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JUNE, 1996 # 56

June 3, 1996

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Mr. Vernon A. Williams
Surface Transportation Board
Case Control Branch
Room 2215
1201 Constitution Avenue, N.W.
Washington, D.C. 20423

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

Dear Secretary Williams:

Enclosed for filing in the above-captioned case are:

1. The original and twenty copies of The Brief of The Kansas City Southern Railway Company (KCS-60) in the above referenced proceeding. KCS's brief is being filed only as a public document. There is not a Highly Confidential version of KCS's brief.

2. Twenty copies of a Highly Confidential Appendix containing copies of all deposition pages and workpapers that are referenced in the Brief. The Highly Confidential Appendix is not being served on parties of record. Parties of record who are represented by outside counsel and such counsel have signed the Protective Order issued in this proceeding may request a copy of the Highly Confidential Appendix by calling Meg Andrews at (202) 274-2968.

3. Included with this filing is a 3.5 inch Word Perfect diskette, Version 5.1, containing the text of KCS-60.

4. The original and twenty copies of pages to be inserted into the Public Version of KCS-33 to replace pages that inadvertently disclosed Highly Confidential information. We ask that all Parties of Record also replace these pages in their copies of KCS-33. The

following pages in the original Public Version of KCS-33 should be destroyed and the enclosed redacted pages substituted in their place:

a. KCS-33, Vol. I, p. 43; and

b. KCS-33, Vol. II, pp. 337 and 339.

Please feel free to contact me if you have any questions.

Sincerely yours,

William A. Mullins
Attorney for The Kansas City Southern
Railway Company

Enclosures

cc: The Honorable Jerome Nelson
Parties of Record (w/o Appendix)

ORIGINAL

KCS-60

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 KANSAS CITY SOUTHERN RAILWAY COMPANY

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June 3, 1996

Attorneys for The Kansas City
Southern Railway Company

KCS-60

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
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June 3, 1996

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INTRODUCTION

The Kansas City Southern Railway Company ("KCS") submits this brief to assist the Surface Transportation Board[1] in its determination of whether the proposed merger between Union Pacific[2] and Southern Pacific[3] is in the public interest. As set forth herein, approval of the merger as proposed by Applicants will result in unprecedented harm to shippers who will experience diminished competition for their business. This was confirmed by one of UP's own executives who, in a presentation to the UP's Board of Directors, stated that one of UP's objectives in attempting the merger was to "Maintain Dominance In The West." Rebensdorf Dep., Exhibit 14, HC33-00004.

KCS will show that its proposed "Comprehensive Solution,"[4] calling for divestiture of parallel duplicative lines, will prevent UP from obtaining such market dominance by ameliorating the harm to shippers, while preserving the vast majority of the anticipated benefits to Applicants. For instance, no new proposed single-line route would be affected, and Applicants will be able to compete via single-line

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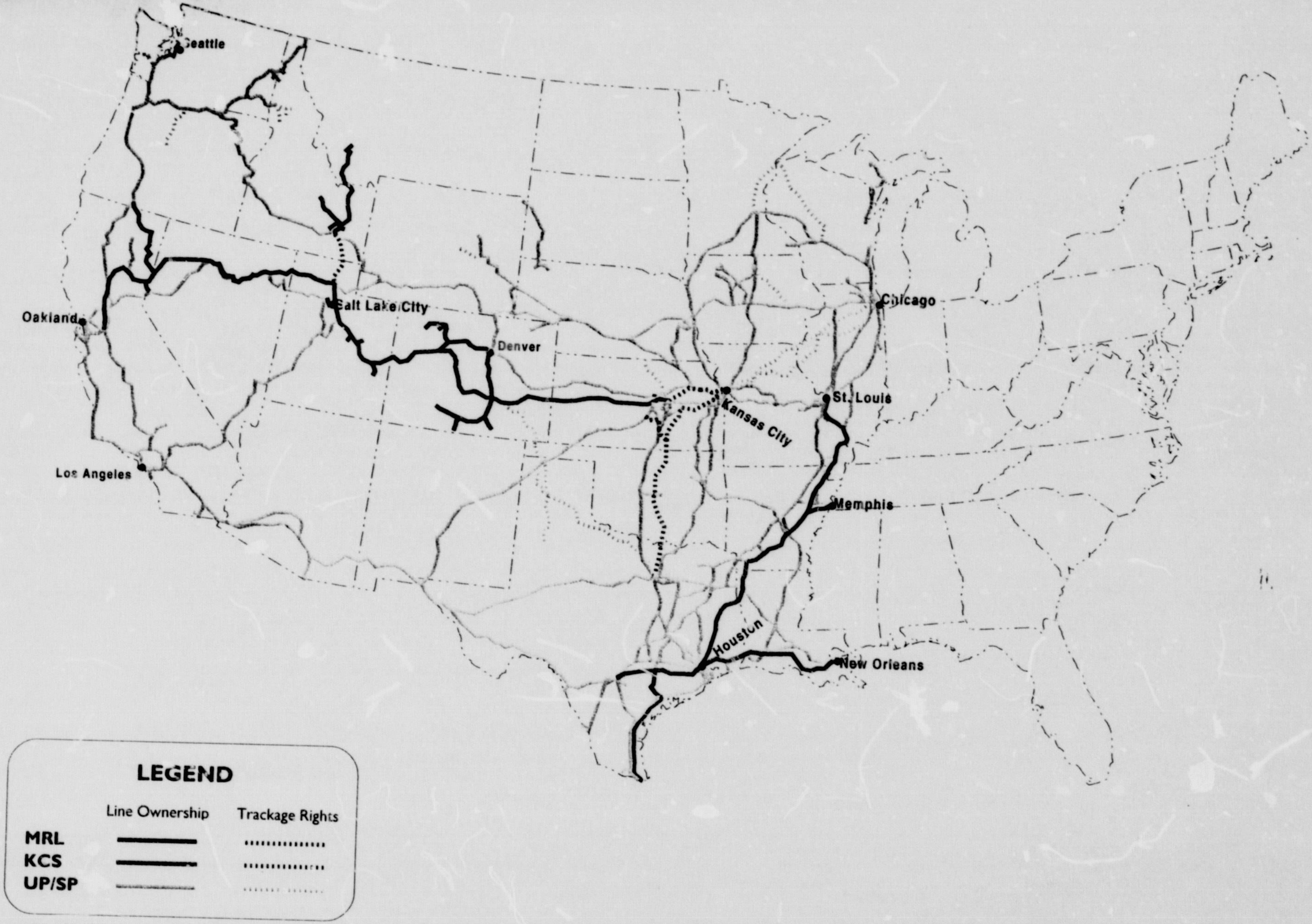
[1] The ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803, took effect on January 1, 1996 (the "Act"). The Act abolished the ICC and transferred certain functions and proceedings, including this proceeding, to the Surface Transportation Board ("STB"). Except as otherwise noted, all citations contained in these comments are to the former section of the Interstate Commerce Act. It is also assumed for purposes of the filing, that all references to the "Commission" or "Interstate Commerce Commission" or the "ICC" are interchangeable with references to the "Board" or the "STB."

[2] Union Pacific Railroad Corporation (UPC), Union Pacific Railroad Company (UPRR), and Missouri Pacific Railroad Company (MPRR) are referred to collectively as "UP."

[3] Southern Pacific Rail Corporation (SPR), Southern Pacific Transportation Company (SPT), St. Louis Southwestern Railway Company (SSW), SPCSL Corp. (SPCSL), and The Denver and Rio Grande Western Railroad Company (DRGW) are referred to collectively as "SP."

[4] A map depicting the "Comprehensive Solution" follows this page. A similar map was submitted in KCS-33, Vol. I, at 4. The map submitted herein is slightly different from the previous map, in that it now more accurately reflects the Montana Rail Link responsive application, the actual lines described by KCS for divestiture or trackage rights, and the actual competitive analysis submitted in KCS-33, Vol. III. KCS has proposed divestiture of one of the parallel lines between St. Louis and Houston; the SP line from Houston to New Orleans; and the SP line from Houston to Brownsville via Flatonia and Victoria. KCS-33, Vol. I at 2-6.

The Comprehensive Solution



May 24, 1996

Snavely King Majoros O'Connor & Lee, Inc.

routes with every BNSF[5] single-line route. Further, many of the lines that KCS proposes for divestiture are scheduled to be abandoned, and none are scheduled for upgrade under Applicants' capital investment program. Finally, divestiture of these lines will not affect Applicants' ability to consolidate overlapping functions and achieve the economics inherent in elimination of duplicative functions.

KCS will also show that Applicants' reliance upon the BNSF/CMA Agreement[6] insufficient in light of the economical and operational disincentives that will prevent BNSF from being an effective competitor. Similarly, Applicants' proposal for saddling the Board with oversight of this proceeding is both economically and practically unworkable.

KCS's "Comprehensive Solution" is the true free market solution that both benefits shareholders and preserves the public interest. The Comprehensive Solution ameliorates competitive harms, retains all service benefits, and provides UP/SP with the vast majority of the benefits they project for their merger. The BNSF/CMA Agreement mitigates only a marginal portion of competitive harms and substitutes constrained BNSF service for unconstrained SP service and price competition.

I. THE BOARD'S MANDATE IS TO CONSIDER THE POTENTIALLY HARMFUL COMPETITIVE EFFECTS OF THE MERGER AND TO MITIGATE THOSE EFFECTS WHEREVER POSSIBLE

The applicable statutory provisions that govern this transaction are codified at 49 U.S.C. 11341-51. "The Act's single and essential standard of approval is that the Commission find the [transaction]

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[5] "BNSF" refers to the entity created by the merger of the BN and the ATSF. *See Burlington Northern Inc. & Burlington Northern R.R. -- Control and Merger -- Santa Fe Pacific Corp. & Atchison, Topeka & Santa Fe Ry.*, Finance Docket No. 32549 (ICC served Mar. 7, 1995).

[6] As their solution to the competitive harms created by the merger, Applicants rely on their agreements with BNSF, collectively referred to herein as "the BNSF/CMA Agreement." The original agreement, which was entered into on September 25, 1995, and supplemented on November 18, 1995, granted BNSF approximately 4,000 miles of trackage rights and sold it another 330 miles of track. UP/SP-22 at 318-359. Subsequently, the Agreement was again amended on April 18, 1996, by virtue of the agreement entered into by Applicants, BNSF and the Chemical Manufacturers Association (the "CMA Agreement"). UP/SP-219. The CMA Agreement granted BNSF access over both UP and SP lines from Houston to St. Louis, adding more than 1,000 miles to the trackage rights covered.

to be 'consistent with the public interest.' 49 U.S.C. § 11344(c)." *Missouri-Kansas-Texas R. Co. v. United States*, 632 F.2d 392, 395 (5th Cir. 1980), *cert. denied*, 451 U.S. 1017 (1981). *See also Penn Central Merger Cases*, 389 U.S. 486, 498-499 (1968). In determining whether a transaction is in the public interest, the legislative history of the statute, prior precedents, and the Commission's own policy statement for proposed railroad consolidations all require the Board to give considerable weight to the competitive effects of a proposed merger. 49 U.S.C. § 11344(b)(1)(E); *McLean Trucking Co. v. United States*, 321 U.S. 67, 87-88 (1944); and *Northern Lines Merger Cases*, 396 U.S. 491, 510-513 (1970). Because this merger is of unprecedented proportion, the Board has a heightened obligation to give strict scrutiny to the claims advanced by Applicants and to carefully consider harms to competition.

Since the passage of the Staggers Act,[7] the Commission has consistently applied the principles established in the above cited cases by emphasizing the need to protect the public from any harmful effects on competition resulting from a proposed rail merger. In the Commission's general policy statement on rail consolidations, *Railroad Consolidation Procedures*, 363 I.C.C. 78 (1981), codified at 49 C.F.R. 1180.1, the Commission noted that the "consolidation of two carriers serving the same market might be contrary to the public interest despite the potential efficiencies that may be gained." 49 C.F.R. 1180.1(c)(2)(emphasis added). This was confirmed in *UP/MP*:[8]

> [o]ur analysis of the potential harm from a proposed consolidation focuses on two impacts highlighted by the statutes and policies discussed above: *any reduction in either intra- or intermodal competition which would likely result from the consolidation;* and any harm to essential services provided by competing carriers.

In *Santa Fe Southern Pacific Corporation-Control-Southern Pacific Transportation Company*, 2 I.C.C. 2d 709 (1986) ("*SFSP*"), the Commission again emphasized that "the effect of a transaction on

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[7] Staggers Rail Act of 1980. Pub. L. 96-448, 94 Stat. 1931 (Oct. 14, 1980) (Staggers Act).

[8] *Union Pacific Corporation, Pacific Rail System, Inc. and Union Pacific Railroad Company -- Control -- Missouri Pacific Corporation and Missouri Pacific Railroad Company*, 366 I.C.C. 462, 486 (1982) (emphasis added).

competition is a *critical factor* in our consideration of the public interest" *Id.* at 726 (emphasis added). The ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (1995) amended section 11344(b)(1)(E) to broaden the role of competition by requiring the Board to consider the competitive effects of the transaction on the entire national rail system, not just "in the affected region." H. Rep. No. 104-422, 104th Cong., 1st Sess. 191 (1995). The Staggers Act and the ICC Termination Act thus reflect an explicit directive that the Board give great weight to the need to preserve competition when considering a major rail merger.

Accordingly, it is clear that the legislative history, prior precedents, and the Commission's own policy statements establish that competition, and not efficiency, should be afforded the greater weight in determining the public interest standard. In determining whether the merger is in the public interest, the effect on competition should be the "critical" factor that the Board considers. In parallel mergers, such as this one (no parallel merger previously considered by the Commission has ever been of this magnitude), this burden is heavy:

> [A]s the Commission warned over five years ago in its Merger Policy Statement, parallel mergers are not favored where there are no other competing railroads. See *Merger Policy Statement*, 363 I.C.C. 784, 791 (1981). The burden of demonstrating that such a merger is in the public interest is a heavy one, and must be borne on the shoulders of substantial evidence, not *in terrorem* legal argument.

SFSP, 2 I.C.C. 2d at 833 (1986)(emphasis added). The presumption is that such mergers are highly disfavored, and it is Applicants' burden to establish that the merger is in the public interest. Applicants herein have failed to carry this burden.

II. AS PROPOSED, THE UP/SP MERGER WILL BE EXTREMELY ANTICOMPETITIVE

The issue in this proceeding is not whether the merger of the UP and the SP would be anticompetitive absent conditions: it will, and Applicants fully acknowledge the need to address the anticompetitive problems created by this merger. UPSP-230 at 11-12. Instead, the competitive issues in dispute are (1) the scope of those competitive harms and (2) which solution will best resolve the admitted competitive harms. Applicants' narrow definition of competitive harm is not supported in the comments of any government agency, shipper group, or other independent party. On the other hand, KCS's definition of competitive harm was confirmed by many independent parties.

A. The Proposed Transaction Will Result In A Significant Number Of "2-To-1 Shippers" That Are Not Granted Access To The BNSF Who Will Incur Competitive Harm

The revenues from shippers that will have their competitive options reduced from 2-to-1 is disputed. A comparison of the revenue calculations of KCS, DOJ, shippers and Applicants reveals a range from $2.6 billion to $796 million:

KCS	$2.0 billion[9]
DOJ	$1.5 billion[10]
SHIPPERS	$2.6 billion[11]
APPLICANTS	$796 million[12]

While Applicants may quibble with the methodologies employed by the other parties, one fact is clear: Applicants have significantly understated the amount of "2-to-1" traffic that currently benefits from independent UP and SP competition. Applicants have attempted to remedy some of this "2-to-1"

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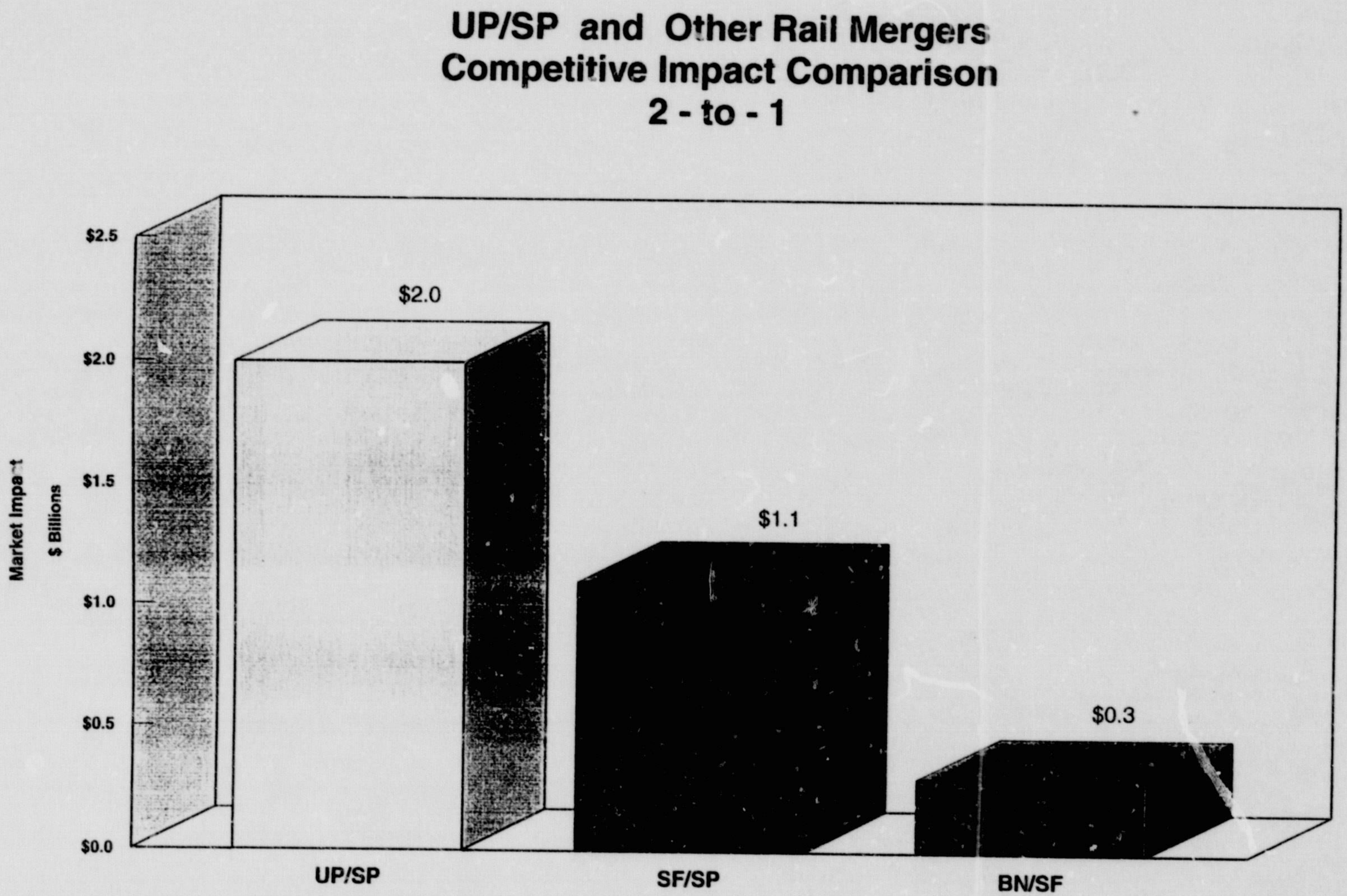
9 KCS-33, Vol. I, V.S. Grimm at 151.

10 DOJ-8, V.S. Dr. W. Robert Majure at 1, 9-15. The analysis by Dr. Grimm and Dr. Majure was conducted independently, with some varying assumptions, but reached very consistent conclusions. Both used a corridor analysis, as opposed to the point definition of competition argued by the Applicants. Grimm's geographic areas were BEA pairs. Majure used BEA pairs for some commodities, and SPLC4 pairs for others. Majure employed a screen and eliminated from consideration certain commodities; Dr. Grimm did not use such a screen, but provided a summary table of commodities/distances for both 2-to-1 and 3-to-2 traffic.

11 NITL-9 at 24, Exhibit TDC-1B and 1C, V.S. Crowley 3, at 9-10.

12 UP/SP-230 at 110; UP/SP-231, R.V.S. Peterson at 26-27; Errata UP/SP-240. The $796 million figure represents the amount of 2-to-1 point traffic for which BNSF may compete under the BNSF/CMA Agreement. There is another $206 million of such 2-to-1 point traffic for which BNSF will gain access but for which UP and/or SP will have exclusive control at origin or destination. Applicants do not consider this $206 million of traffic to be true 2-to-1 point traffic. UP/SP-231, R.V.S. Peterson at 27.

Figure 1.1



Source: 1994 100% traffic tapes and ICC Waybill Sample.
Figures rounded for purposes of public disclosure.

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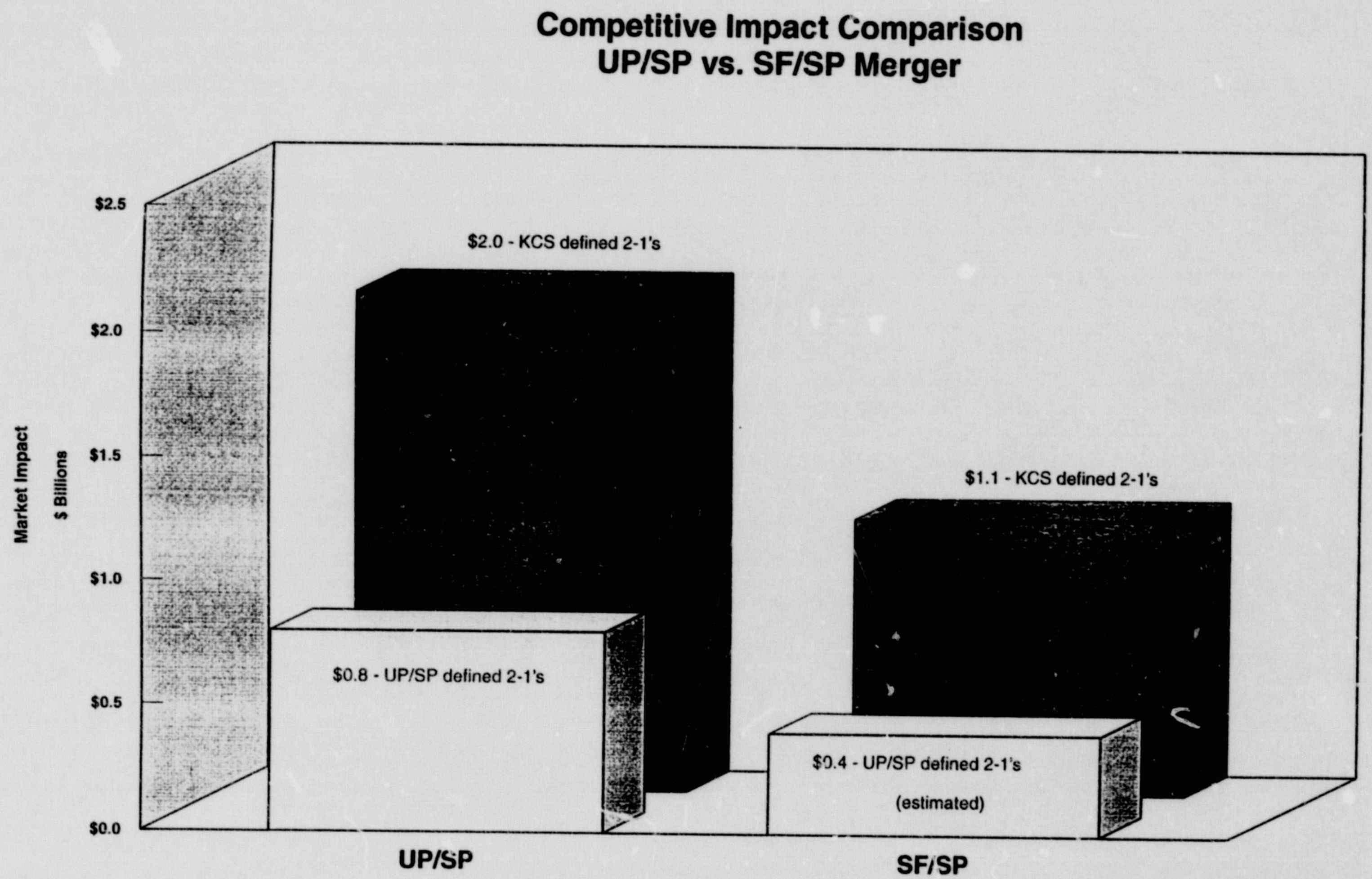
Figure 1.2



Source: 1994 100% traffic tapes and ICC Waybill Sample.
Figures rounded for purposes of public disclosure.

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harm by granting BNSF an extensive set of trackage rights at what Applicants consider "2-to-1 points." This would give BNSF access to only $796 million of the 2-to-1 traffic. Even if BNSF wins the bids for all of the $796 million in 2-to-1 traffic (as defined by Applicants), the other 2-to-1 shippers, *i.e.*, those not included in Applicants' definition, would lose the benefit of two carrier competition as a result of the merger. In fact, based upon Dr. Grimm's methodology, only about $500 million of 2-to-1 shipper revenue will receive access from BNSF under the BNSF/CMA Agreement. TM-34, R.V.S. Grimm at 12.

Regardless of which calculations the Board adopts, it is clear that the amount of traffic revenue that will be subject to a rail monopoly is significantly greater than either the BNSF merger or the failed SF/SP merger. As Figures 1.1 and 1.2 reflect,[13] the 2-to-1 impact of the proposed UP/SP merger is 7 times the size of the BNSF merger and almost twice the size of the rejected SF/SP merger.[14]

B. The Proposed Transaction Will Result In A Significant Number Of "3-To-2 Shippers" That Are Not Granted Access To BNSF And Who Will Suffer Competitive Harm

In addition to the "2-to-1" impacts of this merger, the merger will also result in shippers in many markets throughout the West (and for traffic originating and terminating in Mexico) losing the benefit of three railroad competition. The 3-to-2 impacts of this merger are enormous.

As with the 2-to-1 traffic, Applicants have vastly understated the amount of 3-to-2 traffic, and the BNSF/CMA Agreement does not even attempt to address the anticompetitive effects upon shippers located at these 3-to-2 points.

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[13] These figures are substantially equivalent to those submitted by Dr. Grimm, KCS-33 (Highly Confidential Version), Vol. I, V.S. Grimm at 158 and 190, which were based upon the 100% traffic tapes. They have now been slightly modified to allow public disclosure and to reflect Applicants' own quantification of the 2-to-1 points as reflected in UP/SP-230, R.V.S. Peterson at 26.

[14] Applicants have not challenged the fact that the competitive harm in this proceeding greatly exceeds that projected in the SF/SP merger, which was characterized by Applicants' own witness, Mr. Barber, as a deal that "would have choked off an enormous amount of competition." Barber Rebuttal Dep. at 46.

KCS	$5.1 billion[15]
DOJ	$4.75 billion[16]
Applicants	$2.14 billion[17]

C. The Proposed Transaction Will Result In Significantly Higher Rates To Shippers

The reductions in competition discussed above will significantly raise prices to shippers.[18] This conclusion was confirmed by the Department of Justice--the only party in this proceeding to submit a comprehensive econometric study focusing on grain products. Dr. Majure specifically conducted his study to "test the robustness of MacDonald's finding." DOJ-8, V.S. Majure at 24. Dr. Majure's analysis confirmed Dr. MacDonald's findings. He found price increases from 9.17% to 10.9% for

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[15] KCS-33, Vol. I, V.S. Grimm at 193-194. Figure based upon 100% traffic tapes of UP, SP, BNSF, KCS, and 1994 Waybill Sample for other railroads. Figure was rounded for purposes of public disclosure.

[16] DOJ-8, V.S. Majure at 29-30.

[17] UP/SP-230 at 173-180; UP/SP-231; R.V.S. Peterson at 24.

[18] It is well settled that the reduction in competition in 2-to-1 and 3-to-2 markets would significantly raise prices to shippers. Unlike the analyses done by Mr. Peterson and Mr. Bernheim, the following studies went through a rigorous critique process whereby such studies were scrupulously reviewed before publication: Levin, Richard, "Railroad Rates, Profitability, and Welfare under Deregulation," *Bell Journal of Economics*, Spring 1981, pp. 1-26. Grimm, C., *Horizontal Competitive Effects In Railroad Mergers*, Research in Transportation Economics, Vol. 2, Theodore Keeler, editor, JAI Press, 1985, pp. 27-53; McDonald, J., *Competition and Rail Rates For The Shipment Of Corn, Soybeans, and Wheat*, Rand Journal of Economics, Vol. 18, 1987; McDonald, J., *Railroad Deregulation, Innovation, and Competition: Effects Of The Staggers Act On Grain Transportation*, Journal of Law and Economics, Vol. 32, 1989, pp. 63-95. In the latter study, McDonald notes: "Competition among railroads has a statistically significant, fairly strong effect on rates. More competitors, as measured by RRCOMP, are associated with lower rates." *See also*, Winston, C., Corsi, T., Grimm, C., and Evans, C., *The Economic Effects of Surface Freight Deregulation*, Brookings Institution, Washington, D.C., 1990, and a follow-up article, Grimm, C., Winston, C., and Evan, C., *Foreclosure Of Railroad Markets: A Test of Chicago Leverage Theory*, Journal of Law and Economics, Vol. 35, 1992, pp. 295-310. These studies all focused on the rail industry and were published in highly reputable academic journals or as monographs.

railroad traffic going from 3-to-2 and increases of 19.4% for markets going from 2-to-1.[19] Based upon this analysis, the **Department of Justice has estimated over $800 million of harm to shippers in the form of increased prices.** *Id.*, at 36. **Furthermore, based on Dr. Majure's estimated price increases from 2-1 and 3-2 traffic applied to Dr. Grimm's assessment of 2-1 and 3-2 volumes, shippers would suffer over $1.2 billion per year in price increases.**

The view that shippers will face price increases as a result of the merger was also confirmed by KCS witness Grocki (KCS-33, Vol. I at 113-114; Vol. II, V.S Grocki), who performed an analysis based not on the econometric evidence, but rather upon shareholder value and the share price that UP is paying to SP. Based upon Applicants' claimed "synergies" between UP and SP, Mr. Grocki found UP was paying a "premium" above and beyond the true worth of a wholly intact SP to the UP.[20] This premium must be "made up" from some source. The likely source will be through increased margins on existing business--in other words, through increased prices to shippers. Based purely upon this financial analysis, such "increased margins" for UP could translate into 21% price increases for shippers. KCS-33, Vol. II, V.S. Grocki at 340-45.[21]

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[19] Dr. Majure's analysis was based upon using SPLC-6's for the geographic market. Using BEA's, the price effect of going from 3-to-2 is 13.8% and 24.7% for 2-to-1 traffic. DOJ-10, Errata for DOJ-8, V.S. Majure, at 36, line 5. Multiplying these effects by KCS's $2.0 billion 2-1's and $5.1 billion 3-2's totals $1.2 billion in estimated price increases.

[20] The fact that UP was paying a premium to SP was confirmed by Mr. James A. Runde, a financial analyst employed by SP, who stated that UP's offer was "at the high end." Runde Dep. at 152.

[21] Mr. Rebensdorf criticizes Mr. Grocki for rejecting "other standard means of establishing the value of business." UP/SP-231, R.V.S. Rebensdorf at 34. However, Mr. Grocki used the Discount Cash Flow approach. This approach is widely supported in the literature as the most appropriate means of valuing a business. Mr. Rebensdorf also criticizes Mr. Grocki for using UPC's and SPC's historic working capital levels rather than the railroads' working capital. UP/SP-231, R.V.S. Rebensdorf at 34-35. However, if one consistently applies UPRR and SPRR working capital relationships to the same analysis as Mr. Grocki conducted, the value of the SP (at a 12% weighted average cost of capital) drops from the $21.27 contained in Mr. Grocki's verified statement to $20.00. A reduction in value of (continued...)

D. The Harm To Shippers Is Not Outweighed By Alleged Efficiencies

A strict balancing test, weighing the alleged efficiency gains or net benefits[22] against the $[illegible] million - $1.2 billion in harm to shippers,[23] would result in denial of the proposed transaction. Considering that Applicants also have significantly overstated the net benefits and efficiency gains that would result from the merger, the transaction fails the balancing test even more. KCS witnesses O'Connor and Darling show the merger would not achieve the estimated net benefits. Their analysis shows that Applicants will be able to achieve net benefits in the range of $435 million at most, significantly less than the $750 million claimed by Applicants. KCS-33, Vol. I at 87-89; Vol. II, V.S. O'Connor/Darling. O'Connor and Darling's analysis is consistent with three independent studies done outside the context of this merger proceeding, which found that most benefits were either never achieved

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[21](...continued)
approximately 6%. Similar reductions in value occur at other weighted average costs of capital. Therefore, Mr. Grocki conservatively and correctly used UPC and SPC's working capital relationships in making his adjustments. Mr. Rebensdorf also alleges that the cash flow forecast Mr. Grocki used differs substantially from those of CS First Boston and that his use of "cash flows..... beyond the forecast period are well below that used by CS First Boston". *Id.*, at 34-35. These statements are simply incorrect.

[22] Applicants claim the net benefits to be approximately $750 million per year after year 5. UP/SP-22 at 8, Vol. 1, Exhibit A. Even if such benefits did in fact occur, Applicants have made it clear that they "have no specific plans regarding the passthrough to particular shippers of cost savings attributable to the UP/SP merger." UP/SP-33, Response to KCS Interrogatory No. 33. Accordingly, to the extent there are benefits in the form of cost savings, such benefits are purely private benefits and are not in the public interest.

[23] Although economists may differ on whether the $800 million to $2 billion in revenue transfers from shippers to UP/SP in the form of increased prices is truly a net harm to the public interest, the Commission has made it clear that it considers such wealth transfers harmful to the public:

> Revenue transfers that result in reduced competition, the exaction of monopoly profits, and the reduction of efficient transportation services reflect private benefits harmful to the public.

SFSP, 2 I.C.C. 2d at 725 (1986).

or were the result of overall industry improvements such as productivity gains.[24] Applicants' witness Hartman's testimony regarding the difficulty of implementing "significant productivity gains," (UP/SP-232, R.V.S. Hartman at 15) actually supports KCS's criticisms with regard to the difficulties of trying to impute productivity gains and other benefits solely to mergers. Significantly, UP's Mr. Peterson acknowledged that, "[i]t is simply not possible to isolate merger benefits from other changes in any quantitative way." Peterson R.V.S. at 218.

Similarly, while UP/SP witness Kauders' analysis appears at first glance to contradict the O & D and R.L. Banks studies, he looks at the third, seventh, and eleventh years following only the *UP/MP/WP* merger, while the Banks study examined only the second and fourth years following all mergers.[25] The long time period used by Kauders confuses merger effects with long term institutional changes brought about by deregulation.[26]

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[24] Analysis of N&W-Wabash-Nickel Plate Merger, Prepared for Federal Railroad Administration by Gellman Research Associates, December, 1977; A Prospectus for Change in the Freight Railroad Industry, A Preliminary Report by the Secretary of Transportation, U.S. Department of Transportation, Washington, D.C., October 1978; and R.L. Banks & Associates, Inc./KPMG Management Consulting, *Railway Merger Initiatives: The U.S. Experience, A Report to the Ontario [Canada] Ministry of Transportation*, 84 pg., plus Appendices A-D (March 1995). The fact that mergers do not always achieve their claimed benefits is also confirmed by studies performed for industries other than the rail industry. Scherer and Roth, *Industrial Market Structure and Economic Performance*, (Houghton Miflin, Boston, MA 1990) at 172. ("The question remains how well did acquiror's do with the companies they acquired after the mergers were consummated . . . . The picture that emerges is a pessimistic one: widespread failure, considerable mediocrity and occasional successes.") *Id.* at 174. ("To sum up, statistical evidence supporting the hypothesis that profitability and efficiency increase following mergers is at best weak. Indeed the weight of the evidence points in the opposite direction: efficiency is reduced on average following merger.").

[25] This is consistent with 49 C.F.R. § 1180.9(b), which provides that the relevant time period for analysis is that interval during which the operating plan is implemented.

[26] Most of the benefits achieved by the railroad industry in the post-Staggers Act period were a result of general trends in the industry due to deregulation and not the result of mergers. *See* KCS-33, Vol. I, V.S. Grimm at 153-160; V.S. O'Connor/Darling at 266-295.

Importantly, the notion that this merger will not achieve all of its claimed benefits was confirmed by the United States Department of Justice. Dr. Laurits R. Christensen on behalf of the DOJ found that Applicants' calculations of merger benefits improperly included: (a) efficiencies that the rail industry as a whole would achieve over the next five years; (b) private benefits that may be realized by Applicants but will not inure to the benefit of the public; and (c) benefits that UP and SP could obtain without merging. DOJ-8, V.S. Christensen at 3. Dr. Christensen concludes that the benefits of this merger may be anywhere from as low as $73 million to as high as $504 million. *Id.*, at 37-38.

This merger thus will result in significant price increases to shippers in the range of $800 million - $1.2 billion per year while achieving efficiency gains of $73 to $504 million per year. Accordingly, even if the Board employs the strict balancing test advocated by Applicants, the merger as currently crafted must be denied.

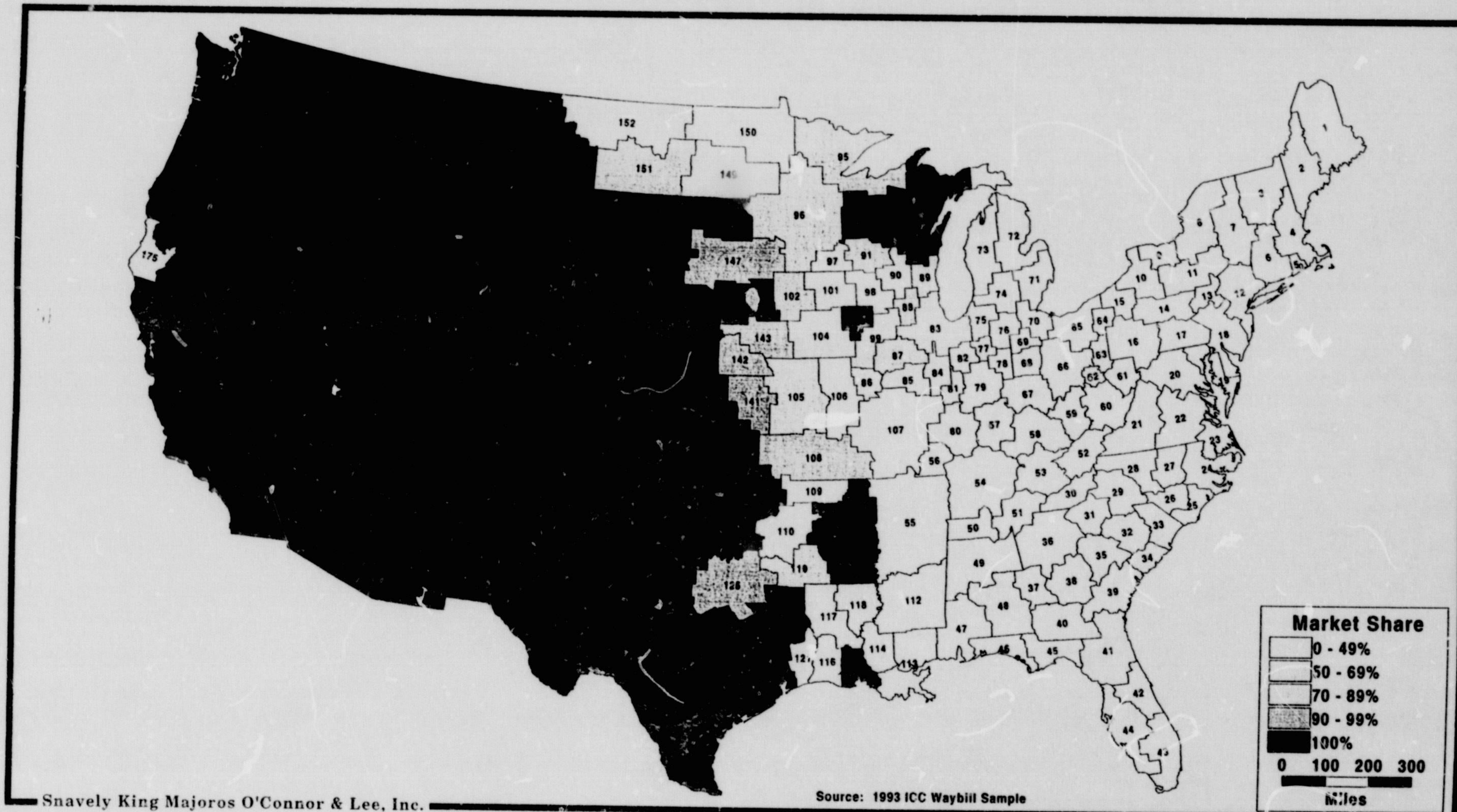
E. The Proposed Transaction Will Result In A Duopoly In The Entire Western United States

The Board should be mindful that it has an obligation to consider the cross-over and cumulative effects of the proposed transaction in light of the effects created by the BNSF merger. 49 C.F.R. § 1180.1(g); Decision No. 6 at 5. *See also BNSF*, Decision No. 38, slip op. at 57-58; *BNSF*, Decision No. 39, slip op. at 6-7. If the proposed merger is approved, BNSF and UP/SP, jointly, will have control over virtually all (over 90%) rail traffic in the entire Western United States. The amount of market share that would be controlled by these two railroads if the merger is approved was graphically illustrated (by BEA) in KCS-33, Figure 8.1, V.S. Grimm at 197 (KCS-33) and is reproduced on the next page.

Furthermore, if this merger is approved, leaving only two railroads in the Western United States, the Board will have precluded the possibility of ever having three transcontinental railroads because it would have set the stage for a duopoly throughout the entire United States. As Mr. Krebs only recently

Figure 8.1

Combined Market Share of UP-SP and BN-SF Railroads



Map of Business Economic Areas

Market Share Basis:
Carloads Originated by Class I Railroads

confirmed in a May 3, 1996 article in the WASHINGTON POST, BNSF is interested in acquiring an eastern carrier.

> If Krebs should go for Norfolk Southern and succeed, Union Pacific [meaning the merged UPSP] 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.

Phillips, *Man With a One-Track Mind, Burlington Northern-Santa Fe President Hopes to Engineer First Transcontinental Line*, WASHINGTON POST, May 3, 1996, 1B.[27] Mr. Krebs' prediction of transcontinental railroads was reaffirmed in his deposition. Krebs Dep. at 20-23. In contrast, and in a bit of irony, UP's President, Mr. Dick Davidson, recently asserted that without the merger there remains a possibility for three transcontinental railroads.[28] The Board's decision in this proceeding thus will have far reaching implications, and if there are only two railroads in the entire United States, the stage would certainly be set for reregulation of the rail industry.

III. A SUBSTANTIAL PORTION OF THE SHIPPING COMMUNITY REMAIN OPPOSED TO THE MERGER AS PROPOSED

Applicants cite to the 1,300 or so shippers that support the merger. This support is small given the fact that Union Pacific and Southern Pacific contacted over 3,500 shippers[29] in an attempt to obtain shipper support. Thus, more than 50% of the shippers contacted did not provide a statement.

