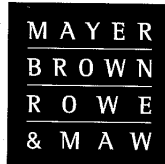


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May 22, 2002

VIA HAND DELIVERY

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

1909 K Street, N.W.
Washington, D.C. 20006-1101

Main Tel (202) 263-3000
Main Fax (202) 263-3300
www.mayerbrownrowe.com

Erika Z. Jones
Direct Tel (202) 263-3232
Direct Fax (202) 263-5232
ejones@mayerbrownrowe.com

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

Dear Secretary Williams:

Enclosed for filing in the above-captioned proceeding are the original and twenty-five (25) copies of The Burlington Northern and Santa Fe Railway Company's Response to Order to Show Cause Why BNSF-98 Petition for Clarification Should Not Be Dismissed (BNSF-102) and the Highly Confidential Appendix to BNSF-102. Also enclosed is a disk with the text of the pleading in Word Perfect 9 format.

BNSF has served copies of the cover pleading of BNSF-102 and supporting verified statements on all parties of record in Finance Docket No. 32760. Any counsel or consultants who would like a copy of the Highly Confidential Appendix and who have signed a highly confidential undertaking in Finance Docket No. 32760 should contact Adrian Steel at 202-263-3237.

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

Sincerely,

Erika Z. Jones/als

Erika Z. Jones

ENTERED
Office of the Secretary
MAY 23 2002
Part of
Public Record

Enclosures

cc: All Parties of Record

1

Brussels Charlotte Chicago Cologne Frankfurt Houston London Los Angeles Manchester New York Palo Alto Paris Washington, D.C.
Independent Mexico City Correspondent: Jauregui, Navarrete, Nader y Rojas, S.C.

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BNSF-102

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

BNSF'S RESPONSE TO ORDER TO SHOW
CAUSE WHY BNSF-98 PETITION FOR CLARIFICATION
SHOULD NOT BE DISMISSED

Jeffrey R. Moreland
Richard E. Weicher
Sidney L. Strickland, Jr.
Michael E. Roper

Erika Z. Jones
Adrian L. Steel, Jr.
Adam C. Sloane

The Burlington Northern
and Santa Fe Railway Company
2500 Lou Menk Drive
Third Floor
Ft. Worth, Texas 76131-0039
(817) 352-2353 or (817) 352-2368

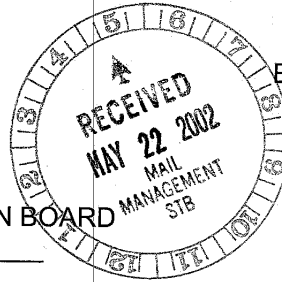
Mayer, Brown, Rowe & Maw
1909 K Street, NW
Washington, DC 20006
(202) 263-3000

Attorneys for The Burlington Northern and Santa Fe Railway Company

May 22, 2002



BEFORE THE
SURFACE TRANSPORTATION BOARD



BNSF-102

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
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BNSF'S RESPONSE TO ORDER TO SHOW
CAUSE WHY BNSF-98 PETITION FOR CLARIFICATION
SHOULD NOT BE DISMISSED

The Burlington Northern and Santa Fe Railway Company ("BNSF") submits this Response to the Surface Transportation Board's directive in Decision No. 96 in this proceeding that BNSF show cause why its Petition for Clarification of the Trackage Rights Fee Adjustment Provision (BNSF-98) should not be dismissed. In its Petition, BNSF sought a clarification as to whether, as part of the process of the annual adjustment of the trackage rights fees under Section 12 of the BNSF Settlement Agreement, BNSF (and derivatively its customers on the UP/SP trackage rights lines) should be required to pay trackage rights fees that are inflated to reflect the purchase premium that UP paid when it acquired SP and/or to reflect certain merger-related capital expenditures that were to be solely funded by UP under Section 9(c) of the

Settlement Agreement. UP filed a Motion to Dismiss the Petition for failure to state a claim (UP/SP-392).

In its decision, the Board concluded that BNSF had not submitted evidence that the two disputed items should be excluded from the Section 12 adjustment process. However, because the Board recognized that "it is important that the trackage rights fee adjustment mechanism work as intended, so that any increases or decreases in UP's costs are properly-reflected in the agreed-upon adjustments to the trackage rights fee",¹ the Board afforded BNSF the opportunity to demonstrate that the disputed items should not be reflected in the Section 12 adjustment factor. Decision No. 96 at 6.

Accordingly, in this response to the Board's directive and in the attached Verified Statements of Carl R. Ice and Richard E. Weicher who negotiated the BNSF Settlement Agreement on BNSF's behalf, BNSF shows that the parties to the Settlement Agreement intended the trackage rights rates to be comprehensive and all-inclusive reflections of UP's costs, including the SP purchase premium and the merger-related capital expenditures which UP was to fund. Because these costs were fully accounted for within the gross ton-mile ("GTM") mill rates set forth in the Settlement Agreement, subsequent adjustments of those rates were *not* to be based on those items.

Further, the CMA Agreement established a mechanism for adjusting the GTM mill rates in accordance with changes in UP's actual maintenance and operating costs associated with the trackage rights lines. All parties to the CMA Agreement indicated

¹ 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 [General Oversight], STB Finance Docket No. 32760 (Sub-No. 21), Decision No. 21 (STB served Dec. 20, 2001) (General Oversight Dec. No. 21), slip op. at 6.

their concurrence that **post**-merger years were to be compared when calculating the annual changes in UP's URCS costs. It is because UP elected to book the purchase premium in 1997, rather than 1996 when the acquisition occurred, that this cost is counted twice in the GTM mill rates.

As shown in the attached Verified Statement of Christopher D. Kent, UP's proposed methodology for calculating the Section 12 adjustment factor results in the comparison of URCS costs from a **pre**-merger year with URCS costs from a **post**-merger year, thereby causing a one-time artificial increase in the GTM mill rates of approximately 0.2 mills. This comparison of pre-merger costs with post-merger costs constitutes an impermissible double-counting of the SP purchase premium and the merger-related capital expenditures, contrary to the terms and intent of both the BNSF Settlement Agreement and the CMA Agreement. Finally, as described the attached Verified Statement of Denis J. Smith, BNSF's Vice President, Industrial Products Marketing, this differential between BNSF's and UP's adjustment methodologies can affect BNSF's competitive presence on the trackage rights lines not only in the near-term but also over the 99-year term of the BNSF Settlement Agreement.

I. THE BNSF SETTLEMENT AGREEMENT: THE PARTIES' INTENT TO ADOPT COMPREHENSIVE GTM MILL RATES THAT ACCOUNT FOR ALL OF UP'S KNOWN OR ANTICIPATED COSTS, INCLUDING THE SP MERGER PREMIUM AND THE MERGER-RELATED IMPLEMENTATION COSTS

The terms for the trackage rights compensation under the BNSF Settlement Agreement were a critical part of the negotiations between UP/SP and BNSF which took place in September of 1995. Verified Statement of Carl R. Ice (hereinafter "Ice V.S.") at

2. The purpose of those negotiations was to address and seek to resolve BNSF's opposition to the UP/SP merger and to reach agreement on the terms under which

BNSF would provide service to preserve the pre-merger competition between UP and SP that would otherwise be lost as a result of their merger. Ice V.S. at 1-2; Verified Statement of Richard E. Weicher (hereinafter "Weicher V.S.") at 1.

It was important to BNSF in the negotiations that BNSF be able, after the UP/SP merger, to offer competitive pricing and that the rates of compensation for BNSF operations on trackage rights lines would not place BNSF at a competitive disadvantage with UP/SP as the landlord railroad. Ice V.S. at 2; Weicher V.S. at 2. In turn, it was important to UP that the trackage rights fees should reimburse it for all costs associated with BNSF's trackage rights operations, plus a factor for a reasonable rate of return on the capital in the trackage rights lines that BNSF would be using. Ice V.S. at 2. And, it was also important to both parties that, once rates had been agreed upon that would allow BNSF to provide competitive service and UP to cover its costs associated with BNSF's operations, their respective interests would continue to be protected over the term of the Settlement Agreement. Ice V.S. at 2-3.²

As Mr. Ice states, the rates agreed to were very close to the upper limit of what BNSF could accept and still offer competitive service. Ice V.S. at 2. Thus, BNSF was concerned that changes in UP/SP's costs would not enable UP/SP to gain a competitive advantage and make BNSF noncompetitive for particular movements – i.e., the reductions in costs which UP/SP projected as a result of the merger should be passed

² In this regard, John H. Rebensdorf, one of UP's principal negotiators in the settlement discussions, stated in his Verified Statement submitted with the UP/SP Application, that it was "the intent that the trackage rights rate place both carriers on a level playing field with neither subsidizing the other." UP/SP-22 at 301. (Copies of excerpts from pleadings cited herein are attached.)

on to BNSF in the form of lower GTM mill rates.³ Ice V.S. at 2. UP was concerned that it should be able to adjust the rates to account for increases in its costs. Ice V.S. at 2-3.

After extensive negotiation, UP/SP and BNSF agreed on GTM mill rates comparable to other then-current trackage rights agreements. Ice V.S. at 3.⁴ Both UP/SP and BNSF intended that the GTM mill rates would be comprehensive and all-inclusive. Thus, as Mr. Ice explains, "It was my understanding of both sides' intent that the GTM mill rates that had been agreed to were comprehensive, and that BNSF would not be expected to pay increased rates based on costs that were already known and taken into account in the negotiations." Ice V.S. at 4.⁵ Mr. Ice goes on to explain that

[w]hen BNSF entered negotiations with UP/SP concerning the GTM mill rates, BNSF was aware that UP had agreed to pay a substantial premium above book value to purchase SP, and we knew that the premium would be an expense that UP would bear to effect the merger. * * * Nothing in the negotiations indicated that either party contemplated that the GTM mill rates would not take account of the purchase premium. To the contrary, it was my fundamental belief that negotiators for both BNSF and UP/SP always intended that the rates agreed to in the September 1995 negotiations were inclusive of all of UP's costs and return on investment in the

³ In this regard, it was BNSF's position that changes in UP/SP's costs should not enable UP/SP to gain a competitive rate advantage. UP/SP had projected substantial improvements in efficiency, and it was important to BNSF that reductions in costs of the merged entity should be passed on to BNSF in the form of lower rates for trackage rights. Ice V.S. at 2; Weicher V.S. at 4.

⁴ The parties agreed that the rate for most carload and intermodal traffic would be 3.1 mills per GTM and that the rate for bulk traffic would be 3.0 mills per GTM. The parties also agreed that the rates would be based on ton-miles rather than car-miles because it was their belief that this would more accurately reflect the actual use made of the trackage rights lines and thus the resulting expense to UP/SP. This conclusion was based on the great variation in size and types of cars and their capacity and BNSF's belief that ton-miles is a more meaningful measure of use. Ice V.S. at 3-4.

⁵ This intent also was expressed by UP's own Mr. Rebensdorf who stated in his Verified Statement that the "rate is comprehensive." UP/SP-22 at 308.

merged UP/SP, including UP's purchase price for acquiring SP, and those mill rates would **not** be subject to adjustment in a subsequent year to take account of these costs.

Ice V.S. at 4-5 (emphasis added). See also Ice V.S. at 6 (stating that "UP/SP shared our understanding that UP would be compensated in the GTM mill rates for all of its costs of any nature").

Mr. Weicher's Verified Statement also sheds light on the parties' intent with respect to the "comprehensive" nature of the GTM mill rates:

We viewed the GTM mill rates as covering all UP/SP's merger-related costs, including merger-related capital expenditures. I believed that the parties agreed that the GTM mill rates covered all merger-related costs. In other words, it was intended by BNSF and UP/SP that the GTM mill rates were comprehensive and were intended to be inclusive of all the costs of UP/SP associated with the trackage rights operations and the UP/SP merger for which BNSF had any responsibility. There was no basis for adding an element to reflect additional compensation to UP for the SP purchase premium or any merger implementation costs.

Weicher V.S. at 2-3.

