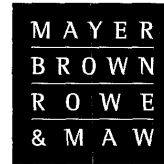


205745



June 28, 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.

ENTERED
Office of Proceedings

JUL 1 2002

Part of
Public Record

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 Rebuttal to UP's Reply to BNSF's and CMA's Responses to Order to Show Cause (BNSF-104).

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

Enclosures

cc: All Parties of Record

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.

Mayer, Brown, Rowe & Maw is a U.S. General Partnership. We operate in combination with our associated English partnership in the offices listed above.

205745

BNSF-104

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 REBUTTAL TO UP'S REPLY TO
BNSF'S AND CMA'S RESPONSES TO ORDER TO SHOW CAUSE

ENTERED
Office of Proceedings

JUL 1 2002

Part of
Public Record

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

June 28, 2002

BEFORE THE
SURFACE TRANSPORTATION BOARD

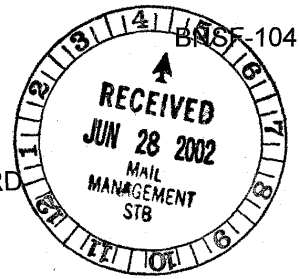
Finance Docket No. 32760

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

-- CONTROL AND MERGER --

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

BNSF'S REBUTTAL TO UP'S REPLY TO
BNSF'S AND CMA'S RESPONSES TO ORDER TO SHOW CAUSE



The Burlington Northern and Santa Fe Railway Company ("BNSF") submits this Rebuttal to the Reply filed on June 19, 2002, by Union Pacific Railroad Company ("UP") (UP/SP-397) in response to BNSF's May 22, 2002 Response to Order to Show Cause why its Petition for Clarification of the Trackage Rights Fee Adjustment Provision (BNSF-102) ("Response") should not be dismissed. BNSF is entitled to make this Rebuttal because UP's Reply was an evidentiary submission and, unless BNSF is permitted to make this Rebuttal, it will have no opportunity to respond to the evidence submitted with UP's Reply.¹ In addition, UP's Reply was the first pleading in which UP

¹ It is the Surface Transportation Board's practice in this regard to permit parties the opportunity to respond to evidence submitted by other parties. For instance, in Illinois Central Railroad Co. - Petition for Crossing Authority - In East Baton Rouge Parish, LA, Finance Docket No. 33877 (Sub-No. 1) (served November 20, 2001), the Board set a procedural schedule which provided IC with the opportunity to submit

set forth its position on the merits of the parties' dispute, and fairness dictates that BNSF be allowed to address the evidence and argument presented for the first time by UP.

UP asserts that BNSF's Petition for Clarification should be dismissed for six principal reasons: (i) BNSF and CMA² have purportedly changed their previous positions and now are advancing an entirely new procedure for the calculation of the annual rate adjustment; (ii) the language of Section 12 of the BNSF Settlement Agreement, which provides for a one-year lag in comparing URCS costs starting July 1, 1997, follows the methodology suggested by CMA's expert witness, Thomas D. Crowley, during the UP/SP merger proceeding; (iii) the parties never agreed or intended to use only post-merger URCS costs; (iv) the language of Section 7 of the CMA Agreement, which expressly provides for the comparison of post-merger URCS costs, has been overridden by the testimony of UP's John Rebensdorf and the Second Supplemental Agreement; (v) BNSF's proposed methodology for calculating the adjustment is internally inconsistent and unworkable; and (vi) there is no competitive justification to alter the adjustment mechanism.

rebuttal to KCS's evidentiary submission. Indeed, fair hearing and due process notions require that BNSF be afforded the opportunity to respond to UP's evidentiary submission here. Moreover, BNSF has limited this rebuttal to argument in response to UP's evidence and has made no new arguments or submitted any new evidence herein. To the extent the Board determines that leave is required to file this Rebuttal, BNSF respectfully requests such leave.

² The American Chemistry Council (formerly known as the Chemical Manufacturers Association) is referred to herein as "CMA".

As shown below, each of UP's alleged grounds for dismissing BNSF's Petition is either flatly wrong or an effort to divert the Board from implementing the clear intent of the parties as expressed in Section 7 of the CMA Agreement.