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[27] *See also* Burke, *NIT League spurns UP overtures on SP merger, sticks with call for divestiture*, TRAFFIC WORLD, May 27, 1996 at 24.

[28] *Id.*, at 25 (Davidson stated that denial of the merger would put pressure on SP to link up with an Eastern carrier which would then create pressure on UP and BNSF to do the same thing "creating three transcontinental systems.").

[29] Applicants' Document Nos. C14-000001-000161, C14-100001-100077.

Considering that UP and SP serve in excess of 12,000 shippers,[30] only a small fraction have provided support statements.

Of the 1,300 "pro merger" statements that were provided, very few were from chemical or bulk commodity shippers located in the Houston to St. Louis and Houston to New Orleans corridors. Most importantly, many of the 1,300 statements that were provided are conditional statements, *i.e.*, support for the merger if appropriate competitive conditions are maintained. The evidence in this proceeding also shows that Applicants offered shippers long term contracts or price breaks in exchange for giving letters of support (*e.g.*, HC45-003923), and many shippers are afraid to speak out against the transaction for fear of "retaliation." CCRT-4 at 2.

On the other hand, a broad range of shippers are adamant in their opposition to the merger unless the Board imposes certain conditions. This opposition includes the NIT League, which represents over 1,400 shippers, which again recently rejected the merger by a vote of 46 to 9.[31] The Society of the Plastics Industry, which has over 2,000 member companies, likewise recently reiterated to Union Pacific its opposition to the merger unless there is a divestiture of tracks in several key corridors, which condition was also requested by NIT League.[32]

Agriculture groups also firmly advocate that conditions, other than the BNSF/CMA Agreement, be imposed on the merger. These include the American Farm Bureau, the National Grange, The Texas Farm Bureau, the National Farmers Union, the Kansas Farm Bureau, the Enid Oklahoma Board of

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[30] Based upon an analysis performed by Snavely, King utilizing the 100% traffic tapes, there are approximately 12,000 shippers between the two carriers. KCS-33, Vol. I, at 46.

[31] Watson, *Transportation League stands firm on UP-SP merger opposition*, JOURNAL OF COMMERCE, May 20, 1996, 1B.

[32] Letter from Larry L. Thomas, President, The Society of the Plastics Industry, Inc. to Mr. Richard K. Davidson, President and Chief Operating Officer, Union Pacific Corporation, dated May 7, 1996.

Trade, together with smaller, but not insignificant groups, such as the Colorado Farm Bureau, the North Dakota Farm Growers Association, the Texas Wheat Producers, and the U.S.A. Rice Federation. Individual shippers also have voiced opposition to the merger as currently crafted. These include some of UP's largest shippers such as, Dow Chemical, Entergy, Shell Chemical, Phillips Petroleum, Union Carbide, Formosa Plastics, Farmland Industries, International Paper, Kimberly Clark, Monsanto, Montell Plastics, FINA Oil and Chemical, Certainteed, Arizona Chemical and Quantum Chemicals. Smaller shippers also have voiced individual opposition or in some cases have banded together in a coalition. For instance, the Coalition for Competitive Rail Transportation submitted comments and close to 300 letters from large and small shippers from 29 states; other coalitions include the Mountain Plains Shippers Association, the Western Shippers Coalition and Western Coal Traffic League, all of whom filed comments on behalf of their shipper members opposing the merger as currently designed. The amount of shipper opposition is overwhelming and cannot be ignored.[33]

IV. THERE IS A COMPREHENSIVE DIVESTITURE SOLUTION AVAILABLE THAT SIGNIFICANTLY REDUCES THE COMPETITIVE HARMS, ALLOWS APPLICANTS TO MAINTAIN THE MAJORITY OF THEIR PUBLIC BENEFITS, PROVIDES AN ADEQUATE RETURN TO SHAREHOLDERS, AND PRESERVES JOBS

Applicants admit the existence of competitive harm, at least with respect to 2-to-1 point shippers, and in order to resolve those harms, they have requested the Board to impose the BNSF/CMA

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[33] Numerous small towns, counties, and communities also have expressed their opposition. These parties, such as the Town of Eads, Colorado, or the cities of Hoisington and Wichita, Kansas, depend upon rail service as a way of getting their products to the market and as a means of attracting new economic growth. Without rail service, it is highly unlikely these communities can continue to be viable economic entities. Even for those small shippers who will retain rail service, such shippers will now be served by a large, unresponsive, dominant railroad with little concern for such shippers, who will give shippers a choice--ship in large quantities or we will not accept your order. As a result, economic development in these small towns will be stymied, and they will lose the ability to attract new economic growth. Approval of the merger as currently proposed is a slap in the face to these shippers. *See* Comments of the Joint Shippers Coalition, JSS-1; Joint Brief of the Kansas-Colorado-Oklahoma Shippers Association in Opposition to the UP/SP Merger and Statement of Enid Board of Trade in Opposition to the UP/SP Merger.

Agreement as a condition to the merger.[34] The BNSF/CMA Agreement does not ameliorate the harm to competition,[35] while divestiture would allow Applicants to maintain most of their efficiency benefits in all major corridors, including all of the single-line benefits, and protect shippers from competitive harm.

A. Applicants Would Be Able To Maintain Their Claimed Benefits Even If Parallel And Duplicative Lines Are Divested

Applicants claim that divestiture "would sharply reduce service quality for shippers, undermine the efficiencies of the merger . . . cause a pervasive decline in rail service and a loss of public benefits." UP/SP-230 at 3-4. Most, if not all, of Applicants' merger benefits to shippers is in the form of new and improved single-line service, including a $1.3 billion line and corridor upgrade program. Most, if not all, of the merger benefits accruing to Applicants are in the form of savings from consolidating labor forces, administrative functions, operations, and other such overhead expenses. *Id.*, at 239; Salzman R.V.S. at 14, Ex. DWS-1. These benefits can be maintained, even with divesture.

KCS agrees with Applicants' statement that "[n]o one disputes that a UP/SP system will provide shippers with shorter, more efficient routes throughout the West." UP/SP-230 at 53. Applicants list these "shorter, more efficient rates" as occurring in the following new and improved routes: the I-5 Corridor; California to the Gulf Coast; California to Dallas and Memphis; Northern California to the Midwest; Southern California to the Midwest; Pacific Northwest to Texas; Colorado and Utah coal to the Midwest; the Kansas City Bypass; and California to Laredo. UP/SP-230 at 52-57. The following

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[34] Because BNSF has not submitted an operating plan, does not yet know the scope of the 2-to-1 points, has not yet determined how it will utilize switching, and the Agreement has numerous unresolved details, the Board does not have an adequate record on which to determine whether or not the BNSF/CMA Agreement actually does resolve the competitive harms. *See* KCS-57 and KCS-58. Accordingly, the Board should not consider that Agreement, but instead, the Board should base its decision on the only evidence that has been thoroughly submitted and debated, *i.e.*, the competitive evidence, which compels denial of the merger or approval with significant divestiture ordered.

[35] *See* discussion at pp. 22-30, *infra*.

maps graphically illustrate that divestiture of lines contained within the proposals set forth by KCS and Montana Rail Link would in no way impact the single-line benefits of the various corridors listed above.

Another claimed benefit of the merger is the fact that Applicants will spend $1.3 billion to upgrade SP facilities, assemble more direct routes, build new terminals and yards, and improve service. UP/SP-230 at 51-59; 230-236; 249-254. However, an examination of the geographic distribution of the Applicants' capital improvement plan clearly reveals that Applicants intend to focus their efforts on the Pacific Northwest, West and Southwest (excluding East Texas), and not on the Midwest and East Texas, *e.g.*, the Houston to St. Louis Corridor. KCS-33, Vol. I, V.S. O'Connor/Darling at 359-62. The final map clearly illustrates this fact.[36] <u>It is clear that the lines proposed by Applicants for their capital investment program are in no way impacted by the divestiture solution</u>.

Finally, Applicants' propose the consolidation and elimination of many purportedly redundant or duplicative activities and facilities. By eliminating duplicate administrative, legal, and management functions and consolidating or closing many activities and facilities that are situated at points that would become common to the new railroad, Applicants project costs savings of approximately $310 million per year.[37] The divestiture proposals would not prevent Applicants from eliminating duplicative management, administrative, and other such functions and duplicate equipment, and Applicants still would be able to maintain all of these savings. It is therefore apparent that divestiture will preserve the

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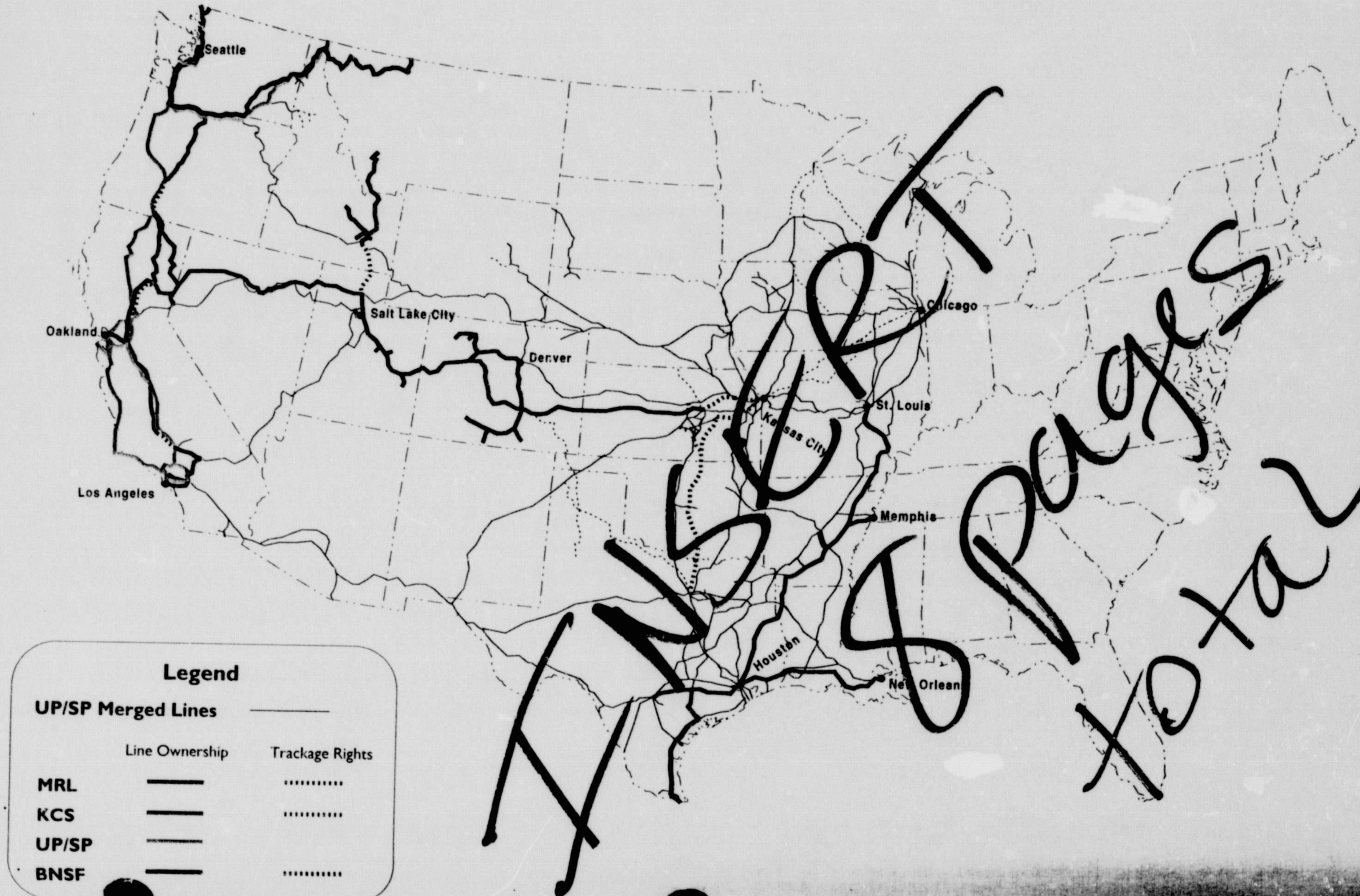
[36] UP's map was published in the March 25, 1996 TRAFFIC WORLD at 21, showing where the major corridor and capital improvement programs were to take place. This map was reproduced in KCS-33, Vol. I, at 363. By overlaying UP's own map over a map depicting the lines that are described in MRL's and KCS's proposals, KCS was able to reproduce the map on the next page.

[37] This figure is obtained by adding all the non-labor savings (except car utilization) projected in Applicants' summary of benefits chart. UP/SP-22, Vol. I, at 93. Divestiture would also allow Applicants to maintain a significant portion of all of the other benefits, listed in the summary of benefits.

Both UP/SP and BNSF I-5 Corridor Routes Still Available



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Major Corridor Upgrades Proposed By UP Are Not Affected By Divestiture

Legend

Divestiture/Trackage Rights
MRL and KCS Proposals

UP's Proposed Major Corridor Upgrades
(Source: Union Pacific Railroad
Traffic World, March 25, 1996, p. 21)

UP/SP M[illegible] Lines

May 23, 1996

UP's Proposed Major Corridor Upgrades

Iowa Jct., LA to Avondale, LA via Kinder	El Paso, TX to Topeka, KS	Denver, CO to Topeka, KS
Ft. Worth, TX to Herington, KS	El Paso, TX to Colton, CA	Alazon, NV to Weso, NV
Ft. Worth, TX to Big Sandy, TX	El Paso, TX to Ft. Worth, TX	Tracy, CA to M[illegible]

benefits of this merger, *i.e.*, the single-line benefits to shippers, the new routes, the corridor and capital upgrade programs, and the elimination of duplicative management and administrative functions.

The divestiture plans call for the divestiture of parallel and duplicate lines. Such lines are not the lines Applicants will use for new single-line routes or on which major upgrades are planned, and some of the lines in fact are scheduled for abandonment. Accordingly, despite Applicants' claims that the divestiture plans by KCS and MRL will "balkanize" the rail systems in the West, the divestiture plans will allow Applicants to preserve single-line benefits (and thus improve service to shippers) on every single route listed by Applicants and will allow Applicants to compete, via single-line routes, with every BNSF single-line route. The benefits of the merger cited by the shippers who support the merger will be fully preserved if divestiture is ordered. Indeed, hundreds of miles of the lines included in MRL's or KCS's divestiture plans are scheduled for abandonment under Applicants' plan and none are scheduled to be upgraded.

B. Divestiture Is Consistent With The Board's Legal Standards For Imposing Conditions

Congress recognized divestiture as a viable condition in the ICC Termination Act (the "Act"). Conditions involve the exercise of the Board's power under former section 49 U.S.C. 11344(c) and are specifically directed at resolving harm related to a merger. The Act elaborated on the conditioning authority contained within this provision to make it explicit that "[t]he Board may impose conditions governing the transaction, including the divestiture of parallel tracks." (emphasis added). While the ICC always had the authority to impose divestiture, it was rarely, if ever, imposed as the remedy. By adding this language, Congress elevated divestiture as a valid remedy, equal to trackage rights.[38]

Because conditions generally tend to reduce the benefits of a consolidation, they are imposed only where certain criteria are met. *UP/MKT*, 4 I.C.C. 2d at 437. The criteria for imposing conditions

[38] ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (1995); H. Rep. No. 104-422, 104th Cong., 1st Sess. 191 (1995).

to remedy anticompetitive effects were set out in the *UP/MP/WP* decision, 366 I.C.C. at 562-565. There, the Commission stated that conditions will not be imposed absent a finding that the consolidation may produce effects harmful to the public interest (such as a significant reduction of competition in an affected market), and that the imposed conditions will ameliorate or eliminate the harmful effects; will be operationally feasible; and will produce public benefits (through reduction or elimination of the possible harm) that outweigh any reduction to the public benefits produced by the merger. Conditions must be narrowly tailored to remedy the anticompetitive effects and must not put a shipper in a better position than it occupied before the consolidation. *UP/CNW*, slip. op. at 97; *See also, Milwaukee--Reorganization--Acquisition by GTC*, 2 I.C.C. 2d 427, 455 (1985); *Soo/Milwaukee II*, 2 I.C.C.2d at 455; *UP/MP/WP*, 366 I.C.C. at 564.

Requiring the sale of one of the parallel lines in the Houston to St. Louis corridor, for example, does not place any shipper in a better position than it was before the merger. It simply replaces one owner, SP, with another owner, KCS. Every shipper on the UP line (which parallels the SP from Houston to St. Louis) and who had benefited from the fact that SP also served that corridor (because such a shipper could have built-out, transloaded, shifted plant capacity, short hauled, relocated its plant, or competed in the same product market as a SP shipper) would still have that ability because KCS, an independent carrier, would serve over the exact former SP line and facilities between the exact origin and destination BEA's. And no shipper on the former SP line (that would with divestiture now be a KCS line) would be placed in a better position than it had before the merger. It was exclusively served by SP before and would be exclusively served by KCS after divestiture. Applicants are simply wrong when they claim that divestiture would add "new competition" to these formerly exclusively served shippers.

C. Divestiture Is Supported By Shippers

As discussed in Section V (p. 22-30, *infra*), the BNSF/CMA trackage rights will fall far short of ameliorating the extensive competitive effects of the merger and will not be financially or operationally feasible. Divestiture becomes the rational solution. All of the numerous shippers groups who have filed comments opposing the merger as proposed, including NIT League, SPI, and the agriculture groups, support some form of divestiture. As Ed Emmett, former I.C.C. Commissioner and now President of NIT League, recently stated:

> A break-up or potential sale of SP to another carrier is not what is worrying shippers. Shippers, other than a few in the West, aren't buying the argument that SP will fail and they all will be left in the lurch. SP could sell off the Cotton Belt and they could sell track across the Southwest for a ton. There are ample buyers for the Central Corridor. The shippers have said, "We're not worried. Short term there may be some turmoil but long-term we're better off."

Burke, *NIT League spurns UP overtures on SP merger, sticks with call for divestiture*, TRAFFIC WORLD, May 27, 1996 at 25. Divestiture of parallel tracks and facilities will result in preservation of competitive options for almost all shippers who will see a reduction of competition from two carriers to one, not just a small few who happen to fit Applicants' definition.[39] Divestiture will also preserve three independent railroads across the West and thus substantially redress the 3-to-2 problems, and divestiture to a qualified buyer resolves the problems associated with trackage rights. KCS-33, Vol. II, V.S. Swanson at 12 ("Ownership provides the ability to be truly competitive.").

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[39] Any ordered divestitures must be further conditioned to prohibit any exclusive dealing obligations. In some recent line sale contracts, the purchasers of branch lines are required to deal exclusively with the seller or to interline with the seller the preponderance of traffic originating and terminating on the branch line. *BNSF*, slip op. at 102. Such exclusive dealing arrangements, if imposed upon the purchasers of lines the STB may order divested as a condition to the proposed UP/SP combination, could be used by UP/SP to undermine the efficacy of these very divestitures.

D. Divestiture Is Consistent With Free Market Principles

KCS's proposal does not suggest that the STB force UP and SP to sell its parallel lines to a specific carrier at a "fire-sale" price, where the government would pick both the buyer and set the price. Instead, KCS suggests that divestiture and trackage rights be ordered as a condition to the merger (meaning such a requirement is merely permissive, *i.e.*, if you want to merge, you must divest). A market supplied solution thereby will be provided.[40] KCS's proposal would allow Applicants to choose which of its two parallel lines should be sold.

The only guidelines that KCS would propose on any divestiture plan are that the lines and facilities be sold (1) to the highest responsible bidder; (2) that the winning carrier have a presence in, and a proven record of commitment to the geographic region served by the divested lines; (3) that the purchaser's financial resources adequately meet existing future capital and investment demands; and (4) that a third independent carrier be preserved in the West, *i.e.*, no carrier should be allowed to purchase divested lines in 3-to-2 markets where it is already one of the three carriers. Such proposed "limits" in no way involve the government's selection of the lines to be sold or to whom they should be sold. This proposal is entirely consistent with a free market auction process that is commonly effected by DOJ in horizontal merger proceedings.

Furthermore, numerous carriers have expressed an interest in acquiring potentially divested lines, which will result in Applicants' not being forced to sell any of its lines at lower than market value.

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[40] Allowing a market supplied solution to a competitive problem is entirely consistent with ICC precedent. *UP/MKT*, 4 I.C.C.2d 409, 417, 452-458 (1988); *BNSF*, slip op. at 68 (1995).

Included among the carriers that have expressed such an interest are: KCS; Conrail; Montana Rail Link; Wisconsin Central; Gateway Western; Texas Mexican; Illinois Central; CSX; and Norfolk Southern.[41]

E. If UP "Walks Away From The Deal," SP Does Not Have To "Retrench" To Survive

Despite the fact that all of the single-line benefits, along with most, if not all of the other benefits claimed by Applicants, can be achieved under KCS's divestiture plan, UP claims it will "walk away from the deal" if divestiture is ordered. If the deal goes sour, Applicants further claim SP will have to "retrench," "pull back," and "shrink its service." UP/SP-231, Vol. 2, Part A, R.V.S. Davis at 13-22. Not 10 years ago, SP made the same arguments as justification for why it should be allowed to merge with the ATSF. The ICC rejected this argument then and it should reject it now as well.[42]

If the merger is not approved, SP could remain independently viable without significant asset sales. Indeed, before issuance of its 1995 Annual Report in March of 1996 (which was issued with this proceeding in mind), SP showed a profit and was on its way to full financial strength.[43] Although SP may be experiencing some cash flow problems, these are due largely to its expansion, upgrading and improved service modes, hardly the types of operations entered into by a company that must "retrench" or "pull back." SP's doomsday forecast is based upon the faulty premise that SP would no longer be able to benefit from the sale of non-rail real estate. UP/SP-231, Vol. 2, Part A, R.V.S. Davis at 14-15.

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[41] Some of these carriers have actually entered into specific agreements with Applicants guaranteeing such carriers "a seat at the table" in the event divestiture is ordered. *See* Applicants' Submission of Settlement Agreements with Illinois Central, Wisconsin Central, and CSX. UP/SP-238 and UP/SP-241.

[42] *SF/SP* at 249-57 (finding that SP was not a failing company notwithstanding applicants' attempt to get approval of their merger on the basis of a failing firm defense evidenced by self-serving "forecast[s] of impending doom for an independent SPT.").

[43] *See* Southern Pacific Transportation Company Form 10-Q For the Period Ended June 30, 1995, at 11 ("[t]he company had an operating...income of $57.6 million excluding the special charge.") At the same time, SP reported that as of June 30, 1995 "[t]he Company had $300 million available under its revolving credit facility and $150 million available under a separate term loan facility." *Id.* at 15. SP also reported increases in revenue per ton and traffic volumes. *Id.* at 8.

Such real estate sales have been used for ten years, however, and have helped to put SP's finances "in the black." There is no rational reason why SP could not continue to rely on such sales until the railroad is firmly re-established as a profitable operation.

The fact that SP could remain as a financially viable independent entity was confirmed by the Department of Justice. Eileen Zimmer, a financial analyst with over 11 years of corporate finance experience, analyzed SP's financial status and concluded that (1) SP is likely to survive for the foreseeable future and will remain a significant competitor; (2) absent a merger with UP, SP is likely to have other sources of funding available for additional capital expenditures; and (3) SP has not explored alternatives to the proposed transaction that are available to it, including a sale of itself in whole or in part. SP's rail assets would not likely exit the rail market. DOJ-8, V.S. Zimmer at 2. Significantly, Mr. Grocki confirmed that if SP chose the latter option, *i.e.*, a sale of its rail assets to various buyers, SP shareholders could realize even a higher share price than that offered by UP. KCS-33, Vol. II, V.S. Grocki at 350-61.

V. THE BNSF/CMA TRACKAGE RIGHTS AGREEMENTS WILL NOT BE AS EFFECTIVE AS DIVESTITURE

As their solution to the competitive harms created by the merger, Applicants rely on the BNSF/CMA Agreement;[44] however, the trackage rights granted to BNSF are not an effective solution and will not resolve the competitive problems of this merger.

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[44] Reference to this agreement as the "CMA Agreement" is actually a misnomer, for it is in fact a second amendment to the BNSF Agreement, and it does not resolve many of the issues raised by CMA in its comments (*e.g.*, there is no detailed operating plan and no detailed investment program). *See also*, *Further Comments of the Society of the Plastics Industry, Inc.*, SPI-16 at 9-11. *See also* letter from Montell Plastics attached to SPI-16, Exhibit 2, at 3-4. While the "CMA Agreement" may have been designed to address the concerns raised by KCS and others, it simply does not resolve these concerns. *See* SPI-16; CR-37; MONT-5; DOW-20; QCC-4; and KCS-57.

A. BNSF's Costs Will Be Much Higher Than UPSP's Costs

The evidence is insufficient for the Board to find that BNSF will in fact be an effective competitor on the routes covered by the BNSF/CMA Agreement. Indeed, regardless of the amount of access afforded to BNSF, if BNSF's costs are higher, service slower, or there is inadequate yard space and storage, access means nothing. Only actual traffic will constitute effective competition. Because BNSF's costs will be significantly higher than a merged UPSP's costs, whether charged as a joint facilities charge or as a trackage rights fee, BNSF will not attract enough traffic to provide effective competition. In his initial verified statement, Mr. Plaistow identified several financial disincentives that BNSF will face. KCS-33, Vol. II at 175-220. Subsequent to the time Mr. Plaistow conducted his analysis, Applicants and BNSF entered into the CMA Agreement, which (1) caps the reciprocal switch charge at $130; (2) adds UP/SP's Houston to St. Louis directional routing provisions to the BNSF Agreement; and (3) permits conversion of the trackage rights charge to a joint facilities usage charge basis. As a result of these changes, Mr. Plaistow revised his analysis to factor in the effects of the CMA Agreement. KCS-57, V.S. Plaistow at 3-7. The revised calculations reflect a slight improvement in the financial benefits to BNSF; however, the disadvantages still outweigh the advantages. *Id.* at 7. Thus,

> No amount of determination will permit BNSF to attain significant traffic levels in the face of BNSF costs 40% to 134% higher than UP/SP's. (The range of BNSF's economic disadvantage prior to the CMA Agreement had been 53% to 157%.)

Id. at 3. With costs of 40% to 134% higher than UP/SP's, it does not appear likely that BNSF will be much of a threat to UP/SP over these routes. Further, the CMA Agreement did not reduce the 3.0 mil per gross ton mile rate for trackage rights that UP/SP will assess BNSF for bulk trains. UP/SP-22, V.S. Rebensdorf, Table 1 at page 304.[45] Thus, regardless of the number of miles or the routes over which BNSF will be granted trackage rights, without the financial incentives to compete, the BNSF/CMA Agreement will be meaningless.

This conclusion was confirmed by Messrs. Hunt and Oderwald, who determined that as a general matter market shares decrease as the percentage of distance travelled on trackage/haulage rights relative to total distance increases, *i.e.*, the longer the distance a carrier must travel using tracking rights, the less likely it is to achieve a significant market share over that route. KCS-33, Vol. II at Figure I following page 282. In response to challenges lodged as to Messrs. Hunt and Oderwald's methodology, and in light of the changes to the BNSF Agreement occasioned by the CMA Agreement, Messrs. Hunt and Oderwald revised their diversion study. Their results are substantially the same as initially filed -- BN/Santa Fe's market share will remain insignificant. CR-37, V.S. Hunt/Oderwald, Attachment A. This conclusion is reached after factoring in the additional changes granted under the CMA Agreement and utilizing "the market share equation without taking account of the difference between operations over owned track and operations under trackage/haulage rights that we identified and discussed in our earlier statement." *Id.* at 2.

B. BNSF Still Faces Significant Operational Problems

As is shown in the comments, verified statements, other filings and depositions, BNSF will face significant operational problems in attempting to provide effective competition via the trackage rights. The operational problems are set forth in the verified statement of Donald A. Swanson. KCS-33, Vol.

[45] The cost for just this one item on a cost per train mile basis would equate to $48.44 per train mile (or $.42 per car mile), significantly higher than UPSP's costs, and the CMA Agreement has done nothing to change this. KCS-33, V.S. Rawert at 248; KCS-57, V.S. Plaistow at 5-7.

II at 250-268.[46] Former BNSF Board Chairman, Mr. Grinstein, confirmed the operational problems associated with trackage rights,[47] as did John Gray, an SP officer involved in the UP/SP's negotiations with BNSF, who stated that there is no incentive for a landlord railroad to provide essential maintenance to tracks used primarily by tenants. Gray Dep. at 133. Mr. Peterson expanded on these problems, pointing to the fact that railroads have a difficult time agreeing on most things and that when the two railroads are competing for the same business, these difficulties are naturally exacerbated. Peterson Dep. at 96, 1011.

If the past is prologue to the future, the "track records" of both UP and BN would indicate that the trackage rights will not translate into track utilization. First, John Hall, who was with BN for over 25 years (retiring as Vice President of Business Development) and is familiar with its utilization of trackage rights, has stated that, with the exception of minor transactions, he is "not aware of any markets in which BN served customers via local trackage right . . . [or] of any other carrier that has entered a significant new market using local trackage rights." V.S. John Hall, MRL-21, Exhibit 1 at 2. Further, although Applicants have attempted to refute the implications, in the UP/CNW merger proceeding SP filed thirteen verified statements describing UP's practice of discriminating against

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[46] Although the Agreement provides that UP/SP shall not discriminate in providing dispatch services, "[t]he management and operation of the trackage right line shall be under the exclusive direction and control of the owning carrier [UP/SP]. The owning carrier shall have the unrestricted power to change the management and operations on and over joint trackage as in its judgment may be necessary, expedient or proper for the operations thereof intended." (emphasis added) (BNSF Agreement, ¶ 9(d)). Although the CMA Agreement provides for a "Dispatching Protocol," the "Draft" Dispatching Protocols attached as Exhibit "A" provides only that UP/SP and BNSF "shall agree" on the dispatching protocol. There is no evidence of any protocols having been agreed upon. Further, as Mr. Grinstein observed, the time spent resolving disputes under the proposed protocols will likely result in lost business. Grinstein Dep. at 177. Additionally, the protocol does not apply to maintenance, switching, servicing locomotives, repairing freight cars, blocking trains, or any other service that must be provided by UP/SP to its competitor BNSF over 5000 miles of trackage rights.

[47] Christopher Palermi and Ann Marsh, *Can Drew Lewis Drive the Golden Nail?*, FORBES, December 18, 1995, at 52; Grinstein Dep. at 69-71, 174-75.

trackage rights tenants.[48] Thus, from a historical perspective, BN is not experienced in competing as a trackage rights tenant, and UP does not provide the tenant services that are conducive to effective competition.

C. <u>There Are A Significant Number Of Unresolved Issues In The BNSF/CMA Agreement</u>

Also of significant importance to Applicants' reliance on the BNSF/CMA Agreement as their "grand solution" is the fact that so many issues remain unresolved both as to the operating plan and the competitiveness of BNSF. Implementation of the Agreement involves both "negotiations" and "the process of refining the details associated with implementation." Ice Rebuttal Dep. at 17. As detailed by Mr. Ice, negotiations yet to be concluded include: reciprocal switching issues; traffic that will move under haulage or trackage; and the specific geographic locations of the two-to-one points. Ice Rebuttal Dep. at 18-19. Asked to define the "specific locations for the two-to-one points," Mr. Ice stated, "part of the implementation process is to define actual physical parameters of where the two-to-one locations start and stop." *Id.* Accordingly, BNSF is not even clear as to what 2-to-1 point traffic it will gain access.

CMA's belief that its Agreement resolves the competitive concerns for its chemical shippers is also in error. For example, while the CMA Agreement gave BNSF access to West Lake, LA, and to Lake Charles, LA, it did not give BNSF access to West Lake Charles, LA. As Mr. Matthew Rose, Senior Vice-President for BNSF, admitted, BNSF gained access to only 7% of the traffic in the Lake Charles, LA area. Rose Rebuttal Dep. at 115. That BNSF secured access to only 7% of the business in the Lake Charles area, only highlights the fact that the other 93% of the chemical shippers located at West Lake Charles, LA did not get BNSF access. When questioned about this, Mr. Rose, stated that it was "somewhat of a puzzle" why the CMA Agreement limited BNSF's access only to West Lake and

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[48] Quotes from these verified statements appear in KCS's Comments, KCS-33, Vol. I at 52.

Lake Charles, Louisiana and did not include West Lake Charles. Rose Rebuttal Dep. at 114. Mr. Rose agreed that there was no operational reason for not including West Lake Charles.

Another issue to be negotiated is the amount of space available to BNSF at the Dayton SIT facilities and the exact terms of the sublease had to be negotiated. Rose Rebuttal Dep. at 99-103. Issues regarding how and who will perform switching services at 2-to-1 points are still unresolved. Owen Rebuttal Dep. at 12; BNSF-54, V.S. Clifton at 9; Clifton Dep. at 45, 58, 93-94; Rose Rebuttal Dep. at 12, 46. Whether haulage or trackage will be used at certain 2-to-1 locations is still to be worked out. Clifton Dep. at 80-83, 88. Indeed, BNSF admits that it does not have a functional operating plan, much less an operating plan as that term is defined in the STB regulations. BNSF-54, Owen R.V.S. at 2; Owen Rebuttal Dep. at 24-27; Rose Rebuttal Dep. at 54, 56; and Clifton Dep. at 95.[49]

With all of these unresolved issues, and the transparent operating and economic disadvantages of trackage rights, UP/SP has not shouldered its burden to prove that the BNSF will ensure competition for 2-to-1 point shippers. Yet, the Board is charged with alleviating the competitive harms of this merger. As Congress recently reconfirmed in the ICC Termination Act, the Board has an obligation to specifically "ensure" that any trackage rights imposed to alleviate an anticompetitive effect actually contain "operating terms or compensation levels" to alleviate such anticompetitive effects.[50] Applicants have not shown (nor can they) that the BNSF Agreement will ensure that the anticompetitive effects of this transaction have been alleviated.

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[49] For a complete discussion of unresolved issues relating to the BNSF/CMA Agreement, *see* KCS-57 at 9-16; KCS-58 at 4-16.

[50] Regardless of whether or not the changes made to section 11324(c) actually apply to this proceeding, Congressional intent as it relates to the <u>policy</u> of imposing trackage rights is clear -- the Board should ensure that any trackage rights imposed actually resolve any anticompetitive effects.

D. <u>The Board Cannot Approve The Trackage Rights Swaps Through The Notice of Exemption Procedures</u>

The trackage rights negotiated between BNSF and UP and SP in the BNSF merger, combined with those in the BNSF/CMA Agreement, total 8,000 miles. When considered in their entirety, the unprecedented "swap" of 8,000 miles of trackage rights in less than two years between UP/SP and BNSF constitutes a separate "transaction" under former § 11343. Such a transaction is inconsistent with the Notice of Exemption procedures used to implement these trackage rights "swaps." *See* 49 U.S.C. § 10505 and the implementing regulations contained at 49 CFR 1180.2(d) and 1180.4(g). Those procedures can only be utilized if the transaction is limited in scope or unnecessary to protect shippers from the abuse of market power. 49 U.S.C. § 10505(a)(2). Such findings could not be made with respect to a 8,000 mile series of line swap transactions. This problem is compounded by the fact that the Board does not have adequate information to even consider the competitive effects of these trackage rights swaps, especially because BNSF has failed to provide an operating plan and other such details with respect to their proposed trackage rights operations in this case. *See* KCS-57 and KCS-58. Accordingly, the Board cannot approve these swaps without reopening the *BNSF* case and considering the cumulative impacts of the trackage rights swaps in one proceeding.

E. <u>The Proposed Oversight Plan Contained Within The CMA Agreement Is Unworkable And Cannot Substitute For Divestiture</u>

As part of the CMA Agreement, Applicants have agreed to an annual STB oversight proceeding for five years whereby the Board could examine whether the BNSF/CMA Agreement has effectively addressed the competitive issues it was intended to address. CMA Agreement, ¶ 14, UP/SP-230 at 21. Such oversight conditions, combined with the BNSF/CMA Agreement is not an effective substitute for the divestiture plans. STB monitoring in lieu of divestiture is a substitute of old-style rate regulation for market determination of rates and services. STB monitoring conditions in a transaction of this magnitude would be tantamount to initiation of rate reasonableness proceedings across the entire West.

It would be an impossible process to determine at some later date whether a specific shipper or a specific commodity had suffered competitive harm as a result of the merger. To do so, the Board would have to assemble huge amounts of information across several years regarding rates, service, equipment supply, scheduling, transit time and accessorial services, and then attempt to control for changes in general economic conditions, changes in rail productivity and the like to discern the effects of the merger on rates and service.

As the Commission explained in *SFSP* in rejecting a "rate constraint proposal" that would have attempted to limit rate increases to the rate of inflation, "there is no reason to assume" that these resulting rate levels would "approximate those that would prevail with true market competition." *SFSP* at 814. Similarly, there is no reasonable way of determining, post merger, whether certain rate increases were due to the market power of a merged UPSP or were a result of general economic conditions. While such an oversight condition is similar to that adopted in the *WCL* case,[51] the scope and magnitude of the competitive harm in this proceeding can in no way compare to that in the *WCL* proceeding.

Oversight by the STB would require numerous manhours of STB staff time just to prepare for and conduct such satellite proceedings. Given that the Board's staff is already stretched under the current caseload, the Board should not "pile-on" additional work, especially since it is highly unlikely that Congress will give the Board additional funds and resources. Because of these restraints, processing minimal objective data regarding merger effect would be of little value, and the Board would be restricted to "shipper complaints" as its primary monitoring tool. However, as shippers have already

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[51] *Wisconsin Central Transportation Corp., et al. -- Continuance in Control -- Fox Valley & Western Ltd.*, Finance Docket No. 32036 (ICC served December 22, 1992)(*WCL*).

been reluctant to come forward for fear of retaliation, CCRT-4 at 7,[52] it is highly unlikely that shippers would come forward in the future, when UP and SP would have considerably more market power and leverage. Furthermore, if shippers do come forward, it will be difficult for the Board to develop objective standards by which to judge such shippers' statements and complaints without imposing further regulation.

The Staggers Act made it clear that the best way to prevent anticompetitive conduct is to foster and preserve competition, not impose government supervised regulations and oversight conditions. This approach has been rejected by Courts, and it should be rejected by the Board. *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 334 (1961).[53] Similarly, divestiture in this proceeding involves less government regulation, would be easier to administer, and would, with little doubt, preserve competition.

VI. DR. GRIMM'S METHODOLOGY IS NEITHER A "CRAFTY SCHEME" NOR AN "ECCENTRIC METHODOLOGY" BUT IS FIRMLY ROOTED IN ICC PRECEDENT

Applicants attack the methodologies employed by Dr. Grimm, Dr. Majure, Dr. McFarland, and Mr. Crowley because in some instances they count, in the 2-to-1 and 3-to-2 categories, traffic that is exclusively served by either UP or SP. UP/SP-230 at 140-146. Applicants question how exclusively served shippers will be harmed by the merger and describe Dr. Grimm's methodology as "eccentric." *Id.* at 141, and a "crafty scheme." UP/SP-231, R.V.S. Peterson at 35. It is true that this methodology treats some UP or SP exclusively served shippers in a given BEA as 2-to-1 or 3-to-2 shippers, but

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[52] We see in this proceeding that shippers are very reluctant to complain against UP/SP (upon which they may become totally dependent for rail services) except under the protective umbrella of large shipper groups such as NITL, SPI, and CCRT.

[53] The Court rejected proposals that were less than full divestiture as not providing an adequate remedy for the anticompetitive behavior. The Court made it abundantly clear that divestiture was the preferred remedy to any other condition because divestiture is "relatively easy to administer, and sure." *Id.* at 329-331.

rather than being "eccentric" or "crafty," this methodology is entirely consistent with the definition of competition employed by the ICC.

In numerous market dominance and other proceedings, shippers served by only one carrier have argued that they were subject to the monopoly power of that carrier and thus entitled to rate relief, but the ICC found that the shippers were not subject to the monopoly power of the single carrier on the ground that other competitive forces provided a competitive check on the rates that the exclusively serving carrier could charge.[54] The ICC concluded that the shipper could (either actually or potentially) transload by truck to a nearby carrier; shorthaul the serving carrier to a nearby interchange with another carrier; build-out to another carrier; threaten to relocate its plant facility to a competitor's line; threaten to shift production levels between different plants located on different rail lines; obtain lower rates in order to compete against shippers of a similar product located on a competing rail line; benefit from interline competition; and finally, if large enough, combine all of its plant locations for competitive package bidding. The evidentiary record in this case is replete with examples of UP exclusively served shippers having benefited in these ways from the fact that SP also served the market and vice-a-versa.[55]

Dr. Grimm applied these principles to those geographic markets where UP and SP are present, choosing a BEA as the appropriate measure of the relevant geographic market.[56] He then determined

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[54] The numerous ICC cases in which these principles have been employed are contained in KCS-33, Vol. I at 28-31.

[55] For a detailed discussion of how these principles are being effectively utilized by existing shippers who are exclusively served by UP or SP to provide a competitive check on rates *see also* KCS-33, Vol. I, V.S. Grimm at 163-182 and Vol. III at 1-98; CCRT-4 at 5-39; Union Carbide, UCC-6 at 2-3 (build-out); Quantum Chemical, QCC-2 at 3-4 (build-out, switch production); Entergy Services, ESI-15 at 5-7 (build-out; source competition); Kennecott Energy Co., KENN-10 at 12 (source competition); Dow Chemical, DOW-11 at 6 (build-in).

[56] The use of BEA's and of corridors have also been specifically endorsed in numerous ICC proceedings and used by UP itself in numerous other cases. *See, e.g.*, KCS-33, Vol. I, at 21-27

those corridors where only UP and SP provide service, through independent routings, between the origin and destination BEA's. This generated the list of corridors, including a description of all traffic (commodity, revenues, routings) moving in that corridor that would see a reduction of independent alternatives from 2-to-1 and from 3-to-2.[57]

Applicants' definition of the relevant geographic market as consisting of only "points" where shippers have direct service from both UP and SP completely ignores the competitive principles enumerated by the ICC and the numerous ways in which exclusively served shippers nonetheless benefit from the fact that another carrier is located nearby and serves the same origins and destinations as the exclusively serving carrier. Applicants rely on the principles followed by Dr. Grimm and the ICC[58] when attempting to explain why there will be plenty of competitive checks on the ability of a merged UPSP to raise rates on UPSP exclusively served shippers after the merger, but are completely unwilling to acknowledge that such principles apply equally well as to defining competition between UP and SP before the merger.[59]

VII. APPLICANTS HAVE FAILED TO REFUTE THE FACT THAT REDUCTION FROM 3 RAILROADS TO 2 RAILROADS WILL RAISE SHIPPERS' RATES

Applicants would have the Board believe that 3-to-2 traffic will not be competitively harmed by the merger and characterize the sworn testimony of a host of academics, professors, and economists as merely "reams of data and rhetoric." UP/SP-230 at 175. To refute the testimony of these noted

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[57] For a complete discussion of the determination of what constitutes an independent routing and its consistency with the Commission endorsed "one-lump" theory, *see* KCS-33, Vol. I at 31-32; V.S. Grimm at 182-187; and, especially, TM-34, R.V.S. Grimm at 9-21, where Dr. Grimm addresses Applicants' primary criticisms of his methodology.