Thus, BNSF was not to be required to pay any additional amounts nor were the GTM mill rates to be increased as a result of either the purchase premium or UP/SP's merger-related expenditures. See Ice V.S. at 7 ("It was BNSF's position during our negotiations that UP/SP should bear the full responsibility for these anticipated capital expenditures and that the GTM mill rates should not be increased as a result of those expenditures.").

When the parties agreed to the comprehensive GTM mill rates, they specifically agreed that the initial relationship between GTM mill rates and UP's costs related to the trackage rights be maintained throughout the term of the Settlement Agreement:

It is the intention of the parties that rates and charges for trackage rights and services under this Agreement reflect the same basic relationship to operating costs as upon execution of this Agreement.

Section 12 of the Settlement Agreement.

The parties also recognized that the initial GTM mill rates would need to be subject to adjustment to reflect changes in UP/SP's costs. It was agreed to use 70% of RCAF-U to enable BNSF to share in UP/SP productivity gains. Ice V.S. at 9; Weicher V.S. at 4. The parties also recognized the possibility that unforeseen developments could cause the adjustment mechanism to be ineffective in achieving the intent of the parties, and language was included in the Settlement Agreement which provided either party with the right to request a review and renegotiation of the adjustment mechanism every five years. Ice V.S. at 9; Weicher V.S. at 4.

II. THE CMA AGREEMENT: THE PARTIES' INTENT TO BASE THE ADJUSTMENT OF THE RATES ON COMPARISONS OF POST-MERGER COSTS

In response to criticism from the Chemical Manufacturers Association (now, the American Chemistry Council) and others concerning the level of the GTM mill rates as well as the use of 70% of RCAF-U as the basis for the annual adjustments to those rates, UP/SP, CMA and BNSF negotiated and executed the CMA Agreement in April of 1996. Weicher V.S. at 5. The annual adjustment mechanism was revised by Section 7 of the CMA Agreement which provides:

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. (Emphasis added.)

The intent of this revision was to reflect changes in UP/SP's own maintenance and operating costs more accurately than was possible using RCAF-U rail industry data. Weicher V.S. at 5-6. It was **not** the parties' intent that, by using URCS data, UP would be able to increase the trackage rights rates based on costs that had already been taken into account in agreeing on the level of rates, such as the premium that UP was paying to acquire SP and the merger-related costs covered in the BNSF Settlement Agreement, Sections 9(c)(i) and 9(c)(iii). See Weicher V.S. at 6.

To this end, as the language set forth above reflects, Section 7 of the CMA Agreement provided for an annual adjustment mechanism in which URCS costs from one **post**-merger year would be compared with URCS costs from another **post**-merger year. However, the methodology which UP uses results in the comparison of URCS costs from what UP has, in effect, booked as a **pre**-merger year (1996) with URCS costs from a **post**-merger year (1997). See Verified Statement of Christopher D. Kent (hereinafter "Kent V.S.") at 2; see also Weicher V.S. at 10-11.

UP's flawed annual adjustment approach results from at least two different factors. First, UP apparently did not book the purchase premium in its 1996 URCS costs even though UP acquired control of SP in 1996. This effectively made 1996 a pre-merger year for purposes of the comparison of URCS costs – a development that was not and could not have been anticipated by BNSF and is contrary to the parties' clear intent in Section 7 of the CMA Agreement. See Weicher V.S. at 6. Second, UP modified the language of the Section 7 revision of the adjustment mechanism in the Second Supplemental Agreement to alter the practical application of the revised mechanism. UP's language provided that the GTM mill rates would be adjusted on July

1 of each year by the difference in the relevant URCS costs for the preceding two years. While BNSF agreed to this change, there was no reason for BNSF to anticipate that UP would disregard the clear intent and concurrence of the parties that the GTM mill rates already included the effects of the purchase premium and merger-related costs for which UP took sole responsibility in Section 9(c).⁶

Accordingly, if pre-merger years are to be used for purposes of the annual adjustments to the GTM mill rates, appropriate adjustments must be made to the URCS costs in such years in order to account for the fact that the SP purchase premium and the Section 9(c) implementation expenditures which UP was to fund (both of which would be included in all post-merger years) are not reflected in pre-merger years.

III. IMPACT OF DISPUTED ITEMS ON GTM MILL RATES

In order to determine the impact of the disputed items on the GTM mill rates, BNSF requested Christopher D. Kent of FTI Consulting, Inc. (i) to identify the differences between the BNSF-proposed approach to adjusting the GTM mill rates and the approach proposed by UP, and (ii) to quantify the impact of UP's proposal to include the premium above book value which UP paid for SP in its adjustment of the trackage

⁶ It should be noted in this regard that, while BNSF executed the Second Supplemental Agreement and has agreed to the continued inclusion of UP's language in the Restated and Amended BNSF Settlement Agreement, it was BNSF's expectation and understanding that the language would be interpreted and applied in such a manner that all comparisons of URCS costs would be between post-merger years. See *Weicher V.S.* at 6-7. This understanding was based on the express language in Section 7 of the CMA Agreement and on the fact that BNSF reasonably understood that UP would book the purchase premium in 1996, thus making it a post-merger year. Indeed, it was not until BNSF audited UP's annual rate adjustment calculations in late 2000 that BNSF first had any indication that UP was interpreting the language in a manner inconsistent with Section 7 of the CMA Agreement. Throughout the parties' negotiations concerning the GTM rate adjustment, BNSF has consistently expressed its understanding that only URCS costs from post-merger years should be used to make the annual rate adjustment calculations.

rights rates effective July 1, 1998. BNSF also requested Mr. Kent to determine whether UP's approach affects the "basic relationship" between the trackage rates and UP's costs.

As shown in his Verified Statement, Mr. Kent estimates that including the SP purchase premium in the adjustment calculation, in the manner UP proposes, would increase the GTM mill rates by approximately 0.2 mills. Kent V.S. at 3-4. Further, Mr. Kent has concluded that the UP approach to adjusting the GTM mill rates results in a greater deviation from the "basic relationship" between the trackage rights rates and UP's operating costs that existed in September 1995 at the time of the execution of the BNSF Settlement Agreement than does the use of BNSF's approach. Id. at 5.

IV. IMPACT OF DISPUTED ITEMS ON BNSF'S COMPETITIVENESS

In Decision No. 96, the Board questioned whether the amount in dispute here has any significant impact on BNSF's ability to maintain its success in establishing a competitive presence over the trackage rights lines. Specifically, the Board noted that the disputed costs amount to approximately 5.7 to 6.7 percent of the GTM mill rates and that, while such increases were not by themselves insignificant, they were misleading in assessing BNSF's competitiveness with UP since BNSF's trackage rights fees are only a small part of its overall total costs. Decision No. 96 at 6. However, as set forth in the attached Verified Statement of Denis J. Smith, BNSF's Vice President, Industrial Products Marketing (hereinafter "Smith V.S."), the amounts represented by the disputed items can readily affect BNSF's competitive presence. As Mr. Smith explains, much of the traffic over the trackage rights lines is highly sensitive to price and, therefore, even though many factors ultimately influence competition on the trackage rights lines, pricing is the most critical in the end. Smith V.S. at 2-3. "Over the long-run, an unfavorable

cost structure (resulting, for instance, from inflated trackage rights fees) can (and likely will) erode BNSF's ability to compete." Id. at 3.

Thus, as Mr. Smith explains, the rate differential caused by the disputed items can indeed be determinative in BNSF's efforts to compete for traffic. The likelihood that the disputed rates will affect BNSF's competitiveness has increased with UP's ability to predict the rates that BNSF can offer over the trackage rights lines. At the beginning of BNSF's operations over the trackage rights lines, there was a fairly wide range between the rates offered by BNSF and UP as each carrier was feeling out the market and adjusting its price, service and routing offerings to compete with the other carrier. Smith V.S. at 3. Now, however, UP is able to determine the rates which BNSF can offer over the trackage rights lines with some accuracy because it knows the GTM mill rates which BNSF will be required to pay. Accordingly, the range of competitive rate offerings has narrowed to \$25.00 to \$50.00 per car. Ibid. This knowledge allows UP to exploit the cost advantage that it has obtained from the artificially inflated trackage rights rates. As Mr. Smith explains, "UP essentially knows how low BNSF can take the price it offers for a movement over the trackage rights lines, and it can then simply underbid that price by \$25.00 to \$50.00." Ibid.

Moreover, as Mr. Smith further explains, the rate differential caused by the amount in dispute (approximately 0.2 mills or 5 to 6 percent of the rates) can cause rate quotation differentials in the \$25.00 to \$50.00 per car range where the parties currently compete and can be expected to compete in the long run. Smith V.S. at 3-4. For instance, a move over the Central Corridor between Stockton, CA and Denver, CO

would result in a reduction of about \$46.00 per car.⁷ Similarly, for a move from Houston, TX to East St. Louis, IL, the disputed amount would result in a reduction of about \$30.00 per car. On moves from Denver, CO to Fernley, NV and Ogden, UT, the disputed amount would result in reductions of approximately \$38.00 and \$21.00, respectively. Id. at 4.

UP has itself recognized in the Confidential Appendices attached to its July 2, 2001 Fifth Annual Report in the general oversight proceeding (UP/SP-384) that rate differentials in the range of \$25.00 to \$50.00 per car can in fact be determinative. For instance, in Appendices B and C to its Report, UP has identified numerous movements where either BNSF or UP reduced its rates by amounts in the range of \$25.00 to \$75.00 to secure or retain traffic which the other carrier was competing to carry. Similarly, UP cited other instances where it was forced to freeze its rates in order to prevent BNSF from successfully gaining the traffic. In those situations, any rate differential can be determinative of which carrier will win the business. Copies of UP's Confidential Appendices B and C from its July 2, 2001 Fifth Annual Report are included in the Confidential Appendix filed herewith.

Thus, the rate differential at issue here can have a significant effect on BNSF's competitiveness.

V. CONCLUSION

As established above and in the Verified Statements of Messrs. Ice and Weicher, the relationship between the GTM mill rates which BNSF pays for its use of the UP/SP

⁷ The rates cited in the text include both the movement of a loaded 286,000 pound car as well as the empty return move. In this regard, for most carload commodities, the trend is to larger and heavier shipments

trackage rights lines and UP's costs associated with those lines is critical to BNSF's ability to provide effective and efficient competitive service as a replacement for SP. The GTM mill rates were intended by both UP and BNSF to be comprehensive and all-inclusive, and the parties set forth their intent that the relationship between the rates and UP's costs was to be maintained. While the mechanism for the adjustment of the rates was revised to better track UP's costs associated with the trackage rights in response to criticism from CMA and others, the adoption of an adjustment mechanism based on the comparison of UP URCS maintenance and operating costs was not intended to enable UP to incorporate the purchase premium it paid for SP and the Section 9(c) merger-related capital expenditures it was to solely fund into the adjustment process in such a manner that there would be a double-counting of those costs. Indeed, the parties clearly intended that the comparison of URCS costs would be made using post-merger years only, and, to the extent UP reads the revised language of Section 12 of the BNSF Settlement Agreement to allow for the comparison of pre-merger URCS costs with post-merger URCS costs, such a reading is clearly contrary to the language of Section 7 of the CMA Agreement and the parties' intent.

The resolution of the issue presented by BNSF's Petition for Clarification is important to BNSF's competitive presence on the trackage rights lines. The differential between BNSF's and UP's adjustment methodologies is significant in terms of the current competition between the two carriers on the trackage rights lines as it has developed, and it will be significant over the 99-year term of the BNSF Settlement Agreement as well.

Accordingly, BNSF respectfully requests that the Board clarify that the SP purchase premium and the merger-related capital expenditures that UP was to solely fund may not be included in the Section 12 adjustment process as UP proposes because doing so would violate the express language of Section 7 of the CMA Agreement and the parties' intent that the GTM mill rates were to be comprehensive and all-inclusive.

