INTERSTATE COMMERCE COMMISSION 07/01/96
FINANCE DOCKET # 32760 61-120 2+

Now, you know, if you were to order to us to divest five miles somewhere, we'd have a fiduciary duty to our shareholders to think about whether we go forward with the transaction. And I'm sure we would go forward.

COMMISSIONER OWEN: Along that line, it's also been stated that Conrail might be the last one to dispose of their property too or divest too.

If that were the case and they did equal service on those other lines, then would it not be your responsibility fiduciary-wise to your stockholders to sell to Conrail if that were the case, if you ever got to that point?

MR. ROACH: Well, it's a complicated question in this sense: nobody has explained what the process for divestiture would be. Part of the fault there lies with Conrail and KCS because they consciously chose not to file an application for this.

Instead they want to delay the case, so they said let's have a second round of proceedings.

If you followed tradition and left it to the Applicants to select the party to whom they would sell, within their business judgement, with the Board retaining authority to review that and decide whether it passed muster, then UP would have to look -- assuming we went down this road at all, we might conclude immediately that it just doesn't -- the numbers don't add up.

We would have to look at the economic value of various alternatives. And part of that is how much someone offers you. And part of it is how much traffic he is going to take away if he buys the line.

Now again, I don't think anybody has said any railroad would be ruled out. And if they did, you know, we have problems of understanding between executives and reporters all the time and nuance.

But Conrail would cost UP/SP a lot more than some other players simply because Conrail exclusively serves the entire chemical industry in the northeast.

And if they come down to Houston and serve all the UP and SP points down there, you know, our projections would indicate they're going to take very,

very large shares of that business.

Now, I come back to my basic question which is why in heaven's name would you do this as a competitive remedy?

These are shippers that are not losing competition. All the shippers that have competition will have it preserved under the BN/Santa Fe settlement. And the very point of these divestiture proposals is for the acquires to get their hands on the shippers that are exclusively served. That's what they want.

But those are the shippers that don't experience any reduction in competition. There's a complete disconnect there. There's no competitive problem. Or to put it in terms of your law, which is important to precedence, it's egregiously over-broad.

It's like, you know, solving a problem with a nuclear warhead instead of a surgical strike. And no one has ever explained the rationale for that. All you hear from the proponents of divestiture is trackage rights aren't good enough. Let's have divestiture.

But they never say, "And boy, will we ever make out like bandits because these shippers who have no say in the matter, are going to end up being served by us instead of served by the railroad that serves them now. And they're going to have worse service, but too bad because they're not able to vote on this matter."

CHAIRPERSON MORGAN: Now, let me stop you right there. In terms of trackage rights, now one of the concerns that the opponents have raised is that the trackage rights agreement really represents collusion between UP and BN/Santa Fe. Can you just respond to that?

MR. ROACH: Yes. Let me comment on the trackage rights agreement and also a little bit on collusion.

I heard the Senator say earlier this morning that it's a terrible thing to let UP choose the party to whom it's going to grant rights.

Well, UP didn't want to grant rights to BN/Santa Fe as a commercial matter. That's the last thing UP would have wanted as a commercial matter.

BN/Santa Fe has a comprehensive western rail network that exceeds that of any other railroad. And if we had granted trackage rights to KCS, the potential traffic diversion would have a been a fraction of what it would have been with BN/Santa Fe.

Why did we do it? We didn't do it because of some sweetheart deal or collusion. We did it because our shippers all told us that no one else could fit the bill. There just wasn't anyone else that could fit the bill.

Mr. Davidson talked to Exxon and the major chemical shippers as we were in the process of negotiating to determine -- to find someone who would take these trackage rights.

And he was uniformly told, "I don't want a KCS. I don't want an IC. I want a railroad that can get me where SP and UP can get me, or preferably even more places." Which is exactly what BN/Santa Fe does.

I mean, the magic of this solution is that you're talking here about shippers that are only served by UP and SP today. So, what they have today is a choice of access to UP points and SP points and all the major gateways.

With the merger and the settlement, they are better off because first of all, they've got UP and SP merged and with greater efficiency, an operating ratio that will drop five points, savings of $580 million a year in costs, much more efficient operations with the directional running, et cetera, et cetera.

And they've got service by BN/Santa Fe, which gives them single-line access to Minot, North Dakota and all kinds of places that they can't get to now.

It's a boon for these shippers. It's a tremendous improvement in competition.

CHAIRPERSON MORGAN: The concern that they have raised is that because trackage rights is a little bit different relationship from an ownership situation, that somehow the landlord, which is in this case UP/SP, has more power over operations, over traffic, and over a whole lot of other things as it relates to real competition. Could you respond to that?

MR. ROACH: Yes. We have entered into a comprehensive, written protocol to govern dispatching of BN/Santa Fe trains and of UP trains on BN/Santa Fe lines too.

CHAIRPERSON MORGAN: And that's on the CMA?

MR. ROACH: That is attached to Mr. King's rebuttal statement. And yes, it is referenced in the CMA agreement. The final version of it is attached to Mr. King's rebuttal statement.

Now, there's a history of this. As you undoubtedly know, because it's been brought up by parties to this case, SP some years ago, accused UP of discriminating against its trains.

And UP took tremendous umbrage at that and there was a huge proceeding on the subject in the UP/CN&W merger case, and then off in federal court. There was massive discovery. And in the end, what SP concluded was that there had not been discrimination.

And SP paid the rent that they owed, $60 million, all before this merger was in anybody's mind.

It wasn't -- it had nothing to do with trying to bury an issue.

It was a full-scale inquiry and an enlightened resolution. Now, were there delays to SP trains? Yes, there were delays to SP trains, and that's why it was a hard problem.

But the reason was, as it turned out when the operating people got together and studied specific incidents, studied the overall situation, it was a communications problem more than anything else.

