

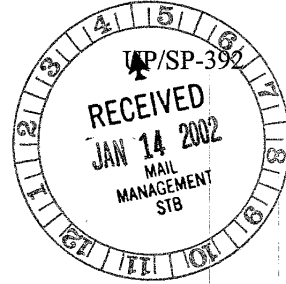
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Public Record

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760



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

**UP'S MOTION TO DISMISS BNSF'S PETITION FOR CLARIFICATION
OF THE TRackage RIGHTS FEE ADJUSTMENT PROVISION**

BNSF seeks clarification of the BNSF Settlement Agreement's provision for adjusting trackage rights fees. BNSF-98, Petition of the Burlington Northern and Santa Fe Railway Company for Clarification ("Petition"), December 21, 2001, pp. 1-2. The Board should dismiss BNSF's Petition and require the parties to arbitrate their dispute. The BNSF Settlement Agreement requires arbitration, and both BNSF and UP invoked arbitration before BNSF filed its Petition. BNSF claims that this dispute raises important policy questions for the Board about whether BNSF can compete with UP, but BNSF's ability to compete effectively using the adjusted fees is well established.

The Board should also dismiss BNSF's petition for failing to state a claim. BNSF's petition relies entirely on unsupported allegations that the parties' intent differed from the language of the BNSF Settlement Agreement. In the absence of evidence, UP cannot respond to BNSF's claims, and the Board has no basis for granting the relief that BNSF seeks.

BACKGROUND

A pending arbitration proceeding encompasses both issues on which BNSF seeks clarification. On October 4, 2001, after good-faith efforts to resolve the parties' differences had failed, UP commenced arbitration regarding the BNSF Settlement Agreement's provision for adjusting trackage rights fees. That provision states explicitly that fees will be adjusted from year to year to reflect changes in URCS costs:

All trackage rights charges under this Agreement shall be subject to adjustment upward or downward July 1 of each year by the difference in the two preceding years in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the trackage rights fee.

Restated and Amended BNSF Settlement Agreement, § 12. The provision defines "URCS costs" as "costs developed using the Uniform Rail Costing System." Id.

UP sought to arbitrate whether URCS costs should be altered to eliminate the effect of normal purchase accounting for UP's purchase of SP.¹ On November 1, 2001, BNSF filed a counter-request for arbitration seeking arbitration on the same issue. BNSF also asked for arbitration on a new URCS-costing issue: whether URCS costs should be altered to eliminate

¹ UP described the URCS-costing dispute as follows:

For the 1997 and 1998 annual adjustments, UP calculated "the difference in the two preceding years" in UP/SP's costs using actual data from 1995 and 1996, and from 1996 and 1997, respectively, as provided in Section 12 [of the BNSF Settlement Agreement]. BNSF claims that the 1995 and 1996 cost data should be artificially adjusted to reflect UP's post-merger cost structure, even though Section 12 does not provide for any such adjustment.

UP's demand for arbitration is attached as Exhibit A.

UP also raised a second issue: whether the adjustment should reflect the difference in URCS costs in the two preceding years, as UP contends, or the percentage change in URCS costs in the two preceding years, as BNSF contends. BNSF does not seek clarification with respect to the second issue. Petition, p. 2 n.3.

certain merger-related investments.² BNSF's counter-request raised three additional issues relating to the application of the fee adjustment provision.³ UP and BNSF have since resolved those three issues.

On December 21, while the parties prepared for arbitration, BNSF filed its petition for clarification. The Petition asks the Board to resolve the same two URCS-costing issues contained in BNSF's counter-request for arbitration.

I. THE BOARD SHOULD REQUIRE UP AND BNSF TO ARBITRATE THIS DISPUTE

The Board should require UP and BNSF to arbitrate their dispute regarding the adjustment provision. The BNSF Settlement Agreement requires arbitration of disputes as the exclusive remedy. Both BNSF and UP have already invoked arbitration. Moreover, the Board does not need to intervene; this dispute does not involve any important policy question about whether BNSF can compete with UP.

