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September 3, 1999

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Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW
Room 711
Washington, DC 20423-0001

Re: Finance Docket No. 32760 (Sub-No. 21), Union Pacific Corporation, et al.
-- Control and Merger -- Southern Pacific Rail Corporation, et al.

Dear Secretary Williams:

Enclosed for filing in the above-captioned proceeding are the original and twenty-five (25) copies of Reply The Burlington Northern and Santa Fe Railway Company To Comments of California Public Utility Commission (BNSF-8). Also enclosed is a 3.5-inch disk containing the text of the pleading in WordPerfect 6.1 format.

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

Sincerely,

Erika Z. Jones /law

Erika Z. Jones

Enclosures

cc: All Parties of Record

BNSF-8

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

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

REPLY OF THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY TO COMMENTS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION

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September 3, 1999

BNSF-8

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REPLY OF THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY TO COMMENTS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION

Pursuant to Surface Transportation Board Decision No. 13 in this sub-docket, served December 18, 1998, The Burlington Northern and Santa Fe Railway Company ("BNSF") submits the following comments regarding the Board's oversight of the Union Pacific/Southern Pacific ("UP/SP") merger and, in particular, the California Public Utilities Commission's ("CPUC") comments filed on August 13, 1999 ("Comments").

INTRODUCTION AND SUMMARY

In Decision No. 13, the Board instituted this third annual general oversight proceeding in accordance with the oversight condition imposed on the UP/SP merger. The purpose of the oversight proceeding is to determine whether the conditions imposed by the Board have effectively addressed the competitive harms that they were intended to remedy. As in past oversight proceedings, the Board required UP and BNSF to file Annual Reports on July 1, 1999. Interested parties were given until August 15, 1999, to file comments on oversight.

Only three parties filed comments on oversight. Of these, only the CPUC suggests that the merger conditions are not working. CPUC doubts BNSF's effectiveness as a competitor using the Central Corridor and I-5 Corridor trackage rights that it received as conditions to the UP/SP merger. CPUC also argues that major improvements are necessary at the Calexico/Mexicali border crossing.

The National Industrial Transportation League ("NIT League") -- an active participant in the merger proceeding and in prior oversight proceedings -- notes that BNSF traffic growth since the approval of the merger is clearly a positive development, but urges the Board to continue its oversight of the merger.

The United States Department of Transportation ("DOT") states that the merger is now progressing in a reasonable manner. DOT concludes that "it is not now necessary to revisit the conditions imposed by the STB. The Board should of course continue these oversight proceedings for the entire five-year period originally contemplated."

In this reply, BNSF will respond to CPUC's assertion that BNSF has been unable to provide effective competitive service in the Central Corridor and the I-5 Corridor. As discussed below, BNSF continues to offer vigorous and effective competition to shippers located on its Central Corridor trackage rights between Denver, CO and Stockton, CA, and has demonstrated its desire to compete for all traffic available to it under the UP/SP merger conditions and to invest in its trackage rights lines. BNSF also offers competitive intermodal service for shipments between the Midwest and California. Finally, another railroad would not be positioned to offer more competitive service than BNSF along the Central Corridor. A key fallacy of CPUC's argument is its failure to distinguish between traffic moving between regions -- i.e., between the Midwest and California -- and the route over which that traffic moves.

In addition, BNSF offers an effective and growing presence in the I-5 Corridor, as demonstrated by BNSF's increase in service offerings following its initial investment in track and facilities improvements. BNSF continues to invest in improvements to ensure that its I-5 Route is competitive for the core merchandise and grain traffic that it envisioned handling at the time of the UP/SP merger.

Accordingly, CPUC's concerns as to competition in the Central Corridor and I-5 Corridor do not warrant action by the Board.

REPLY

A. BNSF HAS BEEN SUCCESSFUL IN OFFERING CENTRAL CORRIDOR SHIPPERS A COMPETITIVE ALTERNATIVE TO UP

With respect to the Central Corridor, CPUC asserts that BNSF has done little with its trackage rights and is providing only token competition. CPUC, however, offers no evidence to support this statement. Indeed, the statement is squarely contrary to the evidence presented by UP and BNSF in their July 1st Annual Reports. However, before discussing this evidence, it is necessary to provide an overview of the Central Corridor trackage rights and customer access that BNSF received in the UP/SP merger proceeding and the current state of BNSF Central Corridor operations.

It is also important to note that CPUC chooses to define the Central Corridor as the entire rail route between Chicago, the Midwest, and California. From BNSF's perspective, however, the Central Corridor is that portion of the former SP and UP that BNSF gained trackage rights over, and customer access along,[1/] between Denver, CO and Stockton, CA. In BNSF's view, there are two groups of customers to be served: (1) overhead Midwest-California shippers and receivers, and (2) customers located along BNSF's trackage rights lines to which BNSF has gained access. BNSF's goal has been, and remains, to provide competitive service to both groups of rail shippers and receivers, using whatever routes are available to it.

1. Background on BNSF's Central Corridor and Transcontinental Operations

As a condition to the UP/SP merger, BNSF was granted overhead trackage rights, with defined customer and transload access at "2-to-1" points and to new customer facilities and transloads along trackage rights lines on the Central Corridor. Prior to obtaining these trackage rights, BNSF had, and still has, a transcontinental route between California and Chicago through Arizona and Southern California which is commonly referred to as the "Transcon Route."

[1/] Specifically, BNSF gained access at "2-to-1" points to existing shipper facilities and transloads, and new customer facilities and transloads the entire length of the trackage rights lines.

BNSF began operating direct train service over its Central Corridor trackage rights on October 8, 1996. During the first two years of operation, BNSF's average monthly trains and volumes along the Central Corridor grew considerably. Initial startup operations were dedicated to serving specific customers along the Central Corridor to which BNSF gained access as a result of the merger conditions. As a result, BNSF did not initially make major changes in its overhead traffic flows. However, in early 1998, as business volumes grew and scheduled service became more frequent and consistent, BNSF began rerouting more overhead traffic from its Transcon Route to the Central Corridor.[2/] This both freed up capacity for other traffic along the Transcon Route and built BNSF's traffic and service frequency along the Central Corridor. Indeed, by June, 1998, BNSF handled 4,467 loaded units on the Central Corridor, averaging 138 average monthly trains along this route.

Although the number of trains and volumes of traffic on the Central Corridor were growing in 1998,[3/] the quality and efficiency of BNSF's service was being adversely impacted by UP congestion and UP crew shortages west of Salt Lake City. BNSF was unable to meet customers' expectations on transit time, consistency, and service performance, and BNSF was faced with possible traffic loss.

2/ In all cases, no rerouting occurred until BNSF was satisfied that it could meet its customers' needs for competitive and consistent transit performance by rerouting such traffic to the Central Corridor.

3/ The 1998 growth was, in part, attributable to the fact that BNSF handled a one-time spot movement of coal for Utah Railway from Sierra Pacific Power at Valmy, NV which temporarily increased BNSF's volumes on the Central Corridor.

Therefore, in early August, 1998, BNSF implemented a number of steps to address the impact of such crew shortages and congestion. BNSF rerouted most of its Central Corridor merchandise trains between Weso (just east of Winnemucca, NV) and Stockton over the former SP Donner Summit route through Reno/Sparks, NV. While this required BNSF to power trains with an additional locomotive each way, due to mountain grades on this route compared to UP's Feather River Canyon Subdivision route through Portola, CA, it relieved pressure on UP crews on the Canyon Sub and helped relieve congestion there as well, benefitting UP during its service problems in 1998. The rerouting also permitted BNSF to offer improved service to new customers it had gained access to as a result of the merger conditions at Fernley and Sparks, NV. At the same time, BNSF began rerouting overhead manifest traffic off of the Central Corridor to BNSF's Transcon Route.[4/]

Use of the Transcon Route in this context made sense for BNSF and its customers. The Transcon Route is under the control of BNSF, and BNSF is well-aware of the route's capabilities. BNSF could meet its commitments to customers relating to transit time, consistency, and service performance. Therefore, for the one market CPUC appears most interested in -- Midwest-California traffic -- BNSF rerouted nearly all traffic to the Transcon Route. Since rerouting these flows to the Transcon Route, BNSF has

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[4/] BNSF also developed a plan for using its own crews for Central Corridor operations beginning January 1, 1999. However, the rerouting of trains over the Transcon Route and the relief of congestion on the UP lines have made it unnecessary for BNSF to use its own crews on the Central Corridor.

not received customer complaints about its service or transit time. Indeed, for the most service sensitive traffic between the Midwest and Southern California -- intermodal traffic -- Union Pacific reports it is following BNSF's geographical preference by upgrading the former Southern Pacific Golden State Route (also known as the "Tucumcari Line") to compete more aggressively and effectively with BNSF for this traffic.

Concerning CPUC's criticism of BNSF for using UP crews in Central Corridor operations west of Provo, UT, BNSF and UP determined prior to UP/SP merger approval that the post-merger UP would have excess crews in this area. At the same time, UP was faced with the possibility of having to displace its operating employees in this area, BNSF was considering having to hire and train crews to commence trackage rights operations. Through a cooperative effort between the railroads, it was determined that the best solution for the involved employees was to use UP crews to handle BNSF trains (with BNSF power) in this area. BNSF crews have since been added between Stockton and Roseville, CA, for trains operating over the SP route through Reno/Sparks, NV, displacing UP crews in this portion of the Central Corridor operations.

At some point in the future, BNSF may have to reconsider placing BNSF crews on Central Corridor trains between Roseville and Stockton, CA and Provo, UT. This step would occur in conjunction with UP input, if UP could no longer supply crews or if BNSF merchandise trains in this corridor were facing consistent delays due to crew shortages. At the present time, however, BNSF believes that its Central Corridor trackage rights trains are operating as efficiently with UP crews as they would with BNSF crews.

2. *BNSF Has Provided A Competitive Discipline To UP's Central Corridor Rates and Services*

In their July 1, 1999 Annual Reports, both UP and BNSF presented extensive data regarding BNSF's Central Corridor traffic volumes. As evidenced by the chart attached hereto as Attachment 1, these traffic volumes continued to grow in late-June and July. BNSF handled 2,932 loaded units in July, up from 2,891 loaded units in June.

Nevertheless, traffic volumes -- regardless of whether they have increased or declined -- are not in and of themselves indicative of whether BNSF is offering a competitive alternative to UP for Central Corridor traffic. In its first oversight decision, the Board found that "BNSF market share . . . should not be a decisive criterion by which the level of competition is judged. BNSF must have sufficient traffic to sustain service levels that allow it to be a realistic choice for shippers, but the traffic level could be far less than that of an independent SP." Fin. Dkt. No. 32760 (Sub-No. 21), Decision No. 10 at 4-5. The Board went on to conclude that "the most important indicator of the impact of the trackage rights conditions is the effect BNSF's presence in the market has on the rates offered by UPSP." Id. at 5.

CPUC does not allege -- nor does it provide any evidence -- that BNSF is not a realistic alternative for the Central Corridor shippers to which BNSF gained access as a result of the merger conditions. Central Corridor shippers, on the other hand, have consistently indicated that they in fact consider BNSF to be a realistic alternative to UP and a competitive restraint on the market place. Additionally, no shipper has lost access to BNSF as a result of BNSF's reroutes off of the Central Corridor.

Further, CPUC offers no evidence that BNSF has not provided a competitive discipline to the rates offered by UP for Central Corridor traffic. To the contrary, the evidence presented by UP and BNSF in their Quarterly and Annual Reports includes numerous examples of significant traffic movements that BNSF has captured using its Central Corridor trackage rights. *See, e.g.*, UP/SP-366 at pp. 72-74, Appendix B. Additionally, UP has stated, and provided evidence to support, that it has improved its rates and service in response to strong competition from BNSF for Central Corridor traffic. *See, e.g.*, UP/SP-366 at pp. 19, 72-74, Appendix C.

Reflecting a further improvement in BNSF service and BNSF's commitment to the Central Corridor, in March, 1997, BNSF began providing competitive local switching, pickup and delivery service for the largest group of Central Corridor shippers to which BNSF gained access, those in Utah. BNSF formed a unique partnership with the local Utah Railway, a carrier with Utah presence, resources, knowledge, capabilities, and 85 years of operating experience in the state. The combination of BNSF roadhaul service and Utah Railway pickup and delivery provides Utah customers with a viable, competitive service option independent to UP which has been difficult to replicate elsewhere. While Utah Railway's service was impacted, as was BNSF's, by UP's service difficulties in 1997 and 1998, BNSF was able to utilize Utah Railway's service capabilities to provide customers with a local service option independent of UP.[5/]

[5/] In other areas, BNSF was forced to either switch customers directly or rely on UP's local service for haulage and reciprocal switch, thereby forcing BNSF traffic into the UP congestion.

3. *BNSF Offers Competitive Intermodal Service for Shipments Between The Midwest and California*

CPUC also repeats its persistent argument that intermodal shipments by BNSF through the Central Corridor are virtually nonexistent. Comments, p. 5. In its 1997 oversight comments, CPUC stated that "BNSF appears to have made little use of its right to run intermodal trains in the Central Corridor."

However, as UP pointed out in its reply to those 1997 comments, UP never projected that BNSF would use its Central Corridor rights to operate any significant volumes of intermodal traffic between points east of Denver and the Bay area. *See* UP/SP-311 at p. 11 fn. 7. Further, CPUC purports to express concerns on behalf of the Port of Oakland, noting that "BNSF is not participating to any degree in the movement through the Corridor of container shipments from the Port of Oakland, the nation's fourth largest container port." Comments, p. 5. However, in a June 30, 1998 letter attached hereto as Attachment 2, the Port of Oakland acknowledged that it never anticipated that BNSF would use its Central Corridor trackage rights for intermodal shipments and expressed satisfaction with BNSF's intermodal service into and out of the Port of Oakland using the Transcon Corridor. The Port of Oakland stated that:

> It is, and always has been, our understanding that BNSF trackage rights over the Central Corridor could not be used as a route to serve double-stack intermodal markets in and out of the Bay Area. This is because restricted tunnel clearances on the route make it impossible for BNSF to provide double-stack service. Unfortunately, it is not feasible to clear the tunnels, particularly those that are located in Colorado due to both cost and environmental considerations. We believe that the existing BNSF route out of Northern California through Barstow already provides excellent transit times. We feel

> that this routing offers our customers the best opportunity to have competitive rail service throughout the United States.[6]

CPUC also addresses the clearance project that UP has underway on the Donner Route in east-central California, to which BNSF has access, but states that BNSF "has a huge disincentive with respect to ever utilizing the Donner Summit portion of the Central Corridor [because] . . . it would become liable for paying one-half of the cost of the UP clearance project". Comments, p. 5, n. 2. However, use of the Donner Summit for intermodal shipments, particularly double-stack container traffic, would not resolve BNSF's major Central Corridor clearance obstacle because that obstacle is not located in California, but rather in Colorado. BNSF's route west from Denver requires passage through a number of clearance-restricted tunnels, including the six-mile long Moffat Tunnel.[7] The alternative route SP had to bypass the Moffat Tunnel route, via the Tennessee Pass route, has been taken out of service by UP and is not accessible to BNSF. Even if the Tennessee Pass route were in operation, the route involves slow-speed, steep-grade, mountainous track which does not lend itself to high-speed, service-sensitive intermodal operations. Thus, while the UP route via the Central Corridor over

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[6] The Port of Oakland recently informed BNSF that its position has not changed since the time of the June, 1998 letter.

[7] Regarding the Moffat Tunnel, UP's Employee Denver Area Timetable #1, effective October 25, 1998, attached hereto as Attachment 3, contains the notation "Doublestack cars or other cars exceeding 19 feet ATR (above top of rail) must not be handled between C&S Junction (Denver) and Phippsburg" (p. 24).

which BNSF has trackage rights can not handle domestic double-stacks,[8/] such intermodal traffic moving between the Midwest and Southern California is extremely well suited to BNSF's Chicago-California mainline.

CPUC's assertions regarding BNSF's use of the Central Corridor demonstrate a fundamental misunderstanding as to the difference between traffic moving between two regions of the country (i.e., the Midwest and California) and the route over which the traffic moves. Thus, while UP and BNSF both move traffic between the Midwest and California, UP primarily operates on the Central Corridor for traffic moving between the Midwest and California while BNSF primarily uses routes located to the north or south of the Central Corridor to handle such traffic.

Although BNSF currently does not use the Central Corridor trackage rights it obtained in the UP/SP merger for intermodal traffic, it provides an extensive intermodal service offering between the Bay Area and Midwest using its Transcon Route. Currently, BNSF operates a total of 62 scheduled intermodal trains per week over its Bay Area-Midwest corridor, including 36 westbound and 26 eastbound intermodal trains. These totals include scheduled intermodal train services only and do not include "extra" trains operated on as-needed basis to accommodate increased business volumes. BNSF offers third day expedited intermodal service, eastbound and westbound, between its Richmond, CA and Chicago, IL intermodal terminals. Similarly competitive service

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[8/] Prior to the UP/SP merger, SP did not use its Central Corridor route to handle double-stacks. Therefore, intermodal shippers did not lose a transportation routing option when BNSF received trackage rights to replace SP in the Central Corridor.

offerings are provided to and from other Midwest points and the Bay Area, including Kansas City and Memphis. BNSF's intermodal service offerings are truck-competitive for its intermodal shippers, including international shippers through the Port of Oakland, where BNSF has been able to capture international container traffic from UP in the past year.

Thus, BNSF's competitive capability for traffic moving between the Midwest and California is not dependent on use of the Central Corridor route, particularly for intermodal traffic.

4. BNSF Has Demonstrated Its Desire To Compete For All Traffic Available To It Under The Trackage Rights Conditions and To Invest In The Trackage Rights Lines

In its Comments, CPUC also raises questions regarding BNSF's willingness to invest in the trackage rights lines and BNSF's willingness to compete for Central Corridor traffic. Comments, p. 5. With regard to the first point, certainly the CPUC is aware that BNSF already has put substantial investment into improving its Central Corridor trackage rights lines, including constructing additional yard space at Midvale, UT, on property leased from UP; restoring two 50 car tracks at Ogden which were out of service in the former Denver & Rio Grande Western Railway ("DRGW") yard; and constructing a crossover from the east end of Utah Railway's yard to the UP mainline at Provo.

Further, since the UP/SP merger, BNSF also has repeatedly demonstrated that it will aggressively seek to capture all traffic available to it along the trackage rights lines. As outlined in BNSF's July 1, 1999 Annual Report, BNSF marketing representatives have continued in their efforts to contact potential customers and market BNSF's services to customers located along the trackage rights lines. In the past year alone, BNSF marketing representatives worked with UP to identify the following Central Corridor customers and facilities which can be accessed by BNSF: Campbell Soup, Sacramento, CA; Capital City Warehouse, West Sacramento, CA; Diamond Plastics Co., Golconda, NV; Dust Chemical, Carlin, NV; J. E. Higgins Lumber Co., Sacramento, CA; Mells Cargo Supply, Inc., Sacramento, CA; Mine Service & Supply, Dunphy, NV; Montgomery Ward & Co. Distribution Center, West Sacramento, CA; Nevada Freeport, Elko, NV; Nevada Ice & Cold Storage, Elko, NV; Par Gas, Elko, NV; Saga Exploration Co., Barth, NV; Thatcher Chemical Co-Nevada, Carlin, NV; Treasure Chest, West Sacramento, CA; and Weyerhaeuser Wastepaper Recycling Plant, Salt Lake City, UT. Thus, as of August, 1999, BNSF had identified a total of 278 Central Corridor customers and facilities to which BNSF has access under the merger conditions.

During the past year, BNSF also has worked with customers to establish new facilities along several trackage rights lines, including the Central Corridor. As reported in BNSF's July 1, 1999 Annual Report, BNSF has sought access to new customer facilities along its Central Corridor trackage rights lines including the BNSF Quality Distribution Center at Sparks, NV; Tahoe-Reno Industrial Center at Patrick, NV; ANDALEX Resources, Inc., at Wellington, UT; Crown Energy Corporation at Gary, CO; Quebecor Printing at Fernley, NV; Total Petroleum and Conoco at Durham (Grand

Junction), CO; and Valley Joist at Fernley. BNSF also has additional projects involving the location of new customer facilities in this corridor currently underway.

Further, BNSF's willingness to aggressively market its services in the Central Corridor was demonstrated by BNSF's efforts to establish a transload at Sparks, NV to serve the R.R. Donnelley facility at Reno, NV. When UP denied BNSF access to that facility, BNSF filed a Petition for Clarification with the Board, and the Board granted BNSF access to the facility. Certainly, if BNSF was not willing to invest in its Central Corridor operations, it would not have gone to the efforts to access the R.R. Donnelley facility.

5. CPUC's Concerns About Abandonment Of UP's Central Corridor Route Ignore Commercial Realities As Well As BNSF Operational Needs

In its Comments, CPUC raises the concern that UP will not need both the UP and SP Central Corridor routes over the long-term, and that one of the routes will be abandoned, particularly at the California end. CPUC states that "[e]ventually, the rest of the line, including the Feather River Canyon route, will become ripe for abandonment. Certainly BNSF, with merely trackage rights, would have little reason to invest in that secondary line." Comments, p. 5.

CPUC's argument, however, ignores commercial realities and BNSF's operational needs. BNSF's operation from Denver is via trackage rights obtained in the UP/SP merger over the former SP (ex-DRGW) route to Salt Lake City, then over the former UP (ex-Western Pacific Railroad ("WP")) route to Alazon, NV. West of Alazon, UP and SP operated two parallel single-track lines as a paired-track arrangement, with both carriers operating directionally over both lines. BNSF's trackage rights permit it to replicate SP's operation, running over both the former SP and former UP routes, with access to all customers between Alazon and the west end of the paired track at Weso, NV, just east of Winnemucca. From Weso to Stockton, CA, BNSF has trackage rights over both the UP (WP) Feather River Canyon route and the former SP route via Donner Summit.

The former SP route east of the Salt Lake City area, as CPUC alludes to, serves a substantial coal franchise on intersecting branch lines and along the main line, as well as a growing merchandise market at a number of points, including in the Grand Junction, CO area, as reflected in BNSF's access to new customer facilities in that area. (In addition, this is an established Amtrak route). To view this line as an abandonment candidate appears unfounded.

Likewise, the former WP line from Salt Lake City to Alazon serves a number of on-line customers and provides needed infrastructure in this corridor, complimenting the former SP's single-track line across the Great Salt Lake farther north. As pointed out in merger filings, this trackage lines up well for BNSF in its alignment with the former DRGW route east of Salt Lake City used by BNSF. Further, BNSF views the paired track across Nevada between Weso and Alazon, NV as trackage which provides necessary capacity and infrastructure to both BNSF and UP. To view either line in this area as an abandonment candidate also appears unfounded.

The western end of UP's former WP route, now referred to as the Canyon Subdivision, is used by BNSF to link its former ATSF trackage Stockton, CA south with its owned trackage from Keddie, CA north. It is the connecting link to BNSF's I-5 Corridor. Suggesting that this line could be abandoned ignores both the customers along the route in communities such as Oroville, Quincy, Portola, and Herlong, CA and Gerlach, NV as well as the route's inherent benefits of lower grades than the former SP route over Donner Summit. This route's importance to BNSF, the additional capacity it appears to offer UP, and its inherent efficiencies suggest that it, too, would not be subject to abandonment.

6. *Another Railroad Would Not Be Positioned To Offer More Competitive Service Than BNSF Along The Central Corridor*

CPUC concludes its arguments regarding the Central Corridor by stating that "the Board should begin a process whereby another railroad, willing to take over the corridor's secondary line between the Midwest and Northern California and reinstitute aggressive competition, can be selected." Comments, p. 8. CPUC is plainly wrong in suggesting that another carrier could offer more competitive service to UP than BNSF. Shippers would lose the benefits of the broad geographic scope of BNSF's single line service and ratemaking capability, and they would also lose the benefit of BNSF's extensive equipment inventory and other resources.

B. BNSF HAS PROVIDED COMPETITIVE SERVICE ALONG THE I-5 CORRIDOR

CPUC states that significant gaps exist in the level of competition taking place in the I-5 Corridor and proposes that the Board grant BNSF trackage rights over the UP from Marysville, CA to Eugene, OR. Comments, p. 9.

CPUC is correct that additional trackage rights over UP's I-5 Route between Marysville, CA and Eugene, OR would be required for BNSF to offer the same level of service in the corridor that UP offers. However, as the traffic data indicate, BNSF is effectively competing with UP in the corridor, and the service it offers is as good or better than pre-merger SP was able to offer with multiple carrier service via the Bieber Route. Further, in its filings with the Board during the UP/SP merger proceeding, BNSF did not represent that it planned to provide competitive intermodal service in the I-5 Corridor.

In addition, CPUC overlooks that reality that BNSF would have to perform substantial upgrades on its line between Salem, OR and Eugene, OR in order to handle time-sensitive intermodal traffic, and that BNSF operates on trackage rights over UP's former SP route into Portland.

The evidence nonetheless demonstrates that BNSF's traffic along the I-5 Corridor has grown steadily since it began operations -- with no initial traffic base -- on July 1, 1997. Indeed, as indicated on the graph attached hereto as Attachment 4, BNSF handled 4,202 loaded units on the I-5 Corridor in July, 1999. Further, Confidential Appendix J to UP's July 1, 1999 Annual Report provides more than 44 examples of traffic movements that have benefitted from BNSF's single-line I-5 Corridor service.[9]

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[9] CPUC exhibits a lack of understanding regarding BNSF's I-5 Corridor operations when its states that the "only BNSF train service involving a PNW location west of the Cascade Mountains (where the centers of population and industry are located) consists of five freight trains a week from Vancouver, WA to Barstow, CA." Comments, p. 9. BNSF trains operating in the I-5 Corridor connect at a number of points along BNSF's network in the Pacific Northwest with other BNSF trains, thereby providing through service for all BNSF points and customers, as well as connecting carriers, in this region.

Further, BNSF has invested, and continues to invest, to ensure that its I-5 Route is competitive for the core merchandise and grain traffic that it envisioned handling at the time of the UP/SP merger. For example, working with UP, BNSF completed major track realignment and construction projects to improve the movement of trains at Stockton and El Pinal, CA, including new track connections, signal work and new switch connections. The track connections make it possible for BNSF trains to enter and exit the Central and I-5 Corridors at Stockton, en route to and from BNSF's Riverbank, CA yard, without requiring backing or run-around movements involving UP's Stockton yard.

As a further example of service improvements, in recognition of traffic growth on the I-5 Corridor, BNSF surfaced track, installed slide fencing, cleaned ditches, stabilized embankments, replaced culverts, and installed 80,000 ties and 14,859 curve blocks to improve the stability of the track structure on the mountainous route of its Gateway Subdivision.[10] This work had to be performed before a substantial upgrade to BNSF's I-5 Corridor merchandise service offering could be undertaken, and has permitted BNSF to operate longer trains over the I-5 Corridor, increasing operating efficiency and capacity for rail shippers.

In 1999, BNSF has made substantial service improvements on the I-5 Corridor and connecting routes. In April, 1999, BNSF's Merchandise Marketing group advised BNSF Operations that daily service was required to be competitive in the I-5 Corridor

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[10] The Gateway Subdivision between Bieber and Keddie, CA was purchased from UP as part of the settlement agreement accompanying the UP/SP merger.

from the Pacific Northwest to Southern California. After analysis of the corridor, BNSF's Service Design and Service Performance groups created a new service plan from the Pacific Northwest to Southern California that would remove from 24 to 72 hours from the existing merchandise trains' schedules then operating in the I-5 Corridor. After two weeks of working with the Seattle and San Bernardino Service Regions, and as discussed in BNSF's July 1, 1999 Annual Report, BNSF added new, five-day/week southbound merchandise train service from Vancouver WA to Barstow, CA on June 15, 1999. This new service was increased to six-day/week service effective July 11, 1999; and it was subsequently increased to daily service effective August 2, 1999. The new service, train H-VAWBAR, departs from Vancouver, WA and arrives at Barstow, CA 62 hours later, in time to be processed for connection to outbound trains the same day. The H-VAWBAR replaced four shorter trains which had operated south on the I-5 Corridor. This new service, in conjunction with the existing merchandise train service connecting to and with trains in the corridor, is designed to handle existing carload growth in the I-5 Corridor and to encourage further growth by improving transit time, speed and consistency.

In addition, BNSF's I-5 Corridor Service Redesign Team is continuing to look for additional operational or commercial actions BNSF can take to build and secure further growth between the Pacific Northwest, California, and Arizona. The Redesign Team has prepared the marketing materials attached hereto as Attachment 5 and circulated them widely to customers located along BNSF's I-5 Corridor.

Beginning in August 1999, BNSF introduced the use of distributed power to its I-5 Corridor merchandise train services, permitting diesel locomotives to be placed within the train consist as well as at the head end, all controlled by the engineer on the lead unit. Since this initiative was begun, approximately 20 percent of southbound merchandise trains on the I-5 Corridor have been operated with distributed power. One of the main advantages of distributed power has been the operation of longer, heavier trains, allowing up to 2,000 additional tons per train. The near-term goal is to operate approximately 30 percent of southbound trains with distributed power, ultimately increasing this amount to 50 percent.

BNSF is using the I-5 Corridor to redistribute empty equipment between the Pacific Northwest and Pacific Southwest. Currently, two southbound "bare table" trains with empty intermodal cars are operated each day. This operation improves equipment utilization and car supply to Southern California ports, permitting BNSF to handle import traffic through these ports on a much more timely basis. BNSF is also using the I-5 Corridor to reposition empty unit grain trains from Stockton, CA to Pasco, WA. Currently, this operation averages one empty grain train every second or third day. This operation improves equipment utilization and car supply to serve the needs of grain producers in Montana. Finally, BNSF is using the I-5 Corridor to reposition empty autorack trains from the Bay Area to the Pacific Northwest, permitting timely handling of automobile traffic moving over the PNW ports.

Thus, BNSF has demonstrated its willingness to invest in the train service, marketing and upgrading of the I-5 Corridor to build its capabilities to compete with UP for I-5 Corridor traffic.

CONCLUSION

As the evidence submitted to the Board establishes, BNSF continues to offer vigorous and effective competition to shippers located on its Central Corridor trackage rights between Denver, CO and Stockton, CA, and has demonstrated its desire to compete for all traffic available to it under the UP/SP merger conditions and to invest in its trackage rights lines. BNSF also offers competitive intermodal service for shipments between the Midwest and California. Finally, another railroad would not be positioned to offer more competitive service than BNSF along the Central Corridor. A key fallacy of CPUC's argument is its failure to distinguish between traffic moving between regions -- i.e., between the Midwest and California -- and the route over which that traffic moves.

In addition, BNSF offers an effective and growing presence in the I-5 Corridor, as demonstrated by BNSF's increase in service offerings following its initial investment in track and facilities improvements. BNSF continues to invest in improvements to ensure that its I-5 Route is competitive for the core merchandise and grain traffic that it envisioned handling at the time of the UP/SP merger.

Accordingly, CPUC's concerns as to competition in the Central Corridor and I-5 Corridor do not warrant action by the Board.

Respectfully submitted,

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Richard E. Weicher
Michael E. Roper
Sidney L. Strickland, Jr.

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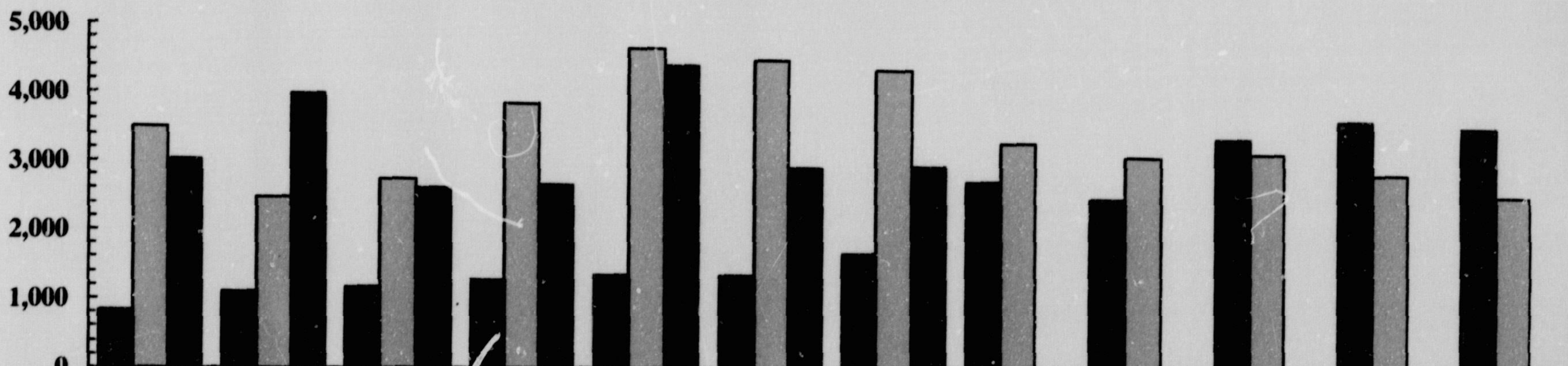
Attorneys for The Burlington Northern and Santa Fe Railway Company

September 3, 1999

ATTACHMENT 1

1997-99 BNSF Loaded Units In UP/SP Trackage Rights Corridors Central Corridor

Units



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
97 Totals	834	1,096	1,176	1,262	1,344	1,343	1,667	2,706	2,466	3,333	3,612	3,522
98 Totals	3,495	2,474	2,720	3,838	4,635	4,473	4,306	3,261	3,074	3,134	2,832	2,511
99 Totals	3,014	3,979	2,599	2,659	4,395	2,891	2,932					

08/31/1999

ATTACHMENT 2

PORT OF OAKLAND

RAYMOND A. BOYLE
Director of Maritime

June 30, 1998

Mr. Ronald Ross
Western Governor's Association
600 17th Street, Suite 1205
South Tower
Denver, CO 80202

Dear Mr. Ross:

Recently, it has come to our attention that a representative of the California Public Utilities Commission may have made certain statements which referenced the Port of Oakland during a presentation at the Western Governors Association Conference held in Omaha on May 5th and 6th. We believe that these statements may have conveyed the impression that the Port of Oakland would be less competitive because of Burlington Northern Santa Fe's (BNSF's) limited use of the Central corridor operating rights obtained through the UP/SP merger for intermodal freight. I would like to clarify the Port of Oakland's position as it relates to the BNSF use of the central corridor for movement of international intermodal cargo.

It is, and always has been our understanding that BNSF trackage rights over the Central corridor could not be used as a route to serve double-stack intermodal markets in and out of the Bay Area. This is because restricted tunnel clearances on the route make it impossible for BNSF to provide double-stack service. Unfortunately, it is not feasible to clear the tunnels, particularly those that are located in Colorado due to both cost and environmental considerations.

We believe that the existing BNSF route out of Northern California through Barstow already provides excellent transit times. We feel that this routing offers our customers the best opportunity to have competitive rail service throughout the United States.

The BNSF is working with the Port of Oakland as we develop our Joint Intermodal Terminal which will provide the railroad with direct access to our international customers in Oakland. We appreciate their support and we are confident that through our cooperative efforts our business will continue to grow with the excellent BNSF services available now and in the future.

Please call me, or Michael Beritzhoff (510) 272-1463, if you have any questions or if we can assist the Western Governor's Association in any way. Thank you for this opportunity to clarify the Port's position in this matter.

Very truly yours,

Ray Boyle

Raymond A. Boyle
Director of Maritime

cc: Jack Fields, BNSF

ATTACHMENT 3

MOFFAT TUNNEL SUBDIVISION (719)

Radio Display:
Denver Union Depot to Prospect - 6666
Prospect to East Portal -2323
East Portal to Winter Park -1997
Winter Park to CP 1666 -5454
CP 1666 to Phippsburg -9292

Mile Post	Rule 6.3	CP #'s	WEST ▼ STATIONS EAST ▲		Sta. #'s	Siding Feet
0.0	YL		DENVER UNION DEPOT (1.0)	Y		
1.0	CTC 2MT		PROSPECT (0.5)		KP640	
1.5			FOX JCT. (1.5)	X	KP641	
3.0	CTC		NORTH YARD (0.2)	BT	KP643	Yard
3.2			UTAH JCT. (1.6)	X(M)	KP644	
4.8			C&S JCT. (2.2)	I	KP645	
7.0		75	ARVADA (5.4)		KP646	
12.4			LEYDEN (5.6)	I	KP651	7020
18.0			ROCKY (3.2)	I	KP657	7330
21.2			CLAY (3.3)	I	KP660	5780
24.5			PLAIN (6.7)	I	KP664	6530
31.2			CRESCENT (6.3)	I	KP670	5550
37.0			CLIFF (4.6)	I	KP676	6900
42.1			ROLLINS (5.0)	I	KP681	8320
47.1			TOLLAND (3.0)	I	KP686	5660
50.1			EAST PORTAL (6.8)	TI	KP689	5750
56.9			WINTER PARK (5.3)	I	KP696	7110
62.2			FRASER (3.8)	I	KP701	4830
66.0			TABERNASH (9.8)	TI	KP705	9830
75.8			GRANBY (10.4)	I	KP715	9360
86.2			SULPHUR (6.8)	I	KP725	7830
93.0			FLAT (5.0)	I	KP732	7050
98.0			TROUBLESOME (5.5)	I	KP737	5570
103.5			KREMMLING (2.5)	I	KP743	5990
106.0			GORE (5.3)	I	KP745	6730
111.3			AZURE (5.1)	I	KP750	4920
116.4			RADIUM (6.6)	I	KP755	8540
123.0			YARMONY (5.8)	I	KP762	4560
128.8			BOND (9.9)	ITX	KP768	E7500 W11750
138.7			CRATER (4.0)	I	MJ410	5160
142.7			VOLCANO (9.3)	I	MJ414	7470
152.0			TOPONAS (13.0)	I	MJ423	5690
165.0			E. PHIPPSBURG (3.0)			
166.6		1666	CP 1666 (1.4)			
168.0	YL		PHIPPSBURG	BTY	MJ439	Yard
			(168.0)			

SI-01 MAIN TRACK AUTHORITY

CTC Between MP 1.0 and MP 166.6.

Yard Limits Between MP 0.0 and MP 1.0. (BNSF 31st Street Yardmaster authorizes movements within these limits); MP 166.6 and MP 168.0.

SI-02 MAXIMUM SPEED TABLE

Maximum Speed Between Mile Posts 0.0 and 128.8	MPH PSGR	FRT
(Except as Below)	**79**	**60**
0.0 and 1.1	10	10
1.1 and 1.6	30	30
1.6 and 3.4	45	45
3.4 and 3.5	25	25
3.5 and 4.0	45	45
4.0 and 7.0	65	45
7.0 and 12.0	45	45
12.0 and 17.2 - E	50	30
12.0 and 17.2 - W	60	50
17.2 and 18.2	35	30
18.2 and 23.1	25	25
23.1 and 28.0	28	25
28.0 and 29.3	25	25
29.3 and 31.3	28	25
31.3 and 31.8	25	25
31.8 and 36.0	28	25
36.0 and 37.0	25	25
37.0 and 40.3 - E	43	30
37.0 and 40.3 - W	43	40
40.3 and 41.2	25	25
41.2 and 41.8	33	30
41.8 and 45.4 - E	40	30
41.8 and 45.4 - W	40	40
45.4 and 48.1 - E	50	30
45.4 and 48.1 - W	50	40
48.1 and 48.6	28	25
48.6 and 49.7	33	25
49.7 and 56.3	40	40
56.3 and 56.8	35	35
56.8 and 58.7	40	35
58.7 and 62.2	30	25
62.2 and 65.3	65	55
65.3 and 65.6	35	35
65.6 and 67.0	55	55
67.0 and 68.7	30	30
68.7 and 69.3	25	25
69.3 and 73.0	30	30
73.0 and 74.0	35	35

SI-14 MISC. INSTRUCTIONS

Six-axle locomotives must not be operated on Chem Spur.

Doublestack cars or other cars exceeding 19 feet ATR must not be handled between C&S Jct. and Phippsburg.

Repeater Signals: Repeater signals designated by the letter "R" are located at Winter Park MP 56.5 and Radium MP 116.1 Repeater signal indicates the aspect of the next absolute signal located beyond the repeater signal. When repeater signal is dark or displays a flashing red aspect it is an indication that the next absolute signal will be displaying a Stop indication. Repeater signal aspects are for information only.

Operation North Yard: Sign at MP 2 on Inbound-Outbound Lead, North Yard bears word "APEX". This sign located at point where maximum grade leaving North Yard begins. In switching movements at south end of North Yard switch engine handling cuts consisting of sufficient cars to make it necessary to pass this sign must have sufficient air brakes coupled and operative on head end of cut to assure necessary braking power to stop locomotive and cars being handled.

Denver Union Depot: Unless switches are actually in use, route must be left lined from Track One to the BNSF Buck Main. DUT property will be indicated by signs at the entrance to DUT, in addition to yard limit signs at the same locations. Yard limit rule applies on all tracks within DUT limits. Maximum speed on DUT tracks and BNSF Buck Main is 10 MPH.

Siding Clay: Loaded coal trains must not occupy Clay siding.

Operation Moffat Tunnel: Not more than one train at a time will be permitted to occupy track in Moffat Tunnel between East switch Winter Park and West switch East Portal except a helper locomotive may be uncoupled from the rear of an Eastward train inside Moffat Tunnel or east of East switch Winter Park.

Helper locomotive cutting off of westward train at East Portal, must not shove beyond absolute signal at the west switch of East Portal.

Absolute signal governing movements over West switch East Portal, in addition to their signal Function, will not indicate Proceed unless ventilation gate is raised.

If train crew finds gate closed, contact dispatcher immediately to open gate. If dispatcher controls will not open gate and train is inside the tunnel, ventilation should be requested until the problem with the gate is resolved.

Gate control switches are located on the south tunnel wall west of the gate and also in the portal office building to the south side of the track. The gate will open 30 seconds after pushing "GATE OPEN" button. A warning buzzer will sound during this 30 second period. When gate is closing or about to close, a red strobe light on the north wall of the tunnel will flash and buzzer will sound warning.

When train or locomotive movement is to be made into or out of the east end of the Moffat Tunnel on other than signal indication (e.g. verbal permission to pass signal displaying Stop indication), authority must first be obtained from the dispatcher before each and every move which requires that movement be made under ventilating gate to insure that gate is locked in the raised position.

Emergency exit air lock doors are located just west of the gate, one on each side of the tunnel walls. If it becomes necessary to use these emergency exits when the gate cannot be raised, PRESSURE MUST BE EQUALIZED before attempting to open air lock doors. This is done by venting a spring loaded relief valve located in the center of each door. Always close and latch door after use BEFORE venting and opening next air lock door.