[58] The principles used by Dr. Grimm, based as they were on ICC precedent, were also followed, in various variations, by the DOJ (Majure), shippers (Crowley), and other government parties (McFarland, Tye, and others). DOJ-8 at 4-7; NITL-10 at 9. Only Applicants, when defining pre-merger competition between UP and SP, attempt to ignore these principles.

[59] Dr. Tye aptly calls this the "accordion theory." KCS-33 at 30.

experts, however, they rely principally upon an analysis performed by a single UP employee, Mr. Richard Peterson, who continues to claim that 3-to-2 "shippers will enjoy stronger, not weaker, competition as a result of the merger." Peterson V.S. at 171. But Mr. Peterson's credentials and objectivity must be weighed against Dr. Lawrence J. White, Dr. William G. Shepherd, Dr. Richard L. Schmalensee, Dr. Curtis Grimm, Dr. William B. Tye, Dr. Henry B. McFarland, Dr. W. Robert Majure, Dr. James M. MacDonald and Dr. George H. Borts; the numerous academic studies (including studies directly analyzing railroad prices) that clearly show that higher concentrations of sellers (that is, fewer competing railroads) means higher prices for buyers (shippers); and the Department of Defense bidding data submitted by Mr. I.W. Ploth. If there was credible objective evidence that 3-to-2 shippers will not see higher rates, Applicants surely would have presented it to the Board, rather than rely on their own employee.

A. <u>The 3-To-2 Traffic Is Dominated By UP And SP Not By UP And BNSF</u>

Applicants attempt to discount the 3-to-2 problems by arguing that "nearly half" of the 3-to-2 traffic is BNSF traffic and that "SP's share of the total 3-to-2 traffic is barely 20%." UP/SP-230 at 176. However, Applicants' characterization of the 3-to-2 market is simply inaccurate. As explained by Dr. Grimm, utilizing the 100% traffic tapes, many of the 3-to-2 situations will be equivalent to *de facto* 2-to-1's because of BNSF's small market share in these corridors. KCS-33, Vol. I, V.S. Grimm at 212-13; KCS-33, Vol. III, Appendix 2. Indeed, as Figure 6.1 in his statement reflected, over $2 billion of the $5.1 billion total 3-to-2 market is in routes where UP and SP controlled over 70% of the market share. Dr. Majure, testifying for the Department of Justice, found that UP and SP accounted for over <u>64%</u> of the <u>total</u> 3-to-2 movements. DOJ-8, V.S. Majure at 29. Such UP and SP dominance of the 3-to-2 corridors is even greater in the specific corridors that KCS proposes for divestiture. For example, for 3-to-2 traffic originating in St. Louis and terminating in Houston, UP and SP control approximately 92% of the carload market share. KCS-33, Vol. III, Appendix 9, at 1014.

Unfortunately for Applicants, the hard data indicate precisely the opposite of their claim: it is not simply a case of UP competing with BNSF so that a merger with SP is inconsequential. UP and SP are by far the largest players in many markets, and as such, many markets, such as the Cotton Belt Corridor, will effectively be 2-to-1 markets because of the weak presence of BN.

B. Chemicals Represent A Large Percentage Of The 3-To-2 Traffic

Applicants claim that the Board should not worry about 3-to-2 traffic for chemicals because "about half is intermodal," "a quarter is auto traffic," and the "remainder is carload traffic." UP/SP-230 176; UP/SP-231, R.V.S. Peterson at 24-26. Applicants, Dr. Grimm, and Dr. Majure all agree that intermodal traffic is the number one commodity in the 3-to-2 markets. As Table 7.3, KCS-33, Vol. I, V.S. Grimm at 192.2 showed, intermodal represented \$1.56 billion of the \$5.1 billion 3-to-2 breakdown, or approximately 31% of the 3-to-2 totals, but not 50% as claimed by Applicants. Applicants' data fails to show the extent of SP's share of chemical traffic in certain corridors; however, KCS's data shows that chemicals are the second largest commodity in the total 3-to-2 category, representing \$835 million of the 3-to-2 market -- or slightly over 16% of the total. KCS-33, Vol. I, V.S. Grimm, Table 7.3 at 192.2. Over 60% of this chemical traffic travels by rail over distances greater than 1200 miles, where 500 miles is considered the distance that is subject to effective truck competition.[60] KCS-33, Vol. I, V.S. Grimm at 225-226.

When one looks at the total 2-to-1 and 3-to-2 commodity breakdowns in those corridors for which KCS has requested divestiture, chemicals represent by far the largest, or next to the largest commodity (KCS-33, Vol. I, V.S. Grimm at 214-215.2):

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[60] The fact that chemicals will be subject to the monopoly power of a merged UP/SP is compounded by the fact that those chemical shippers who do get access to BNSF under the Agreement must depend upon overhead trackage rights over long distances as the competitive check. As Messrs. Hunt and Oderwald established, the longer a commodity must travel on trackage rights, the less market share the tenant railroad can obtain. KCS-33, Vol. II, V.S. Hunt and Oderwald at 269; CR-37; R.V.S. Hunt and Oderwald.

- No. 1 with 43% of the traffic in the Cotton Belt Corridor. Petroleum and Coal Products are No. 2 at 9%;

- No. 2 with 29% of the traffic from San Antonio, TX to New Orleans, LA. Non-Metallic Minerals is No. 1 with 32% while Petroleum or Coal is No. 3 with 9%; and

- No. 2 with 26% of the traffic Houston to Brownsville. No. 1 is Farm Products at 35%, and No. 3 is Paper and Allied Products at 6%

C. The Powder River Basin Example

Applicants cite to the fact that rates for Powder River Basin ("PRB") coal have been dropping for many years and that intermodal rates in the Southern Corridor have similarly dropped as proof that reduction of competitive choices from 3-to-2 is not a problem. UP/SP-230 at 193. Yet, as Applicants admit, these are two railroad markets, not three railroad markets. One cannot draw a conclusion as to the effect on rates going from three railroads to two railroads by analyzing rates in markets that have never been three railroad markets. While rates have gone down in these two railroad markets, one would assume that such rates would have dropped even further and faster if three railroads were present rather than two.[61] More importantly, any such comparison of rates over time must control for the increases in rail productivity and general declines in rates across the railroad industry.

D. The *UP/MKT* Merger Markets

The only actual 3-to-2 markets cited by Applicants involved a scant three markets in the *UP/MKT*[62] case - San Antonio, Abilene/Salina grain, and Houston area aggregates. Mr. Peterson's analysis of these markets shows that, contrary to the claims of opponents in the *UP/MKT* merger that

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[61] The ability to interchange with a number of carriers also may have impacted these rates. For example, prior to the BNSF merger, BN was able to interchange PRB coal at Kansas City with three independent carriers, SP, KCS, and ATSF, for delivery to Gulf Coast locations. As a result of the BNSF merger and the proposed merger, such independent interchanges will be lost, possibly increasing the likelihood of tacit collusion between the merged systems in the PRB basin.

[62] *Union Pacific Corporation, Union Pacific Railroad Company and Missouri Pacific Railroad Company -- Control -- Missouri-Kansas-Texas Railroad Company, et al.*, Finance Docket No. 30800, 4 I.C.C.2d 409 (1988).

rates would either increase or remain steady in these three markets if UP and MKT were allowed to merge, the rates actually decreased. Curiously, however, as Dr. Majure points out, the three markets analyzed by Peterson were not the same three markets cited by DOJ's witness, Dr. Pittman, in the *UP/MKT* case. Indeed, looking at one of the markets cited by Dr. Pittman, such rate increases did in fact occur with respect to intermodal traffic between Chicago and San Antonio. DOJ-8, V.S. Majure at 52. Furthermore, even if rates did decrease in the specific three markets analyzed by Mr. Peterson, one cannot claim that two railroads are better than three by simply pointing to one isolated instance of a rate decrease without conducting an empirical study (controlling for various factors) showing the reasons for the decrease. It could be, as Dr. Grimm pointed out, that overall rates for these commodities fell for a variety of reasons.[63] Normally, rates would have declined even further if three railroads were present rather than two. It could be, as Dr. Majure's analysis points out, that rate declines in these markets, if they did in fact occur, were due to the productivity gains of the railroads. DOJ-8, V.S. Majure at 49-53. Indeed, Applicants' own analysis bears this thesis out. While Applicants' claim rates declined 15% for grain traffic in the Abilene/Salina market, their same data shows productivity gains reduced railroads' costs by 11%. UP/SP-231, R.V.S. Peterson at 87. Thus, numerous other factors could account for the additional 4% rate decrease.[64]

E. The Automobile Traffic Studies Are Not Representative Of The 3-To-2 Traffic

In order to rebut the significant amount of econometric evidence that indicates a reduction from 3 carriers to 2 will increase rates, Applicants' witnesses Mr. Peterson and Mr. Bernheim then performed two minor rate comparison studies using automobile traffic. These studies attempted to show

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[63] KCS-33, Vol. I, V.S. Grimm at 37.

[64] Curiously, while Mr. Peterson relies upon generic rate studies when attempting to show that rates declined in these 3-to-2 markets, he later notes that "there are numerous perils in making such [rate] comparisons, including the impossibility of controlling for all of the many other variables that affect UP's rates." UP/SP-231, R.V.S. Peterson at 91.

that rates are no lower on routes where three railroads (including SP) are present in a route than on routes where only two railroads (not including SP) were present on the route. UP/SP-231, Vol. II, Part A, V.S. Bernheim at 13-21; UP/SP-231, Vol. II, Part B, R.V.S. Peterson at 88-93. Because SP has a small share of the market for automobile transport in the West,[65] it is difficult to use the findings of these studies to establish any sort of general finding about rail competition, yet alone rebut the numerous studies submitted by KCS. However, even assuming the studies are accurate, the studies, upon close examination, actually show that prices are lower in three carrier markets than in two carrier markets.

Unlike the studies submitted by KCS, Peterson's analysis did not control for the many factors that drive costs. Bernheim used Peterson's data to analyze revenue per ton mile while attempting to control for various factors that might affect costs per ton mile, including the size of the shipment and the distance carried. Once cost factors are controlled for, Bernheim finds that UP rates fall by a large and statistically significant amount, 21.8%, when facing three competitors instead of two, as long as SP is not one of the competitors. UP/SP-231, R.V.S. Bernheim, Equation 1, Table 2. He also finds that UP rates fall by a large and statistically significant amount, 14.5%, compared to routes with no competition, when UP faces a single competitor, as long as that competitor is not the SP. Bernheim workpapers HC120-100033. In short, the general implications of Bernheim's automobile results are quite consistent with the results of the KCS studies: the number of competitors seems to have rather significant effects on rail rates, and competition matters in Western rail markets.

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[65] UP/SP-231, R.V.S. Peterson at 88-90. Mr. Peterson found that rates in the three carrier markets to be not that significantly higher than those in the two carrier market. Of course, because Mr. Peterson (and Mr. Bernheim who relied upon Mr. Peterson's data) did not identify the routings of the carloads studied, it is difficult to make any comparative judgment. For example, if UP were a bottleneck carrier in any of the routes studied, UP would have the ability to take its "one lump" in either the three or two carrier markets. Accordingly, as UP would exist as a bottleneck carrier in both the three and two carrier markets, it would not be surprising to find prices in both markets to be relatively equal.

Bernheim also concludes that SP has a weaker effect on UP rates than do other competitors and that "the irrelevance of SP as a third firm remains striking." UP/SP-231, R.V.S Bernheim Equation 1, Table 2. Since Mr. Peterson has described SP as a minor carrier in the automobile market, it can be argued that the results contain no useful inferences beyond the auto market, on the ground that SP should not be expected to affect UP rates in the way that other carriers do or in the way SP would for other commodities.

The relevant issue for the merger, however, is the effect of the removal of the SP as a competitor in those three carrier markets in which SP is a major carrier, *e.g.*, SP is a major carrier of chemical and plastics traffic in the Houston BEA to the St. Louis BEA, having a 47% market share as compared to BNSF (12%) and UP (38%). Thus, Applicants' studies confirm that rates are indeed lower in three carrier markets when compared to two carrier markets, and that the replacement of SP with another rail firm, especially in those markets where UP and SP are the dominant carriers, would put substantial downward pressure on the ability of UP to raise rates after the merger.

F. <u>The Department Of Defense (DOD) Data</u>

Defense Department data, compiled from actual bid data, shows that SP is an aggressive, low price competitor in both 2-to-1 and 3-to-2 markets and that the elimination of SP as competitor would result in increased prices. KCS-33, Vol. I, at 40-41; Vol. II, V.S. Ploth and Nunn.[66] While Mr. Gazetta and Mr. Butcher made many criticisms of Mr. Ploth's and Ms. Nunn's data, neither made any attempt to calculate whether the alleged omissions would have affected Mr. Ploth's conclusions, if at

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[66] For example. Applicants' witnesses Gazetta and Butcher attempted to show that Mr. Ploth omitted bid data from his analysis. However, as admitted in the depositions of Mr. Gazetta and Mr. Butcher, a number of the alleged omissions were "spot bids" involving a relatively small number of cars. Gazetta Dep. at 40-41; Butcher Dep. at 19. Further, a number of the alleged omissions were ammunition bids (Gazetta Dep. at 37-38, Butcher Dep. at 22), which were specifically excluded from Mr. Ploth's study due to the fact that most munitions shipments are repetitive and not actively re-bid, and due to the sensitive nature of munitions shipments. KCS-33, Vol. II, V.S. Ploth at 16.

all. Gazetta Dep. at 34-35, 49; Butcher Dep. at 18-19, 51. In short, the alleged omissions do not affect the conclusions reached by Mr. Ploth.

Applicants' witness Bernheim attempted to re-analyze the Department of Defense data to determine whether the presence of SP as a third carrier bidding for traffic reduces the price of transportation. As with his automotive study, however, Mr. Bernheim's analysis was flawed. First, Mr. Bernheim designated the winning bidder for a particular movement as the bidder with the lowest revenue per ton mile. (N120-100005; HC120-100058 through HC120-100079). But, due to the varying lengths of route for the bidding railroads, the winning bidder may not have had the lowest revenue per ton mile. Bernheim Dep. at 151-152. As a result, Mr. Bernheim's model did not recognize SP as a winning bidder if SP did not have the lowest revenue per ton-mile, even when SP was in fact the winning bidder! (HC120-100068). This analytical flaw alone undermines Mr. Bernheim's conclusion as to the importance of SP competition in the marketplace.

Mr. Bernheim's model also failed to assign credit for the winning bid for interline movements originating in the West and terminating in the West. V.S. Bernheim at 23; Bernheim Dep. at 159-160. Mr. Bernheim's model designated only the originating carrier as the winning bid, and as a result, the terminating carrier of an interline movement was not credited with the winning bid. Mr. Bernheim stated that he used this "method of simplification" because "it's very difficult to define who the competitors actually are . . . because of these issues about having multiple long carriers." Bernheim Dep. at 160. The result of Mr. Bernheim's "method of simplification" is obvious: If SP terminated a West-to-West movement, SP was not reflected as the winning bidder. This analytical error resulted in Mr. Bernheim's model substantially underestimating the value of having SP as a competitor for Western rail traffic.

G. MacDonald's Studies Are Still Valid And Are Confirmed By The DOJ

In contrast to the Peterson and Bernheim studies, which focused solely on automobile traffic, KCS has cited studies of grain transportation (MacDonald, 1987, 1989, 1991), which show that rail rates rise as the number of competitors falls from three to two and from two to one.[67] Grain studies are important to show that the number of competing rail carriers has an important impact on rates, when the analysis is able to accurately measure competition and the factors that drive rail costs. This finding (particularly MacDonald 1991) specifically contradicts Mr. Willig's assertions, who counter-intuitively claims that changes in the number of carriers from three to two can have no effect on the extent of competition (and, therefore, on rates). Although Dr. MacDonald's studies were criticized by Professor Willig for the use of the ICC Waybill Sample, Dr. MacDonald's studies were not based upon "masked" data, but included actual contract rates. KCS-33, Vol. II, V.S. MacDonald at 158-161.

Furthermore, Dr. MacDonald's studies were empirically based, were not performed to promote a certain parties' position in a legal proceeding, contained variables that controlled for various factors (including costs), were subject to academic critique, were published in well respected academic journals, and focused on rail dependent traffic. Significantly, as noted earlier, Dr. MacDonald's study was confirmed by the empirical study performed for the Department of Justice by Dr. Majure, which estimated over $800 million of harm to shippers in the form of increased prices. DOJ-8, V.S. Majure at 34-36.

H. Shippers Of Mexican Traffic Need A Third Independent Carrier

The record indicates that the reduction of the number of rail competitors from 3-to-2 will have anticompetitive results for traffic to and from Mexico. KCS-33, Vol. I, V.S. Haverty at 141-142; TM-23, V.S. Grimm at 120-137. UP and SP currently dominate rail traffic into Mexico controlling 90%

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[67] These results are strongly supported by several other published studies of the relationship between rail concentration and rate, as discussed in detail in Dr. Grimm's V.S., and cited in footnote 18 above.

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of all traffic through the Mexican gateways. KCS-33, Vol. I, V.S. Haverty at 142, citing data provided by ALK Associates. Witness Ellebracht shows UP and SP control 95% of traffic through the Mexican gateways. TM-23, V.S. Ellebracht at 77. To alleviate this competitive harm, Applicants have granted trackage rights to BNSF to Brownsville and to a connection with Tex-Mex at Corpus Christi. As discussed in more detail by Tex-Mex, this will not be an effective solution to the reduction of competition for U.S.-Mexican traffic.

VIII. OTHER ISSUES BARRING APPROVAL OF THE MERGER

A. <u>Applicants Failed to Satisfy the Requirements for an Award of Terminal Trackage Rights Under 49 U.S.C. § 11103(a)</u>

Applicants have requested that the STB grant BNSF trackage rights over KCS trackage in Beaumont and Shreveport pursuant to the Board's authority under 49 U.S.C. § 11103(a). However, Applicants failed to satisfy the requirements for an award of trackage rights under this provision.[68]

First, the trackage segments in question are not "terminal facilities" as required by Section 11103(a). As defined by the Commission, a terminal facility is one used for the "transfer, collection, or delivery of freight."[69] As shown in KCS-32, neither the Beaumont nor Shreveport trackage segments are used for such activities. Applicants' own witness Ongerth described a terminal facility as a "network of tracks, switches, and other facilities which provide[s] access to industry and facilities

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[68] One of the bases for Applicants' objection to divestiture is the fact that divestiture would force them to give up their property and ownership rights. Applicants also object to the Texas Railroad Commission's proposal describing it as "government confiscation of private property." UP/SP-230 at 280. Yet, the only "confiscation of private property" in this case is Applicants' request to have the government force KCS to allow BNSF over its tracks. Applicants request this even in light of private contracts requiring the consent of <u>all</u> parties, including KCS, before another carrier, such as BNSF, is allowed over the tracks and despite the fact that KCS has never competitively abused its ownership of these tracks. Curiously, while requesting access over KCS's tracks for BNSF, Applicants have refused to give BNSF access over its tracks--the Lettsworth to Lobdell segment.

[69] *See Rio Grande Indus., et al. -- Purchase and Related Trackage Rights -- Soo Line Railroad Company Line Between Kansas City and Chicago, IL*, Finance Docket No. 31505, Decision No. 6 (ICC Served November 13, 1989); *see also* KCS-32.

for gathering and distributing cars to and from line haul operations, and those industries." Ongerth Rebuttal Dep. at 43-44. Mr. Ongerth stated that terminal functions would include servicing locomotives, repairing freight cars, and blocking trains, and that terminals usually include crew change points. Ongerth Rebuttal Dep. at 43-44. Notwithstanding this clear definition of terminal functions by their own witness, Applicants presented no evidence of such activities on the Beaumont or Shreveport trackage.

Applicants also failed to present any evidence of anticompetitive conduct by KCS concerning the trackage--a requirement for Section 11103(a) relief set forth in *Midtec Paper Corporation, et al. v. Chicago and North Western Transportation Company*, Finance Docket No. 39021, 3 I.C.C.2d 171, 179 (ICC Decided December 2, 1986) ("*Midtec II*"). Additionally, the cases cited by Applicants for imposition of a standard other than *Midtec II* are easily distinguished from, and inapplicable to, the present case.[70]

Moreover, the express language of Section 11103(a) and governing regulations does not distinguish between requests for relief by shippers and carriers. However, if the STB should choose

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[70] In *Rio Grande Indus., Inc. et al -- Purchase and Trackage Rights -- Chicago, Missouri & Western Railway Company Line between St. Louis, MO and Chicago, IL*, Finance Docket No. 31522, 5 I.C.C.2d 952 (ICC Served September 29, 1989) ("*CMW*"), the Commission granted terminal trackage rights, without applying *Midtec II*, because it merely substituted one carrier in the place of a bankrupt carrier in order to maintain the competitive status quo and preserve service to shippers. In doing so, the Commission emphasized that its findings on terminal trackage rights issues were "limited to the unique circumstances of [the] case." *Id.* at 980 n.30. Applicants here, however, seek to alter the competitive relationships by adding another carrier to the lines. In *Denver and Rio Grande Western Railroad Co. and Missouri-Kansas-Texas Railroad Co. v. St. Louis Southwestern Railroad Co.*, Finance Docket No. 30759, 1987 ICC LEXIS 488 (ICC Decided January 5, 1987), the Commission granted terminal trackage rights to a carrier in order to implement a condition the Commission had imposed in the 1982 consolidation of the Missouri Pacific Railroad Company and the Union Pacific Railroad. The Commission acknowledged that the *Midtec II* standard governs current applications for terminal trackage rights under Section 11103(a). *Id.* at *12, n. 5. However, since the Commission considered its action as merely implementing a condition imposed in a 1982 merger (over four years prior to the *Midtec II* decision), it found no need to apply the *Midtec II* public interest standard. *Id.* Applicants, on the other hand, instituted this consolidation proceeding, and the related terminal trackage rights application, well after the *Midtec II* decision had taken effect.

to distinguish between requests by shippers and carriers (which it should not), it should impose a stricter standard for relief for carriers than for shippers, since Section 11103(a) was designed to protect shippers--not carriers--from anticompetitive conduct. Therefore, the *Midtec II* public interest standard should govern this proceeding.

Finally, under the trackage rights agreements governing the trackage in Beaumont and Shreveport, KCS must consent to any and all uses of the facilities and adjoining trackage by a carrier. Contrary to Applicants' allegations, KCS does not dispute that the STB may have the authority, under former Section 11341(a), to override these contractual provisions and award terminal trackage rights if the requirements of Section 11103 are otherwise met. However, as a matter of policy, the Commission normally avoids infusing itself into voluntary contract disputes.[71] To override the governing contractual provisions and allow UP/SP to invite another carrier over the Beaumont and Shreveport trackage without KCS's consent would undermine KCS's inherent rights of ownership.

B. <u>The Board Should Require The Preparation Of An Environmental Impact Statement</u>

The Board's Section of Environmental Analysis (SEA) has issued a Finding of No Significant Impact (FONSI) in connection with the proposed merger in direct violation of the National Environmental Policy Act (NEPA), 42 U.S.C. § 4332(2)(C). In so doing, SEA failed to take the requisite "hard look" at the environmental impacts, particularly the safety impacts, of the merger and the related BNSF/CMA Agreement by (1) failing to obtain the operational information necessary to accurately assess the potential environmental impacts of the merger; (2) abdicating its duty to fully

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[71] *See Indiana Harbor Belt R. Co. -- Acquisition of Line of Chicago & W.I.R. Co. -- Exemption from 49 U.S.C. 11343*, Finance Docket No. 31148 (ICC Served September 22, 1988); *Iowa Interstate Railroad -- Lease and Operate -- Exemption*, Finance Docket No. 30554 (ICC Served October 1, 1984); *Brotherhood of Locomotive Engineers v. Chicago & N.W. Transp. Co.*, Finance Docket No. 29701, 366 I.C.C. 857 (ICC Decided January 26, 1983); *K&K Warehouse -- Exemption From 49 U.S.C. 11104 and 10901(d)*, Finance Docket No. 30858 (ICC Served April 23, 1987).

assess and mitigate the impacts of the merger in violation of NEPA; and (3) failing to conduct an adequate analysis of other alternatives available.[72]

The significance of the operational changes that will result from the merger and the BNSF/CMA Agreement cannot be understated or ignored. Yet, BNSF has not submitted a functional operating plan in connection with the BNSF/CMA Agreement. Owen Rebuttal Dep. at 37-44. Without this information, SEA has no basis for evaluating the operational changes associated with the proposed merger or independently estimating the resulting increases in rail traffic and rail densities. Thus, SEA could not possibly conduct a proper review of the safety, air quality, noise, and energy impacts of the merger. Second, under the guise of "mitigating" the potential safety, air quality, and other impacts, SEA abdicates its duty to assess and mitigate those impacts by deferring to the Applicants, States, and other agencies. SEA improperly delegates its duty to mitigate by simply requiring Applicants to consult with other agencies and comply with existing laws and regulations.[73] Finally, SEA failed to consider reasonable and feasible alternatives that would reduce the environmental impacts of the proposed merger and related Agreements. NEPA requires the STB to give full and careful consideration to "reasonable" and "feasible" alternatives prior to reaching a decision on the proposed action. 42 U.S.C. § 4332(2)(C); 40 C.F.R. § 1502.14; *City of Grapevine v. DOT*, 17 F. 3d. 1502 (DC Cir. 1994). The SEA considered only the "merger" and "no merger" alternatives. EA, vol. 1 at ES-17 and ES-1. The SEA did not analyze the impacts of alternatives proposed by other parties (including other trackage rights and divestiture proposals).

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[72] *See* KCS-50 and KCS-58 for a full discussion of these issues.

[73] Compliance with existing laws and regulations does not constitute mitigation under NEPA when the SEA has identified potential environmental impacts. *See* 49 C.F.R. § 1105.4; 40 C.F.R. § 1508.20 for the STB definition of "mitigation."

The ICC's abdication of its NEPA obligations in the past have been solidly rejected by the courts. *See, e.g., State of Idaho v. Interstate Commerce Commission*, 35 F.3d 585 (D.C. Cir. 1994) (the ICC may not delegate to the EPA the duty of assessing the potential environmental impact of salvage activities associated with a proposed abandonment); *Calvert Cliffs' Coordinating Comm. v. Atomic Energy Comm'n.*, 449 F.2d 1109 (D.C. Cir. 1971) (relying entirely on the environmental judgment of other agencies in fundamental conflict with NEPA.) SEA must assess safety impacts as part of the EA, before the merger decision. To fulfill NEPA's most basic requirements, the STB and the public must have the opportunity to review and evaluate all information regarding potential public health and safety impacts prior to the merger decision. *See, Robertson v. Methow Valley Citizens Council*, 490 U.S. 332, 349 (1989) (NEPA guarantees that relevant environmental information will be made available to the parties and to the public so they may play a role in both the decision making process and the implementation of that decision"). The EA does not meet these requirements.

C. <u>The STB Should Not Immunize Any Prior Conduct That May Have Violated The Antitrust Laws</u>

When Mr. Krebs was President of ATSF, he commissioned "more than one study . . . about where Santa Fe would end up eventually in the Western rail system." One of these studies "included a BN/SF combination," (Krebs Dep. at 83-86), and one or more of the other studies he commissioned included "the possibility of a carve-up of the Southern Pacific routes." *Id.* Mr. Krebs testified that "[i]t seemed to me that the logical carriers were Santa Fe for the Gulf Coast and Cotton Belt, the Union Pacific across to Southern California, and Burlington Northern to Northern California and up to the Pacific Northwest." *Id.*

Standing alone, the fact that Mr. Krebs commissioned one or more studies of potential "combinations" in the western rail market is quite unremarkable. What *is* remarkable, and indeed disturbing, given the close coordination between UP, SP, and BNSF in this and the previous BNSF merger, is the fact that instead of relying on the analysis solely for internal strategic planning purposes, Mr. Krebs elected to share the study or studies with ATSF's competitors, SP and BN. Krebs Dep. at 84-91. While such actions, or any other past actions, may or may not violate the antitrust laws, the Board should make it clear in any ruling in this matter that its antitrust immunity conferred under former Section 11341(a) does not immunize any conduct that may violate the antitrust laws.

Neither Congress nor the courts has granted the STB the ability to immunize anticompetitive behavior that violates sections 1 and 2 of the Sherman Act, *e.g.*, horizontal agreements to divide territories or monopolize a market. The former ICC consistently acted in accordance with this policy often stating that it does not sit "as an antitrust court in determining compliance with the Clayton Act, Sherman Act or related antitrust acts."[74] Accordingly, in *Burlington Northern, Inc. - Purchase (Portion) - Chicago, Milwaukee, St. Paul and Pacific R.R.*, 363 ICC 298, 1980 ICC LEXIS 60 (Aug. 21, 1980), even though there was evidence of discussions that may have constituted "collective activity during the bidding process," the transaction was ultimately approved. In so doing, however, the Commission expressly foreclosed any argument that its approval could be interpreted as ratification of the anticompetitive actions.

> We do not, however, mean by our action today to condone any negotiations which may have violated the antitrust laws. We specifically withhold any antitrust immunity which might be implied in proceedings under the MRRA upon the negotiations conducted between BN, UP, and the Milwaukee trustee and any resulting agreements. We will refer this matter to the Department of Justice, since it is that agency's statutory responsibility to enforce the antitrust laws.

The STB should therefore follow the precedent of the former ICC and establish that its rulings do not condone or provide insulation to any violations of the antitrust laws that may have occurred.

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[74] *UP/CNW*, 1995 ICC LEXIS 37 at *148; *DRGW/SP*, 4 I.C.C. 2d 834, 1988 ICC LEXIS 267 at *42; *UP/MKT*, 4 I.C.C. 2d 409, 1988 ICC LEXIS 1.5 at *33; and *UP/MP/WP* 366 ICC 459, 1982 ICC LEXIS 16 at *50.

D. <u>Because The Terms Of The Transaction Are Not Fair To SP's Minority Shareholders, The Board Should Not Approve Applicants' Request For A *Schwabacher* Finding</u>

Applicants have requested a finding under *Schwabacher v. United States*, 334 U.S. 182 (1948) that the purchase of the common stock of SP is fair to both the stockholders of UP and SP.[75] *Schwabacher* provides:

> Federal law requires that merger terms be just and reasonable to all groups of stockholders.
>
> * * * *
>
> In determining whether each class of stockholders receives an equivalent of what it turns in, the Commission is under a duty to see that minority interests are protected, especially when there is an absence of arm's length bargaining or the terms of the merger have been imposed by management interests adverse to any class of stockholders.

Mr. Grocki's analysis evaluated the price that other carriers, either independently or jointly, would pay for the various SP lines if SP were broken-up and sold.[76] He then evaluated whether such a scenario would result in an increased value of the SP to its shareholders, versus the sale of SP intact to UP. Nearly all of the scenarios studied indicated that the SP was more valuable broken up than if sold intact to UP. The view that SP shareholders could receive higher prices under a break-up scenario was confirmed by Applicants' witness Mr. Yarberry who "posits total proceeds from the sale of the SP franchise in pieces at levels which I believe are even <u>higher</u> than Mr. Grocki appears to suggest." UP/SP-231, R.V.S. Lincoln at 35.

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[75] Applicants have not requested a similar finding for shareholders of the SSW, a subsidiary carrier of SP.

[76] It is simply not true that Mr. Grocki's analysis "is predicated on neither firm offers nor willing sellers." UP/SP-231, V.S. Lincoln at 34. In determining which carriers desired to purchase which lines, Mr. Grocki relied upon the January 29 public filings requiring a description of inconsistent and responsive applications and also the "offers to purchase" that have been submitted by Conrail and Montana Rail Link.

Mr. Lincoln states that Mr. Grocki "never even approximates the real world values of these parts, mostly because his 'values' are pure guesses." *Id.* Mr. Grocki's values were validated, however, by Montana Rail Link's offer to UP of slightly in excess of $615 million for a package of lines that were somewhat reduced from the package that Mr. Grocki evaluated.[77] Mr. Grocki's valuation of the lines in which Conrail would be interested ranged from $918 million to $1.13 billion. Conrail has made an offer to acquire these lines for $1.5 billion "subject to existing mortgages or financing arrangements." Allowing for the uncertainty of these mortgages and financing arrangements, which are unknown to us, Mr. Grocki's analysis once again appears to be right on the money. Therefore, to state that Mr. Grocki's values are "pure guesses" is frivolous and unsupported by the facts. Accordingly, the purchase price is not fair to the minority shareholder's of SP and the Board should not issue a *Schwabacher* finding.

E. KCS And Others Have Been Denied Adequate Due Process

Applicants have resisted discovery at every turn, *e.g.*, Applicants limited their search of files to a limited list of top executives, excluding personnel in charge of key commodity groups and marketing management, who actually carry out company policy and have the best opportunity for knowledge of competitive situations; fought to avoid disclosure of the details of actual instances of shippers' playing UP and SP off against each other to obtain improved rates or service (UP/SP-30 and UP/SP-70; Objections To KCS Interrogatories 20, 22, 63); and refused to produce examples of source competition, build-out situations, and transloading opportunities (UP/SP-30 and UP/SP-70; Objections To KCS Interrogatories 21, 62, 27, 28). Further, Applicants refused to provide access to any shipper

[77] Mr. Grocki's verified statement indicates a range of values for the lines which Montana Rail Link has expressed an interest in from $808 million to $994 million, based upon information publicly available at the time.

files involving bulk commodities;[78] prevented any meaningful examination of their own analysis of the competitive effects of the BNSF/CMA Agreement (claiming "settlement privilege"); and refused to produce strategic studies showing that SP "break-up" scenarios are indeed valid, such as the McKinsey study. Krebs Dep. at 73-78. This refusal to provide open and fair discovery has prevented KCS from fully exploring the competitive effects of the transaction.

In addition to resisting discovery, UP and SP have stymied opposing parties' full participation in this proceeding by their wholesale use, resulting in abuse, of the "Highly Confidential" designation of documents and deposition transcripts. This abuse deprived outside counsel of the right to share information with their clients, which deprived the parties of the opportunity to analyze, evaluate, critique and respond to the information in the fullest and most meaningful manner.

The absurd extent of this practice was followed to declare simple candid statements by UP and SP executives as "Highly Confidential" purely to prevent public disclosure. As Judge Nelson recently held, Applicants cannot use the Protective Order to shield non-rate or shipper specific material from public view. (May 30, 1996 Discovery Conference, at 3376-3378). Unfortunately, this practice was followed for almost every document, including public reports that must be publicly filed at the SEC. (C20-000073-002977). Because of the abuse of the Commission's Protective Order, many conversations between outside counsel and their clients' employees could not occur, severely limiting the parties' right to consult counsel, violating the procedural due process rights guaranteed under both the Fifth and Fourteenth Amendments. Parties were unable to "petition the government for a redress of grievances" in violation of the First Amendment because the parties themselves were unable to even look at the reams of "Highly Confidential" documents in order to properly advise counsel.

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[78] Applicants produced only a small number of chemical shipper files (less than 10); only 20 plastic shippers files; and only 25 Central Kansas grain shipper files. Considering that Applicants rely upon 1400 shipper statements, the refusal to produce a significant number of shipper files prevented any meaningful examination of Applicants' competitive claims.

CONCLUSION

As currently structured, the proposed transaction is not consistent with the public interest. The proposed UP/SP merger will cause unprecedented competitive harm. The BNSF/CMA Agreement, upon which Applicants rely to alleviate this harm, relies on 5,000 miles of trackage rights, which the evidence suggests will result in little, if any, effective competition to UP/SP. KCS's Comprehensive Solution calls for divestiture, through sale by Applicants, of one of two parallel and duplicate lines and facilities. Divestiture will allow Applicants to maintain all of the proposed single-line benefits to shippers and resolve the competitive harms. Accordingly, without significant divestiture, this merger should be denied.

Respectfully Submitted,

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June 3, 1996

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing "BRIEF OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY" was served this 3rd day of June, 1996, by hand-delivery, overnight delivery, or first-class mail, postage prepaid, on all known parties of record.

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June 3, 1996

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Vernon A. Williams
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Surface Transportation Board
Room 2215
12th Street & Constitution Avenue, N.W.
Washington, D.C. 20423

Re: **Finance Docket No. 32760, Union Pacific Corp., et al. -- Control & Merger -- Southern Pacific Rail Corp., et al.**

Dear Secretary Williams:

Enclosed for filing in the above-referenced docket are an original and twenty copies of SPP-16, Brief of Sierra Pacific Power Company and Idaho Power Company. Also enclosed is one 3.5" computer disc containing a copy of SPP-16 in Word Perfect 5.1 format.

ENTERED
Office of the Secretary
JUN 04 1996
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Sincerely,

Richard A. Allen

Richard A. Allen

Attorney for Sierra Pacific Power Company and Idaho Power Company

Enclosures

2SPP-16

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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

-- CONTROL AND MERGER --

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

BRIEF OF

SIERRA PACIFIC POWER COMPANY

AND

IDAHO POWER COMPANY

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June 3, 1996

BEFORE THE
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COMPANY, SPCSL CORP. AND THE DENVER AND
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BRIEF OF

SIERRA PACIFIC POWER COMPANY

AND

IDAHO POWER COMPANY

Sierra Pacific Power Company and Idaho Power Company (collectively referred to here as "Sierra Pacific") submit this Brief in support of the protective conditions that they have requested the Board to place on any approval of the proposed merger of Union Pacific Railroad Company ("UP") and Southern Pacific Rail Corporation ("SP") (collectively referred to as the "Applicants").

INTRODUCTION AND SUMMARY

Sierra Pacific owns and operates a coal-burning electric generating plant in north central Nevada known as North Valmy

Station. The plant was intentionally located in a place where it would have access to, and could be served by, both UP and SP. As explained in detail in the Request for Conditions and Comments filed by Sierra Pacific, SPP-10, on March 29, 1996, the ability of North Valmy Station to obtain its coal supply from mines in the Uinta and Hanna Basins served either by UP or SP has given it competitive alternatives that have been, and will continue to be, critical in keeping not only its rail rates but also its coal supply prices reasonable.

As further explained in SPP-10, the UP/SP merger will eliminate those competitive alternatives. Contrary to Applicants' claim, the BN/Santa Fe Settlement Agreement[1] will not preserve the competition that North Valmy Station now enjoys. Among other reasons, the Settlement Agreement does not give BN/Santa Fe access to any of the mines in the Uinta and Hanna Basins now served by UP and SP. Accordingly, BN/Santa Fe could deliver coal to North Valmy Station from most of the Uinta and Hanna Basin mines only in two-line service with the merged UP/SP, and from the rest of those mines only in two-line service with UTAH Railway. In addition, the compensation BN/Santa Fe must pay for its trackage operations will not permit it to be reasonably competitive.

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[1] "BN/Santa Fe Settlement Agreement" refers to the September 25, 1995 Settlement Agreement between Applicants and the Burlington Northern Railroad Company ("BN") and The Atchison, Topeka and Santa Fe Railway Company ("Santa Fe") (collectively, "BN/Santa Fe"), as amended.

Accordingly, Sierra Pacific requests that the Board impose the following conditions on any approval of the merger of UP and SP:

(1) The merged carrier must provide another rail carrier, to be selected by Sierra Pacific, with trackage rights enabling that carrier to transport coal to North Valmy Station in single line service from all mines in Colorado and Utah now served by SP.

(2) The merged carrier must provide such trackage rights at a compensation level no greater than 1.48 mills per gross ton-mile for the movement of coal from all mines in Colorado and Utah now served by SP to North Valmy Station, adjusted quarterly based on changes in the RCAF-A.

In their Rebuttal, UP/SP-230 through UP/SP-234, Applicants have not seriously disputed Sierra Pacific's showing that North Valmy Station now enjoys competition between UP and SP, based on the ability of each of them to deliver coal to the plant in single-line service from Uinta and Hanna Basin mines, and that that competition has been and will continue to be extremely important to Sierra Pacific. Instead, Applicants have opposed Sierra Pacific's requested conditions on the basis of their claim that North Valmy Station will in fact have essentially the same competitive alternatives after the merger as it has now. As discussed in greater detail below, however, the facts that Applicants assert in support of that claim are simply incorrect.

STATEMENT OF FACTS

The facts relating to North Valmy Station, its dependence on coal from Uinta and Hanna Basin sources, and the rail service available to it are described in detail in SPP-10 and in the verified statements of Jeffrey W. Hill, Director of Fuel Management and Operations Support of Sierra Pacific Power Company, and Thomas D. Crowley, President of L.E. Peabody and Associates (hereinafter "Hill V.S." and "Crowley V.S."). Most of those facts are not disputed and they will only be summarized here.

Construction of North Valmy Station began after an exhaustive three-year site selection study. As Mr. Hill explained: "One of the important considerations in selecting the site was the fact that it is strategically located between, and with access to, the main line tracks of two competing railroads, UP and SP." Hill V.S. at 4. North Valmy Station's generating capacity is evenly divided between two units. Unit I came on line in 1981 and Unit II came on line in 1985. Both of these units were "specifically designed to burn low-sulphur, high BTU coal, which is the primary fuel burned at the plant." Id.