A. The BNSF Settlement Agreement Requires Arbitration

The fee adjustment dispute is subject to a requirement to arbitrate. UP and BNSF included an arbitration clause in the BNSF Settlement Agreement. They agreed that "unresolved disputes and controversies concerning any of the terms and provisions of this Agreement or the

² BNSF described the URCS-costing disputes as follows:

Whether UP is entitled to include the purchase premium associated with its acquisition of SP and certain merger-related expenditures relating to the trackage rights lines which were to be funded solely by UP in the investment base used in the adjustment of the trackage rights charges payable by BNSF.

BNSF's counter-request for arbitration is attached as Exhibit B.

³ The additional issues involve: (i) the method of combining UP and SP URCS costs for 1995 and 1996; (ii) the categories of maintenance and operating costs that are used to calculate the fee adjustment; and (iii) the source of dispatching expenses that are used to calculate the fee adjustment.

application of charges hereunder shall be submitted for binding arbitration under Commercial Arbitration Rules of the American Arbitration Association which shall be the exclusive remedy of the parties.” Restated and Amended BNSF Settlement Agreement, § 15.⁴ The fee adjustment dispute involves a term or provision of the agreement, so arbitration is the “exclusive” remedy.

The Board should not consider a dispute that is subject to arbitration. In its decision concluding formal UP/SP merger oversight, the Board stated that it would remain available to resolve disputes “subject to any applicable requirement to arbitrate.” Union Pacific Corp. – Control & Merger – Southern Pacific Corp., STB Finance Docket 32760 (Sub-No. 21), Decision No. 21 (STB served Dec. 20, 2001) (“General Oversight Dec. No. 21”), slip op. at 6. The Board specifically expressed a preference for private resolution of the parties’ fee adjustment dispute. See id., slip op. at 7.⁵ The Board should thus dismiss BNSF’s petition in favor of the arbitration proceeding required by the BNSF Settlement Agreement.

⁴ Section 15 of the Restated and Amended BNSF Settlement Agreement states:

Except as otherwise provided by any decision of the STB or by separate agreement, unresolved disputes and controversies concerning any of the terms and provisions of this Agreement or the application of charges hereunder shall be submitted for binding arbitration under Commercial Arbitration Rules of the American Arbitration Association which shall be the exclusive remedy of the parties.

⁵ Board policy strongly favors arbitration and other private methods of dispute resolution. See, e.g., Arbitration – Various Matters Relating to Its Use as an Effective Means of Resolving Disputes that Are Subject to the Board’s Jurisdiction, STB Ex Parte No. 586 (STB served Oct. 26, 2001), slip op. at 1.

B. BNSF and UP Have Already Invoked Arbitration

Even if BNSF could have asked the Board to resolve the fee adjustment dispute, it invoked arbitration first. The Board should not allow BNSF to change forums at whim.⁶

BNSF filed its petition for clarification nearly two months after it had filed its expanded counter-request for arbitration and nearly three months after UP had initiated the arbitration. Before BNSF filed its petition, the parties were actively pursuing arbitration. The parties had agreed to a process for selecting arbitrators, and they had agreed to compromise the three additional issues raised in BNSF's counter-request. If BNSF wanted the Board rather than an arbitrator to decide this dispute, it should have made that request much earlier. BNSF should be held to the choice that it made.

C. This Dispute Does Not Require the Board To Resolve Any Important Policy Question About Whether BNSF Can Compete with UP

The fee adjustment dispute does not involve any important policy question requiring Board intervention. In typical fashion, BNSF argues that, unless its prevails, it will be unable to compete on a "level playing field." Petition, p. 16. No such danger exists. The current level of trackage rights fees has allowed BNSF to compete vigorously for the traffic opened up to it by the merger, as the Board has found in five consecutive oversight decisions. This dispute will not cause those fees to rise in the future. Moreover, the adjustment mechanism is subject to renegotiation and, ultimately, to arbitration. There is thus no important policy question for the Board to address.

