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

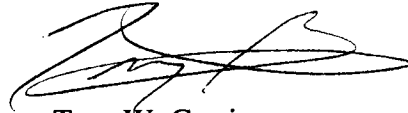
Re: STB Ex Parte No. 634, Consolidated Railroad Reporting – Joint
Comments of Red River Valley & Western Railroad Company, Rutland
Line, Inc., Twin Cities & Western Railroad Company, The Monongahela
Connecting Railroad Company, Aliquippa & Southern Railroad Company,
the Mahoning Valley Railway Company, the Cuyahoga Valley Railway
Company, the River Terminal Railway Company, Chicago Shortline
Railway Company, ParkSierra Rail Corporation d/b/a Arizona &
California Railroad Company L.P., California Northern Railroad
Company, L.P., and Puget Sound & Pacific Railroad, and Montana Rial
Link, Inc., and I&M Rail Link, LLC.

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are an original and 10 copies of
the Consolidated Railroad Reporting for the above-named railroads, pursuant to 49 C.F.R.
§ 1152.50. Also enclosed is a 3.5-inch disk containing this filing formatted in Word Perfect.

Please acknowledge receipt of this letter by date-stamping the enclosed acknowledgment copy and returning it to our messenger.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Troy W. Garris', with a stylized, sweeping flourish at the end.

Troy W. Garris

cc: William Drusch (by facsimile)
Dan Hennessy (by facsimile)
Thomas Schlosser (by facsimile)
Fred Simpson (by facsimile)
Tom Walsh (by facsimile)

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**Part of
Public Record**

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 634

CONSOLIDATED RAILROAD REPORTING

**JOINT COMMENTS OF RED RIVER VALLEY & WESTERN RAILROAD
COMPANY, RUTLAND LINE, INC., TWIN CITIES & WESTERN RAILROAD
COMPANY, THE MONONGAHELA CONNECTING RAILROAD COMPANY,
ALQUIPPA & SOUTHERN RAILROAD COMPANY, THE MAHONING
VALLEY RAILWAY COMPANY, THE CUYAHOGA VALLEY RAILWAY
COMPANY, THE RIVER TERMINAL RAILWAY COMPANY, CHICAGO
SHORTLINE RAILWAY COMPANY, PARKSIERRA RAIL CORPORATION
D/B/A ARIZONA & CALIFORNIA RAILROAD COMPANY L.P., CALIFORNIA
NORTHERN RAILROAD COMPANY, L.P., AND PUGET SOUND & PACIFIC
RAILROAD, AND MONTANA RAIL LINK, INC. AND I&M RAIL LINK, LLC.**

By their attorneys:



Jo A. DeRoche
Troy W. Garris
Weiner Brodsky Sidman Kider PC
1300 19th Street, NW
Fifth Floor
Washington, DC 20036

Dated: November 27, 2000

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 634

CONSOLIDATED RAILROAD REPORTING

JOINT COMMENTS OF RED RIVER VALLEY & WESTERN RAILROAD COMPANY, RUTLAND LINE, INC., TWIN CITIES & WESTERN RAILROAD COMPANY, THE MONONGAHELA CONNECTING RAILROAD COMPANY, ALIQUIPPA & SOUTHERN RAILROAD COMPANY, THE MAHONING VALLEY RAILWAY COMPANY, THE CUYAHOGA VALLEY RAILWAY COMPANY, THE RIVER TERMINAL RAILWAY COMPANY, CHICAGO SHORTLINE RAILWAY COMPANY, PARKSIERRA RAIL CORPORATION D/B/A ARIZONA & CALIFORNIA RAILROAD COMPANY L.P., CALIFORNIA NORTHERN RAILROAD COMPANY, L.P., AND PUGET SOUND & PACIFIC RAILROAD, AND MONTANA RAIL LINK, INC. AND I&M RAIL LINK, LLC.

The Red River Valley & Western Railroad Company, Rutland Line, Inc., Twin Cities & Western Railroad Company, The Monongahela Connecting Railroad Company, Aliquippa & Southern Railroad Company, The Mahoning Valley Railway Company, The Cuyahoga Valley Railway Company, The River Terminal Railway Company, Chicago Shortline Railway Company, ParkSierra Rail Corporation d/b/a Arizona & California Railroad Company L.P., California Northern Railroad Company, L.P., and Puget Sound & Pacific Railroad, and Montana Rail Link, Inc. and I&M Rail Link, LLC (together, “Commenters”) hereby submit their comments to the Surface Transportation Board (“Board”)¹ in STB Ex Parte No. 634, Consolidated Railroad Reporting, as directed by the Board’s September 25, 2000 decision, as modified in the decision served October 20, 2000.

¹ Throughout these Comments, the term “Board” is used to refer to both the Board and its predecessor, the Interstate Commerce Commission (“ICC”). See The ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (Dec. 29, 1995) (abolishing the ICC and transferring certain functions to the Board).

I. SUMMARY OF THE ISSUE

Recently, the Board indicated that it planned to reverse its longstanding policy of requiring only class I railroads to report their operating data on a consolidated basis and only for revenue adequacy purposes, by requiring reporting of “all” railroads and railroad-related activities on a consolidated basis for “all regulatory purposes.” Proposal to Require Consolidated Financial Reporting by Commonly Controlled Railroads, STB Ex Parte No. 634, at 3 (served September 20, 2000) (“Proposed Rule”). The Board stated the purpose of its proposal was to obtain more meaningful and accurate information on “major rail systems” in the United States, while keeping with its “general policy” of following generally accepted accounting principles (“GAAP”), except where inconsistent with regulatory requirements. Id. The Board indicated this new accounting approach could change the class of certain carriers, as the revenues of such carriers would be aggregated with the revenues of corporate siblings to determine whether they, as a group, should be classified as class I, II or III carriers. Id. at 4-5. The Board noted that, if a family of carriers attained class I status, it would be required to follow the Board’s uniform system of accounts of 49 CFR Part 1201, and to file various reports required by 49 CFR §§ 1241-48. Proposed Rule at 5 n.9.

Commenters oppose the Proposed Rule because affiliated short line railroads that operate independently do not form an operating system and should not be regulated as such. GAAP does not dictate this result and there are no benefits that sufficiently weigh against the burdens that will result from this change.

II. BACKGROUND

A. THE DIFFERENT CLASSES OF RAILROADS.

Common carrier railroads are divided into three different classes for regulatory purposes, depending on their levels of annual operating revenue. *See* 49 CFR § 1201 1-1(a). Class I carriers are those with \$250 million or more in revenue (adjusted for inflation), class II's ("regionals") have more than \$20 million but less than \$250 million in adjusted revenue, and class III's ("shortlines") have \$20 million or less. *Id.* § 1-1(a)-(b). To determine class, it has always been Board policy to calculate a carrier's revenues on an individual basis, regardless of affiliation with other companies.

The different classes of carriers are very different kinds of companies from a geographic, market and operational standpoint. The class I carriers are publicly-traded "mega" railroads. Though defined as having more than \$250 million in revenue, they actually far exceed that figure, in 1997 ranging from a low of approximately \$516 million to a high of approximately \$11 billion.² Railroad Facts 1998 Edition, Policy, Legislation and Communications Dept., Association of American Railroads ("Railroad Facts"), Exhibit ("Ex.") 1 at 4-5; 1999 UP Annual Report ("UP Ann. Rep.") Ex 2 at 2. Class I carriers span entire regions of the nation, and in many instances wield substantial market power over shippers and connecting small carriers. *See, e.g.*, 49 USC § 11323 and 49 CFR 1180.0-1180.9 (class I transactions receive greater scrutiny than similar transactions by small carriers). In 1997, the nine class I's, which represented only 2 percent of the total number of carriers, accounted for 71 percent of the road operated,³ 89 percent of the

² The Grand Trunk Western Railroad, which alone had \$352 million in operating revenue, is a subsidiary of another class I, Canadian National Railway Company, which had over \$3 billion in revenue during that year.

³ "Road" represents the aggregate length of roadway, excluding yard tracks and sidings, and does not reflect the fact that a mile of road may include two, three, or more parallel tracks.

employees in the industry and 91 percent of the freight revenue. Railroad Facts at 3, Ex. 1 at 1.⁴ See also graph *infra* at page 24.

The 34 class II railroads in 1997, by comparison, together operated only 13 percent of the road, employed slightly more than 5 percent of the workers, and had only 5 percent of the revenue. Railroad Facts at 3, Ex. 1 at 1; graph *infra* at page 24. The class III's were much smaller still, with all 507 of these carriers together accounting for only 16 percent of the road (three-hundredths of one percent of the total each, on average), 6 percent of the employees (one one-hundredth of one percent of the total each, on average), and 4 percent of the revenue (less than eight-thousandths of one percent of the total each, on average). Railroad Facts at 3, Ex. 1 at 1; graph *infra* at page 24.

Approximately 429 of the class III's had less than \$5 million in annual revenue each.⁵ Acquisition of Rail Lines Under 49 U.S.C. §§ 10901 and 10902 – Advance Notice of Proposed Transactions, STB Ex Parte No. 562, 1997 STB LEXIS 343 at *22 (served Sept. 9, 1997) (“Acquisition”), *aff'd* Association of American Railroads v. STB, 161 F.3d 58 (1998). The class III revenue figures would be even lower if the revenues of the switching and terminal railroads and electric railways were removed.⁶

Since 1980, many new class II and III carriers (together “small carriers”) have been created by the sales of rail lines or cluster of lines that a class I has determined to be only marginally profitable, and which likely would have been abandoned but for the small carriers' intervention. Acquisition, STB Ex Parte No. 562, 1997 STB LEXIS 343, at *12. The lines purchased in this manner are typically short, with light traffic volume,

⁴ These figures represent the class I's excluding non-US carriers and Amtrak. Railroad Facts at 3, 65, Ex. 1 at 1, 2.

⁵ This figure is based on 1995 information, and for comparison purposes assumes no material change in the number of class III's between 1995 and 1997.

and the small carriers created lack any significant market power. See Class Exemption for Acquisition or Operation Under 49 U.S.C. 10902, STB Ex Parte No. 529, 1 S.T.B. 95, 103 (1996) (“Class Exemptions Under 10902”) (regulation of class III acquisitions is not needed to protect shippers from the abuse of market power); Class Exemption for the Acquisition and Operation of Rail Lines Under 49 U.S.C. 10901, 1 I.C.C.2d 810 (1985) (“Class Exemptions Under 10901”) (similar findings for transactions by carriers under former 49 U.S.C. § 10901). In addition, these small carriers are heavily dependent on their class I connections for such things as car supply, pricing and access to the national rail network. As part of the line purchase, many small carriers are required to grant all interline pricing authority to their respective class I connecting carriers and, thereafter, receive a set, per-car allowance for all or substantially all of the interline traffic. Some of these allowances are adjustable by inflationary indices.⁷ Nevertheless, small carriers often can make an otherwise abandonable line viable because they are able to use their limited resources more efficiently, are able to be far more responsive to the needs of their local shippers, and have lower regulatory costs.

B. REGULATION OF THE DIFFERENT CLASSES.

Because the different classes of railroads are so very different, Congress and the Board have, as a matter of policy and practice, identified ways in which their regulatory requirements should differ. For example, class determines if (and if so, how much) labor protection must be provided to employees affected by a carrier’s business transactions. Class I’s engaging in carrier to carrier transactions must pay wage protection, and worker

⁶ Cf. 49 CFR 1201 1-1(d)-(e) (switching and terminal railroads and electric railways are designated as class III carriers regardless of their respective amounts of operating revenues). Several of the terminal railroads are high volume, high revenue carriers (*e.g.*, Indiana Harbor Belt Railroad Co.).

⁷ Pricing authority is typically granted by a short line to the class I from which the short line purchased its rail lines, for all interline traffic handled by the two carriers. Because many short lines have only one class

moving and retraining allowances for affected workers for up to six years. 49 U.S.C. § 11326(a). *See, e.g., New York Dock Ry. – Control – Brooklyn Eastern Dist.*, 360 I.C.C. 60 (1979) (“New York Dock”), *aff’d sub nom. New York Dock Ry. v. United States*, 609 F.2d 83 (2d Cir. 1979). Prior to the ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 805 (Dec. 29, 1995), class II and III carriers were required to provide the same levels of labor protection in such transactions. In 1995, however, Congress expressly reduced that burden for small railroads. Today, class II railroads acquiring an interest in a line, or consolidating with another – unless the class II voluntarily proceeds under 49 U.S.C. § 11323 and a class I or another class II is involved – must pay up to one year of severance pay, but no more. 49 U.S.C. §§ 10902(d), 11326(a), 11326(b). If all the involved carriers are class III's, the Board is prohibited from imposing any labor protection at all. 49 U.S.C. §§ 10902(d), 11326(c).

Class also determines a railroad's STB accounting and reporting responsibilities. Class I railroads are required to submit various monthly, quarterly and annual reports, 49 CFR §§ 1241-48, and must follow a Board-imposed uniform system of accounting, 49 CFR Part 1201. Class II and III carriers have been specifically exempted from these accounting and reporting requirements, as have all switching and terminal companies and electric railways, regardless of amount of operating revenue. 49 CFR §§ 1241-48, 1201 1-1(c)-(e). *See also Elimination of Accounting and Reporting Requirements of Class II Railroads*, ICC Docket No. 37614, 47 Fed. Reg. 6,879 (served Feb. 17, 1982) (“Elimination of Reporting – Class II's”) (“the hours spent to comply with our accounting and reporting requirements [are] no longer justified”); Reduction of Accounting and Reporting Requirements, ICC Docket No. 37523, 46 Fed. Reg. 9,114

I connection (*i.e.*, the class I that sold the short line the property), this results in the class I having the power

(served Jan. 28, 1981) (“Reduction of Reporting – Class III’s”) (Board policy is to require submission only of information regularly and frequently needed, and the Board no longer uses or needs information from class III’s). The Board has indicated, however, it may require information from small carriers on an as-needed basis in particular proceedings. *See, e.g., Minnesota Power, Inc. v. Duluth Missabe and Iron Range Railway Co.* (“Minnesota Power”), STB Docket No. 42038, 2000 STB LEXIS 126, at *13-14 & n.22 (served Mar. 6, 2000).

Similarly, class determines whether a carrier can purchase a line under the statutory “feeder line” program. 49 U.S.C. § 10907. If a line has been designated as a candidate for abandonment or discontinuance on any carrier’s system diagram map, or it is shown that service provided on the line is inadequate and the railroad that owns the line has yet to seek authority to abandon or discontinue, the line can be acquired through a forced sale. *Id.* The only carriers that can use this provision are class III’s. *Id.*

Likewise, class affects the number of regulatory options a railroad has for obtaining authority for certain business transactions, and the stringency of the Board’s review of such transactions. *See Montana Rail Link, Inc. & Wisconsin Central Ltd., Joint Petition for Rulemaking with Respect to 49 CFR Part 1201*, 8 I.C.C.2d 625, 636 (1992) (“MRL”). For example, to acquire, lease or operate a line of railroad, a class I carrier frequently must file an application under 49 U.S.C. § 11323. Such an application involves a before-the-fact rigorous inspection of the competitive effects of and public interests in the transaction. 49 U.S.C. § 11324(d). Class II and III railroads can obtain authority under the less burdensome 49 U.S.C. § 10902, which is unavailable to class I’s.

to price all or substantially all of the traffic handled by the short line.

Class III carriers also have the added option of using certain class exemptions unavailable to the others. *See, e.g.*, 49 CFR §§ 1150.41-45.

Like the regulatory procedures, class affects the speed with which railroad consolidation decisions are made. For “major” transactions, *i.e.*, where two or more class I railroads are involved, the Board has 16 months to issue a decision. 49 U.S.C. §§ 11325(a), (b); 49 CFR § 1180.2(a). For “significant” transactions, those not involving two class I carriers but where the Board finds effects of regional or national transportation significance, the Board has 10 months to issue a decision. 49 U.S.C. §§ 11325(a), (c); 49 CFR § 1180.2(b). For all other merger or consolidation cases -- “minor” and “exempt” transactions -- the Board’s decision is due within six months. 49 U.S.C. §§ 11325(a), (d); 49 CFR §§ 1180.2(c), (d). Class III carriers, however, can engage in certain transactions upon seven days’ notice to the Board. 49 CFR §§ 1150.41-45.

Class also affects the regulatory costs of particular transactions, as the different types of filings require different filing fees reflecting the difference in the amount of scrutiny each will get (from a low of \$1,200 for a notice of exemption for certain acquisitions or operations by class III carriers, to \$976,500 for a consolidation transaction involving two or more class I’s). 49 CFR § 1002.2(f). There are also “hidden regulatory costs” that reflect the amount of time and effort necessary to assemble the information required to be submitted for review, 49 CFR §§ 1180.0-1180.9, and whether a transaction requires particular environmental reports, 49 CFR §§ 1105.1-1105.09.

Outside the Board’s regulatory purview, class determines a carrier’s eligibility for remedies under the Railroad Industry Agreement (the “Industry Agreement”), dated September 10, 1998. Industry Agreement, Ex. 3. This agreement was negotiated and

signed by the Association of American Railroads (“AAR”) on behalf of class I railroads and the American Short Line and Regional Railroad Association (“ASLRRA”) on behalf of small carriers, at the encouragement of the Board.⁸ Section 3 of the Industry Agreement, regarding new routings and the reduction of “paper barriers” (contractual limitations on interchange between railroads), expressly provides remedies and increased flexibility only for class III railroads. Industry Agreement, Ex. 3 at 9-13.

Finally, class affects a railroad’s eligibility for \$1 billion in small carrier set-asides under the low-cost loan program of the Railroad Rehabilitation and Improvement Financing Program of the Transportation Equity Act of the 21st Century (“TEA-21”), Pub. L. No. 105-178 (June 9, 1998), and regulatory treatment by the Federal Railroad Administration (“FRA”), which requires class I and II carriers (but not class III’s) to conduct certain annual reviews and analyses, 49 CFR § 240.309, prepare certain reports, id., and maintain on-site blood and urine sample equipment, 49 CFR §§ 219.5, 205.2.

Although not exhaustive, this list reflects a historic pattern of regulating large and small railroads differently, for a variety of sound reasons.

C. BOARD’S INFORMATION COLLECTION POLICY.

Consistent with the differences discussed above, the Board’s well-settled information collection policy is to require carriers to submit, on a systematic basis, only information the Board “regularly and frequently needs,” using the class system to periodically gather essential data from carriers that make a major impact on the transportation industry, while reducing the burden on smaller carriers by collecting data needed infrequently only when the specific needs arise. MRL, 8 I.C.C.2d at 632; Policy Statement on Financial and Statistical Reporting, 44 Fed. Reg. 27,537 (1979). This

⁸ The agreement followed two days of hearings at the Board regarding rail access and competition. *See*

policy has been reinforced by the Staggers Rail Act of 1980, and subsequently ICCTA, which require cost accounting guidelines to be “the most efficient and least burdensome means by which the required information may be developed for regulatory purposes.” 49 U.S.C. § 11161. The law also requires reporting obligations for expense and revenue information to be cost effective and not duplicative of the railroads’ general managerial accounting obligations, 49 U.S.C. § 11164, and requires the Board to minimize the burden on rail carriers of developing and maintaining the capability of providing such information. 49 U.S.C. § 10101(13).

To carry out this mandate, the Board (like its predecessor) has excluded class II and III carriers from the requirements of its uniform system of accounts and from nearly all periodic reporting requirements. *See* Elimination of Reporting – Class II’s, ICC Docket No. 37614; Reduction of Reporting – Class III’s, ICC Docket No. 37523. The Board has also found that the benefits of elevating even the largest of class II’s to a class I status, thereby requiring such carriers to keep the reports and accounts of class I’s, would not produce meaningful information about the industry, while it would impose heavy costs on the carriers. MRL, 8 I.C.C.2d at 632 (elevating the carriers’ class would impose, *inter alia*, 4,000 burden hours and \$50,000-\$115,000 in reporting and accounting costs (in 1992 dollars), while the information would lack meaning and was unneeded).

D. FASB-94’s CONSOLIDATED ACCOUNTING REQUIREMENTS.

The Board has a general policy of following GAAP, except where inconsistent with regulatory requirements. *See, e.g.*, Proposed Rule, STB Ex Parte No. 634, at 3. GAAP is based, in large part, on statements issued by the Financial Accounting

Review of Rail Access and Competition Issues, STB Ex Parte No. 575 (served Mar. 2, 1999).

Standards Board (“FASB”) and the American Institute of Certified Public Accountants (“AICPA”). *See* Verified Statement (“V.S.”) of Bob Holder, C.P.A., Ex. 4.

In 1959, the AICPA found that shareholders and creditors needed information about corporate subsidiaries to assess the risks of investments in parent companies because, although the success or failure of a parent’s subsidiaries could greatly impact the financial health of the parent, information about such subsidiaries was often unavailable. Consolidated Financial Statements, Accounting Research Bulletin No. 51, (American Institute of Certified Public Accountants 1959) (“1959 Accounting Statement No. 51”), Ex. 5. Thus, the AICPA issued the 1959 Accounting Statement No. 51, requiring parent and subsidiary corporations to prepare consolidated financial statements for reporting purposes. *Id.* at ¶ ARB 51.01, Ex. 5.

In 1987, FASB determined the 1959 Accounting Statement system no longer adequately enabled investors to compare data from different parent companies, because some parents reported information about all significant subsidiaries on a consolidated basis, while others excluded information about various subsidiaries under several available exceptions to the rule. Consolidation of All Majority-owned Subsidiaries, Statement of Financial Accounting Standards No. 94, Appendix B, Basis for Conclusions ¶¶ FAS 94.26 (Financial Accounting Standards Bd. 1987) (“1987 Accounting Statement No. 94”), Ex. 6. To correct that disparity, FASB eliminated three of these exceptions, including the exception for subsidiaries engaging in “nonhomogenous” operations (*i.e.*, subsidiaries whose operations were unrelated to or in a different industry from those of the parent), and the exception that distinguished between domestic and foreign subsidiaries. *Id.* at ¶ FAS 94.09, Ex. 6.

After the 1987 accounting statement was issued, parent corporations were required to keep accounts on a consolidated basis with “all majority-owned subsidiaries”, *i.e.*, all companies in which a parent had a controlling financial interest through direct or indirect ownership of a majority interest, with limited exceptions not here pertinent. Id. at ¶ FAS 94.13, Ex. 6. Recognizing that this was a potential problem for some persons who needed “disaggregated” information for certain regulatory purposes (*e.g.*, the Securities and Exchange Commission), FASB noted that other FASB rules provided sufficient disclosure to fill these purposes. Id. at ¶ 94.56, Ex. 6. Finally, FASB stated the underlying purpose of consolidated statements remained unchanged from 1959: providing useful information about parent companies to those making “investment, credit, or other similar decisions” about that parent. Id. at ¶ FAS 94.34, Ex. 6. *See also id.* at FAS 94.01, Ex. 6.

Subsequently, the Board, relying in part on the reasoning underlying the 1987 Accounting Statement, adopted mandatory consolidated reporting requirements for class I carriers, but only for the purpose of gathering information necessary to make revenue adequacy determinations, not for any other regulatory purposes. Supplemental Reporting of Information for Revenue Adequacy, 5 I.C.C.2d 65 (1988) (“Supplemental Reporting”); Standards for Railroad Revenue Adequacy, ICC Ex Parte No. 393 (Sub-No. 1), 3 I.C.C.2d 261 (1986). In doing so, the Board noted its responsibility to ensure that its accounting rules were the “most efficient and least burdensome means” by which the needed revenue adequacy information could be gathered. Supplemental Reporting, 5 I.C.C.2d at 66. *See also* 49 U.S.C. §§ 11161, 11164. The Board also stated, with regard to the Regulatory Flexibility Act, that the proceeding would not have a significant economic impact on a substantial number of small entities, as the proceeding related only

to class I railroads and certain subsidiaries. Supplemental Reporting of Consolidated Information for Revenue Adequacy Purposes, Ex Parte No. 393 (Sub No. 2), 1987 ICC LEXIS 316, at *13 (served May 5, 1987). Furthermore, the Board estimated it would take the class I's 16 burden hours to collect and supply the new information. Supplemental Reporting, 5 I.C.C.2d at 76.

III. BOARD'S PROPOSED POLICY REVERSAL

Now, the Board has proposed to reverse its longstanding policy regarding consolidated reporting, and require "all" railroads and railroad related activities to be reported on a consolidated basis for "all regulatory purposes." Proposed Rule, STB Ex Parte No. 634 at 3. The Board has stated the benefit of the policy reversal would be the collection of more meaningful and accurate information on major rail systems and the ability to follow GAAP. Id. For reasons not dictated by the desire to obtain additional data and not readily apparent, the Board has also indicated that the effect of this policy reversal would be to change the class of certain carriers, as revenues of the carriers are combined with the revenues of corporate siblings for all regulatory purposes including the determination of class. Id. at 4-5. The benefits of this result have not been stated but, as Commenters will show, the burdens to small carriers will exceed any benefits.

IV. ALL RAILROADS ARE 4'8½" WIDE, BUT NOT ALL ARE 35,000 MILES LONG

Although class I's are defined as any carrier with more than \$250 million in annual operating revenue, the reality is that all class I's far exceed this threshold. The class I carriers span entire regions of the nation, wielding substantial market power over both shippers and connecting small carriers. The largest of these carriers, with approximately \$11 billion in 1997 revenue, is the Union Pacific Railroad Company, Inc.

(“UP”), a wholly-owned subsidiary of Union Pacific Corporation. 1999 UP Annual Report (“UP Ann. Rep.”), Ex. 2 at 2, 5, 9-10.

UP serves the entire western two-thirds of the continental United States, id. at 3-4, 10, with approximately 35,000 miles of road owned, Id. at 11. UP employs approximately 52,533 people, Railroad Facts at 76, Ex. 1 at 5, originates almost 7 million carloads of freight per year, id., and transports every major commodity shipped by rail, UP Ann. Rep., Ex. 2 at 6-7. UP is a behemoth, even among class I’s. The Burlington Northern and Santa Fe Railway Company (“BNSF”) is not far behind, with approximately 26,000 miles of road owned, approximately 43,468 employees, and over 6 million carloads originated each year. Railroad Facts at 68, Ex. 1 at 3.

But even the smallest class I’s are transportation giants. Kansas City Southern Railway Company (“KCS”), smallest of the U.S.-owned class I’s, has revenues that more than double the class I threshold, with approximately \$516 million annually. Railroad Facts at 73, Ex. 1 at 4; Kansas City Southern Industries (“KCSI”) Home Page, Ex. 7 at 3. And like UP, KCS has multiple major transportation-related affiliates, with its parent, KCSI, having 100 percent ownership of Gateway Western Railway (\$42.7 million in revenue), id. at 4, a 49 percent holding in Texas-Mexican Railway (\$28.4 million in revenue),⁹ id. at 5, a 37 percent indirect ownership interest in the joint venture Grupo Transportacion Ferroviaria Mexicana, S.A. de C.V. (\$524.5 million in 1999),¹⁰ id. at 6, and half ownership of the Panama Canal Railway Co., a 47.6 mile transcontinental railroad, running parallel to the Panama Canal, id. at 7.