BNSF's and CMA's Alleged Change of Positions

Initially, in claiming that BNSF and CMA have abandoned their prior positions, UP seizes upon a distinction without a difference in its word-game about what it calls "BNSF's ever-changing stories regarding the parties' intent" UP Reply at 5. The intent at issue is, however, the same as it has been since BNSF filed its Petition on December 21, 2001: Did the parties intend to increase the GTM mill rates by a factor based on the purchase premium UP paid to acquire SP and the merger-related capital expenditures for which it was agreed that BNSF would have no responsibility in Section 9(c) of the BNSF Settlement Agreement?

Excluding or including the disputed costs makes no substantive difference in the effect on the annual GTM rate adjustment. This was specifically addressed by BNSF's witness Richard E. Weicher who participated in the negotiation of the settlement agreements. As Mr. Weicher explains:

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.

BNSF-102, Verified Statement of Richard E. Weicher, at 11. Mr. Weicher made clear that the choice of excluding or including the costs is one that UP should make:

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.

Id.

Moreover, there is no factual basis for UP's complaint that BNSF, having signed the Second Supplemental Agreement which adopted UP's methodology, should have raised its position on the disputed costs sooner. UP Reply at 21-23. Until BNSF audited UP's adjustment methodology, it could not determine that UP was interpreting and applying the Section 12 language in a manner inconsistent with Section 7 of the CMA Agreement and with the parties' intent that post-merger URCS costs would be used.³ The facts are clear that BNSF conducted that audit in late 2000 and that BNSF objected to UP about its methodology immediately thereafter.⁴

Crowley Testimony

UP's reliance on the testimony of Mr. Crowley as evidence of the proper adjustment methodology is misplaced for several reasons. First, Mr. Crowley's

³ It should be noted in this regard that the fact that the language of Section 12 provides for a one-year lag commencing on July 1, 1997, did not necessarily by itself indicate to BNSF that UP did not intend to adjust the rates in a manner that would adhere to the intent of Section 7 of the CMA Agreement. Rather, UP could well have adopted a methodology which provided that, if pre-merger years were to be used for purposes of the annual adjustments to the GTM mill rates, appropriate adjustments would 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. UP did not adopt such a methodology, and thus the present dispute arose.

⁴ The dispute between UP and BNSF concerning UP's adjustment methodology was not raised in this proceeding until BNSF's July 2, 2001 Fifth Annual Report, and thus CMA had no basis on which to express its concerns about UP's methodology before that time. Indeed, it was not until BNSF filed its Petition for Clarification in December that the specifics of the parties' dispute were made a part of the record.

testimony suggesting the use of 1995 and 1996 costs to determine the 1997 rate adjustment was incidental to Mr. Crowley's overarching position that the "proper measure for the adjustment mechanism is cost changes." CMA-7, Verified Statement of Thomas D. Crowley, at 57. All parties were aware that the adjustment mechanism would have no effect or significance until after the merger occurred. It is, therefore, not credible for UP to interpret Mr. Crowley's testimony as if it contemplated comparing pre-merger and post-merger cost changes which result in a double counting of the purchase premium. Second, Mr. Crowley's suggestion was included in CMA's March 29, 1996 Comments. Three weeks later, on April 18, 1996, CMA executed the CMA Agreement with UP/SP and BNSF, and Section 7 of the CMA Agreement provided that the URCS costs comparisons would be made between post-merger years only. Accordingly, to the extent Mr. Crowley's testimony can be read to set forth CMA's position, that position changed, and Mr. Crowley's testimony no longer reflected CMA's view of the annual adjustment process.⁵

Parties' Intent

UP argues that BNSF and CMA submitted no evidence to support the conclusion that the parties intended to use only post-merger URCS costs in the adjustment process. On a basic level, UP is ignoring the intent testimony of BNSF's principal negotiator, Carl R. Ice, on this subject:

The [BNSF settlement] 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

⁵ Thus, UP's labeling of Mr. Crowley's proposal as the "CMA Method" is significantly misleading since CMA rejected his approach just three weeks later, and UP's effort to obscure the weaknesses in its proposed methodology by seeking to legitimize the methodology through Mr. Crowley is imaginative, but not credible.

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 effects of the merger.

BNSF-102, Verified Statement of Carl R. Ice, at 4-5 (emphasis added).

Moreover, given the express contractual language, no such evidence is needed, and UP has ignored that language. First, Section 7 of the CMA Agreement clearly establishes that post-merger URCS costs should be used in making the annual adjustment calculations. There is no other way to reasonably read the language of Section 7, and no evidence of the parties' discussions or negotiations is needed. By comparing "the year in question" with "the preceding year", the language provides for a comparison of post-merger URCS costs since, given that the first adjustment to the rates would be in the second year of the merger, the "year in question" was by definition the second year of the merger. The language means what it says. Second, Section 12 of the BNSF Settlement Agreement establishes that it is the intent of the parties that the GTM mill rates should "reflect the same basic relationship to operating costs as upon execution of this Agreement". As the testimony of Christopher D. Kent in BNSF's Response shows at pages 4 to 5, UP's proposed methodology causes a greater deviation in that relationship than does the methodology proposed by BNSF and CMA.⁶

⁶ Oddly, while UP attacks almost every other aspect of Mr. Kent's testimony, it does not even address this portion of his testimony. The reason is obvious. UP has no grounds on which to counter Mr. Kent's conclusion.

Rebensdorf Testimony and the Second Supplemental Agreement

UP contends that the language of Section 7 of the CMA Agreement is "subject to multiple interpretations". UP Reply at 12. However, there is no reasonable interpretation other than what the straightforward language provides: The trackage rights fees shall be adjusted by the difference in the relevant URCS costs "between the year in question and the preceding year", both of which, by definition, are post-merger years as discussed above. UP nonetheless argues that John Rebensdorf's April 29, 1996 rebuttal verified statement set forth how UP interpreted the language and intended to apply it and that UP and BNSF executed the Second Supplemental Agreement which incorporated language substantially identical to Mr. Rebensdorf's proposed language. UP did not, however, (nor for that matter did BNSF) have the power or authority to revise the language in Section 7 of the CMA Agreement,⁷ and CMA has explained that UP advised it that the language change was a technical modification not intended to alter the substance of Section 7 of the CMA Agreement. CMA-17, Verified Statement of Thomas E. Schick, at 6. Accordingly, UP's reliance on Mr. Rebensdorf's testimony and the language in the Second Supplemental Agreement cannot contradict the language of Section 7 of the CMA Agreement.⁸

⁷ In fact, the CMA Agreement was imposed as a separate independent condition on the Board's approval of the UP/SP merger (Decision No. 44, 1 S.T.B. at 419), and the language of Section 7 of the Agreement must be given effect as it is written.

⁸ In this regard, UP goes to great lengths to explain the reasons why it booked the SP purchase premium in the year after its acquisition of SP rather than in 1996, and UP makes repeated efforts to show that it did not mislead BNSF or CMA about this fact. UP Reply at 23-24. However, UP has created a straw man position for BNSF, which has not contended that it was intentionally misled or that UP's election was improper. Rather, what BNSF has contended is that, regardless of when the purchase premium was actually booked or whether UP adequately advised parties to the UP/SP merger proceeding that it might not be booked in 1996, it was the intent of the parties to the

BNSF's Proposed Adjustment Methodology

UP submits several criticisms of the calculations undertaken by Mr. Kent in order to estimate the impact that UP's proposed methodology has on the GTM mill rates. In so doing, UP disingenuously criticizes Mr. Kent for making a number of assumptions which UP then proceeds to claim are unjustified. UP criticizes Mr. Kent for other alleged errors in his estimation methodology, and UP further attacks BNSF's and CMA's position for being internally inconsistent and not providing a rationale for dealing with the excluded Section 9(c) merger-related capital expenditures.

UP has, however, conveniently ignored the fact that Mr. Kent was, as reflected in his verified statement and accompanying workpapers, limited by lack of access to UP data in his ability to propose a definitive methodology to eliminate the impact of the disputed costs in the adjustment process. While UP did produce certain documents and information in response to BNSF's discovery requests, Mr. Kent's calculations were only an estimate of the impact of UP's methodology, and access to significantly more information from UP concerning exactly how the disputed costs were booked by account, as well as other relevant data, is needed to accurately determine and eliminate that impact.

Moreover, UP's criticisms are misdirected. It is UP that bears responsibility for properly implementing the intent set forth in Section 7 of the CMA Agreement that post-merger URCS costs should be used for the purpose of the rate adjustment calculations,

BNSF Settlement Agreement that the GTM mill rates were all-inclusive and that the purchase premium should not be double counted through the adjustment process. Thus, if the fact that UP did not book the premium in 1996 would cause that to occur, an appropriate adjustment must be made.

and it is no defense to UP's failure to do so for it to assert that BNSF and CMA are unable to do so.

Competitive Justification

UP argues strenuously that there is no competitive justification to alter the adjustment mechanism because BNSF has been able to compete effectively over the trackage rights lines and because the GTM mill rates that BNSF is paying are lower than they might otherwise be if different rates and/or methodologies had been adopted. UP has once again totally misconstrued (perhaps intentionally) BNSF's argument. BNSF has not asserted that the base GTM mill rates are too high or were improperly set. Rather, BNSF has argued that, once the GTM mill rates were set, changes in UP's costs should not enable UP to gain a competitive advantage. Prior to the parties' present dispute, Mr. Rebensdorf recognized that the two carriers should compete on a "level playing field" (UP/SP-22 at 301), and the parties expressly stated that the relationship between UP's costs and BNSF's rates for service over the trackage rights lines was intended by the parties to remain the same. Now, however, UP proposes a methodology that undisputedly causes a deviation in that relationship in favor of UP.

BNSF has submitted the testimony of Denis J. Smith, Vice President of Industrial Products Marketing, to establish that the deviation can and does make a difference in BNSF's ability to compete for traffic. Furthermore, UP itself buttressed this conclusion by examples it cited in the Confidential Appendices to its annual oversight reports of situations where rate differentials equivalent to the amount in question here have made a difference. Tellingly, UP has submitted no evidence from any of its marketing

personnel to counter that conclusion, and thus its argument that there is no competitive effect should not be given weight.⁹

Moreover, and perhaps more importantly, there is no need for BNSF and CMA to show that there is a competitive justification for correcting the adjustment mechanism, when the fundamental purpose of the trackage rights is to provide a vigorous competitor to a merged UP/SP for the long term, not a mere presence subject to degradation over time. This is in addition to the fact that the existing language of Section 7 of the CMA Agreement clearly and expressly provides that post-merger URCS costs are to be utilized in making the adjustment calculations, and the only question before the Board is whether UP should be held to the agreement that it made with BNSF and CMA.

Conclusion

As established in BNSF's Response, the relationship between the GTM mill rates which BNSF pays for its use of the UP/SP 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 long-term replacement for SP. Section 7 of the CMA Agreement reflects the parties' clear intent that the comparison of URCS costs should be made using post-merger years only, and UP's assertion that the revised language of

⁹ UP contends that Mr. Kent's estimate that the impact of UP's position is approximately 0.2 mills is inaccurate because Mr. Kent did not exclude the impact on the rates caused by the disagreement between UP and BNSF over the manner in which the adjustment should be taken into account (i.e., whether the adjustment should be made based on the percentage change in the relevant URCS costs or based on the numerical change in those costs). However, Mr. Kent made his estimate as he did in order to reflect what the impact would be if UP's position was adopted with respect to both disputed issues, and there is no doubt that there is an impact caused by UP's adjustment methodology standing alone. Whether that impact is approximately 0.1 mills (as UP suggests) or some other amount is irrelevant to the issue before the Board. The issue to be decided is whether the language and intent of the parties as set forth in Section 7 of the CMA Agreement should be given effect.

Section 12 of the BNSF Settlement Agreement should be applied to allow for the comparison of pre-merger URCS costs with post-merger URCS costs is clearly contrary to the language of Section 7 and the parties' intent.

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

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

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

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

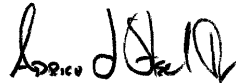
Mayer, Brown, Rowe & Maw
1909 K Street, NW
Washington, DC 20006
(202) 263-3000

Attorneys for The Burlington Northern and Santa Fe Railway Company

June 28, 2002

CERTIFICATE OF SERVICE

I do hereby certify that copies of The Burlington Northern and Santa Fe Railway Company's Rebuttal to UP's Reply to BNSF's and CMA's Responses to Order to Show Cause (BNSF-104) are being served on all parties of record.



Adrian L. Steel, Jr.