⁶ BNSF claims that it "is willing to submit to the arbitrator in the first instance the specific question of whether the adjustments made for the [past five] years were correct." Petition, p. 8. BNSF also states, however, that "it is critical that the Board resolve the key threshold issue of the proper investment base." *Id.* BNSF's first statement apparently refers to arbitration regarding the complex recalculations of UP URCS that would be required if the Board ruled in its favor.

The core of the parties' dispute involves the trackage rights fees that BNSF has been paying UP over the past five years. BNSF claims that the fees it paid were too high because UP misinterprets the adjustment mechanism. Regardless of who prevails in this dispute, BNSF cannot possibly claim that its ability to compete has been harmed. As BNSF reveals in its Petition, it was completely unaware of the fee adjustment issue until it audited UP's adjustment methodology. Petition, p. 2. It competed vigorously while paying the adjusted fees.

Five years of Board oversight proceedings have established that BNSF is an effective competitor using the rights it obtained in the UP/SP merger, despite paying trackage rights fees that BNSF now claims to be flawed.⁷ In its final annual oversight decision, the Board concluded that "BNSF has competed vigorously for the traffic opened up to it by the BNSF Agreement and has become an effective competitive replacement for the competition that would otherwise have been lost or reduced when UP and SP merged." General Oversight Dec. No. 21, slip op. at 4.

The Board's conclusion endorsed BNSF's own pride in its competitive success. In its final oversight report, BNSF told the Board that it "has been and continues to be an aggressive and effective competitor utilizing the rights it obtained pursuant to the BNSF Settlement Agreement and the conditions imposed by the Board." See, e.g., BNSF-PR-20, p. 2. BNSF reported that aggressive marketing efforts have paid off handsomely – its traffic volume on UP lines grew steadily over the five-year oversight period, as did its loadings and deliveries.

⁷ See Union Pacific Corp. – Control & Merger – Southern Pacific Corp., STB Finance Docket 32760 (Sub-No. 21), Decision No. 16 (STB served Dec. 15, 2000); Union Pacific Corp. – Control & Merger – Southern Pacific Corp., STB Finance Docket 32760 (Sub-No. 21), Decision No. 15 (STB served Nov. 30, 1999); Union Pacific Corp. – Control & Merger – Southern Pacific Corp., STB Finance Docket 32760 (Sub-No. 21), Decision No. 13 (STB served Dec. 21, 1998); Union Pacific Corp. – Control & Merger – Southern Pacific Corp., 2 S.T.B. 703 (1997).

Id. at 5-6. Before the merger, BNSF told the Board “that it would grow the traffic associated with its rights . . . to the size and scale of a new Class I railroad.” Id. at 4. Five years later, BNSF reported that it met that commitment and, in fact, “has exceeded that goal.” Id. Even though it had already exceeded its goal, BNSF said that it “anticipates the continued customer growth and commercial success of its UP/SP franchise.” Id. at 7.

BNSF would have to disavow five years of its own oversight reports in order to argue that the fees are too high to permit it to compete. The Board would have to ignore five years of oversight decisions in order to agree.

BNSF warns that it may not be competitive in the future, but those concerns are not credible. First, the trackage right fees will not rise in the future because of the disputed costs. If BNSF wins, the fees will fall, but any disputed “increase” occurred in the past.⁸ Second, the BNSF Settlement Agreement allows either party to request review and renegotiation of the fee adjustment mechanism every five years. If the parties do not agree “on the need for or the extent of adjustment,” then “either party may request binding arbitration.” Restated and Amended BNSF Settlement Agreement, § 12. BNSF has already commenced the review and renegotiation process.⁹ The trackage rights fees that BNSF pays in the future will be adjusted based on the results of that process.

⁸ In fact, the trackage rights fees have not increased above their original levels, with one minor exception. BNSF’s complaint is that the fees have not fallen as much as they should have. The minor exception involves the fee for Keddle-Stockton/Richmond trackage rights. The parties negotiated a separate fee for the Keddle segment, which, unlike the fees for other segments, is calculated to two decimal places. See Restated and Amended BNSF Settlement Agreement, § 9(a). The Keddle fee initially fell, but it later rose above the original level as a result of rounding.