SP has primitive systems. They could not and did not tell UP when a train was going to be arriving or what priority it was supposed to have.

The train crew would end up sitting on a siding and they would think they were being discriminated against.

But the problem was that SP wasn't telling UP, and UP wasn't doing enough to ask. And what we did was we agreed on procedures that would ensure communications.

Now that we have technological advances, we can do a lot of this in real time. WE can have computers on the trains and have a dispatching center tied in directly.

And we took the base of those understandings and built on them with BN/Santa Fe for this case. And we added other features such that the BN/Santa Fe manager will be physically in the Harriman Dispatching Center in Omaha to see how the BN/Santa Fe trains are dispatched.

He's not going to see any commercially sensitive information or rates or anything like that. But he's going to see his train arrive. He's going to know it's priority and he's going to be able to confirm that it's appropriately dispatched.

There are sanctions in the agreement. There's reporting. There's monitoring, et cetera.

Now, the last thing I'll say because it's something that any rail operating person would say, so I had better say it, is that UP, SP and BN/Santa Fe are not going to wrongfully hammer each other's trains because they're dependent on the other just ask much as the other is dependent on them.

And that isn't to say to there's going to be collusion or anything bad. But it does say that -- you know, somebody said these rights are unprecedented. They're not unprecedented at all.

All the railroads in the west and the east have thousands of miles of trackage rights over each other. Individual segments are as long or longer than the segments at issue in this case.

Now, SP has rights from Pueblo to Chicago, 1,000 miles; from Pueblo to St. Louis, 900 miles; from Pueblo to Fort Worth, 700 miles. The longest segment that DOT wants to have divested is Houston to Memphis, which is 600 miles.

There's nothing unusual about these trackage rights. There's no reason they can't work. All those other rights work very well. SP moves billions of ton miles of traffic over those long segments very competitively.

And to get back to my point, all the railroads depend on each other for trackage rights and for dispatching. And they would be insane to set out to disadvantage their tenant and they don't do it.

They have communication problems, and

we've done unprecedented work to overcome those in this dispatching protocol.

CHAIRPERSON MORGAN: Now, one of the things that the Justice Department has suggested is some sort of penalty provision that would, in effect, monitor both UP's relationship with BN/Santa Fe and BN's commitment to serving the shippers along that trackage rights line.

Do you have any thoughts on the penalties provision? Is that something that you've seen in other trackage rights arrangements?

MR. ROACH: Well, as I say, there is a provision for sanctions in the dispatching protocol. I don't know what Justice has in mind for a penalty.

We don't have any problem with meaningful penalties for bad behavior. And that's something we could look at if anybody had a proposal on the table, which they don't.

COMMISSIONER OWEN: I think that would be up to the individual that's harmed to bring it to our attention if that were the case. I'd like to ask about when you were talking about directional traffic there a little bit earlier.

The short lines and the regional have some concern about the merger as contemplated. And so you have directional traffic and local traffic that may have to go in opposite directions. They're very much concerned that they're going to be penalized or hampered or delayed by the hours there.

And I know it's going to take quite a bit of coordination on your part, but what provisions have you implemented for that?

And the second part of that, since I'm not jumping into this that much is I'd like to have you follow up that SP has a poor reputation with reference to Amtrak and how we address that issue and move forward on that also.

So, if we could take the first one first --

MR. ROACH: Sure.

COMMISSIONER OWEN: -- short line, regional, the opposing direction and service to them?

MR. ROACH: Well first of all, I have to wave the flag and say we've got 100 short-lines supporting this case and none, to my knowledge, opposing it.

But I know the concerns you're talking about, and that includes the short-lines in Arkansas and the local two-to-one shippers in Pine Bluff and Camden and so forth.

We have looked very, very carefully at that. Let me say that Union Pacific has more experience than any railroading directional operations of lines.

We run with SP directionally all across Nevada. And we run directionally in Kansas a line that we acquired of the KD, that we thought we were going to abandon, but we needed capacity. And now, those lines are run directionally as well.

There are lines in the upper midwest of the CN&W that we succeeded to that we operate directionally.

In every case, local shippers on those lines receive excellent service. They're not taken out of route. They're not screwed up because they want to go south and they're on a northbound line.

Well, how can that be? Well, it can be just as today, if you have a line that's operated in both directions, you get a local out there and you run it and it makes it from A to B in a reasonable period of time because that's the dispatcher's job.

Beyond that, we have arranged very carefully in the operating plan implementation process to move that traffic as competitively as it is moved today.

It was handed out this morning, so I saw it. My friend at International Paper has a map he's going to show you that purports to show that his traffic has got to go all the way down to Houston and back up and around and that's just hogwash.

We're going to move that car from Pine Bluff over to Little Rock, which is a short distance, and then straight up to St. Louis -- to Memphis and St. Louis.

And that's what you do with local trains is you grab the car, you take it to the nearest efficient classification point, and you classify it, and off you go.

And in lines operated directionally or non-directionally, there's a little -- there is some out of routeness in the very fact of local trains.

I mean, every car of every shipper doesn't go straight to the destination. That's the whole business of switching is that it has to be taken to a yard, switched and moved out.

But we're not going to circuity to these local shippers, and they're not going to suffer inferior service from being on these directional lines.

They're going to have better service because the whole point of the direcitonality is to increase capacity and reduce train meets, which means you can get the local train out there to the local shipper and back much more effectively than you could if it were run as a single-track railroad with trains moving in both directions.

VICE CHAIRPERSON SIMMONS: So, you're telling me that most of the shippers --

MR. ROACH: I owe him an Amtrack answer, but you go ahead.

VICE CHAIRPERSON SIMMONS: You're telling me that most of the shippers are in favor of this proposed merger?

MR. ROACH: Yes, 1,300 shippers have submitted statements. A lot of those are from large organizations of shippers like the Institute for Scrap Recyclers. I know the NIT League is against us.