If train or locomotive is delayed in Moffat Tunnel for any reason, train dispatcher should be promptly notified by radio or nearest telephone. Telephones are located in all Refuges in Moffat Tunnel, No. 1 through No. 21. If necessary to communicate with the dispatcher using these telephones, pick up receiver and dial 911 to initiate an emergency call to the dispatcher, or dial *82 to initiate a non-emergency call to the dispatcher.

Emergency Scott Scram units are stored in a yellow plastic barrel at Refuges No. 1 through No. 21.
Exceptions:
Refuge No. 2 - Located on top of the signal case.
Refuge No. 20 - Located in bungalow.
Refuge No. 21 - Located in locked cabinet on east wall. Cabinet is locked with a UP switch lock.

Winter Park Tool House;
East Portal in entry room adjacent to tunnel.

Yellow barrels have a threaded lid which opens by unscrewing counterclockwise.

To activate the Scott Scram unit, place the hood over your head and pull the activation pin. This will provide approximately 15 minutes of oxygen.

If Scott Scram unit or other breathing equipment including the MSA type W-65 self rescue unit is used, return it to the MTO's office for service or replacement along with a written summary of circumstances that caused breathing equipment to be necessary.

Do not smoke or be around open flames immediately after using a Scott Scram unit.

Prior to operating through the Moffat Tunnel employee must receive training on the proper use of the Scott Scram and MSA type W-65 Self-Rescuer units. Every train and engine crew member is required to have a W-65 Self-Rescuer unit in their possession while working between Plain and Winter Park. W-65 Self-Rescuer unit can be obtained from the MTO at Denver North Yard and Phippsburg. Each employee must check their W-65 Self-Rescuer unit to make sure the seal is not broken.

If an emergency condition exists and use of W-65 Self-Rescuer unit is required, train dispatcher must be notified at the first opportunity. Each person using the W-65 Self-Rescuer unit must turn in the used unit at first tie-up point and receive a new respirator.

Any new or transferred employee must contact and advise MTO or MOP that they need training on Scott Scram and W-65 Self-Rescuer units prior to being called for any assignment which will operate through the Moffat Tunnel.

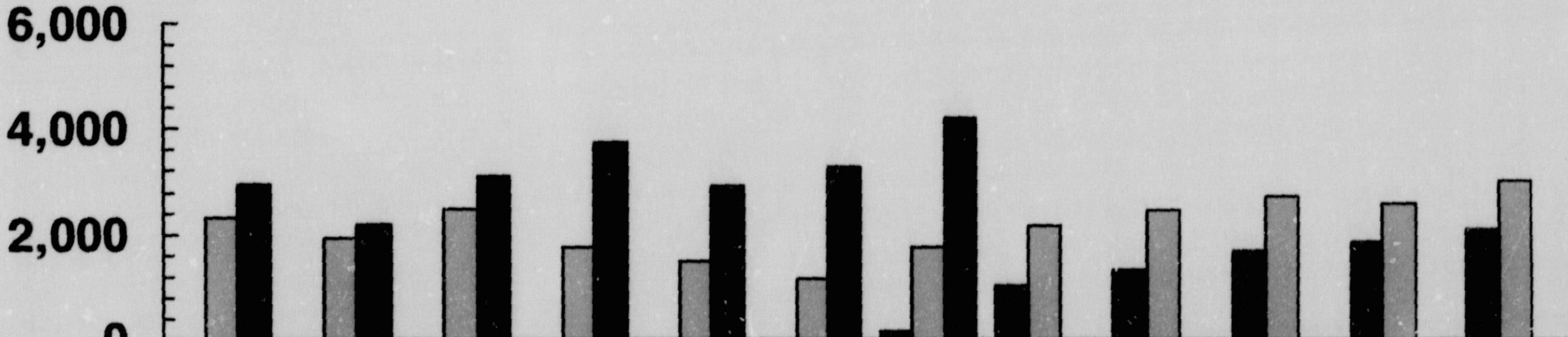
Operation Bond - Craig: Whenever eastward signal 1296 indicates other than clear eastward trains must remain in clear of road crossing and contact train dispatcher for instructions.

Before entering Phippsburg Yard, trains must contact train dispatcher for instructions on which track to use.

ATTACHMENT 4

1997-99 BNSF Loaded Units In UP/SP Trackage Rights Corridors
I-5 Corridor

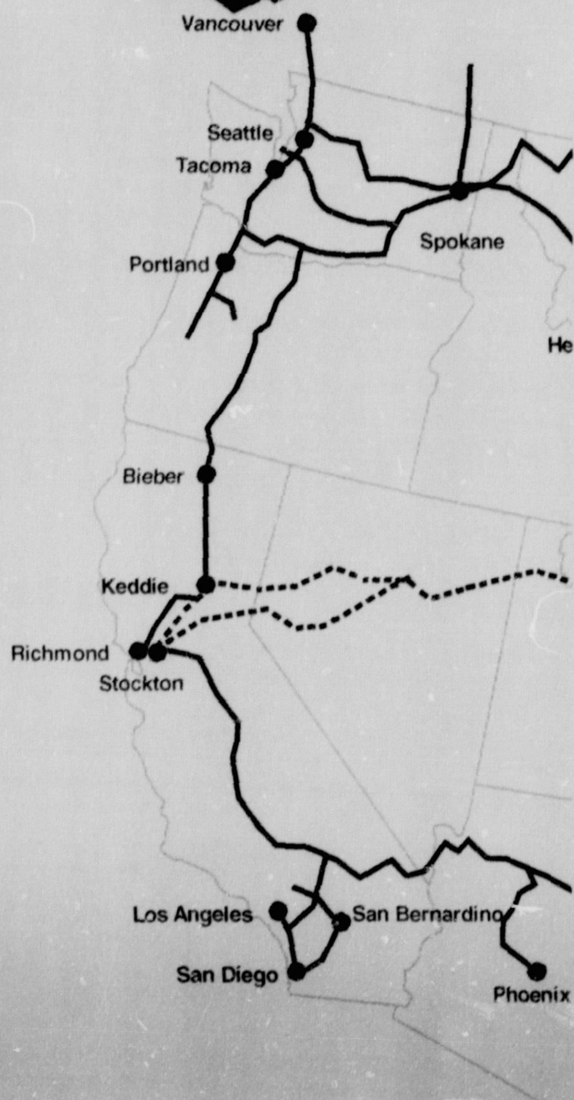
Units



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
■ 97 Totals							177	1,024	1,317	1,680	1,847	2,096
□ 98 Totals	2,310	1,911	2,476	1,741	1,504	1,165	1,762	2,152	2,464	2,705	2,572	3,001
■ 99 Totals	2,954	2,172	3,127	3,759	2,913	3,298	4,202					

08/31/1999

ATTACHMENT 5



BNSF QDC Network

Truck Like Service....
Rail Like Economics!

Combines rail economics with QDC's independent transload expertise to provide a total distribution package:

• One single bill for rail, transload, and trucking.

• Up to 4 truck deliveries from one railcar for facilities located off rail.

•Forward inventory to be closer to your customers rather than move last-minute shipments at premium truck rates.

• Maintains a steady flow of product in the pipeline while taking advantage of low-cost rail rates to reduce transportation costs.

•Permits easier long-range scheduling because shipments can be warehoused locally or near markets.

•Can be tailored to meet a customer's specific distribution and storage needs.

•Offers "just-in-time" deliveries.

Train Schedule in Days

	Origins				
	Vancouver, BC	Seattle	Portland	Spokane	Pasco
Destinations					
Barstow	5	4	4	4	3
Kaiser Area	6	5	5	5	4
Los Angeles	7	6	6	6	5
San Diego	7	6	6	6	5
Phoenix	7	6	6	6	5

Transit times represent scheduled terminal departure to local train availability.

Look for actual performance measurements on our website soon.

•Service redesign to improve consistency for I-5 Customers;

•Truck alternative in I-5 corridor;

•Delivering Transportation Value - Door to Door delivery through QDC

•BNSF Quality Distribution Centers (to serve nonrail customers) - see middle panel inside

•Major Interline Connections with CN, CP,SRY, BCOL

Contacts & Information

Phone Numbers

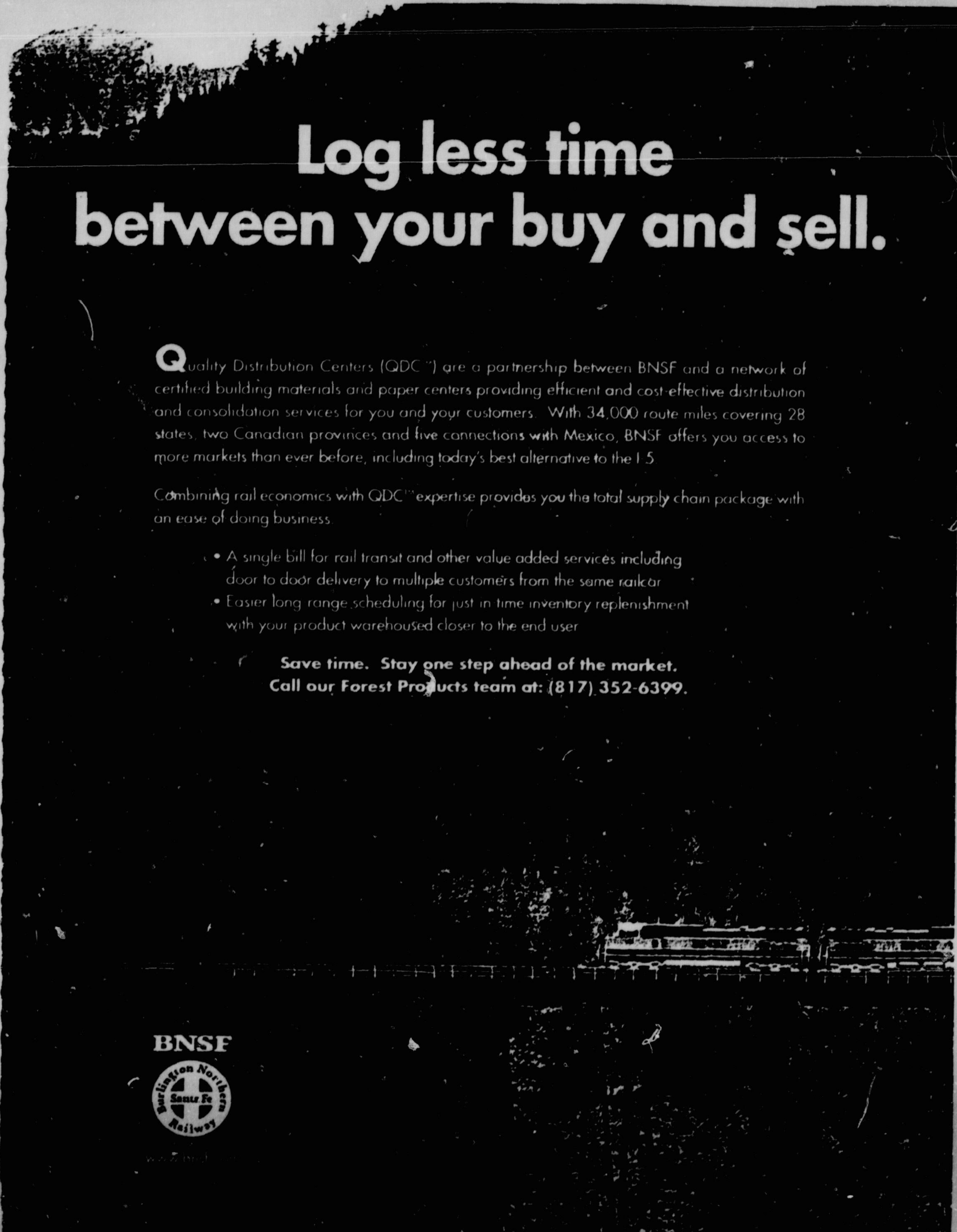
Customer Service......... 1-800-289-2673
Equipment Ordering......1-800-234-8440
Car Tracing 1-800-809-2673
Marketing...................1-817-352-6399
Service Assurance.........1-800-769-2673

Website Information

General Info.........www.bnsf.com
QDC.....www.bnsf.com/website/qdc.nsf
Car Tracing...www.bnsf.com/cws/eqptrace/
Public Rates.... www.bnsf.com/rpms/
I5 service........www.bnsf.com/i5 (coming soon)

BNSF

...your I-5 pipeline


Log less time
between your buy and sell.
Quality Distribution Centers (QDC™) are a partnership between BNSF and a network of certified building materials and paper centers providing efficient and cost-effective distribution and consolidation services for you and your customers. With 34,000 route miles covering 28 states, two Canadian provinces and five connections with Mexico, BNSF offers you access to more markets than ever before, including today's best alternative to the I-5.
Combining rail economics with QDC™ expertise provides you the total supply chain package with an ease of doing business.
• A single bill for rail transit and other value added services including door to door delivery to multiple customers from the same railcar
• Easier long range scheduling for just in time inventory replenishment with your product warehoused closer to the end user
Save time. Stay one step ahead of the market.
Call our Forest Products team at: (817) 352-6399.
BNSF
Burlington Northern Santa Fe Railway

STB FD 32760 (SUB 21) 9-3-99 D 195481

Tittle Thus Jacket . .

STB FD-32760 (Sub 21) 9-3-99 D

ID-195481

UP/SP-368

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

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

APPLICANTS' REPLY TO COMMENTS

What a difference a year makes. By August 1998, UP's service crisis was winding down but some competitors and shippers continued to seek significant concessions from UP, and the Board was embroiled in related litigation. This year, UP's primary annual report on merger implementation drew few comments. DOT expressed relief that UP's improved service appears to be stable and that BNSF and Tex Mex competition continues to be healthy, even with UP returning to full competitive strength. NITL, noting positive trends, asked for continuation of the oversight process. BNSF again reported on its many competitive successes, although it could not resist the temptation to take a few passing shots at UP on minor issues. As we show below in Part A, these comments were unjustified. History demonstrates that BNSF and UP are able to resolve, usually on a cooperative basis, conflicts that arise between these two aggressive competitors without Board involvement.

Only one entity, the California Public Utility Commission ("CPUC"), seeks changes and additions to the conditions imposed by the Board. As we explain in Part B, CPUC presents no factual or legal predicate for any of the relief it seeks. We also show that, for reasons overlooked by CPUC, the conditions it seeks would harm the interests of California and its shippers, and particularly the interests of the Port of Oakland.

A. <u>BNSF's Comments in Its Annual Report</u>

The information contained in BNSF's annual report confirms the evidence presented in UP's report that the competition-preserving conditions imposed by the Board in the UP/SP merger have continued to work well. BNSF reports that its "traffic volumes over the lines to which BNSF received access as a result of the merger continue to grow"; that it "has also experienced traffic growth where [it] works with '2-to-1' shortlines and regional carriers"; and that it "has also steadily grown its traffic volumes for traffic which BNSF or its agent (for example, Utah Railway) switch customers directly." BNSF Report, p. 16.

BNSF also describes the many ways that it has worked cooperatively with UP to resolve issues arising out of the implementation of the merger conditions. For example, BNSF describes how the two railroads have agreed to add customers to the list of "2-to-1" facilities that BNSF can access. <u>Id</u>. BNSF describes how the two railroads have worked together to implement BNSF service on the Baytown and Cedar Bayou branches, <u>id</u>., pp. 10-11, and how they have worked together to coordinate maintenance-of-way windows on UP routes in California, <u>id</u>., p. 13. BNSF also describes how the two railroads are working together to resolve problems relating to data exchange issues that cause delayed and misrouted cars. <u>Id</u>., pp. 20-21.

It is refreshing to see BNSF report that "UP has been very receptive and willing to work with BNSF's customer service and support staff to successfully resolve these problems." Id., p. 21.

The vast majority of BNSF's report is overwhelmingly positive, but BNSF cannot resist the urge to complain about something, even if the complaints have been shown to be meritless or have been resolved long ago.

For example, BNSF resurfaces its false allegation that UP crews its own trains first in the Central Corridor. Id. UP showed nearly one year ago that this allegation was not true, and that BNSF could resolve any concerns it had by providing its own crews in the Central Corridor. UP/SP-361, Sept. 30, 1998, pp. 21-24. Since that time, BNSF has acknowledged that Central Corridor operations no longer present a problem, and it has decided not to supply its own crews. See BNSF-PR-10, Jan. 4, 1999, p. 4.

BNSF also makes the inflammatory allegation that UP "disrupted BNSF traffic on a daily basis" by refusing to spot or pull BNSF cars to an inspection track near Eagle Pass. BNSF Report, p. 22. But when one reads past BNSF's hyperbole, one discovers that the dispute involved an average of "two cars per week," and that an agreement was quickly worked out once BNSF agreed to compensate UP for the service it was providing. Id.

Similarly, BNSF complains that UP threatened to exercise its option to cancel a shipper's lease of UP property when the shipper was considering using BNSF, but in its next breath reports that UP agreed to extend the shipper's lease even though the shipper decided to route its traffic via BNSF. Id.

BNSF also alleges that UP has engaged in a "pattern" of "delivering messages" concerning BNSF's right to access customers through customers, rather than directly to BNSF. Id., p. 23. But a closer reading reveals that BNSF's report refers to only one shipper (Cargill). See BNSF-PR-11, p. 14. In fact UP went out of its way and met with both BNSF and the shipper to clarify that it was the responsibility of BNSF and the shipper to reach an agreement on how BNSF would serve the shipper.

BNSF also apparently felt the need to note its "concerns" about the impacts of the construction of the Port of Brownsville rail bypass, but admits that haulage service in the area "has improved and enabled BNSF to provide competition to UP." BNSF Report, p. 23. Similarly, BNSF notes past delays in the Sacramento area, but reports that instituting its own train operations "appears to have improved service" and that UP and BNSF are cooperating to resolve any remaining issues. Id., p. 24.

Finally, BNSF describes a dispute with UP involving service to Econorail in Baytown. Id., p. 21. UP and BNSF have met to discuss whether BNSF has the right to serve a non-shipper facility like Econorail by reciprocal switch, or whether it must serve such a facility directly, and UP and BNSF have a meeting scheduled later this month to discuss the issue again. If the parties cannot resolve their disagreement, they may have to arbitrate it, but given that good faith efforts to resolve this matter are ongoing, there was no reason for BNSF to complain to the Board.

In sum, the evidence presented by BNSF shows that the merger conditions are working as the Board intended. Even BNSF's complaints, when stripped of their inflammatory language and hyperbole, demonstrate that UP and BNSF have worked diligently to resolve issues that have arisen regarding the implementation of the merger conditions.

B. CPUC's Request for New Conditions

Despite the absence of complaints from shippers, and DOT's conclusion that the Board's conditions to preserve competition "are having their intended effects" (DOT-4, p. 5), CPUC unexpectedly calls for several new conditions. Specifically, it asks the Board to identify a railroad other than BNSF to "take over" a Central Corridor route between the Midwest and Northern California, and it requests trackage rights for BNSF over UP between Marysville, California, and Eugene, Oregon. CPUC Comments, pp. 8-9. It also wants UP to upgrade its route to Mexico via Calexico and Mexicali. Id., p. 11.

CPUC's requests are wholly unwarranted by any diminution of competition or other adverse effect of the UP/SP merger. They are based on fundamental misunderstandings of regulatory law and railroad operations. They would also have devastating effects on the interests CPUC purports to represent.

1. Competition for Northern California Shipments

CPUC says BNSF has provided only "token competition" in the Central Corridor and describes the BNSF trackage rights in that corridor as a "non-starter." Particularly for an agency charged with representing the interests of California shippers, these conclusions border on the bizarre. CPUC presents not a shred of evidence to show that any California shipper has lost rate or service competition due to the UP/SP merger or the BNSF conditions, while UP produced voluminous, detailed and specific evidence to the contrary. UP showed that BNSF is running more than enough trains to provide shippers in the Central Corridor with a competitive option to UP service and that BNSF has been successful in capturing "2-to-1" traffic moving in the Central Corridor.[1]

Ultimately, CPUC's concern turns out to be not whether BNSF provides shippers (none of which complains about loss of competition) with quality service or competitive rates, but instead about which of two alternative routes BNSF chooses to move overhead shipments between Northern California and the Midwest.

As a result of the BNSF-UP settlement agreement, as modified and imposed by the Board, BNSF obtained access to every Northern and Central California shipper that otherwise would have lost competitive service as a result of the UP/SP merger. Decision No. 44, pp. 121-24, 138-40. BNSF has the option of moving shipments between those shippers and the Midwest via trackage rights over the former DRGW Central Corridor route or via BNSF's own Santa Fe route through Arizona and New Mexico (the "Southern Route"). As a general rule, BNSF uses the Southern Route, one of America's finest and fastest rail lines, for overhead traffic. CPUC

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[1] CPUC complains that BNSF's traffic level in the Central Corridor "pales in comparison to the huge daily volume of UP activity." CPUC Comments, p. 7. But the Central Corridor is the core of UP's system, and no one should expect BNSF's traffic levels in that corridor to match UP's. As the Board has recognized, the relevant question is not whether BNSF's volume is equal to UP's, but whether BNSF has "sufficient traffic to sustain service levels that allow it to be a realistic choice for shippers." Finance Docket No 32760 (Sub-No. 21), Union Pacific Corp., Union Pacific R.R. & Missouri Pacific R.R. — Control & Merger — Southern Pacific Rail Corp., Southern Pacific Transportation Co., St. Louis Southwestern Ry., SPCSL Corp. & Denver & Rio Grande Western Ry., Decision served Oct. 27, 1997, p. 5. As we have shown, BNSF offers a realistic choice to shippers in the Central Corridor. Applicants' Third Annual Report on Merger and Condition Implementation, July 1, 1999, pp. 64-74, & Confidential Appendices B & E.

praises that route as "premier and heavily double-tracked." CPUC Comments, p. 4. Much of BNSF's massive capital investment in recent years has gone into that corridor.

CPUC offers no plausible explanation why BNSF's routing choice for Northern California-Midwest overhead shipments should be of any concern to shippers or to the State of California. If shippers are receiving competitive service and rates, routing of overhead traffic has no impact on the public interest. The government should not be in the business of making railroad operating decisions.

CPUC asserts that shippers are "missing out on lower rates" (id., pp. 4-5), but its assertion is unsupported. There is no reason to believe that BNSF's use of its highly efficient Southern Route would raise BNSF's rates. CPUC also objects that BNSF carries few intermodal shipments on the Central Corridor trackage rights, but that is because the former DRGW route over which BNSF has trackage rights was never a fully competitive intermodal route. It is slower than competing routes and cannot accommodate full-size doublestack shipments. As CPUC should recall, prior to the UP/SP merger most of SP's Oakland-Chicago intermodal service moved via El Paso, not over the Central Corridor. BNSF's Southern Route remains the leading intermodal route between the Midwest and Northern California.

CPUC's complaint that BNSF is not participating in Port of Oakland traffic is especially peculiar. The BNSF-UP settlement agreement provided BNSF with its first-ever direct access to the Port. UP is vacating a rail yard adjacent to the Port to facilitate both Port expansion and highly efficient direct BNSF service to the Port. Once the Port is dredged to make it more competitive, both BNSF and UP will be ready to serve it with excellent intermodal routes -- thanks to the UP/SP merger and its competition-enhancing conditions.

CPUC says it fears that UP eventually will drive BNSF out of the Central Corridor and then abandon the former Western Pacific ("WP") line in Northern California. These fears could not be more unfounded. BNSF traffic to and from local shippers in Nevada, Utah and Colorado is growing, not shrinking, so UP is not driving BNSF out of the corridor.[2] And UP requires the WP line as a low-grade route for heavy trains to avoid the 2.4 percent grades over Donner Summit. Only 30 months ago, UP spent tens of millions of dollars to rebuild the WP route to higher standards after massive floods.

CPUC's proposal would be debilitating for precisely those California shippers CPUC seeks to protect, for reasons CPUC appears to have overlooked. Today, the shippers who gained access to BNSF in the UP/SP merger enjoy comprehensive access to the entire BNSF network, with single-line service and ratemaking throughout the West. They also enjoy use of BNSF's alternative routes, including the "premier" Southern Route. If CPUC's condition were granted, however, those shippers would find themselves served by a different railroad with only one route into the West, the DRGW Central Corridor route. They -- as well as all BNSF-served shippers in Nevada and Utah -- would lose BNSF's single-line service and ratemaking capabilities throughout the West. They also would lose their access to BNSF's high-speed Southern Route. They would be forced to rely on a much smaller rail operator, confined to a

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[2] As CPUC says, BNSF's recent reduction of carloads in the Central Corridor results from rerouting overhead traffic.

Central Corridor route through the Rockies that is not fully competitive for intermodal business. For all practical purposes the Port of Oakland -- which requires doublestack trains -- would lose competing rail service because the DRGW route cannot handle full-size doublestack shipments. In short, CPUC would replace highly capable BNSF service with a carrier with all the limitations of the old DRGW Central Corridor route.

2. I-5 Corridor Service

CPUC's request for expanded BNSF rights in the north-south I-5 Corridor along the West Coast reflects a profound misunderstanding of the history and purpose of those rights. As a result of the UP/SP merger and the associated BNSF-UP settlement agreement, BNSF and UP created two single-line routes in this corridor for the first time in history. Rail competition in the I-5 Corridor is far stronger today than before the merger.

Prior to the UP/SP merger, SP's routes from California ended at Portland, where SP interchanged traffic with BNSF or UP. The alternative "Inside Gateway" route via Bieber had historically been a three-carrier route (BN-WP-ATSF) and was by 1996 virtually moribund.

The merger created two new direct single-line routes from Seattle and the Canadian border to California, Arizona, New Mexico and Mexico. UP and SP combined to create one of those routes. By acquiring trackage rights over UP between Stockton and Keddie, California, and buying UP's line from Keddie to Bieber, BNSF transformed the Inside Gateway into a second direct single-carrier route stretching from British Columbia to San Diego. UP granted BNSF those concessions not to resolve any loss of competition as a result of the UP/SP merger, but as a quid pro quo in the negotiations between BNSF and UP to enhance competition in the corridor. UP described the resulting new competition in its July 1 report at pp. 77-79 and Confidential Appendix J.

Looking this gift horse in the mouth, CPUC complains that the horse does not run fast enough. CPUC seeks trackage rights for BNSF over almost 500 miles of UP's mainline between Marysville, California, and Eugene, Oregon, so that BNSF can be more competitive for intermodal and other traffic. As the Inside Gateway route is more competitive today than it has ever been in history, and the UP/SP merger enhanced competition in this corridor, there is no regulatory predicate for these expanded trackage rights.[3] The Board has no legal basis for giving one railroad rights over another simply to make its service even better than it already is. Such trackage rights should arise only from a further voluntary exchange of rights.

CPUC also seeks new conditions to "expand BNSF participation in rail traffic west of the Cascades." CPUC Comments, p. 10. But the UP/SP merger did nothing to harm BNSF access to and from the region west of the Cascades, but instead enhanced it. And BNSF has much more extensive trackage in western Washington than UP, which owns trackage only between Tacoma and Seattle, a distance of 34.4 miles, and three small spurs. BNSF's track mileage dwarfs UP's.

In light of CPUC's mistaken concern that UP might abandon a former WP line it badly needs, CPUC should be similarly concerned about a collateral effect of the condition it

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[3] The Inside Gateway route carries for more traffic today than before the UP/SP merger. Before the merger, it carried had service only three times a week and moved only 6,000 cars a year. See UP/SP-23, Nov. 30, 1995, Peterson V.S., p. 161. Today, as CPUC notes, it operates almost one-third as many trains as UP.

proposes in the I-5 Corridor. CPUC's condition likely would cause a 200-mile rail abandonment in Northern California. If BNSF gains trackage rights over UP's I-5 Corridor mainline, as CPUC advocates, it almost certainly would abandon the Inside Gateway route between Keddie, California, and Klamath Falls, Oregon. That line generates insufficient local traffic to support its costs and is viable only because of overhead traffic that the CPUC condition would reroute.

3. The Calexico-Mexicali Rail Border Crossing

CPUC requests a vaguely-defined condition requiring UP to upgrade its line between Calexico on the California-Mexico border and Niland, California, on UP's Sunset Route. There is, again, no merger-related basis for such a condition, and CPUC offers none. Only SP served the Mexican border gateways west of El Paso before the UP/SP merger, and the merger had no adverse effect on competition via those gateways. The merger did not affect service or track quality via Calexico and Mexicali. If CPUC aspires to upgrade a rail line beyond the level justified by available traffic, it should fund the upgrade.

CONCLUSION

The Board should reject the only requests for new or changed conditions, those recommended by CPUC.

Respectfully submitted,

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

September 3, 1999

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that, on this 3rd day of September, 1999, I caused a copy of the foregoing document to be served by first-class mail, postage prepaid, or by a more expeditious manner of delivery on parties of record in Finance Docket No. 32760 (Sub-No. 21), and on

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

Premerger Notification Office
Bureau of Competition
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Washington, D.C. 20580

Michael L. Rosenthal

STB FD 32760 (Sub 21) 8-16-99 D 195371

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DONELAN CLEARY
WOOD & MASER, P.C.

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August 16, 1999

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

D

Re: Finance Docket No. 32760 (Sub-No. 21), *Union Pacific Corporation, Union Pacific Railroad Company and Missouri Pacific Railroad Company – Control and Merger – Southern Pacific Rail Corporation, et al -- Oversight*

Dear Secretary Williams:

Pursuant to the Board's decision in this proceeding, The National Industrial Transportation League ("League") hereby submits its comments in this proceeding.

In Decision No. 44 in the control proceeding, the agency imposed, as a condition to the approval of the merger of the UP and SP, oversight for five years "to examine whether the conditions we have imposed have effectively addressed the competitive issues they were intended to remedy." Decision No. 44, p. 146. The League has participated actively in the agency's oversight since the issuance of Decision No. 44, and has followed closely the written reports of the carriers required by the agency's oversight condition.

Reports from League members clearly indicate that the service problems experienced by the UP during 1997-98 have abated. Moreover, the reports filed by the BNSF in this proceeding indicate that BNSF's traffic over the trackage rights lines has grown since the approval of the merger. Traffic growth by BNSF since the approval of the merger is clearly a positive development.

However, it is not possible to conclude, either from the BNSF figures or from other sources, particularly given the time that has passed since the service crisis, that BNSF has been able to completely and permanently replicate the rail-

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to-rail competition that existed pre-merger. As one example, a flattening of traffic growth by BNSF, or even worse, a reversal of that traffic growth, may suggest that additional steps are needed to encourage a competitive rail environment in one or more regions of the country affected by the UP/SP merger. Continued oversight is clearly necessary. In addition, continued oversight is necessary to ensure that, if necessary, evidence can be provided that UP is impeding implementation of the merger conditions. *Cf.*, Decision No. 86 in this proceeding (served July 12, 1999) at 5.

The League applauds the Board for mandating the oversight process, and urges the Board to continue to require the quarterly and annual reports by the carriers. The League intends to continue to closely examine those reports, and asks the Board to instruct its staff to continue to analyze whether there is effective rail competition in the area of the nation affected by the merger.

Sincerely,

Frederic L. Wood

FREDERIC L. WOOD
NICHOLAS J. DIMICHAEL

cc: All parties of record

CERTIFICATE OF SERVICE

I hereby certify that I have on this 16th day of August, 1999, served a copy of the foregoing comments on all parties of record in this proceeding by first-class mail, postage prepaid, in accordance with the Rules of Practice.

Shannon R. Harris

Shannon R. Harris

STB FD 32760 (Sub 21) 8-16-99 D 195364

U.S. Department of Transportation
Office of the Secretary of Transportation

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400 Seventh St., S.W.
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August 16, 1999

Vernon A. Williams, Secretary
Surface Transportation Board
Suite 700
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: Fin. Dkt. 32760 (Sub-No. 21)

Dear Secretary Williams:

Enclosed herewith are an original and ten copies of the Comments of the United States Department of Transportation in the above-referenced proceeding. I have also enclosed a computer diskette containing these comments in a format readable by WordPerfect 7.0. Included as well is an additional copy that I request be date-stamped and returned to the messenger delivering these documents.

Respectfully submitted,

Paul Samuel Smith

Paul Samuel Smith
Senior Trial Attorney

Enclosures

18564

DOT-4

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 Railroad Corp., Southern Pacific Transportation Co., St. Louis Southwestern Railway Co., SPCSL Corp., and the Denver & Rio Grande Western Railroad Company (OVERSIGHT)	)	F.D. No. 32760 (Sub-No. 21)

COMMENTS OF THE
UNITED STATES DEPARTMENT OF TRANSPORTATION

Introduction

The Surface Transportation Board ("STB" or "Board") instituted this proceeding to assess the oversight conditions it imposed in Finance Docket No. 32760, the merger of the Union Pacific ("UP") and the Southern Pacific ("SP") railroads (collectively, "UP/SP"). Decision No. 1, served May 7, 1997 ("Decision"). In this proceeding the Board at least annually seeks input on the effects of the merger, on the efficacy of the conditions used to address the transaction's competitive harms, and other matters. Id. at 2. The most important of these conditions were extensive trackage rights awarded to the Burlington Northern Santa Fe Railway Co. ("BNSF") to enable it to replace the competition previously provided by SP.

The United States Department of Transportation ("DOT" or "Department") has participated in this proceeding in each of the last two years. DOT-1 (filed August 1, 1997); DOT-2 (filed August 20, 1997); DOT-3 (filed

September 1, 1998). Since the merger we have been concerned primarily about three issues: the safety of railroad operations, the adequacy of service levels, and the state of intramodal rail competition. Id. We will continue to address these issues, since we share the Board's goals of maintaining competition while assuring that rail safety and service reach and remain at acceptable levels.

Background

Approximately one year after the merger, in its first oversight decision the STB preliminarily concluded that the merger, as conditioned, had not caused substantial competitive harm. Decision No. 10 (served October 24, 1997) at 2. The Board also expressed concern over post-merger safety and service problems. Id. at 13-14. [1]

Last year was the second year following the merger, and UP/SP was still suffering from what had become an unprecedented service crisis. After reviewing the record the Board concluded that "notwithstanding ... the effects of the UP service crisis, the UP/SP merger has not thus far caused any substantial competitive harm." Decision No. 13 (served December 21, 1998) at 8 (emphasis in original). The competition provided by BNSF appeared to the STB to be "at least as effective as the pre-merger UP vs. SP competition." Id. at 11. The Board also found that "the UP service situation, although still not perfect, has improved considerably and all indications are that it will continue to improve." Id. Finally, the Board noted that DOT had found no safety problems requiring action in the context of the general oversight proceeding. Id.

The most fundamental issue in this proceeding, in the Department's view, is safety. The Federal Railroad Administration ("FRA") continues to monitor the

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[1]/ Indeed, the Board instituted separate proceedings to address UP/SP's then-growing service crisis. E.g., Rail Service in the Western United States, STB Ex Parte No. 573 (served October 2, 1997); Joint Petition for Service Order, STB Service Order No. 1518 (served October 31, 1997).

safety of rail operations in the relevant area. As discussed below, it has found significant improvements in rail safety on the UP/SP.

As to competition and service, DOT had concluded last year that the UP/SP service crisis had so skewed rail operations in the affected area that it was impossible to judge the efficacy of the trackage rights conditions. DOT-3 at 5-7. We were concerned that BNSF's initial success at gaining market share might have resulted more from UP/SP's poor service than from BNSF's ability to compete via trackage rights. Id. UP/SP and BNSF have now submitted their comprehensive progress reports on the implementation of the merger and the associated conditions. UP/SP-366; BNSF-PR-12.

The Department must still review the comments of other parties. A more complete record may make it necessary to modify or expand our preliminary views. Based on the reports of the carriers, however, it appears that service levels have recovered and, we are heartened to note, that competition between BNSF and UP/SP still seems to be vigorous. Implementation of the merger thus appears to be proceeding satisfactorily and no significant modifications to the applicable conditions are warranted at this time.

Safety

FRA has worked closely with labor and management on the UP/SP to improve safety. Under the auspices of the FRA's Safety Assurance and Compliance Program ("SACP"), the carrier, its labor unions, and FRA have formed a strong partnership dedicated to improving safety. Considerable progress has been made: one employee fatality occurred during the year 1998 as a result of train accidents or incidents, compared with nine such fatalities during 1997. This is an impressive achievement. Unfortunately, four UP/SP employees were killed in other accidents in 1998, so the safety focus must be continued.

We offer several concrete examples of the progress made to date. Of particular interest has been the efforts of the merged carrier to eliminate safety problems resulting from fatigue. UP/SP is now the only major railroad with a system-wide policy that provides train crews with guaranteed time off. An aggressive hiring program added 3,917 new employees into the Train Engine and Yard ranks during 1998. Another 3,124 employees were brought on board by UP/SP in other areas. A Fatigue Working Group was formed that has led to training and education programs to combat problems stemming from fatigue, agreements to improve accommodations for away-from-home employees, and company policies to limit fatigue.

UP/SP has also taken steps to reduce dispatcher workload, as a result of an FRA study of dispatcher positions in Omaha. The carrier has adjusted workloads, established a dispatching center in Spring, Texas, added dispatcher positions, and trained additional managers to assist, mentor, and supervise dispatchers. Finally, in 1998 UP/SP hired 114 new dispatchers, and it plans to hire an additional 124 train dispatchers by the end of this year.

Progress has also been made toward improving signal accuracy and reliability, safety training, and policies relating to maintenance-of-way personnel. Revised procedures for locomotive operation and inspection and rail car inspection are now in place.

Improvements have made the railroad's culture more supportive of safety by enhancing employee morale and quality of life. UP/SP management has established policies to foster a work environment where employees may openly and honestly report accidents, injuries and safety concerns.

In sum, over the past year, safety on UP/SP has substantially improved. FRA will continue to work with the carrier and its employees to build on that progress.

Service

UP/SP reports that it has overcome its service crisis and that service has now been fully restored and continues to improve. UP/SP-366 at 2. Several indicia of service quality are offered as evidence. For example, UP/SP notes that average train speed (which, in this case, includes time in yards) fell as low as 12 m.p.h. during the service crisis, but was restored to 17.3 m.p.h. in January, 1999, which the carrier reported was "normal." Id. at 6. By mid-June of 1999, UP/SP claims average train speed had climbed to 18.7 m.p.h., indicating continued improvement. Id. at 6. Another measure of service quality, UP/SP's average terminal dwell time, has declined from 43.9 hours during the service crisis to 31.3 hours by early June of this year. Id. at 6. Sidings blocked by cars and delayed trains have declined from 150 at any given time during the crisis to 25 this past January, and to 18 by early June; UP/SP claims that this last figure is consistent with normal operations under which it "stages" trains in sidings from time to time. Id. at 7.

BNSF appears to agree that the service crisis is over. BNSF-PR-12-23. However, it is in this area in particular that the Department is interested in reviewing comments from customers regarding the restoration of service.

Competition

The Department expressed concern last year that the marketplace success BNSF had enjoyed at the expense of UP/SP might be the result of the latter's service problems and might not reflect the adequacy of the conditions ordered by the Board. DOT-3 at 5-7. As noted above, DOT believed that a true test of the adequacy of the trackage rights and other conditions would have to await the completion of the merger integration and a resumption of normal service levels. Id. With UP/SP apparently now able to offer such service, the data in the record thus far suggests that the conditions are having their intended effects.

According to UP/SP, "[e]ach of the competitive conditions continues to work to provide effective competition." UP/SP-366 at 64. In particular, "BNSF continues to provide vigorous and effective competition using the rights that it received as a condition to the merger." Id. UP/SP reports that BNSF's traffic on its trackage rights continues to grow, with BNSF operating more trains, longer trains and carrying more tonnage than in preceding years. In May of 1999, BNSF operated 751 trackage rights trains, compared to 703 for the same month a year earlier; gross tons increased to 3.8 million tons from 3.3 million tons in May of 1998, and cars in trackage rights trains increased to 47,176 in May of 1999, from 40,802 in May of 1998 and 17,834 in May of 1997. Id. at 66. UP/SP also cites numerous examples in its confidential appendix of rate reductions to retain traffic, traffic lost to BNSF, and customers benefiting from the merger by shorter, single-line service. UP/SP-367. These figures overall indicate that BNSF is a robust competitor, gaining business and presumably earning enough from such traffic to warrant continued active participation in the market.

For its part, BNSF also reports that its carloads have increased on the trackage rights lines, reaching 33,419 loaded units (presumably cars and intermodal containers) in May of 1999 on "UPSP Merger Condition Lines," up from 26,212 in May of 1998 and 11,450 in May of 1997. BNSF-PR-12 at Attachment 2. The steady three year increase in traffic speaks well of BNSF's willingness and ability to compete over these lines. Further confirmation of BNSF's commitment to serving the customers on its trackage rights lines is the investment BNSF has made in these lines to allow it to provide better service. BNSF-PR-12 at 12-14.

The Board also awarded trackage rights to the Texas Mexican Railway Company ("TexMex") in order to address the possible loss of competition at the Laredo gateway into Mexico and to protect the essential services provided by that carrier. Finance Docket No. 32760, Decision No. 44 (served August 12, 1996) at 148-51. The record compiled to date shows that TexMex has enjoyed similar success using these rights. UP/SP reports that the volume of traffic handled by TexMex to and from Laredo has more than doubled since the merger. UP/SP-366 at 80. TexMex's share of total traffic moving over the Laredo gateway has also increased. Id. at 81. Clearly, the TexMex has remained a competitive force for traffic through the Laredo gateway.

Conclusion

The merged UP/SP no longer presents a singular safety concern to FRA. Rail service appears to have returned to normal levels on the merged carrier. The Board's conditions seem to have maintained intramodal rail competition. Barring the submission of inconsistent information filed by shippers or other interested parties, it appears that the merger is now progressing in a reasonable manner. Under these circumstances, the Department tentatively believes that it is not now necessary to revisit the conditions imposed by the STB. The Board should of course continue these oversight proceedings for the entire five-year period originally contemplated.

As the merger implementation progresses, it is the adequacy of these conditions to allow effective competition that will continue to be of greatest interest in assessing the competitive impact of the consolidation. This area will continue to merit close scrutiny in future progress reports.

Respectfully submitted,

Nancy E. McFadden

NANCY E. MCFADDEN
General Counsel

August 16, 1999

CERTIFICATE OF SERVICE

I hereby certify that I have on this day caused to be served on all Parties of Record in Finance Docket 32760 (Sub-No. 21) by first-class mail, postage prepaid, a copy of the foregoing Comments of the United States Department of Transportation filed in this proceeding.