⁹ See Letter from Richard E. Weicher, Esq., BNSF’s Vice President and Senior Regulatory Counsel, to James V. Dolan, Esq., UP’s Vice President-Law, dated Nov. 1, 2001 (attached as (continued...))

The fees BNSF has paid in the past have not hindered its ability to compete, and future adjustments to those fees are currently subject to review and renegotiation. Public policy concerns do not justify Board intervention in the dispute.

II. THE BOARD SHOULD DISMISS BNSF'S PETITION FOR FAILING TO STATE A CLAIM

BNSF's petition rests entirely on allegations that the parties intended to apply the adjustment provision in a way that requires modifications to URCS. BNSF claims that the parties intended to exclude the "purchase premium" and certain merger-related investments from URCS when they adjusted trackage rights fees. Those allegations, however, are entirely unsupported. They provide no basis for granting the relief that BNSF seeks.

BNSF offers no evidence to support its claims that the parties intended to depart from URCS. It identifies no witnesses and includes no verified statements. If BNSF's claims are based on statements from BNSF or UP personnel, BNSF should reveal who made the statements, so UP can address the sources and contexts. If there is a document that supports BNSF's claims, it should produce that document. It does neither.¹⁰

Exhibit C). UP and BNSF subsequently agreed to hold the joint review and renegotiation in abeyance pending the completion of the arbitration.

¹⁰ BNSF cites evidence that the BNSF Settlement Agreement was designed to allow BNSF to replace the competition provided by the pre-merger SP. BNSF also cites evidence that the fee adjustment provision was designed to reflect changes in UP's actual costs. Those propositions are undisputed. BNSF offers no support, however, for its key assertions: that the parties intended to capture some of the URCS-cost changes resulting from merger-related expenses in the initial trackage rights fee and that they intended to depart from URCS in the adjustment process because some URCS costs are not "actual" costs. BNSF quotes, with apparent approval, Applicants' statement that trackage rights fees will be adjusted on the basis of changes in "actual UP/SP system average URCS costs for the categories of maintenance and operating costs covered by the fees." BNSF-98, p. 10 n.7. If BNSF is claiming that "actual" maintenance and operating costs are something other than the "system average UCRS costs" and that the adjustment provision does not reflect the parties' intent, BNSF should present evidence that supports its claim.

BNSF also offers no evidence to explain how the parties allegedly intended to modify URCS. It does not explain how the parties intended to identify and remove disputed items from URCS. It refers only to some undefined intent to “exclude” some costs.¹¹ If BNSF claims that the parties agreed to procedures for modifying URCS, it should not only describe those procedures, but also identify where the parties’ agreement to apply those procedures can be found.

The language of the BNSF Settlement Agreement provides no evidence to support BNSF’s “intent” claims. Under Section 12 of the agreement, trackage rights fees are to be adjusted annually based on changes in “UP/SP’s system average URCS costs.” Restated and Amended BNSF Settlement Agreement, § 12. The provision requires that fee adjustments be based on changes in system average URCS costs. It contains no suggestion that the parties agreed to alter URCS costs in any way or did not consider some of the costs reflected in URCS to be “actual” costs.¹² It specifically defines “URCS” costs to mean “costs developed using the Uniform Rail Costing System.” *Id.*

Under these circumstances, UP cannot respond effectively to BNSF’s claims. Neither UP nor the Board can fully address BNSF’s claims about the parties’ intent unless BNSF first clarifies their substance, reveals their factual basis, and explains how it believes the “purchase premium” and merger-related capital expenditures are to be excluded from URCS.

¹¹ BNSF also fails to explain how the relief it seeks could be implemented. BNSF claims that it would not require UP to create and maintain two separate sets of URCS figures indefinitely into the future, but that is exactly what its proposed relief requires. *See* Petition, p. 16 n.12.