VICE CHAIRPERSON SIMMONS: Well, that's what I was getting ready to ask.

MR. ROACH: I know they say they've got 1,300 members or 1,400 members. But hundreds of those members have submitted statements in support of the merger.

And what happens is they get 40 people together who are upset about the merger. They call an open meeting. The people who show up are the ones who are upset or who have their own agendas; you know, the Dows that want to build into their plant, et cetera. And they drive the organizational position.

Now, it's interesting. There's a very different situation with the chemical manufacturers. I really want to underscore that. We settled with them.

VICE CHAIRPERSON SIMMONS: Yes.

MR. ROACH: They went through a very thorough process of consulting with all the members and coming up with a list of concerns. And they submitted that in their comments at the end of March.

And we looked at that and we said, "Let's try to meet every one of these concerns. Let's go sit down with CMA and see if we can't find a way to meet every single one of their concerns."

"And if we can do that, well cross your fingers, maybe we can settle with NIT League and plastics."

VICE CHAIRPERSON SIMMONS: Well, you've said that NIT League might have cherry-picked their members. Is that what you're saying?

MR. ROACH: Well, I think a little bit. And I think the other thing with the NIT League is, which is what I'm trying to say here --

VICE CHAIRPERSON SIMMONS: I mean, he's going to have a chance to talk about it.

MR. ROACH: Yes. I'm sure he'll see it

very differently. But the point I'm trying to drive at is this: we couldn't settle with all these people at the same time.

And you see, once we've settled with CMA and met all their concerns --

VICE CHAIRPERSON SIMMONS: Right.

MR. ROACH: -- if you're the lawyer for the NIT League do you say to them, you know, "Tell the Applicants that's wonderful and drop out of the case," or do you say, "Well, now get your pound of flesh?"

And that's the problem we had. We couldn't put everybody together and make it all contingent on everything else. It just wasn't feasible.

But I'll say to you that we went -- you know, there's a history in rail mergers of reasonable and unreasonable. And I've been here a long time and you've been here a long time and I think unreasonable was SF/SP.

VICE CHAIRPERSON SIMMONS: UP/MOPAC was my personal --

MR. ROACH: You know SF/SP said, "We don't see any problem. Rail competition doesn't matter. Trucks are great. Let's just wipe out rail competition in the southern corridor and please approve our merger, and we don't want to settle with anyone." And they got what they deserved.

Our view is 180 degrees different than that. As I said a while ago, rail competition is vital. It is the heart of this transaction. We're increasing it, not decreasing it.

And what we anted to do with CMA, even where we felt rationally we had a proposal that provided fully effective competition already, we wanted to add features to that to meet their concerns if they didn't, you know, trash the benefits of this transaction or introduce, you know, bias of some kind or -- or whatever.

And we did that. We got a list of 20 provisions that we agreed to with CMA. We extended the trackage rights up to St. Louis. We let BN/Santa Fe run with the flow on the directional lines.

We set up a fund for the trackage rights fees so they would be spent exclusively on improving and maintaining the lines.

We had the dispatching protocol. We expanded the coverage. We let BN/Santa Fe serve new industries that were cited on the SP-owned trackage rights segments and on and on and on.

And you know, rationally, at the beginning of the case, we didn't think all of that was necessary. It wasn't, as Conrail keeps saying, some great confession that we had an anti-competitive transaction.

It was an effort to bend over backwards to meet all the concerns we could possibly meet.

But you know, there's bending over backwards and there's falling over backwards. And we can't agree to divestiture. And we can't agree to putting a second railroad in to serve a lot of exclusively-served shippers that aren't affected competitively except positively by this transaction one bit.

And that's really the agenda of SPI and NIT League. So, there we are.

VICE CHAIRPERSON SIMMONS: Okay.

MR. ROACH: Amtrak: yes, SP has service problems with Amtrak. They have one of the poorest on-time records with Amtrak of any railroad. That is a reflection of the broader problems that this merger is about solving.

SP's service reliability is very poor. That's why SP has lost service-sensitive traffic year after year after year.

It's why they once had the lion's share of the California perishables market, and now they have almost nothing.

It's why they once carried service-sensitive inter-modal traffic and now they can't even bid on it. They can't --

CHAIRPERSON MORGAN: Why is that?

MR. ROACH: Because they can't get their trains from point A to point B reliably on schedule. And why is that? That's because their southern corridor route, their sunset route from Los Angeles to El Paso is terribly congested.

It's a single-track railroad. It needs to be a double-track railroad. They don't have the money to add a second track.

The same is true from El Paso up to Kansas City on the so-called Tucumcari Line. They don't even have CTC out there.

COMMISSIONER OWEN: So, you say it's actually money instead of bad management, right?

MR. ROACH: Yes. I think that you can't blame management when you've had several rounds of highly successful managers, including Jerry Davis, who I know and who did a wonderful job at UP and at CSX.

It's money. It's facilities and it's the traffic base. What you have is a railroad that has a network that can't support -- can't be supported by the necessary traffic base, and it can't get rid of parts of that network.

That's the problem. It needs to go across the central corridor. It needs to go across the southern. But it can't get the traffic volumes on either of those routes to support improvements.

CHAIRPERSON MORGAN: Then why in the record do you have shippers who are now served by SP putting forth a case indicating that SP is a viable competitor in certain markets. How do you reconcile what you've said with that evidence?

MR. ROACH: Yes, well I don't think there ware a lot of shippers that have said "I like SP's service." And I don't think there are a lot of shippers that have even said, "I think SP is going to make it."

But there are shippers who have said, "SP provides me an alternative, and I want that alternative preserved." And we've dealt with that. We've dealt with that.