Paul Samuel Smith

Paul Samuel Smith

August 16, 1999

STB FD 32760 (Sub 21) 8-16-99 D 195362

result of operations over the southernmost portion on which IP is located for 1996. These data clearly are more representative of current traffic levels and demand for services over the Norman Branch than the older 1993 data. Moreover, because AMR has continued to operate, and indeed is currently operating, the southernmost portion to serve IP, that portion of the line plainly has a GCV. Indeed, the Shippers themselves have presented evidence that supports this conclusion, by arguing during the ICC's feeder line proceeding that the projected difference in operating results if IP's traffic is not included is the difference between a $124,701 per year loss and $264,649 per year profit. In these circumstances, even though we have required AMR to sell the line as a single line, it is appropriate to add the GCV of the southernmost portion of the line to the NLV for the rest of the line to develop an overall valuation for this line pursuant to 49 U.S.C. 10907(b)(2).

In determining the GCV for the line's southern portion, we used data furnished by the Shippers and AMR in their supplemental filings that reflect AMR's operations over the southern portion for the year 1996. These data show that in 1996, AMR realized revenues of $425,660 for moving 2,867 cars on the southern portion. AMR reported incurring variable costs of $297,000. Applying a multiplier of 17.7% based on the 1996 pretax cost of capital rate for the railroad industry,[20] we have computed the GCV of the southern portion at $726,893.

Our GCV estimate does not include costs associated with rehabilitating the approximately 3-mile southern portion on which AMR continues to serve IP. It is unclear from the evidence submitted how much rehabilitation will be necessary for the southern portion. Inasmuch as trains are regularly using that portion of the line to serve IP, we have assumed that the amount of rehabilitation on that portion will be minimal. Because the purchaser would be rehabilitating primarily the northern portion, and because that portion of the line has no GCV since AMR is not operating it, the Shippers' projected rehabilitation costs for that segment are not relevant for our GCV analysis.

Also, we have not included fixed costs in our GCV for the southern portion. AMR has contended that there would be no fixed cost savings if the Norman Branch were eliminated, and there is nothing in the record that would pinpoint any fixed cost decreases. Furthermore, fixed costs, by definition, are those that do not vary with volume. Thus, we have not included fixed costs in determining GCV for the southern portion.

In Caddo 2, the ICC set the NLV based on evidence that valued the line in 1994. On remand, neither party has presented any supplemental evidence to update the NLV of the Norman

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[20] In Railroad Cost of Capital—1996, STB Ex Parte No. 558 (STB served July 16, 1997), we found that the after-tax cost of capital for 1996 is 11.9%. The pre-tax cost of capital equivalent of this number is 17.7% (which assumes 35% Federal and 2% state tax rates) is an appropriate number for use as an earnings multiplier here. As noted, we used a 1996 cost of capital here because the parties' evidence was for 1996.

Branch. Without additional evidence, we have no choice but to use the NLV set in Caddo 2, even though that value may not totally reflect current conditions on the Norman Branch.

The value of the entire line using the GCV for the southern portion and NLV for the northern portion is as follows:

Southern segment GCV	Amount
Revenues	$425,660
Variable Costs	$297,000
Net Contribution Before Fixed Costs	$128,660
Estimated Fixed Costs	0
Net Revenue After Fixed Costs	$128,660
Earnings Multiplier	17.7%
GCV	$726,893
Northern segment NLV	$901,834
Total Value	$1,628,727

The statute provides that the constitutional minimum value of a line shall be the greater of the NLV or the GCV. 49 U.S.C. 10907(b)(2). The value of the entire line at $1,628,727, adding the GCV for the southern portion ($726,893) to the NLV for the remainder of the Norman Branch ($901,834), exceeds the NLV for the entire line ($961,096.24). Accordingly, to provide AMR the constitutionally required minimum value, we will set the selling price of the line at $1,628,727.

Financial Responsibility

The feeder line procedures require us to determine if the purchaser of the line is a "financially responsible person." The statute defines a "financially responsible person" as a person who (1) is capable of paying the constitutional minimum value of the line; and (2) is able to assure that adequate transportation is provided over the line for at least 3 years. When it originally reviewed the application in Caddo 2, the ICC found (at p. 6), that CALM would be able to obtain the necessary funding from the Shippers to operate the northern 49.2 mile portion of the line. We are revisiting the issue in light of the court's instruction that we determine whether CALM has the financial resources to operate the entire line, in light of DRRC/CALM's cessation of interim operations and the substitution of ETC.

The Shippers reconfirm their intent and willingness to acquire the Norman Branch, stating that they would acquire the Norman Branch through a newly formed corporation that will be jointly owned by GS Roofing, Bean, and Gifford Hill. They indicate that GS Roofing and Bean will each pay half of the purchase price of the line. The Shippers also submitted confidential financial data under seal showing that GS Roofing and Bean have the financial resources necessary to acquire the line. GS Roofing and Bean state that each is committed to providing the necessary funds to assure rail operations for at least three years.

The Shippers state further that, in the past three years, they have covered many of the costs of rail operations over the Norman Branch over and above the freight rates they paid to UP. They explain that they shared in the purchase of locomotives and other operating equipment and track materials. They also assertedly covered the costs resulting from a major derailment in 1994. In addition, GS Roofing evidently created a separate fund which was used to purchase ties.

In their supplemental statements, the Shippers submitted new projections of future operations on the line, assertedly showing that the line will be viable after being rehabilitated, a process which is anticipated to take about three years to complete. The Shippers point out that their new projections are based on experience gained by three years of operations over the entire line. They claim that, as the line is rehabilitated, operating speeds will increase, thereby reducing operating expenses. In addition, they expect that financial results will improve because they would not have to pay trackage rights fees to AMR for operating over the southern portion.

The Shippers expect that under their ownership the line would generate additional revenues ensuring the line's future viability. Gifford-Hill, IP, and Barksdale likely would maintain their current traffic levels. However, the Shippers anticipate that GS Roofing and Bean will increase their traffic over the Norman Branch, and, in turn, generate additional revenues. A verified statement by Curt Bean indicates that Bean has opened a new facility in Kansas City, KS, which will receive rail shipments that originate on the Norman Branch. John W. Smith testifies that GS Roofing intends to use its facility at Birds Mill as the primary source of roofing granules to supply its manufacturing facilities in Little Rock, AR, Charleston, SC, and Shreveport, LA. The Shippers expect that GS Roofing's shipments of covered hoppers from its Birds Mill facility will provide the major source of revenues realized from operating the Norman Branch.

In response to our request for additional information, the Shippers also updated the record to show that they would cover expenses for service over the line for at least 3 years after they acquire the line, as required by section 1151.3(a)(3)(ii) of our regulations. The Shippers also submitted a cash flow analysis, which is set forth in Appendix A to this decision. The data indicate that revenues will exceed expenses in each of the first 3 years of operating the line. As a result, the Shippers do not expect that they would have to provide any subsidy. However, in the event that operations are unprofitable, GS Roofing and Bean state that they are committed to providing funding necessary to assure rail operations for at least 3 years.

The Shippers further indicate that they propose to spend more than $2 million to rehabilitate the line over three years. In the first year, they propose to replace ties on all curves on a portion of the line between milepost 447 and milepost 479.2, brush-cut the entire line, and perform 17 miles of ditching and drainage work at a total estimated cost of $799,705. In year 2, they propose to replace ties on tangent track between milepost 447 and milepost 479.2, surface and dress tangent track and replace ties and rails on Gifford-Hill lead at a total estimated cost of $617,422. In the third year, they propose to replace ties, and surface and dress track between milepost 447 and milepost 426.3, at a total estimated cost of $604,691. The proposed rehabilitation is detailed in Appendix B to this decision.

The Shippers also submitted an operating plan, which indicates that, after completion of year 1, maximum speed will be increased from 5 mph to 10 mph for the portion between M.P. 447 and M.P. 479.5. The increased speed will allow CALM to make a complete turn on a daily basis, which would give the Shippers complete daily service. According to the plan, train operations during rehabilitation would be adjusted by running trains early or late so as not to disrupt construction during the day. Following completion of the initial phase of the rehabilitation process, the Shippers expect that train speed on the entire Norman Branch should be 10 mph.

According to the operating plan, following acquisition of the entire line, rail service to IP will continue on a daily basis as currently provided by AMR. With the exception of the IP operations which now are being conducted by AMR, the proposed operations will be comparable to the operations which have been conducted by DRRC/CALM and ETC since April 1994 under Service Order No. 1516.

AMR complains that the Shippers have not clarified the identity of the operator of the line or established its financial responsibility. AMR further asserts that the Shippers have not submitted adequate information regarding how the purchase will be funded. Without this information, AMR claims, the Shippers have not shown that the operator is financially responsible within the meaning of the statute. However, the Shippers have adequately explained that they reached an agreement with ETC to replace DRRC/CALM as the operator of the line. Consistent with the requirements of 49 CFR 1151.3(a)(7), ETC submitted a detailed operating plan. ETC also has provided an updated pro forma cash flow statement which details the anticipated financial situation for the first three years after acquisition. Moreover, the Shippers submitted extensive evidence under seal showing the financial condition of the prospective purchasers of the line.

We find that the Shippers have provided sufficient information to show financial responsibility within the meaning of section 10907. The Shippers have shown that they will control and provide financial backing to the operators and insure that operations are conducted for at least three years. Also, the supplemental financial information in the record shows that GS Roofing and Bean have ample resources to purchase and rehabilitate the line and finance its operations for three years. Both shippers project increases in their traffic to generate additional revenues, and both have shown that they are committed to providing the funds to acquire the line and assure that operations will continue for three years. This is adequate to satisfy the statutory requirement of financial responsibility. See Cheney R. Co.—Feeder Line Acq., 5 I.C.C.2d 250, 263 (1989), aff'd sub nom. Cheney R. Co., Inc. v. ICC, 902 F.2d 66 (D.C. Cir.), cert. denied, 498 U.S. 985 (1990).

Exemption

Under section 10907(g)(1), ETC has elected to be exempt from the provisions of part A of Subtitle IV of 49 U.S.C., except the joint rate provisions of chapter 107.

Labor Protection

ICCTA removed mandatory labor protection from the feeder line procedures now in section 10907. However, the statute provides that we shall require, to the maximum extent practicable, the use of employees who would normally have performed work on the line at issue. 49 U.S.C. 10907(e). In the Proposed Decision provided by the Shippers, the Shippers suggest that ETC be required to employ AMR employees currently on the line for a 90-day probation period, and that, at the end of the probation period, each employee be evaluated for further employment. We believe the Shippers' approach represents a reasonable accommodation of the statute, and it will be imposed as a condition.

Closing Terms

To ensure the smooth transfer of the line, we will establish the following terms: (1) payment will be made by cash or certified check; (2) closing will occur within 90 days after the service date of this decision; (3) AMR will convey all property by quitclaim deed; (4) AMR will deliver all releases from any mortgages and original documents conveying interest in the right-of-way to the Shippers or their designee within 90 days from closing; (5) all taxes should be prorated as of the date of closing; and (6) deed recording fees should be paid by Shippers. Mortgage or lien releases, taxes and recording fees should be paid by AMR. The parties may modify the terms of sale by mutual agreement.

SUMMARY

Given the findings of the court in Caddo and GS Roofing, we have little choice but to conclude that the circumstances surrounding the embargo require a finding that the Shippers have met their burden as to the first two criteria of the PC&N standards in 49 U.S.C. 10907(c)(1). We also find that, at the price we are setting, a sale to the Shippers will not cripple AMR financially or operationally. Finally, we find that a sale will lead to better service.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered.

1. The feeder line application is granted.

2. The Shippers must notify the Board and AMR by August 23, 1999 whether they accept or reject our determination.

3. The purchase price of the Norman Branch is set at $1,628,727. The sale is subject to the labor protection condition voluntarily undertaken by the Shippers and the other terms of sale set forth in this decision.

4. This decision is effective September 11, 1999.

By the Board, Chairman Morgan, Vice Chairman Clyburn, and Commissioner Burkes.

Vernon A. Williams

Vernon A. Williams
Secretary

Finance Docket No. 32479

Appendix A

NORMAN BRANCH
NORMAL CASH FLOW PROJECTIONS
FOR THE YEARS 1, 2 & 3

	Year 1	Year 2	Year 3
Projected Revenues:			
Freight	1,473,136.00	1,512,918.00	1,553,088.00
Incidental	55,750.00	56,875.00	58,000.00
Gross Profit	1,528,886.00	1,569,793.00	1,611,088.00
Costs and Expenses:			
MOW Wages	84,764.16	87,010.41	89,316.19
Repairs & Main. - Roadway	48,550.00	49,836.58	51,157.24
Repairs & Main. - Structure	10,000.00	10,265.00	10,537.02
Signals & Interlockers	11,724.33	12,035.02	12,353.95
Other Main of Way Expense	41,392.24	42,489.13	43,615.10
Track Rehab. - Phase I, II & III	799,705.00	617,422.30	604,691.91
Wages - Mechanical	27,507.60	28,236.55	28,984.82
Locomotive Repairs	38,362.80	39,379.41	40,422.97
Car Repairs	5,000.00	5,132.50	5,268.51
Other Equipment Repairs	3,413.88	3,504.35	3,597.21
Equipment Rental	5,500.00	5,845.75	5,795.36
Equipment Depreciation	28,998.60	29,767.06	30,555.89
Other Equipment Expense	6,519.12	6,691.88	6,869.21
*Conductor Wages	56,477.20	57,973.85	59,510.15
*Engineer Wages	72,314.43	74,230.78	76,197.88
Train Fuel	124,860.94	128,169.75	131,566.25
Other Train Fuel	11,991.72	12,309.50	12,635.70
Administrative Expense	207,369.60	212,664.89	218,505.81
Insurance	33,521.92	34,410.25	35,322.12
Other General Expense	11,460.96	11,764.68	12,076.44
Station Expense (Pike City)	3,960.60	4,065.56	4,173.29
General Depreciation	0.00	0.00	0.00
Total Cost & Expenses	1,633,395.10	1,473,205.19	1,483,153.04
Earnings (loss from operations)	(104,509.10)	96,587.81	127,934.96

Other Income and Expenses:

Payroll Taxes	(64,351.76)	(66,057.08)	(67,807.59)
Income Lease of Road & Equipment	0.00	0.00	0.00
Car Hire Expense	(18,000.00)	(18,477.00)	(18,966.64)
Misc. Non-Operating Revenue	0.00	0.00	0.00
Interest Income	0.00	0.00	0.00
Misc. Income	0.00	0.00	0.00
Interest of Funded Debt	0.00	0.00	0.00
Other Income & Expense	200,000.00	0.00	0.00
Misc. Income Charges	0.00	0.00	0.00
Total Income & Expense	117,648.24	(84,534.08)	(86,774.23)
Net earnings (loss) for year	13,139.14	12,053.74	41,160.63

APPENDIX B

NORMAN BRANCH PROPOSED REHABILITATION

Year 1

CURVES ON NORTH END

Milepost 447 To Milepost. 479.2
32.2 MILES

1. Brush Cutting Entire Line (machine and operator)	$10,639.00
2. Crossties (7' x 9' x 8'6" industrial grade)111 1,800 per mile @ $18.00 each x 17 miles	$550,800.00
3. Ballast (10,000 tons @ $4.50 per ton)	$45,000.00
4. Spikes (400 kegs @ $86.00 each)	$34,400.00
5. Tieplates (1500 @ $2.00 each)	$3,000.00
6. Surfacing and Dressing Curve (17 miles @ $.65 per ft)	$58,344.00
7. Drainage work (17 miles)	$30,000.00
8. Track Gang Labor (262 days)	$41,022.00
9. Leased Equipment	
1 tie inserter @ $4,000.00 month x 3 months	$12,000.00
1 tie cranes @ $2,500.00 month (each) x 3 mo	$15,000.00
1 spike driver @ $3,000.00 month x 3 months	$9,000.00
1 ballast plow @ $3,500.00 month x 3 months	$10,500.00
10. Less Salvage Ties (10,000 @ $2.00 each)	($20,000.00)
Total of Year 1	$799,705.00

Year 2

TANGENT TRACK ON NORTH END

Milepost 447 To Milepost 479.2
15 Miles

1. Crossties (7' x 9' x 8'6" industrial grade) 1,500 per mile @ $18.00 each x 15 miles	$405,000.00
2. Ballast (10,000 tons @ $4.75 per ton)	$47,500.00
3. Spikes (360 kegs @ $86.00 each)	$30,960.00
4. Bridge Ties (800 @ $35.00 each)	$28,000.00
5. Surfacing and Dressing Curves 15 miles @ $.55 per ft)	$43,560.00
6. Track Gang Labor (131 days)	$15,902.00
7. Leased Equipment	
1 - tie inserter @ $4,000.00 month x 3 months	$12,000.00
2 - tie cranes @ $2,500.00 month (each) x 3 mo	$15,000.00
1 - spike driver @ $3,000.00 month x 3 months	$9,000.00
1 - ballast plow @ $3,500.00 month x 3 months	$ 10,500.00
Total of Year 2	$617,422.00

Year 3

SOUTHERN END

Milepost 426.3 To Milepost 447
20 Miles

1. Crossties (7' x 9' x 8'6" industrial grade) 1,000 per mile @ $18.00 each x 20 miles	$360,000.00
2. Ballast (12,500 tons @ $4.75 per ton)	$59,375.00
3. Spikes (325 kegs @ $86.00 each)	$27,950.00
4. Surfacing and Dressing Curves (20 miles @ $.65 per ft)	$68,640.00
5. Track Gang Labor (142 days)	$28,326.00
6. Leased Equipment	
1 - tie inserter @ $4,000.00 month x 4 months	$16,000.00
2 - tie handler @ $1,800.00 month (each) x 4 mo	$14,400.00
1 - spike gauger @ $4,000.00 month x 4 months	$16,000.00
1 - ballast plow @ $3,500.00 month x 4 months	$14,000.00
Total of Year 3	$604,691.00

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195362

STATE OF CALIFORNIA

GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
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August 13, 1999

VIA FEDERAL EXPRESS

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

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Re: Finance Docket No. 32760 (Sub-No. 21)
Union Pacific/Southern Pacific Merger Oversight

Dear Secretary Williams:

Enclosed please find an original and 11 copies of a document titled "Comments of The California Public Utilities Commission on The Annual Reports Filed by UP and BNSF Pursuant to Merger Oversight Requirements."

Please file-stamp the extra, enclosed copy and return it to the undersigned in the enclosed stamped, self-addressed envelope. Thank you for your attention to this matter.

Sincerely,

James T. Quinn

James T. Quinn
Commission Attorney

JTQ:jmc

Enclosures (12)

ORIGINAL 195362

BEFORE THE SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 32760 (SUB-NO. 21)

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

COMMENTS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION ON THE ANNUAL REPORTS FILED BY UP AND BNSF PURSUANT TO MERGER OVERSIGHT REQUIREMENTS

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August 13, 1999

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 32760 (SUB-NO. 21)

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

COMMENTS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION ON THE ANNUAL REPORTS FILED BY UP AND BNSF PURSUANT TO MERGER OVERSIGHT REQUIREMENTS

The California Public Utilities Commission (CPUC) herein comments on the July 1, 1999 reports filed by Union Pacific Corporation (UP) and the Burlington Northern and Santa Fe Railway Company (BNSF) in accordance with merger oversight requirements. The CPUC is an administrative agency established pursuant to the Constitution and statutes of the State of California. Among its duties, the CPUC oversees the safe operation of trains in California and participates in railroad merger and abandonment proceedings. The CPUC was an active party in the UP-Southern Pacific (SP) merger case.

I

Introduction

It is plain that the focus of the five-year oversight period is to see that effective competition is attained. Thus, in its decision authorizing the UP/SP merger, the Board stated the following:

> "Oversight: We impose as a condition to approval of this merger oversight for 5 years to examine whether the conditions we have imposed have effectively addressed the competitive issues they were intended to remedy."

UP/SP Merger, STB Docket No. 32760, Decision No. 44 (served Aug. 12, 1996) (Merger Decision), p. 146 (mimeo). The Board went on to state that BNSF will be expected to "compete vigorously for the traffic opened up to it by the BNSF agreement" and that "competition provided by BNSF will be one of the key matters to be considered in the oversight proceeding." Id., pp. 146-147.

BNSF states in its instant report that it "has aggressively continued its efforts to compete with UP on the UP/SP lines" and that "[g]enerally, (it) continues to be effective in marketing its services over those lines." BNSF Quarterly Progress Report (BNSF Report), July 1, 1999, at p. 2. For its part, UP claims that the merger and its competitive conditions "have strengthened rail competition in the West." Applicants' Third Annual Report (UP Report), July 1, 1999, p. 48. Indeed, UP subsequently comments as follows:

> "It is now more clear than ever that BNSF, with its extensive Western network and infrastructure of terminals and other support facilities, was uniquely situated to mount fully competitive service over the new rights, and that there is no

> reason why BNSF cannot regularly handle 50%, or even more, of the entire available universe of traffic – through, as always, UP will fight for every carload."

Id., p. 71.

In its comments, the CPUC looks at BNSF's competitive performance in two corridors vital to California -- the east-west Central Corridor and the north-south I-5 Corridor. At the three-year mark in the oversight process, is BNSF, in its own words, "providing the fully effective competitive service the Board envisioned when it approved the UP/SP merger." BNSF Report, p. 23. Finally, the CPUC returns to a subject it addressed several times during the merger case -- the Calexico/Mexicali border crossing -- to see what steps, if any, UP has taken to enhance rail transportation at this international crossing point.

II

The Central Corridor

Perspective on the Central Corridor

The Central Corridor (aka "the Overland Route") connects Northern California and the nation's midwest heartland and has long been a vital rail transportation corridor for California and the West. It encompasses two routes. From Chicago to California, the original route involved three railroads: the Chicago Northwestern Railway (Chicago-Council Bluffs), UP (Omaha-Ogden), and SP (Ogden-Oakland via the Donner Summit). Subsequently, a competing route was put together comprising the Chicago, Burlington &

Quincy Railroad (Chicago-Denver), the Denver & Rio Grande Western Railroad (Denver-Salt Lake City) and the Western Pacific Railroad (Salt Lake City-Oakland via the Feather River Canyon).[1]

For most of the century, the Central Corridor has been the scene of intense competition. One of the most controversial aspects of the UP/SP merger was its proposal to give UP control of both Central Corridor routes. The question became: How could competition be maintained under such a regime? UP's answer was to give BNSF extensive trackage rights through the corridor. In approving this solution, the STB's expectation was that BNSF would "compete vigorously" for Central Corridor traffic. Merger Decision, p. 146.

Today, three years later, the proposed solution is a non-starter. BNSF has done little with its Central Corridor trackage rights and is providing only token competition. The vast bulk of its California-midwest traffic is still routed the same way as before the merger, namely, over BNSF's premier and heavily double-tracked route between Southern California and Chicago. In short, the heralded Central Corridor head-to-head competition between the West's two giant Class 1 railroads has not happened.

This situation negatively impacts the West and portends an even greater problem in the future. California shippers, receivers, and the public are not benefiting from the

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[1] The merger with SP has made UP the owner of all portions of the two Central Corridor routes, with the exception of the Chicago-Denver segment which BNSF owns.

lower rates that strong Central Corridor competition would produce. Indeed, intermodal shipments by BNSF through the Corridor are virtually nonexistent and UP completely dominates that important field. Among other things, this means that BNSF is not participating to any degree in the movement through the Corridor of container shipments from the Port of Oakland, the nation's fourth largest container port. The weaker the rail competition at Oakland, the less attractive its port becomes as a West Coast point of entry.

As noted, however, the biggest negative impact will be experienced in the future when, if UP's dominance continues undisturbed, the Central Corridor likely will become only a one-route corridor. While the merger has given UP control of both Central Corridor rail routes, UP itself does not need both lines. When the current project to enlarge Donner Summit tunnels is completed, UP's premier Central Corridor route will be established.[2] Only those parts of the secondary or competing line needed to service big shippers, e.g., Colorado coal traffic, will justify an investment in maintenance. Eventually, the rest of the line, including the Feather River Canyon route, will become ripe for abandonment. Certainly BNSF, with merely trackage rights, would have little reason to invest in that secondary line.

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[2] Pursuant to the BNSF Agreement that UP and BNSF formulated prior to the merger, BNSF has a huge disincentive with respect to ever utilizing the Donner Summit portion of the Central Corridor for double-stack intermodal shipments. If BNSF were to send double-stack intermodal traffic via the Donner route, it would become liable for paying one-half the cost of the UP project whereby Donner route tunnels are being enlarged to accommodate double-stack containers.

When this occurs, Northern California (and Southern Oregon), as well as shippers in Nevada, Utah, Colorado, Nebraska and other midwest states, will be left with only one Central Corridor rail route, fully controlled by UP. Far into the future, Northern California shippers and receivers will wrestle with higher transportation costs, because of a lack of competition in the Central Corridor.

BNSF's Weak Competition

Numerous factors support the view that BNSF is not a competitive force in the Central Corridor. One is the manner in which BNSF service is conducted. As regards traffic to and from California, BNSF crews only handle such traffic east of Salt Lake City. Between Salt Lake City and California, BNSF trains are manned by UP crews. [3] Last year BNSF informed the Board that it intended to use its own train crews for all its Central Corridor Operations, effective January 1, 1999. This did not happen and BNSF makes no mention of further plans in its instant (July 1, 1999) report. UP/SP Merger, STB Finance Docket No. 32760 (General Oversight), Decision No. 13 (Served Dec. 21, 1998), p. 25 (mimeo); "Traffic World," July 20, 1998, p. 22.

Thus, while UP is claiming -- three years after the merger -- that the merger's competitive conditions "have strengthened rail competition in the West," BNSF does not even deem its service to and from California in one of the West's most important rail

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[3] Another way that BNSF minimizes the use of its own crews in the Central Corridor is by hiring the Utah Railway (UR) to perform various functions. Indeed, UR performs like a short line, switching cars and gathering traffic for the BNSF.

corridors to be such as to warrant utilizing its own operating personnel west of Salt Lake City.

A look at the number of BNSF trains in the Central Corridor helps explain BNSF's limited use of its own crews. As reported by BNSF, its traffic is miniscule. Insofar as Central Corridor traffic involves Northern California, it consists of one train daily from Denver to Stockton and three trains a week from Riverbank, CA to Denver. BNSF Report, Attch. 1. The level of this transportation pales in comparison to the huge daily volume of UP activity. While UP sets forth no train frequency numbers in its instant report, figures from late 1998 show 28-30 UP Central Corridor trains daily to and from Northern California. BNSF's share of Central Corridor traffic between Northern California and Utah and beyond is approximately five percent.

Further, BNSF traffic is not only much less than UP's, its 1999 level has not kept pace with its own 1998 carloading figures. During the first five months of 1999, BNSF carloads traveling over the Central Corridor declined by 3,250 from what they were in the corresponding five months of 1998. BNSF Report, Attch. 3. A principal explanation for this drop-off in carloads is BNSF's decision to reroute westbound through manifest traffic from the Central Corridor to BNSF's premier southern route between the midwest and Southern California. BNSF Report, p. 9; UP Report, p. 70, ftn. 10. This shows a wholly reasonable BNSF preference for its own route, where it pays no trackage rights fees. It also is another example of BNSF limiting its use of the Central Corridor.

As can be seen, three years into the merger, instead of the vigorous competition between BNSF and UP that the Board anticipated, the Central Corridor exemplifies UP domination.

Need for New Remedy

In establishing its five-year oversight period "to examine whether the conditions we have imposed have effectively addressed the competitive issues they were intended to remedy," the STB made provision for further remedial action. The Board's UP/SP merger decision plainly stated this as follows:

> "We retain jurisdiction to impose additional remedial conditions if, and to the extent, we determine that the conditions already imposed have not effectively addressed the competitive harms caused by the merger."

Merger Decision, p. 146.

It would be difficult to imagine a situation where merger competition has fallen farther short of its goals than in the Central Corridor. As mentioned, even after a three-year span, BNSF handles only a tiny percentage of the Corridor's traffic and then largely in trains crewed by competitor UP. These circumstances make a travesty of the merger conditions as they affect the Central Corridor. Further, as the comments describe, allowing the present imbalance to continue could lead to the Central Corridor becoming a one-route corridor.

There can no longer be any doubt about the negative impact the UP/SP merger has had on competition in the Central Corridor. The BNSF has had three years to initiate truly competitive service and has not done so. As outlined above in the merger decision, the Board should begin a process whereby another railroad, willing to take over the corridor's secondary line between the midwest and Northern California and reinstitute aggressive competition, can be selected.

If effective competition is still the goal, something else should be tried while time remains in the oversight period.

III

The "I-5 Corridor"

After a slow start in the so-called I-5 Corridor connecting California and the Pacific Northwest (PNW), BNSF now offers a developing form of competition which nonetheless has much room for improvement. [4] While the route that UP travels over is superior to BNSF's "Inside Gateway" line, the crucial difference in BNSF's situation (the I-5 Corridor as opposed to the Central Corridor) is that BNSF owns most of the I-5 Corridor route over which it operates.[5] Not surprisingly, BNSF has made a substantial investment in improving its Inside Gateway (I-5) route.

UP's superiority shows in a number of ways, however, and first of all in its dominant traffic figures. UP runs about 119 trains a week compared to competitor BNSF's 31 per week. BNSF Report, Attachment 1. Also, based on loaded car per train statistics, BNSF runs smaller trains. For the five-month period of January through May 1999, the average number of loaded cars per BNSF train for the I-5 Corridor was 24, 21, 25, 24 and 21, respectively. Id., Attachment 10.

The limited nature of the competition that BNSF provides can further be seen in the PNW locale it serves. The only BNSF train service involving a PNW location west of the Cascade Mountains (where the centers of population and industry are located) consists of five freight trains a week from Vancouver, WA to Barstow, CA. Id., Attachment. 1.

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[4] Using the "I-5 Corridor" appellation as a generic title for both the UP and the BNSF routes can be somewhat confusing. In California, UP's line does generally parallel the I-5 Highway that links the large urban centers of California, Oregon and Washington. BNSF's "Inside Gateway" line, on the other hand, runs through more remote California terrain, about 40-60 miles east of the I-5 Highway.

[5] Only between Keddie and Stockton (and in Oregon between Klamath Falls and Chemult) does BNSF operate via trackage rights.

BNSF also is limited in the type of traffic it handles. BNSF's route apparently does not lend itself to the faster delivery times generally required for intermodal service. As a result, intermodal competition is essentially nonexistent. BNSF trains going to and from California in the I-5 Corridor include little, if any, intermodal shipments. On the other hand, UP -- which is very strong in the I-5 Corridor -- transports substantial amounts of intermodal traffic along its I-5 route.

In light of the above, the Board should consider how BNSF's presence in the I-5 Corridor could be intensified. Especially it might look at what is hindering BNSF involvement in I-5 intermodal competition. Also, the Board might consider formulating conditions that would expand BNSF participation in rail traffic west of the Cascades.

As a means towards these goals, the following remedy is proposed. Trackage rights could be granted to BNSF over the UP from Marysville, CA (north of Sacramento) to Eugene, OR. At Eugene the BNSF could connect with its own line north to Portland, and beyond. [6] This would substantially shorten the Inside Gateway's reach to Portland, Seattle and Vancouver, B.C. It therefore would help develop a competitive I-5 Corridor intermodal service between California and PNW/Western Canada.

In summary, sufficient time has gone by since the UP/SP merger to permit the Board to clearly see where the BNSF is falling short of full-scale competition in the I-5 Corridor. With only two years left in the oversight period, the Board should impose "additional remedial conditions" where needed. Otherwise, in the years ahead, California will be saddled with a flawed type of north-south rail competition that, for one thing, will not include intermodal competition between UP and BNSF.

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[6] As the Board is aware, BNSF tracks extend as far north as Vancouver, British Columbia.

IV

The Calexico-Mexicali Rail Border Crossing

One of the results of the merger was that UP gained possession of SP's international rail border crossing at Calexico-Mexicali. This former SP line runs north from Calexico to El Centro and through the Imperial Valley's rich agricultural land. Continuing north to Niland, it joins the former SP line running between Los Angeles and Yuma, Arizona.

The Niland-Calexico line was not well maintained and remains in marginal condition. The hope in California, as expressed in CPUC merger filings, was that new (UP) ownership would bring capital improvements to the line and further develop it for NAFTA trade.

Despite extensive commercial development (maquiladoras) on both sides of the border, UP's line remains essentially as it was at the time of the merger. Presently the area generates a high volume of truck traffic into California and beyond. This has led to the construction of a highway bypass east of Calexico. UP's rail line, which runs through Calexico's central district, likewise could benefit from a bypass, especially as the pace of NAFTA trade increases. South of Calexico and the border, a Mexican rail line, Ferromex, operates to Hermosillo, then along the Gulf of California to Guadalajara and on to Mexico City.

Ideally, the improvement of UP's line to Calexico would be part of a general rehabilitation of regional rail facilities. This would include the rebuilding and restoration of the neighboring San Diego and Imperial Valley Railroad (SDIV) whose operations extend into Mexico. For many years through passage along the line has been blocked by tunnel and trestle problems. Presently, the SDIV is operational between San Diego, Tijuana and a point in Baja California seven miles west of Tecate.

If repaired, SDIV operations from San Diego and Tijuana would continue east in Baja California until reaching the border near Tecate where the line crosses back into the United States. The line then proceeds on to Plaster City, CA where for many years the railroad participated in the transportation of wallboard from gypsum plants. From there the SDIV proceeds east to El Centro where it connects with UP. The rehabilitation of the SDIV would provide rail competition for the California-Mexico Border area, linking it and San Diego with Mexico and the rest of the United States.

A critical first step towards accomplishing these NAFTA and regional goals is for UP to upgrade its Niland-Calexico line.

V

Conclusion

The three-year mark in the five-year oversight proceeding offers a sound vantage point for evaluating how the UP/SP merger has worked out for California, arguably the state most impacted by the merger. By any fair measurement, BNSF is not providing effective competition in the Central Corridor. Moreover, the BNSF Report offers no reasonable basis for assuming that changes are about to occur that could offset UP's thorough domination. It plainly is time for the Board "to impose additional remedial conditions" for the benefit of California shippers and the public.

While the north-south I-5 Corridor does not present as bleak a prospect as the Central Corridor, significant gaps exist in the level of competition taking place there. BNSF's Inside Gateway route provides no intermodal competition and has only a scant presence west of the Cascades. The Board must discern what additional remedies will render I-5 Corridor competition more direct and meaningful.

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Finally, the CPUC again proposes that UP improve its line to Calexico for NAFTA rail transportation purposes. This in turn could lead to other improvements in the region's rail facilities.

Respectfully submitted,

PETER ARTH, JR.
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August 13, 1999

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing document to be served upon all known parties by mailing by first-class mail a copy thereof properly addressed to each.

Dated at San Francisco, California, this 13th day of August, 1999.

James T. Quinn /pst

James T. Quinn

STB FD 32760 (Sub 21) 7-1-99 D 194922 1/3

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July 1, 1999

BY HAND

D

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

Re: Finance Docket No. 32760 (Sub-No. 21), Union Pacific Corp., et al. -- Control & Merger -- Southern Pacific Rail Corp., et al. -- Oversight

Dear Secretary Williams:

Enclosed for filing in the above-referenced docket are an original and twenty-five copies of the Applicants' Third Annual Report on Merger and Condition Implementation. We have enclosed is a 3.5-inch diskette containing the pleading in WordPerfect format.

Also enclosed are an original and twenty-five copies of the Confidential Appendices to Applicants' Third Annual Report on Merger and Condition Implementation, clearly marked "Highly Confidential," along with a diskette containing the confidential appendices, to be filed under seal.

Applicants have served the Report on all parties of record. Applicants have also served the "Highly Confidential" Appendices on parties' outside counsel that indicated, in the merger proceeding, that they will adhere to the restrictions of the Protective Order granted in UP/SP, Decision No. 2, served Sept. 1, 1995.

ENTERED
Office of the Secretary
JUL 02 1999
Part of
Public Record

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

Sincerely,

Michael L. Rosenthal

Enclosures

cc: Parties of Record

UP/SP-366

RECEIVED JUL 1 1999 MAIL MANAGEMENT STB

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

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

APPLICANTS' THIRD ANNUAL REPORT ON MERGER AND CONDITION IMPLEMENTATION

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ORIGINAL

July 1, 1999

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BEFORE THE
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Finance Docket No. 32760 (Sub-No. 21)

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

APPLICANTS' THIRD ANNUAL REPORT
ON MERGER AND CONDITION IMPLEMENTATION

Applicants UPC, UPRR and SPR[1] hereby submit their third annual report on their progress in implementing the UP/SP merger, and on the implementation and effectiveness of the competition-preserving conditions imposed by the Board in its decision approving the merger. This report is being submitted in compliance with Decision No. 13 in this oversight sub-docket, served Dec. 21, 1998.

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[1] Acronyms used herein are the same as those in Appendix B of Decision No. 44. The following original applicants have been merged with UPRR: MPRR (on January 1, 1997); DRGW and SPCSL (on June 30, 1997); SSW (on September 30, 1997); and SPT (on February 1, 1998). For simplicity, and in light of the fact that SPT has merged with UPRR and no longer has any separate existence, we generally refer to the combined UP/SP rail system herein as "UP."

PRELIMINARY STATEMENT

At the time of the last annual oversight proceeding, much attention had been focused on UP's serious service problems, and UP had devoted much of the prior year to overcoming the service crisis and ensuring that no such crisis would occur again. This past year, and particularly in 1999, with the service crisis behind it, UP has renewed its focus on delivering more of the benefits of the merger. This year's annual report on merger and condition implementation describes the fruits of this renewed focus.

Part I provides an update on UP's service today and UP's progress on merger implementation. We review UP's success in overcoming the service crisis, and we present a number of performance measurements that confirm that UP's service has recovered fully and continues to improve. We also review progress during the past year with respect to merger-related service enhancements, including rebuilding the former SP Roseville Yard; implementing expedited intermodal and automotive services; and implementing directional operations and yard specialization plans. In addition, we review the progress in installing TCS and other support systems; in integrating workforces; in merger-related capital investments (including a special report on investment in the Houston-Gulf Coast region); in consolidating and improving terminals and yards, and in enhancing the safety of the merged system's operations. Finally, we review the status of merger-related abandonments and, in an attachment, environmental compliance.

Part II addresses competition. It begins by reviewing how the merger is continuing to produce competitive benefits in the form of single-line service and shorter routes, improved equipment supply, and reduced switch charges. It then shows that, for a third straight year, the competition-preserving conditions imposed by the Board have clearly demonstrated their effectiveness. BNSF and Tex Mex trackage rights volumes have continued to grow. "2-to-1" shippers have continued to benefit both from access to BNSF and from rate and service initiatives that UP is taking in response to BNSF competition. Also, as the Board found would be the case, there has been no competitive harm to "3-to-2" shippers, or to shippers of Utah and Colorado coal, Gulf Coast chemicals, or grain. To the contrary, these shippers continue to enjoy better service, lower rates, and the benefits of the creation of two much more competitive, comprehensive rail systems in the West.

In keeping with the Board's preference for a focused proceeding, we again have not presented lengthy verified statements of UP officers or asked numerous shippers and other affected parties to submit statements. Instead, as we have done for two years, we are submitting this report in verified form. We have also included, as confidential appendices, several hundred specific examples of ways in which shippers are benefitting from the merger and the competition-preserving conditions.

I. MERGER BENEFITS AND IMPLEMENTATION

A. An Update on UP Service

It is a pleasure to be able to report that UP service remains stable and, in fact, has continued to improve since last summer. Service in UP's Southern Region, where the service crisis began but which had largely recovered by April 1998, has been consistently strong throughout the last year and continues to improve. In April, for example, Dow Chemical asked

UP to discontinue issuing a daily report on delayed cars — a report UP had been preparing for Dow for almost two years. There are no longer enough delayed cars to merit a report.

UP devoted the second half of 1998 to recovering from the service crisis, working on service consistency and buttressing its operations and resources to ensure that service remains reliable and continues to improve. As it moved into 1999, UP's focus turned back toward delivering more of the benefits of the UP/SP merger. We begin with a discussion of service on UP today, and then turn to the service improvements of the last year.

1. <u>Service Measurements Reported to the Board</u>

For well over a year, beginning in October 1997, UP provided weekly and, later, bi-weekly reports to the Board that listed numerous measurements of its performance. Taken together, those measurements provided a picture of UP's overall service quality. The reports and measurements reflected sustained service improvement in the Gulf Coast area by early April of last year, as UP implemented the UP/SP merger and directional operations from Missouri to Texas. They confirmed that the merger cured the service crisis of 1997-98 -- a much faster cure than SP had been able to effect of its three-year "World War III" service crisis of 1978-81, which was "cured" by a major recession. By July 31, 1998, the Board was able to declare the service emergency over in Houston and the Gulf Coast region.

On September 18, 1998, UP reported to the Board that its recovery in that region was stable and that its service equaled or exceeded pre-merger service. "UP's Opposition to Condition Applications," Finance Docket No. 32760 (Sub-No. 26), p. 75. In the Far West, UP had experienced a temporary service decline after July 1, 1998, when UP installed its comprehensive Transportation Control System ("TCS") on SP lines, but service in that area recovered by mid-August. UP's service through its Central Corridor, particularly on the line between Kansas City and Gibbon Jct., Nebraska, has improved significantly, but major upgrading and capacity work will continue through mid-2000. UP continues to expand capacity on that line.

Although UP no longer supplies reports to the Board, the measurements we provided for so long provide insight into UP's service quality. They show much improved railroad service getting ever better. We will discuss the principal measurements that UP reported to the Board, updated through the week ending June 5, 1999, the last week before the Conrail breakup in the East began to distort UP's measurements.[2] Please note that the measurements UP calculated for the Board and that we discuss below are prepared in a different manner than those UP and other railroads report under AAR auspices. The two sets of data are not comparable. We discuss some of the differences below.

When UP reported to the Board for the last time in January of this year, the total number of freight cars on the system had dropped from over 353,000 at the height of the service crisis to only 316,698. Notwithstanding substantial growth in carloadings since January, UP's on-line inventory has continued to decline, reaching only 310,475 in early June. The Texas-

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[2] By the second week of June, UP observed a drop in its on-line car inventory and a substantial rise in car inventories on the eastern carriers. UP's interchange patterns with CSX and NS also changed. For example, both carriers asked UP to divert traffic that was to be interchanged in the Chicago area to the Memphis gateway. UP is providing train crews and leasing 66 locomotives to CSX and NS, and those carriers currently have on their systems about 200 more UP locomotives than normal.