North Valmy Station is dependent on obtaining coal from mines in the Uinta and Hanna Basins in Utah, Colorado and southern Wyoming because that coal is significantly higher in BTU content and lower in sulphur content than coal from any other region in the United States.[2/] As shown on the map and list on the following pages (reproduced from Exhibit A of Mr. Hill's statement), there are currently 11 operational mines in the Uinta Basin within approximately 500 rail miles of North Valmy Station

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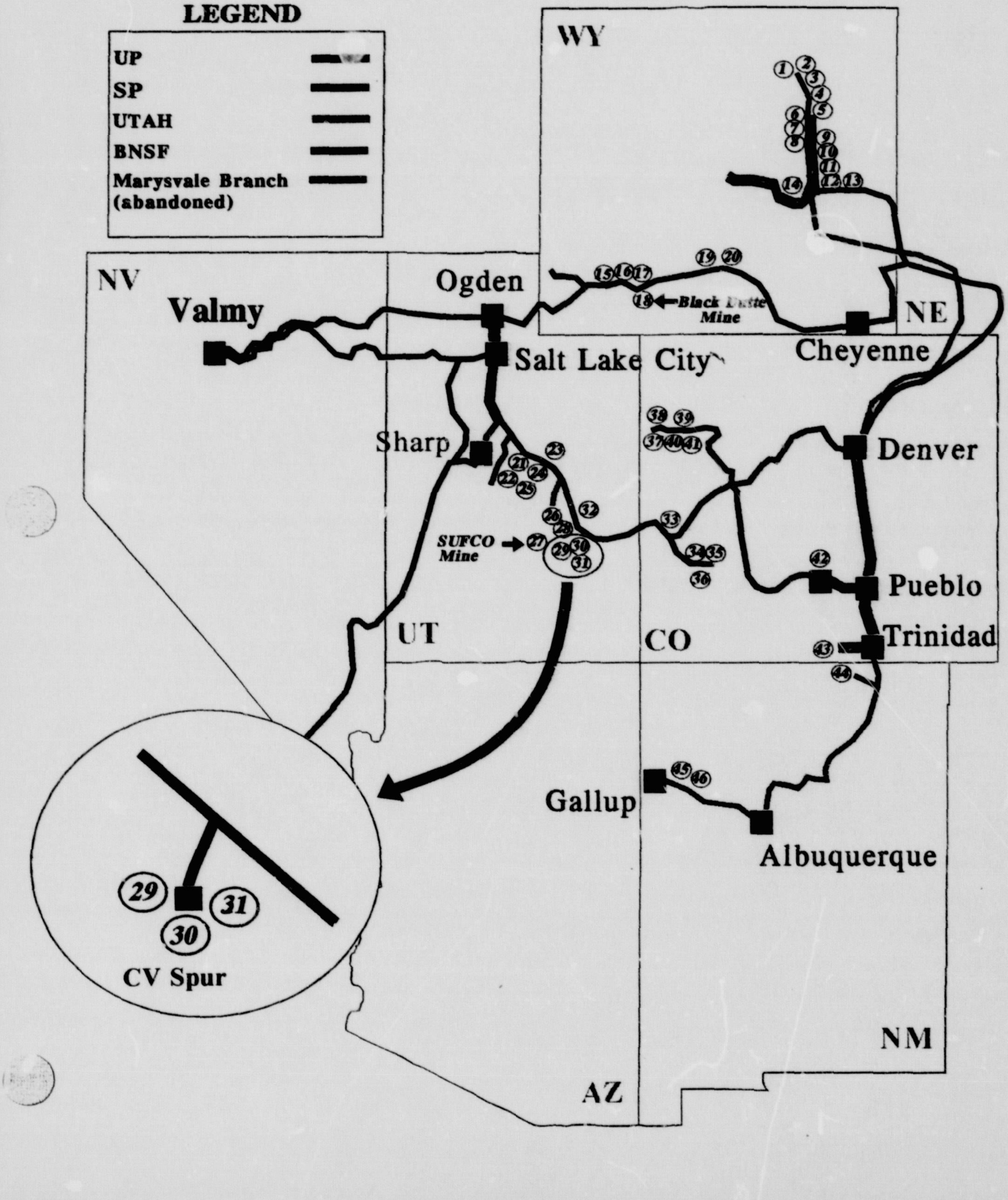
[2/] Hanna Basin coal has a lower BTU and higher sulphur content than most Uinta Basin coal, but it is within the design parameters of North Valmy Station's boilers.

Western UP, SP, UTAH, BNSF Mine Origins



Western UP, SP, UTAH, BNSF Mine Origins

Mine Number	Basin / Mine
	Powder River Basin (WY)
1	Buckskin
2	Rawhide
3	Dry Fork
4	Eagle Butte
5	Caballo
6	Belle Ayr
7	Caballo Rojo
8	Cordero
9	Coal Creek
10	Jacobs Ranch
11	Black Thunder
12	North Antelope
13	Rochelle
14	Antelope
	Green River (WY)
15	Pilot Butte
16	Jim Bridger
17	Leucite Hills
18	Black Butte
	Hanna (WY)
19	Medicine Bow
20	Shoshone No.1
	Uinta (UT)
21	Belina No. 1 & 2
22	Skyline 1 & 3
23	Willow Creek
24	Pinnacle & Aberdeen
25	Star Point
26	Crandall Canyon
27	SUFCO
28	Bear Canyon No. 1
29	Trail Mountain
30	Cottonwood
31	Deer Creek
32	Soldier Canyon

Mine Number	Basin / Mine
	Uinta (CO)
33	Roadside
34	Orchard Valley
35	Sanborn Creek
36	West Elk
	Green River (CO)
37	Colowyo
38	Eagle 5 & 6
39	Trapper
40	Seneca
41	Foidel Creek
	Raton (CO)
42	Southfield
43	Basin Resources
	San Juan (NM)
44	York Canyon
45	McKinley
46	Lee Ranch

and 4 more within 750 rail miles that are served by SP. Mines in the Hanna Basin are within 580 to 760 rail miles from North Valmy Station and are served by UP.

> There are no closer sources of coal for North Valmy Station than the Uinta and Hanna Basin mines shown on Exhibit A. The next closest sources would be mines in New Mexico currently served by BNSF, which are approximately 1,500 rail miles from Valmy, and various Powder River Basin ("PRB") mines served by BNSF and UP, which are approximately 1,400 miles from Valmy. Id. at 6.

North Valmy Station currently obtains its coal supply from two mines: the Southern Utah Fuels Company ("SUFCO") mine in the Uinta Basin and the Black Butte Coal Company mine in the Hanna Basin. The coal from both mines is currently transported by rail entirely by UP under a transportation contract that expires next year.

Throughout the history of the plant, UP and SP have competed to transport North Valmy's coal from the SUFCO and Black Butte mines to the plant. When Sierra Pacific negotiated a rail contract in 1981 to transport coal from the SUFCO mine to North Valmy Station's Unit I, four railroads competed vigorously for the contract. Two railroads, the Denver & Rio Grande Western ("DRGW") and UP, provided origin competition from the mines, and two other railroads, the Western Pacific ("WP") and SP, provided destination competition to the plant. Id. at 8-9.

After protracted negotiations, Sierra Pacific initially selected the combination of UP and WP to transport coal from SUFCO to North Valmy Station under a tariff rate "that was comparable to rail transportation rates for coal to other facilities enjoying rail competition." Crowley V.S. at 4. SP, however, continued to bid aggressively for North Valmy Station's business, and in 1984 succeeded in obtaining a contract with Sierra Pacific to deliver coal to the plant in a two-line haul with UP. Hill V.S. at 8.

In 1986, however, UP succeeded in winning back the right to move the SUFCO coal for the entire haul from the mine to the plant by negotiating a long-term coal transportation contract with Sierra Pacific. Id. at 9. That same year, Sierra Pacific entered into a coal supply contract with Black Butte mine to purchase coal for North Valmy Station's Unit II. The 1986 UP coal transportation contract, which expires next year, awarded UP the movement of both SUFCO and Black Butte coal to North Valmy Station. "The terms of the 1986 contract with UP were favorable to Valmy and were due to the competitive service that Valmy had been receiving from SP." Crowley V.S. at 5.

As Mr. Hill explains, the availability to North Valmy Station of competitive rail service from both UP and SP has been and will be critical to the plant's ability to secure both reasonable rail rates and reasonable coal prices. Hill V.S. at 11-12. The proposed UP/SP merger will deprive North Valmy Station of those competitive options unless the Board imposes protective conditions to preserve them.

Applicants have contended that the BN/Santa Fe Settlement Agreement will preserve rail competition for North Valmy Station because it would allow BN/Santa Fe to deliver coal to the plant. As Sierra Pacific explained in SPP-10, however, the BN/Santa Fe Settlement will not restore the competition North Valmy Station will lose because it does not give the BN/Santa Fe access to any of the Uinta Basin or Hanna Basin mines on which the plant depends for its coal supply. Without such access, the competitive remedy alleged by Applicants is an illusion.

ARGUMENT

I. THE PROPOSED MERGER WILL ELIMINATE CRITICAL RAIL COMPETITION FOR THE TRANSPORTATION OF COAL TO NORTH VALMY STATION

As discussed in the Statement of Facts, North Valmy Station is dependent on obtaining coal from mines in the Uinta and Hanna Basins. Today two railroads, UP and SP, can each deliver coal in single-line service to North Valmy Station from a number of mines in those basins.[3] That fact has given North Valmy Station important competitive alternatives that have served to keep its rail transportation rates and its coal supply costs reasonable. Sierra Pacific contends that the merger will eliminate those competitive alternatives.

Applicants have not seriously disputed Sierra Pacific's contention and its supporting evidence that UP and SP provide competitive transportation alternatives for North Valmy Station's coal supply that have been and will continue to be extremely important to North Valmy Station. Applicants' short rebuttal

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[3] Most of the mines in the Uinta Basin, which produces the highest BTU coal, are served today exclusively by SP.

discussion of Sierra Pacific's Request for Conditions and Comments (UP/SP 230 at 264-265), instead, relies entirely on the contention that Applicants' Settlement Agreement with BN/Santa Fe will preserve those competitive alternatives for North Valmy Station. As we discuss in the following Part II, Applicants' contention in that regard is based on assertions of fact that are simply incorrect and that are not supported by any evidence of record in this case.[4]

II. THE APPLICANTS' SETTLEMENT AGREEMENT WITH BN/SANTA FE WILL NOT PRESERVE THE RAIL COMPETITION AVAILABLE TO NORTH VALMY STATION

Applicants' have addressed Sierra Pacific's competitive concerns and request for conditions only very briefly in their Rebuttal, devoting less than two pages to these issues in their Rebuttal Narrative (UP/SP 230 at 264-65). As noted, they have not disputed Sierra Pacific's contention that North Valmy Station currently enjoys rail competition between UP and SP. Instead, their opposition to Sierra Pacific's comments and requested conditions is based entirely on the contention that the BN/Santa Fe Settlement Agreement will ensure that Sierra Pacific will have

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[4] One of Applicants' witnesses, Robert L. Sansom, also criticizes some of the data relied on by Sierra Pacific's witnesses to illustrate the existing competition enjoyed by North Valmy Station. Sansom RVS at 73. This criticism is insubstantial and Applicants conspicuously make no mention of it in their Rebuttal Narrative. Specifically, Mr. Sansom criticizes Mr. Crowley's comparison of rail rates using Waybill Sample data claiming it is inaccurate data. Mr. Sansom seems to be arguing that Sierra Pacific and its witnesses are not entitled to rely on UP's own data. Regardless of the data used, however, the undisputed fact remains that two railroads are currently able to provide single-line service to North Valmy Station and this competition will be eliminated by the merger.

the same competitive alternatives after the merger as before. Specifically, Applicants have asserted that Sierra Pacific's requested conditions "should be denied because Sierra Pacific has made no showing that its competitive circumstances will be worsened as a result of the merger, and because, in fact, they will be improved." Applicants' Rebuttal Narrative, p. 264.

Applicants do not deny that BN/Santa Fe will not have the right to serve any mines in the Uinta and Hanna Basins on which North Valmy Station depends for its coal supply. Nevertheless, Applicants offer the following comparison of the competitive options available to North Valmy Station before and after the merger. Specifically, Applicants state:

> [I]n the absence of the UP/SP merger North Valmy could obtain Utah coal from one of three basic sources: (a) Utah or Colorado mines served single-line by SP; or (b) Utah Railway mines, via a Utah Railway-UP joint haul; or (c) UP direct from load-out facilities at Sharp, Utah. The same options will remain with the merger and the BN/Santa Fe settlement. North Valmy will then be able to receive coal from the following basic sources: (a) single-line from Utah or Colorado mines via UP/SP; (b) joint line movements from Utah Railway mines, via Utah Railway-BN/Santa Fe; or (c) BN/Santa Fe direct, sourced from a load-out at Provo or other Utah "2-1" points. Id. at 264-65.

In effect, Applicants appear to be arguing that BN/Santa Fe will be able to provide direct single-line service from coal load-outs in Utah, and this will be equivalent to, and serve as an effective competitive substitute for, direct UP service from the SUFCO mine.[5]

Applicants also argue that the BN/Santa Fe Settlement Agreement will give North Valmy Station access to lower BTU, higher sulphur coal from the Powder River Basin ("PRB") mines served by BN/Santa Fe. They state:

> In addition, if North Valmy were to convert to burning PRB coal, it would gain a major advantage from the merger. It would have single-line PRB service from both UP and BN/Santa Fe, whereas today it has only one PRB single-line routing. Id. at 265.

There are two problems with these arguments. First, there are no load-outs at Provo or any other 2-1 point accessible to BN/Santa Fe in Utah, and Applicants' implication to the contrary is simply incorrect. Second, Applicants ignore the fact that burning PRB coal is not feasible for North Valmy Station, first, because PRB mines are from two to three times farther away than Uinta Basin mines, and, second, because North Valmy Station's boilers were not designed to burn PRB coal and converting them to do so is not an economically feasible alternative.

A. Applicants' Assertion That BN/Santa Fe Could Serve North Valmy Station Direct From a Load-Out in Utah is Flatly Incorrect

Contrary to Applicants' implication, there are no load-outs at Provo or any other Utah "2-1" points that BN/Santa Fe could

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[5] A coal load-out is a facility to which coal may be transported by truck where it may then be loaded into rail cars. Coal that North Valmy Station currently receives from the SUFCO mine in southern Utah is trucked from that mine to a load-out owned and operated by that mine on UP's line at Sharp, Utah.

serve. Although Applicants cite Mr. Nock's rebuttal verified statement in support of their assertion, Mr. Nock nowhere mentions any load-outs at Provo or at any other Utah 2-1 points. In fact, Mr. Nock admitted in his deposition that there are no load-outs in Utah that could be served by BN/Santa Fe:

> MR. ALLEN: Are there any load-outs today at Provo or any other place in Utah that BN would have access to?
>
> MR. NOCK: Not to my knowledge, no.
>
> MR. ALLEN: Am I safe in assuming that from your 14 years in the coal business that if there were any, you would know about them?
>
> MR. NOCK: I think so, yes.

Nock Deposition of 5/10/96 at 10 (Appendix A, infra.)

Although Mr. Nock stated his opinion that construction and operation of a load-out at Provo would be feasible,[6] there is no credible basis for that opinion. Indeed, Mr. Nock admitted that he was unaware of any available location for such a load-out and had never studied the physical, environmental or economic feasibility of such a load-out. Nock Dep. at 10-11.

Furthermore, a cursory look at any topographical map reveals that a load-out operation out of Provo to North Valmy Station would clearly not be feasible. To reach Provo from Uinta Basin mines, loaded coal trucks would have to travel a significant

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[6] Id. As Mr. Nock explained at his deposition, if a load-out accessible to BN/Santa Fe were to be constructed, Provo would be the closest location to the coal fields accessible by BN/Santa Fe. Id. at 11.

distance over extremely mountainous terrain.[7] The highway route to Provo from those mines would be difficult, dangerous and prohibitively expensive, especially during the winter, because the loaded trucks would have to negotiate steep four to six percent grades over Soldier Summit,[8] which rises to 7443 feet above sea level.

There is also no merit to Mr. Nock's claim that the fact that coal is currently trucked from the SUFCO mine to a load-out facility at Sharp, Utah indicates that a truck move from Uinta Basin mines to Provo would also be feasible. Nock Dep. at 79. As Mr. Nock acknowledged, the truck route from the SUFCO mine to Sharp is not the route that trucks would take to get to Provo, and it does not go over Soldier Summit. Nock Dep. at 82-83.

In sum, the competitive alternative that Applicants hold out to Sierra Pacific -- long truck moves over the Wasatch Mountains to non-existent load-outs at Provo followed by rail moves via BN/Santa Fe to North Valmy Station -- is completely illusory.

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[7] The highway distance from Provo to the Uinta Basin mines is from between 70 to several hundred miles. Mr. Nock acknowledged in his deposition that "[w]hen you get into 20 to 30 mile truck hauls to get to a rail move, it defeats some of that economics." Nock Dep. at 86.

[8] The town of Helper, Utah, which is located near Soldier Summit, was named as such in 1892 when extra train engines, or "helper engines," stored there were attached to loaded trains in order to provide increased power for climbing the heavy mountain grades. John Keahey, The Art of the Comeback Helper on the Road to Revitalization, Salt Lake Tribune, March 10, 1996.

B. <u>Applicants' Assertion That Burning PRB Coal Is A Feasible Alternative For North Valmy Station Is Erroneous</u>

There is also no merit to Applicants' assertion that burning PRB coal is a feasible alternative for North Valmy Station. As explained in detail in Sierra Pacific's March 29 filing, the closest sources of coal supply to North Valmy Station are mines in the Uinta and Hanna Basins. Mines in the PRB are two to three times further away and are simply too far to be competitive.

Applicants have provided no substantial evidence to refute that proposition. Applicants' witness, Mr. Sansom, argues that the Jim Bridger plant in southern Wyoming uses both Black Butte (Hanna Basin) and PRB coal and that this somehow shows that PRB coal could be transported competitively to North Valmy Station (UP/SP-231, Sansom RVS at 46), but this argument makes no sense whatsoever. The fact that a different plant in southern Wyoming receives both PRB coal and Black Butte coal via UP is completely irrelevant to whether PRB coal could be transported competitively to North Valmy Station in central Nevada.

In addition to the distance disadvantage, PRB coal is incompatible with North Valmy Station's boilers. As Mr. Hill explains, the plant's boilers were specifically designed to burn low-sulphur high BTU coal. Hill V.S. pp. 13-15. Coal from mines in the Uinta and Hanna Basins possess the necessary boiler compatibility characteristics. PRB coal, by contrast, is a lower quality coal with a high-sulphur and low BTU content that is incompatible with the plant's boilers.

Mr. Sansom also suggests that PRB coal is an option for North Valmy Station because the plant has a spare pulverizer. Id. Mr. Sansom fails to realize, however, that running North Valmy Station at full capacity requires the use of all four pulverizers. Moreover, even if North Valmy Station had all the pulverizers in the world, burning PRB coal could not permit the plant to achieve the maximum output for which its boilers were designed. As Mr. Hill stated:

> PRB coal is lower in overall quality than North Valmy Station's existing supplies at SUFCO and Black Butte mines, including lower heating value, higher moisture, and a higher sulphur to heating value. Using PRB coal in addition to or in place of the plant's existing coal supply would raise issues regarding plant performance, efficiency, maintenance, emissions, reliability, availability and capacity. For example, the higher moisture content of typical PRB coal would affect boiler efficiency. Hotter primary air is required to dry the coal for effective pulverization and optimum combustion, resulting in reduced boiler efficiency. Preliminary analyses indicate that using this higher moisture coal would result in a 1.5 to 2.0 percent decrease in boiler efficiency below that experienced with Black Butte coal, which is currently our highest moisture coal supply.
>
> A coal's moisture content, as well as its grindability plays an important role in effective pulverization. Maintaining an optimum fuel to air ratio, as well as a high level of pulverizer performance, is directly affected by moisture and grindability. This is essential for burner stability. It is also essential for reaching designed fineness levels, and for providing reliability in the mills. A reduction in grindability will increase primary air flow requirements in order to circulate more volume inside the pulverizer until it reaches the designed fineness level. Hill V.S. at 14-15.

Finally, Applicants' witness, Mr. Nock, suggests that "with several million dollars of investment, the Valmy plant could be equipped to burn PRB coal." Nock RVS at 50. Mr. Nock's vague reference to "several million dollars" covers a wide range of possible costs, and it provides no basis for any conclusion that such an investment would be economically feasible. In contrast, Sierra Pacific specifically analyzed the economic feasibility of converting North Valmy Station to burn PRB coal. As Mr. Hill stated:

> Because of the relatively lower railhead cost of PRB coal, Sierra Pacific conducted an analysis of whether North Valmy Station could use PRB coal, but we concluded that numerous boiler design incompatibilities precluded such use. Hill V.S. at 13-14.

Furthermore, Applicants' expert coal witness, Richard G. Sharp, agrees that, because of the differences in quality, PRB coal is not usually interchangeable with Uinta Basin coal:

> Because most utility generating plants are designed to burn a single, consistent coal, most coal users have opted for one or the other type. Verified Statement of Richard G. Sharp, UP/SP-23, Volume II, p. 682.

In sum, there is no evidence to support Applicants' assertion that burning PRB coal is a feasible alternative for North Valmy Station. Sierra Pacific, on the other hand, has presented abundant evidence that shows the numerous problems associated with using PRB coal at North Valmy Station, demonstrating that PRB coal is not a competitively viable option for the plant.

III. APPLICANTS' SETTLEMENT AGREEMENT WITH UTAH RAILWAY WILL NOT PRESERVE THE RAIL COMPETITION AVAILABLE TO NORTH VALMY STATION

In SPP-10, Sierra Pacific also explained why Applicants' settlement agreement with the UTAH Railway Company would not solve North Valmy Station's competitive problems. SPP-10 at 20-22 and Crowley V.S. at 43-47. Applicants' Rebuttal did not address or dispute Sierra Pacific's contentions in this regard. To the extent Applicants may rely on that agreement in their brief, there would be no basis for any such reliance.

As shown on the map reproduced earlier, the UTAH Railway is a short line that connects with the SP line at Utah Railway Junction near Price, Utah. As discussed in Mr. Crowley's verified statement in SPP-10, the UTAH Railway, before this settlement, had direct access to two mines, the Pinnacle and Aberdeen mine and the Crandall Canyon mine. Crowley V.S. at 43 and Exhibit TDC-10. UTAH Railway's settlement with Applicants will give it access to a coal load-out facility on SP's CV Spur near Price used by three other mines, and access to the Willow Creek mine on SP near Castle Gate, Utah when that mine opens.

This settlement, however, will not allow UTAH Railway to deliver coal directly to North Valmy Station. It would have to do so in a two-line service with the merged UP/SP or with BN/Santa Fe, interchanging with those carriers at Provo or Utah Railway Junction. As Mr. Crowley explains, such a two-line service is not an adequate competitive substitute for the single-line SP service from the few mines covered by the settlement that is now available to North Valmy Station, and it will not provide effective competition to the merged UP/SP. SPP-10, Crowley V.S. at 43-47.

More importantly, this settlement does not give UTAH Railway access to the 11 Uinta Basin mines now served exclusively by SP or, of course, to any of the Uinta Basin or Hanna Basin mines served by UP. Today, all of those mines are served by competing railroads that can deliver their coal to North Valmy Station. After the merger, even with the BN/Santa Fe and UTAH Railway settlements, all of those mines will be served by only one railroad. That will cause a very substantial loss of competition to North Valmy Station and, in all probability, a significant increase in its rail transportation rates.

IV. APPLICANTS HAVE NOT REBUTTED SIERRA PACIFIC'S SHOWING THAT THE COMPENSATION BN/SANTA FE MUST PAY FOR ITS TRACKAGE RIGHTS IS TOO HIGH TO PERMIT IT TO BE COMPETITIVE.

As we have discussed, from Sierra Pacific's point of view, the major problem with the UP/SP merger as proposed by Applicants is that it will not provide BN/Santa Fe or any other railroad effective competitive access to the only sources of coal that are feasible for North Valmy Station. Even if that problem did not exist, Mr. Crowley showed in his verified statement that the compensation BN/Santa Fe would have to pay UP/SP under the BN/Santa Fe Settlement Agreement is much too high to enable BN/Santa Fe to be an effective competitor in the Central Corridor. The trackage rights compensation is too high because it far exceeds the costs that a merged UP/SP would incur in transporting coal from the same locations to North Valmy Station. Crowley V.S. at 28. According to Mr. Crowley, "3.0 mills per gross ton-mile compensation level under the Agreement suggests an economic rent to landlord UP/SP, which would raise the floor for establishing rates." Id. at 19. Other parties, including the Department of Justice and the National Industrial Transportation League, have reached the same conclusion.

Mr. Crowley determined that UP/SP's costs, including a return on investment based on current cost of capital for the assets consumed by traffic is "not more than 1.48 mills per gross ton-mile, adjusted quarterly beginning in the first quarter of 1996 based on changes in the RCAF-A, from and after that time." Id. at 19-20. Accordingly, BN/Santa Fe could not compete effectively for the transportation of coal to North Valmy Station unless the fee it was required to pay UP/SP was set at not more than 1.48 mills per gross ton-mile.

Applicants' have not rebutted this showing. Instead, one of Applicants' witnesses, William W. Whitehurst, Jr., argues that Sierra Pacific and others have employed the wrong comparison. He contends that the proper comparison of costs is between BN/Santa Fe and SP. Whitehurst RVS at 10. Mr. Whitehurst is not correct. After the merger, BN/Santa Fe will not be competing against a financially struggling SP but against a very cost efficient merged UP/SP. An accurate comparison of costs, therefore, can only be between BN/Santa Fe and UP/SP.

V. THE CONDITIONS SOUGHT BY SIERRA PACIFIC ARE LIMITED AND NARROWLY TAILORED TO REMEDY THE COMPETITIVE HARM THAT THE MERGER WILL CAUSE NORTH VALMY STATION

The conditions sought by Sierra Pacific are limited and narrowly tailored to remedy the competitive harm that the merger will cause North Valmy Station. The conditions would only enable a railroad other than the Applicants to move coal to the plant from mines presently served by SP. They would not authorize such other railroad to move coal from the mines to other destinations, and therefore they would not enhance the competitive service to the mines in ways unrelated to effects of the merger.

Moreover, the requested conditions will not impair the benefits of the merger to the Applicants. They will simply ensure that the Applicants will be subject to the same competitive restraints on the rates and service they provide to North Valmy Station after the merger as UP and SP are subject to today. As Mr. Hill states in his verified statement:

> If, after the merger, Applicants continue to offer better rates and service from UP origin mines than another railroad offers from SP origin mines, the trackage rights we request would go unused and would have no effect on UP's business. Granting those rights will not undermine whatever competitive advantages UP may have over SP and SP origin mines today; Applicants would have the same advantages over another railroad after the merger. Granting those rights simply ensures that the merger will not eliminate an important competitive restraint that has kept, and will continue to keep, Applicants' rates and services to North Valmy Station reasonable. Hill V.S. at 18.

In this regard, there is no merit to the argument of Applicants' witness, Mr. Sharp, that the conditions sought by

Sierra Pacific would unduly or inappropriately enhance North Valmy Station's competitive options after the merger. Specifically, Mr. Sharp claims that Sierra Pacific's coal source options will be greater after the merger if the Board grants Sierra Pacific its requested conditions, because it would enable two carriers to provide single-line service to North Valmy Station from Uinta Basin mines from which only one carrier, SP, can now provide such service. Sharp RVS at 26. While that is true, the solution proposed by Sierra Pacific is the only one that solves a serious competitive problem created by <u>Applicants</u>' desire to merge in a manner that is least restrictive and harmful to Applicants. The only other ways to solve that problem without to some degree increasing North Valmy Station's competitive options would be either (1) to order complete divestiture of the SP line from Uinta Basin mines to the plant to some other railroad (as Montana Rail Link and some others urge) or (2) to grant <u>exclusive</u> access to another railroad. Clearly Applicants would favor neither alternative. To best accommodate and protect the interests of <u>both</u> Sierra Pacific and Applicants, therefore, the Board should provide another rail carrier with trackage rights enabling that carrier to transport coal to North Valmy Station in single-line service from all mines in Colorado and Utah now served by SP.

<u>CONCLUSION</u>

The Board should approve the UP/SP merger only upon the following conditions:

(1) The merged carrier must provide another rail carrier, to be selected by Sierra Pacific, with trackage rights enabling that carrier to transport coal to North Valmy Station in single line service from all mines in Colorado and Utah now served by SP.

(2) The merged carrier must provide such trackage rights at a compensation level no greater than 1.48 mills per gross ton-mile for the movement of coal from all mines in Colorado and Utah now served by SP to North Valmy Station, adjusted quarterly based on changes in the RCAF-A.

Respectfully submitted,

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June 3, 1996

load-out served by BN Santa Fe."

What load-outs would be served by BN Santa Fe after the merger that could serve Valmy?

A. That would have to be a new load-out constructed at someplace like Provo, Utah, in the Provo to Salt Lake City area.

Q. Are there any load-outs today at Provo or any other place in Utah that BN would have access to?

A. Not to my knowledge, no.

Q. Am I safe in assuming that from your 14 years in the coal business that if there were any, you would know about them?

A. I think so, yes.

Q. Has UP ever studied the possibilities of establishing a load-out at Provo or any other place in Utah other than Sharp?

A. No, we have not, not in my years in the group, and Sharp is not a load-out that was constructed by UP. It was constructed by the coal company.

Q. And do you have any information as to whether or not -- as to the feasibility of constructing a load-out at Provo, for example?

A. I would believe it's feasible. It's

approximately the same distance from the coal fields as Sharp is from Sufco mine.

Q. But in terms of Provo in terms of space in Provo for sidings and so forth that would be necessary for a coal load-out?

A. It would be possible to construct a load-out. There obviously would have to be some new trackage laid on private property to construct an efficient loading facility, but it's possible.

Q. But you haven't studied the availability of land and so forth for such a facility?

A. No, we have not.

Q. Is Provo the closest 2-to-1 point at which BN or anybody could establish a load-out that would be accessible to the Utah coal fields?

A. Yes.

MR. HESTER: When you say BN or anybody, who's the anybody you're including in there?

MR. ALLEN: Well, anybody who might construct a load-out facility, whether it would be BN Santa Fe or the mine itself or anybody else who wanted to construct it.

MR. HESTER: Okay.

THE WITNESS: To have access to the BN Santa Fe?

BY MR. ALLEN:

Q. Provo would be the closest place?

A. Yes, it would be.

Q. And what would be the route that trucks would have to take from mines now currently on the SP in Utah to get to Provo?

A. There's a major highway, and I'm not quite sure what it is. I think it's Route 50, but it is a four lane highway that runs out of the coal fields from Price -- or runs from Price, Utah, and actually through Utah to Provo. It's the major route of travel from Salt Lake City to the coal fields down through Provo.

Q. And are you aware that there's a mountain range between those coal fields and Provo?

A. Very much so, yes.

Q. And that that route would have to cross Soldier Summit?

A. Yes, as our trains do.

Q. Do you know the grade of the pass over Soldier Summit?

A. It's about 2 percent, I believe.
Q. 2 percent?
A. The rail grade.
Q. How about the highway grade?
A. I have no idea what the highway grade is, no.
MR. ALLEN: I have no further questions.

EXAMINATION BY COUNSEL FOR
WESTERN SHIPPERS COALITION

BY MR. McBRIDE:
Q. Mr. Nock, my name is Michael McBride, we have known each other in the past, but for formality sake I'm going to call you Mr. Nock today. I represent the Western Shippers Coalition in this proceeding. Are you familiar with that group?
A. Yes, I am.
Q. Picking up on Mr. Allen's questioning there, does the rail line down over Soldier Summit -- this may not be the most technically correct term in railroading -- snake back and forth a bit to achieve that 2 percent or so grade that you just referred to?
MR. HESTER: Object to form. You can

discuss in your testimony about the ability to generate an adequate return going forward on the merged coal business, are those based on the projected costs of the merged system?

A. Yes. What we would project the costs to be postmerger.

Q. And those would not be SP's costs?

A. No.

Q. Okay. If there's testimony from SP witnesses relating to SP's ability to generate an adequate return on investment for coal or for any other segment of its business, would that be more accurate information than what you're able to testify to?

A. Yes.

Q. Now, you discussed with Mr. Allen the potential for a load-out from the Utah coal fields to Provo. Do you recall that?

A. Yes, I do.

Q. And do you consider a load-out to Provo to be feasible?

A. Yes, I do.

Q. Could you explain why.

A. Well, the fact that there's been -- the Sharp load-out is successful. Roughly the same distance that coal would need to be trucked to get to Provo, and over, I think, potentially better roads than the trucking of coal to Sharp would lead me to believe that there would be t possibility to construct such a loading facility.

Q. So is the terrain more favorable for a load-out at Provo than it is for a load-out at Sharp?

A. Well, I believe the truck move is over better highways than occurs over Sharp. The first third of the Sharp move is through very mountainous roads, two-lane-highway type of roads and that the last two-thirds of the move is not -- is more comparable to what would occur from the Price area, Price, Utah area to Provo.

Q. So do you consider the load-out option that you discuss in your testimony for BN Santa Fe at Provo to be a realistic possibility?

A. Yes, I do.

Q. Now, at around -- let me ask you to look at page 50 of your testimony, please. In the second full paragraph on that page you enumerate three options for Valmy to secure access to Utah coal postmerger. Do you see that?

A. Yes, I do.

of Colorado and Utah coal?

A. Yes. In my judgment, the fuel costs would be significantly less, and barring any obstacles the Powder River coal would be used in those plants.

Q. And could you explain again why Powder River Basin coal would be used in those plants?

A. Because of the significantly lower delivered cost of that fuel versus the other options.

Q. And the other options, including Colorado and Utah coal?

A. Yes.

MR. HESTER: Thank you, Mr. Nock. Those are all the questions I have.

MR. ALLEN: I have a couple on redirect.

EXAMINATION BY COUNSEL FOR
SIERRA PACIFIC POWER COMPANY-- Resumed
BY MR. ALLEN:

Q. The current truck move between the Sufco mine and Sharp, am I correct that that is not over Soldier Summit?

A. No, it's a more southerly route.

Q. Do you know the highest altitude that

that route has to ascend?

A. No, I don't.

Q. Is it as high as Soldier Summit?

A. I don't know. The basis of my statement is having traveled on both roads, and as far as comparing the grades and the altitude, I don't --

Q. You haven't done that?

A. No, I haven't, and I can't really recollect that.

Q. Do you know of any truck movements of coal over Soldier Summit to Provo or points north of Provo?

A. I think there are some industrial coal moves that take place over that highway. I have to say that's some speculation and would probably be -- or would be lower volume moves. There's also some Utah Power & Light deliveries, but that basically is still in the area of the coal fields, but they might travel over that highway from Price to Provo.

MR. ALLEN: That's all I have.

EXAMINATION BY COUNSEL FOR
WESTERN SHIPPERS COALITION-- Resumed
BY MR. McBRIDE:

down to that area.

Q. But from today's standpoint of existing rail lines, that coal has to be trucked some considerable distance to get to a railroad if it's going to move by railroad; isn't that right?

A. That is correct.

Q. Whereas any coal that would come out of the coal fields around Price today would not have to be trucked to Provo to get on a railroad, correct?

A. They would not be trucked to Provo. There is typically a reasonably significant truck move involved in getting coal from the coal mines to the rail loading facility.

Q. Yes, but it's much shorter for the remainder of the mines other than the Sufco mine than it would be to truck the coal into Provo; isn't it?

A. It is shorter, yes.

Q. And as a railroad man is it your opinion that the railroad movement of that coal from the vicinity of the coal fields is more economical than -- as far as Provo than it would be to truck it to Provo?

A. I would agree with that statement if

the coal loading facility is adjacent or immediately adjacent to the coal mine. When you get into 20 to 30 mile truck hauls to get to a rail move, it defeats some of that economics.

Q. Have you done a specific economic analysis of the relative costs of putting the coal on the trains that it gets on via load-outs today versus trucking it to Provo and then putting it on trains?

A. We have not done an analysis, no.

Q. Now, earlier when Mr. Hester asked you questions about SP's coal business and your specific knowledge of costs and whatever, I take it you're not disavowing any of your earlier testimony in response to my questions?

MR. HESTER: I would object to the form.

THE WITNESS: Well, I think, you know, clarifying some of the statements.

BY MR. McBRIDE:

Q. Right. But all the statements you gave this morning in response to my questions, I take it, you stand by? You're not correcting those?

A. That's correct.

Q. And so I gather you have some estimate

CERTIFICATE OF SERVICE

I certify that I have served a conformed copy of the foregoing Request for Conditions and Comments of Sierra Pacific Power Company and Idaho Power Company in Finance Docket No. 32760, by first class mail, postage prepaid, or by more expeditious manner of delivery, upon all persons required to be served as set forth in 49 C.F.R. § 1180.4(c)(5), namely all persons on the official service list published by the Surface Transportation Board in Decision No. 15 (served February 15, 1996), as modified by Decision No. 17 (served March 7, 1996), and as further modified by Decision No. 26 (served March 25, 1996). Dated this 3rd day of June, 1996.

Jennifer P. Oakley

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JUNE, 1996 #72

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June 3, 1996

Via Hand-Delivery

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1201 Constitution Avenue, N.W.
Washington, D.C. 20549

Re: Finance Docket No. 32760

Dear Mr. Williams:

Enclosed for filing in the above referenced proceeding are the original and 20 copies of the Brief of Illinois Power Company (ILP-8), along with a 3.5 diskette containing the Brief in Word Perfect 5.1.

An extra copy of the brief is also enclosed. Please date stamp this additional copy and return it to our messenger.

Thank you for your assistance.

Sincerely,

Marc D. Machlin

Marc D. Machlin

cc: All parties of record

Enclosure

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ILP-8

BEFORE THE

SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 32760

UNION PACIFIC CORPORATION, ET AL.
-- CONTROL AND MERGER --
SOUTHERN PACIFIC RAIL CORPORATION, ET AL.

BRIEF OF ILLINOIS POWER COMPANY

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June 3, 1996

ILP-8

BEFORE THE

SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 32760

UNION PACIFIC CORPORATION, ET AL.
-- CONTROL AND MERGER --
SOUTHERN PACIFIC RAIL CORPORATION, ET AL.

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BRIEF OF ILLINOIS POWER COMPANY

Illinois Power Company ("Illinois Power") hereby submits this brief on the Applicants' proposed merger.[1] As we stated in our verified comments (ILP-6), Illinois Power requests that approval of the merger be denied unless the Surface Transportation Board imposes conditions that will maintain effective competition for high-BTU, low-sulphur coal from Western mines to Illinois Power's plants. In those comments, we demonstrated that Illinois Power currently benefits from such competition between Western mines served by SP and Western mines served by UP. In its present form, the proposed merger will destroy this competition. It will harm Illinois Power by unifying the only two railroads capable of efficiently delivering this coal.

BACKGROUND

Illinois Power is a combination electric and gas utility serving customers in various parts of Illinois. Currently, Illi-

1. Throughout this submission, Illinois Power uses abbreviations as they appear to be commonly used otherwise in this proceeding.

nois Power purchases 1.2 million tons annually of high-BTU, low-sulphur coal from Western mines for use at its Wood River and Havana power stations. This coal is shipped from various originating mines via the SP to Illinois where it is then transported to the two plants either by another rail carrier or by barge. At considerable expense, Illinois Power has built facilities at both Wood River and Havana to ensure that both plants are able to receive coal by either rail or barge (and thus ensure that there is competition at the destination). *See generally* ILP-6 at 1-2. Indeed, Applicants do not challenge the fact that IP has competition at the two utility plant destinations at issue here. UP/SP-231 (Sansom R.V.S. at 52).

The Western coal Illinois Power purchases is currently transported as part of a backhaul arrangement whereby the SP transports taconite from the Midwest for Geneva Steel and then backhauls coal for Illinois Power. Furthermore, other Western mines (served in some cases by the UP, in others by the SP) are capable of providing coal with the characteristics that Illinois Power requires.[2] Suitable mines are located in the Hanna Basin (served only by UP) and in the Uinta Basin (served principally by the SP, but also by UP and the Utah Railway).[3] Because of both the favorable backhaul

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2. At the Havana and Wood River facilities, Powder River Basin coal is not a viable alternative. *See* ILP-6 at 2, n.2.

3. UP has direct access to one coal origin in the Uinta Basin, the SUFCO facility located near Sharp, Utah. *See* UP/SP-23 at 679, n.1 (Sharp V.S.). For a variety of reasons addressed in ILP-6 at 2, n.3, mines served by the Utah Railway are unlikely to be able to serve Illinois Power competitively.

arrangement and the competition from various mines and railroads, Illinois Power was able to contract through the year 1999 for favorable coal transportation prices to its Wood River and Havana power plants. These rates were obtained as a direct result of competition between various mines served by either the SP or the UP -- it is not (and clearly was not) necessary that any particular mine be served by both the UP and the SP; rather it is (and was) sufficient that there be competition between carriers serving different mines since this sort of geographic competition drives down the delivered price of coal to a shipper such as Illinois Power. *See generally* ILP-6 at 2-3.

Illinois Power's current rate contracts with SP expire in 1999. At that point, when Illinois Power solicits bids, the proposed merger threatens to destroy the competition that has served the utility so well. After the merger, the only Western mines able to provide the coal Illinois Power needs will be served by the merged company. By reducing the number of rail carriers for the initial portion of the move from two-to-one, competition is destroyed. As a result, the newly formed company will have no incentive to offer rates as low as those that have been obtained under present conditions. *See generally* ILP-6 at 4.

DISCUSSION

In its comments Illinois Power outlined possible conditions which would ameliorate the anticompetitive effects of the merger outlined above.[4] Each of these conditions meet the test set forth in Finance Docket No. 32549, *Burlington N. Inc. & Burlington N. R.R. -- Control & Merger -- Santa Fe Pac. Corp. & The Atchison, T. & S.F. Ry.*, slip op. at 55-56, 93 (served August 23, 1995): (1) the consolidation will produce effects harmful to the public interest due to a significant reduction of competition in an affected market; (2) the conditions Illinois Power has proposed will ameliorate or eliminate these harmful effects (indeed, Applicants have raised no such issue with respect to Illinois Power's conditions); (3) there is no sound basis to believe that the conditions Illinois Power has proposed will not be operationally feasible (again, Applicants have raised no such issue with respect

---

4. Illinois Power set forth three possible appropriate conditions:

1. BN/SF could be granted trackage rights to appropriate Western mines currently served directly by UP and/or SP that have coal capable of being used at Illinois Power's two plants. If this option is chosen, however, BN/SF would also need a trackage rights fee (for the entire BN/SF movement that would be substituting for the SP current moves) that permitted BN/SF to offer competitive prices. The trackage rights and related fee would have to cover not only BN/SF coal movements to Illinois Power's plants or appropriate interchange points, but also any movements to Geneva Steel or other shippers involved in backhaul traffic.

2. Another carrier could be granted ownership of necessary lines in the Central Corridor or trackage rights from the appropriate mines to the current SP destinations. As in option 1 above, the sale price or trackage rights fee needs to be set at an amount that permits the new carrier to offer truly competitive prices. Any new carrier would also require access to a suitable backhaul shipper in the West.

3. The Applicants could provide Illinois Power with an option (exercisable at Illinois Power's sole discretion) to have coal move at current backhaul rates (adjusted by a suitable index and with the same service provisions) for 2000-20 (the approximate end of the useful live of each of the two plants at issue).

to Illinois Power's conditions); and (4) by reducing or eliminating the threatened harm, the conditions Illinois Power has proposed will produce a net public benefit (especially since there is no sound basis to believe that the conditions will cause any reduction in the public benefits produced by the merger -- again, a point upon which Applicants have been silent in their specific discussions relating to Illinois Power).

Therefore any of the conditions proposed by Illinois Power can be entered by the Board. And because of the anticompetitive threats raised by the merger, at least one of them should be.

Rather than face the facts and law (as presented above), Applicants have opted instead to raise three easily-dismissed arguments as to why they believe Illinois Power does not need one of the conditions it has proposed.

First, Applicants argue that because Illinois Power *previously* purchased some coal from the Eastern mines, competition from those mines is sufficient. *See* UP/SP-231 (Sansom R.V.S. at 52; Sharp R.V.S. at 22-23). Applicants are well aware (based on highly confidential data supplied by Illinois Power during discovery)[5] of the truth behind Illinois Power's comment that Eastern "coal is currently not priced to serve as a viable competitive alternative for Illinois Power's purposes." ILP-6 at

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5. If the Board deems it necessary, Illinois Power will make available (under the terms of the Protective Order entered in this proceeding) the highly confidential data needed to confirm the points it makes herein.