Every shipper that goes from two-to-one is going to have a better alternative. And the shippers that go from three-to-two, of whom there are not very many compared to the total rail traffic in the western United States, but there's a block, significant block of shippers that go from three-to-two, are going to have stronger, not weaker, competition as a result of this merger.

They're going to go -- it's not like you have three widget plants and you go and blow one of them up and so that's a loss of a competition.

They're going to go from having a huge, dominant BN/Santa Fe that carries 50 percent of the three-to-two traffic, and a strong, but not as effective UP that can't match BN/Santa Fe in many ways.

BN/Santa Fe has a $1.9 billion capital budget this year. UP can't come close to that. They're going to save a billion dollars a year in costs from their merger. You know, we can't keep up with that operating ratio without this merger.

But you're going to have a UP today and then you have SP, which is a weak third, provides an alternative to some shippers that they want to preserve.

But when you put UP and SP together and you add all those new single-line routes, this much lower cost structure, the improved service, the shorter routes -- I haven't even had a chance to talk to you about shorter routes this morning.

There are fantastic route reduction benefits of this merger that you cannot achieve any other way.

In the central corridor, we're going to save 200 miles, which is phenomenal in transcontinental traffic, very important in terms of providing a meaningful alternative to Santa Fe inter-modal service, which just dominates the field.

All the inter-modal shippers -- there's my colleague showing you the Oakland/Chicago map. You see, we take the UP piece from Chicago to Utah and the SP piece from Utah to California.

If you put those two together, you get a through route that's almost 200 miles shorter.

All the inter-modal shippers, every one of them, supports this merger. And what do they say? They say yes, it's going from three to two. But from our perspective, it's almost more like going from one to two because only Santa Fe has the schedules and the reliability in the transcontinental inter-modal markets that a lot of these shippers need.

Mr. Brown of the Risk Company, who is a broker that puts inter-modal business with railroads for lots of major shippers, says he doesn't even call on SP because he knows they just can't deliver for his service-sensitive customers: the truck-load shippers, the yellow freights and the consolidated freightways.

They want to get their trailer across the country in the fastest way possible.

CHAIRPERSON MORGAN: Now if we were not to approve this merger, what do you think would happen to SP?

MR. ROACH: I think if you did not approve this merger, the record is very clear what will happen to SP. Mr. Davis and Mr. Grey have put in a lot of time thinking about that and submitted rebuttal testimony.

And they said that the best course is not to carve up the company or go bankrupt. The best course is to try to down-size to profitability. They would have to retreat from a lot of markets, and they listed those in their testimony, parts of the central corridor, important markets in Texas, lots of inter-modal markets.

They would have to shrink their equipment fleet. They would have to increase rates where they can increase them because they have shippers that don't have rail competition.

And you see, the strategy SP has been trying to follow, which really has not worked, is to grow their way to prosperity, not to maximize rates in the short-term with these non-competitive shippers, but to grow their way to prosperity.

And that may have made some sense before the BN/Santa Fe merger, although even then, you know, there was great hope in '94 when Jerry Davis -- well, first Ed Moyers and then Jerry Davis came to the company -- great hope they could cut the operating ratio sharply. But it didn't work. It didn't happen, and it didn't work.

And so, the best outcome is they downsize their way to profitability and they become a marginal competitor in the west.

The worst outcome is they get carved up or they go bankrupt.

And we've got our friends here just salivating at that prospect. KCS's experts said, "As Julius Caesar said, 'Divide and conquer'." That was their closing remark in their verified statement.

I think that's a remarkable statement for a supposedly responsible transportation expert to make.

CHAIRPERSON MORGAN: But some would say that we've been hearing this about SP now for some time, about their dire financial situation. What makes us now say this is for real?

MR. ROACH: Well look, we didn't come into this case saying that SP was about to go bankrupt. I mean, SF/SP people did that and it was -- it was fantasy, tao was hyperbole. It was irresponsible advocacy.

This isn't a failing company case. I'm not making that argument. We haven't made that argument.

But the point is though that SP is a weak third and is inevitably doomed to become weaker and weaker as a third in the west.

And you have to take account of that in your competitive analysis. That's the point. As you said in the <u>Gilford</u> case and in the <u>Norfolk Southern</u> case, going from three to two can be pro-competitive if the character of the competition is improved.

Now, when you've got a railroad that is essentially very weak and marginal and going to get moreso in markets, that is vital to your competitive assessment.

We're not saying it's a failing company. We're not saying forget about concentration ratios. We put all the concentration ratios on the record. There isn't a single three to two city or corridor where we are combining the top two.

The situation out there is BN/Santa Fe has half the market. UP has about 30 percent -- I'm talking three-to-two traffic, which is a small subset of the traffic in the west.

But for the three-to-two traffic, UP has about 30 percent and SP has about 20 percent and dropping. And most of it is inter-modal where all the shippers support this transaction.

And the next big chunk of it is automotive where again there is solid, solid support: General Motors, Nissan, Toyota, BMW, Mazda. I can't even remember them all, Mitsubishi.

All the major importers of cars support this transaction. They're all going from three to two.

And they say that. They're not missing the point. They put in verified statements and they say, "We support going to two because it's going to be stronger and better competition than having three."

VICE CHAIRPERSON SIMMONS: What about Chrysler.

MR. ROACH: Chrysler has filed a statement saying they would like to have some kind of an arrangement, maybe a divestiture, to get another railroad to Mexico.

And we respectfully disagree with that. Now, Chrysler has most of its plants exclusive to Conrail. And so maybe they benefit from having Conrail go straight to Brownsville and to the TexMex at Corpus Christi.

But that's a special situation. Most of the manufacturers want network reach throughout the west.

The thing about cars is they go

everywhere. They're consumed everywhere and they go everywhere. And the GMs and the Fords and so forth want to get them as efficiently as possible to as many destinations as possible.

And we preserve all that competition. Every two-to-one point, BN/Santa Fe can create an auto ramp. That's one of the features of the settlement agreement.