¹² Under the Board’s long-established accounting rules, UP’s costs include the cost of transportation property acquired. *See Western Coal Traffic League v. Union Pacific R.R.*, STB Finance Docket No. 33726 (STB served May 12, 2000), slip op. at 7-8.

In light of the deficiencies in BNSF's petition, the Board has no basis for disregarding the express language of the BNSF Settlement Agreement and granting BNSF the relief it seeks. The Board should dismiss BNSF's petition for failing to state a claim upon which relief can be granted.

CONCLUSION

UP and BNSF submitted their fee adjustment dispute to arbitration, as required by the BNSF Settlement Agreement. Nothing justifies releasing BNSF from its commitment to arbitrate these types of disputes, or its specific election to arbitrate this dispute. Even if this were an appropriate forum, the Board should still dismiss BNSF's petition for failing to state a claim.

Respectfully submitted,

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January 14, 2002

CERTIFICATE OF SERVICE

I hereby certify that on this 14th day of January, 2002, I caused a copy of the foregoing "UP's Motion to Dismiss BNSF's Petition for Clarification of the Trackage Rights Fee Adjustment Provision" to be served by first-class mail, postage prepaid, or by a more expeditious manner of delivery on all parties of record in Finance Docket No. 32760 (Sub-No. 21).

A handwritten signature in dark ink, appearing to read "Michael L. Rosenthal", is written over a horizontal line.

Michael L. Rosenthal

EXHIBIT A

American Arbitration Association
COMMERCIAL ARBITRATION RULES
DEMAND FOR ARBITRATION

MEDIATION is a nonbinding process. The mediator assists the parties in working out a solution that is acceptable to them. If you wish for the AAA to contact the other parties to ascertain whether they wish to mediate this matter, please check this box (there is no additional administrative fee for this service)

TO: Name The Burlington Northern and Santa Fe Railway Company			Name of Representative (if known) Richard E. Weicher		Name of Firm (if applicable)
Address 2500 Lou Menk Drive, Third Floor			Representative's Address 2500 Lou Menk Drive, Third Floor		
City Ft. Worth	State TX	Zip Code 76131-0039	City Ft. Worth	State TX	Zip Code 76131-0039
Phone No. (817) 352-2368	Fax No. (817) 352-2399		Phone No. (817) 352-2368	Fax No. (817) 352-2399	
The named claimant, a party to an arbitration agreement contained in a written contract, dated September 25, 1995 and providing for arbitration under the Commercial Arbitration Rules of the American Arbitration Association, hereby demands arbitration thereunder.					
THE NATURE OF THE DISPUTE See Attachment A hereto.					
THE CLAIM OR RELIEF SOUGHT (the Amount, if Any) See Attachment A hereto.					
DOES THIS DISPUTE ARISE OUT OF AN EMPLOYMENT RELATIONSHIP? ☐ Yes ☒ No					
TYPES OF BUSINESS Claimant Railroad Respondent Railroad					
HEARING LOCALE REQUESTED Washington, D.C.					
You are hereby notified that copies of our arbitration agreement and this demand are being filed with the American Arbitration Association at its Washington, D.C. office, with a request that it commence administration of the arbitration. Under the rules, you may file an answering statement within fifteen days after notice from the AAA.					
Signature (may be signed by a representative) 			Title Attorney		
Name of Claimant Union Pacific Railroad Company			Name of Representative Michael L. Rosenthal		Name of Firm (if Applicable) Covington & Burlingame
Address (to Be Used in Connection with This Case) 1416 Dodge Street			Representative's Address 1201 Pennsylvania Avenue, N.W.		
City Omaha	State NE	Zip Code 68179	City Washington	State D.C.	Zip Code 20004-2401
Phone No. (402) 271-5000	Fax No.		Phone No. (202) 662-5448	Fax No. (202) 778-5448	
TO INSTITUTE PROCEEDINGS, PLEASE SEND TWO COPIES OF THIS DEMAND AND THE ARBITRATION AGREEMENT, WITH THE FILING FEE AS PROVIDED FOR IN THE RULES, TO THE AAA. SEND THE ORIGINAL DEMAND TO THE RESPONDENT.					