Respectfully submitted,

Erika Z. Jones/als

Jeffrey R. Moreland
Richard E. Weicher
Sidney L. Strickland, Jr.
Michael E. Roper

Erika Z. Jones
Adrian L. Steel, Jr.
Adam C. Sloane

The Burlington Northern
and Santa Fe Railway Company
2500 Lou Menk Drive
Third Floor
Ft. Worth, Texas 76131-0039
(817) 352-2353 or (817) 352-2368

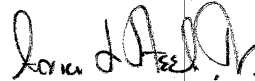
Mayer, Brown, Rowe & Maw
1909 K Street, NW
Washington, DC 20006
(202) 263-3000

Attorneys for The Burlington Northern and Santa Fe Railway Company

May 22, 2002

CERTIFICATE OF SERVICE

I do hereby certify that copies of The Burlington Northern and Santa Fe Railway Company's Response to Order to Show Cause Why BNSF-98 Petition for Clarification Should Not Be Dismissed (BNSF-102) are being served on all parties of record.

A handwritten signature in black ink, appearing to read "Adrian L. Steel, Jr.", written over a horizontal line.

Adrian L. Steel, Jr.

EXCERPTS FROM CITED PLEADINGS

Before the
INTERSTATE COMMERCE COMMISSION

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

RAILROAD MERGER APPLICATION

VOLUME 1

SUPPORTING INFORMATION, SUMMARY OF BENEFITS,
EXHIBITS 1, 8, 10-12 AND 16-19, STATEMENTS OF APPLICANTS' PRINCIPAL OFFICERS,
AND OTHER SUPPORTING STATEMENTS

CANNON Y. HARVEY
LOUIS P. WARCHOT
CAROL A. HARRIS
Southern Pacific Transportation
Company
One Market Plaza
San Francisco, California 94105
(415) 541-1000

PAUL A. CUNNINGHAM
RICHARD B. HERZOG
JAMES M. GUINIVAN
Harkins Cunningham
1300 Nineteenth Street, N.W.
Washington, D.C. 20036
(202) 973-7600

*Attorneys for Southern Pacific
Rail Corporation, Southern
Pacific Transportation Company,
St. Louis Southwestern Railway
Company, SPCSL Corp. and The
Denver and Rio Grande Western
Railroad Company*

CARL W. VON BERNUTH
RICHARD J. RESSLER
Union Pacific Corporation
Martin Tower
Eighth and Eaton Avenues
Bethlehem, Pennsylvania 18018
(610) 861-3290

JAMES V. DOLAN
PAUL A. CONLEY, JR.
LOUISE A. RINN
Union Pacific Railroad Company
Missouri Pacific Railroad Company
1416 Dodge Street
Omaha, Nebraska 68179
(402) 271-5000

ARVID E. ROACH II
J. MICHAEL HEMMER
MICHAEL L. ROSENTHAL
Covington & Burling
1201 Pennsylvania Avenue, N.W.
P.O. Box 7566
Washington, D.C. 20044-7566
(202) 662-5388

*Attorneys for Union Pacific
Corporation, Union Pacific
Railroad Company and Missouri
Pacific Railroad Company*

November 30, 1995

**VERIFIED STATEMENT
OF
JOHN H. REBENS DORF**

My name is John H. Rebensdorf. I am Vice President-Strategic Planning for Union Pacific Railroad Company. I hold a Bachelor's Degree in Civil Engineering from the University of Nebraska and a Master's Degree in Business Administration from Harvard University. Before coming to Union Pacific, I was employed as a management consultant by Temple, Barker and Sloane. I have worked in the Mechanical Department of the Chicago, Burlington & Quincy Railroad and in the Operating and Engineering Department of the Chicago, Rock Island and Pacific Railroad. I joined Union Pacific in 1971 as Manager of Budget Research. I became Assistant Controller in 1976, Assistant Vice President-Planning & Analysis in 1980, Assistant Vice President-Finance in 1984 and was appointed to my present position in 1987.

The purpose of my statement is to describe the settlement agreement that was reached between UP and SP, on the one hand, and BN/Santa Fe, on the other hand, on September 25, 1995. I will review the background of the settlement agreement and the underlying negotiations and describe the key provisions of the agreement, including the rights granted and the compensation terms.

overhead trackage rights on BN/Santa Fe's line between West Memphis and Presley Junction in Arkansas.

Finally, some provisions of the Agreement resolved outstanding issues of concern that have no connection with the merger -- also adding to competition in the process. These included operating rights in Northern Wisconsin for UP/SP to resolve access to the MERC dock at Superior as well as direct access to the DWP and DMIR at Pokegama, Wisconsin. BN/Santa Fe, on the other hand, was granted the right to purchase UP's line between Dallas and Waxahachie, Texas, in order to consolidate maintenance and operating responsibility on this track which is part of BN/Santa Fe's main line between Houston and Dallas.

III. Compensation Terms

My objective in negotiating the trackage rights compensation terms was to ensure that Union Pacific would be fairly reimbursed for the maintenance and operating expense associated with BN/Santa Fe's trackage rights operations, and would receive a reasonable return on the capital tied up in the lines whose capacity BN/Santa Fe would be partially using. It was my intent that the trackage rights rate place both carriers on a level playing field with neither subsidizing the other. I am confident these goals were reached.

The rates ultimately agreed to were the result of arm's-length negotiation with a considerable give and take between the parties. There were several possible starting points for the rate negotiation.

One starting point, which until recently has been traditional in joint facility arrangements, would have been to allocate the actual cost of maintenance and operation between the parties on the basis of their relative usage together with an appropriate "interest rental" factor to provide a return to capital. The Commission has found that, to cover full economic costs, the interest rental factor must be based on the replacement cost of the property times the current cost of capital.

Another starting point was to establish a flat rate. Clerical work and expense associated with traditional joint facility arrangements are substantial, and railroads are increasingly moving to flat rate compensation for these facilities. We and BN/Santa Fe were in agreement that a flat rate was the best alternative.

I began my consideration of an appropriate flat rate by reviewing flat rates in other agreements that the parties had recently negotiated. The most recent flat rates, and ones that were before the Commission when it approved the BN/Santa Fe merger, were the rates included in the settlement agreement reached between SP and BN/Santa Fe in connection with the BN/Santa Fe merger. In fact, the rates we ultimately negotiated were, for intermodal and carload business, lower than the rates in the SP-BN/Santa Fe agreements.

The most important consideration from our standpoint was to recover UP/SP's cost of maintaining and operating the joint UP/SP-BN/Santa Fe track. I believe that the rates negotiated with BN/Santa Fe will cover the relevant costs. However, UP/SP is still exposed to significant risk. The risk results from the fact that the rates apply systemwide and reflect systemwide average costs. In some instances, the cost of

maintaining a particular line segment will be greater than systemwide costs, and in other cases it may be lower. However, several of the line segments in question involve some of the highest-maintenance portions of UP's and SP's systems. These include the UP and SP lines along the Gulf Coast, SP's line through the Rocky Mountains between Denver and Salt Lake City, SP's line through the Sierra Nevada Mountains over Donner Pass, and the former WP line through the Feather River Canyon in California.

The Gulf Coast lines are prone to flooding from hurricanes and other tropical storms. The terrain they cover is low lying and wet, requiring numerous bridges and shortening the life of wooden cross ties. In the Rockies and Sierra Nevadas, the grades and curvature inherent to mountain railroading increase wear and tear on the track structure. Tunnels, snowsheds, cuts and fills must also be maintained. Weather also leads to higher costs. For example, 24-hour-a-day snow removal is occasionally a necessity on Donner Pass. The Feather River Canyon is also subject to floods and slides. In fact, at certain times hi-rail vehicles must precede all trains in the Feather River Canyon to check for rock slides.

The settlement agreement does not restrict the traffic BN/Santa Fe can handle over these rights. BN/Santa Fe can - and likely will - choose to route quite a bit of east-west traffic over the Central Corridor rights. For example, the rights will shorten BN/Santa Fe's mileages in numerous corridors as described in Mr. Peterson's statement. These mileage savings (e.g., 387 miles between Oakland and Denver; 664 miles between Oakland and the Twin Cities) will likely lead to the rerouting over these lines of substantial

traffic that is unrelated to the "2-to-1" situations at which the rights were principally focused.

The rates in the settlement agreement are shown in Table 1 below.

Table 1
Trackage Rights Compensation
(mills per ton-mile)

	<u>Keddie-Stockton/Richmond</u>	<u>All Other Lines</u>
Intermodal and Carload	3.48	3.1
Bulk (67 cars or more of one commodity in one car type)	3.0	3.0

I want to address three likely questions about these rates before discussing them in more detail. First, why is the rate different for intermodal and carload traffic as compared to bulk traffic? Second, why is the intermodal and carload rate higher for the Keddie-Stockton/Richmond segment than for other lines? Third, why is the rate based on ton-miles rather than car-miles?

1. The rate is different for intermodal and carload traffic as compared to bulk traffic. Certain expenses of maintenance and operation such as dispatching and signal operation are traditionally costed on a train mile basis. Spreading these expenses over all traffic on the basis of gross ton-miles will lead to bulk commodities bearing a disproportionately high share of these expenses. The extra one-tenth of a mill charged to intermodal and carload business more properly allocates expenses between the two categories of traffic.

2. The intermodal and carload rate is higher for the Keddie-Stockton/Richmond segment than for other lines. The rate for the rights between Keddie-Stockton/Richmond were set at 3.48 mills per ton-mile because this line segment is unquestionably a very high maintenance area and will handle BN/Santa Fe's north-south traffic in the so-called "I-5 Corridor" as well as some transcontinental business of both railroads. Accordingly, in this one instance, we negotiated a higher rate for a territory we felt would clearly incur high levels of traffic requiring correspondingly high levels of maintenance and expense.

3. The rate is based on ton-miles rather than car-miles. We used gross ton-miles as the basis for assessing the charges because it most accurately reflects the actual use made of the facility, and therefore the resulting expense.

Turning back to the rates themselves, they are not only cost-based, but reflect rates recently negotiated between SP and BN/Santa Fe as well as rates found in other recently negotiated joint facility agreements between UP and parties other than BN/Santa Fe.

Table 2 lists recent flat rate agreements involving UP, SP and BN/Santa Fe. Included in italics in Table 2 is the 3.0-3.1 mill per ton-mile rate applicable to the settlement agreement, which has been converted to a car-mile rate for ease of comparison.² Also converted to a car-mile rate is the mill-per-gross-ton-mile charge from

² The conversion was based on a 100-ton load and 100% empty return. The actual rate will depend on the lading weight and the empty return associated with a given move. The 3.48 mill per ton-mile rate applicable to the Keddie-Stockton/Richmond line segment produces a higher car-mile rate, in the \$0.28 range. It applies to only a small percentage of the overall trackage rights. Even this rate is not out of line with the recent agreements.

the 1995 agreement between BN/Santa Fe and SP.

Table 2
Rates in Other Recent Trackage Rights Agreements

Date	Landlord	Tenant	Location	Miles	1994 Rate Per Car Mile
1990	IC	SP	IL	48	\$0.45
1990	UP	CP	MN	25	\$0.36
1986	UP	DME	IA	48	0.34
1990	BN	SP	KC-Chi	465	0.28
1990	NS	SP	MO	25	0.27
1990	UP	SP	TX	96	0.27
1992	SP	SO	TX	10	0.27
1986	UP	CP	MN	10	0.24
1995	BN/Santa Fe	SP	Various	2,108	0.24-0.28
1995	UP/SP	BN/Santa Fe	Various	3,968	0.24-0.25
1995	BN/Santa Fe	UP	KS	139	0.20

As can be seen, the rates of \$0.22 to \$0.25 per car mile applicable to the settlement agreement are at the low end of rates found in other recent joint facility agreements.

The rates can also be viewed in comparison to costs developed using the Uniform Rail Costing System ("URCS"). A weighted average of UP and SP costs was used because 56 percent of the BN/Santa Fe trackage rights mileage will be over SP lines and 44 percent will be over UP lines. On a weighted average basis, the rates will cover between 143% (at the 3.0 mill rate) and 148% (at the 3.1 mill rate)³ of what URCS defines as the system average variable cost of the so-called "M&O" (maintenance and operations) functions that a trackage rights landlord must perform (e.g., track maintenance/dispatching).

³ At the 3.48 mill per ton-mile rate the coverage of variable cost is 166%.