I'm going to get up against my rebuttal time if I don't save some of it. But let me comment if I could, and if would be agreeable to, about Mexico because that's what I started rambling on about was Mexico and it's an important issue in this case.

We're going to increase competition for Mexican traffic. You've heard one of the Congressman express concern about NAFTA.

There are three big rail gateways in eastern Mexico, one much bigger than the others and that's Laredo.

Today, you've got UP and SP. You've got UP and SP serving Brownsville. You've got UP serving Laredo and SP servicing it through the interchange with the TexMex at Corpus Christi, which takes it on to Laredo.

And then at Eagle Pass, you've got SP and BN/Santa Fe recently got a haulage to go to Eagle Pass. Now, what are we going to do under the settlement?

We are going to increase competition at every one of those three gateways.

BN/Santa Fe will have the right to serve Brownsville directly, and so Brownsville will go from having UP and SP to having the whole UP/SP network and the whole BN/Santa Fe network, just like those two-to-one shippers I was talking about earlier. It's a clear net benefit for Brownsville.

Laredo, the shippers that use UP now at Laredo will now have single-line access through the SP as well, directly. They don't have to go through the TexMex to get to the SP points. They can go direct.

The shippers that use the TexMex will have a connection to the BN/Santa Fe in place of SP, which is a tremendous improvement for the TexMex. Now, they say otherwise, and I'll tell you why they say otherwise. But first, let me explain why it is an improvement.

Because they can go anywhere on the BN/Santa Fe network. And SP doesn't get to most of those places. Much, much wider access to grain, which is a very key commodity for Mexico.

SP handles almost no grain. And with a direct connection to the BN/Santa Fe, the TexMex can bring in all that grain directly to Laredo.

Now, why do they say there's a problem? Well, I suggest to you they would say it's a problem because they are 49 percent owned by the KCS.

And the KCS would dearly love to have a direct route to Mexico. And so you have the TexMex here saying give us trackage rights from Corpus Christi up to Houston and on to Beaumont so we can hook up to the KCS.

Now, does that give shippers a better alternative than connecting directly to the BN/Santa Fe? Not on your lief. The KCS hardly goes anywhere. It goes to Kansas City. But they're proposing something that's in the interest of their owner.

And I think it's really as simple as that. We've got hundreds of Mexican shippers that support this transaction.

The Mexican Competition Agency has been saying publicly they don't have a problem, thanks to the BN/Santa Fe serving these gateways.

We're going to have better service for Mexican shippers, very much better. Equipment gets lost in Mexico. UP has made tremendous strides in dealing with equipment and customs clearance. And those will be extended to all the SP points.

We are going to have single-line service from Laredo to California, which does not exist today, and which is a tremendous boon to NAFTA.

You talk about NAFTA, the real boon is bringing in international traffic and zipping it right over to Laredo. And we can do that with this merger.

Today, SP struggles to take it to San Antonio, put it on trucks, drag it down to the border where it gets lost for a long time.

We're going to take it straight there on a through train. And the shippers love it. The inter-modal shippers love it and the Mexican shippers love it.

COMMISSIONER OWEN: We continue to come back to the shippers. And shippers are looking for quality of service, but I think they're also looking for rates that will be stabilized.

And so what assurance do they have when we reduce the number of railroads in a certain area that they aren't going to be increase?

MR. ROACH: Well, the assurance you have is that there will be at least two railroads competing everywhere there are multiple railroads competing today with our settlement.

And there's a lot of evidence in this record about what happens to rates between three railroads and two railroads. Lots and lots of evidence.

We looked at all the major commodities that are handled by UP and SP. And we went out and we studied what are the rates where there are two railroads competing and where there are three railroads competing.

And we found that the rates with two railroads are invariably -- it's remarkable. They're invariably either the same as or lower than where there are three railroads.

But it comes right to railroading and the nature of railroading and the importance of efficiencies. Railroads compete vigorously against each other because they have a lot of fixed costs. They have confidential contracts.

They're in no position to collude because the rate and service characteristics of each movement are very, very different. They can't passively collude. They just can't do it.

And so when you look at, for example, inter-modal traffic from Seattle to Chicago where there are two railroads versus from L.A. to Chicago, the biggest inter-modal market in the world where there are three railroads, the rates from Seattle to Chicago are actually lower.

It's remarkable. And you find that across the board. Railroads don't collude.

When there are two railroads there to

compete, they compete their brains out. That's the story of the Powder River Basin. I mean, it's the most phenomenal success story of competition in the -- probably the history of this agency.

You forced a second railroad into the Powder River Basin, your predecessor agency, and the rates tumbled and the volume soared.

And if those railroads had been colluding, that wouldn't have happened. And none of our adversaries can explain that.

So, I submit to you that rates will continue to go down. Competition will be incredibly vigorous because both of these railroads will be much more competitive.

BN/Santa Fe and UP/SP will be almost the same size. They will have similar operating ratios. They will serve every major corridor and point in the west. Shippers will have a field day. They will have better access to more markets than they have today or could achieve any other way by far.

Divestiture hurts them and cuts up the rail system. This merger conditioned by the BN/Santa

Fe settlement, is tremendously beneficial.

I'm way past the red light. I don't even have any rebuttal time.

CHAIRPERSON MORGAN: All right, you will have rebuttal time.

MR. ROACH: I love the fact that I could answer your questions.

CHAIRPERSON MORGAN: We just have a lot of questions.

MR. ROACH: Thank you.

CHAIRPERSON MORGAN: Thank you very much. Next we will hear from the representatives from the Burlington Northern and Santa Fe, Erica Jones. You have 20 minutes.

MR. JONES: Good morning, Madam Chairman, Vice Chairman Simmons and Commissioner Owen. My name is Erika Jones and I represent the Burlington Northern Railroad Company and the Atchison-Topeka and Santa Fe Railway Company.