2, n.2.[6] Indeed, the minehead price of some Eastern coal was almost 262% of some Western coal for one recent year at Wood River (with the mine price actually exceeding the total delivered price of Western coal).[7] Thus, Applicants' reliance on the historic fact that Illinois Power once took Eastern coal cannot defeat the simple fact that for the only low-sulphur, high-BTU coal that is competitively priced (Western coal), SP and UP are the two major competing carriers and this merger threatens to end that competition.

Second, Applicants argue that since UP transports very little coal for Illinois Power it is not a true competitor. *See* UP/SP-231 (Sharp R.V.S. at 22). This argument confuses whether UP's presence and ability to transport western coal for Illinois Power has had (and will continue to have) an effect on the price and services Illinois Power receives with who actually wins any given bidding round. Frequently, only a small number of bidders (indeed, often only one) will win a particular bid. But, the price (and service standards) at which the successful bidder wins may have been substantially effected by other potential or active bidders -- that's effective competition. Thus, the fact that UP carries little of Illinois Power's Western coal does *not* show that

6. Applicants offer misleading statistics regarding how much Eastern coal Illinois Power actually used. For 1995 (the most recent year for which numbers are available and the only recent year for which the statistics are not skewed by either flood or strike tonnage), Eastern coal accounted for only 27% of the tonnage at Wood Rover and *none* of the tonnage at Havana.

7. It is thus no surprise that Illinois Power allowed its Eastern coal contracts to expire at the end of their terms.

UP is not an effective competitor (as Applicants would have the Board believe). Rather, it merely shows that UP did not win one round of the competition. The facts show that Illinois Power has benefited from just such competition. *See* ILP-6 at 2-3. And, Illinois Power should not be made worse off by the merger.

Finally, Applicants argue that given the BN/SF settlement, competition will actually increase and Illinois Power will be able to receive coal from origins on the Utah Railway. UP/SP-230 at 260; UP/SP-231 (Sharp R.V.S. at 23). But, numerous other commenters have shown that the terms of this settlement are such that BN/SF will not be an effective competitor. *See, e.g.,* DOJ-8 at 9 (and V.S. Majure); NITL-10; MRL-10; WCTL-12.[8] As these other parties have demonstrated, the trackage rights fee is simply too high for BN/SF to compete effectively. Illinois Power sees no need to add further to the record on this issue at this point. In addition, the Utah Railway has access to only a limited number of coal mines -- far fewer than are now available to either SP or UP. Furthermore, Applicants have repeatedly argued that shippers such as Illinois Power benefit from single-line service. However, use of the Utah Railway-BN/SF option adds another carrier into the mix. Thus, under Applicants' own theory, the Utah Railway-BN/SF

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8. Applicants also argue that Illinois Power's condition relating to BN/SF (the first condition described in n.4, *supra*) goes beyond a return to source competition. UP/SP-231 (Sharp R.V.S. at 23). Illinois Power is open to any suggestions Applicants may have to alleviate their concern in this area, but since the reduction in source competition is ultimately due to Applicants' merger, they (and not the shippers who stand to lose by the merger) should bear any burden caused by conditions that might be broader than might be ideal.

option will be less efficient than either of the options now available to Illinois Power.

Indeed, it seems remarkable that Applicants have chosen to raise these arguments rather than readily adopt Illinois Power's position since: (1) UP's Chairman has recognized that SP's back-haul "rates must have been set rationally and on the basis of *competition* and business opportunities," UP/SP-231 (Davidson R.V.S. at 10; emphasis added); and (2) at least with respect to Illinois Power's third possible condition (*see* n.4, *supra*), Illinois Power merely seeks to have the Board adopt Mr. Davidson's own expectation -- UP did "not base[its] acquisition of SP on any expectation of being able to raise rates to SP-served customers." UP/SP-231 (Davidson R.V.S. at 10).

In any event, because of the adverse effects of the merger as currently proposed, it should not be approved. Illinois Power has shown that, if it is approved, the merger needs to be conditioned on steps that will ensure the continuation of competition for Western coal movements to Illinois Power's plants.[9]

9. Rather than seeking only one option at this time, Illinois Power believes that the Board is better served by having several options (*see* n.4, *supra*) and the chance to choose the one that best comports with the other conditions it imposes.

CONCLUSION

As currently proposed, Illinois Power opposes the merger by the Applicants. As discussed above, however, Illinois Power requests that, if the merger is approved, appropriate conditions be imposed such that the competition Illinois Power currently enjoys is not destroyed.

Respectfully submitted,

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Of Counsel

June 3, 1996

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing Brief of Illinois Power Company (ILP-8) was served on the following parties via hand delivery this 3rd day of June, 1996:

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A copy of the foregoing Brief was also sent by first class mail to all parties of record.

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June 3, 1996

Mr. Vernon A. Williams
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Item No.____________

Page Count 46
JUNE, 1996 #75 77

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Re: 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

Dear Mr. Williams:

Enclosed for filing in the referenced proceeding is the Brief of Save the Rock Island Committee, Inc. (STRC-12). The original and 20 copies of STRC-12 are being filed under seal because they contain material designated as "Confidential" and "Highly Confidential" by the Applicants in the proceeding. An additional 20 copies of STRC-12 redacted for filing on the public record are also enclosed. Also enclosed are two 3.5-inch disks, one containing the redacted version of the text of STRC-12 and the other containing the confidential version of the text of STRC-12, each in WordPerfect 5.1 format.

The confidential version of STRC-12 is being served only upon such parties of record that appear as outside counsel or counsel for governmental agencies on the restricted service list established pursuant to the discovery guidelines served December 7, 1995, in this proceeding. All other parties of record have been served with the version of STRC-12 that is being filed on the public record.

Please acknowledge the receipt and filing of STRC-12 by receipt stamping the copy of this letter, the extra copy of the confidential version of STRC-12, and the extra copy of the redacted version of STRC-12 enclosed for that purpose and returning them to me in the enclosed self-addressed, postage prepaid envelope.

Very truly yours,

W. P. Jackson Jr.

William P. Jackson, Jr.

WPJ/jmb

Enclosures
cc: Mr. Bruce Hanson
Mr. Jack Wright

45P

REDACTED - To Be Filed on the Public Record STRC-12

BEFORE THE

SURFACE TRANSPORTATION BOARD

WASHINGTON, D.C.

ORIGINAL

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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 SAVE THE ROCK ISLAND COMMITTEE, INC.

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Due and Dated: June 3, 1996

REDACTED - To Be Filed on the Public Record STRC-12

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 SAVE THE ROCK
ISLAND COMMITTEE, INC.

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Due and Dated: June 3, 1996

TABLE OF CONTENTS

TABLE OF AUTHORITIES CITED

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 SAVE THE ROCK ISLAND COMMITTEE, INC.

Save the Rock Island Committee, Inc. ("STRICT"), submits this Brief in support of its request for the imposition of conditions upon any approval of the transactions for which authority is sought in this proceeding by Union Pacific Corporation ("UPC"), Union Pacific Railroad Company ("UPRR"), Missouri Pacific Railroad Company ("MPRR"), Southern Pacific Rail Corporation ("SPR"), Southern Pacific Transportation Company ("SPT"), St. Louis Southwestern Railway Company ("SSW"), SPCSL Corp. ("SPCSL"), and The Denver and Rio Grande Western Railroad Company ("DRGW") (collectively "Applicants").[1]

---

[1] On November 30, 1995, the Applicants filed their Railroad Merger Application ("Application") in this proceeding with the Interstate Commerce Commission ("ICC"), the statutory predecessor of the Surface Transportation Board ("Board"). The Application seeks authorization under 49 U.S.C. Sections 11343 to 11345 for the acquisition of control of SPR by UP Acquisition, an indirect wholly-owned subsidiary of UPC, the merger of SPR into UPRR, and the resulting common control of UPRR, MPRR, SPT, SSW, SPCSL, and DRGW by UPC. Consistent with the practice in this proceeding, those rail carriers presently affiliated with UPC will be referred to herein as "UP" while those rail carriers affiliated with SPR will be referred to herein as "SP." UP together with UPC will be referred to as "Union Pacific".

Because this proceeding was pending with the ICC prior to January 1, 1996, the date the ICC was abolished and certain of its functions, (continued...)

WHAT STRICT WANTS

STRICT wants the Board to order sale of the SSW line between St. Louis and Kansas City to a purchaser who will agree to rehabilitate and operate the entire line. Offering the line for sale should be imposed as a condition to approval of the proposed merger. The line is parallel to one presently owned by MPRR. Since discovery has shown that little or no operation of the line by UPRR following the merger is proposed, such action would create no impediment to the merger but would give back to Missouri a rail line that is important for economic development of rural areas. STRICT has located at least one purchaser who is willing to buy and operate the line as a unit if unrestricted interchange is allowed at both ends, but neither SSW nor UPRR will agree to such a sale without impossible restrictions that limit competition and the economic chance for success of the line in the hands of a new operator.

BACKGROUND

STRC-8, the comments and evidence in opposition STRICT filed on the Application and its request for conditions on any approval of the Application, contains an extensive discussion of why STRICT is participating in this proceeding. The facts stated therein were entirely unrebutted by Applicants, both in discovery and in the multi-volume Applicants' Rebuttal.[2]

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[1](...continued)
including its rail merger authority, were transferred to the Board, the law in effect prior to January 1, 1996, governs this proceeding. See The ICC Termination Act of 1995, Pub. L. No. 104-88, § 204(b)(1), 109 Stat. 803, 841-42. Consequently, unless otherwise noted, citations herein will be to the former law, as that is the applicable law in this proceeding.

[2] At the outset it should be noted that the Applicants have characterized STRC-8 as containing "vitriolic and misguided attacks on Applicants' motives and morals." UP/SP-230 at 299. STRICT maintains that STRC-8 is simply fair comment on the evidence adduced thus far in (continued...)

Consequently, in this brief STRICT will not completely restate the factual background of the issues it believes the Board must address in this proceeding, but only summarize it.

1. <u>The Kansas City-St. Louis Rail Corridor</u>

Kansas City and St. Louis are, along with Chicago, the three busiest rail gateways in the United States. As the maps that accompany the Application indicate, there are two UP lines from the Kansas City area to Jefferson City, MO, each of which are MPRR lines. There is then one MPRR line between Jefferson City and St. Louis.[3] These MPRR lines form the eastern end

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[2](...continued)
this proceeding. The acidic level of STRICT's submissions could be increased an order of magnitude without reaching the bounds of propriety. But more importantly, Applicants' Rebuttal contains absolutely no evidence which contradicts the evidence submitted in STRC-8, most of which is of Applicants' own creation.

If STRC-8 is mistaken in some regard, it is up to Applicants to demonstrate as much. They have done not so, choosing instead to sponsor a witness who simply characterizes STRC-8 as "a mean-spirited filing full of false accusations." <u>See</u> UP/SP-232, Rebuttal Verified Statement of R. Bradley King ("King R.V.S.") at 51. That same witness, however, when questioned regarding his knowledge of many of the issues addressed by STRC-8, testified that he knew little or nothing regarding those issues. <u>See, e.g.</u>, Transcript of Deposition of R. Bradley King at 581 (not familiar with plans for UP operation of western segment of SSW Kansas City-St. Louis line), 589 (can't recall whether merger team looked at line segment), 597 (not involved in abandonment decisions), 607 (doesn't know Applicants' post-merger plans for SSW line at issue), and 609 (knows nothing of Applicants' plans to install an alternative operator at eastern end of SSW line). The Board should therefore judge the credibility of his rebuttal statement accordingly, at least with respect to the issues raised by STRICT.

Unfortunately, this is just another indication of Applicants' apparent "hide the ball" strategy in this proceeding. Other parties have addressed this issue at greater length, and STRICT commends the Board to those discussions. <u>See</u>, <u>e.g.</u>, KCS-33 at 117-25.

[3] <u>See generally Union Pacific Corp., Pacific Rail System, Inc., and Union Pacific Railroad Co.--Control--Missouri Pacific Corp. and Missouri Pacific Railroad Co.</u>, 366 I.C.C. 462 (1982), <u>aff'd in part</u>
(continued...)

of UP's Central Corridor route, and have been recognized since before the ICC's decision in Tucumcari[4] as excellent, first class, high-speed lines. Just last year, in UP/CNW,[5] the ICC found UP to have a rail market share of 58.6 percent for the Kansas City-St. Louis city pair.

In addition, as the Application states and its maps indicate, SP trains presently operate via trackage rights over the MPRR lines between Kansas City and St. Louis, in connection with SP's own Central Corridor route. UP/SP-24 at 118-19. The Application states that SP has a Kansas City-St. Louis rail market share of nearly { } percent.[6]

What the Application does not show is that SP has its own line, owned in its entirety by applicant SSW, that connects the St. Louis and Kansas City areas (hereinafter the "SSW Kansas City-St. Louis line").[7] The Application

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[3](...continued)
and remanded in part sub nom. Southern Pacific Transportation Co. v. ICC, 736 F.2d 708 (D.C. Cir. 1984), cert. denied sub nom. Kansas City Southern Railway Co. v. United States, 469 U.S. 1208 (1985) (hereinafter "UP/MP/WP"). The northern MPRR line between Kansas City and Jefferson City is via Marshall, MO, and is known as UP's River Subdivision, while the southern such line is via Sedalia, MO, and thus is known as UP's Sedalia Subdivision. Id. at 585.

[4] St. Louis Southwestern Railway Co.--Purchase (Portion)--William M. Gibbons, Trustee of the Property of Chicago, Rock Island and Pacific Railroad Co., Debtor, 363 I.C.C. 323, 406 (1980).

[5] Finance Docket No. 32133, Union Pacific Corp., Union Pacific Railroad Co., and Missouri Pacific Railroad Co.--Control--Chicago and North Western Transportation Co. and Chicago and North Western Railway Co., slip. op served March 7, 1995, at 70.

[6] As can be seen from Application maps, three other carriers presently provide service between Kansas City and St. Louis. Gateway Western Railway Company, Norfolk Southern Railway Company, and the recently merged Burlington Northern Railroad Company and Atchison, Topeka and Santa Fe Railway Company ("BN/Santa Fe") have independent single-line routes between Kansas City and St. Louis, though all are handicapped to one extent or another in relation to the MPRR lines. See STRC-8 at 38-40.

[7] The line in question was purchased by SSW from the estate of the bankrupt Rock Island, pursuant to the ICC's order in Tucumcari. It (continued...)

maps only show: (1) an SP branch line running parallel to UP's Sedalia Subdivision between the Kansas City, MO, area and Pleasant Hill, MO (hereinafter "Leeds Junction-Pleasant Hill"); and (2) an SP branch line between Owensville, MO, and the St. Louis area. The nearly 200-mile SSW line segment which connects Pleasant Hill and Owensville is thus missing from the Application.

Despite express promises SSW made in Tucumcari as well as a commitment implicit in the representations it made in UP/MP/WP[8] that local service would be provided on that segment of line, neither that segment of line nor the Leeds Junction-Pleasant Hill line segment have ever been operated by SSW since their purchase in 1980. See STRC-8 at 15-17. SSW has instead kept in place an embargo it placed upon the line between Leeds Junction and Owensville immediately upon taking possession of the line in 1980.

Since late 1993, SSW has been seeking to abandon the embargoed segment of the line. SSW's request for an abandonment exemption is presently being held in abeyance. Applicant UPRR has previously indicated its desire to purchase the Leeds Junction-Pleasant Hill line segment pursuant to 49 U.S.C. Section 10905.[9]

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[7](...continued) was part of SSW's acquisition of Rock Island's "Tucumcari" line from Santa Rosa, NM, to St. Louis via Kansas City.

[8] Full citation in footnote 3.

[9] See Docket No. AB-39 (Sub-No. 18X), The St. Louis Southwestern Railway Co.--Abandonment Exemption--In Gasconade, Maries, Osage, Miller, Cole, Morgan, Benton, Pettis, Henry, Johnson, Cass, and Jackson Counties, MO. In a decision served April 1, 1994, in that proceeding, the ICC declared an SSW exemption notice void ab initio. See STRC-8 at 18-19.

2. <u>The Proposed UP-SP Merger</u>

The Application is almost entirely silent regarding post-merger plans for the Applicants' Kansas City-St. Louis operations. The only instance in which the subject is substantively addressed in the Application is an acknowledgement that, in light of SP's existing trackage rights over the MPRR lines, the merger will result in no benefits with respect to the Applicants' operations between Kansas City and St. Louis. UP/SP-24 at 118-19.

The Application has even less to say regarding post-merger use of the SSW Kansas City-St. Louis line. With respect to the Leeds Junction-Pleasant Hill segment, apart from its bare appearance on the Application maps, there is no mention of it whatsoever in the Application, even though, if Applicants had any concrete plans to use the line segment, there would have been a number of instances in which it would have been appropriate to discuss the line segment, including in the Environmental Report that accompanied the Application and was purportedly in compliance with the Board's regulations. <u>See</u> STRC-8 at 23-26. When confronted on the issue, all the Applicants will say is that they plan to "railbank" the line segment indefinitely until they can overcome local opposition to operating a third UP mainline east of Kansas City. UP/SP-230 at 299-300.

Little more reason has been provided by Applicants regarding why they would intend to retain the eastern end of the SSW line in the St. Louis area. Having dropped their claim that Applicants must retain ownership of the line between St. Louis and Labadie, MO, in order that an alternate carrier can serve the Union Electric Company power plant located at Labadie,[10] Applicants

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[10] <u>See</u> STRC-8 at 28-34. In Applicants' Rebuttal, it is stated that a proportional rate agreement that Applicants have entered into with Union Electric will permit Union Electric to receive direct interline service to Labadie via Kansas City or St. Louis. UP/SP-231, Part C, (continued...)

are left with arguing that UP/SP plans to operate or lease the east end of the line to continue to serve customers. UP/SP-230 at 299.

Left unrebutted, however, is the evidence STRICT submitted with its comments. That evidence shows that, apart from Union Electric traffic, which, as discussed, is almost certain to travel over the MPRR lines post-merger, in 1994 SSW only originated or terminated { } carloads of traffic in linehaul service to or from stations on the 80 miles of the SSW line that are still in service. See STRC-8 at 35 and Exhibit 6. That led Applicants' own operating officers and officials to recommend that {

} STRC-8, Exhibit 8.

3. The Interests of STRICT

STRICT is composed of rail shippers, potential rail shippers, and local government agencies representing them and the interests of the general public in central Missouri counties, cities and communities between Kansas City and St. Louis. STRICT's sole objective is to obtain operation of the SSW Kansas City-St. Louis rail line in an unrestricted manner over its entirety, as was promised when SSW purchased the line in 1980. For over two years, STRICT has been active on multiple fronts to accomplish that objective, in order to

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[10](...continued)
Rebuttal Verified Statement of John H. Rebensdorf at 7. Routing via Kansas City must occur via the MPRR lines, as the SSW Kansas City-St. Louis line is out of service for much of the distance between Kansas City and Labadie. {

} Transcript of May 13, 1996, Deposition of Applicants' Witness John H. Rebensdorf at 5-7. Consequently, Applicants had no choice but to concede that no part of the SSW Kansas City-St. Louis line will be required for provision of the rail service contemplated by the agreement with Union Electric. See UP/SP-244, Response to Interrogatory No. 29.

further the cause of economic development in central Missouri. See STRC-8 at 4-5, 15-22, and Exhibit 1, the Verified Statement of James A. Link.

No party is a more reluctant participant in this proceeding than STRICT, for it believes its dispute with SP, and now UP, never should have reached this stage. Unfortunately, the actions of SP now make it painfully clear that SP is intent on dismembering the SSW Kansas City-St. Louis line, thereby making it impossible for an operator to acquire and rehabilitate all of the line and operate it as a unit. While STRICT had all but given up hope that SSW would ever voluntarily live up to the promises it made in a number of ICC proceedings and provide local rail service over the entire Kansas City-St. Louis line, it was STRICT's wish that SP would at least agree to sell the line in its entirety to a short line operator so that the line could be operated by a party seriously interested in providing the long-promised local service under economic conditions that would permit success. If SP had done so, STRICT would have had no reason to participate in this proceeding, saving both its and the Board's scarce resources. But unfortunately, SP has been as obstinate regarding divestiture of the little-used SSW Kansas City-St. Louis line as it has been neglectful of that line. See STRC-8 at 17-21.

The convolutions attendant to STRICT's attempts to have the entire Kansas City-St. Louis line sold to a short line operator were increased by an order of magnitude following announcement of the proposed UP-SP merger. The Applicants' proposal to retain relatively short segments at each end of the SSW line is in STRICT's view a contrived use transparently designed to provide an excuse not to divest the line in its entirety and thus reduce its competitiveness as well as its ability to be economically successful.

For that reason STRICT has requested the Board to impose the following conditions upon any approval of the Application:[11]

1. Divestiture of the entire Kansas City-St. Louis rail line that SSW owns, including appurtenant real estate, between Leeds Junction, MO (at or near milepost 288.3), and Rock Island Junction, MO (at or near milepost 10.3), at a price to be mutually agreed, failing which it will be set by the Board. Sale must be to a single entity or group unaffiliated with the Applicants which certifies in writing to the Board that: (a) it is the acquirer's intention in acquiring the line to reactivate rail operations with a single operator providing local service over the entire line within three years of taking possession; and (b) before abandoning or selling (except in connection with a financing transaction) less than the entire line, it will attempt for a reasonable period of time to sell the entire line as a single unit and assign to the purchaser thereof any trackage rights acquired in connection with owning the line.

2. Included in the purchase price will be assignment of all of SSW's rights and interests under agreements granting to SSW, or any of its predecessors in interest in the aforementioned line, trackage and similar rights that have been, are or could be used by a rail carrier in connection with operating any part of the line.

As the record in this proceeding indicates, there is significant support for such conditions. No less a figure than Mel Carnahan, the Governor of Missouri, in a letter to the Board dated March 29, 1996, indicated his concern regarding the reduction of rail competition within Missouri if the Application is granted. He specifically suggested divestiture of the entire SSW line as an appropriate method of providing for competition in the Kansas City-St. Louis rail markets in the future.

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[11] STRICT originally requested the imposition of a third condition, which would have required the Applicants to permit an alternate carrier to use the MPRR lines to serve Union Electric at Labadie, so that one of the pretexts for the Applicants' continued retention of selected segments of the SSW Kansas City-St. Louis line would be eliminated. See STRC-8 at 50-68. Because, as was discussed, Applicants have entered into a proportional rate agreement with Union Electric whereby the MPRR lines will be used in alternative rail routings to Union Electric, there no longer is the need for such a condition. Consequently, STRICT is withdrawing its request for that third condition.

In contrast, Applicants have been unable to show any support for their plans to retain the end segments of the SSW Kansas City-St. Louis line. While Applicants have been able to muster letters from shippers and government officials opposed to other divestiture proposals in this proceeding, Applicants have yet to produce a statement from anyone opposed to the conditions STRICT seeks to have imposed.[12]

ARGUMENT

As has been repeatedly recognized, "the single and essential standard of approval" for a proposed merger of two rail carriers is that the transaction proposed must be found to be "consistent with the public interest."[13] While there are certain factors that the Board is required to consider in this case, which are set forth at former 49 U.S.C. Section 11344(b)(1), it is former 49 U.S.C. Section 11344(c) that imposes the ultimate standard that the proposed transaction must be found to be in the public interest before it can be approved.

In determining the public interest, the Board's regulations state that the Board will perform a balancing test in which it weighs "the potential benefits to the applicants and the public against the potential harm to the

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12 Indeed, shippers in the Kansas City area who have filed statements opposing divestiture proposals in this proceeding have limited that opposition to those other divestiture proposals, such as for SP lines between Chicago and Texas and Kansas and Colorado. See, e.g., UP/SP-233 at 318-19 (statement from KC Reload Center, Inc.); UP/SP-233 at 587-88 (statement from Terminal Consolidation Kansas City Piggyback).

13 See Finance Docket No. 32549, Burlington Northern Inc. and Burlington Northern Railroad Co.--Control and Merger--Santa Fe Pacific Corp. and The Atchison, Topeka and Santa Fe Railway Co., slip. op. served August 23, 1995, at 50-51 (hereinafter "BN/Santa Fe") (quoting Missouri-Kansas-Texas Railroad Co. v. United States, 632 F.2d 392, 395 (5th Cir. 1980), cert. denied, 451 U.S. 1017 (1981)); UP/C&NW, slip. op. at 53.

public." 49 C.F.R. § 1180.1(c). It was recognized by the ICC in BN/Santa Fe[14] that harm to the public interest is "usually (though not invariably)" shown by a reduction of competition in a market affected by the proposed merger. BN/Santa Fe, slip op. at 93.[15] In addition, "[t]he policies embodied in the antitrust laws provide guidance on public interest considerations in control proceedings." Id. at 52.

In approving a rail consolidation, the Board, like the ICC before it, has broad authority under 49 U.S.C. Section 11344(c) to impose conditions to protect the public interest. The ICC's practice under certain circumstances was to impose conditions in two separate situations: (1) to protect a competing carrier from the impacts of the merger at issue; and (2) to protect the public from any anticompetitive consequences of that merger.[16]

With respect to the latter type of condition - a "public interest" condition - the prerequisites for imposition have never been codified, but were first stated in UP/MP/WP. There, the ICC stated that it would impose public interest conditions on a railroad consolidation proposal when it found

> that the consolidation may produce effects harmful to the public interest (such as an anticompetitive

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[14] The full citation is in footnote 13.

[15] As will be discussed later, the ICC acted in merger proceedings not only to prevent harm to the public interest from a "reduction" in post-merger competition per se, but also to prevent the public interest from being harmed by Applicants' ability to impede potential future competition. Thus, the harmful effects of a merger are not determined solely by traditional market share analysis. It is important to note that the ICC never stated that "harm to the public interest" can only be demonstrated by evidence that there will be a reduction in existing competition.

[16] UP/MP/WP, 366 I.C.C. at 562; see also Chicago, Milwaukee, St. Paul & Pacific Railroad Co. -- Reorganization -- Acquisition by Grand Trunk Corp., 2 I.C.C.2d 161, 263 (1984) (hereinafter "Soo/Milwaukee") (citing Railroad Consolidation Procedures, 363 I.C.C. 784, 788-89 (1981)).

> reduction of competition in the affected market), that the conditions to be imposed will ameliorate or eliminate the harmful effects, that the conditions will be operationally feasible, and that the conditions will produce public benefits (through reduction or elimination of the possible harm) outweighing their harm to the merger.

UP/MP/WP, 366 I.C.C. at 565.

I. There is No Public Benefit to the Applicants' Continued Retention of Any Part of SSW's Kansas City-St. Louis Line

STRICT has spent countless hours in this proceeding searching for one single public benefit to the Applicants' continued retention of any part of the SSW Kansas City-St. Louis line, and has yet to find it. It simply cannot be stated that the public interest in the Kansas City-St. Louis rail corridor will be served by granting the Applicants merger authorization which includes the right to retain possession of any part of the SSW Kansas City-St. Louis line. This is plain from an examination of the reasons Applicants have put forth for retaining the end segments of the SSW Kansas City-St. Louis line.

As stated hereinbefore, Applicants attempt to justify retention of the Leeds Junction-Pleasant Hill line segment at the western end of the SSW Kansas City-St. Louis line on the ground that they want to "railbank" the segment for an indefinite period of time in case they ever need a third main line east of Kansas City. UP/SP-230 at 299-300. In its comments STRICT unequivocally demonstrated that there is no need in the foreseeable future for a UP third main line. See STRC-8 at 61-63. Applicants' Rebuttal conceded as much when it provided absolutely no supporting rationale for Applicants' railbanking scheme.[17] Clearly, the need for a third UP main line east of Kansas City is

[17] In fact, Applicants' Rebuttal significantly undercuts their explanation for retaining the Leeds Junction-Pleasant Hill line (continued...)

a contrived fabrication which cannot stand scrutiny. It is a device that seeks to limit future competition by destroying the utility of the line in the hands of a potential competitor.

Moreover, there is absolutely no support in applicable law for Applicants' railbanking scheme. The Board's regulations clearly state that railbanking can only occur after abandonment or discontinuance of service authorization is granted. Even then, a carrier's right to railbank the remnants of a rail line must give way to the rights of others to acquire the line at issue for rail service purposes. See 49 C.F.R. § 1152.29(c).[18]

Unlike the western end of the SSW Kansas City-St. Louis line, there is existing traffic on the eastern end of the line. The amount of that traffic is so small, however, especially for a carrier of the size that Applicants intend to construct, that there is no valid explanation why the Applicants would retain such a low-density segment of rail line as a short branch line on their combined system.

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[17](...continued)
segment. As STRICT discussed in its comments, the MPRR lines are in large part operated directionally, which has significantly increased their capacity for rail traffic. See STRC-8 at 63. Applicants not only agree with that assessment, but include in Applicants' Rebuttal a detailed description of how those particular directional operations work and the great success UP has had with them, permitting UP to avoid "tens of millions of dollars" in capacity improvements on the River Subdivision alone. UP/SP-232, King R.V.S. at 18-20. Moreover, Applicants' Rebuttal cites the extensive capacity additions on the MPRR lines between Kansas City and Jefferson City that have taken place over the past 13 years. See UP/SP-232, Rebuttal Verified Statement of Dale W. Salzman at 4.

[18] STRICT notes that this is not the only instance in this proceeding in which Applicants stand accused of unreasonably manipulating their proposed post-merger operations so as to prevent one of their lines from possibly being used by others to compete against Applicants. See KCS-33, Vol. 2 at 222 (operating officer of rival pointing out that Applicants' contrived directional southcentral operations defeat divestiture).

While SP's pre-merger retention of the eastern segment is arguably justified by SP's service to Union Electric at Labadie,[19] that justification disappears post-merger since then Union Electric will be served exclusively over MPRR track.[20] Applicants are thus left with arguing, {

}, that they intend to retain in service a 50-mile rail line over which { } linehaul carloads per mile moved in 1994 after subtracting the Union Electric traffic.

It is thus clear that the only benefit to Applicants of retaining either end-segment of the SSW line is to suppress potential competition in the Kansas City-St. Louis corridor. By signaling a scheme to withdraw the Leeds Junction-Pleasant Hill line segment from the scope of the proposed SSW abandonment while at the same time failing to provide any sign that any operations over the segment will be conducted post-merger, Applicants are plainly trying to prevent the line from being used for single-line rail service to connect the Kansas City area with points east. Similarly, Applicants' present position with respect to what, post-merger, will be a lightly used branch line at the eastern end of the SSW line can also only be justified in light of such a plan.

Applicants' position with respect to the SSW Kansas City-St. Louis line is thus anticompetitive on its face and provides ample reason for the Board to condition granting the Application on divestiture of that line, provided a willing buyer is found. When, as here, the only benefits to the Applicants that will result from one aspect of a merger proposal are private benefits which at the same time constitute serious public harm, the Board should use

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[19] As can be seen from Exhibit 6 to STRC-8.

[20] See STRC-8 at 30-31.

the discretion with which it has been entrusted to condition the transaction under review from having such an effect.

II. Applicants' Post-Merger Plans Have the Potential to Cause Serious Competitive Harm in the Important Kansas City-St. Louis Rail Corridor

The Applicants' plans to retain the end segments of the SSW Kansas City-St. Louis line are totally unjustified by any resultant public benefits. Moreover, such retention also has the potential to cause serious public harm because of the proposed merger's parallel effects in the Kansas City-St. Louis market. Such effects are an indication that the merger may be anticompetitive, at least in that market. See 49 C.F.R. § 1180.1(c)(2)(i) ("If two carriers serving the same market consolidate, the result would be the elimination of the competition between the two"). Because of the importance of both Kansas City and St. Louis as busy rail gateways, the Board should not ignore any adverse competitive effects in the Kansas City-St. Louis rail corridor.

The ICC was always especially vigilant with respect to rail competition between the Kansas City, St. Louis, and Chicago markets. In UP/C&NW, the ICC recognized that the merger of two potential competitors could be "problematic" with respect to the St. Louis-Chicago and Kansas City-Chicago corridors, but its concerns were allayed by the fact that, post-merger, there still would be six rail carriers serving the St. Louis-Chicago corridor and six serving the Kansas City-Chicago corridor. UP/C&NW, slip. op. at 70.[21]

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[21] It is clear in the case of those three gateways that the "relevant market" for purposes of competitive analysis is freight rail transportation. While Chicago, Kansas City and St. Louis are all close enough to each other for truck service to be used between those points, the ICC, in analyzing competition in UP/C&NW between those three points, focused just on intramodal rail competition. That is (continued...)

In contrast, if approved by the Board, the UP-SP merger would reduce the number of rail carriers serving the Kansas City-Chicago and Kansas City-St. Louis corridors to only four in each of those important corridors. The merger proposal thus raises a red flag as far as competitive effects are concerned in those corridors, according to authoritative testimony presented in this proceeding.[22]

This is especially true for the Kansas City-St. Louis rail corridor. As the STRICT comments showed, and figures previously cited herein demonstrate, the merger of UP and SP could result in the Applicants' rail market share between those two points exceeding { } percent. <u>See</u> STRC-8 at 39-40.[23] Coupled with the handicaps the Applicants' competitors in the corridor face, <u>see</u> STRC-8 at 38-40, there is a very real possibility that the proposed merger

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[21](...continued)
consistent with the ICC's approach in defining the parameters of a relevant market to take into account "commercial realities." <u>See, e.g.</u>, <u>Soo/Milwaukee</u>, 2 I.C.C.2d at 222. The commercial reality with respect to Kansas City, Chicago and St. Louis is that those points are the preeminent rail gateways, and thus any proposal which would result in an appreciable diminution in rail competition in those markets merits strict scrutiny.

[22] <u>See</u> NITL-10, Verified Statement of William G. Shepherd at 17 (each reduction below five in the number of competitors holds out the potential for a significant loss of competition). That reduction may not be a concern in the Kansas City-Chicago corridor, because BN/Santa Fe will continue to own the best routes between those two points, and the Soo Line Railroad Company route between Kansas City and Chicago will continue to be much more direct than any of the routes that will be owned post-merger by the Applicants.

[23] Applicants' Rebuttal does not argue with this figure, but instead attempts to muddy the waters by stating that "SP handles a mere 2% of the total business moving between Kansas City and St. Louis <u>and points east</u>." UP/SP-230 at 299 (emphasis added). That is not surprising, because SP's east-west Missouri route goes no farther east than the St. Louis area; it is hardly relevant, however, to the clear reduction in rail competition between Kansas City and St. Louis that will occur as a result of the merger.

will lead to a significant reduction in competition in the Kansas City-St. Louis rail market.

Moreover, Applicants' plans to retain the end segments of the SSW Kansas City-St. Louis line have the potential for additional harmful effects in the corridor. If the Application is approved without the conditions requested by STRICT, not only will the Applicants consolidate their present operations in the Kansas City-St. Louis corridor, but they will also be able to ensure that the SSW line in the corridor can never be used on a single-line basis by a competitor to connect those important rail gateways.[24]

While the line has not been used in such a fashion in a number of years, at present there still is the potential for one carrier to do so. Although disgracefully neglected, the line has not been formally abandoned. If the Application is approved without the requested conditions, however, and the Applicants implement their "plans" for the line, the probability of the line ever being used for service over its entire length drops dramatically.

That is because Applicants, with their own MPRR lines between Kansas City and St. Louis, will resist entering into any arrangement which would permit another carrier to provide unrestricted single-line and joint-line service of all kinds over the SSW line between and through the Kansas City and St. Louis gateways. Given the clear probability of such a scenario, the Board is obligated to seriously consider it in deciding whether to grant unconditioned merger authority to the Applicants with respect to their Kansas City-St. Louis rail operations. <u>See</u> <u>Union Pacific Corp., Union Pacific Railroad Co. and Missouri Pacific Railroad Co.--Control--Missouri-Kansas-Texas</u>

[24] Ironically, no less an authority than Applicants' trackage rights partner BN/Santa Fe trumpets the competitive importance of a rail carrier being able to reach <u>both</u> Kansas City and St. Louis. <u>See</u> BN/SF-54, Second Verified Statement of Neal D. Owen at 16.

Railroad Co., 4 I.C.C.2d 409, 436 (1988) (serious competitive problems presented by parallel rail mergers requires that post-merger competitive environment be carefully examined), petition for review dismissed sub nom. Railway Labor Executives Association v. ICC, 883 F.2d 1079 (D.C. Cir. 1989).

The very prospect of the potential for suppression of competition in the Kansas City-St. Louis rail corridor led the ICC in Tucumcari to directly address the issue of whether the carrier that owns the MPRR rail lines between Kansas City and St. Louis should also be permitted under the policies of the antitrust laws to take possession of what is now the SSW line. In circumstances strikingly similar to those presented by the Application, the ICC emphatically denied such an acquisition as not only contrary to the public interest, but possibly as being an outright violation of the antitrust laws. See Tucumcari, 363 I.C.C. at 404-07.

MPRR, which is now a part of the UP rail system but at that time was still an independent rail carrier, filed a competing application in Tucumcari to purchase the Rock Island's Kansas City-St. Louis line. That MPRR had no valid need for a third line between Kansas City and St. Louis quickly became clear from the content of its competing application. Id. at 405-06.[25]

The ICC wasted little time disposing of MPRR's application as a blatantly anticompetitive tactic, holding that the MPRR competing application had been "submitted principally for anticompetitive reasons" and thus could not be granted. Id. at 407. The ICC was clear regarding the anticompetitive

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[25] The fact that MPRR already possessed two of the most direct routes between Kansas City and St. Louis did not prevent MPRR from filing such an application; indeed, that is the primary reason MPRR filed the application. MPRR admitted that approval of its application instead of SSW's primary application for the Rock Island Kansas City-St. Louis line would have prevented the line from becoming part of the SP rail system and thus have prevented it from being used to divert traffic from MPRR. Tucumcari, 363 I.C.C. at 404.

nature of MPRR's application. The ICC explained that it could not lawfully permit the acquisition of a parallel line when that line could otherwise be used in competition against the carrier applying to purchase the line. The ICC went so far as to imply that MPRR's designs on the Rock Island line were violative of the antitrust laws, stating that in light of "the competitive considerations enunciated in Section 7 of the Clayton Act," 15 U.S.C. § 18, "[t]he anticompetitive effects resulting from the acquisition of a bankrupt carrier's parallel line for the purpose of eliminating competition are contrary to public policy." Tucumcari, 363 I.C.C. at 407.

There are substantial grounds for the Board to simply rely on the ICC's previous findings, and hold that it would be just as anticompetitive for UP, which now controls the MPRR lines, to be permitted to acquire the SSW Kansas City-St. Louis line as it would have been to permit MPRR to have done so. Most if not all of the facts remain the same. The MPRR lines remain the preferred lines of shippers in the Kansas City-St. Louis corridor, yet UP has applied to acquire the SSW line in the corridor as well, with an almost identical justification to the one unsuccessfully presented to the ICC by MPRR. See STRC-8 at 44. It is thus clear that the Application in this proceeding is designed to accomplish what MPRR's competing application in Tucumcari was unsuccessful in doing, which is to prevent any other party from acquiring the entire former Rock Island Kansas City-St. Louis line and thus suppress potential competition in that important rail corridor. The ICC saw through MPRR's application for the anticompetitive tactic that it was; the Board should do the same with respect to the merger application in this case.

Indeed, because MPRR is one of the carriers seeking merger authorization in this proceeding, there is a very sound basis for the Board to simply hold that, under the doctrines of res judicata and collateral estoppel, the

Applicants cannot be allowed to acquire the SSW Kansas City-St. Louis line through merger because of the preclusive effect of the ICC's decision in Tucumcari denying MPRR's competing application in that proceeding. To do otherwise, and to grant MPRR and the other Applicants merger authorization with respect to that SSW line, would nullify the ICC's strong statements in Tucumcari regarding the lawfulness and competitive impact of such an acquisition.

The related doctrines of res judicata and collateral estoppel are unquestionably applicable to an administrative proceeding, including this one. In explaining the doctrines, the Supreme Court has stated "that a losing litigant deserves no rematch after a defeat fairly suffered, in adversarial proceedings, on an issue identical in substance to the one he subsequently seeks to raise," regardless of whether the proceeding is that of a court or of an administrative agency. See Astoria Federal Savings and Loan Association v Solimino, 501 U.S. 104, 111 S. Ct. 2166, 2169 (1991). As the ICC recognized, in the latter instance the doctrine of res judicata "applies when the agency is acting in a judicial capacity and resolves disputed issues of fact properly before it that the parties had an adequate opportunity to litigate." General American Transportation Corp. v. Indiana Harbor Belt Railroad Co., 3 I.C.C.2d 599, 616 (1987) (citing United States v. Utah Construction, 384 U.S. 394, 421-22 (1966)). Because the ICC definitively decided in Tucumcari that it is contrary to the public interest to permit the SSW Kansas City-St. Louis line to be controlled by the same party that controls the two MPRR Kansas City-St. Louis lines, the Board should not even consider Applicants' implicit request that the ICC's decision on this issue be overturned in this proceeding.

Res judicata is clearly applicable in this instance, because Applicant MPRR had ample opportunity in the Tucumcari proceeding to convince the ICC that it should be permitted to acquire the SSW line, and in fact filed an application to do so. The ICC, acting in a judicial capacity, clearly found against MPRR on the issue.

In this proceeding, MPRR has returned with the other Applicants to request authorization for, among many other things, control of both the MPRR lines and the SSW line.[26] Applicants have thus made a claim that is "identical in substance" to a claim previously raised by Applicant MPRR and denied by the ICC, and therefore should be precluded from raising that claim before the Board. See Parklane Hosiery Co. v. Shore, 439 U.S. 322, 326 n.5 (1979) (judgement on merits in prior suit bars second suit involving same parties or their privies). It is hard to imagine a more vivid example of an instance in which the doctrine of res judicata would better its serve its intended purpose.[27]

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[26] Applicants' Rebuttal attempts to claim that res judicata is not applicable because of the difference between the Application and the MPRR responsive application in Tucumcari. See UP/SP-230 at 299. Applicants cite no authority for such a proposition and STRICT has yet to locate any. The fact that the merger Application requires the Board to address many more issues than the MPRR responsive application required the ICC to address in Tucumcari is irrelevant for purposes of res judicata, as the anticompetitive nature of the proposal remains the same regardless of the other issues the Board must address in this proceeding.

[27] In addition, Applicants are collaterally estopped from raising the issue of whether it is anticompetitive for the same carrier to own both the MPRR lines and the SSW line between Kansas City and St. Louis. Applicant MPRR litigated this issue before in Tucumcari and lost. Just because STRICT and any other parties in this proceeding who oppose this aspect of the Application may be different adversaries than MPRR had in Tucumcari does not mean that the Applicants are free to relitigate the issue. All litigants are to be protected from relitigating an identical issue with the same party or his privy. See Parklane Hosiery Co. v. Shore, 439 U.S. at 329 (collateral estoppel precludes parties from relitigating identical issues by merely switching adversaries).

III. The Conditions Requested Are Appropriate in Light of the Serious Public Harm Identified

As was stated, STRICT is not suggesting that the Application be totally denied on the basis of the public harm that may result from a grant to the Applicants of authorization to carry out their plans with respect to the SSW Kansas City-St. Louis line. Rather, the Board, through its power to impose conditions, can act in this proceeding to require Applicants to divest that line and thus prevent the clear public harm that will sooner or later flow from Applicants' suppression of potential competition. The Board in making this determination can also consider the potential for economic development of deprived areas in Missouri if the SSW Kansas City-St. Louis line is saved for operation by an independent operator, and the harm that will occur if this potential is snuffed out.