⁹ This figure had ballooned to \$50.5 million in 1999.

¹⁰ Data for 1997 is unavailable for this company.

KCS itself owns 2,633 miles of road in 11 central and southeastern states, Railroad Facts at 73, Ex. 1 at 4, KCSI Home Page, Ex. 7 at 2; provides direct salt water access from the Midwest; has the shortest route from Kansas City to the Gulf of Mexico; and serves ports in Texas, Louisiana, and Mississippi. *See id.* KCS employs approximately 2,585 people; originates approximately 443,910 carloads of freight per year, Railroad Facts at 73, Ex. 1 at 4; and transports a diverse mix of commodities, with no single group constituting more than 25 percent of total carloads, KCSI Home Page, Ex. 7 at 2. The class I's are a different world entirely from the Commenters.

For example, each of the six LTV railroads,¹¹ five of which are wholly-owned subsidiaries of the LTV Steel Company, Inc. ("LTV Steel")¹² and one of which is a subsidiary of one of the subsidiaries, is a switching/terminal railroad located in a separate geographic area from its affiliates, with the exception of the Cuyahoga Valley and the River Terminal which both serve the LTV steel plant in Cleveland, Ohio.¹³ None of the affiliates, except the two serving the Cleveland plant, has any potential for interchanging or connecting with each other. Each is a class III for regulatory purposes, having respective annual revenues ranging from a high of \$19.4 million to a low of \$86,000.¹⁴ Four of the railroads have less than \$5 million in operating revenue and two of these have less than \$1 million.

Each carrier owns five or fewer miles of road to primarily serve the LTV steel plant where it is located. Five of the six are located within the boundaries of these

¹¹ The carriers are The Monongahela Connecting Railroad Company ("MonCon"), Aliquippa & Southern Railroad Company ("Aliquippa"), The River Terminal Railway Company ("River Terminal"), Chicago Shortline Railway Company ("Chicago Shortline"), and The Cuyahoga Valley Railway Company ("Cuyahoga Valley"). Cuyahoga Valley also has a wholly-owned subsidiary, The Mahoning Valley Railway Company ("Mahoning Valley").

¹² LTV Steel is, in turn, a non-rail-related, wholly-owned subsidiary of the LTV Corporation.

¹³ The facts regarding the LTV subsidiary railroads have been provided by Daniel L. Hennessy, President of each of the LTV railroads. *See* verification at Ex. 8.

¹⁴ Unless otherwise noted, all data regarding Commenters' railroads is as of December 31, 1999.

various steel plants. The carriers employ few people, from a high of 177 to a low of 4 individuals, and each railroad has separate collective bargaining agreements (“CBAs”) with its employees. The carriers have light traffic volume (ranging from a high of 15,180 carloads originated per year to a low of 492), serve only a few shippers (from a high of nine to a low of one), and each carrier’s survival depends on three or fewer commodities. Each carrier is incorporated as, acts as and is treated as a separate entity. Even where two of the railroads physically connect, they continue to operate independently, under separate CBAs with their employees, as they did when they were separately owned by Jones & Laughlin Steel Company and Republic Steel Company, prior to their acquisition by LTV Steel. If the operating revenues of these carriers were combined, as proposed by the Board, the total would exceed the class II threshold. If the revenues of the carriers were also combined with that of LTV Steel or its parent, as GAAP would dictate, then the total would exceed the class I threshold.

The Red River Valley & Western Railroad (“RRVW”), Rutland Lines, Inc. (“RLI”) and Twin Cities & Western Railroad (“TCW”) are closely-held corporations with no corporate parent.¹⁵ Each company is owned by the same investors but the percentage of ownership for TCW is different from that of the others. The same investors also own Western Railroad Equipment Company, a non-carrier company that leases rail equipment primarily to shippers. RRVW and TCW are located in different geographic areas, with no potential for interchanging or connecting with each other. RRVW owns 577 miles of road, employs 78 people, and the operating employees are organized under a

¹⁵ The facts regarding the RRVW, RLI and TCW have been provided by William Drusch, President of RRVW and TCW. See verification at Ex. 9.

CBA. RRVW provides the common carrier operations on the approximately 84 miles of RLI line. TCW, on the other hand, owns 145 miles of road, and employs only approximately 45 people, none of whom are organized. The carriers have moderate freight traffic volume: 34,098 carloads originated for RRVW and 17,306 carloads for TCW. Each carrier depends heavily (approximately 60 percent of traffic) on farm products. Although TCW has some control over interline pricing, RRVW and RLI lack such control with 100 percent and 99 percent of prices, respectively, set by connecting class I's. Combined, the operating revenues of these carriers exceed the class II threshold.

Similar in corporate structure, but different in size, Montana Rail Link ("MRL") and I&M Rail Link ("IMRL") are closely-held companies with no corporate parent.¹⁶ IMRL is owned approximately 67% by a holding company (I&M Holdings, LLC) owned by Dennis Washington and MRL is owned approximately 99% by Mr. Washington.¹⁷ MRL and IMRL are located in different geographic areas, with no potential for interchanging or connecting with each other. MRL owns 191 miles of road and leases 654 more. It employs 950 people. IMRL, on the other hand, owns and/or operates 1,396 miles of road and employs approximately 696 people. MRL and IMRL originate 224,929 carloads and 242,902 carloads per year, respectively. Nearly all of MRL's traffic is priced by BNSF, while IMRL retains pricing authority over most of its traffic. Yet they are very different railroads and wholly independent operations. Combined, the operating revenues of IMRL and MRL exceed the class I threshold.¹⁸

¹⁶ The facts regarding the MRL and IMRL have been provided by Thomas Walsh, Senior Vice President and Chief Financial Officer of each of the carriers. See verification at Ex. 10.

¹⁷ MRL and IMRL are also related to Southern Railway of British Columbia Limited, a rail carrier whose operations are located in Canada.

¹⁸ IMRL is also one of the small carriers that has or intends to apply for a low-cost loan under TEA-21. Class I's do not qualify for a special \$1 billion set-aside under that program.

The ParkSierra railroads,¹⁹ each an operating division of ParkSierra Corporation, were until September 2000, separate class III carriers.²⁰ They were combined under a single corporate umbrella at that time for purposes of administrative efficiency. Each operating division has class III-level revenues, from a high of about \$10.9 million to a low of about \$3.9 million. Each is located hundreds of miles from the others, with no potential of connecting or interchanging with any other. The carriers have few employees (from a high of 45 to a low of 21), handle only light freight volume (from a high of 36,627 cars originated per year to a low of 10,269), and each is heavily dependent on a few major commodities. Moreover, the carriers have almost no pricing authority, as the connecting class I's price 99 percent of the interline traffic for CFNR and PSAP, and 100 percent of the interline traffic for ARZC. Two carriers, ARZC and PSAP, handle the vast majority of their traffic with BNSF; the other, CFNR, handles virtually all of its traffic with UP. Both before and after the corporate restructuring, the carriers have operated as wholly independent class III carriers. The only substantive change is in the ownership structure, not how the railroads operate. If the operating revenues of these carriers are combined, the total exceeds the class II threshold.

V. DISCUSSION

The Proposed Rule is inconsistent with the Board's statutory mandate, will fail to accomplish the stated or any other meaningful goals, will burden small carriers, deprive them of certain regulatory differences previously found to be in the public's and the industry's interest, and perhaps even deny them the benefits of bargains previously made. The Board should not adopt this rule.

¹⁹ Arizona & California Railroad ("ARZC") and California Northern Railroad ("CFNR") and Puget Sound & Pacific Railroad ("PSAP").

²⁰ The facts regarding ParkSierra Corporation and its railroads have been provided by Thomas Schlosser, President of ParkSierra Corporation. See verification at Ex. 11.

A. THE PROPOSED RULE CONFLICTS WITH STATUTORY AND REGULATORY REQUIREMENTS.

In ICCTA, Congress directed the Board to exempt a person, class of persons or a transaction from regulation whenever the Board found that regulation was not necessary to carry out the transportation policy of 49 U.S.C. § 10502,²¹ and either that the transaction is of limited scope or regulation is not necessary to protect shippers from the abuse of market power. The Board now proposes a rule that generally contradicts this standard for deregulation and, as Commenters will show, specifically violates other statutory mandates.

1. Collecting Data.

The Board is required to obtain information from regulated carriers using the “most efficient and least burdensome means” available. 49 U.S.C. § 11161; Supplemental Reporting, 5 I.C.C.2d at 66; MRL, 8 I.C.C.2d at 632 n.14. *See also* 49 U.S.C. § 11164 (Board may issue reasonable accounting and reporting requirements, but such rules “shall be cost effective and compatible with and not duplicative” of the carriers’ other managerial and responsibility accounting requirements). In the Proposed Rule, the Board has expressed a desire for more meaningful and accurate information on major rail systems. As further discussed in section “2” *infra*, the rule as proposed will not satisfy this desire, especially for class III carriers elevated to class II’s, and the changes in the accounting requirements will be wholly duplicative of the carriers’ other accounting requirements. MRL and IMRL would have consolidated revenues over \$250 million. If they are forced to report their data as a class I railroad, they will have to substantially increase their accounting systems at great expense, and to no benefit.

²¹ Formerly 49 U.S.C. § 10505.

In the regulatory proceeding in which the Board raised the class I revenue threshold to its current level, MRL 8 ICC2d 625, the Board specifically weighed the benefits of collecting financial data from MRL and the cost that MRL would incur if it were required to do so. The Board concluded that the burdens associated with a regional railroad using the uniform system of accounts far outweighed the public benefits of obtaining that information. IMRL's revenues are less than MRL's and the systems are non-contiguous and wholly independent in terms of operations. The fact that they share a common majority owner does not have any impact on the balancing test that the Board performed in concluding that MRL should not be subjected to the class I accounting and reporting rules.

However, even assuming that it could be shown that the Board will benefit from having additional information, and also that the rule would actually provide such information, it simply does not follow that the collection of such information requires changing any carrier's class, particularly in light of the widespread harmful effects that such a class change would entail. *See* further discussion in section "3" *infra*. In the past, the Board has demonstrated skill in narrowly tailoring rules to serve informational needs without imposing significant and unnecessary burdens on small carriers. *See, e.g., Supplemental Reporting*, 5 I.C.C.2d 65 (requiring consolidated reporting for class I carriers, and certain subsidiaries for the limited purposes of gathering revenue adequacy information, without changing the class of any carrier); Minnesota Power, STB Docket No. 42038, 2000 STB LEXIS 126, at *13-14 (requiring needed information from a small carrier in a particular proceeding). The Board has also granted switching and terminal companies and electric railway companies the exemptions of class III railroads without

regard for their respective levels of revenue. The Board's statutory obligations and longstanding policies require similar discretion here.

2. Labor Protection.

Congress has statutorily mandated the amount of labor protection to be imposed in particular rail carrier transactions. The Proposed Rule is inconsistent with this intent. Where Congress's intent on an issue can be discerned from an accepted canon of statutory construction, the agency lacks discretion to deviate from that intent. *See, e.g., Halverson v. Slater*, 129 F.3d 180, 184 (D.C. Cir. 1997).²² Congress's intent in ICCTA to statutorily mandate the amount of labor protection imposed in small carrier transactions is clear. Congress expressly precluded labor protection in section 11323 and 10902 transactions involving only class III railroads and strictly mandated labor protection at one year of severance pay for similar transactions involving class II's.

This sharply contrasts with the situation prior to ICCTA, where the same transactions by the same carriers would have resulted in mandatorily imposed moving, retraining and wage protection of up to six years, for former section 11343 transactions (now 49 U.S.C. § 11323),²³ and the Board would have had discretion to impose up to six years of labor protection in former section 10901 transactions. Thus, Congress specifically eliminated or removed labor protection for former section 11343 transactions

²² *See also National Ass'n for Better Broadcasting v. FCC*, 830 F.2d 270, 275-77 (D.C. Cir. 1987) (administrative decisions may not frustrate the Congressional policy underlying the statute) (*citing International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 566 n.20 (1979) (the Court's deference to agency interpretations is constrained by its obligation to honor the clear meaning of the statute as revealed by its "language, purpose and history"); *NLRB v. Brown*, 380 U.S. 278, 291 (1965) (Court will not stand aside and rubber-stamp agency decisions inconsistent with statutory mandate or frustrating the Congressional policy underlying the statute)).

²³ *See New York Dock*, 360 I.C.C. 60 (1979); *Mendocino Coast Ry. – Lease and Operate*, 354 I.C.C. 732 (1978), *modified in*, 360 I.C.C. 653 (1980), *aff'd sub nom. Railway Labor Exec. Ass'n v. United States*, 675 F.2d 1248 (D.C. Cir. 1982) (applying similar conditions to lease transactions); *Norfolk & W. Ry. – Trackage Rights – BN*, 354 I.C.C. 605, 610-15 (1978), *modified in Mendocino Coast Ry. – Lease and Operate*, 360 I.C.C. 653, 664 (1980), *aff'd sub nom. Railway Labor Exec. Ass'n v. United States*, 675 F.2d 1248 (D.C. Cir. 1982) (applying similar conditions to trackage rights transactions).

and stripped the Board of all discretion to impose labor protection in transactions under former section 10901. Indeed, the Board has repeatedly held that it lacks discretion in these matters. It would therefore be improper for the Board to attempt to circumvent this clear Congressional mandate by the device of elevating small carriers to a higher class, thereby imposing additional labor protection on the transactions.

3. Impact on Small Businesses.

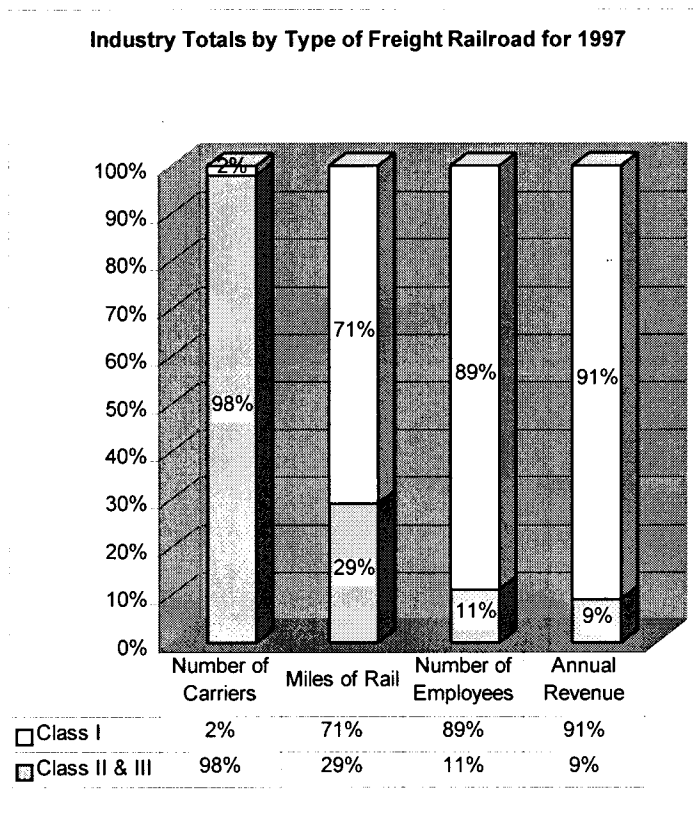
The Board is also required to consider the impact on small business when imposing additional regulations. *See, e.g.,* Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, 110 Stat. 857 (“SBREFA”); Acquisition, STB Ex Parte No. 562, 1997 STB LEXIS 343, at *23 n.10. The Board’s Proposed Rule will go far to prescribe new regulatory burdens on small railroads, by increasing labor and regulatory costs and decreasing regulatory flexibility, with little or no benefit to the public. Without a thorough analysis of whether the impact on small entities outweighs the benefits of the rule, the Board is precluded from implementing such a rule.

B. THE PROPOSED RULE WILL NOT PROVIDE THE INFORMATION SOUGHT.

The stated purpose of the Proposed Rule is to provide “meaningful and accurate information on major rail systems.” The rule will not accomplish this goal because (i) small carriers affiliated with other small rail and rail-related companies do not constitute “major rail systems,” or even minor rail systems, and (ii) consolidated reporting by such companies will not produce any information that is statistically meaningful or accurate, if it produces any new information at all.

As shown above, class II and III railroads and their affiliates comprise only a minute segment of the rail industry. In 1997, the nine class I railroads accounted for 71 percent of the road operated, 89 percent of the employees in the industry and 91 percent

of the freight revenue. Railroad Facts at 3, Ex. 1 at 1. This dwarfed the 34 class II railroads, which together operated only 13 percent of the road, employed less than 6 percent of the workers, and accounted for only 5 percent of the revenue. The class III's, by comparison, were even smaller, with all 507 together accounting for only 16 percent of the road, 6 percent of the employees, and 4 percent of the revenue, using the data from *all small railroads* combined. Those railroads that have rail and rail-related affiliates represent only a fraction of this fraction. For example, MRL and IMRL, both class II's (and the largest among the Commenters) together account for only approximately 1 percent of the road, eight-tenths of one percent (0.8%) of the employees and eight-tenths of one percent (0.8%) of the revenue.



Data from Railroad Facts, at 3, Ex. 1, at 1.

Such a minute segment of the rail industry cannot be said to comprise a “major rail system” by any standard, and collecting information about such a segment would not

in any way be statistically meaningful or accurate, either about the rail industry as a whole, or the shortline or regional rail industry in particular. *Cf. MRL*, 8 I.C.C.2d at 633 (collecting information from carriers comprising approximately 1.7 percent of the industry would have no appreciable impact on the breadth or representativeness of the information the Board receives). Where it is also shown, as here, that the railroads do not operate as a single transportation system, then their combined data does not reflect any system at all, let alone a major one.

Moreover, in the case of the smaller railroads, elevating a class III carrier to class II would not provide any significant level of information that the carrier does not already provide. With minor exceptions, there is no difference between the kinds and amounts of information required to be submitted by class II's on the one hand, and class III's on the other. Class II's and III's are exempt from nearly all of the Boards' accounting and reporting requirements. *See, e.g.*, 49 CFR Part 1201; 49 CFR §§ 1241-48. Thus, although consolidated reporting would elevate certain class III's to class II's – with all the directly resulting increased labor and regulatory costs and decreased regulatory flexibility – no new information about the carriers or the industry would actually be produced. Similarly, class II's elevated to class I, would produce more information, through substantially increased accounting and reporting requirements, but these carriers comprise such a miniscule portion of the industry that the additional information would be insignificant. *MRL*, 8 I.C.C.2d at 633.

The second stated purpose of the proposed change is to adhere to the Board's "general policy of following GAAP" (which includes FASB-94), except where inconsistent with regulatory requirements. However, the proposal is not consistent with the requirements of GAAP. The Board seems to have interpreted FASB-94 to mean that

“all railroads” would need to report on a consolidated basis under FASB-94. This is incorrect. FASB-94 requires consolidated reporting only for non-excepted *subsidiaries of parent corporations*. FASB-94 does not require affiliates controlled by individuals to report on a consolidated basis. 1987 Accounting Statement No. 94, at ¶ FAS 94.13. This makes good sense if one considers the underlying purpose of FASB-94: to provide meaningful information about the parent to those who invest in the parent. Id. at ¶¶ 94.01, 94.34. But, where there is no parent company, the rule is irrelevant. Thus, under both the original rule issued in 1959 and the 1987 amendments in FASB-94, affiliated companies without a corporate parent, such as the RRVW and TCW, or MRL and IMRL, are not required to report on a consolidated basis.

On the other hand, corporate parents like LTV Corporation, the indirect, non-rail-related parent of all the LTV Steel subsidiary railroads, are already required by FASB-94 to report information on all its subsidiaries on a consolidated basis, which LTV Corporation does. The purpose of the reporting is clear, to provide meaningful information to persons investing in the LTV Corporation. FASB-94 has nothing to do with regulation of the companies.

Yet that is what the strict application of FASB-94, as the Board seems to interpret it, would produce. The thrust of FASB-94 was to amend the 1959 Accounting Statement No. 51, eliminating exceptions under that earlier rule, so as to require the reporting of consolidated information about most subsidiaries. 1987 Accounting Statement No. 94, at ¶¶ FAS 94.05-94.08, 94.13. Thus, if the Board strictly followed FASB-94, it would consolidate the revenues of companies like the non-carrier LTV Corporation, which alone exceeds \$250 million, with the revenue of LTV Steel and its indirect subsidiary carriers. Using this consolidated figure for determining class would achieve the absurd result of

the LTV Steel subsidiary railroad with \$86,000 in annual revenue (MonCon) becoming a class I, not to mention the steel company and LTV Corporation.²⁴ Treating the MonCon as a class II on the basis of its affiliation with its larger siblings' revenues is no less anomalous. FASB-94 does not dictate this result.

Furthermore, although the Board's general policy may be to follow GAAP, its specific policy regarding consolidated reporting has for decades been not to follow GAAP to the extent any such reporting might be required. The consolidation rule is not new. The rule was issued in 1959, 1959 Accounting Statement No. 51, and FASB-94 itself was issued in 1987. During all this time, with a limited exception for class I revenue adequacy reports, the Board has not required railroads to report on a consolidated basis. The Board would be directly reversing this longstanding policy, on which small railroads have come to rely, and contrary to the intent of 49 U.S.C. § 10502.

C. THE PROPOSED RULE WILL HAVE FAR-REACHING, UNINTENDED CONSEQUENCES.

In addition to failing to achieve the Board's goals, the Proposed Rule will work great harm to the affected carriers, contrary to the Board's statutory mandate. As discussed above, the different treatment of small railroads based on their class would be disrupted by the Board's proposal. The Proposed Rule would:

- expose small carriers elevated from class III to class II, or even class I, to labor protection liability that was expressly removed by ICCTA;
- impose accounting and reporting burdens on class II and III carriers elevated to class I, even though the Board previously determined this very burden would outweigh any purported benefit;
- undermine contracts the carriers have entered into in good faith reliance on the Board's longstanding classification system, including the Industry Agreement;

²⁴ See Proposed Rule at 5 n.9 (the parent of commonly controlled railroads would be required to file consolidated reports and, if a family of carriers attained class I status, the family would be required to follow the Board's uniform system of accounts and file various reports).

- make the regulation of small carriers much less flexible;
- increase regulatory costs on small carriers by other agencies, and render certain carriers ineligible for small-carrier set-asides under TEA-21; and
- have a chilling effect on investments, discouraging efficient and capable operators from saving future lines from abandonment.

The net result of all of the above increased regulatory cost and decreased flexibility can only be harmful: prices will increase, in the rare instances where small carriers have the power to raise their rates; service will decrease, as small carriers exhaust resources on the increased costs of regulation; and/or small carriers will become unprofitable and exit the industry. Surely, the Board cannot intend to harm the industry in this manner on the basis of adopting an accounting rule, especially when the rule will not achieve the Board's purposes.

D. THE PROPOSED RULE IGNORES THE FUNDAMENTAL PRINCIPLES OF CORPORATE SEPARATENESS.

The Board, like its predecessor, has long recognized that separate corporate entities created for legitimate business purposes serve important needs in the industry, such as insulating one entity from the financial risks of another, or permitting different ownership groups to join together to invest in lines. I&M Rail Link, LLC – Acquisition and Operation Exemption – Certain Lines of Soo Line Railroad Company d/b/a Canadian Pacific Railway, STB Finance Docket No. 33326, 1997 STB LEXIS 63 (served Apr. 2, 1997).²⁵ In doing so, the Board has fostered the establishment of small affiliated but separate corporations, like those of Commenters. It would be improper for the Board to now discard this longstanding system of corporate separateness and treat wholly distinct

²⁵ See also Mountain Laurel Railroad Company – Acquisition and Operation Exemption – Consolidated Rail Corporation, STB Finance Docket No. 31974, 1998 STB LEXIS 131, at *30 (served May 15, 1998), modified in STB Finance Docket No. 31974, 1998 STB LEXIS 216 (served Aug. 12, 1998).

entities as if they were one, not solely for informational purposes (as FASB-94 does), but for all regulatory purposes.

E. ONE SMALL CARRIER'S AFFILIATION WITH ANOTHER DOES NOT CHANGE THE NATURE OF THE CARRIER AS A SMALL BUSINESS.

The Board has long noted that small carriers usually have no significant impact on competition. See Class Exemption, 1 S.T.B. at 103 (regulation of class III acquisitions is not needed to protect shippers from the abuse of market power); Class Exemptions Under 10901 (similar findings for transactions pursuant to former 49 U.S.C. § 10901), MRL I.C.C.2d at 636 (MRL has little market power). This fact is not changed simply because a small carrier becomes affiliated with another – or is reorganized under a single corporate umbrella for administrative efficiency purposes – provided the carriers continue to operate as distinct entities. Considering an average short line carrier in isolation, one finds it has little or no market power, faces great intermodal competition, serves a discrete geographic area, lacks leverage for negotiating with carriers or shippers, owns little equipment, and has its economic fortunes inextricably tied to a limited number of commodities. The nature of this small railroad does not change simply because it is affiliated with another small carrier like itself. Even with the affiliation, which is almost always with a company in a different geographic zone, the carrier has the same lack of market power, the same intermodal competition, and still serves the same limited products and geographic area. Nothing has changed, except that the investors of the first carrier have also invested in a second. With no change in the nature of the carriers, and

in the absence of a merger of their operations, there should not be any change in their class.²⁶

CONCLUSION

For all of the reasons stated. Commenters request that the Board decline to implement the Proposed Rule.



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Fifth Floor
Washington, DC 20036

Dated: November 27, 2000

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²⁶ Commenters also point out that, where separate carriers have wholly separate operations with no possibility of connecting or interchanging with each other, such carriers should not be treated as a single entity for regulatory purposes – even if the carriers have been consolidated under a single corporate umbrella for purposes of administrative efficiency. To the extent a carrier can make such a showing, the Board should use its exemption authority to treat the operating divisions separately for regulatory purposes.

CONSIST OF INDUSTRY

Railroad Facts is an historical statistical presentation of Class I railroads in the United States. Among the several categories of freight railroads, Class I carriers represent a majority of rail activity. The Surface Transportation Board* (STB), the federal agency responsible for economic regulation of the rail industry, classifies railroads by their level of operating revenue, adjusted annually for inflation. For 1997, the Class I railroads had operating revenue of \$256.4 million or more; Class II had revenues of \$20.5 million to \$256.4 million; and Class III railroads had revenues of less than \$20.5 million. Historically, all three types of railroads had to report financial and operating information to the STB, but reporting requirements were eliminated for non-Class I railroads after 1979.