URCS variable cost includes only a percentage of all the costs associated with maintaining and operating the track. The balance of these costs is treated by URCS as fixed in the short term. However, given the permanent nature of these rights, I believe the coverage of full costs is important because over the long-run, as will be the case with these rights, all costs become variable. UP/SP must recover these costs to avoid subsidizing BN/Santa Fe's operations. Moreover, the URCS variable cost computation includes only 50% of the book value of the assets involved, and reflects no return on the other half of the book value, or on the difference between the book value and the current value of the assets. An economic return on the current value of assets must ultimately be earned if a railroad is to continue replacing its plant and stay in business and even URCS fully allocated cost includes only return to capital on the basis of 100% of the book value of the assets, not replacement cost. Looking at these rates on the basis of URCS fully allocated costs, again on a weighted average basis, the ratio of the trackage rights fee to our expense drops to 75% (at the 3.0 mill rate) and 77% (at the 3.1 mill rate).⁴ I believe these rates will be sufficient, but only marginally so, for UP/SP to receive a sufficient return from BN/Santa Fe's trackage rights fees to ensure that UP/SP is not investing its capital to subsidize BN/Santa Fe's operations.

The rates are also subject to adjustment, upward or downward. The adjustment will be undertaken annually by applying 70% of the Unadjusted Rail Cost Adjustment Factor (RCAF-U) to the rates. RCAF-U is the most commonly utilized index for measuring railroad inflation. The RCAF-U Index is developed by the Association of

⁴ At the 3.48 mill per ton-mile rate the coverage of fully allocated costs is 87%.

American Railroads from audited data that is supplied by the Class I railroads, and is approved by the Commission. The use of RCAF-U is appropriate because productivity has been driven more by initiatives in areas such as crew consist and fuel conservation than in the area of maintenance of way. To use a productivity-adjusted RCAF would, among numerous other serious deficiencies, reflect productivity gains that would not reduce maintenance of way costs -- which are the principal costs covered by the trackage rights fees. Using a percentage of RCAF-U as the adjustment mechanism is also common in long term agreements. Here, the 70% factor shares some productivity gains with BN/Santa Fe without disincenting UP/SP from making investments (such as to purchase high production maintenance of way equipment) that will improve maintenance of way efficiency -- investments which must earn an adequate return.

In looking at the relationship between this fee and the cost structures of the two carriers, one must also bear in mind three points. First, the fee is comprehensive. Second, the fee represents only one component of total operating expense, the balance being equipment, fuel, labor, switching and related overheads. Third, because very few moves will involve solely the trackage rights lines, the fee will be further diminished as a fraction of BN/Santa Fe's total cost.

1. The rate is comprehensive. It includes all day-to-day maintenance of the right-of-way, track, ties, bridges, turnouts, subgrade, signals, and communication systems. Replacement of the existing plant including rail relays, tie replacements and bridge replacements is also included. All dispatching expense and the overhead associated with maintenance and operation is also included.

BN/Santa Fe's responsibility for capacity-related improvements is also quite limited. However, there is no limitation on BN/Santa Fe's right to use capacity-related improvements for which it bears no financial responsibility. Specifically, BN/Santa Fe has no responsibility for capacity improvements related to the merger, or for any capacity improvement, whether merger-related or not, made during the first 18 months of operation. Finally, BN/Santa Fe will have no responsibility for the first \$25 million worth of capital expenditures for which it would otherwise have shared responsibility. The settlement agreement calls for establishing a capacity-related capital reserve fund to be drawn down to cover those first \$25 million of capacity-related capital expenditures. Accordingly, it will not be until 18 months after BN/Santa Fe has begun trackage rights operations that it will begin to fund any capacity-related improvements and even the first \$25 million of those will be funded out of a capital reserve fund. This total relief from capital expenditures at the inception of trackage rights operations will be a real advantage to BN/Santa Fe in building its trackage rights traffic base.

The sorts of capital projects that BN/Santa Fe ultimately will be responsible for will include its usage share of projects such as upgrading a signal system from automatic block signals to centralized traffic control; adding CTC and universal crossovers to double track; constructing new sidings; and lengthening existing sidings. However, as I have stated above, BN/Santa Fe will only be responsible for these expenses if they (a) are not merger-related, (b) take place more than 18 months after implementation of trackage rights operations and (c) exceed the \$25 million capital reserve fund.

2. The trackage rights fee is only one element of cost, but a cost both carriers must incur in competing. The balance of operating costs are up to each individual carrier. These costs include locomotives, equipment, crews, fuel and terminal support services.

3. Finally, the trackage rights fee is important, but from BN/Santa Fe's perspective, it will only represent a small portion of total costs for most moves. Few moves will involve a haul solely over the trackage rights lines. In most cases, BN/Santa Fe will utilize its own existing routes -- often for the great majority of the overall haul -- in conjunction with the trackage rights lines. A good example is the Keddle-Stockton segment, which will give BN/Santa Fe single-line routes in the I-5 Corridor. Between Spokane and Los Angeles, this segment, at 183 miles, will be only 12.4% of BN/Santa Fe's total mileage (1,478 miles). On this move, only 4.2% of BN/Santa Fe's URCS variable cost would be attributable to the trackage rights fee. The trackage rights fee as a percentage of total variable and fully allocated cost is shown in Table 3 for Spokane-Los Angeles and several other representative moves:

Table 3
Trackage Rights Fee as a
Percentage of Total Cost

Move	Total Miles	Trackage Rights Miles	Trackage Rights Fees as a % of Total Variable/ Fully Allocated Costs
Spokane-LA	1,478	183	4.2/3.1
Chicago-Eagle Pass	1,487	357	7.1/5.5
Denver-Oakland	1,383	1,383	33.5/27.2
PRB-LCRA*	1,468	115	4.0/3.0

* Powder River Basin to Lower Colorado River Authority Power Plant at Halsted, TX.

In conclusion, the trackage rights charges are fair. They are cost-based and also reflective of rates in similar agreements. They will ensure that UP/SP can cover the costs attributable to BN/Santa Fe's operations and will not result in either carrier's subsidizing the other.

IV. Line Sale Purchase Prices

The Settlement Agreement calls for three line sales. They are: (1) UP's line between Keddie and Bieber, California; (2) UP's line between Dallas and Waxahachie, Texas; and (3) SP's line between Iowa Junction and Avondale, Louisiana, including terminal facilities in the New Orleans area. The purchase prices for these segments are \$30 million, \$20 million, and \$100 million, respectively. As with the trackage rights compensation, these purchase prices were the subject of arm's-length negotiation. They simply reflect what a willing buyer, BN/Santa Fe, would pay a willing seller, UP/SP, for these properties.

In the case of the Dallas-Waxahachie and Avondale-Iowa Junction sales, UP/SP retained trackage rights over those lines. The trackage rights will be subject to the same terms as applied to BN/Santa Fe operations over the rights it was granted by UP/SP. BN/Santa Fe can also elect not to purchase these lines and operate instead via trackage rights. In the case of the Avondale-Iowa Junction and Dallas-Waxahachie segments, trackage rights would be covered by the compensation terms applicable to other trackage rights line segments. The Keddie-Bieber trackage rights charges would, however, be allocated "on a typical joint facility basis." Since BN/Santa Fe will become the sole user of this line should it choose not to purchase the line, we felt it reasonable that BN/Santa

VERIFIED STATEMENT OF CARL R. ICE

I. BACKGROUND

I am Executive Vice President and Chief Operations Officer for The Burlington Northern and Santa Fe Railway Company ("BNSF"). I was appointed to this position in December 2000.

I began my career in the railroad industry with The Atchison, Topeka and Santa Fe Railway Company ("Santa Fe") in the industrial engineering department in 1979. I later held positions in operations, finance and information systems. In 1992, I was named Vice President – Administration. I became Vice President – Carload Business Unit in January 1994 and was named Vice President – Executive in July of the same year. In January 1996 after the merger of Burlington Northern and Santa Fe, I was appointed Vice President and Chief Mechanical Officer of BNSF. I became Vice President Operations North in January 1999 and was promoted to Senior Vice President Operations in June 1999.

I received a Bachelor of Science degree in industrial engineering from Kansas State University. I am a member of the Institute of Industrial Engineers.

II. THE BNSF SETTLEMENT AGREEMENT

I was BNSF's principal negotiator, assisted by Richard E. Weicher, in negotiations for the settlement agreement executed between BNSF and Union Pacific on September 25, 1995 ("BNSF Settlement Agreement"), in connection with the proposed merger of UP and SP. The purpose of the negotiations, which took place over several weeks in September 1995, was to attempt to resolve BNSF's opposition to the UP/SP merger and to reach agreement with UP on the role BNSF would play if the parties were to agree that BNSF would be the carrier to address the competitive issues

raised by the merger. This would include the terms by which BNSF would provide service to preserve the pre-merger competition between UP and SP that would otherwise be lost as a result of their merger.

A. The Gross Ton Mile Mill Rates

The terms of compensation for the trackage rights under the BNSF Settlement Agreement were a critical part of those negotiations and were the subject of intense arms-length discussions. UP/SP's position was that the trackage rights fee should reimburse UP/SP for all the costs associated with BNSF's trackage rights operations, not just direct out-of-pocket costs for operation and maintenance of the trackage rights lines that BNSF would be using. BNSF's position was that the rates should be at levels that would enable BNSF to offer competitive pricing, taking into account all of our costs, and would be comparable to other then-current trackage rights agreements. We emphasized that the rates of compensation should not place BNSF at a disadvantage in competing with UP/SP as the landlord railroad.

In addition to the rates of compensation, the parties also agreed that their respective interests should continue to be protected over the term of the Settlement Agreement. As with any negotiation, we had to find a rate that would work for both parties. In my view, the agreed upon GTM mill rates were very close to the upper limit that BNSF could accept and still offer competitive service. Consequently, any increases later could make us noncompetitive for particular moves. UP/SP had projected substantial improvements in efficiency, and it was important to BNSF that reductions in costs of the merged entity should be passed on to BNSF in the form of lower rates for trackage rights. UP/SP took the position that, once it had agreed on rates to cover

costs associated with BNSF's operations, it should be able to adjust the rates to account for increases in its costs. At the time, it was apparent that BNSF's primary concern was that the trackage rights rates should, over time, reflect reductions in UP/SP's costs, and UP/SP was more concerned that the rates should take account of increases in its costs.

Although our specific interests differed, we were able to agree in principle on all major issues in the negotiations. In this regard, I agree with the statement made in the Verified Statement of John H. Rebensdorf, one of UP's principal negotiators in our settlement discussions, which was submitted with the UP/SP Application, when he said that it was "the intent that the trackage rights rate place both carriers on a level playing field with neither subsidizing the other." UP/SP-22 at 301.

With respect to the form of compensation for trackage rights use, it was agreed between UP/SP and BNSF that a defined, flat rate would be used. This is distinguished from compensation based on periodic sharing of expenses, as is common in some joint facilities and other methods. To determine the appropriate flat rate, we reviewed flat rates in other recent trackage rights agreements that the parties had entered. These included the flat rates in the then-recent settlement agreement reached between SP and BN/Santa Fe in connection with the BN/Santa Fe merger. After significant discussion and negotiation, the parties agreed that the rate, expressed in mills per gross ton-mile ("GTM"), for most carload and intermodal traffic would be 3.1 mills per GTM and that the rate for bulk traffic would be 3.0 mills per GTM.

The parties also agreed that the rates would be based on ton-miles rather than car-miles because it was our belief that this would more accurately reflect the actual use

made of the trackage rights lines and thus the resulting expense to UP/SP. This conclusion was based on the great variation in size and types of cars and their capacity and our belief that ton-miles is a more meaningful measure of use.

It was my understanding of both sides' intent that the GTM mill rates that had been agreed to were comprehensive, and that BNSF would not be expected to pay increased rates based on costs that were already known and taken into account in the negotiations. UP's intent in this regard is reflected in Mr. Rebensdorf's Verified Statement where he stated that the "rate is comprehensive." UP/SP-22 at 308.