Louisiana car inventory dropped from 93,347 in January to 88,510 by early June. Both of those declines reflect the greatly improved fluidity of the railroad, which is able to move more traffic more quickly than at any time since the merger. Much of this traffic is moving faster than it did before the merger.

Another important measure of system performance is average train speed, which is the average train speed for all through trains on the railroad. For purposes of its Board reports and this submission, average train speed includes time in yards, reducing the average speed. Calculations published by AAR for all major railroads exclude yard time and therefore are not comparable to this calculation. UP's average train speed as reported to the Board fell as low as 12 m.p.h. during the service crisis. When we last reported in January, system train speed had climbed to 17.3 m.p.h., within the normal range. By mid-June, that figure stood at 18.7 m.p.h.

UP also measures the efficiency of its operations by computing how much work its locomotives perform. It computes gross ton-miles per horsepower-day, the number of tons moved during a 24-hour period by each unit of horsepower in its locomotive fleet. In January, this figure stood at 108.4 gross ton-miles per horsepower-day, a substantial improvement over service-crisis levels as low as 93.7. In early-June, it had climbed to 127.7 gross ton-miles.

Throughout the reporting period, UP reported terminal dwell time at its yards. As calculated by UP, this is the amount of time cars spend in a geographic terminal area, and is not limited to time within a specific freight yard. The AAR reports employ a narrower definition of terminal time, including only time within a specific freight yard. UP's average terminal dwell time rose as high as 43.9 hours during the service crisis, but it was only 31.3 hours per car by early June. UP's major Houston yards continue to reduce their dwell times. When UP discontinued reports to the Board, Settegast Yard's dwell time was 47.0 hours; it is now 39.9 hours. At Englewood Yard, dwell time stood at 37.4 hours per car. UP has reduced that number further to 34.3 hours.

During the service crisis, UP regularly reported that more than 150 sidings were blocked by cars and delayed trains at any given time, more than 100 of them on lines south of Kansas City. By the time of our last report in January, only 25 sidings were blocked, only nine of them south of Kansas City. As of early June, the system average was only 18 block sidings, with seven of them south of Kansas City. These numbers are consistent with normal operations, under which UP "stages" trains in sidings from time to time. For example, UP frequently must place rock and grain trains in sidings when loading and unloading facilities are unable to accept them.

During the worst of its service troubles, UP was forced to place a second crew on 20 to 25 percent of its trains because the first crew could not complete its assigned run. The recrew rate is now closer to ten percent. During April, UP's Southern Region recorded its lowest recrew rate ever, at only five percent. During April, eight UP Service Units in the Southern Region recorded no recrews at all during at least one 24-hour period, an extraordinary accomplishment. The Houston Service Unit accomplished that feat more than once.

We regularly reported to the Board on car shortages. There are no car shortages on UP today, notwithstanding recent reports suggesting shortages of cars for lumber. In recent months, UP filled all customer car order requests, including requests for grain cars. UP is storing excess gondolas, equipped gondolas, 50-foot plain boxcars, mechanical refrigerator cars, bulkhead flat cars, pipe flat cars, centerbeam flat cars, open top hoppers, woodchip cars and large capacity covered hoppers — a total of 18,230 stored cars as of June 1.

All of these measurements reflect a railroad operating normally. UP's performance in the Texas/Gulf Coast area has been consistent since last spring. In the Far West, the service recovery was complete by late summer, after the TCS cutover in July. And in the Central Corridor, UP has consistently improved service throughout 1999. UP continues to install segments of double and triple track in that corridor, with 22.8 more miles of double track ready for operation early this month between Gibbon and Oxbow, Nebraska, on the route to Kansas City. The service crisis is a dark spot on UP's service history, but it is history.

2. Houston and Gulf Coast Service

Every component of UP's service in the Houston/Gulf Coast region has recovered fully and now equals or exceeds pre-merger standards. We discuss several types of service that suffered during the crisis.

Chemical shipments. By the time the Board declared the transportation emergency in Houston and the Gulf Coast to be over, UP's transit times for shipments to and from the area had improved very substantially. Shippers remained concerned, however, about whether those gains were stable. During the subsequent year, UP service has continued to improve and to become more reliable. UP is now delivering the vast majority of shipments originating on the Gulf Coast in compliance with transportation trip plans, with the percentage of compliance above 90 percent in many corridors. The following are merely examples of a highly consistent pattern:

- Transit time from the Bayport/Strang area to Chicago declined from twelve days and higher during the service crisis to an average of between six and seven days last fall to an average of between five and six days now.

- From Baytown to Chicago, UP's service-crisis transit time ranged from eleven to 13 days. It fell to about seven days last fall and is now generally about 5.5 days. More than 90 percent of shipments in this lane comply with their trip plans.

- Bloomington/North Seadrift-to-Chicago transit times, which averaged approximately seven days and occasionally much longer during the service crisis, are now reliably in the four-day range, thanks to direct service to North Little Rock and reliable connections beyond.

- Transit times to the Salem/East St. Louis gateways exhibit the same pattern. From the Angleton/Freeport area, transit times during the service crisis often exceeded eight days. Shipments now arrive in 4.3 to 4.6 days, with trip plan compliance above 90 percent.

- From Formosa/Lolita to Salem/East St. Louis, transit times dropped from ten days during the service crisis to five days or less in recent months.

- Shipments from Orange, Texas, to Salem/East St. Louis interchanges took more than ten days in early 1998. By last August, transit time was seven to eight days on average. Now, shipments rarely require more than five days to reach those interchanges.

- During the service crisis, UP could not accurately compute transit times from the Gulf Coast to Southern California because TCS had not been implemented in the Far West. Transit times from Baytown just to the New Mexico/Arizona border averaged about 14 days. When the first measurements were taken of transit time to Southern California last August, they averaged about 25 days. UP shipments now regularly reach destinations in California in ten to eleven days.

- Transit times from Bayport/Strang to Southern California are even faster, averaging eight to nine days, compared to twenty days last August and surely longer during the service crisis.

- Transit time from Freeport/Chocolate Bayou to the New Mexico/Arizona border hovered at about 15 days during the service crisis. By last fall, transit time all the way to Southern California was down to 12 to 15 days. UP's normal transit time is now about 11.5 days.

- From Bloomington/North Seadrift to New Orleans, UP's service-crisis transit times ranged from seven to ten days. By last fall, transit times averaged four to five days. For the last three months, transit times have generally been in the 2.8 to 3.3-day range, and trip plan compliance is regularly well into the 90 percent range.

- For cars released from the SIT yard at Spring, transit times to New Orleans have dropped from about nine days during the service crisis to about five days last fall to four days or less in recent months.

The pattern portrayed in these examples is consistent for all of UP's major chemical origin areas (Freeport/Chocolate Bayou; Bloomington/North Seadrift; Baytown; Orange; Bayport/Strang; Formosa/Lolita; and the Spring SIT yard) and all major gateways (Chicago; Salem/East St. Louis; Memphis; New Orleans; Southern California; Sweetwater-BNSF). Undeniably, UP is now providing normal service for Gulf Coast shippers, and service quality is stable.

Intermodal Service. UP lost many of its intermodal customers, both systemwide and in the Texas lanes, during the service crisis. UP had to discontinue a number of intermodal schedules in order to free locomotives and track capacity, forcing some customers to use other carriers. UP has reinstated those services, and is providing generally reliable intermodal service today. During April, for example, eight Southern Region intermodal terminals, including both of UP's Houston ramps, completed all loadings on time. Two intermodal terminals in the region departed every one of their trains on time during that month, and five others exceeded 90 percent on-time departures. At last check, the new Memphis intermodal facility at Marion, Arkansas, had departed every train on time for 128 consecutive days, and the streak was still growing. As always, UP continues to work on improving over-the-road performance once trains leave their terminals.

Texas Aggregates. Impelled by increased highway construction and rapidly growing population, the Texas construction industry continues to prosper and its demand for rail transportation remains strong. UP is continuing to meet shipper requirements. During the first five months of 1999, UP handled 31,000 more carloads of aggregates and cement in Texas than during the same period of 1998. It expects to increase total carloadings from 230,000 last year to over 300,000 in 1999. By reopening 16.7 miles of second main track in the New Braunfels area northeast of San Antonio, UP sharply reduced congestion that limited rock operations in the past.

Laredo Gateway. Last spring, shortly before and after the Mexican government privatized rail routes between Mexico City and Laredo and Brownsville, Texas, UP experienced severe delays in interchanging traffic to the Mexican railroad, especially at Laredo. Up to 3,000 extra Mexico-bound cars congested UP lines as far north as Kansas and severely impeded UP's service recovery throughout the Gulf Coast area. UP worked hard with TFM in Mexico, Tex Mex in the U.S., and governmental authorities on both sides of the border to resolve this additional and unwelcome crisis.

There has been no repetition of Laredo congestion and delays. UP is moving more business than ever through the Laredo gateway, yet the border crossing is fluid. Last year at this time, UP and TFM interchanged an average of some 700 cars per day. In recent weeks, UP and TFM interchanged between 833 and 913 cars per average day. The increased volume has not impaired UP service. During the Laredo service crisis, UP sometimes had as many as 5,000 cars on its lines destined for Laredo and the TFM. Now, even though traffic is heavier, the pipeline to Mexico typically contains 1,900 to 2,000 cars.

B. Additional Service Improvements Resulting From the UP/SP Merger

With the service crisis now well in the past, UP is taking advantage of opportunities to improve service afforded by the UP/SP merger. We describe the recent developments and upcoming improvements. Note that we describe only merger-related improvements, not all changes to UP service.

1. The New Jerry R. Davis Yard at Roseville

On May 26, 1999, UP officially opened the J.R. Davis Yard in Roseville, California, named in honor of UP's long-time Executive Vice President of Operations, and more recently Chairman, Jerry R. Davis. Jerry also served as SP's President prior to the merger and as the senior operating officer at CSX for several years. Known for his commitment to safety and his accessibility to employees, he richly deserved this honor.

The UP/SP merger Operating Plan called for a $38.2 million upgrade of this former SP yard and adjacent tracks. Instead, UP rebuilt it from the ground up at a cost of over $142 million. UP completed the project on time, even though it found 16 unexploded Vietnam War-era bombs, 4.31 tons of bomb fragments and 65.78 tons of ferrous material, all of which had been driven into the earth in a massive 1973 explosion. UP also had to contend with unusual winter rains — twice the normal level — from November 1997 through June 1998.

Originally built in 1906, Davis Yard is now the nation's most modern rail freight yard. As depicted in the attached diagrams (Exhibits 1 and 2) and an aerial photograph (Exhibit 3), Davis Yard is more than six miles long and contains 136 miles of track and 338 turnouts. Once the initial "bugs" are resolved, it will be capable of humping 2,300 cars per day over a "mini-hump" only 5.15 feet high, greatly reducing the amount of energy required to slow cars rolling down the hump into the 55 classification tracks. The yard uses 6,824 low-maintenance, continuous-speed-control retarders to slow cars to precise speeds for coupling to other cars without the squealing associated with traditional retarding systems. All eight arrival and eight departure tracks are adjacent to access roads so that mechanical forces can inspect and repair most freight cars without removing them from arriving or departing trains. The yard's car repair facility, efficiently located adjacent to the hump yard, can repair and release cars in 24 hours or less, reducing delays by two or more days for each repaired car. Many of the yard's features, including a unique handle on each manual switch that makes them easy to throw without back strain, were designed based on employee recommendations. UP made every effort to reduce the risk of injury and ensure that Davis Yard provides the safest possible working environment.

The yard is so extensively automated that yardmasters' duties are greatly reduced. Only one yardmaster oversees all operations, compared to three on duty before the reconstruction. An electronic diagram shows the yardmaster the status of all tracks and even the movement of individual blocks of cars into the classification tracks. A new dispatching office in Roseville will control all tracks and mainline switches within 50 miles of Roseville,

Roseville Yard

Union Pacific Railroad

- 780 Acres
- 6 Miles Long
- 136 Miles of Track
- 338 Turnouts
- 1,785 Cars Switched Daily
- 600 Locomotives Repaired Monthly
- 2,350 Locomotives Serviced Monthly
- 2,350,000 Gallons of Fuel Dispensed Monthly

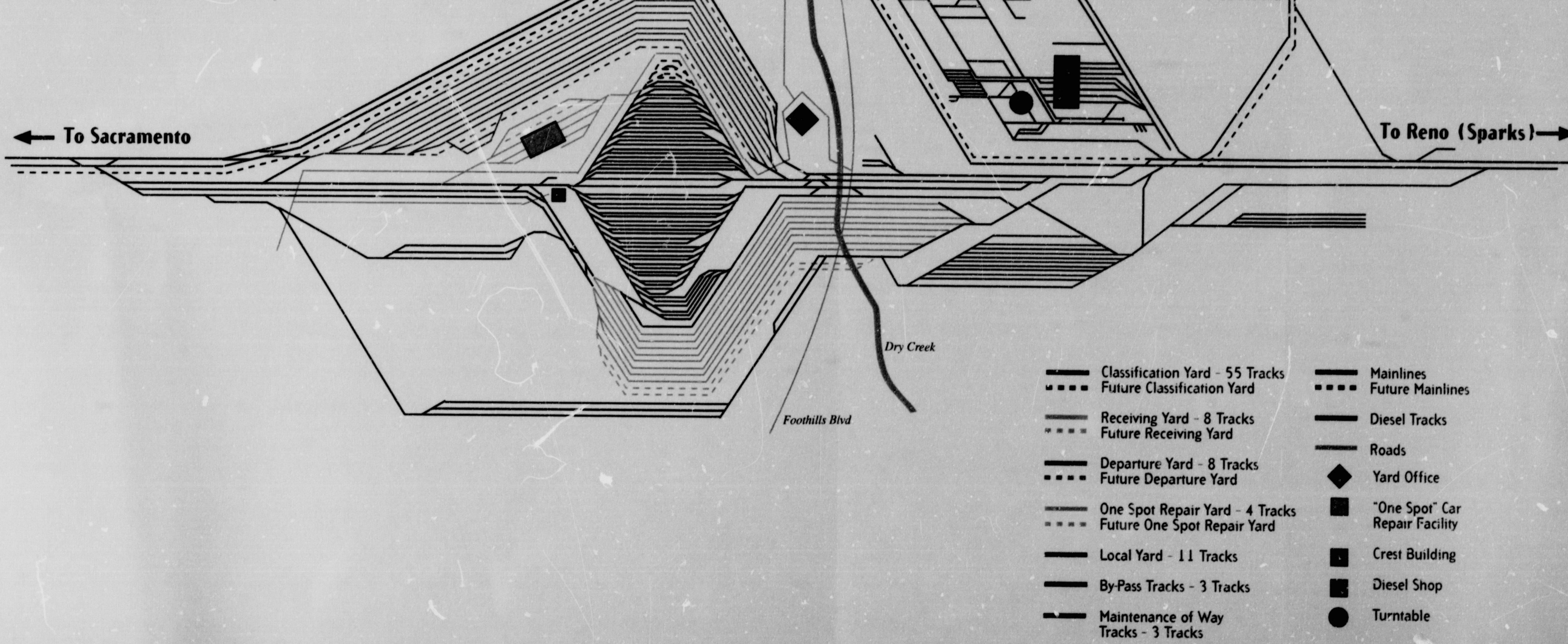
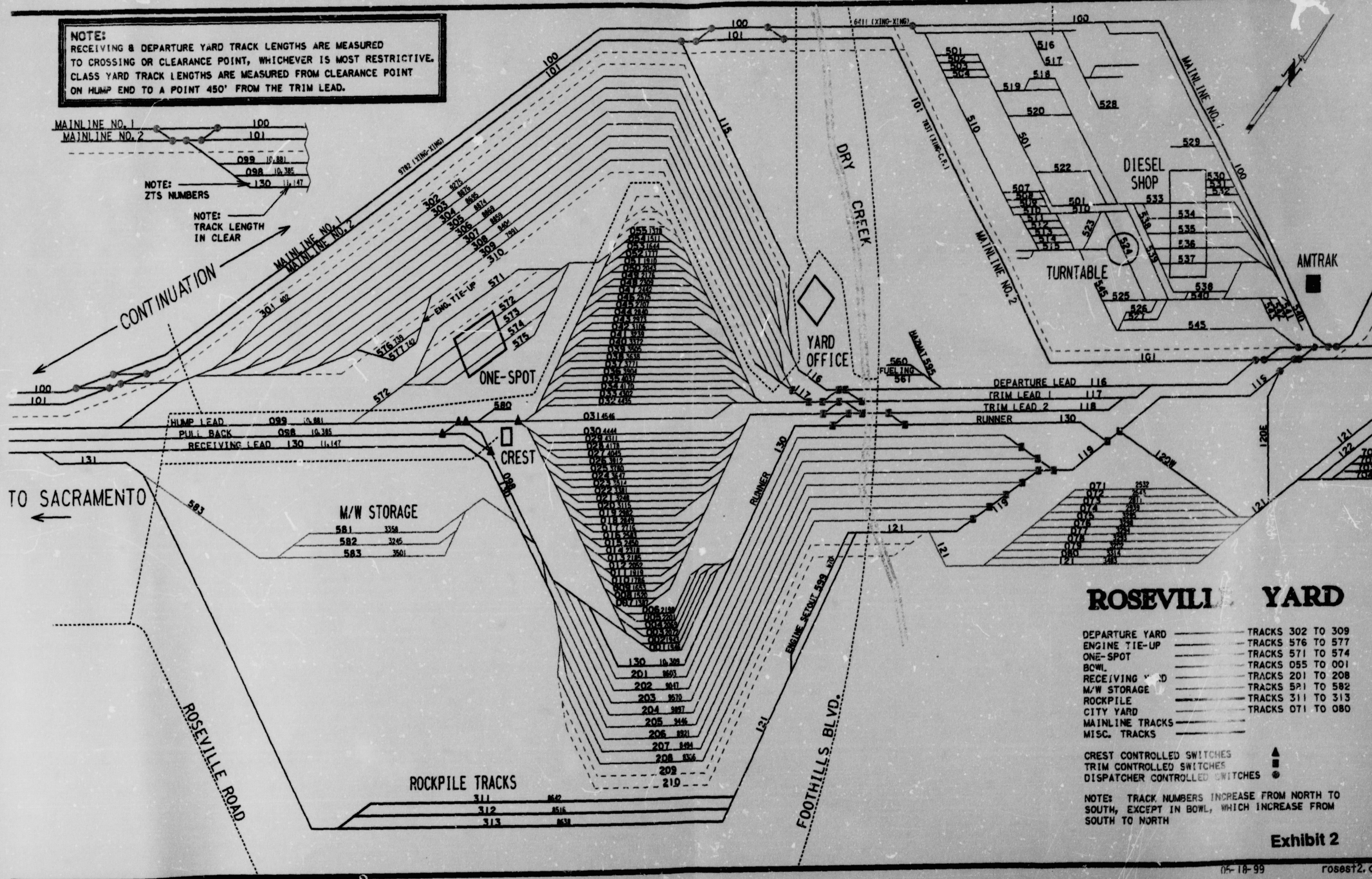


Exhibit 1


NOTE:
RECEIVING & DEPARTURE YARD TRACK LENGTHS ARE MEASURED TO CROSSING OR CLEARANCE POINT, WHICHEVER IS MOST RESTRICTIVE. CLASS YARD TRACK LENGTHS ARE MEASURED FROM CLEARANCE POINT ON HUMP END TO A POINT 450' FROM THE TRIM LEAD.
MAINLINE NO. 1
MAINLINE NO. 2
NOTE: ZTS NUMBERS
NOTE: TRACK LENGTH IN CLEAR
CONTINUATION
TO SACRAMENTO
HUMP LEAD
PULL BACK
RECEIVING LEAD
CREST
ONE-SPOT
ENG. TIE-UP
M/W STORAGE
ROCKPILE TRACKS
ROSEVILLE ROAD
FOOTHILLS BLVD.
ENGINE SETOUT 599
RUNNER
DRY CREEK
YARD OFFICE
FUELING
HAZMAT 595
DEPARTURE LEAD 116
TRIM LEAD 1 117
TRIM LEAD 2 118
RUNNER 130
DIESEL SHOP
TURNTABLE
AMTRAK
ROSEVILLE YARD
DEPARTURE YARD — TRACKS 302 TO 309
ENGINE TIE-UP — TRACKS 576 TO 577
ONE-SPOT — TRACKS 571 TO 574
BOWL — TRACKS 055 TO 001
RECEIVING YARD — TRACKS 201 TO 208
M/W STORAGE — TRACKS 581 TO 582
ROCKPILE — TRACKS 311 TO 313
CITY YARD — TRACKS 071 TO 080
MAINLINE TRACKS
MISC. TRACKS
CREST CONTROLLED SWITCHES
TRIM CONTROLLED SWITCHES
DISPATCHER CONTROLLED SWITCHES
NOTE: TRACK NUMBERS INCREASE FROM NORTH TO SOUTH, EXCEPT IN BOWL, WHICH INCREASE FROM SOUTH TO NORTH
Exhibit 2
05-18-99

View Looking West
From Valley Wye

ROSEVILLE YARD
APRIL 30,1999

Exhibit 3

including the Sacramento terminal area. Davis Yard will call its own crews, providing local contact between crew callers and train and yard crews and administrative support for departing train crews.

Davis Yard is a technological and design marvel, but what counts most is its ability to improve service for shippers. It will do that in many ways. From arrival to departure, the yard will process each car that goes over the hump in approximately half the time required before reconstruction. It also will speed cars on trains that move through Roseville without switching. The old Roseville Yard was a major bottleneck (some called it a "graveyard") for through trains, such as intermodal, grain and automotive trains. Because of its inefficient design, switching operations and traffic congestion frequently caused long delays to through trains. The redesigned yard includes two CTC-controlled main tracks (with room for a third) on which UP (and BNSF and Amtrak) trains will move without interference at 40 m.p.h., after an initial break-in period. This will eliminate thousands of hours of train delay every year.

Davis Yard was designed to help as many cars as possible move as far possible with as little additional switching as possible in order to reduce switching time at other yards throughout the West. Historically, most of the cars SP switched at Roseville moved to and from other terminals, such as Eugene, Oakland, San Jose, Stockton, Fresno and West Colton, where they were switched again. Davis Yard will eliminate most of the second switches. In a sense, Davis Yard acts as a local switching yard for terminals from Fresno, California, all the way to Eugene, Oregon.

At Davis Yard, UP will build blocks of cars for individual local industry jobs within outlying terminals. Trains will carry those blocks to the outlying terminals, where local industry jobs can simply pick up their blocks and go to work, without reclassification. When they return, the local jobs can place most of their cars into a track for movement as a train to Roseville, again with little or no switching. UP will be able to reduce not only transit time but also switching costs, and potentially will be able to release yard space at the satellite terminals.

One train will operate to Sacramento with six blocks of traffic for that terminal; it or another train will return with cars for Roseville. Another train will run to Stockton, with seven blocks of Stockton traffic. A train to Tracy, California, will carry two more Stockton blocks as well as Tracy traffic. An Oakland train will take two blocks to Suisun, California, and three to Oakland. A Fresno train will take seven blocks to that San Joaquin Valley terminal. And the San Jose train will carry cars for Newark, California, and four blocks of San Jose traffic. Other local service trains will deliver shipments to numerous additional points throughout Northern California.

Davis Yard will speed service to and from more distant locations as well. It will launch three daily Central Corridor trains to the Midwest. One will be a new expedited schedule running through to Proviso Yard in Chicago. There, many of its cars will be switched into trains for destinations throughout the NS and CSX systems across the eastern third of the nation. UP expects this expedited schedule to make rail service more competitive for perishable traffic, most of which has been lost to trucks in recent years. UP recently acquired 30 new high-capacity refrigerator cars with improved refrigeration units to serve this market. Davis Yard also will build two daily trains for North Platte, making connections throughout the UP system and beyond. Other Central Corridor trains will provide service to all points between Roseville and Salt Lake City via both UP routes.

Davis Yard will greatly improve carload service in the I-5 Corridor as well. Beginning in August, UP will operate a new train between Hinkle, Oregon, site of UP's largest yard in the Pacific Northwest, and Roseville. This train will provide the first service on UP's merger-related trackage rights over BNSF between Bend and Chemult in Oregon, which was one of the pro-competitive "quid pro quos" in the UP-BNSF merger settlement agreement. The new train will avoid a much longer route through Eugene and Portland, saving 120 miles for each car and avoiding switching in Eugene. The southbound train will carry a through block of cars from CP's Calgary, Alberta, yard — to our knowledge the first such service ever offered. And it will deliver pre-assembled blocks of traffic for points in Southern California. A new manifest train will deliver traffic to City of Industry Yard and J Yard in the Los Angeles Basin (see Exhibit 4), reducing switching in that area. Cars for Arizona and east through the Southern Corridor will move on a train to West Colton.

UP has negotiated new agreements for run-through service with two regional railroads in the Pacific Northwest, avoiding switching and interchange delays and saving one to two days of transit time for all affected traffic, a total of some 300 cars per day. Those railroads expect the improved service to increase their business. The Central Oregon and Pacific ("CORP") and the Willamette & Pacific ("W&P") will build run-through trains with run-through locomotives for Roseville, bypassing switching now performed in Eugene Yard. For W&P, UP will build a train at West Colton that will bypass Roseville and operate directly to W&P. Davis Yard and Klamath Falls will build blocks of cars for W&P as well, which the new train will pick up at Klamath Falls. UP will also operate a run-through train from Portland to CORP at Eugene, primarily to return empty cars from the Midwest and East.

2. Expedited Intermodal and Automotive Services

On April 20, UP reinstated one of the significant new services made possible by the merger. Using a combination of UP and SP line segments, UP trains ZMNLT and ZLTMN provide expedited intermodal service between UP's new Marion, Arkansas (Memphis) intermodal ramp and Southern and Northern California. The combined route is 200 miles shorter than the pre-merger SP route and saves even more mileage compared to the pre-merger UP route. These trains offer second morning service between Memphis and the Los Angeles area and third morning service between Memphis and Lathrop in the San Francisco Bay Area. The trains ran briefly during 1997 before UP encountered service problems in Texas, when UP was forced to cancel them because of on-line congestion and in order to redeploy locomotives to address the crisis.

UP is also moving rapidly to transform its "Tucumcari Line" into primarily an expedited service route between the Midwest and Southern California. Although this route dips all the way down to the Mexican border at El Paso, has slower train speeds and less capacity, it is virtually identical in mileage between Chicago and Los Angeles to the BNSF mainline, and it has significantly less rise-and-fall and curvature than the BNSF route. By the end of 1999, UP expects to increase the number of trains on this route by eight additional trains per day. UP has developed an arrangement with IMRL to operate two doublestack trains over IMRL between Clinton, Iowa and Kansas City. This route allows direct service between UP's "Global" intermodal facilities, which are located on former CNW lines in Chicago, and Southern California using the Tucumcari Line. UP's trackage rights over BNSF between Kansas City and Chicago are very difficult to reach from the Global terminals.

UP continues to operate intermodal trains between Seattle and Southern California, and recently added a second weekly Roadrailer train for Swift between Portland and Los Angeles. Although UP is providing reliable service in the I-5 Corridor, further development in traffic volumes will require increased clearance in snowsheds and tunnels in the Cascade Mountains, which will allow UP to operate doublestack trains. That work probably will not be completed any earlier than 2001. To support its current and future I-5 Corridor service, UP decided to retain the Los Angeles Transportation Center (LATC) on the east side of downtown Los Angeles. The UP/SP Operating Plan had proposed closing this facility.

Thanks to the UP/SP merger, UP is expediting movement of intermodal and automotive traffic to and from the L.A. Basin. Traffic on the Tucumcari and Sunset Routes to and from the east moves over a new connection at Colton, California, between the former SP line and the faster and more direct former UP line to East Los Angeles and ICTF, saving hours of transit time. See Exhibit 4. Similarly, automotive trains that once operated over UP from Kansas City to the Mira Loma auto unloading facility via Ogden, Utah, now take the much more direct Tucumcari Line and use the Colton connection to reach Mira Loma, west of Riverside.

As a result of several new connections between UP and SP lines in Southern California at Pomona, Colton, Keenbrook and Cajon Summit, UP effectively enjoys triple main track between Los Angeles and the top of Cajon Pass. UP uses these routes to improve expedited services. For example, UP's intermodal trains from Los Angeles to Denver originate at East Los Angeles on the UP line, move to the SP line through a new connection at Pomona, then return to UP at a new connection at Summit at the top of Cajon Pass, avoiding longer and more congested routes.

In the Central Corridor UP's expedited service between Chicago and Lathrop, California, via Reno, which uses a combination of UP and SP routes, continues to seek premium traffic. UP slowed this schedule during the service crisis, but it is working to improve transit times in order to regain traffic lost during that period. UP employs the former Western Pacific ("WP") route for doublestack shipments. It uses the yard at Portola, California, to exchange blocks of cars between trains so that it can send full trains from Portola to Lathrop on the former WP and to Oakland via the SP route west of Sacramento.

During the service crisis, UP used its Texarkana, Arkansas, yard to perform relief switching for Ft. Worth and Houston. UP has converted Texarkana into a transfer facility for expedited automotive traffic from Mexico, Louisiana and Texas to the Upper Midwest. Dedicated automotive trains from Laredo (with Mexican shipments); Arlington, Texas; and Shreveport, Louisiana, meet in Texarkana to exchange cars. Trains ALDIN and AARIN run from Texarkana to Indianapolis with blocks for locations on the expanded CSX system. Train

ASHBH operates directly to Bellevue, Ohio, with traffic for NS points. All of the cars on these trains avoid switching at North Little Rock and East St. Louis.

3. General Freight (Manifest) Services

UP's directional operations from Texas through Arkansas and Louisiana to Memphis and southeastern Missouri — which were among the most important factors in solving the service crisis — continue to support fast train speeds and quality service. They also are working well for train crews, which complete their runs more quickly than if they were meeting large numbers of trains coming the other way. Where BNSF and Tex Mex have trackage rights on directionally operated lines, they also benefit. Those who predicted during the merger proceedings that directional running would never work or that UP would abandon the SP routes were mistaken. On the northbound routes from Houston to North Little Rock, average train speed is up to 20.3 miles per hour. The SP southbound route from Missouri through Pine Bluff to Central Texas now operates at an average freight train speed of 28.0 miles per hour.

As important as it was to eliminate hundreds of daily train meets, with attendant delays of from ten minutes to an hour each, it was at least as important to allow major yards to play specialized roles for which they are best suited. Notably, Englewood Yard — which is a poor yard for building long trains — continues to receive inbound cars to the Houston terminal and makes only three through trains per day, all destined for points south of Houston. Meanwhile, Settegast Yard, which is a good train-building yard, is UP's primary outbound

El Paso, Chicago, Kansas City, North Platte, North Little Rock and points throughout the Gulf Coast region.

As predicted in the Operating Plan, UP's modern Livonia Yard near Baton Rouge is classifying rail traffic for points throughout the southeastern states and operating run-through service to CSX and NS. The final blocking plan is slightly different than depicted in the Operating Plan due to changes in traffic patterns, but it is at least as extensive. For CSX, UP builds through blocks and trains for Atlanta; Baldwin, Florida (near Jacksonville); New Orleans; Greenwood, South Carolina; Hamlet, North Carolina; and Birmingham, Alabama. For NS, UP builds through blocks and trains for Birmingham; New Orleans; Chattanooga, Tennessee; Knoxville, Tennessee; and Macon, Georgia. Those railroads build blocks for Livonia and Houston on UP.

As also predicted in the Operating Plan, UP assigned specialized functions to its classification yards at North Little Rock and Pine Bluff, Arkansas. Instead of making duplicate blocks for the same destinations in both directions at both yards, Pine Bluff generally handles southbound traffic and North Little Rock generally handles northbound traffic, with each yard making more numerous blocks for its destination regions. Pine Bluff is blocking for and running trains to points throughout Texas and Louisiana. For example, blocks consisting primarily of empty cars for chemical shippers move without switching from Pine Bluff to Bloomington, Sinton (near Corpus Christi), Mont Belvieu, Strang and PTRA. Similarly, Pine Bluff separates cars into blocks for several Dallas/Ft. Worth-area yards — Mesquite (east of Dallas), Browder (central Dallas), Arlington, and — in Ft. Worth — Ney and Centennial Yards — thereby avoiding reswitching and providing better service than either UP or SP provided before the merger.

At North Little Rock, UP continues to build blocks for A&S at East St. Louis, BNSF at Memphis and IC at Memphis. In addition, it is building blocks of traffic for CN destined to Battle Creek, Michigan; Flint, Michigan; and Toronto, Ontario. Yard specialization also positions UP to provide excellent service to the Northeast once CSX and NS settle into normal operating routines in former Conrail territory. North Little Rock now creates a long list of blocks for CSX and NS:

CSX Blocks:	NS Blocks:
Bruceton, Tennessee	Bellevue, Ohio
Buffalo, New York	Chattanooga, Tennessee
Cumberland, Maryland	Knoxville, Tennessee
Indianapolis, Indiana	Pittsburgh, Pennsylvania
Nashville, Tennessee	Sheffield, Alabama
Selkirk, New York	

All of these blocks move on run-through trains either via Memphis or over routes that bypass both St. Louis and Chicago.

With the combined volume of UP and SP manifest traffic, UP also will be able to provide much improved service through Chicago in connection with CSX and NS. UP operates a major manifest switching yard in the Chicago area at Proviso Yard. UP will run trains to Proviso from Roseville and from Portland, both avoiding intermediate switching anywhere in the West. Other trains will arrive in Proviso from North Platte, from the Twin Cities and Milwaukee, and from local points throughout Iowa and Illinois. Proviso Yard will combine traffic from all those sources into run-through trains for points throughout the Upper Midwest traffic from all those sources into run-through trains for points throughout the Upper Midwest and Northeast on both eastern carriers. UP will run three daily run-through trains to CSX northeastern points, including Selkirk, New York (near Albany); Nashville, Tennessee; and Cumberland, Maryland. UP also will create three daily run-through trains for NS destined to Pittsburgh; Chattanooga, Tennessee; and Bellevue, Ohio. Both eastern railroads will return comparable numbers of trains with traffic blocked for Proviso, Milwaukee and North Platte. Compared to pre-Conrail-merger service, these operations ultimately will reduce transit times by 24 to 39 hours for every one of several hundred cars per day.

UP is now operating through train service over trackage rights acquired from BNSF under the UP-BNSF merger settlement agreement. In Southern California, UP has established scheduled service between Yermo on UP (near Barstow) and Bakersfield, using BNSF trackage rights between Barstow and Mojave. The eastbound trains expedite perishable traffic from the southern part of the San Joaquin Valley to the Midwest and East via North Platte, saving time and mileage compared to the former route via Stockton, California. As noted above, UP will also soon operate Hinkle-Roseville trains over BNSF between Bend and Chemult in Oregon.

UP has improved manifest service to and from Southern California by combining UP and SP traffic flows and coordinating yards and routes. The former SP West Colton Yard builds through trains for the UP route to Pocatello, Idaho, serving the Intermountain region. It also builds trains to North Platte. Both trains bypass Ogden, where those trains used to be switched, saving transit time.

4. Consolidated and Joint Dispatching with BNSF

UP and BNSF achieved extraordinary success with their consolidated and joint dispatching center in Spring, Texas, north of Houston. Although Tex Mex and KCS unfortunately elected not to participate, BNSF and UP placed all of their dispatchers and supervisors who control rail lines in the Gulf Coast area in the same room and gave them the tools to work cooperatively to keep rail traffic moving throughout the region. By discussing daily transportation plans face to face, employees of the two railroads avoid operating conflicts that cause congestion and delays, and, when problems arise, they develop interline solutions in minutes that once took hours or were never found.

This new concept in inter-railroad cooperation played a significant role in curing the service crisis. During the last year, UP continued to add Texas dispatching territories to the Spring Center. It now controls trains on UP lines all the way from New Orleans to El Paso on the Sunset Route and to the Mexican border at Laredo and Eagle Pass, as well as UP directional routes leading to Houston from the north. UP and BNSF added a third dispatching position for the Houston terminal, significantly improving the fluidity of train movements and dispatcher response time.

BNSF and UP took the concept of consolidated dispatching, in which separate railroads co-locate their dispatchers, a step further. On jointly-owned track in the Houston terminal and between Houston and New Orleans, BNSF and UP employ true joint dispatching. A director employed by and reporting to both carriers supervises dispatchers who conduct train operations to serve the best interests of all operators. This experiment has been extremely successful. Because the personnel feel allegiance to both carriers, no disputes have arisen between BNSF and UP about about impartiality.

Encouraged by their successes at Spring, UP and BNSF are consolidating dispatching in other jointly-served areas. On June 15-16, 1999, UP relocated four dispatching positions responsible for UP territories throughout Southern California to BNSF's San Bernardino, California, regional dispatching office. San Bernardino-based dispatchers now coordinate movements on all freight lines between the Mexican border and Bakersfield, including critical links used by more than 100 trains per day of both railroads to cross mountain ranges through Cajon Pass and Tehachapi Pass. UP and BNSF invited Metrolink, which operates commuter trains throughout the Los Angeles Basin and controls freight operations on some former SP lines, to participate in this consolidated center, but it has indicated a lack of interest.

BNSF and UP also are developing plans for a consolidated dispatching center to control train operations throughout the Kansas City terminal area and the surrounding region. They will invite NS, IMRL, KCS, KCT and GWRR to participate in this center, which they expect to open in 2000.

In an attempt to reduce chronic and severe delays on the jointly-owned coal line that serves the Powder River Basin in Wyoming, UP on May 15 and 16, 1999 moved two of its dispatchers and their supervisors to BNSF's National Operations Center in Ft. Worth. Their goal is to control UP trains moving to and from the Basin in conjunction with BNSF dispatchers who control the joint line. Thus far, this arrangement has been less successful than at Spring for a variety of reasons, and delays of 24 hours or more remain common.

C. Progress in Merger Implementation

1. Safety

UP continues a multi-year trend of ever-safer operations. For the first five months of 1999, reportable injuries declined 10 percent compared to the same time period in 1998, as UP continues to bring SP's higher incident rate into line with UP standards. Injuries resulting in loss of a day or more of work declined by 18 percent. UP also achieved a four percent reduction in the number of grade crossing accidents and a 27 percent decline in the number of injuries in those accidents. UP continues to work with local communities to reduce the number of grade crossings, which is the surest way to avoid such accidents.

2. Technology and Support Systems

All UP and SP support technologies have been integrated as planned. UP completed the critical Transportation Control System ("TCS") implementation on SP lines a year ago today, when UP adopted TCS on the SP western region. This caused disruptions and congestion for approximately six weeks, but service in that area recovered strongly after mid-August. UP spent approximately $40 million to train more than 16,000 employees to use TCS, which provides the information backbone for UP service. UP's "Oasis" system, which controls inventory and operations at intermodal terminals, was in use at all SP facilities by the end of last year.

Most former UP and SP lines continue to operate under separate dispatching systems. These separate systems will be maintained until early in the next decade, when UP implements its enhanced "CAD III" dispatching system across the railroad. UP continues to hire train dispatchers, and since the merger, has achieved a net gain of 30 train dispatchers. As of last month, 80 more candidates are undergoing the rigorous six-month training program to qualify them as dispatchers. UP's goal is to assign six dispatchers to each dispatching position to cover all shifts and provide more opportunity for training and familiarization visits in the field.

3. Workforce Integration

UP is proceeding carefully and deliberately through the final stages of implementing merger labor agreements. All agreements with labor organizations representing on-board train operating personnel are complete, with the exception of a few remaining "hub" agreements with locomotive engineers and train crews. The Kansas City hub agreements took effect on January 16, followed on February 16 by the Roseville hub agreements for yard and local crews. On May 1, the second-phase Salina hub agreements became effective. The San Antonio hub agreements followed on June 1. Two weeks ago, on June 16, UP, BLE and UTU implemented the Portland hub agreements and the agreements covering road crews at Roseville.

Only a few hub agreements remain to be completed. In the Los Angeles area, UP and BLE leadership reached an implementing agreement, but rank-and-file engineers did not ratify it. The parties turned to arbitration, and the arbitrators adopted the negotiated agreement, which UP hopes will take effect August 16. UP and the two unions have also negotiated hub agreements for the Dallas/Ft.Worth area. Those agreements are out for a ratification vote, and if approved they should be in place on October 1. UP hopes to complete this multi-year process on September 16 with agreements covering the newly-designated "Southwest Hub," which encompasses Tucson, El Paso and Dalhart, Texas. UP and BLE have reached agreement for this area, and negotiations continue with UTU. This implementing schedule is, as always, subject to change if agreements cannot be reached through negotiation and in response to changing operating conditions.

Agreements for virtually all other crafts are in place. In two instances, involving work equipment mechanics in the southern region of the railroad and water service employees, conflicts between competing unions are still being negotiated. UP also continues to negotiate with the Brotherhood of Railway Signalmen to establish a collective bargaining agreement for the entire system, with negotiations to continue on July 8-9. Finally, issues remain to be solved in connection with a yardmasters agreement and in some areas with BMWE.

4. Merger-Related Capital Investments

After spending $710.8 million to implement the UP/SP merger in 1997 and 1998, UP expects to invest at least $292.8 million of additional capital on merger implementation in 1999, bringing the three-year total to just over one billion dollars. The UP/SP merger application predicted that the merger would require approximately $1.4 billion in capital investments. In fact, UP's total capital expenditures to implement the merger will exceed that amount. Notably, UP spent more than $100 million more on the rehabilitation of its yard in Roseville than the merger application predicted in order to obtain much greater service benefits and operational savings. By the end of 1999, UP also will have spent almost $25 million more on information technology in connection with the merger than the application indicated. Environmental cleanup costs on SP, not reflected in the merger application at all, will have consumed almost $22 million through 1999.

Through various memoranda of understanding with state, regional and local governments, UP committed services, properties and contributions valued at $100 million to offset potential merger impacts. UP offered much of this contribution toward construction of a depressed trainway through the gaming center of Reno, Nevada, and toward substantial improvements in rail/street interfaces in Wichita, Kansas. Other expenditures have been made or are committed to Truckee, California; Placer County, California; and the East Bay Park District in the San Francisco Bay Area.