ATTACHMENT A

NATURE OF DISPUTE AND RELIEF SOUGHT

This dispute involves the procedures for adjusting the compensation that The Burlington Northern and Santa Fe Railway Company ("BNSF") must pay to operate its trains over certain tracks owned by Union Pacific Railroad Company ("UP").

The dispute arises under an Agreement dated September 25, 1995 (Attachment B) and a Second Supplemental Agreement dated June 27, 1996 (Attachment C) between Union Pacific Corporation, Union Pacific Railroad Company, Missouri Pacific Railroad Company, Southern Pacific Rail Corporation, Southern Pacific Transportation Company, The Denver & Rio Grande Western Railroad Company, St. Louis Southwestern Railway Company, and SPCSL Corp. (collectively, "UP/SP"), on the one hand, and Burlington Northern Railroad Company and The Atchison, Topeka and Santa Fe Railway Company (collectively, "BN/Santa Fe"), on the other hand. (There is also a Supplemental Agreement between the same parties dated November 18, 1995, but we do not include it because its provisions are not directly relevant to the parties' dispute.)¹

The September 25, 1995, Agreement as supplemented by the June 27, 1996, Second Supplemental Agreement, collectively referred to as the "BNSF Settlement Agreement," was imposed by the Surface Transportation Board as a condition to its approval of a merger between the Union Pacific and Southern Pacific railroad systems, which was consummated on September 11, 1996.

The BNSF Settlement Agreement provides, *inter alia*, for grants of "trackage rights" that allow BNSF to operate its trains over designated UP tracks and UP to operate its trains over designated BNSF tracks as long as the railroads compensate each other for such operations.

The initial trackage rights compensation levels were set forth in Section 9(a) of the September 25, 1995 Agreement. Section 9(a) also provides that the compensation levels "shall be escalated in accordance with the procedures described in Section 12 of this Agreement."

The procedures described in Section 12 of the September 25, 1995 Agreement were amended by Section 9 of the June 27, 1996 Agreement.² As a result of the amendment, the BNSF Settlement Agreement trackage rights escalation clause currently provides that the

¹ In the years after the agreements, the rail entities in the Union Pacific and Southern Pacific systems merged in a series of transactions, and the surviving entity is UP. The rail entities in the BN/Santa Fe system also merged, and the surviving entity is BNSF.

² The amendment to Section 12 was required by an agreement among UP/SP, BN/Santa Fe, and the Chemical Manufacturers Association, dated April 18, 1996 (Attachment D).

trackage rights charges shall be adjusted each year by the difference in a specified measure of UP's maintenance and operating costs in the two preceding years. Specifically, Section 12, as amended, provides:

All trackage rights charges under [the BNSF Settlement Agreement] shall be subject to adjustment upward or downward July 1 of each year by the difference in the two preceding years in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the trackage rights fees. "URCS costs" shall mean costs developed using the Uniform Rail Costing System.

UP has adjusted its trackage rights charges to BNSF annually in accordance with Section 12. BNSF claims, however, that according to its own calculations, UP has overcharged BNSF. BNSF has demanded that UP refund the alleged overcharges, and BNSF has short-paid on one occasion.

UP accordingly has instituted this arbitration pursuant to the terms of Section 15 of the September 25, 1996 Agreement, which provides:

Unresolved disputes and controversies concerning any of the terms and provisions of this Agreement or the application of charges hereunder shall be submitted for binding arbitration under the Commercial Arbitration Rules of the American Arbitration Association which shall be the exclusive remedy of the parties.

The dispute between UP and BNSF ultimately turns on two differences in the parties' respective interpretations of the Section 12 adjustment procedures:

(1) For the 1997 and 1998 annual adjustments, UP calculated "the difference in the two preceding years" in UP/SP's costs using actual data from 1995 and 1996, and from 1996 and 1997, respectively, as provided in Section 12. BNSF claims that the 1995 and 1996 cost data should be artificially adjusted to reflect UP's post-merger cost structure, even though Section 12 does not provide for any such adjustment.