To fill the information void, the AAR began its own annual survey of non-Class I railroads. Because the AAR found that the smaller railroads have characteristics other than revenues that make them both similar and distinct, it did not adopt the STB revenue classes. Rather, it redefined non-Class I railroads as being either Regional or Local. Regional railroads are line-haul railroads operating at least 350 miles of road and/or earning revenue between \$40 million and the Class I revenue threshold. Local railroads are line-hauls falling below the Regional criteria, plus Switching and Terminal railroads. Industry totals by type of freight railroad for 1997 are shown below.

<u>Railroad</u>	<u>Number</u>	<u>Miles Operated</u>	<u>Employees</u>	<u>Freight Revenue (\$000)</u>
Class I	9	121,670	177,981	\$32,322,291
Regional	34	21,466	10,995	1,611,435
Local	507	28,149	11,741	1,415,730
<u>Total</u>	<u>550</u>	<u>171,285</u>	<u>200,717</u>	<u>\$35,349,456</u>

Class I railroads comprise only 2 percent of the number of railroads in this country, but account for 71 percent of the industry's mileage operated, 89 percent of its employees, and 91 percent of its freight revenue. Statistics for Amtrak (the National Railroad Passenger Corporation), the two largest Canadian freight railroads, and the two largest Mexican railroads appear on pages 77 to 81.

**For simplicity, in this publication, "STB" refers to both the Surface Transportation Board (formed January 1, 1996) and its predecessor, the Interstate Commerce Commission.*

CLASS I RAILROADS - 1997*

*Combined total of: The Burlington Northern and Santa Fe Railway Company; Consolidated Rail Corporation; CSX Transportation; Grand Trunk Western Railroad Inc.; Illinois Central Railroad Company; Kansas City Southern Railway Company; Norfolk Southern Corporation; Soo Line Railroad Company; and Union Pacific Railroad Company.

Plant and Equipment

Miles of road operated	121,670
Miles of road owned	102,128
Freight cars in service	568,493
Locomotives in service	19,684
Net investment, as reported	\$74,196,202,000
Net investment, revenue adequacy	\$54,980,559,000

Financial

Operating revenue	\$33,118,031,000
Operating expenses	\$27,290,643,000
Net railway operating income	\$3,984,016,000
Return on shareholders' equity	9.27%
Return on investment, revenue adequacy	7.56%
Total capital expenditures, road and equipment	\$6,266,330,000

Traffic

Carloads originated	25,016,471
Tons originated	1,585,243,924
Ton-miles	1,348,925,839,000

Employment

Total wages	\$9,235,302,000
Average number of employees	177,981
Hours paid for	455,295,402

THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY - 1997

BNSF

2650 Lou Menk Dr.
Ft. Worth, Texas 76131-2585
(817) 333-2000

Plant and Equipment

Miles of road operated	33,757
Miles of road owned	25,969
Freight cars in service	106,131
Locomotives in service	4,697
Net investment, as reported	\$18,818,899,000
Net investment, revenue adequacy	\$13,893,368,000

Financial

Operating revenue	\$8,408,503,000
Operating expenses	\$6,676,163,000
Net railway operating income	\$1,137,510,000
Return on shareholders' equity	10.38%
Return on investment, revenue adequacy	8.41%
Total capital expenditures, road and equipment	\$2,195,839,000

Traffic

Carloads originated	6,119,788
Tons originated	384,882,036
Ton-miles	424,588,205,000

Employment

Total wages	\$2,331,983,000
Average number of employees	43,468
Hours paid for	111,776,389

KANSAS CITY SOUTHERN RAILWAY COMPANY - 1997



114 West Eleventh Street
Kansas City, Missouri 64105
(816) 983-1303

Plant and Equipment

Miles of road operated	2,845
Miles of road owned	2,633
Freight cars in service	16,197
Locomotives in service	403
Net investment, as reported	\$1,139,683,000
Net investment, revenue adequacy	\$931,746,000

Financial

Operating revenue	\$516,052,000
Operating expenses	\$502,552,000
Net railway operating income	\$27,777,000
Return on shareholders' equity	n.m.
Return on investment, revenue adequacy	3.56%
Total capital expenditures, road and equipment	\$89,943,000

Traffic

Carloads originated	443,910
Tons originated	31,421,460
Ton-miles	19,304,591,000

Employment

Total wages	\$130,337,000
Average number of employees	2,585
Hours paid for	6,441,730

n.m. - not meaningful (negative value)

UNION PACIFIC RAILROAD COMPANY - 1997



1416 Dodge Street
Omaha, Nebraska 68179
(402) 271-5000

Plant and Equipment

Miles of road operated	34,946
Miles of road owned	30,565
Freight cars in service	157,604
Locomotives in service	6,923
Net investment, as reported	\$25,382,792,000
Net investment, revenue adequacy	\$18,370,001,000

Financial

Operating revenue	\$9,800,688,000
Operating expenses	\$8,594,138,000
Net railway operating income	\$882,769,000
Return on shareholders' equity	7.03%
Return on investment, revenue adequacy	5.23%
Total capital expenditures, road and equipment	\$1,850,245,000

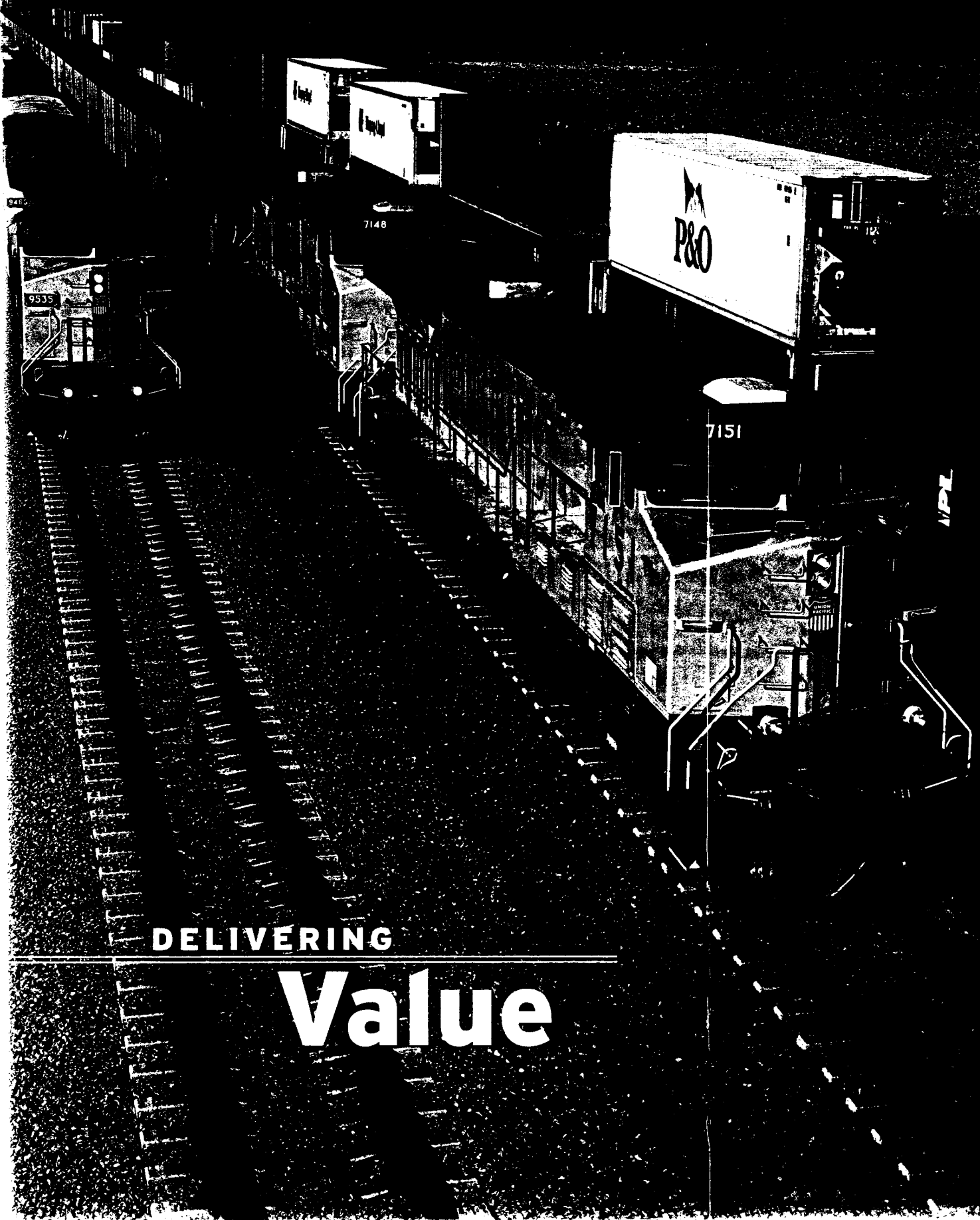
Traffic

Carloads originated	6,849,217
Tons originated	419,677,108
Ton-miles	451,854,919,000

Employment

Total wages	\$2,799,881,000
Average number of employees	52,533
Hours paid for	137,303,808

1999 Union Pacific Annual Report



DELIVERING

Value

FINANCIAL HIGHLIGHTS

Union Pacific Corporation and Subsidiary Companies

◀ On the cover

Intermodal, coal and manifest trains travel along UP's triple track west of Kearney, Nebraska.

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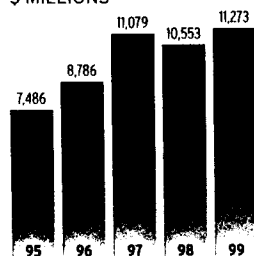
Millions of Dollars, Except Ratios and Per Share Amounts	1999 ^[a]	1998 ^[b]	1997
For the Year			
Operating Revenues	\$11,273	\$10,553	\$11,079
Operating Income (Loss)	1,804	(171)	1,144
Income (Loss) from Continuing Operations	783	(633)	432
Income from Discontinued Operations	27	—	—
Net Income (Loss)	810	(633)	432
Per Share – Basic:			
Income (Loss) from Continuing Operations	3.17	(2.57)	1.76
Income from Discontinued Operations	0.11	—	—
Net Income (Loss)	3.28	(2.57)	1.76
Per Share – Diluted:			
Income (Loss) from Continuing Operations	3.12	(2.57)	1.74
Income from Discontinued Operations	0.10	—	—
Net Income (Loss)	3.22	(2.57)	1.74
Dividends Per Share	0.80	0.80	1.72
Operating Cash Flow	1,869	565	1,600
Capital Investments	1,834	2,111	2,101
At Year-End			
Assets	\$29,888	\$29,374	\$28,860
Total Debt	8,640	8,692	8,518
Common Stockholders' Equity	8,001	7,393	8,225
Equity Per Common Share	32.29	29.88	33.30
Financial Ratios (%)			
Operating Ratio	84.0	101.6	89.7
Debt to Capital Employed	47.6	49.4	50.9
Return on Average Common Stockholders' Equity ...	10.5	(8.1)	5.3

[a] 1999 income from discontinued operations included a one-time, after-tax gain of \$27 million from the adjustment of a liability established in connection with the discontinued operations of a former subsidiary (see Note 3 to the Consolidated Financial Statements).

[b] 1998 operating loss and net loss included a \$547 million pre- and after-tax charge for the revaluation of Overnite goodwill (see Note 1 to the Consolidated Financial Statements).

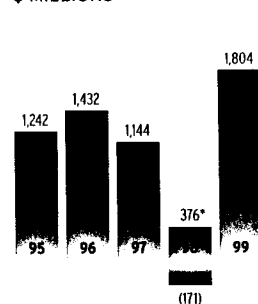
Operating Revenues Union Pacific Corporation

\$ MILLIONS



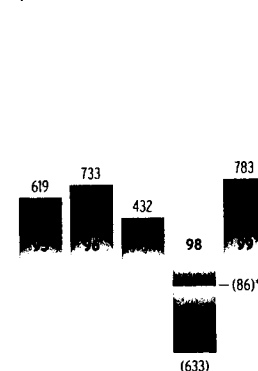
Operating Income Union Pacific Corporation

\$ MILLIONS



Income from Continuing Operations Union Pacific Corporation

\$ MILLIONS



* Excluded \$547 million Overnite goodwill revaluation

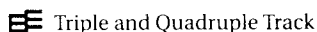
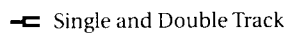
The Union Pacific Franchise

Opening the Roseville yard sped the flow of PNW lumber to meet demand in the rapidly growing Southwest.

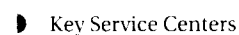
UP's mergers benefited
Midwestern farmers who
found growing demand
for feed grain in Arizona
and California.

On-time performance greater than 95% by year end helped UP move record volumes of western coal.

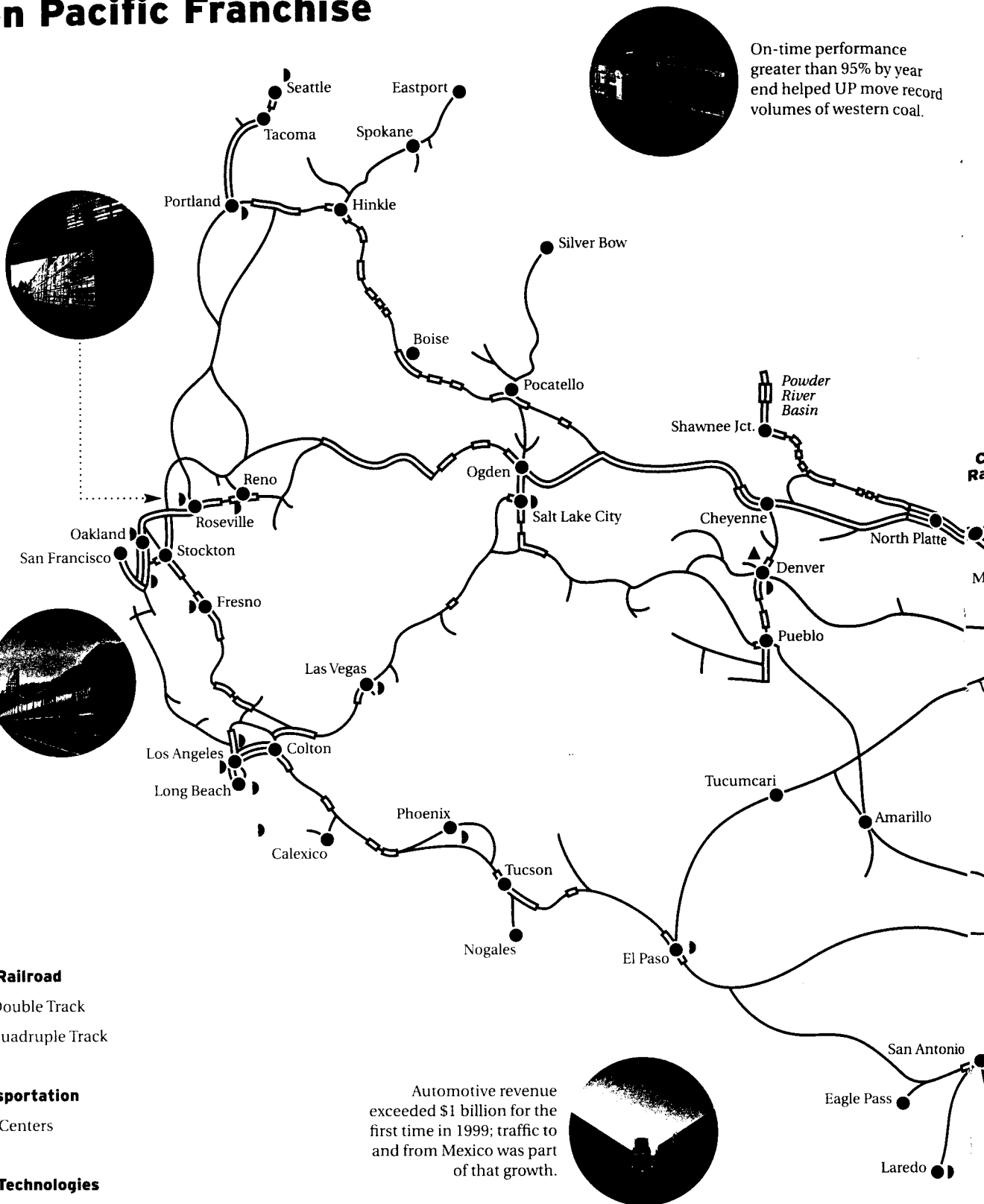
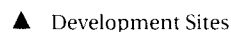
Automotive revenue exceeded \$1 billion for the first time in 1999; traffic to and from Mexico was part of that growth.



Overnite Transportation

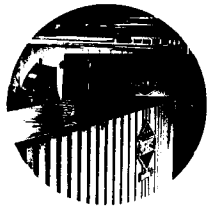
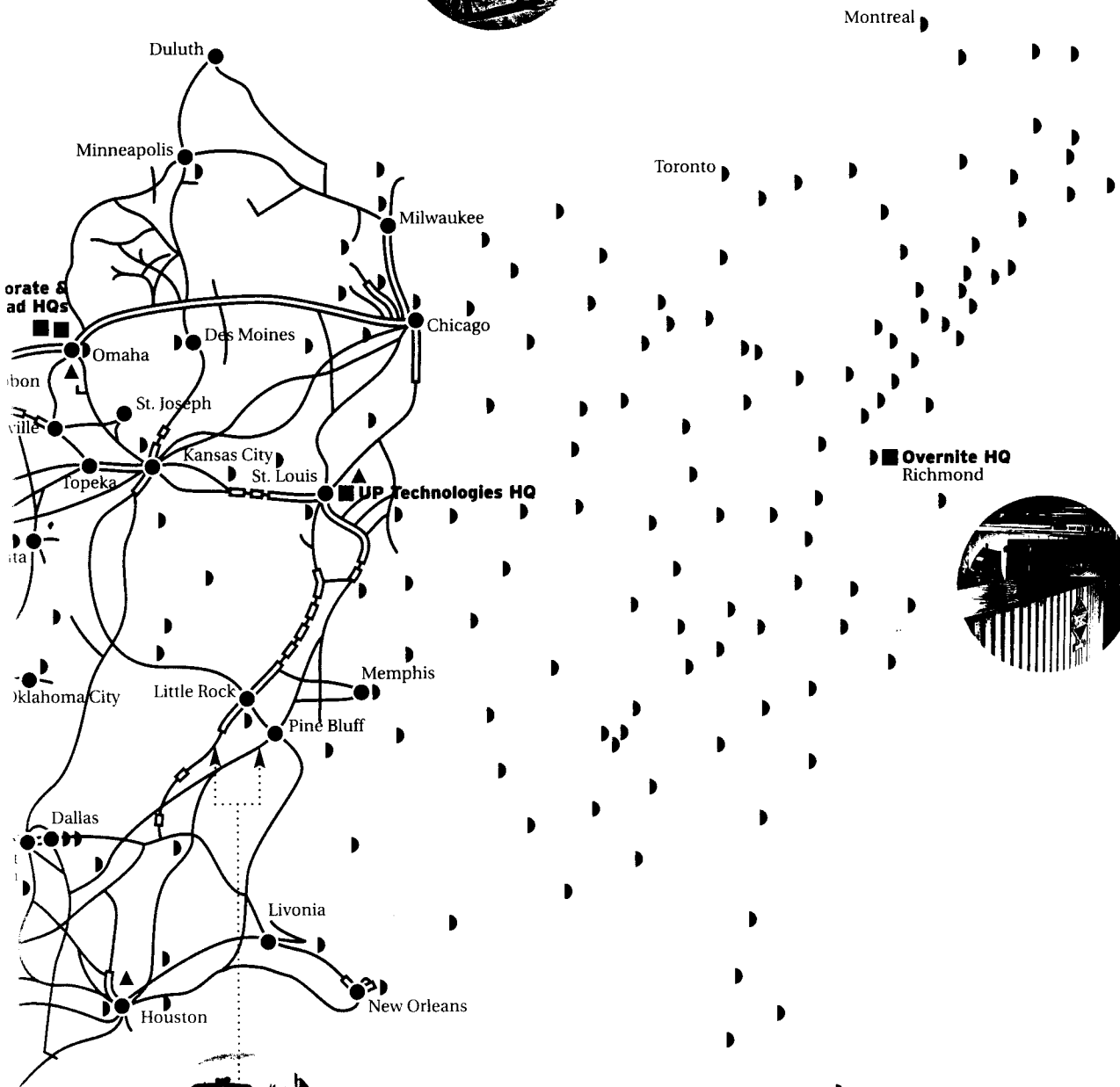


Union Pacific Technologies

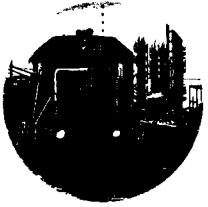




Strong imports led the double-digit growth in intermodal volume.



The success of Advantage Overnite helped Overnite grow the more profitable part of its business.



Directional running between Houston and St. Louis provided faster and more consistent service to UP's Gulf chemical customers.

Brownsville

This review should be read in combination with the consolidated financial statements, notes to the consolidated financial statements and supplementary information.

Union Pacific Corporation (UPC or the Corporation) consists of one reportable segment, rail transportation, and UPC's other product lines (Other Operations). The rail segment includes the operations of Union Pacific Railroad Company (UPRR), its subsidiaries and rail affiliates (collectively, the Railroad). Other Operations include the trucking product line (Overnite Transportation Company or Overnite), as well as the "other" product lines that include technology and self-insurance activities, corporate holding company operations, which largely support the Railroad, and all appropriate consolidating entries (see Note 1 to the Consolidated Financial Statements).

Corporate Structure

In 1999, the Corporation continued implementing its strategy of refocusing on its core rail transportation business. The implementation of this strategy began with the 1994 sale of the Corporation's waste management business. Since then, the Corporation disposed of its oil and gas operations, sold its logistics business and attempted to sell its trucking operations. At the same time, the Corporation invested heavily in rail assets. The Corporation's rail investments included the 1995 purchase of the Chicago and North Western Transportation Company, the 1996 acquisition of Southern Pacific Rail Corporation (Southern Pacific), and the 1997 and 1999 investments in the Pacific-North and Chihuahua Pacific lines in Mexico.

Key strategic transactions in 1999, 1998 and 1997 were as follows:

Mexican Railway Concession – In 1999, the Railroad increased its investment in the Pacific-North and Chihuahua Pacific lines in Mexico. During 1997, the Railroad and a consortium of partners were granted a 50-year concession to operate the Pacific-North and Chihuahua Pacific lines and a 25% stake in the Mexico City Terminal Company at a price of \$525 million. The consortium assumed operational control of both lines in 1998. In March 1999, the Railroad purchased an additional 13% ownership interest for \$87 million from one of its partners. The Railroad now holds a 26% ownership share in the consortium and accounts for the investment under the equity method.

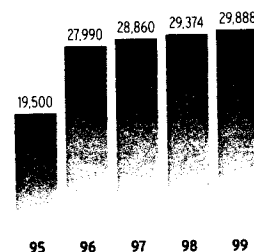
Overnite Divestiture – In May 1998, the Corporation's Board of Directors approved a formal plan to divest of UPC's investment in Overnite through an initial public offering. However, market conditions deteriorated to the point that UPC decided not to consummate the offering.

Skyway – In November 1998, the Corporation completed the sale of Skyway Freight Systems, Inc. (Skyway), a wholly owned subsidiary. Skyway provided contract logistics and supply chain management services. The proceeds were used to repay outstanding debt. The sale of Skyway generated a net after-tax loss of \$50 million, of which \$40 million was recognized in 1997 (see Notes 3 and 13 to the Consolidated Financial Statements).

Southern Pacific – During 1999, UPC continued its integration of Southern Pacific's rail operations. This process is expected to be completed over the next 24 months (see Note 2 to the Consolidated Financial Statements). UPC consummated the acquisition of Southern Pacific in September 1996 for \$4.1 billion. Sixty percent of the outstanding Southern Pacific common shares were converted into UPC common stock and the remaining 40% of the outstanding shares were acquired for cash. UPC initially funded the cash portion of the acquisition with credit facility borrowings, all of which have been subsequently refinanced with other borrowings. The acquisition of Southern Pacific has been accounted for using the purchase method.

Assets
Union Pacific Corporation

\$ MILLIONS



Key Measures – Net income (excluding the one-time revaluation of goodwill at Overnite) as a percentage of operating revenue declined to (0.8)% from 3.9% in 1997. Return on average common stockholders' equity (excluding the one-time revaluation of goodwill at Overnite) dropped to (1.1)% in 1998 from 5.3% in 1997, reflecting the impact of congestion at the Railroad. In addition, the Corporation's operating ratio, excluding the one-time revaluation of goodwill, was 96.4% in 1998 compared to 89.7% in 1997.

Rail

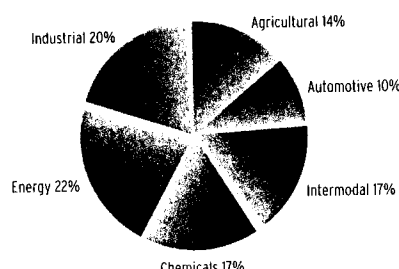
Service Recovery – Congestion in and around Houston and the coastal areas of Texas and Louisiana (the Gulf Coast region) began in the third quarter of 1997. System congestion started in the Gulf Coast region and spread throughout the system during the third and fourth quarters of 1997, and continued to adversely affect the Railroad's operations and financial results in 1998. In response to its operational difficulties, the Railroad adopted certain measures beginning in 1997 designed to alleviate the congestion problems and improve the efficiency and flexibility of rail operations. To ease system congestion, the Railroad focused on reducing the number of cars on the system and restoring system velocity by hiring additional train and engine employees, accelerating and expanding locomotive purchases and leases, improving management of train crews, and using outside carriers for haulage and train switching in congested areas. In 1998, these efforts were supplemented by the institution of directional running in parts of the Gulf Coast region, establishment of a joint dispatching center in Texas, and extensive track maintenance and capacity expansion efforts in UPRR's Central Corridor and southern tier. While in some cases the Railroad's actions temporarily slowed service, they resulted in improved system velocity. Also in 1998, UPRR instituted several key initiatives including a new long-term strategy to improve the effectiveness of the organization. This effort focused on culture change, business process improvement and decentralization, each of which was designed to improve customer satisfaction, increase employee involvement and improve operational efficiency and financial results. The combination of all of the steps described above (the service recovery process) allowed the Railroad to alleviate congestion and improve operations throughout its system. However, despite these improvements, the Railroad's operations and financial results were significantly impacted by congestion in 1998.