Corridor Upgrades. UP continues to invest in upgrading rail corridors that, as a result of the merger, allow it to offer shippers the benefits of more efficient routes. UP is making these investments even though it has needed to place its highest priority in recent years on expanding capacity on the UP's highest-density lines from Chicago and Kansas City to North Platte and beyond to the Powder River Basin. Through 1999, UP will have spent almost $600 million on capital improvements to those lines, including creating triple track between North Platte and Gibbon Jct., Nebraska, and double track between Gibbon Jct. and Marysville, Kansas.[3] Although UP does not consider this spending to be attributable to the UP/SP merger, it improves service in the Central Corridor for all traffic, including former SP traffic.

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[3] UP recently acquired and upgraded a shortline railroad in northeast Kansas, effectively giving it an additional main track between Kansas City and Marysville.

Among the UP/SP corridors requiring merger-related investment, UP invested first in the "KP Line," which provides the most direct route between Kansas City and Denver; the Tucumcari Line between Topeka and El Paso; and the T&P (Texas & Pacific) Line between Ft. Worth and El Paso. UP improved the KP Line primarily to provide a superior route for coal originating on former DRGW lines in Colorado and Utah and destined to Mississippi River transloading facilities and utility plants in the Midwest and Southeast. UP already has invested more in the KP Line than was anticipated, and the investment program will continue into 2000. UP will have spent $134 million by the end of this year on this rehabilitation and capacity expansion project.

UP anticipated that it would need to add capacity on the line, and it is completing a total of 13 new sidings. Each of those sidings will be equipped with remote control switches, giving dispatchers the ability to control switch positions. In addition, however, UP has had to replace huge numbers of ties and upgrade substantial amounts of rail on the line. More upgrading work will be performed next year to increase train speeds and enable the line to handle the volume of traffic that UP needs to operate. Today UP returns empty coal trains from Kansas City to Colorado via North Platte, a circuitous route. Those trains will move down to the KP Line in 2000 or 2001 when trackwork is complete.

UP's investments on the Tucumcari Line will allow it to carry primarily expedited traffic between the Midwest and Southern California. The railroad has already spent $96.1 million of a projected $145.8 million in capital for additional sidings, Centralized Traffic Control ("CTC") and track rehabilitation. In 1999, UP is installing CTC from Omlee, New Mexico, to

Tucumcari, New Mexico, a distance of 249 miles, and between Dalhart and Stratford in Texas. It is also relocating a siding from the tourist city of Alamogordo to Omlee and installing a siding at Dalhart.

On the T&P Line, UP has spent $106.6 million of an estimated $125.4 million to increase speeds and provide more capacity. This line, which links Ft. Worth and mainlines to Memphis and St. Louis with El Paso and the Sunset Route to Los Angeles, forms the central segment of UP's direct route between Memphis and California. UP has invested tens of millions of dollars in new ties and rail, in addition to placing two new sidings in service, with another on the way this year. UP also will move a crew-change location from Big Spring to Sweetwater to improve crew availability. The line now supports, in addition to local service, three pairs of intermodal trains and three pairs of manifest trains daily. UP continues to operate one Memphis-Los Angeles intermodal train pair via San Antonio. As additional capacity becomes available on the shorter T&P Line, these trains may be rerouted, depending on traffic patterns at the time.

Although it has performed limited upgrading work, UP has not rerouted traffic to the OKT Line between Herington, Kansas, and Ft. Worth. It determined more than a year ago that it could provide better service to coal receivers in Texas by continuing to route their trains through Kansas City and improving in that route, rather than on the OKT. UP is likely to use the OKT as a grain route in the future. In Louisiana, UP has invested $30.4 million of a planned $44.3 million on the line segments connecting Iowa Junction through Livonia with Avondale (New Orleans), consisting of new and extended sidings and new rail and ties.

Still to come is substantial work on the "Sunset Route" between El Paso and Los Angeles, where traffic will approach the line's fluid capacity by the end of this year. One new stretch of double track is already in place to eliminate a key bottleneck between Anapra and Strauss (west of El Paso), and grading is complete for the second track between Raso and Luzena (east of Tucson). In the Los Angeles Basin, this line benefits from UP's ability to reroute traffic over the parallel UP line. As traffic expands on the Tucumcari Line, however, additional capacity will be added. UP expects to increase capacity on Beaumont Hill in Southern California next year.

UP is postponing, and may not need to perform, the $20.5 million upgrade of the Northern Nevada "Paired Track" — a segment of parallel UP and SP lines that were operated directionally by the two companies for decades. With a single dispatcher handling both lines, operations have been fluid and average train speeds are higher than before the merger. UP also is deferring further work on the "Mococo Line" between Tracy and Martinez in Northern California. With the new traffic patterns made possible by the extensive reconstruction of the yard at Roseville, this line is not needed at the present time.

Terminal Upgrades. In the UP/SP Operating Plan, the applicants proposed to spend $90.7 million on terminal upgrades and improvements. Through 1999, UP expects to have spent far more than twice that amount, a total of $203.9 million, primarily because of the more ambitious Roseville project. UP also completed an expansion program at Livonia, Louisiana, to enable that yard to process combined flows of UP and SP traffic and build run-through trains to eastern carriers. In 1999, UP finished installing second main track in the Dexter, Missouri, area and improved the crew change facilities there to eliminate a longstanding bottleneck on a former SP line that had been used by both railroads. UP is investing substantial capital to expand West Colton Yard in Southern California, building a second mainline and additional yard trackage, upgrading the hump computer and creating a new coordination center for that region. Six new departure tracks will keep West Colton fluid, allowing it to build more trains at one time without disrupting switching operations. We discuss additional terminal investments in the Houston/Gulf Coast area below.

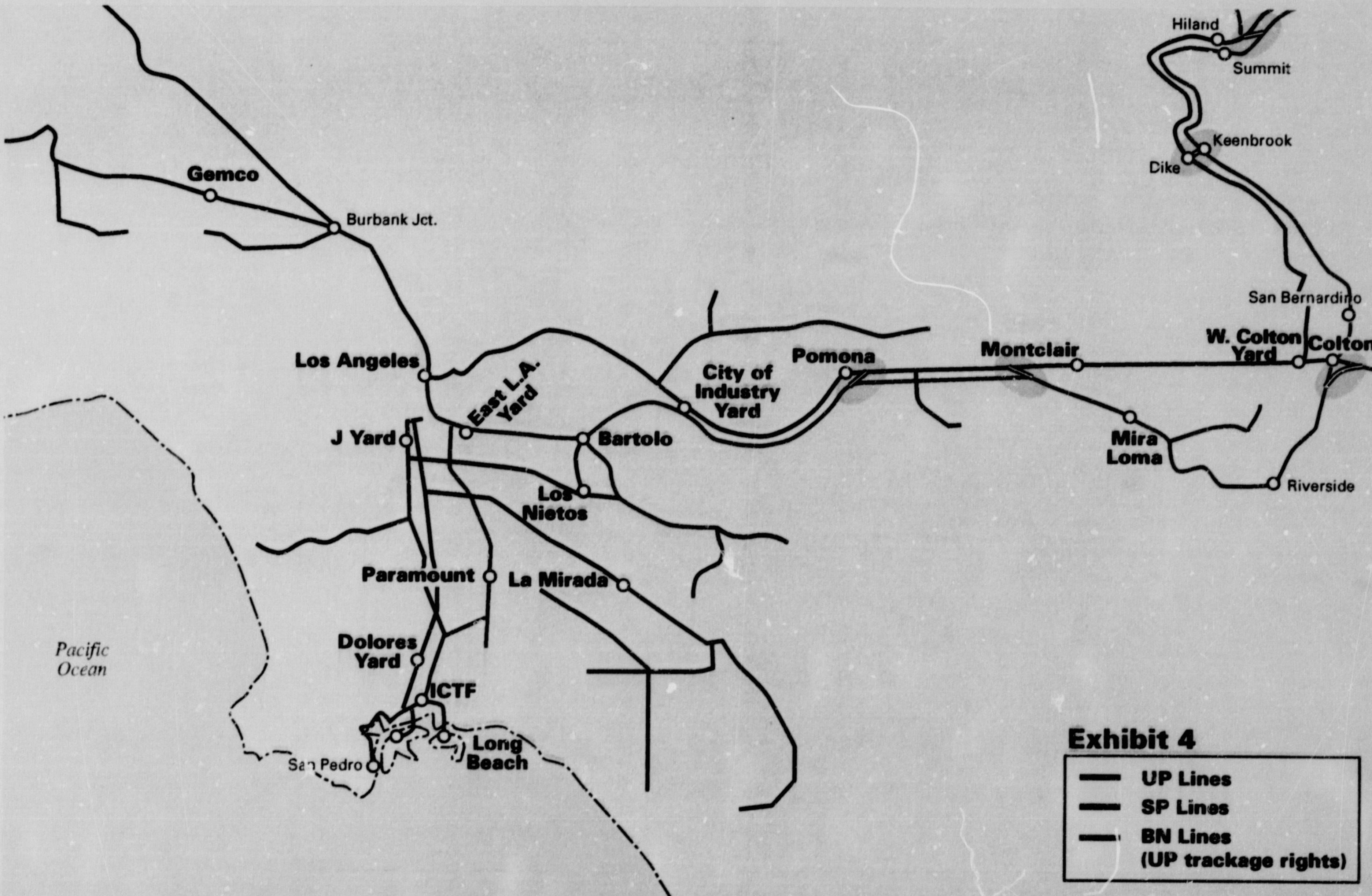
Intermodal Facilities. Through 1999, UP's expenditures on intermodal facilities related to the merger will total approximately $61.5 million, much of it spent to complete the new Memphis-area ramp at Marion, Arkansas. UP deferred expenditures on some intermodal facilities because it deferred expanding, and in fact curtailed, intermodal service during the service crisis. Intermodal service consumes large numbers of locomotives and significant track capacity, both of which UP needed to ration in order to improve service. In addition, UP's plans to build a major new Chicago-area intermodal terminal encountered local opposition in the West Chicago area.

Connections. During the last year, UP continued to build new connections to integrate the UP and SP route networks. Many of these projects were in Southern California, where UP laced together a web of former UP and SP lines to create new through routes. As shown on Exhibit 4, the UP route from Salt Lake City (using BNSF trackage rights between Barstow and Riverside) crosses SP's Sunset Route at Colton, California. From there to Los Angeles, the UP and SP lines are roughly parallel but were not connected. The UP line has more capacity and provides a better route to the Ports of Los Angeles and Long Beach, but the SP line carried more trains. By building a crucial connection in the southeast quadrant of the Colton crossing, UP can now route trains to and from the Sunset and Tucumcari routes over the UP mainline in the L.A. Basin, making better use of capacity and reducing transit times compared to using the SP mainline. Automotive trains to the Mira Loma auto facility, the largest in the L.A. Basin, also run from Kansas City to Colton on the former SP, then directly to the ramp on UP.

As also shown on Exhibit 4, UP installed two additional connections between the UP and SP mainlines at Pomona and Montclair, California. These connections give dispatchers flexibility to move trains back and forth between the two routes. Trains to and from the ports can use the more direct UP route west of Pomona and either route east of Pomona. By creating yet another connection, this one between the former SP mainline and the double-track BNSF mainline at the top of Cajon Pass on which UP has trackage rights, UP effectively created three main tracks between central Los Angeles and the summit of the Pass. UP trains can now use the shorter SP route to the top of the pass, reducing transit time. The SP route over Cajon Pass dates from the 1960s and has more modest grades than the downhill track on the BNSF route. Heavy unit coal trains from Utah and export grain trains can descend the comparatively gentler SP line with less concern about braking systems and without helper locomotives.

In Northern California, UP -- with BNSF's partial participation — has completed a number of important connections. In Sacramento, at a point called Haggin, UP rebuilt two connections between the grade-separated former WP and SP mainlines. Further north at Marysville, UP constructed a connection in the northwest quadrant of another crossing,

L. A. Basin
New Connections



again allowing trains to move between the two mainlines. Together, these connections give UP the flexibility to operate over either of two mainlines from Marysville to Sacramento and beyond to Stockton. At Stockton, BNSF and UP completed the connection that permits BNSF trains to run through the terminal without a backup movement, saving hours of transit time. UP also added a connection in Reno, Nevada, between the UP Reno Branch and the former SP Donner Pass route.

UP completed the critical Tower 87 connections in Houston, where the Sunset Route crosses the HBT East Belt. In the Operating Plan, the applicants proposed a connection in the north<u>west</u> quadrant of this crossing, which is located adjacent to the former SP Englewood Yard and just south of UP's Settegast Yard. The northwest quadrant connection allows trains and engines to move quickly between the two yards, avoiding a circuitous route through the busy Houston terminal. UP also installed a connection in the north<u>east</u> quadrant of the crossing, which allows trains, such as those carrying chemical shipments from Dayton and the Baytown Branch, to run directly into Settegast. Using this crossing, BNSF could also route trains from east of Houston onto the HBT for direct movement to its line northwest from Houston. All of these trains on both railroads avoid central Houston trackage and reduce delays to other trains.

<u>Repair Shops and Other Facilities</u>. To date, UP has invested approximately $60 million in constructing, upgrading and consolidating repair shops and facilities. In addition to a major new locomotive serving shop at Hinkle, Oregon, UP has improved locomotive servicing and fueling facilities at several locations.

Locomotives. Since the UP/SP merger, UP has acquired 618 modern, high-horsepower locomotives at a cost of some $2.5 million each, or approximately three billion dollars. This influx of new locomotives sharply increased UP's total available locomotive capacity and, although not counted as merger spending, allowed it to eliminate SP's fleet of older-model, low-efficiency locomotives that had high maintenance costs and poor emissions characteristics. SP could not have afforded such a wholesale replacement of its locomotive fleet, and even those locomotives that SP did purchase were the most basic available models. In addition, since the UP/SP merger, UP has rebuilt 1,380 locomotives, a rebuild program far beyond SP's means.

Report on Houston/Gulf Coast Region Infrastructure. In a May 1, 1998 report to the Board, UP recommended more than one billion dollars in capital investments that it and other parties should make in rail infrastructure in the Gulf Coast region over a multi-year period. Approximately $48.6 million represented projects previously identified in the UP/SP Operating Plan, while the remainder were in addition to the Operating Plan proposals. Through 1999, UP anticipates that almost $300 million will have been invested, including more than $70 million on new capacity and connections, more than $30 million on terminal improvements, over $30 million on industry support facilities, and some $155 million on track upgrades and improvements. Portions of those amounts come from other railroads through joint facility payments or from governmental entities.

In the Houston area, in addition to the $6 million Tower 87 connection projects, UP is spending $5 million in 1999 at another key rail junction, in the area of Tower 30. This is a complex location where UP's GH&H mainline between Houston and Galveston intersects the former SP Harrisburg Line from the west, SP's Galveston Subdivision to Strang, and PTRA's route on the south side of the Houston Ship Channel. UP is establishing interlocking controls at this intersection, which will allow trains to move much faster through the area, and constructing a new connection in the southwest quadrant. Southeast of that intersection, Phase 1 of the Strang Yard expansion is underway, as UP adds receiving and departure tracks to this capacity-constrained facility serving large numbers of chemical shippers on the Bayport Loop. And UP is building a new connection at Pierce Junction on the Harrisburg Line to improve switching operations and coal train movements.

BNSF and UP (and Tex Mex, to a minor extent) have agreed to fund additional trackage for capacity-constrained PTRA in Houston. They budgeted $8.8 million to construct two additional long yard tracks at North Yard, which should be in service in two weeks, and two more tracks at PTRA's Storage Yard. The authorized amount also includes three additional yard tracks at Pasadena Yard on the south side of the Houston Ship Channel, for construction in 2000 or 2001. This will sharply reduce congestion episodes on PTRA. The Port of Houston is now constructing a second main track between Strang and the Barbours Cut intermodal terminal to facilitate international container movements. UP is working with the Port on plans to extend the second main track westward to Deer Park Jct.

On the west side of Houston, UP is upgrading and adding CTC to the Sunset Route mainline this year between Chaney Jct. and West Belt Junction, the route used by UP, Amtrak, Tex Mex and some BNSF trains to and from the west. On the city's north side, UP is adding additional trackage for Storage in Transit ("SIT") at its Lloyd Yard in Spring, Texas. It is installing a hump computer and scale at Englewood Yard, and completing expansion of the locomotive servicing facility at Settegast.

UP is beginning to relocate the former SP mainline at Dayton, which will reduce conflicts between switching operations and through trains, benefitting Amtrak, BNSF and Tex Mex, as well as UP. UP will also begin this year the $24.7 million project to add a second track on the Baytown Branch, which serves a number of major chemical shippers. Tracks at Mont Belvieu, on the Branch 13 miles south of Dayton, will also be expanded at a cost of $2.5 million. UP has completed its expansion of Coady Yard, which it uses as a base of operations for the Baytown Branch and serves the adjacent Exxon complex. UP and Bayer Chemical are also constructing a yard to support service to the Bayer plant on the Baytown Branch.

Further east from Houston, UP completed a siding at Iowa Junction, Louisiana, to facilitate movements between the former SP Sunset Route and UP's line to Alexandria and Lovonia. At Lake Charles, UP is extending two yard tracks and connecting two other tracks to the main body of the yard to improve switching and reduce transit time. UP also is relocating the mainline, which runs through the middle of the yard, to a bypass route. This will eliminate existing delays to switching when through trains pass, and delays to through trains for switching. BNSF and UP will benefit and are funding this $12.3 million project jointly. UP planned to increase track capacity for car storage in the Lake Charles area, but a local government declined to approve actions necessary for that expansion. UP is looking for another location.

Southwest of Houston along the Gulf Coast, UP will construct a new siding north of Angleton, Texas. Angleton has long been a bottleneck on the Brownsville Subdivision between Houston and Corpus Christi, and dispatchers are forced to use a yard track for train meets and passes, blocking switching activity. The new siding will alleviate this situation, and permit a return to bi-directional operation between Houston and Placedo, Texas. UP will achieve similar benefits from the $4 million project to build three new classification tracks and a new switching lead at Bloomington, Texas, where switching today blocks the mainline. UP also plans to construct $4 million worth of classification tracks at Gregory, Texas, on the Rockport Branch. This trackage will allow UP to classify chemical traffic more efficiently and possibly to assemble full trains for points north.

West of Houston in South Central Texas, UP added CTC between Eagle Lake and Flatonia this year. It completed siding extensions at Rosenberg and Sugar Land, adding capacity to the Sunset Route. UP completed the $10 million installation of CTC between San Antonio and Laredo, as well as a new siding on this segment at Moore, Texas. UP is also investing $1.5 million to extend a wye track in the Laredo area to improve train flow. UP built a new customs facility at the Laredo intermodal facility to expedite northbound customs inspections and reduce delays. The facility, which reduces highway/railroad grade crossing conflicts by removing train inspections from downtown Laredo, provides protected areas for inspection and even a dog kennel for canine units. In San Antonio, UP is performing engineering work for the $3.9 million construction of run-through tracks at SoSan Yard. It also is considering constructing two yard tracks at Ryan's Ruin, Texas, to facilitate international movements through Eagle Pass. Further north, UP in 1998 reopened a second mainline through New Braunfels, Texas, creating almost 17 miles of double track and eliminating a severe bottleneck in an area where shippers originate large volumes of aggregates and cement.

UP will continue to invest heavily in the Houston/Gulf Coast region, but it has invested most heavily in the last year in the Central Corridor, where capacity needs are greatest, and it will continue to do so for the next year. Those investments directly benefit many Gulf Coast-area shippers, including Texas utilities that ship Powder River Basin coal over the Central Corridor lines. Meanwhile, investments, operating changes and consolidated dispatching have allowed UP to achieve unprecedented service levels in the Texas/Gulf Coast area. In recent weeks, for example, UP's Southern Region has been operating at average train speeds of up to 19.0 m.p.h., an increase of almost 50 percent since UP developed its infrastructure proposals. This is equal to the highest average speed ever achieved by UP, SP or UP/SP in that region. By comparison, average train speed in the Central Corridor is somewhat slower, which explains UP's current emphasis on that area.

5. <u>Terminal and Yard Consolidations</u>

UP continues to combine yard and terminal facilities throughout its service area, when doing so will improve service or allow UP to provide it more efficiently. In the following sections, we describe some of the more significant changes implemented in the last year at major terminals and yards other than those already discussed:

<u>Chicago, Illinois</u>. As predicted in the Operating Plan, UP shifted significant volumes of manifest traffic to BRC's Clearing Yard, especially for CSX destinations, after the

merger. This program worked well until last winter, when BRC experienced significant congestion and delays, especially on trains for CSX destinations. With the Conrail breakup, UP will concentrate manifest switching for eastern carriers at Proviso Yard, sharply reducing its reliance on BRC and reducing transit times by increasing the number of run-through trains.

Thus far, UP has been unable to construct a major new intermodal facility in the Chicago area because of local concerns. UP closed the Forest Hill intermodal ramp, as expected. On a temporary basis at least, UP trains continue to use the MIT intermodal facility. Most of UP's traffic at the Bedford Park facility — interline traffic with CSX — moved to CSX's new facility at 59th Street on June 1. As this report was written, NS and CSX intermodal transportation plans through Chicago are still evolving.

East St. Louis, Illinois. As planned, the former SP Valley Yard is inactive and available for expansion or new assignments. UP and IC may use it for run-through unit coal trains. Traffic at A&S Gateway Yard declined sharply as a result of both the UP/SP merger and the Conrail breakup. Both mergers allowed the railroads to consolidate interline traffic into run-through trains that are interchanged at Salem, Illinois (UP-CSX) and Sidney, Illinois (UP-NS). This reduces transit time and eliminates the congestion that sometimes affected Gateway Yard. The former CNW Madison Yard has been closed as expected.

Kansas City, Kansas/Missouri. As proposed in the merger application, UP discontinued manifest switching operations at the former SSW Armourdale Yard. Armourdale's classification responsibilities were dispersed to Neff Yard and 18th Street Yard, former UP facilities. Part of Armourdale will now be reconstructed as a facility for through trains, especially coal and grain trains.

Dallas, Texas. UP implemented the Operating Plan by concentrating manifest traffic and switching at SP's Miller Yard, eliminating a time-consuming reverse route for UP traffic that previously moved from North Little Rock through Dallas to Ft. Worth and then back to Dallas. UP specialized the functions of its two intermodal facilities, but in a somewhat different way than expected. Mesquite Yard, the former UP facility, handles primarily domestic intermodal traffic. The intermodal facility at Miller Yard accommodates primarily international traffic in containers. UP leased most of the former SP and MKT industrial trackage on the north side of Dallas to shortline carrier Dallas, Garland and Northeastern. UP did not implement its plan to close the Mesquite automotive facility because of a substantial increase in Ford business.

Ft. Worth, Texas. As expected, UP closed SP's Broadway Yard and allocated its work to UP's Centennial and Ney Yards. UP continues to use Ney Yard primarily to hold cars destined to Mexico that have not been cleared to cross the border. When UP expands SoSan Yard in San Antonio this fall, these cars will be chambered there, reducing mileage for most of the traffic and freeing Ney Yard for other duties in this busy terminal. UP and BNSF rationalized trackage in the terminal to eliminate crossings and reduce conflicts between trains. The former SP mainline is now a bypass track around Ney Yard.

San Antonio, Texas. UP will complete implementation of the Operating Plan for San Antonio next year. As planned, the former SP East Yard is the receiving yard, and it handles industry work. UP SoSan Yard stages traffic for the Mexican border crossings at Laredo and Eagle Pass. UP plans this year to extend yard trackage at SoSan and construct two new run-through tracks to handle increased business, especially automotive traffic. This will allow UP to shift Mexican traffic from Ney Yard in Ft. Worth to SoSan Yard.

El Paso, Texas. As planned, UP closed the small T&P yard and shifted its activities to SP facilities. As UP began to concentrate more expedited trains on the Tucumcari Line, El Paso loomed as a bottleneck. UP has implemented a number of operating changes, reducing the amount of time trains spend in the terminal. In order to accommodate greater traffic volumes, UP expects to upgrade signals and switches in the terminal next year.

Los Angeles, California. Los Angeles intermodal operations changed significantly after the merger was planned in the summer of 1995. Several steamship companies constructed on-dock container facilities, eliminating UP's need to expand the Intermodal Container Transfer Facility (ICTF). That facility will continue to specialize in handling international containers. As noted earlier, UP decided to retain SP's Los Angeles Transportation Center ("LATC") for I-5 Corridor traffic. The UP East Los Angeles facility will continue to handle east-west domestic traffic between Southern California and points such as New Orleans, Atlanta, Houston, Chicago and Kansas City. The City of Industry intermodal facility, which originally was to absorb LATC traffic, will accommodate Inland Empire traffic until a new intermodal facility is built at the east end of the Basin.

Oakland, California. UP consolidated manifest traffic into SP's yards, as predicted in the Operating Plan. The Operating Plan indicated that UP would retain both the

UP and SP intermodal facilities, and UP preferred this course of action. However, in order to facilitate the Port or Oakland's desire to expand port facilities on an expedited basis, UP is closing the UP intermodal facility in stages and will make that property available to the Port for its planned Joint Intermodal Terminal. UP will also provide a route for BNSF to reach that facility once it opens.

Carlin/Elko, Nevada. UP closed SP's switching operation at its remote yard in tiny Carlin, Nevada. That work shifted to Elko, which now will originate and terminate local service trains to and from Davis Yard in Roseville.

Salt Lake City/Ogden, Utah. UP implemented most of the Operating Plan in Salt Lake City. UP's yard is used for intermodal traffic and as a setout and pickup point for through trains. The former DRGW Roper Yard is the primary manifest switching yard. UP continues to use the Roper intermodal facility for UPS traffic to and from Denver. At Ogden, UP will spend $10 million to restore trackage that historically formed the "Overland Route," connecting UP and SP at this gateway. This trackage and signal project will increase speeds significantly in the terminal.

Denver, Colorado. Denver, unfortunately, remains a problem area. UP built two additional arrival and departure tracks at the former DRGW North Yard to handle increased coal traffic. Its greatest need, however, is a direct route between the former DRGW Moffat Tunnel route and the KP Line so that coal trains can operate through Denver without having to move the locomotives from one end of each train to the other. UP and BNSF have not been able to reach agreement on terms and conditions for UP to cross BNSF tracks on the north side of Denver. The railroads are looking at additional potential solutions.

D. Abandonments

As of this report, UP has carried out the following merger-related abandonments and discontinuances in whole or in part:

- Whittier Junction-Colima Junction, California (Docket No. AB 33 (Sub. No. 93X)).
- Magnolia Tower-Melrose, California (Docket No. AB-33 (Sub-No. 94X)).
- Hope-Bridgeport, Kansas (Docket No. AB-3 (Sub-No. 121)).
- Towner-NA Junction, Colorado (Docket No. AB-3 (Sub-No. 130)).
- Little Mountain Junction-Little Mountain, Utah (Docket No. AB-33 (Sub-No. 99X)).
- Sage-Leadville, Colorado (Docket Nos. AB-8 (Sub-No. 36X) and AB-12 (Sub-No. 188)).
- Malta-Canon City, Colorado (Docket Nos. AB-8 (Sub-No. 39) and AB-12 (Sub-No. 188)).
- Gurdon-Camden, Arkansas (Docket No. AB-3 (Sub-No. 129X)).
- DeCamp-Edwardsville, Illinois (Docket No. AB-33 (Sub-No. 97X)).
- Edwardsville-Madison, Illinois (Docket No. AB-33 (Sub No. 98X)) (portion).
- Barr-Girard, Illinois (Docket No. AB-33 (Sub-No. 96)).
- Iowa Junction-Manchester, Louisiana (Docket No. AB-3 (Sub-No. 133X)).

UP has determined that the Sage-Malta-Parkdale segment of its Tennessee Pass line will be retained in place while Central Corridor capacity requirements are monitored. UP sold the Canon City-Parkdale portion of its Malta-Canon City, Colorado, line to another carrier, retaining overhead freight rights.

As reported last year, UP also decided not to abandon that portion of the Edwardsville-Madison, Illinois, segment between MP 145.2 and 148.78, and not to carry out the Suman-Bryan, Texas, abandonment (Docket No. AB-12 (Sub-No. 185X)). UP has also decided not to carry out the Troup-Whitehouse, Texas, abandonment (Docket No. AB-3 (Sub-No. 134X)).

UP has also decided to defer exercising its authority to abandon several additional line segments, pending further analysis of whether their capacity is needed. Decisions will be made in the future regarding the following abandonment projects, and UP will notify the Board of its decisions promptly:

- Whitewater-Newton, Kansas (Docket No. AB-3 (Sub-No. 132X)).
- Wendel-Alturas, California (Docket No. AB-12 (Sub-No. 184X)).
- Seabrook-San Leon, Texas (Docket No. AB-12 (Sub-No. 187X)).

E. Implementation of Houston Gulf Oversight Decision

In its Decision served December 21, 1998 in Finance Docket No. 32760 (Sub-No. 26), the Board ordered UP to pursue several steps related to service in the Houston and Gulf Coast area. We report here on the status of those initiatives:

Clear Routes Through Houston. UP, BNSF and Tex Mex implemented this proposal soon after the Board's decision. The BNSF-UP joint dispatchers and UP dispatchers who control routes in the Houston terminal area are authorized to reroute trains from their normal routes whenever operating conditions warrant. They use this flexibility to enhance the efficiency of overall operations in the terminal.

KCS/Tex Mex Participation in Spring Dispatch Center. As noted earlier, both carriers elected not to participate.

CMTA. UP is working with Longhorn Railway to develop new trackage for the interchange at McNeil, Texas. Longhorn is to provide a plan to UP. UP also negotiated an arrangement with Longhorn to re-establish the Giddings, Texas, interchange.

Infrastructure Report. UP's annual report is included in this submission. In January, UP placed a senior official in Houston to work with business leaders and public officials on transportation and community issues. As part of this effort, UP has provided quarterly briefings for the Greater Houston Partnership's Rail Freight Task Force on UP operations, including service levels and capital investment in the region.

Trackage Rights Modifications. In the only modification of merger-related trackage rights since the decision, UP invited BNSF to discuss returning its trains to their original route between Temple and San Antonio via Smithville, Texas. BNSF did not object to this change, and it took effect today at midnight this morning.

HGC. UP senior management personnel have met repeatedly with Mr. Kenneth Cotton, who manages this railroad, although it presently has no locomotives and no qualified trainmen. UP, which does not have an active rail line that connects with HGC, pursued a potential arrangement under which HGC would perform storage and switching duties for UP, even though the location would be out-of-route and less efficient for UP and its shippers. The yard HGC originally wanted to use for this service is no longer available to HGC. The proposed arrangement also was contingent on approval of the owner of the rail property on which the activity was to take place, but the owner has rejected the arrangement and indicates that it would not be feasible. The City of Wharton also has raised environmental concerns. Mr. Cotton asked UP to meet again on July 2, and UP will do so in good faith. UP has devoted substantial time and resources to these negotiations to determine whether this rail operation could provide any services that would fulfill a legitimate business need. UP believes that it has discharged its obligation under this condition.

II. COMPETITION

As the merger moves toward the three-year mark, it is clear that both the merger and the implementation of the competitive conditions imposed by the Board have strengthened rail competition in the West.

First, the UP system continues to enhance competition by providing shippers with single-line and shorter routings that were not available prior to the merger, as well as improved equipment supply and reduced switch fees. With the resolution of UP's congestion problems, shippers are increasingly enjoying these merger-related competitive benefits.

Second, the competitive conditions — particularly the extensive trackage and haulage rights granted to BNSF — continue to demonstrate their clear effectiveness. Shippers continue to benefit from BNSF's strong competition, as reflected in both the large volumes of traffic they are awarding to BNSF and the rates and service initiatives that UP has taken to meet BNSF competition. And for a third year, events have continued to prove that the Board was correct in its rejection of claims that the merger would have adverse competitive effects on "3-to-2" traffic, Utah and Colorado coal, Gulf Coast chemicals, or grain.

Indeed, for every competitively relevant category of traffic, this is the third straight year in which rates are steady or down.

A. Competitive Benefits of the Merger

As merger implementation has moved forward for a third year, the merger has continued to generate stronger competition in important ways.

1. New Single-Line Service and Shorter Routes

One of the principal reasons that the Board approved the UP/SP merger was the synergies of the two railroads' networks — the ability, by combining those networks, to produce much-expanded single-line service and shorter routes in many important corridors. With the completion of TCS installation across the former SP, further progress during the past year in completing labor implementing agreements, and continuing merger-related capital investments, the merged system has made ever-increasing progress in exploiting these synergies, to the distinct benefit of the shipping public.

For several years now, the availability of single-line service and shorter routes has yielded extended hauls on existing UP business and attracted new business to the merged system. And new opportunities continue to arise. As a result, shippers are enjoying improved service and, in many cases, significant rate reductions. Confidential Appendix A lists some 160 concrete examples of how, in the year since our last in-depth report, new single-line service and shorter routings made possible by the merger have continued to attract new business to UP and bring shippers lower rates and better service.

In many instances, these enhancements of rail competitiveness have allowed customers to penetrate new markets where they previously could not compete. For example, shippers that continue to take advantage of major new single-line marketing opportunities include: UP grain producers moving their grain to SP destinations such as the Imperial Valley and the Nogales gateway; SP Pacific Northwest and California lumber producers reaching new markets at UP points and via UP routes and junctions; UP-served South Central lumber producers reaching SP destinations; UP-served and SP-served Gulf Coast chemical manufacturers shipping their products to destinations and junctions on the other merging railroad; and SP aggregate producers reaching new destinations served by UP in the Houston area. New shorter routes are bringing benefits to, among others: UP-served shippers using SP's Sunset Route across the Southern Corridor; SP-served Utah coal producers that can cut 300 miles off their routes to export facilities and industrial coal users in Southern California; SP-served rock shippers in Texas; SP-served Louisiana shippers moving goods to Memphis and beyond; and intermodal shippers moving traffic between Memphis and Los Angeles that can cut 200

STB FD 32760 (sub 21) 7-1-99 D 194922 2/3 miles off their route. Examples of all of these situations and more are provided in Confidential Appendix A.

2. Equipment

An additional dimension of strengthened competition arising out of the UP/SP merger involves equipment supply and utilization. For a third year, the merger of the UP and SP equipment fleets, and the consolidation of the car management functions, has allowed UP to bring many competitive benefits to shippers. All across the merged system, UP shippers continue to benefit from access to SP equipment, and vice versa. Consolidation of the two railroads has opened up numerous opportunities for backhauls, triangulation, and more efficient equipment repositioning, which in turn allow more competitive rates and service to be provided to customers.

Since October 1996, UP and SP equipment has been managed as a single fleet. As a result, UP and its shippers have enjoyed the benefits of improved car utilization that the merger application predicted. As was the case last year and the year before, numerous concrete examples can be cited of shippers' benefitting during the past year from combining UP and SP fleets as a single source of car supply, and from the merged system's ability to acquire additional cars to satisfy shipper needs. Some of the most noteworthy examples include: the use of UP's mechanical reefer fleet by SP shippers in California; the acquisition of centerbeam flatcars for Pacific Northwest and California lumber shippers; and the repositioning of intermodal equipment between UP and SP facilities on the West Coast and elsewhere.[4] Many additional customer-specific examples are provided in Confidential Appendix A.

3. Switch Fees

As previously reported, the elimination and reduction of switch fees has been another important dimension of enhanced competition made possible by the UP/SP merger. As soon as the merger was consummated, switch fees between UP and SP were eliminated. These fees, frequently $495 per car, were a major obstacle to the use of the most efficient routes, and to competition for shorter-haul movements against truck and alternate product sources. Switch fees between UP and SP amounted to more than $16 million, for over 50,000 cars, in the year prior to the merger.

SP had imposed its high reciprocal switching charges on all major railroads, and those railroads reciprocated. SP had a policy of imposing high fees because it had a switching imbalance and the fees provided a much needed cash inflow. Pursuant to the BNSF settlement agreement, as augmented by the CMA agreement, fees charged by the merged system to BNSF at "2-to-1" points were set at $130 per car ($60 per car for grain), and fees charged by SP at all other points to all railroads were reduced so that no charge was more than $150 per car. The applicants and BNSF reached further agreement that charges between BNSF and SP at all locations would be reduced to no more than $130 per car. These reductions went into effect promptly upon consummation of the merger. In the first full year following the merger, the

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[4] For additional specific examples of equipment benefits that shippers continue to enjoy, see Applicants' Second Annual Report on Merger and Condition Implementation (UP/SP-344), pp. 45-52.

BNSF-SP reductions alone amounted to more than $11 million on over 65,000 cars. This level of impact has continued in subsequent years.

In total, UP estimates that the elimination and reduction of switching charges that were produced by the merger and the settlement agreements will amount to some $85 million during the first three years following the merger. In addition to this monetary impact, these reductions have prompted new and increased traffic flows, as rail rates have become more competitive.

In addition, in February of last year, UP and BNSF entered into a new systemwide reciprocal switch fee agreement that produced further overall reductions in switch fees (including in particular CNW's high switch fees) and greatly simplified switch fee administration on both railroads. The agreement superseded seven earlier agreements involving former constituent railroads of UP and BNSF, most involving higher charges. Reciprocal switch fees involving the entire UP and BNSF systems were standardized at $75 per car for whole grains and $130 per car for nearly all other traffic. This agreement was attributable in significant part to the merger, because the merger permitted negotiations on a basis of broad equality in switching volumes and brought about a commitment by the entire merged system to promoting traffic development through reducing switch fees.

B. <u>Effectiveness of Competition-Preserving Conditions</u>

The Board imposed, as conditions to its approval of the merger, the settlement agreements entered into between the primary applicants and BNSF and CMA, and augmented those settlements in a number of ways. The Board also granted in part Tex Mex's trackage rights application, and imposed as a condition the applicants' settlement agreement with Utah Railway. All of these conditions have continued to work well during the past year.

1. Compliance With the Conditions

UP continued to devote substantial resources during the past year to complying strictly with all merger conditions. UP's compliance with the competition-preserving conditions is described below.

a. BNSF and CMA Agreements

UP has fully complied with the BNSF and CMA agreements.

Clarifying Decisions. As the Board is aware, even before the merger had been approved, the applicants had completed and filed definitive trackage rights agreements and haulage agreements with BNSF. In the three years since the merger was approved, the number of disputes regarding the scope of BNSF's rights, which was never great to begin with, has rapidly diminished.

During the past year, the Board decided only one dispute between BNSF and UP regarding the scope of the merger conditions. In Decision No. 81, served Oct. 5, 1998, the Board held that BNSF had the right to serve a South Texas Liquid Terminal transload facility near San Antonio, Texas.[5] The Board also stated that "any further disputes between BNSF and UP arising under the settlement agreement should be arbitrated under the provisions of that agreement." Id., p. 5. One dispute, involving access to Four Star Sugar in El Paso, Texas, is presently

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[5] In its decision concluding the second annual oversight proceeding, Finance Docket No. 32760 (Sub-No. 21), Decision No. 13, served Dec. 18, 1998, the Board also denied several shipper and shortline requests seeking access to BNSF because of UP service problems.

pending before the Board, although UP believes that this dispute should be submitted to arbitration in accordance with the Board's instructions in Decision No. 81.

"2-to-1" Protocol. UP has continued to abide by the provisions of the protocol established by UP and BNSF to govern the listing of "2-to-1" facilities. There are no disputes pending before the Board, and there have been no "2-to-1" disputes that have required arbitration or resolution by the Board since the South Texas Liquid Terminal matter was resolved.

Voluntary Further Agreements. As previously reported, in order to facilitate BNSF's operations pursuant to the merger conditions, UP voluntarily entered into a number of haulage agreements with BNSF that were not required by the terms of the parties' settlement agreement. The agreements that had already been entered into at the time of the first annual oversight report c... El Paso-Sierra Blanca; Beaumont-Orange; Odem-Corpus Christi; Pine Bluff-Camden; Shreveport-Tenaha; Texarkana-Shreveport; and service to Nevada Paired Track customers, to Turlock, Fullerton and South Gate, California, and in the Baytown, San Jose, Stockton, Salt Lake City and Lake Charles areas. As reported last year, an additional haulage agreement was entered into for the movement of traffic between Pine Bluff, Arkansas, and the "2-to-1" points of Paragould, Arkansas, and Dexter, Missouri. As previously reported, some of these agreements, such as the Odem-Corpus Christi and Shreveport-Tenaha haulage, are no longer in use because BNSF is instead running trackage rights trains at those locations.

Also, Utah Railway has continued during the past year to serve as BNSF's designated agent for switching customers in the Utah Valley. UP consented to this pursuant to its right of consent under the UP-BNSF settlement agreement to third-party feeder service arrangements.

Implementation Steps. Operating and data systems were put in place for immediate commencement of BNSF service upon consummation of the merger, and UP and BNSF have worked together since the merger to refine those systems, which initially involved considerable manual effort to ensure that each railroad had accurate information about the other's operations. UP and BNSF now have in place automated systems that allow the railroads to exchange accurate and up-to-date information regarding each railroad's trackage rights trains. UP and BNSF had been conducting weekly conference calls to address data exchange issues, but they recently agreed that resolution of data exchange issues has progressed to the point where it is no longer necessary to continue these calls.

As previously reported, in March 1997, UP and BNSF developed a formal process to record, monitor and resolve day-to-day operational issues that arise out of the trackage rights, haulage and reciprocal switching arrangements between the railroads. A problem-log database was created that allows employees of both UP and BNSF to add and update problems. UP has an employee at its National Customer Service Center assigned to work full-time on resolving problems identified in the log. Since January, UP has responded to BNSF log entries within four hours between 95% and 98% of the time. And between January 1, 1999 and June 16, 1999, there have been 651 entries in the problem-log database, as compared to 1,182 over the same period last year. The sharp decline in log entries and UP's rapid responses reflect UP's efforts to ensure that BNSF receives the full benefit of the merger conditions.

Dispatching Protocol. The BNSF-UP dispatching protocol has continued to work well. Both parties have exercised their rights to monitor the dispatching of their trains by the other, and any issues that have arisen regarding dispatching on trackage rights lines have been resolved quickly and cooperatively. BNSF has a full-time manager at the Harriman Dispatching Center and UP has maintained a full-time manager at BNSF's Fort Worth Dispatching center to facilitate to movement of BNSF trackage rights traffic.[6]

In the past, BNSF claimed that UP engaged in discriminatory dispatching of its trains over UP trackage rights segments. UP developed, at substantial expense, an automated measuring system to evaluate this claim and demonstrated conclusively that it was meritless. In fact, comparisons of transit times for comparable BNSF and UP trains on trackage rights segments showed that BNSF trains generally experienced faster transit times.

