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April 9, 2002

The Honorable Vernon A. Williams, Secretary
Surface Transportation Board
1925 K Street, NW Suite 700
Washington, DC 20423-0001



Re: Fin. 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

Dear Secretary Williams:

Enclosed are an original and 25 copies of CMA-17, the Evidentiary Submission of the American Chemistry Council Regarding Trackage Rights Fee Escalator. Included in the submission is the Verified Statement of Thomas E. Schick.

Please stamp the additional copy with the date of receipt and return with our messenger.

Sincerely,

A handwritten signature in black ink, appearing to be "Scott N. Stone".

Scott N. Stone

Counsel for the American
Chemistry Council

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Office of the Secretary
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CMA-17

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY

AND MISSOURI PACIFIC RAILROAD COMPANY

-- CONTROL AND MERGER --

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

EVIDENTIARY SUBMISSION OF THE
AMERICAN CHEMISTRY COUNCIL
REGARDING TRACKAGE RIGHTS
FEE ESCALATOR



ENTERED
Office of the Secretary
MAY 23 2002
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The American Chemistry Council ("the Council")¹ respectfully submits the attached
verified statement of Thomas E. Schick in response to the show cause order served by the
Surface Transportation Board ("the Board") on March 21, 2002. Mr. Schick is counsel to the

¹ The American Chemistry Council (formerly the Chemical Manufacturers Association, or CMA) represents the leading companies engaged in the business of chemistry. Council members apply the science of chemistry to make innovative products and services that make people's lives better, healthier and safer. The Council is committed to improved environmental, health and safety performance through Responsible Care®, common sense advocacy designed to address major public policy issues, and health and environmental research and product testing. The business of chemistry is a \$455 billion a year enterprise and a key element of the nation's economy. It is the nation's largest exporter, accounting for 10 cents out of every dollar in U.S. exports. Chemistry companies invest more in research and development than any other business sector.

Council's Distribution Team and was counsel to CMA's Distribution Committee during CMA's negotiations with the UP in 1996 over what has become known as the "CMA Agreement." Mr. Schick's verified statement explains the background and intent of the relevant provisions of the CMA Agreement.

As Mr. Schick explains, paragraph 7 of the CMA Agreement, as submitted to the Board on April 19, 1996 (UP/SP-219) modified section 12 of the UP/SP-BNSF Settlement Agreement to change the escalator for the trackage rights fees to be paid by BNSF. Paragraph 7 provided that the trackage rights fees would "be adjusted upward or downward each year by the difference between the year in question and the preceding year in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the fee." (Emphasis added.) The most significant aspect of this provision in light of the issues now before the Board is that it would have adjusted URCS costs based upon a comparison of costs for post-merger years only. Because the first adjustment would have been based on a comparison of costs in the second post-merger year with costs in the first post-merger year, there never would have been a comparison of post-merger costs with pre-merger costs. UP/SP-219 clearly reflects this intention.

After CMA management reviewed and approved the CMA Agreement, the Agreement was filed with the Board (UP/SP-219, filed April 18, 1996), and CMA submitted a brief advising the Board that it had withdrawn its opposition to the merger (CMA-12, filed June 3, 1996). However, after CMA filed its brief, the escalation methodology was further amended as part of the "Second Supplemental Agreement" negotiated between UP and BNSF, which was submitted to the Board on June 28, 1996, the last business day before oral argument in the UP/SP merger case. CMA was not a signatory to that supplemental agreement, and indeed was not involved in these last-minute negotiations, except that CMA was aware of a clarification, contained in the

same set of amendments, relating to BNSF access to shippers in the Lake Charles, LA area.

Schick V.S. at 5. Mr. Schick testifies that when he later learned of the change to the escalation formula, he understood that the amendment was intended to be technical in nature only. Schick V.S. at 5-6.

As amended in that Second Supplemental Agreement, the escalator was to be applied on July 1 of each year and was based upon a comparison of the relevant URCS costs in the two preceding years, rather than in the current and preceding year. This technical change arose from the difficulty of making adjustments based upon costs which might normally only be compiled some time after the end of a given year. As interpreted and applied by the UP, however, this amendment to the escalator would not be technical, but rather substantive, because it would base the escalation upon a comparison of URCS costs for the first post-merger year versus the last pre-merger year.