Weather and Other Congestion Issues – During 1998, service in the Railroad's Central Corridor between Chicago and Utah was slowed by track maintenance and capacity expansion work. The Railroad also experienced congestion on its lines in northern California, in the Los Angeles Basin and on the Sunset Route west of El Paso, Texas. This was caused in part by two derailments that occurred in July 1998, tight crew supply and limited track capacity in that region, and the learning curve associated with the integration of the computer system of Southern Pacific in the region with the Railroad's computer system, which commenced in July 1998. The Railroad alleviated this congestion by various measures, including temporarily rerouting trains from this region to other portions of its system. Late in the third quarter and early in the fourth quarter of 1998, the Railroad's operations were also adversely affected by severe weather in the southern portion of its system, including Hurricane Georges, which disrupted operations in New Orleans and other parts of Louisiana at the end of September, heavy rains that moved from northern Texas through Oklahoma and into the Kansas City area in early October, heavy rains that resulted in severe flooding in central and southern Texas later in October, and heavy rains and flooding across parts of Oklahoma and Kansas in early November. The Railroad was able to respond quickly to these problems by rerouting traffic, repairing damages caused by washouts and restoring service without severe or lengthy disruptions to the Railroad's operations, which reflected the success of the Railroad's service recovery process in addressing service and congestion problems. Despite these external difficulties, the Railroad was able to recoup the financial loss generated in the first half of 1998 and reported net income for the full year of 1998.

Net Income – The Railroad returned to profitability in the third quarter of 1998, by posting net income of \$67 million after three consecutive quarterly losses, and continued its earnings improvement in the fourth quarter of 1998, posting net income of \$114 million, as the Railroad began to see the benefits of implementing its service recovery process. Despite service improvements in the second half of 1998, year-over-year results were significantly affected by the congestion problems discussed above. As a result, the Railroad reported net income of \$27 million in 1998 compared to \$620 million in 1997.

1998 Commodity Revenue Mix Union Pacific Railroad

TOTAL REVENUE: \$9.1 BILLION



Operating Revenues – 1998 rail operating revenues were down \$613 million over 1997 (6%) to \$9.4 billion. Revenue carloads for 1998 of 8.0 million were down 5% from 1997 loads of 8.5 million. These declines resulted from system congestion, which significantly lowered overall train velocity and efficiency, weakening demand for whole grain exports (due to strong worldwide crop yields), and a soft export market caused by the Asian economic crisis. Average revenue per car was down 1% for 1998 at \$1,134 per car from \$1,149 in 1997, driven by a shift in corn shipments from long-haul Pacific Northwest moves to shorter-haul Gulf Coast traffic and large volumes of empty repositioning moves for intermodal traffic, partially offset by longer-haul coal traffic.

The following tables summarize the year-over-year change in rail commodity revenue, carloads and average revenue per car by commodity type:

Commodity Revenue In Millions of Dollars	1998	1997	Change
Agricultural	\$1,303	\$1,438	(9)%
Automotive	937	950	(1)%
Chemicals	1,535	1,715	(10)%
Energy	1,996	1,914	4 %
Industrial Products	1,785	1,954	(9)%
Intermodal	1,516	1,741	(13)%
Total	\$9,072	\$9,712	(7)%

Revenue Carloads In Thousands	1998	1997	Change
Agricultural	840	907	(7)%
Automotive	641	638	-
Chemicals	899	972	(8)%
Energy	1,767	1,736	2 %
Industrial Products	1,320	1,430	(8)%
Intermodal	2,531	2,770	(9)%
Total	7,998	8,453	(5)%

Average Revenue Per Car	1998	1997	Change
Agricultural	\$1,552	\$1,585	(2)%
Automotive	1,461	1,490	(2)%
Chemicals	1,708	1,764	(3)%
Energy	1,130	1,102	3 %
Industrial Products	1,352	1,366	(1)%
Intermodal	599	629	(5)%
Total	\$1,134	\$1,149	(1)%

Agricultural – Revenue fell 9% for 1998, as loads finished down 7% and average revenue per car decreased 2%. Low export demand due to strong worldwide crop yields, the Asian economic crisis and falling corn prices caused a decline in corn volumes. System congestion limited traffic for canned and packaged products, fresh fruit and vegetables, beverages, frozen products and food grains. Livestock feed declined 16%, as feed additives were replaced by less expensive corn. These volume declines were partially offset by higher wheat and meals and oils traffic. Average revenue per car declined 2%, as a result of a drop in longer-haul Pacific Northwest corn moves, due to weak export markets.

Automotive – Revenue was down 1%, reflecting flat volume and a 2% decrease in average revenue per car. Finished vehicles volumes were up 3%, reflecting new business and growth in existing business, partially mitigated by the effects of an automotive strike in mid-1998. Parts volumes lost 4% year-over-year as volumes fell because of the Railroad's equipment shortages. Average revenue per car fell 2%, as a result of the new business that generated a shorter length of haul than existing business.

Chemicals – Carloads fell 8%, and revenues dropped 10% compared to 1997. Congestion-related diversions to truck, barge and other railroads plagued most business lines (especially liquid and dry chemicals and petroleum products). Liquid propane gas traffic was hurt by the introduction of new pipelines, while the Asian crisis significantly reduced the movements of soda ash. In addition, an unplanned furnace shutdown reduced shipments of phosphorous. The 3% decline in average revenue per car was largely due to more short-haul storage-in-transit moves, fewer high-average revenue per car liquid and dry chemical and soda ash moves, and the loss of long-haul business due to system congestion.

STATEMENT OF CONSOLIDATED INCOME

Union Pacific Corporation and Subsidiary Companies

	Millions of Dollars, Except Per Share Amounts	1999	1998	1997
Operating Revenues	Rail, trucking and other	\$11,273	\$10,553	\$11,079
Operating Expenses	Salaries, wages and employee benefits [Note 9] ..	4,285	4,348	4,166
	Equipment and other rents	1,336	1,426	1,404
	Depreciation and amortization [Notes 1 and 5] ..	1,083	1,070	1,043
	Fuel and utilities [Note 4]	832	843	1,042
	Materials and supplies	590	565	560
	Goodwill impairment [Note 1]	—	547	—
	Casualty costs	378	475	478
	Other costs	965	1,450	1,242
	Total	9,469	10,724	9,935
Income	Operating Income (Loss)	1,804	(171)	1,144
	Other income [Note 13]	131	189	137
	Interest expense [Notes 4 and 7]	(733)	(714)	(605)
	Income (Loss) before Income Taxes	1,202	(696)	676
	Income taxes [Note 6]	(419)	63	(244)
	Income (Loss) from Continuing Operations	783	(633)	432
	Income from Discontinued Operations [Note 3] ..	27	—	—
	Net Income (Loss)	\$ 810	\$ (633)	\$ 432
Per Share [Note 11]	Basic:			
	Income (Loss) from Continuing Operations ...	\$ 3.17	\$ (2.57)	\$ 1.76
	Income from Discontinued Operations	0.11	—	—
	Net Income (Loss)	\$ 3.28	\$ (2.57)	\$ 1.76
	Diluted:			
	Income (Loss) from Continuing Operations ...	\$ 3.12	\$ (2.57)	\$ 1.74
	Income from Discontinued Operations	0.10	—	—
	Net Income (Loss)	\$ 3.22	\$ (2.57)	\$ 1.74
	Dividends	\$ 0.80	\$ 0.80	\$ 1.72

The accompanying accounting policies and notes to the financial statements are an integral part of these statements.

The accompanying accounting policies and notes to the financial statements are an integral part of these statements.

Significant Accounting Policies

Principles of Consolidation – The consolidated financial statements include the accounts of Union Pacific Corporation (the Corporation or UPC) and all of its subsidiaries. Investments in affiliated companies (20% to 50% owned or where UPC exercises significant influence over an investee's operations) are accounted for on the equity method. All material intercompany transactions are eliminated.

Cash and Temporary Investments – Temporary investments are stated at cost that approximates fair value and consist of investments with original maturities of three months or less.

Inventories – Inventories consist of materials and supplies carried at the lower of cost or market.

Property and Depreciation – Properties are carried at cost. Provisions for depreciation are computed principally on the straight-line method based on estimated service lives of depreciable property.

The cost (net of salvage) of depreciable rail property retired or replaced in the ordinary course of business is charged to accumulated depreciation. A gain or loss is recognized in other income for all other property upon disposition.

The cost of internally developed software is capitalized and amortized over a five-year period. An obsolescence review of capitalized software is performed on a periodic basis.

Intangible Assets – Amortization of costs in excess of the fair value of net assets of acquired businesses is generally recorded over 40 years on a straight-line basis. The Corporation regularly assesses the recoverability of its enterprise level goodwill through a review of discounted cash flows.

Revenue Recognition – Transportation revenues are recognized on a percentage-of-completion basis, while delivery costs are recognized as incurred.

Hedging Transactions – The Corporation periodically hedges fuel purchases and interest rates. Unrealized gains and losses from fuel-related swaps, futures and forward contracts are deferred and recognized as the fuel is consumed. The differential to be paid or received on interest rate swaps is accrued as interest rates change

and recognized as interest expense over the life of the agreements. The effect of extinguishments, maturities, terminations and sales is recorded in earnings in the period the instrument terminates (Note 4).

Earnings Per Share – Basic earnings per share (EPS) is calculated on the weighted-average number of common shares outstanding during each period (Note 11). Diluted earnings per share include shares issuable upon exercise of outstanding stock options (Note 10) and the potential conversion of the preferred securities (Note 7) where the conversion of such instruments would be dilutive.

Use of Estimates – The consolidated financial statements of the Corporation include estimates and assumptions regarding certain assets, liabilities, revenues and expenses and the disclosure of certain contingent assets and liabilities. Actual future results may differ from such estimates.

Change in Presentation – Certain prior year amounts have been reclassified to conform to the 1999 financial statement presentation.

1. Operations and Segmentation

Union Pacific Corporation consists of one reportable segment, rail transportation, and UPC's other product lines (Other Operations). The rail segment includes the operations of the Corporation's wholly owned subsidiary, Union Pacific Railroad Company (UPRR) and UPRR's subsidiaries and rail affiliates (the Railroad). Other Operations include the trucking product line (Overnite Transportation Company or Overnite), as well as the "other" product lines that include technology, self-insurance activities, corporate holding company operations, which largely support the Railroad, and all appropriate consolidating entries.

Rail

Operations – The Corporation's only reportable segment is the Railroad, including as of May 1, 1995, Chicago and North Western Transportation Company (CNW), and as of October 1, 1996, Southern Pacific Rail Corporation (Southern Pacific or SP). In addition, during 1997, the Railroad and a consortium of partners were granted a 50-year concession to operate the Pacific-North and Chihuahua Pacific lines in Mexico (Note 2). The Railroad made an additional investment in the consortium in 1999.

The Railroad has over 33,000 route miles linking Pacific Coast and Gulf Coast ports to the Midwest and eastern United States gateways and providing several north/south corridors to key Mexican gateways. The Railroad serves the western two-thirds of the country and maintains coordinated schedules with other carriers for the handling of freight to and from the Atlantic Coast, the Pacific Coast, the Southeast, the Southwest, Canada and Mexico. Export and import traffic is moved through Gulf Coast and Pacific Coast ports and across the Mexican and (primarily through interline connections) Canadian borders. The Railroad is subject to price and service competition from other railroads, motor carriers and barge operators. The Corporation expects to complete the integration of the operations of Southern Pacific over the next 24 months.

Employees – Approximately 87% of the Railroad's 52,000 employees are represented by rail unions. During 1996, nearly all of UPRR's unionized workforce ratified five-year national agreements, which include a combination of general wage increases and lump-sum payments. In addition, the agreements provide for increased flexibility in work rules. Negotiations under the Railway Labor Act for a new national agreement for all crafts began in late 1999 and are in the initial stages. Under the conditions imposed by the Surface Transportation Board of the U.S. Department of Transportation (STB) in connection with the Southern Pacific acquisition, labor agreements between the Railroad and the unions representing SP employees must be negotiated before the UPRR and SP rail systems can be fully integrated. The Railroad has successfully reached agreements with the shopcraft, carmen, clerical and maintenance-of-way unions. By the end of 1999, negotiations with other operating crafts were nearly complete, with only one hub-and-spoke agreement (Los Angeles) left to implement in early 2000. The terms of ratified and pending labor agreements are not expected to have a material adverse effect on the Corporation's results of operations.

Other Operations

Trucking Product Line

Operations – Overnite Transportation Company, a wholly owned subsidiary of the Corporation, is a major interstate trucking company specializing in less-than-truckload shipments. Overnite serves all 50 states and portions of Canada and Mexico through 166 service centers located throughout the United States. Overnite transports a variety of products including machinery, tobacco,

textiles, plastics, electronics and paper products. Overnite experiences intense service and price competition from both regional and national motor carriers.

Employees – As one of the nation's largest predominantly non-union single operating trucking companies, Overnite is periodically targeted at many of its service centers by major labor organization efforts instituted by the International Brotherhood of Teamsters (Teamsters). The Teamsters conducted a brief job action in July 1999 and began another job action in October 1999 that continued into 2000. Since year-end 1994, Overnite has received 90 petitions for union elections at 67 of its 166 service centers. Twenty-two service centers, representing approximately 14% of Overnite's 13,000 employee nationwide workforce, voted for union representation; and the Teamsters have been certified and recognized as the bargaining representative for such employees. Eleven of these locations filed decertification petitions in 1999. Elections affecting approximately 400 additional employees are unresolved, and there are no elections currently scheduled. Additionally, proceedings are pending in certain cases where a Teamsters' local union lost a representation election. To date, Overnite has not entered into any collective bargaining agreements with the Teamsters.

Operational Initiatives – During 1999, 1998 and 1997, Overnite benefited from several initiatives aimed at better matching its operations to the trucking industry environment. These actions included workforce reductions, service center consolidations, centralization of the line-haul management process and pricing initiatives targeting Overnite's lowest margin customers. Overnite has also benefited from growth in its customer base generated by continuing improvements in its service levels.

Attempted Sale of Overnite – In May 1998, the Corporation's Board of Directors approved a formal plan to divest of UPC's investment in Overnite through an initial public offering. However, market conditions deteriorated to the point that UPC decided not to consummate the offering.

Goodwill Revaluation – During 1998, the Corporation changed its method of measuring impairment of enterprise level goodwill from an undiscounted cash flow method to a fair value method based on discounted cash flows. The Corporation believes that a discounted cash flow approach is preferable since it provides a more current and realistic valuation than the undiscounted method and more closely matches Overnite's fair value. In connection with the change in accounting policy with respect to measurement of goodwill impairment described above, \$547 million of goodwill related to the

Equipment

	1999	1998	1997
Owned or leased at year-end:			
Locomotives	6,974	7,083	6,966
Freight cars:			
Covered hoppers	39,212	40,097	41,149
Boxcars	20,864	23,263	24,718
Open-top hoppers	19,828	20,324	20,674
Gondolas	18,099	17,828	16,083
Other	16,726	18,264	17,143
Work equipment	9,927	9,218	10,045
Purchased or leased during the year:			
Locomotives	187	256	276
Freight cars	453	2,120	1,525
Average age of equipment (years):			
Locomotives	15.4	14.4	14.4
Freight cars	19.3	20.1	19.3
Bad order ratio – freight cars ...	5.4%	4.5%	4.4%

Track

Miles	1999	1998	1997
Main line	26,963	27,197	27,421
Branch line	6,378	6,509	7,526
Yards, sidings and other main lines	21,660	21,597	21,588
Total	55,001	55,303	56,535
Track miles of continuous welded rail at year-end	24,771	23,647	23,392
Track miles under centralized traffic control at year-end ...	16,199	15,944	15,590
Track miles of rail replaced:			
New	950	858	716
Used	444	341	273
Track miles re-ballasted	4,579	3,259	3,557
Ties replaced (thousands)	3,293	2,691	3,853

Rail Operations

	1999	1998	1997
Operating ratio (%)	82.1	95.4	87.4
Carloads (thousands)	8,556	7,998	8,453
Average commodity revenue per car	\$1,151	\$1,134	\$1,149
Average price of diesel fuel per gallon	56¢	62¢	71¢

Trucking

Freight Operations

	1999	1998	1997
Shipments (thousands):			
Less-than-truckload	7,686	7,768	7,482
Truckload	22	21	24
Total	7,708	7,789	7,506
Tonnage (thousands):			
Less-than-truckload	3,974	3,983	3,841
Truckload	224	226	269
Total	4,198	4,209	4,110
Revenue per hundredweight ...	\$12.26	\$11.98	\$11.24
Operating ratio (%) ^[a]	98.1	94.8	96.8

[a] Excluded goodwill amortization and the \$547 million one-time goodwill revaluation charge in 1998 and goodwill amortization in 1998 and 1997.

Equipment and Service Centers

	1999	1998	1997
Owned or leased at year-end:			
Tractors	5,288	4,839	4,799
Trailers	20,111	19,460	19,439
Straight trucks	77	77	77
Automobiles and service units	158	160	162
Service centers	166	165	164
Average age of equipment (years):			
Tractors	6.0	6.8	7.1
Trailers	9.0	8.4	8.7

Capital Expenditures

Millions of Dollars	1999	1998	1997
Revenue equipment	\$36	\$33	\$24
Other	19	26	16
Total	\$55	\$59	\$40

AGREEMENT WITH AMERICAN SHORT LINE AND REGIONAL RAILROAD ASSOCIATION signed 9/10/98.

RAILROAD INDUSTRY AGREEMENT

(Note: This copy of the agreement may have minor format changes to suit the medium)

I. BACKGROUND

On April 2 and 3, 1998, the Surface Transportation Board ("STB") conducted two days of informational hearings to examine issues of rail access and competition in today's railroad industry.

In Ex Parte No. 575, the STB described the areas of concern expressed by the Short Line Railroads:

"Paper Barriers"--Contractual obligations incurred when Short Line carriers acquired lines from larger, connecting carriers;

Inadequate car supply; and

Lack of alternative routings.

The STB noted that private-sector negotiations were already underway and urged the parties to resolve these issues expeditiously.

In order to promote a stronger rail industry, this Railroad Industry Agreement ("Agreement") is entered into by the Association of American Railroads ("AAR") on behalf of participating Large Railroads (Class I carriers as defined by the regulations of the STB who subscribe to this Agreement) and by the American Short Line and Regional Railroad Association ("ASLRRA") on behalf of participating Small Railroads (Class II and III rail carriers as defined by the regulations of the STB who subscribe to this Agreement).

II. DEFINITIONS AND OTHER NOTES

For purposes of this Agreement and accompanying attachments, the following apply:

"Access" means interchange, intermediate switching, or haulage (or trackage rights at grantor's option);

No new Access to industries, shippers or receivers not now served is granted or created; all Access is Railroad to Railroad;

Carrier providing interchange, switching, haulage, trackage rights, or other service will be entitled to fair compensation for use of its facilities and/or services;

"New Traffic" means traffic that (1) is not now moving by rail (except for reasons of seasonality or unusual disruptions of shipping patterns outside the control of the Large Railroad, such as plant shutdowns) and (2) does not unreasonably negatively impact

the Large Railroad.

"Congestion Problem" means that Access to or through a terminal, or to or via a track segment, need not be granted because incremental traffic caused by the New Traffic cannot be handled without causing unreasonable interference with the owner's operations. If the interference can be reasonably remedied by additional facilities and/or services, the carrier seeking Access is entitled to such facilities and/or services, provided it pays fair compensation;

"Short Line" ("SL") is a Class III railroad;

"Small Railroad" ("SRR") is a Class II or III railroad;

Large Railroad" ("LRR") is a Class I railroad;

"Non-Short Line" ("Non-SL") is a Class I or II railroad.

"Railroad" ("RR") is a Class I, II or III railroad.

III. PRINCIPLES OF RELATIONSHIP

The parties agree that this Agreement shall be guided by the following public policy principles:

General

Laws and regulations must be consistent with the fundamentals of rail economics.

That was the genius of Staggers reforms such as permitting differential pricing, authorizing contracts and allowing most rates to be set by the market led to a rail renaissance.

Private sector solutions are best. Railroads and shippers are better served with market based solutions. Parties should turn to government only when the market cannot operate effectively and then only when private negotiations fail.

U.S. freight railroads are the most efficient in the world and wholesale changes in how they are regulated should not be made in the absence of compelling evidence of significant problems. American railroads form the world's most efficient rail system and contribute to the international growth and competitiveness of U.S. industry. It is not sound public policy to mandate major changes unless there are serious problems and proven alternatives.

Large and Small Railroads are integral to the provision of rail service in the U.S. The business common to each is a collective effort for the benefit of both Large and Small Railroads and the railroad shipping public, made possible by the unique contributions of each.

Small Railroads deserve fair and workable solutions. When a Small Railroad has a legitimate grievance, the available remedy should be as fair, quick and inexpensive as possible, particularly for minor disputes. Arbitration should be available to settle most matters.

Paper Barriers

Only legitimate "paper barriers" should be enforceable. Paper barriers are restrictions on interchange imposed by contract at the time of the creation of the Short Line.

Legitimate paper barriers are those that are designed as fair payment for the sale or rental value of the line that created the Short Line. Such barriers should not restrict the Short Line's ability to develop New Traffic with another carrier if the selling or leasing Large Railroad can not or will not participate in the New Traffic. Excessive per car charges or other penalties imposed if a car is interchanged to another Large Railroad (other than legitimate paper barriers) are unreasonable and should not be permitted.

Routing Alternatives and Access

Rail networks should be operated to maximize the efficiency of the network for ALL its users. A law or regulation that requires a Railroad to put the needs of the few ahead of the overall needs of the network is not sound public policy. Both Large and Small Railroads are dependent on interchanges and manifest train schedules.

A Large Railroad seller/lessor should not be able to block a Short Line's reasonable attempts to gain New Traffic that the Large Railroad cannot handle or for which it cannot offer a competitive package. The Short Line's attempt to gain New Traffic is not reasonable, however, if (1) the incremental traffic caused by the new business cannot be handled without causing unreasonable interference with the Large Railroad's operations; or (2) the Large Railroad is not adequately compensated for use of its tracks, yards and other facilities necessary to accommodate the traffic between the Short Line and another Railroad; or (3) the traffic of the Large Railroad is negatively impacted by such action.

Rail revenues, service and routing choices are intertwined. Railroads are networks that require huge amounts of capital investment in order to function most efficiently. A law or regulation that reduces a Railroad's ability to invest in infrastructure is not sound public policy.

Car Supply

Car supply is a problem of mutual concern to Small and Large Railroads. The answer should not lie in government regulation, but in private industry negotiation.

IV. PRINCIPLES OF AGREEMENT

1. Car Supply Policy (applies to all participating Class I, II and III Railroads)

A joint committee of senior representatives of Large and Small Railroads will meet to explore opportunities where they can work together to meet customers' car supply needs for existing and new business. In general, this committee will examine a long list of potential cooperative policies and innovative programs that will enhance car supply within the bounds of sound business principles and appropriate return on investment. A detailed protocol for car supply is attached as Exhibit A.

2. Cooperative Service Actions (applies to all participating Class I, II and III Railroads)

Large and Small Railroads agree to develop and implement Interchange Service Agreements ("ISA's") with each other to include standards for service and measurements to be used to manage improvement. Regular meetings between Large and Small Railroad corporate and operating personnel will be scheduled to resolve issues and improve service to customers. A more detailed protocol governing service is attached as Exhibit B.

3. Paper Barriers and New Routes (applies to participating Class I and III Railroads)

a) General Premise: *If the requested Access or routing helps the connecting Short Line*

and does not harm the Large Railroad, then the request should be approved as it will improve shipper rail service while strengthening the rail industry.

b) Paper Barriers and New Routes: The Large and Short Line Railroads agree to work cooperatively to increase rail freight business. Joint initiatives designed to increase Short Line freight business under certain circumstances include, but are not limited to, waiver of contractual interchange restrictions and Large Railroad haulage of Short Line traffic. See Exhibit C (Examples 1-7).

In other cases, Large and Short Line Railroads may voluntarily agree at any time to renegotiate the terms of sale agreements including, but not limited to, terms relating to limitations on interchange (legitimate paper barriers). The renegotiations of limitations on interchange shall include consideration of additional compensation due to the Large carrier reflecting changes to the economic and market assumptions made by the Large and Short Line carriers at the time of original sale based upon the limitations on interchange at the time of such sale as well as all other relevant factors.

4. Switching, Heavy Axle Loads, and Certain Rate Policies (applies to all participating Class I, II and III Railroads)

a) Switch Charges:

i) General Premise: *The Large and Small Railroads agree that, subject to (iii) and (iv) below, existing (or future) intermediate and reciprocal switching charges between Large and Small carriers shall be comparable to existing (or future) charges between Large Railroads in similar circumstances and conditions.*

ii) Any intermediate (switching between carriers) or reciprocal (switching between customer and carrier) switch charges existing between Large and Small Railroads on or after the effective date of this agreement shall be comparable to existing charges between Large Railroads in similar circumstances and conditions. See Exhibit D (Examples 8 - 12).

iii) This provision will not grant reciprocal switch Access for any carrier to any industry for which Access is not otherwise provided.

iv) This provision shall not apply with respect to any switch charges that are the subject of any administrative or judicial proceeding as of the date of this Agreement.

b) Heavy Axle Loads: With the growth of heavy axle load rolling stock (286,000 lbs. or greater), the Large Railroads agree to proportionately increase the Small Railroad share of the increase, if any, in overall revenue for handling heavy axle loads to reflect tonnage in situations where traffic is priced on a per-car basis for the Small Railroad.**

**Subsection IV(4)(b), Heavy Axle Loads, shall not apply to Montana Rail Link, Inc.: provided that this carve-out is without prejudice to the rights of Burlington Northern Santa Fe or Montana Rail Link, Inc. under their existing agreement..

c) Certain Rates Policies:

i) General Premise: *The Large and Small Railroads commit to provide market-based competitive pricing for their customers, regardless of whether located on a Class I or connecting Small Railroad, that is non-discriminatory under similar circumstances and conditions.*

ii) Recognizing that the establishment of rate and service levels are matters of individual rather than collective consideration, assessment of market conditions upon which joint

line price levels are based will reflect consideration of capital and/or operating savings for the Large Railroads resulting from services provided by the Small Railroads in the route. See Exhibit E for the sole application of this subsection(c).

V. APPLICATION

All sections of this Agreement apply to Large Railroads (Class I) and Short Line Railroads (Class III) that indicate their participation by individual subscription to this Agreement. All sections of this Agreement except Section (IV)(3) Paper Barriers and New Routes apply to Class II Railroads that indicate their participation by individual subscription to this Agreement. All items provided for in this Agreement shall be binding upon all participating Railroads. Any relief available to any party under this Agreement shall be prospective only. To the extent that relief is granted by an arbitrator pursuant to the terms of this Agreement, such relief shall be limited solely to the period commencing on or, at the arbitrator's discretion, after the date that the subject arbitration proceeding was initiated.