BNSF's claims of discriminatory dispatching have been replaced by an ongoing, cooperative effort by both railroads to monitor trackage rights operations over almost all segments on which one of the railroads operates over the other. The latest available results, covering the month of May, continued to prove that BNSF trains received equitable handling on UP trackage rights. Of 49 instances in which it is possible to compare UP and BNSF average transit times for comparable train types (with four or more operations per month), BNSF trains experienced faster average transit times in 29 instances, UP trains moved faster on average in

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[6] In addition, as previously reported, UP and BNSF are participating successfully in the Houston-area regional dispatching center in Spring, Texas, and they are implementing consolidated dispatching in Southern California and the Powder River Basin, as well. UP and BNSF are also developing plans for a consolidated dispatching center to control operations throughout the Kansas City terminal area.

17 instances, and the trains of the two railroads had the same average transit times in the remaining three instances. These results are consistent with the duty of nondiscriminatory dispatching. Nondiscriminatory dispatching does not mean that every train will have the same transit time on every route — it will always be the case that on a day-to-day basis some trains will move faster than others. Nondiscriminatory dispatching means that all trains are subject to fair and equal treatment and there is no systematic imbalance between railroads. The data show that BNSF trains receive fair and equal treatment on UP.

Line Sales. The BNSF settlement agreement provided for the sale to BNSF of three line segments: Dallas-Waxahachie (completed Sept. 20, 1996); Iowa Junction-Avondale (completed Dec. 15, 1996); and Keddie-Bieber (completed July 15, 1997).[7]

Connections. UP work on connections to facilitate BNSF trackage rights operations has been completed at all locations. The final element — signal work at the new Stockton, California, connection, which had been in place for more than a year — was completed in May.

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[7] As previously reported, as part of an overall agreement under which BNSF joined in the Spring regional dispatching center, UP and BNSF agreed on February 18, 1998 to exchange undivided half-interests in UP's line between Iowa Junction, Louisiana, and Houston (Dawes), Texas, and BNSF's line between Iowa Junction and Avondale, Louisiana. The agreement also gave UP trackage rights over BNSF's line between Beaumont and Navasota, Texas, allowing trains to bypass Houston, and further clarified limitations on UP's liability for expenditures that have been and may in the future be made to upgrade the Iowa Junction-Avondale line. In addition, the agreement allowed BNSF new access to customers along the former-SP line between Houston and Iowa Junction. The access, which did not require Board action, went into effect immediately. The Board exempted the exchange of ownership interests in Finance Docket No. 33630, Burlington Northern & Santa Fe Ry. & Union Pacific R.R. — Acquisition Exemption — Lines Between Dawes, TX, & Avondale, LA, served Sept. 29, 1998. UP expects the final agreements to be in place shortly.

Capital Reserve Fund. Section 9c of the BNSF settlement agreement established a $25 million capital reserve fund to finance projects on the trackage rights lines required to accommodate the operations of BNSF and UP on those lines. The parties have concurred on the following projects:

Project	UP Cost Estimate
Avondale Connections	6.1 million
Iowa Jct. Siding	5.5 million
CTC, Echo TX to Iowa Jct.	3.4 million
El Pinal Crossing	3.7 million
Stockton Connection	4.0 million
AEI Readers	0.5 million

These projects total $23.2 million. UP and BNSF have agreed to hold the remainder of the fund as a contingency fund to partially cover any cost overruns.

Storage-in-Transit Capacity. As required by the CMA agreement and the Board's merger approval decision, UP has continued to make storage-in-transit ("SIT") capacity available to BNSF at Dayton Yard, near Houston, and at Beaumont, Texas, for BNSF trackage rights traffic. Most of this capacity (1,350 out of 1,475 storage spots) is at Dayton, where BNSF and the facility operator have constructed receiving and departure tracks to facilitate BNSF's use of the facility.[8] SIT capacity is tight throughout the Gulf Coast area, and UP is pursuing capital investment and other initiatives to add storage space. In the past year, BNSF established a SIT facility on tracks leased from UP in Beaumont. BNSF-PR-9, p. 9.

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[8] Dayton is a 3,000-car yard, but 300 of those spots are used for switching both UP and BNSF cars.

New Facilities. In Decision No. 75, served Oct. 27, 1997, the Board held that it was necessary to determine on a case-by-case basis whether a particular shipper facility qualified as a "new facility" for purposes of the condition giving BNSF the right to serve such facilities on lines where BNSF has trackage rights. UP has promptly responded to BNSF requests for confirmation of its ability to access new facilities. Since Decision No. 75, there has been only one dispute on this subject. BNSF recently filed a petition seeking access to Four Star Sugar in El Paso, Texas — a facility located at the back of a UP yard that can only be reached by moving over an active, multipurpose rail line over which BNSF does not have trackage rights. That petition is presently pending.

Joint Service Committee. The Joint Service Committee provided for in the parties' dispatching protocol has met twice since the last annual report, in October and March. Numerous other informal communications have occurred to follow up on issues addressed at those sessions. Among the merger-related issues addressed were: train performance in trackage rights corridors; the development of performance standards; the status of various capital projects funded out of the $25 million joint fund; operating plans for the Baytown and Cedar Bayou Branches; and data integrity issues affecting service in the Winnemucca-Elko region.

Segregated Funds. In Section 6 of the CMA agreement, Applicants agreed to place trackage rights fees received under the BNSF settlement agreement into two dedicated funds, one with respect to the trackage rights lines in Texas, Louisiana, Arkansas, Missouri and Illinois, and one with respect to the trackage rights lines in the Central Corridor and California. Applicants agreed that the money in those funds would be spent on (a) maintenance on those lines, (b) offsetting depreciation of those lines, (c) capital improvements on those lines, and (d) costs for accounting necessary to administer the two funds. As UP has shown in prior quarterly reports, expenditures on the trackage rights lines are greatly exceeding the trackage rights revenues. The following table provides information regarding the two funds through the quarter ending March 31, 1999, the latest date for which the data has thus far been compiled. (In light of the great excess of outlays over fees, we have not compiled data on capital expenditures on the lines, which have been substantial.)

	Texas, Louisiana, Arkansas, Missouri and Illinois	California and Central Corridor
REVENUE		
Trackage Rights Fees	$37,437,979	$40,732,875
Capacity Improvement Fees	0	0
Total	$37,437,979	$40,732,875
EXPENSES		
Maintenance	$85,319,900	$61,755,114
Depreciation	61,755,114	64,738,240
Capital Expenditures	not calculated	not calculated
Accounting Expenses	53,514	53,514
Total	$147,128,528	$126,546,868

Contract Reopener Process. The CMA agreement, as further augmented by the Board, provided that UP must allow all "2-to-1" shippers to divert to BNSF up to 50% of contracted-for volumes under contracts in effect when the merger was consummated. As explained in our July 1, 1997 report, most affected contracts were of one-year duration, and thus have now expired, and most shippers with affected contracts elected to take no action in response to the notices they were sent setting forth their rights under this provision. However, a substantial number of shippers did elect, in lieu of exercising the formal 50% reopener option, to negotiate new contracts with UP to supersede the pre-merger contracts prior to their expiration. In a number of other instances shippers diverted volumes under pending contracts to BNSF without formally inquiring whether UP would terminate the contract, and UP did not elect to terminate the contract.

I-5 Corridor. As previously reported, the I-5 proportional rate agreement went into effect on July 15, 1997, simultaneously with the Keddie-Bieber line sale. UP's trackage rights over BNSF's Bend-Chemult segment also went into effect on that date. Examples of UP traffic moving under the proportional rate agreement and BNSF traffic moving over the Bieber line are contained in Confidential Appendix J.

UP Trackage Rights on BNSF. UP has exercised the following trackage rights that it received over BNSF lines as part of the BNSF settlement agreement: rights at Superior, Wisconsin, to facilitate access to the MERC Dock coal facility; rights between Mojave and Barstow, California, which have been used to capture new perishables traffic and to bypass the Los Angeles Basin for such movements as industrial sand and Utah coal bound to facilities in Central California; and overhead and local service rights on the Dallas-Waxahachie and Iowa Junction-Avondale lines that were sold to BNSF. All of these rights have strengthened competition and added to UP's efficiency. In August, UP expects to begin to make use of the final trackage rights segment — between Bend and Chemult, Oregon — for traffic that UP and CP will block for movement to and from Roseville Yard.

b. Tex Mex Trackage Rights

As with the BNSF rights, UP had operating and data systems in place to support Tex Mex trackage rights operations when those operations commenced on October 8, 1996. As reported last year, as a result of UP's institution of directional operations between Beaumont and Houston, UP agreed to provide Tex Mex with additional trackage rights over the former-SP line between those points so that Tex Mex could operate with the flow of traffic in each direction. Tex Mex also continues to operate northbound over UP's line between Algoa and Placedo, Texas, on trackage rights that were put in place on a temporary basis to allow Tex Mex to operate directionally between Houston and Placedo.

As previously reported, UP constructed a new connection at Flatonia to facilitate the movement of Tex Mex trains. A new siding south of Flatonia at Adel, Texas, was placed in service in February. Construction of a new connection at Robstown was completed in June of last year, and the rehabilitation of an associated siding was completed in July.

We reported last year that Tex Mex had expressed interest in becoming a member of the Port Terminal Railroad Association ("PTRA") in Houston, and that discussions of that matter were underway. Tex Mex membership in the PTRA has since been approved by the current PTRA members.

c. Utah Railway Trackage Rights

The Utah Railway trackage rights remained fully operational during the past year, with all necessary support systems in place.

2. The Conditions Are Working Well

Each of the competitive conditions continues to work to provide effective competition.

a. BNSF

BNSF continues to provide vigorous and effective competition using the rights that it received as a condition to the merger.

BNSF Service. As we have previously reported, BNSF rapidly made the transition from interim haulage, which had gone into effect immediately following the merger at all points that BNSF had the right to serve, to full trackage rights operations in all major corridors.

During the past year, BNSF has continued to expand its service using rights obtained in connection with the merger. Here are some of the significant actions it has taken:

- In July 1998, BNSF began direct delivery and receipt of intermodal traffic with CSX and NS at New Orleans, thereby bypassing BNSF's Westwego intermodal facility.
- In July 1998, BNSF completed an additional operating siding at Eagle Pass and instituted an improved interchange process with Ferrocaril Mexicano ("FXE").
- On September 2, 1998, BNSF commenced a daily Lafayette-Lake Charles, Louisiana roundtrip local train for handling Lake Charles business through interchange with UP at the former-SP Lake Charles yard.

- On November 12, 1998, BNSF commenced six day/week local service between Stockton and Sacramento, California, replacing service provided by UP haulage between those points.

- On March 1, 1999, BNSF initiated a new operating plan on the former-SP Baytown and Cedar Bayou Branches, replacing UP haulage service with direct service and service via reciprocal switching.

- In March 1999, BNSF completed the construction of three 7,500-foot tracks at its Dayton Yard facility.

- In March 1999, BNSF also completed the construction of a new interchange at Crowley, Louisiana, with Acadiana Railway, a "2-to-1" shortline in Louisiana.

BNSF is operating trackage rights trains over virtually all the lines where it has the right to do so. The sole exception is that BNSF has not used its rights to St. Louis, except for occasional movements, because it has preferred to work with IC to move traffic between Memphis and connections with Eastern carriers.

UP continues to handle BNSF traffic in haulage service between Houston and Brownsville as provided for in the settlement agreement, as well as at several other locations mentioned above. UP also continues to provide haulage for traffic moved by BNSF to and from "omnibus" points, — i.e., "2-to-1" points not located on BNSF trackage rights corridors — pursuant to UP's June 1997 offer to provide service to and from all such points via haulage pending any request by BNSF for an alternative form of access. Significant BNSF haulage movements were handled to or from the following "omnibus" points during the past year:

- Livermore, CA (haulage to/from Warm Springs, CA)

- Trevarno, CA (haulage to/from Warm Springs, CA)

- Sugar Land, TX (haulage to/from Houston)

- Dickinson, TX (on the former Galveston, Houston and Henderson Railroad) (haulage to/from Houston)
- Turlock, CA (haulage to/from Stockton)
- Great Southwest, TX (haulage to/from Ft. Worth)

BNSF Trackage Volumes. The volume of traffic handled by BNSF pursuant to its trackage rights continued to increase this year. For the past two years, after reviewing BNSF's substantial trackage rights volumes and the competitive service BNSF was offering in all major corridors, the Board found that the merger conditions had effectively preserved competition. This year, BNSF's volumes have continued to grow.

Through May of 1999, BNSF had operated a total of 17,443 through freight trains over the trackage rights lines since the commencement of operations in October 1996. This is shown in Exhibits #5, #6 and #7, depicting, by month, the numbers of BNSF through trackage rights freight trains and the number of cars and tons on those trains.

As the exhibits show, the monthly number of BNSF trackage rights trains had grown to 751 in May 1999 — greater than the 703 trackage rights trains that BNSF operated a year earlier, in May 1998, and far greater than the 392 trackage rights trains BNSF operated in May 1997. BNSF tonnages have increased even more sharply than the number of trains, reaching 3.8 million gross tons in May 1999, compared with 3.3 million gross tons in May 1998, and 1.4 million gross tons in May 1997. And cars moving in through trackage rights trains have also increased more sharply than the number of trains, reaching 47,176 (25,401 loads and 21,775 empties) in May 1999, compared with 40,802 (21,889 loads and 18,913 empties) in May 1998, and 17,834 (10,077 loads and 7,757 empties) in May 1997. Thus, not only has the number of

Exhibit #5

BNSF Trackage Rights
Number of Through Trains

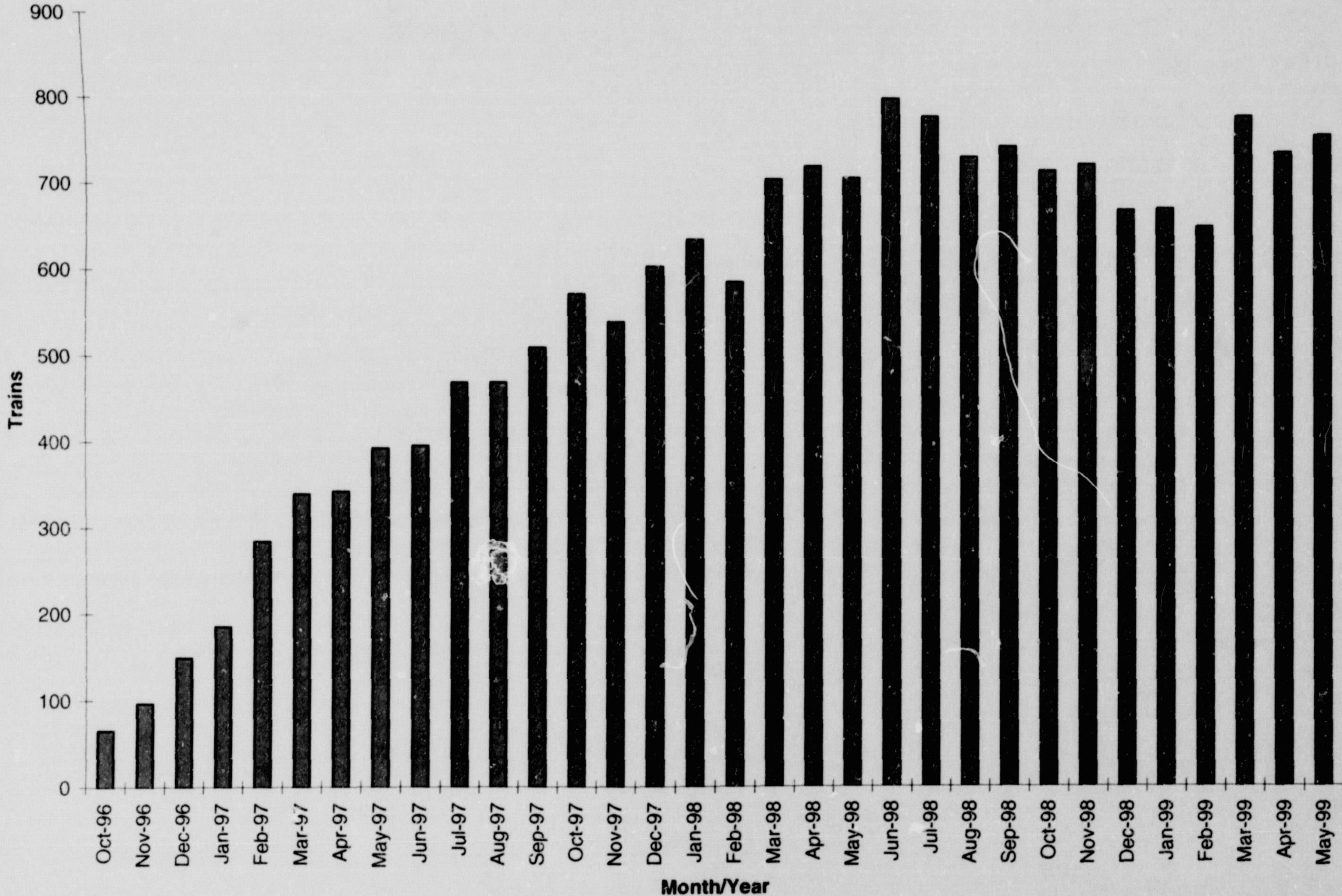


Exhibit #6

BNSF Trackage Rights
Number of Cars (Through Trains)

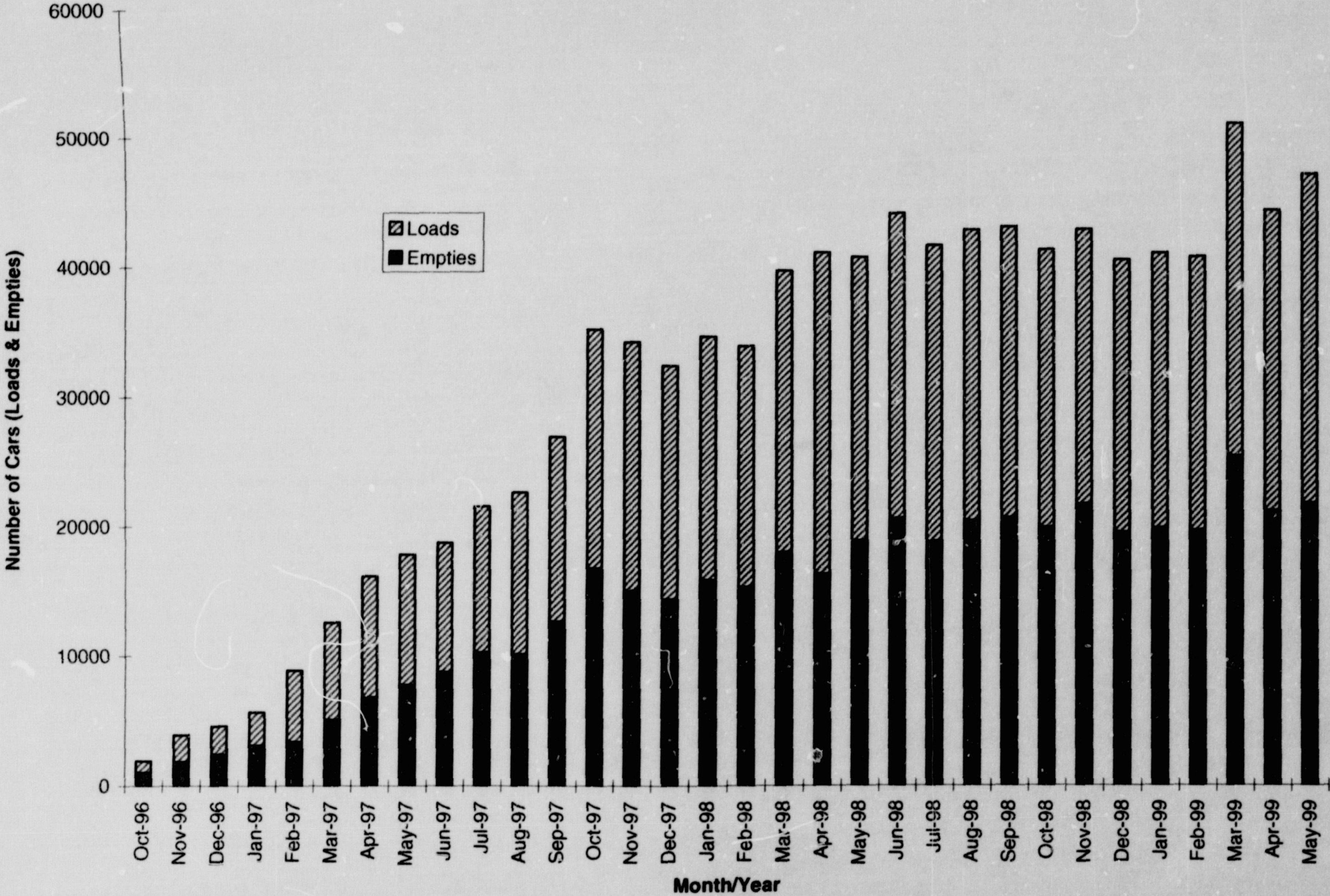
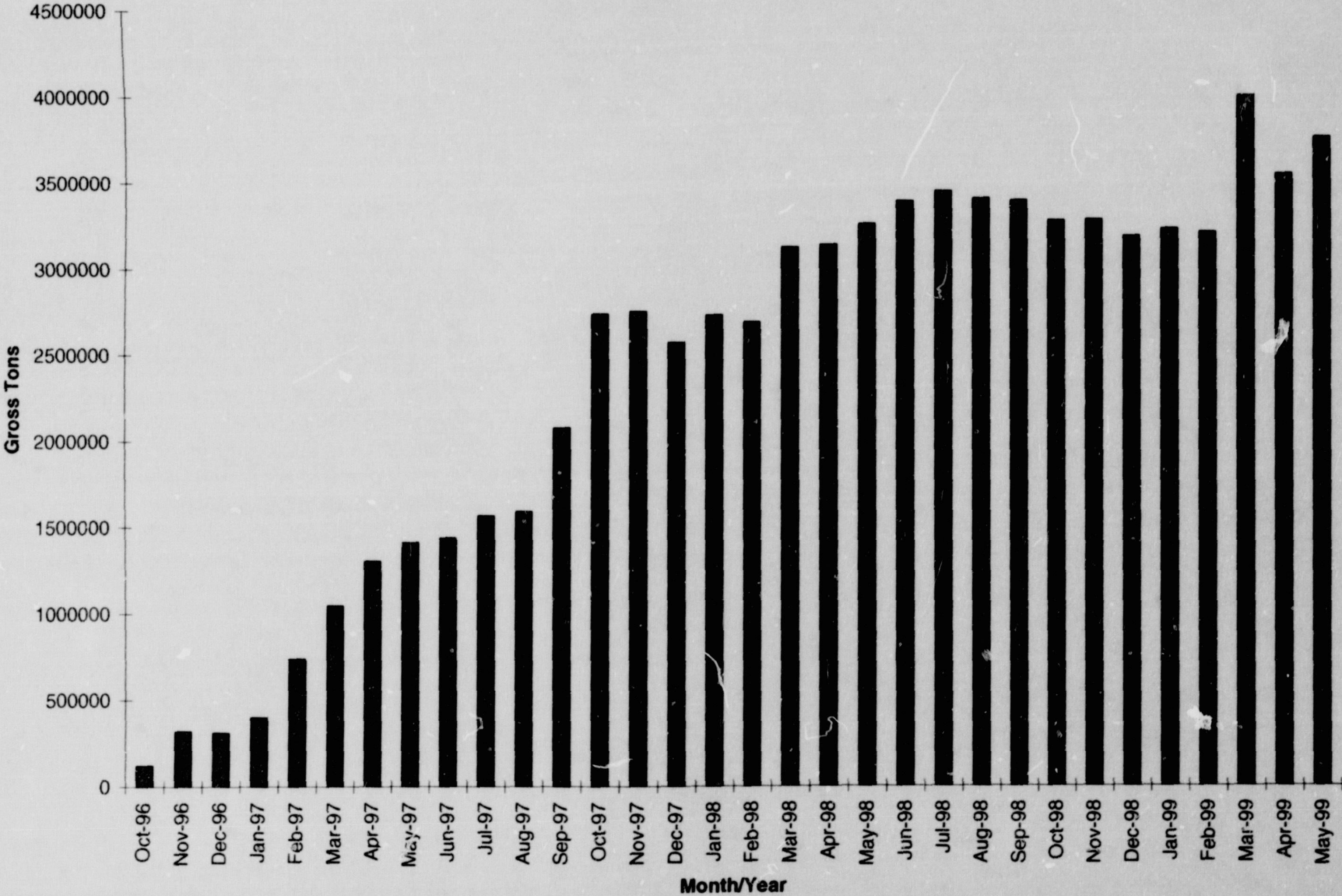


Exhibit #7

BNSF Trackage Rights
Gross Tons (Through Trains)



trains increased, but the tonnage and number of cars carried on each train have increased as well. Gross tons per train were 5,000 in May 1999, compared with 4,630 in May 1998, and 3,592 in May 1997. Cars per train were 63 in May 1999, compared with 58 in May 1998, and 45 in May 1997.

Another way of measuring the continued growth of BNSF's traffic volumes on trackage rights through trains is to examine average monthly data from the three periods UP has used to submit traffic data in the Board's oversight proceedings. The three periods are October 1996-May 1997; June 1997-May 1998; and June 1998-May 1999. In those three periods, average monthly trains have grown from 232 in the first period, to 574 in the second, to 725 in the most recent period. Average monthly tons have grown from 703,822 in the first period, to 2,467,520 in the second, to 3,423,944 in the most recent period. Average monthly cars have grown from 8,940 in the first period, to 31,828 in the second, to 43,459 in the most recent period. These data also show that tonnage and number of cars per train is increasing faster than the number of trains. Average monthly tons per train have grown from 3,034 in the first period, to 4,299 in the second, to 4,723 in the most recent period. Average monthly cars per train have grown from 38 in the first period, to 55 in the second, to 60 in the most recent period.

These figures do not include the many local trackage rights trains that BNSF has also operated. Much of the business on these local trains connects directly with BNSF's through trains at BNSF's own terminals, rather than connecting through trackage rights trains — and thus represents still further traffic secured by BNSF because of the merger conditions. Through

May 1999, BNSF had operated a total of 1,411 locals between Houston and Dayton, Texas;[9] 532 locals between Temple and Waco or Elgin, Texas; and 535 locals between Richmond and Warm Springs or Oakland, California. These trains handled 72,198 loaded and empty cars. In addition, since commencing service as BNSF's agent for local train operations in the Utah Valley on April 1, 1997, the Utah Railway has operated some 3,002 local trains, carrying a total of some 75,083 loaded and empty cars.

BNSF also continues to move appreciable volumes via haulage, though more and more of BNSF's operations have shifted to trackage rights over time. In May 1999, loaded and empty haulage cars totaled nearly 3,700. More than half of these moved to and from Brownsville, with the remainder spread among such other locations as Fullerton, California; Lake Charles, Louisiana; Orange, Texas; the Northern California area; and the "Paired Track" in Nevada.

BNSF's through train frequencies in major corridors continue to underscore BNSF's competitiveness. Those frequencies — generally two or even three trains per day in each direction — clearly support highly competitive service:

- In the Central Corridor, BNSF operated 153 through trains in May 1999, carrying 500,234 gross tons. By comparison, the totals in May 1998, which we cited in last year's report, were 168 through trains and 497,557 gross tons. The totals in May 1997 were 76

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[9] A recent review of BNSF local train data revealed that UP did not capture all of the BNSF Houston-Dayton local train traffic in its previous oversight reports. In this report, we are using corrected data. Had this correct data been used in last year's annual report, the number of Houston-Dayton local trains would have been 429 instead of 340.

through trains and 176,777 gross tons. BNSF's service in the Central Corridor consists of approximately two trains per day westbound from Denver to Stockton via Salt Lake City, one train per day eastbound from Stockton to Denver via Salt Lake City, and one train per day eastbound from Salt Lake City to Denver.

- In the Houston-Memphis Corridor, BNSF operated 115 through trains in May 1999, carrying 692,946 gross tons. The totals in May 1998 were 116 through trains and 609,058 gross tons. The totals in May 1997 were 104 through trains and 391,743 gross tons. BNSF is running two trains per day in each direction in this corridor.

- In the last of the three major BNSF corridors — Houston-New Orleans — BNSF operated 166 through trains in May carrying 781,727 gross tons. The totals in May 1998 were 164 through trains carrying 812,718 gross tons. The totals in May 1997 were 120 through trains carrying 384,942 gross tons. BNSF service in this corridor remains at a level of three trains per day — one of them an intermodal train — in each direction.

Another way of measuring the continued, and indeed increasing, strength of BNSF competition is to consider average monthly data from the three periods UP has used to submit data in these oversight proceedings. In those three periods, in the Houston-New Orleans Corridor, average monthly trains have grown from 67 in the first period, to 132 in the second, to 167 in the most recent period; and average monthly total tons have grown from 164,116 in the first period, to 551,343 in the second, to 772,231 in the most recent period.

In the Houston-Memphis Corridor, average monthly trains have grown from 47 in the first period, to 112 in the second, to 120 in the most recent period; and average monthly total tons have grown from 154,475 in the first period, to 493,446 in the second, to 674,911 in the most recent period.

In the Central Corridor, average monthly trains have grown from 62 in the first period, to 138 in the second, and this year are down slightly to 122; and average monthly total tons have grown from 92,656 in the first period, to 412,999 in the second, and this year are down slightly to 373,370. Despite these small declines in trains and tons, average monthly total tons per train have actually increased.[10]

These data show BNSF's continued strength in all three major corridors.

As was true of the figures presented last year, the foregoing corridor figures do not include many other trackage rights trains, including I-5 Corridor trains that use trackage rights over UP between Keddie and Stockton California (106 trains in May 1999, versus 78 in May 1998 and none in May 1997); trains between Houston and Corpus Christi (84 trains in May 1999, versus 76 in May 1998 and 43 in May 1997); trains between Temple and Eagle Pass via San Antonio (60 trains in May 1999, versus 50 in May 1998 and 19 in May 1997); rock trains interchanged with the Georgetown Railroad (22 trains in May 1999, versus 26 in May 1998 and 21 in May 1997); coal trains to Halsted and Elmendorf Texas (27 trains in May 1999, versus 12 in May 1998 and none in May 1997); grain trains to Ontario, California (18 trains in May 1999, versus 13 in May 1998 and 9 in May 1997); and a variety of locals.

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10 The reduction in Central Corridor trackage rights traffic in the June 1998-May 1999 period reflects, at least in part, BNSF's decision as of August 1998 to re-route westbound overhead manifest traffic back onto BNSF's route through Arizona and Southern California following capacity expansion on that route.

The continued growth of BNSF's Mexico volumes is also notable. In May 1999, BNSF operated 84 trackage rights trains to and from Corpus Christi and Robstown, principally for interchange with Tex Mex of Mexico traffic (the trains also included some Corpus Christi business and perhaps some business interchanged for Tex Mex local points). Those trains handled 6,914 loaded and empty cars and 538,758 gross tons. In May 1998, the figures were 76 trains with 6,688 cars and 436,543 tons. And in May 1997, the figures were 43 trains, with 3,332 cars and 278,836 gross tons. Eagle Pass trains also continue to increase, reflecting BNSF efforts to improve operations at that gateway: 60 trains, carrying 4,161 cars and 395,479 tons in May 1999, compared with 50 trains, carrying 2,877 cars and 333,024 tons, in May 1998, and compared with 19 trains, carrying 703 cars and 60,599 tons, in May 1997.

We noted in the first annual oversight report that, based on its own public statements, BNSF was already earning revenues from traffic moving pursuant to its merger rights at a rate representing some 20% of BNSF's estimate during the merger proceeding of a $1 billion total universe of available traffic. Today, BNSF volumes are more than twice as high. It is now more clear than ever that BNSF, with its extensive Western network and infrastructure of terminals and other support facilities, was uniquely situated to mount fully competitive service over the new rights, and that there is no reason why BNSF cannot regularly handle 50%, or even more, of the entire available universe of traffic — though, as always, UP will fight for every carload.

Last year, we noted the possibility that some part of last year's growth in BNSF's volumes may have reflected the congestion problems on the UP system. However, the continued growth of BNSF trackage rights volumes over the past year demonstrates that BNSF's success is in fact overwhelmingly attributable to its now firmly-established, fully competitive presence using the rights it obtained in the merger. BNSF can capture any available traffic movement at any time. Its trackage rights and haulage service is supported by its existing, comprehensive Western rail network, and its costs for moving trackage rights and haulage traffic are incremental.

BNSF Competitive Successes. BNSF has continued to compete aggressively for the "2-to-1" business, quoting very competitive rates and bidding on all major contracts. It continues to call on many shippers and receivers that had not been actively solicited, and to make repeated proposals in order to capture some or all of a customer's business.

BNSF continues to capture numerous traffic movements across the full range of "2-to-1" points and corridors. Confidential Appendix B contains more than 175 specific examples. As those examples demonstrate, shippers have continued to benefit from lower rates, improved routings, and new single-line access to BNSF points. The many rate reductions described in Appendix B continue to underscore that BNSF is providing stronger competition than SP did in these markets.

Examples of BNSF traffic include:

- Traffic movements from virtually all "2-to-1" chemical plants on the Gulf Coast.

- Traffic movements from Houston-area chemical manufacturers to points in the East, for which the Houston-Memphis trackage rights and New Orleans line sale gave BNSF new direct routes.

- Large volumes of corn, soybeans and milo moving to Mexico via Corpus Christi and the Tex Mex, and via Brownsville and Eagle Pass.

- Auto parts, steel, cotton, scrap paper, tallow, flue dust and chemical movements to and from Mexico.

- Traffic of major "2-to-1" shippers in Arkansas such as 3M, Green Bay Packaging and International Paper.

- Traffic of major Utah shippers such as Arco, Chevron, Kennecott, Cargill, Consolidated Oil and Pennzoil.

- Large volumes of auto parts from the Midwest to the NUMMI plant at Fremont, California, as well as outbound finished vehicles from the plant.

- Large volumes of aggregates from Feld, Texas, to the Houston area.

- Unit-train coal movements to the Lower Colorado River Authority at Halsted, Texas, and City Public Service of San Antonio at Elmendorf, Texas.

- Numerous unit-train movements of grain to O.H. Kruse Grain in the Los Angeles Basin.

- Edible oil movements to Fullerton, California.

- Corn from Midwest origins to Pine Bluff, Arkansas.

- Barites from the UP-SP Paired Track in Nevada.

- Wheat from Kansas to Corpus Christi, Texas, for export.

- Other traffic to and from a wide constellation of "2-to-1" points, including Paragould, Arkansas; Livermore, San Jose, South Gate, Warm Springs and West Sacramento, California; Harbor and Opelousas, Louisiana; and Baytown, Brownsville, Great Southwest, Harlingen, Orange, San Antonio, Sierra Blanca, Sugar Land and Waco, Texas; and "2-to-1" shortlines including the Longhorn Railway, the Little Rock and Western Railway, the Little Rock Port Authority, and the Salt Lake, Garfield and Western Railway.

Benefits for "2-to-1" Shippers Using UP. Just as important as BNSF's successes in capturing traffic, shippers at "2-to-1" points and in "2-to-1" corridors continued this year to gain rate, service and equipment benefits where UP retained traffic in the face of strong competition from BNSF. Confidential Appendix C contains some 105 specific examples from the past year. Again, these many instances of rate, service and equipment improvements versus the pre-merger status quo are proof that UP-BNSF competition is stronger than the UP-SP competition that preceded it.

A particularly notable example remains Geneva Steel in Geneva, Utah, by far the largest single "2-to-1" shipper. As previously reported, after intense competition involving many rounds of bidding, UP secured a 15-year contract for 99% of Geneva's business to and from UP points and competitive junctions. The contract brought Geneva major rate savings and other benefits. Details are set forth in Confidential Appendix D.

Other examples of "2-to-1" traffic enjoying UP rate and service improvements as a result of strong BNSF competition, as fully detailed in Appendix C, include:

- Gulf Coast "2-to-1" chemicals traffic.
- Autos and auto parts from NUMMI's Fremont, California plant.
- Grain and grain products to Mexico, the Gulf Coast and California.
- Nevada barites.
- Utah petrochemicals, intermodal and metals traffic.
- Arkansas building supplies.
- Steel products moving in the Central Corridor.
- Chemicals moving from the Gulf Coast to the East.
- Louisiana carbon black.
- Traffic to and from Mexico.
- Texas aggregates.
- A wide range of other commodities moving over the Central Corridor and the Houston-Memphis Corridor, and to and from such "2-to-1" points as Little Rock, Paragould and Pine Bluff, Arkansas; Warm Springs, California; Beowawe and Carlin, Nevada; Opelousas, Louisiana; and San Antonio and Waco, Texas.

"2-to-1" Rates. Further proof of the effectiveness of BNSF competition for "2-to-1" traffic can be seen in the fact that average UP rates[11] for "2-to-1" traffic declined in the October 1998-March 1999 period compared to the same period a year earlier. See Confidential Appendix E.

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[11] All average rate figures herein are computed as total revenue (net of allowances) divided by total ton-miles for the particular periods and commodities at issue.

It is important to recognize that this analysis reflects only the "2-to-1" traffic that UP handled. Rates for the entire universe of "2-to-1" traffic, including the traffic handled by BNSF, undoubtedly fell even more, given the many movements that BNSF captured through rate decreases.

Build-In Condition. The CMA agreement, as augmented by the Board's merger approval decision, preserved shippers' pre-merger opportunities to build in from SP points to UP points, and vice versa, and thereby obtain rail competition. Though no such build-ins have yet occurred in connection with the BNSF rights, this condition has already had a competitive impact, as described in Confidential Appendix F.

Transload Condition. The BNSF settlement agreement permitted BNSF to serve existing and new transloading facilities at "2-to-1" points. The Board's merger approval decision also gave BNSF the right to serve new transload facilities on all BNSF trackage rights lines. This condition has proven effective. In Decision No. 81, served Oct 5, 1998, the Board held that a facility of South Texas Liquid Terminal near San Antonio, Texas, qualified as a transload facility at a "2-to-1" point, and BNSF has taken advantage of that decision. BNSF also continues to handle soda ash from the UP-exclusive Green River area via transloading facilities that SP had operated in Salt Lake City, steel from Southeast points to Salt Lake City transloads, and a number of other products. Details are in Confidential Appendix G.

New Industries Condition. The BNSF settlement agreement permitted BNSF to serve new industries at "2-to-1" points. The CMA agreement extended this right to SP-owned BNSF trackage rights lines, and the Board's merger approval decision expanded it to all BNSF trackage rights lines. Again, experience continues to show that this condition is effective. BNSF is serving significant new facilities of Total Petroleum and Conoco at Durham, Colorado, on the overhead portion of its trackage rights across the DRGW east-west mainline. BNSF is also serving a major new Pilgrim's Pride feed mill near Tenaha, Texas, on the Houston-Memphis trackage rights line, and Quebecor's printing press in Fernley, Nevada. on trackage rights over the former SP line. Details are in Confidential Appendix H.

"1-to-2" Shippers. Additional competitive benefits have been realized by shippers on the Iowa Junction-Avondale line that was sold to BNSF. As a negotiated "quid pro quo" in the settlement, shippers on this line that had formerly been exclusively served by SP gained service from both BNSF and UP. Substantial rate reductions have resulted, as detailed in Confidential Appendix I.[12]

Pro-Competitive Benefits in the I-5 Corridor. Finally, a further extremely significant pro-competitive "quid pro quo" aspect of the BNSF settlement agreement was the sale to BNSF of the Keddie-Bieber line, which, together with BNSF's trackage rights from Keddie to Stockton, links up the BNSF system on the West Coast and creates a second single-line rail alternative up and down the I-5 Corridor between the Pacific Northwest and the Pacific

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[12] Also, the February 1998 agreement between UP and BNSF to "swap" 50% ownership interests in the Iowa Junction-Avondale line and UP's Houston-Iowa Junction line gave BNSF access to a shippers on the latter line and associated branches. This, however, was not pursuant to a merger condition, but rather was agreed to by UP in order to secure BNSF's agreement to join in the regional dispatching center at Spring, Texas. Shippers located along this line have been affected by merger-related conditions to the extent that they benefit from BNSF's access to New Orleans or the Houston-Memphis trackage rights, and examples of such benefits are included in Confidential Appendices B and C.

Southwest. The establishment of two new single-line alternatives in the I-5 Corridor, together with the proportional rate agreement that allows UP to compete for the business of shippers at BNSF local points and junctions by offering competitive service and rates via a BNSF-Portland-UP route, has brought to this region an enhancement of competition that was without precedent in any previous rail merger.

As demonstrated more fully in the Confidential Appendix material accompanying this report, numerous customers are enjoying benefits from the enhanced competition and new marketing opportunities that have resulted from the creation of new competition in the I-5 Corridor. Confidential Appendix A contains examples of specific traffic movements that have benefitted from new UP-SP single-line routes in the I-5 Corridor made possible by the merger. Confidential Appendix J adds more than 44 examples of traffic movements that have benefitted from new BNSF single-line service in this corridor, and from use of the proportional rate arrangement.

With the merger and its accompanying conditions, UP and BNSF now offer competing single-line alternatives from western Canadian gateways and jointly-served points in Washington and Oregon to jointly-served points in California and Arizona and western Mexican gateways. Prior to the merger, there was no single-line rail service in this huge transportation market. Shippers of lumber and panel products, for example, have taken extensive advantage of the new competition. BNSF has increased its lumber shipments in the I-5 Corridor by moving traffic from the Pacific Northwest to California points on its new single-line routes, by greatly expanding the volumes at its reload facilities in the Los Angeles Basin, and by developing new reload facilities in Arizona. BNSF's expanded use of origin reloads in Eugene, Salem and Portland, Oregon, is a further sign of its growing penetration of the lumber and panel products marketplace. BNSF has also used its new single-line ability to increase its share of petroleum shipments moving from California points to the Pacific Northwest. BNSF is operating approximately two trains per day in each direction in the I-5 Corridor.

UP customers are also benefitting from new single-line routes in the I-5 Corridor. UP-served shippers now have single-line access to the many SP-served destinations in California, as well as to Phoenix and Tucson. SP-served shippers in California and Oregon now have single-line access to important UP-served destinations for lumber and panel products such as Las Vegas. And Canadian producers in British Columbia and Alberta are taking advantage of single-line service to move increasing quantities of panel products via barge to Seattle for onward single-line movement via the UP system.