With me this morning at counsel table are Jeffrey Moreland, Richard Weicher and Sidney Strickland of the Burlington Northern/Santa Fe. Mr.

Weicher will be with us in a moment.

BN/Santa Fe appears today in strong support of the settlement agreements we reached with the Applicants. We urge you to find that the agreements are sufficient to solve the competitive problems that would otherwise arise from an unconditioned merger.

We also urge you to reject the requests of the parties seeking to overturn the settlement agreements or grant rights that duplicate or interfere with the rights granted by the agreements.

These requests are inconsistent with your precedence and unsupported by the evidence in this proceeding.

We also want to assure you that BN/Santa Fe is willing, able and anxious to compete for this traffic to which it will gain access under these agreements.

You have long urged applicants in major control cases to identify the competitive problems for which your precedence demands solution, and to solve these problems through voluntary negotiated agreements, thereby eliminating the need for the imposition of regulatory solutions to such problems.

That's exactly what BN/Santa Fe and the Applicants have done here. And we have done so earlier in a proceeding than ever before. As a result of this early resolution of the competitive problems, you and the parties in this case have had the benefit of an unprecedented amount of detail about the operating plans and marketing intentions of the replacement carrier, here BN/Santa Fe.

These agreements will assure that competitive serve to the two-to-one shippers, the affected shippers, will be preserved.

Those are the shippers for whom your precedence demand protection, and they are assured of the continuation of two-carrier service as a result of these agreements.

Your precedence have been consistent in demanding that these shippers be protected and equally consistent in rejecting conditions that will not fully replace the lost competition or they're not merger-related.

Your consistency in adhering to these principles has provided a valuable incentive to design and implement appropriate voluntary agreements, thereby minimizing the need for federal regulatory control and contributing to fair and expeditious regulatory decisions, both principles of the rail transportation policy.

You will be asked today to depart from your precedence and grant requests for divestiture, layered access for multiple carriers and other conditions that are not justified by the law or the record.

We urge you to reject those unwarranted condition requests as firmly as you have in the past.

Before turning to those condition requests, I want to spend a couple of moments noting that the settlement agreements provide shippers with substantial benefits over and above the preservation of two-carrier service competition.

Mr. Roach has talked about the strengthening of the competition between UP/SP on the one hand and BN Santa Fe on the other. BN Santa Fe shippers are going to benefit from new efficiencies and service improvements such as the opportunities for some attractive reroutes of BN Santa Fe traffic.

New competitive single line service to many areas of the country will be created or expanded. For example, from the Pacific Northwest to the Gulf Coast and Mexico. In the Northern Plains and the Gulf Coast and Mexico, the NAFTA traffic that you heard about earlier.

Grain shippers, Vice Chairman Simmons, will be particularly benefitted by the efficiencies of this improved single line service because it will allow the improvement of cycle time in rain cars, and that will increase their availability.

New single line service, and for the first time single line competition between Los Angeles and Seattle will be created along the so-called I-5 corridor. This is a substantial new benefit that is very important to western shippers. And west coast ports are going to see a tremendous improvement in service such as creating for the first time direct BN Santa Fe railway access to the new joint industrial terminal at the Port of Oakland.

Now the critics of the settlement agreement have complained the trackage rights don't work to permit effective competition. But trackage rights do work. Competition flourishes over trackage rights every day in the railroad industry. For BN Santa Fe, for Union Pacific, for Southern Pacific and for the railroad opponents to this transaction. BN Santa Fe relies on the trackage rights over Southern Pacific through the Tohacha Peak for its highly competitive route from Chicago to Northern California.

Southern Pacific relies on over 900 miles of trackage rights for almost all of its central corridor competition from Pueblo to Chicago. And even the Department of Transportation, while calling for divestiture of other shorter segments, acknowledges that trackage rights in this segment can work with BN Santa Fe as the tenant replacing Southern Pacific.

ConRail relies on extensive trackage rights throughout the East. In fact, our evidence shows that 16 percent of its system operates over trackage rights more than any other major rail carriers. And the best evidence of all is that in the first quarter of 1996, Southern Pacific moved over two billion gross ton miles over trackage rights granted by BN Santa Fe in a settlement agreement that you approved just a year ago.

And in the same time period --

VICE CHAIRPERSON SIMMONS: Pardon me, Ms Jones. Right there, I am aware of the fact that independence of your merger, Southern Pacific got certain agreements out of you.

MS JONES: Yes sir.

VICE CHAIRPERSON SIMMONS: And they made plans immediately and really went aggressively after shippers. There are those that are telling us, and I don't know whether they are for or against you, I guess they are against you. They said that you are not out there right now, even though you have made great plans about what -- if this merger goes through what you propose to do in agreement, but you are not aggressively doing this. Is Burlington Northern is going to really aggressively -- if this merger -- will they be an aggressive competitor?

MS JONES: They absolutely will, Vice Chairman Simmons. And indeed we have sworn testimony in the case from one of the BN Santa Fe executives, that he has already been out meeting with shippers, particularly in the chemical and plastics industries. And he talked extensively about the marketing plans --

VICE CHAIRPERSON SIMMONS: There are those that say you are going to be all right no matter what happens.

MS JONES: Well, there are those who say that, and that's -- they are entitled to their opinion. But we are very, very anxious to meet these new customers and to reroute the traffic over the new lines that will -- our existing traffic is going to be improved as well.

CHAIRPERSON MORGAN: Well even if you have the desire to meet the challenge, many say that you won't have the ability to meet the challenge because you either will not have access to enough traffic or you will have operational difficulties along many of these routes. Would you care to comment on that?