Briefly summarized, the proposed conditions will permit an interested party to acquire the SSW Kansas City-St. Louis line as a single unit, along with accompanying trackage rights. The trackage rights at issue are those which were originally granted to Rock Island in connection with its operation of its Kansas City-St. Louis line, and thus were assigned to SSW as a result of its acquisition of that line, as well as those trackage rights that SSW subsequently acquired in the course of its ownership of the line in furtherance of its limited operations over the eastern segment of the line in the St. Louis area.

A. The Conditions Requested are Designed to Address Harms That are Clearly Related to the Merger

In its request for conditions, STRICT provided extensive evidence and discussion of how the conditions requested met the four prerequisites the ICC first set forth in UP/MP/WP for the imposition of such conditions, previously quoted herein. See STRC-8 at 52-68. Apart from Applicants' feeble attempts to justify their plan to retain the end segments of the SSW Kansas City-St. Louis line, Applicants' Rebuttal presented no argument on this point. Rather, Applicants simply made the unsupported claim that the need for the requested conditions is unrelated to the proposed merger. See UP/SP-230 at 300.

Applicants are flatly wrong on this point. They ignore the fact that the two carriers which strenuously compete in the Kansas City-St. Louis rail corridor will be combining operations after the merger, thus extinguishing one of the competitive rail options between those two important points and creating the carrier that will overwhelmingly dominate traffic in the corridor. In addition, the combined carrier will control the potential alternative route provided by the SSW Kansas City-St. Louis line, for which it, unlike SP,[28] will have absolutely no use.

Belying the contention by Applicants that the proposed conditions should not be considered in this merger case by the Board, there is very recent precedent for imposition of conditions where a merger would result in an increased opportunity for post-merger suppression of competition. Moreover, in that case, UP/CNW, the ICC expressly rejected the applicants' claims that such a harm could not be viewed as merger-related.

In UP/C&NW, it was recognized that control of C&NW by Union Pacific would create the preeminent rail routing in the Upper Midwest-South Central Corridor, because of the unique ability of UP and C&NW to provide the equivalent of single-line service in that corridor. At the same time, it was

[28] Whereas SP has a plausible reason to retain the right to operate over the eastern segment of the SSW line, in order to serve Union Electric at Labadie, post-merger that justification vanishes, because Union Electric can and most likely will receive all of its rail service over the MPRR lines. Consequently, Union Electric now supports the proposed merger. See UP/SP-195, Verified Statement of Udo A. Heinze.

found that the transaction would broaden the circumstances in which there would be an incentive for UP to exercise veto power granted to C&NW in certain C&NW-Soo Line joint track agreements with respect to Soo Line's right under the agreements to admit other carriers onto the C&NW/Soo Line joint track. The ICC held that because C&NW's veto power could potentially be used by UP to prevent competitive responses to UP's new single-line service, it would condition its approval of UP's control of C&NW on the termination of that veto power. See UP/C&NW, slip. op. at 89-91. In so doing, the ICC rejected claims that the harm which the condition was designed to ameliorate was not merger-related. See id. at 90.

In other words, the ICC, with respect to a market in which there was already a number of other rail competitors, conditioned its control approval so as to prevent the applicants from being able to act to suppress competition in the future by keeping new entrants out of the market at issue. That is the exact type of condition that is being requested by STRICT; moreover, in this case there is overwhelming evidence, from the structure of the Application, that the Applicants are already taking steps to suppress future competition.

The ICC correctly recognized in UP/C&NW that if a rail carrier has the ability to suppress competition in a market it will do so, and that, when possible, merging carriers should be prevented by the imposition of merger conditions from using that ability. In this proceeding, the Board has the power, by ordering divestiture of the SSW Kansas City-St. Louis line in its entirety, to deny the merging carriers the ability to prevent that line from being used in the future as a competitive alternative in the Kansas City-St. Louis rail corridor. Thus, Applicants' claim that the harm STRICT's requested conditions are designed to address is not merger-related is just as spurious as a similar claim many of the same applicants made in UP/C&NW, if not more so.

B. The Requested Conditions Satisfy All Four of the Board's Standards

As STRICT demonstrated in its request for conditions, the proposed conditions will not only foster divestiture of a line marked for extinction by Applicants, but are also consonant with the Board's standards for the imposition of merger conditions, previously set forth herein. Much of the foregoing discussion has been devoted to showing that the Applicants' post-merger plans with respect to the SSW Kansas City-St. Louis line will plainly result in effects that are harmful to the public interest in competitive rail transportation service in the important Kansas City-St. Louis rail corridor, thus satisfying the Board's first standard.

With respect to the Board's second standard, it is clear that the requested conditions will at least ameliorate, if not entirely eliminate, those harmful effects. As stated, the harm of the merger in the Kansas City-St. Louis corridor is that it will give the Applicants, who have no other significant use for the SSW Kansas City-St. Louis line but will be after merger the dominant carrier between Kansas City and St. Louis, the ability to prevent any other party from putting the SSW line in the corridor to its highest and best use as a single-line route between Kansas City and St. Louis. What the requested conditions are designed to accomplish is creation of the opportunity for a new carrier to succeed to the former Rock Island's facilities and rights in the Kansas City-St. Louis market and thus make it possible for another carrier to take the place of SSW, while at the same time improving local service that has been disgracefully neglected by SSW.

With regard to the third standard of operational feasibility, STRICT demonstrated in support of its request for conditions that there is no issue regarding the operational feasibility of the conditions, as divestiture of rail lines has long been recognized as an appropriate merger condition and because the line at issue is easily severable from the Applicants' post-merger rail system. <u>See</u> STRC-8 at 59-61. Applicants' Rebuttal recognizes as much; it takes serious issue only with those divestiture proposals covering Applicants' lines in Texas, Arkansas and Louisiana, as well as those for Applicant DRGW's lines. <u>See</u> UP/SP-230 at 29-31.

The Board should not confuse feasibility of the conditions requested with the feasibility of rail operations contemplated by the conditions, as it is only the former that is relevant under ICC precedent. As STRICT predicted in requesting the imposition of conditions, Applicants' Rebuttal attempts to disparage the physical condition of the SSW Kansas City-St. Louis line, but entirely fails to provide any evidence on the issue. <u>See</u> UP/SP-230 at 298-99.[29] While that may be expected of rail carriers that are working for the destruction of a competitive alternative, it is a position that is contradicted by the actions, past and present, of many of the Applicants.

First of all, Applicants must be referring to the middle segment of the SSW line, between Pleasant Hill and Owensville, as beyond "economic rehabilitation," since Applicants have stated an intention to rehabilitate the

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[29] The party line now is that the SSW rail line has been found to "have deteriorated beyond economic rehabilitation." UP/SP-232, King R.V.S. at 51; <u>see also</u> UP/SP-232, Rebuttal Verified Statement of Michael D. Ongerth at 95. It is almost comical to read Applicants' Rebuttal citing the paving over of grade crossings on the line as a reason the line cannot be rehabilitated, when it is Applicant SSW, the owner of the line, that permitted such to occur.

western end of the line for rail operations,[30] and since operations are currently conducted on the eastern end. Otherwise, Applicants would not be proposing to retain those segments post-merger.

As for the middle segment, it is true that trains have not operated ove much of that segment since SSW took possession in 1980 following the I . s decision in Tucumcari.[31] It was in that proceeding that both SSW and MPRR made sworn representations to the ICC regarding the feasibility of operating the entire Kansas City-St. Louis line. As neither carrier has yet to formally withdraw its previous statements on the issue, the Board is left with deciding whether to credit the previous testimony of Applicants SSW and MPRR or accept the unsupported and clearly self-serving statements contained in Applicants' Rebuttal. Given the Applicants' past history on this issue, as well as their interest in seeing the SSW line destroyed in major part, STRICT urges the Board to hold the Applicants to their prior testimony on this issue, at least until such time that Applicants come forward to formally withdraw it.

Finally, as detailed in STRC-8, it as indisputable that the public benefits which will result from the Board's imposition of the requested conditions will greatly outweigh any harm to the merger from those conditions, thus satisfying the Board's fourth and final standard. See STRC-8 at 61-68. There simply will be no harm to the merger from the requested conditions. Moreover, substantial and significant public benefits will flow from

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[30] At some unspecified time in the future beyond UPRR's current five-year plan, insofar as the western end of the line is concerned. See STRC-8 at 26.

[31] The lack of rail operations simply means that the condition of the line segment has not appreciably worsened due to wear and tear since that time. STRICT is not as fearful as Applicants are that the growth of vegetation on the right-of-way since the line was acquired by SSW will prevent the line from being returned to service. See UP/SP-230 at 298. That can be dealt with more easily than the recalcitrance of Applicants to sell the line to someone who will operate it.

imposition of the requested conditions upon approval of the merger. Applicants' Rebuttal did not take issue with this assessment of the conditions requested by STRICT, and the conditions requested would satisfy one of the primary concerns expressed by Missouri's governor about the proposed merger.

It cannot be denied that the conditions STRICT is requesting are in actuality market-based, pro-competitive solutions to an issue that needs to be addressed in this proceeding. Simply put, if the entire SSW line between Kansas City and St. Louis is made available for acquisition, along with accompanying trackage rights, it is the market for rail service which will ultimately decide the need for and value of the line. If there is no market for the reactivation of rail service over the line, it will not occur, leaving the Kansas City-St. Louis rail corridor no different than it would be if the Application is granted without the conditions requested by STRICT.

If, however, Applicants are wrong, and there is, as there was in the past, a market for local and single-line service over the SSW line between Kansas City and St. Louis, the market for such service should be permitted to freely operate, and the entire SSW line should be conveyed as a single unit. It is STRICT's view that the fact that Applicants have been fighting so hard to prevent that from occurring provides the Board with a significant indication of the Applicants' true feelings on whether the SSW Kansas City-St. Louis line can be resuscitated. Consequently, the Board should permit the market for rail service to decide this issue and impose the conditions STRICT has requested, in the absence of any sensible alternative proposed by the Applicants.

CONCLUSION

The Board has a wonderful opportunity to show its sensitivity to public needs in this proceeding by imposing the conditions suggested by STRICT. Imposition of the conditions will not be harmful to Applicants, yet will give the deprived economy of central Missouri a way to bootstrap out of depressingly high rates of rural poverty and unemployment. Failure to impose the conditions will reduce the potential for competition in this corridor, and most of the line will be ripped up. The choices available to the Board have seldom been as starkly juxtaposed as here. What is being requested by STRICT is a hand - not a handout.

WHEREFORE, the foregoing considered, STRICT requests the Board to condition approval of the Application as requested herein, or alternatively to deny the Application because granting it without the conditions requested would be inconsistent with the public interest. STRICT also requests that the Board grant such other, further, and general relief to which STRICT may, in the circumstances, be entitled.

Respectfully submitted,

SAVE THE ROCK ISLAND COMMITTEE, INC.,

By [signature]
William P. Jackson, Jr.
Its Attorney

OF COUNSEL:

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APPENDIX OF DEPOSITION TRANSCRIPT EXCERPTS

Deponent	Deposition Date	Transcript Pages	Confidentiality Designation
R. Bradley King	Feb. 9, 1996	581, 589, 597, 607, 609	Public
John H. Rebensdorf	May 13, 1996	1 through 12	Highly Confidential (Redacted from this copy)

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.

Friday, February 9, 1996

Deposition of R.B. (BRAD) KING and MICHAEL D. ONGERTH, witnesses herein, called for examination by counsel for the Parties in the above-entitled matter, pursuant to agreement, the witnesses having been previously duly sworn, taken at the offices of Covington & Burling, 1201 Pennsylvania Avenue, N.W., Washington, D.C., 20044, at 9:10 a.m., Friday, February 9, 1996, and the proceedings being taken down by Stenotype by FERNITA R. FINKLEY and CRAIG KNOWLES and transcribed under their direction.

Island Line that S.P. owns under the S.S.W. name. It runs between the Kansas City area and St. Louis area.

Are you familiar with that line?

A. (Mr. King) Well, just having seen it on a map or something.

Q. Okay. Well, I will ask you first, Mr. King, are you familiar with U.P.'s plans, either as a result of the merger or independent of the merger to purchase and operate what I will call the western end of the line, it can extend east from Kansas City for a length of about 25 miles or so.

A. (Mr. King) Not really. John Rebensdorf would probably be more familiar with it.

Q. Okay. I take it then that operations over this line were not contemplated as part of the operating plan?

A. (Mr. King) Not that I am aware of, no.

Q. And the operating plan I believe the application represents is a, based on the assumption that it will be implemented within five years, is that correct?

A. (Mr. King) Yes.

Q. On page 118 of the operating plan under rehabilitating it for overhead traffic?

A. (Mr. Ongerth) I have never actually seen the study.

I have seen and talked with people about the conclusions in the study. And my understanding of that study is that it was done, the study focused on rehabilitating that line as a through route for overhead traffic.

Q. Okay.

A. (Mr. Ongerth) In the course of doing that you would also put it back into service.

Q. Right.

A. (Mr. Ongerth) For whatever local traffic you might find.

Q. Regarding the western end of the line, maybe Mr. King is best suited to answer this, that would be common team number 4 that, if it considered it, would have been the team to consider that?

A. (Mr. King) I don't remember the number. There was a team that had Kansas City in that area, and whether they looked at it or not I don't recall.

Q. If they did would that consideration appear in the work papers?

BY MR. SULLIVAN:

Q. Okay.

A. (Mr. Ongerth.) I will confirm that there is nothing on the map east of P. Hill to Owensville.

Q. Okay. We can turn now, Mr. King, feel free to jump in here, but I think your testimony yesterday was that Mr. Ongerth was responsible for abandonments under the operating plan, is that correct?

A. (Mr. King) I think I said he was involved with it.

Q. Okay.

A. (Mr. King) Whereas, I was not.

Q. Okay. What was, Mr. Ongerth, what was the extent of your involvement in deciding, I will just say under the area of abandonments?

A. (Mr. Ongerth) First, the line rationalization group at Southern Pacific is under my direct jurisdiction.

Q. Yes.

A. (Mr. Ongerth) Report directly to me. And I am corporate vice president that has overall responsibility for line rationalization at S.P.

So all of the decisions relative to which

A. (Mr. Ongerth) I haven't studied that part. Post-merger, it's not my decision. I don't know what my role will be post-merger.

Q. Understood.

Mr. King, do you know anything about this subject.

A. (Mr. King) What his role will be?

(Laughter.)

BY MR. SULLIVAN:

Q. No, I mean the future of the Rock Island Line.

A. (Mr. King) No, I don't.

Q. Would Mr. Rebensdorf know about that?

A. (Mr. King) He could. I don't know.

Q. As you can see, Mr. Ongerth, there were two recommendations made in that last paragraph under S.P. Lackland yard. You stated that the abandonment recommendation regarding the line west of Airpark was rejected.

What about the other recommendation that Airpark, which I believe can be summarized as Airpark and east, you should find an alternative operator for that, were you involved in that recommendation?

A. (Mr. Ongerth) No, I was not involved in we short-line that section.

I know of no discussions that putting a short line or regional carrier on this line.

Q. I take it, Mr. King, that you don anything about such discussions, either?

A. (Mr. King) No, I don't.

MR. HEMMER: At this point you better pu the period after "anything."

(Laughter.)

MR. KING: I thought that was where he was going. I was going to be offended.

MR. SULLIVAN: A second.

(Pause.)

BY MR. SULLIVAN:

Q. Mr. Ongerth, going back a few minutes to what we started to discuss, which was the determination of abandonments, of what should be abandoned, as opposed to what shouldn't, would that determination have first been made like in this case, at the common point team level?

A. (Mr. Ongerth) This is a much more strategic type of decision, and that was made at a higher level.

Abandonments were handled outside of the

CERTIFICATE OF SERVICE

I, William P. Jackson, Jr., counsel for Save the Rock Island Commi[illegible] Inc., certify that on this 3rd day of June, 1996, I caused a copy of Bri[illegible] Save the Rock Island Committee, Inc., to be served by first-class m[illegible] postage prepaid, or by a more expeditious manner of delivery, on all kn[illegible] parties of record in Finance Docket No. 32760. Only outside counsel [illegible] counsel for governmental agencies appearing on the restricted service li[illegible] established pursuant to paragraph 9 of the Discovery Guidelines serve[illegible] December 7, 1995, in this proceeding were provided an unredacted copy containing material designated in the proceeding as "Confidential" or "Highly Confidential."

William P. Jackson, Jr.

STB FD 32760 6-3-96 E 83950

DOT-4

BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.

UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY AND MISSOURI PACIFIC RAILROAD COMPANY -- CONTROL AND MERGER -- SOUTHERN PACIFIC RAIL CORPORATION, SOUTHERN PACIFIC TRANSPORTATION COMPANY, ST. LOUIS SOUTHWESTERN RAILWAY COMPANY, SPCSL CORP. AND THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY	Finance Docket 32670, et al.

BRIEF OF THE
UNITED STATES DEPARTMENT OF TRANSPORTATION

JOLENE M. MOLITORIS
Administrator

DONALD M. ITZKOFF
Deputy Administrator

JANE H. BACHNER
WILLIAM O. GELSTON
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Office of Policy and Program Development

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June 3, 1996

DOT-4

BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.

UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY AND MISSOURI PACIFIC RAILROAD COMPANY -- CONTROL AND MERGER -- SOUTHERN PACIFIC RAIL CORPORATION, SOUTHERN PACIFIC TRANSPORTATION COMPANY, ST. LOUIS SOUTHWESTERN RAILWAY COMPANY, SPCSL CORP. AND THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY	Finance Docket 32670, et al.

BRIEF OF THE
UNITED STATES DEPARTMENT OF TRANSPORTATION

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June 3, 1996

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BEFORE THE
SURFACE TRANSPORTATION BOARD
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BRIEF OF THE UNITED STATES DEPARTMENT OF TRANSPORTATION

Congress has broadly charged the United States Department of Transportation ("DOT" or "Department") with providing "leadership in identifying and solving transportation problems" as well as "in the development of transportation policies and programs." 49 U.S.C. §§ 101(b)(5) and 301(2), respectively. In carrying out this general responsibility the Department seeks to promote the long-term development of a balanced transportation system to serve the nation. DOT's participation in this and similar proceedings is one critical element in that effort.

The Department carefully scrutinizes proposed railroad mergers to ensure that they are consistent with the public interest. The instant consolidation, if approved, would create the largest railroad system in the United States. It is the latest in a long trend of rail mergers in the West, all of which DOT has closely evaluated in order to determine their public interest impacts. In this, as in previous cases, the Department's evaluation encompasses not only the terms of the proposal itself, but also the longer-term impact of the proposed merger on the national transportation system, including competition, service to shippers, and other matters.

The Department previously submitted its preliminary comments on the pending consolidation, in which it noted some of the issues presented in this proceeding but reserved its position on the merits for its brief. In this brief the Department addresses the central issues in the proceeding: the merger's likely effects on competition and the appropriate remedy therefor. [1] DOT has concluded that the merger will substantially reduce competition in large regions of the country. Consequently, even though there may be substantial benefits that would flow from the merger, the Department opposes the merger unless the Board imposes conditions to remedy these competitive losses. Under the circumstances of this case, DOT believes that the Board must condition any approval in two significant respects. First, the STB must order divestiture of the lines of track in the Texas Corridors, and second, it must significantly strengthen the trackage rights proposed in the Central Corridor. Without such conditions, the Department believes that the Board should not approve the merger.

1/ DOT has already submitted its views on the consolidation's impact on the environment and safety and recommended mitigation measures. DOT-3, filed May 9, 1996.

I. INTRODUCTION

On November 30, 1995, Union Pacific Corporation ("UPC"), Union Pacific Railroad Company ("UPRR"), Missouri Pacific Railroad Company ("MPRR)"), Southern Pacific Rail Corporation ("SPR"), Southern Pacific Transportation Company ("SPT"), St. Louis Southwestern Railway Company ("SSW"), SPCSL Corp. ("SPCSL"), and The Denver and Rio Grande Western Railroad Company ("DRGW") [2] (collectively "Applicants") filed an application seeking approval and authorization under 49 U.S.C. §§ 11343-45 for: (1) the acquisition of control of SPR by UP Acquisition Corporation ("Acquisition"), an indirect wholly owned subsidiary of UPC; (2) the merger of SPR into UPRR; and (3) the resulting common control of UP and SP by UPC. [3]

The Interstate Commerce Commission ("ICC" or "Commission") accepted the application in Decision No. 9, served December 27, 1995. Thereafter the ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803, abolished the ICC and established as its successor agency the Surface Transportation Board ("STB" or "Board"). See Decision No. 11, served February 2, 1996, at note 1. That statute required that the Board assess this merger pursuant to the substantive provisions previously in place. Section 204(b) of P.L. No. 104-88. The Board adopted the expedited procedural schedules originally set by the ICC in Decision No. 6, served October 19, 1995.

2/ UPC, UPRR, and MPRR are referred to collectively as Union Pacific. UPRR and MPRR are referred to collectively as "UP." SPR, SPT, SSW, SPCSL, and DRGW are referred to collectively as Southern Pacific. SPT, SSW, SPCSL, and DRGW are referred to collectively as "SP".

3/ SPT is a wholly owned subsidiary of SPR. SPCSL and DRGW are wholly owned subsidiaries of SPT. SPT owns 99.9% of SSW.

The UP operates approximately 22,000 miles of railroad track in the Western United States. Its main lines comprise more than 17,000 miles, and extend from all major West Coast ports through the so-called "Central Corridor" to the Midwest and Southwest, as well as the Texas and Louisiana Gulf. Major cities served include Los Angeles, Oakland, Seattle, Portland, Denver, Kansas City, St. Louis, Chicago, New Orleans, Memphis, Dallas, Houston, and Laredo. UP/SP-22 at 40-41. The principal commodities handled by UP include coal, forest products, chemicals and plastic, and grain. UP/SP-22.

The SP operates more than 16,500 miles of railroad track in the West, Midwest, and Southwest. Its main lines run between Portland and Los Angeles, from the Bay Area in California through the Central Corridor (traversing Nevada, Utah, Colorado, and Kansas) to the Midwest, and along the "Southern Corridor" from Los Angeles to El Paso, Texas, and thence through the Midwest to Chicago as well as on to Texas and Louisiana. UP/SP-22. In addition to the cites named above, SP serves Dallas/Ft. Worth, Houston, Laredo, St. Louis, Kansas City, Denver, Salt Lake City, Memphis, and five gateways to Mexico. UP/SP-22 at 41-43. SP principally transports forest products, grain, coal, automotive and intermodal traffic, chemicals, and plastics. UP/SP-22, Verified Statement ("VS") of Gray at 215-228.

The Applicants have submitted statements of support from some 1,300 shippers, state and local government agencies, shortline railroads, and other organizations. UP/SP-25; UP/SP-36; UP/S-233. [4] They claim that the merger offers public benefits in excess of $750 million annually. These benefits include

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4/ E.g., Ciba-Geigy Corporation, General Mills, Inc., General Motors Corp., the ports of Portland and Seattle, Yellow Freight System, Inc., Bechtel Corporation, the California Attorney General, the Governors of Arizona, Arkansas, Idaho, Louisiana, Nebraska, New Mexico, and Wyoming, the Georgetown Railroad Co., ConAgra, Inc., and Minnesota Mining & Manufacturing Co. Inc.

expanded single line service, shorter routes and reduced transit times, greater service reliability and quality, reduced costs, and increased efficiency. UP/SP-22, Appendix A; UP/SP-23 and-24.

The Applicants contend that the creation of the rail carrier formed by the consolidation of the Burlington Northern Railroad Co. and the Atchison, Topeka and Santa Fe Railway Co. ("BNSF") has introduced a competitor that UP and SP individually can never hope to match. Moreover, SP in their view is a financially weak and operationally inferior railroad that not only cannot offer vigorous competition, but also is unlikely to remain viable as an independent railroad. The merger will therefore enable the combined UP and SP systems to provide strong competition against BNSF, improve service to SP shippers and many others, and introduce new and efficient routes throughout the West. UP/SP-22, VS of Davidson at 167, VS of Gray at 232-36, VS of Anschutz at 182-86.

An important element of the transaction before the Board is an agreement entered into between the Applicants and BNSF. The signatories primarily intend for this agreement to address the competitive consequences of the merger. BN/SF-1, VS of Ice and VS of Lawrence; UP/SP-22, VS of Rebensdorf and VS of Peterson. This agreement grants trackage rights and sells rail line to BNSF that total more than 4,000 miles, an unprecedented distance. The result of this, the Applicants contend, is that every shipper previously served by both UP and SP and no other railroad will continue to be served after the consolidation by two rail carriers, UP and BNSF. [5] The lines at issue extend from the Bay Area to west of Denver, Colorado (the "Central Corridor"), and reach from Houston (1) west to Eagle Pass, Texas, (2) south to Brownsville, Texas, (3) east to New Orleans, and

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5/ The agreement also grants trackage rights on some BNSF lines to the Applicants. Id.

(4) north to Memphis, Tennessee. UP/SP-22, VS of Rebensdorf; BN/SF-1, passim. (For convenience, we refer to these areas as "the Texas Corridors.") Through the purchase of discrete segments of track, the BNSF agreement also creates new single-line service in the so-called "I-5 Corridor" along the Pacific Coast. The Applicants have requested that the STB make this agreement a condition of approval of the pending merger.

Subsequently, a settlement agreement between the Applicants and the Chemical Manufacturers Association ("CMA") materially amended the BNSF agreement. UP/SP-219. The CMA modifications would permit BNSF to operate trains on UP and SP lines from the Texas Gulf Coast to Memphis and on to St. Louis in the same "directional flow" highlighted in the Applicants' Operating Plan; it would expand the storage facilities made available to BNSF in the Texas Gulf; it would stipulate the uses of the trackage rights fees paid to Applicants by BNSF; and it would take specific measures to avoid dispatching and related problems to which landlord and tenant railroads are sometimes susceptible. Id; UP/SP-219. The Applicants would also make this modification a condition of approval of the merger.

Opposition to the merger in whole or in part arises from railroads, public bodies, shippers and shipper organizations, and public utilities, among others. Examples of these parties are: the Kansas City Southern Railway ("KCS"), Montana Rail Link ("MRL"), the Railroad Commission of Texas ("RCT"), the National Industrial Transportation League ("NITL"), the Society of the Plastics Industry ("SPI"), the Western Coal Traffic League ("WCTL"), the Western Shippers' Coalition ("WSC"), the Texas Utilities Electric Co., Inc., Dow Chemical Company, Kenecott Energy Company, Wisconsin Power and Light Co./Wisconsin Public Service Corp., Consolidated Rail Corporation ("Conrail"), Union Carbide Corporation, and Entergy Services. These parties contend that the merger will cause competitive harm by reducing the number of railroads in parallel UP and SP corridors and that the BNSF trackage rights agreement is not sufficient to maintain strong intramodal competition in the affected areas. The opponents also argue that shippers in these corridors will lose transloading and build- in/build-out options, which have been used for competitive leverage to gain reductions in rail rates.

The United States Department of Justice ("DOJ" or "Justice Department") has submitted evidence from which it concludes that the proposed transaction, even as modified by the BNSF agreement, would substantially reduce competition. The Justice Department analysis concluded that competitive problems would exist in those areas-where the consolidation would reduce the number of railroads serving shippers from three to two, and from two to one, that the BNSF agreement either did not address or was otherwise inadequate to remedy these problems, [6] that the Applicants had overstated the merger's public benefits, and that the SP is and could remain a viable independent competitor if the transaction is not approved. DOJ-8. DOJ reserved for the brief its ultimate position on the merger.

II. SUMMARY OF ARGUMENT

The proposed merger would combine two of the three largest Class I railroads remaining in the West. The Applicants themselves have maintained that this transaction was prompted by the ICC's decision last year to approve the merger of the Burlington Northern Railroad Company and the Atchison, Topeka and Santa Fe Railway Company. Finance Docket No. 32549, Burlington

6/ DOJ made its filing before the Applicants modified the BNSF agreement by their settlement with the CMA.

Northern, Inc. and Burlington Northern Railroad Co. --, Control and Merger -- Santa Fe Pacific Corp. and the Atchison, Topeka and Santa Fe Railway Co. (served August 15, 1995), slip opinion ("BN/SF"). To the extent that is true, there is reason to suspect that the instant merger might have a like effect on other rail carriers. For these and other reasons, the consequences of the Board's decision in this case on rail transportation and the economies of many regions and industries will be particularly substantial and lasting. Given the diminishing numbers of Class I railroads and the real possibility that the trend toward Class I rail mergers may yet continue, the Department believes that it is incumbent upon the Board to broaden its analytical perspective so that, in addition to the exacting competitive scrutiny to which the STB will subject this merger, it also considers the future of rail transportation in the United States in reaching its decision.

In carrying out its leadership role in setting national transportation policy, the Department has carefully analyzed the likely competitive effects of the proposed merger on the country's transportation system. Based on that review, DOT has concluded that in its present form the pending consolidation would substantially reduce competition in extensive areas of the country. The Department therefore submits that the merger would be consistent with the public interest and warrant approval only if it is subjected to the critical and substantial conditions discussed herein.

To a major extent this proceeding concerns a consolidation of two largely "parallel" railroads that compete head-to-head with each other over extensive areas of the country. Such transactions traditionally pose more competitive problems than so-called "end-to-end" mergers involving rail carriers that directly compete with each other in relatively few areas. [7] Although the parties may

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7/ Cf., e.g., BN/SF, slip op. at 52, and Finance Dkt. No. 32133, Union Pacific Corp. Union Pacific Railroad Co. and Missouri Pacific Railroad to -- Control --

dispute the significance of the competitive problems posed by this transaction, especially where the number of railroads competing in a market is reduced from three to two, there is broad agreement that where the merger would reduce the number of competing railroads from two to one a remedy to preserve competition is absolutely necessary.

The evidence on the competitive impacts in markets where the number of rail carriers would go from three to two is inconclusive. However, two independent railroads in any given market has, in the past, usually proven to be sufficient to maintain vigorous competition. Consequently, the Department does not believe that this merger's reduction in the number of rail competitors from three to two requires relief from the Board.

The Department does, of course, recognize that two unaffiliated railroads are essential to preserve intramodal competition. In the circumstances of this case, however -- where the traffic volume is huge, the distances involved enormous, and there is no other remotely comparable railroad in the West -- DOT submits that the public interest requires that those two railroads must each be completely independent and on an equal competitive plane. In other words, the landlord-tenant relationship that is inherent in a trackage rights proposal is inadequate to the task. The tenant carrier is simply at an inherent disadvantage vis-a-vis the landlord. That disadvantage may well be surmountable in more commonplace situations (*i.e.*, where traffic volumes are lower, where distances are shorter, where there are, ultimately, other suitable railroads). [8] But it is

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Chicago and North Western Transportation Co. and Chicago and North Western Railway Co. (served March 7, 1995), ("UP/CNW") slip opinion at 70 with Santa Fe Southern Pacific Corp. -- Control -- Southern Pacific Transportation Co., 2 I.C.C. 2d 709 (1986)("SF/SP").

8/ It is important as well to note that voluntary trackage rights agreements between railroads are almost always limited to overhead traffic, which further critical here, where the agreement is by far the largest trackage rights arrangement ever contemplated and where two carrier competition would be utterly dependent upon its viability. In such circumstances the difficulties facing a tenant railroad are magnified tremendously. Moreover, BNSF's stance in this proceeding to date raises questions about the seriousness of its intentions to compete aggressively. Accordingly, the Department opposes the proposed merger unless the Board directs the Applicants to divest either the UP or the SP parallel lines of track in the Texas corridors. Because circumstances unique to the Central Corridor militate against divestiture of that line, DOT urges the STB to modify the trackage rights agreement between the Applicants and BNSF so as to position BNSF as a "landlord" or owner on that Corridor to the extent possible. If the Board is not prepared to strengthen these rights in this fashion, it should order divestiture of the Central Corridor as well.

III. APPLICABLE STANDARDS

The Interstate Commerce Act ("the Act") requires the Board to approve consolidations involving Class I railroads that it finds to be "consistent with the public interest." 49 U.S.C. § 11344(c). The Act and ICC precedent further define that broad standard.[9] The Act expressly directs the STB in its consideration of the public interest to take into account the following factors in the context of a proposed merger: (1) the effect of the proposed transaction on the adequacy of

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reduces the competitive friction, if any, that might otherwise exist between the participants.

9/ As noted, the ICC Termination Act did not amend the substantive standards applicable to this merger. It also preserved ICC precedent and made that precedent applicable to the STB unless and until changed by the Board. Section 204(a) of P.L. No. 104-88.

transportation to the public; (2) the effect on the public interest of including or failing to include other rail carriers in the area involved in the proposed transaction; (3) the total fixed charges that result from the proposed transaction; (4) the interest of carrier employees affected by the proposed transaction; and (5) 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). See also BN/SF, slip op. at 51; UP/CNW, slip op. at 53; Finance Docket No. 32133, Union Pacific Corp., Union Pacific Railroad Co. and Missouri Pacific Railroad Co. – Control – Missouri-Kansas-Texas Railroad, 4 I.C.C. 2d 409, 426 (1988) ("UP/MKT"), *pet. for review dismissed sub nom.*, Railway Labor Executive Assn. v. I.C.C., 883 F.2d 1079 (D.C. Cir. 1989).

The Act also lists 15 elements that together establish as the nation's rail transportation policy an emphatic "reliance on competitive forces, not government regulation, to moderate railroad actions and to promote efficiency." UP/MKT, 4 I.C.C. 2d at 427 (citation omitted); see also BN/SF, slip op. at 52; UP/CNW, slip op. at 54. This reliance on competitive forces underscores the important role played by antitrust principles in the agency's consideration of merger cases. 10 See McLean Trucking Co. v. United States, 321 U.S. 67, 87 (1944); BN/SF, slip op. at 52-53; UP/CNW, slip op. at 54; UP/MKT, 4 I.C.C. 2d at 427. While the Board (like the Commission) does not sit as an antitrust court, its obligations under the Act's public interest standard require it to engage in a balancing of a transaction's potential public benefits as against its potential public harms, including the loss of competition. Railroad Consolidation Procedures,

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10/ The Act immunizes from the antitrust laws and other laws, as necessary, transactions approved by the STB. 49 U.S.C. § 11341(a).

363 I.C.C. 784 (1981), codified at 49 C.F.R. § 1180.1. [11] Public benefits derive from operating efficiencies and marketing opportunities that can make the consolidated carrier a more formidable competitor. BN/SF, slip op. at 51; UP/CNW, slip op. at 56; UP/MKT, 4 I.C.C. 2d at 428. Public harms most often arise from significant reductions in competition and serious threats to an unaffiliated rail carrier's ability to provide essential services. Id. [12]

Moreover, the Board has broad authority to impose conditions on its approval of a merger proposal in order to ensure that the public interest standard is met. 49 U.S.C. § 11344(c). Applicable precedent recognizes that conditions may reduce the benefits of a merger, however, and thus conditions are imposed to mitigate public harm only when specified criteria are met. In the face of merger-induced reductions in competition or a loss of essential services, corrective conditions are appropriate when they will (1) effectively ameliorate the adverse effects, (2) be operationally feasible, and (3) produce public benefits that outweigh any reductions they might engender in the public benefits produced by the transaction. Union Pacific -- Control -- Missouri Pacific; Western Pacific, 366 I.C.C. 459, 562-65 (1982) ("Union Pacific Case"); 49 C.F.R. § 1180.1(d)(1). See also BN/SF, slip op. at 55-56.

Finally, rail consolidation proceedings under the Act require a "forward-looking assessment." SF/SP, 2 I.C.C. 2d at 744. That is inevitable, for the Board

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11/ The STB in particular focuses on intramodal competition where long-haul movements of bulk commodities are concerned. 49 C.F.R. § 1180.1(c)(2)(i).

12/ An essential rail service is one for which there is a sufficient public need but for which adequate alternative transportation is unavailable. 49 C.F.R. § 1180.1(c)(2)(ii). The Texas Mexican Railway Company has contended that the merger would likely cause it to go out of business, resulting in a loss of essential services. TM-23. DOT takes no position on this issue; we urge the Board to review the record on this point carefully.

in these cases is attempting to review the likely effects of a proposed -- not a completed -- transaction as the agency determines its consistency with the public interest. The circumstances in which the instant merger comes to the STB make this perspective on the future even more important than in past cases.

The passage of the Staggers Rail Act of 1980 reduced government regulation and greatly assisted in the rationalization and revitalization of the railroad industry. Part of that process has been the reduction in the number of Class I railroads or railroad systems from twenty-six to ten. [13] Precedent and policy combined during this time to ensure that each merger that was approved was conditioned in the manner necessary to maintain competition as well as essential services. The Department believes that the same statutory and policy requirements that make concern for competition the centerpiece of ICC/STB scrutiny of mergers now require a distinct awareness of the present composition of the Class I railroad industry in the United States. As rail carriers become fewer and larger, the intramodal competition that may be necessary to mitigate adverse effects of consolidations among these giants is more likely to be found only in the larger railroads. [14]

The number, geography, financial strength, operating and marketing capabilities, and other such aspects of Class I railroads become more than just

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13/ Eight of these carriers have been merged into other railroads or railroad systems, and eight have been lost through reclassification by the ICC.

14/ The instant merger is illustrative of this point. The large areas of overlap in the UP and SP systems caused the Applicants to cast about for an unaffiliated railroad that could truly maintain effective competition. The distances involved, operational and financial capabilities, and similar factors dictated to those most directly affected -- the shippers -- that only BNSF could meet this standard. UP/SP-22, VS of Rebensdorf at 292-96. The resulting trackage rights agreement is unprecedented in its scope.

relevant and material; they become critical because of the scale in which these transactions are played out. [15] Indeed, should this merger proceed without adequate safeguards it is very possible that large numbers of shippers would face non-competitive rates and services, which in turn could lead to a return of greater industry economic regulation. The Department therefore urges the Board to weigh carefully the implications its decision in this matter may have, not only on the immediate consequences of this merger, but also on the future composition of the railroad industry throughout the nation and the resulting impact on the adequacy of transportation to the public.

The regulatory provision regarding "cumulative impacts and crossover effects" does not dictate otherwise. 49 C.F.R. § 1180.1(g). DOT is not asking the STB to consider any event that has occurred during the pendency of this proceeding. We are asking the Board to focus on the full impacts of transactions, both those that have "already" occurred and the one now before it.

Should the STB nonetheless feel constrained by this provision, it is well established that an agency "faced with new developments or in reconsideration of the relevant facts and its mandate, may alter its past interpretation and overturn past administrative rulings and practice." American Trucking Ass'ns v. Atchison Topeka & Santa Fe Ry. 387 U.S. 397, 416 (1967). See also Building & Construction Trades' Dept., AFL-CIO v. Donovan, 712 F.2d 611, 619 (D.C. Cir. 1983). Clearly a broader view is now required. We no longer have twenty-six Class I railroads or railroad systems, and precedent and rules that were established at that time do not necessarily provide the proper guidance as the

15/ Again, the merger at issue reflects this; the Applicants have strenuously contended that their consolidation was prompted (if not necessitated) by the creation of the nation's largest railroad, the BNSF system. UP/SP-22, VS of Davidson at 162-63. Only by responding in kind, they assert, could they hope to compete. UP/SP-23, VS of Peterson at 11.

Board looks toward the future of rail transportation in this nation. In a similar context, the D.C. Circuit has recently held that when the legitimacy of past agency policy is called into question the agency "must always stand ready "to hear new argument" and "to examine the basic propositions undergirding the policy." Bechtel v. FCC, 10 F.3d 875, 878 (D.C. Cir. 1993) *quoting* McLouth Steel Products Corp. v. Thomas, 838 F.2d 1317, 1321 (D.C. Cir. 1988). Such reconsideration is clearly warranted in circumstances where the number of Class I railroads has so shrunk that there are now only three Western roads, three Central U.S. roads, and four Eastern roads.[16]

IV. THE PROPOSED MERGER THREATENS TO REDUCE COMPETITION SUBSTANTIALLY IN LARGE REGIONS OF THE COUNTRY

A. The Proper Analytical Framework

The importance of competitive analysis in the Board's assessment of the public interest in rail merger proceedings is evident from the final decision reached by the ICC in every such case. In those decisions the ICC drew heavily upon antitrust law and precedent by recognizing that competition takes place, and so is measured, within markets.

> Because competition takes place within economic markets, we must define the economic markets that would be affected by [a proposed consolidation]. A relevant market is the area of effective competition, and necessarily has two dimensions, product and geographic. Generally, two products, whether they are goods or transportation services, are in the same market if they are close substitutes. The closeness of substitution is measured (in principle, though only imperfectly in practice) by the extent to which consumers shift their consumption in response to a change in relative price or quality.

16/ Not only is the diminished population of Class I carriers a basis for arguing a new approach, the prospect of future transcontinental mergers also may warrant a new approach.

UP/MKT, 4 I.C.C. 2d at 432; UP/CNW, slip op. at 57. See also BN/SF, slip op. at 55.

1. The Relevant Product Market

The relevant product market for assessing the competitive effects of proposed consolidations includes all products that are "reasonably interchangeable." UP/MKT, 4 I.C.C. 2d at 432, *citing* United States v. E. I. Dupont de Nemours Co., 357 U.S. 377, 395 (1959). In other words, if buyers of a product can turn to another product and/or another supplier and thus prevent a merged firm from sustaining a price increase, then the definition of the market must be expanded to include the additional product or supplier. The product provided by railroads is the transportation of freight. In past railroad merger proceedings, the Commission did not apply a single, fixed definition of the relevant market, but instead examined the specific circumstances and the evidence of record in each instance, to determine whether the relevant market was confined to rail freight transportation or was broad enough to include other transportation modes or products. See UP/CNW, slip op. at 57; UP/MKT, 4 I.C.C. 2d at 433-34 and cases cited therein. This approach guides the Board as well.

At the same time, the STB is specifically required under 49 U.S.C. § 11344(b)(1)(E) to examine the effect of a transaction on "competition among rail carriers in the affected region." The Commission observed in this regard that the intent of the nation's Rail Transportation Policy (49 U.S.C. § 10101a) is "to ensure the development and continuation of a sound rail transportation system with effective competition among railroads and with other modes." SF/SP, 2 I.C.C. 2d at 721. Therefore, in reviewing rail consolidation proposals the Board, like the Commission, should consider competition among rail freight carriers before and after the proposed transaction as a primary basis for its assessment of the public interest.

The Applicants point out that for some traffic only carriage by rail is appropriate, while for other cargo transportation by other modes is feasible; the critical factors are the commodities hauled and the distances involved. UP/SP-23, VS of Barber at 463. However, they also assert that shippers of large volumes of the traffic at issue (forest products, grain, chemicals, and intermodal traffic) have alternatives to rail: truck, water, and joint truck/rail. Id.