Customers are also seeing benefits from the I-5 proportional rate arrangement. Shippers have used I-5 proportional rates to move lumber, petroleum products, edible oils and other traffic between BNSF-served points in Washington and BNSF-served Canadian gateways, on the one hand, and points on the UP system, on the other hand, via the efficient Portland routing.

b. Tex Mex

Since the inception of its rights, Tex Mex has operated a total of 1,528 through freight trains through May 1999. In the period from June 1998 through May 1999, Tex Mex has averaged 61 trains per month. Exhibits #8, #9 and #10 depict, by month, Tex Mex's through

Exhibit #8

Tex Mex Trackage Rights
Number of Through Trains
(All Traffic Included)

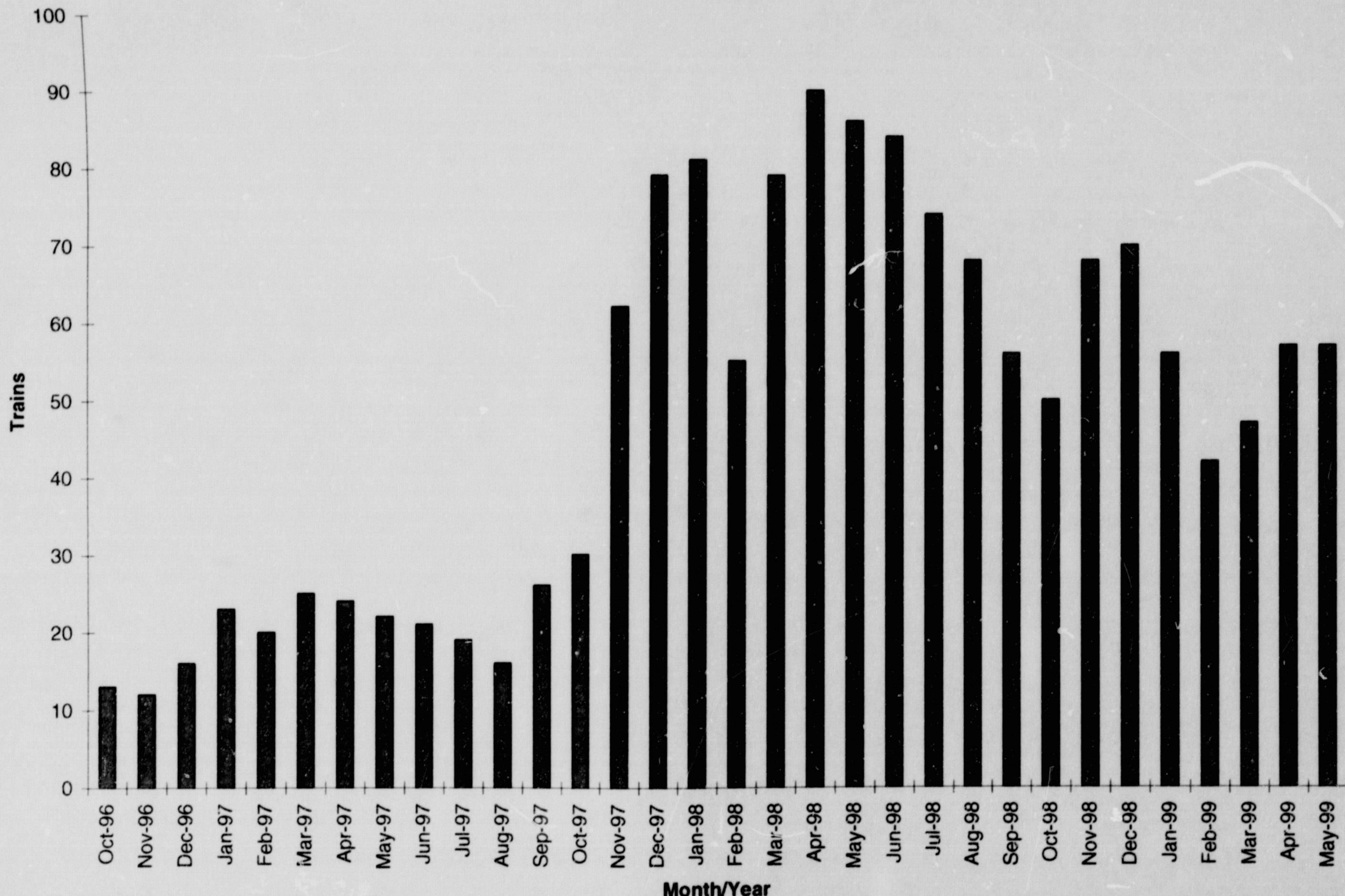


Exhibit #9

Tex Mex Trackage Rights
Number of Cars (Through Trains)
(All Traffic Included)

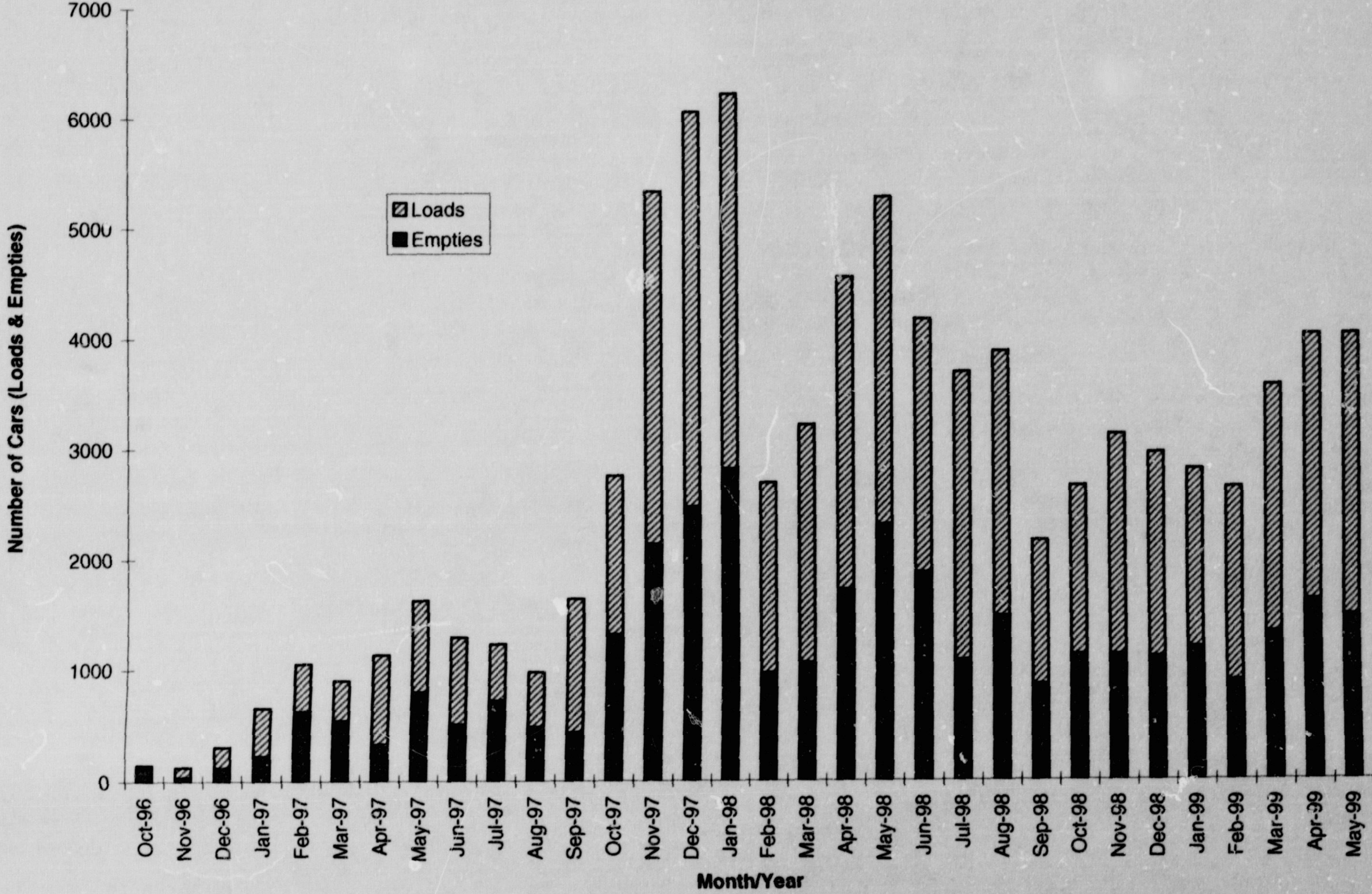
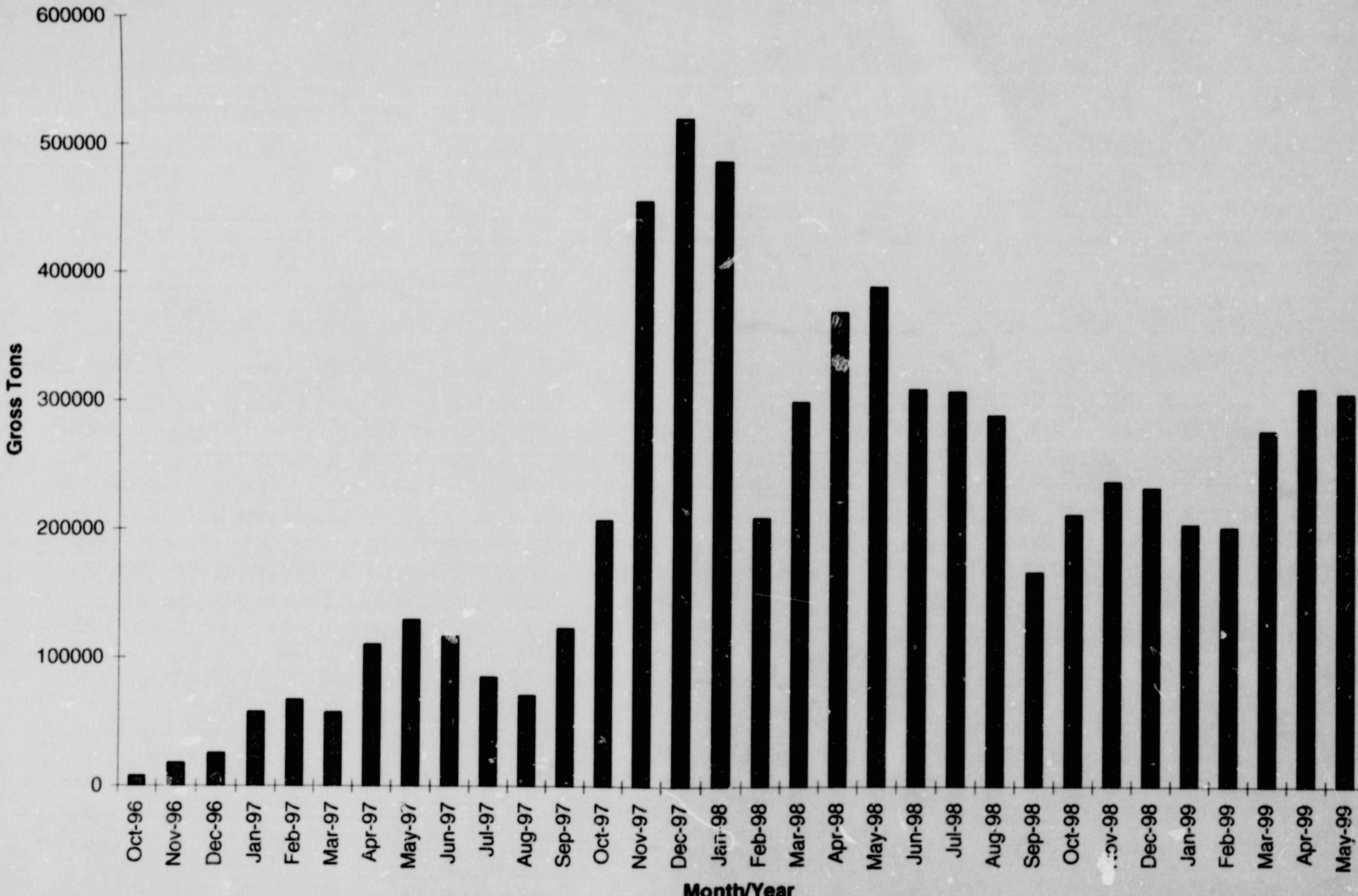


Exhibit #10

Tex Mex Trackage Rights
Gross Tons (Through Trains)
(All Traffic Included)



trackage rights trains, and the number of cars and tons on those trains. Exhibits #11, #12 and #13 present the same data, adjusted to exclude the temporary effects of the Board's Service Order No. 1518.[13]

The Board's purpose in partially granting the trackage rights conditions sought by Tex Mex in the UP/SP merger proceeding was to "address the possible loss of competition at the Laredo gateway into Mexico and to protect the essential services provided by Tex Mex to its shippers." Decision No. 62, p. 6. There is no question that competition has remained strong at Laredo and Tex Mex has remained viable subsequent to the implementation of the merger. The volume of traffic handled by Tex Mex to and from Laredo has more than doubled since the UP/SP merger. Exhibit #14 depicts the dramatic increase in Tex Mex's Laredo traffic. Tex Mex's southbound traffic over Laredo — which has traditionally made up virtually all of its Laredo business — was 50,722 carloads in the June 1998-May 1999 period — 203% of the 24,953 carloads in the same period prior to the merger (June 1995-May 1996). Tex Mex's much

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[13] Tex Mex's trackage rights operations were affected in two significant ways by the Board's Service Order No. 1518. First, between November 10, 1997 and January 29, 1998, BNSF and Tex Mex interchanged considerable volumes of traffic, mostly grain, at Flatonia instead of at Corpus Christi or Robstown pursuant to the Board's emergency order authorizing interchange at that location. As a result, this BNSF-Tex Mex traffic was temporarily included in Tex Mex's trackage rights volumes rather than in BNSF's trackage rights volumes. Second, in February 1998, Tex Mex commenced the operation of new trains between Houston and Tex Mex's interchange with KCS at Beaumont that carry traffic moving between Houston and points north, as permitted by the Board's emergency service order. Exhibits #11, #12 and #13 depict, by month, Tex Mex's through trackage rights trains, and the numbers of cars and tons on those trains, excluding estimates of (a) traffic interchanged with BNSF at Flatonia, (b) traffic on BNSF trains that Tex Mex handled for three months between Corpus Christi and Algoa as BNSF's agent, and (c) traffic carried in Tex Mex's Houston-Shreveport trains.

Exhibit #11

Tex Mex Trackage Rights
Number of Through Trains

(Estimated Service-Order-Related Traffic Excluded)

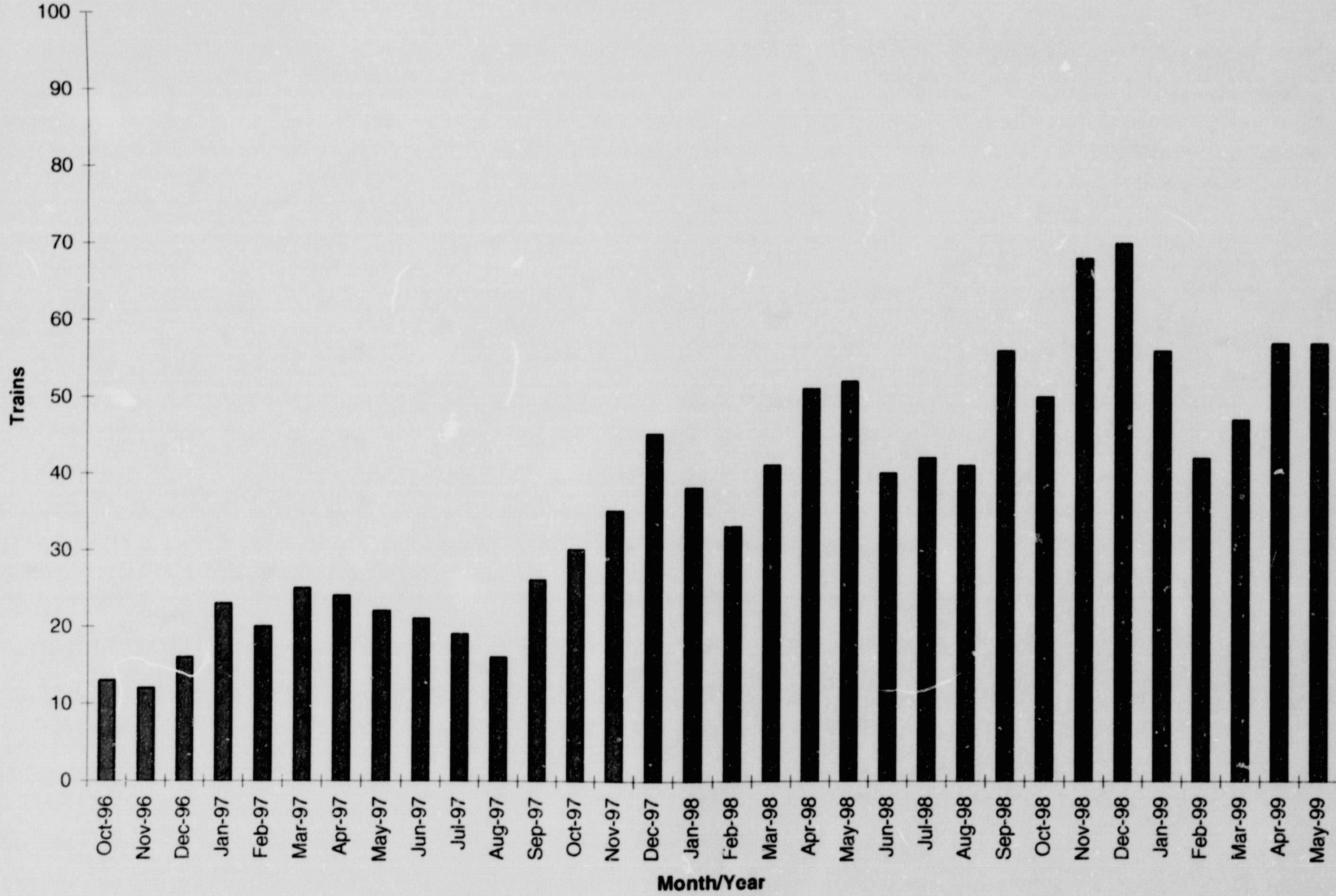


Exhibit #12

Tex Mex Trackage Rights
Number of Cars (Through Trains)
(Estimated Service-Order-Related Traffic Excluded)

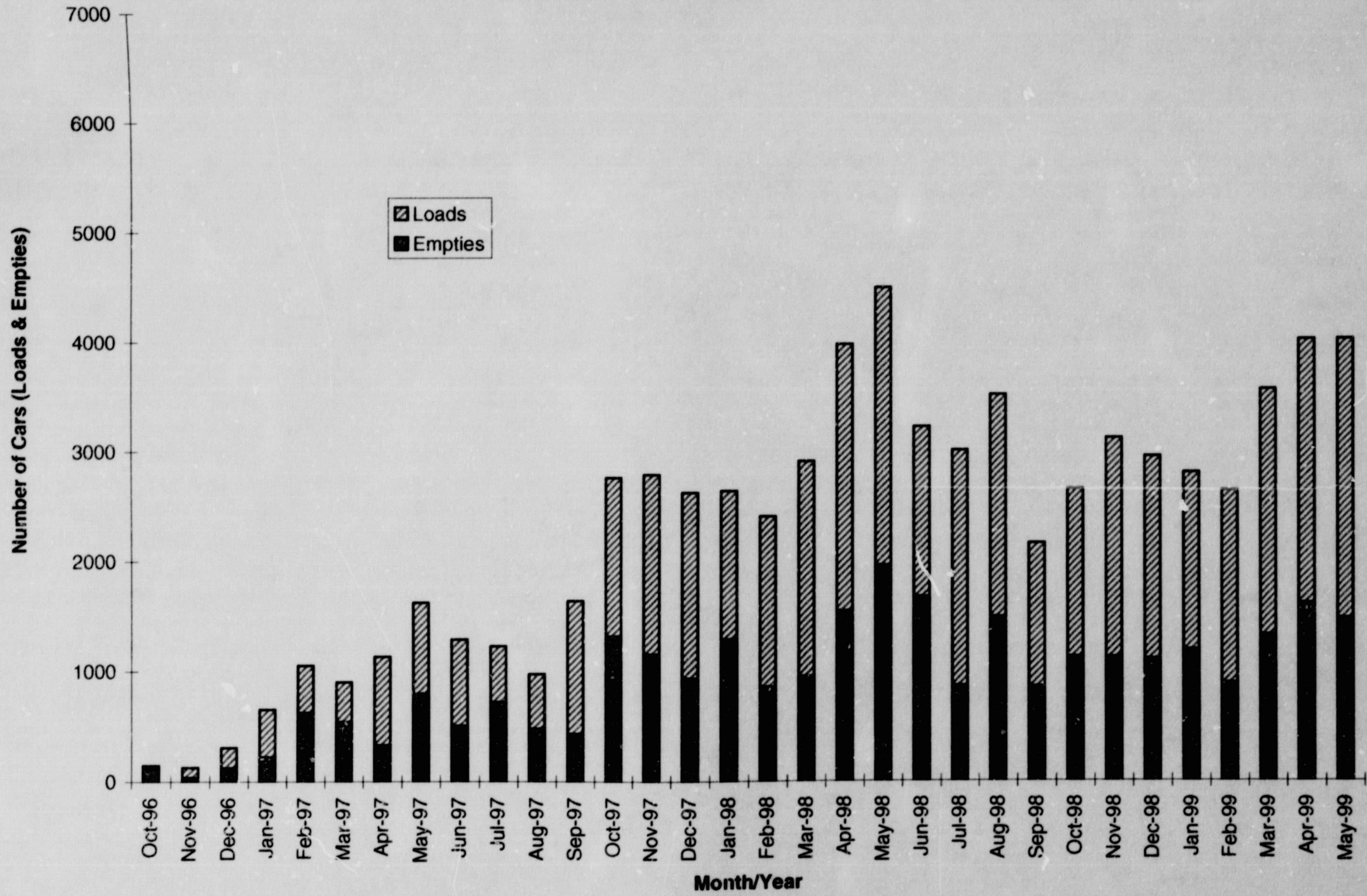


Exhibit #13

Tex Mex Trackage Rights
Gross Tons (Through Trains)
(Estimated Service-Order-Related Traffic Excluded)

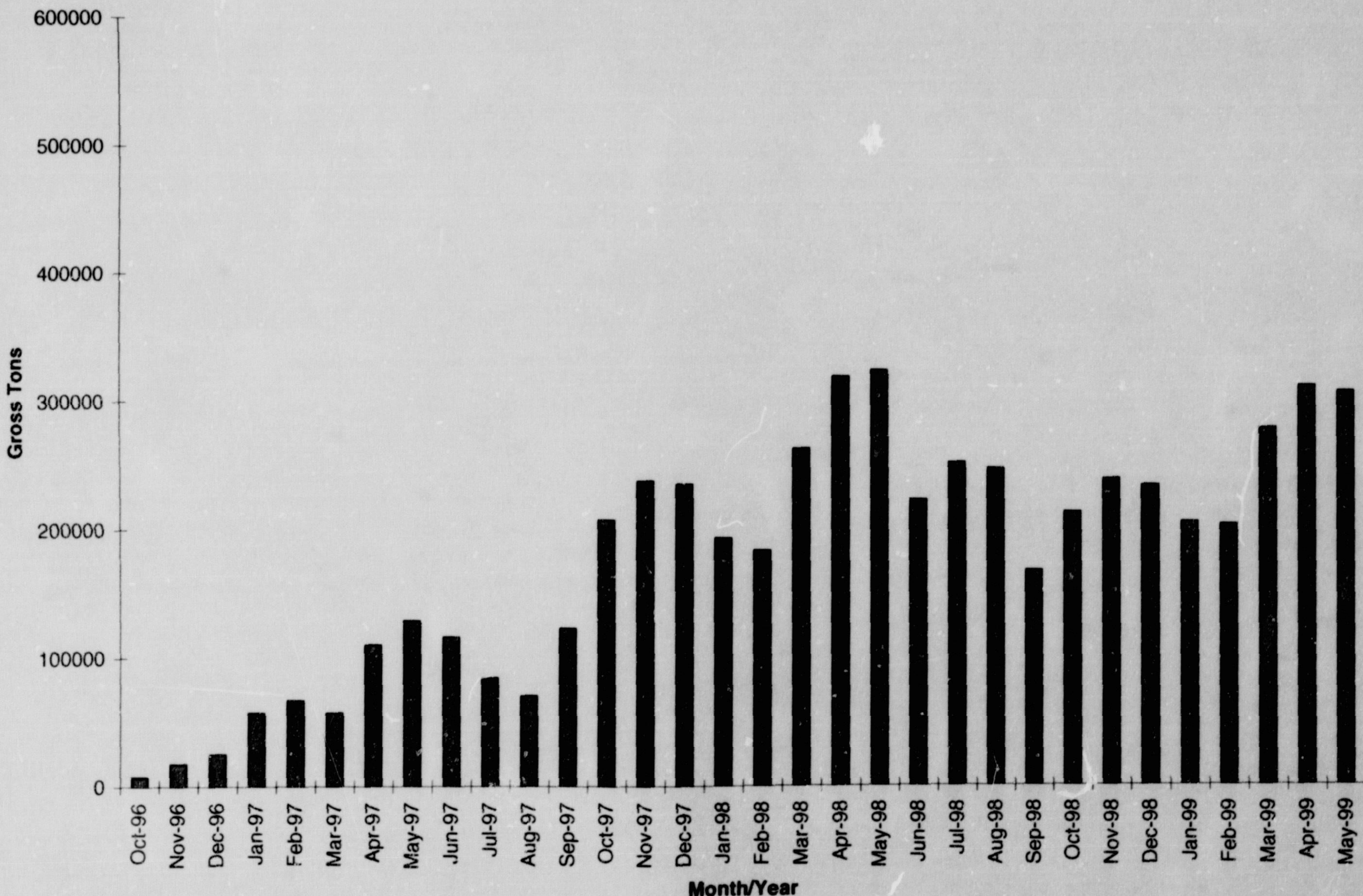
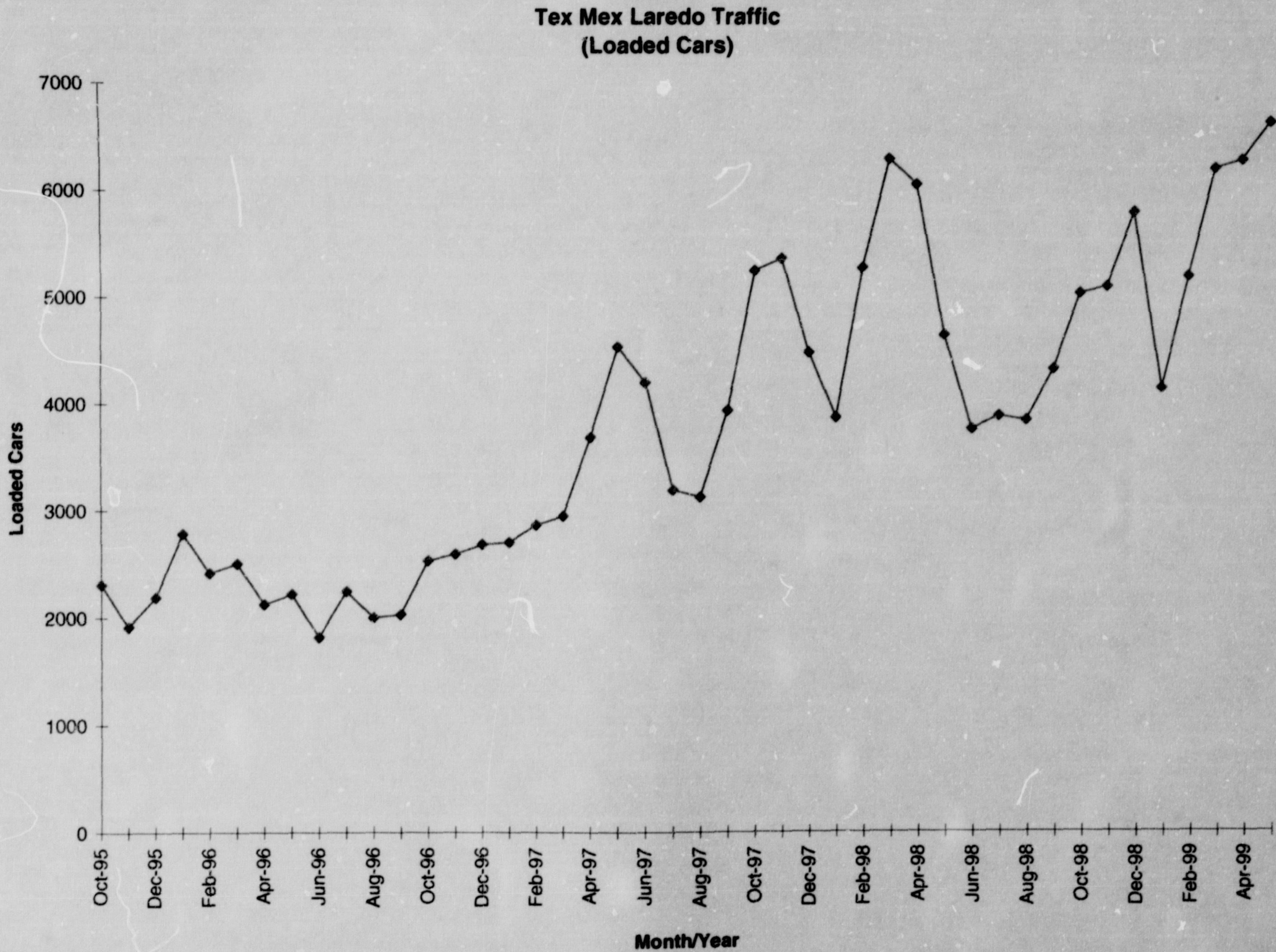


Exhibit #14



Tex Mex Laredo Traffic
(Loaded Cars)
7000
6000
5000
4000
3000
2000
1000
0
Loaded Cars
Oct-95
Dec-95
Feb-96
Apr-96
Jun-96
Aug-96
Oct-96
Dec-96
Feb-97
Apr-97
Jun-97
Aug-97
Oct-97
Dec-97
Feb-98
Apr-98
Jun-98
Aug-98
Oct-98
Dec-98
Feb-99
Apr-99
Month/Year

smaller northbound volumes have increased even more dramatically, from 492 carloads in the June 1995-May 1996 period to 9,175 carloads in the June 1998-May 1999 period.

Tex Mex's share of total traffic moving over the Laredo gateway has also increased. In the June 1995-May 1996 period, Tex Mex's share of total Laredo crossings was 21% southbound and 0.7% northbound. In the June 1998-May 1999 period, those shares were much higher — 34% and 9%.

This post-merger growth in Tex Mex's volumes and shares of Laredo traffic has occurred because the growth in the volume of traffic that Tex Mex interchanges with BNSF at Corpus Christi/Robstown and handles itself using its new trackage rights between Beaumont and Corpus Christi/Robstown has greatly outstripped the decline in the volume of traffic that Tex Mex interchanged with UP and SP. This is most readily seen by focusing on southbound volumes. Exhibit #15 overlays BNSF and Tex Mex trackage rights volumes with SP and UP Tex Mex interchange traffic and graphically demonstrates why Tex Mex's Laredo gateway volumes have increased so significantly.

Tex Mex's volumes and shares can be expected to grow even further. In December 1998, Tex Mex and BNSF reached agreement on a five-year interline divisions arrangement for traffic moving between those two carriers via Robstown to and from Mexico via Laredo.[14] In April 1999, Tex Mex, KCS and TFM announced the introduction of a new intermodal service that takes advantage of Tex Mex's new intermodal facility located in

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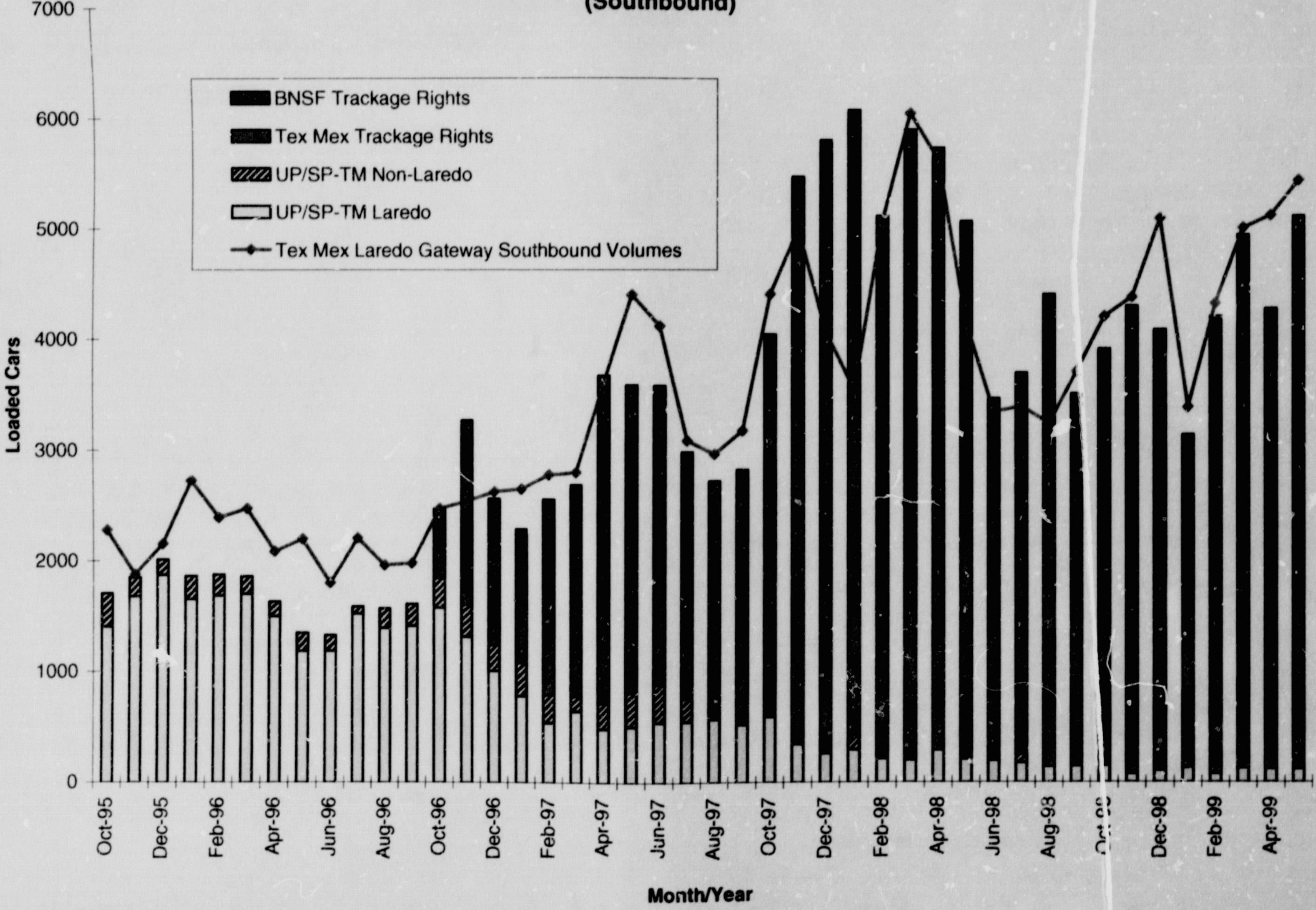
[14] See BNSF-PR-10, p. 7.

Exhibit #15

Tex Mex and BNSF Trackage Rights Traffic to Corpus Christi/Robstown and UP/SP-Tex Mex Interline Traffic (Southbound)



Laredo.[15] And it was recently announced that, as of June 1, General Motors had switched the routings to NS-KCS-Tex Mex for over 13,000 box cars per year of southbound auto parts moving from eleven General Motors facilities in the U.S. to two General Motors manufacturing plants in Mexico.[16]

Finally, rate data also confirm the continued intense competition for Eastern Mexico gateway traffic. UP's revenue per ton-mile for Eastern Mexico gateway traffic again moved downward from the October 1997-March 1998 to the October 1998-March 1999 period.

c. Utah Railway

Utah Railway, a "2-to-1" shortline, obtained the right to interchange with BNSF as a condition to the merger, thereby preserving competitive options for its on-line shippers. In addition, in consideration for settling issues regarding the use of joint UTAH-DRGW track, UTAH received access to the Savage coal transloading facility and the Willow Creek mine, and trackage rights to Grand Junction, Colorado, where it can interchange with both BNSF and UP. UTAH has maintained a high level of activity working as BNSF's agent operating local trains in the Utah Valley. Although no traffic moved over UTAH's trackage rights this past year, these rights continue to act as a competitive check on UP, and as discussed elsewhere, UP's rates for Utah and Colorado coal have remained highly competitive.

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15 See http://notes.kcsi.com/WebApps/kcspress.nsf.

16 See http://notes.kcsi.com/WebApps/kcsnews.nsf.

C. <u>"3-to-2" Traffic and Source Competition</u>

Experience continues to confirm that the Board was correct in determining that the merger would have no adverse competitive effect on "3-to-2" traffic, or on source competition for such commodities as Utah and Colorado coal, Gulf Coast chemicals, and grain. In fact, competition has been strengthened for all these categories of traffic.

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

<u>Rates</u>. For the third straight year, UP rates for "3-to-2" auto traffic are down. Rates for "3-to-2" intermodal traffic and carload traffic, which had remained flat last year, are flat once again this year. <u>See</u> Confidential Appendix E.

<u>Autos</u>. We have previously explained that the competitive benefits of the merger and the BNSF settlement for "3-to-2" traffic had been dramatically illustrated by the results of head-to-head bidding between UP and BNSF for Western automotive traffic, a large portion of total "3-to-2" traffic. In that bidding, each of the Big Three auto makers secured large savings, clearly demonstrating that competition between the new UP and BNSF networks was stronger than the three-railroad competition that preceded it. Confidential Appendix K provides the current estimates of those savings, and details further competition that has occurred during the past year for the major auto makers' business.

<u>Intermodal Traffic</u>. Competition has remained strong for intermodal traffic, the largest single category of "3-to-2" traffic. BNSF's access to New Orleans has strengthened competition for east-west international doublestack container traffic to and from the West Coast ports. UP has recently reinstituted a Los Angeles-Memphis intermodal service that is winning

business from BNSF because, by combining UP and SP routes, it is able to offer the shortest and fastest single-line route between Memphis and Los Angeles.

Carload Traffic. Competition for "3-to-2" carload traffic also remains strong. For example, although the merger reduced the number of railroads able to originate lumber in the Pacific Northwest from three to two, competition for this traffic has intensified, as UP has reduced SP rates and improved SP transit times, and improved equipment supply. Other "3-to-2" shippers are seeing similar benefits.

2. Utah and Colorado Coal

Those who speculated that the merger would disadvantage Utah and Colorado coal continue to be proven wrong. UP has been pursuing this business with the same aggressiveness that SP had employed. See Confidential Appendix E. We had previously reported that UP had reduced rates 5% to keep Colorado and Utah export coal competitive in world markets, and just this past April, UP reduced rates an additional 5%. Utah and Colorado coal shippers also continue to benefit from UP's investment in a new export terminal in Los Angeles, which has led to significant reductions in cycle time, and from UP's investment in the Kansas Pacific line to improve the handling of eastbound Utah and Colorado coal movements.

The merged system continues to market Utah and Colorado coal aggressively. UP recently obtained new contracts for Colorado coal movements to Dairyland's Alma Plant in western Wisconsin and to Southern Company's Plant Daniel in Mississippi. Utah and Colorado loadings are up this year from 1,893 trains between January 1 and June 25, 1996 to 1,930 trains between January 1 and June 25, 1999.

3. Gulf Coast Chemicals

Competition for Gulf Coast plastics and other chemicals traffic also continues to be strong. UP rates for Gulf Coast plastics are down for a third straight year. UP rates for other Texas/Louisiana chemicals and petroleum products (STCCs 28 and 29) were also down last year, as were systemwide UP STCC 28 and STCC 29 rates. See Confidential Appendix E.

As can be seen from the many examples in Confidential Appendices A through C, Gulf Coast chemical shippers have continued to benefit from new single-line service, shorter routes, and the new vigorous rate and service competition from BNSF.

4. Grain

Concerns of USDA and others that source competition for grain would be harmed continue to prove unfounded. UP grain producers continue to benefit from access to SP markets. BNSF continues to use its trackage and haulage rights to move large volumes of grain to Mexico, Arkansas, California and Utah (Confidential Appendix B). Systemwide UP rates for grain movements held steady over the past year. See Confidential Appendix E.

Respectfully submitted,

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VERIFICATION

STATE OF NEBRASKA)
) ss.
COUNTY OF DOUGLAS)

I, John Holm, Jr., Assistant Vice President-Operations-Support Services of Union Pacific Railroad Company, state that the information in Part I (except those subsections relating to capital investments) of the Applicants' Third Annual Report on Merger and Condition Implementation (UP/SP-366), in STB Finance Docket No. 32760 (Sub-No. 21) was compiled by me or individuals under my supervision, that I know its contents, and that to the best of my knowledge and belief those contents are true as stated.

John Holm, Jr.

John Holm, Jr.

SUBSCRIBED and sworn to before me by
John Holm, Jr. this 30 th day of
June 1999.

Nilda Hill

Notary Public

GENERAL NOTARY-State of Nebraska
NILDA HILL
My Comm. Exp. July 11, 2000

VERIFICATION

STATE OF NEBRASKA)
) ss.
COUNTY OF DOUGLAS)

I, Samuel P. Mele, Director-Capital Planning & Financing of Union Pacific Railroad Company, state that the information concerning merger-related capital investments and the Houston/Gulf Cost Region infrastructure investments in Part I of the Applicants' Third Annual Report on Merger and Condition Implementation (UP/SP-366) was compiled by me or individuals under my supervision, that I know its contents, and that to the best of my knowledge and belief those contents are true as stated.

Samuel P. Mele

Samuel P. Mele

SUBSCRIBED and sworn to before me by Samuel P. Mele this 29 th day of June 1999.

Doris J Van Bibber

Notary Public

GENERAL NOTARY-State of Nebraska
DORIS J. VAN BIBBER
My Comm. Exp. Nov. 30, 2000

VERIFICATION

STATE OF NEBRASKA)
) ss.
COUNTY OF DOUGLAS)

I, Richard B. Peterson, Senior Director-Interline Marketing of Union Pacific Railroad Company, state that the information in Part II of the Applicants' Third Annual Report on Merger and Condition Implementation (UP/SP-366) and in the Confidential Appendices to Applicants' Third Annual Report on Merger and Condition Implementation (UP/SP-367) in STB Finance Docket No. 32760 (Sub-No. 21) was compiled by me or individuals under my supervision, that I know its contents, and that to the best of my knowledge and belief those contents are true as stated.