Hence, as interpreted by the UP, the effect of this amendment would permit UP to build into the trackage rights fee, through the escalator, the merger-related write-up of its track assets, reflecting both the purchase price paid for the track in the merger and certain post-merger capital investments that UP had elsewhere prominently pledged to pay for itself. Yet as Mr. Schick testifies, CMA understood that the trackage rights fee already reflected the merger as a fully accomplished transaction. Schick V.S. at 3. It was not and could not have been CMA's intention that a technical amendment, which it did not even negotiate or sign on to, should increase the trackage rights fee further to capture again the price of assets in the merger. In addition, CMA was well aware of, and relied upon, the representations of UP on the record that the trackage rights fee was intended to be

comprehensive, and that UP was itself going to pay for certain merger-related improvements, rather than passing these costs along to BNSF. Id. at 6-7.

In sum, it would be contrary to CMA's intent, and grossly unfair, to permit a last-minute technical amendment which CMA had no involvement in, to overcome both the representations of UP and the intention of CMA regarding the trackage rights escalator. If the escalator formula is to be applied as revised in the Second Supplemental Agreement, such that pre- and post-merger years are compared, then the only fair way to preserve the intention of the parties, in particular the intention of CMA, is to exclude or adjust the items reflecting the merger-related write up of assets and the capital improvements which UP promised to pay for. Hence, the Council fully supports the adjustments requested by BNSF in this proceeding, as reflecting the intention of the Council and its predecessor CMA.

Respectfully submitted,



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Counsel for the American
Chemistry Council

dated and due: May 22, 2002

BEFORE THE
SURFACE TRANSPORTATION BOARD



Finance Docket No. 32760

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

-- CONTROL AND MERGER --

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



VERIFIED STATEMENT OF THOMAS E. SCHICK

My name is Thomas E. Schick. I am Counsel for the Distribution Team at the American Chemistry Council ("the Council").¹ I provide this verified statement to explain the Council's intentions at the time it entered into what has become known as the "CMA Agreement" with

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Union Pacific ("UP"), Southern Pacific ("SP") and Burlington Northern Santa Fe ("BNSF") on April 18, 1996. The CMA Agreement was filed with the Board on April 19, 1996 (UP/SP-219).

As background, I will set out briefly the chronology of the Council's deliberations with respect its position on the UP/SP merger. I served as counsel to the CMA Distribution Committee (predecessor to the Council's Distribution Team) through the period discussed below.

On March 5, 1996, CMA's Executive Committee adopted a policy on railroad mergers in general and the UP/SP merger in particular. The Executive Committee directed that CMA file comments with the Surface Transportation Board ("the Board") expressing eight listed concerns with the UP/SP merger as then proposed, and directed CMA representatives to negotiate with the applicants to seek voluntary agreement to ameliorate the eight concerns. Of the eight concerns, the one of relevance here was number 2C, which stated the following objective:

2C. Renegotiate (lower) the trackage rights fees or establish a trust fund to provide for shared maintenance costs rather than subsidize the host railroad's operations.

On March 27, 1996, CMA's Distribution Committee met and considered whether certain concessions offered by UP prior to that date were adequate to address the eight listed concerns. The Committee determined that those concessions were inadequate and that CMA should file comments opposing the merger. On March 29, 1996, CMA filed comments with the Board opposing the UP/SP merger (CMA-7), and appended (as Attachment 1) the list of eight concerns adopted by the Executive Committee.