In addition to the Applicants, in this proceeding the Justice Department, KCS, and the NITL have formally defined the relevant product market. DOJ recognizes that for some movements truck and barge transportation can be substituted for rail to constrain the merged railroads from increasing rates to a non-competitive level. DOJ-8, VS of Majure at 4. Consequently, DOJ's analysis includes trucks in the relevant product market for shipments of manufactured products moving under 500 miles. [17]

KCS rejects the inclusion of modes other than rail in the relevant product market, asserting that the characteristics of the commodities and length of haul

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17/ DOJ's assumption that trucks do not compete with rail at distances exceeding 500 miles appears overly conservative. Rail intermodal service competes most closely with trucks and it is widely recognized that doublestack container trains provide the lowest cost, most truck-competitive service. A well-received 1990 study commissioned by DOT's Federal Railroad Administration determined that this service does not begin to compete with trucks (on a cost basis) until the rail linehaul exceeds 730 miles, and that assumes a dray of only 30 miles at either end of the move. Manalytics, Inc., Double Stack Container Systems: Implications for U.S. Railroads and Ports (1990); FRA-RRP-90, available through the National Technical Information Service. Moreover, Applicants' evidence displaying tonnage moved region-to-region by rail, truck, and barge, clearly reveals rail-truck competition over very long distances, *e.g.*, from California to the Northeast quadrant of the country. UP/SP-23, VS of Peterson, Appendix A, Regional Traffic Flow Data Table.

render motor carriers ineffective competitors for any shipments. KCS-33, VS of Grimm at 206-208. Barge transportation is also excluded on the assumption that it does not compete in the principal territory served by the merging railroads. Id.

In general the Department agrees with the Applicants that other modes -- truck and barge -- can effectively constrain rail rates for certain traffic, and some evidence in the record supports that position. UP/SP-23, VS of Peterson, Appendix A. However, it is an unfortunate fact that detailed data on truck movements, which account for eighty cents of the nation's freight dollar, are simply not available. The evidence of record is either anecdotal or so general that it is not dispositive for assessing competition for particular commodities moving over designated origin-destination routings. Therefore, based on the evidence submitted by the parties, the Department submits that the relevant product market in this proceeding is restricted to rail freight transportation.

2. The Relevant Geographic Market

The geographic market is the area in which suppliers of a service or product operate, and to which buyers can turn to meet their requirements. Competitive analysis must also encompass any "economically significant submarket" where the transaction may substantially lessen competition. UP/MKT, 4 I.C.C. 2d at 435. As the ICC noted in the Union Pacific Case, 366 I.C.C. at 505, "the distinctions between product and geographic markets are not as clear in transportation as they are in other industries, for carriers, in particular railroads, effectively sell their geography." Thus the determinations of the relevant product market and the relevant geographic market in a particular case will necessarily be interrelated. In analyzing the geographic market, the ICC has analyzed traffic flows between city pairs, as well as flows in rail corridors, and at specific points in the area in which merging rail firms operate. UP/MKT, 4 I.C.C. 2d at 437.

The Applicants have defined the relevant geographic market fairly narrowly, focusing for the most part on Standard Point Location Codes at the six digit level ("SPLC-6") [18] -- *i.e.,* individual rail stations or shippers -- served by both UP and SP and no other railroad. However, they recognize that these points generally tend to congregate along areas where their rail lines overlap, thereby defining corridors with end points at relatively large population and traffic-generating centers. UP/SP-23, VS of Peterson at 12-15.

Other parties proffer broader relevant markets. The Justice Department concentrates on the origins and destinations of the major traffic carried by UP and SP and varies its geographic definition depending on the movement at issue. For commodities that DOJ believes capable of being trucked longer "nontrivial" distances to reach a competing railroad (e.g., grain and manufactured products), it considers "BEA" origin - destination pairs [19] as the relevant geographic market. For those relatively fewer commodities that DOJ believes can economically be trucked only a short distance (e.g., coal, chemicals, and plastic), it considers Standard Point Location Code pairs at the four digit level ("SPLC-4") -- *i.e.,* counties -- to be the relevant geographic market. DOJ-8, VS of Majure at 4-8.

18/ The Association of American Railroads has established Standard Point Location Codes ("SPLCs") to provide each location in the country that originates or terminates traffic a unique number for ease of identification. Generally, states are designated by two digits, counties by four digits, and individual points or shippers by six digits.

19/ The Department of Commerce's Bureau of Economic Analysis has defined business economic areas ("BEAs") to facilitate regional economic analysis. A center of economic activity is the base of each BEA, while surrounding counties that are economically related to the center (by factors such as journey-to-work patterns, and metropolitan newspaper circulation) are included in a BEA. BEAs are comprised of ten to thirty counties; their area varies from 2,000 to over 65,000 square miles.

KCS defines a broader geographic market than the Justice Department, maintaining that BEA origin-destination pairs comprise the relevant market for the movement of all commodities. KCS-33, VS of Grimm at 182-188. The National Industrial Transportation League ("NITL") defines the relevant geographic market as the regions, shipping points, corridors, and origin-destination markets that UP and SP serve, and therefore, to NITL, in which they compete. NITL-9, VS of Shepard at 34.

Based on the evidence submitted by the parties and our own analysis, (discussed further in the section of this brief addressing competition) the Department submits that the relevant geographic market consists of points and parallel corridors where UP and SP compete, and where the merger would reduce the number of carriers from two to one. The corridors identified in DOT's analysis generally correspond with those identified by Applicants, but include points exclusively served by UP or SP as well as the commonly served points identified by Applicants. Specifically, we believe the relevant geographic market in this proceeding is inclusive of the portions of the north-south corridor along the West Coast ("the I-5 Corridor"), the Central Corridor from Denver, Colorado to Oakland, CA; and the Texas Corridors. [20] Other areas in which the merger reduces the number of railroads from two-to-one (hereinafter "two-to-one" points or areas) include two-to-one points in Arkansas and Missouri, and the stretch from El Paso to Sierra Blanca, Texas.

20/ The Texas Corridors consist specifically of the UP and SP lines in southeast and central Texas from Houston to Brownsville and Waco to San Antonio and Eagle Pass; the Applicants' lines in the corridor from New Orleans into east Texas; and their lines in the corridor from Houston to Memphis.

B. The Merger's Impact on Competition Generally

The proposed merger will reduce the number of railroads in many markets in the West from three to two and in many others from two to one. The Department considers that there is insufficient evidence to demonstrate that the reduction in the number of railroads from three-to-two brought about by this merger should be cause for the Board's concern. However, there is some uncertainty on this point. But there is no doubt that the merger's reduction of railroads from two to one in vast areas would cause substantial competitive harm. Accordingly, the Board must impose stringent conditions to ensure vigorous competition in such areas.

1. The Evidence on Competitive Impacts in Duopoly Markets Is Inconclusive.

The merger, if approved, would profoundly alter the structure of railroad competition in the western two-thirds of the nation, reducing service from three to two carriers for most of the large cities and traffic generating points between the Midwest gateways and the West Coast. Applicants, DOJ, and other parties, therefore, have presented evidence prepared by eminent economists on the issue of "competition among the few."

Willig, testifying for the Applicants, maintains that competition would be vigorous and even enhanced in markets served only by UP/SP and BNSF, post merger. UP/SP-23, VS at 577. He believes, for a host of reasons, that the railroads would be unable to successfully implement either unilateral or coordinated actions to raise prices, reduce output, and maximize joint profits. Id., at 58[illegible], [illegible]01-07. Opposing economists, citing both theory and studies of the effects of concentration on competition, insist that there is a strong likelihood of just such an outcome, largely due to enhanced opportunities for tacit coordinated interaction.

While the evidence of the merger's opponents often alludes to oligopoly practices, the basic issue involves duopoly competition. At a fundamental level, economic theory holds that the competitive outcome of duopoly is indeterminate. [21] In principle, competition can lead to a wide range of outcomes: from prices that maximize the joint profits of the duopolists to a competitive equilibrium. The result is determined by the degree of rivalry, i.e., whether the firms compete strongly or employ unilateral actions or tacit coordination to raise prices. Id.

Using that principle as a guide, DOT examined the economic evidence on the record. The evidence presented by Applicants' witness (Willig) and opposing economists consists almost entirely of theoretical discussions of how UP/SP and BNSF are likely to behave in the duopoly markets created by the merger. Willig, as noted, assesses the range of potential outcomes and maintains the behavior will be intensely competitive. Without exception, opposing economists allege the carriers are likely to pursue tacit coordination to produce monopoly, or near monopoly results; none investigates the potential for a competitive outcome in this particular case.

Opponents' positions on the instant merger are drawn from theory and models of firm behavior that lack empirical support. They support their statements with reference to a body of literature on industrial organization, showing that concentration at some point leads to higher prices. However, only a very few of these studies address the railroad industry, and their credibility has been seriously challenged; e.g., the use by Levin (and others) of "conjectural

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21/ This aspect of duopoly is acknowledged not only by Willig, but explicitly or implicitly by submissions of merger opponents. See Schmalensee (CR-22, VS at 6-7), Tye (RCT-4, VS at 8-11), White (KCS-33, VS at 113), and Grimm (KCS-33, VS at 194).

variation", (UP/SP-23, VS of Willig at 559-61), and MacDonald's work on grain prices (UP/SP-23, VS of Willig at 569-71; UP/SP-231, Rebuttal Verified Statement ("RVS") of Caron at 5-6, 9-12; UP/SP-231, RVS of Bernheim at 5-9). Majure, for the Justice Department, performed an analysis similar to MacDonald's using 1994 rail data, and it too has been subjected to serious attack. See Caron, supra, and particularly Bernheim's deposition at 62-64, 133-36.

Bernheim's own econometric study of UP rates in two and three carrier markets contradicted Majure's findings. UP/SP-231, RVS of Bernheim at 19-21. Bernheim's study has in turn been challenged. Bernheim deposition at 1431.

In contrast to the conflicting theoretical analyses, evidence on the record shows that intense competition can exist in duopoly rail markets. The parties opposing this merger, as well as the Applicants have provided extensive evidence of vigorous two railroad competition between UP and SP where their lines are parallel, extending to the use of build-in/build-out and transloading tactics to access shippers on each others' lines. E.g., UP/SP-23, VS of Peterson at 50, 61; WSC-11, VS of Jordan at 11; KCS-33, VS of Grimm at 169-70.

Moreover, increased concentration in the rail industry does not necessarily lead to higher prices. As the number of Class I railroads or railroad systems declined from twenty-six to ten between 1980 and the present, the average rail rate per ton declined more than thirty-eight percent on an inflation-adjusted basis, despite an increase in the average length of haul. See ICC Office of Economic and Environmental Analysis, Rail Rates Continue Multi-Year Decline (1995). For most of that time, up to the early 1990s, growth in rail traffic was stagnant. Also, for most of that period there were no more than four major railroads in the West and three in the East engaged in the east-west movement of traffic. Taken together these facts suggest that competition -- not just the act of deregulation, as alleged by KCS and DOJ -- may have driven railroads to pass productivity gains to shippers in the form of lower rates and more service for the freight dollar.

However, in DOT's view, none of the foregoing analyses, examining both sides of the duopoly issue, leads to a firm conclusion on the competitive outcome in markets in which the number of railroads goes from three to two. Therefore, mindful of ICC precedent that two railroads are often sufficient to maintain competition -- and the lack of dispositive evidence to the contrary on the record -- DOT recommends that the Board refrain from remedial action to maintain three railroad service in these markets. [22]

Nevertheless, the Department is not comfortable with the prospect that market efficiency across the Western United States after the merger would depend on the intensity of the rivalry between the two remaining railroads. Should the merger be approved, therefore, DOT believes it is of utmost importance that the Board take extraordinary care to assure that strong and effective competition is maintained in those markets where merger reduces the number of serving railroads from two to one.

2. The Magnitude of Traffic and Revenue Adversely Affected by the Merger Is Substantial, but Cannot Be Determined with Precision from the Evidence of Record

Because the scope of the Applicants' analysis was far too narrow, their estimate of the amount of traffic and revenue adversely affected by a loss of competition is understated. However, it is also DOT's view that the geographic markets defined by DOJ and KCS lead to a substantial overstatement of the competitive impacts for two-to-one markets.

22/ BN/SF, slip op. at 94 ("Two independent railroads, we think, can provide strong, effective competition provided that, among other things, neither is subject to any artificial restrictions.").

a. Applicants' analysis

DOT considers the Applicants' assertion that the proposed merger would reduce rail competition only at points where currently UP and SP and no other railroad provides service is far too narrow a view of the competitive environment in the identified corridors.[23]

The record is replete with examples of UP and SP competing vigorously to tap the traffic of shippers on each others' lines in the Texas Corridors, through actual or contemplated build-ins/build-outs, transloading facilities, source competition, and even movement of rail cars by barge to a third rail carrier. E.g., UP/SP-13, VS of Peterson at 50, 61, 325-27; KCS-33, Vs of Grimm at 169-71. In the Central Corridor, a substantial share of Uinta basin (Utah) coal is already trucked from mines to either UP, SP, or Utah Railroad transloading facilities. WSC-11, VS of Jordan at 11. Applicants have, in effect, acknowledged the effectiveness of these forms of competition, amending the trackage rights originally proposed to give BNSF build-in/build-out rights to reach shippers on the lines of either UP or SP in the Texas Corridors, and the right to construct transloading facilities at points where the number of railroads is reduced from two-to-one.

Based on the evidence of record, we concur with the position of DOJ, KCS, SPI, Dow Chemical, Union Carbide and others that the merger would not only extinguish intramodal competition at commonly served points, but would also eliminate other forms of rail competition that provide shippers exclusively served by UP and SP competitive leverage to constrain UP and SP rail rates.

23/ I.e., in the I-5 Corridor, in the Texas Corridors, and in the Central Corridor.

b. DOJ and KCS analyses

The Department believes that the DOJ and KCS analyses, identifying reductions from two to one in both independent rail routes and at common points, represent a generally correct approach for assessing the merger's effect on competition.[24] DOT also examines reductions in independent rail routings, sharing some of the decision parameters used by DOJ and KCS, but employing a more conservative definition of geographic markets.[25] However, the use by DOJ and KCS of broad geographic areas leads to a substantial overstatement of the traffic and revenues that would be adversely affected by the merger, in DOT's opinion.

Defining geographic markets to organize analysis of Rail Carload Waybill Sample movements, such as performed by DOJ, KCS, and DOT, is necessarily somewhat arbitrary. Empirical data on commodity markets are not sufficiently detailed to verify the proper scope of the geographic market. KCS uses BEA to BEA geography exclusively; DOJ uses BEAs for most traffic and SPLC-4 (county) geography for the remainder. The Justice Department's assignment of

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24/ KCS' witness, Grimm (KCS 33, VS at 185), quotes the ICC on this point:

> Competition between railroads generally requires the presence of two or more independent routes, that is, routes having no carriers in common. When a single carrier is a necessary participant in all available routes, i.e., a bottleneck carrier, it can effectively control the overall rate sufficiently to preclude effective competition.

Consolidated Papers, Inc., et al v. Chicago and North Western Transportation Company, 7 I.C.C. 2d 330, 338 (1991)

25/ DOT also differs in that it first examines total traffic, bi-directionally, between geographic markets to insure that any route carrying traffic will be revealed. Reductions in independent routes are then determined, followed by assessment of modal alternatives for commodities where independent routes are reduced from two-to-one or, in some situations, from three-to-two.

commodities to BEAs or SPLC-4s, depending upon its conclusions on the extent to which each commodity can be moved to a railroad, is based on a broad judgment, supported only by a few examples.[26] The rationale used by both DOJ and KCS for selection of BEA markets is that a shipper captive to one railroad can dray his goods to another, competing railroad in the same BEA.[27] In addition, KCS appears to believe that the build-in/build-out option also spans a BEA.

At base the issue is whether constructing a build-out or draying across a BEA is a reasonable assumption. BEAs are generally large to begin with, ranging in size from ten to thirty counties. Particularly in the Western United States, where counties are even larger than in the East, BEAs tend to assume huge proportions. In the absence of supporting evidence to the contrary, it is DOT's view that analyses that discount the geographic expanse of these BEAs, where the distance between railroads could be hundreds of miles in some cases, lack credibility as a general proposition.

DOT's analysis of the 1994 Rail Carload Waybill Sample defined markets as traffic flowing between SPLC-4s, the equivalent of county-to-county movements. The shorter drayage distances involved make it a more credible assumption, and one that lends itself to the potential for build-in/build-out and transloading competition. DOT identified UP/SP markets where the number of independent rail routings and jointly-served points would go from two-to-one or three-to-two serving carriers if the merger were approved. Unlike DOJ and

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26/ DOJ states that they used a value-to-weight ratio to assign STCC commodities to BEAs or SPLC-4s, but evidence on the method used does not appear in the record.

27/ KCS cites a number of reasons for selecting BEAs as the relevant geographic market, but none of the reasons cited is uniquely associated with selection of the BEA; they apply with equal force to SPLC-4 geography, for example. In the same manner, the truck drayage used by DOJ applies equally to SPLC-4s.

KCS, our examination took into consideration gateway competition, and, to the extent possible, the effects of the trackage rights agreements granted in the BNSF merger. Compared to DOJ and KCS, our analysis found fewer markets where competition would be reduced from two rail carriers to one. Moreover, where KCS (using BEAs) found the number of three-to-two markets produced by the merger exceeded the number of two-to-one markets, DOT (using SPLC-4s) found the number of two-to-one markets to be almost three times greater than the number of three-to-two markets.

Based on the foregoing discussion of Applicants', DOJ's, and KCS's analyses, DOT believes that the extent of the revenue and traffic affected by the proposed merger has not been, and cannot be, definitively determined on the record in this proceeding. For two-to-one markets, estimates of the affected traffic range from Applicants' (UP/SP-231, RVS of Peterson at 27), to DOJ's (DOJ-8, VS of Majure at 11), to KCS's (KCS-33, VS of Grimm at 193). Estimates of the traffic affected in three-to-two markets range from Applicants' [redacted] (UP/SP-231, VS of Peterson at 24), to DOJ's [redacted] (DOJ-8, VS of Majure at 29), to KCS's [redacted] (KCS-33, VS of Grimm at 193). Nevertheless, it is clear even from the Applicants' understated impact of of affected traffic that reductions in competition would be extensive along the corridors where the number of serving railroads would be reduced from two-to-one by the proposed merger. Applicants clearly recognized that fact when they proposed that the STB grant BNSF trackage rights over the affected corridors as a condition on the merger.

V. TRACKAGE RIGHTS ARE GENERALLY INADEQUATE TO REMEDY THE COMPETITIVE CONSEQUENCES OF THIS MERGER

The record establishes that substantial losses of intramodal competition would be brought about by this merger. It is also clear that the volume and characteristics of traffic subject to this loss, and the enormous geographic distances covered by this loss, are unprecedented. In these circumstances, consistency with the public interest requires that the lost intramodal competition be supplied by railroads that are in every pertinent respect the competitive equals of the Applicants. However, service under traditional trackage rights would not permit this. Rather, such trackage rights introduce inequalities that, magnified by the circumstances of this case, are unacceptable.

A. The Original BNSF Trackage Rights Agreement

To ameliorate the anticompetitive effects of the merger, the Applicants negotiated a comprehensive trackage rights agreement with the BNSF. The agreement covers four large areas where UP and SP operations are largely parallel—the Central Corridor from northern California to Denver, Colorado; south Texas, which includes Mexican gateways at Eagle Pass and Brownsville; east Texas and Louisiana; and the Houston to Memphis corridor.[28] Other parallel areas include El Paso east to Sierra Blanca, Texas.

In addition, the Applicants agreed to sell various lines to BNSF. The most significant of these is from Iowa Junction, Louisiana to Avondale, Louisiana, which includes SP terminals in the New Orleans area; UP's line between Keddie

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28/ Since Houston is the anchor to three important parallel corridors—Houston/Memphis, Houston/New Orleans, and Houston/Brownsville/Central Texas—we will refer to these corridors collectively as "the Texas Corridors."

and Bieber in California; and UP's line between Dallas and Waxahachie in Texas. UP/SP-22, VS of Rebensdorf at 311. BNSF would grant back trackage rights to UP/SP on the Iowa Junction-to-Avondale line and the Dallas-to-Waxahachie line. In sum, Applicants would grant BNSF trackage rights over 3,968 miles of line and sell to BNSF 330 miles of line in the affected areas.

The trackage rights compensation terms provided for in the agreement are paid solely on a variable basis depending on the gross tonnage that BNSF moves over the UP/SP lines. For bulk trains of 67 cars or more of one commodity in one car type, the fee is 3-mils per ton-mile. For intermodal and automotive trains, the fee is 3.48 mils per ton-mile for traffic moving from Keddie to Stockton, California and 3.1 mils on all other lines. Id. at 304.

The UP/SP would be responsible for all maintenance, dispatching, and supervision on the lines covered by the BNSF agreement. Id. at 306. Capacity-related improvements would be borne by the UP/SP for the first 18 months after the merger is approved. Subsequent improvements would be funded out of a $25 million capacity-related capital reserve account established with the proceeds from the line sales to BNSF. Id. at 309. Applicants assert that the BNSF agreement maintains two-railroad competition at all two-to-one points and preserves a two-railroad connection for all short line railroads that interchange with both UP and SP. Id. at 296-297.

Various parties in this proceeding raise significant issues concerning BNSF's ability to be an effective competitor in each of these markets as a tenant over UP/SP lines. Parties assert that the negotiated settlement agreement (1) would not grant BNSF access to sufficient infrastructure facilities to conduct operations for chemicals and plastics traffic; [29] (2) would prescribe costly

29/ CMA, DOW, NITL, SPI, and Conrail emphasize that chemicals and plastics shippers located in the Gulf area rely on storage in transit to operate production compensation fees that would limit BNSF's ability to price competitively; [30] (3) would not ensure equality in dispatching, which would favor UP/SP (the landlord) trains over those of BNSF; [31] (4) would not grant BNSF access to traffic sufficient to justify operations; [32] and (5) would impede BNSF operations by precluding that carrier from participating in the directional traffic flows over the

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plants at capacity and to have the product readily available to move to end markets. (The Applicants agree. UP/SP-22, VS of Gray at 204; UP/SP-23, VS of Peterson at 65.) These parties allege that BNSF would be a limited participant in this market because it lacks sufficient facilities and yard capacity to meet these customers' service requirements, and as a result, would not be an effective competitor with UP/SP until it builds its own facilities. CMA-7, VS of Crowley at 40-41; DOW-11, VS of Crowley at 6-8; SPI-11, VS of Ruple at 17-19; NITL-9, VS of Crowley at 48-49; Conrail, CR-22, VS of Carey et al., at 40-41.

30/ Parties allege that the compensation terms in the BNSF agreement would impede BNSF's ability to compete and as a consequence lead to higher post-merger rail rates. They claim that BNSF would not have the flexibility to price its services over these lines because it would always face a price floor, limiting its ability to price competitively with UP/SP. DOJ-8, VS of Majure at 19-23; SPI-11, VS of Crowley at 5; KCS-33, VS of Plaistow at 191-93; SPI-11, VS of Shepherd at 46-47, 53; KCS-33, VS of White at 127. SPI, in particular, states that BNSF quoted Phillips Petroleum post-merger rates that were [redacted] percent higher than current rates. See SPI-11, VS of Watson at V.S.6.

31/ Parties claim that UP/SP dispatchers would favor their trains over those of the tenant railroad, continually making the tenant's transportation services inadequate to meet shippers' demands, thereby making the tenant an ineffective competitor. CR-22, VS of Carey et al., at 47-51; DOJ-8, VS of Majure at 23-25; NITL-9, VS of Sharpard at 49-50; SPI-11, VS of Shepherd at 45; KCS-33, VS of Swanson at 52-53; KCS-33, VS of White at 127-29; International Paper ("IP")-11, VS of McHugh at 32.

32/ CMA, NITL, and SPI claim that the traffic open to BNSF under the trackage rights agreement would be insufficient for BNSF to conduct operations. SPI-11, VS of Crowley at 53-57; IP-11, VS of Prescott at 8-11. In addition, parties claim that much of the traffic is under contract and would be inaccessible to BNSF. SPI-11, VS of Shepherd at 44; NITL-9, VS of Shepherd at 48; CR-22, VS of McNeil at 7-8; CR-22, VS of Pileggi at 2-3.

Houston/Memphis corridor planned by UP/SP. [33] These parties also argue that the STB's approval of the merger would remove other benefits of two-railroad competition, i.e., build-in/build-out and transloading options, which shippers have used to hold rail rates in check even when they are served by only a single carrier. [34]

Parties state that the extent of these trackage rights, which encompass nearly 4,000 miles, is unprecedented and raises profound questions about whether BNSF could in fact, be an effective competitor to UP/SP over these lines. NITL-9, VS of Crowley at 30-40; CR-22, VS of Carey, et al., at 45-62; KCS-33, VS of Swanson at 251-66.

B. The CMA Settlement Agreement

Following these criticisms, the Applicants negotiated a more extensive agreement with the CMA in an attempt to respond to the parties' concerns. The CMA agreement would provide for storage-in-transit yard capacity for BNSF so it could conduct operations in the Gulf area; would open to BNSF fifty percent of

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33/ To obtain operating efficiencies from Houston to Memphis, UP/SP's operating plan calls for northbound trains to use the UP line while southbound trains will move on the SP line. BNSF was granted trackage rights on the SP line. In order to move trains from Houston to Memphis, BNSF would be "swimming upstream" against the UP/SP traffic flow. NITL-9, VS of Shepherd at 49-50; IP-11, VS of Prescott at 14-16; CR-22, VS of Carey, et al. at 16-19 and 80; SPI-11, VS of Shepherd at 45; KCS-33, VS of Rees at 230-31; IP-11, VS of McHugh at 28-29.

34/ Parties have demonstrated that build-in/build-out and transloading options have been used to gain rate concessions from their serving carrier. KCS-33, VS of Simpson at 94-98; KCS-33, VS of May at 102-06; UCC-6, VS of Baxter at 4-7. Parties have also pointed out that if the merger is approved, any and all opportunities to exercise these options will be gone since only the carrier serving the line (UP/SP) will have control over these decisions. SPI-11, VS of Shepherd, at 44; KCS-33, VS of May at 107; CR-22, VS of McNeil at 8-9; CR-22, VS of Paranzino at 2-6; NITL-9, VS of Shepherd at 48; IP-11, VS of Prescott at 17-18.

the volume of contracts at UP/SP two-to-one points in Texas and Louisiana; would allow BNSF to conduct directional operations over the Houston/Memphis corridor to the same extent as UP/SP; would provide for an extensive protocol to ensure equality in dispatching; would create an account where the fees collected from trackage rights usage would be placed in a fund and used for capital improvements along those lines over which BNSF would have trackage rights; and would preserve shipper build-in/build-out options where economically feasible if the shipper petitions the UP/SP within one year after the merger is approved or their current contracts expire. UP/SP-219. The agreement also gives BNSF the right to handle traffic from Lake Charles, West Lake, and Shreveport, Louisiana and Texarkana, Texas/Arkansas. Id. In addition, the trackage rights would allow BNSF to operate from Memphis to St. Louis. The Applicants assert that the CMA agreement responds to concerns raised by parties and that it would ensure that the BNSF will be a potent competitor. UP/SP-230, at 12.

Not all the parties agree with the Applicants. SPI contends that the CMA agreement would not mitigate the loss of competition from the merger, and many of its concerns cannot be resolved unless UP/SP were required to divest one of the two parallel lines, including yards and facilities. Specifically, SPI charges that the trackage rights compensation fee structure, which the CMA agreement did not change, would still place BNSF at a competitive disadvantage with a merged UP/SP. SPI-16 at 8.[35] SPI also contends that BNSF has not shown an interest in competing in the affected area, as demonstrated by the fact

35/ The Applicants counter that BNSF's overall cost of handling traffic covered by the settlement agreement will be lower than SP's. UP/SP-231, RVS of Whitehurst at 6.

that negotiations to modify the original trackage rights were undertaken by CMA, not the BNSF. Id.

Even though the procedural schedule did not allow parties opposing the merger to respond to the CMA agreement, it is clear to DOT that opposition remains First, some CMA members consider the CMA agreement inadequate because it does not alleviate the cost disadvantages suffered by BNSF and does not address BNSF's lack of infrastructure except in a limited way. SPI-16, Exhibit 2. Second, NITL, which until the CMA agreement coordinated its participation in this case with SPI and CMA, has not reached an agreement with the Applicants, according to published reports.

C. The Department's Views on Trackage Rights

The Department believes that the extensive and unprecedented geographic scope of the problems presented by this merger, together with absence of any other Class I railroad in the affected areas in the West, compel the conclusion that even the augmented trackage rights solution proffered by the Applicants will not provide an adequate level of competition to shippers[3].

Trackage rights introduce a landlord-tenant relationship into railroad operations, and that structure has an inherent potential for problems between the landlord and tenant carriers that does not exist in the paradigm of competition: two "landlord" or owner railroads that compete with each other. The tenant may be at a disadvantage in myriad respects. First, the compensation generally, as here, varies with the amount of use. This structure may not permit the tenant the full range of pricing flexibility that a landlord enjoys, to set a rate at whatever level is necessary to attract traffic so long as it makes any contribution to fixed costs. Second, the landlord typically controls dispatching. This can be a particular problem where, as here, the tenant would be competing with the landlord. The greater the competition between the landlord and tenant, the more incentive the landlord would have to prefer its own traffic to the detriment of the tenant and its shippers. Third, new tenants may have difficulty breaking into a market when the landlord carrier has contracts of greater or lesser duration with shippers. Fourth, trackage rights generally (and here initially) do not provide access to infrastructure services and facilities. The record reflects that these are crucial in the transport of plastics and chemicals from the Texas Gulf. Fifth, trackage rights generally (and still here to a major extent) forbid tenant carriers to access new shippers, whether through the construction of spurs or any other means. Owner-railroads, of course, suffer no such constraints. See generally CR-22, VS of Conway et. al., at 34-40; KCS-33, VS of Swanson at 251-253; CR-22, VS of Schmalensee at 10-11 and 23-24.

The CMA agreement certainly improves upon the terms of BNSF's original access to the problem areas. It would set aside for particular purposes the compensation paid by BNSF, it would place a BNSF manager in the dispatching center of UP, it would permit the construction of build-ins and build-outs to shippers for a limited period, it would invite BNSF to participate in the directional flow planned by the Applicants for Gulf-to-Memphis movements, and it would provide some access to storage facilities for the chemical and plastic traffic in that region. UP/SP-219.

Although these modifications themselves break new ground and would make significant improvements to the prospective landlord-tenant relationship between UP/SP and BNSF, in the unprecedented circumstances of this case they are still inadequate, for several reasons. First, the structure of the compensation paid by the tenant would remain the same. [36] BNSF would still face incentives,

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36/ We note that the Applicants would accept "traditional" joint facility billing to allocate costs, if prescribed by the Board. Costs covered would be maintenance cost structures, and restrictions different than (and competitively inferior to) the railroad against which it would be competing. Second, the CMA agreement does not extend to all the parallel lines that face a reduction in the number of railroads from two to one. The large numbers of shippers not covered by these modifications would remain subject to the terms of the original BNSF agreement, which, as indicated above, is substantially deficient. [37] Third, the CMA agreement would grant BNSF only one year's time to decide with shippers now served by either UP or SP whether to construct a spur and thereby receive intramodal competition. Landlord or owner railroads face no such time constraint. As market conditions change, so, too, may their commercial decisions; a competitor that cannot adapt to circumstances and strive for new business opportunities is a weaker competitor.

In addition to the deficiencies of the CMA agreement, DOT is troubled by BNSF's apparent ambivalence about its competitive role after the merger. BNSF's position has always been that the original agreement enabled it to be an effective competitor; however, no other party (perhaps not even the Applicants, as reflected in their subsequent settlement with CMA) has ever considered that agreement to be sufficient. Second, the improvements to its competitive posture came about through the efforts of CMA, not BNSF. Third, as noted by shippers, when pressed for price quotes post-merger, BNSF has apparently been reluctant to quote rates and service terms, and has only offered rates that may be significantly above current levels. SPI-11, VS of Watson at 6; IP-11, VS of

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and operation of the joint facility on the basis of usage made by BNSF and UP/SP. UP/SP-231, RVS of Rebensdorf at 10, note 1.

37/ The Applicants have acknowledged that they would extend these conditions to all areas covered by the original BNSF agreement if so directed by the Board. UP/SP-230 at 20.

McHugh at 26. Finally, since the outset of this proceeding, BNSF has taken no position on the merits of the transaction, and has maintained that its original agreement with the Applicants would allow it to provide operations sufficient to meet shippers' needs. This remains BNSF's position. BN/SF-54, VS of Clifton at 2. It may be that BNSF is truly unconcerned about the outcome of this case, for it would remain the largest railroad if the STB disapproves the merger, and would gain access to 4,000 miles of track and traffic in the event of approval. It may find either outcome equally acceptable. From a public interest perspective, of course, it is problematic to depend upon such a carrier for the aggressive competition that is necessary here.

The specifics of this case also raise substantial questions about the efficacy of trackage rights, however modified, as a remedy. The distances involved -- roughly 4,000 miles -- have never been approached or even attempted in any prior consolidation of Class I carriers, much less offered to a single carrier. [38] This poses a significant management task all by itself, and more so where, as here, the lines are often in areas where BNSF does not operate today. It is thus unsettled whether, even with the best of intentions, operations of direct competitors over thousands of continuous miles of shared track could proceed without significant risk. The CMA agreement does indeed address some of the concerns of the opposing parties and improves BNSF's ability to be an effective competitor along the parallel corridors. However, the CMA agreement cannot replicate the landlord-landlord competition that currently exists along these extensive areas.

38/ For example, in the course of its own recent merger proceeding, BNSF offered nearly 2,100 miles of trackage rights to SP and much shorter distances to seven other railroads, but the total went "far beyond" that necessary to redress the competitive problems identified by the ICC. <u>BN/SF</u> slip op. at 83. That is not the case with the mileage agreed upon by the Applicants in this proceeding.

Although trackage rights have been an effective remedy to mitigate competitive problems springing from past mergers, the sheer magnitude and extended geographic scope of the trackage rights proposals in this case magnify the inherent inequalities in the landlord-tenant relationship, and raise concerns about maintaining truly vigorous intramodal rail competition. The reduction in rail competition presented by the loss of an independent railroad here requires that the Board maintain the highest, most vigorous level of two-railroad competition possible throughout the affected areas.

VI. DIVESTITURE IS NECESSARY TO PROVIDE THE INDEPENDENT RAIL INTRAMODAL COMPETITION REQUIRED TO REMEDY THE COMPETITIVE LOSSES OCCASIONED BY THIS MERGER IN THE TEXAS CORRIDORS

Only equal competitors, with all the prerogatives, capabilities, and incentives of owners, can maintain the necessary two-railroad competition over the Texas Corridors here at issue. The Board must, therefore, order the Applicants to divest to unaffiliated railroads the lines in these corridors on which this competition is lost. Such a remedy would satisfy the STB's criteria for imposing conditions in merger proceedings.

One of the two parallel lines (UP's or SP's) in the Texas Corridors should be divested. [39] The record clearly demonstrates that other railroads have substantial interest in these lines; they generate large volumes of high margin traffic in an area that is geographically and operationally adjacent to many railroads, for example, KCS, Conrail, the Illinois Central, Norfolk Southern, CSX,

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39/ There is an exception to this recommendation for the Placedo to Brownsville line, on which SP currently operates with trackage rights over the UP line. Maintaining the status quo in this specific corridor will only require providing these same trackage rights to another carrier to replace SP.

and BNSF. 40 The lines connect with major gateways and serve major population centers. This suggests active "bidding" and subsequent vigorous competition between UP/SP and one or more additional landlord railroads. Moreover, there are no obstacles to divestiture of the Texas Corridors. Most of the public benefits claimed by the Applicants inhere in the Central Corridor , the I-5 Corridor, and other areas outside the Texas Corridors. CR-22, VS of Carey, et al., at 64-70. Therefore these lines could be divested without materially affecting the significant public benefits of the merger. See BN/SF, slip op. at 55-56; UP/MKT, 4 I.C.C. 2d at 437.

VII. AUGMENTED TRACKAGE RIGHTS IS THE PREFERRED REMEDY IN THE CENTRAL CORRIDOR

There are unique circumstances that militate against divestiture and in favor of augmented trackage rights in the Central Corridor. The Central Corridor is an area of extensive overlap between UP and SP -- approximately 1,400 miles. The Department's doubts about the efficacy of trackage rights over such vast distances remain; however, the record does not permit us to conclude with confidence that divestiture would produce the desired result (a capable, independent owner railroad) while maintaining adequate service to the public over the entire line.

There are several reasons for this. Although the area of overlap is large—from the Bay Area in northern California to west of Denver—there is a segment that generates relatively little traffic of its own—the Bay Area to Salt Lake City, Utah. Because this segment is therefore dependent upon overhead freight to

40/ The record demonstrates that 38 percent of SP's carloads, other than intermodal, accounting for $627 million, are originated and terminated in the Texas Corridors. CR-22, VS of Malan at 6.

maintain the Central Corridor as a viable independent routing, a railroad needs a network of gathering lines outside the area of overlap to generate enough density to support maintenance and operations. BNSF-54, VS of Owen at 15-16. Such networks are possessed only by SP, UP, and BNSF. The lack of such networks would almost inevitably cause the owner to concentrate service on the most viable portions of the Corridor, with other segments atrophying into candidates for abandonment. It is telling that the Western Coal Transportation League has requested the Board to order divestiture of the lines from Provo, Utah, east to a carrier other than the BNSF; however, its proposed condition does not include the lines from Provo going west.

Montana Rail Link, Inc. ("MRL") has proposed to purchase the SP portion of the Central Corridor, but its application poses major problems. Foremost of these is that MRL does not possess the gathering lines in northern California to capture the traffic that would flow over the corridor. Second, its proposal extends well beyond the area of overlap of the UP/SP lines.[41] Third, MRL would face a significant competitive disadvantage, competing against two carriers in the West that could offer single line service to the major midwestern gateways. It is likely that much of the overhead traffic on the Central Corridor could be rerouted to other, single-line carriers, jeopardizing the viability of competitive service on that corridor. Together, these factors raise serious questions about MRL's application, going most importantly to its ability to supply vigorous competition, maintain adequate service to the public, and satisfy

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41/ Broadly, other than its offer to purchase the Central Corridor, MRL proposes to purchase UP lines that run from north of Ogden, Utah, to Silver Bow, Montana; several UP and SP lines in California; SP's line over "Tennessee Pass" to Pueblo, Colorado; the line from Denver to Pueblo, Colorado; and UP's line from Pueblo to Herrington, Kansas. MRL-10 at 6-7.

the traditional standards that closely tailor conditions to the problems created by mergers.

The Department therefore reluctantly concludes that divestiture is not the optimal solution for the problems caused by the merger in the Central Corridor. It would be possible, however, to strengthen the BNSF and CMA agreements so as to recast the landlord-tenant relationship between UP/SP and BNSF on the Central Corridor into the best approximation of a landlord-landlord relationship, with many of its attendant benefits. The first such change would be a two-tier trackage rights fee such as suggested by DOJ, where an up front "fixed fee" is intended to capture the fixed costs of operating over the line, followed by a usage fee representing the variable cost associated with the line. DOJ-8, VS of Majure at 20-23. The Department believes that this variation to the trackage rights compensation fee structure would more adequately ensure that the tenant carrier would be a committed competitor over this extensive area. It would have the same incentive to recover its investment and the same pricing flexibility as the landlord (UP/SP) it faced. Our second modification to the trackage rights agreements would preserve build-in/build-out and transloading options along the entire stretch of trackage rights without time limit. Again, BNSF would be in a position approximating that of an independent owner of the line. Third, as in the CMA settlement, the STB should order the Applicants to open their contracts with shippers on the Central Corridor at two-to-one points until the BNSF has access to fifty percent of the traffic. Finally, the Board should establish in advance formal annual procedures to review the effectiveness of the trackage rights so modified, and be prepared to order divestiture or transferal of the modified trackage rights to another railroad. If the Board is not prepared to modify these trackage rights in this manner, it should proceed to order divestiture of the Central Corridor.

VIII. CONCLUSION

The proposed merger would create the largest railroad in the United States. The precedent the Board's decision will set and its potential effects on the national railroad system, extent of the overlapping lines of the Applicants, and the absence of other Class I railroads in the West, requires the most strict scrutiny of the competitive consequences of this transaction. After careful review of the record, the Department has concluded that only divestiture of the Texas Corridors can replace the competition that is lost through the merger. Trackage rights, even as modified by the parties, are simply inadequate in the circumstances of this case to remedy the extensive problems created. The only exception to this rule lies in the Central Corridor, due to extraneous factors, and in that case we urge the Board to modify the trackage rights agreements proposed by the parties to place BNSF in a competitive position approximating the Applicants. Alternatively, if the Board is not prepared to strengthen the trackage rights, it should direct the Applicants to divest the Central Corridor as well.

Respectfully submitted,

Nancy E. McFadden

Nancy E. McFadden
General Counsel

June 3, 1996

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CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of the foregoing **Brief of the United States Department of Transportation** in Finance Doc. No. 32760 to be served upon all Parties of Record in this proceeding on this date, by first class mail, postage prepaid.

Paul Samuel Smith

June 3, 1996

STB FD 32760 6-3-96 E 83948

Item No. 83958

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JUNE, 1996 #78

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JAMIE PALTER RENNERT
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June 3, 1996

BY HAND DELIVERY

Honorable Vernon A. Williams
Secretary
Interstate Commerce Commission
Room 1324
12th Street & Constitution Avenue, N.W.
Washington, D.C. 20423

Re: *Union Pacific Corp. et al. -- Control & Merger -- Southern Pacific Rail Corp., et al.*, Finance Docket No. 32760

Dear Mr. Williams:

Enclosed please find an original and 20 copies of the Brief of Canadian National Railway Company in Support of Primary Application (CN-7), for filing in the above-referenced docket. Also enclosed is a 3.5 inch disk containing the text of this pleading in WordPerfect 5.1 format.

Please date-stamp the extra copy provided and return it with our messenger. Thank you.

Sincerely,

Jamie Palter Rennert

Enclosures
cc: All parties of record

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CN-7

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BEFORE THE
SURFACE TRANSPORTATION BOARD
Washington, D.C.

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 CANADIAN NATIONAL RAILWAY COMPANY
IN SUPPORT OF PRIMARY APPLICATION**

Robert P. vom Eigen
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June 3, 1996

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BEFORE THE
SURFACE TRANSPORTATION BOARD
Washington, D.C.

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 CANADIAN NATIONAL RAILWAY COMPANY IN SUPPORT OF PRIMARY APPLICATION

Canadian National Railway Company ("CN"), by its attorneys, files this Brief in Support of the Primary Application for approval of the proposed merger between Union Pacific Corporation, Union Pacific Railroad Company, Missouri Pacific Railroad Company (the "UP") and Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corporation and The Denver & Rio Grande Western Railroad Company (the "SP") (collectively referred to as the "Applicants"), filed in this docket on November 30, 1995.