BNSF agreed with this because, through the GTM mill rates, it was paying for its use of UP's capital in the trackage rights lines. It was my conviction and understanding that these GTM mill rates specifically included all of UP's costs – both short-term as well as long-term costs – that had anything to do with capital maintenance, near-term capacity improvements, or consummation and implementation of its merger – i.e., all costs of any kind whatsoever.

B. The Parties' Intent

When BNSF entered negotiations with UP/SP concerning the GTM mill rates, BNSF was aware that UP had agreed to pay a substantial premium above book value to purchase SP, and we knew that the premium would be an expense that UP would bear to effect the merger. UP's August 3, 1995 press release announcing the merger had valued the transaction at \$5.4 billion, and SP's 1994 Annual Report reflected a book value of approximately \$4.15 billion.

The negotiations occurred after UP's acquisition of SP had been negotiated between those parties and after the terms of that acquisition had been set. By the same

token, the negotiations under way between BNSF and UP/SP were on the terms of a possible settlement under which BNSF would not oppose the merger if it acquired sufficient conditions of value to BNSF that would address the competitive impacts of UP's merger with SP. These were rights which could only be implemented and become effective if that merger was approved and had already been consummated. Clearly, we believed that the GTM mill rates included any effect of the merger.

Nothing in the negotiations indicated that either party contemplated that the GTM mill rates would not take account of the purchase premium. To the contrary, it was my fundamental belief that negotiators for both BNSF and UP/SP always intended that the rates agreed to in the September 1995 negotiations were inclusive of all of UP's costs and return on investment in the merged UP/SP, including UP's purchase price for acquiring SP, and those mill rates would not be subject to adjustment in a subsequent year to take account of these costs.

This intent is reflected in our agreement that the GTM mill rates would stay in the "same basic relationship" to "operating costs" throughout the life of the BNSF Settlement Agreement. Section 12 of the Agreement states: "It is the intention of the parties that the rates and charges for trackage rights and service under this Agreement shall reflect the same basic relationship to operating costs as upon execution of this Agreement." This provision was in the very first draft of the Settlement Agreement, which was prepared by BNSF on September 19, 1995, and provided to UP. The provision identifies a relationship between the GTM mill rates and UP's operating costs, and provides that it is the parties' intent that the relationship should remain the same throughout the term as it was at execution.

During the negotiations, both sides had cost experts available and were considering their costs in relation to the levels of GTM mill rates. BNSF made an evaluation of the impact of the GTM mill rates on our cost structure and whether BNSF could be competitive at those rates. It is my belief that UP/SP's representatives were making comparable analyses of their costs, although we did not share the results with each other.

We knew the 3.1 mill rate per GTM was higher than UP/SP's direct operating costs because it covered all their costs of every nature. It thus clearly was BNSF's intent and belief that the GTM rate included more than UP's operating costs and covered items such as return on investment, capital maintenance and merger implementation. Since we did not exchange the cost data used in these comparisons with UP/SP, I do not know UP/SP's precise internal calculus for understanding that relationship, but I am confident from the course of negotiation and the language agreed upon in the final sentence of Section 12, quoted above, that UP/SP shared our understanding that UP would be compensated in the GTM mill rates for all of its costs of any nature.

It is my understanding that UP now takes the position that the premium above book value that it paid to acquire SP should be taken into account in the annual adjustment to the trackage rights rates, effective July 1, 1998. I believe that both sides intended in September 1995 that the return and depreciation on all UP/SP assets including this purchase premium were fully taken into account when we negotiated and agreed on the rates. Inclusion of the purchase premium in UP's URCS costs used in the annual adjustment mechanism would disrupt the basic relationship between the

GTM mill rates and operating costs because, at the time of execution of the Settlement Agreement, the purchase premium was already encompassed in the amount of the GTM mill rates. In other words, UP's adjustment of the GTM mill rates, effective July 1998, would result in a form of double-counting of the purchase premium paid for SP since the premium has been in the GTM mill rates since the execution of the BNSF Settlement Agreement. The inevitable result of such an adjustment of the GTM mill rates is to disrupt their relationship to the "operating costs", and defeat the guiding principle of the adjustment process that the "same basic relationship" be maintained.

We also knew in September 1995 that UP/ SP planned to undertake numerous capital expenditures necessary to implement the proposed merger. It was BNSF's position during our negotiations that UP/SP should bear the full responsibility for these anticipated capital expenditures and that the GTM mill rates should not be increased as a result of those expenditures. Accordingly, BNSF negotiated for and received a commitment from UP/SP that UP/SP would bear the cost of all capacity improvements necessary to implement the merger as outlined in the Operating Plan submitted with the Application. BNSF Settlement Agreement, § 9(c)(i).

In addition, while the Settlement Agreement provided in Section 9(c)(ii) that any capacity improvements to the trackage rights lines other than those covered by Section 9(c)(i) would be shared by the parties based on their respective usage of the trackage rights line in question, the Agreement provided in Section 9(c)(iii) that BNSF would not be required to share in the cost of any capital improvements for 18 months following UP's acquisition of control of SP.

In addition, UP/SP agreed in Section 9(c)(iv) of the Settlement Agreement to set up a capital reserve fund which was to be used to pay for the first \$25 million worth of capital expenditures for which BNSF would otherwise have had shared responsibility.

At the time the BNSF Settlement Agreement was negotiated and executed, we knew that UP/SP contemplated and would spell out their capital improvements related to the merger, and it was very important to me that BNSF not pay for those expenses beyond the agreed level of GTM mill rates. We could not have any additional responsibility for expenses to facilitate the merger and, at the same time, step into the shoes of SP as an effective competitor to a merged UP/SP.

These provisions which decreed that BNSF was not to be required to contribute to merger implementation costs and that adjustments to the GTM mill rates were not to disrupt the relationship of those rates to operating costs were crucial to us. Both parties wanted something to make it clear that this relationship was to be maintained, but this was probably even more fundamental to BNSF. For UP, it was a matter of dollars. For BNSF, it was a matter of maintaining our competitive capabilities. In the end, we knew that we had to have trackage rights rates that worked to keep us an effective competitor. Without such rates, the trackage rights were meaningless to us. The overarching concept was that we needed to stay competitive, and by its nature this was more important to us than to UP. We took the obligation to be an effective competitor very seriously. We knew we were near the upper limit of what would be an acceptable trackage rights fee, and we had to make it clear that we could not be charged for other elements and that there should be enough capacity on these lines, at UP's expense, for BNSF to operate effectively.

C. The Adjustment Mechanism

The parties recognized that the initial GTM mill rates should be subject to adjustment, upward or downward, for changes in UP's costs that were not known or contemplated at the time of the negotiations. We negotiated at length over the proper adjustment of the GTM rates. Initially, we discussed the various types of indices used in the industry for measuring railroad inflation. We agreed upon annually applying 70% of the Unadjusted Rail Cost Adjustment Factor ("RCAF-U"). By using 70% of the RCAF-U (rather than the fully productivity-adjusted RCAF ("RCAF-A")), the parties agreed to share some of any productivity gains UP achieved.

As discussed above, both UP/SP and BNSF had determined, after internal review and analysis, that the agreed-upon GTM mill rates would enable UP/SP to recover its costs, including a return on its capital or contribution to fixed costs, and would enable BNSF to compete effectively. Nevertheless, we recognized the possibility that unforeseen developments could cause the adjustment mechanism, as written, to be ineffective in achieving the intent of the parties. Thus, we agreed to include language in the Settlement Agreement which provided either party with the right, which could be exercised every fifth year, to request a joint review of the operation of the adjustment mechanism and to renegotiate its application. The purpose of this review and renegotiation process was not to overlap or interfere with the annual adjustment process but, rather, to provide an agreed mechanism for renegotiating the terms of the Settlement Agreement. As Mr. Rebensdorf stated in his Rebuttal Verified Statement, this "truing mechanism" was "designed to ensure that costs do not get out of line with

the trackage rights charges." UP/SP-231, Vol. 2, Part C at 9-10. Again, protecting this relationship was fundamental to protecting our ability to compete.

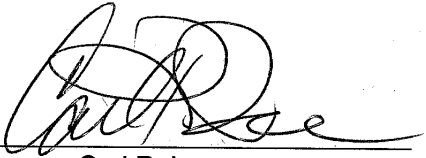
Thus, in my view, the above language in Section 12 providing for periodic review of the adjustment mechanism, the provisions of Section 9(c) dealing with capital improvements, and the whole basis of negotiation of the GTM mill rates themselves all demonstrate the clear intention of the parties that the GTM mill rates were to reflect all costs of any kind of associated with the trackage rights operations and the UP system, including UP's acquisition of and merger with SP.

In summary, the GTM mill rates were intended to be comprehensive. They were at the maximum of what we could afford to pay and still be competitive. The clauses that reflect the importance of the adjustment mechanism maintaining the same relationship of the GTM mill rates to operating costs and that specifically exclude any contribution by BNSF to capital improvements to implement the UP/SP merger were to keep us from becoming less competitive. Philosophically, it was important that this relationship not be denigrated. It would be a distortion of that entire intent to use an adjustment mechanism that would make BNSF any less competitive by reflecting any form of the costs of UP's merger implementation, whether to reflect a purchase accounting premium, specific capital investments to implement the UP/ SP merger or otherwise.

VERIFICATION

I, Carl R. Ice, verify under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on May 21, 2002.



Carl R. Ice

VERIFIED STATEMENT OF RICHARD E. WEICHER

I. BACKGROUND

I am Vice President and Senior Regulatory Counsel for The Burlington Northern and Santa Fe Railway Company ("BNSF"), and have held this position since June 1999. I joined the Law Department of The Atchison, Topeka and Santa Fe Railway Company ("Santa Fe") in 1974 and was named General Counsel for Santa Fe in 1989. I subsequently became Vice President and General Counsel of BNSF in October 1995.

I have worked in the areas of regulatory practice, administrative litigation and transactions in the railroad business throughout my career, including the merger of Burlington Northern and Santa Fe in 1995, and BNSF's participation in the settlement agreements between BNSF and Union Pacific imposed as conditions to the merger of Union Pacific and Southern Pacific in 1996.

I received a bachelor of arts degree from Holy Cross College in 1971, a J.D. *cum laude* from Loyola University of Chicago School of Law in 1974, and an M.B.A. from the University of Chicago in 1986.

II. THE BNSF SETTLEMENT AGREEMENT

I was a negotiator for BNSF with respect to the settlement agreement executed between BNSF and UP on September 25, 1995 ("BNSF Settlement Agreement") as well as the CMA Settlement Agreement, dated April 18, 1996. I worked with Carl R. Ice on the BNSF Settlement Agreement. Throughout the negotiations, I also served as legal counsel. Mr. Ice's and my purpose was to seek a settlement with UP/SP with respect to BNSF's concerns about the proposed merger between UP and SP and to negotiate the terms under which BNSF would provide service to preserve the pre-merger competition between UP and SP that would otherwise be lost as a result of the merger. As Mr. Ice

describes in further detail in his Verified Statement, the terms for the nature and level of compensation for the trackage rights under the BNSF Settlement Agreement were the subject of extended and substantial, arms-length negotiations.

From the earliest point at which BNSF considered the opportunity to provide this competitive service, we intended that the rates charged for rights over UP/SP trackage must be at levels that encouraged competition, and there must be contractual assurances that the rates would decline in line with UP's anticipated merger-related efficiencies. Mr. Ice and I emphasized these objectives to UP/SP's representatives throughout the negotiations, and we further affirmed the importance to BNSF by bringing to the first negotiating session draft language that would accomplish our intentions. UP/SP's representatives advised that they understood the importance we attached to the role of trackage rights fees in providing competitive service and were receptive to our draft contractual language.

The BNSF Settlement Agreement that was executed on September 25, 1995, contained virtually all of the contractual provisions in broad structural terms that we deemed essential to offering competitive pricing.

The level of charges for our trackage rights was expressed in mills per gross ton-mile ("GTM") and, as discussed in Mr. Ice's Verified Statement, the rates were at levels that BNSF considered at the high end of what we could accept and still competitively price our proposed services. We viewed the GTM mill rates as covering all UP/SP's merger-related costs, including merger-related capital expenditures. I believe that the parties agreed that the GTM mill rates covered all merger-related costs. In other words, it was intended by BNSF and UP/SP that the GTM mill rates were comprehensive and

were intended to be inclusive of all the costs of UP/SP associated with the trackage rights operations and the UP/SP merger for which BNSF had any responsibility. There was no basis for adding an element to reflect additional compensation to UP for the SP purchase premium or any merger implementation costs.