As part of its March 29, 1996 comments, CMA also submitted a Verified Statement by Thomas D. Crowley of L.E. Peabody & Associates (Attachment 2 to CMA-7). Mr. Crowley

testified, among his other points, that the trackage rights fees set out in the UP/SP-BNSF Settlement Agreement were above UP/SP costs including a return on capital. Crowley V.S. at 51. Mr. Crowley stated that the trackage rights fee levels reflected the monopoly rents that UP and SP could charge as a merged entity. Id. In other words, the fees reflected the merger as a fully implemented transaction, except that Mr. Crowley stated that even if these fees were lowered to the proper level (the combined UP/SP URCS costs for 1994 indexed to fourth quarter 1995 wage and price levels), the fees calculated in this way would still be too high because they “do not include the cost savings projected by UP/SP as one of the benefits of the merger.” Id. at 51-52. Mr. Crowley also commented on the escalator then proposed – 70% of the Rail Cost Adjustment Factor unadjusted for productivity (“RCAF(U)”). Mr. Crowley showed that this escalator would allow the trackage rights fee to rise over time relative to inflation, whereas using a productivity-adjusted escalation factor would cause the trackage rights fee to rise at a rate commensurate with UP’s actual costs. Id. at 56.

Based on Mr. Crowley’s recommendations, and the Executive Committee’s eight points, CMA sought to negotiate a reduction of the trackage rights fees stated in the UP/SP BNSF Settlement Agreement and/or the establishment of a fund into which the trackage rights fees could be paid to ensure that they were not used to subsidize the maintenance of UP lines other than the trackage rights lines. In addition, CMA sought to change the escalator so that the fees would track the long-term trend of decreasing railroad costs reflecting increased productivity.

Between March 29 and April 16, 1996, I and other CMA representatives met with representatives of Union Pacific for further negotiations. Among the new provisions offered during this period by UP were (1) to place trackage rights fees in two dedicated regional accounts so that these fees would not be used to subsidize improvements elsewhere on UP’s

merged system and (2) to escalate the trackage rights fees not on the basis of 70% of RCAF(U), but rather in accordance with year-to-year changes in UP/SP actual system average costs.

These negotiations resulted in what has come to be referred to as the CMA Agreement. The provisions of the CMA Agreement regarding the escalator formula are worthy of particular note. Paragraph 7 of the CMA Agreement provided as follows:

7. Section 12 of the BN/Santa Fe Settlement Agreement shall be amended to provide that BN/Santa Fe's trackage rights fees shall be adjusted upward or downward each year by the difference between the year in question and the preceding year in UP/SP's system average URCS costs for the categories of maintenance and operating costs covered by the fee. CMA or its designee shall have the right to audit the escalation calculations.²

I would like to point out the phrase that I have underlined. The escalator formula in the CMA Agreement provided for adjustment of the trackage rights fee based on the difference between the current and previous year. Because the base trackage rights fee (unadjusted) would be paid in post-merger year 1, the first time the fee would be adjusted would be in year 2, and the adjustment would be based upon the difference between post-merger year 2 costs and post-merger year 1 costs. There was no provision for adjustments based on comparing pre-merger years with post-merger years.

On April 16, 1996 CMA's Distribution Committee reviewed the final draft of the CMA Agreement and decided that it adequately addressed the eight stated concerns. On April 18, the CMA Agreement was signed, and on April 19 it was filed with the Board (UP/SP-219).

² UP/SP-219 at 3.

After approving the CMA Agreement, the Distribution Committee directed CMA's counsel to advise the Board that CMA had withdrawn its opposition to the merger. CMA did so in its June 3, 1996 brief to the Board (CMA-12). CMA's brief, in summarizing the terms of the CMA Agreement, commented as follows regarding the effect of the CMA Agreement on the trackage rights fee to be paid by BNSF (the italicized emphasis was in the original):

- Places 100% of the trackage rights fees in a segregated fund to be used exclusively for maintenance, improvements and depreciation on the trackage rights lines, with one fund for the South Central region and one fund for the Central Corridor/California. *This ensures that trackage rights fees are used for the trackage rights lines rather than subsidizing other lines.*
- Changes trackage rights fee escalator from 70% of RCAF(U) to year-to-year changes in UP/SP actual system average cost for the maintenance and operating cost elements covered by the fee. CMA will have the right to audit. *This will correct the tendency of the fee to rise above actual costs over time because of the use of an escalator that did not incorporate productivity gains.*

Following the filing of CMA's brief, UP and BNSF continued negotiating between themselves a series of modifications to the UP/SP-BNSF Settlement Agreement. These were incorporated into a "Second Supplemental Agreement" that was submitted to the Board on June 28, 1996, the last business day before the July 1 oral argument on the UP/SP merger. CMA was not a signatory to that agreement and was not involved in negotiating it, except that it was consulted regarding a provision clarifying BNSF's access to certain points in the Lake Charles, LA area.