(2) In making each annual adjustment, UP adjusted the trackage rights charges by "the difference" between UP/SP costs in the two preceding years, as required by Section 12. BNSF claims that the charges should be adjusted by the percentage change in UP/SP's costs, even though Section 12 explicitly refers to "the difference" in costs.

UP requests that the arbitrator find that UP has correctly interpreted and applied Section 12's trackage rights compensation adjustment provision, that BNSF's interpretations are incorrect, and that UP is accordingly entitled to compensation at the levels it has established.

EXHIBIT B

Freeborn & Peters

November 1, 2001

VIA FEDERAL EXPRESS

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Re: 16 Y 181 00545 01; Union Pacific Railroad Company and
The Burlington Northern and Santa Fe Railway Company

Dear Mr. Smith:

We represent The Burlington Northern and Santa Fe Railway Company ("BNSF"), Respondent in the above matter. This will acknowledge receipt of your letter dated October 18, 2001 notifying BNSF of the filing of the demand for arbitration in this proceeding submitted on behalf of Claimant, Union Pacific Railroad Company ("UP"). Please accept this letter as BNSF's answering statement to UP's demand for arbitration, pursuant to Rule R-4(b) of the Commercial Dispute Resolution Procedures of the American Arbitration Association, and as BNSF's counter-request for arbitration as set forth below.

UP's demand for arbitration states that this dispute involves the interpretation and application of Section 12 of a September 25, 1995 Settlement Agreement between UP and BNSF (collectively, the "Parties"), as amended and supplemented by Section 9 of a June 27, 1996 Second Supplemental Agreement between the Parties. BNSF concurs that these agreements are involved in the dispute but disagrees with UP's characterization of the issues to be resolved.

UP's demand acknowledges that the pertinent agreements were "imposed by the Surface Transportation Board ["STB"] as a condition to its approval of a merger between the Union Pacific and Southern Pacific railroad systems, which was consummated on September 11, 1996." But UP neglects to explain that the condition was imposed because, without it, competition for rail transportation of freight would be eliminated in vast areas of the U.S. by merger of UP and SP. The remedy for this anti-competitive merger was for the STB to require that BNSF be allowed to operate competing freight service with its own trains over UP and SP tracks, subject to specified compensation. This practice is known in the industry as "trackage rights".

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In imposing the remedy of trackage rights, the STB recognized that any effective competition offered by BNSF depended on a reasonable level of compensation for use of UP and SP trackage. If the charges by UP for BNSF's trackage rights were too high, the freight rates charged by BNSF to customers would be higher than UP's charges and not competitive. The STB also recognized that BNSF's ability to provide competitive trackage rights service depended upon the proper adjustment of UP's charges to reflect changes in UP's actual maintenance and operating costs. Therefore, the bases for determining annual adjustments to the trackage rights charges, at the heart of this dispute, will determine whether BNSF will be able to provide competitive service over its trackage rights as intended by the STB.

In its demand, UP's selection of issues for resolution and its description of those issues are calculated to result in higher trackage rights charges for BNSF that will discourage competition. The following is a description of issues that must be resolved in order that the provisions and intent of the agreements be realized. The first two of these are restatements of the arguments raised in UP's demand for arbitration; the remaining three are related issues that have arisen between BNSF and UP in the same agreements.

- (1) Whether UP is entitled to include the purchase premium associated with its acquisition of SP and certain merger-related expenditures relating to the trackage rights lines which were to be funded solely by UP in the investment base used in the adjustment of the trackage rights charges payable by BNSF.
- (2) Whether UP has correctly reflected in its adjustment calculations the changes in gross ton-mile costs associated with UP's declining unit costs involved in trackage rights operations.
- (3) In calculating adjustments to the trackage rights fee, UP combined UP and SP costs by use of a weighted average based on respective trackage rights miles. BNSF contends this is improper and not consistent with STB costing methodology. BNSF contends that to create combined UP/SP costs for 1995 and 1996 consistent with STB methodology, total SP costs should be added to total UP costs, by cost category, and this total should be divided by total SP service units plus total UP service units, by cost category.