VI. ARBITRATION

The participating Large and Small Railroads agree that if they have a dispute arising under Sections (IV)(3)--"Paper Barriers and New Routes" or Section (IV)(4)--"Switching, Heavy Axle Loads, and Certain Rate Policies" of this Agreement that cannot be resolved through discussion and negotiation between the parties involved, the parties will submit any unresolved issues to arbitration under the auspices of the STB (Ex Parte No. 560). Such arbitration will be based on the policies and principles of those sections of this Agreement, and to the extent applicable, the associated examples and exhibits, and will be binding on the parties.

VII.SENIOR POLICY COMMITTEE

A joint "Senior Policy Committee" shall be created to provide oversight, review, and, if applicable, non-binding recommendations on all matters relating to the relationship between Large Railroads and Small Railroads created by this Agreement and on all policy aspects and issues relating to the application and effects of this Agreement. This Senior Policy Committee shall be comprised of six members consisting of the Chief Executive Officers of the AAR, the ASLRRRA, two Large Railroads (to be designated by the Large Railroads) and two Small Railroads (to be designated by the Small Railroads). It shall meet semi-annually and, in addition, at any time upon the request of any member of the Committee or upon notification from a participant of its intent to withdraw from this Agreement. The Senior Policy Committee shall not have authority to set rates or charges or reach any agreement respecting rate-related matters.

VIII.AMENDMENT AND TERM

(a) The parties to this Agreement recognize that changes may occur which require modification of the terms of the Agreement. In the event of such changes, the parties agree that they will negotiate in good faith to modify appropriately the Agreement.

(b) The initial term of this Agreement shall be for a period of five years from the date hereof. The provisions of Section IV(4), including Exhibits D and E, shall not become

effective until the Board has entered an order approving those provisions pursuant to 49 U.S.C. § 10706. After the initial term, this Agreement shall remain in effect for additional successive one-year terms; provided, however, that during any such additional term, any party to this Agreement may withdraw from participation in this Agreement, only if such party has first (i) presented the reason(s) for such withdrawal to the Senior Policy Committee and (ii) provided 90 days written notice to the AAR and the ASLRRA.

The parties agree to the policies, principles and procedures stated herein and to advise the Surface Transportation Board of this Railroad Industry Agreement. Individual Large and Small Railroads will indicate their acceptance of this Agreement by executing a separate document indicating their agreement to subscribe to and be bound by the terms and conditions of this Agreement.

For the Large Railroads: For the Small Railroads:

Edward R. Hamberger (AAR) William E. Loftus (ASLRRA)

Date: Date:

LIST OF EXHIBITS

Exhibit A: *Car Supply Protocol* (applies to all participating Class I, II, and III Railroads)

Exhibit B: *Service Policy Protocol* (applies to all participating Class I, II and III Railroads)

Exhibit C: *Guidelines for Paper Barriers and New Routes* (applies to all participating Class I and III Railroads)

Exhibit D: *Guidelines for Intermediate and Reciprocal Switching* (applies to all participating Class I, II and III Railroads)

Exhibit E: *Guidelines for Certain Rate Policies* (applies to all participating Class I, II and III Railroads)

DEFINITIONS AND OTHER NOTES

"Access" means interchange, intermediate switching, or haulage (or trackage rights at grantor's option);

No new Access to industries, shippers or receivers not now served is granted or created; all Access is Railroad to Railroad;

Carrier providing interchange, switching, haulage, trackage rights, or other service will be entitled to fair compensation for use of its facilities and/or services;

"New Traffic" means traffic that (1) is not now moving by rail (except for reasons of seasonality or unusual disruptions of shipping patterns outside the control of the Large Railroad, such as plant shutdowns) and (2) does not unreasonably negatively impact the Large Railroad.

"Congestion Problem" means that Access to or through a terminal, or to or via a track segment, need not be granted because incremental traffic caused by the New Traffic cannot be handled without causing unreasonable interference with the owner's operations. If the interference can be reasonably remedied by additional facilities and/or services, the carrier seeking Access is entitled to such facilities and/or services, provided it pays fair compensation;

"Short Line" ("SL") is a Class III railroad;

"Small Railroad" ("SRR") is a Class II or III railroad;

- "Large Railroad" ("LRR") is a Class I railroad;

"Non-Short Line" ("Non-SL") is a Class I or II railroad; and

"Railroad" ("RR") is a Class I, II or III railroad.

Exhibit A

CAR SUPPLY

(Applies to participating Class I, II and III Railroads)

Large and Small Railroads will explore opportunities where they can work together, consistent with the antitrust laws, to meet customers' car supply needs for existing and new business.

A joint committee of senior representatives of Large and Small carriers will identify car types for which existing fleets (Railroad, shipper, etc.) are projected to be inadequate for current and future demand. Further, the joint committee will examine the ability of Small Railroads to provide freight cars for their customers for the purpose of developing cooperative policies and programs to enhance the ability of the Small Railroads to have the use of more new and used freight cars. Return on investment will be a consideration.

The joint committee will report its recommendations quarterly to the appropriate representatives of the Large and Small Railroads.

Policies and programs to be considered to determine if they are feasible and mutually beneficial include, but are not limited to:

TTX ownership and operation of general service cars

Regional pools for specific car types operated by interested Railroads

Joint ownership of equipment by Large and Small carriers

Underwriting of Small Railroad ownership by a larger carrier

Continued review of rate arrangements

Refurbishment of older cars

Improvement of transit and turnaround times

Opportunity for Small Railroads to buy surplus cars from Large Railroads on a mutually beneficial basis

Longer term bilateral agreements to facilitate equipment financing.

Private agreement to establish car hire rates

Exhibit B

SERVICE POLICY

(Applies to participating Class I, II and III Railroads)

Most Small Railroads are dependent upon and serve merchandise traffic that moves in non-unit manifest or local trains. Therefore, frequency and reliability of both interchange and manifest train schedules are of critical importance to the ability of Small Railroads, as well as Large Railroads, to serve their customers and to grow traffic and revenue.

To maintain a higher level of service, Large and Small Railroads agree to establish procedures for Small Railroad corporate and/or operating personnel and Large Railroad senior corporate and/or operating officers (all of whom having authority within their respective companies to effect a resolution of service issues) to meet on a regular basis in order to review, among other items, train service and interchange priorities.

Each Large Railroad and each Small Railroad connecting with a Large Railroad will develop and implement Interchange Service Agreements ('ISA's') with each other. These ISA's will include agreement on terms and standards to govern service and common procedures to measure interchange performance, manifest and/or local train performance, and car cycle time for the purpose of providing Small Railroad customers with the equivalent level of service provided to similarly situated Large Railroad customers taking into account factors such as volumes, commodities transported and locations.

Exhibit C

GUIDELINES FOR
PAPER BARRIERS AND NEW ROUTES

(Examples 1 - 7)

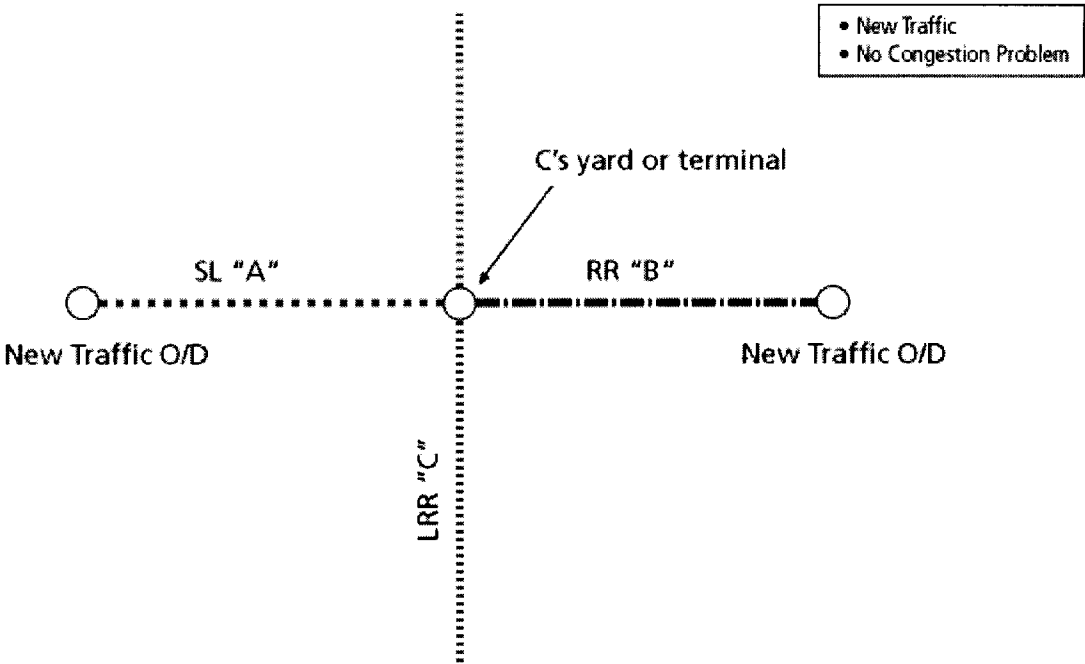
(Applies to participating Class I and III Railroads)

Example 1

Paper Barriers

Short Line "A" (SL "A") and Railroad "B" (RR "B") both connect with Large Railroad "C" (LLR "C") either in a common yard or terminal area. There is an opportunity for New Traffic that would originate on "A" and terminate on "B", or vice versa. There is no Congestion Problem. **"C" must grant Access** by either allowing "A" and "B" to connect directly or by handling the traffic between "A" and "B" within the yard or terminal.

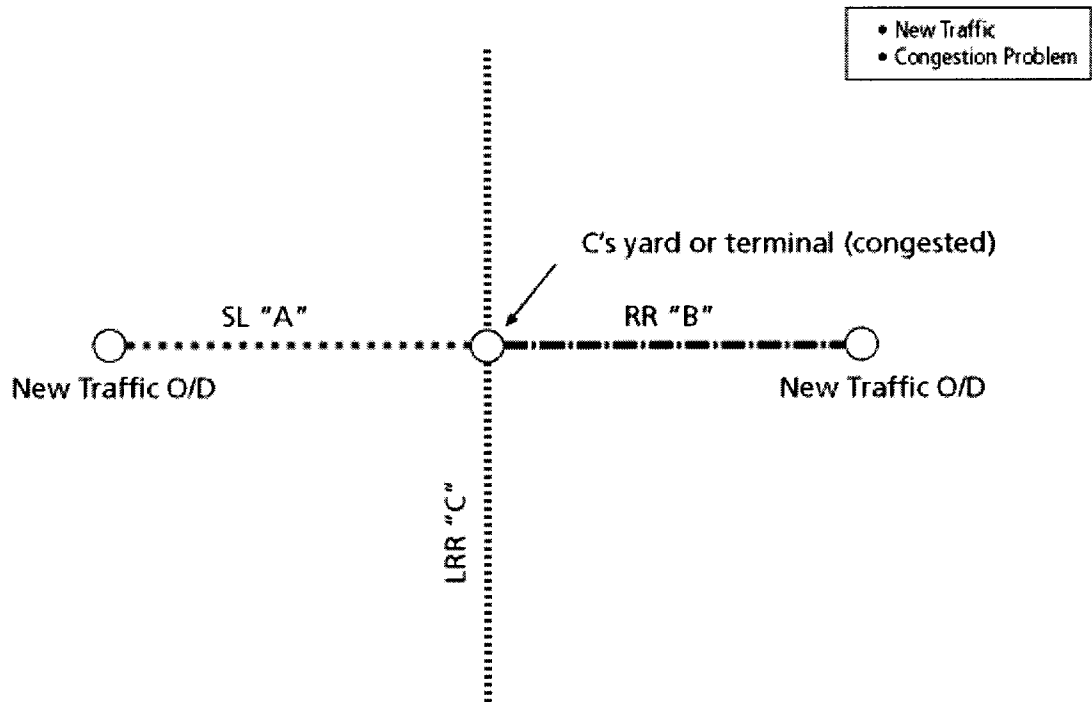
If existing movements between "A" and "B" are provided for by a reasonable intermediate switch charge published by "C", "A" and "B" are already deemed to have Access.



Example 2

Paper Barriers

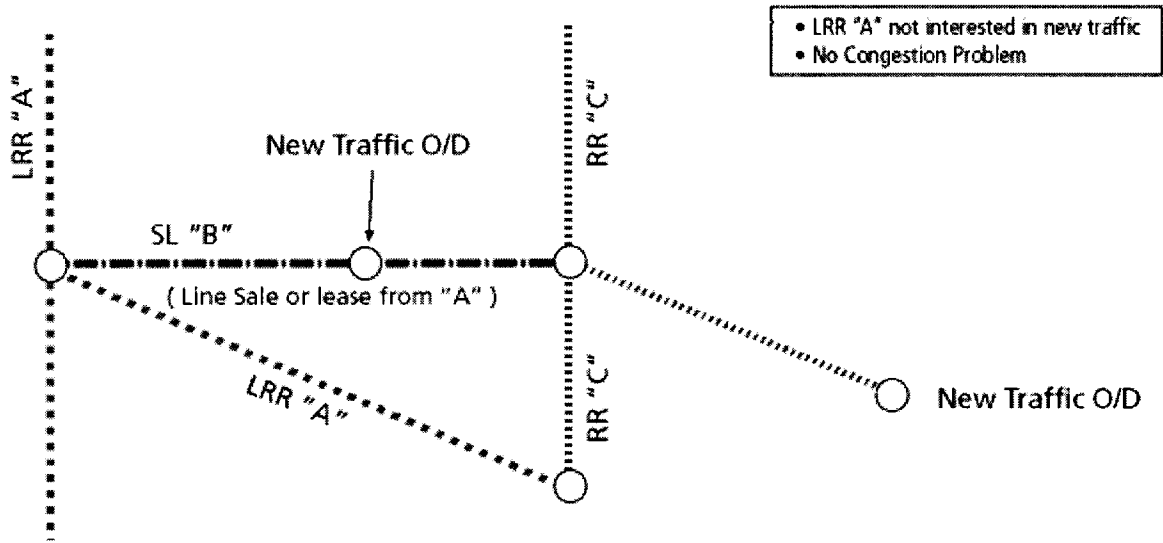
Same facts as Example 1, except there is a Congestion Problem. Large Railroad "C" may deny Access.



Example 3

Paper Barriers

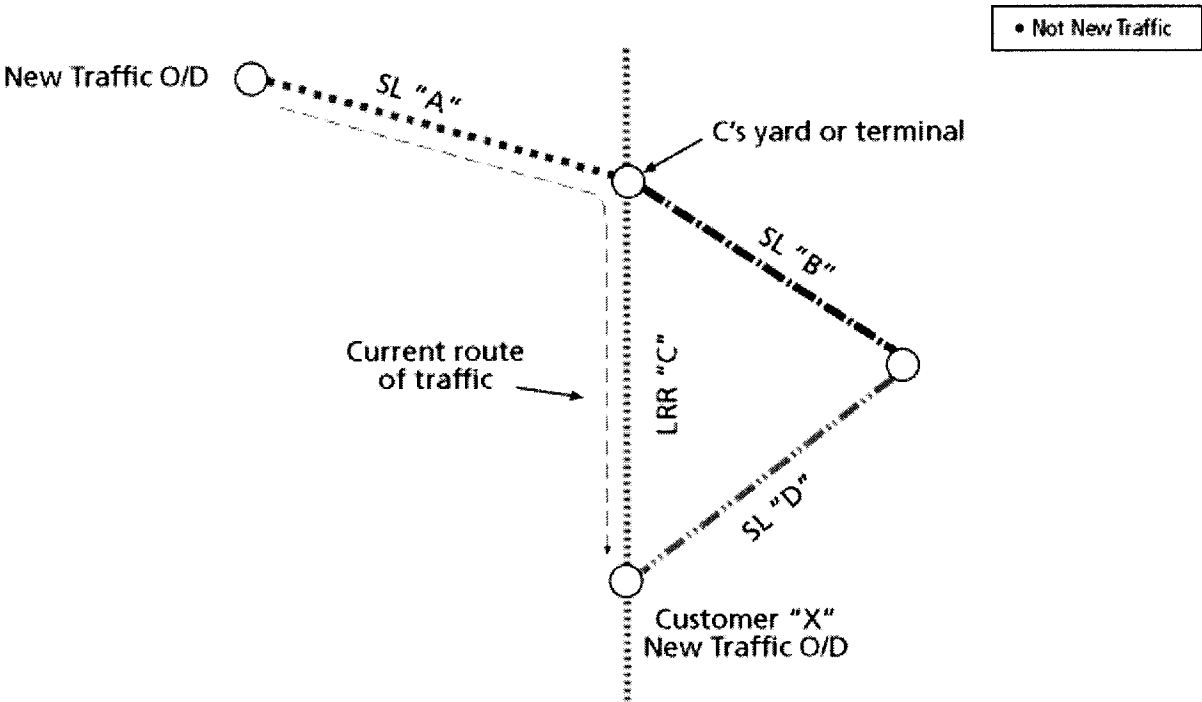
A legitimate paper barrier [see Section (III)(6)] resulting from a line sale or lease by Large Railroad "A" to Short Line "B" which restricts "B" from interchanging with Railroad "C" will be suspended to allow "B" to interchange New Traffic with "C" without penalty if, after request by "B", "A" does not establish a competitive package (rates, service and car supply) and "C" does.



Example 4

Paper Barriers

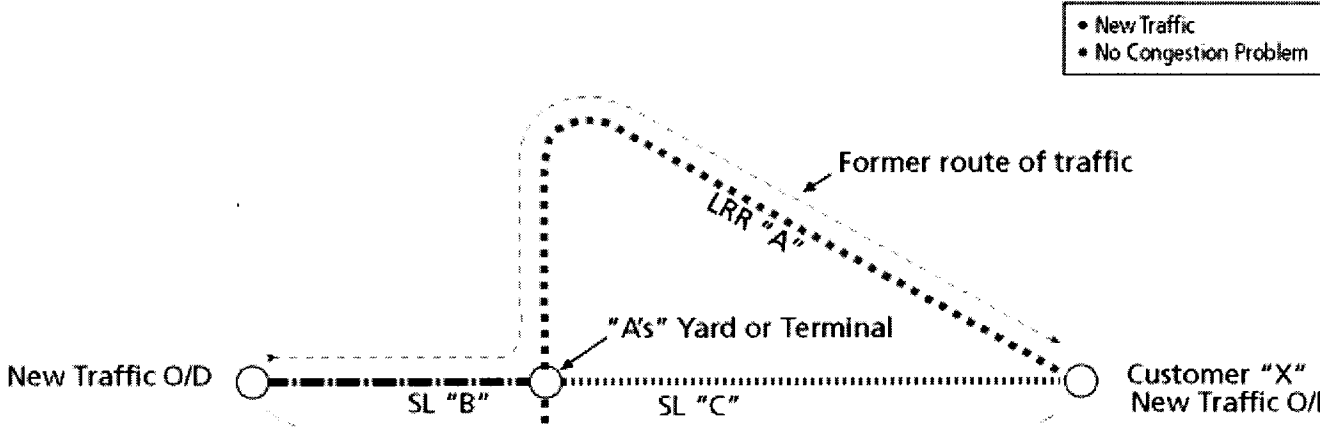
Short Line "A" can physically connect with Short Line "B" via Large Railroad "C's" yard or terminal but a paper barrier restricts "A" from interchanging with "B". "B" connects with Short Line "D" and "D" serves Customer "X" also directly served by "C". "A" and "D" wish to develop business with Customer "X" that is not New Traffic. "C" may deny Access.

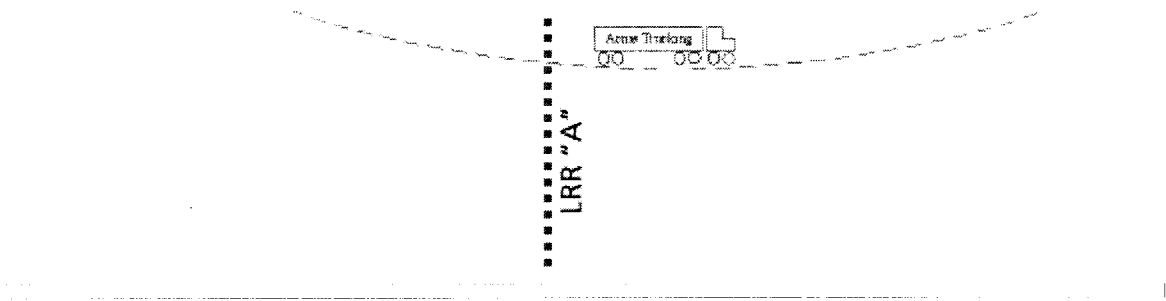


Example

Paper Barriers

Large Railroad "A"/Short Line "B" traffic for Customer "X" has been lost to truck. "B" and "C" had no role in causing the truck diversion to happen. "A" must grant Access to "B" and Short Line "C" through "A's" terminal or yard to redirect traffic to rail from truck (New Traffic). There is no Congestion Problem

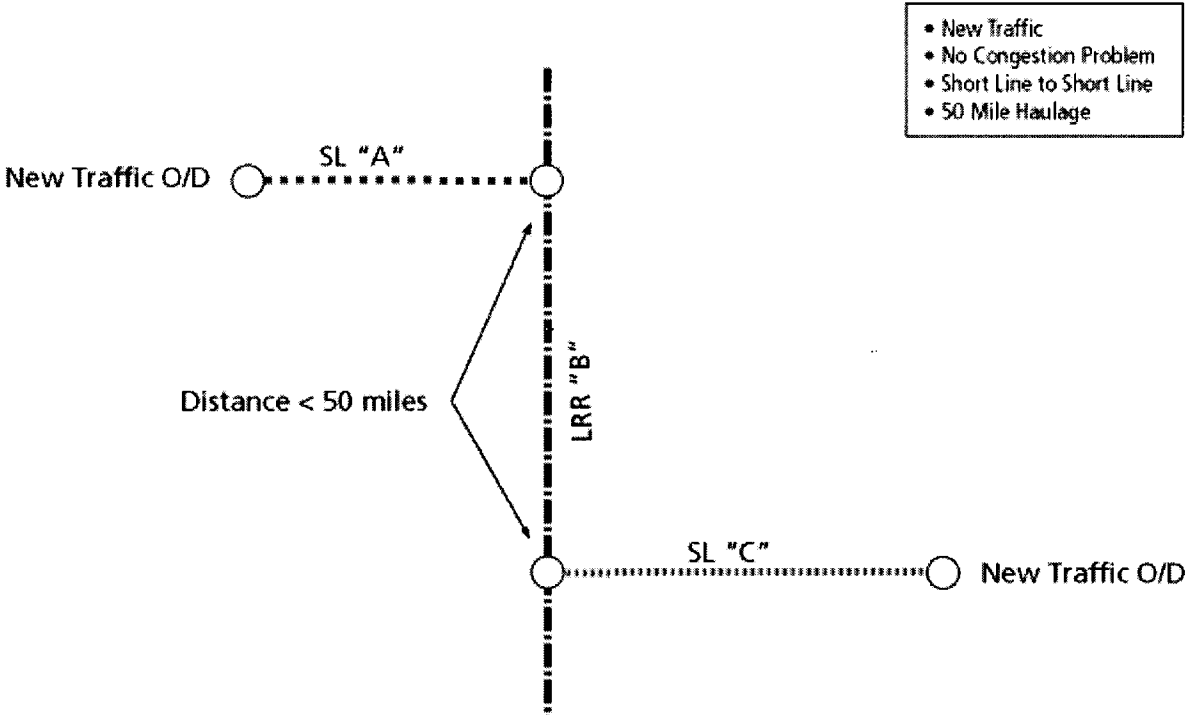




Example 6

New Routes

Large Railroad "B" must grant Access via haulage (or trackage rights at "B's" option) for New Traffic originating on Short Line "A" and terminating on Short Line "C", or vice versa, for distances up to fifty (50) miles along "B's" line of railroad connecting "A" and "C" as long as there is not a Congestion Problem. "B" is not obligated to provide equipment. Haulage (or trackage rights at "B's" option) may be for longer distance by mutual agreement. If "B" does provide equipment, "B" is entitled to participate as a line-haul carrier in the rate if it so chooses.



Example 7

New Routes

Large Railroad "B" must grant Access via haulage (or trackage rights at "B's" option) between Short Line "A" and Non-Short Line "C" to move New Traffic handled by "B" for distances up to fifteen (15) miles along "B's" line of railroad connecting "A" and "C" as long as there is not a Congestion Problem. "B" is not obligated to provide equipment. Haulage (or trackage rights at "B's" option) may be for longer distance by mutual agreement.