Richard B. Peterson

RICHARD B. PETERSON

SUBSCRIBED and sworn to before me by
Richard B. Peterson this 29th day of
June 1999.

Doris J Van Bibber

Notary Public

GENERAL NOTARY-State of Nebraska
DORIS J. VAN BIBBER
My Comm. Exp. Nov. 30, 2000

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that, on this 1st day of July, 1999, I caused a copy of the foregoing document to be served by first-class mail, postage prepaid, or by a more expeditious manner of delivery on parties of record in Finance Docket No. 32760 (Sub-No. 21), and on

Director of Operations Antitrust Division Suite 500 Department of Justice Washington, D.C. 20530	Premerger Notification Office Bureau of Competition Room 303 Federal Trade Commission Washington, D.C. 20580

Michael L. Rosenthal

ATTACHMENT

ENVIRONMENTAL MITIGATION CONDITIONS

The following is a report on steps taken, and plans for future steps, in regard to the Board's environmental mitigation conditions to its approval of the UP/SP merger, which are addressed in the order they are listed in Appendix G to Decision No. 11:

A. System-Wide Mitigation

1-9. These conditions have been satisfied, as previously reported.

10. Security Forces. UP has extended to SP territory its policy of "zero tolerance" of vagrancy and trespassing on railroad property and is participating in a new nationwide initiative by Operation Lifesaver to reduce trespassing on railroad property. UP considers this condition satisfied.

11-13. These conditions have been satisfied, as previously reported.

B. Corridor Mitigation

14. EPA Emissions Standards. EPA's national locomotive emissions rule was published in the Federal Register on April 16, 1998. No appeals were filed, and the rule is now final. UP is working with locomotive industry suppliers to develop its compliance plan.

15. Consultations With Air Quality Officials. UP has held detailed discussions with environmental officials in the states of Arizona, Colorado, Illinois, Nevada, Oregon, Texas, Washington and Wyoming. Dialogue continues between UP and California officials to address ongoing improvement in UP/California air quality issues.

16. Noise Impacts. UP has implemented a noise comment hotline and recently re-notified each affected county and requested comments. UP monitors the noise hotline and will compile and analyze data to determine whether a noise abatement plan is required. There were no calls to the hotline in the first quarter of 1999. UP recently received a call in French, which it will translate.

17. Use of Two-Way-End-of-Train Devices. This condition has been satisfied, as previously reported.

C. Rail Line Segment Mitigation

18. Priority List for Upgrading Grade Crossing Signals. UP provides train density information to states on a regular basis, which they use to prioritize their grade crossing improvements. UP provides the states of Arizona, California, Kansas, Nevada, Oregon, Texas and Colorado with train density data for approximately 500 individual crossing improvements annually.

19. East Bay Regional Park District MOU. The MOU is being implemented in accordance with its specifications. UP is reviewing the Crockett Trail Feasibility Study and is awaiting property descriptions from the District for all trails. A feasibility study is underway for a Park District trail between Point Pinole and Lone Tree Point.

20. Town of Truckee MOU. The MOU is being implemented in accordance with its specifications. UP has completed construction of its portion of the bridge at the I-80 Central Truckee off ramp and is working with the city on roadway approaches. The railroad continues to work with local and federal agencies in the development of a Truckee River hazardous material spill response plan.

STB FD 32760 (Sub 21) D 7-1-99 194922 3/3

21. Placer County MOU. The MOU is being implemented in accordance with its specifications. UP worked with the City of Roseville throughout the reconstruction of the Roseville Yard, to discuss the yard design and operations plan. UP has installed train control mechanisms to facilitate passenger operations. UP jointly funded with the city a feasibility and engineering study, which was accepted by Redevelopment Agency, for a pedestrial/bicycle overpass. UP is in the process of conveying property and drafting leases for numerous properties, as specified in the MOU. In one case, UP executed the deed in favor of the city and the conveyance is pending the city's acceptance of the deed. Several improvement projects specified in the MOU have been deferred or canceled at the request of the county and/or the city involved.

22. City of Reno MOU. Bonds for the depressed trainway project have been issued and the MOU is now in effect. Engineering work is underway.

23. City of Wichita/Sedgwick County. The Board approved an MOU among UP and these parties which provides for mitigation of merger effects, as well as other agreements, in lieu of any other mitigation. The parties are implementing it.

D. Rail Yards and Intermodal Facilities

24. Noise Abatement Plans for Rail Yards. Before it undertakes any rail yard construction at the specified locations, UP will contact appropriate state and local officials and will report to SEA on the results of those consultations. No construction is planned for these facilities at this time.

25. Intermodal Facilities. Before any changes are made at the specified intermodal facilities, UP will contact appropriate state and local air quality

officials in the states of California and Illinois and will report to SEA on the results of those consultations. No construction or operating changes are planned for these facilities at this time.

E. Abandonments

26-61. As abandonments are carried out, UP will comply with all conditions. UP has developed a process to ensure that contractors and railroad personnel comply with all general conditions. Progress on specific abandonment conditions is reported below.

41. This condition has been satisfied, as previously reported.

43. This condition has been satisfied, as previously reported.

44. This condition has been satisfied, as previously reported.

46. Sage - Leadville, CO. UP has ceased operations on this line, but is retaining it between Sage and Malta.

47. This condition has been satisfied, as previously reported.

48. This condition has been satisfied, as previously reported.

49. This condition has been satisfied, as previously reported.

50. UP has entered into a contract for removal of this line.

52. This condition has been satisfied, as previously reported.

55. This condition has been satisfied, as previously reported.

57. This condition has been satisfied, as previously reported.

58. Suman-Benchley, TX. UP has decided to retain this line. The Board vacated the abandonment exemption for the line on June 12, 1998. This condition is no longer applicable.

59. This condition has been satisfied, as previously reported.

60. This condition has been satisfied, as previously reported.

61. This condition has been satisfied, as previously reported.

F. Construction Projects

62-108. As construction projects are carried out, UP will comply with all listed conditions. UP has developed a process to ensure that contractors and railroad personnel comply with all general conditions. A number of projects were deferred to 1999 or beyond as a result of new priorities. Progress on specific construction provisions is reported below.

70. This condition has been satisfied, as previously reported.

78. This condition has been satisfied, as previously reported.

79. This condition has been satisfied, as previously reported.

80. This condition has been satisfied, as previously reported.

81. This condition has been satisfied, as previously reported.

83. This condition has been satisfied. UP recently completed a noise monitoring study of the Stockholm connection and found sound levels to be within existing standards.

84. This condition has been satisfied, as previously reported.

92. This condition has been satisfied, as previously reported.

97. This condition has been satisfied, as previously reported.

99-100. These conditions are being satisfied, except for sloping and seeding, which will be completed this month.

101. This condition has been satisfied, as previously reported.

107. This condition has been satisfied. UP recently completed a noise monitoring study of the Ft. Worth Ney Yard connection and found sound levels to be within existing standards.

108. This condition has been satisfied.

STB FD 32760 (Sub 21) 11-26-97 D 184247

184247

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D

November 26, 1997

RECEIVED NOV 26 1997 MAIL MANAGEMENT STB

VIA HAND DELIVERY

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW
Washington, DC 20423

Re: Finance Docket No. 32760 (Sub-No. 21)

Dear Secretary Williams:

Enclosed for filing in the above-captioned docket, please find an original plus twenty-five (25) copies of BNSF's Proposed "2-to-1" Facilities Protocol (BNSF-4). Also enclosed is a diskette containing the text of BNSF-4.

Please date-stamp the enclosed extra copy and return it to the messenger for our files. Thank you for your time and attention.

Sincerely,

Erika Z. Jones/als
Erika Z. Jones

Enclosures

cc: Parties of Record

ENTERED
Office of the Secretary
NOV 28 1997
5 Part of Public Record

184247

BNSF-4

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

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

BNSF's PROPOSED "2-TO-1" FACILITIES PROTOCOL

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November 26, 1997

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

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

BNSF's PROPOSED "2-TO-1" FACILITIES PROTOCOL

Pursuant to Decision No. 10 served on October 27, 1997, in this proceeding, The Burlington Northern and Santa Fe Railway Company ("BNSF") respectfully submits the attached proposed protocol for the identification of "2-to-1" shipper facilities to which BNSF is entitled to access under the Surface Transportation Board's merger conditions in the UP/SP merger proceeding.

Since the service of Decision No. 10, BNSF and UP have conferred concerning the terms and conditions of such a protocol, and they have been able to resolve a number of their differences. The attached proposed protocol incorporates the provisions on which the parties agree.

The principal remaining differences between the parties relate to Paragraphs 5 and 6 of BNSF's proposed protocol and center on the questions of whether the Board should (i) adopt a presumption that, once BNSF makes a request for access to a prospective "2-to-

1" facility in compliance with the protocol, BNSF should be allowed to serve the facility, and (ii) require UP to bear the burden of showing that a facility does not qualify as a "2-to-1" facility.[1] For the reasons set forth below, BNSF believes that both the rationale of the Board's decision approving the UP/SP merger and the public interest require that such a presumption be adopted and that UP bear that burden.

<u>Background</u>

As BNSF has documented to the Board in several pleadings in this matter,[2] the identification of shipper facilities open to access by BNSF as "2-to-1" facilities should have been a relatively straight forward process with UP simply providing BNSF a definitive list of such facilities soon after the consummation of the merger. However, no such list was provided, and the process has been exceedingly slow and labor intensive. It would seem that, once BNSF identifies a prospective "2-to-1" facility and conveys what information it has about the facility and its pre-merger rail service to UP, UP should be able to promptly make a determination as to whether the facility qualifies as a "2-to-1" facility. The facility by definition will be located on a UP or SP line, and it is UP and SP that will have records of whether or not the facility received service from both of the carriers prior to the merger and no other carrier. UP and SP will also have the more established contacts and

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[1] The most recent proposed revisions to the language contained in paragraphs 5 and 6 of BNSF's proposed protocol that BNSF has received from UP are set forth in the attached letter from John H. Ransom, UP Manager-Interline Marketing, to Peter J. Rickershauser, BNSF Vice President-UP/SP Lines, dated November 25, 1997. This pleading has been prepared on the assumption that those proposed revisions reflect the position that UP will present to the Board concerning BNSF's proposed protocol in its separate submission.

[2] <u>See</u> BNSF-PR-4, V.S. Rickershauser, at 10-11 (F.D. No. 32760); BNSF-1 at 11-13 (Sub-No. 21); BNSF-2, at 3-5 (Sub-No. 21); BNSF-PR-5, at 6-7 (F.D. No. 32760).

relationships with the shipper since one or both of them will have provided pre-merger service. BNSF, by contrast, will have no such records and no such contacts or relationships, and BNSF does not control any of the other information needed to make a determination as to a facility's status.

However, UP has consistently applied the "2-to-1" definition narrowly in a manner that has impeded BNSF's ability to respond promptly to shipper requests for new service at "2-to-1" points. Indeed, UP's insistence that it must approve a shipper's "2-to-1" status before BNSF can have access to the shipper has in effect placed the burden on BNSF and the shipper to gather whatever evidence UP demands before it will decide to grant access, and the slow pace and arduous process have inhibited shippers' ability to take advantage of BNSF's new service capability. Further, UP has on numerous occasions changed its decision and withdrawn its previous approval of BNSF access to a facility, requiring BNSF to recontact the shipper involved and restart the validation process.

As an example of what this means to both BNSF and its customers, BNSF executed a competitive contract with a customer at South Gate, CA who had originally been told by UP that its facility qualified as a "2-to-1" facility. UP subsequently informed the shipper that the facility was not "2-to-1" and could not be accessed by BNSF. The customer researched its files and produced correspondence from UP/SP clearly establishing that it was entitled to "2-to-1" access at the facility. BNSF forwarded this information to UP, which later admitted its error and restored the facility to "2-to-1" status. Considerable BNSF and shipper time and resources were needlessly expended to gather information and data that was in UP/SP's files, and three months of BNSF service under the terms of the customer's contract was disrupted.

The Board itself has recognized that such delay and uncertainty is "unacceptable". Decision No. 10, at 7. "If BNSF has traffic that it would like to be able to move, then it would be unexcusable for UP not to give a prompt reply indicating whether UP believes that shipper may be served." Id. at 7-8. The Board also suggested that UP could be given five (5) business days to respond to a BNSF request and that, if UP did not respond within that time period, BNSF would be authorized to provide the service. Id. at 8.

BNSF's Proposed Protocol

The attached protocol for the identification of "2-to-1" shipper facilities remedies the problems identified by the Board, BNSF and other parties.[3/] It also appropriately places the evidentiary burden of establishing the status of a facility on UP since UP is the party with the pre-merger relationship with the shipper and since UP has or should have control over and access to all the records necessary to make the required determination. Indeed, if UP is serious about fulfilling the representations it made to the Board and to its shippers to

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[3/] As the Board is aware, several other parties to the oversight proceeding agree with BNSF that the "2-to-1" identification process needs improvement. For instance, the United States Department of Transportation ("DOT") states that it "supports the request of BNSF that UPSP provide it with a clear determination on the shippers at 2-to-1 points to which BNSF has access rights." (DOT at 6). In fact, DOT requests that, "since the Board's merger analysis primarily addressed 2-to-1 'points' and traffic in 2-to-1 'corridors' rather than 2-to-1 'shippers' . . . the Board revisit the terms of the traffic rights agreement to consider providing BNSF access to all shippers at 2-to-1 points, regardless of whether a shipper was closed or open to switching under a tariff in place at the time of the merger." (DOT at 6).

Fina Oil and Chemical Company ("Fina") and The Chemical Manufacturers Association and The Society of the Plastics Industry, Inc. ("CMA/SPI") also support BNSF's position. CMA/SPI requests Board action to eliminate the delays that have occurred in identifying "2-to-1" shippers (CMA-2/SPI-3 at 13), and Fina states that "Fina [requests] resolution of the issues that hinder definition of all 2:1 points in order to expedite the expansion of the traffic base to BNSF." (FINA-1 at 7).

preserve all pre-merger competition at "2-to-1" points, it should be willing to bear the evidentiary burden of disproving a facility's "2-to-1" status and of having any doubts resolved in favor of the shipper and in favor of preserving competition.

The attached proposed protocol is simple and direct. Once BNSF has provided UP with the information BNSF has in its possession concerning the name, address, location and pre-merger rail service options of a facility, UP is required to promptly review its records of pre-merger UP and/or SP service to the facility and whatever other information and documents it has to determine if the facility qualifies as a "2-to-1" facility. UP can also more readily contact the shipper since it or SP had a pre-merger commercial relationship with the customer. Moreover, by reason of its or SP's prior service to the facility, UP will have the necessary knowledge of the area in which the facility is located to determine if access was available pre-merger under any applicable switching tariffs, joint facilities agreements or other arrangements.[4/]

BNSF's protocol then provides that, as the Board suggested, if UP does not respond to the request within five (5) business days, BNSF shall be deemed to have access to the facility. By failing to respond, UP will waive any right to any claim that BNSF is not entitled

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[4/] BNSF's protocol incorporates a provision proposed by UP that BNSF traffic en route to a proposed "2-to-1" facility will be handled by UP pending UP's determination of BNSF's right to access to the facility. BNSF direct traffic to the facility will be terminated if UP determines that BNSF is not entitled to access and provides the timely notification to BNSF as required by the protocol. UP would be compensated for any such terminated traffic pursuant to the method of compensation set forth in Paragraph 7 of the protocol.

to serve the facility.[5] If UP approves BNSF's request, then BNSF is entitled to immediately serve the facility as provided in the BNSF Settlement Agreement.[6]

It is at this point that BNSF and UP disagree over (i) the process to be followed in the event that UP believes that BNSF should not be entitled to access a particular facility, and (ii) the burden of proof to be imposed on UP in making a determination on access. First, the parties disagree as to whether BNSF should be entitled to serve a facility if UP denies BNSF access in its fifth business day response. BNSF believes and has proposed in Paragraph 5 of its protocol that, after providing a written reply to UP's response which sets forth BNSF's reasons why it believes that it is entitled to access, BNSF should have the option of immediately providing service to the facility under the BNSF Settlement Agreement. Because of the risks involved, BNSF would only exercise this option if it felt that the evidence available illustrated that a shipper's facility had access to both UP and SP pre-merger and that UP's concurrence was being unreasonably withheld. That access would continue until UP obtained an order from the Board or an arbitrator denying BNSF access. BNSF's protocol proposes that BNSF

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[5] BNSF's protocol also includes a provision in response to concerns expressed by UP as to multiple access requests in one day from BNSF. The protocol provides that UP will be required to respond to five (5) requests within the five (5) business day period. In the event that BNSF makes more than five (5) requests in one day, UP would have five (5) business days to respond to the five (5) requests BNSF identifies as in need of immediate attention, and ten (10) business days to respond to the other requests.

[6] In addition, in order to prevent the uncertainty and delay that have been caused on several occasions, the protocol provides that UP cannot change a decision that a facility qualifies as a "2-to-1" facility without the consent of BNSF or the approval of the Board.

would compensate UP for any such service pursuant to a methodology set forth in Paragraph 7 of the protocol to which both BNSF and UP agree. UP proposes that there be no provision for interim service and that the burden of seeking review of the question of whether BNSF should have access to a particular facility should rest with BNSF.

BNSF's presumption that BNSF should have the right to serve the facility via interim service pending review is the better approach. If, as the Board noted will sometimes be the case (Dec. No. 10 at 8), the parties are in disagreement as to whether a particular facility qualifies as a "2-to-1" facility, the question becomes one of who should bear the burden during the period of Board or arbitrator review. If UP's proposal is accepted, then the shipper will be deprived of competitive service during the review period, and BNSF will be deprived of the additional business it would carry. Moreover, there is no effective way in which this harm to the shipper and BNSF can be remedied -- the competitive service options available to the shipper and the revenues that would have accrued to BNSF are gone forever. On the other hand, if BNSF's proposal is accepted, then the shipper will immediately receive the benefits of competitive service, and BNSF will be able to further build its traffic base under the merger conditions. In addition, if BNSF was wrong and UP obtains an order denying BNSF access to the facility, UP will be protected. It will receive the agreed upon compensation set forth in Paragraph 7 of the protocol.

Second, the parties disagree as to what evidentiary standard should be applied in making an access determination. BNSF's proposed protocol provides in Paragraph 6 that UP shall approve an access request unless UP can provide specific evidence that a particular facility does not qualify as a "2-to-1" facility. UP seeks in effect to reverse this standard and has proposed that access will be allowed only if it is able to affirmatively conclude that the facility does qualify. While the distinction may seem minor, it is not. UP's proposal would require BNSF to provide the information and documents to enable UP to reach the conclusion that access is proper. As explained above, UP is better positioned to obtain from its own records, files and employees the necessary information and documents and to contact the shipper, and imposing the burden of undertaking those tasks on BNSF makes no sense. As BNSF proposes, UP should be required to provide specific evidence that the facility does not qualify (e.g., service by a third carrier, no access under applicable reciprocal switching tariffs) in order for BNSF to be denied access. The protocol provides in this respect that a statement that UP lacks sufficient information to make a determination as to whether a facility is a "2-to-1" facility is not an adequate reason to deny BNSF access.

Conclusion

For the reasons set forth above, BNSF respectfully submits that the Board adopt BNSF's proposed protocol for the identification of "2-to-1" shipper facilities. BNSF's protocol appropriately places the evidentiary burden on UP, the party with ready access to the requisite information and documents, and it reflects a presumption that will lead to the prompt and expeditious resolution of disputes in favor of preserving pre-merger competition and of providing the shipping public with the new competitive service the Board envisioned when it conditioned its approval of the UP/SP merger on the BNSF Settlement Agreement.

Respectfully submitted,

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Richard E. Weicher
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Attorneys for The Burlington Northern and Santa Fe Railway Company

Dated: November 26,1997

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing BNSF's Proposed "2-to-1" Facilities Protocol (BNSF-4) was served, by first-ciass mail, postage prepaid, or by a more expeditious manner of delivery, on all Parties of Record in Finance Docket No. 32760 (Sub-No. 21).

Roxanne J. Hasell

PROPOSED
"2-TO-1" FACILITIES PROTOCOL

As a condition of the Surface Transportation Board's (STB) approval of the consolidation of Union Pacific Railroad Company (UP) and Southern Pacific Transportation Company (SP), The Burlington Northern and Santa Fe Railway Company (BNSF) was granted the right to serve all shipper facilities that, as of September 25, 1995, were open to both UP and SP, and no other railroad, whether via direct service, reciprocal switching, joint facility or other arrangements. Since the consolidation was consummated, BNSF and UP have been working to identify a complete list of "2-to-1" shipper facilities to which BNSF is entitled to access. The purpose of this protocol is to establish procedures and mechanisms for further identifying "2-to-1" shipper facilities open to BNSF as a result of the conditions imposed in the UP/SP merger. Those procedures and mechanisms are as follows:

1. BNSF shall submit to UP, by written or electronic communication, the name and address of any facility to which access is sought. In addition to the name and address of the facility, BNSF shall furnish any additional information relating to the facility's identity and location that is in BNSF's possession when the request for access is made. BNSF shall also provide any information in its possession at such time pertaining to the rail service options that were available to the facility on or before September 25, 1995. UP will handle for BNSF any traffic en route to the facility pending UP's determination of BNSF's right to access the facility in question. If UP determines that BNSF is not entitled to access a particular facility, BNSF will terminate any BNSF direct routing of traffic to that facility. UP shall be compensated for any traffic en route in accordance with the method of compensation set forth in Paragraph 7 below.

2. UP shall have five (5) business days from the date of such communication to respond by written or electronic communication to any request for access, provided that, if BNSF shall request a determination on more than five (5) shipper facilities on a single day or, if a single request pertains to more than five (5) shipper facilities, BNSF shall identify the five (5) shipper facilities that need immediate attention, and the five (5) business day requirement shall apply to those shipper facilities, with the remaining shipper facilities request or requests to be responded to within ten (10) business days after the date of the request(s).

3. If UP fails to respond to an access request by the close of business of the fifth business day or, in the case of requests for which UP has ten business days to respond, by the close of business of the tenth business day, BNSF shall be deemed to have access to such facility or facilities as set forth in Paragraph 4 below, and UP shall be deemed to have waived any claims that BNSF is not entitled to serve the facility or facilities.

4. If UP approves BNSF's request for access, BNSF shall immediately be authorized to serve the facility either directly, through reciprocal switching, or, with UP's prior approval, a third party contractor, as provided for in the UP/BNSF Settlement Agreement dated September 25, 1995, as amended. No less than five (5) business days prior to the date that BNSF proposes to begin service to a facility, BNSF shall elect the mode of service that it intends to utilize and shall notify UP in writing or electronically of its election. BNSF shall have the right, upon 180 days prior written notice to UP, to change its election; provided, however, that BNSF shall (i) not change its election more than once every five years, and (ii) shall reimburse UP for any costs incurred by UP in connection with such changed election. UP may not reverse a prior decision approving BNSF's request for access to a facility without either BNSF's consent or approval by the STB.

5. If UP declines to approve a BNSF request for access to any facility within the applicable time period, and BNSF believes that UP has an insufficient or inappropriate reason to decline access, BNSF may so notify UP, either in writing or by electronic communication, of the reasons why BNSF believes it is entitled to such access, and upon such notice, shall be deemed to have access to the facility and may, at its discretion, transport traffic to or from the shipper facility (in accordance with the procedures set forth in Paragraph 4 above) until a final order of the STB or an arbitrator becomes effective finding that BNSF is not entitled to access to that facility.

6. UP shall approve all requests for access unless UP can provide specific evidence that a particular facility was not open to service by both UP and SP, and no other railroad, either directly or through reciprocal switching, joint facility, or other arrangements, as of September 25, 1995. If UP declines to approve a BNSF request for access to any facility, UP shall provide as part of its notification to BNSF a statement in writing or by electronic communication of its reasons and the specific evidence supporting its determination that BNSF should not have access to the facility. A statement that UP lacks sufficient information to make a determination as to whether a facility is a "2-to-1" facility is not an adequate reason to deny a BNSF request for access to a facility. At any time after UP's notification, BNSF may request UP to reconsider its decision declining to approve BNSF's request for access.

7. If BNSF determines to transport traffic to or from a shipper facility pursuant to paragraph 5 above and it is later determined by the STB or an arbitrator that BNSF is not entitled to access to that facility, BNSF shall compensate UP for the movement of such traffic as follows: If a joint through rate is available, then UP is entitled to $3 per car mile from the applicable junction in the price document. If multiple junctions are available, BNSF receives its longest haul and UP

receives $3 per car mile beyond that junction. If no through rate exists, BNSF receives its longest haul via junctions in existence between UP and BNSF, prior to the date of UP control over SP, September 11, 1996, and UP receives $3 per car mile beyond. UP must file a claim with BNSF to recover revenues under this paragraph, making reference on the claim to this paragraph of the joint "2-to-1" Facilities Protocol.

8. BNSF and UP shall identify an individual or individuals within their respective organizations as the person or persons to whom all communications pursuant to this protocol shall be directed.

9. The parties agree to submit any disputes under this protocol to the STB for resolution or, with the consent of both parties, to arbitration, as described in the UP/BNSF Settlement Agreement dated September 25, 1995, as amended.

AGREED TO AND ACCEPTED BY:

UNION PACIFIC RAILROAD COMPANY

____

THE BURLINGTON NORTHERN AND SANTA FE
RAILWAY COMPANY

____

Dated:__________________________

UNION PACIFIC RAILROAD COMPANY

MARKETING & SALES

1416 DODGE STREET
OMAHA, NEBRASKA 68179

November 25, 1997

Via Fax (817) 352-7154

Peter J. Rickershauser
Vice President UP/SP Lines
Burlington Northern Santa Fe
2650 Lou Menk Drive
Fort Worth, TX 76161-0065

Re: "2-to-1" Protocol

Dear Pete:

As we discussed during our phone conversation, we have reviewed the revised draft that you faxed to us this afternoon. We find the language acceptable except for the presumption of BNSF's right to serve in your paragraph 5 and the burden of proof on Union Pacific in the first sentence of paragraph 6.

We have proposed and continue to maintain that the following language should be inserted as paragraph 5 of the protocol in lieu of BNSF's proposed language:

"5. If UP declines to approve a BNSF request for access to any facility, and BNSF believes that UP has an insufficient or inappropriate reason to decline access, BNSF may so notify UP, and upon such notice, may seek an order from the STB finding that BNSF was entitled to access to that facility."

With respect to your paragraph 6, we propose the following first sentence in lieu of your first sentence. This is a further refinement of our prior language to clarify that UP is not insisting on any particular form of evidence to support a request for access.

"6. UP shall approve all such requests where, on the basis of all available information, UP concludes that a particular facility was open to service by both UP and SP, either directly or through reciprocal switching, joint facility or other arrangements and by no other rail carrier, as of September 25, 1995."

Sincerely,

John

John H. Ransom
Manager - Interline Marketing

STB FD 32760 (Sub 21) 11-26-97 D 184246

184246

UP/SP-329

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

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

D

UP/SP'S SUBMISSION CONCERNING "2-TO-1" FACILITY PROTOCOL

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November 26, 1997

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

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

UP/SP'S SUBMISSION CONCERNING "2-TO-1" FACILITY PROTOCOL

Applicants UPC, UPRR, SPR and SPT[1/] respectfully make this submission in support of their proposed "2-to-1" facilities protocol, pursuant to Decision No. 10 herein, served Oct. 27, 1997. We have sought to make this submission as concise as possible. The factual statements herein are verified by John H. Ransom, UP/SP's Manager-Interline Marketing, who has had principal responsibility for resolving "2-to-1" facility issues raised by BNSF with UP/SP since the consummation of the merger.

In Decision No. 10, the Board directed Applicants and BNSF to do their best to reach agreement on a protocol to govern the resolution of any disputes as to the list of "2-to-1" facilities that BNSF is entitled to serve pursuant to the UP/SP-BNSF Settlement Agreement and the Board's prior

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1/ The acronyms used here are the same as those listed in Appendix B of Decision No. 44.

decisions in the UP/SP merger proceeding. The Board further directed that if complete agreement could not be reached within 30 days, UP/SP and BNSF should submit any disagreements to the Board for resolution.

UP/SP and BNSF have reached agreement on most provisions of a "2-to-1" facility protocol. The correspondence attached as Exhibit A makes clear what language has been agreed upon and the two provisions on which the parties are in disagreement.

We set forth below a succinct description of the two disagreements and of why UP/SP's position on these issues should be adopted by the Board:

1. Presumption and Burden of Proof. The key disagreement concerns BNSF's position that there should be a presumption that any shipper facility cited by BNSF is a "2-to-1" facility unless UP/SP can affirmatively prove, with "specific evidence," that the facility was not open to both UP and SP before the merger. (See Exhibit A, BNSF's proposed ¶ 6, first sentence.) UP/SP maintains that such a presumption and requirement to prove a negative with "specific evidence" would be grossly unfair and inappropriate, and that the protocol should simply provide that UP/SP shall list a facility if, on the basis of "all available information," the proper conclusion is that it was open to both UP and SP before the merger.

As previously detailed in UP/SP-311, at pp. 22-26, UP/SP has not approached these matters as forensic evidence games, and will not do so in the future. From the very beginning, in reviewing requests by BNSF that facilities be added to the "2-to-1" list, UP/SP has not insisted that BNSF present some quantum of "specific" documentary evidence that a facility was open to UP and SP prior to the merger -- or, indeed, any such evidence. Rather, UP/SP has conducted its own investigation, checking traffic records, consulting with personnel familiar with pre-merger operations, speaking with shippers, and drawing upon any and all available information to resolve the issue accurately. It is that approach that UP/SP's proposed language is intended to memorialize. UP/SP has also, of course, taken account of any information that BNSF or the customer has submitted. UP/SP's good faith in addressing these matters is reflected in the fact that, in the year since merger consummation, the Board has not once been asked to resolve such a "2-to-1" dispute.

In light of this history of UP/SP's good faith approach to "2-to-1" questions, there is absolutely no basis for creating a presumption that any facility at a "2-to-1" station was open unless UP/SP can affirmatively prove the negative with "specific evidence" (whatever that means). It is undisputed that many hundreds of facilities at those locations were not open. Id., p. 23. Indeed, at this stage, after the very extensive process that BNSF and UP/SP have gone through to review hundreds and hundreds of such facilities, if <u>any</u> artificial presumption is in order, it is that a facility <u>not</u> now on the list is <u>not</u> a "2-to-1" facility. <u>See</u> <u>id.</u>, pp. 24-25. But the correct resolution is for there to be <u>no</u> artificial presumption, and certainly no untenable affirmative burden of proving a negative (or necessity to dispute what constitutes sufficient proof of a negative).

2. <u>BNSF Right to Serve a Facility Pending Resolution of Disagreement About Whether It Should Be on the List</u>. The second disagreement concerns whether, if UP/SP has denied a BNSF request that a facility be added to the "2-to-1" list and BNSF states that it disagrees with that denial, BNSF should then gain the right to serve the shipper facility until and unless the Board or an arbitrator concludes that BNSF is <u>not</u> entitled to access. BNSF argues that it should have such a service right. In effect, BNSF's position is that UP/SP denial should be conclusively deemed wrong, and that the onus should be on UP/SP to appeal from its own denial of a BNSF request, with BNSF having the right to serve the facility until such a "self-appeal" is affirmed. (<u>See</u> Exhibit A, BNSF's proposed ¶ 5.) UP/SP strongly disagrees.

UP/SP's position on this issue should be adopted because any disputes about listing facilities can and will be expeditiously resolved, and it would be both unfair and disruptive to railroad operations and shipper business activities for BNSF to have the absolute right to serve a facility during the review process simply because BNSF states that it disagrees with UP/SP's decision that the facility is not a "2-to-1" facility.

As noted, UP/SP has demonstrated in previous verified submissions that there are countless facilities at "2-to-1" stations that are not "2-to-1" facilities because they were exclusively served by either UP or SP prior to the merger. See, e.g., UP/SP-311, p. 23; UP/SP-231, Peterson, p. 37. It would be wholly unjust for BNSF to have an absolute right to serve any of those facilities simply by stating that it disagrees with UP/SP's conclusion that they should not be placed on the "2-to-1" list.

The parties have agreed on a speedy process for resolving BNSF requests. UP/SP has agreed to respond to such requests within five business days (or, if more than five requests are made in a single day, within ten business days for those requests in excess of five). If UP/SP fails to respond by the deadline, BNSF is entitled to serve the facility, with no UP/SP right to appeal. If a request is denied, it can be submitted for prompt resolution to the Board or, by agreement of the parties, to an arbitrator. The Board has indicated that it stands ready "to resolve promptly all disputes concerning issues of whether BNSF may serve a particular shipper." Decision No. 10, p. 8.

Moreover, BNSF has substantial control over the timing issue. As long as BNSF submits requests to add a facility to the "2-to-1" list in a timely manner and submits any information available to it at the time of its request, as it has now agreed to do, any disputes can be resolved before the traffic at issue is scheduled to move. UP/SP has been reasonable in handling BNSF traffic already en route to a shipping location pending its consideration of BNSF's right to access the facility in question, and the parties have agreed to a compensation provision if it is later determined that BNSF did not have access, but use of this provision and the administrative costs associated with it should be the exception, not the rule.

In discussions of this matter, BNSF has asked what "sanction" there is if UP/SP unreasonably denies a request -- implying that an absolute right to serve during review of such a denial is needed in order to provide such a "sanction." The answer is that UP/SP has acted in good faith in reviewing BNSF requests, and will continue to do so in the future. And if UP/SP <u>were</u> to act unreasonably, the Board has ample powers to impose penalties or grant a service right at that time. At present, there is simply no justification for the service right that BNSF seeks.

For these reasons, UP/SP's proposals as to the provisions on which there is disagreement should be adopted.

Respectfully submitted,

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November 26, 1997

VERIFICATION

STATE OF NEBRASKA)
) ss.
COUNTY OF DOUGLAS)

I, JOHN H. RANSOM, being duly sworn, state that I have read the foregoing statement, that I know its contents, and that those contents are true as stated.

John H. Ransom
JOHN H. RANSOM

SUBSCRIBED AND SWORN TO before me this 25th day of November, 1997.

GENERAL NOTARY-State of Nebraska
DORIS J. VAN BIBBER
My Comm. Exp. Nov. 30, 2000

Doris J. Van Bibber
NOTARY PUBLIC

My Commission Expires:
Nov. 30, 2000

EXHIBIT A

BNSF

PETER J. RICKERSHAUSER
Vice President UP/SP Lines & Mexico

Burlington Northern Santa Fe

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P.O. Box 961065
Fort Worth, TX 76161-0065
817 352-6686
Fax 817 352-7154

November 25, 1997

Mr. John Ransom
Senior Interline Marketing Officer
Union Pacific Railroad
1416 Dodge Street
Omaha, NE 68179

Dear John:

Referencing our conference call yesterday, attached is a further draft of the "2-to-1 Point Identification Protocol" which contains the changes we discussed. In addition, I have redone Section 7 to adopt the language proposed by Union Pacific, with a further sentence added to clarify the claims process.

I would appreciate your review and comments as quickly as possible. Per our conversation yesterday afternoon, we understand that Union Pacific and Burlington Northern Santa Fe are unable to agree on Sections 5 and 6, and those will be referred to the STB for a final decision.

Sincerely,

Attachment

112597.a

Revised Draft: 11/25/97

2-TO-1 POINT IDENTIFICATION PROTOCOL

As a condition of the Surface Transportation Board's (STB) approval of the consolidation of Union Pacific Railroad Company (UP) and Southern Pacific Transportation Company (SP), The Burlington Northern and Santa Fe Railway Company (BNSF) was granted the right to serve all shipper facilities that, as of September 25, 1995, were open to both UP and SP, and no other railroad, whether via direct service, reciprocal switching, joint facility or other arrangements. Since the consolidation was consummated, BNSF and UP have been working to identify a complete list of 2-to-1 shipper facilities to which BNSF is entitled to access. The purpose of this protocol is to establish procedures and mechanisms for further identifying 2-to-1 shipper facilities open to BNSF as a result of the conditions imposed in the UP/SP merger. Those procedures and mechanisms are as follows:

1. BNSF shall submit to UP, by written or electronic communication, the name and address of any facility to which access is sought. In addition to the name and address of the facility, BNSF shall furnish any additional information relating to the facility's identity and location that is in BNSF's possession when the request for access is made. BNSF shall also provide any information in its possession at such time pertaining to the rail service options that were available to the facility on or before September 25, 1995. UP will handle for BNSF any traffic en route to the facility pending UP's determination of BNSF's right to access the facility in question. If UP determines that BNSF is not entitled to access a particular facility, BNSF will terminate any BNSF direct routing of traffic to that facility. UP shall be compensated for any traffic en route in accordance with the method of compensation set forth in Paragraph 7, below.

2. UP shall have five (5) business days from the date of such communication to respond by written or electronic communication to any request for access, provided that, if BNSF shall request a determination on more than five shipper facilities on a single day or, if a single request pertains to more than five (5) shipper facilities, BNSF shall identify the five (5) shipper facilities that need immediate attention, and the five (5) business day requirement shall apply to those shipper facilities, with the remaining shipper facilities request or requests to be responded to within ten (10) business days after the date of the request(s).

3. If UP fails to respond to an access request by the close of business of the fifth business day or, in the case of requests for which UP has ten business days to respond, by the close of business of the tenth business day, BNSF shall be deemed to have access to such facility or facilities as set forth in Paragraph 4 below, and UP shall be deemed to have waived any claims that BNSF is not entitled to serve the facility or facilities.

4. If UP approves BNSF's request for access, BNSF shall immediately be authorized to serve the facility either directly, through reciprocal switching, or, with UP's prior approval, a third party contractor, as provided for in the UP/BNSF Settlement Agreement dated September 25, 1995, as amended. No less than five (5) business days prior to the date that BNSF proposes to begin service to a facility, BNSF shall elect the mode of service that it intends to utilize and shall notify UP in writing or electronically of its election. BNSF shall have the right, upon 180 days prior written notice to UP, to change its election; provided, however, that BNSF shall (i) not change its election more than once every five years, and (ii) shall reimburse UP for any costs incurred by UP in connection with such changed election. UP may not reverse a prior decision

approving BNSF's request for access to a facility without either BNSF's consent or approval by the STB.

5. If UP declines to approve a BNSF request for access to any facility within the applicable time period, and BNSF believes that UP has an insufficient or inappropriate reason to decline access, BNSF may so notify UP, either in writing or by electronic communication, of the reasons why BNSF believes it is entitled to such access, and upon such notice, shall be deemed to have access to the facility and may, at its discretion, transport traffic to or from the shipper facility (in accordance with the procedures set forth in Paragraph 4, above) until a final order of the STB or an arbitrator becomes effective finding that BNSF is not entitled to access to that facility.

6. UP shall approve all requests for access unless UP can provide specific evidence that a particular facility was not open to service by both UP and SP, and no other railroad, either directly or through reciprocal switching, joint facility, or other arrangements, as of September 25, 1995. If UP declines to approve a BNSF request for access to any facility, UP shall provide as part of its notification to BNSF a statement in writing or by electronic communication of its reasons and of the specific evidence supporting its determination that BNSF should not have access to the facility. A statement that UP lacks sufficient information to make a determination as to whether a facility is a 2-to-1 facility is not an adequate reason to deny a BNSF request for access to a facility. At any time after UP's notification, BNSF may request UP to reconsider its decision declining to approve BNSF's request for access.

7. If BNSF determines to transport traffic to or from a shipper facility pursuant to paragraph 5 above and it is later determined by the STB or an arbitrator that BNSF is not entitled

to access to that facility, BNSF shall compensate UP for the movement of such traffic as follows: If a joint through rate is available, then UP is entitled to $3 per car mile from the applicable junction in the price document. If multiple junctions are available, BNSF receives its longest haul and UP receives $3 per car mile beyond that junction. If no through rate exists, BNSF receives its longest haul via junctions in existence between UP and BNSF, prior to the date of UP control over SP, September 11, 1996, and UP receives $3 per car mile beyond. UP must file a claim with BNSF to recover revenues under this section, making reference on the claim to this section of the joint 2-to-1 Point Identification Protocol.

8. BNSF and UP shall identify an individual or individuals within their respective organizations as the person or persons to whom all communications pursuant to this protocol shall be directed.

9. The parties agree to submit any disputes under this protocol to the STB for resolution or, with the consent of both parties, to arbitration, as described in the UP/BNSF Settlement Agreement dated September 25, 1995, as amended.

AGREED TO AND ACCEPTED BY:

UNION PACIFIC RAILROAD COMPANY

____

THE BURLINGTON NORTHERN AND SANTA FE
RAILWAY COMPANY

____

Dated:________________________

21185494 3 November 25, 1997E 95210647

UNION PACIFIC RAILROAD COMPANY

MARKETING & SALES

1416 DODGE STREET
OMAHA, NEBRASKA 68179

November 25, 1997

Via Fax (817) 352-7154

Peter J. Rickershauser
Vice President UP/SP Lines
Burlington Northern Santa Fe
2650 Lou Menk Drive
Fort Worth, TX 76161-0065

Re: "2-to-1" Protocol

Dear Pete:

As we discussed during our phone conversation, we have reviewed the revised draft that you faxed to us this afternoon. We find the language acceptable except for the presumption of BNSF's right to serve in your paragraph 5 and the burden of proof on Union Pacific in the first sentence of paragraph 6.

We have proposed and continue to maintain that the following language should be inserted as paragraph 5 of the protocol in lieu of BNSF's proposed language:

"5. If UP declines to approve a BNSF request for access to any facility, and BNSF believes that UP has an insufficient or inappropriate reason to decline access, BNSF may so notify UP, and upon such notice, may seek an order from the STB finding that BNSF was entitled to access to that facility."

With respect to your paragraph 6, we propose the following first sentence in lieu of your first sentence. This is a further refinement of our prior language to clarify that UP is not insisting on any particular form of evidence to support a request for access.

"6. UP shall approve all such requests where, on the basis of all available information, UP concludes that a particular facility was open to service by both UP and SP, either directly or through reciprocal switching, joint facility or other arrangements and by no other rail carrier, as of September 25, 1995."

Sincerely,

John

John H. Ransom
Manager - Interline Marketing

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that, on this 26th day of November, 1997, I caused a copy of the foregoing document to be served by first-class mail, postage prepaid, or by a more expeditious manner of delivery on all parties of record in Finance Docket No. 32760 (Sub-No. 21), and on

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

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

Michael L. Rosenthal