MS JONES: Yes, Chairman Morgan. On both

of those issues we put in substantial evidence showing that we think the densities are sufficient to permit the building of trains that will meet the customers' needs. And we've also shown that the operational problems are not insurmountable, especially as improved by the CMA Agreement. The operating problems are actually quite manageable, and we are confident that we can compete for this traffic and that we can do so with very strong vigorous competition.

CHAIRPERSON MORGAN: Do you think there will be in some areas too much traffic density that will create difficult operational problems?

MS JONES: Well not under the agreements, but there will be a few grant access to third carries. The studies that we have done show that the densities are sufficient and that the operational, the operations will work with the two carriers that we have studied, that is granting BN Santa Fe access to replace the Southern Pacific. We have not studied and cannot tell you whether it would work if you put a third carrier on top.

And we have also put into the record

evidence that we have devoted a full time team of dozens of people from throughout the Company to prepare for these operations. They have been working full time to get ready for this. Far in advance of any settlement agreement trackage rights planning that you have ever seen before. These people are working full time walking the lines, looking at every inch of track to figure out where to put the operations, where the trains are going to run. Exactly what is going to need to be done to start service on day one to the shippers that want it. Again, much sooner than you have been able to see in prior proceedings.

COMMISSIONER OWEN: Do you have an opinion on how we would monitor the collusive behavior that the Justice Department warns us about that might exist between you and the applicant?

MS JONES: Well, first of all our Chief Executive Officer vigorously deny that any collusion has occurred, and that's in the record in this proceeding.

But as to the future, the proof is going to be in the vigorous competition. You are going to be watching this and you are going to see that the shippers are going to have the benefit of two carrier service. Not just service competition, but rate competition. And that's the best evidence of all. Watch what we do and watch what the market does.

The record in this proceeding also documents that BN Santa Fe has wanted better access to Mexico for a long time and has worked very hard to obtain it. BN Santa Fe has asked you to allow it in prior control cases, and they have worked through privately negotiated deals to try to get better access to Mexico.

It is just illogical to suggest that after working so hard and so long to gain this Mexican access, that BN Santa Fe wouldn't pursue it aggressively. It's also illogical to suggest that BN Santa Fe wouldn't compete aggressively for traffic to the Gulf Coast region. Look how many other carriers want that business. It's very attractive business and BN Santa Fe finds it attractive and wants to pursue it.

CHAIRPERSON MORGAN: Let's talk about

Mexico for a second. There is a concern on the part of some shippers that because you have other ways of getting to Mexico, apart from Laredo for example, that somehow Laredo's traffic would not be what it is today or what it should be in order to retain the kind of competitive balance in this area. Do you want to respond to that?

MS JONES: Yes, Chairman Morgan. First I would observe that we will be stepping in the shoes of the Southern Pacific, which also had those same alternatives. They too could route to Eagle Pass or to Brownsville. But because the shippers want the traffic to move over Laredo, Southern Pacific served those needs even though it meant it was an inefficient three carrier move.

BN Santa Fe originates most of that traffic that Southern Pacific then picked up and took down to Laredo. After this, if you are to approve the settlement agreements, it will be a two carrier move. Much more efficient, very attractive to those shippers to keep routing it through Laredo.

You have found Laredo as a preferred

gateway, the market supports that. Over 40 percent of the Mexican-bound traffic went over Laredo and there is no reason to think that that market is going to change. Certainly no reason to think BN Santa Fe is going to leave it to the UP or the SP after this merger.

That's an attractive, strong, lucrative market and BN Santa Fe wants to serve it. They want to serve it with Tex-Mex as its partner.

CHAIRPERSON MORGAN: Now, on the Gulf Coast area one of the concerns that, particularly the plastic shippers have raised, is the storage and transit facilities that would be available to you if the merger were approved and the traffic rights agreement were included as part of that provision. SP I understand has several storage and transit facilities in that area now. You would, I understand, have access to one, specifically, Dayton, I believe.

MS JONES: Yes, but we also have, particularly after the CMA Agreement, and I should say that we believe that this was a part of the original agreement as well, but's its clarified now in the CMA

Agreement, that we will have access to all of the storage and transit facilities that we will need coming out of that region.

CHAIRPERSON MORGAN: How will you implement that particular provision?

MS JONES: Well, we will either sign con -- negotiate individual contracts with the storage and transit operators, or, if necessary, we will purchase the space, negotiate with UP/SP if necessary.

And if there are other investments that are needed in that corridor, we are going to make them. We are committed to making any investments that are needed to make these trackage rights work in a commercially reasonable way.

Some of the critics of the settlement agreements have called for divestiture of these lines. And these requests are not only unjustified, they simply do not meet the legal standards for imposition as a condition to this merger. And their consequences are potentially harmful to competition.

First, forced divestiture is precisely the type of transaction restructuring that you have consistently declined to undertake. And you should decline to so here. Most importantly, divestiture does not assure that two carrier single line service is preserved for all of the affected shippers.

Divestiture in this case is particularly problematic for the affected shippers, that is the two to one shippers, because our evidence shows that the vast majority, 71 percent of their traffic that leaves the Gulf Coast region of Texas, Louisiana and Arkansas, stays on the west side of the Mississippi River. These shippers would lose the benefits of two carrier, single line service for their west bound shipments if divestiture occurred to an eastern or regional carrier.

Divestiture therefore does not meet the legal standards for imposition as a condition because divestiture will not assure the replacement of the lost competition and could introduce some harmful reductions in western single line service options.

Second, forced divestiture breaks up the rail network and fragments the rail system. In this case, you would have to trade the known competitive remedy of the settlement agreement, that is well documented before you, for the unknown consequences of divestiture. There is no record developed to support most of the divestiture proposals because the rail carrier proponents elected not to submit responsive applications to you. So you don't have a record on which to predict that divestiture would in fact result in the preservation of full service competition for the affected shippers.

CHAIRPERSON MORGAN: Now if divestiture were ordered, how would you envision that process to work?