- New Traffic

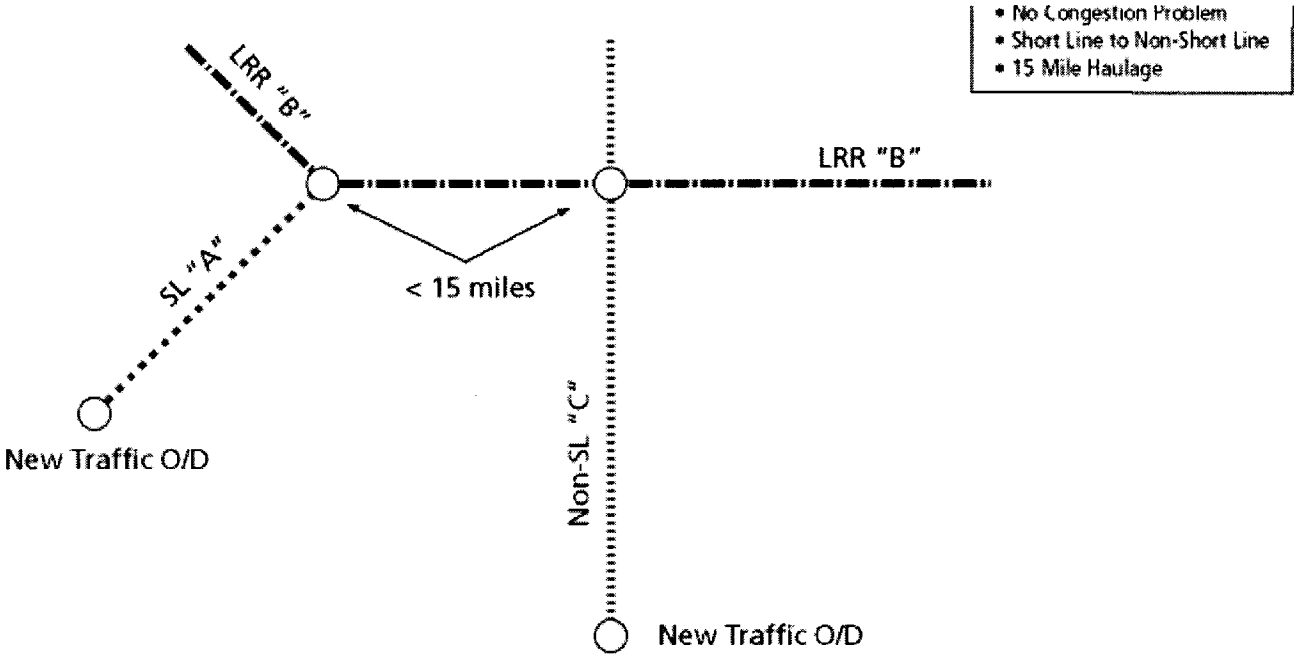


Exhibit D

**GUIDELINES FOR
INTERMEDIATE AND RECIPROCAL SWITCHING**

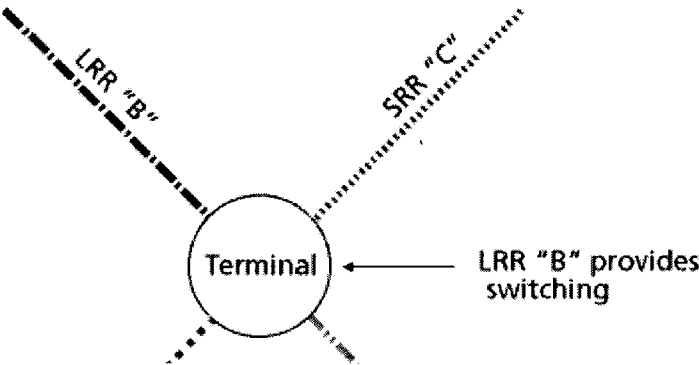
(Examples 8 - 12)

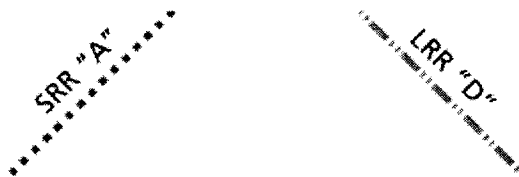
(Applies to participating Class I, II and III Railroads)

Intermediate Switching Charges

Example 8

Small Railroad "A" serves a terminal where Large Railroad "B" currently provides intermediate terminal switching between a number of carriers including Small Railroad "C". Small Railroad "C" serves the same terminal as does another Large Railroad. Assuming the operating conditions are similar, "A" and "C" should pay the same or similar charges as the other Large Railroad for receipt of similar services.

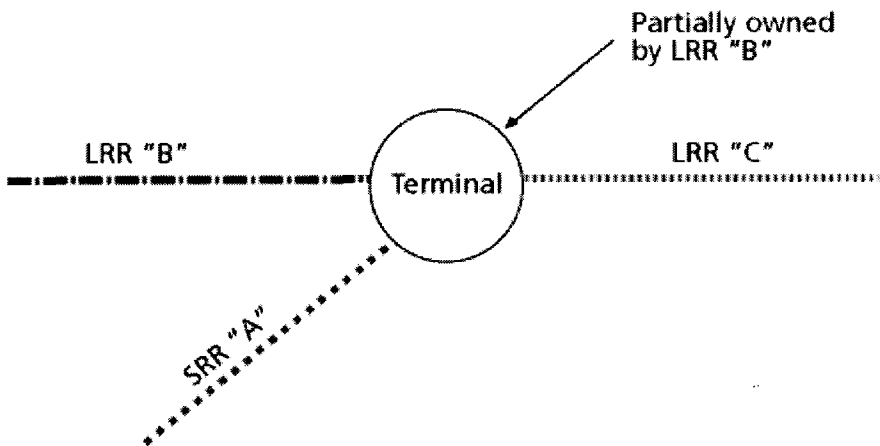




Example 9

Intermediate Switching Charges

Small Railroad "A" serves a terminal, as do Large Railroad "B" and Large Railroad "C". "B" owns a share of the terminal switching company and "A" and "C" own no share of the terminal switching company. "A" and "C" may pay a higher per car intermediate switch charge than "B", reflecting its ownership interest. Assuming the operating conditions are similar, "A" and "C" should pay the same or similar charges for receipt of similar services.



Example 10

Reciprocal Switching Charges

Large Railroads "A" and "B" and Small Railroad "C" serve a terminal. No other Large Railroads serve the terminal. "A" and "B" charge each other \$400 per loaded car for reciprocal switching within the terminal. "A" charges "C" \$500 per loaded car, and "B" charges "C" \$600 or more per loaded car. "A" and "B" must each charge "C" \$400 per loaded car, assuming similar circumstances and conditions.

Example 11

Reciprocal Switching Charges

Large Railroads "A" and "B" and Small Railroad "C" serve a terminal. No other Large Railroads serve the terminal. "A" and "B" have a system-wide reciprocal switching arrangement with each other that provides for a per-car charge less than or equal to \$250 per loaded car. The charge (assessed by "A" and/or "B" to

"C") for switching in this particular terminal exceeds \$250 per loaded car. If 115% of the actual cost of performing the reciprocal switch service is greater than \$250, "A" and "B" shall each charge "C" no more than said 115% of actual cost. If 115% of actual cost is less than or equal to \$250, "A" and "B" shall not charge "C" more than \$250 per loaded car. Nothing in this example prohibits a lower switch charge to "C" if such is mutually agreed to by "A" and/or "B" and "C."

Example 12

Reciprocal Switching Charges

In terminals containing multiple Railroads (greater than three), the carrier, on which the particular customer to be Accessed by reciprocal switch is located, must not charge a Small Railroad a charge that is higher than the highest charge to a Large Railroad or \$250 per loaded car, whichever is greater. (The involved Large Railroads may be parties to one or more system-wide reciprocal switching agreements providing charges to each involved carrier of less than or equal to \$250 per loaded car.)

Note: Nothing in the provisions of Examples 10, 11 and 12 will grant reciprocal switch access for any carrier to any industry for which Access is not otherwise provided.

Exhibit E

GUIDELINES FOR CERTAIN RATE POLICIES

(Applies to participating Class I, II and III Railroads)

In the event that a Small Railroad has only one Class I connection or a Large Railroad has rate making authority on behalf of a Small Railroad, and the Small Railroad is trying to generate New Traffic or is threatened with the loss of existing traffic, and the Small Railroad believes that the Large Railroad is not adequately reflecting the Large Railroad costs or relevant market conditions in a rate charged to a shipper of a comparable commodity located on the Large Railroad in close proximity to a similar shipper located on the Small Railroad (similar circumstances and conditions), then the Small Railroad can request the Large Railroad, within ninety (90) days, to examine its costs and relevant market conditions and meet to discuss the matter. For purposes of this Agreement, a haulage agreement between a Large Railroad and a Small Railroad does not give the Large Railroad rate making authority on behalf of the Small Railroad.

The Large Railroad shall study its costs and the relevant market conditions, on an annual actual total cost basis, from the area requested by the Small Railroad to the first crew change location common for the similar Small Railroad and Large Railroad shipments in question. This study shall include all costs relevant to this segment of the Large Railroad (including any savings attributable to the then present Small Railroad operations as well as including any applicable handling charges paid by the Large Railroad to the Small railroad as part of the costs incurred by the Large Railroad) and shall consider the volume

and seasonality of the traffic in question and capability of the Large Railroad, due to economies of scale, to reallocate assets and personnel during periods of slow demand.

After the requested cost study has been completed, the Railroads shall meet to discuss the results. Terms of confidential transportation contracts to which both Railroads are not a party will not be revealed. Acting on the results of the study, the Large Railroad may choose to adjust one or more rates and/or charges or may elect to retain the status quo.

The Small Railroad, if not satisfied with the result, may invoke arbitration under Section VI of this Agreement. Both parties and the arbitrator will treat all cost information involved in the arbitration as confidential. Particular rates charged to individual shippers or receivers in transportation contracts shall not be considered in arbitration under the terms of this Agreement. The arbitrator's decision can only deal with the rate complained of, that is, the joint Large Railroad/Small Railroad rate.

If the arbitrator determines that the rate charged by the Large Railroad to the Small Railroad shipper improperly favors the shipper on the Large Railroad, then the arbitrator may order a reduction of the rate, but only to the extent needed to eliminate such favoritism. The rights provided in this Exhibit E reflect unique circumstances and create no rights for any third parties.

[Position Paper Home](#)
[AAR Home](#)

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 634

CONSOLIDATED RAILROAD REPORTING

**JOINT COMMENTS OF RED RIVER VALLEY & WESTERN RAILROAD COMPANY,
RUTLAND LINE, INC., TWIN CITIES & WESTERN RAILROAD COMPANY, THE
MONONGAHELA CONNECTING RAILROAD COMPANY, ALIQUIPPA &
SOUTHERN RAILROAD COMPANY, THE MAHONING VALLEY RAILWAY
COMPANY, THE CUYAHOGA VALLEY RAILWAY COMPANY, THE RIVER
TERMINAL RAILWAY COMPANY, CHICAGO SHORTLINE RAILWAY COMPANY,
PARKSIERRA RAIL CORPORATION D/B/A ARIZONA & CALIFORNIA RAILROAD
COMPANY L.P., CALIFORNIA NORTHERN RAILROAD COMPANY, L.P., AND
PUGET SOUND & PACIFIC RAILROAD, AND MONTANA RAIL LINK, INC. AND
I&M RAIL LINK, LLC.**

**VERIFIED STATEMENT OF
ROBERT K. HOLDER, CPA**

1. I am Robert K. Holder, CPA. I am a shareholder in the accounting firm of Stoy Malone & Company, PC, Certified Public Accountants, located at Suite 1100N, 7315 Wisconsin Avenue, Bethesda, Maryland, 20814-3202. I have worked as an accountant since 1962, after I graduated in 1961 from Benjamin Franklin University, now a part of George Washington University. I became a certified public accountant in 1962. I have been with Stoy Malone, and its predecessors-in-interest, since 1962. I was retained by Weiner Brodsky Sidman Kider PC, in connection with the above-captioned proceeding, to clarify certain aspects regarding the consolidated reporting requirements of Consolidation of All Majority-owned Subsidiaries, Statement of Financial Accounting Standards No. 94 (Financial Accounting Standards Bd. 1987)

(“FASB-94”), and its predecessor Consolidated Financial Statements, Accounting Research Bulletin No. 51, (American Institute of Certified Public Accountants 1959) (“ARB No. 51”).

2. When determining proper accounting treatment of an item, Statement on Auditing Standards No. 69 provides a generally accepted accounting principles hierarchy to be used. The hierarchy starts with FASB statements and interpretations, APB Opinions and AICPA Accounting Research Bulletins at the top followed by FASB Technical Bulletins, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position. Next in line are consensus positions of the FASB Emerging Issues Task Force and AICPA Practice Bulletins. Rounding out the hierarchy are AICPA accounting interpretations, industry practices widely recognized and prevalent and other accounting literature.

3. FASB 94, Consolidation of all Majority-owned Subsidiaries amends ARB No. 51, to require consolidation of all majority owned subsidiaries unless control is temporary or does not rest with the majority owner. ARB 51 states the general rule of consolidation is ownership of a majority voting interest, therefore, ownership of over 50% of the outstanding voting shares of another company is a condition pointing towards consolidation. ARB 51 precluded consolidation if control is likely to be temporary or because of “nonhomogeneous” operations. Nonhomogeneous operations became the basis for many entities to exclude from consolidation majority-owned subsidiaries. Subsidiaries most commonly not consolidated on this basis have been finance, insurance, real estate and leasing subsidiaries.

4. FASB 94 eliminated the nonconsolidation exception for “nonhomogeneous” operations and amended paragraph 3 of ARB 51 to read: *All majority owned subsidiaries* – all companies in which a parent has a controlling financial interest through direct or indirect

ownership of a majority voting interest – shall be consolidated, except if control is likely to be temporary or if it does not rest with the majority owner.

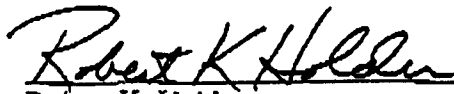
5. FASB 94 requires consolidated reporting only for majority-owned *subsidiaries*. No rule under GAAP, to the best of my knowledge, requires *non-subsidiary* corporate affiliates to report on a consolidated or combined basis.

6. The primary purpose of both ARB No. 51 and FASB 94 is to provide meaningful information to shareholders and creditors of the parent corporation.

VERIFICATION

I, Robert K. Holder, hereby affirm and state that I have read the foregoing statement, that I am personally familiar with its contents, that I have executed it with full authority to do so, and that the statements set forth therein are true and correct to the best of my knowledge, information, and belief.

Executed by the undersigned on this 27th day of November 2000.


Robert K. Holder

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COMMITTEE ON ACCOUNTING PROCEDURE; AICPA; AMERICAN INSTITUTE
OF CERTIFIED PUBLIC ACCOUNTANTS

AUGUST, 1959

ACCOUNTING RESEARCH BULLETIN NO. 51; ARB 51

Consolidated Financial Statements

TEXT:

PURPOSE OF CONSOLIDATED STATEMENTS

[ARB 51.01] The purpose of consolidated statements is to present, primarily for the benefit of the shareholders and creditors of the parent company, the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company with one or more branches or divisions. There is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies.

CONSOLIDATION POLICY

[ARB 51.02] The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty per cent of the outstanding voting shares of another company is a condition pointing toward consolidation. However, there are exceptions to this general rule. For example, a subsidiary should not be consolidated where control is likely to be temporary, or where it does not rest with the majority owners (as, for instance, where the subsidiary is in legal reorganization or in bankruptcy). There may also be situations where the minority interest in the subsidiary is so large, in relation to the equity of the shareholders of the parent in the consolidated net assets, that the presentation of separate financial statements for the two companies would be more meaningful and useful. However, the fact that the subsidiary has a relatively large indebtedness to bondholders or others is not in itself a valid argument for exclusion of the subsidiary from consolidation. (Also, see Chapter 12 of Accounting Research Bulletin No. 43 for the treatment of foreign subsidiaries.)

[ARB 51.03] In deciding upon consolidation policy, the aim should be to make the financial presentation which is most meaningful in the circumstances. The reader should be given information which is suitable to his needs, but he should not be burdened with unnecessary detail. Thus, even though a group of companies is heterogeneous in character, it may be better to make a full consolidation than to present a large number of separate statements. On the other hand, separate statements or combined statements would be preferable for a subsidiary or group of subsidiaries if the presentation of financial information concerning the particular activities of such subsidiaries would be more informative to shareholders and creditors of the parent company than would the inclusion of such subsidiaries in the consolidation. For example, separate statements may be required for a subsidiary which is a bank or an insurance company and may be

preferable for a finance company where the parent and the other subsidiaries are engaged in manufacturing operations.

[ARB 51.04] A difference in fiscal periods of a parent and a subsidiary does not of itself justify the exclusion of the subsidiary from consolidation. It ordinarily is feasible for the subsidiary to prepare, for consolidation purposes, statements for a period which corresponds with or closely approaches the fiscal period of the parent. However, where the difference is not more than about three months, it usually is acceptable to use, for consolidation purposes, the subsidiary's statements for its fiscal period; when this is done, recognition should be given by disclosure or otherwise to the effect of intervening events which materially affect the financial position or results of operations.

[ARB 51.05] Consolidated statements should disclose the consolidation policy which is being followed. In most cases this can be made apparent by the headings or other information in the statements, but in other cases a footnote is required.

CONSOLIDATION PROCEDURE GENERALLY

[ARB 51.06] In the preparation of consolidated statements, intercompany balances and transactions should be eliminated. This includes intercompany open account balances, security holdings, sales and purchases, interest, dividends, etc. As consolidated statements are based on the assumption that they represent the financial position and operating results of a single business enterprise, such statements should not include gain or loss on transactions among the companies in the group. Accordingly, any intercompany profit or loss on assets remaining within the group should be eliminated; the concept usually applied for this purpose is gross profit or loss. (See also paragraph 17.) However, in a regulated industry where a parent or subsidiary manufactures or constructs facilities for other companies in the consolidated group, the foregoing is not intended to require the elimination of intercompany profit to the extent that such profit is substantially equivalent to a reasonable return on investment ordinarily capitalized in accordance with the established practice of the industry.

ELIMINATION OF INTERCOMPANY INVESTMENTS

[ARB 51.07] Where the cost to the parent of the investment in a purchased subsidiary exceeds the parent's equity in the subsidiary's net assets at the date of acquisition, as shown by the books of the subsidiary, the excess should be dealt with in the consolidated balance sheet according to its nature. In determining the difference, provision should be made for specific costs or losses which are expected to be incurred in the integration of the operations of the subsidiary with those of the parent, or otherwise as a result of the acquisition, if the amount thereof can be reasonably determined. To the extent that the difference is considered to be attributable to tangible assets and specific intangible assets, such as patents, it should be allocated to them. Any difference which cannot be so applied should be shown among the assets in the consolidated balance sheet under one or more appropriately descriptive captions. When the difference is allocated to depreciable or amortizable assets, depreciation and amortization policies should be such as to absorb the excess over the remaining life of related assets. For subsequent treatment of intangibles, see Chapter 5 of Accounting Research Bulletin No. 43.

[ARB 51.08] In general, parallel procedures should be followed in the reverse type of case. Where the cost to the parent is less than its equity in the net assets of the purchased subsidiary, as shown by the books of the subsidiary at the date of acquisition, the amount at which such net assets are carried in the consolidated statements should not exceed the parent's cost. Accordingly, to the extent that the difference, determined as indicated in paragraph 7, is considered to be attributable to specific assets, it should be allocated to them, with corresponding adjustments of the depreciation or amortization. In unusual circumstances there may be a remaining difference which it would be acceptable to show in a credit account, which ordinarily would be taken into income in future periods on a reasonable and systematic basis. A procedure sometimes followed in the past was to credit capital surplus with the amount of the excess; such a procedure is not now considered acceptable.

[ARB 51.09] The earned surplus or deficit of a purchased n-1 subsidiary at the date of acquisition by the parent should not be included in consolidated earned surplus.

[ARB 51.10] When one company purchases two or more blocks of stock of another company at various dates and eventually obtains control of the other company, the date of acquisition (for the purpose of preparing consolidated statements) depends on the circumstances. If two or more purchases are made over a period of time, the earned surplus of the subsidiary at acquisition should generally be determined on a step-by-step basis; however, if small purchases are made over a period of time and then a purchase is made which results in control, the date of the latest purchase, as a matter of convenience, may be considered as the date of acquisition. Thus there would generally be included in consolidated income for the year in which control is obtained the postacquisition income for that year, and in consolidated earned surplus the postacquisition income of prior years, attributable to each block previously acquired. For example, if a 45% interest was acquired on October 1, 1957 and a further 30% interest was acquired on April 1, 1958, it would be appropriate to include in consolidated income for the year ended December 31, 1958, 45% of the earnings of the subsidiary for the three months ended March 31, and 75% of the earnings for the nine months ended December 31, and to credit consolidated earned surplus in 1958 with 45% of the undistributed earnings of the subsidiary for the three months ended December 31, 1957.

[ARB 51.11] When a subsidiary is purchased during the year, there are alternative ways of dealing with the results of its operations in the consolidated income statement. One method, which usually is preferable, especially where there are several dates of acquisition of blocks of shares, is to include the subsidiary in the consolidation as though it had been acquired at the beginning of the year, and to deduct at the bottom of the consolidated income statement the preacquisition earnings applicable to each block of stock. This method presents results which are more indicative of the current status of the group, and facilitates future comparison with subsequent years. Another method of prorating income is to include in the consolidated statement only the subsidiary's revenue and expenses subsequent to the date of acquisition.

[ARB 51.12] Where the investment in a subsidiary is disposed of during the year, it may be preferable to omit the details of operations of the subsidiary from the consolidated income statement, and to show the equity of the parent in

the earnings of the subsidiary prior to disposal as a separate item in the statement.

[ARB 51.13] Shares of the parent held by a subsidiary should not be treated as outstanding stock in the consolidated balance sheet.

MINORITY INTERESTS

[ARB 51.14] The amount of intercompany profit or loss to be eliminated in accordance with paragraph 6 is not affected by the existence of a minority interest. The complete elimination of the intercompany profit or loss is consistent with the underlying assumption that consolidated statements represent the financial position and operating results of a single business enterprise. The elimination of the intercompany profit or loss may be allocated proportionately between the majority and minority interests.

[ARB 51.15] In the unusual case in which losses applicable to the minority interest in a subsidiary exceed the minority interest in the equity capital of the subsidiary, such excess and any further losses applicable to the minority interest should be charged against the majority interest, as there is no obligation of the minority interest to make good such losses. However, if future earnings do materialize, the majority interest should be credited to the extent of such losses previously absorbed.

INCOME TAXES

[ARB 51.16] When separate income tax returns are filed, income taxes usually are incurred when earnings of subsidiaries are transferred to the parent. Where it is reasonable to assume that a part or all of the undistributed earnings of a subsidiary will be transferred to the parent in a taxable distribution, provision for related income taxes should be made on an estimated basis at the time the earnings are included in consolidated income, unless these taxes are immaterial in amount when effect is given, for example, to dividend-received deductions or foreign-tax credits. There is no need to provide for income tax to the parent company in cases where the income has been, or there is evidence that it will be, permanently invested by the subsidiaries, or where the only likely distribution would be in the form of a tax-free liquidation.

[ARB 51.17] If income taxes have been paid on intercompany profits on assets remaining within the group, such taxes should be deferred or the intercompany profits to be eliminated in consolidation should be appropriately reduced.

STOCK DIVIDENDS OF SUBSIDIARIES

[ARB 51.18] Occasionally, subsidiary companies capitalize earned surplus arising since acquisition, by means of a stock dividend or otherwise. This does not require a transfer to capital surplus on consolidation, inasmuch as the retained earnings in the consolidated financial statements should reflect the accumulated earnings of the consolidated group not distributed to the shareholders of, or capitalized by, the parent company.

UNCONSOLIDATED SUBSIDIARIES IN CONSOLIDATED STATEMENTS

[ARB 51.19] There are two methods of dealing with unconsolidated

subsidiaries in consolidated statements. Whichever method is adopted should be used for all unconsolidated subsidiaries, subject to appropriate modification in special circumstances. The preferable method, in the view of the committee, is to adjust the investment through income currently to take up the share of the controlling company or companies in the subsidiaries' net income or net loss, except where the subsidiary was excluded because of exchange restrictions or other reasons which raise the question of whether the increase in equity has accrued to the credit of the group. (Adjustments of the investment would also be made for "special" debits or credits shown on the income statements of the unconsolidated subsidiaries below the net income for the period, and for similar items shown in the schedule of earned surplus.) The other method, more commonly used at present, is to carry the investment at cost, and to take up income as dividends are received; however, provision should be made for any material impairment of the investment, such as through losses sustained by the subsidiaries, unless it is deemed to be temporary. When the latter method is followed, the consolidated statements should disclose, by footnote or otherwise, the cost of the investment in the unconsolidated subsidiaries, the equity of the consolidated group of companies in their net assets, the dividends received from them in the current period, and the equity of the consolidated group in their earnings for the period; this information may be given in total or by individual subsidiaries or groups of subsidiaries.

[ARB 51.20] Whichever method of dealing with unconsolidated subsidiaries is followed, if there is a difference between the cost of the investment and the equity in net assets at the date of acquisition, appropriate recognition should be given to the possibility that, had the subsidiaries been consolidated, part of such difference would have been reflected in adjusted depreciation or amortization. Also, appropriate recognition should be given to the necessity for an adjustment for intercompany gains or losses on transactions with unconsolidated subsidiaries. If sales are made to unconsolidated subsidiaries and the investment in the subsidiaries is carried at cost plus the equity in undistributed earnings, an elimination of unrealized intercompany gains and losses should be made to the same extent as if the subsidiaries were consolidated. The same applies where intercompany sales are made by the unconsolidated subsidiaries. If, however, the investment is carried at cost, it is not necessary to eliminate the intercompany gain on sales to such subsidiaries, if the gain on the sales does not exceed the unrecorded equity in undistributed earnings of the unconsolidated subsidiaries. If such gain is material, it should be appropriately disclosed. Where the sales are made by the unconsolidated subsidiaries to companies included in the consolidated group, the intercompany gains or losses should be eliminated in arriving at the amount of the equity in the undistributed earnings of the unconsolidated subsidiaries which will be disclosed in a footnote or otherwise. (See paragraph 19.)

[ARB 51.21] Where the unconsolidated subsidiaries are, in the aggregate, material in relation to the consolidated financial position or operating results, summarized information as to their assets, liabilities and operating results should be given in the footnotes or separate statements should be presented for such subsidiaries, either individually or in groups, as appropriate.

COMBINED STATEMENTS

[ARB 51.22] To justify the preparation of consolidated statements, the

controlling financial interest should rest directly or indirectly in one of the companies included in the consolidation. There are circumstances, however, where combined financial statements (as distinguished from consolidated statements) of commonly controlled companies are likely to be more meaningful than their separate statements. For example, combined financial statements would be useful where one individual owns a controlling interest in several corporations which are related in their operations. Combined statements would also be used to present the financial position and the results of operations of a group of unconsolidated subsidiaries. They might also be used to combine the financial statements of companies under common management.

[ARB 51.23] Where combined statements are prepared for a group of related companies, such as a group of unconsolidated subsidiaries or a group of commonly controlled companies, intercompany transactions and profits or losses should be eliminated, and if there are problems in connection with such matters as minority interests, foreign operations, different fiscal periods, or income taxes, they should be treated in the same manner as in consolidated statements.

PARENT-COMPANY STATEMENTS

[ARB 51.24] In some cases parent-company statements may be needed, in addition to consolidated statements, to indicate adequately the position of bondholders and other creditors or preferred stockholders of the parent. Consolidating statements, in which one column is used for the parent company and other columns for particular subsidiaries or groups of subsidiaries, often are an effective means of presenting the pertinent information.

The statement entitled, "Consolidated Financial Statements" was unanimously adopted by the twenty-one members of the committee, of whom nine, Messrs. Bedford, Dunn, Graese, Graham, Halvorson, Hoyler, Kent, Powell, and Werntz, assented with qualification.

Mr. Bedford objects to the provision in paragraph 2 that ownership of over fifty per cent of the outstanding voting stock is the general rule governing consolidation policy. He believes the over fifty per cent ownership requirement is at best only one of several criteria evidencing the existence of a consolidated entity.