The guiding principle for any changes to the level of the GTM mill rates was expressed in the final sentence of Section 12 of the BNSF Settlement Agreement. The sentence states, "It is the intention of the parties that the rates and charges for trackage rights and service under this Agreement shall reflect the same basic relationship to operating costs as upon execution of this Agreement."

We had agreed on the amount of "the rates and charges for trackage rights and service" as expressed in the GTM mill rates. In the course of negotiations, each side had consulted its cost experts, and both BNSF and UP/SP had understandings of the level of "operating costs" based on their own definitions of the term. The guiding principle would be achieved by comparing the relationship of the GTM mill rates to "operating costs" at the time of execution to whatever relationship existed at a later time by comparing the GTM mill rates and the amount of "operating costs" under the same definition. In other words, the "same basic relationship" could be compared so long as the definitions of "the rates and charges for trackage rights" and for "operating costs" were consistent from one period to the next.

BNSF also negotiated for and obtained provisions that were intended to assure that it would not be responsible for any of UP/SP's costs necessary to achieve the benefits anticipated from the merger, as provided in Section 9(c) of the BNSF Settlement Agreement.

The parties recognized that UP's costs associated with the trackage rights lines could change and, indeed, it was expected by BNSF that these costs would decline as the merged entity achieved the substantial improvements in productivity and efficiencies that were expected from the merger. In line with the guiding principle cited above, BNSF and UP/SP agreed to a mechanism in Section 12 that we intended to serve as an indication of the merged company's costs, based on 70% of annual increases or decreases in the RCAF-U. This mechanism would serve as a surrogate for changes in the merged entity's costs to reflect productivity improvements. The GTM mill rate would be adjusted accordingly, in relation to changes in 70% of the RCAF-U.

The parties further recognized the possibility that the adjustment provisions we had agreed to might not achieve our intentions. Therefore, we included a provision in Section 12 of the BNSF Settlement Agreement that, on each fifth anniversary of the effective date of the Agreement, the parties would review the operation of the adjustment mechanism and renegotiate its terms, subject to arbitration if necessary. The guiding principle of maintaining the "same basic relationship" of GTM mill rates to costs, quoted above, applied to all of these provisions in Section 12.

There were numerous additional negotiations and resulting amendments to the BNSF Settlement Agreement, but none of the provisions discussed above was changed, with the exception of the basis used in the annual adjustment process. The provisions of the guiding principle of maintaining the basic relationship of rates to costs, the terms of Section 9(c) defining UP's sole responsibility for merger-related implementation costs, and the five year review process all remained intact, reflecting the same intentions as when they were agreed to in the September 1995 negotiations.

III. THE CMA AGREEMENT

After the Application was filed, a number of shippers and other parties to the merger proceeding questioned the level of the GTM mill rates and the use of 70% of RCAF-U as the basis for the annual adjustments to the rates, as well as other issues concerning competitive service and access. As to all of these matters, their concerns centered around the need for effective competition to the merged UP/SP entity.

As to RCAF-U and the annual adjustments to the GTM mill rates, these shippers and their representatives were concerned that the differential in the rates BNSF would have to pay would, compared to UP/SP's costs, increase substantially over time because the BNSF rates would not be fully adjusted for the substantial productivity gains that UP/SP was likely to achieve and because any adjustment would be based on industry data rather than UP/SP's own costs. According to these parties, this increased differential would adversely affect BNSF's competitiveness. These parties also objected to the use of 70% of RCAF-U as the adjustment factor because the proper adjustment measure should be based on costs, not prices.

As a result of these concerns, UP/SP, BNSF and the Chemical Manufacturers Association (now, American Chemistry Council) entered into negotiations to revise the Section 12 adjustment mechanism. On April 18, 1996, all three parties executed the CMA Agreement which provided, in Section 7, that the trackage rights fees would be adjusted annually 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.)

A key purpose of these negotiations was to address shippers' concerns and amend the mechanism to better reflect changes in UP/SP's maintenance and operating

costs associated with the trackage rights lines so that the relative relationship between UP's costs and BNSF's costs over the trackage rights lines would be more accurately measured than was possible using industry-based RCAF-U data. The focus of negotiations leading to the CMA Agreement was to protect BNSF's ability to compete with UP from year to year during the life of the trackage rights. The mutual decision to rely on UP's URCS costs was based on the parties' agreement, confirmed by their statements in negotiations, that a more reliable indicator of UP's operating costs, including the achievement of improved efficiencies, would be achieved by relying on "the categories of [UP/SP system average] maintenance and operating costs covered by the [trackage rights] fee," rather than RCAF-U data.

In light of the unanimous intent of the parties in agreeing to these changes, as well as the language that they used in the CMA Agreement, it was never intended or contemplated that the purchase premium UP paid to acquire SP would be used to increase the costs that would be used to adjust the GTM mill rates. All parties understood that BNSF's trackage rights, and related GTM mill rates, would not become effective until after the UP/SP merger was effected. In such a transaction, the purchase premium would be paid at the time the merger was approved and consummated and not in a subsequent year. Nor would the purchase premium be an actual maintenance and operating cost. Therefore, it was not foreseeable that the purchase premium could be used by UP in the annual adjustment mechanism to increase the GTM mill rates.

I submit that this intent is so clear that it should not require contractual language to be self-evident. But the language used in the CMA Agreement further affirms this intent. By comparing "the year in question" with the "preceding year", there was no

opportunity for UP to base the annual adjustment mechanism on a year that did not include the purchase premium since the first year was by definition the year in which the merger occurred.

UP's election to book the premium in 1997 rather than the year of the merger contradicted the foreseeable payment of the purchase premium at the time of acquisition. The parties' intent in the CMA Agreement was so clear that it never seemed plausible that UP would use this change in language as a reason to double count the purchase premium.

IV. THE PURPOSE OF THE RATE ADJUSTMENT PROVISIONS

Since BNSF and UP/SP had agreed in September 1995 on the terms they considered necessary to preserve rail competition as it existed between UP and SP prior to the merger, our main concern in negotiating and executing the CMA Agreement was to protect the essence of our existing agreement and satisfy the concerns of CMA (including its allied interests). Mr. Ice has described in his Verified Statement the issues that concerned BNSF and UP/SP in negotiating the level of trackage rights fees and related provisions that concerned adjustments to those fees and preserving the same basic relationship between rates and costs. The CMA negotiations and resulting Agreement did not result in changes to those provisions, except as to the basis for annual adjustments.

I believe all parties intended that the use of UP URCS data in the annual adjustment mechanism, in lieu of RCAF-U data, was to achieve more reliable measures of UP's actual operating and maintenance costs associated with the trackage rights operations and, thereby, link the level of GTM mill rates more directly to the expected declines in UP's costs. There was no intent, expressed by any party, that this use of

URCS data would enable UP to offset these declining costs by double counting the purchase premium and ignoring the provisions of Section 9(c).

The bases of this belief are, first, the self-evident advantages that CMA saw in using URCS costs, which were based on UP's own experience, versus the RCAF-U index, which is based on industry prices. My second reason is the inconsistency between the intent of the CMA negotiations and CMA Agreement, on the one hand, and the result of UP's efforts to base the annual adjustment on a double counting of the purchase premium and merger-related capital expenditures it had agreed were not BNSF's responsibility. Finally, I base this belief on the intent of the parties as manifested in our negotiations and the language of the agreements that we executed, including the portions of Section 12 that remained unchanged following the CMA Agreement and are in effect today. I will discuss each of these in sequence.

A. UP's Costs Versus Industry Prices

In support of their merger application, UP/SP relied heavily on operating efficiencies that they claimed would result in greater productivity and reduced operating costs. CMA, as well as BNSF, accepted UP/SP's basic premise that the merger would produce efficiencies. That acceptance is at the heart of our negotiations with UP/SP in the settlement process. CMA wanted the preservation of competing rail service after the UP/SP merger, and it was willing to rely on BNSF's proposed service, with certain conditions, including annual adjustment of the trackage rights rates that would give full effect to UP's improved productivity. BNSF also knew that its competition over UP/SP lines could not be effective over the long term unless its rates reflected reductions in UP's costs.

In the September 1995 negotiations, BNSF had been satisfied that the annual application of RCAF-U, reduced to 70 percent, was an adequate surrogate for the anticipated improvements in UP's productivity. UP also agreed to these provisions and accepted the methodology as a satisfactory way to adjust the GTM mill rates. CMA, however, insisted that a much more reliable measure was UP's costs, rather than a modified industry price index, and insisted on the use of UP's annual URCS costs. UP and BNSF were agreeable to this change. Therefore, the driving force behind the decision to rely on URCS costs was that they would reflect declining expenses due to increased efficiencies.

It should be noted that there was no way that the RCAF-U mechanism which is based on industry data would have enabled UP to adjust the GTM mill rates for the SP purchase premium or merger-related capital improvements, further demonstrating that the adjustment was not to be affected by those factors. There was no intention in the CMA Agreement negotiations to adopt an adjustment mechanism that allowed UP to apply costs that were already agreed to be embraced in the GTM mill rates.

B. UP's Result Is Inconsistent With The CMA Negotiations and Agreement

When UP booked the purchase premium in 1997 rather than 1996 when the acquisition occurred, it effectively made the purchase premium a factor in the July 1, 1998 annual adjustment. CMA or BNSF could hardly have anticipated this. We could not know what was in the corporate mind of UP/SP, but UP/SP never suggested that it was thinking of adding the purchase premium in some year after the first year used the annual adjustment comparisons.

Throughout the negotiation of the CMA Agreement, I am not aware that any party ever contemplated that the use of URCS would provide UP with an argument for basing the annual adjustment on the SP purchase premium and merger-related costs that were its responsibility under Section 9(c) of the Settlement Agreement. This result is wholly counter to the purpose of the amendment proposed by CMA and accepted by BNSF and UP/SP. Instead of providing a more accurate measure of UP's operating and maintenance costs that reflected improved efficiency and productivity, UP's application of URCS has the incredibly perverse result of offsetting cost reductions and double counting the substantial costs that had already been taken into account in setting the trackage rights fees.

C. The Parties' Intent Is Confirmed by the Contractual Language

The final sentence of Section 12 of the BNSF Settlement Agreement, unchanged by the CMA Agreement, sets forth the fundamental intent of the parties that "the rates and charges for trackage rights and services under this Agreement reflect the same basic relationship to operating costs as upon execution of this Agreement." The meaning of this guiding principle was well understood by BNSF and UP/SP in our negotiations, and there was no suggestion that it required further definition.

I understand that UP's adjustment of the GTM mill rates effective July 1, 1998, was based on including merger-related costs in its 1997 URCS costs that the parties intended to be included in the GTM mill rates agreed to in 1995. This has distorted the relationship of rates to costs and disregards the intent expressed in Section 12.

The effect of including these costs in 1997 and subsequent years is that the annual adjustments effective on July 1, 1998, and thereafter, are distorted by higher

costs and are not comparable to costs used in 1996. There is no justification for including these costs in 1997 URCS costs, or in any subsequent year, because UP agreed that the GTM mill rates set in September 1995 took full account of all costs, which would include any purchase premium and the Section 9(c) implementation costs.

These costs that UP has improperly included in the annual adjustment effective July 1, 1998, and in subsequent years need to be identified and removed from URCS data for those years. Alternatively, the error of basing the adjustment on use of these costs in 1997 and subsequent years could be corrected by adding those costs in the years 1995 and 1996 and any succeeding years in which such costs are not present in URCS for the preceding year.

It is not my purpose here to propose a mechanism for correcting UP's addition to the base used for the annual adjustments of costs that were already accounted for in September 1995. Rather, the burden should be on UP to correct the error by a procedure that prevents the costs from having any effect in the annual adjustment process.