MS JONES: Well, I expect that first of all you would have to make that a preclosing condition so the merger would not go forward until another proceeding in which you would be asked to review the selected carrier. This is assuming, of course, UP/SP elected to accept that condition and then attempted to proceed with that, because they could, of course, walk away from the transaction.

But, if they decided to proceed, they would presumably conduct some kind of marketplace review, select a purchaser, bring it back to you for further review and we would be back before you here some months from now. And it would substantially prolong the conclusion of this proceeding that's before you.

That didn't have to happen because proponents of divestiture could have filed consistent applications and built the record to allow you to make that judgement on Wednesday. They didn't do that. And that is a procedural delay that was unnecessary.

We, on the other hand, have put in a substantial amount of evidence talking about our plans for implementing trackage rights. Trackage rights that you, in the past, have found to be a perfectly satisfactory replacement for competition.

And, finally, a divestiture order would require you to depart from your consistent precedents declining to use merger cases as vehicles for rail system restructuring. These are well reasoned precedents and should be followed here to reject the calls for divestiture.

The Tex-Mex, I'd like to turn to now for a moment, they have provided no legally supportable basis for it's request to trackage rights condition. They have not shown that there will be a loss of competition from two carriers to one. And they have now shown you that there is a serious risk of the loss of essential services.

We talked a few moments ago with Chairman Morgan's question abut the risk that BN Santa Fe would prefer the Eagle Pass or Brownsville gateway and bypass the Tex-Mex connection. That simply won't happen. The market won't permit it. The Laredo gateway is too strongly preferred by shippers and is too attractive a market.

BN Santa Fe wants it and will serve it. And again --

VICE CHAIRPERSON SIMMONS: That's at Eagle Pass?

MS JONES: No, that's at Laredo. That's the connection at Robstown with Tex-Mex for traffic that is destined for Laredo.

VICE CHAIRPERSON SIMMONS: All right.

MS JONES: The Laredo traffic, as I

mentioned earlier, primarily is SP traffic. That is, interchange today with Tex-Mex originates on the BN Santa Fe, most of it. So that will go from a three carrier service to a two carrier move, if you were to approve this.

And Tex-Mex's proposal is not harmless, even though they would have you believe that it is. There is already some congestion on the route they have selected, as we pointed out in our, in the evidence that we have submitted. And it would return to a three carrier inefficient routing, because the traffic would have to originate with someone, interchange with the KCS and then with the Tex-Mex again at Robstown. So you are losing the benefits of the two line service and replacing it again, or at least layering on top of it, a three carrier inefficient routing.

We think you should be especially cautious before you take a two carrier market to a three carrier market. It is a two carrier market today. Union Pacific serves it. And SP, with its Tex-Mex partner serves it. To replace that competition, you should replace it with the two carriers that are before you here, BN Santa Fe to replace the Southern Pacific, willing and able to interchange with Tex-Mex.

We have said that the Robstown connection construction is one of the highest priorities. That's in the testimony of Mr. Clifton that we submitted on April 29. And we expect to follow through on that commitment.

Tex-Mex has also offered you no evidence to support its request for direct access to traffic in Houston, or trackage rights to Beaumont. In fact, given the numerous shipper concerns about Gulf Coast density and operating issues, concerns that we think are perfectly satisfied when there are two carriers there. But if there is a concern, it gets only worse if you layer in three.

So we believe that the Tex-Mex conditions are unjustified by any credible evidence of competitive harm, or risk to essential services, and we believe that they should be rejected.

I'd like to conclude by reaffirming BN Santa Fe's commitment to vigorous competition for the new business to which we would gain access under these agreements. There is no other railroad that so nearly replicates the network and range or origins and destinations that was offered by the SP. And there is no other railroad with the financial strength, operating capabilities and marketing expertise to serve the long western routes as a replacement for SP.

We are anxious to meet this challenge and we urge you to find that the settlement agreements are consistent with your precedents and are necessary and appropriate condition to this proposed merger. Thank you.

CHAIRPERSON MORGAN: Let me ask you about the benefits from your recent merger.

MS JONES: Yes?

CHAIRPERSON MORGAN: Obviously, as part of your submission here, you estimated a certain number of benefits. How have those estimates panned out?

MS JONES: Well, in fact the estimates that we projected to you just a year ago, we anticipated about $560 million in annual benefits. We now think that those benefits may well exceed a billion dollars a year. Although not all of those are directly related to the merger. Some of those come from just learning each other's best practices. That is BN learned that Santa Fe did something a better way. Santa Fe learned that BN did something a better way.

And by picking up the better of the two, the companies have been able to optimize their operations. We are also ahead of our schedule in meeting those benefits, which is to the benefit of the public and to the shippers.

CHAIRPERSON MORGAN: So you would say you underestimated your benefits, actually, or --

MS JONES: No, I would say that we were conservative in projecting to you. I didn't want to have to stand here in the future and tell you that we were wrong. I'd rather tell you that things are better off than we'd even predicted. We were conservative.

And as I mentioned, not all of the increase that we now are enjoying and that the public is enjoying are directly attributed to synergies, but rather to the improvement of operations that comes from picking up each other's better practices.

CHAIRPERSON MORGAN: And then, with respect to divestiture, if the Board were to order some sort of divestiture, what impact would that have on your trackage rights and your interest in trackage rights?

MS JONES: Well, that's a complicated question because we don't know what happens, we don't know the scope of the divestiture order, and we don't know what would be left of the trackage rights agreements.

The Union Pacific has suggested in its brief that the settlement agreements would collapse. We would have to find out if that's the case, and we would have to consider the effect of your order.

It's too speculative to predict.

COMMISSIONER OWEN: Would you have an opinion as to why the Justice Department underestimated your savings and thought that there would be a loss on your merger BN Santa Fe as opposed to currently we have another projection here, and