One of the provisions of the Second Supplemental Agreement, which again CMA had no involvement in negotiating, modified the escalator formula established by the CMA Agreement. The modification provided that the escalator would be applied on July 1 of each year, and would be based on the difference in costs for the prior two years. To the best of my recollection, I was

not aware of this provision when it was negotiated and submitted to the Board. Although I later learned of the provision, I believe it was portrayed as simply a technical amendment which arose from the difficulty of adjusting fees in the current year based on comparing current year costs to previous year costs, because current year costs (and even the prior year's costs) could not be calculated until some time after the end of the year.

As interpreted and applied by UP, the practical effect of this "technical" modification would be to escalate fees for the second post-merger year based on a comparison of the first post-merger year with the last pre-merger year. This would have the effect of escalating the fee based on the write-up of UP/SP assets resulting from the merger and UP track-related investments made in the first post-merger year. This would certainly be contrary to CMA's intent, because the escalator provision in the CMA Agreement compared costs only for post-merger years, and never compared pre-merger costs with post-merger costs. It would be unjust if CMA's clear intent could be defeated by a technical amendment in a last-minute agreement to which CMA was not a party.

As noted, CMA had presented evidence, through Mr. Crowley, that the trackage rights fee set out in the original UP/SP-BNSF Agreement was already too high and already reflected the merger as an accomplish fact. For these additional reasons it would be directly contrary to CMA's express intent to modify the escalator formula so as to permit UP/SP to further increase the trackage fee as a result of its merger-related write-up of assets.³

³ This write-up would also be inconsistent with the testimony of UP witness Rebensdorf that the trackage rights fee was intended to be "comprehensive." UP/SP Merger Application, Vol. 1, V.S. of John Rebensdorf at 308.

The intent of the CMA Agreement with respect to the trackage rights fee, apart from establishing segregated accounts for the fees and thus avoiding cross-subsidization, was to ensure that, following the merger, the escalation formula would reflect UP's productivity gains and allow BNSF to compete more effectively with UP. It was not CMA's intention that the new escalation formula – URCS system average costs – would be a means of allowing UP to capture for a second time a merger premium which in CMA's understanding was already reflected in the base trackage rights fee.

In conclusion, the current potential inequity (UP's effort to increase the trackage rights fee to reflect its merger-related write-up of assets), is based on UP's interpretation of an agreement (the Second Supplemental Agreement) to which CMA was not even a party. It would be illogical and unfair for this last-minute technical amendment to override the clear intention of CMA that the trackage rights fees not be further written up.

A related point at issue here is whether the trackage rights escalator should include or exclude the effect of certain capital expenditures that UP expressly committed to pay for. Those commitments were incorporated into section 9c of the original UP/SP-BNSF Settlement Agreement. Although CMA did not participate in the negotiation of those provisions, CMA was well aware of them, and relied on them to facilitate BNSF's becoming an effective competitive counterweight to UP. It would be contrary to CMA's intentions and expectations for BNSF to be required to pay for those investments through the back door of the trackage rights fee escalator. Again, the technical fine points should not be interpreted in such a way as to undermine the main points of the agreements that enabled the UP/SP merger to occur.

I, Thomas E. Schick, swear under penalty of perjury under the laws of the United States,
that the foregoing verified statement is true and correct to the best of my knowledge and belief.

Thomas E. Schick

Thomas E. Schick

CERTIFICATE OF SERVICE

This is to certify that I have, this 22nd day of May, 2002, served copies of the foregoing filing by hand upon Washington counsel for the Burlington Northern Santa Fe and Union Pacific and by first class mail upon other parties of record.

A handwritten signature in black ink, appearing to be 'S. Stone', written over a horizontal line.

Scott N. Stone