I believe UP's construction of the adjustment mechanism contradicts the intent of the parties that the GTM mill rates were comprehensive rates covering all costs as well as their intent to preserve the "same basic relationship" between rates and costs over the life of the Settlement Agreement.

VERIFICATION

I, Richard E. Weicher, verify under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on May 21, 2002.

Richard E. Weicher
Richard E. Weicher

VERIFIED STATEMENT OF CHRISTOPHER D. KENT

I. BACKGROUND AND QUALIFICATIONS

My name is Christopher D. Kent. I am Senior Managing Director of FTI Consulting, Inc. My office is located at 1201 Eye Street, N.W., Washington, D.C. 20005. For the past 30 years, I have been continuously involved in economic, financial, and cost studies of network industries, including railroads, telecommunications companies and electric power companies. I have testified on behalf of The Burlington Northern and Santa Fe Railway Company ("BNSF") and other Class I and II railroads numerous times before this Board and its predecessor, the Interstate Commerce Commission. A summary of my qualifications and previous testimony is included as Attachment 1.

II. INTRODUCTION

In this Verified Statement, I estimate the impact of several issues that have arisen in connection with the dispute between BNSF and Union Pacific Railroad ("UP") concerning the proper adjustment of the trackage rights rates negotiated under the BNSF Settlement Agreement.¹ First, I compare the impact of UP's adjustment methodology on the gross ton-mile ("GTM") mill rates with the BNSF-proposed approach to adjusting the trackage rights rates. Specifically, I estimate the impact on the GTM mill rates of including the premium above historic book value that UP paid to acquire SP, and of including the merger-related capital expenditures which UP agreed to pay in Sections 9(c)(i) and (iii) of the Settlement Agreement. As set forth below, I

¹ I am informed by counsel that there were originally three additional issues in dispute between BNSF and UP concerning the proper adjustment methodology. I am further informed that those three issues have been preliminarily resolved by the parties, and the various calculations I have undertaken in preparing this Verified Statement reflect the parties' resolution of those issues.

estimated that UP's proposed adjustment methodology results in GTM mill rates approximately 0.2 mills higher than they would be if BNSF's proposed adjustment methodology were used.

Second, I compared the UP methodology for adjusting the GTM mill rates with the BNSF methodology in order to determine the effect of the different approaches on the "basic relationship" between rates and UP's "operating costs" established in Section 12 of the BNSF Settlement Agreement. I determined that the BNSF methodology is much closer to maintaining the same relationship.

III. IMPACT OF UP'S POSITION ON GTM MILL RATES

In order to determine the impact of including the SP purchase premium and the merger-related capital expenditures on the trackage rights rates, it was necessary to make certain adjustments to the 1995 and 1996 combined UP/SP URCS. These adjustments were required because the UP adjustment methodology compares the pre-merger UP/SP 1996 URCS costs with post-merger UP 1997 URCS costs. The 1997 UP costs include the SP purchase premium as well as post-merger 1996 and 1997 merger-related capital expenditures.² As set forth in the Verified Statements of Carl R. Ice and Richard E. Weicher, such a comparison is directly contrary to the language of Section 7 of the CMA Agreement.

The starting point I used for the process to include the SP purchase premium and merger-related capital expenditures in the 1995 and 1996 combined UP/SP URCS was the STB URCS Master File (the "UMF") that contains five years of selected data culled from carriers' annual R-1 Reports. Under the Board's URCS methodology, the UMF consolidates all data for predecessor roads, i.e., the UP data includes the former C&NW

² UP did not "book" the merger until its 1997 R-1 Report.

and SP. I obtained updated UMF files for UP and SP from the STB for each year 1995 through 1999, inclusive. I then made the following modifications to the 1995 and 1996 UP and SP data in the various UMF files in order to calculate the unit costs shown in URCS Phase II worktable E in my workpapers:³

- Substituted 1997 depreciation charges reported in the Revised R-1 Schedules 410, 412 and 415 for the data in the 1995 and 1996 UP and SP UMF files;
- Substituted the Revised 1997 Schedule 330 "Balance at the Beginning of Year" investment data for the 1995 and 1996 beginning and end-of-year data included in the UP and SP UMF files; and
- Substituted the Revised 1997 Schedule 335 Accumulated Depreciation as of the beginning of 1997 for the 1995 and 1996 beginning and end-of-year accumulated depreciation in the 1995 and 1996 UP and SP UMF files.

It was necessary to use 1997 data for 1995 and 1996 because the Board did not generate a combined UP/SP system URCS for 1995 and 1996.

After including the 1995 and 1996 combined UP/SP URCS, I calculated what the difference was in the GTM mill rate using BNSF's approach and UP's approach. In developing the BNSF figures in the Table, I applied a rate of change (or percentage change) rather than UP's approach of applying the absolute dollar difference. As the table below indicates, the difference is, over the five year period from 1996 to 2000, approximately 0.2 mills.

³ Copies of my workpapers are contained in the Confidential Appendix submitted with BNSF-102.

Comparison of BNSF and UP Approaches to Adjustment of GTM Mill Rates						
BNSF Approach (Adjusted URCS for 1995 and 1996)				UP Approach (Unadjusted URCS for 1995 and 1996)		
Year	GTM Unit Costs*	Annual Rate of Change (lagged 1 year)	Mills per GTM Adjusted Trackage Fee	GTM Unit Costs*	Absolute Change (lagged 1 year)	Mills per GTM Adjusted Trackage Fee
1995	\$0.00178841			\$0.00156806		
1996	\$0.00169823		3.100	\$0.00150524		3.100
1997	\$0.00164835	-5.042%	2.944	\$0.00164885	-0.00006282	3.037
1998	\$0.00164752	-2.937%	2.857	\$0.00164752	0.000014361	3.051
1999	\$0.00157770	-0.051%	2.856	\$0.00157770	-0.00000133	3.050
2000		-4.237%	2.735		-0.00006982	2.980
* Includes maintenance, operations, depreciation and return.						

It was not possible for me to quantify the impact of the dollar impact of UP inclusion of the Section 9(c) merger-related capital expenditures it agreed to fund in the URCS costs used for the adjustment. This is because, although the total dollars UP expended by project may be known, the specific accounts to which these dollars were assigned by UP are not known. In any event, the amount of these merger-related capital expenditures is significant, and inclusion of the expenditures in the URCS costs used to adjustment the trackage right mill rates would increase the resultant rate.⁴

IV. IMPACT OF UP'S POSITION ON THE "BASIC RELATIONSHIP"

BNSF also requested that I determine whether UP's position causes the "basic relationship" between the GTM mill rates and UP's operating costs to deviate from the

⁴ I note in this regard that the substitution of the 1997 investment and depreciation costs for the data in the 1995 and 1996 combined UP/SP URCS, as I described above, accounts for the Section 9(c) merger-related capital expenditures booked by UP in 1997 which UP was to solely fund.

ratio between those two figures at the time of the execution of the Settlement Agreement.

I believe that the meaningful comparison for the basic relationship relates to the adjustments effective July 1, 1997 and July 1, 1998, because those adjustment periods were when the impact of the SP purchase premium is evident. Therefore, for the July 1, 1997 adjustment, I compared the change between the 1995 and 1996 URCS costs on a consistently applied basis and the resultant GTM mill rates for the UP approach with the BNSF approach. The UP approach shows a 4 percent decrease in URCS costs and a 2 percent decrease in the GTM mill rate. In contrast, the BNSF approach shows a 5.6 percent decrease in URCS costs and a 5.0 percent decrease in the GTM mill rates. For the July 1, 1998 adjustment, the same results occur. The UP URCS costs increase by 9.5 percent and the GTM mill rate increases by 0.5 percent. The BNSF approach results in URCS cost decreases of 3.1 percent, and the GTM mill rate decreases by 3.0 percent. Clearly, for the 1997 and 1998 adjustments, the BNSF approach is closer to maintaining the same basic relationship. Finally, a comparison of the overall change between 1995 and 2000 shows that under the UP method costs decrease by 0.6 percent while the rate declines by 3.8 percent. Under the BNSF approach, the costs decrease by 11.7 percent, while the rate declines 11.8 percent. The BNSF approach more closely maintains the same basic relationship of costs and rates.

STATEMENT OF QUALIFICATIONS

OF

CHRISTOPHER D. KENT

My name is Christopher D. Kent. I am Senior Managing Director of FTI Consulting, Inc. My office is located at 1201 Eye Street, NW, Washington, DC 20005.

I hold a Bachelor of Arts degree from the University of Virginia. In 1970 I joined Western Electric, Inc. as a Management Trainee in its "High Risk-High Reward" program. During the next six years I was promoted through various levels in the production, production scheduling and costs and forecasting departments.

Since 1977, I have been involved in various aspects of transportation including traffic analyses, economic studies including costs and revenue analyses, railroad valuations, and the development of railroad operating plans, railroad facility plans and rolling stock requirements.

In 1977, I joined Conrail as Project Manager and worked primarily in assisting the Operating Department in optimizing fleet availability.

In 1978, I was employed by the United States Railway Association as the Manager of Equipment and Facilities. I was subsequently appointed Chief, Equipment and Facilities, Rail Asset Valuation, in the Office of General Counsel. In this capacity, I supervised a staff of in-house professionals and outside consultants in developing the equipment, maintenance of way and operating evidence submitted by the U.S. government in the valuation proceedings before the Special Court created under Section 303(c) and 306 of the Regional Rail Reorganization Act.

In 1980, I formed Kent Associates, a consulting firm dealing with operating, transportation and marketing issues for various clients. Kent Associates was affiliated with the Washington Management Group and I served as Vice President of that firm.

In 1984, I joined the economic consulting firm of Snavelly, King & Associates, Inc. as a Senior Consultant. While with that firm I participated in numerous studies related to Section 229 proceedings and anti-trust litigation.

In 1987, I founded Klick, Kent & Allen, Inc., an economic and financial consulting firm. I was a Principal of KK&A until its acquisition by FTI Consulting, Inc. in June 1998.

I have presented testimony in the valuation proceedings before the Special Court, the House of Courts of Justice Committee of the Virginia General Assembly, various state courts and federal courts and the Interstate Commerce Commission and Surface Transportation Board. Specific transportation-related testimony I have filed is listed below.

TESTIMONY

January, 1980	In the Matter of the Valuation Proceedings Under Sections 303(c) and 306 of the Regional Rail Reorganization Act. Special Court Misc. No. 76-1
October, 1981	In the Matter of the Valuation Proceedings Under Sections 303(c) and 306 of the Regional Rail Reorganization Act. Special Court Misc. No. 76-1
January, 1986	Oral testimony before the House of Delegates, Commonwealth of Virginia, Courts of Justice Committee
May 15, 1987	I.C.C. Docket No. 38301S - Coal Trading Corporation et al. v. The Baltimore and Ohio Railroad Company et al.