Messrs. Graese and Hoyler do not agree with the statement made in the last sentence of paragraph 8. Mr. Graese believes there are cases in which the crediting of a capital surplus account with the "excess credit" will result in a more appropriate presentation of consolidated operations and financial position, particularly in (but not limited to) situations where the acquisition of control of the subsidiary has been accomplished over an extended period of time or where there are acquisitions of minority interest at a date considerably after obtaining control. Mr. Hoyler is of the opinion that there have been, and probably will be, circumstances under which credits to capital surplus of the excesses referred to in this paragraph will be appropriate.

Messrs. Halvorson and Wertz object to the relative emphasis given to the recommendations in paragraph 10, which they believe should be reversed. They believe that the date of the purchase which results in control should generally be considered to be the date of acquisition; however, if a limited number of purchases are made over a period of time pursuant to a plan or program which

culminates in control, they agree that the earned surplus of the subsidiary at acquisition may be determined on a step-by-step basis.

Mr. Halvorson disagrees with the recommendation in paragraph 18. In his view, the usual subsidiary is a closely held corporation, and consequently is under no pressure to declare stock dividends and is under no compulsion to follow the "fair value" method of accounting for them if it does. If it does capitalize earned surplus by means of a stock dividend or otherwise, particularly "otherwise," he feels that it must have been done with a purpose relating to its financial position, at the direction of, and with the acquiescence of, the parent company, and that the capitalization should carry through into the consolidated surplus accounts. If the subsidiary is one in which there is a publicly held minority interest, and a stock dividend is issued and accounted for on a fair-value basis in the manner of an independent publicly owned corporation, the accounting for earned surplus in respect of the majority interest would be the same as that for the minority interest, and again he believes that the capitalization should follow through into the consolidated surplus accounts. Mr. Powell also disagrees with the conclusion expressed in this paragraph. He believes that if a parent causes a subsidiary to freeze a part or all of its earned surplus through the payment of a stock dividend or otherwise, thus making such surplus unavailable for ordinary dividends, it should follow a similar procedure on consolidation.

Mr. Kent believes the consolidation policy section is deficient since it fails to restrict the increasing practice of not including certain subsidiaries in consolidated financial statements. He suggests that the bulletin may possibly result in further increasing such practice as a consequence of the preference expressed in paragraph 19 for the inclusion of the equity in earnings of unconsolidated subsidiaries in consolidated statements. It is his belief that in the usual situation a full consolidation policy as implied in paragraph 1 is generally preferable, supplemented by such summarized financial information, in footnotes or otherwise, as may be appropriate.

Messrs. Dunn and Graham believe that the "preferable" method in paragraph 19 should be recognized as the only acceptable method of dealing with unconsolidated subsidiaries in consolidated statements, and that the method which carries the investment in unconsolidated subsidiaries at cost, and takes up as income only the dividends received, should be discontinued as rapidly as is practicable. They feel that the "preferable" method conforms to the purpose of consolidated statements as set forth in paragraph 1--to present the results of operations and the financial position essentially as if the group were a single company, and that its uniform adoption would increase the comparability of the financial statements of different companies, and would avoid the possibility of manipulation of reported consolidated earnings through the control of dividends received by the parent.

Mr. Dunn believes that paragraph 20 should require the elimination of intercompany gain on sales to unconsolidated subsidiaries if the failure to do so would have a material effect on the reported consolidated income, regardless of whether the gain on intercompany sales exceeds the unrecorded equity in undistributed earnings of the unconsolidated subsidiaries.

NOTES

(See Introduction to Accounting Research Bulletin No. 43.)

1. Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee, the technical services department, and the director of research. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached.

2. Opinions of the committee are not intended to be retroactive unless they contain a statement of such intention. They should not be considered applicable to the accounting for transactions arising prior to the publication of the opinions. However, the committee does not wish to discourage the revision of past accounts in an individual case if the accountant thinks it desirable in the circumstances. Opinions of the committee should be considered as applicable only to items which are material and significant in the relative circumstances.

3. It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. Except where there is a specific statement of a different intent by the committee, its opinions and recommendations are directed primarily to business enterprises organized for profit.

Committee on Accounting Procedure (1958-59)

William W. Werntz,	Newman T. Halvorson	Weldon Powell
Chairman	Charles A. Hoyler	Samuel L. Ready
Norton M. Bedford	Donald R. Jennings	Walter R. Staub
Garrett T. Burns	Ralph E. Kent	William J. von Minden
Keith W. Dunn	George W. Lafferty	Edward B. Wilcox
Carl M. Esenoff	John F. Macha	Delmar G. Wilsey
Clifford E. Graese	John K. McClare	-----
Willard J. Graham	Herbert E. Miller	Carman G. Blough,
		Director of Research

FOOTNOTES:

n1 See Accounting Research Bulletin No. 48, Business Combinations, for the difference in treatment between a purchase and a pooling of interests.

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FASB; FINANCIAL ACCOUNTING STANDARDS BOARD

OCTOBER, 1987

STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 94; FAS 94; SFAS 94; FASBS 94

Consolidation of All Majority-owned Subsidiaries

AN AMENDMENT OF ARB NO. 51, WITH RELATED AMENDMENTS OF APB OPINION NO. 18 AND ARB NO. 43, CHAPTER 12

TEXT:

Summary

This Statement amends ARB No. 51, Consolidated Financial Statements, to require consolidation of all majority-owned subsidiaries unless control is temporary or does not rest with the majority owner. This Statement requires consolidation of a majority-owned subsidiary even if it has "nonhomogeneous" operations, a large minority interest, or a foreign location.

This Statement also makes certain related amendments to APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, and to ARB No. 43, Chapter 12, "Foreign Operations and Foreign Exchange." Among other changes, those amendments preclude use of parent-company financial statements prepared for issuance to stockholders as the financial statements of the primary reporting entity.

This Statement requires that summarized information about the assets, liabilities, and results of operations (or separate statements) of previously unconsolidated majority-owned subsidiaries continue to be provided after those subsidiaries are consolidated.

This Statement is effective for financial statements for fiscal years ending after December 15, 1988. Restatement of comparative financial statements for earlier years is required.

INTRODUCTION

[FAS 94.01] Accounting Research Bulletin No. 51, Consolidated Financial Statements, adopted by the Committee on Accounting Procedure of the AICPA in 1959, concisely describes the purpose of consolidated financial statements in its first paragraph.

The purpose of consolidated statements is to present, primarily for the benefit of the shareholders and creditors of the parent company, the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company with one or more branches or divisions. There is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies.

[FAS 94.02] Similarly, the first sentence of paragraph 2 describes its general rule of consolidation policy.

The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty per cent of the outstanding voting shares of another company is a condition pointing toward consolidation.

[FAS 94.03] While ARB 51's general rule is to consolidate all majority-owned subsidiaries, its paragraphs 2 and 3 describe "exceptions to that general rule."

[FAS 94.04] Paragraph 2 precludes consolidation of a majority-owned subsidiary under two conditions--"where control is likely to be temporary, or where it does not rest with the majority owners (as, for instance, where the subsidiary is in legal reorganization or in bankruptcy)." It also permits exclusion from consolidation of a subsidiary having a relatively large minority interest and of a foreign subsidiary. n1

[FAS 94.05] The exception in paragraph 3 of ARB 51 has become the basis for excluding from consolidation the greatest number of majority-owned subsidiaries. It has often been called exclusion of "nonhomogeneous" operations because of its wording:

. . . even though a group of companies is heterogeneous in character, it may be better to make a full consolidation than to present a large number of separate statements. On the other hand, separate statements or combined statements would be preferable for a subsidiary or group of subsidiaries if

In view of the uncertain values and availability of the assets and net income of foreign subsidiaries subject to controls and exchange restrictions and the consequent unrealistic statements of income that may result from the translation of many foreign currencies into dollars, careful consideration should be given to the fundamental question of whether it is proper to consolidate the statements of foreign subsidiaries with the statements of United States companies. Whether consolidation of foreign subsidiaries is decided upon or not, adequate disclosure of foreign operations should be made. The following are among the possible ways of providing information relating to such foreign subsidiaries:

- a. To exclude foreign subsidiaries from consolidation and to furnish (1) statements in which only domestic subsidiaries are consolidated and (2) as to foreign subsidiaries, a summary in suitable form of their assets and liabilities, their income and losses for the year, and the parent company's equity therein. . . . the presentation of financial information concerning the particular activities of such subsidiaries would be more informative to shareholders and creditors of the parent company than would the inclusion of such subsidiaries in the consolidation. For example, separate statements may be required for a subsidiary which is a bank or an insurance company and may be preferable for a finance company where the parent and the other subsidiaries are engaged in manufacturing operations.

[FAS 94.06] Business enterprises have increasingly used "nonhomogeneity" as a basis for excluding from consolidation majority-owned (even wholly owned) subsidiaries considered different in character from the parent and its other affiliates. Subsidiaries most commonly not consolidated on that basis have been finance, insurance, real estate, and leasing subsidiaries of manufacturing and merchandising enterprises.

[FAS 94.07] However, certain diversified enterprises consolidate all of their majority-owned subsidiaries despite differences in their operations, and significant questions about the "nonhomogeneity" exception have arisen. Present practice has been criticized not only because apparently similar enterprises use different consolidation policies but also because excluding some subsidiaries from consolidation results in the omission of significant amounts of assets, liabilities, revenues, and expenses from the consolidated statements of many enterprises. Omissions of large amounts of liabilities, especially those of finance and similar subsidiaries, have led to the criticism that not consolidating those subsidiaries is an important factor in what is often called "off-balance-sheet financing."

[FAS 94.08] The "nonhomogeneity" exception has only relatively recently become the most prominent reason for excluding majority-owned subsidiaries from consolidation. When ARB 51 was issued, other restrictive consolidation policies--to consolidate only wholly owned subsidiaries, only subsidiaries owned to a specified degree (such as 66 2/3 percent, 75 percent, or 80 percent), only domestic subsidiaries, only North American subsidiaries, and the like--were more common. Those other restrictive policies have become less widely used while exclusion for "nonhomogeneity" has become more widespread.

Consolidation

[FAS 94.09] This Statement eliminates three exceptions to the general rule that majority-owned subsidiaries should be consolidated: the exceptions for "nonhomogeneous" operations, for relatively large minority interests (which apparently is seldom used in practice), and for other restrictive policies. It amends ARB No. 43, Chapter 12, "Foreign Operations and Foreign Exchange," to narrow the exception for a majority-owned foreign subsidiary from one that permits exclusion from consolidation of any or all foreign subsidiaries to one that effectively eliminates distinctions between foreign and domestic subsidiaries.

[FAS 94.10] The other exceptions noted in paragraph 4--control that is likely to be temporary and control that does not rest with the majority owner because of, for example, corporate reorganization or bankruptcy--have not been reconsidered in this Statement. They relate to the concept of control and its place in consolidation policy, which are not within the scope of this Statement but are part of a broader FASB project on the reporting entity, including consolidations and the equity method (paragraphs 19 and 20). Similarly, consolidation of subsidiaries controlled by means other than ownership of a majority voting interest--control by significant minority ownership, by contract, lease, or agreement with other stockholders, by court decree, or otherwise--has not been reconsidered in this Statement because that subject also is part of the project on the reporting entity.

Continued Disclosure

[FAS 94.11] The FASB project on the reporting entity, including consolidations and the equity method, will consider what disaggregated information should be disclosed with consolidated financial statements. To prevent loss in the meantime of information about unconsolidated subsidiaries now required by APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, this Statement requires continued disclosure of that information for subsidiaries that are consolidated as a result of this Statement.

[FAS 94.12] The time between issuance of this Statement and one that would require disclosure of specified disaggregated information provides an opportunity for business enterprises to explore ways to provide additional information that is useful to investors, creditors, and others in understanding and assessing the effects of the differing risks and returns of various activities. A number of enterprises have been providing information about consolidated subsidiaries that goes beyond that required by Opinion 18 and FASB Statement No. 14, Financial Reporting for Segments of a Business Enterprise, and the Board encourages them to continue with and to strive to improve that disclosure and encourages others to follow their example. That experimentation not only should result in improved disclosure but also will provide the Board and its constituents with experience on which to draw in considering the broad issue of disclosures of disaggregated information.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Amendments of ARB No. 51, APB Opinion No. 18, and ARB No. 43, Chapter 12

[FAS 94.13] Paragraphs 2 and 3 of ARB 51 are amended to read: n2

2. The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company is a condition pointing toward consolidation. However, there are exceptions to this general rule. A majority-owned subsidiary shall not be consolidated if control is likely to be temporary or if it does not rest with the majority owner (as, for instance, if the subsidiary is in legal reorganization or in bankruptcy or operates under foreign exchange restrictions, controls, or other governmentally imposed uncertainties so severe that they cast significant doubt on the parent's ability to control the subsidiary).

3. All majority-owned subsidiaries--all companies in which a parent has a controlling financial interest through direct or indirect ownership of a majority voting interest--shall be consolidated except those described in the last sentence of paragraph 2.

[FAS 94.14] The heading "Unconsolidated Subsidiaries in Consolidated Statements" and paragraphs 19-21 of ARB 51 are deleted and replaced by the following heading and new paragraph 19:

DISCLOSURE ABOUT FORMERLY UNCONSOLIDATED MAJORITY-OWNED SUBSIDIARIES
19. Information that was disclosed under APB Opinion No. 18, paragraph

STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 94; FAS 94; SFAS 94; FAS

20(c), about majority-owned subsidiaries that were unconsolidated in financial statements for fiscal years 1986 or 1987 shall continue to be disclosed for them after they are consolidated pursuant to the provisions of this pronouncement as amended by FASB Statement No. 94. That is, summarized information about the assets, liabilities, and results of operations (or separate statements) shall be provided for those subsidiaries, either individually or in groups, as appropriate, in the consolidated financial statements or notes.

[FAS 94.15] Opinion 18 is amended to eliminate its requirement to use the equity method to account in consolidated financial statements for unconsolidated majority-owned subsidiaries and to eliminate its provisions applying to "parent-company financial statements prepared for issuance to stockholders as the financial statements of the primary reporting entity," which are precluded by this Statement. n3 The paragraphs primarily affected are 1, 14, 16, and 17 and the footnotes to them; changes in other paragraphs primarily remove "subsidiaries" or "unconsolidated subsidiaries" from expressions such as "subsidiaries, joint ventures, and other investees which qualify for the equity method" or remove other words or sentences that no longer apply.n4

- a. The second sentence of paragraph 1 is amended to read:

This Opinion extends the applicability of the equity method of accounting (paragraph 6(b)) to investments in common stock of

corporate

joint ventures and certain other investments in common stock.

The third sentence and footnote 1 are deleted.

- b. Footnote 3 to paragraph 4 is amended to read:

See paragraphs 2 and 3 of ARB No. 51 as amended by FASB Statement No. 94.

- c. Paragraph 14 is amended to read:

14. ARB No. 51, paragraphs 2 and 3 (as amended by FASB Statement No. 94), requires consolidation of all majority-owned subsidiaries except the few that meet conditions described in paragraph 2. The equity method is not a valid substitute for consolidation. Moreover, since

ARB

No. 51 as amended requires the general-purpose financial statements of companies having one or more majority-owned subsidiaries to be consolidated statements, parent-company statements are not a valid substitute for consolidated financial statements.

- d. Paragraph 14, footnote 4, is amended to read:

Paragraphs 2 and 3 of ARB No. 51 (as amended by FASB Statement No. 94) describe the conditions under which a majority-owned subsidiary shall not be consolidated. The limitations in paragraphs 2 and 3 of ARB No. 51 (as amended by FASB Statement No. 94) should also be applied as limitations to the use of the equity method.

- e. The second sentence of paragraph 16 is amended to read:

Therefore, investors should account for investments in common stock of corporate joint ventures by the equity method in consolidated

financial

statements. 6

- f. The last sentence of paragraph 17 is deleted. g. The first two sentences of paragraph 19 are deleted. h. In the third sentence of paragraph 19, the words "unconsolidated subsidiaries" are deleted. i. In the first sentence of paragraph 19(a), the word "subsidiary" is deleted. j. Paragraph 20(c) is

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deleted. k. Paragraph 20(d) is amended to delete "of 50% or less" from the first sentence.

[FAS 94.16] Paragraphs 8 and 9 of ARB 43, Chapter 12, "Foreign Operations and Foreign Exchange," are deleted. (Paragraph 8 and part of 9 are quoted in footnote 1 of this Statement.)

Effective Date and Transition

[FAS 94.17] This Statement shall be effective for financial statements for fiscal years ending after December 15, 1988. Earlier application is encouraged. Application to interim financial statements for the year of adoption is not required at the time of their issuance; however, comparative financial statements for earlier periods including those of the year of adoption shall be restated when this Statement is applied.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of six members of the Financial Accounting Standards Board. Mr. Brown dissented.

Mr. Brown does not support this Statement's requirement to continue disclosures for subsidiaries formerly exempt from consolidation. He believes that, although this Statement improves financial reporting by requiring consolidation of most subsidiaries formerly exempt from consolidation, the requirement for continued disclosure is not evenhanded and has not been justified. By requiring continued disclosures for subsidiaries that were not consolidated in 1986 and 1987, this Statement would oblige certain business enterprises to disclose information not required of enterprises in similar circumstances. That additional disclosure would not be based on different circumstances but merely on differences in past accounting practices.

Mr. Brown believes that comparability of financial statements will not be enhanced by those disclosure requirements. On the effective date of the Statement, similarly situated enterprises will have different disclosure requirements. That lack of comparability will increase over time because the proportion of subsidiaries subject to those requirements will decline. That decline will occur because newly formed subsidiaries will not be subject to the disclosure requirements and because the number of subsidiaries for which disclosure is initially required will decrease over time due to attrition. The disclosure requirements are characterized as expedient and are expected to be temporary, pending Board consideration of the broad issue of disclosure of disaggregated activities. Mr. Brown notes, however, that this consideration may be some years in the future.

The stated purpose of those disclosure requirements is to avoid possible loss of information previously disclosed. Mr. Brown observes, however, that the importance of the information that might be lost has not been substantiated, nor is it even clear that significant information would be lost. Many subsidiaries that are newly required to be consolidated under this Statement will be segments under FASB Statement No. 14, Financial Reporting for Segments of a Business Enterprise. For those enterprises, segment reporting will provide supplementary information. In addition, enterprises may well choose to disclose information voluntarily as suggested by the fact that many enterprises already provide information about consolidated subsidiaries that goes beyond existing

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requirements. Further, Mr. Brown thinks that enterprises will have strong incentives to provide disclosures to minimize the possibility that investors, creditors, and others will misinterpret financial statements in which formerly unconsolidated subsidiaries are consolidated.

Members of the Financial Accounting Standards Board:

Dennis R. Beresford, Chairman
Victor H. Brown
Raymond C. Lauver
James J. Leisenring
David Mosso
C. Arthur Northrop
Robert J. Swieringa

Appendix A

BACKGROUND INFORMATION

[FAS 94.18] An AICPA Issues Paper, "Reporting Finance Subsidiaries in Consolidated Financial Statements," dated December 27, 1978, asked the Board to consider whether finance subsidiaries of primarily nonfinancial business enterprises should be required to be consolidated. It said that the permitted exclusion of finance companies from consolidated financial statements in ARB 51 should be reevaluated because of the increased number and size of unconsolidated finance subsidiaries then in existence. Since 1978, unconsolidated finance subsidiaries have continued to proliferate.

[FAS 94.19] The Board added a project on the reporting entity, including consolidations and the equity method, to its agenda in January 1982. The issues in that AICPA Issues Paper, as well as those in several others, were included in the scope of the project.

[FAS 94.20] A major goal of the project is to develop a reporting entity concept for business enterprises. Research and deliberation on the reporting entity concept and other consolidation issues are still in progress. The Board has tentatively concluded that the concept should be based primarily on control rather than on ownership of a majority voting interest, which is the most common but not the only means of controlling a subsidiary. However, the Board has not yet reached agreement on some significant issues, including precisely how to determine if means other than majority ownership have resulted in control and what techniques of consolidation would best report the effects of noncontrolling (minority) interests that arise because subsidiaries are only partially owned. Since more consideration of those matters is needed, the Board's tentative conclusions on a concept of reporting entity for business enterprises is not yet ready to be issued.

[FAS 94.21] The Board's deliberations on the reporting entity concept have proceeded far enough to establish that consolidation of all majority-owned subsidiaries whose control is not in question is consistent with all of the reporting entity concepts that the Board is considering. Therefore, the Board decided to require consolidation of all majority-owned subsidiaries, because that decision will not be affected by resolution of the remaining issues.

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[FAS 94.22] This Statement is a major step in resolving the growing problem of off-balance-sheet financing. Unconsolidated majority-owned subsidiaries have been a significant aspect of that problem. The growing size and importance of finance and other unconsolidated majority-owned subsidiaries and the resulting amounts of assets, liabilities, revenues, and expenses that have not been reflected in many consolidated financial statements have made the matter important.

[FAS 94.23] The Board issued an Exposure Draft, Consolidation of All Majority-owned Subsidiaries, on December 16, 1986. The Board received 232 letters of comment on the Exposure Draft and 21 individuals and organizations presented their views at a public hearing held on May 18 and 19, 1987.

[FAS 94.24] The major difference between this Statement and the Exposure Draft is that the Exposure Draft proscribed the equity method for investments in majority-owned companies that remain unconsolidated because of the provisions of paragraph 2 of ARB 51 as amended by this Statement, while this Statement is silent on that subject. The effective date of the Statement also is one year later than that in the Exposure Draft.

Appendix B

BASIS FOR CONCLUSIONS

Introduction

[FAS 94.25] This appendix reviews considerations that were deemed significant by members of the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

[FAS 94.26] The introduction to this Statement notes that practice under ARB 51 has become increasingly diverse as some enterprises have consolidated all their significant majority-owned subsidiaries and other enterprises have excluded some majority-owned subsidiaries from consolidation. That diversity has been criticized as lessening comparability between enterprises' financial statements. The introduction also notes that practice has been increasingly criticized as often omitting significant amounts of assets, liabilities, revenues, and expenses from consolidated financial statements. That result has made exclusion of some majority-owned subsidiaries from consolidation a significant factor in off-balance-sheet financing.

[FAS 94.27] Most of those criticisms of practice relate to what has commonly been called the "nonhomogeneity" exception to consolidation of all majority-owned subsidiaries. Significant majority-owned subsidiaries also have been excluded from consolidation for other reasons, but the most prevalent exclusions in practice recently have been finance, insurance, real estate, leasing, and other "nonhomogeneous" subsidiaries by manufacturing and merchandising enterprises. The basis in the authoritative literature for that "nonhomogeneity" exception has been the third paragraph of ARB 51 (paragraphs 5-8 of this Statement).

Highly Diverse and Complex Business Enterprises

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[FAS 94.28] In the 28 years since ARB 51 was issued, business enterprises have continued to become more diverse and complex. Enterprises have branched into different lines of business and entered many foreign markets. More enterprises that previously were considered nonfinancial have been diversifying into financial services--financing, insurance, real estate, leasing, and investment banking--while more of those that remain primarily nonfinancial enterprises have been forming separate subsidiaries to carry out financial activities that were formerly carried out by the parents or their existing subsidiaries.

[FAS 94.29] In an economy in which numerous and varied kinds of activities are commonly combined in a single enterprise, whether organized as a single corporation with branches and divisions or as a parent company and subsidiaries, the argument that part of an enterprise has operations so different from those of other parts that it should be accounted for in a fundamentally different way has become increasingly tenuous. The Board concluded that the increasingly diverse nature of business activity, and of business enterprises themselves, makes the fact that the business activity of a subsidiary is different from that of its parent and other subsidiaries an insufficient reason to exclude it from consolidation.

[FAS 94.30] The managerial, operational, and financial ties that bind an enterprise into a single economic unit are stronger than the differences between its lines of business. Consolidated financial statements became common once it was recognized that boundaries between separate corporate entities must be ignored to report the business carried on by a group of affiliated corporations as the economic and financial whole that it actually is. Similarly, differences between the varied operations of a group of affiliated corporations that constitutes an economic and financial whole do not preclude including them all in consolidated financial statements.

[FAS 94.31] Those differences also do not make the equity method a valid substitute for consolidation of majority-owned subsidiaries. Although the equity method described in Opinion 18 usually results in the same net income and the same net assets as consolidation, that method omits significant revenues and expenses from the income statement, omits significant assets and liabilities from the balance sheet, and omits significant receipts and payments from the statement of cash flows. For example, difference in operations has long been rejected as a basis for not consolidating so-called captive leasing subsidiaries. The decision and most of the language now in paragraph 31 of FASB Statement No. 13, Accounting for Leases, was in APB Opinion No. 10, Omnibus Opinion--1966 (and was reaffirmed in Opinion 18):

The accounts of subsidiaries (regardless of when organized or acquired) whose principal business activity is leasing property or facilities to the parent or other affiliated companies shall be consolidated. The equity method is not adequate for fair presentation of those subsidiaries because their assets and liabilities are significant to the consolidated financial position of the enterprise.

The same reasoning applies to other "nonhomogeneous" majority-owned subsidiaries, whether captive or not.

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[FAS 94.32] Other restrictive consolidation practices have been to exclude from consolidation, for example, all foreign subsidiaries, all subsidiaries that are not wholly owned, or all subsidiaries that are not 80 percent owned. Those essentially arbitrary restrictions also are not sufficient reasons to exclude majority-owned subsidiaries from consolidation.

[FAS 94.33] The central issue is whether financial statements that consolidate some majority-owned subsidiaries and report others as investments in the equity securities of other enterprises adequately report the operating results and financial position of the business enterprise of which all the subsidiaries are a part. The Board concluded that consolidated financial statements that include all majority-owned subsidiaries whose control is not in question better meet the objectives of financial reporting and more fully possess the qualitative characteristics of useful financial information described in FASB Concepts Statement No. 2, Qualitative Characteristics of Accounting Information, especially relevance, representational faithfulness, and comparability.

Objectives and Qualitative Characteristics

[FAS 94.34] Investors, creditors, and others who use financial statements need information about a business enterprise that is useful in making investment, credit, or other similar decisions about it (FASB Concepts Statement No. 1, Objectives of Financial Reporting by Business Enterprises, paragraphs 34-40). Those who invest in the parent company of an affiliated group of corporations invest in the whole group, which constitutes the enterprise that is a potential source of cash flows to them as a result of their investment.

Relevance and Representational Faithfulness

[FAS 94.35] Information that is most relevant to investors, creditors, and other users thus includes consolidated financial statements that "present, primarily for the benefit of the shareholders and creditors of the parent company, the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company with one or more branches or divisions" (ARB 51, paragraph 1).

[FAS 94.36] A set of consolidated financial statements that includes all majority-owned subsidiaries fits that description better than a set that excludes significant parts of an enterprise. If the assets, liabilities, revenues, expenses, and cash flows of "nonhomogeneous" subsidiaries are excluded from consolidation, the consolidated financial statements of the enterprise do not faithfully represent the operating results, financial status, and capital structure of the enterprise described in paragraph 35.