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- (4) UP has used certain, specified categories of maintenance and operating costs in determining the annual trackage rights fee adjustment, and these categories are different from the approach that is customary in the industry. BNSF submits that a proper calculation of changes in a rail carrier's maintenance and operating fees must include the equipment and transportation costs in BNSF's application of the Uniform Rail Costing System.
- (5) There is a dispute concerning the definition of "dispatching expenses" for purposes of the trackage rights fee adjustment analysis.

BNSF respectfully requests that the arbitration proceeding address all five of the above issues. As to each of these issues, it is BNSF's position that UP has incorrectly calculated the annual adjustments in trackage rights charges to which BNSF is subject, resulting in higher charges that discourage effective competition. Therefore, BNSF requests that the arbitrator(s) find that UP has incorrectly interpreted and applied the provisions of Section 12 of the Parties' agreement; that BNSF's interpretations are correct; that UP is not entitled to compensation at the levels it has established; and that BNSF accordingly is entitled to appropriate refunds from UP for overpayment of trackage rights charges.

BNSF reserves the right to submit any of these issues for resolution by the STB pursuant to the jurisdiction that it reserved to itself to "provide guidance to the parties and to arbitrators in interpreting the intended scope" of the conditions imposed on the merger of UP and SP. At this time, it appears that issue (1) above fits within the STB's contemplation that "an administrative proceeding might be preferable for the resolution of general matters with broad implications with respect to implementation of our conditions."

BNSF objects to UP's request that the hearing in this matter be held in Washington, D.C. BNSF proposes instead that the Parties be allowed a reasonable period in which to agree on a neutral arbitrator and additional arbitrators to represent each of BNSF and UP. Persons to be considered for these positions would not be limited to those who might be submitted by the AAA. The hearings should be held in a city designated by the neutral arbitrator. In any event, we submit that, until such time as the arbitration panel has been selected and the parties have identified their witnesses, it is premature to select a hearing site. To the extent BNSF is required by the Association's procedures at this time

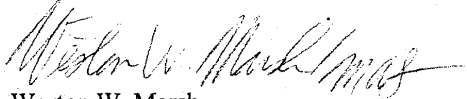
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to propose a hearing locale, BNSF requests that the hearing be held in Chicago, Illinois.

Finally, attached (to your counterpart of this letter only) is BNSF's listing of persons or firms, including potential witnesses, who may be involved in this case. We understand this is used to check for conflicts of interest of potential arbitrators in this proceeding.

Yours very truly,



Weston W. Marsh

cc: ✓ Michael L. Rosenthal, Esq.
Covington & Burling
1201 Pennsylvania Avenue, N.W.
Washington, DC 20044

EXHIBIT C

BNSF



RICHARD E. WEICHER
Vice President & Sr. Regulatory Counsel

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**VIA FAX 402-271-5610 and
UPS OVERNIGHT MAIL**

November 1, 2001

James V. Dolan, Esq.
Vice President-Law
Union Pacific Railroad Company
1416 Dodge Street
Omaha, NE 68179

Re: BNSF Settlement Agreement

Dear Jim:

Pursuant to Section 12 of the BNSF Settlement Agreement as well as Section 3(c) of the individual implementing trackage rights agreements and the July 30, 2001 letter agreement between UP and BNSF extending the time for the giving of notice thereunder, BNSF hereby requests that UP and BNSF jointly review the operation of the trackage rights charges adjustment mechanism and renegotiate its application.

BNSF is willing to hold the joint review and renegotiation of the adjustment mechanism in abeyance pending the completion of the arbitration commenced by UP's letter of October 4, 2001. If UP is interested in such an abeyance, please let me know.

Sincerely,

Richard E. Weicher

REW/tmm