December, 1987	I.C.C. Docket No. 38301S (Sub-No. 1) - Westmoreland Coal Sales Company v. The Denver & Rio Grande Western Railroad Company, et al.
December, 1987	I.C.C. Docket No. 37038 Bituminous Coal -- Hiawatha, Utah to Moapa, Nevada and consolidated proceedings
January 14, 1988	I.C.C. Docket No. 38301S - Coal Trading Corporation et al. v. The Baltimore and Ohio Railroad Company et al.
June 20, 1988	I.C.C. Docket No. 37038 Bituminous Coal -- Hiawatha, Utah to Moapa, Nevada and consolidated proceedings
July, 1989	Oral testimony before the Superior Court of Rhode Island in the matter: National Railroad Passenger Corporation v. DOT, Providence & Worcester Railroad Co. v. RI
July 30, 1990	I.C.C. Docket No. 37038 Bituminous Coal -- Hiawatha, Utah to Moapa, Nevada and consolidated proceedings
October 10, 1990	I.C.C. Docket No. 37063, 38025S - The Dayton Power and Light Company v. Louisville and Nashville Railroad Company
December 14, 1990	I.C.C. Docket No. 37063, 38025S - The Dayton Power and Light Company v. Louisville and Nashville Railroad Company
January 25, 1991	I.C.C. Docket No. 37063, 38025S - The Dayton Power and Light Company v. Louisville and Nashville Railroad Company
July 15, 1991	I.C.C. Docket No. 37038 Bituminous Coal -- Hiawatha, Utah to Moapa, Nevada and consolidated proceedings
April 24, 1992	I.C.C. Finance Docket No. 31951 Southern California Regional Rail Authority For an Order Requiring Joint Use of Terminal Facilities of The Atchison, Topeka and Santa Fe Railway Company
May 7, 1993	I.C.C. Finance Docket No. 21215 (Sub-No. 5) Seaboard Air Line Railroad Company -- Merger -- Atlantic Coast Line Railroad Company -- Petition to Remove Traffic Protective Conditions
June 10, 1994	I.C.C. Finance Docket No. 21215 (Sub-No. 5) Seaboard Air Line Railroad Company -- Merger -- Atlantic Coast Line Railroad Company -- Petition to Remove Traffic Protective Conditions

October 11, 1994	I.C.C. Finance Docket No. 32549 Burlington Northern, Inc. And Burlington Northern Railroad Company -- Control and Merger -- Santa Fe Pacific Corporation and the Atchison, Topeka and Santa Fe Railway Company
March 29, 1995	I.C.C. Docket No. 37809, 37809 (Sub-No. 1) McCarty Farms, Inc., et al., and consolidated proceedings
May 30, 1995	I.C.C. Docket No. 41191 West Texas Utilities Company v. Burlington Northern Railroad Company
October 30, 1995	I.C.C. Docket No. 41185 Arizona Public Service Company and PacifiCorp v. The Atchison, Topeka and Santa Fe Railway Company
April 29, 1996	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 & Rio Grande Western Railroad Company.
May 23, 1996	Docket No. 41191. West Texas Utilities Company v. Burlington Northern Railroad Company -- Petition of Burlington Northern Railroad Company to Reopen Proceeding.
October 15, 1996	Docket No. 41242. Central Power & Light Company v. Southern Pacific Transportation Company; Docket No. 41295 Pennsylvania Power & Light Company v. Consolidated Rail Corporation; Docket No. 41626 MidAmerican Energy Company v. Union Pacific Railroad Company and Chicago & North Western Railway Company.
October 25, 1996	Docket No. 41242. Central Power & Light Company v. Southern Pacific Transportation Company; Docket No. 41295 Pennsylvania Power & Light Company v. Consolidated Rail Corporation; Docket No. 41626 MidAmerican Energy Company v. Union Pacific Railroad Company and Chicago & North Western Railway Company.
July 11, 1997	Docket No. 41989. Potomac Electric Power Company v. CSX Transportation, Inc. Reply Statement and Evidence of Defendant CSX Transportation, Inc.
May 1998	Docket No. 42012, Sierra Pacific Power Company and Iowa Power Company v. Union Pacific Railroad Company

July 1998	Finance Docket No. 33556, Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated -- Control -- Illinois Central Corporation, Illinois Central Railroad Company, and Cedar River Railroad Company.
September 1998	Docket No. 42022, FMC Corporation and FMC Wyoming Corporation v. Union Pacific Railroad Company.
December 1998	Finance Docket No. 33556, Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated -- Control -- Illinois Central Corporation, Illinois Central Railroad Company, and Cedar River Railroad Company.
January 15, 1999	Docket No. 42022. FMC Corporation and FMC Wyoming Corporation, v. Union Pacific Railroad Company. Opening Verified Statement of Christopher D. Kent and Benton V. Fisher.
March 31, 1999	Docket No. 42022. FMC Corporation and FMC Wyoming Corporation, v. Union Pacific Railroad Company. Reply Verified Statement of Christopher D. Kent and Benton V. Fisher. Reply Verified Statement of Christopher D. Kent and John C. Klick.
April 30, 1999	Docket No. 42022. FMC Corporation and FMC Wyoming Corporation, v. Union Pacific Railroad Company. Rebuttal Verified Statement of Christopher D. Kent and Benton V. Fisher.
July 15, 1999	Docket No. 42038. Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Railway Company. Opening Verified Statement of Christopher D. Kent and Benton V. Fisher.
August 30, 1999	Docket No. 42038. Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Railway Company. Reply Verified Statement of Christopher D. Kent and Benton V. Fisher.
September 28, 1999	Docket No. 42038. Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Railway Company. Rebuttal Verified Statement of Christopher D. Kent and Benton V. Fisher.
April 15, 2000	Expert Report. IFL Group, Inc., and Contract Air Cargo, Inc. v. Lincoln General Insurance Company.
June 15, 2000	Docket No. 42051. Wisconsin Power and Light Company v. Union Pacific Railroad Company. Opening Verified Statement of Christopher D. Kent and Benton V. Fisher.

August 14, 2000 Docket No. 42051. Wisconsin Power and Light Company v. Union Pacific Railroad Company. Reply Verified Statement of Christopher D. Kent and Benton V. Fisher.

August 14, 2000 Docket No. 42051. Wisconsin Power and Light Company v. Union Pacific Railroad Company. Reply Verified Statement of Christopher D. Kent and Michael R. Baranowski.

September 28, 2000 Docket No. 42051. Wisconsin Power and Light Company v. Union Pacific Railroad Company. Rebuttal Verified Statement of Christopher D. Kent and Benton V. Fisher.

December 14, 2000 Docket No. 42054. PPL Montana, LLC v. The Burlington Northern Santa Fe Railway Company, Opening Verified Statement of Christopher D. Kent and Benton. V. Fisher.

March 13, 2001 Docket No. 42054. PPL Montana, LLC v. The Burlington Northern Santa Fe Railway Company, Reply Verified Statement of Christopher D. Kent and Benton. V. Fisher.

March 13, 2001 Docket No. 42054. PPL Montana, LLC v. The Burlington Northern Santa Fe Railway Company, Reply Verified Statement of Christopher D. Kent and John C. Klick.

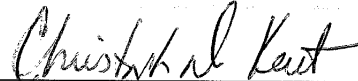
May 7, 2001 Docket No. 42054. PPL Montana, LLC v. The Burlington Northern Santa Fe Railway Company, Rebuttal Verified Statement of Christopher D. Kent and Benton.V. Fisher.

January 15, 2002 Docket No. 42057. Texas Municipal Power Agency v. The Burlington Northern Santa Fe Railway Company, Reply Verified Statement of Christopher D. Kent and John C. Klick.

VERIFICATION

I, Christopher D. Kent, verify under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on May 20, 2002.



Christopher D. Kent

VERIFIED STATEMENT OF DENIS J. SMITH

I. BACKGROUND AND QUALIFICATIONS

My name is Denis J. Smith, and I am Vice President, Industrial Products Marketing for The Burlington Northern and Santa Fe Railway Company (BNSF), a position I have held since March of 2001. My business address is 2650 Lou-Menk Dr., Fort Worth, TX 76131-2830. I have responsibilities of price, markets, capacity, and program direction for BNSF's Industrial Products Business Unit. I began my career as market manager in BNSF's agricultural business unit in 1993 and have held various positions in the Marketing Department since that time.

Before joining BNSF, I was a trading member of the Minneapolis Grain Exchange and was employed by Continental Grain Company in various positions for 13 years. I received a Bachelors of Business Administration (Marketing) from Kent State University in 1976 and a Masters of Agricultural Science from California Polytechnic, San Luis Obispo in 1980.

II. PURPOSE OF VERIFIED STATEMENT

The purpose of my Verified Statement is to describe the competition between BNSF and UP over the trackage rights which BNSF received as a condition to the approval by the Surface Transportation Board of the merger between Union Pacific Railroad Company ("UP") and Southern Pacific Transportation Company ("SP") in 1996. Specifically, I will provide a summary of BNSF's competitive presence on the UP/SP trackage rights lines and will then describe how, even though we believe that we are currently providing competitive service over those lines as a replacement for SP, it is important to BNSF's long-term ability to provide such service (i) that the rates which BNSF pays to UP for its use of the trackage rights lines remain in the same relative

relationship to UP's costs as when the BNSF Settlement Agreement was executed in September of 1995, and (ii) that UP not gain a competitive advantage over BNSF when UP's costs decline.

III. BNSF COMPETITION OVER THE TRUCKAGE RIGHTS LINES

Initially, as set forth in BNSF's quarterly and annual oversight reports filed in the UP/SP proceeding, BNSF has provided effective and efficient competitive service over the truckage rights lines. We have done so by aggressively marketing our services to shippers and by then providing them with reliable, timely service. We have established a number of innovative marketing programs and have introduced several initiatives designed to improve our service offerings. The fact of BNSF's successful competitive presence has been recognized by the Board, and it is a fact of which we at BNSF are quite proud.

We have, however, been able to achieve this success in large part because, when the BNSF Settlement Agreement was negotiated, the GTM mill rates were set at levels which, when compared to UP/SP's costs over the truckage rights lines, allowed us to provide competitive service. Indeed, Section 12 of the Settlement Agreement expressly acknowledged this basic relationship and provided that it was the parties' intent that this relationship be maintained throughout the 99-year term of the Settlement Agreement.

There are a number of factors and variables that determine whether BNSF is able to compete effectively over the truckage rights lines. These factors and variables include primarily factors such as the rate which BNSF offers to shippers, BNSF's schedules and transit times, equipment availability and track access among others. Of these, the rate offered to shippers is often the most critical factor, and the GTM mill

rates which BNSF pays under the Settlement Agreement are a significant element of the rate which BNSF can offer to shippers.

Much of the traffic over the trackage rights lines is highly sensitive to price and, even though many factors influence competition on the trackage rights lines, pricing is ultimately the most critical. In this regard, BNSF's short-term ability to compete by offering particular shippers the combination of price, service and route structure they demand is not determinative. Over the long-run, an unfavorable cost structure (resulting, for instance, from inflated trackage rights fees) can (and likely will) erode BNSF's ability to compete.

IV. IMPACT OF GTM MILL RATE DISPUTE

In the first few years of competition between BNSF and UP over the trackage rights lines, there was often a fairly wide range between the rates offered by the two carriers as each carrier was learning about the new competitive market and adjusting its price, service and routing offerings to compete with the other. Now, UP is able to determine with some accuracy the rates which BNSF can offer for service over the trackage rights lines. Because UP knows the GTM mill rates which BNSF will be required to pay on any given movement, the range of competitive rate offerings has narrowed to a range of \$25.00 to \$50.00 per car. In other words, UP essentially knows how low BNSF can take the price it offers for a movement over the trackage rights lines, and it can then simply underbid that price by \$25.00 to \$50.00.

As the Board has recognized, the approximate amount in dispute between UP and BNSF with respect to the GTM mill rates (0.2 mills) is in the range of five to six percent of the GTM mill rates. When such a percentage is applied to moves over the trackage rights lines, the amount represented by the dispute can often equate to the

\$25.00 to \$50.00 per car range in which, as discussed above, the parties currently compete and can be expected to compete over the long run

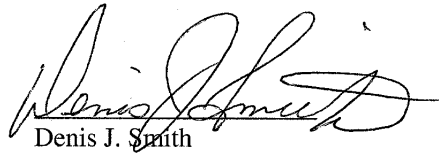
Here are examples of what the impact of the amount in dispute (0.2 mills) is on the rates per car (loaded to 286,000 pounds) for sample round trip moves on the trackage rights lines:

Houston to East St Louis	\$29.51
Denver to Stockton	\$46.26
Denver to Fernley, NV	\$38.34
Denver to Ogden, UT	\$20.97

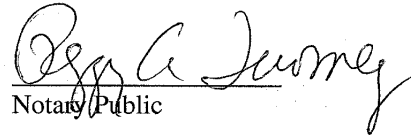
Accordingly, if the productivity improvements which UP has achieved since the merger with SP are not properly reflected in the adjusted GTM mill rates, UP will have gained a competitive advantage over BNSF that will potentially endure for the term of the Settlement Agreement.

VERIFICATION

Denis J. Smith, being duly sworn, deposes and says that he has read the foregoing statement and that the contents thereof are true and correct to the best of my knowledge and belief.


Denis J. Smith

Subscribed and sworn to before me on this 17th day of May, 2002.


Notary Public

My Commission expires:

