr.

Davidson offered to renegotiate the UP/BN/SF Agreement to resolve any concerns which the Railroad Commission might have. See Krebs Deposition at 92-95. Recognizing that Mr. Davidson's offer to change the UP/BN/SF Agreement could have been made at any time during the past six months, and that this Agreement would not alleviate the inherent problems associated with the duopoly, Mr. Davidson's 11th hour offer of March 25, 1996 to re-work the UP/BN/SF Agreement was declined.⁶

As the above plainly demonstrates, the Railroad Commission has given thoughtful consideration to the Merger in response to Governor Bush's request that it examine the potential impacts of the Merger on Texas businesses and citizens. The specific conditions recommended by the independent outside consultants, which the Railroad Commission unanimously adopted, are remarkably similar to the conditions requested by a host of private interests, including the major shippers who are opposed to the merger. This overlap clearly demonstrates the baseless nature of BN/SF's and UP's attempt to brand all of its opponents as "shameless opportunists" who are bent on destroying the merger. UP/SP-230 at 247.⁷ Given the fact that the Railroad Commission, which certainly cannot be accused

⁶ This desperate attempt to influence the Railroad Commission's vote clearly reveals UP's acknowledgement that the Agreement failed to satisfy the competitive concerns which have been raised by the merger's many opponents. Why UP would not have seen fit to make those changes at an earlier date is unknown. However, to the extent that Mr. Krebs admits that the "amendments" which Mr. Davidson had in mind were those which would later surface as part of the CMA Agreement (*id.* at 94), there is little doubt that UP deliberately chose not to make them public until after the parties had filed their opening comments, thereby giving UP a further opportunity to sandbag the opposition.

⁷ Or as characterized by BN/SF, "[t]he requests for divestiture are driven by sheer opportunism [as] Conrail, KCS, and MRL seek Board assistance to carve up SP and expand their systems." BN/SF-54 at 17.

of private opportunism, has joined with numerous shippers in calling for divestiture, the UP's and BN/SF's arguments are obviously deficient and driven by their own sense of opportunism. See Man With a One-Track Mind, supra.

In any event, nothing that has been said by UP/SP or BN/SF in the thousands of pages of rebuttal,⁸ or in the CMA Agreement, has caused the Railroad Commission to retreat from the conditions which it has sought in its March 29 Comments. As shall be demonstrated, the Commission's conditions are merger-related and, if imposed, would ameliorate the anti-competitive consequences of a merger which would be harmful to Texas and the significant international trade which moves through the State as a result of the North American Free Trade Agreement.

III. The Proposed Divestiture And Other Conditions Will Preserve Existing Competitive Conditions In The Rail Industry Without Threatening Any Public Benefits Which May Be Legitimately Attributed To The Merger.

As reflected by their Comments and other pleadings, most opponents of the merger recognize that there are some minimal public benefits to be realized from the merger, e.g., the service improvements along the I-5 corridor. In addition, a limited number of shippers will obtain the professed benefits of single-line rail service. Few of these public benefits

⁸ The Railroad Commission will not attempt to respond to the flood of minutiae which is contained in the UP rebuttal comments and evidence. Rather, this Brief will focus on the big picture and the need for the conditions which are requested by the Railroad Commission on behalf of Texas shippers and communities. Last, the Brief will address the baseless nature of the suggestion that the CMA Agreement has satisfied the concerns voiced by the Commission when it filed its original Comments on March 29.

would be lost as a result of the proposed conditions. More importantly, those which may be lost would be offset by other public gains.⁹

There is remarkable unanimity among the opposing parties, including government agencies, individual shippers and large shipper organizations, that the merger creates significant anticompetitive harms. Indeed, this was conceded by UP when it originally approached BN/SF with the plan to defuse opposition by entering into an Agreement which would "preserve" the rail competition which would be lost by the elimination of SP.

Moreover, there is substantial agreement that the belated UP/CMA Agreement is little more than a charade which is intended to deflect attention from UP's true motives. As the merger opponents have demonstrated in their pleadings, those Agreements do not foster competition. To the contrary, they invite collusion. In sum, as the merger opponents have independently demonstrated, the only effective means of ameliorating the merger's anticompetitive impact concerns is divestiture of parallel lines. By ensuring that the parallel lines are owned by a railroad or group of railroads, other than members of the duopoly, competition will be fostered -- not killed!

The proposed conditions, while tempering UP's overreaching monopolistic ambitions, further the nationwide network integration and economics within the nation's railroad

⁹ Obviously, the conditions proposed by the Railroad Commission would not impact the I-5 corridor. While the divestiture condition might eliminate single-line service for some shippers, it is respectfully submitted that such shippers constitute a distinct minority interest which is more than offset by the tremendous number of shippers which could receive single-line service for shipments moving between the States of Texas and Louisiana, on the one hand, and the eastern portion of the United States, on the other. As reflected by the study submitted by the Society of the Plastics Industry, Inc., shipments to the 24 States located east of the Mississippi River constitute a solid majority (58.1%) of shipments. See SPI-11, V.S.-1, at Table VII.

system. This is especially true with regard to the potential railroad "bridge" over the Mississippi River which would allow single-line service for major movements of product between the Gulf Coast and the eastern portion of the United States for the first time in history.

Assuming that these future transcontinental mergers are inevitable, the divestiture of the eastern portion of the SP in this proceeding will obviously hinder the establishment of such a duopoly. Instead of paving the way for the UP/BN/SF nationwide duopoly, the divestiture of the Texas lines specified by the Railroad Commission would allow the future establishment of three strong, highly competitive rail systems, both in the West and nationwide. While one system may stretch from South Texas to Canada, rather than from the Pacific to the Atlantic, the "radical pro-competitive transformation of rail transportation that was ignited by the Staggers Act 15 years ago"¹⁰ will be preserved and shippers will avoid what Alfred Kahn has termed "the straightjacket of comprehensive cartelization." Kahn, Airline Deregulation--A Mixed Bag, 16 Transp. Law Journal 229, 251 (1988).

When viewed in this light, it should be crystal clear that the divestiture proposals offered by multiple parties represent the true marketplace solution that benefits the entire nation by preserving robust competition in virtually all geographic regions of the country. While the applicants bombastically condemn the marketplace solution which has evolved as a direct result of independent economic analysis and a dose of common sense shared by the many opponents of the Merger, they cannot explain away the obvious fact of duopoly power. Indeed, there is no way to avoid the existence of a duopoly in the Western two-thirds of the

¹⁰ UP/SP-230 at 6.

country if the UP/SP merger were to be authorized without imposing the conditions requested by the Railroad Commission and others.

This is not the time for the Board to follow the lead of what Professor Kahn has termed the "indefensibly complaisant Department of Transportation," which allowed many of the fruits of airline deregulation to be snatched away by ignoring "the necessity for increased effort and vigilance" with regard to vigorous enforcement of the antitrust laws. *Id.*, 16 *Transp. Law Journal* at 234, 251. As Professor Kahn repeatedly has observed, the DOT's failure to enforce those laws led to the "monopolistic exploitation of a minority of customers" and the elimination of smaller, less well capitalized competitors, thereby causing many communities to lose the protection of regulation without gaining the intensity of vigorous multi-carrier competition. *Id.* at 234, 251. See also Kahn, *Deregulation: Looking Backward and Looking Forward*, 7 *Yale Journal on Regulation* 325, 348, 351 (1990).

The Board should not make the same mistake, but should follow the reasoning expressed in Santa Fe Southern Pacific Corp.-Control-SPT Co., *supra*, 2 I.C.C.2d at 722, where the ICC stated as following as predicate to disapproving the merger proposed there:

The fifth factor, dealing with competitive effects on other railroads, was added by §228(a)(2) of the Staggers Rail Act of 1980, Public Law 96-448 (Staggers Act). This additional factor is, in effect, a codification of the Commission's traditional approach to the evaluation of rail consolidations. *See Norfolk Southern Corp.-Control-Norfolk & W. Ry. Co.*, 366 I.C.C. 171, 190 (1982) (*Norfolk Southern*), where we stated:

The Staggers Act was intended to modernize "economic regulation of the railroad industry with a greater reliance on the marketplace." Staggers Act, §2.*** [T]he primary theme of the 15 elements of the Rail Transportation Policy (added by the Staggers Act) is that we "ensure the development and continuation of

a sound rail transportation system with effective competition among rail carriers and with other modes," 49 U.S.C. § 10101a(4). Indeed, the Rail Transportation Policy emphasizes the importance of the relationship between ensuring adequacy of transportation and retention of competition. We are "to allow *** competition and the demand for services to establish reasonable [rail] rates," § 10101a(1); "to foster sound economic conditions *** and to ensure effective competition and coordination between rail carriers and other modes," § 10101a(5); "to minimize the need for Federal regulatory control over the rail transportation system" while maintaining "reasonable rates where there is an absence of effective competition," § 10101a(2), (6); and "to avoid undue concentrations of market power," § 10101a(13).

The 15 elements of the rail transportation policy set forth at 49 U.S.C. § 10101a, taken as a whole, emphasize reliance on competitive forces, not government regulation, to moderate railroad actions and to promote efficiency. H. Rep. 96-1430, 96th Cong., 2d Sess. 88 (1980).

The above principles should be strictly adhered to in this case.

IV. TexMex's Trackage Rights Request Should Be Granted To Preserve Competition and Essential Rail Services.

As stated in its Comments, the Railroad Commission supports the TexMex in seeking a grant of trackage rights which would allow TexMex to connect with the Kansas City Southern Railroad at Beaumont, Texas over the route designated by TexMex in its trackage rights application (TM-23). This condition is essential to preserve the competitive alternatives now available to shippers of goods between the United States and Mexico. The Railroad Commission shares the views expressed by DOJ and other parties that BN/SF, under the terms of its settlement with Applicants, will not be nearly as effective a competitor in the U.S.-Mexican market (and many others) as SP is today. As a result, a

merged UP/SP will have a virtual monopoly in that market. Furthermore, even if BN/SF turns out to be as effective a competitor as it claims it will be, shippers in the market will still lose one of only three major U.S. railroads serving Mexican gateways. This alone would result in a major reduction in competition. Granting TexMex trackage rights to give it a direct, friendly connection with another Class I railroad, the KCS, will ensure that shippers will continue to have three competitive alternatives in this market.

Furthermore, the rights TexMex seeks are needed to prevent the loss of essential rail service to South Texas shippers. The TexMex provides essential local rail service in South Texas that will be endangered if the international traffic which TexMex currently handles via SP is diverted to UP and/or BN/SF. Should this occur, shippers who are dependent upon TexMex will be harmed as they will lose local rail service.

Equally important, the resulting shift to trucks will magnify the burden that currently exists on the South Texas infrastructure due to the extreme congestion on highways near the International boundary. As reflected by the table which is reproduced in the Verified Statement Joseph Kalt, BN/SF-55, at p. 31, trucks already transport 84.6% of ground transportation movements to Mexico. Given this percentage, it is patently absurd for UP to suggest that TexMex's concerns should be ignored because:

[t]he commodities shipped by Tex Mex's exclusively-served customers are grain, scrap metal and oilfield supplies, all of which already require rail-truck moves at origin or destination and are also routinely trucked long distances economically.

RVS Peterson at 135. To the extent that any existing rail traffic would be diverted to trucks in South Texas, the public interest would be harmed due to the unquestioned fact that the highway infrastructure in the Rio Grande Valley in South Texas is already overburdened to

the point of choking. There is no room for truck traffic that historically has moved via TexMex.

UP's further suggestion that the TexMex shippers could be served "via a low-cost shortline or branchline operation from Robstown or Corpus Christi" (*id.*) is simply disingenuous. UP's solution would leave UP as the only U.S. railroad serving Laredo which, at present, is the primary gateway into Mexico. In other words, UP would gain a monopoly status if it could successfully engineer a solution which would convert the TexMex into a branch line operating from Robstown or Corpus Christi.

In any event, TexMex is a low-cost shortline! Simply stated, nothing is to be gained by replacing it with another shortline railroad which would suffer from the same lack of traffic. While UP understandably would like to see the TexMex disappear in order that UP may achieve a total monopoly over international movements via Laredo, that alone justifies the imposition of trackage rights.

Finally, UP seeks to negate TexMex's concerns by claiming that BN can be expected to compete vigorously for Mexican traffic using TexMex as its joint-line partner over Laredo. For instance, UP argues that "BN/Santa Fe will improve on SP's fairly small share of traffic to and from the Eastern Mexican gateways" and that Mr. Krebs "has signalled his intention to turn BN/Santa Fe's extensive system into a '31,000 mile funnel' for traffic flowing between the United States and Mexico." UP/SP-230 at 225-226.

In a further attempt to defuse TexMex's requests, UP reiterates the worn-out argument that BN/SF's "competitive abilities will exceed those of SP" and that BN/SF "will have good, and in many cases significantly better, routes for the traffic flows that make up

the vast preponderance of the existing SP-Tex Mex traffic." *Id.* at 302. Last, UP claims that BN/SF recent shift to the Eagle Pass gateway will be reversed should the Merger be authorized. *Id.* None of these contentions will withstand scrutiny.

While BN/SF claims to back up the UP's position by reference to a redacted version of Mr. Krebs' "31,000 mile funnel" remarks, the full text of those remarks is most revealing. In his Verified Statement, Mr. Krebs makes no specific commitment to continue working with TexMex. Rather, he states as follows:

BN/Santa Fe will have additional access to Mexico through two new gateways, Brownsville and Laredo, the latter through interchange with the Texas Mexican Railway near Corpus Christi. We will also improve our access to Eagle Pass through trackage rights. With several efficient routes stretching from Canada to Mexico and covering important U.S. points in between, BN/Santa Fe will be in an excellent position to be a 31,000-mile funnel for business down to Mexico through the Laredo gateway by interchanging traffic with the Tex Mex at Robstown (including unit trains), through our new access at Brownsville and through our improved service at Eagle Pass. We are already using the haulage rights into Eagle Pass we received from SP in connection with the BN/Santa Fe merger to run about three trains per week, including 100-car unit grain trains into Eagle Pass. We are doing that with a haulage agreement. Our access over trackage rights will enhance our ability to use the Eagle Pass gateway.

VS Krebs at 3-4 (emphasis added). Simply stated, the improvement and enhancement of Eagle Pass operations and the new Brownsville operations cannot be equated with a commitment to work with TexMex.

As Mr. Krebs is well aware, there is little incentive whatsoever to route Mexico-bound traffic over the TexMex. As UP has argued at length throughout the course of this proceeding, the reduction of 100 miles of circuitry is "an improvement that is of clear

competitive significance." VS Peterson, UP/SP-23 at 22. Assuming that UP's assertion is correct, the Board should note that the route which BN/SF will traverse under the trackage rights, i.e., from Temple, Texas to Eagle Pass, via San Antonio, is 319.0 miles. On the other hand, the route with TexMex from Temple to Laredo via Houston covers 565.6 miles. In other words, the routing from Temple to Laredo via Houston is 246.6 miles further than the more direct routing from Temple to Eagle Pass via San Antonio. This represents 77% circuitry. Moreover, BN/SF would likely have to give Tex-Mex a share of the revenue that would not only exceed the cost of the trackage rights between Temple and Eagle Pass, but which may be out of proportion to the 144.2 miles that TexMex would haul the traffic between the connection at Robstown and the Laredo gateway.

Second, as BN/SF has also testified (BN/SF-55, VS Kalt at 32):

[T]he concentration of Mexican trade lies in commodities complementary to BN/Santa Fe's service strengths. The top three U.S. export commodity categories (autos/aircraft, agricultural products, and forest products) are all produced in locations (the industrial Midwest, the grain belt, and the Pacific Northwest) from which BN/Santa Fe can offer service directly to Brownsville, Eagle Pass, El Paso, and San Ysidro. BN/Santa Fe can also interline (without UP or SP) to Laredo via Tex Mex and to Presidio via South Orient.

In other words, were it not for the fact that Laredo currently enjoys a competitive advantage over the other gateways to Mexico because there is a larger infrastructure of customs brokers located at Laredo than at the other gateways, there would be little or no incentive for BN/SF to route traffic via TexMex. Certainly, there is no reason to assume that BN/SF would deliberately route unit trains of grain in joint-line service with TexMex via Laredo when it will have a comparatively direct shot in single-line service at Eagle Pass.

Given the admitted concentration of BN/SF's traffic from the grain belt and the Pacific Northwest and the industrial Midwest, it is only logical to assume that BN/SF would favor the less circuitous, single-line routing via Eagle Pass.

In short, there is no basis for the UP's conclusion that "[t]his merger, and the more efficient access to BN/Santa Fe it will bring, will reverse [BN/SF's aggressive exercise of its rights over Eagle Pass]." UP/SP-230 at 303. Because there is nothing that TexMex can do to alter this flow of traffic which has already been initiated by BN/SF with the convenient assistance of the SP and UP, it is imperative that TexMex be granted trackage rights in order to ensure that it will have one friendly connection to replace SP.

V. The Creation Of Neutral Terminal Railroads Would Effectively Preserve Competition And Prevent UP From Exacting Monopoly Profits.

The UP/SP Merger, if not properly conditioned, will have devastating anticompetitive consequences on many Texas shippers, especially those which are located in the Gulf Coast region of Texas. In order to provide these shippers with a small measure of relief from potentially prohibitive switching charges and retaliatory behavior, the Railroad Commission has requested the imposition of a condition which would require UP to sell certain tracks and satellite and support yards to "neutral terminal railroads that would provide high quality and reasonably priced switching services to all industries located within major urban areas served by two or more Class I railroads." RCT-4 at 21. Under the Railroad Commission's proposal, the terminal railroads would not be government owned or controlled. Rather, "depending on the preferences of the Class I railroads, and the desires of the shippers, . . . the terminal railroads could be for-profit companies, nonprofit associations, or public entities." *Id.* The terminal railroads "would operate on publicly

owned trackage belonging to port authorities, transit authorities, and special rail districts and privately owned trackage belonging to the Class I railroads, shortlines and industrial parks."

Id.

Obviously recognizing that neutral terminal railroads would effectively serve to preserve competition and prevent it from exacting monopoly profits, UP has launched a withering attack on the Railroad Commission's proposal. Unfortunately, rather than fairly focusing on and analyzing the Commission's actual proposal, UP has erected a straw man which it flogs unmercifully in order to mislead the Board into accepting a vastly distorted version of the neutral terminal railroad concept which has been proposed.

A. UP's inflammatory mischaracterization of the neutral terminal railroad condition is deliberately misleading.

At the outset, the Commission's proposal does not entail "government confiscation of private property." UP/SP-230 at 280. Nor is the Commission seeking to have properties "contributed, donated, confiscated or condemned" in order to hand them over to terminal authorities as Mr. Ongerth erroneously asserts. UP/SP-232, RVS Ongerth at 55. While divestiture of certain terminal properties would be mandated by the Board, the UP would be duly compensated for those properties. For example, in the specific instance of Houston, the Railroad Commission's proposal envisions that the Board would, as a condition of the merger, require UP to sell, at fair market value, the SP's trackage from Englewood Yard in Houston to Galveston (plus related yards and support facilities) to the Port of Houston Authority ("PHA"), which already owns a substantial amount of trackage in the port area. See RCT-4 at 25. Of course, while the PHA owns the track, the actual operation of the

track is left to the Port Terminal Railroad Association ("PTRA") which is controlled by the three Class I railroads (UP, SP and BN/SF).¹¹

Given the fact that the PTRA today conducts efficient switching operations over the entire reach of its track, there is no realistic basis for Mr. Ongerth's wild accusation that the proposal would lead to "upheaval, turmoil, service disruption, and higher costs." UP/SP-232, RVS Ongerth at 55. Indeed, Mr. Ongerth is ultimately forced to concede that much of his testimony is grossly overstated when he admits that "[t]erminal and belt railroads can be an adequate way of organizing specific rail activities for defined purposes in terminal areas." Id. at 56. While he attempts to claim that such salutary results can only be achieved if they are made by "voluntary agreement of the parties" in which "the parties receive benefits that they regard as at least as valuable as the rights and properties they grant to the terminal railroad," that is no more nor less than what the Railroad Commission is proposing.¹²

As Mr. Ongerth is well aware and as BN/SF can surely attest, the PTRA's port switching operation in Houston is very efficient. BN/SF originates and terminates at least four to six road trains a day at PTRA yards because that is more efficient than having a transfer run handle cars from PTRA yards to the Houston Belt & Terminal yards used by

¹¹ The Railroad Commission did not recommend the creation of an "Authority" in each urban area. Nor was there any intent to insert local or state government into the equation, unless it was desired by the shippers and railroads (and possibly not even in that case).

¹² While Mr. Ongerth attacks the Railroad Commission for the lack of practical detail to backup its proposal (id. at 55), it should be noted that as of this date, the Applicants have yet to come forth with any detailed plans about how they would implement the various Agreements which they have loosely defined with regard to the BN/SF.

BN/SF. UP/SP could do the very same thing as BN/SF, making it unnecessary to move cars from PTRAs yards to UP/SP's Settegast and Englewood yards.

A DFW Terminal Railroad Association (with UP, BN/SF and KCS as members) could efficiently switch Dallas area industries on former UP, SP and Santa Fe trackage now owned by public entities such as Dallas Area Rapid Transit and RailTran, and then could turn the traffic over to BN/SF and UP at yards near Union Station in downtown Dallas. This would eliminate shipper captivity and put an end to UP's highly inefficient practice of moving Dallas area cars over to Fort Worth before bringing them back to Dallas for local distribution. Currently underutilized yards in the Dallas area are available for DFW Terminal use without any negative operational impact on UP/SP.

The Railroad Commission's proposal will be searched in vain for any role to be played by the State or Federal governments beyond the initial requirement that UP be required to sell certain SP properties in order to gain approval for its Merger with SP. By no means is the Railroad Commission seeking to interfere with the mainline operations of any railroad. Nor is it interested in creating "monopoly" shortlines. This obviously would be precluded by the joint ownership arrangements in which the Class I railroads would keep checks and balances on one another.

Mr. Ongerth further claims that most terminal railroads involve a certain amount of flexibility which leaves the parties the ability to "withdraw from the terminal association, taking their properties with them." *Id.* at 56. While this may be generally true in some situations, the Board should recognize the instant proposal is being recommended only in response to a merger whose anticompetitive impact is unparalleled in the history of

American railroads. Hence, even if the neutral terminal proposal may plow new ground in terms of merger conditions and remove certain elements of "flexibility" which exist in non-monopoly situations, neither the Board, nor its predecessor, has ever been faced with a merger which has such far reaching anticompetitive consequences. Given these consequences, the Board must take steps to counter the negative aspects of the merger, especially in the Texas Gulf Coast area with its heavy concentration of the plastics and chemical industries. If it were to approve the merger, the Board must accept the obligation and responsibility for implementing market driven solutions to the anticompetitive proposal which it has been requested to approve, including the creation or expansion of neutral terminal railroads.

UP's position, however, would prevent BN/SF or any other railroad from having truly competitive access to the 265,000 carloads of captive traffic that originates and terminates on SP's eastern trackage. UP obviously knows that BN/SF cannot begin to provide competitive train frequencies for 2-to-1 and 3-to-2 shippers in Texas and Louisiana without competitive access to traffic other than what it would be granted pursuant to the Settlement Agreement and the amendments thereto which have been crafted by UP without consulting either BN/SF or SP. See Rose Dep. Tr. at 107 (May 10, 1996). As shall be discussed in detail, infra, the limited access is best illustrated by the CMA Agreement where UP has granted access to BN/SF of only 7 percent of the traffic in the Lake Charles, Louisiana vicinity.

Lest the Board underestimate the UP's motivation and power, it should carefully focus on a July 19, 1995 internal UP memorandum which is reproduced in this record as

Exhibit 1 to the Comments filed by Union Carbide Corporation (UCC-6). As stated therein:

Recommendation

We need to be firm with . If they are going to be unreasonable at then we cannot be as flexible as they would like us to be at and .

The in ties our hands in terms of pricing activity at . Given the low on the outbound traffic we may be better off telling that we no longer will bid on their business out of .

As % owner of the , we can continue to increase the switch up [to] the level of \$ /car. The current switch is \$ /car.

The existence of neutral terminal railroads would unquestionably assist in putting an end to this type of anticompetitive behavior which will undoubtedly increase following the Merger.¹ Not only would shippers have ready access to the BN/SF through the neutral

¹ The gravity of the situation is compounded by a "technical amendment" to the Clayton Act (15 U.S.C. § 26) that was made as part of the ICC Termination Act of 1995. Section 318(3). Heretofore, § 26 read as follows:

That nothing herein contained shall be construed to entitle any person, firm, corporation, or association, except the United States, to bring suit in equity for injunctive relief against any common carrier subject to the provisions of the [Interstate Commerce Act] in respect of any matter subject to the regulation, supervision, or other jurisdiction of the Interstate Commerce Commission.

With no legislative history, the above exemption from injunctive relief was substantially broadened "by striking 'in equity for injunctive relief' and all that follows through Interstate Commerce Commission' and inserting in lieu thereof 'for injunctive relief against any common carrier subject to the jurisdiction of the Surface Transportation Board under subtitle IV of title 49, United States Code'." In other words, injunctive relief is now unavailable with respect to any activity of a Board-regulated common carrier and not merely those activities which are subject to the Board's "regulation, supervision, or other jurisdiction."

terminal railroad should UP refuse to bid on their traffic, but the ability to demand excessive switching charges from captive shippers would be eliminated.

B. UP's unsubstantiated objections to the neutral terminal proposal are rebutted by BN/SF's testimony.

While Mr. Ongerth has attempted to paint a horror story with regard to the terminal railroads, it should be carefully noted that the BN/SF does not share Mr. Ongerth's overt hostility. Instead, Mr. Clifton, BN/SF's Assistant Vice President Operations, has testified with regard to the Baytown, Texas Branch that "BN/Santa Fe and shippers prefer using a third party contractor to perform switching and blocking along the Baytown branch." BN/SF-54, V.S. Clifton at 9. Mr. Clifton expanded upon this during the course of his deposition as follows:

Q. When you say that BN/Santa Fe and shippers prefer using a third-party contractor, can you tell us why that is?

A. We thought it would be better to have a neutral individual switching those areas versus one or the other.

Q. And why is that?

A. It seemed to make more sense to me from an operating side.

Q. Okay. I don't mean to belabor this, but why did it make more sense to you?

A. You had somebody that was representing the interests of both parties equally.

Clifton Deposition at 45 (May 15, 1996).

Mr. Clifton's remarks were substantiated by Mr. Rose, BN/SF's Vice President, Chemicals of the Industrial Business Unit. During the course of discussing BN/SF's operations for Exxon involving the Dayton sub, Mr. Rose testified as follows:

A. At the Exxon plant we would like to see a third-party switching service put in there, and that obviously will be something that will have to be negotiated with the UP/SP, that those loads would be brought up to the Dayton storage-in-transit yard and, then we would take them from there on.

Q. And what is the reasoning behind your preference for third-party switching?

A. We believe that the Dayton sub is fairly congested, and instead of having two locomotives, two railroads down there switching the same plant, we feel like it will be a more efficient and lower-cost option to have only one railroad out there.

Rose Deposition at 12 (May 10, 1996).

Mr. Rose's deposition testimony also undercuts Mr. Ongerth's unsubstantiated assertion that neutral terminal railroads would lead to chaos and upheaval. As he further testified (Dep. at 16):

Q. The congestion you indicated earlier, that's at the facility or on this branch line?

A. It's on the branch line, not on the - not in the facility itself.

Q. And who operates over that branch line?

A. Southern Pacific.

Q. And what's the cause of the congestion?

A. Well, there is not congestion right now. What we are concerned about is that there might be congestion if we end up putting another railroad on that line, so there are two - there are a couple different alternatives here: One, we could have a third-party move those loads from the Exxon plant up to the storage-in-transit yard, and if that is not acceptable, then we would simply pay the Southern Pacific/Union Pacific a reciprocal switch charge, which has been negotiated in the merger as well; and then the third option would be to put a Burlington Northern/Santa Fe locomotive down that branch line to the actual Exxon plant itself.

See also Rose Dep. at 45-46. In any event, the BN/SF testimony clearly rebuts Mr. Ongerth's unfounded assertion that neutral terminal railroads would disrupt operations. On the contrary, as BN/SF has testified, the neutral third-party switching is "more efficient" and a "lower-cost option" which actually improves operations by avoiding congestion.

C. Neutral terminal railroads are an integral component of the Mexican government's privatization plan.

Attention is also invited to testimony submitted by BN/SF with regard to the Mexican government's privatization plan. As Professor Kalt has testified (BN/SF-55), "there is no reasonable possibility that the Mexican government intends to foster, or allow to

emerge by default, a monopoly south of the border." VS Kalt at 35. He further states (id. at 36) that:

The Mexican government is actively engaged in marketing and regulatory efforts to ensure competition during and after the privatization. Consistent with its obligations under NAFTA to 'facilitate the cross-border movement of goods and services' and to avoid policy decisions that would distort the free flow of trade, the Mexican government is exerting every effort to make sure the privatization of FNM results in a dynamic and competitive rail sector.

While the Railroad Commission has no quarrel with Mr. Kalt's assessment, it does wish to invite the Board's attention to the deposition testimony of Mr. Peterson, UP's Senior Director, Interline Marketing, that "there's a terminal railroad proposed for Mexico City that would be a neutral terminal railroad and connect to the various concession railroads." Peterson, Dep. at 26-27 (May 8, 1996).

As Mr. Peterson further testified (id.):

I'm well aware that there will be multiple access by the various concession railroads to certain important traffic points. In other words, even though there is one railroad today at Monterrey, the FNM, both the Northeast and the North Pacific concession will serve Monterrey.

In fact, they're going to at least split the yard up and both operate in the Monterrey yard. That's my understanding of the privatization proposal. I believe those two have not gone out yet so they could evolve into something slightly different. but that's an example of the sorts of competitive access that are envisioned in the privatization proposals.

As this plainly shows, the concept of the neutral terminal railroad to ensure competitive access is not simply a "dream" as UP has suggested. UP/SP-230 at 281. Rather, it is a concept that, as the Mexican government obviously understands and accepts,

facilitates the movement of goods and services and results in a dynamic and competitive rail sector." BN/SF-55, VS Kalt, at 36.

In summary, the Railroad Commission strongly urges the Board to recognize the need for neutral terminal railroad condition should the Board authorize the Merger and the UP/BN/SF Agreements. While the Railroad Commission is convinced that the Agreements will not alleviate the merger's anticompetitive impact, the neutral terminal railroad concept would provide BN/SF a measure of access to shippers, particularly those in the heavily industrialized Houston/Gulf Coast area, thereby removing a portion of the handicap under which BN/SF would otherwise labor.

VI. The CMA Agreement Does Not Rectify The Massive Competitive Problems Which Would Result From The Merger.

Although UP and BN/SF attempt to portray the CMA Agreement as the "cure" for the Merger's anticompetitive problems (BN/SF-54 at 4; BN/SF-55 VS Kalt at 3-10; UP/SP-230 at 12), that Agreement, like its predecessors, falls far short of the goal. If anything, the CMA Agreement raises as many questions as it resolves. In the first place, if the CMA Agreement was truly needed in order to overcome the many competitive problems faced by BN/SF, why is it that BN/SF did not recognize that it was competitively disadvantaged by the original UP/BN/SF agreements at an earlier stage of the proceeding? Second, assuming that BN/SF was aware of that fact, why is it that BN/SF had nothing to do with the CMA negotiations? The record does not provide an answer to these questions.

UP attempts to attribute great significance to the CMA Agreement by noting that the CMA is "a trade group of 200 companies that produce 90% of the chemical industry's annual output." *Id.* at 12. This description of the CMA membership is apt. However, it is

extremely misleading. As demonstrated by substantial evidence of record, significant CMA members whose "plant locations in Texas and Louisiana are directly impacted by the reduced competition created by the merger,"¹⁴ including Fina Oil and Chemical Company, Huntsman Corporation, Condea Vista, CertainTeed, Shell Chemical Company, Montell USA Inc., Phillips Petroleum Company, The Geon Company, Union Carbide Corporation and Dow Chemical Company, have challenged the action taken by an undisclosed vote of what may have been a minority of a 16-member committee within CMA which accepted UP's proposal.¹⁵ As several of the above companies have advised the Board, CMA's distribution committee, which was solely responsible for negotiating with UP, did not consult with these major companies before accepting the UP proposal. See SPI-16, Ex. 2 at 2, 6 and 12.

Leaving aside the efficacy of the distribution committee's settlement, the evidence of record conclusively demonstrates that the CMA Agreement does not address the fundamental competitive issues which have been raised by numerous shippers and other opponents of the Merger. As has been forcefully demonstrated by the SPI, which has about

¹⁴ See SPI-16, Ex. 2, Letter to Linda J. Morgan from H. Patrick Jack, Senior Vice President - Chemicals, Fina Oil and Chemical Company, dated April 26, 1996.

¹⁵ Since one member was absent and did not participate, and since there is a suggestion that others may have abstained, it is conceivable that fewer than eight members of the distribution committee made the determination to accept the UP proposal and withdraw from the case. See Dep. Speight at 95-96. The Board should compare the manner in which CMA handled UP's offers with the NIT League approach. The NIT League's Railroad Transportation Committee voted 48 to 11, with four abstentions, to reject a UP settlement offer. Subsequently, the same committee voted 46 to 9, with 5 abstentions, "to maintain the board's opposition to the merger unless major segments are spun off to maintain competition." *NIT League spurns UP overtures on SP merger, sticks with call for divestiture*, *supra*, at 24. More importantly, the NIT League's publicly disclosed vote was based on an "analysis of the settlement proposal by the group's consultants, Peabody Associates, . . . and full membership participation in arriving at a position." *Id.*

2,000 members (as compared with only 200 members of CMA), and which employs 1.2 million people nationwide with 75,000 jobs in Texas with an economic impact on Texas alone of over \$20 billion annually, the "CMA Settlement does not even serve to alleviate CMA's concerns about the effect of the proposed merger." SPI-16 at 2. Equally important, CMA's "withdrawal from the merger proceeding . . . does not impact upon SPI nor alleviate the concerns of SPI expressed in its comment in this proceeding." *Id.* at 4.

Because SPI has fully analyzed the many obvious shortcomings of the CMA Agreement, *see id.* 5-11, the Railroad Commission will not duplicate that effort herein, but will instead incorporate the SPI's arguments by reference. The Commission, however, reiterates its extreme concern that the original UP/BN/SF Agreement, and its most recent update in the CMA Agreement, has wholly failed to cure the fundamental problem that the Merger creates an anticompetitive duopoly.

In any event, the State of Texas, which ranks first in the nation in total miles of rail track and second in total railroad employees, has more at stake in this merger than any other State in the nation. It cannot blindly accept the applicant railroads' unsubstantiated approach. UP, under the Interstate Commerce Act, has the heavy burden of demonstrating that the Merger will not have an anticompetitive impact among rail carriers. Simply stated, if it is relying on the UP/BN/SF and CMA Agreements to carry that burden, UP has failed!

The Railroad Commission admits that the CMA Agreement has addressed a small portion of its concerns about the original UP/BN/SF Agreements which were addressed in its March 29 Comments. *See* RCT-4 at 7-9. However, putting aside for the moment the wisdom of allowing UP and BN to carve up the Western two-thirds of the country between

themselves, extreme doubts continue to persist concerning the fundamental question of whether BN would be able to provide a competitive service. Without question, UP's overwhelming competitive advantage with respect to "exclusively served" (a/k/a "captive") shippers is only marginally impacted by the various Agreements. In fact, the CMA Agreement's lack of impact is demonstrated by Mr. Peterson's admission that it had not resulted in any changes in UP's proposed operating plan. As he candidly admitted, "we don't anticipate any sizable changes in traffic diversions or traffic flows because of the CMA agreement." Peterson, Dep. at 295-96 (May 8, 1996).

Given the information that has surfaced following the announcement of the CMA Agreement, that is not surprising. For example, BN/SF has attempted to leave the impression that the CMA Agreement alleviated the concerns about the amount of traffic available to it by "opening 50% of the volume of shipments under contracts at 2-to-1 points in Texas and Louisiana to bidding by BN/Santa Fe and granting access to a fraction of the traffic at West Lake, Shreveport and Texarkana" (VS Rose at 3). However, those assurances have been severely diluted by cross examination. As cross examination has revealed, UP -- which was solely responsible for negotiating the Agreement with CMA -- structured the CMA Agreement to cover movements at Lake Charles and West Lake, Louisiana. However, BN/SF was denied access to shippers at West Lake Charles, which is a stone's throw from the other two points, even though there is admittedly no substantive difference in terms of transportation requirements.

As demonstrated by the following exchange involving the shippers at those closely situated points, this cannot be attributed to mere oversight:

Q. But there is a very substantive difference in terms of the traffic available between the points that you can access and the points that you cannot access; is that correct?

A. That is correct.

Q. By your calculations here, it's about a 13-to-one ratio; is that right?

A. That's correct.

Q. And the 13 being the traffic that's unavailable to you and the one being the traffic that is available to you, so you have got access to about 7 percent of the traffic; is that correct?

A. That's correct.

Rose Dep. at 116 (May 10, 1996). Mr. Rose further admitted that the traffic that was made available is even more limited than appears at first blush. This is because access was granted only for movements going to either the Mexican gateways or the New Orleans gateway. Id. at 117.

The matter of build-outs is yet another example of the imaginary benefits which are provided by the CMA amendment. While that Agreement seemingly provides a measure of competitive relief by committing UP to future buildouts, that commitment cannot be enforced by the BN/SF since it is a right granted to members of CMA. Second, it is unclear how the mechanics would work due to the time limitation which is placed on the ability to request a buildout. Because the allowable time is measured from the expiration of a shipper's contract, there is no explanation how that right would be determined in a situation

where multiple shippers may have to join together to make any buildout economically feasible.

Furthermore, it appears that neither UP nor BN/SF have a settled understanding concerning the actual intent of the parties with regard to the CMA Agreement. A prime example is provided by the Dayton facility. In response to the question of whether "the commitment under the CMA agreement [is] to extend to the current trackage that's at Dayton or does it contemplate building out additional capacity at the Dayton location," Mr. Peterson candidly admitted that "I can't answer that question." Peterson Dep. at 210. He also admitted that he was unaware of any SP commitments to customers "assuring the customers that they will have car spots reserved at Dayton yard." *Id.* at 208. In a similar vein, the BN/SF witness, Mr. Rose, proved to be unable to provide any specific details concerning the ultimate interpretation to be given the provisions which, on their face, grant BN/SF access to the Dayton Yard. *See* Rose Dep. at 99-107.

While it might be appropriate in some circumstances to leave the fine print to the lawyers, it is respectfully submitted that these details should have been worked out through arms' length bargaining long before they were put before the Board as the competitive solution to the Merger's unquestioned problems. That certainly is not the case here where, as Mr. Rose testified, the Agreement "was between CMA and UP." *Id.* at 107. Given this candid admission, how could BN/SF be expected to know what UP had in mind when it dictated the terms of the latest settlement agreement? What assurances are there that would allow the Board to find that the CMA Agreement cures the Merger's anticompetitive

impact? The answer is simple. There are none. If the BN/SF doesn't know what is going on, how can the Board?

VII. The Need For Special Abandonment Conditions Arises From And Is Related To The Need To Counter The Monopoly Power Which Will Flow From This Merger

The Railroad Commission is mindful that the ICC has previously found that special abandonment conditions are unnecessary "because the Interstate Commerce Act already provides numerous protections regarding abandonments and line sales," Union Pacific Corporation, et al.--Control--Chicago and North Western Transportation Company and Chicago and North Western Railway Company, 1995 WL 141757 at 90 (1995). While the Act may provide a measure of relief for major shippers from abandonments, that is not the principal focus of the Railroad Commission's conditions. What the Railroad Commission is seeking is a condition which, in the event that UP were to follow BN/SF's example of abandoning several thousand miles of track shortly after consummation of their merger, would prevent UP from exercising its monopoly power to control future economic development.

This is not a matter which is covered by the abandonment protections afforded existing shippers on a line of railroad which is to be abandoned. As explained by the example in the Railroad Commission's Comments (RCT-4 at 30):

SP's Suman to Bryan line abandonment does not encompass the entire line between junction points. At both the north and south end of the line, UP intends to retain a small portion of track. As a result, any short-line railroad, rural rail district, developer or industrial rail user that purchases this track would be forced to pay switching charges and trackage-use fees to the UP for any traffic moving into the rail junction -- virtually

capturing any potential shippers who may ever want to locate along this line.

In its Rebuttal Comments (UP/SP-230 at 281), UP has argued that this condition would prevent it from abandoning some lines and would adversely impact potential purchases of track. That clearly is not the case. If anything, this condition would encourage short line railroads to acquire lines that would otherwise be abandoned.

Last, while UP claims that the condition has no nexus to the UP/SP merger, the fact of the matter is that the UP's acquisition of hundreds, if not thousands, of miles of parallel track is likely to set the stage for a slew of abandonments. As a quid pro quo for the monopoly which it will gain in many regions of the western two-thirds of the nation, UP should voluntarily accept certain limitations on its ability to abuse that power in the future, whether it be through exaction of monopoly rents or carefully structured abandonments which leave it in control future economic development. As is obvious from its opposition, UP wants unfettered power.

VIII. The SP Does Not Need To Be Saved By The UP In Order Either To Survive Or To Provide Efficient, Competitive Rail Service.

Throughout this proceeding, the UP has insisted that the Merger:

is the only way to create a comprehensive Western rail system that can compete effectively with the powerful, dominant BN/Santa Fe system. And it will solve the problem of a weak SP that will become weaker and weaker in the wake of the BN/Santa Fe merger.

UP/SP-230 at 3. While this scenario disguises UP's ambitions, it must be suggested that the opportunity for UP to gain a stranglehold on the chemical traffic and the Mexican gateways is the real driving force behind the merger.

Given the admitted anticompetitive aspects of the Merger, the question must be asked whether there may be a better solution which would allow SP both to survive and to prosper. While the Railroad Commission understands that "it is unlikely that SP will continue in its current form" if the Merger is not effectuated, that does not mean that a reconfigured, smaller SP would not be able to carve out a significant competitive niche.¹⁶

A quick glance at the railroad maps reveals that the SP lines across the Southern portion of the country are strategically situated along corridors of major "Sunbelt" economic development which can only be expected to experience continued growth. While UP's attempt to gain monopoly control over these routes would be thwarted by disapproval of the instant application, the Board should consider whether the public interest would not be better served if SP were forced to explore the alternatives to the proposed Merger that are available to it, including a sale of some of its least profitable routes. As DOJ has concluded, SP has not explored any such alternative options.

One such option would involve the sale of the Central Corridor. That corridor has already attracted a purchase proposal from a viable alternative to UP -- Montana Rail Link -- which is free and clear of the anticompetitive baggage which UP brings to the table. If the Central Corridor were to be sold, SP not only would eliminate a major source of its financial hemorrhaging, but would realize a substantial amount of capital which could be used to revitalize the core lines which it would continue to operate with improved service.

Obviously, sheer size is not the determining feature as to whether a railroad can provide financially healthy, competitive service. As the Board's records will show, the only

¹⁶ See RCT-4, Ex. 1 at 12-3.

two railroads which currently are revenue adequate are the KCS and the Illinois Central. There is no reason to believe that a leaner SP with its existing customer base could not achieve a similar status while continuing to provide much needed competition to both UP and BN/SF.

Finally, there is no reason why SP and UP could not follow the example provided by the Conrail/UP coordinated operations over the Salem gateway in order to achieve certain of the benefits which UP has claimed would result from the Merger. The Salem run-through operations reveal a remarkable inconsistency in the UP's position. While UP criticizes DOJ's witness for suggesting that certain of the benefits could be achieved by coordinating operations (UP/SP-230 at 61-63), it attacks Conrail's call for divestitures on the grounds that such proposals would destroy the voluntary coordinations which result in traffic being "handled efficiently in run-through train service with Conrail at the midcontinent gateways." UP/SP-230 at 236 and Peterson RVS, at 207. If such arrangements allow "UP and Conrail . . . to operate solid intermodal run-through trains in both directions that handle highly service-sensitive traffic, including UPS business from New York to Dallas" (Peterson RVS, at 207), it would seem that UP and SP could work together by joining "UP's Texas & Pacific route and SP's Sunset Route" near El Paso. UP/SP-230 at 76-77. That UP and SP management have not been able to agree on voluntary coordinations over these routes for over a hundred years does not mean that it is impossible or infeasible. It just means they have not wanted to do so. Certainly, there are no impediments to voluntary coordinations which further the public interest.

CONCLUSION

UP has literally drowned the Board and its opponents in a flood of paper. However, when all is said and done, UP has failed to carry its burden of proof with regard to the public interest and the preservation of competition. As the record plainly indicates, the Merger, as proposed, is anticompetitive and contrary to the public interest.

From mid-September to mid-April, UP insisted that the cozy arrangement which it devised with BN/SF had cured the Merger's anticompetitive problems. However, as the record reflects, after the Merger's opponents demonstrated that UP's solution was ineffective, UP was forced to return to the drawing board. Although UP has now offered the CMA Settlement Agreement as the solution, those members of CMA who are directly impacted by the Merger have renounced that Agreement. Furthermore, after careful consideration, both NITL and SPI, which represent the interests of thousands of shippers, have rejected the terms and conditions which UP offered shippers in the CMA Agreement.

Finally, neutral public entities which have no economic self-interest in the Merger, such as DOJ and the Railroad Commission, have concluded that the Merger, even with the UP's various cures, continues to be anticompetitive and contrary to the public interest. Most importantly, they have done so only after extensive investigations which have gone far beyond the sea of paper created by UP.

Simply stated, there is no reason for the Board to accept UP's unsubstantiated assurances that this time it has got it right. If the Board were to approve the UP/SP Merger without appropriate conditions, there will be no second chance. When the

opponents are proved to be correct in their assessment, it will be too late to turn back the clock and undo the Merger and its devastating anticompetitive impacts.

Therefore, because UP's solutions do not solve the problems which the Merger would create, the Board is left with but two rational choices. The first is to deny the application in its entirety upon finding that the Merger is anticompetitive and contrary to the public interest. The second is to find that the Merger's anticompetitive impact could be ameliorated by imposing all of the conditions requested by the Railroad Commission and others. At a bare minimum, this would include the divestiture of the parallel lines in Texas, the grant of trackage rights to TexMex and the creation of neutral terminal railroads. Without these conditions, the Merger is not in the public interest and is incurably anticompetitive.

Respectfully submitted,

Richard H. Streeter

Richard H. Streeter
BARNES & THORNBURG
1401 Eye Street, N.W.
Suite 500
Washington, D.C. 20005
(202) 408-6933

Attorneys for the Railroad Commission of Texas

Dated: June 3, 1996

Certificate of Service

I, Richard H. Streeter, do hereby certify that a true and correct copy of the foregoing Brief of the Railroad Commission of Texas has been served on all parties of record this 3rd day of June, 1996, by first-class mail, postage prepaid. Highly confidential versions have been served only on those parties entitled to review "Highly Confidential" material that appear on the restricted service list established pursuant to paragraph 9 of the Discovery Guidelines in Finance Docket No. 32760.

Richard H. Streeter

STB

FD-32760

6-3-96

E

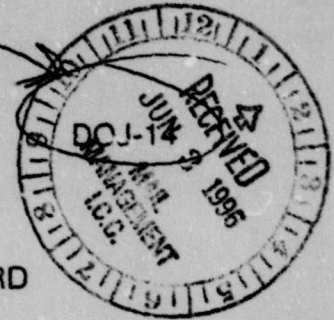
83999

1

OF

4

Disc 3 - 522 83999 621 ✓
PUBLIC (REDACTED) VERSION



BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.

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

FINANCE DOCKET
NO. 32760

BRIEF OF THE UNITED STATES DEPARTMENT OF JUSTICE

Roger W. Fones, Chief
Donna N. Kooperstein, Assistant Chief

Michael D. Billie
Joan S. Huggler
Robert L. McGeorge
Angela L. Hughes
Michele Cano
Attorneys

Transportation, Energy &
Agriculture Section
Antitrust Division
U.S. Department of Justice
325 Seventh Street, N.W., Suite 500
Washington, D. C. 20530

202-307-6666

June 3, 1996

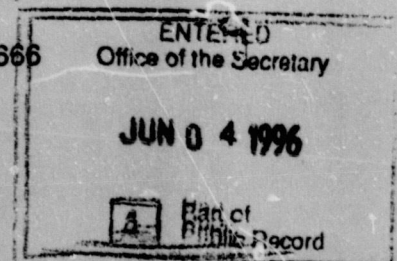


TABLE OF CONTENTS

I	INTRODUCTION AND POSITION OF THE DEPARTMENT OF JUSTICE.....	1
II	APPLICABLE LEGAL STANDARDS.....	6
III	THE UP/SP MERGER WOULD CREATE ENORMOUS COMPETITIVE HARM..	8
	A. The Merger Would Give UP/SP a Monopoly in Markets Throughout the Gulf Coast and Central Corridor.....	8
	B. The Merger Would Give UP/SP and BNSF a Duopoly And Reduce Competition in Hundreds of Markets.....	9
	C. The Likelihood of Unilateral Effects from the Merger.....	11
	D. Approval of the Merger Will Increase the Likelihood and Effectiveness of Coordinated Behavior by the Remaining Carriers.....	14
	E. Empirical Studies Confirm that a Reduction from Three to Two Carriers Will Likely Have a Price Effect.....	17
IV	APPLICANTS' PROPOSED CONDITIONS DO NOT ADEQUATELY REMEDY THE COMPETITIVE HARMS THAT WOULD RESULT FROM THE MERGER.	20
	A. The BNSF Agreement Does Not Provide Relief for All Affected Two-to-One Shippers.....	21
	B. The Applicants' Proposal is Inadequate to Preserve Competition Even for Those Shippers That are Covered.....	23
	1. Trackage Rights are Inherently Inferior to Structural Relief.....	23
	2. The Proposed BNSF Agreement Illustrates the Inherent Problems with Trackage Rights Remedies.....	25
	C. The Board Should Not Rely on Oversight Provisions to Ensure that the BNSF Agreement is Effective.....	32
V	SP'S FINANCIAL CONDITION.....	33
	A. SP is Neither a "Failing Firm" Nor a "Weakened Competitor".....	33
	B. SP is a Viable and Significant Competitor.....	35

C.	SP Will Continue to be a Viable and Significant Competitor.....	38
D.	The BNSF Merger Does Not Put SP's Financial Condition at Greater Risk.....	41
E.	SP's Financial Condition Does Not Justify the UP/SP Merger.....	42
VI	THE EFFICIENCIES RESULTING FROM THIS MERGER WOULD NOT OUTWEIGH THE MASSIVE COMPETITIVE HARMS.....	42
A.	Applicants Improperly Claim Cost Savings From Industry Productivity Gains as Merger-Related Benefits.....	43
B.	Applicants Improperly Count Benefits that Are Purely Private.....	45
C.	Applicants Improperly Claim Benefits that Could Be Achieved By Less Anticompetitive Means.....	46
	CONCLUSION.....	49

TABLE OF ABBREVIATIONS

BEA	Basic Economic Area
BN	Burlington Northern
BNSF	Burlington Northern and Santa Fe
BNSF Agreement	Trackage rights agreement of September 25, 1995 between Union Pacific-Southern Pacific and Burlington Northern/Santa Fe (UP/SP-22 at 318-347); and supplemental agreement of November 18, 1995 (UP/SP-22 at 348-359)
CMA Agreement	Agreement of April 18, 1996 between Union Pacific-Southern Pacific, Burlington Northern/Santa Fe, and The Chemical Manufacturers Association (UP/SP-219)
CCRT	Coalition for Competitive Rail Transportation
CMA	Chemical Manufacturers Association
DOJ	U.S. Department of Justice
DRGW	Denver & Rio Grande Western Railroad
IC	Illinois Central Railroad Company
ICC	Interstate Commerce Commission
KCS	Kansas City Southern Railway Company
MKT	Missouri-Kansas-Texas Railroad Company
MRL	Montana Rail Link
NITL	National Industrial Transportation League
NS	Norfolk Southern
RGI	Rio Grande Industries
RVS	Rebuttal Verified Statement
SF	Santa Fe
SP	Southern Pacific
SPI	Society of the Plastics Industry
SPLC	Standard Point Location Code
STCC	Standard Transportation Commodity Code

UP

Union Pacific

VS

Verified Statement

WCTL

Western Coal Traffic League

WSC

Western Shippers Coalition

TABLE OF SHORT CASE CITATION FORMS

<u>A & M</u>	<u>Arkansas and Missouri Railroad Co. v. Missouri Pacific Railroad Co.</u> , 6 I.C.C.2d 619 (1990), 7 I.C.C.2d 164 (1990), <u>aff'd sub nom. Missouri Pacific Railroad Co. v. ICC</u> , 23 F.2d 531 (D.C. Cir. 1994)
<u>BN/SF</u>	<u>Burlington Northern, Inc., & Burlington Northern R.R. -- Control & Merger -- Santa Fe Pacific Corp. & Atchison, Topeka & Santa Fe Ry.</u> , Finance Docket No. 32549, Slip Opinion (Aug. 23, 1995)
<u>CSX Control</u>	<u>CSX Corp. -- Control -- Chessie System, Inc., & Seaboard Coast Line Industries, Inc.</u> , 363 I.C.C. 518 (1980), <u>aff'd sub nom. Brotherhood of Maintenance of Way Employees v. ICC</u> , 698 F.2d 315 (7th Cir. 1983)
<u>DRGW/SP</u>	<u>Rio Grande Industries, Inc., SPTC Holding, Inc., & Denver & Rio Grande Western R.R. -- Control -- Southern Pacific Transportation Co.</u> , 4 I.C.C.2d 834 (1988)
<u>PPU</u>	<u>Trackage Rights Compensation -- Peoria and Pekin Union Railway Co.</u> (Sub-No. 1), 1994 WL 508802 (ICC)
<u>Rio Grande</u>	<u>Rio Grande Industries, Inc., et al. -- Purchase and Trackage Rights -- Chicago, Missouri & Western Railway Company Line Between St. Louis Mo. and Chicago, IL.</u> , 5 I.C.C.2d 952 (1989)
<u>SF/SP</u>	<u>Santa Fe Southern Pacific Corp. -- Control -- Southern Pacific Transportation Corp.</u> , 2 I.C.C.2d 709 (1986)
<u>SSW Compensation</u>	<u>St. Louis Southwestern Ry. -- Trackage Rights Over Missouri Pacific R.R. -- Kansas City to St. Louis</u> , 1 I.C.C.2d 776 (1984), 4 I.C.C.2d 668 (1987), 5 I.C.C.2d 525 (1989), 8 I.C.C.2d 80 (1991), 8 I.C.C.2d 213 (1991), <u>aff'd mem.</u> , No. 88-1186 (Oct. 30, 1992), <u>cert. denied</u> , 508 U.S. 951 (1993)
<u>Tahachapis</u>	<u>Atchison, Topeka & Santa Fe Railway Co. -- Operating Agreement -- Southern Pacific Transportation Co.</u> , 8 I.C.C. 2d 297 (1992) and 1993 WL 88445 (Mar. 26, 1993)
<u>Trailways</u>	<u>GLI Acquisition Company -- Purchase -- Trailways Line, Inc., et al.</u> , 4 I.C.C.2d 591 (1988)

UP/CNW

Union Pacific Corp., Union Pacific R.R. -- Control -- Chicago & North Western Ry., Finance Docket No. 32133, Slip Opinion (Mar. 7, 1995)

UP/MKT

Union Pacific Corp., Union Pacific R.R. & Missouri Pacific R.R. -- Control -- Missouri-Kansas-Texas R.R., 4 I.C.C. 2d 409 (1988), petition for review dismissed sub nom. Railway Labor Executives Ass'n. v. ICC, 883 F.2d 1079 (D.C. Cir. 1989)

UP/MP/WP

Union Pacific Corp., Pacific Rail System, Inc., & Union Pacific R.R. -- Control -- Missouri Pacific Corp & Missouri Pacific R.R., 366 I.C.C. 459 (1982), aff'd in part & remanded in part sub nom. Southern Pacific Transportation Co. v. ICC, 736 F.2d 708 (D.C. Cir. 1984), cert. denied, 469 U.S. 1208 (1985)

WCT/FVW

Wisconsin Central Transportation Corporation, et al -- Continuance in Control -- Fox Valley & Western Ltd., 9 I.C.C.2d 730 (1993)

BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.

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

FINANCE DOCKET
NO. 32760

BRIEF OF THE UNITED STATES DEPARTMENT OF JUSTICE

I INTRODUCTION AND POSITION OF THE DEPARTMENT OF JUSTICE

The evidence in the proceeding compels one conclusion: the UP/SP merger proposal would result in overwhelming competitive harm in a large number of markets. The only remedy proposed by Applicants, a trackage rights agreement with BNSF, its only remaining competitor in the West, is wholly inadequate to cure these massive competitive problems. Furthermore, neither the financial condition of SP nor any efficiencies generated by the transaction justify this anticompetitive merger.

The competitive problems resulting from the merger can be adequately remedied only through divestiture of the significant lines necessary to provide a new competitor access to markets where shippers would otherwise face a monopoly or a duopoly. Applicants have steadfastly refused to acknowledge the competitive flaws in their proposal or heed the many calls for divestiture and for a real restructuring of this transaction. For the Board to undertake the work that the parties failed to do -- restructure the transaction through extensive divestiture -- raises serious practical problems and the possibility of further competitive harms during the divestiture process. Therefore, denial of the

Application is the most certain, effective, and expeditious way to preserve competition in this case.

The proposed merger of UP and SP is the largest rail merger ever considered by the Board or its predecessor, the ICC, and would have anticompetitive consequences that far exceed any previous merger, including the proposed Santa Fe/Southern Pacific merger, which was disapproved on competitive grounds in 1986. Indeed, the transaction is among the largest horizontal mergers ever proposed in such a concentrated industry. The UP/SP merger proposal follows a series of mergers between western carriers, including the recent consolidation of BN and SF, that has seen the number of Class I railroads in the West drop to only three. Thus, this unprecedented merger would take place in markets that are already highly concentrated.

The magnitude of the horizontal overlaps between UP and SP is also far beyond that involved in prior mergers. The two systems contain extensive segments of parallel track, including the Central Corridor and the lines from south Texas through Houston to Memphis, St. Louis, and Chicago, and the lines from Houston to New Orleans and San Antonio. In many markets, the UP/SP merger would result in a monopoly. Consistent with estimates made by others, DOJ calculates that such markets account for about \$1.5 billion in annual revenues.¹ Markets where the merger would create a duopoly account for an additional \$4.75 billion in annual revenues.²

Based on the available empirical evidence, DOJ estimates that the merger may result in price increases for shippers and consumers in the range of \$800 million per year.³ It is not surprising, therefore, that there is unprecedented shipper opposition to the

¹DOJ-8, Majure VS at 9-10.

²*Id.* at 29-30.

³*Id.* at 36.

transaction.⁴ Several large shipper organizations, including NITL, SPI, WCTL, and WSC oppose the merger as proposed.⁵

Given the enormous competitive consequences of the proposed merger, it would be difficult, if not impossible, to fashion a timely and effective remedy to replace the competition that would be lost. As described more fully below, remedy of the competitive harms in this case can be accomplished only with extensive divestitures. Divestitures of such magnitude would inevitably entail delay while prospective buyers are sought and transactions are negotiated. It appears likely that this process would result in at least two and possibly more divestiture transactions. Then the Board would be required to carefully review the proposed divestitures to ensure that the buyers will provide shippers with a meaningful competitive alternative -- to ensure that all shippers in the affected areas are covered by the divestiture, that the divestiture package includes adequate yards and other facilities, that the buyers have the necessary connections to their own systems or important gateways, that the buyers are financially viable, and that the divestitures themselves do not raise competitive concerns. Competition will be weaker and less effective during this process, as the assets to be divested will remain in limbo. In the interim, UP will own the assets and no competitor will exist.

The best way to preserve competition is to disapprove the Application. Denial would force SP to devise an alternative plan for its future. SP may decide to continue efforts (suspended since the merger agreement) to improve its service, make changes in

⁴Applicants say that the merger has unprecedented shipper support. UP/SP-230 at 47. While "a mere head-count of shippers supporting and opposing the application is not determinative in evaluating the impact of a transaction on competition or the public interest," WCT/FVW at 734, the Department notes that evidence in the record shows that the supporting statements in this case come largely from shippers that will retain competitive options after the merger. SPI-16 at 16 n.8 and Exh. 4. In contrast, the shippers opposing the transaction are those who see their competitive options drastically reduced.

⁵See NITL-9 at 56-59; SPI-11 at 57-63; WCTL-11 at 33-39; WSC-11 at 59-60.

its operations and lower its costs, or alternatively, to sell all or part of its operations to carriers that do not raise competitive problems. In any case, denial of the Application would avert the permanent elimination of an independent competitor to UP and BNSF in the West. SP today is an important player in western rail markets, with a significant share of the traffic in the markets in which it competes. SP is concededly not a failing firm, and is not likely to disappear absent the merger. Its assets will not exit western rail markets -- the only issue is whether they will remain with an independent SP or be sold to a new competitor (a number of carriers have already expressed a strong interest in acquiring SP's assets). With approval of the proposed merger, however, the competitive landscape will be irretrievably altered and a major third competitor will disappear forever.

Should the Board decide to approve the merger subject to conditions, it should consider nothing less than complete divestiture of the major parallel lines involved here. The BNSF Agreement -- a trackage rights agreement of unprecedented scope -- is an inadequate remedy and should be rejected. It provides no relief in duopoly situations, and incomplete and ineffective relief in monopoly situations. The BNSF trackage rights will not become an adequate remedy by imposing oversight conditions or monitoring. Structural relief is the most effective remedy to competitive problems caused by a merger. Divestiture replaces the lost competitor with another independent firm that controls its own facilities and competes on the same terms as the merged firm. Divestiture removes any need to review the contractual details of a trackage rights agreement to ensure that it provides for effective competition. Divestiture also eliminates the costs of continued regulatory oversight and the transaction costs associated with operating and resolving disputes under the agreement.⁶

⁶ See CR-22, Schmalensee VS at 10-11, 35-41.

Divestiture⁷ of the following three routes is the minimum necessary to remedy the bulk of the competitive problems created by the proposed merger:⁸

- One of the two parallel north/south routes from the Gulf Coast to the eastern gateways, specifically the routes radiating from Houston, north through Little Rock and Memphis to St. Louis; east to New Orleans; west to San Antonio; and south to Brownsville.
- One of the two Central Corridor routes from Oakland through Salt Lake City and Denver to Kansas City.⁹
- Sufficient lines to preserve a third independent competitor between Los Angeles and the eastern gateways, particularly Chicago.¹⁰

All of these divestitures must occur promptly and must be to a carrier other than BNSF, which otherwise would be the only competitor of the merged UP SP throughout the West.¹¹

Even these extensive divestitures are unlikely to cure all of the merger's anticompetitive effects, and competition would inevitably be lessened during the pendency

⁷Divestiture must include the yards, storage facilities and other assets necessary for the buyer to effectively compete. In addition, it may be necessary to divest lines beyond those strictly necessary to solve competitive concerns in order to give the buyer connections to its own system or important gateways.

⁸To the extent that there are additional anticompetitive effects that do not involve these routes, it may be possible to mitigate these much more limited problems through appropriate trackage rights arrangements.

⁹Where one of the Applicants currently competes using trackage rights (e.g., SP between Pueblo, CO and Herrington, KS), divestiture would entail transfer of those trackage rights to the buyer.

¹⁰There are alternative means of accomplishing this divestiture, including divestiture of the UP line from Los Angeles to Salt Lake City to connect to the Central Corridor or divestiture of lines in the Southern Corridor to connect to the Gulf Coast line.

¹¹These divestitures can be accomplished without interfering with Applicants' ability to offer shippers in these corridors new single line service and shorter routes simply by allowing Applicants to take back trackage rights on the divested lines. The divestiture proposals of several other parties contemplate just such an arrangement, e.g., NITL-9 at 58-59. Applicants may argue that divestiture would unfairly deprive them of exclusive access to the captive shippers on the divested lines. The Applicants would be compensated for this loss, however. Just as the price UP is offering for SP reflects the value of SP's captive shippers, the value of access to such shippers would be reflected in the price paid for the divested assets.

of the divestiture process. For these reasons, denial of the Application is the most certain, expeditious, and effective way of preserving competition.

II. THE APPLICABLE LEGAL STANDARDS

Under the Interstate Commerce Act, the Board may only approve a merger if it is "consistent with the public interest" 49 U.S.C. § 11344(c). The statute requires consideration of five factors, including "whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region." 49 U.S.C. § 11344(b)(1)(E). If the Board finds that the proposed transaction would adversely affect competition, it may deny the Application or condition approval of the transaction.

The policies embodied in the antitrust laws give "understandable content to the broad statutory concept of the 'public interest.'" FMC v. Aktiebolaget Svenska Amerika Linien, 390 U.S. 238, 244 (1968); see also BN/SF at 52 (antitrust laws provide guidance on public interest considerations). While the Board does not sit as an antitrust court, BN/SF at 53, it "must estimate the scope and appraise the effects of the curtailment of competition which will result from the proposed consolidation," and weigh the competitive effects against any benefits of the merger. McLean Trucking Co. v. United States, 321 U.S. 67, 87-88 (1944).

The Department of Justice/Federal Trade Commission Horizontal Merger Guidelines state the Department's enforcement policy concerning mergers subject to the antitrust laws. The ICC has recognized that the Merger Guidelines are a helpful guide to the analysis of rail mergers. SF/SP at 737; UP/MKT at 432. The Merger Guidelines analysis entails a comprehensive examination of the likely competitive effects of a merger, including consideration of efficiencies created by the transaction and the financial condition of the merging parties. A proper antitrust analysis of a rail merger, far from being a "narrow, theoretical" approach (UP/SP-230 at 37), encompasses most of the

public interest considerations of the Interstate Commerce Act.

In analyzing the competitive effects of a proposed merger, the Board's concern should be whether the merger would be likely to create or enhance market power or facilitate its exercise. Market power is the ability to raise price, reduce output or reduce service. A merger can increase or enhance market power by creating a monopoly or duopoly. A merger can also facilitate the exercise of market power by increasing the likelihood of collusion among those competing firms remaining in the market post-merger, or by otherwise reducing the intensity of competition for the business of particular customers.¹²

It is a fundamental tenet of economic theory, and hence of antitrust enforcement policy, that mergers short of merger to monopoly may have significant anticompetitive effects. For this reason, both the courts and the antitrust enforcement agencies presume that a merger resulting in a significant increase in concentration in a highly concentrated market will enhance market power or facilitate its exercise. United States v. Philadelphia National Bank, 374 U.S. 321, 363 (1963); Merger Guidelines § 1.51.¹³

The Board's public interest determination must also be guided by the rail transportation policy, 49 U.S.C. § 10101a. The rail transportation policy was set out by Congress in the Staggers Act, and emphasizes "reliance on competitive forces, not government regulation, to modernize railroad actions and to promote efficiency."¹⁴ In examining the proposed merger including any proposed remedial conditions, the rail

¹²The first step in analyzing the competitive effect of a merger is to define the relevant market -- in this case, the area within which railroads could profitably impose a price increase. Market definition is explained in greater detail in the Department's comments (Majure VS at 3-8) and in Appendix A.

¹³See, e.g., United States v. Ivaco, Inc., 704 F. Supp. 1409 (W.D. Mich. 1989)(enjoining a merger to duopoly in a market with significant barriers to entry).

¹⁴BN/SF at 52.

transportation policy requires the Board to bear in mind this mandate to favor "greater reliance on the marketplace" over regulatory solutions to competitive problems.¹⁵

III. THE UP/SP MERGER WOULD CREATE ENORMOUS COMPETITIVE HARM

UP and SP are two largely parallel railroads that currently compete in thousands of markets throughout the West and Midwest. The proposed merger would eliminate that competition, leaving hundreds of shippers facing a monopoly and hundreds more with only two competitors. These shippers -- with billions of dollars of traffic -- will face higher rates as a result of the merger, which will ultimately be passed on to consumers in the form of higher prices.

The markets of concern are rail transportation of commodities between particular points where neither truck nor barge are economically viable alternatives and where other forms of competition, such as source and product, do not effectively constrain prices. As even Applicants concede (although they may differ on the precise delineations), there are hundreds of such markets involved here. For commodities such as wood and paper products, grain, automotive traffic, plastics, iron and steel and long haul intermodal, rail is the only economic alternative. And no one argues that new entry or other factors will reduce post-merger concentration in any of these rail markets.

A. The Merger Would Give UP/SP a Monopoly in Markets Throughout the Gulf Coast and Central Corridor

UP and SP are the only competitors in many of the rail markets affected by the merger, primarily involving traffic moving north/south from the Gulf Coast and through the Central Corridor. In these markets, they compete vigorously for shippers' traffic on the basis of price, as well as service -- time, reliability, availability of cars or storage facilities.

¹⁵PL 96-448, § 2 (1980).

UP and SP compete not only for the shippers they reach directly but also for shippers who can truck to a rail head and shippers who can build-out to a railroad.¹⁶ The amount of traffic affected is significant by any count. The estimates range from \$900 million¹⁷ to over \$2 billion.¹⁸ The Applicants admit that the merger will give UP/SP monopoly power in these markets and the undisputed power to raise prices and reduce service.

B. The Merger Would Give UP/SP and BNSF a Duopoly
And Reduce Competition in Hundreds of Markets

In other markets affected by the merger, UP and SP are two of three rail competitors. These markets include every major city in the West -- Los Angeles, Denver, Houston, Portland and San Francisco among others. UP and SP are both significant players in these three-to-two markets, notwithstanding Applicants' claims of SP's ineffectiveness. SP, as well as UP, carries substantial shares of traffic in many of the markets. UP's own analysis reveals that SP handled either the largest or second largest amount of traffic of the three competitors in 17 of the 36 three-to-two markets they studied.¹⁹ Their analysis also showed that SP handled **% of the intermodal traffic

¹⁶See Majure VS at 16-18. A number of parties have described situations in which they can now (or later would) benefit from competition between UP and an independent SP that fall outside the Applicants' narrow view of competition and are not addressed in the proposed relief. Some of these involve potential build-outs from their facilities or other forms of competition that may affect rates or service, or both. See, e.g., QCC-2 at 7; WSC - 11 at 2; CPSB -2 and 3 at 2, 3-6; AEPC-5 at 3-4; WPL - 5 and 6 at 2-3.

¹⁷Applicants' estimate of the traffic available to BNSF at two-to-one points covered by the trackage rights agreement. UP/SP 23, Peterson VS at 165.

¹⁸KCS-33, Vol. I, Grimm VS at 193.

¹⁹Peterson VS at 191-230. Mr. Peterson discussed 26 origin or destination points. Information was provided for three types of traffic in five "major" markets, and for carload only in the remaining 21, for a total of 36 "markets" discussed in his testimony. He then proceeded to discount the traffic in various ways to arrive at "competitive traffic" in those locations, for which he provided shares.

moving from Los Angeles to the Midwest and Northeast.²⁰ In the three-to-two markets identified by Dr. Majure, SP participated in **% of the movements. In the largest three to two markets he identified -- intermodal traffic from Chicago to Los Angeles and from Los Angeles to Chicago -- SP's market share was ****% in the first and **% in the second.²¹ Consistent with these numbers, shippers consider SP a significant factor in three-to-two markets, just as they do in the two-to-one markets.²²

By any count, the amount of traffic affected by the proposed merger in areas where shippers' railroad options go from three to two is staggering. Applicants' own witness concedes that the volume of traffic may be as high as \$2.14 billion.²³ Dr. Majure calculated that volume of traffic to be \$4.75 billion.²⁴ Other parties have submitted even higher estimates.²⁵ Regardless of the estimate the Board finds most persuasive, it is clear

²⁰Peterson VS at 199. Indeed, in Appendix A to his initial Verified Statement, showing regional traffic flow data, SP is recorded as having **% of the traffic flowing between Southern California and Chicago, while UP had ****%.

²¹Majure VS at 28-29. See also, DOJ-9, Attachment 3.

²²See, e.g., letter of Procter & Gamble Co., of March 22, 1996, which states: "The overall reduction from 3 to 2 carriers for our Sacramento, CA, Kansas City, KS and St. Louis, MO operations, as well as our numerous raw material supply points in the Texas Gulf region, will escalate cost affecting our competitiveness." (Exhibit 1) See also, citations to shipper statements in CCRT-4 at 32-34.

²³UP/SP-23, Peterson VS at 186; UP/SP-231, Peterson RVS at 23-25.

²⁴Majure VS at 29. The difference between Mr. Peterson's numbers and Dr. Majure's arises from the way each defined the geographic markets in which to assess the competitive effects of this merger. Dr. Majure's market definition methodology is set out in Appendix A. Mr. Peterson defined the Applicants' three-to-two markets to include only those locations where three railroads were serving each end point of a traffic flow. End points were chosen on the basis of 6 digit SP's. Peterson VS at 189. This definition of affected traffic necessarily produced fewer markets than counting traffic flows from larger end points.

²⁵Dr. Grimm estimates that the three-to-two traffic is over \$*****. KCS-33, Vol. 1, Grimm VS at 193. When the analysis of other parties has deviated from the Applicants' as to the likely effects of this highly significant merger and the assumptions underlying the proffered "fixes," their efforts have been met with derision and accusations ranging from "number bloating" to "crafty schemes." See, e.g., UP/SP-230 at 175-176; Peterson RVS at 35 et seq. Mr. Peterson's loyalty and dedication as a UP employee cannot be doubted. Yet his rebuttal testimony takes an unfortunate turn in characterizing other witnesses' methodology in terms that are more than merely colorful. See, e.g., his RVS at 35-48, where Mr. Peterson

that there are vast numbers of shippers with options to use three rail carriers today that will lose an important competitive alternative because of the merger.

Applicants have attempted to cast the issue of the elimination of one of three competitors in this proceeding as largely a debate over technical aspects of various rate studies. The issue is far more basic -- whether the same economic realities of monopoly and duopoly that are uniformly recognized throughout the rest of the U.S. economy apply to the rail industry and this merger.

The strong presumption that a significant increase in concentration will lead to a reduction in price and service competition is a cornerstone of industrial organization economics and the antitrust laws. Here, the change in concentration is as extreme as it gets short of monopoly -- merger to duopoly with no relief from intermodal, source, or product competition and no prospect for new entry. This presumption that concentration matters is supported by extensive empirical studies of many industries, including the rail industry.²⁶ This presumption and the empirical studies that support it should be accepted here, absent the clearest of evidence that changes in concentration are irrelevant. Applicants' evidence falls far short, and the record instead reconfirms the obvious -- merger to duopoly is anticompetitive.

C. The Likelihood of Unilateral Effects from the Merger

The elimination of one of only three western Class I railroads will significantly affect the pricing decisions of the remaining two carriers, and is likely to lead to price increases

argues variously that others' results are "bizarre," "wacky," or "incoherent", and should not be taken seriously.

²⁶ See, e.g., studies cited in *Majure VS* at 33-34; *KCS-33*, Vol. 2, *White VS* at 120-123; *DOW-11*, *Kwoka VS* at 12-24.

for shippers in many markets.²⁷ UP, SP, and BNSF each offer different price/service combinations in their markets, and each shipper has a different preference for price/service combinations. This means each shipper will prefer different railroads, with one as its first choice, another as its second choice, and still another as its third at various times. Each railroad, when it has the business of a shipper, is constrained in the rates it can charge by that shipper's second choice. Each railroad is unlikely to know the precise combination of price and service at which a particular prospective shipper would be on the edge of accepting that railroad's offering or choosing one of the other carriers. Since the railroad wants to keep the shippers who would switch if prices were raised, and cannot be precisely sure of their identity at any given time, all shippers are protected from a price increase by the existence of three separate railroads. With the merger of two of the carriers, it becomes in the unilateral interest of the remaining competitors to raise prices.²⁸

Dr. Willig disputes the likely unilateral effects of the merger. He does not quarrel with the basic economic model, but instead argues that it is inapplicable because SP is always a weak third competitor in the markets where it competes, or will be soon.²⁹ In essence, Applicants make the highly speculative and implausible argument that SP will inevitably cease to be a competitive factor in any market for any shippers absent the

²⁷ Merger Guidelines § 2.2; Majure VS at 28-29; White VS at 110, 122.

²⁸ Unilateral effects refer to actions taken by UP/SP not dependent upon any accommodating response by BNSF. Willig RVS at 23.

²⁹ Willig VS at 595-598. At his deposition Dr. Willig testified that the only facts he had acquired about the merger had come from UP or from shippers supporting the merger. See, e.g., Willig Tr. at 24, 60. His rebuttal statement indicates he had read draft statements of other rebuttal witnesses, but does not document any other source of information of the facts of this transaction. RVS at 8-9. Thus, his acceptance, without documentation, of the "fact" that SP is most often the third place competitor in a three-railroad market, and of the "fact" that efforts by UP/SP to exercise market power would generally fail because BNSF would have the capacity to divert traffic from the merged carrier, undermines the credibility of his prediction about the likelihood of unilateral effects of this merger.

transaction. The record clearly shows otherwise.

As explained above, Applicants' own evidence shows that SP is currently the first choice of *****percent of the shippers in many markets, and undoubtedly the second choice of many more.³⁰ Further, Dr. Majure tested empirically Applicants' assertion that SP does not compete aggressively. In his study of rail competition for wheat, Dr. Majure tested whether the fact that SP was the originating carrier significantly affected the rate level. He found that it was a significant determinant of the rate both statistically and economically -- with SP estimated to offer rates that were at least 17.8% less than an equally efficient competitor for the same move.³¹ To the same effect, UP's President testified that "Southern Pacific is an aggressive competitor and I know that in a number of cases that they have got business from us."³² Internal UP documents also show that SP is an effective competitor against UP.³³ Finally, many shippers have expressed concern about the loss of a third competitor -- and that competitor is SP.³⁴

Other Applicant witnesses -- notably Messrs. Peterson and Gray -- argue that

³⁰Under the Merger Guidelines, if the combined share of merging parties is at least 35 percent (almost always the case here), there is a presumption that a significant number of customers consider them their first and second choice. Merger Guidelines § 2.211. Moreover, in the absence of information indicating otherwise, it is appropriate to assume that a firm's share reflects its relative appeal as a second choice as well as a first choice. Werden, Froeb, and Tardiff, "The Use of the Logit Model in Applied Industrial Organization," 3 International Journal of the Economics of Business 83, 89 (1996).

³¹ Majure VS at 36 n.37. This finding contradicts assertions made by Applicants that SP cannot be an effective competitor where SP is a higher cost railroad than UP. The finding means that at the very least, SP compensates for any higher costs by cutting its margins to effectively match competitive offers rather than exiting the market. Likewise, arguing that SP has lower quality service in some markets does not mean that SP cannot compete by also cutting margins in those markets.

³²Davidson Tr. at 81. See also Majure VS at 39-40 (discussing shippers that use both UP and SP for various shipments).

³³See *infra* documents cited in Part V.B.

³⁴See, e.g., CR-23 at 101-02 (Dow), 127 (Fina Oil and Chemical Co.); CCRT-4 at 295 (Elbing Grain Co.), 503 (O.K. Transportation, Inc.), 543 (Reagent Chemical & Research, Inc.).

railroads know the precise price/service tradeoffs of their customers, and therefore conclude that the presence of other competitors does not constrain rates, *i.e.*, that UP never loses business to SP or any other railroad. Even if this were true, the merger would still have anticompetitive unilateral effects.³⁵ The record clearly shows, however, that railroads lose traffic to one another, and indeed *****

*****³⁶ In fact, the railroad's marketing personnel would not know the most important element of the shipper's elasticity -- namely, the precise price/quality alternatives offered to the shipper by another railroad

In this case, after UP and SP merge, the merged carrier will no longer have to worry that a particular shipper might have been on the cusp between UP and SP offerings. Likewise, BNSF would have less concern that higher prices would drive shippers to choose UP/SP. Thus, it would be economically rational for UP to raise prices to its customers and for BNSF also to raise price in response, thereby affecting all shippers in a three-to-two market post-merger.³⁷

D. Approval of the Merger Will Increase the Likelihood and Effectiveness of Coordinated Behavior by the Remaining Carriers

As the ICC recognized in SE/SP, "a reduction in competition from three to two can result in significant anticompetitive behavior, such as collusion and mutual

³⁵In the final analysis, unilateral effects occur regardless of the degree of uncertainty about shippers' second choices. To the extent experienced rail personnel can predict when a shipper will switch, this knowledge can even exacerbate unilateral effects post-merger. If a UP customer is "known" to be willing to switch to SP if UP raises its price one percent and then to BNSF if SP raises its price 15 percent, then UP/SP will raise its prices up to 15 percent post-merger.

³⁶Gray Tr. at 45-46 (May 17, 1996). Mr. Peterson also concedes that UP does not always have "perfect knowledge" about its shippers. RVS at 138.

³⁷Majure VS at 41.

forebearance."³⁸ The Merger Guidelines explain that to engage in tacit collusion firms must be able to (1) tacitly reach mutually agreeable terms of coordination; (2) detect deviations from their understanding as to coordination; and (3) respond to any detected deviations with sufficient punishment to deter deviation.³⁹ The record shows market conditions conducive to collusion exist in rail markets and that the UP/SP merger will make such collusion more likely.⁴⁰

Reducing the number of railroads from three to two certainly makes it easier to reach understandings on the rules of the game. At the same time, the merger will increase the similarity between the two western railroads, also making it easier for them to reach mutually agreeable understandings. These understandings need not be complex -- they can be as simple and intuitive as "you keep your customers and I'll keep mine."⁴¹

A world with only two western railroads also decreases the difficulties in monitoring compliance to detect any deviations from the understandings. Where UP/SP or BNSF loses a customer, they will know who took the traffic (there is only one possibility) and know how much was taken. They can even count the number of their rival's cars serving a particular shipper if necessary to determine the exact volume of traffic lost.

Applicants' touted differences between railroads' costs, capabilities, capacity, and

³⁸ *SF/SP* at 791 n.72.

³⁹ *Merger Guidelines* § 2.1. See also *Majure VS* at 41.

⁴⁰
.....
..... Mr. Peterson makes an unconvincing attempt to rebut this evidence,
..... Peterson *RVS* at 136-37. Not only is this
explanation at odds with the plain language of the document,
.....

⁴¹ *Merger Guidelines* § 2.11.

general system complexities are not likely to affect their ability to monitor collusive agreements. Railroad executives know a lot about each others' systems from the public record, their experiences at other railroads, and from the broad spectrum of contacts railroads have with each other through trackage, haulage and other cooperative arrangements.⁴² This merger, with its expansive and reciprocal trackage rights agreements will give UP and BNSF even more information about each others' customers and traffic, which can be used to detect deviations.⁴³

Finally, the proposed merger would enhance punishment options. A temporary abandonment of the terms of coordination can be an effective punishment, and can be limited to a particular shipper or market. The UP/SP merger, with the extensive trackage rights proposal, would dramatically increase the scope of contacts between western railroads across markets, and thus greatly increase the punishment options each would possess against the other.⁴⁴ For example, if UP/SP were to lose market share in one market where BNSF had not followed an understanding, then UP/SP would have the ability (and option) to punish BNSF in another market (as Dr. Majure notes, perhaps as a warning). Both the economic literature and business experience recognize the potential for retaliation in situations where there are multimarket contacts between competitors.⁴⁵

⁴²See, e.g., Peterson Tr. at 27, 149, 467, 990, 1058-59 (Feb. 5-10, 1996).

⁴³Dr. Willig testified that he had no knowledge about the types of information carriers can obtain about each other through trackage rights arrangements. Willig Tr. at 195-96.

⁴⁴See Bernheim and Whinston, "Multimarket Contact and Collusive Behavior," *RAND Journal of Economics* 21:1 (Spring 1990); see also Majure VS at 46-47.

⁴⁵See, e.g., Evans and Kessides, "Living By the 'Golden Rule': Multimarket Contact in the U.S. Airline Industry", in *The Quarterly Journal of Economics* (May 1994). The article quotes a memo by a Northwest Airlines executive stating that "I did not want my pricing analyst initiating actions in another carrier's market like Chicago for fear of what that other carrier might do to retaliate." Evans and Kessides' study of the airline industry between 1984 and 1988 found that airlines refrain from initiating aggressive pricing actions in a given route for fear of what their competitors might do in other jointly contested routes.

Rather than rebut "real world" evidence that railroads can coordinate effectively,⁴⁶ Applicants offer testimony about reasons it could be difficult for railroads to accomplish the elements of tacit collusion.⁴⁷ But anticompetitive coordination need not be perfect to harm customers: "Instead, the terms of coordination may be imperfect and incomplete -- inasmuch as they omit some market participants [not the case in a duopoly], omit some dimensions of competition, omit some customers, yield elevated prices short of monopoly levels, or lapse into episodic price wars -- and still result in significant competitive harm."⁴⁸ Applicants' evidence on possible reasons collusion could be less than perfect misses the mark. The issue is whether the rail markets at issue are sufficiently conducive to coordination between duopolists that shippers will be harmed. The record amply demonstrates that they are, and Applicants' own witness, Dr. Willig, concedes that if the elements of tacit collusion exist in the affected rail markets, then the merger would facilitate collusion between duopolists.⁴⁹

E. Empirical Studies Confirm that a Reduction from Three to Two Carriers Likely Will have a Price Effect

The empirical studies of rail markets confirm that high concentration matters in the rail industry, as it does in virtually all industries. These studies provide a strong basis, in conjunction with the evidence on unilateral effects and collusion, for concluding the merger

As Dr. Majure notes in his testimony, in some respects the airline industry appears very similar to railroads. One way it differs, however, is that there is a far greater likelihood in the airline industry that supracompetitive pricing will induce new entry and thus constrain prices. Majure VS at 47 n.50.

⁴⁶The simple situation reflected in the document discussed in footnote 40, above, provides a perfect example of just how easy and uncomplicated the implementation of these elements can be. Majure VS at 42.

⁴⁷Willig RVS at 37-40.

⁴⁸Merger Guidelines § 2.11.

⁴⁹See Willig VS at 607 n.4.

will result in higher prices for shippers.

Applicants have criticized all of the published economic studies of concentration in the rail industry. While any econometric study, no matter how rigorous, is subject to some critique,⁵⁰ the number and consistency of these studies makes it impossible for Applicants to undermine their significance. These studies, done at different times, by different economists, with different methodologies reached the same result -- high concentration in the rail industry leads to higher rates (hardly a novel result) -- and no published studies reach a contrary result.

In addition, Dr. Majure performed an independent study of the effect of concentration on rail rates, using the general methodology of a previous study by Professor MacDonald with certain refinements. Dr. Majure's study confirmed the conclusion that concentration is a significant determinant of railroad rates.⁵¹

Applicants' empirical evidence, to the contrary, consists entirely of studies commissioned by Applicants for use in this proceeding, and is unpersuasive. They first attempt to demonstrate that rail rates are lower in two-railroad markets than in three-railroad markets,⁵² relying in large part on rate analysis done by Mr. Peterson. He made no attempt to control for any factors that could affect rates, making his conclusions highly

⁵⁰Many of Applicants' specific criticisms have in fact been soundly dismissed. See KCS-33, Vol.2, MacDonald VS at 158-63; Grimm VS at 203-05. Indeed some have turned out to be factually wrong. For example, contrary to Dr. Willig's testimony, the MacDonald studies had controlled for the monopoly effect. MacDonald VS at 182-63. In addition, although he criticized some of the rate studies for using waybill data that contained contract revenues that were "masked", Dr. Willig was unaware that all railroads do not mask rates, Willig Tr. at 398, and that in any case the data used in the studies in question covered a time prior to the time the ICC began to allow masking. MacDonald VS at 160.

⁵¹ The specific study Dr. Majure confirmed is MacDonald, "Railroad Deregulation, Innovation, and Competition: Effects of the Staggers Act on Grain Transportation," *Journal of Law and Economics* 32:2 (April 1989).

⁵² Information purporting to show this appears in Peterson's VS at 178-184 and again in his RVS at 88-90.

unreliable. For example, Mr. Peterson's testimony purported to show a decline in rail rates in certain San Antonio traffic between 1986 (pre-UP/MKT merger) and 1994 (post-merger).⁵³ He later conceded, however, that the post-merger rates for these moves remained flat.⁵⁴ Given that the general level of rail rates declined over this period (while these rates at best were flat), Mr. Peterson's evidence belies Applicants' contention that rail rates are lower with two, as opposed to three, competitors.

Applicants also rely on the testimony of B. Douglas Bernheim. Starting with the "understanding" that "the affirmative case for this merger is based in significant part on the fact that SP has become the weakest and least effective of the three railroads serving the West," Dr. Bernheim conducted a study of automotive traffic.⁵⁵ That study is deeply flawed and should be given no weight by the Board:

- The issue is whether SP affects the overall market prices shippers actually pay, which can only be determined by knowing how much traffic each railroad is carrying and at what prices. Dr. Bernheim only looked at UP prices and examined no market share data. Thus, if he found a corridor where UP charged a relatively high rate, he concluded that SP's presence did not matter. What he does not know is whether SP carried most of the traffic at a much lower rate, and thus clearly affected the rates shippers actually pay.
- Dr. Bernheim failed to control for variations in service quality, including variations from corridor to corridor in the circuitry of UP relative to its competitors. This is particularly noteworthy given that Mr. Peterson testified that quality is more important than price to automotive shippers.⁵⁶
- In comparing UP's rates under different competitive scenarios, Dr. Bernheim

⁵³Peterson VS at 181.

⁵⁴Peterson RVS at 87-88.

⁵⁵Bernheim RVS at 10.

⁵⁶Peterson Tr. at 57-59 (Feb. 5, 1996). In his RVS at 11, Dr. Bernheim criticizes the testimony of Mr. Plott for not accounting for quality differences.

made no effort to control for the identity of the competitors. *****

***** 57 *****

There is thus nothing in the record to support Applicants' contention that the most fundamental economic principles are inapplicable to this merger. The proposed transaction would result in serious competitive harms in those markets where the merger would create a duopoly, and the public interest requires that shippers in those markets be protected.

IV. APPLICANTS' PROPOSED CONDITIONS DO NOT ADEQUATELY REMEDY THE COMPETITIVE HARMS THAT WOULD RESULT FROM THE MERGER

The Board has recognized that competitive harm results from a merger when the merging parties gain sufficient market power profitably to raise rates or reduce service.⁵⁸ In this proceeding, the evidence indicates that an unconditioned approval of the merger application would create unprecedented increases in market power and corresponding reductions in competition in hundreds of markets throughout the West, affecting an estimated \$6.25 billion worth of rail traffic per year.

Given the scope and magnitude of the harm, Applicants, not surprisingly, have proposed a remedy -- an agreement with BNSF granting it access to certain shippers in two-to-one markets through over 3,800 miles of trackage rights. Applicants' "fix" is wholly

57*****

⁵⁸Railroad Consolidation Procedures, 363 I.C.C. 784 (1981); *BN/SF* at 54-56.

inadequate to resolve the competitive problems of this merger.⁵⁹

It does not remedy, nor was it even intended to remedy, any of the three-to-two problems. Because BNSF is almost always the third competitor in such markets, any agreement with BNSF cannot, by definition, cure these competitive harms. Hundreds of markets throughout the West would be affected by the reduction in the number of competitors from three to two. Shippers of approximately \$4.75 billion worth of rail traffic per year (primarily intermodal, automotive, food, wood, iron and steel, and plastics products) would be put at risk due to this reduction in competition.⁶⁰

As for the shippers in two-to-one markets, the BNSF Agreement will do little to preserve existing competition. It excludes many shippers that would suffer a competitive loss from the merger. More importantly, trackage rights are inappropriate and inherently inferior to divestiture where the overlaps are extensive and the number of markets involved is vast.

A. The BNSF Agreement Does Not Provide Relief
For All Affected Two-to-One Shippers

The BNSF Agreement on its face is inadequate to eliminate or ameliorate the harmful effects of the proposed merger.⁶¹ Unlike the divestiture remedy for solving competitive problems, which automatically provides relief to every shipper with access to the divested line, this agreement falls far short of covering even all of the two-to-one

⁵⁹The Board must impose appropriate conditions to ameliorate these competitive harms or deny the merger if significant problems cannot be overcome by appropriate conditions. Conditions must eliminate or ameliorate the harmful competitive effects of the merger, must be operationally feasible, and must produce public benefits (i.e., reduction of possible harm) outweighing any merger benefits lost. *BN/SF* at 55-56. Where the adverse effects of a merger outweigh the expected benefits and the adverse effects cannot be effectively mitigated, the application must be denied. *SF/SP* at 807.

⁶⁰*Majure VS* at 29-32.

⁶¹The following discussion assumes that the BNSF Agreement is amended as contemplated by Applicants' settlement agreement with the Chemical Manufacturer's Association. *UP/SP*-219.

shippers. There is no remedy for shippers who are physically served by only one carrier, but are able to truck to the other; shippers who are not served by either railroad who can truck to both UP and SP; and shippers who could potentially reach another carrier through a build-out. The record in this proceeding contains numerous examples of railroad competition for such traffic.⁶² As former BNSF Chairman Gerald Grinstein recognized, companies able to access different railheads by truck "do have the benefit of some competitive pressures" and are sometimes "very successful" in playing railroads off against each other.⁶³

In a very few cases, the BNSF Agreement provides access to shippers who today have what Applicants deem to be a feasible build-out option. This narrow definition of build-outs warranting protection illustrates why the BNSF Agreement fails to provide competition to many shippers. Absent the merger, any UP or SP shipper able to get its traffic to the lines of the other carrier can take advantage of that competitive alternative, and a credible threat of doing so will constrain prices, without any need to prove the feasibility of the option to an arbitrator or regulatory body. Under the BNSF Agreement, this competitive constraint would be lost.⁶⁴ Furthermore, relief cannot be limited to those shippers with competitive options today: "Because consolidation is irrevocable, it is necessary...to define traffic or corridors that would lose competitive options not only at present but for the foreseeable future."⁶⁵

⁶²NITL-9, Crowley VS at 12-14, Exhs. TDC-3, TDC-4; UCC-6; DOW-23; CCRT-4.

⁶³Grinstein Tr. at 154-55.

⁶⁴Even under the CMA Agreement, shippers would have only one year to request arbitration of a build-out claim, after which that competitive option would be lost forever. CMA Agreement ¶ 13.

⁶⁵SF/SP at 813.

B. The Applicants' Proposal is Inadequate to Preserve Competition
Even for Those Shippers That are Covered

1. Trackage Rights Agreements are Inherently
Inferior to Structural Relief

Applicants' proposed solution to the massive competitive problems arising from the proposed transaction falls far short of preserving the pre-merger competitive balance, even for that fraction of the adversely affected traffic to which the trackage rights would apply. Trackage rights have inherent limitations that no amount of revision or fine-tuning can cure, and those limitations are fatal in cases such as this where the harm is so widespread. At a minimum, Applicants should be required to preserve current competition by selling major portions of the merged railroad's parallel track instead of relying on trackage rights.

A trackage rights tenant can never be put in the same position as an independent railroad. Landlord railroads inevitably have the incentive and opportunity to favor their own trains and to discriminate against competing tenants who operate trains over their track. In addition, there are inherent difficulties involved in providing the tenant with access to necessary facilities and in setting a compensation rate that will allow the tenant to compete.

Nonetheless, the Department has in the past found such a remedy acceptable where a merger raised relatively few or discrete competitive concerns, or where the competitive problems were confined to isolated areas, and divestiture was not a practicable remedy.⁶⁶ As a general proposition, properly structured trackage rights are

⁶⁶See, e.g., *UP/MKT* at 422 ("DOJ argues that the merger would result in significant competitive problems in a few, discrete markets, but that these competitive problems can be resolved through the imposition of certain trackage rights requests."). The Applicants incorrectly state that the Department supported privately negotiated trackage rights to cure the competitive problems raised by the proposed NS acquisition of Conrail. *UP/SP-230* at 105. The Department's position was that a divestiture plan could

most likely to be appropriate remedies in largely end-to-end mergers. In those situations, competitive solutions are required at the relatively few points where the merging railroads' lines overlap; the total amount of commerce at risk is relatively small; and trackage rights may be the most reasonable means of providing a new railroad with access to affected shippers without losing the efficiencies of end-to-end mergers.

The UP/SP merger represents the polar opposite of a merger in which it would be appropriate to rely upon trackage rights to restore lost competition. The Applicants propose the largest horizontal rail merger in history, and reflecting the scope of their extensive parallel and overlapping route structures, propose to protect competition by granting BNSF access to over 3,800 miles of their track -- far exceeding any trackage rights remedy ever proposed or approved in a rail merger. Thus, all of the problems inherent in fixing competitive harms with trackage rights are magnified to unacceptable proportions in this case.⁶⁷

In cases where there is no divestiture option, trackage rights may be the best competitive cure available. Although the Board will not know the full extent of interest here until it actually orders divestiture, four railroads have already come forward offering billions of dollars for SP track that runs parallel to UP track along the Central and Gulf Coast Corridors. None of the potential buyers appears to present a serious competitive concern, and, upon purchasing those lines, the new owners would operate under economic circumstances comparable to their UP/SP competitors on the parallel tracks (after sinking capital into the purchase of those lines, the new owners would establish prices based on their variable costs). Given these circumstances, the Board simply should not subject

include trackage rights, not that trackage rights were sufficient. The divestiture plan the Department reviewed included both line sales and trackage rights.

⁶⁷ See also NITL-9, Crowley VS at 29-30.

affected shippers to the inherent risks of a less than adequate remedy for the problems created by the merger. If the Board attempts to remedy the competitive harms through conditions, at a minimum it should require UP/SP to divest the overlap routes to railroads other than BNSF.

2. The Proposed BNSF Agreement Illustrates the
 Inherent Problems with Trackage Rights Remedies

To assess whether trackage rights restore competition, the Board examines whether the agreement gives the tenant railroad (in this case, BNSF) a realistic opportunity to operate over the rail lines under economic conditions comparable to the landlord's (UP/SP's) economic conditions.⁶⁸ The proposed trackage rights agreement with BNSF would not adequately restore the pre-merger competitive balance because it suffers from defects that are inherent in such agreements: it would place BNSF at an operational and economic disadvantage. Furthermore, giving trackage rights to BNSF, the only other remaining western Class I railroad, would exacerbate the competitive harms in the duopoly markets created by the merger.

Operational Problems. Unlike the divestiture solution to competitive problems, trackage rights arrangements give landlords control over their tenants' operations, and landlord railroads always have an incentive to "tilt the playing field" against tenants that are serving shippers located on the landlord's tracks. Every pound of freight that the tenant carries is one less pound for the landlord. Landlords also have an opportunity to discriminate against the tenant. Even with the most elaborate dispatching protocol and arbitration procedure, the landlord knows that, in most cases, a tenant will not institute arbitration until it encounters serious, systematic and longstanding discrimination --

⁶⁸UP/MP/WP at 590. See also A & M; PPU; Tahachapis; SSW Compensation.

especially if the only penalty is to cease discriminating against the tenant in the future.⁶⁹ UP/SP would have significant incentives to discriminate against BNSF when it operates as a tenant over UP/SP track.⁷⁰ Nothing in the CMA agreement will alter the incentives of UP/SP to disadvantage BNSF, nor is there any agreement that could.

Applicants argue, however, that the CMA agreement eliminates any opportunity for UP/SP to discriminate against BNSF.⁷¹ Although this agreement is a marginal improvement, it would still leave BNSF with significant competitive disabilities, including: BNSF's "severe service disability" in Houston as Mr. Grinstein acknowledged;⁷² BNSF's lack of access to switching and classification yards;⁷³ BNSF's lack of access to storage-in-transit facilities;⁷⁴ the relegation of BNSF to track of doubtful value in several areas;⁷⁵ and BNSF's lack of a sufficient traffic base to operate as efficiently as Applicants.⁷⁶

Operational problems of this nature are unavoidable in any trackage rights package covering almost 4,000 miles of track, and it is inevitable that additional problems would emerge after BNSF attempted to serve shippers over these lines. As Professor Levin testified in a previous case: "There is a substantial body of opinion...that the

⁶⁹See KCS-33, Vol.2, Swanson VS at 255 ("In my entire career as an operating officer of a major carrier, I have never met another operating officer or marketing officer who did not prefer ownership and control of trackage rather than an operating agreement.").

⁷⁰Majure VS at 23-25; *see also* Christensen VS at 19.

⁷¹UP/SP-230 at 16-17.

⁷²Grinstein Tr. at 161; *see also* BN/SF-1, Owen VS at 25; CR-21 at 56, 62-66.

⁷³CR-37 at 10, 11.

⁷⁴*Id.* at 11-12; SPI-16 at 7.

⁷⁵CR-37 at 7-10.

⁷⁶CR-37 *passim*; SPI-16 *passim*.

disadvantages of trackage rights multiply as their distance is increased.⁷⁷ Ultimately, operational problems would remain, not because of any shortcomings in the drafting abilities of rail executives or their lawyers, but because Applicants insist on using arrangements that are better suited to provide surgical remedies for discrete problems than to cure the widespread competitive problems created by a largely horizontal merger.

Moreover, shipper perception may be as crucial as the fine print of the BNSF trackage rights agreement, BNSF operating plans or draft dispatching protocols.⁷⁸ It is clear that an unprecedented number of shippers perceive that BNSF would not be able to use these trackage rights to compete effectively for their business.⁷⁹

Former BNSF Chairman Gerald Grinstein recently stated his perception of service over trackage rights. He called it service with some "disability."⁸⁰ When asked to put himself in the position of a shipper contemplating service by a railroad over trackage rights, Mr. Grinstein said that he would "need assurance from that carrier that you're going to be able to get a level of service that allows you, as a business owner, to be competitive in your relevant marketplace."⁸¹ He then indicated that a provision requiring the landlord to pay a penalty to the tenant if it failed to achieve stipulated service standards would be a

⁷⁷Exhibit 2.

⁷⁸See *Majure VS* at 23 ("even the perception by shippers that a trackage rights tenant provides (or might provide) inferior service will generally suffice to affect adversely the competitiveness of the market.").

⁷⁹*SPI-11* at 28-45; *NITL-9*, *Crowley VS* at 27-30; *IP-10*, *Prescott VS*, *McHugh VS* at 21-38; *CCRT-4* at 40-53; *DOW-23* at 22-25; *Com Refiners Ass'n Comments and Request for Conditions*, *Claussen VS* at 6-7; *Verified Statement of PPG Industries*, *Petrucelli VS* at 3-4.

⁸⁰"Can Drew Lewis Drive the Golden Nail?," *Forbes* at 64 (Dec. 18, 1995)(hereinafter *Forbes*), *WSC-11*, Exh. 6. See also *Grinstein Tr.* at 69 ("ownership is preferred to trackage rights, and if you own it...you can provide a better level of service").

⁸¹*Grinstein Tr.* at 151.

positive factor in providing those assurances. Or, he thought the tenant railroad could provide appropriate assurances by paying a penalty to the shipper if it failed to meet stipulated service standards.⁸²

Neither of these assurances (inadequate though they would be to save Applicants' flawed plan) is available to shippers that BNSF proposes to serve via UP/SP trackage rights. The trackage agreement does not contain a penalty clause. And, the record includes no assurances to shippers that BNSF will pay a penalty if it fails to meet reasonable service standards -- even though BN provided such assurances to shippers served over other trackage rights.⁸³ In short, BNSF's service via these trackage rights would fit the Grinstein definition of service with a disability.

Applicants have argued that criticisms of trackage rights service should be rejected because many carriers currently compete using routes that are at least in part over trackage rights.⁸⁴ Most of the trackage rights segments Applicants cite, however, are far shorter than those involved here (one notable exception being SP's Pueblo-Herrington route, on which SP has complained of service problems).⁸⁵ More to the point, competition is not eliminated when one carrier uses trackage rights; but competition is harmed and rates will likely be higher and service quality will likely be less than if two independent competitors were providing service. Both landlord and tenant, by cooperating instead of competing, may be very profitable in such markets.

Compensation Problems. With the divestiture solution to competitive problems,

⁸²*Id.* at 129, 152-53.

⁸³Grinstein Tr. at 153.

⁸⁴Rebensdorf Tr. at 170-72 (Jan. 22, 1996), 302-03 (Jan. 23, 1996), 743 (Feb. 12, 1996); Anschutz Tr. at 239-41, 256-57.

⁸⁵See KCS-33, Vol. 1, at 58-59.

compensation is not an issue. The merged railroad would sell the lines in question for whatever amount it could negotiate. With the trackage rights arrangements, however, trackage rights compensation becomes an important factor in determining whether the tenant would have a realistic opportunity to operate over the track under economic circumstances comparable to those of the UP/SP.⁸⁶ In this case, the compensation that BNSF would pay to UP/SP would be too high to permit BNSF to restore the pre-merger competitive balance.

The BNSF trackage rights agreement requires BNSF to pay UP/SP fees ranging from 3.0 to 3.48 mills per ton-mile. Converted to a cents per car-mile basis, those fees would range from approximately 26.4¢ to 30.6¢ per car-mile.⁸⁷ On a weighted average basis, those rates would cover between 171% and 199% of UP/SP's system average variable costs.⁸⁸ To put these fees into context, they are approximately 32% to 52% higher than the 20¢ per car-mile fee for the Superior-Abilene trackage rights that UP acquired in the BN/SF merger⁸⁹ (and, more than six months after UP obtained those trackage rights, it appears that it has not yet moved its first train over that stretch of BNSF track).⁹⁰

The landlord, like any rational railroad, sets a price floor for its freight rates at its

⁸⁶UP/MP/WP at 590.

⁸⁷The car mile rate equivalents are shown as 24¢ to 25¢ in Mr. Rebensdorf's Verified Statement (Table 2, p. 306). But, as noted by Mr. Kauders at page 165-67 of his deposition transcript, Mr. Rebensdorf's conversion erroneously omitted locomotive weight. When that factor is included in the conversion, the 24¢ and 25¢ figures are increased by a little over 10% -- to 26.4¢ and 27.5¢, respectively. The 3.48 mills per ton mile figure converts to 30.6¢ per car mile.

⁸⁸Rebensdorf VS at 304-06, as corrected.

⁸⁹These fees are also higher than the fees under a number of other UP and SP trackage rights agreements. See NITL-9, Crowley VS at 74-75.

⁹⁰Majure VS at 27; BN/SF-55, Vol. II, Kalt VS at 9-10.

variable cost of providing the service.⁹¹ For the landlord (UP/SP), the "below-the-wheel" component of that total variable cost is its variable costs for maintaining its track; for the tenant (BNSF), its corresponding variable cost is its trackage rights fee. The trackage rights fees that BNSF would pay under this agreement are 71% to 99% higher than UP/SP's variable trackage costs -- and BNSF's price floor would have to be raised accordingly. As a result, the competitive balance could be altered in several ways: BNSF might not be able to compete for some traffic moving at relatively low rates; BNSF would be less likely to divert scarce resources to shippers served by trackage rights; and both carriers might raise post-merger prices to levels at or above BNSF's higher price floor.⁹²

Applicants argue that they deserve to recover some (or perhaps all) of the fixed costs that they sunk into building the trackage rights rail lines -- including the cost of acquiring rights of way, building the roadbed and constructing the track. If the Board concurs with this view, it can still preserve the current competitor's cost structure by requiring the tenant to pay a fixed fee in addition to a variable trackage rights fee.⁹³ Under that system, the tenant would, like the competitor it is intended to replicate, have incurred sunk costs related to the construction of the track in question that it would attempt to recover by carrying traffic at rates that covered its variable costs and contributed to its fixed costs.

Applicants and BNSF propose more lenient tests for preserving competition through trackage rights. They argue that it should be sufficient if BNSF's total variable costs, including the trackage fees that it would pay UP/SP, are less than SP's total variable costs

⁹¹Ice Tr. at 222-26 (Feb. 14, 1996).

⁹²Evidence in the record indicates that BNSF's bids to shippers that it would serve through these trackage rights have been significantly higher than the rates currently charged by SP. Majure VS at 22.

⁹³See Majure VS at 19-22 for a discussion of how such a system could work.

-- or under an even easier test, if BNSF's total variable costs are less than SP's current rates.⁹⁴

Applicants' and BNSF's focus on SP's total variable costs or rates is misplaced. They cite no ICC authority for comparing the total variable costs of the landlord and tenant to determine whether the trackage rights compensation is too high. In fact, there is no such support for their novel theory, because the ICC consistently (and properly) focused its attention on trackage rights compensation in determining whether the tenant would have a realistic opportunity to compete.⁹⁵

In effect, Applicants and BNSF argue that the Board may impose a tax -- in the form of higher trackage rights fees than necessary to reimburse the landlord for its trackage costs -- on any replacement railroad whose current operating costs are lower than SP's current operating costs. This approach does not put BNSF in the same position as SP is today because it places a permanent limit on the efficiency gains the tenant's customers can realize under true competition.

The entire thrust of the ICC's post-Staggers Act decisions, however, has been to encourage competition as a process that forces carriers to lower operating costs and pass the savings on to consumers. While SP could have lowered its current operating costs, the agreement would lock in BNSF's relative below-the-wheel cost disadvantage.⁹⁶ The ICC has been careful to avoid imposing rate minimums or caps (which would be the

⁹⁴Kalt RVS at 41-44, 48; Rebensdorf Tr. at 451-60 (Jan. 23, 1996); 790-92 (Mar. 20, 1996). Even if either of these theories were valid, it appears that Applicants and BNSF have used flawed methodologies to estimate BNSF's costs. NITL-9, Crowley VS at 40-79.

⁹⁵A tenant with the same total variable costs as the SP would not necessarily compete like the SP. There is evidence in this case that SP's rates are substantially less than other railroads with equal costs. Majure VS at 36 n.37.

⁹⁶The adjustment factor in the compensation provision at best would keep the UP/SP advantage from growing in the future.

indirect effect of equalizing landlord and tenant variable costs) or other forms of regulatory controls (unless needed to protect shippers from insufficient competition), and the Board should reject these regulatory tests here.⁹⁷ Instead, it should require that any trackage rights compensation cover the appropriate trackage costs, but no more than this amount; and let competition between the landlord and tenant determine which is better at reducing costs and prices, improving service or otherwise doing whatever it takes to induce shippers to buy their services.

Duopolist Tenant. The BNSF Agreement presents the unique situation of a merging carrier giving massive trackage rights to a railroad that would be its only remaining competitor in most of the markets it serves. The agreement (together with the trackage rights granted in the BNSF merger) thus would place the duopolists in a landlord/tenant relationship over vast parts of their systems and significantly increase the number of markets where they come into contact. This will inevitably increase the amount of information that the merged UPSP and BNSF gain about each other. In addition, it will give each railroad increased opportunity to retaliate if the other takes traffic or lowers rates elsewhere. As explained in Part III above, this market structure is conducive to tacit collusion and is likely to result in increased rates.

C. The Board Should Not Rely on Oversight Provisions to
 Ensure that the BNSF Agreement is Effective

Applicants' settlement with CMA raises the suggestion that the Board should accept the BNSF Agreement as an adequate remedy, subject to annual oversight proceedings for five years.⁹⁸ The Board should reject any proposal for regulatory supervision of the

⁹⁷Applicants' rule is particularly inappropriate since SP is more likely than most railroads to significantly lower its operating costs in the future.

⁹⁸CMA Settlement Agreement ¶ 14; see also UP/SP-230 at 21.

trackage rights agreement.

First, the Board is required to make a finding that an application, as approved, is in the public interest, and is "not authorized to approve a consolidation based on the prospect of its being made consistent with the public interest at some time in the future."⁹⁹

Second, the oversight proposal flies in the face of the Board's mandate to rely on competitive market solutions to the maximum extent possible. By denying the application or conditioning approval on divestiture, the Board can preserve an independent competitor in the affected markets without any need of further regulatory intervention. Oversight, in contrast, will inevitably draw the Board into detailed review of claims about rates and service -- the very business from which Congress directed the Board to withdraw by enacting the Staggers Act. In addition, the effective structural solutions that are available to the Board today will disappear forever (as assets become entangled) if the Board accepts the BNSF Agreement and allows the proposed merger to proceed.

V. SP'S FINANCIAL CONDITION

A. SP Is Neither a "Failing Firm" Nor a "Weakened Competitor"

The Applicants have introduced the issue of SP's financial condition into this proceeding, although they are not raising the failing firm defense or even a "weakened competitor" defense. Their reasons for not making either claim are clear: they could not satisfy the standards established by the ICC in past decisions for either defense. SP is not a failing firm, not only because it has not conducted a shop for less anticompetitive alternatives to UP, but because its own witnesses have testified that, absent the merger, SP will continue to operate.¹⁰⁰ A weakened competitor claim would be equally flawed.¹⁰¹

⁹⁹*SF/SP* at 817, citing *Baltimore & Ohio R.R. Co. v. United States*, 386 U.S. 372 (1967).

¹⁰⁰See, e.g., *UP/SP-231*, Davis RVS at 16. SP claimed it was a failing firm in *SF/SP* before the ICC in the 1980s. The ICC rejected that claim, finding that SP did not face a "clear probability of business

Instead the Applicants have put forth the curious argument that improvement of SP's financial condition (and its service) is a public benefit of the UP/SP merger. Since most mergers presumably have the purpose of financially strengthening the companies, this standard would mean that virtually every merger would be in the public interest. Applicants are, in effect, asking the Board to expand the failing firm defense far beyond the boundaries established by case law and ICC precedent. Under the Applicants' worst case scenario, SP would reorganize and downsize,¹⁰² a prospect that the ICC has recognized invalidates a failing firm claim.¹⁰³ Moreover, the Applicants' testimony on SP's

failure" and further that SP had not "asserted that there was a good-faith effort made by [SP] to find a less anticompetitive merger partner or purchaser, nor was any evidence presented that [SP] would have no prospect of successful reorganization should it become insolvent." *SF/SP* at 827-831. SP's continued operation 10 years after that decision was rendered has proven the correctness of the ICC's conclusion.

¹⁰¹The ICC in *SF/SP* viewed a weakened competitor claim with skepticism. It stated that the cases cited by SP stand for the "proposition that financial weakness may make a merger of less competitive concern when the market is already competitive and moving away from concentration." *SF/SP* at 832-833. That situation did not apply to SP's merger then, nor does it now. In any event, given the concentrated nature of the markets affected by this merger, a weakened competitor claim is irrelevant unless the Applicants can show that SP's market share should be discounted to near zero. See, e.g., *FTC v. University Health*, 938 F.2d 1206, 1221 (11th Cir. 1991) ("[W]e will credit [a weak company] defense only in rare cases, when the defendant makes a substantial showing that the acquired firm's weakness, which cannot be resolved by any competitive means, would cause that firm's market share to reduce to a level that would undermine the government's prima facie case."); *Kaiser Aluminum & Chemical Corp. v. FTC*, 652 F.2d 1324, 1338 (7th Cir. 1981) ("Financial weakness, while perhaps relevant in some cases, is probably the weakest ground of all for justifying a merger.") Applicants have not even attempted to make such a showing. They have made a quasi-weakened competitor claim by arguing that SP will not be an effective competitor against BNSF. That claim is discussed in greater detail below.

¹⁰² See e.g., *Davis RVS* at 16.

¹⁰³The ICC pointed out in *SF/SP* that an element of a failing firm claim was that the business would fail and could not be successfully reorganized. *SF/SP* at 831. In another railroad case, the ICC stated that the failing firm doctrine means that "without the consolidation the failing firm's assets will exit the market...." *Rio Grande* at 978. In a 1988 case finding that Trailways was a failing firm, the ICC pointed out that Trailways "had attempted to continue an operation by abandoning routes and by selling or mortgaging unencumbered property to support its remaining operations." *Trailways* at 604. These efforts, as well as efforts to obtain additional financing, had all failed. As a result the Department concluded that Trailways satisfied the failing firm defense, and the ICC found that Trailways would have liquidated absent the merger. *Trailways* at 602-06. SP has made no claims like those the ICC found determinative on the failing company issue in *Rio Grande* or *Trailways*. On the contrary, SP has specifically said its business would continue.

need to downsize is speculative, since SP states that it has not studied the issue and has prepared no plans for its future absent a merger with UP.¹⁰⁴

B. SP Is a Viable and Significant Competitor

The evidence shows that SP is a viable company and a significant competitor.¹⁰⁵ In the last three years SP has invested almost \$2 billion in its operations, generating the funds for these investments from cash flow from operations, stock sales, debt, and real estate.¹⁰⁶ SP spent almost \$1 billion in 1995 alone on capital improvements, purchasing locomotives and freight cars,¹⁰⁷ SP has shown some improvement as a result of these investments, but, as DOJ witness Eileen Zimmer testified, "[f]or a heavily capitalized mature industry and company, significant

¹⁰⁴ "We have not created a detailed restructuring plan...." Davis RVS at 18: SP "has not done specific planning or set in place specific tactics for...downsizing...." UP/SP-231, Gray RVS at 26. ***

.....

Mr. Gray's testimony includes some surprising statements which suggest that SP does not currently try to maximize profits. He stated that the "downsized" SP "would increase carload prices to levels just below those of relevant highway, intermodal, rail transload, and water competitors, consistent with product and source competition, for business exclusively served by SP." He also testified that in pricing for carload business to gateways, "[c]ost saving and revenue maximization would be the objective." Gray RVS at 28-29.

.....

¹⁰⁵ SP's financial condition has been troubled since it was placed in trust in 1983. As the ICC recognized in *SF/SP*, "we have no illusions that [SP] is a marginal railroad, and has been for some years." *SF/SP* at 833. Now, ten years later, SP continues to have financial problems, which the merger would likely eliminate, just as a merger with Santa Fe would have in 1986. However, the ICC recognized that the improvement of SP was not a sufficient justification for the anticompetitive merger with Santa Fe since SP was not a failing firm, and that excuse is not a justification for the UP/SP merger.

¹⁰⁶ SP 1995 10K, at 8, 256 (Exhibit 3).

¹⁰⁷

improvements are achieved over a long period of time."¹⁰⁸ In three of the last five years, SP has generated positive cash flow.¹⁰⁹ SP operations improved dramatically in 1994 (net income had also been positive in 1992), and net income would have been positive in 1995, absent merger-related expenses of \$8 million and a special restructuring charge of \$64.6 million.¹¹⁰ Even though SP has been distracted by the merger, SP is the only western railroad that increased revenues and carloads in the first quarter of 1996.¹¹¹ SP's operating ratio has improved since 1991.¹¹²

While no one would deny that SP has service problems, the Applicants suggest that its effectiveness as a competitor should be completely discounted. This implausible assertion is directly contradicted by (1) statements submitted to the Board by shippers in this proceeding, (2) the Applicants' documents, and (3) SP's market share. Many shippers regard SP as a significant competitor whose presence in the market has restrained the prices of other railroads -- notably UP -- and whose independence should be protected by the Board. For example,

- "SP has...been a vigorous and effective competitor for traffic moving to California destinations...." Comments of Formosa Plastics Corporation, USA, FPC-1 at 2-3.
- "Southern Pacific Railroad is the most competitive railroad in the movement of West Coast Freight." Letter of Hunter Transportation Co. included with

¹⁰⁸DOJ-8, Zimmer VS at 14; see also Anschutz Tr. at 131. Michael Ongerth, SP's vice president of strategic planning, testified that SP's service is getting better. King and Ongerth Tr. at 673. See also, Zimmer VS at 9 n.19; *Traffic World*, February 19, 1996, pp. 20-22 (Exhibit 4).

¹⁰⁹SP 1995 10K at 256 (Exhibit 3).

¹¹⁰Zimmer VS at 4.

¹¹¹BNSF's revenues were flat (although its profits increased due to cost cutting), and UP's revenues and profits declined. See 10 Qs for the first quarter of 1996 for SP (pp. 9-10), BNSF (pp. 3), and UP (p. 13)(Exhibits 5-7).

¹¹²Zimmer VS at 7-8.

CCRT-4 at 9-10.

- "Our experience has shown the Southern Pacific presence [in the Sacramento, Cal., Kansas City, Ks., St. Louis, Mo., Texas Gulf areas] has helped maintain a competitive price structure." Letter of Proctor & Gamble to the Board. (Exhibit 1)
- SP's service in the southwest has generally been superior to UP's. "... SP is the price leader [for outbound printing paper and pulpboard shipments traveling long distances] and, by its very existence as a vigorous competitor, has acted to constrain UP's pricing." VS of McHugh, International Paper-10 ay 10, 39. Mr. McHugh went on to state that International Paper had shifted business for shipments from its Pine Bluff mill to UP and away from SP in 1994 because SP's reliability in 1993 had been poorer. When SP improved its transit reliability in 1994, while UP's declined, International Paper awarded SP the bulk of the mill's shipments in 1995. Id. at 17.
- Another example of SP's competitiveness is its taconite ore/coal arrangement involving Geneva Steel. The ability to use cars that would otherwise return empty to the taconite ore mines to carry coal enabled SP to undercut UP on its price quote for a taconite shipper and coal receivers. With the merger, SP will no longer be around to shake up the marketplace with bold moves like this one.¹¹³

The Applicants' documents reflect SP's competitive efforts as well:

- *****

- *****

- *****

¹¹³ See WSC-11 at 4-5.

..... 114 If the SP merges with UP, the benefits from such efforts would be lost forever. 115

C. SP Will Continue To Be a Viable and Significant Competitor

The merger with UP would eliminate the competitive pressure that SP has brought to bear to the benefit of shippers. The vigorous opposition to the merger by many shippers in this proceeding is a testament to the value they place upon SP, now and in the future, and to their belief that absent the merger SP would continue to be an effective, pro-competitive force. Other evidence in the record supports their view. Eileen Zimmer analyzed projections for SP

..... 116 Based on this analysis, Ms. Zimmer concluded that SP can likely generate sufficient cash flow to support currently budgeted annual capital expenditures of \$..... 117 Railroad operations would be augmented by real estate sales of \$..... a year, with additional

114.....
.....
.....
.....
.....

115 SP's merger agreement with UP prohibits SP from making operational changes, including incurring additional debt above specified levels. SP 1995 10K at 258 (Exhibit 3); Merger Agreement, UP/SP-28 at 58-62. As a result, SP cannot make changes while the Application is pending that could improve the railroad's operations.

..... See Zimmer VS at 14-15. As noted above, this merger-imposed limbo argues for disapproval of the Application.

116 UP's investment bankers relied on in advising UP's shareholders and board of directors about the fairness of UP's offer for SP. Month Tr. at 104-105.

117 made by Salomon Brothers Fourth Quarter Railroad Review and Outlook, February, 1996 at 12 (Exhibit 11 at 63).

sales of \$***** 118 *****

***** 119

SP claims that it needs to invest an additional \$1 billion over the next four years,

*****¹²⁰ While there is no doubt that SP, like any corporation, would like to have another \$1 billion to invest, there is no evidence that SP needs to invest this much to continue as an effective competitor. Indeed, if SP received a \$1 billion windfall it is not clear SP would invest it rather than increase distribution to its shareholders. But if SP chooses to invest, SP can finance some additional debt through cash flow, equipment financing, and real estate sales.¹²¹ SP could also sell low density lines. Finally, SP could seek another merger partner or sell part of its system to one of the eager suitors who are participating in this proceeding.¹²² That acquiring company could then use the SP assets to continue offering strong competition against UP and BNSF.

SP has claimed that it does not have access to the capital markets because of its junk bond rating and breach of a senior note covenant. However, SF has been able to

118*****

¹¹⁹SP has suggested that if the merger is not approved, it might stop using proceeds from real estate sales to help support the railroad operations or service the railroad debt. Davis RVS at 14; UP/SP-251, Yarberry RVS at 12-13. DRGW was quite willing to have the ICC count SP's real estate in evaluating its proposal to acquire SP in 1988, and the ICC did so over the objections of some parties. DRGW/SP at 543, 938-943).

120*****

***** While additional investment will likely be needed, there is no evidence that the amount needed is anywhere near the \$1 billion SP claims to need. Mr. Gray testified that no one has disputed that SP needs to make capital investments. Gray RVS at 23. What has been challenged is SP's claim that it needs to invest \$1 billion.

¹²¹Zimmer VS at 11-13.

¹²²Zimmer VS at 17.

fund substantial capital expenditures in the past (e.g. almost \$1 billion in 1995) and ***

***** 123 *****

***** 124 *****

The Applicants (and the California Attorney General) introduced rebuttal testimony in support of SP's claim that absent the merger SP cannot continue to operate without reorganizing or downsizing. Given the ICC's standards for the failing firm defense and weakened competitor claim, the relevance of this testimony is questionable. Even as support for the proposition that SP cannot continue to operate as it does now, the testimony is flawed. For example,

- Mr. Scheffman uses a variety of questionable assumptions to predict SP's financial future, based on the company's 1995 10K which contains no projections. He assumes that SP will have to invest \$1.3 billion (increasing even SP's estimate by one-third) and ignores the positive impact on SP's operating income that each improvement will have.
- Mr. Yarberry extrapolates projections based on SP's 1996 Business Plan, which was prepared after the merger application was filed at the ICC. He continues to assume that SP will have to invest \$1 billion, although he presents no additional evidence of the estimate's validity. Nor does he take into consideration the positive impact that each improvement would have on SP's operations.
- Mr. Levitin, on behalf of the California Attorney General, states that there is a 21% chance that SP will default on its bonds. He bases that statement on SP's 1990 bond rating of "B," ignoring SP's improved bond rating of the last few years to "BB." According to Mr. Levitin's source, companies like SP with a "BB" rating have a default rate of only 9%. Further, Mr. Levitin ignores analysts reports included in his workpapers, such as Salomon Brothers dated February 1996, which attributes the lower-than-expected earnings to

123*****

124*****

"[d]eteriorating employee morale due to the pending merger negotiations with Union Pacific...."¹²⁵

Even if the testimony of SP's witnesses were convincing, all it shows is that, at worst, SP may have to consider downsizing. Since SP has not studied the issue nor prepared plans for such an eventuality, it is pure speculation for the Applicants to argue that such downsizing will adversely affect competition. Even if SP does downsize and withdraws from some competitive markets, it will be free to re-enter those markets when it is financially stronger and that ability to re-enter will preserve the potential for future competition. Approval of the merger will eliminate that potential permanently.¹²⁶

D. The BNSF Merger Does Not Put SP's Financial Condition At Greater Risk

The Applicants have portrayed BNSF as a goliath against whom SP will likely falter. Their argument is not supported by the record. If BNSF were as formidable as the Applicants contend, KCS, MRL, IC, and Conrail would not be lined up at the Board's door as ready suitors seeking parts of the SP system. Competition against BNSF with the SP rail system does not appear to be a forbidding future to them. This market test of the salability of SP lines is the greatest indicator that SP can compete against BNSF.

Moreover, SP has been a little too quick to declare itself in trouble by a future of competing against BNSF. The Application in this case was filed a mere two months after the ICC approved the BNSF merger, and work on the Application had presumably been

¹²⁵Salomon Brothers Fourth-Quarter Railroad Review and 1996 Outlook, Feb. 1996 at 58 (Exhibit 11).

¹²⁶One curious aspect of SP's downsizing strategy is that it simultaneously states that it may have to stop using the Central Corridor, while it is adamant that it will not sell the Central Corridor. Davis RVS at 15-16; Gray RVS at 32-33; SP is willing to consider leasing parts of the Central Corridor but insists that it would harm shareholder value to sell a line because the remaining system would not be profitable. Yarberry RVS at 46. But how could the sale of the Central Corridor harm SP's profitability if it does not plan to use it? Perhaps SP is so loath to sell the Central Corridor because it knows that its "downsizing" would be temporary and it would re-enter any markets it exited.

going on for some time before it was filed. And yet, SP was already convinced that its future was grim. This claim is self-serving on SP's part and should be viewed with suspicion by the Board, especially in light of the apparent attractiveness of the SP system to other, less anticompetitive prospective buyers.¹²⁷

E. SP's Financial Condition Does Not Justify the UP/SP Merger

The Applicants' use of SP's financial condition in this case is simply a red herring. The ICC did not permit an anticompetitive merger with Santa Fe when SP incorrectly claimed to be failing, and the Board should not permit this anticompetitive merger when the Applicants' testimony on its face proves that SP is a viable company. SP is a viable and significant competitor now, and the record shows that, absent the merger with UP, SP will continue to be a viable and significant competitor.

VI. THE EFFICIENCIES RESULTING FROM THIS MERGER WOULD NOT OUTWEIGH THE MASSIVE COMPETITIVE HARMS

Applicants have not sustained their burden of proving that there are "substantial and demonstrable benefits to the transaction"¹²⁸ that outweigh the far-reaching competitive harms described above.¹²⁹ In BN/SF, the ICC defined public benefits as efficiency gains that permit a railroad to provide the same level of service with fewer resources, or a

¹²⁷Interestingly, BNSF revenues have remained flat since BN and SF merged last September. Profitability has improved because of cost cutting, but not from revenue growth. The Applicants have boldly stated that the BNSF merger may even place UP's continued viability in jeopardy. Anschutz VS at 183; Davis RVS at 5. The Applicants are essentially saying that the efficiencies created by the BNSF merger have doomed every other railroad in its service area.

¹²⁸49 C.F.R. § 1180.1(a).

¹²⁹The Administrative Procedures Act places the burden of proof on the proponent of an order. 5 U.S.C. § 556(d); see also FTC v. University Health, Inc., 938 F.2d 1206, 1222-23 (11th Cir. 1991) (burden of proving efficiencies is on merging parties).

greater level of rail services with the same resources.¹³⁰ But, not all efficiency gains are public benefits. ICC precedent, the Board's regulations and economic principle all recognize that:

- public benefits are only those benefits "that will result from the transaction;"¹³¹
- public benefits do not include purely private benefits to the merged carriers;¹³²
- public benefits do not include benefits that "could be realized by means other than the proposed consolidation that would result in less potential harm to the public."¹³³

Applicants' efficiency claims do not withstand scrutiny under these standards.

A. Applicants Improperly Claim Cost Savings From Industry Productivity Gains as Merger-Related Benefits

The Board's public interest determination includes consideration of the public benefits "that will result from the transaction."¹³⁴ The railroad industry has achieved impressive productivity growth in the post-Staggers Act era. Using conservative projections of industry trends -- continuation of the industry's 5.9% annual productivity growth over the 1989-1994 time frame for the next five years¹³⁵ -- Applicants would achieve cost savings of approximately \$564 million in the normal post-merger year merely

¹³⁰ *BN/SF* at 51. See also *CSX Control* at 551-52; *UP/MP/WP* at 487-89; *UP/MKT* at 428-29; *DRGW/SP* at 875; *SF/SP* at 725.

¹³¹ *BN/SF* at 51.

¹³² *Id.* In *CSX Control*, the Commission presumed that every proposed consolidation would provide private benefits for the involved parties. But, it carefully distinguished three types of private benefits: (a) private benefits that are also public benefits (such as cost reductions and service improvements); (b) private benefits that are neutral from a public point of view (such as most traffic diversions); and (c) private gains that are public losses (such as increased profits resulting from a reduction in competition). 363 ICC at 551-52.

¹³³ 49 CFR § 1180.1(c).

¹³⁴ *BN/SF* at 51.

¹³⁵ *DCJ-8*, Christensen VS at 8, 9; Christensen Tr. at 85-89, 159-62.

by keeping pace with projected productivity gains for the industry.¹³⁶ This accounts for 75% of the \$751 million cost savings projected by Applicants.

Applicants argue that the Board should disregard the 1989-1994 rail industry productivity trends, because that period includes productivity gains by railroads from mergers approved before 1989, but still implemented during the 1989-1994 time frame. But, an impressive body of empirical research and economic literature demonstrates that the vast majority of all recent cost-savings in the railroad industry resulted from competition, not mergers.¹³⁷ In fact, Applicants' own witness, Mr. Salzman, admitted that post-Staggers Act competition has been a major factor in forcing railroads to improve their efficiency.¹³⁸ Moreover, even if the 1989-1994 rail industry data includes productivity gains achieved by merging railroads, Applicants cannot deny that deregulation has also produced significant cost savings. Even assuming mergers account for half of the industry

¹³⁶Applicants' pro forma income statement for the UP/SPR normal year projects \$9.56 billion in revenue (Pro Forma Income Statements Exh. 17; Appendix C; Vol. 1, Merger Application, p. 143). By matching the 5.9% productivity growth projected for the railroad industry, UP/SP's costs would decrease by \$563,915,097 without the merger.

¹³⁷Dr. Christensen -- one of the first economists to study the issue -- presented a paper to the Econometric Society in 1983, reporting on the lack of any support in the data for railroad claims of merger-related efficiencies. "Estimating the Cost Savings from Rail Mergers." Professor Velluro and his colleagues subsequently published an article in an economics journal, reporting on the results of their research indicating that there were no significant differences in productivity growth between merged railroads and railroads that had not been involved in mergers. Christopher A. Velluro, Ernst R. Berndt, Ann F. Friedlaender, Judy S.W. Chiang and Mark H. Showalter, "Deregulation, Mergers, and Cost Savings in Class 1 U.S. Railroads, 1974-1986, *Journal of Economics & Management Strategy*, Volume 1, No. 2, Summer 1992, pp. 339-69. In 1993, an article by Professor Berndt and his colleagues concluded that post-Staggers Act deregulation and the competitive forces that it unleashed accounted for 90% of cost reductions in the rail industry -- and mergers for about 9%. Berndt, E.R., Ann F. Friedlaender, Judy S.W. Chiang, Christopher A. Velluro, "Cost Effects of Mergers and Deregulation in the U.S. Rail Industry," *Journal of Productivity Analysis*, Vol. 4, 1993, pp. 127-44. The Banks Report to the Ontario Ministry of Transportation concluded that: "larger [U.S. rail] mergers generally failed to realize their promised efficiencies. . . . Rationalization of physical plant and staff reductions did not meet forecasts and slowed in comparison with other railways." R.L. Banks & Associates, Inc./KPMG Management Consulting, *Railway Merger Initiatives: The U.S. Experience, A Report to the Ontario Ministry of Transportation*, March 1995, at 82.

¹³⁸Draper/Salzman Tr. at 183-87.

productivity trend, Applicants' merger benefit claims must still be reduced substantially.

B. Applicants Improperly Count Benefits that Are Purely Private

Applicants attempt to include a significant number of purely private benefits in their calculation of merger benefits.

- Applicants seek to include \$76 million in projected net revenue gains from traffic diversions in their calculation of merger-related public benefits.¹³⁹ But Applicants have failed to demonstrate how much (if any) of the estimated diversions result from projected UP/SP service improvements or cost reductions; and it is unlikely that they would achieve significant merger-related cost reductions since they project an operating ratio in the first normal year after the merger (1999) that is somewhat higher than the projected railroad industry operating ratio.¹⁴⁰
- Applicants also claim their projected receipt of \$***** in net trackage rights fees from BNSF as a merger-related public benefit. This merely represents a transfer from BNSF to UP/SP resulting from the grant of trackage rights to BNSF to preserve the competitive status quo.¹⁴¹
- A portion of Applicants' labor efficiency claims may also include purely private, rather than public, gains. Some of the reductions in labor will result from inferior service, instead of more efficient use of labor. For example, if UP and SP each had a sales executive handling a particular shipper's account before the merger, the consolidated railroad might eliminate one of those positions. But, since a portion of any sales executive's duties include making sure that any problems with the customer's shipments are brought to the attention of operating personnel, one sales executive will have less time to devote to those activities than two. Moreover, if BNSF competes for new traffic over trackage rights obtained from UP/SP, it will have to hire more

¹³⁹The test for extracting any public benefits from diversions is set out in *UP/CNW*: "Neutral revenue transfers from other railroads...are not public benefits; only the service improvements and cost savings associated with traffic diversions can be counted as public benefits." *UP/CNW* at 61.

¹⁴⁰*Christensen VS* at 28. In addition, Applicants fail to take into account diversion that UP and SP could accomplish through voluntary means of cooperation short of the merger. *Id.* at 29.

¹⁴¹As with many of Applicants' public benefit claims, this claim suffers from multiple defects. If UP/SP's receipt of trackage rights compensation from BNSF were a true public benefit, this would be a benefit that it could gain through a voluntary commercial agreement with BNSF in which it sold trackage rights to that railroad.

workers.¹⁴² To the extent that this offsetting firing and hiring occurs, UP/SP would realize a private gain by eliminating positions; but there would be no net reduction in the labor required to deliver rail services -- and no public gain.¹⁴³

C. Applicants Improperly Claim Benefits that Could Be Achieved By Less Anticompetitive Means

Applicants argue that by combining UP and SP rail lines, the consolidated railroad could achieve significant operating efficiencies. While that may be true, Applicants have the burden of demonstrating that they could not achieve these benefits through less anticompetitive means, such as voluntary forms of cooperation.¹⁴⁴

Applicants chose to avoid that burden, instead of surmounting it. UP did not even consider exploring the possibility of increasing operating efficiency by entering into a trackage rights agreement with SP or other forms of voluntary cooperation short of a merger.¹⁴⁵ Instead, UP asserts that such discussions would have been a "non-starter," and now "argues by assertion" that it could not obtain any portion of the estimated \$**
***** annual savings in operating efficiencies by less anticompetitive means of cooperation with SP.¹⁴⁶ The record shows, however, that trackage rights agreements and other voluntary cooperative arrangements are common in the railroad industry;¹⁴⁷ that

¹⁴²Ice Tr. at 518-19. See also Peterson Tr. at 620-22 (Feb. 7, 1996); Draper/Salzman Tr. at 64-67; Rebensdorf Tr. at 272-74 (Feb. 22, 1996); Christensen Tr. at 107-09.

¹⁴³Christensen VS at 12, 13.

¹⁴⁴5 U.S.C. § 556(d).

¹⁴⁵Rebensdorf Tr. at 56-60, 119-21, 141-42 (Jan. 22, 1996), 731-35 (Feb. 12, 1996).

¹⁴⁶Rebensdorf Tr. at 58-60, 119-21 (Jan. 22, 1996), 731-35 (Feb. 12, 1996); Christensen VS at 20.

¹⁴⁷When they discuss BNSF's ability to operate efficiently over track subject to the UP/SP-BNSF trackage rights agreement, Applicants wholeheartedly agree with this point. See, e.g., UP/SP-232, Vol. 3, King RVS at 9-10 (SF became the leading Chicago-Northern California carrier using trackage rights obtained from SP and the leading North Texas-California carrier using trackage rights obtained from UP), 17-25 (operation of directional trains possible through trackage rights); Rebensdorf VS at 170-72.

eminent railroad executives such as Mr. Grinstein believe that the future of the industry lies in more voluntary cooperation;¹⁴⁸ and that as competitive pressures increase, railroads will be forced to increase operating efficiencies through new and creative means of voluntary cooperation.¹⁴⁹

Applicants maintain persistently that while the BNSF trackage rights are a complete solution to all competitive problems, none of the merger's benefits could possibly be achieved through such arrangements.¹⁵⁰ In so doing, they turn economic principle (and common sense) on its head. In contrast, DOJ witnesses Christensen and Majure rely on widely accepted economic principle -- commercial incentives to cooperate are much greater when both parties can gain substantial financial benefits through cooperation (such as a UP/SP trackage rights agreement that would permit each to operate over shorter and more efficient routes) than they are when one party would gain virtually all of the benefits and the other would bear virtually all of the costs (such as the trackage agreement that purportedly allows BNSF, UP's most frequent competitor, to divert \$*** ***** in traffic from UP/SP by operating over its track). Applicants' arguments to the contrary are undercut by their own witnesses who point to numerous examples of successful trackage rights agreements,¹⁵¹ by Gerald Grinstein who says that "the future of the industry" is in "more coordination of information systems, dispatching and traffic",¹⁵²

Applicants' own witnesses thus show that not all of the claimed efficiencies require merger.

¹⁴⁸*Forbes* at 64, WSC-11, Exh. 6.

¹⁴⁹Christensen Tr. at 58-60.

¹⁵⁰UP/SP-230 at 61-63; King/Ongerth VS at 9-16; Ongerth RVS at 2-17; Peterson RVS at 8-10.

¹⁵¹Rebensdorf Tr. at 170-72 (Jan. 22, 1996), 302-03 (Jan. 23, 1996), 743 (Feb. 12, 1996); Anschutz Tr. at 239-41, 256-57.

¹⁵²*Forbes* at 64.

and by 15 years of experience with the Staggers Act's substitution of competition and voluntary cooperation for regulation.

With this record, the Board has no basis for distinguishing between any operating efficiencies that could be obtained only by merging and the efficiencies that could be obtained by less anticompetitive means. Under these circumstances, Applicants have failed to demonstrate that all, or any specific portion, of the projected \$73 million in operating efficiencies is merger-related.¹⁵³ Since the burden of proving all of the public benefits of the merger is on Applicants, the Board cannot assume that any public benefits would result from operating efficiencies that could not be obtained by voluntary means of cooperation short of a merger.¹⁵⁴

Given the significant competitive harms that would arise from the proposed merger, the Board must hold the Applicants to their obligation to prove the claimed public benefits. For the reasons discussed above, Applicants have not carried this burden. On the contrary, it appears that the efficiencies from this merger would fall far short of offsetting the competitive harms.

¹⁵³ See also KCS-33, Vol. 1, O'Connor/Darling VS at 343 (concluding that Applicants substantially overstate merger-related benefits).

¹⁵⁴ Having failed to sustain their burden of proving that merging is the only way to achieve any operating efficiencies, Applicants also fail to sustain their burden of proving that shippers will gain any of the \$91 million in logistics savings that they attribute to more efficient railroad operations. Applicants' refusal to consider voluntary group purchasing arrangements, new, different or better outsourcing arrangements, cooperative rail car leasing programs and other voluntary means of cooperation likewise leaves them in a position where they cannot demonstrate that any of the projected \$14 million in communications and computer costs and \$13 million in car utilization would remain after non-merger alternatives are exhausted.

STB

FD-32760

6-3-96

E

83999

2

OF

4

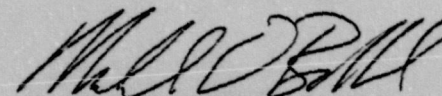
CONCLUSION

The competitive harms that would result from the proposed transaction dwarf those arising from other rail mergers considered by the ICC. These harms are not adequately remedied by the BNSF Agreement, and it appears that there is no effective way to fully replace the significant competition that would be lost. Furthermore, the evidence shows that the merger cannot be justified on the grounds of SP's financial condition or the claimed efficiencies of the transaction. Given the breadth of the competitive problems arising from the proposed transaction, and the difficulty of fashioning effective remedies, the Department urges the Board to deny the Application. If the Board decides to approve the merger subject to conditions, it should do nothing less than require divestiture of the routes described in Part I. Divestiture would preserve an independent competitor in all of the affected markets, and is consistent with the Board's mandate to rely on competitive rather than regulatory solutions.

For the foregoing reasons, the Department urges the Board to deny the Application.

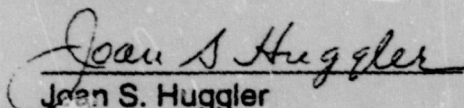
Respectfully submitted,

Anne K. Bingaman
Assistant Attorney General
Antitrust Division



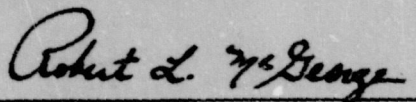
Michael D. Billiel

David S. Turetsky
Deputy Assistant Attorney General



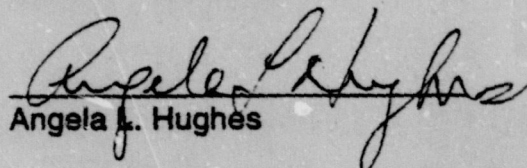
Joan S. Huggler

Constance K. Robinson
Director of Operations



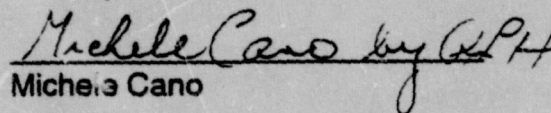
Robert L. McGeorge

Charles E. Biggio
Senior Counselor to the
Assistant Attorney General



Angela L. Hughes

Roger W. Fones
Chief, Transportation, Energy
& Agriculture Section



Michele Cano

Donna N. Kooperstein
Ass't Chief, Transportation,
Energy & Agriculture Section

Attorneys
Antitrust Division
U.S. Department of Justice
325 Seventh Street, N.W.
Suite 500
Washington, D.C. 20530
(202) 307-6666

June 3, 1996

APPENDIX A

MARKET DEFINITION

Framework for Merger Analysis Generally

In determining the competitive effects of a merger, the first step of the analysis is to define the markets within which the merging parties compete. Under the Merger Guidelines, a market is defined as a set of products or services within a geographic area for which a hypothetical monopolist could profitably impose a "small but significant and nontransitory" price increase. Merger Guidelines at §1.0. If the evidence shows that a hypothetical monopolist of that product or service could impose a small but significant and nontransitory price increase, that product or service is defined as the market. If, on the other hand, the evidence shows that a sufficient number of consumers would substitute other products or services, which would make a price increase unprofitable, those products or services are also included in the market. This process continues until a group of products or services is identified for which such a price increase would be profitable. Merger Guidelines at § 1.1.

The parties in a rail merger provide a service -- the transportation of a commodity from an origin to a destination. Transportation of a commodity by all rail carriers, currently transporting the commodity from the origin to the destination, is initially considered a market. If the evidence shows that a hypothetical monopolist (of currently-provided rail transportation of the commodity) could not profitably impose a small but significant and nontransitory price increase -- because shippers would switch to other rail carriers not currently transporting the commodity from the origin to the destination -- transportation by such other rail carriers is added to the market. Similarly, if the evidence shows that shippers would switch to other modes of transportation, such as trucks or barge, transportation by such other modes is added to the market. And, if the evidence shows that shippers would ship the same commodity to other destinations, and receivers would

receive the same commodity from other origins or a substitute commodity from the same or other origins, the market definition is so expanded.

DOJ's Methodology in this Case

Dr. Majure used 1994 Waybill data to identify movements of commodities in origin-destination corridors where the number of rail competitors would be reduced from two to one or from three to two as a result of the merger. These markets are listed in detail in DOJ-9. In counting the number of railroads competing to carry a commodity in a particular O-D pair, Dr. Majure included all railroads that carried any commodity in that O-D pair, based on the presumption that such a railroad could carry any other commodity in the corridor even if it were not currently doing so.

To define commodities, Dr. Majure used the 5-digit STCC classification.¹ He defined origins and destinations as the BEA, which encompasses a group of counties, for those commodities for which trucking substantial distances to or from a rail carrier would be economical. For those commodities for which trucking such distances would not be economical, Dr. Majure used the SPLC4, which includes a county or part of a county, as the origin and destination.² Dr. Majure also analyzed whether other forms of competition, such as intermodal competition or the ability to ship commodities from other origins or to other destinations, would constrain the merged carrier from raising rates or reducing service.

Dr. Majure's analysis is based on a thorough examination of the evidence available on the competitive effects of the proposed merger, including verified statements and deposition testimony of witnesses in the proceeding, Applicants' internal documents, waybill data, extensive interviews with shippers, and his own empirical analysis. His

¹DOJ-8, Majure VS at 4.

²*Id.* at 5.

methodology in analyzing the likely effects of the proposed merger is consistent with the Department's approach to other rail mergers and to mergers generally.³ This methodology has also been generally accepted by the ICC.

³ See, e.g., Verified Statement of Peter A. Woodward, Finance Docket No. 32549; Verified Statements of Russell W. Pittman, Finance Docket Nos. 30800 and 30400; Verified Statement of Charles J. Untiet, Finance Docket No. 32036.

CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of the BRIEF OF THE UNITED STATES DEPARTMENT OF JUSTICE (DOJ-14 and DOJ-15) to be served on counsel for the Applicants by hand and on all other parties of record by first class mail or more expeditious means, this 3rd day of June, 1996.

June 3, 1996

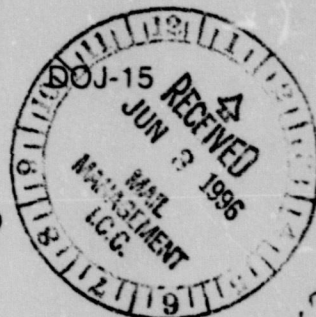
A handwritten signature in dark ink, appearing to read "Michael D. Billiel", written over a horizontal line.

Michael D. Billiel

83999 1071 ✓

PUBLIC (REDACTED) VERSION

BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.



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

FINANCE DOCKET
NO. 32760

BRIEF OF THE UNITED STATES DEPARTMENT OF JUSTICE

APPENDIX - DEPOSITION TRANSCRIPTS AND OTHER MATERIALS

Roger W. Fones, Chief
Donna N. Kooperstein, Assistant Chief

Michael D. Billiel
Joan S. Huggler
Robert L. McGeorge
Angela L. Hughes
Michele Cano
Attorneys

Transportation, Energy &
Agriculture Section
Antitrust Division
U.S. Department of Justice
325 Seventh Street, N.W., Suite 500
Washington, D. C. 20530

202-307-6666

June 3, 1996

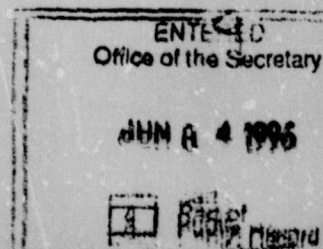


TABLE OF CONTENTS

SUPPLEMENT TO THE BRIEF OF THE UNITED STATES DEPARTMENT OF JUSTICE - DEPOSITION TRANSCRIPTS AND EXHIBITS CITED

A. Deposition Transcripts cited in United States Department of Justice Brief (DOJ - 14)

(in alphabetical order of deponent)

1. Anschutz, Philip
 page 131
 page 239-241
 page 256-257
2. Christensen, Laurits
 page 58-60
 page 85-89
 page 107-109
 page 159-162
3. Davidson, Richard K.
 page 81
4. Draper, Mark & Dale Salzman
 page 64-67
 page 183-187
5. Gray, John T.
 page 148-149 (February 26, 1996) - REDACTED
 page 154 (February 26, 1996) - REDACTED
 page 45-46 (May 17, 1996) - REDACTED
 page 60-61 (May 17, 1996) - REDACTED
 page 64-67 (May 17, 1996) - REDACTED
 page 67-71 (May 17, 1996) - REDACTED
6. Grinstein, Gerald
 page 63
 page 129
 page 151
 page 152-153
 page 154-155
 page 161

7. Ice, Carl
page 222-226
page 518-519
8. Kauders, Richard
page 165-167
9. King, Brad & Michael Ongerth
page 673
10. Month, Stephan
page 104-105
11. Peterson, Richard
page 27 (February 5, 1996)
page 57-59 (February 5, 1996)
page 149 (February 5, 1996)
page 467 (February 7, 1996)
page 620-622 (February 7, 1996)
page 990 (February 10, 1996)
page 1058-1059 (February 10, 1996)
page 289 (May 8, 1996) - **REDACTED**
12. Rebensdorf, John
page 56-60 (January 22, 1996)
page 58-60 (January 22, 1996)
page 119-121 (January 22, 1996)
page 141-142 (January 22, 1996)
page 170-172 (January 22, 1996)
page 272-274 (January 22, 1996)
page 302-303 (January 23, 1996)
page 451-460 (January 23, 1996)
page 731-735 (February 12, 1996)
page 743 (February 12, 1996)
page 790-792 (March 20, 1996)
13. Willig, Robert
page 24
page 60
page 195-196
page 398

14. Yarberry, Lawrence
page 15 - REDACTED
page 27 - REDACTED
page 109-116 - REDACTED
page 119-121 - REDACTED

B. Exhibits cited in United States Department of Justice Brief (DOJ - 14)

- Exhibit 1: Letter from Proctor & Gamble to the Surface Transportation Board on March 22, 1996
- Exhibit 2: Excerpts from the Verified Statement of Richard C. Levin in application of The Kansas City Southern Railway Company and Louisiana & Arkansas Railway Company for Independent Ratemaking Authority, trackage Rights and Asset Purchases (KCS-12).
- Exhibit 3: Excerpts from Southern Pacific's 1995 10K
- Exhibit 4: Traffic World, February 19, 1996 (p.20-22)
- Exhibit 5: Excerpts from Southern Pacific 10Q for the First Quarter of 1996
- Exhibit 6: Excerpts from Burlington Northern/Santa Fe 10Q for the First Quarter of 1996
- Exhibit 7: Excerpts from Union Pacific 10Q for the First Quarter of 1996
- Exhibit 8: REDACTED
- Exhibit 9: REDACTED
- Exhibit 10: REDACTED
- Exhibit 11: Excerpts from Salomon Brothers Fourth-Quarter Railroad Review and Outlook
- Exhibit 12: REDACTED
- Exhibit 13: REDACTED

Q. Mr. Moyers resigned as president and COO of Southern Pacific in February 1995; is that correct

A. I don't recall that date, but it was -- something about that date doesn't sound correct to me.

Q. Was it the first quarter?

A. It could have been, I don't recall.

Q. Now, I think we saw that, during the first quarter of 1995, Southern Pacific had positive net income despite severe weather and floods in California; is that correct?

A. In 1995?

Q. Yes.

A. I believe that was the case, yes.

Q. And, after Mr. Moyers' departure in the second and third quarters, Southern Pacific suffered losses in net income?

A. That's true. You know, it might be helpful that I make an observation of several things. This railroad is very difficult to make an assessment quarter by quarter. What's important here are trends in this business. This is long-term business.

So, while some of your observations are

A. I was not aware of that.

Q. Are you aware that they are concerned that BN/SF has no obligation to invest anything in the lines over which it would have trackage rights under that agreement?

A. I don't find that to be peculiar. I mean isn't that what most trackage rights involve?

Q. It may well be. But let me try the question on you this way, would you expect that BN/SF would have more of an incentive to operate over your central corridor if it had some investment in it as compared to not having some investment in it?

A. I would think their incentive to operate is is there a strong coal market that they can ship coal in. I mean I don't see that it would work any different than any other set of trackage rights. And many people operate very profitably as you well know over trackage rights.

Q. Well, let me ask you to suppose that UP/SP had negotiated the following arrangement with BN/SF, that BN/SF had to pay a lump sum fee at or about the beginning of each year in order to operate over the Rio Grande lines. Would you

expect under such an arrangement, if that had been the terms, that BN/SF would have more of an incentive to operate there if that amount would then be applied against any trackage fees that would be charged?

MR. CUNNINGHAM: Objection as to form.

BY MR. McBRIDE:

Q. You may answer.

A. There are many different kinds of trackage fees I suppose. I'm certainly no expert in them, Mr. McBride, although I must say I've never heard of one quite like that. You're saying would they be more interested in them if they owned them or if they made an investment in them.

I suppose that relates to could they -- would it be more profitable for BN if they invested capital in them. I don't know the answer to that. I can give you one example I do know, if it would help.

Q. Feel free.

A. From Kansas City to Chicago, very important segment of our railroad as you know, I had the chance three or four years ago, SP had the chance three or four years ago, to buy that

line, therefore, making the capital investment in the line, from another railroad. We chose not to. We chose instead to go on trackage rights on the BN. And we've built that business up today to 12 or 15 trains a day in each direction.

Q. Let me ask --

A. So it's very profitable. And we don't own the railroad, somebody else does.

Q. Had you purchased that line from Kansas City to Chicago, would you have felt a greater urgency about using it as opposed to the trackage rights that you obtained from BN?

A. No, because we use it anyway.

Q. If BN's obligation were to make an up-front payment to UP/SP and then have that credited against its use of trackage rights over the Rio Grande lines, would you expect that it would feel some greater urgency about using those trackage rights?

A. Again I think it's going to depend on the coal markets and can they haul the coal to market. I don't know if it's going to incentivize them to use it any more than otherwise.

Q. Are you aware of BN/SF having

observer, I would say it would have been better to have won than to have lost.

Q. I take it from your prior testimony which I'm not going to go back through that you had a similar concern about the BN/SF merger?

A. We filed in that case. Is that what you mean?

Q. Yes. You were concerned about the impact of that merger on your railroads too, were you not?

A. We filed in that case as well.

Q. All other things being equal, do you prefer to own a line or have trackage rights over it?

A. I think it depends. Trackage rights come in many different forms and in many different ways. So I think you need to look at the fact, number one. Number two, I think I have previously testified I'm not an expert in these matters so please don't let me sound like one. And last of all, directed to your question, is it better to own than to have trackage rights, and I would say I think that depends.

Southern Pacific probably has one-third to half of its business operating over trackage

rights from various railroads. And those trackage rights work pretty well. And we have built up our business on that basis. If I could just finish.

And there have been several instances that I can recall where we had the right to own and we chose to have trackage rights instead. I gave an example, Chicago to Kansas City. Another example actually has been from Pueblo to Herington. UP has always been willing to sell me the line, but I never chose to buy it because I would rather have trackage rights.

Q. You indicated an understanding of the differences in trackage rights partway into that answer, did you not?

A. Did I what, sir?

Q. You indicated that you understood that there were differences in types of trackage rights.

A. I just noted that there are a variety of things to assess in trying to value trackage rights.

Q. Do you understand that the trackage rights BN/SF gets over the Rio Grande lines are just rights to serve certain points along the

Schmalensee?

1 A. I'm not sure what you mean by familiar
2 with.

3 Q. Do you know who he is?

4 A. I do.

5 Q. Is he a reputable economist?

6 A. I would say so, yes.

7 Q. Are you familiar with his testimony in
8 the BN/SF case?

9 A. I at least was familiar with it.
10 I can't say I'm too familiar with it now. I do
11 have a recollection that he cited this paper in
12 pretty much the same way that I've cited it
13 here.

14 Q. That's your recollection?

15 A. That's my recollection, yes.

16 Q. On page 7 of your statement, paragraph
17 3 in particular.

18 A. Paragraph numbered 3?

19 Q. Yes.

20 A. Yes.

21 Q. Just review that to yourself.

22 In considering whether efficiencies
23 could be achieved through nonmerger alternatives
24 as stated in that paragraph, is it sufficient in
25

1 your view that there is an abstract or
2 theoretical possibility of such a nonmerger
3 alternative?

4 A. Well, certainly having a theoretical
5 possibility is an important aspect. But also
6 involved here is the fact that the industry is
7 observing -- is implementing lots of nonmerger
8 alternatives through which they're getting
9 efficiency gains of the kind claimed in this
10 merger application. And it's my professional
11 opinion that there is a burden on the applicants
12 to make some showing that gains that they're
13 projecting from the merger could not, in fact, be
14 achieved by nonmerger alternatives.

15 Q. In connection with your statement in
16 paragraph No. 3 on page 7, does it make any
17 difference that the nonmerger alternative is
18 wholly unprecedented?

19 A. I don't know what you mean by does it
20 make any difference?

21 Q. I thought you were pausing. Are you
22 finished with your answer?

23 A. Yes. I'm finished with my question.

24 Q. Well, as I understand your testimony,
25 you're saying that the various efficiencies and

1 benefits that are identified in the application
2 should not be considered because it's possible
3 that they could have been achieved by nonmerger
4 alternatives; is that a fair statement?

5 A. Not only possible, but there's some
6 likelihood that they would be achievable without
7 this merger taking place.

8 Q. How much likelihood would be necessary
9 in your view?

10 A. Well, anything that has any likelihood
11 at all should be considered. I would imagine
12 there are some alternatives that have higher
13 likelihoods or, if you like, lower costs of
14 implementing than others. But that doesn't mean
15 we should ignore ones just because they haven't
16 been done today.

17 After all, this industry is figuring
18 out new ways to do things all the time and is
19 achieving productivity gains at an unprecedented
20 rate. And by definition many of these
21 productivity gains involve things that have never
22 been done before. Otherwise, they wouldn't be
23 productivity gains.

24 Q. So, if there is a theoretical
25 possibility that a particular benefit can be

1 of the proposition that productivity growth in
2 the industry has averaged 5.9 percent annually
3 over the five-year period 1989 to 1994?

4 A. Yes.

5 Q. If you could just show how you used
6 table A or table B in your analysis.

7 A. Well, we see the last line on this
8 page, it says the proposed five-year productivity
9 trend calculated using a geometric average is
10 1.059 or 5.9 percent per year. This as published
11 by the Surface Transportation Board is the
12 productivity trend for the Class I railroad
13 industry of the United States.

14 And this was an important part of my
15 analysis. It's referenced explicitly here under
16 the labor savings section. But this, in fact,
17 played a role in my professional judgment
18 throughout my verified statement in terms of
19 specifying a baseline of 5.9 percent per year as
20 a likely productivity trend or, if you like,
21 efficiency improvement that is ongoing in the
22 railroad industry and in my professional judgment
23 should have been taken into account by applicants
24 and explicitly shown how applicants believe that
25 merger -- if there is a merger, that, in fact, it

would be able to produce productivity improvements over and above this industry trend.

Q. You are familiar with the calculations reflected on table A and B?

A. Yes.

Q. The 5.9 percent is derived from the number preceding it, the 1.059; is that correct?

A. Yes.

Q. Can you explain how the 1.059 number is derived from the other numbers on the table?

A. Yes. The last column that says productivity change -- sorry, on table B, the column furthest to the right says productivity change, column 1 plus column 2 -- sorry, column 1 divided by column 2. These are what are called productivity relatives.

If you subtracted one from each of those five numbers, it would give you the productivity change or I guess -- specifically subtract one and multiply by 100, it would give you the annual percentage change in railroad productivity.

What the Surface Transportation Board does in order to average the information from these five years is to multiply these five

1 figures together and then take the fifth root.

2 And, if you do that, you get the number 1.059.

3 Q. Looking at column 3 for 1990, does that
4 explanation suggest that the productivity change
5 for that year was 5.7 percent?

6 A. Yes.

7 Q. And what would the change in 1991 have
8 been?

9 A. It would be minus 3.8 percent.

10 Q. And in 1992?

11 A. It would be positive 19.0 percent.

12 Q. How far back has the ICC been
13 calculating these productivity changes?

14 A. I believe the first year was 1982.
15 That wouldn't be the first year they had a
16 trend. But, in terms of computing trends, the
17 ICC began doing this computation in 1989. And in
18 1989 they had figures for 1982 through 1987 I
19 believe. And they have been updating this series
20 ever since 1989.

21 Their procedures have varied somewhat
22 over time in terms of how many years they include
23 in the average. But each spring the ICC from
24 1989 to 1995 have published a productivity trend
25 using this approach or using essentially this

1 approach, with some minor changes in the approach
2 over the years. Now, in 1996 the Surface
3 Transportation Board has taken up this task of
4 publishing the trend in productivity growth for
5 the Class I railroad industry.

6 Q. They haven't published their final
7 numbers yet, have they?

8 A. I don't know what you mean.

9 Q. Well, the document we're looking at is
10 a request for comments on a proposed number.

11 A. Mine says decided February 21, 1996.

12 Q. Do you know whether any further order
13 was issued postponing the effective date?

14 A. Not to my knowledge.

15 Q. If you looked at 1992, '93, and '94, as
16 I understand the explanation you just gave, that
17 would indicate the annual productivity change was
18 slowing down considerably. Would that be a fair
19 reading of it?

20 A. Well, it's slowing down to the trend
21 rate. I mean there are going to be year-to-year
22 variations. You could choose any two years.

23 Q. I understand. I just wanted to make
24 sure I understand.

25 A. Well, the numbers -- I mean you didn't

1 finish. The you asked me what the percentage was
2 for 1990, '91, and '92. If you completed the
3 series, the number for 1993 is 9.7 percent and
4 for '94 is 5.8 percent. And, although 1994 is a
5 whisker below 5.9, this column certainly does not
6 suggest to me a decline in the trend.

7 Interestingly enough, the beginning and
8 the end of the series is very close to the 5.9.
9 If you did a regression analysis on this, I
10 suspect you would find an increase in the trend.
11 But that's just the danger of -- well, there was
12 extensive discussion at the ICC about how many
13 years should we use to divine a trend.

14 And the railroads were adamant that in
15 no case should it be less than five years. In
16 fact, the railroads were in favor of doing more
17 years. And for a period it was up as high as
18 looking at eight years. But I think most people
19 would agree that you don't want to look at less
20 than five years to decide a trend or to determine
21 what a trend might be.

22 But, given the fact that business
23 conditions change and economic conditions change,
24 there are going to be ups and downs in this
25 series. And the ICC said we need to have a

1 the application understates the labor savings
2 because even more jobs will be shed than were
3 projected?

4 A. No, I'm not aware of that.

5 Q. In your view is that likely to be the
6 case, if you have a view?

7 A. I haven't done an analysis of how many
8 jobs are likely to be shed, so I don't have an
9 opinion on that.

10 Q. On page 12 of your statement, you refer
11 to the possibility that excess labor shed by UP
12 and SP will be employed by BN/SF in connection
13 with the trackage rights agreement between UP/SP
14 and BN/SF.

15 A. Yes.

16 Q. Have you ever studied the employment
17 effect of trackage rights agreements?

18 A. No, I have not.

19 Q. Do you know whether a railroad's
20 operations pursuant to trackage rights requires
21 as many employees as operation over its own
22 lines?

23 A. I don't know.

24 Q. Do you have any information about
25 whether BN/SF plans to hire additional employees

1 in connection with its operations over the
2 trackage rights involved in this proceeding?

3 A. I don't know, but I would be astounded
4 if they could, in fact, realize
5 additional revenues from hauling freight over
6 tracks and not employ a very large amount
7 additional labor in order to realize that
8 revenue.

9 Suppose we were to take only two-thirds
10 the amount of labor that is used on average for
11 traffic. That would be sufficient in itself to
12 wipe out the 89 million that is left after I
13 subtract out the 164 million from the industry
14 trend and the 8 million from the labor premium,
15 the wage premium.

16 Q. I take it you did not on behalf of the
17 Justice Department to try to get any information
18 about BN/SF's plans in this regard?

19 A. I did not.

20 Q. And, so far as you know, BN/SF may well
21 plan to handle the added business with far fewer
22 additional employees than the number of employees
23 to be shed by UP and SP?

24 A. It may well be fewer. But the merger
25 application doesn't recognize any additional

labor. And surely that's got to be wrong.

Q. Page 14 of your statement, about the middle of the page, there's a sentence beginning, while nonmerger alternatives. Do you see that?

A. Yes.

Q. You go on to say may not always be perfect substitutes for the services of a merged carrier. What are some of the reasons why that is the case?

A. Well, this just allows for the possibility that there are cases where a merged railroad could effect somewhat more in the way of -- or could provide similar services for lower cost or possibly enhance services. But I have not done an analysis of such cases.

Q. Are you saying you haven't done any analysis of the extent to which nonmerger alternatives may be substitutes for merger and vice versa as to a particular potential benefit; is that a fair statement?

A. Sure.

Q. Further in that sentence, you refer to a substantial fraction. Did you quantify that fraction in any way?

A. No, I have not.

1 likely that one could segregate the end-to-end
2 aspects of a particular merger from the
3 horizontal aspects of a particular merger for
4 purposes of the work that Velturo and Berndt have
5 done?

6 A. That would be extremely difficult to
7 do. As we've said many times today, it's not
8 necessarily impossible. But I have not seen a
9 research paper or project that has a method for
10 doing that.

11 Q. I'm going to return to another point
12 raised by Mr. Norton. In fact, this was the one
13 where I believe you had asked whether he wanted
14 your views and he said not right now. And I'm a
15 little bit more curious than he was I think. The
16 question related --

17 MR. NORTON: Just remember what
18 happened to the cat.

19 BY MR. McGEORGE:

20 Q. This relates to whether you had any
21 views on whether the benefits including cost
22 reductions due to deregulation will continue in
23 the future. Do you, in fact, have any views on
24 that?

25 A. Yes. At the time of deregulation of

1 the Staggers Act--there was a lot of skepticism
2 that there really were substantial productivity
3 gains or efficiency improvements that U.S.
4 railroads could achieve. But the record has
5 shown that there has been a steady acceleration
6 of productivity growth; prior to the Staggers
7 Act, the trend in productivity growth for the
8 industry was on the order of 1 percent.

9 In the years immediately following
10 deregulation, it was approximately 2 percent.
11 And, by the late eighties, the trend was showing
12 in the range of 4 percent. And, in the last few
13 years, the trend has accelerated to nearly 6
14 percent. And the most recent publication as I
15 indicated from the Surface Transportation Board
16 indicates a trend of productivity to the railroad
17 industry of 5.9 percent.

18 That is the highest productivity growth
19 trend for this industry that I have ever seen
20 measured by anybody over any period of time.
21 And, given that momentum and this acceleration,
22 in my professional opinion, we're going to see
23 with this momentum improvements of productivity
24 for quite some years to come.

25 Q. You have specifically discussed a 5.9

1 percent industry productivity gain trend with
2 respect to the labor component of the benefits
3 claimed by applicants. Do you have any basis for
4 making a prediction on other items other than
5 labor that would fit into the categories of
6 merger benefits claimed on the applicants?

7 A. Yes. I should make clear that the 5.9
8 percent number put forth by the Surface
9 Transportation Board does not apply simply to
10 labor, it applies to all of the resources used in
11 the railroad industry.

12 And, in fact, I hope I did not mislead
13 anyone by discussing that productivity trend
14 specifically in the labor section, because labor
15 is a large cost category and it is relevant. And
16 I showed some other information that indicated
17 that, in fact, there have been substantial labor
18 improvements, efficiency improvements in the
19 railroad industry.

20 But what the railroad -- sorry, what
21 the Surface Transportation figure shows is that
22 averaged, over all types of resources that the
23 railroads use, they have this trend in
24 productivity or an efficiency of improvements.
25 And, therefore, that same logic that I used in

1 the section on labor benefits applies equally
2 well to the other claimed benefits.

3 Q. When we talk about cost savings by
4 virtue of labor becoming more productive, would
5 you expect that there is a possibility to see
6 similar improvements in senior management
7 productivity without a merger?

8 A. Yes, certainly, as I just indicated in
9 response to a previous question, that 5.9
10 percent, there's no reason not to consider that
11 across the board with all resource categories
12 employed by the railroad industry.

13 Q. We talked about transaction costs,
14 specifically I think Mr. Norton asked you whether
15 there were transaction costs attributed to
16 negotiating voluntary cooperative agreements
17 short of merger by two or more railroads. Are
18 there transaction costs involved in either
19 negotiating or obtaining regulatory approval of
20 or implementing mergers?

21 A. Yes, there are.

22 Q. Do you have any opinion as to whether
23 those are trivial or some factor beyond trivial?

24 A. I would say they are definitely beyond
25 trivial, there are substantial transaction costs

Davidson Tr. at 81

81

A. Well, I don't think there's a general answer on that. The contracts that I'm familiar with, where we bid against them, we win some and lose some. As I'm sure you're aware, we had a number of chemical companies come to us and ask us to access their plants so that they could get more effective transportation from their point of view versus the Southern Pacific.

Q. So would it be your testimony that you do not believe that the Southern Pacific is -- let me restate that.

Do you believe that SP is an aggressive price competitor?

A. I think the Southern Pacific is an aggressive competitor and I know that in a number of cases that they have got business from us because they priced their service cheaper than we did.

Q. Do you think there have ever been any instances in which the Southern Pacific has priced at less than fully allocated costs in order to capture a piece of business?

A. I think we have wondered about that at times, yes.

Q. Could you elaborate on what you have

ALDERSON REPORTING COMPANY, INC.

(202) 289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

Draper/Salzman Tr. at
64-67

64

1 available for other use due to the use of the
2 shorter, faster, more efficient routes.

3 And then on page 237 -- I'm sorry.
4 yes, that also includes the units released due to
5 the common point team studies and the helper
6 locomotives. And then on page 237 there's an
7 indication of the additional locomotives that
8 would be required due to the additional traffic.

9 MR. EDELMAN: Thank you. From your
10 experience would you say it's reasonable to
11 assume that the traffic to be obtained by
12 BN/Santa Fe would require it to use more
13 locomotives as a result of the traffic that it
14 will obtain through the agreement with UP/SP?

15 MR. SALZMAN: It will have to have some
16 locomotives to handle the traffic. Whether they
17 choose to operate on a trackage right or over
18 their own railroad, whether that will require
19 additional locomotives on their part, I'm not
20 sure, we couldn't identify what BN/Santa Fe would
21 intend to do.

22 MR. EDELMAN: To the extent that a
23 carrier requires increased number of locomotives
24 to handle additional traffic, does that also
25 require additional maintenance of equipment

1 employees to maintain those locomotives?

2 MR. SALZMAN: In general you would tend
3 to think that it would depend upon how they chose
4 to meet their locomotive needs in terms of
5 leases, new units, maybe they would get new units
6 that would replace older units that required
7 additional maintenance. So maybe the total
8 maintenance needs might wash out and not be that
9 much greater. That would be up to BN/Santa Fe in
10 terms of how they chose to meet that need and
11 what that need was.

12 MR. EDELMAN: Thank you. Mr. Draper,
13 with respect to the savings on communications and
14 computers, how were those benefits to be
15 realized?

16 MR. DRAPER: Well, the general answer
17 is through the merger. What assumptions the
18 information technologies people made to determine
19 their number I don't know.

20 MR. EDELMAN: Okay. I don't know who
21 to direct this question to so I'll just throw it
22 out. On page 368 there is a reference to savings
23 to be obtained from line abandonments. How does
24 that yield benefits to the applicants?

25 MR. DRAPER: Well, one answer would

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 be -- it would be similar to Dale's discussion
2 awhile ago about yard facilities that are made
3 surplus in the availability of sale and use of
4 those proceeds. A similar theory would hold with
5 lines that were to be abandoned. If you're
6 selling what is primarily an unproductive asset,
7 you can take the cash from that sale and reinvest
8 it in something that would be more productive. I
9 mean that would obviously be one benefit.

10 MR. EDELMAN: And how is that
11 benefit -- sorry, scratch that.

12 There is a reference to more efficient
13 routings on the top of page 368. Who benefits
14 from more efficient routings?

15 MR. SALZMAN: I think that both the
16 railroads and the customers benefit from the more
17 efficient routings. It requires less resources
18 to operate over the more efficient route, whether
19 it's shorter, less grades and curves, reduced
20 motive power requirements. To the extent that
21 that results in shorter, faster transit times,
22 the customer benefits through improved service.

23 MR. HEMMER: Rich, if you are at a
24 breaking point, we might take a break now.

25 Before we do, would you like to sign in

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 for the record.

2 MR. LUBEL: Ms. Williams, Alan Lubel
3 from Troutman Sanders for Kansas City Southern
4 Railway.

5 MR. HEMMER: Why don't we resume in
6 about ten minutes.

7 (Recess)

8 MR. EDELMAN: With respect to the
9 calculation of labor savings, I guess I'll ask
10 you, Mr. Draper, what is the calculation composed
11 of, what types of savings are included in that?

12 MR. DRAPER: My understanding is that
13 the labor savings reflects -- well, it was
14 determined by determining net changes in head
15 count by ICC job code, taking those changes in
16 head counts times the average compensation for
17 that particular position, and then applying the
18 average fringe benefits ratio for that position
19 against the compensation, summing all the various
20 totals by job code together to get the total
21 answer.

22 MR. EDELMAN: So is it correct to say
23 that no element of change in collective
24 bargaining agreements was factored into the labor
25 savings?

ALDERSON REPORTING COMPANY, INC.

(202) 289-2200 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

Draper/Salzman Tr.
at 183-187

183

turned over the summary of benefits exhibits to Mr. Rhoades to put together the pro formas that start on page 94.

MR. McGEORGE: So, if we had a bright financial analyst in our employ, we should be able to trace through the numbers in your summary of benefits table and see how those numbers appear in these pro forma statements?

MR. DRAPER: Yes, the information contained in the summary of benefits is reflected in the pro formas.

MR. McGEORGE: And have you seen any work papers that might have been prepared by Mr. Rhoades?

MR. DRAPER: No. The only documents I saw that Mr. Rhoades prepared are the ones that are included here starting at page 94.

MR. McGEORGE: Let's go off the record.

(Discussion off the record.)

MR. McGEORGE: I'm going to take you back before this merger application. Has Union Pacific achieved any cost savings say since 1980 that would not be attributed to mergers? I guess maybe this is more you, Mr. Salzman.

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

MR. SALZMAN: Oh, yes.

MR. McGEORGE: If we eliminate savings that are related to mergers, what are the factors that led to these savings, if you can give me some of the major factors?

MR. SALZMAN: The nonmerger related savings?

MR. McGEORGE: Yes.

MR. SALZMAN: Technology.

MR. McGEORGE: Can you give me an example.

MR. SALZMAN: Higher horsepower locomotives, improvements in maintenance of way equipment, computer systems, things like that.

MR. McGEORGE: Any other factors?

MR. SALZMAN: Changes in labor agreements.

MR. McGEORGE: Anything else?

MR. SALZMAN: I'm sure there are other things. Those are the things that come to mind right now.

MR. McGEORGE: I use 1980 as kind of a convenient date for thinking in terms of when the deregulation era began. Has that been a factor do you think in terms of railroads achieving cost

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

savings?

MR. SALZMAN: I'm not sure that deregulation itself resulted in cost savings. It probably was an instigating factor in requiring the railroads to generate additional cost savings.

MR. McGEORGE: Okay. And how do you see the deregulation as an instigating factor and then kind of what followed this that did have an impact on railroad savings?

MR. SALZMAN: Would you --

MR. McGEORGE: I'm trying to follow up on your answer. You said that deregulation might have been an instigating factor. Maybe you can just follow that up, what other factors were instigated by deregulation?

MR. SALZMAN: Well, it's the fact that -- I'm not sure I'm answering your question properly. Because rates declined, you know, we needed to reduce costs. Some of these are merger related costs, some are due to the other factors we mentioned. Like we would see, you know, the benefits that we're showing here in the summary of benefits plan as being a key factor in terms of an additional source of benefits and savings.

ALDERSON REPORTING COMPANY, INC.

(202) 289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C. 20005

that we can utilize to help make ourselves more competitive.

MR. McGEORGE: Did competitive pressures become an instigating factor for cost savings?

MR. SALZMAN: Well, competition was always there. But I think the rate base competition, some of the things like what we saw in the access to Powder River Basin and what happened to rates there, what we saw with rates even after our Katy merger and what's happened to rates in various ^{markets.} ~~portions.~~

The average revenues have been coming down and the railroads have been forced to bring their costs down in line. And mergers are one source of those benefits to help us stay competitive.

And, of course, we're also dealing, of course, not only with competition within the industry, but we have to deal with the competition intramodally, whereas, you know, ^{there are more} ~~there is more~~ trucklines that are more efficient, they have new equipment, more fuel efficient equipment. There's probably less of the truckload market or not a whole lot of the

ALDERSON REPORTING COMPANY, INC.

(202) 289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 truckload market that's not unionized, wages have
2 come down. So it's a competitive battle out
3 there.

4 MR. McGEORGE: Do I understand it
5 correctly that you didn't have the same pressure
6 on rates during kind of the golden age of ICC
7 regulation that you've had since the deregulation
8 era began roughly in 1980?

9 MR. SALZMAN: Well, I'm not a marketing
10 person. But I think you have an additional
11 factor there. You have to remember that the
12 competition between railroads and the other modes
13 had been there beforehand, you know, with truck.
14 So that was a factor. But I think the
15 competition, both intermodally and intramodally,
16 has gotten stronger and where we see some of the
17 benefits from the merger here helping us be
18 competitive.

19 MR. McGEORGE: Because that competition
20 has forced railroads to cut costs and become more
21 efficient, right?

22 MR. SALZMAN: Right.

23 MR. McGEORGE: I'll ask you, from the
24 UP perspective, have you generally had access to
25 capital markets in order to finance improvements

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

**Gray Tr. at 148-149
(February 26, 1996)
Redacted**

**Gray Tr. at 154
(February 26, 1996)
Redacted**

**Gray Tr. at 32-33
(May 17, 1996)
Redacted**

**Gray Tr. at 45-46
(May 17, 1996)
Redacted**

**Gray Tr. at 60-61
(May 17, 1996)
Redacted**

**Gray Tr. at 64-67
(May 17, 1996)
Redacted**

**Gray Tr. at 67-71
(May 17, 1996)
Redacted**

1 A. Well, the history would tell us that. When
2 the railroads were subject to regulation in the '60s
3 and '70s, they were performing poorly, and when they
4 got ^{deregulated} ~~reregulated~~ from '80 on, their performance began
5 to improve and by '90 it was significantly better.

6 Q. And what do you mean by better?

7 A. There were less bankruptcies ^{than} ~~as~~ there had
8 been in the '70s. They were more profitable than they
9 had been, and they were capable of reinvesting in
10 plant and providing a higher level of service to their
11 customers.

12 Q. Turning to page 64, and the reason for the
13 gap in the pages I believe is because it was
14 advertisements, but I think the language picks right
15 up. Your view is that trackage rights do not
16 necessarily insure unfettered competition; is that
17 correct?

18 A. That's what I said.

19 Q. Do you still hold that view today?

20 A. Yes. But I mean, the point that I was
21 making there was part of the answer. Is ^{that} ~~it~~ ownership
22 is preferred to trackage rights, and if you own it I
23 think you're -- you can provide a better level of
24 service than you can if it's trackage rights, so
25 there's some disability. At the same time, if you've

Portage

1 portage to Dubuque track --

2 A. Right.

3 Q. -- track; is that right?

4 A. Yeah.

5 Q. You ended up buying that track because it
6 got too cumbersome dealing with the CCP over it; is
7 that correct?

8 A. That's correct.

9 Q. Would you view -- and as I remember this
10 morning, you agreed with the characterization of
11 different types of trackage rights, trackage rights
12 that might be designed to ameliorate a competitive
13 concern that might be attached to, example, a merger
14 application, or trackage rights that might just be
15 between business partners even. How would you
16 characterize the CCP trackage right agreement?

17 A. Well, it was not very well drafted, because
18 we were experiencing lousy service, and we didn't seem
19 to have any recourse to ^{force} ~~enforce~~ them to improve it.

20 Q. So in terms -

21 A. I hope you didn't draft it.

22 Q. No, sir, I didn't. In terms of recourse,
23 one of the important things involved in a trackage
24 rights agreement would be service penalties --

25 A. Yes.

1 could be in a position to serve your plant after the
2 merger. I think I finished with my hypothetical, and
3 now I'm asking you as a shipper, which would you
4 prefer?

5 A. Well, I would go to the carrier that's
6 acquired the trackage rights and say to that carrier,
7 what assurance can you give me that you'll make your
8 service commitments. And if you can't get either a
9 financial guarantee or some certainty about the
10 service, then you might well prefer the other, but,
11 you know, we're ^{taking}~~talking~~ rates out of it.

12 Q. And I am taking rates out of it, because you
13 wouldn't know, I assume, which rates either of the two
14 railroads would charge in the future. But I do not
15 want to limit you. If you're thinking of a way that
16 you can put rates into the picture, I'd like to hear
17 your views.

18 A. If you were a smart shipper, you'd go to the
19 carrier that served you directly and say what rate are
20 you going to charge me, and then you'd go to the other
21 one and find out that rate. But you would need
22 assurance from that carrier that you're going to be
23 able to get a level of service that allows you, as a
24 business owner, to be competitive in your relevant
25 marketplace.

1 Q. I'd like to focus in on those assurances.
2 For example, would a penalty clause give you some
3 assurance? And by "penalty clause" what I mean is
4 some sort of penalty clause that says that if the
5 tenant railroad is not able to achieve stipulated
6 service standards over the trackage rights, that the
7 landlord would have to pay a penalty. Would that be
8 something that would give you some assurance?

9 A. I think that would be a factor in assurance,
10 right.

11 Q. Any other factors that come to mind?

12 A. Is the penalty going to one from the
13 underlying carrier, the host carrier?

14 Q. Yes. A penalty that would be paid by the
15 landlord to the tenant if stipulated service standards
16 are not achieved.

17 A. Maybe another way of reassuring a shipper
18 would be by saying to the shipper, and if we fail to
19 meet that service requirement, I'll pay you --

20 Q. Okay.

21 A. -- a penalty, and we do that or BN has done
22 that.

23 Q. Do you know if BN has done that when the
24 service is provided over trackage rights that it has
25 obtained from some other railroad?

1 A. Well, BN has done it on services that may
2 involve areas where it has trackage rights as opposed
3 to its own owned track, yes. Is that what you're
4 asking?

5 Q. Yes.

6 A. Yes. We have done that, where you have a
7 railroad like Montana Rail Link, and we're serving
8 something from the Midwest in grain going over Montana
9 Rail Link into the Pacific Northwest. We have given
10 service guarantees, and if we fail on those
11 guarantees, then we will pay a penalty.

12 Q. And do you have some sort of underlying
13 right against the Montana railway in that situation?

14 A. If they fail to perform?

15 Q. In other words, if you have to pay the
16 penalty because of their failure somehow to give
17 you --

18 A. Well, two things about it. Yes, there are
19 some penalties if they fail to perform, but the other
20 one is that in most cases with many carriers, you have
21 a relatively civilized relationship because you each
22 need each other, and so you don't try to go out of
23 your way to exploit or take advantage of a situation.
24 That doesn't apply to all companies, but it does apply
25 to many of them.

1 Q. I thought there might be some exceptions to
2 that.

3 A. Yes, there are a few.

4 Q. Again, I'm going to have to give you a
5 context for this next question. And the question
6 deals with shippers who are physically served by only
7 one railroad and who are not able to gain access to a
8 second railroad through a reciprocal switching
9 agreement or some other arrangement. Do shippers in
10 these situations sometimes convince railroads to lower
11 their rates or to lower announced rail rate increases
12 by trucking their cargo to nearby stations on
13 competing railroads?

14 A. Yes.

15 Q. Can they be effective with that strategy?

16 A. Yes.

17 Q. I'm going to give you a little bit different
18 context on another shipper situation. In this case,
19 we're talking about shippers who are not physically
20 located on any rail line but are within a relatively
21 short distance of two different competing rail lines.
22 Can they exert competitive pressure on rail rates by
23 deciding whether to ship to one line or to the other
24 lines?

25 A. If they're a big enough customer, they can,

STB

FD-32760

6-3-96

E

83999

3 OF 4

1 yeah.

2 Q. In other words, if you --

3 A. And there are some factors we are sort of
4 pushing out, you know, that we're not considering. I
5 mean, the cost of handling and a lot of other
6 subsidiary things that might become involved in that.
7 But where you have a company that has the ability to
8 use a truck to access different railheads that will --
9 they will get -- they do have the benefit of some
10 competitive pressures.

11 Q. And some of these shippers are pretty smart,
12 aren't they? They play one railroad off against the
13 other.

14 A. I have yet to meet a very dumb shipper

15 Q. And they've been successful in the strategy
16 of threatening to take their business elsewhere if
17 they're not happy --

18 A. Well, I mean, every once in a while you call
19 a bluff, you know, it's like a poker game.

20 Q. And sometimes they're successful in that?

21 A. Sometimes they're very successful.

22 MR. MCGEORGE: That's all I have.

23 Thank you very much.

24 MR. HEMMER: Could we take a short
25 break?

1 A. No.

2 Q. And was that matter resolved relatively
3 quickly with CNW?

4 A. No.

5 Q. Were you able to reach a resolution with
6 CNW?

7 A. No. It was still hanging fire until the UP
8 bought the CNW.

9 Q. Once the UP bought the CNW, was the matter
10 resolved to both parties' satisfaction?

11 A. Well, I think that it was. I don't know
12 that the UP was totally satisfied with it, but it
13 became a dormant issue.

14 Q. Is Burlington Northern -- has Burlington
15 Northern been an effective competitor for traffic to
16 and from Houston and Galveston?

17 A. We've had severe service disability in the
18 Houston market, and so I would say we're not -- I
19 would not claim that we were as good a competitor as
20 we should be.

21 Q. Are those service disabilities in the
22 Houston area?

23 A. Yes.

24 Q. Has BN's ability to compete for traffic to
25 and from Houston been adversely affected by trackage

Justice.

Let me start off with something on page 1, draw your attention to that.

A. In my testimony?

Q. Yes. This actually is one of your former titles where you were head of the decision support and systems analyst department and it indicates that you developed Santa Fe's internal systems for measuring contribution (revenue less cost). I'm going to ask you, first of all, in terms of those definitions, what do you mean by -- I think I know what revenue means but what does cost mean?

A. It does depend. We believe very strongly that you would have to determine the costs that vary or are affected by a given situation or decision. So we try to calculate contribution. We calculate costs by determining the costs that we think change because a shipment moves.

Q. And is that the same thing as incremental or marginal costs?

A. We don't really use those terms in this case.

Q. Are you familiar with those terms?

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

A. I've heard people use them but I'm not confident that people always consistently use them with the same definitions.

Q. Let me see if I understand. Do you mean the costs that are attributed, for example, to carrying one additional carload of traffic?

A. No, I do not.

Q. What do you mean by cost, then?

A. Again, the costs that would occur associated with the movement. So if there is a portion of the rail that's used up because of the car moves, then the cost of expending that resource would be one of the costs.

Q. And so when you say contribution, that could be a shorthand for revenue minus the costs as you define them?

A. Yes.

Q. Is that the same thing as the concept of contribution to overhead or contribution toward fixed cost?

A. We have a portion of our costs that we knew are fixed and, yes, when we make these calculations, we determine the contributions before the fixed costs and then we show the fixed costs below the line and then the total

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

contribution affixed costs.

Q. Why is it important to measure contribution?

A. It's important to know for your lines of business that each piece of business is contributing towards fixed costs and that it is appropriate in our portfolio. We also measure it so we can see shipments and compare the various kinds of shipments so that we can make improvements. And the system that we're referencing here when ^{we first put it out} ~~we first put it out~~ clearly was a catalyst of the places that our operations were not as efficient as they could or should be and we put initiatives in place to change those things.

Q. At one point during your testimony, you indicated that BN/Santa Fe would be competitive for traffic over the trackage rights where you could make money.

A. Yes.

Q. When you used the term make money, is that the same or roughly the same as making a contribution towards fixed cost?

A. Yes.

Q. And does this operate the costs that

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

you've described? Does this operate as a price floor? In other words, is that the lowest possible price you might ever charge?

MR. WEICHER: Excuse me, Mr. McGeorge, but I'm not sure I heard a predicate. Does this, what was the this?

MR. MCGEORGE: This concept of making a contribution.

MR. WEICHER: Okay.

BY MR. MCGEORGE:

Q. Does that determine your price floor?

A. Yes, in large part. Within the parameters of, again, thinking about the costs that vary by the decision you make. I mean, it's possible, when you asked about marginal costs, it might be possible if someone would ask us to move one car one time and we knew we were going to run no more trains or anything else, we might put something on there that might -- but even in that definition, I would suggest it was covering the costs it incurred because of it.

Q. Does this mean you would never knowingly price a service at less than that amount, being the amount that covers the costs as you've defined them?

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

A. I gave you a definition or situation that you might see a negative number. There are some others that we might do this. I can't say we never would. Again, you have to think about how it fits into the rest of the network. Empty return might be another situation.

Q. Let me turn it on the other side. Are there occasions in which the railroad, a national railroad, which I assume includes BN/Santa Fe --

MR. WEICHER: Thank you.

BY MR. MCGEORGE:

Q. -- would price its service at an amount that just barely covered these costs and made a contribution towards fixed cost, if that's the most you could get and still move the traffic?

A. Yes.

Q. I'm going to move to the BN/Santa Fe traffic right negotiations with UP. Actually, with SP. And I'm taking you back to the Burlington Northern/Santa Fe merger case now.

A. Okay.

Q. I'm going to follow up a question which you've answered before. Why did the SP settlement agreement specifically mention UP and no other railroad that could have acquired SP?

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 Q. I marked it in the margin there in
2 black pen.

3 A. Okay. I'm sorry, what was your
4 question?

5 Q. My question is do you think UP/SP's
6 assumption of a 50/50 split between UP and SP for
7 the traffic to which BN/SF will gain access is a
8 reasonable assumption?

9 MR. WEICHER: If you accept his
10 assumption that that is what UP/SP is saying,
11 because I think you said you didn't read the
12 statement.

13 THE WITNESS: No, I didn't read the
14 statement. I'm not comfortable with suggesting a
15 given percentage. As I said earlier, you know, I
16 looked at the amount of revenue and carloads that
17 were available for the various lines and was
18 comfortable that we could gain a significant
19 enough amount of traffic that we could
20 effectively compete and the agreement would be of
21 benefit to us, but beyond that I don't have a
22 specific percentage.

23 BY MR. EDELMAN:

24 Q. Thank you. Would you anticipate
25 increased employment for BN/Santa Fe as a result

of the September 25 agreement if it goes into effect?

A. That depends to some degree upon the decisions that are made about reciprocal switching or how switching services are provided, terminal services, whether we utilize our rights to have UP/SP provide crews. But, if we gain a significant amount of additional business, that could very well add to the work load and then we might need to add people, yes.

Q. I direct your attention to paragraph 9 E of the settlement agreement please, page 16.

A. Okay.

Q. Can you read that paragraph to yourself, please.

A. I've read it.

Q. Okay. Now, is it fair to characterize this as an agreement between BN/Santa Fe and UP/SP for a preferential hiring arrangement off an eligibles list for a three-year period?

A. I believe so, yes.

Q. How did you arrive at a three-year period?

MR. WEICHER: I'm going to direct you not to answer insofar as it reflects any

Kauders Tr. at 165-167

165

1 actually be up to 28 cents a mile if we wanted to
2 take into account this Keddie-Stockton/Richmond
3 line I believe. Take a look at footnote 2 on
4 page 305 and just see if you agree with me.

5 A. That's what the footnote indicates.

6 Q. Okay. Now, let me take you back to
7 what I understand that you said earlier when we
8 were looking at your matrix in Kauders 2 which is
9 that all of these numbers should be increased by
10 about 10 percent to take into account the weight
11 in the locomotive which is reflected in the mills
12 per ton mile figures but not in the cents per car
13 mile figures; is that correct?

14 A. If I had a car that weighed 30 tons on
15 an empty basis, that would translate to -- and
16 let's say it was a bulk move, instead of
17 receiving 9 cents a car mile, we would receive
18 roughly 9.9 cents a car mile in order to take
19 into account the weight of the locomotives. I
20 believe you would be correct based on that
21 reasoning.

22 Q. So, if we took the numbers in column 3
23 in the line for the UP/SP-BN/Santa Fe settlement
24 agreement, instead of 24 to 25 cents a mile, we
25 should have approximately 26.4 cents to 27.5

ALDERSON REPORTING COMPANY, INC.

(202)289-2280 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 cents?

2 A. It would appear that way, yes.

3 Q. Okay. And would we make the same
4 adjustment to one other item here, I was going to
5 suggest that you look somewhere around 304 and
6 305. I believe that we had to make an adjustment
7 also for one other settlement agreement that's
8 reflected in table 2. This is starting on page
9 305, the last sentence of 305 going to 306, where
10 it says also converted to a car mile rate is the
11 mill per gross ton mile charge from the 1995
12 agreement between BN/Santa Fe and SP.

13 A. I have not seen that agreement and so I
14 don't know whether or not the same language
15 appears in that agreement as does in the
16 UP/SP-BN/Santa Fe agreement which is appended to
17 Mr. Rebensdorf's statement that would include --
18 that would call for the inclusion of the
19 locomotive in the computation of the gross ton
20 miles.

21 Q. Actually I'm sure you're right, we
22 would have to go back and look at that agreement?

23 A. I think we would have to go back to
24 that agreement in order to be sure.

25 MR. McGEORGE: Your counsel has a

ALDERSON REPORTING COMPANY, INC.

(202)289-2280 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 photographic memory it seems like.

2 MR. HEMMER: He hasn't seen it.

3 THE WITNESS: My vague recollection is
4 that there is a confidentiality clause in that
5 agreement which would preclude me from reviewing
6 it.

7 BY MR. McGEORGE:

8 Q. Let's just move on to something else.
9 Are you aware of a distinction between two
10 categories of trackage rights agreements in the
11 context of merger cases? And I'll give you the
12 two categories, at least make a representation
13 that these are two categories which are often
14 recognized.

15 The first would be what I would call
16 remedial trackage rights agreements. That refers
17 to a situation where trackage rights are given to
18 another railroad in order to cure or ameliorate
19 competitive problems. The second category would
20 be what I would call the business trade trackage
21 rights agreements.

22 In the view of the applicants and I
23 Commission or Board,
24 assume also the ~~commission or board~~, these are
25 trackage rights agreements that are not necessary
in order to cure competitive problems but for

ALDERSON REPORTING COMPANY, INC.

(202)289-2280 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 the most difficult part of the explanation.
2 Service didn't really improve. Again, it
3 stabilized at a level. But it didn't really
4 improve.

5 And I think the problem is that S.P. has
6 what I would call systemic problems that are
7 perhaps a lot deeper than perhaps just the
8 deferred purchase of locomotives. And we had a
9 lot of other deferred needs that we simply haven't
10 been able to address.

11 Q. Wasn't Mr. Moyers named railroader of the
12 year during this period?

13 A. (Mr. Ongerth) Yes, he was.

14 Q. What year was that?

15 A. (Mr. Ongerth) I think he was named
16 railroader of the year for 1994.

17 Q. And what's happened to service say in the
18 last year? Has it still stabilized, or is it
19 getting worse or getting better?

20 A. (Mr. Ongerth) I think it's getting
21 better?

22 Q. You think it's getting better?

23 A. (Mr. Ongerth) I think it's getting
24 better. A lot of service is perception, customer
25 perception.

1 what was the due diligence you did. I said, you
2 know, we had daily discussions with management of
3 Union Pacific.

4 MR. VIOLA: Among other things.

5 BY MR. MOLM:

6 Q. Did you keep any notes from those
7 communications?

8 A. Not that I have.

9 Q. Did you use such notes in preparing
10 your fairness opinion letter?

11 A. Absolutely. In the conduct of the
12 preparation of the financial analysis which is
13 the documentation that First Boston worked on, we
14 would reflect in the financial analysis the
15 discussions that we had with Union Pacific
16 management on an ongoing basis. And so the
17 financial analysis would be updated as part of
18 those daily conversations to reflect
19 modifications and variations based on those
20 discussions.

21 So, to the extent that our financial
22 assessment of the stand-alone value of Southern
23 Pacific and the valuation of the what we call
24 synergies changed as a result of those
25 conversations, that would have been reflected in

1 our consistent update of our financial analysis.

2 Q. Please correct me if I'm wrong, but I
3 understood that Union Pacific prepared these
4 synergies data and information?

5 A. Yes. And First Boston recreated Union
6 Pacific's preparation of the synergies analysis
7 so that we could prepare our own presentation of
8 the valuation of the synergies. Union Pacific
9 did not undertake to provide a value of the
10 synergies. They gave us the basic -- they
11 prepared the basic input to -- that we then
12 utilized to assess what the value of those
13 synergies was.

14 They didn't tell us what the value was
15 and then we told them that it's fair. They told
16 us what they believed the synergies would be and
17 then we did the analysis that we normally do to
18 ascribe a valuation to those compilation of
19 synergies.

20 Q. Give us an example of just one item
21 that they might have given to you as an example
22 of synergies and then the steps taken to assign a
23 value to that?

24 A. Well, G&A reduction is an example of
25 one of the line items that we call synergies.

Peterson Tr. at 27
(February 5, 1996)

27

1 compared BN/Santa Fe to Union Pacific/Southern
2 Pacific for ^{intermodal} modal traffic for these particular
3 corridors?

4 A. Well, when you say compared, we did not
5 attempt here to do a detailed physical
6 comparison. We produced an overall analysis of
7 the corridor which provides some important
8 physical types of information such as mileage and
9 so forth and then let a lot of that be said in
10 the operating plan and the statements of Mr. King
11 and Mr. Ongerth and others and John Gray and
12 others and talked probably more about market
13 shares of business and types of business and the
14 way some of those have existed and are changing
15 over time.

16 Q. Well, you did say you looked at
17 schedules; is that not correct?

18 A. We looked at them to some degree. We
19 didn't have to look, I think we are pretty
20 familiar with all intermodal schedules in these
21 corridors.

22 Q. And that's for all railroads?

23 A. Yeah, for the competing railroads,
24 correct.

25 Q. Did you review Mr. Spero's testimony in

ALDERSON REPORTING COMPANY, INC.

(202)299-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON D.C., 20005

Peterson Tr. at 57-59
(February 5, 1996)

57

1 accessible to us and they obviously handle that
2 business. And you can go to Appendix A, if you
3 like, and look at this to answer your question.

4 Q. You're not saying, are you, that UP and
5 SP are not effective competitors?

6 A. Well, I am --

7 MR. ROACH: Object to the form of the
8 question.

9 THE WITNESS: What I'm saying is that
10 Santa Fe -- I'm saying that we are acknowledging
11 in our analysis here, and there's a lot of
12 analysis, that there are three competitors in
13 that market. We call it a three-to-two market.
14 Now, does that mean that there are three
15 effective competitors for all segments of it? I
16 would say our analysis concluded that that's not
17 the case.

18 Take the automotive business. SP has
19 been totally knocked out of that business because
20 of its service and other problems. You take the
21 segments I mentioned like the LTL truck lines and
22 others, neither we nor SP can compete at that
23 level. You know, on other traffic, yes, we
24 handle some carload business, so does SP, so does
25 Santa Fe we handle intermodal traffic.

1 But Santa Fe is by far the dominant
2 carrier. We and SP are below them. And again
3 this is data that's before their merger, before
4 the BN/Santa Fe merger. And so we can see no
5 reason why Santa Fe is not going to improve on
6 its market position.

7 Q. Who knocked Southern Pacific out of the
8 automobile business?

9 A. UP and SP -- or excuse me, I'm sorry,
10 UP and Santa Fe.

11 Q. Where is the NUMMI plant?

12 A. The NUMMI plant is in Northern
13 California.

14 Q. So there are other automotive
15 facilities down in the Los Angeles area?

16 A. Actually Los Angeles at one time had
17 three auto assembly plants. Today it has none.
18 Ford had one, GM had two, they're all closed.
19 And it's things like that that have hurt SP and
20 have resulted in its worsening and worsening
21 financial situation. SP used to serve two of
22 those facilities directly.

23 Q. How did UP knock SP out of the
24 particular automobile facility markets?

25 A. Well, actually SP mostly handled the

1 General Motors business to Los Angeles, UP
2 handled the Chrysler business, and Santa Fe had
3 the Ford business. Santa Fe also served Ford's
4 assembly plant near Los Angeles.

5 We were successful in getting the Ford
6 business a few years ago after building a new
7 facility for them and a lot of other things.
8 Then Santa Fe outbid SP for the General Motors
9 business that SP had. How did they get it?
10 Built a brand-new intermodal facility at San
11 Bernardino, new equipment, better service, tied
12 in a satellite facility in San Diego which Santa
13 Fe serves and SP doesn't, had the ability to
14 serve Phoenix en route for GM business, and won
15 the contract.

16 I don't know the details of the
17 contract, but I believe it was a question of
18 price, service, and perception on GM's part that
19 they wanted to partner up with, you know, the
20 best railroad that was going to give them the
21 best service and be there long term for them.

22 MR. ROACH: Can we take a ten minute
23 break when it's convenient for you.

24 MR. MOLM: That's fine, we can do it
25 now.

ALDERSON REPORTING COMPANY, INC.

(202) 289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

Peterson Tr. at 149
(February 5, 1996)

149

1 So I think, knowing BN's -- knowing
2 BN's existing network, knowing their facilities,
3 knowing their service plan, knowing the reach of
4 their network, I personally believe they'll be
5 competitive from that area to literally every
6 market, competitive with us, a little better in
7 some, maybe we'll be a little better in others.
8 That's unlike SP which is from there quite
9 limited in its route structure.

10 Q. Well, if as a result of their cost of
11 providing service there and more specifically if
12 as a result of the compensation issues for
13 operating over the trackage rights that the BN/SF
14 costs are substantially higher than the cost of
15 UP/SP, would you expect them to be still in a
16 position to provide a competitive service?

17 A. Well, if their costs were significantly
18 higher -- which I know they will not be. But, if
19 they were, there may be some impact. But the
20 impact would be so small because first of all the
21 primary elements of a railroad's costs have
22 nothing to do with, you know, trackage rights
23 payments or anything like that, it's their crew,
24 their wages, their fuel for locomotives and the
25 locomotive investment.

Peterson Tr. at 467
(February 7, 1996)

467

1 A. I believe that's correct.

2 Q. And the reason you used lower diversion
3 percentages than you did for extended hauls
4 generally was because of uncertainty as to
5 whether shipper facilities at either end were
6 actually open to UP/Santa Fe and because the
7 complete nonparticipation by both UP and SP in
8 the existing routing might reflect factors
9 causing the shipper to favor the incumbent
10 carrier?

11 A. That's correct.

12 Q. Did you take those same factors into
13 consideration in arriving at the 40 percent
14 projection with respect to the intermodal traffic
15 that you expected BN/Santa Fe to capture between
16 Memphis and Houston?

17 A. Well, with regard to the two factors
18 here, the shipper facilities would not be a
19 consideration because we would be talking about
20 intermodal traffic between Houston and Memphis.
21 And BN/Santa Fe has very large modern intermodal
22 facilities at both Memphis and Houston and, in
23 fact, better facilities at Memphis than we
24 currently have.

25 Now, yes, the fact that

Peterson Tr. at 620-622
(February 7, 1996)

620

1 optimistic the big mileage savings that we're
2 going to get out of this merger are going to
3 bring a lot of public benefits.

4 Q. And do you understand that, although
5 you might view a reduction in a number of
6 employment positions as a benefit of the merger,
7 other people might look at it differently?

8 A. I can't say how other people may look
9 at things. They're entitled to their
10 perspective. But my view is that it's
11 appropriate to translate operating cost savings
12 into public benefits. And those operating cost
13 savings include reductions of employment which
14 leads to increased productivity which is one of
15 the things, you know, that drives our country's
16 standard of living.

17 Q. Then you said something earlier, a day
18 or two ago, about one of the critical things in
19 putting a merger like this together, assuming it
20 were to be approved, is hiring crews and you
21 wouldn't want to do that before the merger. Do
22 you recall that?

23 A. Yes.

24 Q. Do you think the same would be true for
25 BN/SF in Colorado and Utah and elsewhere where

1 they may have trackage rights, that they wouldn't
2 want to hire crews to handle any traffic they
3 might expect to be getting until after the merger
4 might be approved?

5 A. Let me answer your question, I think
6 that is a good question. With regard to the
7 crews from Denver out to the Glenwood Springs,
8 Grand Junction area, those will be stationed out
9 of Denver and they'll just draw those from their
10 existing crews.

11 They will need to put on new crew
12 districts between there and California. I would
13 expect that BN/Santa Fe would do all their
14 planning, get all their supervisors lined up and
15 so forth and then, following approval of the
16 merger, go out and start hiring crews.

17 I think the experience of both BN/Santa
18 Fe and SP in implementing their settlement in the
19 BN/Santa Fe merger is that it took them
20 approximately three months to then hire the
21 crews, train them, qualify them, and have them
22 ready to go so that they had put in an interim
23 haulage agreement which then was superseded by
24 the trackage rights when the crews were all ready
25 to go.

1 As you know it usually takes the merger
2 railroads much longer than that to start making
3 their changes because the implementing agreement
4 must be reached with the unions and, if they
5 can't be negotiated, then there's a process that
6 must take place. And we've seen that take up to
7 a year to accomplish.

8 Q. Now, you made a comment earlier about
9 the trackage rights fee paid by BN to UP under
10 the agreement as often being a small fraction I
11 think of the overall costs of the movement. Do
12 you remember that testimony?

13 A. Yes.

14 Q. That would not necessarily be true, for
15 example, if a utility in Colorado were using coal
16 off the Rio Grande from Colorado, would it?

17 A. Well, I don't believe BN anticipates
18 serving any mines in Colorado.

19 Q. Okay. How about Utah?

20 A. You're shipping Utah coal to Colorado
21 utilities? I think they pretty much do as you
22 say, draw their coal from Colorado.

23 Q. All right. Utah coal to a Utah
24 utility, then is the trackage rights fee going to
25 be a fairly large portion of the cost to BN?

Peterson Tr. at 990
(February 10, 1996)

990

1 any one of BN/SF, UP, or SP have sufficient
2 capacity to serve all the intermodal traffic
3 going between Chicago and Los Angeles in your
4 opinion?

5 A. Not today, by no means. Additional
6 capacity has been added continually over the past
7 several years. And Santa Fe is adding capacity,
8 they just opened a new facility at San
9 Bernardino, they just opened a new facility at a
10 place called Willow Springs west of Chicago.

11 That has given them the ability to
12 handle more business currently than they have
13 because those are both big incremental increases
14 in capacity. I expect Santa Fe will be
15 successful and eventually fill them up and then
16 look at expanding those facilities or building
17 new ones. But they would need additional
18 capacity to handle 100 percent of the current
19 market and the future market as well.

20 Q. Today do any two of the competitors for
21 that traffic have sufficient capacity to serve
22 all the intermodal traffic on that corridor?

23 A. Well, it's sort of I guess a question
24 of whether you're looking at a completely static
25 analysis or one where railroads can adapt their

Peterson Tr. at 1058-1059
(February 10, 1996)

1058

1 had gotten from these statements that you didn't
2 have before?

3 A. No. I don't want to get too long here,
4 I'll try to make this concise. As I say I hadn't
5 focused as much as I should have on how well
6 BN/Santa Fe will be able to utilize its existing
7 strategically located terminals to support the
8 trackage rights and how they won't require really
9 any new terminals or have to establish large
10 numbers of new crew terminals, crew locations.

11 And I'll just give two or three
12 examples. They have a major yard at Beaumont,
13 they have a major yard -- multiple yards in the
14 Houston area, and they have a very important yard
15 at Temple, Texas, in addition to several other
16 yards, huge facilities in the Dallas-Fort Worth
17 area.

18 But especially Beaumont will make
19 possible their serving this whole two-to-one area
20 at Orange, Texas, Mont Belvieu, Texas, that area
21 really just by adding an additional local train
22 or two at their existing terminal. Similarly
23 they have trackage rights already on us from
24 Houston down to Bay City and they have a local
25 train down there that already runs. So it will

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 be very easy for them to just extend to Corpus
2 Christi.

3 And then they will use Temple which is
4 already a major terminal for them to go north to
5 Waco and serve it, to reach south down to the
6 Georgetown railroad to serve the crushed stone
7 business, and to come on down to San Antonio. So
8 San Antonio will probably be about the only place
9 where they would require a new location say for
10 crews to get on and off.

11 So the combination of the increased
12 train frequency that they predicted and
13 especially this ability to just use these
14 trackage rights as kind of incremental feeder
15 lines into their existing terminals and network
16 is what really impressed me.

17 Q. Okay. You had mentioned that, in
18 regards to the settlement with BN, that you
19 thought that another railroad might give adequate
20 competition; but that you analyzed it and got
21 feedback from your customers and decided that BN
22 was really the best choice. Do you remember that
23 testimony?

24 A. Yeah, along those lines, yes.

25 Q. What I'm focusing on is the fact that

**Peterson Tr. at 289
(May 8, 1996)
Redacted**

Rebensdorf Tr. at 56-60
(January 22, 1996)

56

1 that the only way we could do that was through
2 merger.

3 Q. And how did you come to that
4 conclusion, did you examine the alternatives and
5 evaluate them?

6 A. There are very limited options in the
7 west to accomplish those objectives. One of them
8 was either the Santa Fe or one of them was the
9 Southern Pacific.

10 Q. And, without acquiring either the whole
11 of the Southern Pacific or the Santa Fe, did you
12 consider other possible ways to achieve the
13 objectives? Did you systematically evaluate
14 those?

15 A. As I said there were very limited
16 options to accomplish those objectives.

17 Q. I understand that was your conclusion.
18 And, in reaching that conclusion, what analyses
19 of alternatives other than merger did you look at
20 or did you make such analyses?

21 A. We looked at acquisition of Santa Fe or
22 Southern Pacific.

23 Q. Did you look at acquisition of
24 reasonably extensive trackage rights from
25 Southern Pacific or Santa Fe to effect a

1 shortening of routes and a streamlining of
2 routes, for example?

3 A. We looked at acquisition of either
4 Santa Fe or Southern Pacific.

5 Q. I understand that that is what you
6 looked at. But my question is is that all you
7 looked at or did you systematically evaluate or
8 analyze other ways to achieve your strategic
9 objectives?

10 MR. ROACH: I think at this point
11 you're lapsing into arguing with the witness who
12 has answered your question twice. I'm let him
13 answer one more time.

14 MR. HUT: My problem is the witness has
15 been cooperative until now and now he is not
16 being responsive.

17 MR. ROACH: I don't agree.

18 MR. HUT: I'd like to get an answer and
19 he hasn't told me he doesn't understand the
20 question.

21 THE WITNESS: I'm going to repeat
22 again, we looked at acquisition of either Santa
23 Fe or Southern Pacific in order to achieve the
24 objectives that I previously defined for you.

25 BY MR. HUT:

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

Q. Did you ever consider, in connection with shortening routes or extending networks, whether that could be accomplished through trackage rights or some other device without acquiring the entirety of Southern Pacific or Santa Fe?

A. We felt that the only way we could accomplish this was to acquire either Santa Fe or Southern Pacific.

Q. Sir, that is not my question. I know that that's what you concluded. But what did you do in order to reach those conclusions, did you make the evaluation that I just described with respect to the adequacy of trackage rights?

A. Could you describe for me what you're saying that we looked at? I'm not sure I understand your question. I'm telling you that, in order to achieve those objectives, that we looked at either acquisition of Santa Fe or Southern Pacific.

Q. And did you consider any other ways to achieve the objectives short of the acquisition of Santa Fe or Southern Pacific such as the acquisition of trackage rights, for example, to fill in the gaps in your route structure in the

west?

A. We came to the conclusion that the only way we could accomplish that was through acquisition of one of those two railroads.

Q. And, in order to reach that conclusion, did you consider alternatives, did you evaluate and/or model other alternatives?

A. It was the assessment of our people that to go to either Santa Fe or Southern Pacific and ask for essentially trackage rights through the heart of their system was a nonstarter.

Q. So you didn't do any study of that alternative?

A. We looked at acquisition.

Q. And you didn't look at anything else?

A. We looked at acquisition of the two railroads.

Q. Did you look at anything else?

MR. ROACH: Asked and answered. And I am going to instruct him not to answer. He just told you that they concluded that it would not be productive to go to these railroads and propose trackage rights. It's obvious in that answer that he considered that. You've asked him this at least five times now. Excuse me, I have a

1 cold.

2 BY MR. HUT:

3 Q. So do I. What Mr. Roach stated, was
4 that your answer, is that you did consider it and
5 evaluate it, correct, do you agree with that?

6 A. We considered whether or not it would
7 even be likely that the trackage rights that I've
8 described through the heart of both Santa Fe or
9 Southern Pacific's system would even be
10 reasonable. As I indicated to you, we concluded
11 that was a nonstarter; that, if we were going to
12 achieve these objectives, we had to acquire one
13 or both of those railroads.

14 Q. Was an objective of yours, in order to
15 make sure that you were the ^{premier} ~~premier~~-rail carrier
16 in the west, an effort to identify and alleviate
17 any capacity constraints on the service you could
18 provide your shippers?

19 A. I'm sorry, could you repeat the
20 question.

21 Q. In achieving the role as ^{premier} ~~premiere~~ rail
22 carrier in the west which you identified as one
23 of the objectives in connection with the SP
24 acquisition, was a part of that an effort to
25 eliminate any -- or significant capacity

1 Q. Did you ever consider, in connection
2 with shortening routes or extending networks,
3 whether that could be accomplished through
4 trackage rights or some other device without
5 acquiring the entirety of Southern Pacific or
6 Santa Fe?

7 A. We felt that the only way we could
8 accomplish this was to acquire either Santa Fe or
9 Southern Pacific.

10 Q. Sir, that is not my question. I know
11 that that's what you concluded. But what did you
12 do in order to reach those conclusions, did you
13 make the evaluation that I just described with
14 respect to the adequacy of trackage rights?

15 A. Could you describe for me what you're
16 saying that we looked at? I'm not sure I
17 understand your question. I'm telling you that,
18 in order to achieve those objectives, that we
19 looked at either acquisition of Santa Fe or
20 Southern Pacific.

21 Q. And did you consider any other ways to
22 achieve the objectives short of the acquisition
23 of Santa Fe or Southern Pacific such as the
24 acquisition of trackage rights, for example, to
25 fill in the gaps in your route structure in the

west?

A. We came to the conclusion that the only way we could accomplish that was through acquisition of one of those two railroads.

Q. And, in order to reach that conclusion, did you consider alternatives, did you evaluate and/or model other alternatives?

A. It was the assessment of our people that to go to either Santa Fe or Southern Pacific and ask for essentially trackage rights through the heart of their system was a nonstarter.

Q. So you didn't do any study of that alternative?

A. We looked at acquisition.

Q. And you didn't look at anything else?

A. We looked at acquisition of the two railroads.

Q. Did you look at anything else?

MR. ROACH: Asked and answered. And I am going to instruct him not to answer. He just told you that they concluded that it would not be productive to go to these railroads and propose trackage rights. It's obvious in that answer that he considered that. You've asked him this at least five times now. Excuse me, I have a

ALDERSON REPORTING COMPANY, INC.

(202)289-2280 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

1 cold.

2 BY MR. HUT:

3 Q. So do I. What Mr. Roach stated, was
4 that your answer, is that you did consider it and
5 evaluate it, correct, do you agree with that?

6 A. We considered whether or not it would
7 even be likely that the trackage rights that I've
8 described through the heart of both Santa Fe or
9 Southern Pacific's system would even be
10 reasonable. As I indicated to you, we concluded
11 that was a nonstarter; that, if we were going to
12 achieve these objectives, we had to acquire one
13 or both of those railroads.

14 Q. Was an objective of yours, in order to
15 make sure that you were the ^{premier} ~~premier~~-rail carrier
16 in the west, an effort to identify and alleviate
17 any capacity constraints on the service you could
18 provide your shippers?

19 A. I'm sorry, could you repeat the
20 question.

21 Q. In achieving the role as ^{premier} ~~premiere~~ rail
22 carrier in the west which you identified as one
23 of the objectives in connection with the SP
24 acquisition, was a part of that an effort to
25 eliminate any -- or significant capacity

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

Rebensdorf Tr. at 119-121
(January 22, 1996)

119

A. I never heard that.

Q. Have any customers told you about such opposition since September 1995, the day you negotiated this agreement?

A. Customers saying what? What is it?

Q. Expressing in words or substance opposition to the merger, even with the BN/SF trackage rights deal, on the grounds that it would weaken competition.

A. Again you would have to talk to the people that are dealing directly with the customer.

Q. You have not heard that directly or indirectly?

A. I have not heard that, no.

Q. Directly or indirectly?

A. I haven't heard it either directly or indirectly.

Q. Did you ever undertake as part of your strategic planning analysis at any time an evaluation that compares trackage rights to sale or divestiture as a remedy for anticompetitive effects asserted at two-to-one points?

A. Could you repeat the question.

Q. Sure. At any time, as part of your

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

strategic planning exercises or otherwise, have you compared trackage rights on the one hand to sale or divestiture of lines on the other as a remedy for claims of anticompetitive effects at two-to-one points?

A. We immediately focused on trackage rights as the competitive alternative and to my knowledge did not consider sale. In fact, we made it very clear right up front that we were not going to sell the Cotton Belt, we were not going to sell the DRGW.

Q. The question was intended to be a little broader, Mr. Rebensdorf. Let me try this and see how it goes, outside of the specific two-to-one points that were at issue in the SP acquisition, in connection with any acquisition or as a general proposition, have you made a comparison or seen any comparison between trackage rights on the one hand and sale or divestiture on the other as a competitive effects remedy?

A. Are you saying outside of the UP/SP merger?

Q. Inside or outside.

A. Anywhere?

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

Q. You bet.

A. Not that I can recall.

MR. HUT: This is a good time for a break.

(Whereupon, at 1:05 p.m., the deposition in the above-entitled matter was recessed, to reconvene at 2:05 p.m., this same day.)

Rebensdorf Tr. at 141-142
(January 22, 1996)

141

BY MR. HUT:

Q. Did you consider whether, in the event of a sale of the lines to Conrail as Conrail proposed or to KCS as KCS proposed, that some of the lost benefits could be obtained through trackage rights granted to UP/SP after the merger?

MR. ROACH: I'm sorry, can I hear it back.

THE REPORTER: "Question: Did you consider whether, in the event of a sale of the lines to Conrail as Conrail proposed or to KCS as KCS proposed, that some of the lost benefits could be obtained through trackage rights granted to UP/SP after the merger?"

MR. ROACH: I'm going to instruct him not to answer that.

BY MR. HUT:

Q. Did you discuss the KCS or Conrail proposals with anybody within UP?

A. Yes, the KCS and Conrail proposals were discussed internally.

Q. With whom? You can treat them separately for purposes of the answer.

A. Well, I'm not sure I can sit here and

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

name every person that was involved in these discussions within UP. Certainly, with regard to the Conrail proposal, this was discussed with Dick Davidson, there was discussion with our marketing folks, there was discussion with our corporate people on that particular proposal.

Q. Excuse me, let me interrupt. What do you mean by corporate people?

A. Our corporate finance, corporate legal, and obviously Drew Lewis.

Q. How many people all told would you say, can you estimate it in any way?

A. I couldn't even venture a guess.

Q. How about KCS?

A. KCS, there was discussion within the railroad, particularly again involving Dick Davidson, our marketing people, Jim Dolan, our vice president law was involved in that since he sat in on I believe all three of the meetings we had with KCS, and there was also some discussion with some of our operating people on the KCS proposal.

Q. Neither alternative I take it was ever presented to the Union Pacific Corporation board?

A. No.

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

Rebensdorf Tr. at 170-172
(January 22, 1996)

170

your verified statement on service standards, the trackage rights grants made from UP to BN/SF, who will control dispatch on those line segments?

A. If it is a line where BN/Santa Fe has trackage rights under Union Pacific, Union Pacific will be doing the dispatching on the line.

Q. You do have, do you not, a set of prior trackage rights agreements with BN/SF?

A. We have trackage rights with both the former Burlington Northern and with Santa Fe.

Q. Have you had any disputes of which you are aware, and by you I mean Union Pacific, with either Burlington Northern or Santa Fe with respect to those trackage rights grants?

A. There are no major disputes that I can even think of. And, in fact, if you look at Union Pacific's system, major access to major locations is over trackage rights on both of those railroads. We access the biggest freight market in the west via trackage rights over Santa Fe with Riverside and Daggett, California; that's how we get into Los Angeles.

We operate into Seattle and Tacoma with Burlington Northern, we have trackage rights

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

between Seattle and Portland over the Burlington Northern. We operate into the Powder River Basin on a joint track that is maintained and dispatched by Burlington Northern, essentially you might call it trackage rights to the extent it's maintained and dispatched by BN, major tonnage moving over that line. Our main line between St. Louis and Texas involves trackage rights over the Southern Pacific, between ^{Illmo,} ~~Elmo,~~ Missouri, and Dexter Junction, Missouri.

Trackage rights are an accepted practice in the U.S. railroad network. Without it there wouldn't be any network. And for Union Pacific, without it we would not have access to major points. The fact that we are a very strong competitor to BN/Santa Fe in all those markets attests I think to the fact that trackage rights are a tried and proven alternative to direct access on your own railroad.

Q. And it was an alternative indeed available to you in lieu of the acquisition to achieve some of the benefits such as route consolidation, shorter routes, and the like that you believe you have obtained?

A. I'm sorry?

Q. Trackage routes were an alternative available to you in lieu of an acquisition or a merger to achieve some of the very benefits that you have earlier identified in terms of route consolidation, streamlining, and the like?

A. Trackage rights where?

Q. Trackage rights over the SP.

MR. ROACH: Asked and answered.

You can answer it again.

If you want to take all day asking him the same question two and three times, he can answer it again. You asked him about six times whether he considered it and he told you it was not even worth considering because it wasn't feasible.

MR. LUBEL: He just launched into a speech about how wonderful trackage rights are. He opened it up.

THE WITNESS: Hold it. Let me just repeat it again. You're putting us into a position of saying go to Santa Fe, go to Southern Pacific and ask for trackage rights over the heart of their system. Again that was a nonstarter. As I said this morning at least three times, that was the reason that we looked

lines, you're talking of a railroad that is single track, centralized traffic control, with sidings that are relatively close. So we would not anticipate that, while BN/Santa Fe trains are running against the flow, that they would incur delay again because of the provision for equal dispatch and utilizing the facility that we have out there.

Q. Just so I understand, what you're saying is that trains moving in either one direction or the other are going to be put on a siding while the train going the opposite direction is allowed to pass; is that correct?

A. That's typically what happens.

Q. Okay. Do you anticipate that this grant of trackage rights and the line sales under the agreement with BN/Santa Fe is going to increase traffic for BN/Santa Fe?

A. Oh, I think that the application clearly shows that, \$450 million of additional revenue.

Q. Sorry, for BN/Santa Fe?

A. That's right, that's what I'm saying, \$450 million of additional revenue. And right after this settlement was signed, BN/Santa Fe

made an announcement that they saw this as a potential for a billion dollars additional market potential. They made a public announcement to that effect.

Q. If UP had an arrangement that would give it that revenue in that kind of range, traffic in that kind of range, would you anticipate there would be an increase in employment for UP?

A. Let me make sure I understand your question. If UP's revenues were to go up by a billion dollars, would there be an increase in employment?

Q. Yes.

A. If you're talking of increased volume which is probably the only way you're ever going to achieve that type of revenue increase, I don't know how the employment couldn't help but go up.

Q. So was it reasonable in your experience as a strategic planner to assume that employment should go up on BN/Santa Fe as a result of this agreement?

A. I would be hard-pressed to see why it would not. But again that's all relative to the base that you're looking at. I mean, to handle

ALDERSON REPORTING COMPANY, INC.

202/299-2260 (800) FOR DEPO
1117 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

this additional business, I would anticipate BN/Santa Fe is going to have to add additional people.

Q. Thank you. Now, I direct your attention to paragraph 9e. And this provides for am I correct a preferential hiring off an eligible list; is that correct?

A. That is correct.

Q. And that this preferential hiring would be for a three-year period, correct?

A. That is correct.

Q. How did you arrive at three years?

A. Through negotiation.

Q. Who has planned to determine the criteria for eligibility?

A. I'm not sure of your question.

Q. Do you know the criteria for who gets on the eligible list?

A. The criteria would be any employee that would be adversely affected, particularly in this one provision was -- if I can answer this without getting into trouble.

MR. ROACH: Well, don't disclose the details of the back and forth in the settlement talks, that's my standing instruction. You can

ALDERSON REPORTING COMPANY, INC.

(202) 239-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

Rebensdorf Tr. at 302-303
(January 23, 1996)

302

P R O C E E D I N G S

MR. EDELMAN: I guess we should say a few preliminary remarks, we're continuing the deposition of John Rebensdorf. Do we need to swear Mr. Rebensdorf again or I can just remind him that he's still under oath?

MR. ROACH: You can remind him as far as we're concerned.

MR. LUBEL: That will be everybody's understanding then.

EXAMINATION BY COUNSEL FOR RAILWAY
LABOR EXECUTIVES' ASSOCIATION AND
UNITED TRANSPORTATION UNION -- Resumed
BY MR. EDELMAN:

Q. Mr. Rebensdorf, you understand you're still under oath?

A. Yes.

Q. All right. Continuing with my questioning from last evening, I wanted to ask you a few questions regarding your views on the efficacy of trackage rights which is something you discussed early in your testimony. As I understand it, it's your view that generally trackage rights are as effective as running on your own tracks?

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FOR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

A. It isn't generally. Trackage rights are as effective as running on your own tracks.

Q. So in your mind two railroads running on the same track is as effective as two railroads running over their own track through the same area?

A. If there's adequate capacity, all things being equal, that is correct.

Q. And the length of the distance being traveled is to your mind not an impediment to the efficacy of the trackage rights operation?

A. Not at all.

Q. Are you familiar with the SP's trackage rights requests in the CNW/UP case?

A. Not in any detail.

Q. Now, I have a couple of questions about the Burlington Northern/Santa Fe transaction and your involvement in that. Did you have any involvement in evaluating the consequences of that transaction for UP?

A. I'm not sure I understand your question.

Q. Did you have any involvement in evaluating the consequences of the Burlington Northern/Santa Fe merger for UP?

ALDERSON REPORTING COMPANY, INC.

(202)289-2260 (800) FJR DEPO
1111 14th ST., N.W., 4th FLOOR / WASHINGTON, D.C., 20005

Rebensdorf Tr. at 451-460
(January 23, 1996)

451

1 designed to represent the trackage rights
2 component only?

3 Q. Yes.

4 A. Okay. And we're asking for dollars per
5 net ton?

6 Q. Well, you've --

7 A. Or dollars per gross ton?

8 Q. Excuse me. You've got these in gross
9 tons; is that correct? That's the way the charge
10 works?

11 A. That's correct.

12 Q. So for gross ton would one multiply
13 1,383 times .0031?

14 A. That's correct.

15 Q. All right. So would you accept subject
16 to check that that's \$4.29 cents per ton, per
17 gross ton I should say?

18 MR. ROACH: We'll accept it subject to
19 check.

20 THE WITNESS: Yes.

21 BY MR. McBRIDE:

22 Q. Now, turn back, if you would, to page
23 306. If this were movement at the 3.1 mill rate,
24 you show the revenue variable cost ratio for
25 UP/SP of the same charge to be 148 percent. Am I

1 correct on that?

2 A. That is correct.

3 Q. All right, sir. Would you accept
4 subject to check, therefore, that the variable
5 costs for Union Pacific on this movement, the
6 trackage rights charge we just agreed subject to
7 check being \$4.29 cents would be about \$3?

8 A. Accept subject to check.

9 Q. And I said about.

10 A. Fair enough.

11 Q. So that there's one dollar and 20 some
12 cents difference between the variable cost to
13 UP/SP and the trackage rights charge to BN/SF.
14 Do you accept that?

15 A. In the example you've cited, yes.

16 Q. So that the revenue variable cost ratio
17 to BN/SF for this movement is going to be lower
18 than it will be for the UP/SP because the charges
19 to BN/SF will be higher in variable costs than to
20 the UP/SP?

21 A. Restate the question.

22 Q. Will the revenue variable cost ratio to
23 UP/SP for this movement under the example we've
24 been using be higher than to the BN/SF because
25 the variable costs of UP/SP are lower than those

1 associated with the trackage rights for BN/SF?

2 A. If you go to page 307 in my testimony,
3 and I don't want to get into a lengthy discussion
4 here of costing, but you're focusing on the
5 variable costs. And, at a given point in time on
6 a variable cost basis, what I have shown here is
7 that we are in the range of 140 percent of
8 variable costs.

9 But, as I state on 307, that these
10 trackage rights are long-term. This is a 99-year
11 agreement. And we have got to be somewhere
12 between our variable cost and our fully allocated
13 cost over a long period of time. As I look at
14 these trackage rights, I've got to look at this
15 as a 99-year agreement, not as a snapshot, what
16 is BN's variable costs going to be vis-a-vis my
17 costs on a given day.

18 Q. But you can't testify for BN/SF as to
19 whether it looks at it the same way, can you?

20 A. Well, I think you would have to ask
21 BN/Santa Fe that question. But, as I've stated
22 before, BN/Santa Fe feels very confident that at
23 these rate levels they will be competitive in all
24 of the corridors that we're talking about.

25 Q. Competitive again against UP/SF or

1 against other regions of the country?

2 A. Competitive in serving the two-to-one
3 customers and competitive in the corridors for
4 business moving in those corridors.

5 Q. Now, is it a fact that UP/SP -- or UP
6 at least has stated that it's going to defer
7 nonessential maintenance in the central corridor
8 for five years?

9 A. I don't know where you ever picked that
10 up, I know nothing about that.

11 Q. Is it a fact that UP has had some
12 substantial capacity constraints in the last year
13 or two?

14 A. There are points on our railroad where
15 we have had capacity constraints.

16 Q. And what points might those be?

17 A. We are having capacity constraints
18 South
18 particularly from south Morrill, Nebraska, to
19 North Platte, Nebraska; from North Platte,
20 Nebraska, to Gibbon, Nebraska; Gibbon, Nebraska,
21 to some extent to Kansas City; in the corridor
22 between Fremont, Nebraska, and ^{West} west Denison,
23 Iowa; in the corridor between Little Rock,
24 Arkansas, and Marshall, Texas; in some of the
25 Texas corridors going west from Marshall toward

1 Houston; in the San Antonio-Laredo corridor. We
2 have had some capacity problems in the Kansas
3 City area, particularly between Kansas City and
4 Topeka. Would you like me to go on?

5 Q. Please.

6 A. We've had some capacity problems in the
7 Chicago area. We have had some capacity problems
8 on the portion of the east-west main line that do
9 not have reverse running centralized traffic
10 control. And we have had some capacity problems
11 in the Blue Mountains between Nampa, Idaho, and
12 Hinkle, Oregon.

13 Q. And is it a fact that service problems
14 on the UP got worse following the merger with the
15 Chicago Northwestern?
and North Western?

16 A. It is a fact that we have had some
17 service problems recently. It is not a fact that
18 that can be attributed strictly to the
19 acquisition of the Chicago Northwestern.

20 Q. Bear with me, I'm nearing the end.

21 Has UP/SP stated what reciprocal switch
22 charges would be along the central corridor after
23 the merger?

24 A. The reciprocal switch charges for
25 whom?

1 Q. For shippers generally, are there going
2 to be different charges for each shipper or
3 location?

4 A. Under what agreement? Are we talking
5 about the BN/Santa Fe settlement?

6 Q. Yes.

7 A. The charges is the switch charges
8 within this agreement?

9 Q. Yes, sir.

10 A. They have not been determined. But I
11 would also like to point out to you that we have
12 publicly announced that the Southern Pacific's
13 reciprocal switch charges would be lowered once
14 the merger is approved.

15 Q. Have you determined how much lower?

16 A. No.

17 Q. Will that vary from location to
18 location?

19 A. That has not been determined yet.

20 Q. When do you think that might be
21 determined?

22 A. I would suspect that we would make a
23 determination on that as we get closer to the
24 date of merger consummation.

25 Q. So you would expect then that the