INTRODUCTION

As stated in its March 29, 1996 Statement of Position and Testimony of

Canadian National Railway Company in Support of the Primary Application (CN-3). CN believes the proposed merger possesses significant public interest benefits that would not occur but for its approval. CN's Senior Vice President - Marketing, Gerald Davies, offered testimony about the benefits of the proposed merger to CN and its customers, including access by Canadian shippers to the I-5 Corridor and opportunities to increase rail traffic. In that filing, CN expressed its concern about certain conditions to the proposed merger that certain parties might -- and did -- present to the Board.

On March 29, 1996, Consolidated Rail Corporation ("Conrail") and the Kansas City Southern Railway Company ("KCS") requested that the Surface Transportation Board (the "Board") order the divestiture of certain SP lines and assets (referred to as "SP East," Comments of Consolidated Rail Corporation in Opposition to the Merger (CR-21), Vol. I at 2 n.3), as a condition to approval of the merger application. CR-21 at 1, 7-8; Comments of the Kansas City Southern Railway Company and Request for Conditions (KCS-33) at 2-4. Conrail and KCS further propose that the Board require Applicants to hold a public auction for these lines. CR-21 at 9; KCS-33 at 4, 109-10. Conrail has already made an offer to purchase SP East, and both Conrail and KCS have made clear their intentions to bid should there be a divestiture and public auction. CR-21 at 4-7; KCS-33 at 143-44 (Verified Statement of Michael R. Haverty).[1]

The properties encompassed in SP East are substantial in scope, comprising several thousand miles of track. Applicants estimate the scope of Conrail's and KCS's

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[1] As discussed below, Norfolk Southern, CSX, and Illinois Central have expressed their interest in SP East as well.

divestiture proposals in terms of annual revenues from carload and intermodal diversions, as follows: $864 million if Conrail's divestiture proposal were to be imposed, and $813 million if KCS's proposal were imposed. Applicants' Rebuttal (UP/SP-233), Vol. 2, Pt. B, Rebuttal Verified Statement of Richard B. Peterson at 197. These proposals to require divestiture of the SP East properties constitute a fundamental restructuring of the primary application and would require a restatement of the benefits and other impacts described therein. The successful bidder in this auction process would be required to submit an application for Board approval of its acquisition of these rail lines and assets.[2] In essence, Conrail and KCS seek affirmative relief that requires an application to the Board, and the Interstate Commerce Act (the "Act") and Board regulations require under those circumstances that they file responsive applications in this proceeding. Having failed to file such applications, their requests for divestiture and auction should be rejected by the Board.

Conrail and KCS profess that their solutions to the alleged competitive problems of the proposed merger are superior to those proposed by Applicants. However, neither carrier has provided evidence describing its plans in detail, as required of a party filing a responsive application. Because these carriers have attempted to sidestep the legal requirements for a competing acquisition proposal, the Conrail/KCS "fix," if imposed

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[2] Although seemingly acknowledging that Board approval of the acquisition of SP East is necessary, Conrail and KCS leave unclear their views on the proper timing and procedures involved in securing such approval. CR-21, Vol. II, Verified Statement of Lester M. Passa ("Passa V.S.") at 14-16; *id.*, Verified Statement of Ronald J. Conway at 42; *see* KCS-33 at 143 (Verified Statement of Michael R. Haverty). Conrail suggests that divestiture of SP East would require a subsequent "smaller" proceeding. CR-21, Vol. II, Passa V.S. at 15.

by the Board, will have the effect of engrafting an entire subsequent proceeding upon the present one. Such a subsequent proceeding, and the delay it would entail, contravenes the Act, implementing regulations and Interstate Commerce Commission (the "Commission") precedent.

The options available to the Board are to approve the primary application subject to the remedial undertakings Applicants have proposed, to impose conditions modifying those undertakings, to rule upon responsive applications properly filed in accordance with Board procedures or, in the event the Board finds that alleged competitive issues cannot be addressed by these proposed remedies, to disapprove the primary application. CN does not favor this latter option because of the public benefits it foresees from the transaction, and believes that the Board has available to it the tools adequate to address any issues that Applicants may not have resolved to the Board's satisfaction. For instance, the Board could condition its approval upon revisions to the terms of the BN/SF arrangement to improve the access of BN/SF to markets where there may remain a question as to the efficacy of the competition between BN/SF and a merged UP/SP. For these reasons, and as discussed below, the Board should reject the Conrail and KCS proposed divestiture and auction.

ARGUMENT

I. Conrail's And KCS's Requests For Divestiture Of SP East Are Procedurally Defective: A Carrier May Obtain The Type Of Relief Requested Only By Filing A Responsive Application.

As stated above, Conrail and KCS have requested that the Board condition approval of Applicants' merger on the divestiture of SP East. Conrail and KCS further propose that the Board order Applicants to hold a public auction for these lines and assets, at which these carriers will bid. Thus, in substance, Conrail and KCS seek to purchase these properties, and to obtain Board authorization for that transaction in a separate proceeding. However, the purchase of railroad lines and assets -- which would otherwise become the property of the merged company pursuant to the primary application -- constitutes affirmative relief, inconsistent with the primary application, which is a category of transaction that under the Act must be authorized by the Board. The Act, Board regulations, and Commission precedent require a carrier to submit a responsive or inconsistent application in a merger proceeding to acquire lines and assets such as SP East.

The Act requires that if the merger application involves the merger or control of two or more Class I railroads, as it does here, the Commission shall require inconsistent applications to be filed in the same proceeding as the primary application:

> (2) The Commission shall require that applications inconsistent with an application . . . be filed with it and given to the Secretary of Transportation by the 90th day after publication of notice [of acceptance of the primary application].

49 U.S.C. § 11345(b)(2) (1995) (emphasis added). There is no discretion under the Act for the Board to proceed as Conrail and KCS suggest. The requirement of filing inconsistent and responsive applications was added to the Act as part of the Railroad Revitalization and Regulatory Reform Act of 1976 (the "4-R Act"), and as shown below was inserted to prevent endless delays which had characterized rail consolidation proceedings since the 1940 amendments to the Act.[3]

The Board's implementing regulations similarly require that parties seeking "affirmative relief," such as that sought here, file a responsive application. 49 C.F.R. §§ 1180.3(h), 1180.4(d)(4). Section 1180.3 of the Board's Railroad Consolidation Procedures defines "responsive application" as follows:

> Responsive applications include inconsistent applications, inclusion applications, and <u>any other affirmative relief that requires an application to be filed with the Commission</u> (such as trackage rights, purchases, construction, operation, pooling, terminal operations, abandonment, etc.).

Id. § 1180.3(h) (emphasis added). Purchase of SP East would require an application to be filed with the Board under 49 U.S.C. § 11343 (1995); therefore, any party wishing to purchase SP East was required to file an inconsistent application in this merger proceeding. In revising the Railroad Consolidation Procedures in response to the 4-R Act's enactment, the Commission stated that all information to be relied on by

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[3] The rule of requiring the consideration of mutually exclusive or "inconsistent" applications in administrative proceedings already was well established at the Federal Communications Commission. *See Ashbacker Radio Corp. v. F.C.C.*, 326 U.S. 327 (1945). Although the *Ashbacker* doctrine is rooted in a concern for due process, the concern in the rail context was that parties to merger proceedings were abusing the administrative process to strangle the primary application through endless delay. *See* discussion *infra* at Part II.

applicants, carriers seeking inclusion, or "persons making alternative proposals" should be submitted as early as possible in the course of the proceeding, "to establish a complete record from which all the issues normally raised in a rail merger or other consolidation proceeding can be developed, analyzed, and resolved." Railroad Consolidation Procedures; Various Transactions, Ex Parte No. 282, 41 Fed. Reg. 21481, 21482 (1976) (proposed rule). The filing of comments that effectively request the purchase of SP East does not permit the Board to analyze or resolve the issue of ownership of SP East within this proceeding.

The Commission's procedural order in this case also prohibits the acquisition of SP East through the procedure of requesting imposition of a condition. The Commission ordered that all inconsistent and responsive applications in this proceeding be filed by March 29, 1996. *See Union Pac. Corp., Union Pac. R.R., and Missouri Pac. R.R. --Control and Merger--Southern Pac. Rail Corp., Southern Pac. Transp. Co., St. Louis Southwestern Ry., SPCSL Corp., and the Denver & Rio Grande W. R.R.* ("*UP/SP*"), Finance Docket No. 32760, Decision No. 9 (served Dec. 27, 1995) at 3, 11, 15. The Commission defined the term "responsive application" for the purpose of this proceeding as including:

> inconsistent applications, petitions for inclusion, or <u>any other affirmative relief that requires an application to be filed</u> with the Commission (such as trackage rights, <u>purchase, purchase of a portion, acquisition</u>, extension, construction , operation, pooling, terminal operations, abandonment, etc.).

Id. at 12 (emphasis added). Neither Conrail nor KCS filed such a responsive application, even though their divestiture proposals would involve the purchase and acquisition of

SP East. The substance of these carriers' request for relief thus violates Commission order.

Moreover, Commission precedent does not support granting the relief requested in the manner in which it is requested. Conditions typically involve matters limited in scope that do not require formal application to the Commission and which do not fundamentally alter the structure of the primary transaction, such as the protection of interchange arrangements (*e.g.* the DT&I conditions) or the modification of provisions of joint facilities agreements (*e.g.* the requirement that a primary applicant give its consent to assignment of rights, *Union Pac. Corp., Union Pac. R.R. & Missouri Pac. R.R. -- Control -- Chicago & N.W. Transp. Co. & Chicago & N.W. Ry.*, Finance Docket No. 32133, 1995 ICC LEXIS 37, *71, *175, *244-48 (served March 7, 1995)). There is no precedent for conditioning an approval upon a major restructuring of the primary application, as proposed here, without the filing of responsive applications.

The cases that KCS cites as support for its requested condition are inapplicable to this proceeding. *See* KCS-33 at 109-10 (citing *Union Pac. Corp., Union Pac. R.R. & Missouri Pac. R.R.--Control--Missouri-Kansas-Texas R.R.* ("*UP/MKT*"), 4 I.C.C. 2d 409 (1988) and *Burlington N. Inc. & Burlington N. R.R.--Control and Merger--Santa Fe Pac. Corp. & The Atchison, Topeka & Santa Fe Ry.* ("*BNSF*"), Finance Docket No. 32549 (served Aug. 23, 1995)). These citations are distinguishable from this case because of the limited scope of the condition requested and imposed in them, and because, in *UP/MKT*, responsive or inconsistent applications were in fact filed addressing the very issues that were the subject of the Commission's order imposing the condition. *See BNSF*, slip op. at 68; *UP/MKT*, 4 I.C.C.2d at 417, 452-58.

In sum, the form of Conrail's and KCS's "applications" for acquisition of SP East contravene the Interstate Commerce Act, implementing regulations, and Commission order and precedent. Conrail's and KCS's requests for divestiture and public auction should be denied.

II. The Proposed Auction Procedure Contravenes The Sound Policy Of Requiring Responsive Applications.

The purpose of requiring that requests for affirmative relief be presented in the form of responsive applications is to allow the Board to resolve all issues relating to a merger application in a single proceeding. The purpose of the filing deadlines for responsive applications and supporting information -- and for each phase of a merger proceeding -- is to prevent the proceeding from dragging on interminably. Imposition of divestiture and public auction conditions would require further proceedings and might prevent the Board from ruling on the primary and related merger applications within the statutorily prescribed time frame.

The Act, as amended by the 4-R Act, imposes strict time limits on the Board for resolution of merger proceedings. 49 U.S.C. § 11345(b). Congress enacted these deadlines in response to the "inexcusably long delays" in past merger cases, because of the "great need for swifter merger action by the Commission," and to ensure "expeditious resolution" of these cases. S. Rep. No. 499, 94th Cong., 2d Sess. 18-21

(1975), *reprinted in* 1976 U.S.C.C.A.N. 14, 31-34.[4] Congress cited as "a leading example of unusual delay" the failed Rock Island-Union Pacific proposed merger, proceedings on which lasted over ten years with Rock Island entering into bankruptcy and the parties never consummating the merger. *Id.* at 19, *reprinted in* 1976 U.S.C.C.A.N. at 33; Frank N. Wilner, *Interstate Commerce Commission Dead at Age 108*, 63 JOURNAL OF TRANSPORTATION LAW, LOGISTICS AND POLICY 191, 193-94 (1996).

The purpose of the Board's Railroad Consolidation Procedures is similarly to ensure that the Board resolves all issues raised by a merger proceeding within that proceeding and within specified time limits. In promulgating revisions to these rules to implement the 4-R Act, the Commission stated that:

> Because of the statutory time limits within which rail consolidation proceedings must now be processed and decided, the Commission deems it essential that substantially all the evidence to be relied upon by the applicants, carriers seeking to be included in a transaction, or persons making alternative proposals, <u>be submitted in writing at as early a point in the proceeding as possible</u> rather than during the course of oral hearings. The regulations here being proposed are designed to meet their need. The information which they would require to be filed is, therefore, <u>intended to establish a complete record from</u>

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[4] *Accord* S. Rep. No. 499 at 17-18, *reprinted in* 1976 U.S.C.C.A.N. 31 ("The parade of proposals during the past half-century to restructure the railroad industry has been characterized by two prominent features, the lack of an overall systems planning approach and inexcusably long delays in deciding each case. These two problems are addressed in [the 4-R Act].); S. Conf. Rep. No. 595, 94th Cong., 2d Sess. at 136 (1976), *reprinted in* 1976 U.S.C.C.A.N. 148, 151-52 ("The [4-R Act] takes steps to remedy the chronic problem of extended and unnecessary delay in the Commission's processing of merger applications."); 121 Cong. Rec. S21026 (daily ed. Dec. 4, 1975) (one of the 4-R Act's regulatory reforms is "streamlining . . . railroad mergers and rationalizations in order to avoid situations like the Rock Island case which dragged out for over a decade.") (statement of Sen. Beall).

> <u>which all the issues normally raised</u> in a rail merger or other consolidation proceeding can be developed, analyzed, and resolved.

Railroad Consolidation Procedures, 41 Fed. Reg. at 21481-82 (emphasis added). Further, the Commission and Board in this case have determined to expedite this proceeding. *UP/SP*, Decision No. 6 (served Oct. 19, 1995) at 5-6.

Yet despite all of this law, Conrail and KCS seek to delay and extend this case by calling for another round of proceedings focussed on the ownership of SP East. The divestiture and auction conditions, if imposed, would complicate the Board's ruling on the primary application because all exhibits, testimony and other evidence submitted are premised on Applicants' ownership of SP East. The Board would need to obtain additional argument and evidence from all parties (and possibly from others who have not appeared thus far in this case) analyzing the impacts of the divestiture scenario to be able to measure the anticipated benefits against the potential harm to competition of essential services. As shown in the next section of this argument, this is more than simply an academic concern. Conrail and KCS have inexplicably refused to submit evidence supporting their divestiture requests. The Board simply cannot condone this conduct, and must reject the divestiture proposals outright.

III. <u>Divestiture of SP East Would Raise Competitive Issues That The Board Is Unable To Decide In The Context Of This Proceeding.</u>

A divestiture of SP East would compartmentalize proceedings on the merger application, improperly delaying to another proceeding a resolution of the competitive issues raised by parties in connection with the primary merger application. The Board cannot condition approval on divestiture and require an auction and decide the issues that divestiture/auction would raise within the statutory time limits for consideration of merger applications, much less within the short period of time the Board has set aside to rule on the proposed merger. *See* BN/Santa Fe's Response to Inconsistent and Responsive Applications (BN/SF-54) at 20 (arguing that the Board would need to engage in substantial central planning to decide what to auction off and how, and would need to evaluate the effects and efficacy of each divestiture/auction proposal submitted thus far); *id.* (BN/SF-55), Verified Statement of Joseph P. Kalt at 96-97.

A Conrail acquisition of SP East will raise distinct competitive issues. *See* Response of Norfolk Southern Railway Company to Comments of Consolidated Rail Corporation (NS-3) at 2 ("[D]ivestiture to a major eastern carrier would raise different competitive issues not even touched upon, much less fully discussed and analyzed, during the course of this proceeding."); *see, e.g.*, Response of Redland Stone Products Company to Comments Seeking Divestiture of Southern Pacific Lines Between San Antonio and Houston, Texas (RD-1) (divestiture would have adverse impact on rail transportation shipper currently enjoys); UP/SP-233, Vol. 4 at 197, Statement of Farmers Commodities Corporation ("Other carriers are asking to pick bits and pieces of the system without benefit of an operating plan that serves the public interest. How can the public interest be served without the benefit of a well financed carrier with the ability to compete on a single line basis with the BN-ATSF[?]"). By virtue of Conrail's and KCS's tactics, parties supporting the merger are prevented from presenting and commenting on these issues to the Board.

In addition to simply raising these competitive issues, the divestiture proposals also raise them in a manner that cannot be quickly resolved. First, as discussed above, Conrail and KCS have provided no supporting information for their proposals, making the Board's decisionmaking process more difficult.

Second, carriers other than Conrail and KCS are interested in acquiring SP East if it were for sale. *See* Applicants' Submission of Settlement Agreement With CSX (UP/SP-238) at 1 ("The agreement commits Applicants to negotiate with CSX in the event that they are required to sell or provide access to UP/SP properties and conduct such negotiations with any Eastern carrier."); Reply to Written Comments (CSX-4) at 2 ("[S]hould the Board order any further proceedings with respect to such divestiture proposals, CSX requests the opportunity to participate therein as its interests may appear."); NS-3 at 2 ("In the event the scope of this proceeding is expanded in the manner requested by Conrail and others, Norfolk Southern will be a vigorous contender for the properties in question."); Applicants' Submission of Settlement Agreements with Utah Railway and Illinois Central (UP/SP-74), Exhibit B ¶ 14 (general agreement to negotiate with IC). Moreover, there might be parties intent on acquiring SP East that have not yet expressed their interest in doing so.

Third, if parties were permitted under the precedent of Conrail's and KCS's proposals in this case to seek conditions requiring further divestitures from the winner of the auction in a third round of cases, the Board's ruling on the primary application could be held in abeyance for years. Certain parties have indicated that they see competitive issues in a Conrail acquisition of SP East (and, other parties may find fault with a KCS, CSX or NS acquisition of SP East). It is thus likely that parties would seek conditions of a divestiture to any carrier. If parties were permitted to employ the tactics that Conrail and KCS have used here, parties could seek conditions to the divestiture (such as divestiture of certain lines and assets already held by the acquiring carrier), thus triggering the need for yet another proceeding. This "divestiture-condition-divestiture-condition" process could easily repeat itself several times over.

In sum, the delay inherent in Conrail's and KCS's divestiture proposals jeopardizes the ability of the Board to rule on the primary merger application and the corollary benefits it will generate. These requests for conditions should therefore be denied.

CONCLUSION

CN believes that the primary application possesses substantial public interest benefits in the I-5 Corridor. This is not to say that the Board is powerless to remedy aspects of the transaction that it finds raise competitive issues. The Board may approve the transaction subject to the arrangements proposed with BN/SF; it may impose conditions to strengthen the trackage rights remedy proposed by Applicants; it may grant a responsive application filed by a third party; or it may disapprove the primary application. However, the Board may not grant a condition that triggers a separate acquisition proceeding.

Conrail's and KCS's approach to the acquisition of SP East aspires to exemplify former ICC Commissioner Porter's statement that "if you will but prolong a controversy long enough and come back to the Commission often enough your chances for winning out are excellent." *New York Cent. R.R. Acquisition of Boyne City, Gaylord & Alpena R.R.*, 193 I.C.C. 607, 614 (1933) (Comm'r Porter, dissenting). Conrail and KCS have tried repeatedly in their pleadings and in the media to create a controversy over the ownership of SP East. Yet they cannot win the relief they seek because they have chosen to approach the Board in a manner that does not permit them to succeed. CN therefore respectfully urges the Board to decline to impose divestiture and auction of SP East, and to approve the merger transaction as proposed by Applicants.

Respectfully submitted,

Robert P. vom Eigen

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June 3, 1996

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Page Count 5

JUNE, 1996 #79

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

PORT OF TACOMA'S PETITION TO INTERVENE,
FOR LEASE TO FILE BRIEF AND TO BECOME PARTY OF RECORD

Pursuant to C.F.R. 1112.4, the Port of Tacoma ("POT"), a municipal corporation of the State of Washington, seeks leave to intervene in this proceeding, to file the accompanying brief and to become a party of record. POT previously provided a verified statement in support of the UP/SP merger dated March 8, 1996.

POT together with the Port of Seattle ("POS"), now enjoy the ranking of the second largest container load center in North America with 2.4 million containers annually moving through the ports, largely by rail. A recent study projects that container traffic (20 foot equivalents) moving through both ports will double by 2015 to 2.6 million, and Midwest corn exports through Washington State ports could grow 66 percent, exceeding 10 million metric tons by 2015. Thus, POT is, and will increasingly be, dependent upon rail service to ensure competitiveness.

The POT Commission voted on March 7, 1996, to support the merger between UP and SP, POS, POT, and UP have established a cooperative effort to resolve future rail needs and infrastructure development in the Pacific Northwest. The merger between UP and SP will restore competitive balance in the western United States and enhance competition. POS, POT, and the entire Northwest will receive the direct and immediate benefits of the improvements to be produced by the UP/SP merger.

POT previously participated in this proceeding by filing a verified statement. Its intervention, therefore, will not broaden the issues raised in the proceeding or affect the procedural schedule. Acceptance of the brief will not prejudice any party and will assist the Board in its deliberations.

POT requests that it be allowed to intervene and that the accompanying brief be accepted.

Respectfully submitted,

Donald G. Meyer

Donald G. Meyer
Deputy Executive Director
Port of Tacoma
PO Box 1837
Tacoma WA 98401
(206) 383-9410

Dated this 3rd day of June, 1996.

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 PORT OF TACOMA

The Port of Tacoma ("POT") submits this brief in support of the merger proposed by Union Pacific and Southern Pacific.

1. POT is a port district and municipal corporation of the State of Washington. POT and the Port of Seattle ("POS") together enjoy the ranking of second largest container load center in North America. A recent study projects that container traffic (20 foot equivalents) moving through both ports will double by 2015 to 4.6 million, and Midwest corn exports through Washington State ports could grow 66 percent, exceeding 10 million metric tons by 2015. Thus, POT is, and will increasingly be, dependent upon rail service to ensure competitiveness.

2. POT plays an important part in assuring the region's economic vitality and depends heavily on the ability to move rail freight through the region quickly, economically, and efficiently. The maintenance and enhancement of the region's freight railroads play an important role in maintaining the competitive position of the region's ports in relation to other West Coast ports.

3. POT supports the UP/SP merger, POT, POS, and UP share a common concern over the quality of rail service to and from the Pacific Northwest and mutually desire to ensure long term reliable service and access between intermodal

rail terminals over the main lines of UP and SP in order to accommodate future increases in demand for rail freight service.

4. POT, POS, and UP have entered into a cooperative agreement that, among other things, assures that UP will respond to market demands by increasing capacity for rail traffic between Puget Sound and Chicago and along UP's new single line route in the I-5 Corridor through appropriate investments and operating improvements as described in the UP/SP merger application. (A copy of the agreement was previously submitted by POT with its verified statement.) POT and POS will actively support such improvements to help assure all governmental approvals are obtained quickly.

5. Jointly and cooperatively, POT, POS, and UP will address such issues as, mainline capacity, port access, grade separation, intermodal service, potential diversion, passenger rail issues, etc. This cooperative effort demonstrates the mutual commitment POT, POS, and UP have made to ensure that the Puget Sound region maintains a viable, competitive rail system in relation to other West Coast ports, and illustrates how well the ports can work with the private railroad sector to ensure economic health for the region.

6. The Burlington Northern/Santa Fe merger, which POT also supported, created a much larger and more efficient railroad than either UP or SP. The UP/SP merger, as conditioned on the agreement with BN/Santa Fe, will not only restore competitive balance in the western United States, but it will also enhance competition. The UP/SP merger will create single line service along the West Coast for the first time. The UP/SP agreement with BN/Santa Fe will add competition to that new single line service. POT and the entire Pacific Northwest will receive the direct and immediate benefits of those and many other improvements to be produced by the UP/SP merger.

7. For all the reasons set forth above, POT requests that this Board approve the UP/SP merger and the BN/Santa Fe agreement.

Respectfully submitted,

Donald G. Meyer

Donald G. Meyer
Deputy Executive Director
Port of Tacoma
PO Box 1837
Tacoma WA 98401
206-383-9410

Dated this 3rd day of June, 1996.

CERTIFICATE OF SERVICE

I certify that on this June 3rd, 1996, copies of the Petition of the Port of Tacoma to Intervene, for Leave to File Brief and to Become Party of Record and the Brief of the Port of Tacoma, were served on all parties of record by first class mail, postage prepaid.

Donald G. Meyer

Donald G. Meyer
Deputy Executive Director
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PO Box 1837
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206-383-9410

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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

-- CONTROL AND MERGER --

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

BRIEF OF THE CHEMICAL MANUFACTURERS ASSOCIATION

The Chemical Manufacturers Association ("CMA") is a nonprofit trade association whose member companies account for approximately 90% of the productive capacity for basic industrial chemicals in the United States. CMA's members depend heavily on rail transportation of bulk chemicals, which typically move in tank cars and covered hopper cars owned or leased by the companies.

On March 29, 1996, CMA filed Comments (CMA-7) opposing the proposed merger because it appeared the trackage rights agreement negotiated by Applicants (UP/SP) with the Burlington Northern/Santa Fe ("BNSF Agreement") would not effectively address anti-competitive concerns that would otherwise arise following the merger. CMA raised the possibility, however, that its position regarding the merger could change if the BNSF Agreement were modified to extend its coverage and increase BNSF's ability and incentives to enter the relevant markets and compete for traffic. Attachment 1 to CMA's Comments set out a list of eight points which, if met, could result in a change in CMA's opposition to the merger. These points had been developed and approved by CMA in early March 1996, following several months of deliberations and analysis of the Application and information subsequently developed through discovery.

In April 1996, following several weeks of negotiations, CMA and the Applicants arrived at a proposed settlement that satisfactorialy addressed the eight points set out in CMA's Comments. The settlement was signed by CMA, the Applicants, and BNSF on April 18 and its full text was filed by Applicants in this proceeding on April 19, 1996 (UP/SP-219).

The following summarizes and briefly explains the intent of the terms of the settlement entered by CMA (hereafter, the "CMA Settlement"). As CMA, the Applicants and BNSF noted in the CMA Settlement: "A number of CMA member companies have taken positions in support of or in opposition to the UP/SP merger. This settlement is without prejudice to the right of any CMA member company that is a party to the Control Case to continue to take any position and seek any relief in that docket."

SUMMARY OF TERMS OF CMA SETTLEMENT

- Grants BNSF trackage rights to St. Louis (overhead rights from Bald Knob and Fair Oaks to Valley Junction for traffic to/from points south of Fair Oaks and Brinkley) in addition to other trackage rights in the BNSF Agreement as amended. *This will expedite BNSF's movements to interchanges in the St. Louis area and make BNSF's costs more competitive.*

- Grants BNSF the right to serve new industries that locate on any SP-owned lines over which BNSF receives trackage rights. *This will, over time, open additional traffic to BNSF and increase its traffic density.*

- Provides that UP/SP will release at least 50% of any business subject to contracts at "2-to-1" points in Texas and Louisiana. *This will enable BNSF to compete for this business earlier than it otherwise would be able to.*

- Establishes reciprocal switch charge of no more than $130 at "2-to-1" points, and reduces switch charges at other points that are above $150 to $150, with escalation at 50% of RCAF(U). *These reciprocal switching charges will facilitate access to BNSF for line haul service.*

- Allows BNSF to have equal access to Dayton Yard for storage-in-transit (SIT). UP/SP will work with BNSF to locate additional SIT facilities on the trackage rights lines. *These provisions will help to overcome what might otherwise be SIT capacity limitations for BNSF.*

- Places 100% of the trackage rights fees in a segregated fund to be used exclusively for maintenance, improvements and depreciation on the trackage rights lines, with one fund for the South Central region and one fund for the Central Corridor/California. *This ensures that trackage rights fees are used for the trackage rights lines rather than subsidizing other lines.*

- Changes trackage rights fee escalator from 70% of RCAF(U) to year-to-year changes in UP/SP actual system average cost for the maintenance and operating cost elements covered by the fee. CMA will have the right to audit. *This will correct the tendency of the fee to rise above actual costs over time because of the use of an escalator that did not incorporate productivity gains.*

- Grants BNSF the right to handle traffic to and from certain points in the Lake Charles area to, from or via New Orleans and to and from Mexico via Eagle Pass, Laredo or Brownsville, and "3-to-2" traffic at Texarkana and Shreveport to and from the Memphis BEA. *This corrects situations at certain points where the second remaining carrier after the merger could not offer a competitive routing to and from certain points.*

- Adopts a dispatching protocol which includes provision for on-site BNSF manager, at UP/SP expense, to monitor dispatching of BNSF trains. *This will ensure that BNSF will enjoy equal dispatch of its trains.*

- Affords BNSF the right to run any or all of its traffic, at its option, in either direction on lines operated directionally by Applicants. *This addresses the concern of many parties that BNSF would have difficulty running trains against the flow of traffic, particularly between Houston and Memphis.*

- Confirms BNSF access and interchange rights at Corpus Christi and Brownsville at least as favorable as SP has currently. BNSF will have direct access to the Port of Brownsville, BRGI and FNM, and BNSF will have the right to purchase a yard at Brownsville for trackage rights operations. *This will help to ensure BNSF competitiveness on traffic to and from Mexico.*

- Provides that BNSF will have access rights at "2-to-1" points, regardless of whether traffic has moved from the points as in the past. Switching limits of 2-to-1 points are to be defined reasonably. *These provisions clarify the scope of BNSF access to traffic at 2-to-1 points.*

- Establishes a right on the part of CMA members to arbitration regarding build ins/build-outs, and if successful to obtain access to BNSF service, until one year after expiration of the member's longest contract in effect at the time of the merger. *This allows CMA members to seek a build-in by or build-out to the BNSF, under standards previously applied by the ICC (or as applied by the Surface Transportation Board in this proceeding, if more favorable) if for some reason they are not satisfied with the service of the Applicants following the merger.*

- States that Applicants are agreeable to annual Board oversight proceedings for five years, with the Board to examine whether the BNSF Agreement has effectively addressed the competitive issues it was intended to address. The Board is to have authority to impose additional remedial conditions. *Annual oversight proceedings will further ensure that BNSF actually enters the markets open to it and competes vigorously.*

In consideration for the settlement, CMA agreed to withdraw its opposition to the merger. Analysis of the above points shows that several -- including the new trackage rights to St. Louis, the reciprocal switching fees, and the release of contract traffic, and the provisions for arbitration concerning build-in/build-outs -- actually go beyond the eight points set out by CMA in its March 29 Comments. In addition, as noted, the CMA Settlement explicitly recognizes that many CMA members have participated in and taken positions in the this docket on the merger (both for and against) independently of CMA. The CMA Settlement expressly states that it is without prejudice to the right of individual CMA members to take and position or seek and remedies in this proceeding.

CONCLUSION AND PRAYER FOR RELIEF

In accordance with the CMA Settlement, CMA hereby withdraws the opposition to the merger stated in its Comments filed March 29, 1996. This withdrawal is conditioned upon and in express reliance upon (1) the Board's adoption of the CMA Settlement, and of the BNSF Agreement as amended, (2) BNSF's assurances that it will enter the markets open to it under the BNSF Agreement, as amended, and in particular compete vigorously for the traffic of CMA members and (3) the Board's agreement to institute annual oversight proceedings to examine the effects of the merger on competition and in particular whether BNSF indeed competes vigorously for the traffic open to it.

Respectfully submitted,

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Inside counsel for Chemical
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Dated: June 3, 1996

CERTIFICATE OF SERVICE

I hereby certify that copies of the Brief of the Chemical Manufacturers Association have been served this 3rd day of June, 1996, by hand and overnight courier to counsel for Applicants and for the BNSF and by first-class mail, postage prepaid on all parties of record in Finance Docket No. 32760.

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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

BRIEF
AND REQUEST FOR CONDITIONS
OF
YOLO SHORTLINE RAILROAD COMPANY

ENTERED
Office of the Secretary
JUN - 4 1996
5 Part of
Public Record

David Magaw
President and General Manager
Yolo Shortline Railroad Company
1965 East Main Street
Woodland, CA 95776

May 31, 1996

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

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

BRIEF
AND REQUEST FOR CONDITIONS
OF
YOLO SHORTLINE RAILROAD COMPANY

INTRODUCTION

While we believe that the UP/SP[1] merger will be in our Company's and our customers' best interests and endorse the UP/SP application for merger, the efficiency and competition resulting from the UP/SP merger will be increased by clarifying that Burlington Northern/Santa Fe Railroad (BN/SF) shall have direct access to Yolo Shortline Railroad Company[2] (Yolo Shortline). This will also maintain the capability of our customers to continue to have access to two Class I carriers after the merger.

Secondly, Yolo Shortline believes that its operation of the West Sacramento area will greatly increase the efficiency and safety of the switching operations in that area. We can provide the switching and interchange with UP/SP, BN/SF or any other carrier which will gain access into the West Sacramento area more efficiently and at lower cost. Safety will be greatly improved by reducing the number of carriers operating in this area from three or more to one. This condition will otherwise have no impact on any customer in the West Sacramento area or such customer's ability to access any carrier.

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1 Union Pacific Railroad Company and its affiliates are herein referred to as "UP". Southern Pacific Transportation Company and its affiliates are herein referred to as "SP".

2 We also include any other railroad which will gain access to and through the Sacramento area as a result of this merger proceeding. Presently, we are only aware that Union Pacific has an agreement with BN/SF to serve customers in the Sacramento and West Sacramento areas.

ACCESS TO COMPETING RAILROAD CARRIERS

Yolo Shortline's customers do ship with both UP and SF, thereby making them 2 for 1 customers. Yolo Shortline's primary (and largest) customers are located in Woodland, California[3]. Those customers ship both with Yolo Shortline when they choose to ship via UP, and with SP[4] when they choose to have the line haul by SP. The routing, transit times, service and rates make the difference as to which carrier is chosen. These factors are present whenever there is competition among available carriers.

To give specific examples, Yolo Shortline recently (early 1996) recaptured traffic, which was being shipped via SP by our largest customer, as a result of working with UP to offer lower transportation rates. In another example occurring continuously over the last two years, Yolo Shortline has lost traffic from a large customer on our line, because that customer has access to SP, via a very short transload operation and SP could offer shorter transit times and lower transportation rates than UP. The UP/SP merger will foreclose these customers from those options to access a competing Class I carrier unless they are granted a means to access BN/SF. Unless Yolo Shortline is provided access to BN/SF, those customers will lose their current access to a competing carrier operating in the same vicinity and in the same city because UP will assume ownership of the SP lines in Woodland. Obviously, Yolo Shortline would like to offer these customers a competitive line haul rail carrier, as it will increase our ability to offer competitive transportation services.

Yolo Shortline's access to BN/SF will also place us in the same position as other West Sacramento customers of UP which provide carloads to UP, such as Farmer's Rice Cooperative, Lone Star Cement Company, Weyerhaeuser, and Capitol Coors each of which will gain access to BN/SF as a condition of the merger.

The California Public Utilities Commission argues that the North Coast Railroad should be granted access to competing Class I rail carriers. Yolo Shortline, a California short line railroad, should have

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[3] Woodland, CA is effectively served by both UP and SP. Many of the arguments herein are applicable to customers located in the other areas and communities served by the 28 miles of railroad owned by Yolo Shortline.

[4] The SP line into Woodland is currently leased to the California Northern Railroad which interchanges with SP at Davis, CA 10 miles from Woodland.

access to competing Class I carriers for the same reasons as argued by the CPUC for the North Coast Railroad.

UP states in its rebuttal that Yolo Shortline's interchange rights in West Sacramento will not be affected, and then makes the unsubstantiated claim that consequently there is no basis for the condition allowing Yolo Shortline access to a competitive carrier. As we pointed out above, the access is necessary to permit our current customers to have the same access to more than one carrier that they had prior to the merger. The elimination of competitive access to a competing line-haul carrier is the fundamental reason why there is so much customer opposition to the merger. Our customers should have the same rights to maintain their ability to choose competing carriers as any other 2 for 1 customer of UP or SP.

The ancillary benefits that arise from such Yolo Shortline's proposed condition is that competition and its attendant benefits and efficiencies will be increased. Yolo Shortline will be able to continue to offer competitive transportation services which will strengthen our company and increase our ability to attract new business. We have been told by several potential customers that they would locate on our line (and we have may areas which are ripe for commercial and industrial development) if we could access two Class I carriers. However, those potential customers have made it clear that they do not intend to be captive to a single line-haul carrier. UP seems to be concerned that it will lose traffic if Yolo Shortline would have access to a competing carrier, when in fact, UP has the potential to gain new traffic (and in the process make Yolo Shortline a healthier feeder line) if access to competing carriers is provided.

Yolo Shortline's proposed condition will eliminate useless and uneconomic switches and switch charges between UP/SP and any competing carrier. Such a condition will provide us and our customers with better transportation routes and lower transit times to key areas of the United States. Unless Yolo Shortline is allowed to interchange with competing carriers, we and our customers will be subject, at a minimum, to a UP/SP switch to move cars within the West Sacramento yard from the Yolo Shortline interchange track to the BN/SF interchange track, and a corresponding switch fee. As a practical matter, the switch is a useless and wasteful exercise, necessitated only because of contract restrictions. In most cases, either the switch fee will render the transportation uneconomic or the handling time will subject the shipment to the risk of untimely delivery, and the customer will choose an alternate mode of transportation or carrier. We have worked with potential customers (cement, plastic, lumber products and fencing materials as commodities), only to find that UP's switch charge renders the cost of the shipment uneconomic compared to other alternatives. Even if these problems can be overcome in a reasonable manner, customers will refuse to ship because of the concerns about delays and mishandling between the competing Class I carriers. We have had direct experience with such refusals to ship because of such concerns about delay and mishandling resulting from an unnecessary switch, even when we could make the shipping cost competitive.

SINGLE SWITCH CARRIER IN WEST SACRAMENTO

One area in particular which Yolo Shortline is seeking to gain operation is the entire West Sacramento area where we currently interchange traffic with UP, and we are requesting this as a condition of the merger. Yolo Shortline could clearly provide more economical and efficient rail service to the customers of that switching area while interchanging with the Class I carriers having access to that area at convenient points on their main lines. This will result in faster, safer and more efficient service to the customers in the West Sacramento yard and switching areas, including getting our own traffic to and from the Class I main lines. The delays we and other customers have experienced will be eliminated. Yolo Shortline's proposed condition will eliminate the inefficiency and safety issues which presently exist because of having three or more carriers operating in this small yard and switching area. We have talked with many rail shippers in the West Sacramento area and all would support our operation of the area. Our proposed condition will also reduce the number of local trains entering and leaving the West Sacramento area which utilize the SP main line through Sacramento.

UP argued in its rebuttal that there was no basis for Yolo Shortline's proposed condition requiring UP/SP and BN/SF to negotiate an arrangement under which Yolo Shortline will operate the West Sacramento Area because the merger would not reduce the efficiency of operations in that area. The primary problem in the West Sacramento area is that the efficiency of operations is terrible and safety is a problem in that area. After the merger, this situation will, at best, not change since both UP/SP and BN/SF will serve that area, and Yolo Shortline will continue to operate through and interchange traffic in that area. If other carriers are granted trackage rights in this area similar to BN/SF, then the situation will worsen. Recently an SP train ran over a UP maintainer's hi-rail truck because of the lack of communication between those carriers and the operating crews failure to operate at restricted speed. There have been other derailments, accidents and incidents by the Class I carriers operating in that area. Yolo Shortline has not had any derailments, accidents or incidents while operating in the West Sacramento area..[5]

Yolo Shortline must operate in the West Sacramento area in order to access its lines and to interchange. However, no Class I carrier would need to operate in that area if Yolo Shortline provided the switching and interchanged with those carriers at a convenient point on or near their main lines through Sacramento. UP's own operations managers would strongly favor such an arrangement because it reduces their problems and speeds traffic movements. It is the improvement of the safety factors and efficiency of operations which is desirable and should be mandated. No customer in the West Sacramento area would be adversely affected, nor would any customer lose access to its Class I carrier connections. The customer would realize the savings from improved service and reliability, and lower costs.

CONCLUSION

Yolo Shortline's Woodland customers are in fact 2 for 1 customers as they have access to both SP and UP in Woodland. Access to the SP is currently being made by two major customers of the Yolo Shortline and has been made by our other customers. The UP/SP merger will result in those customers losing access to a competitive Class I carrier unless Yolo Shortline is provided access to competing Class I carriers.

The efficiency and competition for railroad transportation services resulting from the UP/SP merger would be enhanced by providing BN/SF access to our railroad. It would allow Yolo Shortline to attract new customers and remain a viable short line railroad carrier. Both Yolo Shortline and its customers will have greater transportation opportunities and efficiencies by giving them the opportunity to access a competitive carrier. It will also avoid a perpetuation of the inefficient and uneconomic switches and switch charges which create market restrictions and uncompetitive transportation rates for Yolo Shortline and its customers. Lastly it will place Yolo

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[5] In fact we have had no accidents or incidents involving train operations on any of the track we operate on in the last three years. We have never had any significant accidents or incidents involving train operations. Yolo Shortline has an excellent safety record.

Shortline and its customers in a position similar to that of customers served at the same interchange (West Sacramento, CA) and with other short line railroads in Northern and Central California (as supported by the California Public Utilities Commission) which will have interchange rights with both UP/SP and BN/SF.

The safety and efficiency of the switching and service to customers in the West Sacramento area will be greatly improved by Yolo Shortline providing a single carrier switching, with access to competing carriers.

Neither UP nor any other party have provided any evidence to contradict the above, and these facts cannot be truthfully contradicted.

While Yolo Shortline supports UP/SP's application and the proposed merger, for the reasons set forth above, we respectfully request that the Surface Transportation Board include the following conditions when approving the merger application:

1. Yolo Shortline shall have the right to interchange with UP, BN/SF and any other railroad having access to customers in the West Sacramento area in order provide Yolo Shortline and its customers competitive access to alternative rail carriers and rates.
2. Yolo Shortline, UP/SP and BN/SF (and other carriers which may have access to West Sacramento area as a result of this merger) shall enter into good faith negotiations to provide for one carrier (Yolo Shortline) to operate the West Sacramento area to create a safer, more efficient and economical means of serving the customers of that area.

Dated: May 31, 1996

Respectfully submitted,

by: David Magaw

DAVID MAGAW
President and General Manager
Yolo Shortline Railroad Company
1965 East Main Street
Woodland, CA 95776

VERIFICATION

I, David Magaw, declare under penalty of perjury that the foregoing is true and correct. Further I certify that I am qualified and authorized to file this verified statement.
Executed on March 22, 1996.

David Magaw
David Magaw

CERTIFICATE OF SERVICE

I hereby certify that I have this day served copies of the foregoing document, BRIEF AND REQUEST FOR CONDITIONS OF YOLO SHORTLINE RAILROAD COMPANY, upon all parties of record in Finance Docket No. 32760, by mailing by first class, postage prepaid, a copy thereof properly addressed to each such party.

Dated at Woodland, CA, this 31st day of May, 1996.

David Magaw
David Magaw