[FAS 94.37] A significant aspect of both relevance and representational faithfulness is completeness--

The inclusion in reported information of everything material that is necessary for faithful representation of the relevant phenomena. Freedom from bias . . . implies that nothing material is left out of the information that may be necessary to insure that it validly represents the underlying events and conditions. Relevance of information is adversely affected if a relevant piece of

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information is omitted, even if the omission does not falsify what is shown. [Concepts Statement 2, "Glossary," and paragraphs 79 and 80]

Consolidated financial statements that exclude some majority-owned subsidiaries provide an incomplete picture of an enterprise. If they are to see the complete picture, investors, creditors, and other users must themselves attempt to consolidate the excluded subsidiaries. Even then, a "do-it-yourself" consolidation can only be a rough approximation of one done by the enterprise itself because consolidation procedures require detailed information about current amounts and past transactions that is seldom provided by general-purpose financial reporting. The representational faithfulness of a user's consolidation is at least questionable, and its comparability with consolidated financial statements or "do-it-yourself" consolidations of other enterprises, or of the same enterprise for an earlier period, is at best doubtful.

[FAS 94.38] Unconsolidated majority-owned subsidiaries usually have been accounted for by the equity method in accordance with Opinion 18. The equity method described by Opinion 18 normally results in the same net income and stockholders' equity as consolidation, but the information it provides about specific classes of assets, liabilities, revenues, and expenses is significantly different from, and is not a substitute for, information provided by consolidation. The equity method reports a parent's equity in the net assets of its unconsolidated subsidiaries as a single-line item in the consolidated statement of financial position and generally reports its share of the unconsolidated subsidiaries' reported net income as a single-line item in the consolidated income statement.

[FAS 94.39] Although net income and total stockholders' equity are important factors in assessing the enterprise's performance and its financial position, the relative amounts of various assets, liabilities, revenues, and expenses and their relationships to other items in the consolidated financial statements also generally are essential factors in that analysis.

Although . . . simplifications, condensations, and aggregations are both necessary and useful, the Board believes it is important to avoid focusing attention almost exclusively on "the bottom line," earnings per share, or other highly simplified condensations. Summary data, such as the amounts of net assets, comprehensive income, earnings, or earnings per share, may be useful as general indicators of the amount of investment or overall past performance and are often used in efforts to compare an entity with many other entities. But, in a complex business enterprise, summary amounts include many heterogeneous things and events. Components of a financial statement often reflect more homogeneous classes of items than the whole statement. The individual items, subtotals, or other parts of a financial statement may often be more useful than the aggregate to those who make investment, credit, and similar decisions. [FASB Concepts Statement No. 5, Recognition and Measurement in Financial Statements of Business Enterprises, paragraph 22]

[FAS 94.40] The usefulness of information about amounts of various assets, liabilities, revenues, and expenses is also indicated by the fact that most summary indicators other than net income, earnings per share, and stockholders' equity are affected by whether a subsidiary is consolidated or accounted for by

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the equity method. Basic analytical tools such as the current ratio, receivables turnover, inventory turnover, times interest earned, and return on total assets are a few examples. The paramount example is the debt-equity ratio, which, for reasons already described, is much lower if finance or other highly leveraged subsidiaries are accounted for by the equity method rather than consolidated. That effect is one aspect of off-balance-sheet financing that has been criticized because transactions between affiliates and intercompany receivables and payables often make it unlikely that "do-it-yourself" consolidation can adequately approximate debt-equity ratios in consolidated financial statements provided by the enterprises themselves.

[FAS 94.41] Use of the equity method for majority-owned subsidiaries that are significant parts of an enterprise diminishes the usefulness of and raises questions about the credibility of consolidated financial statements as those subsidiaries grow in significance. As enterprises become more diversified, the number and variety of their majority-owned subsidiaries that are not consolidated because of "nonhomogeneity" of operations often increase. Thus, the amounts reported as single-line items in consolidated financial statements not only become larger but also the information they convey diminishes--the resulting consolidated financial statements provide less and less information about the enterprise in which its stockholders have invested. Consolidated financial statements of some enterprises have excluded more assets and liabilities than they have included.

Comparability

[FAS 94.42] Consolidation of all majority-owned subsidiaries will also improve comparability between enterprises. Investment and credit decisions involve comparing available alternative investment or credit opportunities. Thus:

Information about an enterprise gains greatly in usefulness if it can be compared with similar information about other enterprises and with similar information about the same enterprise for some other period or some other point in time. The significance of information, especially quantitative information, depends to a great extent on the user's ability to relate it to some benchmark. [Concepts Statement 2, paragraph 111]

[FAS 94.43] As Concepts Statement 2 also notes (paragraphs 113-119), comparison involves identifying, understanding, and assessing both similarities and differences. To the extent that similarities and differences stem from financial reporting rather than from the enterprises themselves, financial reporting hinders rather than helps investors and creditors in making their decisions. A significant problem in practice under ARB 51 is that large differences between consolidated financial statements of different business enterprises often have resulted from different consolidation policies rather than from significant differences between the enterprises.

Reporting of Cash Flows

[FAS 94.44] Consolidated financial statements that include all majority-owned subsidiaries should also result in more relevant, representationally faithful, and comparable statements of cash flow. Although

the equity method and consolidation may report the same net income and net assets, they do not report the same cash receipts and payments related to operating, investing, and financing activities. Potentially significant information about how an enterprise generates cash through operations, as well as information about its financing and investing activities, is not provided if subsidiaries are not consolidated.

Matters Raised in Comment Letters and at the Public Hearing

[FAS 94.45] Many respondents who opposed the conclusion of the Exposure Draft argued that consolidation of "nonhomogeneous" subsidiaries would make the consolidated financial statements less useful. Many asserted that it would impair comparability of the financial data between enterprises and that it would confuse the expected debt-equity (and other) ratios of manufacturing and financial components of diverse business enterprises, resulting in ratios that would accurately reflect neither component. On the other hand, many respondents who supported the conclusion of the Exposure Draft did so because they thought comparability would be enhanced due to more comprehensive disclosure of financial results.

[FAS 94.46] Before the Exposure Draft was issued, the Board recognized that opinions of respondents on whether consolidated financial statements were more useful probably would be divided. The Board considered the comments on usefulness with emphasis on comparability and noted that usefulness means more than comparability. The Board's conclusions rely on Concepts Statement 2, which emphasizes relevance and representational faithfulness as much as comparability. Thus, the Board concluded that consolidated financial statements that include all majority-owned subsidiaries whose control is not in question better meet the objectives of financial reporting.

[FAS 94.47] Most respondents who opposed the elimination of the "nonhomogeneity" exception acknowledged that it needed some boundaries. Some proposed that finance and insurance subsidiaries ought to be excluded from consolidation by nonfinancial enterprises and suggested the Board establish criteria for excluding certain subsidiaries by examining differences in reported financial ratios or in the operating cycles. Respondents did not suggest a basis for determining threshold values for those criteria, and the Board observed that any choice necessarily would be arbitrary, would differ between industries, and could vary over time due to changes in business practices. Some measures that seem appropriate may not distinguish effectively between subsidiaries. For example, a high debt-equity ratio may reflect either poor financial condition, "nonhomogeneity," or both. The Board concluded that establishing criteria for "nonhomogeneity" based on financial characteristics would be arbitrary and ineffective.

[FAS 94.48] Other respondents suggested that the Board narrow the "nonhomogeneity" exception by requiring consolidation of all "captive" subsidiaries--that is, subsidiaries that conduct a majority of their transactions with their parent company. Those respondents argued that consolidating captive subsidiaries improves comparability with enterprises that have not formed subsidiaries but engage in like activities. They argued that consolidating noncaptive, "nonhomogeneous" subsidiaries impairs that comparability. Respondents suggested that the Board look to a subsidiary's relationship to the primary reporting entity to distinguish captive from

noncaptive. The Board observed that as diversification increases so does the difficulty of identifying the primary business of an enterprise. Respondents were unable to provide substantive guidelines for that identification. The Board agreed with respondents that, if a subsidiary is captive, consolidation of that subsidiary improves comparability. However, the Board concluded that other arguments including improved representational faithfulness and relevance justify consolidating noncaptive subsidiaries.

[FAS 94.49] Many respondents criticized the Exposure Draft's requirements as representing a "piecemeal" approach to establishing revised consolidation criteria. Most indicated that such an approach created a risk that future decisions by the Board may require the consolidation requirements of the Exposure Draft to be reversed. The Board recognizes that deliberation will continue on the reporting entity concept, which may lead to changed consolidation criteria based on control. However, the Board concluded that the risk of reversing the consolidation requirements of this Statement was minimal because the criteria for excluding subsidiaries from consolidation based on "nonhomogeneity" are unrelated to control.

[FAS 94.50] Some respondents recommended that the Board provide guidance for various financial statement display questions that may arise, including how to consolidate a nonclassified statement of financial position used by a financial institution with a classified statement of financial position used by a manufacturing or merchandising company and how to display interest expense of both financial and manufacturing subsidiaries in a consolidated income statement. The Board noted that guidance might reduce diversity of display but concluded that some variety may be appropriate for reporting the financial position and results of diverse enterprises. The Board also noted that the issue is not new because some enterprises have consolidated subsidiaries with those characteristics and have developed reporting formats to present consolidated results effectively.

[FAS 94.51] Many respondents requested a delay in the effective date. The most compelling reasons offered for extending the effective date were the need to allow companies additional time to renegotiate loan covenants or other provisions of loan agreements and to familiarize investors, creditors, and other users with the effects of consolidation on financial statement ratios. Respondents indicated that the risk of increased cost of borrowing at the time loan covenants are renegotiated would be mitigated if additional time was available. Respondents also requested additional time to determine the most effective financial statement display. The Board accepted those arguments and delayed the effective date for one year.

[FAS 94.52] Several respondents questioned whether direct financing and leveraged leases of a majority-owned leasing subsidiary accounted for under the equity method would be required to be reclassified as sales-type capital leases when the subsidiary is consolidated. Paragraph 19 of Opinion 18, which specifies how to account for those subsidiaries under the equity method prior to their being consolidated as required by this Statement, indicated that net income and stockholders' equity generally would be the same whether the subsidiary was accounted for under the equity method or whether it was consolidated. Thus, whether a leasing subsidiary was accounted for by the equity method or is now consolidated as required by this Statement, the distinction between a direct financing and a sales-type capital lease is based on

application of Statement 13 as if the subsidiary were consolidated. Leases of a manufacturing company's equipment sold to a leasing subsidiary that are accounted for as direct financing leases on the subsidiary's financial statements normally would be sales-type capital leases in the consolidated financial statements. This Statement does not change that requirement.

[FAS 94.53] The Exposure Draft's requirement to use the cost method for majority-owned subsidiaries that remain unconsolidated was intended to change Opinion 18 only to the extent necessary to avoid conflict with ARB 51 as amended. However, respondents said that the requirement would change practice because "significant influence" might remain even if control were lost and because of specialized industry practices for investment companies. The Board removed the requirement to use only the cost method, thereby leaving existing pronouncements in effect. The method to be used to account for those subsidiaries will be considered in the broad project described in paragraphs 19 and 20.

Need for Disaggregated Information

[FAS 94.54] Some who favor consolidating all majority-owned subsidiaries whose control is not in question are nevertheless concerned that consolidating "nonhomogeneous" subsidiaries will obscure important information about the primary operations of an enterprise, producing less informative financial statements than those that exclude "nonhomogeneous" subsidiaries but append their separate financial statements or equivalent information. An example is a parent that is primarily a manufacturing enterprise that consolidates an insurance or bank subsidiary. That concern was expressed frequently in interviews conducted in the early stages of the FASB project on the reporting entity (paragraphs 19 and 20), both by those who use financial statements and by those who provide them.

[FAS 94.55] The Board recognizes that aggregation of assets and liabilities resulting from operations with activities that differ from each other in profitability, risks, and returns can obscure important information about each of those activities. However, the Board also believes that disclosures required under FASB Statement No. 14, Financial Reporting for Segments of a Business Enterprise, can provide meaningful information about the different operations within a business enterprise. Consolidated financial statements and adequate disclosure of varied activities are not mutually exclusive.

[FAS 94.56] The financial reporting that has followed the issuance of Statement 14 in 1976 has demonstrated that financial reporting can readily provide both consolidated and disaggregated information. For example, when the Securities and Exchange Commission eliminated its requirement to provide separate financial statements of consolidated subsidiaries engaged in "diverse financial-type" businesses in 1981, it said, "The Commission's decision to delete all requirements for additional financial information for consolidated finance-type subsidiaries . . . was significantly influenced by its conclusion that the disclosures required by [FASB Statement] 14 provide adequate information on these activities to most investors . . ." (Accounting Series Release No. 302, Separate Financial Statements Required by Regulation S-X).

[FAS 94.57] The broad project on the reporting entity will consider disclosure of disaggregated information in consolidated financial statements. Business enterprises have the opportunity to experiment with providing

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additional information in the time between the issuance of this Statement and the completion of that portion of the broader project. The Board encourages experimentation to improve disclosure and to better communicate to investors, creditors, and others. That experimentation should prove beneficial to the preparer and should provide the Board and others with experience that is useful when considering disclosure of disaggregated information in the future.

[FAS 94.58] Opinion 18, paragraph 20(c) has required that summarized information about the assets, liabilities, and results of operations of unconsolidated subsidiaries should be presented in the notes of consolidated financial statements or in separate statements. Some of that information is not required by Statement 14. Many comments were received on the general issue of disclosing disaggregated information. Recommendations ranged from requiring no disclosure to requiring consolidating financial statements. Although opposition to the requirement to continue disclosure presently called for by Opinion 18 was substantial, some suggested less information should be required, while others said more, or at least different, information should be required. Users of financial statements expressed strong concern about the possible loss of information that was currently available.

[FAS 94.59] The Board acknowledges that this Statement's disclosure requirement represents an expedient solution. The Board concluded, however, that alternatives were less attractive. Increasing disclosure requirements to eliminate what is perceived as this Statement's lack of evenhandedness without reconsidering the broad issue of disclosing disaggregated information probably would not result in meaningful requirements. Dropping that requirement would result in loss of information that users of financial statements urged the Board to retain. The Board concluded that to prevent loss of that information was important. The Board also noted that the requirement is reasonably evenhanded. Most enterprises with what generally have been called "nonhomogeneous" subsidiaries will be required to provide continued disclosure because most of those subsidiaries are not now consolidated. Moreover, the Board recognized that many enterprises would voluntarily provide the disaggregated information they thought necessary to meet concerns they expect to result from the revised consolidation policy. Those enterprises would incur no additional cost to implement the disclosure provision of this Statement. After assessing the matters set forth in this and the previous paragraph, the Board decided to continue Opinion 18's disclosure requirements for subsidiaries that are consolidated as a result of this Statement.

Benefits and Costs of Consolidating All Majority-owned Subsidiaries

[FAS 94.60] Paragraphs 25-44 discuss the benefits of requiring consolidation of all majority-owned subsidiaries whose control is not in question. The Board recognizes that initial adoption of that requirement may cause some enterprises to incur certain costs, for example, to renegotiate debt covenants that are technically in default once highly leveraged finance and similar subsidiaries are consolidated and perhaps to educate some investors and creditors about the change in consolidation policy. However, the Board believes that those costs will be outweighed by the benefits of more relevant, representationally faithful, and comparable consolidated financial statements.

Parent-Company Financial Statements

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[FAS 94.61] Opinion 18, paragraphs 14, 16, and 17, requires use of the equity method in "parent-company financial statements prepared for issuance to stockholders as the financial statements of the primary reporting entity." This Statement removes those provisions because, if an enterprise has one or more subsidiaries, consolidated rather than parent-company financial statements are the appropriate general-purpose financial statements. The Board is aware of no instances in which parent-company financial statements have been issued as general-purpose financial statements and believes the elimination of those provisions will result in little or no change in practice.

FOOTNOTES:

n1 Paragraph 2 permits omission of majority-owned foreign subsidiaries from consolidation by reference to the broad provisions of ARB No. 43, Chapter 12, "Foreign Operations and Foreign Exchange," paragraphs 8 and 9:

n2 Details of the changes: Paragraph 2 of ARB 51 is amended to delete the fourth, fifth, and sixth sentences and to delete "For example," to change "should" to "shall," and to add an example in the parentheses in the third sentence. The deleted sentences read: "There may also be situations where the minority interest in the subsidiary is so large, in relation to the equity of the shareholders of the parent in the consolidated net assets, that the presentation of separate financial statements for the two companies would be more meaningful and useful. However, the fact that the subsidiary has a relatively large indebtedness to bondholders or others is not in itself a valid argument for exclusion of the subsidiary from consolidation. (Also, see Chapter 12 of Accounting Research Bulletin No. 43 for the treatment of foreign subsidiaries.)" Paragraph 3 (most of which is quoted in paragraph 5 of this Statement) is entirely deleted and replaced by a new paragraph 3.

n3 Opinion 18 was silent about parent-company financial statements prepared for purposes other than issuance as the general-purpose financial statements of the primary reporting entity. This Statement also does not consider that subject.

n4 Details of major changes: Paragraphs 1, 16, and 17--The deleted parts of all three paragraphs pertain to "parent-company financial statements prepared for issuance to stockholders as the financial statements of the primary reporting entity." A similar provision is also deleted from paragraph 14. Paragraph 14--The first sentence, "The Board reaffirms the conclusion that investors should account for investments in common stock of unconsolidated domestic subsidiaries by the equity method in consolidated financial statements, and the Board now extends this conclusion to investments in common stock of all unconsolidated subsidiaries (foreign as well as domestic) in consolidated financial statements," and the third sentence (whose content was just described) are deleted and replaced by new sentences. In the second sentence the words "and should not be used to justify exclusion of a subsidiary when consolidation is otherwise appropriate" are deleted. Paragraph 19--The deleted sentences read: "The difference between consolidation and the equity method lies in the details reported in the financial statements. Thus, an investor's net income for the period and its stockholders' equity at the end of the period are the same whether an investment in a subsidiary is accounted for under the equity method or the subsidiary is consolidated (except as indicated in paragraph 19i)."

n5 "Representational faithfulness is correspondence or agreement between a

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measure or description and the phenomenon it purports to represent. In accounting, the phenomena to be represented are economic resources and obligations and the transactions and events that change those resources and obligations" (Concepts Statement 2, par. 63).

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Welcome to the Web site of Kansas City Southern Industries (KCSI), an independent transportation company comprised of five primary railroads: Kansas City Southern (KCS), Gateway Western (GWR), Texas Mexican (Tex Mex), Grupo Transportacion Ferroviaria Mexicana (TFM) and Panama Canal Railway Co. (PCRC). More and more people are getting to know us as the *NAFTA Railway* - a leader in providing seamless rail service for North American shippers.

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Kansas City Southern Railway



Kansas City Southern Railway

The Kansas City Southern Railway Co. (KCSR) is a Class I ra system which operates over 2,728 track miles in 11 central an southeastern states. Founded in 1887 with the vision of provid the most direct salt water access from the Midwest, KCSR tod has the shortest route between Kansas City and the Gulf of Mexico, serving the ports of Port Arthur, Texas New Orleans West Lake Charles, La. and Gulfport, Miss.

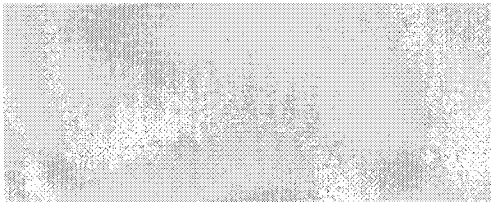
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KCSR transports a diverse mix of commodities with no one commodity group exceeding 25% of total carloads. With connections to all the other Class I rail carriers and coordinate operations with the other entities that comprise the NAFTA Railway, KCSR is strategically positioned to serve the growin number of North American shippers requiring reliable, efficie rail transportation.



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Kansas City Southern Rail Network

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Kansas City Southern Railway

Facts About KCSR

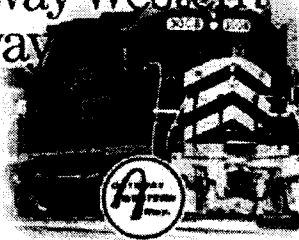
General Description:	A Class I railroad with operati central and southeastern states
Company Headquarters:	114 West 11th Street Kansas City, Missouri 64105 816-983-1303
Employees:	2,888
Labor Status:	Represented by 13 rail labor u under collective bargaining ag
Route Miles:	2,756 miles
Equipment Fleet:	434 locomotives 14,733 freight cars
Carloadings:	1999 - 906,291 1998 - 881,069 1997 - 821,362 1996 - 808,048
Revenues:	1999 - \$545.7 million 1998 - \$551.6 million 1997 - \$517.8 million 1996 - \$492.5 million
Operating Ratio:	1999 - 84.8% 1998 - 79.9% 1997 - 83.4% 1996 - 84.5%
Ownership:	100% - KCSI through indirect

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Gateway Western Railway



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Gateway Western Railway

Facts About Gateway Western

General Description:	A regional bridge carrier betw Louis and Kansas City linkin and eastern railroads.
Company Headquarters:	15 Executive Drive Fairview Heights, IL 62208 618-624-4700
Employees:	263
Labor Status:	Represented by 8 rail labor un collective bargaining agreeme
Route Miles:	402
Equipment Fleet:	32 locomotives 367 freight cars
Revenues:	1999 - \$40.7 million 1998 - \$45.2 million 1997 - \$42.7 million
Operating Ratio:	1999 - 92.1% 1998 - 79.9% 1997 - 82%
Ownership:	100% - KCSI through indirec

Gateway Western Railway
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Texas Mexican Railway

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Texas Mexican Railway

Facts About Tex Mex

General Description:

A regional bridge carrier oper Texas between Laredo and Co with trackage rights through t and Beaumont.

Company Headquarters:

1200 Washington
Laredo, TX 78040
956-728-6700

Employees:

271

Labor Status:

Represented by 7 rail labor un collective bargaining agreeme

Route Miles:

157 miles, 557 miles includin rights

Equipment Fleet:

38 locomotives
905 freight cars

Carloadings:

1999 - 80,966
1998 - 73,699
1997 - 52,000
1996 - 34,000

Revenues:

1999 - \$50.5 million
1998 - \$49.2 million
1997 - \$28.4 million
1996 - \$15.5 million

Operating Ratio:

1999 - 96.8%
1998 - 107.5%
1997 - 97.4%
1996 - 95%

Ownership:

49% - KCSI through indirect
51% - TMM/Grupo Servia

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**Grupo Transportacion Ferroviaria Mexicana,
S.A. de C.V. (TFM)**

Facts About TFM

General Description:

Mexico's primary rail line (th
Railway) providing the shorte
between the United States an
City with access to 80% of M
population and service to all i
industrial and population cent

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Employees:

3987

Route Miles:

2,661 miles

Company Headquarters:

Av. Periferico Sur 4829
Col Parques Del Pedregal
Mexico, D.F. 14010
525-447-5859

Revenues:

1999 - \$524.5 million
1998 - \$431.4 million

Operating Ratio:

1999 - 76.6%
1998 - 85.5%

Ownership:

Grupo Transportacion Ferrovi
Mexicana, S.A. de C.V. (TF
37% - KCSI through indir
subsidiary
38.5% - TMM/Grupo Serv
24.5% - Mexican Govern

Transportacion Ferroviaria Mexicana
Map
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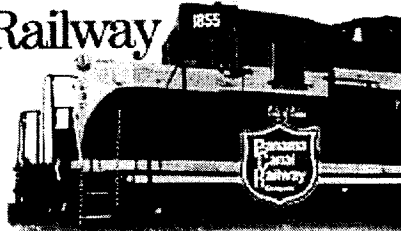
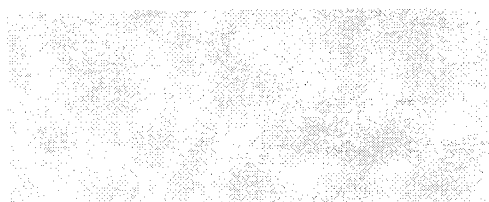
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NAFTA RAILWAY     

Kansas City Southern Rail Network

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Panama Canal Railway

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Panama Canal Railway Co.

Facts About PCRC

General Description:

A 47.6-mile transcontinental r
operating parallel to the Pana
When fully operational in 200
will provide ocean-to-ocean
transshipment service betwee
the Atlantic and Pacific ocean

Company Headquarters:

6382 Grande Place, Los Rios
East)
Panama, Republic of Panama
507-232-6855

Route Miles:

47.6 miles

Ownership:

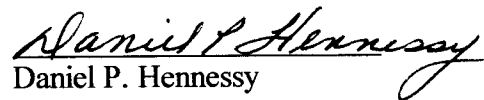
50% - KCSI through indirect
50% - Mi-Jack Products, Inc.

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VERIFICATION

I, Daniel P. Hennessy, am qualified to and have the authority to certify, and do hereby certify under penalty of perjury, that the factual statements regarding the LTV Railroads in the foregoing comments (which I have read) are true and correct to the best of my knowledge, information and belief.


Daniel P. Hennessy

Dated: November 21, 2000

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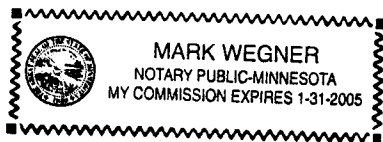
VERIFICATION

I, William F. Drusch, am qualified to and have the authority to certify, and do hereby certify under penalty of perjury, that the factual statements regarding Twin Cities & Western Railroad and River Valley & Western Railroad in the foregoing comments (which I have read) are true and correct to the best of my knowledge, information and belief.


William F. Drusch

Dated: November 21, 2000

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VERIFICATION

I, Thomas Walsh, am qualified to and have the authority to certify, and do hereby certify under penalty of perjury, that the factual statements regarding Montana Rail Link and I&M Rail Link in the attached comments (which I have read) are true and correct to the best of my knowledge, information and belief.

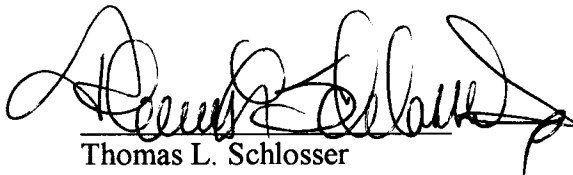

Thomas Walsh

Dated: November 22, 2000

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VERIFICATION

I, Thomas L. Schlosser, am qualified to and have the authority to certify, and do hereby certify under penalty of perjury, that the factual statements regarding ParkSierra Corporation in the foregoing comments (which I have read) are true and correct to the best of my knowledge, information and belief.



Thomas L. Schlosser

Dated: November 21, 2000

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